CHAPTER XVI

FINANCIAL INSTITUTIONS[1]

1. Main Developments

The financial institutions continued to expand their lending operations in 1970, though at a slower rate than in 1969. This is reflected in the volume of gross credit extended over the past three years by the large financial institutions—which account for the preponderant share of total credit granted—and to some extent by the more sluggish expansion of net credit[2] to the different economic sectors, which, at about IL 800 million, was up 15 percent compared with a 20 percent rise in 1969.

A larger proportion of the incremental credit outflow in 1970 stemmed from the general rise of prices, so that in real terms the growth rate was even slacker than indicated by the data in this chapter. The slower growth of the sector's operations was not directly connected with changes in the level of economic activity, since the sector derives most of its funds directly or indirectly from the Government, and extends much of its credit at the Government's behest and at its expense on fixed and especially easy terms. Economic changes are directly reflected in the amount of excess demand for financial institution credit, and only indirectly, through their influence on the Government's development policy, do they affect the sector's operations.

As in previous years, about one-third of the incremental net credit went to the construction and housing sector, which received a total of IL 276 million net, as against IL 213 millon in 1969 and IL 160 million in 1968. The rise was due mainly to the continued strong uptrend in gross lending to buyers of publicly sponsored housing (chiefly new immigrants), and to a lesser extent to the larger volume of advances granted by mortgage banks to contractors and building companies as construction activity accelerated. As opposed to this, gross credit for the purchase of homes in the private market fell off sharply,

[1] Financial institutions, as discussed in this chapter, are defined as financial intermediaries engaged primarily in the mobilization of medium- and long-term funds for investment in financial assets, such as loans and securities. Excluded from this definition are banking institutions, most of whose liabilities are short-term; companies financed by a limited number of proprietors; and holding companies, whose investments are 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 separately.

[2] Incremental outstanding credit.

apparently because mortgage banks were short of uncommitted nondirected means, as did gross construction financing supplied to local authorities, businesses, hotels, institutions, etc., the volume of which largely depends on the amount of funds channelled to the banks by the public sector.

Outstanding agricultural credit went up by about IL 90 million, for the third year in a row. This increase, which far exceeds that of earlier years, has been only partly associated with changes in the level of agricultural investment; it has also stemmed from the gradual expansion of short-term supervised credit provided for financing current operations under the agricultural production financing program, and from an increase in medium- and long-term loans for consolidating agricultural settlements or putting them on a stronger financial footing. While agricultural investment—excluding land reclamation and conservation, afforestation, drainage, etc., which are mostly direct investments of the public sector—rose in 1970 by 12 percent at current prices, gross medium- and long-term farm credit went up by 17 percent.

With the growth of gross industrial credit slackening noticeably, the institutions provided only IL 20 million more net financing in 1970, compared with a rise of IL 64 million in 1969, bringing total net credit up to IL 179 millon. The decline in the expansion of industrial investment, from 50 percent in 1969 (at current prices) to 25 percent in the year surveyed, does not fully explain the much more sluggish rise in gross credit—14 percent as against 65 percent in 1969. In part, it was undoubtedly due to a decision taken in 1969 to reduce the proportion of approved investments[1] to be financed by way of cheap Government loans, which actually made itself felt only in 1970 because of the time-lag between the approval of a loan and implementation of the investment. This step was also one reason for the smaller increase in industrial investment recorded in 1970 (see the discussion in section 3).

As in previous years, the net amount of credit provided to the various economic sectors[2] was largely made possible by the expansion of financial resources under public sector control. The year reviewed apparently saw an even greater dependence on these sources. Although the public sector's direct contribution (deposits earmarked for loans) to the net increase in the institutions' financial resources was about the same as in 1969, there was a sizable growth in the net contribution of the social insurance funds and the rest-of-the-world sector (sources controlled by the public sector—see the discussion in section 2). On the other hand, the net amount supplied by private business declined by IL 10 million, compared with a rise of IL 34 million in 1969.

In contrast to the further growth of the financial institutions' credit business, their activities in the securities market slowed conspicuously. Whereas in 1969 their share and bond portfolio had expanded by IL 146 million (thanks mainly

[1] The reference is to enterprises approved for various concessions under the Law for the Encouragement of Capital Investments.

[2] Excluding credit to the Government.

to the impressive growth of business experienced by the mutual funds specializing in bonds, in 1970 the rise was only IL 26 million.[1] This sharp deceleration is explained both by the continued downtrend in turnover and prices in the equities market, which precluded the expansion of the investment companies' securities operations, and by the weakening of devaluation expectations which, together with the compulsory loans imposed on households, diminished the attraction of the bond fund participation certificates.

The combined balance sheet of the financial institutions sector reached IL 6,570 million at year's end (IL 8,416 million if deposits with the Accountant General are included).

2. Government Influence over Financial Institution Operations

Government influence over the financial institutions' operations (and over the capital market in general) far exceeds the weight of the sector's direct financial liabilities to the Government[2] (as regards the capital market in general, it far exceeds the Government's share in total financial intermediation). The Government, in fact, also controls the allocation of the overwhelming portion of the funds supplied to the sector by the social insurance funds and bank-administered saving schemes, which, after the Government, are the chief lenders to the sector. The Government's domination of most of the domestic sources of finance derives from the income tax exemptions and concessions it grants on the returns from recognized investments,[3] and also from the regulations prescribing the composition of the investment portfolios of social insurance funds, bank saving schemes, and insurance companies.

In addition, the Government directs, by means of foreign currency control, the allocation of most of the loan and share capital mobilized by the sector abroad, as well as part of the funds supplied by households to the sector (Saving-for-Housing scheme deposits). A glance at Table XVI–1 shows that, although the weight of the Government in total liabilities of the sector (exclusive of mutual funds) came to about 38 percent at the end of 1970, the preponderant share of the institutions' financial resources is actually under public sector control. Had it been possible to deduct from the liability items in the table the financing of the securities operations of the investment companies (which also engage in credit business), the extent of Government control over the sector's credit activities would have been even more pronounced.

Government influence over the capital market in general, and the financial institutions in particular, is not confined to the direction of credit, but expresses itself also in the setting of the financing terms for borrowers (the size of the

[1] Before revaluation.

[2] See Table XVI–1.

[3] Securities issued by enterprises where the allocation of the proceeds is subject to Government control.

Table XVI-1

LIABILITIES OF FINANCIAL INSTITUTIONS,[a] BY SECTOR, 1968–70

	IL million			Percent		
	1968	1969[b]	1970	1968	1969[b]	1970
Government	2,341.8	2,660.9	3,021.7(2,992.7)[c]	39.9	39.2	37.9
National Institutions and local authorities	119.1	124.2(147.2)[c]	89.2(135.2)[c]	2.0	2.2	1.7
Public sector companies[d]	183.8	205.5	208.1	3.1	3.0	2.6
Banking institutions	478.9	665.9	956.9(860.9)[c]	8.2	9.8	10.9
Social insurance funds	1,078.0	1,267.1	1,621.2	18.4	18.7	20.6
Insurance companies	12.7	17.4	16.2	0.2	0.3	0.2
Private business[e]	247.7	281.9	272.2	4.2	4.2	3.5
Nonprofit institutions	59.5	71.0	71.4	1.0	1.0	0.9
Rest of the world	542.7	588.4	582.0(678.0)[c]	9.2	8.7	8.6
Households	218.8	233.8	250.9	3.7	3.4	3.2
Accumulated profits	367.6	396.4	456.6	6.2	5.8	5.8
Unspecified[f]	231.0	250.2	321.3	3.9	3.7	4.1
Total	**5,881.6**	**6,762.7(6,785.7)[f]**	**7,867.7(7,884.7)[c]**	**100.0**	**100.0**	**100.0**
Intrasector liabilities	185.9	285.9	338.3			
Grand total	**6,067.5**	**7,048.6(7,071.6)[f]**	**8,206.0(8,223.0)[c]**			

[a] Excluding mutual funds.
[b] Revised data.
[c] Excluding transfers to reserves and/or write-offs.
[d] Companies owned by the Government, National Institutions, or local authorities.
[e] Including farms.
[f] Including sales of securities on the Tel Aviv Stock Exchange.

loans, rates of interest, repayment terms, type of value-linkage or the premium to be paid in lieu of linkage, etc.). This is true of both credit supplied by the Government directly and the overwhelming share of financing from the proceeds of approved bonds. Wherever necessary, the Treasury compensates financial institutions for any difference that may arise between the cost of the capital they mobilize, including value-linkage, and the price of credit granted, leaving them a profit margin of 1–2 percent. Part of the funds mobilized by the institutions are deposited with the Accountant General, who in turn returns all or part to the institutions 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 margins of the financial institutions.[1]

Credit granted for the development of industry, agriculture, crafts, and the tourist trade in accordance with Government directives now generally carries interest of 6–9 percent and is unlinked.[2] However, most of the credit to the services sector (including part of that provided to local authorities, but excluding credit for developing tourism) is still linked to the consumer price index or the rate of exchange and bears interest at rates ranging from 5 to 8 percent. Mortgage loans are mostly unlinked and carry interest of 7–12 percent.

Thus it follows that the financial institutions sector, deriving as it does the bulk of its funds directly or indirectly from the Government and supplying credit (at the Government's behest and at its expense) at fixed and especially soft terms, is hardly directly affected by developments in the money market or by the level of economic activity. These do have a direct bearing on the magnitude of the excess demand for credit and on the composition of the financial resources made available to the sector, but not on the volume of its operations. However, the latter is indirectly affected by these factors, through their influence on the Government's development policy.

The composition of the financial resources at the disposal of the sector for financing its credit operations underwent a change in 1970. Whereas the public sector's direct contribution to the net increase in the sector's resources was about the same as in 1969 (IL 343 million as against IL 347 million), that of the rest-of-the-world sector—chiefly in the form of loans—rose from IL 46 million to nearly IL 90 million, and that of the social insurance funds shot up from IL 189 million to IL 354 million. The accelerated accumulation of the social insurance funds in 1970, along with the changes in the regulations governing their investments, which obligated them to increase the proportion of approved investments in their asset portfolio, enabled the financial institutions to greatly boost their bond sales to the funds.

[1] This procedure of redepositing issue proceeds with the institutions obviously artificially inflates the balance sheet totals of the financial institutions sector.

[2] On the gradual abolition of value linkage on directed medium- and long-term loans between 1962 and 1968 see Bank of Israel, *Annual Report 1967*, pp. 458–59, and *Annual Report 1968*, pp. 378–79.

This structural change in the incremental resources of the financial institutions does not, of course, indicate any weakening of Government influence over their credit operations, since these funds too, as already noted, are controlled by the public sector. Moreover, while the institutions' means under the direct or indirect control of the public sector grew substantially in 1970, those provided by private business fell off by IL 10 million, as compared with a rise of IL 34 million in the previous year; this, of course, meant a further increase in the institutions' dependence on directed financial resources.

3. Financial Institution Credit, by Sector

The amount of financing provided by the sector to the rest of the economy continued upward, although at a slower rate than in 1969. The net credit outflow to the nongovernmental sectors went up by 15 percent, as against 20 percent in 1969, and totalled approximately IL 800 million.

Outstanding loans for construction and housing continued to rise rapidly, by IL 276 million as against IL 213 million in 1969 and IL 160 million in 1968. The 1970 increase is explained primarily by the much larger amount of gross mortgage financing granted for the purchase of homes in public housing projects (chiefly to new immigrants), and to a lesser extent by the increase in advances to contractors and building companies. In contrast to this, gross credit to buyers of private housing and that supplied for building purposes to local authorities, businesses, hotels, institutions, etc. declined sharply.

Gross farm credit, part of which was used for purposes other than the financing of current investments, went up by a substantial IL 90 million, as in the previous two years. On the other hand, the gross credit outflow to industry fell off appreciably, but net credit continued upward, by IL 179 million as against IL 159 million in 1969 and IL 96 million in 1968.

Outstanding credit to the services sector rose by IL 20 million, compared with IL 2 million in 1969 and IL 89 million in 1968.[1] These erratic fluctuations are largely explained by the construction in 1968 of the new Eilat-Ashkelon oil pipeline, which involved a heavy investment, and the developments in 1969 in the international capital markets and the devaluation expectations prevailing in Israel. These factors dampened demand for shipping credits, which are value-linked to the foreign exchange rate and carry interest at a rate similar to that in the world market.

(a) *Government*

Outstanding credit to the Government is defined in this chapter as the total amount of Government securities held by financial institutions and their

[1] Part of the incremental outstanding credit listed in Table XVI-2 under the head "banking and financial institutions" is actually medium- and long-term credit granted indirectly to hotels by financial institutions with no collection facilities.

deposits with the Accountant General. These deposits consist of bond issue proceeds transferred to the Treasury, Saving-for-Housing scheme balances, certain loans received by the institutions from various sources (directly and/or through banks) for deposit with the Accountant General, early debt repayments made to the institutions in the wake of the announcement of Treasury concessions to those paying off their debts ahead of maturity, etc. Approximately 75 percent of the sector's outstanding deposit balances with the Accountant General stem from the arrangements whereby the sector generally deposits 50–70 percent of its bond issue proceeds with the Accountant General for the purpose of financing the development budget.

The balance of the sector's deposits with the Accountant General increased by IL 302 million (only IL 10 million more than in 1969), despite the notable rise in current transfers of bond issue proceeds (IL 277 million as against IL 197 million in 1969) and the much larger index-linkage increments in 1970. This development is explained by the larger amount of bonds redeemed by the institutions (mainly option-type issues and other loans), part of the proceeds of which had been deposited with the Accountant General.

The sector's portfolio of Government securities expanded by some IL 22 million; this contrasts with IL 44 million in 1968 and an average of IL 9–10 million in previous years. The smaller rise in the year reviewed was due to the slower expansion of the bond funds administered by banks, which accounted for most of the incremental Government securities acquired by the financial institutions in the two preceding years.

Since these funds bought chiefly Absorption and Defense Loan certificates in the secondary market (from households), most of these additional holdings did not constitute a flow of funds to the Treasury.

(b) *Construction and housing*

Residential construction in 1970 reached a new high, both in the number of units started and in the number completed and sold, and this was reflected by a stronger demand for mortgage financing on the part of buyers, contractors, and building companies alike.

Gross credit supplied directly by mortgage banks to buyers of private and public housing was up 36 percent (after the level in 1969 soared by 42 percent compared with the previous year and 100 percent compared with 1967) and totalled nearly IL 298 million. Depite the continued rapid uptrend in the amount of financing provided to home buyers, the excess demand for credit apparently mounted further. Since the Government controls the allocation of most of the mortgage banks' additional funds, and in view of the large amount of mortgage credit required for immigrant housing, the excess demand was felt chiefly in the private housing market.

Gross mortgage bank loans for the purchase of homes in the private market declined by 21 percent to stand at only IL 55 million, and this at a time

Table

BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS,

(IL

	1968	1969[a]	1970	Annual
				1968
Industry	988.1	1,147.5	1,326.7	30.6(95.6)[b]
Agriculture	487.2	578.6	653.5	90.8
Construction and housing	1,619.2	1,808.8	2,084.7	160.3
Commerce	20.2	21.7	23.7	-1.6
Local authorities	557.7	646.3	747.3	96.1
Services	420.2	422.5	442.3	88.5
Banking and financial institutions	163.2	245.3	335.0	22.8(27.8)[b]
Households	10.5	32.4	51.7	6.1
Miscellaneous	92.6	127.6	148.5	17.0
Total, excl. Government	**4,358.9**	**5,030.7**	**5,813.4**	**510.6(580.6)[b]**
Government (mainly deposits with the Accountant General)	1,308.9	1,644.5	1,967.9	369.5(304.5)[b]
Total, incl. Government	**5,667.8**	**6,675.2**	**7,781.3**	**880.1(885.1)[b]**

[a] Revised data.
[b] Excluding write-offs.
[c] The percentage increase is not relevant in view of the small sums involved.

when the real interest collected by the banks actually dropped owing to the relative stability of interest rates and a sharp rise in the consumer price index. The number of such loans granted in 1970 fell by 13 percent, and, despite the much higher prices paid for dwellings and the steady improvement in housing standards, the size of the average loan was also down 10 percent. Presumably this shortage of financing for private housing slowed sales and even prompted contractors and building companies, which experienced difficulties in obtaining mortgage loans for their customers, to turn to institutional sources of demand.

By contrast, gross credit extended at the direction of the Government increased by about 64 percent to reach IL 243 million, a development accompanying the precipitate rise in public residential construction and the diverting of new immigrants to the private market. Gross credit to immigrants for public housing expanded by IL 60 million to IL 102 million, and accounted for 65 percent of incremental public housing loans. The number of loans rose by 90 percent, and their average size by 25 percent.

As to advances to contractors and building companies, an estimate based on information supplied by some of the mortgage banks indicates an increase of some 35 percent in 1970, compared with 10 percent the year before. However, it is doubtful whether their liquidity situation improved any, since

XVI-2

BY FIRST SECTOR OF DESTINATION, 1968–70

million)

increase or decrease (–)		Percentage distribution of increment		Percent increase in increment	
1969	1970	1969	1970	1969	1970
159.4	179.2	23.0	22.5	66.7	12.4
91.4	74.9(91.9)[b]	13.2	11.5	0.7	0.1
189.6(212.9)[b]	275.9	30.6	34.5	32.8	29.6
1.5	2.0	0.2	0.2	[c]	[c]
88.6	101.0	12.7	12.6	–0.1	14.0
2.3	19.8	0.3	2.5	[d]	[d]
82.1	89.7	11.8	11.2	195.3	7.5
21.9	19.3	3.2	2.4	259.0	–12.0
35.0	20.9	5.0	2.6	106.0	–40.0
671.8(694.8)[b]	**782.7(799.7)[b]**	**100.0**	**100.0**	**19.7**	**15.1**
335.6	323.4				
1,007.4(1,030.4)[b]	**1,106.1(1,123.1)**				

[d] The percentage increase is of no significance—see the discussion of credit granted to the services sector on p. 348.

the abnormally high level of building starts in the year reviewed greatly increased their financing requirements.

Gross mortgage credit supplied by mortgage banks to local authorities and the business sector (hotels, institutions, companies, etc.), which is also largely under Government control, contracted by an appreciable 34 percent, after a reduction of 10 percent in the previous year. Whereas in 1969 the local authorities had shown a smaller figure with the other economic sectors recording a slight rise, in 1970 the decrease affected all sectors except housing, and was especially noticeable in the private business sector.

All told, outstanding credit from the financial institutions for housing and construction purposes grew by IL 276 million and reached IL 2,085 million, or 36 percent of total outstanding credit granted by the institutions at the end of 1970. Households accounted for an estimated 66 percent of the figure for the construction and housing sector.

(c) *Industry*

Gross credit granted to the industrial sector rose more sluggishly in 1970, in line with the smaller growth of industrial investment. This deceleration is reflected in the figures on net industrial credit for the past three years—IL 179 million in 1970, IL 159 million in 1969, and IL 96 million in 1968. A similar picture is revealed by the data on gross credit provided by the industrial development banks (which channel most of the cheap industrial loan capital supplied by the public sector)—IL 170 million in 1968, IL 280 million in 1969 (up 65 percent), and IL 320 million in 1970 (a rise of only 14 percent).

Although the growth of industrial investment slowed down appreciably during the year (25 percent as against 50 percent in 1969), the sagging rate of increase in industrial loans cannot be attributed entirely to this factor. At the beginning of 1969 the proportion of cheap development budget loans granted to approved enterprises in Development Zones A, B, and C was reduced respectively from 55, 50, and 45 percent of the total value of the investment to 45, 40, and 33 percent. Because of the time-lag between the approval of a loan and the launching of the project (disbursement of the funds), the effect of these reductions was not felt in most cases until 1970, when they naturally contributed, *ceteris paribus,* to the deceleration of the gross credit outflow. Since the reduced loan ratios raised investors' equity financing in approved enterprises by 20 to 65 percent (depending on the location of the enterprise), and since the cost of equity capital is much higher than that of directed loans, it is clear that the above change in credit policy played a significant role in curtailing the growth of industrial investment.

The changes in the flow of this cheaper directed credit through the industrial development banks to the various industrial branches do not reveal a uniform pattern. While gross lending to the metal industries expanded by about 55 percent and that to the leather, textile, and clothing industries by some 85 percent, the rest of the sector (which had received about 65 percent of gross industrial development bank financing in 1969) experienced a much slower increase, and in some cases even a conspicuous drop.

Outstanding industrial credit granted by the financial institutions reached IL 1,327 million at the end of 1970, or 23 percent of the total amount of financing supplied to the nongovernmental sectors.

(d) *Agriculture*

Outstanding farm loans were up IL 92 million, about the same as in 1969 and 1968 and more than double the figure of earlier years. The connection between changes in net farm loans and those in the level of farm investment has become weaker in recent years. This stems partly from the gradual increase in the amount of short-term funds provided for financing current operations under the agricultural production financing scheme, and apparently also from the heavier medium- and long-term lending for consolidating agricultural settlements or strengthening those that are economically weak. The transfer to financial institutions of the responsibility for collecting outstanding loans given in the past to farm settlements by other lenders may be another contributory factor.

While investment in agriculture (excluding land reclamation and conservation, afforestation, drainage, etc., which are generally direct public sector investments) rose by 12 percent at current prices in the year reviewed, gross medium- and long-term credit granted by the major agricultural finance institutions (which account for 90 percent of total outstanding farm credit granted by the sector) moved up by 17 percent.

4. Developments by Type of Institution

The financial institutions sector, as surveyed in this chapter, numbers 83 intermediaries classified into seven groups by area of specialization (see Table XVI–3). An analysis of the sources and uses of funds of the various groups makes it possible to trace the sectoral flows of funds generated by the different activities of the financial institutions.

(a) *Mortgage banks*

This group numbers 17 institutions, of which four—Tefahot, General Mortgage Bank, Housing Mortgage Bank, and Mortgage Development Bank—account for 85 percent of the combined balance sheet of the group. The ratio between the group's equity capital and its liabilities is inordinately low (less than 5 percent), but the group's operations are to a large extent guaranteed by the Treasury.

The net increase in its resources (excluding funds channelled to the Government) came to approximately IL 264 million, as against IL 281 million in 1969 and IL 213 million in 1968.

The mortgage banks' dependence on direct and indirect Government financing continued to grow in 1970. Whereas in 1969 there was a rise of IL 20 million in the group's outstanding liabilities to the private business sector, the year reviewed saw a reduction of IL 30 million. This slowed the increase in its balance sheet, despite the larger amount of direct and indirect public sector funds made available to the banks (chiefly for financing the purchase of homes in public housing estates).

Because of the difficulty encountered by mortgage banks in mobilizing funds from nongovernmental sources, they cut their net credit outflow to the private business sector from IL 90 million in 1969 to IL 35 million.[1]

The group's balance sheet (excluding deposits with the Accountant General) reached IL 2,439 million at the end of 1970, representing about 37 percent of the combined balance sheet of the financial institutions sector.

[1] This type of credit, too, is partly financed from public sector funds.

Table XVI-3

COMBINED BALANCE SHEET TOTALS[a] OF FINANCIAL INSTITUTIONS, BY TYPE OF INSTITUTION, 1968–70

	Number of institutions	IL million			Percent			Annual increase or decrease (–)			
								1969		1970	
		1968	1969[b]	1970	1968	1969	1970	IL m.	%	IL m.	%
Mortgage banks	17	1,917.6	2,175.5	2,439.0	39.4	38.2	37.1	257.9[c]	13.4	263.5	12.1[e]
Industrial development banks	5	959.2	1,117.2	1,300.1	19.7	19.6	19.8	158.0	16.5	182.9	16.4
Institutions granting loans to other sectors[d]	4	560.9	579.4	661.3	11.5	10.2	10.1	18.5	3.3	81.9	14.1
Agricultural credit funds	18	673.2	769.2	865.5	13.8	13.5	13.2	96.0	14.3	96.3[e]	12.5[e]
Investment companies	13	660.1	803.7	1,012.7	13.6	14.1	15.4	143.6	21.8	209.0	26.0
Household finance companies	15	44.9	59.7	81.7	0.9	1.1	1.2	14.8	33.0	22.0	36.9
Mutual funds	11	55.4	185.4	209.6	1.1	3.3	3.2	130.0	234.7	24.2	13.1
Total	**83**	**4,871.3**	**5,690.1**	**6,569.9**	**100.0**	**100.0**	**100.0**	**818.8**	**16.8**	**879.8**	**15.5**
Deposits with the Accountant General	—	1,251.8	1,543.9	1,845.7							

[a] Excluding deposits with the Accountant General.
[b] Revised data.
[c] Less write-offs, the increase was IL 280.9 million, or 14.6 percent.
[d] For tourism and shipping and to local authorities.
[e] Less write-offs, the increase was IL 113.3 million, or 14.7 percent.

(b) *Industrial development banks*

This group numbers five institutions, in the largest of which, the Industrial Development Bank, the Government holds about half of the paid-up share capital. This group is characterized both by an exceptionally high ratio between equity and borrowed funds (45 percent at the end of 1970) and by its almost total dependence on direct and indirect Government financing.

In 1970 the group continued to expand its operations. The net increase in its financial resources (excluding transfers to the Accountant General) came to IL 183 million, compared with IL 158 million in 1969 and IL 82 million in 1968. Besides financing private business enterprises and public sector companies, the group was much more active than in the past in mobilizing funds for its own use and for financing the Government development budget.

Whereas in 1969 the group issued IL 34 million worth of bonds and withdrew IL 33 million of its deposits with the Accountant General, in 1970 it floated IL 130 million worth of bonds, mobilized IL 96 million in foreign loans (through the intermediation of commercial banks), and expanded its net deposits with the Accountant General by IL 130 million.

Net credit granted to the private business sector came to IL 131 million, as against IL 143 million in 1969, while that to public sector companies amounted to IL 35 million, compared with IL 25 million the year before.

(c) *Agricultural credit funds*

This group of 18 institutions, which specialize in the financing of agricultural settlements, is headed by the Israel Bank of Agriculture and the Ya'ad Agricultural Development Bank,[1] which account for about 68 percent of the group's balance sheet. Most of the remaining institutions are joint funds connected with various agricultural settlement organizations, while several are connected with the Jewish Agency.

The strongly advancing trend marking the group's operations in the two preceding years carried over through 1970. The net increase in their financial resources (less transfers to the Accountant General) reached IL 113 million, as against IL 96 million in 1969 and IL 88 million in 1968. As in previous years, most of the incremental resources consisted of Government deposits earmarked for loans, which went mainly to agricultural settlements in order to provide *inter alia* working capital and to put the settlements on a stronger financial basis.

(d) *Institutions financing other sectors*

The four institutions in this group, in order of size, are the Maritime Bank, the Tourist Industry Development Corporation, the Local Authorities Bank, and

[1] These two institutions also perform the functions of commercial banks.

Igarot. They mainly finance the local authorities and the service sectors (shipping, tourism, etc.).

The financial resources of this group rose by IL 82 million (net), after a sluggish advance of IL 19 million in 1969 and a substantial gain of IL 98 million in 1968. About IL 15 million of the 1970 increment was in the form of deposits held abroad and was not used for domestic financing.

Most of the group's net incremental funds came from drawing down its deposits with the Accountant General, the growth of Government earmarked deposits, and the issue of shares abroad. Net credit supplied by this group to local authorities rose from IL 17 million in 1969 to IL 27 million, and that furnished through banking institutions to private business, especially to the tourist trade, went up from IL 20 million to IL 35 million. However, net credit supplied directly to private business (particularly shipping, where loans are linked to the exchange rate and bear interest at rates corresponding to those in the international markets) continued downward, by IL 10 million, following a drop of IL 25 million in the previous year.

(e) *Investment companies*

This group numbers 13 institutions[1] established to mobilize funds from a large number of investors and to spread their portfolio over a wide array of domestic securities. It does not include holding companies, since they generally do not meet the basic criterion of diversification of the investment portfolio, or companies financed by a limited number of proprietors.

Most of the companies surveyed here were set up by banking institutions, and 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 a certain class of shares.

Since there is no special law in this country regulating investment company operations and confining them to the securities market, some of the companies engage in the mobilization of funds for loan purposes. In most cases both the mobilization and the allocation of these funds are subject to the Government's directives and enjoy its guarantee. As a result, the composition of the assets and liabilities of several of the companies does not differ from that of other financial intermediaries, such as industrial development banks, and the greater part of their means is used for credit transactions. At the same time, they are distinguished from the other institutions (which hold securities for liquidity reasons, and/or in order to gain control over companies) in that portfolio management is for them an end in itself.

All of the group's asset growth actually resulted from the supply of medium- and long-term loan capital to the various sectors of the economy under the guid-

[1] As against 15 in 1969. One of the companies ceased operations and liquidated its investment portfolio; another company is now specializing exclusively in household financing and has therefore been shifted to the household finance companies group.

ance (direct and/or indirect) of the Government, as well as from the raising of funds in the bond market for financing the Government development budget. The companies' nongovernmental securities portfolio expanded by IL 20 million in the year under review, as compared with IL 33 million in 1969, but this was mainly the result of stock switching accompanied by bookkeeping revaluations, and the transfer of the securities portfolio of a financial institution not in the investment companies group to the investment company which controls it. It thus appears that the group's activity in the securities market was stagnant in 1970, after it had revived somewhat in the previous year.

The group's financial resources (less transfers to the Accountant General) rose by IL 190 million,[1] as against IL 144 million in 1969. As in 1969, most of the increase in liabilities was in the bonds item. The amount issued in 1970 was IL 180 million, as contrasted with IL 154 million the year before, while proceeds transferred to the Accountant General totalled IL 94 million, compared with IL 77 million in 1969. Social insurance funds and bank-administered saving schemes took 78 percent of the group's bonds, as contrasted with 70 percent in 1969.

The bulk of the group's incremental financial resources was channelled to the local authorities, which received IL 54 million in net credit as against IL 35 million the year before, and to the private business sector, which borrowed IL 78 million as against IL 66 million in 1969.

The group's securities portfolio amounted to IL 262 million, equivalent to 26 percent of its total assets (less amounts deposited with the Accountant General), or 86 percent of the companies' equity capital.

(f) *Mutual funds*

This group numbered 11 institutions in 1970. Four of them, founded in the two preceding years, invest most of their resources in bonds, in contrast to the seven veteran funds, which continue to place between 60 and 90 percent of their investments in shares.

The bond funds maintained their expansion in 1970, though to a much lesser degree than in 1969. The other funds, however, continued to shrink, and they were compelled, as in 1969, to redeem 15 percent of the total par value of their participation certificates.

In 1970 the bond funds issued participation certificates (less redemptions) to the tune of IL 38.4 million, compared with IL 129.2 million in 1969 and IL 28.7 million in 1968 (when only the first two of these funds were in operation). Their total assets at market prices amounted at the end of 1970 to IL 210 million—90 percent of all mutual fund assets.

The impressive gains scored by the bond funds in 1969 can be credited to the jump in yields to maturity on index-linked bonds traded outside the

[1] Before revaluation and the transfer of the securities portfolio mentioned above.

Stock Exchange (especially the Absorption and Defense Loans), along with the prevailing expectations of a rise in the consumer price index and a devaluation of the Israeli pound. In 1970, on the other hand, their expansion was slowed by the weakening of devaluation expectations, which diminished the attraction of their participation certificates,[1] and by the compulsory loans imposed on households by the Government. Were it not for the feeling that prices would continue to climb, the growth of these funds would undoubtedly have sagged even more.

The veteran funds, which place most of their investments in shares, suffered a further setback in 1970, owing to the plummeting of Stock Exchange turnover and prices. In their heyday their investment portfolio totalled some IL 50 million at market prices; the persistent net redemption of participation certificates over the past six years brought this down to IL 21 million by the end of 1970.

As a result of the further retreat of the veteran funds and the expansion of the bond funds, the weight of bonds in the group's aggregate portfolio continued upward, from 77 percent in 1969 to 83 percent. At issue prices, the portfolio amounted to IL 209 million at the end of the year.

Almost half the funds' additional resources in the year under review were invested in financial institution bonds, most of them value-linked and/or denominated in foreign currency, and the remainder in Absorption and Defense Loan certificates purchased in the secondary market.

(g) *Household finance companies*

This group, numbering 15 companies, is the smallest in the sector. One financial institution previously classified as an investment company was added to the group in 1970, while Otzar Hahayal, prior to this year among the largest of the household finance firms, expanded its activities in the short-term loan market and is now classified as a banking institution. None of the companies in this group, with the exception of Iatzil, Idud, Yahav, and the Consumer Cooperation Fund, has assets of more than IL 3 million.

The net increase in the financial resources of these institutions reached IL 22 million in the year surveyed, as against IL 15 million in 1969.

5. Assets and Liabilities

The combined balance sheet of the financial institutions' sector (excluding deposits with the Accountant General) increased by about 15 percent, compared with 17 percent in 1969 and 13 percent in 1968. This brought up the total at the end of 1970 to IL 6,570 million (or IL 8,416 million if deposits with the Accountant General are included).

[1] In 1970 the bond funds continued to invest about half their resources in securities traded in foreign currency or value-linked to the exchange rate.

(a) *Liabilities and capital*

The sector's liabilities and capital accounts are comprised chiefly of medium- and long-term obligations, with the weight of equity capital amounting to about 23 percent at the end of 1970. This ratio is unusually high, considering that the institutions' operations consist largely of the provision of loans from funds placed at their disposal by others and at the latter's responsibility. The ratio between equity capital and nondirected financial resources is even higher. These high ratios are partly explained by the Government's heavy participation in the paid-up capital of several institutions, in which it holds a controlling interest, but they are also an indirect expression of the Government's domination of the capital market, which limits the institutions' ability to mobilize funds from other sources.

An examination of the sector's liabilities in 1970 shows a marked decline in the weight of equity capital and nongovernmental earmarked deposits in the total increment, and a sharp rise in that of bonds and "other deposits and loans" (chiefly from abroad). The smaller rise in equity capital—IL 118 million as against IL 202 million in 1969—can be ascribed to the slower growth of the bond funds, while the conspicuous deceleration in outstanding nongovernmental deposits for loan purposes (a rise of only IL 3 million compared with IL 92 million in 1969) was due to the contraction of National Institution deposits.

In spite of a much heavier bond redemption (especially of option-type loans), the sector's outstanding bonds rose by IL 498 million, as against IL 352 million in 1969. This is explained by both the substantially higher revaluation differentials (up by an estimated IL 120 million approximately) in the year reviewed due to the rise in the consumer price index, and brisker sales of financial institution bonds (IL 534 million as opposed to IL 386 million in 1969); the latter can be largely attributed to the increased accumulation of the social insurance funds and a change in the regulations requiring them to invest a higher percentage of their resources in approved bonds.[1]

The growth of the Government's earmarked deposits, which represents its direct contribution to the financing of the sector's credit operations, amounted to IL 333 million, compared with IL 313 million in 1969; this brought up the balance at the end of 1970 to IL 2,657 million, or some 40 percent of the sector's liabilities (excluding deposits with the Accountant General).

(b) *Assets*

The asset portfolio of the financial institutions consists predominantly (about 90 percent) of loans, and only to a small extent of securities (9 percent) and immovable assets (less than 1 percent).

While loans expanded by IL 800 million, as opposed to IL 695 million in 1969, the growth of the sector's securities portfolio fell off sharply, from IL 146

[1] The social insurance funds are the chief customer for these bonds.

Table

ASSETS AND LIABILITIES

	IL million		
	1968	1969[a]	1970
Assets			
Cash and bank deposits	76.7	76.9	132.8
Credit to the public from own means	1,797.8	1,985.5	2,391.5
Credit to the public from Govt. deposits	1,955.4	2,301.9	2,667.9 (2,638.9)[b]
Credit to the public from deposits earmarked for loans	605.7	743.3 (766.3)[b]	754.0 (800.0)[b]
Government securities	57.1	100.0	122.1
Nongovernmental securities[c]	345.2	448.5	465.2
Immovable property	33.4	34.0	36.4
Total	**4,871.3**	**5,690.1 (5,713.1)**[b]	**6,569.9 (6,586.9)**[b]
Liabilities and capital			
Equity capital	1,209.3	1,411.6	1,529.4
Bonds	1,802.5	2,154.9	2,653.5
Proceeds deposited with Accountant General[d]	930.0	1,115.0	1,385.0
Net proceeds	872.5	1,039.9	1,268.5
Deposits and loans from banks	99.1	173.6	363.3 (267.3)[b]
Govt. deposits earmarked for loans	1,982.6	2,295.5	2,657.4 (2,628.4)[b]
Nongovernmental deposits earmarked for loans	653.7	723.1 (746.1)[b]	680.5 (726.5)[b]
Other deposits and loans	284.1	342.1	381.6 (477.6)[b]
Demand deposits	19.9	16.9	20.0
Other accounts	–249.9	–312.6	–330.8
Deposits with the Accountant General, excl. bond proceeds	–322.0	–428.9	–460.7
Other accounts (net)	72.1	116.3	129.9
Total	**4,871.3**	**5,690.1 (5,713.1)**[b]	**6,569.9 (6,586.9)**[b]

[a] Revised data.
[b] Less transfers to reserves and/or write-offs.

million in 1969 to IL 26 million.[1] As pointed out above, this was due partly to the continued downtrend in equity prices and turnover on the Stock Exchange, which precluded the expansion of the investment companies' activity in this area, and partly to waning expectations of a devaluation which, together with the compulsory loans imposed on the public, slowed the growth of the bond funds.

While the increase in outstanding credit to the public from Government deposits remained more or less constant, the growth of loans to the public from nongovernmental deposits fell precipitately, from IL 161 million in 1969 to IL 57 million. At the same time, there was a much stronger increase (IL 406 million vs. IL 188 million in 1969) in loans from the institutions' "own means",

[1] Before revaluation of shares.

OF FINANCIAL INSTITUTIONS, 1968–70

Percent			Annual increase or decrease (–)			
			1969		1970	
1968	1969	1970	IL m.	%	IL m.	%
1.6	1.3	2.0	0.2	0.3	55.9	72.7
36.9	34.9	36.4	187.7	10.4	406.0	20.5
40.1	40.5	40.6	346.5	17.7	337.0	14.6
12.4	13.1	11.5	160.6	26.5	56.7	7.6
1.2	1.8	1.9	42.9	75.1	22.1	22.1
7.1	7.9	7.1	103.3	29.9	16.7	3.7
0.7	0.5	0.5	0.6	1.8	2.4	7.1
100.0	**100.0**	**100.0**	**841.8**	**17.3**	**896.8**	**15.8**
24.8	24.8	23.3	202.3	16.7	117.8	8.4
37.0	37.9	40.4	352.4	19.6	498.6	23.1
19.1	19.6	21.1	185.0	19.9	270.0	24.2
17.9	18.3	19.3	167.4	19.2	228.6	22.0
2.1	3.0	5.5	74.5	75.2	93.7	54.0
40.7	40.4	40.4	312.9	15.8	332.9	14.5
13.4	12.7	10.4	92.4	14.1	3.4	0.5
5.8	6.0	5.8	58.0	20.4	135.5	39.6
0.4	0.3	0.3	–3.0	–15.1	3.1	18.3
–5.1	–5.5	–5.0	–62.7	–25.1	–18.2	–5.8
–6.6	–7.5	–7.0	–106.9	–33.2	–31.8	–7.4
1.5	2.0	2.0	44.2	61.3	13.6	11.7
100.0	**100.0**	**100.0**	**841.8**	**17.3**	**896.8**	**15.8**

[c] Including investments in subsidiary companies.
[d] Estimate.

which are actually funds channelled indirectly to the financial institutions by the public sector.

Another striking change in the institutions' asset structure was the appreciable increase in "cash and bank deposits", in the main due to the larger deposits in financial institutions abroad.

6. Flow of Funds, by Sector

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 flows

Table

FLOW-OF-FUNDS STATEMENT OF THE

(IL

	Receipts		
	1969[a]	1970	Increase or decrease (–)
Nonfinancial transactions	**518.0**	**635.2**	**117.2**
Transactions in financial assets			
Government	319.0	317.8	–1.2
National Institutions and local authorities	28.1	–35.2	–63.3
Public sector companies	21.7	–1.2	–22.9
Banking institutions	187.0	291.0	104.0
Social insurance funds	189.1	353.1	164.0
Insurance companies	4.7	–1.6	–6.3
Private business[d]	34.2	–12.1	–46.3
Nonprofit institutions	11.5	–3.0	–14.5
Rest of the world	45.7	–6.4	–52.1
Households[e]	129.8	34.4	–95.4
Unspecified[f]	23.2	64.5	41.3
Total transactions in financial assets	**994.0**	**1,001.3**	**7.3**
Errors and omissions			
Total receipts and payments	**1,512.0**	**1,636.5**	**124.5**

[a] Revised data.
[b] Less estimated purchases of Government securities from households.
[c] Less transfers to reserves and write-offs.

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

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

The financial institutions' business volume expanded by 8 percent, as against 20 percent in 1969, and stood at approximately IL 1,636 million. While the sector's real transactions (interest receipts, linkage differentials, etc.) increased by about 22 percent, the same rate as in 1969, there were hardly any changes in the sector's net receipts. Since a large part of these originated from the revaluation of the institutions' bonds following the steep rise in the consumer price index, it may be concluded that the sector's growth slackened in 1970.

Most of the net credit to the financial institutions was provided by the

XVI–5

FINANCIAL INSTITUTIONS, BY SECTOR, 1969–70

million)

Payments			Balance of receipts over payments	
1969[a]	1970	Increase or decrease (–)	1969	1970
479.2	**602.5**	**123.3**	**38.8**	**32.7**
335.4	322.8	–12.6	–16.4(13.6)[b]	–5.0(15.0)[b] (–14.0)[c]
84.6	103.5	18.9	–56.5(–33.5)[c]	–138.7(–92.7)[c]
14.2	9.7	–4.5	7.5	–10.9
35.3	98.6	63.3	151.7	192.4[b](96.4)[c]
–1.6	12.1	13.7	190.7	341.0
5.5	–2.0	–7.5	–0.8	0.4
399.2	307.5	–91.7	–365.0(–388.0)[c]	–319.6(–336.6)[c]
7.5	25.9	18.4	4.0	–28.9
11.3	1.7	–9.6	34.4	–8.1(+87.9)[c]
141.8	163.1	21.3	–12.0(–42.0)[b]	–128.7(–148.7)[b]
—	—	—	23.2	64.5
1,033.2	**1,042.9**	**9.7**	**–39.2**	**–41.6**
–0.4	–8.9	–8.5	0.4	8.9
1,512.0	**1,636.5**	**124.5**	—	—

[d] Including farms.
[e] Including contractors' deposits sold to households through banking institutions.
[f] Including securities sold on the Stock Exchange.

social insurance funds, banks, and the foreign sector. The chief borrowers were private business and households. The Government, which in 1969 had been a net lender to the tune of IL 14 million, became a net borrower of an identical amount in the year under review.[1]

Net receipts from banking institutions added up to IL 96 million, compared with IL 152 million in 1969. The decline was due almost entirely to the smaller growth of the banks' approved saving schemes, as a result of which their investment in financial institution bonds rose by only IL 63 million as against IL 116 million in 1969.

[1] The net flow of funds from the Government to the financial institutions (see Table XVI–5) does not indicate the degree of Government influence over the institutions' financing operations in the loan market, for two reasons: (a) a large part of the institutions' business financed from nongovernmental sources is also conducted in accordance with Government directives (see the discussion in section 2); (b) a substantial proportion of the sector's net disbursements to the Government is made from funds raised by the institutions with Government approval, since the Government controls an overwhelming share of the local capital market, as well as the mobilization of funds abroad. In these activities the institutions actually function as the Government's financial agents.

Net receipts from social insurance funds rose by IL 150 million to IL 341 million. This appreciable gain can be largely credited to the brisker sale of bonds to the funds (up from IL 177 million in 1969 to IL 260 million), and also to the writing-up of the funds' bond portfolio after the sharp rise in the consumer price index.

The rest-of-the-world sector accounted for IL 88 million of net receipts, as against IL 34 million in 1969. The amount actually mobilized was much larger, but part of it was deposited in financial institutions abroad.

Net payments to private business drifted down from IL 388 million in 1969 to IL 337 million, reflecting the slower increase in the volume of financing provided to the various sectors of the economy. On the other hand, net payments to households soared from IL 42 million in 1969 to IL 149 million as a result of the much slower expansion of the bond funds and the larger volume of mortgage financing made available for the purchase of homes in public housing projects.