

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

Press release

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**Research Department Staff Forecast, January 2025**

**Abstract**

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in January 2025 concerning the main macroeconomic variables—GDP, inflation, and the interest rate.[[1]](#footnote-1) According to the forecast’s baseline scenario, the assessment is that GDP grew by 0.6 percent in 2024 and that it is expected to grow by 4.0 percent in 2025, and by 4.5 percent in 2026. The inflation rate in the coming four quarters (ending in the fourth quarter of 2025) is expected to be 2.6 percent, and inflation in 2026 is expected to be 2.3 percent. The average interest rate in the fourth quarter of 2025 is expected to be 4.0/4.25 percent.

This forecast was formulated under the assumption that the war’s direct impact on the economy will continue until the end of the first quarter of 2025. This assumption reflects a moderate intensity of the fighting in early 2025. The downward risk to the forecast has decreased in view of geopolitical developments in the fourth quarter of 2024, particularly the relative calm along the Lebanese front, such that the probability we attribute to security scenarios with more serious economic implications has declined. However, this risk remains much higher than normal. As such, the level of uncertainty surrounding the growth, inflation, interest rate, and government deficit forecasts, remains high.

**The forecast**

The Bank of Israel Research Department compiles a staff forecast of macroeconomic developments based on several models, various data sources, and assessments based on economists’ judgment. The Bank’s DSGE (Dynamic Stochastic General Equilibrium) model—a structural model developed in the Research Department and based on microeconomic foundations—plays a prime role in formulating the macroeconomic forecast.[[2]](#footnote-2) The model provides a framework for analyzing the forces that have an effect on the economy, and allows information from various sources to be combined into a macroeconomic forecast of real and nominal variables, with an internally consistent “economic story”.

1. **The global environment**

Our assessments of expected developments in the global economy are based mainly on projections by international financial institutions and foreign investment houses. Compared with the projections that were used in formulating the staff forecast in October, the growth and interest rate projections in advanced economies remained similar, and the expected inflation rate in the advanced economies increased slightly. Accordingly, we assume that GDP in the advanced economies will grow by 1.5 percent in 2025 and by 1.6 percent in 2026. Investment houses’ forecasts of inflation in the advanced economies in 2025 were revised upward to 2.3 percent (compared with 2.1 percent in October), and the forecast for 2026 is 2.2 percent. Investment houses’ forecasts of the average interest rate in the advanced economies remained similar to October, at 2.9 percent at the end of 2025 and 2.8 percent at the end of 2026. Our assumption is that world trade will grow by 2.4 percent in 2025 and by 2.6 percent in 2026 (compared with 3.4 percent in 2025 in the October forecast). The price of Brent crude oil was relatively stable, and declined to about $74 per barrel, compared with around $77 at the time of the October forecast.

1. **Real activity in Israel**

**In our assessment, GDP grew by 0.6 percent in 2024, and is expected to grow by 4.0 percent in 2025**, slightly higher than our assessment in the October forecast (Table 1). **In 2026, GDP is expected to grow by 4.5 percent.** The forecast is based on the assumption that the war’s direct impact on the economy will continue until the end of the first quarter of 2025. Thereafter, GDP will gradually converge to its prewar trend, but will remain below the trend line in the medium term. We assume that during the forecast period, the existing supply-side limitations will gradually diminish, but that domestic demand will recover slightly more rapidly. Our assessment is that growth in 2024 will be 0.1 percentage points higher than in the forecast published in October. While the intense fighting in the north lasted longer in the fourth quarter than we assumed in the October forecast, and contributed to a lower activity level, the geopolitical situation that has taken shape following the ceasefire, as well as the bringing forward of vehicle purchases due to the increase in tax rates at the beginning of 2025, contributed to an increase in growth in 2024.

The GDP growth rate for 2025 was also revised upward, by 0.2 percentage points, relative to our assessment in the October forecast. This increase reflects the decline in the intensity of fighting in the north, together with the improvement in the geopolitical situation relative to our October assessment, as well as our assessment that public consumption will be higher, in accordance with the proposed State budget. In contrast, fixed capital formation will grow more solely in 2025 due to the continued shortage of workers in the construction industry. In addition, private consumption will be positively affected by geopolitical developments, and exports will be affected by demand for defense exports. The growth forecast for 2026 reflects continued economic recovery from the effects of the war. Our assessment is that the shortage of workers in the construction industry will be solved only in 2026, and we accordingly expect an acceleration of investment beginning in that year. Private consumption will continue to converge moderately from below to its trend, and public consumption will converge from above to its long-term trend. In our assessment, we will see a full recovery in the incoming tourism industry in 2026, which is expected to contribute to growth in exports.

We assume that the decline in the number of soldiers serving in the reserves in 2025 will ease the supply limitations in the labor market and will support a recovery in the volume of employment. The unemployment rate during the forecast period is expected to remain low, and our assessment is that it will average 3.1 percent in 2025 and 2026.

**The government budget deficit is expected to be 7 percent of GDP in 2024, due to a positive surprise in fourth quarter tax revenues, partly due to vehicle purchases being brought forward and to the slight underperformance of expenditures. The 2025 deficit target in the current State budget is 4.4 percent of GDP, but our assessment is that the actual deficit will be 4.7 percent of GDP in view of the changes that have taken place in adjustment measures since the government decision, and our assessments regarding the increments added to the defense budget as part of the Nagel Committee on the force structure and the defense budget. In 2026, the deficit is expected to be 3.2 percent of GDP. Public debt is expected to increase to about 67 percent of GDP in 2024 and to about 69 percent of GDP in 2025, and then to decline back to 67 percent of GDP in 2026.** Since the October forecast, the government approved the proposed budget and economic program for 2025, and they were sent for Knesset approval. The current forecast includes the 2025 budget proposal approved by the government and the changes that were inserted during the legislative process in the Knesset. Relative to our October assessment, civilian expenditure in 2025 will be higher, while defense expenditure will be lower. The decline in the deficit in 2026 mainly reflects a decline in the burden of the defense expenditure, with the end of the temporary war expenditures required in 2025 in order to replenish inventories and return the military to its prewar readiness, alongside an increase in the original defense budget base for the purpose of the new force building program. In parallel, our assessment is that the burden of interest payments will continue to increase, and that civilian expenditures in GDP terms will remain similar to their 2025 level. Therefore, without any further adjustments, the deficit is expected to converge to a structural level that will leave the debt to GDP ratio in future years in the high environment it will reach in 2026.

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| **Table 1**  **Research Department Staff Forecast for 2023–2025**  (rates of change, percenta, unless stated otherwise) | | | | | | |
|  | 2023  Actual | Forecast for 2024 | Change from the October forecast | Forecast for 2025 | Change from the October forecast | Forecast for 2026 |
| **GDP** | **2.0** | **0.6** | **0.1** | **4.0** | **0.2** | **4.5** |
| Private consumption | -0.9 | 4.0 | 1.0 | 7.5 | 0.5 | 5.5 |
| Fixed capital formation (excl. ships and aircraft) | -2.0 | -7.5 | 2.5 | 8.0 | -4.0 | 15.0 |
| Public consumption (excl. defense imports) | 7.2 | 12.0 | -1.0 | -1.5 | 2.5 | 2.0 |
| Exports (excl. diamonds and startups) | -0.2 | -5.0 | 1.0 | 4.5 | 0.5 | 5.5 |
| Civilian imports (excl. diamonds, ships, and aircraft) | -7.2 | -2.0 | 4.0 | 12.0 | 0.5 | 13.0 |
| Broad unemployment rate (average for the year, ages 25–64)b | 4.4 | 3.5 | 0.0 | 3.1 | -0.1 | 3.1 |
| Adjusted employment rate (average for the year, ages 25–64)b | 77.8 | 77.9 | 0.0 | 78.4 | 0.1 | 78.7 |
| Government deficit (percent of GDP) | 4.1 | 7.0 | -0.2 | 4.7 | -0.2 | 3.2 |
| Debt to GDP ratio (percent) | 61.4 | 67.0 | -1.0 | 69.0 | 0.0 | 67.0 |
| Inflation (percent)c | **3.3** | **3.4** | **-0.4** | **2.6** | **-0.2** | **2.3** |
| a The forecasts of the National Accounts components and the debt to GDP ratio are rounded to the nearest half percentage point.  b Annual average. According to the Central Bureau of Statistics definition, the broad unemployment rate includes the unemployed under the normal definition (someone who has not worked, wanted to work, was available to work, and searched for work), as well as employees who were temporarily absent from their jobs for economic reasons (including furloughed workers). Accordingly, the adjusted employment rate does not include those temporarily absent from their jobs for economic reasons.  c The average of the Consumer Price Index in the last quarter of the year compared with the average in the last quarter of the previous year. | | | | | | |

1. **Inflation and interest rates**

**Our assessment is that inflation in 2024 (the four quarters ending in the fourth quarter of 2024) was 3.4 percent. Inflation in 2025 is expected to be 2.6 percent, and in 2026 it is expected to be 2.3 percent** (Table 1), compared with the October forecast of 3.8 percent in 2024 and 2.8 percent in 2025. During the forecast period, we expect an easing of the existing supply-side limitations, together with a recovery of demand that is initially slightly more rapid. In view of this, we expect some continued increase in consumer prices on some goods and services. Despite this, the inflation forecast for 2025 was revised downward, mainly due to an expected appreciation of the shekel by 5.5 percent in terms of the nominal effective exchange rate relative to our assumption in October. The effect of this appreciation will be partly offset by positive contributions to inflation in 2025 due to fiscal measures that are expected to influence price levels from the beginning of the year (beyond the effect that was already attributed to these measures in the October forecast). The increase in the inflation path that is expected in the advanced economies also slightly offsets the impact of the expected appreciation of the shekel, and contributes slightly to the increase in the expected inflation rate in 2025.

**The interest rate is expected to decline slightly, to an average of 4.0/4.25 percent in the fourth quarter of 2025** (Table 2). This is in view of the lower inflation environment than our October assessment and the gradual decline that is expected in surplus demand in view of the expected gradual dwindling of the supply limitations throughout the forecast period.

| **Table 2** | | | |
| --- | --- | --- | --- |
| **Inflation forecast for the coming year and interest rate forecast for one year from now** | | | |
| (percent) | | | |
|  | Bank of Israel Research Department | Capital marketsa | Private forecastersb |
| Inflation ratec | 2.6 | 2.3 | 2.7 |
| (range of forecasts) |  |  | (2.3–3.2) |
| Interest rated | 4.0/4.25 | 4.0 | 3.9 |
| (range of forecasts) |  |  | (3.25–4.4) |
| 1. Inflation expectations are seasonally adjusted (as of January 1, 2025). 2. Data as of January 1, 2025. 3. Research Department: the inflation rate during the four quarters ending in the fourth quarter of 2025. | | | |
| 1. Research Department: the average interest rate in the fourth quarter of 2025.   SOURCE: Bank of Israel. | | | |

Table 2 shows that the Research Department’s inflation forecast is higher than the expectation derived from the capital market and slightly lower than the average projections of the private forecasters. The Research Department’s forecast of the interest rate in another four quarters is higher than the expectations derived from the capital market and even higher than the average projections of the private forecasters.

1. **Main risks to the forecast**

There is still higher-than-normal uncertainty in the current period. As stated, the baseline forecast is based on the assumption that the direct economic impact of the war will continue into early 2025. However, geopolitical developments since the publication of the October forecast have led to a significant moderation of the likelihood that more serious scenarios than those in the baseline scenario will be realized.

In the fiscal area, the government’s approval of the 2025 budget with necessary adjustments and legislation of taxation amendments, alongside a decline in geopolitical uncertainty, markedly lower the likelihood that the deficit and the debt to GDP ratio will grow out of control. As a result, the concern of an additional increase in Israel’s risk premium in the medium term and of a significant depreciation in the shekel has declined, so the downward risks to the growth forecast and the upward risks to the inflation and interest rate forecasts have also declined.

Notwithstanding this, even after the moderation of risks and uncertainty relative to the October forecast, the range of potential developments remains broad, such that the risks to he forecasts are still relatively high. Thus, we assume that the supply limitations will cease during the forecast period. However, a slower cessation of the supply limitations, or a rapid acceleration in demand with the end of the war during 2025, relative to our assumptions, pose an upward risk to the inflation and interest rate forecasts. The high volatility of the exchange rate in the recent period also poses a risk to the inflation and interest rate forecasts, in both directions.

The housing market also poses an upward risk to the inflation forecast. This risk may come to pass on the supply side, insofar as the shortage of workers in the construction industry is not solved. However, there are also upward risks on the demand side in view of the release of young reserve soldiers who are expected to begin or return to their higher education studies or join the labor market, and in view of uncertainty regarding when the evacuees will return to their homes.

Another risk, on the global level, is the policy measures indicated by the new US administration, which may hamper world trade and raise global price levels. These increase the uncertainty with regard to the forecast.

1. The forecast was presented to the Bank of Israel Monetary Committee on January 5, 2025, prior to the decision on the interest rate made on January 6, 2025. [↑](#footnote-ref-1)
2. An explanation of the macroeconomic forecasts formulated by the bank of Israel Research Department, as well as a review of the models on which they are based, appear in the Bank of Israel’s Inflation Report 31 (second quarter of 2010), Section 3c. A Discussion Paper on the DSGE model is available on the Bank of Israel website, under the title: “MOISE: A DSGE Model for the Israeli Economy,” Discussion Paper No. 2012.06. [↑](#footnote-ref-2)