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FOREWORD

This issue of the *Quarterly Economic and Social Monitor* goes into circulation at a difficult time for the Palestinian people in the wake of the latest brutal aggression by the Israeli military against the Gaza Strip, which was unprecedented in its severity and the killings, destruction and displacement that it wreaked. The issue records the developments in the Palestinian economy in Q1 2014 and alludes to other topics of significance to the economy as well as to other relevant local, regional and global developments. Apart from the usual data found in every issue, which draws on reports on the economic situation in Palestine issued by PCBS and PMA, this issue features a number of textboxes that address those developments. We considered devoting a textbox to review the economic effects of the Israeli aggression (which began on July 8, i.e., during Q3 2014) on the Palestinian economy. However, since the aggression was still ongoing at the time of finalizing this issue, and because there are numerous agencies/organizations (including our three organizations, each in its own area of specialization) that are preparing reports on the impact of the continued blockade/aggression on the Gaza Strip in anticipation of relief and reconstruction needs, we have deferred tackling the economic impact of the aggression to a later issue. Yet, we have decided to include a textbox that tackles the impact of the latest Israeli military operations in the Gaza Strip on the Israeli economy itself, since there are already signs of an adverse impact on the 2015 general budget, now being drafted. Indeed, the Palestinian people has incurred severe losses in lives and property, yet estimates coming from Israel portend tangible economic and socioeconomic repercussions that cannot be ignored. Though in evidence, these repercussions will not, however, be discussed in detail and we refer to their presence without further detail.

Let's all hope that, with the release of the next issue of the *Monitor*, the Israeli aggression- with its manifestations: the continued occupation, the ongoing blockade and the military operations- will have ended and become part of history. This will hopefully allow the current effort to inform astute predictions for the future of the Palestinian economy in a climate of less uncertainty.

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Executive Summary

GDP: Palestinian GDP in 2014 Quarter 1 totaled around USD 3,015 million, down 0.6 percent from the previous quarter, but up 7.1 percent over the corresponding quarter a year earlier. Meanwhile, the share of per capita GDP saw a decline of 1.4 percent from the 2013 fourth quarter and a gain of 4 percent over the 2013 corresponding quarter. Final consumption expenditure, on the other hand, accounted for 111 percent of GDP.

The Labor Market: The number of workers in the West Bank and the Gaza Strip rose by 33 thousand from the previous quarter and around 64 thousand from the 2013 corresponding quarter. By place of work, employment data show that 60 percent of them worked in the West Bank, 28.2 percent in the Gaza Strip and 12 percent in Israel & the Settlements. Meanwhile, the unemployment rate stood at 26.2 percent, rising from 25.2 percent in the previous quarter and from 23.9 percent in the prior year's corresponding quarter. On the other hand, the average daily wage in 2014 Q1, as compared to the previous quarter, remained relatively unchanged for those working in the West Bank and Israel & the Settlements, but it fell by 4.4 percent for Gaza's workers. Compared to the 2013 corresponding quarter, however, the daily wage in the West Bank saw a growth of 1.6 percent, and in Israel & the Settlements it rose by 8.9 percent. This occurred against a 5.7 percent decline in the wages of Gaza's workers.

Public Finance: Net domestic revenues saw a remarkable growth: 19 percent compared with the previous quarter and around 50 percent compared to the 2013 corresponding quarter. Total public expenditure, on the other hand, rose by 11 percent from the previous quarter and 2 percent from the corresponding quarter of the previous year. This reduced budgetary total deficit before grants (on a cash basis) from USD 1.3 billion in 2013 first quarter to USD 446 million in the target quarter. Meanwhile, the international aid the budget received during the quarter fell by 20 percent compared to the previous quarter, and by about 60 percent compared to Q1 a year earlier. The contraction in international aid slashed the budget surplus after grants and aid to NIS 309 million on a cash basis. The NIS 560 million arrears have rendered this surplus on cash basis to a deficit of about NIS 251 million on commitment basis.

The Banking Sector: Direct credit facilities during 2014 Q1 totaled USD 4,675.5 million, a rise of 4.4 percent over the previous quarter and an increase of 14.7 percent from the corresponding quarter of 2013. Loan facilities accounted for the largest share of total direct facilities (26.8 percent). Climbing to USD 8,454.4 million, the deposits increased by 1.8 percent over the previous quarter and by 9.6 percent over the 2013 corresponding quarter. Banks operating in Palestine, on the other hand, reported USD 40.5 million in net profits end of Q1 compared with USD 33.3 million in the previous quarter.

Palestine Stock Exchange: Approximately 76.4 million shares were traded on the Palestine Stock Exchange during 2014 Q1, a decline of 11 percent from the previous quarter. The value of shares traded, however, totaled USD 166 million, a 15 percent growth over 2013 Q4. During the same period, Al-Quds Index closed at 548.37, thus posting an improvement of 6.92 points over the previous quarter.

Investment Indicators: The *Monitor* follows four indicators to measure investment in the Palestinian Territory:

- **Company Registration**: The number of companies newly registered in the West Bank during 2014 Q1 totaled 440, an increase of 159 over the previous quarter. The capital of these companies amounted to JOD 59 million, a 42 percent decrease from the previous quarter.
- **Buildings licenses and cement import**: The number of building licenses grew by 7.2 percent compared to Q1 2013. The number of licensed new and existing residential units rose to 4646 (up from 4208 in the corresponding quarter of the previous year). On the other hand, the amount of Palestine's cement imports saw a growth of 37 percent over the 2013

corresponding quarter, yet Gaza's share of imported cement remained marginal as the Israeli ban allowed only 5.6 thousand tons into the Strip, down from 11.8 thousand tons in the previous quarter and 13.1 thousand tons in Q1 a year earlier.

- **Vehicle registration**: During 2014 Q1, some 3,764 new and used vehicles were registered for the first time in the West Bank, a 3.1 % drop from the previous quarter, but a 9.6 % rise over Q1 in 2013. About 50 percent of the first-time registered vehicles were second-hand vehicles imported from abroad (import of second-hand cars from Israel is prohibited).
- Hotel activity: There were 116 hotels operating in the West Bank end of Q1 2014, up from 113 in the previous quarter. The number of hotel guests reported in this quarter totaled 149,526, lodging about 361,711 nights. Hotel guests increased by 24.1 percent relative to Q1 2013, but down 21.7 percent relative to the previous quarter.

Prices and purchasing power: The Consumer Price Index in Q1 2014 rose by 0.64% compared to previous quarter and 2.2 percent compared with Q1 2013. Meanwhile, the purchasing power of the US dollar and the Jordanian dinar dropped by about 1.5 percent compared to the previous quarter and 7.8 percent compared to Q1 2013. This resulted from the price inflation and decline in the exchange rate of both the USD and the JOD against the NIS.

Balance of trade and balance of payments: The Trade Balance deficit for *reported* goods in 2014 Q1 stood at USD 1,036 million. During the same period, the current account deficit in the balance of payments amounted to about USD 419.5 million (11.2 percent of GDP at current prices). This deficit was 14.6 percent higher than in the previous quarter and a whopping 74.2 percent above the figure reported in the corresponding quarter of the previous year. The deficit resulted from a trade balance deficit co-occurring with a surplus in the balance of income, largely generated by USD 411.2 million incomes of Palestinians working abroad. There was also a surplus of USD 558.2 million in the current transfers, primarily in the form of aid.

Net international deposits and external debt: Palestinian total international assets abroad totaled USD 6,318 million end of Q1 2014. Direct foreign investments by Palestinians made up only 5.5 percent of total, while portfolio investment represented 21.2 percent. Meanwhile, the total foreign international liabilities in Palestine totaled USD 4,977 million, 50.3 percent of which was in the form of foreign direct investment in Palestine. Palestine's external debt in Q1 2014 totaled USD 1.718 billion. The government was the main debtor (owing 64.4 percent of total external debt), while the banking sector's share of total external debt represented 32.1 percent.

Textboxes: This issue of the *Monitor* includes 12 textboxes that bring into focus a number of critical issues:

The Cost of the 2014 Gaza War on Israel's Economy

The box surveys various estimates of the costs the war on Gaza inflicted on Israel's economy. The cost estimates range between 0.5 percent of Israel's GDP (NIS 5 billion) to 1.5 percent of GDP (NIS 18 billion). The textbox cites Israel's military estimates of the costs of the offensive during the 37-day engagement as well as the direct effects of the war on the tourism, anticipated growth rate and the rate of unemployment. It also analyzes the government budget deficit, which is expected to rise significantly during this year and exacerbate in the next year, reaching probably double the target the government sat before the war.

Economic Priorities of the 'Arab Spring'

The textbox reviews the results of a questionnaire conducted by the IMF with around 300 decision-makers, businessmen and representatives of the civil society and the academia in the Arab countries. The questionnaire aimed at identifying the economic priorities in the Arab region across four main areas: macroeconomic policy, increasing employment opportunities for young people, methods to achieve good governance, and creating an enabling business climate. The respondents saw a need for crafting a compelling economic vision based on community involvement and under a rational, aware leadership. Responding to questions about employment, respondents stressed the importance of redefining the role of the state, reforming the education system so that the educational outputs will be compatible with the requirements of the labor market. As for improving the business climate, the answers focused on promoting competition, reforming the support systems, introducing reforms of bankruptcy laws and improving funding and borrowing opportunities.

The National Development Plan 2014-16: State Building to Sovereignty

The box discusses the new national development plan 2014-2016, titled 'State Building to Sovereignty.' It reviews first the methodology of the plan and the four main targeted sectors (development and employment, good governance and institution-building, social development and protection, and infrastructure). Thereafter, it summarizes the plan's financial framework that has been developed on the basis of two scenarios: a status quo situation with respect to political and economic conditions, and an optimistic scenario assuming an ease of Israeli restrictions and allowing the Palestinian economy to utilize its potential resources in Area C. The plan provides estimates for international aid to finance developmental and operational spending during the three-year period. The target international aid for development spending is almost 40 percent higher than the aid actually received for this purpose during the previous three years (2011-2013). Furthermore, the plan expects foreign aid for current expenditure to be 50 percent higher than what was actually received in the previous three-year period.

Electricity Sector in Palestine: Current State and Reform Requirements

The textbox outlines the highlights of a background paper conducted by MAS for a roundtable discussion on 'The Electricity Sector in Palestine: Current State and Reform Requirements.' The textbox addresses such issues as the legal framework that regulates the electricity sector in the Palestinian Territory, the amount of electricity available, the problems and quantities of power generation, transferring power, electricity distribution companies, losses, import bill, the prices and the challenges facing this sector. The paper also reviews the most important efforts/initiatives and future plans to improve the electricity sector, including the launch of the National Electricity Transmission Company and building local plants.

Palestine's Public Debt and Arrears: 40 percent of GDP

This textbox examines an International Monetary Fund's report on Palestinian arrears and public debt. The report found that the rise in the foreign aid to the budget in 2013 allowed the government to pay salary arrears and reduce the public debt. Meanwhile, debt owed to the Pension Fund and local suppliers has seen a significant rise during the year, leading to an accumulation of NIS 1.7 billion (4 percent of GDP) in arrears. When the NIS 1.9 billion for the Israeli Electricity Company and advanced clearance payment are taken into account, total Palestinian public debt and net accumulation of arrears totaled NIS 16.9 billion, or about 40 % of GDP by the end of 2013.

Interest Rates Spreads in Palestine: Discrepancy and Harmfully High Levels

This box looks into interest rates spread (the difference between the interest rate paid by banks on various forms of depositors and the rates charged by banks on various forms of loans). This spread is one of the most important indicators of the financial sector, as it shows how effective the financial intermediation in the economy is. The spread increase with the increase of banking intermediation costs, and is influenced by market structure, operational costs and various forms of credit risks, including political risks. There are three interest rate spreads in Palestine in association with the three currencies in use (USD, NIS and JOD). The spreads in Palestine are generally high compared with the corresponding rates in the countries issuing these currencies, and there are significant differences between the interest rate spread of various currencies, being relatively low on the US dollar and high on the Israeli shekel.

Peace Would Give Israel's GDP NIS 180 billion Boost

This textbox summarizes the results of a study carried out by Israeli economists on the gains Israel's economy would reap from peace with the Palestinians. The study divides these gains into two types. First, gains in form higher growth in GDP resulting from increased exports to the Arab and Muslim countries, doubling the number of tourists to Israel and doubling of foreign investment. These would help Israel add around NIS 180 billion a year to its gross domestic product 10 years after striking a peace deal. Second, improvement in public finance due to the rise in GDP and cut in military spending and spending on settlements which are likely to improve public purse by a further NIS 67 billion a year.

IMF: Peace is No Substitute for Aid and Economic Reform in Palestine

The box outlines the results of an IMF study on the economic gains the Palestinian economy would achieve from peace. The study's estimates are built on some assumptions: the gradual lifting of Israel's restrictions on the movement of labor and goods, maintaining the currently prevailing monetary arrangements and a non-increase in the number of Palestinians working in Israel and the settlements. The study found that under these assumptions, the performance of the Palestinian economy will improve significantly, and that GDP will grow by 6 percent in 2013 and 10 percent in the medium term, which would increase budget revenues, while the employment rate would remain high. Though indispensable, peace is not a substitute for foreign aid and economic reform, the study concluded.

One-Third of Palestinian households are Food Insecure

This textbox discusses the results of a recently published report on Palestine's food security conducted by the PCBS, UNRWA,WFP and FAO. The report, which covered the 2013 full year, found that food insecurity among Palestinian households remains high, with 33 percent of households (or 1.6 million people) being food insecure. The report reveals a gap between West Bank and Gaza Strip households (19 percent and 57 percent, respectively). The report also found that refugees in Gaza continue to report lower food insecurity rates than non-refugees (54 percent compared to 63 percent for non-refugees). These figures were released before the recent attack on the Gaza Strip which might have led to a serious deterioration of food security indicators there.

Poverty Atlas of Palestine

This box reviews a World Bank's recent report entitled 'Seeing is Believing: Poverty in the Palestinian Territories.' The report builds on an analysis of the Atlas of Poverty, developed by the WB in collaboration with the PCBS. The Atlas seeks to provide a comprehensive visualization of the disparity in the distribution of poverty and other resources between different communities within the Palestinian Territory. Poverty mapping helps policy makers design programs aimed at fighting poverty regionally and within local communities. These maps are particularly important in countries with differences in levels of development between local communities across the country. This, for sure, applies to Palestine. The Atlas of Poverty found that the highest poverty rates are mainly reported in the southern Hebron communities (sometimes reaching 80 percent) and the Gaza Strip communities.

Israel's Exports to Palestine: Low Technological Content and Limited Value Added

This textbox summarizes the results of a paper published in the *Recent Economic Developments* of the Bank of Israel. The study evaluated the benefits Israel's economy gains from its trade with the Palestinian Territories. It found that 73 percent of Israel's exports to the Palestinian Territories are of low technological content, with a total value added figure somewhere between NIS 6.1 billion and NIS 8.9 billion (based on minimum and maximum estimates). This represents only 0.8 percent to1.2 percent of the value of Israel's production in 2012.

Incorporating Illegal Activities in GDP Calculation

This textbox elaborates on the decision that the Italian National Institute of Statistics has lately taken regarding the inclusion of illegal activities**,** such as drugs, alcohol and cigarettes smuggling and prostitution in the GDP calculations starting from October 2014. The decision sparked discontent from statistics bureaus all over the world, particularly in the European Union, which strives to unify the national accounts calculation methods in all EU countries, because the national contributions to and benefits from the EU’s budget are based on the relative GDP shares of each country. Though acknowledging the difficulty in estimating illegal activities, experts from the INIS say that it's not impossible, especially for Italy which had before succeeded in incorporating the “black” activities in the GDP in the eighties of the last century. These are legal activities and transactions but are carried out without proper reporting to the tax department.

1. GDP

Quarterly data show a decline of 0.6 percent in GDP in 2014 Q1 from 2013 Q4. Compared to the same period of the previous year (which, given the seasonal nature of economic activities, is a more authentic measure of growth), there was a growth of 7.1 percent in GDP (see Table 1-1). This can be attributed exclusively to growth in the West Bank, as GDP in Gaza shrank by around 1 percent. On the other hand, the per capita GDP growth rate (roughly equivalent to GDP growth minus the rate of population growth) fell by 1.4 percent from the previous quarter, but grew by 4 percent from the corresponding quarter a year earlier. Once more, the figures show a gap between the West Bank, whose per capita GDP grew by 7 percent, and Gaza. = Gaza's per capita GDP saw some decline compared to the previous quarter (3.5 percent) and the corresponding quarter of last year (4.3 percent).

Table 1-1: Palestine's GDP * (constant prices, base year 2010)

Indicator	2013				2014
	Q1	Q2	Q3	Q4	Q1
GDP (USD)	**2,814.4**	**3,034.6**	**3,023.7**	**3,034.2**	**3,015.1**
−West Bank *	2,106.8	2,295.6	2,287.2	2,314.6	2,314.9
−Gaza Strip	707.6	739.0	736.5	719.6	700.2
GDP per capita (USD)	**682.5**	**730.5**	**722.5**	**719.6**	**709.8**
−West Bank *	862.2	933.2	923.6	928.4	922.4
−Gaza Strip	421.2	436.2	431.0	417.5	402.9

Source: Palestinian Central Bureau of Statistics 2014, National Accounts Statistics, Ramallah - Palestine.
Data are preliminary and thus subject to further revision.
* Data do not include that part of Jerusalem governorate which was annexed by Israel in violation of international law following its occupation of the West Bank in 1967.

GDP Structure

Compared to the corresponding quarter of 2013, 2014 Q1 saw a drop in the share of GDP contributed by mining & manufacturing and construction by 1.6 and 2.1 percentage points, respectively. In contrast, the share of services increased by 0.5 percent, while that of wholesale & retail and repair of vehicles and motorcycles grew by 3.8 percent (See Table 1-2).

Table 1-2: % Distribution of the shares of economic sectors in Palestinian GDP * (constant prices, base year 2010)

Economic Activity	2013				2014
	Q1	Q2	Q3	Q4	Q1
Agriculture, forestry and fishing	**3.4**	**3.8**	**3.6**	**4.1**	**3.2**
Mining, manufacturing, water and electricity	**15.8**	**17.1**	**17.3**	**15.0**	**14.3**
-Mining and quarrying	0.3	0.4	0.4	0.4	0.3
-Manufacturing	14.2	15.5	15.5	13.6	12.6
-Electricity, gas, steam and air conditioning supplies	1.0	0.9	1.1	0.8	1.2
-Water supply, sanitation activities and waste management & treatment	0.3	0.3	0.3	0.2	0.2
Construction	**11.1**	**11.5**	**10.2**	**11.4**	**9.0**
Wholesale & retail and repair of vehicles	**17.3**	**17.3**	**18.4**	**18.2**	**21.1**
Transport and storage	**2.0**	**2.3**	**2.2**	**2.0**	**2.0**
Financial and insurance activities	**3.6**	**3.3**	**3.3**	**3.3**	**3.4**

Economic Activity	2013				2014
	Q1	Q2	Q3	Q4	Q1
Information and communication	**5.4**	**5.4**	**5.4**	**5.1**	**5.0**
Services	**19.1**	**19.0**	**18.4**	**19.2**	**19.6**
-Accommodation and food services	1.2	1.6	1.3	2.0	1.5
-Real estate and renting	4.0	3.7	3.9	3.6	4.0
-Professional, scientific and technical activities	1.0	1.0	0.8	0.8	0.9
-Administrative services and support services	0.6	0.6	0.8	1.2	0.9
-Education	7.0	6.8	6.7	6.5	6.9
-Health and social work	3.2	3.1	3.0	3.0	3.1
-Arts, recreation and leisure	0.3	0.4	0.4	0.6	0.5
-Other services	1.8	1.8	1.5	1.5	1.8
Public administration and defense	**12.6**	**11.5**	**11.4**	**11.4**	**11.4**
Home Services	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Financial intermediation services indirectly measured	-2.7	-2.5	-2.5	-2.5	-2.6
Customs duties	5.6	5.2	5.9	5.3	5.6
Net value added tax on imports	6.7	6.0	6.3	7.4	7.9
Total (%)	**100**	**100**	**100**	**100**	**100**

Source: Palestinian Central Bureau of Statistics 2014, National Accounts Statistics, Ramallah - Palestine.

All data are preliminary and thus subject to further revision.

* Data do not cover that part of Jerusalem governorate which was annexed by Israel in violation of international law following its occupation of the West Bank in 1967.

GDP Expenditure

Table 1-3 shows spending on major components of GDP in 2013 and 2014 Q1. The table features the basic equation in the national accounts: Private Consumption + Investment + Government Consumption + Exports - Imports = GDP (GDP = C + I + G + X - M).

Figures of 2013 and 2014 first quarter are shown below

USD billions (constant prices 2010)	Q1 2013	Q1 2014
Private consumption	2.38	2.60
Investment (gross capital formation)	0.59	0.59
Government consumption	0.74	0.76
Exports	0.45	0.46
Imports (-)	(1.34)	(1.50)
Net errors and omissions	0	0.11
GDP	**2.81**	**3.02**

These figures suggest that the 7.1 percent growth in GDP between the corresponding quarters resulted primarily from a 9.2 percent increase in private consumption (including the spending of non-profit institutions), a 3.4 rise in government consumption and 2.9 percent growth in exports.

Table 1-3: Expenditure on the GDP* (constant prices, base year 2010)

(USD millions)

Item	**2013**				**2014**
	Q1	**Q2**	**Q3**	**Q4**	**Q1**
Final consumption expenditure	**3,117.4**	**3,373.3**	**3,385.9**	**3,286.0**	**3,354.6**
Household final consumption expenditure	2,296.2	2,544.1	2,508.3	2,480.3	2,499.9
Government final consumption expenditure	737.6	742.7	795.1	712.1	762.9
Final consumption expenditure of not-for-profit organizations that serve households	83.6	86.5	82.5	93.6	91.8
Gross capital formation	**586.6**	**702.5**	**655.4**	**710.3**	**590.1**
Gross fixed capital formation	621.8	757.0	690.9	710.8	589.2
- buildings	529.0	657.2	595.1	616.5	489.6
- non-buildings	92.8	99.8	95.8	94.3	99.6
Changes in inventories	-35.2	-54.5	-35.5	-0.5	0.9
Net precious property	0.0	0.0	0.0	0.0	0.0
Net exports of commodity and services	**-889.6**	**-1,041.2**	**-1,017.6**	**-962.1**	**-1,036.3**
Exports	448.4	484.1	434.2	493.0	461.3
- commodity	342.7	374.4	331.5	385.1	360.8
- services	105.7	109.7	102.7	107.9	100.5
Imports	1,338.0	1,525.3	1,451.8	1,455.1	1,497.6
- commodity	1,149.5	1,326.4	1,267.7	1,225.7	1,337.6
- services	188.5	198.9	184.1	229.4	160.0
- Net errors and omissions	0.0	0.0	0.0	0.0	106.7
GDP	**2,814.4**	**3,034.6**	**3,023.7**	**3,034.2**	**3,015.1**

Source: Palestinian Central Bureau of Statistics 2014, National Accounts Statistics, Ramallah - Palestine.
All data are preliminary and thus subject to further revision.
* Data do not cover that part of Jerusalem governorate which was annexed by Israel in violation of international law following its occupation of the West Bank in 1967.

Several points can be concluded from Table 1-3:

- ✧ The Palestinian final consumption expenditure during 2014 Q1 outweighed GDP by 11.3 percent.
- ✧ This expenditure was distributed as follows: 74.5 percent for household consumption, 22.7 percent for government expenditure and 2.7 percent for final consumption expenditure of non-profit organizations that serve households.
- ✧ Compared to 2013 Q1, household final consumption in 2014 Q1 increased by 8.9 percent. In parallel, the consumption expenditure of the government and non-profit organizations rose by 3.4 percent and 9.8 percent, respectively.
- ✧ In 2014 Q1, gross capital formation saw scant growth, 0.5 percent over 2013 Q1. Strikingly, the share of fixed capital formation attributed to buildings fell from 90 percent to 83 percent between the corresponding quarters.
- ✧ Exports of goods and services saw a growth of 2.9 percent compared to Q1 a year earlier, while imports of goods and services increased by 11.9 percent during the comparison period.

Textbox 1: Israel's Economy: The Cost of the 2014 War on Gaza

Yair Lapid, Israel's Finance Minister, a TV presenter turned into populist politician, , boasted at the beginning of the recent war on the Gaza Strip that Israel's economy was impervious and that Israel's 2014 budget would be able to absorb the costs incurred during the war without a need to raise taxes or modify spending targets.[1]

However, contrary to Lapid's predictions, various estimates of the costs of the war began to show a huge economic impact. Moshe Asher, head of the Israel Tax Authority, said the war has cost the economy about NIS 7 billion (USD 2billion). This figure includes NIS 4.4 billion as a result of a decline in production, NIS 1.5 billion in lost tax revenues, and around NIS 1 billion in compensation to Israeli residents and businesses within a radius of 40 km of Gaza.[2]

Meanwhile, Doron Cohen, Director General of Israel's Ministry of Finance projected a figure that is double Asher's estimate. Cohen's 15-billion-shekel (USD 4.3 billion) loss estimate is equivalent to 1.5 percent of the country's GDP. This figure reflects a loss in tax revenues somewhere between 3-5 billion shekels as well as 4-5 billion shekels in direct military expenditures.[3] In a television interview, the governor of the Central Bank, Karnit Flug, gave an estimate of 0.5 percent of Israeli GDP, or about 5 billion shekels.

Certainly, providing an accurate estimate of the costs of the war is a daunting task, as there are direct as well as indirect costs, which are likely to impact the economy for years to come. There are also difficulties estimating some abstract costs (e.g. human life, trauma and psychological effects). Estimates might also usher political and strategic implications, and therefore they are often influenced by political orientations of the researcher or the institution. All of these caveats must be taken into consideration when analyzing such estimates.

Israel's economy entered the last war with slow growth compared to the first quarter of the year. According to the Israel Central Bureau of Statistics, the growth slowed to an annualized 1.7 percent in the second quarter of 2014 compared with 2.5 percent in the first quarter of the year.[4] The direct and indirect costs of the war further slowed growth and increased the budget deficit and unemployment rates beyond targets.

Direct costs for the military operations

As soon as the first temporary truce entered into effect, the Israeli military handed its operation bill to the Ministry of Finance. The military's costs for the 37-day war totaled NIS 8.7 billion. The Ministry of Finance protested the size of expenditures and conducted a full audit on the basis of daily reports of military spending, including reports of the number and types of missiles, catering, compensations to soldiers, etc. The figure of direct costs the Ministry of Finance arrived at was NIS 6.5 billion, nearly NIS 2 billion lower than the military estimate.

Defense officials said that the difference in figures is due to the Ministry of Finance not taking into account the costs of returning military equipment to installations. Additionally defense ministers said the cost of each reservist is NIS 500 a day (60,000 × 500 = NIS 30 million a day).[5]

In light of these figures, the Israeli military requested 18 billion shekels (5.2 billion dollars) in additionally funding. This includes an increase of NIS 7 billion over this year's budget and NIS 11 billion over next year. If this happens, the military budget will increase to NIS 70 billion in 2015 (about 7 percent of GDP), compared with NIS 58.4 billion in 2013.[6]

There are some who capitalize on the armed conflict and make immense profits from the sale of arms and benefit enormously frm the free publicity that the Gaza laboratory provides their products.. Israel Military Industries, particularly in Nazareth, were working in their assembly lines around the clock during the four-week war.[7] Israel Military Industries will double their profits, first because the military wants to replenish its

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1 This textbox was written during the truce that ended on August 19. Thus, the estimates of the costs do not include the entire period of the war.
2 http://www.ibtimes.co.uk/gaza-strip-crisis-war-costs-total-6bn-palestine-2bn-israel-1459985
3 http://www.haaretz.com/business/.premium-1.608538
4 http://www.jpost.com/Israel-News/Economic-growth-slowed-to-17-percent-before-Gaza-conflict-371322
5 http://www.haaretz.com/news/diplomacy-defense/.premium-1.610877
6 http://www.haaretz.com/news/diplomacy-defense/.premium-1.609920
7 http://www.haaretz.com/news/diplomacy-defense/1.609919

arsenal, and second because the battle-tested weapons will win these industries new customers in overseas markets. Past experience indicates that Israeli arms sales increase dramatically after every war Israel wages. Unfortunately, Israel's use of the Gaza Strip as a testing ground for its arms gives them a competitive advantage over military industries in other countries and a perverse economic incentive to continue using Gaza as a firing range. Additionally, Israeli cement and steel manufactures will see a huge increase in revenue from the Gaza reconstruction effort.

Tourism

Israel's tourist-related businesses incurred a massive loss during July and August (peak tourist season). Tourism in Israel provides job opportunities for about 100 thousand people and contributes about 5 percent of GDP.

In 2013, the number of tourists visiting Israel reached a record high of more than 3.5 million people. Israel hoped to increase this number in 2014, but all indicators point in the direction of a reversal. In July, the figure was only 218 thousand, which is 26 percent lower than the figure reported in July 2013. By some estimates this reduction cost Israel’s tourism industry30 million dollars a day.[8]

Israel formed an interministerial committee to estimate the losses to the tourism sector. The committee asked for assistance of 750 million shekels (215 million dollars) due to damage caused by the offensive. The committee decided that this amount be used to compensate all businesses whose revenues fell by 20 percent in July 2014 compared to July 2013. However, the committee set the amount of aid at only 30 percent of the amount of loss.[9]

Budget deficit

The increase in spending along with low tax revenues due to lower growth and increased tax breaks granted to Israeli businesses around the Gaza Strip will inevitably lead to fundamental changes in the government's budget for the current year and next year. The data indicate that the Israeli government has only two options in the current year. First, it might opt to maintain 2.5 percent of GDP as a ceiling for the target budget deficit. However, this would require reductions in government spending and allocations for social and cultural services by at least 4 billion shekels. Recently, the Ministry of Finance asked the Finance Committee in the Knesset, in conjunction with the increase in the defense allocations, to reduce public transport allocations by NIS 125 million indicating the Knesset is considering this option.[10] On the other hand, maintaining such a ceiling can also be achieved through raising taxes, as raising the value-added tax by one percentage point can yield NIS 4.2 billion as additional revenue for the government. Some have proposed an end to the first time home buyer VAT exemption. This could increase government revenues by 3 billion shekels.[11] Second, the government might choose to implicitly admit its misestimates and, accordingly, raise the budget deficit to at least 3 percent of GDP. There was a heated debate among parties of the ruling coalition about how much and how to account for the demands of the army in next year's budget. If, by the end of March, the coalition parties fail to agree on a budget, the government will resign and the Prime minister will call for new parliamentary elections. The Netanyahu government had this experience in 2012.

Slow growth and high unemployment rates

These direct losses, when leading to significant increases in chronic budget deficit, can threaten Israel's credit position (AAA) and significantly increase the cost of external debt. It is safe, then, to conclude that the 2014 target economic growth of 3 percent or more will not likely to materialize due to two reasons: a growth of only 2.5 percent in the first half of the year, and big costs of the war during the summer. This slow growth has adversely impacted some important indicators in the economy: a rise in unemployment rate (from 5.6 percent in April to 6.3 percent in June), and an increase the budget deficit. It is now almost certain that the budget deficit in the current year will increase to 2.6 percent. For 2015's budget deficit, official sources have projections of 3 percent of GDP. However, Adi Bredner, Head of Macroeconomics and Policy Division at the Bank of Israel, predicts that even with a 3 percent target, the budget will still miss the mark by NIS 12 billion given the cost of the war which will extend into the next year's budget.[12]

8 http://www.juancole.com/2014/07/devastates-fragile-apartheid.html
9 http://www.haaretz.com/news/national/.premium-1.610459
10 http://www.haaretz.com/business/economy-finance/.premium-1.610199
11 http://www.haaretz.com/news/diplomacy-defense/.premium-1.609920
12 http://www.jpost.com/Israel-News/Economic-growth-slowed-to-17-percent-before-Gaza-conflict-371322 (ibid)

Textbox 2: The Economic Priorities of the 'Arab Spring'

What are the economic priorities in the Arab region? There is almost a consensus that the region needs an 'economic spring' side by side with the 'political spring.'

What are the parameters of this long-awaited economic spring? In an attempt to answer this question, the IMF conducted a questionnaire with around 300 political decision-makers, businessmen and representatives of civil society and academia in Arab countries. The questionnaire aimed at identifying the economic priorities in the Arab region across four main areas: macro-economic policy, increasing employment opportunities for young people, methods to achieve good governance, and creating an enabling business climate.[13]

In the first area of focus, around one-third of the respondents saw a need for crafting a compelling economic vision based on community involvement under rational leadership. Respondents also saw a need to work on three interrelated trajectories: improving the components of government spending; promoting tax collection; and the active use of labor market policies to create jobs (see Figure 1).

Figure 1: What should be the priorities of macroeconomic policies (% of respondents)

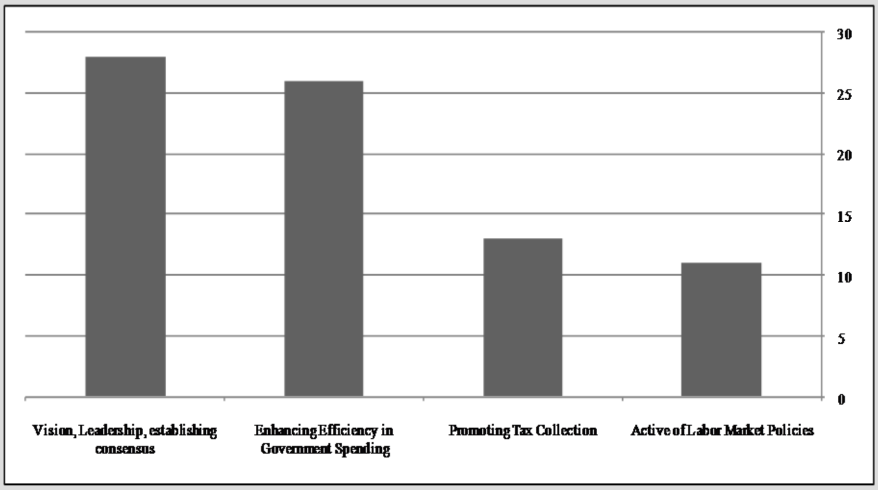
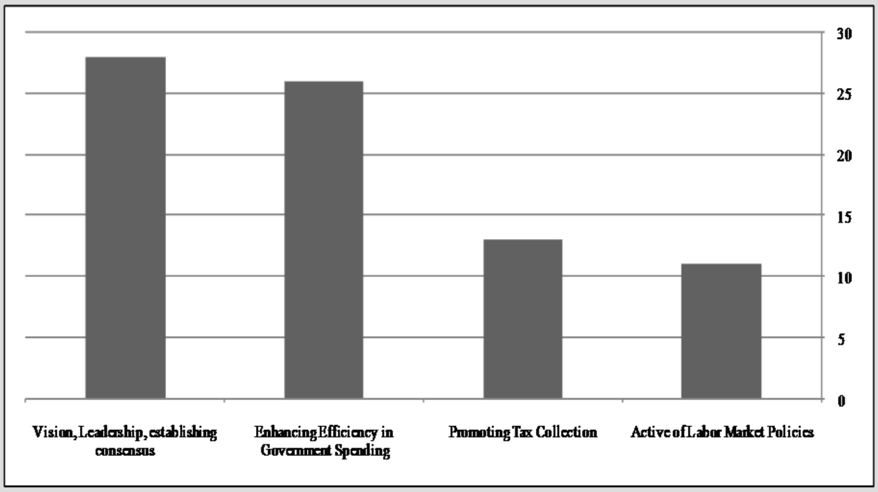


Figure 2: How to create jobs for young people? (% of respondents)



13 http://blog-montada.imf.org/?p=3043

The responses to the question on 'how to create jobs for young people' focused on redefining the role of the state and reforming the education system so that the educational outputs are compatible with the requirements of the labor market (see Figure 2).

Regarding transparency and the principle of accountability, respondents said that decisions and actions of those in the government should be open to scrutiny from the public/civil society organizations, with a special focus on improving the principles of justice, integrity and transparency (see Figure 3). As for improving the business climate, the responses focused on promoting competition, reforming the support systems (e.g. restricting oil subsides to those in real need), introducing reforms of bankruptcy laws and improving funding and borrowing opportunities (see Figure 4).

Figure 3: How to achieve good governance? (% of respondents)

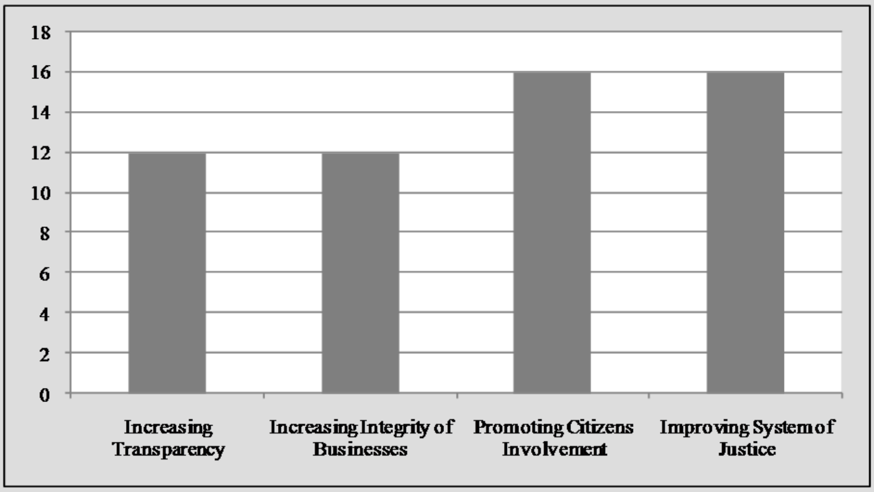
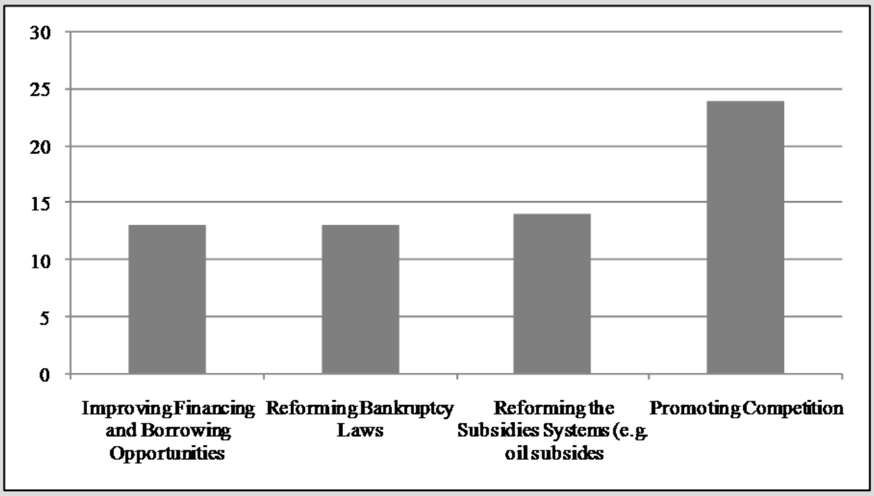


Figure 4: What are the business climate elements that need to be prioritized? (% of respondents)



The responses provide a snapshot of the priorities that should be taken into consideration when it comes to instituting an Arab economic spring that moves in parallel with the political spring. These general priorities need detailed programs, each country responding to its own conditions and utilizing its own unique resources.

2. The Labor Market

2.1 Labor force and participation rate

During 2014 Q1, the West Bank and Gaza Strip (WBGS) labor participation ratio (i.e. the percentage of those of working age who are either working or seeking work) stood at 46.3 percent compared with 43.4 percent in the previous quarter (see Table 2-1). The number of WBGS employees in 2014 Q1 was 3.7 percent (or 23 thousand) higher than in the previous quarter. Meanwhile, the workforce grew by 5 percent (see Table 2-2). Compared to the corresponding quarter of the previous year, the number of workers rose by 64 thousand (or 7.4 percent), while the workforce increased by 10.6 percent. These differences have definitely impacted the unemployment rates, as we will see later in this section.

Table 2-1: WBGS labor force participation rate for individuals 15 years and above– by Region and Sex 2013-2014 (%)

Region and Sex	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Males & Females							
West Bank	45.5	45.0	44.4	44.9	45.7	45.0	47.2
Gaza Strip	40.1	40.5	40.4	41.4	42.4	41.2	44.8
West Bank & Gaza	**43.6**	**43.4**	**43.0**	**43.6**	**44.5**	**43.6**	**46.3**
Males							
West Bank	71.4	71.3	70.9	71.3	71.6	71.3	73.8
Gaza Strip	65.0	65.0	64.8	66.4	67.1	65.8	68.5
West Bank & Gaza	**69.1**	**69.0**	**68.7**	**69.5**	**70.0**	**69.3**	**71.9**
Females							
West Bank	18.9	18.0	17.3	17.8	19.0	18.0	19.8
Gaza Strip	14.7	15.4	15.4	15.8	17.2	16.0	20.5
West Bank & Gaza	**17.4**	**17.1**	**16.6**	**17.1**	**18.3**	**17.3**	**20.1**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

Table 2-2: Individuals (15 years and above) working in Palestine– by Place of Work, 2013-2014

Place of Work	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Population (in thousands)	2,557	2,615	2,638	2,661	2,684	2,649	2,708
Workforce (in thousands)	1,114	1,134	1,133	1,161	1,194	1,155	1,254
No. of employees (in thousands)	858	862	900	886	893	885	926
- West Bank (%)	60.4	58.5	58.3	57.8	59.6	58.6	59.9
- Gaza Strip (%)	29.9	30.7	31.0	30.5	28.5	30.2	28.2
- Israel & Settlements (%)	9.7	10.8	10.7	11.7	11.7	11.2	11.9

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

Table 2-3 also reveals that the private sector was the main employer of Palestinian labor in the West Bank during 2014 Q1- employing 65.7 percent of the total workers. Employment in the public sector, on the other hand, accounted for 15.9 percent of employees. In the Gaza Strip, the private sector was also the main employer, and even after a 2.7 percent fall in relative share, private sector employment remained higher than 50 percent.

This decline coincided with a 2.5 percent rise in the share of the public sector from 2013 Q1. In parallel, the share of those employed in Israel and the settlements grew by 1 percent.

Table 2-3: Individuals (15 years and above) working in Palestine – By Region and Sector, 2012-2014 (%)

Sector	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Palestine							
Public sector	22.6	23.6	22.5	22.9	23.1	23.0	22.9
Private sector	64.5	62.4	63.6	62.4	62.4	62.7	62.2
Other sectors	3.2	3.2	3.2	3.0	2.8	3.1	3.0
Israel & the Settlements	9.7	10.8	10.7	11.7	11.7	11.2	11.9
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
West Bank							
Public sector	15.8	16.6	16.4	17.1	16.4	16.6	15.9
Private sector	68.5	66.1	66.4	64.3	65.4	65.5	65.7
Other sectors	1.9	1.7	1.7	1.8	1.8	1.8	1.8
Israel & the Settlements	13.8	15.6	15.5	16.8	16.4	16.1	16.6
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Gaza Strip							
Public sector	38.8	39.3	36.2	36.2	39.5	37.8	40.5
Private sector	55.0	54.2	57.3	58.2	55.1	56.2	53.6
Other sectors	6.2	6.5	6.5	5.6	5.4	6.0	5.9
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

2014 Q1 data show a drop in the share of wage earners from the 2013 corresponding quarter (by 0.5 points in Gaza and 2.8 points in the West Bank), see Table 2-4. During the same period of comparison, the share of unpaid family members fell by 3.2 points in Gaza, while it increased by 1.5 points in the West Bank.

Table 2-4: Distribution of Palestine's Workers- by Employment Status and Region, 2013-2014 (%)

Region and Employment Status	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Palestine							
Employer	6.4	6.2	6.2	6.5	5.9	6.2	6.7
Self-employed	17.9	17.0	17.8	18.7	19.0	18.1	18.6
Wage earner	66.9	69.9	68.0	67.6	67.2	68.2	67.6
Unpaid family member	8.8	6.9	8.0	7.2	7.9	7.5	7.1
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
West Bank							
Employer	7.6	7.5	7.1	7.1	6.8	7.1	7.5
Self-employed	18.7	17.5	18.4	18.8	18.9	18.4	18.8
Wage earner	63.9	67.6	65.8	65.9	64.6	65.9	64.8
Unpaid family member	9.8	7.4	8.7	8.2	9.7	8.6	8.9
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Region and Employment Status	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Gaza Strip							
Employer	3.7	3.3	4.2	5.2	3.6	4.1	4.5
Self-employed	16.0	15.8	16.3	18.5	19.1	17.4	18.3
Wage earner	74.1	75.1	72.9	71.6	73.8	73.3	74.6
Unpaid family member	6.2	5.8	6.6	4.7	3.5	5.2	2.6
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

Quarterly data also signal a slight change (primarily related to seasonal cycles, rather than structural, changes) in the distribution of employees by economic activity compared to the previous quarter. However, there were some changes between the West Bank and the Gaza Strip compared to the corresponding quarter a year earlier (see Table 2-5). While the share of those working in construction fell dramatically from 7 percent to 2.6 percent in the Strip, the share of their counterparts in the West Bank rose by around 1 percentage point. Also, the share of the services sector in Gaza saw some increase, while that in the West Bank saw some decline.

Table 2-5: Distribution of Palestine's Workers- by Economic Activity and Region 2013-2014 (%)

Economic Activity and Region	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Palestine							
Agriculture, fishing and forestry	11.5	9.6	11.2	10.3	11.0	10.5	10.2
Quarries and manufacturing	11.9	13.5	12.3	11.3	11.6	12.2	12.4
Building and construction	14.4	15.0	15.7	16.4	15.2	15.6	14.9
Trade, restaurants and hotels	19.6	18.5	19.0	20.6	20.4	19.6	21.1
Transport, storage and telecommunications	6.5	6.7	6.6	6.4	6.0	6.4	5.7
Services and others	36.1	36.7	35.2	35.0	35.8	35.7	35.7
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
West Bank							
Agriculture, fishing and forestry	12.8	10.3	12.2	11.2	12.1	11.5	10.6
Quarries and manufacturing	14.7	16.8	15.2	14.1	14.4	15.1	15.3
Building and construction	17.2	18.6	18.9	20.5	19.2	19.3	19.7
Trade, restaurants and hotels	20.5	19.0	19.3	20.4	20.4	19.8	21.5
Transport, storage and telecommunications	5.6	5.7	6.0	5.2	5.6	5.6	5.3
Services and others	29.2	29.6	28.4	28.6	28.3	28.7	27.6
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Gaza Strip							
Agriculture, fishing and forestry	8.4	8.2	9.2	8.3	8.0	8.4	9.4
Quarries and manufacturing	5.4	6.2	5.7	4.9	4.4	5.3	4.9
Building and construction	7.7	6.9	8.7	7.0	5.2	7.0	2.6
Trade, restaurants and hotels	17.5	17.3	18.3	21.0	20.4	19.2	20.2
Transport, storage and telecommunications	8.4	8.9	7.9	9.2	7.1	8.3	6.6
Services and others	52.6	52.5	50.2	49.6	54.9	51.8	56.3
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

2.2 Unemployment

The unemployment rate in Q1 2014 stood at 26.2 percent up from 25.2 percent in the previous quarter. This primarily resulted from a rise of 2.3 percentage points in Gaza Strip's unemployment (to 40.8%) compared to an unchanged rate in the West Bank (18.2%). As compared to the prior year's Q1, the unemployment rate climbed by 2.3 percentage points, and while it declined by 2 percentage points in the West Bank, in Gaza it increased by about 9.8 percentage points (see Table 2-6).

Table 2-6: Unemployment rate among individuals participating in the labor force (15 years and above) in Palestine- by Region and Sex: 2012-2014 (%)

Region and Sex	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Palestine							
Males	20.5	21.2	17.6	20.3	23.1	20.6	23.3
Females	32.9	35.3	33.6	37.8	33.5	35.0	36.5
Total	**23.0**	**23.9**	**20.6**	**23.7**	**25.2**	**23.4**	**26.2**
West Bank							
Males	17.3	18.6	14.9	16.8	16.9	16.8	15.9
Females	25.3	27.4	25.1	28.2	23.2	25.9	27.1
Total	**19.0**	**20.3**	**16.8**	**19.1**	**18.2**	**18.6**	**18.2**
Gaza Strip							
Males	26.8	26.3	22.7	26.9	34.8	27.8	37.4
Females	50.1	51.6	50.4	56.7	53.4	53.1	52.4
Total	**31.0**	**31.0**	**27.9**	**32.5**	**38.5**	**32.6**	**40.8**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

Features of unemployment in Palestine during Q1 2014

- Unemployment rate in Palestine is high among young people, reaching 42.1 percent for the age group 15-24 years (60.1 percent for females versus 38.9 percent for males), suggesting that a large proportion of the unemployed are new entrants to the labor market (see Table 2-7).

Table 2-7 Unemployment rate among individuals participating in the labor force (15 years and above) in Palestine- by Sex and Age Group, 2012-2014 (%)

Age Group	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Males & Females							
15-24	38.8	40.9	37.0	42.6	43.2	41.0	42.1
25-34	24.9	25.2	22.0	25.5	27.9	25.2	29.4
35-44	12.2	13.1	11.4	11.3	12.7	12.1	14.9
45-54	13.3	14.5	10.0	10.5	13.4	12.1	13.9
55+	9.2	9.9	6.8	10.1	10.9	9.4	12.7
Total	**23.0**	**23.9**	**20.6**	**23.7**	**25.2**	**23.4**	**26.2**
Males							
15-24	34.5	36.9	32.4	37.7	40.5	36.9	38.9
25-34	19.2	18.1	14.9	17.8	21.4	18.1	21.8
35-44	12.0	12.8	11.0	11.0	12.8	11.9	13.9
45-54	14.9	16.8	10.9	11.8	15.0	13.6	15.3

Age Group	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
55+	11.1	11.5	8.1	12.0	13.3	11.2	15.3
Total	**20.5**	**21.2**	**17.6**	**20.3**	**23.1**	**20.6**	**23.3**
Females							
15-24	62.2	64.4	65.2	69.3	59.5	64.7	60.1
25-34	43.3	48.1	45.8	50.8	47.3	48.0	51
35-44	12.8	14.3	12.9	12.7	12.6	13.1	18.9
45-54	6.0	4.1	6.1	4.4	6.6	5.3	8.8
55+	1.3	2.2	-	-	-	0.5	2.9
Total	**32.9**	**35.3**	**33.6**	**37.8**	**33.5**	**35.0**	**36.5**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

- Unemployment is particularly high among uneducated males. According to 2013 data, the unemployment rate among uneducated males was 27.5 percent compared to 18.8 percent among those with 13 years of schooling or more. The opposite trend is true for females: the unemployment rate for women with 13 years of schooling or above is 49.7 percent compared to a scant 6 percent among uneducated females.

Table 2-8: Unemployment rate among individuals participating in the labor force (15 years and above) in Palestine- by Sex and Years of Schooling, 2012-2014 (%)

Years of schooling	2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	2013	Q1 2014
Males & Females							
0	9.4	18.5	6.2	10.2	16.8	13.0	15.7
1-6	20.6	21.3	15.7	20.0	22.2	19.8	25.3
7-9	21.8	21.8	19.5	21.7	23.8	21.7	23.0
10-12	20.7	21.6	18.6	20.1	23.5	21.0	23.5
+13	27.0	28.3	25.0	29.5	28.7	27.9	30.9
Total	**23.0**	**23.9**	**20.6**	**23.7**	**25.2**	**23.4**	**26.2**
Males							
0	18.2	26.2	14.1	23.4	35.2	25.3	27.5
1-6	23.3	24.3	17.5	22.3	26.1	22.6	29.2
7-9	23.2	23.2	20.4	23.0	25.4	23.0	24.5
10-12	21.1	22.0	18.9	20.5	24.5	21.5	24.1
+13	16.3	17.1	13.3	17.0	17.8	16.4	18.8
Total	**20.5**	**21.2**	**17.6**	**20.3**	**23.1**	**20.6**	**23.3**
Females							
0	1.6	10.9	-	-	1.7	2.8	6.0
1-6	3.2	2.6	3.6	3.9	1.6	2.8	5.8
7-9	7.2	5.1	9.7	4.0	6.3	6.4	9.1
10-12	16.5	16.9	15.2	14.6	12.1	14.7	17.7
+13	44.6	46.7	45.2	49.9	46.1	47.0	49.7
Total	**32.9**	**35.3**	**33.6**	**37.8**	**33.5**	**35.0**	**36.5**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014. Ramallah, Palestine.

2.3 Unemployment among graduates of universities and colleges

Table 2-9 records the rates of unemployment among individuals with intermediate diploma or higher. The unemployment rate among this segment increased from 31.3 percent in 2013 Q4 to 33.3 percent in 2014 Q1. The table shows that, with 2.8 percent, the unemployment rate among those who obtained a degree in law was the lowest (i.e. for every one hundred graduates, there were 3 without a job), while the rate among those with a degree in educational sciences and preparation of teachers was the highest (about 50.6 percent). A high rate (42.1 percent) was also reported among graduates with a degree in mathematics and statistics.

Table 2-9: Employed and unemployed graduates (with diploma and above) by Major: 2012-2014 (%)

Major	2012		Q4 2013		2013		Q1 2014	
	Employed	Unemployed	Employed	Unemployed	Employed	Unemployed	Employed	Unemployed
Educational sciences & preparation of teachers	58.5	41.5	60.4	39.6	57.3	42.7	49.4	50.6
Humanities	69.1	30.9	61.9	38.1	66.5	33.5	65.5	34.5
Social and behavioral sciences	66.4	33.6	65.1	34.9	65.7	34.3	59.2	40.8
Journalism and media	61.9	38.1	61.3	38.7	60.1	39.9	71.7	28.3
Business and administration	71.8	28.2	73.2	26.8	73.8	26.2	71.8	28.2
Law	86.2	13.8	89.9	10.1	91.6	8.4	97.2	2.8
Natural sciences	76.8	23.2	64.3	35.7	68.0	32.0	68.5	31.5
Math and statistics	70.1	29.9	61.9	38.1	69.2	30.8	57.9	42.1
Computer	69.4	30.6	70.7	29.3	67.4	32.6	63.6	36.4
Engineering and engineering professions	78	22.0	72.2	27.8	75.7	24.3	74.2	25.8
Architecture and construction	84.6	15.4	81.4	18.6	81.2	18.8	76.5	23.5
Health	81.4	18.6	79.2	20.8	78.9	21.1	77.8	22.2
Personal services	69.2	30.8	68	32.0	65.3	34.7	60	40.0
Others	70.1	29.9	63.6	36.4	69.2	30.8	62.3	37.7
Total	**71.1**	**28.9**	**68.7**	**31.3**	**69.8**	**30.2**	**66.7**	**33.3**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014.

2.4 Wages and working hours

There are no quarterly changes reported in the average daily wage for those working in the West Bank and Israel & the Settlements during 2014 Q1, while it fell by 4.4 percent for those working in the Gaza Strip. Compared to the corresponding quarter a year earlier, however, the average daily wage for WB workers grew by 1.6 percent, while it increased by 8.9 percent for those employed in Israel & the Settlements. The average daily wage for Gaza's workers saw a decline of 5.7 percent during the same period (see Table 2-10).

Table 2-10: Average weekly working hours, monthly working days and daily wages (in NIS) of known-wage workers in Palestine- by Place of work: 2012-2014

Place of work	Average weekly hours	Average monthly working days	Average daily wage	Median daily wage
		2012		
West Bank	43.3	22.2	87.1	76.9
Gaza Strip	37.1	23.6	64.3	50.0
Israel and the settlements	40.9	20.5	164.1	153.8
Total	**41.2**	**22.3**	**92.9**	**76.9**
		Q1 2013		
West Bank	43.5	22.2	88.8	76.9
Gaza Strip	36.6	23.3	65.2	50.0
Israel and the settlements	43.5	20.0	167.6	153.8
Total	**41.6**	**22.1**	**95.7**	**80.0**
		Q2 2013		
West Bank	44.2	22.7	88.6	76.9
Gaza Strip	39.1	23.5	63.2	50.0
Israel and the settlements	43.0	19.9	172.1	153.8
Total	**42.6**	**22.5**	**95.4**	**76.9**
		Q3 2013		
West Bank	43.3	22.3	88.3	76.9
Gaza Strip	38.0	23.8	59.3	46.2
Israel and the settlements	41.6	19.7	178.9	165.4
Total	**41.5**	**22.2**	**97.6**	**80.0**
		Q4 2013		
West Bank	42.8	22.4	90.2	80.0
Gaza Strip	36.6	24.2	64.4	50.0
Israel and the settlements	41.8	19.7	182.9	173.1
Total	**41.0**	**22.4**	**100.3**	**84.6**
		2013		
West Bank	43.4	22.4	89.0	76.9
Gaza Strip	37.6	23.7	63.1	50.0
Israel and the settlements	42.4	19.8	175.6	160.0
Total	**41.7**	**22.3**	**97.2**	**80.0**
		Q1 2014		
West Bank	44.2	21.9	90.2	80.0
Gaza Strip	38.3	23.9	61.7	50.0
Israel and the settlements	43.1	19.8	182.6	173.1
Total	**42.4**	**22.0**	**99.3**	**83.3**

Source: Palestinian Central Bureau of Statistics 2014, Labor Force Survey, 2012-2014.

2.5 Vacancy announcements[14]

The number of vacancies posted in Q1 2014 was 876, a 20 percent increase from the previous quarter and a 19 percent increase over Q1 2013 (see Table 2-11). However, there

[14] MAS collected job advertisements from daily newspapers (Al-Quds, Al-ayyam and Al-Hayah) as well as from the website www.jobs.ps

were 76 announcements with no specific number of vacant posts. Furthermore, the posted vacancies do not necessarily cover all available job opportunities, though all government jobs, as per law, must be advertised.[15]

With 419 vacancy announcements, the NGO sector accounted for the largest share of job vacancies advertised in 2014 Q1 (48 percent). The shares of the private sector and the public sector were 41 percent (358 jobs) and 11 percent (99 jobs), respectively. Compared to 2013 Q4, the percent of vacancies posted by the private sector dropped by 1 point, while that of the public sector declined by 2 percentage points (see Table 2-11). In the Gaza Strip, 65 percent of the vacancies advertised were by NGOs.

By region, data show that the central West Bank reported the majority of vacancies advertised (58 percent). The share of Southern West Bank governorates had 12 percent, while each of the Gaza Strip and Northern West Bank area reported 15 percent of the total posted vacancies. The BA was the most required degree with 74 percent of jobs requiring a BA (see Table 2-11).

Table 2-11: Number of job vacancies advertised in daily newspapers in Palestine, Qs 1&4 2013 and Q1 2014

	Q1 2013	Q4 2013	Q1 2014			
			January	February	March	Total
By Sector						
Private sector	318	309	119	102	137	**358**
Public sector	79	97	24	40	35	**99**
NGOs	376	329	300	255	321	**419**
By Region						
Northern West Bank	98	126	64	32	37	**133**
Central West Bank	477	408	152	145	210	**505**
Southern West Bank	99	88	28	33	46	**107**
Gaza	99	113	58	45	28	**131**
By Degree						
MA and above	63	70	16	32	19	**67**
BA	516	500	219	179	253	**651**
Intermediate Diploma	78	59	27	17	19	**63**
Below Diploma	116	106	38	27	30	**95**
Total						
	733	736	300	255	321	**876**

Source: MAS collected job advertisements from daily newspapers (Al-Quds, Al-ayyam and Al-Hayah) as well as from the website www.jobs.ps

With 42 percent, the demand for administrative and economic sciences majors had the largest share of advertised vacancies. Meanwhile, the demand for applied sciences was 19 percent, ahead of humanities & social sciences (17 percent) and medical & health sciences (14 percent). Other professions (crafts, maintenance technicians, secretarial work, etc) accounted for only 9 percent of total demand (see Table 2-12).

15 Article (19) of the Civil Service Law No. (4) of 1998 states that the government departments shall announce job vacancies in which appointment is made by the competent authority within two weeks of vacancy in at least two daily newspapers. The announcement shall contain detailed information about the job and conditions to be met.

Table 2-12: Number of job vacancies advertised in daily newspapers in Palestine- by Major, Sector and Region- Q1 2014

Major	West Bank			Gaza			Total
	Public sector	Private sector	Civil sector	Public sector	Private sector	Civil sector	
Medical & health sciences	2	55	45	8	2	9	121
Humanities and social sciences	11	18	86	2	4	27	148
Applied sciences	27	66	44	3	13	13	166
Administrative and economic sciences	34	130	156	6	5	33	364
Other (crafts, maintenance, secretarial work, etc.)	6	63	3	0	2	3	77
Total	**86**	**332**	**334**	**19**	**26**	**85**	**876**

Source: MAS collected job advertisements from daily newspapers (Al-Quds, Al-ayyam and Al-Hayah) as well as from the website www.jobs.ps

Textbox 3: National Development Plan: State Building to Sovereignty

In late April 2014, the Council of Ministers ratified the 'State Building to Sovereignty' National Development Plan 2014-2016,[16] which is the eighth national development plan since 1994.

The current plan maintains the same methodology used by the previous plan, viz. identifying strategic targets in four key areas:

- Economic development and employment: encouraging investment (especially in small and medium-size enterprises), promoting partnerships between the public and private sectors, improving the regulatory framework so as to create a business-friendly environment, and enhancing competitiveness.
- Good governance and institution-building: development and reform of public fiscal systems (by coordinating between tax divisions, developing tax collection capabilities and fostering computerization), reconsidering public spending items to ensure effective financial management and improving the services provided to the public.
- Social development and protection: improving the high-quality social services system, promoting the services and programs targeting detainees and ex-detainees, and improving educational and health services.
- Infrastructure: upgrading roads and communication networks, diversifying energy sources, rationing the use of energy and ensuring the efficient use of water.

Two goals are of particular importance: first, aligning the plan with the government annual budgets in terms of goals, funding, and implementation; and second, strengthening and institutionalizing control over implementation using a number of indicators and monitoring systems. In accordance with these goals, the government is developing a 'project cycle' system based on the principle of 'one-gate policy' in the implementation of projects. The government will also create the 'Projects Record' which keeps stakeholders updated on the progress of each project cycle. A key objective of this effort is to reduce donor projects that fall outside the framework of the development plan and to restrict the role of the Ministry of Planning and the Ministry of Finance to providing guidance and ensuring compatibility between the activities of various governmental institutions.

The plan identified four major challenges that might impede the accomplishment of the aforementioned goals: Israeli restrictions, the WBGS internal political/administrative divide, the deterioration of economic conditions (poverty and high unemployment rates, especially among the youth), and the exacerbation of the financial crisis.

[16] Ministry of Planning and Administrative Development. National Development Plan 2014-2016: State Building to Sovereignty. http://www.mopad.pna.ps/images/PDFs/Arabic%20Palestine%20State_%20final%20draef.pdf

The government has set the financial framework of the plan under two possible scenarios: the baseline scenario assumes the continuation of the status quo; and the optimistic scenario envisions a broad-based easing of Israeli restrictions, allowing the Palestinian economy to exploit its resources in Area C.

Baseline forecast: This scenario envisions a slowdown in GDP growth rates during 2014, 2015 and 2016 to 2 percent, 1.5 percent and 1 percent, respectively. The scenario anticipates no significant increase in the government revenue-to-GDP ratio due to weak economic growth and investment. The scenario also assumes that donor countries will continue to provide financial aid to the government's budget at increasing rates. Yet, the financial situation in 2013 will lead to a large funding gap, thus forcing the government to take severe austerity measures to plug the deficit. To avoid the accumulation of arrears and borrowing from banks, this scenario assumes lowering the current expenditure-to-GDP ratio over the next three years, with a target of 32 percent in 2016. This can only be achieved through controlling salary expenses and reducing net lending.

Optimistic forecast: This scenario assumes a breakthrough in the political climate and an Israeli easing of restrictions, which would result in a significant increase in domestic and foreign investment and push GDP growth to 12 percent in 2016. This will, in turn, lower the annual need for external budget support to only USD 900 million.

Owing to the uncertainty of political conditions and the related economic climate, the national plan adopted the baseline forecast when it accounted for budgetary outlays. Based on macroeconomic and macro financial estimates provided by the Ministry of Finance, the total expenditure, both operational (including net lending) and developmental, is expected to reach approximately USD 13.5 billion during the 2014-2016 period, with allocations for developmental expenses totaling USD 1.5 billion. The Table below shows the distribution of development expenditures on the four main sectors over the plan's three years. Around 70 percent of the planned developmental expenditure will be financed by the general budget and only USD 450 million will be obtained from external sources.[17]

Table 1: Distribution of Development Expenditures-
By Sector and Current Spending in 2014-2016 Development Plan

	2014	2015	2016	Total
Development expenditure	400	500	600	**1,500**
- Economic development and employment	64	100	123	287
- Good governance	120	127	145	392
- Social protection and development	90	134	186	410
- Infrastructure	125	139	152	416
Current (operating) expenditure and net lending	3,866	3,982	4,101	**11,949**

http://www.mopad.pna.ps/images/PDFs/Arabic%20Palestine

According to the plan, development spending will be funded by two sources: about USD 600 million from local sources and around USD 900 million by foreign aid. Interestingly, the plan's projection for financing for the development budget from international aid during 2016-2014 is almost 40 percent higher than the amount received for this purpose during the previous three years (2011-2013). Besides, the plan's expectation about aid for the current expenditure during the next three years is 50 percent higher than what the government obtained in the previous three years. In other words, although the plan used the pessimistic baseline economic growth forecast for financial planning, it is still too optimistic in its income expectations.

[17] Perhaps this is the reason behind the IMF's conclusion that the total expenditure in the development plan during the three years is USD 539 million, including USD 281 million as investments and USD 242 million as operating expenses. See http://www.imf.org/external/country/WBG/RR/2014/063014.pdf

Textbox 4: The Electricity Sector in Palestine: Current State and Requirements for Reform

MAS regularly hosts a Roundtables to discuss topical issues and provide policy recommendations to decision-makers. In May 2014, MAS held a roundtable on 'The Electricity Sector in Palestine: Current State and Reform Requirements.' For this purpose, MAS prepared a background paper for the discussion. Below, we cite some excerpts from the paper:

1. Background and Rationale

Effective infrastructure is a key for development and social well-being and a main driver for private investment. The electricity sector, with its institutions, facilities and legal framework, is one of the most fundamental components of infrastructure. The sector comprises a number of fundamental elements; namely power plants, transmission, distribution, power grid, tariff regime, supervisory institutions and legal framework- all affecting the performance of the sector and its contribution to economic development.

2 . Electricity in Palestine: Facts and Figures

- **The legal framework**

The sector is regulated by Decree No. (13) 2009 which details the terms of reference and functions of the executive and supervisory institutions in the sector as well as the provisions pertaining to granting licenses to producers and distributors. The Decree provides for establishing a national transmission company, and it involves a chapter on sanctions for violations. The 2009 Decree was amended by Decree No. (16) 2012. The amendments were related to penalties against offenders, specifically replacing the termination of service with four-months of imprisonment and a fine of up to JD 1,500 for those implicated in electricity theft.

- **The amount of electricity available**

  According to PCBS 2013 data, almost all Palestinian households are connected to the power grid, compared with 97.2 percent in 1999. While 99.8 percent of households in the West Bank have a 24-hour access to power, the daily power service for 97.2 percent of Gaza's households is barely 16 hours.[18]

  The amount of electricity available in Palestine from all sources in 2012 was 5,370 GW / hour (3,700 in the West Bank and 1,670 in Gaza). The annual per capita consumption of electricity (after deducting transmission loss) was 950 kilowatt/hour,[19] which is well below the rates of neighboring countries in 2011: 2093 in Jordan, 1743 in Egypt and 6926 in Israel in 2011. [20]

- **Power Generation**

  Palestine depends on multiple sources for the supply of electricity. Nearly 88 percent (4702 GW/h) comes from Israel, while imports from Egypt and Jordan represent about 4 percent (or 207 GW/h) of total supply. The power plant in Gaza produces around 392 MW/h or 7.3 percent of consumption in Palestine and 23.5 percent of consumption in Gaza.

- **Transmission**

  Pursuant to the Palestinian Electricity Law, Palestinian Electricity Transmission Company Limited (PETL) was launched in February 2014. Under the law, the main functions of the company involve the transmission of electricity from the source to distribution companies and consumers, as well as importing and exporting electricity. The PETL holds, develops and maintains the National Transport Network, and it is expected to replace the West Bank's already existing 230 substations and transformers.

- **Distribution companies**

  Communities in Palestine receive electricity from 6 distribution companies, 5 in the West Bank: North Electricity Distribution Company, Tubas District Electricity Company, Jerusalem District Electricity Company, *Hebron* Electric *Power Company*, Southern Electricity Company; and 1 in Gaza: Gaza Electricity Distribution Corporation, in addition to the local councils not affiliated with any distribution company. Three of these companies have the legal form of joint stock private companies, while the other three still work informally without proper registration at competent departments.[21]

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18 Press Release on Household Energy Survey, July 2013. PCBS.
19 The Palestinian Electricity Regulatory Council (PERC)- Annual Report, 2012
20 http://data.albankaldawli.org/indicator/EG.USE.ELEC.KH.PC
21 Southern Electricity Company, Hebron Electric Power Company and Tubas District Electricity Company

With 204 thousand subscribers, GEDC distributes electricity to all areas in the Gaza Strip. In the West Bank, there are 545 thousand subscribers. Distribution companies have 390 thousand subscribers (or 72 percent) versus 155 thousand subscribers who have subscribed with local councils. Meanwhile, only 316 councils (49 percent of all local councils) have already joined the distribution companies.

- **Transmission Loss**
  Transmission loss is calculated by deducting the amount of electricity sold from the amount produced/imported. In 2012, the loss was estimated at 711 GW/h, which means 24 percent of electricity purchased is lost somewhere between the source and the residential/commercial destination. The loss results from either technical issues (worn-out grid/transmission lines) or non-technical issues, i.e. electricity theft. The rate of transmission loss in neighboring countries is by far lower than in Palestine (14 percent in Jordan and 6.5 percent in Israel).

- **Producer and consumer prices**
  The electricity tariff in Palestine is determined by several factors, mostly external factors because of Palestine's heavy reliance on external sources for its supply of electricity. The PERC estimated 2012 electricity imports at NIS 2.537 billion (NIS 1.923 billion in the West Bank and NIS 614 million in Gaza), with an estimated cost of NIS 0.53 (tax inclusive) per one KW/h.

The PERC set a new tariff based on four criteria: price from the supplier, transmission loss, demands of low-income households; and demands of the productive sectors. Accordingly, the PERC set a new uniform pricing regime which divided residential consumers into five groups instead of three (ranging from NIS 0.465 up to NIS 0.69 per KW/h). The tariff for the commercial sector is NIS 0.63 per KW/h. The industrial sector, on the other hand, has two tariffs: NIS 0.5 for low voltage and NIS 0.45 for medium voltage, while the tariff for the agricultural sector is NIS 0.46 generally and NIS 0.5 for water pumps. The highest price is reported in the services sector (NIS 0.8). These are very expensive prices. In Jordan, for example, electricity costs about 1/3 as much as in Palestine. While Israeli tariffs are very close to Palestinian tariffs Israel and Palestine are very different economies with very different standards of living and different needs regarding economic inputs.

3. Key challenges
A MAS background paper identified several key challenges facing the Palestinian electricity sector:

- There is no definitive delineation of power between the executive and supervisory bodies in the sector. Duplication of powers still exists, especially in terms of tariff setting as well as matters related to grid code, distribution and development of specifications and standards.[22]
- Local councils' and distribution companies'compliance with PERC and Energy Authority regulations and instructions is still inadequate. This is probably due to poor mechanisms for implementation and oversight, and inconsistent enforcement of sanctions against offenders.[23]
- The high rate of technical and non-technical loss, failure to collect payment by distribution companies and the high proportion of local councils not subscribing with distribution companies impede the development of the sector and the application of regulatory strategies and policies.
- Dependence on Israeli electricity has resulted in deductions from the transfer of customs revenues Israel collects on behalf of the PA (which Israel transfers to Israel Electric Corporation) which further compounds the PA's financial burden. Palestine's energy dependence also grants Israel power over Palestine and the threat that Israel could shut off Palestine's electricity. Starting in 2009, the Israel Electric Corporation stopped providing the Palestinian Finance Ministry with detailed invoices of accounts, which undermined the Ministry's ability to collect debts from local authorities and distribution companies, in turn encouraging lawlessness and theft.
- The biggest challenge facing the electricity sector is its heavy reliance on external sources for the supply of electricity. This dependence (especially on Israel, which views an impoverished Palestine as less of a geopolitical threat) harms investment in strategic projects and influences pricing and financial policies

The challenges facing the electricity sector go beyond the current obstacles and impact future outlooks. In addition to the natural increase in demand for electricity (roughly 6 percent annually), the economic growth rate of 0.22 percent (resulting from GDP growth of 1 percent)[24] will further increase the demand for electricity.

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22 The Palestinian Electricity Regulatory Council (PERC)- Annual Report, 2012
23 Ibid
24 Abualkhair, Ayman (2006). Electricity sector in the Palestinian territories: Which priorities for development and peace? University of Geneva, Switzerland.

4. Efforts, initiatives and future plans

Efforts are being made to regulate the sector and improve indicators. Below is a summary of these efforts and initiatives together with future plans:

- **Launch of the National Transmission Company:** The National Transmission Company is instrumental to controlling the activities associated with the transmission subsector. The Company was registered at the Companies Controller Department as a public company with capital of USD 2 million.
- **Building local power plants:** An initiative to build a power plant in the Jenin area has recently been proposed. According to initial plans, the plant will be implemented by the Palestinian private sector, while local authorities, can contribute up to 25 percent of the startup capital.[25] The plant is expected to reduce the price of 1 KW/h to NIS 0.35, and to supply power to the Northern and Central West Bank[26] with a production capacity of 200 MW (about 20 percent of current electricity consumption) that can expand to 400 MW at a later stage of development.
- **At the official level**: Two renewable-energy strategies have been approved since 2011 with a target of supplying 50 percent of Palestinian demand by 2020. Recently, the Council of Ministers approved the Palestine Solar Initiative which aims to produce 5 megawatts of solar power by 2015 by installing 1000 solar panels on the roofs of homes.

3. Public Finance

Net domestic revenue rose significantly during 2014 Q1 up 18.6% since 2013 Q4 and more than 50 percent from the corresponding quarter of 2013. Public spending increased by 11 percent from the previous quarter and only 2 percent from 2014 Q1, leading to a significant drop in the total budget deficit before aid (on cash basis) from NIS 1.3 billion in 2013 Q1 to only NIS 446 million in 2014 Q1. On a different note, the decline in international aid by 60 percent from the 2013 Q1and 20 percent from 2013 Q4 lowered the budget surplus (after grants and aid) to NIS 309 million, or 20 percent. This surplus is, however, misleading, as it is calculated on a cash basis which ignores government arrears. When these arrears (NIS 560 million) are taken into account, there is a budget deficit of NIS 251 million.

Table 3-1: Summary of the financial position of the PNA– 2013 & Q1 2014

(NIS millions, cash basis)

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
Public revenues and grants (net)	**3,736.7**	**2,726.1**	**3,495.9**	**3,317.0**	**3,556.3**
Total domestic revenues (net)	**1,842.5**	**2,191.5**	**1,965.2**	**2,361.8**	**2,801.5**
Tax revenues	666.5	471.3	469.4	550.1	827.2
Non-tax revenues	326.7	207.8	203.5	183.3	261.5
Clearance revenues	1,314.6	1,533.4	1,547.6	1,693.4	1,825.7
Tax rebates (-)	465.3	21.0	255.3	65.0	112.9
External grants and aid	**1,894.2**	**534.6**	**1,530.7**	**955.2**	**754.8**
For budget support	1,814.1	461.3	1,453.6	802.2	631.5
To support developmental projects	80.1	73.3	77.1	153.0	123.3
Total public expenditure	**3,180.1**	**3,071.5**	**3,159.6**	**2,931.2**	**3,247.7**
Current expenditure, including:	**3,053.1**	**2,877.2**	**3,003.5**	**2,801.2**	**3,031.1**
Wages and salaries	1,823.2	1,531.9	1,593.5	1,599.6	1,615.6
Non-wage expenses	1,114.1	1,138.4	1,184.1	990.3	1,192.2
Net lending	115.8	206.9	225.9	211.3	223.3

[25] Council of Ministers Resolution No. (02/35/14) 2013.

[26] A statement by the President of the Palestinian Energy Authority at a hearing session hosted by AMAN on January 23rd, 2014. http://www.maannews.net/arb/ViewDetails.aspx?ID=667747

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
Development expenses	**127.0**	**194.3**	**156.1**	**130.0**	**216.6**
Treasury-funded	46.9	121.0	79.0	(23.0)	93.3
Donor-funded	80.1	73.3	77.1	153.0	123.3
Current deficit (before grants and aid)	**(1,210.6)**	**(685.7)**	**(1,038.3)**	**(439.4)**	**(229.6)**
Total deficit (before grants and aid)	**(1,337.6)**	**(880.0)**	**(1,194.4)**	**(569.4)**	**(446.2)**
Total deficit / surplus (after grants and aid)	**556.6**	**(345.4)**	**336.3**	**385.8**	**308.6**
Net financing from local banks	**(613.6)**	**234.7**	**(372.3)**	**(143.8)**	**(368.9)**
Remainder	**(57)**	**(110.7)**	**(36)**	**242**	**(60.3)**
Reminders					
Nominal GDP (USD millions)	**3,041.3**	**3,353.8**	**3,411.4**	**3,483.6**	**3495.9**
Average exchange rate (USD against NIS)	**3.69**	**3.62**	**3.60**	**3.52**	**3.51**

Source: Data available in the financial reports published by the Palestinian Ministry of Finance (cash basis), Table (3). Figures in brackets indicate negative values.

3.1 Revenues and grants

Total domestic revenues

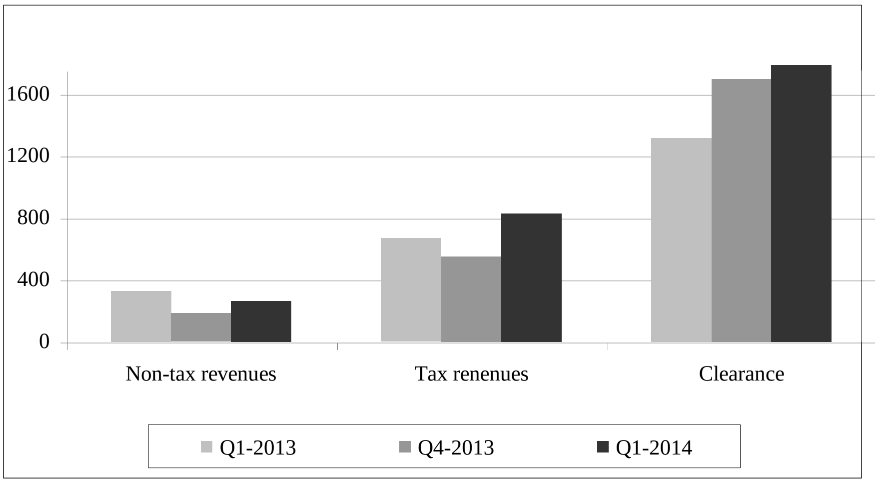
During Q1 2014, public revenues and grants totaled NIS 2.8 billion (an increase of 18.6 percent from the previous quarter), primarily due to an increase in income tax, clearance revenues and non-tax revenues. Clearance revenues formed the largest share of domestic revenues (65.2 percent), while tax revenues came in the second place (29.5 percent).

In the 2014 Q1, tax revenue totaled NIS 827 million, up 50 percent from the previous quarter and 24 percent from Q1 a year earlier. This was the result of an increase in income tax (43.3 percent of tax revenue) which was about double the figure reported in the previous quarter. A significant rise in tax revenues from 2013 Q4 was expected since income and property taxes mature only in the first quarter of the year. The growth in domestic revenues also resulted from a NIS 324 million increase in VAT, which was far higher than in the previous quarter.[27]

In 2014 Q1, clearance revenues reached NS 1.8 billion, an increase of 8 percent from the previous quarter and 39 percent over the corresponding quarter of 2013. These revenues covered about 60 percent of current expenditures during 2014 Q1.

Figure 3-1: Structure of domestic revenues

(NIS millions)



Source: Palestinian Ministry of Finance

[27] In October 2012, VAT rate was raised from 14.5 percent to 15 percent, and again to 16 percent in early June 2013.

In the meantime, non-tax revenues increased by 42.7 percent (to NIS 261.5 million) from 2013 Q4, but declined by 20 percent from the same quarter of 2013.

Grants and Foreign Aid

Foreign aid in 2014 Q1 declined dramatically to NIS 754.8 million, down 21 percent from the previous quarter and 60 percent from the 2013 corresponding quarter. Around 84 percent of this aid was slated for support of the general budget. About 72 percent of foreign aid was contributed by Arab States (Saudi Arabia and Oman); 6 percent by the Palestinian European Mechanism- PEGASE; and 23 percent by the World Bank (see Table 3-2).

Table 3-2: Grants and foreign aid to the Palestinian Government

(NIS millions)

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
Budget support	**1,814.5**	**461.3**	**1,453.6**	**802.2**	**631.5**
Arab grants	558.6	0.0	278.1	551.7	452.5
International grants	1,255.9	461.3	1,175.5	250.5	179.0
Developmental funding	**80.3**	**73.3**	**76.9**	**152.8**	**123.3**
Total foreign aid	**1,894.8**	**534.6**	**1,530.5**	**955.0**	**754.8**

Source: Palestinian Ministry of Finance, Table (7) - External Support Table.

Taken together, domestic revenues and international grants/aid raised total budget revenues by 7.2 percent (to NIS 3.5 billion) from the previous quarter thanks to a significant rise in domestic revenue. Total revenue, however, saw a 4.8 percent decline from the same quarter a year earlier. Table 3-3 shows the figures for current development budget revenues and their ratios to key economic variables.

Table 3-3: Indicators of public revenues and grants

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
Total domestic revenues (NIS millions)	**1,842.5**	**2,191.5**	**1,965.2**	**2,361.8**	**2,801.5**
As % to total revenues and grants	49.3	80.4	56.2	71.2	78.8
As % of current expenditure	60.3	76.2	65.4	84.3	92.4
As % of GDP	16.4	18.1	16.0	19.3	22.8
External grants and aid (NIS millions)	**1,894.2**	**534.6**	**1,530.7**	**955.2**	**754.8**
As % of total revenues and grants	50.7	19.6	43.8	28.8	21.2
As % of current expenditure	62.0	18.6	51.0	34.1	24.9
As % of GDP	16.9	4.4	12.5	7.8	6.2

Source: Table (3-1)

3.2 Public Expenditure

During Q1 2014, public spending stood at NIS 3.2 billion (or 26.5 percent of nominal GDP)- rising by 10.8 percent from the previous quarter. Current spending during the quarter made up 93.3 percent of public spending, leaving only 6.7 percent to development spending.

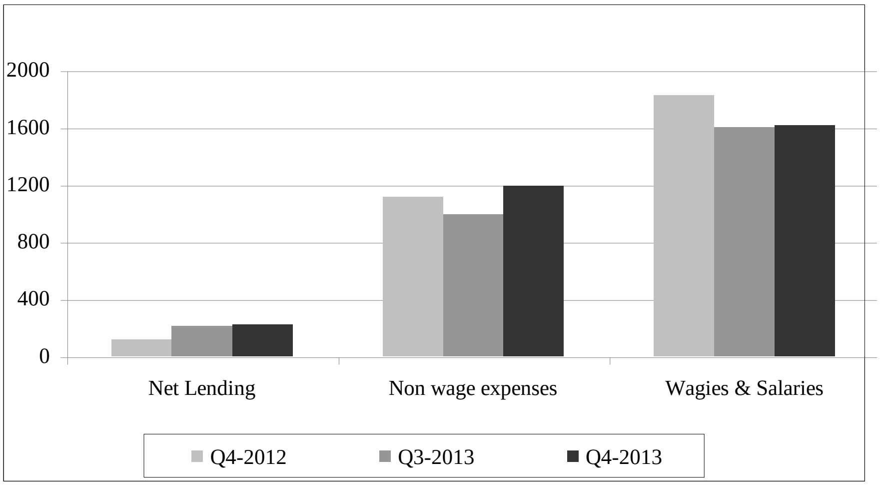
Current Spending

Current spending comprises three items: the wage bill (53 percent), non-wage spending (39 percent) and net lending (8 percent). During 2014 Q1, current spending grew by about 8.2 percent from the previous quarter. This was a result of a 20.4 percent increase in non-wage expenses which, in turn, resulted from a rise in operational spending and transfers to the social services as well as a growth of 5.7 percent in net lending expenditure from the previous quarter[28] (see Figure 3-2).

[28] The item 'net lending' refers to the amounts that are deducted from the clearance revenues and then transferred to utility companies in Israel and electricity providers in Palestine.

Figure 3-2: Structure of current expenditure

(NIS millions)



Source: The Palestinian Ministry of Finance

On a cash basis, the wage bill (the main component of current spending) remained virtually unchanged compared to the previous quarter (about NIS 1.6 billion), but decreased by 11 percent from 2013 Q1. Continued deficits undermined the PA's ability to cover the wage bill. According to quarterly data, the actual amount paid as wages and salaries was NIS 144.3 million below the actual value of the bill.[29]

Development Spending

Development spending in 2014 Q1 totaled NIS 216.6 million, up 66.6 percent from the previous quarter, thanks to NIS 93.3 million the government earmarked for development spending. Table 3-4 below shows the spending budget in 2013 and the first quarter of 2014.

Table 3-4: Public Expenditure Indicators

Tem	2013				2014
	Q1	Q2	Q3	Q4	Q1
Current spending (NIS millions)	**3,053.1**	**2,877.2**	**3,003.5**	**2,801.2**	**3,031.1**
As % to total public spending	96.0	93.7	95.1	95.6	93.3
As % to GDP	27.2	23.7	24.4	22.8	24.7
Developmental spending (NIS millions)	**127.0**	**194.3**	**156.1**	**130.0**	**216.6**
As % to total public spending	4.0	6.3	4.9	4.4	6.7
As % to GDP	1.1	1.6	1.3	1.1	1.8

Source: Table (3-1)

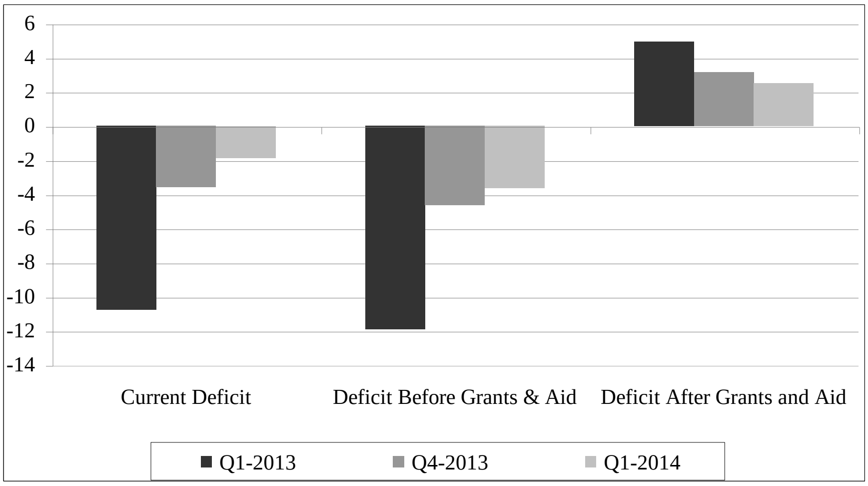
3.3 Financial Surplus/Deficit

In 2014 Q1, because the growth in total domestic revenues was greater than for current spending there was a decline in the current deficit before aid (on cash basis) to NIS 229.6 million (1.9 percent of GDP) compared with NIS 439.4 million (3.6 percent of GDP) in the previous quarter.

The total deficit (before grants and aid) totaled NIS 446.2 million, 21.6 percent lower than in 2013 Q4 and 66.6 percent below the figure reported in 2013 Q1 (see Figure 3-3).

[29] The actual wage bill shortfall totaled NIS 95 million on average for each quarter of 2013, compared to NIS 204 million on average for each quarter of 2012.

Figure 3-3: Fiscal deficit as % to nominal GDP



Source: Table (3-1)

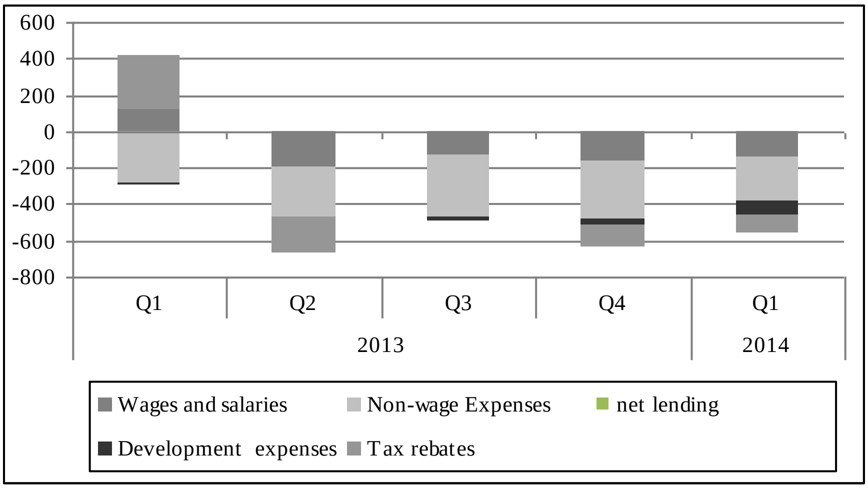
The government budget balance posted a surplus (after grants and aid) of NIS 308.6 million, down from NIS 385.8 million in the previous quarter; yet it did nothing to reduce the accumulation of arrears.

3.4 Accumulation of Arrears

The PNA's net accumulation of arrears in the target quarter totaled NIS 560 million, comprised of obligations owed to the private sector (NIS 244.5 million); outstanding tax rebates (NIS 100 million); wage bill arrears (NIS 144.2 million); and development spending outlays (NIS 71.3 million). The net accumulation of arrears (NIS 560 million) and the current deficit on a cash basis (NIS 446.2 million) result in a total deficit of NIS1.006 billion. Also, taking arrears into account turns the total budget surplus on a cash basis (NIS 309 million) to a deficit of NIS 254 million. Figure 3-4 shows arrears accumulation in 2013 and 2014 Q1.

Figure 3-4: Quarterly developments in the net accumulation of arrears

(NIS millions)



Source: The Palestinian Ministry of Finance

3.5 Clearance Revenue (commitment basis)

Table 3-5 displays the quarterly developments in clearance revenues on a commitment basis.[30] The table demonstrates that in Q1 2014, clearance revenues were nearly NIS

[30] Commitment basis is used because these data alone contain details of all clearance constituents.

(VAT, customs and fuel tax) made up relatively equal shares with fuel forming a slightly higher percentage than the other two components.

1,816.5 million, a 6.5 percent growth from the previous quarter and a 31 percent increase from the corresponding quarter of 2013. The three major components of clearance revenues

Table 3-5: Clearance revenues (commitment basis)

(NIS millions)

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
Clearing revenue	**1,388.6**	**1,421.4**	**1,587.0**	**1,705.6**	**1,816.5**
Customs	459.3	492.5	562.0	559.5	565.9
VAT	488.6	**457.9**	**521.3**	**548.7**	579.6
Fuel	431.5	470.2	503.0	565.6	634.4
Purchase tax (sales)	5.5	**-3.6**	**0.7**	**0.0**	-1.1
Income tax	3.7	4.4	0.0	31.8	37.7

Source: Tables of financial operations, details of revenue, spending and funding sources (commitment basis), Ministry of Finance.

3.6 Public Debt

The surplus in the total balance (on a cash basis) brought the public debt down to NIS 8,123 million (or 16.5 of nominal GDP), which is a 1.7 percent decline from the previous quarter.

External debt represented 47.5 percent of total debt versus 52.5 percent for domestic debt. The external debt consisted of obligations to Arab financial institutions (57 percent), international and regional institutions (30.7 percent) and bilateral loans (12.3 percent). The largest part of domestic debt was owed to the Palestinian banking system (about 19.2 percent of this debt consisted of loans provided to the Petroleum Authority, guaranteed by the PA)– see Table 3-6. Meanwhile, the cost of servicing public debt totaled NIS 54.2 million (1.9 percent of total domestic revenue), an increase of 25 percent from the previous quarter.

Table 3-6: Public Debt- Q1 2014

(NIS millions)

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
a. Domestic debt	**4,257.3**	**4,774.5**	**4,457.5**	**4,408.8**	**4,268.3**
Bank loans	2,376.8	2,345.7	2,474.6	2,300.1	2,228.8
Bank facilities (overdraft)	1,255.1	1,666.9	1,171.7	1,274.0	1,171.1
Petroleum Authority loans	594.9	731.4	780.7	783.9	817.6
Other public institutions loans	30.5	30.5	30.5	50.8	50.8
b. External debt	**3,989.9**	**3,956.1**	**3,892.0**	**3,856.1**	**3,854.7**
Arab financial institutions	2,283.0	2,266.7	2,226.3	2,191.8	2,195.7
Al-Aqsa Fund	1,906.0	1,890.5	1,853.0	1,822.2	1,826.9
Arab Fund for Economic and Social Development	204.6	204.7	202.0	201.4	202.2
Islamic Development Bank	172.4	171.5	171.3	168.2	166.6
International and regional institutions	**1,244.1**	**1,223.8**	**1,192.9**	**1,191.3**	**1,185.2**
World Bank	1051.9	1038.0	1008.2	986.3	982.3
European Investment Bank	109.8	104.0	104.0	125.6	122.8
International Fund for Agricultural	11.2	10.9	10.9	10.5	10.6

Item	2013				2014
	Q1	Q2	Q3	Q4	Q1
Development					
OPEC	71.2	70.9	69.8	68.9	69.5
Bilateral loans	**462.8**	**465.6**	**472.8**	**473.0**	**473.8**
Total public debt	**8,247.2**	**8,730.6**	**8,349.5**	**8,264.9**	**8,123.0**
Debt service	**52.8**	**34.5**	**26.6**	**43.0**	**54.2**
Public debt as % to GDP	**18.4%**	**18.0%**	**17.0%**	**17.2%**	**16.5%**

Source: The Palestinian Ministry of Finance

Textbox 5: Palestine's total public debt and arrears: 40 percent of GDP

In June 2014, the International Monetary Fund released a report on WBGS macroeconomic development and outlook, including the issue of arrears (government's outstanding payments) and public debt.[31] According to the report, due to additional support from several donors, total budget support for 2013 reached USD 1.25 billion, almost USD 0.5 billion higher than in 2012. This helped to reduce domestic debt and repay wage arrears (see the analysis of the government's budget in *Monitor 36*). However, 2013 saw a significant increase in dues accrued to the Pension Fund and private suppliers, which brought the figure of arrears up to NIS 1.7 billion (or about 4 percent of GDP) as shown in the table below.

Table 1: Composition of Net Arrears Accumulation (NIS million)

	2009	2010	2011	2012	2013
Contributions to the Pension Fund:	526	357	947	1,152	1,250
• Employee's share	171	185	374	544	612
• Government's share	355	172	573	608	630
Wage arrears	-	-	-	272	-232
Nonwage expenditure (arrears to suppliers)	460	92	353	439	582
Net lending	77	-103	-	-	-
Development projects	118	88	270	124	66
Tax refund	-140	-39	368	239	27
Total	**1,040**	**394**	**1,939**	**2,226**	**1,694**

http://www.imf.org/external/country/WBG/RR/2014/063014.pdf

In addition to the arrears in Table (1), the report cites two other items:

- Clearance revenue advances from Israel during 2012 of about NIS 600 million; and
- The PA's debt and contingent liabilities to Israel Electric Corporation, some of which are in dispute, have gone up, reaching NIS 1.3 billion at the end of December 2013. The PA disputes its liability to Israel Electric Corporation, arising from Jerusalem District Electricity Company (see *Monitor 30*). According to the report, the amount of debt to Israel Electric Corporation rose to NIS 1.5 billion by the end of May 2014.

The IMF found that PA's public debt, including arrears and clearance revenue advances, is estimated to have reached NIS 16.9 billion (USD 4.6 billion), more than 40 percent of GDP, at the end of 2013. The figure further increased to an estimated NIS 17.4 billion after 2014 Q1, with domestic debts and arrears rising, resulting from a cash crunch related to back-loaded donor disbursements the report concluded.

The level of public debt (40 percent of GDP) should set off alarm bells as it signifies a structural crisis in the Palestinian fiscal sustainability.

[31] West Bank and Gaza: Report on Macroeconomic Development and Outlook.IMF, June 30, 2014. http://www.imf.org/external/country/WBG/RR/2014/063014.pdf

4. The Banking Sector

Table 4-1 documents the primary components in a consolidated balance sheet for banks operating in Palestine between 2013 Q1 and 2014 Q1.

Table 4-1: Consolidated balance sheet for licensed banks operating in Palestine

(USD millions)

Item*	2013				2014
	Q1	Q2	Q3	Q4	Q1
Total assets	**10,372.0**	**10,479.3**	**10,984.5**	**11,191.2**	**11,450.8**
Direct credit facilities	4,077.1	4,258.2	4,404.0	4,480.2	4,675.5
Deposits at PMA & Banks	3,882.1	3,723.5	3,718.4	4,130.3	4,108.4
- Deposits held by PMA	*1,031.3*	*970.3*	*976.2*	*996.6*	*984.0*
- Deposits held by Banks	*368.3*	*350.7*	*348.6*	*452.6*	*472.4*
- Banks' offshore deposits	*2,482.5*	*2402.5*	*2393.6*	*2681.1*	*2652.0*
Securities Portfolio	799.0	827.2	850.8	857.3	788.4
Cash and precious metals	830.3	868.2	1,200.3	956.0	1,023.3
Investments	150.1	146.8	148.5	155.1	158.6
Bankers' acceptances	5.6	5.7	4.9	7.6	5.3
Other assets	627.8	649.7	657.6	604.7	691.4
Total liabilities	**10,372.0**	**10,479.3**	**10,984.5**	**11,191.2**	**11,450.8**
Total deposits of the public**	7,713.2	7,830.9	8,181.3	8,303.7	8,454.4
Proprietorship (equity)	1,297.4	1,276.4	1,309.0	1,359.9	1,411.2
Deposits of PMA and Banks	734.7	731.0	813.8	900.2	911.1
- Deposits held by PMA	*192.2*	*174.1*	*184.1*	*189.5*	*200.0*
- Deposits held by Banks	*349.2*	*330.6*	*330.7*	*445.4*	*458.6*
- Banks' offshore deposits	*193.3*	*226.3*	*299.1*	*265.3*	*252.5*
Other liabilities	170.7	182.9	219.4	167.5	201.5
Allocations and depreciation	456.0	458.1	461.0	460.0	472.0

Source: PMA – The Consolidated Balance Sheet for Banks.
* The items listed in the table above are aggregate (including allocations).
** Public deposits include private and public sector deposits.

✧ **Assets**

The net assets of banks totaled USD 11.5 billion at the end of 2014 Q1 (an increase of 2.3 percent from the previous quarter and 10.4 percent over the corresponding quarter of 2013). Below, we present the most important changes occurring on the assets side.

✧ **Direct Credit Facilities**

In 2014 Q1, direct credit facilities totaled USD 4.68 billion, a growth of 4.4 percent from the previous quarter and 14.7 percent over the same quarter a year earlier. Despite this growth, the share of credit facilities in banks' assets remained around 40.8 percent. The increase in credit facilities during the first quarter of 2014 was mostly reported in the private sector, with a growth rate of 7 percent during the quarter. The credit granted to the private sector accounted for 71 percent of total credit facilities, with only 29 percent going to the public sector.[32]

By type of credit, loans represented 73.6 percent, while overdrafts constituted 26.1 percent and lease financing made up a scant 0.3 percent of total credit facilities. This distribution suggests an increase in the share of loans in 2014 Q1 by about two percentage points over 2013 Q4 while overdrafts whose share to the public sector saw some decline during this period.

By region, Gaza's share of residential private sector credit facilities fell by about half a percentage point to 15.5 percent compared to 84.5 percent for the West Bank. Within the West Bank, the Ramallah area received 64.9

[32] The government was the recipient of around 99 percent of public sector credit facilities.

percent of the total West Bank's share, while Nablus came second with 9.9 percent. Within the Gaza Strip, 68.9 percent of Gaza's share went to Gaza governorate.

By currency, the USD continued to hold the highest share of credit facilities (57.7 percent), ahead of the Israel shekel (31.5 percent) and the Jordanian dinar (10.1 percent) see Table 4-2.

Table 4-2: Distribution of direct credit facilities portfolio– by Beneficiary, Type and Currency

(USD millions)

	2013				2014
	Q1	Q2	Q3	Q4	Q1
By Beneficiary					
Public sector	1,243.6	1,337.2	1,382.7	1,373.2	1,355.8
Resident private sector	2,792.3	2,882.6	2,983.4	3,070.5	3,285.1
Non-Resident private sector	41.2	38.3	37.9	36.5	34.6
By Type					
Loans	2,914.1	2,975.0	3,118.8	3,207.7	3,442.5
Overdraft	1,151.5	1,270.8	1,272.0	1,258.5	1,218.2
Lease financing	11.5	12.4	13.2	14.0	14.8
By Currency					
USD	2,221.5	2,288.0	2,426.1	2,464.1	2,696.9
JD	516.1	503.8	478.4	471.1	472.4
NIS	1,315.4	1,436.3	1,462.9	1,510.7	1,470.7
Other currencies	24.1	30.0	36.6	34.3	35.5
Total	**4,077.1**	**4,258.2**	**4,404.0**	**4,480.2**	**4,675.5**

Source: PMA - The Consolidated Balance Sheet for Banks

Table 4-3 shows credit facilities by sector. Quarterly figures reveal a decline in credit granted for investment in stocks and financial from 1.6 to 1.2% of total credit and a drop in the share for car purchase (from 4.2 to 3.7%) between Q4 2003 and Q1 2014. Credit facilities granted to finance consumer goods fell to 26.8 percent, declining from 28.5 percent in the previous quarter, but remained the largest single category, ahead of facilities granted to finance real estate and construction (21.4 percent).

Table 4-3: Shares of various economic sectors of the facilities granted to the private sector (%)

Economic Sector	2013				2014
	Q1	Q2	Q3	Q4	Q1
Real estate and construction	21.1	21.8	21.8	20.9	21.4
Land development	1.4	1.8	1.9	1.8	1.7
Mining and manufacturing	6.1	6.2	6.2	7.2	7.0
Internal and external trade	18.3	18.3	18.1	19.8	19.3
Agriculture and livestock	1.0	1.2	1.2	1.2	1.9
Tourism, hotels and restaurants	2.0	2.1	2.0	1.9	1.7
Transport and communications	0.8	0.9	0.8	0.7	0.7
Services	9.9	8.4	8.0	7.8	10.3
Financing investment in equity and financial instruments	2.2	1.8	1.9	1.6	1.2
Financing automobile purchase	4.2	4.2	4.2	4.2	3.7
Financing consumer goods	28.1	28.5	29.0	28.5	26.8
Others in the private sector	4.9	4.8	4.9	4.4	4.8
Total Facilities (USD millions)	**2,833.6**	**2920.9**	**3021.3**	**3107.0**	**3319.7**

Source: PMA

✧ Banks Deposits at the PMA

During Q1 2014, assets held by banks and the PMA totaled USD 4.11 billion, down 0.5 percent from the previous quarter due to a 1.1 percent decline in banks' overseas and a 1.3 percent drop in deposits held by the PMA.

✧ Cash and precious metals

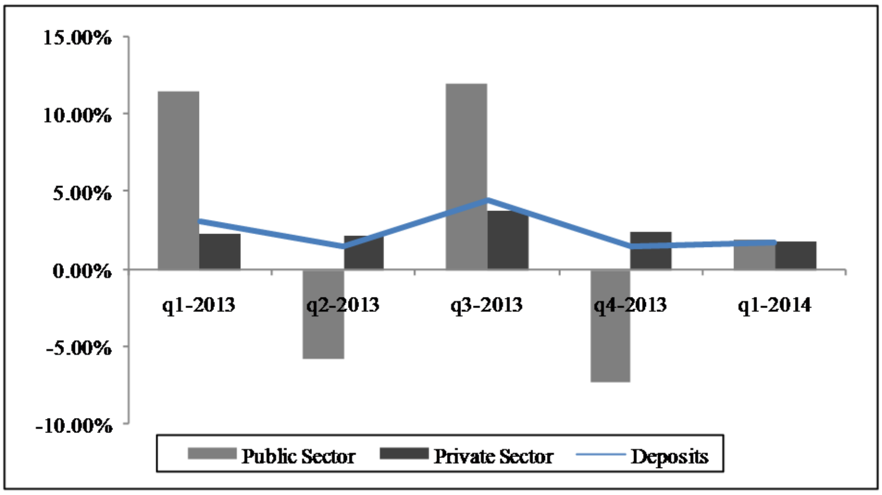
The 'cash and precious metals of banks in Palestine amounted to USD 1.02 billion in 2014 Q1, up 7 percent from 2013 Q4, thanks to a growth in cash at banks operating in both the West Bank (by 30.1 percent) and Gaza (by18.8 percent). The increase is in part a result of the difficulties of transferring the shekel surplus to Israeli banks.

✧ Liabilities

Public deposits totaled USD8.45billion at the end of Q1 2014, a growth of 1.8 percent from 2013 Q4 and 9.6 percent over the previous year's first quarter.

In 2014 Q1, public deposits consisted of public sector deposits (8.2 percent) and private sector deposits (91.8 percent). With 96.1 percent, the residents' deposits accounted for the bulk of private sector holdings. Figure 4-3 shows growth in public deposits between 2013 Q1 and 2014 Q1.

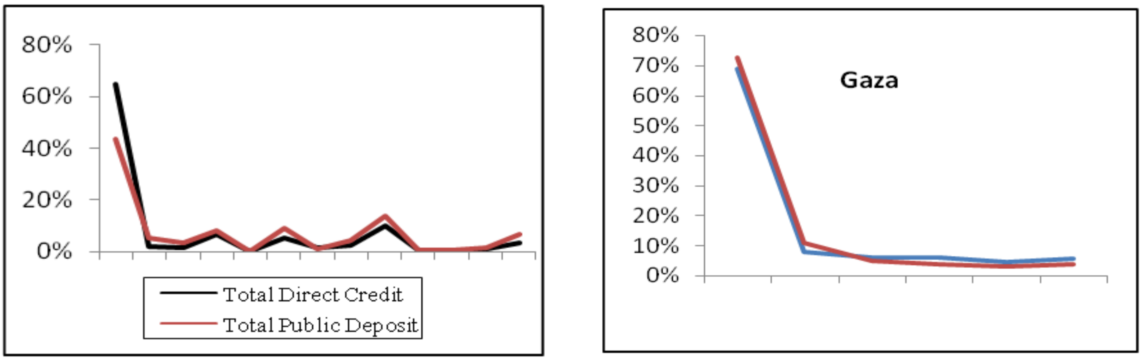
Figure 4-3: Growth in public deposits



Source: PMA - The Consolidated Balance Sheet for Banks

By region, the West Bank retained the lion's share of about 89.7 percent of total public deposits, with the Gaza Strip accounting for only 10.3 percent. Figure 4-4 shows the distribution of deposits and credit by governorate in both the West Bank and the Gaza Strip at the end of 2014 Q1.

Figure 4-4: Deposits and credit granted to governorates, as of end Q1 2014



Source: PMA

By type, deposits remained virtually unchanged during 2014 Q1. Current (on-demand) deposits accounted for 40 percent of total public deposits. Time deposits and saving deposits remained around 28.5 percent and 31.5 percent, respectively. By currency, with 41.1 percent, the US dollar retained its position as the leading currency for public deposits. The share of accounts denominated in the Israeli shekel and the Jordanian dinar were 28.8 percent and 26.3 percent, respectively (see Table 4-4).

Table 4-4: Distribution of Public Deposits by Depositor, Type and Currency

(USD millions)

	2013				2014
	Q1	Q2	Q3	Q4	Q1
By depositor					
Public sector	691.4	651.6	730.2	676.9	689.7
Resident private sector	6,786.0	6,924.7	7,186.0	7,345.4	7,465.4
Non-resident private sector	235.8	254.6	265.1	281.4	299.3
By type of deposit					
Current deposit	3,121.0	3,163.1	3,317.1	3,339.2	3,380.1
Time deposit	2,258.9	2,276.2	2,380.9	2,381.6	2,410.2
Saving deposit	2,333.3	2,391.6	2,483.3	2,582.9	2,664.1
By currency of deposit					
USD	3,120.3	3,196.9	3,438.8	3,460.6	3,477.2
JD	1,838.9	1,898.6	2,067.7	2,106.0	2,226.2
NIS	2,353.4	2,384.4	2,342.6	2,409.9	2,430.7
Other currencies	400.6	351.0	332.2	327.2	320.3
Total	**7,713.2**	**7,830.9**	**8,181.3**	**8,303.7**	**8,454.4**

Source: PMA

4.1 Banking System Performance Indicators

The general indicators for the performance of banks operating in Palestine reveal some improvement in Q1 2014. The share of credit facilities to total public deposits grew by 1.4 percentage points from the previous quarter to 55.3 percent, while the ratio of interest income to total income grew from 73.5 percent in 2013 Q4 to 75.3 percent in the quarter (see Table 4-5).

Table 4-5: Banking System Performance Indicators (%)

Indicator	2013				2014
	Q1	Q2	Q3	Q4	Q1
Equity / total assets	12.5	12.2	11.9	12.2	12.3
Interest income / total revenue	74.8	76.7	74.8	73.5	75.3
Credit facilities/ public deposits	52.9	54.4	53.8	53.9	55.3
Credit facilities of the private sector / private sector deposits	40.4	40.7	40.5	40.7	42.7
Foreign investments / total deposits	37.8	37.0	35.7	38.2	36.8
Nonperforming credit facilities/ total facilities	3.2	3.1	2.9	2.9	2.9

Source: PMA

By contrast, the share of foreign investments declined by 1.4 percentage points slipping to 36.8 percent during the same comparison period. It is noteworthy that 77 percent of foreign investments were in the form of banks' overseas deposits.[33]

Meanwhile, nonperforming credit facilities constituted 2.9 percent of total facilities (USD 132.8 million).

✧ **Profits of banks operating in Palestine**

The net profits of banks operating in Palestine at the end of 2014 Q1 reached USD 40.5 million, up from USD 30.3 million in the previous quarter. Table 4-6 shows sources of revenue, expenses and net profits of banks from 2013 Q1 to 2014 Q1. The profits achieved between the two quarters came primarily from reducing spending rather than increased revenue.

Table 4-6: Sources of revenue, expenses and net income of banks

(USD millions)

	2013				2014
	Q1	**Q2**	**Q3**	**Q4**	**Q1**
Net revenues	**109.2**	**113.3**	**116.9**	**122.2**	**118.6**
Interest	81.7	86.9	87.5	89.8	89.3
Commissions	18.2	19.3	20.5	22.3	19.8
Debt securities & investment	0.73	-0.21	1.4	3.2	3.0
Operations of evaluating and exchanging foreign currency	7.3	6.2	6.2	5.0	4.4
Hedging and trading	0.13	0.07	0.08	0.05-	0.6
Other operating revenue	1.2	1.1	1.2	2.0	1.5
Expenses	**69.3**	**80.9**	**76.7**	**91.9**	78.1
Operating expenses	57.2	60.8	63.8	69.7	64.7
Allocations	1.4	4.5	1.7	1.4	1.6
Tax	10.7	15.6	11.2	20.8	11.8
Net income*	**39.9**	**32.4**	**40.2**	**30.3**	**40.5**

Source: PMA

* Net income = net revenue – expenses

4.2 Average interest rates on deposits and loans

In 2014 Q1, interest rates on deposits for all currencies remained unchanged compared to the previous quarter, though interest rates for the JD deposits were relatively higher than those for the USD and the NIS.. The interest rates for the NIS and the USD loans fell to 11.4 percent and 6 percent, respectively. Meanwhile, the interest rate for JD loans rose to 9.4 percent (see Table 4-7).

Table 4-7: Weighted average interest rates for deposits and loans (%)

Period		**JD**		**USD**		**NIS**	
		Deposits	**Loans**	**Deposits**	**Loans**	**Deposits**	**Loans**
2013	Q1	1.7	8.7	0.5	7.3	1.1	11.7
	Q2	2.4	9.5	0.8	7.9	1.4	11.5
	Q3	2.1	9.5	0.5	7.7	1.4	11.2
	Q4	2.1	9.0	0.8	7.1	1.4	12.0
Average		**2.07**	**9.2**	**0.65**	**7.5**	**1.32**	**11.6**
2014	Q1	**2.1**	**9.4**	**0.8**	**6.0**	**1.4**	**11.4**

Source: Quarterly Statistical Bulletin – PMA

[33] Foreign investments include banks' overseas deposits, investments in investment instruments and facilities granted to nonresidents.

4.3 Check Clearing

Data from the Palestine Monetary Authority clearance houses in both Ramallah and Gaza demonstrate that in 2014 Q1, checks presented for clearing fell by 5.5 percent in number and 2 percent in value as compared to quarter 4 of the previous year (see Table 4-8).

Table 4-8: Number and value of checks presented for clearing & number and value of checks returned

Period		Checks presented for clearing		Checks returned	
		No. (checks)	Value (USD millions)	No. (checks)	Value (USD millions)
2013	Q1	1,021,161	2,326.7	139,098	164.4
	Q2	1,075,125	2,705.5	111,954	159.3
	Q3	1,093,428	2,698.0	112,562	161.3
	Q4	1,156,713	2,837.5	123,730	174.2
Total		**4,346,427**	**10,567.7**	**487,344**	**659.2**
2014	Q1	1,093,504	2779.3	110,488	168.4

Source: PMA, Monthly Statistical Bulletin

4.4 Banking Penetration

The eight new bank branches that opened during 2014 Q1 brought the total number of branches operating in Palestine to 245 (131 for local banks and 114 for foreign banks)- see Table 4-9.

Table 4-9: Banking Penetration in Palestine- as of March 31, 2014

Item	Local banks	Foreign banks	Total
Number of banks	7	10	17
Number of bank branches and offices	131	114	245
Number of ATMs	272	222	494
Number of ATM cards	081,128	674,7	755,135
Number of credit cards	086,24	550,38	636,62
Number of debit cards	643,150	258,266	901,416

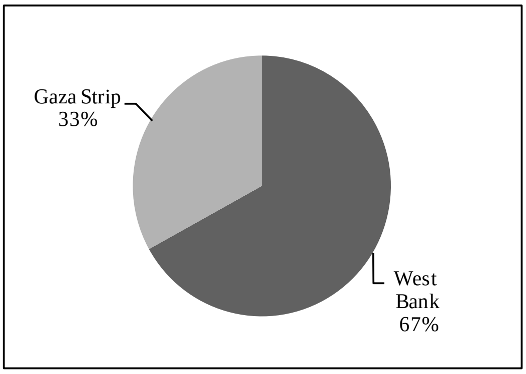
Source: PMA

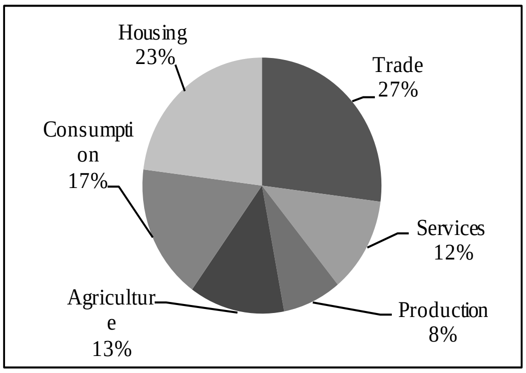
4.5 Specialized lending institutions (SLI)[34]

Specialized lending institutions operate through a network of branches and offices that totaled 64 at the end of 2014 Q1, with 518 employees serving 55,186 clients (63.2 percent in the West Bank and 36.8 percent in Gaza). Females represented 52.3 percent of clientele during the target period. In 2014 Q1, these institutions granted 9434 loans with a total value of USD 21.5 million, while the loan portfolio at the end of the quarter amounted to USD 107 million. During the quarter, the commercial sector was the largest beneficiary with 27 percent of the total value of credit, followed by the housing sector (23 percent), the consumer sector (17 percent) and the agricultural sector (13 percent)– see Figure 4-5.

[34] Data particularly cover six lending institutions: ASALA, ACAD, FATEN, UNRWA, REEF and CHF, all of which, except for UNRWA, have already obtained PMA license in accordance with the system in place.

Figure 4-5: Regional and sectoral distribution of SLI facilities





4.6 Palestine Stock Exchange

The *Quarterly Economic and Social Monitor* studies three groups of financial indicators for the Palestine Stock Exchange:

- Financial market indicators:
  - Market capitalization:[35] The share of market capitalization in the Palestine Stock Exchange in 2013 was 24 percent, compared to 28 percent a year earlier.
  - Number of listed companies: The number of companies listed on the Palestine Stock Exchange at the end of Q1 2014 was 49 (9 companies working in banking and financial services; 12 manufacturing companies; 7 insurance companies; 9 investment companies; and 12 companies working in the services sector).
- Liquidity Indicators
  - of the value of traded shares to GDP: In 2014 Q1, this ratio was 6 percent, up from 5 percent in the previous quarter.
  - Turnover (This indicator calculates the volume or value of shares traded on a stock exchange during a day, month or year): In the target quarter, turnover was 5 percent, up from 4 percent in the previous quarter. At the sectoral level, the turnover in the investment sector was 11 percent; the services sector 5 percent; the banking and financial services sector 3 percent; the insurance sector 2 percent and the manufacturing sector 1 percent.
- Degree of Concentration is used to measure the influence of large companies on stock prices. The influence is measured by calculating the share of the top five (or sometimes ten) largest companies in the total value of shares traded on the stock market. About 85 percent of the total value of shares traded in Q1 2014 was held by the largest five companies on the Palestine Stock Exchange, namely Palestinian Telecommunications Group (37 percent); Palestine Development and Investment (36 percent); Bank of Palestine (6 percent); Palestine Islamic Bank (3 percent); and the Arab Palestinian Investment Company-APIC (3 percent).

The market value of shares for the companies listed on the Palestine Stock Exchange at the end of Q1 2014 amounted to USD 3.3 billion, up from USD 3.2 billion in the previous quarter. By sector, services remained the largest share of the total market value (44 percent). The banking and financial services sector followed with 25 percent of total value (see Figure 4-6).

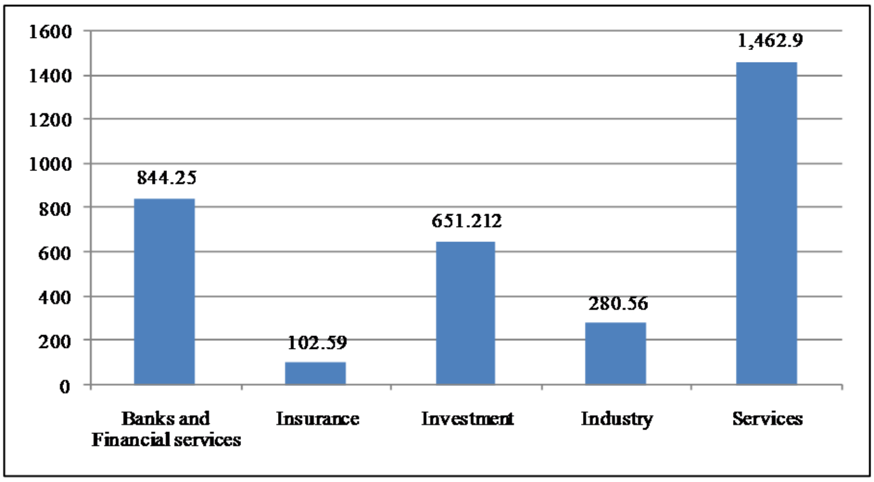
Shares traded on the Palestine Stock Exchange during 2014 Q1 totaled 76.4 million, down 11 percent from 2013 Q4. The market value of shares traded was USD 166 million, a growth of 15 percent from the previous quarter (see Figure 4-7).

Of the total value of shares traded during the quarter, the investment sector and the services sector had the largest percentage (with 41 percent each), while the banking & financial services sector followed, with 15 percent (see Figure 4-8).

[35] This indicator is used to measure the importance and role of the financial market in an economy. It is calculated by dividing the market value of shares listed on the market to the GDP at current prices. This indicator is calculated for the entire year rather than individual quarters.

Figure 4-6: Value of shares listed on PSE by Sector, Q1 2014

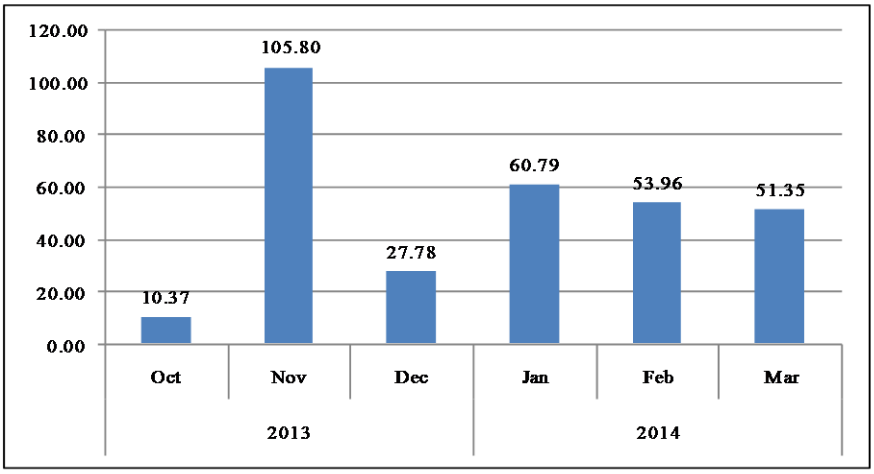
(USD millions)



Source: Palestine Stock Exchange www.pse.com

Figure 4-7: Value of shares traded on PSE, Q4 2013 & Q1 2014

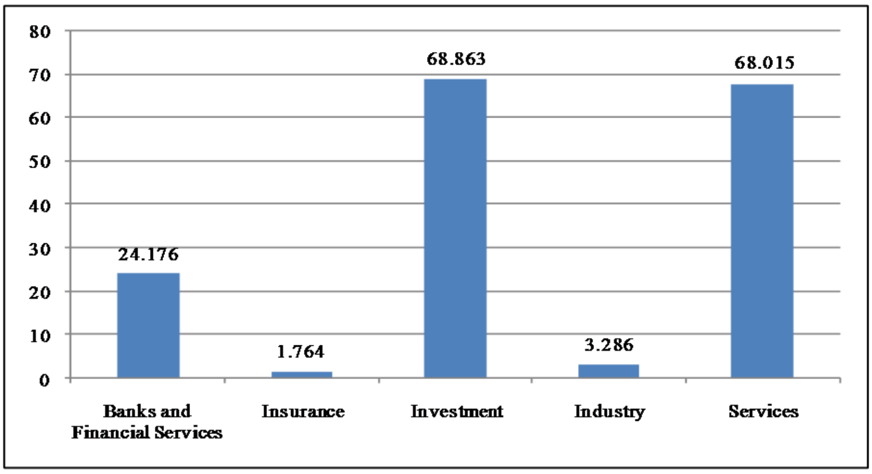
(USD millions)



Source: Palestine Stock Exchange www.pse.com

Figure 4-8: Value of shares traded on PSE by Sector, Q1 2014

(USD millions)

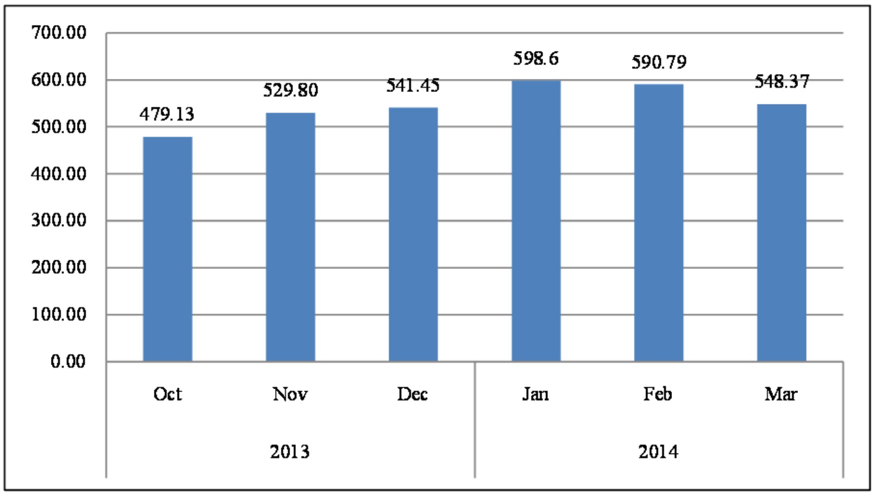


Source: Palestine Stock Exchange www.pse.com

Al-Quds Index

At the end of March 2014, the Al-Quds Index closed at 548.37 points, gaining 6.92 points from 2013 Q4 (see Figure 4-9).

Figure 4-9: Al-Quds Index, Q4 2013 & Q1 2014



Source: Palestine Stock Exchange www.pse.com

Textbox 6: Interest Rates Spreads in Palestine: Discrepancy and Harmfully High Levels

The World Bank defines 'Net Interest Rate Spread' (NIRS) as the difference between the average yield banks receive from loans and other interest-accruing activities and the average rate they pay on demand deposits, savings deposits and term deposits. The net interest rate spread is a key determinant of a financial institution's profitability and the effectiveness of bank intermediation. Since financial intermediation services (accepting deposits and granting credit) are the main activities of banks, the interest rate spread reflects the profit the banks receive in return for bearing the risk of financial intermediation. The greater the cost of banking intermediation, the greater the interest rate spread, which is primarily influenced by the structure of the market, operational costs and credit risk.[36]

Interest Rate Spread is relatively low in the developed countries, and far lower than in developing countries. For example, in 2012, it was 2.7 percent in Switzerland and 0.9 percent in Japan, as compared to 16.8 percent in Peru and 8.2 percent in Kenya.[37] This difference is mainly attributed to higher operating costs for banks in poor countries. This, in turn, results from auxiliary performance factors, such as low efficiency, as well as macro factors, such as a poor banking sector regulatory framework, low competition and high risks resulting from political instability.

Related literature confirms that NIRS is influenced by the efficiency of banks and their ability to provide banking services at the lowest possible cost to their clientele, since the higher the bank's potential to provide low cost services, the higher the profits and, thus, the lower the need to raise NIRS. The risk of default, high debt and the availability of alternative opportunities to invest the central banks' financial resources are key factors behind the tendency to raise NIRS. These factors are particularly important in areas suffering from political and economic instability, such as Palestine. At the macro level, the efficiency of banks is closely related to conditions surrounding the banking business (e.g. institutional framework and the competitive environment), which, in turn, influences the interest rate spread.[38]

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36 Wong, P. (1997) “The Determinants of Bank Interest Margins Under Credit and Interest Rate Risks”. Journal of Banking and Finance. No. 21, pp. 251-271.

37 World Bank: The Global Financial Development Database

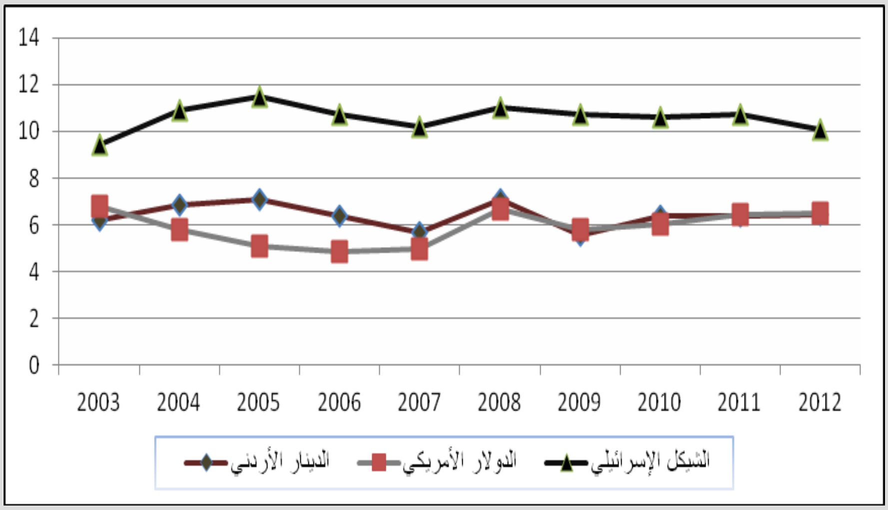
38 See:
- Randall, R. (1998) “Interest Rate Spreads in the Eastern Caribbean,” IMF Working Paper No. WP/98/59,
- Angbazo, L. (1997): “Commercial bank net interest margins, default risk, interest rate risk and off-balance sheet banking”, Journal of Banking and Finance. (http://www.imf.org/external/pubs/ft/wp/2006/wp06257.pdf)
- Barajas A., R. Steiner&N. Salazar (1999): “Interest spreads in banking in Colombia 1974-96”. IMF Staff Papers, **46**.

There are three currencies traded in Palestine (USD, NIS and JOD), which results in three interest rate spreads that are generally high compared to the corresponding rates in the countries issuing these currencies. There are also significant differences between the interest rate spread for these three currencies; relatively low for the USD compared to the NIS.

In 2012, interest rate spread in Palestine was 10.75 percent for the NIS, 6.5 percent for the USD and 6.4 percent for the JD. The average spread during the period from 2003 to 2012 was 10.6 percent for the NIS, 5.9 percent for the USD and 6.4 percent for the JD (see Figure 1).

Interest rate spreads for the USD and the JD are convergent- a result of the fact that since 1995, the JD (equivalent to USD 1.41044) has a fixed exchange rate against the USD. The low interest rate for the JD can also be attributed, in part, to the free movement of capital between the West Bank and the East Bank and the integration between the two capital markets.

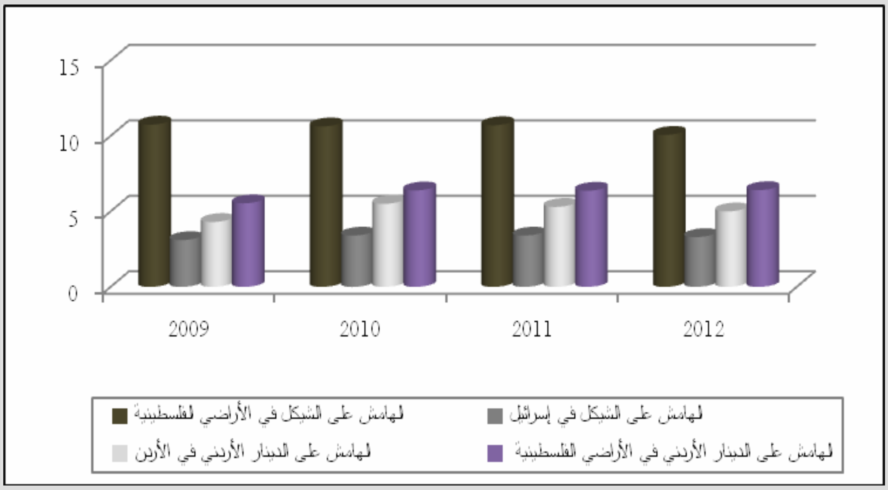
Figure 1: Interest rate spread for the NIS, the USD and the JD in Palestine, 2003-2012



Source: PMA Database

The rates in Palestine are generally higher than in the countries issuing these currencies. As demonstrated in Figure 2, the interest rate spread for the JD in Palestine was quite close to the rate in Jordan during 2003-2012. By contrast, the rate for the NIS in Palestine is three times its level in Israel, probably due to the risks of volatile NIS exchange rates (Israel's currency has had a volatile past). More importantly, transferring the NIS between Palestinian and Israeli banks is perilous, with many crises arising in the past years leading to either overflows or shortages in the availability of the NIS in Palestine.

Figure 2: Interest rate spread for the NIS and the JD in Palestine vs. Israel and Jordan



Source: PMA Database, World Bank Database

On the whole, the interest rate spread in Palestine is high for all currencies compared with other neighboring countries (1.5 percent in Lebanon, 4.4 percent in Egypt, 2.9 percent in Kuwait).[39] The high interest rate spread adversely impacts investment and saving. The high interest rate spread in Palestine, compared to neighboring countries and those with similar levels of development, is due to political and economic uncertainty and other risks. However, internal problems might also play a factor such as: low banking efficiency, the feverish pursuit of profits, and the restricted competitive environment surrounding the banking sector.

5. Investment Indicators

5.1 Company Registration

The Ministry of National Economy registers companies in Palestine under two different laws in effect in the West Bank and the Gaza Strip.[40] This issue of the *Monitor* documents the new companies registered in Q1 2014 in the West Bank only because data on the registration of companies in the Gaza Strip are not available to the Ministry of National Economy in Ramallah.

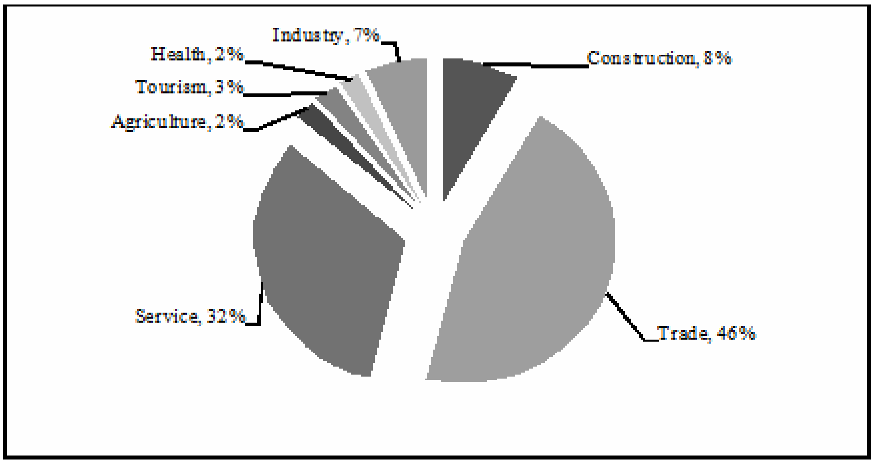
The number of companies newly registered in the West Bank in Q1 2014 totaled 440, up 56 from the previous quarter and 61 from the corresponding quarter of 2013 (see Table 5-1).

Table 5-1: New companies registered in the West Bank (2008-2014)

Quarter	2008	2009	2010	2011	2012	2013	2014
1	247	454	334	389	319	272	440
2	334	412	428	373	278	317	n.a
3	315	349	164	287	228	302	n.a
4	287	438	290	337	245	281	n.a
Total	**1,183**	**1,653**	**1,216**	**1,386**	**1,070**	**1,172**	**n.a**

Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2014.

Figure 5-1: Distribution of capital of new companies registered in the West Bank- by economic activity, Q1 2014



Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2014.

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39 World Bank: The Global Financial Development Database

40 Jordanian Companies Law No. (12) of 1964 is applied in the West Bank, while the Companies Law No. (18) of 1929 is applied in the Gaza Strip.

The new companies registered in 2014 Q1 had total capital investment of JD 59 million, down 42 percent from the previous quarter.[41] By sector, data available show that with a share of 46 percent (JD 27 million), companies in the trade sector held the largest share of capital of newly-registered companies in the quarter. The services sector ranked second with a share of 32 percent (JD 19.2 million). The construction and industry sectors came third and fourth, with 8 percent (JD 4.8 million) and 7 percent (JD 4 million), respectively (see Figure 5-1).

In terms of the legal form of companies registered in 2014 Q1, data show that 183 companies were classified as public ordinary companies, 254 were private joint stock companies, 3 were foreign private joint stock companies. Private joint stock companies' accounted for 65 percent of the total capital of newly-registered companies, while public ordinary companies accounted for 35 percent (see Table 5-2).

Table 5-2: Distribution of the value of capital of companies registered in the West Bank- by Legal Form, 2013 & Q1 2014

(JD millions)

Year	Legal Form				Total
	Public Ordinary	Private Shareholding	Public Shareholding	Foreign Private Shareholding	
Q1 2013	13.936	16.346	0	14.346	44.628
Q2 2013	15.370	33.357	0	18.730	67.457
Q3 2013	10.220	33.430	0	86.059	129.708
Q4 2013	11.555	36.713	2	50.133	100.402
2013	**51.081**	**119.846**	**2**	**169.268**	**342.195**
Q1 2014	**20.882**	**38.295**	**0**	**0.672**	**59.244**

Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2014.

5.2 Building Licenses

The number of building licenses issued during a given period may be taken as a significant indicator of investment activity, in general, and investment in the housing sector, in particular. The number of building licenses changes seasonally- increasing in the second and third quarters (during summer), while declining in the first and fourth quarters (during winter). In general, the number of licenses issued in Palestine does not include all building activities in the construction sector, as numerous construction activities, especially in rural areas, are not registered or licensed.

Table 5-3: Building licenses issued in Palestine: 2013-2014 (area in 1000 sq m)

Indicator	2013					2014
	Q1	Q2	Q3	Q4	Total	Q1
Total licenses issued	2,281	2,501	2,219	2,137	9,138	2,445
Residential buildings	2,053	2,282	2,026	1,954	8,315	2,239
Non-residential buildings	228	219	193	183	823	206
Total licensed areas	1000.9	1,081.6	1,047.1	854.6	3,984.2	1,149.4
No. of new units	3,173	3,540	3,926	2,927	13,566	3,804
Area of new units	541.3	593.5	675.3	508	2,318.1	686.5
No. of existing units	1,035	829	656	874	3,394	842
Area of existing units	171.9	144.9	106.2	152.1	575.1	140.3

Source: Palestinian Central Bureau of Statistics (2014): Building Licenses Statistics, Ramallah - Palestine.

41 In Q1 2014, companies were registered in three currencies: the Jordanian Dinar, the U.S. Dollar and the British Pound. The exchange rate was calculated according to the quarterly rate of the Jordanian dinar exchange rates against the U.S. Dollar (0.7059) and the British Pound (1.1742).

Building license data show a growth of 14.4 percent in the number of building permits during Q1 2014 compared to the previous quarter and a growth of 7.2 percent from the previous year's corresponding quarter. Quarterly data also show that the total area licensed for building in 2014 Q1 saw a growth of 34.5 percent from the previous quarter and 14.8 percent from the corresponding quarter of 2013.

5.3 Cement Import

During this quarter, the quantity of cement imported into Palestine dropped by 0.5 percent from the previous quarter, but it was 37.3 percent higher than the quantity imported in the prior year's first quarter. Cement volume entering Gaza saw sharp decline compared to 2013 Q4 and 2013 Q1 (see Table 5-4).

Table 5-4: West Bank and Gaza Imports of Cement: 2013-2014

(in thousand tons)

Region	2013				2014
	Q1	Q2	Q3	Q4	Q1
West Bank	246.4	393.5	327.5	346.2	350.6
Gaza	13.1	13.8	13.0	11.8	5.6
Palestine	259.4	407.2	340.6	358.0	356.2

Source: Palestinian Central Bureau of Statistics: Administrative Records, 2014. Ramallah, Palestine.

5.4 Vehicle Registration

This section records the number of new or used vehicles registered for the first time in the West Bank and imported from Israel and abroad. The vehicle registration indicator can mirror the economic situation of the population, on the one hand, and the degree of reliability and optimism about future economic conditions, on the other. Since vehicles are expensive and because they are often purchased through borrowing from banks, improvement in this indicator reflects the confidence of both people and banks in the sustainability of employment and the ability of debtors to pay obligations.

During Q1 2014, 3,764 new and used vehicles were registered in the West Bank, down 3.1 percent from the previous quarter, but up 9.6 percent from the same quarter a year earlier. Around 51 percent of vehicles registered in the West Bank during this quarter were used vehicles imported from overseas markets, while 33 percent were new cars imported from overseas markets, and the rest (16 percent) were used vehicles purchased from the Israeli market (see Table 5-5).

Table 5-5: New and used vehicles newly registered in the West Bank

	Vehicles from international market (new)	Vehicles from international market (used)	Vehicles from the Israeli market (used)	Total
Q1 2013	1,274	1,345	815	3,434
Q4 2013	1,535	1,743	606	3,884
January	306	744	191	1,241
February	460	567	184	1,211
March	493	592	226	1,311
Q1 2014	1,259	1,903	601	3,763

Source: Department of Customs and Excise, unpublished data.

5.5 Hotel Activity

The total number of hotels operating in the Wet Bank rose to 116 end of Q1 2014, up from 113, the figure reported in 2013 Q4. During the quarter, hotel guests totaled 149,526 (an increase of 24.1 percent from the previous quarter, but a decline of 21.7 percent from the corresponding quarter of 2013). These guests lodged a cumulative 361,711 nights in the West Bank's hotels (see Table 5-6).

Table 5-6: Key Hotel Indicators in the West Bank, 2012-2014

Indicator	2012	2013					2014
	Total	Q1	Q2	Q3	Q4	Total	Q1
No. of operating hotels	98	101	107	111	113	113	116
Average no. of employees	2449	2,635	2,793	2,794	2,950	2,797	3,035
No. of guests	575,495	120,441	153,085	135,808	190,893	600,362	149,526
No. of nights stayed	1,336,860	279,591	376,848	321,264	489,517	1,467,709	361,711
Average room occupancy	1,513.7	1,212.0	1,539.2	1,374.1	1,703.3	1,458.5	1,527.4
Average bed occupancy	3,652.6	3,106.6	4,141.2	3,492.0	5,320.8	4,021.1	4,019.0
Room occupancy %	29.1	22.0	26.2	22.9	28.0	24.8	23.0
Bed occupancy %	30.7	24.6	30.7	25.5	38.3	29.9	27.3

Source: PCBS, 2014: Hotel Activity in the West Bank

Textbox 7: Peace would give Israel's GDP NIS 180 billion boost

An Israeli team of economists, led by Yarom Ariav (Director General of Israel's Ministry of Finance), carried out a study on the gains Israel's economy would reap from a functional peace based on the Arab Initiative. The peace potential gains are the other face of what Israel will miss form the lack of peace.[42]

The study used a model to estimate the annual economic gains for Israel after ten years of peace, and accordingly divided these gains into two types: growth in GDP and an improvement in the government budget.

Growth in GDP

According to the study, a 'glass ceiling' is restricting Israel's economic growth to 3 percent a year, and stimulating growth higher than this rate requires a fundamental change in the conditions surrounding the Israeli economy. The study suggests that this restriction could be broken if the peace process is renewed, allowing the economy to grow at higher rates. Among the most important factors that could break this restriction is stimulating exports to Arab and Muslim countries. The study maintained that peace would bring a 6 percent annual increase in exports every year, or USD 27 billion (NIS 97 billion) as growth in GDP after a decade of functional peace. On the other hand, the number of incoming tourists would rise to more than double the current figure (from 3 million to 8 million a year), contributing another USD 22 billion to Israel's GDP. Finally, foreign investment would grow to USD 10 billion annually, the study projected.

If there were to be 10 years of functional peace with the Palestinians, these three factors would likely add around 180 billion shekels (USD 52.5 billion) a year to Israel's gross domestic product, the study estimated. This would increase Israel's growth rate from its current 3 percent a year to 4.8 percent, a 60 percent increase in the growth rate. The study found that this is not even the best-case scenario, as the actual rates could be higher than that.

The government budget

According to the study, an 18 percent increase in Israel's GDP would generate around NIS 54 billion in additional annual tax (direct and indirect) revenues by the end of the decade. On the other hand, peace would reduce spending by NIS 13 billion a year. First, defense spending would go down from its current 7 percent of GDP to 4.5 percent (as is the case in the United states), thus saving NIS10 billion a year by the end of the decade. Second, peace would save NIS 1 billion that the budget currently subsidy on settlements. Third, a functional peace would cut the state's annual borrowing costs by NIS 2 billion by reducing the borrowing interest rate. The increased revenues and reduced spending could have an additional NIS 67 billion a year impact by the decade.

These gains would make it possible to cut the value-added tax to 12 percent, from 18 percent and, instead, increase spending on such vital areas as education and social services (which protesters demanded in demonstrations that swept the country in 2011).

[42] See http://www.haaretz.com/business/.premium-1.603907
http://tlv1.fm/business/the-cost-of-doing-business/2014/07/08/67-billion-nis-the-money-to-be-made-from-peace-3/
http://www.jpost.com/Business/Business-Features/Peace-could-increase-growth-rate-by-60-percent-362048

Textbox 8: The IMF study on potential Palestinian economic gains from peace: Peace is not a substitute for aid and economic reform

In June 2014, the IMF released a study on the economic gains the Palestinian economy would achieve from peace. The study's estimates are built on a set of assumptions [43]:

- ✧ A final status agreement by the end of 2014
- ✧ A gradual lifting of Israeli restrictions on internal and external movement of goods and people and access to land and other resources in 2015–2017.
- ✧ No net increase in the number of Palestinian workers in Israel and settlements.
- ✧ Increase in foreign direct investment and domestic private investment of 20 percent of GDP in 2015-2017.
- ✧ Continuation of current monetary arrangements (i.e., three traded, exchangeable currencies).
- ✧ Additional donor support in the short run: a 50 percent increase in total donor aid (budget and project support) in 2015, phased out in 3 years after which donors would provide USD 1 billion per year.
- ✧ Expansion of health and education services to accommodate the phasing-out of UNWRA (from 2017). From 2017, USD 100 million is added to the PA’s budget until all services provided by UNWRA are covered by the PA. UNWRA's budget for the WBG is around USD 450 million per year, according to IMF.

The study found that under these assumptions, the performance of the Palestinian economy will improve significantly, and that real GDP growth would rise to 6 percent in 2015 and increase further to above 10 percent in the medium term. Despite inflationary pressure, inflation would remain lower than 10 percent, anchored by modest inflation rates in Israel. By contrast, unemployment would remain at above 20 percent as a result of high population and labor force growth, as well as existing labor market distortions. Additionally, public finances would improve thanks to higher revenues that are generated by stronger growth and imports.

The study outlined two issues, in particular. First, despite a reduced reliance on external aid should the peace process succeed, aid flows to Palestine should be maintained in the future. Second, though indispensable for unleashing Palestine’s economic potential, peace is not a substitute for economic reform, improving the efficiency of public administration and enhancing the investment climate and PMA capacity. In sum, while necessary, peace is alone is insufficient for Palestine to flourish economically.

6. Prices and Purchasing Power

6.1 Consumer Prices

Indices of consumer prices in Q1 2014 showed an increase of 0.64 percent from the previous quarter and 2.19 percent from the corresponding quarter of 2013. 'Medical care' expenses had the strongest influence on indices, increasing by 6.79 percent from the previous quarter. Also, 'alcohol and tobacco' prices rose by 1.66 percent, while 'lodging and related supplies' prices increased by 1.41 percent during the same comparison period. This occurred against a 3.11 percent drop in the prices of education services and a 2.51 percent decrease in the prices of transportation and travel (see Table 6.1).

Table 6-2 outlines the change in price of some categories of commodities in Palestine during 2014 Q1 compared to the previous quarter. Looking at some representative commodity groups in detail, the prices of dairy and eggs rose by 11.45 percent. The price of eggs, for example, saw an increase of 5.62 percent (the price of local fresh eggs was NIS18.36 / 2 kg carton in January 2014). Likewise, the price of poultry increased by 8.15 percent (the price of local fresh skinned chicken reached NIS 16.79 / 1 kg in January 2014). Similarly, the price of domestic fuel rose by 4.19 percent as the price of home liquid fuel increased by 3.65 percent

[43] West Bank and Gaza: Report on Macroeconomic Development and Outlook. IMF, June 30, 2014. http://www.imf.org/external/country/WBG/RR/2014/063014.pdf

(e.g., the price of kerosene reached NIS 6.51 / 1 liter during March 2014). In parallel, car fuel prices showed an increase of 2.97 percent (e.g. the price of unleaded Israeli gasoline 95 octane was NIS 7.41 / 1 liter during September 2013, while the price of Israeli diesel reached NIS 6.90 during the same month).

Table 6-1: Average CPI Change in Palestine by Commodity Group

Group	% Change in Q1 2014 from Q4 2013	% Change in Q1 2014 from Q1 2013
Food stuff and soft drinks	0.08	1.30
Alcohol, beverages and tobacco	1.66	12.97
Textiles, apparels, and footwear	(1.51)	(1.54)
Lodging and related supplies	1.41	4.59
Furniture & home appliances	(1.63)	(2.20)
Medical care	6.79	9.01
Transportation & travel	(2.51)	(3.67)
Telecommunications	(1.94)	(1.90)
Recreational & cultural goods & services	(1.61)	(2.57)
Educational Services	(3.11)	5.08
Restaurant, cafe, and hotel services	2.81	5.41
Miscellaneous goods and services	10.84	6.26
General CPI	0.64	2.19

Source: PCBS.
* Figures in brackets indicate negative values (decline in prices).

By contrast, the prices of fresh meat fell by 6.58 percent. For example, the price of fresh beef dropped by 8.08 percent Also, the price of fresh vegetables saw a 5.55 percent decline. Particularly, the prices of tomatoes dipped by 31.73 percent.

Table 6-2: Price changes of selected commodity groups in Palestine

Commodity Group	% Change in Q1 2014 from Q4 2013
Fuel for cars	2.97
House fuel	4.19
Fresh Vegetables	(5.55)
Fresh Meat	(6.58)
Sugar	(5.38))
Rice	0.83
Fresh Poultry	8.15
Flour	(2.32)
Dairy Products & eggs	11.45
Fresh Fruit	0.68

Source: PCBS.
* Figures in brackets indicate negative values (decline in prices).

6.2 Producer Prices and Wholesale Prices

The Wholesale Price Index measures the sale price to industrial and commercial retailers or producers, including VAT and freight/shipping costs. The Wholesale Price Index increased by 0.67 percent during Q1 2014 compared to the previous quarter (and 2.53 percent compared to the previous year's corresponding quarter). This primarily resulted from a 1.69 percent climb in the prices of agricultural commodities which constitute 29 percent of the wholesale price index value. There was also a 0.30 percent rise in the prices of manufactured goods which represent 70 percent of the wholesale price index value. Additionally, prices of the fishing category increased by 8.01 percent, while prices for mining and quarrying saw a 5.40 percent decline.

The rise in the Wholesale Price Index was primarily caused by a rise of 0.68 percent in the prices of imported goods versus a 0.23 percent drop in the prices of locally-produced goods.

The Producer Price Index measures prices received by domestic producers for their output after all taxes are deducted, including VAT and freight/shipping costs. The Producer Price Index dropped 0.21 percent from the previous quarter, but rose 0.82 percent over quarter 1 a year earlier. This decline resulted from a 0.83 percent fall in the prices of agricultural products (which represent 36 percent of the producer price basket) versus a 0.10 percent increase in the prices of manufactured goods (which constitute 61.66 percent of the producer price basket). Prices of fish & shrimp and mining & quarrying also jumped by 15.53 percent and 0.13 percent, respectively.

The decline in the Producer Price Index was a result of a drop in both exported goods (0.27) and locally produced goods (0.20 percent).

6.3 Construction and Road Costs Index

The Construction Cost Index measures the changes that occur in the prices of construction materials and services. During Q1 2014, the West Bank Construction Cost Index showed a slight growth from the previous quarter (0.32 percent for residential and 0.24 percent for non-residential units). There are no updated data on the Gaza Strip.

The Road Cost Index detects changes in the prices of materials and services used in the construction of roads in the West Bank. This index rose 0.21 percent from the previous quarter. Again, there are no updated data on the Gaza Strip (see Table 6-3).

Table 6-3: % Change in the West Bank's Construction and Road Costs Index (CRCI)

Period	CRCI			Monthly Percentage Change			Quarterly Percentage Change		
	Construction costs for residential buildings	Construction costs for non-residential buildings	Road cost	Construction costs for residential buildings	Construction costs for non-residential buildings	Road cost	Construction costs for residential buildings	Construction costs for non-residential buildings	Road cost
	Base year 2013 = 100	Base year 2013 = 100	Base month: December 2008 = 100						
October 2013	99.99	100.03	117.14	(0.22)	(0.17)	(0.19)			
November 2013	100.07	100.12	117.00	0.08	0.08	(0.11)			
December 2013	100.03	100.05	117.09	(0.04)	(0.06)	0.07			
Q4 average	**100.03**	**100.07**	**117.08**				**0.05**	**0.16**	**(0.13)**
January 2014	100.15	100.10	117.03	0.12	0.04	(0.05)			
February 2014	100.37	100.32	117.19	0.23	0.23	0.14			
March 2014	100.53	100.50	117.75	0.16	0.17	0.47			
Q1 average	**100.35**	**100.31**	**117.32**				**0.32**	**0.24**	**0.21**

Source: PCBS.
* Figures in brackets indicate negative values.

6.4 Exchange rates and purchasing power[44]

As we demonstrated earlier, the consumer price index for 2014 Q1 was 0.6 higher than in 2013 Q4. This occurred in conjunction with a 0.8 percent decline in the exchange rate of the USD against the NIS in Q1 relative to Q4. Therefore, the US dollar purchasing power declined by about 1.5% between the two successive quarters. And this is the same decline in the Jordanian dinar exchange rate is fixed with the US dollar.
(see Table 6-4).

The purchasing power of the USD and JD in the 12 months separating 2013 Q1 and 2014 Q1 sank by 7.6 percent as a result of a 2.2 percent inflation rate and a 5.6 percent decrease in the exchange rate during the year. In other words, the purchasing power for individuals who receive their wages and salaries in USD or JD fell by 7.6 percent during the year compared to a decline of 2.2 percent for those receiving their wages and salaries in NIS (which is equivalent to the NIS inflation rate during the year). This calculation is based on two assumptions: that those receiving their salaries and wages in USD or JD have their entire spending only in NIS; and that the nominal value of salaries and wages is constant.

Table 6-4: Average change in Purchasing Power and Exchange Rates of USD and JD against NIS

Period			USD / NIS			JD / NIS		
		Inflation rate*	Average exchange rate	Change in exchange rate (%)	Change in purchasing power (%)	Average exchange rate	Change in exchange rate (%)	Change in purchasing power (%)
2013	Q1	0.45	3.70	(3.67)	(4.12)	5.22	(3.68)	(4.12)
	Q2	(0.40)	3.63	(2.00)	(1.61)	5.12	(2.00)	(1.61)
	Q3	0.9	3.58	(1.3)	(2.2)	5.05	(1.3)	(2.2)
	Q4	1.0	3.53	(1.6)	(2.6)	4.97	(1.6)	(2.6)
2014	Q1	**0.6**	**3.50**	**(0.8)**	**(1.5)**	**4.9**	**(0.9)**	**(1.5)**
	January	0.3	3.5	(0.3)	(0.6)	4.9	(0.3)	(0.6)
	February	(0.2)	3.5	0.7	0.9	5.0	0.7	0.9
	March	(0.1)	3.5	(1.1)	(1.1)	4.9	(1.1)	(1.1)

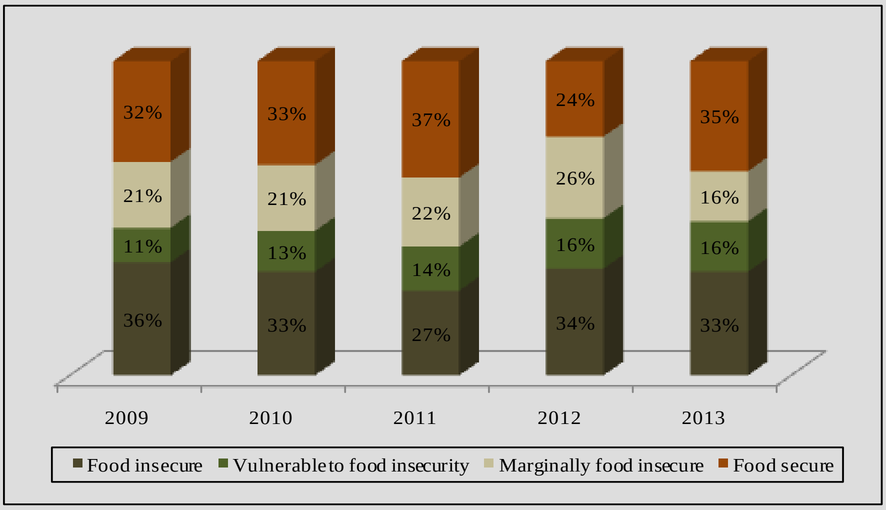
Source: Calculations based on data obtained from the PMA and the PCBS.
* Inflation rate represents the change in the NIS purchasing power.

[44] Purchasing power is defined as the value of a currency expressed in terms of the amount of goods or services that one unit of money can buy. It is directly dependent on the income of the consumer and the change in the rate of prices and (where more than one currency is involved) in the currency exchange rate. The change in purchasing power (assuming constant income) of the USD and JD can be measured as: 1 - (rate of change in the exchange rate of the currency against the shekel) times (the inversion of the rate of inflation) i.e. the change in purchasing power = 1 - (change in exchange rate) times (1/x) where x = 1 plus the rate of inflation.

Textbox 9: One third of Palestinian households experience food insecurity

The Palestinian Central Bureau of Statistics (PCBS), the Food and Agriculture Organization (FAO), the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) and the World Food Program (WFP) jointly released an annual report on the food security situation in Palestine. Lately, they published the 2013 survey[45] which found that food insecurity in Palestine remains at very high levels, with a third of households – 33 percent or 1.6 million people – food insecure. The report adopts the internationally accepted definition of food security: Food security exists when all people, at all times, have physical and economic access to sufficient safe and nutritious food that meets their dietary needs and food preferences conducive to an active and healthy life. The survey divides households into four groups: food secure, marginally food insecure, vulnerable to food insecurity and food insecure. Figure 1 shows household food security levels by group (2009-2013).

Figure 1: Household Food Security Levels in Palestine, 2009-2013



For both food insecure households and households vulnerable to food insecurity, the level of food insecurity remained almost unchanged between 2012 and 2013, while a significant proportion of marginally food insecure households became secure, thus raising the share of secure households by10 percentage points to 35 percent. The worrying levels of food-insecurity in 2012 and 2013 reversed the improvement that took place over the 2009-2011 period. According to the report, this deterioration coincides with an ongoing decrease in funding for critical UN programs focused on assisting those in greatest need.

The figures reveal a gap in the standard of living between households in the West Bank and Gaza Strip, on the one hand, and between refugees and non-refugees, on the other. The survey found that 57 percent of Gaza's households are food insecure, which is three times the rate in the West Bank (19 percent). In the West Bank, rates of food insecurity for refugees are similar to those for non-refugees (20 percent and 19 percent, respectively). Refugees in Gaza continue to report lower food-insecurity rates than non-refugees (54 per cent compared to 63 per cent for non-refugees).

According to the report, food insecurity is driven by high rates of poverty resulting from unemployment and the relatively high food prices in Palestine. Numerous studies on the Palestinian economy have found that high rates of poverty and unemployment are, in part, a result of the ongoing Israeli restrictions on access and movement, as well as the blockade that continues to suffocate the Gaza Strip.

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45 http://www.pcbs.gov.ps/site/512/default.aspx?tabID=512&lang=ar&ItemID=1134&mid=3915&wversion=Staging

Textbox 10: Palestine's Atlas of Poverty

In early 2014, the World Bank released a report entitled "Seeing is Believing: Poverty in the Palestinian Territories.'[46] The report was a collaborative effort, between the Palestinian Central Bureau of Statistics and the World Bank, that began in 2010 and culminated in the PCBS's release of *Palestine's Atlas of Poverty* in 2013. The Atlas provides a comprehensive visualization of the disparity in the distribution of poverty and other resources between different communities within Palestine.

Poverty mapping helps policy makers design programs aimed at fighting poverty regionally and within local communities. These maps are particularly important in countries with differences in levels of development between local communities across the country. This also applies to Palestine, since despite its small area, there is a relatively large variation in rates and characteristics of poverty in different regions. This, of course, is coupled with a disparity in the availability of natural and human resources, wealth, infrastructure, market development, population density, population structure and the percent of the population made up of refugees.

Poverty statistics in Palestine are based on the official definition of poverty- a definition that was introduced in 1998 according to the household consumption patterns obtained from the 'Survey of Palestinian Household Consumption and Spending.' However, because this estimate is based on a sample rather than a comprehensive census, it lacks some necessary details regarding geographical distribution. A survey of household spending and consumption can provide estimates about poverty at the national and regional levels and about type of locality (urban, rural, camp), as well as at the provincial level. However, policy-makers need indicators of the distribution and prevalence of poverty at more detailed levels- a requirement that the Survey of Household Consumption and Spending cannot provide.

Poverty maps give accounts of poverty rates at very specific geographical levels (small localities, and even households) in order to identify poor sections of society, which will, in turn, help in the process of planning and development for poverty reduction. By definition, an atlas of poverty is not necessarily limited to maps, it can involve social and economic databases that offer a range of other indicators with a clear and detailed visualization of the living conditions of a group of people in a geographical area.

Poverty maps in the Atlas of Poverty link two types of data produced periodically by the Palestinian Central Bureau of Statistics: data from the Survey of Household Consumption and Spending (2009-2010) and data from the General Census of Population and Housing (2007). This linkage helped in overcoming the shortcomings of the Survey of Household Consumption and Spending (being a survey based on a mere sample rather than a survey of the entire population) as well as the shortcomings in the General Census of Population and Housing (which does not provide information on consumption).

The Atlas modified the methodology for estimating the Palestinian poverty line in terms of the structure of the average household and the purchasing power in different areas within Palestine. The Palestinian Central Bureau of Statistics found that the average household size of 6 persons (2 adults and 4 children) has become less prevalent and eventually replaced by the 5-member family (2 adults and 3 children). Additionally, purchasing power in NIS differs in the three Palestinian areas due to differences in prices. This requires a modification of the value of the poverty line, as expressed in NIS in different areas. For example, an item which has a price of 100 shekels at the national level is 101 shekels in the West Bank, 112 shekels in Jerusalem and 94 shekels in Gaza.

The Atlas methodology is twofold:
First, it estimates the consumption of each household (in the Population and Housing Census) using the least square regression with relation to a set of explanatory indicators:

- Labor indicators: working-age males, working-age females, head of the household-labor force relationship, working status of the head of the household, workplace of the head of the household, the head of the household's work sector, the head of the household's economic activity, etc.
- Demographic indicators: number of adult males in a household, number of adult females in a household, sex of the head of household, age of the head of household, refugee status of the head of the household, marital status of the head of the household, the average household size, dependency ratio, etc.
- Educational indicators: formal education of the head of the household, the highest number of years of schooling for the family members, etc.
- Health indicators: type of health insurance, the number of individuals with disabilities in the household, etc.

[46] World Bank (2014): Seeing is Believing: Poverty in the Palestinian Territories. http://documents.worldbank.org/curated/en/2014/01/19243623/seeing-believing-poverty-palestinian-territories and http://www.pcbs.gov.ps/Portals/_PCBS/Downloads/book1987.pdf

- ✧ Housing indicators: housing type, density of housing, access to public water facilities, connection to the electricity grid, connection to a sewage network, the main source of energy used in cooking, the main source of energy used in heating, availability of durable goods (such as private cars, TVs, gas cookers, etc.), etc.

Second, comparing the average poverty rates (at the governorate level) that have been drawn from the model introduced above with poverty rates obtained from the survey of Household Consumption and Spending: This comparison ensures the validity and accuracy of the findings of the model. Indeed, there have been almost identical results, suggesting an accuracy of the information about the distribution of the detailed poverty rates in the 577 small communities (524 in the West Bank and 33 in Gaza).

The results of the regression model suggest that the rate of poverty in the West Bank is 21.3 percent compared to 37.6 percent in the Gaza Strip. Within the West bank, the governorate of Jericho reported the highest rate of poverty (31.3 percent), while the lowest rate was found in the governorate of Ramallah (8.9 percent). In the Gaza Strip, the highest rate of poverty was recorded in the governorate of Khan Younis (45.9 percent), while the lowest rate was reported in the governorate of Northern Gaza Strip (28.2 percent). These results are comparable to the poverty rates found in the actual consumption data obtained from the 2009 Survey of Household Consumption and Spending.

The Atlas of Poverty found that the highest poverty rates are mainly reported in the southern Hebron communities (sometimes reaching as high as 80 percent) and the Gaza Strip communities. Table 1 shows the distribution of poverty in the Palestinian governorates according to the regression model estimates.

Table 1: Poverty Rates in the Palestinian Governorates (2009)

Governorate	Poverty rate (%) in atlas of poverty
Jenin	19
Tubas	24
Tulkarm	21
Nablus	20
Qalqilya	16
Salfit	24
Ramallah	9
Jericho	31
Bethlehem	17
Hebron	30
Northern Gaza	28
Gaza	38
Deir Al-balah	41
Khan Younes	46
Rafah	33
West Bank (excluding Jerusalem)	21
Gaza Strip	38

The Atlas of Poverty has a wide array of maps that pictorially give a clear overview of the rates and distribution of poverty in Palestine by community (557 communities in the West Bank and the Gaza Strip). Other specific maps in the Atlas depict poverty within each of the governorates at the individual and community levels. There are also maps that show the distribution of the population over the different Palestinian territories. Another type of map outlines the distribution of the population in Palestine by the average number of household members. Still others represent the population distribution by unemployment rates among household heads; population distribution by unemployment rates among young people; and distribution of individuals by years of schooling. There are also maps that delineate the spread and distribution of primary and secondary schools (by sex and location), as well as the distribution and spread of medical facilities throughout the West Bank and the Gaza Strip.

The Atlas of Poverty is an ample source that provides a solid understanding of the prevalence, rates, forms, causes, and effects of poverty in Palestine. This information is essential when considering the development and implementation of successful policies aimed at fighting and reducing poverty.

7. Foreign Trade

7.1 Balance of Trade

The balance of trade is an account of Palestine's registered exports and imports of goods and services. The value of registered[47] commodity imports during Q1 2014 totaled USD 1,246.7 million, up 6.4 percent over Q4 2013 and 16.8 percent from the same quarter of 2013. The value of commodity exports was about USD 210.7 million—a decline of 9.1 percent from the previous quarter, but a growth of 7.6 percent over the corresponding quarter of 2013. These figures suggest a deficit of USD 1.036 billion in the commodity trade balance, a 10.2 percent increase from the previous quarter and an 18.9 percent increase over the corresponding quarter in 2013.

The recorded service imports from Israel surged by 19 percent as compared to the previous quarter and the corresponding quarter of 2013. Service exports, meanwhile, shrank by 8.8 percent, resulting in a trade deficit of USD 6.5 million, which is double the figure reported in 2013 Q4 or in 2013 Q1.

Table 7-1: Imports and Exports of Registered Goods and Services, 2012-2014

(USD millions)

Indicator	2012	Q1/2013	Q2/2013	Q3/2013	Q4/2013	2013**	Q1 2014
Goods imports	4,697.4	067.1,1	188,1	152.9,1	171.8,1	4,579.8	1,246.7
Service imports*	119.0	36.9	38.6	38.3	36.6	150.4	43.6
Goods exports	782.4	195.8	217.1	194.7	231.8	839.4	210.7
Service exports*	157.8	34.8	39.1	35.2	40.7	149.9	37.1

Source: Registered Foreign Trade, PCBS (2014).

* Exports and imports of goods and services from and into Israel only.

** Data for 2013 were obtained from official sources, and might be subject to modification.

7.2 Balance of Payments

According to the PCBS and the PMA, the current account deficit totaled USD 418.5 million in Q1 2014 (about 11.2 percent of GDP at current prices in the same period), up 14.6 percent from the previous quarter and 74.2 percent from the corresponding quarter a year earlier.

The current balance in the balance of payments consists of three items: the trade balance, the return on factors of production and the balance of current transfers.

The increase in the current account deficit resulted from a trade balance deficit of USD 1.293 billion against a surplus of USD 411.2 million in the income balance (generated mainly from Palestinian workers abroad) and a growth of USD 558.2 million in current transfers (mostly international aid).

The balance of payments consists of two main items: the current balance and the capital and financial account. The current account deficit was financed by the surplus in the capital and financial account, which secured USD 355.4 million (see Table 7-2). It is necessary to note that this item (the capital and financial account) represents a debt on the national economy as long as it has a positive value.

Strictly speaking, there should be a perfect balance between the current account deficit and the surplus of capital and financial account. In other words, the net value of these two items must be zero. However, there is often a gap between them, usually tallied under 'errors and omissions', the value of which was USD 63.1 million in Q1 2014.

[47] Registered imports and exports are those recorded in the clearing accounts and billing, while registered services involve only those traded with Israel.

Table 7-2: Palestinian Balance of Payments, Q1 2014

(USD millions)

	Q1/2013	Q2/2013	Q3/2013	Q4/2013	*2013	Q1/2014
1. Trade balance of goods and services*	**-1203.2**	**-1326.7**	**-1271.2**	**-1264.8**	**-5065.9**	**-1387.9**
- Net goods	-1106.1	-1226.9	-1174.6	-1125.7	-4633.3	-1293.1
- Net services	-97.1	-99.8	-96.6	-139.1	-432.6	-94.8
2. Income balance	**292.9**	**310.5**	**340.8**	**361.4**	**1305.6**	**411.2**
- Workers' remunerations received from abroad	292.5	306.7	337.7	349.4	1286.3	388.1
- Investment income received from abroad	28.6	30.2	33.9	36.8	129.5	35.9
- Income paid abroad	28.2	26.4	30.8	24.8	110.2	12.8
3. Balance of current transfers	**670.1**	**420.5**	**677.7**	**538.1**	**2306.4**	**558.2**
- Net transfers to the government	314.1	134.1	402.2	226.7	1077.1	189.9
- Net transfers to other sectors	393.1	326.1	316.4	362.1	1397.7	492.0
-Transfers paid abroad	37.1	39.7	40.9	50.7	168.4	123.7
4. Balance of current account (1 +2 +3)	**-240.2**	**-595.7**	**-252.7**	**-365.3**	**-1453.9**	**-418.5**
5. Net capital and financial account	**191.9**	**646.8**	**136.3**	**479.5**	**1454.5**	**355.4**
- Net capital transfers	144.2	59.1	59.7	87.0	350.0	80.0
- Net financial account	47.7	587.7	76.6	392.5	1104.5	275.4
- Net direct foreign investment	71.3	13.2	34.2	67.8	186.5	49.1
- Net portfolio investment	-72.1	-38.0	-24.9	24.9	-110.1	15.1
- Other net investment	69.3	595.1	34.5	350.5	1049.4	115.3
- Change in reserve assets (– = rising)	-20.8	17.4	32.8	-50.7	-21.3	95.9
6. Net errors and omissions	**48.3**	**-51.1**	**116.4**	**-114.2**	**-0.6**	**63.1**

Source: PCBS and the PMA, 2014. Preliminary quarterly results of the Palestinian Balance of Payments.

* Figures of exports and imports of commodities and services in the balance of payments differ from the figures in the trade balance because the latter records only exports and imports that are registered (i.e. recorded in the clearing accounts and billing), while the balance of payments records the total expected value of imports and exports. In addition, import and export of services from Israel are recorded only in the trade balance, while the balance of payments records services from different sources.

7.3 External Assets, Liabilities and Debt– 2012

In 2014 Q1, Palestine's foreign assets (overseas investments by Palestinians) totaled USD 6.318 billion. Nearly, 5 percent of total foreign assets was in the form of direct investment, while portfolio investment represented 21.2 percent. At the sectoral level, foreign investment of the banking sector accounted for the bulk of total foreign assets (approximately 71.7 percent).

Table 7-3 : Net international investment position (NIIP) as of March 31, 2014

(USD millions)

Item	Balance as of March 31, 2014
Net external deposits and investments (net foreign assets)	**1,341**
Total assets	**6,318**
Direct foreign investment abroad	346
Foreign portfolio investment abroad	1340
Other foreign investments abroad, including	4,043
Currency & other deposits	3,951
Reserve assets	589
Total liabilities	**4,977**
Direct foreign investment in Palestine	2,501
Foreign portfolio investment in Palestine	776
Other foreign investments in Palestine	1,700

Source: PCBS and PMA, 2014: Press release on international investment position and external debt as of the end of Q1 2014

Total external liabilities (domestic investments and assets held by foreigners) reached USD 4,977 million (50.3 percent as foreign direct investment, 15.6 percent as foreign portfolio investment, and 34.1 percent for other foreign investments).

These figures suggest that overseas investments by Palestinians were USD 1.341 billion higher than total external liabilities. We should, however, consider this difference with some caution, as the majority of overseas investments by Palestinians take the form of deposits by Palestinian banks abroad. Indeed, foreign direct investment in Palestine outweighs actual Palestinian investment abroad by USD 2.156 billion.

Palestine's external debt, in the meantime, totaled USD 1.718 billion at the end of 2014 Q1, with the government (64.4 percent) and the banking sector (32.1 percent) as the main debtors.

Table 7.4: Palestine's total external debt, by sector, as of March 31, 2014

(USD millions)

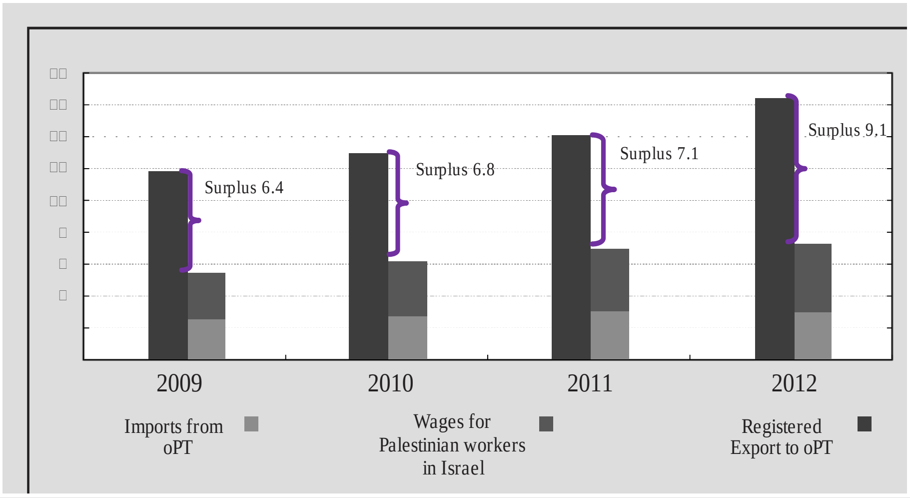
Economic Sector	**Balance as of March 31, 2014**
Government	**1,105**
Short-term debt	78
Long-term debt	1,027
PMA	**0**
Short-term debt	0
Long-term debt	0
Banks	**552**
Short-term debt	552
Long-term debt	0
Other sectors	**43**
Short-term debt	7
Long-term debt	36
Direct investment (Intercompany lending)	**18**
Debt liabilities to affiliated enterprises	0
Debt liabilities to direct investors	18
Gross external debt	**1,78**

Source: PCBS and PMA, 2014: Press release on international investment positions and external debt as of the end of Q1 2014

Textbox 11: Israel's exports to Palestine: Low technological content and limited value-added products

In June 2014, the Central Bank of Israel published in its *Recent Economic Developments* Journal a study on the trade links between Israel and the Palestinian Authority.[48] The study mentions that the value of Israeli registered exports to Palestine reached NIS 16.4 billion in 2012 (the last year for which data are available in full). During the same period, Palestinian registered exports to Israel had a value of NIS 3 billion. This gap was relatively narrowed by the payments Palestinian workers received from their employment in Israel's market (about NIS 4.3 billion), an export of services which brought down the trade deficit with Israel to NIS 9.1 billion in 2012. As demonstrated in Figure 1, the net trade in goods and services rose steadily over the past few years in favor of Israel's economy from NIS 6.4 billion in 2009 to NIS 7.1 billion in 2011 to NIS 9.1 billion in 2012.

Figure 1: Palestine-Israel registered balance of trade in goods and services, 2009-2012 (NIS billions)



Israel's reported exports to Palestine in 2012 represented about 5 percent of total Israeli exports (excluding diamonds) and around 1.7 percent of Israel's GDP. Registered commodity exports had a value of NIS14.8 billion, or about 8 percent of total commodity exports, making Palestine the second largest importer of Israeli commodities behind the United States (roughly NIS 41 billion). According to the study, this figure suggests at first glance that the Palestinian economy is very important for Israeli exports, especially when the Palestinian GDP is barely 4 percent of Israel's GDP. However, the uncertainty that surrounds the origin of some goods, their sectoral distribution and their added value hint at their limited importance for the Israeli economy.

The study obtained figures of Palestine-Israel trade from clearance bills that are used to calculate and transfer the value-added taxes between the two sides. This source, according to the authors of the study, has three major shortcomings:

- ✧ Clearance bills do not have figures for trade in agricultural products, since they are exempt from VAT. The authors obtained agricultural trade figures directly from the records of Israel's Ministry of Agriculture and not clearance bills.
- ✧ A quite large part of trade between the two sides is not recorded in clearance bills. This includes West Bank and East Jerusalem's direct purchases from the Israeli market and Israelis' direct purchases from the Palestinian market,[49] as well as smuggling activities.
- ✧ Clearance bills do not distinguish between actual export and re-export. Palestinian imports from Israel are either produced in Israel or originate abroad, sold to Israel and then resold to the Palestinian market. The clearance bills do not distinguish which products imported into Palestine originate abroad and which originate in Israel.

[48] Trade links between Israel and the Palestinian Authority”. Recent Economic Development, October 2013-March 2014. Bank of Israel
http://www.boi.org.il/he/NewsAndPublications/PressReleases/Documents/heb-137.pdf

[49] According to the study, the PMA estimated Israeli Arabs' direct purchases from the West Bank market at about 1.2 billion shekels in 2011.

The last point was of particular significance to the study whose main aim was to assess the importance of trade with Palestine for Israel's economy.

Clearance bills classify trade activities between Israel and Palestine according to the type of company that imports and exports rather than the type of manufacturer or producer (in the method used in international trade statistics). Although some Israeli manufacturers sell their products directly to Palestinian market, a large part of Israel's trade with the West Bank and the Gaza Strip (27 percent, excluding fuel) is recorded as exports by Israeli companies.

For the sake of accurate estimates of the importance of these exports for Israel, the study adopted two different approaches in categorizing Israel's exports to the West Bank and Gaza. The first approach assumes that all goods Israel exports to Palestine are originally imported goods entering Israel (assuming the minimum importance of the Palestinian market for Israel's manufacturers). The second approach assumes that all of these goods are produced in Israel (assuming the maximum importance of the Palestinian market for Israel's manufacturers).

Table 1 reveals that in 2012, the value of Israeli industrial exports to Palestine totaled NIS 3.3 billion (in the minimum estimate) or NIS 9.6 billion (in the maximum estimate). The majority of these exports consist of oil derivatives and chemicals (20 percent in the minimum estimate and 37 percent in the maximum estimate) or foodstuffs (21 percent in the minimum estimate and 35 percent in the maximum estimate). However, sales of oil derivatives to Palestine are barely 4.1 percent of their sales in the Israeli market, while the sale of foodstuffs to the Palestinian market is roughly 3.4 percent of the sales in the Israeli market, according to the maximum estimate (see Table 1). The only exception is in wood products, where, according to the maximum estimate, 19 percent of the revenue comes from exports to the Palestinian market. This estimate, we should reiterate, assumes that the wood product imports sold to Palestine are entirely produced in Israel.

Technological content of exports

The study found that Israeli exports to Palestine are of low technology content (59 percent of manufactured exports) or medium-low-technology content (14 percent of manufactured exports). The high-technology exports constitute just 3 percent of Israel's total manufactured exports to the Palestinian market. By contrast, 45 percent of Israel's total manufactured exports to international markets have a high-tech content, while low technology content exports are merely 7 percent. In fact, the Palestinian market is a destination for around 17 percent of Israel's total low technology exports. The Palestinian imports from Israel are highly concentrated in electricity, water, oil derivatives and foodstuffs (see Table 1), which largely explains the reason behind the low technological content.

Table 1: Importance of the Palestinian market for the Israeli economy- by registered exports classification

	First classification (minimum)			First classification (maximum)		
	Sales to Palestine (NIS millions)	**As % to total**	**As % to sector's revenues**	**Sales to Palestine (NIS millions)**	**As % to total**	**As % to sector's revenues**
Total exports	**16,467**	**100**	**1.0**	**16,467**	**100**	**1.0**
Agricultural products and fish	885	5.4	2.3	1,638	9.9	4.3
Industry and quarries	3,363	20.4	0.8	9,648	85.6	2.4
○ Manufactured food products	1,189	7.2	2.0	2,052	12.5	3.4
○ Beverages and tobacco	288	1.7	3.7	529	3.2	6.7
○ Wood products	117	0.7	5.8	385	2.3	19.0
○ Paper products	266	1.6	3.5	309	1.9	4.1
○ Oil and chemical products	675	4.1	0.8	3,651	22.2	4.1
Electricity, water and sewage	3,181	19.3	7.2	3,254	19.8	7.3
○ Electricity	3,046	18.5		3,119	18.9	
○ Water and sewage	135	0.8		135	0.8	
Construction	142	0.9	0.1	253	1.5	0.2
Vehicle wholesale, retail and repair	172	1.0	0.3	7	0.0	0.0
Wholesale and retail trade	7,100	43.1	1.6	1	0.0	0.0
○ Fuel wholesale and retail trade	2,759	16.8				
Transportation, storage and mail	520	3.2	0.7	520	3.2	0.7
Financial and insurance services	752	4.6	3.1	752	4.6	3.1
Other	352	2.1	0.1	352	2.1	0.1

Value-added content of exports

The study found that in 2012, the value-added content (the sum of profits, wages and taxes) of Israeli exports to the Palestinian market was somewhere between NIS 6.1 billion (in the minimum estimate) and NIS 8.9 billion (in the maximum estimate), representing 0.8 percent (in the minimum estimate) or 1.2 percent (in the maximum estimate) of total production in Israel. The ratio of the value-added to the total value of sales (according to the maximum estimate) was 54 percent for Israel's exports to Palestine, compared with 68 percent for Israel's exports to international markets. This relatively low proportion is a result of the low value-added oil refining (11 percent) and the high share of Israeli refined oil exports to Palestine (see Table 2).

Table 2: Total value added of Israeli exports to Palestine (2012)

(NIS millions)

	First classification (minimum)	**First classification (maximum)**
Total exports	6,084 (0.8% of production)	8,888 (1.2% of production)
- Agricultural products and fish	716	1,345
- Industry and quarries	2,026	4,038
- Electricity and water and	1,883	1,925
- Transportation and storage	414	414
- Telecommunications and information	137	163
Financial and Technology Services	747	747

Textbox 12: Incorporating illegal activities in GDP calculation

The announcement by Italian National Institute of Statistics (Istat)– that from October 2014 it would include drug trafficking, prostitution, alcohol-and-tobacco smuggling and illegal brokering in its economic-output calculations– has sparked discontent from statistics bodies around the world. To some critics, the decision smacks of 1987, when Istat started taking account of its shadow economy (the off-the-books business involving legal transactions concluded without proper reporting to the tax department). As a result of the 1987 decision, the Italian economy grew by 18 percent overnight, overtaking Britain to be the West's fourth-largest economy. After two decades of economic mismanagement, however, Italy's economy has tumbled back down global GDP rankings.[50]

In fact, with the two decisions, Italy was merely one of the first countries to announce its compliance with international GDP accounting standards. Under the European System of Accounts (ESA), all economically productive activities (whether legal or illegal) which all parties take part in voluntarily must be reported and recorded in the national accounts. However, the ESA guidelines have not outlined how to measure drug deals, fake cigarettes and other illegal activities. This is probably the reason why few countries comply with the ESA guidelines when calculating GDP.

For the European Union, which strives to unify the national accounts systems in all countries of the euro zone, a unified GDP calculation system would help the Union determine the contribution of each country to the EU budget and the amount of aid members might receive, of course based on actual figures. Experts estimate that the inclusion of illegal activities in the national accounts would lead to an increase in French GDP of 3.2 percent– equivalent to two or three years' growth at current rates. On the other hand, UK's Office of National Statistics announced that the inclusion of illegal activities in the national accounts would not lead to a significant increase in the UK’s GDP.[51] Though Istat admits that tracking such activities is a difficult business, experts say that Italy was a pioneer in estimating the shadow economy and that the methods it introduced for that purpose were rather successful. The various European states’ accounting bodies are now waiting on tenterhooks to see the next move of Istat and assess the option of copying the Italian experience in the rest of the European continent, or even the whole world.

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[50] In a former issue of the *Monitor*, we discussed the inclusion of spending on research & development and artwork in the calculation of GDP, which increased the US GDP by 3.6 percent and Israel's GDP by 7 percent. See *Quarterly Economic and Social Monitor*, Issue 34, November 2013).

[51] The Economist, May 21st, 2014.

Key Economic Indicators in the West Bank and the Gaza Strip for the years 2000-2013

Indicator*	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Population (mid-year, thousands)														
Occupied Palestinian Territory	3,053.3	3,138.5	3,225.2	3,314.5	3,407.4	3,508.1	3,612.0	3,719.2	3,825.5	3,935.25	4,048.40	4,169	4,293	4,420
- West Bank	1,943.7	1,992.6	2,042.3	2,093.4	2,146.4	2,203.7	2,262.7	2,323.5	2,385.2	2,448.4	2,513.3	2,580	2,649	2,719
- Gaza Strip	1,109.7	1,145.9	1,182.9	1,221.1	1,261.0	1,304.4	1,349.3	1,395.7	1,440.3	1,486.8	1,535.12	1,589	1,644	1,701
Labor Market														
Number of Employees (thousands)	600	505	477	564	578	603	636	690	667	718	745	837	858	885
Participation Rate (%)	41.5	38.7	38.1	40.3	40.4	40.4	41	41.7	41.2	41.6	41.1	43	43.4	43.6
Unemployment (%)	14.1	25.2	31.3	25.6	26.8	23.5	23.7	21.7	26.6	24.5	23.7	20.9	23	23.4
- West Bank	12.2	21.6	28.2	23.7	22.8	20.4	18.8	17.9	19.7	17.8	17.2	17.3	19.0	18.6
- Gaza Strip	18.9	34.0	37.9	29.1	35.3	30.3	34.8	29.7	40.6	38.6	37.8	28.7	31.0	32.6
National Accounts** (Million US Dollars, constant 2004 prices)														**Constant 2010 prices**
GDP	4,146.7	3,810.8	3,301.4	3,800.5	4,198.4	4,559.5	4,322.3	4,554.1	4,878.3	5,239.3	5,724.5	6,421.4	6,797.3	11,906.9
GDP per capita (USD)	1,460.1	1,303.5	1,097.2	1,227.3	1,317.0	1,387.2	1,275.4	1,303.2	1,356.3	1,415.2	1,502.1	1,635.2	1,679.3	2,855.1
Household Expenditure	3,981.3	3,884.5	3,589.7	4,088.9	4,400.3	4,467.5	4,197.5	4,591.2	4,851.9	5,229.4	5,204.0	5,713.0	6,436.8	9,828.9
Public Expenditure	1,080.3	1,003.7	930.3	886.4	1,048.9	833.3	870.4	892.7	995.9	1,159.5	1,322.3	1,772.2	2,027.1	2,987.5
NGOs Expenditure	135.1	164.1	184.3	200.4	152.3	196.7	189.0	185.9	290.9	305.5	270.2	264.3	260.2	346.2
Gross Capital Formation	1,386.7	992.3	841.7	1,063.0	1,022.3	1,265.7	1,347.2	1,122.9	1,060.5	1,137.3	1,090.5	1,066.8	1,074.0	2,654.8
Balance of Payments (million, US Dollar)														
Commodity Exports		339	282	318	348	378	378	562	569	631	666	1,525	1,250	1,675
Commodity Imports		1,980	1,507	1,782	2,300	2,613	2,738	3,280	3,511	4,136	4,319	6,188	6,134	6,122
Net Balance of Goods Trade		(1,641)	(1,224)	(1,464)	(1,952)	(2,236)	(2,352)	(2,718)	(2,942)	(3,504)	(3,653)	(4,663)	(4,884)	(4,447)
Services Exports		117	103	154	192	202	179	252	357	579	831	686	649	608
Services Imports		603	600	475	519	451	455	634	698	931	1,143	948	1,032	1,038
Net Balance of Services Trade		(486)	(497)	(320)	(327)	(249)	(275)	(382)	(342)	(352)	(312)	(262)	(353)	(430)
Current Account		(875)	(452)	(854)	(1,334)	(1,020)	(944)	(467)	530	(713)	(691)	(2,430)	(2,815)	(1,317)
Exchange Rates and Inflation														
Average US$ /NISl	4.086	4.208	4.742	4.550	4.477	4.482	4.454	4.110	3.587	3.929	3.739	3.578	3.85	3.61

Indicator*	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Average JOD/NIS	5.811	5.928	6.674	6.417	6.307	6.317	6.292	5.812	5.061	5.542	5.275	5.050	5.43	5.09
Inflation Rate (%)***	2.8	1.2	5.7	4.4	3.0	4.1	3.8	1.9	9.9	2.75	3.75	2.88	2.78	1.72
Public Finance (million US Dollar, on a cash basis)														
Domestic Revenues (net)	939	273	290	747	1,050	1,370	722	1,616	1,780	1,548.4	1,900.4	2,176	2,240	2,320
Recurrent Expenditures	1,199	1,095	994	1,240	1,528	1,994	1,426	2,567	3,273	2,920	2,983	2,952	3,047	3,250
Development Expenditure	469	340	252	395	0	287	281	310	-	46.8	275.1	296	211	168
Recurent Budget Before Foreign Aid	(260)	(822)	(704)	(493)	(478)	(624)	(704)	(951)	(1,493)	(1,342)	(1,083)	(776)	(807)	(931)
Total Foreign Grants & Aid	510	849	697	620	353	636	1,019	1,322	1,763	1,402	1,277	978	932	1,358
Total Budget After Foreign Aid	(219)	(313)	(259)	(268)	(125)	(275)	34	61	270.2	(144)	(81)	(94)	(86)	259
Public Debt	795	1,191	1,090	1,236	1,422	1,602	1,494	1,439	1,406	1,736	1,883	2,213	2,483	2,376
Banking Sector (million US Dollars)														
Assets/Liabilities	4,593	4,430	4,278	4,728	5,101	5,604	5,772	7,004	5,645	7,893	8590	9,110	9,799	11,195
Equity	242	206	187	217	315	552	597	702	857	910	1,096	1,182	1,258	1,362
Clients' Deposits	3,508	3,398	3,432	3,625	3,946	4,190	4,216	5,118	5,847	6,111	6,802	6,973	7,484	8,306
Credit Facilities	1,280	1,186	942	1,061	1,417	1,788	1,843	1,705	1,829	2,109	2,825	3,483	4,122	4,480

Source: Palestinian Central Bureau of Statistics, the Palestinian Monetary Authority.

* All data, except population and labour, exclude the part of Jerusalem governorate which was annexed by Israel following 1967 war.

** Foreign trade figures are taken from the Balance of Payments tables prepared by the Palestinian Central Bureau of Statistics in collaboration with PMA.

*** Inflation rate is the percentage increase of consumer prices index in a year relative to the index in previous year.

- Figures in brackets are negative.