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40

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FOREWORD

We are glad to present to the reader the 40th issue of the quarterly Economic and Social Monitor, which covers developments in the Palestinian economy during the 4th quarter of 2014, as well as in the year as a whole with a comparison to the previous year 2013. Unlike in previous 4th quarter issues, here we have included the whole-year data within the overall presentation and not as a separate section.

As we remarked in the foreword to the preceding issue, the National Accounts and the Labor Market data for the 3rd quarter of 2014 were not available at that time. To fill this gap, we have included these data in the current issue's tables. This publication also incorporates an analysis of the crisis caused by Israel's recent withholding of Palestinian clearance revenues (December 2014 through April 2015), to which we eluded in the previous issue of the Monitor. The analysis is presented in one of the ten analytical text boxes featured in this Monitor, which address economic matters that, directly or indirectly, impact the Palestinian economy. We hope that the reader will find the information and analyses in the text boxes useful and enriching.

With this publication, we have completed the 2014 issues and will embark next on preparing the 2015 issues with a new coordinator on behalf of MAS, which is a routine procedure at the Institute whereby young researchers are given different responsibilities from time to time to widen their experience. We wish to thank Arwa Abu Hashhash, the outgoing coordinator from MAS, for her work and effort and for a job well done over the past two years.

Nabeel Kassis	**Ola Awad**	**Jehad Alwazir**
Director General	*President*	*Governor*
Palestine Economic Policy Research Institute (MAS)	*Palestinian Central Bureau Of Statistics (PCBS)*	*Palestine Monetary Authority (PMA)*

Executive Summary

Issue 40 of the Quarterly Economic and Social Monitor provides an overview of the key developments in the main economic indicators in the Palestinian Territory during the fourth quarter of the year as well as during the whole of 2014. The executive summary will focus on the year-on-year changes in addition to summarizing the topics discussed in the boxes.

Overview

We can sum up the economic performance in the Palestinian Territory during 2014 in few words: in 2014 the Palestinian economy has not witnessed noticeable changes, if it has not actually worsened. Consumption was 20 percent higher than production; the unemployment rate remained at around 25 percent; recorded exports were as little as 20 percent of imports; around a third of public revenuecame from grants and donations; and the government accumulation of arrears (on a commitment basis) reached 23 percent of current expenditure.

Fiscal policy has seen no changes either, as the primary (or even the only) concern of the budget remained paying the public staff salaries that depleted 68 percent of total domestic revenues, including clearance revenues. The public debt exceeded its ceiling, thus threatening the banking system.

One cannot, however, ignore the momentous events during the year, particularly the Israeli war on the Gaza Strip in the summer of 2014 and the withholding of clearance revenues, which had definite implications on the economic performance. Nevertheless, some may argue that the reconstruction efforts and the additional pledged aid were supposed to catalyze the economic activity in the Gaza Strip, and eventually in the West Bank. However, this unfortunately has never been the case. We should always remember that poor economic performance reflects – or perhaps is a product of – a stalled political process, both externally (the relationship with Israel) and internally (the national reconciliation).

The regulatory environment was not in a better condition and was arguably chaotic. The 2014 presidential executive order on the amendment of the Income Tax Law was the seventh amendment since 2007. This means that one of the most important laws that affect production and investment was amended once a year on average. As a case in point, the presidential executive order on public procurement, which was released in late May 2014, was amended by a new order before the end of the same year.

GDP

Palestinian 2014 GDP totaled around USD 7.5 billion (2004 prices), a growth of less than 0.5 percent over 2013 (+5 percent in the West Bank versus -15 percent in Gaza). This brought Gaza Strip's GDP share down from 27 percent to 22 percent. Per capita GDP, meanwhile, fell to USD 1,734, thus declining by 3.3 percent from 2013.

Labor Market

The number of West Bank and Gaza's workers rose to 917,000, an increase of 3.6 percent over 2013. By place of work, 60 percent of them worked in the West Bank, 27 percent in the Gaza Strip and 12 percent in Israel and the settlements. Public employment remained unchanged at 23 percent, with a massive share for Gaza (41 percent). Meanwhile, the unemployment rate stood at 27 percent (18 percent in the West Bank and 44 percent in Gaza), rising by 3.5 percentage points over 2013. On the other hand, the average daily wage rose to NIS 84.6. The average daily wage for West Bank workers was only 44 percent for those working in Israel and the settlements, while for Gaza Strip workers it was only 30 percent compared to those working in Israel and the settlements.

Public Finance

Compared to the previous year, 2014 public revenues and grants saw an increase of 8.1 percent to NIS 14.3 billion, thanks to a 20 percent growth in clearance revenue and a 5 percent increase in non-tax revenues. International aid (which made up 30 percent of total public revenue) fell by 10 percent, and tax revenues remained unchanged. Meanwhile, public expenditure reached NIS 12.8 billion (95 percent for current spending and 5 percent for developmental spending). These changes produced a surplus of NIS1.5 billion (on a cash basis), which the government used to pay off a large part of the banking sector's arrears. This is, however, not the case when figures are calculated on a commitment basis. The government liabilities hiked 64 percent over 2013 to NIS 2.8 billion. Finally, at the 2014 close, the public debt totaled NIS 8.6 billion (or 19 percent of GDP), of which around 50 percent was owed to the local private sector. Together the public debt and the liabilities produced a figure that was very close to 40 percent, the ceiling set for the public debt (See Monitor 37).

The Banking Sector
Total assets of banks grew during the year by 5.6 percent to USD 11.8 billion on a 9.3 percent rise in credit facilities. Total liabilities, on the other hand, saw an increase of 5.6 percent, with public deposits (the most important component of liabilities) touching USD 9 billion. Interestingly, the ratio of non-performing facilities to total facilities fell from 2.9 percent to 2.5 percent during the year. At the same time, the net profits of banks totaled USD 145.8 million though the difference between the average lending interest rate and deposit interest rate fell slightly for all traded currencies.

Investment Indicators
The number of companies newly registered in the West Bank in 2014 was 1,490, upby 318 (or 27 percent) from 2013.The new companies registered in the year had a capital of JD 224 million, down by 34 percent from the previous year.

Around 16,830 building permits (either for new or for annexes to existing housing units) were issued during 2014, with no significant change from 2013. Meanwhile, the amount of imported cement rose by 12 percent during the same period to 1.5 million tons. While cement import increased in the West Bank by 13 percent, it fell in the Gaza Strip by 23 percent (only 39 thousand tons).

Prices and Purchasing Power
The 2014 consumer price index saw a rise of 1.73 percent over 2013. The change basically resulted from an increase in the prices of beverages and tobacco (11.8 percent), medical services (8.7 percent) and lodging (3.3 percent), against a decline in transportation and telecommunication prices.

The purchasing power for individuals who receive their wages and salaries in USD or JD (but have their spending in NIS) fell by 2.7 percent (an inflation rate of 1.73 percent coincided with a 0.9 percent decline in the USD exchange rate).

Balance of Trade and Balance of Payments
Commodity imports fell to USD 5 billion, down by 2.1 percent from 2013. Similarly, commodity exports declined by 4 percent to USD 865 million. This produced a deficit of USD 4.2 billion, approximately the same figure reported in 2013. Meanwhile, the deficit in the balance of trade in services with Israel reached USD 15.3 million. The current account deficit in the balance of payments totaled USD 1.4 billion, down by 42 percent from 2013. This drop resulted from a 24 percent increase in the surplus in the income balance and a 128 percent growth in the current transfers. The current account balance deficit was financed by the capital and financial account, which provided USD 1.4 billion.

External Assets, Liabilities and Debt
Palestine's 2014 foreign assets totaled USD 5.9 billion, of which 2.8 percent was in the form of direct investment, while portfolio investment accounted for 19.9 percent. The total external liabilities, on the other hand, reached USD 4.7 billion, of which 52 percent was in the form of foreign direct investment. Palestine's external debt, in the meantime, totaled USD 1.6 billion, with the government as the largest holder (around 70 percent of total external debt).

Box Topics: Issue 40 of the Monitor has 10 boxes, each of which discusses a specific topic:

Middle East and North Africa (MENA) Regional Economic Developments and Outlook
The box sheds light on the IMF report on the prospects for growth and the challenges facing the MENA economies. The report, which was released in late 2014, focused on the prospects for medium-term economic growth and potential cooperation in the region. However, the developments that took place in late 2014 (namely the decline in oil prices and demand, exchange rate movements, and high interest rates) forced theIMF to make changes to its growth outlook. The box provides a review of the prospects for growth in the MENA in 2015

and highlights the decline in oil prices and the impact on oil exporters and importers.

Israel's Economy in 2014

This box summarizes the most important economic developments which Israel's economy saw in 2014. The GDP growth (2.8 percent) came mainly from a growth in domestic public and private demand. The slow growth, especially in the GDP per capita (0.8 percent), resulted from the continued slump in international trade, the shekel appreciation, and a fading demand for investment. The box also focuses on the steady decline in unemployment rate as a result of modest increases in wages and reduced working hours. Finally, it outlines the main elements of the trade balance as well as the key fiscal and monetary policies during the year.

A Study by the Bank of Israel: Greater Stability but Less Privileges for West Bank Workers in Israel

Box three summarizes the results of a report on Palestinian employment in Israel and its characteristics. The report found that the number of Palestinians residing in the West Bank and working in Israel (including both workers with a work permit and those without a work permit) has reached around 92,000 in 2014. The findings suggested three important highlights. First, there is high stability in the relationship between the West Bank workers (who hold work permits) and their Israeli employers. Second, among Palestinians working with a permit in the Israeli economy, only a very small share claimed that they are employed through a contract (only 2 percent, according to Palestinian labor force surveys). Third, there is a marked wage gap between the Israeli and Palestinian workers working in Israel.

Withholding Clearance Revenues: A Recurrent Crisis and Long-Term Economic Repercussions

This box examines the impact of Israel's recurrent withholding of Palestinian clearance revenue, particularly during the recent crisis between Israel and the PNA. The box spotlights the gap between revenues on a commitment basis and cash basis from April 2008 to February 2015, and the impact of this gap on the economic performance. The box then examines the economic effects of the freeze and the tools the PNA government used to solve the liquidity problem. In fact, the impact stretches beyond the short-term effects that end with the release of revenues to long-run implications on aggregate demand, the business cycle, the public debt interest onus, and the adverse effects on the sustainability of the banking system. Perhaps the first casualty is the investment climate, which will sustain serious threats with negative implications on production and employment in the long-run.

Trading Commission onthe Palestine Stock Exchange, the Highest in the Region

Is the high stock trading commission a result of low volume and value of shares traded? Or is the low trading a result of high commission? These are two questions that this box raises and tries to answer. After drawing a comparison between the stock trading commissions in the Palestine Stock Exchange and a group of stock exchanges in neighboring countries, the box concludes that the commission in Palestine is the highest. The Monitor team met with the Director General of the Securities Department in the Palestinian Capital Market Authority to learn more about such a high commission and its impact on the shares trade movement. According to the Director General, there are many reasons behind weak trading other than the high commission, which is the main source of revenue for the Authority and the securities sector institutions, the biggest losers of low trading. The real problem in the securities industry is that the current trading volume does not allow economies of scale that are necessary for the sustainability of the sector, he said. Accordingly, lowering the commission will never be the solution unless it is coupled with a set of policies that aim at enhancing trading. In his reflection on the problem, he gave, as an example, the levying of value added tax by government on both the buyer and the seller, which he maintained is a unique practice.

Liquidity Crisis in the Palestinian Economy

This box looks at the liquidity semi-chronic crisis facing the Palestinian banking system. This crisis is basically triggered by the Israeli recurrent violations of the Paris Protocol provisions on the use of the shekel as a trading currency in the Palestinian Territory and Israel's obligation to provide sufficient liquidity and withdraw the surplus of its currency through traditional banking channels. The liquidity crisis in the banking sector aggravated in the second half of 2007, when Israel declared the Gaza

Strip a hostile territory and severed all ties with banks operating in the Gaza Strip. This triggered a lack of liquidity crisis in the Gaza Strip against a shekel cash surplus in the West Bank. The crisis resurfaced again in 2009, when the surplus started to rise, reaching its historical high in 2013. The box outlines the effects of these changes and the efforts the Palestine Monetary Authority made to help the banking sector overcome these crises.

The Effects of NIS Appreciation on the Palestinian Economy

The box highlights the fluctuations in the USD exchange rates against the NIS and the resulting implications on the Palestinian economy. The USD/NIS exchange rate reached its historical high in 2011 (4.084). It then started to decline but rebounded thereafter, coming close to its 2011 rate in March 2015. This appreciation is a double-edged sword. On the one hand, it can increase exports and reduce imports, and thus improve the trade balance. On the other hand, it can lead to a rise in inflation and create a wage-price spiral, which adversely impacts the competitiveness of goods in the global market. The box focuses on the effects of the NIS/USD depreciation on the Palestinian economy in four areas: impact on individuals who are paid in dollars (or Jordanian dinars), impact on spending resulting from NIS higher prices, impact on the state budget, and impact on competitiveness of goods in the global market.

Have Palestinian Consumers Felt the Plunge in Prices of Global Crude oil?

This box tries to answer the question: why the oil prices in Palestine have not dropped in line with the fall in global markets. The box provides the percentage decrease in petrol and diesel prices in Palestine and Israel, compared to the fall in crude oil prices. The box shows the mechanism of setting oil prices in Palestine and the close linkage with the prices in Israel. The box highlights the Paris Protocolconstraints on oil prices and the high tax levied on petroleum products. The box finds that a price decrease in the Palestinian market proportional to that in crude prices is not necessarily justified, and that while gasoline prices in the Palestinian Territory fell in 2014 by a percentage similar to that in Israel (16 percent), the reduction in diesel prices was higher in Palestine. It is no secret, the box concludes, that the Palestinian government purpose of increasing its tax revenue keeps it from reducing oil prices in the local market to be in line with the decline in the prices of crude oil.

Different Effects of Lebanon and Gaza Conflicts on Israel's Economy

The box summarizes the findings of a study in the annual report of the Bank of Israel. The study, which examined the economic costs of the Israeli recent wars, drew a comparison between the economic effects of the recent war in the Gaza Strip and the Second Lebanon War (in 2006), both of which lasted for a long period and broke in the summer. The study found that the economic impact of the war on Gaza was peculiar to the demand side and did not significantly affect the supply side (i.e., production) of the Israeli economy. The effect of the Lebanon war was a far departure, with implications touching the supply side, in particular. The study also found that the difference in the sectoral impact of the two wars coincided with different social effects.

Israeli Universities Drop in International Rankings and Uncertainties in the Sustainability of the High-Tech Industry

The box highlights the significant decline in the academic ranking of Israeli universities in both the Times Higher Education World University Rankings and the Shanghai University Rankings. The box compares the Israeli universities places in the tables of the two systems in 2015 compared to previous years and provides explanations for the drop. The box then outlines the stumbling blocks to the high-tech industry and start-ups in Israel, with bleak outlook on the rosy, upbeat image among global businesses and media.

Key Economic Indicators in the West Bank and the Gaza Strip for the years 2000-2014

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014[d]
Population at mid year (thousands)															
Palestinian Territory	3,053.3	3,138.5	3,225.2	3,314.5	3,407.4	3,508.1	3,612.0	3,719.2	3,825.5	3,935.25	4,048.40	4,169	4,293	4,421	4,550
- West Bank	1,943.7	1,992.6	2,042.3	2,093.4	2,146.4	2,203.7	2,262.7	2,323.5	2,385.2	2,448.4	2,513.3	2,580	2,649	2,719	2,790
- Gaza Strip	1,109.7	1,145.9	1,182.9	1,221.1	1,261.0	1,304.4	1,349.3	1,395.7	1,440.3	1,486.8	1,535.12	1,589	1,644	1,702	1,760
Labor Market															
Employment (thousands)	600	505	477	564	578	603	636	690	667	718	745	837	858	885	917
Participation Ratio (%)	41.5	38.7	38.1	40.3	40.4	40.4	41	41.7	41.2	41.6	41.1	43	43.4	43.6	45.8
Unemployment (%)	14.1	25.2	31.3	25.6	26.8	23.5	23.7	21.7	26.6	24.5	23.7	20.9	23	23.4	26.9
- West Bank	12.2	21.6	28.2	23.7	22.8	20.4	18.8	17.9	19.7	17.8	17.2	17.3	19.0	18.6	17.7
- Gaza Strip	18.9	34.0	37.9	29.1	35.3	30.3	34.8	29.7	40.6	38.6	37.8	28.7	31.0	32.6	43.9
National Accounts															
GDP (Mill. USD)	4,313.6	4,003.7	3,555.8	3,968.0	4,329.2	4,831.8	4,910.1	5,505.8	6,673.5	7,268.2	8,913.1	10,465.4	11,279.4	12,476.0	12,765.8
Private Consumption	3,713.0	3,594.6	3,217.7	3,736.3	4,270.3	4,891.7	5,111.7	5,595.3	6,575.8	6,822.8	7,976.0	9,199.0	9,693.6	10,522.5	11,599.0
Public Consumption	1,098.9	1,116.4	985.8	906.0	1,227.0	1,363.3	1,374.5	1,603.2	1,832.8	2,342.7	2,500.8	2,892.3	3,126.9	3,381.7	3,578.3
Gross Capital Formation	1,358.9	1,184.2	930.5	1,143.0	1,151.5	1,241.3	1,155.1	1,204.9	1,371.9	1,504.8	1,921.5	1,863.8	2,378.5	2,707.3	2,375.1
GDP per capita (USD)															
In Current prices	1,518.9	1,369.4	1,181.8	1,281.4	1,358.1	1,470.1	1,448.8	1,575.6	1,855.5	1,963.2	2,338.7	2,664.9	2,787.2	2,992.2	2,973.4
In Constant 2004 prices	1,526.7	1,345.0	1,143.7	1,267.0	1,358.1	1,459.4	1,360.1	1,406.0	1,449.1	1,529.8	1,606.4	1,752.5	1,807.5	1,793.3	1,734.6
Foreign Trade[b] (Mill. USD)															
Commodity Exports		339	282	318	348	378	378	562	569	631	666	1,525	1,250	1,756.1	2,018.7
Commodity Imports		1,980	1,507	1,782	2,300	2,613	2,738	3,280	3,511	4,136	4,319	6,188	6,134	6,053.0	7,071.0
Trade Balance (Goods)		(1,641)	(1,224)	(1,464)	(1,952)	(2,236)	(2,352)	(2,718)	(2,942)	(3,504)	(3,653)	(4,663)	(4,884)	(4,296.9)	(5,052.3)
Services Exports		117	103	154	192	202	179	252	357	579	831	686	649	315.7	279.3
Services Imports		603	600	475	519	451	455	634	698	931	1,143	948	1,032	751.0	710.1
Trade Balance (Services)		(486)	(497)	(320)	(327)	(249)	(275)	(382)	(342)	(352)	(312)	(262)	(353)	(435.3)	(430.8)
Current Account of BoP		(875)	(452)	(854)	(1,334)	(1,020)	(944)	(467)	530	(713)	(691)	(2,430)	(2,815)	(1,317)	(1,387)
Exchange Rates and Inflation															
Average USD/NIS	4.086	4.208	4.742	4.550	4.477	4.482	4.454	4.110	3.587	3.929	3.739	3.578	3.85	3.611	3.577
Average JOD/NIS	5.811	5.928	6.674	6.417	6.307	6.317	6.292	5.812	5.061	5.542	5.275	5.050	5.43	5.093	5.046

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014[d]
Inflation Rate (%)[c]	2.8	1.2	5.7	4.4	3.0	4.1	3.8	1.9	9.9	2.75	3.75	2.88	2.78	1.725	1.733
Public Finance on Cash Basis, mill. USD															
Net Domestic Revenues (incl. Clearance)	939	273	290	747	1,050	1,370	722	1,616	1,780	1,548.4	1,900.4	2,176	2,240	2,320	2,787
Recurent Expenditure	1,199	1,095	994	1,240	1,528	1,994	1,426	2,567	3,273	2,920	2,983	2,952	3,047	3,250	3,438
Development Expendt.	469	340	252	395	0	287	281	310	-	46.8	275.1	296	211	168	164
Deficit (before Grants)	(260)	(822)	(704)	(493)	(478)	(624)	(704)	(951)	(1,493)	(1,342)	(1,083)	(776)	(807)	(931)	(651)
Foreign Grants	510	849	697	620	353	636	1,019	1,322	1,763	1,402	1,277	978	932	1,358	1,233
Surplus/deficit (after Grants)	(219)	(313)	(259)	(268)	(125)	(275)	34	61	270.2	(144)	(81)	(94)	(86)	259	418
Public Debt	795	1,191	1,090	1,236	1,422	1,602	1,494	1,439	1,406	1,736	1,883	2,213	2,483	2,376	2,422
Banking Sector (Million Dollars)															
Assets/Liabilities	4,593	4,430	4,278	4,728	5,101	5,604	5,772	7,004	5,645	7,893	8590	9,110	9,799	11,191	11,822
Equity	242	206	187	217	315	552	597	702	857	910	1,096	1,182	1,258	1,360	1,467
Deposits	3,508	3,398	3,432	3,625	3,946	4,190	4,216	5,118	5,847	6,111	6,802	6,973	7,484	8,304	8,935
Credit	1,280	1,186	942	1,061	1,417	1,788	1,843	1,705	1,829	2,109	2,825	3,483	4,122	4,480	4,896

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

All data exclude the part of Jerusalem governorate which was annexed illeagaly by Israel (with the exception of the data on unemployment and population). Figures in brackets are negative.

a. The national accounts are in current prices, taken from the revised series of GDP values issued by PCBS in 2015. (for more information on the revised series, see the text box No. 2 in the Monitor No. 38)
b. Foreign trade figures are taken from the balance of payments prepared by the Palestinian Central Bureau of Statistics in collaboration with PMA.
c. The inflation rate is based on the comparison of average indices of consumer prices for the comparison year with its average in the previous year.
d. Data for 2014 are Preliminary and subject to revision and amendments.