BANK OF ISRAEL

64 | Monetary Policy Report

Second Half of 2025

Jerusalem, January 2026

Table of Contents

Monetary Policy Report
Second Half of 2025

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 July 2025 (published on August 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 second 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 January 5, 2026, including the CPI for November 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. At the beginning of the half-year reviewed, there were 6 Monetary Committee members. Beginning with the November decision, the Committee had 4 members—one from among the public instead of the regular 3.

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 point 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 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 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 a high solvency position.

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.

A. Policy measures

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 at the end of the reviewed period the interest rate was 4 percent (Figure 1). All the interest rate decisions during the half year were unanimous.

In the first part of the half year, the Committee kept the interest rate in place against the background of the global and domestic geopolitical un-certainty the continued supply constraints, and in view of inflation that was still above the upper bound of the target range. In this period, the Committee's policy continued to focus on stabilizing the markets and strengthening the convergence of the inflation rate to its target, through supporting economic activity.

In the second part of the half year, following the ceasefire agreement and after there was some moderation in the inflation environment as seen in actual inflation, inflation expectations, as well as the exchange rate and the risk premium, the Committee reduced the interest rate in its November 2025 and January 2026 decisions. The Committee emphasized that the interest rate path will be determined in accordance with the development of inflation, economic activity, the geopolitical uncertainty, and fiscal developments.

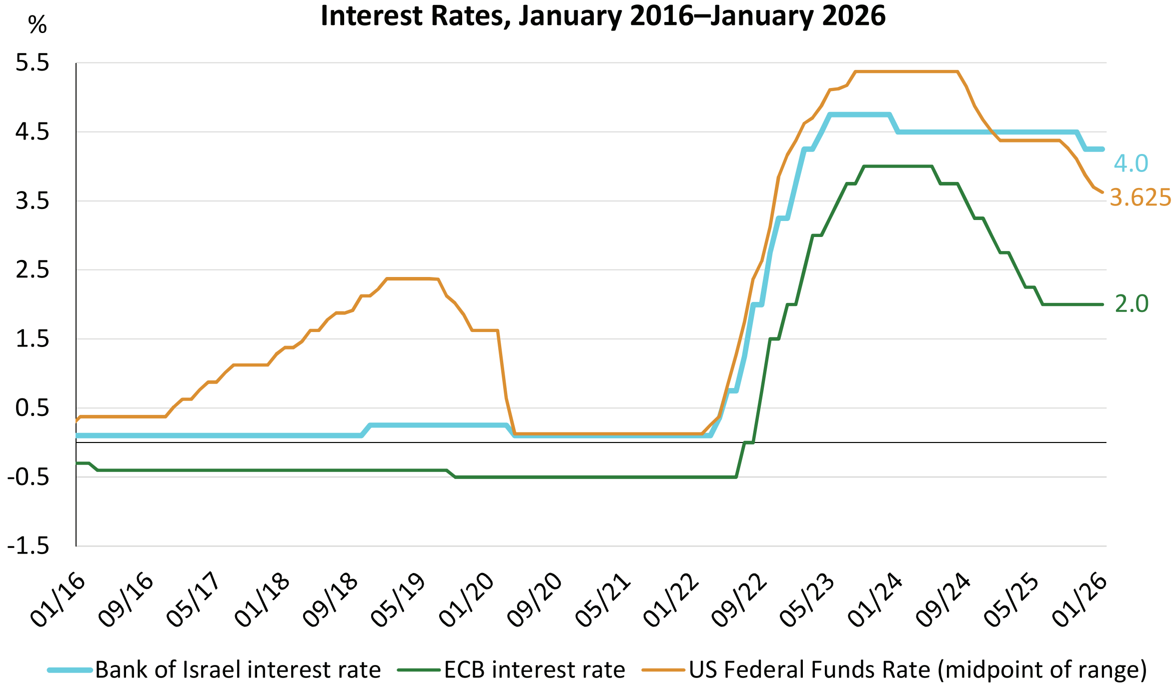
An important factor that impacted on the economic environment in Israel during the reviewed period was the geopolitical situation and the changes in it. Economic history—worldwide and in Israel—shows that wars, certainly intense and prolonged wars, tend to lead to inflation and even hyper-inflation, alongside a severe adverse impact on GDP. Wars' economic impacts on inflation and growth are determined according to the balance among several forces. Uncertainty and an increase in precautionary savings tend to moderate private demand for consumption and investments. In contrast, during times of war government demand expands due to the increase in defense expenditures and civilian expenditures related to the war. In parallel, an adverse impact on supply, due to the contraction of activity in parts of the economy where activity is disrupted by a decrease in availability of workers and inputs, the interruption of supply chains, and an increase in operating expenses, exerts inflationary pressures and adversely impacts GDP. When supply constraints are noted and prolonged, and particularly when in parallel there is fiscal expansion, the overall effect tends to be inflationary.

Accordingly, the Monetary Committee examined the dynamics and alignment between supply and demand, in order to place the policy in line with the changing economic conditions. In Israel, during the war, demand remained strong, as reflected in, for example, data on credit card expenditures and government expenditures. In parallel, GDP was adversely impacted by supply constraints, chief among them a marked shortage in workers, mainly due to military reserves call ups and a decline in non-Israeli workers. The labor market remained tight throughout the period, with numerous job vacancies, a historically low unemployment rate, and notable wage increases in the business sector.

The tight labor market, together with the strong level of demand, indicate that the main constraint on economic activity was from the supply side. In such circumstances reducing the interest rate was liable to be reflected in price pressures with only a limited impact on real growth. Against this background, and in view of the high uncertainty, the Committee assessed that monetary easing would contribute only a little to short term activity, but in contrast would be liable to shift inflation upward—just after it had begun to converge toward the target. Such a scenario was liable to undermine the anchoring of inflation expectations and increase the risk of additional wage and price increases.

Looking back, the interest rate level throughout the half year was not accompanied by weakening of the tight labor market. Unemployment remained low, the job vacancy rate remained high, and the pace of wage increases did not moderate markedly. Alongside that, maintaining the interest rate level created the conditions for the convergence of inflation to its target, so that at the end of the half year reviewed the inflation rate was 2.4 percent, compared with 3.1 percent at the end of the previous half year.

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



SOURCE: Bank of Israel.

The developments and data that accumulated in the second part of the half year, after the ceasefire, led to the conditions being in place for an interest rate reduction. The geopolitical uncertainty declined, the supply constraints eased, and the inflation environment moderated notably, among other things impacted by the strengthening of the shekel—which strengthened in the second half of 2025 against the dollar by approximately 6 percent, and by about 12 percent throughout 2025.

Israel's risk premium declined and stabilized at a level close to what it was just before the war. In the most recent data, ahead of the January 2026 decision, there was an indication of an easing in supply constraints in the labor market—an increase in the participation and employment rates, a decline in the share of those absent due to military reserves service, and moderation in the pace of the wage increase in the business sector. Alongside these, the inflation rate moderated in the second part of the half year, to a level of 2.4 percent in November. This moderation was broad and seen both in tradable and in nontradable components, including the housing item, and was also reflected in the paces seen in the most recent data, for the past 3 months and the past 6 months data.

B. Background conditions from the Monetary Committee's perspective

1. 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.

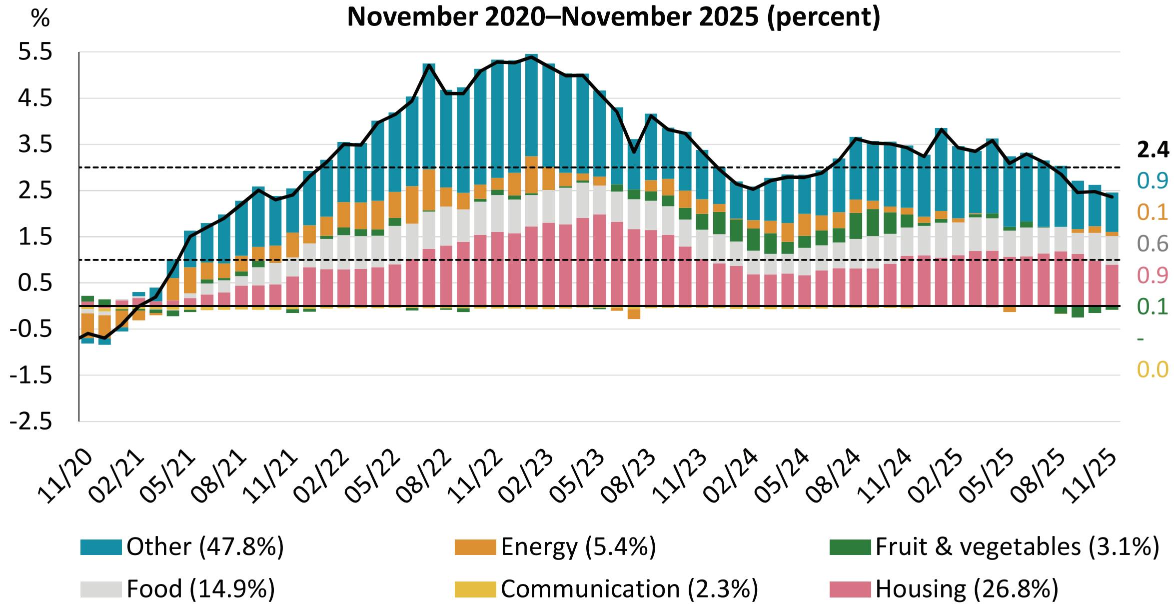
At the end of the second half of 2025, the annual inflation rate was 2.4 percent, within the target range (based on the November CPI), compared to the 3.1 percent at the end of the previous half year (on the basis of the May CPI) (Figure 2). The inflation rate of the CPI nontradable components declined to 3 percent, compared to 3.9 percent at the end of the previous half year —a level that reflected excess demand against the background of the supply constraints. The inflation rate among tradable components continued to decline during the half year, ending at 1.2 percent, compared to 2.9 percent a year ago and 1.5 percent at the end of the previous half-year. Net of energy and fruit and vegetables the annual rate of inflation was 2.6 percent (Figure 3).

The VAT increase in January 2025 impacted on the year over year inflation rate (in the past 12 months) throughout the entire year, and beginning from the January 2026 CPI (which will be published on February 15), the abovementioned VAT increase will not impact on the year over year inflation rate. Accordingly, the forecasters expected that in the December CPI there will be some increase in the annual inflation rate, and then it is expected to decline to around the midpoint of the target range. One-year inflation expectations from all the various sources declined during the half year, and at the end were slightly below the midpoint of the target range (Figures 5 and 6). Throughout the half year, expectations and forecasts for longer terms hovered around the midpoint of the inflation target range.

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.

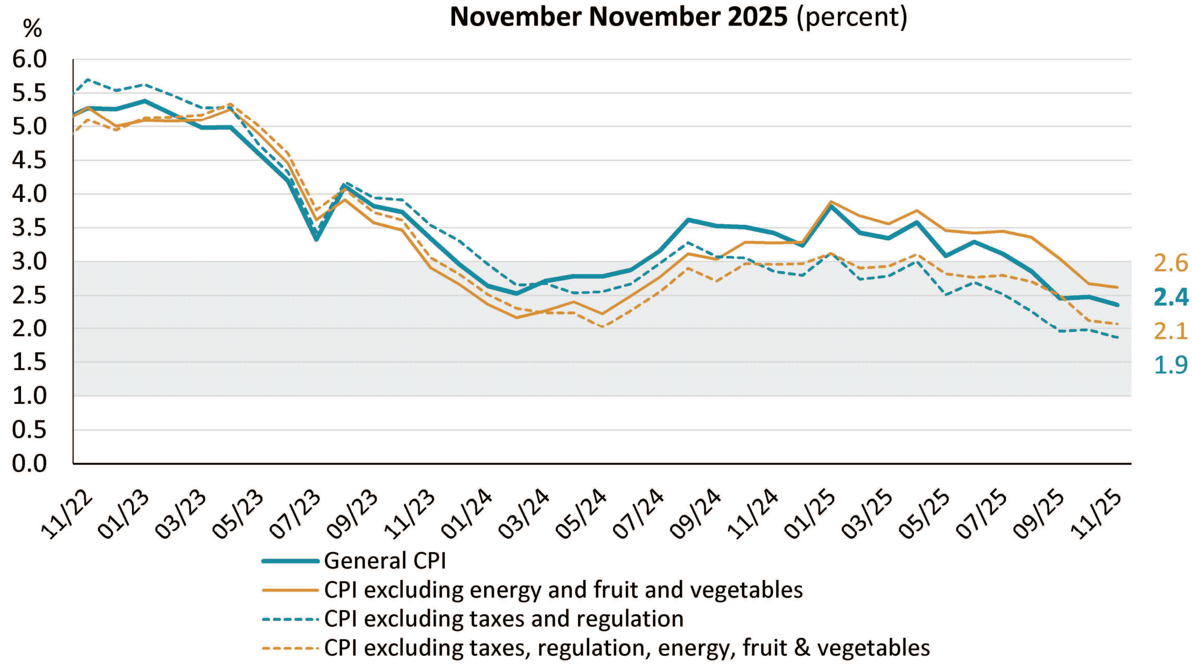
In the half year reviewed, the inflation rate in Israel declined, and at the end it was slightly below the OECD median (Figures 4a and 4b).

Figure 2 | Contribution of the Main CPI Components to Inflation November 2020–November 2025 (percent)



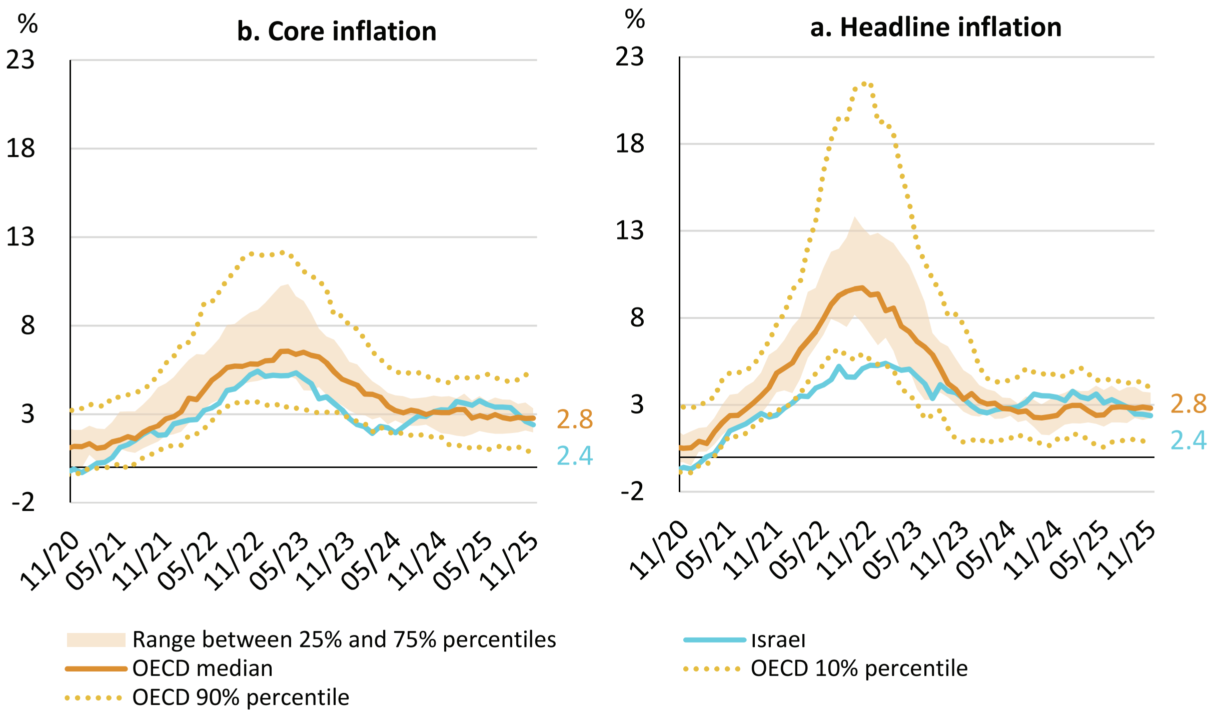
Notes: The number in parentheses is the relevant component's share of the general CPI (as of 2025).
"Other components" includes furniture and household equipment, clothing and footwear, miscellaneous, and the household maintenance and transportation components net of subcomponents related to energy prices.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



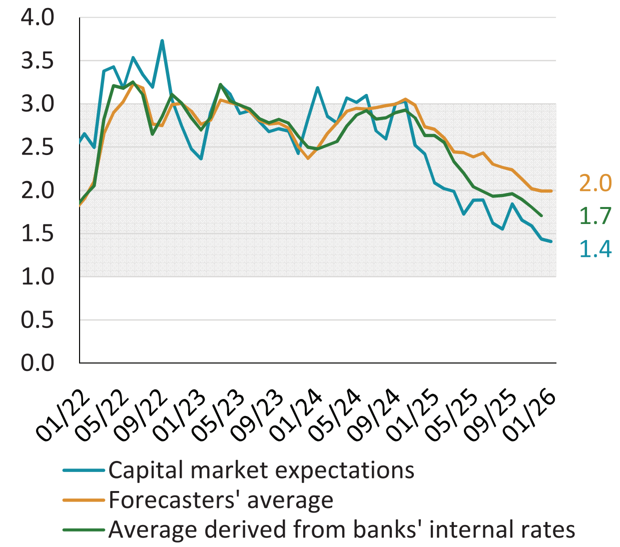
SOURCE: Based on Central Bureau of Statistics.

Figure 4 | Year-over-Year Inflation in Israel and the OECD
November 2020–November 2025 (percent)



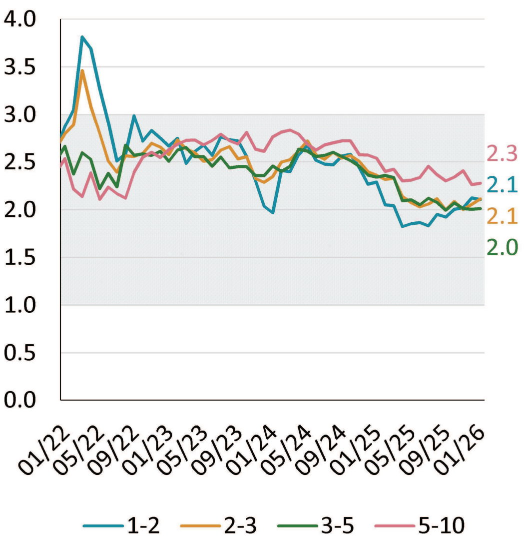
SOURCE: Based on OECD.

Figure 5 | One-Year Inflation Forecasts from the Various Sources, January 2022–January 2026
(monthly averages, percent)



SOURCE: Bank of Israel.

Figure 6 | Forward Inflation Expectations Derived from the Capital Market, January 2022–January 2026
(ranges of years, monthly averages, percent)



SOURCE: Bank of Israel.

2. 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 due to Operation Rising Lion. 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 each of 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 (Tables 1 and 2).

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		07/07/2025	20/08/2025	29/09/2025	24/11/2025	05/01/2026
GDP	2025:Q1	3.7	3.1	3.1	4.8	4.5
	2025:Q2		-3.5	-3.5	-4.3	-4.8
	2025:Q3				12.4	11.0
Business sector product	2025:Q1	4.5	3.0	3.0	5.3	4.8
	2025:Q2		-6.2	-6.2	-7.6	-7.8
	2025:Q3				14.9	13.1
Private consumption	2025:Q1	-4.7	-6.0	-6.0	-5.6	-5.6
	2025:Q2		-4.1	-4.1	-5.3	-5.1
	2025:Q3				23.0	21.6
Fixed capital formation	2025:Q1	6.1	6.4	6.4	9.6	9.5
	2025:Q2		-12.3	-12.3	-11.1	-11.3
	2025:Q3				36.9	34.0
Exports excluding diamonds and startups	2025:Q1	9.8	5.9	5.9	8.2	7.6
	2025:Q2		-3.5	-3.5	-2.2	-3.9
	2025:Q3				18.9	12.2
Civilian imports excluding ships, aircraft, and diamonds	2025:Q1	3.6	4.0	4.0	0.5	5.0
	2025:Q2		3.1	3.1	6.2	9.2
	2025:Q3				38.6	13.4

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	2024:Q2	2024:Q3	2024:Q4	2025:Q1	2025:Q2	2025:Q3
GDP	6.4	2.1	1.0	2.0	4.4	1.9	4.5	-4.8	11.0
Business sector product	7.6	1.1	-0.4	3.0	4.8	2.9	4.8	-7.8	13.1
Civilian imports excluding ships, aircraft, and diamonds	12.4	-6.9	-2.2	-1.9	23.0	12.0	5.0	9.2	13.4
Private consumption	7.3	-0.6	3.9	15.4	10.9	3.5	-5.6	-5.1	21.6
of which excl. durables	7.1	0.2	3.4	9.2	8.2	4.5	1.6	-8.2	17.8
Public consumption	0.3	8.1	11.8	-2.8	-5.5	10.1	1.5	0.1	4.4
of which : excl. defense imports	1.1	7.5	9.4	-11.3	3.4	13.9	-4.9	-4.5	19.4
Gross domestic investment	11.8	-4.2	-8.9	-25.1	51.6	-18.3	25.9	3.3	23.1
of which : fixed capital formation	11.1	-2.1	-5.5	3.7	31.5	7.2	9.5	-11.3	34.0
Exports excl. diamonds	10.1	0.2	-4.4	-1.2	11.5	9.8	0.5	-6.6	15.5
of which: excl. diamonds and	10.2	0.0	-3.7	2.2	9.0	1.6	7.6	-3.9	12.2

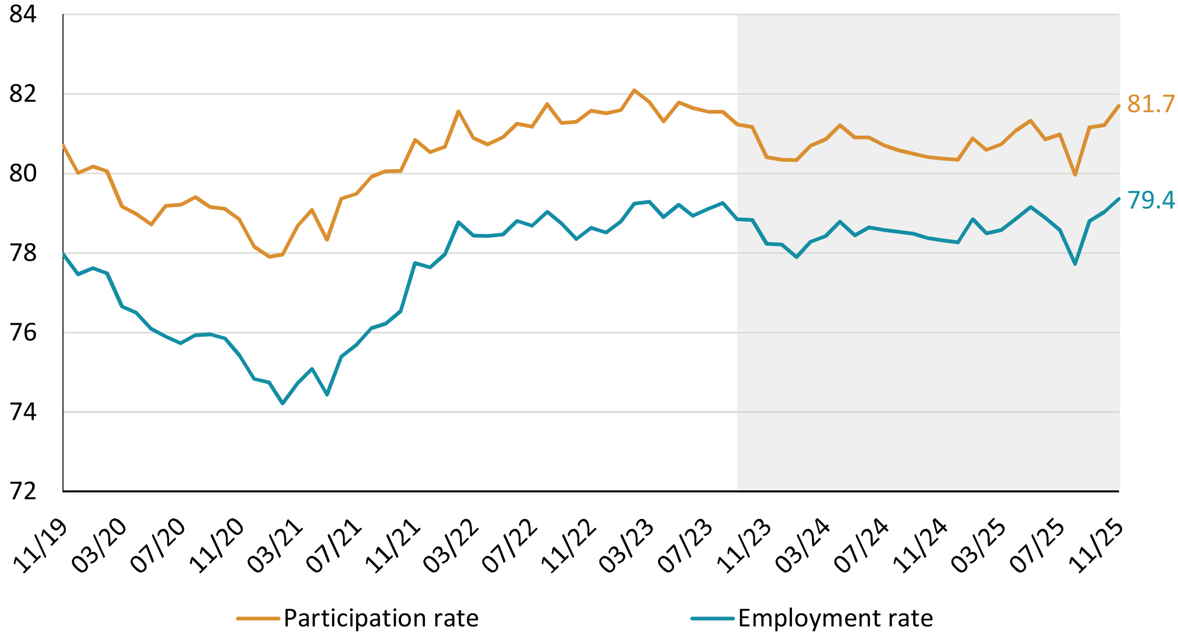
SOURCE: Based on Central Bureau of Statistics.

Current indicators of economic activity showed continued expansion. Credit card expenditures increased during the period under review and remained broadly in line with the long term trend. The aggregate balance (seasonally adjusted) in the Business Tendency Survey conducted by the Central Bureau of Statistics remained stable following the recovery at the conclusion of Operation Rising Lion—but remains below its prewar level. According to the Survey (as well as overnight stay and revenue data), activity in the hospitality industry recovered in November. In the construction industry, the number of workers continued to increase in the third quarter and returned to its prewar level, (albeit with a change in workforce composition). Consumer confidence stabilized at a high level following a marked increase in October. Capital raising in the high tech sector during the reviewed period remained significantly higher than in previous periods. In the second and third quarters of 2025, there was a sharp decline in the surplus of the goods and services balance.

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.

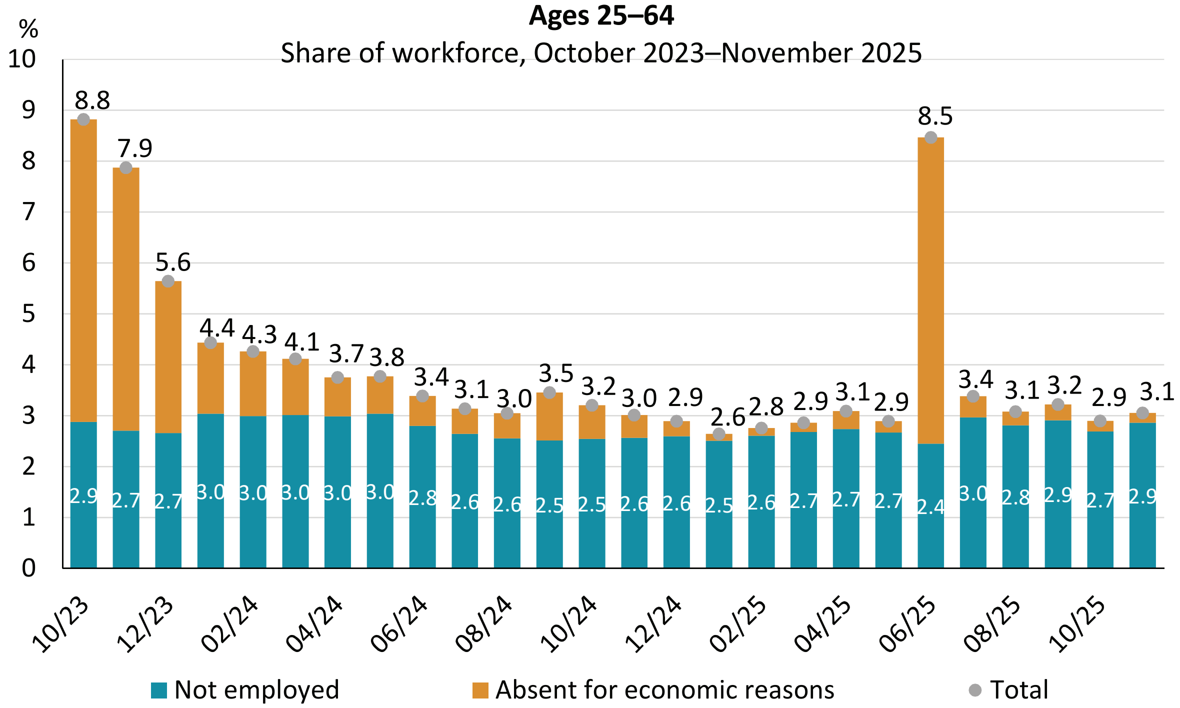
The employment and participation rates among the prime working ages (25–64) increased in November and the share of those absent from work temporarily due to military reserves services in November declined slightly to 0.5 percent (Figures 7 and 8). In August–October, the rate of wage increases in the business sector moderated after accelerating in the preceding months—business sector wages increased by 5.3 percent relative to the corresponding period of the year before, compared to 5.9 percent in July–September, Alongside this, the ratio of number of job vacancies to the number of unemployed people is stable at a high level, and the job vacancy rate increased slightly.

Figure 7 | Employment and Participation Rates, Ages 25–64,
(seasonally adjusted, Swords of Iron War in gray,
November 2019 - November 2025)



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

Figure 8 | Share of Unemployed and Those Absent from Work among Ages 25–64
Share of workforce, October 2023–November 2025



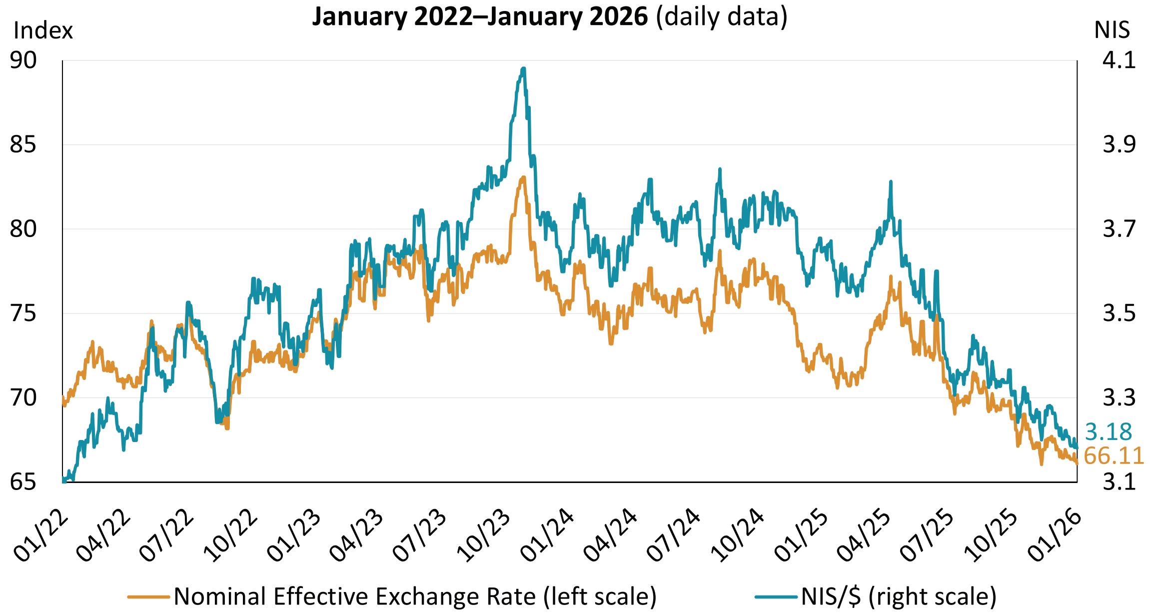
SOURCE: Based on Central Bureau of Statistics.

3. 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 (Figure 9). 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 (Figure 10).

During the period, ratings agency S&P revised its rating outlook for Israel, from Negative to Stable, and domestic equity indices were notably good compared to the world overall (Table 3). Credit to the business sector continued to expand in the reviewed period by a high rate, led by credit to large companies. 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. Access to credit, according to the Business Tendency Survey for November, remained relatively high.

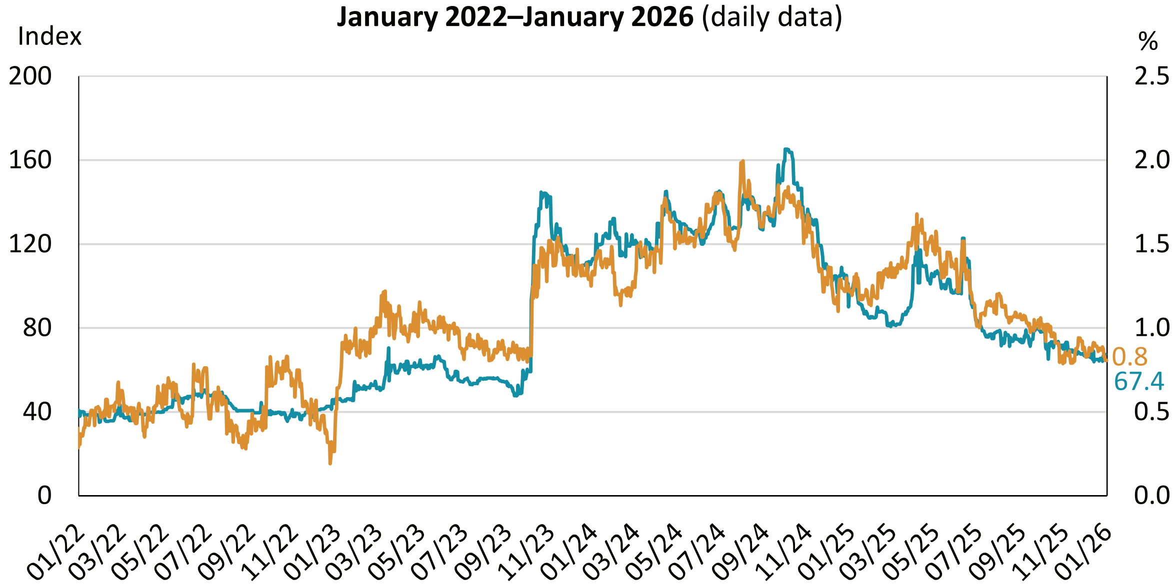
Figure 9 | Nominal Effective and NIS/$ Exchange Rates, January 2022–January 2026 (daily data)



Nominal effective exchange rate: December 31, 2019 = 100

SOURCE: Bank of Israel.

Figure 10 | 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, January 2022–January 2026 (daily data)



SOURCE: Based on Bloomberg.

Table 3 | Developments in the domestic asset markets

	07/25	08/25	09/25	10/25	11/25	12/25
Yield to maturity (monthly average, percent)						
3-month Makam	4.3	4.3	4.3	4.2	4.2	4.0
1-year Makam	4.1	4.2	4.1	4.0	3.9	3.8
5-year unindexed bonds	4.0	4.0	4.0	3.8	3.8	3.8
10-year unindexed bonds	4.2	4.2	4.2	4.0	4.0	4.0
20-year unindexed bonds	4.6	4.6	4.6	4.4	4.4	4.4
1-year indexed bonds	2.4	2.5	2.2	2.2	2.2	2.4
5-year indexed bonds	2.0	2.0	2.0	1.8	1.8	1.8
10-year indexed bonds	2.0	2.0	2.0	1.8	1.8	1.9
Yield spread between government bonds and AA-rated corporate bonds (percentage points)[a]	0.9	0.9	1.0	0.9	0.9	0.9
Equity market (rate of change during the month, percent)						
General Shares Index	1.9	1.1	3.3	3.0	3.8	5.2
Tel Aviv 35	1.7	1.5	4.7	2.3	4.7	6.0
Foreign exchange market (rate of change during the month, percent)						
Dollar/shekel	0.5	-1.7	-0.8	-1.9	0.6	-2.2
Euro/shekel	-2.0	0.4	-0.3	-3.3	0.6	-0.8
Nominal effective exchange rate	-1.0	-0.8	-0.8	-2.6	0.6	-1.6

[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.

4. 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.

The Committee members referred to the impact of the budget on demand and on inflation. The Committee was of the view during the half year that compiling a budget for 2026 that implements a downward path of the debt to GDP ratio will help in maintaining markets' trust and accordingly will support the stability of bond yields and the anchoring of inflation expectations.

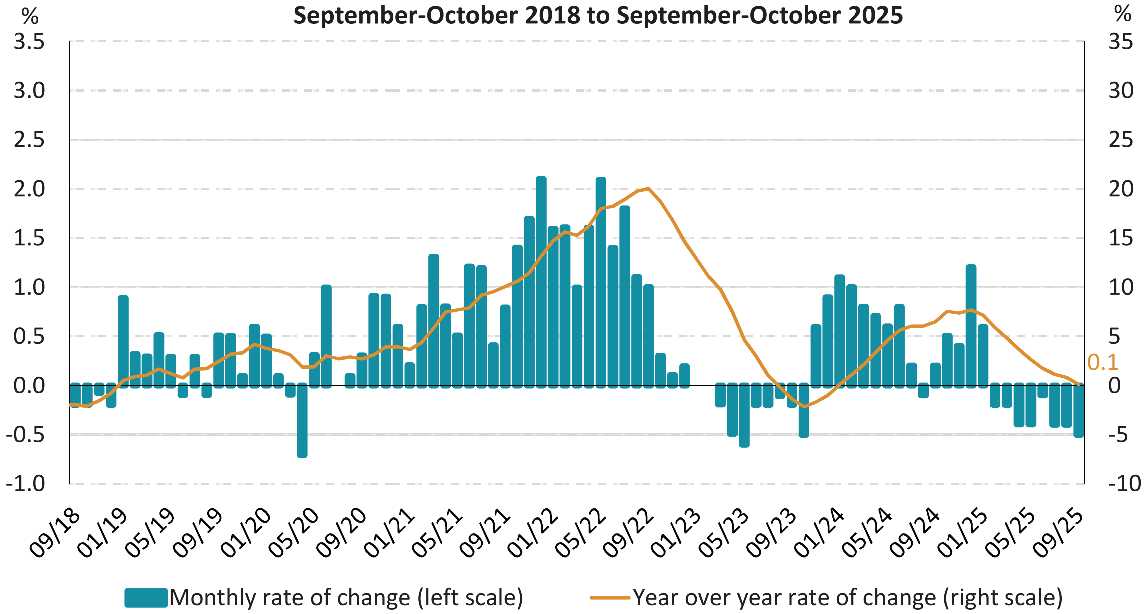
At the end of the half year, the government approved the 2026 budget proposal with a deficit ceiling of 3.9 percent of GDP, a level that is higher than the deficit planned previously and higher than one in line with a declining path of the debt to GDP ratio. Meeting this deficit target depends on, among other things, there not being geopolitical developments that will require a further increase in defense expenditures and that the assumptions about the revenue path will in fact materialize. The Committee members were of the view that it is important to approve the 2026 budget in the Knesset, while taking care not to deviate from this deficit target. This is in order to support the markets' trust in the economy and the continued decline in the risk premium.

5. 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. Home prices declined during the half year and led to a decrease in the year over year rate of increase that in September–October was 0.1 percent compared to 5.1 percent at the end of the previous half year (March-April data) (Figure 11). 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). In November, mortgage volume was approximately NIS 9 billion (seasonally adjusted) (Figure 12).

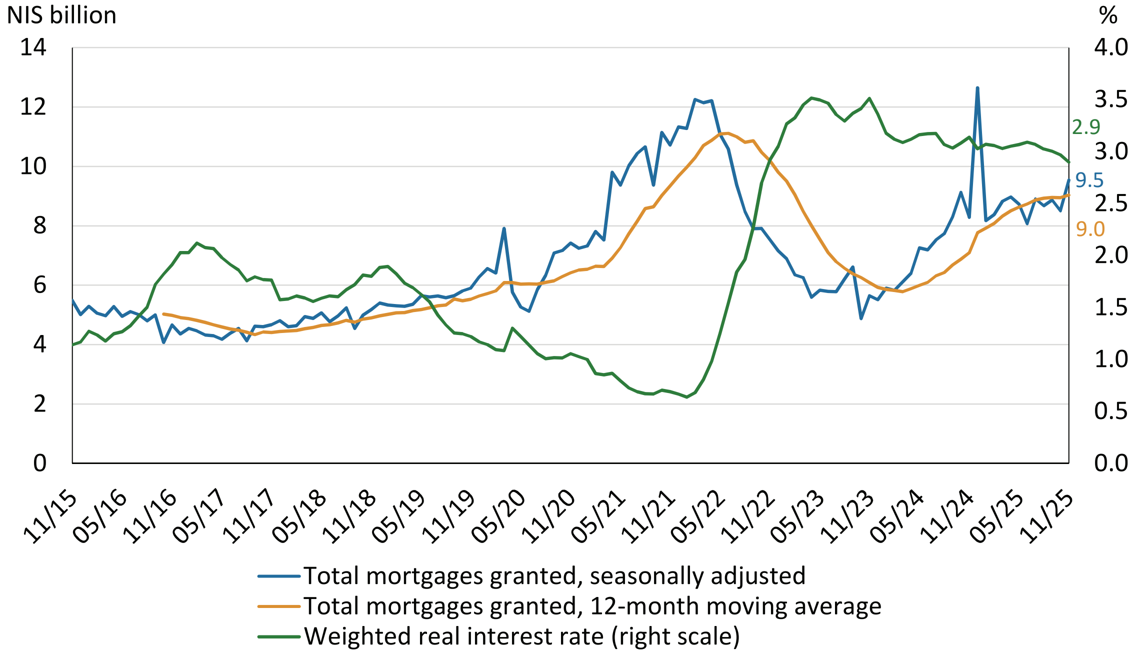
Alongside that, the level of activity in the construction industry is high. Over the four quarters ending in the third quarter there was an increase of approximately 31 percent in building starts relative to the preceding four quarters (23 percent relative to the four quarter preceding the war) while 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.

Figure 11 | Home Prices
September-October 2018 to September-October 2025



SOURCE: Based on Central Bureau of Statistics.

Figure 12 | Total New Mortgages and Weighted Real Interest Rate on Mortgages, November 2015–November 2025



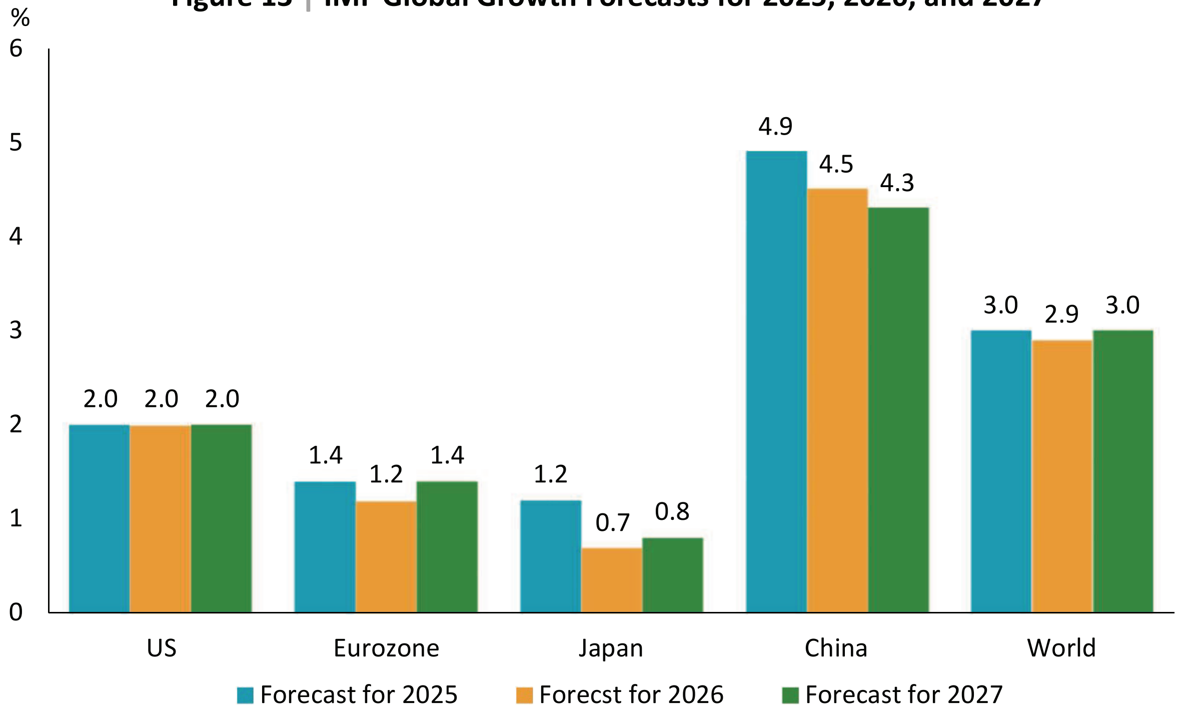
SOURCE: Bank of Israel, Banking Supervision Department.

6. The global economy

During the reviewed half-year 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 (Figure 13).

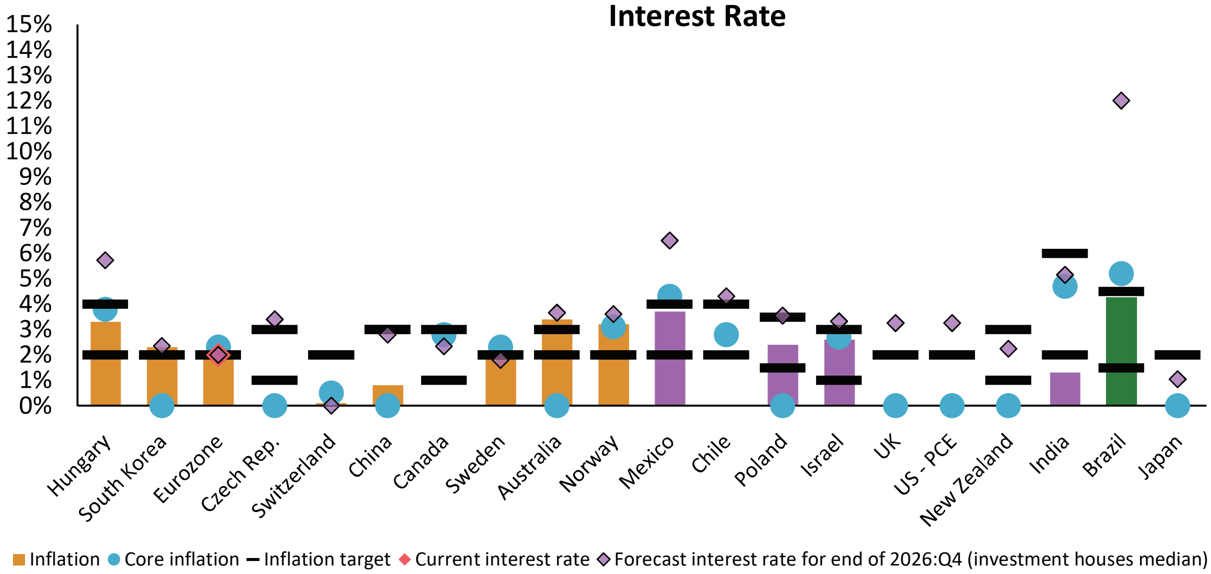
The global Purchasing Managers Index is at a level indicating continued expansion in global output. The pace of expansion of world trade was moderate. In the US, various sentiment indices pointed to continued expansion of economic activity, and third quarter GDP surprised, growing by 4.3 percent in annual terms. US equity indices were notably good in the second half, particularly after a mixed first half. In the eurozone, moderate recovery continued. In China, growth was slightly above forecasts but various indicators showed some weakness in private consumption. In most countries, the inflation rate continued to moderate slowly, due mainly to the decline in energy prices and the relative calm in the trade war. The US inflation rate (CPI) was 2.7 percent in November. In the eurozone, inflation continued to be moderate, and in annual terms the inflation rate for November was 2.1 percent. 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 (Figure 14).

Figure 13 | IMF Global Growth Forecasts for 2025, 2026, and 2027



SOURCE: Based on Bloomberg.

Figure 14 | Inflation Level Compared to Central Bank Target and Interest Rate



Notes: In orange are countries that reduced the interest rate in the current cycle. In green are countries that increased the interest rate in the current cycle. In purple are countries that reduced the interest rate in the last meeting. The Bank of Israel interest rate forecast is the average interest rate projected by forecasters one year ahead. SOURCE: Based on Bloomberg.

c. The Research Department's macroeconomic forecast

During the reviewed period, the Research Department published 3 scheduled forecasts, together with the interest rate decisions in July 2025, September 2025, and January 2026 (Table 4).

The July forecast was prepared following the declaration of a ceasefire at the end of Operation Rising Lion, under the assumption that the ceasefire would hold. The September forecast was formulated after a large-scale reserves mobilization and the launch of a significant ground operation in the Gaza Strip, and assumed that the fighting would conclude during the first quarter of 2026. The January 2026 forecast was formulated based on the assumption that the ceasefire would continue and that the number of reservists would continue to decline. The Department assessed that the supply-side constraints would gradually ease over the forecast period, alongside a moderate increase in domestic demand.

According to the Department's January 2026 assessment, GDP grew by 2.8 percent in 2025, compared with the 3.3 percent growth projected 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 projected GDP growth of 4.3 percent in 2027, reducing the output gap relative to the long term trend to approximately 1 percent by year end.

According to the January 2026 forecast, year over year inflation at the end of 2025 is expected to be 2.5 percent, compared with 3 percent in the September forecast and 2.6 percent in the July forecast. In 2026, inflation 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, inflation is projected to be 2 percent.

The debt to GDP ratio was estimated to be 68.5 percent at the end of 2025 and was expected to remain at a similar level in 2026 and 2027. The Department projected that the interest rate would stand at 3.5 percent at the end of 2026.

Table 4 | Research Department forecasts

(rates of change in percent, unless otherwise noted)

Forecast for the year	2025			2026			2027
Forecast date	07/25	09/25	01/26	07/25	09/25	01/26	01/26
GDP	3.3	2.5	2.8	4.6	4.7	5.2	4.3
Private consumption	3.5	3.0	4.0	7.0	7.0	7.5	5.0
Fixed capital formatioan (excl. ships and aircraft)	9.5	7.5	10.0	13.5	14.0	13.0	8.0
Public consumtion (excl. defense imports)	1.5	0.5-	2.0	-1.0	-1.0	1.0	3.5
Exports (excl. diamonds and startups)	4.0	3.5	4.5	3.0	3.5	4.5	5.0
Civilian imports (excl. diamonds, ships, and aircraft)	8.0	8.5	10.0	8.0	8.5	8.0	7.0
Unemployment rate - annual average (ages 25–64)	2.9	3.4	3.4	3.3	3.4	3.3	3.5
Government deficit (percent of GDP)	4.9	5.1	4.8	4.2	4.3	3.9	3.6
Debt to GDP ratio	70.0	71.0	68.5	71.0	71.0	68.5	68.5
Inflation[a]	2.6	3.0	2.5	2.0	2.2	1.7	2.0
Forecast date	07/25	09/25	01/26				
Inflation in the coming year[b]	2.2	2.4	1.7				
Interest rate in one year[c]	3.80	3.75	3.50				

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