The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

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Main reports

The World Bank produced a report on Palestine's electricity sector, citing non-payment to the Israel Electric Corporation as a hindrance to fiscal and economic stability

A new Credit Guarantee Facility to support the recovery of the private sector in Gaza will soon be launched by the World Bank

Zahi Khouri was announced as one of five honourees globally of the Business for Peace Foundation's 2015 Oslo Business for Peace Award

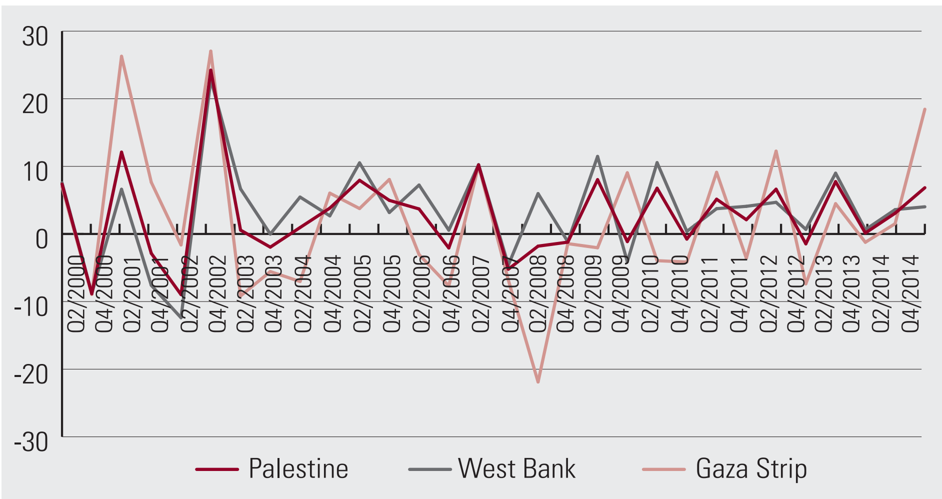
In Q4 2014 the current account deficit reached 6.4% of quarterly GDP at current prices, a substantial decline from the previous quarter

In Q4 2014 Palestine's International Investment Position (defined as external assets minus foreign liabilities) stood at $1,234m, marking a 5.4% increase from Q3 2014

National Accounts

The Palestinian Central Bureau of Statistics (PCBS) released preliminary national accounts estimates for Q4 2014.[1] National GDP increased by 6.8% in real terms from the previous quarter to $1,878.6m, but fell 1.1% year on year. This expansion followed a sharp contraction of 9.1% in Q3 2014 following the war in Gaza. Real GDP in the West Bank ($1,470.9m) increased by 4% from Q3 2014 and by 4.9% from Q4 2013. In Gaza, which had seen real GDP fall by 28.4% in Q3 2014, GDP rose by 18.5% in the last quarter of 2014 to $407.7m, indicating a partial recovery from the economic damage caused by the war in the summer. Public administration and defence continued to make up a very high proportion of GDP in Gaza, at 35.6%, compared to just 7% in the West Bank. Much of the growth in Gaza was driven by improvements in construction (up by 159% to $17.1m, but still lagging significantly behind its previous levels) and wholesale & retail trade (up by 64%, although again still substantially lower than the levels achieved throughout 2013 and up to Q2 2014). However, compared to the corresponding quarter in 2013, real GDP in Gaza was down 18.3%, highlighting that Gaza has a long way to go to even achieve parity with the already depressed economic conditions of 2013. For 2014 as a whole, national real GDP is estimated to have decreased by 0.4% overall, which when disaggregated translates into a 5.1% rise in the West Bank and a substantial 15.2% fall in Gaza. Figure 1 shows the high volatility in growth experienced in recent years, which is particularly significant in Gaza.

Figure 1: Quarterly GDP Growth by Region (%), 2000-2014



Source: PCBS

Real GDP per capita increased by 6.1% in Q4 2014, to reach $432.6 at the national level. It rose by 3.3% in the West Bank to $574.6, while Gaza saw GDP per capita rise by 17.5% to $228.7. The latter is an improvement from Q3, when per capita GDP levels reached their lowest since 2008, but still sees West Bank incomes 2.5 times higher than in Gaza. For 2014 overall, real GDP per

1 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_QNAQ42014E.pdf

capita reached $1,734.6, sustaining the huge gap between the West Bank ($2,265.4) and Gaza ($970.3).

Electricity Sector

According to a recent World Bank report, despite the electricity sector in Palestine undergoing reforms to increase its efficiency, non-payment to the largest supplier, the Israel Electric Corporation (IEC), remains a key challenge that is impacting the overall fiscal situation.[2] Palestine is highly dependent on electricity provided by the IEC, which accounts for almost 90% of total consumption. The Palestinian energy market has limited options to develop indigenous sources of electricity and Israeli restrictions have prevented the construction of power networks in Area C, which comprises 60% of the West Bank. Political uncertainty continues to discourage private investment in the sector.

The non-payment by Palestinian distribution companies and municipalities for purchased electricity (largely motivated by non-payment by end consumers) has put further constraints on the Palestinian National Authority's (PNA) budget and has hindered economic stability. In fact, the two largest non-payer electricity distributors account for around 70% of the total non-payments during 2010-2013 (the Gaza Electricity Distribution Company accounts for 42% and the Jerusalem District Electricity Company, JDECO, for 26%).

According to Steen Lau Jorgensen, World Bank Country Director for the West Bank and Gaza, "The outstanding payments owed to the Israeli Electric Company took a heavy toll on a struggling Palestinian fiscal situation. Non-payments have led to arbitrary cuts in power supply, deduction of arrears from tax revenues owed to the Palestinian Authority by Israel and to the accumulation of debt. The challenge is how to place the provision of electricity services on a financially sustainable basis."[3]

To recover part of the debt to the IEC, in 2012 the Government of Israel (GoI) deducted an estimated $280m from clearance revenues that it collects on behalf of the PNA. The amount deducted represents 14% of the PNA's total revenues, a mechanism commonly referred to as 'net lending'. As of February 2014, the remaining balance accumulated brought the debt to $330m. According to President Mahmoud Abbas, when the GoI resumed clearance revenues this month, it attempted to deduct one third of the funds to cover electricity, water and health services bills.[4] However, after further negotiations between the two sides, an agreement was reached to return the withheld clearance revenues in full, with the only deductions being those usually taken on a monthly basis.

2 www.bit.ly/1HebPbD
3 www.bit.ly/1JPh15B
4 www.maannews.com/eng/ViewDetails.aspx?ID=760312

The World Bank report also highlights the high network losses arising from poor infrastructure (estimated at 23-30% between 2010 and 2013) and electricity theft, which cause significant revenue loss to Palestinian distributors. As distributors lack proper tools to measure losses, they cannot differentiate between technical and non-technical losses. In 2013, for instance, network losses caused Palestinian distributors to lose 726m NIS ($201m) in revenues. In the West Bank, invoiced amounts to end customers (i.e. not necessarily paid in full by consumers) only equalled the cost of electricity purchased from the IEC and not the distributors' operating and investment costs. Meanwhile, in Gaza the amount invoiced to customers paid for just two thirds of the electricity purchased for the entire Gaza Strip (247m NIS were lost due to technical or non-technical losses). Overall electricity bill collection rates from citizens decreased in the West Bank from 90% to 81% between 2011 and 2013, and increased in Gaza from 65% to 71% during the same period, following the implementation of a pre-paid meter pilot project.

The World Bank proposed an action plan with a set of recommendations by priority level. High priority measures include the installation of monitoring meters to measure and identify the location of non-technical losses, the rehabilitation of electricity networks to reduce technical losses, the conducting of regular awareness campaigns, the enforcement of law and the implementation of legal action under the amended electricity law, the continuation of capacity building activities at the Palestinian Electricity Regulatory Commission (PERC) and the Palestinian Electricity Transmission Company Ltd. (PETL), the finalising of a Power Purchase Agreement (PPA) between the PETL and the IEC, the establishment of a web-based database between the PETL and the IEC to ensure the timely transfer of invoices and payments to the IEC and the expanding of the mandate of the existing net lending governmental committee to manage and monitor actions proposed in this action plan. "The non-payment of electricity bills by the Palestinian electricity distributors has reached unprecedented levels and calls for decisive action by the distribution companies and relevant municipalities. On the other hand, the IEC should coordinate with Palestinian counterparts on the establishment of a web-database for timely and transparent transfer of invoicing and payments data," said World Bank Energy Specialist Roger Coma Cunill.

Gaza Reconstruction Update

On 8 April the World Bank Group and the Palestine Monetary Authority (PMA) held a joint workshop to discuss the design of a new Credit Guarantee Facility (CGF) for the private sector to support recovery in Gaza.[5]

5 http://bit.ly/1FdRfYY

The new CGF will place companies in a better position to negotiate existing loan restructuring as well as new loans with the financial institutions, in addition to contributing to stabilising the banking system by offering to share the risk with the CGF. In this way, the facility will make credit more accessible for businesses which have lost collateral and face difficulties in accessing financial resources. Mr Youssef Habesch, IFC Principal Country Officer, representing the World Bank Group, said, "The CGF will give the opportunity to borrowers whose loans were affected by the Gaza conflict to continue running their businesses. We see a great value to help the productive sector in Gaza, a key vector for economic growth and employment." Dr. Jihad Al-Wazir, PMA Governor, said, "We wanted to set up a facility that could help the Gaza businesses to overcome the challenges created by the recent war and to encourage the banking system to play its role while safeguarding the quality of their assets."

In related news, the Ministry of Finance has disbursed $9m (out of a $25m Qatari grant) to compensate owners of lightly damaged micro-enterprises.[6] About 3,200 enterprises, approximately 60% of all damaged and destroyed enterprises, will receive a compensation of up to $6,800 per facility. This intervention targets the least damaged enterprises with the aim of returning them to operation quickly in order to reduce the need for humanitarian assistance to their owners and their families.

Oslo Business for Peace Award

Zahi Khouri, CEO and Chairman of the National Beverage Company (NBC), was announced as one of five honourees globally of the Business for Peace Foundation's 2015 Oslo Business for Peace Award.[7] The award is given annually to exceptional business leaders who ethically create economic value that also creates value for society. Honourees are selected by an independent committee of Nobel Prize winners in Peace and in Economics after a global nomination through the International Chamber of Commerce, UN Global Compact and UNDP. Mr Khouri was recognised for his work in establishing PADICO Holding and Paltel Communications after the signing of the Oslo Accords, as well as launching the NBC, which produces and sells Coca-Cola products in the West Bank and the Gaza Strip. The Foundation also praised the work of the Zahi Khouri Fellowship Program, which provides Palestinian-American students and graduates with the experience of professional development in Palestine in the fields of education, youth/female empowerment and economic development.

6 www.english.pnn.ps/index.php/national/9373-eye-on-gaza-reconstruction
7 www.bit.ly/1FdRfYY/

Income Tax Law Update

On 6 April President Mahmoud Abbas issued a decree to amend the Palestinian Income Tax Law.[8] The amendment comes as a response to a sustained period of difficult economic conditions in Palestine, with the aim of easing the tax burden and stimulating increased consumption and investment in the local economy. The annual exemption on salaries has been set at 36,000 NIS (instead of the previous level of 30,000 NIS), while amended income tax brackets have also been introduced (Table 1). Corporation tax remains at 15% for most companies, with the exception of telecommunications companies and other companies with franchise and/or monopoly rights in the Palestinian market, which have to pay 20%.

Table 1: Amended Income Tax Brackets

Percentage	Current Bracket in NIS	Previous Bracket in NIS
5%	1-75,000	1-40,000
10%	75,001-150,000	40,000-80,000
15%	Over 150,000	Over 80,000

Source: Palestinian Legal and Judicial System "Al-muqtafi"

Balance of Payments Q4 2014

Palestine's current account deficit fell substantially for the second consecutive quarter in Q4 2014 to $194.3m, a level lower than in any quarter in recent years.[9] This represents a 21.1% drop from the level observed in the previous quarter. The decline is even more significant in comparison with the corresponding quarter of 2013, with the deficit down by 64.6%. The deficit amounted to only 6.4% of quarterly GDP at current prices,[10] down from 8.1% in Q3 2014. Traditionally, Palestine's current account deficit has been mainly caused by the consistently high deficit in the trade balance of goods. This decreased by 5.8% compared to the previous quarter and increased by 7.7% from Q4 2013. This drop in the deficit was dictated by an increase of $47.7m in exports and a simultaneous decline of $31.1m in imports between Q3 and Q4 of 2014.[11] At the same time, the $36m deficit in the trade balance of goods from Q3 2014 turned into a $8.8m surplus in Q4 2014, similar to Q4 2013. There was a large surplus of current transfers at $742m, representing a fall of 7.7% compared to the previous quarter but an increase of 128.9% from Q4 2013. Data shows this is primarily driven by donor inflows to central government, which remained at historically high levels, at $332.9m.

At the same time, the capital and financial account surplus experienced a fall from both the previous quarter (54.8%) and Q4 2013 (70.9%). This decline can largely be attributed to substantial reductions in the net financial account.

8 Pending publication www.bit.ly/1Phn85R
9 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_BOPQ42014E.pdf
10 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_QNAQ42014E.pdf
11 www.bit.ly/1HkqTX5

Table2: Balance of Payments Q4 2013, Q3 and Q4 2014

Item	Q4 2013 (USD millions)	Q3 2014 (USD millions)	Q4 2014 (USD millions)	Change (%) (Q4 2013-Q4 2014)	Change (%) (Q3 2014-Q4 2014)
Current Account	**-$548.5**	**-$246.3**	**-$194.3**	**-64.6**	**-21.1**
Trade Balance of Goods	-$1,191.8	-$1,362.9	-$1,284.1	7.7	-5.8
Trade Balance of Services	$5.2	-$36.0	$8.8	69.2	-124.4
Income Balance	$313.3	$349.1	$339.0	8.2	-2.9
Balance of Current Transfers	$324.8	$803.5	$742.0	128.4	-7.7
Capital and Financial Account	**$576.8**	**$372.2**	**$168.1**	**-70.9**	**-54.8**
Net Capital Account	$136.5	$78.5	$99.9	-26.8	27.3
Net Financial Account	$440.3	$293.7	$86.2	-80.4	-70.7

Source: PCBS and PMA

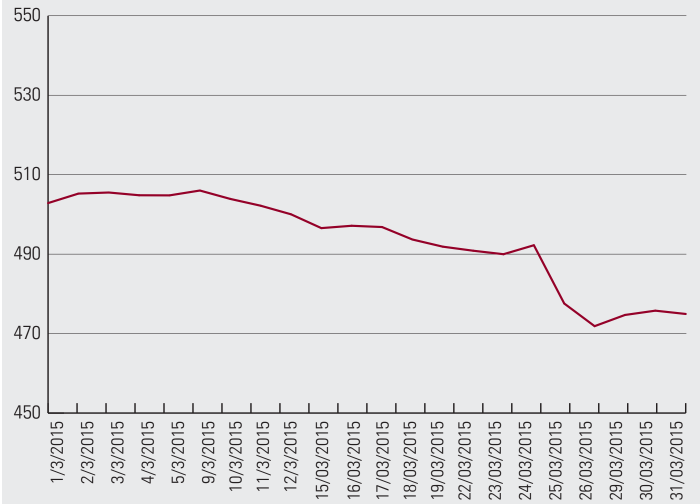
International Investment Position

In line with a medium-term trend, in Q4 2014 the stock of investments of Palestinian residents outside Palestine (total external assets) exceeded investments in Palestine by non-residents (total foreign liabilities). Palestine's International Investment Position (IIP, defined as external assets minus foreign liabilities) stood at $1,234m, marking a 5.4% increase compared to the previous quarter.[12] The observed change was the result of a $14m increase in external assets as well as a $49m drop in foreign liabilities. While foreign portfolio investments increased by $43m, this was more than offset by declining foreign direct investment (down by $33m) and reduced foreign holdings of currency and deposits (down by $48m) in Palestine.

March Trading

In March the Al-Quds index decreased by 4.8%, reaching a peak of 506.01 on 9 March and closing the month at 474.94.[13] The General and Services sectors performed particularly poorly, falling by 4.1% and 10.4%, respectively. National Aluminium and Profile enjoyed the best performance, with its share price rising 25%, while Palestine Plastic Industrial saw double digit improvements for the third consecutive month. Arab Hotels saw its share price drop dramatically, falling by 34.2%. A total of 31.3m shares, worth $59.4m, were traded in March. This marked an increase of 151.8% in the volume and 142% in the value of traded shares from February. Market capitalisation was $2.99bn, down by 4.1% from $3.12bn in February.

Figure 2: Al-Quds Index, March 2014



Bank of Palestine (BOP) enjoyed significantly more liquidity than the other listed companies, providing 42.5% of the volume and 56.5% of the total value of shares traded. This included over $30m in new investment from international investment funds, Gulf investors and local and expatriate Palestinians.[14] This was important, given that Kuwait Kharafi Group decided to sell its entire 7% share of the company, in order to prevent instability in the market. Of particular note, Kuwaiti investor Mr. Qais Abdullah Thunayan Al-Ghanim raised his share in BOP's stocks to 5%. In related news, BOP gained approval from the PMA to distribute $34.2m in dividends for the year 2014, 21.4% of the company's paid-in capital, to be split between $15m in stock and $19.2m in cash.[15] These dividends are the largest, in terms of value, in BOP's history.

12 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_IIP2014Q4E.pdf
13 www.pex.ps/PSEWebSite/publications/PEXIssue-7apr2015.pdf
14 www.bankofpalestine.com/en/media-center/newsroom/details/455
15 www.bankofpalestine.com/en/media-center/newsroom/details/458

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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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