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August 12, 1986

To: Members of the Executive Board
From: The Acting Secretary
Subject: Israel - Exchange Arrangements

Attached for the information of the Executive Directors is a paper on recent changes in the exchange arrangements of Israel.

Mr. Huh (ext. 8525) is available to answer technical or factual questions relating to this paper.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

ISRAEL

Exchange Arrangements

Prepared by the European and Exchange and
Trade Relations Departments

(In consultation with the Legal Department)

Approved by P. de Fontenay and J. T. Boorman

August 12, 1986

In the attached communication dated August 4, 1986, the Governor of the Bank of Israel has notified the Fund of the following change in the country's exchange arrangements. Effective August 1, 1986, the value of the new sheqel is determined in accordance with a weighted basket of currencies reflecting the composition of Israel's exports and imports with its main trading partners. Under the modified arrangements, the currency weights are as follows: U.S. dollar, 60 percent; deutsche mark, 20 percent; pound sterling, 10 percent; French franc and Japanese yen, 5 percent each. The Bank of Israel will aim at stabilizing the exchange rate of the new sheqel against the basket, with due regard to developments in wages and other economic factors. Small movements in the exchange rate around its present level are considered possible.

The sheqel was devalued by 15.8 percent on July 1, 1985 (EBS/85/190, 8/13/85) as part of a comprehensive stabilization program; the rate fixed at that time with respect to the U.S. dollar has subsequently been kept broadly unchanged. Israel's competitive position has changed little since the July 1985 devaluation, having benefited from the decline in the value of the U.S. dollar against the currencies of Israel's major European trading partners, as well as from a marked reduction in the rate of domestic inflation. This position has been reflected in a broadly unchanged level of the real effective exchange rate of the Israeli currency since July 1985.

The staff notes that the foregoing change in Israel's exchange arrangements is intended to result in greater stability of the effective exchange rate of the new sheqel and to contribute to the authorities' anti-inflation program. The staff welcomes the assurance that the stabilization of the effective exchange rate of the new sheqel remains conditional on "wage levels and other economic developments." Israel's exchange rate policy will be discussed on the occasion of the next Article IV consultation: the consultation discussions between the Israeli authorities and the staff are tentatively scheduled for early March 1987. No action by the Executive Board is proposed at this time.

Attachment

AUGUST 4, 1986

TO: INTERFUND WASHINGTON

ATTENTION: DR. J.J. POLAK

1. EFFECTIVE AUGUST 1, 1986, THE BANK OF ISRAEL PUBLISHES THE SHEQEL VALUE OF A BASKET OF FOREIGN CURRENCIES ON A DAILY BASIS, TOGETHER WITH THE REPRESENTATIVE RATES FOR OTHER FOREIGN CURRENCIES. THE BANK OF ISRAEL WILL AIM AT STABILIZATION OF THE SHEQEL VALUE AGAINST THE BASKET OF CURRENCIES, CONDITIONAL ON WAGE LEVELS AND OTHER ECONOMIC DEVELOPMENTS.
2. THE STABILIZATION OF THE SHEQEL VALUE AGAINST A CURRENCY BASKET WILL REDUCE FLUCTUATIONS IN THE SHEQEL VALUE AGAINST MAJOR CURRENCIES. IT IS ENVISAGED TO REDUCE DISTURBANCES TO THE EXTERNAL SECTOR OF THE ECONOMY AS WELL AS TO THE DOMESTIC PRICE LEVEL. NEVERTHELESS SMALL MOVEMENTS OF THE REPRESENTATIVE BASKET RATE AROUND ITS PRESENT LEVEL WOULD BE POSSIBLE.
3. THE COMPOSITION OF THE CURRENCY BASKET IS BASED ON ISRAEL'S IMPORTS AND EXPORTS OF GOODS AND SERVICES WITH ITS MAIN TRADING PARTNERS (THE COMPOSITION OF A PREVIOUS BASKET USED FOR INDICATIVE PURPOSES SINCE 1976 WAS BASED ON EXPORTS OF GOODS ONLY). THE COMPOSITION OF THE NEW BASKET IS AS FOLLOWS:

<u>CURRENCY</u>	<u>CURRENCY WEIGHTS (PCT) ON AUGUST 1</u>	<u>UNITS OF CURRENCY</u>
U.S. DOLLAR	60	0.60
GERMAN MARK	20	0.4177
POUND STERLING	10	0.0670
FRENCH FRANC	5	0.3394
JAPANESE YEN	5	7.7

THE VALUE OF THE CURRENCY BASKET ON AUGUST 1, 1986, WAS SET AT ONE U.S. DOLLAR, AND ITS REPRESENTATIVE RATE WAS NIS 1.4923.

WITH KIND REGARDS
MICHAEL BRUNO
GOVERNOR, BANK OF ISRAEL

Received in the Cable Room: August 4, 1986