

Economic Monitor

55

Palestine Economic Policy Research Institute (MAS)
Palestinian Central Bureau of Statistics (PCBS)
Palestine Monetary Authority (PMA)
Palestine Capital Market Authority (PCMA)

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FOREWORD

- **GDP:** GDP rose during Q3 2018 by 4% compared with the previous quarter (at 2015 constant prices), which is attributed to an increase in the West Bank of 4.4% and of 2.5% in the Gaza Strip. This led to an increase in per capita GDP by about 3.8% in the West Bank and by 1.8% in the Gaza Strip. However, compared with the corresponding quarter 2017, per capita GDP declined by 1.1% in the West Bank and 9.3% in the Gaza Strip.
- **Employment and Unemployment:** The unemployment rate in Palestine declined by 0.7 percentage points in Q3 2018 compared with the previous quarter, reaching 31.7% (17.3% in the West Bank and 54.9% in the Gaza Strip). The percentage of private sector waged workers who earn sub-minimum wages was 31%, which attests to a significant drop compared with the corresponding quarter 2017 (38%).
- **Public Finance:** In Q3 2018, public expenditures amounted to NIS 3.3 billion. External funding for budget support reached NIS 522 million (58% of which from Arab countries), whereas external funding for developmental expenditure reached NIS 171.3. The government's arrears amounted to NIS 724.7 million, and the public deficit dropped by 0.5% compared with the previous quarter, reaching USD 2.4 billion.
- **Banks:** during Q3 2018 credit facilities grew by 0.4% compared to Q2 of the same year, reaching USD 8.3 billion, 14% of which were granted to the public sector. On the other hand, non-bank deposits were stable at around USD 12.2 billion during the same period.
- **PEX:** The market value of shares listed on PEX reached USD 3.7 billion by the end of Q3, a drop of 3% compared with the corresponding quarter. Al Quds index closed at 528.8 points, a drop of 7% compared with the corresponding quarter 2017.
- **Vehicles Registration:** The number of new and second-hand vehicles (registered for the first time) in the West Bank reached 8,361 in Q3 2018, 79% of which were second-hand vehicles imported from international markets and Israel.
- **Inflation and Prices:** During Q3 2018, the inflation rate in Palestine was 0.49% compared with the previous quarter. This implies a decrease in the purchasing power of those who receive and spend their income in shekels. The purchasing power of those who receive their salaries in dollars and dinars and spend in shekels increased by 1.25% and 1.56% compared with the previous and corresponding quarter respectively.
- **The Balance of Payments:** During Q3 2018, the deficit in the Palestinian balance of payments reached USD 444.7 million. This is attributed to a deficit in the trade balance (USD 1.5 billion), against a surplus in the balance of income (USD 608.8 million) and a surplus in the balance of transfers (USD 467.1 million).

Note: The fractional components of ratios in the Monitor's sections, except for GDP and Prices and Inflation and Interest Rates, are presented as integer figures.

CONTENTS

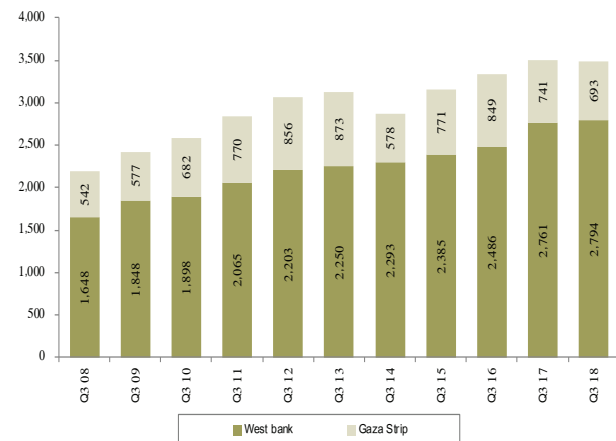
- ◆ **GDP**
- ◆ **Labor Market**
Box 1: Human Capital in Palestine: Half of what it can be!
- ◆ **Public Finance**
Box 2: Palestine in 2050: 2 million more jobs needed
- ◆ **The Banking Sector**
Box 3: The excess NIS amounts: causes and solutions
Box 4: Financial Inclusion in Palestine
- ◆ **Non-Banking Financial Sector**
Box 5: Survey of establishments, workers, productivity and profits in Palestine
- ◆ **Investment Indicators**
Box 6: Industrial Estates and Free Zones in Palestine
- ◆ **Prices and Inflation**
Box 7: Economic Outlook for the Middle East and North Africa (MENA) countries
- ◆ **Foreign Trade**
- ◆ **Economic Concepts and Definitions: The Dutch Disease**
- ◆ **Key Economic Indicators in Palestine 2013-2018**

1. GDP¹

Gross Domestic Product (GDP) is a monetary measure of the market value of all types of goods and services produced in an economy during a specific period of time. Palestinian GDP rose by 4% in Q3 2018 compared with the previous quarter, reaching USD 3,486.5 million (at 2015 constant prices): 80% of this was produced in the West Bank and the remaining share in the Gaza Strip. The growth in GDP distributed as 4.4% in the West Bank and 2.5% in the Gaza Strip. Comparing the corresponding quarters (Q3 2018 and Q3 2017), GDP declined by 0.5% in Palestine, composed of a rise of 1.2% in the West Bank against a decline of 6.5% in the Gaza Strip (Figure 1-1).

This increased GDP during Q3, accompanied by an increase in the population, resulted in an increase in per capita GDP by 3.4% compared with the previous quarter. Compared with the corresponding quarter 2017, however, per capita GDP was lower by 2.9% (Table 1-1).

Figure 1-1: Palestinian GDP* by Corresponding Quarters (at 2015 constant prices) (USD million)



(*) Data do not include that part of Jerusalem which was annexed by Israel following the West Bank occupation in 1967. Figures differ from those presented in the previous issue of the Monitor as the percentages of the two regions for the years 2017-2018 were revised.

Figure 1-2: GDP in the West Bank* and Gaza Strip (constant prices) %

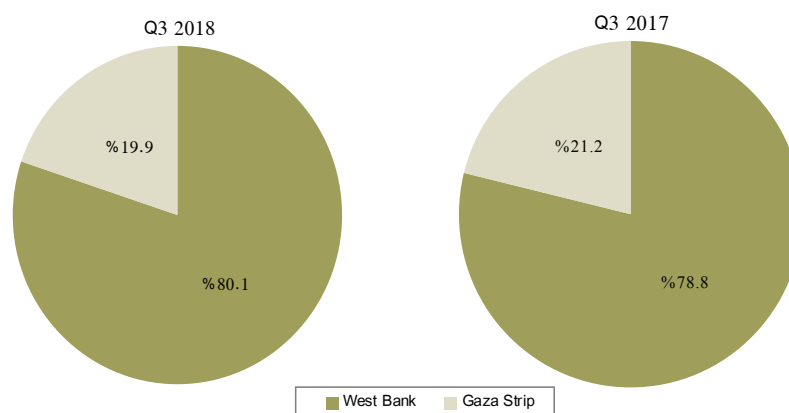


Table 1-1: Per capita GDP* by Region (constant prices, base year 2015) (USD)

	Q3 2017	Q2 2018	Q3 2018
Palestine	783.6	735.8	760.5
-West Bank	1,068.0	1,018.1	1,056.5
-Gaza Strip	393.5	350.8	357.1

(*) Data do not include that part of Jerusalem which was annexed by Israel following the West Bank occupation in 1967.

The GDP Gap between the West Bank and the Gaza Strip

The GDP gap between the West Bank and the Gaza Strip has expanded over the last decade (Figure 1-1). Gaza Strip's share of GDP declined further (by 0.3 percentage points) in Q3 2018 compared with Q3 2017. In Q3 2018, Gaza Strip's contribution to GDP was around 20% compared with 25% in Q3 2017. Meanwhile, the gap in the per capita GDP between the West Bank and Gaza Strip increased further because of the

higher increase of the population in the Strip. The per capita GDP in Gaza Strip is less than third of per capita GDP in the West Bank (Figure 1-2).

Composition of GDP

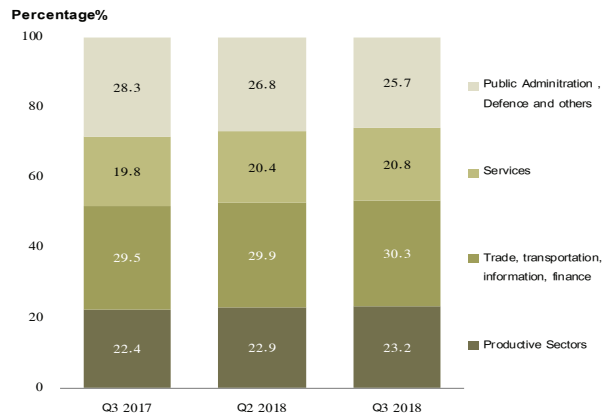
The contribution of the productive sectors to Palestinian GDP increased by 0.3 percentage point between Q2 and Q3 2018, driven by an increase in the share of the industrial and agriculture sectors. Meanwhile, the share of the services sector increased by 0.4 percentage point against a decline in the share of administration and security (Figure 1-3).

Expenditure on GDP

The absolute decrease in GDP between Q3 2017 and Q3 2018 amounted to about USD 15.8 million (a decline of 0.5% as shown above). This is the result of the rise in final consumption expenditure (public and private) of USD 44.4 million, and in investment of USD 39.3 million. This increase was offset by the increase in net imports (minus exports) of USD

1 Source: PCBS, 2018, Periodic Statistics on National Accounts, 2008-2018. Ramallah- Palestine.

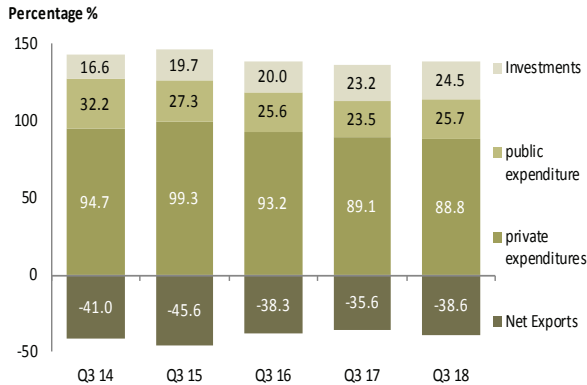
Figure 1-3: % Contribution of Economic Sectors to Palestinian GDP* (constant prices, base year 2015)



100.4 million. In other words, the increase in consumption and investment was accounted for by a larger increase in net imports (refer to figure 1-4 showing expenditure shares of GDP).

The total does not equal 100%, due to 'net errors and omissions' item.

Figure 1-4: % Expenditure on GDP in Palestine* (constant prices, base year 2015)

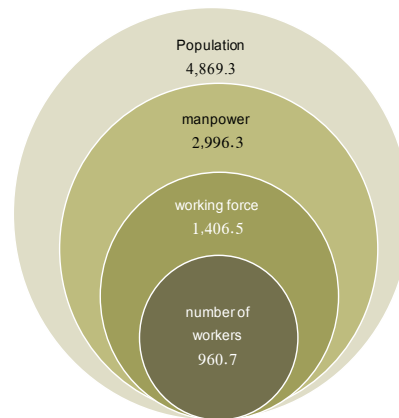


(* Data do not include that part of Jerusalem which was annexed by Israel following its occupation of the West Bank in 1967.

2- Labour Market¹

According to PCBS, manpower (all persons aged 15 years and above) in Palestine amounted to 2,996 thousand person by the end of Q3 2018. The labor force (all persons qualified to work and actively seeking employment) amounted to 1,407 thousand. The workforce comprises workers/labor force and the unemployed. The difference between the labor force and the actual number of employed, i.e. workforce, is the measure of the rate of unemployment. Figure 2-1 shows the relation between these three variables and the size of population in Q3 2018.

Figure 2-1: The Total Population, Manpower and Workforce in Palestine (Q3 2018) (Thousands)



As shown in Figure (2-1), the participation rate (ratio of labor force to manpower) reached 47% in Palestine. This ratio is close to the general average in the Middle East, reaching 48% in Turkey for example. However, compared with many developing countries, the Palestinian rate is considered low (63% in Latin America, 61% in South Korea).² This is mainly attributed to the low female participation rate in Palestine.

Distribution of Workers

The number of workers in Palestine increased by 4.2% between Q2 and Q3 2018 (a decline of 1% in the Strip against 6% rise in the West Bank), reaching 960.7 thousand. By region, 61% of workers were in the West Bank, around 25% were in Gaza Strip and 14% (around 132 thousand) in Israel and the colonies. By sector, the public sector employed around one fifth of workers in Palestine, while this ratio rises to 35% in the Gaza Strip (Figure 2-2).

Figure (2-3) presents the sectoral distribution of Palestinian employed (including those working in Israel and the colonies) during Q3 2018. The number of workers in the services sector in Palestine was 34% of total number of workers, rising to 53% in the Gaza Strip. The number of workers in the construction and building sector was 24% in the West Bank compared with less than 4% in the Gaza Strip. The ratio of workers employed in the trade, restaurants & hotels sectors in the West Bank is close to that in the Gaza Strip, about 22%.

¹ Data for this section draws on PCBS, 2018, Labor Forces Survey, 2018. Ramallah, Palestine.

² World Bank database.

Unemployment

The number of the unemployed in Palestine stood at 445.8 thousand by the end of Q3 2018. The unemployment rate (the number of unemployed workers divided by the labor force) was 32% in Q3 2018, 2 percentage points more than the corresponding quarter of 2017 and less by 0.7 percentage compared with the previous quarter. The rise of the unemployment rate in Palestine over the corresponding quarters was driven by an 8 percentage point rise in the Gaza Strip, despite it's a decline in the West Bank of 1.6 percentage points among both males and females (Table 2-1).

Table 2-1: Unemployment Rate among Labor Force Participants in Palestine by Region and Gender (%)

		Q3 2017	Q2 2018	Q3 2018
West Bank	Males	15.4	16.0	14.0
	Females	34.2	31.8	32.1
	Total	18.9	19.1	17.3
Gaza Strip	Males	39.4	44.5	46.3
	Females	71.1	78.3	78.0
	Total	46.9	53.7	54.9
Palestine	Males	24.2	26.4	25.5
	Females	50.4	53.7	54.0
	Total	29.6	32.4	31.7

Two of the enduring characteristics of unemployment in Palestine are that:

1. It is high among youth compared with the general average: the unemployment rate in the age group 15-24 years reached 48% (80% for females against 41% for males). This indicates that a large proportion of the unemployed are new entrants to the labor market (see Figure 2-4 and Box 1: Results of the Survey of the Youth Transition from Education to the Labor Market in Issue 47 of the Economic Monitor).
2. The unemployment rate decreases with the attainment of higher educational levels for males, contrary to females (Figure 2-5): The unemployment rate in Q3 2018 reached 27% for males who had not completed secondary education, while it was 22% for males with tertiary education. On the other hand, the unemployment rate for females with a tertiary education was 57%, against 40% for females who had not completed secondary education (see Figure 2-5 and Box 1: in monitor issue (53) discussing this important phenomenon).

Wages

The average daily wage for workers in Palestine amounted to NIS 125.3 in Q3 2018. Yet this figure masks the wide divergence between the average wage for workers in the West Bank and the Gaza Strip on the one hand, and that for workers in Israel and the colonies on the other hand, and between the average wage in the West Bank and that in the Gaza Strip (Table 2-2).

As figures demonstrate, the average wage of workers in Israel and the colonies is four times the wage of workers in the Gaza Strip. The gap is even wider when considering the median wage, which

Figure 2-2: % Distribution of Palestinian Workers by Region and Sector, Q3 2018 (%)

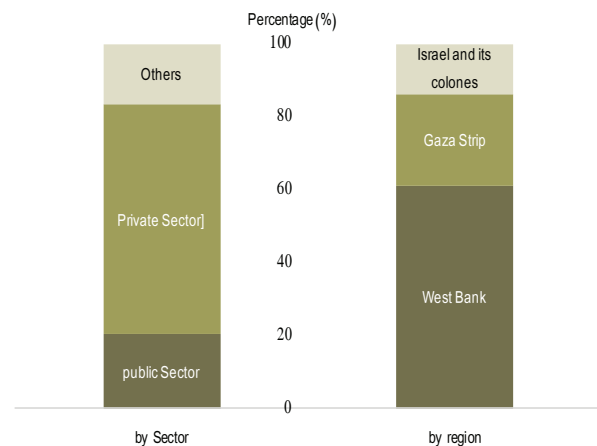


Figure 2-3: % Distribution of Palestinian Workers by Economic Activity, Q3 2018 (%)

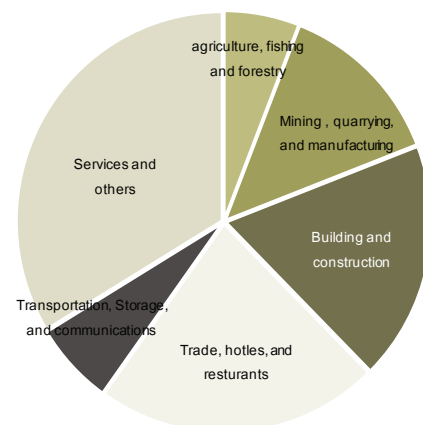
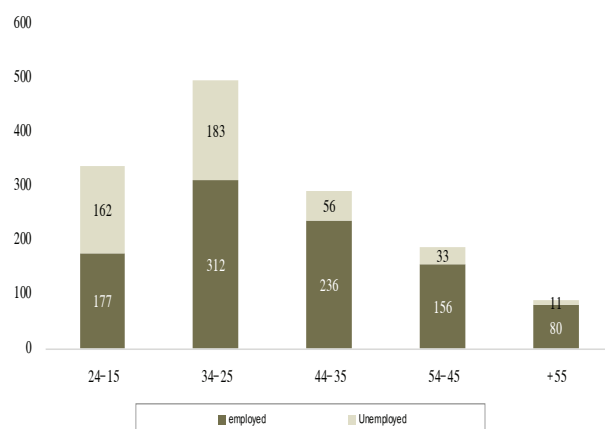


Figure 2-4: Number of Employed and Unemployed in Palestine by Age Group (Q3 2018) (Thousands)



is a stronger indicator than the average wage, because it marks the topmost wage level for half of all workers (the other half receiving wages above that level. Notably, the median wage in the Gaza Strip is less than half that in the West Bank (Table 2-2).

The average daily wage of workers rose by NIS 1.3 between Q2 and Q3 2018, as a result of the rise of the average wage of workers in the West Bank (by NIS 2.5), in Israel and the colonies (by NIS 4.2), and in Gaza Strip (by NIS 2.9).

Table 2-2: Average and Median Wages of Waged Workers, Palestine, Q3 2018 (NIS)

Work Place	Average Daily Wage	Median Daily Wage
West Bank	110.4	100.0
Gaza Strip	60.2	39.4
Israel and the colonies	243.7	250.5
Total	125.3	100.0

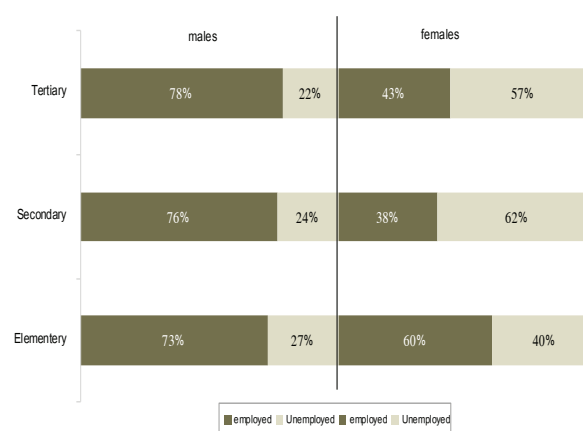
Minimum Wage

During Q3 2018, waged workers employed by the private sector who earned sub-minimum wages (less than NIS 1,450) reached 31%: 35% females and 31% males. The average monthly wage of those workers was NIS 782. By region, 11% of the private sector waged workers in the West Bank were sub-minimum wage earners, compared with 84% in the Gaza Strip (Table 2-3). Compared with the corresponding quarter 2017, the percentage of waged workers who are sub-minimum wage earners declined during Q3 2018 by 7 percentage points, and the average daily wage decreased from NIS 839 to NIS 782.

Table 2-3: The Number and Average Wage of Waged Workers Employed by the Private Sector and the Number and Average Wage of those who Earned Sub-minimum Wages (do not include workers in Israel and the Colonies), Q3 2018

	Number of waged workers in the private sector (Thousand)			Number of waged workers who earn sub-minimum wages (less than NIS 1,450) (Thousand)			Average monthly wage for sub-minimum wage earners (NIS)		
	males	females	Both	males	females	both	males	females	Both
West Bank	191	35	226	13	11	24	1,181	1,007	1,101
Gaza Strip	81	7	89	70	4	74	689	498	679
Palestine	272	42	314	83	15	98	766	873	782

Figure 2-5: Number of Employed and Unemployed in Palestine by Educational Level and Gender % (Q3 2018)



Child Labor

Child labor (children aged 10-17 years, employed in the labor market) increased slightly during Q3 2018 compared with Q2 2018, from 2.5% to 3.1%. By region, child labor constituted 4.3% of the employed labor force in the West Bank and 1.3% in Gaza Strip.

Box 1: Human Capital in Palestine: Half of What it Can be!

Human capital, the physical and intellectual resources of a country's population, plays a key role in long-term economic growth. Investment in human capital, however, is not always a priority for policymakers, as returns from such investment do not materialize in the short term and they are not directly linked to an increase in the popularity of politicians, which also means more votes in elections. To address this, the World Bank, in the belief that human resources have not been given due attention from policymakers, has recently launched the Human Capital Index (HCI), which is akin to the Human Development Index (HDI), a reliable benchmark both by international organizations and development studies.¹

The Human Capital Index- HCI²

The HCI measures the level of human capital that a child born today can expect to attain by age 18 under the assumption that current health and

1 See "A review of HCI components in Palestine and Jordan," The Monitor, Issue 44.

2 Methodology for a World Bank Human Capital Index. Policy Research Working Paper No 8593. Sep 2018.

<http://documents.worldbank.org/curated/en/300071537907028892/pdf/WPS8593.pdf>

education conditions in a country prevail into the future. The HCI is designed to highlight how investments that improve health and education outcomes today will affect the productivity of future generations of workers. The Index has three components:

- The Survival Rate: The probability of survival until age 5 or the under-five mortality rate
- Education: The average years of schooling between 4 and 18 years of age. The average is weighted against the results of international student learning achievement tests (such as the OECD's PISA program). The Expected Years of Quality³-Adjusted School combines information on the quantity and quality of education and takes into account the enrollment ratio at each educational stage, starting with the primary grades (for those aged 4-5 years) to upper secondary grades (for those aged 15-18 years).
- Health environment: This component uses two proxies:
 1. Adult survival rate: This is the fraction of 15 years-old that survive until age 60, used as a proxy for the range of non-fa-
 - 3 See "A review of the PISA report on the efficiency of education in the MENA Region, The Monitor, Issues 26 and 34.

tal health outcomes that a child born today would experience as an adult if current conditions prevail into the future.

2. The rate of stunting for children under age 5 whose height for age is two or more standard deviations below the median height for age of a reference population. Stunting rate serves as an indicator for the pre-natal, infant and early childhood health environment, summarizing the risks to good health that children born today are likely to experience in their early years – with important consequences for health and well-being in adulthood.

Components of the HCI combined into an aggregate index

After selecting the appropriate variables that affect persons' ability to work, i.e. productivity, building the composite index entails two basic steps. The first is to quantify the impact of each proxy on productivity, for example measuring how improvement in the health of individuals contributes to their productivity. Empirical literature was used to translate the qualitative indicators of education and health into percentages and figures related to labor productivity in different countries. For example, in the case of education, literature found that an additional year of school raises earnings by about 8 percent. In the case of health, the empirical literature relies on the correlation between health and earnings among adults. In particular, studies have used adult height as a proxy for overall adult health, since adult height reflects the accumulation of shocks to health through childhood and adolescence. These studies focus on the relationship between adult height and earnings across individuals within a country. In the case of survival, the expected productivity is reduced by a factor equal to the survival rate.

The second step is combining the effects of the three proxies on worker productivity to construct a single aggregate index that allows for making comparisons between time intervals as well as cross-country comparisons. For this, the contribution of each indicator to work productivity has been calculated against a benchmark. For example, compared with a benchmark where all children obtain a full 14 years of school by age 18, a child who obtains only 9 years of education can expect to be 40 percent less productive as an adult.⁴

Based on this approach, it is possible to construct an aggregate human capital index that measures the rate of loss of future labor productivity due to insufficient conditions of education and health compared to the benchmark (when all children receive 14 years of quality schooling before they reach the age of 18, when adult survival rate is 100%, and when stunting is zero). The HCI, which provides rankings for 157 countries, has 90% for the best performing countries and 30% for the lowest performing countries.

Palestine's Human Capital

Table 1 below presents the figures for human capital in Palestine as obtained from the World Bank report. "At the age of 18, children born in Palestine today will be 55 percent as productive when they grow up as they could be if they enjoyed complete education and full health," wrote the authors of the report.

Four points are particularly noticeable in the report. First, the HCI for girls is higher than for boys (58% compared to 53%), meaning that girls are performing better than boys in all proxies, particularly in the survival rate (up to 60 years) and in education (this is the case in almost all countries).⁵

Second, the HCI in Palestine is lower than the average for the MENA region but higher than the average for its income group (lower middle-income countries). In other words, Palestine's performance is better than what is expected from a country within the lower middle-income group.

Third, Palestine's HCI is close to that of Jordan (56%) and Lebanon (54%), but significantly higher than that of Tunisia (51%) and Morocco (50%)—owing to higher average years of schooling in Palestine, but also due to higher rates of stunting in Morocco.

Fourth, in the West Bank and Gaza, children who start school at age 4 can expect to complete 11.4 years of school by age 18. However, factoring in what children actually learn, expected years of school are only 7.5 years.⁶ This last observation should enlighten policymaking as to the areas where development efforts must be focused for bettering the future human capital.

Table 1: Human Capital Index and Components in Palestine, MENA and Lower Middle-Income Countries

	Palestine			MENA Average	Lower Middle-Income Countries
	Males	Females	Males & Females		
Component 1: survival					
Probability of Survival to Age 5 (2017)	0.977	0.981	0.979	0.984	0.961
Component 2: education					
Expected Years of School (2016)	11.2	11.6	11.4	11.5	10.4
Harmonized Test Scores *(2011)	399	424	412	408	391
Component 3: health					
Adult Survival Rate (15-60 years) (2017)	0.867	0.908	0.888	0.906	0.807
Not Stunted Rate (2014)	0.919	0.934	0.926	0.847	0.730
HCI	0.53	0.58	0.55	0.57	0.48

Note: The years are specific for Palestine.

*The score 625 represents advanced attainment and 300 represents minimum attainment.

http://databank.worldbank.org/data/download/hci/HCI_2pager_PSE.pdf

<http://www.worldbank.org/en/publication/human-capital>

⁴ In this example, the child loses 5 years of education. Assuming that each year of education increases productivity by 8%, this child's productivity will be 40% less than the productivity benchmark when s/he reaches at the age of 18.

⁵ The report states that the poorer the country, the narrower the HCI gender gap.

⁶ Learning-Adjusted Years of Schooling are calculated by multiplying the number of years of schooling (11.5) by the score of the Palestinian pupils in the learning tests relative to the highest score achieved by the students of the best performing country ($412/625 = 0.659$).

3- Public Finance¹

Public Revenues

During Q3 2018, net public revenues and grants rose by 12.8% compared with the previous quarter and by 35% compared with the corresponding quarter, reaching around NIS 4.1 billion.² This is attributed to the increase in clearance revenues by 23% and 47% respectively, reaching NIS 2.4 billion. Foreign aid and grants increased, as well, by 24% and 55% compared with the previous and corresponding quarters respectively, reaching NIS 693 million (Figure 3-1). Domestic revenues, on the other hand, declined by 5.5% compared with the previous quarter. However, they were 14% higher compared with the corresponding quarter, reaching NIS 1.1 billion. This is ascribed to the significant decline in non-tax revenues of 35% compared with the previous quarter, although it was higher by 4.6% compared with the corresponding quarter. Tax revenues increased by 18% and 19% compared with the previous and corresponding quarters respectively, reaching around NIS 737 million (Table 3-1).

Public revenues and grants (net) were equivalent to 117.4% of actual public expenditures during the quarter compared with 107.7% in the previous quarter. However, revenues accounted for 96% of accrued public expenditures (commitment basis) during Q3 2018 compared with 91% in the previous quarter.

Public Expenditure

Compared with the previous and corresponding quarters, actual public expenditure increased by 3.1% and 15.3% during Q3 2018, reaching NIS 3.3 billion. This is attributed to an increase in all expenditure items. Salaries and wages saw an increase of 4% and 2% compared with the previous and corresponding quarters respectively, reaching about NIS 1.4 billion. In addition, non-wage expenditure increased by 4% and 35% during the same period reaching NIS 1.5 billion. Net lending expenditure, as well, increased by 7% and 19% respectively, amounting to NIS 286.2 million, and development expenditure increased by 10% and 23% over the consecutive and corresponding quarters respectively, reaching NIS 232.4 million (Table 3-2).

Figure 3-1: Structure of Public Revenues (NIS million)

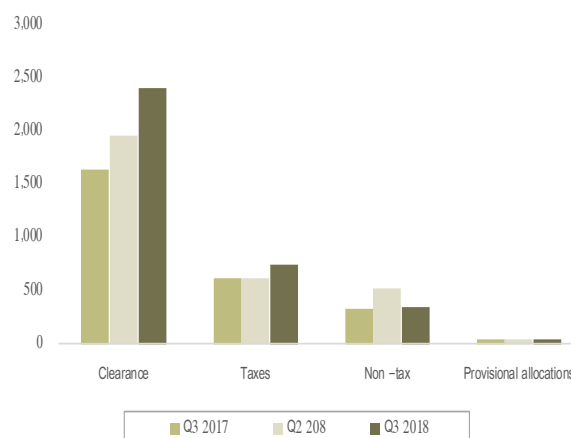
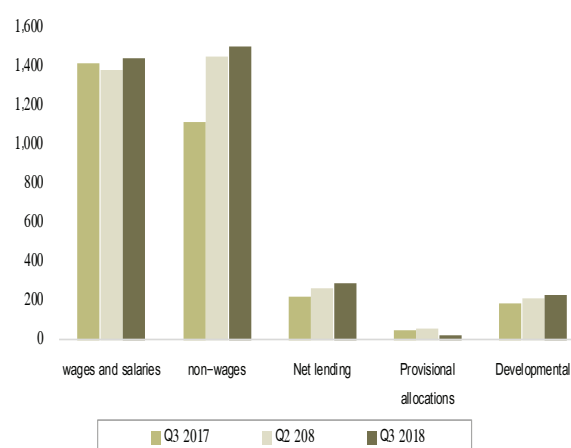


Figure 3-2: Structure of Public Expenditure (NIS million)



Actual public expenditure constituted 26% of GDP during the quarter compared with 27% in the previous quarter. The ratio of actual public expenditure to accrued expenditures (commitment basis) was 81% during the quarter, compared with 84% in the previous quarter.

Table 3-1: Grants and Foreign Aid to the PA (NIS Million)

Item	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Budget support	640	283.8	329.5	712.9	157.6	482.1	522
-Arab grants	113	94.9	111.5	205.5	140.1	236.3	303.7
- International donors	527	188.9	218	507.4	16.5	245.8	218.3
Development funding	217.5	118	118	178	119.9	77.8	171.3
Total	857.5	401.8	447.5	890.9	276.5	559.9	693.3

1 Source of data: MOF, Monthly Financial Reports: Financial Operations, Expenditure and Revenues, and sources of Funding.

2 During Q3 2018, tax refunds reached NIS 123 million compared with NIS 78 million in the previous quarter.

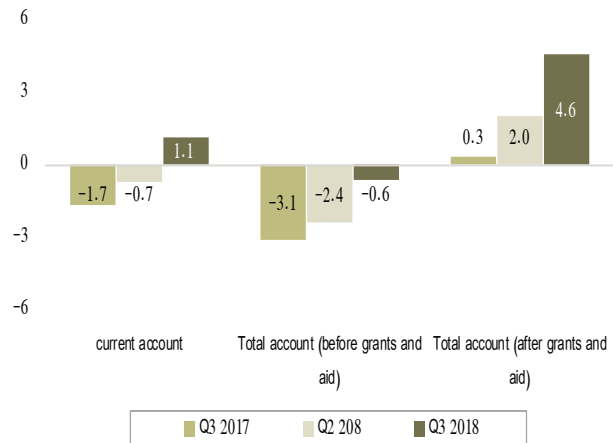
Government Arrears

During Q3 2018, government arrears reached NIS 724.7 million, compared with NIS 578.6 million in the previous quarter and NIS 975 million in the corresponding quarter 2017, and were equivalent to about 18% of public revenues and grants. Arrears consist of NIS 129.2 million in wages and salaries, NIS 478.2 million in non-wage arrears, NIS 161.7 million in development expenditures, and NIS 28 million in provisional payments. The government paid off NIS 72.4 million of the tax refunds arrears in Q3 (Table 3-2).

Financial Surplus/Deficit

Developments on both the revenue and the expenditure sides during Q3 2018 led to a deficit in the total balance (before grants and aid) of NIS 85.5 million. Grants and foreign aid turned the deficit into a surplus of NIS 607.8 million (on cash basis), about 4.6% of GDP. Whereas the deficit in the total balance (before grants and aid on commitment basis) reached NIS 1,266.0 million, dropping to NIS 572.7 million after grants and aid during the same period (Figure 3-3).

Figure 3-3: Government's Financial Balance (cash basis) as % to Nominal GDP



Public Debt

By the end of Q3 2018, public debt remained unchanged compared with the previous quarter, standing at around NIS 8.6 billion (about 16% of GDP).¹ About 56% of the debt was domestic and 44% was external. Debt service during the quarter was NIS 65.7 million, which was paid on domestic debt only (Table 3-3).

Table 3-2: PA's Accumulated Arrears (NIS million)

Item	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Tax refunds	84.1	(0.4)	9.3	(23.3)	(82.3)	(50.3)	(72.4)
Wages and salaries	111.5	(118.1)	457.9	116.8	132.3	126.1	129.2
Nonwage expenditures	292.1	390.1	388.6	560.3	262.8	389.1	478.2
Development expenditures	59.3	66.2	119.4	155.4	82.4	122.4	161.7
Provisional payments	115.5	(0.9)	(0.2)	0.6	104.3	(8.7)	28
Total arrears	662.5	336.9	975.0	809.8	499.5	578.6	724.7

Figures between brackets indicate negative value

Table 3-3: Palestinian Government Public Debt (NIS million)

Item	2017				2018		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Domestic debt	5,291	5,155.1	5,283.7	5,224	4,913.9	4,860	4,785.5
Banks	5,238.7	5,102.8	5,231.4	5,171.7	4,863.1	4,809.2	4,734.8
Public institutions	52.3	52.3	52.3	52.3	50.8	50.8	50.7
External debt	3,818.1	3,578.3	3,668.6	3,625.7	3,674.2	3,777.7	3,784.3
Total public debt	9,109.1	8,733.5	8,952.3	8,849.7	8,588	8,637.6	8,569.8
Paid interest	93.7	80.3	46.2	57.2	43.1	81.9	65.7
Public debt as % to nominal GDP*	18.6%	17.4%	17.9%	17.5%	16.6%	16.5%	16.1%

* Figures differ slightly when calculated in USD due to changes in exchange rate.

1 By the end of Q3 2018 the government's debt denominated in dollars declined by 0.5% compared with the previous quarter, reaching USD 2,355.7 million.

Box 2: Palestine in 2050: 2 million more jobs needed

In 2016, the United Nations Population Fund (UNFPA), in collaboration with the Office of the Palestinian Prime Minister, published a study titled “Palestine 2030- Demographic Change: Opportunities for Development”, which provided projections for the population and the labor market in Palestine until 2050. Below is a summary of the main projections of that study.¹

The growth in a country’s population depends on three factors: the total fertility rate, life expectancy at birth, and the net migration rate (the difference between the number of immigrants and the number of emigrants).

Palestine’s fertility rate

The Total Fertility Rate (TFR) is the average number of children that would be born to a woman over her lifetime. The Palestinian²TFR declined sharply over the past decades, from an average of 7.91 children during 1976-1981 to 6.23 in 1996 (7.4 in the Gaza Strip and 5.6 in the West Bank). The rate fell further to 4.06 in 2013 (4.5 in Gaza and 3.7 in the West Bank). The fertility rate of women is closely related to their years of schooling, as shown in Table 1 below.

Table 1: TFR of women in Palestine in relation to years of school, child / year (1996)

Less than secondary school education	Secondary school education	Higher Education
6.62	5.57	4.72

Scenarios for estimating population growth

The study envisioned three scenarios for population projections (from 2015 to 2050):

- A baseline scenario whereby fertility remains at its present level of 4.06 during 2015-2050. This unrealistic scenario is given just to provide figures for comparison.
- Under Scenario 2, the total fertility rate would drop from 4.06 in 2014 to 2.17 in 2050, a little under the replacement level. This significant decline in fertility results from two factors: an annual decline in the fertility of women (with less than secondary education by 1.3%, with secondary education by 1.9%, and with higher education by 2.5%); and an increase of women with higher education at the expense of women with less than secondary school.
- Scenario 3 assumes that the total fertility rate would slightly decrease from 4.06 to 3.44. In this scenario, the fertility changes are only due to the restructuring of the women’s fertile age group by level of education. Therefore, the total fertility rate of

1 Palestine 2030, Demographic Change: Opportunities for Development. <https://palestine.unfpa.org/sites/default/files/pub-pdf/Palestine%202030%20Full%20Report%20English.pdf>

2 This definition stipulates two things: first, a woman is to survive from birth to the end of her reproductive life; second, she is to pass through the childbearing years bearing children according to a current schedule of age-specific fertility rates. Note that 2.1 children / year is the total fertility rate, which is also called “replacement level” (the rate which ensures that the population remains unchanged, with other factors remaining constant)

women with less than secondary school education remains constant at 4.54, for those with secondary school it remains at 3.95, and for women with higher education it is at 3.30.

The study built on assumptions that mortality rates are the same under all three scenarios. Based on the 2014 figures for life expectancy at birth (71.8 years for males and 74.7 years for females), it is assumed that this life-expectancy will regularly increase until 2050, to reach 74.9 for males and 80.9 for females.

Finally, the study assumed that in the three scenarios, net migration will remain equal to zero until 2050. Table 2 below provides the population projections according to the three scenarios.

Two important observations can be drawn from the Table:

- In Scenario 2, the population of Palestine would double, reaching 9.5 million in 35 years (2015-2050), despite the fact that fertility would be slashed by half during this same period. This doubling is the result of the population momentum: the population age-sex structure at the beginning of the period (a large proportion of the population (40%) under 15 years old), meaning that in subsequent years, a large number of women will reach reproductive age.
- The projected figures for the population under Scenarios 2 and 3 in 2050 will be relatively close, with a 12% difference despite the fact that the high scenario assumes stability of part of women’s fertility by their level of education. This, of course, proves how important female education is in affecting population growth.

Manpower in 2050: 7 million people

A fundamental change in the structure of the future population of Palestine is very likely thanks to decreases in the fertility rate. Figure 1 shows the age pyramid for the population in 2015, 2035 and 2050. In 2015, the pyramid had a pointed apex and a relatively broad base (suggesting that about 40% of the population was under 15 years old, and that the elderly proportion was limited). Over time however, the middle area of the pyramid will expand at the expense of the base, and its apex will become less pointed. This structural change means the manpower of Palestine (the population over the age of 15) will increase at a rate higher than both the population growth rate and the increase in the life expectancy rate. The ratio of persons over the age of 15 years will rise from about 60% to more than 75% between 2015-2050 (from 2.9 million to 7.2 million). This is good news for the Palestinian economy, as the high rate of those over 15 years means lower dependency and higher proportions of active, productive population.

Manpower 2050: 3.8 million workers

Manpower is the supply of people who are able to work (whether working or looking for a job opportunity), while the labor force participation rate refers to the number of people available for work as a percentage of the total population. The study assumed that Palestine’s male participation, already high at about 72%, will continue to be higher than the female’s rate in the future as well. However, the current low rate of female participation (about 20%) is projected to gradually increase to 28% by 2030 and to 32% by

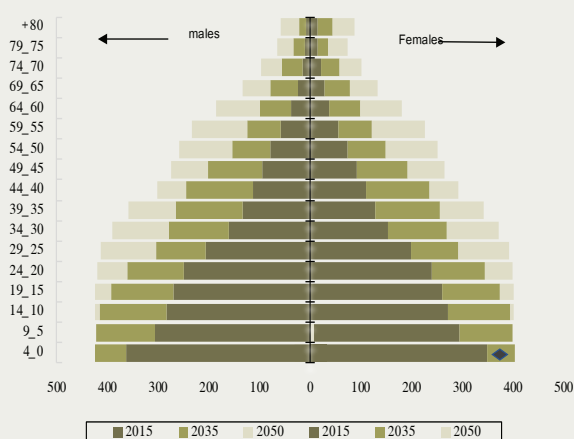
2050. Furthermore, the increase in the proportion of individuals who would continue their secondary and university education will delay their entry into the labor market. Based on these assumptions, the study concluded that by 2030, the size of the labor force in Palestine is expected to increase from 1.3 million workers in 2015 to 3.8 million in 2050. Therefore, the number of jobs that should be created per annum will increase from 58,000 now to 72,000 in 2030-35, where they will level off at 76,000 in 2045-50. In other words, the Palestinian economy will need to create more than 2 million new jobs for new entrants into the labor market between 2015 and 2050. This figure, however, does not take into account the job opportunities needed to be created for the currently unemployed persons. While doubling of the workforce poses a big challenge, it provides a historic way out of stagnation and underdevelopment, as an efficient workforce is ultimately the most important factor for growth and development. IMF estimates show that a scenario where all new labor entrants find a job could boost GDP per capita—up by 50 percent by 2030 and nearly tripling by 2050.³

3 Cited in IMF: West Bank and Gaza- Report to the AD HOC Liaison Committee, August 31, 2017. P. 12.

Table 2: The three scenarios' projections of the total population (thousands) of Palestine, 2015-2050

	2015	2020	2025	2030	2035	2040	2045	2050
Scenario 1: Constant fertility	4,752	4,572	6,294	7,196	8,184	9,279	10,509	11,893
Scenario 2: Sharp decline in fertility	4,752	5,448	6,175	6,900	7,610	8,298	8,944	9,519
Scenario 3: Slight decrease in fertility	4,752	5,460	6,236	7,051	7,901	8,798	9,753	10,707

Figure 1: Population by age group and sex (thousands), Palestine 2015, 2035 and 2050, medium scenario



Note: The bullet • represents a decline in the number of persons within the 0-9 years old group in 2050 compared to 2035.

4. Banking Sector¹

By the end of Q3 2018, there were 14 banks operating in Palestine licensed by the PMA; 7 domestic banks and 7 chartered banks,² operating through 345 branches and offices; 286 in the West Bank and 59 in the Gaza Strip.³ By the end of Q3 2018, net assets (liabilities) of the banking sector increased by 2.6% compared with Q2, reaching USD 16.2 billion, and an increase of 4.6% compared with the corresponding quarter 2017 (Table 4-1)

Credit Facilities

During Q3 2018, the credit portfolio constituted 51% of total bank assets compared with 52.4% in the previous quarter, reaching USD 8,293.6 million. Total credit facilities were 68% of total public deposits during the quarter. The private sector had the lion's share of credit facilities, which reached USD 7,134.1 million (around 86% of total facilities) against USD 1,159.5 million granted to the public sector (14% of the total).

- 1 The source of data in this section: PMA, Nov 2018. The Consolidated Balance Sheet for Banks, List of profits and losses, PMA database.
- 2 In Aug 2018, A merger was concluded between Al Quds Bank and Jordan Kuwait Bank, thus the number of banks dropped to 14 banks
- 3 In Aug 2018, A merger was concluded between Al Quds Bank and Jordan Kuwait Bank, thus the number of banks dropped to 14 banks

Table 4-1: Consolidated Balance Sheet of Licensed Banks Operating in Palestine (USD millions)

Item*	2017		2018	
	Q3	Q2	Q3	Q2
Total assets	15,461.0	15,763.0	16,179.4	16,179.4
Direct credit facilities	7,761.9	8,260.0	8,293.6	8,293.6
Deposits at PMA & Banks	3,863.1	3,937.2	3,875.2	3,875.2
Securities portfolio for trading and investment	1,275.7	1,324.3	1,325.4	1,325.4
Cash and precious metals	1,518.6	1,255.9	1,642.6	1,642.6
Other assets	1,041.7	985.5	1,042.4	1,042.4
Total liabilities	15,461.0	15,763.0	16,179.4	16,179.4
Total deposits of the public (non-bank deposits)**	11,526.8	11,992.6	12,194.2	12,194.2
Equity	1,804.6	1,819.7	1,863.9	1,863.9
Deposits of PMA and Banks (bank deposits)	1,279.6	1,006.9	1,178.0	1,178.0
Other liabilities	291.7	293.8	263.5	263.5
Provisions and depreciation	558.3	650.1	680.1	680.1

* Items in the table are totals (including provisions).

** Non-bank deposits include the private and public sectors' deposits

By region, the West Bank's share of total credit facilities stood at 86% compared to 14% for the Gaza Strip. During the quarter, loans share increased to around 84% of total credit facilities, against about 15% for overdraft accounts. By currency, the US dollar continued to account for the biggest share of credit (46%) in Q3 2018 compared with 36% granted in Shekels, and 15% in Jordanian Dinars, and the same percentage of 2% in other currencies (Figure 4-1).

This rise in credit facilities is ascribed mainly to the growing credit share of the various economic sectors; 5% in the trade sector (about USD 68.5 million), 5% in the services sector (USD 39.2 million), 2% in the real estate and construction sector (equivalent to USD 32.2 million), and 7.5% in vehicle financing (USD 21.6) (Figure 4-2).

Balances at PMA and Banks

By the end of Q3 2018, balances at PMA and banks declined by 1.6%, reaching USD 3,875.2 million, accounting for less than a quarter of total assets of banks (24%). This decline is attributed to a 2.6% decrease in balances at the PMA, and 6% in balances at banks abroad. Compared to the corresponding quarter of 2017, a 0.3% increase has been witnessed due to a 10.4% increase in PMA balances in Palestine and a 3.8% increase in balances at banks abroad (Figure 4-3).

Deposits

By the end of Q3 2018, total deposits (bank and non-bank deposits) rose by 3% compared to the previous quarter, reaching USD 13,372.2 million. Compared with the corresponding quarter 2017, total deposits increased by 4%. About 91% of total deposits were deposits of the public (non-bank deposits) during Q3 2018, compared with 9% as banks deposits.

The share of the West Bank of total deposits was 90%, against 6% for the Gaza Strip, noting that the private sector deposits were 95% of the total, compared with 5% for the public sector (Figure 4-4).

Current deposits constituted 38% of the total deposits by the public during Q3, while 29% were time deposits, and 34% were saving deposits. By currency, the US dollar continued to dominate deposits (39% of the total), followed by the Shekel (35%), and then the Jordanian Dinar (24%), and 3% for the remaining currencies.

Bank Profits

According to banks income statements, by the end of Q3 2018 bank profits rose by 3% compared with the previous quarter, reaching USD 176.3 million. However, expenditures increased by 2%, reaching USD 130.5 million. Banks' net income (revenues) increased by 8% compared with the previous quarter, reaching USD 45.8 million, and by 11% compared with the corresponding quarter 2017 (Table 4-2).

Figure 4-1: Distribution of Total Direct Credit Facilities (USD million)

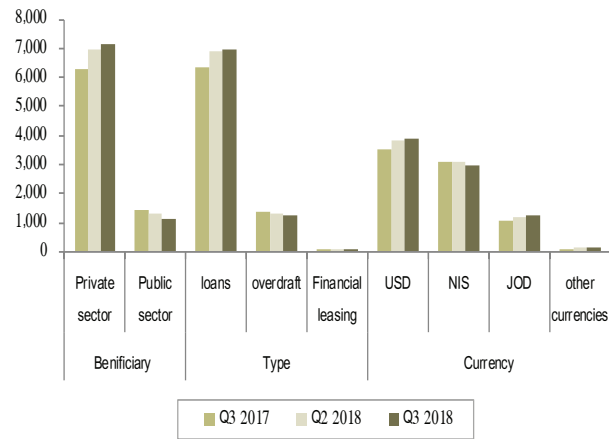


Figure 4-2: Distribution of Total Direct Credit Facilities by Sector

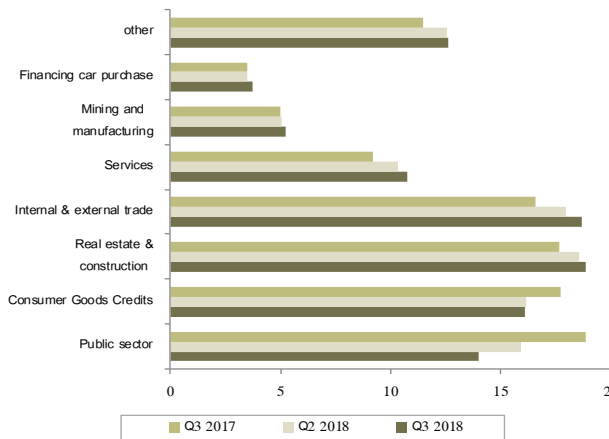


Figure 4-3: Balances at PMA and Banks (%)

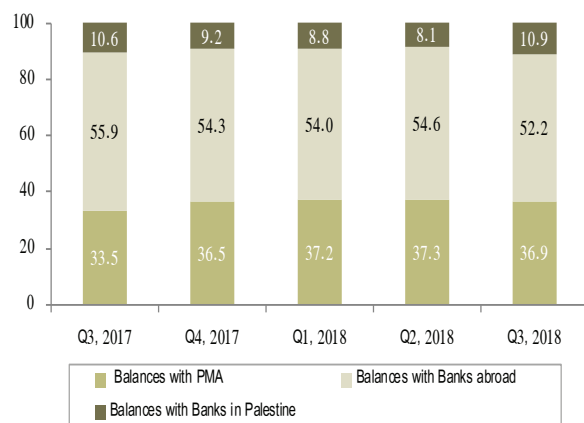


Table 4-2: Licensed Banks Revenues and Expenditures by Source (USD millions)

Item*	2017		2018	
	Q3	Q2	Q3	Q2
Revenues	163.3	170.7	176.3	
Net Interests	122.7	124.7	131.7	
Commissions	30.2	29.6	29.1	
Other operating revenues	10.4	16.4	15.5	
Expenses	121.9	128.1	130.5	
Operating expenses and tax allocations	107.1	111.1	120.5	
Tax	14.8	17.0	10.0	
Net income*	41.4	42.6	45.8	

*net income = net revenues - expenses

Interest Rates

During Q3 2018, the average interest rate on JOD and USD deposits increased to 2.75% and 2.55% respectively compared with the previous quarter, against the rise of the average interest rate on JOD and USD loans to 6.90% and 5.98% respectively. On the other hand, average interest rates on NIS deposits dropped to 1.98% against its rise on NIS loans to 7.11%. These changes over the consecutive quarters affected the margins between the deposits interest rates and that of lending facilities, as the margin on the Jordanian Dinar increased from 3.68% to 4.15% and on the Israeli Shekel from 4.83% to 5.13%. The margin on the US dollar meanwhile declined from 3.59% to 3.43%. The rise in the margin reflects inefficiency, albeit small, of the financial intermediation role of the banking system (Figure 4.5).

Clearance

During Q3 2018, the value of cheques presented for clearance increased by 4% compared with the previous quarter, amounting to USD 3,245.9 million. This increase was driven by an increase in the value of cheques presented for clearance in the West Bank by 5% reaching around USD 3,034 million against its sharp decline in the Gaza Strip (15%), reaching USD 211.9 million. Compared with the corresponding quarter 2017, cheques declined massively by 19%, due to its decline in the West Bank by 19% and in Gaza Strip by 24%. The quarter has witnessed, as well, an increase in the value of returned cheques of 2% compared with the previous quarter, reaching USD 275.4 million, as a result of 2% rise in the West Bank (USD 254.6 million), against a 3% decline in the Gaza Strip (USD 20.8 million). Compared with the corresponding quarter 2017, the value overall declined by 9% (consisting of a 7% growth in the West Bank and 31% drop in the Gaza Strip). (Figure 4-6)

Notably, 79% of cheques presented for clearance were in NIS, followed by 15% in USD. In the same context, the value of returned cheques as a percentage to total cheques presented to clearance, declined slightly from 8.6% in the previous quarter to 8.5% during Q3, while it was 7.6% in the corresponding quarter 2017 (see Figure 4-7 and box4 in the Monitor, issue 53).

Figure 4-4: Distribution of Deposits (USD million)

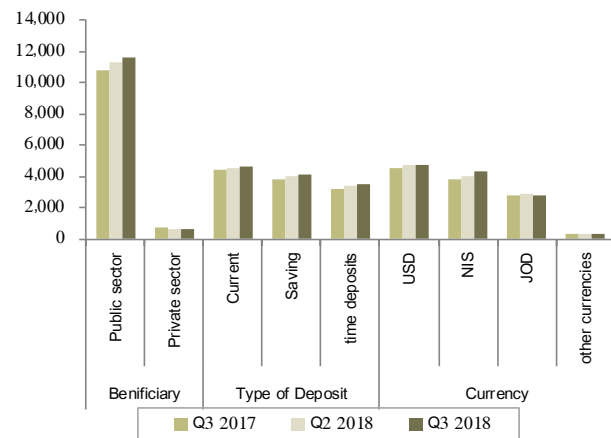


Figure 4-5: Average Interest Rates on Deposits and Loans by Currency, (%)

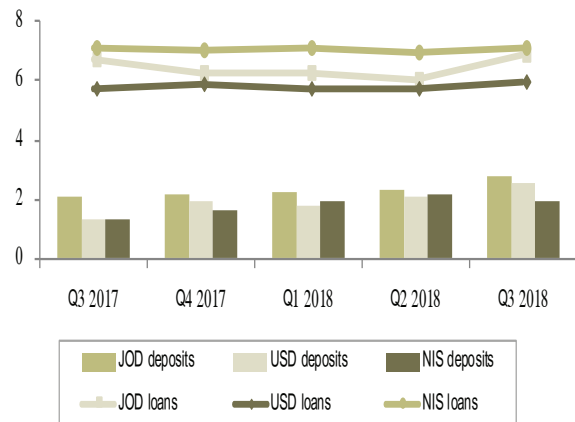
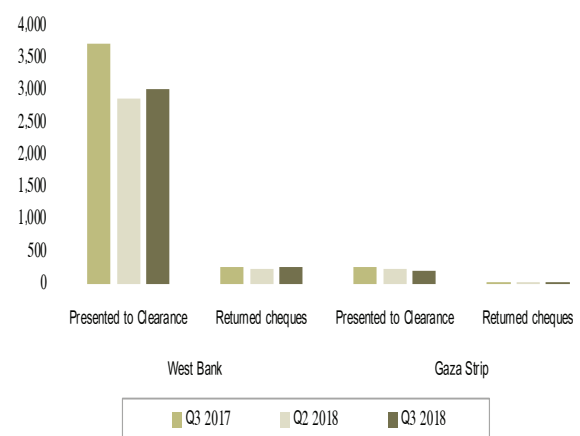


Figure 4-6: Value of Cheques Presented for Clearance and Returned Cheques by Region (USD million)



Specialized Credit Institutions (SCIs)

By the end of Q3 2018, total assets of specialized credit institutions (SCIs) dropped by 3% compared with the previous quarter, reaching USD 227.6 million. This resulted from the drop in both current deposits by 24% and cash by 31%, and Islamic loans by 11% during the same period. SCIs offered 680 job opportunity.

The credit portfolio of SCI companies licensed by the PMA (6 companies) reached USD 212.5 million by the end of Q3 2018. Around 73% of loans were granted in the West Bank against 27% in the Gaza Strip (Table 4-3).

Real estate sector loans continued to dominate with the biggest share of loans (around 30%), followed by the commercial sector (28%), then the agricultural sector (12%), consumption loans and public services sector (10% each), and finally the industrial and tourism sectors (6% and 4% respectively).

Figure 4-7: Percentage of Cheques Presented for Clearance to Returned Cheques (%)



Table 4-3: SCIs data

Item*	2017		2018		
	Q3	Q4	Q1	Q2	Q3
Total of Loans Portfolio (USD millions)	213.0	215.0	215.5	215.4	212.5
- West Bank	145.8	147.8	149.8	153.1	154.4
- Gaza Strip	67.2	67.2	65.7	62.3	58.1
Active Clientele	72,048	72,209	71,759	70,922	68,942
No. of Offices and Branches	83	84	81	81	81
Employees	665	652	664	675	680

Box 3: Excess NIS Liquidity in the Palestinian Banking System: Causes and Remedies

Regulatory framework: Paris Protocol

The Paris Economic Agreement, signed by the Palestine Liberation Organization and Israel, provided for the establishment of a monetary authority to regulate banking, hold and manage currency reserves, oversee banks and serve as a financial and economic adviser to the Palestinian National Authority (PNA) and perform other functions usually assigned to monetary authorities. By Article IV of the Agreement, the Israeli Shekel is one of the circulating currencies in Palestine and serves as legal means of payment for all purposes including official transactions.

In the matter of regulating the banking and monetary issues between the two sides, the Agreement stipulates financial and monetary obligations. As per the Agreement, Israel commits itself to transferring excess NIS and allowing currency exchange between its banks and their Palestinian counterparts, while the Palestine Monetary Authority (PMA) and the Bank of Israel will coordinate their efforts with respect to shared issues. Paragraph 18 of Article IV thereof reads “The exchange of foreign currency for NIS and vice-versa by the PMA will be carried out through the BOI Dealing Room, at the market exchange rates.” Moreover, Paragraph 15 of the said Article states that “The PMA will have the right to convert at the BOI excess NIS received from banks operating in the Areas into foreign currency, in which the BOI trades in the domestic inter-bank market.”

Israeli correspondent banks: Bank Hapoalim and Discount Bank¹

Both sides agreed that Palestinian banks would transfer their excess NIS to the Israeli side through Israeli correspondent banks (Hapoalim and Discount) and that the excess NIS amounts accumulated would be transferred through two channels:

- Bank of Palestine: The excess NIS amounts are first pooled from all branches of banks operating in Palestine by the Palestinian Company for Cash and Valuables Transportation and Financial Services- AMAN, which, in turn, transfers the excess² NIS to Israeli banks through the Brink's Company for cash management. The transfer of excess NIS from banks operating in the Gaza Strip is done exclusively through the Bank of Palestine in accordance with the understandings between the PMA and the banks. The amounts are transferred to banks' headquarters in the West Bank by Brink's and then they are transferred to Israel.
- Jordanian banks: Jordanian banks transfer excess NIS amounts either directly to the Israeli correspondent banks or through Brink's.

¹ See “Correspondent Banks”, The Economic Monitor, Issue 45.

² AMAN is a private shareholding company founded in 2008 in Ramallah. It provides services to banks and private sector companies, such as the transfer and shipment of funds and valuables as well as the ATM feed service.

The transfer technical arrangements changed later. Bank Hapoalim (starting from 2009) and Discount Bank (starting from early 2017) refused to receive cash from the Palestinian banks on the grounds that the source of the funds is not fully known to them. Transactions with these two banks were henceforth restricted to remittances. Since then, the cash was transferred through Israel's cash deposit centers, and then to Israeli correspondent banks. In the past two decades, the two banks more than once stopped dealing with Palestinian banks for alleged fear of potential international charges of supporting terrorism or money laundering. Two years ago, the Israeli government granted these two banks immunity against any potential charges in connection with financing of terrorism which may arise from their dealings with Palestinian banks and committed to compensating these banks for any losses that may result from such dealings.

Costs of the transfer mechanism and accumulation of excess NIS

This mechanism of transfer resulted in additional costs incurred by the Palestinian banking sector: the cost of storing, maintaining, guarding and transferring excess NIS; the high cost of clearing between Palestinian and Israeli banks; and the cost of procedures as regarding Palestinian banks' obligations to Israeli banks, with the Palestinian banks unable to transfer NIS amounts needed to support their accounts at Israeli banks. These costs change according to the general attitudes of the occupation authorities in the way they deal with the Palestinian side in general and in times of crises in particular. There are also indirect costs, such as the excess NIS opportunity cost, i.e. the interest that could have been generated if the excess NIS amounts had been deposited with Israeli banks. Equally detrimental is Israeli banks' refusal to deal with all banks operating in the Gaza Strip and denying or restricting the movement of funds between the West Bank and the Gaza Strip, which makes the transfer of the excess NIS anything but easy. All these obstacles have created a situation where Palestinian banks have been burdened with what came to be known as the excess NIS problem.

The fact is that the root cause for the excess NIS crisis is the insistence of the Israeli authorities on setting a monthly ceiling for the excess NIS amount the Palestinian banks can transfer to them. The PMA has aptly communicated the reasons behind such excess, and it used its connections with the European Union, the International Monetary Fund and the World Bank to persuade the Bank of Israel to accept the excess NIS amounts with Palestinian banks. Accordingly, the Bank of Israel raised the monthly ceiling from NIS 80 million to NIS 120 million, then to NIS 300 million and most recently in 2018 to NIS 1 billion, subject to further increases in the future.

Sources of NIS stocks in Palestine

The PMA, in cooperation with international organizations, has screened the sources of NIS accumulated at the Palestinian banks to defeat Israeli claims that the sources are unknown and that the amounts are beyond what can be justified through legitimate channels. The effort has identified these sources, listed here in order of importance:

1. Wages of Palestinians working in Israel;
2. Purchases in the Palestinian territories by Palestinians from inside Israel;
3. Purchases of goods and services by Palestinian students from inside Israel, as well as pilgrims on their way to Mecca;
4. Financial inclusion and banking expansion (which increases shekel deposits in Palestinian banks), and exchange of old banknotes for new notes; and

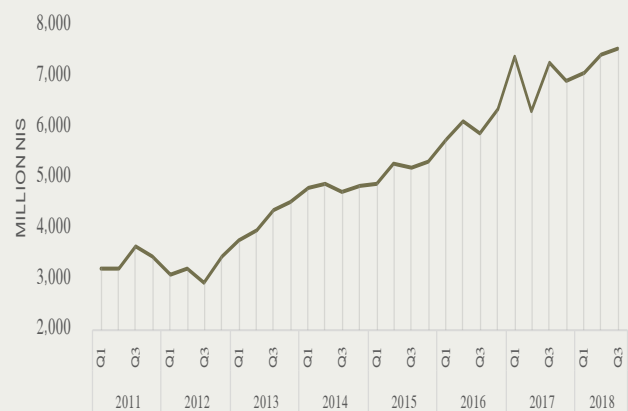
5. Different laws in force in Palestine and Israel. For example, Israel treats gold like other goods and thus it makes it subject to taxation. In Palestine, gold is tax-exempt cash, which encourages Palestinians from inside Israel to buy gold from Palestinian markets, which in turn increases the stocks of the shekel there.

We will examine the first two sources only. It is estimated that about 7.6 billion shekels flow annually to Palestine in wages paid to workers of the West Bank and Gaza Strip in Israel and the settlements. The number reached 131.2 thousand at the end of the third quarter of 2018, with an average daily wage of NIS 243.7 and 19.7 work days per month. There has been a significant increase in the number of workers in Israel and the settlements since 2012, when the crisis of excess NIS started to materialize (see Figure 1).

The second major source of excess NIS is spending by Palestinians from Jerusalem and inside Israel. Tempted by the relatively low prices, these Palestinians prefer to expend on shopping and leisure in West Bank towns. Furthermore, many of them study in West Bank universities, and their tuitions are paid in NIS. A study carried out on behalf of the PMA in 2018 estimated that about NIS 3 billion per year enter the Palestinian territories through these two channels. It is important here to note that the Israeli credit cards cannot be used in Palestine, and as such paying in cash is the only available method for payments made by the 1948 land Palestinians. To shopping and higher education tuitions should be added two factors. First, Palestinians from inside Israel often bring shekels to exchange in Palestinian markets for other currencies. Second, many Palestinians from Jerusalem have bank accounts at Palestinian banks, and usually their deposits are made in Israeli shekels.

In an effort to help solve the excess NIS problem, the PMA is addressing some of its causes– by improving electronic payment methods and encouraging the use of bank debit/credit cards by Palestinians from inside Israel. Recently, the Palestinian and Israeli sides agreed on a new mechanism for transferring the excess NIS amounts. According to the agreement, Israel will create a government agency that will replace Israeli correspondent banks, while Palestine will create a financial services company– similar to the Israeli agency– to replace Palestinian banks in transferring the excess NIS amounts to Israel.

Figure 1: Flow of NIS to Palestine in wages paid to Palestinian workers in Israel, 2011-2018



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Palestinian Monetary Authority

Box 4: Financial Inclusion in Palestine

Financial inclusion in Palestine has garnered attention from national and international organizations concerned with socioeconomic development. The National Strategy for Financial Inclusion defines the term as “Enhancing access to, and use of, financial products and services by all segments of the society via formal channels, while meeting their needs in a timely and affordable manner, protecting their rights and promoting their financial knowledge to enable them to make well-informed financial decisions.” This, in turn, entails considering the use of financial instruments provided by mainstream financial institutions as an important tool for the betterment of economic conditions for all individuals in a society. International organizations have designed policies to enhance financial inclusion and urged governments of the developing world to adopt clear goals and policies that would bring about a comprehensive and equitable financial system for all segments of the society, including disadvantaged groups. On that account, financial inclusion— as it was found to reduce poverty and unemployment and as well advance economic growth and social well-being— has been made a priority in development agendas.

A study of financial inclusion in Palestine revealed that notwithstanding the efforts of the financial sector and regulatory bodies to raise citizens’ financial knowledge and increase their access to and use of financial services, the financial exclusion rates in Palestine are still high, with about 1.6 million people (or 64% of the adult population) found to be financially excluded. In addition to poor access and use of financial services, the authors found significant male-biased gender differences in employment in the financial sector as well as poor financial knowledge, particularly among females.¹

Since 2014, the Palestine Capital Market Authority (PCMA) and the PMA have worked hard to design a national strategy for financial inclusion in Palestine, in line with international best practices adopted by the Alliance for Financial Inclusion (AFI) and in accordance with the G20 Principles for Innovative Financial Inclusion. It was emphasized that financial inclusion is an integrative process— starting with sensitizing people to the benefits and proper use of financial products and services, through creating equal access opportunities, to protecting consumers’ rights and helping them know their rights and their duties when using financial products/services.

An enabled financial inclusion system would bode well for the performance of capital market sectors. Undoubtedly, strengthening the legal and regulatory framework of the non-banking financial sector, broader access to financial services by all citizens, and protection of consumer rights would improve the investment climate and make it attractive. Likewise, increased consumer awareness and financial education efforts are likely to increase demand for financial services. For example, enhancing the confidence of citizens in the insurance sector would lead to increased demand for insurance services and thus more penetration of such services, which eventually contributes to increased social and economic protection (as potential compensation against damages helps individuals and businesses continue their activities and reduces economic and social risks).

Seeing the promising potentials of financial inclusion, the Palestinian Council of Ministers formed in December 2017 the National Committee for Financial Inclusion, co-chaired by the PCMA and the PMA. The Committee— comprised of concerned ministries, the Union of Chambers of Commerce and Industry, the Palestinian Federation of Insurance Companies, the Association of Banks in Palestine and the Microfinance Institutions Network— was tasked with designing policies related to the proper implementation of the National Strategy for Financial Inclusion. The imperative for implementing this strategy is driven by two main factors: low access and use of financial products and services by a large part of individuals and businesses; and recognition of the important role that financial inclusion can play in addressing some critical problems such as high levels of poverty and unemployment, low rates of economic growth and socioeconomic disparities.

Rabab Sabbah, Capital Market Authority

¹ Financial inclusion in Palestine, 2016 (a study carried out by MAS on behalf of the Capital Market Authority and the Palestine Monetary Authority): <http://www.mas.ps/files/server/financial%20inclusion%202016.pdf>

5- The Non-Banking Financial Sector¹

The Securities Sector

By the end of Q3 2018, the market value of traded shares in Palestine Stock Exchange (PEX) reached USD 3.7 billion, equivalent of 26% of GDP at constant prices. By the end of Q3 2018, Al Quds index closed at 528.8 points, a decrease of 2% (11.9 points), compared with the previous quarter and of 7% compared with the corresponding quarter 2017.

Table 5-1: A Selection of Financial Indicators on the Trading Activity in PEX

Item	Q3 2017	Q2 2018	Q3 2018
Volume of Traded Shares (million share)	98.48	35.17	40.92
Value of Traded Shares (USD million)	167.29	72.74	69.55
Market Capitalization (USD million)	3,815.59	3,784.40	3,718.69
Total Trades	17,868	8,763	9,073
Total number of Traders	71,981	71,341	71,128
- Palestinians	68,603	68,022	67,761
- Foreigners	3,378	3,319	3,367

Although the volume of traded shares increased by 16% over the consecutive quarters Q2 and Q3 2018, their value decreased by 4% during the same period. However, compared with the corresponding quarter the volume and value of traded shares dropped sharply by 58% (Table 5-1). This is attributed to investors sentiment on such prevailing atmosphere of uncertainty. The decline was not offset by the rise in the listed companies' profits of 3% compared with the corresponding quarter,

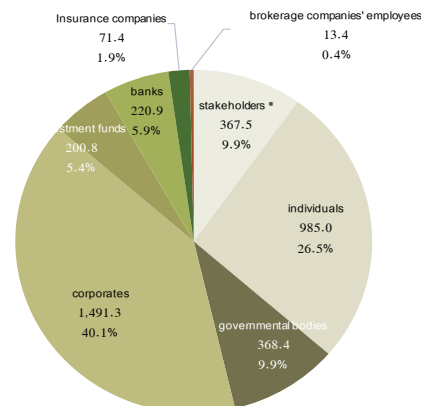
The profits of listed companies during Q3 2018 reached USD 241.4 million after taxes (8% of equity rights). Around 39 out of the listed 45 companies that made financial disclosures were gainers.²

Figure 5-1 shows the distribution of market capitalization by trader type. It shows that corporations' shares reached 40% against 27% for individuals

Insurance Sector

By the end of Q3 2018, the insurance portfolio (gross written insurance premiums) declined by 2% compared with the previous quarter and rose by 7% compared with the corresponding quarter 2017 respectively, reaching USD 68.6 million. This is attributed to the usual volatility in the gross written insurance premiums from one quarter to the other, noting that during Q1 2018 a new insurance company (Tamkeen company) entered the market.

Figure 5-1: Distribution of Market Capitalization by Trader Type (as of the end of Q3 2018) (USD million)



* Individuals who have direct or indirect relation with the company because of their job position or relation.

On the other hand, net compensations incurred by the insurance sector increased by 6% by the end of Q3 2018 compared with the end of the previous quarter. In addition, insurance sector investments reached USD 246.2 by the end of Q3 2018, a marked growth of 12% compared with the corresponding quarter 2017 (Table 5-2).

Table 5-2: A Selection of Financial Indicators of the Insurance Sector in Palestine (USD million)

Item	Q3 2017	Q2 2018	Q3 2018
Gross written Insurance premiums	64.03	70.12	68.62
Total investments of insurance companies	219.06	245.85	246.18
Net compensations incurred by the insurance sector	(37.91)	(40.98)	(43.38)
Retention ratio	88.72%	85.93%	90.49%
Claims ratio	66.73%	68.02%	69.86%

As figure 5-2 shows, there is a significant concentration in vehicle insurance in the insurance portfolio in Palestine, which constituted 65% of total insurance portfolio, followed by health insurance (13%). Figure 5-3, on the other hand, presents the market share of insurance companies, where three companies of the ten operating companies dominated 58% of gross written premiums in the sector by the end of Q3 2018.

Financial Leasing

The number of leasing companies registered with PCMA was 14. The total investment value of registered contracts with the PCMA stood at USD 22.3 million, through 384 contracts during Q3 2018, a rise of 19% in the value and of 6% in the volume compared with the end of Q2, and a rise of 27% in

¹ The source of figures in this section: Palestinian Capital Market Authority (PCMA), 2018.

² PEX, a press release dated 11/11/2018.

Figure 5-2: Distribution of the Insurance Portfolio Components by the Insurance Sector Activities (as of the end of Q3 2018) %

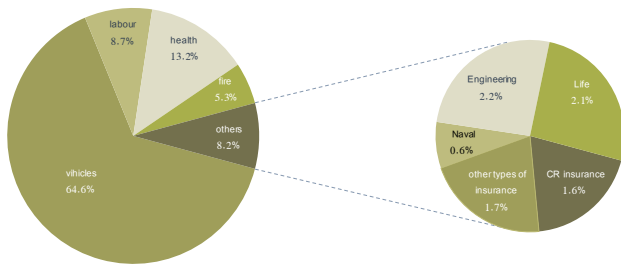


Figure 5-3: Distribution of the Insurance Portfolio Components by the Insurance Company (as of the end of Q3 2018) %

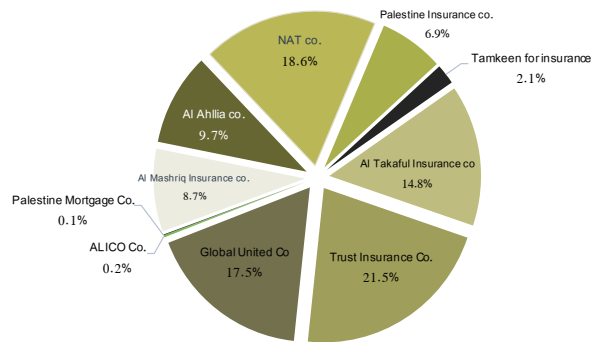


Table 5-3: Total Value and Volume of Financial Leasing Contracts

	Q3 2017	Q2 2017	Q3 2018
Total Value of Financial Leasing Contracts (USD million)	17.54	18.81	22.31
Total Volume of Financial Leasing Contracts	280	382	384

value and 37% in volume compared with the corresponding quarter (Table 5-3). This increase in the value and volume of financial leasing contracts is attributed to the increased promotional campaigns launched by some of these companies, in addition to new leasing companies entering the market.

As Figure 5-4 shows, financial leasing contracts are concentrated in Ramallah (38%), followed by Nablus (17%), then Hebron (13%), while 33% of contracts distribute among the rest of the Palestinian cities.

Figure 5-5 shows that the financial leasing portfolio is still concentrated in motor vehicle leasing (78% of total value of contracts). Financing of moveable assets increased compared with previous quarters, as newly licensed leasing companies started financing renewable energy equipment leasing which are risky investments.

Figure 5-4: Geographical Distribution of Financial Leasing Contracts by Volume (as of the end Q3 2018) (%)

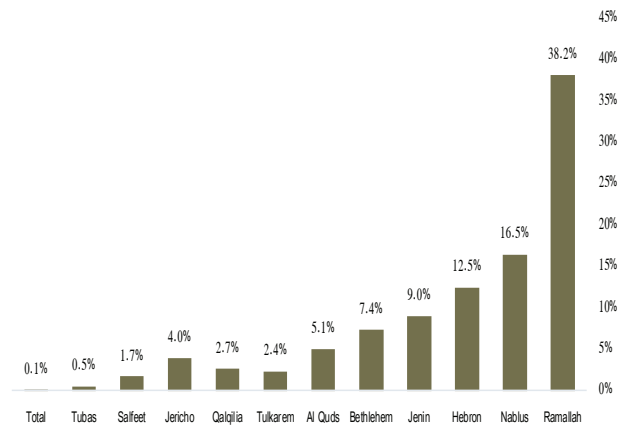
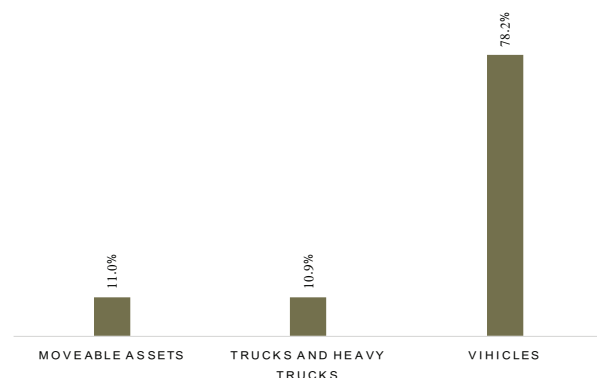


Figure 5-5: Distribution of Financial Leasing Portfolio by Type of Leased Property, as of the end of Q3 2018 (%)



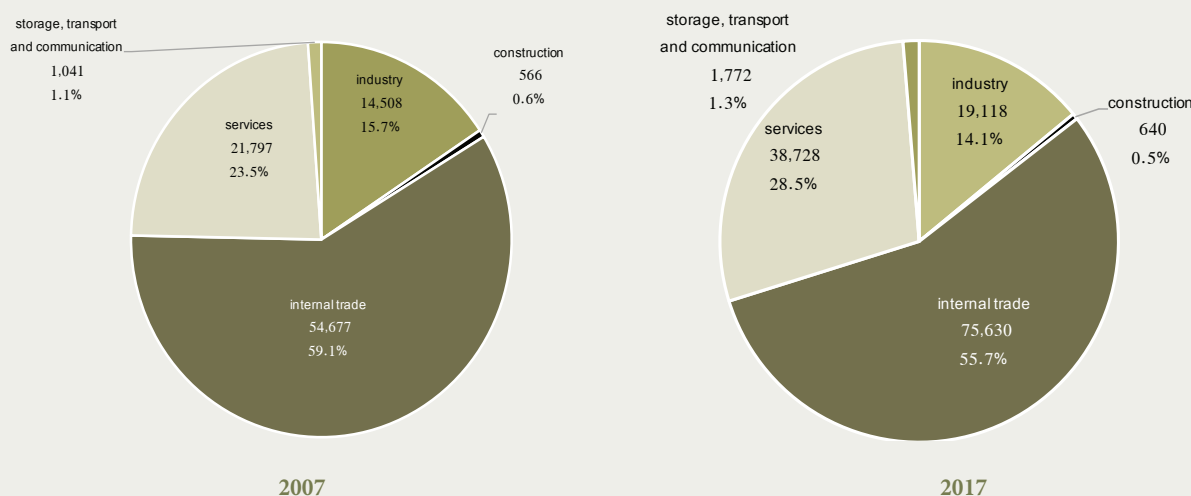
Box 5: Survey of establishments, workers, productivity and profits in Palestine

Each year, the Palestinian Central Bureau of Statistics (PCBS) publishes the Economic Survey Series, which includes detailed statistics on private and civil society sector enterprises operating in the Palestinian economy. The surveys– which serve as a foundation for calculating national accounts– cover enterprises across all economic sectors (excluding agriculture, finance and insurance and government) and provide data on the number of establishments in each sector, the number of workers and their compensation, value added figures, gross fixed capital formation, production and commercial activity inputs, both in the West Bank (excluding J1 in Jerusalem) and the Gaza Strip.

Growth in establishments and workers

The October 2018 survey cited an increase in the number of enterprises by around 50% over a decade (2007-2017), with employment increasing even more (85%). In 2017, the number reached 135,000 enterprises, with 443 thousand workers. Figure 1 shows that the distribution of enterprises across sectors has remained the same during the decade, with the trade sector still at the top of the list, while services and industry came second and third. The distribution of workers across sectors followed the same order, so the largest employer was the trade sector, followed by services and then industry.

Figure 1: Distribution of establishments across sectors, by number– 2007 and 2017



Source: Palestinian Central Bureau of Statistics (2018). The Economic Surveys Series, 2017.

Productivity

Data for 2017 show that the smallest sector (the ICT sector) in terms of number of enterprises and size of employment recorded the highest productivity values (= gross value added / total number of employees). In 2017, the ICT productivity per worker reached \$ 61,922, more than six times that of a worker in the service sector and three times that of a worker in the domestic trade sector. Construction sector productivity came second at \$ 32,168 per worker, much higher than workers' productivity in industry (\$ 20,658) (see Figure 2 and Table 1). It seems obvious that high productivity is particularly found in sectors with high proportions of wage earners. This is clearly the case for telecommunications, information and construction businesses, as shown in Table 1.

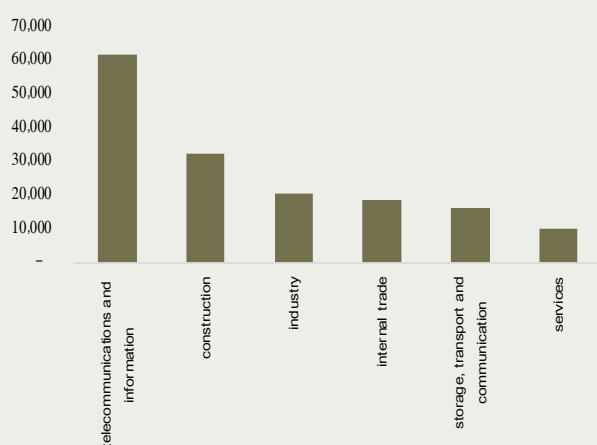
Economists usually correlate labor productivity with capital intensity (real capital in relation to the number of workers) in different economic sectors. The figures in Table 1 attest to this correlation in the Palestinian ICT sector. In other sectors, however, it is uncertain whether this reasoning is valid. Although the ratio of gross capital formation in the services sector is three times higher than in the construction sector, labor productivity in construction is three times higher than that of services.

Table 1: Selected Indicators of Economic Establishments in Palestine, 2017

Sector	Worker's productivity (USD)	Average number of workers	Wage earners / Total workers (%)	Gross fixed capital formation/Total workers (%) *
ICT	61,922	12	92.6	11,587
Construction	32,168	17	94.1	217
Industry	20,658	5	76.3	552
Transport and storage	16,396	6	85.4	725
Domestic trade	18,594	2	48.0	297
Services	10,060	4	68.6	673

Source: Palestinian Central Bureau of Statistics (2018). The Economic Surveys Series, 2017.

* Gross fixed capital formation was taken as an exemplar of capital.

Figure 2: Average worker productivity by sector (in \$), 2017

Source: Palestinian Central Bureau of Statistics (2018). The Economic Surveys Series, 2017.

Profit margin

The profit margin is the net income generated from business transactions, and it is equal to the gross profit generated from trading. The margin is calculated by subtracting all costs from sales revenue (taking into consideration the inventory change). Data from 2017 economic surveys reveal wide gaps in the average profit margin for businesses (gross margin / number of businesses) between different sectors of the Palestinian economy. Domestic trade businesses were more profitable than businesses in other sectors, about 32 times the average profitability in the services sector, 20 times the average profitability in the telecommunications sector, and 17 times the average profitability in the industry sector. In general, however, the average profitability of enterprises in the West Bank is many times higher than in the Gaza Strip. For example, West Bank transport & storage companies and industry companies, reported net profits 10 and 8 times, respectively, higher than their Gaza's counterparts.

Salam Salah, MAS

6- Investment Indicators¹

Building Licenses

Figure 6-1 shows the changes in the number of registered building licenses and licensed areas. Licenses of non-residential buildings constituted 10% of the total. On the other hand, licensed areas of buildings in Q3 2018 amounted to around 1.2 million square meters, which is higher by 17% compared to the previous quarter (Figure 6-1).

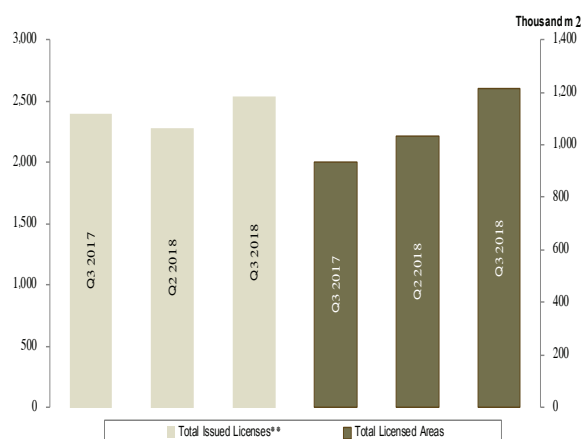
Vehicles Registration

Since vehicle prices are high and vehicles are often purchased via bank loans, the number of vehicles registered for the first time is considered a good indicator of the general economic situation and prospects. During Q3 2018, the number of new and second-hand vehicles (registered for the first time) in the West Bank was 8,361, higher by 1,383 compared to their number in the previous quarter, and less by 1,065 compared to the corresponding quarter 2017. The second-hand vehicles made 79% of the total number of vehicles, 7% of which came from Israel (Table 6-1).

Table 6-1: New and Second-hand Vehicles Registered for the First Time, West Bank (Q3 2018)

month	Vehicles from international market (new)	Vehicles from international market (second-hand)	Vehicles from the Israeli market (second-hand)	Total
July	735	2,653	163	3,551
Aug	469	1,341	136	1,946
Sep	550	2,159	155	2,864
total	1,754	6,153	454	8,361

Figure 6-1: Total Issued Building Licenses and Licensed Areas in Palestine*



* Data do not include that part of Jerusalem which was annexed by Israel following its occupation of the West Bank in 1967.

** do not include licenses of fences

¹ The source of figures in this section: PCBS, 2018, Statistics on Building Licenses, and the MoF, 2018, Palestinian Customs and Excise Dep.

Box 6: Industrial Estates and Free Zones in Palestine

An Industrial estate is a geographically defined area sub-divided into industrial plots with provision for infrastructure (public utilities of water, electricity, sanitation services, roads and transport, and telecommunications) developed according to a comprehensive plan which encompasses economic, social and environmental and urban roles and aspects of the industrial estate.¹ Industrial estates and free zones (IEFZs) are an essential determinant of economic development worldwide, considering their significant contribution to GDP, employment, and exports. IEFZs can be a real lever for economic growth. In Turkey, for example, their number rose from 12 in 1980 to 120 in 2009 with an operating capacity of more than 880 thousand worker. In Thailand, there are 27 large industrial estates and zones with investment worth of USD 21 billion, while in Vietnam there are 71, employing 22% of the workforce.²

There are three main drivers for establishing IEFZs; the first is developmental, i.e. aims to develop and improve manufacturing industries in a specific area; the second, the promotional driver aims to encourage the creation of new industries, and the development of existing ones, and enhancing synergies between industrial enterprises by strengthening backward linkages of existing industries with new industries; third, the organizational driver aims to gather dispersed industries through the provision of “industrial clusters” and through providing solutions to ecological and traffic and many other issues of concern.

The UNIDO Handbook (UNIDO, 1997) presents the incentives that IEFZs projects could benefit from, which include:³

- Relatively low rental fees for built-up industrial establishments and for using the lands;
- Subsidies for infrastructure services (water, electricity, telecommunications, and other facilities and services);
- Establishment of a one-stop shop to facilitate licensing procedures and other paper work;
- Tax exemptions on imports and exports as well as other taxes, such as income tax.

Distribution of IEFZs in Palestine

Since its establishment in 1994, the Palestinian National Authority (PNA) has been keen on planning for and establishing industrial estates and free zones. In 1996, the PNA designated a specialized department within the (then) Ministry of Industry, to follow up on the industrial estates and zones program. Later in 1998, the department was transformed into the Palestinian Industrial Estates & Free Zones Authority (PIEFZA). During the same year, the PNA issued Law No. 10 of 1998 on the Investment Encouragement Law, which included a package of incentives for Industri-

al zones including custom and tax exemptions for IEFZ imports and exports.

In addition, Cabinet Decision No. (8) of 2017 on the regulation of incentive package contract to encourage investments within IEFZ, which provides for tax reduction incentive for five years, is extended up to an additional three years; soft loans granted by banks and financing institutions for new projects within IEFZ should be treated as loans granted to small and medium-sized enterprises, as stipulated by the Income tax law.

In cooperation with donor countries and international organizations, four IEFZs have been established in the Palestinian territory, namely: Gaza Industrial Estate -GIE, Jenin Industrial Free Zone (JIFZ), Jericho Argo-Industrial Park (JAIP), Bethlehem Industrial Estate -BIE. In addition to Tarqumiya Industrial Zone, which is still under construction.

This section presents a brief on existing IEFZs only, and excludes estates and zones that are not in operation yet. In addition, Figure-1 depicts IEFZs main indicators.

1. Gaza Industrial Estate (GIE)

GIE was established in 1997, and started operating in two years. The estate enjoys a strategic location being located 3 km north of Gaza city, close to airports, ports, and crossing points. Facilities in the area include: banking services, customs clearance, freight and shipping, and infrastructure services, as well as a central electricity station in addition to the national grid. GIE's total area covers 50 hectares (500 thousand square meter), 66% of which are designated for industrial uses, 30% for roads and green spaces. GIE targeted most of Palestinian industries, including food, plastic, metal, clothing, textiles and other industries. By the end of 2017, the number of operating factories was around 26 employing 700, however, its full employment capacity is expected to reach 1500. According to PIEFZA's data, its total investments, after aid and grants, reached about USD 168 million.

2. Jenin Industrial Free Zone (JIFZ)

JIFZ is located north of the city center, about 1.6 km west of road 60, on the borders between the north West Bank and 1948 lands. The total area of JIFZ is 95 hectares (950 dunums), 68.6 hectares of which are used by industrial and commercial enterprises, while the remaining lands are allocated for roads, parking lots, storehouses, in addition to green spaces. The project was launched in 1996 to create new jobs, absorb increasing numbers of the workforce in the northern West Bank governorates, reduce Palestinian dependence on Israeli labor market. The German government was highly interested in JIFZ, and has taken upon itself the provision of the external infrastructure in the area. In addition, the Turkish government supported the project by allocating USD 12 million for the acquisition and preparation of land for leasing. The concession of running and developing the internal infrastructure of JIFZ was granted to a Turkish company (TOBB-BIS). Investment in establishing the industrial zone, including internal and external infrastructure, is expected to reach USD 74 million. Although it has been two decades now since the start of work, JIFZ is expected to start operation by 2020.

3. Jericho Argo- Industrial Park (JAIP)

JAIP was part of the Japanese government's initiative in 2006 “the Corridor for Peace and Prosperity”, which responds to the Palestinian development vision envisaged for Jericho and the Jordan valley.

1 Industrial zones should be differentiated from industrial estates. The former are usually unplanned industrial communities coming without a comprehensive development plan. They are merely a tract of land earmarked by the local authority for clustering industrial projects in one site, which means prohibiting establishing industrial projects outside that site. What distinguishes industrial estates is that they are established according to a comprehensive plan set in advance, which encompasses economic, social and environmental and urban roles and aspects of the industrial estates. For example, this definition does not apply on Ramallah and Al Bireh industrial zone (MAS, 2013).

2 Fallah, Belal, Abu Hantash, Ibrahim. (2013). The Transfer of Industries in Ramallah and Al-Bireh Governorate from Existing Areas to New Industrial Zone: an Exploratory Study. Ramallah: Palestine economic Policy Research Institute (MAS).

3 UNIDO (1997): Industrial Estates: Principles &Practice. Vienna.

In 2012, the PNA, represented by PIEFZA, signed a concession contract with Jericho Agro-Industrial Park Company, to launch work on the industrial park's internal infrastructure. JAIP company implemented this step, in collaboration with PIEFZA and Japan International Cooperation Agency (JICA), started operating in 2014. JAIP is located north-east of Jericho, 4km from the city center, 800m from road 90 connecting northern Palestine to the south. The Park has an area of 615 dunums. In phase I of the implementation (at that point covering 140 dunums) the Park targeted agro industries and related activities. However, in phase II (covering 485 dunums) the number of operating factories and companies in the Park reached 15, yet some 50 more factories are expected to become operational by the end of 2018. In addition, the Japanese government has donated USD 4 million to fund the establishment of an industrial training center in JAIP. In addition, it has collaborated with the developer to build a solar energy system on the roofs of the industrial buildings and hangars at an estimated cost of about USD 5 million.

Bethlehem Industrial Estate –BIE

BIE is located in Hindaza-Bred'a village, 10 km from Bethlehem's city center. The French government supported establishing BIE following the signing of a Protocol in 2008 between the State of Palestine and the French Republic. BIE was established on an area of 195 dunums and targeted small and medium industries. PIEFZA has contracted a Palestinian-French developer to develop the infrastructure of the estate in 2013. The project will be built in two phases, the first phase covers rehabilitating around 53 dunums, the second covers 40 dunums, and industrial building on 16 dunums.

Currently the number of operating factories is 10. However for phase I, the estate is designed to accommodate 23 operating factories, which are expected to employ 350-400 workers. When finished, the estate is expected to create 1500 direct job opportunities, while the number of operational factories will reach around 60. Total investment in BIE is estimated at USD 50 million, including aid and grants from the French government and funds allocated for the rehabilitation of external and internal infrastructure.

Table -1: IEFZs Main Indicators

Estate/Free Zone	Investments USD Million	Purpose / type	Size	Labor size (currently)	Leased Areas	Rent Fees per square meter annually	Start of Operation
JAIP	80	Agro-industrial	615	600	140	Open lots: 9 Hangars: 17	2014
GIE	168	industrial	500	700	85	Open lots: 8 Hangars: 26	1999
BIE	50	Hi-tech agro food industries	195	350-400	53	Open lots: 6	2013
JIFZ	40	Multiple industries	902	---	---	---	2020

Source: PIEFZ and developer companies, 2018.

Nasr Etyani, Economist

7- Prices and Inflation¹

The consumer price index (CPI) measures the prices of a selection of primary goods and services that reflect the average consumption pattern of families in an economy (this group of goods and services is referred to as the "consumption basket"). The average change in the CPI between the beginning and the end of a given period measures the inflation rate, which reflects the average change in the purchasing power of families and individuals' income. If nominal wages and salaries are assumed to be fixed, an inflation rate of 10% per year means that the purchasing power of families and individuals will decline by the same ratio. Figure 7-1 shows two curves, the first measures the average change in CPI (right axis) between Q3 2010 and Q3 2018. The second curve (left axis) measures the percentage change in the CPI each quarter compared to its previous quarter, i.e. the quarterly inflation rate. During Q3 2018, the CPI reached 111.10 compared with 110.56 in Q2 2018, i.e. the inflation rate was positive quarter on quarter (rise in prices) by 0.49%. This rise is attributed to the increase in the education services group by

1.55%, in the transportation group by 1.40%, prices of alcoholic drinks group by 1.21%, the housing and related items by 0.94%, the food and soft drinks group by 0.65%, against the fall in the prices of garments, cloths and footwear group by 2.11%. In addition, Q3 2018 witnessed a positive inflation of 0.58% compared with the corresponding quarter 2017.

Wholesale Prices and Producer Prices

The wholesale price index -WPI (sale price to retailers) rose by 0.45% between Q2 and Q3 2018, driven by the increase in wholesale prices of imported goods by 0.58% and the drop in wholesale prices of local goods by 0.62%. The producer price index- PPI (prices received by domestic producers) has also risen by 1.26% quarter on quarter. This resulted from the rise in the producer prices of locally-produced and consumed goods of 1.37%, and of 0.20% in the producer prices of locally-produced exports (Figure 7-2).

¹ The source of figures in this section: PCBS, 2018, Price Indices Surveys, 2010-2018. The purchasing power was calculated in cooperation with PMA.

Prices and Purchasing Power ²

NIS Purchasing Power: the rate of inflation in the economy measures the development in the purchasing power of all individuals who receive their salaries in NIS and spend all their income in that currency, i.e. the change in the NIS purchasing power is equivalent to the inflation rate, but in the opposite direction, during the same period. PCBS data show a rise in the CPI during Q3 2018 of 0.49% and 0.58% compared with the previous and corresponding quarters respectively, which means that the NIS purchasing power has decreased by the same percentage.

USD Purchasing Power: During Q3 2018, the USD exchange rate against the NIS increased by about 1.74 % and 2.14% compared with the previous and corresponding quarters respectively. Therefore, the purchasing power of individuals who receive their salaries in USD and spend all their income in NIS has increased during this quarter compared to the previous and corresponding quarters by 1.25% and 1.56%, giving the increase in the average exchange rate of the USD against the NIS. Considering that the JOD exchange rate is pegged to that of the USD, the purchasing power of the JOD has seen almost the same developments as that of the USD (Figure 7-3).

Figure 7-1: Change in the Average CPI and the Inflation Rate (Base year 2010)

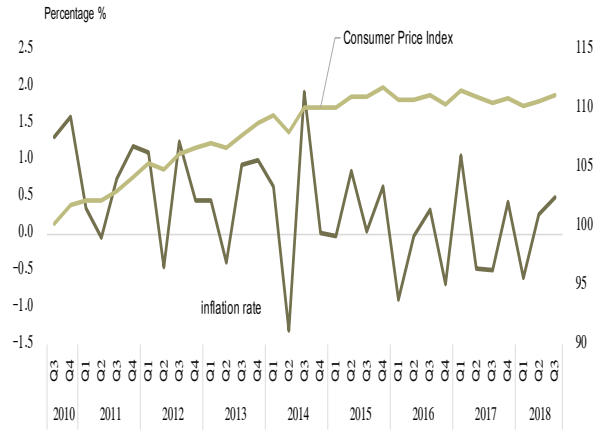


Figure 7-2: Evolution of WPI and PPI (base year 2007)

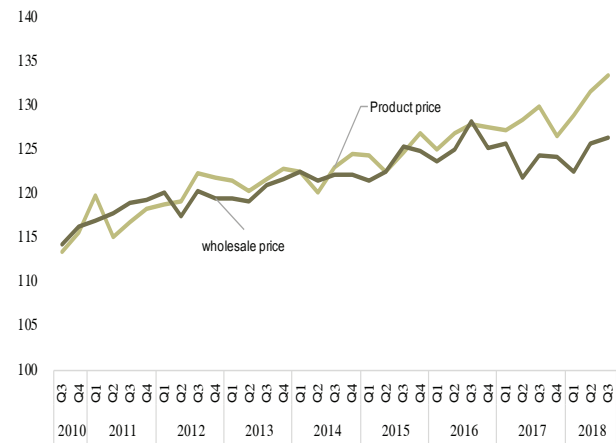
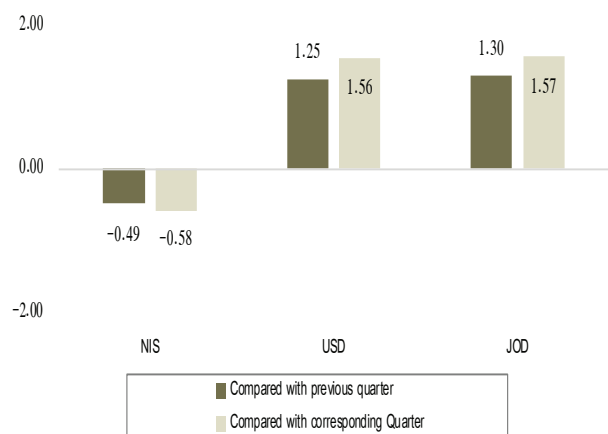


Figure 7-3: Change in Purchasing Power by Type of Currency, Q2 2018 (percentage %)



Source: Figures were calculated based on PMA and PCBS data.

² The purchasing power measures the ability of the individual to buy goods and services using the income he generates. It is dependent on the level of income and variance in prices, add to that the change in the average prices and the currency's exchange rate. Based on this, the change in the purchasing power (assuming income is constant) = the average change in the exchange rate of the currency against the shekel – inflation rate.

8- Foreign Trade¹

Balance of Trade

The value of “registered”² merchandise imports during Q3 2018 was around USD 1,443 million, an increase of 2% compared with the previous quarter, and 5% compared with the corresponding quarter. Meanwhile, the value of merchandise exports reached USD 262.1, decreasing by 2% compared with the previous quarter, and an increase of 3% compared with the corresponding quarter (20% of the value of imports). The value of exports constituted around 18% of the value of imports during Q3. The difference between merchandise exports and imports creates a deficit in the merchandise trade balance of USD 1,180.4 million. The overall trade deficit has dropped slightly because of the surplus in the balance of service imports from Israel (USD 5.2 million) (Figures 8-1 and 8-2).

Balance of Payments

The current account in the balance of payments is the net aggregate in three sub-balances: 1) the balance of trade (net trade in goods and services), 2) the balance of factor income (the net international transactions associated with income on factors of production, like the remittances of Palestinian workers in Israel and overseas, and 3) the balance of current transfers (international aid to the government and private transfers).

The current balance of payments account continued to run a deficit during Q3 2018 (which is also called deficit in the balance of payments) reached USD 444.7 million, a rise of 19% compared with the previous quarter and remained at the same level compared with the corresponding quarter. This deficit resulted from a deficit in the trade balance (USD 1,125.7 million), in addition to deficit in the balance of services reaching (USD 265.9 million), against a surplus in the balance of factor income of USD 608.8 million (generated mainly from the income of Palestinian workers working in Israel), and a surplus in the balance of current transfers of USD 467.1 million. The current account deficit was financed by a surplus in the capital and financial account, which covered an amount of USD 574.0 million. This item (the capital and financial account) represents a debt on the national economy, as long as its value is positive Table 8-1).

International Investments

Palestine’s foreign assets totaled USD 6,489 million by the end of Q3 2018, 5% of which represent direct foreign investments, and 21.5% portfolio investments. On the other hand, total external liabilities amounted to about USD 5,056 million, more than 54% of which were direct investments.

The difference (negative) between assets and liabilities means that the overseas investments by Palestinians were USD 1,433 million

1 The source of data in this section: PCBS, 2018, Registered Foreign Trade Statistics, and PMA & PCBS, 2018, Palestinian Balance of Payment, Q3 2018.

2 Registered imports and exports are those registered in the clearance accounts of trade (between Palestine and Israel) and in the customs data (including direct trade with overseas markets). Add to that the agricultural goods (which are registered by the Ministry of Agriculture). The registered trade figures are significantly lower than the actual figures of the Palestinian foreign trade. The actual figures are placed in the Palestinian balance of payments, mentioned later in this section.

Figure 8-1: Imports and Exports of “Registered” Merchandise (USD million)

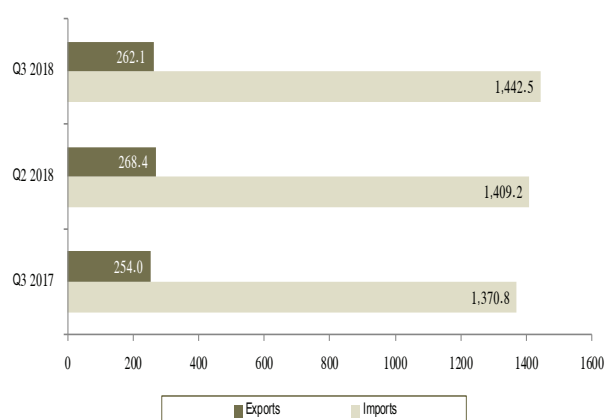


Figure 8-2: Exports and Imports of Registered Services from Israel (USD million)

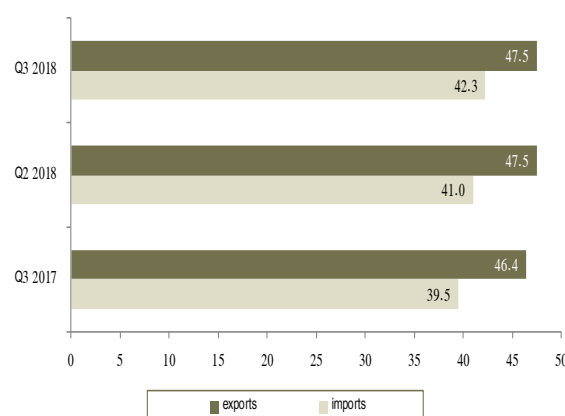


Table 8-1: Palestinian Balance of Payments *(Million USD)

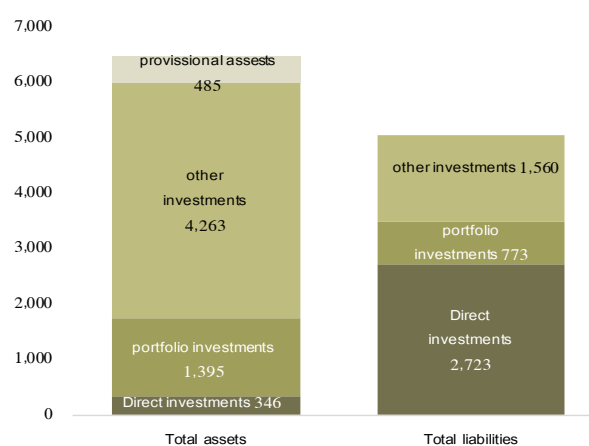
	Q3 2017	Q2 2018	Q3 2018
Trade balance of goods and services**	(1,419.3)	(1,427.2)	(1,520.6)
- Net goods	(1,171.4)	(1,178.9)	(1,254.7)
- Net services	(247.9)	(248.3)	(265.9)
2. Income balance	558.6	603.7	608.8
3. Balance of current transfers	417.0	450.2	467.1
4. Balance of current account (1 +2 +3)	(443.7)	(373.3)	(444.7)
5. Net capital and financial account	278.6	288.3	574.0
6. Net errors and omissions**	165.1	85.0	(129.3)

* Data do not include that part of Jerusalem governorate, which was annexed by Israel following the West Bank occupation in 1967.

** Exceptional financing has been calculated within the “Net errors and omission” item.

higher than investments of non-residents. A significant portion of these assets (62%) is cash deposits (mostly by local Palestinian banks abroad), which are not considered conventional outward investments. When examining foreign direct investments in Palestine (non-residents), figures show that it outweighed Palestinian investments abroad (by residents in the West Bank and Gaza Strip) by USD 2,377 million (Figure 8-3).

Figure 8-3: International Investments Balance (as of the end of Q3 2018) (Million USD)



Box 7: Economic Outlook for the Middle East and North Africa (MENA) Countries

Late in 2018, the International Monetary Fund (IMF) published its “Regional Economic Outlook: Middle East and North Africa” report (covering 21 country in the MENA region including Afghanistan and Pakistan. However, Palestine was not covered in the analysis).¹ The main conclusion of the report is that the region’s outlook is fragile and fraught with risks. Supportive fiscal and monetary policies are still needed for growth, which should be accompanied by structural reform and private sector investment to catalyze development and growth that includes everyone.

MENA Oil Exporting Countries

Around 11 of the 21 MENA countries covered in the report are oil exporters. According to the report, the MENA region was projected to experience significant improvements in external and fiscal balances in 2018–2019 due to higher oil prices and expansion in non-oil activities. As table 1 shows, oil exporters’ growth is projected to reach 2% in 2019. Despite the current surge in oil prices, they are projected to decline gradually to about USD 60 a barrel by 2023, slowing MENA oil exporters’ growth down to a projected average of 2.3% between 2020–2023, which is well below historical trends. Strong oil prices have improved the external balances of MENA oil exporters. The surplus in the balance of payments for 2019 is projected to reach 4.8% of GDP, 1.6% higher than 2017. According to the report, the overall fiscal deficit is projected to decline as well to 1.6% and 0.1% of GDP in 2018 and 2019 respectively, dropping from 5.1% in 2017. Yet risks remain; the tightening global financial conditions (stopping quantitative easing policies);² escalation of global trade tensions affecting growth and oil prices; spillovers from regional conflicts; delays in the implementation of key fiscal and structural reforms due the lack of urgency once oil prices peak.

1 IMF: Regional Economic Outlook, Middle East, North Africa, Afghanistan and Pakistan. November 2018.

<https://www.imf.org/en/Publications/REO/MECA/Issues/2018/10/02/mreo1018>

2 IMF: Regional Economic Outlook, Middle East, North Africa, Afghanistan and Pakistan. November 2018.

<https://www.imf.org/en/Publications/REO/MECA/Issues/2018/10/02/mreo1018>

MENA Oil Importing Countries

Giving the ongoing reforms and external demand, growth among MENA oil-importing countries³ is expected to continue at a modest and uneven pace. Table-1 shows that oil importers’ growth⁴ was projected to reach 4.1% in 2019, while growth averaged 5% per year during the years 2000–2014. The growth rate for 2019, as well, is uneven among MENA oil-importing countries. For instance, growth in some countries like Egypt, is projected to reach high levels compared to other countries running high deficits and suffering from structural distortions and ongoing conflicts.

Though MENA oil-exporters benefit from high oil prices, they put strains on external and fiscal balances of these countries. However, the strong growth of exports (which have doubled in 2018 compared with 2017, reaching up to 15.4% of GDP) mitigated the negative impacts of oil prices. The payments balance deficit of MENA oil-importers is expected to improve slightly, from 8.5% of GDP in 2017 to 6.8% in 2019. Fiscal deficit, as well, is projected to decline from 6.8% of GDP in 2017 to 6.2% of GDP between 2017–2019, due to improved revenue collection, and expenditure cuts.

Fiscal Consolidation Still Important

The IMF report emphasizes the need for continued fiscal consolidation in the MENA region to limit rapid debt accumulation and maintain fiscal sustainability. Even with consolidation, debt is expected to remain high at more than 60% of GDP in a number of countries (such as Bahrain, Egypt, Jordan, Lebanon, Morocco and Tunisia). To ensure equitable growth, countries should rebalance expenditures towards growth-enhancing and capital investment, while fostering well-targeted social spending for the benefit of the poor strata, and moving towards more progressive tax structures and diversified revenue bases. The tax base in the MENA countries is relatively low, especially oil exporting countries where it is less than 10% of GDP compared with more than 20% in other emerging economies in the world.

3 MENA oil importers: Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Somalia, Sudan, (Syria).

4 The aggregate growth of this country grouping is pulled upwards by strong growth in Egypt (FY2018), which hides weaker growth in other countries where structural weaknesses, elevated public debt, limited policy space, and conflict present major obstacles to growth.

Table-1: MENA Selected Economic Indicators (% of GDP)

	Average 2000–2014	2017	2018	2019
*MENA oil exporters				
Real GDP (annual %)	5.0	1.2	1.4	2.0
Current account balance	12.6	1.6	4.7	4.8
Overall fiscal balance	6.7	-5.1	-1.6	-0.1
CP Inflation (annual average %)	7.1	3.6	9.8	9.9
*MENA oil importers				
Real GDP (annual %)	4.2	3.5	3.8	4.1
Current account balance	-3.3	-8.5	-7.3	-6.8
Overall fiscal balance	-6.5	-6.8	-6.9	-6.2
CP Inflation (annual average %)	4.8	20.6	14.2	12.0

As stated in the report, increased budgetary transparency facilitates greater public awareness regarding tax burden, and that these policies are rewarding on the long-run though hard to implement in the short-run.

Private Investment is Needed for Inclusive Growth

Since 2000, annual private investment in the MENA region -covered in this report- reached 15.6% of GDP on average, the second lowest worldwide. The plunge, was thought in the past to be spurred on by the global financial crisis. Yet, today it is correlated with policy uncertainty, macro-

economic structural distortions and tightening global financing conditions. Private investment is needed for a dynamic private sector for job creation and increasing productivity through adopting new techniques. This is especially crucial for oil-importers haunted by high unemployment rates averaging 10% and more. In addition, investing in education and infrastructure, and improving government effectiveness and governance is crucial. Moreover, according to the IMF, increasing private investment requires reducing the role of the state in the economy especially in the MENA region where the public sectors may be crowding out private investment and competing with it for limited resources.

Economic Concepts and Definitions:

The Dutch Disease

In 1959, vast natural gas deposits were discovered in northeastern Netherlands. After a period of economic prosperity and wealth generated by oil exports, signs of recession and unemployment began to emerge in the Dutch economy in the 1960s. The boom in the export of oil was led to recession in non-oil sectors. In 1977, The Economist magazine coined the term “Dutch disease” to describe this paradoxical situation. The term became popular even before it was scrutinized by a coherent economic analysis that would have explained and proved the existence of a correlation between a country’s export of natural raw materials and the contraction of its productive sectors.

Dutch Disease: Symptoms and Causes

In the simplest form, the Dutch Disease is a situation where more exports of natural raw materials (oil and gas in particular) from a country leads to a large inflow of foreign currency into that country, which increases the demand for the local currency. This would cause the value of the local currency to rise sharply, making imports more affordable and more competitive, while equally making exports (in foreign currencies) higher in prices and lower in competitiveness. The main victims of this paradox are productive sectors (agriculture and industry) in the economy. Since the raw material export sector usually employs a limited number of workers, the continued prosperity of this sector would do nothing to reduce unemployment resulting from recession in other sectors, eventually raising the unemployment

figures in the country. In short, the Dutch disease describes a causal relationship, where stagnation of productive sectors in an economy results from local currency appreciation due to spikes in the exporting a natural raw material and the resulting inflow of foreign currency to the country.

For a Dutch disease to develop in a country’s economy, two conditions must exist. First, the country runs a floating exchange rate regime, so that free supply and demand forces control the exchange rate. Second, the supply of the natural resource and the external demand for it are not sensitive to changes in the local currency exchange rate.

Tradable and non-tradable goods

In 1982, a more systematic economic model describing the Dutch Disease was developed.¹ The model distinguishes between tradable and non-tradable goods and services.

Non-tradable goods and services are those produced and consumed locally, and for which there is no imported equivalent, such as buildings, houses, personal services, and all that cannot be imported from other countries, either because of logistical / natural obstacles or due to policy constraints. The fundamental difference between tradable and non-tradable goods is that the prices of the former are determined by the global markets, while the prices of the latter are

¹ M. Corden & P. Neary (1982): Booming Sector and De-Industrialisation in a Small Open Economy. The Economic Journal, Vol. 92, pp. 825-848

determined by domestic supply and demand forces. Unlike tradable goods, non-tradable goods do not face foreign competition, and hence the development of its labor productivity is often lower than average international figures for labor productivity. Since wage increases are often uniform in an economy, the prices of non-tradable goods rise at a faster pace than the prices of tradable goods.

This brief review might allow us to propose a new understanding of globalization as the trajectory through which an increasing number of goods and services are converted from non-tradable to tradable.

The theoretical interpretation of the Dutch Disease suggests that resource export boom leads to stagnation in non-resource sectors and appreciation of local currency in two ways:

- Resource movement effect: The resource export boom in the sector attracts more labor and capital from other sectors. This shift of labor and capital causes stagnation in the lagging sectors. However, this effect can be negligible if the resource sector does not deplete large domestic resources.
- The spending effect: This occurs as a result of the extra revenue brought in by the resource export boom. It increases demand for both tradable and non-tradable products, which leads to increases in wages. While producers of non-tradable goods can compensate for the loss they incur from higher wages by increasing the prices of their products, producers of tradable goods have a narrow margin for raising the prices of their products as they always face competition from imported goods. Thus, the rise in wages slashes profits of tradable sector producers, which throws production sectors into recession episodes, often accompanied by high appreciation of the local currency.

The Dutch Disease in Palestine

The foregoing discussion suggests that the symptoms of the Dutch disease can initially appear in any economy with relatively large inflows of foreign currency, regardless of the causes of these inflows. Particular attention has been paid to symptoms similar to those of the Dutch disease that may arise from expat remittances into the economies of Latin America countries. In this particular area (transfers),² the Dutch disease is quite relevant for the Palestinian economy, where foreign aid, private transfers and labor remittances constituted around 25% of GDP in 2015.

The fact that the foreign funds inflow into the Palestinian economy does not produce a Dutch-like disease is proof that the channels of influence on the economy function in a way that is somehow different from what is typically found in other economies:

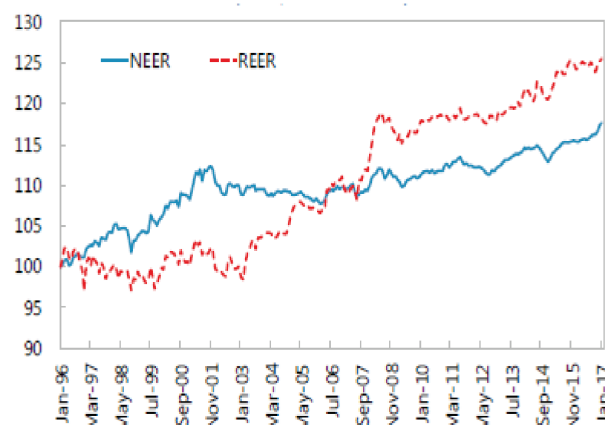
- Resource movement effect: Resource sector does not drain skilled labor and capital from the productive sectors. Rather, workers move from the Palestinian productive sectors to the Israeli economy. Apart from the negative impact on production, the movement of labor into Israel produces more inflows (workers' wages) into the local Palestinian economy.
- The spending effect: The flow of more than \$ 3 billion in aid and remittances leads to increases in aggregate demand as well

2 P. Acosta et.al. (2007): Remittances and the Dutch Disease. Federal Reserve Bank of Atlanta. Working paper series 2007-8. <https://www.frbatlanta.org/-/media/documents/filelegacydocs/wp0708.pdf>

as in prices of non-tradable goods disproportionately to the production capacity of the local economy. Such negative impacts on productive sectors (agriculture and industry) are further compounded by intense competition from Israeli goods.

Figure 1 shows the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) of the NIS in Palestine during 1996-2017. The nominal curve³ measures the fluctuations in the NIS exchange rate against the currencies of countries that import Palestinian products. The real curve, on the other hand, captures both the change in NEER and the price differentials between Palestine and its trading partners. This is quite significant in financial terms. First, the rise in the exchange rate produces a reduction in the competitiveness of Palestinian goods in the export markets. Second, these curves are peculiar to the shekel in relation to the Palestinian economy, and they differ from the exchange rates within the Israeli economy. This is due to two factors. First, Israel's trading partners are different from Palestine's trading partners. Second, inflation rates in Israel are different from those in Palestine.⁴

Figure 1: Effective Exchange Rate in Palestine (Index, 1996 = 100)



IMF (2017): West Bank and Gaza, Report to Ad Hoc Liaison Committee, August 3.

Figure 1 shows a steady decline in the competitiveness of Palestinian goods in export markets. In nominal terms, the decline resulted from the appreciation of the shekel against currencies of Palestine's trading partners. The REER trend line represents the change in the nominal exchange rate of the shekel and the rise of prices in Palestine at rates higher than in the markets of the trading partners. This rise might in part be due to inflows of funds from abroad and in part a result of Dutch disease symptoms. Here, too, we must remember the impact of Israeli restrictions on the price rise in Palestine.

The flow of income from abroad is, therefore, a double-edged sword. For one, it helps improve the standard of living in the country. For another, it has negative consequences both on producers of tradable goods and on exports.

3 The Nominal and Real Effective Exchange Rates.

4 In fact, the NIS effective exchange rate for Israel witnessed a significant decline in 2001-2006 (reflecting an improvement in competitiveness). Despite fluctuations, the effective and real exchange rates in 2017 were close to their 1999 values. See:

http://www.boi.org.il/en/DataAndStatistics/Pages/seriesgraph.aspx?SeriesCode=RER_LEVEL_CHAINED.M_E&DateStart=01/07/1999&DateEnd=31/12/2017&Level=4&Sid=51

Key Economic Indicators in Palestine, 2013-2018

Indicator	2013	2014	2015	2016	2017	2017		2018 ²		
						Q3	Q4	Q1	Q2	Q3
Population (One thousand)										
oPt	4,327.8	4,429.1	4,530.4	4,632.0	4,733.4	4,748.4	4,778.6	4,808.8	4,838.9	4,869.3
West Bank	2,643.5	2,696.7	2,750.0	2,803.4	2,856.7	2,864.8	2,880.9	2,897.0	2,913.1	2,929.3
Gaza Strip	1,684.3	1,732.4	1,780.4	1,828.6	1,876.7	1,883.6	1,897.7	1,911.8	1,925.8	1,940.0
Labor Market										
No. of workers (thousand)	885.0	917.0	963.0	980.5	948.7	949.8	966.4	935.4	921.7	960.7
Participation rate (%)	43.6	45.8	45.8	45.8	45.3	46.3	43.9	45.4	45.9	46.9
Unemployment rate (%)	23.4	26.9	25.9	26.9	27.7	29.6	24.8	30.2	32.4	31.7
- West Bank	18.6	17.7	17.3	18.2	17.9	18.9	13.6	18.3	19.1	17.3
- Gaza Strip	32.6	43.9	41.0	41.7	43.9	46.9	43.0	49.1	53.7	54.9
National Accounts (USD millions)										
GDP	12,476.0	12,715.6	12,673.0	13,425.7	14,498.1	3,728.3	3,728.8	3,689.9	3,559.5	3,659.8
- Household expenditure	11,062.6	11,840.4	11,805.1	12,337.7	12,844.7	3,386.6	3,173.8	3,182.9	3,258.5	3,316.9
- Government expenditure	3,381.7	3,478.2	3,429.5	3,530.3	3,809.8	892.7	1,068.6	977.5	904.3	957.7
Gross capital formation	2,707.3	2,415.0	2,677.4	2,827.0	3,305.6	879.6	894.9	876.7	837.3	916.1
Exports	2,071.8	2,172.3	2,338.1	2,381.0	2,692.7	671.3	717.9	713	714.3	707.0
Imports (-)	6,804.0	7,208.9	7,537.6	7,626.7	8,066.7	2,090.5	2,104.5	2,072.3	2,141.5	2,227.7
GDP per capita (USD)										
at Current prices	3,064.8	3,051.7	2,973.1	3,080.1	3,254.6	834.2	828.6	815.4	781.5	798.3
at Constant prices (base year 2004)	3,015.5	2,940.7	2,973.1	3,044.4	3,072.4	783.6	772.4	746.2	735.8	760.5
Balance of Payment (USD millions)										
Trade Balance	(4,732.2)	(5,036.7)	(5,199.6)	(5,246.2)	(5,374.2)	(1,419.3)	(1,386.6)	(1,359.3)	(1,427.2)	(1,520.6)
Income Balance	1,160.3	1,482.4	1,712.2	1,896.0	1,991.9	558.6	544.3	568.9	603.7	608.8
Current Transfers Balance	1,188.5	1,405.3	1,421.4	1,408.6	1,818.6	417.0	538.7	348.3	450.2	467.1
Current account Balance	(2,383.4)	(2,149.0)	(2,066.0)	(1,941.6)	(1,563.7)	(443.7)	(303.6)	(442.1)	(373.3)	(444.7)
Exchange Rates and Inflation										
USD/NIS exchange rate	3.611	3.577	3.884	3.840	3.603	3.559	3.512	3.461	3.573	3.635
JOD/NIS exchange rate	5.093	5.046	5.483	5.418	5.083	5.019	4.953	4.881	5.037	5.127
Inflation rate (%) ¹	1.72	1.73	1.43	(0.22)	0.21	(0.49)	0.43	(0.60)	0.26	0.49
Public Finance (cash basis USD million)										
Net domestic revenues (including clearance)	2,319.9	2,791.2	2,891.4	3,552.0	3,651.3	722.3	976.9	988.6	861.3	936.0
Current expenditure	3,250.7	3,445.9	3,424.9	3,661.6	3,794.8	782.6	1,059.7	933.2	886.1	895.6
Developmental expenditure	168.4	160.9	176.4	216.5	257.9	53.0	113.4	46.6	59.4	63.9
current budget deficit/surplus (before grants)	(1,099.2)	(815.6)	(709.9)	(326.2)	(401.4)	(113.3)	(196.2)	8.8	(84.2)	(23.5)
Total grants and aid	1,358.0	1,230.4	796.8	766.3	720.4	125.9	254.2	80.3	157.1	190.6
Total budget deficit/surplus (after grants and aid)	258.7	414.8	86.9	440.1	319.0	12.5	58.0	89	72.2	167.1
Public debt	2,376.2	2,216.8	2,537.2	2,483.8	2,523.2	2,526.0	2,523.2	2,448.8	2,367.6	2,355.7
The Banking Sector (USD millions)										
Banks assets/liabilities	11,190.7	11,815.4	12,602.3	14,196.4	15,850.2	15,461.0	15,850.2	15,916.7	15,763.0	16,179.4
Equity	1,360.0	1,464.0	1,461.7	1,682.4	1,892.7	1,804.6	1,892.7	1,926.8	1,819.7	1,863.9
Deposits at banks	8,303.7	8,934.5	9,654.6	10,604.6	11,982.5	11,526.8	11,982.5	12,002.3	11,992.6	12,194.2
Credit facilities	4,480.1	4,895.1	5,824.7	6,871.9	8,026.0	7,761.9	8,026.0	8,175.4	8,260.0	8,293.6

Data do not include that part of Jerusalem which was annexed by Israel following its occupation of the West Bank in 1967 (except for data on unemployment and population).

1. The inflation rate estimation is based on year-over-year comparisons of the average CPI in the target year (each quarter) with its average in previous year (quarter).

2. Figures for 2018 are preliminary and subject to further revision.

Figures between brackets indicate negative values.

Note1: Data on population for 2013-2017 are based on estimates in the Population, Housing and Establishments Census 2017.

Note 2: Figures for mid-2017 were updated based on final results of the Population, Housing and Establishments Census 2017.

Noe 3: the numbers of workers for the years before 2017 are based on estimates for the 2007 Census of Population, Housing and Establishments and will be updated to reflect the final results of the 2017 census.