



BANK OF ISRAEL
Office of the Spokesperson and Economic Information

January 19, 2026

Press release:
Monetary Policy Report
Second Half of 2025

Abstract

Monetary policy: The Monetary Committee kept the interest rate unchanged at 4.5 percent in its July, August, and September 2025 decisions. In the November 2025 and January 2026 decisions, the Committee reduced the interest rate by 0.25 percentage points in each of the decisions, so that the interest rate ended the reviewed period at 4 percent.

The inflation environment: In the first part of the period reviewed, the inflation rate was above the target range, one-year inflation expectations from most sources were in the upper portion of the target range, and the economy was characterized by supply constraints. In contrast, in the second part of the half year, actual inflation entered the target range, one-year inflation expectations from all sources were mostly around the midpoint of the target range and the shekel appreciated markedly. Alongside that, throughout the entire half-year, longer term expectations hovered around the midpoint of the inflation target range. At the end of the second half of 2025, the annual inflation rate was 2.4 percent, within the target range (based on the November CPI), compared to the 3.1 percent at the end of the previous half year (on the basis of the May CPI). The Committee assesses that several risks to a renewed increase in the inflation rate remain: geopolitical developments and their impact on economic activity, an increase in demand alongside supply constraints, and fiscal developments.

Real activity in Israel and the labor market: Economic activity recovered sharply during the third quarter, after contracting in the second quarter, in view of Operation Rising Lion against Iran. The third-quarter growth rate for 2025 in annual terms—11 percent—reflects growth in all GDP components, following a contraction of 4.8 percent in annual terms in the second quarter. In the third quarter there was an increase in uses, which was met by, among other things, a sharp increase in imports—a figure that indicates that over the half-year, supply constraints in the domestic market continued to weigh on the activity level. The gap between the long term trend and the level of GDP in actuality decreased to 3.3 percent, a decline compared to the gap in the two previous half years, which was 4 percent. A considerable part of the GDP gap from its trend is explained by supply constraints that derive mainly from the shortage of workers due to a shortage in non-Israeli workers and the absence of employees due to military reserves service. The labor market remained tight during the half-year and was characterized by a low unemployment rate and a rapid increase in business-sector wages. With that, in the most recent data, there was some easing in the

supply constraints, which was reflected in an increase in the participation and employment rates, a decline in the share of those absent from work due to military reserves service, and a decline in the growth rate of business sector wages.

The exchange rate, the risk premium, and the financial markets: During the half year reviewed, financial market trading remained volatile, influenced by global and domestic uncertainty. The shekel appreciated by approximately 6 percent against the dollar, following a similar growth rate in the first half of 2025 as well. Israel's risk premium—as measured by CDSs and dollar government bond spreads—declined markedly after Operation Rising Lion in June, and continued to decline during the period reviewed mainly after the declaration of a ceasefire in Gaza—at the end of the half-year reviewed the premium was only slightly higher than its level just before the war. Domestic equity indices were notably good compared to the world overall. Credit to the business sector continued to expand in the reviewed period by a high rate. The rates of arrears in all activity segments remained at a low level, the banking system maintained high capital ratios, and the insurance companies maintained high economic solvency ratios.

Fiscal policy: The cumulative deficit in the state budget over the past 12 months declined during the reviewed period, and totaled 4.7 percent of GDP in December, compared to 5 percent of GDP in June. According to the Research Department's January 2026 forecast, the debt to GDP ratio increased from 68 percent in 2024 to 68.5 percent in 2025, and is expected to remain at the same level in 2026. At the end of the half year, the government approved the 2026 budget proposal with a deficit ceiling of 3.9 percent, a level that is higher than the deficit planned previously and higher than one in line with a declining path of the debt to GDP ratio.

The housing market: The housing market slowed in 2025. This is reflected in the low level of transactions compared to previous years and a high level of stock of unsold homes held by developers. This is alongside a decline in home prices in all months of the half-year reviewed. The annual growth rate of the owner-occupied housing services component (rents in new and renewing leases) in the CPI moderated to 2.6 percent by the end of the half year (November data), compared to 3.6 percent at the beginning of the period reviewed (May data). Alongside that, the level of activity in the construction industry is high. Over the four quarters ending in the third quarter there was an increase of approximately 31 percent in building starts relative to the preceding four quarters, while building completions increased by 4.3 percent relative to the same period. In addition, property purchases by developers in Israel Land Authority tenders remained at a high level in 2025.

The global economy: During the reviewed period, economic activity worldwide expanded at a moderate pace. This was similar to the global growth rate in the preceding half year. With that, the 2025 global growth rate, which at the end of the previous half year was relatively low at 2.6 percent—in view of US tariff policy and its potential impact on world trade, growth, and inflation—was revised upward to around 3 percent, a level similar to that forecast for 2026 and 2027. In most countries, the inflation rate continued to moderate slowly mainly due to the decline of energy prices and the relative calm in the trade war. The US inflation rate (CPI) was 2.7 percent in November, and inflation was 2.1 percent in the eurozone. The Fed reduced its interest rate by 0.75 percentage points during the half year, while the ECB kept the interest rate unchanged in the half year reviewed, after the previous half when it reduced the interest rate in each one of its decisions.

The Research Department forecast: According to the Research Department forecast in January 2026, GDP grew by 2.8 percent in 2025, compared to an assessment of 3.3 percent in the July

2025 forecast. In the baseline scenario of the January 2026 forecast, GDP is expected to grow by 5.2 percent in 2026, about half a percentage point higher than the September and July forecasts (which were similar). The Department assessed that in 2027 GDP will grow by 4.3 percent, so that at the end of the year the GDP gap with the long term trend is expected to contract to around 1 percent. According to the January 2026 forecast, the year over year inflation rate at the end of 2025 will be 2.5 percent, compared to 3 percent in the September forecast and 2.6 percent in the July forecast. The inflation rate in 2026 is expected to be 1.7 percent, compared to 2.2 percent in the September forecast, and 2 percent in the July forecast. In 2027, it is expected to be 2 percent. The debt to GDP ratio was estimated to be 68.5 percent at the end of 2025, and is expected to stay at a similar level in 2026 and 2027. The Department assessed that at the end of 2026 the interest rate will be 3.5 percent.