The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

Issue 106

July 2015

Main reports

The PNA Ministry of Public Works and Housing announced the official commencement of a new "residential" stream under the Gaza Reconstruction Mechanism, aimed at enabling access to construction materials by families whose homes were completely destroyed during the 2014 war

The Palestine Investment Fund recently announced plans to launch a $200m fund to invest in the development of solar energy utilities in Palestine

The PMA and the Swiss-based global company BPC Banking Technologies announced the launch of the "National Switch of Palestine", a country-wide electronic payments system

The Korea International Cooperation Agency signed agreements with Palestinian Ministries to support IT start-ups with $7m in grants

National Accounts

In Q1 2015, country-level quarterly GDP decreased by 0.8% in real terms from the previous quarter and from Q1 2014.[1] The year-on-year drop was mainly explained by a 8.2% decrease in Gaza´s quarterly GDP, where the very slow pace of post-war reconstruction efforts and the limited lifting of external restrictions on economic activity resulted in sharp drops in the value added by services (-18.7%) and wholesale and retail activities (-16.8%). The West Bank´s GDP increased by almost 2% from Q1 2014, although this was mainly motivated by rises in the net collection of VAT on imports (23%) and custom duties (27%). Enhanced tax collection partly compensated real drops in the value added by important economic activities, including construction (-8%) and manufacturing (-10%). Poor economic performance in the West Bank during Q1 2015 is likely to be related to decreased consumption due to the inability of the Palestinian National Authority (PNA) to pay public workers´ salaries in full during January and February, after the Government of Israel (GoI) temporarily suspended the transfer of clearance revenues.

Most economic sectors contracted at the country level in Q1 2015 with respect to the previous year (Table 1). Relative contribution to GDP fell for nearly all productive sectors.

Table 1: Value Added by Economic Activity and Sectorial Contribution to GDP, Palestine, Q1 2014 / Q1 2015

	Value Added (Millions of Constant 2004 USD)			Contribution to GDP (%)	
Economic Activity	**Q1 2015**	**Q1 2014**	**% Change**	**Q1 2015**	**Q1 2014**
Agriculture, Forestry and Fishing	59.9	67.8	-11.7%	3.2	3.6
Mining, Manufacturing, Electricity and Water	244.9	281.9	-13.1%	13.1	15.0
Construction	133.8	140.0	-4.4%	7.2	7.5
Wholesale and Retail Trade	345.6	359.5	-3.9%	18.5	19.2
Transportation and Storage	34.3	30.8	11.4%	1.8	1.6
Financial and Insurance Activities	75.9	65.1	16.6%	4.1	3.5
Information and Communication	107.9	106.8	1.0%	5.8	5.7
Services	373.4	388.9	-4.0%	20.0	20.7
Public Administration and Defence	232.5	229.6	1.3%	12.2	12.2
Households with Employed Persons	1.0	1.0	0.0%	0.1	0.1
FISIM	-52.1	-42.7	-22.0%	-2.8	-2.3
Customs Duties	124.1	102.0	21.7%	6.7	5.4
VAT on Imports, net	181.8	146.5	24.1%	9.8	7.8
Total	**1,863.0**	**1,877.2**	**0.8%**	**100**	**100**

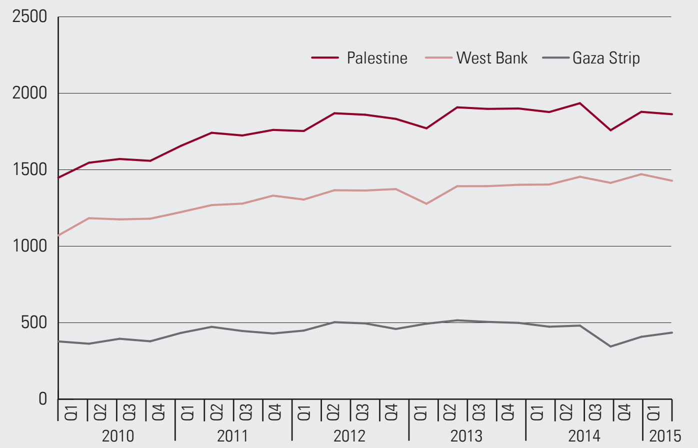
Source: PCBS

The overall decline in quarterly output in Q1 2015 resulted in a year-on-year real drop of 3.6% in per capita GDP (0.9% in the West Bank and 11.2% in Gaza).

1 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_National-Accounts-First%20Quarter-2015-e.pdf

Quarterly GDP per capita in Gaza remains much lower than in the West Bank, after having registered an all-time low of less than $200 (constant 2004 USD) in the aftermath of the war last summer (Figure 1).

Figure 1: Quarterly GDP by Region (constant 2004 USD), Palestine, 2010-2015



Source: PCBS

Gaza Reconstruction

On 24 June the PNA Ministry of Public Works and Housing (MoPWH) announced the official commencement of a new "residential" stream under the Gaza Reconstruction Mechanism (GRM), aimed at enabling access to construction materials by families whose homes were completely destroyed during the 2014 war.[2] The GRM, which until then had included the "shelter" and "projects" streams, is a UN-brokered temporary agreement between the PNA and the GoI to allow for the entry into Gaza of much needed construction materials.[3] With the pace of the reconstruction remaining much slower than originally expected, critics of the GRM argue that its requirements and procedures are partially responsible for delays in the process.

The residential stream aims to enable the reconstruction of 12,600 homes. Between 24 June and 27 July (latest available data) 663 beneficiaries applied under this new stream, with 262 having purchased part of their construction materials allocation.[4] UNRWA submitted applications for nearly 90 refugee families through the GRM. Following the initial approval of more than a third of these submissions, an existing German funded project to assist refugee families could commence.[5] As UNRWA seeks to leverage further donor funding for the reconstruction of destroyed refugee homes, Director of Operations for UNRWA in Gaza, Mr Robert Turner, considered that "the reconstruction process has been too slow, but it is a huge relief to be able to say we have started, and I am confident this is only the first of what will be a series of positive announcements."

As the Bulletin went to print, more than 89,000 households (out of 100,000 applicants) had accessed construction materials through the GRM´s "shelter" stream. However, reports suggest that although many families have received financial assistance to purchase materials, many lack funding to cover labour and other building costs. For this reason, some beneficiaries are reselling the cement purchased via the GRM for up to four times its price (of $6-7 per bag) on the black market.[6] For many citizens in Gaza, this is the only means of generating cash to feed their families, even at the expense of delaying reconstruction works in their homes. The emergence of an extended black market also challenges one of the main purposes of the GRM, originally aimed at enforcing tight controls on the final destination of construction materials imported into Gaza.

In related news, the Palestinian Federation of Chambers of Commerce, Industry and Agriculture (PFCCIA) announced on 27 July that a delegation of over 100 businessmen from the West Bank will visit Gaza Strip during the first week of August.[7] It is expected that the delegation will include directors and members of administrative boards from private sector institutions in the West Bank. Khalil Rizq, a spokesperson for the PFCCIA, said that the mission is aimed at enhancing economic and commercial cooperation between the West Bank and the Gaza Strip.

Solar Energy Fund

The Palestine Investment Fund (PIF) recently announced plans to launch a $200m programme to invest in the development of solar energy utilities in Palestine. The fund is part of PIF´s strategic approach to develop alternative and renewable energy resources, with the ultimate goal of reducing electricity imports.[8]

Dr Mohammad Mustafa, Chairman of PIF´s Board of Directors, stressed the importance of the fund to foster activity in the sector, promote greater energy independence, balance the PNA´s accounts and increase private sector competitiveness. Dr Mustafa said: "supplying electricity has long caused a burden on the State. The high annual energy bill from importing electricity plays a major role in declining competitiveness of the private sector on the one hand, and limits the improvement of the standard of living for the Palestinian citizen on the other hand."

The programme is expected to channel investment through two seperate vehicles, the first of which will comprise of $150m for the establishment of 10 solar fields, with a total generation capacity of up to 100MW (roughly equivalent to 20% of Palestine's current demand). The electricity generation stations, to be developed in different locations across both the West Bank and Gaza, will be connected to the existing electricity distribution

2 www.bit.ly/1Ig2nYw
3 www.bit.ly/1D6piyD
4 grm.report/#/
5 www.unrwa.org/newsroom/emergency-reports/gaza-situation-report-100

6 www.bit.ly/1AAUyJ7 and www.bit.ly/1HMAVfc
7 www.bit.ly/1IGyzo0
8 PIF´s press release (July 2015)

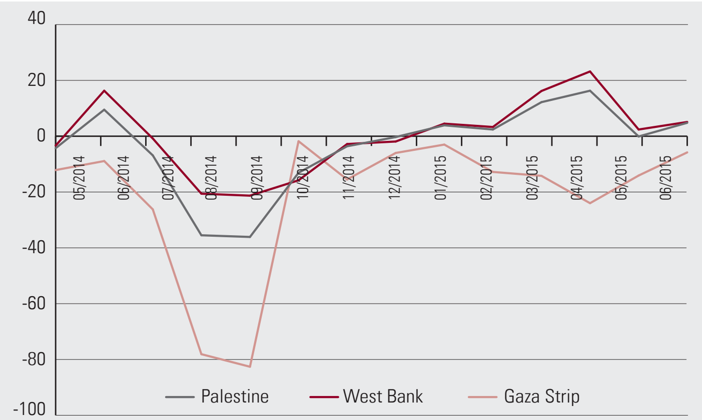
network. The programme is expected to boost economic activity and create thousands of new direct and indirect job opportunities, including in electrical engineering, maintenance, logistical services, transportation and construction.

The second vehicle consists of a $50m leasing fund to invest in domestic and medium sized photovoltaic systems, aimed at covering the electricity needs of households, small businesses, hospitals, universities and industrial and agricultural establishments. At the same time, PIF will invest in a training programme for Palestinian technicians and energy specialists, specifically aimed at improving skills in the installation and maintenance of solar panels.

Business Indicators

The Palestine Monetary Authority Business Cycle Index (PMABCI), a monthly index reflecting the current state and the evolution of economic activity in Palestine, decreased in May (to reach -0.1 points), but bounced back in June (4.8 points).[9]

Figure 3: PMABCI (by Region), May 2014- June 2015



Source: PMA

The West Bank index dropped from 23.2 points in April 2015 to 2.4 points in May, to partially recover in June (5.1). The profound deterioration in May reflected weaker performance of all industrial sub-sectors, particularly textiles and construction. Recovery in June was pushed by the food sub-sector.

The Gaza Strip index increased in May (from -24 to -14 points) to continue its recovery in June (5.8). According to the PMA, the recovery reflected some improvement in the flow of raw materials into Gaza. The food index also saw enhanced performance ahead of the preparations for the holy month of Ramadan.

National Switch System

The PMA and the Swiss-based global company BPC Banking Technologies announced the launch of the "National Switch of Palestine", a country-wide electronic payments system. The new system is based on SmartVista technology, a single integrated solution for transaction processing and card management.[10]

The development is part of the PMA's strategy to promote the adoption of electronic retail payments as a way of reducing risks related to the use of cash, cheques and other paper-based payment instruments in commercial transactions. The launch of the new system is expected to encourage banks operating in Palestine to issue more debit and prepaid cards, and also to promote the distribution of POS-terminals throughout the country.

Currently only Bank of Palestine, Bank of Jordan and Cairo Amman Bank are switched to the integrated ATM/POS network, enabling ATM card holders to use any banks' ATMs. Dr Jihad Al Wazir, Governor and Chairman of the Board of Directors of the PMA, said that the Monetary Authority is "also planning to continue working with the remaining banks (to make it mandatory for them to) connect to the national switch by the end of the third quarter of 2015", adding that "the implementation of the switch will increase access to banking services, especially in rural areas."

Research Paper: Options for a New Trade and Economic Regime

The Palestine International Business Forum (PIBF), in cooperation with the Office of the Quartet Representative and the International Council of Swedish Industry, published a research paper studying the potential for Palestinian economic development under alternative trade and economic arrangements. The investigation argues that "…the present economic and trade regime, based on the Paris Protocol of 1994, combined with the restrictions associated with Israeli administrative and security measures, has had a dramatic negative effect on Palestinian economic growth" and is therefore "unsustainable." PIBF estimates that the Palestinian economy forgoes up to $15bn in GDP per year (more than 100% of the current output level) due to the trade and economic arrangements currently governing economic activity. As such, the research considers that a new trade and economic regime with Israel is crucial "to break the impasse and realise Palestine's true growth potential", since the current Palestinian growth model, "based on recurrent fiscal deficits, has proved unsustainable."

PIBF´s analysis concludes that a Free Trade Agreement (FTA) between Palestinians and Israelis would yield the best results for the Palestinian economy, with substantial gains to be made by Israel as well. Major removal of restrictions to economic activity would result in considerable short-term economic impact, with the fast and continuous development of Palestinian exports being identified as the single most important long-term economic growth factor. PIBF's analysis suggests that by

9 www.pma.ps/Default.aspx?tabid=205&ArtMID=793&ArticleID=767&language=en-US

10 www.bit.ly/1D5V1Vn

entering an FTA the potential exists to increase the share of exports in Palestinian GDP from a current level of 16% to over 40% in 15 years. This, according to PIBF, could boost GDP from $12bn to $44bn in ten years. PIBF's research estimates that the FTA would enable double-digit growth rates during the first decade following its establishment, based on the experience of other post-conflict countries.

The research suggests that export-driven growth could be centred on high potential economic sectors, most notably the manufacturing industry, agriculture and tourism (all of which have experienced poor growth under the status quo). Opportunities for these and other sectors are deemed greater in the Pan-Arab market, which is expected to become the main destination for Palestinian exports, alongside Israel.

Korean Support for Tech Start-ups

In June the Korea International Cooperation Agency signed agreements with the PNA Ministry of Planning and Administrative Development and the PNA Ministry of Telecommunication and Information Technology to support Palestinian IT start-ups with $7m in grants, to be disbursed under the Palestine Start-Up Support (PASS) programme.[11] The PASS aims to activate the start-up ecosystem in both the West Bank and Gaza by improving the investment environment, intensifying an acceleration programme and fostering greater collaboration between universities and the business sector. The Representative Office of the Embassy of the Republic of Korea, the Korea National Information Society Agency and the Al-Bireh Municipality also signed a Memorandum of Understanding for the establishment of an IT centre at the Al-Bireh Youth Center.[12]

Korean cooperation in the high-tech sector is part of the country´s broader efforts to intensify its ties with Palestine. These were presented and discussed during a seminar hosted by the Palestine Economic Policy Research Institute (MAS) on 15 June, attended by the Economic Advisor to the President Dr Mohammad Mustafa and the Mission Head to the Representative Office of Korea in Palestine, Mr Pak Woong Chul.[13]

11 www.on.fb.me/1Jtn3Xx and www.bit.ly/1HMAzW9
12 www.on.fb.me/1Dr9vd7
13 www.mas.ps/files/server/Lectures/KIEP/PR%20%20KIEP%20Conf%20final%20-En.pdf

Balance of Payments and International Investment Position

In the first quarter of 2015 the Palestinian current account deficit increased by 66.4% from the previous quarter, to reach $323.4m.[14] However, it decreased by more than 20% from Q1 2014. The deficit in Q1 2015 amounted to 11% of quarterly GDP at current prices, up from 6.4% in Q4 2014. The increase in the deficit from Q4 2014 was the result of a sharp decline in the balance of current transfers, in turn driven by a drop in external transfers to the government (amounting to 30% of total transfers from abroad).

At the same time, the capital and financial account balance increased by 27.7% from Q4 2014, but dropped by almost a third from Q1 2014. A 50% drop in net transactions of financial assets largely drove the decline.

During the same period, the stock of investments of Palestinian residents outside Palestine (total external assets) exceeded investments in Palestine by non-residents (total foreign liabilities) by $1.3bn, marking a 6.0% increase in Palestine's International Investment Position (IIP, defined as external assets minus foreign liabilities) from Q4 2014.[15] The change came as a result of a drop in foreign liabilities, mainly in direct and portfolio investments of foreign companies in Palestine.

The gross external debt in different sectors of the Palestinian economy reached $1,575m in Q1 2015, a slight increase from the previous quarter. The debt of the general government represented almost 70% of the total.

June Trading

In June the Al-Quds index decreased by 0.1% from the previous month, reaching 478.4 points on the last day of trading.[16] A total of 7.9m shares worth $12.7m were traded during the month. This marked a drop of 12.6% in the volume and 14.8% in the value of traded shares from May 2015. Market capitalisation increased over the month by 0.3%, reaching $3bn.

14 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_BoPQ12015E.pdf
15 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_IIPQ12015E.PDF
16 www.pex.ps/PSEWebSite/NASHRA/20150630.pdf

The Portland Trust

MAS

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

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