

CHAPTER XVIII

THE SECURITIES MARKET

1. MAIN DEVELOPMENTS

NEW DOMESTIC security issues¹ were on about the same scale in 1969 as in the previous year. Bonds, which in recent years have accounted for the overwhelming proportion of total new issues, fell from IL 897 million in 1968 to IL 867 million, while equities went up from IL 6.5 million to IL 28.5 million.

In bonds, there was a decline of IL 96.6 million in long-term issues, particularly the Absorption Loan, which in 1969 was collected almost solely from companies and self-employed. (On the other hand, the distribution of Absorption Loan certificates paid for in previous years rose from IL 57.7 million in 1968 to IL 112.4 million.²) New option-type loans³ went up by IL 63.4 million, the resultant of a 72 percent increase in the Defense Loan and a decline in all other option-type loans. As to securities traded in foreign currency (including Israeli securities traded on the Tel Aviv Stock Exchange and foreign securities listed on overseas exchanges), new Israeli issues increased by only IL 3.2 million (\$ 0.95 million at the official exchange rate); by contrast, net sales of foreign securities rose by an appreciable \$ 14.3 million.⁴ Even though domestic share issues were greater than in 1968, this does not mean that the new issue market rebounded from its low level of the previous year, since the increment consisted entirely of rights issues to stockholders of record.

Net sales of the Government Short-Term Loan plummeted from IL 115.6 million in 1968 to -IL 27.9 million (i.e. redemption exceeded sales), in spite of two increases in the nominal rate of interest, in April and November.

The share of the public (i.e. net of institutional purchases, except those by mutual funds) in the total growth of security holdings was higher in 1969 than in the previous year. There was a particularly striking rise in investments of the mutual

¹ See the definition of new issues in note 2 on p. 362.

² The value of certificates distributed is not included in the value of new issues.

³ Option-type loans permit the investor to choose, upon maturity, between a high rate of interest without linkage of the principal, and a lower rate with the principal linked to the consumer price index.

⁴ The comparison is made in dollars because both types of securities are purchased in this currency. Moreover, the Israeli pound equivalents calculated at the official rate of exchange are understated, as the prices which Israeli and foreign investors paid for their dollars in the Natad market in order to purchase these securities were far above the official rate (see the discussion in section 5 below).

funds operated by banks—IL 126 million as against IL 25 million in 1968. Brisk sales of participation certificates, in the main to private individuals, largely explain this upsurge.

Stock Exchange transactions in both equities and bonds expanded more slowly than in the previous year. Turnover in bonds was only 16 percent larger, compared with an 89 percent rise in 1968, while that in shares, which had soared 104 percent in 1968, fell by 4 percent in the year reviewed. Bonds linked to the exchange rate were an exception to the general trend, trading therein being 58 percent over the 1968 level.

Bond prices moved up throughout most of the year. The sharpest rise was in dollar-linked bonds, which advanced 17 percent between January and September. Bond yields, which were high at the beginning of the year (particularly in the case of Defense and Absorption Loan certificates), retreated steadily until the last quarter, when they reversed direction as prices slipped.

Both prices and yields of equities displayed a downward trend in 1969, except in the industrial and commercial group, where prices moved up 4 percent, mainly because of larger stock and cash dividends.

The price of the investment (Nataf) dollar reached an all-time high in 1969. The agio—the percentage difference between the price of the dollar in the Nataf market and the official rate—stood at 36 in August, but declined to 25 toward the end of the year.

These developments in the securities market were influenced by two special factors at work in the economy during the year. The first was the tightness of credit (attributable in the main to the heavy depletion of foreign currency reserves), which drove up the interest rate on short-term assets. But owing to the nature of the new issue market for bonds, this did not produce any change in issue terms. Despite the credit squeeze, portfolio investments by the public did not fall off, apparently because of the prevailing expectations of a general price rise. On the one hand, these expectations induced a larger purchase of assets linked to the consumer price index, such as bonds and deposits in option-type saving schemes; on the other hand, they dampened investments in short-term unlinked assets (apart from brokered bills, where special circumstances stimulated demand),¹ despite the raising of the interest rates thereon.

The second factor affecting the securities market was developments in the international money market, particularly the devaluation of the French franc in August and the upward revaluation of the German mark in October. These changes engendered expectations of a devaluation of the Israeli pound,² which

¹ See Chapter XIV, section 5.

² The revaluation of the mark indirectly generated expectations of a local devaluation: the public believed that in its wake sterling would be devalued, with the Israeli pound following suit.

in turn had a marked effect on sales of securities traded in foreign currency, as well as on the price of the investment dollar and the growth of Pazak and Tamam deposits.¹

2. THE NEW ISSUE MARKET

(a) *The nature of the market*²

In Israel the new issue market, unlike the secondary market, which is largely competitive, is characterized by a high degree of Government intervention. In addition to floating issues directly, the Government mobilizes funds through other issuers, who deposit the proceeds with it. Some of these funds then flow back to various financial institutions to be used for purposes specified by the Government, in the main mortgage loans and credits for tourism and agriculture. The terms granted to the financial institutions are better than those governing the new issues. In this manner the Government covers the difference between the relatively high return paid to investors in new bonds and the rather low interest charged borrowers (the credit is generally granted unlinked, while the funds raised through new bond issues are linked).

Government intervention affects nongovernmental issues on both the supply and demand sides. On the supply side, income tax concessions enable the issuer to compete in the market, particularly since such concessions are granted on Government securities. Acceptance of Government direction of the issue proceeds is another condition for authorization of new issues (all new issues have to be approved before they may be offered to the public).³ On the demand side, the Government requires certain types of institutions, such as social insurance funds, to invest a large part of their assets in approved bonds. In addition, there have been flotations of forced loans (such as the Absorption and Compulsory Saving Loan), as well as semi-compulsory issues (such as the Defense Loan), whose sale was promoted by the exertion of strong social pressure.

It follows, therefore, that in a sense the financial institutions may be regarded as agents of the Treasury for the floating of bond issues,⁴ so that the differentiation between governmental and nongovernmental bond issues is of limited

¹ Foreign currency deposits, originating largely in the receipt of personal restitution from West Germany.

² For a more detailed discussion of this subject, see Bank of Israel, *Annual Report 1967*, pp. 504–10.

³ As of July 1969, the scrutinizing of prospectuses fell within the purview of the Securities Authority, which was established under the Securities Law, 5728–1968. The establishment of the Authority had a marked effect on the time distribution of approvals granted in 1969. Of the IL 528.5 million total (nominal) value of new issues approved in 1969, 73 percent was approved in the first half of the year and 38 percent in June alone. From July to October no new issues were approved.

⁴ In 1969 financial institution deposits with the Treasury declined. See Chapter XVI.

Table XVIII-1
DOMESTIC SECURITY ISSUES,^a 1968-69
(IL million)

	1968			1969			Increase or decrease (-) in net issue
	Gross issue	Redemption ^b	Net issue	Gross issue	Redemption	Net issue	
Long-term loans							
Absorption Loan ^c	76.9	29.0	47.9	25.2	46.2	-21.0	-68.9
Other Government loans ^d	87.7	41.3	46.4	33.9	27.3	6.6	-39.8
Nongovernmental loans	335.0	76.6	258.4	407.2	136.7	270.5	12.1
Total	499.6	146.9	352.7	466.3	210.2	256.1	-96.6
Option-type loans							
Defense Loan, 1967	15.6	—	15.6	—	—	—	
Defense Loan, 1968	180.3	—	180.3	93.5	—	93.5	141.5
Defense Loan, 1969	—	—	—	243.9	—	243.9	
Development loan	145.2	30.7	114.5	147.2	76.9	70.3	-44.2
Nongovernmental loans ^e	213.0	8.1	204.9	204.6	33.6	171.0	-33.9
Total	554.1	38.8	515.3	689.2	110.5	578.7	63.4
Bonds traded in foreign currency^f							
Total bonds	1,118.6	221.4	897.2	1,231.8	364.6	867.2	-30.0
Short-Term Loan	—	—	115.6	—	—	-27.9	-143.5
Shares	6.5	—	6.5	28.5	—	28.5	22.0

^a Excluding sales of foreign securities in Israel and sales of bonds without a prospectus; including sales to the banks under an arrangement with the Treasury (the Defense and Development Loans).

^b Scheduled redemptions (principal plus linkage differentials). Includes actual data on the early redemption of option-type loans and redemption of securities traded in foreign currency. There are some discrepancies between the data on redemption of Government bonds cited in this table and those in Chapter VII, which are based on actual redemptions.

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

^d Including sales of Jewish Agency bonds held by the Accountant General, in the amount of IL 51 million in 1968 and IL 16 million in 1969. These sales apparently served as a substitute for new issues by Hevrat Ovdim, a major issuer of nongovernmental securities taken up by Histadrut-administered social insurance funds, and it is reasonable to assume that had it not been for these sales, other bonds would have been issued.

^e Includes issues by financial institutions, social insurance funds, insurance companies, and other institutions.

^f The data were converted into Israeli pounds at the official rate of exchange (see Table XVIII-9).

SOURCE: State Loans Administration.

economic significance. But obviously the initiative taken by banks in distributing these fixed-interest securities through their approved saving schemes and by other means created the opportunity for the Government to raise capital for its own use through nongovernmental issues.¹

(b) *New issues in 1969*²

The volume of capital raised in 1969 through net sales of new bonds and shares remained at about the level of the previous year.³ There was a slight fall in bond sales, a rise in share issues, and a sharp decline in sales of the Government Short-Term Loan. As in previous years, bonds were far out in front in net sales (see Table XVIII-1). Issue terms were the same as in 1968.

This stability in new issues stands out because of the tight money market and excess demand for credit that marked 1969, conditions which as a rule generate expectations of an increase in the volume of new flotations and a change in issue terms. As to bonds, the Government, the beneficiary of most issue proceeds, decided to employ the Defense Loan as its main instrument for raising debt-financed funds in 1969. While this policy boosted sales of the Defense Loan, it dampened sales of other loans. The stability in the volume of share issues in 1969 is ascribable to the fact that, as in the past, potential issuers had alternative sources from which to raise funds on more favorable terms.

1. *Bonds*

In 1969 net sales of new bonds reached IL 867.2 million, as against IL 897.2 million the year before. Less collections on the Absorption Loan, which have been diminishing since 1968,⁴ net sales of new bonds rose by 4.5 percent,

¹ Most of the financial institutions are connected with the large banks, and the latter prefer to invest their approved saving scheme and other deposits in bonds issued by their affiliates. The institutions associated with the two largest banks are among the three leading bond issuers in Israel.

² These consist of all Government and non-Government securities offered to the public by means of a prospectus, as well as the Absorption and Defense Loans.

³ The data relate to actual sales less redemptions, and not to the nominal value of the issues. Redemptions are scheduled redemptions, including linkage increments on the principal (the latter are omitted from the data up to 1969). These increments are included on the assumption that the willingness to hold a value-linked bond depends on the prospects for receiving the real price of the bond at maturity. If linkage increments were not included, prices and redemptions would have to be measured in pounds of different worth.

⁴ Inclusion of the Absorption Loan distorts the picture somewhat. Collection of the loan from employees was discontinued in April 1968, while in 1969 it was collected from businesses and self-employed on account of previous years. In contrast to the declining trend in collections, the distribution of bond certificates rose sharply. As the public can deal in the loan only after receipt of the certificates, any analysis of the changes in the public's securities portfolio should be based on the value of certificates distributed and not on the sums collected (see section 3).

Table XVIII-2

NET SALES OF OPTION-TYPE LOANS, BY PURCHASER, 1968-69

(IL million)

	1968	1969	Increase or decrease (-)
Sales to the public^a			
Defense Loan	114.3	238.7	124.4
Development Loan and nongovernmental loans	236.0	179.2	-56.8
Total	350.3	417.9	67.6
Sales to banking institutions^b			
Defense Loan	81.6	98.7	17.1
Development Loan	83.4	62.1	-21.3
Total	165.0	160.8	-4.2
Grand total	515.3	578.7	63.4

^a The public consists of all purchasers of option-type loans other than banks acquiring bonds under a special arrangement with the Treasury.

^b Under a special arrangement with the Treasury.

SOURCE: State Loans Administration.

from IL 849.3 million in 1968 to IL 888.2 million. This increase was due mainly to a 72 percent jump in Defense Loan sales; net sales of other option-type loans fell off sharply.¹ Option-type loans grossed more in the year reviewed than in 1968, and accounted for 65.2 percent of the total value of new issues, as against 60.7 percent in 1968. Net sales of long-term bonds fell by 4 percent and accounted for 31.2 percent of the total, compared with 35.9 percent the year before. Israeli bonds traded in foreign currency netted somewhat more than in 1968.

Sales of option-type loans underwent a marked structural change in 1969, owing largely to the Government's decision to syphon off funds from the public by means of the Defense Loan (see Table XVIII-2). Obviously purchases of the Defense Loan at source by the public and the banks (the latter under special arrangements) were partly at the expense of other option-type issues. Moreover, since a large percentage of these purchases were not strictly voluntary but were made as the result of moral suasion, the distribution of the loan certificates led to heavy offers in trading outside the Exchange, which depressed the price to below the par value (the 1968 and 1969 loans have not yet been listed on the Exchange) and pushed up the net yield to 11 percent. This induced part of the

¹ There was a big increase in redemptions, both on and ahead of final maturity date, of the option-type Development Loan and option-type nongovernmental loans. The rise in early redemptions was apparently connected with the rumors spawned during the year that the practice of "bond washing" (the sale of bonds close to maturity to an investor exempt from payment of income tax) was to be forbidden. This practice can be carried out in the case of both early and full-term redemptions.

public to acquire the Defense Loan in the secondary market. Another reason for the reduced sales of other option-type loans was the strong demand for the Absorption Loan. This is explained by its high yield throughout most of the year and the possibility of depositing this paper in the conversion-type saving schemes, which offer both option terms and higher yields than other saving schemes.

The drop in net sales of long-term bonds was the resultant of a sharp decrease in Government bonds—particularly the long-term Development Loan (only IL1.7 million out of a gross total of IL 33.9 million in 1969, as compared with IL 20 million out of IL 87.7 million in 1968),¹ and a slight rise in sales of nongovernmental long-term bonds, whose share in the net total went up from 84.8 percent in 1968 to 97.6 percent.

In 1969 transactions in bonds traded in foreign currency and purchases of foreign securities were strongly affected by international monetary developments—the devaluation of the French franc in August, the revaluation of the mark in October, and expectations of the devaluation of sterling. Bonds traded in foreign currency netted only slightly more than in 1968, but gross sales went up steeply in the course of the year²—from IL 29.9 million in the first half to IL 46.4 million in the second half. In foreign securities the increase was particularly outstanding—from \$ 8.7 million in 1968 to \$ 23 million (see section 5 below). In IL terms the growth was even more pronounced, because of the price rise of the Natad dollars used to purchase these securities.

Issue terms remained unchanged for all types of bonds in 1969. The “lengthening” of the life of the bond portfolio, a trend that started in 1968 with the extension of the maturity of the Defense Loan from five to ten years, continued in 1969.³ The share of long-term bonds in total new issues floated rose from 62 percent in 1968 to 68 percent.

2. *Short-Term Loan*⁴

Net sales of the Short-Term Loan plummeted from IL 115.6 million in 1968 to -IL 27.9 million in 1969, a development explained largely by the switch from unlinked to linked assets during the year because of expectations of a general price rise and devaluation. Notwithstanding a substantial rise in the balance of bills brokered by banks, the growth of unlinked financial assets⁵ held by the public slowed down noticeably. The public's propensity to hold linked assets in

¹ This decline is an indication of the continued unpopularity of this loan.

² There are no intrayear figures for net sales.

³ Although the Defense Loan offers option terms, it is treated as a long-term security because its redemption period is ten years. The 1970 Defense Loan will not offer option terms, but will be linked to the cost-of-living index and mature in 15 years.

⁴ The Short-Term Loan is included in this chapter because, although alternative investments are mostly short-term money-market instruments, it has the characteristics of a bond and is traded on the Stock Exchange.

⁵ Consisting of currency, demand deposits, fixed-term deposits in Israeli currency, brokered bills, and the Short-Term Loan. See the discussion in Chapter XIV.

Table XVIII-3

SHORT-TERM LOAN HELD BY THE PUBLIC, BY REDEMPTION DATE, 1968-69
(IL million)

Number of days to redemption	Jan. 1, 1969	Dec. 31, 1969	Increase or decrease (-)
Up to 91	196.3	164.6	-31.7
98-182	103.9	126.1	22.2
189-364	95.3	118.7	23.4
371-546	95.6	57.4	-38.2
Total	491.1	466.8	-24.3 ^a

^a There is a discrepancy between this datum and the corresponding figure in Table XVIII-1, as the former does not include Bank of Israel operations in the Short-Term Loan market.
SOURCE: State Loans Administration.

the year reviewed found expression in a larger investment in linked securities, approved saving schemes offering linkage options, and Pazak and Tamam deposits. The nominal rate of interest on all series of the Short-Term Loan was raised twice during 1969—in April and November. This spurred sales at the time, but they slumped again in subsequent months.

A comparison of the public's holdings at the end of 1968 and 1969 (see Table XVIII-3) reveals a divergent pattern of development for the various Short-Term Loan series in 1969. The decrease in holdings occurred primarily in those series with a redemption period of up to 91 days and from one to one and a half years, while there was a rise in series with a maturity ranging from three months to a year. The decline in the series with longer maturities may have been partly connected with the fact that, because the rate of interest was already close to the ceiling set by the Interest Law, the increase in the rate on the 18-month series was small relative to that for the other series.

3. Shares

Although new equity issues went up from IL 6.5 million in 1968 to IL 28.5 million, this is no indication that the market shook off its listlessness, since these were all rights issues to shareholders of record.¹ The main reason for this stagnation is that potential share issuers can obtain financing on more favorable terms from other sources, particularly in the form of unlinked loans. This being so, the protracted preparation and high costs involved in floating an equity issue render it hardly worthwhile. Shares enjoy but very limited trading on the Stock Exchange (a discussion of the share market follows below), and institutional investors tend to shy away from equity investments. Social insurance funds,

¹ The shares issued by Electric Wire and Cable Co. of Israel Ltd. were the first industrial issue in four years.

for instance, are permitted to invest 5 percent of their assets in shares, but unlike similar institutions abroad, they do not utilize this allotment. This is a vicious circle, the listless state of the equity market stemming from its small size, and vice versa.

3. BEHAVIOR OF BOND AND EQUITY PURCHASERS IN 1969¹

Despite the slower rate of monetary expansion in 1969, security investments by private individuals rose, stimulated by expectations of a general price increase and devaluation. A particularly strong growth was recorded by the mutual funds

Table XVIII-4
GROWTH OF SECURITY PORTFOLIOS, BY TYPE OF PURCHASER, 1968-69
(IL million)

	1968		1969	
	IL m.	%	IL m.	%
(1) Increase in the economy's aggregate portfolio	884.5 (903.7)	100.0 (100.0)	982.9 (895.7)	100.0 (100.0)
(2) Less: Purchases by institutional investors				
Social insurance funds	384.0	43.4 (42.5)	332.0	33.8 (37.1)
Insurance companies	58.5	6.6 (6.5)	64.4 ^c	6.6 (7.2)
Approved saving schemes	235.3	26.6 (26.0)	269.1	27.4 (30.0)
Banking institutions ^a	15.6	1.8 (1.7)	7.9	0.8 (0.9)
Financial institutions ^b	38.1	4.3 (4.2)	28.5	2.9 (3.2)
Total	731.5	82.7 (80.9)	701.9	71.5 (78.4)
(3) Increase in portfolio of the general public (1-2)				
Mutual funds run by banks	24.8	2.8 (2.7)	125.5	12.8 (14.0)
Direct investments	128.2 (147.4)	14.5 (16.4)	155.5 (68.3)	15.7 (7.6)
Total	153.0 (172.2)	17.3 (19.1)	281.0 (193.8)	28.5 (21.6)

NOTE: The figures in parentheses include collections of the Absorption Loan, while the others include the value of Absorption Loan certificates distributed. See the discussion in the text.

^a Excluding the investment of approved saving scheme funds.

^b Excluding investments of mutual funds run by banks; including a small amount of loans to subsidiaries.

^c Estimate.

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

¹ Since securities are purchased both at source and on the Exchange, the discussion below is also connected with developments on the Tel Aviv Stock Exchange. Our purpose is not to analyze the distribution of net sales by purchases at source, but to investigate the increase in the securities portfolio of various types of investors. The data cover both bonds and shares.

of the banks, where the figure soared from IL 25 million in 1968 to IL 126 million.¹

In measuring the growth of the economy's securities portfolio, two different sets of data can be used for the Absorption Loan—collections or the value of certificates distributed. The first more accurately reflects changes in the financial assets held by the public, and it is therefore a better indicator of behavior. The second provides a more accurate measure of the actual growth of the public's securities portfolio. According to the first measure, the increase in aggregate holdings in the economy declined from IL 903.7 million in 1968 to IL 895.7 million in the year reviewed. This was partly due to the drop in net collections on the Absorption Loan—from IL 47.9 million in 1968 to -IL 21 million in 1969. Measured by the distribution data, holdings expanded from IL 884.5 million in 1968 to IL 982.9 million, mainly because of a sharp rise in the gross value of Absorption Loan certificates distributed, from IL 57.7 million in 1968 to IL 112.4 million (see Table XVIII-4).

In Israel most securities are acquired by institutional investors. Their incremental investments are directly related to their annual asset accumulation, and the composition of their portfolios is related to the types of deposits or investments they offer the public.² As in previous years, social insurance funds topped the list of institutional investors. However, because of the expansion of their direct loans and their increased redemption of bonds, both the growth of their portfolios and their share in incremental investments fell off. Most of their purchases are of long-term bonds acquired at source.³

Treasury regulations prescribe that 60 percent of approved saving scheme deposits must be invested in approved securities, which as a rule are not purchased at source, and a further 25 percent must be used to provide directed credit; however, under a special arrangement with the Treasury, the latter portion may be applied toward the purchase of the banks' quota of the Defense Loan. In the past two years the banks utilized their option to buy these bonds because of their liquidity situation. But this did not lead to any significant increase in portfolio investments out of saving scheme funds, since most of the 25 percent had already been invested in securities and not used to grant credit.

In 1969 saving scheme balances expanded by IL 323 million, compared

¹ A significant part of this increase reflected purchases of Absorption and Defense Loan certificates from the general public. In general, such purchases have no bearing on the total increase in the aggregate securities portfolio of private investors, but they do affect the distribution as between direct purchases and indirect purchases through the mutual funds.

² For instance, most purchases by insurance companies are of special bonds issued by the Government and the Israel Electric Corporation. The linkage terms and redemption dates of these bonds are fixed to correspond to those of the insurance contracts. These bonds are not traded on the Stock Exchange.

³ According to Treasury regulations, social insurance funds must invest 80 percent of their assets in approved securities, and 90 percent of that amount in long-term bonds. See the discussion in Chapter XVII.

with IL 276 million in 1968. This growth can be ascribed to the public's desire to acquire linked assets in a year when a general price increase was expected and to the raising of the interest rate on the conversion-type saving schemes in April. In these schemes deposits can be made partly in cash and partly in Absorption Loan certificates; it was the use of the certificates for this purpose and their high yields in 1969 that created the strong demand for them.¹ Even though the earnings on their own investments had not risen, the banks were able to offer their depositors a higher rate of return, because the amount with which the Treasury credited the banks for Absorption Loan certificates deposited in the saving schemes was greater than their market price. The portfolio of the saving schemes increased in 1969 by about IL 269 million, of which IL 67 million was in the Defense Loan² and IL 53 million in the Absorption Loan within the framework of the above-mentioned schemes.

After allowing for the portfolio growth of institutional investors, it turns out that according to both methods of measuring the increase in the economy's securities portfolio, the share of the general public—business and households—in total security holdings went up in the year reviewed. This is contrary to what might have been expected in the light of the monetary restraint which characterized 1969. It should be noted that indirect investments of the public through bank-operated mutual funds rose substantially in 1969, accounting for a greater portion of total security investments by the public. This can be ascribed to the banks' efforts to persuade their clients to invest in the funds, coupled with the public's desire to place the management of their securities portfolio in professional hands.

The period between May 1968 and March 1969 saw the establishment of four funds investing most of their resources in bonds,³ purchased in the main in the secondary market and not at source. Almost all of the IL 126 million increase in mutual fund investments was accounted for by these four, the older funds showing little change. The new funds were launched at a time when

¹ Before April 1969 savers were entitled to deposit Absorption Loan certificates in these schemes only in an amount up to that collected from them on account of this loan. In 1968 deposits in these schemes totalled IL 9 million and constituted 2.7 percent of incremental saving scheme balances. Between April and December 1969 the figure soared to IL 92 million, representing 35.5 percent of the total growth of saving schemes. Calculated according to the prices quoted for the Absorption Loan in April 1969, the return on the conversion-type schemes was 11 percent, compared with 9 percent for the ordinary schemes.

² This is less than total Defense Loan sales to banks in 1969, which amounted to IL 99 million. Apparently the banks made some purchases outside the framework of the schemes; moreover, not all banks operate saving schemes.

³ This is in contrast to the older funds, which invest 60–90 percent of their portfolios in shares. In the new funds bonds linked to the cost-of-living index and option-type bonds account for about half of their total investment; the rest consists of bonds linked to the exchange rate and shares. See the discussion in Chapter XVI.

the yields to maturity of certain bonds (particularly the Defense and Absorption Loan issues) were high, and it was this that induced the initiators of the funds—the investment companies of the three largest banks—to start operations. Apparently the public shared their expectations of capital gains, for it was its heavy purchases of participation certificates that enabled the funds to expand their investments.

The incremental portfolio investment of the general public was financed by a switch from unlinked financial assets in anticipation of a general price rise. This occurred within the context of a fall in the rate of private sector saving, due partly to the above-mentioned expectations which stimulated purchases of consumer durables.¹

4. TRADE ON THE STOCK EXCHANGE

(a) *General trends*

After a year of very lively trading in both equities and bonds, Stock Exchange turnover slowed down in 1969 (see Table XVIII-5). Bond transactions rose by 15.6 percent, after soaring 89 percent in 1968, while equity turnover fell by 4.4 percent, after an exceptionally strong advance of 104 percent the year before. Transactions in the Short-Term Loan also expanded more slowly, by 37 as against 54 percent in 1968, but their weight in total turnover moved up from 25.2 to 30.1 percent.

The data presented here relate only to transactions on the Stock Exchange.

Table XVIII-5
GENERAL TRENDS IN STOCK EXCHANGE TRADING, 1968-69
(IL thousand)

	1968	1969	Percent increase or decrease (-)
		Turnover	
Bonds	183,656.9	212,215.5	15.6
Long-term	71,706.5	69,606.2	-2.9
Option-type	73,393.9	102,992.8	40.3
Traded in foreign currency	38,556.5	39,616.5	2.7
Short-Term Loan	99,676.2	137,186.7	37.6
Shares	111,994.9	107,056.1	-4.4
		Percentage distribution	
Bonds	46.5	46.5	
Short-Term Loan	25.2	30.1	
Shares	28.3	23.4	

SOURCE: Based on data of the Tel Aviv Stock Exchange.

¹ This point is discussed in Chapter IV.

Table XVIII-6
MARKET VALUE AND TURNOVER OF SECURITIES LISTED ON THE TEL AVIV STOCK EXCHANGE, 1968-69

(IL million)

(End of year)

	1968		1969		Annual change in marketable capital			
	Average marketable capital (IL m.)	Annual turnover (%)	Average marketable capital (IL m.)	Annual turnover (%)	1968		1969	
					IL m.	%	IL m.	%
Long-term bonds	1,144.4	6.8	1,435.5	4.7	185.4	19.3	291.1	25.4
Option-type bonds	1,232.4	8.0	1,508.8	7.5	637.3	107.1	276.4	22.4
Bonds traded in foreign currency	651.3	6.2	631.4	6.2	61.3	10.4	-19.9	-3.1
Total bonds	3,028.1	7.1	3,575.7	6.6	884.0	41.2	547.6	18.1
Shares ^a	962.3	12.1	1,080.0	10.5	72.4	10.8	117.7	11.2
Grand total	3,990.5	8.5	4,655.7	7.4	991.1	13.3	665.2	11.7

NOTE: The rate of turnover is based on the data in Table XVIII-5. Average marketable capital has been calculated as the arithmetic mean of the listed capital at market prices at the end of the previous year and the end of the current year.

^a For details of share groups see Appendix Table XVIII-2 (Hebrew only).

SOURCE: Based on data of the Tel Aviv Stock Exchange.

They do not include the matching of buy and sell orders by stockbrokers and the banks in particular, although this accounts for a large percentage of total trading volume.¹ The data available on over-the-counter transactions are fragmentary and therefore are not included here.

1. Trade in listed securities

The volume of transactions is very limited in comparison with the total capital registered on the Stock Exchange (see Table XVIII-6). Registration of securities on the Stock Exchange is a necessary condition for trading, but it does not guarantee that trading in them will actually take place. In 1969 the increase in the value of listed bonds dropped from 41 percent the year before to 18 percent, in spite of rising quotations. The slowdown was particularly marked for option-type loans, reflecting the fact that in the year reviewed the 1968 and 1969 series of the Defense Loan were not registered, whereas in the previous year the 1967 Defense Loan had been registered. Coupled with the deceleration of turnover, this slower increase in registrations led to the levelling-off of the annual rate of bond turnover.

A much larger volume of shares was listed in 1969 and this, combined with a fall in trading volume, depressed the annual rate of turnover, after a sharp rise the year before.

2. Structure of trading

In recent years the volume of share transactions has been much smaller than that in bonds, in contrast to the situation during the securities market boom of 1962-64. In 1969 the weight of shares in total turnover continued downward, from 28 percent in 1968 to 24 percent.

Trade on the Exchange is fairly concentrated, in the sense that a small number of securities account for a good part of the turnover. This is more marked for bonds—where most of the trade is in Government paper—than for shares (see Table XVIII-7).

(b) Trade in shares and price and yield trends

Despite the increase in the value of shares listed in 1969, the volume of transactions fell off. During the year turnover fluctuated and no consistent trend emerged (see Figure XVIII-1): after slipping noticeably in the first half of the year, trading volume picked up between August and October, but subsequently it resumed its downward movement. Trade in the variables² dropped from 22 percent of total turnover in 1968 to 17 percent.

¹ Publication of data on offsetting buy and sell orders was instituted in April 1970.

² The reference is to trade at freely varying prices during the second session of the day; this takes place if during the first session, when trading is at fixed opening prices, there is excess demand or supply.

Table XVIII-7
DISTRIBUTION OF LISTED SHARES AND BONDS,
BY ANNUAL TRADING VOLUME, 1969

Annual volume (IL '000)	Ordinary shares		Bonds ^a	
	Number of shares	Percent of total trading volume	Number of bonds	Percent of total trading volume
Under 100	14	0.2	46	0.4
100-250	8	1.3	13	0.9
250-500	11	4.2	9	1.4
500-1,000	17	12.8	18	5.3
1,000-2,500	23	35.7	9	5.4
2,500-5,000	7	24.9	1	1.4
5,000-10,000	3	20.9	2	4.8
Over 10,000	—	—	5	80.3
Total	83	100.0	103	100.0

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

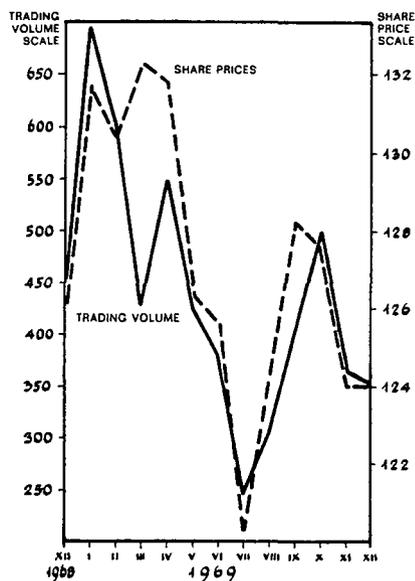
In 1969 share prices traced a path similar to that of turnover. At the beginning of the year there were sharp rises in most groups, in particular industrials and commercials—a reflection of the confident mood of the market. After advancing 5 percent in the first quarter, the index of share prices slipped 9.2 percent to reach its low point in July. At this level shares became more attractive, and a revival of demand in August and September pushed the index up by 6.6 percent; in the last two months of the year, however, the trend was again reversed. For the year as a whole, the index fell by 0.8 percent, as against a rise of 15.7 percent in 1968.

Price fluctuations were not as sharp in 1969 as in the previous year (see Table XVIII-8), and in spite of the decline in the general index, the average level of share prices was higher than in 1968. The price movements for the various groups

Figure XVIII-1

INDEX OF SHARE TRADING VOLUME^a AND PRICES, 1969

(Daily index; March 31, 1967=100)



^a Average daily volume.

Table XVIII-8
SHARE PRICE INDEXES^a AND YIELDS,^b BY GROUP, 1968-69
(March 31, 1967=100)

Share group	1968						1969					
	End-year prices	Percent annual change in prices	Average monthly price fluctuation ^c	Overall rate of return (%)	Average profit or loss per share ^d (%)	Dividend yield at Dec. 31, 1968 (%)	End-year prices	Percent annual change in prices	Average monthly price fluctuation ^c	Overall rate of return (%)	Average profit or loss per share ^d (%)	Dividend yield at Dec. 31, 1969
Banks, insurance, and financial institutions	114.8	3.1	3.1	11.4	15.0	8.1	113.5	-1.1	2.2	5.7	16.8	8.2
Land and development	94.2	2.4	6.5	8.3	4.8	7.9	86.2	-8.5	4.9	-4.2	6.4	7.8
Industry and commerce	154.7	40.4	4.3	59.5	5.6	5.9	160.7	3.8	3.4	13.2	13.9	7.0
Fuel and oil	129.1	11.7	5.3	31.7	7.1	5.4	111.3	-13.8	9.3	-13.7	7.9	7.9
Investment companies	119.0	12.5	4.0	18.3	4.7	6.7	117.9	-0.9	2.6	1.7	6.9	7.6
Total	125.6	15.7	3.6	33.3	8.8	7.2	124.6	-0.8	2.8	4.3	12.2	7.7

^a Base: March 31, 1967=100.

^b The overall rate of return, dividend yield, and profit or loss per share were calculated as the arithmetic means for each group, thereby assuming an equal investment in each share of the group.

^c For each month the ratio between the monthly range—the difference between the high and low points—and the monthly low point is calculated and then averaged over the year.

^d The profit includes capital gains before provision for reserves and dividends but after income tax. The profit per share is calculated as a percentage of the par value.

SOURCE: Based on data of the Tel Aviv Stock Exchange and the Central Bureau of Statistics.

of shares were similar to those of the general index, though not all groups moved downward during the year. Industrials and commercials advanced 3.8 percent, owing to the higher profitability of industrial firms in 1969, which allowed them to pay larger dividends.¹ Profit per share (for a definition see Table XVIII-8), which is an indicator of profitability, rose in all groups, but most sharply for industrials and commercials. Dividend yields went up as well.² It seems, however, that these two developments were not sufficient to keep prices from dropping in all groups other than industry and commerce. Unlike dividend yields, the overall rate of return³ declined for all groups in 1969.

These trends in the equity market are explained by the following factors:

(1) Tight credit resulted in higher yields on interest-bearing assets and reduced the relative profitability of shares, a development which tends to depress their prices.

(2) High yields on linked bonds and the prevailing expectations of a general price increase attracted investors to bonds and other linked assets. This expectation, plus that of a rise in taxes, also led to larger purchases of consumer durables. Both types of purchases were made partly at the expense of shares.

(3) The desire to invest in shares is influenced by profit expectations. Although profits were good in 1969, there were apparently doubts that the economic boom and high level of corporate profits would continue.

(c) *Trade in bonds and price and yield trends*

Bond transactions on the Stock Exchange are overwhelmingly in Government loans—chiefly the 1967 Defense Loan and the Absorption Loan—and consequently they largely determine the trends in total bond trading. The data cited below understate the total volume of transactions, since the 1968 and 1969 Defense Loans were not yet registered on the Stock Exchange and the 1964 Absorption Loan was registered only in September; there was heavy over-the-counter trading in these securities during the year. In addition, the matching by banks of buy and sell orders for the Absorption Loan was on a particularly large scale in 1969.

¹ Ata Textile Co., Moller Textile Co., and Teva Pharmaceutical and Chemical Works distributed larger dividends in the form of both cash and bonus shares. For Dubek Ltd. (cigarettes) and American-Israeli Paper Mills the incremental dividends took the form of bonus shares (in addition to the annual cash dividend), whereas Motor House Ltd., Palestine Cold Storage and Supply, Electric Wire and Cable Ltd., Nechushtan Wholesalers and Manufacturers Ltd., Shemen Israel Oil Industry Ltd., and Alliance Tire and Rubber Co. all paid a higher annual cash dividend.

² The number of firms paying dividends rose from 56 in 1968 to 61 in 1969, and dividend payments from IL 78 million to IL 93 million.

³ The overall rate of return shows the profit earned by the investor who buys a share on January 1 and sells it on December 31 of the same year. It is defined as follows (in percent):
$$\frac{\text{Price at end of year} + \text{dividends} - \text{price at beginning of year}}{\text{Price at beginning of year}} \times 100$$

Table XVIII-9

BOND TURNOVER, PRICES, AND YIELDS, BY TYPE, 1968-69

Type of bond	1968			1969			Percent increase or decrease (-)	
	Average weekly volume of transactions (IL '000)	End-year price ^a	End-year yield ^b (%)	Average weekly volume of transactions (IL '000)	End-year price ^a	End-year yield ^b (%)	Volume of transactions	Price
Dollar-linked	416	116.9	1.7	656	123.8	-3.5	57.7	5.9
Index-linked	700	101.1	6.2	684	109.4	5.4	-0.9	8.2
Traded in foreign currency	795	117.8	—	788	116.4	—	-1.0	-1.2
Option-type	1,818	104.8	8.1 ^c	2,109	107.4	7.4 ^c	16.0	2.5
Total ^d	3,803	—	—	4,303	—	—	13.1	—

^a The base is March 31, 1967=100. For monthly data see Appendix Table XVIII-6 (in Hebrew only).

^b For monthly data see Appendix Table XVIII-7 (in Hebrew only).

^c According to the nonlinked alternative.

^d Includes other unlinked bonds.

SOURCE: State Loans Administration and Central Bureau of Statistics.

One explanation of the more sluggish growth of bond transactions in 1969 is that the incremental value of loan capital registered on the Exchange—particularly the Absorption Loan—was smaller than in 1968. In that year registration of the Absorption Loan amounted to IL 143 million (the 1962 and 1963 series), whereas in 1969 only IL 62 million (the 1964 series) was registered, and that only in September. Turnover in the Absorption Loan fell slightly in comparison with 1968, despite an upsurge in trade immediately after registration. This downward drift affected total turnover in index-linked bonds (excluding those of the option type), since the Absorption Loan accounted for 97 percent of total transactions in this category.

The option-type loans displayed a divergent pattern: transactions in the Defense Loan held steady during the year, while those in other option-type loans (chiefly development bonds) rose by an appreciable 64 percent.¹ The stability in the Defense Loan was due partly to the nonlisting of the latest series, which led to a considerable volume of trade outside the Exchange, and partly to the narrowing of the price differential between the 1967 issue and other bonds—at least until the last quarter of the year, when its yield rose once again.

¹ These calculations are based on weekly averages.

Transactions in bonds linked to the exchange rate spurred in 1969, reflecting the prevailing devaluation expectations. On the other hand, the volume of bonds traded in foreign currency held steady. This dissimilar development pattern can be ascribed to the fact that bonds traded in foreign currency are only one of the investment outlets open to owners of foreign currency, and the latter apparently preferred to hold Natad dollars or to invest in foreign securities (see the discussion in section 5).

Because of the preponderance of Government loans in total bond transactions, they strongly influence prices and yields. Prices of fixed-interest securities linked to the cost-of-living index (excluding option-type bonds) went up 8.2 percent in 1969, mainly because of the heavy demand for Absorption Loan certificates in connection with the conversion-type saving schemes, the returns on which were revised upward in April 1969. The price rise depressed rates of return on all three series of the Absorption Loan, although their prices did not move up throughout the year. On listing, the 1964 Absorption Loan attracted investors' interest away from the earlier series, with the result that there was a decline in their prices accompanied by a slight rise in yields during the last quarter of the year.

Prices of option-type loans advanced 2.5 percent in 1969. Net yields on the Defense Loan receded steadily until August, but in that month they turned sharply upward, and by December 1969 yields on an unlinked basis were higher than in December 1968. The fairly small price rise in 1969, coming on top of a small rise in the previous year as well, can be attributed to the weakening of institutional demand. Apparently part of this demand shifted to the 1968 and 1969 series of the Defense Loan, which were traded outside the Stock Exchange and whose yields reached high levels as their prices sank below par value.

Prices of bonds linked to the exchange rate rose 17.5 percent from January to August, but subsequently they retreated by a total of 7.7 percent. The steepest rise was in August, when the franc was devalued. Later, the expectations of a devaluation of the Israeli pound waned, and the revaluation of the mark (accompanied by expectations of a sterling devaluation) produced little change in the index. Quotations of bonds traded in foreign currency followed a reverse path—a downward movement in the first half of the year and an upturn in the second half. Since bonds denominated in foreign currency are only one of several investment outlets available to holders of foreign currency assets, their prices fluctuated much less sharply than those of bonds pegged to the rate of exchange. Moreover, there was a lack of new issues of the former type of security in 1969. In fact, there have been no new issues since 1962,¹ and consequently the stock of such bonds is being steadily reduced as the various series reach maturity. This contraction of supply, together with the heavier demand, generated upward

¹ The market-price value of this category of listed paper moved down from IL 284 million at the end of 1967 to IL 240 million at the end of 1968 and IL 208 million at the end of 1969.

pressure on prices in 1969, so that the high prices of these bonds actually resulted in negative yields to maturity between May and the end of the year, particularly on those series with less than five years to run.

5. SECURITIES TRADED IN FOREIGN CURRENCY AND THE NATAD MARKET¹

Developments in securities traded in foreign currency and the Natad market were especially interesting in 1969 in view of the devaluation expectations, touched off by events in the international market and by the country's mounting external deficit.

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

Table XVIII-10

FOREIGN CURRENCY SECURITIES HELD BY ISRAELI RESIDENTS, 1968-69

(\$ million)

End of year	1968	1969
Outstanding balance^a		
Israeli securities traded in foreign currency	91.9	101.2
Foreign securities	38.6	61.6
Revaluation increment ^b	57.7	76.4
Total	188.2	239.2
Annual increment		
Gross (incl. revaluation)	57.1	51.0
Net (excl. revaluation) ^c	17.0	32.3
Israeli securities traded in foreign currency ^d	8.3	9.3
Foreign securities	8.7	23.0

^a These data are based on actual and not scheduled redemptions.

^b Cumulative revaluation. The increment arises from the writing-up of the portfolio according to the prices at the end of March. Until 1967 the increment was estimated, but in 1968 and 1969 it was based on actual data.

^c For the monthly distribution see Appendix Table XVIII-9 (in Hebrew only).

^d These figures accord with those in Table XVIII-1, with dollar amounts converted into IL terms at the official rate of exchange.

SOURCE: Based on data of the Foreign Currency Department of the Treasury and the State Loans Administration.

¹ The analysis in this section is subject to statistical limitations, and the available data are not very reliable. In contrast to their separate treatment in previous years, securities traded in foreign currency and the Natad market will here be discussed together. To distinguish between operations in the two seems artificial, since the Natad market is the source of the dollars for dealing in these securities.

The Natad market sprang up as the result of an arrangement designed to enable certain categories of foreign currency owners to legally offer their holdings to Israeli residents¹ for the specific purpose of purchasing securities traded in foreign currency. It should be noted, however, that while it is not possible to buy such securities without going to the Natad market, Natad dollars can be held without purchasing securities.

The price of the Natad dollar is not set by the official rate of exchange but is determined by supply and demand. Devaluation expectations accentuate the demand for Natad dollars, reduce their supply, and push up their price; they also influence transactions in securities traded in foreign currency. There is a certain degree of substitutability between potential investments in Natad dollars and those in securities traded in foreign currency; to some extent this depends on how soon a devaluation is anticipated. Natad deposits do not carry interest, so that investors not expecting an imminent devaluation will prefer securities earning interest or dividends. Anticipation of an imminent devaluation, on the other hand, will induce a preference for Natad deposits because of the brokerage fees involved in the buying and selling of securities.

The strong devaluation expectations that prevailed in 1969 partly explain the net annual increase² in securities traded in foreign currency from \$ 17 million in 1968 to \$ 32.3 million in 1969 (see Table XVIII-10). To translate these figures into Israeli pounds, the Natad dollar price must be used and not the official rate of exchange. Such a calculation yields increases of IL 64.6 million and IL 139.2 million respectively, a greater proportional rise than that in dollar terms.³

Whereas in 1968 the net increase in holdings was equal for Israeli securities and those traded in foreign currency, in 1969 incremental holdings of the latter were two and a half times greater than those of Israeli securities. A large percentage of the foreign securities purchased were participation certificates in foreign mutual funds, even though their prices softened appreciably during the year. The importance of foreign securities in the portfolios of Israeli investors has been growing in recent years, although domestic securities traded in foreign currency still remain more popular.⁴

Table XVIII-11 shows the development in 1969 of Natad deposits,⁵ the principal substitute for securities traded in foreign currency in a period when devaluation is anticipated. These balances held firm during the first five months

¹ For a description of the sources of supply and demand in the Natad market, see Bank of Israel, *Annual Report 1968*, p. 435.

² The difference between the gross and net increment stems from the revaluation of securities in March of each year according to prevailing market prices.

³ The Israeli pound equivalents were calculated by multiplying net monthly sales by the average monthly Natad prices.

⁴ There also seems to be a growing tendency to diversify the portfolio of Israeli securities traded in foreign currency, as reflected by a drop in the weight of Hollis bonds in total holdings of Israeli securities.

⁵ Even the mutual funds of the banks held small amounts of foreign currency.

Table XVIII-11

BALANCES IN NATAD ACCOUNTS, 1968-69

(IL million, at the official rate of exchange)

End of month	1968	1969
January	26.7	29.8
February	24.6	30.7
March	30.0	27.9
April	31.9	30.9
May	28.4	31.6
June	28.8	35.9
July	29.4	38.0
August	27.6	40.4
September	25.3	46.0
October	26.0	55.8
November	29.3	53.3
December	32.3	49.7

SOURCE: Bank of Israel.

of the year, but between May and October they soared 77 percent, an indication that a devaluation was expected in the near future. Most of the growth took place in the third quarter of the year, when security purchases fell off. From October to December Natad deposits dropped and net purchases of securities rose precipitately, evidence that toward the end of the year an immediate devaluation was thought less likely.

The price of the Natad dollar shot up to a new high in 1969. At the beginning of the year the agio (the percentage difference between the legal exchange rate and the Natad dollar price) was 12 percent. It moved steadily upward, reaching 27 percent at the end of July, and in August, the month of the French devaluation, it peaked at 36 percent—a level maintained until the end of September. At the beginning of October it lost ground, a sign that the devaluation expectations had reached their maximum intensity. The agio resumed its upward movement at the beginning of November in the wake of the revaluation of the German mark,¹ and by the end of December it stood at 24 percent.

¹ Natad deposits are not limited to dollar holdings. At the time of the revaluation many investors held marks. The upturn in November was due largely to expectations of a sterling devaluation.

As in 1968, the price of the Natad dollar exceeded the free-market dollar rate. The two are highly correlated and move together. The free-market rate, like the Natad price, reached a record high during the year (see Figure XVIII-2); nevertheless, the gap between the two widened, the average annual ratio between the Natad and the free-market price edging up from 1.02 in 1968 to 1.11 in 1969. This disparity stemmed partly from the different nature of the two markets. On the supply side there is no substitutability between them, and on the demand side there is only a limited degree of substitutability. The widening of the gap in 1969 may have been due to the stronger institutional demand for Natad dollars.

Since a large proportion of the bonds and shares traded in foreign currency are not purchased at source, the Stock Exchange trade in these securities assumes great importance. As was mentioned above, the total volume of transactions in domestic securities traded in foreign currency remained at virtually the same level as in 1968. However, at the time of the devaluation of the franc and the revaluation of the mark turnover spurted strongly. During most months of the year fluctuations in the volume of transactions in these securities were in an opposite direction to those in Natad deposits, strengthening the assumption that there is a high degree of substitutability between the two.

Figure XVIII-2
NATAD AND FREE-MARKET
DOLLAR RATES, MONTHLY
AVERAGES, 1969
 (IL per dollar)

