The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

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Main reports

A new Palestinian research paper was published on 18 March investigating the long-term impact of bank lending on economic growth in Palestine.

The Palestinian Central Bureau of Statistics published on 27 March, Palestine's Balance of Payments report for the fourth quarter of 2018.

The Palestinian Central Bureau of Statistics published on 19 March the International Investment Position and External Debt report for the fourth quarter of 2018.

PMA Strategy to Expand Electronic Transactions in Palestine

On 30 March, the Palestine Monetary Authority (PMA), announced the launch of a strategy to increase the use of electronic transactions and reduce the reliance on cash in the Palestinian economy. The strategy was prepared by the PMA in cooperation with the banking sector and other stakeholders and was approved by the Palestinian Cabinet in mid-2018.

To implement the strategy over the next five years, the PMA seeks to promote the use of electronic payment methods in local transactions, in both the private and the public sectors. This includes the launch of a system that will allow for the automated electronic transfer of the wages of Palestinian workers in Israel directly to their personal bank accounts on a monthly basis and with minimal fees.[1] The PMA will also work to allow the use of electronic payment cards issued by Israeli banks for purchases by Palestinians from Israel in local markets.

According to the Governor of the PMA, Mr Azzam Al Shawwa, the accumulation of New Israeli Shekels (NIS) in the Palestinian market is mainly caused by the excessive reliance on cash in local economic transactions, in addition to cash payment of the wages of around130,000 Palestinian workers in Israel (a monthly average of around NIS 600 million), and the purchases made by Palestinian Israeli citizens when they visit the West Bank, estimated by the PMA at an average of NIS 250 million monthly.[2]

One of the main goals of the strategy is to curb the accumulation of Israeli Shekels in circulation in Palestine, due to the negative impact of the surplus on the stability of the Palestinian banking system and the Palestinian economy.[3] The build-up of cash, mostly in shekels, in Palestinian markets is particularly costly to the Palestinian financial system, due to a cap on the transfer of Shekels to Israel imposed on Palestinian banks by the Government of Israel (GoI).[4] Any excess cash beyond the ceiling imposed by the GoI (currently limited to one billion Shekels per month[5]) continues to be retained within the Palestinian banking system with significant negative implications. These include the cost of physically securing large quantities of cash, the loss of potential interest on cash (above permitted transfer ceilings) that might otherwise be deposited in Israeli banks, and the holdings by Palestinian banks of excessive surplus capital leading to a drag on their return on equity (ROE).

1 www.pma.ps/Default.aspx?tabid=205&ArtMID=793&ArticleID=2380&language=en-US
2 Around NIS 3 billion annually: these unrecorded "exports" to Palestinian consumers from Israel are approximately equivalent in value to the total annual registered Palestinian merchandise exports to Israel. Ibid.
3 https://bit.ly/2UcxlMY
4 According to the terms of the Paris Protocol on Economic Relations signed between the GoI and the Palestine Liberation Organisation as part of the Oslo Accords, the Bank of Israel permits selected Israeli banks to receive monthly Shekel clearance transfers from the PMA in exchange for foreign currency. This process was modified in 2018 where the concerned Israeli banks were replaced by a central Israeli government agency authorised to facilitate currency clearance on behalf of Israeli banks. http://english.wafa.ps/page.aspx?id=60iHbya106216586553a60iHby
5 This ceiling was originally limited to NIS 80 million monthly but has been raised over the years with the buildup of NIS cash in circulation. See Box 3 in MAS Economic Monitor 55 (Q3 2018): http://www.mas.ps/files/server/20191403104037-2.pdf

The impact of bank lending on Palestine's economic growth

On 18 March, a new Palestinian research paper was published investigating the long-term impact of bank lending on economic growth in Palestine.[6] In the paper, the authors measured the impact of bank lending in Palestine on GDP growth using an econometric analysis of time series data for the years 1996 to 2015.

The paper shows that, contrary to economic theory and current development practice, bank lending in Palestine does not drive economic growth, but rather, that economic growth drives the demand for bank lending. Based on this finding, the authors conclude that inclusive and sustainable economic growth can only be achieved through addressing failures of traditional market mechanisms which should generate growth, rather than focusing on access to finance. The paper recommends that policymakers should pay more attention to the composition of bank lending in Palestine, which currently disadvantages private sector growth.

The paper suggests that Palestinian monetary authorities should incentivise financial institutions to provide more funding to productive sectors, such as manufacturing and agriculture, continue banking development processes that focus on performance of the real economy more generally, and decrease the gap between savings and lending rates through financial reforms. The paper also recommends that the Government should avoid excessive borrowing from the private sector, which risks depleting financial resources for productive private investment.

This paper builds on a study published by the Palestine Economic Policy Research Institute (MAS) in 2016, exploring the same relationship between economic growth and bank lending.[7] MAS findings were consistent with the assumption of a positive relationship between development in the banking sector and economic growth: in the short-term economic growth leads to increased demand for banking services. However, the MAS study also demonstrated that growth in the banking sector is a key factor in overall economic growth in the long-run, suggesting the importance of a long-term effective credit policy which encourages investment activities and thus stimulates economic growth.

Balance of Payments in Q4 2018

On 27 March, the Palestinian Central Bureau of Statistics (PCBS) published Palestine's Balance of Payments (BoP) report for the fourth quarter of 2018. BoP is a record of all economic transactions between Palestinian resident in Palestine and the rest of the world during a specific period. These transactions consist of imports and exports of goods, services and capital, as well as transfer payments such as foreign aid and remittances.

Table 1: Breakdown of Balance of Payments into sub-accounts

Balance of Payments = Current Account + Capital Account + Financial Account
1. **Current Account** = Net Trade in Goods + Net Trade in Services + Net Income + Net Current Transfers
a. Net Trade in Goods and Services = Exports of Goods and Services – Imports of Goods and Services
b. Net Income = Receipts from Abroad[8] – Foreign Payments
c. Net Current Transfers = Net Transfers to General Government + Net Transfers to Other Sectors[9]
2. **Capital Account** = Net Capital Transfers + Net Acquisitions/Disposals of Non-Produced, Non-Financial Assets
3. **Financial Account** = Net Direct Investment + Net Portfolio Investment + Net Other Investment (including currency, loans and deposits) + change in Reserve Assets at PMA + Net Errors and Omissions

Source: PCBS

According to the latest data, the current account deficit reached $399m (or 10.7% of GDP) in Q4 2018, a decrease of 10% compared to the previous quarter.[10] This shrinking of the deficit was mainly caused by a 51.9% ($40.3m) increase in the net investment income, which stood at $118m.

Despite the positive development in the current account, a broader view of the data indicates that Palestine's persistent current account deficit, which reflects a chronic trade deficit, worsened throughout 2018. Between Q4 2017 and Q4 2018, Palestine's trade deficit increased by 9.6%, driving a 31.5% increase in the current account deficit. Although both imports and exports increased between Q4 2017 and Q4 2018 (by 8.8% and 7.1% respectively), the large gap between the value of total imports ($2,289.4m) and the value of total exports ($769.1m), means that increase in the level of exports is miniscule when compared to increased import levels.

Table 2: BoP, Palestine, Q4 2017, Q3 2018 and Q4 2018

Item	Q4 2017 (USD millions)	Q3 2018 (USD millions)	Q4 2018 (USD millions)	Change (%) (From Q3 2018 to Q4 2018)	Change (%) (From Q4 2017 to Q4 2018)
Current account	-303.6	-444.7	-399.2	-10.23%	31.5%
Ratio of Current account to GDP	8.2%	12.2%	10.7%	-	-
Trade Deficit	-1,386.6	-1,520.6	-1,520.3	0%	9.6%
Ratio of Trade Deficit to GDP	37%	42%	41%	-	-
Compensation of workers in Israel	507.2	567.8	533.2	-6.09%	5.1%
Investment Income	61.7	77.6	118	51.9%	191.1%
Current transfers (net)	538.7	467.1	508.8	8.93%	-5.6%
Capital account (net)	120.5	110.6	105.3	-4.79%	-12.6%
Financial account (net)	192.9	463.4	222.9	-51.90%	15.6%

Source: PCBS and PMA

6 Awad, I.M. & Al Karaki, M.S. "The impact of bank lending on Palestine economic growth: an econometric analysis of time series data". Financial Innovation (2019) 5:14. https://doi.org/10.1186/s40854-019-0130-8.

7 Rabeh Morrar, Linkages between Aggregate Banking Indicators and Economic Growth, MAS 2016. http://www.mas.ps/files/server/20161005145013-1.pdf

8 Receipts from Abroad = Compensation of Employees in Israel + Compensation of Employees in Countries Other Than Israel + Foreign Investment Income

9 Net Transfers to the General Government and To Other Sectors Are Divided Between Transfers from Donors and Transfers from Non-Donors

10 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_27-3-2019-BOP-en.pdf

Palestine recorded a financial account surplus of $222.9m in Q4 2018, a 51.9% decrease in surplus from the preceding quarter. This decrease was driven by a significant decline in the net equity and debt portfolio investments from abroad. Similarly, the capital account surplus reached $105.3m in Q4 2018, dropping by 4.8% from Q3 2018. These decreases were caused by a decline in capital transfers to the general government from donors by 14.1%.

International Investment Position and External Debt in Q4 2018

On 19 March, the PCBS published the International Investment Position (IIP) and External Debt report for the fourth quarter of 2018. IIP reflects a nation's balance sheet with the rest of the world including overseas assets and liabilities held by a nation's government, private sector institutions and citizens. External debt refers to the portion of a country's debt that was borrowed from foreign lenders including commercial banks, governments or international financial institutions.

According to the report, the stock of investments by Palestinian residents (corporate and individual) outside Palestine (total external assets of $6,638m) exceeded investments in Palestine by non-residents (total foreign liabilities of $4,979m) by $1,659m in Q4 2018.[11] Compared to the previous quarter, Palestine's IIP increased by 15.8%, driven by a 4% increase in Palestinian portfolio investments abroad and a 6.1% decrease in foreign portfolio investments in Palestine. Compared to Q4 2017, IIP increased by 20.8%, driven by an 85.4% increase in net portfolio investment. These figures indicate an increase in Palestinian investment abroad, given discouraging economic and political prospects in Palestine.

Table 3: IIP, Palestine, Q4 2017, Q3 2018 and Q4 2018

	Q4 2017 (USD millions)	Q3 2018 (USD millions)	Q4 2018 (USD millions)	Change (%) (From Q3 2018 to Q4 2018)	Change (%) (From Q4 2017 to Q4 2018)
1. Direct investment, net	-2,281	-2,377	-2,374.0	-0.1%	4.1%
2. Portfolio investment, net	391	622	725.0	16.6%	85.4%
3. Other investment, net	2,817	2,703	2,770.0	2.5%	-1.7%
4. Reserve assets, net	446	485	538.0	10.9%	20.6%
Net IIP	**1,373**	**1,433**	**1,659.0**	**15.8%**	**20.8%**
Ratio of Net IIP to GDP	**36.8%**	**39.2%**	**44.8%**	**-**	**-**

Source: PCBS and PMA

At the end of Q4 2018, Palestine's gross external debt amounted to $1.5bn, a decrease of 4.3% from the previous quarter, and 10.8% compared to Q4 2017. The changes in gross external debt from the previous quarter were triggered by a significant drop in the long-term debt of private banks ($235m, an 20.2% decrease from Q3 2018). On the other hand, the drop in gross external debt from the corresponding quarter in 2017 was mainly caused by a 46.7% drop in short-term debt. The general government debt constituted 67.2% of the total debt, while the debt of private banks amounted to 27.2%.

Table 4: External Debt, Palestine, Q4 2017, Q3 2018 and Q4 2018

Economic Sector	Q4 2017 (USD millions)	Q3 2018 (USD millions)	Q4 2018 (USD millions)	Change (%) (from Q4 2017 toQ4 2018)	Change (%) (From Q3 2018 toQ4 2018)
General Government	1042	1037	1032	-1.0%	-0.5%
Banks	603	481	417	-30.8%	-13.3%
Other Sectors	70	42	42	-40.0%	0.0%
Direct investment: lending between affiliated companies	5	44	44	780.0%	0.0%
Gross External Debt Position	1720	1604	1535	-10.8%	-4.3%
External Debt to GDP	46.4%	43.8%	41.2%	-	-

Source: PCBS and PMA

March Trading

The Al-Quds index reached 530.5 points on the last day of trading in March, a decrease of 1.98% from the last day of trading in February.[12] During the month, a total of 20.6m shares, with a value of $36.4m, were traded, marking an 8.5% increase in the number and a 9.8% increase in the value of traded shares compared to February 2019.

The banking and financial services sector witnessed the highest increase on the Index (1.8%), while the services sector witnessed the highest decrease (-5.2%). The drop in the services sector was mainly driven by a 9.5% decrease in Palestine Telecommunication (PALTEL) stock price during the month.

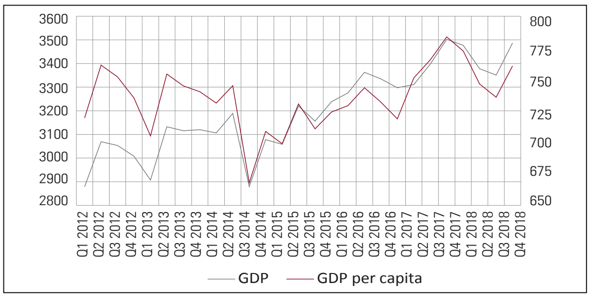
11 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_19-3-2019-invPos-en.pdf

12 www.pex.ps/FileManagerWeb/Default.aspx?AID=1&UID=1&WFID=29&DocAction=610&HashCode=669&PathCode=1&TRID=38084&TID=536

Palestine Economic Dashboard

Growth

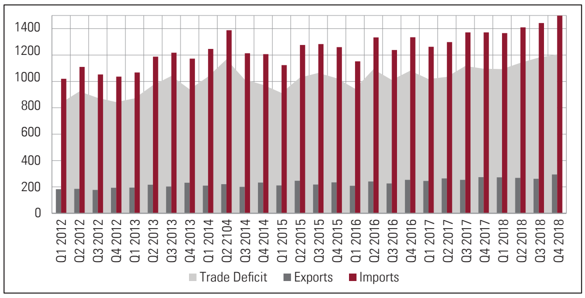
GDP (in million USD) and GDP Per Capita (in USD) in Palestine, Q1 2012 – Q4 2018



GDP (Q4 2018): $3,594.4m   GDP per capita (Q4 2018): $778.9
Source: PCBS

Trade

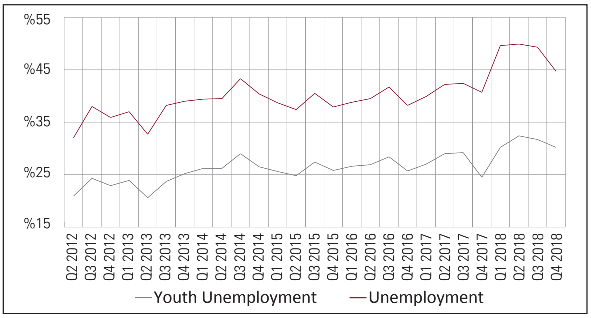
Exports, Imports and Trade Deficit in Palestine ('000 USD), Q1 2012 – Q4 2018



Imports (Q4 2018): $1,497.8m   Exports (Q4 2018): $294.2m
Trade deficit (Q4 2018): $1,203.6m   Source: PCBS

Unemployment

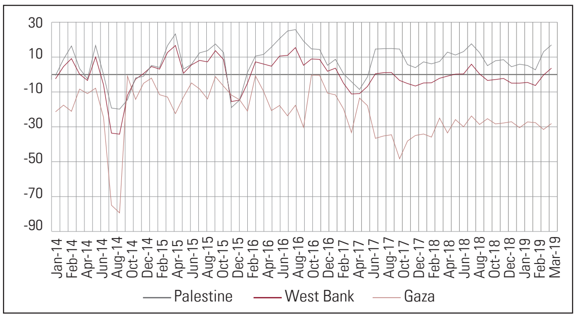
Unemployment & Youth Unemployment in Palestine, Q2 2012 – Q4 2018



Unemployment rate (Q4 2018): 30.2%   Youth Unemployment rate (Q4 2018): 44.7%
Source: PCBS

Business Cycle Index

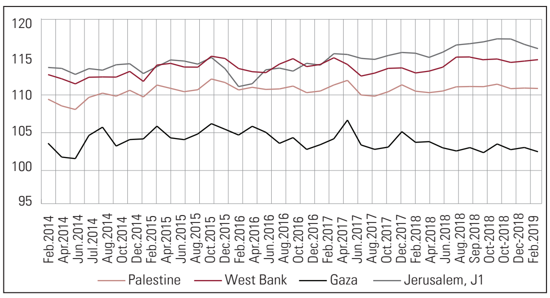
Palestine Monetary Authority Business Cycle Index, January 2014 – March 2019



Palestine (March 2019): 2.9   West Bank (March 2019): 16.7
Gaza (March 2019): -29.8   Source: PMA

Inflation

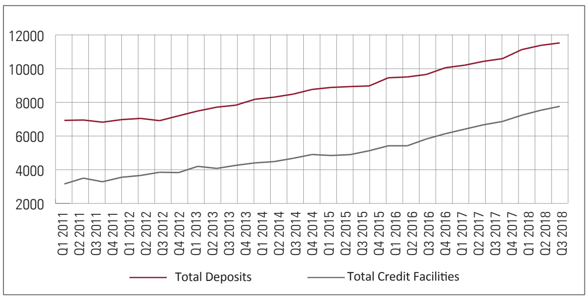
Consumer Price Index (Base year = 2010), February 2014 – February 2019



Palestine (February 2019): 110.87   West Bank (February 2019): 114.8
Gaza (February 2019): 102.2   Source: PMA

Banking Sector

Total Credit Facilities and Total Deposits in Palestine ('000 USD), Q1 2011–Q3 2018



Total Credit Facilities (Q3 2018): $ 8,293.6m   Total Deposits (Q3 2018): $12,194.2m
Source: PMA

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The Palestinian Economic Bulletin is prepared by the Palestine Economic Policy Research Institute (MAS) and edited by The Portland Trust. Please send any comments, suggestions, or complaints to feedback@portlandtrust.org

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