

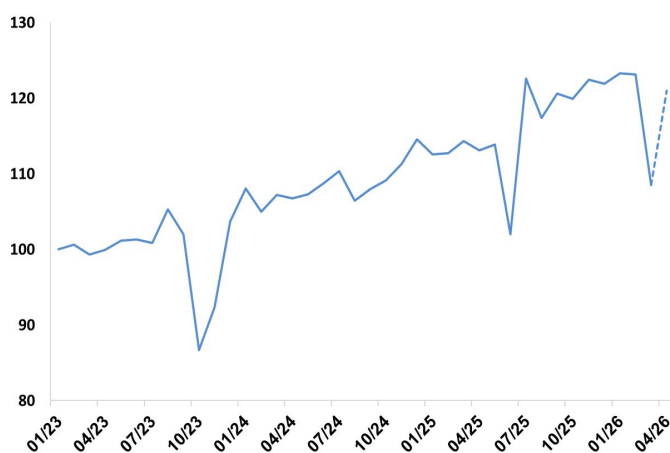
May 03, 2026

## Negotiations appear increasingly fragile

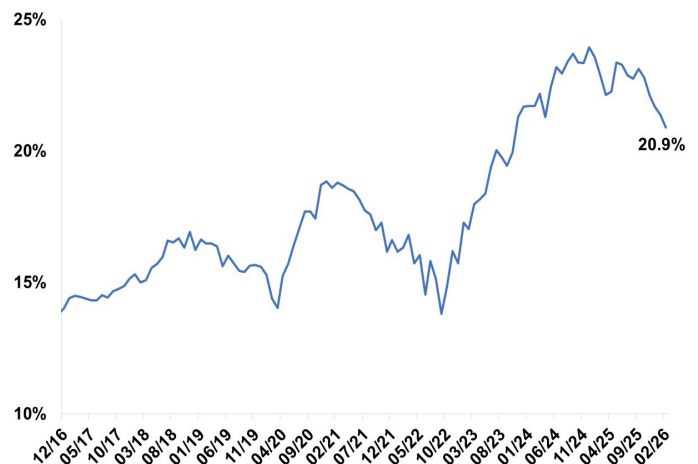
- Talks between the U.S. and Iran are not progressing, and the probability of another confrontation with Iran has increased over the past week. This did not prevent the shekel from continuing to strengthen slightly against the U.S. dollar, nor did it stop stock indices from reaching new highs.
- There is apparently a common factor pushing all markets higher, while ignoring elements such as spiking energy prices; which in the past have caused significant volatility and/or geopolitical crises.
- Opposing forces are impacting inflation, complicating the Bank of Israel's decision. On one hand, the sharp appreciation of the shekel moderates price pressures; on the other, rising fuel prices, the global environment, and the risk of renewed hostilities increase inflationary risks.
- Markets expect one interest rate cut this year and another cut in the first half of 2027.
- Institutional investors believed in a strong shekel, and that belief itself contributed to strengthening the currency.

Talks between the U.S. and Iran are not progressing, and the probability of another confrontation with Iran has increased over the past week. This did not prevent the shekel from continuing to strengthen slightly against the U.S. dollar, nor did it stop stock indices from reaching new highs. The story here is not restricted to Israel: the S&P 500 has also reached a new high, and European stock indices are not far from their peaks. There is apparently a common factor pushing all markets higher, while ignoring elements such as spiking energy prices; which in the past have caused significant volatility and/or geopolitical crises. This cannot be attributed to expected monetary loosening, as markets no longer expect rate cuts globally in the near term. So what can explain this surge of optimism? One possible explanation is expansionary fiscal policies, which in one way or another translate into increased financial wealth for households and supports higher financial markets. If this was the only explanation, we would likely see high inflationary pressures globally, but in practice inflationary expectations remain fairly stable, suggesting that additional factors are at play. A second factor that may explain this optimism is technology, especially AI, which raises expectations for future corporate profitability. Thus, even though markets are reaching new highs, forward price-to-earnings ratios remain at reasonable levels. In reality, both factors likely play a role to some extent.

**Strong purchases in April are expected to partially offset the contraction in the first month of the war**  
Credit card purchases index, S.A., Jan 2023=100,  
Source: CBS, BNHP



**The reduction of FX exposure by institutions contributed to shekel appreciation**  
Institutional investors' exposure to foreign currency out of total assets, Source: BOI



Data from the first month of the war (March) has begun to come in: credit card purchases declined by 11.9% compared to February (seasonally adjusted). We estimate that April largely compensated for March, with purchases increasing by about 10%. Total purchases in the first quarter were approximately 5% lower than in the previous quarter. Labor market data for March reflects a surge in the number of people absent from work for economic reasons, reaching about 592,000. The official unemployment rate was rather low at 2.5%, but if temporarily absent workers (such as those on unpaid leave) were included, the unemployment rate reached 15.8%.

**Opposing forces are impacting inflation, complicating the Bank of Israel's decision. On one hand, the sharp appreciation of the shekel moderates price pressures; on the other, rising fuel prices, the global environment, and the risk of renewed hostilities increase inflationary risks.** The derivatives market expects inflation of about 2% over the coming year, but the level of certainty around this figure is low. A renewal of fighting could change this picture, and there is also uncertainty regarding the policy of the new government which will be formed and whether it will choose to raise taxes in order to reduce the deficit. From a foreign exchange perspective, the Bank of Israel would likely be happy to cut interest rates, but from an inflation standpoint it may be better to wait, especially given that even in the U.S. there are no expectations for rate cuts this year. The next interest rate decision is on May 25. By then, the April CPI (expected to rise by a relatively high 1.3%) will already be known, and if the

ceasefire holds, we are likely to see a rapid decline in market inflation expectations. In such a scenario, a rate cut could come as soon as this month. If fighting resumes, monetary loosening will be postponed. **Markets expect one rate cut this year and another cut in the first half of 2027.**

**Institutional investors believed in a strong shekel, and that belief also helped strengthen it.** The share of foreign currency exposure among institutional investors declined by three percentage points from the end of 2024 through February 25. This rapid reduction in exposure is reflected in increased foreign currency sales by institutional investors, which in turn contributed to the actual appreciation of the shekel.

<b>BOI Rate and CPI Forecast</b>			
<b>BOI Rate</b>		<b>CPI</b>	
December 2026	3.75%	Apr 2026	1.3%
12M Forecast	3.50%	May 2026	-0.2%
		12M Forecast	2.1%

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