CHAPTER XVII

FINANCIAL INSTITUTIONS[1]

1. Main Developments

Financial Institution operations were stepped up in 1968, the amount of outstanding finance provided to the non-Government sectors[2] increasing by 15.1 percent, compared with 9.2 percent in 1967 and 16.5 percent in 1965–66. If account is taken of the fact that in 1965 and 1966 linkage differentials of 6 to 8 percent per annum were added to the outstanding credit linked to the consumer price index, as compared with an increment of some 3 percent in 1968, it seems that in 1968 the institutions' activity in financing non-Government sectors returned, with the general economic recovery, to its prerecession level.

In 1968 as well, the different groups of institutions did not display a uniform growth pattern. In previous years, changes in the sector's growth rate were mostly dictated by the mortgage banks, whereas in 1968 this group expanded at a rate below the average for the sector as a whole. The increase in outstanding credit for housing and construction (in which the mortgage banks account for the predominant share) was higher than in 1967, but the growth rate still did not regain its level of earlier years. This is partly explained by the increased volume of repayments to mortgage banks in 1968, both by contractors and building companies and by home buyers, which tended to slow down the expansion of outstanding credit (this is discussed below).

Outstanding industrial credit grew at a more sluggish rate in 1968. To a large degree, the deceleration was apparently connected not with the flow of current credit but with the writing-off of part of come outstanding loans, following the retroactive easing of interest and linkage terms on industrial development loans, at the Treasury's behest and on its account, and also to the reduction of arrears as compared with the recession period.

1 Financial institutions, as discussed in this chapter, are defined as financial intermediaries primarily engaged in the mobilization of medium- and long-term funds for investment in financial assets, such as loans and securities. Excluded from this sector are banking institutions, most of whose liabilities are short-term; companies financed by a limited number of proprietors; and holding companies, whose investments are mostly in subsidiaries. Although conceptually they come under the category of financial institutions, social insurance funds and insurance companies are also omitted from this chapter, as they are discussed seperately.

2 Excluding deposits with the Accountant General and the write-off of part of some outstanding loans, at the Government's behest and on its account.

Table XVII-1

COMBINED BALANCE SHEET TOTALS OF FINANCIAL INSTITUTIONS,[a] BY TYPE OF INSTITUTION, 1967–68

Group[b]	Number of insti-tutions	IL million		Percent		Percent increase or decrease (–) as against previous year	
		1967	1968	1967	1968	1967	1968
Mortgage banks	17	2,163.8	2,520.2	41.3	40.8	15.9	16.5
Industrial development banks	5	1,097.4	1,147.1	21.0	18.6	15.8	4.5
Institutions granting loans to other sectors[c]	4	492.2	598.5	9.4	9.7	–13.7	21.6
Agricultural credit funds	18	698.5	855.7	13.3	13.9	19.8	22.5
Investment companies	15	679.5	903.6	13.0	14.7	22.2	33.0
Household finance companies	17	72.6	83.3	1.4	1.4	10.8	14.7
Mutual funds	9	30.6	55.4	0.6	0.9	–5.0	81.0
Total	**85**	**5,234.6**	**6,163.8**	**100.0**	**100.0**	**13.3**	**17.8**

[a] Including the Yaad Agricultural Development Bank.
[b] Revised figures.
[c] For tourism, shipping, and local authorities.

There was a striking rise in outstanding credit to the services sector, which was mainly due to the financing of the new oil pipeline. The increase in outstanding farm credit was almost doubled, despite the relative standstill in the level of investment in this sector.

The continued recovery of the stock market in 1968 did not lead to any significant growth in the securities portfolio of most financial institutions. Of the IL 56 million increase in the sector's holdings of non-Government securities, the overwhelming share was accounted for by three institutions (two of which were the new bond funds, which have met with great success).

As for the institutions' direct transactions with the Government, it should be noted that, whereas in 1967 the growth of their outstanding deposits with the Accountant General was about IL 27 million higher than that of outstanding Government deposits for loan purposes (excluding the write-offs), in 1968 (discounting the effect of the retroactive concessions granted at the Treasury's expense) there was a net increase in the opposite direction of about IL 55 million.[1] These findings indicate that the sector's bond issues in 1968 (IL 390 million—about IL 30 million less than in 1967) were insufficient to provide

[1] These data are not identical with those on the gross flow of funds between the financial institutions and the Government. Revaluation increments, imputed interest, debt repayments, etc. are not included in the gross credit figures, even though they affect the institutions' balance sheet totals—the changes in which form the basis for the calculations in this chapter.

the direct financing (that part of the proceeds which are retained by the institutions) and indirect financing (the rise in earmarked Government deposits for loans) which were required by the sector during the year.

Examination of the structure of the sector's incremental liabilities shows that the share of earmarked Government deposits rose from 24.4 percent of the total increase in 1967 to 36.5 percent in 1968, while that of bonds dropped from 61.4 to 38.6 percent. The share of nongovernmental earmarked deposits and of deposits and loans from banks and other institutions rose: these items grew by IL 138.4 million in 1968, compared with only IL 44.9 million the year before (when the economy was slack). It should also be pointed out that in line with the trend of recent years, when net receipts from the rest-of-the-world sector gradually declined, this sector became a net borrower in 1968.

The "gross" increase in the financial institutions' combined balance sheet reached 17.8 percent (IL 929 million), a higher rate than in 1967 but lower than in 1966. This rise reflects the changes in the volume of financing provided to the various sectors of the economy, and also the arrangements between the Government and some of the institutions serving as its agents for the mobilization of funds in the local and overseas markets in order to finance the development budget.

2. Government Influence Over Financial Institution Operations

In an economy with a free capital market, the financial intermediaries have a twofold function: they contribute both to the perfection of the capital market (i.e. they ensure a more efficient allocation of a given volume of savings through the interest rate mechanism) and to the expansion of the level of saving and investment in the economy. On the one hand, they enable economic units with surplus funds to purchase assets relatively more liquid and less risky than the obligations of deficit economic units, and on the other hand they enable units with deficits to obtain credit more cheaply than by selling their obligations directly to surplus units.

In the Israeli economy, where there are legal restrictions on interest rates, most local and foreign sources of medium- and long-term credits are under Government control, and it is the Government that directs their allocation. The role of the financial institutions is therefore limited to assisting the Government in implementing development policy and directing the flow of credit, while the function of financial intermediation is actually performed by the Government.

The Government's domination over the local sources of finance derives principally from its requirement that the bulk of domestic contractual savings be invested in approved securities in order to be eligible for income tax concessions; to some extent it also stems from Government restriction of the maximum interest rates, which prevents the institutions from competing with bond issues recognized as approved investments and whose yield is only slightly below the maximum legal interest rate. In addition, the Government directs the allocation of loan capital from abroad by means of foreign currency control.

Government influence in the capital market is not confined to the direction of credit, but expresses itself also in the determination of the financing terms set for borrowers (rate of interest, type of value-linkage or the premium to be paid in lieu of linkage, repayment terms, etc.). This is true not only of financing from earmarked Government deposits but also of financing from the proceeds of approved bond issues. Wherever necessary, the Treasury compensates financial institutions for any difference that may arise between the cost of the capital they mobilize and the price of credit granted, leaving them a profit margin of 1–2 percent. When directed unlinked credit is granted from the institutions' value-linked resources, the Accountant General collects the premium which in his opinion must be imposed on the borrower (as a rule, 2–4 percent per annum on the outstanding credit) and assumes responsibility for covering linkage differentials. Under existing arrangements, part of the bond issue proceeds are used directly by the financial institutions for extending loans at the Government's behest, while the rest of the proceeds are deposited with the Accountant General, who returns all or part to the institutions (together with approvals of loan applications) in the form of earmarked Government deposits. The deposit terms take into account the price at which the loans are to be granted and the profit margin of the financial institutions. This procedure of depositing the issue proceeds with the Accountant General and redepositing them with the institutions obviously artificially inflates the balance sheet totals of the financial institutions sector.

The gradual abolition of value-linkage on medium- and long-term loans, which started in 1962 and was almost completed by 1967 in respect of the current credit flow,[1] continued in the year reviewed. In 1968 the Government made it possible for those who had in the past received directed value-linked loans for development purposes in industry, crafts, agriculture, and the tourist trade to replace, retroactively from January 1, 1967, the linkage on their outstanding debts with a fixed annual premium of 2–4 percent. It was also stipulated that the total rate of interest (including the premium) on outstanding credits (new and old) extended for the above-mentioned purposes, should not exceed 9 percent. In addition, the arrangement for the abolition of linkage on old mortgage loans was further extended to include loans granted before January 1, 1966.

This arrangement whereby linkage is abolished for the borrower without being abolished for the lender (the purchaser of bonds)[2] increases Government control over the financial institutions in particular and the capital market in

[1] See Bank of Israel, *Annual Report 1967,* Chapter XVII, section 3, pp. 458–59.

[2] As stated, the Government assumes responsibility for linkage differentials in exchange for a premium of 2–4 percent.

general. The refusal of the banks to assume responsibility for even part of the linkage differentials on the sources of finance in exchange for the payment of a premium by the borrower (not to mention the fixing of a maximum overall 9 percent nominal interest rate for loans granted to industry, crafts, agriculture, and tourism) doubtless indicates that the abolition of linkage has widened the gap between the effective yield rate to the lender and the real cost of capital to the borrower. This development tends to stimulate the level of investment in the economy (all other conditions being equal), but at the same time it affects the development prospects of the Israeli securities market.

3. Assets and Liabilities

The combined balance sheet of the financial institutions sector expanded in 1968 by 17.8 percent to IL 6,163.8 million. This is a higher growth rate than in the previous year (13.3 percent), but is below that of 1966 (20.1 percent).

If we deduct from the asset side the deposits with the Accountant General (where changes stem mainly from institutional arrangements between the Government and the financial institutions and are not directly connected with the volume of finance supplied to the various sectors) and ignore the accounting decrease in outstanding loans (due to the aforementioned retroactive concessions on linkage and interest terms) which the institutions managed to carry out this year, we find that the "net" growth in total assets was 15.1 percent in 1968, compared with 16.3 percent in 1966 and 16.8 percent in 1965. Since revaluation increments of 6 to 8 percent per annum were added in 1965 and 1966 to the balance of loans pegged to the consumer price index, as compared with 3 percent in the year reviewed, it can be said that, despite the slower balance sheet increase, the growth of financial institution operations regained its prerecession level.

(a) *Liabilities*

The sector's liabilities consist predominantly of medium- and long-term obligations, with the weight of equity capital amounting to 19.4 percent in 1968. The ratio between equity capital and total liabilities is especially low among the mortgage banks (about 6 percent).

The principal changes in the liability structure in 1968 were a further decline in the weight of equity capital and a further increase in that of bonds. But in contrast to 1967, the weight of earmarked deposits of the Government rose.

Equity capital was up about 8 percent in 1968 (compared with approximately 6 percent in 1967), and totalled IL 1,196.8 million. Whereas in 1967 the growth of equity stemmed mainly from allocations to the reserve funds and the revaluation of shares denominated in foreign currency (as a result of the devaluation), in 1968 most of the increase was in paid-up share capital (especially in the mutual funds and the investment companies group).

Table XVII-2

ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS,[a] 1967–68

	IL million		Percent		Increase or decrease (–) in 1968			
					Incl. write-offs		Excl. write-offs	
	1967[b]	1968	1967	1968	IL m.	%	IL m.	%
Assets								
Cash and bank deposits	91.0	82.0	1.7	1.3	–9.0	–9.9	–9.0	–9.9
Credit to the public from own means	1,723.3	1,814.3	33.0	29.4	91.0	5.3	156.0	9.1
Credit to the public from Government deposits	1,657.4	1,982.1	31.7	32.2	324.7	19.6	329.7	19.9
Credit to the public from deposits earmarked for loans	497.6	606.8	9.5	9.8	109.2	21.9	109.2	21.9
Loans to the Govt. (mainly deposits with the Accountant General)	939.4	1,293.8	17.9	21.0	354.4	37.7	289.4	30.8
Nongovernmental securities[c]	293.6	349.6	5.6	5.7	56.0	19.1	56.0	19.1
Immovable property	32.3	35.2	0.6	0.6	2.9	9.0	2.9	9.0
Total—unadjusted	**5,234.6**	**6,163.8**	**100.0**	**100.0**	**929.2**	**17.8**	**934.2**	**17.8**
Total—adjusted[d]	**4,343.0**	**4,927.7**			**584.7**	**13.5**	**654.7**	**15.1**
Liabilities								
Equity capital	1,103.0	1,196.8	21.1	19.4	93.8	8.5		
Bonds	1,439.1	1,797.8	27.5	29.2	358.7	24.9		
Deposits and loans from banks	78.9	99.4	1.5	1.6	20.5	26.0		
Government deposits earmarked for loans	1,667.3	2,006.8	31.8	32.6	339.5	20.4	344.5	20.7
Nongovernmental deposits earmarked for loans	560.3	652.9	10.7	10.6	92.6	16.5		
Other deposits and loans	261.4	286.7	5.0	4.6	25.3	9.7		
Demand deposits	26.6	31.2	0.5	0.5	4.6	17.3		
Other accounts (net)	98.0	92.2	1.9	1.5	–5.8	–5.9		
Total	**5,234.6**	**6,163.8**	**100.0**	**100.0**	**929.2**	**17.8**	**934.2**	**17.8**

[a] Including the Yaad Agricultural Development Bank.
[b] Revised data.
[c] Including investments in subsidiary companies.
[d] Less deposits with the Accountant General.

Outstanding bonds totalled IL 1,797.8 million in 1968, a rise of 24.9 percent, as against 35.4 percent in the previous year. This item accounted for 38.6 percent of incremental liabilities in the year reviewed, as contrasted with 61.4 percent in 1967. Bond sales added up to approximately IL 390 million, some IL 30 million less than in 1967. The share of investment companies in total bond issues advanced from 30 percent in 1967 to 43 percent, while that of mortgage banks dropped from 51 to 35 percent.

Earmarked Government deposits for loan purposes swelled by IL 339.5 million, or 20.4 percent, as against 9.9, 17.3, and 13.6 percent in 1965, 1966, and 1967 respectively. At the end of 1968 they amounted to IL 2,006.8 million, representing 32.6 percent of total liabilities (as against 31.8 percent in 1967).

In 1967, when demand for financing sagged noticeably, sharp declines were registered in "deposits and loans from banks" (down approximately IL 31 million, or 25.3 percent) and "other deposits and loans" (down by some IL 10 million, or 3.7 percent). In 1968, however, these two items rose—by IL 20.5 million (26 percent) and IL 25.3 million (9.7 percent) respectively.

(b) *Assets*

Most of the funds at the sector's disposal were used for granting loans to the Government (including the purchase of Government securities) and to the rest

Table XVII-3
LIABILITIES[a] OF FINANCIAL INSTITUTIONS,[b] BY SECTOR, 1966–68

	IL million			Percent		
	1966[c]	1967[c]	1968	1966[c]	1967[c]	1968
Government	1,864.1	2,019.7	2,366.7	40.2	38.5	38.5
National Institutions and local authorities	72.0	88.7	118.9	1.6	1.7	1.9
Public sector companies[d]	165.7	187.9	187.3	3.6	3.6	3.0
Banking institutions	213.8	322.2	457.6	4.6	6.2	7.4
Social insurance funds	700.4	890.3	1,075.0	15.1	17.0	17.4
Insurance companies	12.1	10.9	13.1	0.3	0.2	0.2
Private business[e]	206.3	230.0	244.8	4.5	4.4	4.0
Nonprofit institutions	59.1	42.0	62.7	1.3	0.8	1.0
Rest of the world	509.2	544.0	537.4	11.0	10.4	8.7
Households	150.9	217.4	277.6	3.3	4.2	4.5
Accumulated profits	317.3	324.5	363.9	6.9	6.2	5.9
Unspecified[f]	217.9	221.0	270.6	4.7	4.2	4.4
Intrasector liabilities	132.7	136.0	188.2	2.9	2.6	3.1
Total	**4,621.5**	**5,234.6**	**6,163.8**	**100.0**	**100.0**	**100.0**

[a] Including equity capital and participation certificates.
[b] Including Yaad Agricultural Development Bank.
[c] Revised and reclassified data.
[d] Companies owned by the Government, National Institutions, or local authorities.
[e] Including farms.
[f] Including sales on the Tel Aviv Stock Exchange.

Table XVII–4

BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS,[a] BY FIRST SECTOR OF DESTINATION, 1967–68

	1967[b]	1968	Increase or decrease (–) as against previous year	
			1967[b]	1968
		IL million		
Government (mainly deposits with Accountant General)	939.4	1,293.7	256.7	354.3 (289.3)[c]
Industry	964.4	1,003.3	115.6	38.9 (103.9)[c]
Agriculture	399.4	488.2	43.0	88.8
Construction and housing	1,455.9	1,611.6	64.8	155.7
Commerce	21.8	21.2	–3.3	–0.6
Local authorities	462.1	557.9	120.4	95.8
Services	332.2	419.7	–48.5 (21.5)[c]	87.5
Banking and financial institutions	140.4	175.7	26.7	35.3 (40.3)[c]
Households	30.0	36.3	1.9	6.3
Miscellaneous	72.1	89.4	3.7	17.3
Total	**4,817.7**	**5,697.0**	**581.0 (651.0)[c]**	**879.3 (884.3)[c]**
Total excl. Government	**3,878.3**	**4,403.3**	**324.3 (394.3)[c]**	**525.0 (595.0)[c]**
		Percentages		
Government (mainly deposits with Accountant General)	19.5	22.7	37.6	37.7 (30.8)[c]
Industry	20.0	17.6	13.6	4.0 (10.8)[c]
Agriculture	8.3	8.6	12.1	22.2
Construction and housing	30.2	28.2	4.7	10.7
Commerce	0.5	0.4	–13.1	–2.8
Local authorities	9.6	9.8	35.2	20.7
Services	6.9	7.4	–12.7 (6.5)[c]	26.3
Banking and financial institutions	2.9	3.1	23.5	25.1 (28.7)[c]
Households	0.6	0.6	6.8	21.0
Miscellaneous	1.5	1.6	5.4	24.0
Total	**100.0**	**100.0**	**13.7 (15.4)[c]**	**18.3 (18.4)[c]**
Total excl. Government			**9.1 (11.1)[c]**	**13.5 (15.3)[c]**

[a] Including Yaad Agricultural Development Bank.
[b] Revised data.
[c] Excluding write-offs.

of the economy, while a small proportion (about 6 percent) was invested in nongovernmental securities, and less than 1 percent in real estate.

The major changes in the asset structure in 1968 were a further rise in the weight of outstanding credit to the Government (mainly in the form of deposits with the Accountant General), from 17.9 percent in 1967 to 21.0 percent,[1] and a decline in the weight of outstanding credit to other sectors, from 74.2 to 71.4 percent.[2]

The nongovernmental securities portfolio expanded by IL 56.0 million in 1968, compared with a slight increase of IL 6.4 million in 1967, and totalled IL 349.6 million. As a consequence, the declining trend in the weight of these securities in total assets, which had persisted for several years, was checked. A considerable part of the increase was accounted for by the investment companies and mutual fund groups. However, not all of the institutions in these groups contributed to the growth; in fact it was confined almost entirely to three institutions—two new bond funds (see the discussion below) and one investment company, which acquired the entire securities portfolio of a holding company.

(c) *Credit granted*

The general economic recovery (and the marked growth in capital formation) in 1968 was reflected in the volume of credit provided by the financial institutions to other sectors. Outstanding credit granted went up by IL 879.3 million to IL 5,697.0 million—a rise of 18.3 percent, as against 13.7 percent in 1967[3] and 22.7 percent in 1966.

Outstanding credit to the non-Government sectors amounted to IL 525.0 million (less the write-offs due to the linkage and interest concessions, this came to IL 595.0 million), as compared with IL 324.3 million in 1967 (IL 394.3 million excluding the write-offs).

In contrast to the smaller increase in 1968 in outstanding credit to industry and local authorities, there was a larger increase in outstanding credit to construction and housing, agriculture, and services. The balance of credit granted to the commerce sector declined to a smaller extent than in 1967. Most of the growth in outstanding credit to banking and financial institutions (IL 35.3 million, or IL 40.3 million excluding the aforementioned concessions) stemmed from the deposits made by one of the institutions, which does not directly provide the credit to the branch financed.

[1] Excluding the linkage and interest concessions mentioned above, this came to 20 percent.

[2] Excluding the linkage and interest concessions mentioned above, this came to 72.4 percent.

[3] Excluding the aforementioned write-off, the growth in 1967 amounted to IL 651 million, or 15.4 percent.

(i) Government

Outstanding credit to the Government rose by IL 354.3 million, as against IL 256.7 million in 1967, and totalled IL 1,293.7 million.

Approximately IL 65 million of the 1968 increase originated in the compensation received by the financial institutions on account of linkage and interest differentials on their loan portfolios. Less this amount, the growth of the credit balance declined from 37.6 percent in 1967 to 30.8 percent. Roughly IL 10 million of the increment consisted of Government securities held by the institutions (apparently purchases of the Defense Loan).

Whereas in 1967 the growth of the institutions' deposit balance with the Accountant General exceeded the growth of the balance of earmarked Government deposits for loan purposes by about IL 97 million (approximately IL 27 million excluding the write-offs), in 1968 there was a net increase (excluding the compensation for linkage differentials) in the opposite direction in the amount of approximately IL 55 million.[1] These findings indicate that the institutions' bond issues in 1968 were not sufficient to provide all of the direct financing (that part of the proceeds which they retained) and indirect financing (the rise in earmarked Government deposits) required during the year.

(ii) Industry

Outstanding industrial credit expanded by IL 38.9 million in 1968, as against IL 115.6 million the year before, and totalled IL 1,003.3 million, or 17.6 percent of total outstanding credit granted by the sector.

Even if allowance is made for the write-offs in outstanding credit due to the linkage and interest concessions, the growth in 1968 was still below that of the previous year—IL 103.9 million as against IL 115.6 million. In view of the much larger industrial investment in 1968, outstanding credit to this sector could have been expected to rise more rapidly than in 1967. That this did not occur may be explained by the following factors: (1) part of the additional funds provided in 1967 were not intended to finance investments but to help extricate the concerns from the tight financial position in which they found themselves as a result of the economic slowdown; (2) arrears in debt repayments, a result of the recession, were reduced in 1968; (3) the share of private enterprise in the financing of industrial investments rose in 1968, owing to the increased profitability of the sector.

(iii) Agriculture

Outstanding farm loans, as shown in the financial institutions' balance sheets, went up by IL 88.8 million, as against IL 43.0 million in 1967, and amounted

[1] See the note on p. 376.

to IL 488.2 million, or 8.6 percent of total outstanding credit provided by the sector. By far the greater part of the 1968 increment consisted of development budget loans. It is noteworthy that this striking increase in outstanding credit occurred despite the downward trend in agricultural investments in recent years.

(iv) Construction and housing

Outstanding credit for financing construction and housing expanded by IL 155.7 million, compared with IL 64.8 million in 1967 and IL 288.8 million in 1966, and totalled IL 1,611.6 million, or 28.2 percent of the aggregate balance of credit granted by the sector.

The growth rate (10.7 percent) was higher than in 1967 (4.7 percent), but lower than in the preceding years (25.8 percent in 1966 and 18.7 percent in 1965); and this despite the continued upswing in construction starts and home purchases, which began in the second half of 1967.

The marked divergence between the percentage increase in outstanding credit in 1968 and that in 1965 and 1966 cannot be explained by the change in the volume of home purchases (although the total area of completions continued downward in 1968, there was a large stock of unsold dwellings on hand at the beginning of the year), but is ascribable to other factors. In 1966 credit to contractors and building companies was stepped up appreciably because of the financial difficulties which they faced as a result of the slump in the housing market, and the average size of mortgage loans was also increased noticeably in an attempt to stimulate sales; as a consequence, outstanding credit grew at the rapid rate of 25.8 percent.

The marked difference between the growth rates in 1965 and 1968 can be attributed to the following principal factors: (1) In 1965 index-linkage differentials of approximately 8 percent were added to the outstanding credit linked to the consumer price index, whereas in 1968 a premium of 3–4 percent was charged. (2) Part of the mortgage loans granted during the year under review represented, as far as the institutions were concerned, merely a change in the borrowers' identity (a large percentage of the unsold dwellings held by contractors and building companies, for whose maintenance they had received substantial interim financing in 1966, were sold during 1968). (3) Arrears in mortgage loan repayments, a result of the recession, were reduced, thereby depressing the balance of credit granted.

When comparing the growth rates of 1968 and 1965, it should be recalled that in 1965 there was a larger volume of early loan repayments (due to the expectation of a rapid price rise prevailing that year) than in 1968 (despite the concessions granted on the Treasury's instructions to those paying off their loans ahead of maturity).[1] Were it not for the difference in early repayments, the gap between the growth rates of outstanding credit in 1965 and 1968 would have been wider still.

4. Developments, by Type of Institution

The financial institutions sector, as surveyed in this chapter, numbers 85 intermediaries classified into seven groups (see Table XVII–1). This is actually a sectoral classification, but it should nevertheless be emphasized that some of the groups lend a large part of their resources to other sectors of the economy as well. It follows, therefore, that the credit extended to a certain sector by the group of institutions engaging primarily in the financing of that sector represents only part of the total amount lent by the financial institutions to that sector.

(a) *Industrial development banks*

This is the second largest group of financial institutions. It numbers five institutions, the largest of which, the Industrial Development Bank, accounts for about 80 percent of the group's combined balance sheet. The direct contribution of the Government (by way of participation in the institutions' equity capital and earmarked deposits for loan purposes) to the group's resources (excluding reserve funds, etc.) amounted to 55 percent in 1968.

The group's share in outstanding industrial credit granted by the sector reached 88 percent in 1968. Directed loans for industrial development (whether from Government deposits or from the institutions' own means but under Government direction) are given without linkage and at interest not exceeding 9 percent p.a. At the end of 1968, 30 percent of the outstanding credit extended by the industrial development banks had been given to the textile and clothing industry, 20 percent for stone, cement, and brick production, about 12 percent for the production of metal goods, and some 12 percent to the food industry.

The group's combined balance sheet increased in 1968 by IL 49.7 million, as against IL 149.5 million in 1967, and totalled IL 1,147.1 million. Even if we deduct deposits with the Accountant General and the accounting decrease in outstanding loans carried out under the Treasury's instructions and on its account, the growth in 1968 was still lower than in 1967 (the reasons for the slower rise in outstanding credit, despite the much larger volume of investment, were listed above in the discussion of outstanding industrial credit).

Whereas in 1967 roughly 50 percent of the group's incremental liabilities were in bonds, in 1968 this item went up by only some IL 9 million. The biggest rise was recorded in earmarked Government deposits (about IL 45 million).

[1] In view of the abolition of the value-linkage of mortgage loans and the collection instead of a premium of 3 to 4 percent per annum, the concessions offered evidently did not constitute a sufficient inducement to pay off mortgage debts ahead of maturity.

(b) *Agricultural credit funds*

In 1968 this group ranked fourth in size among the financial institutions. It comprises 18 institutions, headed by the Israel Bank of Agriculture and the Yaad Agricultural Development Bank, which together account for about 65 percent of the group's combined balance sheet. The Government's share in the paid-up capital of these two comes to about 87 percent. Most of the remaining institutions in the group are joint funds connected with various agricultural and settlement organizations; there are also a number of institutions connected with the Jewish Agency.

The group's combined balance sheet rose by IL 157.2 million in 1968, as against IL 115.5 million in 1967, and totalled IL 855.7 million. Less deposits with the Accountant General, the growth rate was 15 percent, as against 11.5 percent in 1967.[1] Half of the increase was accounted for by the Israel Bank of Agriculture and the Yaad Bank, which also function as commercial banks.

Over 70 percent of the net[2] increase in liabilities was in outstanding Government deposits for loan purposes, and the rest in deposits and loans from banks and institutions.

(c) *Institutions financing other sectors*

The four institutions in this group, in order of size, are the Maritime Bank, the Local Authorities Bank, the Tourist Industry Development Corporation, and Igarot. They mainly finance the local authorities and the service sectors (shipping, tourism, etc.).

Whereas in 1967 the group's combined balance sheet shrank by IL 78.1 million, owing to the cancellation of part of a loan granted out of Government funds and the repayment of a short-term foreign loan, the proceeds of which were transferred to the Accountant General, in the year reviewed the balance sheet rose by IL 106.3 million (21.6 percent) to stand at IL 598.5 million. Even discounting the two aforementioned factors depressing the 1967 figures, growth was still much higher in 1968 than in the previous year (9 percent). A significant part of the increase is explained by the group's participation in the financing of the new Eilat-Ashdod oil pipeline.

The overwhelming share of the incremental liabilities consisted of earmarked Government deposits, the balance of which amounted at the end of 1968 to IL 367.2 million, or 61.4 percent of the total balance sheet.

(d) *Mortgage banks*

The mortgage banks, which engage primarily in financing construction and the purchase of dwellings, are the largest group of financial institutions, accounting

[1] Nearly IL 20 million of the incremental outstanding credit in 1967 did not go to agriculture.
[2] Less the institutions' deposits with the Accountant General.

for 40 percent of the sector's combined balance sheet at the end of 1968. It numbers 17 institutions, four of which—Tefahot, General Mortgage Bank, Housing Mortgage Bank, and Mortgage Development Bank—account for about 85 percent of the group's balance sheet.

By far the greater part of the funds lent out of earmarked Government deposits are guaranteed by the Treasury. (At the end of 1968 the balance of loans from Government deposits amounted to about half of all outstanding credit extended by the group to the various sectors, excluding the Government.)

Loans granted on the mortgage banks' own responsibility generally do not exceed 40 percent of the value of the mortgaged property.

The group's combined balance sheet increased by IL 356.4 million, as compared with IL 297.2 million in 1967, and totalled IL 2,520.2 million. Net of deposits with the Accountant General (the changes in which mainly stem, as already stated, from institutional arrangements and are not directly connected with the volume of funds placed by the mortgage banks at the disposal of the various sectors), the asset growth rate in 1968 was 13.3 percent (IL 226.2 million), as against 11.9 percent (IL 182.5 million) in 1967.

The sluggish 1968 growth rate is partly explained by the smaller increase in outstanding credit to the local authorities, from 28.7 percent in 1967 to 21.4 percent in 1968, and also by the various factors enumerated above regarding the decelerated growth in net outstanding credit for construction and housing (see the discussion on p. 385).

Gross mortgage credit granted directly for private and public housing (excluding credit to cooperative settlements, institutions, enterprises, etc.) amounted to approximately IL 150 million, as against IL 110 million in 1967.

Most of the growth in liabilities was in deposits earmarked for loans (Government deposits amounted to about IL 110 million, and other institutional deposits to approximately IL 75 million) and in bonds (about IL 140 million).

(e) *Investment companies*

This group numbers 15 institutions set up to deal in portfolio investments. It does not include holding companies, which generally do not meet the basic criterion of diversification of the investment portfolio, or companies financed by a limited number of proprietors.

The common characteristic of the institutions in this group is that they generally invest in a wide array of listed securities; at the same time, some of them invest in unlisted securities, sometimes even with the object of gaining control of the companies. Several of the major firms also grant loans to institutions and enterprises from earmarked deposits and from own means. The criterion for classifying institutions in this group is diversification of their securities portfolio.

Most of the investment companies surveyed here were set up by banking institutions. Even though the founding banks no longer hold the majority of the share capital, they have ensured control over the companies by according preferential voting rights to special classes of shares.

As in previous years, the investment companies led the entire sector in rate of balance sheet growth. The increase amounted to IL 224.1 million, compared with IL 123.5 million the year before; this brought the figure up to IL 903.6 million. Most of the growth again resulted from the activities of the largest companies in the group in supplying medium- and long-term credit to various sectors of the economy under the guidance (direct and/or indirect) of the Treasury, and also in mobilizing funds in the bond market for financing the development budget (the bond proceeds are deposited with the Accountant General).

Less the deposits with the Accountant General, the group's assets expanded by IL 118.9 million (21.9 percent), as against IL 54.0 million (11.1 percent) in 1967. Loans outstanding (excluding credit to the Government) rose by IL 96.2 million, and the securities portfolio by approximately IL 28 million. About 85 percent of the growth in the securities portfolio was recorded by one investment company, which acquired the entire portfolio of a holding company. With this single exception, it can be said that the continued recovery in the securities market had hardly any effect on the business volume of the majority of investment companies. Nevertheless, the profitability of their operations in the securities market continued upward. The market value of the companies' portfolio of marketable securities exceeded their book value by about IL 20 million at the end of 1968, as compared with IL 7 million in 1967.

Most of the incremental credit provided to the various sectors in 1968 went to local authorities (about IL 33 million), banks and financial institutions (about IL 20 million), and industry (about IL 13 million).

(f) *Household finance companies*

All the 17 companies in this group, with the exception of Otzar Hahayal, Idud, Yahav, and Consumer Cooperation Fund, have total assets of under IL 3 million.

The combined balance sheet went up by IL 10.7 million, compared with IL 7.1 million in 1967, and stood at IL 83.3 million. About half the increase on the liabilities side was in earmarked Government deposits.

Outstanding credit rose by about IL 10 million, of which some IL 6 million went to households and IL 3 million to finance construction.

(g) *Mutual funds*

This group numbered nine mutual funds in 1968, as against seven the year before. In contrast to the veteran funds, which have invested between

60 and 90 percent of their securities portfolio in shares, the two new funds founded in 1968 concentrate on the bond market.

In spite of the recovery of the stock market (which, as already noted, started in the second half of 1967), the veteran mutual funds hardly succeeded in issuing new participation certificates. The redemption of certificates, however, slowed down: whereas in 1967 net redemption by the veteran funds amounted to IL 2.1 million at par value (IL 2.4 million at redemption prices), in 1968 the figure came to IL 1.5 million (IL 2.2 million at redemption and issue prices).

In contrast to the standstill experienced by the older mutual funds, the two new funds succeeded in 1968 in issuing participation certificates to a total of IL 28.7 million at par value[1] (about one-and-a-half times the par value of the older funds' participation certificates at the end of 1968). This brought up the group's balance sheet by 81 percent, to IL 55.4 million at issue prices.

As a result of the addition of the new bond funds, the weight of shares in the group's investment portfolio fell from 65 percent in 1967 to 36.4 percent, while the weight of bonds went up from 28 to 60.1 percent.

The weak connection revealed also in 1968 between the expansion of Stock Exchange turnover and the rise of prices on the one hand and the development of the older mutual funds on the other must be partly attributed to the strong subsitution effect of both the foreign mutual funds, which were much more active in Israel after the restrictions on their operations were lifted, and the highly successful bond funds.

The timing of the new bond funds and their success in competing with the foreign mutual funds were connected, *inter alia,* with the situation prevailing in the bond market. The distribution of the Absorption and Defense Loan certificates greatly increased the supply of bonds in the market, thereby engendering temporary price fluctuations which were exploited by the funds.

5. Flow of Funds, by Sector[2]

This analysis of the flow of funds between the financial institutions and other domestic sectors is based on the institutions' balance sheets and profit and loss accounts. A balance sheet comparison of two consecutive years shows the flow of

[1] These funds continued to expand rapidly in the early part of 1969, and a third bond fund has been established.

[2] There are discrepancies between some of the data received from the financial institutions (on which the flow-of-funds statement in this chapter is based) and those obtained from other sectors regarding their transactions with the financial institutions. These discrepancies (see Chapter XVI, "Flow of Funds") originate in part from differences between the sectoral classification of the credit flows appearing in the institutions' accounts and that adopted by the other sectors. Another reason for discrepancies lies in the fact that this chapter deals with balance sheet changes, while the discussion of some of the other sectors deals with actual credit flows.

Table XVII-5

FLOW-OF-FUNDS STATEMENT OF THE FINANCIAL INSTITUTIONS,[a] BY SECTOR, 1967-68

(IL million)

	Receipts			Payments			Balances of receipts over payments	
	1967[b]	1968	Increase or decrease (–)	1967[b]	1968	Increase or decrease (–)	1967[b]	1968
Nonfinanical transactions	**342.6**	**415.4**	**72.8**	**324.2**	**383.9**	**59.7**	**18.4**	**31.5**
Transactions in financial assets								
Government	155.6	347.0	191.4	256.6	354.3	97.7	–101.0 (–31.0)[c]	–7.3 (62.7)[c]
National Institutions and local authorities	16.7	30.2	13.5	111.6	109.6	–2.0	–94.9	–79.4
Public sector companies	22.2	–0.6	–22.8	–79.0	69.0	148.0	101.2 (31.2)[c]	–69.6 (–73.6)[c]
Banking institutions	108.4	135.4	27.0	58.8	21.1	–37.7	49.6	114.3 (109.3)[c]
Social insurance funds	189.9	184.7	–5.2	–0.9	1.7	2.6	190.8	183.0
Insurance companies	–1.2	2.2	3.4	–1.2	0.7	1.9	—	1.5
Private business[d]	23.7	14.8	–8.9	197.6	168.0	–29.6	–173.9	–153.2 (–214.2)[c]
Nonprofit institutions	–17.1	20.7	37.8	–2.5	42.6	45.1	–14.6	–21.9
Rest of the world	34.8	–6.6	–41.4	10.9	5.4	–5.5	23.9	–12.0
Households[e]	66.5	60.2	–6.3	59.9	101.7	41.8	6.6	–41.5
Unspecified[f]	3.1	49.6	46.5	—	—	—	3.1	49.6
Total transactions in financial assets	**602.6**	**837.6**	**235.0**	**611.8**	**874.1**	**262.3**	**–9.2**	**–36.5**
Errors and omissions	—	—	—	9.2	–5.0	–14.2	–9.2	5.0
Total receipts and payments	**945.2**	**1,253.0**	**307.8**	945.2	1,253.0	307.8	—	—

[a] Including Yaad Agricultural Development Bank.
[b] Revised and reclassified data.
[c] Less write-offs.
[d] Including farms.
[e] Including contractors' deposits sold to households through banking institutions.
[f] Including securities sold on the Stock Exchange.

receipts and payments arising from transactions in financial assets, while the profit and loss statements show the flow defined as "nonfinancial transactions" (see Table XVII–5.)

In flow-of-funds analysis all balance sheet changes that do not represent actual flows but bookkeeping changes only, such as revaluations, allocations to reserves, etc., must be eliminated. In the flow-of-funds statement presented in Table XVII–5, however, no adjustments have been made for changes stemming from the revaluation of assets and liabilities, and part of the reserve allocations, which could not be identified in the balance sheets, were not deducted.

The financial institutions' business volume expanded by 32.6 percent in 1968, after shrinking by 15 percent in 1967, and stood at IL 1,253 million.

The main sectors providing net credit to the financial institutions were the social insurance funds, banking institutions, and the Government. The chief borrowers were private business, local authorities, public sector companies, and households.

The Government became a net lender in 1968 instead of a net borrower, owing to the larger volume of finance provided by the institutions to the non-Government sectors on the one hand, and the smaller volume of financial institution bond issues on the other. As against net payments of IL 31 million to the Government in 1967, the sector received IL 62.7 million in net credit in the year reviewed.

Net receipts from the social insurance funds were IL 8 million less than in the previous year and totalled IL 183 million. This decrease was apparently connected with the reduced volume of financial institution bond issues.

Net receipts from banking institutions rose from IL 49.6 million in 1967 to IL 109.3 million.

Net payments to private business rose from IL 173.9 million in 1967 to IL 214.2 million. Net payments to households amounted to IL 41.5 million, as contrasted with net receipts of IL 6.6 million the year before, and this despite the much larger issue of mutual fund participation certificates (following the establishment of the bond funds).

The diminishing importance of the rest-of-the-world sector as a source of funds, which has marked the past few years, continued in 1968, when it became a net recipient instead of a net supplier of credit.