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PALESTINIAN ECONOMIC BULLETIN

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Main reports

The PCBS released a report on the Palestinian economy which reviews recent trends and provides forecasts for the year 2013.

A report by the International Monetary Fund (IMF) evaluates the structural characteristics and recent performance of the labour market in the Palestinian Territory.

New international aid commitments to projects and programmes in the Palestinian Territory were secured during the last quarter of 2012.

The Palestine Exchange (PEX) held its 6th Annual Palestinian Capital Market Forum on 11 December 2012.

Palestinian Authority's Financial Crisis

The recent decision by the Government of Israel (GoI) to withhold tax revenues collected on behalf of the Palestinian Authority (PA) has exacerbated the financial crisis in the Palestinian Territory. Israeli authorities decided to retain the PA's tax revenues collected during the months of November and December and stated that they would use them to offset the latter's debt to the Israel Electric Corporation.[1] As established in the 1994 Oslo accords, Israel collects VAT, customs and income tax from Palestinians working in Israel and the Israeli settlements on behalf of the PA on a monthly basis.

In a recent interview the Palestinian Prime Minister Salam Fayyad claimed that due to the current financial situation the PA is close to bankruptcy.[2] He added that tax money withheld by Israel amounts to around $125m monthly, around two thirds of the PA's total revenues.

The financial situation of the PA has worsened during 2012. A report by the World Bank issued in September noted that by the end of the first half of last year the Palestinian public recurrent deficit was 32% above the budgeted target, amounting to $632m. The organisation pointed out that the imbalance was a result of higher than expected expenditure, lower than forecasted revenue and declining donor aid. Total external support received by the PA was only $446m during the first six months of 2012, around 40% lower than the total amount needed to finance recurrent and development expenditures. With local public debt almost at the limit that the banking sector can sustain (around $1.3 billion), the report considered the likelihood that the PA would be 'forced to finance the gap through accumulating additional arrears to the pension system and cutting some of its basic spending such as wages, which could have severe social impacts.'[3]

Overall the recent action taken by the GoI, together with the vulnerable pre-existing financial conditions, hinder the PA's ability to guarantee the provision of basic services in the Palestinian Territory.[4] PA employees received only half of November's salaries, which payment was financed with an extra $100m borrowed from local banks[5] and international aid.[6] As the Bulletin went to print, December wages remain unpaid. As a response, several public sector strikes and protests took place during December and January.[7] Overall, the PA employs around 150,000 workers, including civil servants and members of the security forces.

Health services have also been greatly affected. As a result of the PA's accumulated unpaid arrears, which reached more than NIS85m as of 30 November 2012, the hospitals in the East Jerusalem Hospital Network (EJHN) have been unable to pay salaries and are highly indebted to medical suppliers. Emergency measures have had to be implemented to cut expenses, including laying-off staff and delaying

1 www.bit.ly/VQ7iok
2 www.alquds.com/news/article/view/id/409274
3 www.bit.ly/S5jp0n
4 www.maannews.net/eng/ViewDetails.aspx?ID=547149
5 www.gulfnews.com/news/region/palestinian-territories/fayyad-warns-west-of-collapse-of-pna-1.1127416
6 www.bit.ly/144guZV
7 www.maannews.net/ENG/ViewDetails.aspx?ID=554165

non-urgent care. There is growing concern that the vital services provided by the EJHN will be jeopardised if financial assistance is not secured soon.[8]

Given the lack of alternative local funding sources, the PA is seeking to secure stable flows of foreign aid in substantial amounts. Regarding assistance from Arab countries, the Palestinian Cabinet has expressed surprise and concern over the delays in the activation of a $100m monthly safety net promised by Arab donors at the Arab League summit held in Baghdad in March 2012.[9 10]

According to Fayyad's estimations, if a solution is not provided soon, the financial crisis will rapidly double the poverty rate in the Palestinian Territory to 50% of a population of around 4 million people.[11]

Economic Forecast for 2013

The Palestinian Central Bureau of Statistics (PCBS) released a report on the Palestinian economy which reviews recent trends and provides forecasts for the year 2013.[12]

Figure 1 below shows the main indicators under the four scenarios evaluated in the analysis. The 'base' scenario assumes that the economic and political situation in the Palestinian Territory will remain the same as it was throughout the year 2012. Key variables include donor aid, measures adopted by the PA to cut the fiscal deficit, restrictions on movement and goods and stability of the flow of customs revenues from Israel.

Figure 1: Economic forecasts for 2013

	Scenario			
Indicator	**Base**	**Optimistic**	**Pessimistic (least severe)**	**Pessimistic (more severe)**
GDP growth (annual rate)	5.5%	10.9%	-2.9%	-14.5%
Central Government deficit (change from 2012)	10.5%	5.1%	28.3%	>28.3%
Gross government revenues (change from 2012)	12.6%	13.6%	-26.6%	-54.0%
Total unemployment (rate)	23.1%	20.6%	25.0%	27.0%
External current account deficit (change from 2012)	21.8%	-12.1%	47.4%	50.3%

Source: PCBS

The 'high growth' (optimistic) scenario assumes an improvement in the economic and political conditions in the Palestinian Territory, including easing of trade and other restrictions, increased donor aid (by 20%) and continuous transfer of tax revenues by the GoI. Under these conditions a notable double-digit GDP growth rate is predicted, although its impact on unemployment is estimated to be modest. Increased trade is expected to have a sound impact on the reduction of the external deficit with respect to 2012.

The two alternative 'pessimistic' scenarios are indicative of the relatively low capacity of the Palestinian economy to show resilience against adverse conditions. In both cases a profound deterioration of the political and economic situation in the Palestinian Territory is assumed, including the establishment of increased barriers to the movement of goods and people and a continued withholding of tax revenues by the GoI.

The outcome in the most severe scenario (virtual freezing of tax flows) predicts a disastrous GDP drop of nearly 15%, resulting in high unemployment (27%) and upper limit levels of central government and external deficit.

Labour Market, Growth and Unemployment

A report by the International Monetary Fund (IMF) evaluates the structural characteristics and recent performance of the labour market in the Palestinian Territory.[13] The study indicates that since the 1994 Oslo accords, employment growth has been insufficient to absorb new labour market entrants. Whilst the population of working age has been growing at a relatively high average annual rate of 4%, labour force participation has only increased marginally, reaching a (low) level of 44% in mid-2012. As a consequence, low levels of employment have been registered during the post Oslo period, especially among youth aged 15-24 (30% in 2012) and in Gaza. Also unemployment duration is found to be high (around 11 months).

The labour market characteristics, in part, reflect the relative inability of the Palestinian economy to support private sector driven growth and promote sustainable job creation. The strong GDP growth observed between 2008 and 2011 did not result in increased employment and, remarkably, could not prevent real wages from falling by 8% in the West Bank during the same period.

In this respect the IMF report finds that to achieve a reasonable rate of real wage growth in the long run, high real GDP growth together with consistent productivity gains are required. A simulation exercise shows that to attain an annual real wage growth of 1.5% and achieve target unemployment of 7% by the year 2020, real GDP and total factor productivity need to grow annually by 8% and 3% respectively.

Finally, the report also indicates that insufficient job creation in the private sector and high and persistent unemployment in the Palestinian economy can be attributed, among other factors, to restrictions on imports and exports, continued constraints on labour mobility, low levels of private sector investment and the small size of Palestinian enterprises.

Aid

New international aid commitments to projects and programmes in Gaza were secured during the last quarter of

8 www.bit.ly/WTbMY2
9 www.maannews.net/eng/ViewDetails.aspx?ID=551949
10 www.lacs.ps/documentsShow.aspx?ATT_ID=6645
11 www.guardian.co.uk/world/feedarticle/10598962
12 www.bit.ly/VnA2Uf

13 www.imf.org/external/country/WBG/RR/2012/121312.pdf

2012. UNRWA received €3m from the German Government for the construction of two schools[14] and $4.2m from the Swiss[15] and Malaysian[16] Governments to support its regular programme and operations. Austria, Belgium and Switzerland also contributed about €11m through the EU PEGASE mechanism to support Palestinian families living in extreme poverty in the West Bank and Gaza.[17]

The Japanese Government gave $10m in the form of a development aid grant for the improvement of solid waste management in the Hebron, Jenin, Jericho, Salfeet, and Tulkarem Governorates.[18] Japan also contributed an extra $2.5m to assist the PA in the procurement of industrial products needed for economic and social development.

Additionally, in December 2012, Spain, Ireland, the Netherlands and Sweden contributed €7.4m, in response to the PA's current fiscal crisis, to support the partial payment of the November 2012 salaries and pensions to Palestinian public workers.[19] More recently the European Union decided to bring forward the first part of its 2013 assistance package for the Palestinian people to the beginning of the year. An initial €60m amount will help finance the PA's budget deficit and contribute to the payment of salaries and pensions during the first three months of 2013. A second payment of €40m will be allocated to UNWRA's 2013 regular budget.[20]

Annual Palestinian Capital Market Forum

The Palestine Exchange (PEX) held its 6th Annual Palestinian Capital Market Forum on 11 December 2012. Discussions focused on the present challenges and future prospects of the brokerage industry in the Palestinian Territory.

Among the main conclusions and recommendations were the need for firms to improve corporate governance, expand their activities, pool resources and enhance transparency and accountability. This is in order to offer better services as a way of attracting additional investment into the Palestinian Territory.[21]

A call was also made for local business leaders to work more closely with regulators and embark on a regional and international campaign to help improve the image of the Palestinian Territory as a market for investments.

Capital market report

United Arab Emirates based Rasmala Investment Bank Ltd. recently issued a report highlighting capital market investment opportunities in the Palestinian Territory. The analysis considers that '…the Palestinian market offers investors a compelling opportunity', mainly based on the country's demographics and on the fact that some of the economy's key sectors (such as banking, telecoms and infrastructure) are structurally underpenetrated.[22]

The report, considered to be the first of its kind to be produced by a Gulf Cooperation Council (GCC) banking institution, focuses on three PEX stocks that represent 67% of the Al Quds' index market cap: PalTel Group, Bank of Palestine, and PADICO HOLDING.[23] The economic sectors in which these companies operate (telecoms, banking and construction) performed particularly well during the past years and are expected to continue growing at a double-digit rate until 2014. The stocks under analysis are considered to be well positioned to capitalise on this growth given their solid management, dominating market position and strong balance sheets.

MIGA Support for start-up projects

Two new company start-up projects in the Hebron area have received support from the Multilateral Investment Guarantee Agency (MIGA), the political risk insurance arm of the World Bank Group. The initiatives will be developed by Al Haram Modern Plastic Products Industry Company, a plastic manufacturing facility, and Al Jebrini Cheese Industry, a dairy factory. They are expected to generate around 80 local jobs, reduce reliance on imports and bring technical expertise and skills to the agribusiness industry.

Al Haram will employ new technology to produce high-quality plastic dairy packaging and will supply plastic cups and containers to local dairy businesses.[24] Al Jebrini will produce and supply high-quality dairy products, including cheese and cream cheese.[25]

The support for these start-ups will be in the form of investment guarantees totalling €2.7m issued by the MIGA administered West Bank and Gaza Investment Guarantee Trust Fund, established in 1997. Although prior to 2010 the fund only managed to provide assistance to one project (in 1998), in the last two years it has supported four. MIGA's Executive Vice President, Izumi Kobayashi, notes that the fund has 'several additional projects in the pipeline', mainly in the Small and Medium Enterprises (SMEs) and local infrastructure sectors.[26]

Jerusalem Business Forum

The Jerusalem Business Forum, held on 12-14 December 2012, brought together a group of local, regional and international investors to explore business and investment opportunities in East Jerusalem. Around 300 Palestinian, Arab and international experts shared their knowledge, insights and perspectives on doing business in the city.

14 www.unrwa.org/etemplate.php?id=1558
15 www.unrwa.org/etemplate.php?id=1556
16 www.unrwa.org/etemplate.php?id=1555
17 www.bit.ly/UTRolv
18 www.ps.emb-japan.go.jp/PressRelease/PressRelease2012/n08Dec2012.pdf
19 www.bit.ly/144guZV
20 www.europa.eu/rapid/press-release_IP-13-18_en.htm
21 www.pex.ps/PSEWebSite/NEWS/18122012.doc

22 www.rasmala.com/equity_report/Palestine10Dec2012.pdf
23 www.pex.ps/psewebsite/NEWS/11-12-2012.docx
24 www.miga.org/projects/index.cfm?pid=1226
25 www.miga.org/projects/index.cfm?pid=1227
26 www.miga.org/news/index.cfm?aid=3408

The different working sessions held during the conference focused on the development of crucial economic sectors for the local economy, such as real estate, tourism, and ICT.[27]

The event was described by the Office of the Quartet Representative (OQR) as a 'real success' and it was considered to be 'an important step forward in efforts to promote sustainable economic development' and to improve living conditions in the city.[28] The OQR also confirmed that four deals were signed during the event at a reception hosted by the British Consul, Sir Vincent Fean. These included an agreement between Al Quds Holdings (one of the main sponsors of the event) and the Jordanian company Maathen Al Quds for the development of 250 apartments, and for investment in the first IT Company in Jerusalem.

Historically, East Jerusalem has been supported almost exclusively by religious tourism, which has proven insufficient in sustaining the local economy. The city now faces several challenges, including high unemployment and a shortage of affordable housing. The city's geographic location has undermined many of its industries and business opportunities as a result of the difficulty in accessing Palestinian consumers in the West Bank. By drawing positive external interest and attention to East Jerusalem beyond the local business community the Forum seeks to tackle the city's investment deficit.

PMA Developments

The Palestinian Monetary Authority (PMA) became a member of the International Association of Deposit Insurers (IADI). IADI was formed in May 2002 to enhance the effectiveness of deposit insurance systems by promoting standardised guidelines and international cooperation.[29] The achievement followed the PMA's announcement that the legal framework for the Palestinian Association of Deposit Insurance has been approved by the Council of Ministers and is expected to soon be signed by President Mahmoud Abbas. The new association is expected to insure more than 92% of all deposits in the Palestinian banking system.

Additionally, the PMA has also recently adopted the International Bank Account Number (IBAN) system, an internationally agreed means of identifying foreign bank accounts aimed at enabling more efficient international transactions.[30]

These important PMA developments are expected to increase banking deposits, promote investment, and enhance domestic and international confidence in the Palestinian banking sector.

Balance of Payments

In Q3 2012 the current account deficit decreased by 15.2% compared with the previous quarter, reaching $672.6m, which represents a high 47.1% of quarterly GDP at current prices.[31] This variation was mostly caused by a 41.9% rise in the surplus of the balance of current transfers from Q2.[32] The donors' current transfers amounted to 27.4% of the total value of receipts from abroad. The surplus in income balance ($279.1m) resulted from the compensation of employees working in Israel ($247.8m) and investment income ($32.1m, mostly explained by the interest received on Palestinian deposits in banks abroad).

Figure 2: Q2 and Q3 2012 Balance of Payments

Item	*Q3 2012 Amount*	*Q2 2012 Amount*	*Change (%)*
Current account	**-$672.6m**	**-$793.6m**	**-15.2%**
Trade Balance of Goods	-$1232m	-$1237.5m	-0.4%
Trade Balance of Services	-$84.2m	-$90.9m	-7.4%
Income balance	$279.1m	$278m	0.4%
Balance of Current Transfers	$364.5m	$256.8m	41.9%
Capital and financial account	**$614.1m**	**$875.2m**	**-29.8%**
Net Capital Account	$81.4m	$71.1m	14.5%
Net Financial Account	$532.7m	$804.1m	-33.8%

Source: PCBS and PMA

December Trading

In December the Al-Quds index increased by 4.95%, closing at 477.59 points. The index reached its lowest (455.08) and highest (478.81) levels on 2 and 27 December, respectively. 22.9m shares worth $44.29m were traded in 21 sessions. Market capitalisation was $2.85bn.

27 www.alquds.com/news/article/view/id/404613
28 www.bit.ly/VQ9Q5V
29 www.bit.ly/140zMzq
30 www.bit.ly/143fpAI
31 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_BoPQ32012E.pdf
32 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_BOPQ22012E.pdf

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