The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

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Main reports

In Q3 2014 Palestinian quarterly GDP was 7.4% lower than in Q3 2013. In the West Bank it increased by 1.5% year-on-year, while in Gaza it was 31.8% lower

In Q4 2014 total unemployment in Palestine was 26.2%, an increase of 1.3% from Q4 2013. Unemployment in Gaza stood at 42.8%

The Palestine Monetary Authority Business Cycle Indicator, reflecting the evolution of the business environment in Palestine, returned to a positive state for the first time since June 2014. This continued a trend of gradual improvement from the all-time low reached in September 2014

The Israel Electric Company announced plans to reduce electricity supplies to the West Bank due to mounting debts owed by the Palestinian National Authority

The Al-Quds Index declined 2% in January, reversing some of the gains experienced towards the end of 2014

Palestine's Looming Fiscal Crisis

Concerns over Palestine's precarious fiscal position continue to mount as the Israeli government withheld $125m of vital clearance revenues for the second consecutive month. These revenues, which Israel collects on behalf of the Palestinian National Authority (PNA) in return for a 3% fee in accordance with the provisions of the Paris Protocol, make up two thirds of domestic revenues and account for three quarters of the public sector wage bill.[1] In December, public sector employees received just 60% of their wages, although public sector customers of The National Bank were provided with the remaining 40% of December salaries without interest.[2] As a further mitigation measure, the Palestine Monetary Authority (PMA) also requested banks not to impose fees for bounced checks drawn on public employee accounts from 7 January 2015 until salaries are paid in full.[3] Prime Minister Dr Rami Hamdallah recently confirmed that only partial payment of January wages will be possible,[4] and it is likely that reduced wage payments will continue until the clearance revenue streams are resumed unless alternative funds can be sourced.

A recent IMF mission, headed by Christoph Duenwald, concluded that "the ongoing fiscal crisis exacerbated by the withholding of clearance revenue could deepen over the next few months. The absence of clearance revenue will need to be compensated by curtailment of wages and allowances, cuts in non-wage spending, further borrowing from the banking system, or additional arrears accumulation."[5] The IMF believes that this will likely prevent a strong economic recovery in 2015. "Reduced wage payments and other public spending cuts necessitated by the suspension of clearance revenues in the presence of financing constraints will likely cause a sharp reduction in private consumption and investment." This is likely to have a significant impact given that public sector employment accounts for 22.4% of jobs in Palestine.[6] Mr Duenwald called for reduced salary payments to be differentiated to minimise the impact on low income salary earners, and urged donors to front-load assistance to provide bridge financing. The announcement of €130m of budget support from the EU brought some positive news.[7] However, even assuming a resumption of clearance revenue transfers within a few months, the IMF still projects a large financing gap in 2015.

In related news, Deputy Prime Minister Dr Mohammed Mustafa and UN Humanitarian Coordinator James W. Rawley launched the Strategic Response Plan (SRP) for 2015.[8] With a total budget of $705m, three quarters of which is devoted to the Gaza Strip, the SRP presents the response of the international

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community to the most urgent humanitarian needs of the Palestinian people.[9] The plan addresses the needs of 1.6m of the most vulnerable Palestinians. If the plan fails to attract the needed funding, the risks for the Palestinian population are dramatic. Evidence of constrained funding streams for humanitarian assistance can be seen by UNWRA's recent suspension of its cash assistance programme for repairs to damaged and destroyed homes and for rental subsidies to the displaced in Gaza due to lack of funds.[10] More than 96,000 homes of Gazan refugees were damaged or destroyed in the war last summer, requiring $720m to address the residential needs of this population. By the end of January UNRWA had received only $135m in pledges. While some funds remained available for the reconstruction of fully destroyed homes, the budget for partial repairs and rental subsidies had been exhausted.

National Accounts

On 4 February, the Palestinian Central Bureau of Statistics (PCBS) released preliminary national accounts estimates for Q3 2014. The destruction and disruption to economic activity caused by the Gaza war had a significant negative effect on the Palestinian economy. During Q3, national GDP contracted by 9.1% in real terms from the previous quarter and 7.4% year on year.[11] Real GDP in the West Bank ($1,414.1m) decreased by 2.7% from Q2 2014, although it did exhibit a slight increase of 1.5% from Q3 2013. Most of the national decline can therefore be attributed to the economy in Gaza, where the war and its aftermath saw real GDP fall 28.4% from Q2 2014 and 31.8% year on year to $344.2m. Many sectors saw a substantial decline in their economic value added, with major drivers of the economy such as wholesale and retail trade (down 52.3% from Q2 2014), construction (down 75.3%), agriculture (down 78.5%) and manufacturing (down 56.9%) suffering particularly badly. Construction activity had already been depressed in the first half of 2014, falling from $74.8m of economic value added in Q4 2013 to $27m in Q1 2014 and then to just $6.6m in Q3 2014. While construction was the main driver of economic recovery after previous wars in Gaza, concerns remain over the prospects of recovery given the slow pace of reconstruction to date.

Palestine's demographic trends saw this decline in economic value added amplified in per capita terms. Real GDP per capita in Palestine fell 9.8% from Q2 2014 and 10.1% year on year to $407.90. The West Bank saw more modest declines of 3.4% and 1.1% respectively, with per capita income ending the quarter at $556.10. However, in the aftermath of the war, Gaza saw income plummet – real GDP per capita fell 29% from Q2 2014 and 34.1% from Q3 2013. At just $194.70, real GDP per capita in Gaza has fallen below $200 for the first time since Q2 2008 and is now equivalent to only 35% of the West Bank level.

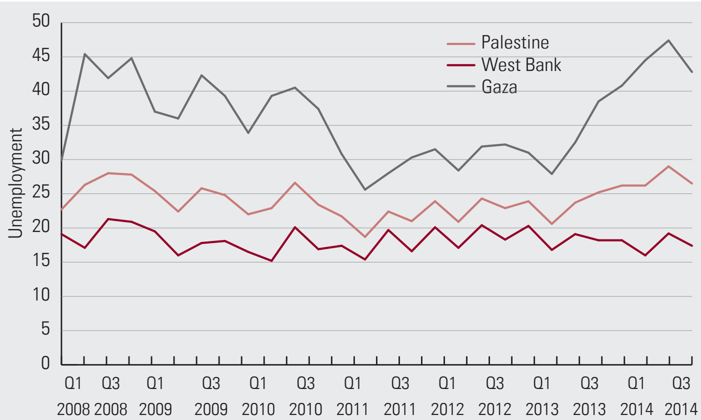
While official data for Q4 2014 is not yet available, the severity of the contraction experienced in Q3 supports pessimistic forecasts for overall 2014 economic performance by the PMA (2.7% fall in real GDP)[12] and IMF (1% fall in real GDP).[13] Both expect growth to rebound only modestly in 2015, with the PMA forecasting a 2.9% increase in GDP.

Labour Market

In Q4 2014 total unemployment in Palestine was 26.2%. This marked a return to pre-Gaza war levels after spiking to 29% in Q3 2014 but still remains 1.3 percentage points higher than in Q4 2013.[14] After disruption to the data collection process, results for both Q3 and Q4 were released simultaneously in February.

In the West Bank, unemployment levels improved slightly from 19.3% in Q3 2014 to 17.4% in Q4 2014, but were 0.8% higher than in Q4 2013. Unemployment in Gaza, which had reached record high levels of 47.4% in Q3 2014, recovered to 42.8%. However, this remains significantly higher than the 32.5% recorded in Q3 2013. This trend, as reported in Bulletins 92[15] and 95[16], had already seen the labour market in Gaza experiencing the most challenging conditions since 2008, with over 30,000 jobs lost in the Gazan construction sector in the first half of 2014 in the wake of the destruction of tunnels by Egypt and the long-standing restrictions on imports of construction materials from Israel (Figure 1). Construction-related employment had accounted for 7% of employment in Q3 2013, but fell to just 1.3% in Q3 2014 and rebounded only marginally to 1.8% in Q4. Deir Al Balah in Gaza had the highest rate of unemployment in Palestine at 49.9%. During Q3 2014, 56.5% (127,000) of employed persons in Gaza were absent from their work due to disruptions caused by the war.

Figure 1: Quarterly Unemployment Rate, 2008-2014 (%)



Source: PCBS

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13 www.imf.org/external/np/sec/pr/2015/pr1524.htm
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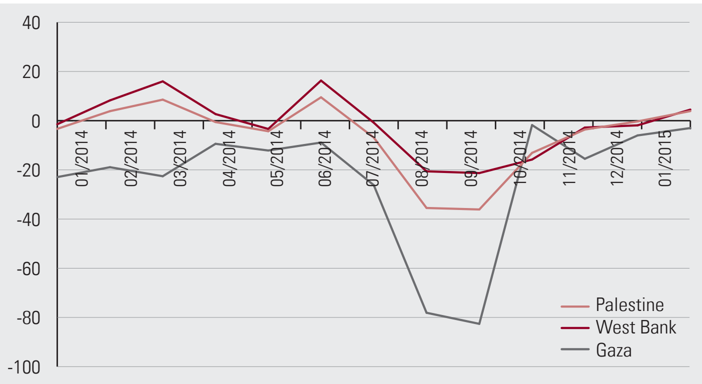
In Q4 2014 unemployment among Palestinian women was 36.5%, a decrease of 5 percentage points from Q3 2014 but an increase from 33.5% in Q4 2013. Male unemployment, at 23.8%, decreased by 2.0 percentage points compared to Q3 2013 and was 0.6 percentage points lower than in Q4 2013. A significant structural gap between the female and male labour force participation rate continues to exist. Youth employment remains a major issue in Palestine, with the highest levels of unemployment witnessed among young women aged 20-24 (61.8%) and 25-29 (56.8%).

The average daily net wage in Q4 2014 for Palestinians employed in Israel or Israeli settlements (194.2 NIS) remained significantly higher than in both the West Bank (113.7 NIS) and Gaza (66.2 NIS). There was a nominal wage increase from Q3 2014 in Israel or Israeli settlements (from 189.2 NIS). However, wages declined significantly in Gaza, falling over 5% from 69.9 NIS. Wages also fell marginally in the West Bank, having averaged 113.9 NIS in Q3.

Business Indicators

The Palestine Monetary Authority Business Cycle Index (PMABCI), a monthly index which reflects the current state and evolution of Palestinian economic activity by tracking the performance of the industrial sector, released results for January 2015. Continuing a trend of gradual improvement from the all-time low reached in September 2014 (as reported in Bulletin 98[17]), the index rose at the national level from -0.3 in December to 3.9.[18] After the volatility and economic contraction experienced by Palestine in the second half of 2014, this marked a return of the index to a positive state for the first time since June 2014. It also represents an improvement from January 2014, when the PMABCI was recorded at -3.3 (Figure 2). The PMA attributes most of this increase to heightened demand for manufactured goods in both the West Bank and Gaza.

Figure 2: PMABCI by Region, January 2014-January 2015



Source: PMA

In the West Bank, the index rose from -1.9 in December to 4.5 in January. This increase reflected improvements in nearly all sub-sectors, with the exception of furniture, paper and engineering. The primary drivers of the increase were the textile and food sub-sectors, which account for over one third of total employment in the industrial sector. The increases in both sub-sectors can, in part, be attributed to seasonal factors, such as preparations for winter. The PMA cites increased current demand, expectations for higher production and moderate optimism about the near future as the main contributing factors to this overall increase.

In the Gaza Strip, the index recovered from -6.0 points in December to reach -3.0 in January. Improvements were observed in most sub-sectors, with the most significant increases in the food industry, which employs around one third of Gazan workers. Contrastingly, the construction sector continued to struggle and saw a decline for a second consecutive month due to continuing restrictions on the importation of building materials for Gaza's reconstruction. Overall sentiment, despite relative improvement, remains negative due to delays in donors fulfilling commitments towards reconstruction and the continuing restrictions on the movement of goods and people.

The PCBS Perceptions Survey, an alternative indicator of the strength of the business environment in Palestine, released results for the final quarter of 2014.[19] At the national level, 23.6% of active industrial enterprises reported a decline in business performance during the quarter. Just 12.5% of surveyed businesses reported an improvement in overall performance, and in Gaza this applied to only 10.3% of companies. The main factors which owners/managers pointed to as obstacles to production expansion were both demand-driven (small market size, 89.7% and low income levels, 82.5%) and supply-driven (increase in electricity price, 82.2%). Another important obstacle was the low confidence in the Palestinian economy. West Bank enterprises were largely satisfied with the services provided by governmental and private entities with most satisfaction rates above 50%. The situation was very different in the Gaza Strip, however, where companies were largely dissatisfied with services provided, with many of the satisfaction levels below 10%.

Looking ahead, Palestinian businesses are slightly more optimistic for Q1 2015. 25.8% of enterprises expect performance to improve, compared to 17.2% expecting further deterioration. However, 55.3% expect overall performance to remain unchanged, a worrying prediction given the current economic performance in Gaza in particular. This pessimism could be a reaction to the previous trend of businesses being overly optimistic and then failing to meet expectations. For instance, while as many as 79.1% of enterprises in the Gaza Strip expected

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improvement in their overall performance between Q3 and Q4, in reality this was the case for only 10.3% of them, perhaps as a result of the slow pace of reconstruction witnessed to date.

Energy Supply

On 29 January 2015, an Israel Electric Corporation (IEC) official announced plans to reduce electricity supplies to the West Bank due to a mounting debt of over $450m owed by the PNA.[20] The IEC intends to reduce electricity provision by an hour each morning and each night until the PNA commences repayment of its debt. The IEC has threatened such action in the past, but such restrictions on energy supply would require the approval of Prime Minister Benjamin Netanyahu. The announcement came at a time of diplomatic tension, following Israel's decision to freeze the transfer of clearance revenues to the PNA. On 23 February, the IEC implemented its first cuts, withdrawing power to the northern West Bank cities of Nablus and Jenin for an hour.[21]

Palestine is highly dependent on imports to provide electricity. In 2012, the total amount of electricity available was 5,370 GWh. Of this, 88% was imported from Israel and 4% was imported from Egypt and Jordan.[22] The only domestic production which is fed into the grid via the six Palestinian distribution companies is in Gaza, where the Gaza Power Plant uses imported diesel given the absence of gas supplies. Such dependency on imports means that Palestine faces both high costs and a shortfall in supply of electricity. Reduction in the energy supply from Israel could substantially reduce Palestine's ability to provide power to the country through local distributors. Over the medium term, it will be important for Palestine to expand domestic energy production through both fossil fuels and renewable energy.

Technology and Entrepreneurship in Gaza

Gaza Sky Geeks, a startup accelerator in Gaza, successfully raised over $267,000 through an innovative international crowdfunding campaign.[23] Founded in 2011 by Mercy Corps with support from Google, it provides a home for startups, young people who are exploring the idea of launching a company, and the local Microsoft Student Partners and Google Developers Groups. Gaza Sky Geeks' most promising startups receive seed investment and acceleration in partnership with Oasis500, while other startups can access training and mentoring services. The funds will allow the accelerator to continue providing a valuable co-working space, promote female entrepreneurship, build its startup pipeline and allow Gaza's top youth to compete in a global hackathon.

January Trading

After a strong performance end to 2014, in January the Al-Quds index decreased by 2.0%, reaching a peak at 505.14 points on 22 January and closing the month at 501.43 points.[24] All sectors fell during the month, with investment companies performing particularly poorly (-3.9%). Palestine Plastic Industrial enjoyed the best performance, with its share price gaining 15.8%, while Wataniya Palestine Mobile Telecommunications saw its price drop by 16.5%. A total of 4.8m shares worth, $9.2m, were traded in January. This marked a substantial decrease of 61.8% in the volume and 59.4% in the value of traded shares since December 2014. Market capitalisation was $3.13bn, down by 1.8% from $3.19bn in December. Bank of Palestine enjoyed significantly more liquidity than the other listed companies, providing 35.4% of the volume and 50.8% of the total value of shares traded.

The three largest companies on the exchange, which combined account for almost 60% of total market capitalisation, released preliminary year-end financial statements for 2014. All three saw profits fall compared to 2013. Paltel saw net profits decline 7.4% to JOD 85.1 million ($120m),[25] Bank of Palestine experienced a net decrease of 0.5% to $40.2m[26] and PADICO's profits fell 21% to $20m.[27]

20 bit.ly/1ErVexO
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22 pcbs.gov.ps/Portals/_Rainbow/Documents/EB-%20ETime%202012.htm

23 www.gazaskygeeks.com/en/donate/
24 www.pex.ps/PSEWebSite/publications/PEX_Issue_58_January_2015.pdf
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