The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

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Main reports

Three international reports survey the crisis in the Palestinian economy. Real GDP per capita has fallen over 25% since 1999. According to UNCTAD, imports totalled 86% of Palestinian GDP in 2006, and the trade deficit was 73% of GDP.

PCBS's 2006 Economic Survey Series shows that employment in five major sectors fell by 8.5% in 2006, while the number of businesses in these sectors fell by 4.4%.

Rising prices in Gaza drove inflation up at its fastest rate this year. The CPI rose 4.19% in Gaza and 2.17% overall.

Preliminary national account figures from PCBS show GDP rising by 6.5% in the second quarter of 2007 compared with the first quarter, reflecting the impact of public sector strikes in the earlier period. Compared with the second quarter of 2006, GDP in the second quarter of 2007 fell by 4.9%

Gaza banking system in jeopardy

On 25 September, Israel's largest bank, Bank Hapoalim, announced it would cease doing business with banks in Gaza. Bank Hapoalim's decision came after Israel declared Gaza "hostile territory" on 19 September. Although legally obliged to give two months notice, Bank Hapoalim informed the Palestinian Monetary Authority (PMA) that the freeze would take effect on 23 October.

A banking disruption would deal Gaza's economy a serious blow. The absence of a cheque-clearing mechanism would delay resumption of trade between Israel and Gaza even further. Scarcity of currency could also interfere with payment of salaries. For example, the Ministry of Finance told the Bulletin that the PA employs around 34,000 full-time civil servants in Gaza, and about 35,000 security officers, which requires a monthly transfer of around NIS 240m. In August, Gaza imported 400 million shekels [$100m] from Israel, according to Israeli authorities.[1]

Amir Shaat, the head of the Foreign Relations Division at the Bank of Palestine, the largest in Gaza, told the Bulletin that if Israel halts cash transfers between the West Bank and Gaza, business would become especially difficult. The Bank of Palestine is officially headquartered in Gaza, where it has 12 branches. As the Bulletin went to press, the Bank was awaiting Israeli permission to transfer its headquarters to the West Bank, where it has 18 branches and where its senior management is based.

Last year, the PMA and the Central Bank of Israel (BOI) worked together to overcome difficulties created by an earlier bank freeze. Contacts between the two have been initiated again.[2] The PMA convened an emergency meeting of Palestinian banks on 26 September, telling the Bulletin that it was especially anxious to know whether Israel Discount Bank would also severe ties. Meanwhile, the BOI suggested the state-owned Israel Postal Bank might supply currency to Gaza, but this step would require Israeli government approval.[3]

Gaza's energy supply in the balance

Gaza's fragile energy supply appeared further threatened following Israel's 19 September declaration that indicated it might provide only enough fuel and electricity to meet humanitarian needs.[4] At the time of publication, Israel had not put this policy into effect. Gaza currently receives 120 megawatts, or 60%, of its municipally distributed electricity from the Israel Electric Company (IEC). Another 56 MW, or 30%, is generated locally at Gaza's sole power plant (GPP). At full capacity, the GPP could supply 140 MW, but four obstacles have kept it from doing so.

[1] http://www.haaretz.com/hasen/spages/907251.html
[2] http://www.pma-palestine.org/arabic/dailyrep/rep.pdf
[3] http://www.haaretz.com/hasen/spages/907626.html
[4] http://www.mfa.gov.il/MFA/Government/Communiques/2007/Security+Cabinet+declares+Gaza+hostile+territory+19-Sep-2007.htm

First, the EU, which pays for the gas-oil that fires the GPP, only buys enough to generate 56 MW. Second, only two of the plant's four generators, each of which can generate up to 35 MW, have been in service in recent months. A repair team from Siemens was expected to make the other two operational in October, according to Rafeeq Malikha, CEO of the Gaza Generating Company. Third, because gas-oil is more expensive than natural gas, electricity from the GPP is more expensive than from the gas-fired plants of the IEC. Consequently, Gaza consumes electricity from the IEC in preference to the GPP, regardless of the GPP's output. Finally, even if it could generate 140 MW, transmission bottlenecks mean the GPP can only put 65 MW on the grid. Italy's proposed installation of five transformers under Phase II of the Palestinian Trust Fund Gaza Recovery Plan has stalled.

The one reliable, if small, source of electricity for Gaza has been from Egypt, which currently supplies 17 MW to the southern town of Rafah. Egypt may well hold the key to Gaza's energy independence. The World Bank has recommended that the GPP be converted to use natural gas instead of the more expensive gas-oil.[5] It estimated this would cost $5m. The gas could reliably be brought in from Egypt through a new $10m pipeline. In the long-term, gas could come from the large but unexploited field recently discovered off the coast of Gaza.[6] Together with the restoration of its generating and transmission capacity, these developments would reduce the vulnerability of Gaza's energy supply through diversification. They would also help keep large sums of money from flowing out of Gaza's economy. An EU official indicated that Europe, in cooperation with the PA, would be open to exploring a modification in the structure of energy assistance.

Second quarter national accounts

GDP grew at an annualised 6.5% in the second quarter, according to preliminary figures released by the Palestinian Central Bureau of Statistics (PCBS).[7] Per capita GDP was also up, rising by 5.7%. PCBS cautioned, however, that direct comparisons between the first and second quarters may be misleading, as the economic impact of public sector strikes was at its height during the former. Compared to the second quarter of 2006, GDP fell by 4.9% and GDP per capita by 8.0%.

The largest increases in gross value added were registered in the education sector (+32.1%), hotels (+24.9%), health (+15.2%), construction (+13.9%) and agriculture (+12.8%). Value added fell in the mining, manufacturing, water and electricity sector (-0.2%) and in the transport sector (-3.0%). Manufacturing's contribution to GDP fell by 0.7% to 10.2%.

Real quarterly GDP (Base Year 1997)

Three report on the Palestinian economy

Three separate reports* on the Palestinian economy agreed that its state was precarious and a change of direction was urgent. Between 1999 and 2006, real GDP per capita declined by over 25%, from $1,612 to $1,192. The reports stressed that inaction might lead to an economic collapse that puts a peace settlement out of reach. They urged that the benefits of measures that improve security in the short-term be weighed against their economic costs, whose cumulative effect could imperil security in the long-term.

The World Bank reported on the lack of progress toward the economic policy goals set by the Ad-Hoc Liaison Committee (AHLC)† in 2005 in London. These were a marked improvement in the overall security environment; an easing of restrictions on movement and access; and

* *Two Years After London: Restarting Palestinian Economic Recovery* (World Bank); *Report on UNCTAD assistance to the Palestinian people* (UNCTAD); *Economic aspects of peace in the Middle East* (UK government)

† The AHLC is a 12-member committee that was set up in 1993 by the steering committee of the multilateral peace talks. It serves as the principal policy-level coordination mechanism for Palestinian development assistance.

[5] See *West Bank and Gaza Energy Sector Review* at http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/294264-1166525851073/EnergySectorReviewMay07.pdf

[6] See *Palestinian Economic Bulletin* Nos. 9-10, June-July 2007

[7] http://www.pcbs.gov.ps/Portals/_pcbs/PressRelease/pressQ207e.pdf

progress on Palestinian institution-building and reform.[8] On all three goals progress has stalled. The World Bank was troubled by the changing composition of the Palestinian economy, which shifted toward government and private consumption, fuelled by aid, borrowing and remittances from abroad. Very little money was left for investment and development. Business investment declined by 15% between 2005 and 2006. The World Bank welcomed steps Prime Minister Salam Fayyad had taken to reform PA financial institutions and controls.

The United Nations Conference on Trade and Development (UNCTAD) annual report estimated that between 2000 and 2005, the Palestinian economy lost potential income of $8.4bn.[9] UNCTAD noted that Palestinian economic dependence on the Israeli economy has grown. In 2006, imports totalled 86% of Palestinian GDP, and the Palestinian trade deficit was 73% of GDP. Two-thirds of this deficit was owed to Israel. While imports rose by 20% from 2005, exports declined by 3%. To reverse these trends, the report recommended a diversification of trading routes and partners. In particular, UNCTAD urged that shipments currently routed through Israel be rerouted through Egypt and Jordan, a shift that could save Palestinian traders $20m a year. More desirable still, according to UNCTAD, would be the opening of Gaza's seaport.

The British government report also expressed concern at the growth of public spending and concomitant decline of the private sector, which it maintained is the only source of sustainable economic growth.[10] Citing The Portland Trust's study on Northern Ireland, the authors argued that economic growth is vital to a peace settlement.[11] The report emphasised the paramount importance of improving movement and access, in accordance with the November 2005 agreement, and it echoed UNCTAD's call for a diversification of Palestinian trade routes.

Mixed picture of 2006 economic trends

Employment and the number of businesses in five major sectors of the Palestinian economy fell between 2005 and 2006, according to the Palestinian Central Bureau of Statistics' (PCBS) latest Economic Surveys Series.[12] In a pattern mirroring the previous year's, Palestinian business activity was distributed among these sectors as follows: 61.8% of firms were engaged in internal trade, 21.7% in service provision, 15.8% in industry, 0.8% in storage and communication and 0.6% in construction.[‡] These businesses employed 197,302 people, 8.6% fewer than in 2005. The number of businesses fell by 4.4% to 71,966. Despite these declines, value of output ($3,198m), gross value added ($1,957m) and gross fixed capital formation ($89m) were higher.

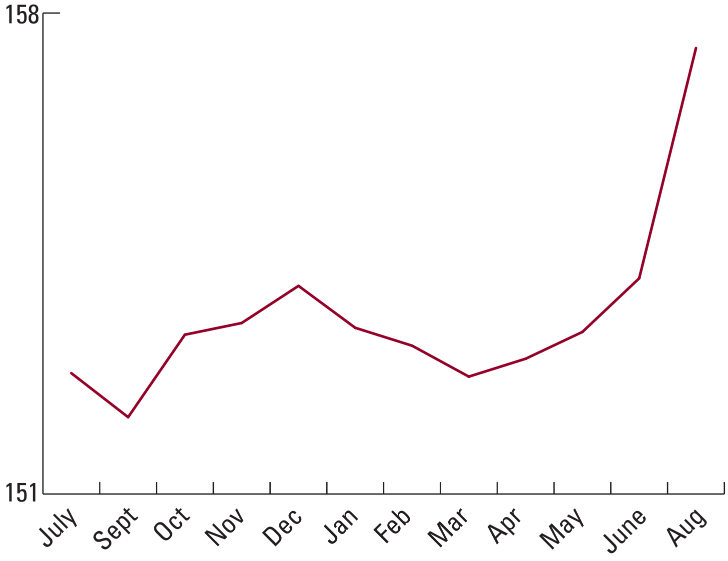
Karni remains closed

Karni, the main commercial crossing between Gaza and Israel, remained closed in September. Limited quantities of humanitarian goods continued to be imported through the secondary crossings of Sufa and Kerem Shalom, but exports have stopped.

Gaza drives continuing inflation

The consumer price index (CPI) rose for the fourth month in a row.[13] In August, it rose by 2.17%, its highest one-month gain in 2007. The rise reflected the political crisis in Gaza, where prices increased by 4.19%. Prices rose by 1.91% in the relatively stable West Bank and by only 0.20% in East Jerusalem. Prices in Gaza, which has been cut off from most imports, like building materials, since mid-June, increased especially steeply in three categories: beverages and tobacco (+18.11%), food (+4.51%) and housing (+6.97%). Reacting to the rising prices, the government in Ramallah announced it would give 117,000 of the poorest Palestinian families $100 each.

Consumer Price Index (Base Year 1996 = 100)



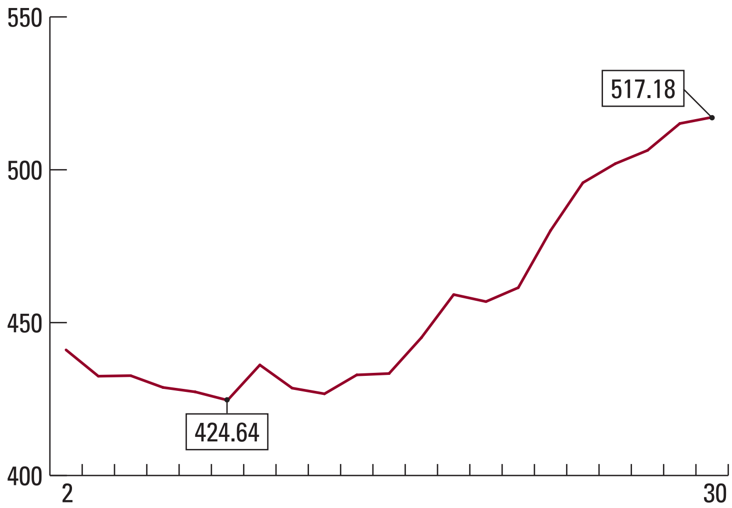
‡ Total does not sum to 100% due to rounding errors.

8 http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/AHLCMainReportfinalSept18&cover.pdf
9 http://www.unctad.org/en/docs/tdb54d3_en.pdf
10 http://www.fco.gov.uk/Files/kfile/378781_PU158.pdf
11 See The Portland Trust's Economics in Peacemaking: Lessons from Northern Ireland, available at http://www.portlandtrust.org/Economics%20in%20Peacemaking%20-%20Lessons%20from%20Northern%20Ireland.pdf
12 http://www.pcbs.gov.ps/Portals/_pcbs/PressRelease/Release%20_E2006_.pdf
13 http://www.pcbs.gov.ps/Portals/_pcbs/PressRelease/Press%20E%2007.9.pdf

Stock market

The Al-Quds index of leading shares was up 17% in September. 30.8 million shares changed hands, an increase of 106.7% from August. The value of traded shares was $96.8m, an increase of 146%. Thameen Kayed of the Palestine Securities Exchange told the Bulletin that investors were buoyed by financial data indicating many companies had been undervalued.

September Al-Quds stock market index



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The Portland Trust launched the Palestinian Economic Bulletin in October 2006. It represents an attempt to gather the most valuable Palestinian economic and financial news and analysis in one readable document. Our electronic readership has grown to over 600, with an additional 200 hard copies being sent out by post. The feedback from our readers has been positive.

As the first year of publication comes to a close, we would like to conduct a thorough review of the Bulletin. We would like to know how useful you have found this monthly publication and what changes you would like to see to either the format or the focus.

All comments are welcome.

Please send your response to: feedback@portlandtrust.org

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