

PALESTINIAN ECONOMIC BULLETIN

Issue 113

February 2016

Main reports

This month the Palestinian Economic Bulletin interviews H.E. Mr Azzam Shawwa. Mr Shawwa was appointed by President Mahmoud Abbas on November 20 2015 as the Governor and Chairman of the Board of Directors of the Palestine Monetary Authority (PMA).

The monthly Palestine Monetary Authority (PMA) Business Cycle Index (PMABCI) rallied in the West Bank and Palestine overall but fell in Gaza in January.

Palestinian exports reached \$81.3m in November 2015 a 7% increase on November 2014, according to recent data from the Palestinian Central Bureau of Statistics (PCBS).

According to PEX provisional data, 75% of listed companies achieved profits in 2015. Net joint profit was \$273m, up by 21.8% from 2014.

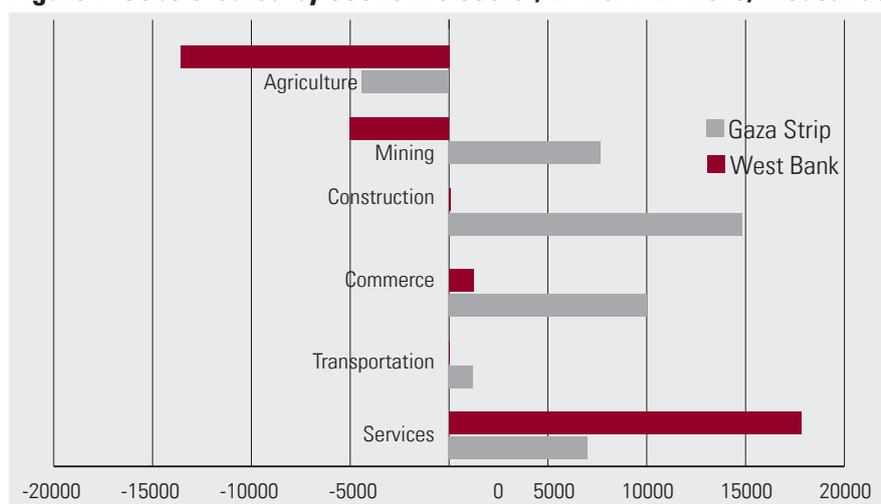
Labour Market Q4 2015

Unemployment in Palestine reached 25.8% in the fourth quarter of 2015, down from 26.5% in Q4 2014.¹ The year-on-year change is mostly explained by a drop of 4.4 percentage points in Gaza's unemployment rate from 42.8% in Q4 2014 to 38.4% in Q4 2015. Unemployment in Palestine, however, continues to be extremely high, particularly in Gaza. Over the past decade, the unemployment rate in Gaza has not fallen below 29%.

The number of people employed in Gaza grew from 259,000 in Q4 2014 to 295,100 in Q4 2015. The construction sector absorbed 40.9% (14,800 persons) of the new jobs, followed by commerce, restaurants and hotels (27.6%), and mining and manufacturing (21.1%). At the same time, 4,420 jobs were lost in agriculture and fishing. As a result, agriculture's share of total employment in Gaza decreased from 9% in Q4 2014 to 6.4% in Q4 2015. The agricultural sector share of employment in Gaza has been falling gradually from 11.7% in 2005 to 8.7% in 2014.

In the West Bank, between Q4 2014 and Q4 2015 only 600 new jobs were created. 13,600 jobs were lost in the agricultural sector and 5,030 jobs in the mining and manufacturing sector. However, 17,800 jobs were created in the services sector. The construction, commerce and transportation sectors also created an additional 1,380 jobs. As a result, the share of services sector in the West Bank grew from 31.8% in Q4 2014 to 34.9% in Q4 2015.

Figure 1: Jobs created by economic sector, Q4 2014-Q4 2015, thousands



Source: PCBS

Palestinian women's labour force participation decreased from 19.4% in Q4 2014 to 19.1% in Q4 2015. This is contrary to a longer-term trend which has seen women's participation in the labour force increase from 12.9% in 2000 to 19.4% in 2014. Despite this long-term improvement, significant gender gaps remain. The men's labor force participation was nearly four times higher (71.5 percent) than that of women. Women are more likely than men to be unemployed and remain

¹ www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_LFSQ42015E.pdf

unemployed for longer periods. Unemployment among Palestinian women was 39.7% in Q4 2015 compared to 28.4% for men. The average unemployment duration was 17.5 months among women compared to 9.2 months among men in Q4 2015. Palestinian women rely heavily on the services and agriculture sectors for work, which together accounted for over 75% of women's employment compared to 39.2% for men, in Q4 2015. This may suggest that women do not have equal access to employment across different sectors.

Business Indicators

The monthly Palestine Monetary Authority (PMA) Business Cycle Index (PMABCI) rallied in the West Bank and Palestine overall but fell in Gaza in January². The index for Palestine increased sharply to -5.9 points in January 2016, compared to around -16 points in December 2015. On a yearly basis, the index remained substantially below its level in January 2015 of 3.9 points.

In the West Bank the index increased significantly from -16 points in December 2015 to 0.5 points in January 2016. The increase was due primarily to improvements in the textiles sub-sector (from -5 points to 2.2 points) and the food sub-sector (from -2 points to 2 points). The index dropped significantly in Gaza to -22.5 points, mostly driven by a decline in the textiles sub-sector (from 0 points to -2.3 points) and construction (from -4.2 points to -7.3 points). Gaza's index has remained negative for two years (with the exception of June 2015), reflecting the difficult political and economic conditions. Continuing challenges include lack of raw materials, shortages in electricity and fuel supplies, prolonged delays in reconstruction efforts, continuing restrictions placed on the movement of goods and people between Gaza and Israel, and the closure of the Rafah crossing by Egypt.

Trade

Palestinian exports reached \$81.3m in November 2015 a 7% increase on November 2014, according to recent data from the Palestinian Central Bureau of Statistics (PCBS).³ Meanwhile, imports rose by 5.2% from November 2014 to \$417m. These changes resulted in an increase in the trade deficit of 4.8% compared to November 2014. The trade deficit remained significant at \$335m.

In related news, in the first month of 2016 a total of 288 truckloads were exported from Gaza, the highest level in recent years⁴. This marks an increase of 227% from January 2015 and of 433% from January 2014. Exports to the Israeli market amounted to 62 truckloads, the highest since March 2015. 204 truckloads were transferred to the West Bank, once again the highest since the partial easing of restrictions in November 2014. The remaining 22 truckloads were exported abroad.

Economic Delegation Visits Gaza

An economic delegation from the West Bank, headed by the PMA Governor H.E. Mr. Azzam Shawwa, visited the Chamber of Commerce and Industry of Gaza City, in January. The delegation focused on the performance and needs of financial and economic institutions and explored interventions to strengthen the effectiveness of the financial sector in Gaza. The visit also included the opening of a training workshop for employees of banks and lending institutions on the upgraded version of the Credit Registry System and the inauguration of two new branches of Al-Quds Bank in Rafah and Jabalya. Mr. Shawwa affirmed that Gaza is given a priority status by the PMA and the banking system at large, owing to the difficult conditions it is facing. He added that there will be future visits to Gaza to explore how to restore financial and economic stability⁵.

Digital Entrepreneurship

Palestine participated for the first time in the Global Game Jam (GGJ) between 29 and 31 January.⁶ GGJ is the world's largest game jam event. Participants engaged in events hosted all around the world to design, test and develop new games.⁷ The Ramallah event was organised by the Goethe Institut Ramallah in cooperation with Al-Bireh Municipality, AMAZE, Pinch Point, Leaders Organization, Institute Français Jerusalem and Gaza Sky Geeks.⁸ A total of 21 participants, mostly aged from 22 to 30 years, took part in the event.

Interview with Palestine Monetary Authority Governor, H.E. Mr Azzam Shawwa

This month the Palestinian Economic Bulletin interviews H.E. Mr Azzam Shawwa. Mr Shawwa was appointed by President Mahmoud Abbas on November 20 2015 as the Governor and Chairman of the Board of Directors of the Palestine Monetary Authority (PMA). Prior to becoming the Governor of the PMA, Mr Shawwa served as the General Manager of the Palestine Commercial Bank and Quds Bank. As such, he chaired the Association of Banks in Palestine. Mr Shawwa is also a former Minister of Energy and Natural Resources in the Palestinian National Authority (PNA).

How do you see the role of the PMA within Palestine's national agenda?

The PMA was established as an independent public entity following a Presidential Decree issued in 1995. The PMA was originally enshrined in the Protocol on Economic Relations between the Government of Israel and the PLO (the Paris Protocol), which became part of the 1995 Interim Agreement on the West Bank and the Gaza Strip (the Oslo II Accords). Accordingly, the PMA's stated mission is mainly to maintain a fairly moderate and stable general price level (inflation rate) in Palestine, and to regulate and supervise the bulk of

2 <http://bit.ly/1RmH5cJ>

3 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_ExTrdReg112015E.pdf

4 gisha.org/graph/2401?datares=monthly

5 <http://bit.ly/1WIm65F>

6 globalgamejam.org/2016/jam-sites/game-jam-palestine-ramallah,

7 globalgamejam.org/about

8 www.facebook.com/events/934020886690794/

Palestine's financial system, including the banking sector, microfinance institutions (MFIs) and moneychangers. However, beside its above-mentioned basic mission, I believe the PMA should more forcefully cultivate its role as an agent of economic development by energizing MFIs; encouraging more partnering between the non-financial private sector and the financial (mainly banking) sector; and advocating increased bank credit directed to generally labour-intensive small and medium enterprises. To enable the PMA to better carry out its responsibilities, we will press ahead with ongoing plans and efforts aimed at continued capacity building and staff career development in addition to a smooth and efficient relocation to the PMA new building (scheduled for mid to late 2016).

What are your priorities for your time in office?

My first priority is to expand the PMA's network of relationships with other central banks which would help it enhance the capacity building required in the process of transforming to a fully-fledged central bank and back the statehood efforts.

Second is to monitor and deal with various domestic, financial and banking developments and issues, with a view of maintaining a stable and sound financial and banking system. In this context, the PMA will continue to closely monitor and deal with the unduly hard circumstances and difficulties our Gaza-based bank branches have to grapple with due to the economic devastation the Strip suffered as a result of recurrent conflict over the last few years and the restrictions placed on the movement of goods and people between Gaza and Israel, and the closure of the Rafah crossing by Egypt. To this end, the PMA Ramallah and Gaza offices will redouble their contacts (e.g., by conducting more field visits to PMA-Gaza by the Governor, senior staff, and occasionally the Board of Directors and by holding more joint staff training, common seminars, etc.); and the PMA will maintain its efforts to tackle problems specific to our Gaza bank branches (e.g., expediting the PMA-World Bank Credit Guarantee Facility agreement to increase loans to businesses devastated by the 2014 Gaza War and intermediating with the Bank of Israel and/or international donors on behalf of Gaza bank branches to ensure the smooth entry or exit of shekel cash replenishments (spoiled shekel notes and surplus shekel cash) into and out of Gaza.

My third priority is to follow closely local economic developments, especially the overall growth, inflation and the fiscal situation and their interaction with the monetary and financial system, particularly the banking sector.

What are your strategies for maintaining financial stability in such volatile environment?

The PMA pays great attention to ensure a sound and stable banking system by persistently assessing and mitigating risks that threaten the financial stability of banks. The following are the most significant among these risks:

First is the risk posed by the threat from Israeli banks to suspend or sever correspondent relations with their Palestinian counterparts. Although originally sanctioned by the Paris Protocol, some of the above-mentioned relations (most importantly Israeli banks' refusal to accept all or part of the shekel cash surplus accumulated by Palestinian counterparts) have been occasionally disrupted by Israel.

Second is the potential risk posed by exposure of the local banking sector to borrowing by the PNA and its employees. Naturally, the PMA closely monitors this risk and assesses its potential impact on the finances of individual banks and of the banking sector at large. This entails subjecting banks to a set of graduated, rigorous stress tests conducted on a quarterly basis. Since their start in 2012, these tests have generally revealed that for both individual banks and the banking sector at large, the ratios of core capital to risk-weighted assets have remained comfortably higher than the minimum limit set forth by either the PMA (at 12%) or the Basel Committee on Banking Supervision (at 8%).

Third is the risk posed by the relative size of consumer and real estate loans' share in banks' total credit portfolios. The PMA closely monitors the potential risk posed to banks by an unduly high share, i.e., a concentration of personal and real estate loans in their total credit portfolio. To alleviate such concentration, the PMA has steadily encouraged banks to diversify their loan portfolios in favour of investment projects, small and medium enterprises, export trade and other productive sectors, such as industry and agriculture.

What are your plans with respect to the long-term goal of turning the PMA into a central bank issuing its own currency?

The International Monetary Fund and the World Bank have repeatedly commended the PMA for the various financial reforms that it has introduced. Both have declared the PMA ready to become a fully-fledged central bank. We believe that the PMA should pursue this objective more forcefully in 2016, including by finalizing the drafting and passage of the Central Bank Law.

The PMA does not conduct a comprehensive monetary policy (i.e., setting an inflation rate target and the concomitant interest rate) as a result of the absence of a national currency in Palestine. However, the PMA has: (a) employed a major monetary policy instrument, the required reserve ratio on customers' bank deposits; and (b) put in place the right analytical and informational framework for setting monetary policy in the future. To this end, the PMA has been collecting and analysing critical economic and financial data, developing the appropriate instruments and econometric models for economic and financial data analysis and forecasting, conducting and disseminating essential studies and reports (including a quarterly Inflation Report, a quarterly and annual Economic Report, and an annual Financial Stability Report).

As for the issue of converting to a central bank issuing its own national currency, the PMA believes that such an undertaking requires fulfilling at least the following three pre-conditions: (1) ensuring the independence of the central bank, both administratively and financially, and enabling it to autonomously set forth and implement monetary and banking policies. Instrumental in this regard would be the approval and legal passage of the nearly-finalised Central Bank Law (2) coordinating with fiscal authorities to ensure robustness of government finances by maintaining a sustainable budget deficit that can be financed without excessive borrowing from the banking system; and (3) ensuring control over border crossings to secure the free movement of goods, services and capital, especially the import of foreign currency to back up the national currency.

How do you ensure that the banking system can withstand shocks and continue to provide financial services to the real economy?

To enable banks to better withstand various possible shocks and provide essential financial services, the PMA has already put in place, or has plans to introduce, several mechanisms and regulations, including: (a) conducting quarterly individual-bank and banking-sector stress testing, as a key tool of risk management; (b) instituting business continuity and disaster recovery planning; (c) raising banks' minimum capital requirement to \$75m, and mandating banks to maintain adequate counter-cyclical reserves; (d) tightening restrictions on banks' placements abroad to cover concentration, counterparty and country risks; and (e) establishing a state-of-the-art credit information registry, the Credit Bureau, essentially to help banks better assess their borrowers' creditworthiness.

What are the key opportunities and risks for monetary and financial stability in 2016?

In 2016, the most important risks (some of which were elaborated above) are: severing of the Palestinian-Israeli correspondent banking relations; political instability and associated risks; and Government and public employees' credit concentration risks.

Opportunities include: enacting the new Central Bank Law affirming the PMA's independence; ensuring a

robust banking system with sound financial stability indicators; adhering to international, sound banking standards and practices, including risk management and business continuity; fostering well-trained human capital; concluding various cooperation agreements with other central banks in the region and beyond; and securing technical assistance from the IMF, the World Bank and other regional and international bodies.

What is the impact of recent mergers and acquisitions within the banking sector?

In general, compared to small banks, big banks are more highly capitalised and so possess a greater capacity to carry out financial brokerage transactions and withstand potential shocks. Bank mergers have spawned a more resilient banking sector and enhanced financial stability. Over the past few years, the banking sector has carried out a number of mergers and acquisitions, with the number of banks operating in Palestine cut from 18 in 2012 to 15 at present.

January Trading

In January, the Al-Quds index decreased by 0.58% from the previous month, reaching 529.7 points on the last day of trading. It peaked at 536.3 points on 19 January. A total of 16.3m shares worth \$25.1m were traded, marking a 65% decrease in the number and a 71.7% decrease in the value of traded shares. Market capitalisation reached \$3.3bn.⁹

At the time of publication, 48 out of the 49 companies listed on PEX have disclosed their preliminary financial statements for the year 2015.¹⁰ According to PEX provisional data, as in 2014, 75% of listed companies achieved profits, while the remaining 25% made a loss. Net joint profit was \$273m, up by 21.8% from 2014.

According to this preliminary data, in 2015 the three most profitable companies were PALTEL with profits of \$117m (a decline of 2.4% from 2014), BoP with profits of \$43.2m (an increase of 7.5% from 2014) and PADICO with profits of \$24.9m (an increase of 24.5% from 2014). PALTEL accounted for 41% of total profits, BoP for 15.1% and PADICO for 8.7%.

⁹ www.pex.ps/PSEWebSite/publications/PEXIssue70January2016.pdf

¹⁰ Ahliea Insurance Group has not disclosed yet.

The Portland Trust



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

© 2016 The Portland Trust

Printed for The Portland Trust in Ramallah by Al Nasher Advertising and PR