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Expectations for peace in Israel and the value of the Israeli shekel, 1999–2008

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Abstract

This article presents a regression analysis of some of the factors that influenced the value of the Israeli shekel from 1999 to 2008. The regression results show that changes in domestic expectations for peace in Israel had a significant effect on the value of the shekel. These results combined with a review of the political and economic developments in 2002 suggest that the exchange rate crises in the Israeli foreign currency market in the second quarter of 2002 was due to a decrease in expectations for peace and that the exchange rate stabilized in the end of the quarter due an increase in expectations for peace in Israel in the end of June.

Keywords:

intifada

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interest rate parity

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Notes

1. See Avi Ben-Bassat, "The Obstacle Course to a Market Economy in Israel," in *The Israeli Economy, 1985–1998: From Government Intervention to Market Economies*, ed. Avi Ben-Bassat (Cambridge, MA: MIT Press, 2002), 33, 34.
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4. Asaf Zussman, Noam Zussman and Morten Orregaard Nielsen, "Asset Market Perspectives on the Israeli-Palestinian Conflict," *Economica* 75 (2008): 84–115.
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6. Zvi Eckstein and Daniel Tsiddon, "Macroeconomic Consequences of Terror: Theory and the Case of Israel," *Journal of Monetary Economics* 51 (2004): 971–1002.
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8. Tamir Levy, "The Oslo Index and Stock Returns," *International Research Journal of Finance and Economics* 23 (2009): 7–22.
9. This and all subsequent data on Israeli fatalities due to terrorism is from B'tselem, <http://www.Btselem.org>.

10. This data does not include foreigners (64 deaths through 2008) and the data for 2008 is up to December 26, prior to Operation Cast Lead, which began on December 27. With regard to Palestinians, 2002 was also the deadliest year with 1032 deaths.
11. Data from <http://www.mfa.gov.il>, the website of Israel's foreign ministry. The data for 2008 and 2009 do not include the period of Operation Cast Lead.
12. Annual data of Israel's GDP and inflation rates from Israel's Central Bureau of Statistics (CBS), Statistical Abstract of Israel 2011, <http://www.cbs.gov.il>.
13. Quarterly GDP from the Bank of Israel website, <http://www.boi.gov.il>.
14. Press announcement by CBS on August 16, 2011.
15. US data from US Bureau of Labor Services, <http://www.bls.gov>.
16. Data from England from UK's office of National Statistics, <http://www.statistics.gov.uk>.
17. See discussion by Nissan Liviatan and Nathan Sussman, "Disinflation Process in Israel in the Past Decade," in *The Israeli Economy, 1985–1998*, ed. Ben-Bassat, 129–56.
18. Information concerning shekel/dollar exchange rates and interest rates of the Bol are available from the Bol's website, <http://www.boi.gov.il>.
19. Joseph Djivre and Daniel Tsiddon, "A Monetary Labyrinth: Instruments and the Conduct of Monetary Policy in Israel 1987–1998," in *The Israeli Economy, 1985–1998*, ed. Ben-Bassat, 126. Also see Dov Elkayam, "The Long Road from Adjustable Peg to Flexible Exchange Rate Regime: The Case of Israel," Bol Discussion Paper, 2003.
20. See the Bol's Foreign Currency Department Annual Report, 2007, Bol's Market Operations Department Annual Report 2008, 2009 and 2010 and Bol's Recent Economic Developments May–August 2011, p. 13.
21. For surveys of this literature see K.A. Froot and R.H. Thaler, "Anomalies: Foreign Exchange," *Journal of Economic Perspectives* 4, no. 3 (1990): 179–92, Charles Engel, "The Forward Discount Anomaly and the Risk Premium: A Survey of Recent Evidence," *Journal of Empirical Finance* 3, no. 2 (1996): 123–92, and Karin Lewis, "Puzzles in International Finance," in *Handbook of International Economics*, vol. 3, ed. G.M. Grossman and K. Rogoff (Amsterdam: North Holland, 1995), 1913–71.

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25. For announcement of the interest rate reduction, see Bol Press Release, December 23, 2001, and for an example of the disagreement between the Bol and the Finance Ministry, see article by Moti Bassok, "Klein: The Depreciation is Not Likely to Cause Inflation" [in Hebrew], *Haaretz*, March 25, 2001.
26. The Bank of Israel's Monetary Program for June 2002, Press Release of the Bol, May 27, 2002.
27. Nehemia Shtrasler, "The Dollar Dive/No Crisis, No Disaster," *Haaretz*, April 14, 2007, wrote, 'In June 2002 Israel went into panic mode when the dollar climbed to an all-time high of five shekels. Everyone wondered whether it would break the five-shekel psychological barrier and reach six to the dollar.'
28. According to an article in the *New York Times*, "The Markets: Stocks & Bonds; Nasdaq Index Tumbles 3%, to Its Lowest Point This Year," June 20, 2002, even the Dow Jones and Nasdaq indices fell due to the terrorism in Israel. The article reports, 'The selling was accelerated by the second suicide bombing in Israel in as many days. Analysts said the bombing gave investors already skeptical about second-quarter earnings another reason to stay away.'
29. See articles by John Kifner, "Cabinet in Israel Endorses Seizure of the West Bank," *The New York Times*, June 22, 2002, and "Israeli Forces Hit Palestinian Offices in Hebron in Effort to Dislodge Gunmen," *The New York Times*, June 28, 2002.
30. Data on attacks from Israeli army is reported in an article by James Bennet, "Israelis Say Hamas Is Not Able to Mount Major Retaliation," *The New York Times*, May 27, 2004.
31. In the Bol's Press Release for its Monetary Program of July 2002, announced on June 24, 2002, they explain that 'price stability would encourage growth and employment'.
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