CHAPTER XVII

FINANCIAL INSTITUTIONS

1. Main Developments

Financial institutions are defined here as financial intermediaries primarily engaged in the mobilization of funds for investment in financial assets. Excluded from this sector are banking institutions, provident funds, and insurance companies, which are discussed separately. Also excluded are holding companies, a large part of whose assets consists of investments in subsidiaries,[1] and companies financed by a limited number of proprietors and therefore ineligible for definition as financial intermediaries.

The expansion of financial institutions, which in recent years was quite rapid, slowed down slightly in 1965. Their combined balance sheet increased by 17 percent, compared with 22 percent in each of the two preceding years, and amounted to IL 3,800 million. The balance of credit extended by the institutions grew by 18 percent—this too slightly lower than in the previous year—and totalled IL 3,405 million at year's end. The construction and housing sector accounted for about a third of the IL 517 million credit increment, while some 18 percent went to industry, 12 percent to the Government, and 8 percent to agriculture.

The deceleration in the financial institutions' development occurred in most of the subgroups, but was particularly striking in the mortgage banks, industrial development banks, and investment companies. Net credit for construction and housing purposes came to IL 177 million, as against IL 251 million the year before. This drop apparently reflects some easing of demand for mortgage loans and an increase in early mortgage repayments. The year reviewed also saw a decrease in industrial credits (by about 25 percent). This was apparently connected primarily with the reduction of existing sources of funds, since there is presumably excess demand for industrial long-term credit under present conditions.

As stated, investment companies also experienced a decline in activity during the year reviewed. Business volume here depends on the companies' ability to mobilize funds among the public by issuing shares and finding suitable investment goals. In view of the depressed state of the stock market, they were unable to expand their activities in 1965. Portfolio investment increased by some IL 14 million only, and a considerable part of this was in securities not traded

[1] Such as Koor Industries and Crafts Co. and the Israel Central Trade and Investment Co.

on the Tel Aviv Stock Exchange. The unit trusts, which raise capital by issuing participation certificates and invest the proceeds in securities, were forced to reduce their investments and redeem participation certificates.

The financial institutions' operations in 1965 were financed from two main sources: debenture issues and deposits earmarked for loans. Sales of debentures, mainly to social insurance funds and foreign investors, reached IL 183 million, a rise of 65 percent over the preceding year. Issues abroad totalled IL 46 million, compared with IL 40 million in 1964. Most of the issues, both in Israel and abroad, were raised by mortgage banks, which converted the foreign currency proceeds into local currency in order to grant housing loans. Despite the expansionary effect which the raising of capital abroad by mortgage banks has on the country's monetary position, and despite the high price of such capital, this activity continued during the year reviewed.

Deposits earmarked for loans were again an important source for financing financial institution operations. The balance of such deposits held by the Government grew by nearly IL 150 million. A considerable increase took place in deposits of contractors and building companies, part of which are sold to the public (the amount of deposits sold to the public went up by about IL 50 million in 1965, to some IL 70 million).

The Government's net share in financing the activities of this sector—reflected by the weight of liabilities to the Government—continued downward in 1965. On the other hand, the Government enabled the institutions to expand their own resources through the issue of debentures. As will be seen below, a large part of the debenture proceeds are also used for giving loans under Government direction. To correctly evaluate the extent of such direction, we have to examine the share in total liabilities of direct Government participation in the financing of the institutions' activities, plus total debentures issued. Here we find that, in line with the trend of recent years, the figure continued to decline.

In contrast to previous years, share issues were not an important source of financing in 1965. Total issues by financial institutions amounted to IL 54 million, compared with IL 234 million the year before. If shares taken up by the Government and foreign investors are deducted, the figure falls to IL 28 million, or IL 120 million less than in 1964.

Industrial and farm loans granted in 1965 were not linked to the consumer price index, since borrowers were enabled to avoid such linkage by paying a yearly premium of 3–4 percent (of which they took advantage). A similar arrangement existed with regard to outstanding loans given in the past. This was not the case, however, with housing loans extended by the financial institutions and which totalled about IL 800 million at year's end. A public committee set up to examine the situation of housing loans and to submit recommendations regarding the terms of mortgage loans given under Government direction, did not propose the abolition of linkage but recommended

Table XVII-1

CONSOLIDATED BALANCE SHEET TOTALS OF FINANCIAL INSTITUTIONS, BY TYPE, 1964–65

(End of period)

	No.	IL million		Percent		Percent increase or decrease (–) as against previous year	
		1964	1965	1964	1965	1964	1965
Mortgage banks	16	1,185.0	1,463.0	36.5	38.5	44.4	23.5
Industrial development banks	5	805.3	895.7	24.8	23.6	16.0	11.2
Institutions granting loans to other sectors[a]	5	421.4	510.3	13.0	13.4	10.9	21.1
Agricultural credit funds	17	398.2	418.7	12.3	11.0	9.5	5.1
Investment companies	16	340.2	413.5	10.5	10.9	47.3	21.5
Household finance companies	18	51.6	58.1	1.6	1.5	14.9	12.6
Unit trusts	7	42.7	40.2	1.3	1.1	12.1	–5.9
Total	84	3,244	3,799.5	100.0	100.0	26.1	17.1

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

that loans be pegged to the cost-of-living allowance instead of the consumer price index.

The gross profit of the financial institutions, relative to average equity capital, remained unchanged in 1965 at about 10 percent. However, there were some changes as between the various groups, the most noteworthy being the increase from 24.8 to 27 percent in the case of mortgage banks and the decline from 8 to 5.5 percent in the case of investment companies.

2. Types of Financial Institutions

Unlike the banking institutions, which deal mainly with short-term credit and deposit accounts, financial institutions are primarily engaged in granting credit for investment on a long-term basis—sometimes as much as 20 years—and must therefore seek sources of funds of an appropriate nature. In western countries they generally obtain such funds from household savings, by means of security issues and saving schemes. The rapid development of the financial institutions in Israel—reflected in the fourfold increase in assets over a period of five years—has precluded utilization of such sources, owing to the limited size of the local long-term capital market.

The Government has played a decisive role in this rapid development. A considerable part of the investment in Israel's economy has been financed from funds mobilized at home and abroad by the Government (loans and unilateral receipts). Some of this money has been made available to the financial institutions in the form of deposits and participation in share capital, for the purpose of granting loans to various sectors of the economy under Government direction and in accordance with the terms set by it. These terms are convenient compared with alternative sources of finance, and this has generated a persistent excess demand for loans out of Government funds. Another source of finance available to the sector is the debenture market. Up to the end of the fifties most of the funds in this market were generally mobilized directly by the Government. Part of the proceeds were lent to the different sectors of the economy through the financial institutions from deposits earmarked for this purpose. The main buyers of debentures have been the social insurance funds, which have to invest a substantial part of their accumulation in securities approved by the Government, in return for income tax concessions. In recent years the Government has changed its method of mobilizing capital and has enabled the financial institutions to issue their own debentures, by including them in the list of investments recognized as being eligible for income tax concessions. The issue proceeds have been used to grant loans under Government direction, and some of them have been transferred to the Accountant General, mainly for financing residential construction within the framework of the development budget. Most long-term credit supplied by the financial institutions originates, therefore, from Government funds and from their own debenture issues.

The preponderant role of the Government in financing the financial institutions—directly in the form of earmarked deposits and participation in equity capital, and indirectly by influencing debenture issues—has given it a decisive say in the activities of a large percentage of the institutions. This is expressed by the Government's deciding—as regards the bulk of the credit—which borrowers shall benefit and what shall be the terms. This applies even to institutions where the Government does not participate in the management, and of course even more so where it holds a controlling interest or is represented on the board.

In addition to Government deposits, this sector holds earmarked deposits of various institutions and companies. These sums are not deposited in order to earn interest, but to utilize bank facilities for granting and collecting loans. Such deposits include, for instance, those of contractors and building companies intended for loans to their clients. Contractors' deposits, as is explained below, are in fact largely sold to the public.

Government influence makes itself felt, as stated, not only in the determination of the destination of credit but also in the fixing of its prices. Government funds are deposited in the financial institutions under conditions which facilitate the extension of credit on easy terms to the various sectors of the economy at the Government's behest. Controlled credit from the financial institutions' own funds is also available on favorable terms—without linkage, for example. Credit to industry, for instance, is now given without linkage upon payment of a yearly premium of 4 percent. The Government has undertaken to compensate the institutions for any differentials which may accrue from a rise in the price index in excess of the level of the annual premium.

The above characteristics do not apply to all the financial institutions. Some of them do not receive Government funds and the credit which they grant is not directed by the Government. Such institutions, however, form only a small part of the sector. The large institutions predominating in the sector—such as the Industrial Development Bank, Israel Bank of Agriculture, Tefahot, General Mortgage Bank, Housing Mortgage Bank, the Maritime Bank, and the Tourist Industry Development Corporation—operate more or less as described above. It should be noted that these concerns are largely institutional instruments for raising funds and for allocating credit in accordance with Government policy.

These institutions generally confine their activities to a single sector, some concentrating on industry, others on agriculture, housing, etc. A second type deals primarily with investment in securities.

The number of financial institutions surveyed in this chapter is 84, and they break down into seven groups, as shown in Table XVII–1.

3. Loan Linkage Policy

The year 1965 was marked by a number of developments in loan linkage policy. From the mid-fifties up to the devaluation of 1962, most loans given by the financial institutions were linked to the dollar or the consumer price index. After devaluation the linkage of new loans to the dollar was discontinued, and for a large part of the existing loans the dollar linkage was converted into an index link. As regards new loans to industry and agriculture, the borrower is now allowed an option between linkage to the index and non-linkage in return for a yearly premium of 3–4 percent. Most borrowers have chosen the second course, since they expect the index to rise by more than the premium rate. This concession is given not only to those borrowing from Government funds but also to those borrowing from the institutions' own means. The Government, on its part, has undertaken to bear any losses resulting from the difference between the rise in the price index and the level of the premium.

These arrangements do not apply to the construction and housing sector. Since the devaluation, loans to home buyers have been pegged to the consumer price index. In September 1965 the Minister of Finance appointed a public committee to examine the linkage arrangements in force for Government-directed mortgage loans. The committee recommended that such loans be linked to the cost-of-living allowance instead of the consumer price index, in order to ensure synchronization between payment of an increase in the cost-of-living allowance and a rise in mortgage payments. In actual fact, implementation of this recommendation will not necessarily lead to any real alleviation in the borrower's position, and in certain cases it is even liable to increase the repayment burden. The index used for determining the cost-of-living allowance differs slightly from the consumer price index, both in the method of calculation and in the relative weights of the various components. In the cost-of-living index the share of housing is smaller. If the prices of the other components advance more rapidly than housing prices, the cost-of-living allowance index will rise more than the consumer price index. This means that under the proposed arrangement the mortgator would have to repay more than under the present system. It should also be remembered that the cost-of-living allowance is paid only if the index goes up at least 3 percent, whereas payments on mortgage loans given at the Government's behest are presently increased only if the index rises by at least 5 percent. According to the proposed arrangement, mortgage payments would rise even if the index goes up by less than 5 percent. On the other hand, it is possible for the index used in calculating the cost-of-living allowance to lag behind the consumer price index, as has been the case in recent years, owing to the different methods of calculating the indexes. It is also possible that payment of the cost-of-living allowance increment may be postponed or not paid in full, and this would reduce the mortgage repayment burden.

4. Assets and Liabilities

The combined balance sheet of the financial institutions rose by IL 555 million, or 17 percent, in 1965, and amounted to IL 3,800 million. The rate of growth was slower than in the previous year; this was true for nearly all types of institutions, but especially so for the mortgage banks, investment companies, and industrial development banks. The first two of these groups had experienced an exceptionally rapid development in 1964 (over 40 percent).

(a) *Assets*

According to the definition of financial institutions in this chapter, their assets are predominantly financial assets, i.e. loans, securities, deposits, and liquid reserves. At the end of 1965 the balance of loans granted to the various sectors, apart from Government, amounted to about 78 percent of total financial insitution assets, loans to the Government to some 12 percent,[1] and investments in nongovernmental securities to about 8 percent. It will be seen from Table XVII–2 that the rates of growth in the main asset items were very similar (17–18 percent), so that no marked changes took place in the asset structure. Loans to the public from the institutions' own means held steady at about 37 percent

[1] In the form of deposits with the Accountant General and investments in Government securities.

Table XVII-2

ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS, 1964–65

	IL million		Percent		Increase or decrease (–) from 1964 to 1965	
	1964	1965	1964	1965	IL m.	%
Assets						
Cash and bank deposits	63.7	58.7	2.0	1.5	–5.0	–7.9
Credit to the public from own means	1,183.0	1,402,8	36.5	36.9	219.8	18.6
Credit to the public from Government deposits	1,083.3	1,271.8	33.3	33.5	188.5	17.4
Credit to the public from deposits earmarked for loans	235.8	278.3	7.3	7.3	42.5	18.0
Loans to the Government	385.5	451.7	11.9	11.9	66.2	17.2
Nongovernmental securities[a]	272.1	308.9	8.4	8.2	36.8	13.5
Immovable assets	21.0	27.3	0.6	0.7	6.3	30.0
Total	3,244.4	3,799.5	100.0	100.0	555.1	17.1
Liabilities						
Equity capital	899.3	973.2[b]	27.7	25.6	73.9	8.2
Debentures	606.4	773.5[c]	18.7	20.4	167.1	27.6
Deposits and loans from banks	45.8	89.8	1.4	2.4	44.0	96.1
Government deposits earmarked for loans	1,125.6	1,275.9	34.7	33.6	150.3	13.4
Nongovernmental deposits earmarked for loans[d]	238.4	333.8	7.3	8.8	95.4	40.0
Demand deposits	9.3	11.7	0.2	0.3	2.4	25.8
Other deposits and loans	190.0	217.4[e]	5.9	5.7	27.4	14.4
Other accounts (net)	129.6	124.2	4.1	3.2	–5.4	–4.2
Total	3,244.4	3,799.5	100.0	100.0	555.1	17.1
Contingent accounts	101.5	122.0	—	—	20.5	20.2

[a] Including investments in subsidiary companies.
[b] Of this sum, 41 percent was held by the Government.
[c] Of this sum, IL 170 million was in foreign currency. In 1964 the balance of debentures in foreign currency came to IL 150 million.
[d] Including deposits of contractors sold to the public.
[e] Including IL 88 million deposited in the Saving-for-Housing scheme.

of total assets, while loans from earmarked Government deposits made up about 33 percent. In 1964 the growth rates for the main asset items, except loans from Government deposits, were much higher.

(b) *Liabilities*

Of the main changes that took place in 1965 in the institutions' liability structure, the smaller increment to share capital stood out: the increase amounted to IL 74 million, compared with IL 263 million in 1964. The lower figure was apparently due in part to the difficulty of floating new issues because of the stock market slump. The proportion of equity capital in total liabilities edged down from 28 to 26 percent. Earmarked Government deposits expanded by IL 150 million—slightly less than in 1964—and their weight in total liabilities remained stable at around 34 percent. The share of the Government in financing the financial institutions—deposits for loan purposes and investment in shares—continued to decrease and stood at approximately 43 percent. On the other hand, the weight of debentures issued subject to Government control went up following a rise of 65 percent in gross issue amount, which

Table XVII-3

LIABILITIES[a] OF FINANCIAL INSTITUTIONS, BY SECTOR, 1963-65

	IL million			Percent		
	1963	1964	1965	1963	1964	1965
Government	1,294.6	1,475.1	1,631.8	50.4	45.5	42.9
National Institutions and local authorities	27.4	32.1	48.8	1.1	1.0	1.3
Public sector companies[b]	33.5	76.3	131.9	1.3	2.4	3.5
Banking institutions	116.5	106.7	158.7	4.5	3.3	4.2
Social insurance funds	229.8	301.4	380.8	8.9	9.3	10.0
Insurance companies	7.2	8.0	7.5	0.3	0.2	0.2
Private businesses[c]	81.9	132.4	153.7	3.2	4.0	4.1
Nonprofit institutions	22.6	23.7	20.6	0.9	0.7	0.5
Rest of the world	244.3	312.5	375.4	9.5	9.6	9.8
Households	25.1	126.6	173.7	1.0	4.0	4.6
Accumulated profits	226.7	292.3	306.8	8.8	9.0	8.1
Unspecified[d]	262.5	357.3	409.8	10.2	11.0	10.8
Total	2,572.1	3,244.4	3,799.5	100.0	100.0	100.0

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

[1] IL 70 million of this as a result of the conversion of Government deposits into shares.

reached some IL 183 million. Issues in Israel rose by 93 percent and amounted to IL 137 million, of which 39 percent was deposited with the Accountant General (compared with 14 percent in 1964). Gross issues abroad rose by 16 percent and totalled IL 46 million, of which 23 percent was deposited with the Accountant General. Most of the debentures in foreign currency were issued by the mortgage banks, and the proceeds, less the sums transferred to the Treasury, were used for granting housing loans, mainly for privately built dwellings. In contrast to previous years, there was a marked increase in 1965 in the amount transferred to the Accountant General for financing the development budget. It should be noted that the proceeds not transferred to the Treasury are also used for giving credit under Government direction, and the distinction between the two categories merely indicates a certain division of issue proceeds among the various uses, in accordance with Government policy. In evaluating the Government's share in directing the financial institutions' operations, we have to determine the weight of liabilities to the Government, plus the balance of debentures and less credit to the Government, in the sector's total liabilities. The Government's share, so determined, has displayed a steady downtrend in recent years.

Another source of financing is nongovernmental deposits earmarked for loans, the weight of which in total liabilities has been moving up for some years. The balance of such accounts increased in 1965 by IL 95 million. Most of these sums were deposited by contractors and public construction companies, and some have been sold at a discount to various investors.

Paid-up share capital of the financial institutions grew in 1965 by 7 percent—which is lower than the previous year's rate—and totalled IL 790 million. The Government holds about 42 percent of this capital, while another 20 percent approximately is held by foreign investors.

Table XVII–4

DOMESTIC DEBENTURE ISSUES OF FINANCIAL INSTITUTIONS, 1961–65

(IL million)

Year	Amount issued	Transferred to the Treasury	
		IL m.	%
1961	45.4	31.5	69.4
1962	70.5	49.5	70.2
1963	71.0	34.0	47.9
1964	71.0	13.8	19.4
1965	136.7	53.4	39.1

5. Credit

The balance of credit extended by the financial institutions amounted at the end of 1965 to about IL 3,400 million—a rise of IL 517 million, or 18 percent, over the preceding year. Total outstanding credit increased more in 1965 than in 1964, but in percentage terms the growth was slower, and in some sectors there was even an absolute decline. This applies chiefly to the construction and housing sector, which received 30 percent less credit (net) than in 1964. This drop was partly connected with the slower expansion of construction activity in 1965 and the increase in early mortgage-loan repayments. Net credit to industry was down some 25 percent. Credit to the Government increased considerably, the growth being due to the depositing with the Accountant General of some of the proceeds from the issue of debentures at home and abroad.

Destination of credit

(a) *Government*

Oustanding credit to the Government rose in the year under review by IL 66.1 million, compared with an increase of only IL 1.5 million the year before. Most of this credit consisted of deposits with the Accountant General, while part of it was in the form of Government bonds. The gross amount deposited with the Accountant General was IL 64 million, of which IL 53.5 million was from the sale of debentures in Israel and IL 10.5 million from sales abroad. These deposits help finance residential construction under the development budget. It should be noted that the issue of debentures abroad and the depositing of part of the proceeds with the Accountant General is a new feature in the arrangements between the Government and the financial institutions.

(b) *Industry*

The net amount lent by the financial institutions to the industrial sector in 1965 came to IL 91 million, compared with IL 122 million in the previous year. Most of the credit was extended by the Industrial Development Bank (owned by the Government, banking institutions, and foreign investors), the bulk of it for a period of more than eight years. As of December 1963, borrowers were given an option between linking the loans to the consumer price index and paying an annual premium of 4 percent over and above the normal interest of some 8 percent p.a. The majority of borrowers chose unlinked loans in expectation of a rise in the index in excess of the premium. This arrangement was in force for loans granted by the Industrial Development Bank even before 1964. The Bank agreed to convert the index-linked loans given after the devaluation of 1962 for a period exceeding five years into unlinked loans in return for an annual premium of 4 percent. Most borrowers took advantage of this offer. The Government agreed to compensate the financial institutions for losses arising from the difference between the premium rate and the increase in the price index.

(c) *Agriculture*

Net credit to agriculture totalled IL 39 million in 1965, compared with IL 32 million in 1964. In contrast to previous years, the increase was not accounted for by the leading credit agency in this field, the Israel Bank of Agriculture. Some 45 percent of the amount lent during the year came from institutions which do not specialize in farm credits.

(d) *Construction and housing*

Outstanding credit for financing construction and housing increased in 1965 by IL 177 million, or 17 percent, and amounted to IL 1,121 million—one-third of aggregate outstanding credit by the sector. The net amount provided during the year was down some 30 percent from the 1964 level, following several years of continuous expansion. This drop was connected with the reduced activity in the building market and the steep rise in early mortgage repayments. Total new loans given by the mortgage banks to households remained at the previous year's level—about IL 180 million. On the other hand, the number of new loans fell from 20,000 in 1964 to 17,000 in 1965.[1]

The marked growth in early loan repayments was the main factor in the net decrease in housing credit. Total mortgage loan repayments were 58 percent greater than in 1964, which far exceeded the increment from the current obligations of borrowers. Early mortgage repayment was prominent in all the mortgage banks and was due to the expectation of a steep rise in the consumer price index, to which such mortgages are linked. Repayment on such a scale was apparently made possible by the wage differentials received by many employees. It should be pointed out that no steps have as yet been taken toward abolishing linkage in this sector, as has been done for industry and agriculture. In Septmber 1965 the Minister of Finance appointed a committee to examine the problem of linked mortgage loans given under Government direction (on its recommendations, see section 3 above).

The proportion of non-Government-directed loans in total housing credit rose in 1965 by 35 percent, compared with 26 percent in 1964. About half of these loans were granted from funds mobilized abroad; they bear interest of 10–11 percent per annum and are linked to the consumer price index.

The size of the average loan rose during the year to IL 10,600, compared with IL 8,900 in 1964. There were particularly striking increases in the average loan

[1] The increase in the average size of mortgage loans took place in a year when an attempt was made to limit it. In March 1965 the mortgage banks agreed to the request of the Ministry of Finance to restrict such loans to IL 10,000 for a period of one year.

Table XVII-5

BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS, BY FIRST SECTOR OF DESTINATION, 1964–65

Sector	1964	1965	Increase over previous year[a]	
			1964	1965
		IL million		
Government (incl. deposits with Accountant General)	385.5	451.7[b]	1.5	66.2
Industry	693.0	784.4	122.4	91.4
Agriculture	257.3	296.7	32.2	39.4
Construction[c]	943.8	1,120.6	235.8	176.8
Commerce	10.8	14.3	2.8	3.5
Services[d]	358.4	410.2	4.8	51.8
Households	31.0	32.7	1.5	1.7
Miscellaneous[e]	207.8	294.1	57.1	86.3
Total	2,887.6	3,404.7	458.1	517.1
		Percentages		
Government (incl. deposits with Accountant General)	13.3	13.3	0.5	17.2
Industry	24.0	23.0	21.5	13.2
Agriculture	8.9	8.7	14.3	15.3
Construction[c]	32.7	32.9	34.0	18.7
Commerce	0.4	0.4	35.0	32.4
Services[d]	12.4	12.1	1.4	14.5
Households	1.1	1.0	5.1	5.5
Miscellaneous[e]	7.2	8.6	37.9	41.5
Total	100.0	100.0	19.7	17.9

[a] Net of the increase in outstanding credit not actually extended during the year in question.
[b] Including IL 44.6 million in Government securities.
[c] Including credit for financing home purchases.
[d] Transport, hotels and other guest accommodation, education, health, and religion.
[e] Including credit to local authorities, National Institutions, and financial institutions, the destination of which is unspecified.

for immigrant housing—from IL 12,900 in 1964 to IL 16,500—and in non-Government-directed housing loans—from IL 9,000 to IL 12,500. The latter increase apparently reflected the difficulties experienced in the sale of dwellings during the year—larger mortgage loans were offered in an attempt to stimulate sales.

A notable development in the mortgage field during the year was the trade in deposits of building contractors and companies, which actually began in 1964. These funds were originally deposited in the mortgage banks in order to provide loans to home buyers for a period of five years, at 6 percent interest p.a.

and linked to the consumer price index. Subsequently, they were sold to the general public at a discount through the offices of the banking institutions, and also to institutional investors. The return to the investor on these deposits amounts to some 7 percent, after deduction of income tax at the rate of 25 percent on interest income. In addition, the investor benefits from linkage to the price index and from a guarantee of payment on the part of the banks. These investments are redeemed at yearly or half-yearly intervals. Because of the difficulty in selling dwellings, the volume of such activity grew during the year reviewed, the balance of these deposits at the end of 1965 standing at an estimated IL 70 million, compared with IL 20 million at the end of 1964.

6. Developments, by Type of Institution

(a) *Industrial development banks*

This group numbers five institutions, which deal exclusively in industrial credits. Total assets of the group amounted in 1965 to approximately IL 900 million, or about 25 percent of the sector's balance sheet.

The largest institution here is the Industrial Development Bank of Israel, which accounts for 80 percent of the total credit balance; two other major concerns are the Israel-American Industrial Development Bank and Otzar La'taasiya. The group's assets increased by 11 percent in 1965, compared with 16 percent in the previous year. Outstanding credit went up by IL 72 million, as against IL 111 million in 1964, and amounted to IL 730 million. The credits were financed through short-term bank loans (mainly in foreign currency),[1] share issues abroad, and debenture issues.

(b) *Agricultural credit funds*

This group numbers 17 institutions. Foremost among them is the Government-owned Israel Bank of Agriculture, whose weight in the group's balance sheet stands at 65 percent. The remaining institutions are joint funds connected with the various agricultural settlement organizations. They finance their operations chiefly from own means and through loans from banks and various financial institutions (in this respect they resemble secondary financial institutions).

For the second year running, this group displayed a slower growth trend in relation to both the previous year and to other financial institutions. Its balance sheet advanced by 5 percent to IL 419 million. The increase in outstanding credit came to IL 18 million, and was financed mainly by debenture issues and National Institution deposits. Nearly all of the growth was in one institution; the

[1] Loans from banks totalled IL 43 million and were intended as intermediate financing pending the mobilization of funds abroad.

others, including the Israel Bank of Agriculture, were stagnant and some even experienced a contraction of activity.

(c) *Institutions financing other sectors*

There are five institutions in this group, among them the Tourist Industry Development Corporation, the Maritime and Investments Bank, and the Local Authorities Bank. Total assets rose by almost IL 90 million, or 21 percent, and amounted to IL 510 million. Most of the increase in outstanding credit, which totalled IL 465 million at the end of the year, was due to the larger amount extended to the services sector, mainly shipping. Credit to local authorities, hotels, and agriculture also increased during the year.

(d) *Mortgage banks*

After rising steadily in previous years, the number of mortgage banks remained unchanged in 1965. Of the 16 institutions in this group, the four large banks—Tefahot, General Mortgage Bank, Housing Mortgage Bank, and Mortgage Development Bank—granted over 80 percent of all credit. Outstanding credit went up 26 percent, compared with 38 percent the year before, and totalled IL 1,160 million approximately.[1] The percentage increase in credit to home buyers and building companies was lower, since a considerable part of total credit (about 25 percent) was extended to the local authorities for various purposes.

Most of the mortgage bank loans are given under Government direction, in view of its preponderant role in financing the banks. The share of Government-directed loans in the total credit balance of the mortgage banks comes to about 80 percent. The credit was financed from four main sources in 1965: Government deposits (about 35 percent), debenture issues (about 30 percent),[2] deposits of building contractors sold to the public (about 20 percent), and company and institution deposits (about 15 percent). During the year the mortgage banks issued debentures to the amount of IL 108 million—some IL 70 million in Israel and IL 38 million abroad. Of the proceeds, approximately IL 27 million was transferred to the Accountant General. Funds raised abroad during the year were used primarily to finance private building, while the balance, some IL 6 million only, was transferred to the Acountant General.

In addition to granting mortgage loans from their own resources and earmarked deposits, the banks in 1965 administered three saving schemes for individual home buyers,[3] one of them for nonresidents. Total deposits in these schemes came to approximately IL 14 million.

[1] Excluding credit to the Government.
[2] Net of the sum transferred to the Government.
[3] Apart from the Saving-for-Housing scheme administered by Bank Tefahot.

(e) *Investment companies*

In 1965 there were 16 companies engaging primarily in portfolio investment. Most of them were established by commercial banks, which maintain a controlling interest in them. While these companies are in the same field of activity, there are several distinct differences between them. Some engage not only in portfolio investment, but also in the granting of credit to various sectors of the economy from deposits (mainly Government) and from the proceeds of debenture issues (the Bank Leumi Investment Company, for example). In this respect they resemble other financial institutions which lend to other sectors of the economy. One difference arises from the nature of investment in securities. Some of the institutions' portfolios are broadly dispersed, so that they do not gain control of the companies in which they invest; from this aspect they resemble unit trusts. On the other hand, some institutions concentrate their investment with the object of obtaining full or partial control of the companies in which they invest, and even take an active part in running them.

Total assets of the investment companies rose during the year by 21 percent, compared with 47 percent the year before, and reached IL 413 million. Of this sum, about IL 197 million was invested in nongovernmental securities, IL 7 million in Government securities, and the rest in loans and deposits. The growth of security investment was more moderate than in 1964—7 percent only. Developments in the share market after the middle of 1964 contributed to this slowdown in two ways: difficulty was experienced in raising additional capital through public issues, and the composition of portfolio investment underwent a change, the proportion of unlisted shares and of debentures going up. As to the sectorial composition of investments, those in banks and financial institutions rose somewhat, while those in industry declined.

(f) *Household finance companies*

This group numbers 18 institutions, the main ones being Otzar Hahayal. Yahav, and Idud, and the remainder being private institutions operating on a small scale. Total assets amounted to IL 58 million, or less than 2 percent of the sector's balance sheet. Outstanding loans to households added up to about IL 37 million, or two-thirds of all assets held by these institutions.

(g) *Unit trusts*

Seven unit trusts were in operation in 1965. These institutions raise funds by issuing participation certificates to the general public through the companies running them (the latter are subsidiaries of commercial banks), and they invest the proceeds in securities.

Four of the institutions operate as cumulative trusts, i.e. they do not distribute dividends but reinvest all their income; the other three distribute dividends either in cash or in the form of participation certificates.

Since most of the trusts' assets are invested in securities registered on the Stock Exchange, their progress depends to a decisive extent on the position of the stock market. The depressed state of the market, which continued in 1965, was reflected *inter alia* in the reduction of unit trust investments as a result of the drop in the value of the investments and the cashing-in of participation certificates. In most of the trusts redemption of existing certificates exceeded the amount issued during the year; this was a reversal of the trend of previous years, when issue amount exceeded redemption payments. Net redemption in 1965 amounted to IL 3.8 million at par value, or IL 4.8 million at issue price; this brought down the balance of outstanding participation certificates to IL 23.9 million at par value, or IL 40.2 million at issue price.

The composition of the unit trusts' investment portfolio changed slightly during the year, the proportion of equities falling from 71 to 66 percent and that of debentures going up from 22 to 29 percent. It should be noted that the unit trusts, as a group, have not evinced great adaptability in selecting their investments during the stock market slump. The overall rates of return on investment in unit trust participation certificates might have been expected to decline more moderately than the average rate of return on listed stocks; in actual fact, the decline was almost identical.

7. Flow of Funds, by Sector

The financial institutions are one of the financial sectors which channel funds to the real sectors, such as industry, agriculture, and construction. A sectorial analysis of money flows (see Table XVII–6) shows *inter alia* which sectors serve as a source of funds for the financial institutions and which resort to them for financing. It should be emphasized that the financial institutions' flow of funds is largely determined by other sectors, particularly the public sector, and that these institutions do not have a decisive say in the size and distribution of such flows.

The volume of financial institution transactions[1] increased during the year by 7 percent, totalling IL 755 million as against IL 706 million in 1964. Financial transactions declined somewhat during the year, reflecting the slower development of the institutions, as described above.

As in the previous year, the sectors which granted the financial institutions net credit were the Government, social insurance funds, banking institutions, and the rest of the world. Public sector companies were net recipients of credit, in contrast to their position the year before.

[1] The volume of transactions is measured here as total current expenditure, which consists mostly of interest payments, outlay on capital account, and the increase in financial assets; this sum is identical with total current income, which consists mainly of interest receipts, plus the increase in the obligations of the financial institutions.

Table XVII-6

"BALANCE OF PAYMENTS" OF THE FINANCIAL INSTITUTIONS, BY SECTOR, 1964–65

(IL million)

Transaction and sector	Receipts			Payments			Balance of receipts over payments	
	1964	1965	Increase or decrease (–)	1964	1965	Increase or decrease (–)	1964	1965
Nonfinancial transactions	174.4	234.3	59.9	150.4	224.5	74.1	24.0	9.8
Transactions in financial assets								
Government	165.5	156.7	–8.8	1.5	66.1	64.6	164.0	90.6
National Institutions and local authorities	4.7	16.7	12.0	59.0	82.7	23.7	–54.3	–66.0
Public sector companies	42.8	55.6	12.8	–16.6	70.9	87.5	59.4	–15.3
Banking institutions	25.2	52.0	26.8	8.1	3.0	–5.1	17.1	49.0
Social insurance funds	60.6	79.4	18.8	1.6	–1.2	–2.8	59.0	80.6
Insurance companies	0.8	–0.5	–1.3	1.0	0.3	–0.7	–0.2	–0.8
Private business[a]	50.5	21.3	–29.2	328.1	196.4	–131.7	–277.6	–175.1
Nonprofit institutions	1.1	–3.1	–4.2	25.7	–1.1	–26.8	–24.6	–2.0
Rest of the world	68.2	62.9	–5.3	–3.1	0.3	3.4	71.3	62.6
Households[b]	15.0	47.1	32.1	147.3	111.1	–36.2	–132.3	–64.0
Unspecified[c]	97.3	32.6	–64.7[d]	—	—	—	97.3	32.6
Total transactions in financial assets	531.7	520.7	–11.0	552.6	528.5	–24.1	–20.9	–7.8
Errors and omissions[e]	—	—	—	3.1	2.0	–1.1	–3.1	–2.0
Total receipts and payments	706.1	755.0	48.9	706.1	755.0	48.9	—	—

[a] Including farms.
[b] Including contractors' deposits sold to households through the banking institutions.
[c] Including securities sold on the Stock Exchange.
[d] The big decrease in receipts from unspecified sectors was due primarily to the reduced volume of shares issued on the Stock Exchange (the purchasers of such shares are generally unknown).
[e] Errors and omissions arise from the fact that the volume of nonfinancial transactions has to be estimated because of the institutions' delay in reporting.

Net receipts from the Government decreased by IL 73 million and amounted to IL 91 million. This was due to some decline in purchases of shares and in deposits for loans purposes on the one hand, and to the larger amount of debenture proceeds deposited with the Accountant General on the other.

The volume of transactions between the Government and the financial institutions does not necessarily reflect the volume of financing provided by the Government to the various sectors of the economy, since much of the credit is given directly and not through the financial institutions.

Net receipts from the social insurance funds amounted to IL 81 million, as compared with IL 59 million in 1964. This sum consisted mainly of the proceeds of debentures issued by the financial institutions. The funds, it will be recalled, are required to invest a considerable share of their accumulation in accordance with Treasury directives, such investment including financial institutions debentures. Changes in the volume of the funds' receipts are therefore influenced by Treasury policy.

Receipts from abroad dropped slightly during the year, from IL 71 million to IL 63 million. This was due to the somewhat smaller volume of shares issued abroad. Debenture proceeds, on the other hand, were somewhat larger.

Net receipts from the banking institutions amounted in 1965 to IL 49 million, compared with IL 17 million in 1964. Most of the increase was in short-term loans for financing industrial credits.

The sectors which received net credit from the financial institutions were private business, households, local authorities, and public sector companies. Net payments to the private business sector declined during the year by some IL 100 million and amounted to about IL 175 million. This decline was reflected both by the smaller amount of net credit advanced to the sector and by the reduced investment in its securities. Net payments to households dropped from IL 132 million in 1964 to IL 64 million. This can be attributed to the marked rise in mortgage repayments in contrast to the nonincrease in loans to home buyers, and also to the substantial growth of household investment in contractors' deposits, as described above.