

CHAPTER XVII

THE SECURITIES MARKET

1. MAIN DEVELOPMENTS

DEMAND FOR FINANCIAL investments maintaining their real value grew heavier in 1972 owing to the strong expectation that the rapid inflation would persist, and perhaps also to the appreciable nominal expansion of the household sector's total asset portfolio. As regards bonds, the burgeoning demand was mainly reflected in the volume of new issues, and only slightly in changes in yields to maturity in the secondary market. In shares, the principal effect was a rise in prices, although new issues were also up sharply. Demand for bonds by social insurance funds and insurance companies was likewise brisker in 1972, owing to their accelerated accumulation. These two developments resulted in the mobilization of a much larger amount of capital through the securities market, the increase amounting to 55 percent in real terms in the case of bonds alone.

New issues of bonds denominated in Israeli currency (less compulsory loans) grossed IL 2,703 million, while net proceeds came to IL 1,226 million, as against IL 696 million in 1971. Net voluntary purchases of Israeli currency bonds by the general public rose from IL 180 million in 1971 to IL 475 million. Sales in the primary share market (including convertible bonds) totalled IL 199 million, as contrasted with only IL 53 million in 1971. Nevertheless, the index of share prices shot up 95 percent.

In spite of the much heavier bond redemption in 1972 (notably the retirement of the 1967 Defense Loan), net receipts, as already mentioned, rose appreciably; this supports the assumption that the duration of the contractionary monetary effect of a compulsory loan depends mainly on the date when the certificates become tradable rather than when they mature.

Trade in bonds by the general public (as distinguished from the long-term bonds purchased by the social insurance funds and insurance companies) was affected by the inflation prevailing in the economy and the belief that it would persist. Private investors displayed a tendency to adjust their financial assets portfolio, with a shift toward value-linked medium-term assets (equities and especially linked and option-type¹ bonds). Activity in the bond market was also stimulated by the increase in real private disposable income per capita and especially in

¹ Option-type loans permit the investor to choose, upon maturity, between a high rate of interest without linkage of the principal and interest, and a lower rate with the principal and interest linked to the consumer price index.

private saving from total disposable income,' by the rapid monetary expansion, and the sharply larger capital import (part of which was probably channelled to financial assets). The absence of expectations of a change in the external value of the Israeli pound moderated activity in bonds linked to the foreign exchange rate and those denominated in foreign currency. These developments pushed up the public's net voluntary purchases of Israeli currency bonds from IL 180 million in 1971 to IL 475 million.

Turnover in bonds (both on the Stock Exchange and in the over-the-counter market) shot up 129 percent in 1972 to hit IL 3,500 million; only IL 690 million worth changed hands on the Stock Exchange, the rest being accounted for by brokers' matching of buy and sell orders. The soaring of share prices led to an even sharper gain in turnover in this market, so that the weight of bonds in total securities turnover both on the Exchange and over the counter fell from 87 to 76 percent. The expectation that rapid inflation would continue, coupled with the stability of the exchange rate of the Israeli pound, enhanced demand for index-linked and option-type securities, and their yields to maturity edged down about half a percentage point in 1972. As a result of this, as well as of the greater degree of perfection attained by the bond market, it was devoid of surprises in the year reviewed, serving as an instrument for secure investments promising a relatively modest real return.

The share market enjoyed a bullish trend the like of which had not been seen in the past decade: volume (both on the Exchange and over the counter) was up by a staggering 408 percent, the average net yield came to 110 percent, and new flotations totalled IL 199 million. The boom was sustained throughout the year, apart from a slight pause in May, which was probably due to temporary liquidity difficulties and some profit-taking. The principal factors behind the 1972 boom were the much livelier demand for financial assets offering a hedge against inflation; the developments in the economy as a whole, which led to the growth of cumulative undistributed company profits (this had previously not been fully reflected in share prices); the sizable monetary expansion, which stimulated demand for securities both directly—by increasing liquidity and the economy's financial assets holdings—and indirectly by way of the expected continued growth of company profits; the real estate boom and the ensuing enhanced interest in land and development shares; and the larger capital import, part of which apparently flowed to the financial assets market (e.g. the organization of investors clubs among Jews abroad for investing on the Tel Aviv Stock Exchange). In this context it should be noted that in the share market, more than in most other spheres of economic activity, we find the phenomenon of self-feeding expectations (rising share prices and investors' profits greatly heightening the interest and activity of new investors, which in turn gives a further fillip to prices and profits).

No new companies made new placements in 1972, all 12 of the firms raising capital in the new issues market being familiar faces. Financial institutions and

banks accounted for 82 percent of the total in 1972, land and development companies for 13 percent, and the commerce and industry group for only 5 percent. The striking features this year were the larger proportion of funds raised through convertible bond issues and the fact that most of the new share flotations were rights issues. In addition, in 1972 more Israeli firms turned to foreign capital markets to raise equity capital.

Short-Term Loan holdings of the public rose by IL 32 million in 1972, after soaring IL 157 million in 1971. The more sluggish growth in the year reviewed was mainly due to the shift from nonlinked to index-linked financial assets, a mild decline in the relative yield on the Short-Term Loan, and the tighter liquidity situation which developed toward the end of the year and apparently prompted banks to plug time deposits over the Short-Term Loan.

As regards securities traded in foreign currency, the uptrend in both Stock Exchange turnover and total holdings sagged noticeably, owing to the absence of expectations of an imminent devaluation of the Israeli pound as well as of extensive speculative transactions in connection with the various exchange rate changes that took place abroad during the year. The same factors were behind the marked decline in net receipts from new issues of Israeli securities traded in foreign currency, which totalled IL 19 million compared with IL 87 million in 1971. Another possible reason was the swelling of Pazak and Tamam deposits, due partly to the fact that not all the personal restitution receipts were converted and, primarily, to the revaluation of several European currencies and the devaluation of the U.S. dollar and the Israeli pound, which appreciated the IL value of the deposits denominated in revalued currencies.

The lack of devaluation expectations depressed the agio on the Natad² and free market dollars to an extremely low level in 1972. Since the 1971 devaluation the agio on the free market dollar has exceeded that of the Natad dollar, in contrast to the situation between the 1967 and 1971 devaluations.

2. THE BOND MARKET

The year under review saw a growing demand for bonds, especially those linked to the cost-of-living index. This reflected the expectations engendered by the ongoing inflation and apparently also the big increase in the households' asset portfolio, which stimulated demand for financial investments, including bonds. Because of the structure of the bond market, and especially the highly elastic supply in the primary market, the livelier demand found expression primarily in the volume of new issues and only slightly in a rise in secondary market prices over and above that attributable to the increase in the cost-of-living index and the accumulation of interest.

² The Natad dollar is explained in section 6.

Table XVII-1
DOMESTIC SECURITY ISSUES, 1971-72*

(IL million)

	1971					1972					Increase or decrease (-) in net proceeds
	Gross issue	Redemption of principal	Net issue	Redemption of interest & linkage differentials	Total proceeds	Gross issue	Redemption of principal	Net issue	Redemption of interest & linkage differentials	Total proceeds	
Regular bonds											
Long-term ^b	898.6	118.0	780.6	264.9	515.7	1,281.4	112.3	1,169.1	337.6	831.5	315.8
Government loans	30.7	13.1	17.6	28.1	-10.5	3.5	11.4	-7.9	22.0	-29.9	-19.4
Nongovernmental loans ^c	867.9	104.9	763.0	236.8	526.2	1,277.9	100.9	1,177.0	315.6	861.4	335.2
Long-term issues to insurance companies ^d	71.1	6.1	65.0	11.7	53.3	109.3	9.8	99.5	32.8	66.7	13.4
Government loans	29.2	0.7	28.5	0.2	28.3	54.1	4.9	49.2	13.3	35.9	7.6
Nongovernmental loans ^e	41.9	5.4	36.5	11.5	25.0	55.2	4.9	50.3	19.5	30.8	5.8
Option-type ^f	396.9	102.4	294.5	63.0	231.5	869.0	206.2	662.8	137.7	525.1	293.6
Government loans	223.1 ^g	41.0	182.1	21.4	160.7	495.9	120.6	375.3	80.6	294.7	134.0
Nongovernmental loans	173.8	61.4	112.4	41.6	70.8	373.1	85.6	287.5	57.1	230.4	159.6
Linked 6.5 percent loans	0.0	0.0	0.0	0.0	0.0	443.6	0.0	443.6	5.6	438.0	438.0
Government	0.0	0.0	0.0	0.0	0.0	241.6	0.0	241.6	3.5	238.1	238.1

Nongovernmental	0.0	0.0	0.0	0.0	0.0	202.0	0.0	202.0	2.1	199.9	199.9
Total regular bonds traded											
in Israeli currency	1,366.6	226.5	1,140.1	339.6	800.5	2,730.3	328.3	2,375.0	513.7	1,861.3	1,060.8
Bonds traded in foreign currency ^b	197.0	38.9	158.1	71.5	86.6	156.9	48.2	108.7	89.9	18.8	-67.8
Compulsory loans¹											
From the public	1,041.4	63.8	977.6	40.8	936.8	1,180.9	374.4	806.5	260.6	545.9	-390.9
Absorption Loan	7.3	63.8	-56.5	40.8	-97.3	0.0	70.6	-70.6	58.0	-128.6	-31.3
Defense Loan	448.3	0.0	448.3	0.0	448.3	588.4	303.8	284.6	202.6	82.0	-366.3
Compulsory Savings Loan	585.8	0.0	585.8	0.0	585.8	592.5	0.0	592.5	0.0	592.5	6.7
Bank Defense Loan	101.3	0.0	101.3	0.0	101.3	129.0	0.0	129.0	0.0	129.0	27.7
Shares and convertible bonds	52.8	0.0	52.8	0.0	52.8	199.2	0.0	199.2	0.0	199.2	
Shares ¹	25.8	0.0	25.8	0.0	25.8	143.2	0.0	143.2	0.0	143.2	117.4
Convertible bonds	27.0	0.0	27.0	0.0	27.0	56.0	0.0	56.0	0.0	56.0	29.0

^a Excluding sales of foreign securities in Israel. The data in this table relate only to issues with a prospectus and securities of the Government, Jewish Agency and its subsidiary, which are issued without a prospectus.

^b Issued mainly to the social insurance funds.

^c Consists mainly of financial institution issues.

^d The reference is to the deposits made by the insurance companies with the Bank of Israel and not to the value of Insurance Companies Loan certificates into which the deposits are converted at fixed dates during the year. These estimates assume that none of the bonds issued by the Electric Corporation and registered on the Exchange were held by insurance companies.

^e By the Israel Electric Corporation.

^f Includes early redemptions (actual figures for Government loans and estimates for nongovernmental loans).

^g Includes the Development Loan issue sold to the banks, in the amount of IL 400,000 in 1971.

^h The data were calculated in Israeli pounds, according to the official rate of exchange: until August 1971 at IL 3.5 to the dollar, and from August 1971 at IL 4.2 to the dollar.

ⁱ The amount collected from the public and not the value of the certificates distributed.

^j Share issues of companies listed on the Stock Exchange which were offered to shareholders of record or to the general public.

SOURCE: State Loans Administration, Bank of Israel.

(a) *New issues*

Sales of long-term bonds to social insurance funds and insurance companies grossed IL 1,391 million in 1972, as against IL 970 million the year before, while sales of option-type and index-linked bonds (which are mostly purchased by the general public) shot up from IL 397 million in 1971 to IL 1,313 million. Net long-term loan receipts (i.e. after deducting the value of bonds redeemed and reinvested) rose from IL 569 million in 1971 to IL 898 million, while net proceeds from option-type and index-linked loans (less IL 506 million in compulsory loan redemptions) came to IL 328 million in 1972,³ compared with IL 127 million the year before. Foreign currency bonds issued by Israeli companies and institutions totalled IL 157 million, as against IL 197 million in 1971, but net receipts from this source amounted to only IL 19 million (these data will be detailed below).

The growth of net bond receipts far outpaced the rise in the general price level or national income; they increased the total amount of capital mobilized in 1972 by 55 percent⁴ and brought up the weight of bond proceeds (less compulsory loans) in national income from 3.65 percent in 1971 to 5.16 percent.

It is noteworthy that in spite of the heavier redemption, particularly of the various compulsory loans, net proceeds from sales to the general public (i.e. option-type and index-linked bonds) rose appreciably. This lends support to the assumption that the redemption of bonds does not, as a rule, affect the size and composition of the investor's portfolio, for as the security approaches maturity, the owner holds it voluntarily and not under compulsion, and it is therefore plausible to assume that he will reinvest the proceeds in similar paper. Consequently, the compulsory loans begin to exert their expansionary monetary influence when they become tradable, either on the Exchange or in the over-the-counter market, and not when they are actually redeemed (those who have no desire to hold on to this sort of financial asset sell their certificates in the market, thereby dampening new issues). The duration of the contractionary effect of a compulsory loan thus depends mainly on the date when the paper becomes tradable, and not when it matures (see Table XVII-1).

The public's voluntary purchases,⁵ both direct and through mutual funds or

³ The total of items 3 and 4 in Table XVII-1, less redemption of principal, interest, and linkage differentials on the compulsory loans.

⁴ Deflated by the annual average rise in the implicit GNP price index. The use of the consumer price index gives an increase of approximately 56 percent.

⁵ Voluntary purchases of bonds denominated in Israeli currency were calculated in the following manner: to total net receipts from option-type and the new seven-year index-linked bonds we added that portion of the compulsory loans which had been held by the social insurance funds and insurance companies and whose redemption thus increased gross purchases of long-term securities rather than securities of the type purchased by individual investors (this is estimated at IL 5 million in 1971 and IL 25 million in 1972), and that portion of the compulsory loan certificates which had become tradable, resulting in their

Table XVII-2

MEDIUM- AND LONG-TERM BOND ISSUES, 1972^a

(IL million)

End of period	Medium-term bonds sold to the public					Long-term bonds						
	Option-type		6.5% index-linked		Total	Sold to insurance companies & social insurance funds		Bank Defense Loan	Total denominated in IL	Bonds denominated in foreign currency ^c	Convertible bonds	Shares
	Govt.	Other	Govt. ^b	Other		Govt. ^b	Other					
1971	223.1	173.8	—	—	396.9	95.9	909.8	101.3	1,071.0	197.0	27.0	25.8
1972	495.9	373.1	241.6	202.0	1,312.6	57.6	1,333.1	129.0	1,519.7	156.9	56.0	143.2
January	33.0	21.4	—	—	54.4	5.6	58.3	12.1	76.0	13.8	—	—
February	44.2	13.4	—	—	57.6	3.5	60.2	10.6	74.3	4.8	—	—
March	43.0	14.7	—	—	57.7	3.0	67.2	11.2	81.4	10.5	—	-6.4
April	17.2	11.0	62.5	35.6	126.3	3.8	111.4	0.7	115.9	—	—	—
May	36.7	34.8	24.8	4.6	100.9	6.2	88.6	15.4	110.2	21.7	6.0	1.3
June	51.9	28.6	21.0	20.8	122.3	7.1	99.7	7.8	114.6	13.7	—	66.4
July	44.2	33.2	15.4	8.6	101.4	3.5	92.9	7.8	104.2	38.9	4.0	8.9
August	41.8	33.2	17.2	19.2	111.4	4.0	85.2	21.8	111.0	24.0	6.0	—
September	43.2	29.6	15.6	31.9	120.3	4.0	117.7	10.4	132.1	6.5	7.0	12.0
October	39.8	36.7	23.3	21.1	120.9	5.3	195.4	10.4	211.1	1.6	—	—
November	46.2	60.7	20.1	39.5	166.5	5.5	144.4	10.4	160.3	0.1	33.0	39.9
December	54.7	55.8	41.7	20.7	172.9	6.1	212.1	10.4	228.6	3.3	—	8.3

^a See note ^a to Table XVII-1. The data here refer to actual sales and not the volume of authorized issues. However, not all the issues were listed on the Stock Exchange, especially in the case of long-term bonds.

^b Excluding Compulsory Loans.

^c Including Hollis.

SOURCE: State Loans Administration.

approved bank savings plans, increased by IL 475 million in 1972, compared with IL 180 million the year before.⁶

The greatest spur to security purchases, as already noted, was the spiralling of prices in the economy and the expectation that this trend would continue, which enhanced investors' preferences for financial assets linked to the cost-of-living index over short-term nonlinked assets and even over those linked to the foreign exchange rate (mainly Pazak and Tamam accounts and bonds linked to or denominated in foreign currency). The result was not only a reshuffling of the economy's total portfolio of financial assets, but also a rise in the weight of index-linked bonds in incremental holdings. This was reflected by some slackening in the growth of unlinked financial assets (such as time deposits and the Short-Term Loan) and a big increase in linked assets. This process of portfolio adjustment found expression in both the primary and secondary markets, and it was facilitated by the existence of a stock of linked bonds with differing periods to maturity, including bonds falling due within a few months, so that it was possible to make linked investments even for very short periods.⁷

Several other factors stimulated the sale of securities: the rise in real private spendable income per capita; the increase in private saving, some of which undoubtedly flowed to the securities market; the rapid monetary expansion, which was mainly fueled by the large-scale capital import, part of which was apparently channelled to financial assets, including bonds; and the appearance of a new type of bond on the market in April.⁸ (It is not clear exactly how much the diversification of the types of bond issues boosted net sales. But in general it seems to have had a stimulative effect, at least marginally, for the new bond, which pays interest every six months, is a suitable instrument for those desiring a current income from their investment.)

An examination of the trends in the primary bond market in the course of the year shows an uninterrupted rise in both gross and net issues and in total pro-

sale by some of the recipients. (In 1972 about IL 160 million worth of compulsory loan certificates were distributed, as against IL 64 million in 1971; assuming that half this sum was sold at an average price of 150, this source added IL 120 million to voluntary securities holdings, compared with IL 48 million in 1971; from this we deducted the value of compulsory loans redeemed.)

⁶ This figure is still downward-biased, as we have assumed that all the interest received was reinvested. Actually, part of it was spent on current consumption, so that the demand for these bonds was greater than indicated here.

⁷ While linked bonds with long maturities may also be purchased and resold after several months, there is the risk of a capital loss due to changes in secondary market yields.

⁸ This is a seven-year linked bond bearing 6.5 percent interest payable every six months; one series features the redemption of principal in installments. Since the interest is paid currently, there is not much chance of bond washing (the sale of bonds close to maturity, mostly to investors exempt from the payment of income tax thereon). The net yield will therefore be 4.9 percent, the same as on option-type linked bonds; however, this is more certain in the case of the seven-year bond, since there is no danger of the future abolition of bond washing, which would affect the yields on option-type paper.

ceeds. In the last quarter gross issues of Israeli currency bonds reached IL 1,029 million, in contrast to IL 368 million in the first, while net issues and total proceeds reached IL 884 million and IL 710 million respectively in the last quarter, as against IL 311 million and IL 206 million respectively in the first. This development was due to a number of factors, the most important of which were as follows: redemption of the 1967 Defense Loan in June, seasonality in the accumulation of the severance pay and provident funds for self-employed, the strong rise of the general price level and expectations that this trend would persist, and the long-run advancing trend in the mobilization of capital through Israeli currency securities, reflected in 1972 not only in the annual average level but also by the change in the course of the year (see Table XVII-2).

The weight of direct Government issues tapered off in 1972, after a notable increase in the preceding year;⁹ this reflected the Government's policy of shifting from the flotation of bond issues through the financial institutions in favor of direct sales by the Treasury. The identity of the issuer has almost no significance to the investor, so that this policy was not due to any change in investors' preferences. The advertising campaign mounted in connection with Government loans apparently has had some influence on sales, especially as the other bond issues have not benefited from similar publicity. However, this has been partially counterbalanced by the fact that the certificates are acquired through commercial banks, which encourage the sale of bonds issued by their affiliated financial institutions. Nevertheless, Government paper is more heavily traded than the other bonds, giving it an edge over the latter.

In contrast to previous years, there was hardly any increase in 1972 in the amount of compulsory linked loans listed for trade on the Exchange. The net result of the continued redemption of early Absorption Loan series on the one hand and the listing of the 1966 series on the other was a IL 35 million increase in tradable Absorption Loan capital (excluding the distribution of certificates of the 1967 Absorption Loan, which was not yet listed for trade on the Exchange). As regards the option-type bonds, redemption of the 1967 Defense Loan amounted to IL 506 million. The 1970 Defense Loan and the 1970 Savings Loan (whose certificates were distributed in 1972) are not listed on the Exchange, nor can they be traded outside the Exchange, so that the distribution of these certificates had almost no effect on bond sales in the primary market.¹⁰

⁹ See Bank of Israel, *Annual Report 1971*, p. 403 for a discussion of the extent of Government supervision and control over the primary market—both the raising of funds and their allocation.

¹⁰ Assuming that those who regard these bonds as part of their financial assets portfolio are not a victim of the "distribution date illusion" and date their ownership to the time the loan was collected and not when the certificates were distributed, and who therefore adjusted their voluntary securities purchases in the year in which the loan was collected. This applies especially to the Savings Loan, which will mature in the near future.

Table XVII-3

GENERAL TRENDS IN STOCK EXCHANGE TRADING, 1970-72

(IL million)

	Bonds						Total	Short-Term Loan	Shares ^a	Total securities
	Linked to the exchange rate	Linked to the c-o-l index	Option-type	Traded in foreign currency	Convertible into shares	Non-linked and mixed linkage				
1970	19.6	49.8	102.3	48.9	—	1.1	221.7	115.7	52.3	389.7
1971	15.4	56.8	210.4	82.2	2.4	0.9	368.1	150.1	105.7	623.9
1972	15.5	112.4	441.9	107.8	12.8	0.6	691.0	212.5	762.9	1,666.4
January	1.1	5.4	29.4	9.8	0.2	0.1	46.0	18.3	34.4	98.7
February	1.2	4.9	34.6	10.2	0.6	0.1	51.6	11.6	56.4	119.6
March	1.0	5.0	36.0	9.5	0.3	0.0	51.8	17.2	50.7	119.7
April	1.2	11.1	32.2	7.8	0.3	0.1	52.7	17.2	85.4	155.3
May	1.2	8.1	26.3	7.8	0.4	0.0	53.8	17.4	49.1	120.3
June	1.8	8.0	49.9	9.3	0.3	0.0	69.3	16.3	45.5	131.1

July	1.3	11.6	46.1	7.2	0.6	0.1	66.9	13.0	51.8	131.7
August	1.5	9.5	40.1	8.7	1.5	0.0	61.3	16.5	64.8	142.6
September	0.7	7.9	31.9	8.1	1.1	0.1	49.8	11.8	64.2	125.8
October	2.2	11.5	35.3	8.7	2.1	0.1	59.9	17.5	100.8	178.2
November	1.4	9.9	32.9	12.2	1.0	0.0	57.4	29.8	56.7	143.9
December	0.9	19.5	37.2	8.5	4.4	0.0	70.5	25.9	103.1	199.5

Percent annual increase or decrease (-)

1970	0.6		-0.7	24.7	^b	^b	4.5	-15.7	-51.2	-14.6
1971	-21.4	14.1	105.6	68.1	^b	^b	66.0	29.7	102.1	60.1
1972	0.7	97.9	110.0	31.1	^b	^b	87.7	41.6	621.8	167.1

Percentage distribution

1970	5.0	12.8	26.3	12.5	—	0.3	56.9	29.7	13.4	100.0
1971	2.5	9.1	33.7	13.2	0.4	0.1	59.0	24.1	16.9	100.0
1972	0.9	6.7	26.5	6.5	0.8	0.0	41.4	12.8	45.8	100.0

^a Listed ordinary and preferred shares, unlisted shares traded off the floor, and shares traded in foreign currency.

^b Because of the small sums involved the percentage change lacks significance.

SOURCE: Tel Aviv Stock Exchange.

(b) *The secondary market*

Turnover in listed bonds was, at IL 3,500 million,¹¹ up 129 percent in 1972; of this sum, only IL 690 million (20 percent) was traded on the Exchange, while the rest was mainly accounted for by brokers' matching of buy and sell orders.¹² Nevertheless, the boom in equities depressed the weight of bonds in total listed securities traded both on the Exchange and in the over-the-counter market from 87 percent in 1971 to 76 percent (see Table XVII-6).

Yields, especially of index-linked and option-type bonds, edged down a bit because of the brisker demand for bonds and the inability of the primary market to completely meet it due to the insufficient diversification (from the aspect of period to maturity) of the bond issues. It should be noted here that the heavier turnover implied an increase in the liquidity of bond investment, and this is its principal significance.¹³

Option-type paper accounted for 64 percent of total bond transactions on the Exchange¹⁴ in 1972, compared with 57 percent the year before. The weight of the Defense Loan in total option-type bond turnover fell from 73 percent in 1971 to 57 percent, owing to the redemption of the 1967 issue. The upswing in option-type bond turnover from IL 210 million in 1971 to IL 441 million and in their weight in total Stock Exchange trade reflects the dominant position of this instrument in the secondary bond market, which is not connected solely with the availability of tradable compulsory loans.

As regards the investor, the distinction between option-type and index-linked bonds was narrowed this year, because the accelerated rise of the consumer price index over the past several years and the expectation that this trend would continue made it virtually certain that the option-type bonds would be redeemed according to the linkage alternative (see note ¹ on p. 421). Demand shifted to financial assets pegged to the index, with the result that issues of both types of paper were stepped up, the yield to maturity declined, and trade therein rose to IL 554 million, or 80 percent of total bond turnover on the Exchange (see Table XVII-3).

Since the inflation made the linkage alternative on option-type bonds virtually

¹¹ The significance of the volume of such trade and changes therein lies in the fact that they not only indicate the changes in investors' expectations but also in the liquidity of this type of investment.

¹² It makes no difference to either the purchaser or the seller whether the order was transacted on the Exchange floor or through internal offsetting; therefore, in analyzing the supply and demand factors it is total turnover that counts.

¹³ If the expectations of all the individual investors in the economy concerning the determinants of the demand for bonds were to change in the same direction and at the same rate, there would be no great expansion of turnover in periods of changing demand. But as this is not the case, even when expectations change in the same general direction, turnover generally expands.

¹⁴ The discussion of turnover in the various share groups will be confined to trade on the Stock Exchange owing to the lack of a reliable group breakdown of overall trading volume.

Table XVII-4

AVERAGE NET YIELDS TO MATURITY^a OF BONDS TRADED ON THE EXCHANGE,^b 1972

(percentages)

Month ^c	Dollar-linked				Index-linked ^d				Option-type		
	Years to maturity	Up to 2	2-5	5+	Total	Up to 2	2-5	5+	Total	On a linked basis	On a nonlinked basis
1971 December		9.6	7.7	6.4	6.9	—	5.2	4.9	5.0	8.0	8.1
1972 January		8.4	7.6	6.6	6.9	6.7	5.1	5.4	5.4	6.4	6.0
February		8.7	8.0	6.8	7.1	6.7	4.6	5.3	5.1	6.5	5.0
March		9.4	8.2	7.1	7.5	4.3	4.4	4.8	4.6	5.4	5.7
April		10.7	8.6	7.6	8.1	7.6	5.6	5.2	5.5	6.9	6.7
May		10.9	9.0	7.5	8.0	6.3	5.4	5.3	5.4	5.9	4.9
June		9.2	9.0	6.9	7.3	6.9	5.6	5.5	5.7	5.8	5.0
July		5.4	°	6.1	6.0	4.0	4.6	5.2	4.9	4.3	4.4
August		5.4	—	5.7	5.7	4.5	5.0	5.2	5.1	5.6	8.4
September		5.7	—	5.8	5.8	5.0	4.8	4.9	4.9	5.2	7.9
October		5.9	—	5.4	5.2	5.6	5.0	5.3	5.1	5.0	7.8
November		6.1	—	5.8	5.8	6.6	5.8	5.3	5.9	5.1	7.1
December		6.0	—	5.9	5.9	—	6.8	5.4	5.9	4.9	6.4
Yields on newly issued bonds				No sale				4.8		4.8	10.8

^a Less 25 percent income tax in the case of dollar- and index-linked bonds. For option-type bonds the gross yield to maturity is given here, as this is what the investor will actually receive net because of the practice of bond washing. However, for comparison with the yield on other bonds purchased in the secondary market, several tenths of a percentage point have to be deducted, because the investor who sells his bond close to maturity will not receive the full redemption value but a slightly lower sum.

^b The principal type of bond excluded here (as only a small fraction is listed on the Exchange) is the long-term paper sold to social insurance funds and insurance companies. The Absorption Loan and the 10-year Defense Loan are also excluded from the data, even though they are traded on the Exchange and account for the lion's share of the volume. This diminishes the significance to be attached to the rates of return listed here.

^c According to the quotations on the 18th of each month.

^d The yields on newly issued index-linked bonds relate to the new seven-year series.

^e No data published.

SOURCE: Central Bureau of Statistics.

certain, the yields on a nonlinked basis fell far below their level upon issue and thus lost their relevance to the investor (see Table XVII-4). For this reason, the analysis here will be confined to yields calculated on a linked basis. In 1972 the average net yield to maturity so computed was 5.6 percent, compared with 5.9 percent in 1971. It held steady throughout the year, except for a sharp spurt in April, apparently because of the tight liquidity situation that month, which also affected the bond market.

Trading in index-linked bonds soared 98 percent this year to reach IL 112 million, though their weight in total bond turnover only inched up from 15 percent in 1971 to 16 percent. The brisker trade reflected the operation of a number of supply and demand factors: The year reviewed saw the start of Stock Exchange trade in the 1966 Absorption Loan, while the partial redemption of earlier Absorption Loan series continued, the net result being a IL 35 million increase in total listed capital in this loan. In addition, trade began this year in the new linked bonds issued for seven years at 6.5 percent (gross) interest (see section 2a), and this too augmented the stock of linked bonds. But at the same time the much larger supply of index-linked paper, the mounting inflation, and the absence of devaluation expectations led to a heavier demand for linked assets (see the discussion above).

Examination of the development of Stock Exchange transactions in linked bonds in the course of 1972 shows a steep rise from April onward: whereas during the first three months turnover averaged IL 5 million a month, during the last nine months the level jumped to IL 11 million. This was mainly due to the listing of the 1966 Absorption Loan and the start of sales of the new seven-year linked loan—both of which occurred in April and greatly enlarged the stock of securities.

Table XVII-4 shows that yields to maturity on index-linked bonds declined from an annual average of 5.9 percent in 1971 to 5.3 percent during the year under review. The yields on option-type bonds calculated on a linked basis also slipped somewhat, but remained a bit higher than those on the former type of paper. However, since the data on the linked bonds are based on only a small fraction of the total stock of tradable paper, little significance should be attached to this development, especially in view of the difference in the periods to maturity of these two types of bonds.

Turnover in bonds traded in foreign currency rose relatively little in 1972—from IL 82 million in 1971 to IL 108 million (the reasons for this are presented in section 6).

A new feature of the Israeli bond market is the appearance, since last year, of capital notes issued by various banks and of bonds convertible into shares. Since changes in the price and turnover of this kind of paper are largely connected with the price which will be set for the share into which the bond may be converted, it is impossible to analyze this segment of the bond market, especially in view of its newness and the differential terms of the various bonds.

Table XVII-6 shows that in 1972 bond transactions in the over-the-counter market expanded while equity trade on the Exchange shrank. The difference in trend is mainly attributable to the lack of a developed market for trading in bonds at variable prices, an arrangement permitting the offsetting of buy and sell orders received during the day. The possibilities of offsetting increase with a rise in turnover, so that the growth of turnover in 1972 resulted in a larger volume of such transactions.

The concentration of bond trading is presented in Table XVII-8. It reveals three distinct groupings: a small group of heavily traded bonds, a not very large intermediate group of bonds with a limited but nevertheless active trade, and a large group of bonds which are in fact inactive (and whose prices and yields to maturity are therefore of little significance).

The Absorption Loan series are the most heavily traded of the linked bonds (they accounted for 68 percent of total turnover in such paper in the year reviewed). They were followed in 1972 by the new seven-year loan, which in the few months since its appearance succeeded in contributing 16 percent to the year's turnover. There is hardly any trade in the other listed linked bonds, as they are mostly held by institutional investors who either do not trade in them at all or do so in the over-the-counter market. Fluctuations in the prices of these bonds mainly represent "price adjustments" which are made from time to time because of a rise in the cost-of-living index and the accumulation of interest; there is no connection between these changes and turnover, and they stem to only a minor extent from fluctuations in the supply and demand for such paper.

The stock of listed bonds in 1971-72 is presented in Table XVII-9, which shows the changes that took place during the year reviewed in both the composition and size of the economy's bond portfolio due to the operation of the market forces described above.

Finally, it should be noted that since equities proved more glamorous in the year reviewed, they tended to moderate the expansion of activity in the bond market, as part of the funds which in previous years had flowed to the bond market now went to shares. Other contributory causes were the lack of "bargains" in the bond market, which had attained a high degree of perfection, the fact that no trade was allowed in the Defense and Savings Loan certificates distributed in 1972; and the rather unattractive yield offered by the 1966 Absorption Loan (listed for trade on the Exchange in 1972) compared with earlier series of this loan.

If to these factors is added the absence of devaluation expectations, it can be said that the bond market was devoid of surprises in 1972, serving as an instrument for conservative investments, although in common with many other stock exchanges, it occupies a dominant position from the aspect of the volume of trade and issues.

Table XVII-5
MONTHLY SHARE TURNOVER ON TEL AVIV STOCK EXCHANGE
AND OVER-THE-COUNTER MARKET, BY SHARE GROUP, 1972^a
(IL thousand)

Month	Finance and insurance ^b	Land and development	Industry and commerce ^c	Fuel and oil	Investment companies	Listed preferred shares & unlisted shares sold off the floor	Total ^d
January	10,846	5,990	9,905	731	4,617	2,266	34,355
	8,586	1,819	4,219	319	2,228	595	17,766
February	18,454	10,478	15,982	1,706	8,020	1,796	56,436
	8,813	4,993	6,491	1,455	4,097	499	26,348
March	15,698	12,108	13,064	1,734	6,624	1,469	50,697
	8,308	4,509	3,937	846	3,056	335	20,721
April	36,871	17,240	14,769	2,578	11,561	2,372	85,391
	12,685	8,694	4,665	999	4,957	634	32,634
May	16,281	11,512	10,877	1,819	7,146	1,496	49,131
	7,804	3,078	2,760	653	1,917	307	16,519
June	14,469	8,633	14,283	604	4,377	3,105	45,471
	18,855	1,717	13,667	181	1,661	692	36,773
July	13,603	12,629	12,097	763	9,170	3,585	51,847
	18,869	11,812	3,869	240	3,724	2,095	40,609
August	20,373	13,788	14,087	1,322	12,422	2,779	64,771
	12,902	3,974	3,505	424	3,821	1,895	26,521
September	19,972	10,010	14,576	2,106	14,610	2,956	64,230
	11,162	3,054	5,290	447	6,041	4,534	30,528
October	45,565	9,699	15,626	1,673	22,210	6,040	100,813
	18,265	2,849	3,685	571	6,982	4,405	36,757
November	23,755	6,328	10,101	784	12,399	3,376	56,743
	11,759	2,045	2,749	298	5,482	971	23,304
December	48,515	12,552	13,637	2,044	21,100	5,234	103,082
	18,721	3,745	3,897	750	8,233	6,076	41,422
Total, 1972	440,861	183,256	217,738	25,047	186,457	59,512	1,112,871
On the Exchange	284,402	130,967	159,004	17,864	134,258	36,474	762,967
Over the counter	156,459	52,289	58,734	7,183	52,199	23,038	349,902
Total, 1971	121,585	22,396	31,510	4,468	29,336	9,893	219,188
On the Exchange	46,021	15,166	22,563	3,046	11,345	7,250	105,691
Over the counter	75,564	6,930	8,947	1,422	17,991	2,643	113,497
Percent change	263	718	591	461	536	502	408
On the Exchange	518	747	605	486	1,083	403	622
Over the counter	107	655	566	405	190	772	208

^a Upper and lower figures indicate the volume of trade on and outside the Stock Exchange (the over-the-counter market) respectively.

^b Shares traded in both Israeli and foreign currency.

^c Includes public utilities.

^d Discrepancies in total are due to the rounding of individual figures.

SOURCE: Tel Aviv Stock Exchange.

3. THE SHARE MARKET

Demand for financial assets maintaining their real value grew sharper in 1972. This was especially true of shares, but unlike the situation in the bond market, the supply of new share issues is relatively inelastic in the short run, so that the stronger demand was reflected primarily in a steep price rise, and to a relatively small extent in an increase in new issues. However, the latter was substantial in comparison with the past few years. In addition, several other developments in the demand for equities and the business outlook of the companies with listed shares contributed to the upsurge of turnover, prices, and even new issues.

(a) *The secondary market*

The secondary market for listed shares experienced a boom recalling that of the early 1960s: the daily index of share prices jumped 95.3 percent in the course of the year, trading volume soared 408 percent, and the net average yield on shares held for the entire year reached 110 percent. While this trend had begun at the end of 1970 and grew more pronounced during 1971, it picked up considerable momentum in the year under review.

An examination of developments in the course of 1972 (Figures XVII-1 and XVII-3 and Table XVII-7) reveals two interesting features: first, the boom was sustained throughout the year, with the exception of a slight retreat in May; and second (and even more important), the sharp uptrend in share prices

Table XVII-6
QUARTERLY TURNOVER ON TEL AVIV STOCK EXCHANGE
AND OVER-THE-COUNTER MARKET, 1971-72

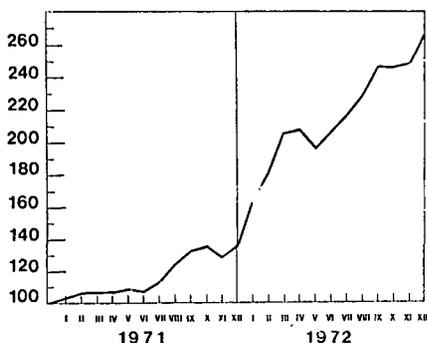
(IL million)

	Shares				Bonds ^a			
	Over-the-counter market	On the Exchange	Total	Ratio (1) ÷ (2)	Over-the-counter market	On the Exchange	Total	Ratio (5) ÷ (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1971	113.5	105.7	219.2	1.07	1,155.1	368.1	1,523.2	3.14
1972	349.9	762.9	1,112.8	0.46	2,793.1	691.0	3,484.1	4.04
1972 I	64.8	141.5	206.3	0.46	335.5	149.4	484.4	2.25
II	85.9	180.0	265.9	0.48	667.2	175.8	843.0	3.80
III	97.7	180.8	278.5	0.54	704.0	178.0	882.0	3.96
IV	101.5	260.6	362.1	0.39	1,086.4	187.8	1,274.2	5.78

^a Excluding the Short-Term Loan.
SOURCE: Tel Aviv Stock Exchange.

was accompanied by an even faster increase in turnover, testifying to a relatively broad and firm capital base rather than reflecting a technical rise in prices in a tiny market.

Figure XVII-1
DAILY INDEX OF SHARE PRICES,
1971-72
 (December 1970=100)



SOURCE: Central Bureau of Statistics.

the board, without investors displaying any discriminative judgment or attempting to study the performance of the various groups.

This unprecedented boom in the secondary share market was sparked off and fueled by a relatively large number of factors, of which only the most important will be described here. First was the buoyant level of activity in the economy as a whole in the last several years, which led to a marked improvement in company profits and prospects for the future, which in the past had not been fully reflected in the movement of share prices. True, the adjustment process had begun in 1971, but it reached full swing only in 1972. Company policy contributed to this: the number of stocks on which cash dividends were paid rose from 78 in 1970 to 85 in 1972, dividend rates went up this year, and the number of stock dividends rose from 9 in 1970 to 35. The second factor was the appreciable capital import, whose impact on the share market was felt both directly (part of the capital was invested in financial assets) and indirectly (by way of the accelerated monetary expansion and the resulting high level of liquidity which marked most of 1972). These developments contributed to the share market boom through the adjustment of the public's securities portfolio, the expansion of the banks' potential for financing investors' securities transactions, and by influencing company profits and future business prospects. In this context it should be stressed that, while the sizable capital inflow was a major cause of the rapid monetary expansion in 1971, an above-average portion was intended from the outset for investment in financial assets rather than for consumption, and this gave added impetus to the share market boom. Thirdly, an increasing number of investors clubs were established in Jewish communities abroad for invest-

The equity market boom permeated all groups in almost equal measure, the overall arithmetic average net yield ranging from 101 percent (for finance and insurance stocks) to 113 percent for industrials. In turnover, however, the differences were wider, the rise ranging from 263 percent (in finance and insurance) to 718 percent (in the land and development group). Such an even group distribution of yields was a rarity in previous years; it is explained by the fact that the forces producing the 1972 boom operated in all sectors of the economy, and also because a boom of this year's dimensions tends to pull up prices across

ing in Israeli securities, mainly shares. The year reviewed was especially favorable for this sort of activity, given the absence of devaluation expectations and the vigorous bullish trend in the Israeli share market.¹⁵ Fourthly, in 1972 the boom in the real estate market gathered momentum, and since the purchase of land and development shares is about the only way the small investor could participate in this boom (the smallest investment unit is relatively large and thus beyond the reach of the small investor), turnover in such shares rose by a staggering 720 percent, compared with the 408 percent gain in overall share trading on the Exchange.

Finally, the share market, more than any other economic sphere, exhibits what is known as self-feeding expectations; that is, the rallying of the market and share prices attracts the interest of the general public, institutional investors, and speculators in both short- and long-term investments through the Exchange, and funds start to flow to this market, thereby accentuating the upswing. There are no reliable figures on the number of persons investing in the stock market, but information from various sources points to a big spurt in 1972; thus this market joined the real estate market in attracting speculative capital in 1972. Most likely not all the newcomers will pull out of the market as soon as the speculative boom peters out, but some will continue to invest on the Exchange, thereby augmenting the fairly small nucleus of long-term equity investors. Institutional investors—social insurance funds, commercial banks, financial institutions, etc.—have also manifested a growing interest in the Stock Exchange, as reflected by their larger volume of transactions thereon and the expansion of their share portfolio.

A glance at Table XVII-5 shows that the growth of turnover on the Exchange far eclipsed that in over-the-counter transactions—620 as against 210 percent; this depressed the weight of the latter from 52 percent of total trade in listed shares in 1971 to 31 percent.

Two types of transactions are conducted outside the Exchange. The first is the matching by brokers of buy and sell orders of the general investing public, with only the balance being brought to the Exchange at the opening of the day's trading. The second type consists of transactions of institutional investors (investment companies, mutual funds, etc.) and other large investors who for various reasons (including anxiety about the effect that large demand or offers may have on prices) prefer to execute part of their transactions in the over-the-counter market. In contrast, the bulk of the trade on the Exchange represents orders of the general public which were not matched by brokers, as well as orders received in the variables session, which *ipso facto* hardly lends itself to the offsetting of buy and sell orders.

The downtrend in the weight of over-the-counter trading embraced all share

¹⁵ Formal foreign currency transfers for securities investment totalled about \$ 35 million, as against some \$ 20 million in 1971.

Table XVII-7

NET OVERALL RATES OF RETURN ON AN INVESTMENT IN LISTED ORDINARY STOCKS, SELECTED PERIODS, 1970-72

(percentages)

Period	Lowest overall rate of return	Overall rates of return by deciles					Highest overall rate of return	Arithmetic average rate of return	Average overall rate of return (weighted by total listed capital ^a)	Average overall rate of return weighted by annual volume of trade ^b	Number of stocks	Number of companies
		10	25	50	75	90						
1. Banking, financing, insurance												
31.12.71-30.6.72	-5.2	4.8	24.8	35.1	47.8	79.8	102.0	36.8	35.3	47.7	41	26
30.6.72-31.12.72	-2.0	4.4	26.7	44.4	53.4	69.8	109.7	42.2	48.7	39.1	38	24
31.12.71-31.12.72	5.8	41.7	67.5	100.7	132.4	166.1	195.3	100.8	100.8	103.8	38	24
2. Land and development												
31.12.71-30.6.72	16.8	27.0	56.7	75.4	97.7	99.6	123.4	71.4	66.1	88.1	15	12
30.6.72-31.12.72	-4.4	6.2	12.4	16.4	19.6	39.0	79.4	20.6	27.9	18.2	15	12
31.12.71-31.12.72	28.8	44.5	77.2	103.9	125.7	170.3	205.8	106.8	112.8	122.0	15	12

3. Industry and commerce

31.12.71-30.6.72	14.2	26.1	40.0	66.6	85.9	107.0	205.7	70.3	73.1	91.9	34	22
30.6.72-31.12.72	-35.1	-1.8	9.5	25.2	36.4	52.7	80.3	23.9	17.5	18.8	34	22
31.12.71-31.12.72	-10.5	28.7	69.0	95.9	157.2	197.7	361.9	112.7	98.7	123.7	34	22

4. Investment companies

31.12.71-30.6.72	0.33	4.0	32.4	47.4	52.4	56.2	76.8	40.0	31.7	43.3	19	15
30.6.72-31.12.72	6.6	12.6	30.1	46.8	54.6	57.6	144.2	46.1	89.7	49.2	17	14
31.12.71-31.12.72	38.9	67.5	78.5	114.4	119.9	143.0	208.1	108.8	147.3	103.1	17	14

5. Total companies listed on the Exchange^c

31.12.71-30.6.72	-5.2	12.3	28.3	48.3	76.6	97.7	205.7	53.7	43.0	67.1	113	78
30.6.72-31.12.72	-35.1	3.2	13.6	33.3	50.6	59.1	144.2	33.4	48.3	30.8	108	75
31.12.71-31.12.72	-10.5	38.5	68.2	105.3	135.8	175.3	361.9	106.8	109.8	112.8	108	75
31.12.70-31.12.71	-22.0	5.3	17.4	33.3	44.2	71.2	160.0	38.7	34.8	44.9	111	77
31.12.69-31.12.70	-35.1	-25.8	-16.5	-3.1	6.3	20.3	64.3	-2.3	-3.9	-4.0	110	76

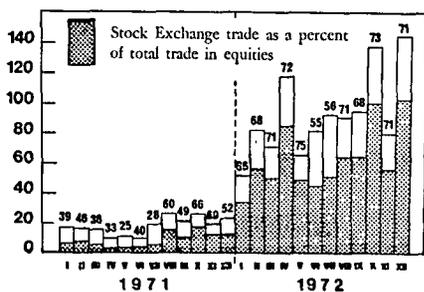
^a According to the composition of listed capital, at market prices, at the end of the previous year.

^b According to the composition of trade in the year for which the calculation is made, less the data for 1972 calculated on the basis of the 1971 composition.

^c Includes several stocks that are not classified under any of the four above-mentioned groups.

SOURCE: Bank of Israel calculations.

Figure XVII-2
**SHARE TURNOVER ON THE
 STOCK EXCHANGE AND
 OVER-THE-COUNTER MARKET,
 1971-72**
 (IL million)



SOURCE: Tel Aviv Stock Exchange.

A study of Table XVII-7 shows that, according to all three measures of the average net yield on equity investment,¹⁶ there was a big improvement in 1972 (ranging between 150 and 200 percent), with the gain in industrials and commercials and the land and development group being concentrated in the first half of the year, and in the banking, finance, and insurance and the investment companies groups in the second half. A comparison of the results yielded by the three measures reveals that on an average the less heavily traded stocks had the lowest rate of return, while those with the largest listed capital were more profitable.¹⁷ Further evidence that this was an across-the-board boom and not one confined to a few select groups is the fact that the yield for the lowest decile jumped from 26 percent in 1970 and 5 percent in 1971 to 39 percent in the year under review.

The advance in share prices, and hence in the rates of return on equity investment, may be partly ascribed to the relatively inelastic supply of new issues, due both to factors specific to the Israeli share market (see section 3b) and to objective circumstances, such as the fairly long period required for preparing a new offering to the public.

Along with the share market boom and the greater interest and participation of the general investing public in the Stock Exchange, the year surveyed also saw some improvement in the investment services available to the public:

¹⁶ On the method of calculating the net overall rate of return, the significance of each of the three measurements, and the results of the calculations for 1969-72, see R. Zentler, "The Profitability of Investment in Common Stocks on the Tel Aviv Stock Exchange, January 1969 to June 1972", Bank of Israel, *Economic Survey*, No. 41 (forthcoming).

¹⁷ With respect to some of the stocks there is a mutual relationship between their heavy trade and their relatively large listed capital; but since this does not necessarily apply to all the stocks, both observations should be noted.

groups, and was sharpest in banking, finance, and insurance (the largest group), where the figure plunged from 62 to 35 percent. This development was apparently due primarily to the lengthening of the session devoted to trade in the variables at the expense of the opening session, and the greater contribution of small investors to total trade in listed equities. The drop in the weight of over-the-counter transactions should probably be regarded as a desirable development, as it strengthens the significance of, and credibility in, the prices set on the Exchange.

A study of Table XVII-7 shows that, according to all three measures of

two new brokerage firms were opened, there was an improvement in the scope and quality of the statistical and other informational material made available to securities advisers and to the public at large, a system was developed for the automatic telephone reporting of Stock Exchange prices, and closed circuit television was installed in the main branches of the banks for reporting on Stock Exchange price movements.

No essential modifications were introduced in the Stock Exchange's system of trading this year, but in order to cope with the brisker volume of business without reducing the number of rounds of trade in the variables, more hours were devoted to such trade, with the result that one round could be held in the opening session and two or three more in the variables, thus enabling the public to respond during the day's trading to developments both on the Stock Exchange and in the economy as a whole.

Table XVII-8

DISTRIBUTION OF ORDINARY SHARES AND BONDS BY ANNUAL TRADING VOLUME, 1972^a

Annual volume (IL '000)	Ordinary shares ^b		Bonds ^c	
	Number of shares	Percent of total volume	Number of bonds	Percent of total volume
Not traded	—	0.0	185	0.0
Up to 49	—	0.0	168	0.6
50-99	—	0.0	48	0.9
100-249	—	0.0	56	2.2
250-499	1	0.1	42	3.6
500-999	5	0.4	33	6.3
1,000-2,499	9	1.8	90	35.0
2,500-4,999	14	6.2	31	25.0
5,000-9,999	18	14.6	8	13.5
10,000-14,999	8	10.4	1	3.6
15,000-19,999	8	14.7	1	4.3
20,000-39,999	8	27.8	1	5.0
40,000-59,999	3	16.6	—	0.0
60,000+	1	7.4	—	0.0
Total	75	100.0	664	100.0

^a The data for shares relate to trade in listed shares sold on the Stock Exchange (both on and off the floor) and in the over-the-counter market, while the data on bonds relate only to trade on the Exchange. The distribution of shares is by issuer only and not by individual issues; that is, all types of shares issued by a particular company are treated here as a single unit. In the case of bonds, however, each series listed on the Exchange is treated as a single unit.

^b For a group breakdown see Appendix Table A-XVII-2 (in Hebrew only).

^c Excluding the Short-Term Loan.

SOURCE: Tel Aviv Stock Exchange.

Examination of the daily indexes of ordinary share prices for the various groups shows that the most impressive advance was posted by land and development stocks (117.4 percent), while the smallest (apart from fuel and oil) was in the finance and insurance group (82.8 percent). Prices climbed steadily throughout most of the year (apart from some softening in May, which was mainly due to profit-taking—a typical development on any exchange after a prolonged advance—and a standstill in November). In addition, the trend was fairly similar in all the share groups—further evidence that every group shared in the equity market boom rather than just a few selected pacesetter stocks.

An outstanding feature this year was the relatively high turnover in most stocks and their more equal contribution to total trading volume in comparison with previous years—this too testifying to the all-embracing character of the demand for equities in 1972 (see Table XVII-8).

Table XVII-9 presents the stock of listed securities at the end of 1971 and 1972 and the changes which occurred in the year reviewed due to the developments described above.

(b) *New share issues (primary market)*

The mobilization of new equity capital on the Stock Exchange continued upward in 1972 against the background of the boom in the secondary share market. Flotations of shares and convertible bonds added up to IL 199 million, as against IL 53 million in 1971 and no issues whatsoever in 1970. Nevertheless, there was still some reluctance to raise capital through public offerings, as indicated by the lack of flotations by new companies not yet listed on the Exchange and the fact that most of the new issues were of share rights or convertible bonds and not share offerings to the general public.

The IL 199 million raised in 1972 consisted of IL 143 million in shares and IL 56 million in convertible bonds and capital notes¹⁸ (see Table XVII-10), and, as mentioned above, was entirely accounted for by companies with shares already being traded on the Exchange. Banking institutions accounted for 82 percent of the total new capital, the land and development group for 13 percent, and industrial firms for only 5 percent. This pattern, which was similar to that of previous years, is explained by a number of factors. First, the various types of financial institutions have been experiencing a vigorous expansion of business, and since there is need—and sometimes institutional pressure—to maintain a certain minimum ratio between equity and total assets, these institutions must from time to time take advantage of a buoyant share market to raise additional equity capital. Second, unlike industrial and other enterprises, the financial institutions have no access to development budget funds or other sources of rel-

¹⁸ Capital notes are bonds with a low preference upon the dissolution of the company; in Israel they have been issued by banking institutions, where deposits outrank loan capital in the event of dissolution.

atively cheap financing (other than what they can raise through financial intermediation). Third, the financial institutions have easy access to the primary securities market and also serve as underwriters; as a result, their own flotation expenses are relatively low and they can therefore better ensure the success of their issues. Finally, because of their relatively large size and the fact that they are accustomed to use this method of raising additional equity capital, they are less hesitant about deciding between stagnation or a private placement on the one hand and a public offering on the other. Furthermore, the paucity of family-owned financial institutions makes it natural for this group to turn to the Exchange to raise capital.

Industrial firms, in contrast, have a better alternative for raising capital, namely soft Government development budget loans. In addition, there is a reluctance in this sector for private companies to go public, with all that this involves concerning the obligation to reveal information on the firm's operations, the intervention of new shareholders in management, etc.

Table XVII-9

**SECURITIES LISTED ON THE TEL AVIV STOCK EXCHANGE,^a
AT PAR AND MARKET VALUES, 1971-72**

(IL million)

End of period	1971		1972		Percent increase or decrease (-)	
	Par value	Market value	Par value	Market value ^b	Par value	Market value
Bonds						
Linked to the foreign exchange rate	85.1	130.2	74.9		-12.0	
Index-linked	1,244.2	1,736.3	1,701.3		36.7	
Traded in foreign currency	1,111.8	1,127.4	1,207.6		8.6	
Option-type	2,228.0	2,992.7	2,351.3		5.5	
Mixed linkage	7.9	16.8	2.6		-67.1	
Nonlinked	57.0	47.0	112.8		97.7	
Total	4,734.0	6,050.5	5,450.5		15.1	
Shares						
Ordinary	886.5	1,175.0	986.0	2,467.8	11.2	110.0
Preferred	25.7	34.1	41.3	105.0	60.7	207.9
Traded in foreign currency	187.9	213.4	187.9	226.3	0.0	6.0
Total	1,100.1	1,422.5	1,215.2	2,799.1	12.5	96.8

^a Does not include all the issues sold with a prospectus; among long-term index-linked bonds a large percentage are issued with a prospectus but are not listed on the Exchange. A distinction should also be made between the amount of securities listed on the Exchange and the actual marketable stock of securities, because of the existence of large blocks (held by individuals and institutions) which are not for sale.

^b Data on bonds had not yet been published when this Report went to press.

Most of the 1972 flotations fared quite well on the Exchange, being completely subscribed and with their shares commanding a higher price in the case of rights issues and with oversubscriptions and a price rise in the case of offerings to the general public. The bulk of the equity capital was raised through share issues (72 percent of the total), with convertible bonds providing the balance. Resort to the latter began in 1971 and increased during the year reviewed, when six of the 12 companies mobilizing capital on the Exchange did so by way of convertible bonds, which produced a total of IL 56 million. This instrument has three principal advantages, one of which favors the investor and the other two mainly the issuer. First of all, as far as the investor is concerned, this type of paper is less risky than a share, but its long-run prospects are hardly affected thereby.¹⁹ Second, for a company whose shares are already being traded on the Exchange, a convertible bond issue is likely to fare better than a share issue. If it floats a new share issue, those already owning the company's stock will not necessarily increase their holdings, while the appearance on the market of convertible bonds, with different characteristics from those of the company's shares, alters the optimal portfolio composition and usually makes it worthwhile to purchase them. Finally, in the initial years the current payments on such bonds constitute a deductible interest expense, and not a nondeductible dividends payment.

Table XVII-10

NEW SHARE AND CONVERTIBLE BOND ISSUES, BY GROUP, 1971-72

(IL million)

Group	1971				1972			
	Shares	Con- vertible bonds and capital notes	Total	Percent of total	Shares	Con- vertible bonds and capital notes	Total	Percent of total
Banking institutions (incl. holding companies)	10.5	25.0	35.5	67.3	84.6	30.0	114.6	57.5
Other financial institutions	12.8	—	12.8	24.2	35.9	13.0	48.9	24.6
Industry and commerce	2.5	2.0	4.5	8.5	4.0	6.0	10.0	5.0
Land and development	—	—	—	—	18.7	7.0	25.7	12.9
Total	25.8	27.0	52.8	100.0	143.2	56.0	199.2	100.0

¹⁹ A certain premium has to be paid for this relative to a regular bond investment.

Eleven of the 12 new equity issues in 1972 were of stock rights to holders of record, with only a single company making an offering to the public. There are three principal reasons for raising equity capital by way of a rights issue. First, some companies are legally bound by their articles of association to float new equity issues only in the form of stock rights. The second reason is to enable existing stockholders to retain their share in total capital and thus control of the firm, even if this is not explicitly stipulated in the articles of association. The third reason is to ensure the success of the issue, for the rights enable the existing stockholders to acquire new shares for less than the market price, thereby providing an incentive for them to exercise their rights. Given the conditions of the Israeli market, it seems that the dominant motivation has been a combination of the legal obligation and the desire to ensure the success of the flotation. Another feature of many of the 1972 equity issues was the offering of part of the issue to the company's employees on preferential price and credit terms. This practice grew more widespread this year owing to the boom and the high rate of return on listed stocks, which enhanced the readiness of employees to accept part of their wage increments in this form, while the companies were interested in letting their workers participate in the ownership, thereby giving them a bigger stake in the concern.

The convertible bond issues, on the other hand, were offered to the general public, rather than in the form of rights issues, but in some cases there was a preallotment to preferred investors (generally institutional). This was due to the desire to enable affiliated institutional investors to share in the profits of the flotation, and to ensure a nucleus of institutional investors—a desirable situation in times of stock market slump and crisis. As mentioned above, this section deals with the mobilization of equity capital by companies listed on the Tel Aviv Stock Exchange, with the shares offered either to all stockholders of record (by means of rights issues) or to the general public. At the same time, it should be noted that in 1972 several listed firms made private placements either to part of their stockholders or to outsiders by prior arrangement. These flotations are not included in the above data, and the shares involved are generally not listed for trade on the Exchange.

In 1972 Government policy regarding the desired company financing structure, especially of industrial concerns, moved further in the direction of a diminished reliance on subsidized directed loan capital and a greater resort to the Stock Exchange for raising investment capital. But apart from moral encouragement, no substantive steps have yet been taken to implement this policy (e.g. participation in flotation costs, tax concessions, according preference to firms raising capital through the Exchange by granting them subsidized supplementary loans, etc.).

Finally, it should be noted that this year more Israeli companies floated share issues abroad, especially in the U.S.A. There were six such issues, totalling IL 200 million, compared with a single IL 34 million issue in 1971. Some of

these shares are traded in the over-the-counter market, while others were probably issued under partnership agreements and are not held by the general investing public abroad.

4. SHORT-TERM LOAN

The outstanding balance of the Short-Term Loan rose by only IL 32 million, or 4.4 percent, in 1972, after increases of IL 157 million and IL 93 million in 1971 and 1970 respectively. The deceleration in the year reviewed coincided with a rapid monetary expansion and the growth of other short-term nonlinked financial asset holdings (both time and demand deposits were up 31 percent). There were three principal factors behind this development: (a) the continuation of the inflation and its exacerbation toward the end of the year (see section 2), which induced a shift from unlinked to linked assets; (b) the decline in the Short-Term Loan yield relative to that of other nonlinked financial assets and linked assets, including those with a short term to maturity; and (c) the tight liquidity situation which developed toward the end of the year and apparently prompted bank investment advisers to push time deposits rather than the Short-Term Loan. In 1972 as well, the yield on the Short-Term Loan lagged behind the rise in the consumer price index, so that there was a negative real rate of interest on this paper.

The amount of funds absorbed from the public through the Short-Term Loan²⁰ showed an even more drastic change in 1972, dropping from IL 87 million in 1971 to IL 55 million. In other words, not only did the Short-Term Loan fail to help check the monetary expansion in the year reviewed, but by generating an external infusion of IL 55 million it further stimulated it.

The tendency for the Short-Term Loan to become less a capital market and more a money market instrument continued in the year reviewed. The underlying cause of this development is the prolonged rapid rise in the general price level, which has strengthened the propensity to acquire financial assets (notably linked bonds and shares) as a hedge against inflation. This development has been reflected by a steady decline in the weight of Loan series maturing in one year or more—from 37.7 percent of total holdings of this paper at the end of 1969 to 25 percent at the end of 1970, 21.8 percent in 1971, and 18 percent in the year reviewed. A breakdown of the composition of new sales of the Short-Term Loan—a variable more sensitive to changes in the public's demand than the composition of the outstanding balance—points up this phenomenon even more sharply. Whereas gross sales of the three-month series expanded by 54 percent and those of the six-month series by 21 percent, the one-year series showed no increase at all, and the 18-month series plunged 35 percent.

²⁰ Absorption by way of the Short-Term Loan is defined as the difference between the public's incremental holdings on the one hand and interest payments and the disagio on the other; it represents the net proceeds from sales of this paper.

Table XVII-11

SHORT-TERM LOAN HELD BY THE PUBLIC, BY REDEMPTION DATE, 1971-72

(IL million)

Number of days to redemption	Dec. 31, 1971		Mar. 31, 1972		July 6, 1972 ^a		Sept. 30, 1972		Dec. 31, 1972		Change during 1972 (IL m.)
	IL m.	%	IL m.	%	IL m.	%	IL m.	%	IL m.	%	
	Up to 91	389.5	54.3	414.0	54.4	447.1	56.4	470.2	58.4	436.0	
98-182	171.3	23.9	194.1	25.5	200.3	25.3	195.4	24.3	178.1	23.8	6.8
189-364	135.1	18.9	135.8	17.9	130.6	16.5	125.9	15.6	120.3	16.1	-14.8
371-546	20.9	2.9	17.0	2.2	14.4	1.8	14.0	1.7	13.9	1.9	-7.0
Total	716.8	100.0	760.9	100.0	792.4	100.0	805.2	100.0	748.3	100.0	31.5

^a There are no data for June 30, 1972.

SOURCE: State Loans Administration.

The rising trend in Short-Term Loan holdings weakened in the course of 1972, until it tapered off and even turned sharply downward in the last quarter. The balance rose by IL 44 million in the first quarter, IL 31 million in the second, and IL 13 million in the third; after peaking in October at IL 817 million, it dropped by IL 70 million to stand at IL 748.3 million at year's end (see Table XVII-11).

Stock Exchange trade in this paper expanded by 42 percent to reach IL 213 million; the lion's share represented Bank of Israel open-market operations aimed at propping up the yield level and sales. Most of the public's transactions in the secondary market are executed by brokers on own account: as a series approaches maturity, the latter buy up all the certificates put on the market (which generally constitute a large percentage of the total outstanding balance of the series, since the brokers offer the investors the full net proceeds several days before official redemption date). It follows that the brokers do not permit any current trade in this paper on the Stock Exchange.

5. COMPULSORY LOANS

Compulsory loans levied on the public brought in IL 1,181 million in 1972, compared with IL 1,041 million the year before. Redemptions of loans imposed in the past (including the Absorption Loan and the 1967 Defense Loan) added up to IL 635 million, as contrasted with IL 105 million in 1971. (The question of how to treat this loan, including the reinvestment of redemption proceeds, is discussed in section 2.)

The compulsory loans cannot be regarded as part of the primary securities market, but they do account for part of the total capital mobilized in the

economy and to some extent have supplanted purchases of ordinary securities.²¹ The IL 1,181 million compulsory loan receipts in 1972 were collected on two types of loans: IL 588 million on the Defense Loan and IL 593 million on the Savings Loan (collection of the latter loan from employees was terminated in April 1972). As the receipts from these two levies are determined by the level of wage income and profits, they rose along with the latter two variables. But because of the discontinuation of collection of the Savings Loan from employees, total compulsory loan proceeds lagged behind the growth of these two variables.

In 1972 certificates were distributed as follows: IL 122 million—1970 Defense Loan; IL 63 million—Savings Loan; IL 52 million—1967 Absorption Loan; IL 106 million—1966 Absorption Loan; and IL 2 million—earlier Absorption Loan series.

It should be noted that the 1970 Defense Loan and the Savings Loan are not negotiable (either on or outside the Stock Exchange), and hence they have no direct bearing on either the primary or the secondary market. But by affecting both the disposable income of households and their wealth (as distinguished from negotiable financial assets), they do have an indirect effect.

Besides the compulsory loans, which are levied on all persons paying income tax, IL 129 million was collected on account of the Defense Loan issue to banks. Adding this item brings the total amount of capital raised by the Government through compulsory loans up to IL 1,350 million, compared with IL 1,142 million in 1971.

6. SECURITIES TRADED IN FOREIGN CURRENCY AND THE NATAD MARKET

Activity in securities traded in foreign currency slackened in 1972, owing to the August 1971 devaluation of the Israeli pound and the enormous expansion of the country's foreign currency reserves—which eliminated expectations of another devaluation of the IL in the near future—and also because of the weakening of the U.S. dollar in the world's money markets. Net receipts from Israeli security issues denominated in foreign currency plummeted from IL 87 million in 1971 to a mere IL 19 million, while the balance of Natad deposits and foreign currency security holdings went up by \$ 32 million, after soaring \$ 77 million in 1971. The agio on the Natad dollar was very close to zero (0.7 percent—the commission charge on such transactions) throughout most of the year. Such was the situation in spite of the upheavals which shook the world's currency markets at the end of the previous year and the feeling that equilibrium had not yet been restored—a development which should have enhanced interest here in securities traded in foreign currency, if not from expectations of a change in the external value of the Israeli pound, then from the anticipation of a

²¹ For a more detailed discussion of how compulsory loans are treated in the analysis of the securities market, see Bank of Israel, *Annual Report 1970*, p. 394.

change in the major world currencies. However, it should be noted that this slackening of activity occurred against the swelling in recent years of Pazak and Tamam accounts due to nonconversion of all the receipts and—even more important—to the revaluation of several European currencies and the devaluation of the U.S. dollar and Israeli pound. To be sure, these accounts are not negotiable and not everyone may hold them, but because of their wide ownership they serve as a substitute for securities traded in foreign currency, and it is a reasonable inference that they have had a moderating effect on the demand for securities linked to or denominated in foreign currency.

Table XVII-12

NET PURCHASES^a OF FOREIGN CURRENCY SECURITIES OUT OF TAMAM
AND NATAD FUNDS, 1970-72

(\$ million)

End of period	1970	1971	1972			
			Total ^b	Listed in Israel	Hollis	Listed abroad
Net purchases						
January	2.7	5.1	1.7	1.4	-0.1	0.4
February	5.0	3.9	-0.1	-0.6	0.6	-0.1
March	0.7	0.8	-0.3	-0.5	0.5	-0.3
April	6.0	4.6	-1.1	-0.9	0.1	-0.3
May	5.2	3.4	7.1	5.5	0.4	1.2
June	5.7	5.2	4.4	4.6	0.3	-0.5
July	3.9	5.1	4.1	4.0	0.0	0.1
August	2.4	1.9	2.6	3.0	0.1	-0.5
September	2.5	2.5	0.0	0.7	-0.1	-0.6
October	3.1	2.1	-0.5	-0.4	0.0	-0.1
November	2.7	0.9	0.3	-1.0	0.6	0.7
December	6.2	3.1	1.3	1.4	0.3	-0.4
Total net purchases	46.1	38.6	19.5	17.2	2.7	-0.4
Revaluation ^c						
Total increase in holdings	13.1	73.0	38.3	21.7	4.2	12.4
Holdings at end of period	252.3	325.3	363.6	189.8	92.4	81.4

^a Total securities purchased, less total securities sold during the period.

^b Includes \$ 1.0 million differentials due to changes in foreign exchange rates.

^c The differential arising from the revaluation of the portfolio according to the prices at the end of March (or May); does not include the increment arising from changes in foreign exchange rates.

SOURCE: Based on data of the Foreign Exchange Department, Ministry of Finance.

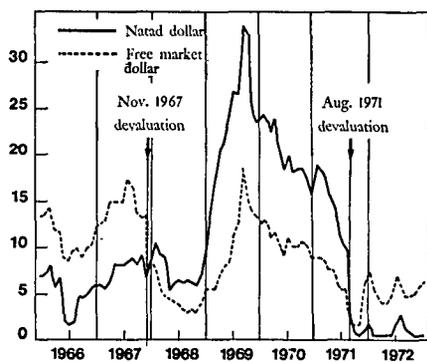
The outstanding balance of securities traded in foreign currency held by Israeli residents came to \$ 364 million at the end of 1972, with issues of Israeli institutions (including Hollis) accounting for 75 percent of the total and foreign

securities for only 25 percent. The scales were even more heavily tilted in favor of the former in the 1972 growth of the portfolio: whereas net sales of new Israeli issues came to \$ 19.9 million, there was a mere \$ 400,000 trickle in the case of foreign securities (see Table XVII-12). But since the exchange rate differentials on the latter amounted to \$ 12.8 million, as opposed to \$ 6.0 million for the Israeli securities (including Hollis), the foreign securities accounted for \$ 12.4 million of the \$ 38.3 million portfolio increment. From the foregoing it may be concluded that the demand for foreign currency securities stems primarily not from a desire to trade on foreign stock exchanges or to geographically diversify investment portfolios, but from the investors' desire to hedge themselves against a change in the external value of the Israeli pound.

Figure XVII-3

**THE AGIO ON THE NATAD AND
FREE-MARKET DOLLAR, 1966-72**

(percent change)



SOURCE: State Loans Administration.

securities and financial assets denominated in or linked to foreign currency picked up somewhat, did the Natad rate edge up to reach a monthly average high of IL 4.32 in July. A currency breakdown of the Natad deposits strengthens the conclusion that these accounts served to only a minor extent as an instrument for speculating against the dollar, for 78 percent of the end-1972 balance was denominated in dollars.²² It thus appears that the agio on the Natad dollar is primarily influenced by expectations regarding the external value of the Israeli pound and not by a desire to participate in the worldwide speculation against various currencies—which an Israeli can do legally through the Natad market.

²² At the end of 1971 the weight of dollar-denominated securities was 93 percent. The decline in the year reviewed may be attributed to the influence of the currency market upheavals, which resulted in half the Israeli foreign currency issues being denominated in Swiss francs rather than dollars, as well as to the increments arising from the various exchange rate changes this year.

The subsidising of demand for foreign currency securities was undoubtedly also due to the rise in nominal yields on bonds and especially stocks denominated in Israeli currency, and perhaps also to the further liberalization of foreign currency control, which has enlarged the array of foreign currency assets Israelis may hold.

As a result of these developments—which dampened demand for Natad dollars and led to a greater conversion of current personal restitution receipts and Tamam funds, thereby augmenting the supply of Natad dollars—the price of the Natad dollar hovered during most of the year at a low of IL 4.23. Only from June through September, when conversions fell off and demand for foreign

Table XVII-13

**NATAD AND FREE-MARKET DOLLAR RATES, NATAD BALANCES,
AND HOLDINGS OF SECURITIES TRADED IN FOREIGN CURRENCY, 1971-72**

(\$ million)

	1971							1972						
	Securities traded in foreign currency	Natad balances	Total	Natad dollar rate (monthly average ^a) (IL)	Agio on Natad dollar (%)	Free- market dollar rate (monthly average ^a) (IL)	Agio on free- market dollar (%)	Securities traded in foreign currency	Natad balances	Total	Natad dollar rate (monthly average ^a) (IL)	Agio on Natad dollar (%)	Free- market dollar rate (monthly average ^a) (IL)	Agio on free- market dollar (%)
January	257.3	16.9	274.2	4.16	18.6	3.82	9.2	327.0	20.8	347.8	4.23	0.7	4.44	5.7
February	261.2	17.4	278.6	4.13	17.9	3.81	8.9	326.9	18.0	344.9	4.23	0.7	4.41	5.0
March ^b	296.5	23.4	319.9	4.06	15.9	3.78	7.9	326.6	20.0	346.6	4.23	0.7	4.38	4.2
April	301.2	21.5	322.7	4.03	15.1	3.78	7.9	325.5	19.6	345.1	4.23	0.7	4.38	4.2
May	304.6	23.0	327.6	3.92	12.0	3.72	6.2	351.4	10.1	369.5	4.23	0.7	4.42	5.2
June	309.7	21.9	331.6	3.88	10.8	3.70	5.7	355.8	17.2	373.0	4.28	1.9	4.50	7.1
July	314.8	21.5	336.3	3.85	10.0	3.70	5.7	359.9	15.8	375.7	4.32	2.9	4.46	6.2
August	316.7	22.0	338.7	4.31	2.6	4.29	2.0	362.5	15.8	370.3	4.26	1.4	4.41	5.0
September	319.2	24.3	343.5	4.24	1.0	4.27	1.8	362.5	15.3	377.8	4.24	1.0	4.41	5.0
October	321.3	21.6	342.9	4.23	0.7	4.28	1.9	362.0	15.4	377.4	4.23	0.7	4.42	5.2
November	322.2	20.2	342.4	4.25	1.1	4.47	6.4	362.3	14.9	377.2	4.23	0.7	4.45	6.0
December	325.3	22.3	347.6	4.28	1.9	4.52	7.6	363.6	16.0	379.6	4.23	0.7	4.48	6.6

^a Thursday averages.^b Including revaluation increments.

SOURCE: Bank of Israel and Foreign Exchange Department, Ministry of Finance.

The agio on the free-market dollar was also relatively low during 1972, slipping to an annual average of about 5.5 percent. This is attributable primarily to the absence of expectations of a devaluation of the Israeli pound; however, the sources of supply and demand in this market are more diversified, so that the changes in the agio may also have been due to other factors. A glance at Figure XVII-3 reveals a very interesting phenomenon: although the agio on the free-market dollar did not move parallel to that of the Natad dollar in recent years, their paths crossed at only two points, both after a devaluation of the Israeli pound.