61

Position Paper

# The Estimated Cost of the Gaza War on the Israeli Economy

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## Introduction

More than a year after the Hamas attack on the towns of the so-called Gaza envelope, it has become clear that the economic and financial cost of Israel's genocidal war on the Gaza Strip and its expansion into Lebanon will be very high. Indeed, it will be different from previous wars on Gaza or the Second Lebanon War in 2006.

The current war has specific peculiarities that have made projections and economic costs high. These include:

1. Israel entered the war with an unstable economic situation because of political fractures in Israeli society in the past year, the global economic decline, and high prices, inflation, and interest rates, although these did not turn into a serious economic crisis.

2. There was a precipitate decline in several economic indicators during 2023 and the international standing of the Israeli economy as well as a threat of a decline in Israel's credit rating.

3. For the first time since 1948, the war started after a military offensive inside Israeli towns in the south of the country. The war has greatly affected the home front, causing serious destruction to the infrastructure and housing in those towns.

4. Economic activity was almost completely disrupted in the southern regions for more than a month. Economic activity in the heart of Israel also declined for several weeks and was followed by a stoppage in the northern towns as a result of Hezbollah's opening of the support front. It finally ceased completely with the large-scale Israeli attack on Lebanon in September 2024 that led to the disruption of civil and economic activity in the northern towns.

5. For the first time, Israel has moved large numbers of Jewish residents from their homes in border towns in the south and north—some 150,000 citizens—and relocated them to shelters in other areas at the government's expense.

6. This was the first time since 1973 that the Israeli Army has recruited, at a high cost, nearly 300,000 troops.

7. The war on Gaza and Lebanon is one of the longest wars Israel has fought since its establishment in 1948.

8. The Israeli military has used vast quantities of weapons since the beginning of the genocidal war on Gaza, which translates into significant costs to the Defense Ministry's budget.

9. A high number of dead and injured soldiers and increasing numbers of those with physical and psychological disabilities cannot rejoin the labor market completely or partially. This means that the Ministry of Defense will have to bear the brunt of their funding.

Combined, these factors make economic cost very high and promises to stay that way for a long time to come.

This position paper addresses the most significant economic projections and the financial cost of the genocidal war on Gaza, and its expansion on the northern front into a full-scale confrontation with Hezbollah. It argues the following:

1. Despite the high cost, the financial and economic factor has not yet constituted an obstacle to the continuation of the war on Gaza and its expansion at the northern front,

2. The direct and indirect financial and economic cost of the war on Gaza and Lebanon is very high, and its impact will be far-reaching and profound,

3. The decline in Israel's global image and standing and the international protest and boycott movements will make it difficult for the Israeli economy to recover,

4. The government's performance, the presence of Bezalel Smotrich as Minister of Finance, as well as the government's plan to restrict the independence of the judiciary are further impediments to the restoration of the Israeli economy,

5. Despite the high economic costs, the Israeli economy has not collapsed or declined significantly to a point that may pose a risk or a phase that disables its recovery,

6. These conditions will increase the Israeli economy's need for external support, especially from the US administration.

## Economic Conditions before the War

On the eve of the war, the Israeli economy experienced a period of instability as a result of fissures in Israeli society and political protests against the government's plan to restrict the judiciary. Generally speaking, however, economic indicators were fairly good. Economic growth forecasts for 2023-2024 were around 3 percent, the labor market was performing well with a low unemployment rate of 3.5 percent, and the expectations were of a moderate inflation of around 3.8 percent. At the same time, there was a devaluation of the shekel (NIS) against the US dollar in 2023, banks' prime interest rose to a record 4.75 percent, concerns began to grow about downgrading Israel's credit rating, and the government's fiscal deficit rose to 1.5 percent of GDP. These figures, though slightly worse than they were in 2022, were generally moderate and did not indicate a serious economic crisis in Israel.

But the current and expected economic projections of the cost of the current war on Gaza and Lebanon have changed these data and estimates. Some 15 months after the beginning of the war, it has become clear that the costs that the Israeli economy is paying, and will pay in the future, will be heavy and will impact many economic aspects.

In the following paragraphs, we review the most important expected future effects on the overall Israeli economy due to the war on Gaza.

## The Cost of Military Operations

The economic and financial costs and losses of war consist of the direct cost of military operations as well as the indirect losses that extend over the medium and long term. One of the most direct costs of the war on Gaza was the recall of about 300,000 reservists in the early days, which meant that the government would bear the cost of conscription, and the Israeli economy would bear that of output due to their absence from the workforce.

According to the Ministry of Finance, the direct cost to the state treasury of one day for 100,000 reservists is approximately NIS 70 million in salaries. This figure is not final; there is an additional cost related to sheltering and feeding these soldiers, so the figure is closer to NIS 100 million per day. There is also an indirect cost reflected in the loss of output, which is also estimated at NIS 100 million per day. Therefore, estimates are of a direct total cost of about NIS 200 million per day. According to the Ministry of Finance, the cost of each day in the war, in terms of equipment, ammunition, and reservists, is one NIS billion.[1]

The Israeli military used vast amounts of weapons, ammunition, and equipment, particularly high-cost smart missiles and Iron Dome rockets. The army will surely need to make up shortages in the stockpile, which will also raise military expenses after the war (as we will explain later).[2] All these factors have made the direct and indirect military economic cost of the war very high and unprecedented in the history of Israeli wars.

The Bank of Israel and the Ministry of Finance estimate the financial cost of the war on Gaza, up to May 2024, to reach NIS 250 billion, which includes the military cost and the

1. Zeiton, Yoav et al. (2024, January 7). The most expensive war- and Israel's goals have not yet been met: a snapshot after 3 months. Ynet. [Hebrew]

2. Hezki, Baruch. (2024, January 22). Bank of Israel Governor: this will be the price of war in Gaza. Channel 7. [Hebrew]; Lior, Gad. (2024, October 7). The deficit, interest rates, inflation and credit rating: This is what happened to the Israeli economy in the year of war. Ynet. [Hebrew]

direct and indirect financial losses of the war. There also are estimates that the cost of the war after its expansion into Lebanon comes to 300 billion shekels.

## More Military Spending

The 2023 budget of the Ministry of Defense—i.e., before the outbreak of the war—amounted to about NIS 60 billion. For 2024, it is about NIS 99 billion, after accounting for the increases. The Nagel Commission[3] is expected to allocate an additional NIS 20-30 billion annually to the security budget in the coming years, and the ministry's budget for 2025 is expected to be around NIS 118 billion, almost twice the 2023 budget. In addition to the current needs as a result of the war, the increase in spending is intended to finance strengthening the army because of the change in the security situation.[4]

Thus, one of the most prominent financial projections of the cost of the war is the need to almost double the defense budget. The 2024 security budget is expected to account for about 7 percent of Israel's GDP, which is double what it was in 2022 and about 2 percent higher than it was in 2023 until the outbreak of the war.[5] It is the second highest share in the world (after Ukraine, where the security budget accounted for about 23 percent of GDP), which will prompt major adjustments in the overall budget as well as budget cuts that will impact economic growth.

## Declining Economic Growth

One of the most significant negative effects of the war on Gaza is the decline in Israel's economic growth. Since the beginning of the war, and particularly in the first two months, there has been a decline in consumption, production, and investment, and a complete disruption of the economy in the south and, partially, in the north of the country. This has led to a decline in tax collection and in economic growth. In contrast, the rise in government spending because of the war is expected to mitigate this decline.

According to recent data from the Central Bureau of Statistics, there was a 1.4 percent decline in GDP in the second quarter of 2024 compared to that of 2023. As for business GDP, there was a serious decline of 4.8 percent in the second quarter of 2024, which meant that the economy was entering a recession. The volume of exports also declined

3. "The Nagel Commission" is an expert committee that looks into the army's and military institution's financing and equipment needs. It was appointed by the government at the beginning of August 2024.

4. Toker, Nati. (2024, November 28). Nine pits that the war created in the economy. The Marker. [Hebrew]

5. Lior, Gad. Reference No. 2.

by 8.1 percent, imports of goods and services dropped by 9.8 percent, and real estate investments slowed by 16.9 percent.[6]

According to the Ministry of Finance and the Bank of Israel, expected growth in 2023 declined from 3 percent to 1.5 percent. There are predictions of a slowdown in growth for 2024 from 3 percent to around 1.7 percent.[7] If the natural increase in population is taken into account, there is zero growth in 2024. The Aaron Institute for Economic Policy at Reichman University predicts that economic growth in 2024 will be negative, reaching -3.1 percent, which means a decline in GDP per capita by 5 percent; that the GDP fiscal deficit will reach about 9 percent; and that the ratio of external debt to GDP will reach 71 percent.[8] The Institute also estimates economic growth to be about 1.7 percent in 2025, and a decline in the deficit to 7.8 percent of output, while external debt will rise to 76 percent of GDP.

Finally, the International Monetary Fund also lowered the growth forecast for the Israeli economy for the years 2024 and 2025, as part of its forecast for the global economy published at the end of October 2024. It said that the growth of the Israeli economy for this year will be 0.7 percent compared to the previous forecast of 1.6 percent. The forecast for economic growth for 2025 has also been lowered from 5.4 percent to 2.7 percent now.[9]

## Government Budget

In light of these economic conditions as the war continues, the Israeli government was forced to raise the 2023 budget by NIS 30 billion to become NIS 510 billion. The Ministry of Finance also reconfigured the 2024 general budget and adapted it to the state of war, and proposed budget cuts and tax hikes.[10] The Ministry also proposed reducing all ministries' budgets by 3 percent, raising the value added tax from 17 percent to 18 percent at the beginning of 2025, increasing the total budget for 2024 by NIS 69 billion to reach NIS 585 billion, raising the government's fiscal deficit by 5-6 percent of GDP in 2024 and 2025. External debt is expected to reach 70 percent of GDP.

This means that the government will have to make new cuts in the budgets of all ministries and raise taxes to finance the expenses of the war and lift the burden of external debt. For

6. Central Bureau of Statistic. (2024, December 16). National Accounts: Third Quarter of 2024. Central Bureau of Statistic. [Hebrew]

7. Pilot, Adrian. (2024, January 14). JP Morgan warns: Israel's deficit could jump NIS 100 billion within two years. Calcalist. [Hebrew]

8. Eckstein, Zvi; et al. (2024, September 26). Complete update of economic forecasts 2024- 2025. Aaron Institute for Economic Policy, Reichman University. [Hebrew]

9. Nagy, David. (2024, October). IMF cuts Israel's growth by more than half. The Marker. [Hebrew]

10. Lior, Gad. Reference No. 2.

example, in the 2025 budget, Finance Minister Bezalel Smotrich proposed a reduction in the higher education budget by NIS 400 million starting in 2026, and another in the transportation budget by NIS 700 million in each of the four years 2025-2028.[11] The proposed cuts also include a significant cut of NIS 270 million in the budget of the Ministry of Economy in areas dedicated to encouraging innovation and industrial technology.

## Increasing Budget Deficit

The budget deficit is expected to rise as a result of declining economic growth and consumption, lower revenues, especially from taxes, and higher government expenditures to cover the costs and losses of war and reconstruction, especially in the southern region. According to preliminary estimates, the value of civilian damage in southern towns amounted to about NIS 6 billion (about $1.5 billion). There will also be a need to finance military expenses for the war and to complete stockpiles of equipment, weapons, and ammunition, which would require significant increases in the defense budget.

According to Ministry of Finance data and estimates, before the outbreak of the war, the government budget deficit in 2023 was expected to reach 1.3 percent of GDP, and in 2024 to be approximately 1.1 percent. After the outbreak of the war, the deficit in 2023 is expected to reach 3 to 4 percent, and in 2024 to be about 8 percent.[12]

## Foreign Debt

The ratio of external debt to GDP is expected to rise to nearly 70 percent, compared to 60 percent in recent years. According to the Aaron Institute, this is the highest percentage Israel can reach without harming its international credit rating.[13] Last November, the government again revised the fiscal deficit ceiling by an additional 1.1 percent, from 6.6 percent of GDP to 7.7 percent, bringing the government budget in 2024 to NIS 660 billion.[14] IMF estimates updated until October 2024 indicate that the deficit will reach approximately 9 percent of GDP. These estimates are based on the fact that the government is unable to implement all the required budget cuts for political reasons.[15]

11. Ibid.

12. Eckstein, Zvi; et al. (2023, December 24). Economic impact of the Gaza war on Israel's economy and needed policy recommendations. Aaron Institute for Economic Policy, Reichman University. [Hebrew]

13. Ibid.

14. Teitelbaum, Shlomo. (2024, November 11). Hacked for the third time: The government approved increasing the 2024 budget by more than NIS 33 billion. Calcalist. [Hebrew]

15. Plutscher, Saber. (2024, October 23). IMF: Budget deficit will be NIS 40 billion larger than Smotrich's estimate. Ynet. [Hebrew]

To finance these costs, the Ministry of Finance borrowed on an almost unprecedented scale. Government debt has risen from NIS 1.04 trillion at the end of 2022 to NIS 1.25 trillion in the second half of 2024.[16]

## Inflation

Inflation rose in 2023 and was expected to reach about 4 percent, which prompted the Governor of the Bank of Israel to raise the basic bank interest rate several times to reach about 4.5 percent, after it had been 0.5 percent in the last decade.

The war on Gaza has contradictory effects on inflation. On the one hand, there are factors that cause a decline in inflation, the most important of which are a decline in public consumption and an expected economic recession following the war. On the other, the shekel exchange rate against the dollar is expected to continue to decline—that is, there will be higher prices for imported goods and services and high volume of government spending—and the war will lead to a shortage of many agricultural products due to the concentration of Israeli agriculture in the southern region. There are also expectations of a global rise in oil prices, which will lead to higher fuel prices in Israel.

These contradictory factors will create pressures toward higher inflation in the short and medium terms and to remain between 4.5 and 5 percent.

## Labor Markets

The impact of the war on labor markets varies according to economic sectors. At the beginning of the war, Israel prevented the entry of Palestinian workers from the West Bank, and the majority of foreign workers left the country. As a result, there has been damage to traditional economic branches such as construction, infrastructure, traditional industry, and agriculture. This is expected to lead to a decline in the construction of apartments and houses, a rise in real estate prices, a negative impact on construction companies due to the disruption of many projects, as well as a decline in agricultural output and a rise in the prices of vegetables, fruits, and agricultural products.[17]

On the other hand, there is damage to the high-tech sector and advanced manufacturing resulting from the recruitment of reserve forces who work in this sector, as well as the

16. Research Unit, Bank of Israel. (2024, October 9). Economic Forecasts. Bank of Israel. [Hebrew]

17. Teitelbaum, Shlomo. (2024, January 4). The government is relying on foreign workers instead of Palestinians-and it is only making the problem worse. Calcalist. [Hebrew]

deactivation of thousands of Israelis due to physical and psychological injuries in the war.[18] There will also be an almost complete halt of activity in the tourism sector for several months. Instead, the entire military-industrial sector is likely to witness an expansion in orders and number of workers. This is in addition to the global rise in demand for weapons, military equipment, and ammunition from Israel's military industries and the continuation of sales of Israeli weapons systems in 2024 in the global and local markets.[19] For example, earlier this year, the Ministry of Defense signed huge deals with Israeli military manufacturers, including Elbit Military Industries, to purchase thousands of weapons, precision ammunition, and aircraft shells designed specifically for the Israeli army, worth one billion shekels, to ensure a self-supply of weapons and ammunition and to reduce the dependence on American weapons.[20]

Overall, unemployment did not rise sharply during the war. Currently, the unemployment rate, after accounting for seasonal factors, hovers around 3.6 percent compared to 3.4 percent before the war. This comes despite the recruitment of tens of thousands of reservists and the disruption of thousands of workplaces during the year of war around the Gaza Strip and on the Lebanese border.[21]

However, Israel's employment rate continues to decline compared to that of the world, due to the absence of a large number of ultra-Orthodox men and Arab women from the labor market. According to data from the Central Bureau of Statistics and the Bank of Israel, the employment rate for the age group 15 years and over in September 2023 was approximately 61.5 percent, and is now at a lower level of 60.9 percent.[22]

## A Decline in Israel's Credit Rating

There was a decline in Israel's credit rating from international rating companies in 2024, as a result of the decline in the performance of the Israeli economy and increased risks. For example, Moody's warned that a military confrontation would materially weaken Israel's institutions, particularly policymaking tools. Moody's is concerned about the fiscal lack of discipline in the aftermath of the war, and there is uncertainty about the NIS 15 billion to NIS 20 billion increase in annual war spending in the coming years.[23]

18. Shihadeh, Mtanes. (2024, August 1). The War on Gaza and Israel's Technology Sector. Arab Center Washington DC.

19. Economic Walla. (2024, December 9). In a world of amazement: The Israeli defense industry is selling more weapons than ever before. Walla. [Hebrew]

20. Srugim. (2024, December 7). Huge deal: Ministry of Defense reduces dependence on Americans. Srugim. ]Hebrew[

21. Teitelbaum, Shlomo. Reference No. 17.

22. Ibid.

23. Alon, Ilan. (n.d). The Economic repercussions of the war: How much will it cost us? [A lecture by Head of the Economics Department at the "College of Management"]. College of Management. [Hebrew]

The war has caused severe damage to the Israeli economy and raised fears that Israel may find it difficult for the first time to pay off part of its debt in the future. Subsequently, credit rating agencies have lowered Israel's credit rating levels. This was accompanied by sharp reports expressing concern about the expansion of the war in the Middle East and on Israel's borders, and harshly criticizing the Israeli government for not taking appropriate steps to deal with the crisis situation and for undermining the foundations of democracy in the country.

Before the war, Israel's credit rating was at an all-time high, and the outlook was positive for a possible future increase in grading. Israel was listed by some agencies among the top 20 countries for strong, stable, and prosperous economies globally.

After the outbreak of the war, rating agencies hesitated about a credit downgrade, but in February came Israel's first-ever lowering of credit rating. Moody's downgraded the rating by one grade, and several months later downgraded it by two. Standard & Poor's, the world's largest, first cut the rating in April of this year by one grade, and then by an additional level last week to A. Soon after, Fitch joined the same grading to A for the first time.[24]

The negative outlook of these agencies threatens to further reduce Israel's credit rating soon if the war expands further, and if the government continues to avoid taking the necessary steps to reduce the budget deficit and ensure economic stability. These reductions have also led to a higher cost of insuring government bonds, reflecting the high risk of investing in them.

## Conclusion

After the signing of a ceasefire agreement between Israel and Hezbollah, the reduction in the intensity of the war on Gaza, and the almost complete cessation of rocket attacks on Israeli towns, the Israeli economy began to gradually return to normal, as the assessment of the damage of the war and addressing its economic consequences began. At the beginning of December 2024, the Knesset approved, for the fourth time, raising the allowable budget deficit to 7.7 percent of GDP, and the government began implementing fiscal policies to finance the deficit and cut expenditures, especially military ones, through a series of tax decisions, including raising the value-added tax by 1 percent (from 17 percent to 18 percent); increasing the national insurance tax rate; freezing children's allowances; and making cuts in the ministries' budgets.

The economic impacts of the war until the end of December 2024 were widespread,

24. Waxman, Avi & Halpern, Nimrod. (2024, September 27). Lowest level ever: Moody's downgrades Israel's credit rating by two levels- to Baa1. The Marker.

including significant damage to economic activity, both domestic and international (exports and foreign investments), along with a significant increase in government expenditures for consumption and emergency budgets to support evacuees, losses in economic activity, and reduced government revenues. All of this threatens economic stability that may deviate from the growth path of recent years.

Additionally, there is a general lack of confidence by the business sector and large companies in the economic and financial management of the government. The current government has chosen to deal with the economic changes as a result of the war with the same traditional economic tools by reducing the budget and raising the deficit, and has not imposed additional significant income taxes, especially on the wealthy classes or on companies. It also has not reevaluated the division of resources, and has continued to adhere to existing economic approaches.

The government approved a 3 percent across-the-board reduction in the allocations to all ministries in the 2024 budget, but instead kept all reserve funds in accordance with the coalition agreements, specifically budgets allocated to settlements and others allocated to ultra-Orthodox groups. The government does not want to increase the public debt significantly for many years and continues to abide by the terms of the governing coalition and to allocate special budgets to the coalition partners. Thus, it adds future obstacles and problems to the economic situation, heightening economic uncertainty. All this will increase economic distress and crises, and may prolong and deepen the economic calamities long after the end of the war on Gaza.

Despite all of this, the Israeli economy remains solid and has not collapsed, foreign investment has not stopped or declined significantly, GDP remains high, and tax collection has improved in recent months. Under current conditions, and despite the damage and economic decline, the Israeli economy can recover in the coming years. This can be done with significant American support, continued reliance on the primary economic sectors—including high-tech—in playing a central role in the Israeli economy, and a significant increase in arms exports that will continue to provide large amounts of foreign currency, taxes, and a plethora of jobs.

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