

## CHAPTER XVII

# FINANCIAL INSTITUTIONS<sup>1</sup>

### 1. MAIN DEVELOPMENTS

THE VOLUME OF BUSINESS conducted by financial institutions expanded greatly in 1966, in contrast to the standstill in the country's economic activity and the sharp drop in investments. This growth was reflected by an increase of IL 745 million, or 20 percent, in the institutions' asset portfolio—which brought the total up to IL 4,500 million—as compared with an increase of IL 555 million, or 17 percent, in the previous year. The balance of credit extended by the institutions went up by 22 percent, as against 18 percent in 1965, to stand at approximately IL 4,165 million.

The striking growth in the credit outflow of this sector in 1966, at a time when economic activity had tapered off, can be ascribed to two main factors: an increase in credit to the Government, which is not directly connected with the level of economic activity, and the much larger amount provided to the housing and construction sector, which experienced a slump. The growth of industrial and farm credits continued to slow down as a result of the slackening of demand for investment funds; however, this did not affect the rapid expansion of the financial institutions, owing to the marked rise in outstanding credit to the Government and the construction sector, which accounts for about half the total figure.

Credit to the Government was provided under the institutional arrangements whereby some of the institutions have been permitted to issue debentures on condition that part of the proceeds are used to grant loans under Government direction and part are transferred directly to the Treasury. Debenture issues are taken up largely by the social insurance funds, which have to invest in securities approved by the Government—among them debentures issued by the financial institutions—in return for income tax concessions. The extension of credit to the Government in this form has replaced the direct issue of Government bonds to the social insurance funds, and it reflects the control exercised

<sup>1</sup> Financial institutions are defined as financial intermediaries primarily engaged in the mobilization of funds for investment in financial assets, i.e. loans and securities. Excluded from this sector are banking institutions, social insurance funds, and insurance companies, which are discussed separately. Also excluded are holding companies, a large part of whose assets consists of investment in subsidiaries, and companies financed by a limited number of proprietors and which therefore cannot be regarded as financial intermediaries.

by the Government over the capital market. In 1966 the balance of credit to the Government went up by IL 184 million, as compared with IL 66 million the year before. The source of this growth was the increase in debentures issued by the financial institutions and in the amount of proceeds transferred to the Accountant General, as well as the larger amount borrowed from abroad, the proceeds from which were transferred to the Accountant General.

Another factor, as already mentioned, was the situation in construction activity. Because of the slump which hit this sector and led to the accumulation of unsold dwellings in the hands of contractors and building companies, the financial institutions expanded their credit to them with the help of the Government and through the issue of debentures. In addition, the mortgage banks increased the average size of their loans to home buyers, mainly to those purchasing from private builders, in an effort to stimulate sales. (Other steps taken to boost sales were the reduction of housing prices and the granting of unlinked loans by contractors to home buyers.)

The fall in housing sales, reflected by the smaller number of loans granted during the year by the mortgage banks, did not, however, result in a decline in total mortgage lending owing to the larger average size of the loans. Outstanding credit to the construction and housing sector rose by nearly IL 290 million, compared with approximately IL 180 million in 1965. Most of this credit was granted by the mortgage banks, which enlarged their asset portfolio by over IL 400 million—more than double the previous year's increment.

The two factors described above—the increase in credit to the Government, which is not directly connected with the level of economic activity, and the larger amount lent to the construction sector—explain the expansion of the financial institutions' operations during the year reviewed. While credit to industry, agriculture, and the services was smaller than in 1965, that granted to the Government and the construction sector, as already stated, was increased considerably, so that the total amount provided was appreciably larger.

The depressed state of the securities market prevented the financial institutions from mobilizing funds in this market, as they did in 1963 and 1964. Those institutions which engage mainly in the issue of shares to the public and in Stock Exchange investment curtailed their operations and sustained considerable capital losses. Included among these institutions are some of the investment companies and the unit trusts. The latter redeemed a large portion of their participation certificates and greatly reduced their investment portfolio. Nevertheless, the assets of the investment companies as a whole expanded markedly—from IL 413 million in 1965 to IL 556 million; this was due to the increase in their credit operations financed by the Government and by overseas sources, investment in securities falling off by IL 25 million.<sup>1</sup>

<sup>1</sup> Part of the decline resulted from the transfer of the investment portfolio of one of the investment companies to its subsidiaries.

As in the previous year, the sector's operations were financed from two principal sources: debenture issues, which for the most part were taken up by the social insurance funds, and deposits earmarked for loans, which came in the main from the Government. The debentures are issued under Government control, and this, plus the large share of the Government in earmarked deposits, gives it a decisive influence over the volume and destination of the credit granted by the institutions, despite the fact that only a few of the institutions are owned entirely by the Government (on the nature of the financial institutions, see section 2 below). During the year reviewed the financial institutions issued IL 273 million worth of debentures, nearly 50 percent over last year's figure. Of this sum, the amount issued abroad came to IL 62 million, compared with IL 46 million the year before. The overseas issues are in foreign currency, and as the loans granted out of the proceeds are not linked to the dollar, they are insured with the Government-owned insurance company Yuval against the possibility of devaluation. Debenture issues in Israel amounted to IL 211 million, with the major part—some 56 percent—being floated by the mortgage banks. Debentures issued in Israel and abroad financed about 34 percent of the sector's incremental investment in 1966.

The main source of finance in the year reviewed was Government deposits for loan purposes. These rose by IL 240 million, or 19 percent, as against

Table XVII-1

COMBINED BALANCE SHEET TOTALS OF FINANCIAL INSTITUTIONS,  
BY TYPE, 1965-66

(End of period)

	No.	IL million		Percent		Percent increase or decrease (-) as against previous year	
		1965	1966	1965	1966	1965	1966
Mortgage banks	17	1,463.0	1,866.6	38.5	41.1	23.5	27.5
Industrial development banks	5	895.7	947.9	23.6	20.9	11.2	5.8
Institutions granting loans to other sectors <sup>a</sup>	4	488.9	570.3	12.9	12.6	19.0	16.6
Agricultural credit funds	18	440.1	505.5	11.5	11.1	7.0	14.9
Investment companies	16	413.5	556.0	10.9	12.2	21.5	34.5
Household finance companies	18	58.1	65.5	1.5	1.4	12.6	12.7
Unit trusts	7	40.2	32.2	1.1	0.7	-5.9	-20.0
<b>Total</b>	<b>85</b>	<b>3,799.5</b>	<b>4,544.0</b>	<b>100.0</b>	<b>100.0</b>	<b>17.1</b>	<b>19.6</b>

<sup>a</sup> For tourism, shipping, and local authorities.

IL 150 million, or 13 percent, in 1965 and totalled IL 1,516 million. However, the Government's share in the institutions' aggregate liabilities did not rise in 1956, because of the more rapid increase in other sources of finance, notably debentures, and it stood at some 41 percent.

## 2. TYPES OF FINANCIAL INSTITUTIONS

This sector numbers 85 financial institutions, which break down into seven groups, as shown in Table XVII-1. Although some of them are designated as banks, they are distinguished from banking institutions (which are dealt with separately) in that they engage primarily in the granting of long-term credit—sometimes for up to 20 years or more—in contrast to the banks, which deal mainly in short-term credit. Accordingly, their sources of finance differ from those of the banks, the majority being long-term funds such as shares, debentures, and earmarked deposits.

By far the largest of the seven groups are the mortgage banks, which deal chiefly in loans to home buyers. They account for 41 percent of total assets of the sector. Next in size come the industrial development banks, which include the Industrial Development Bank, the Israel-American Industrial Development Bank, and Otzar La'taasiya. Also included under financial institutions are investment companies which, besides investing in securities, provide credit to various branches of the economy; agricultural credit funds, including the Israel Bank of Agriculture and joint funds of the various settlement organizations; household finance companies; unit trusts, which issue participation certificates to the public and invest in securities listed on the Stock Exchange; and four institutions which extend credit to other branches, such as shipping, tourism, and local authorities.

Unlike financial institutions in other countries, those in Israel obtain only a very small percentage of their funds directly from households. Household savings reach them mainly indirectly and to a large extent under Government direction, through the investment by social insurance funds in the institutions' debentures.

The Government plays a decisive role in financing the operations of the sector and in directing its investments. The rapid expansion of the institutions has not come about by the development of a free capital market, as in other countries. This market has remained relatively small and has been unable to provide the financial institutions with any substantial amount of funds. It is mainly the Government that has encouraged and financed their operations. The Government's access to overseas sources of finance (loans and unilateral receipts), its control of foreign currency, and its domination of internal sources of finance such as the bond market, have given it a decisive influence over the flow of long-term credit in the economy. Owing to the limited scope of the free capital market and the Government's control over the supply of capital, a

large number of financial institutions have sprung up. They serve largely as an instrument for allocating credit to the various branches of the economy at the Government's behest, employing funds which the Government places directly at their disposal. These are mainly earmarked deposits or other sources which the Government controls, such as debenture issues. These two sources together account for two-thirds of total financial institution liabilities.

Government influence on the financial institutions' operations is expressed not only in the direction of credit, but also in the determination of its price and terms of repayment. The Government sets the interest rates and the conditions of the loans according to their destination, even when it does not finance them directly. In such cases the Government covers losses incurred by the financial institutions as a result of the difference between the cost of the capital they mobilize and the price of the credit they grant under Government direction.

The degree of Government influence varies among the financial institutions. It is considerable in most of the large institutions, such as the Industrial Development Bank, Israel Bank of Agriculture, Tefahot, General Mortgage Bank, Maritime Bank, Tourist Industry Development Corporation, and Housing Mortgage Bank, some of which are owned outright by the Government. The institutions whose operations are directed by the Government predominate in the sector. Institutions whose activities are not directed by the Government and which are not financed by Government funds or sources under direct Government control include investment companies and unit trusts—which raise funds through the Stock Exchange—as well as household finance companies and joint agricultural credit funds. However, these institutions form only a small part of the sector.

### 3. LOAN LINKAGE POLICY

In the last few years the linkage of agricultural and industrial loans has been discontinued and replaced by the payment of a fixed annual premium. During the year reviewed arrangements were made to abolish linkage in other sectors of the economy. At the beginning of 1966 the Government accepted some of the recommendations of the special committee set up to examine linkage arrangements in force for mortgage loans granted from Government funds, and instead of linkage to the consumer price index, the loans are now pegged to the cost-of-living allowance. The Government did not instruct the banks to synchronize the rise in mortgage payments with the payment of an increase in the cost-of-living allowance, as the committee had recommended. These arrangements have given rise to several major problems. First, the breakdown of loans by source of finance does not correspond to the breakdown of the types of housing by the economic situation of the borrowers:

some of the loans under the Saving-for-Housing scheme have been granted from Government funds, while part of the loans to immigrants have been granted by mortgage banks, to whom the concessions do not apply. Secondly, both indexes rose in 1966 to almost the same extent—the consumer price index went up by 7.8 percent, while the index used for calculating the cost-of-living allowance rose by 7.3 percent—and consequently the new arrangement did not result in any real alleviation. At the beginning of 1967 talks began on the discontinuation of loan linkage for all types of publicly financed housing, including retroactive arrangements, and its replacement by the payment of a fixed annual premium. Some steps in this direction have already been taken in respect of new loans.

In 1966 the linkage of loans to hotels and transport companies was cancelled retroactively and replaced by the payment of an annual premium of 3–4 percent, in line with the procedure adopted in the previous year with regard to new loans for such purposes. Thus, the loan linkage system, which was adopted in the fifties and covered most of the long-term credit granted by the Government or under its direction, has been greatly reduced in scope. It should be noted that the abolition of the linkage clause does not apply to debentures. The financial institutions continue to issue linked debentures to finance their operations, and the suspension of the linkage of loans granted from the proceeds imposes on the Treasury the obligation to compensate the institutions if the annual premium is less than the rise in the consumer price index, to which the debentures are pegged.

#### 4. ASSETS AND LIABILITIES

##### (a) *Assets*

Total assets of the financial institutions expanded in 1966 by IL 745 million, or 20 percent, compared with IL 555 million, or 17 percent, the year before. These are mostly financial assets—in the main loans, and to a smaller degree deposits and securities; immovable property forms a very small percentage of the total. The balance of credit granted by the institutions, which accounts for 90 percent of all assets, increased in 1966 by 22 percent, as against 18 percent the year before, and totalled some IL 4,165 million. Particularly striking were the 40 percent rise in deposits with the Accountant General and that of 20 percent in loans from Government deposits. Loans to the public from the institutions' own means—mostly equity capital and debentures—rose by only 14 percent, as contrasted with 37 percent in 1965. The institutions' securities portfolio shrank by IL 25 million, or 8 percent, to stand at IL 284 million, or approximately 6 percent of total assets. This decline was connected with the falling trend of Stock Exchange prices and was particularly conspicuous in the unit trusts and investment companies.

Table XVII-2

## ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS, 1965-66

	IL million		Percent		Increase or decrease (-) from 1965 to 1966	
	1965	1966	1965	1966	IL m.	%
<b>Assets</b>						
Cash and bank deposits	53.7	60.8	1.4	1.3	7.1	13.2
Credit to the public from own means	1,402.8	1,604.6	36.9	35.3	201.8	14.5
Credit to the public from Government deposits	1,271.8	1,528.0	33.5	33.7	256.2	20.1
Credit to the public from deposits earmarked for loans	278.3	391.7	7.3	8.6	113.4	40.7
Loans to the Government	456.7	640.0	12.0	14.1	184.2	40.3
Nongovernmental securities <sup>a</sup>	308.9	284.2	8.2	6.3	-24.7	-8.0
Immovable assets	27.3	33.8	0.7	0.7	6.5	23.8
<b>Total</b>	<b>3,799.5</b>	<b>4,544.0</b>	<b>100.0</b>	<b>100.0</b>	<b>744.5</b>	<b>19.6</b>
<b>Liabilities</b>						
Equity capital	973.2	1,033.3 <sup>b</sup>	25.6	22.7	60.1	6.2
Debentures	773.5	1,028.1	20.4	22.6	254.6	32.9
Deposits and loans from banks	89.8	124.3	2.4	2.7	34.5	38.4
Government deposits earmarked for loans	1,275.9	1,516.3	33.6	33.4	240.4	18.8
Nongovernmental deposits earmarked for loans	333.8	457.0	8.8	10.1	123.2	36.9
Other deposits and loans	217.4	264.2	5.7	5.8	46.8	21.5
Demand deposits	11.7	17.0	0.3	0.4	5.3	45.3
Other accounts (net)	124.2	103.8	3.2	2.3	-20.4	-16.4
<b>Total</b>	<b>3,799.5</b>	<b>4,544.0</b>	<b>100.0</b>	<b>100.0</b>	<b>744.5</b>	<b>19.6</b>
<b>Contingent accounts</b>	<b>122.0</b>	<b>196.8</b>	<b>—</b>	<b>—</b>	<b>74.8</b>	<b>61.3</b>

<sup>a</sup> Including investments in subsidiary companies.

<sup>b</sup> Of this sum, 31.1 percent was held by the Government.

(b) *Liabilities*

The financial institutions' liability structure underwent several significant changes during the year. The proportion of debentures went up from 20 to 23 percent as a result of increased issues in Israel and abroad. Gross issues amounted to nearly IL 273 million, of which IL 62 million was from abroad. The net increment (gross issues less redemption) brought up the outstanding balance from IL 773 million to IL 1,028 million; of this sum, approximately

25 percent was held by foreign investors, and most of the remainder by social insurance funds. Share capital rose by only IL 27 million, and its weight in total liabilities continued downward to 23 percent. The drop was due to the difficulty of floating new issues because of the depressed state of the equity market.

Table XVII-3

LIABILITIES\* OF FINANCIAL INSTITUTIONS, BY SECTOR, 1964-66

	IL million			Percent		
	1964	1965	1966	1964	1965	1966
Government	1,475.1	1,631.8	1,859.7	45.5	42.9	40.9
National Institutions and local authorities	32.1	48.8	71.8	1.0	1.3	1.5
Public sector companies <sup>b</sup>	76.3	131.9	137.2	2.4	3.5	3.0
Banking institutions	106.7	158.7	221.3	3.3	4.2	4.9
Social insurance funds	301.4	380.8	493.7	9.3	10.0	10.9
Insurance companies	8.0	7.5	14.0	0.2	0.2	0.3
Private businesses <sup>c</sup>	132.4	140.7	157.5	4.1	3.7	3.5
Nonprofit institutions	23.7	20.6	57.7	0.7	0.5	1.3
Rest of the world	312.5	375.4	509.2	9.6	9.9	11.2
Households	126.6	160.7	188.4	3.9	4.2	4.1
Accumulated profits	292.3	306.8	316.2	9.0	8.1	7.0
Unspecified <sup>d</sup>	267.3	303.5	367.9	8.2	8.8	8.1
Intrasector liabilities	90.0	132.3	149.4	2.8	2.7	3.3
Total	3,244.4	3,799.5	4,544.0	100.0	100.0	100.0

\* Including equity capital and participation certificates.

<sup>b</sup> Companies owned by the Government, National Institutions, or local authorities.

<sup>c</sup> Including farms.

<sup>d</sup> Including sales on the Tel Aviv Stock Exchange.

Government deposits for loans purposes expanded conspicuously. The increase came to IL 240 million, or about 19 percent, bringing the total up to IL 1,516 million, or some 34 percent of total liabilities. About two-thirds of the incremental deposits were in mortgage banks. Nongovernmental deposits for loans purposes were up about 37 percent, and their weight in total liabilities came to 10 percent. Most of the increase was in deposits with mortgage banks and with agricultural credit funds. Part of the deposits were made by contractors for granting loans to their customers. In previous years some of these deposits were sold to the public through various banking institutions, but in 1966 such sales were on a small scale.

Deposits and loans from banks increased by 38 percent and totalled IL 124 million. Most of the increment went to agricultural credit funds and investment companies.

**Table XVII-4**  
**DOMESTIC DEBENTURE ISSUES OF FINANCIAL**  
**INSTITUTIONS, 1961-66**  
 (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
1966	210.9	122.8 <sup>a</sup>	58.2

<sup>a</sup> In addition to this, the financial institutions transferred to the Accountant General about IL 33 million received from issues abroad.

## 5. CREDIT

The balance of credit extended by the financial institutions amounted to IL 4,165 million at the end of 1966—a rise of IL 755 million, or 22 percent, over the preceding year. This was the highest growth rate in the past four years. Nearly 65 percent of the increase was accounted for by the housing and construction sector and the Government. Credit to other sectors of the economy—industry, agriculture, and the services—expanded only slightly, and their weight in total outstanding credit declined from 43 to 38 percent.

### (a) *Government*

Outstanding credit to the Government rose by IL 184.2 million, as against IL 66.2 million the year before, and totalled approximately IL 641 million. The increment consisted of IL 193.4 million in deposits with the Accountant General and a decline of IL 9.2 million in Government securities held by the financial institutions. Deposits with the Accountant General are made under an arrangement between the Government and the financial institutions whereby the latter may issue debentures—which are mostly taken up by the social insurance funds and also by foreign investors—on condition that part of the proceeds are used for granting credit under Government direction, and part are transferred to the Accountant General as a long-term deposit. Only a small portion of the proceeds from domestic issues is used for nondirected loans. During the year reviewed the institutions transferred to the Accountant General some IL 123 million in proceeds from local issues (58 percent of total issue amount) and IL 33 million from issues abroad. Another component of incremental outstanding credit to the Government was loans from abroad, the receipts from which were also transferred to the Accountant General.

(b) *Industry*

The net amount lent to industry in 1966 came to IL 68 million, as compared with IL 91 million the year before. Outstanding industrial credit in 1966 totalled IL 852 million, or 21 percent of all outstanding credit granted by the financial institutions.

The continued deceleration of the growth of such credit in 1966 was connected with the smaller demand for loans, in contrast to the excess demand of previous years. The volume of industrial credit is largely determined by the amount of the funds which the Government places at the institutions' disposal for this purpose, either directly or indirectly (through the issue of securities under Government control). The slackening of demand for industrial credit apparently reflects the marked contraction of investment activity in this sector during the year reviewed.

(c) *Agriculture*

The balance of farm loans went up by IL 33 million, as against IL 39 million in 1965, and amounted to IL 329 million, or 8 percent of total outstanding credit extended by the institutions. The slower rise in the net amount provided agriculture in 1966 occurred despite a marked increase in the balance of credit granted by the institutions financing this sector, and is explained by the fact that they lent a substantial part of their funds to other sectors, especially the construction sector and the Government. The reason for the smaller growth in the amount granted agriculture is to be found in the continuation of the downtrend in agricultural investment which began in 1965.

(d) *Construction and housing*

Credit for financing construction and housing went up by IL 289 million, or 26 percent, to reach IL 1,409 million—one-third of the aggregate balance. This is a striking rise compared with that of IL 177 million, or 19 percent, in the previous year. Most of the increase was accounted for by building companies, whereas gross credit for the purchase of homes remained at the same level as in 1965, totalling some IL 180 million. The number of loans given for this purpose dropped by about 8 percent, but their average size came to IL 10,800, as against IL 10,300 in 1965 and IL 8,900 in 1964. The biggest increase was in loans for the purchase of homes from private builders—from an average of IL 11,500 in 1965 to IL 13,700 in 1966. While the number of loans for publicly sponsored housing rose slightly, those for homes put up by private builders fell 33 percent compared with the previous year. Moreover, the average loan for private housing was increased by a substantial 19 percent in an attempt to stimulate sales, while the average loan for public housing increased to only a modest extent. Another incentive given in 1966 by private

Table XVII-5

**BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS,  
BY FIRST SECTOR OF DESTINATION, 1965-66**

Sector	1965	1966	Increase or decrease (-) as against previous year	
			1965	1966
<b>IL million</b>				
Government, incl. deposits with Accountant General	456.7	640.9 <sup>a</sup>	66.2	184.2
Industry	784.4	852.1	91.4	67.7
Agriculture	296.7	329.3	39.4	32.6
Construction and housing	1,120.6	1,409.4	176.8	288.8
Commerce	14.3	25.1	3.5	10.8
Services <sup>b</sup>	378.2	407.1	51.8	28.9
Households	32.7	28.2	1.7	-4.5
Miscellaneous <sup>c</sup>	326.1	473.0	86.3	146.9
<b>Total</b>	<b>3,409.7</b>	<b>4,165.1</b>	<b>517.1</b>	<b>755.4</b>
<b>Percentages</b>				
Government, incl. deposits with Accountant General	13.3	15.4	17.2	40.3
Industry	23.0	20.5	13.2	8.6
Agriculture	8.7	7.9	15.3	11.0
Construction and housing	32.9	33.8	18.7	25.8
Commerce	0.5	0.6	32.4	75.5
Services	11.1	9.8	14.5	7.6
Households	1.0	0.7	5.5	-13.0
Miscellaneous <sup>c</sup>	9.5	11.3	41.5	45.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>17.9</b>	<b>22.2</b>

<sup>a</sup> Of this, IL 35.4 million was in Government securities.

<sup>b</sup> Transport, hotels and other guest accommodation, education, health, and religion.

<sup>c</sup> Including credit to local authorities and National Institutions, the destination of which is unspecified.

contractors was the granting of unlinked loans to home buyers through the mortgage banks.

Early mortgage loan repayments continued upward in 1966, but at a more moderate rate than in 1965, when it was extremely high and a conspicuous feature in all the mortgage banks. The slower growth of such repayments during the year reviewed was apparently connected with the decline in part of the borrowers' incomes—which was also reflected in an increase in arrears—and with the expectation that prices would stabilize and that new arrange-

ments would be made between the Government, banks, and home buyers in order to lighten the burden of linkage-differential payments (some of the arrangements already came into effect in 1966).

Whereas credit to home buyers remained at the same level as in 1965, there was a significant rise in the amount granted to contractors and building companies hit by the depression in the housing market, which led to an accumulation of unsold dwellings. This credit was financed by the Government and through the large-scale issue of debentures.

## 6. DEVELOPMENTS, BY TYPE OF INSTITUTION

### (a) *Industrial development banks*

This group numbers five institutions which deal primarily in industrial credit. The biggest is the Industrial Development Bank, which accounts for 80 percent of the group's combined balance sheet; two other major concerns are the Israel-American Industrial Development Bank and Otzar La'taasiya. As in 1965, the group's development was slow: total assets, which consist largely of industrial credits, grew by some IL 50 million, or 6 percent, compared with IL 90 million in 1966 and IL 115 million in 1964. The group's weight in the balance sheet of the financial institution sector fell from 24 percent in 1965 to 21 percent. In the past, business volume largely depended on the sources of finance which the Government put at their disposal, but in 1966 the slower increase in outstanding credit can also be attributed to the smaller demand for loans. The credit granted during the year reviewed was financed in the main from earmarked deposits, and to a lesser extent from the proceeds of debentures issued in Israel and abroad. The short-term bank loans raised in 1965 for the intermediate financing of industrial credits have not yet been converted into long-term liabilities.

### (b) *Agricultural credit funds*

This group comprises 18 institutions, the largest of which is the Government-owned Israel Bank of Agriculture. The remaining institutions are joint funds connected with the various agricultural settlement organizations, and which finance their operations through the participation of the settlements in the equity capital and through loans from banks and financial institutions. Also included in the group are a number of institutions connected with the Jewish Agency.

Compared with the two preceding years, the group developed rapidly in 1966. Its assets, which consist in the main of agricultural credits, increased by IL 65 million, or 15 percent, and totalled IL 505 million. However, only about half the increment went to agriculture, the remainder going to other sectors, mainly construction. The credits were financed primarily from ear-

marked Government deposits, debenture issues, and loans and deposits from institutions and banks. The growth in business volume was concentrated in three institutions: the Palestine Agricultural Settlement Association, Nir, and the Bank of Agriculture. Development of the joint funds continued to be very sluggish.

(c) *Institutions financing other sectors*

In this group are the Tourist Industry Development Corporations, the Maritime Bank, the Local Authorities Bank, and Igarot. Its assets increased by some IL 80 million during the year reviewed to stand at IL 570 million. Most of the incremental outstanding credit originated in the deposit with the Accountant General of the proceeds of a foreign loan. There was also an increase in the amount provided to local authorities, as well as in that granted to tourist enterprises through banks and other financial institutions.

(d) *Mortgage banks*

The continued slump in construction activity did not result in any contraction of mortgage banking business in 1966. On the contrary, the banks considerably expanded their credit operations, and this at a rate comparable with that during peak building periods. Mortgage bank assets rose by 28 percent, as against 24 percent in 1965, and amounted to IL 1,867 million, or 41 percent of total assets of the financial institution sector. The depression in the housing market affected both the size and composition of the group's asset portfolio. Credit to households, which is directly connected with housing sales, fell considerably even though, as has already been pointed out, gross credit to home buyers did not decline. On the other hand, a larger amount was extended in 1966 to contractors and building companies following the accumulation of a stock of unsold dwellings and the worsening of their liquidity position. Credit to local authorities and the Government also rose markedly, but not all of such credit was directly connected with the construction sector. Thus the growth of the mortgage banks in 1966 was not limited by the demand for housing loans, and they managed to lend out the substantially larger amount of funds which they raised this year with the help of the Government, without this being accompanied by any drop in the price of the loans. In this respect they were not affected by the building slump, a conclusion strengthened by some of the profit and loss statements, which show a stable rate of gross profit in relation to equity capital as compared with the preceding year.

The appreciable growth in mortgage lending was made possible by the receipt of Government deposits for this purpose—the balance of such deposits expanded by about IL 125 million—as well as by the issue of debentures on a far larger scale than the year before—IL 154 million as against IL 108 million. The amount issued locally came to IL 128 million, as against IL 70

million in the preceding year, while issues abroad totalled IL 26 million and IL 38 million respectively. Nearly IL 70 million in proceeds from domestic issues were transferred to the Accountant General, compared with IL 27 million in 1965. Government financing—directly through deposits for loan purposes, and indirectly through the authorization of domestic debenture issues, less proceeds transferred to the Accountant General—accounted for 80 percent of the incremental mortgage lending in 1966—a high rate compared with the previous year.

In 1964–65 the construction sector raised considerable sums by the sale through the banks of private contractors' deposits for the provision of loans to private investors. In 1966 such deposits grew comparatively little and did not constitute an important source of finance. Deposits in saving schemes administered by mortgage banks declined by nearly IL 12 million during the year reviewed, because of the smaller accumulation in the Saving-for-Housing scheme.

(e) *Investment companies*

In 1966 there were 16 companies dealing primarily in portfolio investment. Most of them were established and are controlled by commercial banks. All the concerns in this group hold listed securities, but some of them engage in other activities. Some invest also in unlisted securities with the object of gaining control of the companies, and even take part in running them. Several also grant loans to companies and institutions from earmarked deposits and from own means.

The group's operations expanded appreciably in 1966. Total assets went up by about IL 143 million, or 35 percent, and amounted to IL 556 million. In 1965 the rise was smaller—IL 73 million or 22 percent.

This conspicuous increase did not result from the growth of security investment, the purpose for which the companies were originally established. The falling trend in equity prices precluded their floating new share issues, and they even refrained from investing in the stock market altogether. Some reduced their securities portfolio or did not carry out any transactions therewith. The group's portfolio investment declined by IL 35 million during the year. This was due partly to the disposition of listed equities, and in part it reflected a purely institutional change: one of the large investment companies transferred most of its shareholdings, which were showing considerable losses, to a subsidiary company established especially for the purpose of the transfer.<sup>1</sup> The growth of the group's balance sheet stemmed entirely from the expansion of over IL 100 million in the volume of credit granted<sup>2</sup>—mainly to industry,

<sup>1</sup> The transfer was made in the form of a loan to the subsidiary company.

<sup>2</sup> Excluding the above-mentioned institutional charge.

construction, the Government, and local authorities. The incremental credit was financed chiefly through debenture issues. The amount floated in Israel came to about IL 57 million, and that abroad to nearly IL 35 million. The rest of the funds came from deposits and from the increased participation of the parent companies in the share capital.

Thus, the stock market slump did not hinder the group's development, but it did alter drastically the direction of its operations: from security investment, the income from which is subject to fluctuations, to the granting of ordinary loans to institutions and enterprises, which ensure a fixed income. Companies with access to the bond market, Government deposits, and overseas sources of finance did in fact develop along these lines and succeeded in maintaining their profit level. But those companies which were closely tied to the local equity market sustained substantial losses for the second consecutive year.

(f) *Household finance companies*

The credit granted by the 18 institutions in this group goes predominantly to households. The leading institutions are Otzar Hahayal, Yahav, and Ihud, which account for nearly 85 percent of the group's combined balance sheet. The companies' asset portfolio advanced by some 13 percent in 1966 to stand at about IL 66 million, or less than 2 percent of the aggregate figure for the sector. Apart from the institutions mentioned above, the group's development was slow and some even reduced their asset holdings.

(g) *Unit trusts*

The continued slump on the stock market greatly reduced the operations of the country's unit trusts and caused them further losses. The seven institutions in this group mobilize their funds by issuing participation certificates, and invest chiefly in securities registered on the Stock Exchange. Hence their development is closely connected with price trends on the Exchange. Following the decline in the number of investors, the trusts redeemed participation certificates held by the public and liquidated some of their investments. Net redemption of participation certificates totalled IL 5.2 million at par value, or IL 6.2 million at issue price, compared with IL 3.8 million and IL 4.8 million respectively in 1965. This brought down the balance of participation certificates to IL 23.4 million at par value, or IL 32.2 million at issue price.

The composition of the unit trusts' investment portfolio changed in 1966 as well, but in an opposite direction to that in the previous year: the proportion of equity investment edged up from 66 to 69 percent, while that of debentures dropped from 29 to 25 percent.

## 7. FLOW OF FUNDS, BY SECTOR

The volume of financial institution transactions<sup>1</sup> expanded by 34 percent in 1966, as against only 7 percent the year before, and totalled IL 1,010 million. This considerable increase occurred in financial transactions (which represent the bulk of their business), the figure going up by approximately IL 200 million.

As in 1965, the Government, social insurance funds, banking institutions, and the rest of the world were the sectors granting net credit to the financial institutions. The main borrowers were businesses, public sector companies, households, and local authorities.

Net receipts from the Government totalled approximately IL 44 million. Government earmarked deposits grew by nearly IL 240 million, against which must be offset the deposit with the Accountant General of financial institution receipts from debenture issues and foreign loans. Government participation in the institutions' equity capital remained unchanged in 1966.

Net receipts from social insurance funds totalled IL 110 million—IL 30 million more than the year before. These receipts reflect the sharp increase in the institutions' debenture issues, which in the main are taken up by the social insurance funds. The latter are required to invest a large part of their annual accumulation in securities approved by the Treasury.

Net receipts from abroad amounted to IL 133 million, this too a higher figure than in the preceding year. Most of the sum came from foreign loans received for the Treasury through two of the institutions, and overseas debenture issues totalling IL 62 million gross. The increase in foreign holdings of financial institution shares was small this year—approximately IL 14 million.

Net receipts from the banking institutions totalled IL 50 million, about the same as in 1965; the bulk of this sum came from loans.

There was a sharp rise in net payments to private businesses. These totalled IL 266 million, as against IL 175 million the year before, and for the most part went to the construction sector. Net payments to households were up by some IL 38 million. This was the resultant of smaller purchases of contractors' deposits (such purchases had increased the year before) and a slower rise in early mortgage loan repayments (which was exceptionally steep in 1965). Gross payments to households, which consist mostly of loans to home buyers, did not go up during the year reviewed. Payments to local authorities were some IL 10 million larger.

<sup>1</sup> The volume of transactions is measured here as total current expenditure, which consists 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 institution's liabilities.

**Table XVII-6**  
**"BALANCE OF PAYMENTS" OF THE FINANCIAL INSTITUTIONS, BY SECTOR, 1965-66**  
 (IL million)

	Receipts			Payments			Balance of receipts over payments	
	1965	1966	Increase or decrease (-)	1965	1966	Increase or decrease (-)	1965	1966
<b>Nonfinancial transactions</b>	234.3	291.9	57.5	224.5	282.7	58.2	9.8	9.2
<b>Transactions in financial assets</b>								
Government	156.7	227.9	134.2	66.1	184.2	118.1	90.6	43.7
National Institutions and local authorities	16.7	23.0	6.3	82.7	98.6	15.9	-66.0	-75.6
Public sector companies	55.6	5.3	-87.3	70.9	3.7	-67.2	-15.3	1.6
Banking institutions	52.0	62.6	10.6	3.0	12.4	9.4	49.0	50.2
Social insurance funds	79.4	112.9	33.5	-1.2	2.8	4.0	80.6	110.1
Insurance companies	-0.5	6.5	7.0	0.3	2.0	1.7	-0.8	4.5
Private business <sup>a</sup>	21.3	16.8	-4.5	196.4	282.9	86.5	-175.1	-266.1
Nonprofit institutions	-3.1	37.1	40.2	-1.1	34.4	35.5	-2.0	2.7
Rest of the world	62.9	133.8	44.9	0.3	0.6	0.3	62.6	133.2
Households <sup>b</sup>	47.1	27.7	-19.4	111.1	129.9	18.8	-64.0	-102.2
Unspecified <sup>c</sup>	32.6	64.4	31.8	—	—	—	32.6	64.4
<b>Total transaction in financial assets</b>	<b>520.7</b>	<b>718.0</b>	<b>197.3</b>	<b>528.5</b>	<b>751.5</b>	<b>223.0</b>	<b>-7.8</b>	<b>-33.5</b>
<b>Errors and omissions</b>	—	—	—	2.0	-24.3	-26.3	-2.0	24.3
<b>Total receipts and payments</b>	<b>755.0</b>	<b>1,009.9</b>	<b>254.9</b>	<b>755.0</b>	<b>1,009.9</b>	<b>254.9</b>	—	—

<sup>a</sup> Including farms.

<sup>b</sup> Including contractors' deposits sold to households through the banking institutions.

<sup>c</sup> Including securities sold on the Stock Exchange.