

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

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**Research Department Staff Forecast, April 2024**

**Abstract**

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in April 2024[[1]](#footnote-1) concerning the main macroeconomic variables—GDP, inflation, and the interest rate. Similar to the January forecast, this forecast was formulated under the assumption that the Swords of Iron War’s direct impact on the economy reached its peak in the fourth quarter of 2023, and that it will continue until the end of 2024 with decreasing intensity. For 2025, the forecast assumes that the war will have no additional significant direct impact. In addition, we assume that for the most part, the war will continue to be restricted to Gaza. The forecast naturally features a particularly high level of uncertainty, partly with regard to the duration and nature of the war in Gaza, its implications following its conclusion, and the potential worsening of the situation on the northern front and in other areas.

According to the forecast, GDP is expected to grow by 2 percent in 2024 and by 5 percent in 2025—the same as in our assessment in the January forecast. The inflation rate in the coming four quarters (ending in the first quarter of 2025) 2024 is expected to be 2.8 percent. Inflation in 2024 is expected to be 2.7 percent (compared with 2.4 percent in the January forecast), and in 2025 it is expected to be 2.3 percent (compared with 2.0 percent in the January forecast). The interest rate in the first quarter of 2025 is expected to be 3.75 percent.

**The forecast**

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

In order to formulate estimates of the economic impact of the war, special emphasis was placed on an analysis of real-time data that show the scope of the impact and the pace of recovery of the output of various industries and uses, as well as on an analysis of past confrontations. In addition to the use of the DSGE model, we used industry-level assessments of the volume of the supply-side impact derived partly from the lack of workers during the war period and the security restrictions on activity. On the demand side, data obtained so far were analyzed in order to assess the impact on the various uses, and in order to assess the pace of their recovery so far. The results were integrated into a full forecast of the sources and uses, which contributed to the formulation of the forecast presented herein.

1. **The global environment**

Our assessments of expected developments in the global economy are based mainly on projections by international financial institutions and foreign investment houses. The main assumptions regarding the global environment remained similar to those used in the January forecast. Accordingly, we assume that growth in the advanced economies will be 1 percent in 2024 (compared with 0.8 percent in the January forecast), and 1.4 percent in 2025 (compared with 1.5 percent in the January forecast). Our assumption is that world trade will grow by 3.1 percent in 2024 compared with 3.5 percent in the January forecast), and by 3.4 percent in 2025 (compared with 3.0 percent in the January forecast). The inflation forecasts for the advanced economies for 2024 were revised to 2.4 percent (compared with 2.3 percent in the January forecast), and the forecast for 2025 is 2.2 percent (similar to the January forecast). Investment houses’ forecasts of the average interest rate in the advanced economies were lowered slightly, to 3.8 percent at the end of 2024 (compared to 3.9 percent in the January forecast) and 3.0 percent at the end of 2025 (compared to 3.1 percent in the January forecast). The price of Brent crude oil rose to $90 per barrel, compared with around $78 at the time of the January forecast.

1. **Real activity in Israel**

GDP is expected to grow by 2 percent in each of 2023 and 2024 and by 5 percent in 2025 (Table 1).

The forecast in Table 1 is based on the assumption that the war’s direct impact on the economy reached its peak in the fourth quarter of 2023, and that its intensity will decline gradually in 2024. In 2025, a recovery is expected, which will bring the GDP closer to the trend that it showed prior to the COVID-19 crisis (Table 1). The growth forecast remained unchanged because most of the developments since the publication of the January forecast were in line with our assumptions, and the deviation of those that were not in line with our assumptions were in differing directions. According to credit card purchases, it seems that private consumption is recovering faster than expected, while there is a delay in finding a solution to the shortage of non-Israeli workers, as well as in the return of northern residents to their homes.

The expected effect on GDP in 2024 is due to the negative impacts on both the supply side and the demand side. On the supply side, the broad emergency mobilization of the reserves was reflected in a decline in the supply of labor in all industries, but that supply is recovering following a significant decline in the volume of reserve soldiers relative to the beginning of the war. There is a particularly significant impact to the supply of labor in the construction industry due to restrictions on the entry of Palestinian laborers from Judea and Samaria and the complete cessation of employment of workers from Gaza. In this forecast, we assume that the construction industry will manage to operate better than expected despite the shortage of workers. However, there is a marked impact to investment, derived mostly from the expected extension of partial activity at construction sites, and it seems that the time it will take to solve the shortage of workers will take longer. In addition to the decline in the supply of labor, production capacity in the combat areas and in threatened regions has been impaired due to the impact to physical capital and the ability to work. The impact in the southern region is currently declining in view of the return of residents, while the evacuation of residents in the north is expected to continue for longer than our assessment in the January forecast.

On the demand side, our assessment is that negative consumer sentiment is expected to continue to have an impact on consumer demand. Demand for the export of tourism services (incoming tourism) has suffered significantly, and experience from previous confrontations shows that this impact is expected to be prolonged. In contrast, in the construction industry, an increase in demand is expected within the forecast period, partly due to the need to rehabilitate structures. In view of these developments, our assessment is that the broad unemployment rate[[3]](#footnote-3) among the prime working ages, which declined in the first quarter of 2024, will continue to decline gradually in 2024, and will converge to its prewar level in 2025.

**The government budget deficit is expected to be 6.6 percent of GDP in 2024 and 4.6 percent of GDP in 2025. Government debt is expected to rise to 67 percent of GDP in 2024, and to remain at a similar level in 2025.** The revised state budget for 2024 was passed by the Knesset in March 2024. Relative to the original budget, it includes an increase of NIS 70 billion in expenditures, of which NIS 55 billion is for defense expenditures[[4]](#footnote-4) and NIS 15 billion is for civilian expenditures related to the war. Beyond that, the government is expected to pay compensation totaling NIS 18 billion (0.9 percent of GDP) from the State Compensation Fund, which is not recorded as an expenditure in the budget but requires government financing.[[5]](#footnote-5) The budget revision also included a change in the composition of other expenditures due to the unexpected price increases that took place prior to the war and a temporary increase of about NIS 5 billion in revenues.[[6]](#footnote-6)

The fiscal measures legislated by the Knesset thus far with regard to 2025 include a permanent increase of NIS 8 billion in revenue, mainly due to raising the VAT rate from 17 percent to 18 percent. The deficit forecast does not take additional revenue measures decided upon by the government into account. These measures total about NIS 3 billion per year, and have not yet been legislated by the Knesset. Public expenditures are expected to be about NIS 48 billion higher in 2025 (NIS 25 billion permanent) than forecast prior to the war. This is in view of working assumptions regarding the spread of the war’s temporary cost to the 2025 budget as well, due to the rehabilitation of military supplies, the existing budgetary agreement regarding an increase in the defense budget base by about NIS 10 billion from 2025 onward relative to the multiyear plan that existed prior to the war, and an expected increase in interest payments, rehabilitation expenses in the confrontation zones, and an increase in social service expenditures for victims of the war. If the government decides on such increments, they will require further offsetting budgetary adjustments to restrain the growth of the deficit in the state budget.

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| **Table 1****Research Department Staff Forecast for 2023–2025**(rates of change, percenta, unless stated otherwise) |
|  | 2023Actual | Forecast for 2024 | Change from the January forecast | Forecast for 2025 | Change from the January forecast |
| **GDP** | **2.0** | **2.0** | **-** | **5.0** | **-** |
| Private consumption | -0.8 | 4.5 | 1.5 | 5.5 | -0.5 |
| Fixed capital formation (excl. ships and aircraft) | -3.1 | -3.5 | -0.5 | 10.5 | 4.0 |
| Public consumption (excl. defense imports) | 7.2 | 4.5 | -2.0 | -2.0 | -2.5 |
| Exports (excl. diamonds and startups) | 0.3 | -1.0 | -1.5 | 4.0 | -1.0 |
| Civilian imports (excl. diamonds, ships, and aircraft) | -7.2 | -4.0 | - | 8.0 | -1.5 |
| Broad unemployment rate (average for the year, ages 25–64)b | 4.4 | 3.7 | -1.6 | 3.3 | 0.1 |
| Adjusted employment rate (average for the year, ages 25–64)b | 77.8 | 77.3 | 0.6 | 78.2 | -0.5 |
| Government deficit (percent of GDP) | 4.1 | 6.6 | 0.9 | 4.6 | 0.8 |
| Debt to GDP ratio (percent) | 62 | 67 | 1 | 67 | 1 |
| Inflation (percent)c | 3.3 | 2.7 | 0.3 | 2.3 | 0.3 |
| a In the forecast of National Accounts components, the rate of change is rounded to the nearest half percentage point.b According to the Central Bureau of Statistics definition, the broad unemployment rate includes the unemployed under the normal definition (someone who has not worked, wanted to work, was available to work, and searched for work), as well as employees who were temporarily absent from their jobs for economic reasons (including furloughed workers). Accordingly, the adjusted employment rate does not include those temporarily absent from their jobs for economic reasons.c The average of the Consumer Price Index in the last quarter of the year compared with the average in the last quarter of the previous year. |

1. **Inflation and interest rates**

According to our assessment, **inflation in the coming four quarters (ending in the first quarter of 2025) is expected to be 2.8 percent.** Inflation in 2024 is expected to be 2.7 percent (compared with 2.4 percent in the January forecast), and inflation 2025 is expected to be 2.3 percent, (compared with 2.0 percent in the January forecast) (Table 2). The moderation of inflation within the forecast range, compared to 2023, reflects a trend that began even before the war, influenced by developments abroad and domestic monetary policy. It is also affected by the war’s impact on consumer sentiment and demand for consumption. Relative to the January forecast, the increase in the inflation path in 2024–2025 is mostly due to expected changes in taxation. The taxation changes in 2024 include an increase in tax on cigarettes and the cancellation of the subsidy on fuel excise, which already took place at the beginning of the year. The expected increase in inflation in 2025 is mostly due to the expected increase in VAT from 17 percent to 18 percent, in accordance with Knesset legislation.

**The interest rate is expected to be 3.75 percent in the first quarter of 2025** (Table 2). The interest rate path during the forecast period is intended to maintain price stability while helping to stabilize the financial markets and support domestic demand.

Table 2 shows that the Research Department’s staff forecast regarding inflation is similar to that of the professional forecasters, and slightly lower than the market’s expectations. The Research Department’s forecast regarding the interest rate is similar to the market’s expectations and slightly higher than the forecasters’ projections.

| **Table 2** |
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| **Inflation forecast for the coming year and interest rate forecast for one year from now** |
| (percent) |
|  | Bank of Israel Research Department | Capital marketsa | Private forecastersb |
| Inflation ratec | 2.8 | 3.0 | 2.8 (2.3–3.2) |
| (range of forecasts) |  |  |  |
| Interest rated | 3.75 | 3.8 | 3.6 |
| (range of forecasts) |  |  | (3.30–4.00) |
| a) Inflation expectations are seasonally adjusted (as of April 7, 2024).b) The average of forecasts published following the publication of the Consumer Price Index for February 2024.c) Research Department: the inflation rate during the four quarters ending in the first quarter of 2025.  |
| d) Research Department: the average interest rate in the first quarter of 2025. Expectations derived from the capital market are based on the Telbor market (as of April 7, 2024).SOURCE: Bank of Israel. |

1. **Main risks to the forecast**

The forecast is based on the assumption that the main part of the war will be on one front against the terrorist organizations in Gaza, and that its effects will continue during 2024 with declining intensity. Various developments that may affect the duration and severity of the war may, of course, have a material impact on economic developments. In particular, an expansion of the war on the northern front is expected to have a material negative macroeconomic impact. Such an expansion will be accompanied by an additional impact to growth, and for some time it may be accompanied by interruptions in the ability to conduct routine economic activity. These will have an impact on the markets and on inflation, as well as on the government deficit and debt, among other things. Another risk, with regard to the 2024 deficit, is due to uncertainty surrounding the assistance from the US during the year, in view of the expected defense procurements. In view of these risks, our assessment is that the balance of risks relating to the growth forecasts tends downward, while in relation to the inflation and deficit forecasts, it tends upward.

1. The forecast was presented to the Bank of Israel Monetary Committee on April 7, 2024, prior to the decision on the interest rate made on April 8, 2024. [↑](#footnote-ref-1)
2. An explanation of the macroeconomic forecasts formulated by the bank of Israel Research Department, as well as a review of the models on which they are based, appear in the Bank of Israel’s Inflation Report 31 (second quarter of 2010), Section 3c. A Discussion Paper on the DSGE model is available on the Bank of Israel website, under the title: “MOISE: A DSGE Model for the Israeli Economy,” Discussion Paper No. 2012.06. [↑](#footnote-ref-2)
3. In addition to the unemployed, the broad unemployment rate includes those temporarily absent from their jobs for economic reasons (including furloughed employees). It does not include employees who were absent due to military service. [↑](#footnote-ref-3)
4. The budget for the defense establishment was based on the assumption that American aid of $8.7 billion (about 1.6 percent of GDP) would be transferred to Israel in whole during 2024. This aid has not yet been approved in the US. Insofar as the defense establishment relies on financing from this grant to make purchases and the grant is not forthcoming, it will increase the deficit. [↑](#footnote-ref-4)
5. Compensation in respect of direct and indirect damages to civilians are not considered expenditures in the State Budget, but rather as extra-budgetary expenditures based on the Property Tax and Compensation Fund Law, 5721–1961.  Because this compensation is unfunded, its costs do not increase the budgetary deficit. However, the government is required to finance it by raising debt or by reducing government cash balances with the banks. The budget deficit is affected through the revenue side when deducting some purchase tax receipts to the Fund. In order to finance the Fund’s expenses beyond the balance in the fund prior to the war, the government decided to increase the deduction to the Fund, which is expected to total NIS 5 billion in 2024 and NIS 7 billion in 2025. These amounts are factored into the current deficit forecast. [↑](#footnote-ref-5)
6. The largest of these revenues include the withdrawal of dividends from government corporations and temporary taxation of convalescent days from workers and of the banking system. [↑](#footnote-ref-6)