

CHAPTER XIV

FINANCIAL INSTITUTIONS¹

1. MAIN DEVELOPMENTS

THE FINANCIAL institutions continued to expand their lending operations in 1973, but at a much slower pace than in 1972. Gross credit supplied to the various sectors of the economy rose 25–30 percent, as against 35–40 percent in 1972. However, this does not signify any reduction in the level of investment financing, for the sluggish increase in real investment in 1973 was reflected by a sharp decline in the nominal investment growth rate despite the sharpening of inflation. This high level of investment financing, for the third consecutive year, was again mainly made possible by the much larger amount of funds channelled directly or indirectly to the institutions by the public sector for the provision of subsidized credit. The rapid spiralling of prices in 1973 made such credit cheaper still in real terms, and most of it bore a negative real rate of interest. At the same time, the institutions' resources not under public sector control also continued to grow at a relatively strong rate, enabling them to further step up their nondirected credit, especially to households (for financing the purchase of housing and durable goods).

In 1973 the financial institutions continued to expand their short-term (up to two years) financing (which, however, still accounted for only a relatively small share of the sector's total transactions) especially to agriculture, industry, and households. Part of this credit was granted at a low and part at a relatively

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 generally discussed separately. 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. Quarterly data on the sector's gross long-term lending are not available, so that it was not possible to analyze developments in the first nine months of the year separately from those in the last quarter. The data in this chapter are for the entire year; where an assessment is made of developments in various subperiods of the year, it is based on reports obtained from part of the financial institutions sector and on conclusions derived in an indirect manner.

high rate of interest (up to 24 percent). The increase in such credit, together with that in subsidized medium- and long-term credit, reduced demand pressure on the commercial banks. As a consequence, the financial institutions' net credit outflow² (less transfers to banking and other financial institutions) rose from IL 1,750 million in 1972 to IL 2,310 million in the year reviewed.

The growth of gross financing (most of it subsidized) supplied to industry and agriculture lagged behind the 1972 figure—25 as against 35 percent—but it still exceeded the increase in their nominal investment, so that there was a further rise (only a slight one in industry) in the level of investment financing granted at concessionary terms to these two sectors. In the last quarter of the year the level of industrial financing greatly exceeded the annual average, while in the other three quarters it apparently fell below its level in the corresponding period of 1972. In agriculture, on the other hand, there was no marked deviation from the usual seasonal pattern.

The rapid uptrend in gross housing credit carried over through the year reviewed, but here too the rate was lower than in 1972—31 vs. 38 percent. Mortgage banks granted over 32,300 loans, totalling IL 765 million. The growth of such financing was especially striking (even in comparison with the previous year) given the slower advance of housing prices (26 percent as against 33 percent in 1972) and the technical delay in the processing of loans in the last quarter of the year (this was made up at the beginning of 1974).

There was a sharp 25 percent drop in the number of loans granted to new immigrants and a decline in the volume of such credit, following a decline in the flow of immigration from the affluent countries and a consequent rise in the proportion coming from other countries, who generally prefer rental housing. On the other hand, other types of directed mortgage financing (mainly to newlyweds and participants in the Saving-for-Housing Scheme) were up 44 percent. The amount of mortgage credit for the purchase of private housing (some of which in effect became subsidized in the course of 1973—discussed below) also expanded considerably—by 30 percent, in contrast to a 5 percent decline the year before.

More credit was granted to the local authorities in 1973 than in the previous year. Presumably much of it was intended to help extricate them from their financial difficulties arising from the linkage of most of their liabilities to the cost-of-living index, which shot up during the year.

As already indicated, the institutions' stronger credit outflow was mainly made possible by the much larger amount of funds channelled to them by the public sector both directly (IL 683 million compared with IL 487 million in 1972) and indirectly (i.e. funds which are lent by various public bodies in accordance with the Government's directives or subject to its control). Sales of financial institution bonds, which form the bulk of the Government's indirect

² Incremental outstanding credit.

contribution to the sector's resources, grossed IL 1,304 million in the year reviewed, as against IL 960 million in 1972.³ The Government's total contribution to the institutions' incremental resources is estimated at over 80 percent in each of the past three years.

In addition, for the third successive year the sector enjoyed a big increase in resources available for granting loans at their own discretion, although they were still dwarfed by the volume of directed credit funds at their disposal. The contribution of private business firms (chiefly contractors and financial companies) to the institutions' resources rose by IL 220 million, as against IL 173 million in 1972 and IL 57 million in 1971 (before 1971 it was practically nil).

As for the sector's activity in the securities market, the stock market slump depressed the investment companies' business but did not sharpen the downturn in the operations of the mutual funds specializing in shares. On the other hand, the prevailing belief that inflation would get worse spurred the development of the mutual funds investing predominantly in bonds. In 1973 these funds succeeded in mobilizing IL 265 million (at issue price) from sales of participation certificates to the public.

The combined balance sheet of the financial institutions increased by IL 3,022 million to reach IL 13,021 million (IL 17,932 million if deposits with the Accountant General are included).

2. GOVERNMENT INFLUENCE ON FINANCIAL INSTITUTION OPERATIONS

Government influence on the financial institutions' operations far exceeds the weight of the sector's direct liabilities to the Government⁴ (as regards the capital market, it far exceeds the Government's share in total financial intermediation). This endows the Government with considerable influence on economic developments in general, while lessening the importance of the market mechanism in the allocation of financial, and hence also real, resources.

The Government's influence upon the capital market is not confined to directing the bulk of the credit granted, but extends to the regulation of the terms of the loans, which ultimately determine the subsidy element in the various types of cheap credit granted at the behest and expense of the public sector.

Besides controlling the allocation of resources transferred directly to the financial institutions, the Government in effect also controls the allocation of the overwhelming share 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

³ Excluding capital note issues to the Government.

⁴ See Table XIV-1.

of most of the domestic sources of finance derives from the income tax exemptions and concessions it grants on the returns from recognized investments,⁵ as well as 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 and other schemes). In addition, it can regulate, by means of foreign currency control, the mobilization of capital abroad (loans and bond issues) and direct the allocation of the funds raised in this manner. It is therefore obvious that, although the weight of the Government in the total liabilities of the sector (excluding mutual funds) continued downward to stand at 29 percent by year's end (see Table XIV-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,⁶ the preponderant share of their financial resources is actually under public sector control.

As already noted, the Government's influence upon the capital market in general and the financial institutions in particular is not limited 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 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 and other funds raised in Israel and abroad. Where necessary, the Treasury compensates the 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. Regarding that part of the institutions' funds deposited with the Accountant General (who in turn redeposits all or part of the money with them), the deposit terms take into account the price at which loans are to be granted and the institutions' profit margin.⁷

Credit granted in accordance with Government directives for the development of industry, crafts, agriculture, and tourism is unlinked and carries interest ranging from 6 to 9 percent, depending on the zone in which the enterprise is located and the destination of its production. Another part of the directed credit, granted at the behest of various authorized public

⁵ Securities issued by enterprises where the allocation of the proceeds is subject to Government control.

⁶ A large percentage of the Government's payments is connected with the funds whose mobilization is authorized by the Treasury 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.

⁷ This redeposit procedure inflates, of course, the sector's balance sheet.

LIABILITIES OF FINANCIAL

	IL million		
	1971 ^a	1972 ^b	1973
Government	3,524.9	4,011.6	4,694.3
National Institutions and local authorities	96.6	115.1	171.9
Public sector companies ^c	236.2	274.4	292.1
Banking institutions	1,294.8	1,729.9	2,789.6
Social insurance funds	2,140.3	2,941.5	3,850.7
Insurance companies	19.7	27.3	46.8
Private business ^d	311.6	484.7	702.3
Nonprofit institutions	116.7	157.1	191.1
Rest of the world	674.0	1,058.0	1,273.7
Households	291.6	401.1	504.8
Accumulated profits	} 954.6	1,272.4	1,916.6
Unspecified			
Total	9,661.0	12,473.1	16,433.9
Intrasector liabilities	359.6	474.6	731.3
Grand total	10,020.6	12,947.7	17,165.2

NOTE: The big increase in the "unspecified" item in 1973 was mainly due to the inability to sectorally decompose the financial institutions' bond issue proceeds. While it is clear that, as in previous years, part of this sum actually represents private sector bond purchases (mainly of financial institution issues, which declined in 1973), it supports the assumption that social insurance funds probably stepped up their purchases in the secondary bond market in 1973, thereby enabling noninstitutional investors to make relatively large purchases in the new issues market.

INSTITUTIONS,^a BY SECTOR, 1971-73

Annual increase or decrease (-)		Percent			Annual increase or decrease (-)	
		1971 ^b	1972 ^b	1973		
1972	1973				1972	1973
486.7	682.7	36.5	32.2	28.6	17.3	17.2
18.5	56.8	1.0	0.9	1.0	0.7	1.4
38.2	17.7	2.4	2.2	1.8	1.4	0.4
435.1(355.1) ^d	1,059.7(879.7)	13.4	13.9	17.0	15.5	26.8
801.2(521.2)	909.2(329.2)	22.2	23.6	23.4	28.5	23.0
7.6	19.5	0.2	0.2	0.3	0.3	0.5
173.1	217.6	3.2	3.9	4.3	6.1	5.5
40.4	34.0	1.2	1.3	1.2	1.4	0.9
384.0	215.7	7.0	8.4	7.8	13.6	5.4
109.5 ^f	103.7	3.0	3.2	3.0	3.9	2.6
317.8	644.2	9.9	10.2	11.6	11.3	16.3
2,812.1	3,960.8					
115.0	256.7					
2,927.1	4,217.5	100.0	100.0	100.0	100.0	100.0

^a Excluding mutual funds.

^b Revised data; includes an institution which previously was inactive.

^c Companies owned by the Government, National Institutions, or local authorities.

^d Excluding revaluation increments (estimate).

^e Including farms.

^f Consists mostly of household accumulation in the Saving-for-Housing Scheme.

bodies, is also unlinked but carries interest ranging between 9 and 12 percent.

Directed mortgage loans are unlinked and carry interest of 7–13 percent. That part of such financing which the Government permits the institutions to provide for the purchase of homes in the private market (subject to various area and price limitations) is granted on an unlinked basis (in return for an unrealistic premium of 3–4 percent) and at interest which now comes to 16 percent.

Most of the credit 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 ranging from 6 percent on loans linked to the consumer price index to 12 percent on those granted in foreign currency.

The maximum interest rates on development loans to industry, crafts, agriculture, and tourism were set in 1967–68 after the abolition of value-linkage on most medium- and long-term credit.⁸ Until 1970 these rates still left a real interest of 3–4 percent (between 1967 and 1969 the price level moved up by an average of 2 percent a year). But in the past three years rampant inflation (the rise in the price level jumped from a long-run 6 percent average to 26 percent in 1973 alone), combined with the inflexible ceiling nominal interest rate structure fixed in the past, increased the subsidy element of directed credit several times over. This has indisputably constituted an unexpected boon to entrepreneurs, which they are enjoying after implementation of their investment and which the public sector certainly never intended bestowing upon them at the time the loan was granted (when the long-term annual price rise was expected to be 6 percent). It is estimated that in 1973 this unforeseen subsidy element in outstanding soft credit granted by the financial institutions reached IL 400–440 million in industrial credit, IL 200–220 million in agricultural credit, and IL 400–440 million in directed housing credit (more than half the mortgage credit provided to immigrants).⁹

As a result, the financial institutions (which provide the preponderant share of low-interest credit for the development of industry, crafts, agriculture, and tourism, as well as cheap housing credit) have over the years become not only an important instrument for the implementation of the Government's development budget and a supplemental quasi-budget, but also an instrument for

⁸ 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.

⁹ These figures were derived by calculating the extent to which the rate of price increase in 1973 (about 26 percent) deviated from the rate reckoned with at the time of fixing the premium in lieu of value-linkage (about 4 percent); or alternatively, the deviation from the long-run annual price rise (about 6 percent) multiplied by the annual average balance of such credit.

the granting each year of a sizable subsidy, the lion's share of which is not budgeted.

From the foregoing it is obvious that the greater part of the sector's activity 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. As already noted, this sector obtains the bulk of its funds either directly or indirectly from the Government and supplies most of its credit at the Government's behest and expense on fixed, especially soft terms, and hence it cannot suffer from a lack of demand (except, theoretically, during a recession). Nevertheless, these developments have a direct bearing on the magnitude of the excess demand for directed cheap 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 depends largely on monetary development 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 or for the provision of directed credit. However, it is quite likely that in the absence of stringent control some of the funds earmarked from the outset for the granting of directed soft credit were in fact used to finance the institutions' autonomous operations. The reference is to that portion of their bond issue proceeds which in the past was used for granting directed credit.¹⁰ When these loans fall due before the bonds (the issues usually have maturities of 17 to 20 years), it is not clear whether the difference between these 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 increased further in 1973. This was reflected in both the Government's direct contribution—IL 683 million as against IL 487 million in 1972—and in the greatly increased volume of funds indirectly channelled by the public sector (and/or funds lent by various public bodies in accordance with the Government's directives or subject to its control).

Sales of Treasury-authorized financial institution bonds grossed IL 1,304 million in 1973, as opposed to IL 260 million the year before.¹¹ If account is also taken of the fact that most of the sector's incremental foreign liabilities arose from the financing of institutions and enterprises in conformity with

¹⁰ Without first being deposited with the Treasury.

¹¹ Excluding capital note issues to the Government. From Table XIV-1 it will be seen that the lion's share of these sums, plus IL 900 million linkage differentials and less repayments, breaks down between banking institutions, social insurance funds, and the "unspecified" item.

Government directives and that most of the incremental net obligations to households, public sector companies, and nonprofit institutions also consisted of funds supplied indirectly by the public sector, we can gain some notion of the extent to which public sector financing permitted the expansion of the institutions' lending operations. It is estimated that the Government's contribution to their additional resources came to over 80 percent in each of the last three years.

Along with this appreciable growth of funds under public sector control, there was a further relatively large increase in the institutions' resources available for the provision of loans at their own discretion (these, however, were of a much smaller magnitude than the former). This was reflected by a continued growth in the contribution of the private business sector—IL 220 million as against IL 173 million in 1972, IL 57 million in 1971, and virtually nil in previous years. It should also be pointed out that a relatively small but not insignificant proportion of the funds supplied to the sector by the banking institutions was also used for the provision of nondirected loans. As usual, the sector expanded its equity (paid-up share capital and undistributed profits), which some institutions used for granting discretionary loans.

3. FINANCIAL INSTITUTION CREDIT, BY SECTOR

The amount of gross medium- and long-term financing supplied by the sector to the rest of the economy expanded strongly in 1973, but not as fast as in the previous year. The rate of increase was 25–30 percent, compared with 35–40 percent in 1972, which was consistent with the trend in nominal domestic investment. While industry, agriculture, and housing and construction borrowed less heavily in 1973, the local authorities, which are among the largest recipients of financial institution credit, borrowed much more heavily than in 1972. Presumably not all the latter's funds were used to finance capital expenditures. Since a large percentage of the authorities' outstanding debt is linked to the consumer price index, the galloping inflation put them in difficult financial straits; very likely they used part of the borrowed funds to ease their burden. All told, their net credit inflow rose from IL 260 million in 1972 to IL 465 million.

(a) *Housing and construction*

The rapid uptrend in the amount of mortgage financing provided to home buyers carried over through 1973, but at a slower pace than in 1972. Credit extended directly by mortgage banks to those buying homes in public housing projects or in the private market was up 31 percent, as against 38 percent in 1972, with 32,300 loans, totalling IL 765 million, being granted during the year.

Even though the growth of mortgage credit slackened in 1973, it was still very high considering the following developments:

(a) The slower advance of housing prices in 1973—according to the Central Bureau of Statistics, the index of dwelling prices rose 26 percent compared with 33 percent in 1972.

(b) The technical delay encountered in the last three months of 1973 in the processing of loans, which is estimated to have been one-third below the average monthly level for the year (this delay was made up in the early part of 1974).

Despite these two developments and contrary to the trend in the housing market, there was a sizable excess demand for mortgage credit, which even exceeded that in the preceding years. The relative subsiding of housing demand, which has been evident since early 1972 and has led to the buildup of a large stock of unsold dwellings, was even more pronounced in 1973, as reflected by the retardation of the uptrend in dwelling prices and, in the second half of the year, even by their trailing behind the rise in residential construction input prices. But this did not weaken demand for mortgage credit. On the contrary, the steep jump in the consumer price index, together with the relative constancy of nominal interest rates on mortgage loans, greatly increased the subsidy element in such credit and hence also the demand therefor. This refers particularly to mortgage financing granted in accordance with public sector directives, but it is also true of nondirected mortgage credit provided for the purchase of private housing conforming to certain area and price limitations (which entitle the borrower to exemption from the payment of linkage differentials in exchange for an unrealistic premium). On this type of unlinked financing the public sector has set a ceiling rate of interest ranging from 13 to 16 percent. Given the high inflation in 1973 and the expectation that it will persist in the near future, it is obvious that part of this type of financing has also become subsidized. According to a Central Bureau of Statistics survey, the average interest paid on directed mortgage financing came to 7.62 percent in 1973 (7.43 percent in 1972) and to 15.6 percent on credit for the purchase of homes in the private market (14.43 percent in 1972).

In 1973 too there were marked changes in the distribution of gross mortgage credit, some of them in line with the trend begun in previous years. The percentage of current loans granted to newlyweds and Saving-for-Housing Scheme credit increased, while the share of loans for immigrant housing declined. But in contrast to the previous year, the growth of credit to other subsidized groups (chiefly veteran settlers) was relatively sluggish. As to credit for the purchase of private housing, which fell off in absolute terms in 1972, in the year reviewed it expanded at about the same rate as directed credit, so that it maintained its relative share in the total volume of mortgage credit.

Gross credit extended directly by mortgage banks for the purchase of public housing was up 32 percent (as against 53 percent in 1972) and totalled

Table XIV-2

BALANCE OF CREDIT GRANTED BY FINANCIAL INSTITUTIONS, BY FIRST SECTOR OF DESTINATION, 1971-73
(IL million)

	1971 ^a	1972 ^a	1973	Annual increase or decrease (-)			Percentage distribution of increment		Percent increase in increment	
				1971	1972	1973	1972	1973	1972	1973
Industry	1,609.1	2,064.4	2,496.4	303.9	455.3	432.0	24.2	17.0	49.8	-5.1
Agriculture	557.4	987.7	1,289.5	122.7	212.3	301.8	11.3	11.9	73.0	42.2
Construction and housing	2,477.5	3,125.4	4,059.4	413.0	647.9	934.0	34.5	36.7	56.9	44.2
Trade	22.2	32.2	31.3	1.5	10.0	-0.9	0.5	0.0	^b	^b
Local authorities	909.9	1,169.5	1,634.7	163.6	259.6	465.2	13.8	18.3	58.7	79.2
Services	528.1	605.0	705.6	85.8	76.9	100.6	4.1	4.0	-10.4	30.8
Banking and financial institutions	464.2	593.4	824.9	70.2	129.2	231.5	6.9	9.1	84.0	79.2
Households	61.0	122.1	210.2	9.3	61.1	88.1	3.3	3.5	^b	44.2
Miscellaneous	69.8	95.9	83.9	7.5	26.1	-12.0	1.4	-0.5	^b	^b
Total, excl. Government	6,917.2	8,795.6	11,335.9	1,177.5	1,878.4	2,540.3	100.0	100.0	59.5	35.2
Government (mainly deposits with the Accountant General)	2,706.1	3,689.5	5,244.5	761.2	983.4	1,555.0				
Total, incl. Government	9,623.3	12,485.1	16,580.4	1,938.7	2,861.8	4,095.3				

^a Revised data; includes an institution which previously was inactive.

^b Because of the small sums involved the percentage increase is of no significance.

IL 630 million. The share of new immigrants, who in the early 1960s had received nearly half of total directed mortgage credit, fell to 22 percent in the year reviewed.

Following the further dwindling of the flow of newcomers from affluent countries and the concomitant increase in the proportion hailing from other lands, the number of immigrant housing loans fell by an appreciable 25 percent (compared with a 1–2 percent decline in 1972), while the amount of such credit contracted by 7 percent to return to its 1971 level of IL 140 million. This is explained by the fact that immigrants from poorer countries, unlike the others, prefer to rent homes rather than buy them. On the other hand, the size of the average loan increased by 26 percent to reach IL 37,000; this was at least partly due to the raising in the second half of the year of the ceiling set on immigrant housing loans.¹²

Mortgage financing granted to young couples in accordance with public sector directives, which in 1970 totalled a mere IL 4 million, soared 86 percent in the year reviewed to reach IL 200 million. This dramatic development demonstrates the importance which the public sector attaches to the housing problem of this group—a problem which has grown increasingly acute in recent years because of rocketing dwelling prices. The number of soft public loans granted to newlyweds reached 7,900, as against a mere 320 in 1970, with the size of the loans averaging IL 25,000.

Another component of directed mortgage financing which grew noticeably in 1973 as well was Saving-for-Housing Scheme credit, which totalled IL 110 million. Those registered in this scheme are entitled to a low-interest mortgage loan of some IL 30,000, provided they have made deposits for a minimum period of three years and have accumulated at least IL 6,000. The rapidly growing scheme membership resulted in an acceleration of this type of credit in 1972–73, which will undoubtedly become even stronger in the next few years. Credit to families relocated under urban renewal schemes, which was expected to increase appreciably in the fourth quarter of the year following the introduction of a new plan,¹³ went up by 34 percent to IL 39 million—the same rate as in the previous year.

Despite the fourth-quarter delay in the processing of loans to subsidized groups in general and to those relocated under urban renewal schemes in particular, the volume of housing directed credit granted to all groups other than immigrants expanded by 44 percent during the year, compared with 54 percent in 1972.

As regards discretionary loans for the purchase of homes in the private market, part of which in effect became subsidized in the year reviewed

¹² The maximum for Jerusalem was raised from IL 50,000 to IL 90,000, and for the rest of the country from IL 40,000 to IL 70,000.

¹³ This plan entitles a family with a density of more than three persons per room to receive a low-interest mortgage loan of up to IL 70,000 for improving its housing conditions.

owing to the rampant inflation and the covering of linkage differentials by the public sector in return for an unrealistic premium, there was an increase of 11 percent in the number of loans and of 17 percent in their average size, following an 8 percent drop in the number of loans and a slight growth in their average size in 1972. It seems that at least part of the increment can be attributed to the deposits made with mortgage banks by contractors and building companies in an effort to promote sales. In all, 7,400 loans totalling IL 135 million were granted for the purchase of private housing in 1973.

As to advances to contractors and building companies, a provisional estimate shows that these were up 30 percent to IL 250 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 934 million, compared with IL 648 million in 1972. Households received 70 percent (IL 2,845 million) of the total. This is a very sizable amount, and the principal and interest payments on such a large debt, which for 1973 are estimated at IL 420 million (IL 390 million in 1972), affect the level of current household saving. This nominal growth of 8 percent is equivalent to a real decrease of 11 percent.¹⁴ These figures underline the fact that this component of household saving, if constant in nominal terms, nevertheless decreases in real value with a rise in the general price level.

(b) *Industry*

In line with the real decline in industrial investment, the growth of gross long-term financing extended to this sector slowed from 33 and 35 percent in 1971 and 1972 respectively to 23 percent in 1973. Nevertheless, the extraordinarily high ratio of the last two years (about 44 percent) between the volume of such financing and capital expenditure at current prices was maintained (and even went up fractionally), since the decline was sharper in the latter. Gross industrial credit added up to IL 725 million, compared with a total investment of IL 1,570 million.

Industrial Investment Credit from Financial Institutions, 1971-73

(IL million)

	1971	1972	1973
Estimated gross medium- and long-term credit	440	590	725
Industrial investment, at current prices	1,060	1,350	1,570
Ratio of credit to investment (%)	42	44	46

¹⁴ IL 40 million at 1972 prices.

As in previous years, the overwhelming share of industrial financing provided through the financial institutions consisted of soft credit subsidized by the public sector. By far the greater part is given in conformity with development budget policy guidelines, with the loans being disbursed as the project progresses; a small fraction is granted at the behest of other public bodies (chiefly Hevrat Ha'ovdim—the Histadrut holding company), without the disbursement of the loans being closely connected with the progress made on the project. The financial institutions also supply industry with unsubsidized loans linked to the consumer price index or to the rate of exchange, but the share of such loans in the sector's total credit outflow is small and they do not amount to more than a few tens of million of pounds a year. In recent years about 95 percent of all soft industrial development budget credit was funnelled through the financial institutions.¹⁵ These loans, which are granted in accordance with the Law for the Encouragement of Capital Investments, account for more than 80 percent of the gross industrial credit furnished by the sector. Other soft loans extended to industry—mostly at the behest of Hevrat Ha'ovdim—are of a complementary nature (they are granted out of social insurance fund monies authorized by the Accountant General for this purpose); they are unlinked and carry interest of 9 or 12 percent.

Since monthly data on gross long-term industrial credit supplied by the financial institutions are not available, it was not possible to make a separate analysis of developments during the two subperiods—the first nine months of 1973 and the last quarter, when industrial investment was cut back sharply. But there are monthly data on loan approvals, and these show a sharp decline in the last three months of the year. However, no conclusions should be drawn from this as regards the gross credit flow, since past experience shows that over a short period of a few months there is no connection between the total volume of approvals and total loans disbursed (there is usually about a three-year lag between the approval of a loan and its disbursement).

An examination of the monthly balance of credit granted by the institutions specializing in industrial finance and of reports received from some of the sector's institutions shows that there was no contraction of loan disbursements in the last quarter of the year. On the contrary, the level rose faster than it usually does during this period. Since the last quarter saw a sharp decline in industrial investment in both real and nominal terms, this would seem to suggest that the proportion of investment covered by such financing in the last three months was much higher, and that in the other three quarters lower, than in the corresponding periods of the previous year (for the year as a whole the ratio was similar to that in 1972—44–45 percent). This conclusion is supported by two developments.

¹⁵ The allocation of such credit falls within the purview of the Ministry of Commerce and Industry, and exceeds the sums appropriated in the development budget.

(a) In recent years (since 1969) the proportion of development budget loans granted through the financial institutions to enterprises in Development Zones A, B, and C has been 45, 40, and 33 percent respectively of the value of the investment (approved enterprises have also received an outright cash grant). From the second half of 1970 until April 1972 the financial institutions were authorized to extend additional financing (over and above the existing ratios)¹⁶ 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. This supplementary credit contributed to the strong upsurge in the value of development budget loan capital provided to industry in 1971 and 1972. Most of the loans in those years were given on the strength of approvals issued during this period of supplemental financing (in 1972 more than in 1971). By contrast, about half the 1973 sum was disbursed on the strength of approvals granted after May 1972, when supplementary financing was no longer being provided.

(b) In 1973 the increase in loan capital granted in conformity with development budget guidelines was fairly sluggish (about 20 percent), so that the differential between it and the growth of nominal investment shrank compared with the previous year, or even disappeared entirely. On the other hand, the other component of soft credit—which, as already mentioned, is of a supplementary nature and whose disbursement is not closely connected with the progress made on the project—increased by an appreciable 35 percent this year. The volume of such credit apparently did not describe an even path, the growth rate for the last quarter exceeding that of the other three.

It is important to note that 1973 was the third consecutive year marked by an extraordinarily high ratio between cheap credit and nominal industrial investment, and that the nominal interest rates on such loans were not raised despite the aggravation of inflation. This means that, given the steep price increases and the constancy of the nominal interest rates at a level less than one-third the rate of inflation in 1973 (and also of the rate anticipated in the coming year), even if from 1975 onward prices do not advance by more than 5–6 percent a year, most of the loans given this year carry a negative real interest. This further augments the excess demand for such credit by entrepreneurs whose projects meet the development policy criteria,¹⁷ and it becomes difficult to determine which projects are most worthwhile for the economy; even if it should turn out that they are the ones receiving the cheap credit, it is clear that the incentive granted is greater than required to induce entrepreneurs to go ahead.

As an indicator of the intensification of excess demand for such credit we may use the data on loan applications handled by two financial institutions

¹⁶ At 12 percent interest.

¹⁷ This development renders economically feasible previously unattractive low-yield investment projects.

which between them account for more than half of all soft industrial loan capital. The value of such applications reached IL 910 million at the end of 1973, as against IL 420 million the year before. Even if allowance is made for the fourth-quarter delays in examining projects and approving loans, there was still an impressive growth in this item in comparison with the previous year.

In line with the slower growth of gross industrial credit, the net flow increased by IL 432 million, as against IL 455 million in 1972. The outstanding balance reached IL 2,496 million at the end of 1973, with the preponderant share consisting of subsidized credit.

(c) *Agriculture*

The amount of gross medium- and long-term credit supplied to agriculture rose strongly in 1973, following notable increases in 1971 and 1972, which far exceeded the percentage growth of the sector's investment at current prices (excluding land reclamation, afforestation, drainage, etc., which are public sector investments). Despite the sharp decline in agricultural investment in the last quarter of the year, there was no slowdown in the financing supplied to the sector by the financial institutions during this period; on the contrary, estimates show that the proportion of total financing granted during the year was even slightly higher in the last three months of 1973 than in the corresponding period the year before.

Agricultural Investment Credit from Financial Institutions, 1972-73

(IL million)

	1972	1973
Estimated gross medium- and long-term credit granted to farms by agricultural credit funds ^a	320	405
Agricultural investment at current prices (less land reclamation and conservation, afforestation, drainage, etc.)	295	300
Ratio of credit to investment (%)	108	135

^a In accordance with Ministry of Agriculture and Jewish Agency directives.

For the third consecutive year, medium- and long-term financing granted to farms far outpaced the growth of agricultural investment at current prices¹⁸—26 vs. 2 percent. This credit flow totalled IL 405 million, as contrasted with an investment of IL 300 million.¹⁹ While the bulk of the credit provided

¹⁸ Part of the long-term credit was probably not connected with the implementation of current investment but was used to consolidate debts, while part of the medium-term credit may have been borrowed for working capital purposes.

¹⁹ Excluding direct investments of the public sector.

by the agricultural finance institutions in accordance with Ministry of Agriculture and Jewish Agency directives was almost certainly used to finance farm investments, part of the other credit was probably used to finance other economic activity (industry and building not connected with agricultural purposes). However, it must be remembered that not all medium- and long-term credit to this sector is channelled through financial institutions; hence it is a safe inference that the ratio of cheap credit to total investment in agriculture was exceptionally high in 1973 and was on the rise during the past three years.

Besides financing agricultural investments, several institutions in this group provide short-term credit at interest of 12–16 percent. Although no data are available on the outstanding balance of such credit, which is a good substitute for commercial bank credit, there are indications that these institutions greatly stepped up the volume of such financing in the past two years.

In the year reviewed the total amount of net agricultural credit supplied by the financial institutions reached IL 302 million, as against IL 212 million and IL 123 million in 1972 and 1971 respectively.

(d) *Government*

“Outstanding credit to the Government” is defined in this chapter as the total amount of Government securities held by the 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 place 50–70 percent of their bond issue proceeds with the Accountant General for financing the development budget; these funds accounted for nearly 77 percent of the sector’s total deposit balances with him.

The balance of such deposits swelled by IL 1,470 million in 1973, as against IL 920 million and IL 700 million in 1972 and 1971 respectively. This exceptional upsurge was largely connected with the unprecedented volume of bonds issued in 1973. As in the previous year, 70 percent of the institutions’ bond issue proceeds (totalling IL 930 million as compared with IL 650 million in 1972) were transferred to the Accountant General. The growth in Saving-for-Housing Scheme deposits, which are automatically transferred to the Accountant General, contributed to the bigger increase in the sector’s deposits with him in the year under review (IL 80 million compared with IL 50 million in 1972). Another part of the institutions’ incremental outstanding deposits with the Accountant General (a much larger proportion than in 1972) stemmed from the sizable linkage differentials debited to him

on account of their value-linked deposits, as well as differentials on funds linked to the consumer price index, 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, amounting to several million pounds, do not of course represent an actual flow of funds to the Treasury but are a bookkeeping entry only.

The sector's holdings of Government securities expanded by IL 90 million, compared with IL 60 million in 1972. Whereas in 1972 the mutual funds accounted for most of the growth, in the year reviewed it was spread over a wide range of institutions. The increment was partly connected with the compulsory loans imposed on the institutions, but they probably also enlarged their portfolio of Government securities held as liquid assets.

The sector's financial claims on the Government reached IL 5,245 million at the end of 1973.

4. DEVELOPMENTS BY TYPE OF INSTITUTION

The financial institutions sector surveyed in this chapter number 81 intermediaries classified into seven specialized groups (see Table XIV-4). An analysis of the sources and uses of funds of the various groups makes it possible to trace the sectoral fund flows generated by their operations.

(a) *Mortgage banks*

This group numbers 16 concerns, four of which—Tefahot, General Mortgage Bank, Housing Mortgage Bank, and Mortgage Development Bank—account for 80 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 and other public bodies.

The strong expansion of mortgage bank resources continued in 1973, with the net increase (excluding deposits with the Accountant General) amounting to IL 1,070 million, as contrasted with IL 765 million and IL 425 million in 1972 and 1971 respectively.

The impressive growth of business was again mainly made possible by the much larger volume of funds obtained 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). But, as in the previous year, much larger sums were also obtained from other sources (these were used partly for granting discretionary loans and partly in accordance with depositors' instructions). Whereas in 1970 and 1971 deposits

Table XIV-3
GROSS MORTGAGE BANK CREDIT, 1971-73

Recipient group	1971		1972		1973	
	IL '000	No. of loans	IL '000	No. of loans	IL '000	No. of loans
Directed credit	314,484	16,675	479,558	22,361	630,746	24,915
Immigrants	141,388	5,115	150,102	5,052	140,541	3,757
Slum dwellers	21,815	1,352	28,989	1,825	38,764	2,121
Saving-for-Housing Scheme	33,874	1,571	65,370	2,178	108,806	3,389
Young couples	26,118	1,487	106,193	5,345	198,041	7,919
Other	91,289	7,150	128,904	7,961	144,594	7,729
Other credit						
Private housing	109,652	7,247	104,794	6,653	134,933	7,397
Total mortgage credit	424,136	23,922	584,352	29,014	765,679	32,312

of private business firms (chiefly contractors and building companies) expanded by IL 20 million and IL 50 million respectively, in 1972 they swelled by IL 100 million and in 1973 by IL 160 million. This growth of free resources and of funds mobilized overseas enabled the mortgage banks to step up their private mortgage loan operations and to lend private business some IL 200 million net, compared with IL 150 million in 1972 and IL 50 million in 1971.

(b) *Industrial development banks*

This group numbers six institutions, in the largest of which—the Industrial Development Bank of Israel—the Government holds more than half of the paid-up share capital. The group is characterized by a very high ratio between equity and borrowed funds (26 percent at the end of 1973) and by its almost complete dependence on Government financing, direct and indirect, as well as on other sources under Government control (monies of the social insurance funds earmarked for loans to industry—these funds are transferred to the financial institutions through commercial banks and are loaned at the behest of Hevrat Ha'ovdim).

The net increase in the group's financial resources (excluding deposits with the Accountant General) came to IL 495 million, compared with IL 470 million in 1972. The Government's contribution to the increment was smaller than in 1972 (IL 355 million as against IL 420 million), while that of Hevrat Ha'ovdim increased noticeably.

A sectoral breakdown of the group's incremental uses shows a striking change this year: a big increase in net credit to private business (up from IL 270 million in 1972 to IL 380 million) and a decline in that to public sector companies (from IL 175 million to IL 70 million). Even if allowance is made for the fact that in 1972 one of the institutions in this group financed a large nonindustrial project of a public sector company subsidiary (which accounted for about IL 80 million out of the IL 175 million), it may still be concluded that private industrial concerns received a much larger share of the total financing provided by this group in 1973.

(c) *Agricultural credit funds*

This group of 18 institutions, which specializes in the financing of agricultural settlements, provides mostly medium- and long-term loans, but some of the institutions also supply short-term financing. The Israel Bank of Agriculture, a large percentage of whose paid-up share capital is held by the Government, accounts for over 45 percent of the group's combined balance sheet. Most of the other institutions are joint funds of agricultural settlements and agricultural settlement organizations, while several are linked to the Jewish Agency.

This group obtains most of its funds from bond issues and Government and commercial bank deposits (consortium and other). Unlike the industrial development banks, this group greatly increased its net financial resources²⁰—a rise of IL 385 million compared with IL 280 million in 1972; most of the funds were lent to agricultural settlements.

(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 the past two years one of the institutions used a large part of its incremental resources to finance industry.

Despite a heavy repayment of value-linked liabilities by shipping companies (out of Government deposits earmarked for loans), the group increased its balance sheet by IL 275 million, as against IL 210 million in 1972. A relatively large proportion of its funds was deposited abroad (an increase of IL 70 million as against IL 5 million in 1972), while the net sum supplied to the tourist industry (through various banking institutions) and to local authorities rose from IL 150 million in 1972 to IL 200 million in 1973.

(e) *Mutual funds*

This group numbers 12 institutions, as against 11 in 1972; four of them invest most of their resources in shares, five (four in 1972) in bonds, and the remaining three in both shares and bonds.

²⁰ Excluding deposits with the Accountant General.

Table XIV-4
**COMBINED BALANCE SHEET TOTALS* OF FINANCIAL INSTITUTIONS,
 BY TYPE OF INSTITUTION, 1971-73**

	Number of insti- tutions	IL million			Percent			Annual increase or decrease (-)			
		1971	1972 ^b	1973	1971	1972	1973	1972		1973	
								IL m.	%	IL m.	%
Mortgage banks	16	2,864.3	3,628.3	4,696.5	36.7	36.3	36.1	764.0	26.7	1,068.2	29.4
Industrial development banks	6	1,704.1	2,174.2	2,670.0	21.9	21.7	20.5	470.1	27.6	495.8	22.8
Institutions granting loans to other sectors ^c	4	847.3	1,058.7	1,331.7	10.9	10.6	10.2	211.4	24.9	273.0	25.8
Agricultural credit funds	18	1,946.0	1,322.6	1,709.0	13.4	13.2	13.1	276.6	26.4	386.4	29.2
Investment companies	11	924.9	1,159.4	1,616.3	11.9	11.6	12.4	234.5	25.4	456.9	39.4
Household finance companies	14	108.6	159.5	230.7	1.4	1.6	1.8	50.9	46.9	71.2	44.6
Mutual funds	12	296.8	496.2	766.9	3.8	5.0	5.9	199.4	67.2	270.7	54.6
Total	81	7,792.0	9,998.9	13,021.1	100.0	100.0	100.0	2,206.9	28.3	3,022.2	30.2
Deposits with the Accountant General	—	2,521.3	3,444.9	4,911.1							

* Excluding deposits with the Accountant General.

^b Revised data; includes an institution which previously did not extend medium- and long-term credit.

^c For tourism and shipping and to local authorities.

As in 1972, this group, the overwhelming majority of whose customers are households, succeeded in mobilizing large sums from the public. Bond issues netted IL 241 million at issue price, as against IL 177 million in 1972 and IL 50–60 million in both 1969 and 1970.

The continued expansion in 1973 of the mutual funds specializing in bonds—which in recent years have been the pacesetters in this group—can be credited to the inflationary expectations. The sensitivity of household investment in these funds to such expectations and to the rate of inflation is evident from a monthly breakdown of net sales of mutual fund participation certificates during the year. The marked aggravation of inflation toward the end of 1972 and the end of 1973 sparked a flurry of sales. Those in January and February 1973 alone accounted for 40 percent of the year's net total, and there was a brisk sale in December as well. October and November saw a fairly light volume of trade, which is undoubtedly explained by the extensive, prolonged mobilization.

As to the institutions specializing in shares, just as the extraordinary share market boom of 1972 failed to influence their development, so too the retreat of share prices in the year reviewed did not greatly depress the group's share capital. Net redemptions of mutual fund certificates totalled, as in 1972, approximately IL 1 million. This is explained by the fact that both the spurting and the sliding of share prices in the past two years were largely due to a wave of short-term speculative investors (who are willing to take a big risk for the sake of earning a handsome capital gain), and not to a change in the basic attitude toward equity investment by those seeking a good savings instrument and for whom the need to spread the risk is an overriding consideration (the latter are the potential buyers of the funds' participation certificates).

The mutual funds further increased their edge over the other institutions in mobilizing funds for financing various sectors of the private economy and the Government. This year too the proportion of financial institution bonds in the group's securities portfolio went up at the expense of Government loans. This was in continuation of the trend which began in the latter part of 1970, with the contraction of over-the-counter trade in the Absorption and Defense Loans, and the greater perfection of the bond market, which narrowed the yield-to-maturity differential between these and other loans. As a result, the mutual funds diverted a larger proportion of their resources to the purchase of bonds issued by financial institutions connected with the companies operating the funds. Whereas in 1971 Government securities accounted for about 58 percent of the growth of the funds' securities portfolio, their share plunged to 22 percent in 1972 and to 16 percent in 1973. This is a significant development, since the shrinkage of the proportion of original-issue bonds purchased from households implies a reduction in the funds' intermediation between household consuming and saving units.

The funds' liquid assets expanded noticeably—far more than required by their volume of business—and this in a period when galloping inflation and a tight credit market greatly increased the cost of holding money. Total liquid assets (Short-Term Loan, cash, demand deposits, etc.) went up from IL 10 million in 1972 to IL 27 million in 1973. This can apparently be explained by the increase in 1973 in the ratio between redemptions and net sales of certificates, which compelled the funds to hold more liquidity (because of the uneven path traced by redemptions and sales over the year). However, it is likely that the sizable 1972 redemption of Absorption and Defense Loan certificates in the funds' securities portfolio was reinvested in bonds with a relatively long maturity, and that the increase in liquid assets was intended to moderate this from the aspect of the composition of the funds' securities portfolio.

As a result of the further vigorous expansion of the bond funds' activity and the steep rise in the general price level, the market value of their asset portfolio swelled 66 percent, as in 1972, and reached IL 892 million. Nevertheless the rate of household saving in the form of fund participation certificates slipped in real terms from 49 percent in 1972 to 30 percent.²¹

(f) *Investment companies*

The institutions in this group raise 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 them have for many years raised funds for financing the development budget and for providing loan capital (chiefly to local authorities), mostly subject to the Government's directives and with its guarantee. Consequently, the composition of the assets and liabilities of several companies hardly differs from that of other financial intermediaries, such as the industrial development banks, and most 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.

Following last year's impressive IL 45 million growth of the companies'

²¹ End-year balances.

securities portfolio due to the rebounding of the share market,²² the gain this year amounted to IL 20 million. This strong upswing was made possible by the expansion of the group's equity capital.

In contrast to the slight rise in the group's security market operations, several companies greatly stepped up their contribution to the funding of the development budget as well as their lending operations. The amount of bond issue proceeds deposited with the Accountant General increased by IL 515 million, as against IL 290 million in 1972. There was also a striking growth in net credit provided to local authorities—IL 245 million as against IL 110 million in 1972.

All told, the group's net resources (excluding deposits with the Accountant General) doubled to reach IL 460 million.

(g) *Household finance companies*

This group, numbering 14 companies in 1973, is the smallest in the financial institutions sector as far as resources are concerned: only four of them—Iatzil, Idud, Yahav, and the Consumer Cooperative Fund—have assets exceeding IL 3 million.

This group, which provides households with medium-term credit for financing the purchase of durable goods, obtains its resources partly from the National and nonprofit institutions, and partly from the private business sector and banking institutions. The funds obtained from the first source are lent to households for periods of up to five years and at low interest, while the other funds are lent for two years at a high rate of interest (about 24 per cent).

The group's resources expanded by IL 70 million in 1973, compared with IL 50 million in 1972 and IL 27 million in 1971. Because of the relatively short period for which the credit is given, the gross credit outflow is much larger than the net increase in the group's balance sheet. Gross medium-term lending to households amounted to IL 150 million in the year reviewed, as against IL 90 million in 1972 and IL 50–60 million in previous years.

5. ASSETS AND LIABILITIES

The combined balance sheet of the financial institutions sector was, at IL 13,021 million, up 30 percent, compared with increases of 28 and 21 percent in 1972 and 1971 respectively. The addition of deposits with the Accountant General brings the total up to IL 17,932 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

²² After several years of standstill in the group's activity in the securities market.

Table XIV-5
ASSETS AND LIABILITIES OF FINANCIAL INSTITUTIONS, 1971-73

	IL million			Percent			Annual increase or decrease (-)			
	1971 ^a	1972 ^a	1973	1971	1972	1973	1972		1973	
							IL m.	%	IL m.	%
Assets										
Cash and bank deposits	183.3	216.5	366.7	2.4	2.2	2.8	33.2	18.1	150.2	69.4
Credit to the public from own means	2,823.9	3,745.4	5,186.2	36.2	37.5	39.8	921.5	32.6	1,440.8	38.5
Credit to the public from Govt. deposits	2,980.5	3,488.7	4,043.8	38.2	34.9	31.1	508.2	17.0	555.1	15.9
Credit to the public from deposits earmarked for loans ^b	1,112.8	1,562.6	2,109.7	14.3	15.6	16.2	449.8	40.4	547.1	35.0
Government securities	184.7	244.6	333.5	2.4	2.4	2.6	59.9	32.4	88.9	36.3
Nongovernmental securities ^c	475.8	710.4	952.6	6.1	7.1	7.3	234.6	49.3	242.2	34.1
Immovable property	31.0	30.7	28.6	0.4	0.3	0.2	-0.3	-1.0	-2.1	-6.8
Total	7,792.0	9,998.9	13,021.1	100.0	100.0	100.0	2,206.9	28.3	3,022.2	30.2
Liabilities and capital										
Equity capital	1,593.6	1,925.2	2,402.3	20.5	19.2	18.4	331.6	20.8	477.1	24.8
Bonds	3,551.7	4,755.3	6,778.3	45.6	47.5	52.1	1,203.6	33.9	2,023.0	42.5
Proceeds deposited with Accountant General	1,780.0	2,530.0	3,800.0	22.8	25.3	29.2	750.0	42.1	1,270.0	50.2
Net proceeds	1,771.7	2,225.3	2,978.3	22.8	22.2	22.9	453.6	25.6	753.0	33.8
Deposits and loans from banks	619.8	917.7	1,553.4	7.9	9.2	11.9	297.9	48.1	635.7	69.3
Govt. deposits earmarked for loans	3,027.9	3,946.2	4,054.4	38.9	35.0	31.1	468.3	15.5	558.2	37.3
Nongovernmental deposits earmarked for loans and other deposits and loans	1,365.2	2,197.6	2,865.7	17.5	22.0	22.0	832.4	61.0	668.1	30.4
Demand deposits	19.9	20.3	33.7	0.2	0.2	0.3	0.4	2.0	13.4	66.0
Other accounts	-606.1	-783.4	-866.7	-7.8	-7.8	-6.6	-177.3	-29.3	-83.3	-10.6
Deposits with the Accountant General, excl. bond proceeds	-741.3	-915.0	-1,111.1	-9.5	-9.1	-8.5	-173.7	-23.4	-196.1	-21.4
Other accounts (net)	135.2	131.6	244.4	1.7	1.3	1.9	-3.6	-2.7	112.8	85.7
Total	7,792.0	9,998.9	13,021.2	100.0	100.0	100.0	2,206.9	28.3	3,022.2	30.2

^a Revised data; includes an institution which previously was inactive.

^b Includes consortium loans granted from earmarked bank deposits.

^c Includes investments in subsidiary companies.

dropping steadily for some years, amounting at the end of 1973 to 18 percent, and less the mutual funds to 13 percent. This ratio is still very 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.

On the liabilities side there was a sharp rise in bonds (which stemmed only partly from the crediting of linkage differentials) and in deposits and loans from banks; "other deposits and loans", on the other hand, declined (see Table XIV-5).

Outstanding bonds rose by IL 2,023 million, as against IL 1,200 million in 1972. Part of the increment consisted of linkage differentials, which doubled to reach an estimated IL 900 million; but gross bond issues²³ also went up considerably, from IL 986 million in 1972 to IL 1,425 million.

The greatly increased contribution of deposits and loans from banks to the balance sheet growth consisted mostly of subsidized public sector funds which were transferred to the financial institutions for providing directed credit to industry, tourism, etc. But it also included some free resources which were used by the institutions to give discretionary loans, mainly to households.

"Other deposits and loans" expanded by IL 670 million, compared with IL 830 million in 1972. The smaller rise is explained primarily by the much more sluggish growth of deposits and loans from abroad, probably because of the Treasury's policy in 1973 of restricting the raising of funds from foreign sources (by granting fewer foreign loans permits). But given the dearer cost of foreign credit in 1973, there may also have been some waning of demand.

The Government's contribution to the institutions' net incremental resources was much greater than indicated by the growth of Government deposits earmarked for loans, since the Government also purchased a substantial amount of the sector's capital notes.

(b) *Assets*

The asset portfolio of the financial institutions consists predominantly (about 90 percent) of loans and only to a small extent of securities (10 percent) and immovable assets (less than 1 percent).

Outstanding loans were up IL 2,540 million, compared with IL 1,880 million in 1972. Although more than half the increment was ostensibly granted from the institutions' own means (as distinct from deposits for loan purposes), it

²³ Including capital notes.

should be remembered that the overwhelming proportion of the sector's loanable funds derive from the proceeds of Treasury-authorized bond issues, which are disbursed in accordance with public sector directives, as well as from loans received from abroad for loan purposes, etc. But the last few years undoubtedly witnessed a big expansion of the institutions' free resources.

The sector's securities portfolio (whose share in the balance sheet had been moving downward for many years) maintained its relative position in 1973, thanks chiefly to the continued vigorous growth of the mutual funds.

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, while the flow defined as "nonfinancial transactions" (see Table XIV-6) is gleaned from a comparison of two consecutive profit and loss accounts.

In flow-of-funds analysis all balance sheet changes that represent not actual flows but bookkeeping changes only, such as revaluations, transfers to reserves, etc., must be eliminated. In the flow of funds presented in Table XIV-6 no adjustments have been made for changes stemming from the revaluation of assets and liabilities²⁴ or for those transfers to reserves that could not be identified in the balance sheets.

An additional limitation of the flow-of-funds model here (as well as in that for the entire economy) is that it does not accurately describe (and at best does not at all reflect) some of the intersectoral flows arising from the purchase and sale of securities in the secondary market. Because of the special characteristics of the Israeli capital market (the practice of bond washing, etc.), this limitation has become more glaring in recent years with the growth of the economy's stock of bonds and of the volume of trade on the Tel Aviv Stock Exchange and in the over-the-counter market.

The sector's transactions expanded by 48 percent, as against 40 percent in 1972, despite the slacker growth of its financing operations. This is explained by the notable increase in the linkage differentials paid (and collected) by the sector (which conceptually constitute part of its real transactions) and in the adjustment of its liabilities for such differentials (which in the flow-of-funds table are treated as financial transactions). Nevertheless, the more sluggish growth of the sector's business is reflected by the fact that the increase (compared with 1972) in financial transactions was milder than that in real transactions.

²⁴ In Table XIV-6 estimates of the principal items adjusted for revaluation differentials are shown in parentheses.

Table XIV-6
FLOW-OF-FUNDS STATEMENT OF THE FINANCIAL INSTITUTIONS, BY SECTOR, 1972-73
(IL million)

	Receipts			Payments			Surplus of receipts over payments	
	1972 ^a	1973	Increase or decrease (-)	1972 ^a	1973	Increase or decrease (-)	1972	1973
Nonfinancial transactions	1,150.0^b	1,900.0^b	750.0	1,100	1,820.0^b	720.0	50.0	80.0
Transactions in financial assets								
Government	486.7	682.7	196.0	983.5	1,555.1	571.6	-496.8(-200.0)	872.4(-250)
National Institutions and local authorities	18.5	56.8	38.3	266.4	459.5	193.1	-247.9	-402.7
Public sector companies	38.2	17.7	-20.5	184.4	86.6	-97.8	-146.2	-68.9
Banking institutions	435.1	1,059.7	624.6	186.0	218.6	32.6	249.1(169.1) ^c	841.1(661.1) ^c
Social insurance funds	801.2	909.2	108.0	-0.8	-0.1	0.7	802.0(522.0) ^c	909.3(329.3) ^c
Insurance companies	7.6	19.5	11.9	-3.2	0.7	3.9	10.8	18.8
Private business ^d	173.1	217.6	44.5	862.5	1,051.8	189.3	-689.4	-834.2
Nonprofit institutions	40.4	34.0	-6.4	20.3	44.1	23.8	20.1	-10.1
Rest of the world	384.0	215.7	-168.3	5.9	75.8	69.9	378.1	139.9
Households ^e	252.5	303.2	50.7	510.6	741.7	231.1	-258.1	-438.5
Unspecified ^f	343.4	666.0	322.6	—	—	—	343.4	666.0
Total transactions in financial assets	2,980.7	4,182.1	1,201.4	3,015.6	4,233.8	1,218.2	-34.9	-51.7
Errors and omissions				15.1	28.3	13.2	-15.1	-28.3
Total receipts and payments	4,130.7	6,082.1	1,951.4	4,130.7	6,082.1	1,951.4	—	—

^a Revised data; includes an institution which previously was inactive.

^b Estimate.

^c Less estimated revaluation differentials.

^d Including farms.

^e Including contractors' deposits sold to households through banking institutions.

^f Including securities sold on the Stock Exchange.

Most of the credit to the financial institutions was provided, as in the past, by the social insurance funds, commercial banks, and the foreign sector. The chief borrowers were the public sector, private business (and public sector companies), and households.

The social insurance funds sector again appeared as the chief lender, but it owes this foremost position to the large linkage differentials credited to its bond holdings. Less these differentials, net receipts from this source added up to only IL 330 million, compared with IL 520 million in 1972. For the first time in many years, the uptrend in gross purchases of original-issue financial institution bonds was reversed (the growth of total gross purchases of original-issue bonds was also slower than in 1972; the level rose 10 percent, which was less than the advance of the consumer price index, to which the bulk of household contributions are linked). These developments strengthen the assumption that the social insurance funds probably invested a larger proportion of their accumulation in the secondary market, thereby indirectly helping to increase sales of financial institution (and other) bonds to other sectors of the economy.

There was a notable growth in the banking institutions' net contribution to the resources of the financial institutions, which stemmed only partly from the revaluation of the latter's liabilities for linkage differentials on saving scheme security holdings. Less these differentials, net receipts from this sector amounted to about IL 661 million, as opposed to IL 170 million in 1972.

Net receipts from the foreign sector declined sharply from IL 378 million in 1972 to IL 140 million. This can probably be attributed to the declared policy of the Treasury's Foreign Exchange Department of restricting foreign loan permits. But it is also possible that there was a weakening of demand for such credit because of its dearer price.

The Government appears as a net borrower to the tune of IL 870 million, compared with IL 500 million in 1972. However, a large percentage of the "payments" to it in recent 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. If not for these adjustments, there would have been a net outflow to the Government of IL 200–250 million in each of the past two years.²⁵

²⁵ 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 large 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 agent.

Whereas payments to the private business sector increased by 20 percent to total IL 835 million, net payments to households increased by about 70 percent to reach IL 440 million. These data square with the above developments in the institutions' lending operations in general, and in the financing of household purchases of housing (and other durable goods) in particular.