

CHAPTER XVIII

THE INSTITUTIONAL STRUCTURE OF THE CAPITAL MARKET^{1,2}

I. OVERALL ANALYSIS

1. MAIN DEVELOPMENTS

The resources available to the system of financial intermediaries surveyed in this chapter expanded by a rapid 42 percent in 1975, about the same rate as the annual average advance of consumer prices. But there were substantial changes in the weights of the component items, especially household financial saving. The principal one was a sharp decline in the second half of the year in total household saving through the institutions, along with an impressive increase in household investment in mutual funds, chiefly those placing a large percentage of their resources in assets pegged to foreign currency. These developments attest to the great importance the public attached this year to linking its savings to the foreign exchange rate (reflected in the steep price rise of securities linked to and/or

1 The institutional structure of the capital market is defined here as the system of financial intermediaries engaged primarily in the mobilization of medium- and long-term funds for investment in financial assets, such as loans, deposits, and securities. Included in this definition are banks providing development loans to various sectors, mortgage banks, investment companies of various financial concerns, household finance companies, such primary financial intermediaries as provident and pension funds, insurance companies, and mutual funds, as well as savings schemes (and the banks' own securities portfolios), and deposits for loan purposes administered by commercial banks separately from their monetary financial intermediation (the creation of money and granting of short-term credit). Excluded from this system are institutions financed by a limited number of proprietors and holding companies, the bulk of whose investment is in subsidiaries. This chapter therefore covers all institutional nonmonetary financial intermediation, apart from direct government operations in the capital market (such as the direct financing of local authorities, collection of compulsory loans from households and business, and so forth); these operations will be incorporated in the system in the future.

2 Since the statistical and conceptual framework used here is relatively new, the reader is referred to sections 2 and 3, which explain the methodology used.

traded in foreign currency), as well as the diminished attraction (especially in the second half of the year) of savings linked to the cost-of-living index.

In the last six months of 1975 total household financial saving through the system declined 14 percent in nominal and 22 percent in real terms compared with the first half of the year. This sharp downturn was connected with the much more sluggish net accumulation of approved savings schemes and social insurance funds, as well as with the tendency of households to reduce their direct bondholdings, in line with the trend evident throughout most of 1974. The greatly impaired attraction of index-linked saving in the second half of 1975 was apparently due to no small degree to anxiety about a possible adverse change in the saving terms. This applied in the second half of the year (in contrast to the situation in 1974) not only to direct bondholdings but also to institutional saving, in the wake of the deliberations, widely aired by the media, regarding the full linkage of such saving for medium and long terms.

As regards the system's lending operations, there were marked divergences this year in the growth of financing supplied for the various purposes. That granted to the producing and service sectors of the economy (notably industry) expanded fairly rapidly, stimulating overinvestment and a further drop in the capital stock utilization rate. On the other hand, there was a much smaller increase this year in credit to households, because of the sharp decline in home sales, and to local authorities.

The total gross medium- and long-term credit outflow to households, producing and service sectors, and local authorities was, at IL6.8 billion, up 44 percent, compared with 49 percent in 1974. Despite the slacker growth this year, there was a further increase in the average amount supplied for the various types of transactions financed by the system, with the weight of subsidized credit granted in accordance with public sector directives continuing to rise, after a hefty increase in the second half of the year which brought its share up to its highest level in the present decade.

If the subsidy element in the cheap credit were budgeted annually as a grant, it would have been necessary, given the size of the outstanding balance of such loans at the end of 1975 and the price advance expected next year, to include some IL3 billion for this item in the 1976/77 budget proposal.

The much slower expansion of credit to households affected both mortgage and other financing. The 27 percent growth of mortgage loans trailed a little behind the average rise in dwelling prices; in 1974 this item had shot up by an unprecedented 88 percent, as against a 40 percent advance in dwelling prices. But this year too preferred group of home buyers received a much higher rate of financing (the lion's share of it subsidized)

Table XVIII-1

SOURCES AND USES OF MEDIUM- AND LONG-TERM FUNDS — CAPITAL MARKET INTERMEDIARIES,^a 1973-75

(IL million)

Sources	1973	1974	1975	Uses	1973	1974	1975
Household savings, net of withdrawals	1,850	4,532	6,245	Gross medium- and long-term credit to:			
Business deposits and sale of securities ^b (net)	175	442	310	Households	1,079	1,928	2,387
Net receipts from household and business security transactions	857	-595	-648	Agriculture	387	485	672
Total	2,882	4,379	5,907	Industry	823	944	1,650
Loan repayments from:				Construction	116	240	342
Households	602	741	1,148	Services (incl. electricity)	296	404	905
Business	968	1,256	1,765	Local authorities	459	720	831
Local authorities	300	495	629	Total	3,160	4,721	6,787
Subtotal	1,870	2,492	3,542	Net transfers to:			
National Institutions (net)	83	130	193	Government	1,144	1,208	1,656
Rest of the world (net) ^c	40	-47	282	Banking institutions	135	347	-7
Unknown	28	21	-1	Total	1,279	1,555	1,649
Subtotal	151	104	474	Short-term uses, net ^d	194	183	585
Total sources	4,903	6,975	9,923	Surplus of expenditure over income	381	500	925
				Dividends	161	262	380
				Other payments, net ^e	-272	-246	-403
				Total uses	4,903	6,975	9,923

NOTE: Receipts and payments on account of medium- and long-term debt repayment, savings withdrawals, and redemption of securities include not only the principal (as in the past) but also interest and linkage increments paid. In the flow-of-funds system these components were previously defined as real (i.e. nonfinancial) transactions and included in the surplus of income over expenditure. In the present system the "surplus of expenditure over income" includes, in addition to payroll, service charges, purchases of real assets, etc., only interest received and paid on short-term credit transactions. It should not be concluded from this that the intermediaries wind up the year with an operating loss; most of the interest and linkage differential items in their financial statements are included under other items in this table or are totally excluded from the system.

^a As defined in note 1 in the text. The sources and uses are presented on a cash basis.

^b The net proceeds from security transactions with households and businesses (see the detailed explanation in section 2 of the 1974 *Annual Report*, pp. 479 ff.)

^c Includes short-term transactions of the intermediaries with the foreign sector.

^d The increase in outstanding short-term assets, including cash and demand deposits, less the increase in outstanding short-term liabilities (does not include short-term items in connection with allocations to reserves and other bookkeeping entries or transactions with the foreign sector). Since we could not separate the changes in cash balances and demand deposits from short-term uses in 1975, these two items are lumped together this year.

^e Taxes, general insurance premium and claims payments, and receipts and payments in connection with reinsurance.

because of the sharp drop in sales.

The rate of such credit provided in 1975 is estimated to be double that in 1973. The slacker growth of other credit to households in the year reviewed was mainly due to the smaller amount supplied by provident and pension funds, apparently because the amendment of the regulations obligated them to place a larger proportion of their accumulation in recognized investments.

As to the local authorities, their capital spending greatly eclipsed the growth of their borrowed funds--40 vs. 15 percent. This is apparently explained by the more stringent supervision of their financial transactions by the Ministry of the Interior. But

since the local authorities are heavily dependent upon direct public sector financing,³ this derogates from the significance attaching to the connection between the incremental financing raised in the capital market and their incremental investment.

Long-term industrial finance expanded by a formidable 75 percent, permitting the 18 percent real and 65 percent nominal growth of capital spending; the rate of such financing also rose. The big increase this year was accompanied by an absolute decline in nondirected credit, which became much dearer. The diminished recourse to nonsubsidized credit was of course made possible by the extremely rapid growth of cheap credit (which more than doubled and accounted for the preponderant share of industrial borrowing). The more liberal application of the criteria for granting soft credit and the steep rise in its subsidy element because of the inflation were among the main factors stimulating overinvestment in this sector.

As in 1974, the growth of agricultural credit lagged behind that of the sector's investment--39 as against 47 percent (excluding land amelioration, afforestation, and drainage, which are primarily direct public sector investments). Despite the smaller sum provided to agriculture in the last two years, in 1975 it still covered 83 percent of total investment; in 1973 the volume of financing had exceeded the value of investment.

One of the outstanding features of the year reviewed was the marked disparity in the second half between the reduced volume of household saving through the system and the increased volume of long-term loans extended in conformity with government directives. This imbalance between the principal source of the system's funds and the main use to which they are put was mainly redressed by reducing the net outflow to the government and the banking institutions to negligible proportions--some IL80 million all told, as opposed to IL1.6 billion in the first half of the year (see Table XVIII-4). These developments probably go some way to explain the government's liquidity injection and the growth of the banks' liquidity deficiencies in the second half of the year.

To sum up, in 1975 the institutions' gross outflow was in the neighborhood of IL28 billion, compared with a gross inflow of some IL10 billion. This big gap can be partly attributed to the overcomplex nature of the capital market transactions of the system; i.e. the numerous stages of financial intermediation (mainly between institutions under common ownership) involved in channeling funds from the saving to the borrowing public (businesses and households). This is not due to the operation of market forces,⁴ and it

3. And on credit from earmarked government deposits in banks.

4. I.e. it is not associated with a desirable competition for funds, which ultimately leads to a more efficient capital market.

unquestionably hampers the public sector in effectively controlling the resources it subsidizes.

2. STATISTICAL-ANALYTIC FRAMEWORK⁵

The flow-of-funds system presented in this chapter is a comparatively new statistical framework, whose object is as follows:

a. To describe the composition and magnitude of the funds made available to the intermediaries for financing the various producing and consuming sectors.

b. To trace the primary sources of the funds which enable the system to transact its business.⁶

c. To delineate the intrasystem flows, which are analyzed in detail in the relevant chapters of this Report.

Table XVIII-2
CAPITAL MARKET TRANSACTIONS^a OF THE SYSTEM, 1973-75
(IL million)

Receipts	1973	1974	1975	Payments	1973	1974	1975
Deposits, loans, and sale of securities	5,065	7,051	10,512	Deposits, loans, and purchase of securities	6,813	9,677	14,786
Receipts o/a assets (deposits, loans, and securities) ^b	3,432	5,002	7,809	Payments o/a liabilities (deposits, loans, and securities) ^b	1,220	1,544	2,047
Subtotal	8,497	12,053	18,321	Subtotal	8,033	11,221	16,833
Intrasystem transactions	3,425	6,004	9,734	Intrasystem transactions	3,425	6,004	9,734
Total	11,922	18,057	28,055	Total	11,458	17,225	26,567

^a Medium- and long-term financial transactions only; hence the imbalance between receipts and payments.

^b Includes interest and linkage differentials received and paid.

The data for this chapter were obtained through a form of statistical reporting for the various segments of the system, which is based on their operating budgets (which deal solely with actual fund-flows⁷), and with the flows arising from the receipt and supply of medium- and long-term funds separated from those connected with short-term financial transactions. Medium- and long-term transactions appear in the operating budgets as gross fund-flows, while flows arising from the repayment (to, within, and outside the system) of

5. For a more detailed description of the statistical-analytic framework see *Annual Report 1974*, pp. 477 ff.

6. As distinguished from the financial resources transferred from one segment of the system to another.

7. As distinguished from revaluations, allocations to reserves, and so forth, which do not involve actual flows of funds.

medium- and long-term obligations include interest and linkage differentials received and paid in connection with these obligations. The intermediaries' short-term transactions in the money market, on the other hand, are represented in the operating budgets as net changes in outstanding assets and liabilities. All imputations (linkage increments and the like), as well as all allocations to reserves, which appear in financial reports but do not involve an actual flow of funds, do not show up in our data. This is essentially a closed system of accounts with no residual items.

The business sector comprises producers of goods and services in agriculture, industry, construction, and the various services. At this stage no differentiation is made between private companies, Jewish Agency concerns, public sector companies, and nonprofit institutions.

The banking sector is defined here more narrowly than usual. Since nongovernmental deposits for loan purposes and the savings schemes administered by the banks (as well as their own securities portfolios) constitute part of the transactions of the intermediaries covered in this chapter, the fund-flows connected with these activities are not classified as part of the banking system. Consequently, the flows between the intermediaries to the banking system are to an unspecified destination, at least as far as the individual component items are concerned (e.g. earmarked loan deposits). Much of this is funneled back to the secondary financial intermediaries, while another (relatively small) portion is unidentified. In principle, the latter may augment the banks' medium- and long-term funds used for financing short-term money market transactions or for some other purpose (not identified at this stage of integrating the capital market transactions).

3. GOVERNMENT INFLUENCE ON THE SYSTEM'S OPERATION

The degree to which the government determines the character and volume of the institutions' operations far transcends the weight of the latter's direct financial transactions with the government. In fact, as will be explained below, the government is involved in the whole financial intermediation process. This applies to (a) the mobilization of primary sources of funds (mostly household saving through provident and pension funds, insurance companies, approved savings schemes, and mutual funds); (b) the intermediate stage of financial intermediation, i.e. the onlending of the bulk of the funds mobilized to secondary financial intermediaries⁸ through the purchase of bonds and

8. The reference is to the financial institutions and earmarked loan deposits in the banking system.

the placing of deposits for loan purposes by the primary financial intermediaries; and (c) the final stage, i.e. the channeling of funds to the producing and service sectors of the economy and to households for financing production and consumption.

As regards the first stage, the government is responsible for the lion's share of the economy's voluntary saving finding its way to the system of intermediaries, as it directly and indirectly permits them to guarantee a 3-6 percent real return on long-term saving, regardless of the rate of inflation, besides granting income tax concessions on earnings from this source. The upshot is that the government has in effect prevented the development of a capital market worthy of its name alongside that discussed here--one that can compete in raising funds from domestic sources. At the same time government intervention has undoubtedly had a very positive effect on the level of saving in the economy, especially in periods of high inflation.

As to the second stage, by requiring the primary financial intermediaries to divert 80-90 percent of their resources to the acquisition of bonds (considered a recognized investment for purposes of the regulations), the government assures that most of the funds so raised go to the purchase of financial institution bonds as well as its own issues.

Regarding the third stage, every financial institution seeking to raise capital through the flotation of bonds (or other securities) has to obtain a special permit for this; this applies in particular to institutions desiring recognized investment status (for the purposes of the regulations governing the placing of primary financial intermediaries' resources) for a proposed bond issue. The Treasury can make the receipt of the permit conditional on the institution's agreeing to the allocation of the issue proceeds (either wholly or in part) in accordance with its guidelines. The Treasury actually makes extensive use of this power, and it directly and indirectly controls the overwhelming portion of such proceeds, in conformity with national development policy. It makes loan capital available on unlinked, relatively inexpensive terms for high-priority activities and needs, using the proceeds of its own bond issues to the financial intermediaries and part of the latter's issue proceeds deposited with it on terms matching those of the bonds. Some of these funds flow back to the institutions for granting soft loans at the government's behest; the deposit terms take into account the terms on which the credit is to be granted, as well as the institutions' guaranteed profit margin. However, only a relatively small share of the preferred activities and requirements is financed by the public sector in this fashion. The greater part of such low-cost credit is granted directly by the financial institutions from their own bond issue proceeds in accordance with government directives, with the Treasury compensating them for the difference between

the price of the capital so raised and the linkage terms on the one hand and the terms of the credit they extend on the other.

In actual fact, the preponderant share of the credit originating in bond issue proceeds is directed by the government, and is granted on unlinked, low interest terms, with the Treasury covering the linkage differentials. Even that relatively small part of the bond issue receipts that is defined as free of government control for the most part constitutes the institutions' contribution to the subsidized credit funds from their freely loanable resources, and this because of their desire to assure Treasury coverage of the linkage differentials.

One other facet of the government's intervention should be noted. The raising of capital abroad likewise requires a special permit from the Treasury's Foreign Exchange Department, and the prospects of lending out the funds on exchange-rate linkage terms are very slim in the prevailing circumstances (especially after the introduction of the creeping devaluation in June 1975). The institutions therefore tend to grant such loans too in conformity with public sector guidelines so as to be entitled to linkage differential coverage. This gives some notion of how much the government influences the nature and volume of the business conducted by the system of intermediaries discussed in this chapter.

At the same time the institutions transact some autonomous credit business (on a relatively modest scale) with monies obtained from provident and pension funds, insurance companies, and approved savings schemes, as well as from business concerns and various other sources. The volume of the resources depends largely upon monetary developments and the economy's liquidity situation. (It should be mentioned that the financial institutions of Hevrat Ovdim--the holding company of the Histadrut⁹--were granted a general permit to use an agreed portion of the funds they raise for financing Hevrat Ovdim's investment program.)

4. SOURCES OF FUNDS

(a) *General*

The intermediaries' principal source of funds is the household sector, which mainly takes the shape of saving through social insurance funds, insurance companies, approved savings schemes, and mutual funds. Besides such saving, which can be precisely identified,

9. *General Federation of Labor.*

in recent years (until 1973) households supplied a growing volume of funds through direct secondary market purchases of securities issued and/or sold by the institutions. There is no way of isolating this portion, but the net proceeds from the issue and redemption of securities and from trade in the institutions' securities by households and business (a relatively small portion) combined can be reliably estimated (see Table XVIII-1). In 1974-75 the share of household saving was negative, i.e. there was a net sale of securities to the institutions (explained below).

Businesses, besides borrowing from the intermediaries, supply them with funds (albeit on a relatively modest scale) in the form of earmarked loan deposits (primarily for financing households and local authorities), as well as through the purchase of original-issue financial institution bonds. Also included in this source are the monies transferred by the State Lottery, chiefly for onlending to local authorities. Other quite modest contributing sectors are the National Institutions and the rest of the world.

Another, more significant, source is current payments (principal, interest, and linkage differentials) on account of borrowers' (households, business, and local authorities) obligations.

Not all the receipts from the sources listed above are lent to the producing and consuming public. Part is absorbed by the government and the banking institutions, whose relations with the intermediaries are quite complex. The government pumps out money for financing its operations, including *inter alia* the provision of funds to the institutions. The banks, which mobilize funds for their affiliated financial concerns, channel to them a sizable share of the intermediaries' resources, part of which flows back to the latter and is redistributed among the secondary financial intermediaries. The affiliated financial concerns transfer part of the resources they mobilize (mainly bond issue proceeds, but also savings, loans, and deposits from both domestic and foreign sources etc.) to the parent banks. Some of these funds are deposited with the Treasury and/or lent out in the name of the financial concerns. Another part is, as far as the latter institutions are concerned, deposits to an unspecified destination. On the other hand, the parent banks place various deposits with these affiliates--representing both their share in the financing of the concerns' operations and repayments of deposits that have matured. Differences between the monthly fund-flows from the system of intermediaries to the banking sector and the return flows to the intermediaries can affect the current liquidity position of the banks and thus their shortfalls in liquid asset cover. Because of this network of interrelations, the system of institutions (which, as noted, is largely controlled by the government) serves as a kind of regulator capable of transmitting

liquidity deficits (or injections) between the government and the banking system, and vice versa.

(b) *Volume and Composition of Resources*

As in 1974, the system's sources of funds expanded appreciably, by 42 percent, and totaled approximately IL10 billion. The gross flows arising from the intermediaries' operations increased even more (55 percent) to reach IL28 billion. This tremendous inflow-outflow differential can be mainly attributed to the multistage financial intermediation process,¹⁰ which in no way contributes to a more efficient capital market and certainly does not further the public sector's control over the resources it subsidizes.

What mainly characterized the intermediaries' operations in 1975 was undoubtedly the disruption in the second half of the year of the relative equilibrium between their main source of funds, household saving, and the main use, the extension of long-term credit for financing the capital expenditures of the producing and service sectors and local authorities and for financing households. In other words, during the second half of the year a big gap arose between the flow of savings to the system and the sum it actually allocated according to public sector directives. Whereas the savings inflow fell short of the system's uses (as defined above) by IL453 million in 1973 and IL784 million in 1974, in the first half of 1975 there was a surplus of IL120 million, which in the second half turned into an enormous IL1,310 million "deficit".¹¹

Even though this marked disparity was accompanied by a greatly increased net mobilization of funds abroad (about IL300 million in the second half of 1975)¹²--mainly by institutions under government control--the inevitable consequence was the shrinkage, in the second half of the year, of the net absorption of resources by the government and banking sector to negligible proportions: about IL80 million compared with IL1,560 million in the first six months (see Table XVIII-4). These developments shed light on some of the factors behind the government's liquidity injection and the banks' liquidity deficit in 1975. The net transfer of funds to the government dropped from IL960 million in the first

10. The funds pass through a relatively large number of financial intermediaries until they reach their final destination--the granting of credit to the producing and consuming sectors of the economy.

11. See Tables XVIII-3 and XVIII-5, which show that in 1973 there was IL2,707 million in household saving, as against a IL3,160 million credit outflow; in 1974 they totaled IL3,937 million and IL4,721 million respectively; in the first half of 1975--IL2,593 million and IL3,903 million; and in the second half--IL2,593 million and IL3,903 million.

12. As against a net use abroad of approximately IL50 million in 1974.

half of 1975 to IL690 million in the second half, while a IL600 million net transfer to the banking system in the first half flowed back to the intermediaries in the second half. Much of this return flow probably occurred toward the end of the year, due to massive bond purchases (mainly by institutional investors). This largely represented the advancing of purchases in the hope of earning capital gains following an anticipated worsening of the terms of new issues. but it had almost no effect upon the net transfer of resources to the government and the banking sector in the second half of the year. (A large percentage of the bond purchases from the intermediaries was financed by the transfer of funds from the banking institutions to the intermediaries, and the lion's share of the issue proceeds was deposited by the latter with the Treasury.)

(c) *Households and Business*

The amount received from households and business (net of loan repayments) grew much more slowly this year--35 percent as opposed to 52 percent in 1974--and totaled IL5,907 million (see Table XVIII-1). The flow from businesses contracted from IL440 million in 1974 to IL310 million, while the household contribution increased about as fast as in the previous year (42 vs. 45 percent in 1974). Most of the decline in the case of business was in net deposits (by contractors and construction companies) for the granting of mortgage loans, which is apparently explained by the sagging of home sales in 1975. The steep rise during the year in the price of nondirected credit--upon which contractors and the building companies are more than a little dependent--was probably a contributory factor.

The relative stability of the annual growth rate of total household saving through the intermediaries was accompanied by drastic changes in the component items: the uptrend in net saving through social insurance funds and approved savings schemes lost considerable impetus, while in mutual funds it accelerated. These changes took place mainly in the second half of the year, and accompanied the sharp decline during that period in the amount of household saving through the intermediaries, and apparently in total household financial saving. Concurrently households resumed their unloading of direct security investments (at an even greater rate), after an apparent checking of this trend in the first half of the year. On balance the intermediaries' securities transactions with households resulted in a negative saving by the latter of approximately IL650 million in 1975 (compared with IL595 million in 1974), the bulk of it in the second half of the year (see Table XVIII-3). These developments can be attributed to a combination of factors that operated in the last two years.

1. In 1974 the rumors that abounded about a mooted worsening of the terms of new bond

Table XVIII-3
FUNDS SUPPLIED TO THE SYSTEM BY HOUSEHOLDS, BY SOURCE, 1973-75
(IL million)

Source	1973	1974	1975			Percent annual increase	
			Entire year	Jan.-June	July-Dec.	1974	1975
Social insurance fund savings ^a	887	1,505	1,735	838	897	70	15
Approved savings schemes ^a	542	1,704	2,187	1,338	849	214	28
Mutual funds ^a	240	1,000	1,869	627	1,242	317	87
Life insurance	181	323	454	213	241	78	41
Subtotal	1,850	4,532	6,245	3,016	3,229	145	38
Net receipts from security transactions—households and business ^b	857	-595	-648	-12	-636		
Total	2,707	3,937	5,597	3,004	2,593	45	42

^a Deposits less withdrawals of principal, interest, and linkage increments.

^b Purchase of original-issue securities by the system of intermediaries, less redemptions and net sales in the secondary market.

issues, such as the taxing of linkage gains,¹³ induced households to drastically alter the composition of their current saving--a switch from direct investment in bonds to institutional saving through social insurance funds, approved savings schemes, and mutual funds--and to reshuffle their existing savings portfolio in favor of social insurance funds and approved savings schemes. Since it is a plausible inference that this adjustment mostly took place in the course of 1974, a much slacker growth of these components was to be expected, *ceterus paribus*, in the year reviewed.

2. At the end of 1974 the social insurance fund saving terms were modified, with contributions exceeding IL9,600 being deemed to be a new deposit and hence withdrawable only after ten years. A similar restriction (a minimum saving period of five years) was imposed on severance scheme withdrawals and capitalized pensions. In view of the sizable sums deposited in the provident funds in the past, these changes unquestionably contributed to the sluggish growth of saving through the social insurance funds.

3. In the second half of the year rumors of an adverse change in bond terms again cropped up. This time institutional saving was also affected, because of the deliberations and debate (reported by the media) over the question of full linkage of such saving for long and medium terms. At the same time the probability of a big devaluation grew stronger, and the mutual funds--whose portfolio includes a substantial foreign currency component--became attractive to households. These funds were the sole financial

13. And the actual adverse change in the interest terms on bonds issued to the general public.

intermediary to experience an increase (and a hefty one at that) in household saving in 1975.

Some of these reasons for the drastic changes in the composition of household saving through the financial intermediaries also explain the quite sharp 14 percent nominal and 22 percent real decline in household saving in the second half of the year. These findings are of grave import and relate to the period preceding the measures taken in December 1975. They may have represented the public's response to the revision of the saving terms, which to some extent was actually implemented in 1975 and in part was still on the cards. There is as yet no clear indication of how financial saving is faring in 1976, but in view of the trends described above, the authorities should consider how to encourage saving and direct it to desirable channels according with government policy.

(d) *Loan Repayments*

Current payments of borrowers' obligations rose 42 percent in 1975 to reach IL3,540 million. This item, whose size is a function of past credit transactions and hence does not fluctuate with changes in current loan business, increased faster than in the previous year (about 33 percent), owing to the much larger volume of gross credit extended in 1974. In recent years this component has accounted for about a third of the intermediaries' total funds and in a sense is an autonomous source, whose weight could have been much larger had the credit been granted linked (or had the price level gone up more moderately). There is no need to call attention to the possible consequences of a change in the credit terms on the net amount the government could absorb from the intermediaries, with all that this implies regarding its liquidity injection.

(e) *Government and Banking System Absorption*

The weight of the net government absorption from the intermediaries is rather small (less than 20 percent), but, as has been explained, this by no means reflects the extent of government intervention in their operations (see section 3).

The government's financial relations with the system are quite complex. Essentially they fall into four categories (see Table XVIII-4):

1. Part of the system's resources flows to the government in the form of financial institution deposits of some of their bond issue proceeds and sales of government bonds to the various segments of the system (see col. 5 in Table XVIII-4).

2. The government places deposits with the system's secondary financial intermediaries for granting loans in conformity with its guidelines (col. 4).

3. The government repays linked debts to the system (col. 1).

Table XVIII-4

FLOW OF FUNDS BETWEEN THE SYSTEM AND THE GOVERNMENT AND BANKING INSTITUTIONS, 1973-75

(IL million)

Sector	Year	Receipts	Payments	Surplus of	Current	Current	Surplus of	Total
		o/a long-term assets ^a	o/a long-term liabilities ^a	long-term receipts over payments ^a (1-2)	long-term receipts ^b	long-term payments ^b	current receipts over payments ^b (4-5)	surplus (3+6)
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
Government	1973	1,070	351	719	773	2,636	-1,863	-1,144
	1974	2,039	465	1,574	1,078	3,860	-2,782	-1,208
	1975							
	Entire year	2,871	488	2,383	1,818	5,857	-4,039	-1,656
	First half	1,181	167	1,014	660	2,636	-1,976	-962
	Second half	1,690	321	1,369	1,158	3,221	-2,063	-694
Banking institutions	1973	310	160	150	558	843	-285	-135
	1974	525	317	208	854	1,409	-555	-347
	1975							
	Entire year	1,061	477	584	1,487	2,064	-577	7
	First half	356	229	127	668	1,398	-730	-603
	Second half	705	248	457	819	666	153	610

^a Deposits, loans, and securities (including interest and linkage differentials received and paid). In the case of the government col. 1 consists mainly of repayments of past deposits and col. 2 of redeposits.

^b Deposits, loans, and sales (and purchases) of securities. In the case of the government col. 4 consists mainly of sums redeposited by the government and col. 5 of deposits of security issue proceeds.

4. The system makes repayments to the government on account of the latter's assets held with it (col. 2).

The government's net absorption from the system increased by an appreciable IL450 million in 1975 to reach IL1,656 million (see Table XVIII-1). Much of the increment stemmed from the advancing of bond purchases by the institutional investors in the system (toward the end of 1975), with funds supplied primarily by the banking sector as narrowly defined (see col. 5 in Table XVIII-4). Were it not for the advancing of purchases, the net government absorption--which dropped from IL960 million in the first half of the year to IL690 million in the second half--would have contracted even more sharply.

The financial relations of the banking sector with the system of intermediaries surveyed here are no less complex than those of the latter with the government. The banking institutions, as already noted, fulfill the function of mobilizing funds for the financial concerns with which they are affiliated, which as a rule comprise social insurance funds, insurance companies, approved savings schemes, mutual funds, investment companies, development banks, and mortgage banks. On the other hand, the large banking houses channel to them a sizable portion of the system's resources, the overwhelming share

of which flows back to the system and is redistributed among the secondary financial intermediaries. In 1975 the amount drained off in this way came to approximately IL2.5 billion (see columns 1 and 4 in Table XVIII-4).¹⁴ Although over the year as a whole the banking sector did not siphon off any funds from the intermediaries, the pattern of its transactions with the latter apparently influenced that of its liquidity deficits. In contrast to a net absorption of approximately IL600 million from the system in the first half of 1975, the banking sector transferred back to it an equal amount in the second half of the year (see Table XVIII-4).

5. CREDIT TERMS AND DESTINATION

(a) *Credit Terms*

Most of the medium- and long-term lending of the system consists, as noted above, of unlinked low-interest credit allocated according to the public sector's directives and at its expense. This applies especially to the funds supplied to households, agriculture, and industry, more than 90 percent of which was granted on concessionary terms in 1975. It also applies to part of the financing made available to the construction industry, and to a much smaller extent to local authorities. However, experience has shown that the latter group is not very sensitive to the interest terms.

Development credits extended in accordance with government guidelines to industry, agriculture, and tourism (hotel construction loans are classified here as credit to the service sector) have since the mid-1960s been granted unlinked and at a quite low nominal rate of interest. Interest on loans made in 1975 ranged from 8 to 12 percent, depending on the firm's location and the economic destination of its output. Another part of the subsidized financing to these sectors has been granted unlinked at 12-15 percent, on the instructions of authorized public bodies.

Directed mortgage credit (and some of the other credit to households) is also unlinked and bears interest of 7-13 percent. As regards part of the nondirected mortgage credit for private housing, which is subject to certain price and space limitations, the mortgage banks are likewise allowed to grant it unlinked at interest ranging from 12 to 20 percent. Most of the loans granted in 1975 carried these terms.

The interest rates on development loans to industry, agriculture, and tourism, as well as those on directed mortgage credit, were fixed by the public sector in 1967-68, when the

14. Excluding deposits transferred by the intermediaries to the government.

linkage clause was lifted on most of the medium- and long-term credit and a 9 percent ceiling was set. At the time, and in fact until the early 1970s, prices moved up at a moderate pace and this trend was expected to continue; thus the nominal rates of interest were expected to represent a 2-3 percent real cost in most cases. The sharpening of inflation from 1970 onward was not accompanied by an appropriate revision of interest rates. The public sector's response was long overdue (it came only in mid-1974) and rather restrained. Whereas inflation accelerated from an average 6-8 percent rate during the 1960s to 25-30 percent in recent years, the interest on subsidized credit went up only 2-3 percent until 1975. The boosting of interest rates at the beginning of 1976 by 3-5 percentage points for newly authorized loans was more significant, but will apply only to loans granted in 1977, since presumably most of the funds that will be disbursed in 1976 will be on account of loans authorized in previous years.

At the end of 1975 the balance of loans granted on concessionary terms by the intermediaries to agriculture, industry, tourism, and households came to approximately IL12 billion, with the interest rate averaging less than 9 percent. If the subsidy element in such financing were treated as a grant, it would have been necessary--given the balance outstanding at the end of 1975 and the forecast rise in the price level next year--to budget for 1976/77 approximately IL3 billion for this purpose (the unpaid part of the balance will continue to carry a "grant" element, the size of which will vary with the annual rate of inflation).

(b) *Volume of Credit*

Gross medium- and long-term lending by the intermediaries (to households, producing and service sectors, and local authorities) was, at IL6,790 million, up 44 percent; this contrasts with a 49 percent rise in 1974 (see Table XVIII-5). In real terms as well the growth curve flattened a bit. (The annual average increase in the consumer price index was about the same as in 1974, while investment prices went up faster this year.) Since the uptrend in total investment slowed conspicuously and home sales sank well below their 1974 level, the rate of financing provided by the system apparently rose on average.

The drop in the credit growth rate occurred in the household item, and even more severely in the local authorities. The deceleration in nondwelling investment financing took place in the first half of the year, the second-half volume spurting at an unprecedented rate (primarily in industrial credit--see Table XVIII-5).

In 1975 more than in any other year, low-interest credit accounted for a decisive share of the investment financing provided by the intermediaries, and the subsidy component has

Table XVIII-5
GROSS MEDIUM- AND LONG-TERM CREDIT GRANTED, 1973-75
(IL million)

	1973		1974		1975						Percent increase	
					Jan.-Dec.		Jan.-June		July-Dec.		1974	1975
	IL m.	%										
To households	1,079	34	1,928	41	2,387	35	1,109	38	1,278	33	78	24
Mortgage credit	767		1,445		1,830		802		1,028		88	27
Other credit	312		483		557		307		250		55	15
To producing and service sectors	1,622	51	2,073	44	3,569	53	1,320	46	2,249	57	28	72
Agriculture	387		485		672		299		373		25	39
Industry	823		944		1,650		605		1,045		15	75
Construction	116		240		342		128		214		107	43
Services ^a	296		404		905		288		617		36	124
To local authorities	459	15	720	15	831	12	455	16	376	10	57	15
Total	3,160	100	4,721	100	6,787	100	2,884	100	3,903	100	49	44

^a Includes electricity.

swelled enormously because of the high inflation of the past two years and that expected in the coming period. If to this we add the rumors abounding in the second half of the year (and which were unaccompanied by any official decisions) concerning the need to reduce the subsidy element, the overinvestment and resulting drop in the capital stock utilization rate are understandable. The public sector's behavior is less comprehensible, considering its declared policy for 1975.

The local authorities stepped up their borrowing by 15 percent, far less than the 42 percent expansion of nominal capital outlays; the total amount obtained from the intermediaries was IL830 million gross, only about half the authorities' investment. But it should be remembered that they also rely heavily on direct public sector financing, and even in 1975 the total amount received may have surpassed their capital spending because of the need to roll debts. Debt repayment to the intermediaries amounted to IL630 million in the year reviewed. The much slacker growth of the authorities' borrowing from the intermediaries was due not to a relative abundance of other available funds or to the authorities' inability to compete for funds as far as the interest rate goes, but to the more rigid supervision exercised by the Ministry of the Interior.

The changes in the destination of the intermediaries' credit outflow are worthy of note. The share of the producing and service sectors of the economy rose from 44 percent in 1974 to 53 percent, at the expense of households and the local authorities--exactly the opposite of what happened in the previous year.

(c) *Credit to Households*

Long-term lending to households rose far less steeply this year, 24 vs. 78 percent in 1974, and totaled IL2,390 million. The deceleration occurred in both mortgage financing (see below) and other credit (which rose only 15 percent, as opposed to 55 percent in 1974). Most of the latter is granted by social insurance funds to their members (part of it is unlinked and part is indirectly linked, in that the borrower forgoes for the period of the loan the linkage of a corresponding amount of his savings with the fund); the rest is subsidized credit extended mainly to new immigrants, civil servants, and college students. The slower growth of long-term lending to households can be ascribed to the amendment of the regulations governing social insurance fund investments, which increased the proportion of recognized investments in total uses, as well as to the downward drift in immigration in the last few years (which of course reduced the number of persons eligible to receive financial help for their initial arrangements). By contrast, the remaining components of household credit expanded fairly strongly, as in 1974.

Mortgage lending was, at IL1,830 million, up 27 percent. Although this matched the average increase in dwelling prices in 1975, the proportion of the total price covered from this source rose because of a sharp contraction in home sales.¹⁵ This was the second year running to see a big increase in the rate of mortgage financing: in 1974, despite the sagging of home sales, mortgage credit shot up 88 percent, in contrast to only 40 percent in dwelling prices. As a result, the rate of mortgage financing doubled in 1975, with the overwhelming portion being subsidized directly and/or indirectly by the public sector. This development should of course be viewed against the changes in the demand for homes and the special supply and demand conditions in the Israeli mortgage market.

As regards housing demand, it weakened in 1974 and even more in 1975. This was reflected not only in the slumping of sales (and an increase in the stock of unsold units held by both the public and private sectors), but also in the limping of dwelling prices behind residential construction costs. Two causes of the downturn in demand in 1974 were an adverse change in the migration balance and the pessimistic outlook regarding future income. In 1975 these influences operated even more strongly, and were joined by such other factors as the heavier taxation of homes (especially those that are not owner-occupied but were bought for investment or other purposes), which further depressed demand.¹⁶

15. The index of private home sales fell 25 percent in 1975.

16. See the discussion in Chapter VIII.

In an economy where the mortgage market is free of intervention and financing is available for almost the entire price of the dwelling (e.g. in the West), a decline in home sales is accompanied by a falling demand for mortgage credit; in inflationary periods the mortgage loan may even fall short of the value of the dwelling because of the rising cost of such finance. This does not hold for Israel, however, since the bulk of the financing is subsidized and falls far short of the value of the dwelling. For the most part it is exogenously determined (directly or indirectly) by the public sector, and fluctuations in housing demand usually affect only the magnitude of the excess demand for such credit. In 1974-75, despite the ebbing demand for housing and the relatively steep rise in mortgage credit, the excess demand for the latter did not diminish. On the contrary, various indicators point to its intensification, a consequence of the greatly increased subsidy element due to the widening gap between the rates of interest set by the public sector and the rate of inflation. The much larger subsidy enjoyed by part of the home buyers was tantamount to the lowering or supporting of the price of the home by the public sector. Thus the change in the volume of mortgage credit in the last two years tended to check the contraction of demand on the part of preferred groups.

In 1975 the public sector introduced a number of changes which resulted in a much larger volume of mortgage finance. The principal one was the amendment in the first half of the year of the regulations applicable to young couples and new immigrants, which made them eligible for much bigger loans. It should also be noted that the ratio between the number of directed loans and the number of homes purchased continued to rise in 1975, though less than in the previous year. Despite the steep drop in home sales, directed loans declined only 10 percent. This means that more than in any other year the preferred groups of home buyers were able to obtain such financing from more than one source. In addition, the number of persons receiving directed credit may have risen because of the more liberal application of the eligibility criteria.

Directed mortgage credit expanded 33 percent to reach IL1,610 million (see Table XVIII-6), with the average loan being about 50 percent larger this year. A breakdown by destination reveals that the biggest rises were enjoyed by newlyweds (up about 60 percent) and recipients of "other directed credit" (about 40 percent). The latter group was the only one to show an increase in 1975 in the number of loans received--10 percent, as against declines of 10-30 percent for the others. The eligibility criteria for this type of credit are not as stringent as those governing the other categories.

Mortgage loans for the purchase of homes in the private housing market were, at IL220 million, down 5 percent. That part which is given at the going open-market rates (fully

Table XVIII-6
GROSS MORTGAGE BANK CREDIT, 1973-75
(IL million)

Recipient group	1973			1974			1975		
	IL m.	No. of loans	Average loan (IL'000)	IL m.	No. of loans	Average loan (IL'000)	IL m.	No. of loans	Average loan (IL'000)
Directed credit									
New immigrants	140.8	3,761	37.4	174.8	3,662	47.7	199.9	2,851	70.1
Slum dwellers	38.7	2,121	18.2	58.4	2,614	22.3	46.6	1,628	28.6
Saving-for-Housing Scheme	108.8	3,389	32.1	171.2	4,291	39.9	130.7	2,926	44.7
Young couples	198.9	7,947	25.0	513.9	17,579	29.2	819.4	15,531	52.7
Other	144.7	7,734	18.7	297.1	11,505	25.8	415.0	12,650	32.8
Total	631.9	24,952	25.3	1,215.4	39,651	30.6	1,611.6	35,586	45.3
Other credit									
Private housing	135.1	7,406	18.2	229.5	9,047	25.4	218.1	6,534	33.3
Total mortgage credit	767.0	32,358	23.7	1,444.9	48,698	29.7	1,829.7	42,120	43.4

linked and/or bearing nominal interest determined by market forces) almost disappeared in 1975. On the other hand, the bulk of the sum was indirectly subsidized by the public sector in the year reviewed, and even though this is nondirected credit, it was made available to those meeting certain space and price limitations which entitled them to linkage differential insurance in return for the payment of an unrealistic premium.¹⁷ In this type of credit too the public sector loosened the strings in 1975.

1. At the end of March the maximum home price for which the public sector was willing to provide linkage differential insurance on the mortgage financing was raised from IL225,000 in Jerusalem and IL205,000 in the rest of the country to IL270,000 and IL250,000 respectively, with the linkage premium being upped by an insignificant 2 percent.

2. In July the maximum nondirected loan a mortgage bank could grant was raised from IL50,000 in Jerusalem and IL40,000 in the rest of the country to IL80,000 and IL65,000 respectively. This change had significance only for nondirected loans granted without the Treasury's linkage differential insurance.

3. In April the maximum home price for which mortgage financing could be obtained was raised from IL300,000 in Jerusalem and IL265,000 elsewhere to IL360,000 and IL325,000 respectively. At the end of the year the ceiling was abolished altogether.

These changes had less of an impact on the volume of mortgage credit for private

17. On this type of credit, which is granted unlinked, the public sector has set an interest rate ceiling ranging from 13 to 20 percent, including the premium mortgage banks receive from the government.

housing than those introduced in directed mortgage credit. This was because the public sector directly and indirectly sees to it that there are enough funds available for onlending in accordance with its directives and criteria, while as regards homes bought in the private market the burden of mobilizing the necessary resources falls on the mortgage banks. This probably accounted for the steep 28 percent drop in the number of loans extended for private housing, even though they are mostly unlinked and contain a sizable subsidy element.

(d) *Industrial Credit*

Long-term industrial credit expanded by a resounding 75 percent in 1975 to total approximately IL1,650 million. This unprecedented growth was connected primarily with the 65 percent spurt in nominal capital outlays, although the rate of financing also rose. The intermediaries' share in the financing of industrial investment increased from 43 percent in 1974 to 46 percent.

The previous year's absolute decline in nondirected industrial credit gained impetus. In 1974 the main factor was probably the more sluggish growth of investment, which permitted a diminished resort to nondirected credit, which had become much more expensive because of inflation. In 1975 this component continued to shrink, even though the heavier capital spending heightened the need for external financing.

Table XVIII-7
INDUSTRIAL INVESTMENT CREDIT, 1973-75
(IL million)

	1973	1974	1975
Gross medium- and long-term credit granted	823	944	1,650
Industrial investment, at current prices	1,650	2,180	3,610
Ratio of credit to investment (%)	50	43	46

The reduced recourse to such financing was made possible by the faster growth of soft credit granted according to public sector directives; this more than doubled in 1975 and accounted for the bulk of industrial investment funding supplied by the intermediaries.

The marked divergence between the rate of increase in directed credit (about 110 percent) and that in nominal investment (about 65 percent) requires an explanation. An investigation showed that only a small fraction of the difference can be attributed to the advancing of investment financing, such as apparently happened in the last quarter of 1973 (the investments were actually implemented at the beginning of 1974); this in itself

somewhat accelerated the growth of directed credit in 1975. Since in the last few years the eligibility criteria (type of enterprise and location) for industrial credit on concessionary terms were not modified, only two possible explanations remain:

1. In the geographical distribution of investments implemented there was a shift in favor of the development areas (which are entitled to higher rates of funding), while the distribution by type of enterprise shifted toward firms granted recognized status under the Law for the Encouragement of Industry. (According to the criteria in effect in 1975, the rates of soft credit--as a percent of the value of the investment--to which recognized enterprises were entitled were 60, 50, and 45 percent respectively in Development Zones A, B, and C, while enterprises approved under the Law for the Encouragement of Capital Investments and other firms were entitled to 45, 40, and 33 percent respectively.¹⁸

2. Such financing exceeded the above rates because of a more liberal application of the relevant criteria.

As regards the first possibility, there may very well have been some veering toward the development areas. This assumption is based on the public sector's declared policy as reflected in the detailed instructions issued during the year, which were meant to increase the degree of selectivity regarding investment in Development Zone C. But a possible change in the regional distribution of investment can by no means fully explain the enormously larger volume of directed industrial credit this year; in other words, there was probably also a much more liberal application of the relevant criteria.

Soft credit became 2 percent dearer on average this year, following the upping in July 1974 of the interest charged on industrial development loans. On that date the rates on loans to industrial establishments were hiked from 7-9 percent (depending on the regional location) to 8-12 percent, and for semi-industrial firms from 12 to 15 percent.¹⁹ This modest interest rate revision had little significance. On the other hand, the acceleration of inflation during the past two years (by tens of percent), as well as the much larger amount of industrial investment financing provided directly and/or indirectly by the public sector in 1975, greatly increased the subsidy element of such credit. This explains why, despite the marked slackening of the sector's current activity in 1975, its real capital outlays expanded faster than in any of the last eight years (about 18 percent).

Notwithstanding the pessimistic forecasts for the near future, the balance of directed loan commitments of the industrial development banks came to IL3,280 million, compared

18. Approved enterprises are also eligible for an export grant.

19. The increase applied only to that part of the loans disbursed in 1975 on the strength of authorizations granted after July 1974.

with IL1,735 million at the end of 1974 and IL890 million at the end of 1973. The growth of industrial credit (and apparently also investments implemented) accelerated greatly in the second half of the year. Whereas in the first half the volume of directed investment credit rose 60-65 percent above its level in the same period in 1974, during the second half of 1975 it swelled to more than 2.5 times its volume during the same period in the previous year. The steep upswing occurred not only in the chemical, textile, and printing and paper industries, where it more than doubled even in the first half of 1975, but also in such other industries as food, metal, plastics, etc., where such financing expanded quite slowly during the first half (about 30-40 percent). The much heavier borrowing this year can probably be ascribed partly to the expectation of the stiffening of development loan terms, which mounted the longer the deliberations on the amendment of the capital investments law dragged on.

At the end of December 1975 the interest on development loans was altered under the proposed amended version of the law. Instead of being charged 8, 10, and 12 percent for Development Zones A, B, and C respectively, newly authorized loans will from 1976 onward bear 5 percent interest, with 50 percent linkage. At the same time the interest ceiling (including linkage differentials) has been set at 12, 14, and 17 percent respectively for these three zones for industrial establishments, and at 17.5 percent for semi-industrial firms (such as silos, cold storage facilities, sorting and packing plants, etc.). This ceiling will actually be reached when the price level rises 14 percent in Zone A, 18 percent in Zone B, and 24 percent in Zone C; this doubtless removes much of the sting of the linkage clause for the next year or two. On the other hand, the November 1974 decision that all establishments in Development Zone C receiving loans must pay linkage differentials (upon maturity) if the consumer price index goes up more than 20 percent in any single year was rescinded. The interest rate ceiling placed on development loans does not solve the problem of how to absorb the gains accruing to borrowers as the result of steep, unexpected jumps in the consumer price index. Such profits are not compatible with the economic policy objectives, and they detrimentally affect the distribution of income.

(e) *Agricultural Credit*

As in 1974, the growth of gross long- and medium-term agricultural credit lagged behind that of the sector's nominal investment--39 vs. 47 percent (excluding land amelioration, afforestation, and drainage, which are chiefly direct public sector investments). The year 1974 was the first in this decade to see a decline in the rate of financing (consisting mostly of cheap credit), after the volume of borrowed funds had exceeded the sector's

Table XVIII-8
AGRICULTURAL INVESTMENT CREDIT, 1973-75
(IL million)

	1973	1974	1975
Gross medium- and long-term credit to farms	387	485	672
Agricultural investment, at current prices ^a	385	550	810
Ratio of credit to investment (%)	100	88	83

^a Less land reclamation and conservation, afforestation, drainage, etc.

investment in 1973. Thus, despite the drop in the rate of financing over the past two years, the sum granted in 1975 still covered about 83 percent of the total investment.²⁰ This is quite a high figure, as the sector also receives a significant amount of credit directly from the public sector.

The bulk of the funding discussed here is subsidized credit granted in accordance with Ministry of Agriculture and Jewish Agency guidelines by a small group of institutions specializing in this field. The criteria governing its supply assure such financing for up to 90 percent of the value of the investment, but because of the ramified system of intermediation, the actual figure can conceivably come to more than this. At the same time, it may also be that part of the sum provided under the supervised credit and other arrangements is initially intended to finance other economic activity (nonfarm construction, purchase of durables, and so forth), as well as to provide working capital and permit the consolidation of debts arising out of past investments.

In July 1974 the interest was also jacked up about 2 percentage points on directed agricultural credit (from 9 to 11 percent, and to 12 percent for regional enterprises). This modest change was unquestionably outweighed by the big increase in the subsidy element stemming from the high rate of inflation over the past two years. The subsidy element is much larger in agricultural than in industrial credit, even though the interest charges are the same. This is because agricultural loans are for longer periods--generally 17 years (and in some cases even more), compared with eight years for industry: this renders the subsidy element especially sensitive to changes in the general price trend.

(f) *Credit to the Rest of the Economy*

Unlike agriculture and industry, the construction and service sectors are not very dependent on the system of financial intermediaries,²¹ the funds provided by the latter

20. Excluding investment in land amelioration, afforestation, and drainage.

21. With the exception of investment financing for tourist enterprises.

generally constituting a small fraction of the required investment financing. Even so, changes in these sectors' capital expenditure can usually be judged from the changes in their total credit inflow from the intermediaries.

Medium- and long-term lending to the construction industry was stepped up 43 percent to IL340 million. This was still a small sum compared with the total amount required by contractors and building firms (most of which comes from customers' credit and own sources). The relatively steep increase in such credit (mainly medium-term) during the past two years may be indicative of the sector's difficult financial straits brought on by the accumulation of a stock of unsold units.

The volume of medium- and long-term funds received by the services industry from the intermediaries more than doubled in 1975 to reach IL905 million. Most of the increment was for financing investments of the Israel Electric Corporation, but the amount provided to other borrowers rose 57 percent to IL440 million. As mentioned, this sum was quite small compared with the sector's capital outlays. The service establishments rely more heavily on funds borrowed abroad and directly from the public sector.²¹ Credit to the hotel industry, which is included in the figure for the services industry, shrank about 30 percent in nominal terms during 1975, after it had hardly risen the year before. This was consistent with the sharp cutback in real hotel investment during the past two years, which grew more acute in 1975 with the general freeze on construction.

II. COMPONENTS OF THE CAPITAL MARKET INSTITUTIONAL SYSTEM

1. SOCIAL INSURANCE FUNDS²²

(a) *Structure of the Sector and Nature of its Operations*

Approximately 200 social insurance funds administer pension, provident, and severance pay schemes in Israel. Some of the funds also cover such social benefits as mutual assistance, paid vacations, sick leave, etc., but these account for only a small fraction of their activity.

The funds may be divided into three main categories:

22. In this chapter the term "fund" designates the legal entity, which accumulates employee and employer contributions in one or more of the various types of schemes or plans, such as provident, pension, severance pay, etc. In the case of bank-administered funds, since they each operate a single scheme, the two terms are sometimes used interchangeably.

1. Histadrut-affiliated pension funds, which control over 90 percent of the pension schemes.

2. Social insurance funds managed by the banks, which cover about 70 percent of the provident and severance pay schemes.

3. Social insurance funds administered by companies and other enterprises. This group falls into all three categories, and while its share of pension and severance pay schemes is rather limited, it administers nearly one-quarter of the provident schemes.

Social insurance funds are primary financial intermediaries. They mobilize their resources from savings, allocate a small portion directly, and transfer the bulk to other financial intermediaries, which in turn allocate them to the producing and service sectors of the economy and to households. Table XVIII-9 shows that most of the sector's resources originate in savings, and that approximately 80 percent of the total is transferred to other financial intermediaries (mainly financial institutions). These savings are defined partly as employee and partly as employer contributions; however, in reality the latter can also be regarded as household saving if fringe benefits are included in the definition of wages and salaries.

The law clearly favors saving through social insurance funds over other forms of financial saving. The reason is that this encourages long-term contractual saving providing households (employees and self-employed alike) with a suitable postretirement income. This preference is expressed in various income tax reliefs. A self-employed person may deduct up to 7 percent of his taxable income (up to a maximum of IL3,500 a year) for social insurance fund contributions. Employees whose employers have no provident or pension arrangements may deduct up to 5 percent of their taxable income (up to a maximum of IL2,500 a year). On contributions in excess of these amounts both self-employed and employees are entitled to a tax credit of 25 percent of their contributions, up to IL2,500 a year. These benefits are in addition to those granted on income from long-term financial saving.

At the beginning of 1975 the government stiffened the social insurance fund saving terms. Sums deposited in excess of IL9,600 a year were henceforth deemed to be new savings, eligible for the tax concessions only after 10 years (five years for severance payments and capitalized pensions of those aged 60 or more). At the end of 1975 the term of new savings was extended to 15 years.

The regulations also prescribe the manner in which the funds may invest their resources. This is designed primarily to safeguard the members' interests by directing their savings to solid financial investments yielding a suitable real return, and to

ensure that most of the funds' resources are utilized for what the public sector considers to be essential purposes.

In 1975 the social insurance funds were required to invest 87 percent of their assets (before revaluation) in index-linked bonds deemed to be a recognized investment for the purpose of the regulations. For provident and severance pay funds the bonds mature in 17 years and bear 6 percent interest, and for pension funds they mature in 20 years and bear 6.5 percent interest. Since these are better terms than those of bonds issued to the general public, the funds are not allowed to trade in the securities without prior approval.

(b) *Receipts and Payments*

The resources at the disposal of the sector expanded much more slowly in 1975--17 as against 63 percent in 1974--and totaled IL1,990 million. The inflow of loan repayments (up 27 percent--see Table XVIII-9) trailed behind the rise in the general price level. This was because loans to households (the recipients of most of the financing) are partly nonlinked and in part are indirectly linked, in that the linkage differentials thereon are deducted from the linkage increments accrued on the borrowers' savings in the fund and are not actually paid at the time the loan is returned.

Table XVIII-9
SOURCES AND USES OF SOCIAL INSURANCE FUNDS, 1973-75
(IL million)

Sources	1973	1974	1975	Uses	1973	1974	1975
Net savings deposits ^a	887	1,505	1,735	Net transfers ^b	739	1,256	1,625
Repayment of medium- and long-term loans	157	200	253	Medium- and long-term credit granted	216	308	306
				Short-term uses, net ^c	14	62	28
				Surplus of expenditure over income	51	48	49
				Net change in cash balances and demand deposits	24	31	-20
Total sources	1,044	1,705	1,988	Total uses	1,044	1,705	1,988

NOTE: Receipts from medium- and long-term debt repayment, savings withdrawals, and redemption of securities consist not only of the principal but also interest and linkage differentials paid. In the flow-of-funds system these components were formerly defined as real (i.e. nonfinancial) transactions and included in the surplus of income over expenditure. In the present system the "surplus of expenditure over income" consists, in addition to payroll, service charges, purchase of real assets, etc., only of interest received and paid on short-term credit transactions.

^a Net of withdrawals and assuming that contributions to severance pay schemes are treated as part of household saving.

^b Consists predominantly of net purchases of securities.

^c The increase in outstanding short-term assets, less the increase in outstanding short-term liabilities.

1. *Savings receipts*

Gross deposits rose 31 percent to IL3,240 million (see Table XVIII-10), after having shot up 61 percent in 1974. Contributions to pension funds expanded at roughly the same

Table XVIII-10
FLOW OF SAVINGS, BY TYPE OF FUND, 1973-75
(IL million)

Type of fund	Deposits					Payments					Net accumulation				
	1973	1974	1975	Percent annual increase		1973	1974	1975	Percent annual increase		1973	1974	1975	Percent annual increase	
				1974	1975				1974	1975				1974	1975
Pension ^a	740	1,037	1,438	40	39	462	630	914	36	45	278	407	524	46	29
Provident ^b	612	1,182	1,481	93	25	112	210	414	87	97	500	972	1,067	94	10
Severance pay ^c	140	192	213	37	11	44	97	148	120	53	96	95	65	-1	-31
Mixed and other ^d	39	60	107			26	29	28			13	31	79	2	
Total	1,531	2,471	3,239	61	31	644	966	1,504	50	56	887	1,505	1,735	70	15

^a Funds administered by the Histadrut (General Federation of Labor), companies, and commercial banks.

^b Bank-administered and company provident funds and advanced study schemes.

^c Bank-administered central pay funds and company funds.

^d Company funds administering provident and severance pay schemes combined and paid-vacation schemes.

rate as in 1974 (40 percent), but the uptrend in provident fund contributions slowed from 93 to 25 percent, and in severance pay funds from 37 to 11 percent.

The growth of pension fund receipts corresponded to the increase in the private sector's payroll outlay²³ (about 40 percent). By contrast, provident fund receipts went up more sluggishly than in the previous year and in real terms even fell about 10 percent. This occurred even though the maximum contribution eligible for tax relief in the form of either a tax deduction or tax credit was hiked substantially. The reason apparently lay in the amendment of the regulations at the beginning of 1975, which stipulated that sums deposited in excess of IL9,600 a year would no longer be deemed to constitute part of the member's existing deposit but would be treated as a new deposit eligible for the tax benefits only after 10 years (five years for pensioners). This revision, which also applies to severance payments, capitalized pensions, etc., greatly worsened the saving terms for a substantial part of the social insurance fund membership.

Contributions to severance pay funds expanded by a fairly slack 11 percent, well below the annual average rise in the price level. This was presumably due to the tight liquidity situation in 1975 and the steeply rising cost of nondirected credit, which apparently prompted some employers to defer their contributions.

As to savings withdrawals, whereas in the case of pension funds they increased to about the same extent as prices, in the provident funds there was a staggering 97 percent jump, after an almost equally resounding 87 percent rise in 1974. In the case of severance pay funds the increase fell far short of that in 1974--53 as against 120 percent--but was still quite high.

23. Public servants are covered by noncontributory pension schemes.

2. Use of funds

As already noted, the allocation of the savings mobilized by the social insurance funds is dictated by the aforementioned regulations, and hence most of the resources are used to purchase bonds. In the year reviewed the social insurance funds invested 94 percent of their net accumulation in the securities market, compared with 84 percent in 1974. The increase was due to two main factors:

a. The raising of the proportion of assets that must be placed in recognized investments from 86 percent at the end of 1974 to 89 percent at the end of 1975. This necessitated a much larger acquisition of securities in relation to the net annual accumulation.

b. The sector greatly stepped up its purchases of new share issues.

As a result, the securities portfolio amounted to fully 85 percent of total assets (both before revaluation). Most of the investment was in financial institution bonds, with a smaller proportion being placed in government bonds and bank shares and capital notes.

In the last few years the social insurance funds have been investing more heavily in financial institution bonds, at the expense of those of other bodies (notably the National Institutions). Consequently, net redemptions have exceeded current purchases of bonds issued by the latter group. This is explained by the preference displayed by the large social insurance funds for issues of institutions belonging to their own financial concerns.

The sector is also moderately active in supplying medium- and long-term credit, primarily to households. The balance of such financing, part of which is indirectly linked (see above), rose 6 percent to IL260 million; this compares with a 33 percent growth in 1974. After rising 43 percent in 1974, the total credit outflow did not expand this year, owing to the heavier investment in securities and perhaps also to the banks' participation in the credit extended by the funds to its members.

Because of the deceleration of inflation and of the mobilization of resources in 1975, the growth of the sector's combined balance sheet (after revaluation) slowed from 72 percent in 1974 to 46 percent and amounted to IL25.7 billion at the end of the year. That the social insurance funds are primary financial intermediaries may be seen from the balance sheet, which is composed mainly of securities on the asset side and of provident, pension, and severance reserves on the liabilities side.

2. INSURANCE COMPANIES

(a) Structure of the Industry and Nature of its Operations

The insurance industry in this country consists of Israeli companies (about 30), branches of foreign firms (approximately 40), and Lloyd's agents. The preponderant share of the life insurance business is in the hands of Israeli companies which, thanks to the public sector, can offer insurance policies linked to the consumer price index. Israeli firms also dominate the general insurance branch (accounting for 80 percent of total premium receipts), though much less so than in life insurance.

The volume of life insurance business falls short of general insurance, premiums collected from households in 1975 on life insurance policies amounting to 37 percent of general insurance premiums (see Tables XVIII-11 and XVIII-12). At the same time life insurance is an incomparably more important source of long-term funds. The life insurance reserve, which represents the accumulated saving of households through the insurance companies, is more than six times as large as the general insurance reserve. This is because general insurance generates short-term assets, while life insurance generates long-term assets.

Table XVIII-11
INCOME, OUTGO, AND ACCUMULATION OF LIFE INSURANCE
COMPANIES IN ISRAEL,^a 1973-75
(IL million)

	1973	1974 ^b	1975
1. Income			
Premiums	286.4	459.2	653.3
Interest	61.0	96.4	140.0
Total	347.4	555.6	793.3
2. Outgo			
Benefits to policyholders	105.9	136.4	200.4
Agents' commissions	39.4	56.0	85.4
Other operating expenses	40.4	58.3	81.8
Gross profit ^c	9.9	34.4	66.6
Total	195.6	285.1	434.2
3. Surplus of income over outgo (1-2)	151.8	270.5	359.1
4. Income from investment of life insurance funds	111.2	347.3	617.8
5. Annual accumulation (growth of the life insurance reserves (3+4))	263.0	617.8	976.9

^a Israeli and foreign insurance companies operating in Israel and Lloyd's agents; before deducting reinsurance abroad and net of reinsurance in Israel.

^b Revised data.

^c Including profits of reinsurers abroad.

SOURCE: Central Bureau of Statistics.

Life insurance companies are also primary financial intermediaries: they mobilize funds directly from households and invest the proceeds in government-approved long-term securities (government and Israel Electric Corporation bonds) issued especially for them, with maturities of 30 years or more.

The benefits accruing to those saving through social insurance funds (discussed above) also apply to life insurance policyholders and, with a few exceptions connected with the terms and nature of life insurance business, most of the restrictions on the investment of social insurance fund monies also apply to life insurance.

Under the existing regulations life insurance companies must hold assets with matching terms against their liabilities on account of linked life insurance,²⁴ with the exception of (1) 5 percent, which they may hold in cash; (2) outstanding premiums; and (3) other current assets. As to the composition of assets subject to linkage, insurance companies may grant policyholders loans up to the cash surrender value of their policies without any limitation; of the balance, they may invest up to 20 percent in securities approved by the Commissioner of Insurance and up to 20 percent in linked loans against bank guarantees. The remainder (60 percent) must be invested in government or government-guaranteed bonds. Because of the profitability of this type of investment, the companies actually purchase more bonds than legally required.

(b) *Income and Outgo of the Life Insurance Branch*

Life insurance premium receipts increased in 1975 by 42 percent to reach IL653 million. In real terms, however, growth came to only 2 percent, compared with 12 percent in 1974. This suggests some weakening of the public's insurance-consciousness, which had increased after the 1973 war.

Interest receipts were, at IL140 million, up 45 percent (see Table XVIII-11). Capital gains on investments--i.e. the appreciation of the investment portfolio due to indexation--shot up 78 percent to IL618 million. However, this figure should be accepted with reserve, for it is residually calculated and hence collects all the errors and omissions.

Competition between the insurers was reflected, as usual, in the hiking of agents' commissions rather than the lowering of premiums. Commissions went up 53 percent, outstripping the growth of premiums.

Claims paid to policyholders rose 47 percent to about IL200 million; in 1974 the

24. The regulations governing unlinked life insurance are based on the same principle but are more favorable to the policyholder.

Table XVIII-12
GENERAL INSURANCE PREMIUM RECEIPTS,^a 1973-75
(IL million)

	1973 ^c	1974 ^b	1975
Total general premium receipts	888.8	1,239.3	1,750.2
Motor vehicle insurance	355.4	497.9	682.3
Other insurance	533.4	741.4	1,067.9
Percent annual increase in premium receipts			
Total general insurance	31.4	39.4	41.2
Motor vehicle insurance	41.4	40.1	37.0
Other insurance	25.5	39.0	44.0

^a Of Israeli and foreign companies and Lloyd's agents. Includes registration fees and marine insurance; excludes reinsurance in Israel.

^b Revised data.

SOURCE: Central Bureau of Statistics.

increment was only 28 percent. The much higher rate in 1975 was presumably connected with the settlement of numerous claims that had been pending in the past two years. The net accumulation in the life insurance branch, excluding the appreciation of investments, expanded by IL359 million or 33 percent (see Table XVIII-1). Including the appreciation of investments, the level rose 58 percent to IL977 million. It will thus be seen that most of the growth in household saving through life insurance (63 percent) originated in linkage increments.

Net purchases²⁵ of government and Israel Electric Corporation bonds added up to IL245 million, or nearly 70 percent of the surplus of receipts over expenditures (see Table XVIII-11).

(c) *Income and Outgo of the General Insurance Branch*

Premium receipts from general insurance were up 41 percent in 1975. Excluding motor vehicle insurance (which accounted for some 40 percent of total general insurance business), the increase was 44 percent, which was consistent with the expansion of economic activity.

Motor vehicle insurance premiums went up 37 percent, compared with 40 percent in 1974. The slower growth is explained by the fact that the number of vehicles increased only 4.5 percent as against 14 percent in 1974. The rise in automobile prices in 1975 averted a greater deceleration in premium receipts.

(d) *Balance Sheet of Israeli Companies*

The combined balance sheet of Israeli insurance companies expanded about 50 percent in 25. Net of redemptions, interest, and linkage increments.

Table XVIII-13

ASSETS AND LIABILITIES OF ISRAELI INSURANCE COMPANIES, 1973-75

	IL million			Percent		
	1973	1974 ^a	1975	1973	1974 ^a	1975
Assets						
Government or government-guaranteed bonds	933.5	1,606.2	2,547.9	45.6	51.5	54.3
Other securities	53.3	61.2	69.6	2.6	2.0	1.5
Loans on policies	34.0	38.4	57.2	1.7	1.2	1.2
Other loans	259.6	334.2	565.4	12.7	10.7	12.1
Long-term deposits	66.7	69.0	132.2	3.3	2.2	2.8
Real estate and investment in subsidiaries	104.5	138.6	198.6	5.1	4.4	4.2
Outstanding premiums	241.9	303.3	444.4	11.8	9.7	9.5
Sundry debtors	184.2	276.8	374.5	9.0	8.9	8.0
Cash and demand deposits	170.0	293.3	304.7	8.2	9.4	6.4
Total assets	2,047.7	3,121.0	4,694.0	100.0	100.0	100.0
Liabilities						
Paid-up share capital	96.4	117.4	166.3	4.7	3.8	3.5
General and other reserves	109.5	147.2	199.9	5.3	4.7	4.3
Life insurance reserve (less reinsurance)	848.9	1,444.8	2,355.4	41.5	46.3	50.2
General insurance reserve (less reinsurance)	190.9	269.6	370.8	9.3	8.6	7.9
Extraordinary risks reserve	76.0	107.0	159.0	3.7	3.4	3.4
Deposits of reinsurers	135.4	206.0	243.3	6.6	6.6	5.2
Pending and approved claims	366.0	561.9	798.6	17.9	18.0	17.0
Current liabilities	224.6	266.2	400.7	11.0	8.6	8.5
Total liabilities	2,047.7	3,121.0	4,694.0	100.0	100.0	100.0

^a Revised data.

SOURCE: Central Bureau of Statistics.

1975 to reach IL4,694 million. This was similar to the previous year's 52 percent gain, and in the main it stemmed from the appreciation of the linked investments portfolio (40 percent in 1975, as against 38 percent the year before).

The fact that (despite the delay in revaluing the balance sheet) securities accounted for more than 55 percent of total assets and the various reserves (including pending claims) for more than 75 percent of total liabilities indicates, as already mentioned, that the insurance companies are basically primary financial intermediaries, although less so than the social insurance funds. However, because of the nature of their activities and the competition between them, they divert a larger proportion of their resources to short-term uses than do the social insurance funds. "Other loans", "outstanding premiums", and "sundry debtors", which are short-term assets, increased by IL470 million in 1975, as against IL230 million the year before. Half of this significant gain was accounted for by "other loans", which expanded by a respectable 70 percent to reach IL565.4 million. This is attributable to the strong demand pressure for credit this year, which resulted in a

greater resort to the relatively expensive insurance company credit.

On the assets side, the weight of the linked securities portfolio moved up from 51 to 55 percent of total assets. This was partly due to net purchases²⁵ of government and government-guaranteed bonds, which rose from IL180 million to IL245 million.

3. MUTUAL FUNDS

These institutions issue participation certificates (redeemable on demand) to households, and invest all the proceeds, except for a small portion kept in liquid assets, in bonds and shares, the big majority of them listed on the Stock Exchange. As in the previous two years, the group made impressive progress in 1975. Six new funds made their appearance this year, bringing the number up to 21, with an aggregate portfolio of IL5.2 billion, or nearly 15 percent of the market value of all listed securities. This high percentage endows the fund managers with no little say over Stock Exchange developments, especially since more than 90 percent of the assets of the group (17 funds) are held by only three concerns, which are very active in the market.

In 1975 the funds netted IL1.87 billion from the sale of participation certificates, compared with some IL1 billion and IL240 million in 1974 and 1973 respectively. A monthly breakdown of the sales shows that, whereas in 1974 they more or less corresponded to the monthly fluctuations in the consumer price index, in 1975 there was a bigger divergence between them. For example, during the first quarter, when the index moved up at a 26 percent annual rate, net sales came to approximately IL180 million, while in the second and third quarters, when the price level slowed to an annual 10 percent rate, net sales shot up to approximately IL430 million a quarter. This was apparently connected with the

Table
SOURCES AND USES OF
(IL

Sources	1975						
	1973	1974	Total	I	II	III	IV
Participation certificates sold, at issue price	276	1,247	2,140	245	500	532	863
Less: Shares redeemed, at redemption price	36	247	271	62	56	118	35
Net issue proceeds	240	1,000	1,869	183	444	414	828
Total sources	240	1,000	1,869	183	444	414	828

diminished impact of inflationary expectations on household demand for mutual fund certificates. (In 1974 such expectations had decisively affected the growth of the bond funds, as they also accelerated the switch from direct bondholdings to indirect institutional purchases because of the fear that linkage gains would be taxed.) On the other hand, the influence of devaluation expectations grew stronger in 1975 (some of the mutual funds are committed to investing a substantial part of their resources in bonds linked to or traded in foreign currency). This assumption is supported by a comparison of the performance in 1975 of the funds investing most of their assets in index-linked bonds with those placing a third or more of their assets in bonds linked to or traded in foreign currency.

Net issues of the former group declined in the third and fourth quarters, when inflation slowed, and rebounded modestly in the fourth quarter, when prices went up faster. The funds investing more heavily in foreign currency moved from a negative net sale of about IL20 million in the first quarter to positive net sales of IL90 million, IL200 million, and IL375 million in the second, third, and fourth quarters respectively. There is little doubt that the upswing in the second group in the second half of the year (a doubling of net sales in comparison with the first half) can be credited to the declared policy of some of the funds to invest the bulk of their money in bonds pegged to or traded in foreign currency.

As in the past, the bond funds were again the pacesetters in 1975. The strong recovery of share prices (especially nonfinancials) was not sufficient to revive the mutual funds specializing in equities. Of the five funds of this type operating in 1974, two continued to stagnate while the other three switched to a mixed bond-share portfolio.

XVIII-14
MUTUAL FUNDS, 1973-75
million

Uses	1973	1974	1975				
			Total	I	II	III	IV
Purchases of original-issue securities	87	160	458	44	72	146	196
Less securities redeemed (principal, interest, and linkage differentials)	47	114	289	34	51	46	158
Net purchases of original-issue securities	40	46	169	10	21	100	38
Net purchases in secondary market	122	779	1,420	70	392	251	707
Expenses, taxes, dividends	69	141	255	114	26	87	28
Change in liquid means	9	34	25	11	5	24	55
Total uses	240	1,000	1,869	183	444	414	828

Despite this change, and even though these funds outperformed an investment in index-linked bonds, they did not manage to net more than IL20 million from the sale of participation certificates. Thus it is obvious that, despite the sharp advance in share prices in 1975, one cannot yet speak of a basic change in the saving public's attitude toward equity investment.

In 1975, for the first time in many years, the overall rate of return of the mutual fund industry apparently outgained the weighted average yield on the portfolio of listed securities, thanks to the relatively large proportion of its foreign currency investment (18 percent compared with 10 percent for the portfolio of listed securities). This in itself should enhance the funds' ability to compete for household financial saving. But the new capital market regulations published in mid-December 1975 may diminish the attraction of mutual funds, as they are no longer permitted to issue bearer certificates--a change likely to close this savings medium to those wishing to remain anonymous. For most of the funds this regulation actually went into effect in the second half of January 1976, when they published their new prospectuses. It is still too early to gauge the effect of this change on the mutual fund industry; after net sales plummeted to IL75 million in January, they picked up in February and March to reach IL210 million and IL140 million respectively. But it is still not clear if this was only a short-lived recovery connected with the hefty dividend payments during this period, which could be reinvested in the funds on preferential terms.

Despite the funds' respectable position among the primary financial intermediaries, their direct contribution to the financing of the government and the institutions providing credit to the various sectors of the economy remained small. Net sales of participation certificates surpassed net household saving through social insurance funds, yet less than 10 percent of the money was used for buying original-issue bonds, most of them from financial institutions. As in 1974, almost 80 percent of the net amount mobilized by the mutual funds was invested in the secondary market, where they accounted for more than a tenth of total trade in listed securities.

The percentage of securities with short maturities in the funds' index-linked portfolio again rose a bit, but there was also an appreciable increase in the proportion of those maturing in six years or more, at the expense of medium-term securities. Although this has heightened the risk involved in a massive redemption of certificates (the longer the life of a bond, the sharper are the expectations-induced fluctuations in its price), it has also increased the expected return on the portfolio. This may be related to the continued vigorous growth of the funds in 1976, which has apparently made the managers a little less

apprehensive about a possible heavy redemption of certificates. Indeed, the ratio of total redemptions (after the matching of buy and sell orders) to the value of the group's total portfolio in the middle of the year fell from 15 percent in 1974 to 8 percent in 1975.

Because of the much larger sale of certificates to the public in 1975 and the hefty appreciation of their investments, the mutual funds' portfolio (at market prices) soared 120 percent to hit IL5.2 billion, after distribution of some IL200 million in dividends.