December 08, 2024

The Shekel as a Barometer of Optimism

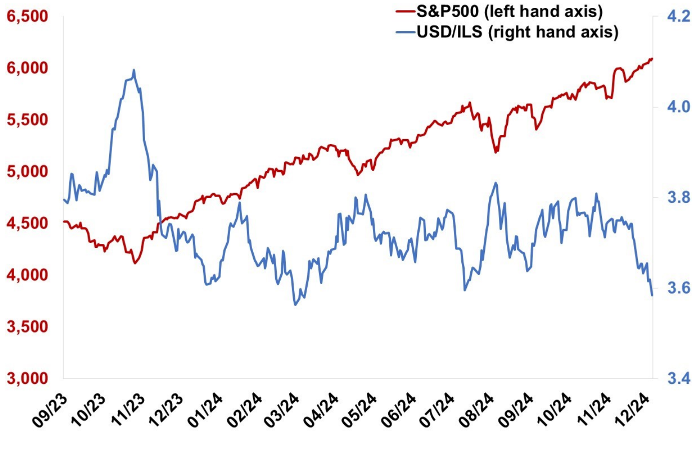
- **Towards a change in the composition of the economy's growth – More investments, less consumption are expected.**
- **The strengthening of the shekel is attributed to record-breaking levels in U.S. stock indices and, apparently, expectations of capital inflows into the economy as part of the regional reconstruction.**
- **The sharp appreciation of the exchange rate is expected to moderate inflation.**
- **During February 2025, inflation expectations are likely to decline sharply (following the temporary effect of tax increases), which will pave the way for a gradual reduction in interest rates.**

The rapid pace of geopolitical developments in the region makes it challenging to fully comprehend their long-term implications. In a matter of weeks, Israel's northern front has undergone significant changes: a ceasefire agreement with Hezbollah, the fall of the Assad regime in Syria, and renewed negotiations for a hostage deal in Gaza. Globally, events are similarly dynamic, including the fall of the French government and the temporary declaration of military rule in Korea. Interestingly, these developments have had a relatively modest impact on financial markets. For example, the French stock index has risen by 1.7% since the government's fall, while the Korean stock index has declined by only 2.8%. Notably, Tel Aviv stocks increased by 3.0% in the past week, showing particularly high returns since the start of the year.

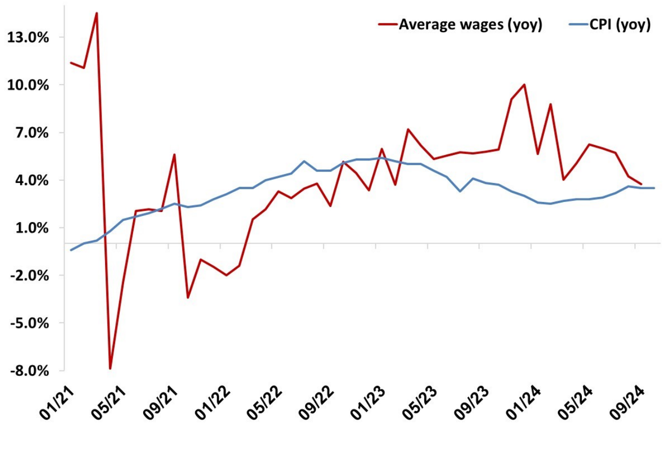
More investments, less consumption are expected. With the gradual return of northern residents to their homes, investments in residential construction and infrastructure are expected to rise as part of reconstruction efforts and to address gaps from the war period. At the same time, public consumption is likely to decrease, and private consumption may moderate due to declining disposable income.

The shekel strengthened by 1.3% in the past week and has appreciated nearly 7% against the dollar since the beginning of the war. **This strengthening is linked to record-breaking U.S. stock indices and anticipated capital movements tied to regional reconstruction.** The country's risk premium remained stable over the past week at approximately 1.36% over a ten-year period.

The shekel strengthened by 7% since the beginning of the war.
USD/ILS and S&P500 index, Source: Bloomberg



Slowdown in wage growth
YOY, Source: CBS



The sharp appreciation of the shekel and the slowdown in wage growth are expected to moderate inflation. Last week, our inflation forecast for the coming year was lowered to 2.7%. The shekel's appreciation will likely influence the CPI, and wage growth appears to have slowed to an annual rate of less than 4%. These factors suggest a declining inflation trajectory. We will provide an updated forecast after the November CPI release.

Markets are already pricing in two interest rate cuts for the coming year, potentially lowering rates to 4.0%. **During February 2025, we expect a sharp decline in inflation expectations (following the temporary effects of tax hikes), which will pave the way for a gradual reduction in interest rates.**

BOI Rate and CPI Forecast			
BOI Rate		CPI	
December 2024	4.50%	Nov 2024	-0.3%
12M Forecast	4.00%	Dec 2024	-0.1%
		12M Forecast	2.7%

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