CHAPTER XX

THE SECURITIES MARKET

1. Main Trends

The outstanding development in the securities market in 1967 was a big increase in new bond issues. Also noteworthy was the arresting of the downward trend in share trading volume and prices discernible since the middle of 1964.

Net issues of bonds amounted to over IL 1,150 million, or two-thirds more than in 1966. This strongly rising trend in a year that saw a sharp drop in domestic investment should occasion no surprise in view of the special circumstances prevailing in 1967 and the structure and nature of Israel's securities market (in former years as well there was only a slight correlation between the level of investment and that of new issues).

The volume of bond sales is affected first and foremost by the domination of the market by the Government. The Government's decision to float new bonds —or to allow financial institutions to do so—largely determines the amount of new issues. The budgetary requirements of 1967, affected as they were by the recession and the war, afford a partial explanation of the much greater sale of Government bonds. It should be noted, however, that included among the issues are the Absorption Loan, which is of a compulsory nature, and the Defense Loan, the purchase of which by the public is motivated by other than purely economic considerations. Net of these two loans—about IL 440 million in 1967—the following picture emerges: net Government issues soared from IL 110 million in 1966 to IL 250 million, whereas other issues (mostly by financial institutions[1] and the National Institutions) increased from IL 390 million to IL 460 million.

Only a small percentage of the new issues were purchased directly by the public. One aspect of Government influence on the bond market is reflected in the legal obligation falling on a number of major institutions to invest a substantial proportion of their assets in bonds approved by the Government for this purpose. The social insurance funds, banking institutions (mainly for their approved savings schemes), and financial institutions took more than IL 550 million of the approximately IL 700 million worth of bonds issued in 1967. Purchases by the public thus amounted to some IL 150 million. This sum is

[1] Among the financial institutions in this chapter are several which do not conform to the definition in Chapter XVII. The data on the amounts issued by the institutions are therefore not identical in the two chapters.

considerably larger than in the two preceding years, and reflects the greater propensity of the public to hold financial assets in 1967. The increased investment in the Government Short-Term Loan was partly due to the diminished confidence in the bill brokerage market, while the attraction of the option-type bonds can be ascribed to the relative rise in their yield compared with other investments.

This fact highlights another area in which the Government exercises a commanding influence. The restrictions of the Interest Law, the granting of income tax concessions to purchasers of approved securities, and the arrangements enabling financial institutions to raise value-linked loan capital and grant nonlinked credits prevent competition with Government or Government-approved bonds. Through these arrangements the Government subsidizes both savers and borrowers, thereby virtually nullifying the regulatory function of the interest rate in the capital market.

The readiness to invest in the nonlinked Short-Term Loan in 1967 was presumably influenced by the price stability prevailing during the year, since the nominal yield on this loan was reduced several times by the Bank of Israel. The option-type loans, which are medium-term (five years) and permit the investor to choose, at maturity, between a relatively high interest without linkage and a relatively low interest but with principal and interest linked to the consumer price index, became more attractive as the interest thereon remained unchanged. On the other hand, long-term linked loans with a lower rate of interest looked much less promising to investors, in view of the stable prices, and their share of total loans issued in Israeli currency (excluding the Absorption and Defense Loans as well as the Short-Term Loan) fell from about 70 percent (net) in 1966 to 30 percent in 1967.

The stagnation in new share issues, noticeable since the second half of 1964, carried over through the year reviewed. On the other hand, the downtrend in equity trading volume was virtually halted. The volume of Stock Exchange transactions came to IL 55 million in 1967—about a quarter of that in 1963 and 1964 but only slightly lower than in 1966 (a decrease of 9 percent in 1967 as against 37 percent in 1966 and 58 percent in 1965). At the same time, the general index of share prices moved up at a moderate rate (about 9 percent), as did most of the group indexes (with the exception of land and development shares, which continued to tumble).

The volume of bond transactions, which has been on the rise in the last several years, continued upward in 1967. The figure was almost triple that of trade in the equity market, whereas the reverse was true in 1964. The Absorption Loan, which was in abundant supply and yielded a relatively high return, was one of the most actively traded fixed-interest securities. The price index of bonds linked to the consumer price index held steady owing to the general stability of the price level. The index of dollar-linked bonds jumped after the November devaluation, following a decline in the three preceding months.

Foreign currency security holdings by Israeli residents were up $ 25 million in 1967, a similar growth as in 1966. This sum consists largely of bonds issued by Israeli organizations and institutions (Keren Hayesod and a number of financial institutions).[1] The agio on the Natad (investment) dollar, used for purchasing foreign currency securities, amounted in the last nine months to 8–10 percent, considerably higher than in 1966.

2. The Scope of the Securities Market

The securities market, as surveyed in this chapter, may be subdivided: the new issue market, where securities issued by organizations and companies wishing to raise capital are sold to the public; and the secondary market, where trading in existing securities takes place.

The scope of the secondary market can be easily established, it being identified with the Tel Aviv Stock Exchange, the only organized securities market in Israel. The listing of securities on the Exchange facilitates trade therein and clearly defines the limits of the secondary market.

In contrast, it is more difficult to determine unambiguously which of the new issues may be considered as falling within the orbit of the securities market. The sale of a company's shares or bonds to a private investor is of no interest here if it takes place outside the framework of an organized market.[2] In such a case no great significance attaches to the fact that capital was raised through the sale of securities: while the bond or share defines the legal relationship between the parties concerned, it is not, to all intents and purposes, a marketable instrument. On the other hand, it is doubtful whether there is justification for confining our present analysis solely to securities quoted on the Stock Exchange at the time of issue. Such a limitation is undesirable for two reasons: the first on general grounds, while the second is connected with the special structure of the Israeli securities market:

(1) The listing of a security on the Stock Exchange is not necessarily connected with its issue, but is intended to permit trade in the security, whether newly issued or otherwise. It is possible that for technical or other reasons a security is registered on the Stock Exchange long after its issue.

(2) Owing to the formidable weight of institutional investors among purchasers of securities in Israel (the provident and pension funds in particular), many new issues are floated with them in mind. A not inconsiderable number of series of this type are not listed, although this may be done at some future

[1] The reference is to bonds denominated in dollars and sold in Israel. Bonds issued overseas by the Industrial Development Bank and several other institutions are excluded here.

[2] A typical example of such a transaction is the establishment of a private company by an individual or group of investors. (In this respect there is a difference between an analysis of money flows in the economy, which purports to cover all financial transactions, and an analysis restricted to the securities market alone.)

time should it be deemed necessary.[1] The distinction between listed and unlisted securities sold to institutional investors is not always meaningful.

The fundamental differentiation that must be made is between securities sold to the public and those issued to a specific purchaser (and hence do not depend on the functioning of an organized market). The weight of the social insurance funds and the fact that certain issues are intended for them alone make it difficult to clearly delimit the Israeli securities market: is there any essential difference between an emission intended from the start for purchase by social insurance funds only and one ostensibly offered for sale to the public but which is actually taken up by the funds alone?

The differentiation between securities offered by a prospectus (and supposedly intended for the public) and those issued without a prospectus also fails to meet the requisite criterion, since the issues taken *in toto* by social insurance funds fall partly in one category and partly in the other.

The discussion of new issues in this chapter will therefore cover all Government bonds, nongovernmental securities offered to the public by a prospectus, and sales without prospectus to institutional investors. The value of new issues and estimated sales to the general public will be given (apart from the above institutional investors, as their portfolio purchases are largely governed by Treasury directives prescribing the securities which may be purchased).

In this context, it should be pointed out that the collection of the Absorption Loan is also included among Government bond sales. The reasons for not treating the Absorption Loan as a tax were explained in the 1966 Annual Report.[2] It should nevertheless be recalled here that this is not an ordinary loan: it is compulsory, and the holding thereof does not indicate any preference for this type of asset (it is collected *inter alia* from those who generally do not own securities). Moreover, the loan certificates are distributed only after several years, and only in 1967 did trading in such certificates begin on the Stock Exchange. This was marked by a heavy offer, which drove down the price, and suggests that the loan, collection of which was discontinued in April 1968, will in the next few years be an important factor in the bond market.

3. New Issues

Bond issues reached a new high in 1967, but again almost no new shares were sold to the public.

[1] Registration of a security on the Stock Exchange involves an expense. As long as it is presumed that there will be no trading, registration is apparently unnecessary. However, it should be pointed out that in many cases the possibility of sale to the public depends on a promise to list the security on the Stock Exchange. Many securities have therefore been listed on the Tel Aviv Stock Exchange, even though trade in them has been negligible.

[2] See Bank of Israel Annual Report for 1966, pp. 163 and 461.

(a) *Issuers of bonds*

The growth of bond sales over the past two years is shown in Table XX–1. Besides the big increase in new issues in 1967, the rise in the proportion of Government bonds stands out. The net value of new issues soared from IL 677.0 million in 1966 to IL 1,153.1 million, or by nearly 70 percent. Government loans in 1967 added up to IL 692.4 million net—almost 146 percent more than in the preceding year. This can be partly ascribed to the emergency situation: the new Defense Loan, of which IL 282.5 million was taken up during the year, constituted almost 40 percent of the total. The size of the anticipated budgetary deficit, which was influenced by the reflationary policy aimed at checking the recession, likewise induced the Government to step up bond sales.[1] At the same time, there was undoubtedly a greater propensity to acquire financial assets, of which the option-type loans were among the most appealing (the reasons will be discussed below): in 1966 nine series of the Developmnt Loan were issued (IL 44.4 million), and in the following year 37 series (IL 181.0 million gross, from which should be deducted IL 12.4 million in repayments).[2]

The outstanding balance of the Short-Term Loan swelled in 1967 by IL 117.5 million, compared with IL 86 million the year before, despite several cuts in the nominal yield.[3] (It should be noted that, following the agreement of 1966 between the Government and the Bank of Israel, the proceeds from this source were not used to finance the Government's expenditure but to repay its long-term debts to the Bank.[4]) In contrast to the brisk sale of short- and medium-term loans (the option-type bonds are for five years, and until September 1967 could be cashed in after two years), the long-term Government bond market remained listless. Sales of the Development Loan (17 years) amounted to IL 15 million, far less than the value of bonds reaching maturity.[5]

The limited demand for this loan is explained by the fact that it offers only

[1] Some maintain that in the first half of 1967, before signs of economic recovery began to appear, there was no point in financing the Government deficit by the sale of bonds to the public. Proponents of this step argued that the anticipated budgetary deficit was sufficient to stimulate economic activity. Moreover, sales of Government bonds (excluding the Absorption and Defense Loans) amounted during the first five months of the year to only some IL 50 million, approximately one-fifth of total net sales during the year.

[2] These were early repayments of loans sold in 1965. About 25 percent of those holding certificates with an early redemption clause availed themselves of the opportunity in 1967.

[3] Of this increment, about IL 14 million (net) went to banking institutions and a smaller sum to the Bank of Israel's securities portfolio as a result of purchases in the open market.

[4] On this point see the Bank of Israel Annual Report for 1966, p. 382.

[5] Besides the Development Loan, long-term loans in the amount of IL 17.5 million were sold to insurance companies under a special arrangement with the Treasury. In addition to a IL 23.4 million long-term Development Loan, about IL 48 million worth of other bonds (including the Absorption Loan and Compulsory Savings) were redeemed during the year.

Table XX–1

DOMESTIC SECURITY ISSUES,[a] 1966–67

(IL million)

	1966			1967		
	Gross sales	Re-demption	Net issue amount	Gross sales	Re-demption	Net issue amount
Securities issued						
Long-term loans	535.7	99.3	436.4	511.2	193.3	317.9
Absorption Loan	177.2	6.4	170.8	170.8	10.2	160.6
Other Government loans	17.5	36.7	–19.2	34.2	71.0	–36.8
Other loans	341.0	56.2	284.8	306.2	112.1	194.1
Option-type loans[b]	107.9	—	107.9	678.0	12.5	665.5
Defense Loan	—	—	—	282.5	—	282.5
Other Government loans	44.4	—	44.4	181.0	12.4	168.6
Other loans	63.5	—	63.5	214.5	0.1	214.4
Short-Term Loan[c]	85.8	—	85.8	117.5	—	117.5
Shares	11.6	—	11.6	20.5	—	20.5
Securities traded in foreign currency	62.1	15.2	46.9	63.4	11.2	52.2
Total	803.1	114.5	688.6	1,390.6	217.0	1,173.6
			Net purchases			Net purchases
Purchasers of domestic issues						
Social insurance funds			323.0			334.0
Insurance companies			38.3			50.5
Approved saving schemes (in banking institutions)			38.1			117.0
Banking and financial institutions[d]			15.5			52.0
Total			414.9			553.0
Residual[e]			273.7			620.6
Less: Absorption and Defense Loans			170.8			443.1
Net residual[e]			102.9			177.5

[a] Excluding overseas sales by Israeli companies.
[b] Including in 1966 linked nonoptional loans for five years.
[c] Data on gross sales are not given, since they may give an erroneous impression of the total volume of securities issued.
[d] Excluding banking institution investment through approved saving schemes. The estimate has been adjusted for changes in the value of investments and the revaluation of items appearing in the balance sheets.
[e] Purchases by households and businesses.
SOURCE: Based on data of the State Loans Administration.

a slim advantage (0.66 percent) over option-type loans in the event of a rise in prices justifying the holder's choosing redemption of the latter on a linkage basis. On the other hand, the option-type loans offer an appreciable yield differential (up to 5.26 percent) in the event of price stability, a reasonable possiblity in the light of the experience of 1966 and 1967.

The stepped-up sale of Government loans was of considerable economic significance, since it was not at the expense of nongovernmental issues. As may be seen from Table XX–1, sales of other bonds also rose, though at a far slower rate. It should be emphasized, however, that in recent years the distinction between Government and other loans has become blurred, as the issuing institutions must obtain the Government's approval to float new issues, and the uses to which the proceeds are put are largely determined by the latter. Government domination over the bond market is expressed in the following ways:

(1) All issues must be formally approved under the Defense (Finance) Regulations.

(2) The main institutional purchasers of bonds—social insurance funds and banking institutions (for their approved saving schemes)—are required to invest most of their resources in securities approved by the Treasury. This approval largely ensures the sale of the bonds.

Table XX–2

GROSS ISSUES OF NONGOVERNMENTAL LOANS, BY ISSUER GROUP, 1966–67

(IL million)

		1966	1967
(1)	Hevrat Haovdim[a]	199.0	124.9
(2)	Bank Leumi le-Israel[b]	68.9	168.2
(3)	Israel Discount Bank[c]	44.0	78.3
(4)	Tefahot Israel Mortgage Bank	65.5	83.8
(5)	National Institutions[d]	22.4	74.6
(6)	Others[e]	66.8	54.3
	Total	466.6	584.1

[a] Gmul, Bitzur, Housing Mortgage Bank, Israel-American Industrial Development Bank, Investment Company of Bank Hapoalim, Investment Fund of Hevrat Haovdim, Amot Investments, Nir.

[b] General Mortgage Bank, Bank Leumi Investment Company, Otzar Lata'asiyah, Ya'ad—Agricultural Development Bank.

[c] Discount Bank Investment Corporation, Israel Development and Mortgage Bank.

[d] Keren Hayesod, Jewish Agency, Hollis.

[e] Israel Electric Corporation, G.U.S.–Rassco, Bank of Jerusalem, Adanim, Mortgage and Investment Bank for Building, Hamizrachi Bank Investment Company, Israel Land Development Co., Carmel Mortgage Bank, Clal Israel Investment Co.

(3) Approval for income-tax concessions (limitation of the tax to 25 percent) is a prerequisite of the bond's competitiveness in the market. Government bonds bear interest so close to the ceiling laid down in the Interest Law that it is impossible to compete with them without such a concession.

To these factors, which have existed for many years, there has recently been added one more: as a result of pressure for the abolition of loan linkage generated by the devaluation of the Israeli pound in 1962, the Government enabled financial institutions to give unlinked loans, in accordance with Treasury directives.[1] This created complications, since the financial institutions were unable to raise capital from the public and from institutional investors without linkage, and they continued to issue bonds pegged to the consumer price index. In order to cover any difference that may arise between income from unlinked interest on the one hand and interest payments and linkage differentials on the other, two steps were taken:

(1) The Government insurance company Yuval insured issuers against losses liable to result from such differentials (this applies mainly to bonds denominated in dollars, which Israeli financial institutions were permitted to issue at home and abroad).

(2) The issuing financial institutions deposited the proceeds with the Accountant General on the same terms as those of the issue (i.e. value-linked); the Accountant General in turn redeposited these sums, either in full or in part, with the financial institutions on terms corresponding to those of the loans given according to Treasury directives. This system has not only solved the problem of the difference between issue and loan terms but has also enabled the Accountant General to regulate the utilization of the issue proceeds. In 1967 new issues (and the sum deposited with the Accountant General) far exceeded the volume of loans granted.

Since companies in the public services, industry, agriculture, and the tourist trade can borrow from the financial institutions without linkage, while it is virtually impossible to issue unlinked bonds, they have had no incentive to issue their own bonds in recent years. Apart from the Government and the National Institutions, the financial institutions are virtually the only issuers of bonds.[2] However, as explained above, they are dependent on the Government for approval of the issues, for instructions as to the utilization of the proceeds, and for covering any differences between the cost of the capital they mobilize and the price of the credit they grant under Government direction. The financial

[1] For developments in the value-linkage policy of financial institutions, see the chapter on Financial Institutions in the Annual Reports from 1962 onward.

[2] An exception is the Israel Electric Corporation, which under a special arrangement issues long-term value-linked bonds, taken up by insurance companies operating linked life insurance schemes. The Corporation also issued bonds for sale to social insurance funds. (The definition of financial institutions, as indicated, is broader here than in Chapter XVII.)

institutions may therefore be regarded as agents of the Treasury in the matter of bond issues (nearly all of which are acquired by institutional investors—social insurance funds and banking institutions for purposes of their approved saving schemes). Allocation of the bond issue between the Government and the financial institutions is subject to Treasury decision, and thus has little significance as regards the national economy. However, the fact that the Government considerably stepped up the sale of its bonds in 1967, without a reduction taking place in financial institution issues, was of course a significant development.

Although the identity of bond issuers in 1967 was not important from the point of view of the economy, it was significant for the financial institutions raising loan capital and for the institutions (mainly banks) distributing bonds. The composition of the financial institutions issuing bonds is illuminating (see Table XX-2). The new issue market is dominated by three groups of financial institutions, which are connected with the three large banks, and the Government mortgage bank Tefahot. All operate, as stated, in accordance with Government directives. The implications concerning the structure and efficiency of the new issue market will be discussed after considering the issue terms and the composition of bond purchasers.

2. *Issue terms*

There were two major developments in 1967 regarding the terms of new issues.

(a) The relative share of medium- and short-term loans increased.

(b) Changes in interest rates by maturities were not uniform: the nominal return on the Short-Term Loan was reduced, but that on medium- and long-term loans remained unchanged. It should also be noted that the loan terms, as far as repayment dates and rate of interest are concerned, were made almost uniform for the three main types of issues (the option-type, long-term loans, and loans denominated in foreign currency). This unusual development can be attributed to the Government's predominance in the bond market—the issuers, which are subject to the Treasury's directives, adjust the terms of their bond issues to those of the Government.

It will be seen from Table XX-1 that in 1966 net issues of long-term bonds in Israeli currency amounted to more than double the value of short- and medium-term bonds. In 1967 there was an opposite ratio, and even if the Defense Loan—which was not an ordinary issue—is excluded, the composition of the issues by maturities was conspicuously different.

This shortening of the "life" of the bonds is worthy of note. The rise in the outstanding balance of the Short-Term Loan was not exceptionally large compared with previous years, but it stands out when viewed in the light of the substantial cuts in the nominal yield in 1967. These amounted to 1.5–1.75 percent, and came on the heels of a reduction of about 0.5 percent at the end of 1966.

It should be stressed, however, that the stability of the price level in 1967 added more to the real return on this unlinked loan than was lost by the nominal reductions. Despite price stability, no change took place during the year in the interest paid on option-type loans, so that they became a particularly attractive investment—the unlinked interest amounts to 10.76 percent, and if the holder chooses redemption on a linkage basis, it comes to 4.84 percent a year.[1] The interest in the case of nonlinkage is considerably higher than the return on the Short-Term Loan (especially from August 1967 onward), while in the case of linkage it is only slightly lower than that paid on 17-year bonds (5.5 percent).

Table XX–3

BOND YIELDS, BY MATURITIES, 1967

(percentages, at purchase prices)

	Short-Term Loan						Option-type		
	3 months		6 months		12 months		Early re-demption[c]	5 years	17-year linked
	Jan.[a]	From Oct.	Jan.[a]	From Oct.	Jan.[a]	From Oct.[b]			
Gross	9.975	7.65	10.25	8.31	10.97	8.98	10.45	10.76	5.50
Net	7.5	5.75	7.71	6.25	8.25	6.75	7.94	8.45	4.125

[a] The yield until January 31, 1967.
[b] The yield as from October 18, 1967.
[c] Up to September 1967 series were issued with facilities for prior surrender after 24 months. The yield has been calculated accordingly.

When prices are stable, as in 1967, preference will obviously be given to medium-term option-type loans—the unlinked return on which is high and which are also "insured" against a possible rise in the price level of more than 5 percent a year—over long-term linked loans. Until September 1967 the option-type loans carried the right of early redemption two years after issue, and this made them very similar to the Short-Term Loan from the viewpoint of liquidity, on top of their yield advantage over other loans. It should be pointed out that the money market anticipated a stiffening of the terms of Government option-type loans, and when it came, it was expressed not in the reduction of the yield, but in the abolition of the early redemption facilities for loans issued as from

[1] Interest compounded, since the interest (or the interest plus the linkage differentials) is paid at maturity, when it becomes clear according to which of the two alternative calculations the holder will be paid. The return of 4.84 percent gross is equivalent to an annual rate of 3.7 percent net.

September.[1] This diminished somewhat the liquidity of option-type loans relative to the Short-Term Loan.

The implications of the growing volume of short- and medium-term securities are twofold:

(1) It will be necessary in the next few years to maintain a high level of sales in order to repay the series falling due. How this can throw off the Government's revenue estimates was illustrated in 1965 and the beginning of 1966, when the outstanding balance of the Short-Term Loan fell by about IL 145 million, whereas the budget for 1965/66 had envisaged a substantial income from this source.

(2) The Short-Term Loan, and to a lesser degree the option-type loans, are fairly liquid financial assets. The proliferation of liquid financial assets, purchases of which have jumped in the last two years, constitutes a potential source of inflationary pressure, since a convenient way to finance a spending program is to desist from reinvestment in these assets after they reach maturity.

The reluctance to trim the interest rate on the Government option-type loans can apparently be ascribed to the unwillingness to risk a possible drop in sales—in the second half of the year the economy showed signs of picking up, and the monetary expansion of the first half gave cause for concern.[2] Since the interest rate was not revised, sales of the Development Loan more than doubled in the second half of the year as compared with the first. That the option-type loans were more attractive was strikingly illustrated by the fact that the social insurance funds heavily increased their purchases of these loans at the expense of long-term bonds (in January 1968 the Government limited the funds' investment in securities with a maturity of less than 10 years to 10 percent of their approved investments; this will undoubtedly affect the composition of new issues in 1968).

The terms the Government lays down for its loans actually determine the minimum terms for other issuers. Since the allocation and terms of the credit extended by the financial institutions are prescribed by the Government, there is in fact complete correspondence between the terms offered by the Government and those by other issuers. All the option-type loans provide for the same rate of interest and maturity period (five years, 10.76 percent interest unlinked and 4.84 percent linked). The terms of long-term loans as well are almost identical:

[1] See, for example, the *Stock Exchange Newsletter* (July 31, 1967), published by Bank Leumi le-Israel: "The logical conclusion which the Bank of Israel will probably reach is to gradually reduce the interest on the option-type five-year loans, since these bonds offer holders the option of early repayment after two years with a net interest of over 8 percent." (Contrary to this quotation, the terms of the Development Loan are determined by the Treasury and not by the Bank of Israel.)

[2] In April the first series of the Absorption Loan was listed on the Stock Exchange; the heavy offer, which sent the price tumbling to 80 percent or less of the adjusted nominal value, resulted in yields of 7 to 9 percent (linked). It was apparently feared that the attraction of new issues would be lessened if the interest terms were worsened.

a repayment period of 17 years and interest of 5.5 percent. The same is true of foreign currency loans sold to Israeli residents—interest of 7 percent and in most cases repayment after 14 years.[1]

In recent years the role of the interest rate as an instrument for regulating saving and investment and their allocation has largely diminished. To the distorting influence of the Interest Law there has recently been added the virtually total separation between the terms offered those purchasing bonds and the terms of loans provided from the funds mobilized. This has been made possible by the Government's guarantee to cover any differences liable to arise between the proceeds from unlinked bond issues and payment on account of linked bonds. Besides this disparity between income and expenditure, there is a difference between the maturity period of the bonds and that of Government deposits with the financial institutions. Thus, institutions issuing five-year bonds can lend for periods of ten years or more. So long as no change takes place in the existing arrangements, the bond market will remain under the sole control of the Government, and the influence of economic variables will continue to be slight.[2]

3. *Purchasers of bonds*

In order to evaluate the structure and performance of the bond-issue market, it is important to examine the demand for bonds, both its constant components and the special factors influencing demand in 1967.

Purchases by social insurance funds constitute the largest component. This will be seen from Table XX–1, particularly after subtracting from total issues the amount collected on account of the Absorption Loan (because of its compulsory nature, this should not be regarded as a component of demand) and sales of the Defense Loan in 1967, which were only slightly motivated by

[1] These loans may be purchased with Natad dollars (see section 5 below). In 1967 only one new bond issue was put on the market with terms differing from those mentioned above. The reference is to unlinked bonds bearing 8 percent interest and convertible into shares, issued by the Bank Leumi le-Israel Investment Company. The prospects of a greater use of convertible bonds depend on the situation in the share market, which will be discussed below.

[2] In a number of countries the system of competitive bidding for Government bonds is prevalent. The Government sells the bonds to underwriters, who resell at a higher price. The prices of the bonds (and thus the return thereon) are determined by market forces. Conditions in the local bond market do not permit the institution of this method for medium- and long-term loans. The possibility of introducing competitive bidding for short-term loans was considered, but was rejected for two main reasons:

(a) The fact that the commercial banks are the sole distributors of bonds and the high degree of concentration marking Israel's banking system reduce the chances for any real competition.

(b) The bond-purchasing public, composed mainly of households, has greater confidence in the Bank of Israel as regards the determination of the yield.

economic considerations.[1] Net of these two, the social insurance funds took up 60 percent of total new issues in 1966 and about 45 percent in 1967. The funds have to invest in approved bonds if they want their income to be tax-exempt. The granting of approved investment status to loans issued by any body or institution generally ensures their sale, since it opens the social insurance fund market to them. The Ministry of Finance, which deals with this matter, grants such status to the bonds of institutions using the proceeds in accordance with its directives.[2]

Insurance companies are also numbered among purchasers of bonds, but most of their acquisitions are of special loans issued by the Government and the Israel Electric Corporation accordingly as their linked life insurance business develops. The linkage terms and repayment dates of the bonds correspond to those of the insurance contracts; they should not be regarded as part of the regular supply of loan capital (nor are they traded on the Stock Exchange).

Another institutional investor, whose importance increased in 1967, is the banking community. Approved savings schemes—which entitle the savers to certain tax concessions—carry an obligation to invest in approved bonds 60 percent of the amounts deposited. In recent years these schemes have offered optional conditions similar to those mentioned above in connection with option-type loans. A considerable percentage of the savings thus accumulated is accordingly invested in bonds of this type, and the growth in issues of option-type loans in 1967 was partly due to the marked expansion of approved savings schemes. The banking institutions also increased their portfolio investment on own account—a development which suggests both the appeal of the high bond yield and the weakening of demand for ordinary bank credit.

In addition, the financial institutions—which are the principal bond issuers in the non-Government sector—themselves acquired a certain amount of bonds, but they were not an important component of demand. After the institutional investors, the leading purchasers of fixed-interest securities are households and businesses. There are some indications that in 1967 business saving rose, and in view of the steep drop in investments during the year, it would be reasonable to assume that the liquidity of the business sector increased. Part of the incremental Short-Term Loan sales to the public were probably made to businesses, but there are no data on the amount.

In the absence of reliable data, household investment in securities can be

[1] Purchases of the Defense Loan had some economic effect in that they reduced potential purchases of other loans, but presumably this was not of great importance, since most households bought Defense Loan certificates, whereas only a small percentage of them tend to invest in securities.

[2] Bonds issued by financial institutions affiliated to the Histadrut holding company Hevrat Haovdim are invested in the company's enterprises, under an agreement between the Treasury and the Histadrut concerning the investment of monies accumulated by social insurance funds.

Table XX–4

PARTIAL ESTIMATE[a] OF CHANGES IN FINANCIAL ASSETS OF HOUSEHOLDS,[b] 1966–67

	1966		1967	
	IL m.	%	IL m.	%
Cash	70	6.2	276[c]	21.2
Fixed-term deposits (in Israeli currency)	118	10.4	371	28.6
Approved savings schemes	42	3.7	161	12.4
Pazak and Tamam deposits (of restitution recipients)	157	13.9	204[d]	15.7
Bill brokerage	247	21.8	–279	–21.4
Short-Term loan	80	7.1	75	5.8
Other securities in Israeli currency[e]	—	—	50	3.8
Securities denominated in foreign currency	76	6.7	78[d]	6.0
Claims on social insurance funds and insurance companies	341	30.2	363	27.9
	1,131	100.0	1,299	100.0

[a] Excluding direct investments in businesses and other financial transactions not carried out through organized markets.
[b] A direct estimate of household holdings is not available. Part of the assets attributed to households are apparently held by nonfinancial businesses.
[c] Including cash holdings in the administered areas (up to IL 100 million), which should be deducted for purposes of comparison with 1966.
[d] Excluding differentials due to the devaluation of November 1967. Included among securities are foreign securities (hence the difference between this table and Table XX–1).
[e] Excluding changes in the value of securities held by households at the beginning of the period; the Absorption and Defence Loans are also excluded (see Table XX–1).

estimated only in an indirect and far from precise manner. Since almost all the long-term loans are known to be acquired by social insurance funds and insurance companies, while households are the main purchasers of foreign currency bonds, the unknown residual is comprised of the Short-Term Loan and the option-type loans. According to Table XX–1, purchases of securities by the public (excluding institutional investors) jumped from about IL 100 million in 1966 to more than IL 175 million in 1967.

If we deduct purchases of foreign currency bonds (about IL 50 million) and take into account that in 1966 households apparently purchased most of the incremental Short-Term Loan certificates (about IL 80 million),[1] we can con-

[1] In 1966 Short-Term Loan holdings of banking and financial institutions dropped by IL 6.2 million. Comparable data are not available on the net investment of social insurance funds in this paper, but partial data suggest that it failed to offset the decline in the investment of banking and financial institutions. Estimates of the profitability of businesses and their liquidity in 1966 seem to rule out the possibility of large-scale purchases of the Short-Term Loan by this sector. It emerges, therefore, that the growth in the balance of the loan was mainly accounted for by households.

clude that in that year households did not take up any substantial amount of option-type or long-term loans.

In 1967 the picture changed. Purchases of foreign currency bonds did not increase, and households apparently did not invest in the Short-Term Loan more than they did in 1966 (banking institutions took up a larger amount than in the previous year, and presumably so too did nonfinancial businesses). If household investments in the aforementioned fixed-interest securities did in fact amount to IL 100–120 million, then this leaves about IL 50–75 million in option-type bonds—almost a sixth of the total issue of such loans. Regarding this estimate, two facts should be noted:

(1) Despite the increased purchase of securities in 1967, they still did not form an appreciable share of the incremental financial assets of households (see Table XX–4). The leading components remained claims on social insurance funds and insurance companies and various types of bank deposits. The proportion of liquid financial assets was relatively large.[1]

(2) Deposits in approved savings schemes, which reached a record high of about IL 160 million in 1967, were mostly made under conditions similar to those of the option-type loans. Since the banking institutions invest a large percentage of the accumulated savings in option-type loans, such savings may be regarded as an indirect investment in loans of this type.

4. *New bond issues—summary*

Israel resembles other countries in that institutional investors, and not households, are the main buyers of bonds, but in other respects its new issue market has an unusual structure and features.

(1) The issuers do not have to compete with one another (or with the issuers of other securities) in order to ensure sales. The social insurance funds are required by law to purchase bonds approved as a recognized investment—this approval in fact guarantees their sale.

(2) Even if they wanted to compete, the issuers are unable to do so, as they have no real say as to the terms of the issue. They are subject to the Government's directives regarding the use of the proceeds, and in many instances depend on it to cover differentials liable to arise between the terms of issue and those applicable to the use of the proceeds. (In these circumstances approval of a security for income tax concessions is an essential condition, though not an adequate one, to ensure its ability to compete.)

(3) Apart from the Government, financial institutions are almost the only other issuers of fixed-term securities. As the public is little inclined to purchase medium- and long-term bonds, the financial institutions often act merely as

[1] The data in Table XX–4 do not include changes in equity investment. There were hardly any new public share issues in 1967, and it is impossible to ascertain from the available data the change in the proportion of the existing stock held by households.

brokers between the institutional investors acquiring the bonds and the Government or Hevrat Haovdim, which determine how the money will be used.[1]

The conclusion that emerges from the foregoing is that to a large extent the bond issues market is subject to administrative constraints and lacks the characteristics of a competitive market. Buyers and sellers do not come together at their own volition, and prices are not determined by the interplay of supply and demand (this generalization does not apply to the Short-Term Loan, which competes in the money market and is purchased mainly because of economic considerations). Moreover, a considerable part of the funds could be transferred from their source (the institutional investors) to their destination (the Accountant General or Hevrat Haovdim companies) otherwise than through the issue of bonds. Since they are marketable instruments, bonds possess some advantages over deposits, for instance, and they are also a better secured investment; as against these advantages, however, the flotation costs must be reckoned with (distributors' fees generally amount to 2 percent of issue amount, while legal and other expenses add up to another 1.5 percent). The issue of over IL 500 million worth of bonds by the financial institutions in 1967 involved an outlay of more than IL 15 million.[2]

The most desirable solution to this situation in the bond market is to relax the administrative controls—to allow issuers to compete with one another for the investor's money by offering terms set at their own discretion. The Government's requirements, reflected in the State budget and largely connected with the defense burden, necessitate the large-scale mobilization of funds in the capital market. It is therefore inevitable that the Government should wield considerable influence in this market, but it would be desirable to reduce its intervention in the raising of capital for financing other sectors of the economy.

(b) *Share issues*

The new share-issue market continued in the doldrums in 1967, for the third year running. In the secondary market, the retreat of equity prices was checked, but this was not enough to cause any substantial change in new issue amount. This can be ascribed to several factors, some specific to 1967 and others of a more general nature:

(1) The issue of shares is generally associated with investment planning and an optimistic evaluation of the company's prospects. The early months of 1967 were marked by economic recession and uncertainty—a situation unconducive to embarking on new investments on commercial terms.

1 Under an agreement between the Government and the Histadrut, about half of the recognized investments are diverted to enterprises affiliated to Hevrat Haovdim, mainly through Gmul Ltd. and Bank Hapoalim.

2 In some cases it was so arranged that the flotation costs were not borne by the issuer, but it was the recipient of the credit from the issuer who ultimately covered the costs.

(2) The preparation of a share issue is a lengthy process, especially in the case of companies whose shares have not yet been listed on the Stock Exchange.

(3) Companies with listed shares were reluctant to launch new issues in 1967 because of the low level of share prices (the rise that took place during the year was insufficient inducement—see Diagram XX-1).

Another, more fundamental, factor which contributed to the dearth of stock issues was unconnected with the circumstances specific to 1967. Businesses are not inclined to turn to the equity market to raise funds as long as they can obtain loan capital at reasonable terms. The desire to retain control over the business and the profitability of their investment prompt the owners to favor an increase in the financial leverage insofar as this is possible. From this point of view, the developments of 1967 did not encourage resort to the equity market: in most sectors of the economy businesses could borrow from financial institutions on relatively easy terms. The value-linkage clause, which until a few years ago had deterred companies from assuming too large a loan burden, was almost entirely abolished. The data show that institutions providing loan capital to industry expanded such credits in 1967 to a greater extent than in the two preceding years, despite the slump in investment activity. It would seem, therefore, that even if the three aforementioned factors had not operated, there probably would not have been any increase in share issues.

Discussion of the absence of share issues has hitherto revolved around supply factors—the availability of alternative sources of financing and unsuitable market conditions. But the demand factors should not be ignored, for these too did not encourage new issues. The yield offered investors in bonds was high, so that willingness to invest in more risky securities depended on the propects of earning a return which the issuing companies were unable to offer. In other words, there was no chance of selling new shares on terms considered reasonable from the point of view of the issuer. This of course was connected with the low level of Stock Exchange prices. The situation in the secondary market determines both the profitability of a new issue to the company concerned and the investor's prospects of reaping a capital gain, a factor which more strongly influences the readiness to invest in shares than does the dividend yield.

4. Developments in the Secondary Market

(a) *Listed shares*

The registration of securities on the Stock Exchange facilitates their trade in an organized market. The value of securities thus listed is therefore a yardstick of the size of the marketable stock of securities in the economy.

In 1967 the value of securities listed on the Tel Aviv Exchange grew by about IL 630 million, or some 28 percent, to reach IL 3,000 million (see Table

Table XX-5

SECURITIES LISTED ON THE TEL AVIV STOCK EXCHANGE, AT MARKET VALUES, 1966–67

	1966		1967	
	IL m.	%	IL m.	%
A. Securities traded in Israeli currency				
(1) Government loans				
Linked[a]	372.2	15.7	490.6	16.4
Nonlinked	28.6	1.2	25.3	0.8
Total	400.8	16.9	515.9	17.2
(2) Other loans				
Linked[a]	757.9	31.9	1,000.4	33.4
Nonlinked	0.5	..	3.2	0.1
Total	758.4	31.9	1,003.6	33.5
(3) Total loans (1+2)	1,159.2	48.8	1,519.5	50.7
(4) Ordinary shares				
Finance and insurance	300.4	12.7	365.3	12.2
Land and development	114.3	4.8	105.2	3.5
Industry and commerce[b]	67.6	2.8	122.7	4.1
Fuel and oil	10.4	0.4	12.7	0.4
Investment companies	127.2	5.4	142.3	4.7
Total	619.9	26.1	748.2	24.9
(5) Preference shares	17.5	0.8	13.1	0.4
(6) Total shares (4+5)	637.4	26.9	761.3	25.3
(7) Total securities traded in Israeli currency (3+6)	1,796,6	75.7	2,280.8	76.0
B. Securities traded in foreign currency				
(1) Bonds	458.8	19.3	590.0	4.3
(2) Shares	118.3	5.0	128.6	19.7
Total	577.1	24.3	718.6	24.0
C. Grand total (A+B)	2,373.7	100.0	2,999.4	100.0

[a] Including option-type loans.
[b] Including public services.
SOURCE: Tel Aviv Stock Exchange.

XX–5). Of this increase, about IL 200 million can be attributed to the change in the value of securities listed at the beginning of the year, and about IL 430 million to the listing of new securities.[1] The increase in the value of securities listed at the beginning of the year was due to a number of developments:

(1) The rise in the index of share prices, which added about IL 80 million to the value of listed shares (the value of newly listed shares amounted to only IL 45 million).

(2) The devaluation of the Israeli pound in 1967 increased by a sixth the nominal value of securities traded in foreign currency or linked to the dollar[2] (the rise in the index of linked bond prices corresponded to the rate of devaluation). About IL 75 million was added to the value of shares and bonds traded in foreign currency, and IL 30 million to the value of linked bonds.

(3) Bonds linked to the consumer price index did not advance much during the year owing to the stability of the index. The increment that can be attributed to the slight rise in the prices of index-linked bonds is approximately IL 20 million.

Table XX–6

TOTAL MARKET VALUE AND TURNOVER OF SECURITIES DENOMINATED IN ISRAELI CURRENCY TRADED ON THE TEL AVIV STOCK EXCHANGE,[a] 1961–67

	Shares			Linked bonds		
	Average marketable capital (IL million)	Annual turnover		Average marketable capital (IL million)	Annual turnover	
		IL million	Rate (%)		IL million	Rate (%)
1961	173.0	45.6	26.1	347.7	33.2	9.5
1962	246.1	67.6	26.9	540.6	46.8	8.5
1963	579.7	231.9	40.0	617.5	37.8	6.1
1964	806.6	216.9	26.6	702.4	41.2	5.8
1965	789.5	89.4	11.3	814.0	44.9	5.5
1966	701.0	56.9	8.1	984.3	47.7	4.9
1967	694.1	43.3	7.6	1,178.9	55.2	4.7

[a] The data differ from those in Tables XX–7 and XX–11, which also include turnover in securities denominated in foreign currency.
SOURCE: Central Bureau of Statistics.

[1] Against the nearly IL 635 million (gross) in new securities listed during the year, we have to offset those struck from the register, in the main bonds reaching maturity.

[2] The value of bonds with a mixed linkage (i.e. linked half to the consumer price index and half to the exchange rate) rose by about 8 percent as a direct result of the devaluation.

While the listing of a security on the Stock Exchange permits trading therein, this does not guarantee that there will in fact be trading. From the data in Table XX–6, which relate to securities denominated in Israeli currency only, it will be seen that in recent years the annual rate of turnover in shares and linked bonds has declined. As regards shares, this is explained by a sharp fall in the volume of transactions (prices also dropped, but at a lower rate). As to bonds, the reason is different: the volume of trading increased, but the total value of listed bonds increased much more rapidly. The decline in annual bond turnover was connected with the holding of a growing percentage of the existing stock by such investors as social insurance funds, which do not trade much in the securities they acquire. The rate of turnover in listed securities definitely moved downward, but one must be wary of drawing conclusions about the degree of the decline, since the data on which the calculation was based are not complete: they do not include the offsetting of buy and sell orders by brokers, the extent of which is liable to fluctuate considerably from one period to another.

(b) *Trade on the Stock Exchange*

The slump in the share market, which had persisted almost unbrokenly since the second quarter of 1964, came to a halt in 1967. Between 1964 and 1966 there had been short-lived rallies lasting for a month or so, followed by a resumption of the decline. In 1967 the upward trend in turnover did not continue throughout the entire year, but after reaching a peak in the second quarter the figure stabilized at a level above that of the first quarter.

Equity turnover in the first quarter of 1967 dropped to its lowest point since the second quarter of 1960, but in the middle of March it began to pick up. Between April and June it nearly trebled compared with the beginning of the year. This is partly explained by the fact that the prices of many established shares dropped to a level where they held out prospects of not only capital gains over time but also a substantial dividend yield (see below). Moreover, it is evident that because of the small size of this market a fairly modest rise in demand can cause prices to spurt. The temporary rallies in 1964–66 did not bring back any large number of buyers to the market; on the contrary, investors took advantage of these brief recoveries to unload shares acquired in the past, thereby causing the renewal of the downward trend. In 1967 quotations were so low that the sharp rise in March and April (by about 23 percent) did not produce a flurry of sales. In the second half of May prices again dipped—this time by 10 percent—as a result of profit-taking and the effects of the period of tension preceding the Six Day War. In June, however, turnover was lively owing to increased demand and a renewed rise in quotations. In the second half of the year trade in shares was considerably lower than in the second quarter, but there was no resumption of the downtrend.

Table XX-7

SHARE TRANSACTIONS ON THE TEL AVIV STOCK EXCHANGE, 1966–67

	1966			1967		
	IL m.	Average volume per trading day (IL '000)	Change in price index[a]	IL m.	Average volume per trading day (IL '000)	Change in price index[a]
January	4.7	225	–3.7	2.7	124	–2.8
February	5.4	272	–3.5	2.5	125	–1.9
March	4.9	224	–2.9	2.9	138	+4.5
First quarter	15.0	239	–9.7	8.1	129	–0.5
April	3.0	217	+0.4	7.0	389	+15.9
May	10.6	506	+5.2	8.4	421	–10.6
June	8.7	394	+1.6	7.2	378	+7.2
Second quarter	22.3	392	+7.2	22.6	397	+11.1
July	5.2	258	–7.1	4.5	205	+1.1
August	3.7	163	–2.2	3.7	168	–1.6
September	3.0	175	–0.9	4.2	209	+2.1
Third quarter	11.9	198	–10.0	12.4	194	+1.5
October	2.7	132	–3.7	3.1	162	–1.2
November	3.5	160	–6.3	4.4	198	+0.3
December	3.9	185	–2.6	4.2	201	–0.7
Fourth quarter	10.1	160	–12.1	11.7	188	–1.6
Entire year	59.3	244	–23.4	54.8	223	+10.5

[a] The percentage change in the monthly index of ordinary share prices (Central Bureau of Statistics).
SOURCE: Tel Aviv Stock Exchange.

Equity trading on the Tel Aviv Stock Exchange is still on a very small scale—an idea of how small can be gained by comparing the annual turnover of IL 55 million in 1967 with the volume of new bond issues that year, which totalled more than IL 700 million net (excluding the Absorption and Defense Loans). The number of investors in shares is still relatively small, and this may lead to developments liable to undermine the confidence of the general public in the stock market. The reference is to sharp fluctuations in quotations set off by slight changes in supply or demand. Trade on the Stock Exchange is fairly concentrated in that a small number of shares account for a considerable part of the turnover. As may be seen from Table XX–8, in 1967 only 14 listed shares showed an annual turnover of more

Table XX–8

DISTRIBUTION OF ORDINARY SHARES BY ANNUAL TRADING VOLUME, 1967[a]

L '000	Group					Total	Percent of total trading volume	Percent of total market value of shares[d]
	Banks and financial institutions	Land and develop-ment	Industry and commerce[b]	Public services, fuel and oil[c]	Investment companies			
nder 100	4	2	8	1	5	20	1.8	5.8
0–250	4	1	9	2	4	20	7.3	11.6
0–500	5	6	5	—	2	18	14.2	17.9
0–1,000	6	—	3	—	2	11	17.2	9.9
,000–2,500	3	3	1	1	3	11	37.6	35.6
ver 2,500	3	—	—	—	—	3	21.9	19.2
Total	25	12	26	4	16	83	100.0	100.0

Distribution of companies with listed shares; where a company has listed more than one class of shares, the figures have been combined.
Two shares in the under-IL 100,000 group were not traded.
The two groups were combined, since in the public services there was only one company with listed shares. In one fuel and oil share there was no trade at all.
Market value at December 31, 1967.
OURCE: Based on data of the Tel Aviv Stock Exchange.

than IL 1 million, and three a turnover of over IL 2.5 million. These 14 concerns accounted for almost 60 percent of the total volume of share trading,[1] and 55 percent of the market value of all listed shares at the end of 1967. As for the less heavily traded shares, it was to be expected that fairly small changes in trading volume would cause sharp swings in prices; however, even the most heavily traded shares fluctuate appreciably following slight changes in supply or demand. (The "size" of the supply or demand, from the aspect of its possible influence on prices, should be measured in relation to the marketable stock of the security concerned.[2] Since such data were not available, the volume of transactions has been evaluated in relation to the amount of funds operating in the money market.) This is borne out by Table XX–9, which shows the price changes for several shares that were heavily traded during the months March to May 1967 and the average monthly turnover of these shares.

[1] The data on trading volume do not include the matching of buy and sell order by brokers. Presumably this is greater in the case of more heavily traded shares.

[2] Theoretically, the entire listed amount of a share is marketable, but in practice large blocks are usually held by groups or by individuals possessing a controlling interest in the firm. Apart from special instances of transfer of control or of death, these shares are not for sale, so that the marketable stock is smaller than the amount listed on the Exchange.

Table XX-9

PRICE FLUCTUATIONS AND AVERAGE VOLUME OF TRADE IN SELECTED SHARES, MARCH–MAY, 1967

	Average monthly volume, March-May (IL '000)	Price rise, March–April (%)	Price decline in May (%)
Share A[a]	378	36.6	–17.2
Share B[a]	372	38.3	–15.7
Share C[a]	207	50.2	–28.5
Share D[b]	217	32.3	–14.1
Share E[c]	64	25.6	–18.7
Share F[d]	105	39.1	–18.4
Share G[d]	192	24.0	–12.9

[a] Banking and financial institution group.
[b] Land and development.
[c] Industry and commerce.
[d] Investment companies.
SOURCE: Based on data of the Tel Aviv Stock Exchange.

Trading was so small that a few speculators could cause prices to fluctuate. When the fluctuations—in both directions—are very sharp, the cautious attitude of the investing public toward equities is understandable.

The volume of bond transactions rose in 1967, continuing the trend of the past few years. Trading in bonds accounted for nearly three-quarters of the total value of Stock Exchange transactions (excluding the matching of buy and sell order by brokers)—an inverse ratio to that in 1964 (see Table XX–11).

Four main types of bonds are traded on the Exchange: the Short-Term Loan, option-type loans, loans linked to the consumer price index, and loans traded in foreign currency or linked to the exchange rate.

Table XX–11 indicates that in the past two years trade in the Short-Term Loan exceeded that in index-linked bonds (including the option-type), as well as that in bonds denominated in foreign currency or linked to the exchange rate. However, it should be pointed out that, in contrast to 1966, the past year saw a more vigorous growth of medium- and long-term bond transactions relative to the Short-Term Loan. In 1966 trade in the latter paper was 74 percent above the 1965 figure, while the increase in other bonds came to only 5 percent. In 1967 the growth rates were 9 percent for the Short-Term Loan and 31 percent for other bonds. Index-linked and option-type loans showed particularly high growth rates. Contributing to this was the expanded trade in the

Table XX–10

BOND TRANSACTIONS ON THE TEL AVIV STOCK EXCHANGE, WEEKLY,[a] 1966–67

(IL thousand)

	1966				1967			
	Index-linked[b]	Dollar-linked[c]	Short-Term Loan	Total (IL million)	Index-linked[b]	Dollar-linked[c]	Short-Term Loan	Total (IL million)
January	338	1,036	1,093	10.6	955	1,152	1,328	14.9
February	397	1,330	1,033	10.9	583	1,081	1,730	14.3
March	395	1,058	1,070	11.7	788	1,158	1,179	12.7
First quarter	377	1,141	1,065	33.2	775	1,130	1,412	41.9
April	384	893	1,611	8.4	1,282	1,238	1,653	14.4
May	280	956	798	8.2	715	1,314	1,734	14.9
June	312	854	1,073	10.5	434	848	1,071	9.2
Second quarter	325	901	1,161	27.1	810	1,133	1,486	38.5
July	274	844	1,771	11.1	733	1,055	1,417	12.9
August	255	738	1,114	9.1	643	840	959	10.8
September	230	667	1,317	7.3	761	707	509	8.0
Third quarter	253	750	1,401	27.5	712	867	962	31.7
October	252	729	1,931	11.9	1,113	722	1,035	10.5
November	1,399	867	1,093	14.8	1,430	1,135	1,267	15.6
December	1,674	1,344	1,146	17.5	1,170	1,729	2,007	20.4
Fourth quarter	1,108	980	1,390	44.2	1,238	1,195	1,436	46.5
Entire year	516	943	1,254	132.0	886	1,081	1,324	158.5

[a] Adjusted for the number of trading days per week.
[b] Including the Absorption Loan and option-type issues.
[c] Including bonds denominated in foreign currency.
SOURCE: Total transactions—Tel Aviv Stock Exchange; weekly averages—State Loans Administration, based on Tel Aviv Stock Exchange data.

Absorption Loan (which was listed on the Stock Exchange only in 1967, having been previously traded on the free market) and the relatively greater importance of the option-type loans as regards both new issues and volume of trade.

As may be seen from Table XX–10, trade in bonds did not move upward throughout the entire year. After reaching a peak in the first quarter, the figure turned downward in the second and third quarters, and then regained ground in the last quarter. The contrasting pattern in the share and bond markets should be noted. The last quarter of 1966 and the first quarter of 1967, which saw a slump in share trading, were marked by lively activity in the bond market. In the second quarter of 1967, when trade in equities picked up, the bond market contracted somewhat. This may indicate a shift of investment funds from one market to the other.

Table XX–11

TRANSACTIONS ON THE TEL AVIV STOCK EXCHANGE, 1964–67

	IL million			Percent		
	Shares	Bonds	Total	Shares	Bonds	Total
1964	222.2	72.8	295.0	75.3	24.7	100.0
1965	91.3	103.8	195.1	46.8	53.2	100.0
1966	59.3	131.9	191.2	31.0	69.0	100.0
1967	54.8	158.5	213.3	25.7	74.3	100.0

SOURCE: Tel Aviv Stock Exchange.

Mention has been made above of the concentration of trade in the share market. The bond market too is marked by a high degree of concentration. The Exchange lists hundreds of series of loans issued by the Government and scores of companies and institutions, but in many cases the volume of trade is negligible. This is because most of the bonds purchased at source by institutional investors are retained by them and do not form part of the loan capital actively traded on the Exchange. Of the option-type loans, most of the trade in 1967 was in the Government Development Loan, while the Absorption Loan headed the list of linked issues. In foreign currency bonds, Hollis (a Jewish Agency subsidiary) predominated, and only in dollar-linked bonds was there a broader dispersion. Apart from Tavei Dollar and a number of other Government loans, trade in bonds of the Electric Corporation, Dead Sea Works, and a number of other companies was also far from negligible in 1967 (see Table XX–12).

Table XX-12

DISTRIBUTION OF LISTED BONDS[a] BY VOLUME OF STOCK EXCHANGE TRADE, 1967

IL '000	Index-linked	Dollar-linked	Mixed-link[b] and nonlinked	Option-type	Traded in foreign currency	Total	Percent of total trade	Percent of total market value
Up to 100	15	4	15	7	9	50	1.2	23.0
100–250	2	5	4	2	4	17	3.0	18.0
250–1,000	3	6	1	—	6	16	9.9	16.4
1,000–2,500	2	5	—	—	4	11	16.7	11.5
Over 2,500	2	3	—	1	1	7	69.2	21.1
Total	24	23	20	10	24	101	100.0	100.0
Percent of total trade	17.4	20.7	1.4	27.1	33.4	100.0		
Percent of total market value	27.6	14.0	4.4	26.3	27.7	100.0		

[a] Distribution of issuers and not of individual issues.
[b] Linked half to the dollar and half to the consumer price index.
SOURCE: Based on data of the Tel Aviv Stock Exchange.

(c) *Price trends*

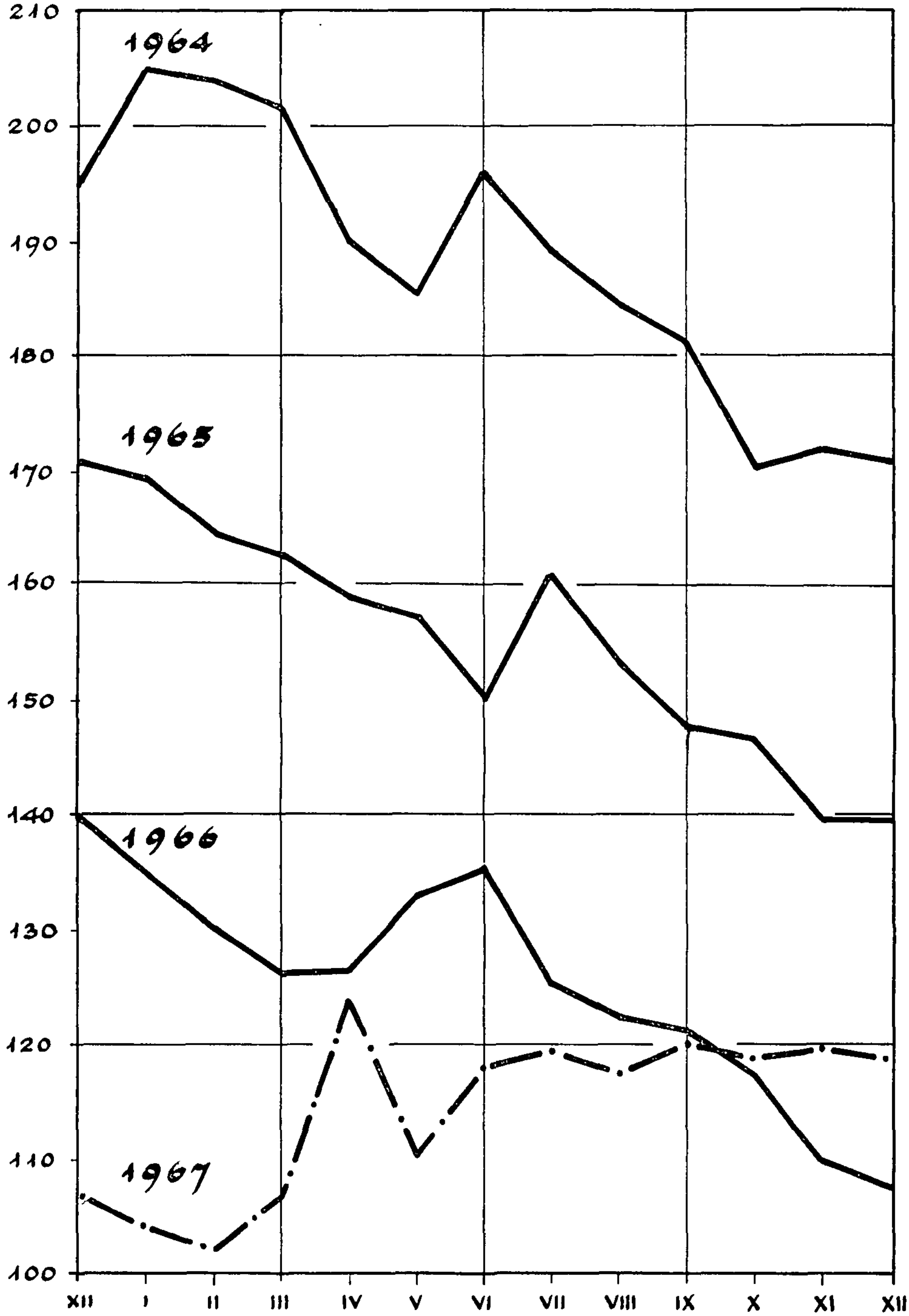
The receding of share prices, which had continued virtually without interruption since the beginning of 1964, came to a halt in 1967 (see Diagram XX–1). The monthly index of ordinary share prices was lower at the end of the year than it was in April or most of the second half of the year, but over 1967 as a whole it rose by approximately 11 percent, compared with declines of 23 percent in 1966, 18 percent in 1965, and 14 percent in 1964.

The change was first perceptible in the middle of March, and by the end of the month the index had gone up by more than 6 percent. This rise in prices, which was not connected with any exceptional increase in the volume of transactions, apparently attracted investors eager to take advantage of the change to pick up securities at a relatively low price. Just as in 1964 the belief that the protracted boom was coming to an end was one of the factors depressing prices, so in 1967 it was felt that share prices could not possibly drop much more (except for several companies which became financially involved). Equity investment is not motivated as a rule by current-income considerations, but it should be noted that the dividend yield of a number of established firms did not lag far behind the returns on other financial assets. (In 1966 investors in listed shares were equated with purchasers of bonds as far as the 25 percent tax limit is concerned.)

Diagram XX-1

MONTHLY INDEX OF ORDINARY SHARE PRICES, 1964–67

(End of month; 1960=100)



Source: Central Bureau of Statistics.

Table XX-13

PRICES AND YIELDS OF SELECTED SHARES, 1964-67

(percentages)

	1964		1967		
	Price on Feb. 26	Dividend yield[a]	Price on Feb. 26	Dividend yield[a]	Overall return
Share A[b]	430	2.9	188	7.4	47.9
Share B[b]	389	2.1	170	7.8	41.6
Share C[b]	147	5.4	144	11.1	41.2
Share D[b]	321	3.1	101	10.0	22.4
Share E[b]	383	1.6	80	12.5	57.4
Share F[c]	419	1.7	140	12.1	10.4
Share G[d]	223	4.5	103	14.5	-3.7
Share H[d]	149	—	99	7.1	40.7
Share I[e]	276	5.1	110	9.1	42.1
Share J[f]	326	—	121	8.3	24.8
Share K[f]	393	2.5	149	8.1	36.9

[a] The dividend yield is calculated as of February 26 according to the cash dividend paid in the preceding year.
[b] Finance and insurance
[c] Land and development.
[d] Industry and commerce.
[e] Fuel and oil.
[f] Investment companies.
SOURCE: Based on data of the Tel Aviv Stock Exchange.

Thus there were good prospects of reaping a capital gain without sacrificing much in the way of current income. Table XX-13 presents the prices of several heavily traded shares, together with dividend yields in 1964 and 1967 and the overall return in 1967.[1] A comparison of share prices during the stock market boom with their level at the beginning of 1967 strikingly points up the extent of the slump in the three years 1964-66. The dividend yield on most shares in 1964 was considerably lower than most interest rates in the free market. By the beginning of 1967 the differential had considerably narrowed, and investors entering the market at that time enjoyed a high overall return, which reached an average of 17 percent for all ordinary shares. The return on some shares, especially those most heavily traded, was much higher, as may be seen from the table.

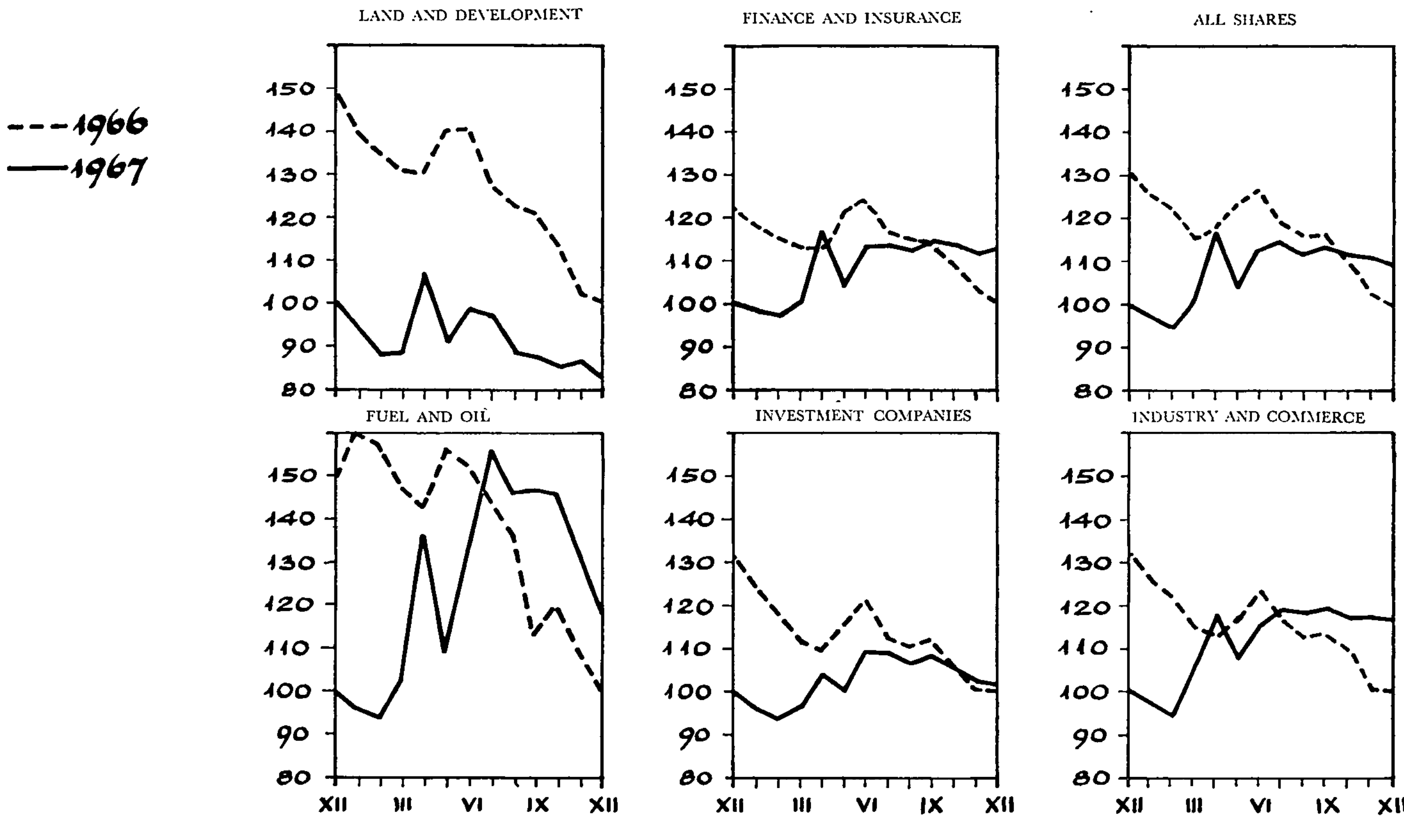
It is still too early to say whether the stabilization of share prices in 1967 heralds the beginning of a new boom in the share market (during the first few months of 1968 the price trend continued upward and the volume of trade expanded considerably). It has been explained above why it was

[1] The overall return takes account of both the dividend paid during the year and the change in the price of the share between the beginning and end of the year.

Diagram XX-2

INDEXES OF SHARE PRICES, 1966–67

(End of month; December 1966=100)



Source: Central Bureau of Statistics.

Table XX-14

DAILY INDEXES OF SECURITY PRICES, 1967

(December 29, 1966=100)

Date	Shares						Bonds	
	All shares	Finance and insurance	Land and development	Industry and commerce	Investment companies	Fuel and oil	Dollar-linked	Index-linked
Jan. 31	97.2	98.1	95.0	97.8	96.2	95.6	99.6	100.4
Feb. 28	94.7	97.2	89.5	94.1	94.0	93.6	98.9	100.2
March 30	100.2	100.7	89.4	105.5	96.0	102.1	100.8	99.3
April 27	116.3	117.0	106.5	117.1	114.0	136.4	100.9	99.0
May 31	103.5	104.8	90.9	107.4	100.5	109.2	100.9	99.3
June 29	112.5	113.1	98.5	115.0	109.7	131.8	99.8	100.2
July 31	114.2	113.8	97.0	118.6	109.2	155.9	100.3	100.3
Aug. 31	111.9	112.5	88.9	118.0	106.7	145.9	99.2	101.0
Sept. 28	113.2	114.3	87.8	118.7	108.8	146.5	98.1	100.4
Oct. 31	111.5	113.5	85.8	116.6	105.5	145.4	97.1	100.0
Nov. 30	110.1	111.7	86.6	116.7	102.4	131.7	112.2	101.0
Dec. 31	108.8	112.1	82.2	116.2	101.5	118.1	115.4	101.3

SOURCE Central Bureau of Statistics.

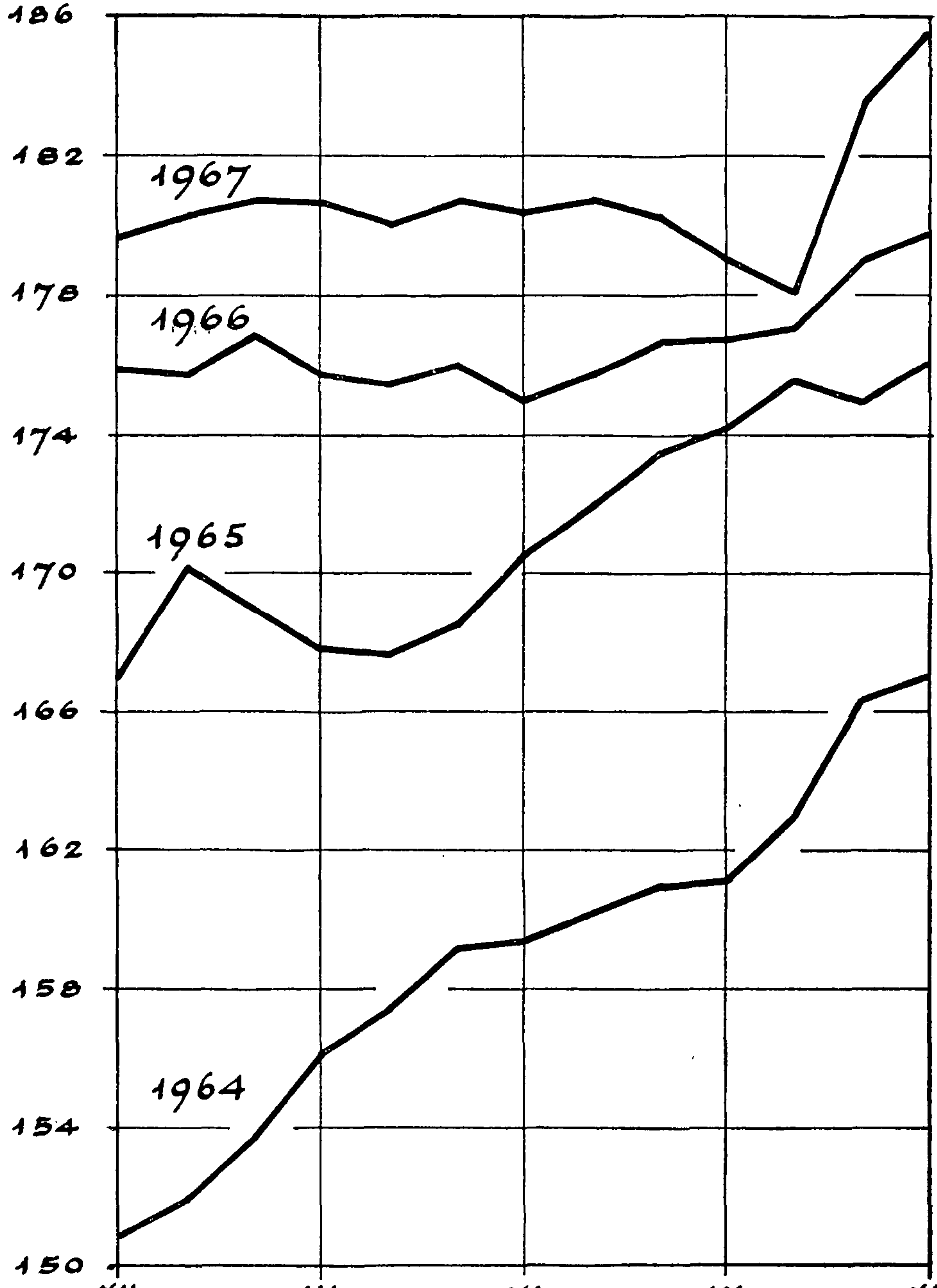
reasonable to assume that the market would turn in 1967, but it should be recalled that from 1964 to 1966 there were also short-lived rallies, followed by a resumption of the slump. The firming of prices in the second half of 1967 and the upswing in both prices and turnover in early 1968 give reason to believe that the change in 1967 was essentially different from those in the three preceding years. Nevertheless, it should be stressed that the market is still fairly small, and speculation is liable to cause sharp price fluctuations. Long-run stability hinges on an increase in the number of investors (including institutional investors), and apparently this was not achieved in 1967 (it also depends, of course, on the revival of the new issue market).

The group price indexes developed similarly to the general index, but there were marked differences in the magnitude of the changes (see Table XX-14 and Diagram XX-2). The index of the finance and insurance group, the largest and most actively traded of all groups listed on the Stock Exchange, moved in line with the general index, and was slightly higher than the latter in nearly every month of the year. Land and development shares rose in April, similarly to the other groups, but unlike them they fell in the second half of the year. The decline over the year as a whole amounted to 18 percent —less than in 1966 but in distinct contrast to the general trend. Industrials and commercials advanced more than most of the other groups (apart from fuel and oil)—the price level at the end of 1967 was 16 percent higher than

Diagram XX-3

INDEX OF LINKED BOND PRICES,[a] 1964-67

(End of month; 1960=100)



[a] All bonds linked either to the exchange rate or to the consumer price index, or with a mixed linkage.

SOURCE: Central Bureau of Statistics.

Table XX-15

MONTHLY INDEXES OF SECURITY PRICES, 1967

(December 1966=100)

	Bonds					Shares	
	Total	Dollar-linked	Index-linked	Mixed-linked	Non-linked	Preference	Ordinary
January	100.3	100.0	100.4	100.3	99.3	97.7	97.1
February	100.5	99.8	100.7	101.1	97.7	97.4	95.2
March	100.4	101.1	100.2	100.9	97.8	97.3	99.5
April	100.1	101.4	99.7	100.7	98.9	100.8	115.3
May	100.5	102.5	99.8	101.3	96.7	98.1	103.1
June	100.3	100.3	100.2	101.0	93.5	101.8	110.6
July	100.5	100.3	100.5	101.0	95.5	101.6	111.8
August	100.2	98.9	100.5	100.7	97.9	101.3	110.0
September	99.5	97.2	100.1	99.6	97.1	102.1	112.2
October	99.0	95.9	99.8	98.3	96.7	100.7	110.9
November	101.9	109.9	100.0	104.1	98.4	102.3	111.2
December	103.2	113.0	100.8	105.6	99.5	104.5	110.5

SOURCE: Central Bureau of Statistics.

at the end of 1966. It should be noted, however, that during the slump years the index of industrial and commercial share prices dropped to a greater extent than the general index. At the end of 1966 the index of this group stood at 72.8 (1960=100), compared with a general index of 125.5 and 199.1 for the finance and insurance group. Investment company shares matched the rises recorded by the other groups in April, but subsequently nearly all of the gains were erased, and the level at the end of the year was only 1.5 percent higher than at the beginning. (The unit trusts performed much better in 1967, prices here advancing more rapidly than the general index.)

The fuel and oil group, consisting of a small number of companies, has the greatest appeal to speculators, and its prices showed sharper swings than the others: in April the rise was double that of other groups, and from July to October the group's index was also considerably higher than that of the others (during this period it was 45 to 55 percent above the end-1966 level). In the latter part of the year it receded, but even so the final quotations for 1967 were 18 percent higher than at the beginning of the year.

It should be noted that the development of share prices in the various groups was affected in some cases by special occurrences. For example, the decision to convert shares of the Dead Sea Works into bonds in March was largely responsible for the doubling of the price, which in the preceding months had fluctuated between 32 and 42. As a result, the index of the industrial and commercial group rose considerably that month, and the share prices of investment companies, which held substantial blocks of this stock, were also favorably affected.

In August Rassco published its annual report as at the end of March 1966, and investors' evaluation of its business outlook caused the shares of the company (and of some of its subsidiaries) to tumble, depressing the index of the land and development group as a whole.

Bond prices displayed less striking changes in 1967. The index of dollar-linked bonds fell precisely between August and October, indicating that no devaluation was expected.[1] On the other hand, it went up in December by more than the rate of the devaluation of the previous month. This was in contrast to what happened after the 1962 devaluation, when prices took several months to catch up with the change in the exchange rate.

Index-linked bonds showed only very slight changes (1967 was a year of price stability). The nonlinked bond index moved downward until June (an unexpected development in view of the price stability and fall of interest rates in the economy), but thereafter a gradual rise set in, wiping out almost all of the decline of the first half-year.

Prices of bonds with a mixed linkage advanced moderately in 1966 and 1967 compared with the two preceding years (see Diagram XX–3). Comparison of Diagrams XX–1 and XX–3 underlines the marked difference between the position of investors in bonds and that of investors in shares in recent years. The index of bond prices rose in every year, whereas the reverse was true of shares (apart from the change in the last months of 1967).

5. Securities Traded in Foreign Currency

Securities traded in foreign currency and held by Israeli residents may be divided into two main categories:

— Securities issued by companies or other bodies in Israel and denominated in foreign currency.

— Foreign securities.

Data of the Controller of Foreign Exchange do not distinguish between these two types, and there is no certainty that the figures in Table XX–1 on local security issues denominated in foreign currency are an exact estimate. There is therefore no way of ascertaining the precise amount of foreign securities acquired by Israeli residents. As in 1966, the incremental securities traded in foreign securities totalled nearly $ 25 million in the year reviewed. If the net increase in

[1] On October 31 the *Stock Exchange Newsletter* of Bank Leumi sized up the situation as follows: "Whether justified or not, the general feeling is that there is not likely to be a currency devaluation in the near future." On the other hand, there were expectations of a devaluation in March, when the index of dollar-linked bond prices advanced more than 2 percent.

domestic securities denominated in foreign currency did in fact come to approximately IL 50 million, then investment in foreign securities amounted to $ 8–9 million. (In 1967 foreign mutual funds sold more participation certificates than in previous years, but exact data are not available.)

It should be noted that Table XX–16 is based on purchase prices and not on market values at the end of each year. The estimated annual increment is therefore more accurate than the estimated value of security holdings. (The alteration of the exchange rate in November affected the IL value of the outstanding balance.)

Table XX–16

FOREIGN CURRENCY SECURITIES HELD BY ISRAELI RESIDENTS, 1963–67

($ million)

End-year	Balance	Annual increment
1963	36.8	11.1
1964	50.6	13.8
1965	80.4	29.8
1966	105.8	25.4
1967	131.1	25.3

SOURCE: Ministry of Finance.

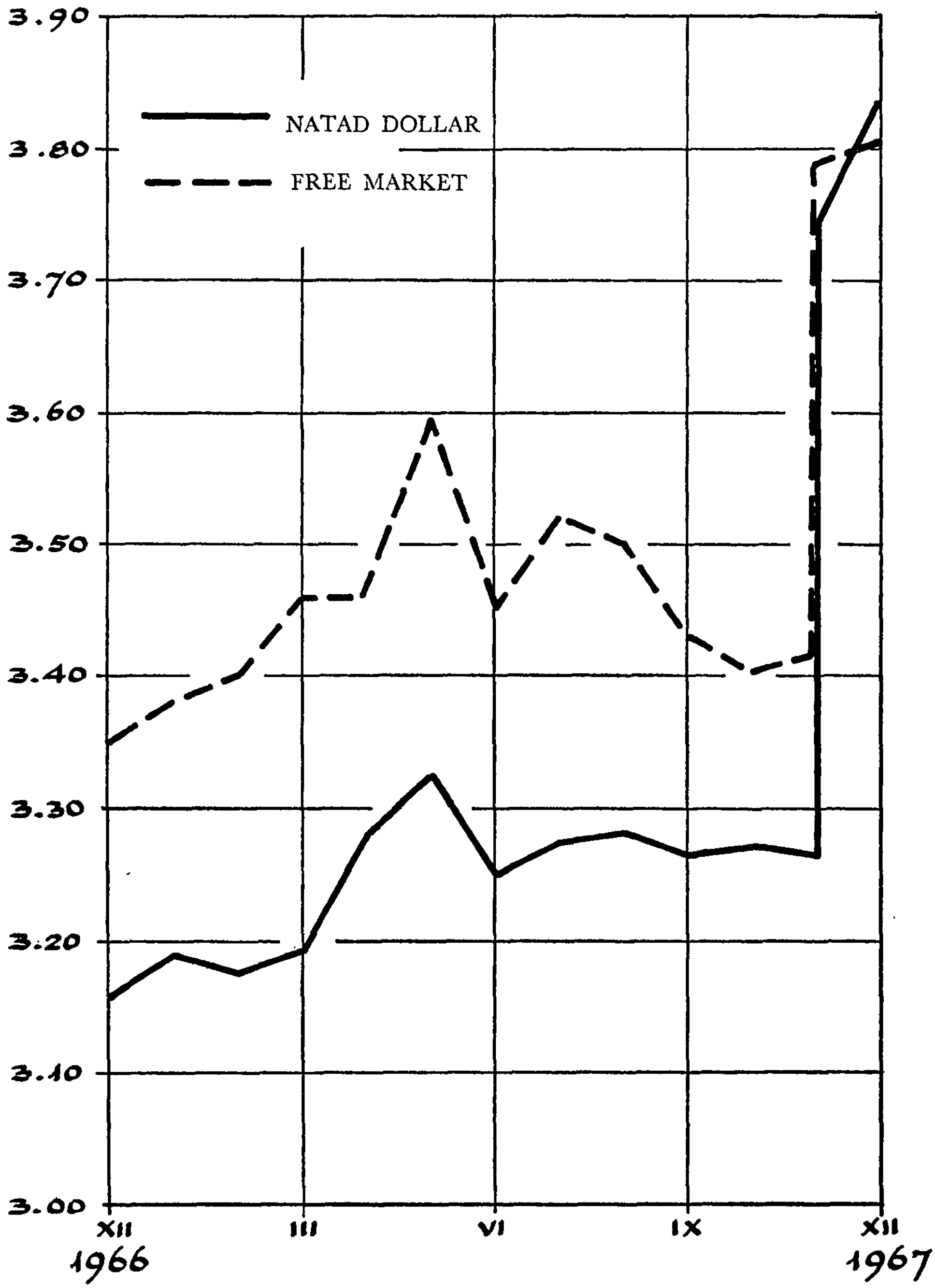
The opportunity to invest in securities traded in foreign currency is given to recipients of personal restitution from Germany, who are entitled to use their Tamam deposits for this purpose (as well as for several other purposes, such as financing foreign travel). They may also sell their deposits to other Israeli residents wishing to buy foreign securities. The deposits are sold not at the official rate of exchange, but at a rate determined by supply and demand conditions in the market. The agio—the difference between the official rate of exchange and the Natad (investment) dollar rate—stood at about 6 percent in the first three months of 1967, rose to 9–11 percent in April and May (monthly averages), and on June 1 reached more than 15 percent.

It is hard to find any clear connection between changes in the amount invested in foreign currency securities and those in the agio on Natad dollars in the period March to May. In March, when the agio virtually held steady, incremental holdings totalled $ 11.2 million. On the other hand, the agio shot up in April and May, when the additional investment came to only $ 4.2 million. The rumors of an imminent devaluation that were prevalent in March and the tense security situation in May may have resulted in a smaller offer of Tamam funds. Another possible explanation of the rise in the agio during the period of

Diagram XX–4

NATAD (INVESTMENT) AND FREE-MARKET DOLLAR RATES, MONTHLY AVERAGES,[a] 1967

(IL per dollar)



[a] Arithmetic mean of Thursday prices.
SOURCE: State Loans Administration.

prewar tension was the stronger demand for Natad dollars in order to repatriate investments held in blocked accounts following their liquidation.

In the second half of the year the agio dropped from its May high, but it remained above its level in the first quarter and most of 1966. Here too it is difficult to attribute the rise in the agio to demand factors, since during the months June to October there was no net increase in the value of securities traded in foreign currency. Even a comparison of 1967 as a whole with the previous year gives no grounds for ascribing the higher agio in 1967 to stronger demand for foreign securities.

For most months of the year there was a fairly high correlation between the Natad and the free-market dollar rate — a correlation which would seem to indicate that both markets are influenced by similar variables (the demand for securities traded in foreign currency is not the most decisive of them). In 1966 as well there was a close correlation between the two rates. It is interesting to note that in December the price of the Natad dollar was higher than that of the free dollar—an unprecedented phenomenon. There is no ready explanation of this development, which apparently did not stem from random factors, since it carried over into the early months of 1968. (The average agio on the Natad dollar ranged from 9.2 to 10.7 percent between December 1967 and March 1968—a little above the high level which had prevailed from April 1967 until the devaluation in November. In contrast, the agio on the free-market dollar during this period dropped to 5.0–8.7 percent, about half of what it was before the devaluation.)