CHAPTER XVII

# FINANCIAL INSTITUTIONS[1]

## 1. Main Developments

The growth of the financial institutions' business slowed down in 1967. The combined balance sheet of the institutions expanded by IL 545.4 million to reach IL 5,089.4 million—an advance of 12 percent, compared with 26.1 percent in 1964, 17.1 percent in 1965, and 19.6 percent in 1966. The balance of credit extended rose by IL 518.9 million (12.5 percent), compared with IL 755.4 million (22.2 percent) in 1966, and reached IL 4,681.5 million.

There was an even more striking deceleration in the growth of outstanding credit to the non-Government sectors of the economy (credit to the Government consists overwhelmingly of bond issue proceeds deposited with the Accountant General): the figure went up by about IL 315 million, or 9.0 percent, in contrast to IL 571 million, or 19.3 percent, in 1966. The rise was particularly slow in the construction and housing sector, which may explain nearly 6 percent of the total decline in the growth rate of outstanding nongovernmental credit.

The slower balance sheet increase was largely an outcome of the more sluggish expansion of business volume. The difference in net revaluation increments (which does not reflect any real change in the scope of activities) between 1967 and 1966 accounted for at most 3 percent of the 8 percent decline in the growth rate.

The less vigorous expansion in 1967 accompanied the deepening of the economic recession. This positive connection between the level of economic activity and the rate of the institutions' expansion can apparently be explained by the decline in the demand for credit, thus making the demand for credit the effective constraint on the institutions' growth, instead of supply, as in previous years.

Holdings of Government securities, which had decreased by IL 9.2 million in 1966, went up IL 10.8 million in the year reviewed. At the same time, cash

[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; holding companies, the bulk of whose investments are in subsidiaries; and companies with a limited number of proprietors. 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 separately.

and bank deposits were augmented by IL 38.2 million, or 83 percent, while outstanding loans from banks declined. These developments suggest that the financial institutions were in a position to extend more credit than they actually did.

The marked disparity between the sums raised by the Government through the financial institutions (that portion of bond proceeds which is transferred to the Treasury) and the increase in Government deposits with these institutions for loan purposes very likely can also be attributed to the slackening of demand for their credit.

The intensification of the recession in the first half of 1967 strengthened expectations that prices would remain steady, as well as the pessimistic expectations regarding future earnings. As a result, financial assets were generally preferred over real assets, and this, coupled with the impending abolition of the value-linkage of loans, kept the construction and housing sector in the doldrums throughout most of 1967. This in turn left its stamp on the development of the mortgage banks, the largest single group among the financial institutions (it presently accounts for about 42 percent of the sector's combined balance sheet).

The lifting of the linkage clause on development budget loans as from the middle of 1967 and the collection of a fixed annual premium of 3–4 percent in lieu thereof, the increase in the average loan granted home buyers in all types of housing schemes, and the steps taken by the Government to stimulate the sale of the dwelling stock held by private builders and to promote new building, all these led to a revival of activity in the construction and housing sector in the last few months of the year. However, they were not sufficient to change the overall picture for 1967, which showed a sharp decline in gross lending to home buyers, contractors, and building firms. The exceptionally heavy volume of loans granted in 1966 to contractors and building companies, which experiencied financial difficulties because of the accumulation of a big stock of unsold finished dwellings, also contributed to this development. The net amount of credit extended to the construction and housing sector in 1967 was up IL 70.2 million, or 5.0 percent, as against IL 288.8 million, or 25.8 percent, in 1966.

Outstanding credit to the service sector fell by IL 41.4 million, or 9.5 percent, whereas in 1966 there was a net rise of IL 28.9 million, or 7.6 percent. This, however, was a bookkeeping decrease only, the result of writing off part of a debt of a public sector company.

Outstanding credit to the Government went up from IL 184.2 million in 1966 to 203.9 million, that to industry from IL 67.7 million to IL 104.7 million, and that to local authorities from approximately IL 90 million to IL 120 million. These increases, however, failed to offset the much slower rise in construction and housing credit.

Of the incremental outstanding credit of IL 518.9 million, IL 203.9 million (about 39 percent) went to the Government. (Net of the aforementioned increase in earmarked deposits, the Government received about IL 110 million,[1] whereas in 1966 it provided the financial institutions IL 85 million more than it received from them.[2]) Credit to the Government was provided under the existing arrangements whereby some of the institutions have been permitted to issue bonds on condition that part of the proceeds are used to grant loans under Government direction and part are transferred directly to the Treasury (the latter redeposits some of these funds with the financial institutions for the purpose of granting directed credit). Sale of the bond issues is virtually assured by the arrangements under which income tax concessions are granted to social insurance funds and on saving scheme deposit funds, insofar as the assets accumulated are invested in securities approved by the Government. In 1967 the institutions issued IL 320.7 million worth of bonds in the domestic market. Of this sum, IL 192.1 million was transferred to the Treasury. The overwhelming share of the proceeds from overseas issues—about IL 53 million out of IL 60 million—was also transferred to the Treasury.

The recovery of the stock market in 1967 checked the contraction of the non-governmental securities portfolio of the financial institutions, but did not lead to any signficant expansion of their investment in this type of paper—a mere IL 6.1 million, compared with a decline of IL 24.7 million in 1966.

Among the seven groups of financial institutions, investment companies showed the most rapid balance sheet growth (22.6 percent), but this was due to a rise in directed credit granted and not in the purchase of securities. As to the unit trusts, the redemption of their participation certificates slowed down in the year reviewed, but they did not succeed in issuing any new certificates.

As in previous years, the sector's operations were financed from two principal sources: bond issues and deposits earmarked for loans, in the main from the Government. During the year reviewed gross bond issues came to about IL 381 million. Less redemption but including the devaluation increments on dollar-linked bonds, the net balance sheet increase was IL 325 million, or 31.7 percent, bringing the total amount of outstanding bonds up to IL 1,353.7 million by the end of the year.

Earmarked Government deposits grew much less in 1967 than in the previous year—by IL 95.2 million, or 6.4 percent, as against IL 240.4 million, or 18.8 percent (exclusive of the debt write-off, the increase in 1967 came to approximately IL 165 million). In 1966 bond issue proceeds in the amount of IL 155.8 million were transferred to the Government, which in turn redeposited IL 240 million with the institutions for loan purposes; in 1967 the figures were re-

[1] Excluding the aforementioned write-off of the public sector company debt, the figure came to about IL 40 million.

[2] That portion of the bond issue proceeds transferred to the Treasury, less the increase in outstanding Government deposits for loan purposes.

Table XVII-1

COMBINED BALANCE SHEET TOTALS OF FINANCIAL INSTITUTIONS, BY TYPE, 1966–67

| Group | No. of institutions | IL million | | Percent | | Percent increase or decrease (–) as against previous year | |
|---|---|---|---|---|---|---|---|
| | | 1966 | 1967 | 1966 | 1967 | 1966 | 1967 |
| Mortgage banks | 17 | 1,866.6 | 2,163.7 | 41.1 | 42.5 | 27.5 | 15.9 |
| Industrial development banks | 5 | 947.9 | 1,097.2 | 20.9 | 21.6 | 5.8 | 15.8 |
| Institutions granting loans to other sectors[a] | 4 | 570.3 | 492.2 | 12.6 | 9.7 | 16.6 | –13.7 |
| Agricultural credit funds | 17 | 505.5 | 551.7 | 11.1 | 10.8 | 14.9 | 9.1 |
| Investment companies | 15 | 556.0 | 681.8 | 12.2 | 13.4 | 34.5 | 22.6 |
| Household finance companies | 17 | 65.5 | 72.2 | 1.4 | 1.4 | 12.7 | 10.2 |
| Unit trusts | 7 | 32.2 | 30.6 | 0.7 | 0.6 | –20.0 | –5.0 |
| Total | 82 | 4,544.0 | 5,089.4 | 100.0 | 100.0 | 19.6 | 12.0 |

[a] For tourism, shipping, and local authorities.

spectively IL 204.0 million and IL 95.2 million (about IL 165 million including the loan written off).

These data suggest that the financial institutions did not have to increase their bond issues to the extent that they did in order to provide the direct financing (that part of the proceeds which they retained) and indirect financing (the rise in earmarked Government deposits) required in 1967, and that a surplus was left over to finance Government operations.

## 2. Types of Financial Institutions

This sector, as defined here, numbers 82 financial institutions,[1] which break down into seven groups (see Table XVII-1). Although this is essentially a sectorial classification, it should be stressed that some groups loan a considerable portion of their funds to other domestic sectors; hence the credit extended to a given sector by the banks specializing in financing that sector represents only part of the total credit received from the financial institutions as a whole. It follows, therefore, that the total amount lent for construction and housing pur-

[1] In 1966 there were 85 institutions. Three were struck off the list after they became holding companies.

poses, for instance, is equivalent neither to total mortgage bank credit nor to the total volume of construction and housing loans granted by the mortgage banks.

The largest of the seven groups is that of the mortgage banks, which deal chiefly in loans to home buyers and builders. Their share in the sector's combined balance sheet has increased steadily over the last few years and amounted to 42.5 percent by the end of 1967.

Next in size are the industrial development banks, which grant medium- and long-term loans on relatively easier terms.

Third place is held by the investment companies. Their weight in the combined balance sheet has been moving up in recent years, not because of the expansion of portfolio investment (its share in the group's total assets dropped to less than half several years ago and has continued downward), but mainly because the major companies have been engaging more heavily in long- and medium-term loan business.

The fourth largest group, the agricultural credit funds, is headed by the Government-owned Israel Bank of Agriculture, which accounts for over half of the group's balance sheet. The remaining institutions were set up by various settlement organizations or by commercial banks (to provide long- and medium-term farm credit).

The institutions financing other sectors cater mainly to shipping, tourism, and the local authorities; about 80 percent of their share capital is held by the Government.

The remaining two groups are household finance companies and unit trusts, which account for only 2 percent of the sector's aggregate assets. The unit trusts raise their capital by issuing participation certificates to the public and investing the proceeds in listed securities. They are distinguished from investment companies in that the certificates are redeemable on demand, in contrast to the shares issued by the latter.

The Government's control over local and foreign sources of medium- and long-term borrowed capital has made the financial institutions a convenient instrument for implementing national development policy and directing the flow of credit. The Government's domination of internal sources of finance derives principally from its requirement that the bulk of domestic contractual savings must be invested in approved securities in order to be eligible for income tax concessions; to some extent it also stems from Government restriction of interest rates, which makes it impossible for the institutions to compete with bond issues recognized as approved investments and whose yield is only slightly below the maximum legal interest rate. The Government influences the allocation of loan capital from abroad by means of foreign currency control.

Government intervention in the capital market is not confined to the direction of credit, but is also expressed in the determination of the price and repayment terms of loans granted from Government deposits and from bond issue proceeds. The Treasury compensates the financial institutions for any difference which may arise between the cost of the capital they mobilize and the price of the credit they grant under Government direction, leaving them a profit margin of about 1 percent. Under the existing arrangements, part of the bond issue proceeds[1] are used directly by the 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 interest 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 blows up the balance sheet totals. The extent of this inflation may be seen from Table XVII–2, where loans to the Government, consisting mostly of deposits with the Accountant General, are listed at IL 852.9 million at the end of 1967.

Only a very small percentage of the financial institutions mobilize all their capital in the free market and hence are not subject to any Government direction. Most of the resources of the major institutions lending to industry, agriculture, construction and housing, "other sectors", and even to households are directly or indirectly controlled by the Government. As to the investment companies, most of their growth in recent years has stemmed from their invading the sphere of Government-directed loans. At present the unit trusts are the only group that is free of Government direction, but it accounts for less than 1 percent of the sector's combined balance sheet. Assets of all financial institutions that are not subject to Government direction amounted at the end of 1967 to about IL 340 million, or 7.2 percent of the total for the sector as a whole.

## 3. Loan Linkage Policy

The gradual abolition of value-linkage on medium- and long-term loans granted by financial institutions continued in the year reviewed. The process actually started after the 1962 devaluation, when the dollar linkage of most new loans was replaced by linkage to the consumer price index. In 1964 index linkage was replaced by the payment of a fixed annual premium of 3–4 percent in respect of agricultural and industrial loans, and in 1966 for loans granted to hotels and transport companies. This arrangement did not apply to loans granted by the mortgage banks, which, as stated, account for over 40 percent of the sector's combined balance sheet. In 1966, in accordance with the recommendations of a special committee set up to examine linkage arrangements in force for mortgage loans granted from Government deposits, the loans were pegged to the cost-of-living allowance instead of the consumer price index, in order to ease the debt burden of those buying homes in public projects, who

[1] In recent years this has amounted to 40 percent.

generally belong to the lower-income brackets. In practice, however, they did not gain from this arrangement, since the mortgages were not linked to the cost-of-living allowance actually paid but to the cost-of-living allowance index, which generally rises at the same rate as the consumer price index.

In 1967 talks began on the abolition of loan linkage for all types of public and private housing (including loans granted from funds raised abroad). In the middle of the year the linkage of loans granted from Government funds was replaced by a fixed annual premium of 3–4 percent; the arrangement was applied retroactively to loans granted from April 1, 1967.

On November 28 the arrangement was extended to all directed loans, whether by the Ministry of Housing or by any other authority. According to a draft agreement submitted by the Accountant General to the mortgage banks, the Ministry of Finance would collect the premium of 3–4 percent and assume responsibility for compensating the latter for linkage differentials also on loans granted out of the banks' own funds, provided the mortgages did not exceed IL 15,000 and were given for homes costing not more than IL 40,000 (IL 50,000 in Jerusalem).

In this manner linkage was abolished for the borrower without abolishing it for the lender (the purchaser of bonds). In the protracted negotiations the Government tried to persuade the mortgage banks to assume part of the linkage-differential risk against collection of a 3–4 percent premium, but its efforts were not successful.

In December 1967 this arrangement was made applicable also to nondirected mortgage loans pegged to the consumer price index, and retroactively to loans granted since January 1, 1966. Thus, linkage has been lifted on practically all types of mortgage bank loans.[1]

## 4. Assets and Liabilities

Total assets of the financial institutions expanded in 1967 by IL 545.4 million, or 12 percent, compared with IL 744.5 million, or 20 percent, in 1966. This is the slowest growth rate in the past five years.

The deceleration can be explained in part by the stability of the consumer price index, which had gone up by 5–8 percent in preceding years. Any rise in this index automatically inflates all assets and liabilities pegged to it, without reflecting any real increase in the institutions' operations. However, the price stability in the year reviewed cannot explain more than 2 percent of the total drop of 8 percent in the 1967 growth rate. The devaluation in November 1967 had the opposite effect of increasing the institutions' balance sheets without any real

[1] The timing of the cancellation of the linkage clause on mortgage loans, discussion of which had been going on for many years, suggests that one of the main considerations tipping the scales in favor of this step was the desire to stimulate building activity.

### Table XVII–2

### ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS, 1966–67

| | IL million | | Percent | | Increase or decrease (–) from 1966 to 1967 | |
|---|---|---|---|---|---|---|
| | 1966[a] | 1967 | 1966 | 1967 | IL m. | % |
| **Assets** | | | | | | |
| Cash and bank deposits | 45.8 | 84.0 | 1.1 | 1.6 | 38.2 | 83.4 |
| Credit to the public from own means | 1,610.2 | 1,751.1 | 35.4 | 34.4 | 140.9 | 8.8 |
| Credit to the public from Government deposits | 1,500.4 | 1,582.1 | 33.1 | 31.1 | 81.7 | 5.4 |
| Credit to the public from deposits earmarked for loans | 420.1 | 497.3 | 9.2 | 9.8 | 77.2 | 18.4 |
| Loans to the Govt. (mainly deposits with the Accountant General) | 647.3 | 852.9 | 14.2 | 16.8 | 205.6 | 31.8 |
| Nongovernmental securities[b] | 286.4 | 292.5 | 6.3 | 5.7 | 6.1 | 2.1 |
| Immovable assets | 33.8 | 29.5 | 0.7 | 0.6 | –4.3 | –12.7 |
| Total | 4,544.0 | 5,089.4 | 100.0 | 100.0 | 545.4 | 12.0 |
| **Liabilities** | | | | | | |
| Equity capital | 1,033.3 | 1,098.1 | 22.7 | 21.6 | 64.8 | 6.3 |
| Bonds | 1,028.1 | 1,353.7 | 22.6 | 26.6 | 325.6 | 31.7 |
| Deposits and loans from banks | 109.7 | 103.8 | 2.4 | 2.0 | –5.9 | –5.4 |
| Government deposits earmarked for loans | 1,488.7 | 1,583.9 | 32.8 | 31.1 | 95.2 | 6.4 |
| Nongovernmental deposits earmarked for loans | 492.4 | 530.3 | 10.8 | 10.4 | 37.9 | 7.7 |
| Other deposits and loans | 271.0 | 299.6 | 6.0 | 5.9 | 28.6 | 10.6 |
| Demand deposits | 17.0 | 24.1 | 0.4 | 0.5 | 7.1 | 41.8 |
| Other accounts (net) | 103.8 | 95.9 | 2.3 | 1.9 | –7.9 | 7.6 |
| Total | 4,544.0 | 5,089.4 | 100.0 | 100.0 | 545.4 | 12.0 |

[a] Revised data.
[b] Including investment in subsidiary companies.

expansion of operations. But whereas before the 1962 devaluation a large percentage of the assets and liabilities had been linked to the dollar, so that the nominal rise was considerable, the 1967 devaluation had a negligible effect of less than 1 percent on the balance sheet totals, as most of the liabilities formerly linked to the dollar were now linked to the consumer price index.

Another artificial reduction of the sector's balance sheet resulted from the Government's waiving part of a loan granted out of funds it had deposited with one of the institutions. This write-off accounts for about 1.5 percent of the decline in the 1967 growth rate as compared with that for 1966.

It emerges, therefore, that these net accounting changes between 1966 and 1967 explain at most 3 percent of the 8 percent decline in the growth of the sector's combined balance sheet; the remaining 5 percent must be ascribed to the slower expansion of operations.

As in previous years, the rate of balance sheet change was not the same for all groups, but all groups showed a slower rise in 1967, with the exception of the industrial development banks, where the growth rate went up from 5.8 percent in 1966 to 15.8 percent.

(a) *Assets*

Over 90 percent of the financial institutions' asset portfolio in 1967 consisted of loans (including deposits with the Accountant General), while some 6 percent consisted of nongovernmental securities and less than 1 percent of real estate. The most notable changes in the asset structure in 1967 were the decline in the proportion of loans to non-Government domestic sectors from 77.7 percent of total assets to 75.3 percent, and the rise in the proportion of loans to the Government from 14.2 to 16.8 percent. The share of nongovernmental securities continued downward in line with the trend of previous years and stood at 5.7 percent, as against 6.3 percent in 1966 and 8.2 percent in 1965.

(b) *Liabilities*

The sector's liabilities consist predominantly of medium- and long-term obligations, with equity capital amounting to only 22 percent of the total in 1967. The main changes in the liability structure displayed the same pattern as in 1966.

Equity capital grew by only IL 64.8 million in 1967 and totalled IL 1,098.1 million; its share in total liabilities, which stood at 27.7 percent in 1964, continued downward, standing at 21.6 percent by the end of 1967. The increase in equity capital did not stem from the issue of shares but from allocations to reserve funds and from the revaluation of shares denominated in foreign currency. About half of the increase was recorded by the industrial development banks, part of whose shares are in foreign denominations. Bonds outstanding rose by IL 325.6 million, or 31.7 percent. While this was slightly below the 1966 growth rate of 32.9 percent, the item accounted for 60 percent of the in-

Table XVII-3

LIABILITIES[a] OF FINANCIAL INSTITUTIONS, BY SECTOR, 1965–67

| | IL million | | | Percent | | |
|---|---|---|---|---|---|---|
| | 1965 | 1966[b] | 1967 | 1965 | 1966 | 1967 |
| Government | 1,631.8 | 1,832.1 | 1,932.9 | 42.9 | 40.3 | 38.0 |
| National Institutions and local authorities | 48.8 | 71.8 | 88.0 | 1.3 | 1.6 | 1.7 |
| Public sector companies[c] | 131.9 | 165.2 | 187.5 | 3.5 | 3.6 | 3.7 |
| Banking institutions | 158.7 | 182.6 | 205.7 | 4.2 | 4.0 | 4.1 |
| Social insurance funds | 380.8 | 532.2 | 702.9 | 10.0 | 11.7 | 13.8 |
| Insurance companies | 7.5 | 12.1 | 11.1 | 0.2 | 0.3 | 0.2 |
| Private businesses[d] | 140.7 | 204.5 | 250.5 | 3.7 | 4.5 | 4.9 |
| Nonprofit institutions | 20.6 | 58.1 | 52.1 | 0.5 | 1.3 | 1.0 |
| Rest of the world | 375.4 | 509.2 | 580.5 | 9.9 | 11.2 | 11.4 |
| Households | 160.7 | 150.9 | 173.0 | 4.2 | 3.3 | 3.4 |
| Accumulated profits | 306.8 | 316.2 | 321.8 | 8.1 | 7.0 | 6.3 |
| Unspecified[e] | 333.5 | 376.4 | 442.2 | 8.8 | 8.3 | 8.7 |
| Intrasector liabilities | 102.3 | 132.7 | 141.2 | 2.7 | 2.9 | 2.8 |
| Total | 3,799.5 | 4,544.0 | 5,089.4 | 100.0 | 100.0 | 100.0 |

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

cremental liabilities (including equity capital), as against 34.2 percent in 1966. Bond issues totalled approximately IL 381 million (including some IL 60 million issued abroad), as contrasted with IL 273 million in 1966. These issues, less current redemption and plus the revalution of dollar-linked bonds, brought up the outstanding balance to IL 1,353 million, or 26.6 percent of the institutions' total liabilities in 1967, compared with 22.6 percent the year before.

Most of the issues were floated by mortgage banks (about 51 percent of the total value), investment companies (30 percent), and industrial development banks (about 17 percent). The bulk of the funds raised abroad and about 60 percent of those from domestic issues were transferred to the Treasury.

Government deposits for loan purposes increased by IL 95.2 million (6.4 percent), as compared with IL 240.4 million (18.8 percent) in 1966, and stood at IL 1,583.9 million. Their share in total liabilities accordingly edged down from 32.8 percent in 1966 to 31.1 percent. The decelerated growth of these deposits, which amounted to about 40 percent of total liabilities in the early sixties, coupled with the accelerated rise in outstanding bonds, might create the misleading impression that Government influence over the medium-

Table XVII-4

DOMESTIC BOND ISSUES OF FINANCIAL INSTITUTIONS, 1962-67

(IL million)

| Year | Amount issued | Transferred to the Treasury | |
|---|---|---|---|
| | | IL m. | % |
| 1962 | 70.5 | 49.5 | 70.2 |
| 1963 | 71.0 | 34.0 | 47.9 |
| 1964 | 71.0 | 13.8 | 19.4 |
| 1965 | 136.7 | 53.4 | 39.1 |
| 1966 | 210.9 | 122.8 | 58.2 |
| 1967 | 320.7 | 192.1 | 59.9 |

and long-term capital market is waning. It should be borne in mind, however, that the Government directs the use not only of its own earmarked deposits but also the proceeds of bond issues (as stated, part of these funds are transferred to the Accountant General while another part is used directly by the financial institutions for granting Government-directed loans). The overwhelming portion of the incremental Government deposits went to mortgage banks (which received about 36 percent of the total as against two-thirds in 1966), industrial development banks (about 21 percent), and the agricultural credit funds (approximately 30 percent).

Other noteworthy changes in the liability structure were the much more sluggish growth of nongovernmental loan deposits—which rose by only 37.9 million, or 7.7 percent, in 1967 as contrasted with 123.2 million, or 36.9 percent, in 1966—and the absolute decline in deposits and loans from banks by IL 5.9 million, or 5.4 percent.

## 5. Credit

The balance of credit extended by financial institutions amounted to IL 4,681.5 million at the end of 1967—a rise of IL 518.9 million (12.5 percent), compared with IL 755.4 million (22.2 percent) in the previous year. Excluding outstanding credit to the Government, the increase came to about IL 315 million (9.0 percent), as against some IL 571 million (19.3 percent) in 1966. The net amount provided industry was 12.4 percent larger in 1967, compared with an 8.6 percent rise the year before. In all other destinations—except households, which anyway account for a negligible share of total financial institution loans—the increase in outstanding credit was slower than in previous years. Only loans to local authorities (shown under "miscellaneous" in Table XVII–5) expanded at more or less the same rate—by about IL120 million, or 37.8 percent, compared with IL 90 million, or 39.3 percent, in 1966.

The Government's share in outstanding credit went up from 24.4 percent in 1966 to 39.3 percent. This sharp rise is explained by the fact that, because of the recession, the institutions did not curtail the mobilization of capital in line with the slower expansion of their credit outflow to non-Government sectors.

Outstanding credit to the services sector fell off by about IL 41.4 million, or 9.5 percent. As stated, this was due to the writing-off of part of a loan granted out of Government deposits. Otherwise, the growth rate would have been only slightly lower than in 1966 (7.6 percent).

The commerce sector, at IL 25.1 million, showed the same balance as in 1966, when there was a growth of IL 10.8 million.

(a) *Government*

Outstanding credit to the Government rose by IL 203.9 million, as against IL 184.2 million the year before, and totalled approximately IL 851.2 million. The Government's share in total financial institution credit thus continued upward, from 15.6 percent in 1966 to 18.2 percent.

The increment consisted of IL 193 million in deposits with the Accountant General and IL 10.8 million in Government securities. Whereas the deposits are made under an arrangement requiring the financial institutions to place part of their bond issue proceeds with the Accountant General, Government securities are purchased at the institutions' own volition. The fact that this item increased by IL 10.8 million in 1967 after declining by IL 9.2 million in 1966 suggests that in the year reviewed the institutions did not expand their credit outflow to the extent that they could have done, taking into account the volume of freely disposable funds available to them.

(b) *Industry*

Outstanding industrial credit in 1967 came to IL 950.2 million, or 20.3 percent of the total balance of loans granted by the institutions; this represents an increase of IL 104.7 million, or 12.4 percent, over 1966, which saw a rise of IL 67.7 million, or 8.6 percent. The accelerated expansion in 1967 reversed the slower growth trend in evidence since 1964—when the rate came to 21.5 percent, compared with 13.2 percent in 1965, 8.6 percent in 1966, and 12.4 percent in 1967—and apparently reflects the effort to stimulate industrial investment.

(c) *Agriculture*

The balance of farm loans went up IL 24.3 million (7.4 percent), as against IL 32.6 million (11.0 percent), in 1966, and amounted to IL 353.6 million,

Table XVII-5

## BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS, BY FIRST SECTOR OF DESTINATION, 1966–67

| | 1966[a] | 1967 | Increase or decrease (–) as against previous year | |
|---|---|---|---|---|
| | | | 1966[b] | 1967 |
| | | | **IL million** | |
| Government (mainly deposits with Accountant General) | 647.3 | 851.2 | 184.2 | 203.9 |
| Industry | 845.5 | 950.2 | 67.7 | 104.7 |
| Agriculture | 329.3 | 353.6 | 32.6 | 24.3 |
| Construction and housing | 1,415.5 | 1,485.7 | 288.8 | 70.2 |
| Commerce | 25.1 | 25.1 | 10.8 | — |
| Services | 435.2 | 393.8 | 28.9 | –41.4 |
| Households | 28.1 | 30.0 | –4.5 | 1.9 |
| Miscellaneous | 436.6 | 591.9 | 146.9[c] | 155.3[d] |
| Total | 4,162.6 | 4,681.5 | 755.4 | 518.9 |
| | | | **Percentages** | |
| Government (mainly deposits with Accountant General) | 15.6 | 18.2 | 40.3 | 31.5 |
| Industry | 20.3 | 20.3 | 8.6 | 12.4 |
| Agriculture | 7.9 | 7.6 | 11.0 | 7.4 |
| Construction and housing | 34.0 | 31.7 | 25.8 | 5.0 |
| Commerce | 0.6 | 0.5 | 75.5 | — |
| Services | 10.4 | 8.4 | 7.6 | –9.5 |
| Households | 0.7 | 0.6 | –13.0 | 6.8 |
| Miscellaneous | 10.5 | 12.7 | 45.0[c] | 35.6[d] |
| Total | 100.0 | 100.0 | 22.2 | 12.5 |

[a] Revised data.
[b] Since the 1965 data were not revised, the percentage changes have been calculated from unrevised 1966 figures.
[c] Including IL 90 million (an increase of 39.3 percent) to local authorities.
[d] Including IL 120 million (an increase of 37.8 percent) to local authorities.

or 7.6 percent of total outstanding credit extended by the institutions. The slower growth in 1967 continued the trend which began in the early sixties and which is connected with the downtrend in agricultural investment.

(d) *Construction and housing*

Outstanding credit for financing construction and housing went up by IL 70.2 million (5 percent), compared with IL 288.8 million (25.8 percent) in 1966, and totalled IL 1,485 million, or 31.7 percent of the aggregate balance of credit granted by the financial institutions.[1]

Demand for housing apparently continued to weaken in 1967; even though it picked up in the second half of the year, this failed to change the picture for the year as a whole. In 1966, despite the decrease in the number of loans, gross credit for the purchase of private and public housing remained about the same as in 1965. In 1967, on the other hand, both the number of loans and the aggregate amount of financing fell steeply, although the average loan continued to increase. Gross credit granted directly by banks to those buying homes put up by private or public builders (other than loans to cooperative settlements, institutions, firms, etc.) totalled approximately IL 106 million in 1967, as against IL 138 million the year before, even though the average loan came to IL 13,100 as contrasted with IL 10,700 in 1966. Advances to contractors and construction firms also went down, from IL 84 million in 1966 to about IL 64 million.

As regards current loan repayments, the year reviewed falls into two distinct periods. In the first half there was a further increase in arrears, which reached a peak in May-July (the period of general mobilization and war); in the second half of the year borrowers began to catch up on their payments and by year's end the arrears had virtually disappeared.

Early mortgage loan repayment was on a much smaller scale in 1967, although the liquid asset holdings of households increased. This decline can be attributed to the expectation that prices would remain stable, and above all, to the impending retroactive abolition of the loan linkage provisions, which had been mooted since the beginning of the year.

## 6. Developments, by Type of Institution

(a) *Industrial development banks*

This group numbers five institutions, headed by the Industrial Development Bank, which accounts for 80 percent of the group's combined balance sheet and over half of whose share capital is held by the Government.

[1] The decrease in the growth rate of outstanding credit from 25.8 percent in 1966 to 5 percent in 1967 stemmed partly from the stability of the consumer price index in 1967 following an 8 percent rise in 1966; however, this accounts for no more than one-fifth of the decline.

The weight of the industrial development banks in the sector's combined balance sheet in 1967 came to 21.6 percent. Whereas in 1966 their assets had grown by only 52.2 million, or 5.8 percent, in the year reviewed the figure went up by IL 149.3 million, or 15.8 percent, to stand at IL 1,097.2. million. Some of this increase represented the revaluation of assets and liabilities (including equity capital) linked to the foreign exchange rate.

Whereas in 1966 the increase in business volume was financed primarily through earmarked Government deposits and to a minor extent by way of bond issues, in the year reviewed nearly half of the balance sheet growth stemmed from the sale of bonds. This is explained by the fact that, in contrast to 1966, the Government increased its outstanding earmarked deposits by less than the amount which it obtained from the financial institutions' bond issue proceeds.

Equity capital was about IL 30 million larger in 1967. Only a small part of the increment originated from the sale of shares, most of it stemming from the revaluation of shares denominated in foreign currency and the expansion of reserve funds. Bond sales brought in approximately IL 68 million; of this amount, IL 45 million was raised abroad and transferred to the Accountant General.

### (b) *Agricultural credit funds*

This groups comprises 17 institutions, the largest of which is the Israel Bank of Agriculture, which accounts for about 54 percent of the combined balance sheet. The remaining institutions are joint funds connected with the various agricultural settlement organizations and a number of institutions connected with the Jewish Agency.

The percentage rise in the balance sheet of this group was below the average for the sector as a whole, and varied from one institution to another, with some showing a further stagnation of business. The combined balance sheet went up by IL 46.2 million, or 9.1 percent, compared with IL 65.4 million, or 14.9 percent, in 1966, and stood at 551.7 million.

Over 80 percent of the incremental liabilities consisted of earmarked Government deposits, and the rest of deposits and loans from banks and institutions. Bond sales totalled IL 3 million; IL 2 million of the proceeds were transferred to the Accountant General.

Outstanding credit went up by IL 35.5 million to IL 485.3 million. Nearly 75 percent of the incremental credit went to agriculture and the rest to construction and industry.

### (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. About 80 percent of their share capital is held by the Government.

The combined balance sheet shrank by IL 78.1 million, or 13.7 percent, in

1967, after having expanded by IL 81.4 million, or 16.6 percent, in the preceding year. This can be attributed to the cancellation of part of a loan granted out of Government funds and to the repayment of a short-term foreign loan, the proceeds of which were transferred to the Accountant General. Excluding these two, the group's combined balance sheet would have increased by about 9 percent.

(d) *Mortgage banks*

Four of the 17 banks in this group—Tefahot, General Mortgage Bank, Housing Mortgage Bank, and Mortgage Development Bank—accounted for about 85 percent of the group's combined balance sheet in 1967. The development of this group slowed down considerably in the year reviewed: its assets grew by IL 297.1 million, or 15.9 percent, as against IL 403.6 million, or 27.5 percent, in 1966, and totalled IL 2,163.7 million. Nevertheless, its weight within the sector as a whole edged up from 41.1 to 42.5 percent.

The slump in the housing and construction sector, which was aggravated in the first half of 1967, affected mortgage banking business. In 1966 more credit was extended to contractors and building companies (whose financial situation had worsened following the accumulation of a stock of unsold dwellings), and the average size of mortgage loans was increased, so that the banks were able to sustain their rapid expansion despite the economic recession. In 1967, however, they sharply curtailed the flow of gross credit to households, contractors, and building companies; although the average loan continued to rise—from IL 11,100 to IL 13,700 for public housing and from IL 10,000 to IL 12,000 for private housing—the total volume of gross credit (excluding loans to the Government but including loans to cooperative settlements, institutions, enterprises, etc.) amounted to only IL 312 million as against IL 370 million in 1966.

The revival of the economy toward the end of the year found expression *inter alia* in home purchases and building starts, but this was not sufficient to bring about any significant change in the combined balance sheet position of the mortgage banks. The recovery can be partly credited to various steps taken to ease financing terms for home purchases and to bolster the financial position of builders:

1. In the middle of 1967 the linking of loans granted from Government funds was done away with and fixed annual premiums of 3–4 percent were charged instead—a measure that stimulated demand for public housing.[1]

2. Nonlinked mortgage loans were granted jointly by the Government, mortgage banks, and contractors to foster the sale of dwellings put up by private builders.

[1] In private housing (see section 3), these provisions actually came into force only at the beginning of 1968.

3. The Government purchased dwellings from the unsold stock that had accumulated with private contractors.

Most of the expansion of mortgage banking business was financed by the sale of IL 193 million worth of bonds, constituting 51 percent of the sector's total proceeds from bond issues. Net of redemptions, this brought up the mortgage banks' outstanding bond balance to IL 155 million. The rest of the funds came from earmarked Government deposits (about IL 70 million) and deposits of other institutions (about IL 50 million).

The sale of contractors' deposits by the mortgage companies through the banking institutions was on a much smaller scale in 1967, both because of the depression in the private housing market and because of the sale of homes against non-linked mortgages, as a result of which the contractors had no linked deposits to offer.

(e) *Investment companies*

This group numbers 15 companies originally set up to deal primarily in portfolio investment. It does not include holding companies, which generally do not meet the basic criterion of diversifying their investment portfolios, or companies with a very small number of shareholders. All the institutions included in this group generally invest in a wide array of listed securities, although some also invest in unlisted securities, sometimes even with the object of gaining control of the companies. Several of the major firms also grant loans to companies and institutions from earmarked deposits and from own means.

The combined balance sheet of this group grew in 1967 by IL 125.8 million, or 22.6 percent, compared with IL 142.5 million, or 34.5 percent, the year before and reached IL 681.8 million. Although the growth rate was lower than in 1966, it was still the highest among the financial institution groups; however, as already pointed out, this was not due to a larger investment in securities, the primary purpose for which these companies were established.

Most of the companies which do not engage in loan business continued to show little or no progress, and some of them even took advantage of the revival of the securities market to unload part of their holdings.

The liability item showing the biggest increase in 1967 was bonds, which rose by approximately IL 100 million; about IL 117 million worth of bonds were sold during the year and some IL 77 million in proceeds were transferred to the Accountant General. In contrast, the balance of earmarked Government deposits increased by only IL 8 million as compared with 1966. It is obvious from these data that a considerable portion of the bond issue proceeds was intended neither for portfolio investment nor for expanding credit to the public. The resorting to financial institutions to mobilize funds for disposition by the Government is most conspicuous in this group.

The companies' securities portfolio grew by IL 7 million (of which IL 2 million was in Government bonds); this compares with a decline of about IL 35 million in 1966.

The credit balance increased by IL 57 million, compared with IL 100 million in 1966; most of the increment went to local authorities and industry, while outstanding credit for construction and housing purposes was less than in the previous year.

### (f) *Household finance companies*

All the 17 companies in this group, except Otzar Hahayal, Yahav, Consumer Cooperation Fund, and Idud, have a balance sheet of under IL 2 million. The combined balance sheet went up by IL 6.7 million, or 10.2 percent, compared with 7.4 million, or 12.7 percent, in 1966 and stood at IL 72.2 million. Net credit increased by IL 4 million, of which IL 2 million went to households and the rest to other economic sectors.

### (g) *Unit trusts*

This group numbers seven unit trusts, which are distinguished from the investment companies in that their equity capital is in the form of redeemable participation certificates and their operations are confined by law to investment in listed securities.

In spite of the much larger overall yield on these participation certificates in 1967—ranging from 15 to 28 percent, compared with a negative return of 5–17 percent in 1966—the unit trusts did not succeed in issuing any new certificates during the year. But at the same time, net redemption declined from IL 5.9 million at par value (IL 7.1 million at issue prices) in 1966 to IL 2.1 million and IL 2.4 million respectively in 1967.

The group's combined balance sheet went down by only IL 1.6 million (at per value), or 4.9 percent, compared with a decline of IL 8 million, or 20 percent, in 1966, and totalled IL 30.6 million. The proportion of equities in the investment portfolio fell from 69 percent in 1966 to 65 percent, while that of bonds rose from 25 to 28 percent.

## 7. Flow of Funds, by Sector[1]

This analysis of money flows between the financial institutions and other domestic sectors is based on their balance sheets and profit and loss accounts. A balance sheet comparison of two consecutive years shows the flow of receipts and payments arising from transactions in financial assets, while the profit

[1] Owing to discrepancies between the data received from the financial institutions (on which the "balance of payments" in this chapter is based) and those obtained from other sectors, the figures here are not identical with those in Chapter XVI.

## Table XVII–6

### "BALANCE OF PAYMENTS" OF THE FINANCIAL INSTITUTIONS, BY SECTOR, 1966–67

(IL million)

| | Receipts | | | Payments | | | Balance of receipts over payments | |
|---|---|---|---|---|---|---|---|---|
| | 1966[a] | 1967 | Increase or decrease(–) | 1966[a] | 1967 | Increase or decrease(–) | 1966[a] | 1967 |
| **Nonfinancial transactions** | 291.9 | 322.3 | 30.4 | 282.7 | 305.2 | 22.5 | 9.2 | 17.1 |
| **Transactions in financial assets** | | | | | | | | |
| Government | 227.9 | 100.8 | –127.1 | 184.2 | 205.8 | 21.6 | 43.7 | –105.0[b] (–35.0) |
| National Institutions and local authorities | 23.0 | 16.2 | –6.8 | 98.6 | 113.2 | 14.6 | –75.6 | –97.0 |
| Public sector companies | 5.3 | 22.3 | 17.0 | 3.7 | –87.2 | –90.9 | 1.6 | 109.5[b] (39.5) |
| Banking institutions | 62.6 | 23.1 | –39.5 | 12.4 | 58.5 | 46.1 | 50.2 | –35.4 |
| Social insurance funds | 112.9 | 170.7 | 57.8 | 2.8 | –0.9 | –3.7 | 110.1 | 171.6 |
| Insurance companies | 6.5 | –1.0 | –7.5 | 2.0 | –1.3 | –3.3 | 4.5 | 0.3 |
| Private business[c] | 16.8 | 46.0 | 29.2 | 282.9 | 174.1 | –108.8 | –266.1 | –128.1 |
| Nonprofit institutions | 37.1 | –6.0 | –43.1 | 34.4 | 8.8 | –25.6 | 2.7 | –14.8 |
| Rest of the world | 133.8 | 71.3 | –62.5 | 0.6 | 11.1 | 10.5 | 133.2 | 60.2 |
| Households[d] | 27.7 | 22.1 | –5.6 | 129.9 | 59.1 | –70.8 | –102.2 | –37.0 |
| Unspecified[e] | 64.4 | 65.8 | 1.4 | — | — | — | 64.4 | 65.8 |
| Total transaction in financial assets | 718.0 | 531.3 | –186.7 | 751.5 | 541.2 | –210.3 | –33.5 | –9.9 |
| **Errors and omissions** | — | — | — | –24.3 | 7.2 | +31.5 | 24.3 | –7.2 |
| Total receipts and payments | 1,009.9 | 853.6 | –156.3 | 1,009.9 | 853.6 | –156.3 | — | — |

[a] Since the figures for 1965 have not been revised, the preliminary data for 1966 have been taken here.
[b] The figure is inflated by approximately IL 70 million owing to the write-off of part of a loan granted from Government funds. The figure in parentheses is the balance less the write-off.
[c] Including farms.
[d] Including contractors' deposits sold to households through the banking institutions.
[e] Including securities sold on the Stock Exchange.

and loss statements show the flows defined as "nonfinancial transactions" (see Table XVII–6).

In flow-of-funds analysis all balance sheet changes that do no represent actual money flows but bookkeeping changes only must be eliminated (such as revaluations, allocations to reserves, etc.). In the "balance of payments" presented in Table XVII–6, however, 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 shrank by 15.5 percent in 1967, following a 34 percent increase in 1966, and stood at IL 853.6 million. Nonfinancial transactions continued to grow, but financial transactions were down IL 187 million approximately, this obviously reflecting the slower growth of the institutions' business compared with 1966.

The main sectors providing net credit to the financial institutions were the social insurance funds, the rest-of-the-world sector, and public sector companies. Local authorities, private business, households, and the Government were the leading borrowers.

Net receipts from the social insurance funds increased from IL 110.1 million in 1966 to IL 171.6 million. This reflects the larger volume of bonds issued by the institutions, which are mostly taken up by the social insurance funds.

Net financial institution receipts from abroad fell from IL 133.2 million in 1966 to IL 60.2 million, mainly as a result of the redemption of a short-term foreign loan raised in 1966.

Net receipts from public sector companies continued upward, amounting to IL 39.5 million,[1] compared with IL 15.3 million in 1965 and IL 1.6 million in 1966. This increase stemmed partly from a decline in the net amount supplied by the financial institutions to public sector companies and partly from an increase in outstanding deposits of the latter with the institutions.

The banking institutions were a net borrower in the year reviewed instead of a net lender, as in 1966. As against net receipts of about IL 50 million from this sector in 1966, the financial institutions had a net credit outflow of some IL 35 million in 1967.

Net payments to the Government totalled approximately IL 35.0 million in 1967, as contrasted with net receipts of IL 43.7 million the year before.

Net credit to private business and households fell off sharply: that to private business from IL 266.1 million in 1966 to IL 128.1 million, and that to households—from IL 102.2 million to IL 37 million.

[1] See note [d] to Table XVII–6.