Surge in outbound tourism leads to a decline in domestic purchases

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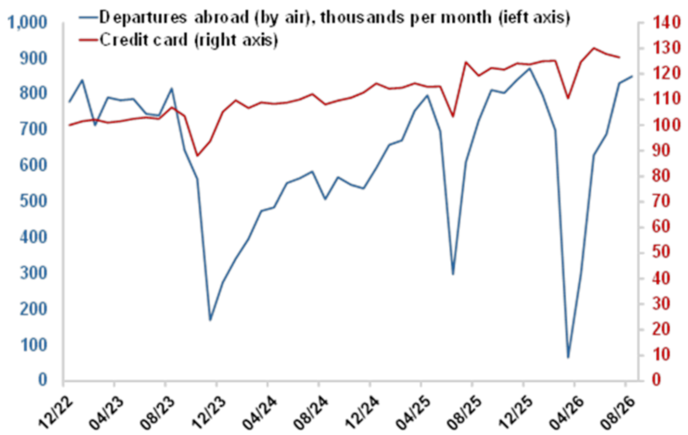
- **The window of opportunity for another rate cut in the coming months has closed, and at the beginning of next year, much will depend on geopolitical and political developments.**
- **Credit card purchases declined by 1% in July, following a -1.8% decline in June.**
- **Somewhat surprisingly, the rapid pace of wage growth, which characterized almost all sectors of the economy, has not been reflected in higher service prices in the CPI, as we would have expected.**

The yield on the Israeli ten-year government bond is similar today to the level witnessed at the beginning of the year, while in the US it is around 60 basis points higher. The 10-year bond yield in Israel is currently around 90 basis points below that of US treasuries. Before the war broke out, we usually saw shekel-denominated bonds trading at lower yields relative to US treasuries. If we ignore risk and liquidity premia for a moment, this gap reflects market expectations for significant shekel appreciation of around 0.9% per year over the next decade (Uncovered Interest Rate Parity). If we add the country risk premium, the expected appreciation of the shekel is even more significant: reaching 1.7% per year. This is the theory, but in reality, if we conducted a survey and asked investors where they think the shekel-dollar exchange rate will be in ten years, it is likely that most would say above NIS 2.5 per dollar. So why do institutional investors, who can easily purchase Israeli government bonds denominated in dollars and also receive the risk premium, purchase more of this asset? This is where additional elements that characterize the Israeli economy come into play and help explain this equilibrium. Firstly, the benchmark for every investment manager is in shekel terms (not dollars). As low as an exchange rate of NIS 2.5 per dollar may seem, three years ago an exchange rate of NIS 3 per dollar also seemed unimaginable. Therefore, most investment managers would prefer to keep their foreign-currency exposure limited. Why do yields in Israel tend to be lower level than in the US? The savings and investment differential plays a role. The household savings rate in Israel is high while the government deficit is low relative to the US, and investments in Israel are not particularly high compared with the rest of the world. This creates a situation in which Israeli savings can easily finance both the government deficit and investments, thereby keeping yields low.

The Bank of Israel reduced the policy rate last week to 3.25%. We assigned a slightly higher probability to a no cut decision, but it cannot be said that the decision was a total surprise. Inflation, which is the central bank's primary mandate, is well within the target range, at 1.5% over the past 12 months, while inflation expectations are also slightly below the midpoint of

A surge of Israelis traveling abroad slowed domestic consumption
Credit card purchases index, S.A, December 2022=100,
Departures abroad (by air), Source: CBS



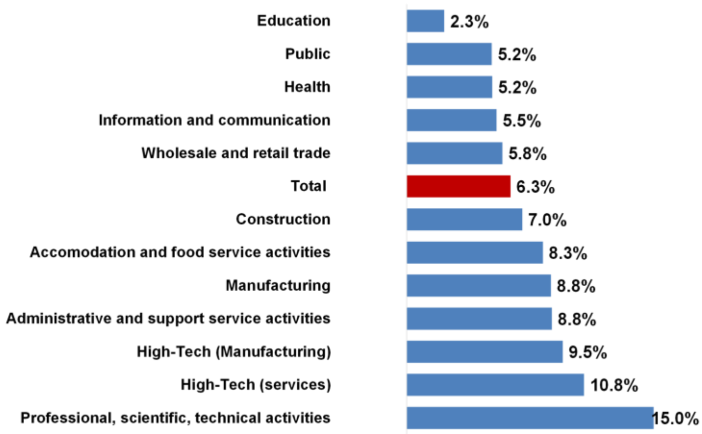
the target range. We believe the Bank of Israel also placed some weight on the fact that it will be difficult to cut rates as the elections approach, while following the elections we may still face political uncertainty. We nevertheless assigned a slightly higher probability to the possibility of rate stability last week, given the global trend toward higher interest rates and rising long-term yields, as well as the fact that the economy is growing at a very rapid pace. Regarding growth, the Bank of Israel added some qualification, noting that excluding production abroad by Israeli companies, particularly Nvidia, GDP in the second quarter of 2026 was 3.8% higher than in the fourth quarter of 2025, compared with 6.2% growth for headline GDP, in annualized terms. In any case, we believe **the window of opportunity for another rate cut in the coming months has closed, and at the beginning of next year, much will depend on geopolitical and political developments**. US interest rates are likely to rise twice by then, opening a rate differential of around 1 percentage point between US and Israeli rates. Markets are currently pricing in no change in the Bank of Israel's policy rate over the coming year.

Credit card purchases declined by 1% in July, following -1.8% in June. The decline may have been influenced by the increase in Israelis traveling abroad, with the number of outbound Israelis rising sharply by 38% in June-August compared with the previous year.

Average wages in the economy continue to rise, and in the second quarter of the year were 6.3% higher than in the corresponding quarter of last year. **Somewhat surprisingly, the rapid pace of wage growth, which characterized almost all sectors of the economy, has not been reflected in higher service prices in the CPI, as we would have expected**. One possible explanation could be an increase in labor productivity due to the adoption of new technologies, ranging from self-service checkouts to writing code using AI.

Wages growth remains rapid

Average wage, rate of change, last three months compared to the same period last year. Source: CBS



BOI Rate and CPI Forecast			
BOI Rate		**CPI**	
December 2026	3.25%	Aug 2026	0.8%
12M Forecast	3.25%	Sep 2026	-0.3%
December 2027	3.25%	12M Forecast	2.0%

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