

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

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**Research Department Staff Forecast, September 2025**

**Abstract**

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in September 2025 concerning the main macroeconomic variables—GDP, inflation, and the interest rate.[[1]](#footnote-1) According to the forecast, in a scenario in which the fighting in Gaza comes to an end in the first quarter of 2026, GDP is expected to grow by 2.5 percent in 2025, and by 4.7 percent in 2026. The inflation rate in the coming four quarters (ending in the third quarter of 2026) is expected to be 2.4 percent, inflation in 2025 is expected to be 3.0 percent, and inflation in 2026 is expected to be 2.2 percent. The average interest rate in the third quarter of 2026 is expected to be 3.75 percent.

The forecast under this scenario was formulated following the broad mobilization of reserve soldiers and the beginning of a significant land operation in the Gaza Strip, and under the assumption that the fighting would come to an end in the first quarter of 2026. Such developments will have a marked effect on the forecast—strengthening the restrictions on the supply side, particularly due to the broad mobilization of military reserves, and increasing economic uncertainty, thereby contributing to a lower growth forecast and increasing the inflation forecast and the expected interest rate path relative to the July forecast. In parallel, developments have led to an increase in the forecast deficit in the state budget, due to increased government expenses resulting from the extension of the war. However, there is great uncertainty regarding the development of the geopolitical situation, as detailed in the section on risks to the forecast. The extension of the fighting in Gaza for a more prolonged period will be reflected in lower growth, higher inflation and interest rate paths, an expansion of the deficit in the state budget, and a deepening of economic risks. In contrast, if the talks currently taking place result in a ceasefire agreement and a rapid end to the war, it will ease the supply constraints in the economy, which will support expanded activity.

**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”.

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. Accordingly, we assume that GDP in the advanced economies will grow by 1.4 percent in each of 2025 and 2026 (compared with 1.2 percent and 1.3 percent, respectively in the July forecast), inflation in these economies will be 2.6 percent in 2025 and 2.2 percent in 2026 (unchanged from our July forecast), and the interest rate will be 3.3 percent in 2025 and 2.7 percent in 2026 (compared with 3.3 percent and 2.9 percent respectively in the July forecast). Our assumption is that imports to advanced economies will grow by 1.8 percent in 2025 and 1.2 percent in 2026 (compared with growth of 1.9 percent and 2.0 percent respectively in the July forecast).

The price of Brent crude oil is currently $68 per barrel, similar to its level at the time of the July forecast.

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| **Table 1****Research Department Staff Forecast for 2025–2026**(rates of change, percenta, unless stated otherwise) |
|  | Forecast for 2025 | Change from the July forecast | Forecast for 2026 | Change from the July forecast |
| **GDP** | **2.5** | **-0.8** | **4.7** | **0.1** |
| Private consumption | 3.0 | -0.5 | 7.0 | 0.0 |
| Fixed capital formation (excl. ships and aircraft) | 7.5 | -2.0 | 14.0 | 0.5 |
| Public consumption (excl. defense imports) | -0.5 | -2.0 | -1.0 | 0.0 |
| Exports (excl. diamonds and startups) | 3.5 | -0.5 | 3.5 | 0.5 |
| Civilian imports (excl. diamonds, ships, and aircraft) | 8.5 | 0.5 | 8.5 | 0.5 |
| Broad unemployment rate (average for the year, ages 25–64)b | 3.4 | 0.5 | 3.4 | 0.1 |
| Adjusted employment rate (average for the year, ages 25–64)b | 78.4 | -0.2 | 79.0 | 0.3 |
| Government deficit (percent of GDP) | 5.1 | 0.2 | 4.3 | 0.1 |
| Debt to GDP ratio (percent) | 71 | 1.0 | 71 | 0.0 |
| Inflation (percent)c | **3.0** | **0.4** | **2.2** | **0.2** |
| a The forecasts of the National Accounts components are rounded to the nearest half percentage point and the forecasts of public debt are rounded to the nearest percentage point.b Annual average. 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. The increase in the forecast broad unemployment rate relative to the July forecast reflects a significant and temporary increase in unemployment during the military operation against Iran, and does not reflect a significant change in the development of unemployment during the year.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. **Real activity in Israel**

**GDP is expected to grow by 2.5 percent in 2025 and by 4.7 percent in 2026** (Table 1). Since the outbreak of the war in October 2023, the GDP level has been below the pre-COVID trend. In the second quarter of this year, economic activity contracted by an annual rate of 4.0 percent, largely due to the impact on economic activity during the military operation against Iran in June (Operation Rising Lion). Supply-side constraints—mainly in the labor market, due to the mobilization of reserve soldiers and a shortage of non-Israeli workers—continue to weight upon activity. These are partly reflected in a low unemployment rate (about 3 percent among those aged 25–64)[[3]](#footnote-3), a high job vacancy rate (above 4 percent), and expanded imports. We note that a downward revision of the forecast for public consumption (Table 1) mainly reflects developments that have already taken place: In the first half of 2025, real public consumption was lower than the previous assessment.[[4]](#footnote-4) The economic environment has, for a long time, been characterized by a high level of uncertainty due to the war. The recent escalation, together with the impact to Israel’s foreign relations, increases that uncertainty. While Israel’s risk premium, as reflected by the CDS level and yield spreads on dollar-denominated Government of Israel bonds, declined markedly following the military operation against Iran, it remains higher than it was prior to the Swords of Iron War.

The continuation of the war beyond the assessment at the basis of the July forecast is expected to delay the dissipation of the supply constraints, increase government expenditures, and deepen the impact to global demand for Israeli exports. The upward revision of the forecast for imports reflects the delay in the recovery of supply. As part of the forecast presented in Table 1, we assume that, from the first quarter of 2026, the high intensity fighting in Gaza will not continue, the mobilization of reserve soldiers will decline, and the supply constraints will moderate accordingly. Under such a scenario, demand is expected to remain stable, and the unemployment rate is expected to increase slightly, to 3.4 percent. Relative to the July forecast, our current assessment is that GDP growth and uses will increase in 2026, partly due to the delay in recovery from the second half of 2025 to 2026.

**The state budget deficit is expected to be 5.1 percent of GDP in 2025 and 4.3 percent of GDP in 2026. Public debt is projected to be 71 percent of GDP in each of 2025 and 2026.** This forecast includes an increase in the budget framework—mainly for increased fighting in Gaza and the military operation against Iran, as well as assessments regarding the cost of prolonging the war and the increased defense needs in the coming years. It also assumes takes into account the increase in revenues that has taken place in recent months, and expectations for anomalous revenues from the sale of Wiz.[[5]](#footnote-5) The 2026 year is expected to begin with an interim budget, but we assume for the purposes of the forecast that the budget will be approved by the end of the first quarter, without significant adjustments. The forecast illustrates that without budgetary adjustments (tax increases or reduction of other expenditures), the debt to GDP ratio is not expected to decline in 2026.

1. **Inflation and interest rates**

**The inflation rate over the four quarters ending in the third quarter of 2026 is expected to be 2.4 percent (Table 2). For the year 2025, it is projected to be 3.0 percent, and for 2026, it is expected to be 2.2 percent** (Table 1). The CPI readings published since the July forecast contribute to a slight increase in the inflation path in the coming quarters. In contrast, the shekel has appreciated moderately, oil prices have remained stable, and the IMF’s forecast for inflation in the advanced economies has not changed. The continuation of the war is delaying the dissipation of the supply constraints, and is therefore reflected in the upward revision of the inflation forecast. Once the war ends and the volume of reserve mobilizations declines, which are expected under this scenario in the first quarter of 2026, the supply constraints in the labor market are expected to ease, together with a reduction in public consumption. These developments are expected to lead to a moderation of inflation.

**The Bank of Israel interest rate is expected to average 3.75 percent in the third quarter of 2026** (Table 2). This forecast reflects a gradual reduction in the interest rate from its current level in accordance with the convergence of inflation to the midpoint of the target range according to the baseline scenario in the forecast.

Table 2 shows that the Research Department’s forecast for inflation in the next four quarters is higher than the private forecasters’ average projections and the forecast derived from the capital market. The Department’s interest rate forecast for the next four quarters is similar to both the expectations derived from the capital market and the private forecasters’ average 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 Departmenta | Capital marketsb | Private forecastersc (range of forecasts) |
| Inflation rate | 2.4 | 2.1 | 2.2 |
| (range of forecasts) |  |  | (1.9–2.8) |
| Interest rate | 3.75 | 3.8 | 3.7 |
| (range of forecasts) |  |  | (3.25–4.0) |
| 1. The inflation rate during the four quarters ending in the third quarter of 2026, and the average interest rate in the third quarter of 2026.
2. As of September 28, 2025. Inflation expectations are seasonally adjusted and the interest rate expectations are based on the Bank of Israel’s analysis of the average quotes from the SHIR market.
3. As of September 28, 2025. The forecasters’ projections relate to the coming 12 index readings (September 2025–August 2026).
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| SOURCE: Bank of Israel. |

1. **Main risks to the forecast**

There is a high level of uncertainty surrounding the forecast, which includes the following risks derived from the intensification or prolongation of the fighting. These may be realized in tandem or separately: The supply constraints may continue to weigh upon the recovery of economic activity, defense expenditures may increase, and demand for Israeli exports may decline (due to impaired sentiment toward Israel). Furthermore, the risk premium may increase, which could lead to a decline in investment in the economy. In contrast, the earlier the war ends, the earlier we can expect an easing of the supply constraints, which would lead to an earlier recovery of activity. Such a scenario will also moderate defense expenditures.

Every additional quarter in which the war in Gaza is prolonged beyond what is assumed in the forecast is expected to be reflected in a worsening of the supply constraints in the economy and in an impairment of about 0.25 percent in annual GDP, alongside impaired demand for Israeli exports. This is in addition to an increase in government expenditure of about 0.15 percent of GDP and a parallel increase in the deficit during that quarter. These are all expected to be reflected in an increase of inflation, by more than 0.1 percentage points during the year, and in a slowing of the pace of decline in the interest rate. The implications of extending the war beyond one quarter are difficult to forecast. In particular, there is a risk that any additional extension of the war will have a more serious additional impact that increases over time, with prolonged implications for economic activity.

In addition to risks derived from the war, there are, of course, risks including a worsening of the trade war and its global and domestic implications.

1. The forecast was presented to the Bank of Israel Monetary Committee on September 28, 2025, prior to the decision on the interest rate made on September 29, 2025. [↑](#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. During the military operation against Iran, there was particularly high unemployment, which affected the annual average. In our assessment, the broad unemployment rate in the fourth quarter among those aged 25–64 will be 3 percent. [↑](#footnote-ref-3)
4. These assessments were based on the increase in defense expenditure in the state budget as a result of the renewed operations in Gaza (Gideon’s Chariots 1) and the military operation against Iran (Rising Lion) during the second quarter of the year. However, public consumption prices were higher than expected. As such, when dividing defense expenditure among defense investment, real current expenditure, and prices, we attributed greater weight to real public consumption, which turned out to be lower in retrospect. [↑](#footnote-ref-4)
5. Insofar as these revenues are not received in 2026, our assessment is that they will be received in 2027. Therefore, their impact on the level of public debt in the medium term will not change. [↑](#footnote-ref-5)