

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

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**Research Department Staff Forecast, July 2025**

**Abstract**

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in July 2025 concerning the main macroeconomic variables—GDP, inflation, and the interest rate.[[1]](#footnote-1) According to the forecast, GDP is expected to grow by 3.3 percent in 2025, and by 4.6 percent in 2026. The inflation rate in the coming four quarters (ending in the second quarter of 2026) is expected to be 2.2 percent, inflation in 2025 is expected to be 2.6 percent, and inflation in 2026 is expected to be 2.0 percent. The average interest rate in the second quarter of 2026 is expected to be 3.75 percent.

This forecast was formulated after the announcement of the ceasefire at the end of Operation Rising Lion, and under the assumption that it will be maintained. Operation Rising Lion has an impact on the forecast, both due to the economic impact while it was taking place and in relation to the forward-looking forecast. With regard to the fighting in Gaza, the forecast was formulated under the assumption that the ceasefire agreement currently being discussed will lead to a situation in which during the forecast horizon, beginning in July 2025, there will be no intense fighting in Gaza. Compared to the April forecast, the current forecast includes some moderation of the impact of the tariffs announced by the United States in April. The forecast is characterized by an exceptionally high level of uncertainty, with positive and negative possibilities both in the geopolitical sphere and with regard to the American government’s tariff policy. At this stage, there is also significant uncertainty regarding the government’s decisions concerning the state budgets for 2025 and 2026, and the forecast is based on assessments and working assumptions formulated by the Research Department regarding decisions that will be made.

**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. 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. Accordingly, we assume that inflation in the advanced economies will be 2.6 percent in 2025 and 2.2 percent in 2026 (compared with 3.2 percent in 2025 and 3.1 percent in 2026 in our April forecast), GDP in the advanced economies will grow by 1.2 percent in 2025 and by 1.3 percent in 2026 (compared with 1.0 percent and 1.2 percent, respectively in the April forecast), and the interest rate will be 3.3 percent in 2025 and 2.8 percent in 2026 (compared with 3.3 percent and 2.9 percent respectively in the April forecast). Our assumption is that imports to advanced economies will grow by 1.9 percent in 2025 and 2.0 percent in 2026 (compared with growth of 0.3 percent and a decline of 0.7 percent respectively in the April forecast). These developments reflect, to a great extent, the moderation of tariffs relative to their expected level in April.

The price of Brent crude oil returned to its level from before Operation Rising Lion, and is currently $68 per barrel, slightly higher than it was at the time of the April forecast.

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| **Table 1****Research Department Staff Forecast for 2025–2026**(rates of change, percenta, unless stated otherwise) |
|  | Forecast for 2025 | Change from the April forecast | Forecast for 2026 | Change from the April forecast |
| GDP | 3.3 | -0.2 | 4.6 | 0.6 |
| Private consumption | 3.5 | -2.5 | 7.0 | 3.5 |
| Fixed capital formation (excl. ships and aircraft) | 9.5 | -0.5 | 13.5 | 1.5 |
| Public consumption (excl. defense imports) | 1.5 | 2.0 | -1.0 | 1.5 |
| Exports (excl. diamonds and startups) | 4.0 | 1.5 | 3.0 | 0.5 |
| Civilian imports (excl. diamonds, ships, and aircraft) | 8.0 | -4.5 | 8.0 | 0.5 |
| Broad unemployment rate (average for the year, ages 25–64)b | 2.9 | 0.0 | 3.3 | 0.1 |
| Adjusted employment rate (average for the year, ages 25–64)b | 78.6 | 0.0 | 78.7 | 0.3 |
| Government deficit (percent of GDP) | 4.9 | 0.7 | 4.2 | 1.3 |
| Debt to GDP ratio (percent) | 70 | 1 | 71 | 3 |
| Inflation (percent)c | 2.6 | 0.0 | 2.0 | -0.2 |
| 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.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. **Real activity in Israel**

**GDP is expected to grow by 3.3 percent in 2025 and by 4.6 percent in 2026** (Table 1). The forecast’s baseline scenario was formulated under the assumption that an agreement will be reached in the coming period on a ceasefire in Gaza, and that thereafter, there will be no intense fighting in Gaza. The forecast also assumes that the ceasefire with Iran will be maintained. In our assessment, the direct economic impact of Operation Rising Lion, which lasted 12 days, was exhausted in the direct negative impact during the period of the Operation. However, depending on geopolitical developments, there may be long-term effects on the economy—on the risk premium and investments in the economy, on demand for Israel’s exports, on potential growth, and more. The appreciation of the shekel and the increase in share prices on the Tel Aviv Stock Exchange, both before the ceasefire between Israel and Iran took effect and afterward, reflect the markets’ optimism regarding such developments. However, at this stage, while the country’s risk premium, as reflected by the CDS level and the spreads on Israeli government bonds, declined relative to its level prior to Operation Rising Lion, it remains higher than it was before the Swords of Iron War.

The forecast includes a revised assessment regarding the effect of the tariffs announced by the American government. According to the revised assessment, most countries will not see a significant increase in tariffs relative to the current level, but uncertainty regarding the issue remains high and, on its own, is having a negative impact on activity, particularly on investments both globally and in Israel.

**The state budget deficit is expected to be 4.9 percent of GDP in 2025 and 4.2 percent of GDP in 2026. Public debt is projected to be 70 percent of GDP in 2025 and 71 percent of GDP in 2026.** This forecast includes the initial assessments regarding the costs of the campaign against Iran, alongside additional costs that were not in the original 2025 budget for continued fighting in Gaza. It also assumes that the government will adopt the increments to the defense budget recommended by the Nagel Committee to Examine the Defense Budget and Force Building, minus some of the components the purchase of which was brought forward for Operation Rising Lion. At the same time, our assessment is that the civilian costs of the campaign against Iran will total about NIS 10 billion. Most of this will be paid by the Property Tax Fund and, accordingly, is not included in the central government’s deficit, but it will require raising debt to finance it.

The deficit forecast for 2025 also reflects the significant increase in tax revenues at the beginning of the year, which was due to purchases being brought forward and dividends distributed before the increase in tax rates on undistributed profits. This increase makes it possible to increase government expenditures without a significant growth in the deficit set in the 2025 budget. The forecast for 2026 also assumes that one-off revenue will be received as a result of the sale of Wiz, but the current assessment regarding the size of that revenue is about half a percent of GDP smaller than the previous assessments in April. We also assume that the government will extend the increased contributions to the Property Tax Fund in order to bring the Fund’s balance back to the level planned before Operation Rising Lion.

1. **Inflation and interest rates**

**The inflation rate over the four quarters ending in the second quarter of 2026 is expected to be 2.2 percent (Table 2). For the year 2025, it is projected to be 2.6 percent, and for 2026, it is expected to be 2.0 percent** (Table 1). Operation Rising Lion may have conflicting short-term impacts on the development of inflation. The disruptions in the supply of housing and the increased demand for rentals due to damage to buildings may have inflationary implications within the forecast range. However, these effects are expected to be offset to some degree by the appreciating trend of the shekel. In sum, the Research Department’s inflation forecast for 2025 is similar to the April forecast, but the forecast for one year forward is slightly lower.

We anticipate that given the assumption regarding the fighting in Gaza and the resulting decline in the volume of reserve mobilization, supply-side constraints in the labor market will ease, alongside a moderation of demand for public consumption, which will lead to a continued moderation of inflation. Since the publication of the April forecast, Consumer Price Index readings for April and May were obtained, and their cumulative effect is similar to our assessments in the April forecast.

**The Bank of Israel interest rate is expected to average 3.75 percent in the second quarter of 2026** (Table 2). This forecast reflects a gradual reduction in the interest rate from its current level in accordance with the convergence of inflation to the midpoint of the target range according to the baseline scenario in the forecast.

Table 2 shows that in the Research Department’s assessment, the inflation forecast is slightly lower than the private forecasters’ average projections and higher than the forecast derived from the capital market. The interest rate forecast is similar to both the expectations derived from the capital market and the private forecasters’ average projections.

| **Table 2** |
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| **Inflation forecast for the coming year and interest rate forecast for one year from now** |
| (percent) |
|  | Bank of Israel Research Departmenta | Capital marketsb | Private forecastersc (range of forecasts) |
| Inflation rate | 2.2 | 1.6 | 2.3 |
| (range of forecasts) |  |  | (1.8–2.7) |
| Interest rate | 3.75 | 3.7 | 3.7 |
| (range of forecasts) |  |  | (3.3–4.3) |
| 1. The inflation rate during the four quarters ending in the second quarter of 2026, and the average interest rate in the second quarter of 2026.
2. As of July 6, 2025. Inflation expectations are seasonally adjusted and the interest rate expectations are based on the Bank of Israel’s analysis of the average quotes from the SHIR market.
3. As of July 6, 2025. The forecasters’ projections relate to the coming 12 index readings (June 2025–May 2026).
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| SOURCE: Bank of Israel. |

1. **Main risks to the forecast**

There is a high level of uncertainty surrounding the forecast, but as opposed to previous forecasts, it includes both upward and downward risks to the forecast. On one hand, the results of Operation Rising Lion reflect the possibility of reduced security risks for Israel, and possibly the potential for an arrangement that will end the fighting in Gaza and perhaps even enable a broad arrangement of relations in the region, particularly if the ceasefire in Gaza leads to an agreement that will end the fighting and remove the threat to Israel that Hamas poses. The realization of arrangements on the various fronts is expected to reduce the economy’s risk level and to ease supply constraints. Such arrangements may also increase demand and investments in the economy over the coming years.

In contrast, uncertainty with regard to Operation Rising Lion’s long-term effects and the security situation vis-à-vis Iran brings with it risks that the improvement will be limited in time and that its positive effects on the economy will be short-lived. On the Gaza front as well, if the ceasefire does not lead to a sustainable arrangement and the fighting intensifies or is prolonged, there is a risk that supply constraints will continue to weigh upon the recovery of economic activity, growth will be more moderate, and the budget deficit will be higher.

The above developments are obviously not exhaustive of all potential scenarios, and there are other possible developments that may lead to significant changes in the risk premium.

In our assessment, the risk to the deficit and debt forecasts tends upward, in view of the uncertainty concerning the budgetary cost of Operation Rising Lion and in view of the risk that the intense fighting in Gaza will continue and will therefore further increase the costs of reserve service.

The level of uncertainty also remains high with regard to international trade. In this context as well, developments are possible in both directions: worsening tariffs and the cancellation of the suspension of “mutual” tariffs, or reduced tariffs.

1. The forecast was presented to the Bank of Israel Monetary Committee on July 6, 2025, prior to the decision on the interest rate made on July 7, 2025. [↑](#footnote-ref-1)