The Israeli Economy

Israel Hedge Funds Association

Prof. Amir Yaron

Governor, Bank of Israel

Key takeaways

- ***Israel entered the war in a good economic state.***

- ***Despite the negative impact on the economy, it has demonstrated remarkable resilience throughout the war.***

- ***The war has come at a significant economic cost; GDP is estimated to be about 5% below its pre-war trend, mainly due to supply constraints.***

- ***Risk premium spiked, but fell sharply after the northern campaign and the conflict with Iran, now nearing pre-war levels.***

- ***Market confidence rests largely on responsible fiscal policy. After the rise in the debt, the end of hostilities should mark a shift to <u>a declining debt path</u>, with a deficit target of just above 3% of GDP. Israel now faces a fiscal trilemma of balancing defense needs, limited civilian spending, and fiscal responsibility - leaving very limited room for further budgetary easing.***

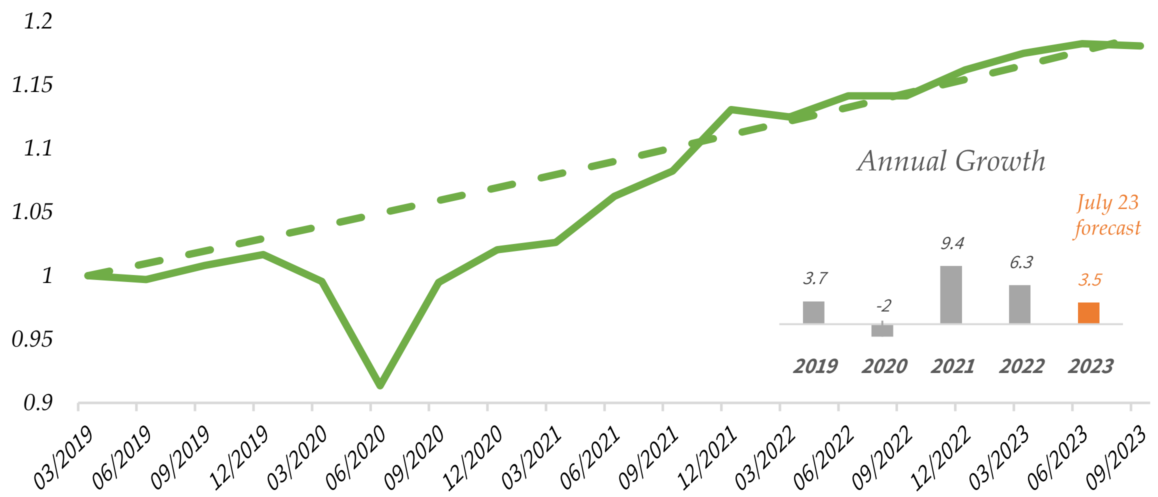
- ***We want to see a consistent convergence of inflation into the target range. The appreciation and easing supply constraints are likely to reduce inflationary pressures, while improved geopolitical conditions may boost demand and push prices upward.***

- ***Upcoming CPI and Q3 GDP data will provide a clearer picture of the alignment between demand and supply.***

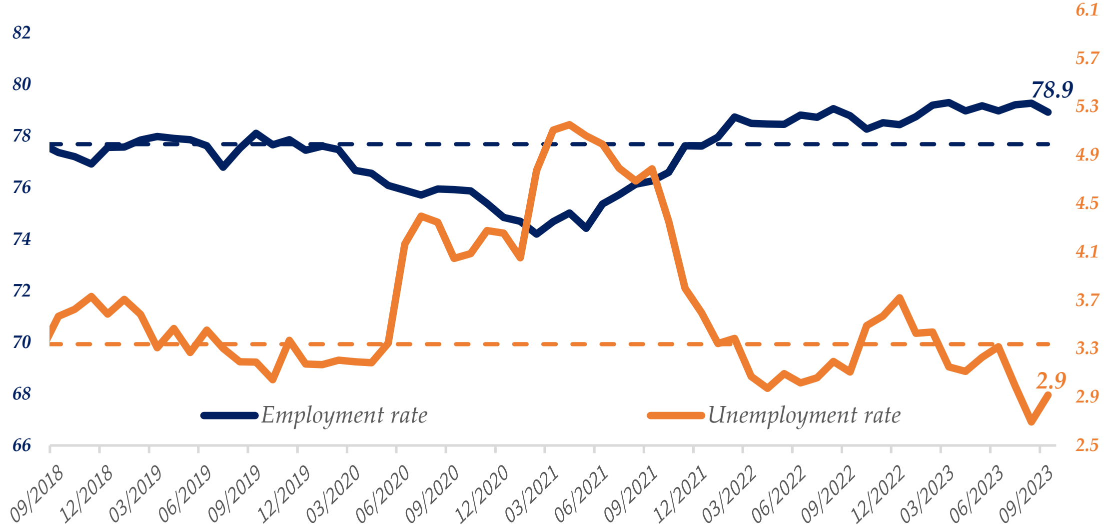
- ***The Bank of Israel is leading innovation and promoting competition in the financial ecosystem.***

Before the war *- On a path to soft landing:*
GDP above its trend; tight labor market; debt falling, and inflation moderating

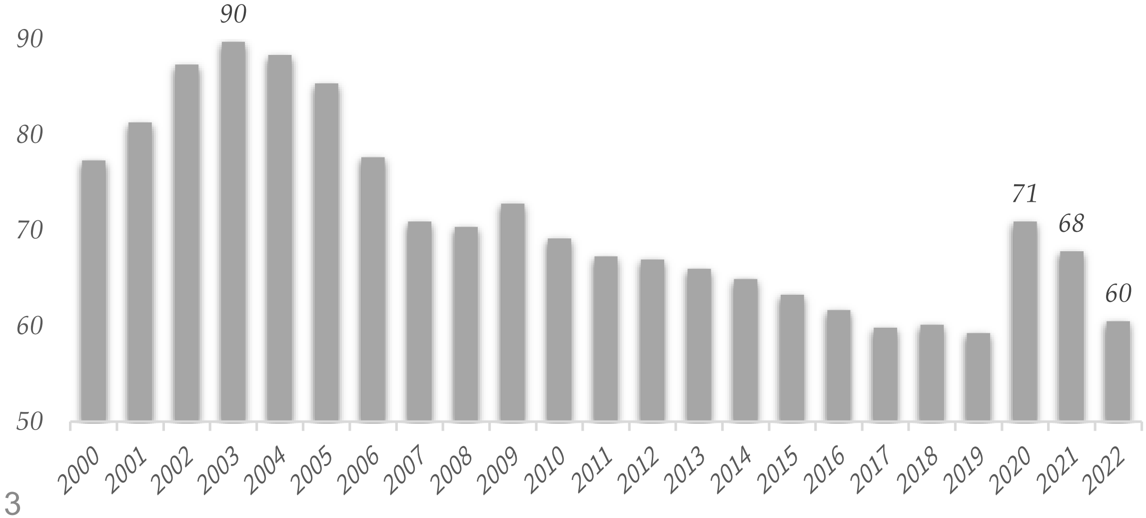
GDP relative to its trend
quarterly, fixed prices, index: Jan 2019=1



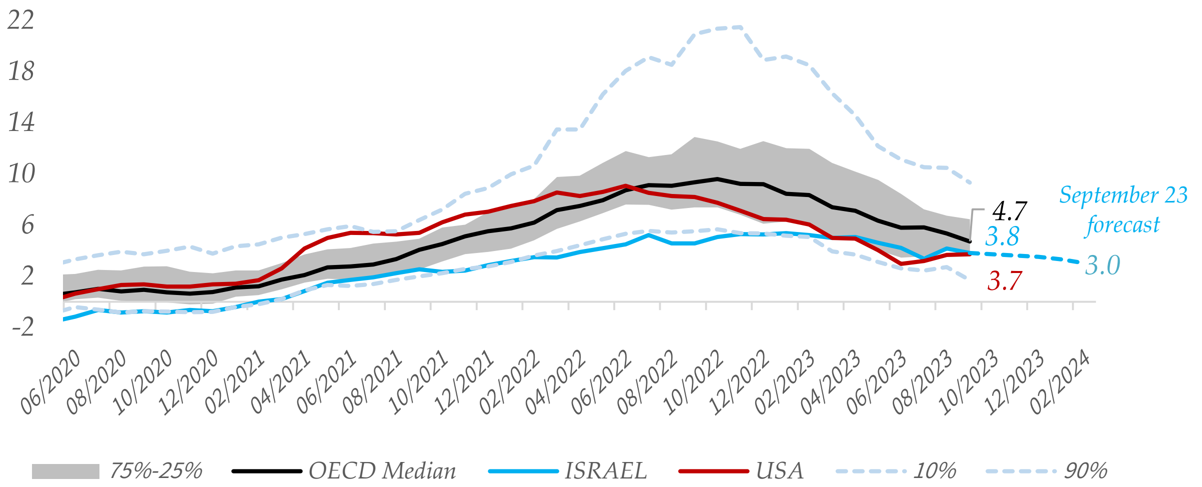
Employment rate and unemployment
Dashed line: 2019 Average



Debt to GDP ratio

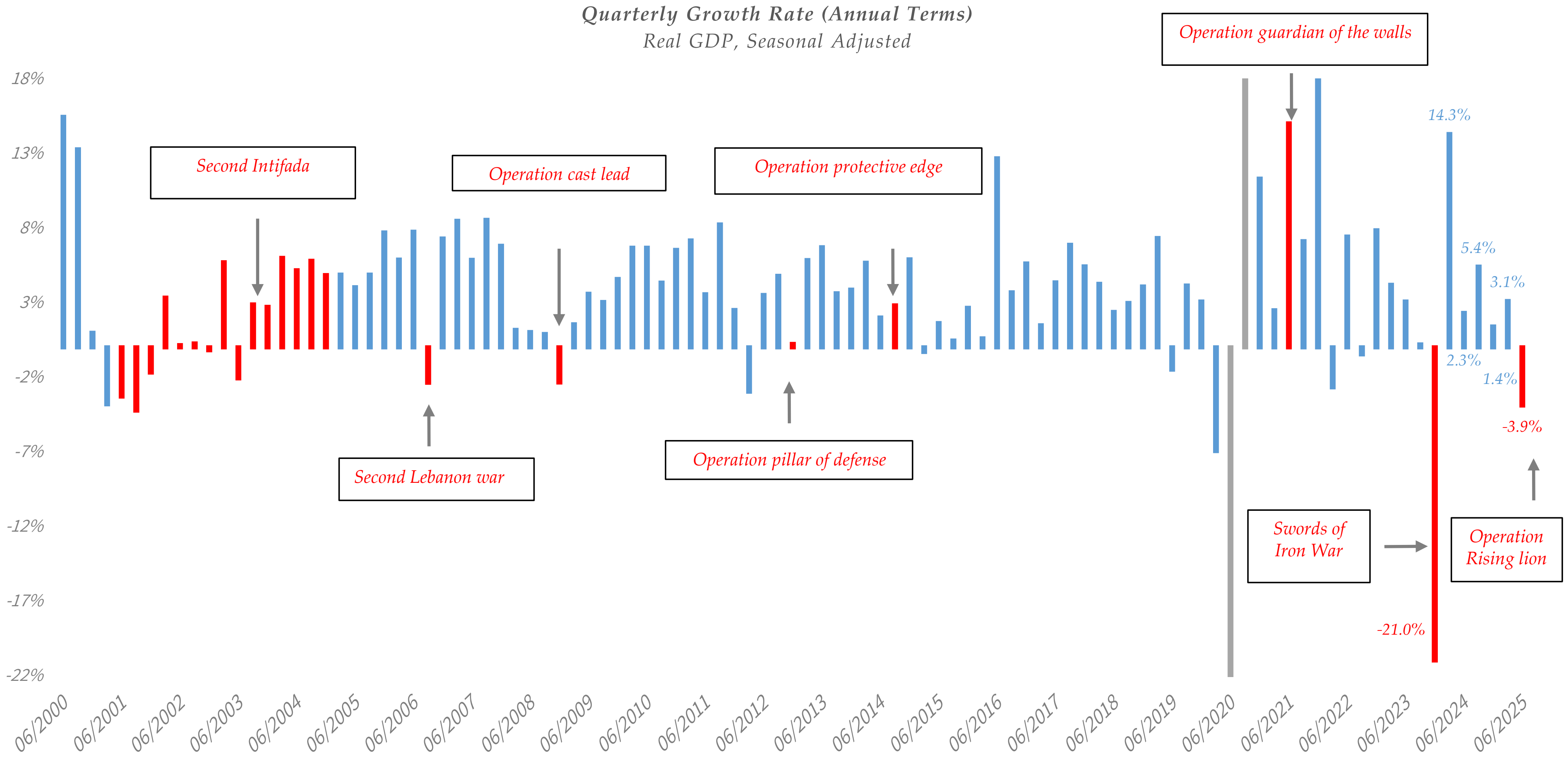


Inflation in Israel and OECD



Sources: BOI, OECD, IL CBS

In the past, the Israeli economy recovered quickly after geopolitical conflicts

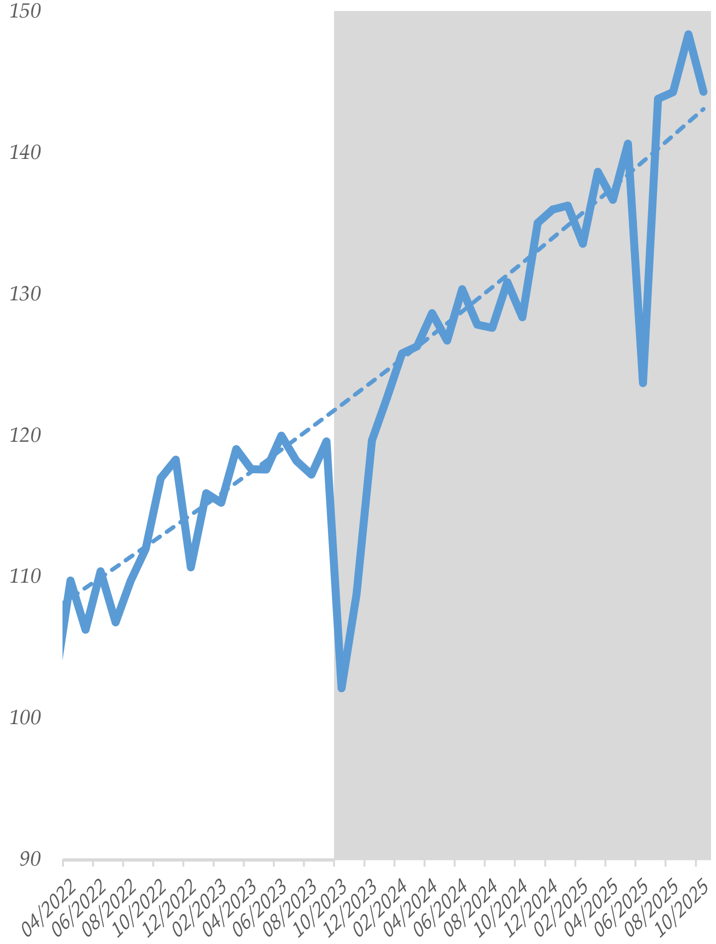


Source: BOI's Analysis of IL CBS data

The War Led to Economic Damage Initially Driven by Demand Decline, and Subsequently by Supply Constraints

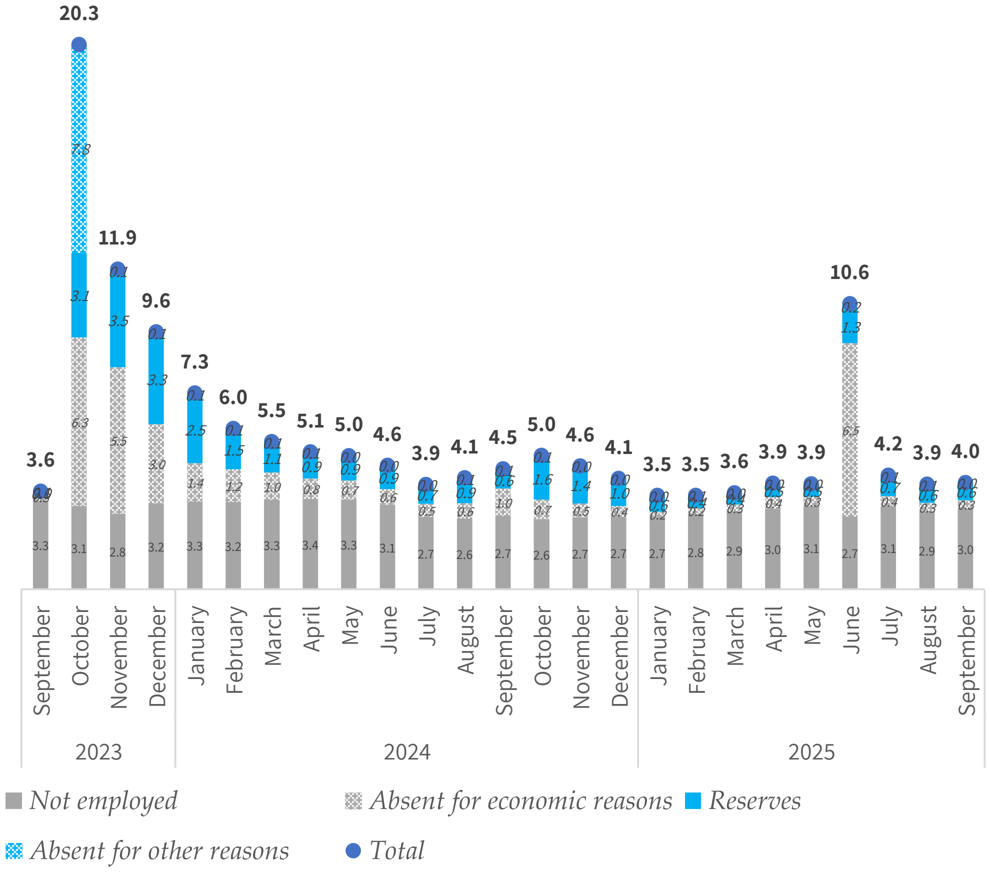
Credit cards expenditure index

Monthly average, Seasonally adjusted, 2021=100



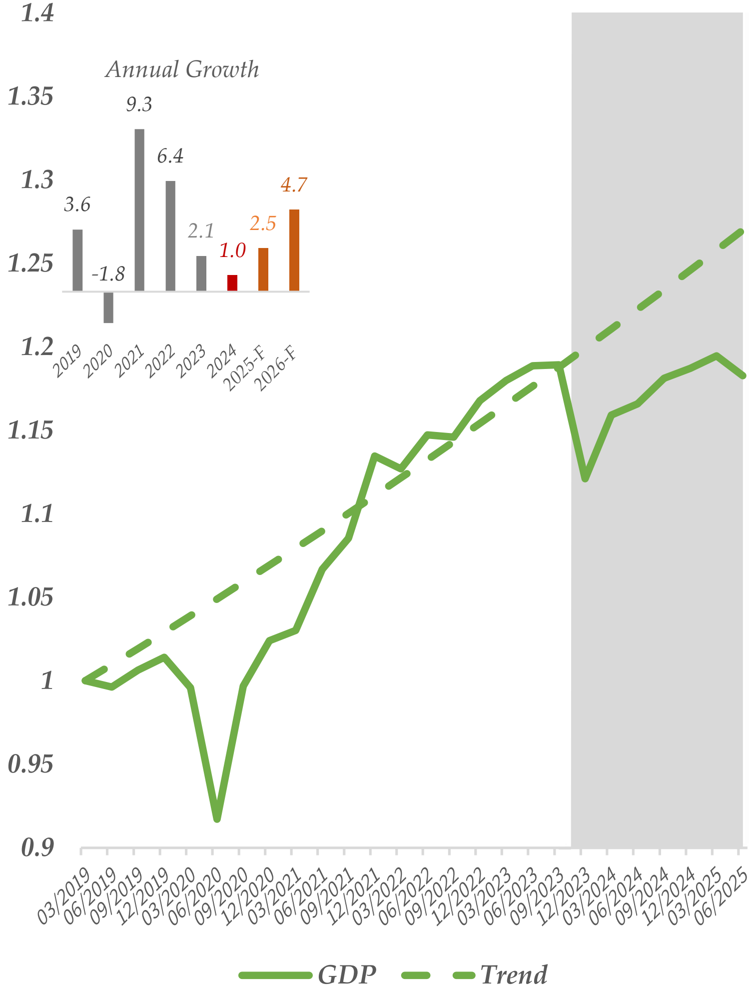
Unemployment rate

15+, unemployed - seasonally adjusted, other - without adjustment



GDP in relation to its trend

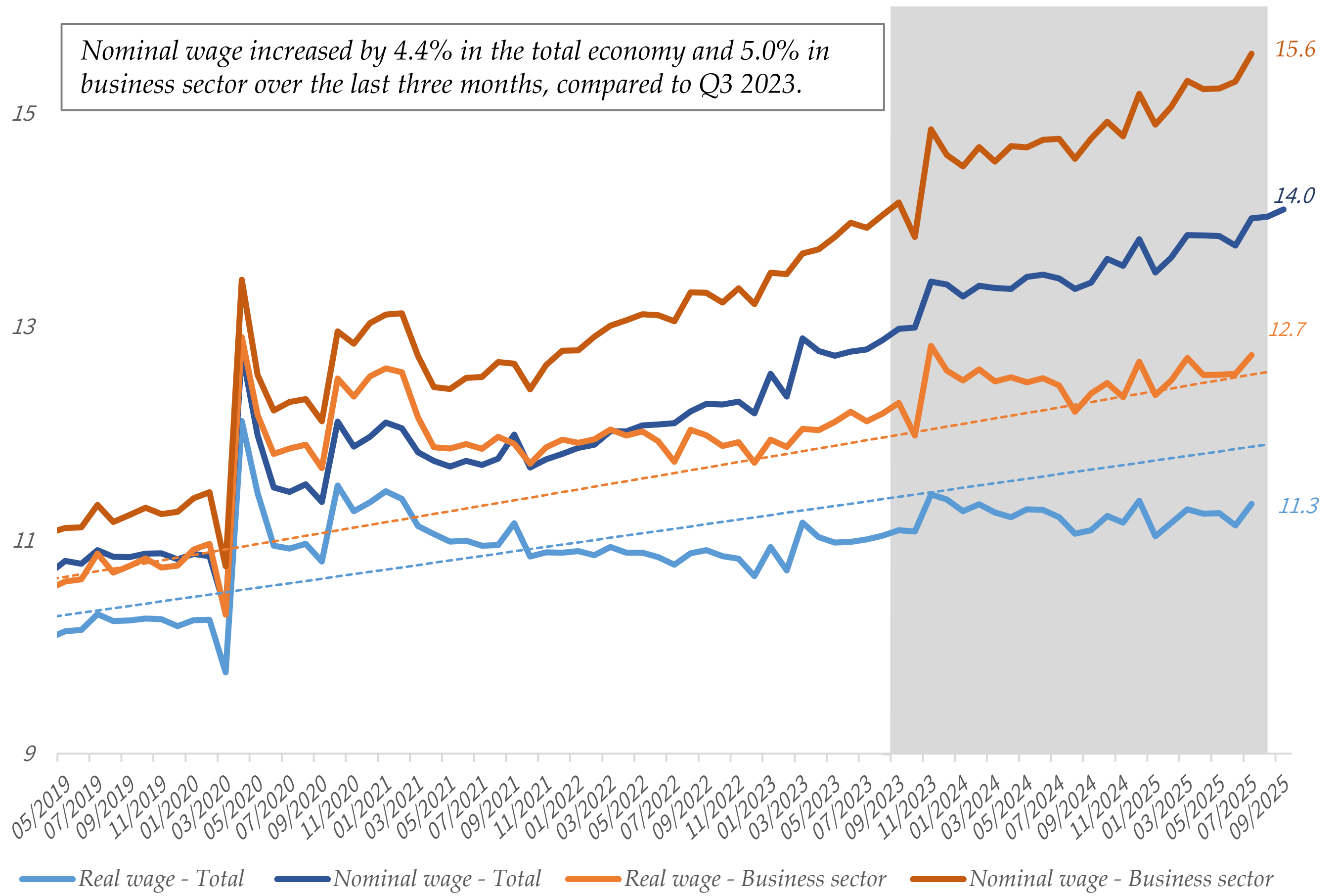
quarterly, fixed prices, index: Jan 2019=1



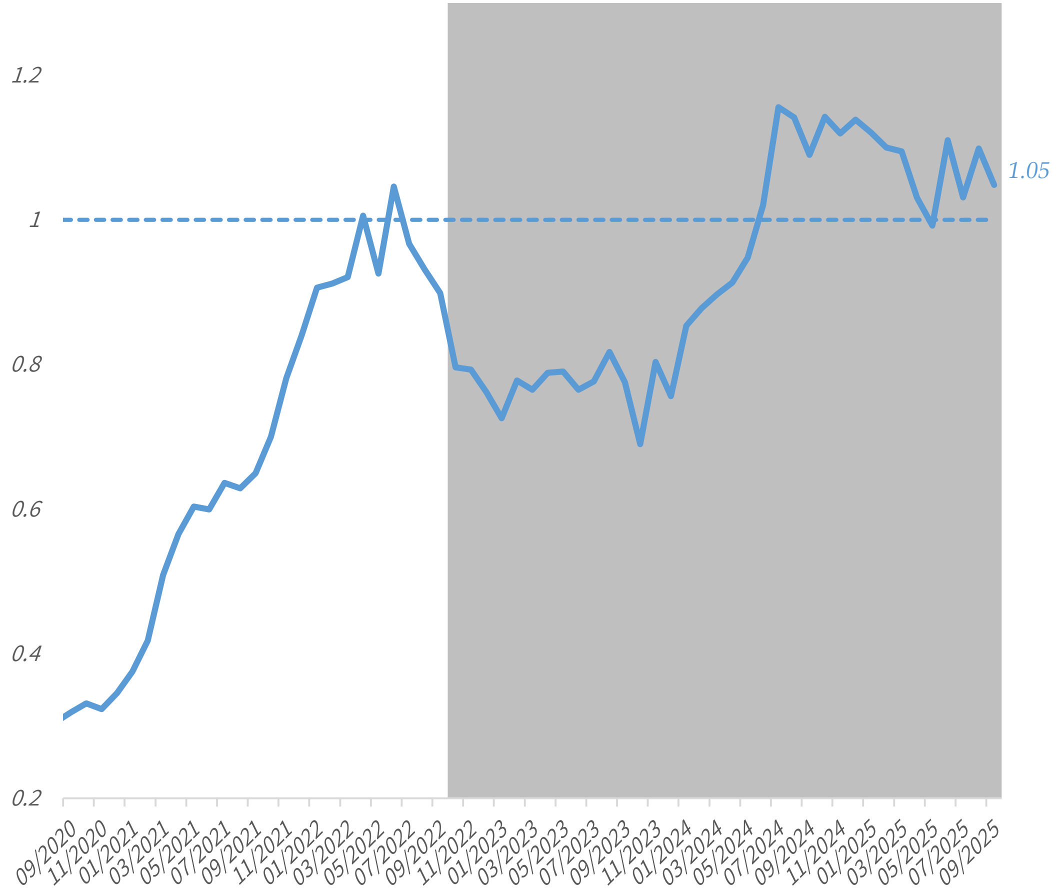
Sources: BOI and IL CBS

The labor market is characterized by supply pressures;
Moderation in nominal wage growth rage; real wage is similar to pre-war levels, and remains below the long-term trend

Average wage - Total econamy and buisness sector
seasonally adjusted, Thousands, Dashed line - 2016-2019 trend



The vacancy-to-unemployment ratio
Seasonally Adjusted Data, Unemployment Rate for Ages 15+

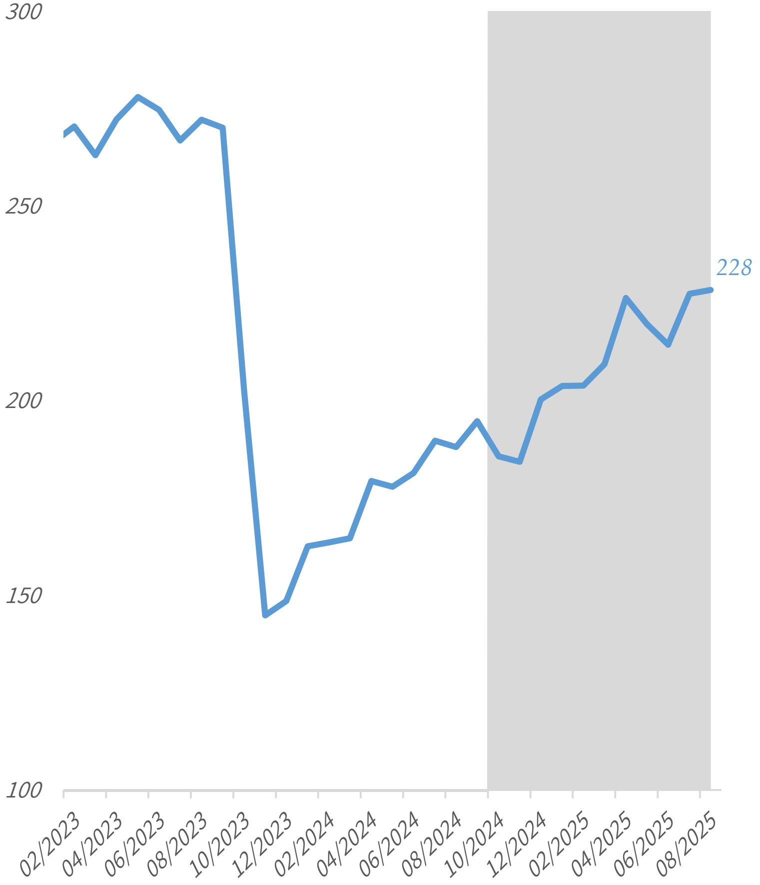


Sources: BOI, IL CBS

Supply constraint *stemmed mainly from labor shortages – entry bans on Palestinian workers, and high reserves duty; the worker shortage was felt primarily in the construction sector, and in hospitality and food services*

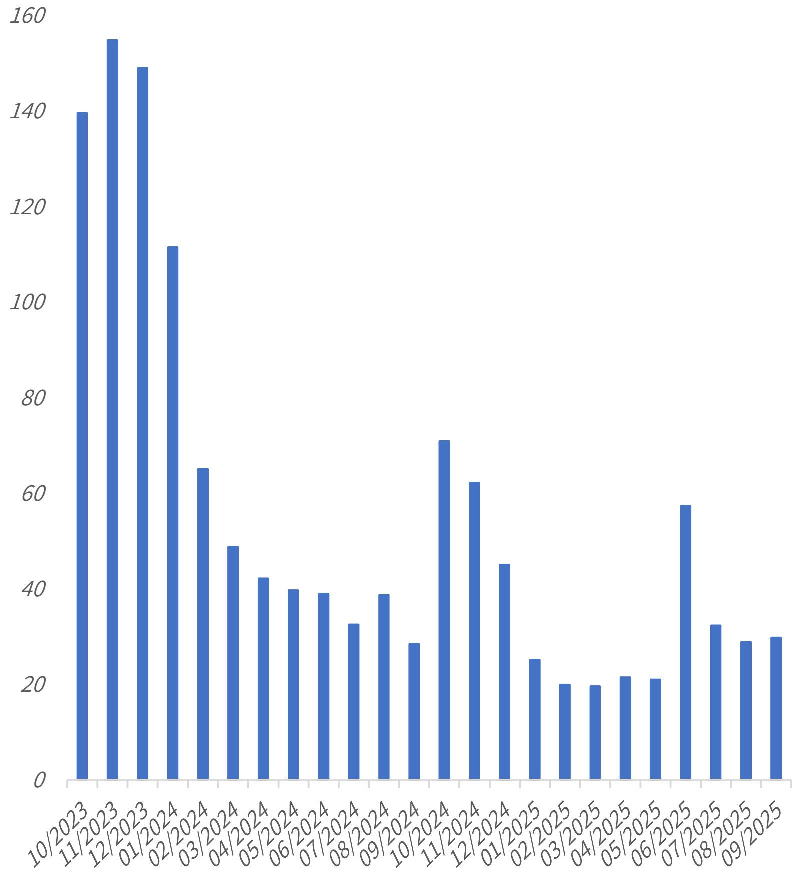
Employment of non-Israeli workers

Non-Israeli and foreign workers, seasonally adjusted, excluding Palestinians without permits employed in Israel



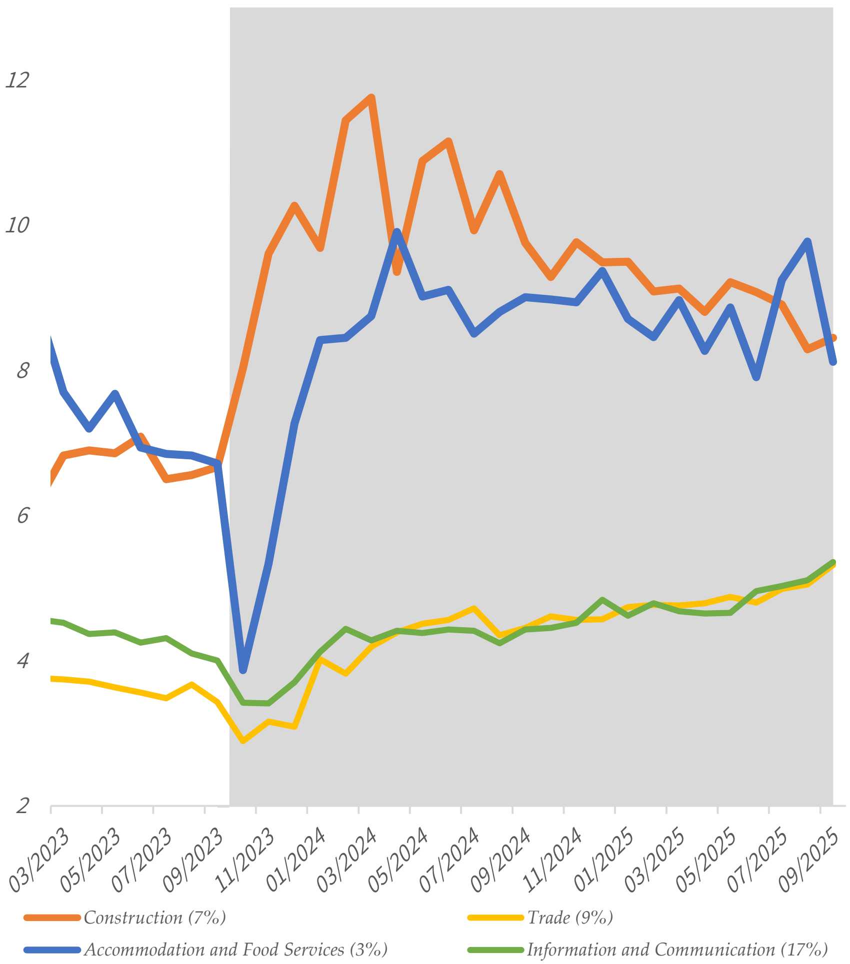
Temporarily absent from their work due to reserve service

Thousands



Vacancy rate in various sectors

Thousands, seasonally adjusted

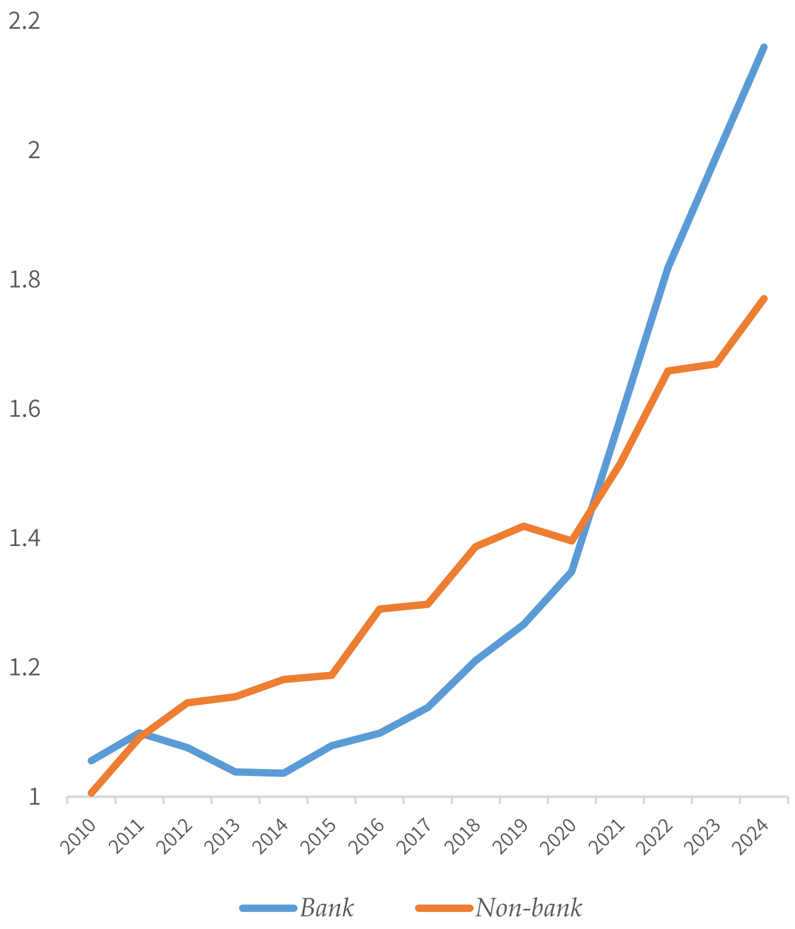


Sources: BOI and IL CBS

Credit continued to expand despite the war; The share of businesses reporting equipment constraints above the pre-war level; credit-constraint share stable

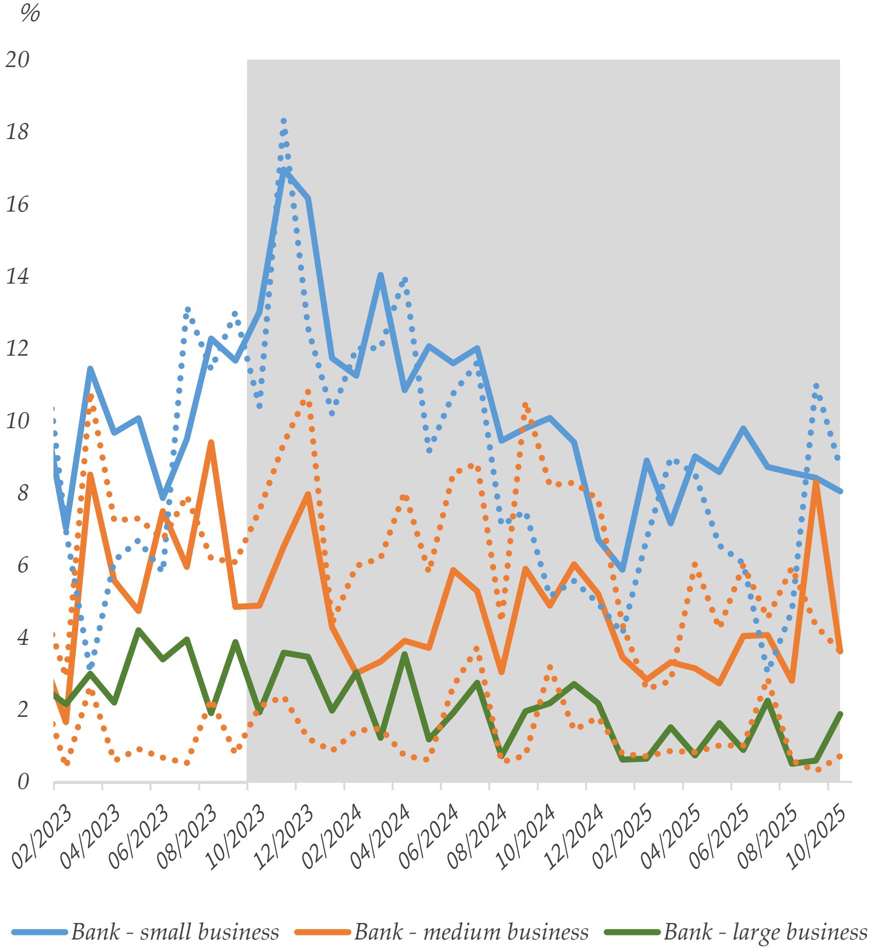
Business credit

Index 2009=1

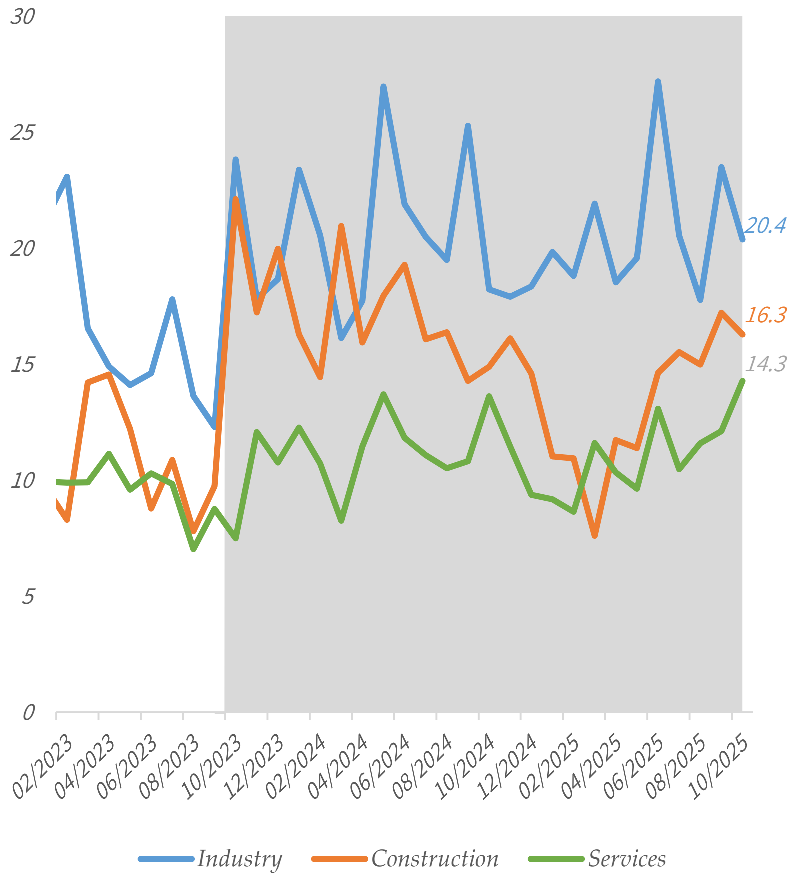


Share of businesses reporting severe credit constraints, Bank and non-bank credit by businesses size

Dashed line – Non-Bank credit

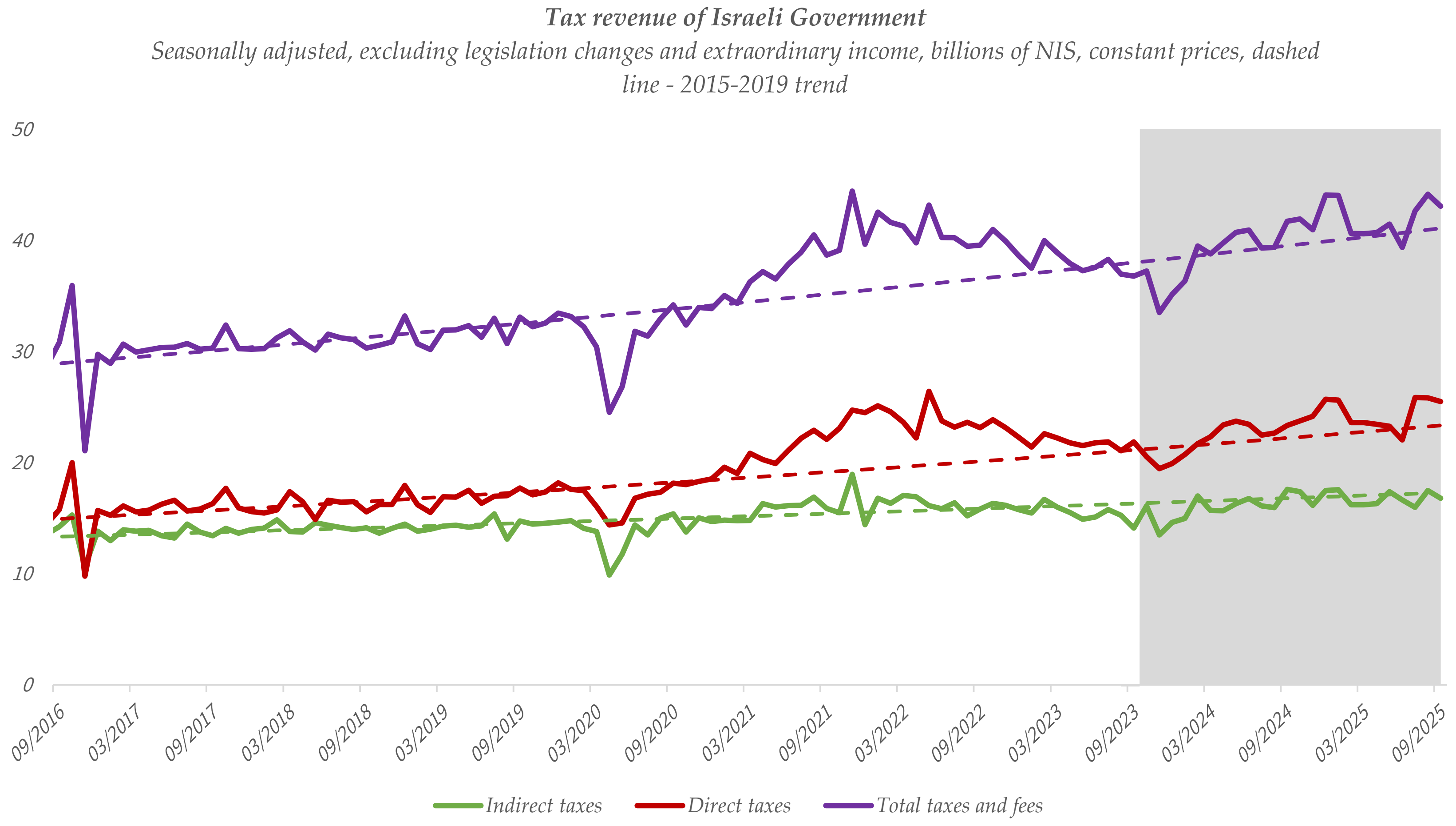


Share of companies that reported in the trends survey a moderate or severe limitation in equipment and raw materials, by sector



Sources: BOI, IL CBS

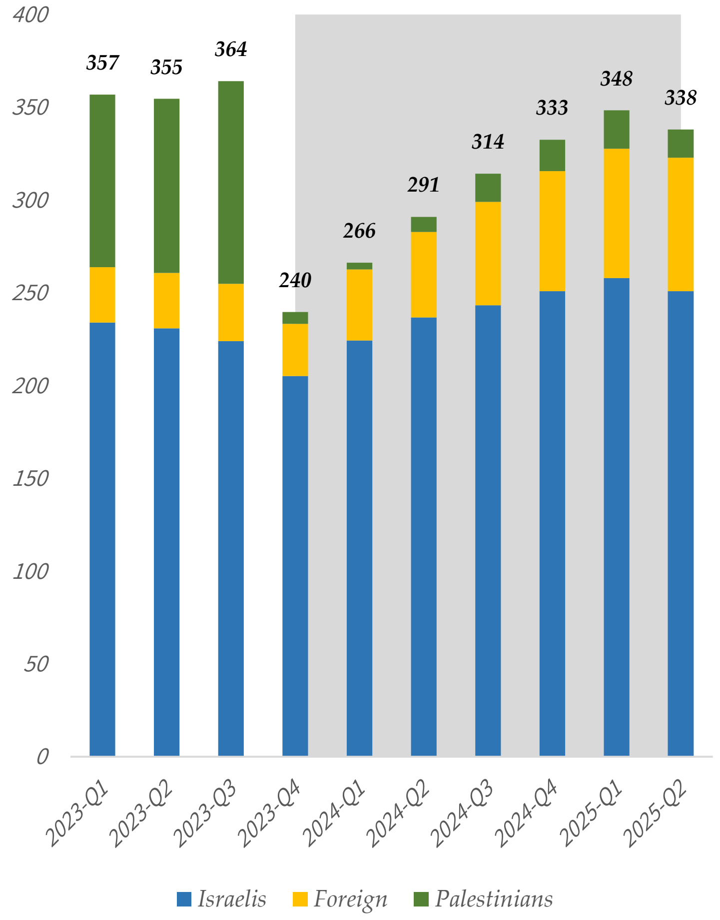
Tax revenues is moving around its trend, and still similar to GDP development



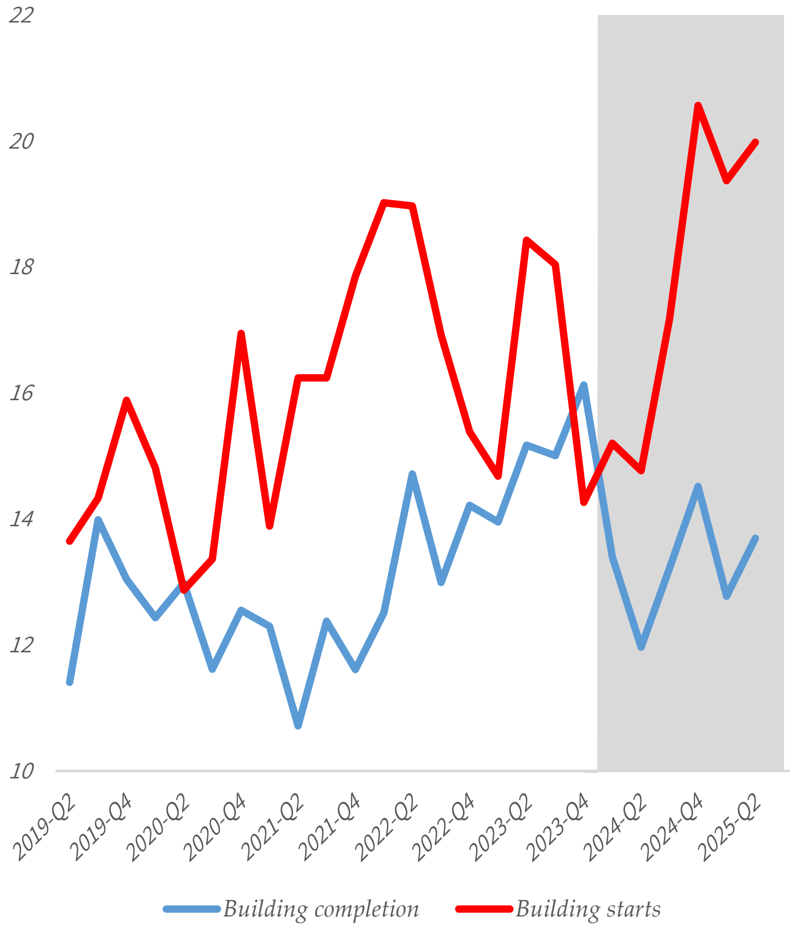
Sources: BOI, Ministry of Finance

Increase in construction employment, building starts and completions; housing prices declined in recent months

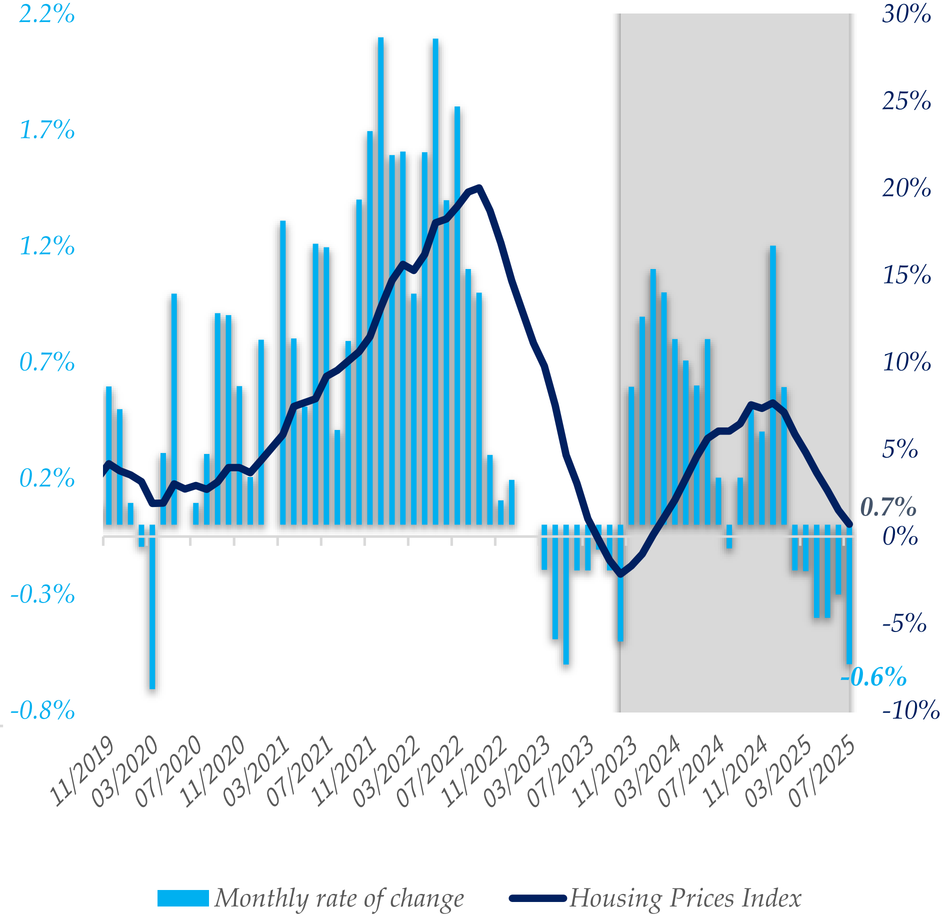
Employees in the Construction Industry
Original data, 2020-2024



Building starts, building completion, and building permits
Seasonally adjusted, Thousands

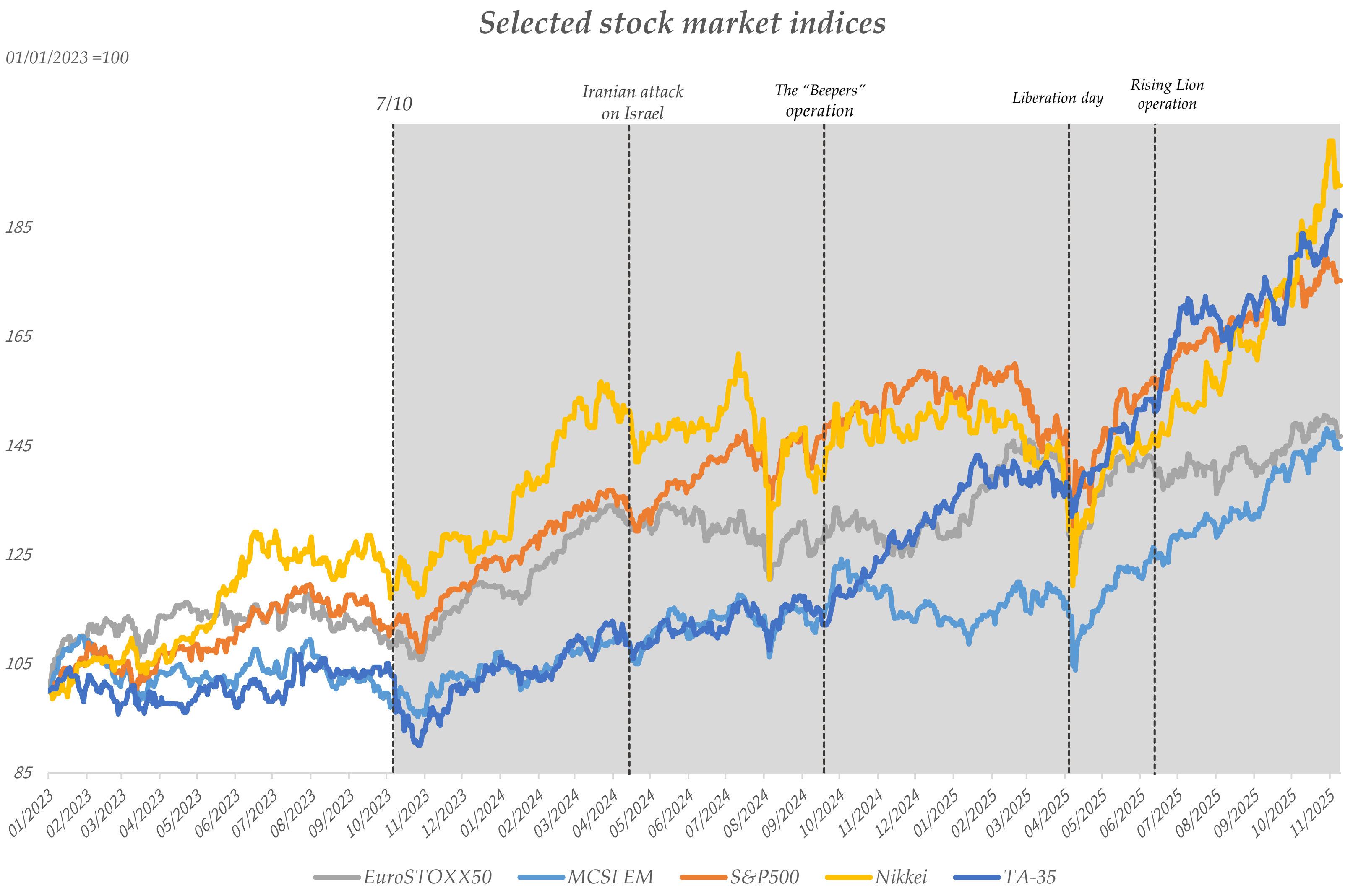


Housing Prices
Blue (left axis): Monthly rate of change,
Black (right axis): Yearly rate of change, Jan 2021 = 100



Sources: BOI and IL CBS

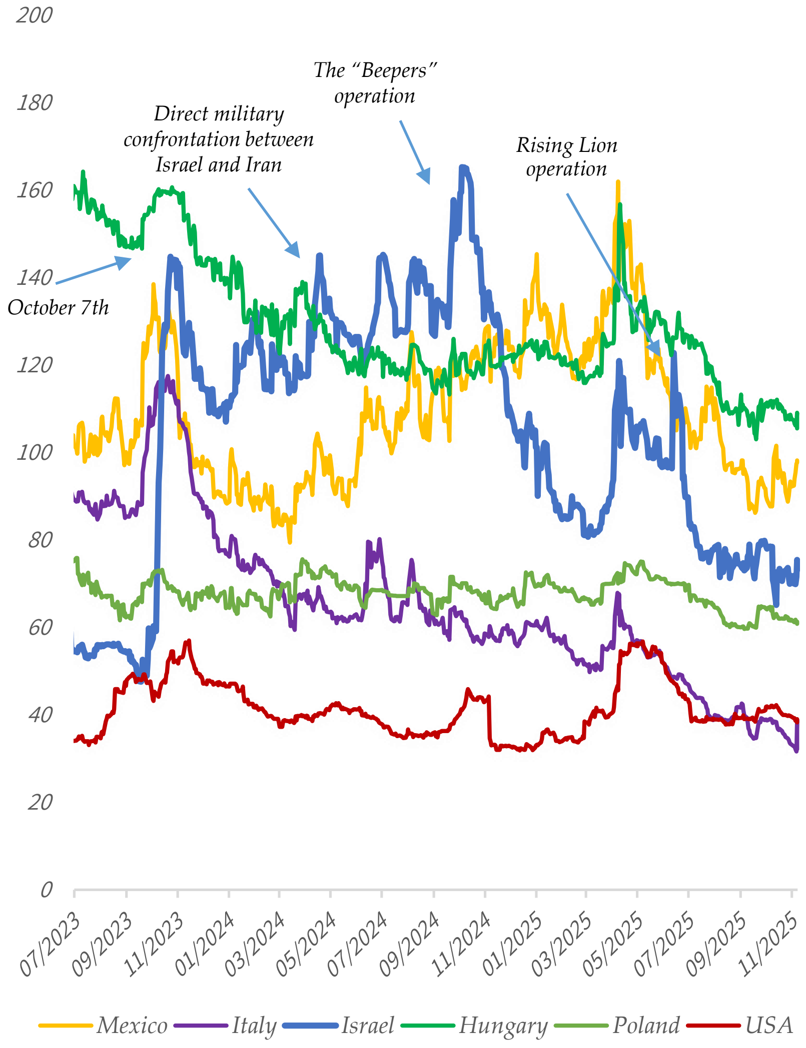
Israeli stock market shows strong performance



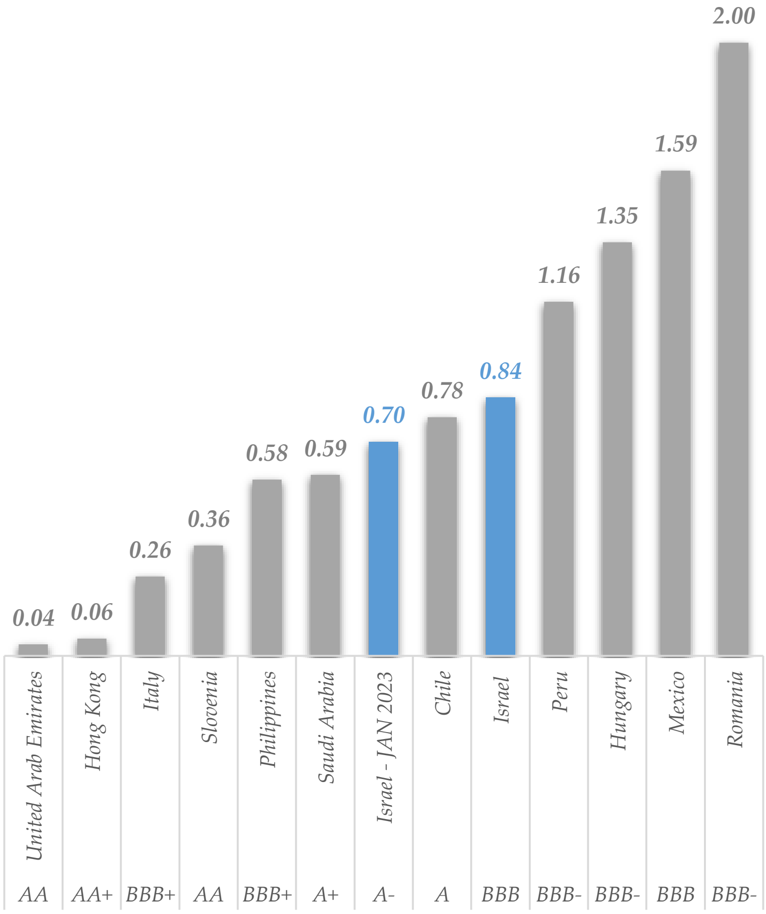
Sources: BLOOMBERG and BOI

There is a decrease in Israel's risk premium but it still remains at a high level compared to pre-war levels

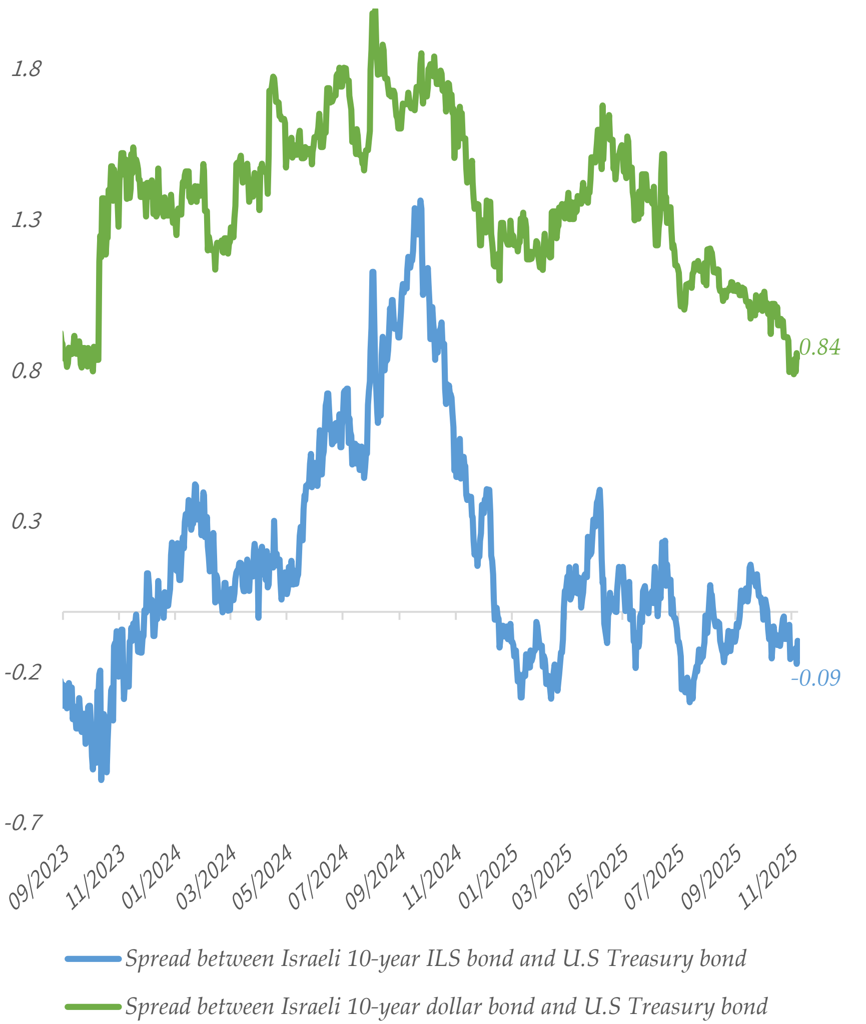
CDS 5Y
As of 07/11/25



Spread between Israel 10-Year dollar bond and Treasury Bond
As of 10/11/25



Spread between Israeli 10-year bond and U.S. Treasury bond
As of 07/11/25

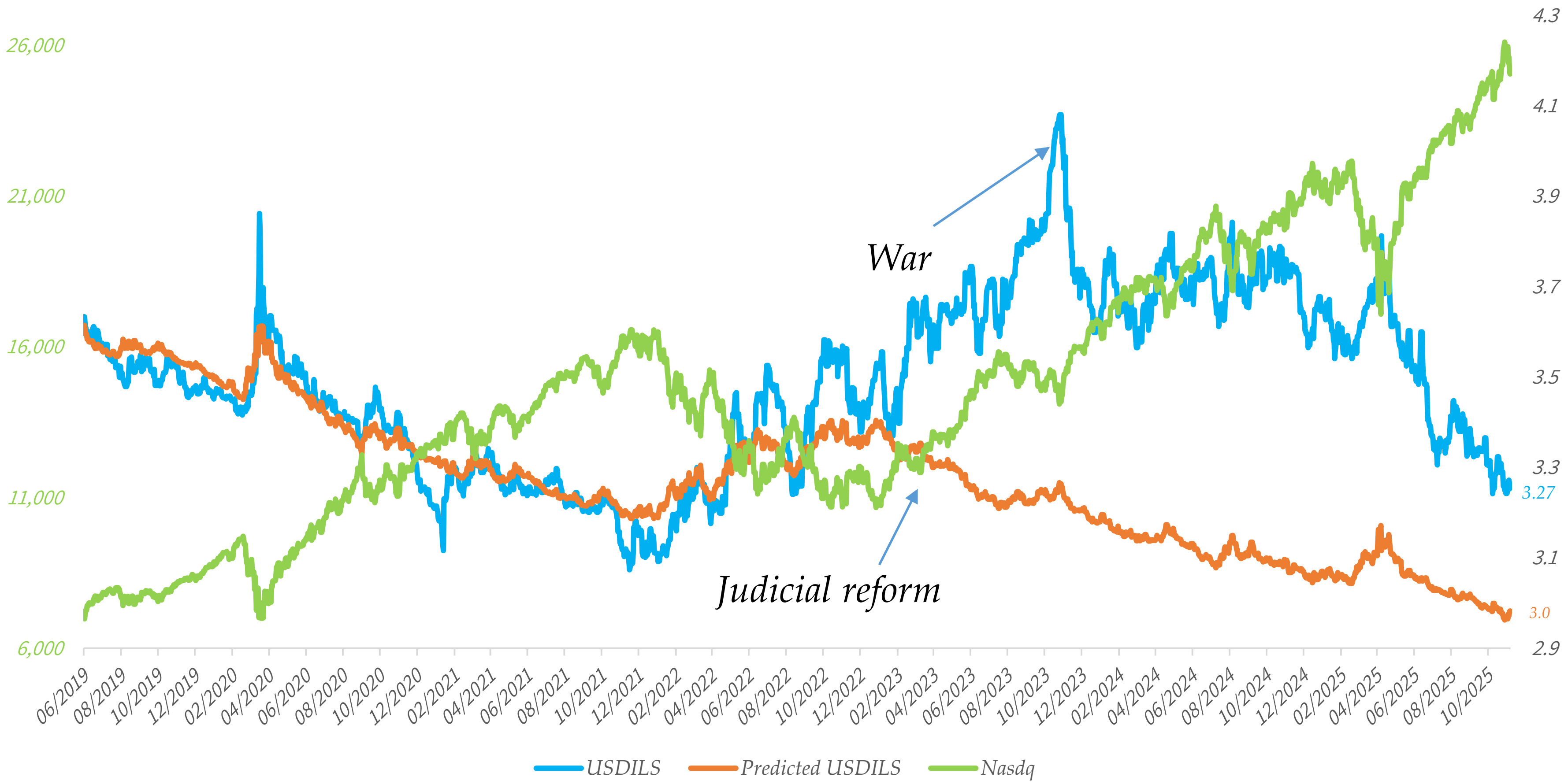


Sources: BLOOMBERG and BOI's data

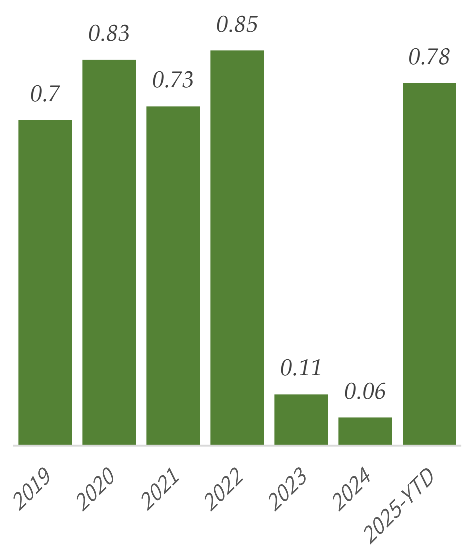
*For Israeli USD bonds, the calculation refers to redemption in 2034 starting from 1/8/24

There is an "excess depreciation" relative to the long-term trend that characterized the ILS exchange rate

The Nasdaq index, the exchange rate, and the predicted exchange rate from a regression of the exchange rate on Nasdaq



R^2 of $\frac{USD}{ILS}$ on Nasdaq – yearly



$$log(ILS\_USD_t) = \beta^0 + \beta^1 * log(NDX_t) + \varepsilon$$

Sources: BOI and BOI's analysis of BLOOMBERG data

Steps taken by the BOI during “Swords of iron” war

Monetary policy and financial stability

- ✓ FX market: Up to $30 billion FX sales
- ✓ Up to $15 billion SWAP transactions
- ✓ Government & Corporate bond repos
- ✓ Low-interest loans to banks conditional on providing credit to SME'S.
- ✓ Reduced interest rate by 0.25 PP

Banking, credit and Payments

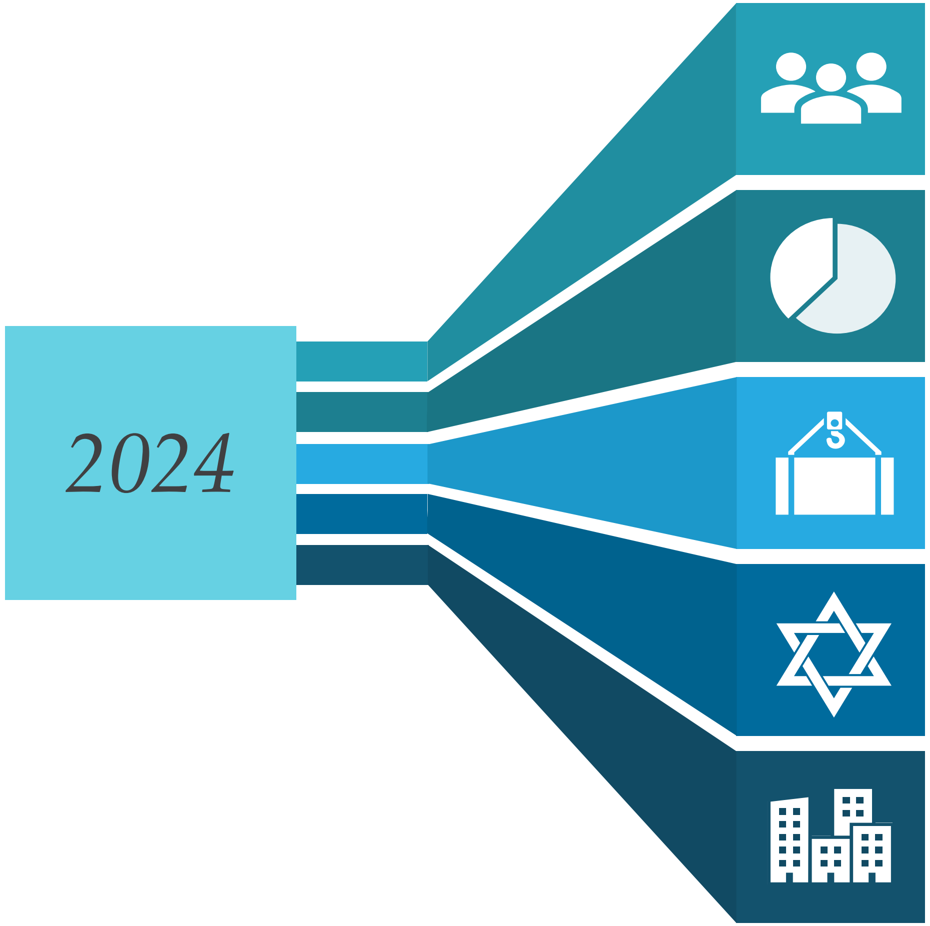
- ✓ Deferring loans free of interest and fees .
- ✓ Enhancing remote banking services
- ✓ Mitigating abuse of credit cards and accounts.
- ✓ Easing of financial restrictions
- ✓ Issued guidance to adopt a conservative policy regarding dividend distribution and credit loss allowance.

Economic advice to government

- ✓ Publication of an macro-economic forecast for the Israeli economy.
- ✓ Micro-level economic analysis of economic activity & industries
- ✓ Ongoing work vis-à-vis relevant government entities
- ✓ An advisory role for fiscal plans and framework

The High-tech Sector

The High-Tech sector has a considerable significance to the Israeli economy



~16%
of employees in the business sector (~11.5% total workforce)

$\frac{1}{3}$
of all income tax is paid by high-tech employees

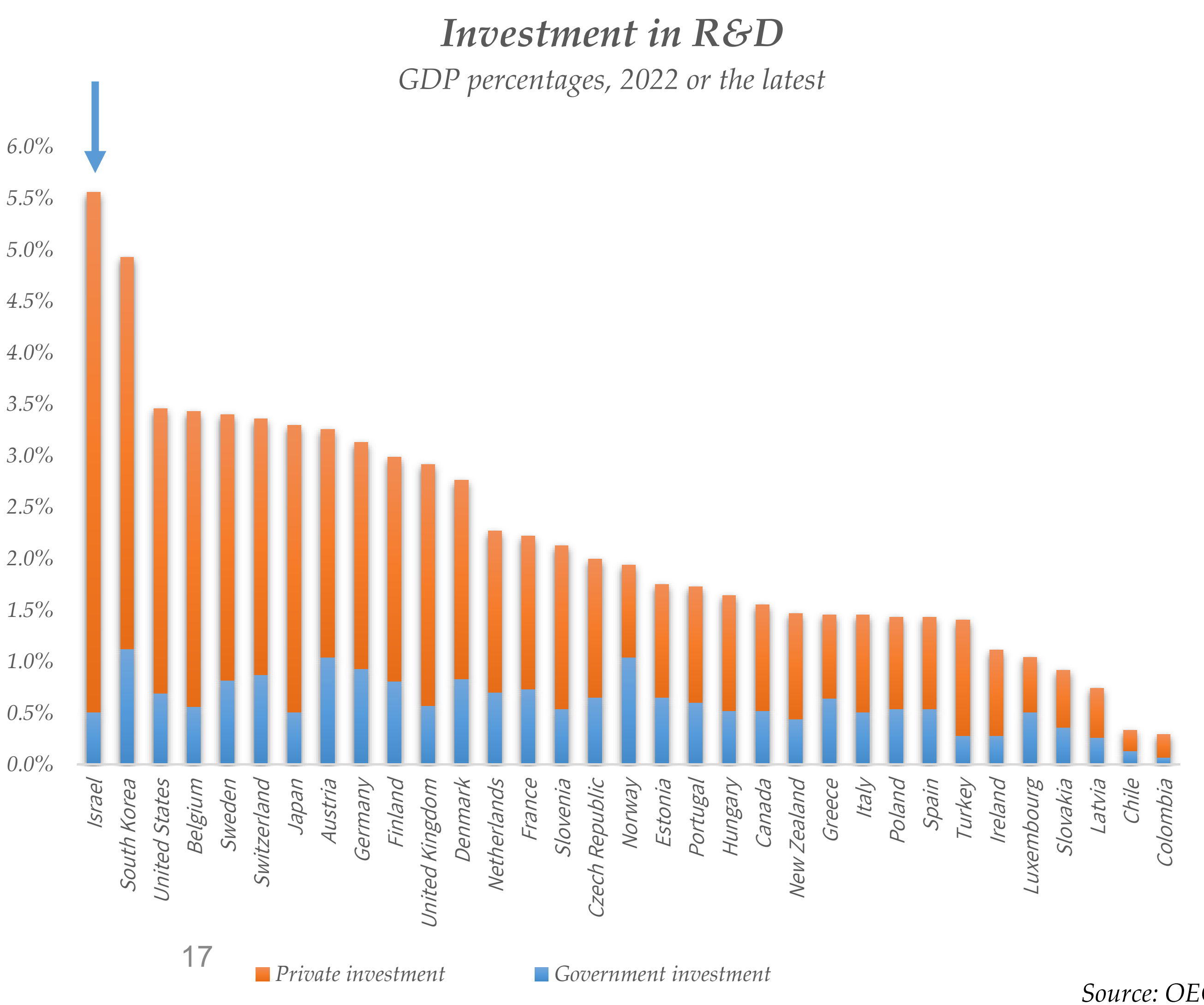
~57%
Of Israeli exports is attributed to high-tech companies

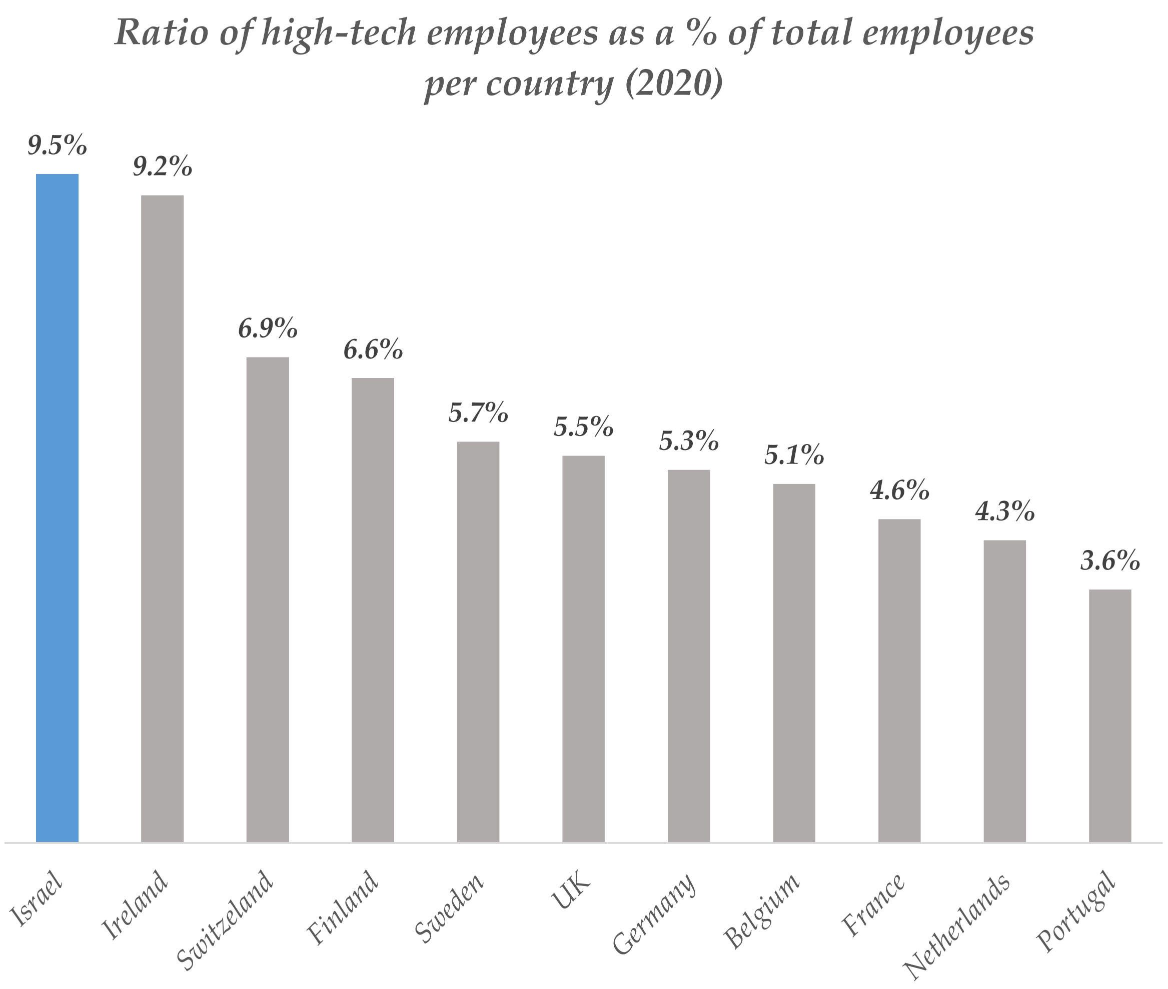
~16%
of Israel's GDP is created by high-tech companies

Above 40%
Of the business GDP growth, in the last 5 years, is related to high-tech sector

Sources: The Israeli Innovation Authority, Pitchbook

Israel leads the world in ratio of high-tech employees, and R&D investments

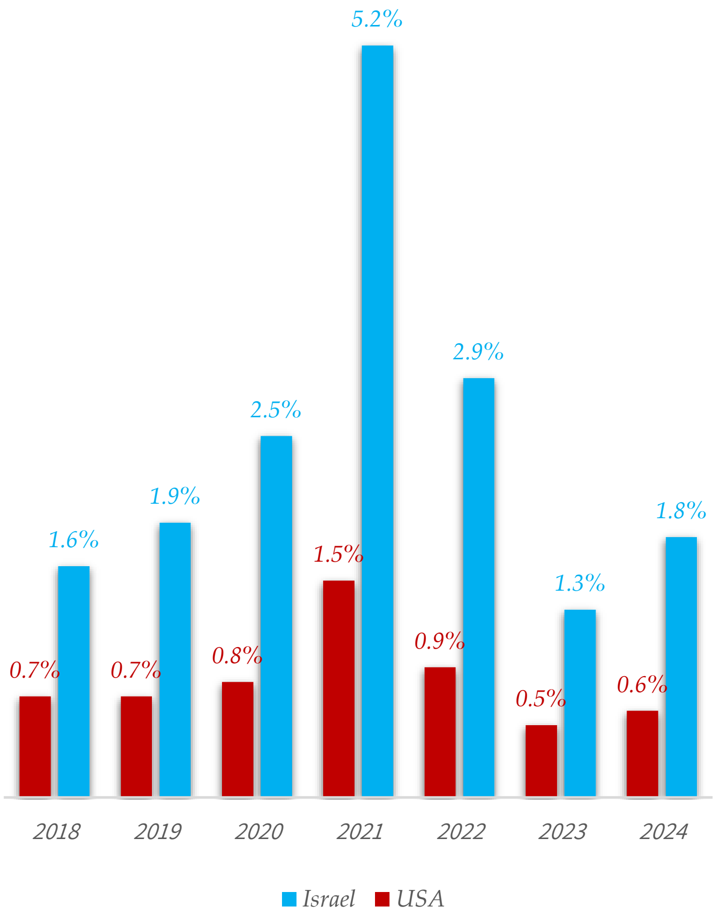




Source: OECD

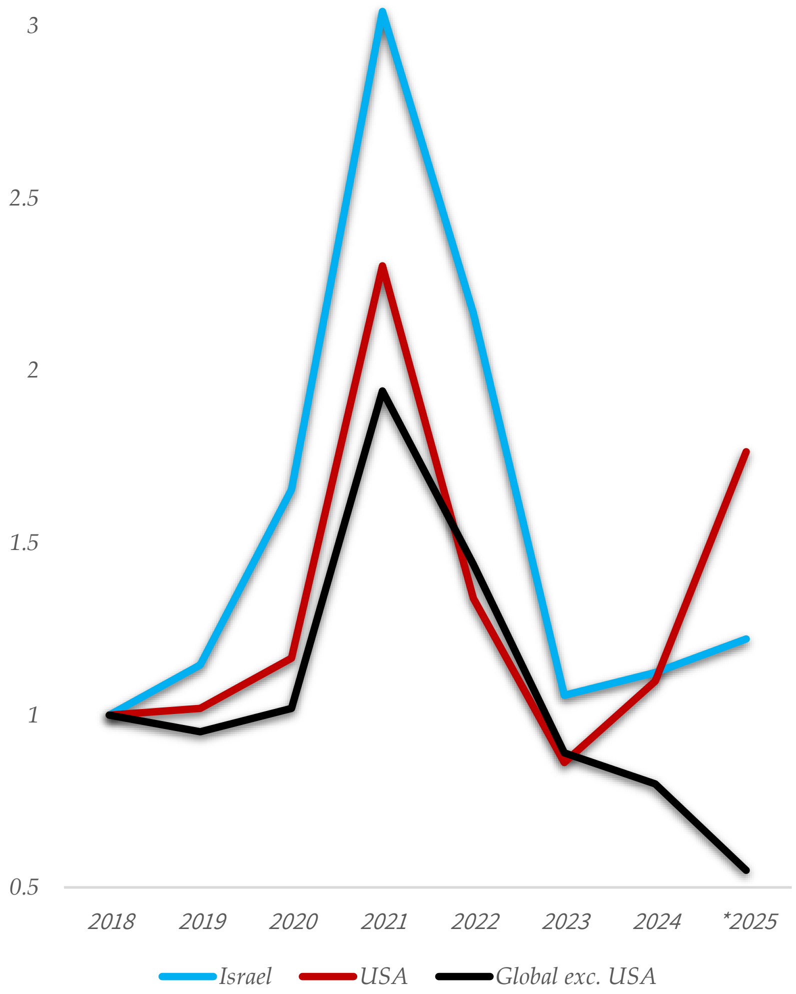
High volume of capital raising by high-tech companies in the last two Quarters

Capital raised as a percentage of GDP



Scope of capital raising

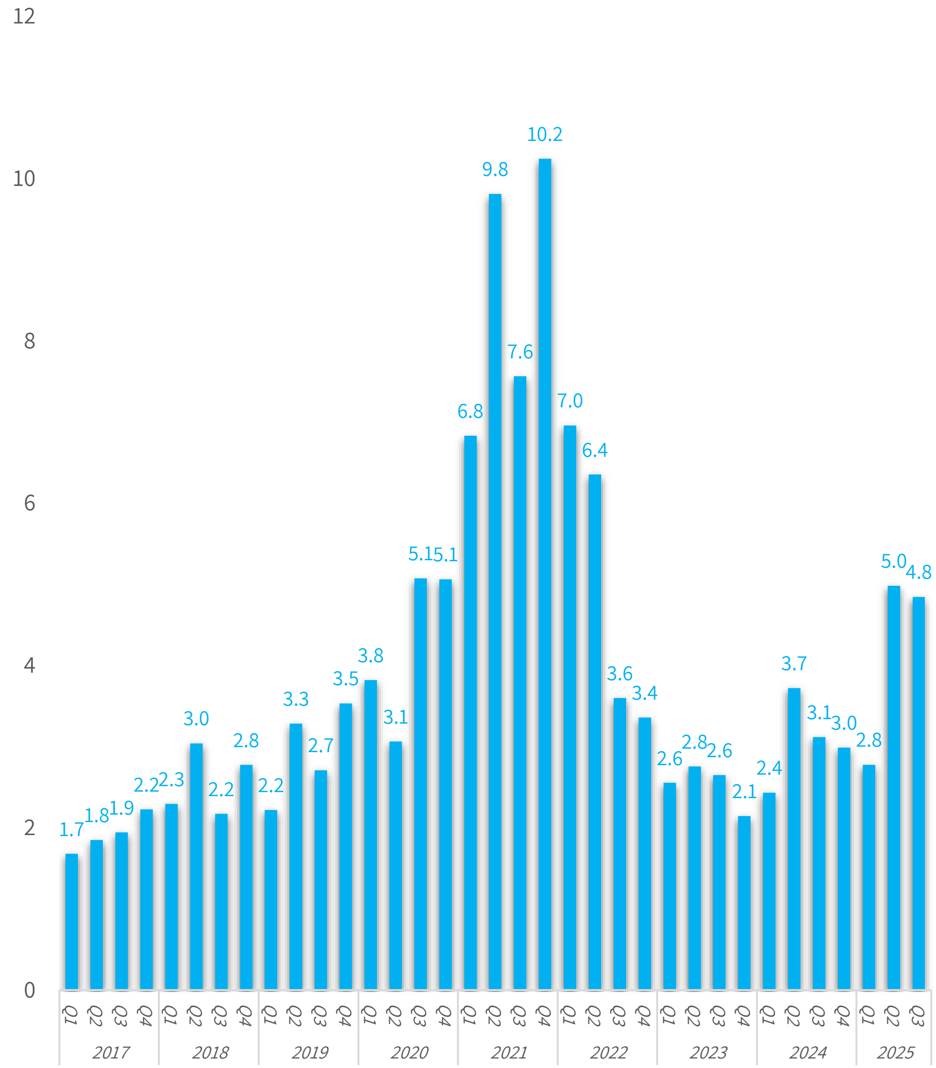
Index, 2018 = 1, Source: Pitchbook



*2025 data was inflated based on the data existing today.

Capital Raising of high-tech companies

Quarterly, Billion dollars

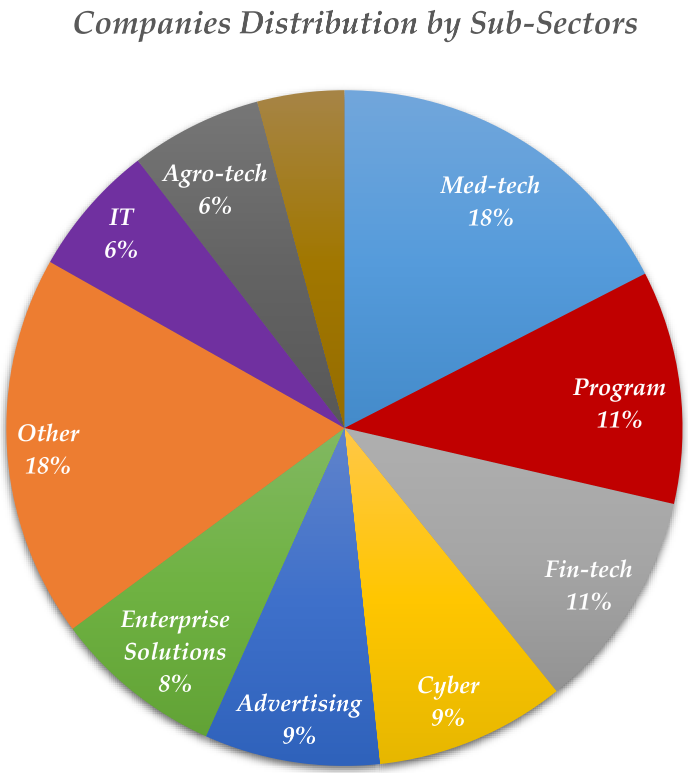


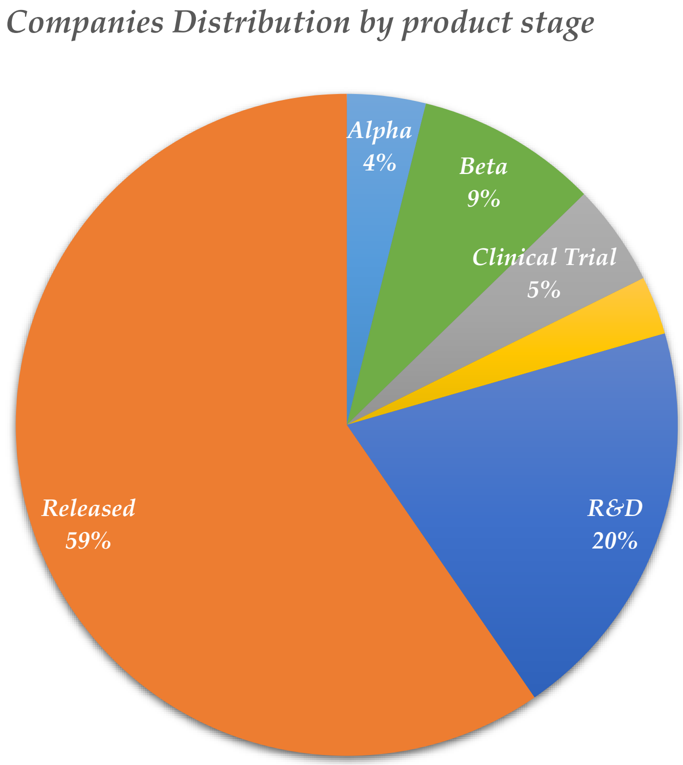
Sources: The Israeli Innovation Authority, IVC

Are High-tech companies today similar to those that closed during the dot-com bubble?
Decentralization and activity

- ***DOT-COM companies***
  - *Centralization in individual sub-sectors (Telecommunication).*
  - *Business immaturity (Dream companies).*

- ***Today:***
  - *A more "decentralized" High-tech*
  - *A large majority of the companies are in the production stage*



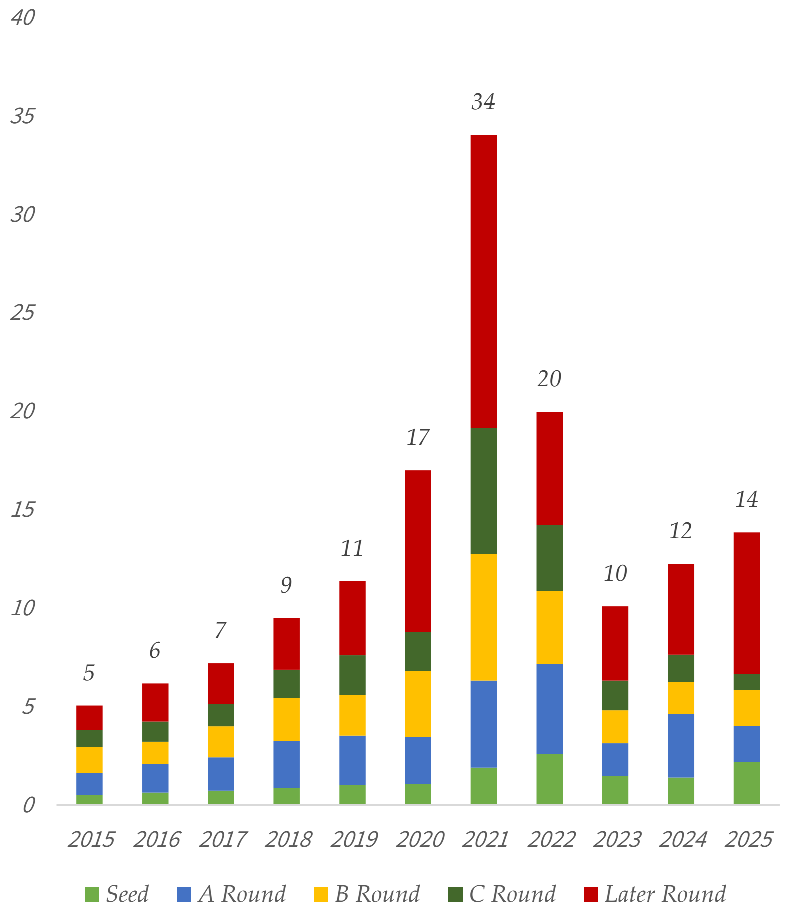


Sources: The Innovation Authority, IVC, Meitar, CBS, BOI, National Economic Council and TASE

The rise in fundraising is driven by larger funding rounds among more mature companies; Large focus on DeepTech

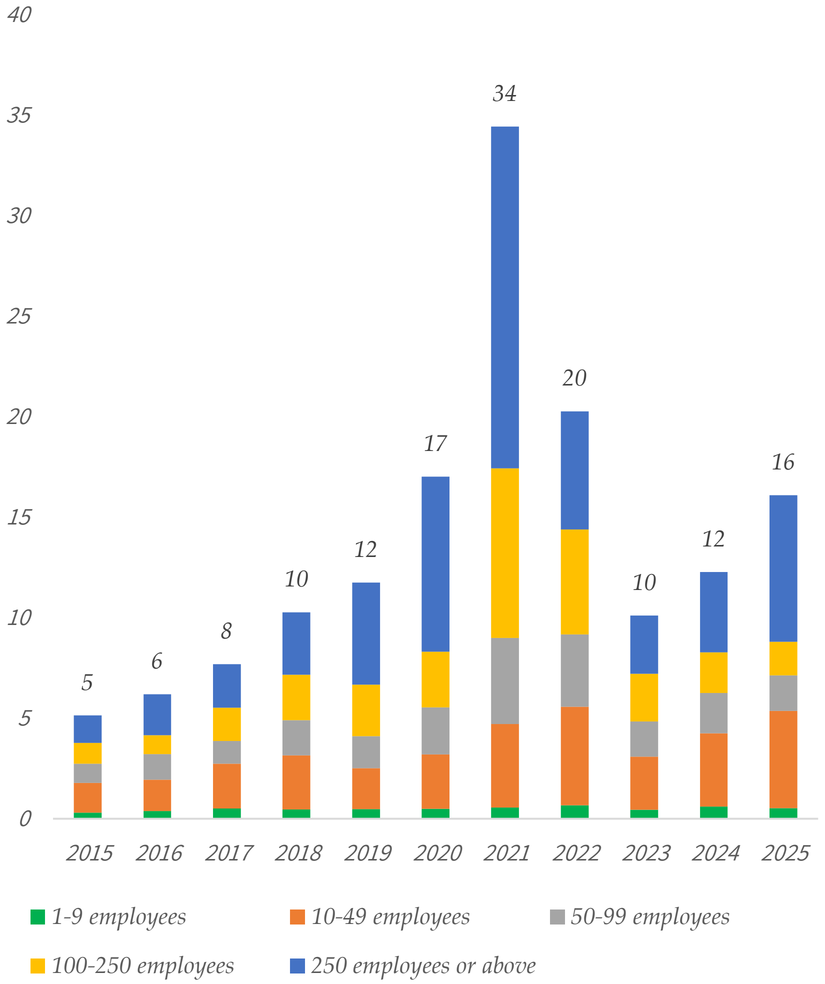
Capital rising by deal type

B$



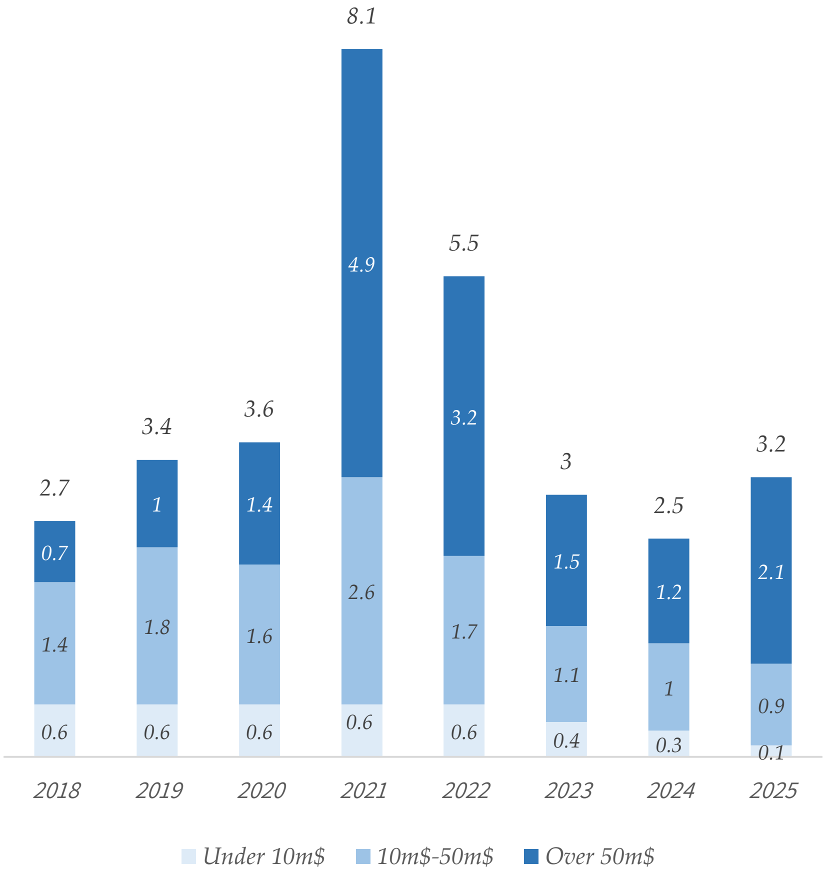
Capital raised by company size

B$



Capitol raised by DeepTech Companies, by raising size

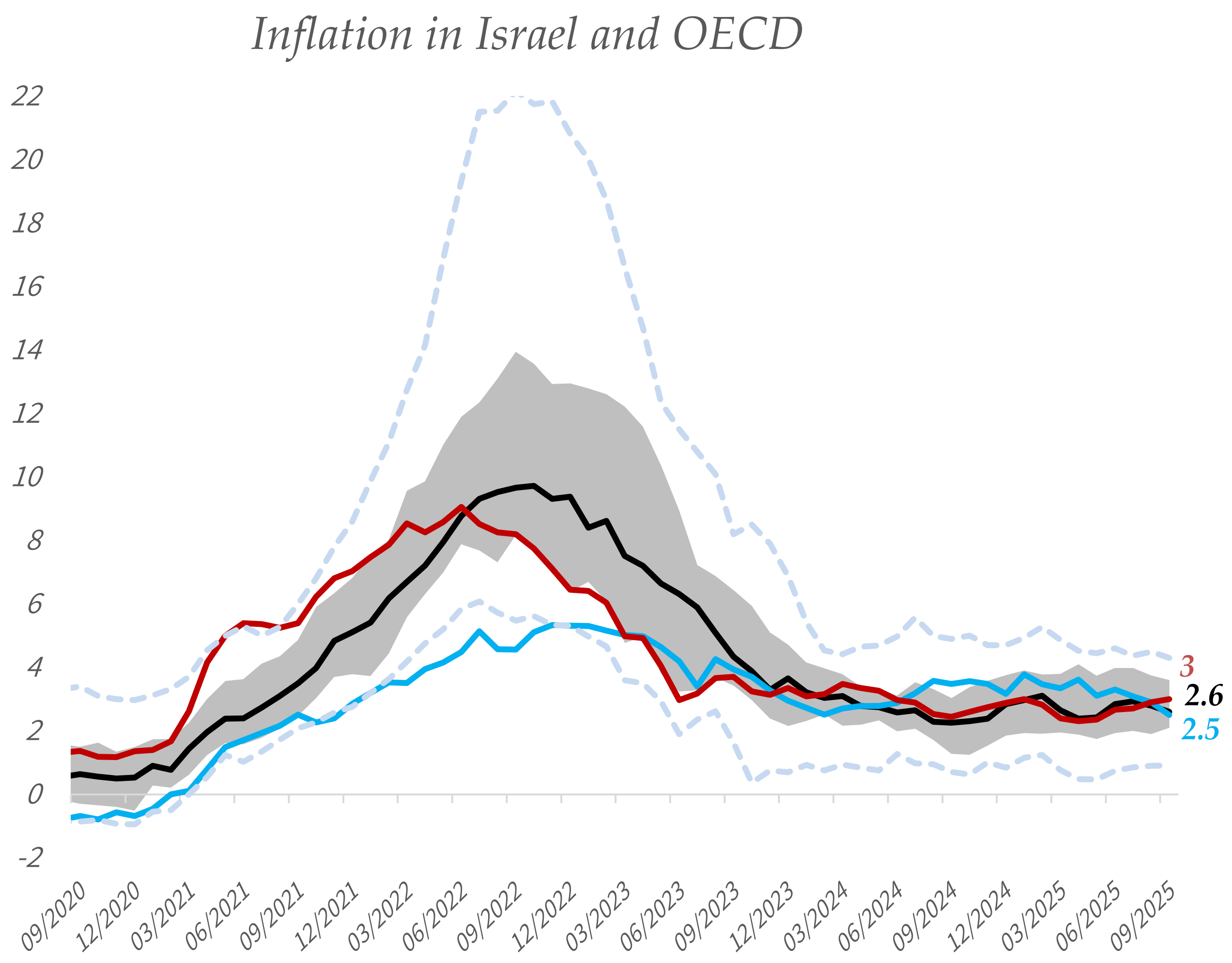
B$

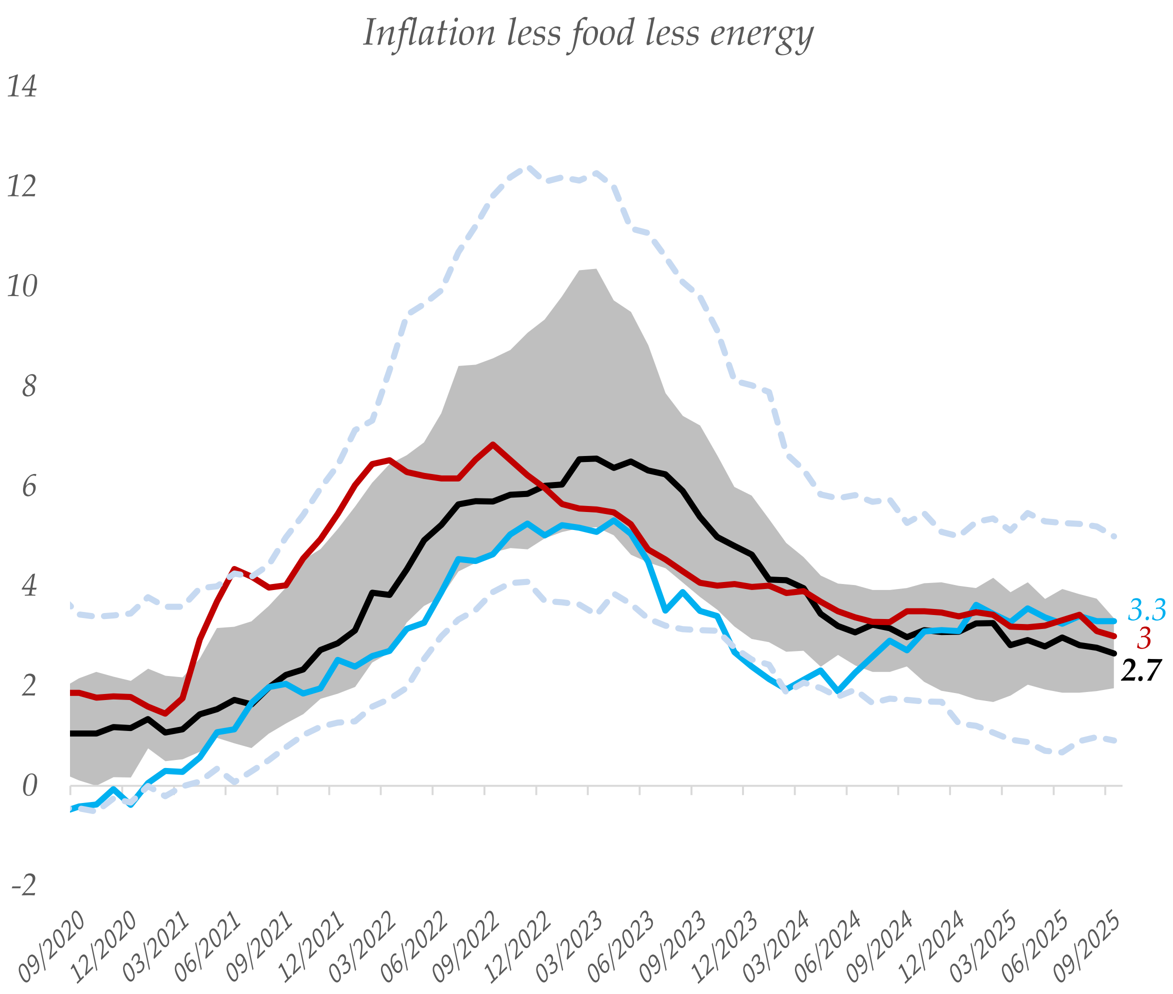


Sources: The Israeli Innovation Authority, IVC

Inflation

Inflation rate in Israel is similar to the OECD median

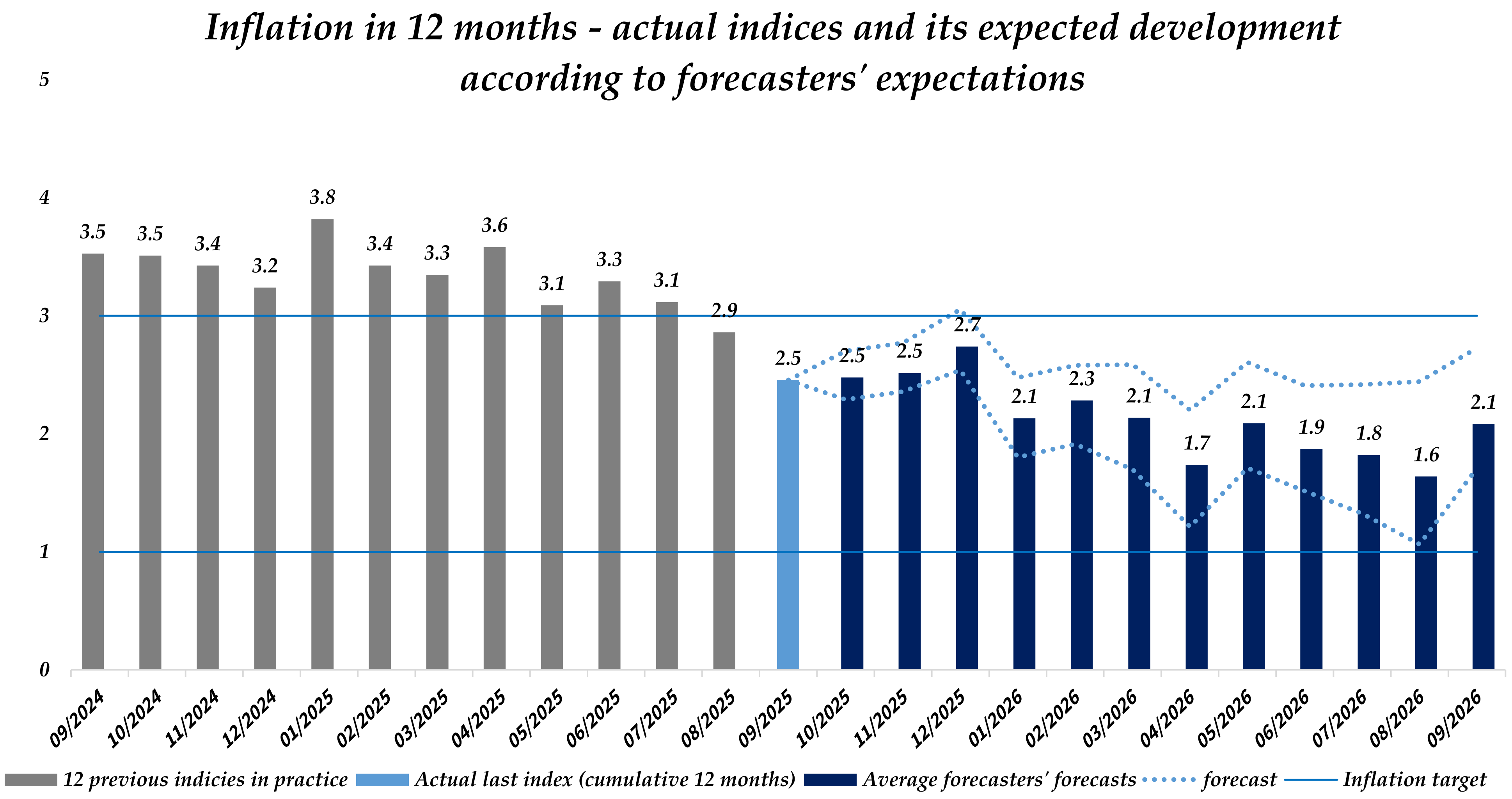




75%-25% | OECD Median | ISRAEL | USA | 10% | 90%

Source: OECD

Expectations are that inflation rate will move around the upper limit of the target in the coming months



Source: BOI

Fiscal Policy

The cost of the war, as estimated today, is about 350 billion shekels

Estimate for the costs of the war: 2023-2026

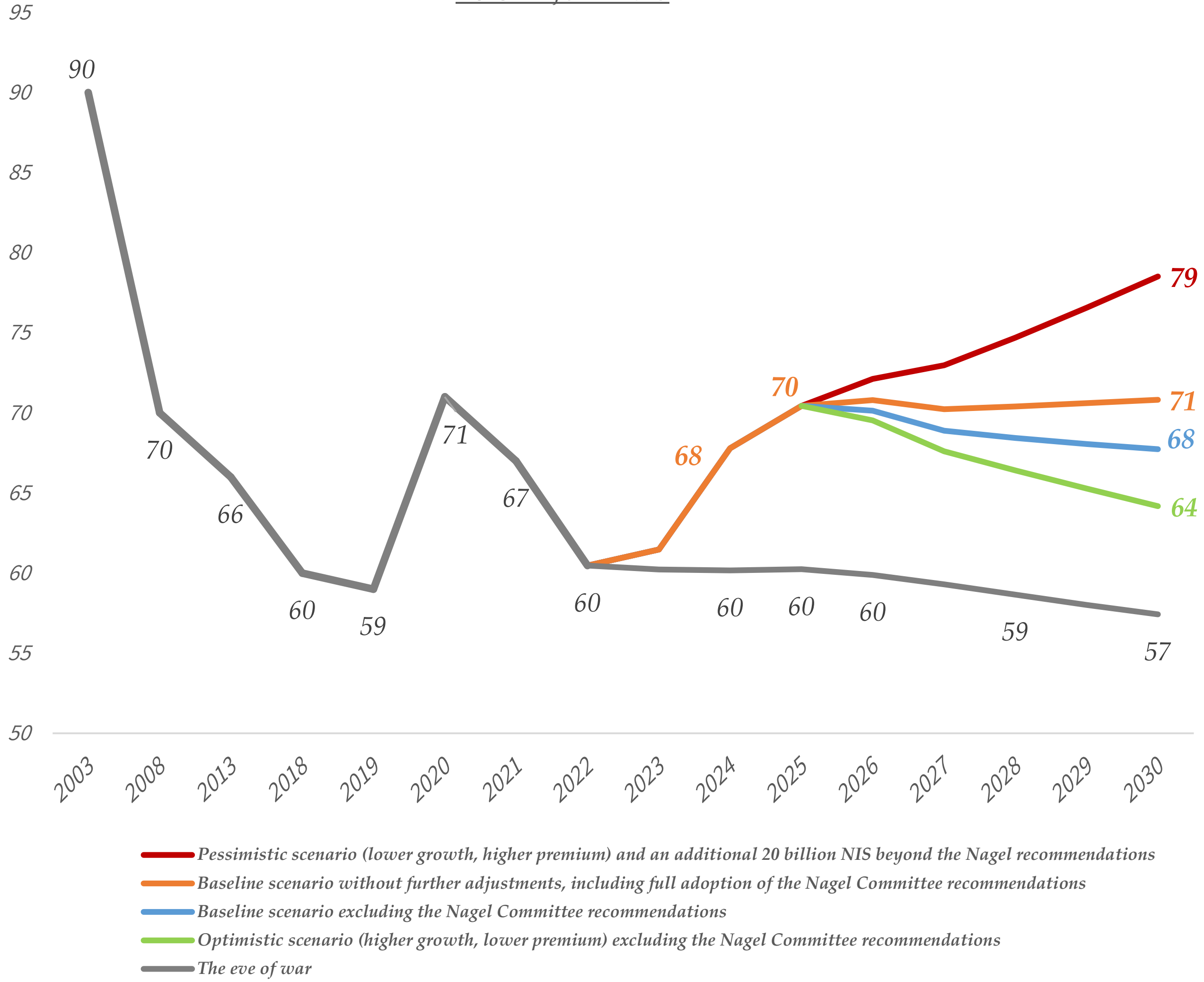
	Cost (Billions of NIS)
Defense expenditures	**243**
Compensation on direct and indirect damages	**33**
Other civilian expenditures	**57**
Interest payments	**19**
Total effect of the war	**352**

Source: BOI

Fiscal Trilemma: Low Civilian expenditure, High Defense Spending and Fiscal Responsibility

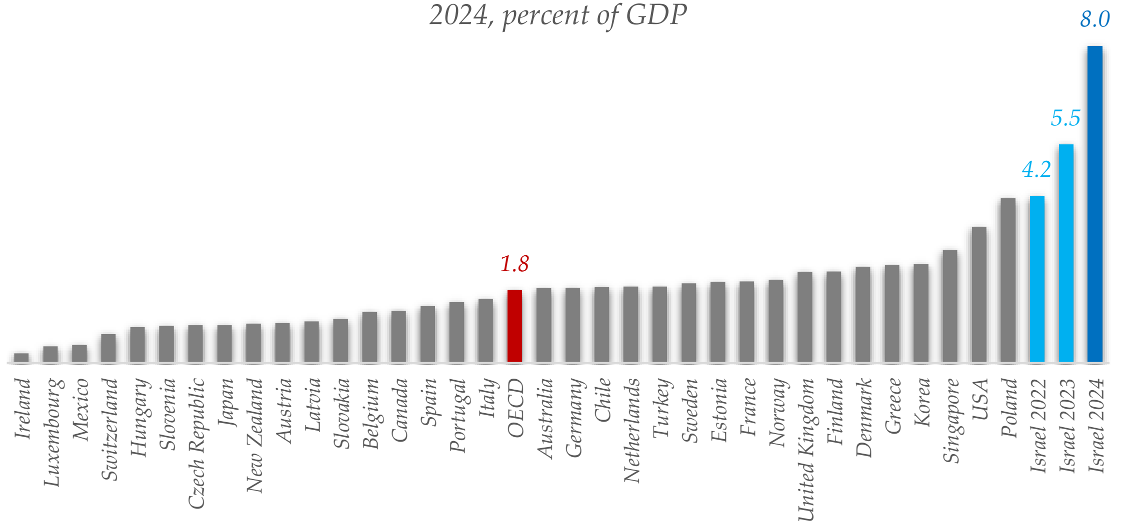
Debt to GDP - various scenarios

AS OF – JULY 2025



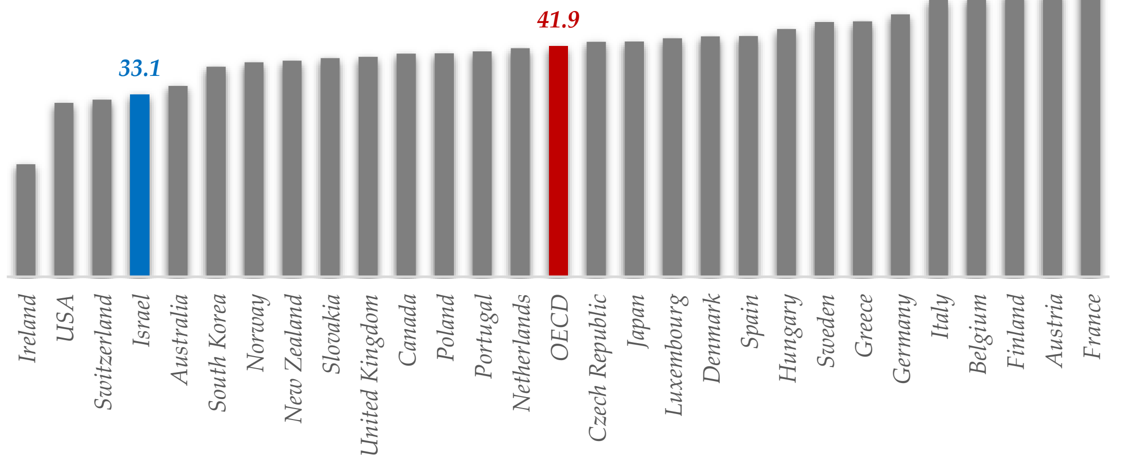
Defense expenditure

2024, percent of GDP



Civilian public expenditure excluding interest

2022, percent of GDP



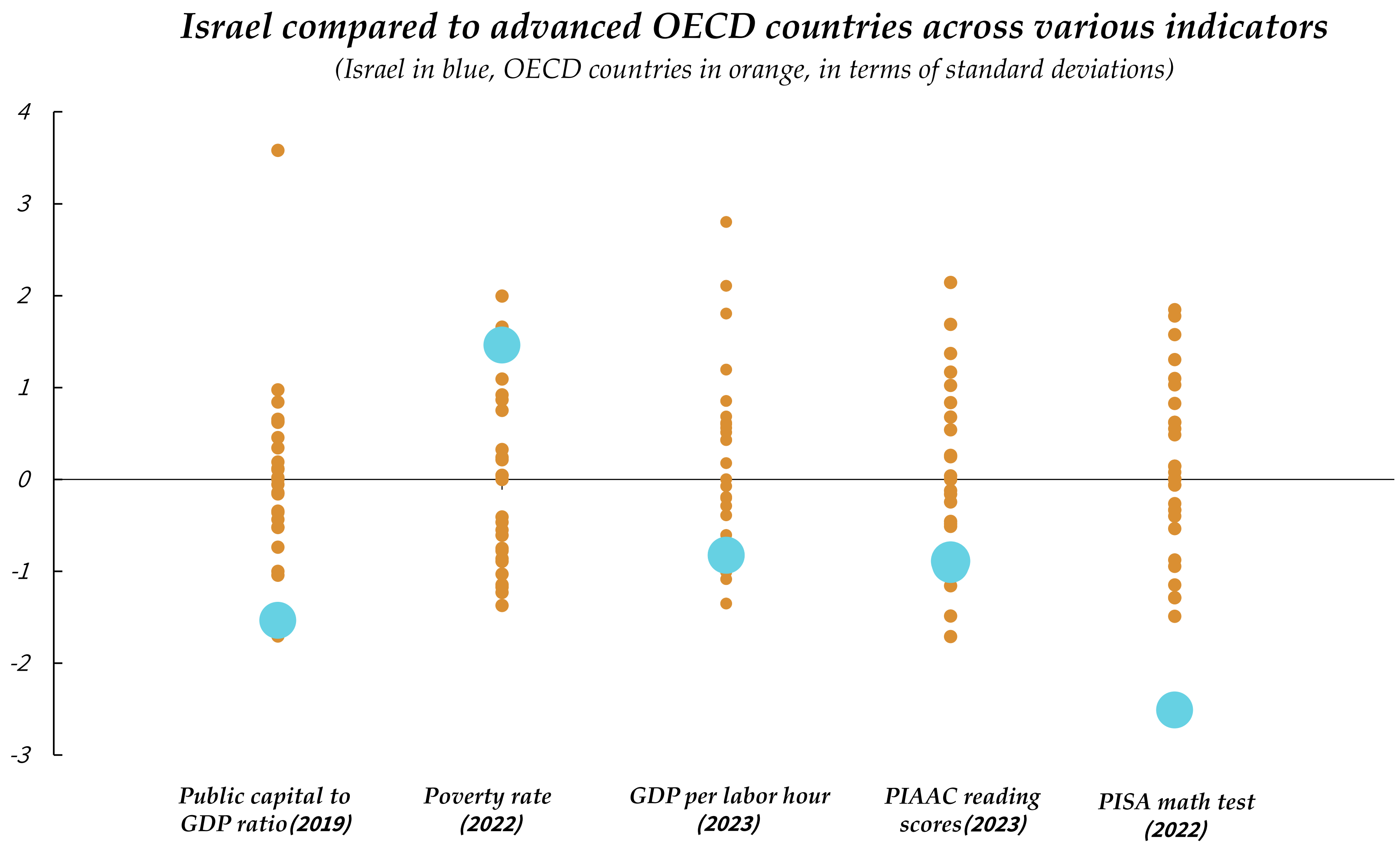
Source: OECD, BOI

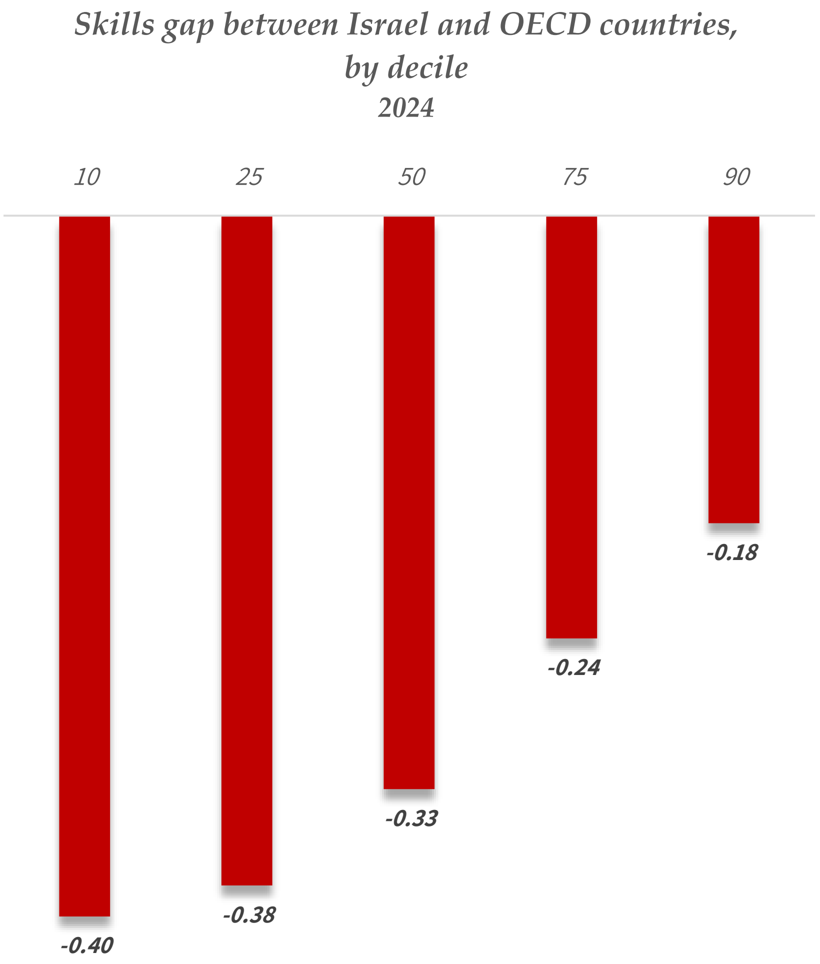
Principles for Drafting the State Budget for 2026

- *To preserve fiscal space for potential future shocks, the state budget should set a clear downward path for the debt-to-GDP ratio starting in 2026, implying a deficit of at just above 3%.*
- *Priority should be given to investments in key growth drivers, such as education, advanced transportation infrastructure, etc.*
- *The defense budget, which has risen sharply, <u>will play a central role</u> in shaping the overall budget. It should be formulated in line with current geopolitical risks, while considering the broader economic needs.*
- *To meet the deficit target, either a substantial adjustment in defense spending relative to last year or finding large-scale alternative funding sources will be required.*
- *The scope for introducing additional fiscal relief measures without identifying alternative funding sources is very limited, if at all.*

Long-Term Challenges: ***Accelerating Growth***

Low student achievement → Low worker skills → Low labor productivity → High poverty rate

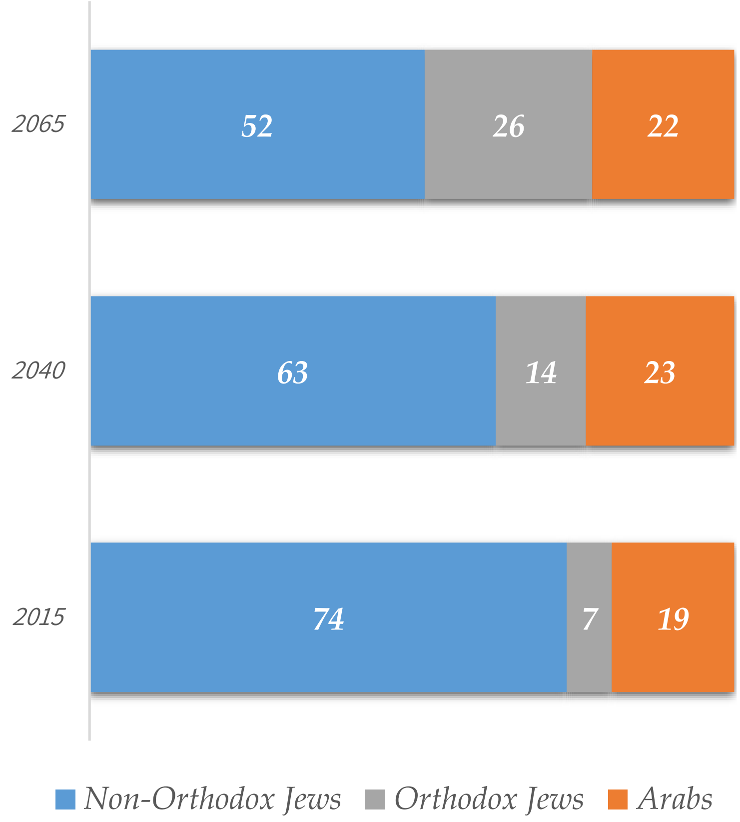




The employment rates of Arab women and ultra-orthodox men are low. There are significant wage gaps among employees. The weight of the ultra-Orthodox population is expected to increase significantly, so it is of great importance that they are qualitatively integrated into the labor market

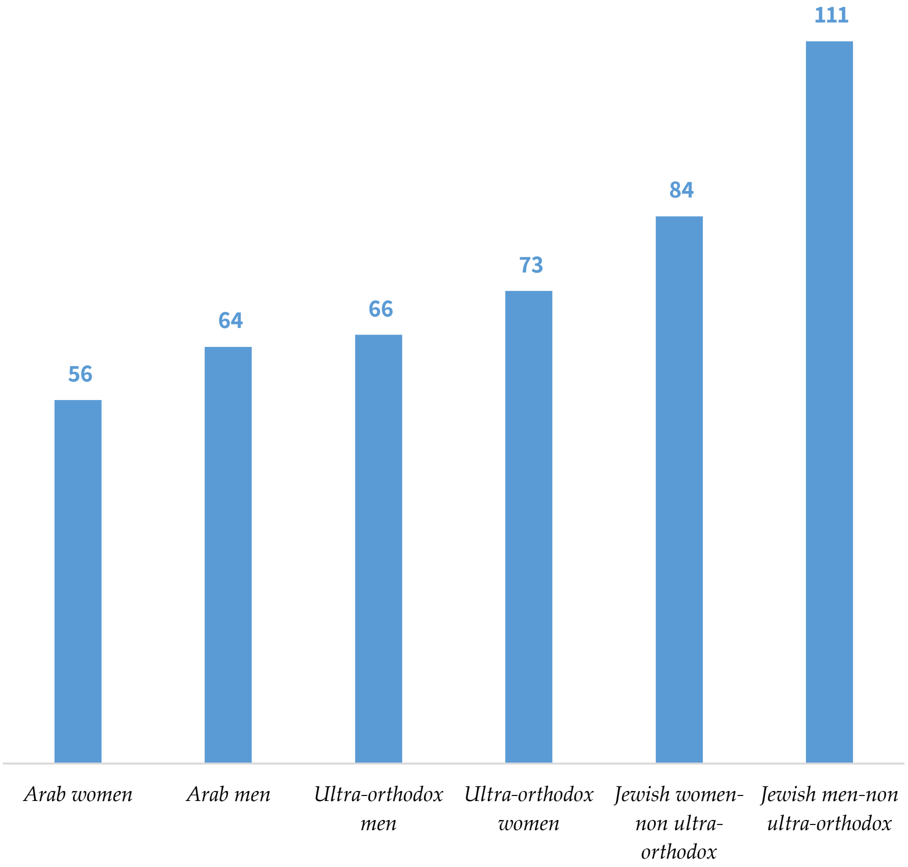
Share of various population groups in the prime working ages

Data for 2015 and forecast for 2040 and 2065



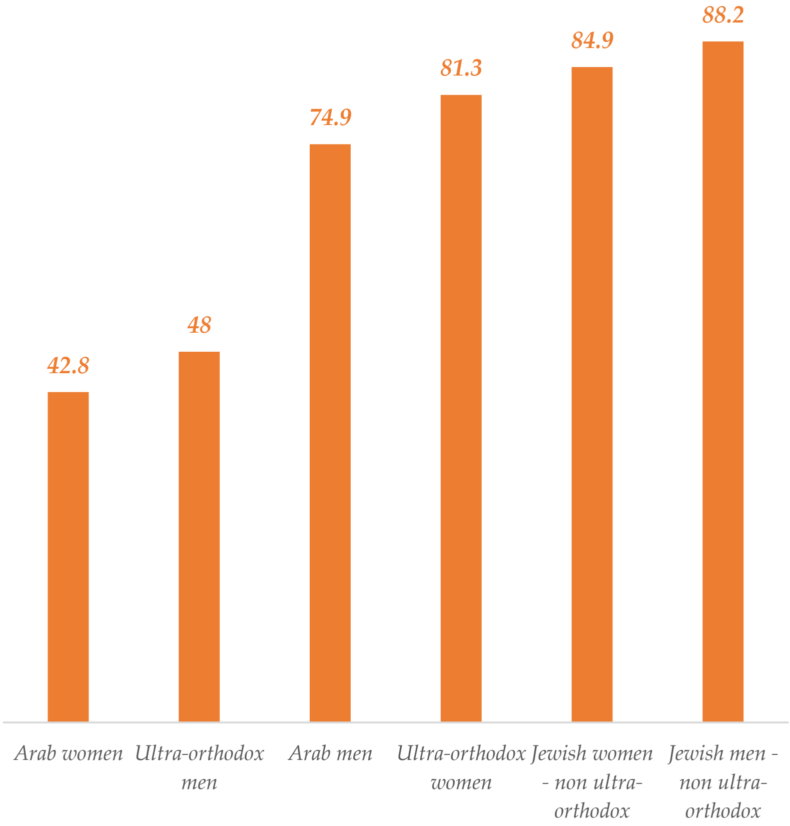
Average hourly wage

₪, 2022



Employment rates

%, 2022



Sources: IL CBS and Boi's Analysis

Driving Innovation in Israel's Financial Markets

Steps Taken by the BOI to Promote

- *Established two new digital banks.*
- *Advancing a tiered bank licensing framework.*
- *Promoted open banking.*
- *Opened the payments system to global players and fin-techs.*
- *Launched SHIR (Shekel Overnight Interest Rate) as a new "IBOR" benchmark and the development of a repo market based on SHIR-quoted rates.*
- *Advancing securitization law.*
- *Shifting TA Stock Exchange trading days to Monday–Friday.*

Forward-Looking Challenges of the Financial System

- *Cross-border and faster payments*
- *Stable coins*
- *Tokenized assets (financial and non-financial)*
- *Distributed ledger technologies*
- *Atomic settlement and delivery versus payment (DvP)*
- *CBDC*

Key takeaways

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- ***Despite the negative impact on the economy, it has demonstrated remarkable resilience throughout the war.***
- ***The war has come at a significant economic cost; GDP is estimated to be about 5% below its pre-war trend, mainly due to supply constraints.***
- ***Risk premium spiked, but fell sharply after the northern campaign and the conflict with Iran, now nearing pre-war levels.***
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- ***Upcoming CPI and Q3 GDP data will provide a clearer picture of the alignment between demand and supply.***
- ***The Bank of Israel is leading innovation and promoting competition in the financial ecosystem.***

Thank you