



Palestine Monetary Authority

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Executive Summary

The performance of the **global economy** during 2009, especially in its second half, was better than expected, supported by growing optimistic expectations that the world's economy can return to the course of recovery, and the declining of risks posed by global financial crisis. However, this performance moved at different speeds; slow in many advanced economies, but relatively strong in most developing and emerging economies. While the initial forecasts of the IMF indicated a negative growth of about 1.1% in the global real gross product, the IMF revised those expectations to a negative growth of about 0.6%. Such performance was substantially associated with a group of developed countries and the impact of their economic leverage on the global economic activity.

In practice, there are two sets of factors that affected this performance. On the one hand, the various basic incentives, monetary and financial, introduced by the states and governments to face the crisis, provided an exceptionally significant flow of liquidity, that contributed to controlling the continued decline in the economic activity. On the other hand, the good performance in many developing and emerging countries also helped alleviate this decline, and improved the optimistic expectations for the possible return of the world economy back to its proper track.

Furthermore, the economic conditions in many developing and emerging economies and the low interest rates in developed countries, contributed to attracting more cash flows, especially from official sources. The changes that took place in foreign exchange rates of the major currencies that resulted in the decline in the volume of international trade, as well as changes in terms of trade exchange also played a role in narrowing the deficit gap in the balance of payments of many countries, especially between the developed countries and the developing and emerging countries.

Despite the likelihood of global economic recovery, there is still an atmosphere of uncertainty in many countries stemming out of the public budgets of those countries, and the vulnerability, fragility and lack of sustainability they have demonstrated. Subsequently, those public budgets were the source of a major concern in many developed countries, especially when combined with the rapid accumulation of public

debt in many developed, developing and emerging countries alike. Adding to the aforesaid are the originally-high rates of unemployment, suffered by the developed countries, and the potential loss of more jobs, especially those of a temporary nature turning into long-term unemployment, particularly in light of the fact that the prospects for recovery are still incipient.

At the Palestinian level, the performance of the **Palestinian economy** in 2009 was influenced by the positive atmosphere created by the Palestinian Authority's adoption of a plan and program for the establishment of a Palestinian state within two years, and the apparent resulting improvement in the environment for investment, security and economic conditions in general, especially in the West Bank. The plan placed greater importance to institution-building and reforms, specially, in the security, public finance, and governance areas. Added to the above was the relative relaxation of measures and restrictions imposed on the access and movement, especially in the West Bank, and allowing the Arab citizens inside Israel to access some Palestinian areas, which enhanced the economic activity. In Gaza Strip, the economic activities are still the hostage of the continued siege, which thus played a thwarting role to growth during the said year.

These factors, combined together, helped provide an economic environment that contributed to improving the economic performance, as expressed by a growth rate in the real GDP by about 6.8%, compared to 5.9% in 2008. However, this improvement was blemished in its structure because its major part was only associated with the West Bank. While the real GDP in the West Bank had grown by about 8.5%, the GDP growth rate in Gaza Strip remained in the range of 1%. Nevertheless, the positive effects of this performance affected several different areas.

On the one hand, this improvement contributed to increasing the **real per capita GDP**. The average real per capita GDP increased by about 3.7%, compared to 2.9% in 2008, an indicator of the possibility that such income will return to its levels before the Aqsa Intifada. In addition, there was a considerable improvement in the purchasing power, due to the improved nominal exchange rate of the U.S. dollar (and the Jordanian dinar) against the Israeli Shekel. As regards real wages, and despite the

high average of nominal daily wage, the level of real wages has declined due to increasing inflation rates at higher pace than the rate of increase in the nominal wages. On the other hand, the improvement also contributed to the decline in **unemployment rates** in the Palestinian territory from about 26% in 2008 to 24.5% in 2009, in both the West Bank and Gaza Strip though at different rates. Unemployment rates in the West Bank have declined from 19% in 2008, to 17.8% in 2009, and in Gaza Strip from 40.5% to 38.6% during the same period. However, unemployment rates remain high and pose a substantial challenge to the Palestinian economy.

Moreover, the decline in the global demand for raw materials (especially energy) and basic foodstuffs resulted in lower levels of their prices in the world, which translated at the Palestinian level into a decline in the inflation rate to about 2.8%, compared with an inflation rate of 9.9% in 2008. Yet, the **deficit in the trade balance**, as a percentage of the GDP, increased to about 54.8%, compared to 54.6% in 2008, due to the exports declining at a greater pace than imports.

On the other hand, the **financial performance of the National Authority** substantially improved in the year 2009, with the total net revenue rising by about 1.9% over the year 2008 and the total public spending (current and capital) decreasing by more than 5% below their levels in 2008. In practice, these reductions were, primarily, associated with the government's completing the payment of arrears on salaries and non-salary obligations. In addition, the government has complied with the adopted policies to curb the increase in the wage and salary expense item by reducing or suspending staff appointments.

Despite this reduction in public expenditures, the government, however, faced rigorous difficulties in providing the necessary liquidity to meet its various obligations. On the one hand, the external funding sources fluctuated throughout the year, noting that the budget depends on this support to cover a major part of its obligations, and in particular more than 45% of the total obligations in 2009. On the other hand, this support dropped by more than 20%, compared to funding received in the year 2008, which exceeded the ceiling of expectations at the time.

At the level of the **Palestine Monetary Authority (PMA)**, the year 2009 was distinguished by a greater activation of the role of PMA in the macro economy despite of all obstacles and difficulties. Such role was required to meet its responsibility to maintain the financial stability and ensure banking management in accordance with best international norms and practices in a manner that would help stimulate and boost sustained economic growth and development. The year also witnessed tremendous accomplishments at the level of the legal, regulatory and supervisory framework governing the banking business and banking environment.

At the **legal level**, the comprehensive review of the legal wording of the draft Law on Banks was completed, in line with developments in the banking and legal environment and in accordance with the best international practices. Furthermore, the final draft of the licensing and control regulation on specialized lending institutions was also finalized. Both drafts are in the process of endorsement. At the **organizational level**, PMA finalized, by the end of 2009, the first phase of the strategic transformation plan, which was focused on updating and developing the legislations governing the operation of PMA and the banking system. A new organizational structure for PMA was also introduced. This phase was characterized by a focus on human capital, the investment therein and management thereof, in order to empower it to effectively contribute to achieving the PMA objectives, represented in the financial stability in the first phase, and the monetary and price stability at a later stage, when conditions are favorable.

At the **Supervisory level**, PMA continued a process to update and develop comprehensive instructions to regulate the banking sector. Most important were the instructions related to the thresholds of the paid-up capital for banks, the instructions for developing disaster recovery and business continuity plans, good governance instructions, as well as instructions for fair lending, external audit, disclosure requirements, market control, risk management, and instructions to compel the banks to establish risk management committees.

PMA also maintained its new policy pertaining to bank **branching**, which directs banks to open branches in a number of targeted areas, especially in the rural areas. In addition, efforts were exerted in the development of the Credit Bureau, which links

banks and lending institutions operating in Palestine within one information network, as well as the development of the new automated check system, and its role in reducing the phenomenon of bounced checks and maintaining the legal status of the check.

On the other hand, the developments of 2009 highlighted the major and distinctive role of the Monetary Authority in addressing certain issues of extremely high priorities, in particular, the weak banks and problems in connection with the relationship with the Israeli correspondent banks.

As for the **Palestinian banking sector**, many significant achievements and developments were realized in 2009, marking an increase in the **net assets/ liabilities** of the banks by 6.5%. Such improvement was due to the continued public confidence in the banking system. The main increase in the consolidated balance sheet of the banks was due to the growth of **customer deposits** by 7.7% over the previous year.

The **ownership equity** (net) also grew by 12.4% from previous year, due to the increase in the volume of **paid-up capital** of banks by 15.3% due to PMA instructions issued in 2009, which obligated banks to raise their capital to \$ 50 million, as part of a plan to strengthen the banking system's ability to cope with any potential risks.

In an apparent indication of the response of banks to the PMA plan to promote local investment, a significant trend was observed in these banks to invest their funds in the local economy. On the one hand, the funds for **credit facilities** granted in 2009 increased by 22.2% over the previous year, to reach its highest level since the inception of the banking business in 1994. Consequently, there was an increase in the ratio of facilities to customer deposits amounting to 35.5% compared to the past year. On the other hand, **placement abroad** declined by 3.3%, in response to the new PMA instructions aimed at reducing the ratio of outbound investments to the total deposits.

The financial viability indicators of the banking sector have experienced an apparent improvement in 2009. With the rising of capital in the banking sector, the ability of the banks was enhanced to absorb the expected and unexpected losses, resulting from non-performing loans net of loans-loss provisions, which declined as a percentage of

capital to only 1.7% in 2009. NPLs as a percentage of total facilities have also significantly declined in 2009 to 4.1% compared with 8.1%, which contributed to enhancing the quality of bank assets.

The positive indicators in the consolidated balance sheet of banks reflected on the profits of banks. Net income after tax of the licensed banks increased by 22.2% over the previous year, which resulted in an improvement in the indicators of profitability. The **ROAE** (return on average equity) index increased to 15%, in addition to the increase in the **ROAA** (return on average assets) index to 1.8% compared to the year 2008. Alternatively, despite the slight decline in liquid assets as a percentage of net assets to 61.4%, liquid assets still accounts for a good percentage of net assets in the banking sector. Therefore, there are no risks to the sector's ability to meet its obligations, or to be vulnerable to financial crises such as lack of liquidity for example, which is one of the most serious risks to the banking sector.

On the other hand, 2009 witnessed improvement in the performance of the Palestine Securities Exchange, and the general index of the market (**Al-Quds index**) has increased by 11.6%, influenced by the increased indicators of all sectors except the insurance sector. This improvement was mainly due to the banking sector index rising by 30.6%, following the positive developments in the banking indicators for the banks operating in the Palestinian territories.

Palestinian Key Economic Indicators, (2006-2009)

Indicator	2006	2007	2008	2009
Output, Prices and Unemployment	(Annual Percentage change %)			
Real GDP (2004 market prices)	-5.2	5.4	5.9	6.8
Real Per capita GDP	-8.1	2.2	2.9	3.7
Inflation Rates	3.8	1.9	9.9	2.8
West Bank	5.0	0.8	9.8	0.6
Gaza Strip	4.6	1.6	14.0	4.4
Unemployment rates	23.6	21.5	26.0	24.5
West Bank	18.6	17.7	19.0	17.8
Gaza Strip	34.8	29.7	40.6	38.6
Consumption, Investment and Saving	(In Percent of GDP %)			
Aggregate Consumption, of which:	123.9	127.4	127.7	125.3
Public	18.8	19.8	20.4	19.3
Private	105.1	107.6	107.3	106.0
Gross Capital Formation, of which:	30.2	29.8	26.3	30.8
Public	12.3	12.2	10.0	7.1
Private	17.9	12.6	16.3	23.7
Aggregate Saving	-23.9	-27.4	-27.7	-25.3
Public Finance	(In Percent of GDP %)			
Revenues and External Support	37.7	56.7	58.0	48.2
Domestic Revenues	8.2	6.3	12.4	9.6
Clearance	7.4	25.4	18.6	17.8
Budget Support	22.1	25.5	28.9	22.9
Recurrent Expenditures and Net Lending	37.0	55.5	53.6	50.8
Recurrent Expenditures, of which:	30.9	49.5	53.6	47.7
Wages and Salaries	14.2	26.4	29.0	23.3
Non-Wage Expenditures	8.5	12.8	17.3	18.7
Net Lending	8.1	10.3	7.3	5.8
Capital Expenditures	6.1	6.0	N.A	3.0
Recurrent Balance (before External Support)	-15.2	-18.4	-24.4	-22.4
Recurrent Balance (after External Support)	0.7	1.2	4.4	-0.1
Over all Balance (before External Support)	-21.3	-24.3	-24.4	-24.7
Over all Balance (after External Support)	0.7	1.2	4.4	-2.5
External Sector*	(In Percent of GDP %)			
Exports of Goods and Services	12.3	15.7	15.2	12.5
Imports of Goods and Services	69.1	75.5	68.9	67.4
Net Factor Income, of which:	8.8	10.4	10.5	12.6
Compensation of employees	6.3	7.2	7.7	10.1
Net Current Transfers, of which:	27.7	40.4	51.9	38.5
Official Transfers	23.7	20.2	32.3	22.2
Current Account Balance (excl. official transfers)	-44.1	-29.2	-23.6	-25.9
Current Account Balance (encl. official transfers)	-20.4	-9.0	8.7	-3.7
Monetary Sector	(Annual Percentage Change %)			
PMA's Assets	-5.1	37.1	55.2	8.8
Banks Assets	2.9	21.4	10.4	6.5
Total Credits, of which:	3.1	-7.5	7.2	22.2
Credit to The Private Sector		-5.6	0.9	23.3
Deposits, of which:	0.5	21.4	14.2	7.7
Private Sector Deposits	6.1	20.1	13.9	9.1
Balances Abroad	1.4	32.9	4.1	-13.8
Banks Equity, of which:	8.1	17.5	21.6	12.4
Paid up Capital	52.3	10.1	19.4	15.3
Al Quds Stock Market Index	-46.4	-12.8	-16.2	11.6
Memorandum Items:				
Real GDP (million USD)	4,322	4,554	4,821	5,147
Nominal GDP (million USD)	4,619	5,182	6,108	6,117

* Based on Balance of Payments data. Source: Calculated from different sources.