

CHAPTER XIX

THE SECURITY MARKET

THE LARGE-SCALE absorption of new securities was the most striking event of the security market in 1956. New capital raised on the security market totalled IL.37.3 million, of which IL.19.7 million represented the value of securities registered at the Tel Aviv Stock Exchange during the year. These figures do not include the Defence Loan, which was floated in November 1956. The total nominal value of securities registered at the Tel Aviv Stock Exchange increased from IL.147.6 million at the end of 1955 to IL.158.4 million at the end of 1956¹, as shown in table XIX-1:

TABLE XIX-1

The Nominal Value of Securities Registered at the Tel Aviv Stock Exchange Ltd., in 1955 and 1956

	31.12.1955		31.12.1956		<i>Change in per cent</i>
	<i>IL. thousands</i>	<i>per cent</i>	<i>IL. thousands</i>	<i>per cent</i>	
Government Loans*	117,636	79.7	111,906	70.7	- 4.9
Non-Governmental Securities	29,964	20.3	46,482	29.3	+55.1
of which:					
Ordinary Shares	12,857	8.7	14,502	9.2	+12.8
Preference Shares	4,668	3.2	2,700	1.7	- 42.2
Unlinked Debentures	6,255	4.2	7,308	4.6	+16.8
Linked Debentures	6,184	4.2	21,972	13.9	+255.3
<i>Total</i>	147,600	100.0	158,388	100.0	+ 7.3

* Includes only direct Government Loans; loans of companies in which the Government is a partner and debentures guaranteed by the Government to the amount of IL. 10 million, appear under non-Governmental Securities. The amounts in this item differ from the total of Government loans cited in Chapter XX since they do not include loans in foreign currency.

SOURCE: The Tel-Aviv Stock Exchange Ltd. and calculations of the Bank of Israel.

Of the new securities issued during the year under review, 92.6 per cent. were linked debentures, amounting to 13.9 per cent (excluding Tavei Dollar) of the total volume of registered securities. Linked debentures are bound to play

¹ The net increase was IL.10.8 million. New securities registered totalled IL.19.7 million, but securities to the value of IL.9.9 million were redeemed or ceased to be registered during the year.

an even more important part on the security market in the future, once the Local Authorities Loan of IL.7.5 million (floated in 1956 but not registered) and the IL.40 million Defence Loan (floated in November 1956, of which IL.9 million had been subscribed to by the public by the end of 1956²) will have been duly registered on the stock exchange. The majority of the linked debentures issued have been guaranteed by the Government, thus raising the proportion of Government and Government-guaranteed securities to about 80 per cent of all securities registered on the stock exchange.

Whilst these new issues were being absorbed, ordinary shares of all kinds continued their downward trend at an even more striking rate than during the preceding years. The same was true, though to a lesser extent, of unlinked debentures.

1. THE SCOPE OF THE SECURITY MARKET

The considerable expansion of the security market, which began in 1955 with the issue of debentures linked to the consumers' price index or to the exchange rate of the U.S. dollar, continued during 1956 at an accelerated pace. The first issue of linked debentures to the value of IL.10 million, by the Palestine Electric Corporation Ltd., took place in the summer of 1955; additional linked debentures to the value of IL.34.5 million (excluding the Defence Loan) were floated up to the end of 1956, as shown in table XIX-2.

In spite of the large-scale issues of new securities, borne out by table XIX-2, the general scope of the security market remained restricted, its significance as an instrument for directing private savings towards the financing of investments still being limited. In the more developed countries, the security market is instrumental in encouraging savings destined to increase the share of domestic capital in the financing of investment. The limited scope of the Israel security market, however, necessarily reduces its importance as an instrument for the financing of investments and as a factor encouraging saving.

The little weight carried by the security market in Israel, both as a means of absorbing private savings and as a source of capital, is the result of a variety of factors. The public is not accustomed to investing its savings in securities. Many people, even though already economically and socially integrated, still have not built up the stock of durable goods they would wish to acquire and, in so far as they accumulate liquid savings, these are intended in advance for the purchase of such goods³—and in particular of flats.

² Sales totalled IL.29.8 million, out of which IL.5 million were purchased by the Bank of Israel and IL.15.8 million were held by the banks but not yet sold to the public.

³ During the year under review, the public spent at least IL.25 million on electric refrigerators and wireless sets, while out of the new security issues, valued at IL.37.3 million, only IL.6-7 million were bought by private persons, the remainder having been taken up by financial institutions.

TABLE XIX-2

Security Issues Registered at the Stock Exchange during 1956

<i>Company</i>	<i>Type of security</i>	<i>Amount issued</i>	<i>Amount registered at the stock exchange by 31.12.1956^a</i>
<i>New Capital</i>			
Palestine Electric Corporation Ltd.	6½% Debentures, 1958/65	6,000	4,000
Iqroth Ltd.	"	10,000	5,000
Keren Hayesod-U.J.A.	"	10,000	6,919
Rassco-Rural and Suburban Settlement Company, Ltd.	"	1,000	1,000
Local Authorities	6½% Debentures (Bearer)	7,500 ^b	
'Delek', Israel Fuel Corp. Ltd.	"C" Ordinary Shares	318	318
Jordan Exploration Company Ltd.	Ordinary Shares (Reg.)	894	894
P.E.C. Investment Corp. Ltd.	"B" Ordinary Shares (Reg.)	107	107
'Isras'—Israel-Rassco Investment Company, Ltd.	8% Convertible Debentures, 1960/67 (Bearer)	250	250
Bank Leumi Le-Israel Ltd.	Bearer Savings Certificates (redeemable 1.7.1959)	1,197	1,197
<i>Total—New Capital</i>		37,266	19,685
<i>Bonus Shares</i>			
Ata Textile Co. Ltd.	Deferred Shares (Reg.)	234	234
Kurdaneh Textile Works, Ltd.	"C" Ordinary Shares (Reg.)	99	99
Gazit Israel Investment Co. Ltd.	Ordinary Shares (Reg.)	20	20
<i>Total—Bonus Shares</i>		353	353
<i>Substitution</i>			
3% Government Loan (Date of Redemption 30.9.61) in place of 3% Government Loan (Date of Redemption 30.9.56)		6,500	6,500
<i>Total—New Securities</i>		44,119	26,538

^a Bearer Debentures only are now registered at the Tel Aviv Stock Exchange. Debentures registered in the name of the holder represented a considerable proportion of the new issues.

^b Had not been registered on the stock exchange by the end of the year.

SOURCE: The Tel Aviv Stock Exchange Ltd.

Inflationary pressure, which has been continuous since World War II, although with varying intensity, caused a decline not only in the value of debentures, but also—owing to reasons outlined below—in the value of shares. This impeded the expansion of the security market. Moreover, the level of

personal savings is in any case low, if compulsory saving and contractual saving are not taken into account.

Two essential factors should be mentioned in order to explain the limited importance of the Israel security market. First, the inflow of capital from abroad contributed to an increasingly expanded volume of investment capital available to the Government. Enterprises are thereby provided with an alternative possibility of financing their investments, which is in many respects more convenient to the individual undertaking than the raising of capital through the issue of securities.

Secondly, the Israel economy is to a great extent composed of small and medium-sized enterprises which, because of their very structure, do not call upon the security market to finance their investments. In correspondence with this structure, the overwhelming majority of industrial enterprises choose a form of legal association which does not authorize the raising of capital through the security market. The industrial census of 1951 covered 20,000 industrial undertakings out of which only 60 were public companies⁴ with limited liability, the remainder being private businesses, partnerships, co-operatives and private companies.

Moreover, even public companies do not resort very much to the security market for the raising of capital, as the requisite capital is obtained either directly from non-government financial institutions, or through Government loans out of the Development Budget. There are of course enterprises which, from the aspect of legal association and financial scope, are in a position to turn to the security market; however, more often than not both the founders and the economic activity they are engaged in are new to Israel. Their business prospects are as yet unknown to the general public and potential investors are consequently inclined to regard this type of investment as hazardous.

At the end of 1956 the number of companies without sizeable Government or public participation which issued securities quoted on the Tel Aviv Stock Exchange did not exceed 22, seven of these being financial or investment companies.

Table XIX-3 gives the breakdown of the remaining 15 companies by economic sectors.

The nominal value of the various types of securities issued by these companies therefore amounted to 6.4 per cent of the total nominal value of all securities registered at the stock exchange by the end of 1956.

The capital raised through the security market was insignificant, as compared both with the total capital invested in the different economic sectors (mainly by enterprises which did not call upon the security market) and with total capital investments made by the companies listed in table XIX-3.

⁴ Israel Company law covers two types of limited companies: Private Companies Ltd. and Public Companies Ltd. Only the latter are authorized to sell their securities to the general public.

TABLE XIX-3

Private Corporations^a—Other than Financial Institutions—which Issued Securities Registered at the Stock Exchange, End of 1956
(by Economic Sectors)

<i>Sector</i>	<i>Number of companies</i>	<i>Nominal value of securities registered at the stock exchange (in IL.thous.)</i>
Manufacturing Industry	9	7,974
Minerals and Mining	1	894
Transport and Communications	1	32
Commerce	3	847
Settlement, Housing and Construction	1	355
All Sectors	15	10,102

^a Corporations in which the Government or the national institutions do not own a controlling interest. Companies belonging to "Hevrat Ha-ovdim" are therefore excluded from this definition. It is sometimes awkward to say precisely what a controlling interest is where the Government or the national institutions are concerned, as the capital of certain companies consists to a large extent of Government loans. For the present purpose, such companies are included under "Private Corporations", the criteria being the part of the share capital held by the Government or the national institutions.

SOURCE: Stock Exchange publications.

2. STOCK EXCHANGE OPERATIONS AND TURNOVER

Because of the limited scope of the security market, the turnover of securities on the Tel Aviv Stock Exchange is small; it amounted to IL.7.7 million in 1956. This amount is, however, not entirely representative of the total volume of transactions in quoted securities registered on the stock exchange. The Tel Aviv Stock Exchange deals, in effect, only with balances of securities transacted by its members in the form of a daily clearing of supply and demand. Part of the sale and purchase orders accepted by stock exchange members are carried out by offsetting customers' purchases against their respective sales. Each member operates therefore as an independent clearing house. Such "internal" transactions too are effected at a uniform price fixed by the stock exchange for the day. The limited turnover on the one hand, and the restricted number of stock exchange members on the other, lend the Tel Aviv Stock Exchange some of the attributes of an oligopolistic market. On this market, any relatively large buyer or seller can assume that his transaction is likely to affect the price of most of the securities quoted; he is, however, unable to achieve a purposeful manipulation. The effect upon the individual holder of securities is therefore that the liquidity of such investments is inferior to that prevailing on larger markets having more participants and dealing with a greater number of transactions.

3. ORDINARY SHARES

(a) *The Prices of Ordinary Shares*

The most striking development in the price structure of securities during the year under review was a further steep decline in the prices of ordinary shares, which in certain cases exceeded 30 per cent.

These price movements are reflected by the index of security prices calculated by the Central Bureau of Statistics and reproduced in table XIX-4.

TABLE XIX-4
Index of Security Prices, End of Month, 1956
(Average 1950=100)

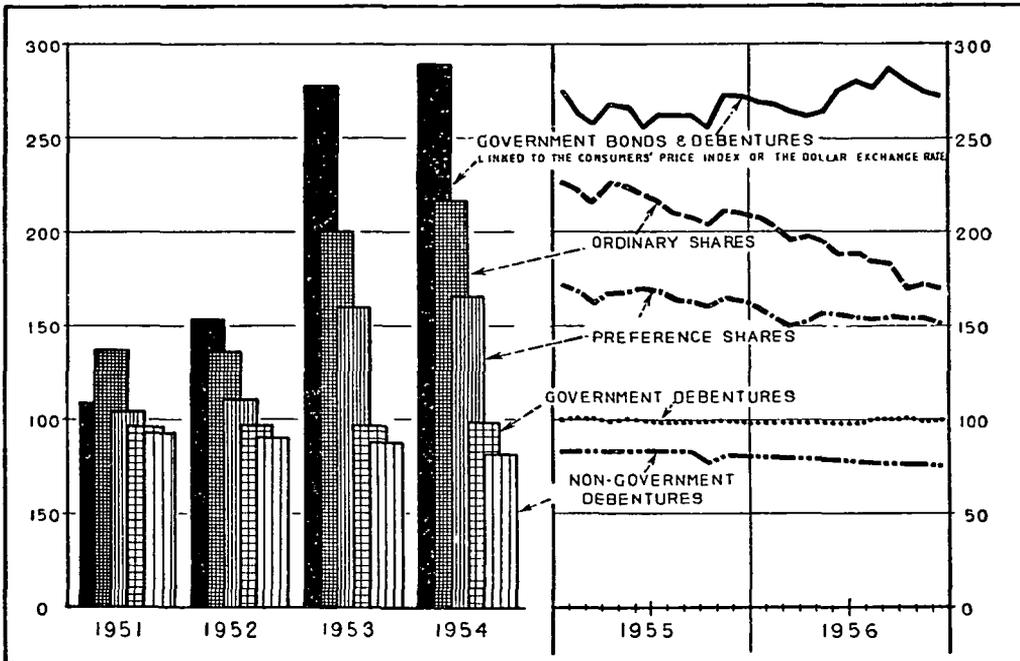
<i>Year and Month</i>	<i>Government loans and debentures linked to C-o-L index or to foreign currency</i>	<i>Other Government loans</i>	<i>Unlinked debentures</i>	<i>Preference shares</i>	<i>Ordinary shares</i>
1954—Average	289.3	98.7	86.9	170.8	227.4
1955—Average	265.3	99.6	82.0	166.3	217.6
1956 January	270.0	99.0	80.0	159.8	209.2
February	268.1	99.4	79.7	155.0	204.3
March	263.9	99.6	79.4	150.1	196.7
April	262.4	98.9	79.2	152.6	198.5
May	264.1	98.9	78.6	156.9	195.5
June	277.5	98.7	78.2	156.0	189.2
July	280.9	98.8	77.4	154.4	189.4
August	278.1	100.3	77.1	153.9	185.2
September	289.6	100.3	76.6	155.5	183.9
October	281.9	100.8	76.1	154.5	190.7
November	276.6	99.9	76.0	155.6	172.3
December	273.6	100.1	75.2	151.8	170.6

SOURCE: The Central Bureau of Statistics.

Table XIX-4 shows a decline of 18.5 per cent in the price of ordinary shares between January and December 1956. The index of security prices, being weighted by the value of the different share issues, is therefore only slightly influenced by the price fluctuations of shares issued to a smaller amount, in spite of the fact that their turnover may be considerable. Another index (see table XIX-5) weighted by the turnover of securities on the stock exchange in 1956 has been calculated by the Bank of Israel⁵; it shows a decline of 22 per cent between January and December 1956.

⁵ Shares have been weighted by the average monthly turnover on the stock exchange during 1956. Prices are the average of the highest and lowest quotation for each month.

DIAGRAM XIX-1
Index of Security Prices, 1951-1956
 (Average 1950=100)



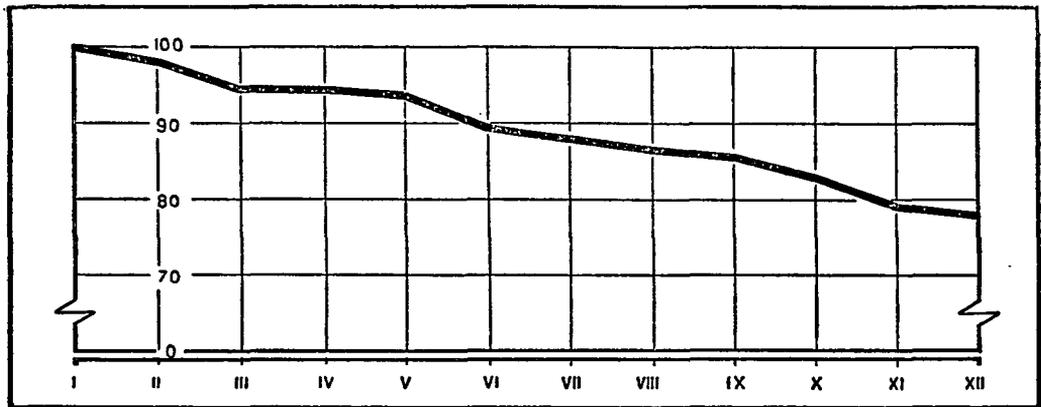
SOURCE: Table XIX-4.

TABLE XIX-5
Index of Ordinary Share Price, 1956
 (Monthly average prices)

January	100.0
February	98.0
March	94.5
April	94.5
May	93.9
June	89.2
July	87.9
August	86.5
September	85.7
October	82.1
November	78.9
December	78.0

SOURCE: Calculations of the Bank of Israel

DIAGRAM XIX-2
Price Index of Ordinary Shares, 1956
(January 1956=100)



SOURCE: Table XIX-5

The fall in the prices of ordinary shares was general and continuous throughout the year, but it was not uniform as far as the different types of ordinary shares were concerned. This is borne out by table XIX-6. Shares of investment companies fell by 10.8 per cent on the average⁶, whereas industrial shares declined by 26 per cent.

(b) The Causes of the Decline in the Price of Ordinary Shares

Several factors contributed to the considerable decline in the price of ordinary shares, affecting the development of their prices in different ways.

One of the principal factors intensifying the general downward trend was the large-scale issue of linked debentures towards the end of 1955. Once on the security market, these debentures became a competitive form of investment. For various reasons, ordinary shares of Israel undertakings have not proved to be a type of investment providing safeguards against depreciation arising out of inflation. The new debentures, linked either to the consumers' price index or to the dollar exchange rate were considered by part of the investing public as an effective protection against the gradual decline of the value of savings caused by the rising price level, (which—if moderate in comparison with the preceding years—was nevertheless continuous). At the same time, the link to the exchange rate provided a safeguard against devaluation. Faced by the decline in the prices of ordinary shares—which had begun in 1952—part of the investors converted their ordinary shares into linked debentures. Apart from being linked, the new securities carried other provisions which made it difficult for ordinary

⁶ Unweighted average of share prices.

TABLE XIX-6
Quotations of Ordinary Shares, End of Month, 1956
(End of 1954=100)

<i>Shares</i>	<i>1954</i>	<i>1955</i>	<i>1956</i>	<i>Feb.</i>	<i>Mar.</i>	<i>Apr.</i>	<i>May</i>	<i>Jun.</i>	<i>Jul.</i>	<i>Aug.</i>	<i>Sep.</i>	<i>Oct.</i>	<i>Nov.</i>	<i>Dec.</i>	<i>Change in per cent at end of 1956 as against end of 1955</i>
	<i>Dec.</i>	<i>Dec.</i>	<i>Jan.</i>												
<i>Financial Institutions and Investment Companies</i>															
Bank Leumi Le'Israel Ltd., Ord. Shares	100.0	93.0	86.6	82.7	78.7 ^a	77.4	74.4	70.3	68.5	65.0	64.8	57.5	58.7	58.7	-36.9
A.P.B. Investments Co., "B" Ord. Shares	100.0	93.9	93.9	95.2	88.4 ^a	88.4	89.0	89.0	89.2	89.4	89.4	89.0	89.2	89.2	- 5.0
Gazit Investment Co. Ltd., Ord. Shares	100.0	94.4	94.6	94.9	88.8 ^a	89.0	89.3	88.6	88.3	87.9	88.6	88.6	88.3	88.8	- 5.9
Ellern Investment Co. Ltd., Ord. Shares	100.0	98.1	98.1	95.4	95.1	94.8	93.5	93.2	93.2	93.2	93.8	93.8	93.8	88.9	- 9.4
P.E.C. Investment Co. Ltd., Ord. Shares	100.0	95.6	92.0	92.5	92.5	93.7	93.7	93.7	93.4	92.7	93.0	92.3	91.3	90.4	- 5.4
Africa-Palestine Investment Co.Ord. Shares	100.0	78.3	74.1	74.3	73.1	70.2	67.5	66.8	66.1	60.5	61.7	57.0	57.5	57.0	-27.2
<i>Industrials</i>															
Palestine Potash Co. Ltd., "B" Ord. Shares	100.0	81.0	74.5	68.0	60.5	65.4	63.1	53.6	54.4	54.2	52.9	50.0	52.3	51.8	-36.0
Ata Textile Co. Ltd., "B" Ord. Shares	100.0	88.7	83.7 ^a	82.5	80.5	81.3	79.9	76.1	76.3	75.6	74.2	62.9 ^a	66.7	65.1	-26.6
Ata Textile Co. Ltd., Deferred Shares	—	100.0	94.6 ^a	94.1	92.0	90.8	87.5	85.6	83.8	80.9	78.1	65.2 ^a	66.8	63.1	-36.9
Kurdaneh Textile Works Ltd. "B" Ord. Shares	100.0	87.5	83.9 ^a	81.7	79.5	80.1	78.3	73.5	74.5	72.6	71.7	61.6 ^a	64.7	62.5	-28.6
Moller Textile Corp., Ord. Shares	100.0	105.9	104.6	102.5	95.4	97.1	98.7	97.9	97.1	99.2	98.3	95.4	90.8	92.9	-12.3
Assis & Bejerano Bros. Ltd., Ord. Shares	100.0	87.5	86.9	85.8	82.8	81.9	80.9	81.9	84.1	80.5	73.1 ^a	66.0	62.5	62.5	-28.6
Teva Ltd., Ord. Shares	100.0	97.9	87.8	89.3	89.3	88.2	88.7	88.0	86.8	86.1	85.3	80.3	83.6	81.2	-17.1
<i>Other Shares</i>															
Palestine Land Devt. Co. Ltd., Ord. (bearer)	100.0	85.0	80.6	76.5	75.1	76.9	75.7	75.8	73.2	67.9	69.0	64.9	60.5	58.6	-31.1
Palestine Land Devt. Co. Ltd., Ord. (reg.)	100.0	84.7	80.5	75.8	74.8	76.0	75.3	72.1	73.2	67.0	68.6	64.3	60.0	57.9	-31.6
Pal.Cold Storage&Supply Co.Ltd.,Ord.Shares	100.0	102.3	107.5	100.9	96.0	99.3	95.8	92.7	92.5	91.8	88.6	75.1	77.9	77.9	-23.9

^a Ex dividend.

SOURCE: The Tel Aviv Stock Exchange Ltd., and calculations of the Bank of Israel.

shares to compete with them, such as the exemption from declaring holdings to the income tax authorities, a 25 per cent income tax ceiling and a Government guarantee. These provisions, and in particular the lower rate of income tax, made the linked debentures considerably more attractive than ordinary shares to investors on the security market.

It is generally accepted that ordinary shares (as opposed to debentures, which are assets with a fixed nominal value) constitute investments well protected against depreciation arising out of inflation, and particularly against large-scale inflationary pressures. This view is based on the assumption that the ordinary share represents real assets, the current value of which tends to rise when the purchasing power of money falls. The ordinary investor does not, of course, envisage a realization of the physical assets represented by the share; he is inclined to assume that the profits of the company in which he has invested his money will not lag behind the general rise of the price level over a long period and, that an increase of the company's assets due to new investments is effected with a view to greater profits in the future. The investor, therefore, expects higher company profits to lead to an increase in his income, which will be parallel to the rise of the general price level. In so far as these assumptions materialize, the prices of shares can be expected to rise up to the point when current income therefrom will more or less correspond to the interest rates prevailing in the economy.

During the past few years, however, these assumptions did not prove to be justified as regards ordinary shares in Israel. Whereas interest rates continued their steady upward trend, nominal dividends distributed to shareholders remained virtually unchanged throughout this period. The desire of enterprises to keep, as far as possible, their accumulated liquid assets, and the fact that no capital gains tax is levied on securities in Israel, led to the distribution of dividends in the form of bonus shares. This, in turn, increased the supply of shares in the market, an additional factor depressing the prices of shares. The influence of this factor was strengthened by the fact that inflationary pressure, in so far as reflected by rising price levels, was gradually reduced during these years; investors therefore attributed growing importance to the rate of current income derived from their investments rather than to the safeguarding of the original investment value.

(c) *The Decline in Real Current Income from Shares*

Real income from investments in shares shrank considerably during recent years. Table XIX-7 shows nominal and real income during 1952-1955⁷ from an investment of IL.100 in various ordinary shares; for the purpose of these calculations, it has been assumed that the shares had been bought at the lowest price prevailing in 1952. According to this table, nominal current income from

⁷ Data for dividends distributed during 1956 have so far not been available. It seems, however, that the general trend remained unchanged.

an investment in ordinary shares averaged 7.8 per cent per annum in 1955. This rate of income was lower than that obtainable from other unlinked investments. Thus, for example, the earnings yield⁸ on unlinked debentures, according to the rates prevailing at the end of 1956, often exceeded 12 per cent per annum.

The issue of linked debentures began in the middle of 1955; part of the investing public considered them an effective protection against the loss in value afforded by the alternative of linking them to the consumers' price index or to the dollar exchange rate. While the linked debentures carried interest of 6½ per cent per annum—this interest being linked as well—the market adjusted the price of unlinked debentures to a level which safeguarded an earnings yield of about 12 per cent per annum. Ordinary shares, which normally carry a certain risk and are therefore expected to yield a higher rate of income than debentures, were unable to compete against this alternative form of investment. The gap thus created on the security market between the income from shares and the income from debentures was therefore too wide to prevent an increasing supply of ordinary shares being offered for sale.

The steady decline in real current income from investments in ordinary shares (the price of shares began its downward trend as far back as 1952 and

⁸ A distinction should be made between current income (dividend yield or interest yield) and earnings yield; the latter includes not only current payments on account of interest or dividends but also the gain resulting from appreciation of the security. Income from debentures consists therefore of two parts: 1. Current revenue received periodically against the surrender of interest coupons; 2. The difference between the purchase price of the debenture and its nominal value which is the amount payable upon redemption. This difference is tantamount to the payment of cumulative interest. This is not considered as current income but as a capital gain; but as no capital gains tax is levied on securities in Israel it is therefore tax-free. For example, a debenture with a nominal value of IL.100 carrying interest at the nominal rate of 4 per cent per annum, which is purchased at 74¾, will yield (after deduction of income tax at the rate of 25 per cent) an annual current income of 4.01 per cent. Supposing the debenture is to be redeemed within five years, its redemption yield will amount to 5.99 per cent per annum (calculated on the basis of compound interest). The yield to maturity thus totals 10 per cent per annum. Assuming a stable rate of interest of 10 per cent, the relations between prices, current yield and redemption yield on the stock exchange will be, according to the redemption period, as follows:

Nominal interest, after deduction of tax=3 per cent.

<i>Years until redemption</i>	<i>Price</i>	<i>Current income (in per cent)</i>	<i>Redemption yield (in per cent)</i>	<i>Yield to maturity (in per cent)</i>
5	74¾	4.01	5.99	10.0
4	78⅞	3.82	6.18	10.0
3	83	3.61	6.39	10.0
2	88	3.41	6.59	10.0
1	93⅞	3.20	6.80	10.0
4 months	98	3.06	6.94	10.0

TABLE XIX-7

Nominal and Real Income in IL. from Dividends^a of an Investment of IL.100 in Various Ordinary Shares, purchased at the Lowest Prices current in 1952

Shares	1952	1953		1954		1955	
		Nominal income	Real income	Nominal income	Real income	Nominal income	Real income
A.P.B. Investment Company Ltd.							
Ordinary "B" Shares	7.273	7.273	5.682	8.182	5.682	9.091	5.981
Ent. of Assis and Bejerano Bros., Ltd.							
Ordinary "B" Shares	8.348	8.348	6.522	8.746	6.074	8.746	5.754
Ata Textile Co. Ltd. "B" Ord. Shares	9.854	10.202	7.970	7.874	5.468	7.602	5.001
Capital bonus ^b	(16.759)	(10.552)	(8.244)	(7.915)	(5.497)		
Kurdaneh Textile Works Ltd.							
Ordinary "B" Shares	7.692	7.692	6.009	7.692	5.342	7.575	4.984
Capital bonus ^b	(16.403)	(14.253)	(11.135)	(9.605)	(6.670)		
Teva Pharmaceutical and Chemical Works Ltd.							
Ordinary Shares	9.950	9.950	7.773	11.940	8.292	9.950	6.546
Africa-Palestine Investment Co., Ltd.							
Ordinary Shares	6.075	6.405	5.004	—	—	5.385	3.543
Bank Leumi Le-Israel Ltd. Ord. Shares	7.368	6.579	5.140	6.579	4.568	6.579	4.328
Capital bonus ^b	(42.807)	(33.289)	(26.007)				

^a The nominal income has been calculated before deduction of income tax. As regards bonus shares, income has been computed on the assumption that they were sold at the lowest price of the shares during the year in which they were issued (i.e. the year subsequent to that for which they were distributed), after adding the income tax deduction at the rate of 26.875 per cent. The real income has been computed in accordance with the average level of the consumers' price index during each year (1952=100).

^b The table shows only income from dividends. Figures of income from bonuses have also been quoted, whenever such bonuses were given following a revaluation.

SOURCE: The Official Yearbook of the Tel Aviv Stock Exchange Ltd. 1955/56, and Calculations of the Bank of Israel.

became especially pronounced during the second half of 1954) was thus further intensified by the advent of an alternative form of investment. The fall in share prices (the primary reason being, as has already been pointed out, the low level of current income as compared with income from other investments), unchecked by expectations of future improvement, added a considerable capital loss to the decline of current real income. Thus, ordinary shares ceased to be considered as a protection against the depreciation of investments. Indeed, many investors who had purchased ordinary shares a few years ago suffered considerable losses as a result of the very extensive decline in the value of their investments.

(d) *The Limited Voting Power of Ordinary Shares*

Contrary to accepted practice in most countries, great differences exist in Israel with regard to the rights assigned to various shares. The right to participate in profits is generally equal for all shares. Voting rights, however, are in the great majority of undertakings reserved to a small percentage of paid-up shares. This advantage is guaranteed in various ways—such as the issue of “Founders’ Shares,” “Directors’ Shares,” “Special Shares” and similar shares, the priority right of which to influence the business policy of the undertaking is *ab initio* embodied in the company’s statutes, or through the issue of shares of different denominations so that each share, regardless of its nominal value, has equal voting rights. This procedure is customary not only in the case of undertakings or companies founded by public bodies or national institutions, where it may be in the public interest that full control should remain vested in the institution concerned, but also in the case of privately-owned companies. In most instances, the founders of these companies have the majority of voting rights in spite of the fact that their share of the total capital is disproportionately small, while most of the paid-up capital is denied the possibility adequately to influence the management of the firm. In certain cases, shares carrying voting rights are not even quoted on the stock exchange, either because they are not registered there, or because, being closely held by a restricted group of investors, they do not reach the market. These differences in the rights of various kinds of shares leave the sole control of business policy—including dividend policy—in the hands of company directors, who represent such share-holders as possess voting rights.

The companies’ dividend policy, which is the main factor influencing the price of shares on the security market, is largely influenced by the present income tax law, which—for the purpose of calculating depreciation—recognizes only the historical value of the companies’ assets; nor does it permit the free apportioning of depreciation deductions but divides them into equal, pre-determined parts. This is tantamount to the imposition of a capital tax. Depreciation, which is not calculated on the basis of the real replacement value of equipment, is likely to compel companies to keep a larger proportion of their

liquid assets for allocation to various funds and not to distribute them as dividends to shareholders. This tendency will become more pronounced as long as the general level of prices continues to rise, and consequently allowed amortization is proportionally smaller than real depreciation.

Enterprises and companies whose shares are quoted on the Tel Aviv Stock Exchange expanded their business and the volume of their investments during the very years when the price of their shares was falling. In spite of the fact that these additional investments had not yet resulted in the distribution of higher dividends, investors were inclined to assume that the additional capital would yield—at least after a certain lapse of time—profits which would be distributed to them in the form of increased income. This prospect, though it has failed to materialize over a period of several years, could have checked the decline in share prices to a certain extent. However, its effect was defeated by the knowledge of most shareholders (representing the large majority of paid-up capital) that they were unable to influence the business policy of those companies in which they had invested. They were thus not inclined to believe that the income from their investments was likely to be higher in the future. The absence of voting rights has therefore become yet another factor which can affect the price of shares autonomously, even though it should usually be considered in conjunction with developments relating to the rates of current income.

The influence of the differences in voting rights, attached to the various types of shares, can be explained by the contrast in the moderate decline of the price of investment company shares and that of ordinary shares. Investment in the shares of an investment company is from the outset characterized by the assumption that the investor is not interested in influencing the business policy of any specific firm. His main interest is to spread the risk and to have the greatest possible security; that is why he is prepared to accept a relatively low, but safer rate of current income. This is the reason why real income from investment company shares, although decreasing, was not affected to the same extent as that of ordinary shares⁹. Only an extraordinary decline in current income from investment company shares could bring about a fall in their price similar to that of other ordinary shares.

An additional factor causing the decline in the price of shares is the fact that all ordinary shares (except for the shares of the General Mortgage Bank of Palestine Ltd. and of the Israel Land Development Co. Ltd.) in Israel are

⁹ It is not unlikely that the relative stability in the price of investment company shares is due to the fact that they are being supported by purchases of the companies themselves; furthermore a large percentage of their assets is in the form of loans guaranteed by the Government, while a sizeable proportion is invested in securities which on the companies' balance sheets have been valued at less than their market price. It is obvious that such assets are easier to realize than physical assets, and for this reason these companies presumably enjoy greater confidence among investors.

registered in the name of the holder and not made out to bearer. The transfer of such shares is cumbersome; it involves the payment of registration fees, and their liquidity is therefore reduced. Moreover, the knowledge that his capital is registered constitutes a deterring factor for the investor, since he may fear that registration will make it possible to levy taxes on his property; registration of the capital also compels him to declare the income to the tax authorities.

Apart from the long-term factors enumerated above, share prices were also influenced during 1956 by temporary phenomena, such as the unstable political situation and the labour conflict in the textile industry, which having begun during the first half of 1956 was not finally settled until the end of the year. This conflict influenced principally industrial shares. It should also be recalled that the Defence Tax (11.5% of income), introduced towards the end of 1956, contributed to a further reduction of current income from shares; while interest on linked debentures, which were anyhow strongly competing with shares, was exempted from this tax.

These developments are of considerable importance as far as future possibilities of raising capital through the issue of shares are concerned. The value of shares at present market prices is far below that of the companies' active capital; this is the result of the various factors which contributed to the decline in the price of shares, on the one hand, and the considerable expansion of enterprises with the help of other financing means, on the other hand. New capital to be raised through the issue of shares would therefore be required to pay dividends which will be able to compete with incomes that are yielded by the purchase of existing low-price shares. However, payments made by companies for the use of capital are considerably lower than the rate of income obtained through the purchase of existing shares, in view of the fact that loans constitute a large proportion of this capital. Interest on loans is considered as expenditure for the purpose of calculating profits liable for income tax. This is not the case with dividends—even though from the company's point of view there is no distinction between the payment of dividends and that of interest. New capital raised by floating shares will therefore have to yield higher profits than those derived from the active capital of existing companies. Higher taxes on company profits and dividends have strengthened the downward trend of the price of existing shares, thus widening the gap between the rate of profit yielded by existing capital and that which would be required from new share capital. One of the likely consequences may therefore be an even greater reliance on loans—particularly from the Development Budget, be it for the financing of new investments or for working capital.

4. UNLINKED DEBENTURES

The decline in the price of unlinked debentures was relatively small during 1956. The average price (after deduction of accrued interest, which is in-

cluded in the nominal stock exchange quotations) fell from 82 at the end of 1955 to $77\frac{3}{4}$ at the end of 1956. It should be taken into account, however, that the real decline is greater than would appear from a comparison of nominal prices, since quotations include redemption yields, and the prices of debentures generally rise as their date of maturity approaches.

With the issue of linked debentures there appeared, as already stated, a new form of investment which competed with ordinary shares. In point of fact, linked debentures competed with ordinary debentures; this competition, however, did not cause a further substantial fall in prices as was the case for ordinary shares last year, since the majority of debentures had already reached a level below which their redemption by companies would have been worth while. The more or less steady decline in the price of unlinked debentures during recent years (see table XIX-4) is due to the continuously rising rate of interest. Contrary to shares, which fell because of the non-realisation of the expectation that the value of investments would remain stable despite inflationary developments, debentures were not influenced by such factors. These were rather insignificant where liabilities fixed and known several years ahead were concerned. The consequences of the competition between linked and unlinked debentures will make themselves more fully felt in the future. No new issues of unlinked debentures are to be expected, unless they carry special provisions, such as the right to convert them into shares or a rate of interest considerably higher than that of linked debentures.

An analysis of the different types of debentures shows that the permanent and temporary factors which influenced the development of share prices, also seem to have affected debentures issued by industrial and commercial companies. Therefore, the decline in the price of industrial and commercial debentures was considerably steeper than that of debentures issued by public or financial institutions. The average price of debentures of five industrial or commercial companies which was $101\frac{1}{2}$ at the end of 1955 fell to 86 towards the end of the following year.

Current income from debentures generally fluctuated around 6 per cent per annum, the average income from 32 debentures being 5.9 per cent at the end of 1956, as against 5.8 per cent at the end of 1955—an increase which reflects the fall in the price of debentures during the year. Such current income was supplemented by redemption yields which vary according to the security concerned and are determined by the date and terms of redemption, as well as by the market price of the debenture, which in turn is fixed by factors having no direct bearing on the rate of interest.

A considerable percentage of debentures have been purchased and kept by institutions out of non-profit-seeking considerations; these purchases and sales are neither decisively affected by stock exchange quotations, nor by changes in the interest rate. Indeed, nominal stock exchange prices do not always correspond to the price at which such transactions have actually been made; they are only

buyers' or sellers' prices. One can therefore hardly assume the existence of a close relationship between the prevailing general rate of interest and the prices of these debentures. The yield to maturity at any given price can therefore not be regarded as a precise indicator of the general rate of interest. Generally speaking it may be said that the annual yield to maturity from debentures (including redemption yield, grossed-up to an income tax rate of 25 per cent) did not exceed 10 or 12 per cent. Table XIX-8 shows prices of various debentures as well as the annual income received therefrom, according to quotations at the end of 1956.

Preference shares followed the same trend as unlinked debentures. As shown in table XIX-4, their prices fell by about 5 per cent during the year under review. The importance of this type of security has been steadily decreasing and, at the end of 1956, the outstanding balance of preference shares on the market did not exceed IL.1.7 million.

5. DEBENTURES LINKED TO THE CONSUMERS' PRICE INDEX OR TO THE RATE OF EXCHANGE OF FOREIGN CURRENCY

The large-scale issue of debentures linked to the consumers' price index or to the rate of exchange of the U.S. dollar was, as already pointed out, the outstanding event of the security market during 1956. The linking of financial assets to the rate of exchange of foreign currency, in order to protect the value of such assets against the decreasing purchasing power of local currency, is a customary procedure among investors in countries where no foreign exchange controls exist. Investors are, however, to a certain extent, prevented from protecting their investments in this way where the holding and sale of foreign securities is not allowed by foreign currency control. Indeed, most of the debentures linked to the U.S. dollar which have been issued since the establishment of the State until 1955—and in particular the Tavai Dollar issued to the amount of \$25 million—were a direct equivalent of foreign securities, which holders had to sell to the Treasury under foreign exchange regulations.

Quotations of these debentures were low owing to their low nominal interest which lagged behind the general rate of interest and also, because with the introduction in 1951 of multiple exchange rates, interest on debentures was paid at the lowest official rate. When, in 1953, the Supreme Court laid down that both the principal and interest on linked debentures must be paid according to the highest official rate of exchange of the dollar, prices of these securities began to rise. However, during 1954 and 1955, the stability of Israel currency increased as the rise of the price level was slowed down and, with the progress of this trend, investors began to give less consideration to the safeguarding of the value of their principal which formerly had been of decisive importance. Attention was now being directed towards the rate of current income; however, the rate of interest paid on linked debentures lagged behind

TABLE XIX-8

Current Income, Redemption Yield^a and Yield to Maturity of Various Unlinked Debentures, based on Quotations at the End of 1956^b

	Amount in circulation, end of 1956 (in IL.)	31.12.55	31.3.56	30.6.56	30.9.56	31.12.56	Current Redemption Yield to		
							income	yield	maturity
							(in per cent)		
A.P.B. Investment Co. Ltd.									
4½-6%, Debs. 1957/71	142,000	73½	72½	73½	73	74	6.08	2.72	8.80
Gen. Mortgage Bank of Palestine,									
4% Debs. 1948/63	151,750	66¾	66½	67½	67¼	67	5.97	8.47	14.44
4% Debs. 1955/70	136,670	60½	60½	59¾	59¼	59	6.78	5.31	12.09
Bizur Ltd.									
4% Debs. 1946/58	11,670	94¼	92½	91¾	90	92¾	4.31	10.43	14.74
4½% Debs. 1952/66	145,950	91¾	93⅞	91¼	89⅞	88½	5.08	1.83	6.91
Nir Ltd.									
4% Debs. 1939/59	26,820	92½	92	91	87¾	82	4.88	9.12	14.00
Pasa Palestine Agric. Settlement Assn. Ltd.									
4% Debs. 1942/62	50,000	82¾	83	84	83¼	81½	4.91	5.05	9.96
4% Debs. 1950/70	146,960	76½	76¾	78	79¾	78	5.13	2.44	7.57
Inva Investment Corp. of Israel Ltd.									
5% Debs. 1951/62	4,100	84	82¾	81¾	81	81	6.17	4.90	11.07
Israel Land Development Co. Ltd.									
5% Debs. 1956/66	219,150	83¼	83⅞	85½	85	78	6.41	3.67	10.08
Rassco, Rural and Suburban Settlement Co. Ltd.									
4% Debs. 1947/61	3,000	90¾	92¾	92	91¼	92½	4.32	2.64	6.96
Ata Textile Co. Ltd.									
6-8% Debs. 1956/67	459,000	92	91¼	89½	83½	84	7.14	2.35	9.49
Kurdaneh Textile Co. Ltd.									
7% Debs. 1959/68	586,700	95¼	90	87	81¾	75¼	9.30	3.20	12.50
Palestine Breweries Ltd.									
8% Debs. 1959/64	509,550	83½	79¼	72¾	72¼	67¾	11.81	5.33	17.14
Pal. Central Trade & Investment Co. Ltd. 8% Debs. 1953/57	55,650	95	96¼	94	96¼	94	8.51	8.41	16.92

^a Income from redemption yield grossed-up on the basis of an income tax deduction at the rate of 25 per cent.

the general rate of interest of the economy, which exceeded by far the 3 or 3½% per annum paid for long-term investments. The interest paid on loans to industry out of the Development Budget, for example, which is usually lower than that charged by other lenders, had gradually risen from 5 to 6 per cent in 1953, to 7–8 per cent in 1955 and 1956. Moreover, during the past two years a linking provision has been introduced into the terms of the Development Budget loans, which is tantamount to an additional increase of the interest rate for such loans as do not contain a linking clause.

As long as the moderate rise of the price level is expected to continue, it can be assumed that the rate of interest will include, in addition to real interest, a certain compensation for anticipated losses in the value of the principal (see "Purchasing Power Guaranteed Securities in Israel," Bank of Israel Bulletin No. 3, July 1956). Debentures floated during the years 1951–1955 did not, upon their issue, provide such compensation in addition to the actual higher rate of interest in accordance with the general trend in the economy. As has already been pointed out in connection with developments relating to the price of shares, the market reacted by a decline in security quotations up to the point when their yield became closer to the anticipated rate of interest.

The main innovation from the stock exchange angle was that with the issue of linked debentures the higher rate of interest, prevailing so far in the economy, was practically introduced to the security market by the borrowers. Before the floating of linked debentures, an interest rate of 6½ per cent was obtained only by those investors who purchased debentures at prices far below their nominal value. This interest rate was, however, obtained at the expense of the loss of principal incurred by previous investors, and not through higher payments made by borrowers for the use of capital. At the same time, the new issues provided the lenders with two alternative ways of protecting the value of their principal: a link to the consumers' price index, or a link to the exchange rate of the dollar. This made the new debentures more attractive to a wide circle of investors having different expectations.

The additional advantages attached to these debentures—such as the Government guarantee, the relatively short maturity period (9–10 years) as compared with other debentures, the exemption from the obligation to declare such investments to the income tax authorities, and the 25 per cent ceiling of income tax deductions at the source—contributed to their success. The nominal value of linked debentures issued in 1955 and 1956 totalled IL.44.5 million; this figure does not include the Defence Loan debentures, the latter still having been on sale at the end of 1956.

Approximately two-thirds of the securities issued were linked by the investors to the consumers' price index; the breakdown by type of link is shown in table XIX-9.

Upon the issue of linked debentures, the public showed a decided preference for a link to the consumers' price index. Out of the first issue of Palestine Elec-

TABLE XIX-9
Linked Debentures Issued in 1955 and 1956, by Type of Link
(in IL. thousands)

<i>Security</i>	<i>Dates of redemption</i>	<i>Linked to dollar</i>	<i>In per cent</i>	<i>Linked to index</i>	<i>In per cent</i>	<i>Registered in name of holder</i>	<i>Made out to bearer^a</i>
Palestine Electric Corporation, First Issue	1957/64	2,128	21.3	7,872	78.1	4,574	5,426
Palestine Electric Corporation, Second Issue	1958/65	639	10.7	5,361	89.3	2,000	4,000
Keren Hayessod-United Jewish Appeal	1958/65	3,706	37.1	6,294	62.9	3,081	6,919
Igroth Ltd. ^b	1958/65	5,000	—	5,000	—	5,000	5,000
Rassco, Rural and Suburban Settlement							
Company, Ltd.	1958/64	539	53.9	461	46.1	—	1,000
Local Authorities	1958/65	3,174	42.3	4,326	57.7	1,537	5,963
<i>Total</i>		15,186	34.1	29,314	65.9	16,192	28,308

^a Only debentures made out to bearer are now being registered at the Tel Aviv Stock Exchange. The debentures registered in the name of the holders are accordingly not quoted on the stock exchange, and are held mainly by institutions, such as provident funds.

^b As regards these debentures, there was no choice between a link to the consumers' price index and a link to the dollar. They are linked *pari passu* to the index and to the dollar.

SOURCE: The Tel Aviv Stock Exchange, Ltd.

tric Corporation debentures (in 1955) 78.7 per cent of the total were linked to the index, while this proportion rose to 89.3 per cent for the second issue. The share of index-linked debentures represented 62.9 per cent of the total Keren Hayessod loan, while it amounted to 46.1 and 57.7 per cent for the Rassco and Local Authorities debentures respectively. Due to the relative stability of the currency, expectations of a possible devaluation were no longer present and, this in turn, led most investors to prefer the safeguard of their short-term current income afforded by the link to the consumer price index.

This tendency changed significantly during the second half of 1956. The unstable political situation and the increase in Government expenditure arising therefrom, which led to a decline in the country's foreign currency balances, somewhat weakened the confidence of part of the investors in the long-term stability of the existing rate of exchange. Moreover, the results of the Government's subsidy policy, which was destined to prevent a rise of the consumers' price index in view of its effect on wages, caused some concern to the public.

This new preference was reflected in the quotations of linked debentures. Whereas the nominal prices of debentures linked to the index were generally higher than those linked to the dollar during the first half of 1956, the contrary was true as from August of that year. Dollar-linked securities attained their peak in September, when fears of a war in the Middle East became widespread. The tendency to prefer dollar-linked debentures continued until the end of the year; in November, there was, however, a general decline in the price of securities on the Tel Aviv Stock Exchange as a result of the Sinai campaign. While the price of linked debentures, after deduction of accrued interest and the rise in the consumers' price index, had until August been very close to their par value⁹, they stood, due to various factors, at 5-6 points below par towards the end of the year. Monthly changes in the price of linked debentures are shown in table XIX-10.

The low prices prevailing at the end of 1956 were caused not only by the tense political situation in the wake of the Sinai campaign, but also by the floating of the Defence Loan, for the sale of which to the public some recourse was had to moral pressure. The statement that a Defence Loan of IL.40 million was being floated created a psychological movement towards an increased supply of securities to the market, which was in any case somewhat bearish after the Sinai campaign. The increased supply of securities led to a reduction in the price of existing linked debentures, which in turn may have retarded Defence Loan sales to a certain extent, as expectations relating to future developments of the quotation of such securities underwent a change.

In this connection, it must be stated that the very successful distribution of linked debentures which have been issued since 1955 may have caused a some-

⁹ The nominal value of the bond, including increment resulting from the rise of the consumers' price index.

TABLE XIX-10

Nominal Prices of Linked Debentures (after Deduction of Accrued Interest and Allowing for a rise in the Consumers' Price Index), End of Month, 1956

Consumers' Price Index	239	238	239	244	246	249	249	244	247	260	259	248	250
<i>Security</i>	<i>1955 Dec.</i>	<i>1956 Jan.</i>	<i>Feb.</i>	<i>Mar.</i>	<i>Apr.</i>	<i>May</i>	<i>Jun.</i>	<i>July</i>	<i>Aug.</i>	<i>Sep.</i>	<i>Oct.</i>	<i>Nov.</i>	<i>Dec.</i>
3½% Tavei Dollar, 1959/66	100.0	98.3	97.7	95.8	94.6	94.8	100.3	102.6	101.9	106.9	103.1	102.3	101.4
Registered Stock "A", 1954/61	100.0	99.1	96.4	96.3	100.3	98.9	101.3	99.7	98.9	98.3	96.5	92.0	92.2
Nesher, 6% Debs. "A", 1955/64	100.0	91.0	102.2	102.1	100.2	101.3	104.3	106.2	108.2	108.8	108.9	107.6	107.7
Nesher, 6% Debs. "B", 1953/58	100.0	96.4	97.3	96.2	100.4	99.9	100.0	102.9	102.9	104.6	103.6	103.3	109.2
Pal. Electric Corp. 6½% Debs. 1957/64 (\$-linked)	100.0	100.6	99.8	99.1	99.5	101.0	104.0	104.3	102.6	110.2	106.6	98.9	103.0
Pal. Electric Corp. 6½% Debs. 1958/67 (\$-linked)	—	—	—	100.0	100.5	102.0	105.5	107.0	103.6	110.8	108.2	99.9	104.2
Keren Hayesod-UJA, 6½% Debs. 1958/65 (\$-linked)	—	—	—	—	—	—	—	—	—	—	100.0	97.9	97.1
Igroth Ltd. 6½% Debs. 1958/65 (½ \$-linked, ½ linked index=246)	—	—	—	—	—	—	—	—	—	—	100.0	97.6	95.2
Adjusted for index rise	—	—	—	—	—	—	—	—	—	—	(95.9)	(96.6)	(93.4)
Pal. Electric Corp. 6½% Debs. 1957/64 (linked index=233)	100.0	102.4	100.0	100.0	101.8	104.0	107.8	105.0	102.8	103.9	104.0	100.9	99.6
Adjusted for index rise	(100.0)	(102.9)	(100.0)	(98.0)	(99.0)	(99.9)	(103.3)	(102.9)	(99.5)	(95.6)	(96.0)	(97.2)	(95.3)
Pal. El. Corp. 6½% Debs. 1958/65 (linked index=239)	—	—	—	—	100.0	102.3	105.3	103.1	100.6	101.5	102.2	99.1	97.5
Adjusted for index rise	—	—	—	—	(99.1)	(100.2)	(103.1)	(103.0)	(99.3)	(95.1)	(96.2)	(97.4)	(95.1)
Keren Hayesod-UJA (linked index=249)	—	—	—	—	—	—	—	—	—	—	100.0	97.9	94.3
Adjusted for index rise	—	—	—	—	—	—	—	—	—	—	(96.1)	(98.3)	(93.9)

SOURCE: The Central Bureau of Statistics and calculations of the Bank of Israel.

what over-optimistic assessment as to the absorptive capacity of the security market and—consequently a tendency to precipitate the issue of such debentures.

The purchases of debentures issued in 1955 and 1956 were only partly financed by current savings, either savings by individuals or compulsory savings through provident funds. A certain part of such debentures was apparently purchased out of the proceeds of personal restitution payments from Germany, while another part undoubtedly represents a switch of capital from other forms of investment. A too rapid rate of issue of additional debentures, exceeding the volume of accumulated current savings and foreign transfers earmarked for such investment, are liable to cause harmful competition on the security market and a decline in prices and thus create adverse expectations which are likely to interfere with sales of new loans in the future.

The security market should be considered only to a limited extent as an independent instrument for the mobilization of personal savings. The overwhelming majority of securities floated during the year under review were not purchased by private persons but by financial institutions, in particular by "Gmul" Ltd., the investment company of the provident funds. Purchases of "Gmul" accounted for 30 to 40 per cent of last year's new issues. A further considerable part was acquired by financial institutions, such as banks, insurance companies and investment companies. Purchases by private persons and businesses have been estimated at no more than IL.6 million to IL.7 million—an insignificant proportion of the total volume of personal savings in the economy, which in turn is very low in relation to the annual volume of investment.