

PALESTINIAN ECONOMIC BULLETIN

Issue 67
April 2012

Main reports

The 2012 Palestinian Authority Budget has been approved. The total budget is \$3.54bn, with the recurrent deficit forecast to decrease to less than \$1bn.

The current account deficit increased by 29.9% compared with the previous quarter, reaching \$378.8m in Q4 2011.

The World Bank has announced its new two-year strategy for assistance to the Palestinian Territory to support private sector led growth and to strengthen public institutions. This includes a \$55m replenishment for the Trust Fund for Gaza and the West Bank.

The US Congress has released \$88.6m in development aid for the Palestinians which had been frozen since September last year.

The Bulletin interviews Dr Iyad Masrouji, CEO of Jerusalem Pharmaceuticals.

World Bank and IMF Reports on the Palestinian Economy

The IMF and the World Bank released reports on the Palestinian economy in March which consider recent trends and the challenges ahead.

Both highlight the slowdown in economic growth in the West Bank in 2011. This was a result of decreased foreign assistance, the uncertainty caused by the Palestinian Authority's (PA) fiscal crisis, the lack of significant new easing of Israeli restrictions and the global economic crisis.¹ The West Bank economy grew at 7.1% in 2009, 6.8% in 2010 and 5.8% in 2011.² In contrast there was high GDP growth of 26.6% in 2011 for Gaza, partly due to easing of Israeli restrictions, aid inflows, international projects and the tunnel trade, but also because of the initial very low base. The World Bank notes that Gaza still needs major investment in water, wastewater, electricity and solid waste to generate jobs and promote long-term growth.

The ongoing fiscal crisis takes a central place in both reports. The PA required \$1.5bn in budget support and development expenditure in 2011. By the end of the financial year, total expenditure and net lending were kept in line with the budget but gross domestic revenues were nearly 12% lower than budgeted. Furthermore, the PA only received about \$814m in budget support and \$169m of development financing (around \$0.5bn short of what was needed). The PA financed the gap by borrowing from the local banking sector, increasing net domestic bank borrowing by \$140m (raising the stock of government debt to the banking system to a total of \$1.1bn or 11% of GDP), and accumulating arrears of \$0.5bn to the private sector and the public pension fund.³ In the reports both the World Bank and the IMF called for donors to increase their financial support to the PA to preserve the achievements of recent years and continue the provision of basic services.

The IMF report notes that the Palestinian banking system continued performing well throughout 2011 with significant improvements in financial market infrastructure. The Palestine Monetary Authority (PMA) has conducted stress tests on banks and the banking system, with the results showing that they are resilient to a broad range of shocks. That resilience has been helped by the PMA's prudential measures, including an increase in capital requirements. However, rising exposure to the PA is a source of concern with the PA's debt to commercial banks now reaching 93% of banks' equity.

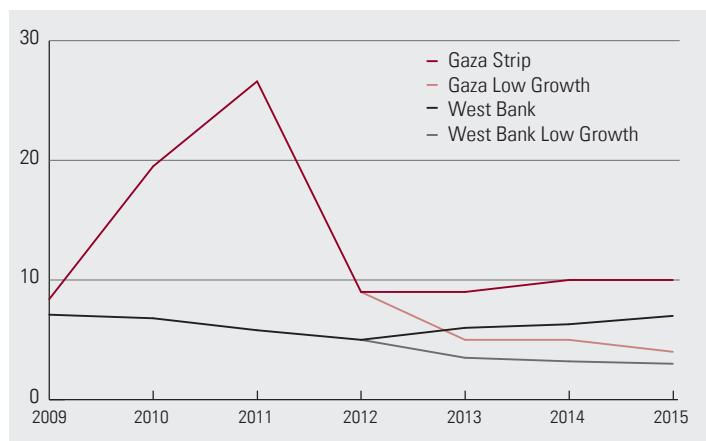
Figure 1 below shows real GDP growth in the West Bank and Gaza and medium-term forecasts under two scenarios by the IMF. 'High growth' assumes significant easing of trade and other restrictions, allowing for increased private sector activity and investment alongside sufficient and timely aid by donors. In the 'low growth' scenario, restrictions would remain the same as they are now, inhibiting trade and private investment. Revenue growth would slow down, while emergency spending would rise. Donor aid would remain below the level needed to finance the deficit, leading to further substantial arrears accumulation.

1 siteresources.worldbank.org/INTWESTBANKGAZA/Resources/WorldBankAHLCreportMarch2012.pdf and www.imf.org/external/country/WBG/RR/2012/032112.pdf

2 The IMF and World Bank reports were published before the Q4 2011 GDP figures had been released by the PCBS. Those have now been released: www.pcbs.gov.ps/Portals/_pcbs/PressRelease/Q4_11e.pdf

3 Bulletin 65, February 2012.

Figure 1: GDP Growth rates (%) in the West Bank and Gaza



Source: IMF and PCBS figures

In its conclusion, the World Bank once again reinforced the importance of the unobstructed movement of people and goods between the West Bank and Gaza. It noted that the PA needs to expand land registration in the West Bank, reform the laws governing business and build its capacity to regulate the economy and ensure competition. The World Bank also called for further easing of the Israeli restrictions which remain the biggest constraint to Palestinian private sector growth.

Palestinian Authority Budget 2012

On 10 April President Mahmoud Abbas approved the PA budget for 2012.⁴ The total budget reached \$3.54bn, with a recurrent deficit forecast to decrease to less than \$1bn. The 2012 budget has reduced the dependence on foreign assistance.

Figure 2: Government Budget for Fiscal Year 2012 (in million \$)

Item	Amount
Total Revenues	2,354
Public Revenues	2,235
Domestic Revenues	812
Clearance with Israel	1,542
Tax Refunds	-119
Total Expenditure	3,538
Recurrent Expenditure	3,188
Wages	1,793
Non-Wages	1,290
Net Lending	105
Development Expenditure	350
Total Deficit	1,303
Recurrent Deficit	953
Development Expenditure	350
Total External Financing	1,303
Budget Support	1,003
Development Financing	300
Financing Gap	0

Balance of Payments

The current account deficit increased by 29.9% compared with the previous quarter reaching \$378.8m, or 14.6% of

4 english.wafa.ps/index.php?action=detail&id=19516 and www.lfd.ps/documentsShow.aspx?ATT_ID=5397

GDP, in Q4 2011.⁵ The income balance surplus was \$287m, comprising \$258.4m in earnings from Palestinians working in Israel and \$28.6m in investment income, primarily resulting from interest received on Palestinian deposits held in banks abroad.

Figure 3: Q3 and Q4 2011 Balance of Payments

Item	Q3 2011 Amount	Q4 2011 Amount
Current Account	-\$291.6m	-\$378.8m
Trade Balance of Goods	-\$1,013.0m	-\$855.8m
Trade Balance of Services	-\$88.9m	-\$71.8m
Income Balance	\$305.1m	\$287.0m
Balance of Current Transfers	\$505.2m	\$261.8m
Capital and Financial Account	\$199.7m	\$257.8m
Net Capital Account	\$194.7m	\$63.1m
Net Financial Account	\$5.0m	\$194.7m
Net Foreign Direct Investments	\$49.1m	\$75.1m
Net Foreign Portfolio Investments	\$44.3m	-\$34.7m
Net Foreign Other Investments	-\$192.4m	\$264.7m
Change in Reserve Assets	-\$104.0m	-\$110.4m

Source: PCBS and PMA

New World Bank Strategy

The World Bank has announced its new two-year strategy for assistance to the Palestinian Territory to support private sector led growth and to strengthen public institutions.⁶ This was prepared jointly with the International Finance Corporation, the private sector arm of the World Bank, and comes with a \$55m replenishment for the Trust Fund for Gaza and the West Bank, through which the World Bank's assistance is provided.

The Bank has also approved a series of grants totalling \$50m to support Palestinian development, to be drawn from the previous year's Trust Fund.⁷ These include \$40m of budget support to the PA, focussed on improving transparency and accountability to ensure the efficient use of public finances. An \$8m grant will assist in rehabilitating and expanding Gazan electricity networks, and \$2m will help municipalities improve their management and governance.

Foreign Aid

In March the US Congress released \$88.6m in development aid for the Palestinians which had been frozen since September last year, although the funds cannot be used in the Gaza Strip or for West Bank road construction or trade and tourism promotion.⁸ At the time of going to press \$58.6m of US aid remains blocked. The US has separately announced an additional contribution of \$10m to UNRWA's General Fund.⁹

5 www.pcbs.gov.ps/Portals/_PCBS/Documents/317704e7-0aa7-440b-9b30-1d31a4b8e984.htm

6 go.worldbank.org/R34YC6XJ70

7 go.worldbank.org/2YYBDJ1QL0

8 www.bbc.co.uk/news/world-middle-east-17496561 and Bulletin 61, October 2011.

9 www.unrwa.org/etemplate.php?id=1311

EU High Representative Catherine Ashton and Prime Minister Dr Salam Fayyad have signed two agreements worth €35m.¹⁰ €22m will finance the building of a wastewater treatment plant in the Tubas Tayasir area. It will be the first in the Palestinian Territory to reuse treated water for agricultural purposes. €13m will fund the upgrading of Kerem Shalom, the only formal goods crossing point between Gaza and Israel that is currently open.

In addition the EU contributed €22.5m to the payment of March salaries and pensions of around 84,000 PA civil servants and pensioners in the West Bank and Gaza.¹¹

On 27 March the Islamic Development Bank (IDB) signed several agreements worth \$52m for projects in Gaza, including roads and solid waste facilities, housing units, education, a public children's hospital and a health centre.¹²

Health Crisis

The PA's fiscal crisis is affecting the Ministry of Health's ability to secure supplies for its hospitals and clinics with severe shortages in 90 essential medicines and 60 medical disposable items.¹³ This is the result of the accumulation of more than \$77m in unpaid arrears to suppliers. The Ministry of Health has called on Arab and international health and aid organisations to help resolve the crisis.

Inflation

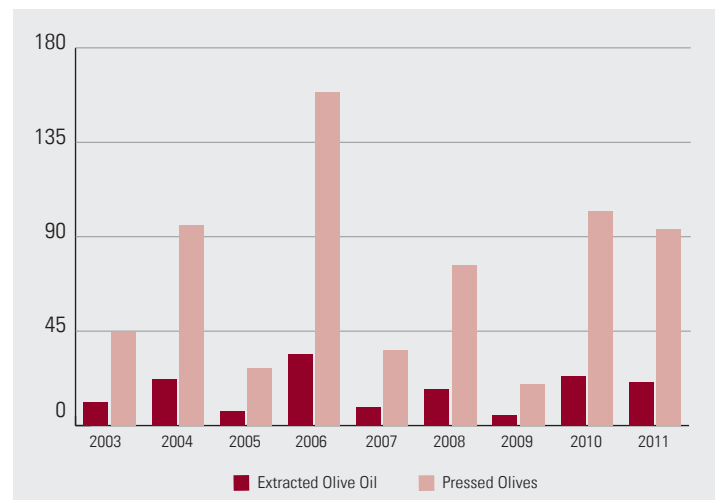
The PMA's most recent quarterly inflation report indicates that the inflation rate of 2.9% in 2011 continued to be low relative to other parts of the world and the region.¹⁴ The PMA only expects it to rise slightly to 3.1% in 2012, and argues that Palestinian inflation is largely driven by global food and fuel price changes.

The report found that the average lending rate of the NIS circulating in the Palestinian Territory in Q3 2011 was 11.2% compared with 5.8% in Israel. The corresponding rates for USD were 6.8% in the Palestinian Territory and 3.3% in the US. This reflects the risk premium that banks require to engage in lending operations in the Palestinian economy.

Olive Press Activities in 2011

The amount of olive oil extracted in 2011 decreased by 12.6% compared with 2010 and the quantity of pressed olives declined by 8.4%.¹⁵ The value added of olive pressing activities was \$7m, a drop from \$8m in 2010. 1,326 individuals participated in the olive pressing, 70.2% of whom were waged workers, earning a total of \$1m, compared with \$1.1m in 2010.

Figure 4: Extracted Olive Oil and Pressed Olives (Tonnes)



Source: PCBS

Olive production is cyclical, with a bad year following a good one. It was expected that the 2011 harvest would add up to only about half of the 2010 harvest.¹⁶

ICC Banking Commission Meeting

The International Chamber of Commerce (ICC) of Qatar held its biannual Banking Commission Meeting in Doha on 26-29 March.¹⁷ Representatives of the Palestinian banking sector, led by the Bank of Palestine, held a side session in which they discussed various investment opportunities in the Palestinian Territory with foreign and regional investors and bankers.

Renewable Energy Conference

On 20 March Konrad-Adenauer-Stiftung organised a conference with the Palestinian Authority on renewable energy investment in the Palestinian Territory.¹⁸ The event, which was attended by more than 270 local and international experts and Palestinian public and private sector representatives, discussed the main challenges and opportunities facing the renewable energy sector in the Palestinian Territory and ways to maximise the participation of the private sector.

Interview with Jerusalem Pharmaceuticals

This month the Bulletin interviews Dr Iyad Masrouji, CEO of Jerusalem Pharmaceuticals, which was founded in the late 1960s. It employs more than 350 staff, and manufactures a wide range of pharmaceuticals, over the counter preparations, nutritional supplements, detergents, personal care items and veterinary products.

You had good results for 2011, with a 6% increase in pre-tax profits. How are things looking for the future?

"We're pursuing a growth strategy. Palestine and Jordan are important for us, but our aim is for those markets

10 www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/129055.pdf

11 www.lfd.ps/documents/Show.aspx?ATT_ID=5429

12 english.wafa.ps/index.php?action=detail&id=19393

13 www.moh.ps/?lang=0&page=3&id=1114

14 www.pma.ps/images/stories/inflationreports/inf%20rep%20jan%202012.pdf

15 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/OlivePrsSurv2011E.pdf and www.pcbs.gov.ps/Portals/_pcbs/PressRelease/Oli_Pres_2010e.pdf

16 Bulletin 62, November 2011.

17 maannews.net/arb/ViewDetails.aspx?ID=471767

18 www.kas.de/palaestnensische-gebiete/en/publications/30566/

to account for 20% of sales in the future, with the rest coming from other places in the Middle East and North Africa. To help do that we've acquired a packing company in Algeria, and are acquiring manufacturing facilities in both Algeria and Jordan."

What will that mean for employment at your company?

"We currently employ 200 staff in Palestine, with the rest in Jordan, Algeria and the Gulf. We don't plan to take on any more manufacturing staff within the Palestinian Territory, but we do expect that our headquarters will grow here which will mean more staff with strategic business skills. We also intend to open an applied research centre in Palestine to help us research new product lines and methods of analysis."

Has your company had difficulties because of the Palestinian Authority's fiscal crisis?

"Yes we supply the PA and we haven't been paid for 18 months now. That's tough because we have to borrow from banks to meet our obligations to our staff and suppliers. Not only is this a cash flow problem, but it also means that we don't have that money to invest in our company's future growth."

What other challenges do you face?

"The political situation is obviously a factor. We have difficulty exporting, and since 2009 we have been prevented from selling in East Jerusalem. That's motivated us to expand production outside the Palestinian Territory. Import restrictions make things hard too. For example it recently took six months to clear a small, basic piece of equipment through customs which measures carbon in water and we've had to cancel some product lines because we can't get the right raw materials."

How is the Palestinian pharmaceutical sector doing?

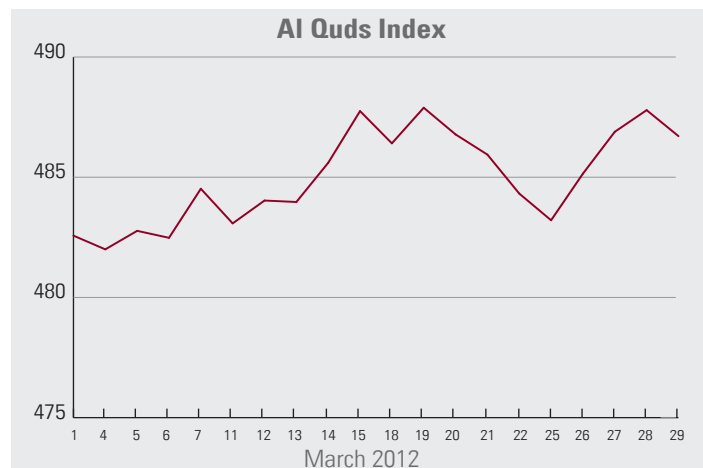
"It's tough: there's stiff competition, also from abroad, and prices for drugs are going down. Also as governments look to make savings they are cutting back on health spending. Having said that, the regulatory and business environment for our sector is very good here. There's been a huge improvement, and in our practical experience, the ministries that we deal with are helpful and efficient. Our industry has worked with the PA to help ensure that we work to international standards of testing and registering, which helps us to enter even European and US markets."

What are the prospects for the Palestinian economy?

"Well with a solution to the political difficulties we could have a much better economic situation than at the moment. To prosper you need more foreign investment and the ability to export products and services. I don't see much happening in these two areas at the moment, so things do not look promising for our economy."

Monthly Trading

During March the AI-Quds index increased by 0.93% closing at 486.7 points on the last day of trading. The Index reached its lowest (482.0) and highest (487.9) levels on 4 and 19 March respectively.



Source: PEX

A total of 15.4m shares worth \$38.3m were traded in 20 sessions.

On 4 April, the 15th anniversary of its founding, the Palestine Exchange (PEX) listed its own shares on the exchange.¹⁹ Publicly traded stock exchanges are common elsewhere in the world, but PEX will be only the second one in the Arab world after the Dubai financial market. Ahmed Aweidah, CEO of PEX, said that they decided to list, 'mainly to increase transparency and credibility, and enlarge the shareholder base.'²⁰ PEX became the first newly listed company for 2012, raising the total number on the exchange to 47.

19 www.pex.ps/PSEWebSite/NEWS/ListingPromo_PressReleaseENG20032012_Updated.docx

20 www.themedialine.org/news/news_detail.asp?NewsID=34771

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

© 2012 The Portland Trust

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

