

March 01, 2026

Will the Lion's Roar Return to Iran's Flag?

Economic assessments are generally anchored in previous historical experience, structural models, and the interplay between the two. Israel has accumulated over the past two years quite a few historical events from which one might derive an informed assessment, although each time hostilities break out the nuances differ slightly: different starting conditions, different arenas, and especially a shift in the response of investors and households. While in October 2023 the event undermined the concept of Israeli military superiority - and was at the very least perceived as having lasting economic implications- the 12- day war against Iran in June 2025 was no longer perceived in the same way. The current campaign is even creating a situation in which investors see upside potential in the present environment. In the coming days, this psychology will likely shape market trends far more than factors such as the direct economic costs of the war.

Returning to basics, Israel begins the week with a shut-down of most non-essential activities, quite similar to what we saw in June of last year. Here, no surprises are expected: in terms of growth, we will likely see a sharp decline in economic activity, which is a direct function of the number of days of war. The main damage is in the services sector, while commerce tends to remain stable, with deferred purchases postponed to a later date. During the 12 - day war we saw a 4.3% annualized contraction in GDP in the second quarter. The good news is that in the following quarter, growth already rebounded

sharply. From a long-term perspective, this should not materially change Israel's growth trajectory, as long as no exceptional developments occur- such as a departure of foreign workers, for example.

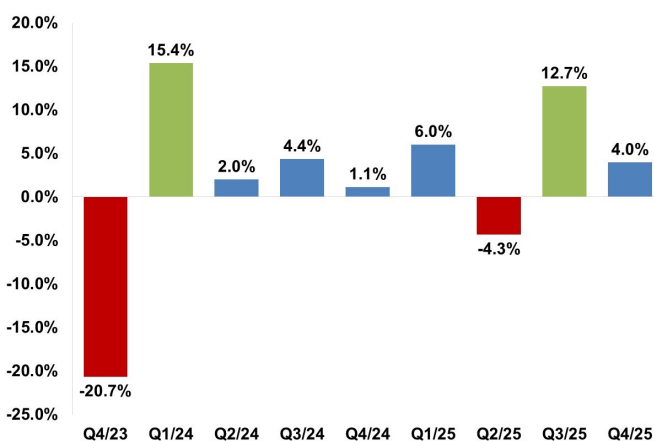
Fiscal policy and local politics go hand in hand. This time, unlike events of the past two years, it is likely that credit-rating agencies will not apply pressure, to downgrade and markets may even be supportive.

The government is supposed to approve the state budget by the end of March in the Knesset; otherwise, the result would be early elections, unless the deadline is postponed due to the war. Given that this is already an election year (late October), early elections would not constitute a political shock. War-related expenditures will likely require another amendment to the budget law, raising the projected deficit for the year to over 4% of GDP. In today's global environment, credit-rating agencies will not penalize Israel for a deficit of this magnitude, and will instead focus on the geopolitical situation. A successful conclusion to the campaign against Iran could even provide credit-rating agencies with "a way out" enabling upgrading of Israel's rating. Israel recently raised capital in global markets at spreads of roughly 100 basis points above 10-year U.S. Treasury yields. We tend to assess that this premium, which reached as high as 200 basis points in 2024, will not change significantly as a result of the war with Iran.

The Shekel Exchange Rate - Wall Street may have

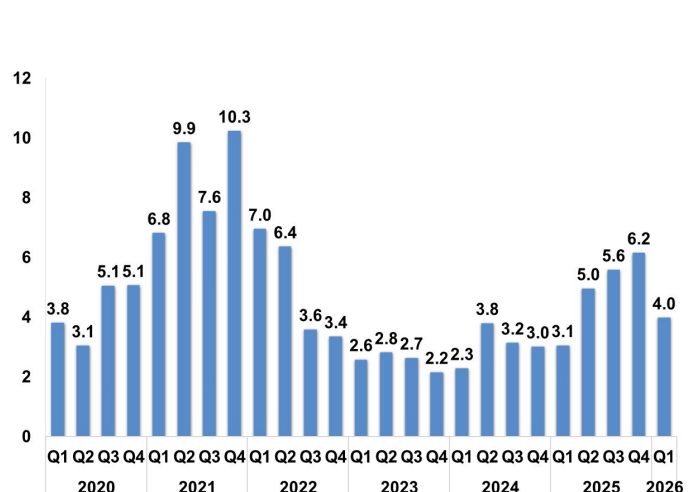
A moderation in activity, followed by a rebound in the post-war period

GDP qoq saar, % of change
Source: CBS



Israeli tech companies raised surged after the war in June

Investments in hi-tech companies, \$billion per quarter
Source: IVC, BOI



more influence than the war. The shekel depreciated by 0.6% in February against the currency basket, mainly due to the decline in U.S. equity markets. Foreign investors are unlikely to rush to sell shekel-denominated assets this time, they remain in FOMO mode, as Israel is still perceived as a story of opportunity, especially in a reality in which the business models of high-tech companies are being reassessed. In the short term, we do not expect a sharp reaction in the exchange rate in either direction. Over a somewhat longer horizon, much depends on the outcome of the current campaign. In the optimistic scenario in which the “roaring lion” is back to the Iranian flag, the shekel could receive a massive boost. This currently partially priced in and is expected to help keep the shekel stable even during the war.

The Bank of Israel explained that interest rates were not cut in the latest decision partly due to elevated security risks. We believe that global conditions also played a role, as reflected in the Fed minutes, which show a reluctance to cut rates quickly. The Governor noted in the media that the Bank of Israel interest rate at year-end will not be far from 3.5%, implying two rate cuts. Assuming no significant war-related spike in flight prices, inflation is expected to fall to around 1% y/y by August. Pressure on the Bank of Israel to cut rates will intensify, and we estimate that policy rates will indeed be close to 3.5%, and even possibly slightly below.

What else differs from the previous war? Market momentum today is not the same as after the 12-day war in June 2025. That momentum was a key factor that propelled the Israeli economy in the second half of 2025.

U.S. equity indices rose by roughly 10%, Israeli tech companies raised \$11.8 billion in the second half of 2025, and we witnessed exits at valuations not previously encountered. The global mood has since shifted somewhat, everything related to AI is now being tested mostly through the lens of profitability potential, rather than technological quality alone.

BOI Rate and CPI Forecast			
BOI Rate		CPI	
December 2026	3.25%	Feb 2026	0.0%
12M Forecast	3.25%	Mar 2026	0.4%
		12M Forecast	1.8%

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