BANK OF ISRAEL
Office of the Spokesperson and Economic Information

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Research Department Staff Forecast, January 2026

Abstract

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in January 2026 concerning the main macroeconomic variables—GDP, inflation, and the interest rate.[1] In our assessment, GDP grew by 2.8 percent in 2025, and is expected to grow by 5.2 percent in 2026 and 4.3 percent in 2027. The inflation rate in the coming four quarters (ending in the fourth quarter of 2026) is expected to be 1.7 percent, and inflation in 2027 is expected to be 2.0 percent. The average interest rate in the fourth quarter of 2026 is expected to be 3.5 percent. In 2027, the deficit is expected to decline to 3.6 percent of GDP, and the debt to GDP ratio is expected to be 68.5 percent.

The forecast was formulated following the October 2025 ceasefire, against the background of an economy featuring excess demand and a tight labor market. The ceasefire that took hold earlier than assumed in the September 2025 forecast led to an earlier easing of supply constraints, mainly thanks to the release of reservists and their return to employment in the business sector. The current forecast is based on the assumption that the relative calm on the various fronts will continued. However, our assessment is that there are still supply constraints, and that these will ease only gradually, thanks to a continued gradual increase in the participation rate of young people following military service and the continued increase in the number of foreign workers. However, even at the end of the forecast horizon at the end of 2027, the number of workers is expected to remain lower than the level derived from the prewar trend, due to a higher volume of reserve duty than before, some of those wounded in the war remaining out of the labor market, and a negative migration balance. The ceasefire and the lower geopolitical uncertainty support an expansion of economic activity, with no signs of unusual excess demand. Investments are expected to grow rapidly in response to the shortage of manpower, compensating somewhat for the years in which investment moderated. Imports and exports are expected to expand more rapidly than the pace of GDP growth, and in our assessment, the decline in surplus exports observed during 2025 will moderate thanks to the easing of supply constraints.

The easing of supply constraints, the decline in defense expenditures and the decline in Israel's risk premium, as well as the appreciation of the shekel, are contributing to the moderation of the inflation environment, which is expected to become entrenched around the midpoint of the target range, and support the process of lowering the interest rate that began in November 2025.

The forecast

[1] The forecast was presented to the Bank of Israel Monetary Committee on January 4, 2026, prior to the decision on the interest rate made on January 5, 2026.

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] 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".

a. 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. Accordingly, we assume that GDP in the advanced economies will grow by 1.5 percent in 2026, and by 1.6 percent in 2027 (compared with 1.4 percent in 2026 in the September forecast), inflation in these economies will be 2.3 percent in 2026 and 2.2 percent in 2027 (unchanged from our September forecast), and the interest rate will be 2.6 percent in both 2026 and 2027 (unchanged from the September forecast). Our assumption is that imports to advanced economies will grow by 1.3 percent in 2026 (compared with growth of 1.2 percent in the September forecast).
The price of Brent crude oil is currently $61 per barrel, compared with $68 at the time of the September forecast.

Table 1
Research Department Staff Forecast for 2025–2027
(rates of change, percent[a], unless stated otherwise)

	2024 actual figures	Forecast for 2025	Change from the September forecast	Forecast for 2026	Change from the September forecast	Forecast for 2027
GDP	**1.0**	**2.8**	**0.3**	**5.2**	**0.5**	4.3
Private consumption	3.3	4.0	1.0	7.5	0.5	5.0
Fixed capital formation (excl. ships and aircraft)	-5.5	10.0	2.5	13.0	-1.0	8.0
Public consumption (excl. defense imports)	9.4	2.0	2.5	1.0	2.0	3.5
Exports (excl. diamonds and startups)	-4.4	4.5	1.0	4.5	1.0	5.0
Civilian imports (excl. diamonds, ships, and aircraft)	-6.9	10.0	1.5	8.0	-0.5	7.0
Broad unemployment rate (average for the year, ages 25–64)[b]	3.5	3.4	0.0	3.3	-0.1	3.5
Adjusted employment rate (average for the year, ages 25–64)[b]	77.8	78.2	-0.2	80.1	1.1	81.1
Government deficit (percent of GDP)	6.8	4.8	-0.3	3.9	-0.4	3.6
Debt to GDP ratio (percent)	67.6	68.5	-2.5	68.5	-2.5	68.5
Inflation (percent)[c]	3.3	**2.5**	**-0.5**	**1.7**	**-0.5**	2.0

[a] The forecasts of the National Accounts components are rounded to the nearest half percentage point and the forecasts of public debt are rounded to the nearest 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. The broad unemployment rate in 2025 reflects a significant temporary increase in unemployment during Israel's campaign against Iran. Net of that period, we expect some increase in the unemployment rate during the forecast horizon.
[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.

b. Real activity in Israel

In our assessment, GDP grew by 2.8 percent in 2025, and is expected to grow by 5.2 percent in 2026 and by 4.3 percent in 2027 (Table 1). The ceasefire that took hold earlier than assumed in the September 2025 forecast led to an earlier easing of supply constraints, mainly thanks to the release of reservists and their return to employment in the business sector. Our

[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.

assessment is that GDP and its components will gradually converge toward their long-term trend. Private consumption is expected to return to a moderate growth path (4.3 percent in 2026 in Q4 year-over-year terms) at a pace similar to that of GDP growth, following a relatively moderate impact at the beginning of the war. Investments in the economy are expected to grow rapidly and to cross the original trend level, on the way to closing the capital stock gaps that were created in the business sector and in the housing market. This process is expected top be supported by a recovery in the construction industry as the number of workers returns to its prewar level, and by increased investment in machinery and equipment as a replacement for the shortage of manpower (in view of the high marginal productivity of capital, partly due to the transition to construction of taller buildings). In parallel, imports and exports are expected to increase their share of activity, similar to the long-term trend of increasing openness of the Israeli economy, while moderating the decline in surplus exports thanks to an easing of supply constraints. In contrast, public expenditure is expected to moderate after two years of high war expenses, with a change in the mix toward civilian expenditures and moderation of public consumption prices due to a decline in the volume of wage payments to reservists.

The state budget deficit is expected to be 3.9 percent of GDP in 2026 and 3.6 percent of GDP in 2027. Public debt is projected to be 68.5 percent of GDP in each of 2026 and 2027. The year 2026 began with an interim budget that is expected to remain in place until March. The working assumption in the forecast is that the budget will be approved by the end of the first quarter without significant changes relative to the framework that the government has already approved. The forecast illustrates that without budgetary adjustments (tax increases or expenditure reductions), the debt to GDP ratio is not expected to decline. The forecast deficit declined slightly as a result of the ceasefire that took effect earlier than expected in the previous forecast—a development that is leading to a larger reduction in the defense budget in 2026—assuming that the ceasefire continues—and an increase in forecast revenues.

c. Inflation and interest rates

The inflation rate over the four quarters ending in the fourth quarter of 2026[3] is expected to be 1.7 percent, and inflation in 2027 is expected to be 2.0 percent (Table 2). Inflation during 2025 is expected to total 2.5 percent, compared with 3.0 percent in the September forecast, mainly due to the downward surprise in the September CPI reading. The ceasefire that took effect one quarter earlier than our assessment in the September forecast means that the process of easing the supply constraints in the economy is brought forward, which, as stated, is expected to moderate excess demand and inflationary pressures. In addition, Israel's risk premium and the spread on dollar yields declined, and the shekel strengthened. This is in addition to the decline in oil prices and the low pace of inflation expected in advanced economies. All of these are contributing to a moderation of the inflation environment, the entrenchment of inflation near the midpoint of the target range, and an expectation that the process of interest rate reductions that began with the November 2025 decision will continue.

The Bank of Israel interest rate is expected to average 3.5 percent in the fourth quarter of 2026 (Table 2). This forecast reflects a gradual decline in the interest rate from its current level in accordance with the convergence of inflation to the midpoint of the target range.

Table 2 shows that the Research Department's forecast for inflation in the next four quarters is higher than the forecast derived from the capital market and lower than the private forecasters'

[3] Average of the CPI in the fourth quarter of 2026 compared with the fourth quarter of 2025.

average projections. The Research Department's interest rate forecast for the next four quarters is similar to the other projections.

Table 2
Inflation forecast for the coming year and interest rate forecast for one year from now

(percent)

	Bank of Israel Research Department[a]	Capital markets[b]	Private forecasters[c] (range of forecasts)
Inflation rate (range of forecasts)	1.7	1.4	2.0 (1.5–2.5)
Interest rate (range of forecasts)	3.5	3.5	3.5 (3.25–3.75)

a) The inflation rate during the four quarters ending in the fourth quarter of 2026, and the average interest rate in the fourth quarter of 2026.
b) As of January 1, 2026. Inflation expectations are seasonally adjusted and relate to one year forward from January 1, 2026. Interest rate expectations are based on the Bank of Israel's analysis of the average quotes from the SHIR market.
c) As of January 1, 2026. The forecasters' projections relate to the coming 12 index readings.

SOURCE: Bank of Israel.

d. Main risks to the forecast

The level of uncertainty surrounding the forecast has declined following the ceasefire, but the balance of risks remains complex. On one side, there is the possibility of a rapid expansion of demand beyond the baseline assessments, which would lead to an acceleration of inflation in view of the tight labor market and the shortage of workers. On the other, geopolitical risks remain bidirectional. While a return to intense combat poses a main threat to price stability, a diplomatic breakthrough and expansion of the Abraham Accords may constitute a positive factor. Alongside these, the potential of early elections remains a cause of uncertainty that affects fiscal developments.