

## CHAPTER XV

# FINANCIAL INSTITUTIONS<sup>1</sup>

### 1. MAIN DEVELOPMENTS

THE FINANCIAL INSTITUTIONS greatly expanded their lending operations in 1972, for the second consecutive year. Gross credit supplied for investment purposes rose by 35 and 40 percent in 1971 and 1972 respectively, as against 20 percent in 1970. This accelerated increase can be partly credited to a relatively large expansion of the institutions' resources not under public sector control, but it was mainly made possible by the much larger amount of funds channelled directly or indirectly to them by the public sector and used to provide soft credit—usually at a virtually zero or even negative rate of real interest. The sharply higher volume of inexpensive medium- and long-term credit granted in 1972 under public sector direction apparently diverted demand from the relatively more expensive short-term bank credit.

As a consequence, the financial institutions' net credit outflow<sup>2</sup> (less transfers to banking and other financial institutions) soared from IL 695 million in 1970 and IL 1,110 million in 1971 to IL 1,700 million in the year reviewed. As in 1971, the incremental gross financing (mostly low-interest credit) supplied to industry and agriculture exceeded the growth of real investment in these sectors and the rise of prices in the economy. Medium- and long-term industrial loans amounted to about half the value of total nominal investment in this sector, while those extended to agriculture were some 20 percent greater than incremental farm investment (excluding infrastructure outlays on land reclamation and conservation, drainage, etc., which are mostly direct investment of the public sector). Part of the medium- and long-term credit granted to the agricultural sector was probably used for financing construction and other economic activities.

<sup>1</sup> 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 entire 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 (see below).

<sup>2</sup> Incremental outstanding credit.

The year reviewed saw a further strong increase (about 40 percent) in gross housing credit. Mortgage banks granted a total of some 29,000 loans, amounting to IL 584 million. But whereas there was a big increase in all types of mortgage financing (apart from that to new immigrants) provided at the direction of the public sector (especially to newlyweds), in respect to both the number and the average size of the loans, the amount of credit provided for the purchase of homes in the private market was down 5 percent to IL 105 million (after having doubled in 1971), with the number of loans dropping 8 percent. Presumably the much greater volume of directed credit granted in 1972 for bettering the housing conditions of various strata of the population met part of the demand which in the past had been supplied by the private mortgage credit market from own resources.

Mortgage bank advances to contractors and building companies were, at IL 200 million, nearly double their 1971 volume. This sum, however, covered only a fraction of the total working capital required by the construction industry in 1972.

As already indicated, the stronger credit outflow was mostly made possible by the much larger amount of funds channelled to the institutions by the public sector. Although the Government's direct contribution to the sector's liabilities was down from IL 521 million in 1971 to IL 487 million and the sector's flow-of-funds statement shows that the Government was a net recipient of credit to the tune of IL 487 million, as against IL 220 million in 1971, the funds which it indirectly provided to the institutions rose conspicuously. The amount of direct and indirect financing flowing from the public sector to the institutions in the past two years is estimated at 80 percent of their total incremental resources. This figure is consistent with the estimated share of the credit granted by the institutions in accordance with public sector directives in their total gross lending during the past two years (80–82 percent). The most outstanding features in the year reviewed were the much larger volume of gross bond issues which the public sector permitted the institutions to float—IL 960 million compared with IL 650 million in 1971—and the IL 385 million net sum raised abroad (mainly by institutions operating under Government direction), as contrasted with IL 138 million in 1971.

At the same time, as indicated above, there was a relatively large growth in the institutions' funds available for granting loans at their own discretion. The contribution of private business firms to the institutions' financial resources rose by IL 170 million, compared with IL 60 million in 1971 and a decline of IL 10 million in 1970. As in 1971, most of the increment consisted of deposits made by contractors and building companies with the mortgage banks.

As for the sector's activity in the securities market, the extraordinary boom enjoyed by the stock market throughout most of the year ended the stagnation which the investment companies had experienced for the past several years, but it had very little effect on the mutual funds specializing in shares. On the

other hand, the prevailing inflation and the expectation that prices would continue upward heightened demand for participation certificates in the mutual funds investing predominantly in bonds, which succeeded in mobilizing a record IL 150 million from the public.

The combined balance sheet of the financial institutions increased by IL 2,157 million to reach IL 9,949 million (IL 13,394 million if deposits with the Accountant General are included).

## 2. GOVERNMENT INFLUENCE ON FINANCIAL INSTITUTION OPERATIONS

Government influence on the financial institutions (and on the capital market in general) far exceeds the weight of the sector's direct liabilities to the Government.<sup>3</sup> 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 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,<sup>4</sup> 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 raised in this manner.

Although the weight of the Government in the total liabilities of the sector (excluding mutual funds) continued downward to stand at 32 percent by year's end (see Table XV-1), and although in the sector's flow-of-funds statement the Government sometimes appears as a net recipient of credit from the financial institutions,<sup>5</sup> the preponderant share of the institutions' financial resources is actually under public sector control.

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, interest rates, repayment terms, type of value-linkage or premium to be paid in lieu

<sup>3</sup> See Table XV-1.

<sup>4</sup> Securities issued by enterprises where the allocation of the proceeds is subject to Government control.

<sup>5</sup> A large percentage of the payments to the Government is connected with the mobilization of funds with the Treasury's authorization on condition that they are transferred to it. As regards this part, the institutions act as financial agents of the Government. The balance consists almost entirely of linkage differentials on the Government's linked liabilities to the sector.

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. Where 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 deposited with the Accountant General (who in turn redeposits all or part of the money with the institutions), the deposit terms take into account the price at which loans are to be granted and the institutions' profit margins.<sup>6</sup>

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.<sup>7</sup> 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 ranging from 5 to 8 percent. Mortgage loans are mostly unlinked and generally carry interest of 7–13 percent.

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 not only of 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 developments in the money market or in the level of economic activity, except insofar as they influence the public sector's development policy. But these developments have a direct bearing on the magnitude of the excess demand for directed soft credit granted by the institutions and on the composition of the financial resources (internal and external) made available to them by the public sector.

The institutions' autonomous lending operations—which constitute a relatively small percentage of their total business—are financed from several sources: funds supplied by private business firms—the magnitude of these resources largely depends on monetary developments and the liquidity situation in the economy; part of the funds which the Treasury permits the institutions to mobilize abroad for their own free use; and the sector's bond issue proceeds not earmarked for deposit with the Accountant General and/or for providing directed credit. However, it is quite likely that, in the absence of stringent con-

<sup>6</sup> This redeposit procedure artificially inflates the sector's balance sheet.

<sup>7</sup> 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.

Table XV-1

LIABILITIES OF FINANCIAL INSTITUTIONS,<sup>a</sup> BY SECTOR, 1970-72

	IL million					Percent				
	1970 <sup>b</sup>	1971 <sup>b</sup>	1972	Annual increase or decrease (-)		1970 <sup>b</sup>	1971 <sup>b</sup>	1972	Annual increase or decrease (-)	
				1971	1972				1971	1972
Government	3,003.7	3,524.9	4,011.6	521.2	486.7	38.9	36.5	32.4	26.9	17.7
National Institutions and local authorities	89.2	96.6	115.1	7.4	18.5	1.2	1.0	0.9	0.4	0.7
Public sector companies <sup>c</sup>	203.0	236.2	274.4	33.2	38.2	2.6	2.4	2.2	1.7	1.4
Banking institutions	997.8	1,290.8	1,673.4	293.0(243.0) <sup>d</sup>	382.6(302.6) <sup>d</sup>	12.9	13.4	13.5	15.1	13.9
Social insurance funds	1,571.7	2,140.3	2,943.8	568.6(388.6) <sup>d</sup>	803.5(523.5) <sup>d</sup>	20.4	22.2	23.7	29.4	29.3
Insurance companies	16.2	19.7	27.3	3.5	7.6	0.2	0.2	0.2	0.2	0.3
Private business <sup>e</sup>	255.0	311.6	481.4	56.6	169.8	3.3	3.2	3.9	2.9	6.2
Nonprofit institutions	87.8	116.7	180.6	28.9	63.9	1.1	1.2	1.5	1.5	2.3
Rest of the world	491.5	674.0	1,058.0	182.5	384.0	6.4	7.0	8.5	9.4	14.0
Households	250.9	291.6	377.6	40.7 <sup>f</sup>	86.0 <sup>f</sup>	3.2	3.0	3.0	2.1	3.1
Accumulated profits	436.1	954.6	1,258.4	202.0	303.8	5.7	9.9	10.2	10.4	11.1
Unspecified <sup>g</sup>	316.5					4.1				
Total	7,719.4	9,657.0	12,401.6	1,937.6	2,744.6	100.0	100.0	100.0	100.0	100.0
Intrasector liabilities	327.6	359.6	496.1	32.0	136.5					
Grand total	8,047.0	10,016.6	12,897.7	1,969.6	2,881.1					

<sup>a</sup> Excluding mutual funds.<sup>b</sup> Revised data; excluding one institution which changed its status to a holding company.<sup>c</sup> Companies owned by the Government, National Institutions, or local authorities.<sup>d</sup> Excluding revaluation increments (estimate).<sup>e</sup> Including farms.<sup>f</sup> Consists mostly of household accumulation in the Saving-for-Housing Scheme.<sup>g</sup> Including sales of securities on the Tel Aviv Stock Exchange.

trol, part of the funds earmarked from the outset for the provision of directed soft credit are in fact eventually used to finance the institutions' autonomous operations. The reference is to that portion of the institutions' bond issue proceeds which in the past were used for granting directed credit.<sup>8</sup> When these loans fall due before the bonds (the issues usually have maturities of 17 or 20 years), it is not clear whether the difference between the two flows is always put at the disposal of the Treasury during the interim period.

The additional financial resources channelled directly or indirectly to the institutions by the public sector rose in 1972. Although the Government's direct share in the sector's incremental liabilities declined from IL 521 million in 1971 to IL 487 million and the Government was a net borrower from the sector to the tune of IL 487 million, as against IL 220 million in 1971 (see Table XV-5), the institutions' gross bond issues reached IL 960 million, compared with IL 650 million in 1971,<sup>9</sup> and the net amount raised abroad (mostly for financing institutions operating under Government control) totalled IL 385 million, as against IL 183 million in 1971. In addition, most of the growth in net liabilities to households (excluding those of the mutual funds), public sector companies, and nonprofit institutions also consisted of financial resources supplied indirectly by the public sector. It is estimated that in the last two years the portion of the institutions' total incremental resources which may be fairly reliably regarded as flowing to them directly or indirectly from the public sector reached 80 percent. This figure accords with the estimated share of directed credit in the institutions' total gross credit outflow during the past two years (80-82 percent).

Along with the sizable expansion of funds under public sector control, there was a relatively large increase in the institutions' resources available for the provision of discretionary loans; the increase in net liabilities to the private business sector came to IL 170 million, as against IL 60 million in 1971 and a decline of IL 10 million in 1970. As in 1971, most of the additional funds obtained from private business were deposits of contractors and building companies with the mortgage banks.

### 3. FINANCIAL INSTITUTION CREDIT, BY SECTOR

After some slackening of growth in 1970, the amount of medium- and long-term financing supplied during the past two years to the rest of the economy (the bulk of such financing, as already mentioned, was granted at low rates of interest and under the direct or indirect control of the public sector) expanded strongly, with housing and construction, industry, agriculture, and local authorities receiving an estimated 40 percent additional gross credit in each of

<sup>8</sup> Without first being deposited with the Treasury.

<sup>9</sup> Table XV-1 shows that the lion's share of these sums, plus value linkage differentials, is accounted for by banking institutions, social insurance funds, and the "unspecified" item.

the past two years. This is indicated by the data on the sector's net credit outflow,<sup>10</sup> which rose from IL 590 million and IL 695 million in 1969 and 1970 respectively to IL 1,110 million in 1971 and IL 1,700 million in 1972.

(a) *Housing and construction*

The rapid uptrend in the amount of mortgage financing provided to home buyers in the three preceding years carried over through 1972 (as regards contractors and building companies it even accelerated). During this period the burgeoning demand for housing, reflected in the soaring of housing and land prices, resulted in a strong demand for mortgage financing. This mounted steadily, and even though the supply of such credit was expanded, it could not keep pace with demand. Hence the relative easing of demand for homes which began to be felt in early 1971 (and which retarded the rise in housing prices) did not alter the picture in the mortgage credit market—the sizable excess demand prevailed throughout the entire year despite the much larger supply of funds to this market. Gross credit granted directly by mortgage banks to buyers of private and public housing expanded by a respectable 38 percent in 1972 to reach IL 584 million.

Although the percentage rise in gross mortgage credit to home buyers was similar to that of the past few years, there was a marked change in its distribution, in line with the trend begun in 1971. The percentage of gross loans to new immigrants continued downward, while the proportion granted to newlyweds and families relocated under urban renewal schemes rose. However, the volume of credit for the purchase of homes in the private market declined somewhat, after doubling in 1971, and there was an exceptional increase in other subsidized groups (Saving-for-Housing Scheme, veteran settlers, etc.), following a fairly sluggish growth in recent years.

Gross credit extended by mortgage banks from public funds was up 53 percent, as against 30 percent in 1971, and totalled IL 480 million. The share of immigrants, who in 1970 received nearly half of total directed mortgage credit, fell to 30 percent in the year reviewed.

Despite the continued growth of immigration, only 6 percent more credit was given to newcomers in 1972, and there was even a slight decline in the number of loans. This is probably at least partly explained by the rise in the proportion of immigrants from nonaffluent countries, some of whom prefer to rent a home rather than buy one, and also by the tightening, in the latter part of 1971, of the criteria governing the size of mortgage loans. A technical or real shortage of immigrant housing may have been another factor.

Mortgage financing to young couples from public funds, which had increased from IL 4 million in 1970 to IL 26 million in 1971, trebled in 1972 to reach

<sup>10</sup> Excluding transfers to banking and other financial institutions.

**Table XV-2**  
**BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS, BY FIRST SECTOR OF DESTINATION, 1970-72**  
 (IL million)

	1970 <sup>a</sup>	1971 <sup>a</sup>	1972	Annual increase or decrease (-)			Percentage distribution of increment		Percent increase in increment	
				1970	1971	1972	1971	1972	1971	1972
Industry	1,305.2	1,644.1	2,137.4	174.1	338.9	493.3	28.7	27.0	94.7	45.6
Agriculture	652.7	775.4	987.7	74.1(91.1) <sup>b</sup>	122.7	212.3	10.4	11.6	34.7	73.0
Construction and housing	2,064.5	2,477.5	3,141.1	275.7	413.0	663.6	35.1	36.3	49.8	60.7
Trade	20.7	22.2	32.2	2.0	1.5	10.0	0.1	0.5	-25.0	<sup>c</sup>
Local authorities	746.3	909.9	1,169.5	100.0	163.6	259.6	13.9	14.2	63.6	58.7
Services	442.3	493.1	466.3	20.8	50.8	-26.8	4.3	-1.4	<sup>c</sup>	<sup>c</sup>
Banking and financial institutions	394.0	464.2	593.4	165.7	70.2	129.2	6.1	7.1	<sup>c</sup>	84.0
Households	51.7	61.0	122.1	19.3	9.3	61.1	0.8	3.3	<sup>c</sup>	<sup>c</sup>
Miscellaneous	62.3	69.8	95.9	10.3	7.5	26.1	0.6	1.4	<sup>c</sup>	<sup>c</sup>
Total, excl. Government	5,739.7	6,917.2	8,745.6	842.0(859.0) <sup>b</sup>	1,177.5	1,828.4	100.0	100.0	37.1	55.3
Government (mainly deposits with the Accountant General)	1,944.9	2,706.1	3,689.5	327.9	761.2	983.4				
Total, incl. Government	7,684.6	9,623.3	12,435.1	1,169.9	1,938.7	2,811.8				

<sup>a</sup> Revised data; excluding an institution that changed its status to a holding company.

<sup>b</sup> Excluding write-offs.

<sup>c</sup> Because of the small sums involved the percentage increase is of no significance.

IL 106 million. This demonstrates the importance which the public sector attaches to the housing problem of young couples—a problem which has grown increasingly acute in recent years because of the rocketing of dwelling prices. In 1972 the volume of cheap public loans granted to young couples reached three-quarters of that extended to immigrants, with the size of the loans averaging IL 20,000, compared with IL 30,000 for the latter.

Another component of directed mortgage finance which grew noticeably in 1972 was connected with the improvement of housing conditions of various strata of the population. Saving-for-Housing Scheme credit doubled compared with the previous two years to stand at IL 65 million; there was a 40 percent jump in the number of loans and the average size went up from IL 21,000 to IL 30,000. Credit to families relocated under urban renewal schemes and that to other subsidized groups (veteran settlers, etc.) rose 30–40 percent to reach IL 29 million and IL 129 million respectively.

While all components of directed mortgage credit (other than that to immigrants) showed a sharp rise in the number and, in general, in the size of the loans, discretionary loans for the purchase of homes in the private market were, at IL 105 million, down 5 percent, with the number of loans falling 8 percent. Whereas with respect to directed mortgage credit it may safely be stated that, despite the enormously larger amount of finance provided, the only effective constraint in 1972 was that of supply, the situation as regards loans for private housing is not clear. On the one hand, the decline in the total amount granted, even though the size of the average loan remained unchanged (despite the 20 percent jump in dwelling prices), and the imposition in the second half of 1972 of a ceiling on the size of the loans which mortgage banks were permitted to grant support the assumption that here too the effective constraint was on the supply side. On the other hand, it is a reasonable inference that the retardation of the spiralling of home prices since the early part of 1972 would depress demand for the relatively more expensive discretionary loans, especially as public sector credit for the improvement of housing conditions (which to some extent is a substitute for discretionary loans) rose substantially in 1972.

As to advances to contractors and building companies, a provisional estimate based on information supplied by part of the mortgage banks shows that the volume doubled to reach IL 200 million; this, however, represents only a small fraction of the total working capital required by this group.

All told, outstanding credit from the financial institutions for housing and construction grew by a respectable IL 664 million and totalled IL 3,141 million; this compares with increases of IL 413 million and IL 276 million in 1971 and 1970 respectively. Households received 72 percent of the total sum in 1972; this is a very sizable amount, and the repayments on such a large debt, which for 1972 are estimated at more than IL 200 million, affect the level of current household saving.

## (b) *Industry*

Gross credit to industry grew by an appreciable 40 percent in 1972, following an equally impressive 35 percent rise in the previous year and a sluggish 15 percent rise in 1970. The big 1972 increase occurred even though the expansion of nominal industrial investment edged down from 30 percent in 1970 to 28 percent, and long-term loans extended to the sector in 1972 covered about half its total investment, compared with 40–45 percent in 1971.<sup>11</sup>

As in previous years, the heavier industrial borrowing may be attributed predominantly to the public sector's development finance policy. To illustrate, about 92 percent of the industrial credit was granted in accordance with public sector directives and another 5 percent at the behest of other public bodies (such as *Hevrat Ha'ovdim*—the *Histadrut* holding company), whose sources of funds are also largely under public sector control.

The relatively sluggish 1970 increase in credit in relation to the value of investments was due to the reduction of the percentage of loan capital in the total investment to which enterprises were entitled under the development policy. At the beginning of 1969 the proportion of development budget loans granted to 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 the loan and the launching of the project (and the disbursement of the funds), these cuts mainly affected investment projects begun in 1970. In contrast, the much larger volume of financing provided in the past two years can be ascribed, at least partly, to the authorization granted toward the end of 1970 to the financial institutions to extend additional financing (over and above the existing 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 credit granted on concessionary terms during the past two years, it should be noted that the rapid rise in 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 rendered economically feasible previously unattractive low-yield investment projects. In the prevailing conditions of excess demand for soft credit by entrepreneurs whose projects meet the development policy criteria, an 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. It thus becomes difficult to determine which projects are most worthwhile for the economy, and even

<sup>11</sup> These exceptionally high rates of increase can apparently also be attributed to the fact that part of the medium- and long-term credit granted to industry was not connected with the implementation of current investments but was provided for the consolidation of debts, etc.

if it should turn out that they are the ones that receive the cheap credit, it is clear that the incentive granted is greater than required to induce entrepreneurs to go ahead.

All told, outstanding credit to industry rose from IL 174 million in 1970 and IL 339 million in 1971 to IL 493 million in the year reviewed.

(c) *Agriculture*

The amount of credit supplied to agriculture again rose strongly in 1972. While investment in this sector (excluding land reclamation and conservation, afforestation, drainage, etc., which are generally public sector investments) rose in 1971 and 1972 by about 13 and 20 percent respectively at current prices, gross medium- and long-term credit provided by the major agricultural finance institutions went up 40 percent in each of the past two years, and in 1972 it exceeded the sector's total investment (excluding those made directly by the public sectors) by over 20 percent. Part of the medium- and long-term credit was probably used to finance building and other economic activity (industry, etc.) not connected with agricultural investment or to consolidate debts, while another part of the medium-terms funds may have been borrowed for working capital purposes. However, it seems fairly evident that in recent years a growing share—and in 1972 the preponderant share—of the sector's investment finance requirements is provided by the financial institutions at low interest rates from Government and other public sector funds.

In the year reviewed the total amount of net agricultural credit supplied by the financial institutions reached IL 212 million, as against IL 123 million and IL 91 million in 1971 and 1970 respectively.

(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. The 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/or through banks) for deposit with the Accountant General, and early debt repayments prompted by the concessions granted by the Treasury 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 financing the development budget; these funds accounted in 1972 for nearly 73 percent of the sector's total deposit balances with him.

The balance of such deposits swelled by IL 920 million in 1972, as against IL 700 million in 1971 and less than half this amount in 1969 and 1970. The exceptional upsurge in 1972 was largely connected with the much larger volume of bonds issued in the past two years by the institutions specializing in the financing of the development budget and the various sectors of the

economy, and with the increase in the share of the proceeds deposited with the Accountant General to about 70 percent of the institutions' total proceeds from domestic and overseas issues (this yielded IL 655 million in 1972, compared with IL 410 million in 1971). The growth of Saving-for-Housing Scheme deposits, which are automatically transferred to the Accountant General, contributed to the IL 50 million increase in each of the past two years in mortgage bank deposits with the Accountant General.<sup>12</sup> Another part of the institutions' incremental outstanding deposits with the Accountant General stemmed from the sizable increase in revaluation differentials debited to the Accountant General on account of the institutions' value-linked deposits, as well as differentials on funds linked to the consumer price index or to the rate of exchange from which they grant unlinked loans with the Government's guarantee (against payment of an annual premium of 2–3 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 by about IL 60 million. As in the previous year, the mutual funds accounted for most of the increase.

Following the rapid growth of the Government's liabilities to the financial institutions, the sector's financial claims on the Government reached IL 3,690 million, or 27 percent of its total liabilities.

#### 4. DEVELOPMENTS BY TYPE OF INSTITUTION

The financial institutions sector surveyed in this chapter number 79 intermediaries classified into seven specialized groups (see Table XV-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 16 concerns, four of which—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 very low (about 5 percent), but the group's operations are to a large extent guaranteed by the Treasury.

The strong expansion of the mortgage banks' financial resources continued in 1972, with the net increase (excluding deposits with the Accountant General) amounting to IL 765 million, compared with IL 425 million in 1971 and IL 200 million and IL 300 million in 1969 and 1970 respectively.

<sup>12</sup> It should be pointed out in this connection that in 1972 the public sector provided IL 65 million in mortgage finance to members of this scheme.

Table XV-3

**COMBINED BALANCE SHEET TOTALS<sup>a</sup> OF FINANCIAL INSTITUTIONS,  
BY TYPE OF INSTITUTION, 1970-72**

	Number of insti- tutions	IL million			Percent			Annual increase or decrease (-)			
		1970	1971 <sup>a</sup>	1972	1970	1971 <sup>b</sup>	1972	1971		1972	
								IL m.	%	IL m.	%
Mortgage banks	16	2,439.0	2,864.3	3,628.3	37.9	36.7	36.5	425.3	17.4	764.0	26.7
Industrial development banks	5	1,375.1	1,704.1	2,124.2	21.4	21.9	21.3	329.0	23.9	420.1	24.7
Institutions granting loans to other sectors <sup>c</sup>	4	661.3	847.3	1,058.7	10.3	10.9	10.6	186.0	28.1	211.4	24.9
Agricultural credit funds	18	865.5	1,046.0	1,322.6	13.4	13.4	13.3	180.5	20.9	276.6	26.4
Investment companies <sup>d</sup>	11	799.7	924.9	1,159.4	12.4	11.9	11.7	125.2	15.7	234.5	25.4
Household finance companies	14	81.7	108.6	159.5	1.3	1.4	1.6	26.9	32.9	50.9	46.9
Mutual funds	11	209.6	296.8	496.2	3.3	3.8	5.0	87.2	41.6	199.4	67.2
<b>Total</b>	<b>79</b>	<b>6,431.9</b>	<b>7,792.0</b>	<b>9,948.9</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>1,360.1</b>	<b>21.1</b>	<b>2,156.9</b>	<b>27.7</b>
Deposits with the Accountant General	—	1,824.5	2,521.3	3,444.9							

<sup>a</sup> Excluding deposits with the Accountant General.

<sup>b</sup> Revised data.

<sup>c</sup> For tourism and shipping and to local authorities.

<sup>d</sup> Excluding an institution that changed its status to a holding company.

The funds obtained by the mortgage banks directly or indirectly from the public sector (Government deposits earmarked for loans, the sale of bonds coming under the category of recognized investments, funds mobilized abroad by the Treasury, and the accumulation in the Saving-for-Housing Scheme) were appreciably greater in 1972. But, as in the previous year, there was also a big increase in the amounts obtained from other sources, as indicated by the IL 100 million growth in deposits of private business firms, following a IL 50 million rise in 1971 and a decline of IL 20 million in 1970.

This expansion of their free resources enabled the mortgage banks to step up their private mortgage loan operations and also to lend private business (mainly contractors and building companies) some IL 150 million net, compared with IL 50 million in 1971.

#### (b) *Industrial development banks*

This group numbers five institutions, in the largest of which, the Industrial Development Bank, the Government holds more than half of the paid-up share capital. The group is characterized by an exceptionally high ratio between equity and borrowed funds (25 percent at the end of 1972) and by its almost complete dependence on Government financing, direct and indirect.

The net increase in the group's financial resources (excluding deposits with the Accountant General) came to about IL 420 million, compared with IL 330 million in 1971 and IL 180 million, in 1970.

Along with the continued sharp uptrend in financial resources, there was a decline in the Government's direct contribution<sup>13</sup> to the increment and a rise in that of overseas sources and domestic bond issue proceeds, which are indirectly controlled by the public sector.

The group's balance sheet (excluding deposits with the Accountant General) reached IL 2,124 million at the end of the year, which represented some 21 percent of the combined balance sheet of the sector.

#### (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 capital is held by the Government), which between them accounted in 1972 for about 65 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 General) came to IL 280 million, as against IL 180 million in 1971

<sup>13</sup> By way of an increase in deposits and investment in shares and capital notes issued by the group.

and IL 110 million in 1970. As in 1971, there was a decline in the Government's direct contribution to the group's incremental resources, the lion's share of which is lent out in accordance with the directives of the Government and other public sector authorities.

(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.), but in 1972 one of the institutions used a large part of its incremental resources to finance industry and construction.

The net increase in the group's financial resources (less transfers to the Accountant General) amounted to IL 210 million, compared with IL 185 million in 1971. As in 1971, the most striking feature was the contribution of the rest-of-the-world sector and the Government, which together provided 80 percent of the group's additional funds. Incremental net credit to local authorities was doubled this year and totalled IL 70 million. The net sum provided the tourist industry (through various banking institutions) increased from IL 50 million in 1971 to IL 80 million. Outstanding loans to other private business concerns and to Government and Jewish Agency companies went up to about the same extent as in 1971 (IL40-45 million), but whereas in 1971 all the increment went to shipping, this year part was also granted to industry.

(e) *Mutual funds*

This group comprises 11 institutions, four of which invest most of their resources in bonds, four in shares, and the remaining three in both shares and bonds.

In 1972 this group, the overwhelming majority of whose customers are households, succeeded in mobilizing IL 177 million from the public, as contrasted with IL 43 million in 1970 and IL65 million in 1971. The impressive 1972 advance may be chiefly credited to the expectation of a further rapid general rise in prices which, together with the increased savings accompanying the growth of income, greatly heightened the demand for participation certificates of the bond funds; this occurred even though the rebounding of the share market (and the surging of quotations) in 1972 contributed relatively little to the group's capacity to mobilize funds from the public. About 86 percent of the net issues (at issue price) were accounted for by the bond funds.

The fact that the extraordinary share market boom had only a slight influence on the expansion of the mutual funds strengthens the assumption that the buoyant demand for equities must be attributed to a wave of speculative short-term investors and did not originate, or cause a change, in the basic attitude toward equity investment by those who formerly regarded this as a good savings

instrument and for whom the need to spread the risk is an overriding consideration.

Sales of mutual fund certificates, which *ipso facto* do not constitute short-term investment because of the relatively high commission charged on sales and purchases, were very modest. Furthermore, out of the seven funds that invest the bulk of their means in shares, only one managed to enlarge its capital base, and it was one that adhered to its declared policy of spreading its investments more or less evenly over shares and bonds. It should be noted in this context that, although the bond funds expanded very rapidly, they were outperformed by the funds investing more heavily in shares with respect to the rate of return on participation certificates—10–30 percent as against some 60 percent. While these rates are high, they were greatly eclipsed by the average rise in the index of ordinary share prices.

The accelerated expansion of the bond funds enabled them to maintain and even increase their edge over the other financial institutions in mobilizing funds from households for financing the various sectors of the economy and the Government. It should be pointed out that the weight of Government securities (which are generally acquired by the mutual funds in the secondary market) in the incremental assets of the bond funds plunged from about 60 percent in 1971 to some 20 percent, while the proportion of financial institution bonds (which are acquired at source) went up to about 60 percent. This had a very significant bearing on the character of the mutual funds' contribution to the development of the capital market, signifying that with the improvement of the securities market in the wake of the boom, the bond funds shifted the focus of their operations from secondary market trading in financial assets (mostly compulsory loans) to intermediation between consuming units (households) and producing units (recipients of the credit financed by way of financial institution bond issues).

As a result of the vigorous expansion of the bond funds' activity and the substantial rise in the market value of their share holdings, their investment portfolio grew by 67 percent to reach IL 542 million (at market prices) at the end of 1972.

#### (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 the 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 established by banking institutions, and even though the latter 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.

Since there is no special law in this country regulating the operation of investment companies and confining them to the securities market, some of the

companies engage in the mobilization of funds for loan purposes, mostly subject to the Government's 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 to gain control over companies) in that portfolio management is for them an end in itself. The net increase in the group's resources (excluding funds transferred to the Accountant General) came to IL 235 million in 1972, compared with IL 125 million in the previous year.

Since in the past few years the group's activity in the securities market came to a standstill and the 1971 rebounding of share prices and trading volume was not enough to alter this trend, the investment companies took advantage of the exceptionally vigorous bull market in 1972 to step up their operations in this field. This was reflected by the diversion of IL 45 million of the companies' equity capital to enlarging their securities portfolio.

In 1972 the companies continued to expand their medium- and long-term lending operations. Most of the credit was provided under public sector direction from the proceeds of bond sales, but at the same time there was probably some increase in credit granted from their free resources.

#### (g) *Household finance companies*

This group, which helps households to finance the purchase of durable goods, numbers 14 companies and is the smallest in the sector as far as financial resources are concerned: only four of them—Iatzil, Idud, Yahav, and the Consumer Cooperation Fund—have assets exceeding IL 3 million.

The net growth of the group's resources amounted to IL 51 million in 1972, compared with IL 27 million in 1971. Besides the usual principal sources of funds—the National Institutions and nonprofit institutions—the private business sector accounted for an appreciable share in the year reviewed. The balance sheet reached IL 170 million at the end of 1972, less than 2 percent of the total for the entire sector.

## 5. ASSETS AND LIABILITIES

The combined balance sheet of the financial institutions was, at IL 9,949 million, up 28 percent, compared with a 21 percent rise in 1971. The addition of deposits with the Accountant General brings the total up to IL 13,394 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 drop-

Table XV-4  
ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS, 1970-72

	IL million			Percent			Annual increase or decrease (-)			
	1970 <sup>a</sup>	1971 <sup>a</sup>	1972	1970	1971	1972	1971		1972	
							IL m.	%	IL m.	%
<b>Assets</b>										
Cash and bank deposits	124.5	183.3	216.5	1.9	2.4	2.2	58.8	47.2	33.2	18.1
Credit to public from own means	2,235.9	2,823.9	3,695.4	34.8	36.2	37.1	588.0	26.3	871.5	30.9
Credit to public from Govt. deposits	2,607.8	2,980.5	3,488.7	40.5	38.2	35.1	372.7	14.3	508.2	17.0
Credit to public from deposits earmarked for loans <sup>b</sup>	829.0	1,112.8	1,562.6	12.8	14.3	15.7	283.8	34.2	449.8	40.4
Government securities	120.4	184.7	244.6	1.9	2.4	2.5	64.3	53.4	59.9	32.4
Nongovernmental securities <sup>c</sup>	483.4	475.8	710.4	7.5	6.1	7.1	-7.6	-1.6	234.6	49.3
Immovable property	30.9	31.0	30.7	0.5	0.4	0.3	0.1	0.3	-0.3	-1.0
<b>Total</b>	<b>6,431.9</b>	<b>7,792.0</b>	<b>9,948.9</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>1,360.1</b>	<b>21.1</b>	<b>2,156.9</b>	<b>27.7</b>
<b>Liabilities and capital</b>										
Equity capital	1,443.9	1,589.6	1,943.0	22.5	20.4	19.5	145.7	10.1	353.4	22.2
Bonds	2,545.8	3,551.7	4,755.3	39.6	45.6	47.8	1,005.9	39.5	1,203.6	33.9
Proceeds deposited with Accountant General <sup>d</sup>	1,365.0	1,780.0	2,530.0	21.2	22.8	25.4	415.0	30.4	750.0	42.1
Net proceeds	1,180.8	1,771.7	2,225.3	18.4	22.8	22.4	590.9	50.0	453.6	25.6
Deposits and loans from banks	419.9	619.8	865.2	6.5	7.9	8.7	199.9	47.6	245.4	39.6
Govt. deposits earmarked for loans	2,639.4	3,027.9	3,496.2	41.0	38.9	35.2	388.5	14.7	368.3	15.5
Nongovernmental deposits earmarked for loans	695.5	804.5	1,193.7	10.8	10.3	12.0	109.0	15.7	389.2	48.4
Other deposits and loans	372.2	560.7	1,006.4	5.8	7.2	10.1	188.5	50.6	445.7	79.5
Demand deposits	20.0	19.9	20.3	0.3	0.2	0.2	-0.1	-0.5	0.4	0.2
Other accounts	-339.8	-602.1	-801.2	-5.3	-7.7	-8.1	-262.3	-77.2	-199.1	-33.1
Deposits with the Accountant General, excl. bond proceeds	-459.5	-741.3	-915.0	-7.2	-9.5	-9.2	-281.8	-61.3	-173.7	-23.4
Other accounts (net)	119.7	139.2	113.8	1.9	1.8	1.1	19.5	16.3	-25.4	-18.2
<b>Total</b>	<b>6,431.9</b>	<b>7,792.0</b>	<b>9,948.9</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>1,360.1</b>	<b>21.1</b>	<b>2,156.9</b>	<b>27.7</b>

<sup>a</sup> Revised data.

<sup>b</sup> Includes consortium loans granted from earmarked bank deposits.

<sup>c</sup> Includes investments in subsidiary companies.

<sup>d</sup> Provisional estimate for 1972.

ping steadily for some years—amounting at the end of 1972 to about 20 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 still 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 show a sharp rise in equity capital and in nongovernmental deposits and loans. The increase in equity capital totalled IL 353 million, as against IL 146 million in 1971. About two-thirds of the increment is attributable to the accelerated development of the bond funds and the expansion of the group's equity capital, which enabled it to enlarge its securities portfolio.

The rise in the share of nongovernmental earmarked deposits and "other deposits and loans" (see Table XV-4) reflects the increased importance of the foreign sector and, to a lesser extent, of private business in the financial institutions' resources.

Government deposits earmarked for loans—which went up by IL 468 million, as against IL 389 million in 1971—accounted for 35 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 and capital note issues.

The weight of outstanding bond proceeds deposited with the Accountant General continued upward in 1972, when a total of IL 655 million was transferred to him, as against IL 410 million in 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).

Outstanding loans rose by IL 1,830 million, compared with IL 1,245 million in 1971. As in 1971, nearly half the incremental credit was provided from the institutions' own means (as distinct from deposits for loan purposes), but it should 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 in accordance with public directives, as well as from loans received from abroad for loan purposes, etc.

The more vigorous activity of the mutual funds and investment companies in 1972 was clearly reflected in the contribution of the securities item to the sector's total asset growth: whereas in 1971 it accounted for only 4 percent of the total growth, in the year reviewed the figure reached 14 percent.

## 6. FLOW OF FUNDS, BY SECTOR

The 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 XV-5) is gleaned from a comparison of two consecutive profit and loss accounts.

In flow-of-funds analysis all balance sheet changes that do not represent actual flows but bookkeeping changes only, such as revaluations, transfers to reserves, etc., must be eliminated. In the flow of funds presented in Table XV-5 no adjustments have been made for changes stemming from the devaluation 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 43 percent, with financial transactions outgaining real transactions—48 percent vs. 31. The difference was connected with the writing-up of the institutions' liabilities for linkage differentials due to the rapid price rise in 1972.

Most of the credit to the financial institutions was provided, as in 1971, by the social insurance funds, the foreign sector, and the banks. The chief borrowers were private business (and public sector companies), the public sector, and households. The Government appears as a net borrower to the tune of IL 487 million, as against IL 220 million in 1971, but a large percentage of the "payments" to it during the past two years were of a bookkeeping 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 3 percent p.a.) the payment of linkage differentials on the sector's external sources of funds that were lent out on an unlinked basis. If not for these adjustments, there would have been a net inflow to the Government of IL 200 million.<sup>14</sup>

Net receipts from the social insurance funds sector, which again was the chief lender, added up to IL 803 million, compared with IL 577 million in 1971; less revaluation differentials, the respective figures are IL 525 million and IL 400 million. Net receipts from the banking sector were similar to the previous year's level (IL 190–200 million), with the incremental purchases of financial institution bonds by the bank-administered saving schemes being balanced by the

<sup>14</sup> 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.

Table XV-5

## FLOW-OF-FUNDS STATEMENT OF THE FINANCIAL INSTITUTIONS, BY SECTOR, 1971-72

(IL million)

	Receipts			Payments			Surplus of receipts over payments	
	1971 <sup>a</sup>	1972	Increase or de- crease (-)	1971 <sup>a</sup>	1972	Increase or de- crease (-)	1971 <sup>a</sup>	1972
<b>Nonfinancial transactions</b>	<b>875.1</b>	<b>1,150.0<sup>b</sup></b>	<b>274.9</b>	<b>828.0</b>	<b>1,100.0<sup>b</sup></b>	<b>272.0</b>	<b>47.1</b>	<b>50.0</b>
<b>Transactions in financial assets</b>								
Government	521.2	486.7	-34.5	761.2	983.5	222.3	-240.0(-220.0) <sup>c</sup>	-496.8(-486.8) <sup>c</sup>
National Institutions and local authorities	7.4	18.5	11.1	182.6	266.4	83.8	-175.2	-247.9
Public sector companies	33.2	38.2	5.0	87.8	181.4	93.6	-54.6	-143.2
Banking institutions	293.0	382.6	89.6	100.0	186.0	86.0	193.0	196.6
Social insurance funds	568.6	803.5	234.9	-8.0	1.2	9.2	576.6	802.3
Insurance companies	3.5	7.6	4.1	0.8	-3.2	-4.0	2.7	10.8
Private business <sup>d</sup>	56.3	169.8	113.5	505.2	792.0	286.8	-448.9	-622.2
Nonprofit institutions	28.9	63.9	35.0	24.7	20.3	-4.4	4.2	43.6
Rest of the world	182.5	384.0	201.5	30.0	5.9	-24.1	152.5	378.1
Households <sup>e</sup>	104.8	229.0	124.2	331.6	510.6	179.0	-226.8(-246.8) <sup>c</sup>	-281.6(-291.6) <sup>c</sup>
Unspecified <sup>f</sup>	164.4	325.4	161.0	—	—	—	164.4	325.4
<b>Total transactions in financial assets</b>	<b>1,963.8</b>	<b>2,909.2</b>	<b>945.4</b>	<b>2,015.9</b>	<b>2,944.1</b>	<b>298.2</b>	<b>-52.1</b>	<b>-34.9</b>
Errors and omissions	—	—	—	-5.0	15.1	20.1	5.0	-15.1
<b>Total receipt and payments</b>	<b>2,838.9</b>	<b>4,059.2</b>	<b>1,220.3</b>	<b>2,838.9</b>	<b>4,059.2</b>	<b>1,220.3</b>	<b>—</b>	<b>—</b>

<sup>a</sup> Revised data; excluding an institution that changed its status to a holding company.<sup>b</sup> Provisional estimate.<sup>c</sup> Less estimated purchases of Government securities from households.<sup>d</sup> Including farms.<sup>e</sup> Including contractors' deposits sold to households through banking institutions.<sup>f</sup> Including securities sold on the stock Exchange.

expansion of the institutions' financial transfers to banks (mainly to finance tourist services):

Net borrowing from the foreign sector expanded substantially—IL 380 million as against IL 150 million in 1971; most of the funds were used to grant directed credit.

Private business heads the list of recipients of funds from the financial institutions, net payments to the sector going up from IL 450 million in 1971 to IL 620 million in the year reviewed. Net payments to the public sector companies more than doubled to stand at IL 145 million.

In contrast, net payments to households went up only slightly in 1972—IL 290 million compared with IL 245 million in 1971—as the much larger volume of mortgage loans granted home buyers was largely offset by the brisker sale of bond fund participation certificates to households.