CHAPTER XIX

THE SECURITIES MARKET

1. Main Developments

New security issues were smaller in 1968 than 1967, but far higher than in previous years. The volume of transactions in shares and bonds almost doubled in 1968, a development accompanied by a rise in price levels.

Net issue amount fell from IL 1,045 million in 1967 to IL 930 million, of which over IL 920 million was in bonds.[1] The decline occurred entirely in Government issues, especially the Absorption Loan (collection of which was discontinued) and the Defense Loan.

The bond issue market is completely dominated by the Government as far as supply is concerned, and partly dominated by it with respect to demand. On the one hand, the Government decides whether to float its own issues or to permit financial institutions to do so; on the other hand, it ensures the sale of the bonds by obligating social insurance funds, approved saving schemes, and insurance companies to invest a high percentage of their resources in these securities.

Direct purchases by the public in 1968 came to only about IL 235 million, or some 25 percent of total new issues. Social insurance funds, the biggest customer, took nearly IL 380 million worth (net), banks about IL 210 million, and insurance companies and financial institutions another IL 100 million approximately. Among the new issues, there was a notable rise in long-term loans—this too by Government design. There was little change in the terms of the 1968 issues. Those floated by the different institutions feature the same terms with respect to maturity, value-linkage, and interest rate. The Government determines these terms as a consequence of the special arrangements it has entered into with the financial institutions.

The low level of new share issues, which has marked most of the years since the establishment of the State, continued in 1968. This was due to the fear that industrial and land companies would end up in the red, but even more so to the ability of potential issuers to obtain capital from other sources on more convenient terms (this is discussed below).

Trade on the Tel Aviv Stock Exchange, which began to rebound in 1967, continued upward as a result of the growth of economic activity and the higher

[1] Domestic issues, excluding the Short-Term Loan.

profitability in the year reviewed of the companies listed on the Exchange. The volume of equity transactions soared 104 percent to reach IL 112 million. Turnover in bonds (including the Short-Term Loan), advanced more than 89 percent, reaching a record IL 283 million. Trade was particularly lively in the 1967 Defense Loan and the Absorption Loan.

A small number of shares and bonds again accounted for the bulk of the transactions, trade in the remaining securities being of negligible proportions.

Share prices rose substantially in 1968, particularly in the first three months of the year. In contrast to previous boom periods, the advance of prices was more selective. Industrials and commercials made the biggest gains. The overall rate of return on all listed shares went up from 17 percent in 1967 to 26 percent.

Dollar-linked bond prices turned upward at the end of the year, owing to expectations of devaluation. Prices of bonds linked to the consumer price index increased by 2 percent in the second half of the year.

The net increase in securities traded in foreign currency totalled $ 22 million (before revaluation), of which some $ 12 million was in foreign securities and participation certificates of foreign mutual funds.

The price of the Natad (investment) dollar averaged about 8 percent above the official exchange rate, the agio rising to 12 percent at the end of the year.

2. The Nature and Scope of the New Issue Market

In view of the huge development requirements of the Israeli economy and the formidable weight of Government development budget loans in financing investments (in 1968 net security issues constituted about one-third of gross domestic investment, as against approximately one-half in 1967), the Government regards the medium- and long-term bond market as an instrument that should serve it in directing investments in the economy.

Government approval[1] is required for the floating of bond issues. In practice, a bond issue has no chance of succeeding unless it is recognized as an "approved security".[2] The Government controls the issue and purchase of bonds by virtue of its power to grant such approval, through special regulations pertaining to social insurance funds, bank-administered saving schemes, and insurance companies, and through special arrangements with financial institutions[3] and banks.

[1] A public committee grants approvals on behalf of the Government. In addition, there is a committee that approves prospectuses. Hitherto this was the Securities Committee, but beginning in July 1969 the approvals will come under the purview of the Securities Authority, established under the Securities Law, 5728–1968.

[2] Since the interest ceiling under the Interest Law is 11 percent and the Government option-type loans yield 10.76 percent, it is obvious that no private issuer can compete with these bonds, even if he enjoys income tax concessions similar to those granted purchasers of Government bonds.

[3] See also Chapter XVII, "Financial Institutions", especially section 2.

In addition, the Government has levied compulsory loans, such as the Absorption and Savings Loan, as well as loans of a special nature, such as the Defense Loan.

We see, therefore, that by and large the new issue market for bonds is of an institutional, artificial nature: it lacks the characteristics of a competitive market such as exists in many other countries, and prices are not determined by the interplay of supply and demand.[1] Moreover, a large percentage of the funds could be transferred from their source (the institutional investors) to their destination (the Accountant General or Hevrat Ovdim companies) otherwise than through the issue of fixed-interest securities. Since they are marketable instruments, bonds possess some advantages over deposits, for example, and they are also a better secured investment; as against these advantages, however, the flotation costs must be reckoned with.[2]

The securities market, as defined in this chapter, may be subdivided: (a) the new issue market, where securities issued by companies and organizations wishing to raise capital (and which have received the required Government approval) are sold to the public and to institutional investors; and (b) the secondary market, where trading in existing securities is conducted (see the discussion in section 4 below).

It is difficult to determine unambiguously which of the new issues may be regarded as falling within the orbit of the securities market, since the sale of shares to a private investor is of no interest here.[3] The criterion is, in general, the issuing of securities by a prospectus and for sale to the general public, but a few bond issues floated without a prospectus have been included here, since they were designed solely for social insurance funds and resemble other issues in all respects.

The discussion of domestic issues in this chapter will therefore cover the following securities:[4] (a) all Government and nongovernmental securities offered to the public by a prospectus; (b) sales without a prospectus to institutional investors; (c) Absorption and Compulsory Savings Loan; (d) Government and nongovernmental loans to insurance companies; and (e) the 1967 and 1968 Defense Loans.

1 This generalization does not apply to the Short-Term Loan, which competes in the money market and is purchased mainly because of economic considerations. Nor does it apply to the compulsory issues acquired by households, who may sell the certificates in their possession.

2 Distributors' fees generally amount to at least 2 percent of issue amount, while legal and other expenses add up to another 1–1½ percent. The issue of approximately IL 600 million worth of bonds by financial institutions and banks in 1968 involved an outlay of over IL 20 million. In some cases arrangements are made whereby the flotation costs are borne not by the issuing company but ultimately by the recipient of the credit.

3 A more exhaustive discussion of this subject will be found in Bank of Israel, *Annual Report 1967,* p. 504.

4 In Table XIX–1 bond issues are shown at par value and share issues at purchase price.

It should be kept in mind, however, that the Absorption Loan[1] differs from ordinary loans: it is a compulsory loan, and the holding of certificates does not necessarily indicate any preference for this type of asset. Sales of the Defense Loan—mainly the 1967 issue but also that of 1968—likewise do not testify to any change in the public's propensity to acquire securities, since sales were governed by national considerations, aided to some extent by the social pressure of workers' associations and institutions (both the Absorption and Defense Loans were sold to persons who generally do not own securities). Moreover, the Absorption Loan certificates are distributed after a lag of several years,[2] and only in 1967 did trading in such certificates begin on the Stock Exchange. Trading in the Absorption and Defense Loans in 1967 and 1968 was marked by heavy offers, which drove prices down—evidence that these loans would not have been sold in such a large volume had it not been for the institutional arrangements governing their issue.

3. New Issues

The volume of new security issues declined from its record 1967 level of IL 1,043 million[3] to IL 930 million—i.e. by 11 percent. Nevertheless, it was still much higher than in previous years.

If collections on account of the Absorption Loan, which is of a compulsory nature, are subtracted, there was practically no change in net new issues, which totalled about IL 870–880 million in each of the two years 1967 and 1968.

(a) *Bonds*

1. *New issue amount*

Sales of new loans over the past two years are presented in Table XIX–1. It shows that net sales fell from IL 1,023 million in 1967 to IL 923 million, i.e. by about 10 percent. The 1968 figure, however, was still 56 percent higher than in 1966. 1967 was an exceptional year owing to the Six Day War and the Defense Loan which came in its wake, as well as to the economic uncertainty which prevailed for the better part of the year and strengthened the propensity to acquire financial assets. The decline in sales in 1968 is explained by the termination of collections on the Absorption and Compulsory Savings Loan (in April 1968), and apparently also by the country's stronger security position, which tended to dampen sales of the Defense Loan. Yet another reason was the fact that payroll deductions for the Defense Loan began only in May and were

[1] The reasons for not treating the Absorption Loan as a tax were discussed in the 1966 Annual Report, pp. 163 and 461.

[2] The distribution of Absorption Loan certificates is discussed in Chapter XX, section 8.

[3] Excluding the Short-Term Loan.

Table XIX–1

DOMESTIC SECURITY ISSUES,[a] 1967–68

(IL million)

Issue	1967			1968		
	Gross issue	Redemption[b]	Net issue	Gross issue	Redemption[b]	Net issue
Long-term loans[c]						
Absorption Loan[d]	170.8	10.2	160.6	82.0	24.2	57.8
Other Government loans[a]	89.0	71.0	18.0	87.4	43.7	43.7
Nongovernmental loans	267.4	112.1	155.3	342.5	46.5	296.0
Total	**527.2**	**193.3**	**333.9**	**511.9**	**114.4**	**397.5**
Option-type loans						
Defense Loan, 1967	282.4	—	282.4	15.6	—	15.6
Defense Loan, 1968	—	—	—	180.3	—	180.3
Development Loan	180.9	12.4	168.5	145.2	30.7	114.5
Nongovernmental loans	200.5	0.1	200.4	213.0	8.1	204.9
Total	**663.8**	**12.5**	**651.3**	**554.1**	**38.8**	**515.3**
Shares	20.5	—	20.5	6.5	—	6.5
Securities traded in foreign currency	69.1	31.8	37.3	49.0	39.3	9.7
Grand total	**1,280.6**	**237.6**	**1,043.0**	**1,121.5**	**192.5**	**929.0**

[a] Excluding overseas sales by Israeli companies, sales of foreign securities in Israel, and sales of the Short-Term Loan. For the percentage distribution, see Table XIX–1 in the appendix. The 1967 data are partly revised, and those for 1968 are provisional. Includes the sale of Jewish Agency bonds held by the Accountant General to social insurance funds and others, in the amount of approximately IL 55 million in 1967 and IL 51 million in 1968. Bond sales are given at par value and sales of shares at market prices.

[b] Theoretical redemption. Since most of the bonds are held by institutional investors, this fairly accurately reflects the actual redemption.

[c] Excluding the 1968 Defense Loan, which is listed among the option-type bonds.

[d] The amount collected from the public and not the value of certificates distributed. For the distribution of certificates, see Chapter XX.

SOURCE: Based on data of the State Loans Administration, the Ministry of Finance, and the Tel Aviv Stock Exchange.

spread over ten months.[1] On the other hand, there was a sharp rise in net sales of long-term nongovernmental loans, from IL 155 million in 1967 to IL 296 million. The smaller net sale of bonds meant a smaller absorption of funds from

[1] Collection of the 1968 Defense Loan continued until April 1969. At the end of 1968 outstanding obligations from the public totalled IL 50 million, and from the banks IL 30 million.

the public. This development, as already noted, was connected with the stronger tendency to invest in real assets as compared with 1967.

2. *Issue terms*

There were three major developments in 1968 regarding the terms of new bond issues:

(a) Only very insignificant changes occurred in the terms of bonds issues, whether for short, medium, or long periods.

(b) The terms of the 1968 Defense Loan were less favorable than those of the previous year's issue.

(c) The relative weight of long-term bond issues rose, while that of medium-term issues declined.

Even though there were only isolated changes in the terms of new bond issues in 1968, two of them should be noted. First was the revision of the terms of the 1968 Defense Loan, as compared with those of the previous year's issue.[1] The 1967 Defense Loan provided for redemption after five years, whereas the 1968 issue was the first option-type loan with a long maturity[2]—10 years. In addition, for redemption on a nonlinked basis, the net return was reduced for the public and banks alike.[3]

The second change was the renewed issue, as from March 1968, of the 18-month series of the Short-Term Loan. The net return to the public was set at 7.25 percent. The resumption of this series contributed to heavier sales (both gross and net) of the Short-Term Loan to the public.

Apart from the above changes, the three types of bonds issued (long-term, option-type loans for five years, and those denominated in foreign currency) offered the same terms as in 1967 as regards maturity, value-linkage, and interest rate.[4] This unusual phenomenon was connected with the fact that the terms which the Government fixes 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 of the option-type loans (except for the 1968 Defense Loan) provide for the same interest rates and redemption period (five years, 10.76 percent unlinked and 4.84 percent linked). The terms of the long-term loans are likewise almost identical (except for those sold to the insurance companies): a 17-year redemption period and interest of 5.5 percent. The same is

1 In 1968 sales of the 1967 Defense Loan totalled IL 15.6 million.

2 Short-term loans are defined as those issued for a period of up to 18 months; medium-term loans—from 18 months to five years; and long-term loans—over five years

3 The 1968 Defense Loan offered differential terms to the public and the banks (the banks were given better terms; see Table XIX-2 in the appendix).

4 For further details on the terms of the various bond issues—in which no changes occurred in 1968—see Bank of Israel, *Annual Report 1967,* pp. 510–11.

true of foreign currency bonds sold to Israeli residents—most of them are redeemable after 14 years and bear 7 percent interest.[1]

In 1968 there was a substantial lengthening of the "life" of the bonds issued during the year, in contrast to the opposite development in the previous year (see Table XIX–1 in the appendix). Whereas in 1967 net issues of long-term bonds (including those traded in foreign currency) accounted for about 36 percent of total issue amount, their share in 1968 (with the inclusion of the 1968 Defense Loan) rose to 62 percent.

The "lengthening" of the life of the bonds stemmed mainly from the following factors:

(a) The longer maturity of the 1968 Defense Loan as compared with the 1967 issue (see above).

(b) The smaller redemption in 1968 of long-term bonds (Government and nongovernmental), as against an increase in the case of medium-term bonds.

(c) The much larger accumulation in 1968 of social insurace funds, which are required to invest most of their funds in long-term bonds.[2]

(d) A decline in 1968 in the relative profitability of buying option-type bonds at source as compared with buying them on the Exchange (see below).

Sales of long-term bonds linked to the consumer price index (nonoptional) rose 19 percent, despite a decrease of about 65 percent in the value of Absorption Loan certificates distributed. The value of linked bonds issued went up from IL 334 million in 1967 to IL 398 million. Most of the increment stemmed from a growth of approximately IL 141 million in net issues of nongovernmental loans—in the main issues floated expressly for social insurance funds by institutions affiliated to Hevrat Ovdim, the holding company of the Histadrut (General Federation of Labor).[3]

The proportion of option-type loans in net new security issues declined in 1968 to about 55 percent, compared with 62 percent in 1967 (in absolute terms, IL515 million in 1968 and IL 651 million in 1967—see Table XIX–1 and Appendix Table XIX–1).

Even disregarding the Defense Loans, sales of which fell off steeply in 1968, there was a drop of IL 50 million in net issues of option-type loans. There were several reasons for this. First, at the beginning of January 1968 a regulation was gazetted which permitted social insurance funds to make no more than 10 percent of their total recognized investment in securities issued for a period of less

[1] These bonds are purchasable with Natad (investment) dollars (see section 5 below). Hollis bonds, which are issued abroad and are bought with Natad dollars, bear 6 percent interest.

[2] The new regulations for social insurance funds are discussed below.

[3] Social insurance funds are required to make about 90 percent of their recognized investments in long-term bonds. Under an agreement with the Treasury, the Histadrut-administered social insurance funds place half of their recognized investments in nongovernmental securities, mostly those issued by Hevrat Ovdim.

than ten years; this of course limited purchases of the five-year Development Loan (as well as the 1967 Defense Loan). Secondly, in May 1968 the banks were authorized to buy Defense Loan certificates out of the 25 percent of saving scheme funds which previously had to be invested in option-type bonds. Since the yield on the 1967 Defense Loan purchased on the Exchange[1] was higher throughout most of the year than that on the option-type loans purchased at source, the banks preferred to buy the Defense Loan on the Exchange; as a result, sales of Government option-type loans fell off. Another factor operating in the same direction was the diminished liquidity of the option-type loans: whereas up to September 1967 buyers could cash in the bonds ahead of maturity (two years after issue), this privilege was discontinued at that date.

On the other hand, it should be recalled that in 1968 there was a substantially larger accumulation by social insurance funds, as well as a very rapid expansion —by IL 276 million as against IL 160 million in 1967—of approved saving schemes, the leading investor in option-type bonds.

As to long-term Government loans linked to the consumer price index, the new issue market remained listless. Sales of the Development Loan (17 years) amounted to IL 20 million, about half the value of all bonds reaching maturity.[2] The Treasury sold about IL 50 million worth of Jewish Agency bonds from its portfolio; part of these securities were acquired by social insurance funds (see Table XIX–1). The other long-term Government bonds were purchased by insurance companies in order to ensure their capacity to redeem index-linked insurance policies as they fall due.

Net sales of securities traded in foreign currency were down considerably from their 1967 level. This was connected with both the smaller gross issue amount and the increase in redemptions. The decline in gross issues can apparently be ascribed to the increased investment in foreign securities (this is discussed below).

3. *Issuers of bonds*

Whereas in 1967 there was a sharp rise in the relative share of Government bonds in new issues (from approximately 42 percent in 1966 to 60 percent), the year reviewed saw a reversal of trend (44 percent). This was mainly con-

[1] Beginning January 1968, the 1968 Defense Loan was traded on the Stock Exchange. Owing to the heavy offer—particularly by households, who were not accustomed to investing their savings in securities—the prices of these bonds dipped and the yield to maturity was particularly high, exceeding that on the option-type issues of the Development Loan.

[2] Most of the bonds reaching maturity were five-year, index-linked certificates of the Development Loan series. The limited demand for the long-term Development Loan is explained by the fact that it offers only a slim advantage in yield (0.66 percent) over the option-type loans, in the event that a rise in prices justifies 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 of up to 5.26 percent in the event of price stability, a reasonable possibility in the light of the experience of the years 1966–68 and the redemption of the first few series.

nected with the precipitate drop in issues of the Absorption and Defense Loans and with the increased redemption of Government bonds relative to nongovernmental loans. Sales of other Government loans fell off to a smaller extent.

Total issues (net) of Government loans declined from their record high of IL 630 million in 1967 to IL 412 million, which was still considerably above the 1966 level of IL 282 million. Excluding the Absorption and Defense Loans, net sales of Government loans dropped from IL 187 million in 1967 to IL 159 million, with all of the decline being due to a fall of IL 54 million in option-type issues.[1]

In contrast to the absolute and relative decline in net issues of Government loans, nongovernmental loans showed a higher figure in 1968—IL 511 million compared with IL 401 million in 1967 and IL 282 million in 1966. The 1968 increment resulted entirely from a rise of about IL 141 million in net issues of long-term loans. This increase, accompanied as it was by a decline in Government loan issues, was of limited economic significance.

The financial institutions[2]—excluding those of Hevrat Ovdim—in effect may be regarded as agents of the Treasury in the matter of bond issues.[3] Allocation of the bond issue function between the Government and the financial institutions is subject to Treasury decision, and thus has little significance as regards the national economy.[4] The fact that Government issues decreased at a time when sales of nongovernmental bonds rose was due chiefly to the increased redemption of Government bonds compared with a decline in the case of nongovernmental bonds, and to a lesser extent to the decision to discontinue collection of the Absorption Loan.

The identity of bond issuers is important from the viewpoint of the financial institutions raising loan capital and of the institutions (mainly banks) distributing bonds. The new issue market for nongovernmental bonds is dominated by three groups of financial institutions, which are affiliated to the three large banks (see Table XIX–3 in the appendix). This is explained by the fact that these banks account for the bulk of the funds accumulated in the social insurance funds and approved saving schemes, and the latter expanded rapidly in the past two years. The importance of these groups has been growing since 1966. In 1966 and 1967 they were responsible for about two-thirds of all nongovernmental bond issues, while in 1968 the figure rose to over 80 percent. There was an especially noteworthy rise in the share of Hevrat Ovdim companies.

In 1968 gross issues by this group were up approximately IL 105 million

[1] The reasons for this decrease were explained above.

[2] The financial institutions here include, in addition to those mentioned in Chapter XVII, banks, Keren Hayesod, Hollis, Gmul, Bitzur, and Mizrahi Bank Investment Corporation.

[3] A more detailed explanation of the arrangements between the Treasury and the financial institutions will be found in Chapter XVII, "Financial Institutions", and in the Annual Report for 1967, pp. 509–10.

[4] Except for the influence on Hevrat Ovdim enterprises (see below).

(see Table XIX–3 in the appendix), whereas the figure for other nongovernmental issuers fell off. This is ascribable to the fact that half of the gross purchases of the social insurance funds are from issues of financial institutions controlled by Hevrat Ovdim.

4. *Purchasers of bonds*

Most of the securities sold in Israel are taken by institutional investors. The demand for bonds is closely connected with the annual accumulation of these institutional investors, the most important of which are the social insurance funds and the banks (particularly for their approved saving schemes). Another major investor is the insurance companies sector, whose purchases are geared to the growth of its linked life insurance business.

Social insurance funds are the leading institutional investor: in 1968 they acquired about 40 percent of total new issues, and in 1967 approximately 33 percent (see Table XIX–2). As noted above, most of their purchases are made in accordance with Treasury regulations.[1]

The bank-administered saving schemes—whose bond purchases grew considerably in the last two years—are likewise subject to Treasury regulations. In 1968 these schemes expanded by IL 276 million, and their portfolio investment by IL 244 million,[2] of which some IL 81.6 million was in Defense Loan certificates sold to banks and IL 31.4 million in certificates sold to the public (see Table XIX–2 in the appendix). The saving schemes purchased about IL 131 million of other securities, in the main nongovernmental.

The banking community also purchases securities on own account, for their asset portfolio. In 1967 they invested over IL 100 million in securities, chiefly Defense Loan certificates, in accordance with an agreement with the Treasury. In 1968, however, following the growth of credit demand and the incurring of liquidity deficiencies (particularly toward the end of the year), they reduced their securities portfolio by about IL 35 million.

The insurance companies are also numbered among bond purchasers, but most of their acquisitions are of special loans issued by the Government and the Israel Electric Corporation, and purchases are geared to the development of their linked life insurance business. The linkage terms and redemption dates of the bonds correspond to those of the insurance contracts. The bonds are not traded on the Exchange, nor do they constitute part of the regular supply of loan capital. In 1968 the insurance companies purchased about IL 41 million of long-term index-linked bonds. The financial institutions themselves—which

1 See the discussion in the 1967 Annual Report, p. 514.

2 Their investment in medium- and long-term securities rose by IL 244.5 million, and that in the Short-Term Loan declined by IL 16.2 million; their incremental net investment in these securities thus came to IL 228.3 million.

Table XIX-2

PURCHASERS OF SECURITIES, 1967–68

	1967		1968	
	IL m.	%	IL m.	%
(1) Net sales of securities[a]	1,043.0	100.0	929.0	100.0
(2) Less: Purchases by institutional investors				
Social insurance funds[b]	340.6	32.7	377.3	40.6
Insurance companies[c]	48.6	4.7	40.7[d]	4.4
Approved saving schemes	111.3	10.7	244.5	26.3
Banking institutions[c]	114.1	10.9	–34.7	–3.7
Financial institutions[b]	16.9[e]	1.6	66.0[e]	7.1
Total	**631.5**	**60.6**	**693.8**	**74.7**
(3) Residual[f] (1–2)	**411.5**	**39.4**	**235.2**	**25.3**
(4) Less:				
Absorption Loan	160.6	15.4	57.8	6.2
Estimated purchases of the Defense Loan by the public[g]	187.2	17.9	78.5	8.5
Total	**347.8**	**33.3**	**136.3**	**14.7**
(5) Net residual[f] (3–4)	**63.7[h]**	**6.1**	**98.9**	**10.6**

[a] Including sales of Jewish Agency bonds held by the Accountant General to social insurance funds and others, to a total of approximately IL 55 million in 1967 and IL 51 million in 1968.
[b] No adjustment was made to exclude the Short-Term Loan, but sales were apparently negligible.
[c] Excluding banking institution investments through approved saving schemes.
[d] Estimate.
[e] Estimate; includes a small amount of loans to affiliated institutions.
[f] Purchases by households, businesses, and nonprofit and other institutions.
[g] Total sales of the Defense Loan each year, less the amounts known to have been purchased by institutional investors. In 1967 social insurance fund purchases came to about IL 4 million; in 1968 the figure was approximately IL 4.4 million, while banks bought about IL 31.4 million worth for their approved saving schemes, making a total of IL 35.8 million.
[h] This is apparently biased downward.

SOURCE: Based on data of the Ministry of Finance, the State Loans Administration, and the Research Department of the Bank of Israel.

are the chief issuers of bonds after the Government—purchased a certain amount of securities.

After the institutional investors, the leading customers for fixed-interest securities are households and businesses. Total noninstitutional purchases declined from IL 412 million in 1967 to IL 235 million. This was due primarily to the smaller collection of the Absorption and Defense Loans in the wake of the aforementioned institutional arrangements. Net of the Absorption Loan (which resembles a tax) and purchases of the Defense Loan by the public,[1] there was

[1] Many of those acquiring Absorption and Defense Loan certificates would not have done so voluntarily. On the other hand, there is no doubt that for some households and businesses purchases of the Defense Loan were at the expense of other securities.

a marked rise in noninstitutional purchases—approximately IL 99 million as against IL 64 million in 1967.[1]

From what is known about purchases by the social insurance funds and saving schemes, it may be assumed that households acquired mainly option-type bonds, securities traded in foreign currency, and shares. Of total security purchases (excluding the Absorption and Defense Loans), households and business accounted for about 11 percent in 1968, compared with some 6 percent the year before.[2]

The brighter economic picture in 1968—the much bigger earnings of self-employed and business profits—and the expectations that profits would continue upward, the rise in Stock Exchange prices, the high real yields, and the growth of turnover, all encouraged households and business to enlarge their portfolio investment. In some cases this may have constituted a substitution for the Absorption and Defense Loans, after collection of the former was discontinued and sales of the latter slackened.

Despite the increased purchase of securities in 1968, they were not the main component in incremental financial asset holdings of households. The principal items continued to be claims on social insurance funds and insurance companies and bank deposits.[3]

5. *Development of bond issues during the year*

Gross sales of option-type loans declined in January and February of the year reviewed, turned upward in March, peaked in the third quarter, and dropped again in the fourth quarter (see Table XIX-4 in the appendix). Sales of the Defense Loan to the public were very sluggish in the first five months of the year, since the 1967 Loan was collected for the most part in five installments during 1967, while collection of the 1968 issue began in most cases only in June 1968. Gross issues of long-term loans and of securities denominated in foreign currency were at a relatively low level in the first quarter, but moved upward during the year, peaking in the fourth quarter. As for securities traded in foreign currency, developments here apparently reflected—at least on the demand side

[1] It is hard to say which residual is of greater economic significance. Some households most likely acquired part of their Absorption and Defense Loan certificates from other households, so that the adjusted residual is relatively small and does not reflect the actual purchases. There is no reason to assume that households and businesses bought only new issues at source; some of them may have bought securities on the Exchange from institutional investors. It should be remembered that the discussion here is based on the changes in outstanding holdings at the end of the year of the groups listed in Table XIX-2. This assumption holds for both 1967 and 1968.

[2] Most of the data for 1966 and 1967 do not separate the Short-Term Loan from other fixed-interest securities, so that it is difficult to determine the exact percentage. See Bank of Israel, *Annual Report 1967,* pp. 514-16.

[3] See Table IV-5 in the appendix to Chapter IV, "Consumption and Savings".

—the uncertainty prevailing in the money markets of the West and the effort to insure the assets against devaluation (see the discussion below).

Redemption of Short-Term Loan certificates exceeded gross sales in the first quarter, a development for which banking institutions were entirely responsible, and which was apparently of a seasonal nature. In the second and third quarters sales were brisk (netting about IL 56 million per quarter); purchasers were the public and institutional investors but not banks. In the fourth quarter the figure fell to a low of IL 5.5 million,[1] owing to the drop in the relative yield of this paper as compared with bill brokerage and fixed-term deposits. The return on the latter two rose following the tightening of the money market, which began in October and was reflected by a rise in the outstanding balance of the bill brokerage trade.

Total bond issues (excluding the Absorption Loan, the Insurance Companies Loan, and bonds sold without a prospectus) rose steadily during the first seven months of the year, reached a high in the third quarter, and drifted downward in the fourth.

It should be noted that the decline in bond sales (including the Short-Term Loan) in the last quarter would have been greater still if the banks had not taken up a large amount in December. These purchases were made in accordance with an agreement between the banks and the Government providing for the acquisition of IL 200 million of bonds in 1968, and apparently they partly covered purchases that had been deferred earlier because of the banks' liquidity difficulties.

(b) *Share issues*

The new issue market for shares continued to be listless in 1968—a condition that has characterized it in most years since the establishment of the State. Sales to institutional investors and the public added up to IL 6.5 million, as against approximately IL 20 million in 1967. While prices of most shares listed on the Stock Exchange advanced, the rise was not sufficient to induce the issue of new shares to the public in any sizable sum. Toward the end of 1968, and for the first time since 1964, two issues were offered (by prospectus) to the public;[2] this may be a sign that the new issue market is reviving, but it is too early to say for certain.[3]

The main cause of the dearth of new share issues is the fact that companies

[1] For further details, see Chapters XV and XX.

[2] Sales of these shares were actually made for the most part in 1969.

[3] Share issues in 1967 were intended for institutional investors and were sold without a prospectus. In 1968 approval was granted for the issue (without a prospectus) of about IL 243 million worth of shares to private investors, as against IL 75 million in 1967. As already pointed out, in most cases this did not constitute the mobilization of capital from the public. The large increase undoubtedly reflects the changed economic situation.

whose profitability and business standing would enable them to issue shares are not inclined to do so as long as they can obtain loan capital on reasonable terms and relatively more cheaply than equity capital. In this way they can also increase their financial leverage. It should be emphasized that this factor was not typical of 1968, but it is a fundamental feature of the Israeli economy. Despite the extremely high ratios of loan capital to equity capital,[1] most companies can obtain additional loan capital when necessary, without having to pay more interest or undertaking to raise additional equity capital through share issues. Another group of companies with listed shares would like to enlarge their equity capital, but at the prevailing prices for their shares, or in view of their performance and financial standing,[2] they would not find buyers for new issues; moreover, they too can obtain credit.

Abolition of the value-linkage arrangements reduced the risk involved in accepting additional loans, since borrowers could gauge more accurately their principal and interest payments. The data show that the amount of credit extended to the different sectors of the economy[3] by the financial institutions was nearly IL 285 million greater than in 1967, while credit granted by banks from their own means and from earmarked deposits rose by IL 780 million.

On the other hand, there is no great demand for shares of the companies that would like to issue them, owing to the relatively low yields of most shares in the past, and even more important, to the risk and uncertainty involved in equity investment. The bitter experience of the years 1964–67, in which there were sharp price declines and numerous capital losses, contributed greatly to the hesitation to invest in new shares. On the other hand, investors can put their money into various types of fixed-interest securities, in which the risk is negligible, the liquidity high, and the yield quite handsome. For this reason, the readiness of the public to invest in shares (which always involves a risk) depends on the prospects of earning a particularly high yield for a number of years. This the issuing companies were not yet able to offer in 1968, despite the high yields that year.

4. The Nature and Scope of the Secondary Market

(a) *Definition of the market and the Government's influence*

The secondary market, as surveyed in this chapter, is identified with the Tel Aviv Stock Exchange. While the Exchange (all the data in this chapter relate to

[1] Under free market conditions, these high ratios rule out the extension of new loans, or result in an incomparably higher interest rate, owing to the risk of defaulting on the debt.

[2] It was found that a large percentage of these listed companies are less profitable than unlisted companies of the same size and in the same branches.

[3] The reference is to agriculture, industry, construction, and commerce.

trading thereon) is the only organized securities market in Israel, it should be noted that the turnover figures do not include the offsetting of buy and sell orders by brokers, and particularly by banks, nor do they include trade outside the framework of an organized securities market.[1] Data on the latter are very scanty and will therefore not be included in this chapter, even though they are of interest.

The Government influences the secondary market to a much lesser extent than it does the new-issue market. It exerts such influence mainly in an indirect manner. It exercises general supervision over trading, and from time to time issues special directives, such as that permitting the banks to increase their purchases of the 1967 Defense Loan out of approved saving scheme funds, thereby boosting turnover in these bonds to a considerable degree and arresting the price decline. The regulations on the social insurance funds and saving schemes undoubtedly reduce the marketable stock of bonds, and hence the scope of the market as well. The Government also regulates the mutual funds and trade with Natad (investment) dollars.[2]

(b) *Listed securities*

The registration of securities on the Stock Exchange facilitates their trade in an organized market. The value of listed securities is thus a measure of the size of the marketable stock[3] of securities in the economy. In 1968 the value of securities listed on the Tel Aviv Exchange rose by about IL 950 million,[4] or 32 percent, to reach IL 3,950 million; in 1967 the increase came to 27 percent (see Table XIX–3). Of the 1968 increment, approximately IL 50 million stemmed from the change in the value of shares, IL 92 million[4] from the change in the value of bonds, and IL 800 million[4] from the listing of new securities.

While the listing of securities on the Exchange is necessary for permitting organized trade therein on the Exchange, this does not guarantee that there will in fact be trading. Table XIX–4 shows that from 1963 to 1967 the annual rate of turnover in shares and linked bonds decreased each year, while in 1968 the figure turned sharply upward. The annual rate of turnover in shares almost doubled as a result of the much larger volume of transactions, which can be partly ascribed to the sharp price rises during 1968. As for bonds, the rate of turnover

[1] A number of brokers are working for the establishment of an additional exchange which would trade in securities not listed on the existing one.

[2] The Securities Authority and Treasury directives issued under the Securities Law, 5728–1968, will apparently try to improve the supervision of trading so as to better safeguard the investor.

[3] Theoretically the entire listed amount of a share is marketable, but in practice large blocks are usually held by groups or by individuals owning 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.

[4] Provisional figures; see notes to Table XIX–3.

Table XIX-3

SECURITIES LISTED ON THE TEL AVIV STOCK EXCHANGE, AT MARKET VALUES, 1967–68[a]

(End of year)

	1967		1968	
	IL m.	%	IL m.	%
A. Securities traded in Israeli currency				
Bonds	1,519.5	50.7	2,335.1	59.1
Government[b]	*515.9*	*17.2*	*1,050.7*	*26.6*
Others	*1,003.6*	*33.5*	*1,284.4*	*32.5*
Shares	761.3	25.3	840.9	21.3
Ordinary	*748.2*	*24.9*	*821.8*	*20.8*
Preference	*13.1*	*0.4*	*19.1*	*0.5*
Total securities traded in Israeli currency	**2,280.8**	**76.0**	**3,176.0**	**80.4**
B. Securities traded in foreign currency				
Bonds	590.0	19.7	651.3	16.5
Shares	128.6	4.3	121.7	3.1
Total securities traded in foreign currency	**718.6**	**24.0**	**773.0**	**19.6**
Grand total	**2,999.4**	**100.0**	**3,949.0**	**100.0**

[a] A more detailed breakdown appears in Appendix Table XIX–5.
[b] Provisional data. Revised data will appear in *Trends and Figures, 1969,* Tel Aviv Stock Exchange.
SOURCE: Tel Aviv Stock Exchange.

was up nearly 50 percent, owing to the exceptionally large growth (2.5 times) in the annual volume of transactions and to a rise of about 65 percent in the average stock of marketable capital.[1]

(c) *Trade on the Stock Exchange*[2]

1. *Equity trade*

The recovery of the share market, which began in March 1967, carried over through 1968. Equity turnover soared 104 percent in the year reviewed, and constituted 28 percent of total Stock Exchange trade. The annual level was only 7 percent lower than the average for 1962–67 (see Table XIX–5).[3]

[1] One must be wary of drawing conclusions about the significance of the rates of turnover and the annual changes therein, since the data on which the calculations were based do not include the offsetting of buy and sell orders by brokers, the extent of which is liable to fluctuate substantially from one period to another.
[2] Most of the data in this section are based on *Developments in the Capital Market in 1968,* a pamphlet published (in Hebrew) by the State Loans Administration in the Bank of Israel, Tel Aviv, 1969.
[3] The years 1962–64 witnessed a boom on the Exchange and 1965–67 a slump, so that the six years constitute a complete cycle.

Monthly share turnover rose rapidly in each of the first three months of the year, reaching a high in March. In the second quarter the figure turned sharply downward, but in the last quarter it again reversed direction. The growth of turnover is attributable primarily to the following factors: (a) the strong upswing in economic activity from the middle of 1967 onward; (b) expectations of a continuation of the boom; (c) the higher profitability of most companies with listed shares, a development that found expression in a rise in their quotations; (d) the larger cash and stock dividends distributed to shareholders; (e) the relatively low price level at the beginning of the period; (f) a few successful takeover bids.

These and other factors induced potential investors, especially those who had already bought in the market, to turn to shares. After a rise of 15 percent in the general index of share prices during the period January-March and an average weekly turnover of over IL 5 million in March, the second quarter witnessed a gradual slackening of transactions, accompanied by sagging prices. In June and July the market rebounded, and after holding steady in September it resumed its upward movement in October and November, the price level hitting a new high in the second half of the latter month. In December both trading volume and prices lost some ground—a seasonal phenomenon.

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 some IL 100 million in 1968 with new bond issues, which totalled more than IL 670 million (excluding the Absorption and Defense Loans). Since the market is not

Table XIX–4

TOTAL MARKET VALUE AND TURNOVER OF SECURITIES DENOMINATED IN ISRAELI CURRENCY TRADED ON THE TEL AVIV STOCK EXCHANGE,[a] 1962–68

Year	Shares			Linked bonds		
	Average marketable capital (IL m.)	Annual turnover		Average marketable capital (IL m.)	Annual turnover	
		IL m.	Rate (%)		IL m.	Rate (%)
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	52.1	7.5	1,178.9	55.2	4.7
1968	770.1	110.8	14.2	1,915.3	139.0	7.1

Source: Central Bureau of Statistics.

Table XIX-5

SHARE TRANSACTIONS ON THE TEL AVIV STOCK EXCHANGE, 1966–68

(IL thousand)

Period	Volume of transactions	Average volume per trading day	Change in price index[a] (average 1960=100)
1966	59,300.0	244.0	–23.4
1967	54,800.0	223.0	+10.5
1968	111,994.9	459.0	+14.6
1968 January	8,403.4	382.0	+5.0
February	11,644.7	554.5	+4.6
March	19,866.9	993.3	+3.2
First quarter	**39,915.0**	**633.6**	**+11.3**
April	8,477.4	403.7	–4.3
May	6,316.4	315.9	–1.3
June	5,680.6	295.2	–2.3
Second quarter	**20,402.4**	**340.0**	**–7.6**
July	6,950.3	302.2	–1.0
August	6,133.7	306.7	–3.2
September	6,105.4	321.3	–0.1
Third quarter	**19,189.4**	**309.5**	**+2.0**
October	10,237.1	602.2	+4.2
November	12,761.9	638.1	+4.1
December	9,489.1	431.3	–1.0
Fourth quarter	**32,488.1**	**550.6**	**+7.4**

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

yet developed and the number of investors in shares is still relatively small, it is highly sensitive—sharp fluctuations in quotations can be triggered by slight changes in demand or supply. Trade on the Exchange is fairly concentrated, in the sense that a small number of shares account for a good part of the turnover. In 1968 only 12 listed shares showed an annual turnover of IL 2.5 million or more. They accounted for less than 40 percent of the market value of all listed shares,[1] but for about 55 percent of the total volume of share trading (see Table XIX–6).[2]

The four most heavily traded shares accounted for only about 13.5 percent of the market value of all listed shares, but for nearly 27 percent of total transactions.

[1] They constituted 14 percent of the number of shares listed on the Exchange.

[2] The data on trading volume do not include the matching of buy and sell orders.

Table XIX–6

DISTRIBUTION OF LISTED SHARES AND BONDS, BY ANNUAL TRADING VOLUME, 1968

Annual volume (IL '000)	Ordinary shares			Bonds[a]	
	Number of shares	Percent of total trading volume	Percent of total market value of shares	Number of bonds	Percent of total trading volume
Under 100	13	0.2	4.1	56	0.6
100–250	12	2.1	4.1	17	1.5
250–500	7	2.8	7.0	9	1.8
500–1,000	25	16.6	22.2	9	3.8
1,000–2,500	16	22.9	23.0	11	8.0
2,500–5,000	8	28.4	26.1	1	1.9
5,000–10,000	3	16.7	6.6	2	7.0
Over 10,000	1	10.3	6.9	4	75.4
Total	**85**	**100.0**	**100.0**	**109**	**100.0**

[a] Excluding the Short-Term Loan.
SOURCE: Tel Aviv Stock Exchange (see detailed tables in the appendix).

All shares, but particularly the less active ones, are subject to sharp price fluctuations as a result of relatively small changes in demand or supply.[1]

2. *Trade in bonds*

The volume of bond transactions (excluding the Short-Term Loan) jumped 89 percent in 1968 and constituted 47 percent of total Stock Exchange turnover. Trade in the Short-Term Loan rose 54 percent, bringing up its share in total turnover to about 25 percent. In contrast to the situation in the equity market, the growth of bond turnover in 1968 continued the trend marking the past several years.

The degree of concentration in the bond market exceeds that in the share market: about 84 percent of all trading was accounted for by seven bonds (see Table XIX–6). In a large percentage of the bonds trade was of negligible proportions, while in 56 others the figure for 1968 came to less than IL 100,000. This is explained by the fact that 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.

Four main types of bonds are traded on the Exchange: the Short-Term Loan (3–18 months), option-type loans, loans linked to the consumer price

[1] The magnitudes of the supply and demand, from the aspect of their possible influence on prices, should be measured in relation to the marketable stock of the security concerned (see note 3 on p. 423).

index, and loans traded in foreign currency or linked to the exchange rate. Table XIX–7 shows that in 1968 average weekly turnover in index-linked bonds (including the option-type) was greater than that in the Short-Term Loan or in dollar-linked bonds; this was in contrast to 1966 and 1967, when the Short-Term Loan topped the list. Trade in the index-linked group (including the option-type) nearly tripled, while that in the Short-Term Loan was up 54 percent. There was a more modest rise (about 12 percent) in dollar-linked bonds. The proportion of index-linked loans in total turnover rose strongly in 1967 and 1968. This is ascribable to the following factors: (a) the listing of the 1961 Absorption Loan; and (b) the heavy issue of option-type loans, which doubled their stock. In 1968 there were two additional factors: the listing of the 1967 Defense Loan and the 1962 and 1963 Absorption Loans, and the high yields

Table XIX–7

BOND TRANSACTIONS ON THE TEL AVIV STOCK EXCHANGE, 1966–68

(IL thousand)

Period	Weekly average[a]			Total[d]
	Index-linked[b]	Dollar-linked[c]	Short-Term Loan	
1966	516	943	1,254	132,000
1967	886	1,081	1,324	158,500
1968	2,518	1,211	2,040	283,334
1968 January	2,770	1,285	1,281	21,411
February	2,401	1,293	1,185	20,731
March	2,148	1,253	1,824	21,320
First quarter	2,440	1,277	1,430	63,462
April	2,890	1,037	1,940	25,297
May	2,802	990	1,283	20,532
June	2,400	959	1,669	20,606
Second quarter	2,697	995	1,631	66,435
July	1,120	955	2,084	24,099
August	2,521	970	3,195	25,771
September	2,042	1,067	2,226	21,130
Third quarter	2,228	997	2,502	71,000
October	2,575	1,201	2,326	20,129
November	2,359	1,644	2,310	25,941
December	3,191	1,877	3,158	36,367
Fourth quarter	2,708	1,574	2,598	82,437

[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.
[d] Including the Short-Term Loan.
SOURCE: Total transactions—Tel Aviv Stock Exchange; weekly averages—State Loans Administration, based on Tel Aviv Stock Exchange data.

on the loans owing to the tendency of those unaccustomed to holding securities to sell their certificates almost without regard to the price, and this because they did not acquire them voluntarily.

The most actively traded bond during the better part of the year was the 1967 Defense Loan. Average weekly turnover of this paper was IL 1.1 million; its share in total medium- and long-term bond transactions[1] was quite high, fluctuating between 23 and 39 percent and averaging 30 percent. There was also lively trading in other option-type loans, particularly those featuring the right of early surrender. This is explained by the willingness of institutional investors to buy these bonds at prices higher than their after-tax value to other investors (the institutional investors are exempt from income tax on such securities).

Trade in the Absorption Loan also expanded considerably. Average weekly turnover soared from about IL 250,000 in April-December 1967 to IL 640,000 in 1968, i.e. by roughly 150 percent. Particularly high figures were recorded in April and May, following the large distribution of certificates in March. Of the approximately IL 40 million of certificates distributed during these two months, about IL 2.4 million worth made their way to the Exchange. This is not to say that other owners of certificates did not dispose of their holdings or that they regarded them as a desirable form of savings, since no data are available on trading outside the Exchange (the offsetting of buy and sell orders by banks). Another reason for the increased turnover in April and May is that it was at that time that regular trading began in the 1962 and 1963 issues of the Absorption Loans.[2]

Transactions in dollar-linked securities were up slightly in 1968—by about 12 percent. Sales did not display a uniform trend over the year. During the first six months turnover drifted downward, reaching a low in July. In August the market rallied; trading volume advanced steadily throughout the rest of the year, and in December the figure was twice as high as in July. The high turnover in November and December was influenced by the European currency crisis. The bulk of the trading (60 percent) was in Hollis bonds, but investment in foreign securities was also on a much greater scale than in 1967.[3] Monthly trading in fixed-interest securities (including the Short-Term Loan) was fairly even in the first ten months of 1968, with above-average figures in April, July, and August. Toward the end of the year the level turned sharply upward, with all types of bonds, in particular index-linked and the Short-Term Loan, contributing to the rise.

It should be noted that the market for dollar-linked bonds is shrinking gradually, while that for securities traded in foreign currency is growing.

[1] Excluding the Short-Term Loan.

[2] Previously trade in this paper was more cumbersome, being carried out by means of transfer certificates.

[3] Part of this investment was made through foreign mutual funds operating in Israel (see section 5 below).

(d) *Price and yield trends*[1]

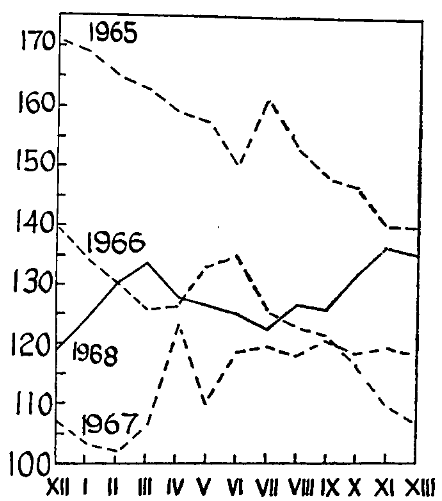
1. Shares

The rising trend in share prices, which began in March 1967, continued in 1968 (see Diagram XIX–1). According to the weighted monthly index of share prices, ordinary shares advanced about 15 percent, after an increase of close to 11 percent in 1967. The year reviewed witnessed selective increases, in contrast to the past, when all shares rose to roughly the same extent. Industrials and commercials showed the biggest rises in prices and yields.

Diagram 1

MONTHLY INDEX OF ORDINARY SHARE PRICES

(End of month; average 1960=100)



Share prices did not display a uniform trend in 1968 (see Appendix Tables XIX–8 and XIX–9). From January to March the general level advanced by a steep 13 percent. This was followed in the second quarter by the receding of prices and a gradual decrease in the volume of transactions. In July and August prices resumed their upward movement, and after they tapered off briefly in September, the advance gathered momentum in October-November, the level reaching a new high in the third week of November. In December the curve turned slightly downward.

There is no doubt that the mounting price trend reflects the changed economic picture in general and the higher profitability of most firms in particular, as well as expectations of a further improvement in profitability. The share market, as already noted, was more selective than in former years, and there were marked intergroup divergences in rates of change, although prices rose in all the groups. Industrials stood out in particular, the trend here moving up at a steady pace throughout the year. The daily index of these shares rose about 40 percent during 1968. The average[2] overall rate of return[3] on shares came to about

[1] Much of the analysis in this section and in the other sections dealing with trading on the Tel Aviv Stock Exchange is based on data from the aforementioned pamphlet, *Developments in the Capital Market in 1968.*

[2] The assumption underlying the simple arithmetic average is that an equal sum is invested in every share in the same group.

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

Table XIX–8

YIELDS OF SELECTED SHARES,[a] 1967–68

Share	1967 Dividend yield[b]	1967 Overall rate of return	1968 Dividend yield[c]	1968 Overall rate of return
Israel-American Paper Mills[d]	7.1	40.7	7.2	186.6
Israel Discount Bank[e]	7.8	41.6	4.4	37.3
Discount Bank Investment Corp.[f]			5.7	36.1
Motor House Ltd.[d]			8.5	33.0
Delek, Israel Fuel Corp.[g]	9.1	42.1	—	31.7
Bank Leumi Investment Co.[f]	8.1	36.9	8.6	31.5
Bank Leumi le-Israel[e]	7.4	47.9	38.0	31.3
Solel Boneh[d]	14.5	–3.7	0	24.8
Israel Central Trade and Investment Co.[e]	10.0	22.4	3.6	21.5
Africa-Israel Investment Ltd.[h]			0	5.0
Wolfson-Clore-Mayer[e]	0	7.9	0	1.1
Israel Land Development Co.[h]	12.1	10.4	5.2	–3.2
Tefahot, Israel Mortgage Bank[e]	11.1	41.2	0	–3.5
Share groups				
Industry and commerce				59.5
Banks, financial institutions, and insurance				11.4
Land and development				8.3
Investment companies				18.3
Fuel and oil (two shares)				14.8
Total shares		17.0		26.3
Total selected shares[i]				33.3

[a] Shares with a turnover of over IL 1 million.
[b] For the year ending February 26, 1967.
[c] Calculated according to the last dividend distributed and the price of the share on December 31, 1967, including other benefits.
[d] Industry and commerce group.
[e] Finance and insurance.
[f] Investment companies.
[g] Fuel and oil.
[h] Land and development.
[i] The arithmetic average was calculated for each group, assuming an equal investment in each share of the group.
SOURCE: Based on data of the Tel Aviv Stock Exchange.

59 percent in 1968 (see Table XIX–8). It should be recalled that during the 1964–66 stock market slump industrials tumbled more than the other groups and produced the biggest capital losses.[1] Some price increases can perhaps be attributed to the desire of investors to gain a controlling interest in the company.

Following the price rises in 1967 and 1968, some dividend yields declined,

[1] See Bank of Israel, *Annual Report 1967*, p. 533.

but the overall rate of return was considerably higher, amounting for all shares to about 26 percent, compared with 17 percent in 1967. The return on a number of shares, including some of those most heavily traded, was much higher, as may be seen from the table.

The development of prices in the industrial group left its mark on the general index. The changes during the year were not uniform as between the various groups (see Diagram XIX–1 in the appendix). The four nonindustrial groups reached their peak in March, while the investment companies and the finance and insurance group dipped to their lowest point in July, and the land and development and fuel and oil groups in December.

As already mentioned, the market is still quite small and narrow, and speculation is liable to cause sharp price fluctuations. Long-run stability depends on an increase in the number of investors, including institutional investors, which hold about 80 percent of all securities in the economy.

2. *Bonds*

Bond prices displayed less striking changes in 1968. The index of dollar-linked bonds was low from the end of 1967 through most of 1968 (see Appendix Table XIX–9), but it turned sharply upward in December 1968 owing to expectations of devaluation, a development expressed in a negative rate of return on some of these bonds.

Prices of index-linked bonds advanced in the second half of the year, reflecting expectations of a general price rise in the economy following the rapid growth of economic activity. These expectations were also reflected by a decline in the nonlinked bond index. Most of the trading in this group was in the Defense Loan, after the banks were permitted to buy this paper on the Exchange out of the 25 percent of their saving scheme funds which could be lent out in the form of directed credit. Demand on the part of the banks led to a change in the price trend of these loans. Quotations for the Defense Loan stabilized in August at a level 1–4 percent below the adjusted par value. The net yield if redemption was chosen on an unlinked basis declined from 9.5 percent at the beginning of the year to 8.5 percent; toward the end of the year prices again fell, and the yield rose to 9 percent.

In other option-type loans the Stock Exchange prices were close to the gross adjusted par values on an unlinked basis—i.e. about 11 percent. It will therefore be seen that it definitely paid to sell on the Exchange rather than cash in the bonds ahead of maturity, and also to invest for intermediate periods. At the prevailing Stock Exchange prices, the seller could obtain almost the full gross redemption amount (in any case higher than the after-tax value), and this before the early redemption date. Prices and yields on the various series of the Absorption Loan declined at the end of the year, whereas at the end of 1967 there was a rise of 1–2 percent.

5. Securities Traded in Foreign Currency[1]

(a) *Purchases of securities traded in foreign currency*

Securities traded in foreign currency and held by Israeli residents may be divided into two main categories: (a) those issued by companies or other bodies in Israel and denominated in foreign currency; and (b) foreign securities.

In 1968 the incremental securities traded in foreign currency reached $ 22 million net, compared with $ 18 million in 1967 and $ 14 million in 1966. The value of holdings actually went up by $ 57 million in 1968, but some $ 35 million of this sum stemmed from the revaluation of securities in March 1968 according to the prevailing prices (see Table XIX-9).[2]

It is estimated that purchases of foreign securities by Israeli residents totalled $ 12 million in 1968, compared with about $ 8 million in 1967.

The growth of economic activity and the improved financial position of households in 1968 led to a larger investment in securities in general, and in foreign securities in particular. The instability of the world money market and the fear of changes in exchange rates in Europe and Israel—an apprehension strengthened by the devaluation of the Israeli pound in November 1967—

Table XIX-9

FOREIGN CURRENCY SECURITIES HELD BY ISRAELI RESIDENTS, 1963-68

($ million)

End of year	Outstanding balance				Annual increment	
	Securities traded in foreign currency	Foreign securities	Revaluation[a]	Total	Gross (incl. revaluation)	Net[a] (excl. revaluation)
1963[b]	—	—	—	36.8	—	11.1
1964[b]	—	—	—	50.6	—	13.8
1965[b]	—	—	—	80.4	—	29.8
1966[c]	73.6	21.7	10.5	105.8	25.4	14.9
1967[d]	83.6	29.9	17.6	131.1	25.3	18.2[e]
1968[f]	93.7	41.9	52.6	188.2	57.1	22.1[e]

[a] Estimate. The revaluation seems to have an upward bias, particularly in view of the predominance of bonds.
[b] No data are available on the distribution of holdings.
[c] The actual distribution for February 28, 1967, the closest date for which data are available.
[d] The actual distribution for March 31, 1968.
[e] See the monthly distribution in Table XIX-10 in the appendix.
[f] *Estimate based on the actual distribution for March 31, 1968.*

[1] The data in this section are less reliable than those in the rest of the chapter as the exact breakdown between foreign securities and securities traded in foreign currency is not known, and also because there is no precise information on revaluations.

[2] The revaluation increment partly reflects the rise of prices in 1968, and partly the rise of prices in previous years, for which no revaluation had yet been made.

resulted in a heavier demand for dollar-linked assets. These were the main factors explaining the larger purchases of securities traded in foreign currency in 1968. Since the yield to maturity on dollar-linked bonds amounted to only about 4.5 percent throughout most of the year,[1] some investors (particularly those willing to take a risk) preferred to buy foreign securities (directly or through mutual funds) where the principal is also linked to the exchange rate and the yield is higher.[2] An additional advantage of foreign securities over domestic securities linked to the exchange rate lies in the possibility of selling them in dollars without a capital loss after a devaluation.[3]

The heavier demand led to the creation of new investment mediums and the expansion of existing ones. Thus a number of mutual funds were established by the large banks, and they undertook to hold a certain percentage of their portfolio in securities traded in foreign currency. These mutual funds, which in the main purchase bonds, expanded very rapidly in 1968, and as a result they bought a relatively large quantity of securities traded in foreign currency.

Moreover, purchases of participation certificates in foreign mutual funds were substantially greater than in previous years, owing partly to the more vigorous sales campaign waged by the funds. The high rates of return earned on such investments in the past have made them very attractive.[4] In the year reviewed foreign securities gained in importance as an investment outlet, and presumably their weight in investors' asset portfolios rose.[5] At the end of March 1968, about 78 percent of the securities purchased with Natad dollars were listed on the Tel Aviv Stock Exchange; most of the foreign securities were denominated in dollars.

(b) *The Natad market*[6]

The Natad[7] arrangement is designed to enable certain categories of foreign currency owners to legally offer their holdings to Israeli citizens and foreign

1 According to Central Bureau of Statistics data.

2 This is less true when a high agio is paid on Natad (investment) dollars. It should be recalled that the yield to the investor in Israel is lower than to the investor abroad, since an agio has to be paid on the Natad dollar in order to purchase foreign securities.

3 In the case of dollar-linked domestic securities, there is the apprehension that, owing to the relatively small size of the Israeli market, prices will slip as a result of any tendency to realize linkage gains after a devaluation, whereas the market for foreign securities is vastly larger.

4 The yield on one foreign mutual fund in 1968 was about 14.6 percent (without allowing for the agio paid on the Natad dollar).

5 This is not to say that foreign issuers raised more capital in Israel from households and businesses than did local issuers: most of the foreign securities were not bought at source, and furthermore, the foreign mutual funds were required to invest in Israel.

6 This section is largely based on an internal memorandum prepared by Robert Zentler, of the Bank of Israel Research Department.

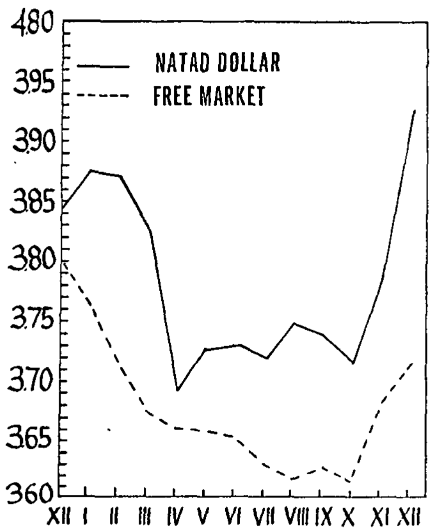
7 See Bank of Israel, *Annual Report 1967,* p. 547, and Chapter XX, p. 445 below.

nationals in exchange for Israeli pounds. The foreign currency can be held in a restricted account in Israeli banks, or used to purchase securities traded in foreign currency (listed on the Tel Aviv Stock Exchange or on foreign exchanges). Most of the Natad funds originate from the conversion of Tamam deposits. Additional sources are the resale of securities purchased in the Natad market, interest and dividends received on securities acquired with Natad dollars, and earnings from approved overseas projects. Natad dollars are not sold at the official rate of exchange, but at a price determined by supply and demand; hence they tend to display relatively sharp fluctuations. The agio is the difference between the official exchange rate and the price of the Natad dollar.

Diagram XIX-2

NATAD AND FREE-MARKET DOLLAR RATES, MONTHLY AVERAGES,[a] 1968

(IL per dollar)



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

Demand for Natad dollars originates in a number of sources, the principal ones in 1968 being institutional investors such as mutual funds, which in their by-laws have undertaken to invest part of their assets in securities traded in foreign currency, and private investors who wish to acquire securities traded in foreign currency or to invest in foreign mutual funds. There is also some demand on the part of investors in foreign projects and of foreign nationals who have invested in Israel and wish to repatriate their investment.

The agio stood at almost 11 percent in the first months of 1968, dipped sharply in March and April, and from April to October fluctuated between 7.1 and 5.6 percent. In November and December, with the growing international monetary crisis, the price of the Natad dollar jumped—it averaged 8.2 percent in November and over 12 percent in December (at the beginning of 1969 it soared to over 20 percent). The volume of transactions in the Natad market in November and December was double the average for the first ten months of 1968. It is difficult to find a clear connection between the size of the investment in securities traded in foreign currency and the agio on Natad.[1] In 1968 the agio averaged slightly lower than in 1967, standing at about 8 percent. The Natad dollar rate was higher throughout the entire year

[1] This is true of both 1967 and 1968. See the discussion in Bank of Israel, *Annual Report 1967*, p. 535.

than the free-market dollar rate (see Diagram XIX–2); this contrasts with the situation in previous years, when the free-market rate was substantially higher than that for the Natad dollar. As in 1967, there was a fairly high correlation between the Natad and the free-market rate during most months of the year reviewed, a correlation that would seem to indicate that both markets are influenced by the same variables.

Although both markets deal in foreign currency, there are differences between them. The divergence is more striking on the supply side, which is marked by a very low degree of substitution between the two, and less so on the demand side, where there may be a certain degree of substitution. The relative change in the rates for these two markets is apparently explained by two factors:

(1) Up to the devaluation of November 1967, the Ministry of Finance tended to intervene in the Natad market and influence its prices, whereas it has not done so since then.

(2) In 1967 there was an exceptionally strong demand for Natad dollars on the part of institutional investors, and in particular mutual funds. Institutional investors operate in the Natad market, a legal market in which it is possible to acquire assets yielding a foreign currency return, and not in the illegal free-dollar market, where only currency can be acquired.