

International Commentary - November 4, 2024

Middle East Geopolitical Scenario Analysis Update

Summary

More than a year since military conflict erupted in the Middle East, developments have intensified and conditions have shifted in the direction of what we originally envisaged as our "regional conflict" downside scenario. Recent commentary from Iran suggesting a third strike on Israel is under consideration suggests momentum toward de-escalation may be elusive for the time being. With that said, a more forceful push for peace may follow U.S. elections—regardless of who wins the White House—as attention can gravitate toward conflict containment rather than election campaigns. Even as our downside scenario has materialized and the shekel has become a more vulnerable currency, we believe ILS could continue to demonstrate impressive resilience into year-end 2024 and over the course of 2025.

Economist(s)

Brendan McKenna International Economist | Wells Fargo Economics Brendan.McKenna@wellsfargo.com | 212-214-5637 Geopolitical developments in the Middle East have trended toward our downside scenario



Downside Scenario Regional Conflict

BaseCase **Conflict** Contained

Upside Scenario **De-escalation**

Scenario Description: Foreign intermediaries

intercede in the conflict and negotiate a ceasefire or other form of material de-escalation. De-escalation

could take the form of a temporary ceasefire in Gaza

or Lebanon, firm commitments to no future direct

military strikes between Iran-Israel or establishing a

timeline/quideposts to ending the war. Military

actions continue, but should hostilities be scaled

back regional/global actors are unlikely to remain

involved. Middle East geopolitical relations

experience a minor setback, but the trend for more

collaboration and normalized relations can continue.

• FX: ILS experiences a major relief rally as

geopolitical risks and broader uncertainty ease.

BOI FX intervention may not be needed at scale,

and ILS reverts to "low vulnerability" currency

Scenario Description: External de-escalation efforts are not heeded, and military confrontations intensify. Israel launches a ground invasion of Gaza and escalates retaliation to target both Hamas and Hezbollah, while at the same time escalating tensions with Iran and other regional stakeholders. Escalations with Iran could occur through proxies in Lebanon, Syria or elsewhere, while Israel also threatens direct military conflict with Iran. Regional stakeholders look to isolate Israel, potentially orchestrating an oil embargo, pushing geopolitical uncertainty higher and risk sentiment sharply lower.

Financial Market Implications:

- FX: Bouts of ILS volatility ensue as the currency becomes particularly sensitive to geopolitical headlines. BOI intervention stabilizes ILS, and the shekel trades rangebound for an extended period.
- YE'24 USD/ILS Target: ILS3.70

YE'25 USD/ILS Target: ILS3.85

Scenario Description: Military confrontation between Israel and Hamas continues for the foreseeable future with no material escalation or de-escalation in the conflict. By "no escalation", we refer to no additional regional nor global actors entering the war, no direct Israel-Iran military conflict, and no intensification nor extension of existing Israel-Iran proxy battles (Lebanon, Syria etc.). Confrontations are contained to areas in Israel and Gaza, and as hostilities persist, progress on improving intra-Middle East relations regress and a full reset of regional relations begins to materialize.

Financial Market Implications:

YE'24 USD/ILS Target: ILS3.60

YE'25 USD/ILS Target: ILS3.70

- FX: ILS initially weakens sharply but rebounds below pre-conflict levels as markets experience a geopolitically-induced relief rally. Modest volatility exists, although broader market forces drive ILS
 - - YE'24 USD/ILS Target: ILS3.50
 - YE'25 USD/ILS Target: ILS3.55

Financial Market Implications:

Source: Wells Fargo Economics

For additional insight and for how our views on geopolitical developments in the Middle East have evolved, please refer to the below publications.

<u>The Geopolitical Influence on Global Trade</u> — July 2024

Israel-Iran Military Conflict Views & Takeaways - April 2024

<u>Middle East Travel Takeaways</u> — November 2023

Israel-Gaza Conflict Scenario Analysis — October 2023

Israel-Gaza Conflict Views & Potential Implications - October 2023

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