



**BANK OF ISRAEL**



# **63 | Monetary Policy Report**

## **First Half of 2025**

July 2025

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# Monetary Policy Report

## First Half of 2025

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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, from the publication of the CPI for July 2024, on August 15, 2024 through the publication of the CPI for May 2025 (published on June 15, 2025). The inflation rate in that period was above the upper bound of the target range, and the reasons for that are discussed in Section B below (“Background conditions from the Monetary Committee’s perspective”).

The Monetary Policy Report for the first half of 2025 was prepared by economists in 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 7, 2025, including the CPI for May 2025.

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 most of the half-year reviewed, rather than 6 Monetary Committee members, there were 5 members—two from among the public instead of the regular 3. In May 2025, an additional member from among the public was appointed, and the Committee now has 6 members.

## Executive Summary

**Monetary policy:** The Monetary Committee kept the interest rate unchanged at 4.5 percent in all its decisions in the first half of 2025. In view of the geopolitical uncertainty, both global and domestic, and considering the inflation environment, the Monetary Committee's policy focused on stabilizing the markets and converging inflation to its target, alongside supporting economic activity.

**The inflation environment:** At the end of the first half of 2025, the year-over-year inflation rate was 3.1 percent (CPI for May), above the target range, compared to 3.4 percent at the end of the previous half year (CPI for November 2024). The inflation rate of nontradable components remained stable at a high level of 3.9 percent (May CPI), reflecting excess demand in view of supply constraints. The year-over-year inflation rate during the period was volatile, ranging from 3.1 to 3.8 percent, in view of tax increases, particularly the increase in VAT in January, and influenced by the travel abroad component. According to forecasters, inflation is expected to converge to the target range in the third quarter of 2025—similar to the assessment at the end of the previous half-year. Expectations and forecasts for a range of 1 year and for longer ranges declined during the reviewed period, and are around the midpoint of the inflation target range.

**Real activity in Israel and the labor market:** Economic activity recovered moderately during the reviewed period, in view of geopolitical developments. The growth rate in annual terms during the first quarter—3.7 percent (3.4 percent in the first reading)—was similar to the growth rates prior to the war and to the long-term economic growth trend. However, the level of GDP remains about 4 percent lower than what is consistent with the long-term trend—similar to the gap at the end of the previous half-year. A considerable part of the gap is explained by supply constraints deriving from a shortage of workers—a shortage of non-Israeli workers and the absence of workers who are serving in the military reserves. During the half-year, the labor market remained tight, with a low unemployment rate. Nominal wages in March–May 2025 reflect an average annual increase of more than 4 percent, compared to their level in the third quarter of 2023, prior to the war. Toward the end of the period, there was some moderation in the tightness of the labor market.

**The exchange rate, the risk premium, and the financial markets:** During the first half of 2025, trading in the financial market remained volatile, influenced mainly by global and domestic geopolitical developments. In June, with the completion of Operation Rising Lion, Israel's risk premium—as measured by the CDS and dollar-denominated government bond spreads between Israel and the US—declined prominently, but remained higher than its level prior to the Swords of Iron War. Israel's equity indices increased sharply, shekel-denominated government bond yields declined significantly, and the shekel strengthened markedly. During the reviewed period, business credit continued to expand in line with the trend, while delinquency rates remained stable and low in all activity segments.

**Fiscal policy:** The cumulative deficit in the state budget over the past 12 months totaled 5.0 percent of GDP in June. Total government receipts from taxes in June, excluding legislative changes and one-off revenues, returned to the long-term trend (in fixed prices), after being above the trend line at the end of the previous half-year. The immediate budgetary cost of Operation Rising Lion is estimated at 1 percent of GDP. According to the Research Department's July 2025 forecast, the debt to GDP ratio is expected to rise from 68 percent in 2024 to 70 percent in 2025 and 71 percent in 2026. It is essential to set a policy path in the upcoming budget that will lead the debt ratio to converge to a downward trend in the coming two years.

**The housing market:** Activity in the construction industry slowed somewhat, as the number of home transactions declined and the inventory of unsold homes increased. However, the pace of building starts remained relatively high. The pace of home price increases moderated during the period, to 5.1 percent (March–April data) in annual terms, compared with a pace of 7.7 percent in the December–January data. The annual pace of increase in the housing component of the Consumer Price Index was 4.0 percent at the end of the period (May figure), and ranged during the period between 3.9 and 4.4 percent. The damage caused by the Iranian missile attacks, which impaired the supply of available housing units, may lead to an increase in demand for rentals, and as a result to an increase in rental prices in the affected areas.

**The global economy:** During the reviewed period, equity indices rose with increased volatility in the global markets in view of the US government’s tariff policy and its potential effects on global trade, growth, and inflation. The global growth rate in the first quarter of the year remained moderate, and the global growth forecast for 2025 was relatively low, at 2.6 percent, at the end of the half-year. During the period, the US dollar weakened relative to the other major currencies. Inflation data in the major markets during the reviewed period indicated continued convergence, but at varying paces. While the Federal Reserve did not change its interest rate, the ECB lowered its policy rate at each meeting during the half-year, alongside rate reductions by other central banks.

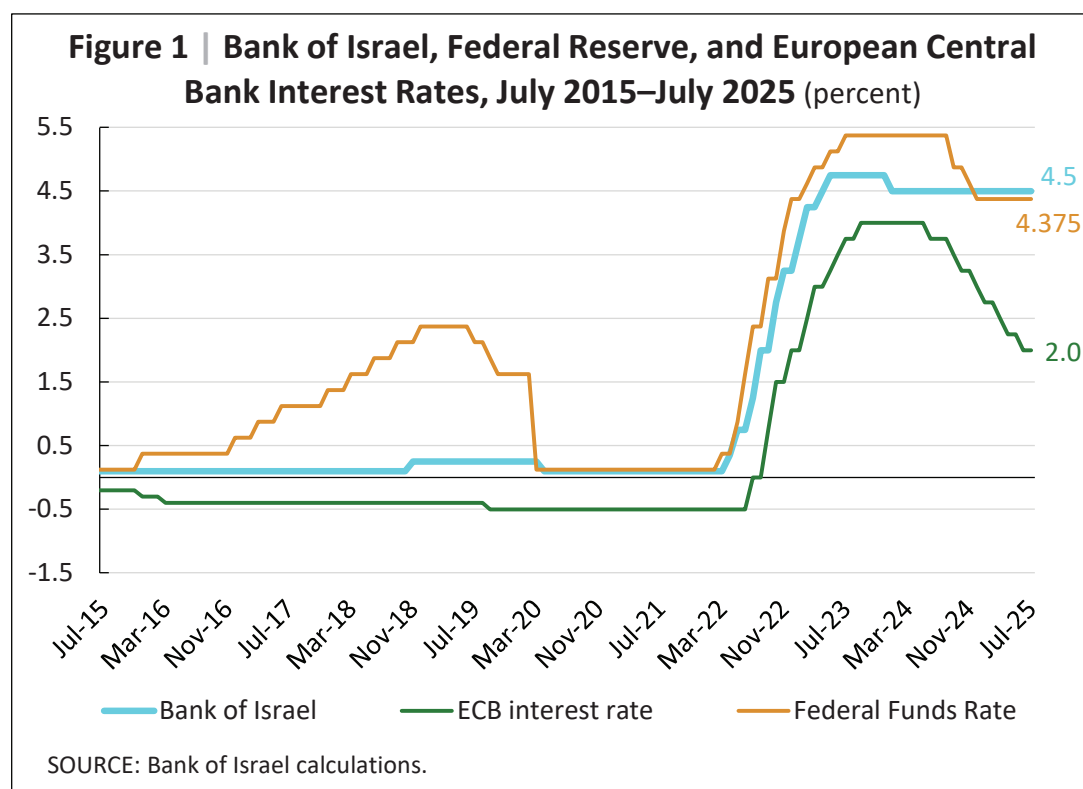
**The Research Department forecast:** The Research Department forecast that was published in July 2025 was formulated under the assumption that the proposed ceasefire agreement in Gaza would prevent further intense hostilities there within the forecast horizon (beginning in July), and under the assumption that the ceasefire with Iran would be maintained. According to this forecast, GDP is expected to grow by 3.3 percent in 2025 and by 4.6 percent in 2026 (compared to 4.0 percent and 4.5 percent respectively in the January 2025 forecast). The inflation rate is expected to be 2.6 percent in 2025, and 2.0 percent in 2026 (compared with 3.4 percent and 2.3 percent respectively in the January 2025 forecast). The broad unemployment rate among the prime working ages (25–64) is expected to average 2.9 percent in 2025 and 3.3 percent in 2026 (compared with 3.1 percent in each year in the January 2025 forecast).

## A. Policy measures

The Monetary Committee kept the interest rate unchanged at 4.5% in all of its decisions during the first half of 2025 (Figure 1). Until the May decision (and since the January 2024 decision), the Committee stated in its announcements that, “In view of the continuing war, the Monetary Committee’s policy is focusing on stabilizing the markets and reducing uncertainty, alongside price stability and supporting economic activity. The interest rate path will be determined in accordance with the convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.” In its July decision, the Committee adapted its statement to the changing environment, stating: “In view of the geopolitical uncertainty, the interest rate path will be determined in accordance with the convergence of inflation to its target range, stability in the financial markets, economic activity, and fiscal policy.”

The interest rate decisions during the first half of 2025 were made against a backdrop of considerable uncertainty, influenced by geopolitical events—including the Swords of Iron War and Operation Rising Lion against Iran—as well as global developments, notably the US administration’s tariff program.

Accordingly, the interest rate decisions in most months of the first half (those of January, February, April, and May) were made in an environment featuring a high risk premium, volatile exchange rates, and inflation above the target range, largely due to supply-side constraints leading to excess demand.



**The July interest rate decision, coming after the conclusion of Operation Rising Lion,** was made against the backdrop of a sharp decline in the risk premium, a notable appreciation of the shekel, and a significant drop in shekel yields. At that time, the Committee's assessment was that the shekel's appreciation could help moderate inflation, but that the decline in the risk premium and the possibility of reaching an agreement in Gaza could spur growth in demand—potentially adding to inflationary pressures, particularly if supply constraints persist.

**Following the onset of Operation Rising Lion, the Bank of Israel took several measures to support economic activity.** Among these, the Bank led and published a banking program to assist households and businesses affected by rocket attacks, aimed at providing those populations with more time to reorganize financially. The Bank also worked to ensure the continued proper functioning of the markets, payment systems, and cash availability in the country—even under emergency conditions—while maintaining ongoing communication with all relevant government and business-sector entities. In June 2025, to support the normal operation of the foreign exchange market, the Bank of Israel sold foreign currency totaling to US\$273 million.

## **B. Background conditions from the Monetary Committee's perspective**

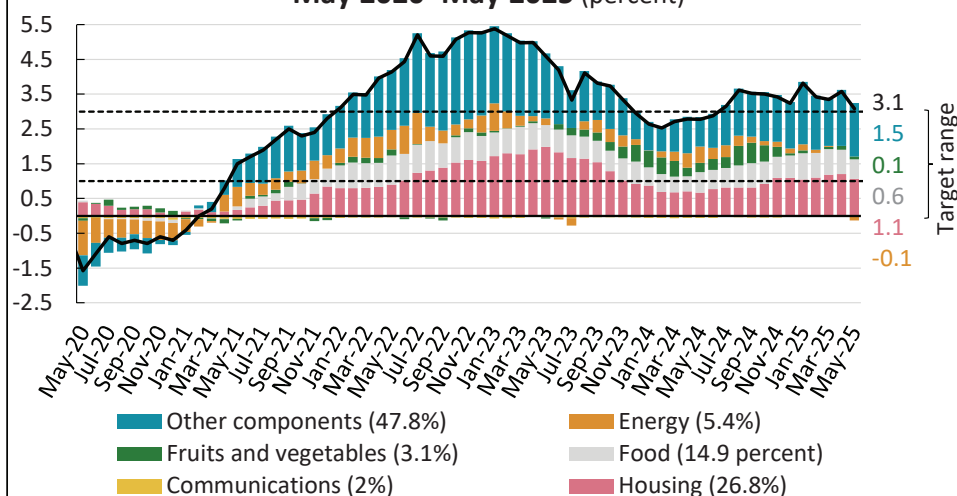
**At the end of the first half of 2025, the annual inflation rate stood at 3.1 percent (May 2025 index), above the inflation target, compared with 3.4 percent at the end of the previous half-year (November 2024 index) and 2.8 percent at the end of the first half of 2024 (May 2024 index).** The annual inflation rate during the half-period was volatile, ranging between 3.1 and 3.8 percent, influenced by tax increases—primarily the VAT hike in January—and by the travel abroad component (Figures 2 and 3). The inflation rate for nontradable components remained stable at a high level of 3.9 percent (May index), reflecting excess demand amid supply constraints, while inflation in the tradable components moderated to 1.5 percent. Inflation in Israel remains higher than the OECD median (Figures 4a and 4b).

According to forecasters' estimates, inflation is expected to converge to the target range in the third quarter of 2025—similar to the assessment at the end of the previous half-year—and to remain in the upper portion of the target range over the coming year. Short- and long-term inflation expectations and forecasts declined during the reviewed period, and are now around the midpoint of the inflation target range (Figures 5 and 6).

In the Committee's assessment, there are several risks that may lead to an acceleration of inflation or impede its convergence to the target: geopolitical developments and their impact on domestic economic activity, rising demand amid supply constraints, and a deterioration in global trade conditions.



**Figure 2 | Contribution of the Main CPI Components to Inflation<sup>a,b</sup>, May 2020–May 2025 (percent)**

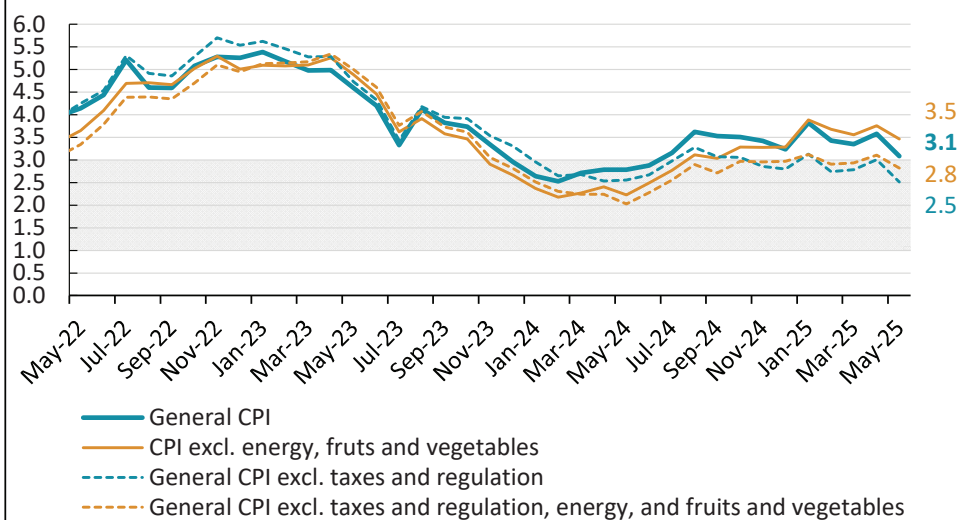


<sup>a</sup> The number in parentheses is the relevant component's share of the general CPI (as of 2025).

<sup>b</sup> "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.

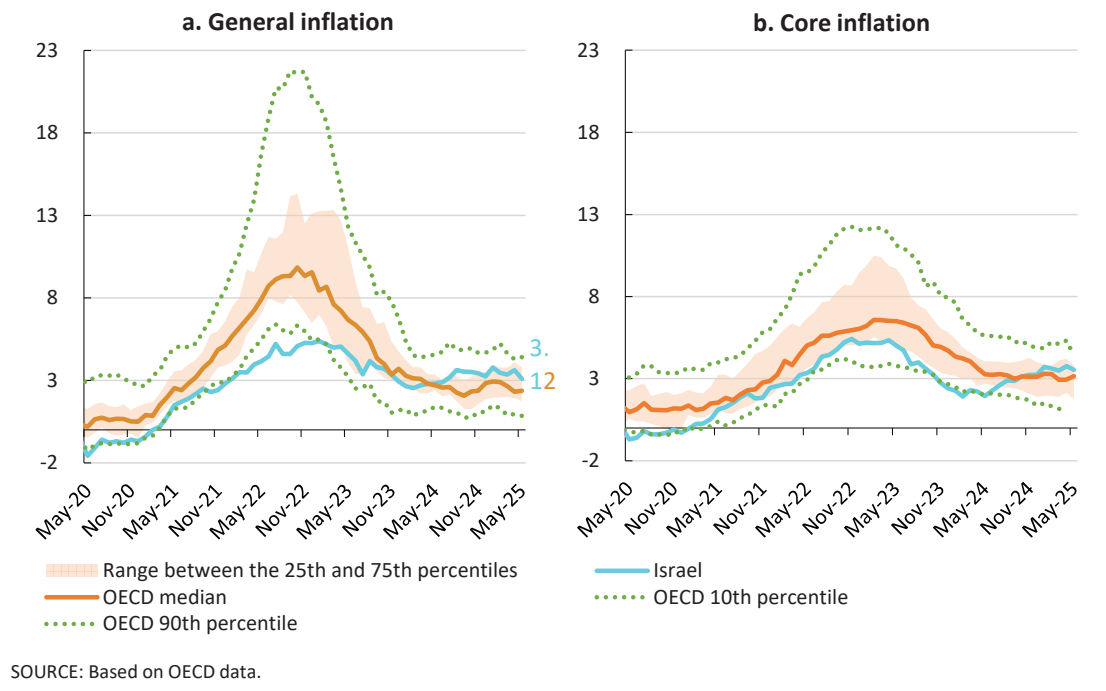
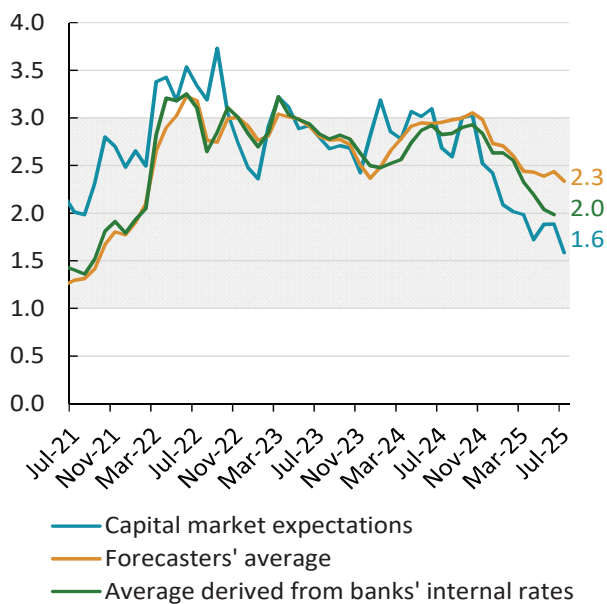
SOURCE: Based on Central Bureau of Statistics data.

**Figure 3 | Inflation as Reflected in the General CPI, the CPI Excluding Energy and Fruits and Vegetables, and the CPI Excluding Taxation and Regulation, May 2022–May 2025 (percent)**

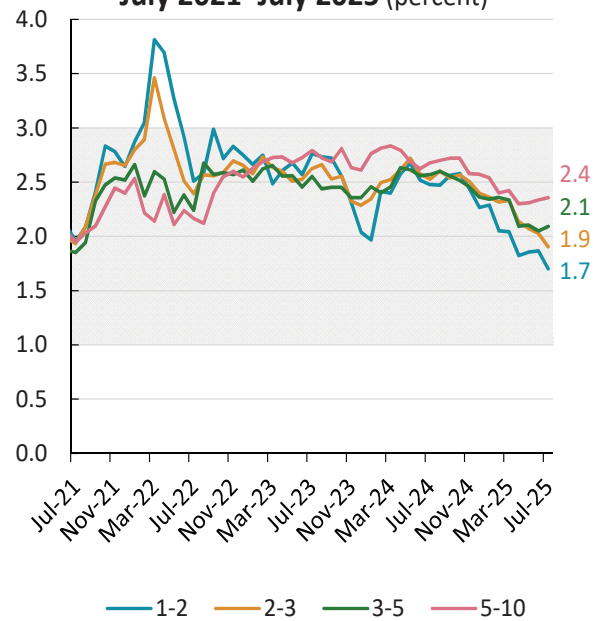


SOURCE: Based on Central Bureau of Statistics data.



**Figure 4 | Year-Over-Year Inflation in Israel and the OECD, May 2020–May 2025 (percent)**

**Figure 5 | One-Year Inflation Forecasts from the Various Sources<sup>a</sup>, July 2021–July 2025 (percent)**

<sup>a</sup> Monthly averages.

SOURCE: Bank of Israel calculations.

**Figure 6 | Forward Inflation Expectations Derived from the Capital Market<sup>a</sup>, July 2021–July 2025 (percent)**

<sup>a</sup> Monthly averages, yearly ranges.

SOURCE: Bank of Israel calculations.

## 1. Real activity in Israel

Economic activity recovered at a moderate pace during the reviewed half-year, against the backdrop of geopolitical developments. Annualized growth in the first quarter of 2025 was 3.7 percent (3.4 percent in the initial estimate), similar to prewar growth rates and the economy's long-term growth trend. However, GDP remains approximately 4 percent below its long-term trend—a gap similar to that at the end of the previous half-year. A significant portion of this deviation is attributable to supply constraints, primarily due to a shortage of non-Israeli workers and the absence of employees due to reserve duty (Tables 1 and 2).

Current indicators of economic activity pointed to continued moderate growth. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey remained stable throughout most of the period and then declined significantly at the end of June, in view of Operation Rising Lion. According to a flash survey conducted by the Central Bureau of Statistics in June, the business sector sustained some disruption during the operation, though it was milder than in October 2023.

During the reviewed half-year, services exports rose and goods exports remained stable, while the surplus in the current account of the balance of payments increased in the first quarter of the year. Credit card expenditures in current prices, which also reflected relative stability for most of the period, recorded a sharp decline at the onset of Operation Rising Lion, followed by a swift rebound once the operation concluded. Capital raised in the high-tech sector rose during the period and remained above its level from prior to the Swords of Iron War.

**Table 1 | National Accounts data available at the time of the interest rate decision**

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

Decision date		Jan 6, 2025	Feb 24, 2025	Apr 7, 2025	May 26, 2025	July 7, 2025
GDP	2024:Q3	3.8	4.0	5.0	5.8	5.7
	2024:Q4			2.0	2.1	2.0
	2025:Q1				3.4	3.7
Business sector product	2024:Q3	4.7	5.1	5.1	6.2	6.3
	2024:Q4			2.0	2.1	2.4
	2025:Q1				4.4	4.5
Private consumption	2024:Q3	8.4	8.2	8.7	8.7	13.3
	2024:Q4			9.6	9.6	4.2
	2025:Q1				-5.0	-4.7
Fixed capital formation	2024:Q3	23.3	25.4	29.1	28.2	32.8
	2024:Q4			11.8	10.1	8.0
	2025:Q1				8.7	6.1
Exports excluding diamonds and startups	2024:Q3	4.7	5.4	4.7	8.8	8.9
	2024:Q4			-1.0	1.6	2.3
	2025:Q1				6.2	9.8
Civilian imports excluding ships, aircraft, and diamonds	2024:Q3	26.1	26.3	26.2	26.2	26.1
	2024:Q4			13.2	13.2	11.7
	2025:Q1				2.5	3.6

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)

	2022	2023	2024	2023:Q4	2024:Q1	2024:Q2	2024:Q3	2024:Q4	2025:Q1
GDP	6.3	1.8	1.0	-20.9	16.0	0.1	5.7	2.0	3.7
Business sector product	7.4	0.9	-0.7	-33.2	25.0	-0.2	6.3	2.4	4.5
Civilian imports excluding ships, aircraft, and diamonds	12.9	-7.0	-1.9	-35.5	20.8	-2.5	26.1	11.7	3.6
Private consumption	7.6	-1.2	3.7	-28.0	24.9	11.3	13.3	4.2	-4.7
<i>of which</i> excl. durables	7.4	-0.4	3.2	-26.8	27.2	7.7	8.7	4.7	2.4
Public consumption	0.2	7.9	13.8	86.5	0.4	-2.1	-1.9	8.9	0.1
<i>of which</i> : excl. defense imports	1.0	7.2	11.4	95.6	-7.1	-10.7	5.7	13.5	-1.4
Gross domestic investment	11.3	-3.9	-9.8	-69.9	71.2	-26.0	54.6	-19.7	19.4
<i>of which</i> : fixed capital formation	10.6	-1.8	-6.4	-68.9	50.7	-1.2	32.8	8.0	6.1
Exports excl. diamonds	10.1	0.2	-4.6	-18.9	-9.2	-5.9	11.4	10.6	2.3
<i>of which</i> : excl. startups	10.3	0.0	-3.9	-23.5	-0.7	-2.7	8.9	2.3	9.8

SOURCE: Based on Central Bureau of Statistics.

## 2. The labor market

**During the reviewed half-year, the labor market remained tight, although there was some moderation of this tightness toward the end of the period.**

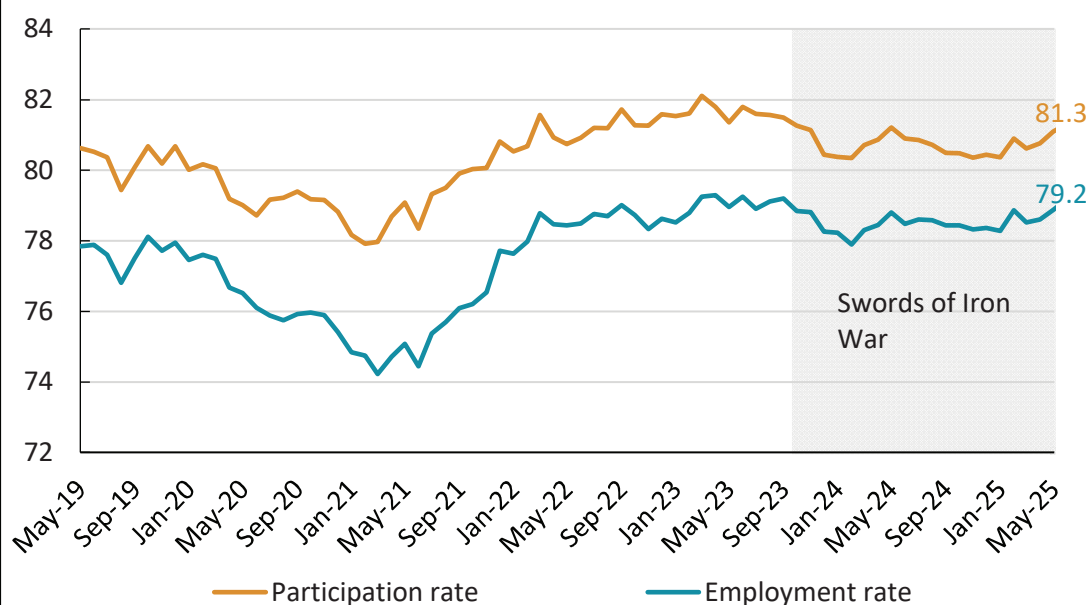
The ratio of job vacancies to unemployed persons remained high. The broad unemployment rate among those aged 25–64 remained stable at 2.9 percent (seasonally adjusted) at the end of this period.<sup>1</sup> The job vacancy rate stood at 4.4 percent and remained consistently higher over the past year than it was prior to the Swords of Iron War. The proportion of those temporarily absent due to reserve duty ranged between 0.2 and 0.5 percent throughout the period. At the end of May, the employment rate and the participation rate for ages 25–64 stood at 79.2 percent and 81.3 percent, respectively, slightly lower than their levels prior to the war (Figures 7 and 8).

Nominal wages over the last three months (March to May) were 4.5 percent higher on an annualized basis than in the third quarter of 2023, prior to the war. In recent months, wage growth in the business sector has accelerated, such that the annualized growth rate from 2023:Q3 to 2025:Q1 was 5.2 percent. Wages in the non-high-tech business sector increased even more sharply, at 5.6 percent, whereas the pace in the public sector was more moderate. Real wages per employee post across the economy held steady during the half-year, growing by 1.1 percent on an annualized basis over the same period.

Activity in the construction industry moderated in the first quarter of the year but remained at a high level, constrained by a significant shortage of skilled labor. In the hotels industry as well, labor constraints have been markedly more pronounced throughout the half-year—as reflected in the Business Tendency Survey—than they were prior to the Swords of Iron War - capital, and rose further during Operation Rising Lion (June survey) (Figure 9).

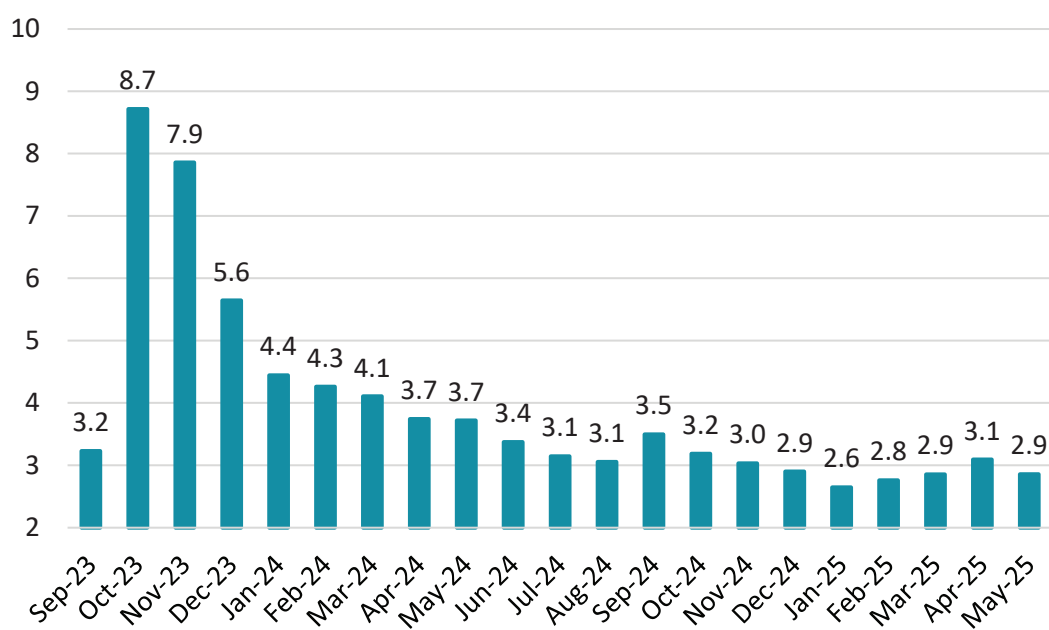
<sup>1</sup> “Broad unemployment” includes not only individuals officially classified as unemployed but also other nonemployed persons, such as those placed on unpaid leave, and individuals absent from work all week for economic reasons (as opposed to vacation, reserve duty, etc.).

**Figure 7 | Employment and Participation Rates, Ages 25–64,  
May 2019–May 2025 (seasonally adjusted, percent)**



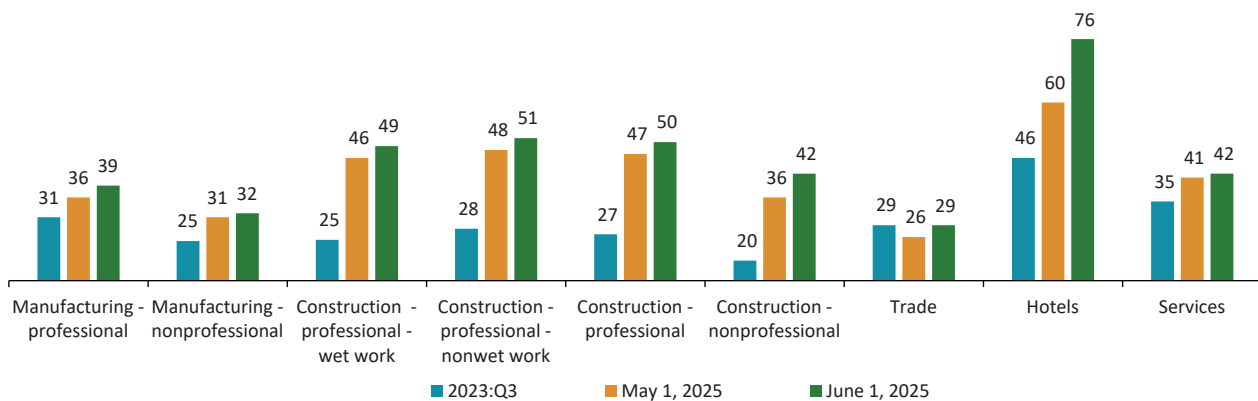
SOURCE: Based on Central Bureau of Statistics Labor Force Survey.

**Figure 8 | Broad Unemployment Rate, Ages 25–64,  
September 2023–May 2025 (seasonally adjusted, percent)**



SOURCE: Based on Central Bureau of Statistics data.

**Figure 9 | Rate of Companies Reporting Moderate or Serious Hiring Constraints, 2023:Q3 vs. May–June 2025**  
(selected industries, not seasonally adjusted, percent)



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

### 3. 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—primarily against the backdrop of the ongoing Swords of Iron War, Operation Rising Lion, and US tariff policy.

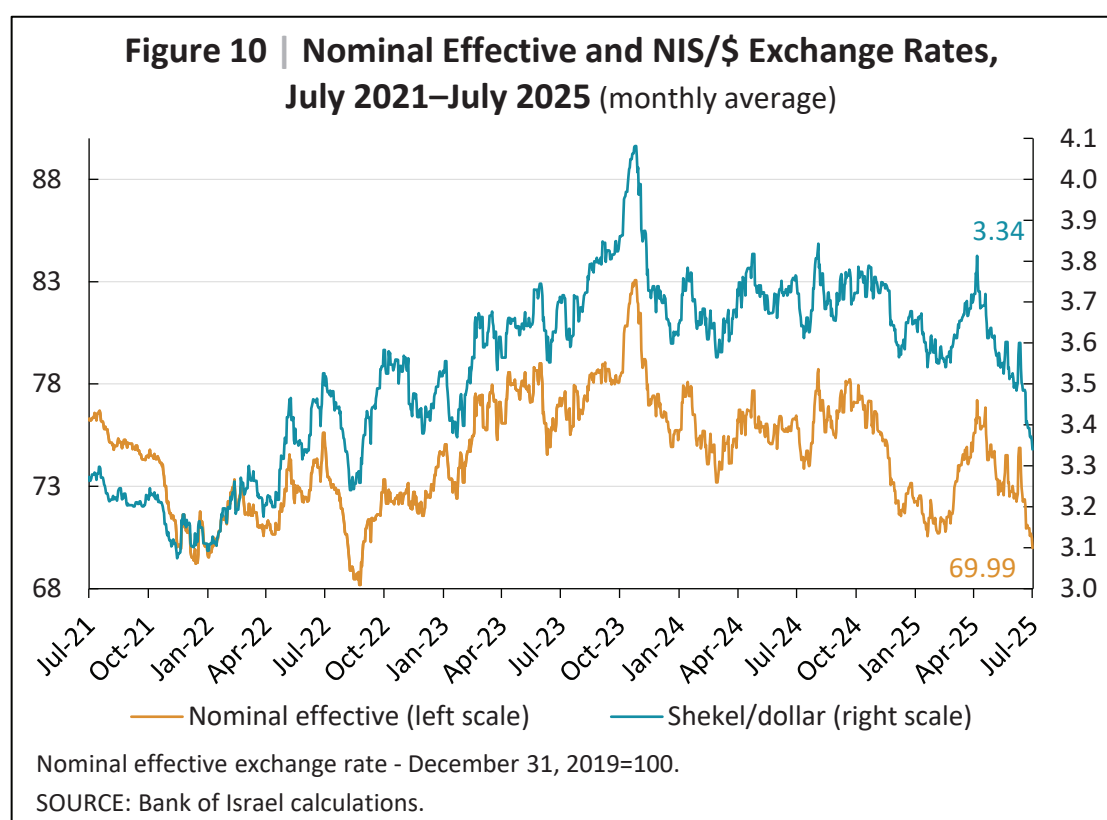
In the first quarter of 2025, Israel's risk premium remained relatively stable, following the steep decline in the fourth quarter of 2024. The 5-year CDS indices ranged between 80 and 100 basis points, and the spreads on 10-year dollar—denominated government bonds fluctuated between 1.1 and 1.3 percent. These levels were considerably higher than those recorded prior to the Swords of Iron War (about 55 basis points and 0.8 percent, respectively). During this period, the shekel weakened against the euro and several other currencies, while slightly strengthening against the US dollar. Meanwhile, domestic financial markets remained relatively stable.

In the second quarter of 2025, the risk premium was marked by substantial volatility, especially toward the end of the quarter. When the trade war broke out in mid-March, the risk premium began to climb, peaking in mid-April. The CDS rose to 120 basis points, and bond spreads reached 1.5 percent. A gradual decline set in thereafter, and by early June these indicators had returned to slightly below 100 basis points and 1.3 percent, respectively. However, in mid-June, at the beginning of Operation Rising Lion, the risk premium spiked again—the CDS climbed to 123 basis points and bond spreads rose to 1.5 percent.

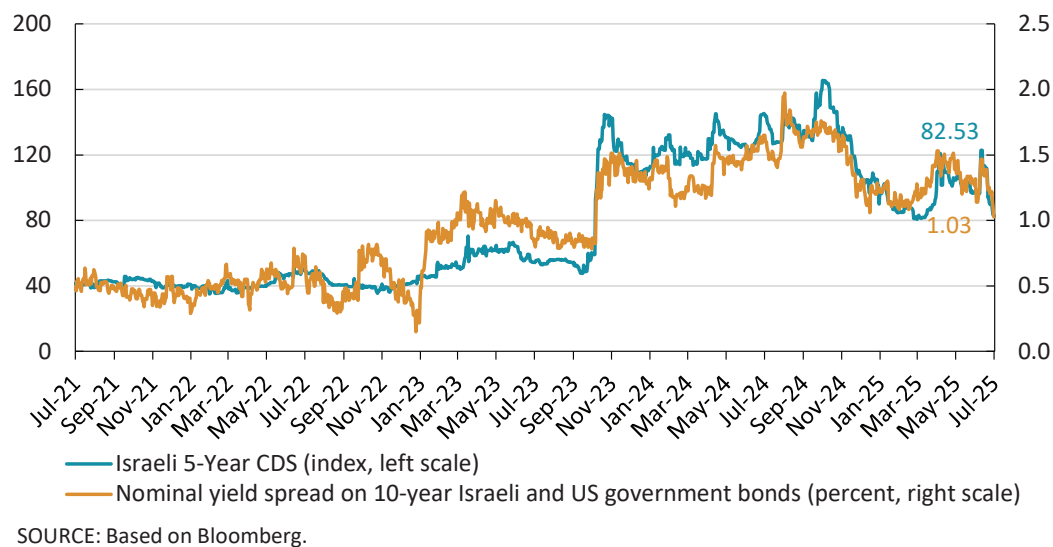
Once the operation concluded at the end of June, the risk premium declined markedly, with the CDS falling to around 80 basis points and bond spreads to about 1.0 percent. Simultaneously, financial markets responded with sharp increases in equity indices, a significant drop in shekel bond yields, and a rapid appreciation of the shekel. From the start of Operation Rising Lion (June 12, 2025), the shekel strengthened by about 6.6 percent against the dollar, 10-year shekel bond yields fell by approximately 0.5 percentage points, and equity indices rose by around 12.6 percent.

**Summarizing the first half of 2025**, Israel's risk premium remained elevated relative to before the Swords of Iron War, despite a gradual decrease from the peaks recorded in 2024 (when the CDS exceeded 160 basis points and bond spreads stood at 1.7 percent). The shekel appreciated by about 9 percent against the dollar, yields on shekel-denominated bonds declined by about 0.4 percentage points, and equity indices rose by approximately 27 percent (see Figures 10–11 and Table 3).

**Over the reviewed half-year**, business credit continued to expand in line with its prevailing trend, sustaining low delinquency rates across all areas of activity. Meanwhile, household credit also kept growing, led by housing credit, without any significant increase in delinquency rates. According to the Central Bureau of Statistics' June Business Tendency Survey, the proportion of businesses reporting severe credit constraints remained low. Spreads between corporate bonds and government bonds remained narrow, consistent with global market trends.



**Figure 11 | Israel's Risk Premium as Reflected in the Nominal Yield Spread on Israeli and American 10-Year Dollar-Denominated Government Bonds, and the 5-Year CDS, July 2021–July 2025 (daily figures)**



**Table 3 | Developments in the domestic asset markets**

	01/25	02/25	03/25	04/25	05/25	06/25
<b>Yield to maturity (monthly average, percent)</b>						
3-month MAKAM	4.3	4.3	4.3	4.3	4.3	4.4
1-year MAKAM	4.2	4.2	4.2	4.2	4.2	4.3
5-year unindexed bonds	4.3	4.2	4.2	4.2	4.2	4.3
10-year unindexed bonds	4.5	4.3	4.4	4.4	4.5	4.5
20-year unindexed bonds	4.8	4.7	4.8	4.8	4.8	4.8
1-year indexed bonds	2.1	2.1	2.2	2.4	2.3	2.3
5-year indexed bonds	2.0	1.9	2.0	2.2	2.2	2.3
10-year indexed bonds	2.0	2.0	2.1	2.2	2.3	2.3
Yield spread between government bonds and AA-rated corporate bonds (percentage points) <sup>a</sup>	1.0	1.0	1.0	1.1	1.0	0.9
<b>Equity market (rate of change during the month, percent)</b>						
General Shares Index	2.7	1.5	-4.3	4.7	6.3	10.6
Tel Aviv 35	2.2	0.9	-2.1	4.1	7.3	9.5
<b>Foreign exchange market (rate of change during the month, percent)</b>						
Dollar/Shekel	-1.9	0.4	3.6	-2.2	-3.3	-4.2
Euro/shekel	-2.3	0.7	7.7	2.9	-3.6	-0.9
Nominal effective exchange rate	-1.7	0.7	4.9	-0.1	-3.1	-3.0

<sup>a</sup> 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.



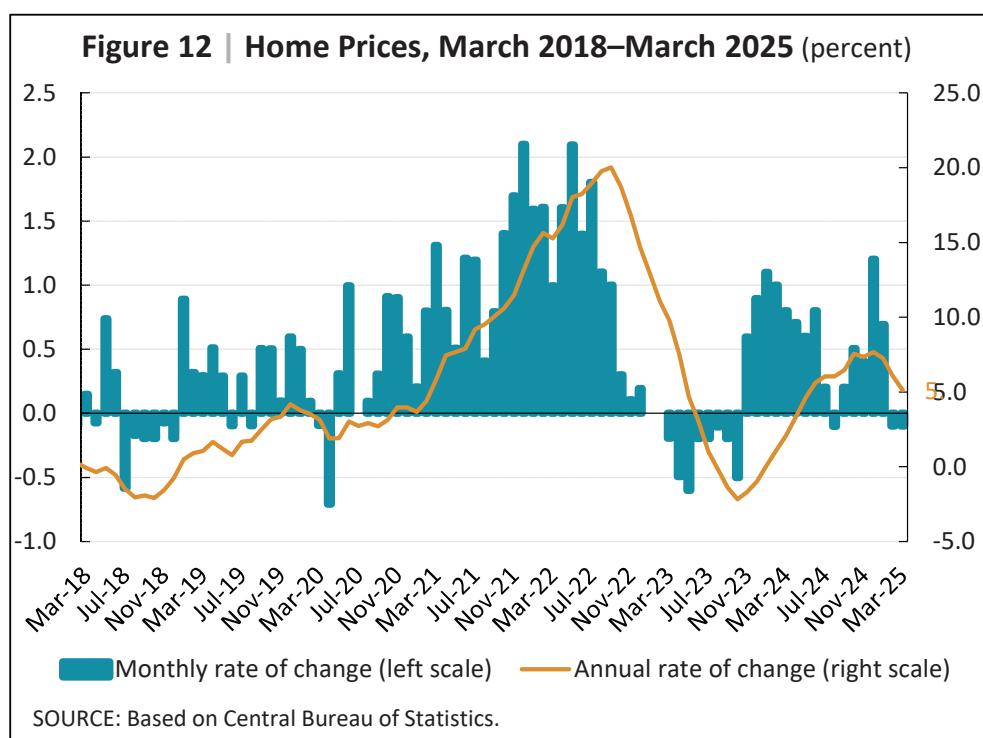
## 4. Fiscal policy

The cumulative government budget deficit over the past 12 months stood at 5.0 percent of GDP in June. Total tax receipts in June, net of legislative changes and one-off revenues, returned to their long-term trend in real terms, having been above that trend at the end of the previous half-year. The immediate budgetary cost of Operation Rising Lion is estimated at around 1 percent of GDP.

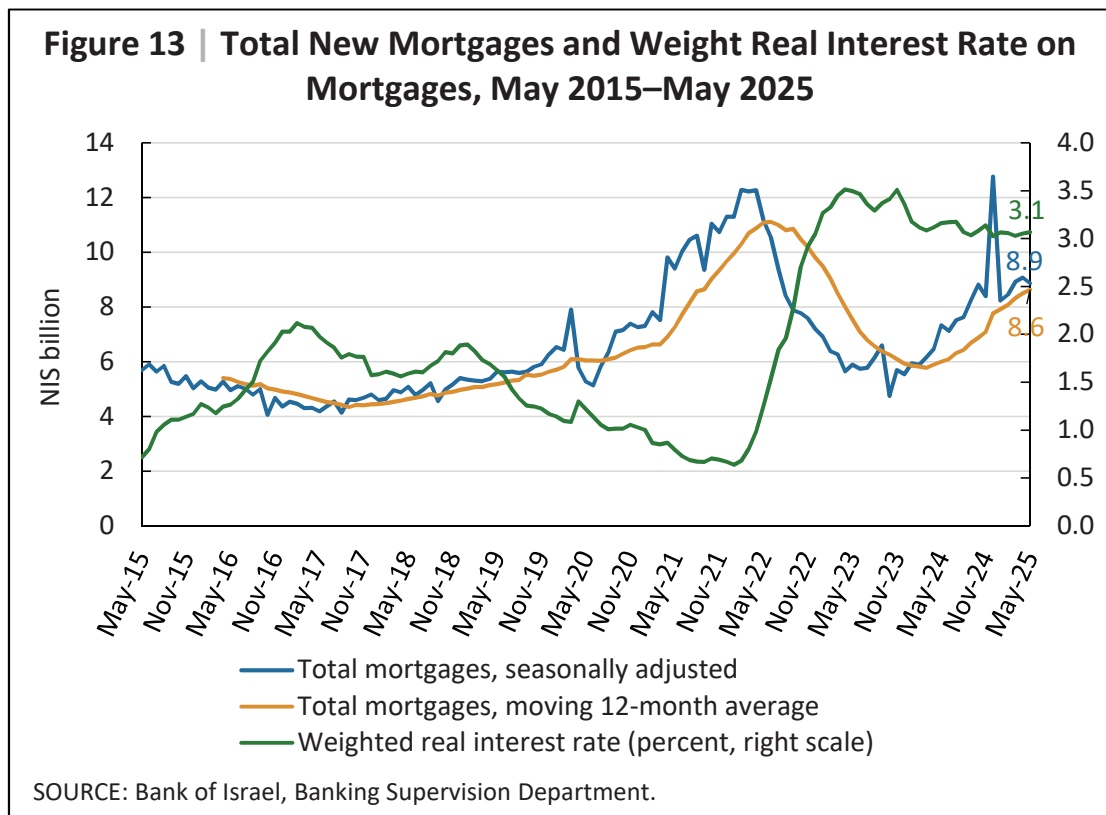
According to the Research Department's July 2025 staff forecast, the debt-to-GDP ratio is expected to rise from 68 percent in 2024 to 70 percent in 2025 and 71 percent in 2026. It is essential to set a policy path in the upcoming budget that will lead the debt ratio to converge to a downward trend in the coming two years.

## 5. The housing market

**Activity in the housing market slowed somewhat.** The number of residential transactions declined, while the inventory of unsold homes increased. Nevertheless, the pace of housing starts remained relatively high. The rate of home price increases moderated during the period, reaching 5.1 percent in annual terms (March–April data), compared with 7.7 percent in the December–January data (Figure 12). The annual increase in the housing component of the Consumer Price Index stood at 4.0 percent at the end of the half-year (May data), ranging between 3.9 and 4.4 percent during the period. The damage caused by the Iranian missile attacks, which impaired the supply of available housing units, may lead to an increase in demand for rentals, and as a result to an increase in rental prices in the affected areas.

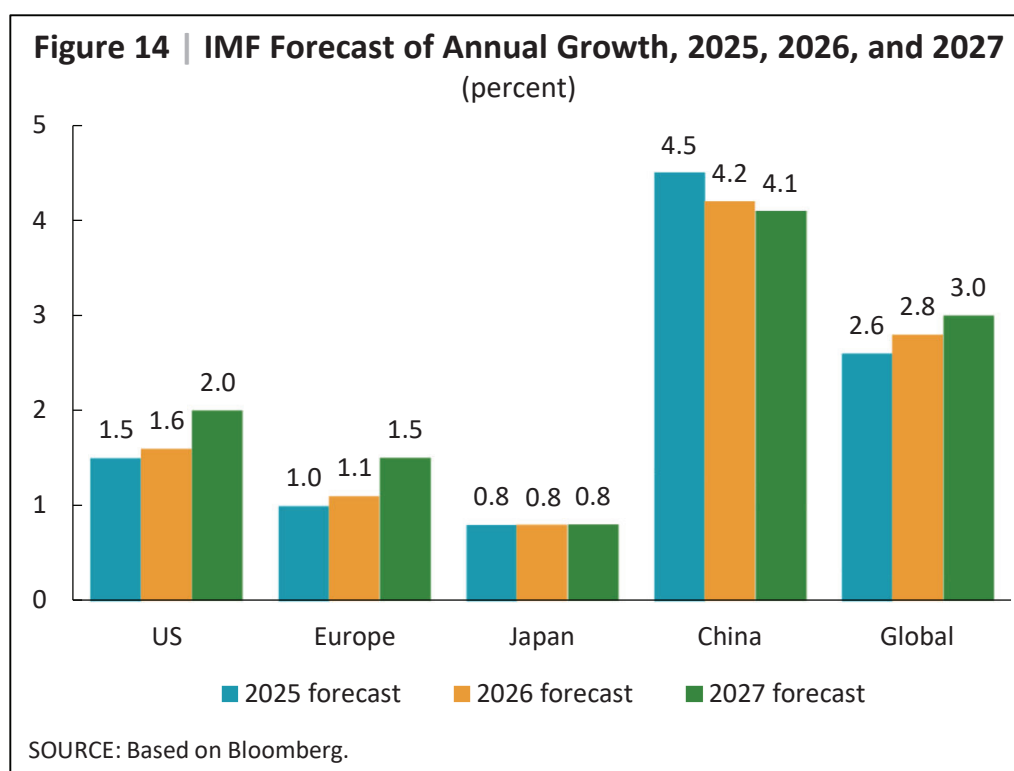


**Construction activity moderated somewhat in the first quarter of the year but remained at a high level.** Equipment and raw-material constraints in the construction industry are close to their prewar levels. The shortage of workers—primarily skilled professionals—remains significant. According to Central Bureau of Statistics data, compared with the same quarter of the previous year, housing starts rose by 6.5 percent, and building permits increased by 14.2 percent. However, housing completions fell by 8.8 percent, remaining below their level prior to the war. In the most recently published figure for May, mortgage loans totaled NIS 9.3 billion (Figure 13).



## 6. The global economy

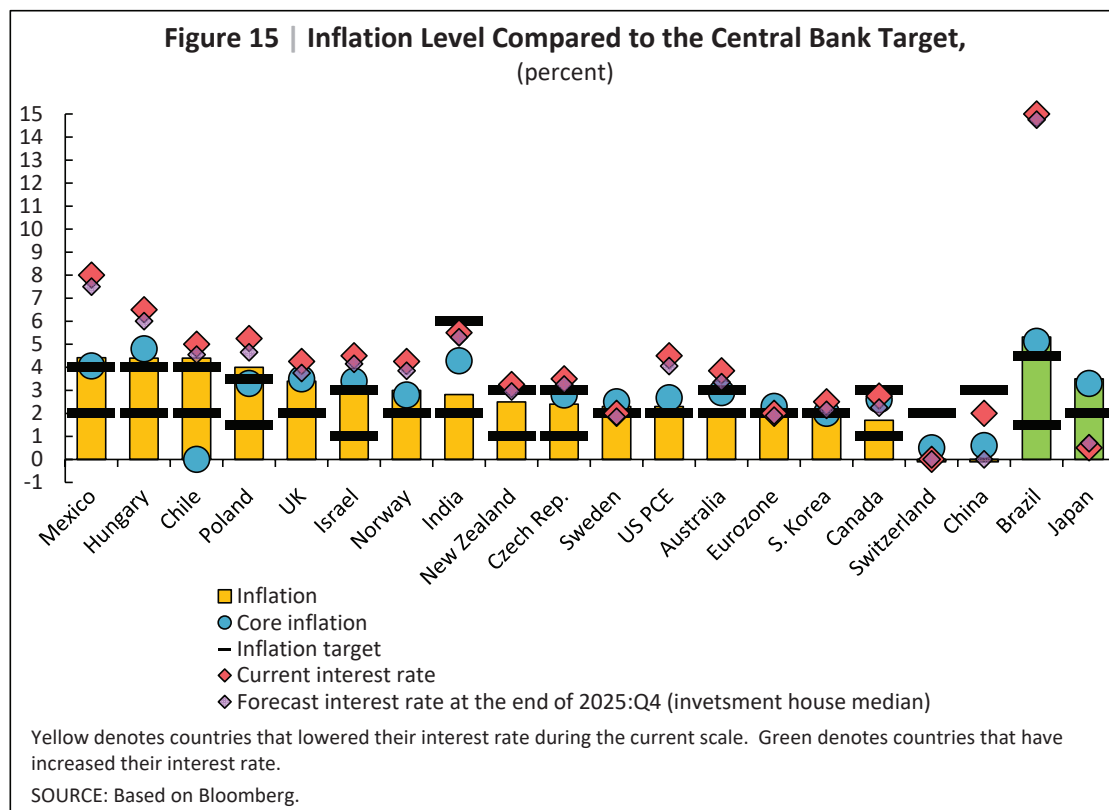
During the reviewed half-year, equity indices rose amid heightened global market volatility triggered by US tariff policy and its potential effects on trade, growth, and inflation worldwide. Global growth remained moderate in the first quarter of the year, and at the end of the half-year, the global growth forecast for 2025 stood at a relatively low rate of 2.6 percent (Figure 14). Over the course of the half-year, the dollar weakened against the major currencies. Economic activity data for the first quarter showed mixed trends. In contrast, the pace of expansion in world trade over the past year remained high, propelled by activity brought forward in anticipation of tariff measures. The global Purchasing Managers' Index was volatile during the half-year but generally pointed to moderate expansion. Oil prices were especially volatile, largely due to the conflict with Iran, but volatility subsided following the ceasefire.



**Global growth in the first quarter of the year remained moderate.** In the US, GDP contracted by 0.5 percent in annualized terms in the first quarter (revised from 0.3 percent), with private consumption expanding at just 0.5 percent—the lowest rate since COVID. However, labor market data for May–June still point to a tight labor market, albeit with some weakening in certain indicators, alongside a continued decline in the participation rate. In the eurozone, quarterly growth reached 0.6 percent in the first quarter (revised from 0.3 percent). In China, first-quarter growth was 5.4 percent in annualized terms. Growth forecasts anticipate a moderate global recovery over the next two years, although the level is expected to remain relatively low.

**Inflation data for the major economies during the reviewed half-year indicated ongoing convergence, albeit at varied speeds.** In the US, CPI inflation stood at 2.4 percent and core CPI was 2.8 percent (May reading). In a preliminary estimate for the eurozone in June, inflation rose slightly to 2 percent, while core inflation remained unchanged at 2.3 percent.

**While the Federal Reserve made no changes to its interest rate, the ECB reduced its interest rate at each meeting during the half-year, alongside rate reductions by other central banks.** The Fed left its rate unchanged during this period—following rate cuts totaling one percentage point in the previous half-year—and the market-implied rate path declined over the period. In addition, the US credit rating was downgraded by Moody's in May, due to the sharp rise in American debt and the high interest payments associated with it, as well as the administration's tariff policy (Figure 15).



## C. The Research Department's macroeconomic staff forecast

During the reviewed period, the Research Department released three official forecasts, coinciding with the interest rate announcements in January 2025, April 2025, and July 2025.

The July 2025 forecast was formulated under the assumption that the proposed ceasefire agreement in Gaza would prevent further intense hostilities there over the forecast horizon (beginning in July), and based on the assumption that the ceasefire with Iran would be maintained. The Department estimates that supply constraints in the economy will continue to ease during the forecast period, while demand for private consumption and investment will rise.

According to the July 2025 forecast, GDP is expected to grow by 3.3 percent in 2025 and 4.6 percent in 2026 (compared with 4.0 percent and 4.5 percent, respectively, in the January 2025 forecast). The broad unemployment rate among the prime working-age population (25–64) is projected to average 2.9 percent in 2025 and 3.3 percent in 2026 (compared with 3.1 percent in each year in the January 2025 forecast). Inflation is expected to be 2.6 percent in 2025 and 2.0 percent in 2026 (compared with 3.4 percent and 2.3 percent, respectively in the January 2025 forecast). The government budget deficit is projected to reach 4.9 percent of GDP in 2025 and decline to 4.2 percent in 2026 (compared with 4.7 percent and 3.2 percent, respectively, in the January 2025 forecast). The debt-to-GDP ratio is expected to be about 70 percent at the end of 2025 and about 71 percent in 2026 (compared with 69 and 67 percent in the January 2025 forecast) (Table 4).

The half-year forecasts were characterized by a high degree of uncertainty. In the July forecast, uncertainty was two-sided—risks could materialize in either direction—whereas in previous forecasts released during the period, most risks leaned primarily to the downside. In the July forecast, the main risks reflected geopolitical developments and their influence on the Gaza and Iran fronts. These developments will affect the pace of economic recovery, how inflation evolves, the budget deficit, and the debt-to-GDP ratio.

Looking ahead, two opposing forces are expected to influence inflation trends. On one hand, the strengthening of the shekel should help reduce inflation. On the other hand, the decline in the risk premium following the operation in Iran and increased likelihood of an agreement in Gaza could lead to an expansion of demand that is faster than the easing of labor market supply constraints. Such a scenario could add to inflationary pressures. At present, there is uncertainty regarding the intensity of these two opposing forces over different time horizons.

**Table 4 | Research Department forecasts**

(rates of change in percent, unless otherwise noted)

Forecast for the year	2024	2025			2026		
Forecast date	01/25	01/25	04/25	07/25	01/25	04/25	07/25
GDP	0.6	4.0	3.5	3.3	4.5	4.0	4.6
Private consumption	4.0	7.5	6.0	3.5	5.5	3.5	7.0
Fixed capital formation (excl. ships and aircraft)	-7.5	8.0	10.0	9.5	15.0	12.0	13.5
Public consumption (excl. defense imports)	12.0	-1.5	-0.5	1.5	2.0	-2.5	-1.0
Exports (excl. diamonds and startups)	-5.0	4.5	2.5	4.0	5.5	2.5	3.0
Civilian imports (excl. diamonds, ships, and aircraft)	-2.0	12.0	12.5	8.0	13.0	7.5	8.0
Unemployment rate - annual average (ages 25–64)	3.5	3.1	2.9	2.9	3.1	3.2	3.3
Government deficit (percent of GDP)	7.0	4.7	4.2	4.9	3.2	2.9	4.2
Debt to GDP ratio	67.0	69.0	69.0	70.0	67.0	68.0	71.0
Inflation <sup>a</sup>	3.4	2.6	2.6	2.6	2.3	2.2	2.0
Forecast date		01/25	04/25	07/25			
Inflation in the coming year <sup>b</sup>		2.6	2.5	2.2			
Interest rate in one year <sup>c</sup>		4.0/4.25	4.0	3.75			

<sup>a</sup> 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.

<sup>b</sup> In the four quarters ending in the same quarter in the following year.

<sup>c</sup> In the same quarter in the following year.

SOURCE: Bank of Israel.