BANK OF ISRAEL

65 | Monetary Policy Report

First Half of 2026

Jerusalem, July 2026

Table of Contents

Monetary Policy Report
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According to the Bank of Israel Law, 5770–2010, the Bank of Israel has three objectives: (1) to maintain price stability, as its central goal. Price stability is defined as an annual inflation rate of between 1 percent and 3 percent; (2) to support other objectives of the government's economic policy, particularly growth, employment, and reducing social gaps, provided that this support does not prejudice the attainment of price stability; and (3) to support the stability and orderly activity of the financial system.

Section 55(a) of the Bank of Israel Law, 5770–2010, regulates the publication of this report, which the Bank of Israel submits to the government and the Knesset Finance Committee twice a year. The report surveys the economic developments that took place during the period it covers. It also surveys the policy adopted in order to maintain the inflation rate within the range set by the government and to achieve the other objectives of the government's economic policy. The economy's financial stability is surveyed by the Bank of Israel in its Financial Stability Report.

In accordance with Section 55(b) of the Law, the current Monetary Policy Report presents the reasons for the deviation of the inflation rate from the target range determined by the government for more than 6 consecutive months.

The Monetary Policy Report for the first half of 2026 was prepared by economists from the Bank of Israel Research Department, under guidance from the Monetary Committee. The report is based on data published up to the interest rate decision reached on July 6, 2026, including the CPI for May 2026.

The Monetary Committee was established under the Bank of Israel Law, 5770–2010. In routine times the Committee has 6 members—the Governor, who serves as Committee Chairperson, the Deputy Governor, a Bank of Israel employee appointed by the Governor, and 3 members from among the public. The Monetary Committee members discuss the monetary policy, and at the end of the discussion there is a vote on the interest rate. Pursuant to Section 18(c) of the Bank of Israel Law, 5770–2010, the decision on the interest rate is reached by a majority of the Committee members participating in the vote. For the decisions reached in January, February, March, and May, there were 4 Monetary Committee members, one from among the public rather than the regular three. For the July decision, the Committee had 5 members—two from among the public.

Executive Summary

Monetary policy: The first half of the year was marked by continued geopolitical uncertainty. Annual inflation declined, in contrast with the global trend, and stabilized around the midpoint of the target range. The unemployment rate remained low except for a temporary increase during Operation Roaring Lion (the military confrontation with Iran that began on February 28, 2026). Against this background, and considering the high level of uncertainty, the Monetary Committee lowered the interest rate gradually during the first half of the year. In the January, May, and July 2026 decisions, the Committee reduced the interest rate by 0.25 percentage points in each of the decisions, so that the interest rate at the end of the reviewed period was 3.5 percent.

At the beginning of the period, the Monetary Committee's assessment was that the risks to inflation tended upward. During the half-year, partly in view of the increased appreciation of the shekel, the downward risks to inflation also increased. At the beginning of June, the Governor clarified that as long as inflation expectations continue to decline, and particularly if they draw near to the lower bound of the target range, it would justify a more accommodative monetary policy and a more rapid pace. In its decisions, the Committee noted that the interest rate path would be determined in accordance with the development of inflation, economic activity, geopolitical uncertainty, and fiscal developments. Therefore, the Monetary Committee would continue acting in accordance with the data and with assessments of the most recent economic developments.

The inflation environment: Throughout the period reviewed, the inflation rate hovered around the midpoint of the inflation target range, after entering the target range in the previous half-year. At the end of the first half of 2026, annual inflation was 1.9 percent, near the midpoint of the target (based on the May CPI reading), compared with 2.4 percent at the end of the second half of 2025 (based on the CPI reading for November 2025), and 3.1 percent at the end of the first half of 2025 (based on the CPI reading for May 2025). One-year inflation expectations from all sources were around the midpoint of the target range throughout the half-year, and they declined slightly toward the end of the period. Longer-term expectations hovered around the midpoint of the target range. The inflation environment was impacted by the fact that the shekel strengthened markedly, among other things.

Real activity in Israel: National Accounts data for the first quarter of 2026 reflected the impact of Operation Roaring Lion on economic activity. In the first quarter of the year, GDP contracted by an annual rate of 3.8 percent, while business sector output also declined by 3.8 percent (seasonally adjusted in annual terms). This contraction was more moderate than earlier forecasts had projected and than the contraction during Operation Rising Lion (the military confrontation with Iran in June 2025).

Against the background of the decline in growth in the first quarter, the gap between the level of GDP and its long-term trend widened to about 4.6 percent. However, indicators for growth in the second quarter of 2026 suggested that this gap was expected to narrow significantly.

The contraction in GDP in the first quarter of 2026 was driven primarily by declines in private and public consumption, while exports increased. At the same time, civilian imports rose significantly—a development consistent with the assessment that supply constraints in the domestic market continued to weigh on the level of activity during the half-year.

Analyses conducted by the Research Department indicate that a substantial share of economic growth in the recent period reflected production abroad by global firms operating in Israel. Excluding the activity of these firms, growth was lower, given the prevailing supply constraints. If these constraints ease, growth is expected to become broader-based across a wider range of industries and firms, while GDP converges toward its long-term trend.

The labor market: During the half-year, the labor market remained tight—unemployment was low and wages increased at a rapid pace. The labor market was affected significantly, though temporarily, by Operation Roaring Lion. The rate of those temporarily absent from work due to reserve military service rose sharply in March, but declined significantly in April and May, reaching a relatively low rate of 0.5 percent in May. The broad unemployment rate among those aged 25–64 declined in May to a low level of 3 percent. The job vacancy rate increased slightly, though it remained below its level from prior to Operation Roaring Lion. The employment rate and the labor force participation rate among those aged 15 and over declined in May, similar to recent months. Among the core working-age population, aged 25–64, the employment rate and the participation rate remained stable in May.

The rate of wage growth in the economy in March–May was 6.8 percent relative to the corresponding period of the previous year. The increase in wages partly reflected changes in the composition of workers due to Operation Roaring Lion, an increase in the minimum wage, and a public sector wage increment that took effect in April under the framework agreement.

The exchange rate, the risk premium, and the financial markets: During the reviewed half-year, trading in the financial markets remained volatile, influenced by both domestic and global uncertainty. Since January 2026, the shekel appreciated by about 10 percent against the US dollar, reaching NIS 2.8 per dollar at the end of May. In June, however, the shekel depreciated, such that by the end of the period, the exchange rate stood at about NIS 3.0 per dollar.

The appreciation over the past two years was influenced to a large extent by three factors: geopolitical developments and the decline in Israel's risk premium, gains in US equity markets, and the weakening of the US dollar worldwide. The Bank of Israel purchased foreign exchange totaling $801 million in May and $1,027 million in June. These purchases were made on a one-off basis in order to preserve the continued orderly functioning of the markets.

Israel's risk premium—as measured by CDS spreads and the spreads on US dollar-denominated government bonds—continued to decline after rising at the beginning of Operation Roaring Lion, and remained in an environment similar to its level prior to October 7. Domestic equity indices outperformed global markets during most of the period under review. However, since the announcement of the memorandum of understanding between the United States and Iran in June, they have underperformed relative to global markets.

Credit to the business sector continued to expand at a rapid pace during the reviewed period, led by bank credit. This expansion was evident across all industries—with an emphasis on the financial services and construction industries—and across all business size groups, with the exception of small and micro businesses. Payments in arrears in all activity segments remained low. The banking system continued to maintain high capital ratios, and insurance companies continued to maintain high solvency positions.

Fiscal policy: The cumulative deficit in the state budget over the previous 12 months declined during the reviewed half-year, to 3.8 percent of GDP in May, compared with 4.7 percent of GDP in December. This was mainly due to a low level of government expenditure in view of the interim budget in the first quarter of the year. Government revenues from direct taxes (at fixed prices and net of legislative changes and one-off revenues) remained above the long-term trend line.

The housing market: The level of activity in the construction industry remained high. Housing starts, housing completions, and building permits remained at high levels. These developments, together with some decline in the volume of transactions relative to 2024, led to an increase in contractors' inventory of unsold homes and to a decline in home prices totaling 1.3 percent in annual terms.

The annual rate of increase in the owner-occupied housing services component (rent in new and renewing contracts) of the Consumer Price Index stood at 4 percent at the end of the half-year (May data), compared with 2.6 percent and 3.6 percent at the end of the previous half-years (November and May 2025 data, respectively). In May, new mortgage borrowing totaled about NIS 9.5 billion (seasonally adjusted).

The global economy: During the reviewed half-year, global economic activity expanded at a moderate pace. Despite the high geopolitical uncertainty resulting from the confrontation between the United States and Iran, the disruption to supply chains, and the increase in commodity prices, growth remained positive in most of the major blocs during the period.

Energy prices were highly volatile, and were influenced to a large extent by geopolitical developments. Brent crude oil, which stood at $60 per barrel at the beginning of the period, rose to $120 during the half-year and declined to about $70 by its end. The global Purchasing Managers' Index remained throughout the period at a level indicating continued expansion in global output, similar to the previous half-year.

In April, the International Monetary Fund (IMF) revised its global growth forecast downward and its forecast for global inflation upward, mainly due to the effect of the shock in energy markets and the high level of uncertainty. In the United States, GDP grew in the first quarter at an annual rate of about 2 percent, significantly higher than in the previous quarter. Employment reports during the half-year were mostly strong and, on balance, pointed to a tight labor market. In the eurozone, the data for the first quarter of 2026 pointed to a slowdown in the pace of growth, with GDP increasing by only 0.1 percent in quarterly terms, below market expectations.

Annual inflation in the United States accelerated, and the Consumer Price Index (CPI) for May stood at 4.2 percent, compared with 2.7 percent at the end of the previous half-year. Annual inflation in the eurozone also accelerated, reaching 3.2 percent in May, compared with 2.1 percent at the end of the previous half-year.

During the reviewed period, the ECB raised its policy rate in June, while the Fed left its policy rate unchanged. Since the beginning of the confrontation with Iran, the market-implied interest rate paths of many central banks have risen significantly.

The Research Department forecast: According to the Research Department's July 2026 staff forecast, GDP is expected to grow by 4 percent in 2026, compared with 5.2 percent in the January 2026 forecast. The Research Department projected that GDP would grow by 5.5 percent in 2027, compared with 4.3 percent in the January forecast.

According to the July 2026 forecast, inflation is expected to be 1.8 percent in 2026 and 2027, compared with 1.7 percent and 2 percent, respectively, in the January forecast. The Research Department's assessment is that the interest rate one year from now will be 3 percent.

In the July forecast, the projected deficit for 2026 stood at 4.9 percent of GDP—1 percent of GDP higher than the deficit projected in the January forecast, which had been prepared prior to Operation Roaring Lion. According to the July 2026 forecast, the debt-to-GDP ratio was expected to be 69 percent in both 2026 and 2027, compared with 68.5 percent in the January 2026 forecast.

The government is considering the possibility of increasing the 2026 defense budget later in the year by up to an additional NIS 25 billion, which would bring it to NIS 183 billion. Should this materialize, the deficit is expected to be higher than projected, at about 5.5 percent of GDP, while inflation over the coming year would be about 0.3 percentage points higher than projected, depending on the composition of the expenditure and its effect on the economy's supply constraint.

a. Policy measures

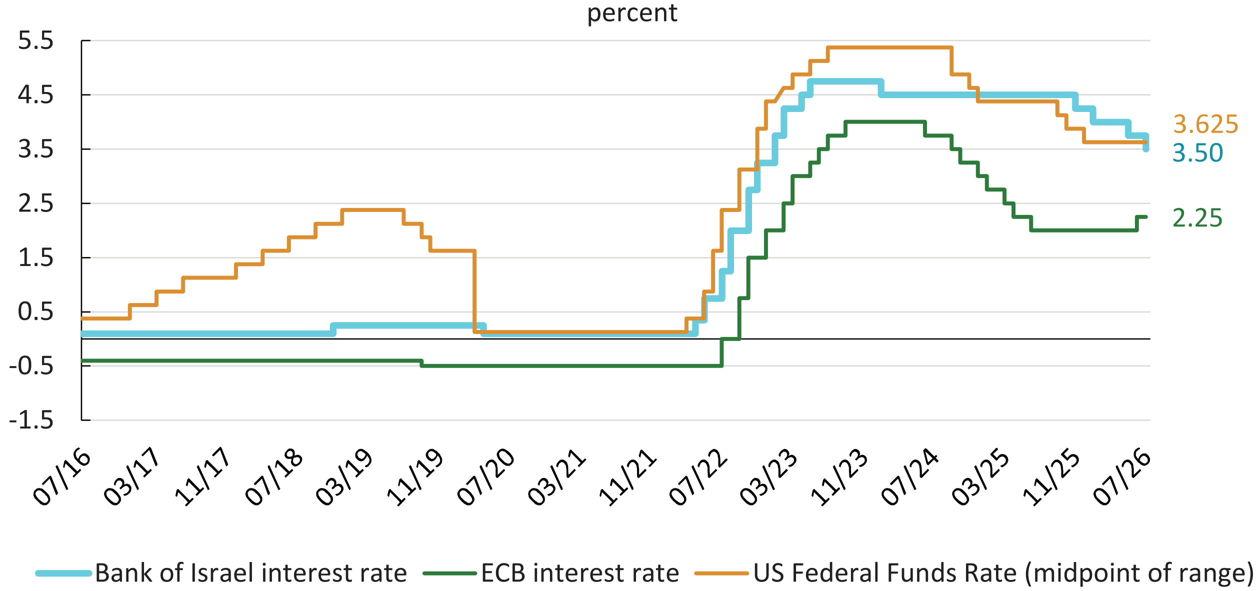
In all decisions in the first half, the Committee noted that the Monetary Committee's policy is focused on price stability, support for economic activity, and market stability. The interest rate path shall be determined in accordance with the development of inflation, economic activity, geopolitical uncertainty, and fiscal developments.

In the first three decisions of the reviewed half-year, the Committee emphasized that there are risks of a renewed rise in inflation. In the May decision, the Committee added that the appreciation of the shekel may act to moderate inflation. In the July decision, the Committee noted that several factors could affect the development of inflation in opposite directions. The inflation environment will be largely influenced by geopolitical developments and their impact on economic activity and energy prices, by risk premia and the exchange rate, by the development of demand alongside supply constraints, and by fiscal developments.

At the time of the January interest rate decision, the inflation environment had moderated, partly due to the appreciation of the shekel. The most recent labor market data indicated some easing of supply constraints. This was reflected in an increase in participation and employment rates, a decline in the absenteeism rate due to reserve duties, and a slowdown in wage growth in the business sector. The ratio of job vacancies to unemployed persons remained high and stable, and the job vacancy rate rose slightly. Committee members discussed the easing of labor market constraints and whether it indeed represented a continuing process. Israel's risk premium had for several months been at a level close to that prevailing on the eve of the war. **All committee members supported the decision to cut the policy rate by 0.25 percentage points to 4 %** (Figure 1).

Figure 1 | Bank of Israel, Federal Reserve, and European Central Bank Interest Rates, July 2016–July 2026

percent



SOURCE: Based on Bloomberg.

At the time of the February interest rate decision, geopolitical uncertainty had again risen in view of a possible regional confrontation, and indeed, five days after the rate decision Operation Roaring Lion erupted. Inflation continued to ease, the labor market remained tight, and supply constraints stayed significant. Housing prices again increased. Since the January rate decision, the shekel appreciated modestly against the dollar, in line with the global trend, and Israel's risk premium rose slightly. Committee members emphasized that, in the risk balance analysis and in view of two consecutive rate cuts, the total set of considerations does not justify an additional rate reduction at this stage. **All committee members supported the decision to leave the policy rate unchanged at 4%.**

Discussions of the March decision took place during Operation Roaring Lion, amid high geopolitical uncertainty, particularly regarding the duration and intensity of the fighting and the manner in which it would end. **Since the February interest rate decision, inflationary pressures had risen mainly due to a marked increase in global energy prices. The response of financial variables, including risk premia, exchange rates, and equity prices, was relatively moderate.** Since the February rate decision, the shekel had weakened against the dollar and strengthened against the euro. The labor market remained tight and the constraint on labor supply continued to be the dominant constraint in the economy. **All committee members supported the decision to keep the policy rate unchanged at 4%.**

In the May interest rate decision, in view of inflation stabilizing near the midpoint of the target range and the resilience demonstrated by the economy, the Committee examined the appropriate balance between two significant geopolitical risks that could affect inflation in opposite directions: upward in the event of an escalation of hostilities, and downward in the event of an agreement that would lead to a further decline

in the risk premium and additional appreciation of the shekel. It was evident that Operation Roaring Lion had implications for real economic activity, and the most recent data indicated recovery. Inflation in Israel remained near the midpoint of the target range. However, global inflation levels rose sharply since the March interest rate decision. The shekel strengthened against the dollar and outperformed the global trend. Israel's risk premium, after having risen at the outset of Operation Roaring Lion, subsequently fell and remained near its pre-October 7 level. The labor market was noticeably affected by Operation Roaring Lion, and the constraint on labor supply remained significant. **All members of the Committee supported the decision to reduce the interest rate by 0.25 percentage points to a level of 3.75%.**

At the beginning of June, the governor clarified that if inflation expectations decline further, and especially if they approach the lower bound of the target range, this would justify a more accommodative monetary policy at a faster pace.

At the time of the July interest rate decision, the memorandum of understanding signed between the United States and Iran had led to a decline in energy prices and a moderation of global geopolitical tensions, although the level of uncertainty remained high. Economic activity continued to recover, and the annual inflation rate in the May index remained stable slightly below the midpoint of the target range. Since the May interest rate decision, the shekel had depreciated amid considerable volatility, and the risk premium lingered near its pre-October 7th level. According to forecasters' assessments, inflation is expected to decline in the coming months, and later on to stay slightly below the midpoint of the target range. **All members of the committee supported the decision to reduce the interest rate by 0.25 percentage points to 3.5%.**

b. Background conditions from the Monetary Committee's perspective

1. The inflation environment

Throughout the reviewed period, inflation hovered around the midpoint of the target range, after having entered the target range in the preceding half-year. At the end of the first half of 2026, the annual inflation rate was 1.9 percent (Figures 2 and 3), near the midpoint of the target (based on the May index), compared with 2.4 % and 3.1 % at the ends of the previous half-years (based on the November and May 2025 indices, respectively). One-year inflation expectations from all sources remained around the midpoint of the target throughout the period, and declined slightly toward its end (Figure 5). Long-term expectations likewise hovered around the midpoint of the target range (Figure 6). The inflation environment was influenced by a pronounced appreciation of the shekel, among other factors.

In the discussions leading up to the January decision, the Committee examined the inflation environment. The annual inflation rate was 2.4 percent. Annual inflation excluding energy and fruit and vegetables was 2.6 percent (Figure 3). The annual inflation rate of nontradable components remained unchanged at 3.0 percent, and the annual pace of inflation of tradable components declined to 1.2 percent.

In the discussions leading to the February decision, the Committee examined the inflation environment. The consumer price index remained unchanged in December, and declined by 0.3 percent in January. The development of annual inflation was in line with prior forecasts. Following the December index, annual inflation increased, whereas it moderated with the January index to near the midpoint of the target range, at

1.8 percent. Excluding energy and fruit and vegetables, the annual inflation rate in January was 1.9 percent. The annual inflation rate of nontradable components declined to 2.9 percent, and the annual pace of inflation of tradable components dropped sharply to -0.2 percent.

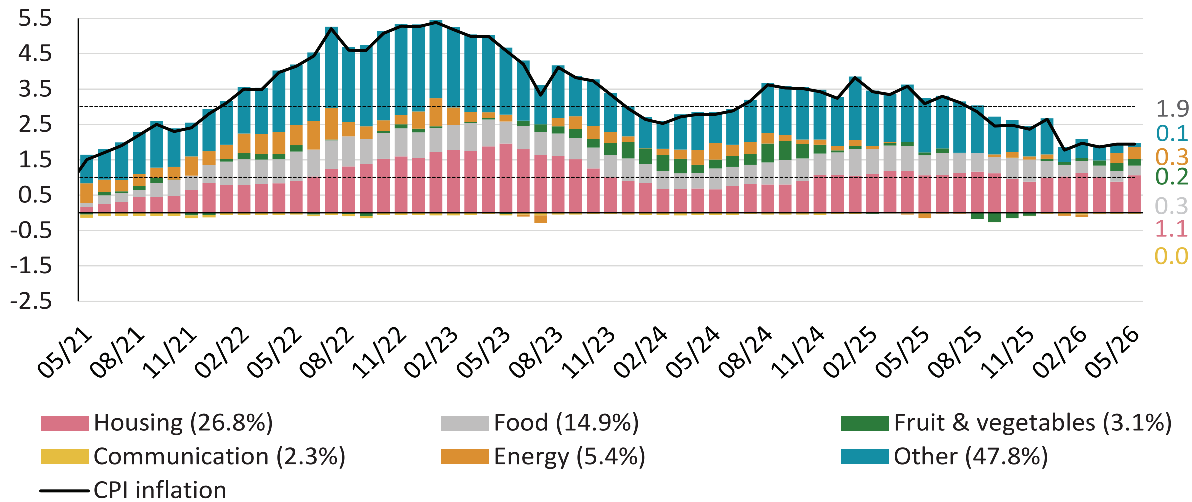
In the discussions leading up to the March decision, the Committee discussed the inflation environment. Inflation over the past twelve months rose slightly to 2.0 percent. The February index had not yet reflected the economic developments, particularly the increase in energy prices, that occurred with the outbreak of Operation Roaring Lion, and the Committee's assessment was that these would be reflected in the coming months. Excluding energy and fruit and vegetables, annual inflation was 2.2 percent. The annual inflation rate of nontradable components increased to 3.1 percent, and the annual pace of inflation of tradable components rose to -0.1 percent. **Due to Operation Roaring Lion and the increase in global oil prices, forecasters raised the annual inflation outlook for the coming months by approximately 0.5 percentage points. This increase was relatively modest compared with other countries, partly due to a lower exposure of Israeli inflation to world energy prices.** One-year inflation expectations from various sources increased and remained around the midpoint of the target. Expectations for the second year and beyond increased slightly, and were also close to the midpoint of the target range. **In the Committee's assessment, the risks of a renewed increase in inflation intensified during the same period.**

At the time of the discussions leading up to the May decision, inflation over the preceding twelve months was 1.9 percent. Annual inflation in April, excluding energy and fruit and vegetables, was 1.5 percent. The annual inflation rate of nontradable components in March and April was stable at 2.8 percent, and the annual pace of inflation of tradable components rose to 0.3 percent, mainly in view of the increase in global energy prices. At the time of the discussions, according to forecasters' estimates, inflation was projected to increase slightly and to remain near the midpoint of the target range over the following months. Inflation expectations for the coming year, as derived from various sources, were close to the midpoint of the target range. Expectations for the second year and thereafter remained around the midpoint of the target range. **In the Committee's assessment, there were risks of a renewed rise in inflation, while the appreciation of the shekel may act to moderate inflation.**

At the time of the discussions leading up to the July decision, the annual inflation rate remained at 1.9 percent, near the midpoint of the target range. Annual inflation excluding energy and fruit and vegetables was 1.6 percent in May. The annual inflation rate of nontradable components in May was 2.9 percent, and the annual pace of inflation of tradable components was 0.4 percent. According to the forecasters' projections, inflation was expected to decline in the coming months and later on to remain slightly below the midpoint of the target range. Inflation expectations for the coming year from various sources were below the midpoint of the target range. Expectations for the second year and beyond were slightly below the midpoint of the target range. **The Committee's assessment was that several factors could exert opposing influences on the development of inflation. The inflation environment will be largely affected by geopolitical developments and their impact on economic activity and energy prices, by risk premia and the exchange rate, by the development of demand alongside supply constraints, and by fiscal developments.**

Figure 2 | Contributions of the Main CPI Components to Inflation, May 2021–May 2026

percent

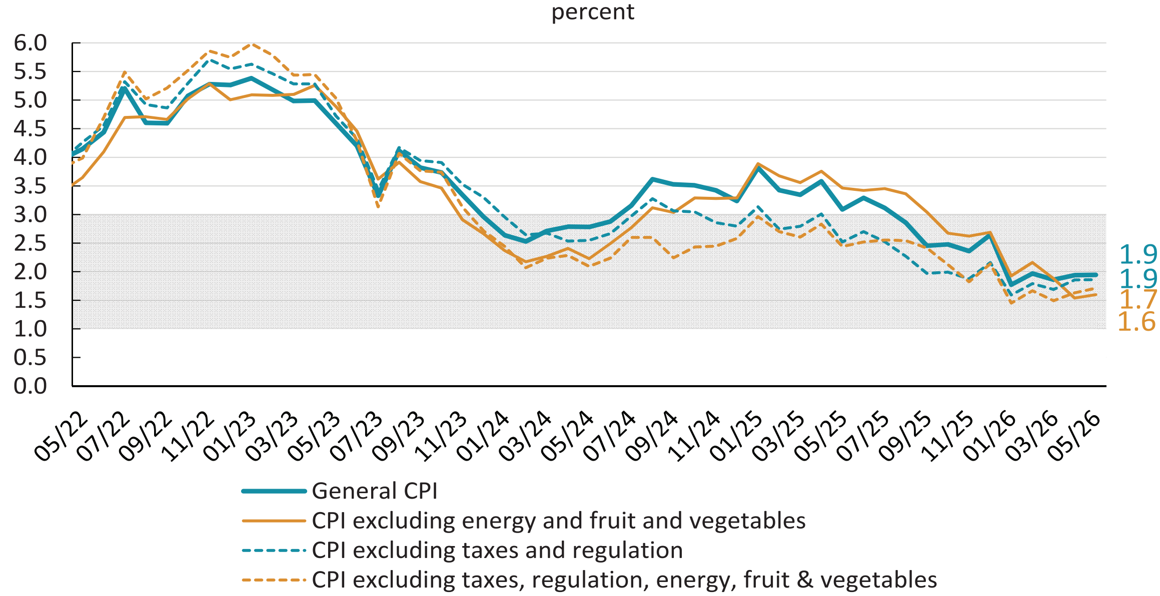


NOTES: The numbers in parentheses are the relevant component's share of the general CPI (as of 2025). "Other components" includes furniture and household equipment, clothing and footwear, miscellaneous, and the household maintenance and transportation components net of subcomponents related to energy prices.

SOURCE: Based on Central Bureau of Statistics.

Figure 3 | Inflation as Reflected in the General CPI, the CPI Excluding Energy and Fruit & Vegetables, and the CPI Excluding Taxation and Regulation, May 2022–May 2026

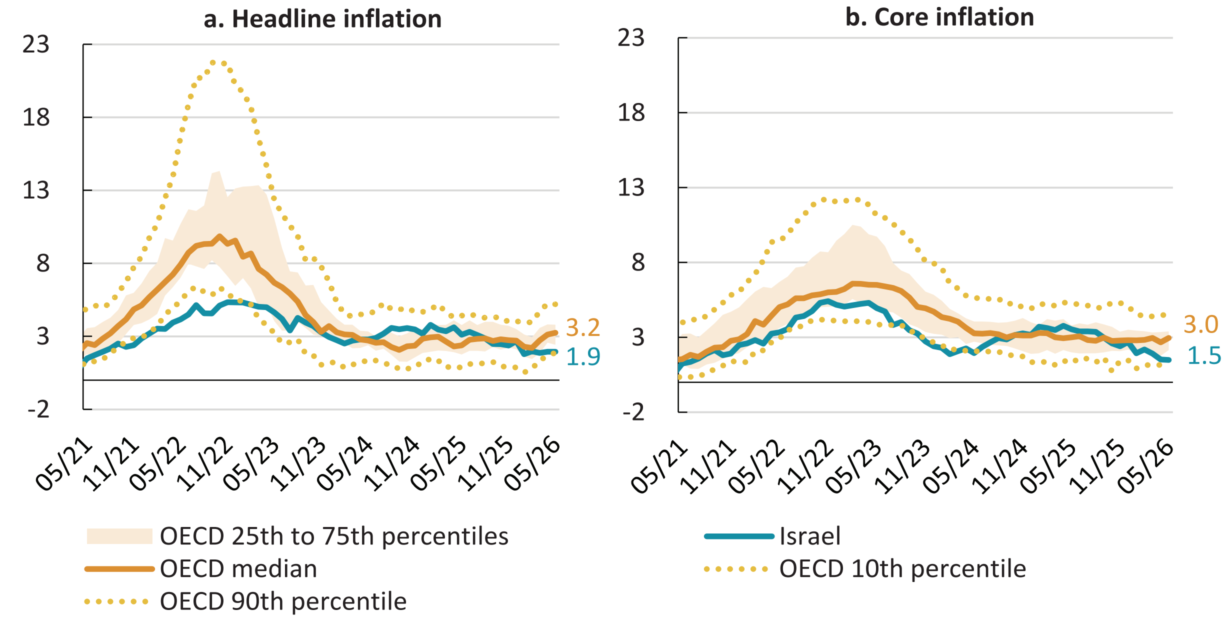
percent



SOURCE: Based on Central Bureau of Statistics.

Figure 4 | Annual Inflation in Israel and the OECD, May 2021–May 2026

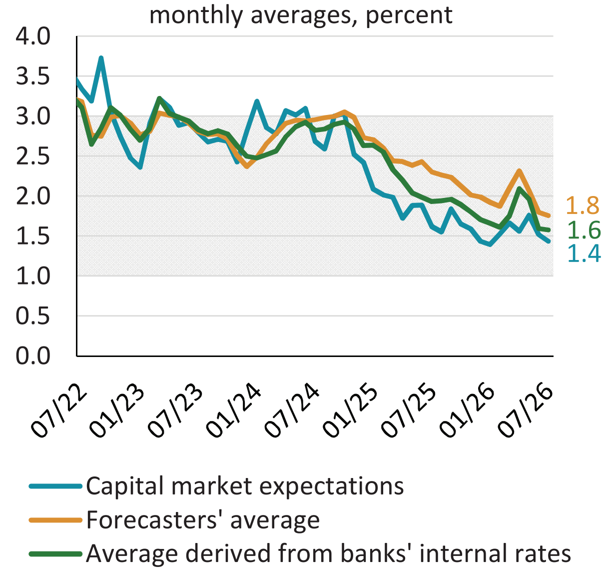
percent



SOURCE: Based on OECD data.

Figure 5 | One-Year Inflation Expectations from the Various Sources, July 2022–July 2026

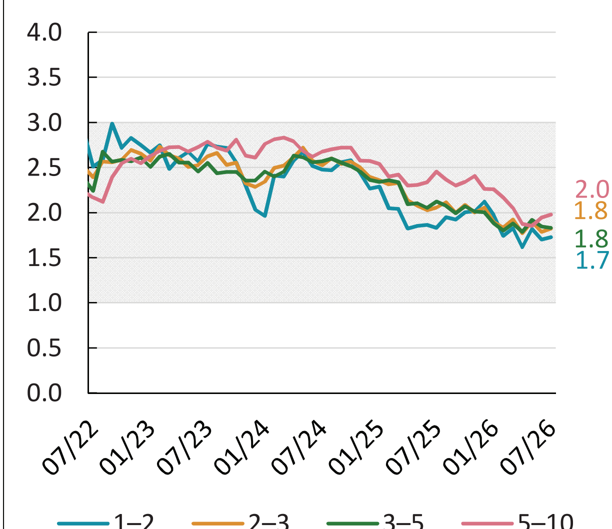
monthly averages, percent



SOURCE: Bank of Israel.

Figure 6 | Forward Inflation Expectations Derived from the Capital Market, July 2022–July 2026

ranges of years, monthly averages, percent



SOURCE: Bank of Israel.

2. Real activity in Israel

National Accounts data for the first quarter of 2026 reflected the impact of Operation Roaring Lion on economic activity. In the first quarter of the year, GDP contracted at an annualized rate of 3.8 percent, and business output also contracted by 3.8% (annual terms, seasonally adjusted). This contraction was more moderate than earlier forecasts had projected and than the contraction during Operation Rising Lion (Tables 1 and 2). Against the backdrop of the decline in growth in the first quarter, the gap between the GDP level and its long-term trend widened to approximately 4.6 percent. **Nevertheless, growth indicators for the second quarter of 2026 suggested that the gap was expected to narrow markedly.** The contraction of GDP in the first quarter of 2026 was driven by declines in private and public consumption, while exports increased. At the same time, there was a significant rise in civilian imports—a development consistent with the assessment that supply constraints in the domestic market continued to weigh on activity levels during the half-year. Research Department analyses indicated that a substantial share of the economy's recent growth reflected production abroad by global companies operating in Israel, and after excluding the activity of those firms, growth was lower due to supply constraints. As supply constraints ease, growth will be based on a broader range of industries and firms in the economy, with GDP converging toward the long-term trend line.

In the discussions leading to the February decision, the Monetary Committee examined the National Accounts data for the fourth quarter of 2025. The quarterly growth rate stood at 4 percent (annualized, seasonally adjusted), which was above the long-term trend. The increase in GDP in the fourth quarter was driven by a sharp rise of 25.6 percent in exports. Current consumption grew by 3.6 percent on an annualized basis, remaining near the trend line, while public consumption excluding defense imports declined modestly. Business output expanded by 7.1 percent in annual terms, seasonally adjusted, while the growth figures for the third quarter of 2025 were revised upward to 12.7 percent. For the year as a whole, and in view of the revision to previous data, GDP grew at a rate of 3.1 percent, slightly above previous estimates.

In the deliberations leading up to the March decision, while Operation Roaring Lion was underway, the committee examined the various indicators of economic activity that reflected the operation's impact on activity. As during Operation Rising Lion (in June 2025), credit card expenditure data at current prices indicated a sharp decline of approximately 20 percent in activity with the commencement of Operation Roaring Lion. The data showed a partial recovery after the first two weeks of the operation, yet remained below the levels from before the operation. A Central Bureau of Statistics flash survey conducted after the start of Operation Roaring Lion showed that the impairment factors were similar to those observed during Operation Rising Lion. The majority of businesses indicated that the impairment of activity was largely due to employee absenteeism and the closure of educational institutions.

Table 1 | National Accounts data available by month

(seasonally adjusted, quantitative rate of change from the previous period, annual terms)

	Month	January	February	March	April	May	June	July
GDP	2025:Q3	11.1	12.7	12.1	12.3	12.4	12.3	12.3
	2025:Q4		4.0	4.2	3.3	2.9	2.8	2.8
	2026:Q1					-3.3	-3.8	-3.8
Business sector output	2025:Q3	13.2	16.3	15.6	15.5	15.5	15.2	15.2
	2025:Q4		7.1	7.2	6.1	5.4	4.9	4.9
	2026:Q1					-3.1	-3.8	-3.7
Private consumption	2025:Q3	21.4	22.2	22.0	22.0	20.9	20.9	20.9
	2025:Q4		-3.6	-3.7	-3.0	-4.6	-4.6	-4.6
	2026:Q1					-4.7	-5.0	-4.9
Fixed capital formation	2025:Q3	34.5	33.6	33.7	33.7	33.3	33.3	33.3
	2025:Q4		-6.4	-4.0	-5.7	-4.3	-4.3	-4.3
	2026:Q1					12.6	12.8	12.8
Exports excluding diamonds and startups	2025:Q3	12.2	14.4	15.4	15.2	15.7	15.3	15.3
	2025:Q4		25.6	24.5	20.2	20.1	19.9	19.9
	2026:Q1					5.6	1.9	1.8
Civilian imports excluding ships, aircraft, and diamonds	2025:Q3	12.8	11.0	13.9	13.9	14.1	14.1	14.1
	2025:Q4		-3.9	-2.9	-2.8	2.1	2.1	2.1
	2026:Q1					33.1	32.7	32.7

SOURCE: Based on Central Bureau of Statistics.

Table 2 | Development of GDP, imports, and uses

(seasonally adjusted, quantitative rate of change from the previous period, annual terms)

	2023	2024	2025	2024 Q4	2025 Q1	2025 Q2	2025 Q3	2025 Q4	2026 Q1
GDP	2.1	1.0	2.9	1.2	5.9	-4.4	12.3	2.8	-3.8
Business sector product	1.1	-0.4	3.2	1.9	6.7	-7.3	15.2	4.9	-3.8
Civilian imports excluding ships, aircraft, and diamonds	-6.9	-2.2	8.8	13.1	2.8	9.5	14.1	2.1	32.7
Private consumption	-0.6	3.9	2.7	3.5	-2.0	-6.8	20.9	-4.6	-5.0
of which: excl. durables	0.2	3.4	3.7	4.5	3.8	-8.9	18.8	1.4	-10.1
Public consumption	8.1	11.8	1.7	10.2	4.5	-2.1	4.2	0.5	-4.8
of which: excl. defense imports	7.5	9.4	2.1	15.1	-3.4	-6.3	18.9	-1.0	-5.8
Gross domestic investment	-4.2	-8.9	7.4	-16.5	22.8	3.1	22.9	-11.8	10.6
of which: fixed capital formation	-2.1	-5.5	8.3	8.1	10.3	-12.7	33.3	-4.3	12.8
Exports excl. diamonds	0.2	-4.4	5.8	7.8	-0.2	-1.4	18.6	27.2	-3.1
of which: excl. startups	0.0	-3.7	5.7	-0.3	6.8	1.5	15.3	19.9	1.9

SOURCE: Based on Central Bureau of Statistics.

3. The labor market

During the first half of the year, the labor market remained tight, as the unemployment rate was low and wages rose at a rapid pace. The labor market was markedly but temporarily affected by Operation Roaring Lion. The share of workers temporarily absent due to reserve duty rose sharply in March, but fell significantly in April and May, reaching a relatively low level of 0.5 percent in May. The broad unemployment rate for those ages 25–64 declined in May to a low of 3 percent (Figure 8). The job vacancy rate increased slightly, yet remained below the level that prevailed before Operation Roaring Lion. The employment rate and the participation rate for those aged 15+ fell in May, similar to the preceding months. Among the prime working ages (25–64), the employment and participation rates remained stable in May (Figure 7). The rate of wage growth in the economy for the months March-May stood at 6.8 percent compared with the corresponding period last year. The wage increase partly reflects changes in the composition of the workforce due to Operation Roaring Lion, an increase in the minimum wage, and a public-sector wage increase implemented in April under the framework agreement.

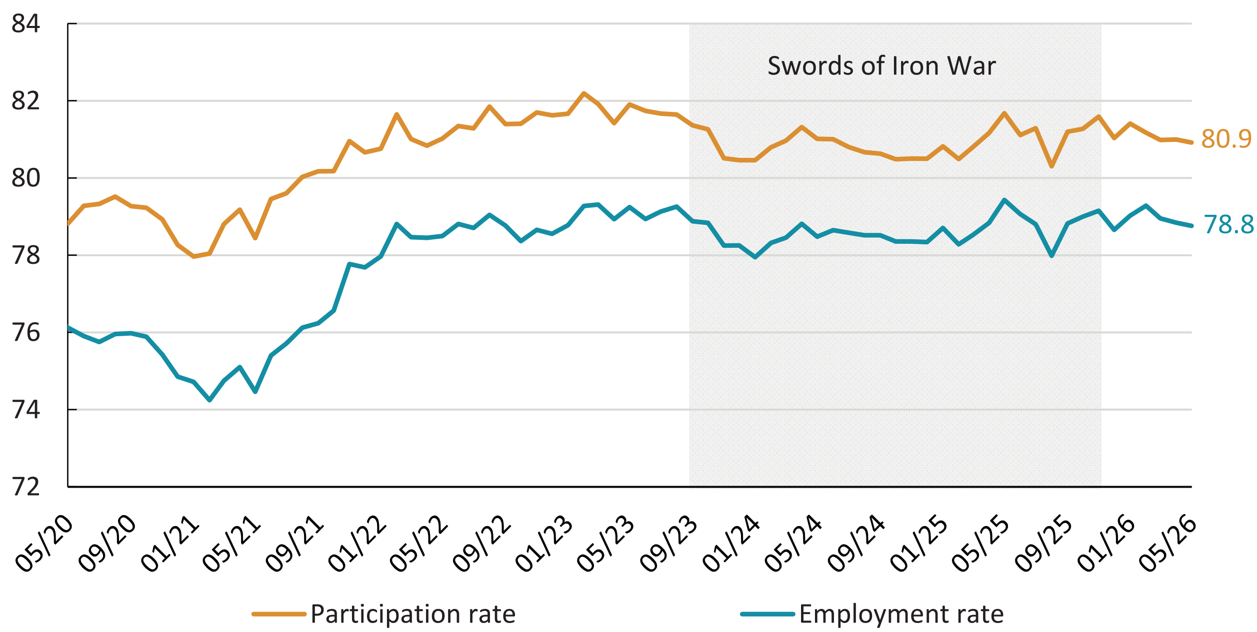
At the time of the deliberations leading to the January decision, the labor market remained tight, although the most recent data indicated an easing of supply constraints. The employment rate and the labor force participation rate among the prime working ages (25–64) increased in November, while the broad unemployment rate among those ages remained stable. The rate of temporary absences from work due to reserve service fell slightly in November to 0.5 percent. In the August–October (2025) period, business sector wages rose by 5.3 percent relative to the same period last year, compared with 5.9 percent in the July–September period. At the same time, the job vacancy-to-unemployment ratio remained high and stable, and the job vacancy rate increased modestly. Committee members discussed the easing of labor-market constraints and the extent to which they represent a continuing process.

During the discussions leading to the February decision, Committee members believed that the labor market data since the January interest rate decision indicated that the labor market remained tight and the supply constraint remained significant. The job vacancy-to-unemployment ratio stayed high, with the job vacancy rate stable at 4.6 percent in both December and January. The broad unemployment rate among the prime working ages (25–64) remained low and stable, at 3.2 percent in December. The rate of temporary absence from work due to reserve service fell slightly in December, to 0.4 percent. The employment rate and the labor force participation rate among the prime working ages (25–64) declined in December to 78.8% and 81.1% respectively, levels comparable with those prior to the ceasefire, after having risen by half a percentage point in November. Business sector wages rose sharply in September–November, by approximately 5.1 percent relative to the previous year, a rate similar to the increase recorded in August–October. According to the flash estimate, overall wage growth in October–December moderated, and, according to the Committee members' assessment, pointed to the possibility of a comparable slowdown in business sector wage growth.

During the discussions leading to the March decision, the ratio of job vacancies to the unemployed remained elevated, while the job vacancy rate remained stable at 4.5 percent in February. In January, the broad unemployment rate among the prime working ages (25–64) was 3 percent, with a moderate increase in the proportion of absentees due to reserve service compared with December. The pace of wage growth in the business sector resumed its increase, to a high level of about 4.7% for the November–January period relative to the corresponding period of the previous year.

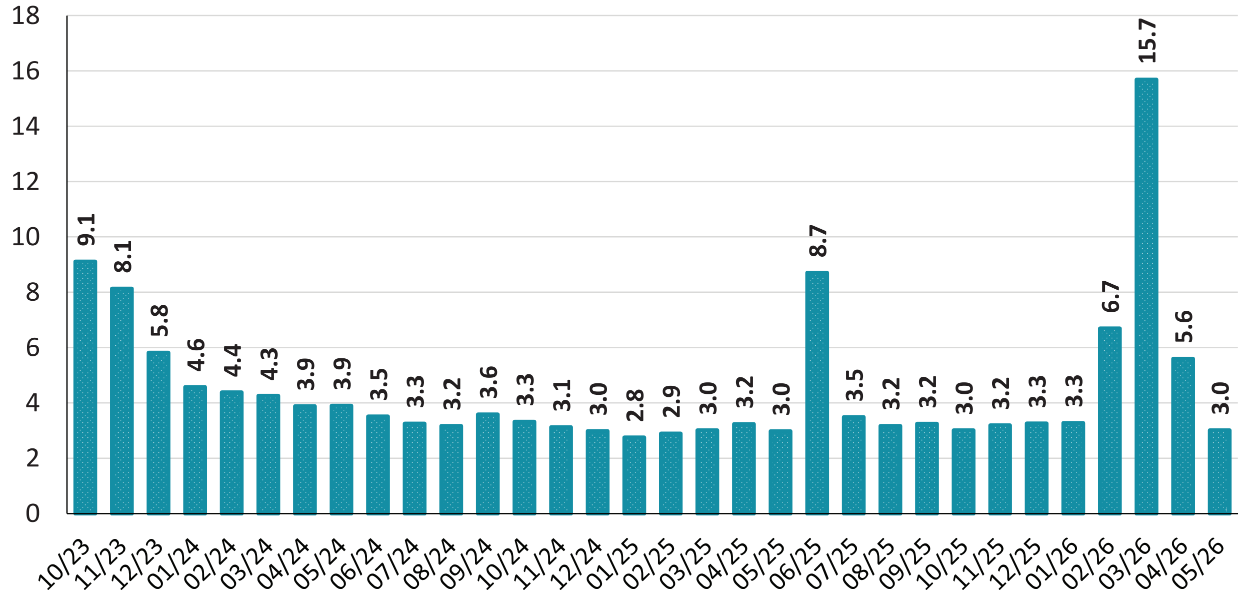
In the discussions leading to the May decision, it appeared that the labor market was significantly affected by Operation Roaring Lion, and that the constraint on labor supply remained substantial. The proportion of workers temporarily absent due to reserve service rose sharply in March and fell slightly in April, to 1.2 percent. The broad unemployment rate among those aged 15 + fell sharply from 15.9 percent in March to 5.9 percent in April, despite the continuation of the fighting into April. Prior to Operation Roaring Lion, the pace of wage increases in the business sector remained stable at a high level, at 4.6 percent in December–February relative to the same period of the previous year. The overall wage growth rate in the economy in March was 5.9 percent, but this was affected by changes in the composition of the labor force in view of Operation Roaring Lion.

Figure 7 | Employment and Participation Rates, Ages 25–64, May 2020–May 2026
seasonally adjusted, percent



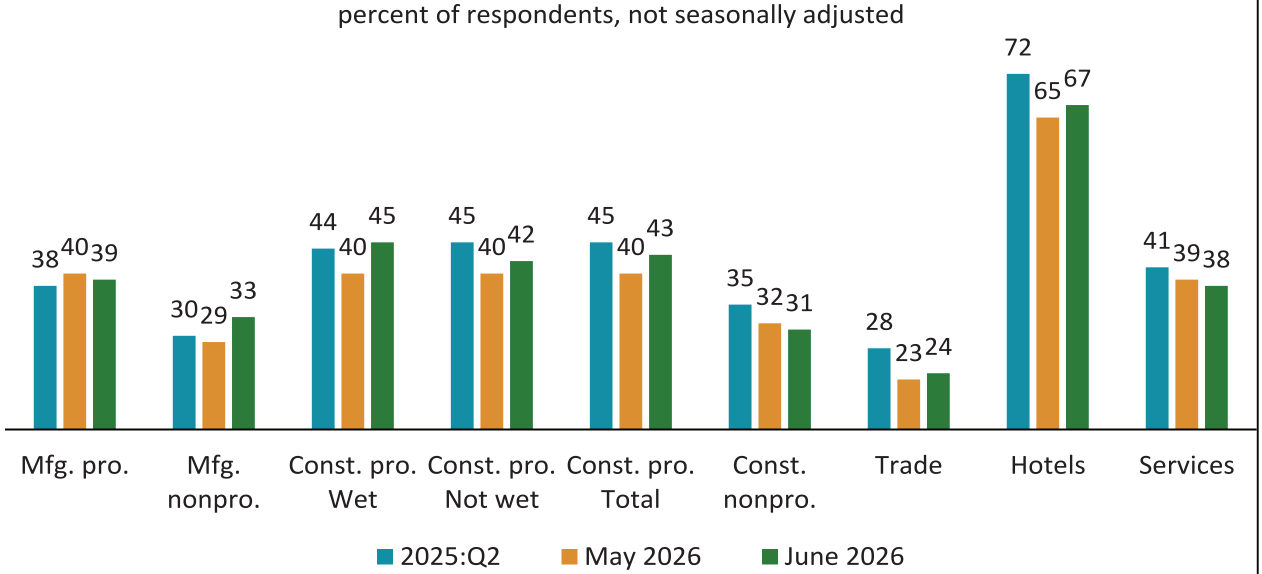
SOURCE: Based on Central Bureau of Statistics Labor Force Survey.

Figure 8 | Broad Unemployment Rate, Ages 25–64, October 2023–May 2026
seasonally adjusted, percent



SOURCE: Based on Central Bureau of Statistics.

Figure 9 | Percentage of Companies Reporting a Moderate or Severe Constraint in Hiring Workers, 2025:Q2 Average Compared to April–May 2026
percent of respondents, not seasonally adjusted



SOURCE: Based on Central Bureau of Statistics Business Tendency Survey.

4. The exchange rate, the risk premium, and the financial markets

During the reviewed half-year, trading in financial markets remained volatile, amid domestic and global uncertainty. The shekel appreciated by approximately 10 percent against the dollar since January 2026, to NIS 2.8 / US dollar at the end of May. In June the shekel's value depreciated, so that at the end of the period the exchange rate was roughly NIS 3 to the dollar (Figure 10 and Table 3). The appreciation over the past two years was influenced to a large extent by three factors: geopolitical developments and the decline in Israel's risk premium, gains in US equity markets, and the weakening of the US dollar worldwide. The Bank of Israel purchased foreign exchange totaling $801 million in May and $1,027 million in June. These purchases were made on a one-off basis to preserve the orderly functioning of the markets.

Israel's risk premium—as measured by CDS spreads and the spreads on US dollar-denominated government bonds—continued to decline after rising at the beginning of Operation Roaring Lion, and remained in an environment similar to its level prior to October 7, 2023 (Figure 11). Domestic equity indices outperformed global markets during most of the period under review. However, since the announcement of the memorandum of understanding between the United States and Iran in June, they have underperformed relative to global markets.

Credit to the business sector continued to expand at a rapid pace during the reviewed period, led by bank credit. This expansion was evident across all industries—with an emphasis on the financial services and construction industries—and across all business size groups, with the exception of small and micro businesses. Payments in arrears in all activity segments remained low. The banking system continued to maintain high capital ratios, and insurance companies continued to maintain high solvency positions.

In the discussions leading to the January decision, the Monetary Committee discussed developments in the foreign exchange market and financial markets. The shekel had appreciated against the US dollar by 3.1 percent since the November interest rate decision, and by 12.5 percent over the course of 2025. Israel's risk premium during the reviewed period remained at a level close to that prevailing on the eve of the war. During the reviewed period, local equity indices increased and outperformed the global market.

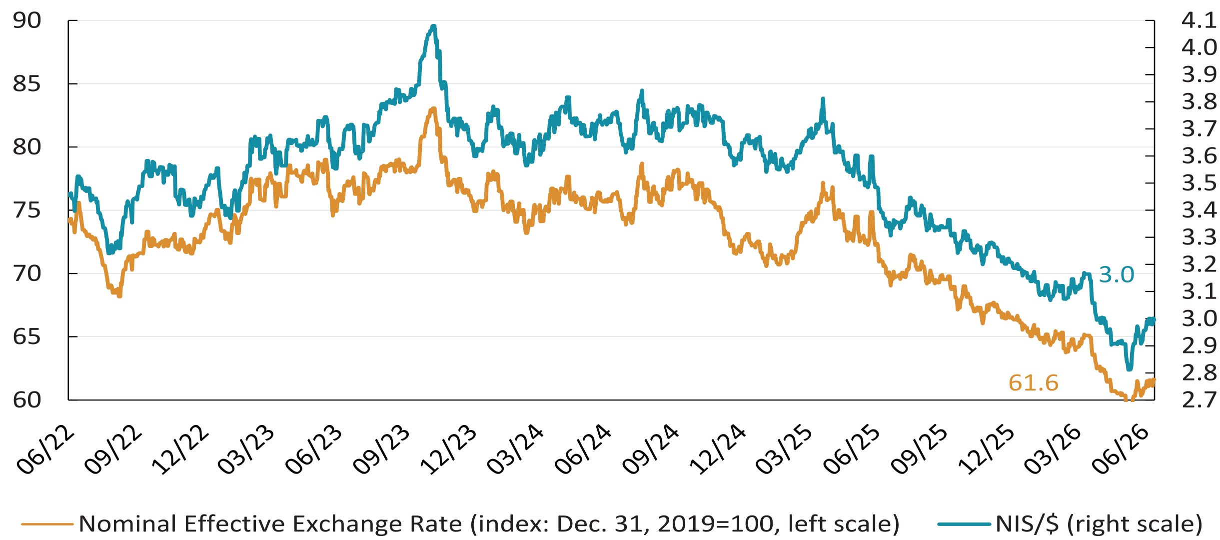
At the time of the discussions leading to the February decision, the shekel had strengthened by 1.1 percent against the US dollar and by 0.4 percent against the euro since the January 2026 decision. Domestic equity indices recorded further gains and outperformed the global market, and Israel's risk premium increased modestly in the days preceding the decision in response to geopolitical developments.

At the time of the discussions leading to the March decision, the shekel had weakened by 0.8 percent against the US dollar and had strengthened by 1.4 percent against the euro since the February 2026 interest rate decision. Concurrently, domestic equity indices declined, albeit more modestly than the global trend, and Israel's risk premium increased slightly.

At the time of the discussions leading to the May decision, the shekel had appreciated by 8.3 percent against the US dollar, by 7.2 percent against the euro, and by 7.4 percent in terms of the nominal effective exchange rate since the March interest rate decision. Local equity indices continued to increase. Israel's risk premium, after having risen at the outset of Operation Roaring Lion, continued to decline and remained around its pre-October-7th level.

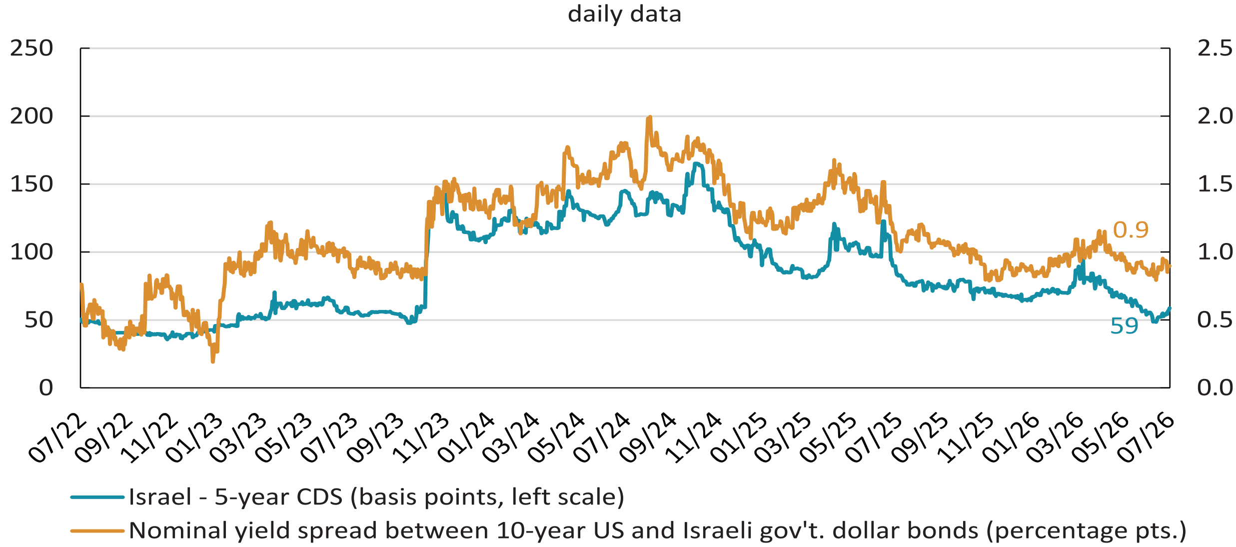
At the time of the deliberations on the July decision, the shekel had depreciated by 3.1 percent against the US dollar and by 1.5 percent against the euro, amid volatility throughout the period and after a pronounced appreciation at the outset (since the May interest rate decision based on the spot rate set on 21 May 2026). In terms of the nominal effective exchange rate, the shekel depreciated by 2.1 percent. **Local equity indices fell and underperformed relative to global markets, following outperformance over the past two years.** Israel's risk premium remained around its pre-October-7th level.

Figure 10 | Nominal Effective and NIS/$ Exchange Rates, July 2022–July 2026
daily data



SOURCE: Bank of Israel.

Figure 11 | Israel's Risk Premium as Reflected in the Nominal Yield Spread on Israeli and US 10-Year Dollar Government Bonds, and the 5-Year CDS, July 2022–July 2026
daily data



SOURCE: Based on Bloomberg.

Table 3 | Developments in the domestic asset markets

	01/26	02/26	03/26	04/26	05/26	06/26
Yield to maturity (monthly average, percent)						
3-month *MAKAM*	3.8	3.7	3.8	3.8	3.8	3.4
1-year *MAKAM*	3.6	3.5	3.7	3.7	3.6	3.3
5-year unindexed bonds	3.6	3.5	3.8	3.8	3.7	3.4
10-year unindexed bonds	3.9	3.8	4.0	4.0	3.9	3.8
20-year unindexed bonds	4.3	4.3	4.4	4.4	4.3	4.2
1-year indexed bonds	2.2	1.9	2.0	2.1	1.8	1.7
5-year indexed bonds	1.8	1.7	1.9	2.0	1.8	1.7
10-year indexed bonds	1.8	1.8	2.0	2.2	2.1	1.9
Yield spread between government bonds and AA-rated corporate bonds (percentage points)[a]	0.8	0.9	0.8	0.8	0.8	0.9
Equity market (rate of change during the month, percent)						
General Shares Index	7.6	2.5	-0.6	6.5	9.0	1.2
Tel Aviv 35	10.2	3.1	-0.7	6.7	1.8	-8.7
Foreign exchange market (rate of change during the month, percent)						
Dollar/shekel	-3.0	0.9	1.4	-6.8	-4.7	5.9
Euro/shekel	-1.4	-0.2	-1.4	-4.9	-5.4	3.8
Nominal effective exchange rate	-2.1	0.6	-0.4	-5.6	-4.9	4.6

[a] The calculation is for fixed-rate CPI-indexed bonds, excluding convertible and structured bonds, with a yield of up to 100 percent and a term to maturity of more than 6 months.
SOURCE: Bank of Israel.

5. Fiscal policy

At the time of the discussions preceding the January decision, the government had approved the proposed 2026 budget with a deficit ceiling of 3.9 percent of GDP—a level higher than the previously planned deficit and above the level consistent with a declining path of the debt-to-GDP ratio. Compliance with this deficit target was partly dependent on the absence of geopolitical developments that would necessitate a further increase in defense expenditure, and on the realization of the assumptions underlying the projected revenue path. Committee members referred to the budget's effect on demand and inflation, and held the view that it was important for the 2026 budget to be approved by the Knesset, while ensuring that this deficit target was not exceeded. This was seen as necessary in order to support market confidence in the economy and the continued decline in the risk premium.

During the discussions preceding the February decision, it was noted that 2026 began under an interim budget, as the state budget had not yet been approved by the Knesset. The cumulative deficit in the state budget over the previous 12 months increased to 4.9 percent of GDP in January. Government receipts from direct taxes in that month (at constant prices and net of legislative changes and one-off revenues) remained at a high level relative to the long-term trend.

During the discussions preceding the March decision, it was noted that the cumulative deficit in the state budget over the previous 12 months stood at 4.7 percent of GDP in February. Government receipts from direct taxes in February (at constant prices and net of legislative changes and one-off revenues) remained above the long-term trend line. The government raised the deficit target in the 2026 budget approved by the Knesset to 4.9 percent of GDP, following a revision of the budget framework after the start of Operation Roaring Lion.

During the discussions preceding the May decision, it was noted that the cumulative deficit over the previous 12 months (May 2025–April 2026) declined to 3.8 percent of GDP, mainly due to a low level of government expenditure against the background of the interim budget in the first quarter of the year. Government receipts from direct taxes in April (at constant prices and net of legislative changes and one-off revenues) remained above the long-term trend line. There was uncertainty regarding an increase in the defense budget, along with the possibility of a higher deficit target.

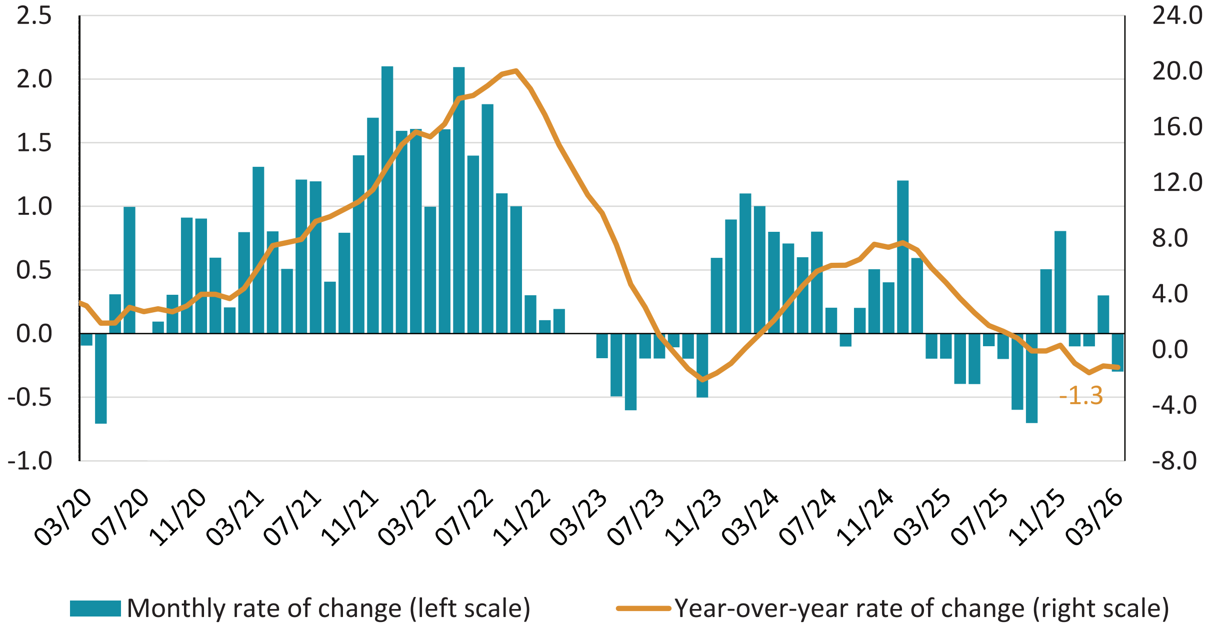
During the discussions preceding the July decision, it was noted that the cumulative deficit in the state budget over the previous 12 months declined during the reviewed period to 3.8 percent of GDP in May, compared with 4.7 percent of GDP in December. This was mainly due to a low level of government expenditure against the background of the interim budget in the first quarter of the year. Government receipts from direct taxes (at constant prices and net of legislative changes and one-off revenues) remained above the long-term trend line.

6. The housing market

The level of activity in the construction industry remained high. Housing starts, housing completions, and building permits remained at high levels. These developments, together with some decline in the volume of transactions relative to 2024, led to an increase in contractors' inventory of unsold homes and to a decline in home prices totaling 1.3 percent in annual terms (Figure 12).

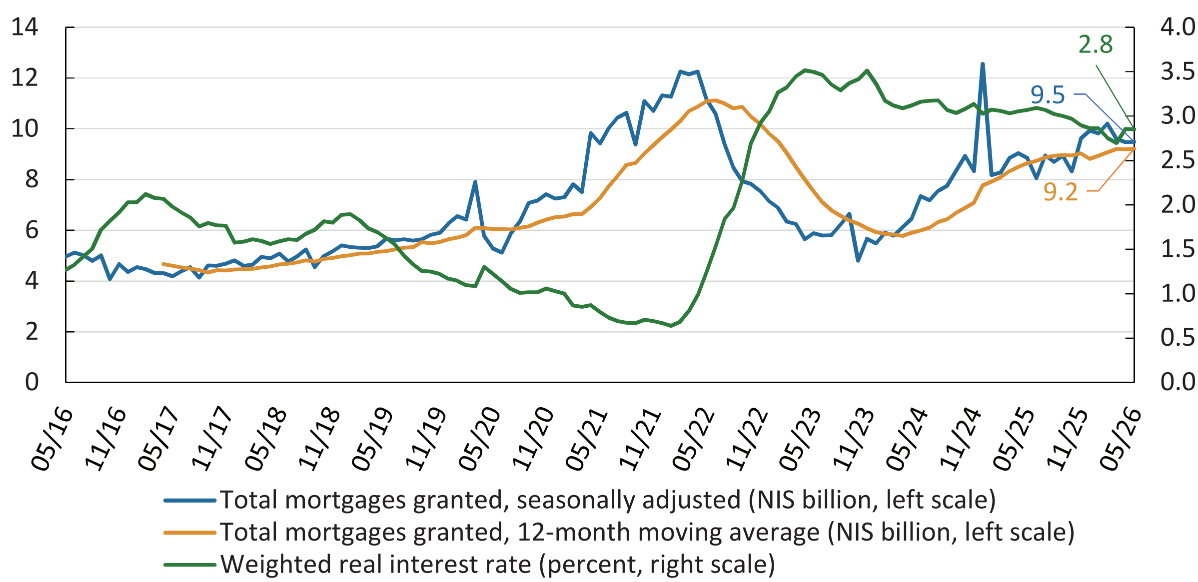
The annual rate of increase in the owner-occupied housing services component (rent in new and renewing contracts) of the Consumer Price Index stood at 4 percent at the end of the half-year (May data), compared with 2.6 percent and 3.6 percent at the end of the previous half-years (November 2025 and May 2025 data, respectively). In May, new mortgage borrowing totaled about NIS 9.5 billion (seasonally adjusted) (Figure 13).

Figure 12 | Index of Home Prices, March 2020–March 2026
percent



SOURCE: Based on Central Bureau of Statistics.

Figure 13 | Total New Mortgages and Weighted Real Interest Rate on Mortgages, May 2016–May 2026



SOURCE: Bank of Israel, Banking Supervision Department.

7. The global economy

During the reviewed half-year, global economic activity expanded at a moderate pace, similar to the global growth rate in the previous half-year. Despite the high geopolitical uncertainty resulting from the confrontation between the United States and Iran, the disruption to supply chains, and the increase in commodity prices, growth remained positive in most of the major blocs during the period.

Energy prices were highly volatile, and were influenced to a large extent by geopolitical developments. Brent crude oil, which stood at $60 per barrel at the beginning of the period, rose to $120 during the half-year and declined to about $70 by its end. The global Purchasing Managers' Index remained throughout the period at a level indicating continued expansion in global output, similar to the previous half-year.

In April, the International Monetary Fund (IMF) revised its global growth forecast downward and its forecast for global inflation upward, mainly due to the effect of the shock in energy markets and the high level of uncertainty. In the United States, GDP grew in the first quarter at an annual rate of about 2 percent, significantly higher than in the previous quarter. Employment reports during the half-year were mostly strong and pointed to a tight labor market. In the eurozone, the data for the first quarter of 2026 pointed to a slowdown in the pace of growth, with GDP increasing by only 0.1 percent in quarterly terms, below market expectations.

Annual inflation in the United States accelerated, and the Consumer Price Index (CPI) for May stood at 4.2 percent, compared with 2.7 percent at the end of the previous half-year. Annual inflation in the eurozone also accelerated, reaching 3.2 percent in May, compared with 2.1 percent at the end of the previous half-year.

During the reviewed period, the ECB raised its policy rate in June, while the Fed left its policy rate unchanged. **Since the beginning of the confrontation with Iran, the market-implied interest rate paths of many central banks have risen significantly.**

During the discussions preceding the January decision, it was noted that global economic activity continued to expand at a moderate pace, and global growth in 2025 was expected to total about 3 percent. Global inflation continued to moderate gradually, mainly due to lower energy prices and the relative easing of the trade war. In the United States, the Consumer Price Index moderated, and in November the annual CPI inflation rate stood at 2.7 percent. In the eurozone, inflation remained moderate, and annual inflation in November stood at 2.1 percent. **In its December interest rate decision, the Fed reduced the policy rate by 25 basis points,** while the ECB left its policy rate unchanged.

During the discussions preceding the February decision, it was noted that global economic activity continued to expand, alongside a moderating inflation trend, although in a number of advanced economies inflation remained above target. The volume of global trade in goods increased by 1.1 percent in November, following a decline of 0.9 percent in October. However, **Committee members were of the view that uncertainty remained regarding the implications of the US Supreme Court's tariff policy ruling for global trade.** In the period since the January interest rate decision, the major central banks in advanced economies left their policy rates unchanged. The Fed policy rate path edged up slightly, while the ECB path remained broadly unchanged.

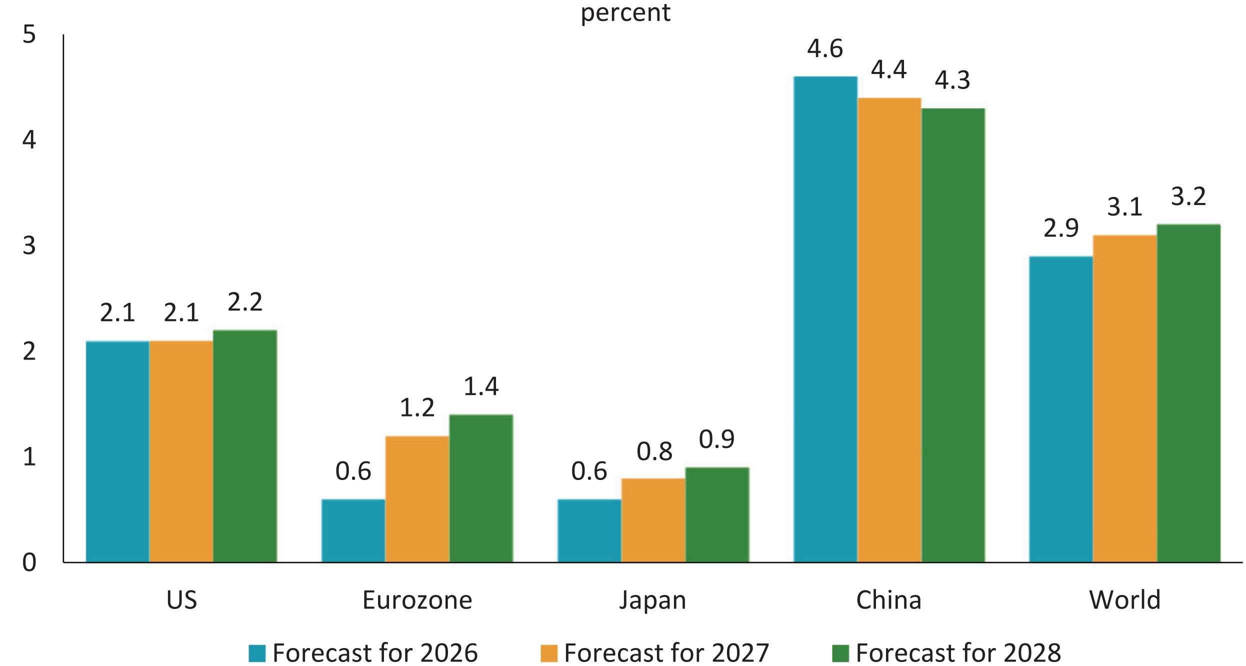
During the discussions preceding the March decision, it was noted that uncertainty was high regarding the expected effects of the military confrontation with Iran, as reflected in financial markets and in central bank communications. Forecasts of the confrontation's downward impact on growth and upward impact on inflation depended on the extent of the damage to infrastructure, the duration of the war, and disruptions to supply chains. Against the background of the confrontation, **the price of Brent crude oil rose sharply** amid volatility and stood at about $113 per barrel at the end of the reviewed period (an increase of about 60 percent), while the price of natural gas in Europe rose to EUR 55 per MWh (an increase of about 70 percent). However, futures contracts indicated that markets viewed part of the increase as temporary, and that Brent crude prices were expected to decline to about $84 per barrel by the end of 2026. During the reviewed period, the major central banks in advanced economies left their policy rates unchanged. **The uncertainty and the confrontation with Iran led to an increase in inflation expectations and in the policy rate paths of many central banks as priced in by markets.**

During the discussions preceding the May decision, it was noted that global inflation had increased markedly. In the United States, annual inflation accelerated in April, with the Consumer Price Index (CPI) standing at 3.8 percent and Core CPI at 2.8 percent. In the eurozone, annual inflation also accelerated, reaching 3 percent in April, while core inflation stood at 2.2 percent. During the reviewed period, the major central banks in advanced economies left their policy rates unchanged. **Since the start of Operation Roaring Lion, the policy rate paths of many central banks as priced in by markets increased significantly.**

During the discussions preceding the July decision, it was noted that the memorandum of understanding signed between the United States and Iran led to a sharp decline in oil prices and in inflation expectations worldwide, returning them to levels similar to those prevailing before the confrontation with Iran that began at the end of February 2026. Since the May interest rate decision, the price of Brent crude oil declined by about 30 percent to around $72 per barrel. The global Purchasing Managers Index for May remained unchanged at a level indicating continued expansion in global output. In the United States, GDP grew at an annual rate of 2.1 percent in the first quarter. Despite weakness in job creation in the US labor market in June, the average in recent months remained high. In the eurozone, data for the first quarter of 2026 pointed to a slowdown in the pace of growth. In the United States, annual inflation for May increased sharply, with the Consumer Price Index (CPI) standing at 4.2 percent and Core CPI at 2.9 percent. In the eurozone, annual inflation moderated to 2.8 percent in June, while core inflation also moderated to 2.4 percent. During the reviewed period, the Fed left the policy rate unchanged, while the European Central Bank (ECB) raised its policy rate by 25 basis points for the first time since September 2023 (Figure 15). In the United States, the policy rate path implies one increase and a 50 percent likelihood of a second increase within one year, while in Europe the path implies one additional rate increase over the coming year.

Figure 14 | Investment Houses' Median Growth Forecasts for 2026, 2027, and 2028

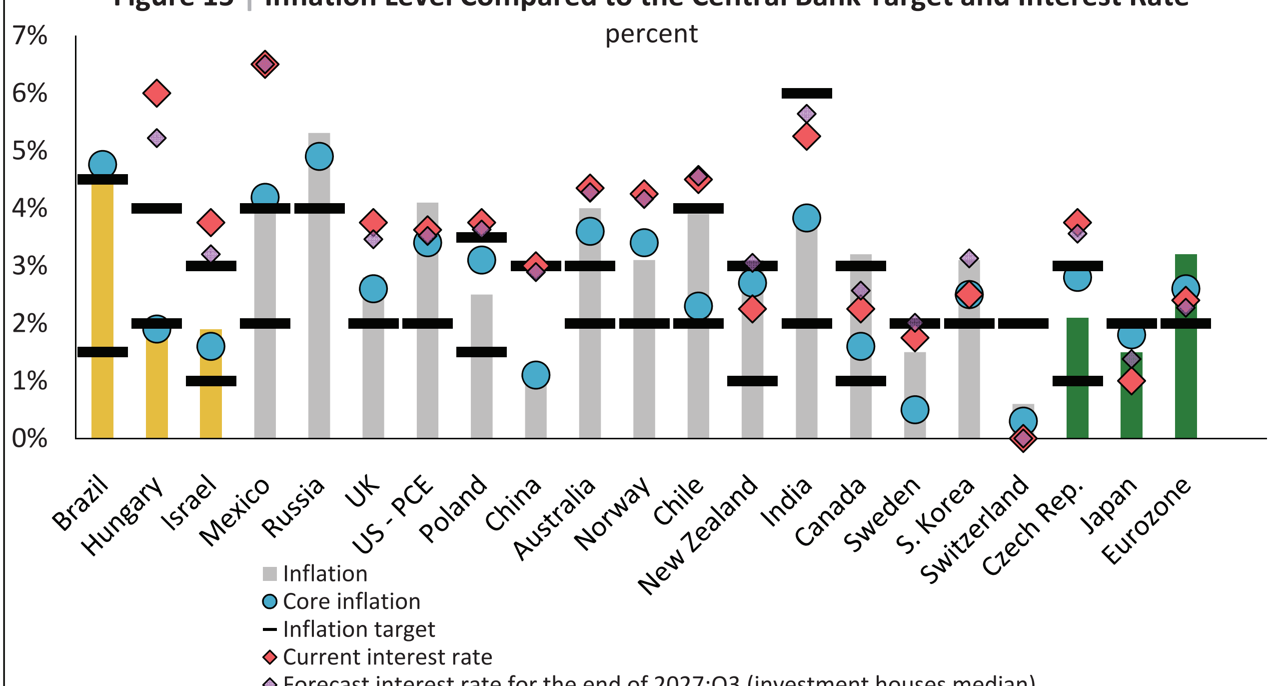
percent



SOURCE: Based on Bloomberg.

Figure 15 | Inflation Level Compared to the Central Bank Target and Interest Rate

percent



In green: Countries that raised interest rates at their most recent policy decision. In yellow: Countries that lowered interest rates at their most recent policy decision. The interest rate forecast for Israel is the average of Bloomberg survey respondents' forecasts for the policy rate 12 months ahead.

SOURCE: Based on Bloomberg.

8. The Research Department's macroeconomic forecast

According to the July 2026 forecast, GDP is expected to grow by 4 percent in 2026, compared with 5.2 percent in the January 2026 forecast. The Research Department projected that GDP would grow by 5.5 percent in 2027, compared with 4.3 percent in the January forecast. According to the July 2026 forecast, inflation in 2026 is expected to stand at 1.8 percent, compared with 1.7 percent in the January forecast, and in 2027 it is expected to stand at 1.8 percent, compared with 2 percent in the January forecast. In the Research Department's assessment, the interest rate one year from now is expected to be 3 percent. In the July forecast, the projected deficit for 2026 stood at 4.9 percent of GDP—1 percent of GDP higher than the deficit projected in the January forecast, which had been prepared prior to Operation Roaring Lion. According to the July 2026 forecast, the estimated debt-to-GDP ratio was projected to be 69 percent in both 2026 and 2027, compared with 68.5 percent in the January 2026 forecast. The government is considering the possibility of increasing the 2026 defense budget later in the year by up to an additional NIS 25 billion, which would bring it to NIS 183 billion. Should this materialize, the deficit is expected to be higher than currently projected, at about 5.5 percent of GDP, while inflation over the coming year would be about 0.3 percentage points higher than projected, depending on the composition of the expenditure and its effect on the economy's supply constraint (Table 4).

Table 4 | Research Department forecasts

(rates of change in percent, unless otherwise noted)

Forecast for the year	2025	2026			2027		
Forecast date	01/26	01/26	03/26	07/26	01/26	03/26	07/26
GDP	2.8	5.2	3.8	4.0	4.3	5.5	5.5
Private consumption	4.0	7.5	3.0	3.0	5.0	7.0	6.5
Fixed capital formation (excl. ships and aircraft)	10.0	13.0	6.5	8.0	8.0	14.5	6.0
Public consumption (excl. defense imports)	2.0	1.0	2.5	2.0	3.5	2.5	0.5
Exports (excl. diamonds and startups)	4.5	4.5	5.5	8.0	5.0	8.0	7.0
Civilian imports (excl. diamonds, ships, and aircraft)	10.0	8.0	10.0	10.5	7.0	12.0	5.5
Unemployment rate - annual average (ages 25–64)	3.4	3.3	4.5	4.6	3.5	3.4	3.0
Government deficit (percent of GDP)	4.8	3.9	5.3	4.9	3.6	4.4	4.2
Debt to GDP ratio	68.5	68.5	70.5	69.0	68.5	70.5	69.0
Inflation[a]	2.5	1.7	2.2	1.8	2.0	1.8	1.8
Forecast date	01/26	03/26	07/26				
Inflation in the coming year[b]	1.7	2.3	1.8				
Interest rate in one year[c]	3.50	3.75/3.5	3.00				

[a] The average of the Consumer Price Index in the fourth quarter of the year compared with the average in the fourth quarter of the previous year.

[b] In the four quarters ending in the same quarter in the following year.

[c] In the same quarter in the following year.

SOURCE: Bank of Israel.