



BANK OF ISRAEL

Office of the Spokesperson and Economic Information

July 6, 2026

Research Department Staff Forecast, July 2026

Abstract

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in July 2026 concerning the main macroeconomic variables—GDP, inflation, and the interest rate.¹ According to the baseline scenario, GDP is expected to grow by 4.0 percent in 2026 and by 5.5 percent in 2027. The inflation rate in the coming four quarters (ending in the second quarter of 2027) is expected to be 1.8 percent. Annual inflation in 2026 is expected to be 1.8 percent. The average interest rate in the second quarter of 2027 is expected to be 3.0 percent. If the defense budget is not expanded beyond the reserve allocated in the State budget, the state budget deficit is expected to be 4.9 percent of GDP in 2026, and 4.2 percent of GDP in 2027. The debt to GDP ratio is expected to stabilize at about 69 percent during these years.

The forecast is based on the working assumption that the intensity of the fighting in Lebanon will decline in a way that somewhat eases the supply constraints in the economy. In addition, we assume that there will be no additional fighting with Iran during the forecast horizon. However the geopolitical environment is expected to remain tense, so the forecast continues to reflect the need for preparedness should there be an additional round of fighting. Another assumption underpinning the forecast is that global energy prices, which have fallen in view of the agreement, will remain in the current environment throughout the forecast horizon.

¹ The forecast was presented to the Bank of Israel Monetary Committee on July 5, 2026, prior to the decision on the interest rate made on July 6, 2026.

With regard to the state budget, the working assumption is that the defense budget will not be increased in 2026 beyond the reserves already set aside in the budget.

On the basis of these assumptions, the forecast reflects continued convergence of GDP toward the trend, supported by continued easing of the supply constraints with the release of reservists and the continued increase in the number of foreign workers. However, even at the end of the forecast horizon (end of 2027), GDP is expected to remain below the trend, since the supply of workers is still expected to be lower than the level derived from the prewar trend. In parallel, the easing of supply constraints, the declines in oil prices and in Israel's risk premium, and the appreciation of the shekel contribute to moderation of the inflation environment, which is expected to become entrenched around the midpoint of the target range, and support the process of lowering the interest rate.

The forecast

The Bank of Israel Research Department compiles a quarterly 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) models—structural models developed in the Research Department and based on microeconomic foundations—play a prime role in formulating the macroeconomic forecast. The models provide a framework for analyzing the forces that have an effect on the economy, and allow information from various sources to be combined into a macroeconomic forecast of real and nominal variables, with an internally consistent “economic story”. The models also help analyze scenarios and policy alternatives, and thereby support the formulation of policy under uncertain conditions.

a. 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 1.2 percent in 2026, and by 1.4 percent in 2027 (compared with 1.5 percent and 1.6 percent respectively in the March forecast). We further assume that inflation in these economies will be 3.0 percent in 2026

(compared with 2.4 percent in the March forecast) and 2.3 percent in 2027 (compared with 2.0 percent in the March forecast). The interest rate is expected to be 3.0 percent in 2026 (compared with 2.8 percent in the March forecast) and 2.9 percent in 2027 (compared with 2.6 percent the March forecast). These revisions mainly reflect the assessments of the foreign investment houses regarding the impact of the increase in oil prices due to Operation Roaring Lion.

The price of Brent crude oil declined significantly from \$112 per barrel at the time of the March forecast to \$72 per barrel currently.

Table 1 Research Department Staff Forecast for 2026–2027 (annual rates of change, percent ^a , unless stated otherwise)					
	2025 actual figure s	Forec ast for 2026	Change from the March forecas t	Forec ast for 2027	Change from the March forecas t
GDP	2.9	4.0	0.2	5.5	0.0
Private consumption	2.7	3.0	0.0	6.5	-0.5
Fixed capital formation (excl. ships and aircraft)	8.4	8.0	1.5	6.0	-8.5
Public consumption (excl. defense imports)	2.1	2.0	-0.5	0.5	-2.0
Exports (excl. diamonds and startups)	5.7	8.0	2.5	7.0	-1.0
Civilian imports (excl. diamonds, ships, and aircraft)	8.8	10.5	0.5	5.5	-6.5
Broad unemployment rate (average for the year, ages 25–64) ^b	3.6	4.6	0.1	3.0	-0.4

Adjusted employment rate (average for the year, ages 25–64) ^b	78.2	77.4	-0.1	79.0	0.4
Government deficit (percent of GDP)	4.7	4.9	-0.4	4.2	-0.2
Debt to GDP ratio (percent)	68.5	69.0	-1.5	69.0	-1.5
Inflation (percent) ^c	2.5	1.8	-0.4	1.8	-0.0
^a The forecasts of the National Accounts components and of public debt are rounded to the nearest half 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 forecast average unemployment rate for 2026 is greatly affected by the months of combat against Iran. In the second half of 2026, it is expected to be 3 percent on average. ^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.					

b. Real activity in Israel

GDP is expected to grow by 4.0 percent in 2026, and by 5.5 percent in 2027 (Table 1). The upward revision relative to the previous forecast (growth in 2026 of 3.8 percent) mainly reflects the impact of National Accounts data for the first quarter, which were higher than our assessment in the March forecast. The release of reservists and their return to employment are easing the supply constraints. Our assessment is that GDP will gradually converge toward the trend, but even at the end of the forecast horizon, at the end of 2027, GDP will remain below the trend line since the supply of workers is still expected to be lower than the level derived from the prewar trend. This is due to a higher volume of reserve duty than in the past, some of those harmed by the war remaining outside the labor market, and a negative migration balance. In view of the expected easing of the supply constraint and decline in the interest rate environment, private consumption is expected to expand by 3.0 percent in 2026, and by an accelerated rate of 6.5 percent in 2027. Investments in the economy are expected to grow rapidly and to close the gaps in the stock of capital that were created in the business

sector and in the housing market. This process is supported by the recovery in the construction industry with the return of the number of workers to its prewar level, and through increased investment in machinery and equipment. The downward revision in the forecast of investment in 2027 reflects the assessment regarding the more gradual spread of recovery in investment, such that it is expected to continue beyond the forecast horizon. The revision of the forecast of imports was in line with that of investment needs, which are import-intensive. Thus, in our assessment, the decline in net exports that was observed during 2025 will moderate during the forecast horizon, in a way that reconciles with the easing of the supply constraint. The increase in public consumption is expected to moderate, after two years of high costs related to the war, with a change in the mix in favor of civilian expenditures and moderation in the prices of public consumption due to the decline in the volume of wage payments to reservists.

In the labor market, the broad unemployment rate is expected to be 4.6 percent on average in 2026, mainly due to the sharp increase during the fighting with Iran, and to stabilize in the second half of the year at 3.0 percent. The adjusted employment rate is expected to be 77.4 percent in 2026 and 79.0 percent in 2027.

The baseline scenario is based on a working assumption that the defense budget for 2026 will increase by NIS 15 billion, slightly more than the reserve the government has allocated as part of the 2026 State budget (NIS 12.8 billion), and that in 2027, defense expenditure will be lower than in 2026, mainly due to a decline in the ongoing combat supplement. Based on this assumption, **the deficit in the state budget is expected to be 4.9 percent of GDP in 2026, and 4.2 percent of GDP in 2027.** The public debt to GDP ratio is expected to stabilize in these years at about 69 percent. Relative to the staff forecast from March 2026, the decline in the deficit forecast for 2026 is due to an increase in estimated revenue, mainly thanks to higher-than-expected tax collection in the first half of the year. In parallel, the working assumption regarding expenditures for these years remains similar to the previous forecast. In particular, the forecast continues to assume that the geopolitical environment and concern of further rounds of combat in the various spheres will keep the volume of reserve mobilizations and the defense budget significantly higher during the forecast horizon than they were prior to the war. However, the government is weighing the possibility of increasing the 2026 defense

budget by up to NIS 25 billion more during the year. If this takes place, the deficit and the debt will increase, and inflation will be higher, as detailed in Section d below. Furthermore, there is uncertainty regarding the fiscal policy that the next government will implement following the elections for the 26th Knesset, particularly with regard to the size of the defense budget in the coming years and how it will be financed.

c. Inflation and interest rates

The inflation rate over the four quarters ending in the second quarter of 2027 is expected to be 1.8 percent (Table 2). Inflation during 2026 is expected to be 1.8 percent, compared with 2.2 percent expected in the March forecast. With the end of Operation Roaring Lion, there was a decline in Israel's risk premium, and the shekel strengthened. In view of the agreement between the US and Iran and the opening of the Strait of Hormuz, oil prices dropped sharply, beyond our assessment in the March forecast. These forces contributed to a decline in the short-term inflation environment.

The Bank of Israel interest rate is expected to average 3.0 percent in the second quarter of 2027 (Table 2). This forecast reflects one or two interest rate reductions in the coming year. The interest rate path will be determined in accordance with the development of the inflation environment, economic activity, developments in the financial markets and in the geopolitical sphere, and fiscal policy.

Table 2 shows that the Research Department's forecast for inflation in the next four quarters is higher than the forecast derived from the capital market and similar to the private forecasters' average projections. The Research Department's interest rate forecast for the next four quarters is similar the forecast derived from the capital market and the professional forecasters' average projections.

Table 2**Inflation forecast for the coming year and interest rate forecast for one year
from now**

(percent)

	Bank of Israel Research Department ^a	Capital markets ^b	Private forecasters ^c (range of forecasts)
Inflation rate	1.8	1.4	1.8
(range of forecasts)			(1.3–2.0)
Interest rate	3.0	3.0	3.0
(range of forecasts)			(2.75–3.5)

a) The inflation rate during the four quarters ending in the second quarter of 2027, and the average interest rate in the second quarter of 2027.

b) As of July 3, 2026. Inflation expectations are seasonally adjusted and relate to one year forward. Interest rate expectations are based on the Bank of Israel's analysis of the average quotes from the SHIR market.

c) As of July 3, 2026. The forecasters' projections relate to the coming 12 index readings.

SOURCE: Bank of Israel.

d. Main risks to the forecast

The forecast is characterized by uncertainty regarding the geopolitical environment, particularly with regard to the duration of fighting in Lebanon, the necessary volume of reserve mobilization, and the risk level due to the agreement between the US and Iran. A renewed flare-up against Iran or on other fronts, and the continued need for mobilization of the reserves may worsen the supply constraints, impair the recovery of economic activity, increase defense expenditures and the risk premium, and create inflationary pressures that will require a more restrained interest rate path. In contrast, a positive development that leads to a further decline in the risk premium and a strengthening of the shekel may support a more rapid recovery of activity and a more rapid decline of inflation alongside a more rapid decline of the interest rate.

There is also uncertainty with regard to the pace of increase in exports, particularly those of the high-tech sector. The cumulative appreciation of the shekel in 2025 and early 2026 largely reflects a welcome decline in the economy's risk premium, but the potential impairment of profitability of exporting companies in view of that appreciation may moderate their activities to some extent.

Finally, the risks in the deficit and the debt tend to the upside. The defense establishment is demanding a significant increase in its budget for 2026. A roughly NIS 25 billion increase of the defense budget to NIS 183 billion this year will lead to an increase in the deficit and the debt, and an increase of 0.2–0.5 percentage points in inflation relative to the baseline scenario, based on the composition of the expenditure and its impact on supply constraints in the economy. There is even greater uncertainty regarding the 2027 defense budget, in the absence of understandings on the multiyear budget for the defense establishment, and given the late timetable for the 2027 budget in view of the elections for the Knesset. An expansionary policy that will lead to an upward path of the debt-to-GDP ratio may have a negative impact on the risk premium and lead to increased inflation and a higher interest rate.