



## **BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

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### **Press release:**

#### **Remarks by the Governor of the Bank of Israel at the press briefing on monetary policy held today at the Bank of Israel**

Good afternoon.

Recent weeks, since the beginning of Operation Roaring Lion, have been marked by considerable geopolitical uncertainty, and the war's impacts on the economy and on real activity can be seen across all industries. However, even at this challenging time, the economy continues to display resilience, flexibility, and robustness, as has been the case for the past two and a half years as well. In parallel with domestic developments, the increase in geopolitical tension in the region was reflected in increased uncertainty in global markets, and a sharp rise in energy prices.

Yesterday and today, the Monetary Committee held discussions in order to reach the policy decision. At the end of the meetings, the Monetary Committee decided to keep the interest rate unchanged.

The Committee's discussions focused on the state of the economy, an analysis of local and global economic processes, and the impacts of the geopolitical uncertainty on the economy. I will refer now to the main considerations that we took into account when making our decision, and I will elaborate on the main economic developments in Israel and abroad.

As we discussed in detail in the Bank of Israel Annual Report and as I have noted on various occasions, wars—especially those that last for a prolonged period of time—are accompanied by high inflation, and by a considerable negative impact on GDP, at times even at double-digits rates. The GDP shortfall at the end of 2025 was 3.4 percent, and the cumulative shortfall over the course of the war that began on October 7, 2023, is a not-insignificant 8.5 percent. However, as I have already noted several times, the Israeli economy is continuing to display robustness and resilience. Throughout the war, the Monetary Committee has adopted a balanced monetary policy that takes into account the inflation developments, potential activity, and geopolitical risks. In the months just prior

to Operation Roaring Lion, the inflation rate in Israel declined to around the midpoint of the target range, and the February reading was 2 percent.

However, it is important to remember that the February CPI does not yet reflect the economic developments, and particularly the increase in energy prices, that began with the outbreak of the operation, and which will be reflected in the coming months' CPI readings. Accordingly, forecasters increased their year over year inflation forecast for the coming months by 0.5 percent.

In addition, 1-year inflation expectations according to the various sources increased, but are still around the midpoint of the target—a relatively small increase compared to other countries. This is in view of, among other things, a lower exposure of inflation in Israel to global energy prices. However, as the Committee noted, there is an increase in the risks of a renewed rise in the inflation rate—the geopolitical developments and their impact on economic activity and on energy prices, an increase in demand alongside supply constraints and fiscal developments.

Current economic indicators are starting to reflect the effects of Operation Roaring Lion on activity. The fighting against Iran and Lebanon and the damage on the home front due to the operation negatively impact economic activity through several channels: on the demand side there is a decline in credit card expenditures and in tourism, and on the supply side there is an adverse impact on labor supply due to employee absences and military reserves call ups, alongside disruptions in the supply chains. Credit card expenditure data indicate a sharp decline with the outbreak of the war. This trend is similar to that seen during Operation Rising Lion, though this time the recovery is slower in view of the prolonged fighting and the uncertainty, and the expenditure level is low compared to before the operation. A flash survey by the Central Bureau of Statistics carried out with the beginning of Operation “Roaring Lion” shows adverse impact factors that are similar to “Rising Lion”, with most businesses noting that the negative impact on activity derives to a large extent from the absence of employees and the closure of educational establishments.

The labor market remains tight, with the labor supply constraint continuing to be the dominant limitation in the economy. In February, the ratio of job vacancies to unemployed persons remained high, and the job vacancy rate remained stable. The broad unemployment rate among the prime working-age population (25–64) remained low and stable in January, while the share of employees absent from work due to reserve duty is expected to rise significantly as a result of Operation “Roaring Lion.”

Wage growth in the business sector has resumed its upward trend and remains elevated, standing at approximately 4.7 percent in November–January compared with the same period a year earlier. The flash estimate for overall wage growth in December–February compared with the corresponding period last year was 4.1 percent, an increase relative to previous months, suggesting the potential for continued acceleration in business-sector wage growth.

In February, home prices declined again and in annual terms the prices declined by about 1 percent. The housing component in the CPI accelerated, rising to an annual rate of 4.2 percent. The owner-occupied housing services (which is a major item in the CPI) is sticky, and the annual rate was 4.5 percent. The rate of increase in rents in which there was tenant turnover remained relatively high at 5.8 percent in the February CPI. Alongside that, based on Central Bureau of Statistics data, in the last quarter of 2025 there was high volume of activity in the residential construction industry, particularly in building starts and completions.

In the financial markets, since the previous monetary policy decision, the shekel weakened by 0.8 percent against the dollar and strengthened by 1.4 percent against the euro. Israel's risk premium, as measured by CDS spreads, increased slightly. Domestic equity indices declined in the reviewed period although less than other international markets

The updated macroeconomic forecast published today by the Bank's Research Department includes the developments since the outbreak of "Roaring Lion". Around each forecast there is a wide dispersion marking the uncertainty, and it is clear that the range of possible scenarios and outcomes in view of the current situation is especially large. The baseline scenario of the forecast is based on the working assumption that Operation Roaring Lion and the fighting in Lebanon will conclude toward the end of April, and that the direct economic impact of the operation will persist for as long as the hostilities continue. The forecast is characterized by an exceptionally high level of uncertainty, both regarding the duration of the fighting and the magnitude of geopolitical risks, which are expected to be reflected—among other factors—in the risk premium, the exchange rate, energy prices, and their implications for overall economic activity.

According to the Research Department's assessment under this scenario, GDP is expected to grow by 3.8 percent in 2026, representing a 1.4 percentage point decline compared with the January forecast. In 2027, GDP growth is projected at 5.5 percent, 1.2 percentage points higher than the January forecast.

In 2026 and 2027, the broad unemployment rate among the prime working-age population (25–64) is expected to average 4.5 percent and 3.4 percent, respectively. The unemployment rate in 2026 reflects particularly high levels of broad unemployment during Operation Roaring Lion, and an average of around 3.5 percent for the remainder of the year.

Inflation is projected to be 2.2 percent in 2026 and 1.8 percent in 2027. The Department's assessment is that the government budget deficit is expected to reach 5.3 percent of GDP in 2026 and 4.4 percent in 2027, while the debt-to-GDP ratio is projected to stand at approximately 70.5 percent at the end of 2026 and 70.5 percent in 2027.

The Department forecasts that within about a year, the interest rate will stand at 3.75 percent or 3.5 percent.

Given the exceptionally high level of uncertainty, the Research Department also examined alternative scenarios regarding the duration of the conflict and the manner in which it may

conclude. A prolonged period of fighting and continued restrictions on activity on the home front could lead to a more sustained slowdown in economic activity, which may intensify and extend to additional channels.

The manner in which the conflict ends could also have a significant impact on the risk premium, energy prices, the exchange rate, and the defense budget. These, in turn, will impact on the inflation environment.

Inflation risks are assessed to be biased to the upside. A prolonged period of geopolitical uncertainty, reflected in a higher risk premium, currency depreciation, and energy prices exceeding the assumptions underlying the forecast, would lead to higher inflation. Conversely, a more favorable geopolitical development could support a faster recovery in activity and a quicker decline in inflation—or alternatively, could result in stronger demand pressures and higher inflation.

The Knesset approved the proposed budget for 2026. The government raised the deficit target to 4.9 percent of GDP, lower than the updated Research Department forecast. The increase in the deficit target derives from the government's decision to increase the defense budget for this year by NIS 32 billion, and to allocate an additional reserve, of NIS 13 billion, for defense and civilian needs in a case of the war's lengthening. Given a deficit level above 5 percent and a debt to GDP ratio that is expected to be above 70 percent, it would have been desirable to avoid approving steps that increase the deficit, such as coalition budgets and tax reductions, which were included in the Budget Law. Given the budget that was approved, and to strengthen fiscal reliability, it is important to ensure that the reserve that was approved will be used solely for the goals for which it was set, and not diverted to other goals. In addition, to the extent the war lasts longer, and defense needs increase beyond the reserve amount, and to avoid a debt to GDP ratio that increases even more, it will be necessary to make adjustments to the 2026 budget, and they should be from items that do not support growth.

The war impacts on economic activity, including on small and medium sized businesses. It is important that the government takes supporting steps for those companies mainly from the aspect of financial liquidity, which will enable them to get past the period in which business activity is at a low intensity, and to return to activity immediately with the end of the fighting. In terms of assistance to households, there is considerable value to a plan that grants relief in the terms for unpaid leave, relative to routine times, as an alternative to wages for employees that have been forced to be absent from their place of work due to the war. This is in order to avoid a negative impact on their revenues is liable to lead to an adverse impact in private consumption and thus a negative impact on business activity.

Looking ahead we face a significant fiscal challenge. Compared with expectations prior to October 7, defense spending has increased and is expected to remain elevated in the coming years. Consequently, the government faces a growing challenge in identifying sources that will allow for a reduction in the debt-to-GDP ratio, while simultaneously supporting defense needs and making the investments required to sustain long-term economic growth—chief among them improvements and investments in education and infrastructure.

The events of recent years have demonstrated that security risks can materialize and lead to a rapid increase in the debt-to-GDP ratio. It is therefore important to build fiscal buffers to prepare for future shocks or crises. Accordingly, starting with the 2027 budget, it will be essential to moderate the deficit in order to return to a downward trajectory in the debt-to-GDP ratio.

As noted in the Bank of Israel's Annual Report published last week, achieving such a declining path—while supporting defense needs and investing in long-term growth drivers—will require the government to take measures to eliminate expenditures that adversely impact growth while at the same time increase revenues.

Globally, there is high uncertainty relative to the expected impacts of the fighting with Iran. The extent of damage to infrastructures, the lengthening of the war, and the harm to supply chains are liable to weigh on growth, with a sharp increase in inflation in the major blocs, mainly due to a rise in energy prices.

Against the backdrop of the conflict, the price of a barrel of Brent crude oil rose sharply and with high volatility, reaching approximately \$113 at the end of the reviewed period—an increase of about 60 percent. The price of natural gas in Europe also increased, reaching EUR 55 per MWh, representing a rise of roughly 70 percent. Futures contracts indicate that markets expect energy prices to decline to around \$84 per barrel by the end of 2026.

During the reviewed period, the major central banks in advanced economies left their policy rates unchanged. In light of the heightened uncertainty and the conflict with Iran, inflation expectations increased, leading to a sharp upward shift in the interest rate paths priced into markets for many central banks. Markets now anticipate three interest rate hikes by the ECB by the end of the year, and no change in the Federal Reserve's interest rate through year-end.

To conclude, as I have said several times in the past, the Israeli economy has continued to display resilience over the course of the past two and a half years. With that, it is important to remember that in view of global development, the geopolitical situation in Israel, and the high volatility in financial markets, the uncertainty is at a very high level and the range of possible scenarios is wide. The Monetary Committee will continue to act in accordance with data, and the updated assessment of economic developments. The interest rate path will continue to be determined in accordance with inflation developments, economic activity, geopolitical uncertainty, and fiscal developments.

The Bank of Israel and the Monetary Committee continue to express our support and appreciation for the soldiers and other security forces who are fighting bravely for us on the various fronts. We extend our sympathies to the families of those who have fallen, and wish a rapid and complete recovery for the injured.

I will take this opportunity as well to say Chag Sameach – Have a happy Pesach holiday.

Thank you.