

PALESTINE MONETARY AUTHORITY



# Annual Report 2011







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# Annual Report

# 2011

Research & Monetary  
Policy Department

July 2012

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## Vision

To be a full-fledged and a modern central bank for an independent and sovereign Palestinian state, capable of achieving monetary stability and keeping inflation under control, and maintaining financial stability. Thereby, contributing to further development in the Palestinian financial sector, promoting integration into the regional and global economy, and ultimately, fostering high rates of sustainable economic growth in Palestinian Territory.

## Mission

Ensuring monetary stability and keeping inflation under control, by issuing and managing national currency and implementing a sound monetary policy to create an environment appropriate to achieve price stability, as well as contributing to maintaining financial stability, through providing safe, sound and secure banking system and national payment system, along with exercising the role of economic and financial advisor to the Palestinian government. To these ends, the PMA implements effective policies and employs its financial, human resources, and technical capabilities.



# PMA's Board of Directors

- **Dr. Jihad Alwazir**  
Governor and Chairman
- **Dr. Shehadah Hussein**  
Deputy Governor
- **Dr. Ismail Elzabri**
- **Mr. Mohammad Abu Ramadan**
- **Dr. Mahmoud Eljafari**
- **Mrs. Mona Almasri**
- **Dr. Nabeel Kassis**
- **Dr. Said Haifa**
- **Dr. Samir Abdullah**

# Foreword

On behalf of the PMA, I am honored to present the 2011 Annual Report, which is issued as part of a series of regular reports. This report reviews local and international economic developments, provides reliable information, and serves as a tool to supervise performance. Moreover, the report is meant to introduce developments and achievements made by the PMA within its tasks and responsibilities, and consistent with its role in the economy aimed at the preservation of financial system stability, with a view to ensuring financial and monetary stability and encouraging sustainable economic growth.

The year 2011 witnessed many economic crises, political events and natural disasters, the most notable of which are the European debt crisis, US economic slowdown, Japan's devastating earthquake and the Arab Spring. All of these led to increasing uncertainty, decreasing global demand and raising concerns in financial markets regarding the performance of major economies. In addition, there was a remarkable increase in oil prices as a result of political turmoil in production areas, especially in the Middle East and North Africa (MENA) countries, which adversely affected global economic growth.

These crises and their consequences were the main hurdles that slowed down the global economy, after positive signs of recovery during 2010. Both developed and emerging and developing countries have seen a general slowdown in growth rates, accompanied by high inflation and unemployment rates, particularly in developed countries. There was also a general reluctance for lending and investing, especially that the effectiveness of fiscal and monetary policies adopted by affected countries continued to be questioned by financial markets, investors and analysts alike.

At the domestic level, the Palestinian economy continued to achieve high growth rates, backed by strong economic recovery in the Gaza Strip in light of loosening some Israeli restrictions on importing consumer goods and production inputs for internationally-supervised investment projects, in addition to the increasing importing from Egypt. Meanwhile, economic activity in the West Bank has seen a clear slowdown in the wake of continuing fiscal austerity measures by the government, the decline in foreign assistance, slowdown in global economic activity and restrictions on the freedom of movement.

Despite the abovementioned improvement, many doubts lingered surrounding the ability of the Palestinian economy to achieve sustainable growth rates. On one hand, the economy continues to rely on international events and changes, especially in Israel, and suffers from near-total dependence on the Israeli economy. On the other hand, there are many drawbacks that undermine the efficiency of attempts to improve private sector performance and its role as the main stimulus to sustainable development.

Indicators of the Palestinian banking system reflected the PMA's success in maintaining a high level of performance for banks operating in the Palestinian Territory (PT), and preserving financial stability in light of global and regional political and economic crises. Through implementing the best international practices and standards, adhering to banking governance principles, addressing weak banks and developing the banking system infrastructure, the PMA has managed to maintain public confidence in the Palestinian banking system. This was consequently reflected in improvements in the financial indicators of the Palestinian banking system, as assets rose, customer deposits grew,



the credit facilities portfolio increased and improved in quality, and the system's ability to face expected and unexpected risks was solidified by increasing capital. All of these would not have been realized without PMA achievements, driven by its responsibility to preserve financial stability and guarantee sound banking management according to the best international standards and practices. These developments also contributed to the stimulation of sustainable economic development and growth.

For this year, the Annual Report includes four main chapters, the first of which tackles the real economy through reviewing the most important developments and changes to the international and local economic environments. Chapter II is dedicated to the public finance sector and describes developments of the Palestinian government's finances; chapter III talks about the foreign sector and reviews developments of foreign trade and the Palestinian balance of payments. A chapter was devoted to discussing the Palestinian financial sector and the significant and commendable achievements made by the PMA with respect to all bodies it supervises.



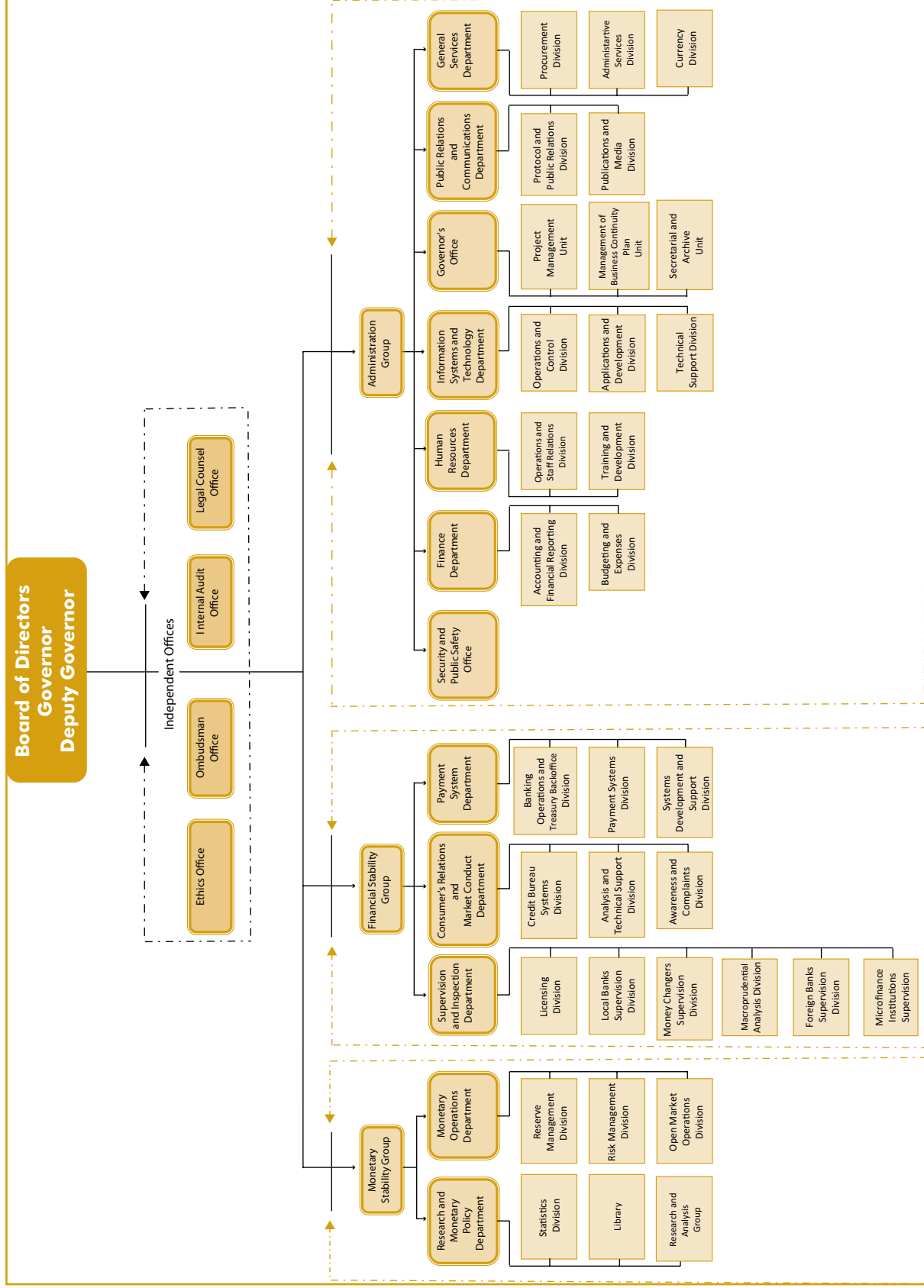
I hope this overview has provided valuable insights on the overall changes and developments that took place in 2011 and on the underlying thorough analysis. The analysis at hand is supported by statistical time-series for the most prominent economic variables.

Finally, I would like to extend my thanks and appreciation to the PMA's board members and staff for their relentless effort to achieve the objectives of the PMA and its aspirations to become the central bank for the independent and sovereign Palestinian State. I would also like to express my gratitude to all Arab, regional and international institutions for their continuous contribution to support and develop the PMA and the banking and financial systems, thus backing Palestinians' steadfastness on their land and promoting sustainable development in the PT.

A handwritten signature in black ink, written in Arabic script, belonging to Dr. Jihad Khalil Alwazir.

Governor  
Dr. Jihad Khalil Alwazir

# PMA Organizational Structure



# Palestinian Banking System Institutions 2011

## PMA

### Local Banks

|      |                                  |    |
|------|----------------------------------|----|
| 1960 | Bank of Palestine P.L.C          | 46 |
| 1994 | Palestine Commercial Bank        | 6  |
| 1995 | Palestine Investment Bank        | 13 |
| 1995 | Arab Islamic Bank                | 10 |
| 1995 | Palestine Islamic Bank           | 15 |
| 1995 | Al Quds Bank                     | 21 |
| 1996 | Arab Palestinian Investment Bank | 1  |
| 2006 | Al Rafah Microfinance Bank       | 6  |

### Foreign Banks

|      |                                  |    |
|------|----------------------------------|----|
| 1986 | Cairo Amman Bank                 | 24 |
| 1994 | Arab Bank                        | 22 |
| 1994 | Bank of Jordan                   | 32 |
| 1994 | Egyptian Arab Land Bank          | 6  |
| 1994 | Jordan Commercial Bank           | 4  |
| 1995 | Jordan Ahli Bank                 | 5  |
| 1995 | Housing Bank for Trade & Finance | 12 |
| 1995 | Jordan Kuwait Bank               | 2  |
| 1995 | Union Bank                       | 1  |
| 1998 | HSBC Bank Middle East Limited    | 1  |

### Money Changers

Companies  
162

Individuals  
130

### Specialized Lending Institutions

Institutions\*  
12

\* Number of institutions working in the PT, but not licensed by the PMA yet, since the license applications are still under processing.

- Year of establishment for local banks, or re-opening of the first branch for foreign banks.
- Number of branches and representative offices.

# Executive Summary

During 2011, the world economy experienced a general slowdown in growth rates of developed economies, as well as of emerging and developing economies, accompanied with a rise in inflation rates, as a result of the crises and natural disasters that befell the world during that year. At the global level, the weakness of the U.S. economy, and natural disasters in both Japan and Thailand, as well as the European sovereign debt crisis and the consequent austerity measures caused a decline in demand in many developed countries, and raised fears among investors about the performance of major economies. At the regional level, the Arab Spring and political turmoil in some countries in the Middle East contributed to a rise in oil prices, which in turn, significantly affected the trend of global economic growth. At the local level, and despite some improvement in economic performance, doubts lingered about the ability of the economy to achieve sustained growth, especially in light of continuing restrictions on the freedom of movement and access to resources, in addition to the continuous fiscal austerity to overcome the decline in external budget support.

As a result of these risks, the global economy grew by 3.9 percent, compared to 5.3 percent during 2010, with a clear discrepancy between different economies. While emerging and developing economies grew by 6.2 percent, growth in developed economies did not exceed 1.6 percent. The slowdown in growth was associated with an increase in unemployment rates, a decrease in demand, and reluctance to lend and invest in many developed countries, especially as the effectiveness of monetary and fiscal policies adopted by affected countries continued to be questioned by markets, investors and analysts alike.

Domestically, the economy has continued its growth during 2011, as GDP rose by 9.9 percent, compared with 9.8 percent in 2010. This growth was driven by Gaza Strip, underpinned by easing Israeli restrictions on consumer goods and production materials, in addition to increased imports from Egypt. Gaza's economy has grown by up to 23 percent, compared to 5.2 percent in the West Bank. However, there is a high risk that growth in the West Bank will dampen further due to fiscal austerity, declining aid and severe liquidity difficulties, as well as restrictions on movement and access to resources.

This performance was reflected positively in both per capita GDP, which grew by 6.6 percent, and the unemployment rate, which fell to about 20.9 percent of total labor force. Again, Gaza Strip was behind this improvement, since it witnessed the largest decline in unemployment, as it fell to 28.7 percent.

Nevertheless, the economy continued to suffer from some economic risks. On the one hand, the rise in the price level during 2011 by 2.9 percent caused a decline in real wages, and a negative impact on the standard of living. On the other hand, the decline in the exchange rate of the USD against the NIS (along with higher prices) contributed to lowering the purchasing power of those who had transactions in dollar (or JD) by an estimate of 6.6 percent. This negatively affected the poverty level in the Palestinian Territory, especially in Gaza Strip.

On the other hand, despite the fact that 2011 has witnessed some improvements in the fiscal position of the Palestinian National Authority (PNA), this improvement hides many contradictions. On one side, the current account deficit fell by 27.7 percent compared to 2010, to about USD 783 million, due to clearance and tax revenues improvements by 19.8 percent and 1.7 percent, respectively, while expenditures remained relatively stable, as a result of government's efforts to retrench expenditure and improve tax collection. On the other side, that PNA faced many difficulties as the external budget support declined by about 23 percent, and tax revenues fell below the expected level in light of slowing economic growth. This caused a sharp liquidity problem for the government, with a further accumulation of arrears of domestic payments and an increase in net borrowing



from the banking sector by more than 30 percent compared to 2010, bringing government debt to the banking sector to about USD 1.1 billion, or 11 percent of GDP. Moreover, external debt increased by 6.8 percent. This raised total public debt of the PNA at the end of 2011 by about 17.5 percent compared to 2010, to reach USD 2.2 billion, amounting to about 22.2 percent of GDP.

In addition, 2011 witnessed a considerable increase in the current account deficit of the balance of payment up to 24.3 percent of GDP, compared with 8.3 percent in 2010, basically as a result of a growing trade deficit to 46.7 percent of GDP. Simultaneously, income transferred from abroad remained relatively stable at a level of 11.5 percent of GDP, with a decline in current transfers by 37.1 percent, due to a significant decline in public sector's transfers (budget support) by 40.1 percent, in addition to the decline in private sector's transfers by 28.8 percent during the same period.

From another perspective, 2011 is considered an extension to previous years in terms of the success achieved by the PMA in various fields, most notably, maintaining stability and a high level of performance of banks operating in the Palestinian Territory, in light of the global and regional political and economic crisis. These achievements reflected PMA's responsibility for maintaining financial stability, ensuring banks' management according to the highest standards and international best practices, and stimulating and accelerating sustainable economic growth. In this context, the PMA launched several new projects, such as the International Bank Account Number (IBAN), and the Housing Loans and Mortgage database. The latter came in view of the importance of the construction sector in the PT and the need to monitor risks associated with this sector. Also, the PMA joined different programs, such as the Reserves Advisory and Management Program (RAMP) at the World Bank, The International Network on Financial Education (INFE) in OECD, and The Child Youth Finance International (CYFI) in Netherlands.

On the other hand, the PMA has strengthened the relationship between the banking sector and different segments of the population. A new department was introduced especially for this purpose: "Department of Consumers' Relations and Market Discipline". Also, the PMA proceeded to establish a modern infrastructure of the banking system through continuous development of the payment system "BURAQ" and strengthening the legislative and supervisory framework of the banking system, including money changers and specialized lending institutions. This was achieved through introducing several draft laws, such as the Central Bank Law, the Payment Systems Law, and Deposit Insurance Law. In addition, there were several instructions in line with the Banking Law no. (9), and with global developments in the banking business. In the same context, and in order to enable the PMA to overcome expected and unexpected risks that might arise while carrying out its tasks and responsibilities, the PMA gradually strengthened its capital to USD 120 million.

Those achievements substantially impacted the banking system performance and contributed to economic growth and development by activating financial intermediation between surplus and deficit units in the economy, and providing further funding opportunities. Thus, credit facilities rose 23.5 percent, to reach about USD 3.5 billion, distributed among various sectors and activities, with the private sector having the largest share of 68.5 percent during 2011. At the same time, customer deposits grew by 2.5 percent, to reach nearly USD 7 billion. It is noteworthy in this context that the loans to deposits ratio increased to approximately 50 percent. On the other hand, net assets grew by 6.1 percent to reach around USD 9.1 billion. As an indication of its steady improvement, the banking sector net profits reached USD 128.9 million by the end of 2011.

## Main Economic Indicators, 2006-2011

| Indicator                                  | 2006                            | 2007  | 2008  | 2009  | 2010  | 2011  |
|--|---------------------------------|-------|-------|-------|-------|-------|
| <b>Output and Prices</b>                   | <b>(Annual percent change)</b>  |       |       |       |       |       |
| Real GDP (2004 market prices)              | -5.2                            | 5.4   | 7.1   | 7.4   | 9.8   | 9.9   |
| Real Per capita GDP                        | -8.1                            | 2.2   | 4.1   | 4.3   | 6.7   | 6.6   |
| Inflation rate                             | 3.8                             | 1.9   | 9.9   | 2.8   | 3.7   | 2.9   |
| West Bank                                  | 5                               | 0.8   | 9.8   | 0.6   | 4.2   | 3.5   |
| Gaza Strip                                 | 4.6                             | 1.6   | 14    | 4.4   | 1.7   | 0.6   |
| <b>Unemployment Rates</b>                  | <b>(Percent of labor force)</b> |       |       |       |       |       |
| Palestinian Territory                      | 23.6                            | 21.6  | 25.9  | 24.6  | 23.7  | 20.9  |
| West Bank                                  | 18.7                            | 17.7  | 19    | 17.7  | 17.2  | 17.3  |
| Gaza Strip                                 | 34.7                            | 29.7  | 40.5  | 38.6  | 37.8  | 28.7  |
| Relaxed definition, Palestinian Territory  | 29.6                            | 27.9  | 31.7  | 30.1  | 30    | 30.1  |
| West Bank                                  | 25.0                            | 24.5  | 25.3  | 23.4  | 23.4  | 22.3  |
| Gaza Strip                                 | 39.9                            | 35.2  | 45.0  | 43.8  | 43.7  | 33.1  |
| <b>Consumption, Investment and Savings</b> | <b>(Percent of nominal GDP)</b> |       |       |       |       |       |
| Fainl Consumption                          | 123.9                           | 127.4 | 130.7 | 133.4 | 123.2 | 126.7 |
| Public                                     | 18.8                            | 19.8  | 20.6  | 26.1  | 24.5  | 25.6  |
| Private                                    | 105.1                           | 107.6 | 110.2 | 107.3 | 98.7  | 101.1 |
| Gross Investment                           | 30.7                            | 30.6  | 19.3  | 18.3  | 18.5  | 18.5  |
| Public                                     | 7.2                             | 8.9   | 6.1   | 4.7   | 4.9   | 4.6   |
| Private                                    | 23.5                            | 21.7  | 13.2  | 13.7  | 13.6  | 13.9  |
| Domestic Saving                            | -23.9                           | -27.4 | -30.7 | -33.4 | -23.2 | -26.7 |
| <b>Public Finance</b>                      | <b>(Percent of nominal GDP)</b> |       |       |       |       |       |
| Total Net Revenue and External Aid         | 37.7                            | 56.7  | 60.2  | 43.9  | 38.1  | 31.7  |
| Domestic Revenue (Tax and Non-Tax)         | 8.2                             | 6.3   | 12.1  | 8.7   | 8.9   | 7.0   |
| Clearance Revenue                          | 7.4                             | 25.4  | 18.2  | 16.2  | 14.9  | 14.9  |
| Foreign Aid                                | 22.1                            | 25.5  | 31.7  | 20.9  | 15.3  | 9.9   |
| Total Expenditures                         | 37.0                            | 55.5  | 55.8  | 46.2  | 39.1  | 32.6  |
| Current Expenditures and Net lending       | 30.9                            | 49.5  | 52.4  | 43.4  | 35.8  | 29.7  |
| Wage Expenditures                          | 14.2                            | 26.4  | 28.3  | 21.2  | 18.8  | 16.8  |
| Non-Wage Expenditures                      | 8.5                             | 12.8  | 16.9  | 17.0  | 13.9  | 11.4  |
| Net Lending                                | 8.1                             | 10.3  | 7.2   | 5.3   | 3.2   | 1.4   |
| Development Expenditures                   | 6.1                             | 6.0   | 3.4   | 2.8   | 3.3   | 3.0   |
| Overall Balance (Excl. Foreign Aid)        | -21.3                           | -24.3 | -27.3 | -23.2 | -16.3 | -10.8 |
| Overall Balance (Inc. Foreign Aid)         | 0.7                             | 1.2   | 4.3   | -2.3  | -1.0  | -0.9  |

| Indicator                                   | 2006                            | 2007  | 2008  | 2009  | 2010 | 2011  |
|---|---------------------------------|-------|-------|-------|------|-------|
| <b>External Sector</b>                      | <b>(Percent of nominal GDP)</b> |       |       |       |      |       |
| Exports of Goods and Services               | 14.7                            | 19.6  | 18.6  | 18.0  | 18.0 | 22.2  |
| Imports of Goods and Services               | 69.3                            | 88.1  | 75.9  | 75.4  | 65.6 | 71.5  |
| Income From Abroad, net                     | 8.8                             | 14.8  | 14.7  | 13.0  | 13.2 | 11.5  |
| Of which: compensation of employees         | 6.3                             | 11.5  | 11.9  | 12.4  | 12.9 | 11.2  |
| Current transfers, net                      | 27.7                            | 45.7  | 54.7  | 33.7  | 26.1 | 13.5  |
| Of which: to public sector                  | 23.7                            | 20.3  | 31.7  | 22.1  | 14.6 | 7.3   |
| Current Account                             | -20.4                           | -8.1  | 12.2  | -10.6 | -8.3 | -24.3 |
| <b>Monetary Sector</b>                      | <b>(Annual percent change)</b>  |       |       |       |      |       |
| PMA Assets                                  | -5.1                            | 37.1  | 55.2  | 8.8   | -9.9 | -11.2 |
| Banks Assets                                |                                 | 21.4  | 10.4  | 6.5   | 9.1  | 6.1   |
| Direct Credit Facilities                    | 3.1                             | -7.5  | 7.2   | 22.2  | 29.2 | 23.6  |
| Of which: to the private sector             | 1.1                             | -5.6  | 0.9   | 23.3  | 28.3 | 20.3  |
| Deposits                                    | 0.5                             | 21.4  | 14.2  | 7.7   | 8.0  | 2.5   |
| Of which: from the private sector           | 6.1                             | 20.1  | 13.9  | 9.1   | 6.8  | 4.4   |
| Balances Abroad                             | 1.4                             | 32.9  | 4.1   | -13.8 | -7.2 | -5.9  |
| Ownership Equity                            | 8.1                             | 17.5  | 22.1  | 12.0  | 14.2 | 8.4   |
| Of which: paid-up capital                   | 52.3                            | 10.1  | 19.4  | 15.3  | 10.9 | 8.0   |
| <b>Memorandum Items</b>                     |                                 |       |       |       |      |       |
| Real GDP (USD Million, 2004 = 100)          | 4322                            | 4554  | 4878  | 5239  | 5754 | 6323  |
| Nominal GDP (USD Million)                   | 4619                            | 5182  | 6247  | 6720  | 8331 | 9982  |
| Al-Quds Stock Market Index (percent change) | -46.4                           | -12.8 | -16.2 | 11.6  | -0.7 | -2.7  |





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# **Chapter One**

## **Global and Local Economic Developments**







# Part I: Global Economic Developments

## Overview

As a result of the successive crises that took place in 2011, global economic performance witnessed signs of decline that raised the concerns and fears of global markets of a precipitous downturn in economic growth and of global economic recession, thus dispelling hopes for potential recovery from the financial crisis that hit the world in 2010.

Data indicate a decline in the rate of economic growth on the global level during 2011 as well as on the level of country groups. In some European countries unbalanced financial policies have ignited the sovereign debt crisis. In addition to the impact of this crisis on the economies of those countries and several of their trading partners, it raised questions about the future of the Eurozone and the possibility of its sustainability in the current economic order. While this concurred with the unstable economic conditions in the USA, the crises have shaken the status of those economies and their currencies as a safe haven for investment in 2011. Despite the slowdown of the economies of emerging and developing countries (EDC), they continued to attract investments and global capital flows in light of the existing instability in advanced economies.

In spite of the enormous efforts made by countries to rectify their economic conditions, investors have little trust in the performance of global economy as a whole. In fact, the economies of developed countries, in particular, are still relatively weak, and the fiscal and monetary policies adopted by countries in 2011 were called into question by many financial markets, investors and analysts alike. This particularly occurred when those policies were subjected to the influence of adverse pressures such as the fears of investors, weak domestic demand, the reservations banks put on loans, the protests against political and social conditions in many countries, and the rise in the global prices especially oil prices.

## Economic performance

Several economic, political, social and even climatic developments have casted their shadow over global economic performance during 2011. The European sovereign debt crisis caused a decline in global financial markets as a result of investors' fears of the failure of some European countries to pay their sovereign debts. Moreover, the slow pace in the growth of US economy and the downgrading of credit rating of the US Treasury by international credit rating agencies have boosted the concerns and fears of a recession in global growth after the relative improvement that was achieved in 2010. In addition, the political changes arising from the Arab spring have led to a drop in economic performance in several Arab countries and the Middle East region in general. Furthermore, expectations of political destabilization in some oil-producing countries have brought about a considerable rise in oil prices, which reflected negatively on global economic development and growth. What is more is that the devastating earthquake and tsunami that struck Japan, world's third largest economy, provoked a sharp degradation in Japanese

economic performance. Consequently, several European and Asian industries that depend on Japanese technological exports were adversely affected.

### *Growth*

2011 was a challenging year for many countries in the world and the repercussions of the recent economic and political crises have overtaxed global growth. As a result of the financial crisis growth rate slowed down by about 3.9 percent compared to 5.3 percent in 2010. But the crises have had different

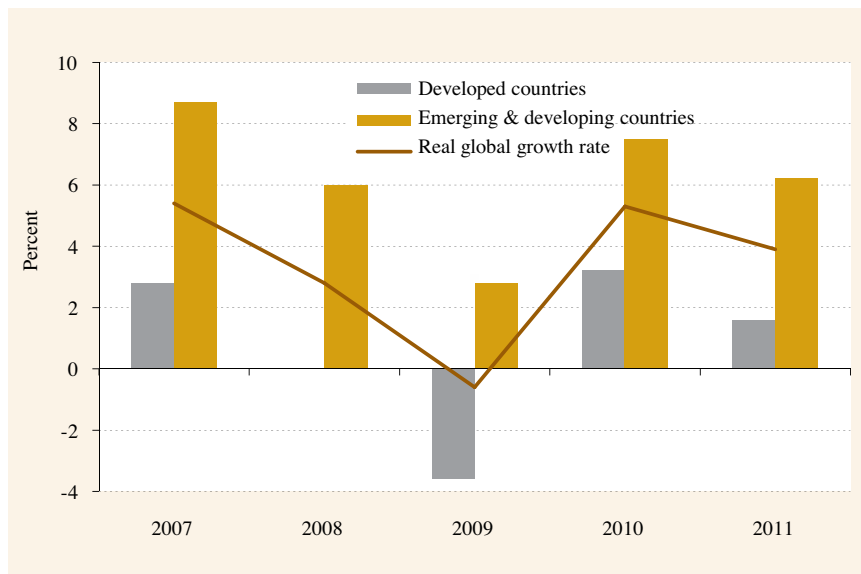
impact on the country groups. Whereas the emerging and developing countries group continued to expand and grow at relatively high rates, some developed countries like the US and the Eurozone were cause for serious concern. Emerging and developing countries achieved growth at the rate of 6.2 percent in 2011 compared to 7.5 percent in 2010, while developed countries grew by 1.6 percent in 2011 compared to 3.2 percent in 2010.

In the developed countries group Japanese economy witnessed the greatest rate of decline among the largest world economies shrinking by 0.7 percent as a result of the natural disaster that struck Japan early in 2011, as well as the floods that befell Thailand and affected Japanese industries. Likewise, the US witnessed a relatively low growth rate of 1.7 percent during the same year, while the Eurozone achieved a growth of 1.4 percent. Regarding the Euro zone, the Greek and Portuguese economies shrank by about 6.9 percent and 1.5 percent respectively, while Italian economic growth dropped to 0.4 percent. Generally, however, the developed countries group achieved a growth of 2.5 percent in 2011.

As for the developing and emerging countries group, Asian developing countries topped the group with a growth of 7.8 percent in 2011 compared to 9.7 percent in 2010. In the MENA region the growth rate dropped from 4.9 percent in 2010 to 3.5 percent in 2011 as a result of the unusual and volatile political and economic conditions in the region. The economy in Libya was greatly affected by these volatile conditions shrinking by about 61 percent in 2011.

It is worth mentioning that despite the relatively good economic performance of some country groups like the emerging and developing countries and central and eastern European countries, the fall in demand in the US, the Eurozone and Japan in particular has clearly affected the growth of those countries.

**Figure 1-1: Growth rates of global real GDP, 2007-2011**



Source: World Economic Outlook, IMF.

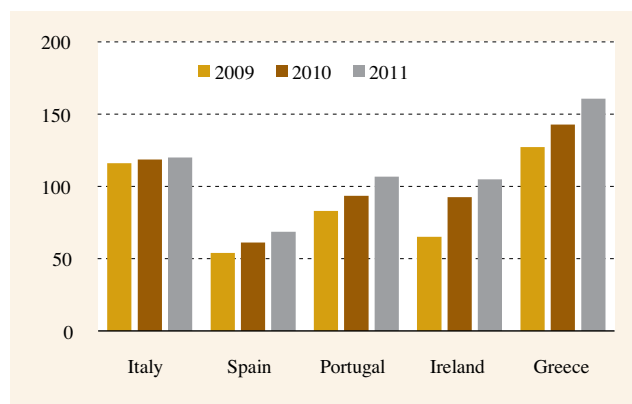
## Box 1: European sovereign debt crisis

The European sovereign debt crisis and its resulting ramifications were amongst the most significant developments in 2011. The crisis casted its shadow on the overall performance of European and global economy as well as on the dynamics of global financial markets which made Europe in general and the most vulnerable PIIGS<sup>[1]</sup> nations in particular the focus of the attention of investors, politicians and economists alike.

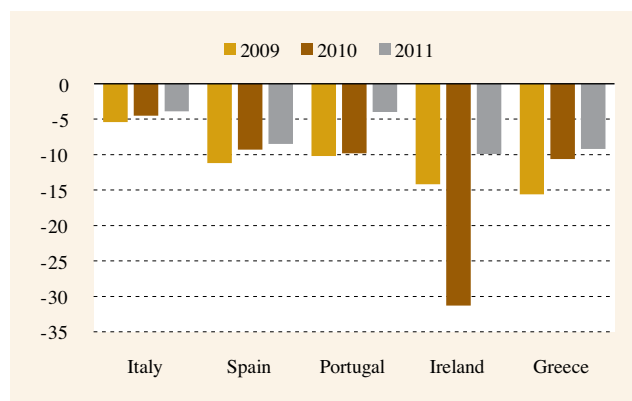
### Origin of crisis

The European sovereign debt crisis has its roots in the 2008 financial crisis and the policies adopted by European countries in facing its spillovers. The G-20 countries agreed to encounter the economic recession with huge rescue plans that depended largely on tax reduction and an increase in government spending with a view to inject new funds in their economies and financial markets for recovery. The G-20 countries depended on loans as a main source of funding for their increasing spending which resulted in the exacerbation of sovereign debts especially in the Eurozone and raised questions among investors about the capability of some countries to pay their accumulated debts.

### Sovereign debt as a percent of GDP



### Budget deficit as a percent of GDP



Source: World Economic Outlook database, IMF.

<sup>[1]</sup> PIIGS countries include Portugal, Ireland, Italy, Greece and Spain.

The constant rise in sovereign debts and the concern expressed by the EU and IMF in this regard engendered a state of panic in the markets in 2010 and ignited a severe financial crisis in Greece that soon spread to other countries like Ireland and Portugal. Therefore these countries had much difficulty obtaining funds from the financial markets due to investors' reluctance to purchase their sovereign bonds. In addition, the rise in the interest rate of these bonds has overburdened the debt service of those countries which drove Greece to adopt austerity measures aiming to reassure global markets and avoid more devastating damage.

However, the failure of the Euro countries to contain the crisis pushed the EU and IMF to intervene decisively in order to support and assist the affected countries (including writing off of about 50 percent of Greek sovereign debts and the rescheduling of the remaining debts) in return for the adoption by those governments of structural reform programs and taking more severe austerity measures aiming to reduce the budget deficits and the volume of debts. The EU has also developed at the beginning of 2011 the European Stability Mechanism and set its initial maximum lending volume at EUR 500,000 million in the event similar crises will occur in the future. But disagreements among European leaders on how to balance between defending their national interest on the one hand and the necessity to rescue the Eurozone on the other were clearly reflected in the European action, which was very slow and indecisive. As a result the financial markets went through a period of great turmoil in 2011, especially during the third quarter of the year. Moreover, fears of European and global economies entering a new cycle of economic recession heightened. There were also increasing worries in the markets that the scorching finger of economic recession would touch larger European economies. Hence Italian and Spanish government bonds came under heavy pressure from speculators in the global market due to the exacerbated volume of both countries' debts which at the same time made the situation more difficult and rendered unavailable the resources and mechanisms the EU could utilize to rescue major countries in the event they come under similar heavy pressure. For this reason the European Central Bank has bypassed its traditional role of preserving stability of prices to purchasing Italian and Spanish government bonds for billions of US dollars in order to prevent the deterioration of the status of these countries in the financial markets.

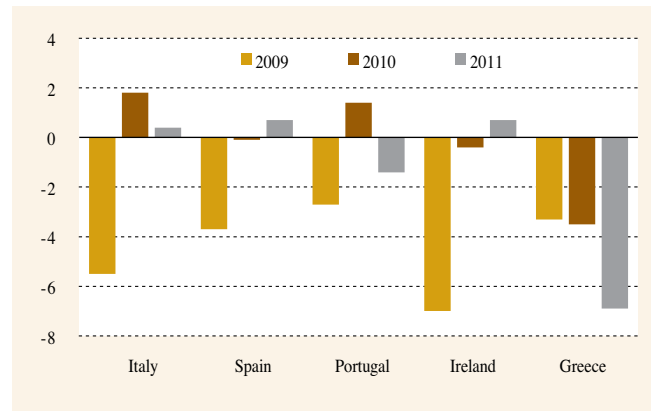
In Greece the crisis was so exacerbated that the country threatened to withdraw from the Eurozone which put to question the future of the Eurozone and the fate of its standard currency. As a result, and in order to avoid facing a new crisis, European politicians moved toward exerting pressure on Greece and assuring the markets of the possibility to remedy the crisis without dismantling the euro.

### **Economic consequences**

As a result of the crisis and austerity measures, the economies of PIIGS countries witnessed a general weakness in performance and a decline in growth due to the drop in government spending and the resulting fall of demand and investment. For example, Ireland, Spain

and Italy have witnessed low growth rates of no more than 1 percent, while Greece and Portugal suffered from a 6.9 percent and 1.5 percent GDP downswing respectively. The weak economic performance of these countries has also affected the rates of unemployment in all PIIGS countries during 2011 except Italy where the rate of employment rested at 8.4 percent. In

Real economic growth rate



Source: World Economic Outlook database, IMF.

contrast, Spain and Italy witnessed the highest rates of employment reaching 21.6 percent and 17.3 percent respectively. On the other hand, and in spite of the drop in demand, those countries (except Greece) have witnessed a rise in inflation levels as a result of the considerable rise in oil and food prices.

### Implications and lessons learned

The debt crisis has shaken trust in several economic concepts and models that prevailed in major countries during the past two decades. The crisis has rocked the status and prestige of sovereign debts as safe investments. In addition, it proved the failure of the growth model through continuous borrowing. In fact, the dependence of countries on borrowing as an infinite source for funding expenditures and exceeding the accepted limits of borrowing have destabilized the economy and caused loss of investor's confidence in the capability of countries to proceed in this unbalanced pattern of consumption. In addition, the euro crisis and the global financial crisis have raised many questions as to the role of major financial institutions in the world and the freedoms they enjoy which might cause (in fact have caused) the collapse of the economies of many countries. Thus the US and euro countries have actually started to legally prosecute those financial institutions for their suspicious role in the crises that befell these countries.

On the European level, in spite of the efforts made by European countries during the past decade toward the consolidation of economic unity among them and the formation of a joint European vision, the current crisis has revealed a clear structural defect in the composition of the EU that reflects the absence of a strong institutional structure, a clear vision and a unified decision. Moreover, the crisis has revealed a weakness in

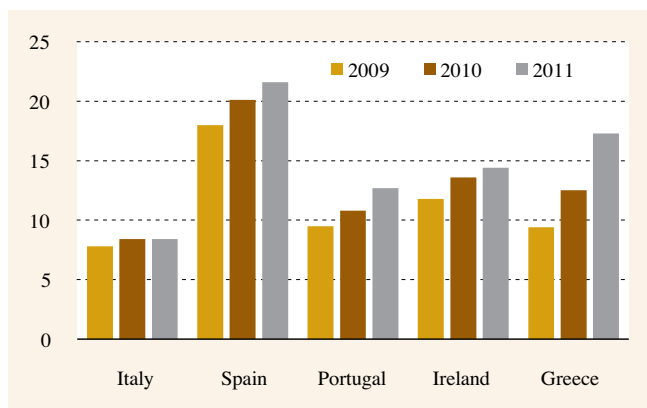
the European banking system, namely capital shortfalls in the banks in order to face crises of this kind and lack of wisdom and objectivity in their investment decisions. As a result, they have been exposed by billions of dollars to heavily indebted countries in light of a fragile global and European economy. Eventually several banks incurred heavy losses and faced the risk of bankruptcy.

Furthermore, the crisis revealed the failure of European countries to bypass their interests and national orientations, and disclosed disagreements

on the future of the Eurozone and how to avoid similar crises in the future. National doubts are on the rise and the Europeans still refuse to give up national sovereignty or decisions that are in the interest of the EU, especially in light of the absence of a clear vision on how to achieve greater economic integration in a way whereby countries with good economic performance will not bear the brunt of the mismanagement and low productivity of other countries, or that smaller countries will not be marginalized for the interest of heavyweight countries in the EU.

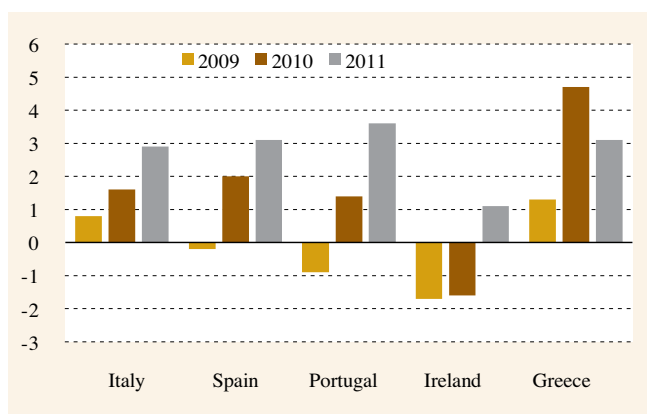
Until the end of 2011, some European countries especially Germany were still reluctant on whether to support decisive intervention to rescue the affected countries or move toward larger

### Unemployment rate as a percent of labor force



Source: World Economic Outlook database, IMF.

### Inflation rate



Source: World Economic Outlook database, IMF.



integration and form financial unity among the euro countries. Moreover, Germany remained adamantly opposed to the French tendency toward nationalization of European debts through the issuance of European bonds, especially in light of the absence of organizational and monitoring mechanisms on government spending. In addition, the debts proposed for nationalization are debts that serve the national interests of debtor countries and not the unified interests of Europe.

Lack of decisive intervention by the EU to rescue affected countries and allow for the dismantling of the euro will be costly for all parties inside and outside the Eurozone. On the one hand, European countries will forfeit freedom and ease of trade and flow of capital and labor. In addition, countries with high productivity rates such as Germany will forfeit part of their competitiveness and ease in reaching European markets with less productivity rates such as Greece. Besides, affected countries will bear the brunt of high economic costs once they are out of the Eurozone. On the other hand, the Eurozone is still the largest economic partner of the US and several other major countries. The volume of European exports to the US amounted to USD 367.8 billion and European imports from the US to USD 268.6 billion in 2011.<sup>[2]</sup> In addition, the euro is the second most widely used currency after the US dollar in terms of volume and accumulation of international reserves. Hence the dismantling of the euro will have a heavy cost that other countries are not ready to put up with.

In light of this situation, economists and politicians believe it is best to override national concerns and interests and move toward a larger monetary, financial and economic integration. In spite of the cost of this alternative, the consequences of dismantling of the euro remain to be harsher on the already fragile economy of Europe and the world.

#### Sources:

- The Euro Crisis File, a collection of articles published in the economic file on Al-Jazeera website [www.aljazeera.net](http://www.aljazeera.net).
- IMF database.

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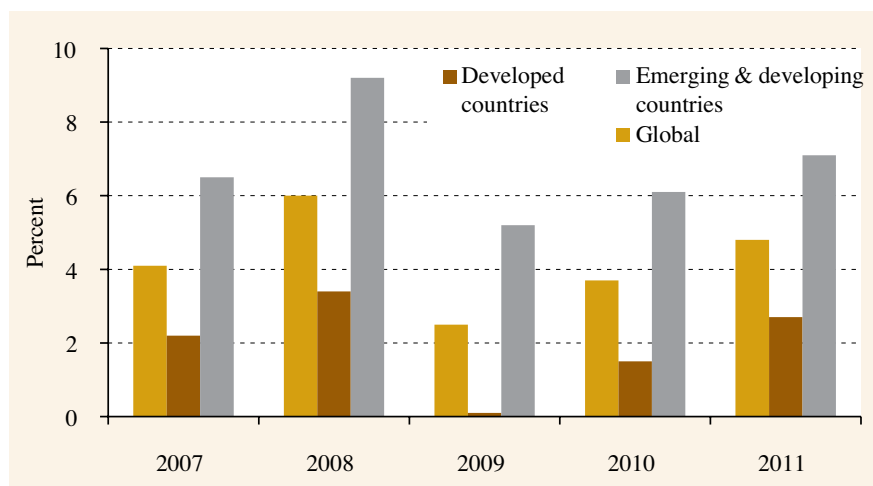
<sup>[2]</sup> US Bureau of Statistics, US Trade in Goods with the European Union, 2011.

## Prices and inflation

Global price levels faced several pressures in the first half of 2011 the most important of which is the rise in the prices of some commodities such as oil and food. This led to a relatively high level of inflation reaching 4.8 percent in 2011 compared to 3.7 percent in 2010.

There is a clear divergence, however, in inflation rates among the different country groups that justify the various levels of demand and the different monetary policies adopted by them. Developed countries groups witnessed an approximately 2.7 percent rate of inflation in the consumer price index (CPI) in 2011, while the rate of inflation in emerging and developing countries reached 7.1 percent in 2011 compared to 6.1 percent in 2010.

Figure 1-2: Global inflation rate, 2007-2011

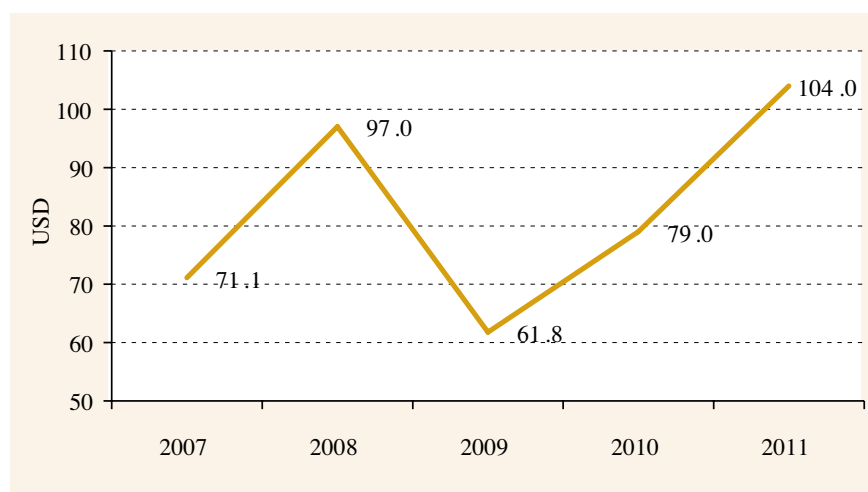


Sources: World Economic Outlook, IMF.

### a. Oil prices<sup>[1]</sup>

Political fluctuation and global economic developments that took place in 2011 have casted their shadow on the levels of global prices in general and the prices of oil in particular. Prices of oil rose by 31.6 percent in 2011 and the annual average price soared to USD 104 per barrel compared to USD 79 in 2010. More-over, the political turmoil in MENA, especially in Libya and

Figure 1-3: Crude oil prices (average), 2007-2011



Source: International Financial Statistics database, IMF.

<sup>[1]</sup> The price of crude oil is the average price of a barrel of oil from Dubai Fateh, West Texas and UK Brent.

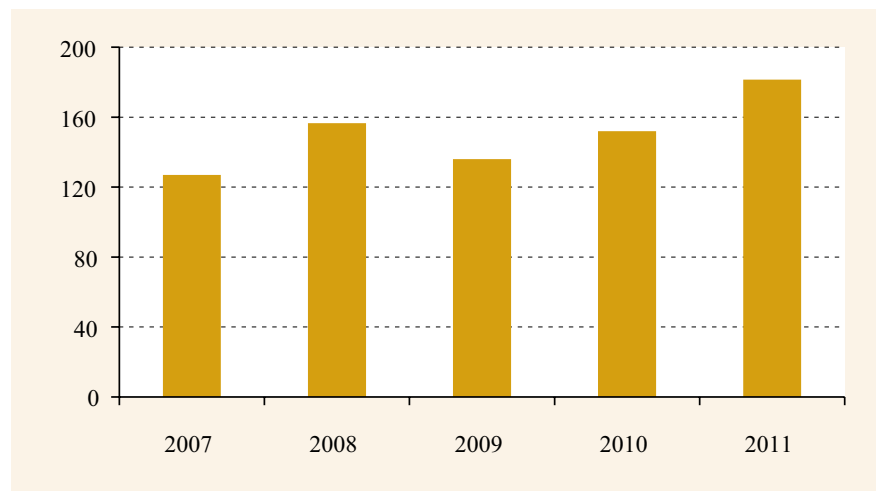
Bahrain, as well as the political agitation engendered by threats to strike Iran's nuclear project and the closure of the Arabian Gulf and Strait of Hormuz, and the significant depreciation in the exchange rate of the dollar against other major currencies were all decisive factors in the fluctuation of oil prices in 2011. In fact, oil prices rose from USD 85.4 per barrel in the fourth quarter of 2010 to USD 99.7 in the first quarter of 2011.

However, the prices of oil skyrocketed to USD 110 per barrel in the second quarter of 2011 as a result of the ongoing political turmoil in the MENA region, especially in Libya where oil production almost completely ceased,<sup>[2]</sup> and the increase in demand for oil in Japan in order to meet the needs for reconstruction in the aftermath of the devastation of the earthquake and tsunami that struck the country in 2011. On the other hand, oil prices tended to stabilize during the second half of the year even though at relatively high rates (USD 103 per barrel). The ongoing rise in oil prices in the second half of 2011 was attributed to the economic recovery experienced by some countries, and hence the rise in demand for oil which also concurred with the emergence of positive signs of US economic recovery from the recession that hit the country as a result of the global financial crisis.

### *b. Food prices*

Food prices continued to rise significantly worldwide in 2011 concurrently with the rise in demand for food products, the rise in oil prices and the deterioration in climatic conditions in food producing countries such as Russia, Australia and Canada. Food prices rose by 19.4 percent in 2011 especially during the first half of the year as a result of the rise in the price of wheat, corn and meat by more than 16 percent each.<sup>[3]</sup>

**Figure: 1-4: Global food price index, 2007-2011**



Sources: World Economic Outlook, IMF.

It is important to note that food prices have been steadily rising during the past three years particularly in countries that have gone through political turmoil in 2011. Food prices rose in Egypt and Tunisia by 19 percent and 4 percent respectively, while food prices in Syria rose by 13 percent in December 2011. The rise in food prices is usually related to poverty rates and the living conditions of individuals especially in poor and middle-income countries which could become a causing factor for political, social and economic instability as was the case in the aforementioned countries.

<sup>[2]</sup> IMF, MENAP Oil Exporters: Benefiting from High Oil Prices amid Growing Risk, October 2011.

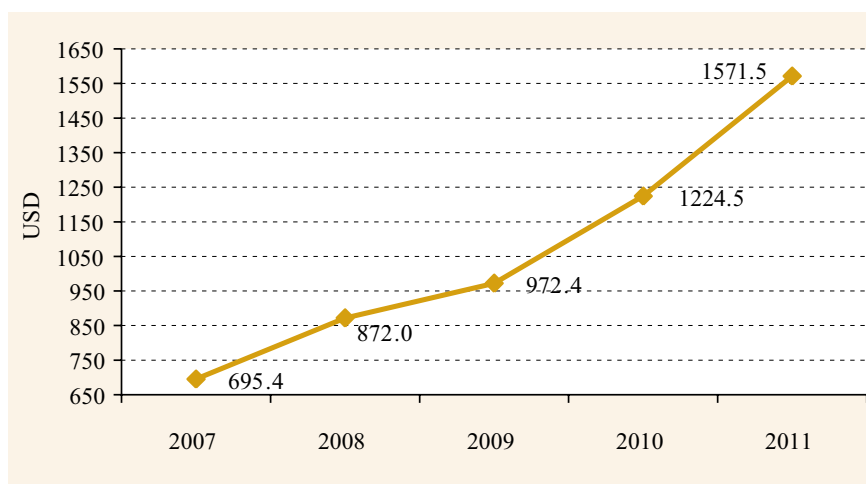
<sup>[3]</sup> Food Price Watch, World Bank, April 2011.

### *c. Gold prices*

The impact of the recent successive economic crises on major countries such as the US, the Eurozone and Japan as well as on investors' trust in their economies and the accumulation of their sovereign debts turned gold into a safe haven for investors and central banks alike. Moreover, the expansionary policies adopted by the US during the past years which have influenced the USD exchange rate against other currencies have been

inversely linked with the significant rise of gold prices in global markets. In this context 2011 was not an exception as prices of gold continued to rise by about 28.3 percent compared to 2010 thus bringing the average price of an ounce of gold to USD 1571.5.

Figure 1-5: Global gold prices, 2007-2011



Source: www.kitco.com, London fix.

### *d. Interest rates*

As part of their monetary policies aiming to incentivize economic activity and push towards economic recovery after national and global crises, some major central banks have moved the rates of interest on their currencies in 2011. The Central Bank of Europe curtailed the interest rate on the euro from 1.25 percent to 1 percent in December of 2011. Likewise, the Central Bank of Switzerland lowered the interest rate on the Swiss franc from 0.25 percent to 0 percent in August of the same year. On the other hand, major currencies maintained a relatively low rate of interest. For example, the Federal Reserve and the Bank of Japan have maintained a 0.25 percent and 0.1 percent rate of interest respectively since 2008. And since 2009 the sterling pound rate of interest has not changed from 0.5 percent.

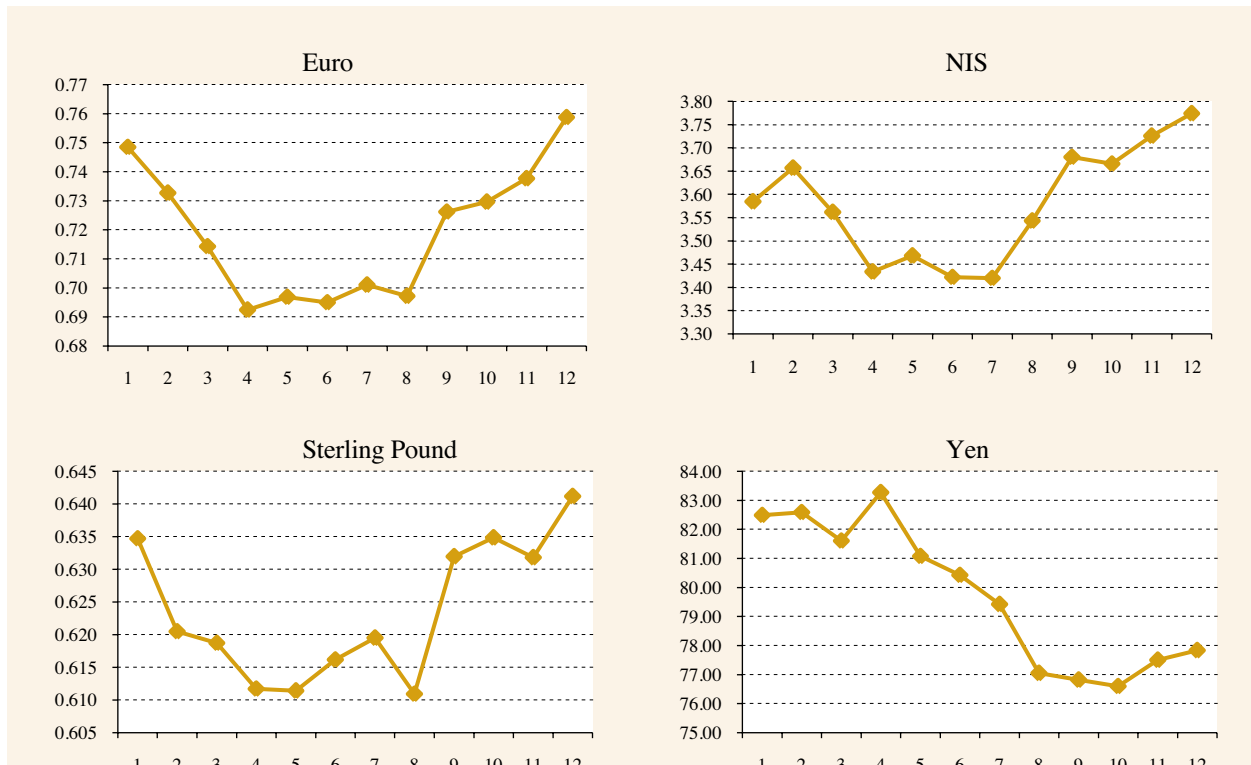
With regard to the Israeli shekel, the Bank of Israel has gradually raised the rate of interest to 2 percent at the end of 2010 until it reached 3.25 percent in the third quarter of 2011. However, at the end of December 2012 the rate of interest dropped to 2.75 percent.

### *e. Exchange rates*

The fluctuations in the exchange rates usually reflect the economic, monetary and financial policies of countries and constitute a significant factor in determining trade relations among countries and direction of the flow of capital. In this context, the fluctuations in the exchange rates of the main currencies (Euro, Sterling Pound, and Yen) in

addition to the New Israile Shekel (NIS)<sup>[4]</sup> against the USD in 2011 also reflect the reactions of markets to each of the crises encountered by major economies and the policies taken to contain the crises.

**Figure 1-6: Main currencies exchange rates against USD on monthly basis, 2011**



Source: central banks of currencies referred to, [www.oanda.com](http://www.oanda.com)

During the first half of 2011, the USD continued to decline against the aforementioned currencies as a result of a mix of expansionary monetary policies adopted by the Federal Reserve during the year, the most important of which is the injection of about USD 500 billion in the US banking system and maintaining a low interest rate. With respect to the euro, in spite of the crisis the Eurozone is going through and its repercussions on the exchange rate fluctuation, it is obvious that generally there will be no substantial changes over long periods of time that might compensate for the apparent drop in the exchange rate of the USD against other currencies.

<sup>[4]</sup> The Israeli shekel has been added since it is the currency in circulation in the PT and because of the impact the significant change in its exchange rate against the dollar has on the living standard of Palestinian individuals especially those who receive their salaries in USD and JD.

## **Box 2: The tripartite dilemma; fixed exchange rate, free capital movement, and independent monetary policies**

Policy makers face an impossible trinity upon choosing the overall macroeconomic policy system that could be applied. This dilemma is represented in the inability to choose more than two of the following three policies:

- Free movement of capital across borders.
- Fixed exchange rate system.
- A targeted independent monetary policy to realize national economic objectives.

In case a fixed exchange rate system was chosen with a desire to adopt an independent monetary policy, policy makers would not be able to control the freedom of capital movements across borders in order to separate movements of national interest rates from international interest rates, which is a precondition to guarantee independence of monetary policies.

If a fixed exchange rate was chosen with a desire to realize complete freedom to move capital across borders, policy makers would not be able to apply targeted independent monetary policies to realize national economic objectives, since measures of monetary policies will be restricted to defending the fixed exchange rate against any changes to the international interest rates.

Finally, if policy makers wished to implement an independent monetary policy with free movement of capital across borders, they should abandon the policy of a fixed exchange rate, because of their inability to realize a fixed exchange rate objective together with the national objectives under freedom of capital movement.

Source: Arab Monetary Fund, the Unified Arab Economic Report, 2003.

## **Unemployment**

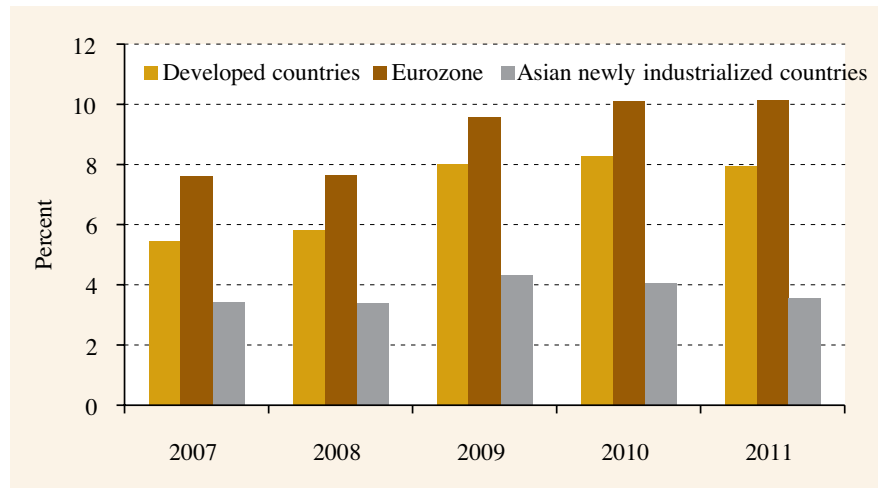
Unemployment rates dropped in most countries of the world in 2011. In developed countries, the unemployment rate dropped to 7.9 percent compared to 8.3 percent in 2010. In the US, it dropped by 0.7 percent in 2011 to reach 9 percent. Similarly, in Japan the rate fell to 4.6 percent compared 5.1 percent in 2010.

In the case of the Eurozone the impact of austerity measures was clearly mirrored in employment rates. The reduction in government spending in light of the sovereign debts crisis rendered European countries incapable of dealing with the already high rates of unemployment resulting from the global financial crisis. Consequently, during the past two years unemployment in the Eurozone rested at 10.1 percent, while the rate in Spain and Greece reached 21.7 percent and 17.3 percent in 2011 respectively compared to 20 percent and 12.5 percent in 2010.



In the Asian newly industrialized countries including South Korea, Taiwan, Hong Kong and Singapore, the rate of unemployment dropped from 4.1 percent to 3.6 percent in 2011. But Asian countries were in a better situation regarding unemployment rates during the past decade compared to European countries and the US. This could be attributed to the growth achieved by these countries which largely depends on cheap labor.

**Figure 1-7: Global unemployment rate, 2007-2011**



Sources: World Economic Outlook, IMF.

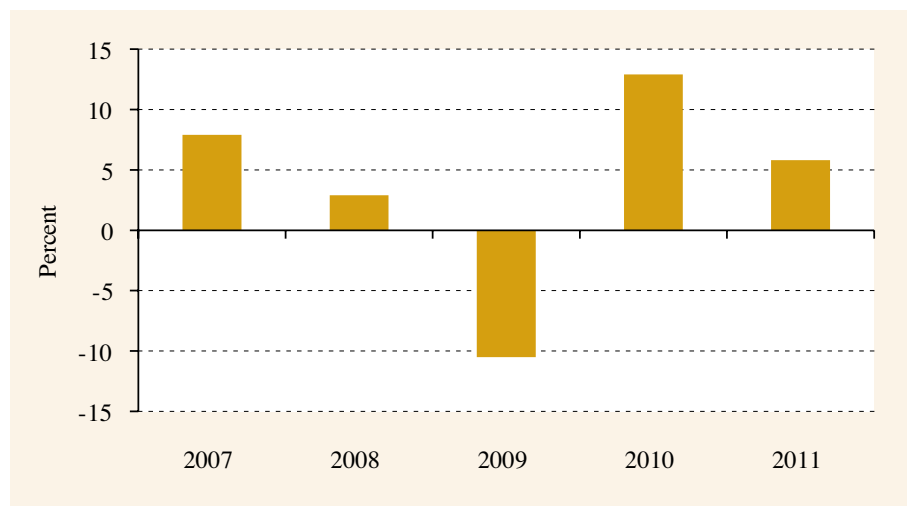
It is also worth mentioning that unemployment rates in developed countries reached high levels since the beginning of the global financial crisis. This constitutes a pressing factor on government in different countries, causing social and political turmoil in some.

Concerning Arab Spring countries, unemployment rates rose in Tunisia from 13 percent in 2010 to 18.9 percent in 2011 and in Egypt from 9 percent to 10.4 percent during the same period.<sup>[5]</sup>

## International trade

International trade witnessed a growth slowdown in 2011 as a result of the global economic developments and the subsequent drop in demand, investment and government spending. Even though the volume

**Figure 1-8: Growth rate of global trade volume, 2007-2011**



Sources: World Economic Outlook, IMF.

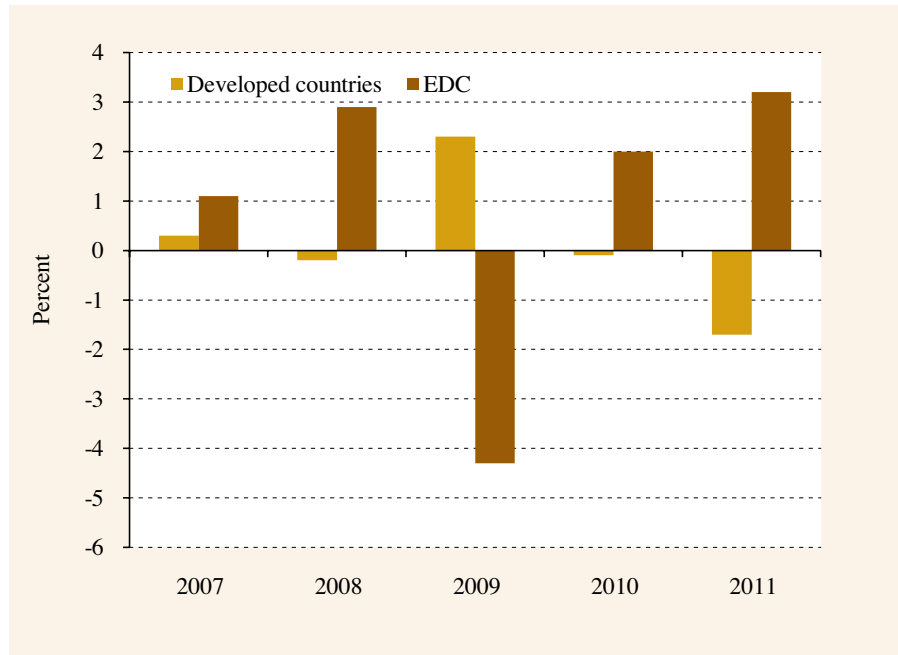
<sup>[5]</sup> Data from Libya, Syria and Yemen not available.

of international exports of goods and services reached USD 21,982 billion in 2011, the growth rate of exports did not exceed 5.8 percent- a relatively low rate compared to 12.9 percent in 2010.

As for country groups, the growth rates of exports in developed countries in 2011 reached 5.3 percent and that of developing and emerging countries group 6.7 percent compared to 12.2 percent and 14.7 percent respectively in 2010. This reflects the disparity in dependence on imports between the two groups of countries.

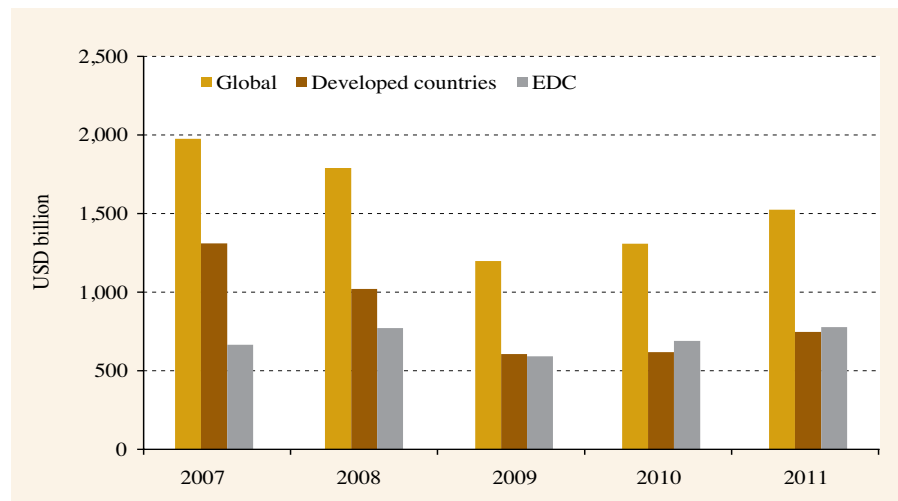
In addition, the terms of trade were reflected in the developments of trade volume and prices; they dropped in the developed countries group by 1.7 percent in 2011 compared to a rise of 3.2 percent in emerging and developing countries group. This demonstrates the decline of competitiveness of developed countries compared to emerging and developing countries and points to the increase in money flow from exports to the latter countries allowing for capital formation.

Figure 1-9: Terms of trade, 2007-2011



Sources: World Economic Outlook, IMF.

Figure 1-10: Foreign direct investment, 2007-2011



Source: global investment reports, UNCTAD indicator, 2012.

## Foreign direct investment

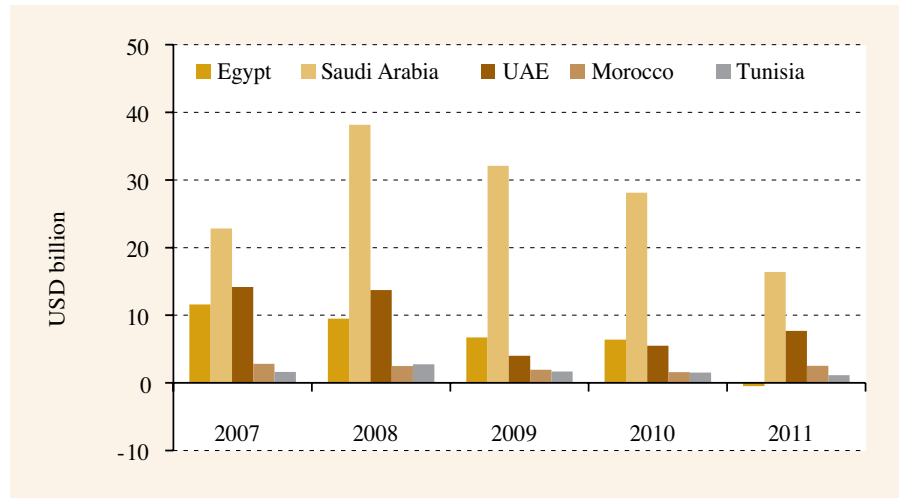
World foreign direct investment witnessed a rise of 16.5 percent in 2011 compared to 2010 as the value of investments amounted to more than USD 1.5 trillion. The rise resulted from the considerable 20.9 percent increase in this kind of investment in developed countries. In contrast, foreign direct investment slowed down in emerging and developing countries by 12.5 percent.

Nevertheless, the share of developed countries in the overall foreign investment flow declined to 47.3 percent in 2011 compared to a rise of 52.7 percent in emerging and developing countries in the same year. It must be said that the Euro zone has the highest share of foreign direct investment acquiring 19.4 percent, followed by the US with a share of 15.1 percent, then China with 8.8 percent.

Foreign direct investment achieved a growth of 21.3 percent in the Euro zone and of 14.7 percent in the US, but continued to drop in Japan by 40.4 percent in 2011 compared to 110.5 percent in 2010.

As to emerging and developing countries, China, Brazil and Turkey achieved a growth of 8.1 percent, 37.4 percent and 75.7 percent respectively in foreign direct investment in 2011 compared to 2010. With regard to Arab countries, foreign direct investment continued to decline for the past three years in a row, falling by 37.5 percent in 2011. The latter was the biggest drop in the past three years as in 2009 and 2010 there was a decline of 20.7 percent and 14.6 percent respectively. The decline was in fact one of the negative consequences of the Arab Spring especially in countries that experienced political turmoil and instability or in neighboring countries. Egypt recorded the highest rate of decline reaching up to 107.6 percent in 2011 as huge amounts of money generated by foreign investment ceased to flow into the country. Similarly, the flow of foreign direct investment dropped in Tunisia by 24.5 percent. In Saudi Arabia it dropped by 41.6 percent due to the country's proximity to the incidents in the Gulf region – noting that Saudi Arabia accounts for more than 40 percent of the overall foreign direct investment flow in the Arab world. In Lebanon, foreign direct investment dropped by 25.2 percent due to the impact the incidents in neighboring Syria have on the country; in Jordan it declined by 11 percent, and in Sudan by 6.2 percent. In contrast, some Arab countries that enjoyed some kind of stability like Morocco for instance have witnessed a rise in foreign direct investment of 60 percent in 2011 compared to 2010. Generally, the share of the Arab world in 2011 constituted 5 percent of the world's foreign direct investment.

Figure 1-11: Foreign direct investment in some Arab countries, 2007-2011



Source: global investment reports, UNCTAD indicator, 2012.

## International reserves

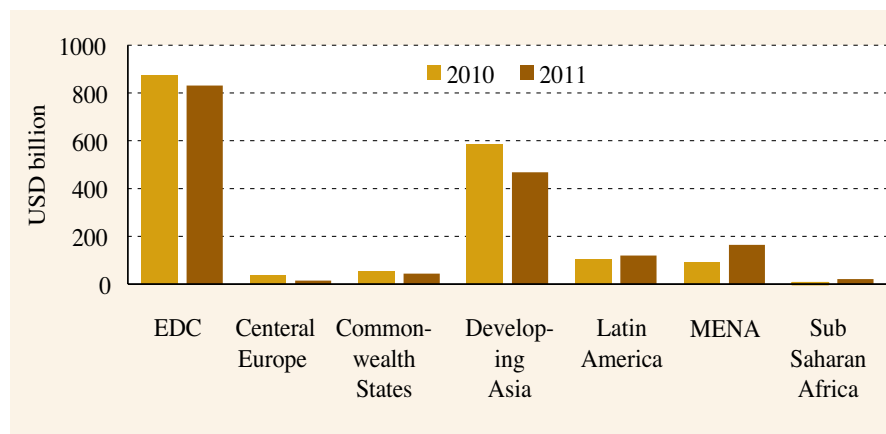
Changes in international reserves are closely related to developments in trade balances and capital flow among countries. Improvement in exports and capital flow to countries is usually associated with a rise in their reserves of foreign currencies. The slowdown in the growth of trade among world countries in 2011 led to a similar slowdown in the growth of international reserves, which are basically concentrated in developing and emerging countries.

The reserves of these countries rose by USD 831.6 billion in 2011 compared to USD 873.8 million in 2010. Asian developing countries group had the lion's share of this increase amounting to 56.3 percent (around USD 468.5 billion) due to the fact that China, the world's largest reserve holder, is part of this group and has achieved trade surpluses with most world countries. These trade surpluses allow China to accumulate more reserves. By comparison, MENA countries came second with 19.8 percent of the overall increase in international reserves for the value of USD 164.4 billion. Latin American and Caribbean countries came third with 14.4 percent or USD 119.4 billion, while reserves in the Commonwealth Independent States rose by 5.3 percent or USD 44 billion. In the remaining groups (Africa, Middle and Eastern Europe) reserves rose by 4.2 percent or USD 35.4 billion in 2011 compared to 2010.

## External debt

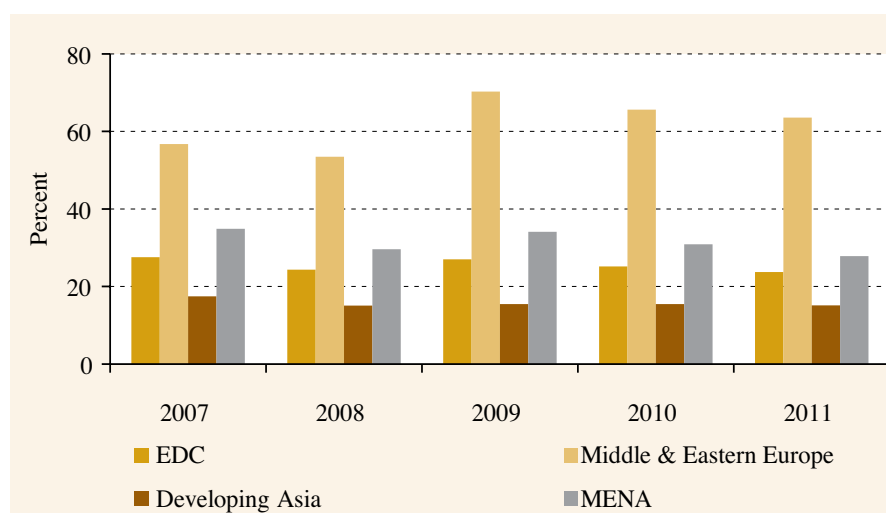
The sovereign debts of developed countries constituted the biggest source of concern in 2011. Greece ignited the European debt crisis as the country failed

**Figure 1-12: Change in official reserves of emerging & developing countries, 2010 & 2011**



Source: World Economic Outlook Database, IMF.

**Figure 1-13: External debt as a percent of GDP, 2007-2011**



Source: World Economic Outlook database, IMF.

to pay its sovereign debts and as a result concerns were raised about the debts of other countries in the Euro zone such as Italy, Ireland, Spain and Portugal. Consequently, the progress of global growth and global economic and financial stability in the Euro zone faced a serious threat. In addition, the US high levels of indebtedness and the downgrading of the US Treasury debts by Moody's Credit Rating Agency have overburdened growth in the US and the world in general.

On the other hand, 2011 witnessed a drop in the ratio of external debt to GDP in emerging and developing countries reaching 23.8 percent compared to 25.2 percent in 2010. Likewise, in Asian emerging countries the ratio dropped from 15.5 percent to 15.1 percent in the same year, while in Latin American and Caribbean countries group the same ratio rose slightly from 21.3 percent to about 22 percent. However, in the MENA and in spite of the political and economic disturbances that prevailed in the region, the ratio of external debt to GDP dropped significantly to reach 27.9 percent in 2011, compared to 30.9 percent in 2010.

## Global financial markets

Financial markets are easily affected by political and financial crises. The crises of 2011 were extremely difficult for many global financial markets, except for the US market where Standard & Poor's 500 index climbed above 1260 points, thus achieving a rise of nearly 11.6 percent compared to 2010. In contrast, Eurozone markets witnessed a significant drop as a result of mounting concern about the economic conditions in most member states as well as of downgrading of the credit rating of some member states. Dow Jones Euro Stoxx 50 Index reached 2600 points with a decline of 5.8 percent compared to 2010. Similarly, the Japanese Nikkei index registered a drop by 5.6 percent reaching 9425 points in 2011.

## Economic outlook

It is anticipated that the global economy would gradually recover but remain fragile<sup>[6]</sup> due to the risks that still beset some parts of the world especially in developed countries where the sovereign debts crisis in the Eurozone is still at its peak despite the measures and policies taken by the EU countries to alleviate the crisis. Moreover, the economic recovery in the US remains weak and vulnerable to decline any moment. However, it is anticipated that several factors will emerge in the coming few years which will accelerate global economic recovery. The factors include an improvement in the global financial performance, moving toward easing financial policies, persisting with the fiscal austerity policies, plus other factors such as the reconstruction of Japan and Thailand in the aftermath of the natural disasters of 2011.

Accordingly, the IMF anticipates global economic growth by 3.5 percent in 2012 and by 4.1 percent in 2013 compared to 3.9 percent in 2011. Furthermore, the IMF anticipates a drop in economic growth in developed countries from 1.6 percent in 2011 to 1.4 percent in 2012 and a rise of about 2 percent in 2013. With respect to developing and emerging countries, the IMF anticipates a decline of 5.7 percent in their economy in 2012 compared to 6.2 percent in 2011 to be followed by a growth of 6.0 percent in 2013. In the MENA countries the IMF anticipates economic growth of 4.2 percent in 2012 and a decline of 3.7 percent in 2013.

The volume of international trade is also anticipated to drop in 2012 in both developed and developing and emerging countries to reach 4 percent compared to 5.8 percent in 2011. But a rise of 5.6 percent is anticipated

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<sup>[6]</sup> Horizons of Global Economy, IMF, April 2012.

in 2013. Concerning consumers' prices, the rate of inflation is anticipated to fall in developed countries from 2.7 percent in 2011 to 1.9 percent in 2012 and from 7.1 percent to 6.2 percent in developing and emerging countries. The rate of inflation is anticipated to decline in 2013 to reach 1.7 percent in developed countries and 5.6 percent in developing and emerging countries. The IMF anticipates prices of oil to undergo an increase in prices<sup>[7]</sup> in 2012 with the price of the barrel reaching USD 114.7 before dropping to USD 110 in 2013. It should be mentioned that the price of oil reached USD 104 per barrel in 2011.

### Box 3: Arab Spring countries at a glance

**About a year ago, a historic transformation process has begun in some Middle East countries. In fact, the Middle East region has passed through periods of great turmoil and instability that surpassed all expectations (the loss of life in Libya, Syria and Yemen). Until today a state of uncertainty envelops the region which might augment the political crisis and put the Middle East on the threshold of a more difficult and yet more uncertain future. The region is in the middle of a critical transitional stage – rejection of the past and drawing up the features of the future. It is a stage where people have to choose from difficult alternatives especially as it has concurred with global economic instability. But the final goal of the Arab Spring is to unleash the capabilities of the Arab people.**

| Real growth rate |      |      |      |      |      |       |       |
|------------------|------|------|------|------|------|-------|-------|
| Country          | 2006 | 2007 | 2008 | 2009 | 2010 | 2011  | 2012* |
| Egypt            | 6.8  | 7.1  | 7.2  | 4.7  | 5.1  | 1.8   | 1.5   |
| Libya            | 6.7  | 7.5  | 5.4  | -0.1 | 2.5  | -61.0 | 76.3  |
| Syria            | 5.0  | 5.7  | 4.5  | 5.9  | 3.4  | n.a   | n.a   |
| Tunisia          | 5.7  | 6.3  | 4.5  | 3.1  | 3.1  | -0.8  | 2.2   |
| Yemen            | 3.2  | 3.3  | 3.6  | 3.9  | 7.7  | -10.5 | -0.9  |

| Inflation rate (average period) |      |      |      |      |      |      |       |
|---------------------------------|------|------|------|------|------|------|-------|
| Country                         | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012* |
| Egypt                           | 4.2  | 11.0 | 11.7 | 16.2 | 11.7 | 11.1 | 9.5   |
| Libya                           | 1.4  | 6.2  | 10.4 | 2.4  | 2.5  | 14.1 | 1.9   |
| Syria                           | 10.4 | 4.7  | 15.2 | 2.8  | 4.4  | n.a  | n.a   |
| Tunisia                         | 4.2  | 3.4  | 4.9  | 3.5  | 4.4  | 3.5  | 5.0   |
| Yemen                           | 10.8 | 7.9  | 19.0 | 3.7  | 11.2 | 17.6 | 17.1  |

| Unemployment rate as a percent of labor force |      |      |      |      |      |      |       |
|---|------|------|------|------|------|------|-------|
| Country                                       | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012* |
| Egypt   | 10.9 | 9.2  | 8.8  | 9.5  | 9.0  | 10.4 | 11.5  |
| Libya   | n.a  | n.a  | n.a  | n.a  | n.a  | n.a  | n.a   |
| Syria   | 8.3  | 9.2  | 10.9 | 8.1  | 8.6  | n.a  | n.a   |
| Tunisia                                       | 12.5 | 12.4 | 12.4 | 13.3 | 13.0 | 18.9 | 17.0  |
| Yemen   | n.a  | n.a  | n.a  | n.a  | n.a  | n.a  | n.a   |

\* Projections

**Even though the Arab Spring was initiated by the strong desire of the Arab people for freedom and for a wider range and fairer distribution of economic opportunities, the economic aspect**

<sup>[7]</sup> Expected prices of oil for 2012 and 2013 are based on the prices of Future Markets.

has not been given much attention. Economy can in fact be a cause for serious concern. At the time when 2011 witnessed dramatic changes in the political arena, most economic indicators have taken a distorted path in the Arab Spring countries. The rate of growth dropped by almost half, while rates of unemployment rose and reserves were subjected to enormous pressure. Likewise, the value of local currency and interest rates, the banking sector, the financial markets and perhaps the sovereign rating of the Arab Spring countries came under heavy pressure. Moreover, deficits in national budgets widened as governments responded to social pressure by increasing spending on wages and subsidies, especially as the new governments in the region were keen on fulfilling the demands for jobs and social justice. But soon the governments were confronted with the bitter reality of limited resources.

In an attempt to curb the impact of the political situation on the economic condition, monetary and financial authorities in some Arab countries, as well as countries affected by the Arab Spring, have resorted to measures like injecting cash flow in the markets to limit their shrinkage and controlling interest rates and rates of exchange through intervention. These measures aimed to meet the demand for the USD

| Budget deficits as a percent of GDP |      |      |      |       |      |      |       |
|-------------------------------------|------|------|------|-------|------|------|-------|
| Country                             | 2006 | 2007 | 2008 | 2009  | 2010 | 2011 | 2012* |
| Egypt                               | -9.6 | -7.3 | -6.8 | -6.9  | -8.1 | -9.8 | -9.8  |
| Libya                               | 15.1 | 32.4 | 29.4 | 11.7  | 5.0  | n.a  | n.a   |
| Syria                               | -1.9 | -3.0 | -2.9 | -4.8  | n.a  | n.a  | n.a   |
| Tunisia                             | -2.7 | -2.8 | -0.7 | -2.6  | -1.2 | -3.2 | -5.7  |
| Yemen                               | 0.2  | -7.2 | -4.5 | -10.2 | -4.0 | -4.4 | -5.0  |

| Sovereign debt as a percent of GDP |      |      |      |      |      |      |       |
|------------------------------------|------|------|------|------|------|------|-------|
| Country                            | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012* |
| Egypt                              | 90.3 | 80.2 | 70.2 | 73.0 | 73.2 | 76.4 | 79.2  |
| Libya                              | 0.6  | 0.0  | 0.0  | 0.0  | 0.0  | n.a  | n.a   |
| Syria                              | 46.9 | 43.2 | 37.4 | 31.4 | 29.4 | n.a  | n.a   |
| Tunisia                            | 48.8 | 45.9 | 43.3 | 42.8 | 40.4 | 42.4 | 43.5  |
| Yemen                              | 40.8 | 40.4 | 36.4 | 49.9 | 40.9 | 42.5 | 43.4  |

\* Projections

and reduce required reserve ratios in order to enable banks to meet withdrawals, increase their lending capabilities, and suspend work in the stock market to restrict further deterioration in stock prices. Generally, however, as the Arab Spring opened the door for the discussion of the political situation in the Middle East, it should also allow for the discussion of economic issues and for drawing lessons and revisiting the economic future awaiting the region.

Among the lessons learned in this context is that rapid economic growth cannot continue at the same pace unless all are benefited by it and unless it is able to create new job opportunities for the increasing number of job seekers (high unemployment rates are considered a time bomb in the Middle East especially in non-oil countries) accompanied with social policies to support the poorest segments of society. In order for the economic reforms to be sustainable, all must share the fruit, and the exclusive gain of a group of influential people is a form of corruption that deprives ordinary citizens of economic benefits they are entitled to. In addition, the absence of transparency, accountability and fairness impedes the achievement of comprehensive national growth.



Another lesson learned in this regard is that the implementation of the agenda encompassing all social segments cannot persist without economic and financial stability. Since the start of the transformation process, the Middle East has witnessed a state of uncertainty and enormous economic pressure from both national and international sources. The pressure exacerbated as global economic conditions worsened, and as a result, Arab countries increased their spending to meet the needs and aspirations of their peoples. Even though the increase in spending could be necessary in the short term, the design of the increase should allow for reversing it at a later time so that spending may return to sustainable levels and hence alleviate the long-term repercussions on public finance. Moreover, and due to the difficult economic conditions, some countries will need foreign financial support.

Therefore, it may be appropriate to start formulating national reform strategies necessary for building trust and developing the foundation for sustainable and comprehensive growth. (And this is indeed what some countries have started doing). Equally appropriate and important is to identify the goals and the track of change for each country, including rates of economic growth warranting the provision of additional work opportunities, economic integration, increased social justice and protection for the vulnerable segments of society, and institutional guarantees of accountability, transparency and good governance.

In this context it may be pointed as well to the fact that the international community is contributing to the success of the abovementioned goals through a multilateral and ambitious support program, providing incentives such as financial aid, access to markets, free movement of labor and loan guarantees. Noteworthy is that the IMF has declared its full commitment to assist the region and provide oil-importing countries with financial support amounting to about USD 35 billion in addition to USD 38 billion to international and regional financial organizations. Moreover, the IMF continues to expand its technical assistance learning lessons at the same time lessons from the Arab Spring and giving much attention not only to how the economy might benefit from recommendations regarding relevant policies but also to the fairness of those recommendations and the extent of their impact on the different segments of the population.

If the state of uncertainty and envisaged challenges are properly dealt with, the next stage of the Arab Spring may herald many benefits which will eventually improve the living standards of the population and achieve more prosperity in the region. The Middle East enjoys several advantages such as young, trained and relatively cheap labor force, abundant natural resources, ancient civilizations, large regional market, and a distinguished geographical location which provides easy access to many international markets.

#### Sources:

- Masoud Ahmad. What We Learned from the Arab Spring. IMF, October 2011.
- Nimat Shafiq. Why the Arab World Needs Economic Spring. IMF, May 2012.
- Christin Lagard. The Arab Spring After One Year. IMF, December 2011.
- IMF database.

## Part II: Local Economic Developments

### Overview

The year of 2011 was an extension to the comprehensive development process initiated by the Palestinian economy since 2007. Despite the crippling financial crisis the Palestinian government suffered lately, the Palestinian economy maintained fairly similar growth rates in last three years, backed by strong economic recovery in Gaza Strip.

Within the same context, this growth was positively reflected in many significant economic and social indicators such as per capita GDP, employment and unemployment rates.

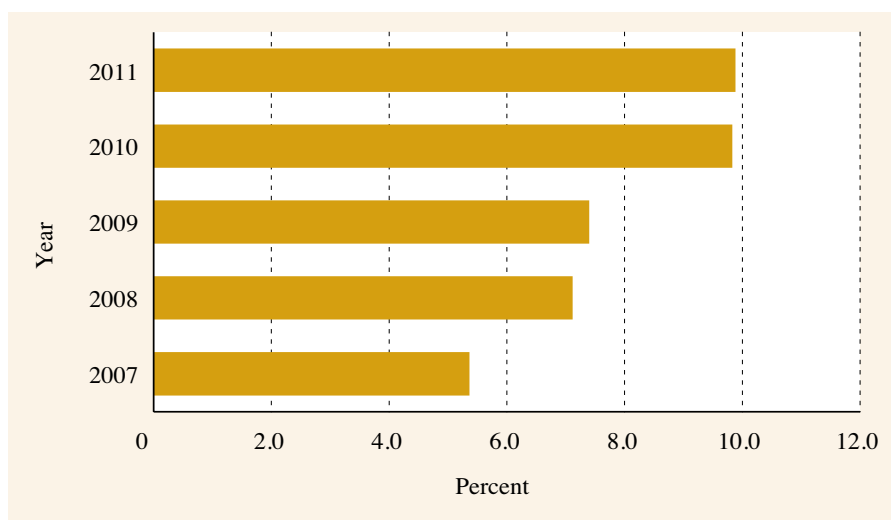
It should be noted that despite that growth was led by Gaza Strip, it is still a long way to bridge the economic gap between the two parts of the nation and realizing sustainable development, especially under Israeli occupation and restrictions on the Palestinian economy and movement of individuals and goods, particularly in the Gaza Strip.

Recent developments were relatively isolated from international economic developments; especially that the Israeli economy (the most influential factor) was not significantly affected by international developments, except for the rise in fuel and food price last year and their impact on price levels in the two economies in question.

### Economic performance

The Palestinian economy kept growing during 2011 at a rate similar to those of previous years despite the crippling financial crisis the Palestinian government suffered since mid-year. Data provided by the Palestinian Central Bureau of Statistics (PCBS) suggest that real domestic product has grown 9.9 percent in 2011 (9.8 percent in 2010) as a result of significant growth in Gaza Strip at 23 percent against 5.2 percent in the West Bank. The high growth achieved in the Gaza Strip was due to the ongoing output recovery in the wake of loosening Israeli restrictions on consumer goods imports, production inputs for internationally supervised projects and imports from

Figure 1-14: Real GDP growth rate in Palestinian Territory, 2007-2011



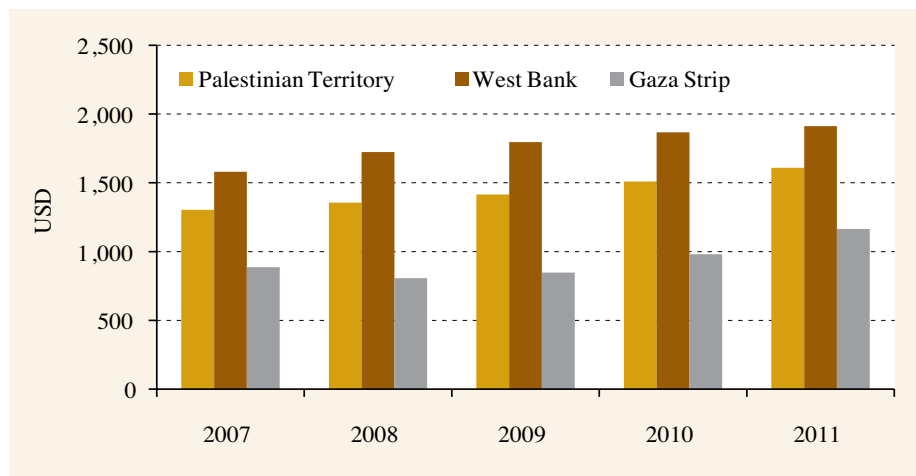
Source: PCBS, 2011.

Egypt. On the other hand, the slowdown of growth in the West Bank came as a result of continuous financial austerity policy, decline in foreign assistance, slowdown of global economic activity and constant restrictions on freedom of movement, domestically and abroad.

The real growth rate in the PT is high compared with global economic performance and growth rates in the region. The MENA countries realized a growth rate of 3.5 percent in 2011, whereas the growth in Jordan, Egypt and Israel was 2.5 percent, 1.8 percent and 4.7 percent respectively.

The change of per capita income is usually used as an indicator to the change of social welfare level in a given country, where it shows the actual impact of economic growth on per capita income, taking population growth into account. In this respect, the growth seen by average per capita in the past five years is an indicator to improvement of Palestinians' economic welfare, where per capita income increased 21 percent in the past five years to USD 1,609.9 in 2011, in which it increased about 6.6 percent over 2010. Despite that improvement, per capita income in the PT is still less than what it was in 1999. On the other hand, it is modest if compared with the Israeli counterpart, which is about 18 times as large.

**Figure 1-15: Per capita real GDP in Palestinian Territory, 2007-2011**



Source: database of World Economic Outlook, IMF.

Geographically speaking, growth of real per capita GDP in the West Bank has not exceeded 2.4 in percent 2011 (USD 1,912.1), against considerable growth in Gaza Strip at 18.8 percent (USD 1,164.5). However, the economic gap is still evident between these two regions despite the remarkable variance of growth rates between them, as the per capita income in Gaza Strip did not exceed 61 percent its level in the West Bank in 2011, against 68 percent in 2006. Nevertheless, the economic recovery and high growth rates that have been achieved in Gaza Strip have recently contributed to a partial narrowing of the inter-regional economic gap, which had widened due to the crippling Israeli blockade in the past few years.

### *a. Economic activities*

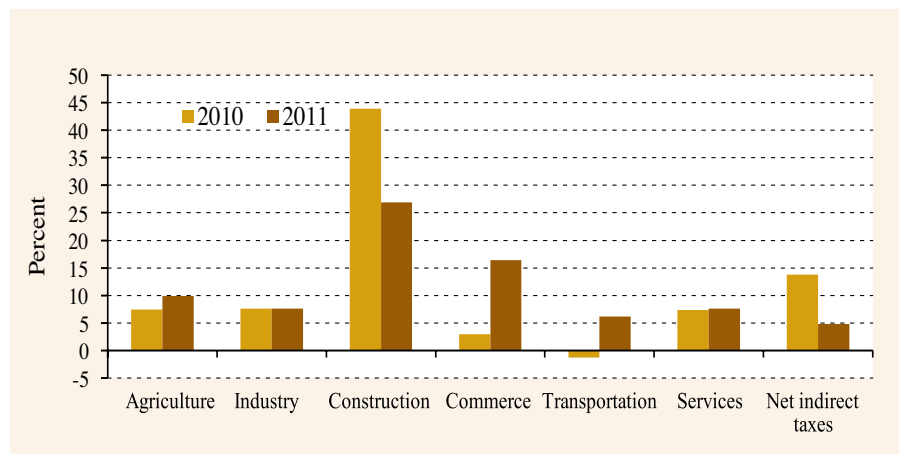
As to the growth of economic activities, the commodity production activities have seen significant growth of 14.7 percent in 2011, compared with 17.8 percent in 2010, denoting the relative improvement in

production sector of the Palestinian economy. By contrast, service activities have grown 9 percent in 2011 against 5 percent in the previous year, while indirect tax growth slowed down by 4.8 percent in the same year (13.8 percent in 2010).

Regarding commodity production activities, the construction sector witnessed the highest growth rate during the year at around 26.9 percent, followed by agriculture (9.9 percent), and industry (7.6 percent). Regarding services activities, commerce, restaurants and hotels have seen the highest growth rate at 16.4 percent, followed by, transportation and storage (6.2 percent), while other services grew by 7.6 percent.

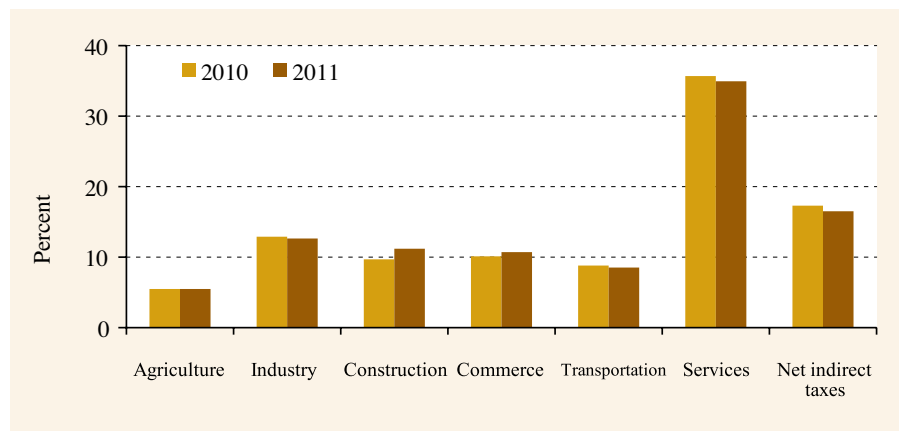
As for the contribution of economic activities to real GDP, the contribution of commodity production activities has increased from 28.1 percent to 29.3 percent in 2011, against relative stability in service activities' contribution (54.2 percent compared with 54.6 percent in 2010). Contribution of indirect taxes to GDP has declined to 16.5 percent against 17.3 percent in 2010. Regarding individual activities, there has not been any significant change between 2010 and 2011, except for the construction sector whose contribution went up from 9.7 percent in 2010 to 11.2 percent in 2011.

**Figure 1-16: Real growth rates of economic activities, 2010 & 2011**



Source: PCBS.

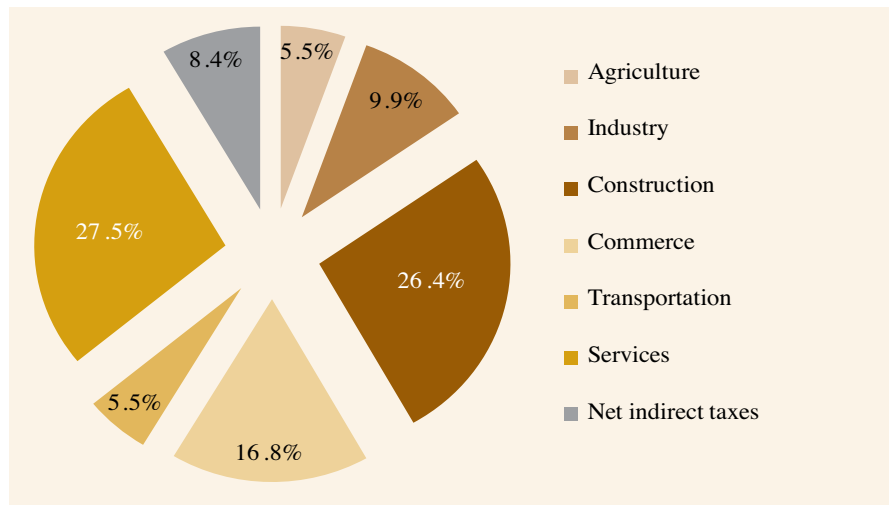
**Figure 1-17: Economic activities contribution to real GDP, 2010 & 2011**



Source: PCBS.

Regarding the contribution of activities to the growth rate of real GDP<sup>[8]</sup>, although the share of productive activities does not exceed 29.3 percent, it is responsible for about 41.8 percent of the growth achieved during 2011, against 49.7 percent contribution from non-productive activities. On the contribution of productive activities, it is clear that the main growth driver during 2011 was the construction sector (26.4 percent), followed by industry (9.9 percent) and agriculture (5.5 percent). Regarding non-productive activities, the main growth driver was the commerce sector by 16.8 percent followed by transportation (5.5 percent), while other services contributed by 27.5 percent in real GDP growth.

**Figure 1-18: Economic activities contribution to real GDP growth rate, 2011**

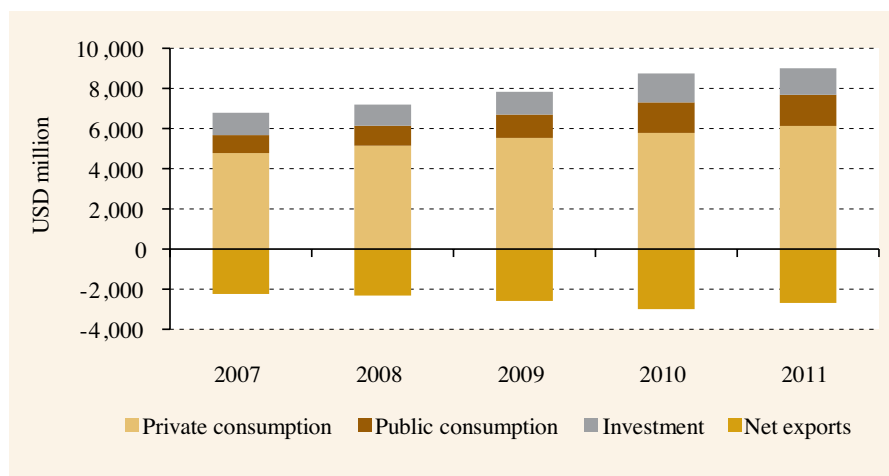


Source: PCBS.

### *b. Aggregate demand*

The year 2011 has witnessed a growth in some items of real aggregate demand of the Palestinian economy, and a decline in some others compared to 2010, as final consumption (public and private) and exports have grown, whereas investments and imports have declined. As for final consumption, private consumption constituted 82 percent of final consumption in the same period, while public

**Figure 1-19: Aggregate demand components in the Palestinian Territory, 2007-2011**



Source: PCBS.

<sup>[8]</sup> Contribution of activity to growth rate = growth rate of economic activity in 2011 X contribution of economic activity to GDP in 2010.

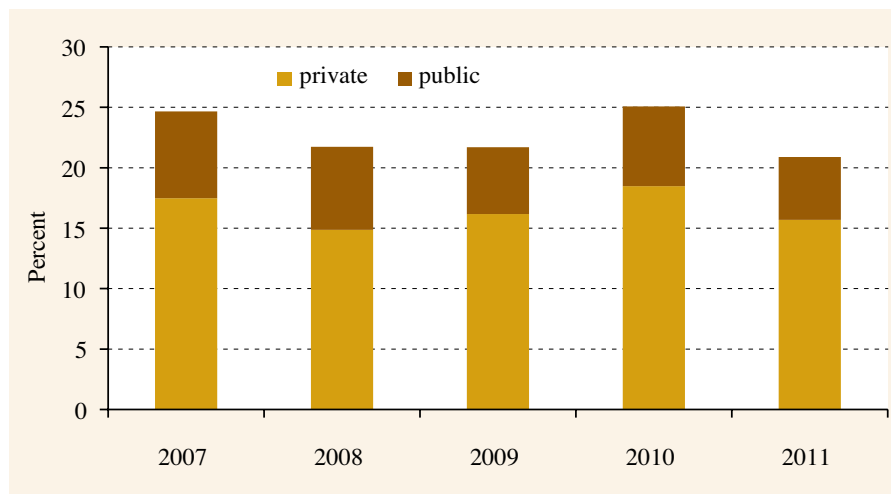
consumption received 18 percent on average during the same period. It is also noted that the public consumption as a share of final consumption rose (from 15.7 percent in 2006 to 20.3 percent in 2011).

Data also denote that private consumption has grown 6 percent in 2011 compared with 4.5 percent in 2010. Nevertheless, the share of private consumption formed 96.9 percent of real GDP in 2011, which fell below the level of 2010 (100.5 percent).

Regarding public consumption, data indicate it has grown by 2.4 percent in 2011 (31.2 percent in 2010). This slowdown was caused by a remarkable drop of the Palestinian government's development spending in 2011, compared with high development spending during 2009 and 2010. The Palestinian government –with foreign financing- carried out many infrastructure projects and invested in capital formation during these two years compared to a considerable decline in this aspect of consumption in 2011. This slowdown in government consumption has negatively affected its share of real GDP, which went down from 26.4 percent in 2010 to 24.6 percent in 2011.

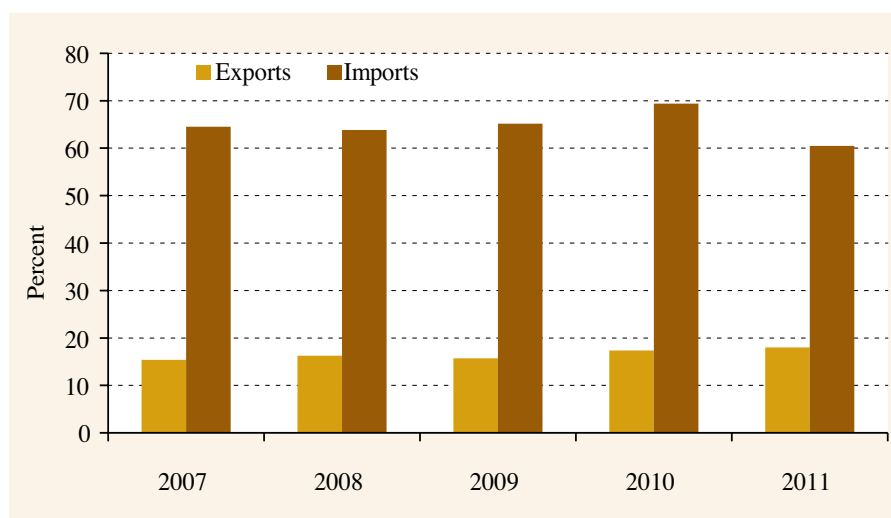
Furthermore, real gross capital formation (investment) has considerably declined in 2011 to 8.4

**Figure 1-20: Public & private investment as a percent of real GDP, 2007-2011**



Source: PMA estimates.

**Figure 1-21: Exports and imports as a percent of real GDP, 2007-2011**



Source: PCBS.

percent against a growth rate of 26.9 percent in 2010<sup>[9]</sup>, and this was due to a 6.7 percent decline of private investment and 13.5 percent of public investment compared with the previous year. On that basis, investment share in real GDP went down to 20.9 percent in 2011 (25.1 percent in 2010).

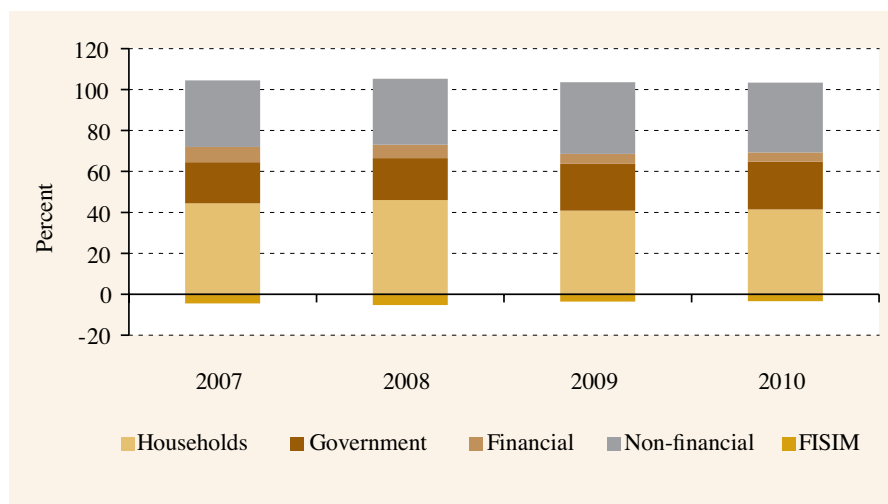
By contrast, the trade deficit (goods and services) declined considerably by 10.3 percent in 2011, compared with an increase of 15.4 percent in 2010. The deficit constituted 42.5 percent of GDP in 2011 compared with 52 percent in 2010. The decline in deficit could be attributed to the growth in exports on one hand, and to the decline in imports on the other. Exports have grown 14 percent in 2011 compared to 21.5 percent in 2010, while imports declined by 4.2 percent in 2011 compared with 16.9 percent in 2011.

It should be mentioned that exports share in real GDP rose to 18 percent in 2011 against 17.4 percent in 2010, and imports share dropped to 60.5 percent of real GDP in 2011 compared to 69.4 percent in the previous year.

### c. Institutional economic sectors

According to the national accounts system of the UN (1993), the economy is generally divided into households sector<sup>[10]</sup>, government sector, non-financial sector and financial sector. When subtracting indirectly measured financial services from total production of these sectors, the result is the gross domestic product at cost prices of these sectors combined. After adding indirect taxes to GDP at cost prices, GDP is concluded.

**Institutional economic sectors contribution to nominal GDP at factor cost, 2007-2010**



Source: PCBS.

The households sector in the Palestinian Territory has the biggest share in GDP at factor cost, as its share amounted to 45 percent on average during the previous period. Non-financial corporate sector comes in second place in terms of relative importance at a share of 32 percent, whereas the government sector's share is about 22 percent. The share of financial corporate sector does not exceed 6 percent on average, and the indirectly-measured financial services has a share of less than 5 percent.

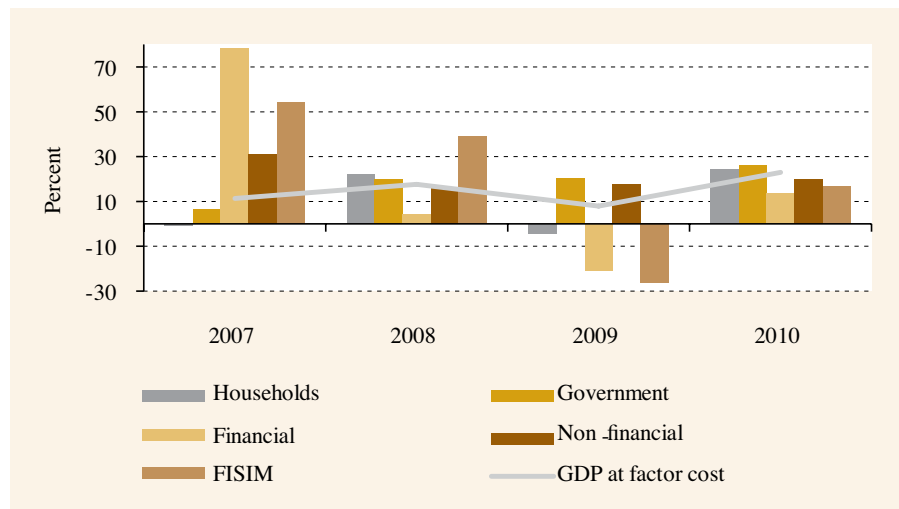
<sup>[9]</sup> The PMA team tried to seek reasons behind this significant drop of investment. However, there are no indicators to such drop in investment on the ground, and data indicate a growth in all economic sectors in 2011. Moreover, PCBS did not provide an explanation of that decline in investment.

<sup>[10]</sup> Includes non-profitable institutions that serve households.



Data indicate that nominal GDP at factor cost has seen a growth of 23 percent in 2010 as a result of the growth enjoyed by the households sector (around 24.5 percent), government sector (26 percent), financial corporate sector (13.5 percent), non-financial corporate sector (19.8 percent), and indirectly measured financial services (16.5 percent) in 2010.

**Figure 1-23: Growth rates of institutional economic sectors, 2007-2010**



Source: PCBS.

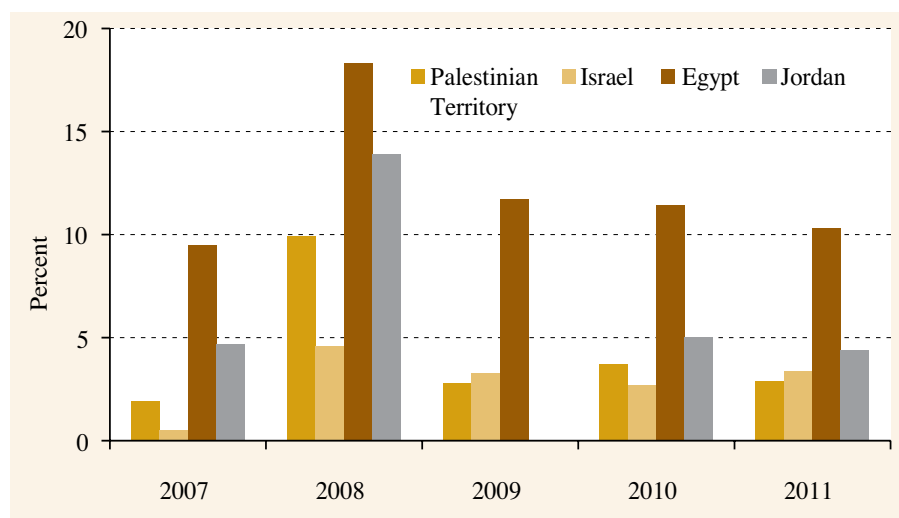
## Prices, inflation and purchasing power

Fluctuations of prices in the PT remained within relatively acceptable levels in 2011 compared with previous years, where consumer prices index went up from 129.0 to 132.7. There were no severe fluctuations in levels of monthly inflation in the PT during the year.

It is worth mentioning that this rate is relatively low if compared to international and regional inflation rates, especially in the wake of economic changes and fluctuation of basic goods prices in 2011. For example: international price levels increased by 4.8 percent in 2011, and the MENA countries witnessed a high inflation rate of 9.8 percent, as is the case in neighboring countries such as Jordan (4.4 percent) and Egypt (10.3 percent).

Regarding Israel, the inflation rate reached 3.4 percent, which is an exception in the relationship between price fluctuations in Israel and Palestinian Territory. It has been usual that Palestinian inflation rate exceeds the Israeli counterpart; the opposite this time could be explained by the

**Figure 1-24: Inflation rates at selected countries**



Source: PCBS and IMF.

remarkable increase of housing services prices in Israel in 2011 (housing prices bubble), which went up at a rate of 5.9 percent, whereas inflation of other items did not exceed 2.7 percent in the same year.

It should be also mentioned that price levels in the PT are basically affected by inflation in Israel, being the biggest trading partner, as well as the biggest supplier for most of basic goods.

Mismatch in inflation levels is clear between the two geographic regions in Palestinian Territory. Inflation rate in the West Bank reached 3.5 percent compared to 4.3 percent in 2010, while this rate did not go beyond 0.6 percent in the Gaza Strip compared to 1.72 percent in 2010. This mismatch of inflation rates between the West Bank and Gaza Strip reflects the extent of economic, political and social dissimilarity between these two regions, as goods prices in the West Bank are primarily associated with prices in Israel and the size of domestic demand, whereas, in the Gaza Strip they depend on prices of imported goods (or smuggled through underground tunnels) from Egypt, which are relatively low.

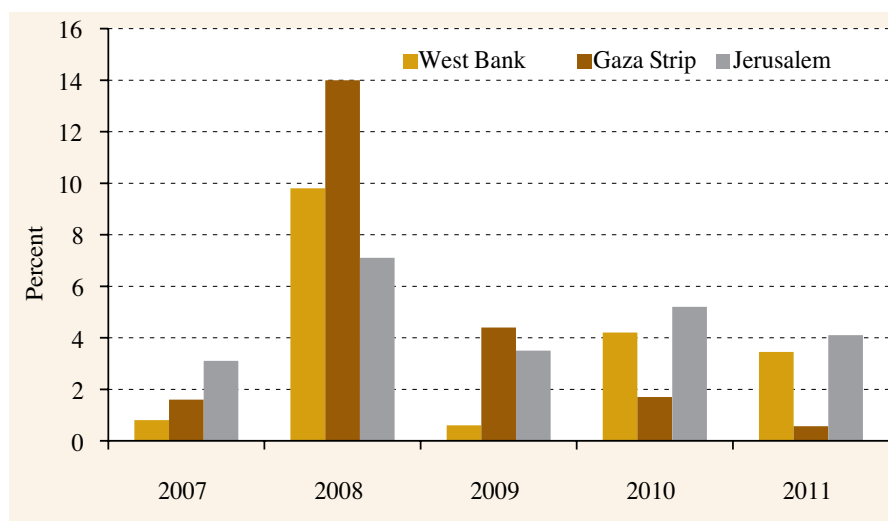
The boost of consumer goods availability and the drop of prices of petroleum products and other goods contributed to the price drop in Gaza Strip<sup>[11]</sup>. The price deflation in Gaza Strip has countered the price increase in the West Bank, thus lowering the average price level in the PT in 2011.

Inflation level in the PT reflects varying price fluctuations between goods and services within the consumer's basket, where the two groups of tobacco and beverages and restaurants, cafeterias and hotels have seen the highest inflation level among the twelve groups at 6.2 percent and 5.9 percent respectively in 2011 as a result of increased taxes imposed to components of these two groups.

However, the greater weight is given to food substances, housing, and transportation, where

these three groups form almost 58 percent of overall weights. Prices of food substances went up by 2.4 percent in 2011 due to the significant increase in world food prices. Housing prices also rose (by 3 percent) due to high fuel prices, incompatibility of supply to the increased demand of tenants and constant increase in land and real estate prices in the PT in the past few years. Additionally, price of transportation services

**Figure 1-25: Inflation rates in Palestinian Territory, 2007-2011**



Source: PCBS and IMF.

<sup>[11]</sup> The change in the volume and prices of goods in Gaza Strip is a result of a shift in trade direction from from Israel to Egypt.

leaped by 4.8 percent as a result of the global rising of fuel prices and high fuel taxes imposed by the Israeli government. The remaining groups have not seen any noticeable change.

#### **Box 4: Real estate sector in the Palestinian Territory**

Dwellings are a foremost priority of the Palestinian society, where most of savings are spent. They are also considered as a means to improve living standards, develop quality of life and improve overall conditions. The real estate sector in the PT witnessed considerable growth along with the launching of the peace process, where there was an atmosphere of optimism and improvement in different economic areas. This improvement in the real estate sector lasted until late 1990s, as investment in the construction sector reached about USD 994 million in 1999. However, the outbreak of the second uprising has resulted in an obvious decline in this sector as well as other sectors. Data indicate a drop of the construction sector's contribution to GDP from 23.8 percent in 1999 to around 12.3 percent in 2006 and 2007, and a rise again to 18.9 percent of GDP in 2011.

Prices of land and real estate in the PT constantly increased in the past periods, especially in Jerusalem (due to the apartheid segregation wall) and Ramallah (due to concentration of population, commerce and state institutions). The remaining provinces saw a price increase, albeit it remained reasonable and did not reach as high levels as in Jerusalem and Ramallah. The question arises as to whether this increase is an adequate proof for the existence of a bubble in the Palestinian Territory, or is it a serious indicator that the Palestinian real estate market suffers a crisis, especially in light of the mismatch between supply and demand (available apartments are not affordable –in terms of price and area- to the greatest portion of people who wish to have their own homes).

If there is a real estate bubble in the Palestinian Territory, is there a possibility this bubble will burst? In other words: will the severe drop in demand be accompanied by increase in supply result in a sudden and sharp price drop? During the second half of 2011 for instance, a great drop was observed in demand for apartments in the Palestinian Territory, so the supply outstripped demand. Still, apartment prices have not dropped.

Economically speaking, in case land and real estate prices deteriorated, there will be negative consequences to macroeconomic performance for a long period of time. On the other hand, the degree of exposure of Palestinian banks and mortgage firms to mortgage loans is relatively small (value of housing loans and mortgages do not exceed USD 429 million or 12.3 percent of total credit facilities portfolio of banks by end of 2011). Nevertheless, the possible results of a price collapse, once it occurs, should not be underestimated.

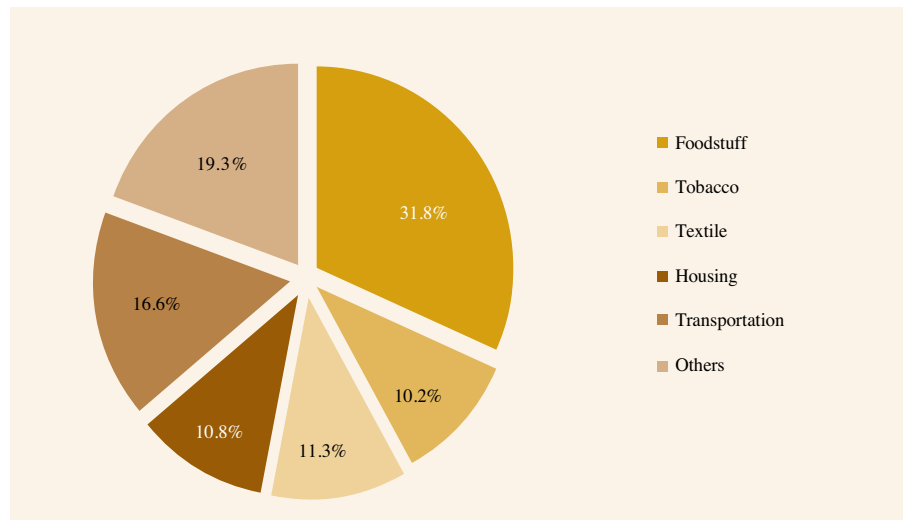
Source:

MAS Institute, round table paper on real estate market in the Palestinian Territory: is there a real estate bubble? 2012

Regarding the contribution of these groups to inflation rate in 2011, it is clear that the biggest contribution was for food substances (31.8 percent), followed by transportation (16.6 percent), footwear and cloth (11.3 percent), housing (10.8 percent) and tobacco and beverages (10.2 percent).

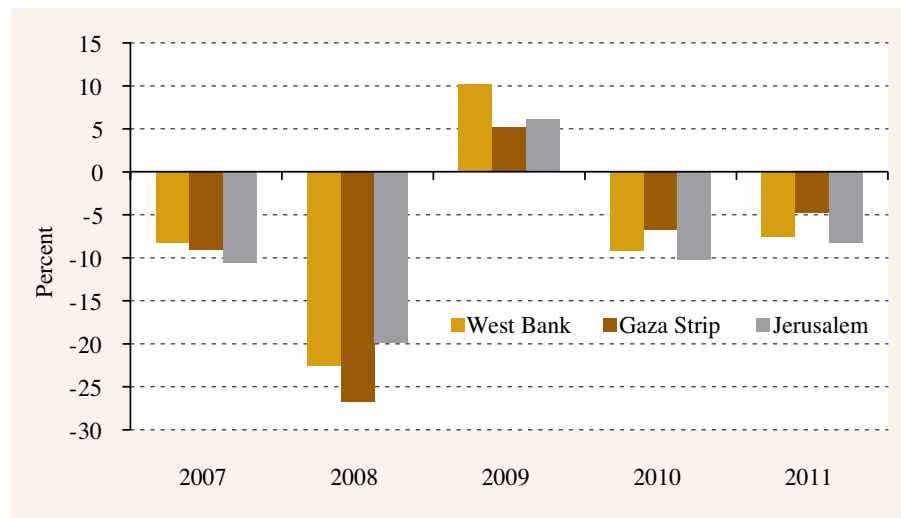
On the other hand, change in purchasing power is usually associated with the change of nominal wages and inflation level in the country in question. But if we tackled the Palestinian case we will find that exchange rate is crucial to the determination of Palestinians' purchasing power, since a significant proportion of Palestinians get paid in currencies other than NIS. This might be an indication of the importance of targeting exchange<sup>[12]</sup> rate in future as a basic part of monetary policies.

Contribution of CPI groups to inflation rate, 2011



Source: PCBS.

Figure 1-27: Purchasing power of USD in Palestinian Territory, 2007-2011



Source: PCBS, Bank of Israel.

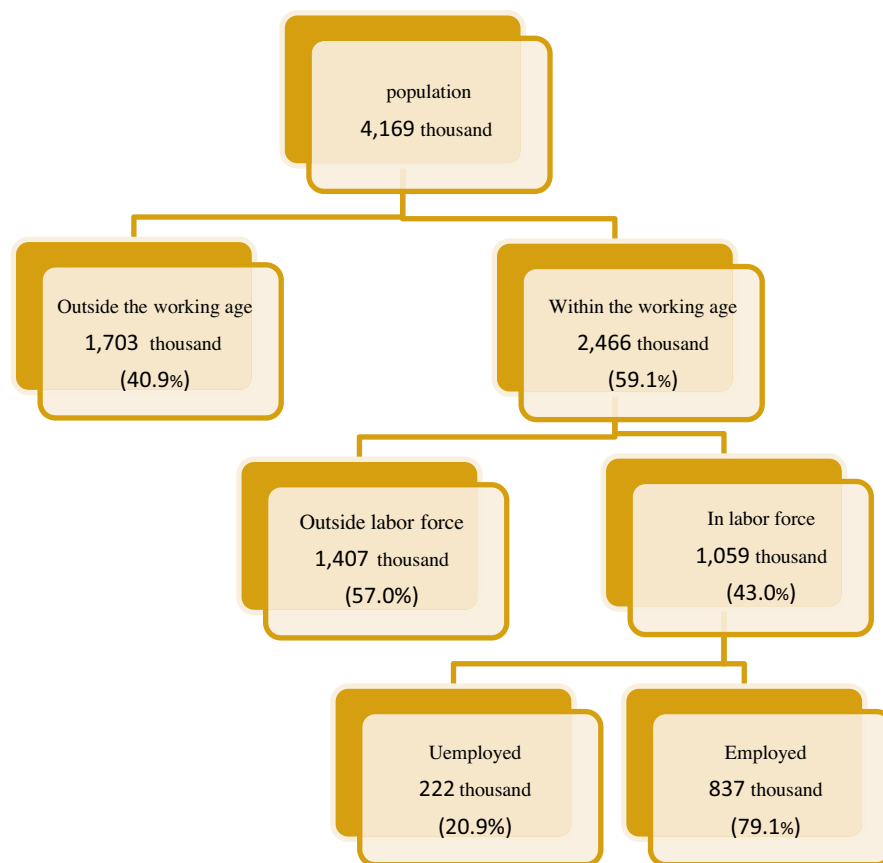
<sup>[12]</sup> This system basically works to fix the value of national currency against the currency of a big country with a low inflation rate, where inflation in the country applying the system is expected to move gradually to match its level in the country of the peg currency. This system, although simple and clear, restricts the use of monetary policy expansively to revive the economy in the short term, which contradicts the longer term stability objectives. Moreover, the international experience in applying this system showed some associated problems, most important of which is loss of independent monetary policy and inability to use it to face internal shocks not associated with country of the peg currency. Also this system might transmit shocks from the peg currency country to the applying country, besides exposing the applying country to possible speculation waves against its currency, thus increasing the likelihood of financial crisis.

In this context, it should be mentioned that NIS purchasing power has diminished in the Palestinian market with the rate of inflation in the PT (2.9 percent), whereas this power has dropped about 3.5 percent and 0.6 percent in the West Bank and Gaza Strip respectively, assuming that nominal wages are fixed. As for Palestinians who get paid in USD and JD<sup>[13]</sup>, their purchasing power has dropped 6.6 percent as a result of inflation, first, and devaluation of USD exchange rate against NIS second, where average annual exchange rate declined 3.7 percent in 2011 compared with 2010.

## Labor force and productivity

Population of the PT reached about 4.1 million in 2011, of which roughly 2.5 million (59.1 percent) are within employment age (15 and more). Of this group, the Palestinian labor force is 43 percent (1.1 million workers) during 2011, against 41.1 percent in 2010. Workforce is distributed at 45.5 percent in the West Bank and 38.4 percent in Gaza Strip, which means that about one fourth of the Palestinian Territory's population are working or looking for a job, while the largest proportion of employment age group does not effectively produce, which is an economic loss. Although this percentage (43 percent) is better than in the past ten years, it is still low compared with many Arab and nearby countries, where this percentage reached about 50 percent in Egypt and Jordan and 57 percent in Israel.

Figure 1-28: Labor force framework in Palestinian Territory, 2011



Source: PCBS, Palestinian workforce survey, Annual Report 2011.

<sup>[13]</sup> It was assumed that the drop of wages purchasing power is equal in USD and JD due to relative fixed exchange rate in both currencies.

The rate of participation in the labor force shows how effective the human resources are used in the economy. Thus improving this rate might require combined efforts to encourage the private sector to create further employment opportunities. This might be achieved through provision of a congenial investment environment and proper incentives to enhance competition, supporting and encouraging small projects through facilitating their finance, increasing productivity through investment in human capital and promoting women participation in the labor force.

### *a. Employment*

Number of workers in the PT has increased by 12.6 percent in 2011 to reach 837,000 (71 percent in the West Bank and 29 percent in the Gaza Strip), compared with 744,000 in 2010. Regarding the sectoral distribution of workers, although there was an increase of workers to 188,000 (5.4 percent) in the public sector in 2011, the ratio of workers in this sector has dropped from 24 percent to 22.5 percent of the total number. This decline comes as result of

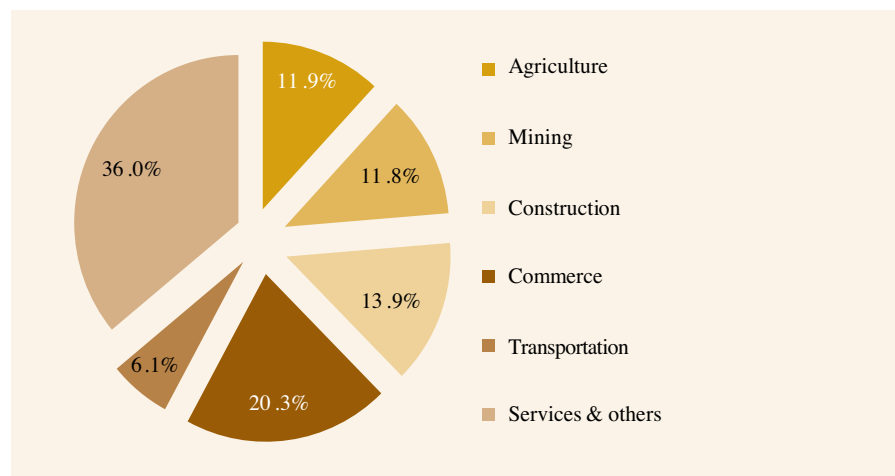
the policy adopted by the Palestinian government in the last few years to reduce employment in the public sector.

Within the same context, the percentage of Palestinians working in the private sector increased by 67.5 percent in 2011, against 65.5 percent in 2010. Gaza Strip faced the more substantial changes in employment rates in public and private sectors, where rates dropped for the public sector in Gaza Strip from 46.1 percent to 39.6 percent in 2011, against an increase for the private sector from 53.9 percent to 60.4 percent in the same year. This was due to increasing employment in projects under international management in light of loosening of Israeli constraints imposed on this sector since mid-2010.

On the other hand, despite the rise in number of workers in Israel and settlements to 84,000 in 2011, their percentage of overall labor force remained at the same levels since 2009 (10 percent). It is worth mentioning that all Palestinian workers in Israel come from the West Bank, where Palestinians from Gaza Strip are banned from working in Israel and settlements since 2005.

Regarding distribution of workers by economic activity, the service sector remains in the lead in terms of number of workers in spite of the slight drop in workers relative distribution in 2011 (from 38.3 percent to 36 percent). In contrast, the ratio of workers in commerce, restaurants and hotels went up from 19.3 percent to 20.3 percent in the same year, where no change occurred to relative distribution of workers in the other sectors.

**Figure 1-29: Distribution of workers by economic activity, 2011**



Source: PCBS.

## *b. Unemployment*

Provision of new jobs necessary to absorb the existing accumulated unemployment as well as newcomers to the labor market is one of the important challenges to economic development. This is a massive task that requires huge efforts in light of the limited productivity, relatively high population growth and the increasing number in the labor force.

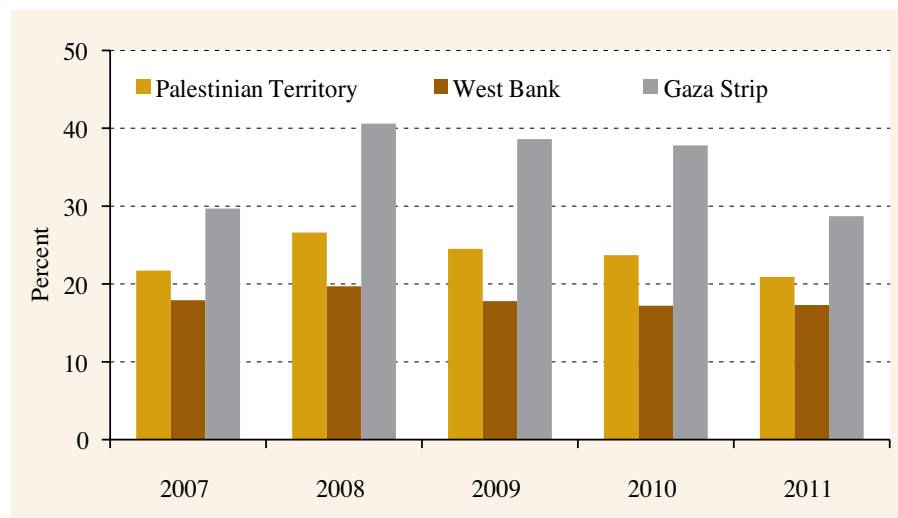
Creating employment opportunities every year requires an increase in available investment resources with rates exceeding those prevailing at the moment, so the economy would be able to achieve a growth rate that is able to provide jobs with a rate higher than the growth rate of the newcomers. Thus the economy would be able to absorb both newcomers and the currently unemployed.

Unemployment rates kept dropping gradually in the past few years due to improved economic performance and high growth rates seen at the PT in the same period,

especially that gradual improvement of economic performance in Gaza Strip increased absorption of newcomers to the labor market. Unemployment rate of 2011 dropped to 20.9 percent against 23.7 percent in 2010. Still the unemployment rate in the PT is higher than in neighboring countries, as more than one fifth of the labor force is unemployed, compared with 12.9 percent in Jordan, 10.4 percent in Egypt and 5.6 percent in Israel.

The unemployment rate of 2011 in the West Bank stood at 17.3 percent, indicating the limited impact of economic growth on unemployment due to restraints imposed against labor-intensive sectors, especially in areas under the Israeli occupation's administrative and security control ('C' areas). On the other hand, unemployment rate in Gaza Strip dropped dramatically to 28.7 percent against 37.8 percent in 2010 because of high employment in internationally supervised interim projects. The temporary nature of these projects, however, threatens a possible comeback of increasing unemployment rates. It should be noted that unemployment rates clearly increased among female (28.4 percent in 2011), and among male youth (15-24 years) at 35.7 percent in the same year, which suggests a structural defect in the labor market that reduces ability to absorb these job seeking groups.

**Figure 1-30: Unemployment rate in Palestinian Territory, 2007-2011**



Source: PCBS.



### c. Average daily wage

Nominal average daily wage in the PT remained stable at NIS 91.7 in 2010 and 2011, as there was no significant change to this rate in the West Bank, with a slight decrease of 0.9 percent to reach 85 NIS in 2011 compared with 2010. On the other hand average daily wage in Gaza Strip, Israel and settlements increased by 5.8 percent and 2.7 percent respectively.

Speaking of the real average daily wage, the relative stability of nominal wage in the PT and an inflation rate of 2.9 percent meant a real wage drop at the same rate (i.e. 2.9 percent), compared

to 2010. The real wage for workers in the West Bank has dropped 4.4 percent, and wage of the Palestinian workers in Israel and settlements has dropped by 0.8 percent. In contrast, the real wage for workers in Gaza Strip increased by 5.2 percent, taking into account the difference in inflation levels between the two Palestinian regions.

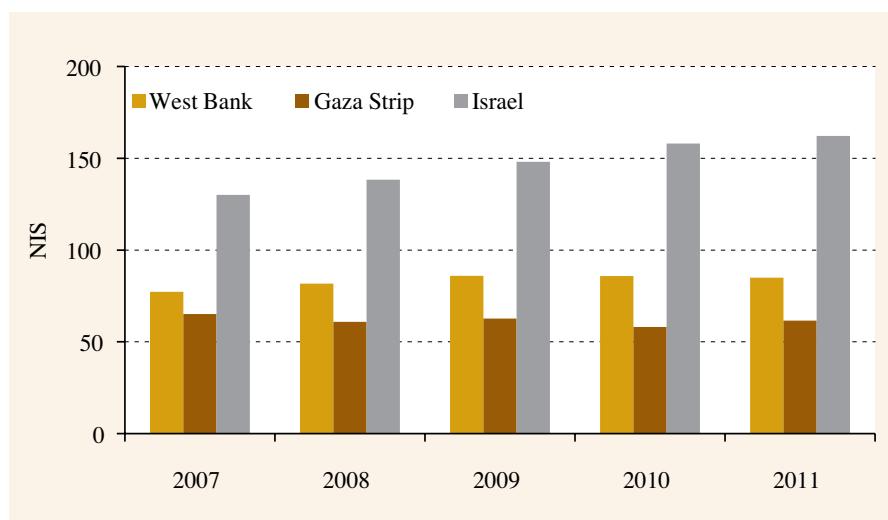
Although these numbers indicate a substantial improvement of wages in the Gaza Strip, the differences are apparent among workers in West Bank and Gaza Strip on one hand and those working in Israel and settlements on the other hand. This difference denotes the variance in economic conditions between these regions, especially that Gaza Strip still suffers a crippling Israeli blockade since 2005. As a result, wage of Gazan workers remains less than West Bank workers' wages by almost 38 percent, and less than those working in Israel and settlements by 62 percent.

### d. Dependency ratio

The dependency ratio is associated with the rate of participation in the labor force. It is regarded an indicator for the size of economic burden incurred by employed individuals in society. It is defined as the number of individuals sustained by every employed individual; thus, the increase of employed people over the increase in population would reduce economic burden for the employed. This is what took place in the PT in 2011, as the population growth rate stood around 3 percent during the year, against an increase of 12.6 percent in the number of workers.

Consequently, the rate of economic dependency in the PT has dropped to 5.0 individuals per employed

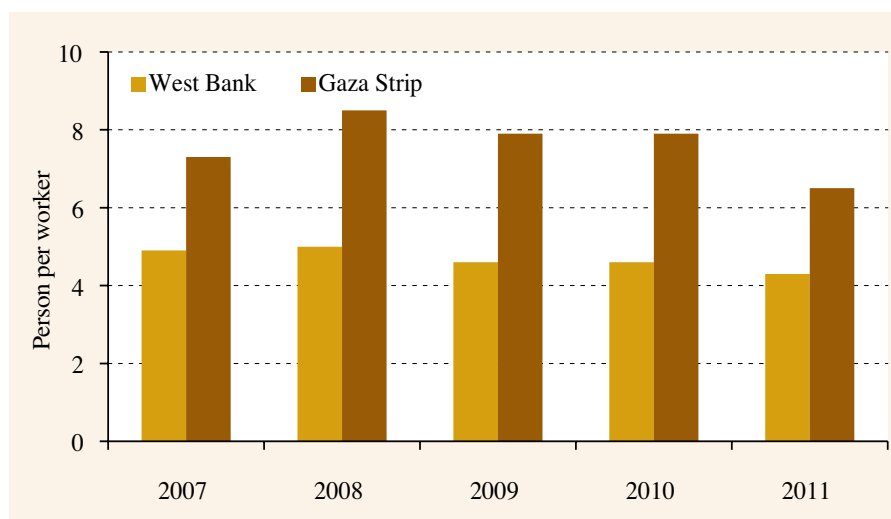
Figure 1-31: Average daily wages for Palestinian workers, 2007-2011



Source: PCBS.

person in 2011 against 5.4 individuals for the last year (every employed person sustains himself as well as another four). This rate fell in the West Bank and Gaza Strip to 4.3 and 6.5 individuals respectively during the same year. This drop is an indicator of improvement in the Palestinian market's capacity to absorb labor force as a result of economic growth in the past few years.

Figure 1-32: Dependency ratio, 2007-2011

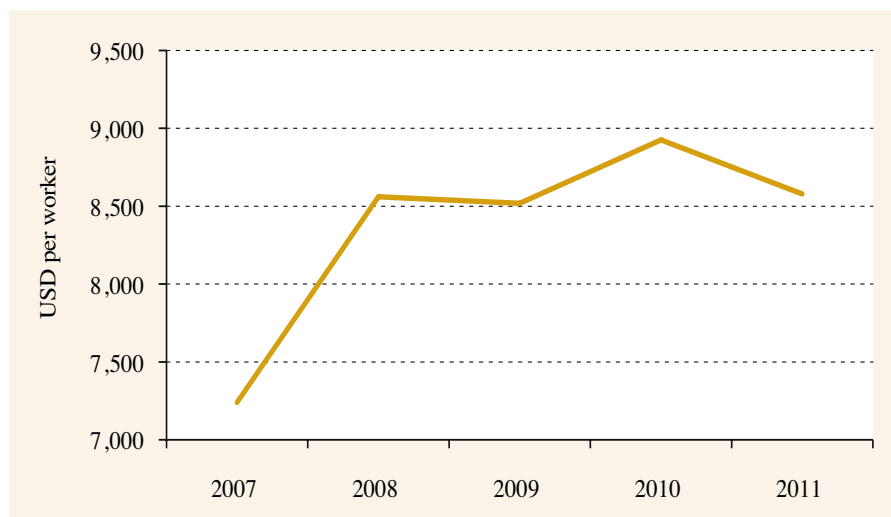


Source: PCBS.

### e. Productivity

Despite economic growth, productivity of the Palestinian labor force<sup>[14]</sup> dropped around 3.9 percent in 2011 compared with 2010 (from USD 8,332 per worker to USD 8,293 per worker). It is worth mentioning that the productivity of the Palestinian labor force had progressively increased during 2007-2010, reflecting the remarkable economic growth in that period. However, the year 2011 is an exception, which could be attributed to the increase in labor force during that year of about 12.6 percent, compared with a growth of 9.9 percent in gross domestic product.

Figure 1-33: Palestinian worker's productivity, 2007-2011



Source: PCBS.

### f. Poverty

Despite the growth in the Palestinian economy, no change has occurred in poverty rates in the PT during 2011. Almost a quarter of Palestinians are still living below poverty line, and statistics showed relative stability in poverty rate at 25.8 percent of the total population in 2011,

<sup>[14]</sup> Productivity: value added/number of workers.

compared with 25.7 percent in 2010. At the geographic level, despite the tangible economic improvement in the Gaza Strip in relation to the West Bank, levels of poverty jumped in the Gaza Strip from 38 percent to 38.8 percent in 2011, against a drop in the West Bank from 18.3 percent to 17.8 percent in the same year.

It should be mentioned that the poverty line for a five-member household reached NIS 2,293 in 2011, while the extreme poverty line reached about NIS 1,832 in the same year.

## Economic outlook

The Palestinian economy is viewed as a fragile economy that is highly prone to surrounding changes, especially those of the Israeli economy due to the close relation with that economy especially in terms of workforce and trade, which makes it harder to anticipate and forecast the future of the economy. Still, the PMA has devised economic models (mathematical and econometric) throughout the past period in order to predict economic changes in the short- and long terms. This was intended to guide the financial sector in general and the banking sector in particular, to guarantee their stability and soundness, in addition to assuming the role of economic and financial advisor of the Palestinian government..

Outcomes extracted from these models suggest that the Palestinian economy will keep growing in 2012-2013, albeit at a rate slower than that achieved in the past years. This will be supported by economic recovery and improved conditions in the Gaza Strip and ongoing financial reforms undertaken by the Palestinian government to enhance domestic economy and reduce dependence on foreign assistance. Still, this improvement depends on risk of the political situation, Israeli measures and continuation of regular flow of foreign assistance.

Accordingly, anticipations of the PMA indicate that real gross domestic product in the PT will keep growing at 6.1 percent and 6.2 percent in 2012 and 2013 respectively, compared with a growth rate of 9.9 percent in 2011. This slowdown of growth reflects the anticipated decline of governmental spending, especially investment spending, in addition to the predictable decline of private sector investment. In terms of unemployment, forecasts indicate an increase of rates during 2012-2013 to reach 21.6 percent and 22.1 percent respectively, compared with 20.9 percent as a result of reduced governmental spending and private sector investment. Regarding prices of goods and services, an increase of 3.1 percent is expected in 2012 in comparison with 2.9 percent in 2011, which reflects the anticipated increase of import costs.

## Box 5: Economic forecasts of the PMA

Like other central banks, PMA seeks to enhance the use of forecasting and modeling in the long run to assist it in analyzing policies, especially monetary policies, and to help it assume its advisory role to government and other institutions. The PMA also discusses these forecasts and policies with international organizations such as the International Monetary Fund and the World Bank, and use them in different studies and researches.

Within its policy to upgrade to a fully-fledged central bank, the PMA sets to reinforce self-capacity in economic forecasting and analysis and provide appropriate expertise in order to move from extrapolation of the past to extrapolation of the future. To that end, the PMA has devised and developed many mathematical and econometric models to use in economic forecasting in the short, medium and long terms. Among these models are:

| Indicator                                       | Actual | Forecasts |       |
|---|--------|-----------|-------|
|   | 2011   | 2012      | 2013  |
| <b>Annual growth rate</b>                       |        |           |       |
| Gross domestic product                          | 9.9    | 6.1       | 6.2   |
| Value added of private sector                   | 10.6   | 6.7       | 6.3   |
| Inflation rate                                  | 2.9    | 3.1       | -     |
| Unemployment rate                               | 20.9   | 21.6      | 22.1  |
| <b>As a rate of real gross domestic product</b> |        |           |       |
| Private sector consumption                      | 97.0   | 104.3     | 106.2 |
| Private sector investment                       | 21.3   | 11.5      | 10.0  |
| Total exports                                   | 18.0   | 14.5      | 14.2  |
| Total imports                                   | 60.1   | 54.8      | 53.9  |

- Structural Model of the Palestinian economy:** this was devised in order to be used in analysis and prediction of long term economic indicators and under a variety of scenarios. This model is used to analyze the relationship between major economic changes and factors affecting their level and trend. This is also used to measure the effectiveness and impact of different financial and economic policies on economic performance and balance of payments. This model includes the following sub-models: 1- Analysis of the supply aspect of the Palestinian economy, in which factors that affect production of goods and services have been studied and analyzed, and factors that determine demand for production factors, pricing mechanism of goods and services and factors affecting wage setting. 2- A model to analyze demand of the Palestinian economy has been set, where it focuses on components of demand such as consumption, private sector investments and computation of income and capital of the household sector. 3- A model to analyze and anticipate changes of the public sector, which studies governmental operations and the factors impacting its productivity and value added. Factors that affect the rate of daily wage and consumer spending of the public sector have been determined. 4- A model on international trade in the Palestinian Territory, which analyses the relationship between international trade and international competitiveness of domestic products

in local and foreign markets on one hand, and relationship with the future monetary policy in the PT on the other.

- **Financial Programming Model:** this model is extensively used in many central banks, and it is one of the important models that IMF greatly depends on in analyzing policies of member states. This model presents a number of economic measures and actions aimed at elimination of imbalance between aggregate demand and supply in economy through annual analysis and forecasting (medium term) of the economy's main sectors; real sector, external sector, public sector and monetary sector. Programs have been set assuming there is a strong relationship between economy's financial variables (monetary and fiscal) and non-financial variables (income and price levels).

This model reflects an important fact derived from IMF member states' experience that inappropriate financial policies were in many cases the reason for imbalance in the external sector.

- **Reduced Form Equation:** this model was set to obtain quick, quarterly and short term forecasts for gross domestic product in the Palestinian Territory, depending on rapid and regular indicators (quarterly or monthly). The Autoregressive Distributed Lag (ARDL) method has been followed in setting that model as there was a lack of sufficient long term time series to build a quarterly structural model for major economic indicators. In this model, it was shown that growth of the quarterly GDP could be derived through some exogenous changes that have been determined in the PMA annual structural model (such as Israel's quarterly GDP, number of Palestinian workers in Israel,...and the like), in addition to some domestic changes like construction activities in the Palestinian Territory, which reflect the number of building permissions granted in the PT on a quarterly basis.
- **Inflation Model:** this model has been developed in order to forecast the rate of inflation in PT and to analyze domestic and foreign factors that affect inflation. This model is used to provide short and medium term predictions about inflation (on quarterly and annual basis) by adopting co-integration analysis methodology and ARDL.

# Chapter Two

## Public Finance Developments







## Overview

Despite the financial hardships incurred by the Palestinian National Authority (PNA), the public finance data denote significant improvement in performance in 2011, as PNA managed to rationalize expenditures and amplify volume of revenues, which led to a decline in existing deficit for the third consecutive year. This improvement was a result of the government's relentless efforts in the past years to control government spending and reduce dependence on foreign assistance, which has significantly dropped in 2011.

On the other hand, data indicate a great increase in public debt and accumulation of domestic payment arrears during the same year, which could be explained by the persistent lack of self-financing resources and the inability of domestic revenues to cover expenditures. This implicitly suggests a need for the government to raise domestic revenues and find new ways to further downsize public expenditure.

## Revenues

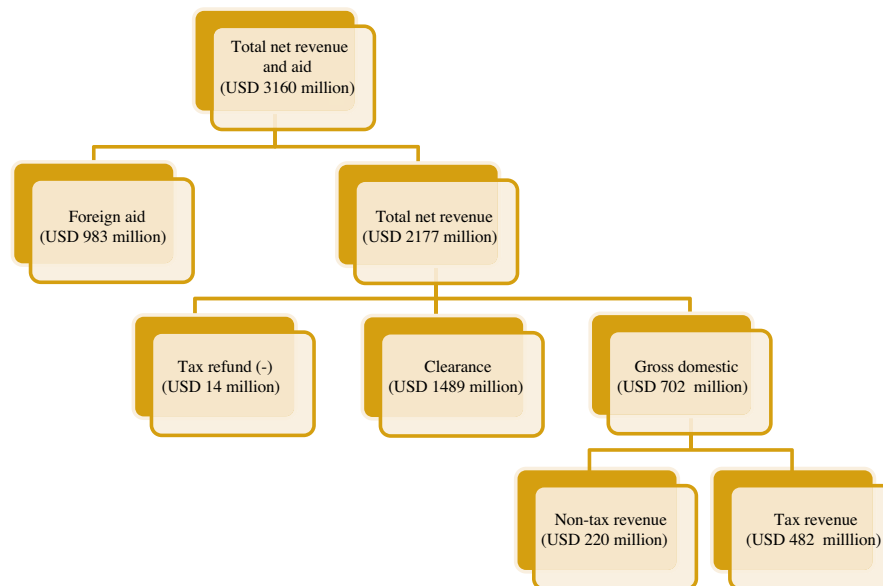
Generally, the PNA depends on three major resources for revenue:

1. Gross domestic revenue (tax and non-tax revenues).
2. Gross clearance revenues: collected by Israel on behalf of the PNA, as stated in the Paris Protocol of 1994.
3. Foreign aid, either to support the budget or to finance development projects.

Data of public finance suggest that 2011 witnessed a slight drop in gross domestic revenue, against a significant increase in gross clearance revenues. In contrast, 2010 has seen a remarkable increase of both components alike. The following is a detailed description of developments that occurred to PNA revenues during 2011:

1. Gross domestic revenues relatively declined by 5.8 percent

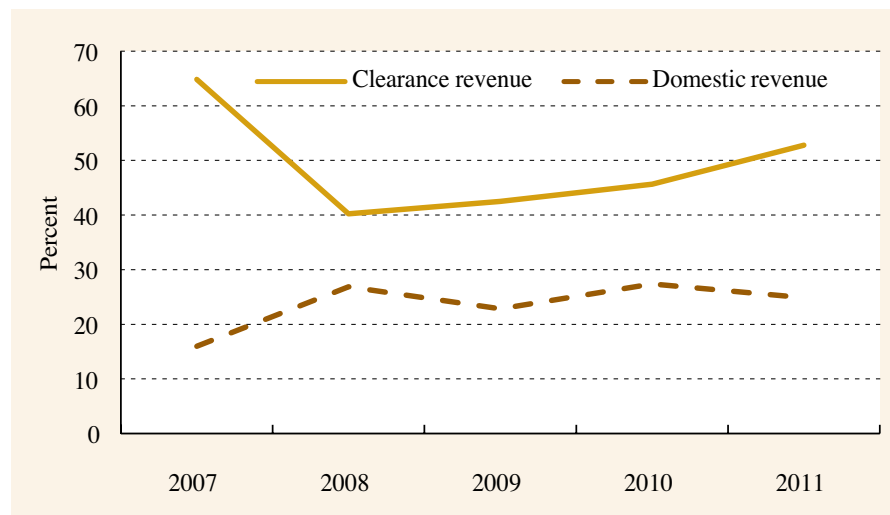
**Figure 2-1: Total net revenues & aid to Palestinian Territory, 2011**



Source: Ministry of Finance.

in 2011, to reach about USD 702 million on cash basis, after being affected by the slow-down in economic growth. It should be mentioned that revenues collected constituted almost 86.4 percent of targeted amount in the general budget of 2011 (USD 812 million). This decline in domestic revenues is attributed to the fall in non-tax revenues by 19 percent (about USD 220 million by the end of 2011). The

**Figure 2-2: Domestic & clearance revenues as a percent of current expenditure, 2007-2011**



Source: Ministry of Finance.

decline occurred as the PNA reimbursed (deducted) telecommunications companies (JAWWAL and ZAIN of Kuwait) following the termination of an agreement with the PNA<sup>[1]</sup>. Besides, the distributed profit payments of Palestine Investment Fund (a sovereign wealth fund fully owned by the PNA) were less than reported in the general budget. Non-tax revenues were 31.2 percent of gross domestic revenues in 2011 (36.3 percent in 2010).

Tax revenues, on the other hand, slightly increased (1.7 percent more than 2010) to reach around USD 482 million. They constituted 68.8 percent of gross domestic revenues in 2011, against 63.7 percent in 2010. However, the PNA paid as little as USD 14 million in tax refunds in 2011, compared to USD 87 million in 2010. It is noteworthy that the 2011 General Budget Law anticipated that the PNA would pay USD 105 million in tax refunds during the year; thus, the PNA's inability to fulfill its financial obligations towards the private sector, and contractors in particular, denotes the intensity of the financial distress it suffers.

2. Gross clearance revenues went up significantly in 2011 (an increase of about 19.8 percent) compared to 2010, reaching up to USD 1489 million. This increase came even though Israel has cut down production and sales taxes imposed on petroleum products at the beginning of the year, in addition to substitution of products imported from Israel to Gaza Strip with the much cheaper alternative from Egypt. Nevertheless, clearance revenues' share was about 68 percent of total net revenues during 2011<sup>[2]</sup>. Clearance revenues collected in 2011 constituted 103.3 percent of the amount targeted in the general budget of this year (USD 1442 million).

As a result of the decline in gross domestic revenues, coverage of current expenditures shrank to 24.9 percent during 2011, compared to 27.4 percent in 2010. In contrast, coverage from clearance revenues went up to 52.8 percent of total current expenditures, against 45.7 percent during the same period.

<sup>[1]</sup> Partnership agreement between JAWWAL and ZAIN of Kuwait, by virtue of which USD 100 million were paid to the PNA.

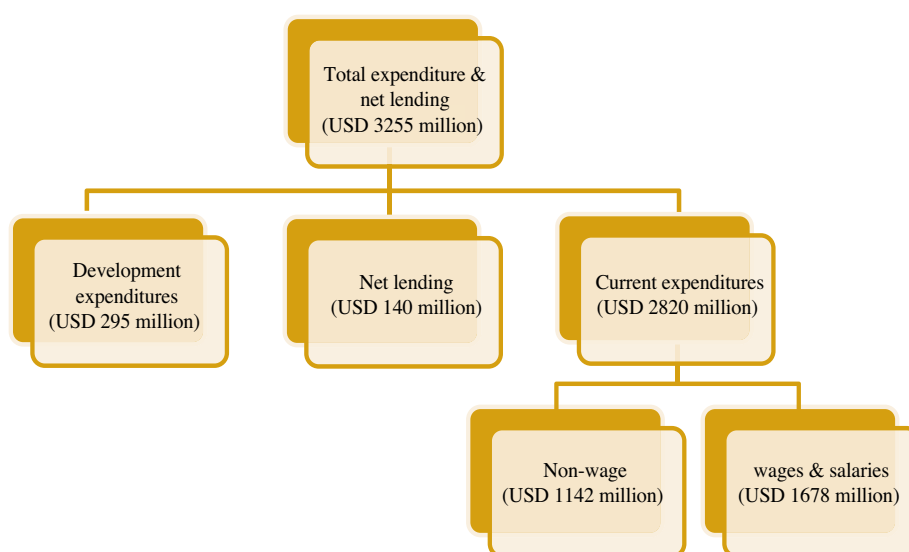
<sup>[2]</sup> Net public revenues represent total of both domestic revenue collection (tax and non-tax) and clearance revenues, with deduction of tax refunds.

- The third source of revenues is the foreign aid received by the PNA from international donors every year. The volume of aid in 2011 reached about USD 983 million (USD 1277 million in 2010). The aid was divided into grants to support the budget (USD 814 million), and grants to finance development projects (USD 169 million). Despite the PNA's efforts to reduce dependence on such aid during the past few years, it remains a fundamental source of funds necessary to offset the total budget deficit. It reduced total deficit in 2011 from USD 1078 million (10.8 percent of GDP) to USD 94 million (0.9 percent of GDP). In other words, it contributed to the downsizing of total deficit by 9.9 percent of GDP in 2011, and it also covered about 30 percent of total public expenditures during the same year.

## Expenditures

Unlike 2010, the PNA has managed to control and rationalize total public expenditures during 2011. Public finance data suggested a decline of 0.1 percent in public expenditures in 2011 (compared to a 4.9 percent increase in 2010), to reach USD 3255 million. It must be said that actual total public expenditures were less than allocated in the General Budget Law of 2011 by about 12.8 percent, as actual total public expenditures formed 87.2 percent of the target in the general budget (USD 3733 million).

Figure 2-3: Total expenditures in Palestinian Territory, 2011



Source: Ministry of Finance.

Total public expenditures include both current expenditures (gross wages and salaries, non-wage expenditures and net lending) and development expenditures, where current expenditures were 86.6 percent of total public expenditures, and development expenditures were around 9.1 percent, whereas net lending was 4.3 percent in 2011.

The slight decline of public expenditures could be attributed to the fall in net lending<sup>[3]</sup> to 46.9 percent, compared to 2010 (USD 140 million). It is noteworthy that the share of this item in total public expenditures dropped significantly over the past few years, where it reached 4.3 percent in 2011, compared to 18.6 percent in 2007. This indicates improvement in PNA's ability to control this item through improving collection of utility bills by local

<sup>[3]</sup> Net lending is the direct lending paid by MOF and the indirect lending deducted from clearance revenues (includes government's payment for utility bills of local government bodies, tax deductions or losses associated with petroleum products). The biggest portion of net lending is indirect lending through deducting accumulated utility bills local government bodies failed to pay for Israeli providers from monthly clearance revenues without referring to the PNA. Some local government bodies later pay some of their arrears to the PNA.

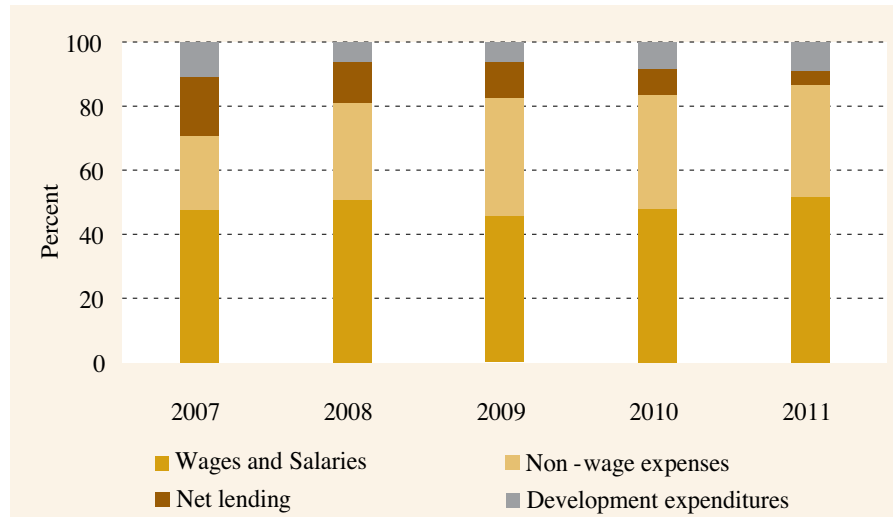
government authorities and adopting a number of policies and incentives to encourage payment of liabilities. It should be mentioned that the volume of actual spending for this item was less than targeted in the general budget by about USD 20 million.

With regard to current expenditures, which dominate total public expenditures, they increased in 2011 by 3.7 percent (USD 2820 million) compared to 2010 due to a 7.3 percent increase

in wage and salary expenditures, to reach USD 1678 million. This rise could be attributed to new recruitments<sup>[4]</sup>, cost of living allowance, promotions and other bonuses. In contrast, non-wage expenditures (operational, transfers and minor capital expenditures) went down by 1.2 percent in 2011 to reach USD 1142 million.

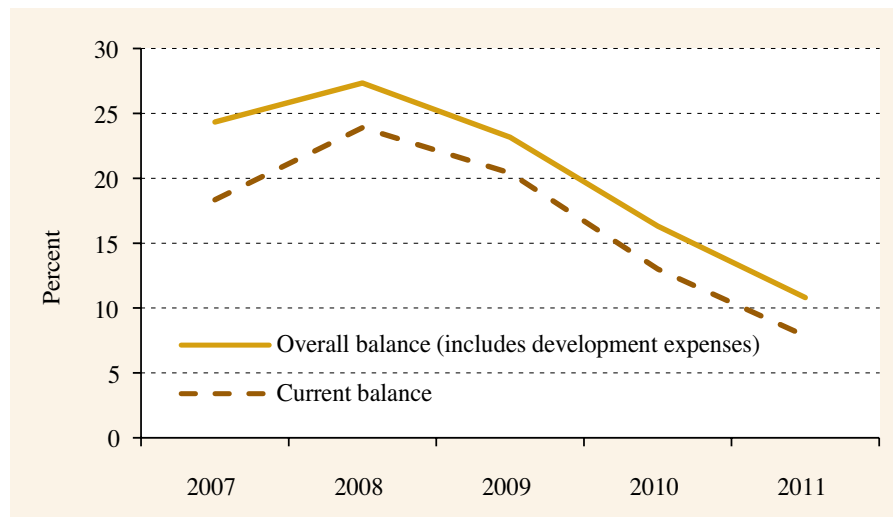
It should be mentioned that wages and salaries constituted 59.5 percent of total public expenditures during 2011, against 40.5 percent for non-wage expenditures. It is also worth mentioning that the amounts targeted in the General Budget Law for these items were higher than the actual amounts disbursed, as the budget targeted about

**Figure 2-4: Share of spending items as a percent of total expenditures, 2007-2011**



Source: Ministry of Finance.

**Figure 2-5: Deficit (exc. budget support) as a percent of GDP, 2007-2011**



Source: Ministry of Finance.

<sup>[4]</sup> Number of civil servants went up in 2011 to 3701 employees, of which 2177 at education sector, 1325 at security agencies and 199 at health sector. By comparison, number of civil servants declined to 1048 employees in other sectors.

USD 1710 million for wages and salaries and about USD 1363 million for non-wage expenditures. This is an indicator to PNA's ability to control and rationalize public expenditures as part of its efforts to reduce dependence on foreign aid, and rely on domestic revenues, instead, to bridge the financial gap.

As the case with current expenditures, development expenditures rose by 7.1 percent in 2011 to reach USD 295 million compared to 2010. The Palestinian treasury financed around USD 126 million of these expenditures, while foreign aid contributed the remaining 169 millions. Despite that increase, the volume of development expenditures in 2011 was less than targeted in the budget by around 58.9 percent, and this is due to insufficient financial resources available to the PNA, on one hand, and Israeli restrictions and procedures on the other, which usually impede or lead to cancellation of many of these projects.

## Budget deficit

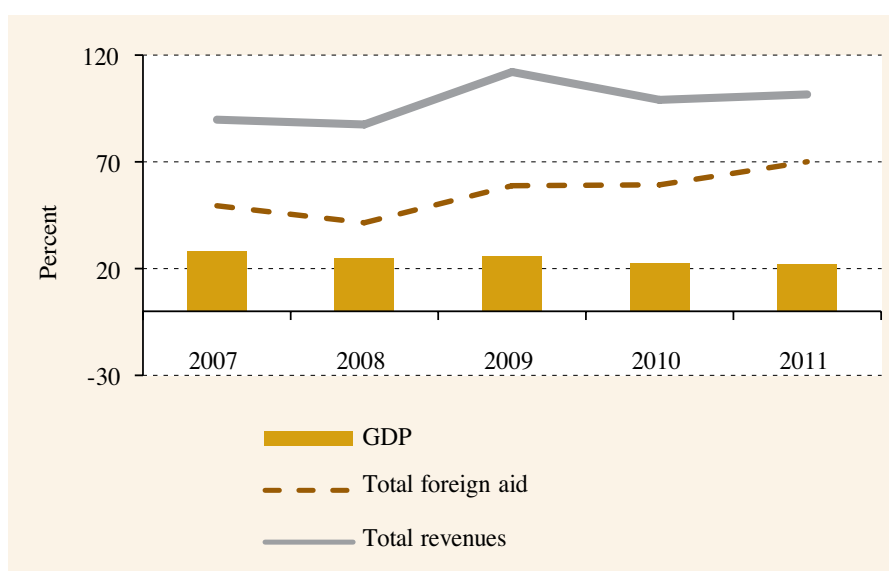
The current balance deficit continued to decline throughout 2011 to reach USD 783 million, against USD 1083 million in 2010 and USD 1371 million in 2009. This is attributed to the growth in clearance and tax revenues alike, and the stability of total public expenditures. This is all in accordance with the reform plan adopted by the Palestinian government over the past few years, which intends to reduce dependence on foreign aid through the rationalization of government spending and improvement of tax collection. Overall deficit, which includes foreign aid, reached USD 94 million (0.9 percent of GDP) in 2011, all of which was financed by local banks.

## Public debt

Although the government has managed to control expenditures, foreign aid shortage and less-than-anticipated domestic revenues had a hand in increasing lending and accumulating more arrears during 2011. Overall public debt (domestic and foreign) held by the PNA rose by 17.5 percent by end of 2011, compared to 2010, to reach USD 2212.8 million.

Despite that increase, public debt to GDP went down to 22.2 percent in 2011, against 22.6 percent in 2010. However, these rates remain low compared to rates in some nearby countries such as Jordan, in which the public debt to GDP reached 70.7 percent in 2011 (67.1 percent in 2010). On the other hand, the rise in public debt has increased

Figure 2-6: Public debt as a percent of government revenues & GDP, 2007-2011



Source: Ministry of Finance.

the Palestinian citizen's average share in that debt to USD 530.8 in 2011, whereas it was USD 465.1 in 2010.

Public debt formed 70 percent of total government revenues in 2011, compared to 59.3 percent in 2010. This rate rises to 101.6 percent upon exclusion of foreign aid, and this indicates that the PNA is facing financial and collection problems that affect its ability to service debt. As for the distribution of public debt, it was distributed between domestic (49.6 percent) at USD 1098.5 million, and external debt (50.4 percent) at USD 1114.3 million.

Banks operating in the PT are the main source of domestic debt, as the PNA's outstanding balance due to banks constituted 99.2 percent of total domestic debt (USD 1089.9 million), while other public institutions added the remaining 0.8 percent of total domestic debt (USD 8.6 million). It is noteworthy that domestic debt's share of total public debt continued to increase over the past years, as this share went up from 28.7 percent in 2007 to 49.6 percent in 2011, while the share of external debt dropped from 71.3 percent of total public debt in 2007 to 50.4 percent in 2011.

In contrast, the external debt was divided between Arab financial institutions, international and regional foundations and bilateral loans. Arab financial institutions (al-Aqsa Fund, Arab Fund for Economic and Social Development and Islamic Development Bank) made a contribution of USD 617.4 million (55.4 percent of total external debt), of which 84.6 percent was given by al-Aqsa Fund, 7 percent by the Arab Fund for Economic and Social Development and 8.4 percent by Islamic Development Bank.

Some international and regional institutions have contributed with USD 341.9 million (30.7 percent) of total external debt, and they are divided as: the World Bank (86.9 percent), the European Investment Bank (6.6 percent), OPEC (5.5 percent) and the International Fund for Agricultural Development (1 percent). Bilateral loans were USD 155.2 million (13.9 percent) of total external debt, of which Spain, Italy, Sweden and China made contributions by USD 92.9, 31.3, 25.8 and 5.2 million respectively.

With the continuous rise in public debt, the burdens of this debt mounted, as public debt service reached USD 100.6 million in 2011, compared with USD 63.7 million in 2010. The PNA has managed to pay USD 36.5 million of which, which means an accumulation of public debt arrears of around USD 64.1 million.

It should be mentioned that the austerity plan the PNA adopted through rationalizing expenditures has reduced to a great deal the financial stimulation to economic growth, and therefore, reduced domestic revenues (revenue collection) below anticipated levels.

As a result, arrears accumulated to amount to USD 538 million. These arrears are owed to many entities, such as the Palestinian Pension Fund, private sector importers and development projects. Cash flow problems have also caused an increase in net domestic finance from banks by USD 137 million, which led to the rise of the government's debt balance with banks to USD 1.1 billion, forming around 11 percent of GDP in 2011, and about 93 percent of owners' equity of banks operating in the PT.



# Chapter Three

## Foreign Sector Developments







## Overview

Foreign trade constitutes one of the key links between countries and the outside world, through which countries cease to be isolated entities and become an integrated network of mutual impact relations, each according to weight and multitude of trade partners. The Palestinian foreign sector, as for any other country, is the link with the outside world and an indicator to the sensitivity of the Palestinian economy to shocks and policies of trade partners, which makes developments in this sector a point of interest for economic policy makers in general, and monetary policy makers in particular.

Registered data of foreign trade and balance of payments (BoP) data indicate a growing trade deficit as a percentage of GDP in 2011 as a result of a growth in imports and exports in varying proportions, which shows that the consumption trend of the Palestinian economy was growing during 2011, making Palestinians rely more on imported goods. In contrast, data show relative stability in the ratio of income from abroad to GDP, which is an important source for financing trade deficit in the PT. Current transfers, the other BoP component financing trade deficit, has witnessed a significant drop in 2011 as a result of the considerable plummet in foreign aid to the Palestinian government, as well as decreasing transfers of other sectors during the same period.

## Registered foreign trade in goods<sup>[1]</sup>

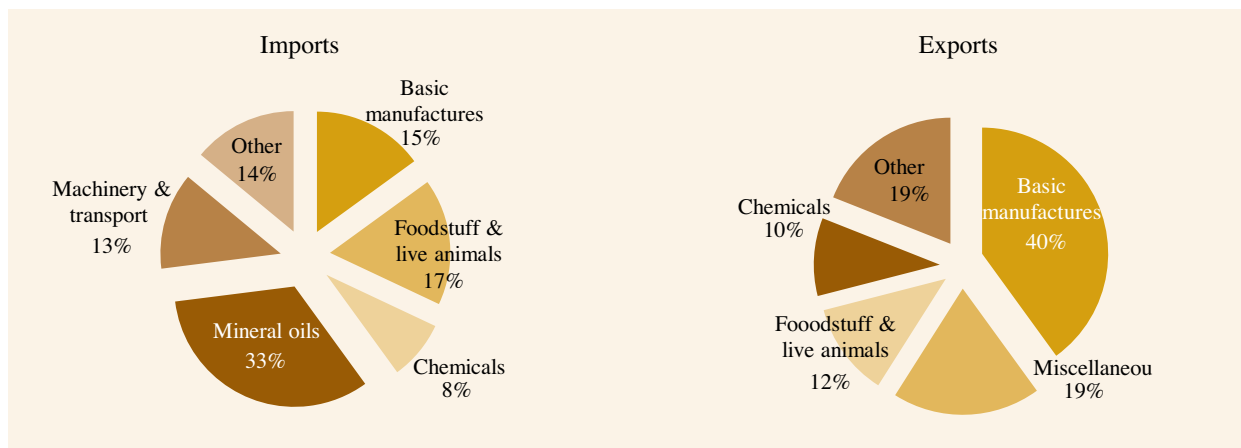
The volume of foreign trade in goods reached around USD 5250 million in 2011, an increase by 15.7 percent over the previous year, as a result of the rise in both imports and exports of goods, where imports scored an increase of 13.4 percent (USD 4,491 million) in 2011. Meanwhile, exports of goods went up in the same year by 31.8 percent (USD 759 million). Despite this notable growth, the relatively small volume of Palestinian exports hindered its ability to cover imports, so trade deficit in goods went up to USD 3,733 million in 2011 (42.6 percent of GDP), compared to USD 3,383 million in 2010 (40.9 percent of GDP). That means the Palestinian economy is depending more on imports, which renders it vulnerable to external variables such as the trade policies and inflation levels of trade partners. As for the structure of Palestinian exports and imports in goods recorded by groups in 2011, we notice the following:

Structure of exports in goods: manufactured goods (wood, paper and metal works, textile,...) enjoyed the biggest share of exports' volume (40 percent), followed by miscellaneous manufactured goods (furniture, clothes, footwear,...) with 19 percent, food and live animals (12 percent) and chemicals (10 percent).

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<sup>[1]</sup> Includes all exports and imports of all kinds of goods from the world, whereas services come only from Israel. Source of this data is clearance records of the Palestinian Ministry of Finance.

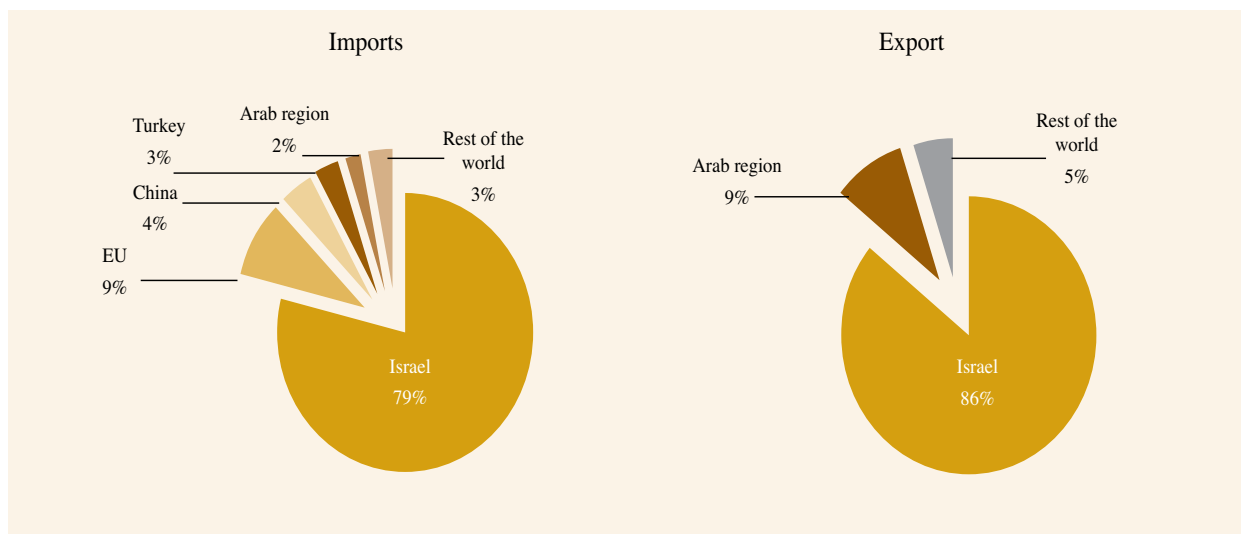
**Figure 3-1: Structure of trade in goods, 2011**



Source: PCBS.

Structure of imports in goods : mineral fuels took the first place (33 percent), followed by food and live animals (17 percent), manufactured goods (15 percent), machinery and transport equipment (13 percent) and chemicals (8 percent). The following figure shows the geographic distribution of exports and imports.

**Figure 3-2: Trade directions, 2011**



Source: PCBS.

Most of Palestinian exports in goods tend to go towards Israel as a result of the direct liaison between Palestinian and Israeli markets, as they were 86 percent of overall exports, while exports directed to Arab countries (intra-regional trade) constituted 9 percent, while the rest of the world got 5 percent.

This was also the case with imports in goods, where goods imported from Israel constituted 79 percent of total imports, while the European Union's share was 8 percent. China got 4 percent, turkey 3 percent and Arab countries combined (intra-regional trade) did not exceed 2 percent. This confirms the dependence of the Palestinian economy on its Israeli counterpart, and the gravity of impact Israel's economic and commercial policies have on the Palestinian economic performance and individual well-being, since Israel is the primary source of goods consumed in the Palestinian market, and enjoys control over the flow of goods to and from the PT.

## Balance of payments (BoP)

The BoP is usually the core of central banks' attention, as it is a vital measurement tool for national economic performance compared to the outside world; in addition, it evaluates the current status of a state's external debt. The BoP provides insights on a given country's level of dependence on foreign support and the structure of its economic relationship with the outside world, all in aims of conducting analytical studies to determine causes of BoP imbalances and the measures needed to correct these imbalances.

### *a. Current account*

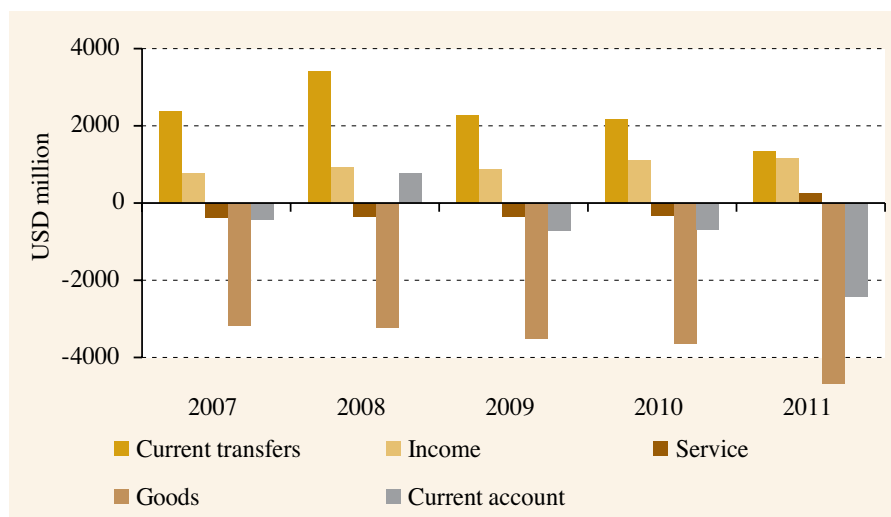
The current account in the BoP (goods, services, income and current transfers) scored a deficit estimated at USD 429.6 million in 2011

or what measures up to 24.4 percent of GDP, compared to a deficit of 8.3 percent of GDP in 2010. Upon analysis of the current account deficit, we must look for its primary causes and its sustainability in light of current circumstances. In addition, methods of treatment must be found, whether by adopting certain policies, if possible, or resorting to a reform program. It is also vital to identify a sustainable mechanism to finance the current account deficit.

The following is a summary of the four accounts that form the current account:

Goods: the main reason behind the increase in current account deficit is the considerable growth in the chronic deficit in the trade in goods balance, which has reached USD 4663.4 million in 2011 (46.7 percent of GDP), compared with USD 3652.8 million in 2010 (43.8 percent of GDP). This is a

Figure 3-3: Balances on current account, 2007-2011



Source: PCBS and PMA.

result of the rise in imports of goods by 43.4 percent, whereas exports of goods rose by 128.9 percent<sup>[2]</sup> compared to 2010.

Imports of goods constituted about 62 percent of GDP (51.8 percent in 2010), while exports of goods were 15.3 percent of GDP in 2011 (8 percent in the previous year). Minor development has occurred to coverage of exports over imports (24.6 percent), while this rate was 15.4 percent in 2010.

Services: the second contributor to the deficit in the BoP in 2011 is the service trade balance. Deficit in this balance fell to USD 261.8 million (a drop of 16.1 percent) primarily as a result of the fall in exports of services by 17.4 percent (to USD 686.3 million), despite the drop in imports of services by 17 percent (to USD 948.1 million).

Speaking of the structure of the trade in services account, exports of travel services took the biggest portion (80 percent), while imports of travel services had 50 percent, followed by government services (22 percent). It is worth mentioning that the increase in imports of government services during 2010 and 2011 is an exception caused by

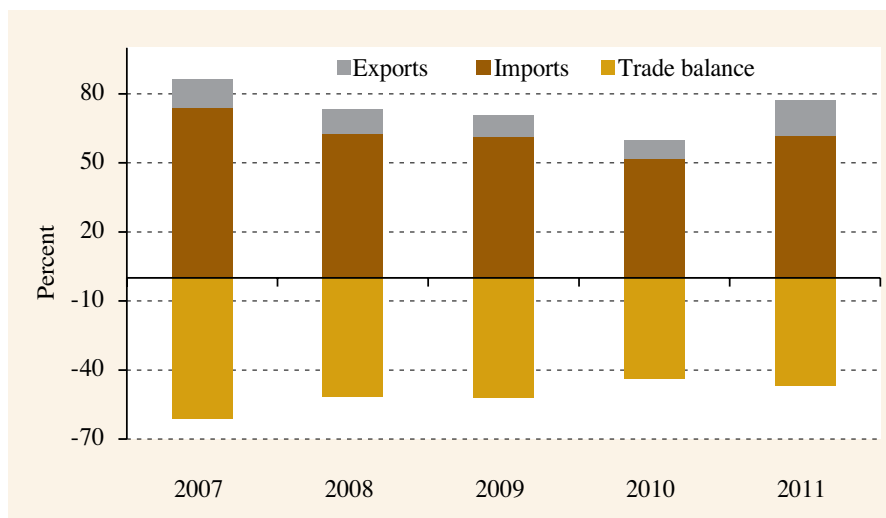
activities carried out by the PNA, represented by diplomatic missions abroad, to mobilize international support for Palestine's statehood bid at the United Nations, as well as other international organizations.

When examining the balance of goods and services as a whole (difference between commodity and service imports and exports), it is noted that the deficit of this balance reached USD 4925.2 million in 2011 (49.3 percent of GDP), compared to 47.6 percent of GDP in 2010.

### Income from abroad

The income account achieved a surplus of USD 1148.9 million in 2011 (11.5 percent of GDP), compared to a surplus of 13.2 percent of GDP in 2010. When looking at the components of this account, we find that the biggest contribution comes from the compensation of employees that mostly comes from Palestinian labor inside Israel, as this item formed 97.3 percent of net income from abroad in 2011. The remaining items of this account are primarily investment income (interest on Palestinian investments abroad), and vice versa for payments.

Figure 3-4: Trade deficit as a percent of GDP, 2007-2011



Source: PCBS and PMA.

<sup>[2]</sup> Despite the considerable growth in commodity exports, its relatively negligible volume compared to imports makes the increase in exports value less than that of imports. This explains the growing deficit in trade balance.

This account is important to the Palestinian trade balance that suffers chronic and accumulated deficit for the benefit of non-Palestinians. As such, the income account has financed almost 23.3 percent of the trade balance deficit during 2011 (27.7 percent in 2010).

In the Palestinian case, the compensation of employees is usually associated with the Palestinian labor in Israel, which witnessed substantial decline throughout the past years, especially in the aftermath of the Intifada in 2000. Consequent blockade and restraints imposed by the Israeli occupation limited the movement of Palestinian workers considerably. With the drop in numbers of these workers, the importance of their transfers started to retreat, and the relative volatility of Palestinians allowed into Israel (in addition to the volatility in the NIS exchange rate against the USD) has caused instability in the value of these transfers from year to another.

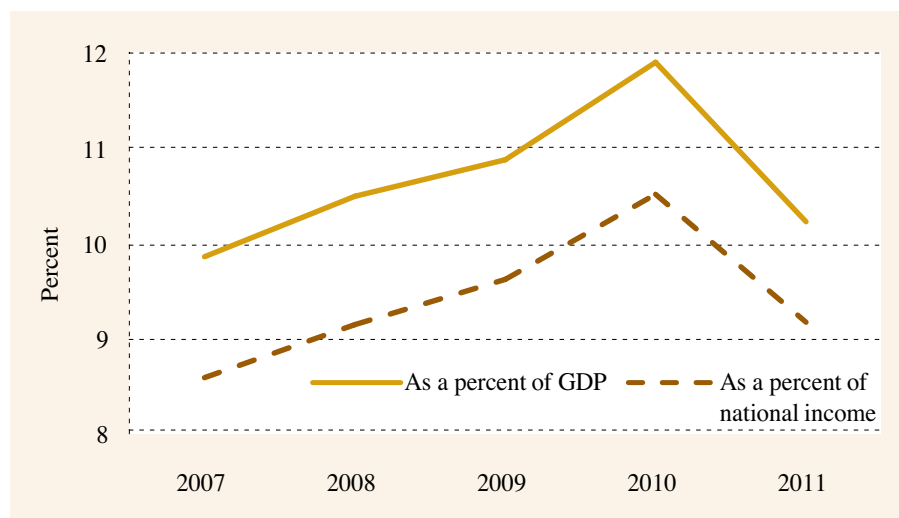
In this respect, it is noteworthy that the PT used to depend on exporting labor force to the Israeli labor market during the past years as one of the few alternatives to provide a source of income, and to alleviate unemployment. In addition, these transfers contributed positively to financing a substantial part of trade deficit (19 percent on average) during the period (2000-2011). However, experience during the past years has proven this policy ineffective, as the importance of compensations of Palestinian workers in Israel shrank along with the decrease of their numbers. Transfers during the period (2000-2011) constituted about 11

Figure 3-5: Income from abroad, 2007-2011



Source: PCBS and PMA.

Figure 3-6: Compensation of Palestinian employees in Israel, 2007-2011



Source: PCBS and PMA.

percent of GDP, on average, and 10 percent of GNP, while they exceeded 20 percent of GDP before 2000. Moreover, this policy was also proven unworthy in alleviating unemployment as the flow of Palestinian workers to Israel remained hostage to Israeli procedures and restraints.

The long-term dependence on this policy has left a clear negative impact on the Palestinian economy, as the decline in opportunities for Palestinian workers in Israel, and the subsequent loss of income, has affected local demand and directly contributed to the negative impact on many economic and social indicators such as growth, unemployment, poverty and others. Such situation makes it imperative to look for other alternatives to provide resources for cash flows and to handle unemployment.

### Current transfers

Current transfers have special significance to the Palestinian economy, whether on the public sector level or the private sector level. It is usually the case, however, for transfers to the private sector to bear most significance in most economies, as is the case for the Palestinian economy. The importance of this item for the BoP lies in being a vital financier to the trade balance, where these transfers have financed 27.3 percent of trade balance in 2011, compared to 54.9 percent in 2010.

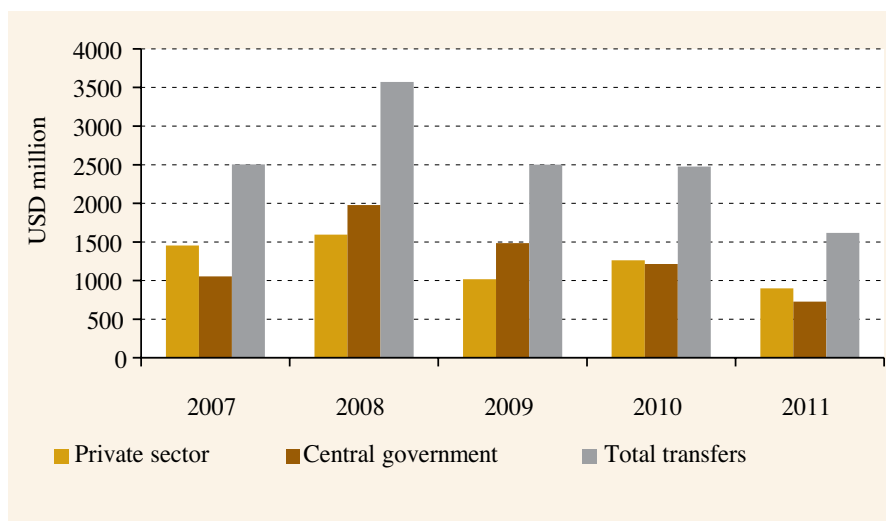
A decline in current transfers is observed in 2011 to USD 1346.7 million (38.1 percent). The reason behind that drop is the significant fall in transfers directed to support the government budget,

which have plummeted to USD 727.5 million (40.1 percent), against what has been in 2010. This came in light of a donor's policy to redirect funds from current transfers (budget support) into capital (developmental) transfers for the central government, or the public sector. Donor's transfers to other sectors have also dropped to USD 259 million in 2011 (52

percent below what have been scored in 2010). Furthermore, remittances decreased to USD 639.3 million in 2011, or 11.5 percent compared to 2010.

It must be noted that current transfers, as a percentage of GDP, have dropped from 26.1 percent in 2010 to 13.5 percent in 2011, which requires looking for procedures and policies to compensate for that enormous shortage in budget support, and particularly to finance wages and salaries of public employees.

Figure 3-7: Current transfers, 2007-2011

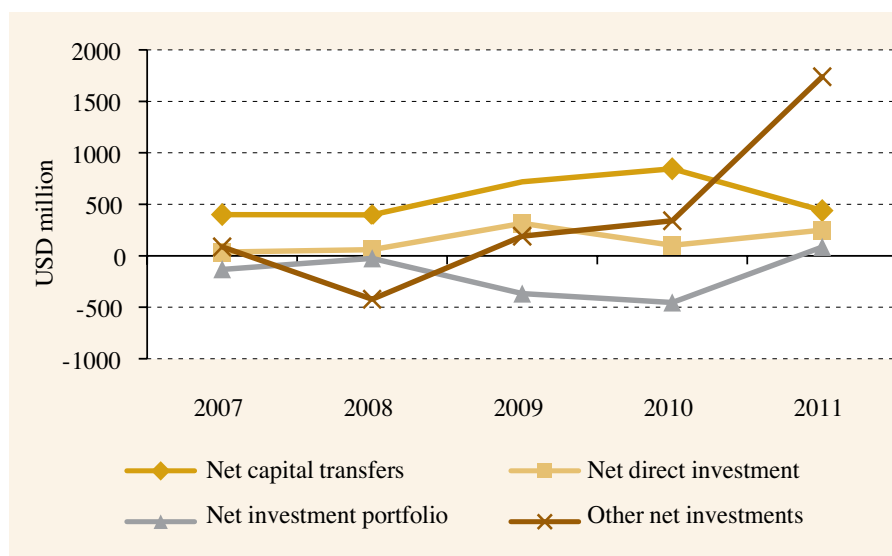


Source: PCBS and PMA.

## b. Capital and financial account

The capital and financial account (including reserve assets) has achieved a surplus of USD 2549.4 million in 2011, an increase of 218.6 percent over rate scored in 2010. It represented 25.5 percent of GDP in 2011 (9.6 percent of GDP in 2010). The reason behind the accumulated surplus in this account could be attributed to the increase of net other investment flows in the financial account, which climbed to USD 1739.8 million in 2011 (410.2 percent), whereas net direct investment flows rose to USD 250.9 million; an increase of USD 143.6 million over 2010. Net portfolio investment flows also went up to USD 86.2 million compared to a negative flow of USD 453.4 million in 2010.

Figure 3-8: Capital and financial account components, 2007-2011



Source: PCBS and PMA.

As a result, the financial account has financed 86.9 percent of the current account deficit in 2011, whereas the capital account (represented by capital transfers of USD 438.9 million) financed 18.1 percent. Keeping in mind that the current level constitutes a decline compared to 2010, when it reached USD 84.1 million, due to a fall in donor's transfers to the public sector excluding the central government. In general, financial and capital account financed around 104.9 percent of the current account deficit in 2011.

On the other hand, net change of official reserves dropped in 2011 to USD 33.6 million, compared to an increase of USD 36.4 million in 2010. These reserves reflect the sum-up of total balance in the BoP and therefore the finance of the balance as a whole, due to the absence of a national currency and other financing resources.

When discussing the sustainability of the current account, several economic indicators must be examined and the main causes of current account deficit must be determined. So, status of current account (good or sustainable) could be determined by the fact that it expresses general economic trends, whether sought-after and required or not sought-after but required for a given country and within specific timeframe as well. As mentioned before, the trade deficit in the Palestinian economy is the main reason for the current account deficit, which normally mirrors problems in competitiveness. However, in light of restraints imposed on the Palestinian economy in addition to the Israeli control over borders and crossing points, limitations to free flow of trade and absence of an exchange rate policy due to absence of a national currency, it is hard to say that trade deficit is the only cause of current account deficit, albeit it is the most important one. Additionally, there is a public finance deficit which normally contributes substantially to the current account deficit. Meanwhile, the current account deficit might reflect the shrinking of saving without an increase to investment, so links are established with consumption, the

economy as a whole is described as consumer-dominated or some public financial policies are not well-deliberated.

Speaking of sustainability, the most prominent measurement indicator of current account sustainability is the trade balance to GDP ratio, which is high in the Palestinian case (up to 50 percent of GDP, on average, over the past years). Moreover, there is the ratio of national savings to GDP, which is low in the Palestinian case (up to 25 percent of GDP). The third indicator is net direct investment flows (do not exceed 12 percent, on average), whereas external debt and debt service to exports ratios constitute the fourth indicator for sustainability (more than 100 percent, on average).

As for financing the current account, direct investment (property rights/shares) is the best way to finance current account deficit in general, as direct investment flows are more sustainable than others such as portfolio flows. Besides, direct investment does not originate debts, thus, it does not increase external debt balance. Moreover, when looking at the financial account in the Palestinian BoP, it appears that the current account deficit has been financed by withdrawing from the foreign assets of the Palestinian banking system and from capital transfers, not from investing in property rights, which did not exceed 10.3 percent of GDP in 2011.

On the other hand, the huge trade deficit indicates that many trade agreements and protocols the PNA signed with many countries, especially EU and Arab countries, were not successful in inhibiting its growth and impact on current account deficit, in particular, and on the BoP in general, which requires alternative sources of financing, especially reserve assets.

Regarding the connection between gross national savings and the current account deficit, it is observed that the latter occurs whenever a given country spends more than its capacity or absorbs more than what it produces. This means that the deficit in the BoP reflects a rise in domestic absorption (domestic demand or total domestic consumption) over income. Accordingly, in order to lower current account deficit, a state's income must be increased or domestic absorption must be reduced, or both.

### **Box 6: International investment position in Palestinian Territory, 2011**

**The international investment position is described as an accounting log in which balances of residents' (individuals, corporate and governments) investments abroad are registered as assets, and balances of non-residents' (individuals, corporate and governments) investments in the local economy as liabilities.**

**The international investment position in the PT compiled jointly between the PMA and PCBS. The outcomes denoted that the net international investment position in the PT (foreign assets-foreign liabilities) reached USD 721 million in 2011. That means that the Palestinian economy, with all sectors, invested outside the Palestinian economy with a value that exceeds that invested inside the Palestinian economy from abroad.**

**Total Palestinian assets invested abroad have reached USD 5233 million, from which the Palestinian direct investment abroad was 3.7 percent, whereas portfolio investments**



abroad were 21.9 percent. Other investments abroad took 64.9 percent, while reserve assets constituted 9.5 percent, with emphasis on the fact that the reserve assets are listed under assets only, not liabilities.

Total foreign liabilities (non-residents balances invested in the PT) reached about USD 4,512 million, of which foreign direct investment was 51.6 percent, while foreign portfolio investments in the PT were 13.5 percent, and other foreign investments inside the Palestinian economy took 34.9 percent.

### International Investment Position (IIP) stock for the Palestinian Territory, 2011

(USD million)

| Item                                    | PMA | Government Sector | Banking Sector | Other Sectors                            |                   | Total |
|---|-----|-------------------|----------------|--|-------------------|-------|
|   |     |                   |                | Non-financial Institutions & NGOs Sector | Households Sector |       |
| International Investment Position (net) | 807 | -1113             | 2478           | -714                                     | -737              | 721   |
| Total External Assets                   | 807 | 1                 | 3793           | 543                                      | 89                | 5233  |
| Foreign Direct Investment Abroad        | 0   | 0                 | 19             | 120                                      | 53                | 192   |
| Portfolio Investments Abroad            | 145 | 0                 | 754            | 247                                      | 1                 | 1147  |
| Other Investments Abroad                | 165 | 1                 | 3020           | 176                                      | 35                | 3397  |
| Of which: currency and deposits**       | 165 | 0                 | 2964           | 162                                      | 35                | 3326  |
| Reserve Assets                          | 497 | 0                 | 0              | 0  | 0                 | 497   |
| Total Foreign Liabilities               | 0   | 1114              | 1315           | 1257                                     | 826               | 4512  |
| Foreign Direct Investment in Palestine  | 0   | 0                 | 767            | 738                                      | 823               | 2328  |
| Portfolio Investments in Palestine      | 0   | 0                 | 189            | 422                                      | 0                 | 611   |
| Other Investments in Palestine          | 0   | 1114              | 359            | 97                                       | 3                 | 1573  |
| Of which: Loans from Abroad             | 0   | 1114              | 0              | 94                                       | 0                 | 1208  |
| currency and deposits***                | 0   | 0                 | 359            | 0  | 0                 | 359   |

Data in the above table are closed to nearest integer.

\* International Investment Position (net): equals total external assets minus total foreign liabilities.

\*\* Including residents deposits abroad, in addition to foreign cash in the Palestinian economy.

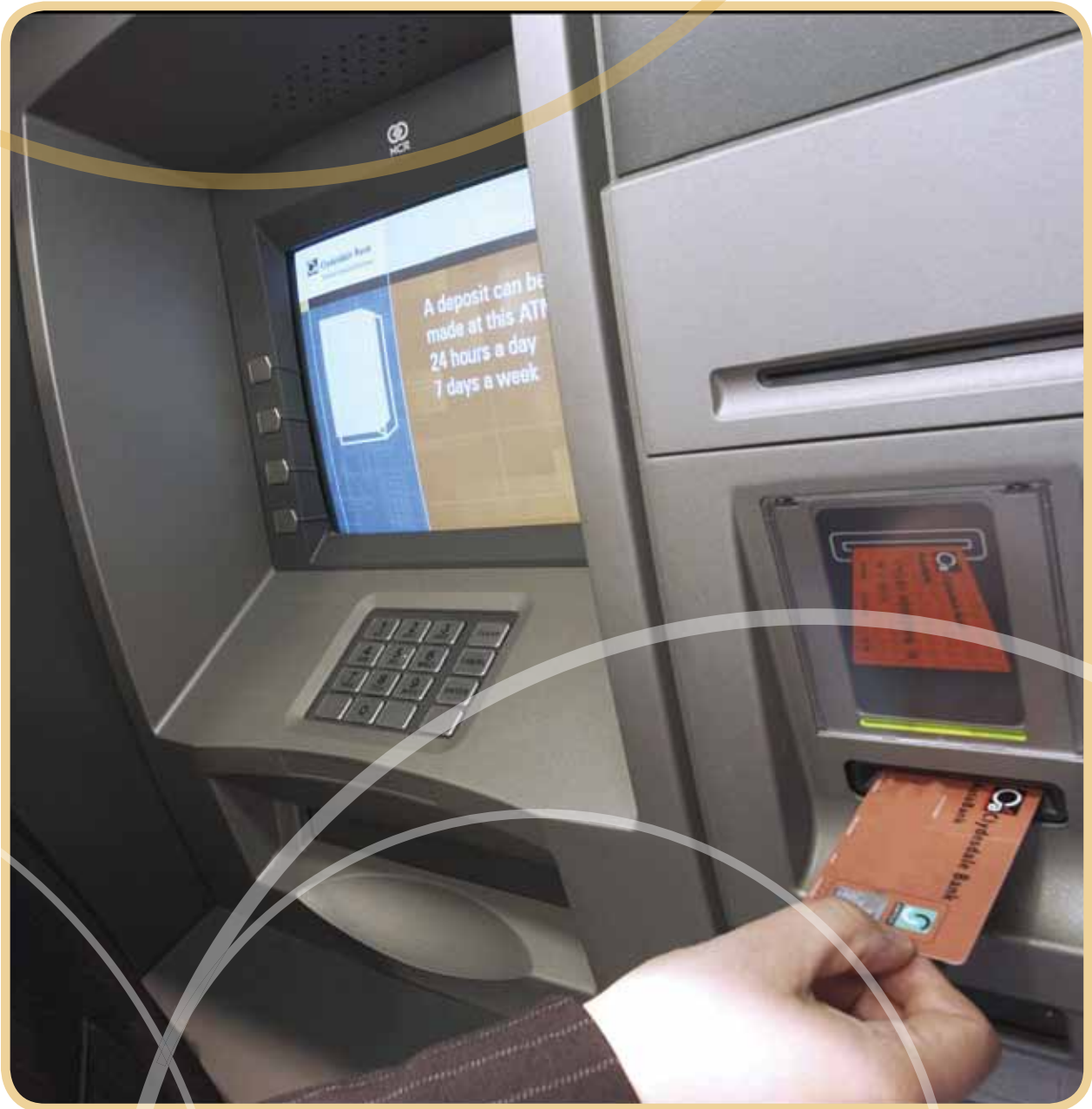
\*\*\* Including deposits of non-residents deposits in Palestinian banks.

Source: PMA and PCBS.



# Chapter Four

## Palestinian Financial Sector Developments





# Part I: PMA Developments

## Overview

Seeking to fulfill its responsibility of maintaining financial stability and introducing best international practices and criteria to the banking sector, and in order to stimulate and promote sustainable economic growth, the PMA continued its unwavering efforts in all relevant spheres and areas throughout 2011. New projects have been launched, such as the IBAN Project and the establishment of a database for housing loans and real estate mortgage. In addition, the PMA has joined the World Bank Treasury Reserve Advisory Management Program (RAMP), the OECD International Network on Financial Education, and Children and Youth Finance International in Amsterdam, Holland.

Moreover, the PMA has completed the infrastructure and legal and supervisory framework of the banking and money-changing sector, including specialized lending, by means of constantly developing the banking payments system to reduce risks and accelerate transfers and payments, in addition to preparing the Central Bank drafts laws, payments system, and deposits insurance scheme. Furthermore, the PMA has developed supervision instructions in line with the new Banking Law No. (9) of 2010 and global developments.

Within the context of enhancing the PMA's capacity in overcoming the risks, its capital has been gradually increased. Consequently, owners' equity grew by 4.3 percent, reaching USD 89.3 due to the rise in paid-up capital by about 7 percent as a result of transferring profits yielded to the PMA's capital account during 2011.

These achievements have supported PMA's policies aimed at banking services dissemination and integration within the Palestinian society, enhancing relations and trust between the different segments of the community and the banking system units, and providing banking services to the largest portion of the Palestinian people in all localities.

## Legal and supervisory developments

Supervision laws, regulations and instructions are indispensable for developing the legal infrastructure of the banking system in Palestinian Territory. They are also vital for sparing the banking system, as much as possible, the effects of global financial crises and maintaining financial stability in the two parts of the country. Many of the laws and regulations have been developed in exceptional circumstances such as the dysfunction of the Legislative Council and the national split. However, while developing those laws and regulations, the PMA was keen on distancing itself from the national split and kept on working in both the West Bank and Gaza Strip with integrity and impartiality.

## *a. Laws and legislations*

### **Payments system law**

The Payments Systems Draft Law has already been submitted to the Council of Ministers and it is anticipated that the law will be issued by a presidential decree. The law represents the appropriate and comprehensive legal framework that governs the payments systems in Palestinian Territory. In addition, the law is complementary to PMA procedures aiming to develop a comprehensive legal infrastructure for organizing the payments systems and monitoring them. Moreover, the law provides for an increasing automation of mutual payment processes among banks and helps entrench the principle of the finality of payments in accordance with the most modern international criteria including Basel criteria. It should be mentioned that the Palestine National Payments Council was established in 2010, whose responsibility is to draw up national policies and strategies for the development of the payment system.

### **Palestine deposits insurance law**

The Palestine Deposits Insurance Draft Law has already been prepared in cooperation with IMF experts and after consultation with relevant stakeholders, in particular the banking system and the government. The draft has also been approved by the PMA Board of Directors as a preliminary move towards the completion of other legal steps for approval. The law is anticipated to be issued before the end of 2012. The decision of the PMA Board of Directors to approve the draft law is part of the authority's efforts to enhance and complete the building of the financial safety net which is considered the foundation for the establishment of a secure, sound and efficient banking system that is consistent with the requirements of Basel Committee on Banking Supervision(BCBS) and best international practices in this field.

The new draft law provides for the establishment of an independent institution concerned with insuring clients' deposits in banks operating in PT within a range to be decided by the institution's Board of Directors and in consultation with the PMA. This will provide more than 94 percent of depositors with insurance for their deposits. The banking deposits insurance system is founded on the integration of two main parties, namely, the banking system and the PMA; it aims to strengthen confidence in the banking system and achieve financial and economic stability to ensure the sustainability of the operation of the banking system as one of the main constituents of state building.

### **Central bank law**

Pending approval and endorsement, the Central Bank Draft Law is also expected to pass by a presidential decree in the near future. The law constitutes the basic legal structure for transforming the PMA into a modern fully-fledged central bank. The proposed law contains clear-cut measurable objectives (price stability), adequate tools and authority for the achievement of those objectives (independent performance), and means of oversight, preparation and publication of periodic reports on how those objectives have been achieved (accountability). In addition to highlighting the concept of independence, the new legislation provides for the application of the principles of transparency and accountability that are consistent with the best international principles and practices.

The new legislation benefits from the most modern practices, as it encompasses provisions on modern payments systems and on dealing with troubled banks. It also clarifies the responsibilities of both the PMA and PCMA with regard to licensing and organizing financial companies, as well as their relation with the Ministry of Finance concerning the management of national debt. Furthermore, the legislation includes provisions regulating the issuance and management of currency. The Central Bank Law grants the Central Bank exclusive authority for

the issuance of national currency whenever the required conditions are met. The most important conditions include secured independence of the Central Bank, the sustainability or stability of the PNA's financial position, and control over borders and crossings, including the free movement of trade and flow of capital and currency. Finally, this law, in addition to the Banking Law and Anti-Money Laundering and Combating the Financing of Illegal Activities Law, provide the elements of contemporariness, inclusiveness and effective frameworks for monetary and financial stability.

### **New banks licensing system**

Based on Article (11) of the Banking Law No (9) of 2010 regarding the fees and services allowance paid-up by banks, Presidential Decree No. (62) of 2011 was issued concerning banks license fees<sup>[1]</sup> to substitute the Banks Licensing Fees Regulations issued by a Presidential Decree on 9 June 2007.

### **Specialized lending institutions license and oversight system**

The Specialized Lending Institutions License and Oversight System was issued by Presidential Decree No. (132) of 2011. The system comes in line with international best practices and enhances the principles of good governance. It aims to preserve the safety and effectiveness of the activities of specialized lending institutions so as to enhance their sustainability and contribute to financial stability.

### *b. Supervision instructions*

In light of the new Banking Law No (9) of 2010,<sup>[2]</sup> the PMA embarked in 2011 on a comprehensive review of all the supervision instructions previously issued to achieve more consistency with the amendments and additions made to this law. In addition, the PMA issued new supervision instructions regulating and controlling banking activities in light of the national and international legal and supervisory developments. In this respect, the instructions that have been revisited and amended in 2011 focused on the following aspects:

- **Instructions No. (1/2011) concerning counter-cyclical reserve:** These instructions oblige banks to appropriate 15 percent of their annual net profits under the name of “counter-cyclical reserve” provided that this annual appropriation continues until the reserve balance constitutes 20 percent of the bank's paid-up capital. These instructions have been implemented as of the publication of the financial statements of banks for the completed fiscal year 31 December 2010. They aim to strengthen the capital of banks and increase their capability to withstand credit, operational and market risks provided for in Basel Committee's Instructions. This move complements previous instructions that obliged banks to raise their capital up to 50million USD by the end of 2010.
- **Instructions No. (3/2011) concerning banks license in Palestinian Territory:** These instructions were put forth within the context of amending previous instructions so that they become consistent with the Banking Law No. (9) of 2010. These instructions substituted the outdated Instructions No. (2/2008).

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<sup>[1]</sup> Published in the *Palestinian Gazette*, No. (91) on 10 October 2011.

<sup>[2]</sup> For further information please see the *Financial Stability Report of 2010* at [www.pma.ps](http://www.pma.ps).

- **Instructions No. (3/2011) concerning clients' access to their credit reports and objection to them:** These instructions have been issued as part of the PMA's policy to enhance public confidence in the Palestinian financial sector, especially banks and specialized lending institutions, and consolidate the principles of transparency and disclosure between banks and their clients. These instructions include clear guidelines on how clients can obtain their own credit reports from the Credit Information Registry and the Bounced Cheques System at the PMA. They also give clients the right to object to the reports, noting the right to provide clients with a copy of their credit reports is limited to the PMA for the time being.
- **Instructions No. (5/2011) concerning stress testing:** These instructions oblige the banks to carry out periodic financial stress testing in accordance with an annual schedule approved by the bank's Board of Directors and based on international criteria utilized in this area, especially those issued by the Basel Committee on Banking Supervision in 2009. These instructions identify the nature of the scenarios required for biannual testing by banks. Stress testing is considered one of the instruments used for measuring and assessing the impact of banking, financial or economic shocks on the financial position of banks. In addition, stress testing helps the bank's management in the assessment of the risks they may encounter in the foreseeable future and consequently in opting for precautionary policies and procedures such as determining the ceilings for exposure and, raising capital, amendment of work and operational procedures, and development of contingency plans.

### **Box 7: Stress testing**

**Stress testing gained attention and emphasis soon as Basel II Accord came into practical application as one of the main principles that make up the second pillar of capital, a cornerstone in the institutional governance system and a major risk management component for banks. Stress testing is defined as a set of procedures used by financial institutions to measure their capabilities in withstanding and encountering probable extraordinary events that might have a negative impact on their portfolios and financial position. Stress testing is used to support and strengthen risk control process by way of strengthening statistical measures of risks and assist the boards and senior managements in taking suitable decisions and identifying operational policies and procedures that could remedy the bank's weaknesses. Moreover, stress testing is used to assess the bank's capability to withstand difficult conditions and their impact on profitability and capital adequacy.**

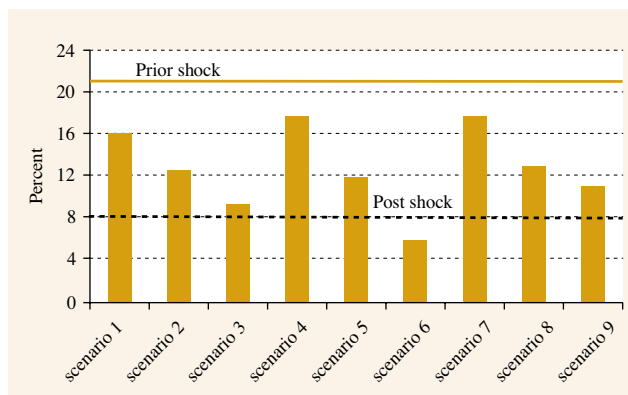
**The PMA took all necessary measures to introduce stress testing in risk management processes in the banks in mid-2011 by means of issuing Instructions No. (5/2011) that contain many scenarios that accommodate for potential financial, economic and political shocks of various intensities. The stress test was designed in such a manner that provides a high degree of flexibility in dealing with any of the virtual scenarios that can be proposed**



or modified. The model provides the possibility of determining the impact of each single-variable and multi-variable scenarios on the data of every bank, total national banks, total foreign banks, total commercial banks, total Islamic banks and overall banking system.

The results of tests conducted by the PMA to estimate the impact of credit shocks, cash flow, market, and operational shocks on the financial position of banks and capital adequacy and cash flow demonstrated that the banking system is capable to withstand a wide range of shocks. In fact, the banking system enjoys a reasonable level of capitalization. As a percentage of the risk-weighted assets, the core capital amounts to 21.7 percent (before the shock). It is noteworthy that the PMA tested nine sets of shocks consistent with an economic scenario that presumes a negative growth in real GDP. In all cases, however, the ratio of core capital after the shock was higher than the mandatory minimum of 8 percent, with the exception of one extreme scenario that involves an assumption that 30 percent of the private sector loans becomes default loans with a drop in the fair value of shares by 35 percent and the withdrawal of 20 percent of the total deposits within one month.

### Stress testing on core capital, 2011



#### Shocks

- 20-40 percent of government loans become classified.
- 25-50 percent from PA employees loans become delinquent.
- 10-30 percent of private sector loans (excluding PA employees) become delinquent.
- 5-20 percent from deposits withdrawn within one month.
- 1-5 percent of largest borrowers become delinquent.
- 1-5 percent of largest depositors withdraw deposits.
- 5-35 percent drop in fair value of shares and stocks.

- **Instructions No. (6/2011) concerning credit risk management:** These instructions are consistent with the recommendations of Basel Committee in Banking Supervision which emphasize the necessity for providing sound bases for credit risk management within the framework of four main components representing the minimum quality principles that must be followed. The four components include the existence of a suitable environment conducive for credit risk management, working in accordance with sound procedures and controls for the general letter of credit, the availability of a prudent management and feasible measurement and follow-up procedures, and verification of adequate oversight and monitoring on credit risk and control.
- **Instructions No. (7/2011) on user fees of the immediate settlement program (BURAQ):** These instructions specify subscription and variable fees in BURAQ as well as regular fines for the purpose of covering BURAQ's operational costs, noting that the operational costs for using the program have been shared between banks and the PMA with a view to secure the work sustainability of the program at all times efficiently and effectively.
- **Instructions No. (8/2011) concerning fees and commissions:** These instructions replaced Item (5/11) of the Instructions No. (5/2008) in line with the Banking Law of 2010. In addition, the instructions require the banks to disclose all fees and commissions to the public and abstain from imposing new commissions except after the approval of the PMA. The Instructions provide for 119 commissions<sup>[3]</sup> identified in order to incentivize the use of plastic money and encourage the use of e-services with a view to secure reasonable and fair balance between the profitability of banks and preservation of the rights of clients.
- **Instructions No. (9/2011) concerning appointments, transfers, disciplinary measures and resignation:** These instructions replaced Instructions No. (1/2010) within the framework of reformulating previous instructions so that they become compatible with the Banking Law of 2010. Generally, these instructions specify the procedures and policies that control the actions taken by the banks against their employees, whether actions relating to employment or any other actions such as transfer, discipline and resignation. Moreover, the instructions specify the nature of tasks and functions that require the prior approval of the PMA for their occupancy. Furthermore, the instructions require the banks to immediately notify the PMA of any disciplinary measures taken against any bank official or employee especially procedures relating to the breach of trust or treason. The PMA has been very proactive with regard to this kind of instructions.
- **Instructions (10/2011) concerning the system for updating or modifying the financial and personal statements of clients:** These instructions fall within the framework of the PMA's efforts to develop and automate work tools and mechanisms, and reduce manual and paper work. A system for updating the financial and personal statement of clients and their warrantors was developed through the credit information site with the view of dispensing with the use of paper forms. The instructions outline detailed guidelines for the banks on how to use the electronic version to make the required modifications.

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<sup>[3]</sup> This constituted an increase in commissions compared to last year due to the fact that several banks have introduced new financial products and services, noting that the PMA undertakes the review of commissions and periodically follows the up through the PR Department.

- **Instructions No. (12/2011) concerning the system for updating or modifying the financial and personal statements of clients.** These instructions canceled the use of paper forms in modifying statement as of 26 December 2011 and required the use of the electronic system only.

On the other hand, the PMA issued in 2011 several circulars regulating the routine procedures and developments of the banking business. For example, Circular No. (70/2011) requires the banks to issue a life insurance policy for clients who have direct banking facilities (including Islamic financing forms) whose duration of payment exceeds 48 months provided that the ratio of coverage of the insurance policy is no less than 100 percent of the value of the loan or facility. The aim of this circular is to reduce credit risks.

Likewise, in an attempt to combat money laundering, Circular No. (75/2011) requires banks to give special attention and care to financial processes that exceed USD 10,000. Within the same context, the PMA, in coordination with the National Anti-Money Laundering Commission and Financial Follow-up Unit, has organized a training program through the Finance and Banking Studies Institute during the period between 12 June 2012 and 7 July 2012 targeting compliance monitors and bank employees of all levels. At the end of the program, trainees were granted a Palestinian Anti-Money Laundering Certificate pursuant to Circular No. (99/2011). There are also other circulations that will be mentioned later under the headline PMA's Relations with the Public.

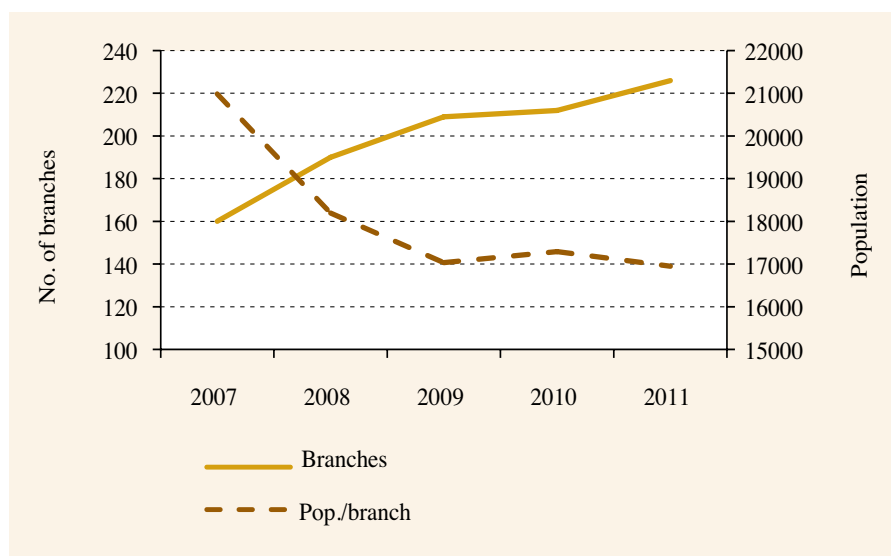
## Branching policy

As part of the banking branching policy adopted by the PMA since 2007, 14 new branches and offices have been opened in 2011; four offices for bank of Palestine, two branches and two offices for Al quds bank, a branch and an office for Cairo-Amman bank, one branch for bank of Jordan and one branch for Jordan commercial bank.

The banking branches and offices network continued to grow during 2011 to reach 226 branches and offices in 2011. By licensing new branches and offices, the PMA aims at delivering banking services to all Palestinian cities and villages, and prioritizing rural communities and remote regions in order to facilitate commercial and economic activities and different financial transactions.

By means of the branching plans, the PMA is seeking to reduce the ratio of the population to number of branches in order to raise the efficiency of services provided, and to be consistent with internationally-recognized rates (10,000 persons/ branch). With this augmentation in

**Figure 4-1: Branches of banks operating in Palestinian Territory, 2007-2011**



Source: PMA

branches, the population/ number of branches and offices ratio has decreased to about 16,800 persons/branch or office by the end of 2011.

In light of the outcomes of previous bank merging and restructuring last year, the number of banks operating in PT in 2011 stood at 18, of which 8 are national banks that operate 118 offices and branches and 10 are foreign banks (8 Jordanians, one Egyptian and one international) that operate 108 branches and offices. It is anticipated that bank mergers will continue, so the number will drop to 16 banks in 2012.

On a different note, banks were directed to establish disaster recovery sites and alternative operation sites, which guarantee the continuity of bank services to customers, even in emergency situations. Plans have been set to ensure that banks keep working and tested for effectiveness. This comes as the PMA strives to maintain the milestones achieved in the banking sector, and to face risks of negative impact business continuity in the banking sector.

### **Box 8: Business continuity of the banking system**

**Maintaining business continuity and risk management is a necessity that could not be ignored in light of increasing dependence on information technology and communications, and the overlap between the operations of banking and financial institutions. System shutdowns or service halt at a given bank might have catastrophic consequences on other banks and financial institutions, so catastrophic that they might compromise financial and economic stability and even individual and corporate properties. In order to face these risks and ensure continuous provision of services and products under any circumstances, an effective methodology must be adopted for proper planning to encounter risks and events that may negatively impact continuity.**

**Driven by the PMA's responsibility for preserving financial and monetary stability, the focus on business continuity in the PMA and the banking sector was evident in PMA's senior management plans, in order to raise responsiveness to different events and risks. Additionally, the PMA seeks to implement best international practices that focus on this side, such as the best practices approved by the Business Continuity Institute and Basel Committee recommendations on the requirements of business continuity in financial and monetary institutions, including supervisory bodies like the PMA and banks supervision in this respect.**

**To that end, the PMA has established a special unit that follows the governor's office for planning, follow-up and supervision in terms of business continuity at the PMA and banking sector levels. This unit has qualified and trained staff to carry out this task in cooperation with the other PMA departments and banks; it also adopted the international practices issued by the Business Continuity Institute of the UK as the basis for the management of business continuity program at the PMA, taking into account Basel Committee recommendations. The staff assigned to this unit was provided with special training in this respect, as they became the first Palestinians to join BCI after passing the required exams.**

Throughout the past period, and by means of the business continuity program, this unit has studied different PMA departments to determine their critical operations and the consequences of any interruption of these operations. This process relied on anticipating events of such impact and then determining necessary resources to restore these operations, procedures, equipment, staff, facilities and outsourcing providers. Afterwards, a business continuity strategy was adopted at the PMA level and plans were made to restore critical and important operations to all departments, in addition to designing a testing software that has been initiated in the middle of the year. The PMA has also prepared alternative business continuity sites to manage operations in cases of emergency, in addition to planning an IT systems recovery, emergency management and training staff in this respect. The unit has worked to raise awareness of business continuity and the need to take it into account upon planning operations and projects on a continuous basis, through awareness campaigns via-mails and workshops that have been held for the PMA's core departments, and through seminars arranged to incorporate the business continuity concept in all departments' activities.

The PMA seeks in the long-run to raise the responsiveness of the banking sector to different events and risks through continuous planning and coordination among members of this sector, up to tests for the recovery of some basic services at sectoral and national levels.

Continuous coordination and planning between the PMA and banks in the business continuity field are a must, in order to support the stability of business and the financial sector, foster confidence and reduce fears from any sudden interruptions.

## Developments and updates to the banking systems

The PMA continued tireless efforts to develop state-of-the-art banking systems according to the best international practices, all as part of building and adapting robust and comprehensive banking infrastructure that reduces the risks threatening the banking system, in particular, and the financial system in general. In this regard, the PMA pursued during 2011 several improvements in some banking systems that have been initiated in the past years<sup>[4]</sup>:

### a. Real-time gross settlement system (BURAQ)

The PMA has made tangible progress in developing payment systems for the Palestinian banking system after the launch of BURAQ system in November 2010, , which was a great leap in the field as this system constitutes the backbone of the payment system in Palestinian Territory. The PMA reduced risks of high liquidity in RTGS v1.0 compared to the previous system (DNS). After completing phase one of RTGS successfully in 2010, the more advanced version of BURAQ (Hybrid) has been launched as of 25/9/2011 in cooperation with the World Bank.

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<sup>[4]</sup> For more information about nature of these systems and date of initiation, please see the financial stability report, p24, available on [www.pma.ps](http://www.pma.ps)

The newer version of BURAQ combines between lowering liquidity risks in the Differed Netting Settlement System and lowering credit risks in the Real-Time Gross Settlement System. The launch of the new version came after the PMA has made necessary preparations, workshops and sufficient training for all banks staff.

In addition to real-time payment methods, the v1.0 offers additional and more effective methods of payment orders management (transfers), which compete with the most advanced systems worldwide. The most important features of the new version are:

- **Settlement mechanisms:** they work as part of Real-Time Gross Individual Settlement of Financial Payments upon availability of sufficient balances and in a way that reduces credit risks, in addition to the activation of settlement mechanisms for net balances in relatively close dates, which reduces the overall volume of cash needed to carry out financial payments.
- **Waiting lists system:** this system enables member banks to the BURAQ system to issue all payment orders with minimum operational and liquidity risks. If the settlement account of the bank issuing the transfer order does not have enough balance at the time, it would be referred to the waiting list of the settlement system until enough balance is available to settle the order without being directly rejected.
- **System incentives:** this method elevates the level of system stability, effectiveness and liquidity, as it contributes to resolving what is known as a system gridlock, which would lead to liquidity and credit risks and cease cash flow at the level of all members. Therefore, two methods have been adopted to incite the system; the first one is the Stimulated Net Balances method and the second is the Offsetting method, as well as other means that could be used in the future as 'First in, first out' (FIFO).
- **Supporting the national currency:** the new version of BURAQ supports PMA's future strategic plans aiming at issuing a national currency, issuance of government bonds and providing guarantees. This version has been successfully tested among simulation mechanisms. The new system has a special feature; it executes electronic settlements for four currencies (NIS, USD, Euro and JD), plus a room for a fifth currency (the prospective national currency). It should be mentioned that all personal transfers have been ceased through PMA clearing houses as of 1/7/2011, where they are being executed directly through the BURAQ system as stipulated by circular 94/2011 of 9/5/2011, so as to gain maximum benefit from the system and to reduce the period of personal transfers settlement and record them in involved bank accounts as soon as possible.

The total value of operations executed through BURAQ reached about USD 29.6 billion during 2011, with a monthly average of USD 2.5 billion, of which there have been bank transfers at 4.4 billion (14.9 percent of total operations). Personal transfers reached USD 5.8 billion (19.6 percent) of total operations executed. This reflects how important the BURAQ system is for the settlement of all kinds of transfers, regardless of value, and whether they are inter-bank, personal or for PMA transfers.

## **b. International bank account number (IBAN)**

At the end of 2011, the PMA has formed a special committee to prepare and implement this project in the PT. The project aims at applying a unified and recognizable international system for the length and number of bank account digits, and in line with international standards of bank accounts, issued by ISO Organization (ISD Standard 13616), and recommendations of the secretary of central bank governors' council and Arab

monetary authorities. The PMA's declared strategy in this respect depends on not executing major structural modifications to numbers of bank customers, and within stages that extend to 2013 to guarantee stability in banking operations and the smoothness and safety of the process. This is accompanied by the dissemination of required banking education.

The IBAN project is supposed to produce several benefits, such as to ensure the accuracy of information related to transfers, allow verification of information provided, reduce errors, facilitate and speed up transfers, minimize costs and increase efficiency and reliability.

### **c. Establishing a database for housing and mortgage loans**

A new database that includes full information about the portfolio of the housing and mortgage finance sector has been established, with the purpose of detecting different risks that surround economic sectors, especially the housing and mortgage sector. Data of this database is of great importance for analyzing risks of the sector, drawing monetary policies and determining loan-to-value ratio. In light of that, a number of monitoring and statistical reports have been devised in order to be used for regular analysis on a quarterly basis. It is expected that the PMA would issue a special housing index in the upcoming period as a reference for matters that have to do with housing and mortgage loans. This database and the financial leverage concepts mentioned in box (9) below enables the analysis of the so-called leverage cycle for the Palestinian real estate sector.<sup>[5]</sup>

#### **Box 9: Financial leverage ratios**

**The financial leverage concept is given to the use of financing that carries a fixed charge (interest) which magnifies the effect of both gains and losses for the corporation. This term is occasionally used to describe debt ratios; the more such ratios increase, the more will be the impact of financial leverage on profits of corporations/banks. Financial leverage ratios could also be raised by using other financial tools such as Options and Futures.**

**Financial leverage ratios are a most important monitoring tool, as they help in assessing the financing structure of corporations on specific date in terms of dependence on financial resources (internal or external). Generally, the less banks or corporations depend on loans to finance assets the less they are prone to risks, because serving debts will drain cash resources needed for their operations. Therefore, it is preferable to invest in companies with fewer debts as this would be an indicator to their reliable financial position considering solvency and liquidity. However, the investors' responsibility is to benchmark the debt ratio of the corporation with the acceptable ratio of the sector. Hence, it is imperative to avoid investing in a corporation that has a much higher debt**

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<sup>[5]</sup> To review leverage cycle in the United States, see: John Geanakoplos, The Leverage Cycle in D. Acemoglu, K. Rogoff and M. Woodford, NBER, Macroeconomic Annual, 2009.



ratio than that of the sector. Additionally, it is imperative to have an idea about long-term loans/debt covenants. For example, some banks set a condition for a minimum liquidity and debt ratios, so when the corporation violates the covenant, the loan becomes immediately due, which would end up with their default. A wide array of financial leverage ratios could be referred to, such as:

- **Financial Leverage Ratio = total assets/common equity**

Financial leverage ratio is the most used indicator to measure degree of using external finance resources in a corporate financing structure and to determine the volume of debts per each JD/USD of total assets. This measurement gives an idea of possible risks a corporate would encounter in terms of debt burden. If debt ratio is more than 100 percent, this is an indicator that corporate debt is higher than assets, so they face the highest level of risk. The 40 percent ratio is acceptable for most of industries, the lower this ratio is, the less dependent the corporation is on external funding

In addition to the above ratio, there are Capital Structure and Solvency Ratios that are also needed in financial leverage analysis. These include:

- **Debt Ratio = total debts/total assets**

The total debts to total assets ratio measures the proportion of the corporation's total assets that are financed by creditors, and therefore, the firm's ability to pay its debts. For creditors, the lower this ratio is, the better, as it indicates a lower chance of default on interest payments when they come due. The higher this ratio is, the higher the cost of the corporation. This ratio includes all liabilities, which makes it a more conservative ratio than ratios that only include long-term debt in the numerator.

The short-term debt ratio and long-term debt ratio are used to analyze liquidity and solvency, and so, the ability of the corporation's assets to serve its debt could be determined according to the following formulas:

Short-term debt ratio = short-term debts/total assets

Long-term debt ratio = long-term debts/total assets

- **Debt/Equity = total debts / total shareholders' rights**

The term 'total debts' means all the external financing a corporate acquires corporate. It represents current and long-term liabilities and compares between liabilities and equity. Therefore, it refers to how much of the financing of assets comes from creditors and how much comes from owners. If a leveraged corporation's Return on Assets (RoA) is greater than its cost of financing, this means the corporation



has successfully leveraged and the common shareholders will benefit. However, any increase in revenues at a leveraged corporation will result in an even greater increase in profits and vice versa; any decrease in revenues will also result in an even greater decrease in profits. In this case, management bears the responsibility for determining the best combination of financial structure in order to avoid possible risks, with the need to take the sector in which the corporation works into account. For example, this ratio in the car industry equals 200%, while the ratio is 50% in the computer industry.

To make sure companies do not increase short-term borrowing to finance long-term operations; the financial analyst will resort to calculating ratio of short-term loans for shareholders' benefit in accordance with the formula below:

#### **short-term loans / total shareholders' rights**

It might happen that a corporation would exhaust its long-term borrowing ability due to losing creditors' confidence in existing circumstances or the possibility that the corporation's operations would be affected by political or economic changes. Augmentation of this ratio to almost 67% might be an indicator to imminent risk of the corporation's inability to serve its debts.

For more analysis, long-term debt to capitalization ratio is calculated by dividing long-term debts to available capital according to the following formula:

#### **Long-term loans / (long-term loans + total shareholders' rights (common and preferred shares))**

This ratio clarifies the volume of debt compared to available capital, and compares them to their levels in other companies to determine the volume of risks. Generally, the higher the ratio, the higher the risk.

- **Shareholders equity ratio = shareholders' common shares / total assets**  
This ratio is used to determine the percentage that bearers of common shares will get from total assets in case of liquidation. For example, if a corporation's common stocks are of total assets, and the latter amount to 400 million USD, it means that common equity shareholders will get 140 million USD in case of liquidation (35% × 400 USD).
- **Assets Coverage Ratio = book value of fixed tangible assets + operating capital / total debts**  
This ratio measures how many times a corporation is able to cover its debts (short-term and long-term) through tangible assets, and after paying short-term liabilities. Analysts

often resort to a standard average that sets the acceptable ratio at less than 1.5, and no less than 2 for any corporation.

- **Debt Coverage Ratio = cash flow of operational activities / total debts**  
This ratio measures the corporations' ability to generate annual cash flows from their operational activities to serve their short-term and long-term debts. When this ratio rises, corporations will acquire additional cash flows to cover short-term loans, including the part due from long-term debts as well as total long-term debts.

- **Interest Coverage Ratio = (profits before interest and taxes / interest expense) or (profits before depreciation, interest and taxes / interest expense)**  
It is also called 'times interest earned', and it reflects the corporation's ability to pay its fixed interest expense. In other words, it measures how much the corporate has available for the payment of interest, which denotes a margin of safety that would help corporations pay interest when they come due. Normally, a corporation with strong ability to cover the cost of external financing enjoys a financial position that is capable of facing possible risks. In contrast, a corporation that cannot cover the cost of financing is prone to bankruptcy.

It is clear that a corporate with "times interest earned" ratio less than 1.0 means that the corporation is unable to generate income to cover payments of fixed interest, regardless of the industry in question. Nevertheless, covering interest with ratio of 1.5 is generally considered the minimum safety level for any corporation, whatever the industry is. Upon calculation of coverage, all types of debt should be considered for a full year, and that by distributing interest throughout the year.

- **Long-term debt service coverage = net income from operations / interest expense, required principal payments and annual capital lease payments**  
This ratio assesses the ability of operational cash flows to encounter interest and installments of long-term loans that would be due within a fiscal year. This ratio gains importance since the earnings before interest and taxes are the main source to meet obligations. Although this ratio excludes unusual or infrequent and extraordinary items, it is still an important tool to measure the corporation's ability to service debts. If the ratio is less than 1.0, this indicates negative cash flow, or there are no adequate cash flows to cover debt payments.

Source: Fahmi Mustafa, Financial Analysis, Chapter Five, 2008, © SME Financial , sme@palnet.com

#### **d. File exchange system**

This system has been developed so that the banking system, specialized-lending institutions and the PMA could exchange data with maximum security and safety, provided that it would be available only for officials responsible for sending and receiving data automatically and via the banking network to and from the PMA.

#### **e. Financial and personal data modification system**

As the PMA seeks to develop and automate operations by reducing paperwork, a system to update financial and personal data has been set for borrowers and their guarantors through the Credit Bureau, and in accordance with abovementioned instructions 12/2011. By virtue of this system, paper-based applications to modify data have been cancelled as of 26/12/2011, and an electronic system has been introduced.

#### **f. Automated monthly facilitations reporting service**

This service was introduced to provide monthly reports on credit portfolios and provide them to credit managers at banks and lending institutions, where they will be provided automatically and without referring to the PMA, as paper-based reports have been cancelled.

### **Relation with money changers**

As part of PMA endeavors in following up and organizing the money changing profession, it has set a comprehensive strategy for 2011 in order to organize this profession, and initiated a plan to control and supervise the money changing sector through extensive field visits and eliminating itinerant money changers.

Furthermore, in the course of continuous development and automation of money changing profession, the PMA has compelled money changing firms to utilize a financial and accounting software according to certain basis and specifications in order to guarantee transparency, accuracy and soundness of the Palestinian financial system, and pursuant to circulars 52/2011, 80/2011 and 193/2011. Moneychangers were allowed to determine the appropriate software for each firm and start implementing within the period between 1/4/2011 and 31/7/2011. Additionally, the PMA has issued three new instructions based on presidential decree 13/2008, besides instructions 2/2011 of 5/9/2011, which deal with and regulate procedures for moneychangers' licensing, branching, moving and closing, in addition to license renewal, fees and altering legal form.

Instructions 3/2011 dated 20/12/2012 set permitted and unacceptable actions for money changing firms, such as taking cash deposits or precious metals, offering loans and direct or indirect facilitations, acquiring credit facilitations from banks outside Palestinian Territory, trading in financial derivatives and foreign stock markets and buying all kinds of goods and services.

### **Relation with specialized lending Institutions**

The PMA continues to enforce procedures to regulate specialized lending institutions and put them under supervision, last of which was the 'license and control of specialized lending institutions' code, issued by virtue of the aforementioned presidential decree 132/2011, consistent with this new code and what the banks law 9/2010 stipulates. A new division for controlling and licensing specialized lending institutions has been established, which regulates and controls these institutions and incorporates them within the Palestinian financial system through linking its components with one another, and in a way that realizes integration and guarantees the stability of the Palestinian financial system in general.

## Relation with the public

Having been keen to provide banking services with best possible quality at least possible cost, the PMA gives special care to the relation with the public and invests in enhancing bonds and confidence between different public groups and units of the banking system. To complement continuous development efforts, a new Consumer Awareness and Market Conduct Department has been introduced as part of the PMA's financial stability units, and in accordance with circular 85/2011 dated 19/5/2011. This department takes charge of public awareness and education about their rights and duties upon dealing with the banking system, and follows up on public complaints, where banks –pursuant to circular 68/2011 on 27/4/2011- were compelled to respond to public complaints through an official letter, and in line with the PMA's vision to realize more transparency and professionalism in the relationship between the banking system and the public.

Additionally, the department manages the credit information systems, credit rating and bounced checks, where the PMA has set up a waiting hall last year to receive people dealing with the banking system and specialized lending institutions in order to provide a group of services. The most important of these services is receiving applications filed by the public to get copies from their credit reports and bounced checks, and to object accuracy of the data provided in these reports as stated by instructions 3/2011 mentioned above. These services aim at strengthening public confidence in the Palestinian banking sector and establish transparency and disclosure among banks and clients.

In the same context, banks were compelled, in accordance with circular 34/2011 on 2/3/2011, to review files of check-issuing clients, and to acquire their authorization to disseminate information regarding their status to enquirers, in order to guarantee legal and proper use of checks and to reduce operational risks of the banking system. This step is a prelude to launching a unified information system on the PMA's website for the same purpose. It should be noted that this service would only disseminate information regarding check-issuing clients . Banks were asked to acquire authorization because this service requires full legal coverage in order to maintain the confidentiality of information and avoid disclosure, unless this is done within a legal framework.

The PMA showed great flexibility upon dealing with bounced checks, as it allowed clients to do consensual settlements –as stated in circular 39/2011 on 8/3/2011- with the purpose of modifying their rating in bounced checks system. This circular says that consensual settlements should be done only twice a year for individuals, provided that duration between them should not be less than 6 months, whereas corporates, foundations and associations are allowed to do them three times a year, no less than 4 months apart. The rating of clients is altered in the electronic Bounced Checks System in light of these settlements. The newly-established department follows up on the development of banking products and services as well as their prices, and guarantees transparency and full disclosure of those products and services in line with global developments. Circular 96/2011 on 31/5/2011 compels banks to have PMA consent prior to the launch of any new banking product, including prize programs. It also requests that the information, terms and conditions of these products or prizes be clear, detailed and in a simple language without any vague or overstated promises upon advertising banking products, prize programs or any planned public advertisement campaigns. This comes as part of protecting peoples' rights and enhancing transparency and disclosure of the banking system.

Due to public complaints, especially in the Gaza Strip, about the lack of commitment by banks to pay salaries in the same exchange currency, circular 209/2011 on 29/12/2011 made it imperative for banks to pay salaries in the same currency by which they were transferred, and to provide enough amounts of that currency to pay banks' liabilities. In case this was not possible and banks were forced to pay part of the salaries in different

currencies, banks are compelled to exchange according to exchange rates on Reuters screen with a margin of only 100 points.

As part of its continuous efforts to safeguard the rights of citizens, The PMA has solved all Issues between aggrieved Palestinian workers in Gaza Strip and the National Insurance Institute of Israel, where all items required by the PMA were met and all technical and legal problems were resolved. More than 50 million NIS was paid to workers as accumulated dues after the National Insurance Institute of Israel stopped paying them since early 2009. The PMA's intervention had brought a great direct effect to end the suffering of workers in Gaza Strip and ensuring that workers benefits are collected and transferred regularly on a monthly basis.

Regarding the liquidity crisis in banks, the PMA's continuous efforts helped banks operating in the West Bank to ship cash surplus they have, through the activation of Paris Protocol in terms of relations with the Israeli Central Bank. This led to an interim mechanism to ship 120 million NIS on monthly basis to all Palestinian banks that do not have direct relations with Israeli counterparts. Furthermore, cash was shipped to Gaza Strip and damaged money was replaced in order to cover severe shortage in bank branches there. Nonetheless, efforts are still being made to reach a radical solution that would revive the mutual banking relationship between Palestinian and Israeli banks routinely and without further complications, to guarantee fair banking competition and sustaining financial stability.

### **Box 10: Banking awareness campaigns**

**The PMA has been consistently working to increase banking awareness and disseminate the banking culture amongst people in order to bring up wider comprehension about the nature, kinds and conditions of the services banks provide. Through the aforementioned efforts, the PMA hoped to encourage banks to raise the levels of disclosure and transparency about banking services provided to the public, so as to offer clear and comprehensible information that enable comparison between services. In this context, the PMA has launched a number of awareness campaigns that serve an array of purposes which could be outlined as follows:**

- 1. Initiate the financial awareness campaign under the theme 'Think right... develop your life', supported by ESAF program and in cooperation with the Palestine Capital Market Authority, Palestinian Insurance Federation and the Association of Banks in Palestinian Territory. The campaign included audio-visual and printed media, banners and websites of all parties involved. It aimed at promoting banking awareness amongst those dealing with participating financial institutions and through four phases: 1- Introduction to the importance of financial services 2- Introduction to financial uses 3- Introduction to regulators 4- Explanation of complaints procedures. The campaign lasted four months.**
- 2. Enhance banking awareness amongst the public within a 3-year plan, which has been set based on the results of a field survey which concluded that almost 47 percent of the survey's sample does not deal with banks for different, mainly religious, reasons. Therefore, the campaign put Islamic banks that follow provisions of Islamic sharia under spotlight, and focused on raising public confidence in the banking system and**

its regulators. Within the same context, PMA has established a unit<sup>3</sup> that was tasked with handling complaints filed by the public and to increase banking awareness, as well as managing a page on the PMA website (Arabic and English) for public awareness.

3. Promote public awareness on how to deal properly with moneychangers through an extensive campaign to publish bulletins in local newspapers, electronic media and PMA website.
4. Promote public awareness on permitted and unpermitted actions of moneychangers through advertising in local newspapers, leaflets and audiovisual media, in addition to holding workshops for moneychangers nationwide to guarantee quality service for the public with least cost, and in a way that prevents fraud.
5. Promote public awareness on usurers through advertising in local newspapers, and warning the public from dealing with them as they are considered outlaws, who are not subject to regulation and are not licensed by any official body, and that people should limit their financial deals to banks as they are the only licensed and safe way to deal with deposits and offer facilities, and they fall under the PMA's supervision.
6. Reinforce financial education and banking awareness for students through seminars about the PMA's tasks and objectives, and about the PMA and banking laws, supervision and organizational scope, sectors it regulates and the kinds and significance of banking services.
7. Contribute to the development of the awareness material for home buyers' guide of the mortgage market development program that is issued by the CHF.

## International relations

- **Joining reserves advisory and management program (RAMP) of the World Bank's treasury;** the program intends to provide advisory and training services to central banks' investment managers, and to introduce advanced technical capacities that add to efficient management of foreign reserves and other portfolios. According to this program, 100 million USD was invested for the benefit of the PMA, as well as training PMA reserves management staff and developing their skills in reserve and risk management. This will be done through training courses and workshops that will last over the next three years, and special accounts have been provided for all Monetary Operations Department staff<sup>6]</sup> on the comprehensive educational website, offered by the World Bank.

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<sup>6]</sup> During 2011, the PMA Board of Directors adopted the Basic Principles for Management of Foreign Reserves, based on the best international standards in the field. The adoption followed recommendations made by the World Bank, International Monetary Fund and the PMA Investment Committee. A procedural and moral guideline for the Monetary Operation Department was approved, as well as another guideline for operations of investment unit, in line with the latest international standards in investment and treasury fields. The Monetary Operations Department also started operating the Open Market Operations Division, with help from West Bank experts in, which will be tasked with issuing monetary tools such as certificates of deposit at central bank, and managing the issuance of government debt tools on behalf of the Palestinian government.

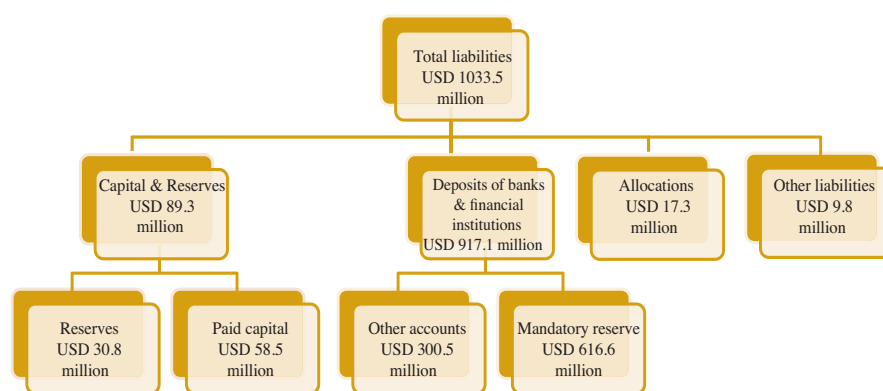
- **Gaining membership of the child and youth finance international (CYFI) in Holland:** this was to raise financial awareness and education for children and youth to develop their capacities in dealing with financial products and services, and to realize principles of incorporation and financial partnership for all society groups.
- **Joining the international network on financial education (INFE),** which is a subordinate to the Organization for Economic Cooperation and Development (OECD). This will contribute to raising financial awareness at schools and to making use of such effort abroad.
- **Publishing several english reports on performance and development of the banking system** in several international financial websites and journals, such as the website of International Capital Market in London, Bloomberg, LinkedIn, Ogarit Journal and others.

## Financial activity of the PMA

Data on The PMA's financial activity indicate a drop in assets (table 4-3) by 11.2 percent to reach USD 1033.5 million by the end of 2011, compared to 2010. The main cause of this decrease liabilities was a 13.2 percent (USD 139 million) drop in deposits of banks and financial institutions at the PMA compared to 2010, as a result of the decline in the 'other accounts' item by USD 140.1 million (31.8 percent compared to 2010). It is noteworthy that other accounts include all bank deposits at the PMA beside required reserves, together with banks' investment accounts and that portion of capital foreign banks are required to deposit at the PMA, in addition to settlement accounts (or current accounts) used for clearance and transfer purposes. Therefore, these accounts are prone to fluctuate according to banks' day-to-day activities. It should be mentioned that the relative importance of banks and financial institutions' deposits at the PMA retreated to 88.7 percent of total liabilities by end of 2011 (90.7 percent in 2010).

The second item of liabilities which witnessed slight decline by 0.6 percent is reserves (general reserves and re-evaluation reserves), and this is because of the drop seen in re-evaluation reserve by 7.7 percent, whereas general reserve remained standing at 28.8 million USD. Regarding the rest of liabilities, they scored a growth at varying rates, as the required reserves item went up by 0.2 percent as a result of the increase seen in customer deposits at 2.5 percent in 2011 compared to 2010.

Figure 4-2: The PMA's liabilities structure, 2011



Source: PMA.

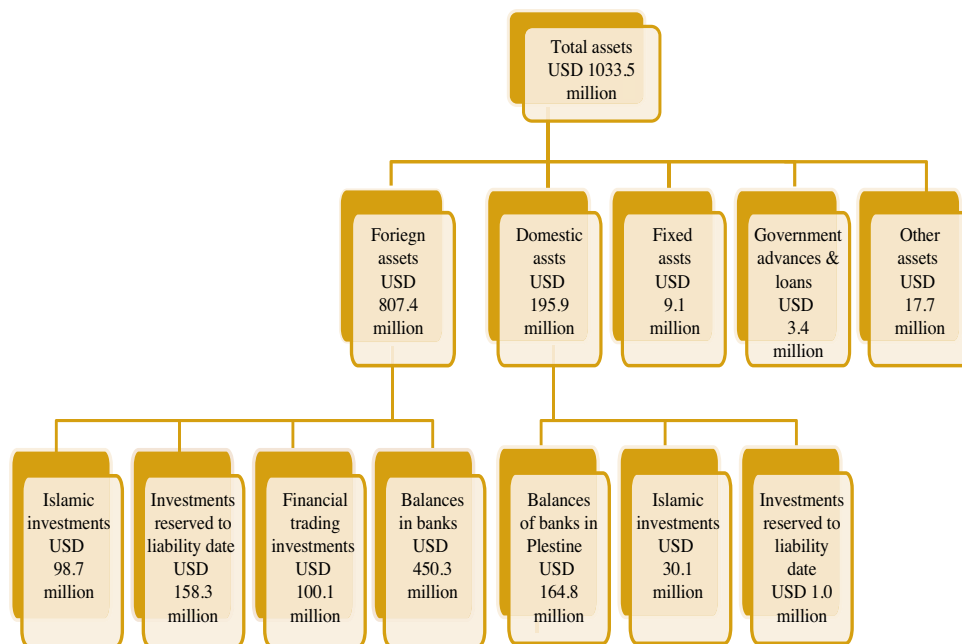
The paid-up capital has risen by 7 percent to reach USD 58.5 million, as part of efforts to support PMA capital to gradually reach USD 120 million. It is worth mentioning that paid-up capital has been increased for the second



time to reach USD 120 million<sup>[7]</sup>, following the PMA board's recommendation and based on a study prepared in cooperation with the IMF. This step was driven by the individuality of the Palestinian banking system and its associated risks and responsibility of the PMA to take precautions against these risks. As a result of capital increase, the capital and reserves item in the PMA balance sheet has grown by 43.3 percent to reach USD 89.3 million (about USD 85.6 million in 2010).

As for the source of decline in assets, PMA balances abroad dropped by 41.1 percent (consistent with the drop in the 'other accounts' item of liabilities), in order to meet with banks' withdrawals and demand for liquidity. Also, the PMA's current deposits and Islamic investments at local banks declined by 71.6 percent and 27.1 percent respectively, where current deposits have reached USD 4.2 million by the end of 2011 (USD 14.8 million by end of 2010), while Islamic investments were USD 30.1 million, against 41.3 million during 2010.

**Figure 4-3: The PMA's assets structure, 2011**



Source: PMA.

The PMA's Foreign assets constitute 78.2 percent of the total assets by the end of 2011 (80.1 percent in 2010). The percentage of local assets (Islamic investments and balances at local banks) went up to 19 percent of total assets by the end of 2011 (16.8 percent by end of 2010).

Speaking of profits and losses (table 4-4), they showed a growth in net interest and investment profits at 9.7 percent in 2011 (14.5 percent in the previous year). Even though, revenues declined by 27.3 percent, reaching up to USD 18.6 million by the end of 2011 due to payback of provision of cases by USD 10 million in 2010. As for expenses, they reached USD 14.5 million, falling back by 28.9 percent from the previous year. This drop in expenses is attributed to provision for doubtful debts to 2 million USD in 2011 (USD 10 million in 2010), whereas staff expenses went up by around 28.4 percent to reach USD 9.5 million, against USD 7.4 million in 2010. Administrative expenses, on the other hand, remained within level achieved in 2010 (USD 2.1 million).

<sup>[7]</sup> PMA capital has been increased for the first time in 2007, when the board, following presidential consent, has decided to raise the declared capital from 15 million USD to 60 millions, as part of strategic transform plan towards the Palestinian Central Bank in the future, and in order to guarantee that PMA undertakes entrusted tasks.



Net result of revenue and expense items has shown net profits at USD 3.8 million by the end of 2011 (USD 4.7 million in 2010), scoring a decline of 19.1 percent; all of net profit was completely transferred to the PMA's paid-up capital account.

## The PMA's staff

The PMA kept improving staff (table 3-5) through attracting technical and professional competencies and skills appropriate to work at different PMA departments, where staff went up to stand at 332, a raise of 40 in 2011, of which 25 employees went to core departments (financial stability group and monetary stability group).

It is noteworthy that this increase came as part of a policy adopted by the PMA to focus on employing fresh graduates, and within "the excellence" program, which focuses on attracting outstanding college graduates in specialties that have to do with nature of PMA's work, only after they pass recruitment exams and interviews, after which successful candidates would be recruited.

The PMA kept increasing technical and professional competency and capacities of staff, according to their specialties, through various professional programs and courses, covering different aspects and specialties of PMA departments (table 3-6), and carried out at the finest local and international institutions.

Within the same context, the PMA has managed to train, establish and develop banking staff in the PT through courses and programs provided by the Financial Follow-up Unit and the Palestine Institute for Financial and Banking Studies (PIFBS). Through the Financial Follow-up Unit<sup>[8]</sup>, the PMA trained 72 financial sector employees for 60 training hours (banks, the PCMA, insurance companies, brokerage companies and stock exchange market) according to a specialized anti-money laundry curriculum, in which trainees get a certificate on anti-money laundry in Palestinian Territory. It also took part in the training of compliance officers and IT staff at banks on how to extract bank statements, in accordance to GOAML requirements, in addition to many specialized money laundry lectures for Palestinian college students.

Through the PIFBS<sup>[9]</sup>, the PMA trained more than 12,500 financial and banking employees since its establishment back in 1999. As part of the same efforts, three major courses were initiated in 2011 in order to promote modern quality training that is responsive to the immediate and long-term needs of the financial and banking sectors, which are:

**Course I: Professional diplomas and certificates:** Three specialized diplomas were executed:

1. Business risk management, diploma (150 training hours).
2. Auditing diploma (150 training hours).

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<sup>[8]</sup> The Financial Follow-up Unit was established pursuant to the Anti-Money Laundry Law 9/2007 as an independent unit positioned at PMA offices. The unit aims at fighting money laundry, protecting the national economy against negative impacts brought by this crime, raising the quality of anti-money laundry procedures and system in Palestine and operating local cooperation frameworks with all involved authorities. The unit is supervised by the National Anti-Money Laundry Committee, which draws policies to fight this crime and devise an effective prevention system.

<sup>[9]</sup> The Palestine Institute for Financial and Banking Studies was established in 1999 pursuant to PMA Law 2/1997 and Banking Law 2/2002. It is an independent non-profit institution, where the panel comprises 19 members representing the PMA and banks operating in Palestine. The 9-member board is headed by the PMA governor. The PIFBS' goal is to disseminate financial and banking knowledge, train, and develop the capacities of financial and banking staff in Palestine.

3. Training of trainers program (75 training hours).

Additionally, the following professional programs have been carried out:

1. Certified lender diploma
2. Certified branch manager diploma
3. Six sigma black belt (in cooperation with Arizona State University, US)

**Course II: Short-term program:** 78 training programs have been accomplished, including courses on the role of the press in banking awareness, work ethics, Palestinian Income Tax Law, banking cards and banking marketing, as well as training programs in Jordan.

Programs of 2011 included the Palestine Anti-Money Laundering Accreditation (PAMLA) certificate program, which has been carried out by the PMA Financial Follow-up Unit. The program witnessed remarkable success, and specialized anti-money laundry training material was developed in cooperation with Modernizing Financial Institution (MFI), with the help of international experts in the field, where two Arabic and English versions have been released.

**Course III: Agreements with local and international institutions such as:**

- **Agreement with the American Certifications Center**  
An exclusive agreement to provide international professional certification programs and that ACC is the exclusive testing center. This agreement is a qualitative leap in the programs and services ACC offers, where it rises to the international certification level.
- **Agreement with the Jordanian Institute of Banking Studies**  
The Institute's director general signed the agreement that is expected to generate cooperation with BSI to develop training.
- **An understanding with international organizations was made to offer training programs by international experts to raise administrative, supervisory and leadership skills.**
- **An agreement with Investment Training and Consulting Center/ALQUDS University:**  
To provide a professional diploma program in investment portfolios and financial risk management.

# Part II: Palestinian Banking Sector Developments

## Overview

The year 2011 was an extension to previous years in terms of performance level and continuous improvement to vital indicators of the Palestinian banking system. Such achievements were the fruits of the PMA's tireless efforts to promote the Palestinian banking sector. With the application of the best international standards and practices, adherence to governance principles, development of infrastructure and addressing weak banks, the banking system fostered public's confidence, which was consequently reflected in positive changes in the system's financial indicators. As such, assets have grown, customer deposits have increased, the quality of the credit portfolio has enhanced and the role of the banking system has become essential to stimulate and boost economic development.

Raising the paid-up capital of banks operating in the PT helped increasing their capacity to encounter expected and unexpected risks; especially the year 2011 has witnessed an increase in degree of exposure of the Palestinian banking system.

## Consolidated balance sheet

Developments of the banking system's assets is one of the main indicators denoting improvement of performance. In this regard, financial data of the consolidated balance sheet for banks operating in the PT indicate a growth in most of the major items during 2011 compared with the previous year. This increase is mainly caused by a remarkable boom to the value of direct facilities in terms of assets, against an increase in most of liabilities with varying rates. The following are the most important components of assets and liabilities of the Palestinian banking system balance sheet during 2011.

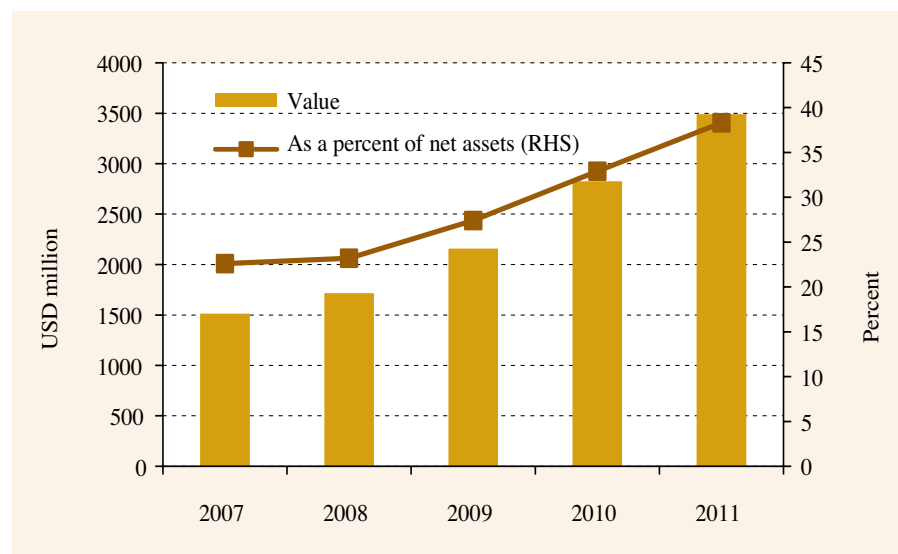
### *a. Assets*

Most of asset items of the Palestinian banking system showed an unstable increase compared to the previous year as shown below:

#### **Direct credit facilities portfolio (net)**

This one is by far considered the most important component of assets of banks operating in the Palestinian Territory, whether

Figure 4-4: Direct credit facilities, 2007-2011



Source: PMA.

in terms of relative importance or being an important foundation of the banking system in general, represented by financial brokerage between economic sectors with surplus (deposits) and economic sectors with deficit (credit facilities).

As a product of the relative stability in economic conditions, the relative importance for this item went up to 38.3 percent (USD 3491 million) of banks' net assets by the end of 2011, with a growth rate of 23.6 percent (USD 667.4 million) compared to the previous year. It could be deduced from historic data that this item is increasing over the years, whether in terms of value or relative weight of banks' net assets.

In light of liquidity pressures that the PNA suffers, the public sector's share reached 31 percent by the end of 2011 because of extended credit, against a drop of the private sector's share to 69 percent. The public sector has acquired USD 1101 million worth of facilities with an increase of 31.5 percent (USD 263.8 million) compared to the end of 2010.

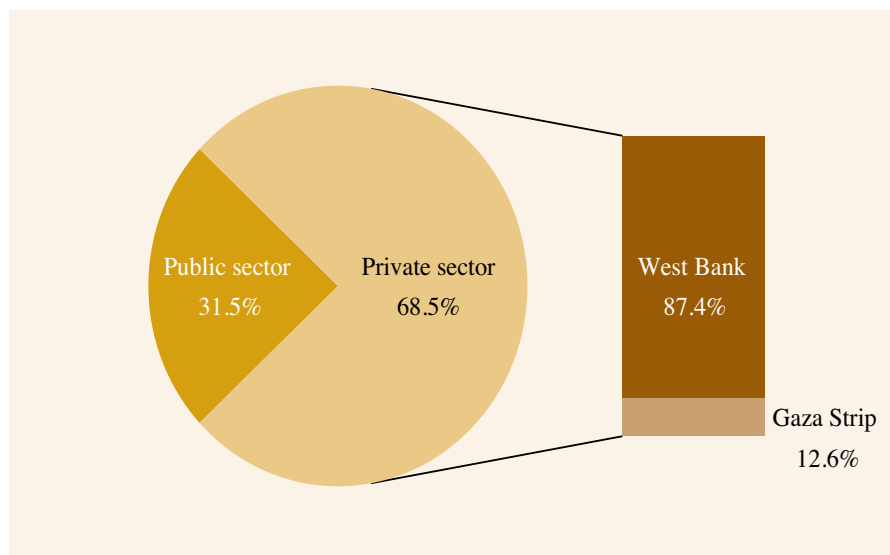
Therefore, facilities given to the public sector constituted about 93 percent of property rights for banks operating in the Palestinian Territory, and the reason behind that is the severe financial crisis the Palestinian government suffered from during 2011 due to the decline of foreign budget support, which pushed it to borrow from local banks to cover expenses and try to fulfill obligations.

The overstated lending to the public sector in view of flow hardship the government suffers might have many direct consequences to the stability of the banking system, the most significant of which is the increase to incidents in which the government temporarily defaults on its loans, in addition to indirect consequences such as the faltering of loans extended to government employees or its private-sector suppliers, in case the government failed to pay salaries or meet financial obligations. .

On the other hand, facilities extended in the West Bank were 91.4 percent of total credit facilities<sup>[10]</sup> (USD 3191 million), against 8.6 percent (USD 300 million) in Gaza Strip. Facilities provided to the private sector reached 87.4 percent for the West Bank and 12.6 percent for Gaza Strip.

It should be mentioned that the credit facilities portfolio is composed of loans worth of USD 2497.1 million

**Figure 4-5: Credit facilities by sector, 2011**

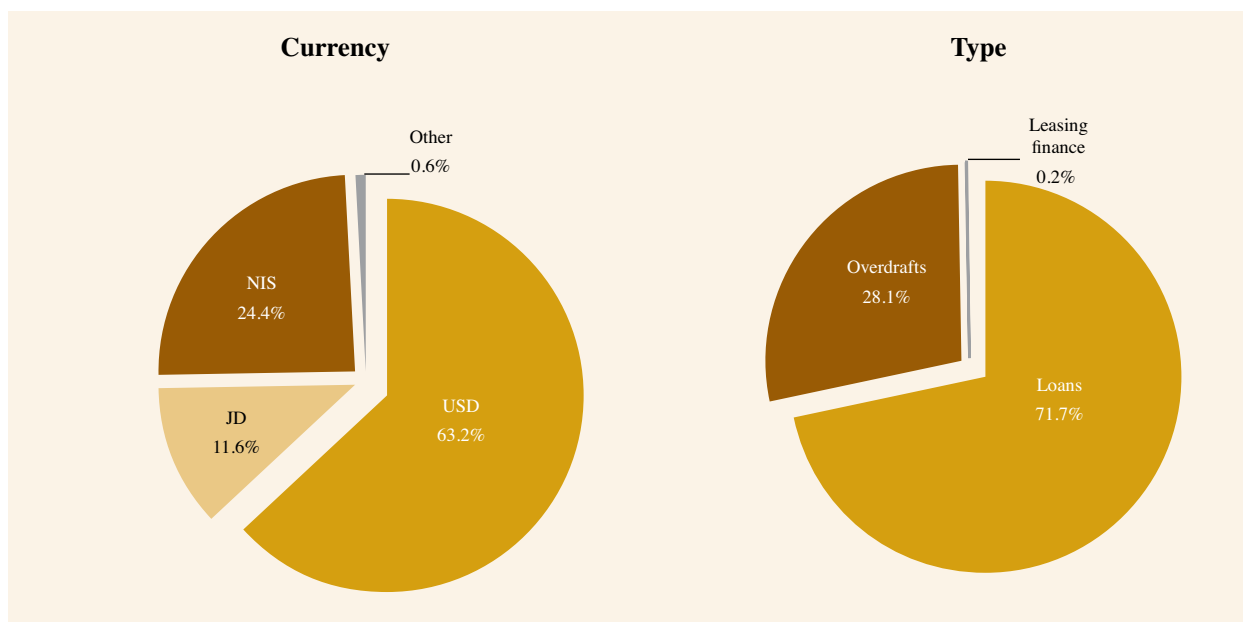


Source: PMA.

[10] West Bank's share includes facilities provided to the public sector.

(71.7 percent of total portfolio), overdrafts<sup>[11]</sup> of USD 985.8 million (28.1 percent), and leasing finance of USD 8.1 million (0.2 percent of total facilities portfolio). This structure is also divided according to the different currencies used in the Palestinian banking system, where the USD share was 63.2 percent (USD 2207.1 million), followed by NIS at 24.4 percent (USD 851.2 million) and then JD at 11.8 percent (USD 412.7 million), while the remaining percentage (0.6 percent) with USD 20 million was given in other currencies such as the Euro and the Sterling Pound.

**Figure 4-6: Distribution of facilities by type and currency, 2011**



Source: PMA.

In light of the aforementioned developments, the loans/deposits ratio went up from 42.4 percent in 2010 to 50.9 percent in 2011. The volume of non-performing loans has also risen from USD 88.5 million to USD 98.2 million during the same period. As the credit portfolio grew, the percentage of non-performing loans decreased from 3.1 percent to 2.8 percent of total portfolio. It is also worth mentioning that the coverage of credit facilities provisions has reached 61 percent.

### Securities portfolio

This portfolio consists of debt securities and equity investment, as the data in the banks' consolidated balance sheet indicate that the debt portfolio rose by USD 9.3 million (4.3 percent) in 2011, reaching up to USD 826.3 million. Its relative importance, however, declined to 9.1 percent of net assets, against 9.3 percent at the end of 2010. The banks equity investment portfolio rose to USD 137.4 million at the end of 2011 (an increase of 11.5 percent from 2010). These investments are focused in subsidiary and affiliate companies, and in minority shares.

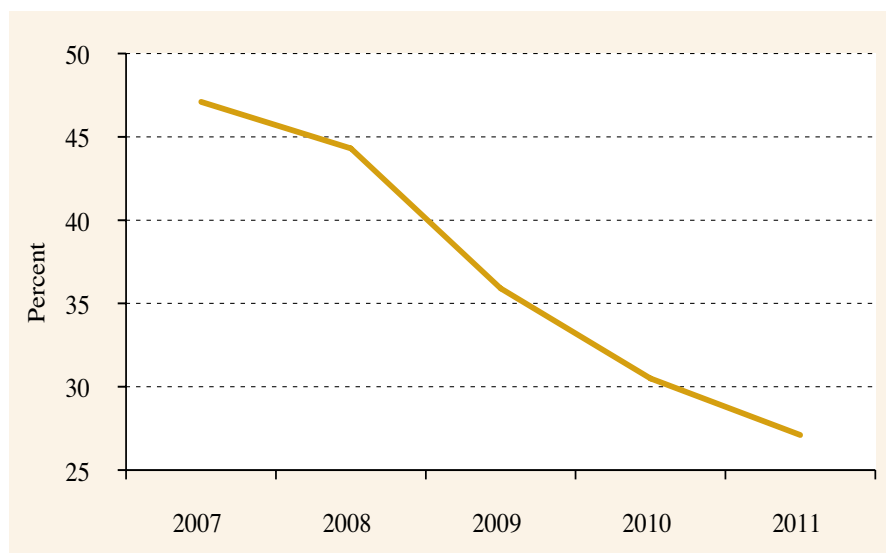
<sup>[11]</sup> According to PMA instructions (5/2008) dated 29/12/2008 (article 5/6/10-paragraph 2), balance of overdrafts must not exceed 30 percent of total banks' credit facilitations portfolio.

### Balances with banks in the PT

Balances with banks in PT constituted 3.7 percent of net assets (USD 335.3 million) by end of 2011, scoring an increase of 32.9 percent up from the level of 2010. It should be mentioned that these balances are prone to constant fluctuations, as banks withdraw or deposit to and from these balances continuously.

The remaining assets items witnessed varying decline in 2011, the most important of which were:

Figure 4-7: Foreign balances as a percent of net assets, 2007-2011

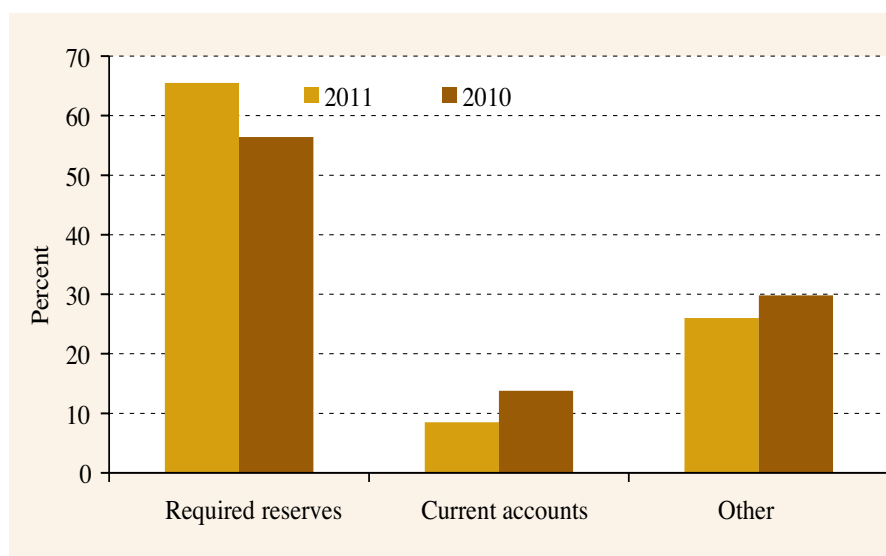


Source: PMA.

### Balances at banks outside Palestinian Territory

This item is one of the basic components of assets and foreign investments for banks operating in the Palestinian Territory, where it formed 27.1 percent of banks assets at the end of 2011 (USD 2467.5 million). This item declined by 5.9 percent below the level of 2010, given that the relative weight of these balances in the net assets structure is declining from one year to another.

Figure 4-8: Relative importance of bank balances at PMA, 2010 & 2011



Source: PMA.

### Banks balances at the PMA

They reached USD 940.9 million (a decrease of 12.5 percent from 2010), and about 10 percent of net bank assets. Banks keep balances at the PMA in the form of required reserve accounts, settlement (current) accounts and other accounts.

## Cash

This item reached USD 496.7 million by the end of 2011 (a decline of 8.5 percent) compared to the previous year. This item constituted 5.4 percent of net assets at the end of 2011.

## Other items

Represented in banking acceptances, whose contribution remains moderate, whether in terms of value or relative weight in net assets, and with a value not exceeding USD 5.9 million at end of 2011 (USD 3.6 million in the previous year). Another component is the fixed assets, which include: lands and real-estate used in banking operations, assets reserved to be re-sold and some other tangible and intangible assets. The value of this item reached USD 174.9 million at end of 2011, an increase by 21.2 percent from the previous year. Other assets (include items in course of collection) saw an increase by 19.2 percent in 2011 compared to 2010, reaching up to USD 240.1 million (2.6 percent of net assets).

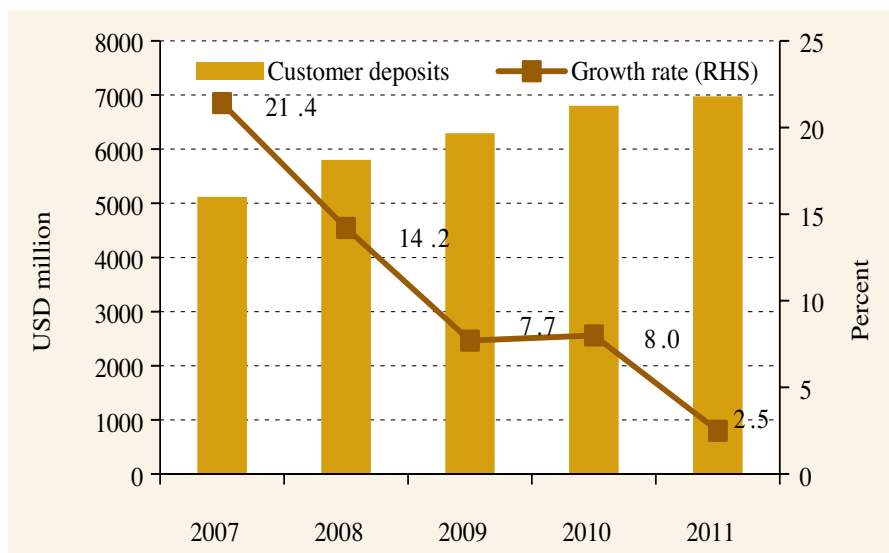
## b. Liabilities

### Customer deposits (non-bank deposits)

Customer deposits are the main component of liabilities, where the importance of this item comes from being one of the major external financing resources for banks, together with its continuous increase throughout the past years. It is characterized by the upward trend, where customer deposits have grown by 2.5 percent in 2011 (USD 170.3 million), and reached USD 6972.7 million by the end of the same year compared with the previous one. These

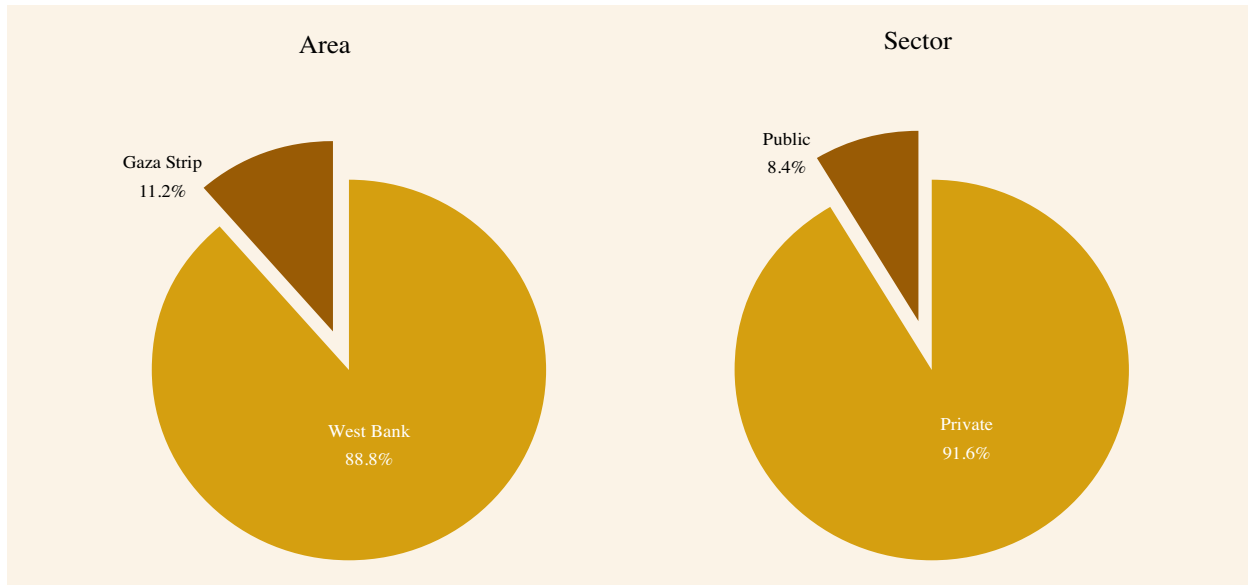
deposits were around 76.5 percent of liabilities at the end of 2011, and historic data indicate that customer deposits are continuously growing from one year to another, albeit to varying rates. Political developments during the past years might have caused this disparity.

Figure 4-9: Customer deposits, 2007-2011



Source: PMA.

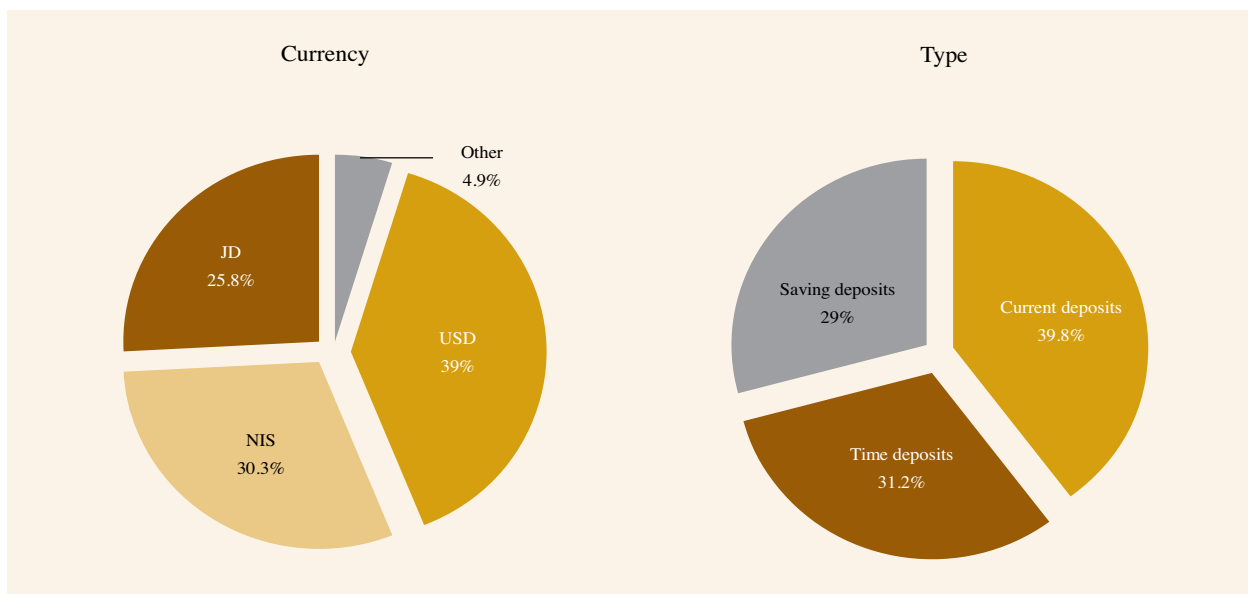
**Figure 4-10 : Distribution of customer deposits by sector and area, 2011**



Source: PMA.

These deposits have been distributed between the public and private sectors, whether resident and non-resident, at 8.4 percent (USD 584.5 million) and 91.6 percent (USD 6388.2 million USD) respectively in 2011. Geographically speaking, they were distributed at 88.8 percent (USD 6194.2 million) for the West Bank, and 11.2 percent (USD 778.3 million) for Gaza Strip . These rates were relatively stable during the past two years.

**Figure 4-11 : Distribution of customer deposits by type and currency, 2011**



Source: PMA.

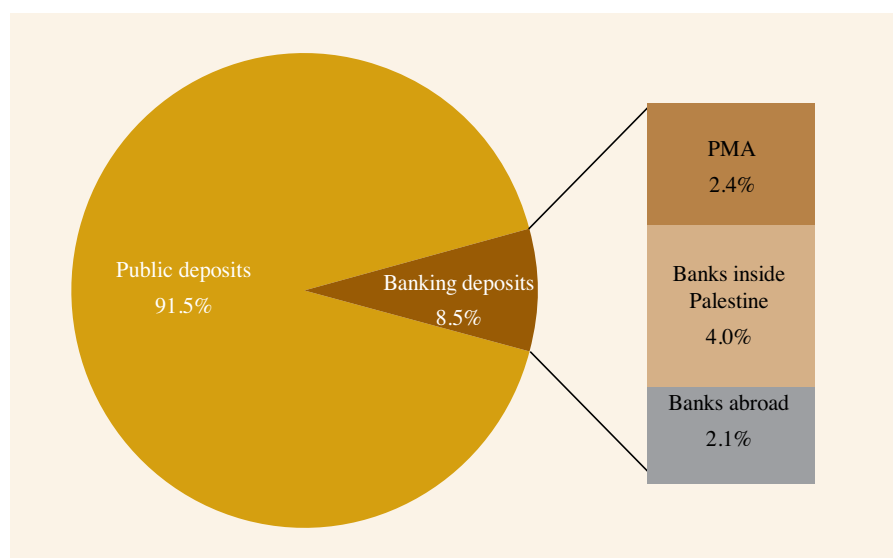


The USD acquired the biggest portion of customer deposits, with a value of USD 2718.7 million (39.0 percent), followed by the NIS, with a value estimated at USD 2115.8 million (30.3 percent), the JD (USD 1801.4 million) and other currencies, with a value of USD 336.8 million (4.9 percent). It is noteworthy that the share of both customer deposits in USD and JD have declined from 44.5 percent and 27.2 percent, respectively, at the end of 2008 to 39 percent and 25.8 percent, in the same order, at the end of 2010, all against an increase to the NIS share from 22.1 percent to 30.3 percent during the same period. The Distribution of customer deposits varied according to type within the same period, where the share of current deposits was 39.8 percent (USD 2773 million), time deposits (31.2 percent, or USD 2172.6 million) and saving deposits acquired 29.1 percent (USD 2027.1 million).

### Bank deposits

These deposits are made up of deposits of the PMA, deposits of banks in PT and deposits of banks abroad. These deposits combined totaled USD 646.5 million USD, 7.1 percent of net bank liabilities, and around 8.5 percent of total deposits at the end of 2011. Deposits of the PMA rose by 8.1 percent in 2011 to reach USD 178.9 million, representing 2 percent of net liabilities. The deposits of banks in PT also went up to 48.9 percent (USD 304.7 million) at the end of 2011. As for the deposits of banks abroad, the total has reached around USD 162.9 million at the end of 2011.

Figure 4-12: Banking and non-banking deposits structure, 2011



Source: PMA.

### Net equity (capital)

Equity rights are of special interest to the PMA, where bank's capital is the primary line of defense against expected and unexpected risks. This item has been characterized by positive growth for the past years. By the end of 2011, net equity rights of banks operating in the PT reached USD 1184.5 million, scoring a growth of 8.4 percent (USD 91.9 million), compared to the same period the previous year.

Basically, equity rights are composed of: the paid-up capital that constituted 73.8 percent in 2011 (USD 874.6 million), legal reserve formed 8.1 percent (USD 95.8 million), general reserves of banking operations at 4.9 percent

(USD 57.7 million) and declared reserves at 3.9 percent (USD 45 million), in addition to some other items with low rates such as surplus capital and retained earnings.

### Executed and outstanding acceptances

Those are payable acceptances for banks operating inside and outside the Palestinian Territory, where the value of this item topped USD 16.2 million at the end of 2011, rising by 4.5 percent compared to 2010.

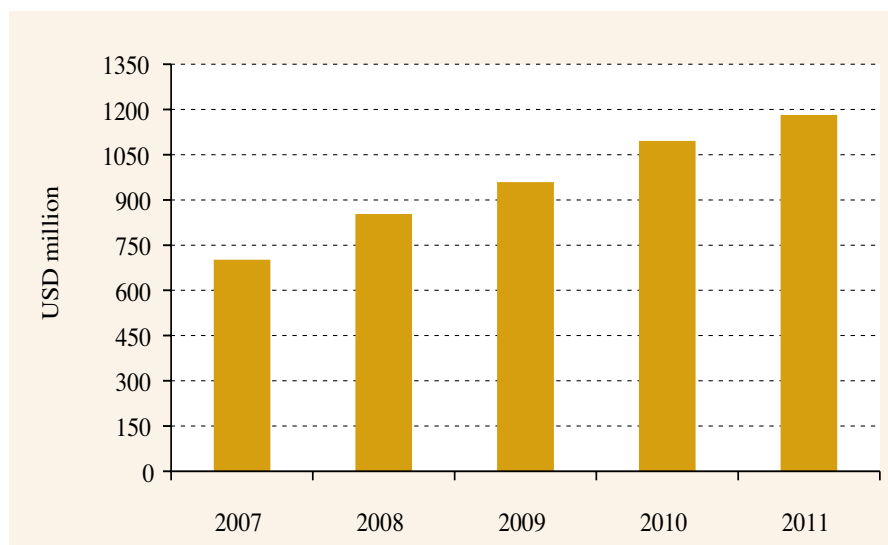
### Other liabilities

They include credit items in course of transmission, accrued interest payable and some other items. The value of this item was USD 122.8 million (an increase of 12.9 percent, or USD 14.1 million) compared to 2010.

### Provisions

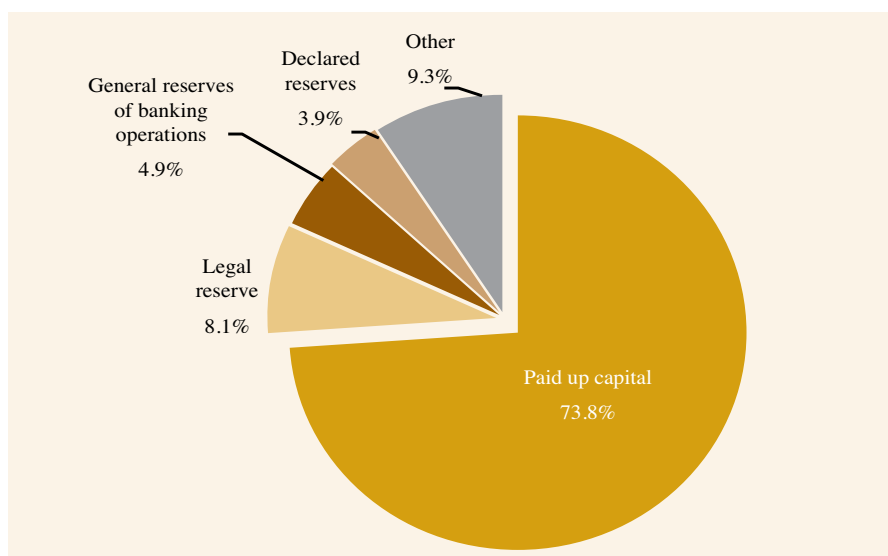
They include tax and other provisions. The two items combined amounted to about USD 173.1 million at the end of 2011, with an increase of USD 25.2 million against 2010 (an increase of 17 percent).

Figure 4-13: Ownership equity (net) of banks, 2007-2011



Source: PMA.

Figure 4-14: Ownership equity (net) Structure, 2011



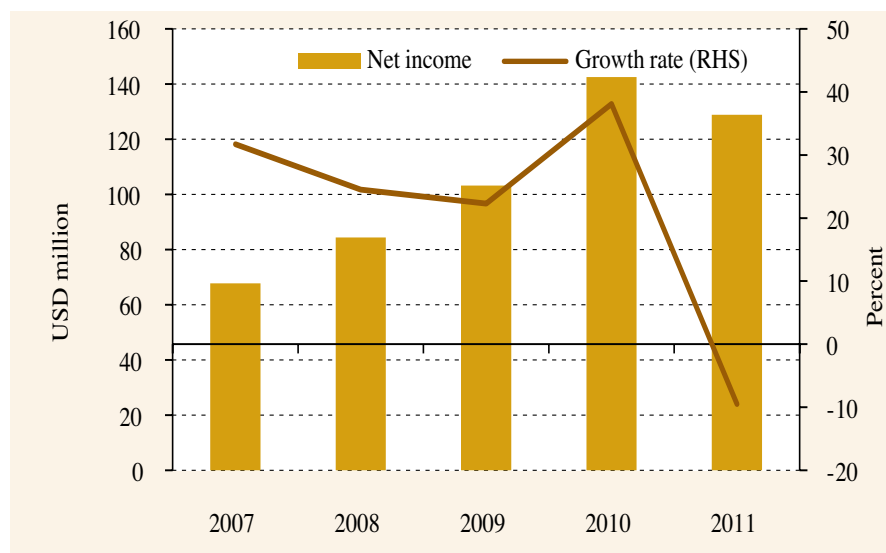
Source: PMA.

## Profits and losses

Banks operating in the PT frequently make profits throughout the years, albeit the growth in these profits differ from one year to another. The year 2011 is no exception, when banks have achieved net profits of USD 128.9 million, falling down by 7.9 percent (USD 11.1 million) below the level of 2010. This could be explained by observing net non-interest income, especially for debt

securities and investment, which remarkably decreased by the end of 2011 (27.5 percent).

Figure 4-15: Net income for banks operating in the Palestinian Territory, 2007-2011



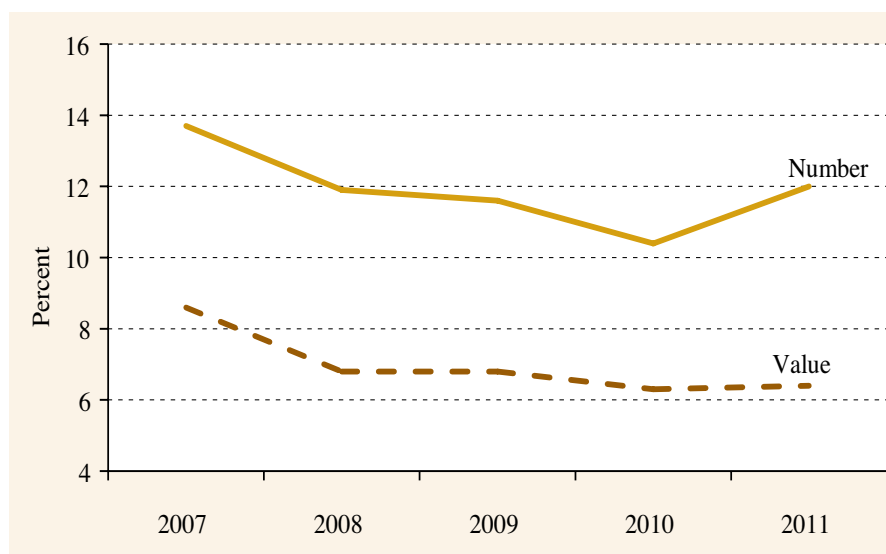
Source: PMA.

## Clearing house activities

Data of the PMA Clearing Houses state that total cheques submitted for clearance in currencies used in the Palestinian market in 2011 have reached 4,050,255 cheques, with a value of USD 11,895 million. On the other hand, the number of bounced cheques was 488,126 (USD 758.0 million). When comparing with 2010, we find that a growth of 11.7 percent has been achieved in the number of cheques and a 24.3 percent in their value.

In parallel with that, bounced cheques have risen by 30 percent in terms of number, and by 26.6 percent in terms of value, which caused a boom in number of cheques returned for

Figure 4-16: Bounced cheques as a percent of clearance, 2011



Source: PMA.

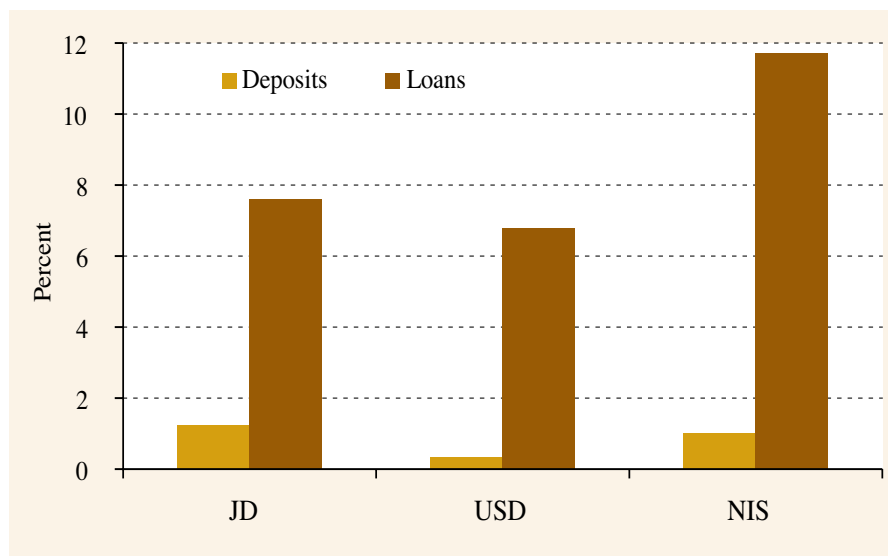
clearance by 1.6 percentage points during 2011 to reach 12 percent, compared to 2010, whereas cheques returned for clearance stood at 6.4 percent in terms of value, with no notable change.

## Interest rates

The absence of a national currency in the PT prevents the use of adequate monetary tools. During 2011, the average interest rate on deposits in JD reached 1.22 percent, rising by 0.7 percentage points over the rate of 2010. The interest rate on credit facilities in JD was 7.81 percent (0.3 percentage point over 2010), while interest rates on the USD reached 0.33 percent for deposits (0.4 percentage points increase), and 6.86 percent for facilities (0.5 percentage points increase)

during the comparison period. The interest rate on deposits in NIS was 1.02 percent (an increase of 0.7 percentage points) and 11.22 percent for facilities (an increase of 0.3 percentage points for the same comparison period).

**Figure 4-17: Deposits & lending average interest rates in currencies used in the Palestinian Territory, 2011**



Source: PMA.

# Part III: Non Banking Financial Institutions Developments

## Overview

Non-bank financial institutions are supervised by two oversight bodies; specialized lending institutions and money exchange companies are supervised by the PMA, while the Palestine Stock Exchange, insurance companies, leasing finance companies and mortgage companies are supervised by the Palestine Capital Market Authority (PCMA).

Although these institutions have witnessed notable improvements lately, especially regarding the legislative environment, they remain in need of further support and activation of their role in the national economy, in general, and the financial system in particular. The following are the most important developments seen by these institutions in 2011.

## Money changers

The number of money changers licensed by the PMA in 2011 rose to 292 (10 have got preliminary approval), 248 of them are in the West Bank and 44 in Gaza Strip. Regarding the legal form, there are 162 money changers that are legally set-up as corporates and 132 are single proprietorships. It should be mentioned here that supervision and oversight for money exchange companies have been separated as an independent division within the PMA's Supervision and Inspection Department, where these tasks were originally within the responsibility of Micro-Finance Institutions Supervision Division, which includes supervision over specialized lending institutions.

## Specialized lending institutions

As part of efforts to organize and control conditions of specialized lending institutions, the 'Specialized Lending Institutions Licensing and Supervision' statute was issued by the presidential decree 132/2011. Also, a new department has been established for licensing, supervising and linking these institutions with other components of the financial system, which is meant to realize integration and guarantee the stability of the Palestinian financial system in general.

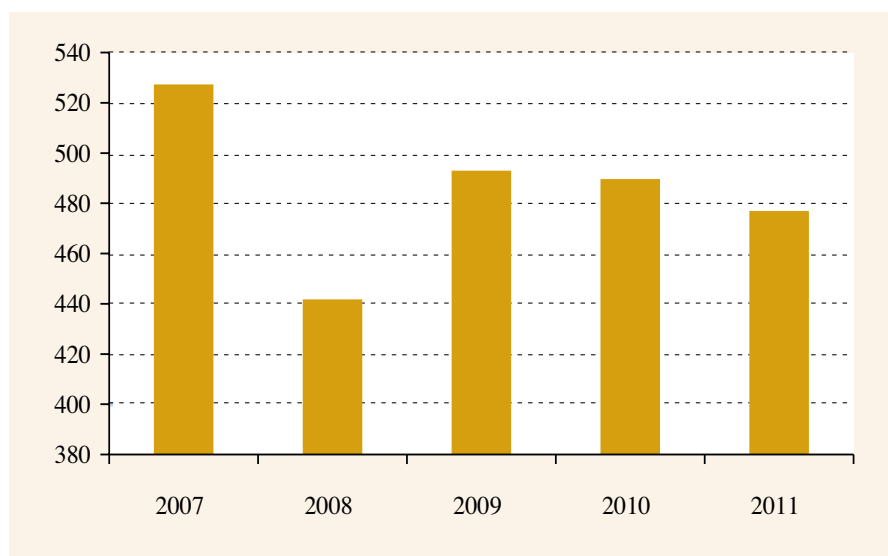
The specialized lending institutions have been listed at the Credit Bureau, to enable enquiries about prospective borrowers. It is anticipated that detailed instructions and guidelines on the licensing and organization of these institutions will be issued during 2012.

## Palestine stock exchange

In 2011, ALQUDS Index fell by about 12.7 points (a fall of 2.6 percent compared to 2010), closing at the end of the year at 476.9 points (489.6 points in 2010). This came as a result of the drop witnessed by all sectors' indexes, with the exclusion of the banking and financial services index. There has been a drop in the indices of investment (10.48 percent), insurance (3.65 percent), industry (1.45 percent) and services (1.15 percent), whereas banks and financial services indicator went up by 0.72 percent.

On the other side, the number of companies listed in the Palestine Stock Exchange grew by 7 companies in 2011, reaching up to 46 companies (8 banks, 11 industrial companies, 7 insurance companies, 8 investment companies and 12 service companies). The number of brokerage companies listed in PEX stood at 10, as was in 2010.

Figure 4-18: Al-Quds index of PEX, 2007-2011



Source: PCMA.

In terms of PEX trading volume, the number of trading sessions went down at the end of 2011 by one session below the previous year (248 in 2010), while the number of shares traded fell by about 20 percent. However, the market value of shares traded rose by 13.6 percent during the year, compared to what has been in 2010 (USD 2782.5 million).

The rate of daily deals decreased by 25 percent to 250 deals per day in 2011 against 322 deals per day in the previous year. The daily rate of shares traded declined by 20 percent (0.7 million shares everyday), so the daily rate of shares traded went down by 18.6 percent (USD 1.5 million daily), which was negatively reflected in the cash flow levels<sup>[12]</sup> at PEX, dropping by around 5.2 points to reach 13.1 percent, compared to 2010.

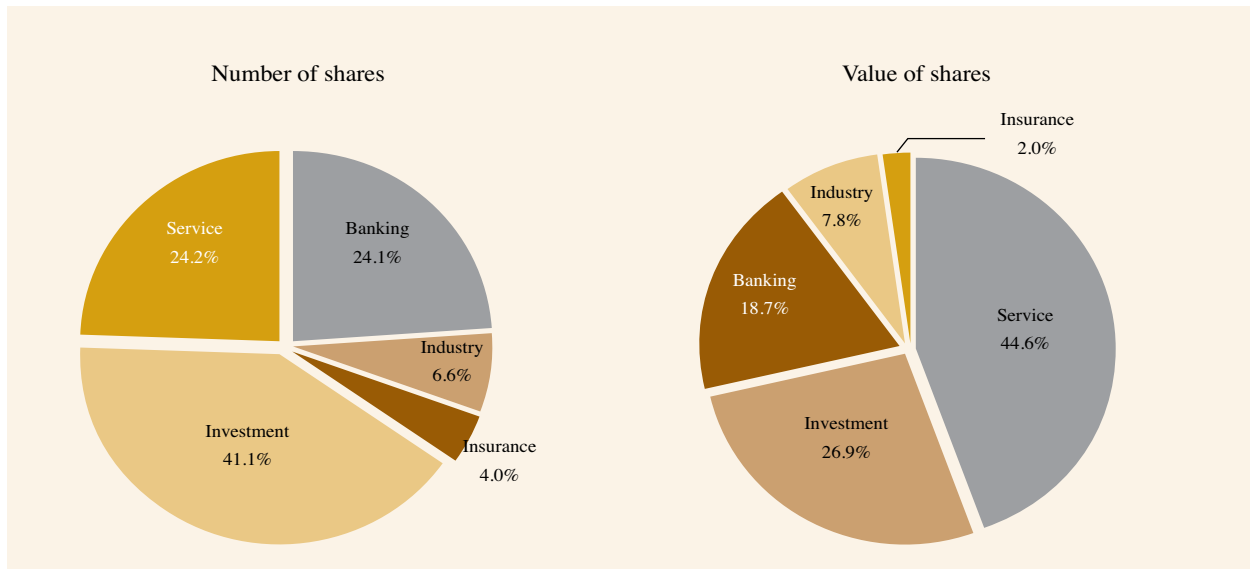
Regarding the distribution of shares traded in different sectors, the service sector came first in terms of value (44.6 percent of the total value of shares traded), climbing up by 0.7 percent from the previous year, followed by investment (26.9 percent), banks and financial services (18.7 percent), which fell back by 0.6 percent, and industry and insurance sectors (7.8 percent and 2.0 percent respectively).

As for the number of shares traded, the biggest portion went to investment companies (41 percent of total shares traded), decreasing by 1.2 points from the previous year. The banking and services sectors have achieved

<sup>[12]</sup> Cash flow level indicator is value of shares traded / market value of shares traded.

similar rates (24.2 percent and 24.1 percent respectively), and the rest of shares were distributed to industry and insurance sectors (6.6 percent and 4.0 percent respectively).

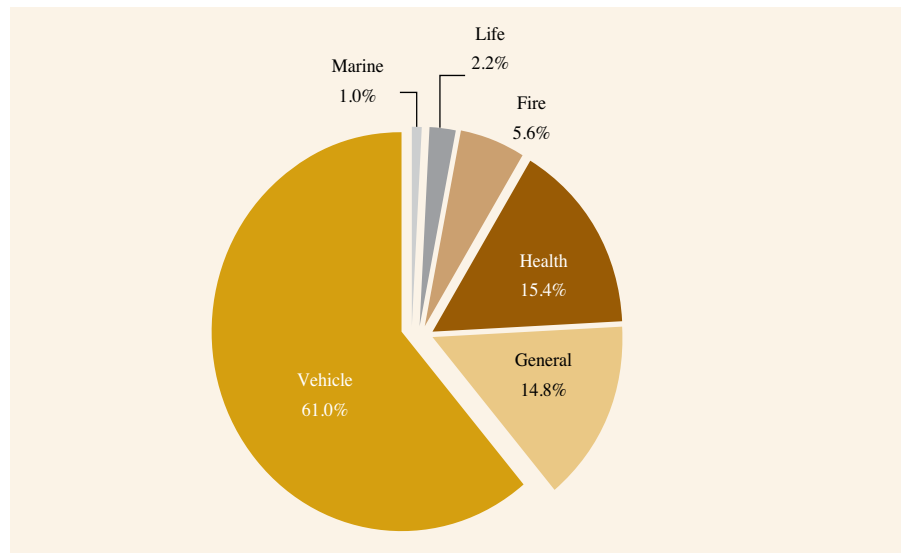
**Figure 4-19: Number & value of traded shares by sector, 2011**



Source: PEX.

At the regional level, PEX has achieved the lowest decline rate, compared to Arab stock exchanges that dropped in 2011. Arab stock exchanges have all declined except for Iraq, which scored an increase by 34.7 percent, and Qatar stock exchange, whose index went up by 1.1 percent compared to 2010. On the other hand, the PEX's membership to the World Federation of Exchanges has been promoted to a supporting member in 2011, and this promotion would bring wider horizons to promote investment opportunities and attract international investments.

**Figure 4-20: Contribution of insurance activities in insurance sector, 2011**



Source: PCMA.

## Insurance companies

Supervised by the PCMA, this continuously growing sector is witnessing many improvements to performance. Data available about this sector show an increase in total insurance company assets by 8.4 percent in 2011 when compared to 2010, beside an increase to paid-up capital by 1.3 percent (USD 63 million). Profits went up as well by 124 percent, against a growth of 78 percent in 2010 (USD 4 million).

Even though the number of insurance companies in 2011 in the PT stood at 10, the number of branches shrank to 99 (103 branches in 2010). The number of agents has also dropped to 239 (265 agents in 2010).

Concerning the contribution of different insurance activities in the sector during 2011, vehicle insurance premiums were 61 percent of total premiums (USD 91.8 million), while health insurance and general and engineering insurance premiums were 15.4 percent and 14.8 percent respectively. The rest was divided between fire insurance (5.6 percent), life insurance (2.2 percent) and marine insurance (1.0 percent).

## Mortgage and leasing companies

Both sectors still suffering absence of proper organizational and legal environment, since both are newly-introduced to the PT. The Leasing Draft Law has been approved in 2011, and the number of leasing companies has reached 8, whereas there were only two mortgage companies by the end of the year (same as the previous year) with total assets of USD 69 million, and new 7 appraisers have been licensed.



# Appendices







# Chapter One

## Global and Local Economic Developments

## Part I: Global Economic Performance

Table (1-1): Real global GDP, 2007-2011

(Annual percent change)

| Country                                  | 2007          | 2008          | 2009          | 2010          | 2011          |
|--|---------------|---------------|---------------|---------------|---------------|
| <b>World</b>                             | <b>5.2</b>    | <b>3.2</b>    | <b>-0.5</b>   | <b>5.3</b>    | <b>3.9</b>    |
| <b>Developed countries</b>               | <b>2.8</b>    | <b>0.0</b>    | <b>-3.5</b>   | <b>3.2</b>    | <b>1.6</b>    |
| United States                            | 1.9           | 1.1           | -2.6          | 3.0           | 1.7           |
| Euro area                                | 3.0           | 0.4           | -4.3          | 1.9           | 1.4           |
| Germany                                  | 3.4           | 0.8           | -5.1          | 3.6           | 3.1           |
| France                                   | 2.2           | -0.2          | -2.6          | 1.4           | 1.7           |
| Italy                                    | 1.7           | -1.2          | -5.5          | 1.8           | 0.4           |
| Japan                                    | 2.2           | -1.0          | -5.5          | 4.4           | -0.7          |
| United Kingdom                           | 3.5           | -1.1          | -4.4          | 2.1           | 0.7           |
| Canada                                   | 2.2           | 0.7           | -2.8          | 3.2           | 2.5           |
| Israel                                   | 5.5           | 4.0           | 0.8           | 4.8           | 4.7           |
| Major developed countries                | 2.2           | -0.4          | -4.0          | 3.0           | 1.4           |
| Newly industrialized Asian countries     | 5.9           | 1.8           | -0.7          | 8.5           | 4.0           |
| <b>Emerging and Developing Countries</b> | <b>8.7</b>    | <b>6.0</b>    | <b>2.8</b>    | <b>7.5</b>    | <b>6.2</b>    |
| Africa- Sub-Saharan                      | 7.1           | 5.6           | 2.8           | 5.3           | 5.1           |
| Central and Eastern Europe               | 5.4           | 3.2           | -3.6          | 4.5           | 5.3           |
| Commonwealth of Independent States       | 9.0           | 5.4           | -6.4          | 4.8           | 4.9           |
| Developing Asia                          | 11.4          | 7.8           | 7.1           | 9.7           | 7.8           |
| China                                    | 14.2          | 9.6           | 9.2           | 10.4          | 9.2           |
| India                                    | 10.0          | 6.2           | 6.6           | 10.6          | 7.2           |
| <b>Middle East and North Africa</b>      | <b>5.6</b>    | <b>4.7</b>    | <b>2.7</b>    | <b>4.9</b>    | <b>3.5</b>    |
| Egypt                                    | 7.1           | 7.2           | 4.7           | 5.1           | 1.8           |
| Jordan                                   | 8.2           | 7.2           | 5.5           | 2.3           | 2.5           |
| Lebanon                                  | 7.5           | 9.3           | 8.5           | 7.0           | 1.5           |
| Saudi Arabia                             | 2.0           | 4.2           | 0.1           | 4.6           | 6.8           |
| Latin America and the Caribbean          | 5.8           | 4.2           | -1.6          | 6.2           | 4.5           |
| Brazil                                   | 6.1           | 5.2           | -0.3          | 7.5           | 2.7           |
| Mexico                                   | 3.2           | 1.2           | -6.3          | 5.5           | 4.0           |
| <b>At Market Exchange Rates</b>          | <b>55,678</b> | <b>61,167</b> | <b>57,761</b> | <b>63,075</b> | <b>69,660</b> |
| <b>At Purchasing Power Parities</b>      | <b>66,755</b> | <b>70,030</b> | <b>70,139</b> | <b>74,604</b> | <b>78,897</b> |

Source: World Economic Outlook, International Monetary Fund, April 2012.

Table (1-2): Global inflation rates, 2007-2011

(Annual percent change)

| Country                                  | 2007       | 2008       | 2009       | 2010       | 2011       |
|--|------------|------------|------------|------------|------------|
| <b>Developed countries</b>               | <b>2.2</b> | <b>3.4</b> | <b>0.1</b> | <b>1.5</b> | <b>2.7</b> |
| United States                            | 2.9        | 3.8        | -0.3       | 1.6        | 3.1        |
| Euro area                                | 2.1        | 3.3        | 0.3        | 1.6        | 2.7        |
| Germany                                  | 2.3        | 2.8        | 0.2        | 1.2        | 2.5        |
| France                                   | 1.6        | 3.2        | 0.1        | 1.7        | 2.3        |
| Italy                                    | 2.0        | 3.5        | 0.8        | 1.6        | 2.9        |
| Japan                                    | 0.1        | 1.4        | -1.3       | -0.7       | 0.3-       |
| United Kingdom                           | 2.3        | 3.6        | 2.1        | 3.3        | 4.5        |
| Canada                                   | 2.1        | 2.4        | 0.3        | 1.8        | 2.9        |
| Israel                                   | 0.5        | 4.6        | 3.3        | 2.7        | 3.4        |
| Major developed countries                | 2.2        | 3.2        | -0.1       | 1.4        | 2.6        |
| Newly industrialized Asian countries     | 2.2        | 4.5        | 1.3        | 2.3        | 3.6        |
| <b>Emerging and Developing Countries</b> | <b>6.5</b> | <b>9.2</b> | <b>5.2</b> | <b>6.1</b> | <b>7.1</b> |
| Africa- Sub-Saharan                      | 6.9        | 11.7       | 10.6       | 7.4        | 8.2        |
| Central and Eastern Europe               | 6.0        | 8.1        | 4.7        | 5.3        | 5.3        |
| Commonwealth of Independent States       | 9.7        | 15.6       | 11.2       | 7.2        | 10.1       |
| Developing Asia                          | 5.4        | 7.4        | 3.0        | 5.7        | 6.5        |
| China                                    | 4.8        | 5.9        | -0.7       | 3.3        | 5.4        |
| India                                    | 6.4        | 8.3        | 10.9       | 12.0       | 8.6        |
| Middle East and North Africa             | 10.1       | 13.6       | 6.6        | 6.9        | 9.6        |
| Egypt                                    | 11.0       | 11.7       | 16.2       | 11.7       | 11.1       |
| Jordan                                   | 4.7        | 13.9       | -0.7       | 5.0        | 4.4        |
| Lebanon                                  | 4.1        | 10.8       | 1.2        | 4.5        | 5.0        |
| Saudi Arabia                             | 4.1        | 9.9        | 5.1        | 5.4        | 5.0        |
| Latin America and the Caribbean          | 5.4        | 7.9        | 6.0        | 6.0        | 6.6        |
| Brazil                                   | 3.6        | 5.7        | 4.9        | 5.0        | 6.6        |
| Mexico                                   | 4.0        | 5.1        | 5.3        | 4.2        | 3.4        |

Source: World Economic Outlook, International Monetary Fund, April 2012.

**Table (1-3): Developed economies: unemployment, 2007-2011**

(Annual percent change)

| Country                    | 2007       | 2008       | 2009       | 2010       | 2011       |
|----------------------------|------------|------------|------------|------------|------------|
| <b>Developed countries</b> | <b>5.4</b> | <b>5.8</b> | <b>8.0</b> | <b>8.3</b> | <b>7.9</b> |
| United States              | 4.6        | 5.8        | 9.3        | 9.7        | 9.0        |
| Euro area                  | 7.6        | 7.7        | 9.6        | 10.1       | 10.1       |
| Germany                    | 8.8        | 7.6        | 7.7        | 7.1        | 6.0        |
| France                     | 8.4        | 7.8        | 9.5        | 9.8        | 9.7        |
| Italy                      | 6.1        | 6.8        | 7.8        | 8.4        | 8.4        |
| Japan                      | 3.8        | 4.0        | 5.1        | 5.1        | 4.6        |
| United Kingdom             | 5.4        | 5.6        | 7.5        | 7.9        | 8.0        |
| Canada                     | 6.0        | 6.2        | 8.3        | 8.0        | 7.5        |
| Israel                     | 7.3        | 6.2        | 7.6        | 6.7        | 5.6        |
| Major developed countries  | 3.4        | 3.4        | 4.3        | 4.1        | 3.6        |

Source: World Economic Outlook, International Monetary Fund, April 2012.

**Table (1-4): Interest rates of main currencies, 2007-2011**

(period end, percentage)

| Country        | 2007 | 2008 | 2009 | 2010 | 2011 |
|----------------|------|------|------|------|------|
| United States  | 4.25 | 0.13 | 0.25 | 0.25 | 0.25 |
| Euro area      | 4.00 | 2.50 | 1.00 | 1.00 | 1.00 |
| United Kingdom | 5.50 | 2.00 | 0.50 | 0.50 | 0.50 |
| Japan          | 0.50 | 0.10 | 0.10 | 0.10 | 0.10 |
| Canada         | 4.25 | 1.50 | 0.25 | 1.00 | 1.00 |

Source: World Economic Outlook, International Monetary Fund, April 2012.

**Table (1-5): Global trade volume, 2007-2011**

(Annual percent change)

| Country                                     | 2007   | 2008   | 2009   | 2010   | 2011   |
|---|--------|--------|--------|--------|--------|
| <b>Total World Trade</b>                    | 7.9    | 2.9    | -10.5  | 12.9   | 5.8    |
| <b>Exports</b>                              |        |        |        |        |        |
| Developed Countries                         | 6.8    | 1.9    | -11.5  | 12.2   | 5.3    |
| Emerging and Developing Countries           | 10.5   | 4.7    | -7.7   | 14.7   | 6.7    |
| <b>Imports</b>                              |        |        |        |        |        |
| Developed Countries                         | 5.2    | 0.5    | -12.2  | 11.5   | 4.3    |
| Emerging and Developing Countries           | 14.9   | 9.0    | -8.1   | 15.3   | 8.8    |
| <b>Export of Goods</b>                      |        |        |        |        |        |
| Developed Countries                         | 5.8    | 1.5    | -13.3  | 14.0   | 5.7    |
| Emerging and Developing Countries           | 9.5    | 4.3    | -8.4   | 15.0   | 6.4    |
| <b>Import of Goods</b>                      |        |        |        |        |        |
| Developed Countries                         | 4.7    | -0.1   | -13.1  | 13.3   | 5.1    |
| Emerging and Developing Countries           | 14.3   | 8.3    | -9.3   | 16.0   | 9.4    |
| <b>Change in Terms of Trade</b>             |        |        |        |        |        |
| Developed Countries                         | 0.3    | -2.0   | 2.3    | -1.0   | -1.7   |
| Emerging and Developing Countries           | 1.1    | 2.9    | -4.3   | 2.0    | 3.2    |
| <b>Total Value of Exports (USD Billion)</b> |        |        |        |        |        |
| Goods and Services                          | 17,248 | 19,707 | 15,755 | 18,758 | 21,982 |
| Goods                                       | 13,868 | 15,902 | 12,383 | 15,084 | 17,958 |

Source: World Economic Outlook, International Monetary Fund, April 2012.

**Table (1-6): Balances on current account, 2007-2011**

(percent of GDP)

| Country                                  | 2007        | 2008        | 2009        | 2010        | 2011        |
|--|-------------|-------------|-------------|-------------|-------------|
| <b>Developed countries</b>               | <b>-0.8</b> | <b>-1.2</b> | <b>-0.2</b> | <b>-0.2</b> | <b>-0.4</b> |
| United States                            | -5.1        | -4.7        | -2.7        | -3.2        | -3.1        |
| Euro area                                | 0.4         | -0.7        | 0.0         | 0.3         | 0.3         |
| <b>Emerging and Developing Countries</b> | <b>4.0</b>  | <b>3.5</b>  | <b>1.6</b>  | <b>1.9</b>  | <b>1.9</b>  |
| Africa- Sub-Saharan                      | 1.5         | 0.1         | -3.1        | -2.4        | -1.8        |
| Central and Eastern Europe               | -8.3        | -8.3        | -3.1        | -4.7        | -6.0        |
| Commonwealth of Independent States       | 4.2         | 5.0         | 2.5         | 3.7         | 4.6         |
| Developing Asia                          | 6.6         | 5.5         | 3.8         | 3.2         | 1.8         |
| Middle East and North Africa             | 14.6        | 15.2        | 2.5         | 7.8         | 13.2        |
| Latin America and the Caribbean          | 0.4         | -0.7        | -0.6        | -1.1        | -1.2        |

Source: World Economic Outlook, International Monetary Fund, April 2012.



Table (1-7): Foreign direct investment (FDI) inflows, 2007-2011

(USD Billion)

| Country                                  | 2007             | 2008             | 2009             | 2010             | 2011             |
|--|------------------|------------------|------------------|------------------|------------------|
| <b>World</b>                             | <b>1,975,537</b> | <b>1,790,706</b> | <b>1,197,824</b> | <b>1,309,001</b> | <b>1,524,422</b> |
| <b>Developed countries</b>               | <b>1,310,425</b> | <b>1,019,648</b> | <b>606,212</b>   | <b>618,586</b>   | <b>747,860</b>   |
| United States                            | 215,952          | 306,366          | 143,604          | 197,905          | 226,937          |
| Euro area                                | 553,422          | 357,171          | 245,254          | 253,473          | 307,348          |
| Germany                                  | 80,208           | 8,109            | 24,156           | 46,860           | 40,402           |
| France                                   | 96,221           | 64,184           | 24,219           | 30,638           | 40,945           |
| Italy                                    | 43,849           | -10,835          | 20,077           | 9,178            | 29,059           |
| United Kingdom                           | 196,390          | 91,489           | 71,140           | 50,604           | 53,949           |
| Japan                                    | 22,550           | 24,426           | 11,938           | -1,252           | -1,758           |
| Canada                                   | 114,652          | 57,177           | 21,406           | 23,413           | 40,932           |
| Israel                                   | 8,798            | 10,875           | 4,607            | 5,510            | 11,374           |
| <b>Emerging and Developing Countries</b> | <b>665,111</b>   | <b>771,058</b>   | <b>591,611</b>   | <b>690,416</b>   | <b>776,562</b>   |
| China                                    | 83,521           | 108,312          | 95,000           | 114,734          | 123,985          |
| Hong Kong                                | 54,341           | 59,621           | 52,394           | 71,069           | 83,156           |
| Singapore                                | 46,930           | 11,798           | 24,418           | 48,637           | 64,003           |
| Brazil                                   | 34,585           | 45,058           | 25,949           | 48,506           | 66,660           |
| Mexico                                   | 31,492           | 27,140           | 16,119           | 20,709           | 19,554           |
| Turkey                                   | 22,047           | 19,504           | 8,411            | 9,038            | 15,876           |
| <b>Arab Countries</b>                    | <b>80,485</b>    | <b>96,263</b>    | <b>76,309</b>    | <b>65,140</b>    | <b>40,724</b>    |
| Egypt                                    | 11,578           | 9,495            | 6,712            | 6,386            | -483             |
| Marocco                                  | 2,805            | 2,487            | 1,952            | 1,574            | 2,519            |
| Tunisia                                  | 1,616            | 2,759            | 1,688            | 1,513            | 1,143            |
| Sudan                                    | 2,426            | 2,601            | 1,816            | 2,064            | 1,936            |
| Lebanon                                  | 3,376            | 4,333            | 4,804            | 4,280            | 3,200            |
| Saudi Arabia                             | 22,821           | 38,151           | 32,100           | 28,105           | 16,400           |
| UAE                                      | 14,187           | 13,724           | 4,003            | 5,500            | 7,679            |
| Jordan                                   | 2,622            | 2,826            | 2,413            | 1,651            | 1,469            |
| Palestinian Territory                    | 28               | 52               | 301              | 180              | 214              |

Source: World Investment Reports, United Nations Conference on Trade and Development (UNCTAD), various years.

**Table (1-8): Emerging and developing countries: change in reserves, 2007-2011**

(USD Billion)

| Country                                  | 2007          | 2008         | 2009         | 2010         | 2011         |
|--|---------------|--------------|--------------|--------------|--------------|
| <b>Emerging and Developing Countries</b> | <b>1210.0</b> | <b>724.9</b> | <b>520.3</b> | <b>873.8</b> | <b>831.6</b> |
| Africa- Sub-Saharan                      | 28.4          | 19.1         | -10.5        | 3.5          | 20.9         |
| Central and Eastern Europe               | 36.4          | 4.0          | 29.0         | 36.8         | 14.4         |
| Commonwealth of Independent States       | 168.0         | -27.0        | 7.9          | 52.7         | 44.0         |
| Developing Asia                          | 612.2         | 491.5        | 467.3        | 584.5        | 468.5        |
| Middle East and North Africa             | 231.2         | 186.6        | 49.7         | 104.6        | 164.4        |
| Latin America and the Caribbean          | 231.2         | 186.6        | -23.1        | 91.7         | 119.4        |

Source: World Economic Outlook, International Monetary Fund, April 2012.

**Table (1-9): Emerging and developing countries: external debt, 2007-2011**

| Country                                  | 2007  | 2008          | 2009          | 2010          | 2011          |
|--|---|---------------|---------------|---------------|---------------|
|  | <b>External Debt (USD Billion)</b>                  |               |               |               |               |
| <b>Emerging and Developing Countries</b> | <b>4357.3</b>                                       | <b>4649.2</b> | <b>4892.8</b> | <b>5443.4</b> | <b>5982.5</b> |
| Africa- Sub-Saharan                      | 203.7   | 211.4         | 222.1         | 246.4         | 266.7         |
| Central and Eastern Europe               | 924.0   | 1024.3        | 1119.9        | 1145.5        | 1208.8        |
| Commonwealth of Independent States       | 681.8   | 731.4         | 737.5         | 790.6         | 801.0         |
| Developing Asia                          | 1057.9  | 1123.2        | 1223.2        | 1476.6        | 1711.8        |
| Middle East and North Africa             | 650.4   | 689.7         | 703.5         | 742.3         | 760.4         |
| Latin America and the Caribbean          | 839.5   | 869.2         | 886.8         | 1042.0        | 1233.9        |
|  | <b>Percent of GDP</b>                               |               |               |               |               |
| <b>Emerging and Developing Countries</b> | <b>27.6</b>   | <b>24.3</b>   | <b>27.0</b>   | <b>25.2</b>   | <b>23.8</b>   |
| Africa- Sub-Saharan                      | 24.6  | 22.5          | 24.8          | 23.6          | 22.2          |
| Central and Eastern Europe               | 56.8  | 53.5          | 70.3          | 65.6          | 63.6          |
| Commonwealth of Independent States       | 39.9  | 33.6          | 45.0          | 39.9          | 32.9          |
| Developing Asia                          | 17.4  | 15.1          | 15.4          | 15.5          | 15.1          |
| Middle East and North Africa             | 34.9  | 29.6          | 34.1          | 30.9          | 27.9          |
| Latin America and the Caribbean          | 22.7  | 20.2          | 22.0          | 21.3          | 22.0          |
|  | <b>Percent of Total Exports</b>                     |               |               |               |               |
| <b>Emerging and Developing Countries</b> | <b>76.8</b>   | <b>67.1</b>   | <b>90.2</b>   | <b>79.7</b>   | <b>72.1</b>   |
| Africa- Sub-Saharan                      | 64.6  | 54.0          | 75.7          | 66.3          | 58.6          |
| Central and Eastern Europe               | 157.1   | 143.5         | 197.7         | 178.7         | 159.1         |
| Commonwealth of Independent States       | 115.4   | 92.2          | 139.5         | 116.9         | 89.8          |
| Developing Asia                          | 46.1  | 41.6          | 53.4          | 49.5          | 48.3          |
| Middle East and North Africa             | 64.6  | 52.5          | 74.5          | 63.9          | 53.5          |
| Latin America and the Caribbean          | 96.0  | 85.9          | 110.9         | 104.4         | 101.0         |
|  | <b>External Debt Service Payments (USD Billion)</b> |               |               |               |               |
| <b>Emerging and Developing Countries</b> | <b>1443.2</b>                                       | <b>1782.3</b> | <b>1754.6</b> | <b>1781.1</b> | <b>2123.7</b> |
| Africa- Sub-Saharan                      | 52.9  | 59.3          | 54.4          | 58.3          | 54.7          |
| Central and Eastern Europe               | 289.1   | 395.7         | 404.4         | 377.8         | 422.1         |
| Commonwealth of Independent States       | 230.5   | 316.9         | 251.7         | 243.5         | 264.2         |
| Developing Asia                          | 436.1   | 511.1         | 531.6         | 581.3         | 798.9         |
| Middle East and North Africa             | 139.6   | 187.1         | 195.2         | 207.2         | 216.8         |
| Latin America and the Caribbean          | 295.0   | 311.4         | 317.3         | 313.1         | 367.0         |
|  | <b>Percentage of GDP</b>                            |               |               |               |               |
| <b>Emerging and Developing Countries</b> | <b>9.1</b>  | <b>9.3</b>    | <b>9.7</b>    | <b>8.2</b>    | <b>8.4</b>    |
| Africa- Sub-Saharan                      | 6.4   | 6.3           | 6.1           | 5.6           | 4.6           |
| Central and Eastern Europe               | 17.8  | 20.7          | 25.4          | 21.7          | 22.3          |
| Commonwealth of Independent States       | 13.5  | 14.5          | 15.4          | 12.3          | 10.8          |
| Developing Asia                          | 7.2   | 6.9           | 6.7           | 6.1           | 7.1           |
| Middle East and North Africa             | 7.5   | 8.0           | 9.5           | 8.6           | 7.9           |
| Latin America and the Caribbean          | 8.0   | 7.2           | 7.9           | 6.4           | 6.5           |
|  | <b>Percentage of Total Exports</b>                  |               |               |               |               |
| <b>Emerging and Developing Countries</b> | <b>25.5</b>   | <b>25.8</b>   | <b>32.4</b>   | <b>26.1</b>   | <b>25.6</b>   |
| Africa- Sub-Saharan                      | 16.6  | 15.2          | 18.7          | 15.8          | 12.2          |
| Central and Eastern Europe               | 49.3  | 55.6          | 71.6          | 59.1          | 55.7          |
| Commonwealth of Independent States       | 39.0  | 40.0          | 47.6          | 36.0          | 29.7          |
| Developing Asia                          | 19.0  | 19.0          | 23.2          | 19.5          | 22.6          |
| Middle East and North Africa             | 13.9  | 14.2          | 20.7          | 17.9          | 15.3          |
| Latin America and the Caribbean          | 33.7  | 30.8          | 39.6          | 31.4          | 30.0          |

Source: World Economic Outlook, International Monetary Fund, April 2012.

## Part II: Domestic Economic Performance

Table (1-10): Palestinian Territory: real GDP and GDI, 2007-2011

(base year: 2004)

(USD Million)

| Activity                          | 2007           | 2008           | 2009           | 2010           | 2011           |
|-----------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>A) Productive Sectors</b>      | <b>1,246.9</b> | <b>1,361.6</b> | <b>1,370.9</b> | <b>1,615.3</b> | <b>1,853.0</b> |
| <b>Agriculture and Fishing</b>    | <b>252.2</b>   | <b>286.1</b>   | <b>293.2</b>   | <b>314.9</b>   | <b>346.1</b>   |
| <b>Industry</b>                   | <b>695.6</b>   | <b>761.1</b>   | <b>690.0</b>   | <b>742.5</b>   | <b>798.7</b>   |
| Mining and Quarrying              | 20.8           | 21.5           | 22.6           | 23.4           | 23.4           |
| Manufacturing                     | 527.8          | 539.3          | 540.6          | 512.0          | 552.5          |
| Electricity and Water Supply      | 147.0          | 200.3          | 126.8          | 207.1          | 222.8          |
| <b>Construction</b>               | <b>299.1</b>   | <b>314.4</b>   | <b>387.7</b>   | <b>557.9</b>   | <b>708.2</b>   |
| <b>B) Service Sector (1 +2)</b>   | <b>2,830.2</b> | <b>2,946.7</b> | <b>3,224.9</b> | <b>3,379.5</b> | <b>3,690.0</b> |
| <b>1- Productive services</b>     | <b>1,088.1</b> | <b>1,157.1</b> | <b>1,348.2</b> | <b>1,368.4</b> | <b>1,515.0</b> |
| Wholesale and Retail Trade        | 442.3          | 497.5          | 536.3          | 538.8          | 587.0          |
| Transportation and Storage        | 336.1          | 345.5          | 513.4          | 506.8          | 538.1          |
| Financial Intermediation          | 272.9          | 280.0          | 269.0          | 279.1          | 298.9          |
| Hotels and Restaurants            | 36.8           | 34.1           | 29.5           | 43.7           | 91.0           |
| <b>2- Social Services</b>         | <b>1,742.1</b> | <b>1,789.6</b> | <b>1,876.7</b> | <b>2,011.1</b> | <b>2,175.0</b> |
| Education                         | 372.2          | 398.8          | 426.1          | 442.3          | 478.8          |
| Health and Social Work            | 124.0          | 135.0          | 146.5          | 164.3          | 168.7          |
| Public Administration and defense | 658.8          | 685.2          | 750.7          | 782.1          | 884.0          |
| Others*                           | 587.1          | 570.6          | 553.4          | 622.4          | 643.5          |
| <b>C) FISIM</b>                   | <b>-257.0</b>  | <b>-275.3</b>  | <b>-231.9</b>  | <b>-236.3</b>  | <b>-263.7</b>  |
| <b>D) Net Taxes</b>               | <b>734.0</b>   | <b>845.3</b>   | <b>875.4</b>   | <b>995.8</b>   | <b>1,043.7</b> |
| Customs Duties                    | 283.8          | 328.9          | 345.5          | 409.0          | 442.7          |
| VAT on Imports, net               | 450.2          | 516.4          | 529.9          | 586.8          | 601.0          |
| <b>Real GDP (A + B + C +D)</b>    | <b>4,554.1</b> | <b>4,878.3</b> | <b>5,239.3</b> | <b>5,754.3</b> | <b>6,323.0</b> |
| Net Income Transfers from Abroad  | 439.8          | 531.5          | 469.7          | 506.1          | 392.7          |
| Net Current Transfers             | 1,913.2        | 2,898.7        | 1,979.6        | 1,841.0        | 678.0          |
| <b>Real GDI</b>                   | <b>6,907.1</b> | <b>8,308.5</b> | <b>7,688.6</b> | <b>8,101.4</b> | <b>7,393.7</b> |
| Real GDP percapita                | 1,303.2        | 1,356.3        | 1,415.2        | 1,1509.9       | 1,609.6        |
| Real GDI percapita                | 1,976.6        | 2,310.0        | 1,076.8        | 2,125.7        | 1,709.7        |
| <b>Nominal GDP</b>                | <b>5,182.4</b> | <b>6247.3</b>  | <b>6719.6</b>  | <b>8,330.6</b> | <b>9,982.1</b> |
| Nominal GDP percapita             | 1,483.0        | 1,737.0        | 1,815.0        | 2,185.9        | 2,541.3        |

\* Includes Real estate, Rental and Business Services, Community, Social and Personal Services.

Source: PCBS, National Accounts, Different Issues, 2012.

**Table (1-11): Palestinian Territory: expenditure on real GDP, 2007-2011**

(base year: 2004)

| Activity                                | 2007                  | 2008    | 2009    | 2010    | 2011    |
|---|-----------------------|---------|---------|---------|---------|
|   | <b>USD Million</b>    |         |         |         |         |
| <b>Gross Domestic Expenditure</b>       | 6792.7                | 7199.2  | 7831.7  | 8746.7  | 9007.5  |
| <b>Final Consumption</b>                | 5669.8                | 6138.7  | 6694.4  | 7303.5  | 7686.2  |
| Private*                                | 4777.1                | 5142.8  | 5534.9  | 5782.8  | 6129.0  |
| Public                                  | 892.7                 | 995.9   | 1159.5  | 1520.7  | 1557.2  |
| <b>Gross Investment</b>                 | 1122.9                | 1060.5  | 1137.3  | 1443.2  | 1321.3  |
| Private                                 | 796.0                 | 724.7   | 847.4   | 1063.2  | 992.4   |
| Public                                  | 326.9                 | 335.8   | 289.9   | 380.0   | 328.9   |
| <b>Net Export of Goods and Services</b> | -2238.6               | -2320.9 | -2592.4 | -2992.4 | -2684.5 |
| Exports                                 | 700.2                 | 793.0   | 822.7   | 999.3   | 1139.5  |
| Imports                                 | 2938.8                | 3113.9  | 3415.1  | 3991.7  | 3824.0  |
| <b>Real GDP</b>                         | 4554.1                | 4878.3  | 5239.3  | 5754.3  | 6323.0  |
|   | <b>Percent of GDP</b> |         |         |         |         |
| <b>Gross Domestic Expenditure</b>       | 149.2                 | 147.5   | 149.5   | 152.0   | 142.5   |
| <b>Final Consumption</b>                | 124.5                 | 125.8   | 127.8   | 126.9   | 121.6   |
| Private                                 | 104.9                 | 105.4   | 105.6   | 100.5   | 96.9    |
| Public                                  | 19.6                  | 20.4    | 22.2    | 26.4    | 24.7    |
| <b>Gross Investment</b>                 | 24.7                  | 21.7    | 21.7    | 25.1    | 20.9    |
| Private                                 | 17.5                  | 14.9    | 16.2    | 18.5    | 15.7    |
| Public                                  | 7.2                   | 6.8     | 5.5     | 6.6     | 5.2     |
| <b>Net Export of Goods and Services</b> | -49.2                 | -47.5   | -49.5   | -52.0   | -42.5   |
| Exports                                 | 15.4                  | 16.3    | 15.7    | 17.4    | 18.0    |
| Imports                                 | 64.5                  | 63.8    | 65.2    | 69.4    | 60.5    |
| <b>Real GDP</b>                         | 100.0                 | 100.0   | 100.0   | 100.0   | 100.0   |

\* Includes the final consumption of households and that of producers of not-for-profit special services for households.  
Source: PCBS, National Accounts, Different Issues, 2012.

Table (1-12): Palestinian Territory: consumer price index (CPI), 2007-2011

(Annual Percent change)

| Activity                                | 2007                           | 2008         | 2009         | 2010         | 2011         |
|---|--------------------------------|--------------|--------------|--------------|--------------|
|   | <b>Main Expenditure Groups</b> |              |              |              |              |
| Foods and Soft Drinks                   | 115.1                          | 135.0        | 139.9        | 144.6        | 148.1        |
| Alcoholic Beverages and Tobacco         | 114.6                          | 123.2        | 135.4        | 151.8        | 161.2        |
| Textile, Clothing and Footwear          | 100.7                          | 101.2        | 105.0        | 109.2        | 114.2        |
| Housing                                 | 113.3                          | 121.9        | 121.0        | 127.2        | 131.0        |
| Furniture, Household Goods              | 98.4                           | 104.8        | 112.3        | 115.3        | 115.3        |
| Medical Care                            | 106.4                          | 114.1        | 113.7        | 114.8        | 116.3        |
| Transportation                          | 111.8                          | 120.8        | 117.6        | 120.7        | 126.5        |
| Communications                          | 109.5                          | 110.1        | 109.2        | 106.9        | 107.3        |
| Recreational, Cultural Goods & Services | 97.7                           | 99.0         | 101.2        | 103.0        | 104.2        |
| Education                               | 100.4                          | 99.8         | 104.2        | 110.5        | 112.8        |
| Restaurants and Cafés                   | 112.1                          | 126.6        | 132.6        | 136.9        | 144.9        |
| Miscellaneous Goods and Services        | 108.1                          | 109.3        | 114.2        | 120.1        | 124.9        |
| <b>All-items Index</b>                  | <b>110.1</b>                   | <b>121.0</b> | <b>124.3</b> | <b>129.0</b> | <b>132.7</b> |
|   | <b>Regions</b>                 |              |              |              |              |
| West Bank                               | 110.0                          | 120.8        | 121.5        | 126.7        | 131.2        |
| Gaza Strip                              | 108.9                          | 124.1        | 129.6        | 131.8        | 132.6        |
| Jerusalem                               | 110.3                          | 118.1        | 122.3        | 128.7        | 134.1        |
| <b>All-items Index</b>                  | <b>110.1</b>                   | <b>121.0</b> | <b>124.3</b> | <b>129.0</b> | <b>132.7</b> |
|   | <b>Inflation Rates</b>         |              |              |              |              |
| West Bank                               | 0.8                            | 9.8          | 0.6          | 4.2          | 3.5          |
| Gaza Strip                              | 1.6                            | 14.0         | 4.4          | 1.7          | 0.6          |
| Jerusalem                               | 3.1                            | 7.1          | 3.5          | 5.2          | 4.1          |
| <b>All-items Index</b>                  | <b>1.9</b>                     | <b>9.9</b>   | <b>2.8</b>   | <b>3.7</b>   | <b>2.9</b>   |

Source: PCBS, Index of Consumer Prices, Different Issues, 2012.

Table (1-13): Palestinian Territory: labor market indicators, 2007-2011

| Key Indicators  | 2007        | 2008        | 2009        | 2010        | 2011        |
|---|-------------|-------------|-------------|-------------|-------------|
| <b>Population (thousand)*</b>                                   | <b>3719</b> | <b>3826</b> | <b>3935</b> | <b>4048</b> | <b>4169</b> |
| West Bank   | 2323        | 2385        | 2448        | 2513        | 2580        |
| Gaza Strip  | 1396        | 1440        | 1487        | 1535        | 1589        |
| <b>individuals Over 15 Years (thousand)</b>                     | <b>2025</b> | <b>2118</b> | <b>2288</b> | <b>2376</b> | <b>2466</b> |
| West Bank   | 1307        | 1374        | 1469        | 1523        | 1577        |
| Gaza Strip  | 718         | 744         | 819         | 853         | 889         |
| <b>Labor Force (thousand)</b>                                   |             |             |             |             |             |
| <b>Palestinian Territory</b>                                    | <b>849</b>  | <b>875</b>  | <b>951</b>  | <b>976</b>  | <b>1059</b> |
| West Bank   | 576         | 591         | 643         | 665         | 718         |
| Gaza Strip  | 273         | 284         | 308         | 311         | 341         |
| <b>Unemployment (thousand)</b>                                  |             |             |             |             |             |
| <b>Palestinian Territory</b>                                    | <b>183</b>  | <b>227</b>  | <b>234</b>  | <b>232</b>  | <b>222</b>  |
| West Bank   | 102         | 112         | 115         | 114         | 124         |
| Gaza Strip  | 81          | 115         | 119         | 118         | 98          |
| <b>Unemployment: Percent of Labor Force</b>                     |             |             |             |             |             |
| <b>Palestinian Territory</b>                                    | <b>21.6</b> | <b>25.9</b> | <b>24.6</b> | <b>23.7</b> | <b>20.9</b> |
| West Bank   | 17.7        | 19.0        | 17.7        | 17.2        | 17.3        |
| Gaza Strip  | 29.7        | 40.5        | 38.6        | 37.8        | 28.7        |
| <b>Relaxed Unemployment: Percent of Labor Force</b>             |             |             |             |             |             |
| <b>Palestinian Territory</b>                                    | <b>27.9</b> | <b>31.7</b> | <b>30.1</b> | <b>30.0</b> | <b>25.8</b> |
| West Bank   | 24.5        | 25.3        | 23.4        | 23.4        | 22.3        |
| Gaza Strip  | 35.2        | 45.0        | 43.8        | 43.7        | 33.1        |
| <b>Distribution of Palestinian workers by Region (thousand)</b> |             |             |             |             |             |
| <b>Total workers</b>  | <b>666</b>  | <b>648</b>  | <b>718</b>  | <b>744</b>  | <b>837</b>  |
| Workers in Israel   | 63          | 75          | 73          | 78          | 84          |
| Workers in the PT   | 603         | 573         | 645         | 666         | 753         |
| Workers in the public sector                                    | 155         | 160         | 178         | 179         | 188         |
| Workers in the private sector                                   | 448         | 413         | 467         | 487         | 565         |

Table (1-13): Cont.

| Key Indicators   | 2007        | 2008        | 2009        | 2010        | 2011        |
|--|-------------|-------------|-------------|-------------|-------------|
| <b>Distribution of workers by Economic Activity (thousand)</b> |             |             |             |             |             |
| Agriculture and fishing  | 102         | 87          | 85          | 88          | 100         |
| Industry (mining and manufacturing)                            | 83          | 78          | 87          | 85          | 99          |
| Constructions (build. & constructions)                         | 73          | 71          | 84          | 98          | 116         |
| Trade, restaurants and hotels                                  | 130         | 131         | 137         | 143         | 170         |
| Trans., storage and communications                             | 38          | 32          | 41          | 44          | 51          |
| Other services and branches                                    | 239         | 249         | 284         | 286         | 301         |
| <b>Dependency Ratios (%)</b>                                   |             |             |             |             |             |
| <b>Palestinian Territory</b>                                   | <b>5.6</b>  | <b>5.9</b>  | <b>5.5</b>  | <b>5.4</b>  | <b>5.0</b>  |
| West Bank  | 4.9         | 5.0         | 4.6         | 4.6         | 4.3         |
| Gaza Strip   | 7.3         | 8.5         | 7.9         | 7.9         | 6.5         |
| <b>Daily Average wage in NIS</b>                               |             |             |             |             |             |
| <b>Palestinian Territory</b>                                   | <b>81.9</b> | <b>87.0</b> | <b>91.3</b> | <b>91.7</b> | <b>91.7</b> |
| West Bank  | 78.6        | 85.5        | 85.9        | 85.8        | 85.0        |
| Gaza Strip   | 65.4        | 60.9        | 62.7        | 58.1        | 62.5        |
| Israel and settlements   | 131.2       | 139.7       | 148.1       | 158.0       | 162.2       |

\* Mid-year Estimates

Source: PCBS, Workforce Survey, various publications





## Chapter Two

# Fiscal Developments

**Table (2-1): Palestinian Territory: fiscal operations (cash basis), 2007-2011**

(USD Million)

| Items   | 2007         | 2008           | 2009           | 2010           | 2011           |
|---|--------------|----------------|----------------|----------------|----------------|
| <b>Total Net Revenues and Grants</b>                      | <b>2938</b>  | <b>3757.8</b>  | <b>2950.4</b>  | <b>3177.7</b>  | <b>3160.2</b>  |
| <b>Total Revenues, net<sup>1</sup></b>                    | <b>1616</b>  | <b>1779.7</b>  | <b>1548.6</b>  | <b>1900.4</b>  | <b>2176.9</b>  |
| Gross Revenue   | 1642         | 1896           | 1675.1         | 1987.3         | 2190.4         |
| Domestic Revenue  | 324          | 759            | 585.1          | 744.8          | 701.5          |
| Tax   | 202          | 272.8          | 301.5          | 474.4          | 482.3          |
| Non-tax <sup>2</sup>                                      | 122          | 486.2          | 283.6          | 270.4          | 219.2          |
| Clearance Revenue   | 1318         | 1137           | 1090           | 1242.5         | 1488.9         |
| Tax Refunds (-)   | 26           | 116.3          | 126.5          | 86.9           | 13.5           |
| <b>Grants and aid (external revenues)</b>                 | <b>1322</b>  | <b>1978.1</b>  | <b>1401.8</b>  | <b>1277.3</b>  | <b>983.3</b>   |
| For Budgetary Support                                     | 1012         | 1763.1         | 1355           | 1146.8         | 814.3          |
| For development Financing                                 | 310          | 215            | 46.8           | 130.5          | 169            |
| <b>Total public expenditure</b>                           | <b>2877</b>  | <b>3487.9</b>  | <b>3105.3</b>  | <b>3258.8</b>  | <b>3254.5</b>  |
| <b>Current expenditure and net lending</b>                | <b>2567</b>  | <b>3272.9</b>  | <b>2919.4</b>  | <b>2983.7</b>  | <b>2960</b>    |
| Wages Expenditure   | 1369         | 1771           | 1423           | 1564.1         | 1677.9         |
| Non-wage Expenditure                                      | 663          | 1055           | 1141.7         | 1156.1         | 1142.2         |
| Net lending   | 535          | 446.9          | 354.7          | 263.5          | 139.9          |
| <b>Development Expenditure</b>                            | <b>310</b>   | <b>215</b>     | <b>185.9</b>   | <b>275.1</b>   | <b>294.5</b>   |
| Funded by the Treasury                                    | 0            | 0              | 139.1          | 144.6          | 125.5          |
| Funded by grants  | 310          | 215            | 46.8           | 130.5          | 169            |
| <b>Current balance</b>                                    | <b>-951</b>  | <b>-1493.2</b> | <b>-1370.8</b> | <b>-1083.3</b> | <b>-783.1</b>  |
| <b>Overall balance (Excl. grants and aid)<sup>3</sup></b> | <b>-1261</b> | <b>-1708.2</b> | <b>-1556.7</b> | <b>-1358.4</b> | <b>-1077.6</b> |
| <b>Overall balance (inc. grants and aid)</b>              | <b>61</b>    | <b>269.9</b>   | <b>-154.9</b>  | <b>-81.1</b>   | <b>-94.3</b>   |
| <b>Financing</b>  | <b>-61</b>   | <b>-269.9</b>  | <b>154.9</b>   | <b>81.1</b>    | <b>94.3</b>    |
| Net financing from local banks                            | -132         | -227           | 176            | 83.6           | 93.2           |
| Residual  | -7           | -42.9          | -21.1          | -2.5           | 1.1            |
| <b>Financial gap</b>                                      | <b>0</b>     | <b>0</b>       | <b>0</b>       | <b>0</b>       | <b>0</b>       |

<sup>1</sup> Total net revenue: Gross revenue after tax refunds deduction.

<sup>2</sup> Non-tax revenues for the year 2008 include USD 197.1 million received as revenues (profits of equity) from the Palestinian Investment Fund, which were used to settle part of the debt of the Palestinian Authority for the Investment Fund.

<sup>3</sup> Balance before grants and foreign aid, which includes current expenditure and development expenditure.

Source: Ministry of Finance, Department of the General Budget, the draft general budget for several years.

Table (2-2): Palestinian Territory: public debt, 2009-2011

(USD Million)

| Items  | 2009          | 2010          | 2011          |
|--|---------------|---------------|---------------|
| <b>Total Domestic Debt</b>                             | <b>649.4</b>  | <b>839.6</b>  | <b>1098.5</b> |
| Local banks  | 639.5         | 830.8         | 1089.9        |
| Loans  | 304.2         | 345.0         | 506.1         |
| Overdrafts   | 257.0         | 390.7         | 441.0         |
| Petroleum Authority <sup>2</sup>                       | 78.4          | 95.0          | 142.8         |
| Other Public Institutions Loans <sup>(1)</sup>         | 9.9           | 8.8           | 8.6           |
| <b>Total External debt</b>                             | <b>1086.9</b> | <b>1043.3</b> | <b>1114.3</b> |
| <b>Arab financial institutions</b>                     | <b>551.2</b>  | <b>539.4</b>  | <b>617.2</b>  |
| Al-Aqsa Fund <sup>(2) (3)</sup>                        | 444.1         | 444.1         | 522.4         |
| Arab Fund for Economic and Social Development          | 54.7          | 42.6          | 43.3          |
| Islamic Development Bank                               | 52.4          | 52.7          | 51.5          |
| <b>International and Regional Institutions</b>         | <b>370.6</b>  | <b>348.3</b>  | <b>341.9</b>  |
| World Bank <sup>(4)</sup>                              | 308.2         | 302.9         | 297.0         |
| European Investment Bank <sup>(3)</sup>                | 41.5          | 23.4          | 22.6          |
| International Fund for Agricultural Development (IFAD) | 3.7           | 3.4           | 3.3           |
| OPEC <sup>(2)</sup>                                    | 17.2          | 18.6          | 19.0          |
| <b>Bilateral loans</b>                                 | <b>165.1</b>  | <b>155.6</b>  | <b>155.2</b>  |
| Greece   | 12.9          |               |               |
| Spain <sup>(2)</sup>                                   | 93.0          | 92.9          | 92.9          |
| Italy <sup>(4)</sup>                                   | 29.8          | 31.2          | 31.3          |
| China <sup>(2)</sup>                                   | 4.8           | 4.9           | 5.2           |
| Sweden <sup>(2)</sup>                                  | 24.8          | 26.5          | 25.8          |
| <b>Total Public Debt</b>                               | <b>1736.4</b> | <b>1882.8</b> | <b>2212.8</b> |

<sup>(1)</sup> loans from the orphanage institution to the Petroleum Authority.

<sup>(2)</sup> Tentative data pending confirmation.

<sup>(3)</sup> Includes loan guarantees.

<sup>(4)</sup> includes on lending.

<sup>2</sup> It represents the value of loans granted by the Ministry of Finance to support the Petroleum Authority.

Source: Ministry of Finance website.

**Table (2-3): Palestinian Territory: government outstanding arrears (Net), 2009-2011**

(NIS million)

| Items                            | 2009        | 2010       | 2011        |
|----------------------------------|-------------|------------|-------------|
| Contribution to the pension fund | 526         | 356        | 947         |
| Non-wage expenses                | 460         | 92         | 353         |
| Net lending                      | 77          | -103       | 0           |
| Development projects             | 118         | 88         | 270         |
| Tax refund                       | -140        | -39        | 368         |
| <b>Total</b>                     | <b>1041</b> | <b>394</b> | <b>1938</b> |

Source: IMF.



# Chapter Three

## Foreign Sector Developments

Table (3-1): Palestinian Territory: balance of payment, 2007-2011

(USD Million)

| Items  | 2007     | 2008     | 2009     | 2010     | 2011     |
|--|----------|----------|----------|----------|----------|
| <b>Current Account (Net)</b>                   | -417.5   | 764.4    | -712.6   | -690.9   | -2,429.6 |
| <b>Goods (Net)</b>                             | -3,178.2 | -3,234.4 | -3,504.4 | -3,652.8 | -4,663.4 |
| Exports (Fob)                                  | 646.5    | 668.4    | 631.3    | 666.1    | 1524.9   |
| Imports (Fob)                                  | 3,824.7  | 3,902.8  | 4,135.7  | 4,318.9  | 6,188.3  |
| <b>Services (Net)</b>                          | -373.1   | -340.3   | -351.8   | -312.1   | --261.8  |
| Exports  | 369.5    | 496.1    | 579.3    | 830.7    | 686.3    |
| Imports  | 742.6    | 836.4    | 931.1    | 1,142.8  | 948.1    |
| <b>Income (Net)</b>                            | 765.7    | 919.2    | 876.1    | 1,098.1  | 1,148.9  |
| Receipts                                       | 773.6    | 922.6    | 955.8    | 1,213.2  | 1,207.6  |
| Compensation of employees                      | 598.5    | 746.2    | 831.1    | 1,077.4  | 1,117.4  |
| Of which from Israel                           | 510.7    | 655.3    | 730.7    | 991.2    | 1,020.6  |
| Investment Income                              | 175.1    | 176.4    | 124.7    | 135.8    | 90.2     |
| Payments                                       | 7.9      | 3.4      | 79.7     | 115.1    | 58.7     |
| <b>Current Transfers (Net)</b>                 | 2,368.1  | 3,419.9  | 2,267.5  | 2,175.9  | 1,346.7  |
| Inflows  | 2,505.4  | 3,572.8  | 2,502.0  | 2,476.5  | 1,616.8  |
| To the Public Sector                           | 1,053.0  | 1,977.8  | 1,484.3  | 1,214.2  | 727.5    |
| To the Private Sector                          | 1,452.4  | 1,595.0  | 1,017.7  | 1,262.3  | 898.3    |
| Outflows                                       | 137.3    | 152.9    | 234.5    | 300.6    | 270.1    |
| <b>Capital and financial Account (Net)</b>     | 302.6    | -521.2   | 870.5    | 800.3    | 2,549.4  |
| <b>Capital Account (Net)</b>                   | 401.5    | 398.8    | 719.0    | 846.1    | 438.9    |
| Capital Transfers (Net)                        | 400.2    | 397.5    | 719.0    | 846.1    | 438.9    |
| Inflows  | 400.2    | 397.5    | 719.0    | 846.1    | 438.9    |
| Outflows                                       | 0.0      | 0.0      | 0.0      | 0.0      | 0.0      |
| Acquisition of Non-Produced Assets (Net)       | 1.3      | 1.3      | 0.0      | 0.0      | 0.0      |
| <b>Financial account (Net)</b>                 | -98.9    | -920.0   | 151.5    | -45.8    | 2,110.5  |
| Direct Investment (Net)                        | 36.3     | 59.8     | 315.9    | 103.0    | 250.9    |
| Portfolio Investment (Net)                     | -130.7   | -24.7    | -367.0   | -453.4   | 86.2     |
| Other Investment (Net)                         | 86.8     | -421.3   | 191.5    | 341.0    | 1,739.8  |
| <b>Net Errors and Omissions</b>                | -114.9   | -243.2   | 157.9    | 109.4    | -119.8   |
| <b>Change in Reserve Assets (- = Increase)</b> | -91.3    | -533.8   | 11.1     | -36.4    | 33.6     |

Source: PMA and PCBS, data series of balance of payments.



# Chapter Four

## Financial Sector Developments

## Part I: Palestine Monetary Authority (PMA)

Table (4-1): Palestinian Territory: banks and branches by nationality, 2007-2011

| Items           | 2007   | 2008       | 2009       | 2010       | 2011       |
|-----------------|--|------------|------------|------------|------------|
|                 | <b>Number of Banks</b>                                 |            |            |            |            |
| Local Banks     | 10   | 10         | 10         | 8          | 8          |
| Foreign Banks   | 11   | 11         | 10         | 10         | 10         |
| Jordanian Banks | 8  | 8          | 8          | 8          | 8          |
| Egyptian Banks  | 2  | 2          | 1          | 1          | 1          |
| British Banks   | 1  | 1          | 1          | 1          | 1          |
| <b>Total</b>    | <b>21</b>  | <b>21</b>  | <b>20</b>  | <b>18</b>  | <b>18</b>  |
|                 | <b>Number of Branches &amp; representative Offices</b> |            |            |            |            |
| Local Banks     | 82   | 89         | 104        | 110        | 118        |
| Foreign Banks   | 78   | 101        | 105        | 102        | 108        |
| Jordanian Banks | 71   | 93         | 98         | 95         | 101        |
| Egyptian Banks  | 6  | 7          | 6          | 6          | 6          |
| British Banks   | 1  | 1          | 1          | 1          | 1          |
| <b>Total</b>    | <b>160</b>   | <b>190</b> | <b>209</b> | <b>212</b> | <b>226</b> |

In 2010, Palestine International Bank and Al-Aqsa Bank was liquidated. In addition, two branches of the Arab Bank were closed in Gaza Strip.

Source: PMA.

Table (4-2): Palestinian Territory: money changers, 2007-2011

| Items        | 2007       | 2008       | 2009       | 2010       | 2011       |
|--------------|------------|------------|------------|------------|------------|
| West Bank    | 140        | 154        | 182        | 215        | 248        |
| Gaza Strip   | 49         | 43         | 44         | 45         | 44         |
| <b>Total</b> | <b>189</b> | <b>197</b> | <b>226</b> | <b>260</b> | <b>292</b> |

Source: PMA.



Table (4-3): PMA: assets and liabilities, 2007-2011

(USD Million)

| Items   | 2007         | 2008          | 2009          | 2010          | 2011          |
|---|--------------|---------------|---------------|---------------|---------------|
| <b>Deposits of banks and financial institutions</b> | <b>687.0</b> | <b>1091.3</b> | <b>1189.7</b> | <b>1056.1</b> | <b>917.1</b>  |
| Required reserves                                   | 438.6        | 537.7         | 549.1         | 615.5         | 616.6         |
| Other accounts                                      | 248.4        | 553.7         | 640.6         | 440.6         | 300.5         |
| <b>Provisions</b>                                   | <b>12.4</b>  | <b>12.8</b>   | <b>13.6</b>   | <b>14.2</b>   | <b>17.3</b>   |
| <b>Capital and reserves</b>                         | <b>64.4</b>  | <b>79.6</b>   | <b>80.9</b>   | <b>85.7</b>   | <b>89.3</b>   |
| Paid capital  | 29.6         | 45.0          | 50.0          | 54.7          | 58.5          |
| Reserves  | 34.8         | 34.6          | 30.9          | 31.0          | 30.8          |
| <b>Other liabilities</b>                            | <b>1.1</b>   | <b>3.6</b>    | <b>7.7</b>    | <b>8.5</b>    | <b>9.8</b>    |
| <b>Assets = Liabilities</b>                         | <b>764.9</b> | <b>1187.4</b> | <b>1291.9</b> | <b>1164.5</b> | <b>1033.5</b> |
| <b>Domestic assets</b>                              | <b>307.3</b> | <b>194.5</b>  | <b>253.2</b>  | <b>195.7</b>  | <b>195.9</b>  |
| <b>balances with banks in Palestine</b>             | <b>246.1</b> | <b>145.1</b>  | <b>200.2</b>  | <b>154.4</b>  | <b>164.8</b>  |
| Current deposits                                    | 15.0         | 21.5          | 49.2          | 14.8          | 4.2           |
| Time deposits                                       | 231.1        | 123.6         | 150.9         | 139.6         | 160.6         |
| <b>Islamic investments</b>                          | <b>61.2</b>  | <b>49.5</b>   | <b>53.0</b>   | <b>41.3</b>   | <b>30.1</b>   |
| <b>Financial investments held to maturity</b>       | <b>-</b>     | <b>-</b>      | <b>-</b>      | <b>-</b>      | <b>1.0</b>    |
| <b>Foreign assets</b>                               | <b>443.2</b> | <b>977.0</b>  | <b>1024.4</b> | <b>933.3</b>  | <b>807.4</b>  |
| <b>Balances with banks abroad</b>                   | <b>291.7</b> | <b>688.6</b>  | <b>722.5</b>  | <b>685.7</b>  | <b>450.3</b>  |
| Current and demand deposits                         | 4.7          | 9.4           | 14.3          | 39.3          | 69.7          |
| Time deposits                                       | 287.0        | 679.2         | 708.2         | 646.4         | 380.6         |
| <b>Islamic investments</b>                          | <b>151.5</b> | <b>182.0</b>  | <b>102.5</b>  | <b>99.0</b>   | <b>98.7</b>   |
| <b>Financial investments held to maturity</b>       | <b>-</b>     | <b>106.5</b>  | <b>199.4</b>  | <b>148.6</b>  | <b>158.3</b>  |
| <b>Investment portfolio for trade</b>               | <b>-</b>     | <b>-</b>      | <b>-</b>      | <b>-</b>      | <b>100.1</b>  |
| <b>Fixed assets*</b>                                | <b>5.6</b>   | <b>5.5</b>    | <b>5.5</b>    | <b>7.6</b>    | <b>9.1</b>    |
| <b>Government loans</b>                             | <b>6.5</b>   | <b>5.7</b>    | <b>4.6</b>    | <b>3.5</b>    | <b>3.4</b>    |
| <b>Other assets</b>                                 | <b>2.5</b>   | <b>4.7</b>    | <b>4.3</b>    | <b>24.4</b>   | <b>17.7</b>   |

\* Includes development projects under implementation  
Source: PMA.

Table (4-4): PMA: profit and loss statement, 2007-2011

(USD Million)

| Items   | 2007        | 2008        | 2009        | 2010        | 2011        |
|---|-------------|-------------|-------------|-------------|-------------|
| <b>Revenues</b>   | <b>25.6</b> | <b>24.8</b> | <b>15.8</b> | <b>25.6</b> | <b>18.6</b> |
| Net interest and investment revenue                             | 25.0        | 24.1        | 15.3        | 14.5        | 15.9        |
| Other revenues  | 0.6         | 0.7         | 0.5         | 11.1*       | 2.7         |
| <b>Expenditure</b>  | <b>9.4</b>  | <b>8.6</b>  | <b>9.2</b>  | <b>20.4</b> | <b>14.5</b> |
| Employee expenses   | 7.5         | 6.6         | 6.9         | 7.4         | 9.5         |
| Administrative expense  | 1.4         | 1.4         | 1.9         | 2.1         | 2.1         |
| Depreciation and Capital expenses                               | 0.3         | 0.4         | 0.4         | 0.6         | 0.5         |
| Development projects' expenses                                  | 0.2         | 0.1         | 0.0         | 0.0         | 0.0         |
| Financial Follow-up Office expenses                             | -           | -           | -           | 0.3         | 0.4         |
| Expenses for doubtful debts                                     | -           | -           | -           | 10.0        | 2.0         |
| <b>Excess of revenue over expenditure in regular activities</b> | <b>16.2</b> | <b>16.2</b> | <b>6.6</b>  | <b>5.2</b>  | <b>4.1</b>  |
| Amendments of previous years                                    | 0.1         | 0.0         | 0.1         | 0.04        | -0.03       |
| Expenses of the money seizure case                              | 1.6         | 0.8         | 1.7         | 0.6         | 0.2         |
| <b>Net excess of revenues over Expenditure</b>                  | <b>14.6</b> | <b>15.4</b> | <b>5.0</b>  | <b>4.7</b>  | <b>3.8</b>  |

\* includes payback provision by USD 10 million.

Source: PMA.

Table (4-5): PMA: employees distribution, 2007-2011<sup>(1)</sup>

| Items  | 2008       |            |            | 2009       |            |            | 2010       |            |            | 2011       |            |            |
|--|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
|  | Ramallah   | Gaza Strip | Total      | Ramallah   | Gaza Strip | Total      | Ramallah   | Gaza Strip | Total      | Ramallah   | Gaza Strip | Total      |
| Governor's Office  | 8          | 2          | 10         | 7          | 2          | 9          | 9          | 2          | 11         | 17         | 3          | 20         |
| Security and Public Safety Office                              | 7          | 18         | 25         | 10         | 17         | 27         | 8          | 18         | 26         | 8          | 18         | 26         |
| Financial Follow-up Unit                                       | 6          | -          | 6          | 6          | 0          | 6          | 7          | 0          | 7          | 10         | 0          | 10         |
| <b>Independent Offices</b>                                     | <b>4</b>   | <b>6</b>   | <b>10</b>  | <b>5</b>   | <b>4</b>   | <b>9</b>   | <b>7</b>   | <b>4</b>   | <b>11</b>  | <b>9</b>   | <b>3</b>   | <b>12</b>  |
| Ombudsman  | -          | -          | -          | -          | -          | -          | -          | -          | -          | -          | -          | -          |
| Ethics   | -          | -          | -          | -          | -          | -          | -          | -          | -          | -          | -          | -          |
| Legal Counsel  | 1          | -          | 1          | 1          | 1          | 2          | 1          | 1          | 2          | 3          | 1          | 4          |
| Internal Audit   | 3          | 6          | 9          | 4          | 3          | 7          | 6          | 3          | 9          | 6          | 2          | 8          |
| <b>Core Departments</b>  | <b>75</b>  | <b>29</b>  | <b>102</b> | <b>144</b> | <b>69</b>  | <b>217</b> | <b>97</b>  | <b>29</b>  | <b>126</b> | <b>122</b> | <b>29</b>  | <b>151</b> |
| <b>Monetary Stability Group</b>                                | <b>16</b>  | <b>6</b>   | <b>22</b>  | <b>16</b>  | <b>6</b>   | <b>22</b>  | <b>16</b>  | <b>6</b>   | <b>22</b>  | <b>27</b>  | <b>4</b>   | <b>31</b>  |
| Research & Monetary Department                                 | 11         | 1          | 12         | 11         | 1          | 12         | 10         | 1          | 11         | 16         | 2          | 18         |
| Monetary Operations Department                                 | 5          | 5          | 10         | 5          | 5          | 10         | 6          | 5          | 11         | 11         | 2          | 13         |
| <b>Financial Stability Group</b>                               | <b>59</b>  | <b>23</b>  | <b>82</b>  | <b>63</b>  | <b>23</b>  | <b>86</b>  | <b>81</b>  | <b>23</b>  | <b>104</b> | <b>95</b>  | <b>25</b>  | <b>120</b> |
| Supervision and Inspection Department                          | 52         | 17         | 69         | 54         | 17         | 71         | 66         | 17         | 83         | 63         | 15         | 78         |
| Payment System Department                                      | 7          | 6          | 13         | 9          | 6          | 15         | 15         | 6          | 21         | 17         | 4          | 21         |
| Consumer Relations & Market Displent Department <sup>(2)</sup> | -          | -          | -          | -          | -          | -          | -          | -          | -          | 15         | 6          | 21         |
| <b>Supporting Departments</b>                                  | <b>56</b>  | <b>37</b>  | <b>93</b>  | <b>65</b>  | <b>40</b>  | <b>105</b> | <b>71</b>  | <b>40</b>  | <b>111</b> | <b>66</b>  | <b>47</b>  | <b>113</b> |
| External Relations Department                                  | 1          | 2          | 3          | 2          | 2          | 4          | 1          | 2          | 3          | 2          | 2          | 4          |
| General Services Department                                    | 26         | 20         | 46         | 30         | 20         | 50         | 32         | 20         | 52         | 21         | 29         | 50         |
| IT Department  | 11         | 6          | 17         | 12         | 6          | 18         | 15         | 6          | 21         | 16         | 5          | 21         |
| Human Resources Department                                     | 10         | 4          | 14         | 10         | 4          | 14         | 10         | 4          | 14         | 12         | 3          | 15         |
| Finance Department   | 8          | 5          | 13         | 11         | 8          | 19         | 13         | 8          | 21         | 15         | 8          | 23         |
| <b>Total</b>   | <b>156</b> | <b>92</b>  | <b>248</b> | <b>172</b> | <b>92</b>  | <b>264</b> | <b>199</b> | <b>93</b>  | <b>292</b> | <b>240</b> | <b>92</b>  | <b>332</b> |

<sup>(1)</sup> Does not include consultants or employees with contracts.

<sup>(2)</sup> Established in 2011.

Source: PMA.

Table (4-5): PMA: staff training courses, 2007-2011

| Items   | 2007       | 2008       | 2009       | 2010       | 2011       |
|---|------------|------------|------------|------------|------------|
| Governor's Office                               | 2          | 5          | 6          | 10         | 12         |
| Security and Public Safety Office               | 7          | 12         | 8          | 15         | 5          |
| <b>Independent Offices</b>                      | <b>8</b>   | <b>5</b>   | <b>6</b>   | <b>9</b>   | <b>13</b>  |
| Legal Counsel                                   | -          | 1          | -          | 3          | 4          |
| Internal Audit                                  | 8          | 4          | 6          | 6          | 9          |
| <b>Core Departments</b>                         | <b>89</b>  | <b>77</b>  | <b>96</b>  | <b>95</b>  | <b>127</b> |
| Monetary Stability Group                        | 14         | 20         | 16         | 22         | 39         |
| Research & Monetary Department                  | 11         | 15         | 8          | 13         | 23         |
| Monetary Operations Department                  | 3          | 5          | 8          | 9          | 16         |
| Financial Stability Group                       | 75         | 57         | 80         | 73         | 88         |
| Supervision and Inspection Department           | 42         | 33         | 43         | 28         | 53         |
| Payment System Department                       | 17         | 11         | 20         | 20         | 17         |
| Consumer Relations & Market Displent Department | 16         | 13         | 17         | 25         | 18         |
| <b>Supporting Departments</b>                   | <b>60</b>  | <b>72</b>  | <b>43</b>  | <b>47</b>  | <b>68</b>  |
| External Relations Department                   | 2          | 5          | 4          | 3          | 4          |
| General Services Department                     | 15         | 20         | 8          | 11         | 15         |
| IT Department                                   | 13         | 14         | 9          | 12         | 17         |
| Human Resources Department                      | 15         | 15         | 9          | 8          | 8          |
| Finance Department                              | 15         | 18         | 13         | 13         | 24         |
| <b>Total</b>                                    | <b>166</b> | <b>171</b> | <b>159</b> | <b>176</b> | <b>225</b> |

Source: PMA.

## Part II: Banking Sector

Table (4-7): Palestinian banking sector: assets and liabilities, 2007-2011

(USD Million)

| Items  | 2007          | 2008          | 2009          | 2010          | 2011          |
|--|---------------|---------------|---------------|---------------|---------------|
| <b>Total assets</b>  | <b>6703.8</b> | <b>7399.2</b> | <b>7876.3</b> | <b>8587.6</b> | <b>9115.9</b> |
| Cash and Precious Metals                                     | 341.4         | 346.2         | 534.9         | 542.8         | 496.7         |
| Due from PMA and Banks (Total):                              | 4186.7        | 4674.1        | 4185.1        | 3949.3        | 3743.7        |
| Due from PMA   | 703.1         | 1111.3        | 1214.7        | 1074.8        | 940.9         |
| Due from banks in Palestine                                  | 333.6         | 285.7         | 143.6         | 252.4         | 335.3         |
| Due from banks abroad  | 3150.1        | 3278.6        | 2826.8        | 2622.1        | 2467.5        |
| Securities portfolio for trade and investment <sup>(1)</sup> | 165.0         | 213.8         | 547.6         | 574.0         | 826.3         |
| credit facilities <sup>(1)</sup>                             | 1512.7        | 1716.6        | 2158.1        | 2823.6        | 3490.9        |
| Banking acceptances  | 4.9           | 6.2           | 3.9           | 3.6           | 5.9           |
| Investment <sup>(1)</sup>                                    | 153.3         | 125.1         | 137.3         | 348.8         | 137.4         |
| Fixed assets <sup>(1)</sup>                                  | 112.9         | 120.0         | 139.4         | 144.3         | 174.9         |
| Other assets   | 226.9         | 197.2         | 170.0         | 201.3         | 240.1         |
| <b>Total Liabilities</b>                                     | <b>6703.8</b> | <b>7399.2</b> | <b>7876.3</b> | <b>8587.6</b> | <b>9115.9</b> |
| <b>Due to PMA and Banks (Total):</b>                         | <b>605.5</b>  | <b>442.9</b>  | <b>381.4</b>  | <b>420.6</b>  | <b>646.5</b>  |
| Due to PMA   | 245.7         | 157.8         | 208.8         | 159.9         | 178.9         |
| Due to banks in Palestine                                    | 324.3         | 266.0         | 153.1         | 204.6         | 304.7         |
| Due to banks abroad  | 35.4          | 19.0          | 20.5          | 56.1          | 162.9         |
| <b>Customer deposits</b>                                     | <b>5117.7</b> | <b>5846.9</b> | <b>6296.8</b> | <b>6802.4</b> | <b>6972.7</b> |
| <b>Executed and outstanding acceptances</b>                  | <b>19.1</b>   | <b>21.0</b>   | <b>12.4</b>   | <b>15.3</b>   | <b>16.2</b>   |
| <b>Equity (net), of which:</b>                               | <b>701.6</b>  | <b>856.5</b>  | <b>958.9</b>  | <b>1095.5</b> | <b>1184.5</b> |
| Paid-up capital  | 530.4         | 633.3         | 730.3         | 809.6         | 874.6         |
| Legal reserve  | 31.2          | 40.9          | 58.2          | 82.5          | 95.8          |
| Declared reserves  | 11.2          | 11.2          | 11.2          | 29.4          | 45.0          |
| General reserves for banking operations                      | 24.5          | 29.3          | 35.0          | 47.0          | 57.7          |
| Undistributed profits  | -26.8         | -48.8         | -40.3         | 96.7          | 90.1          |
| Unrealized profit (loss) on long-term investment             | 41.5          | 37.7          | 41.9          | 9.2           | 2.3           |
| <b>Tax provisions</b>  | <b>31.3</b>   | <b>51.0</b>   | <b>73.5</b>   | <b>90.3</b>   | <b>107.2</b>  |
| <b>Other provisions</b>                                      | <b>45.7</b>   | <b>49.2</b>   | <b>56.5</b>   | <b>57.6</b>   | <b>65.9</b>   |
| <b>Other liabilities</b>                                     | <b>182.9</b>  | <b>135.2</b>  | <b>96.8</b>   | <b>108.8</b>  | <b>122.8</b>  |

<sup>(1)</sup> Shown in net values after excluding the proper provisions.

Source: PMA.

**Table (4-8): Palestinian banking sector: profit and loss statement, 2007-2011**

(USD Million)

| Items   | 2007         | 2008         | 2009         | 2010         | 2011         |
|---|--------------|--------------|--------------|--------------|--------------|
| Interest received                                   | 304.8        | 299.1        | 234.1        | 247.2        | 312.8        |
| Interest paid                                       | 99.4         | 75.5         | 34.4         | 26.3         | 35.3         |
| <b>Net interest income</b>                          | <b>205.5</b> | <b>223.6</b> | <b>199.7</b> | <b>220.9</b> | <b>277.5</b> |
| Net commission income                               | 36.9         | 40.1         | 52.7         | 61.9         | 69.6         |
| Net debt securities and investments                 | 9.5          | -3.9         | 16.2         | 51.7         | 2.4          |
| Net currency exchange and appreciation transactions | 20.9         | 29.1         | 29.0         | 24.7         | 26.0         |
| Net off-balance-sheet items                         | 0.9          | 1.9          | 1.7          | 0.7          | 0.4          |
| Net expenses and other operating income             | 1.8          | 2.3          | 4.2          | 8.5          | 8.6          |
| <b>Total non-interest income</b>                    | <b>70.0</b>  | <b>69.5</b>  | <b>103.8</b> | <b>147.5</b> | <b>107.0</b> |
| <b>Total income from all operations</b>             | <b>275.5</b> | <b>293.1</b> | <b>303.5</b> | <b>368.4</b> | <b>384.5</b> |
| Operating expenses                                  | 145.9        | 173.8        | 184.7        | 201.3        | 218.5        |
| Net Provisions                                      | 36.0         | 3.1          | -15.5        | -4.7         | 2.1          |
| Net extraordinary profit and loss                   | -1.8         | 0.5          | 0.0          | 0.7          | 0.0          |
| <b>Net income before taxes</b>                      | <b>91.7</b>  | <b>116.1</b> | <b>134.2</b> | <b>172.5</b> | <b>163.7</b> |
| Taxes   | 23.9         | 32.2         | 31.1         | 32.6         | 34.9         |
| <b>Net income after taxes</b>                       | <b>67.8</b>  | <b>84.4</b>  | <b>103.2</b> | <b>139.9</b> | <b>128.9</b> |

Source: PMA.

Table (4-9): Palestinian banking sector: customer deposits, 2007-2011

(USD Million)

| Items                          | 2007                    | 2008          | 2009          | 2010          | 2011          |
|--------------------------------|-------------------------|---------------|---------------|---------------|---------------|
|                                | <b>Depositing Party</b> |               |               |               |               |
| Public sector, of which:       | 505.3                   | 595.0         | 566.1         | 682.7         | 584.5         |
| Palestinian National Authority | 361.0                   | 467.9         | 413.2         | 534.1         | 437.1         |
| Private sector, of which:      | 4612.4                  | 5251.9        | 5730.7        | 6119.4        | 6388.0        |
| Resident                       | 4495.4                  | 5121.0        | 5412.4        | 5947.8        | 6192.3        |
|                                | <b>Region</b>           |               |               |               |               |
| West Bank                      | 4237.6                  | 4955.7        | 5370.9        | 6019.6        | 6194.2        |
| Gaza Strip                     | 880.1                   | 891.2         | 925.9         | 782.8         | 778.3         |
|                                | <b>Type</b>             |               |               |               |               |
| Current deposits               | 1792.6                  | 2064.0        | 2353.8        | 2680.6        | 2773.0        |
| Savings deposits               | 1142.4                  | 1389.6        | 1669.8        | 1844.2        | 2027.1        |
| Time deposits                  | 2182.7                  | 2393.3        | 2272.2        | 2277.6        | 2172.4        |
|                                | <b>Currency</b>         |               |               |               |               |
| USD                            | 2637.0                  | 2600.5        | 2697.4        | 2853.4        | 2718.5        |
| JD                             | 1261.4                  | 1588.0        | 1786.7        | 1852.5        | 1801.4        |
| NIS                            | 916.9                   | 1290.8        | 1465.8        | 1728.9        | 2115.8        |
| Others                         | 302.4                   | 367.6         | 346.9         | 367.6         | 336.8         |
| <b>Total</b>                   | <b>5117.7</b>           | <b>5846.9</b> | <b>6296.8</b> | <b>6802.4</b> | <b>6972.5</b> |

Source: PMA.

**Table (4-10): Palestinian banking sector: direct credit facilities, 2007-2011**

(USD Million)

| Items                          | 2007               | 2008          | 2009          | 2010          | 2011          |
|--------------------------------|--------------------|---------------|---------------|---------------|---------------|
|                                | <b>Beneficiary</b> |               |               |               |               |
| Public sector, of which:       | 421.5              | 532.7         | 637.4         | 837.2         | 1101.1        |
| Palestinian National Authority | 404.0              | 515.9         | 627.2         | 821.2         | 1098.9        |
| Private sector, of which:      | 1283.7             | 1295.5        | 1596.9        | 2048.7        | 2449.6        |
| Resident                       | 1208.7             | 1165.9        | 1449.0        | 1990.8        | 2335.4        |
|                                | <b>Type</b>        |               |               |               |               |
| Loans                          | 1077.3             | 1114.2        | 1562.9        | 1978.0        | 2531.7        |
| Overdrafts                     | 616.8              | 703.7         | 663.6         | 900.4         | 1010.3        |
| Finance lease                  | 11.1               | 10.4          | 7.8           | 7.5           | 8.7           |
|                                | <b>Region</b>      |               |               |               |               |
| West Bank                      | 1390.6             | 1558.6        | 2009.6        | 2633.2        | 3249.9        |
| Gaza Strip                     | 314.6              | 161.9         | 154.7         | 192.3         | 300.8         |
|                                | <b>Currency</b>    |               |               |               |               |
| USD                            | 1167.0             | 1190.2        | 1427.1        | 1756.6        | 2245.9        |
| JOD                            | 186.2              | 147.5         | 218.7         | 246.2         | 420.9         |
| NIS                            | 336.6              | 474.3         | 579.0         | 866.7         | 863.6         |
| Others                         | 15.4               | 16.2          | 9.5           | 16.4          | 20.3          |
| <b>Total</b>                   | <b>1705.2</b>      | <b>1828.2</b> | <b>2234.3</b> | <b>2885.9</b> | <b>3550.7</b> |

Source: PMA.



**Table (4-11): Palestinian banking sector: provisions for direct credit facilities, 2007-2011**

(USD Million)

| Items                                   | 2007          | 2008          | 2009          | 2010          | 2011          |
|---|---------------|---------------|---------------|---------------|---------------|
| Loans                                   | 102.2         | 57.4          | 44.2          | 34.7          | 34.6          |
| Overdrafts                              | 90.2          | 54.1          | 32.0          | 27.0          | 24.5          |
| Finance lease                           | 0.1           | 0.0           | 0.0           | 0.6           | 0.7           |
| <b>Total Provisions</b>                 | <b>192.5</b>  | <b>111.5</b>  | <b>76.2</b>   | <b>62.3</b>   | <b>59.8</b>   |
| <b>Direct Credit Facilities, net</b>    | <b>1512.7</b> | <b>1716.6</b> | <b>2158.1</b> | <b>2823.6</b> | <b>3490.9</b> |
| <b>Total Direct Credit Facilities</b>   | <b>1705.2</b> | <b>1828.2</b> | <b>2234.3</b> | <b>2885.9</b> | <b>3550.7</b> |
| Outstanding interests                   | 103.7         | 46.1          | 24.0          | 13.7          | 14.4          |
| <b>Non-Performing Loans<sup>1</sup></b> | <b>260.6</b>  | <b>148.0</b>  | <b>92.0</b>   | <b>88.5</b>   | <b>98.1</b>   |

<sup>1</sup> For the principles of classification of non-performing loans and how to calculate their provisions, please refer to instructions No. (1/2008), Classification of Credit Facilities, Provisions and Acceptable Guarantees on 20/12/2008, published on the website of the Monetary Authority ([www.pma.ps](http://www.pma.ps)).

Source: PMA.

**Table (4-12): Palestinian banking sector: sectoral distribution of private sector's loans, 2009-2011**

| Items                                 | 2009              |                         | 2010              |                         | 2011              |                         |
|---------------------------------------|-------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
|                                       | Value USD Million | Relative Importance (%) | Value USD Million | Relative Importance (%) | Value USD Million | Relative Importance (%) |
| Real estate, constructions, and lands | 266.2             | 16.7                    | 408.3             | 19.9                    | 441.1             | 18.0                    |
| Industry and mining                   | 184.8             | 11.6                    | 257.9             | 12.6                    | 303.7             | 12.4                    |
| General trade                         | 341.4             | 21.4                    | 392.2             | 19.1                    | 489.6             | 20.0                    |
| Agriculture and livestock             | 38.6              | 2.4                     | 45.3              | 2.2                     | 33.8              | 1.4                     |
| Services                              | 521.3             | 32.6                    | 576.8             | 28.2                    | 434.2             | 17.7                    |
| Consumer goods financing              | 133.6             | 8.4                     | 230.0             | 11.2                    | 526.5             | 21.5                    |
| Others                                | 110.9             | 6.9                     | 138.1             | 6.8                     | 220.7             | 9.0                     |
| <b>Total</b>                          | <b>1596.8</b>     | <b>100.0</b>            | <b>2048.6</b>     | <b>100.0</b>            | <b>2449.6</b>     | <b>100.0</b>            |

Source: PMA.

**Table (4-13): Palestinian banking sector: lending and deposits interest rates, 2007-2011**

(Quarterly average, Percent)

| Dates                    | Lending |            |       |            |       |            | Deposits |        |      |        |      |        |
|--------------------------|---------|------------|-------|------------|-------|------------|----------|--------|------|--------|------|--------|
|                          | JD      |            | USD   |            | NIS   |            | JD       |        | USD  |        | NIS  |        |
|                          | Loans   | Overdrafts | Loans | Overdrafts | Loans | Overdrafts | Time     | Saving | Time | Saving | Time | Saving |
| 31/3/2007                | 9.0     | 8.9        | 8.0   | 7.9        | 11.4  | 13.6       | 0.4      | 3.5    | 0.3  | 3.4    | 0.3  | 2.5    |
| 30/6/2007                | 9.0     | 9.0        | 8.0   | 8.0        | 11.3  | 13.6       | 0.4      | 3.6    | 0.3  | 3.3    | 0.3  | 2.0    |
| 30/9/2007                | 9.0     | 8.9        | 8.3   | 7.8        | 11.2  | 13.3       | 0.4      | 3.5    | 0.3  | 3.1    | 0.3  | 2.1    |
| 31/12/2007               | 8.9     | 8.8        | 8.2   | 7.9        | 11.4  | 13.2       | 0.4      | 3.5    | 0.3  | 2.8    | 0.4  | 2.2    |
| 31/3/2008                | 9.0     | 8.9        | 7.9   | 7.0        | 10.4  | 13.4       | 0.4      | 3.2    | 0.2  | 1.4    | 0.4  | 1.6    |
| 30/6/2008                | 8.8     | 8.9        | 7.3   | 7.1        | 11.7  | 13.0       | 0.4      | 3.1    | 0.2  | 1.3    | 0.4  | 1.6    |
| 30/9/2008                | 8.7     | 8.8        | 7.3   | 7.3        | 11.0  | 12.9       | 0.4      | 2.9    | 0.2  | 1.3    | 0.4  | 1.7    |
| 31/12/2008               | 8.8     | 8.8        | 7.5   | 7.5        | 10.9  | 12.9       | 0.4      | 2.3    | 0.1  | 0.6    | 0.3  | 0.9    |
| 31/3/2009 <sup>(1)</sup> | 8.6     | 9.0        | 6.4   | 5.9        | 10.0  | 13.2       | 0.3      | 2.0    | 0.0  | 0.5    | 0.2  | 0.2    |
| 30/6/2009                | 8.1     | 8.1        | 6.3   | 6.7        | 10.4  | 13.4       | 0.1      | 2.0    | 0.0  | 0.4    | 0.0  | 0.2    |
| 30/9/2009                | 6.4     | 7.3        | 4.8   | 6.4        | 8.7   | 12.1       | 0.1      | 1.9    | 0.0  | 0.4    | 0.0  | 0.3    |
| 31/12/2009               | 5.3     | 7.9        | 5.1   | 6.5        | 8.0   | 12.3       | 0.1      | 1.7    | 0.0  | 0.3    | 0.0  | 0.2    |
| 31/3/2010                | 6.7     | 8.4        | 6.0   | 6.6        | 8.7   | 12.8       | 0.1      | 1.2    | 0.0  | 0.3    | 0.0  | 0.3    |
| 30/6/2010                | 6.3     | 8.5        | 5.5   | 6.6        | 9.1   | 13.0       | 0.0      | 1.2    | 0.0  | 0.3    | 0.0  | 0.3    |
| 30/9/2010                | 6.8     | 8.3        | 5.7   | 6.9        | 9.0   | 12.7       | 0.0      | 1.1    | 0.0  | 0.3    | 0.0  | 0.3    |
| 31/12/2010               | 6.8     | 8.5        | 6.0   | 7.5        | 9.1   | 13.0       | 0.0      | 1.1    | 0.0  | 0.3    | 0.0  | 0.3    |
| 31/3/2011                | 6.7     | 8.5        | 5.9   | 7.2        | 9.0   | 12.8       | 0.0      | 1.1    | 0.0  | 0.3    | 0.0  | 0.6    |
| 30/6/2011                | 6.5     | 9.3        | 6.1   | 7.6        | 9.5   | 13.0       | 0.0      | 1.2    | 0.0  | 0.3    | 0.0  | 1.1    |
| 30/9/2011                | 6.6     | 9.3        | 6.1   | 7.6        | 10.2  | 12.1       | 0.0      | 1.2    | 0.0  | 0.3    | 0.0  | 1.1    |
| 31/12/2011               | 6.0     | 9.6        | 6.4   | 8.0        | 9.3   | 13.9       | 0.0      | 1.4    | 0.0  | 0.4    | 0.0  | 1.3    |

(1) Until 31/03/2009, the average interest rates were calculated by calculating the minimum and maximum interest rates on a quarterly basis. However, after that date they have been calculated by the weighted average interest rates on deposits and facilities on a monthly basis. Source: PMA.

Table (4-14): Palestinian banking sector: clearing activities, 2007-2011

| Years       | USD                                  |                     | JD            |                     | NIS           |                     | EUR           |                     | Total         |                     |
|-------------|--------------------------------------|---------------------|---------------|---------------------|---------------|---------------------|---------------|---------------------|---------------|---------------------|
|             | No. of Checks                        | Value (USD Million) | No. of Checks | Value (USD Million) | No. of Checks | Value (USD Million) | No. of Checks | Value (USD Million) | No. of Checks | Value (USD Million) |
|             | <b>checks presented for clearing</b> |                     |               |                     |               |                     |               |                     |               |                     |
| <b>2007</b> | 170,187                              | 1423.7              | 102,887       | 3747.9              | 1,939,748     | 4162.0              | 3,362         | 35.4                | 2,216,184     | 5638.6              |
| <b>2008</b> | 156,694                              | 1804.8              | 93,695        | 614.0               | 2,392,999     | 5,706.2             | 10,836        | 143.3               | 2,654,224     | 8268.4              |
| <b>2009</b> | 171,838                              | 1945.3              | 91,182        | 532.4               | 2,798,708     | 5554.5              | 6,669         | 71.2                | 3,068,397     | 8103.5              |
| <b>2010</b> | 192,309                              | 2193.2              | 103,848       | 579.5               | 3,322,381     | 6688.3              | 6,970         | 107.5               | 3,625,508     | 9568.5              |
| <b>2011</b> | 196,789                              | 2743.0              | 112,551       | 915.0               | 3,734,636     | 8001.0              | 6,279         | 235.0               | 4,050,255     | 11894.0             |
|             | <b>Bounced checks</b>                |                     |               |                     |               |                     |               |                     |               |                     |
| <b>2007</b> | 24,373                               | 63.2                | 18,966        | 39.3                | 286,579       | 382.7               | 122           | 1.1                 | 330,040       | 486.3               |
| <b>2008</b> | 16,085                               | 69.3                | 14,425        | 26.0                | 285,448       | 463.1               | 247           | 2.0                 | 316,205       | 560.4               |
| <b>2009</b> | 16,386                               | 79.7                | 12,882        | 30.1                | 326,611       | 439.2               | 162           | 1.5                 | 356,041       | 550.5               |
| <b>2010</b> | 17,233                               | 71.2                | 13,001        | 29.1                | 345,058       | 496.7               | 164           | 1.8                 | 375,456       | 598.8               |
| <b>2011</b> | 21,196                               | 76.0                | 15,653        | 32.0                | 451,160       | 650.0               | 153           | 1.0                 | 488,162       | 759.0               |

Source: PMA.

Table (4-15): Palestinian banking sector: inflows/ outflows transfers, 2007-2011\*

(USD)

| Years | Inflows of Transfers from |                     |                  |                     |                  |                     | Outflows of Transfers to |                     |                  |                     |                  |                     |
|-------|---------------------------|---------------------|------------------|---------------------|------------------|---------------------|--------------------------|---------------------|------------------|---------------------|------------------|---------------------|
|       | Israel                    |                     | Other Countries  |                     | Total            |                     | Israel                   |                     | Other Countries  |                     | Total            |                     |
|       | No. of Transfers          | Value (USD Million) | No. of Transfers | Value (USD Million) | No. of Transfers | Value (USD Million) | No. of Transfers         | Value (USD Million) | No. of Transfers | Value (USD Million) | No. of Transfers | Value (USD Million) |
| 2007  | 41,713                    | 1,304.45            | 93,321           | 2,035.37            | <b>135,034</b>   | <b>3,339.82</b>     | 48,274                   | 1,247.55            | 173,318          | 3,201.07            | <b>221,592</b>   | <b>4,448.62</b>     |
| 2008  | 38,191                    | 1,699.17            | 99,374           | 2,890.29            | <b>137,565</b>   | <b>4,489.46</b>     | 45,901                   | 1,249.39            | 161,302          | 4,906.76            | <b>207,203</b>   | <b>6,156.15</b>     |
| 2009  | 35,917                    | 1,424.59            | 520,102          | 3,220.87            | <b>138,437</b>   | <b>4,644.46</b>     | 33,111                   | 2,016.49            | 144,958          | 4,491.26            | <b>178,069</b>   | <b>6,507.76</b>     |
| 2010  | 32,555                    | 1,345.30            | 93,101           | 3,409.50            | <b>125,656</b>   | <b>4,754.81</b>     | 27,566                   | 2,325.80            | 118,144          | 4,276.20            | <b>145,710</b>   | <b>6,602.02</b>     |
| 2011  | 33,105                    | 1,627.70            | 111,005          | 3,772.70            | <b>144,110</b>   | <b>5,400.40</b>     | 37,226                   | 2,810.10            | 143,594          | 3,846.70            | <b>180,820</b>   | <b>6,674.80</b>     |

Source: PMA.

**Table (4-16): Palestinian Territory: palestine stock market, 2007-2011**

(USD Million)

| Items                                       | 2007                                | 2008   | 2009   | 2010   | 2011   |
|---|-------------------------------------|--------|--------|--------|--------|
| Number of trading sessions                  | 248                                 | 244    | 246    | 249    | 248    |
| Number of shares traded (million)           | 148.4                               | 339.2  | 238.9  | 230.5  | 184.5  |
| Value of shares traded (USD million)        | 813.5                               | 1185.2 | 500.4  | 451.2  | 365.6  |
| Number of executed transactions             | 157300                              | 152319 | 88838  | 82625  | 61928  |
| Market value of shares traded (USD million) | 2474.7                              | 2123.1 | 2375.4 | 2449.9 | 2782.5 |
|   | <b>Daily Averages</b>               |        |        |        |        |
| Value of shares traded (USD million)        | 3.3                                 | 4.9    | 2.0    | 1.8    | 1.5    |
| Number of shares traded (million)           | 0.6                                 | 1.4    | 1.0    | 0.9    | 0.7    |
| Number of transactions executed             | 634                                 | 624    | 361    | 332    | 250    |
|   | <b>Turnover rate(%)<sup>1</sup></b> |        |        |        |        |
|   | 32.9                                | 55.8   | 21.1   | 18.4   | 12.6   |
|   | <b>Al-Quds index</b>                |        |        |        |        |
|   | 527.3                               | 441.7  | 493.0  | 490.0  | 476.9  |

<sup>(1)</sup> Turnover = turnover value of shares traded / market value of shares traded.

Source: www.pse.com





