

CHAPTER XVIII

THE SECURITIES MARKET

1. MAIN DEVELOPMENTS¹

In 1979 the public's assets portfolio shrank in real terms, as savings dipped (see Chapter XV). Security holdings declined even more sharply, with a shift toward Patam local residents' foreign currency accounts. By the end of 1979 the public's bond holdings were down 14 percent in real terms² compared with the previous year, while shares dropped 18 percent. This represents a continuation of the decline recorded in 1978, following the extraordinary growth of security holdings in 1977. In the bond market there was a gradual rise in demand in the first part of the year and a precipitous falling-off at year's end. The share market was just the reverse: increased demand at the end of 1979 offset the impact of a large overall decline in the preceding months.

The slackening of demand for shares and bonds should be viewed against the aforementioned decline in the public's financial portfolio (detailed in Table XV-1). This reflected the combined effect of several factors: (a) an impressive growth in the public's demand for durables; (b) an increase in the private sector's basic balance of payments deficit; and (c) a rise in the real interest rate on credit accompanied by the imposition of ceilings on credit expansion. The influence of the last two factors became more pronounced in the second half of the year. In the first few months the public's financial assets portfolio grew somewhat, but this expansion was checked in the second half of the year for the reasons enumerated.

As already stated, the increased demand for bonds, which began in mid-1978, continued through the first part of 1979. This can be ascribed to the relative advan-

¹ This chapter deals with securities issued by prospectus (including government and Jewish Agency securities which are exempt from this requirement) and listed for trading on the Stock Exchange, with the accent on transactions of the public (viz. households and nonfinancial firms). Due to statistical limitations, the data on issues to the public also include purchases or redemptions by the financial sector (except those for savings schemes of securities of the kind issued to the public). Compulsory loans (which are not tradable) are not included in the calculation of net issues, but redemptions of compulsory loans which became tradable (and were held voluntarily) have been subtracted.

² In this chapter purchasing power has been converted into constant price terms (or real growth rates) using the consumer price index (or its growth rate). Annual flows (e.g. issues) have been deflated by the annual average price index, unless otherwise specified.

Table XVIII-1
DEVELOPMENTS IN THE SECURITIES MARKET, 1976-79
 (IL billion)

	1976	1977	1978	Total	1979	
					Monthly average	
					Jan.- Aug.	Sept.- Dec.
A. Bonds						
1. Net issues, at 1979 prices ^a	-9.2	-16.8	-12.1	-2.0	0.8	-2.1
To the public	-7.0	-9.0	-7.7	-1.0	0.7	-1.7
For savings schemes	-2.2	-7.8	-4.4	-1.0	0.1	-0.4
2. Overall real rate of return on indexed bonds (%) ^b	6.8	-0.8	2.0	-5.7	-1.3	-4.4
3. Stock Exchange trade, at 1979 prices	13.9	14.2	12.7	19.6	1.0	2.8
4. Annual rate of Stock Exchange turnover (%)	15.6	18.8	17.0	27.7	18.6	38.7
B. Shares and convertible securities						
1. Issues at 1979 prices	2.7	10.7	9.9	2.0	0.2	0.1
2. Percent annual increase in issues at constant prices (annual rates)	-28	300	-8	-79	-73	-93
3. Overall real rate of return (%)	8.9	34.7	3.4	-23.7	-14.0	-11.2
4. Volume of trade, at 1979 prices						
Stock Exchange	5.8	33.9	29.6	24.2	1.8	2.4
Stock Exchange and over-the counter market	10.8	62.3	61.9	70.4	4.7	8.2
5. Annual rate of turnover (%)	30.6	111.8	87.6	103.8	97.5	131.2
C. Total securities market						
1. Total issues, at 1979 prices (A1 + B1)	-6.5	-6.1	-2.3	2.5	1.3	1.9
2. Weight of bonds in total Stock Exchange trade (%)	70	30	30	45	39	56
3. Weight of securities in the financial assets portfolio, ^c at end of period (%)	27	25	23	20	23	20

^a The net data for 1976 and 1977 (the total and its distribution) are an estimate, which is less reliable than the other data.

^b Before 1979 includes option bonds.

^c As defined in Table XV-1.

tage bonds offered in preserving the real value of liquid savings even during periods of rapid inflation. Under these circumstances, the weight of Patam accounts in the public's portfolio shrank, as did the demand for shares. At the end of 1979 the bond market suffered a crisis generated by fears that the government, as part of its anticipated war on inflation, would restrict bond transactions. This impelled the public to redeem a large (net) quantity of bonds in the closing third of the year. The Bank of Israel stepped in and through intensive efforts averted a radical drop in bond prices. The real decrease in prices, together with the large net redemption, represented a substantial real decline in bond demand.

The demand for shares, which are close substitutes for bonds, surged at the end of the year; however, this sharp rise in share activity was insufficient to overcome the cumulative decrease from the earlier part of the year. Fluctuating share rates did not become more stable in 1979 in spite of a marked real growth in trading by "interested parties". The bullish tone of the share market continued in early 1980, and demand for bonds gradually picked up; in April 1980 purchases rose steeply.

2. SECURITIES AND FINANCIAL ASSETS³

In 1979 the rapid real growth in financial assets, which had been evident for a number of years (see Table XV-1), came to a halt, as total assets shrank 4 percent. The decline was concentrated in liquid assets, whose volume fell 6 percent, but did not affect long-term assets, which expanded 6 percent. The weight of securities in the portfolio dropped in 1979 and stood at 20 percent. The serious crisis which struck the bond market at the end of the year blunted the rising demand for bonds, while increased share demand beginning in December was not sufficient to offset the prolonged cumulative downturn in share prices. The share market boom continued into 1980 and the bond market displayed signs of recovery.

The rapid growth of financial assets in the preceding years occurred against a background of sizable liquidity injections and the free flow of capital imports following the lifting of foreign currency controls. It may be that excess liquidity accumulated because actual liquid asset holdings were only partially adjusted to the required long-term needs. The exogenous injection in 1979 (see Table XVI-1, line 4) was sufficient to maintain the continued real growth of the financial portfolio; however, as the public diverted a considerable proportion of these means to finance the increasingly expensive import surplus and, to some extent, to invest in foreign banknotes, financial demand diminished. Consequently the financial asset base declined in real terms (see Table XVI-1, line 6). The ebbing of financial de-

³ The statistics available do not include the public's investment in foreign banknotes, which was high in 1979. Nevertheless it appears that the rapid growth in assets was in fact halted. It should be stressed that data on international securities movement is not available (i.e., the acquisition of foreign securities by Israelis and the purchase of Israeli securities by foreigners).

Table XVIII-2
MARKET VALUE OF SECURITIES LISTED FOR TRADING ON TEL AVIV STOCK EXCHANGE, 1976-79^a
 (IL billion)

	Market value			Weight in total securities held by the public (%)			Percent increase in market value		
	1976	1978	1979	1976	1978	1979	1977	1978	1979
A. Bonds									
1. Linked and traded in foreign currency	3.4	7.0	11.9	8.8	7.5	7.2	5.2	-7.3	-19.6
2. Index-linked issued to the public ^b	15.2	43.5	107.0	34.3	46.9	65.0	9.8	23.4	16.4
3. Option-type loans (linked-unlinked)	14.3	6.1	2.0	36.9	6.6	1.2	-22.0	-74.1	-84.5
4. Double option (indexed or dollar-linked)	—	2.8	7.0	—	3.0	4.3			18.3
5. Estimate of bonds not yet listed for trade ^c	1.4	3.5	0.2						
6. Total bonds	34.3	62.9	128.1	88.7	67.8	77.8	-7.1	-6.5	-3.7
Thereof:									
7. In portfolio of banks	5.3	10.3	29.0	13.7	11.1	17.6	-6.0	-2.1	33.2
8. In Bank of Israel portfolio	1.5	4.1	11.3	3.9	4.4	6.9	21.6	6.5	30.4
9. Estimated holdings of the public ^d (6—7—8)	27.5	48.5	87.8	71.1	52.3	53.3	-8.9	-8.3	-14.4
B. Shares^e									
10. Traded in Israeli currency	9.8	40.9	73.5	25.3	44.1	44.7	68.9	17.0	-15.0
11. Traded in foreign currency	1.0	1.8	2.0	2.6	1.9	1.2	40.3	-39.2	-47.4
12. Total shares and options (10+11)	10.8	42.7	75.5	27.9	46.0	45.9	66.3	12.6	-16.4
13. Convertible securities	0.9	4.0	5.5	2.3	4.3	3.3	40.3	50.0	-35.0
14. Total shares and convertible securities (12+13)	11.7	46.7	81.0	30.2	50.3	49.2	64.3	15.1	-17.9
Thereof:									
15. In portfolio of banks	0.5	2.4	4.2	1.3	2.6	2.5	96.4	15.7	-17.2
16. Estimated holdings of the public (14—15)	11.2	44.3	76.8	28.9	47.7	46.7	58.6	15.0	-18.0
C. Total bonds and shares held by the public (9+16)	38.7	92.8	164.6	100.0	100.0	100.0	11.8	1.5	-16.1

^a Excludes securities not intended to be listed for trade, such as certain institutional bonds.

^b Excludes bonds issued to institutional investors.

^c The face value plus accrued linkage differentials and interest.

^d Since the portfolios of institutional investors contain bonds that were issued to the public, this estimate is biased upward; includes investments through mutual funds.

^e Includes shares held by institutional investors.

Source: Tel Aviv Stock Exchange and Bank of Israel.

mand was related to the increase in interest rates and to the unprecedented inflation rate, which augmented the uncertainty of expected economic variables, such as the price level, relative prices, wages, and profits. Mounting anxieties over a possible impairment of the bond market toward the end of the year also affected financial demand, which was already hit by the declining relative price of imported durable assets (which constitute a substitute for financial savings). During this period private disposable income did not decline, which would have restricted demand. In fact, the public opted for real estate and durables over financial assets in 1979.

Concerning the influence of developments in the credit sphere on financial assets demand in 1979, it is clear that the shrinking of credit, brought about by the Bank of Israel's policy of restraint, reduced financial asset demand. However, the decline in financial demand exceeded the extent of the credit squeeze, as was reflected in the downturn in private savings.⁴

The real contraction of the financial portfolio for the entire year conceals the moderate growth at the beginning of the year, which was swallowed by the overwhelming decline at the end. The squeeze focused on liquid assets, while medium-term financial assets declined slightly and long-term assets continued to increase, as in the past (see Table XV-1). It also reflects the reduction of the excess liquidity which had accumulated over the two preceding years.

In 1979 the decreasing weight of unlinked assets in the total financial portfolio fell off even more as a result of accelerating inflation, which increased the cost of holding them. Correspondingly, the demand for substitutes for unlinked assets became more pronounced.⁵

Foreign currency assets continued to gain strength in 1979. This was due to the shift from Patam accounts to foreign currency, for the weight of international trade in total uses did not rise. The foreign currency liberalization made it possible to conduct transactions by direct transfers from the Patam account to another, thus minimizing the risk of holding money: capital risk for transactions whose costs are denominated in foreign currency is negligible, and the fluctuations in Patam's real purchasing power were relatively low also in 1979 (see Table XVIII-4 for consumer price index terms). It could be that expectations of a real devaluation intensified, and that fears of restrictions being imposed on the foreign currency market grew along with the increase in the current account deficit, and these stimulated Patam demand. As the result of a change in the Bank of Israel's directives in 1979, some of the restitution deposits were redefined as Patam deposits.

⁴ This also reflects the above-mentioned increase in the acquisition of durables.

⁵ The unutilized balance of overdraft accounts (general lines of credit) might also have increased, or the use of credit cards become more widespread, which caused an unreported growth in money substitutes held by the public, in addition to the stated rise in the possession of foreign banknotes.

Table XVIII-3

DOMESTIC SECURITY ISSUES AND NET CAPITAL MOBILIZED, 1976-79^a
(IL million)

	Bonds sold to the public ^b					Total net capital mobilized from the public	Tradable bonds issued for savings schemes			
	Sales	Redemption ^c	Net Bank of Israel purchases on and outside the Exchange	Net capital mobilized	Shares and convertible securities ^d		Sales ^e	Redemption ^f	Net Bank of Israel purchases	Net capital mobilized ^f
1976	1,875	3,173	647	-1,945	754	-1,191	—	600	—	-600
1977	1,223	4,330	239	-3,346	3,973	627	—	2,900	—	-2,900
1978	10,668	15,228	-258	-4,302	5,545	1,243	1,892	4,386	—	-2,494
1979	15,719	14,558	2,181	-1,020	2,041	1,021	2,837	2,865	963	-991
January	955	3,338	-133	-2,250	101	-2,149	323	296	—	27
February	2,661	388	-178	2,451	140	2,591	205	48	—	157
March	2,024	403	-21	1,642	30	1,672	78	125	—	-47
April	3,085	1,447	-31	1,669	86	1,755	281	177	—	104
May	590	784	-7	-187	103	-84	453	235	—	218
June	270	991	9	-730	—	-730	45	297	—	-252
July	3,432	582	103	2,747	1,289	4,036	797	141	—	656
August	1,446	801	13	632	61	693	174	161	388	-375
September	901	1,300	-29	-370	199	-171	464	197	-159	426
October	157	856	639	-1,338	32	-1,306	16	250	52	-286
November	59	1,702	1,541	-3,184	—	-3,184	1	553	-170	-382
December	139	1,966	275	-2,102	—	-2,102	—	385	852	-1,237

^a Revised data; does not include compulsory loan issues and redemption of nontradable compulsory loans. There may have been purchases in the secondary market to cover savings schemes, in which case the data on issues for them would be biased upward and those on issues to the public biased downward.

^b Includes sales to and redemption of bonds purchased by the financial sector, other than for savings schemes (until 1978), of the type issued to the public.

Source: Bank of Israel calculations.

^c Repayment of principal and payment of interest and linkage increments.

^d The parent company of one of the commercial banks committed itself to buy IL522 million of the bank issue in 1977 (IL154 million in 1976), while it issued shares for a bigger sum; in order to avoid double-counting of this issue, the sum has been netted out.

^e "Double-option" bonds, purchased to cover 40 percent of the accumulation of the "dollar-option" schemes.

^f The data for 1976 are estimates, and hence less reliable.

The weight of index-linked assets picked up in 1979: the weight of bonds held by the public dropped and savings schemes and social insurance funds expanded. The increased weight of social insurance funds (see Chapter XVII) was related to agreements which extended the pension coverage for salaried employees and broadened the pension base. The net accumulation in provident funds declined in real terms, in spite of the protection which they afford against any impairment of savings, and the increase in the net return caused by the real erosion of tax brackets. They may have become more liquid with the maturation of long-standing closed accounts. The weight of savings schemes in the financial portfolio rose at the same time that the real net accumulation dropped sharply. The larger grants offered by the banks this year did not overcome the diminution of this asset's attractiveness, and as old schemes reached maturity some savers took advantage of this to withdraw their deposits.

Demand for shares weakened in the face of investors' preference for bonds—a development which characterized most of 1979. The continuation of the bearish tone which began in mid-1978, kept short-term investors away from the share market. The movement of the two markets in opposite directions was further aggravated by their substitutability: at the beginning of 1979 bond demand strengthened while the share market languished; in the final part of the year the bond market slumped and shares staged a comeback, a situation which carried over into early 1980.

3. THE SHARE MARKET

The share market was depressed in 1979; but it did not drop below past low points: the real return on shares was -24 percent,⁶ there were 80 percent fewer new issues, and monthly turnovers from January to November fell 10 percent short of the 1978 level. In December share demand perked up, a trend which continued in 1980.

The real decline in share prices started midway through 1978 when a wave of new issues greatly increased the supply. Accelerating inflation also contributed to the slump by shifting demand to bonds and Patam accounts which, by providing a hedge against inflation, constituted substitutes for shares. The persistent decline in share prices precluded any attempt at new flotations, and consequently emissions fell off in 1979.

Developments during the year underscore the instability of the share market, which was predominated by short-term fluctuations and capital movements. Share

⁶ This is a drop of 36 percent from June 1978. The return on securities in this chapter refers to the overall rate of return, which until November 1979 was calculated on the 23rd of each month by the Central Bureau of Statistics and in December, on the 31st of the month.

Table XVIII-4

**YIELD AND STANDARD DEVIATION OF REAL^a RATE OF RETURN ON BONDS,
SHARES, AND FOREIGN CURRENCY, AND OF PURCHASING POWER OF
MONEY, 1972-79**
(Percent)

	Index- linked bonds	All ordinary shares	Finance and insurance shares	Indus- trial shares	Foreign currency ^c	Purchas- ing power of money
Arithmetic average for 1972-76						
Annual yield ^b	8.32	3.65	3.02	-3.90	-9.03	-19.46
Annual standard deviation ^c	2.51	5.28	4.41	5.37	3.02	1.61
Monthly standard deviation ^d	2.56	4.74	4.03	6.79	2.77	1.73
1977 Annual yield	-0.08	34.85	48.34	-6.70	8.63	-29.8
Annual standard deviation	4.89	18.37	16.88	16.20	6.64	2.69
Monthly standard deviation	4.43	12.63	11.96	12.67	6.01	2.69
1978 Annual yield	8.03	3.44	-1.35	-10.55	-4.24	-32.5
Annual standard deviation	2.11	7.18	5.47	10.75	3.70	1.20
Monthly standard deviation	1.85	7.10	5.24	10.20	3.56	3.34
1979 Annual yield	-5.68	-23.70	-13.10	-57.38	-0.20	-52.7
Annual standard deviation	2.77	3.86	4.30	6.25	3.81	1.01
Monthly standard deviation	3.55	4.75	4.45	9.20	3.69	2.04

^a Deflated by the consumer price index.

^b Overall rate of return for the year. Before 1977 the change in the prices and not the yield.

^c This measures the risk involved in holding an asset for more than one month. It is calculated as the square root of the sum of the square differences between the monthly index of prices and the trend index during the year (end of previous year = 100), divided by the number of degrees of freedom.

The trend index during the year is calculated by regressing the prices against the variables "time".

^d This measures the risk involved in holding an asset for one month. It is calculated as the square root of the square differences between the monthly rate of change in the index of prices and the average rate of change therein, divided by the number of degrees of freedom.

^e Until 1977 the Natad dollar; since 1978 a basket of currencies.

Source: Bank of Israel calculations.

investment picked up when prices rose, and immediately fell off at the first sign of a drop. As a result, as the turnover of share transactions increased (Table XVIII-1), the volatility of their return rose (Table XVIII-4) in spite of attempts to regulate prices. It appears that over time the commitment of the regulating bodies deepened, and as a result of the activity of "interested parties", in 1979 it doubled in real terms. It is reasonable to assume that part of the activity in shares, notably bank shares, in effect constituted a substitute for the holding of money.

The real decline in prices is also attributable to the announcement of disappointing business results in the first half of the year. In May and June the share market rallied briefly, as reflected by an increase in prices and volume, especially in the over-the-counter market. One of the large banks announced its intention of

Table XVIII-5

STOCK EXCHANGE AND OVER-THE-COUNTER MARKET TURNOVER, 1976-79

	Bonds							Shares			Total shares traded on Stock Exchange and over-the-counter ^b	
	Total ^a	Thereof: government bonds	Linked to c-o-l index	Option-type loans	Linked to exchange rate or traded in foreign currency	Double option	Convertible securities	Total shares	Commercial banks	Total securities	Total	Commercial banks
	IL million											
1976	3,844	3,369	1,558	2,017	269	0	178	1,432	601	5,454	2,826	1,546
1977	5,297	4,771	2,647	2,299	351	0	1,291	11,345	5,421	17,933	21,861	12,001
1978	7,142	6,422	4,189	2,168	473	312	2,233	14,336	7,741	23,711	32,468	22,581
1979	19,602	18,928	17,733	455	543	871	2,220	21,966	13,903	43,788	68,168	53,164
	Percent annual increase											
1976	9.3	16.6	16.4	7.7	-12.1	—	72.7	83.6	105.1	24.0	107.5	133.9
1977	37.8	41.6	69.9	14.0	30.5	—	625.3	692.2	302.0	229.0	673.6	676.3
1978	34.8	34.6	58.3	-5.7	34.8	—	73.0	26.5	42.8	32.2	48.5	88.2
1979	174.5	194.7	323.3	-79.0	14.8	179.2	-0.6	53.0	79.6	84.7	110.0	135.4
	Stock Exchange trade as a percent of total trade											
	Weight in total Stock Exchange turnover (%)											
1976	70.5	87.6	28.6	37.0	4.9	—	3.3	26.3	11.0	100.0	50.7	38.9
1977	29.5	90.0	14.8	12.8	2.0	0	7.2	63.2	30.2	100.0	51.9	45.2
1978	30.1	89.9	17.7	9.1	2.0	1.3	9.4	60.4	32.6	100.0	44.2	34.3
1979	44.7	96.6	40.5	1.0	1.2	2.0	5.3	50.2	31.8	100.0	32.2	28.2

^a Excludes trade in unlinked bonds and the Short-Term Loan.

^b Over-the-counter trade—according to the reports of Stock Exchange members.

Source: Tel Aviv Stock Exchange.

mobilizing funds through the Stock Exchange and other companies followed suit; however, the real decline in prices resumed in July and lasted until November. Share prices for this period were 26 percent lower in real terms than the 1970-78 level. In December there was the usual end-year seasonal gain as companies moved to window-dress their balance sheets. This rally reflected the effect of self-fulfilling expectations of a seasonal upswing: once again trading volume gained, both on the Stock Exchange and even more in over-the-counter trade. "Interested parties" began to sell shares from their portfolio, which in effect may be regarded as a public issue that is not caught in the statistical data.⁷ The share market rally continued in early 1980.

While booming demand in 1977 and 1978 encouraged frequent issues, interest in new emissions flagged in 1979, and the amount raised was only 20 percent (in real terms) of its 1978 level. Since the banks have an advantageous marketing position, they were relatively less vulnerable to the slump, and their weight in new issues rose (see Table XVIII-7). A single issue by one large bank accounted for the bulk of the shares floated in 1979 (63 percent). The slow market depressed the number of issuing companies to about one-third of the 1978 figure, and only two companies listed their shares on the Stock Exchange for the first time, compared with fifteen in the previous year. Another manifestation of the slump was the doubling of the proportion of rights issues to share holders (as distinguished from shares offered to the general public or employees). Similarly, the weight of convertible bonds dropped drastically because their high-risk nature adversely affected their marketability during a period lacking in positive expectations. As a result, shares accounted for 82 percent of the capital raised, compared to 53 percent in 1978.

The profitability of investing in shares, as with other financial assets, was enhanced by their anticipated return and diminished by their inherent risk. The return on shares declined sharply in 1979, but its volatility—as measured by the standard deviation—also weakened (see Table XVIII-4). However, the volatility of the return on an investment longer than one month was higher for shares due to the accumulated effect of continuous monthly price fluctuations in one direction. Interestingly enough, the analysis of risk for an investment horizon of between one month and a year shows that the financial sector's shares in general, and those of the banks in particular, were the riskiest of all. The fact that the prices of these shares are regulated does not nullify the advantages of diversifying among various sectors. Prices are regulated in order to increase the shares' liquidity (not necessarily an expensive matter), and thereby stimulate demand for shares and the raising of capital through new issues.

⁷ More than IL1.5 billion for December, as opposed to the IL2 billion of issues reported for all of 1979.

Table XVIII-6

MONTHLY OVERALL RATE OF RETURN ON LISTED SECURITIES,^a MUTUAL FUNDS, BASKET OF CURRENCIES, AND THE DOLLAR, 1975-79
(December 1978 = 100)

	Indexed IL bonds		IL shares		Foreign currency deposits			Mutual funds
	Total	80% indexed	Bonds traded in foreign currency	Total ordinary and preferred ^b	Commercial banks	Basket of five currencies		
						Dollar ^c		
1975	28.6		48.3	23.9	22.7		43.7	
1976	43.9		32.6	34.0	31.7		49.0	45.1
1977	62.5	67.0	83.2	65.3	65.6	70.5	75.5	70.9
1978	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1979								
January	106.9	103.9	99.9	109.1	109.2	99.9	101.3	102.3
February	113.9	109.3	105.0	105.3	109.7	101.7	102.8	106.5
March	118.1	117.6	109.7	104.0	105.4	114.0	115.1	111.0
April	121.6	121.3	118.8	105.1	109.0	120.1	122.8	116.1
May	126.4	127.6	127.0	111.3	114.3	128.9	132.7	121.8
June	132.1	133.8	132.0	122.4	125.8	138.7	139.0	127.6
July	143.6	145.5	137.8	124.9	132.7	146.8	143.6	136.9
August	151.0	157.7	145.5	131.6	139.8	152.1	150.8	145.0
September	154.9	160.3	144.3	131.6	146.0	167.6	163.1	148.9
October	159.5	163.7	156.1	137.2	160.2	173.3	173.9	153.1
November	180.9	184.0	171.1	139.9	176.3	193.8	188.7	168.5
December	199.4	206.6	189.5	161.3	205.1	211.8	205.1	187.5
	Real overall rate of return (percent)							
Jan.-Aug.	-1.3	3.0	-4.9	-14.0	-8.7	-0.6	-1.5	-5.3
Sept.-Dec.	-4.4	-5.1	-5.7	-11.2	6.3	0.8	-1.5	-6.4
Jan.-Dec.	-5.7	-2.3	-10.3	-23.7	-3.0	0.2	-3.0	-11.3

^a Since 1977, data are for the 23rd of each month. Previously indexes were calculated for the end of the month, and excluded interest payments and cash dividends. In December 1979 data were calculated for the end of the month.

^b The weight of preferred shares in the total is very low.

^c Before 1977 the Natad dollar.

Source: Central Bureau of Statistics; foreign currency and mutual funds—Bank of Israel.

Table XVIII-7

**MARKET VALUE OF EXISTING SHARES BY ISSUING GROUP AND NEW ISSUES OF
SHARES AND CONVERTIBLE SECURITIES,^a 1979**
(IL million)

	Market value of listed shares and convertible securities			Sales of newly issued shares and convertible securities, 1979					Weight of new issues in total market value of group's shares at end of 1978 (%)
	Weight of group in total market value, end of 1979		Percent real increase in market value of shares, 1979	Group's weight in total issues (%)					
	IL million	%		1976	1977	1978	1979		
			%				IL million		
Commercial banks and bank holding companies	58,672	72.4	-2.5	80.2	70.0	59.4	63.1	1,289	4.5
Mortgage banks	3,160	3.9	-43.6	6.9	5.0	7.5	0.0	1	0.0
Specialized financial institutions	2,255	2.8	-33.3	0.0	1.7	0.5	2.0	40	2.5
Insurance	1,295	1.6	-54.1	2.5	5.0	5.1	5.6	114	8.6
Total financial sector	65,382	80.7	-9.2	89.6	81.7	72.5	70.7	1,444	4.2
Commerce and services	712	0.9	-40.9	3.5	0.8	0.3	2.3	46	8.1
Land, building, development and citrus ^b	2,362	2.9	-57.8	0.3	1.9	6.9	5.3	108	4.1
Industry	4,565	5.6	-45.3	6.6	12.4	11.4	15.4	314	8.0
Investment and holding companies	7,989	9.9	-30.7	0.0	3.2	8.9	6.3	129	2.4
Total	81,010	100.0	-17.9	100.0	100.0	100.0	100.0	2,041	4.4

^a Excludes bonus shares, conversion of convertible bonds, issues not against cash, and existing shares listed for trade on the Stock Exchange.

^b Includes an oil exploration company founded in 1978, which issued IL100 million worth of shares.

Source: Tel Aviv Stock Exchange and Bank of Israel.

Table XVIII-8

**OVERALL RATE OF RETURN INDEX FOR ORDINARY AND PREFERRED SHARES
LISTED ON STOCK EXCHANGE, 1974-79**
(Base: December 1978 = 100)

	General Stock Exchange index	Finance and insurance							Land, building, development ^a
		Total	Commercial banks	Mortgage banks	Specialized financial institutions	Investment companies	Industry	Commerce and services	
End of year									
1974	17.4	16.4	18.0	18.8	25.2	14.4	25.7	22.6	12.4
1975	24.5	22.5	22.7	22.9	31.0	20.3	39.2	41.4	18.9
1976	34.0	32.3	31.7	39.3	44.2	29.2	56.8	54.9	31.7
1977	65.3	68.4	65.6	94.0	80.6	47.2	75.5	87.4	53.2
1978	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1979 end of quarter									
March	104.0	103.4	105.4	92.0	96.3	114.2	106.1	105.4	103.8
June	122.4	121.4	125.8	108.8	103.7	145.2	111.4	124.8	125.8
September	131.6	136.6	146.0	98.2	107.9	144.4	110.1	129.7	112.9
December	161.3	183.7	205.1	106.2	115.1	137.2	90.1	119.5	80.2
Real index for December	76.3	86.9	97.0	50.3	54.4	64.9	42.6	56.5	37.9
Real rate of change in annual average index ^b	-19.3	-17.3	-9.7	-49.4	-40.6	-3.5	-37.2	-34.8	-26.8

^a Until 1976 includes citrus.

^b The conversion into real terms was done monthly, using the consumer price index.

Source: Central Bureau of Statistics.

Table XVIII-9

**NET OVERALL RATES OF RETURN ON ORDINARY SHARES LISTED ON TEL AVIV
STOCK EXCHANGE, 1978-79
(Percent)**

	Overall rate of return			Lowest overall rate of return	Highest overall rate of return	Deciles of the distribution of the rates of return					Dispersion index ^c	Number of shares	Number of companies
	Arithmetic average	Weighted by listed capital ^a	Weighted by annual Stock Exchange turnover										
						10	25	50	75	90			
1. Banks, insurance companies, and financial institutions													
1978	18.0	38.9	37.0	-26.3	58.3	-17.9	-7.7	17.7	38.1	54.8	0.62	49	23
1979													
First half	20.6	26.4	36.1	-35.0	82.1	22.3	-2.2	26.1	40.2	55.3	0.26		
Second half	29.4	53.2	54.1	-58.2	79.1	-38.2	5.1	41.0	58.3	71.7	0.78		
Total	62.6	95.2	104.1	-69.0	181.9	-40.2	-9.8	75.0	110.8	152.0	1.10	66	24
2. Land and development companies													
1978	80.7	77.2	63.9	20.4	243.0	24.9	29.2	53.5	98.0	208.1	1.12	15	11
1979													
First half	31.6	32.7	42.2	-4.6	157.1	-3.8	5.3	17.7	52.2	74.3	0.66		
Second half	-18.0	-25.8	18.5	-72.5	38.2	-69.7	-56.6	-24.6	19.5	31.0	1.34		
Total	-0.2	-5.7	4.3	-73.5	79.7	-62.3	-29.5	16.5	28.7	32.7	0.82	19	12
3. Industrial and commercial companies													
1978	35.1	18.5	24.9	-32.2	208.3	-14.6	-6.3	23.3	54.3	86.8	0.82	43	25
1979													
First half	30.4	39.3	45.0	-27.5	141.5	-14.1	3.6	20.2	40.9	106.7	1.01		
Second half	-20.4	-18.1	-19.6	-68.8	63.4	-50.6	-43.5	-24.0	-7.8	22.3	2.28		
Total	1.9	13.0	15.1	-60.0	101.2	-45.3	-33.3	-3.5	25.9	63.2	1.12	56	32

4. Investment companies													
1978	50.8	48.8	52.1	-15.1	294.9	-12.2	9.2	43.0	65.4	154.9	1.17	31	19
1979													
First half	46.3	59.4	62.7	-42.2	194.8	-32.2	12.6	30.4	62.9	124.1	1.20		
Second half	-12.0	-20.7	-24.9	-68.0	108.7	-65.8	-53.6	-17.5	16.5	29.5	1.16		
Total	24.3	16.3	12.3	-76.8	159.7	-72.4	-23.8	17.6	77.8	113.6	1.58	38	22
5. Total ordinary shares													
1978	37.1	38.7	38.8	-32.2	294.9	-13.6	3.0	26.8	53.5	96.1	0.87	138	78
1979													
First half	30.3	32.3	37.2	-42.2	194.8	-22.2	3.1	23.6	46.2	77.1	1.61		
Second half	0.0	31.1	33.5	-72.5	108.7	-54.6	-37.8	-9.3	34.5	58.9	1.25		
Total	28.8	69.9	79.1	-76.8	181.8	-45.3	-25.4	17.6	78.0	120.8	1.41	179	90

- ^a Weighted by the listed capital at market prices, at the end of the previous calendar year.
- ^b Weighted by Stock Exchange turnover during the calendar year.
- ^c The index of dispersion is calculated as follows: the overall rate of return for the lowest decile is subtracted from the overall rate of return for the highest decile; the remainder is divided by 1 plus the return for the median group. For example, the index of dispersion in 1979 for the banking, in-

urance, and financial institution group is calculated as follows:

$$\frac{\frac{152.0}{100} - \frac{-40.2}{100}}{1 + \frac{75.0}{100}} = 1.10$$

Source: Bank of Israel calculations.

Bank shares performed differently than other types; their real return was -3 percent,⁸ as against -47 percent for the other shares. Trade in bank shares grew 32 percent in real terms, while that in other shares declined 15 percent (see Table XVIII-5). In 1979 the trend toward increased over-the-counter trade in bank shares intensified, and it accounted for two-thirds of the transactions. This trend was less pronounced for other shares, and more than half of the transactions took place on the Stock Exchange.

4. THE BOND MARKET

By the end of 1979 the real volume of bonds held by the public was 14 percent lower than a year earlier; this exceeded the decline in each of the two preceding years (see Table XVIII-2). Severely reduced demand at the end of 1979 overshadowed the increase earlier in the year. Net capital mobilization through bond sales to the public reached IL1 billion (at December 1978 prices).⁹

The renewed interest in bonds which began in mid-1978 lasted until the end of 1979, and was connected with the clear advantage bonds possess in preserving liquid purchasing power during periods of rapid inflation. In the first eight months of the year, the public's net bond purchases equalled IL700 million per month, after the sizable (net) redemptions common in prior years nearly disappeared in the second half of 1978.

Demand for bonds began to ease in September with the start of an intensive drive by the banks to market savings schemes. It appears that the unprecedented inflation level at year's end increased uncertainty to new heights. Expectations of measures aimed at halting inflation raised fears that bonds would be affected and, when this impression was reinforced by the assumption of office by a new Minister of Finance, the market was hit by a serious crisis. Since February 1980, however, this segment has shown signs of recovery. The real advantage of bonds declined appreciably in the closing third of the year. Massive intervention by the Bank of Israel, and to a lesser degree, purchases by the banks to cover their savings schemes, slowed the decline in the return on indexed bonds, which stood at 4 percent in the final third of the year despite the steep fall-off in public's demand. In March 1980 the yields to maturity began to drop, and in April the public bought a sizable quantity of bonds.

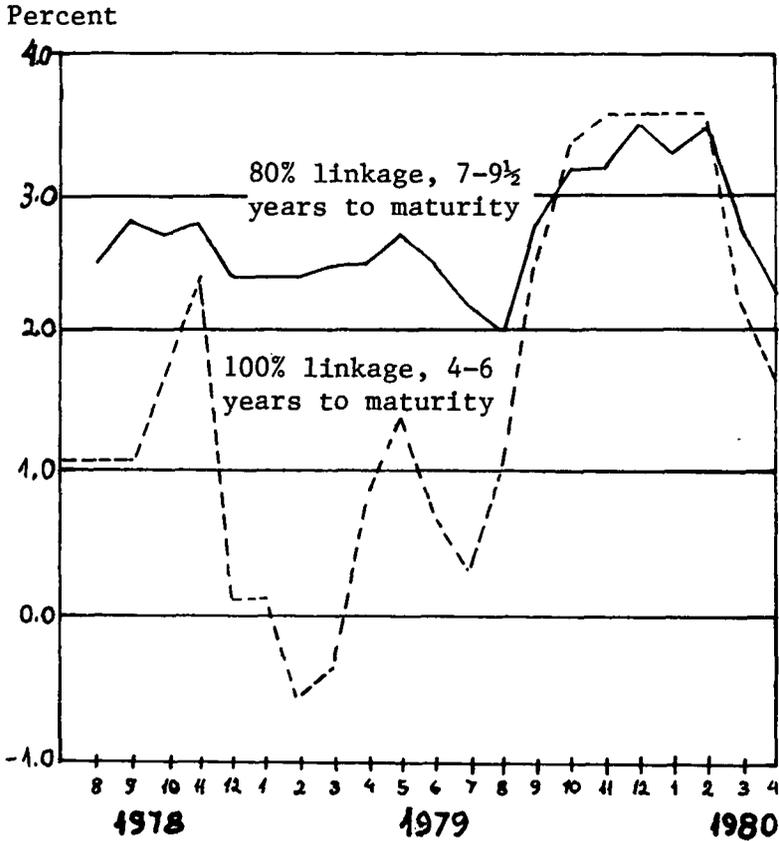
The confidence in bonds, which began to gather strength in mid-1978, continued into 1979 as the price of bonds with distant maturity dates outpaced those close to maturity. Growing concern over bond restrictions reversed this trend at the end of

⁸ The real return, weighted by the market value, for Bank Leumi, I.D.B. (the Discount group), and Bank Hapoalim shares was -2.5 percent.

⁹ The monthly issue deflated by the monthly consumer price index.

Figure XVIII-1

REAL YIELDS TO MATURITY OF BONDS, 1978-80^a



^a The average of Thursday prices for each month, assuming that the public correctly forecasts the changes in the consumer price index.

the year. The investment policy of mutual funds spurred the demand for bonds close to maturity at the same time that their supply dwindled because of redemptions.

Despite the increased demand for bonds due to the enhancement of their advantage in providing liquidity during inflationary periods, until August bond turnover did not gain either on the Stock Exchange or in original issues, an indicator which, within certain limitations, may suggest how intense was the use of bonds as a source of liquidity.¹⁰ At the end of the year, when the liquidity of bonds decreased,

¹⁰ Because bonds were used for capital account transactions in excess of current liquidity needs; information on the volume of trading outside the Stock Exchange is not available.

Table XVIII-10

BANK OF ISRAEL OPERATIONS ON THE STOCK EXCHANGE, 1976-79^a
(IL million)

	1979								
	1976	1977	1978	Total	Monthly average				
					Jan- Feb.	March- Sept.	Oct.	Nov.	Dec.
Net purchases	412	415	97	689	208	-7	610	1,475	-17
Volume of trade ^b	611	720	1,782	6,104	503	32	637	2,407	1,804
Weight in total trade (%)	9.7	7.3	13.4	22.3	22.4	1.9	14.4	30.9	21.7

^a Does not include short-term loans or over-the-counter transactions. Since the data on net purchases appearing in Table XVIII-3 include redemptions and purchases of newly issued bonds for the Bank of Israel, they differ from the data presented here.

^b Until 1977 trade in index-linked and option-type; in 1978 also double-option bonds (dollar- or index-linked).

trade in such securities increased—in part because of the marked variability in the public's expectations concerning the future of the market, and even more because of the heavy sale of bonds, which were absorbed by the Bank of Israel. The paucity of over-the-counter buyers shifted transactions to the Stock Exchange itself.

In 1979 institutional participation in bond trade accelerated. Halfway through 1978 the banks began to purchase tradable bonds of the type issued to the public, to cover their savings schemes, a trend that became more pronounced in 1979.

The Bank of Israel usually operates in the Stock to minimize the risk of price fluctuations of bonds issued to the public, and thus to encourage bond demand. The necessity for the Bank's actions was a response to the minimal involvement of institutional investors whose purchases of bonds issued to the public were limited by the regulatory authorities. The Bank of Israel was not very active between March and September, but renewed its activity in October as the slump in the market deepened. This massive involvement was not designed to counteract the effects of the tight monetary policy, which was reflected in higher interest rates, but to prevent an unjustified deterioration brought on by panic. In November the Bank of Israel purchased (net) IL1.5 billion of bonds, which constituted 31 percent of total turnover, a new record (see Table XVIII-10). This drove up their prices in real terms that month.

The market crisis substantially increased the capital risk due to real fluctuations in bond prices (see Table XVIII-4). In 1979 the risk associated with the linked bonds and optional bonds was reversed. In 1978 there was less risk associated with a one-month investment in linked bonds, whereas a long-term investment was in-

Table XVIII-11

AVERAGE REAL NET YIELDS TO MATURITY OF BONDS, MONTHLY, 1979
(Percent)

Years to maturity	Index-linked			Double-option linkage		Trade in foreign currency 5
	½-1	4-6	8-10	Index-linked	Dollar	
				9-10		
1978						
May	4.9	2.4	3.0	1.8	2.9	3.7
June	1.5	1.6	2.3	1.2	2.4	3.7
July	1.5	1.7	2.6	1.8	2.9	3.8
August	-0.4	1.1	2.5	1.8	2.9	3.8
September	0.3	1.1	2.8	2.1	3.1	3.8
October	0.4	1.7	2.7	2.2	3.0	4.2
November	0.6	2.4	2.8	2.4	2.8	6.2
December	-1.3	0.1	2.4	2.1	2.2	5.7
1979						
January	-1.2	0.2	2.4	2.2	2.3	6.2
February	-14.1	-0.6	2.4	2.0	2.1	6.3
March	2.9	-0.4	2.5	2.5	2.5	6.2
April	-3.1	0.3	2.5	2.5	3.0	6.6
May	3.9	1.4	2.7	2.6	3.5	7.1
June	0.9	0.9	2.5	1.7	3.5	7.5
July	2.6	0.3	2.2	1.1	2.1	7.9
August	2.7	1.0	2.0	1.9	2.3	7.1
September	6.6	2.5	2.8	2.6	3.0	7.7
October	7.6	3.4	3.2	3.4	4.0	7.1
November	1.7	3.6	3.2	3.2	3.4	10.5
December	0.5	3.6	3.5	3.2	3.1	9.2

Notes:

1. The yields shown in this table are averages of end-of-week data for government bonds.
2. The nominal yields were deflated by the consumer price index.
3. Bonds traded in foreign currency are represented by Hollis bonds.
4. The yield on bonds traded in foreign currency, or for the dollar option in the case of double option bonds, is in dollar terms. If, for example, a 10 percent devaluation is expected, the real expected yield on bonds traded in foreign currency is 7 percent, instead of 5 percent in dollar terms. If a real upward revaluation of 10 percent is expected, the real return will be 3 percent.
5. The yield to maturity of original-issue bonds linked 80 percent to the consumer price index was 2.26 percent, assuming a 30 percent annual inflation rate.

ferior to the purchase of optional bonds (interest-linked), because of the cumulative monthly fluctuations in one direction; in 1979, however, long-term (in excess of one month) investment in linked bonds was preferable, and of these, those linked 80 percent to the consumer price index involved less risk than those with 90 percent linkage.

Table XVIII-12
MUTUAL FUND ASSETS AND THEIR COMPOSITION, NET ISSUES, AND RATES OF
RETURN, 1979
 (IL million)

Classification of fund by specialization ^a	Composition of assets portfolio, ^b 31.6.1979 (%)			Assets at market value (end of year)		Net issues ^c			Real rate of return weighted by market value of funds (%)			Standard deviation of real monthly rate of return ^d (%)
	Index-linked and option-type	Foreign currency	Shares in Israeli currency			Jan.- Aug.	Sept.- Dec.	Jan.- Dec.	Jan.- Aug.	Sept.- Dec.	Jan.- Dec.	
				1978	1979							
Indexed securities	92.9	2.5	3.9	6,152	19,254	5,392	-580	4,812	-2.3	-4.9	-7.1	2.6
Foreign currency	3.7	92.2	3.9	962	1,885	-117	-123	-240	-9.0	-6.6	-15.0	3.3
Shares and dual shares—foreign currency	14.1	2.8	81.8	354	233	-25	-131	-156	-12.4	-22.6	-32.2	6.5
Dual foreign currency—indexed	63.3	33.4	3.0	4,627	7,117	-12	-905	-917	-5.6	-3.4	-8.8	2.5
Dual shares—indexed	39.7	1.3	57.8	1,544	1,536	-433	-421	-854	-8.8	-13.9	-21.3	4.1
Mixed with guaranteed index	63.4	21.2	14.2	7,112	10,903	69	-1,780	-1,711	-5.3	-7.4	-12.3	2.6
Mixed with guaranteed foreign currency	17.4	72.1	9.3	644	505	-27	-93	-120	-6.6	-7.3	-13.4	2.6
Mixed with guaranteed shares	28.7	2.1	67.9	257	138	-119	-62	-181	-10.6	-17.9	-26.6	4.6
Pure mix	34.1	30.2	35.2	1,818	1,508	-637	-483	-1,120	-10.0	-11.5	-20.4	2.8
Total funds	67.4	19.4	12.4	23,470	43,072	4,091	-4,578	-487	-5.3	-6.4	-11.3	2.7

^a A specialized fund is one which invests at least 75 percent of its assets in a particular category. A "dual" fund is one where the weight of the two asset categories comes to at least 80 percent and that of each category to at least 30 percent. A "mixed" fund is one which invests at least 50 percent of its assets in a particular category. A "pure mix" refers to those funds not included in the above classifications.

^b Does not add up to 100 percent because of the omission of cash and the rounding of figures.

^c Mutual fund shares sold less redemptions, on a cash basis.

^d The standard deviation measures the risk associated with monthly changes in the real return on mutual fund shares in the last 18 months.

Source: Bank of Israel.

Table XVIII-13
MUTUAL FUND OPERATIONS, 1975-79
(Percent)

	Net issues ^a (IL million)	Real change in net issues	Net issues divided by funds' assets at end of previous year	Weight of funds' assets in listed securities portfolio at end of year	Composition of funds' assets at end of year ^b		
					Bonds traded in IL	Shares traded in IL	Foreign currency assets
1975	1,869	34	80	13	72.2	8.2	19.6
1976	1,822	-26	35	15	68.5	7.5	22.7
1977	2,182	-11	25	17	62.4	12.7	24.9
1978	2,190	-33	14	17	58.8	15.2	26.0
1979	-487	-112	-2	21	69.8	11.5	18.4

^a Defined as mutual fund shares sold at issue price, less redemptions at redemption value.

^b Does not include cash.

Source: Bank of Israel calculations.

In 1979 the public preferred index-linked bonds—which comprised about 95 percent of the bonds acquired by the public, as opposed to 78 percent the previous year—to dollar-linked or double-option bonds. This was due to the nonadjustment of these bonds' interest rate to the rate paid on Patam accounts, which are adjusted for inflation abroad. Only at the end of the year, when the demand for index-linked bonds subsided, did the bonds traded in or linked to foreign currency rise rapidly.

During the bond market crisis, at the end of 1979, the banks introduced three-year savings schemes covered by tradable bonds issued to the public. The beginning of 1980 saw large deposits in these savings schemes.

5. MUTUAL FUNDS

The decline in financial demand in the last part of 1979 also affected the demand for mutual fund shares. After the public purchased (net) IL4.1 billion worth of shares in the first eight months of the year (double the 1978 acquisition)—in the final third net redemption came to IL4.6 billion (see Table XVIII-12). Apparently the public prefers to invest in linked bonds through the funds which is the reason for these fluctuations: when bond demand soars sales of mutual fund shares increase, and when demand weakens they fall off—to the point of a net redemption. It should be pointed out that although the total net issue for 1979 (at current prices) was negative, the total net monthly issue, at December 1978 prices, was positive—IL800 million.

The growth of the fund group specializing in linked bonds was noteworthy in 1979, in contradistinction to the other groups' development. This group's sales approached IL5 billion, and the weight of its assets in total mutual fund assets rose from 26 percent at the beginning of the year to 45 percent at the close.

Ten new funds were established this year, broadening the range of investment possibilities offered to investors. These funds issued IL2.6 billion of certificates in 1979, and held 11 percent of the industry's assets at year's end. New shares in the funds were offered to the public at their net asset value with no commission charge¹¹ during the various marketing campaigns; in this way the liquidity of these funds grew, and it became cheaper to invest in mutual funds than to make a direct investment in securities. In this connection it should be noted that fund certificates are held for three years on average and are not used for current liquidity.

The real return on mutual funds was -11 percent, with a standard deviation of 2.7 percent (see Table XVIII-12). Funds with a high concentration of index-linked investments yielded larger returns than expected from their composition, while funds investing in shares and foreign currency had lower yields in 1979 than the market returns on these components. In general, it is difficult to assess the risk stemming from real fluctuations in the price of mutual fund shares; however, the group specializing in index-linked investments held an advantage over a direct investment in index-linked bonds.

The asset composition of the mutual fund industry is determined by the funds' management and the investing public combined. During 1979 the weight on index-linked assets gradually increased from 59 percent at the beginning of the year to 70 percent at the end. On the other hand, the weight of foreign currency-related assets dropped, as did that of shares (see Table XVIII-13).

¹¹ Usually the share price is the market price plus a commission charge (which can reach 1.5 percent).