

CHAPTER XVI

FLOW OF FUNDS

1. CONCEPTUAL FRAMEWORK¹

THIS CHAPTER analyzes the mutual financial relationships between the various sectors of the economy, and shows the influence of the sectors on aggregate demand for goods and services and the means of financing the demand generated by each of them. These intersector relationships are reflected in flows of payments pertaining to three types of transactions: purchase and sale of goods and services, unilateral transfers such as taxes and subsidies, and credit transactions such as loans and the purchase of securities.

The analysis distinguishes between three groups of sectors:

(1) Five domestic sectors active mainly in the real (i.e. nonfinancial) sphere: the public sector (the Government, National Institutions, and local authorities), public sector companies,² nonprofit institutions, households, and nonfinancial private business enterprises.³

(2) Three domestic sectors active in the financial sphere: the banking system (including the Bank of Israel), provident funds and insurance companies, and other financial institutions such as mortgage banks and investment companies.

(3) The rest-of-the-world sector, in respect of its transactions with the domestic sectors.

The influence of each of the sectors on domestic demand for goods and services is measured by a number of indicators, the most important of which are the demand surplus on the one hand, and the total amount of net credit extended to sectors with a demand surplus on the other. A sector is considered as having a demand surplus when its sales plus transfer receipts from other domestic sectors are less than its purchases of goods and services. In other words, the demand

¹ For a more detailed description of flow-of-funds analysis, see the chapter on "Flow of Funds" in the Bank of Israel Annual Reports for the years 1959-62.

² Public sector companies are companies operating as independent legal entities (as distinct from the Post Office and Israel Railways, for example), and at least 25 per cent of whose equity capital is owned by public sector authorities, which actively participate in the management. Public sector companies include Amidar, Mekorot, Israel Electric Corporation, Zim, El Al, Rassco, and others.

³ Owing to the lack of suitable data, it is generally impossible to differentiate between the transactions of households and those of private business enterprises. Hence an analysis of the relationships between these two sectors is largely a matter of conjecture and estimation. Where it is impossible to separate the two, we shall call the combined sector the "private sector".

surplus represents that portion of purchases financed by credit from other domestic sectors, unilateral transfers from abroad, and foreign credit.

The demand pressure generated by the domestic sectors is responsible for the two central problems of the Israeli economy: the large deficit on current account in the balance of payments, and the inflationary pressure. Domestic sectors operating in the real sphere all have a demand surplus, and analysis of the developments in the magnitude of the demand surplus of each is likely to indicate the factors responsible for the deterioration in the balance of payments on the one hand, and for the inflationary pressures expressing themselves in price increases on the other.

In order to finance their demand surplus, the domestic sectors rely on transfer receipts and borrowing from abroad. This does not mean that each individual sector has to be a net recipient of transfers and credit from abroad, but this must be true for all domestic sectors taken together. Those sectors receiving foreign transfers and credit in excess of their demand surplus—e.g. the public sector and households—make credit available to other domestic sectors. Therefore, the influence of such sectors on aggregate domestic demand is reflected not only in their own demand surplus, but also in the amount of credit they extend to other sectors with a demand surplus.

Financial sectors are also net lenders, but they themselves are not a major source of financing. They serve mainly as intermediaries which transfer funds from one real sector to another (and from the rest of the world to domestic sectors). An exception to this is the banking system, which is able to create new sources of financing of an inflationary character.¹

One of the limitations of the analytical method employed here is that it gives no reliable indication of the possible inflationary influence of the banking system. As against the expansion of credit by the banking system, there is an increase in its liabilities in the form of cash and various deposits; in the intersectorial structure of net credit flows² the credit increment is offset by the additional liabilities. The impossibility of pointing with any degree of certainty to the existence of a causal relationship applies particularly to the activities of the banking system, but it applies likewise to probable developments in other sectors. An ex-post measurement of the demand surplus is by itself insufficient to determine whether changes in its magnitude were the cause or effect of the inflationary pressures revealed in the economy.

It is clear, therefore, that the conclusions which one may draw from flow-of-funds analysis are limited owing to the nature of the data presented. The size

¹ Because of the conditions prevailing in the Israeli economy during the past few years, the expansionary influence of the banking system has stemmed more from the accumulation of foreign exchange reserves than from its ability to expand credit on the basis of a given magnitude of reserves.

² Net credit is the balance of credit given over credit received; deposits constitute credit to the banking system.

of the demand surpluses points to possible sources of inflationary pressure, while the structure of credit flows and transfers permits an analysis of the means of financing the existing demand surpluses.

2. MAIN DEVELOPMENTS

The aggregate demand surplus of the real domestic sectors is more or less equal to the deficit on current account in the balance of payments, or to the import surplus (the import surplus is identical with the supply surplus of the rest-of-the-world sector, i.e. with the excess of the domestic sectors' purchases from abroad over their sales abroad), since the aggregate supply surplus of the financial sectors is not likely to reach any appreciable magnitude.

The size of the supply surplus of the rest-of-the-world sector is of course significant for the economy, but this problem is dealt with in another chapter of this Report. For the purpose of the present analysis, no great importance attaches to this magnitude, since the nominal changes in the demand surplus from year to year do not in themselves indicate the trend of developments in the various domestic sectors. This fact stood out after the alteration of the exchange rate in 1962. In ascertaining the significance of the changes in the size of the demand surpluses, it is necessary to examine primarily their relative magnitude, from two aspects:

- (1) The changes in the ratio between the demand surplus and total purchases of the various sectors. This ratio measures the weight of purchases not covered by sales and transfer receipts from other domestic sectors.
- (2) The changes in the division of the aggregate demand surplus between the domestic sectors, which indicate the changes in the contribution of the different sectors to the prevailing demand pressure.

A look at Table XVI-1 shows that the trend of the changes in the size of the demand surpluses of the various sectors differed in 1963 from that discernible after the devaluation of 1962. The demand surplus of the public sector decreased somewhat, and that of public sector companies even more so. In contrast, there was a slight rise in the demand surpluses of the private sector and nonprofit institutions. An examination of the share of the sectors in the aggregate demand surplus brings out even more sharply the change which, on the face of it, seems to have taken place in the trend. (Later on we shall see that this change can be misleading in connection with developments in the year 1962.) The real domestic sectors which increased their share in the aggregate demand surplus in 1963 were the private sector and the nonprofit institutions. The former showed a rise from 40 to 45 per cent, whereas in 1962 its share had remained stable; the weight of nonprofit institutions went up slightly, following a decline in 1962. On the other hand, the public sector companies showed a further decline in 1963, while the share of the public sector also went down, in contrast to a marked advance in 1962 (from 21 to 30 per cent).

Table XVI-1

INDICATORS OF THE INFLUENCE OF REAL DOMESTIC SECTORS
ON TOTAL DEMAND, 1961-63^{a,b}
(IL million)

	Demand surplus	Net credit to or from (-) real domestic sectors ^c	Net credit from or to (-) financial sectors ^d	Net credit and transfers from abroad
	(1)	(2)	(3)	(4)
Private business enterprises and households				
1961	336	-177	-153	297
1962	569	—	-284	814
1963	624	-40	-232	815
Public sector				
1961	175	353	74	454
1962	429	225	31	623
1963	393	255	207	435
Public sector companies				
1961	214	-167	8	39
1962	313	-205	46	62
1963	238	-190	16	31
Nonprofit institutions				
1961	109	-9	8	92
1962	121	-20	-16	114
1963	132	-25	-17	123

^a For 1961 and 1962—revised figures.

^b Demand surplus (1) plus credit granted to other real sectors (2) is conceptually equal to credit and transfers from abroad (4) plus credit from financial sectors (3). Discrepancies in totals are due to errors and omissions.

^c Credit given by the sector to other real sectors, less the credit received from them. (A minus sign indicates that more credit was received from other real sectors than was given to them.)

^d Credit received from financial sectors (including the banking system), less credit given to them (including the increase in bank deposits).

If we add to the demand surplus of each sector the influence of its credit transactions with other domestic sectors operating in the real sphere, the picture changes greatly as far as 1962 is concerned, but not for 1963. The reason for adding the net balance of credit transactions with real domestic sectors to the demand surplus is, that by extending credit to a sector with a demand surplus, the lending sector enables it to finance the surplus. (The sector receiving the credit reduces thereby the funds available to the lending sector, thus "contribut-

ing” to the easing of demand pressure.¹ We therefore add to the demand surplus only the net outstanding credit advanced to sectors with a demand surplus.)

If the amount lent by the public sector to real domestic sectors is added to its demand surplus, we find that in 1962 its influence on aggregate domestic demand decreased, while in 1963 there was no significant change. The share of the public sector in the aggregate demand surplus plus net credit advanced to real domestic sectors dropped from 63 per cent in 1961 to 45 per cent in 1962, and rose slightly to 47 per cent in 1963.

If we add the net amount lent (or borrowed) to the demand surplus of the private sector, a different development emerges. Whereas an examination of the demand surplus alone reveals no change in this sector's influence on aggregate demand in 1962 and a marked rise in 1963, an examination of the share of the private sector in the aggregate demand surplus plus net credit granted shows a large increase in 1962, and a rise less than that in the demand surplus alone in 1963. The share of the private sector in the aggregate demand surplus plus net credit granted rose from 17 per cent in 1961 to 40 per cent in 1962 and 42 per cent in 1963.

With regard to public sector companies and nonprofit institutions, the divergence between the development of the demand surplus alone and that of the demand surplus plus net credit given to or received from real domestic sectors was less pronounced.

The disparities between these two magnitudes in the private and public sectors in 1962 can be attributed to the fact that while the weight of the demand surplus of the latter increased, the sector considerably reduced its contribution to aggregate demand by granting credit to other real sectors, especially the private sector. On the other hand, in 1961 the private sector financed about half of its demand surplus by borrowing from other real sectors, especially the public sector. This reduced its total influence on aggregate domestic demand. In 1962 the private sector financed its larger demand surplus exclusively from external sources. Its influence on total demand was therefore considerably greater. In 1963 the patterns observed the year before were on the whole maintained in respect of the influence exerted by the private and public sectors on total demand through their demand surpluses and net lending, although the credit granted by the public sector in 1963 had an opposite effect than in 1962.

From the above, it will be seen that the manner of financing demand surpluses has as much significance as their magnitude. The financing of demand surpluses is summarized in Table XVI-2. The presentation of developments in the private sector is incomplete because of the combining of private business and households

¹ The reference is to sectors operating in the real sphere only. Borrowing from a financial sector, especially the banks, does not reduce the demand for goods and services, and therefore is not taken into account in this discussion.

Table XVI-2
FINANCING OF DEMAND SURPLUSES, BY SECTOR, 1961-63^a
 (IL million)

	Transfers from rest of the world	Net credit from rest of the world	Net credit from domestic sectors	Net credit to domestic sectors	Total net credit received or granted (-) (1) + (3) - (4)	Adjust- ments and rounding- off	Demand or supply (-) surplus (1) + (5) + (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Private business enter- prises and households							
1961	280	17	336	308	45	11	336
1962	581	233	301	565	-31	19	569
1963	694	121	483	669	-65	-5	624
Public sector							
1961	249	205	100	379	-74	—	175
1962	233	390	169	363	196	—	429
1963	245	190	217	265	142	6	393
Public sector companies							
1961	—	39	180	5	214	—	214
1962	—	62	319	68	313	—	313
1963	—	31	238	32	237	1	238
Nonprofit institutions							
1961	92	—	17	—	17	—	109
1962	114	—	22	18	4	3	121
1963	123	—	26	18	8	1	132
Provident funds and insurance companies							
1961	—	4	101	112	-7	—	-7
1962	—	1	140	158	-17	—	-17
1963	—	3	168	189	-18	—	-18
Banking system							
1961	—	-130	174	47	-3	-5	-8
1962	—	-347	377	58	-28	8	-20
1963	—	-204	354	196	-46	—	-46
Financial institutions							
1961	—	49	77	139	-13	-4	-17
1962	—	50	89	167	-28	—	-28
1963	—	78	62	173	-33	—	-33
Rest of the world^b							
1961	-621	—	140	325	-185	4	-802
1962	-928	—	363	752	-389	-50	-1,367
1963	-1,062	—	237	456	-219	-9	-1,290

^a For the years 1961 and 1962—revised figures.

^b The figures here differ from those presented in the chapter on the balance of payments because of conceptual differences.

—two sectors which differ greatly from each other as far as their position in the credit-flows structure is concerned (the former is a net borrower, and the latter a net lender). Nevertheless, two facts should be noted:

- (1) Transfers and credit from abroad provided the private sector with 150 per cent more funds in 1962 and 1963 than in 1961. (Between 1962 and 1963 there was practically no change in the magnitude of net receipts from abroad.)
- (2) The combined sector, which until 1961 was a net borrower, has now become a net lender.¹

The composition of the public sector's sources of financing changed considerably during 1961–63. Unilateral transfers from abroad decreased in terms of foreign currency, but thanks to the rise in the rate of exchange, their counterpart in Israeli pounds remained at the same level. On the other hand, credit receipts from abroad almost doubled in terms of Israeli pounds between 1961 and 1962. In 1963 net credit receipts declined owing to the advance repayment of foreign debts with the help of a loan granted to the Government by the Bank of Israel. (The influence of this loan was reflected in a reduction of the rate of increase in the banking system's balances abroad, defined in Table XVI–2 as credit extended to the rest of the world.) From 1961 until 1963 there was a steady growth in the net amount of credit received by the public sector from other domestic sectors, both real and financial, and a decline in the net amount of credit which it advanced to others. The significance of this development is described below.

Public sector companies rely mainly on credit from domestic sectors (primarily the public sector). Their pattern of financing did not change in 1963, although there was a decline in net credit received locally and from the rest of the world, after an increase in 1962.

The demand surplus of nonprofit institutions is financed almost entirely through unilateral transfers from abroad. The slow increase in such transfers in 1963 enabled the sector to finance a somewhat larger demand surplus. (It should be noted that in 1962 the amount of dollars transferred declined appreciably.)

An examination of the composition of the financial sectors' sources of financing shows that the amount of net credit which they extended was relatively small, as explained above.

Two developments in this sphere are worthy of note:

- (1) Following the Bank of Israel loan to the Government for the advance repayment of foreign debts, there was an increase in 1963 in the incremental net credit extended by the banking system to domestic sectors and a decrease in the incremental net credit granted by the banking system to the rest of the world. (This development is also reflected by the fact that

¹ The reference is to credit from all sectors, including the rest of the world, and not merely from real sectors, as in Table XVI–1.

the balance of outstanding credit from the rest of the world to domestic sectors rose in 1963 to a lesser extent than in 1962.)

- (2) In 1963 the financial institutions borrowed more from abroad and less from domestic sources than in 1962.

3. DEMAND SURPLUSES OF THE VARIOUS SECTORS

Purchases by the public sector, which on account of the devaluation rose in 1962 at a much higher rate than domestic transfers¹ to it, increased at a lower rate than the latter in 1963, thus reducing somewhat the large demand surplus created the year before. The change was not due to the growth in tax revenue, but to the slower expansion of public sector purchases, especially Government imports and publicly financed construction. This development, although limited in scope, helped to ease the inflationary pressure to some degree. In view of the very strong demand pressure prevailing in other sectors of the economy, it would have been desirable, of course, had the decrease in the demand surplus of the public sector been much greater (this point is discussed in the chapter on public sector operations).

The significance of this decrease is also brought out by the changes that occurred in the manner of financing the demand surplus, which was summarized briefly in the previous section. Part of the public sector purchases are not for the purpose of supplying ordinary services to the public, but are capital outlays which add to the productive capacity of the economy (purchases on capital account, which in 1963 comprised about 20 per cent of total public sector purchases, included *inter alia* investments in the National Water Carrier, transport and postal enterprises, road construction, and public buildings). The public sector contributes to the expansion of domestic capital formation by granting credit to other sectors, mainly through the development budget. Until 1961 unilateral transfers from abroad more than covered the demand surplus of the public sector, and the balance was mainly used for providing credit (actually the public sector lent more than the amount of this balance, borrowing the difference from foreign and domestic sources). In 1962 and 1963, however, unilateral transfers did not cover the demand surplus,² nor is any increase expected in the coming years. Consequently, the public sector has had to resort to borrowing in order to cover its demand surplus. The further supply of credit to other sectors for development purposes will entail, unless the demand surplus is reduced, even more extensive borrowing. Two possible sources are available:

- (1) Foreign credits. Even if it is still possible to borrow large sums from the rest of the world, this cannot serve for any length of time as a source of net

¹ Including Government tax receipts, which constitute the bulk of this item.

² Government receipts from unilateral transfers decreased from IL 140 million in 1961 to IL 70 million in 1963; this was balanced by a rise in the transfer receipts of the National Institutions (in IL).

Table XVI-3
DEMAND OR SUPPLY SURPLUSES, BY SECTOR, 1961-63^a
 (IL million)

	Purchases on current account	Purchases on capital account	Sales	Net purchases (1) + (2) - (3)	Transfers to domestic sectors	Transfers from domestic sectors	Net transfers from domestic sectors (6)-(5)	Demand or supply (-) surplus (4)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Private business enterprises and households^b								
1961	3,281	976	—	—	—	—	—	336
1962	3,990	1,252	—	—	—	—	—	569
1963	4,722	1,386	—	—	—	—	—	624
Public sector^c								
1961 [†]	1,119	224	129	1,214	508	1,547	1,039	175
1962	1,556	377	153	1,780	520	1,871	1,351	429
1963	1,794	443	181	2,056	575	2,238	1,663	393
Public sector companies^d								
1961	561	295	610	246	8	40	32	214
1962	781	425	887	319	—	6	6	313
1963	863	371	991	243	—	5	5	238
Nonprofit institutions^e								
1961	376	55	78	353	14	258	244	109
1962	430	59	90	399	16	294	278	121
1963	482	71	99	454	18	340	322	132

^a For 1961 and 1962—revised figures.

^b Purchases of the sector include consumption and investment of households and investment of private business enterprises, as recorded in the national accounts. The demand surplus is calculated as a residual, by deducting the demand surpluses of the sectors from the supply surpluses of the other sectors.

^c As defined in Chapter VII, "Public Sector Operations".

^d Companies in which the public sector holds at least 25 per cent of the equity capital and actively participates in the management.

^e As defined in Chapter VIII, "Nonprofit Institutions".

Table XVI-3

DEMAND OR SUPPLY SURPLUSES, BY SECTOR, 1961-63 (cont.)

(IL million)

	Purchases on current account	Purchases on capital account	Sales	Net purchases (1) + (2) - (3)	Transfers to domestic sectors	Transfers from domestic sectors	Net transfers from domestic sectors (6) - (5)	Demand or supply (-) surplus (4) - (7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Provident funds and insurance companies^f								
1961	70	7	67	10	55	72	17	-7
1962	90	6	107	-11	90	96	-6	-17
1963	110	10	118	2	98	118	-20	-18
Banking system^g								
1961	133	9	178	-36	28	—	-28	-8
1962	194	13	265	-58	38	—	-38	-20
1963	205	12	311	-94	48	—	-48	-46
Financial institutions^h								
1961	37	3	65	-25	8	—	-8	-17
1962	60	2	103	-41	13	—	-13	-28
1963	70	4	124	-50	17	—	-17	-33
Rest of the worldⁱ								
1961	—	756	1,558	-802	—	—	—	-802
1962	—	1,429	2,796	-1,367	—	—	—	-1,367
1963	—	1,789	3,079	-1,290	—	—	—	-1,290

^f As defined in Chapter XVIII, "Provident Funds and Insurance Companies".^g Commercial banks, credit cooperative societies, and Bank of Israel.^h As defined in Chapter XVII, "Financial Institutions".ⁱ Sales include, in addition to imports as per the balance of payments, payments of the Jewish Agency abroad (excluding interest). Purchases include exports as per the balance of payments, less Jewish Agency expenditure on the transport of immigrants.

credit, since the foreign debt incurred up to now already involves substantial payments on account of principal and interest. The Independence and Development Loans provide a good example of this. Bond sales reached \$ 80 million in 1963, but repayments on account of principal alone came to \$ 56 million. If we add interest payments and distribution costs, it will be seen that this no longer constitutes a source of net credit.

- (2) Credit from other domestic sectors. It is possible to borrow from the banking system, but such credit is of an inflationary character. The chief source of noninflationary credit is the household sector, but the supply of this type of credit—either directly from households or through financial intermediaries—is not unlimited. Increasing the share of credit to the public sector means reducing, at least relatively, the amount available for private business enterprises. The growing demand of the public sector for domestic credit has been reflected in recent years by tighter controls on the investment of monies accumulated from households by provident funds, insurance companies, and financial institutions on the one hand, and by larger direct sales of securities (the Short-Term Loan) to the household sector on the other.

The continued provision of credit for investment purposes hinges upon a further increase in foreign borrowing or the complete cornering of the credit supply of households, unless the public sector succeeds in creating a supply surplus, or at least in greatly diminishing its present demand surplus.

Although public sector companies are independent legal entities, the relationships between them and the public sector should not be overlooked. These relationships influence the size of the companies' demand surplus, at least in that most of the credit which they require for its financing originates from the public sector. But it must not be concluded from this that the companies' investment programs are governed by the amount of capital that the public sector is prepared to supply (in several cases the amount of capital was governed by the size of the investment undertaken). Nevertheless, it is clear that the large-scale investment programs of public sector companies are drawn up in coordination with the public sector, and in view of the long-range character of some of them (e.g. in respect of immigrant housing, shipping, and aviation), far-reaching conclusions should not be drawn from changes in the magnitude of investment during any one particular year.

At the same time, it is noteworthy that the decrease in the demand surplus of public sector companies exceeded that in their purchases on capital account. This suggests that a larger percentage of the investment was financed from internal sources (i.e. other than by borrowing). No striking structural changes occurred in the financing of the demand surplus of public sector companies. The growth in net borrowing from abroad which marked 1962 was not repeated in 1963, although the gross credit inflow from this source was similar in both years.

The demand surplus of the nonprofit institutions again rose slightly in 1963. The sector's activities, as reflected in the amount of its purchases, expanded at the same rate as in 1962. The growth in transfers from other domestic sectors during the last two years failed to keep pace with the expansion of purchases, and the larger demand surplus was financed by an increase in unilateral transfers from abroad. In 1963 the sector's purchases on capital account rose somewhat, after several years of stability. It is difficult to ascertain if the increase in transfers from abroad was connected with a growth in the nonprofit institutions' investment, since part of their current activities are also financed by foreign transfers.

Private business and households constitute the largest domestic sector, but the information available does not make it possible to isolate developments in each of the component segments. In 1963 there was a further rise in the sector's demand surplus, and it accounted for approximately 45 per cent of the aggregate demand surplus of the domestic sectors (compared with about 40 per cent in 1962).

In 1962 the increase in the demand surplus of the private sector was attributed mainly to the rapid growth of consumption. However, revised data show that investment in housing increased at a faster rate than consumption. In any event, it is almost certain that the household sector was mainly responsible for the larger demand surplus in 1962.

Table XVI-4

CONSUMPTION, INVESTMENT, AND DEMAND SURPLUS OF
HOUSEHOLDS AND PRIVATE BUSINESS ENTERPRISES, 1961-63^a
(IL million)

	1961	1962	1963
Purchases by households			
Consumption	3,281	3,990	4,722
Investment in housing ^b	396	547	562
Investment of business enterprises	580	705	824
Total purchases by households and investment of business enterprises	4,257	5,242	6,108
Demand surplus of households and business enterprises	336	569	624
Demand surplus as a percentage of total purchases	7.9	10.9	10.2
Demand surplus as a percentage of purchases on capital account	34.4	45.4	45.0

^a For the years 1961 and 1962—revised figures.

^b Total investment in housing less new dwellings acquired by public sector companies. (The figures on household investment in housing are inflated to a certain extent since dwellings under construction, which actually belong to private business enterprises, are included under households.)

In 1963 both household expenditure on consumption and housing and business investment increased, although at a lower rate than in 1962. But since there was no marked variance in the rate at which both parts of this sector expanded their purchases during the year, neither of them can be singled out as the main source of the large demand surplus of the combined sector.

Just as it is difficult to point to the expenditure items responsible for the size of the demand surplus, so the picture is unclear as to the composition of the sources of financing the demand surplus, especially the influence of the rest-of-the-world sector. Personal restitution receipts from Germany remained at the high level reached in 1962, and accounted for a substantial part of the increased demand of the household sector. At the same time, there was also an increase in capital transfers by immigrants and direct investment from abroad, which probably indicates an expansion of business investment. It appears, therefore, that the big demand surplus of the combined household and private business sector was connected with the increased consumption of households no less than with the expansion of investment by private business firms.

A noteworthy development was the rise in the supply surpluses of the financial sectors. These surpluses are not likely to reach large proportions owing to the character of the sectors' activities, which consist mainly of credit transactions and not the sale of goods and services. The expansion of the surpluses over the past several years was connected with the increased profitability of these sectors, reflected by the growth of their reserves.¹

The decline in the supply surplus of the rest-of-the-world sector reflects the improvement that took place in the balance of payments in 1963. A marked change also occurred in the composition of the sources of financing this supply surplus. In 1962 the share of unilateral transfers had declined sharply and that of borrowed receipts had risen, whereas in 1963 the weight of transfers again went up—a desirable development for the economy, although it is not expected to be sustained in the coming years.

4. CREDIT FLOWS

Tables XVI-1, XVI-2, and XVI-3 set forth the mutual relationships between each of the sectors and all the other sectors combined (or between a number of sectors with common characteristics). Tables XVI-5 and XVI-6 present the credit flows between each pair of sectors.

Table XVI-5 indicates the gross credit flows: the amount of credit given by each sector to each of the other sectors is listed in the relevant row, and the amount of credit each sector received from each of the other sectors is listed in the rel-

¹ The demand surplus of the private sector in the tables is slightly overestimated, as complete data are not available on dividend payments, which decrease the supply surpluses of the financial sectors.

evant column.¹ Conceptually, credit includes, besides loans granted, deposits and purchases of securities. Table XVI-6 shows the net credit flows, i.e. the net balance of the change in the credit relationships between each pair of sectors during the year. The credit received by a sector is deducted from the amount of credit which it advanced, and only the net increment appears in the table.

The table of gross credit flows makes it possible to ascertain the amount of credit passing from one sector to another. The table of net credit flows indicates the net changes which occurred in the credit relationships between each pair of sectors during the period reviewed.

In view of the significance attached to the difference between credit granted to sectors with a demand surplus and that extended to other sectors, both tables show the total amount of credit given by each sector to sectors with a demand surplus.

Attention should again be called to the serious shortcoming of the data—the lack of full details on credit transactions between households and private business enterprises. This year one item is included whose approximate magnitude is known—the increase in the bill brokerage trade, most of which constitutes credit from households to private business. However, many important details are still missing, among them consumer credit, the dimensions of which apparently also expanded during the past few years.

Following are the main developments in the credit flows of the various sectors:

(a) *Households*: There was a rise of about 10 per cent in the amount of gross credit received by households, as well as a change in its composition. Credit from the public sector rose, while that from public sector companies declined (this development was associated with the transfer of the mortgage loan business of Amidar Ltd. to Tefahot Israel Mortgage Bank);² in addition, credit from the banking system contracted, while that from financial institutions increased, following a decline in 1962 in the balance of outstanding loans granted by these institutions to households. Gross credit advanced by households rose at an even greater rate, but only that to private business increased to a marked extent, as far as can be judged from the partial information available.

An examination of the net credit flows indicates a growth in credit to private business enterprises (although data on consumer credit are liable to change this conclusion), the banking system, provident funds and insurance companies, public sector companies, and the rest of the world. On the other hand, there was a decline in the amount of net credit extended to the public sector and financial institutions.

¹ These credit flows are not entirely gross, for payments on account of short-term loans granted in the past are generally deducted from the figures. Repayments of long-term loans are shown, as far as possible, as a credit flow.

² Before Tefahot started dealing with mortgage loans to persons buying homes through Amidar and its subsidiaries, Amidar itself granted the loans and the mortgages were included among its assets.

Table XVI-5
GROSS CREDIT FLOWS BETWEEN SECTORS, 1962-63*
 (IL million)

Receiving sector	Public sector	Public sector companies	Nonprofit institutions	Private business enterprises	Households	Total credit to sectors with a demand surplus	Rest of the world	Banking system	Provident funds and insurance companies	Financial institutions	Total credit extended
Lending sector											
Public sector											
1962	×	228	4	76	74	382	213	119	3	31	748
1963	×	181	14	65	112	372	401	20	—	29	822
Public sector companies											
1962	-35	×	—	71	53	89	3	7	—	10	109
1963	7	×	—	74	8	89	33	15	—	12	149
Nonprofit institutions											
1962	-3	—	×	3	3	3	—	14	1	6	24
1963	2	—	×	4	3	9	—	10	—	1	20
Private business enterprises											
1962	90	53	9	×	^b	152	36	66	21	10	285
1963	-14	65	10	×	^b	61	106	109	21	17	314

Households												
1962	105	13	10	100 ^c	×	228	16	294	171	32	741	
1963	122	33	10	170 ^c	×	335	33	293	199	31	891	
Rest of the world												
1962	603	65	—	285	^b	953	×	78	1	53	1,085	
1963	591	64	—	260	^b	915	×	127	3	79	1,124	
Banking system												
1962	26	-3	-2	116	37	174	425	×	—	10	609	
1963	132	-8	3	193	4	324	331	×	—	12	667	
Provident funds and insurance companies												
1962	52	15	-1	65	33	164	—	11	×	40	215	
1963	57	11	1	55	31	155	—	35	×	53	243	
Financial institutions												
1962	106	51	8	59	-10	214	3	2	1	×	220	
1963	67	40	-10	94	61	252	1	12	2	×	267	
Total credit received												
1962	944	422	28	775	190	2,359	696	591	198	192	4,036	
1963	964	386	28	915	219	2,512	905	621	225	234	4,497	

^a For 1962—revised figures.

^b No data are available on credit flows between these sectors.

^c Partial figures.

Table XVI-6
NET CREDIT FLOWS BETWEEN SECTORS, 1962-63^a
(IL million)

Receiving sector	Public sector	Public sector companies	Nonprofit institutions	Private business enterprises	Households	Total credit to sectors with a demand surplus	Rest of the world	Banking system	Provident funds and insurance companies	Financial institutions	Total credit extended
Lending sector											
Public sector											
1962	×	263	7	—	—	270	—	93	—	—	363
1963	×	174	12	79	—	265	—	—	—	—	265
Public sector companies											
1962	—	×	—	18	40	58	—	10	—	—	68
1963	—	×	—	9	—	9	—	23	—	—	32
Nonprofit institutions											
1962	—	—	×	—	—	—	—	16	2	—	18
1963	—	—	×	—	—	—	—	7	—	11	18
Private business enterprises											
1962	14	—	6	×	^b	20	—	—	—	—	20
1963	—	—	6	×	^b	6	—	—	—	—	6

Households												
1962	31	—	7	100 ^c	×	138	16	247	138	42	581	
1963	10	25	7	170 ^c	×	212	33	289	168	—	702	
Rest of the world												
1962	390	62	—	249	^b	701	×	—	1	50	752	
1963	190	31	—	154	^b	375	×	—	3	78	456	
Banking system												
1962	—	—	—	50	—	50	347	×	—	8	405	
1963	112	—	—	84	—	196	204	×	—	—	400	
Provident funds and insurance companies												
1962	49	15	—	44	—	108	—	11	×	39	158	
1963	57	11	1	34	—	103	—	35	×	51	189	
Financial institutions												
1962	75	41	2	49	—	167	—	—	—	×	167	
1963	38	28	—	77	30	173	—	—	—	×	173	
Total credit received												
1962	559	381	22	510	40	1,512	363	377	141	139	2,532	
1963	407	269	26	607	30	1,339	237	354	171	140	2,241	

^a For 1962—revised figures.

^b No data are available on credit flows between these sectors.

^c Partial data.

(b) *Private business enterprises*: The principal changes in gross credit receipts in 1963 were increases in the amount borrowed from households, the banking system, and financial institutions. Receipts from other sectors approximated the 1962 level. In respect of credit granted, there was a conspicuous change—a sharp drop in loan repayments and in credit extended to the public sector; in addition, foreign loan repayments were somewhat higher than in 1962.

As a result of these developments, a number of changes occurred in the net credit flows of the private business sector. There was an increase in net credit receipts from the public sector and households (a conclusion which must be accepted with some reservation in view of the fragmentary nature of the data), and to a lesser extent from the banking system and financial institutions. On the other hand, net credit receipts from abroad decreased. The latter development may be surprising in view of the expansion of direct investment from abroad; however, it must be remembered that direct investment includes credit to financial institutions and the banking system, and the repayment of foreign loans must be set off against it.

(c) *Public sector*: The public sector showed three major changes in its gross credit receipts. Credit from the banking system went up (owing to the receipt of a Bank of Israel loan for the advance repayment of foreign debts), while credit from financial institutions and private business enterprises declined. (Receipts in 1962 were particularly large on account of the advance repayment of loans after the devaluation.)

As to the outflow of credit, there was a big increase in the amount extended to the rest of the world in connection with the aforementioned advance repayments, and a modest rise in the amount lent to households. On the other hand, credit to public sector companies and to the banking system contracted.

These developments were reflected by a decrease in net credit from the rest of the world, and as against this an increase in credit from the banking system; in a decrease in net credit to public sector companies and in credit from financial institutions and households; and a considerable rise in credit to private business enterprises.

(d) *Public sector companies*: The outstanding change in 1963 was the decline in credit from the public sector. The decrease in net receipts from abroad and the financial sectors should also be noted.

(e) *Nonprofit institutions*: The amount of credit extended by these institutions is very limited. It is interesting to note that this sector is a net lender to the financial sectors.

(f) *Rest of the world*: Gross credit receipts of this sector increased considerably following the repayment of loans by the public sector (and to a lesser degree by private business enterprises), a rise that was only partly offset by the smaller increase in credit from the banking system to the rest of the world (i.e. in the accumulation of foreign exchange reserves).

As to the gross credit outflow of the rest-of-the-world sector, the year 1963 saw few changes, the outstanding ones being increases in the amount of credit extended to the banking system and to financial institutions (deposits of foreign residents and the purchase of the institutions' securities by foreign residents).

The net credit flows of the rest-of-the-world sector showed more marked changes: net receipts from the banking system were below the 1962 figure, and there was likewise a reduction in the amount lent to the public sector, private business enterprises, and public sector companies. Only financial institutions received more credit from abroad in 1963.

(g) *Banking system*: The main changes in the credit relationships of the banking system with the public and rest-of-the-world sectors have already been noted. There was some growth in the amount of credit granted to private business enterprises, as well as in the amount borrowed from households, public sector companies, and provident funds and insurance companies.

(h) *Financial institutions*: The gross credit inflow of these institutions showed minor changes, the most noteworthy of which being a rise in receipts from the rest-of-the-world and the provident fund and insurance sector. The structural changes in credit outflow were more pronounced: there was a decline in credit to the public sector, public sector companies, and nonprofit institutions, and an increase in the amount extended to households and private business enterprises. These changes indicate a return to the pattern existing before 1962.

(i) *Provident funds and insurance companies*: The composition of this sector's credit flows, which expanded by more than 10 per cent, showed no outstanding changes.

In conclusion, it should be noted that while aggregate gross credit flows increased in 1963 by more than 10 per cent, aggregate net credit flows were lower than in 1962. This is explained by the structure of the credit flows. To the extent that the credit relationships between each pair of sectors are more bilateral, i.e. the sector receives credit from the same sector to which it gives credit, the greater will be the amount of credit balanced out in presenting net flows. It appears that in 1963 the structure of intersector credit flows was much more bilateral in nature than in 1962.