

PALESTINIAN ECONOMIC BULLETIN

Bulletin 189
June 2022

Main reports

On 16 May, the European Investment Bank formally opened its first office in Palestine, and confirmed a number of projects including the largest ever EIB backing for Palestinian business investment

On 31 May, the Palestinian Ministry of Finance announced that more than 400 jobs had been created by the Investment Co-Financing Facility funded by the World Bank

The Al-Quds Index increased by 6.2% in May 2022 compared to the previous month, reaching 644.8 points on the last day of trading

AHLC Meeting

The Ad-Hoc Liaison Committee (AHLC)¹, which meets twice-yearly to co-ordinate international support for Palestine, met on 9-10 May 2022 to consider development needs and propose policy steps to help address the Palestinian National Authority's (PNA) deep financial crisis.² The Brussels meeting was hosted by the EU High Representative and the Norway's Minister of Foreign Affairs, with participants from the PNA, Government of Israel (GoI) and several donor countries.³ The PNA presented a comprehensive 21-step reform plan, calling for more donor support and collaboration with international organisations.⁴ The AHLC also reviewed a report from the International Monetary Fund (IMF), its first to the AHLC since 2018, and more-regular reports from the World Bank, United Nations and the Office of the Quartet. The reports provided an assessment of the Palestinian economy and the PNA's biggest challenges. Discussions of policy packages focused on establishing a medium-term macroeconomic and fiscal framework for reform as an alternative to short-term liquidity management.

Economic Situation

The reports underline a Palestinian economy in a profound slump, not set to reach even its pre-pandemic GDP level until the end of 2023.⁵ Following an economic contraction of 11.3% in 2020, growth reached only 7.1% in 2021, which itself was due to higher consumption in the West Bank. At just 3.4%, the Gaza Strip's recovery was slower, and impacted by the May 2021 conflict. Unemployment levels are a stubbornly high 26%, and poverty on the rise. Increasing food and fuel prices due to the Invasion of Ukraine are aggravating a bad situation, as some 1.8 million in Palestine already suffer from food insecurity. Over 1.1 million Palestinians, mainly in the Gaza Strip, are severely food insecure.

Decline in donor aid

Despite the weak state of Palestine's economy, aid contributions have now reached their absolute lowest level in two decades, at only 1.8% of GDP in 2021, compared to a one-time high of 27% in 2008.⁶

On 16 May, the EU announced €25m in humanitarian aid to meet the basic needs of vulnerable Palestinians, with a focus on providing healthcare assistance and improving access to schooling.⁷ Before this announcement, a large portion of EU funding committed to Palestine, some €215m, has been repeatedly delayed since 2021 as it became conditioned on specific changes to Palestinian school textbooks. The suspension of aid posed significant risks for critical sectors and services, including healthcare in East Jerusalem and delayed cash transfers to poor families. The delayed aid agreement was finally signed on 21 June at a ceremony presided over by the Palestinian President, Mahmoud Abbas, and funds are expected to be disbursed soon.⁸ However, the EU meanwhile reduced its aid contribution to the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) by 40% for the 2022-24 period, down from \$135 million to just \$82 million.⁹

PNA Fiscal Situation

Despite fiscal consolidation efforts by the PNA in the past two decades, which have contributed to the decrease of the relative size of the PNA's budget deficit, before grants, from 21% of GDP in 2006 to 7% in 2021, the fiscal deficit remains large,¹⁰ a forecast 5.1% of GDP for 2022 (before aid).¹¹

¹ The AHLC is a body established in November 1993 with the primary function to coordinate the delivery of international aid to Palestinians and the PA. It normally meets twice a year, usually in New York or Brussels.

² https://www.un.org/unispal/wp-content/uploads/2022/05/AHLCCHAIRSUM_100522.pdf

³ <https://bnews.ps/ar/node/18903>

⁴ <http://www.palestinecabinet.gov.ps/portal/news/details/52011>

⁵ https://www.un.org/unispal/wp-content/uploads/2022/05/AHLCIMFRPT_100522.pdf

⁶ https://www.un.org/unispal/wp-content/uploads/2022/05/WBAHLRPT_100522.pdf

⁷ https://ec.europa.eu/commission/presscorner/detail/en/IP_22_3052

⁸ <https://bit.ly/3HFuphu>

⁹ <https://bit.ly/3HFuphu>

¹⁰ Ibid

¹¹ <https://bit.ly/3QxheDv>

The PNA's financing gap has created a substantial accumulation of new arrears in 2021 to the pension fund, suppliers, contractors, and public employees.¹² The IMF estimates the value of these arrears to be 28.4% of GDP in 2021, bringing total internal and external public debt to 49.3%, up from 34.5% in 2019. The IMF estimates that, continuing with the same policies, public debt will continue to grow. With limited domestic borrowing or revenue enhancement options remaining, steadily increasing deficits imply rising public debt, forecasted to reach 65% of GDP by the end of 2027.¹³

Equally of great concern is the banks' direct exposure to the PNA, comprising 21% of total banking sector loans, some 11% of assets and 111% of capital/equity at the end of 2021 – substantially above the informal 100% prudential limit). Loans to PNA employees add another 16% to loans (8% of assets) in indirect exposure, which is further increased through loans to PNA suppliers.

Crisis drivers

The AHLC reports identify several key issues that are driving the PNA's sustained financial crisis:

1. The growing wage bill: the stability of government employment and mandatory annual salary increases for its employees have made public sector employment an attractive option. At 13% in 2021, the public sector wage bill in Palestine is much higher than the average for comparable economies in the region and grew by a further 13.2% last year.¹⁴ The PNA committed at the AHLC meeting to reduce the wage bill to 70% of revenues in 2022, to within rational practice standards by the end of 2023, and is working with the World Bank on options to comprehensively reform the public employment system.¹⁵
2. The inefficient public health system: the capacity of the public health system is low, while public health spending is on the rise. The PNA is also working with the World Bank to develop reforms to control costs related to health referrals to Israeli or private Palestinian providers, while also considering reforms to the insurance system.¹⁶ Investing in the public health system and undertaking comprehensive reform remains a long-term goal.
3. The high cost of the public sector pension system: the PNA is exploring reform options to the pension system, with the goal of streamlining transfers to the pension fund. The World Bank recommends reforms such as increasing the retirement age and bringing the pension level in line with international practices.
4. Net lending and revenue leakages in Area C, East Jerusalem, and the Gaza Strip: the issue of net lending has resulted in more than \$370 million inadvertent annual government subsidies to local government units. Additionally, while the PNA spends about a third of its budget in Gaza and East Jerusalem, it collects virtually no revenue from these areas. Likewise, while the Israel Civil Administration collects revenues in Area C, it does not transfer them to the PNA as it is mandated to do under the 1995 interim agreement. Granting Palestinian businesses access to Area C could increase the PNA's revenues by 6% of GDP.¹⁷

The PNA is exploring reforms to address the net lending problem. However, necessary reforms to the intergovernmental fiscal transfers system require

cooperation from Israel.¹⁸ As discussed in many previous AHLC meetings,¹⁹ these policies include expanding implementation of the E-VAT system, redesigning the intergovernmental fiscal transfers system, negotiating border crossing and import fees, co-operating on water infrastructure projects, obtaining permits for renewable energy projects in the West Bank, allocating 4G and 5G spectrum to the West Bank and Gaza and developing trade opportunities through the Allenby bridge crossing.²⁰ These are only part of the different channels of Palestinian fiscal leakage (to the Israeli Treasury), estimated by a recent United Nations report to have averaged as much as \$306 million annually between 2010 and 2021.²¹ However, Israel has not shown interest in addressing these fiscal issues despite recurrent AHLC discussions on the matter over several years.

Scenarios for reform

The IMF demonstrated the importance of reform by presenting simulations for three growth and debt scenarios:

1. No reforms: annual growth is projected to decrease to 2% over the medium term
2. Partial reform (PNA alone): economic growth would level off at 3.5% and public debt (including arrears) would gradually increase to 56% of GDP by 2027
3. Full reform (PNA reform and collaboration with Israel, improving movement and access conditions and resolving most intergovernmental fiscal leakage issues): the economy's growth rate would gradually increase to 6% and public debt would return to pre-2020 levels. Undertaking these reforms will require donors to increase their financial support from current historical lows.

While essential and urgently needed, the different AHLC reports also concur that economic steps alone will not sustainably address the multiple crises facing the PNA or lay the groundwork for a return to a path toward meaningful negotiations and conflict-resolution, also urgently needed but irresponsibly absent.²²

European Investment Bank

On 16 May, the European Investment Bank (EIB) formally opened its first office in Palestine. It also confirmed the largest ever EIB backing for Palestinian business investment, namely the first dedicated financing for business in Gaza, co-funded by the European Union (EU). There is also new cooperation with the World Health Organisation (WHO) to improve public health across Palestine.²³ The new office will be located within the EU Representation to the West Bank and Gaza in Jerusalem. Werner Hoyer, President of EIB, noted that the new dedicated local presence would further strengthen the impact of EIB financial and technical support and engagement with Palestinian, European and international partners.

Support for Businesses Investment

The EIB launched three new business-financing programmes with the EU, Palestine Monetary Authority (PMA) and Cairo-Amman Bank Palestine.

The first programme includes \$192m of new business financing, to be managed by local banks in Palestine. This includes \$50m dedicated for new investment by companies across the Gaza Strip. This is EIB's largest ever credit line to the PMA, helping expand its flagship economic recovery programme called 'Estidama' (meaning sustainability). This

12 <https://bit.ly/3nnIXJk>

13 Ibid

14 Ibid

15 <https://bit.ly/3Aipa5X>

16 <http://www.palestinecabinet.gov.ps/portal/news/details/52011>

17 <https://bit.ly/3HAbBQU>

18 <https://bit.ly/30LRQrV>

19 Refer to B183 for more details

20 <https://bit.ly/30dImGY> - see B183 for more details

21 <https://bit.ly/3HJ7HFf>

22 Ibid

23 <https://bit.ly/3xUkHo6>

was launched by the PMA in May 2020, with the aim of providing \$300m in financing for SMEs and micro-projects affected by the pandemic. In June 2021, it expanded the programme to include an additional \$435m, of which \$10m was allocated to micro-projects, to provide further support to the micro, small and medium enterprises most affected by the pandemic, as well as low-cost funding to newly launched projects.²⁴ More than 2,000 projects with capital of some \$635 million, and around 19,700 employees, have benefited from the Estidama Fund.²⁵ Women-led businesses constitute about 19% of the micro-enterprises funding programme, which has a zero interest rate.

The second programme includes the first dedicated EIB and EU support for economic recovery, reconstruction efforts and business investment in the Gaza Strip. The EIB, EU and PMA have agreed to deliver additional €15 million in the form of EU portfolio guarantees (€8m), incentive grants (€5m) and technical assistance (€2m). This will help more entrepreneurs and smaller companies in Gaza to access finance and strengthen lending activities by local financial institutions and to enhance the business investment and financial capabilities of local businesses.²⁶

The third programme is the EIB's first credit line with Cairo-Amman Bank Palestine, backed against credit and political risk by the EU. It includes \$22m of new financing made available by the EIB and managed by Cairo Amman Bank Palestine for Palestinian companies to launch new investments.

Palestinian companies active in tourism, manufacturing and services are expected to benefit from the new EIB, EU-backed business financing, which is part of the EU's overall response to the COVID-19 crisis to support the sustainable social and economic recovery of the region. The programmes also aim to promote investment in clean energy projects, accelerate digital transformation and encourage the use of green technologies, investing in health and agriculture services, and economic empowerment of women by providing funding for projects led by women.

Supporting Public Health

During the office opening ceremony, the WHO and EIB representatives confirmed the successful ongoing implementation of the technical assistance assignments conducted under the global EIB-WHO partnership for health.²⁷ EIB is supporting the WHO to assist the Palestinian Ministry of Health in assessing and reshaping the national primary healthcare and oncology services strategies. Palestine is the first pilot area where cooperation has been initiated between these two organisations.

Investment Co-Financing Facility

On 31 May, the Palestinian Ministry of Finance announced that more than 400 jobs had been created by the Investment Co-Financing Facility (ICF) through the Finance for Jobs (F4J) project, implemented by DAI global and funded by the World Bank.²⁸ The ICF is a risk-sharing grant to support commercially sound, job-creating, private sector investments which otherwise may not be considered viable due to market and institutional failures, and other risk considerations.²⁹ It aims to leverage private capital investment to create sustainable new jobs - especially for women, youth, unemployed and other vulnerable categories. F4J financing is given as a grant that fund

up to 30% of the capital investment of a project. Only investments greater than \$1m are eligible in sectors such as light manufacturing, agriculture and processing, IT and technology driven sectors, clean energy and tourism. The facility has mobilised more than \$30m in private sector investments over the past four years, including the below.

- Energy sectors: ICF supported the implementation of solar energy systems with a total generation power of 7MW on the rooftops of factories and buildings in Gaza Industrial City. This helped reduce their electricity costs by 25% compared to conventional sources. It also supported the implementation of solar energy systems on the rooftops of 400 public schools in Palestine, with a total capacity of about 35MW, with the aim of fulfilling the schools' electricity needs and generating clean, green energy.
- Agriculture and Agro-industry: five different economic projects were supported, including the first automated poultry slaughterhouse project in the Gaza Strip with a total area of 2,070 square meters and wastewater treatment equipment. Supported investments also include "Dalia farm" for the greenhouse production of seedless grapes, a project to produce milk and cheese in Gaza (set to create 125 job opportunities), and a pickles factory in the northern West Bank that is set to export 4,000 tons of pickles over the next five years. Another supported project is the Agricultural Central Irrigation System in the West Bank's Tubas area, which will use solar energy to support the irrigation of 1,000 dunums of cucumbers, potatoes, tomatoes, aubergine, and onions, and is expected to create over 200 job opportunities in marginalised rural areas.
- ICT: two projects were supported, the installation of modern internet networks in rural and remote areas in the Gaza Strip, and the development of fibre-optic infrastructure in the West Bank to facilitate access to the Internet and improve its quality, i.e. stability, security, and speed.
- Light industry: two projects were supported, one project in Gaza to produce veterinary medicines and another in the West Bank to produce various types of glassware.

Other financial instruments utilised by the F4J project include a Development Impact Bond (DIB) and the Entrepreneurship Ecosystem Matching Grants (EE-MG). The DIB matches socially motivated investors with high-performing workforce development organisations to reduce youth unemployment.³⁰

May Trading

The Al-Quds Index increased by 6.2% in May 2022 compared to the previous month, reaching 644.8 points on the last day of trading.³¹ A total of 60.1m shares worth \$95.5m were traded during the month, marking a 437.6% increase in the number and 264.6% increase in the value of traded shares compared to April 2022.

On 25 May, PEX released the consolidated performance of listed companies for Q1 2022, showing a 23.7% increase in net profits to \$104.9m compared to Q1 2021. Thirty-eight out of forty-seven listed companies reported profits (a 23.3% increase), while three companies reported losses totaling \$0.89m. Six companies failed to disclose their results within the legal timeframe.

24 <https://bit.ly/3QBVGFf>, <https://www.pma.ps/ar/>

25 <https://bit.ly/3b5eEEu>

26 <https://bit.ly/3QpAeDD>

27 <https://bit.ly/3HqhwB6>

28 <https://bnews.ps/ar/node/19043>

29 <https://www.f4j.ps/whatwedo/6.html>

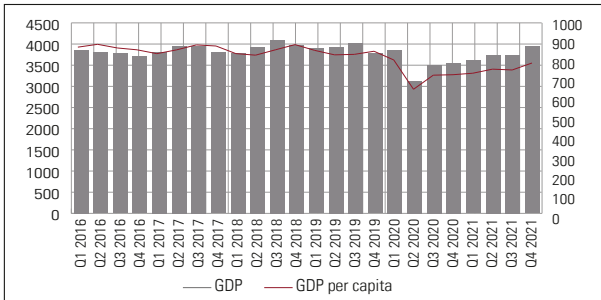
30 <https://www.f4j.ps/whatwedo/8.html>

31 <https://web.pex.ps/>

Palestine Economic Dashboard

Growth

GDP (in million USD) and GDP Per Capita (in USD) in Palestine, Q1 2016 – Q4 2021



GDP (Q4 2021): \$3,940.9m
Source: PCBS

GDP per capita (Q4 2021): \$791.4

Trade

Exports, Imports and Trade Deficit in Palestine ('000 USD), Q1 2016 – Q1 2022

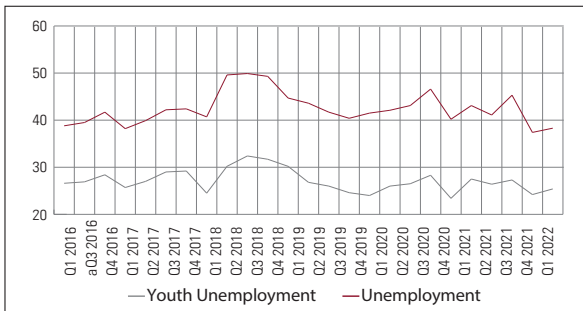


Imports (Q1 2022): \$1,920.8m
Trade deficit (Q1 2022): \$1,547.7m

Exports (Q1 2022): \$373.1m
Source: PCBS

Unemployment

Unemployment and Youth Unemployment in Palestine, Q1 2016 – Q1 2022

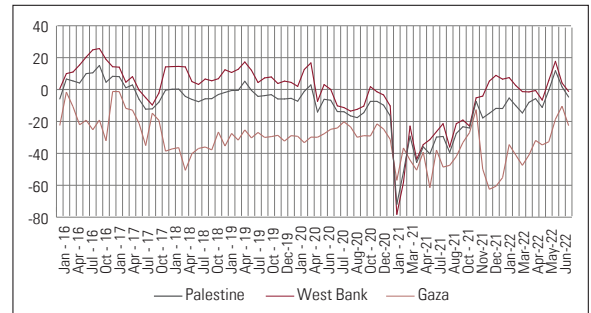


Unemployment rate (Q1 2022): 25.4%
Source: PCBS

Youth Unemployment rate (Q1 2022): 38.3%

Business Cycle Index

Palestine Monetary Authority Business Cycle Index, January 2016 – June 2022

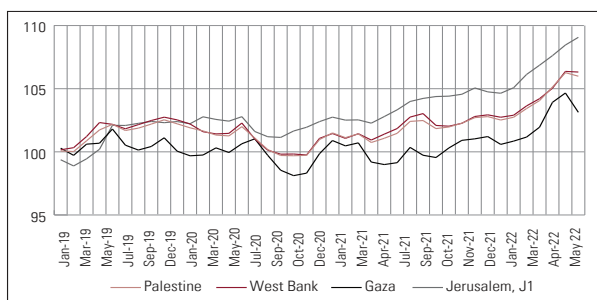


Palestine (June 2022): -4.7
Gaza (June 2022): -22.6

West Bank (June 2022): -1.2
Source: PMA

Inflation

Consumer Price Index (Base year = 2018), January 2019 – May 2022

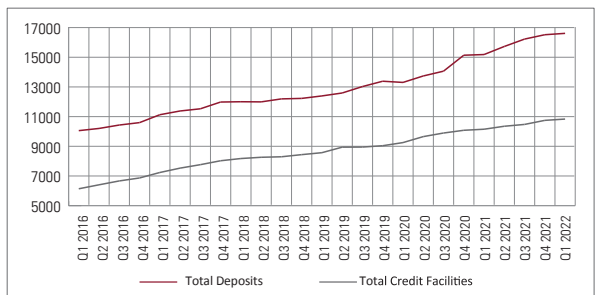


Palestine (May 2022): 105.99
Gaza (May 2022): 103.13

West Bank (May 2022): 106.32
Source: PCBS

Banking Sector

Total Credit Facilities and Total Deposits in Palestine ('000 USD), Q1 2016 – Q1 2022



Total Credit (Q1 2022): \$10,835.09m
Source: PMA

Total Deposits (Q1 2022): \$16,610.30m

The Portland Trust



The Palestinian Economic Bulletin is prepared by the Palestine Economic Policy Research Institute (MAS) and edited by The Portland Trust. Please send any comments, suggestions, or complaints to feedback@portlandtrust.org

Printed for The Portland Trust in Ramallah by Al Nasher Advertising and PR. © 2022 The Portland Trust