Feb 01, 2026

Waiting for Trump's decision

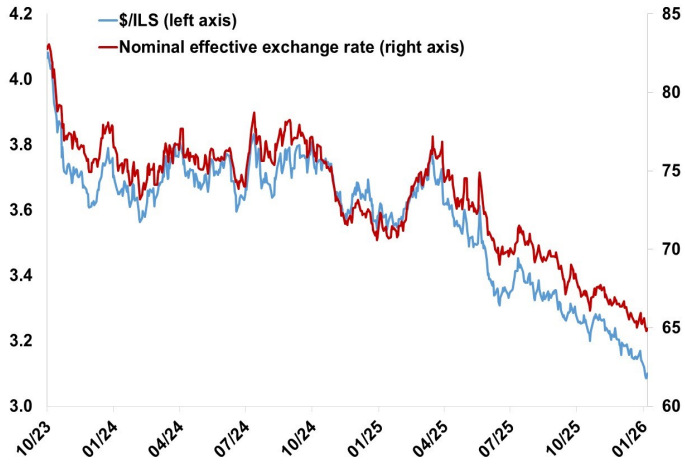
- **At this stage, the impact of the credit rating on the economy is not particularly high. We have recently seen the government and local banks issue large bond offerings in international markets at relatively low spreads, which were only marginally affected by the country's credit rating.**
- **The shekel is breaking new highs due to the high-tech sector and continued increase in global markets.**
- **The rapid pace of appreciation in recent months could, to some extent, serve as a justification in itself for intervention in the foreign exchange market. We saw a similar move by the Bank of Japan, which hinted at intervention in order to curb the weakening of the Japanese yen - a situation opposite to that of Israel, but still indicative of a willingness to intervene when changes in a currency's value are rapid.**
- **Short-term inflation expectations have declined to an annual rate of 1.5%, influenced by the strengthening of the shekel. Inflation reflected in the bond curve has become steeper, while long-term inflation expectations have remained at around 2% per year.**
- **In light of the shekel's appreciation, it is likely that during the year we will see interest rates in Israel decline to a level below those in the U.S.**

While we are waiting to see how developments unfold in Iran, the credit rating agency Moody's decided that the improvement in Israel's geopolitical situation already justifies a move from a negative outlook to a neutral outlook. The credit rating itself remained unchanged at Baa1, which is two notches below the ratings of the other two agencies. The rating decision reflects a partial closing of the gap in light of several risk factors that underpinned the low rating and have since changed. Moody's had difficulty estimating how Israel would emerge from the war in Gaza, while a prolonged war could have worsened the country's fiscal position and increased the credit risk. Given that the likelihood of this severe downside assumption materializing has declined significantly, Moody's decided not to wait and to prepare the ground for narrowing the rating gap vis-à-vis other agencies. Stabilization of Israel's fiscal situation was another factor which supported this decision. **At this stage, the impact of the rating on markets is not particularly high. We have recently seen the government and local banks issue large bond offerings in international markets at relatively low spreads, which were only marginally affected by the country's credit rating.**

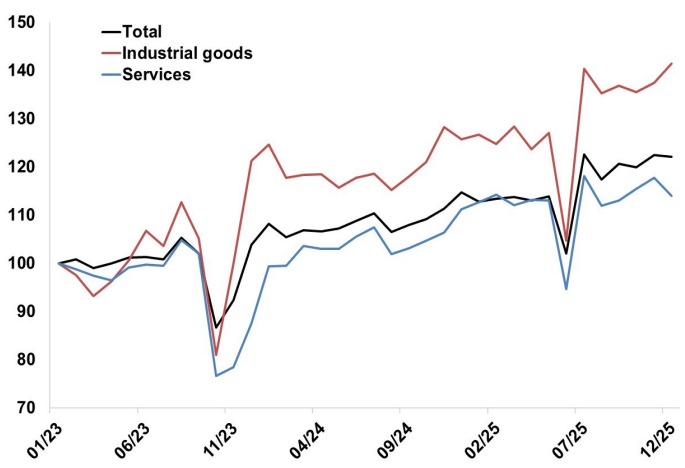
Strong growth is expected in the fourth quarter of 2025 as well. Credit card purchases fell by 0.2% in December, but on average they still rose in the fourth quarter by 1.1% (quarterly change). Exports of high-tech services continue to expand, and momentum is also evident in construction investment. We estimate that GDP growth in the fourth quarter will be high, at around 4.5%.

The shekel is breaking new highs due to the high-tech sector and continued increase in global markets. The shekel strengthened in January by about 3% against the dollar and 2% against the basket of currencies. Over the past year, the shekel has appre-

The shekel is breaking new highs
Daily exchange rates
Source: Bloomberg



Credit card purchases increased in the fourth quarter
Credit card purchases index, S.A ,Jan 2023=100,
Source: CBS,



ciated by about 14% against the dollar. Alongside rising equity markets globally, institutional investors have also reduced their exposure to foreign currency. The latest data are from November reflect a decline of about one percentage point in institutional exposure to foreign currency. It is likely that the reduction in FX exposure continued over the past two months as well. Prior to the war in 2023, the level of foreign currency exposure was about two percentage points lower than today, and given the decline in risks, a gradual return to that level is not unlikely. A second factor supporting the shekel is the high-tech sector—startups have resumed capital raising at a high pace of more than $5 billion per quarter. This is translated in part into salaries paid in shekels over time. At the same time, we are seeing continued recovery in incoming tourism by about 14% y/y through November.

How can the strengthening of the shekel be stopped? The Bank of Israel has the interest rate as a tool, and theoretically it can also intervene by purchasing foreign currency. The Bank of Israel has cut interest rates twice consecutively, and it is not unlikely that it will cut again at the next decision if the appreciation continues. Interest rate cuts do not impact global markets, nor do they affect high-tech fundraising, therefore this impact is limited. Purchasing foreign currency is a less elegant step that would be difficult to explain to the markets, since there is no external shock or disorderly FX selling impacting liquidity, but rather a global trend of higher market valuations. **The rapid pace of appreciation in recent months could, to some extent, serve as a justification in itself for intervention in the foreign exchange market. We saw a similar move by the Bank of Japan, which hinted at intervention in order to curb the weakening of the Japanese yen—a situation opposite to that of Israel, but still indicative of a willingness to intervene when changes in a currency's value are rapid**. It is not unlikely that if global markets continue push higher and put pressure on the shekel, we will also see such action from the Bank of Israel.

Short-term inflation expectations have declined to an annual rate of 1.5%, influenced by the strengthening of the shekel. Inflation reflected in the bond curve has become steeper, while long-term inflation expectations have remained at around 2% per year. The appreciation of the shekel has been so sharp that even if we assume very low pass-through coefficients between the exchange rate and inflation, we still arrive at a very low short-term inflation forecast, similar to that reflected by the markets and even lower. Nevertheless, the labor market remains tight and somewhat offsets the impact of shekel appreciation on inflation. A situation in which inflation is low mainly due to a strong shekel is problematic from a policy-response perspective—accelerating interest rate cuts in an economy at full employment could damage price stability in the medium term, and therefore the Bank of Israel will seek to find a middle ground between policy objectives over time. Financial markets are pricing in interest rate cuts to a level of 3.0%–3.25% by the end of the year. **In light of the shekel's appreciation, it is likely that during the year we will see interest rates in Israel decline to a level below those in the U.S.**

BOI Rate and CPI Forecast			
BOI Rate		CPI	
December 2026	3.25%	Jan 2026	-0.2%
12M Forecast	3.25%	Feb 2026	0.1%
		12M Forecast	1.8%