

PALESTINIAN ECONOMIC BULLETIN

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Main reports

The Palestinian Central Bureau of Statistics and the Ministry of Tourism and Antiquities jointly issued a press release on 27 September, detailing the performance of the tourism sector in Palestine during the COVID-19 pandemic

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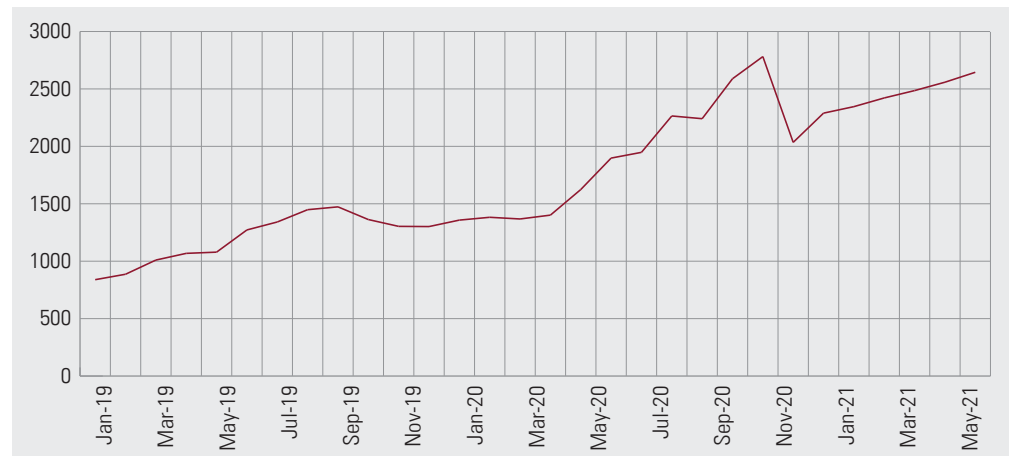
The European Bank for Reconstruction and Development announced on 1 September that it will provide a \$5 million trade finance guarantee facility to the Bank of Palestine to boost Palestinian export and import activities

Al-Quds index reached 579.5 points on the last day of trading in September 2021, an increase of 1.0% from the previous month

Stacking Arrears to the Private Sector

The Palestinian National Authority (PNA) has resorted to arrears accumulation to manage the ongoing budget crisis. According to Ministry of Finance and Planning (MoF) estimates, arrears to the private sector grew by \$300m in the first two quarters of 2021, comprising over one-third of total arrears.¹ Total accumulated arrears now stand at over \$2.6bn. As a result, the private sector and the broader Palestinian economy are facing immense pressure and vocally demanding a resolution of the issue.

Figure 1: Total Government arrears, January 2019 - June 2021, million USD



Source: Ministry of Finance²

Construction sector

The construction sector, which contributes 5.6% of value added to GDP³, is currently on the verge of a crisis in part due to the PNA's debt to the sector. According to Ahmed Al-Qadi, head of the Palestinian Contractors' Syndicate, about NIS 450m is owed to construction companies by the public sector.⁴ The Palestinian Government's failure to pay financial dues on time undermines the construction companies' ability to fulfill projects and pay their suppliers. These debts are compounding the lingering pressures on the construction sector from the Covid-19 pandemic, leaving many companies facing fines and legal prosecution for failure to pay creditors or fulfill contracts.

Healthcare sector

Arrears to the private sector indirectly impact critical public sectors such as healthcare by undermining the quality and timeliness of services these sectors receive from contracting private companies, especially pharmaceutical companies and importers. Fearing such an outcome in the health sector, the Ministers of Finance and Health held a meeting at the end of September in which a plan was

¹ www.pmf.ps/pmf/documents/accounts/monthly/2021/June.2021.En.pdf

² <https://bit.ly/3lBRpVo>; <https://bit.ly/3BGGqQ2>; <https://bit.ly/3mRphNj>

³ www.pcbs.gov.ps/post.aspx?lang=en&ItemID=3879

⁴ www.alhadath.ps/article/145938/

negotiated to provide further liquidity to pharmaceutical suppliers of the health sector.⁵

Banking sector

Arrears accumulation also leads to pressure on the banking sector and its financing capacity from both the Government and private sector.⁶ Specifically, the Government must borrow from banks to repay arrears to the private sector, the private sector undertakes borrowing to finance projects contracted by the Government on account of arrears, and the Government borrows to repay the arrears. In the short run, these economy-wide effects may only worsen the Government's financial situation through reduced productivity and therefore, reduced tax revenues.

Limited policy space

The PNA's significant arrears accumulation is symptomatic of its limited policy space to manage the crisis. According to Finance Minister Shukri Bishara, the PNA has already employed all available mechanisms to improve the financial situation, including significant borrowing from domestic banks, calls to international donors to increase aid levels, austerity measures, arrears accumulation, and appeals to the Government of Israel to transfer withheld clearance revenues.⁷

Anticipated relief

Prime Minister Muhammad Shtayyeh indicated in early September that the financial situation will begin to improve on account of expected foreign aid contributions before the end of the year.⁸ The European Union is expected to contribute \$140m to the PNA 2021 budget for the payment of civil servants' salaries and retirement benefits.⁹ Additionally, the German Government pledged €100m to the Palestinian Government on 17 September to finance projects in the Gaza Strip and the West Bank over the next two years.¹⁰ This aid contribution will serve as additional support from the German Government, which also donates annually through the United Nations Relief and Works Agency (UNRWA). Furthermore, on 24 September, Denmark agreed to provide a \$72m grant towards development projects, in addition to \$82m in humanitarian aid through UNRWA over the next five years.¹¹ For the Palestinian economy, which saw aid contributions decline 90% in 2021, these agreements may offer some relief from the current financial strain, though much of the slated donor funding will cover the development budget rather than current expenditures.¹²

Tourism: Pending Recovery

On 27 September, the Palestinian Central Bureau of Statistics (PCBS) and the Ministry of Tourism and Antiquities (MOTA) jointly issued a press release that detailed the performance of the tourism sector in Palestine during the COVID-19 pandemic.¹³ The report estimated the losses to the tourism sector during 2020 reached \$1.02bn, with the tourism sector in the Bethlehem Governorate experiencing the greatest contraction nationwide.

Impact of COVID-19

The Bethlehem Governorate, which annually hosts more than 60% of the hotel guests and visitors to the West Bank, had no hotels in operation at the end of 2020 or the first half of 2021. In the first half of 2019, the Bethlehem Governorate accommodated 232,457 guests. This number fell to 56,274 in January and February of 2020—the only two months in which hotels were operating—and has since remained at zero.

Across the West Bank, only 47 of the 124 hotels operating at the beginning of 2020 were still in operation by December 2020.¹⁴ During the same period, hotel room occupancy rates fell from 40% to 6.2% and hotel employment declined from 2,895 employees to just 1,141 employees.

Slow recovery

As of the first half of 2021, the tourism sector made little progress towards reaching pre-pandemic performance and, in some respects, has continued to decline. The growth of local tourism offers some optimism for the Palestinian tourism sector (as in other countries since 2020). The number of hotel guests in the West Bank was 58,765 during the first half of 2021, compared to 90,570 in the same period in 2020 and 363,385 in the same period in 2019. However, the Jericho and Al-Agwhar Governorate experienced a record increase in hotel guests during the first half of 2021, with the number of guests reaching 42,258 (72% of total guests in the West Bank) compared to 20,451 during the same period in 2019 (5.6% of total guests in the West Bank).

The number of visits to tourist sites in the West Bank by local visits improved slightly during the first half of 2021 domestic visits increased by 48% compared to the same period in 2020 but remained 52% below pre-pandemic levels. Meanwhile, the number of inbound visits continues to decline, with visits in the first half of 2021 down 52% and 82% from the same period in 2020 and 2019, respectively.

The Minister of Tourism and Antiquities, Rola Maayah, stated that the Ministry is planning to help revive the sector by introducing health protocols in line with international standards and increasing promotion of the sector.¹⁵ Additionally, MOTA launched two projects

5 <http://pnn.ps/news/607998>

6 <https://bit.ly/3AFHLFC>

7 <https://bit.ly/3ayfYfB>

8 www.aliqtisadi.ps/article/83129/

9 <http://pnn.ps/news/608066>

10 <http://pnn.ps/news/607269>

11 <http://pnn.ps/news/608705>

12 <https://bit.ly/2YPbLle>

13 https://pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_27-9-2021-tour-en.pdf

14 <https://pcbs.gov.ps/Downloads/book2577.pdf>

15 <http://pnn.ps/news/609315>

focused on improving efficiency and employment in the sector; the first of which offers training to teams working in the tourism sector, while the second project offers wage subsidies to incentivise tourist establishments to rehire unemployed workers in the sector.

However, without a return to the pre-pandemic levels of incoming international tourists, the sector is bound to remain hobbled, and recovery will not be speedy. Israel's borders have largely been closed to foreigners since March 2020. In an effort to increase the numbers of incoming tourists, the Israeli Government announced on 21 October a plan to allow the admission of foreigners who received vaccines within the last six months starting at the beginning of November. This development is likely to have an impact on the Palestinian tourism sector, as any tourist planning to visit the West Bank has to pass through Israeli border controls.

The West Bank Swamped with Shekels

On 29 September, the Palestine Monetary Authority (PMA) announced that it has commenced organising and executing the transfer of excess Israeli Shekels (NIS) from local Palestinian banks to Israeli Banks, a move anticipated to curtail the perpetuating surplus cash crisis.¹⁶ Last month, local Palestinian banks refused to accept any additional deposits in Shekels, upon reaching a total of NIS 6bn in accumulated Shekel deposits.¹⁷

The Shekel surplus has become a recurring cumulative crisis as Israel continues to impose ceilings on the amount of Shekels that its central bank accepts to exchange for hard currency and limits daily cash transactions. The ceiling was raised by the Bank of Israel (BoI) in 2019 from a previous ceiling of NIS 1.5 bn to NIS 4bn each quarter.¹⁸ On an annual basis, total cash inflow amounts to around NIS 20bn, of which, NIS 12-15bn are directly carried by Palestinian workers in Israel.

Impact on the economy

Excess NIS amounts have become a huge burden as the Palestinian banking sector continues to incur the costs of storing, insuring and guarding large amounts of cash in its vaults.¹⁹ Banks are becoming more exposed as they continue to transfer money abroad, usually in USD, to pay for Palestinian import operations.²⁰ Due to their inability to transfer the surplus and maintain adequate foreign currency balances, they are forced to borrow from Israeli banks to secure these payments at a high interest rate while the Shekel cash continues to pile up. The surplus also limits the bank's ability to offer loans in USD and/or Jordanian Dinars, the two reference currencies in

Palestine for investment capital, hindering their capacity to invest in economic development projects and decreasing the Return On Equity (ROE).²¹ Banks also lose the potential interest that could have been generated on cash had they been able to transfer full accumulated amounts. Added to these costs is the seigniorage revenue loss that results from using the Israeli currency in the West Bank and Gaza, estimated by some sources to reach 4.2% of Gross National Income (GNI) in 2019.²²

The refusal of banks to accept deposits also has negative effects on business owners, especially those who rely on USD in their operations or cash-based transactions. Most notably, gas stations, restaurants and other businesses that heavily rely on cash in their daily transactions, have been bearing a high risk as they hold on to cash through non-banking instruments.²³

Causes behind the surplus

The root cause for NIS surplus crisis is the BoI policy of setting a monthly ceiling for the excess amounts that Palestinian banks are allowed transfer back into Israel, despite the complete monetary integration between both economies provided for under the Paris Protocol on Economic Relations.²⁴ In an effort to justify the need to raise the transfer ceiling, the PMA continues to analyse and communicate the reasons behind the cash buildup. Including the increase in number of Palestinian workers in Israel, increased cash deposits, cash purchases by Palestinians from Israel in West Bank markets, growth, and rising domestic demand for USD due to drop in exchange rates. Alone, the 145,000 Palestinians officially estimated to be working in Israel bring in about NIS 1.3bn into the Palestinian markets monthly.²⁵ These numbers are likely higher, however, as the total number of Palestinians working in Israel, legally and illegally, is estimated to reach 200,000. Other factors include the excessive reliance on cash in daily transactions in the West Bank and Gaza, and the high demand for the USD and Jordanian Dinar amongst Palestinians as a short-term investment tool.²⁶

This crisis has intensified due to the newly enforced Israeli laws to limit the use of cash. In 2018, the Israeli Government passed the "Locker" law, seeking to tackle the large shadow economy and financial crime.²⁷ The law took effect in 2019, forbidding cash transactions over the value of NIS 11,000 (\$3000) between customers and

21 Palestinians rely on NIS mostly for transactional purposes and not investment, further limiting NIS demand.

22 www.un.org/unispal/document/auto-insert-187596/

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

24 <https://bit.ly/3nnlTKc> - The 1994 Protocol on Economic Relations between Israel and Palestine, also known as the Paris Protocol, restricts internal and external financial transfers in Palestine except through the Israeli banking system. According to Article IV paragraph 17 of the Protocol, the PMA has the right to convert excess NIS to foreign currencies at the BoI, up to the amounts determined per period and under certain arrangements.

25 www.aliqtisadi.ps/article/83449/

26 www.aliqtisadi.ps/article/83449/

27 In 2019, the Israeli shadow economy was valued at approximately \$77bn, of which a significant proportion is expected to overlap with the Palestinian economy in the West Bank and Gaza.

16 www.alhadath.ps/article/145733/

17 www.alhadath.ps/article/145706/

18 <https://bit.ly/3CbGZS3>

19 It is estimated that storing and maintaining NIS 1 million costs Palestinian banks \$1,500 annually

20 <https://bit.ly/30udjlr>

business to combat tax evasion, money laundering, illegal trade and counterfeit currency trade, and reduce the cost of cash management.²⁸ Due to the deep integration between the Palestinian and Israeli economy and the Shekel serving as a legal and official means of payment in the West Bank and Gaza, the Palestinian market has become the de facto destination of much of the surplus in cash. As a result, increasing numbers of Palestinians, including from Israel, are choosing to invest their surplus cash by purchasing gold or real-estate in the West Bank, mostly Jericho and Ramallah, along with increased daily purchases from the Palestinian market.²⁹

EBRD and Bank of Palestine Boost Trade

On 1 September, the European Bank for Reconstruction and Development (EBRD) announced that it will provide a \$5m trade finance guarantee facility to the Bank of Palestine (BoP) to boost Palestinian export and import activities.³⁰ The trade finance lines will be used to issue guarantees in favour of conforming banks for pre-export and post-import financing, the EBRD explained.³¹

In 2020, Palestinian exports decline by 7%, to \$2.5bn, and imports contracted by 15%, to \$7.1bn, resulting in a rise to a trade deficit of \$4.6bn.³² As it stands, the trade deficit is equivalent to 33% of GDP, highlighting the need for expanding trade networks and international business opportunities.

Launched in 1999, the EBRD Trade Facilitation Programme (TFP) aims to promote foreign trade to, from, and within the EBRD regions through providing a range of products to facilitate this trade such as guarantees and trade-related cash advances. In 2020, the TFP's support of foreign trade totalled more than €3.3bn, responding to the strong demand for trade finance during the coronavirus pandemic.³³

The EBRD aims to support local exporters and importers of the West Bank and Gaza by expanding BoP's correspondent banking network.³⁴ Joining the EBRD TFP provides the BoP access to a community of more than 100 issuing banks and 800 confirming banks worldwide. Moreover, it is likely to boost trade by expanding international business opportunities available for Palestinian merchants and businesses.

September Trading

The AI-Quds index reached 579.5 points on the last day of trading in September 2021, an increase of 1.0% from the previous month.³⁵ During the month, a total of 17.7m shares with a total value of \$36.5m were traded, marking a 36.1% decrease in the number and 32.2% decrease in the value of traded shares compared to August 2021.

In 2020, total dividends distributed by listed companies reached \$134m, a decline of 16.3% compared to 2019.³⁶ Total cash dividends amounted to \$105m (25% decrease compared to 2019) and the total value of stock dividends reached \$28.6m (an increase of 46%). Overall, the PEX recorded a dividend yield of 4.7% in 2020.

28 <https://bit.ly/2XQ30vR>

29 www.pcma.ps/portal/english/EconomicMonitors/monitor_%2055_eng.pdf

30 <https://bit.ly/3Ca3qY3>

31 Pre-export finance is the process in which a financial institution advances funds (a portion of the cost of the goods) to a borrower/exporter (supplying the goods/services to be exported) based on the proven orders from buyers. These funds are then used by the borrower/exporter to produce and supply the goods. Post import financing is a short-term credit facilitation that is available to imports for the purpose of settling billings of exchange that have matured and remain outstanding.

32 https://unctad.org/system/files/official-document/tdbex71d2_en.pdf

33 www.ebrd.com/work-with-us/trade-facilitation-programme.html

34 *ibid*

35 <https://bit.ly/3prdlzn>

36 <https://bit.ly/3b8Tq1C>

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