CHAPTER XVI

FINANCIAL INSTITUTIONS[1]

1. Main Developments

The financial institutions greatly stepped up their lending operations in 1971, after some slackening of growth the year before. Gross credit provided for investment purposes was up about 40 percent, as against 20 percent in 1970. This was an unprecedented rise, and it was mainly made possible by the increased financial resources channelled directly and indirectly to the institutions by the public sector. At the same time there was a relatively large expansion (in contrast to 1970) of other financial resources, which served mainly to finance the sector's autonomous lending to the housing and construction sector.[2]

As a consequence, the institutions' net credit outflow[3] (less transfers to banking and other financial institutions) expanded by 61 percent, as opposed to 18 and 26 percent in 1970 and 1969 respectively, and totalled IL 1,193 million. The percentage increase in gross financing supplied to industry and agriculture exceeded that in real investment and prices. The lion's share of this credit bore negative real interest and was in very heavy demand, most of which was met by the financial institutions. The net credit flow to these two sectors amounted to IL 340 million and IL 123 million respectively (compared with IL 180 million and IL 91 million in 1970).

The rapid uptrend in gross housing credit carried over through the year reviewed. But whereas in 1970 there had been a 64 percent increase in loans granted on concessionary terms to buyers of publicly sponsored housing and a decline of about 20 percent in those

1. The financial institutions discussed in this chapter are defined as financial intermediaries engaged primarily in the mobilization of medium- and long-term funds for investment in financial assets, such as loans and securities. The definition excludes banking institutions, most of whose liabilities are short-term; companies financed by a limited number of proprietors; and holding companies, most of whose investments are in subsidiaries. Although they fit the definition, social insurance funds and insurance companies are also omitted here, as they are discussed separately in the next chapter. This chapter therefore does not cover the whole of the medium- and long-term credit market; but as far as industry, agriculture, housing, and to a certain extent construction are concerned, this limitation does not preclude the drawing of macroeconomic conclusions about developments in investment financing.
2. Actually only part of such activity is entirely autonomous, since many of the suppliers of funds for these purposes stipulate how they are to be used (contractors and building companies, for example, make deposits with the financial institutions for granting loans to those buying homes from them).
3. Incremental outstanding credit.

for the purchase of homes in the private market, the picture was reversed in 1971: gross lending for private housing doubled, while credit granted at the direction of the public sector grew by only some 30 percent (chiefly because of a slower rise in the case of new immigrants). At the same time, there was a significant increase in both the number and the average size of soft mortgage loans extended to the newly wed and to families relocated under urban renewal projects.

Mortgage bank advances to contractors and building companies were, at IL 105 million, approximately 50 percent greater than in 1970. This sum covered only a fraction of the total working capital required by the construction industry in 1971, the balance being obtained from other sources.

As already indicated, the larger credit outflow in 1971 was mostly made possible by the continued expansion of the institutions' resources under public sector control. There was a notable increase in the Government's direct contribution,[4] from IL 324 million in 1970 to IL 517 million, and in the sums obtained from the social insurance funds (through the sale of bonds having the status of a recognized investment – see below), which rose from IL 270 million in 1970 to IL 470 million.[5]

There was also a relatively large growth in the funds available to the institutions for granting loans at their own discretion.[6] The contribution of private business firms to the institutions' financial resources rose by about IL 80 million, compared with a decline of some IL 10 million in 1970; this can apparently be ascribed to the increased liquidity of the economy resulting from monetary developments during the year. The change in the Treasury's foreign currency control policy was another contributory factor. At least IL 50 million of the funds raised abroad by private business were made available to the financial institutions for providing discretionary loans. As a consequence, the institutions were able to reduce their dependence on Government resources after a conspicuous increase in the two preceding years.

As for the sector's activity in the securities market, the rebounding of Stock Exchange prices and trading volume was not sufficient to arrest the downward drift of the mutual funds specializing in shares and of the investment companies. The companies' portfolio of marketable securities shrank further, and they continued to concentrate on shares and bonds issued by their subsidiaries, thus increasingly assuming the function of holding companies. On the other hand, the vigorous upswing of prices and the prospect that it would continue enabled the bond funds to step up their operations.

4. The direct contribution of the Government (mostly deposits earmarked for the granting of loans) is the relevant datum for measuring the share of the public sector in the institutions' resources available for financing the various economic sectors. Since the Government also employs the institutions as financial agents through which it channels part of the funds raised for financing the development budget, the sector's net receipts from the Government are not relevant to our discussion of the direct share of the Government in financing the sector's credit business.
5. Less estimated linkage differentials on the sector's liabilities. Actually part of these funds are deposited with the Accountant General. But even minus these deposits, the proportion of "net" resources supplied by the social insurance funds for the financial institutions' credit operations was quite sizable.
6. See note 3 on p. 353.

The combined balance sheet of the financial institutions increased by IL 1,412 million to reach IL 8,057 million (IL 10,600 million if deposits with the Accountant General are included).

2. Government Influence on Financial Institution Operations

Government influence on financial institution operations (and on the capital market in general) far exceeds the weight of the sector's direct liabilities to the Government.[7] As regards the capital market, it far exceeds the Government's share in total financial intermediation. The Government, in fact, also controls the allocation of the overwhelming part of the funds supplied to the institutions by the social insurance funds and bank-administered saving schemes, which, after the Government, are the chief lenders to the sector. The Government's domination of most of the domestic sources of finance derives from the income tax exemptions and concessions it grants on the returns from recognized investments,[8] and also from the regulations prescribing the composition of the investment portfolios of social insurance funds, bank-administered saving schemes, and insurance companies.

The Government also directs part of the funds supplied by households to the sector (Saving-for-Housing scheme deposits). In addition, it can regulate, by means of foreign currency control, the mobilization of capital abroad and direct the allocation of the funds thus raised.

Although the weight of the Government in the total liabilities of the sector (excluding mutual funds) continued downward in 1971 to stand at 36 percent by year's end, the preponderant share of the institutions' financial resources is actually under public sector control (see Table XVI-1). Were it possible to deduct from the liability items in the table the financing of the securities operations of the investment companies (which also engage in credit business), the extent of Government control over the sector's credit activities would turn out to be even more pronounced.

Government influence upon the capital market in general, and the financial institutions in particular, is not confined to directing the bulk of the credit granted, but extends to the regulation of the terms of the loans (size, rates of interest, repayment terms, type of value-linkage or premium to be paid in lieu of linkage, etc.). This applies both to credit supplied by the Government itself and to the overwhelming share of that granted from the proceeds of approved bond issues. Wherever necessary, the Treasury compensates financial institutions for any difference between the cost of the capital they mobilize, including value-linkage, and the price of the credit granted, leaving them a profit margin of 1-2 percent. As regards that part of the institutions' funds that is deposited with the Accountant General (who in turn redeposits all or part of the money

7. See Table XVI-1.
8. Securities issued by enterprises where the allocation of the proceeds is subject to Government control.

with the institutions), the deposit terms take into account the price at which loans are to be granted and the institutions' profit margin.[9]

Credit granted in accordance with Government directives for the development of industry, agriculture, crafts, and tourism now generally carries interest of 6-9 percent and is unlinked.[10] However, most of the financing furnished to the services sector (including part of that provided to local authorities, but excluding loans for the development of tourism) is still linked to the consumer price index or the rate of exchange, and bears interest at rates presently ranging from 5 to 8 percent. Mortgage loans are mostly unlinked and generally carry interest of 7-12 percent. The Treasury also guarantees payment of linkage differentials (against payment of a 4 percent premium) on part of the non-directed loans[11] which the sector provides from funds raised abroad to private business firms and households.

Because it obtains the bulk of its funds either directly or indirectly from the Government, and because it supplies credit at the Government's behest and expense on fixed and especially soft terms, the financial institutions sector has, over the years, developed into an important instrument for the implementation of not only the Government's development budget but also of a supplemental quasi-budget.

In these circumstances, the greater part of the sector's activities is hardly affected by fluctuations in the money market or in the level of economic activity, except insofar as they influence the public sector's development policy. But these fluctuations have a direct bearing on the magnitude of the excess demand for directed soft credits granted by the institutions and on the composition of the financial resources (internal and external) made available to them by the public sector. However, the institutions' autonomous lending operations – which constitute a relatively small percentage of their total business and do not affect their development – are quite sensitive to changes in the money market.

Side by side with the sizable expansion of the funds under direct or indirect Government control, there was a relatively large increase in 1971 in the sums made available to the sector for the provision of discretionary loans. As a result, the institutions had to depend less on Government resources – a reversal of the situation in the previous two years. This is probably attributable both to the increased liquidity of private business, which was able to make a greater contribution to the institutions' funds, and to the Government's 1971 foreign currency control policy, which enabled the institutions to raise funds abroad for granting loans at their own discretion (especially for housing and construction purposes).

The net increase in the Government's direct contribution to the institution's resources was IL 517 million, compared with IL 324 million in 1970. But at least IL 150 million of this represents sums transferred from institutions abroad with the help of the public sector.

9. This redeposit procedure obviously artificially inflates the sector's balance sheet totals.

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

11. Interest on these loans is higher than the rates listed above.

Table XVI–1

LIABILITIES OF FINANCIAL INSTITUTIONS,[a] BY SECTOR, 1969–71

	IL million					Percent				
	1969	1970[b]	1971	Annual increase or decrease (–)		1969	1970[b]	1971	Annual increase or decrease (–)	
				1970	1971				1970	1971
Government	2,660.9	3,013.8 (2,984.8)[c]	3,530.7	323.9	516.9	39.2	38.0	35.6	27.0	26.1
National Institutions and local authorities	124.2 (147.2)[c]	89.2 (135.2)[c]	96.6	11.0	7.4	2.2	1.1	1.0	0.8	0.4
Public sector companies[d]	205.5	203.0	242.3	–2.5	39.3	3.0	2.6	2.4	–0.2	2.0
Banking institutions	665.9	1,016.9 (920.9)[c]	1,317.8	255.0 (225.0)[e]	300.9 (250.9)[e]	9.8	12.8	13.3	21.3	15.2
Social insurance funds	1,267.1	1,628.8	2,279.2	361.7 (271.7)[e]	650.4 (470.4)[e]	18.7	20.5	23.0	30.2	32.8
Insurance companies	17.4	16.2	19.7	–1.2	3.5	0.3	0.2	0.2	–	0.2
Private business[f]	281.9	271.9	352.4	–10.0	80.5	4.2	3.4	3.6	–0.8	4.0
Nonprofit institutions	71.0	87.8	121.7	16.8	33.9	1.0	1.1	1.2	1.4	1.7
Rest of the world	588.4	582.0 (678.0)[c]	769.3	89.6	187.3	8.7	7.3	7.8	7.5	9.5
Households	233.8	250.9	291.6	17.1	40.7	3.4	3.2	2.9	1.4	2.1
Accumulated profits	396.4	446.6	903.6	50.2		5.8	5.6	9.0	4.2	6.0
Unspecified[g]	250.2	335.9		85.7	121.1	3.7	4.2		7.2	
Total	6,762.7 (6,785.7)	7,943.0 (7,960.0)[c]	9,924.9	1,197.3	1,981.9	100.0	100.0	100.0	100.0	100.0
Intrasector liabilities	285.9	338.3	378.7							
Grand total	7,048.6 (7,071.6)[c]	8,281.3	10,303.6							

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

The contribution of the social insurance funds (chiefly through the purchase of financial institution bonds) increased notably, from IL 270 million[12] in 1970 to IL 470 million, thanks to their much larger accumulation. On the other hand, there was virtually no change in the banking sector's contribution. The reasons for this were some slackening in the growth of bank-administered saving schemes and the fact that in 1971 the Government increased its share in issues of option-type loans (the security generally purchased by banks) at the expense of the institutions' share.

The sector's net liabilities to the rest of the world were, at IL 187 million, more than double the previous year's figure. In contrast to 1970, only part of this amount represented funds under public sector control; the balance consisted of an estimated IL 50 million provided for the granting of discretionary loans and revaluation differentials arising out of the devaluation. But most of the growth in the institutions' autonomous activities was made possible by an IL 80 million net increase in funds supplied by private business, after a IL 10 million decline in 1970.

3. Financial Institution Credit, by Sector

The amount of medium- and long-term financing extended by the sector to the rest of the economy expanded strongly, with housing and construction, industry, and agriculture all receiving between 40 and 45 percent more gross credit than in 1970. This growth is also reflected in the net credit figures, which show that the total amount provided the economy[13] was up IL 1,193 million, or 61 percent, as against increases of 18 and 26 percent in 1970 and 1969 respectively.

The services sector (including the local authorities) also received a much larger volume of directed medium- and long-term financing, the net figure rising from IL 120 million in 1970 to IL 237 million. However, no conclusions should be drawn from these data regarding the ratio of low-interest credit to the volume of service investments since, unlike industry and agriculture, this sector receives a large percentage of such credit not from financial institutions but directly from the public sector in the form of loans and/or equity investment.

(a) *Housing and construction*

The continued acceleration of residential construction (due to the steadily mounting demand for housing since the Six Day War) and the soaring of dwelling and land prices resulted in a strong demand for mortgage financing on the part of buyers and, to a lesser extent, contractors and building companies. The demand was heavier in the case of buyers, because the boom conditions allowed contractors and building companies to impose stiffer payment terms on their customers.

12. Less revaluation differentials.

13. Excluding transfers to banking and other financial institutions.

Table XVI–2

BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS, BY FIRST SECTOR OF DESTINATION, 1969–71

(IL million)

	1969	1970[a]	1971	Annual increase or decrease (–)			Percentage distribution of increment		Percent increase in increment	
				1969	1970	1971	1970	1971	1970	1971
Industry	1,147.5	1,326.7	1,667.2	159.4	179.2	340.5	21.2	28.5	12.4	90.0
Agriculture	578.6	652.7	775.4	91.4	74.1 (91.1)[b]	122.7	8.8	10.3	–	34.7
Construction and housing	1,808.8	2,085.5	2,496.1	189.6 (212.6)[b]	276.7	410.6	32.8	34.4	45.9	48.4
Trade	21.7	23.7	26.0	1.5	2.0	2.3	0.2	0.2	33.3	15.0
Local authorities	646.3	747.3	910.2	88.6	101.0	162.9	12.0	13.7	14.0	61.3
Services	422.5	442.3	516.4	2.3	19.8	74.1	2.3	6.2	–[c]	–[c]
Banking and financial institutions	245.3	410.0	479.5	82.1	164.7	69.5	19.5	5.8	–[c]	–[c]
Households	32.4	51.7	61.0	21.9	19.3	9.3	2.3	0.8	–[d]	–[d]
Miscellaneous	73.8	81.5	82.9	35.0	(7.7)	1.4	0.9	0.1	–[d]	–[d]
Total, excl. Government	**4,976.9**	**5,821.4**	**7,014.7**	**671.8 (694.8)**[b]	**844.5 (861.5)**[b]	**1,193.3**	**100.0**	**100.0**	**28.2**	**38.5**
Government (mainly deposits with the Accountant General)	1,644.5	1,967.9	2,735.1		323.4	767.2				
Total, incl. Government	**6,621.4**	**7,789.3**	**9,749.8**		**1,167.9**	**1,960.5**				

[a] Revised data.
[b] Excluding write-offs.
[c] The percentage increase is of no significance.
[d] The percentage increase is not relevant in view of the small sums involved.

The larger volume of funds allocated by the public sector to mortgage banks in 1971, coupled with the greater amount of private capital available for financing private housing, enabled mortgage banks to again step up their loan business. Nevertheless, there continued to be a sizable excess demand for Government-directed mortgage loans. The same was true of the private mortgage market, where the effective price of credit (interest, commision, etc.) fluctuates to a certain extent. The excess demand here can be attributed to expectation of a further rise in dwelling prices and to the possibility of obtaining unlinked loans against the payment of a premium of some 4 percent p.a., which the inflation of the last few years has rendered unrealistic.

Gross credit supplied directly by mortgage banks to buyers of private and public housing expanded by a respectable 40 percent (roughly the same as in the two preceding years) and totalled IL 424 million – approximately four times the 1967 figure.

Although the percentage growth of mortgage credit in the year reviewed was similar to that in 1970, there was a marked change in its distribution in favor of young couples and families relocated under urban renewal schemes on the one hand and buyers of private housing on the other.

Gross credit extended at the direction of the public sector was up 30 percent, as against 64 percent in 1970, and totalled IL 314 million. Loans to new immigrants were responsible for the slower increase: after doubling in 1970, their volume rose only 16 percent in the year under review. The rise, relatively small as it was, was solely in the number of loans; the average size remained unchanged at IL 27,500.

Credit to families relocated under urban renewal schemes jumped from IL 6.5 million in 1970 to IL 22 million. The number of such loans more than doubled to stand at 1,350, with the average size of the loans increasing by about 50 percent to IL 16,200.

Mortgage financing to young couples from public funds expanded even more rapidly, the gross figure shooting up from IL 4 million in 1970 to IL 26 million, without borrowers being restricted to any particular type of housing scheme. The average size of such loans rose 37 percent, while the number granted more than quadrupled to reach 1,490.

As opposed to these striking increases, directed loans to other subsidized groups declined somewhat.[14] But they still accounted for 40 percent of total mortgage bank financing granted under Government direction, as against 45 percent for immigrants and 15 percent for young couples and slum dwellers.

Gross mortgage bank credit for the purchase of homes in the private market doubled in the year reviewed to total IL 110 million, compared with a decline of 21 percent in 1970.

The number of such loans jumped 70 percent to reach a new high of 7,250. But although this class of borrower was most affected by the soaring real estate prices, the average size of the loans increased by only 20 percent. This means that for recipients of private mortgage loans there was a decline in the percentage of the dwelling price covered from this source, in contrast to the increase, or at least stability, in the case of young couples and slum dwellers.

14. Veteran settlers, Saving-for-Housing schemes, etc.

Gross credit supplied by mortgage banks for nonresidential construction – mainly for local authority projects, business premises, and hotels – expanded by 5 percent, reversing a decline of 35 and 10 percent in 1970 and 1969 respectively.

As to advances to contractors and building companies, a partial estimate based on information furnished by some of the mortgage banks shows an increase of some 50 percent, compared with 35 percent in the previous year. These advances, which totalled an estimated IL 105 million, represent such a small proportion of the total working capital required by contractors and building companies that they cannot be regarded as indicative of any improvement in their liquidity position in 1971. Although the market boom enabled the builders to impose stiffer sales terms, this apparently did not provide them with all the working capital needed to finance their expanded activities.

All told, outstanding credit from the financial institutions for housing and construction purposes grew by about IL 411 million, as against IL 277 million and IL 213 million in 1970 and 1969 respectively. Households accounted for IL 2,496 million, or 68 percent, of the end-1971 figure.

(b) *Industry*

Gross credit extended to industry rose appreciably in 1971. This is reflected in the figures on the net flow over the past three years – IL 341 million in 1971, as contrasted with IL 179 million in 1970 and IL 159 million in 1969.

Although part of the industrial credit is not granted from public funds and hence bears a higher rate of interest,[15] most of the additional credit granted in the year reviewed may be attributed to the Government's development policy. This is borne out by the data on gross credit provided by the industrial development banks (which channel most of the cheap industrial loan capital supplied by the public sector): the volume of such financing is estimated at IL 375 million for 1971, as against IL 265 million in 1970 and IL 230 million in 1969. This is an increase of 42 percent, and compares with one of about 30 percent in nominal industrial investment; in the previous year the growth rates were 14 and 27 percent respectively.

The sluggish 1970 increase in soft credit in relation to the volume of investment was probably due to the reduction of the percentage of loan capital to which approved enterprises[16] are entitled. At the beginning of 1969 the proportion of soft development budget loans granted approved enterprises in Development Zones A, B, and C was reduced from 55, 50, and 45 percent respectively of the total value of the investment to 45, 40, and 33 percent respectively. Because of the time-lag between the approval of a loan and the launching of a project (and the disbursement of the funds), these cuts mainly affected investment projects started in 1970. In contrast to the development in 1970, the comparatively large increase in 1971 in such financing relative to the volume of investment is at least partly explained by the authorization granted toward the end of 1970

15. Part of the low-interest credit also has no connection with the Government's development policy, but is granted, from income tax considerations, by financial concerns to their subsidiaries.
16. Enterprises approved under the Law for the Encouragement of Capital Investments receive a number of concessions.

(and which will lapse on September 30, 1972) to the financial institutions handling Government development budget loans to extend additional financing (over and above the existing loan ratios) of up to 10 percent of the value of the investment to "recognized" enterprises and up to 15 percent to other enterprises not enjoying approved status, in both cases at 12 percent interest.

As regards the much larger volume of development budget financing granted in 1971, it should be noted that the rapid rise of prices in the economy, together with the constancy of the nominal interest rate, sharply depressed the real rate of interest, and for the majority of loans it was even negative. This development has rendered economically feasible previously unattractive low-yield investment projects. In the prevailing conditions of excess demand for credit by entrepreneurs whose projects meet the development policy criteria, the increase in inexpensive financing, combined with the reduction of the real rate of interest, accentuates still further the excess demand for such credit, which is allocated administratively. This makes it difficult to determine which projects are most worthwhile to the economy, and even if it should turn out that they are the ones that receive the cheap credit, it is clear that the incentive granted is larger than is required to induce the entrepreneurs to go ahead.

(c) *Agriculture*

Outstanding farm loans from public funds were up IL 123 million in 1971, as against IL 90 million in each of the years 1968-70 and between IL 30 million and IL 40 million in the period before that. The large increases of the past three years can be ascribed to the growing recourse to short-term loans for financing current operations and to the transfer to financial institutions of the responsibility for collecting outstanding loans given in the past to farm settlements from other sources. Most of the additional net credit in 1971 consisted of medium- and long-term loans for financing current operations and for consolidating agricultural settlements or strengthening those that were economically weak.

While investment in agriculture (excluding land reclamation and conservation, afforestation, drainage, etc., which are generally public sector investments) rose in 1971 by 11 percent at current prices, gross medium- and long-term credit granted by the major agricultural finance institutions (which account for 90 percent of the total outstanding farm credit provided by the sector) expanded by 40 percent.

(d) *Government*

"Outstanding credit to the Government" is defined in this chapter as the total amount of Government securities held by financial institutions and their deposits with the Accountant General. These deposits include such items as bond issue proceeds transferred to the Treasury, Saving-for-Housing scheme balances, loans received by the institutions from various sources (both directly and through banks) for deposit with the Accountant General, and early debt repayments prompted by the Treasury's announcement of concessions to those paying off their debts ahead of maturity. The institutions generally deposit 50-70 percent of their bond issue proceeds with the Accountant General for the purpose of financing the development budget; these funds account for approximately 70 percent of the sector's total deposit balances with him.

The balance of such deposits swelled by IL 700 million in 1971, as against IL 300 million in 1970 and IL 290 million in 1969. The relatively sluggish growth in 1970 is explained by the heavier redemption of bonds (mainly option-type issues), part of the proceeds of which had been deposited with the Accountant General. The upsurge in 1971 resulted from a number of developments: an increase in deposits of bond issue proceeds; the growth of Saving-for-Housing scheme deposits (which are automatically transferred to the Accountant General); and a sizable increase in revaluation differentials debited to the Accountant General on account of the institutions' value-linked deposits, as well in differentials on value-linked funds from which they grant unlinked loans with the Government's guarantee (against the payment of an annual premium of 2-4 percent, which is transferred to the Accountant General). These revaluation differentials do not, of course, represent an actual flow of funds to the Treasury but are a bookkeeping entry only.

The sector's portfolio of Government securities expanded appreciably, by about IL 70 million as against IL 22 million in 1970. This is largely attributable to the faster growth of the bond funds during the year. A large percentage of the additional securities were probably purchased in the secondary market and not at source.

4. Developments by Type of Institution

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

(a) *Mortgage banks*

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

The much larger volume of business in 1971 and the writing up of the banks' linked securities because of the devaluation and the ensuing rise in prices were the main factors in the doubling of the group's balance sheet. The net increase in its resources was approximately IL 425 million, compared with IL 264 million in 1970 and IL 281 million in 1969. These figures exclude deposits with the Accountant General, who, as already mentioned, guarantees a large part of the mortgage banks' linked liabilities, so that the revaluation of these liabilities involves a consequent revaluation of the deposits.

As in previous years, the mortgage banks obtained most of their net incremental resources directly or indirectly from the Government (the sale of bonds to social insurance funds and saving schemes, part of the funds mobilized abroad, etc.). But the year reviewed also saw, with the intensification of building activity and soaring housing prices,

Table XVI–3

COMBINED BALANCE SHEET TOTALS[a] OF FINANCIAL INSTITUTIONS, BY TYPE OF INSTITUTION, 1969–71

	Number of institutions	IL million			Percent			Annual increase or decrease (–)			
								1970		1971	
		1969	1970[b]	1971	1969	1970[b]	1971	IL m.	%	IL m.	%
Mortgage banks	17	2,175.5	2,439.0	2,864.3	38.2	36.7	35.6	263.5	12.1	425.3	17.4
Industrial development banks	5	1,117.2	1,375.1	1,704.1	19.6	20.7	21.1	257.9	23.1	329.0	23.9
Institutions granting loans to other sectors[c]	4	579.4	661.3	847.3	10.2	10.0	10.5	81.9	14.1	186.0	28.1
Agricultural credit funds	18	769.2	865.5	1,046.0	13.5	13.0	13.0	96.3[d]	12.5[d]	180.5	20.9
Investment companies	12	803.7	1,012.7	1,189.9	14.1	15.2	14.8	209.0	26.0	177.2	17.5
Household finance companies	15	59.7	81.7	108.6	1.1	1.2	1.3	22.0	36.9	26.9	32.9
Mutual funds	11	185.4	209.6	296.8	3.3	3.2	3.7	24.2	13.1	87.2	41.6
Total	**82**	**5,690.1**	**6,644.9**	**8,057.0**	**100.0**	**100.0**	**100.0**	**954.8**	**16.8**	**1,412.1**	**21.3**
Deposits with the Accountant General	–	1,543.9	1,845.8	2,543.3							

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

a relatively large growth in funds procured from other sources. Whereas in 1970 deposits by business firms had dropped by IL 20 million, in 1971 they rose by IL 50 million. This, as already mentioned, enabled the mortgage banks to step up to an unprecedented degree their volume of private mortgage loans. In contrast to this, there was only a small increase in mortgage financing supplied to private business (from IL 35 million to about IL 50 million).

The group's balance sheet (excluding deposits with the Accountant General) reached IL 2,864 million at the end of 1971; this represented some 36 percent of the combined balance sheet of the sector.

(b) *Industrial development banks*

This group numbers five institutions, in the largest of which, the Industrial Development Bank, the Government holds about 53 percent of the paid-up share capital. This group is characterized by an exceptionally high ratio between equity and borrowed funds (30 percent at the end of 1971) and by its almost complete dependence on Government financing, direct and indirect.

The institutions expanded their operations in 1971, granting much more financing to industry and continuing to float new bond issues (the proceeds of which are deposited with the Accountant General). Excluding these deposits, the net increase in their financial resources came to about IL 329 million, compared with IL 183 million[17] in 1970 and IL 158 million in 1969.

There was a sharp decline in the contribution of the domestic nongovernmental sectors to the institution's net incremental resources.[18] On the other hand, the public sector boosted its share enormously, from IL 50 million in 1970 to IL 280 million; this derived from funds raised abroad and channelled directly to the industrial development banks[19] and from the sale of capital notes to the Government by one of the banks.

Most of the additional financing in the year reviewed was supplied to business, which received IL 240 million in net credit as against IL 113 million in 1970, while public sector companies received some IL 65 million – about the same amount as in the previous year.

(c) *Agricultural credit funds*

This group of 18 institutions, which specialize in the financing of agricultural settlements, is headed by the Israel Bank of Agriculture and the Ya'ad Agricultural Development Bank (a large percentage of whose paid-up share capital is held by the Government), which between them account for about 70 percent of the group's balance sheet. Most of the remaining institutions are joint funds of agricultural settlements and agricultural settlement organizations, while several are linked to the Jewish Agency.

The net increase in the group's financial resources (less transfers to the Accountant

17. Less the redeposit of some IL 75 million by one of institutions in the group.
18. As mentioned above, the allocation of these resources is also controlled by the public sector.
19. In the flow-of-funds system of the economy such funds are treated as a direct flow from the Government.

General) came to IL 177 million, as against IL 113 million in 1970.[20] Whereas in previous years earmarked Government deposits accounted for about 90 percent of the net rise, the figure dropped to 30 percent in 1971 despite the much larger volume of Government-directed funds made available during the year by other financial institutions.

(d) *Institutions financing other sectors*

The four institutions in this group, in order of size, are the Maritime Bank, the Tourist Industry Development Corporation, the Local Authorities Bank, and Igarot. They mainly finance the local authorities and the services sector (shipping, tourism, etc.).

The expansion of this group fluctuates sharply from year to year, owing to the erratic swings in the long-term financing requirements of the shipping industry, interest rate changes in the international money market (shipping loans are given in foreign currency at the rates prevailing in the international market), and devaluation expectations.

The net increase in the group's resources (excluding deposits with the Accountant General) amounted to IL 186 million, as against IL 82 million in 1970. The most striking change was a IL 75 million rise in the contribution of the rest-of-the world sector, following a IL 15 million drop in 1970; but some IL 30 million of the 1971 increment was in the form of deposits held abroad and was not used for domestic financing.

After declining in 1969-70, outstanding loans granted directly to private business and to Government and Jewish Agency companies (mainly for shipping purposes) expanded in 1971 by IL 50 million. The trend turned upward only after the August devaluation; until then the figure fell, as in the two preceding years, by IL 15 million. Net credit to local authorities rose from IL 27 million to IL 35 million and that supplied to the tourist industry through banking institutions continued upward, from IL 35 million to IL 52 million.

(e) *Mutual funds*

This group comprised 11 active institutions in 1971. Four of them invest most of their resources in bonds, while the remaining seven (including a new fund established in the first half of the year) placed between 65 and 95 percent of their investments in shares.

The bond funds maintained their expansion in 1971, and for the first time in many years the share funds recorded a net increase in sales of participation certificates and in their asset portfolio. The growth of the bond funds was sustained throughout the year, but there were sharp fluctuations from quarter to quarter. As regards the share funds, all of the increase in their capital occurred in the first half of the year, when the new fund was established, whereas in the second half they again lacked vigor, there being a net redemption of certificates.

During 1971 the bond funds issued participation certificates (less redemptions) to the tune of IL 58.6 million, compared with IL 38.4 million in 1970. The total market value of their assets at the end of the year was IL 294 million.

20. Excluding write-offs.

As in the past, the growth of the bond funds was fueled chiefly by the expectations of a rise in the consumer price index, which sharpened after the August devaluation.

A much brisker sale of participation certificates in the first quarter of the year was followed by some slackening in the second and third quarters, but the trend picked up again in the final three months. The deceleration in the middle of the year and the time-lag between the devaluation and the renewal of the sharp upswing were apparently due to the Government's price control policy which, by holding prices steady, diminished the attraction of value-linked financial assets as against physical assets. Another retarding factor was the expectation of a rise in bond interest rates and its effect on bond prices in the secondary market. Support for this assumption is found in the jump in the mutual funds' Short-Term Loan holdings, which expanded nearly sixfold, from IL 1.3 million in 1970 to IL 7.5 million, even though their asset portfolio increased by only 40 percent.

The funds investing in shares posted a IL 10 million growth in the total market value of their assets. This reversed a steady six-year decline, stemming from a net redemption of certificates and the retreating of share prices on the Tel Aviv Stock Exchange. The 1971 change of trend is explained by the rocketing of share prices and a IL 5 million net issue of certificates.

But it would be premature to conclude from this that the recovery of the share market bolstered the funds' position. While advancing Stock Exchange prices increased the profits of the share funds, it was only the new mutual fund that succeeded in issuing participation certificates; all the veteran funds experienced a standstill or even a setback, winding up the year with a net redemption of certificates. Thanks to a guarantee to redeem its certificates at 150 after five years, the new fund had net sales of IL 7 million in the first half of the year. But it ceased to develop in the second half and even had to redeem certificates, since the surging of stock market prices (and with it the rise in the offering price of the certificates) greatly impaired the effectiveness of the yield guarantee.

The year reviewed therefore did not witness a turning point in the development of the share funds. For the first time in many years they did not move in step with stock market trends. The failure of the funds – whose basic policy is to spread their investments over a solid and broadly diversified share portfolio – to attract new customers during a stock market boom suggests that the stronger demand for shares in 1971 can be attributed to speculative factors rather than to a change of attitude toward equity investment on the part of those who formerly regarded this as a good savings instrument and for whom the need to spread the risk is an overriding consideration.

In 1971 sales of mutual fund certificates to households (the leading customer) came to IL 64 million at market prices (IL 25 million in 1970);[21] the proceeds were used, as in the past, to purchase financial institution bonds. Because of the substitutability of the various savings instruments, not all of this sum represented a net increase in household savings, but there is no doubt that during the past three years, with the appearance of the bond funds, the mutual funds have become a promising medium for promoting savings.

21. Net of the increase in Absorption and Defense Loan certificates, which presumably were acquired from the securities portfolio of households.

(f) *Investment companies*

The institutions in this group mobilize funds from a large number of investors and spread their portfolio over a wide range of domestic securities. Excluded from this group are holding companies, since they generally do not meet the basic criterion of diversification of investments, and companies financed by a limited number of proprietors. Most of the companies surveyed here were set up by banking institutions, and even though the founding banks no longer hold the majority of the share capital, they have ensured control over the companies by according preferential voting rights to a certain class of shares.

The 1971 stock market boom failed to arrest the downtrend in the development of this group. The number of institutions again fell, standing at 13 as opposed to 18 in 1964, and still more are in the process of winding up their operations following the contraction of their portfolio of marketable securities and a growing shift to nonmarketable securities of subsidiary firms.

Since there is no special law in this country regulating the operations of investment companies and confining them to the securities market, some of the companies have broadened the scope of their activities to include the mobilization of funds for loan purposes, mostly subject to Government directives and with its guarantee. As a result, the composition of the assets and liabilities of several of the companies hardly differs from that of other financial intermediaries, such as industrial development banks, and the bulk of their funds are used for credit transactions. At the same time, they are distinguished from other institutions (which hold securities for liquidity reasons and/or in order to gain control over companies) in that portfolio management is for them an end in itself.

There was some small growth – about IL 10 million – in the group's holdings of Government securities, while the portfolio of nongovernmental securities other than those of subsidiary and auxiliary companies continued to shrink. But investment in shares and bonds of subsidiary and auxiliary companies expanded by IL 57 million to reach IL 208 million, or 64 percent of the group's aggregate portfolio.

The group was able to step up its financing of the Government development budget and its lending to the various economic sectors, thanks mainly to the much brisker sale of bonds to social insurance funds and bank-administered saving schemes – this totalled IL 245 million as against IL 180 million in 1970. Current deposits of bond proceeds with the Accountant General doubled to reach IL 180 million. On the other hand, the net credit flow to the other sectors contracted from IL 154 million in 1970 to IL 136 million.

(g) *Household finance companies*

This group, which helps households to finance the purchase of durable goods, numbers 15 companies, and is the smallest in the sector as far as financial resources are concerned: only four of the members – Iatzil, Idid, Yahav, and the Consumer Cooperation Fund – have assets exceeding IL 3 million.

The group's resources, most of which are supplied by nonprofit institutions and public sector companies, expanded by IL 27 million in 1971, as against IL 22 million the year before. The balance sheet reached IL 109 million, less than 2 percent of the total for the entire sector (excluding deposits with the Accountant General).

5. Assets and Liabilities

The combined balance sheet of the financial institutions sector was, at IL 8,057 million, up 21 percent, compared with a 17 percent rise in 1970. The addition of deposits with the Accountant General (who is debited for most of the linkage differentials on the institutions' liabilities) brings the total up to IL 10,600 million.

(a) *Liabilities and capital*

The sector's liabilities and capital accounts consist primarily of medium- and long-term obligations, with the weight of equity capital – which has been dropping steadily for some years – amounting at the end of 1971 to about 21 percent. This ratio is still unusually high, considering that the institutions' operations consist largely of the provision of loans from funds supplied and controlled by others, and is higher yet when calculated in relation to the institutions' free resources. This is partly explained by the Government's heavy participation in the paid-up share capital of several institutions in which it holds a controlling interest, but it is also a reflection of the Government's domination of the capital market, which limits the institutions' ability to mobilize funds from other sources.

The sector's liabilities in 1971 show a sharp rise in bonds and, to a lesser extent, in nongovernmental earmarked deposits and "other deposits and loans" (see balance sheet).

Outstanding bonds soared IL 1,028 million, as against IL 499 million in 1970. This dramatic rise is only partly attributable to livelier bond sales (IL 780 million[22] as contrasted with IL 534 million in 1970). Other factors were the postdevaluation appreciation of bonds traded in foreign currency or linked to the foreign exchange rate and the substantially higher index-linkage differentials imputed to the financial institutions' accounts.

Of the total growth in outstanding bonds, IL 415 million (IL 270 million in 1970) actually represented an increase in the Accountant General's liabilities arising from the deposit with him of the proceeds of bond issues floated specifically for this purpose. Such issues totalled IL 410 million in the year reviewed, as against IL 277 million in 1970.

The expansion of nongovernmental earmarked deposits and "other deposits and loans" reflects the increased weight of private business and the foreign sector in the financial institutions' resources.

Earmarked Government deposits grew by IL 389 million, as against IL 325 million in 1970, and accounted for 38 percent of the sector's total liabilities. But it should be noted that the Government holds much of the sector's equity capital as well as a substantial part of its bond issues.

22. Of which IL 130 million derived from the sale of capital notes to the Government by one of the large financial institutions.

Table XVI–4

ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS, 1969–71

	IL million			Percent			Annual increase or decrease (–)			
							1970		1971	
	1969[a]	1970[a]	1971	1969	1970	1971	IL m.	%	IL m.	%
Assets										
Cash and bank deposits	76.9	132.8	188.3	1.3	2.0	2.3	55.9	72.7	55.5	41.8
Credit to public from own means	1,931.7	2,374.5	2,910.7	33.9	35.7	36.1	442.8	22.9	536.2	22.6
Credit to public from Govt. deposits	2,301.9	2,617.9 (2,588.9)[b]	2,991.2	40.5	39.4	37.1	279.0	12.1	373.3	14.3
Credit to public from deposits earmarked for loans[c]	743.3 (765.3)[b]	829.0 (875.0)[b]	1,112.8	13.1	12.5	13.8	131.7	17.7	283.8	34.2
Government securities	100.0	122.1	191.8	1.8	1.8	2.4	22.1	22.1	69.7	57.1
Nongovernmental securities[d]	502.3	532.2	627.0	8.8	8.0	7.8	29.9	6.0	94.8	17.8
Immovable property	34.0	36.4	35.2	0.6	0.6	0.5	2.4	7.1	–1.2	–3.3
Total	**5,690.1 (5,713.1)[b]**	**6,644.9 (6,661.9)[b]**	**8,057.0**	**100.0**	**100.0**	**100.0**	**971.8**	**17.1**	**1,412.1**	**21.3**
Liabilities and capital										
Equity capital	1,411.6	1,529.4	1,679.1	24.8	23.0	20.8	117.8	8.3	149.7	9.8
Bonds	2,154.9	2,653.5	3,681.2	37.9	39.9	45.7	498.6	23.1	1,027.7	38.7
Proceeds deposited with Accountant General[e]	1,115.0	1,385.0	1,800.0	19.6	20.8	22.3	270.0	24.2	415.0	30.0
Net proceeds	1,039.9	1,268.5	1,881.2	18.3	19.1	23.4	228.6	22.0	612.7	48.3
Deposits and loans from banks	173.6	423.3 (327.3)[b]	630.8	3.0	6.4	7.8	153.7	88.5	207.5	49.0
Govt. deposits earmarked for loans	2,295.5	2,649.5 (2,620.5)[b]	3,038.6	40.4	39.9	37.7	325.0	14.1	389.1	14.7

Nongovernmental deposits earmarked for loans	723.1 (746.1)[b]	695.5 (741.5)[b]	796.3	12.7	10.5	9.9	18.4	2.5	100.8	14.5
Other deposits and loans	342.1	389.5 (485.5)[b]	606.4	6.0	5.8	7.5	143.4	41.9	216.9	55.7
Demand deposits	16.9	20.0	19.9	0.3	0.3	0.3	3.1	18.3	-0.1	-0.5
Other accounts	-312.6	-330.8	-595.3	-5.5	-5.0	-7.4	-18.2	-5.8	-264.5	-80.0
Deposits with the Accountant General, excl. bond proceeds	-428.9	-460.8	-743.3	-7.5	-7.0	-9.2	-31.9	-7.4	-282.5	-61.3
Other accounts (net)	116.3	130.0	148.0	2.0	2.0	1.8	13.7	11.8	18.0	13.8
Total	**5,690.1 (5,713.1)[b]**	**6,644.9 (6,661.9)[b]**	**8,057.0**	**100.0**	**100.0**	**100.0**	**971.8**	**17.1**	**1,412.1**	**21.3**

[a] Revised data.
[b] Less transfers to reserves and/or write-offs.
[c] Includes consortium loans granted from earmarked bank deposits.
[d] Includes investments in subsidiary companies.
[e] Provisional estimate for 1971.

(b) *Assets*

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

Loans expanded by IL 1,193 million in 1971, compared with IL 862 million in the previous year. Half of the incremental credit was provided from the institutions' own means (as distinct from deposits for loan purposes), but it must be remembered that most of the institutions' loan funds derive from bond proceeds which, although they have not been deposited with the Accountant General, are disbursed by the institutions in accordance with public sector directives. Nevertheless, earmarked deposits from non-Government sources contributed to the 1971 balance sheet growth, increasing from IL 132 million in 1970 to IL 284 million.

The securities portfolio expanded by IL 165 million, compared with IL 51 million in 1970, as a result of the growth of the bond funds and also because of the larger investment made by some of the investment companies in subsidiaries.[23]

6. FLOW OF FUNDS, BY SECTOR

This analysis of the flow of funds between the financial institutions and the other domestic sectors is based on the individual balance sheets and profit and loss accounts of the various institutions. A comparison of two consecutive balance sheets shows the flow of receipts and payments arising from transactions in financial assets during the year, while the flow defined as "nonfinancial transactions" (see Table XVI-5) is gleaned from a comparison of two consecutive profit and loss statements.

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

The sector's business expanded by 66 percent, as against 16 percent in 1970, and reached IL 2,905 million. Although the accelerated increase partly reflected revaluations due to the devaluation and the rapid rise of prices, in the main it represented an actual expansion of the sector's transactions, which rose by 42 percent as against 23 percent in 1970.

Most of the net credit to the financial institutions was provided by the social insurance funds, banks, and the foreign sector. The chief borrowers were private business, households, and the public sector. The Government appears as a net borrower to the tune of IL 230 million, but a large percentage of the "payments" to it were of a bookeeping nature only – the adjustment of Government liabilities to the sector for linkage differentials and adjustments arising out of the Treasury's guaranteeing (against a premium of 2-4

23. Investments in auxiliary companies (securities and loans) are included in the balance sheet under "nongovernmental securities".

FLOW-OF-FUNDS STATEMENT OF THE FINANCIAL INSTITUTIONS, BY SECTOR, 1970–71

(IL million)

	Receipts			Payments			Surplus of receipts over payments	
	1970[a]	1971	Increase or decrease (–)	1970[a]	1971	Increase or decrease (–)	1970[a]	1971
Nonfinancial transactions	**635.2**	**900.5**	**265.3**	**602.5**	**851.9**	**249.4**	**32.7**	**48.6**
Transactions in financial assets								
Government	331.4	516.9	185.5	323.4	767.2	443.8	8.0 (–1.0)[b](28.0)[c]	–250.3 (–230.3)[c]
National Institutions and local authorities	–35.1	7.4	42.5	104.0	181.9	77.9	–139.1 (–93.1)[b]	–174.5
Public sector companies	–4.4	39.3	43.7	41.8	79.0	37.2	–46.2	39.7
Banking institutions	351.0	300.9	–50.1	178.1	96.7	–81.4	172.9 (76.9)[b]	204.2
Social insurance funds	361.2	650.4	289.2	12.1	–8.2	–20.3	349.1	658.6
Insurance companies	–1.4	3.5	4.9	–2.0	0.8	2.8	0.6	2.7
Private business[d]	–11.2	80.2	91.4	278.5	565.3	286.8	–289.7 (–306.7)[b]	–485.1
Nonprofit institutions	15.1	33.9	18.8	26.3	24.7	–1.6	–11.2	9.2
Rest of the world	–6.4	187.3	193.7	1.7	30.0	28.3	–8.1 (87.9)[b]	157.3
Households[e]	43.7	104.8	61.1	196.0	333.2	137.2	–152.3 (–132.3)[c]	–228.4 (–248.4)[c]
Unspecified[f]	75.3	79.5	4.2	–	–	–	75.3	79.5
Total transactions in financial assets	**1,119.2**	**2,004.1**	**884.9**	**1,159.9**	**2,070.6**	**910.7**	**–40.7**	**–66.5**
Errors and omissions	–	–	–	–8.0	–17.9	–9.9	8.0	17.9
Total receipts and payments	**1,754.4**	**2,904.6**	**1,150.2**	**1,754.4**	**2,904.6**	**1,150.2**	–	–

[a] Revised data.
[b] Less transfers to reserves and/or write-offs.
[c] Less estimated purchases of Government securities from households.
[d] Including farms.
[e] Including contractors' deposits sold to households through banking institutions.
[f] Including securities sold on the Stock Exchange.

percent p.a.) the payment of linkage differentials accruing on the sector's external sources of funds that were lent out on an unlinked basis. Were it not for these adjustments, there would have been a net inflow of some millions of pounds from the Government.[24]

Net receipts from the social insurance funds sector, which once again was the chief lender, added up to IL 659 million, compared with IL 349 million in 1970; less revaluation differentials, the respective figures are IL 480 million and IL 260 million.

Two factors were responsible for the decline in gross receipts from the banking sector. One was the slackening in the growth of bank-administered saving schemes; the other was the Government's decision to issue more of the optional loans, the type of security most in demand by the saving schemes, at the expense of the financial institutions' share of such issues. Net receipts, however, were considerably higher than in 1970, when the institutions' payments to the banks were exceptionally heavy.

The private business sector heads the list of recipients of funds from the financial institutions. In the year reviewed, which witnessed a notable growth in the institutions' lending operations, net payments to this sector soared 58 percent to IL 485 million. The much heavier volume of mortgage loans granted for the purchase of homes in public and private housing projects was, of course, reflected in net payments to households. Despite the accelerated growth of the bond funds (whose main clients are households) and despite the relatively large increase in Savings-for-Housing scheme deposits, such payments jumped 88 percent to IL 248 million.

24. The net flow of funds from the Government to the financial institutions does not indicate the degree of Government influence over the institutions' credit operations, for two reasons: (a) much of the credit granted out of non-Government funds is also subject to Government directives (see section 2); (b) a substantial proportion of the sector's net payments to the Government is made from funds raised by the institutions with Government approval, since the Government controls an overwhelming share of the local capital market. In these activities the institutions really act as the Government's financial agents.