PALESTINE MONETARY AUTHORITY

Annual Report
2012

Research and Monetary Policy Department

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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 Palestine.

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 it's financial, human resources, and technical capabilities.

Board of Directors

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Deputy Governor

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Forward

On behalf of the PMA, I'm honored to present the new issue of our annual report. This report is part of the PMA's scheme to execute its functions and responsibilities in insuring reliable information, based on the monitoring and analysing of its macroeconomic performance. By fulfilling its role, the PMA aims to achieve financial and monetary stability, and contribute to sustainable growth.

This report is issued in a time that has witnessed a number of global and regional political and economic developments which have affected the economic performance of a number of countries around the world. These developments have transpired amid growing fears of a worsening of crises due to the failure in finding radical solutions. These crises are capable of posing a great threat on the global economic structure as well as that in the local arena.

Although the Palestinian economy has been somewhat cut-off from direct impacts of global and regional developments during 2012, its own problems and challenges, in turn have played the role of economic inhibitor. The main causes behind the slow economic performance are the obstacles and restrictions set by the occupation on one hand, in addition to the issue of liquidity and minimal external support and the rigidity of the political horizon on the other. This increased doubts on whether the Palestine's economy is capable of achieving sustainable growth rates.

However, the banking system is considered an exception to this rule, whereby performance indicators of the banking system highlighted the success of the PMA. This is with regards to maintaining financial stability in general, and more specifically, in the stability of banks operating in Palestine in a highly volatile environment.

The annual report is comprised of four main sections, pertaining to real economy and the most important developments and changes that have taken place in the local and global economic arena. It also includes the public finance development as well as the external sector, including foreign trade developments and the Palestinian Balance of Payments (BoP). This issue includes sections on the Palestinian financial sector and the most important achievements of the PMA, which was behind the developments of all the institutions under its direct supervision.

It is my hope that through this review the PMA will have been successful in addressing the most important changes of 2012. This is within a framework of analysis based on accurate information, supported by several statistical time series involving the most prominent global and regional economic indicators.

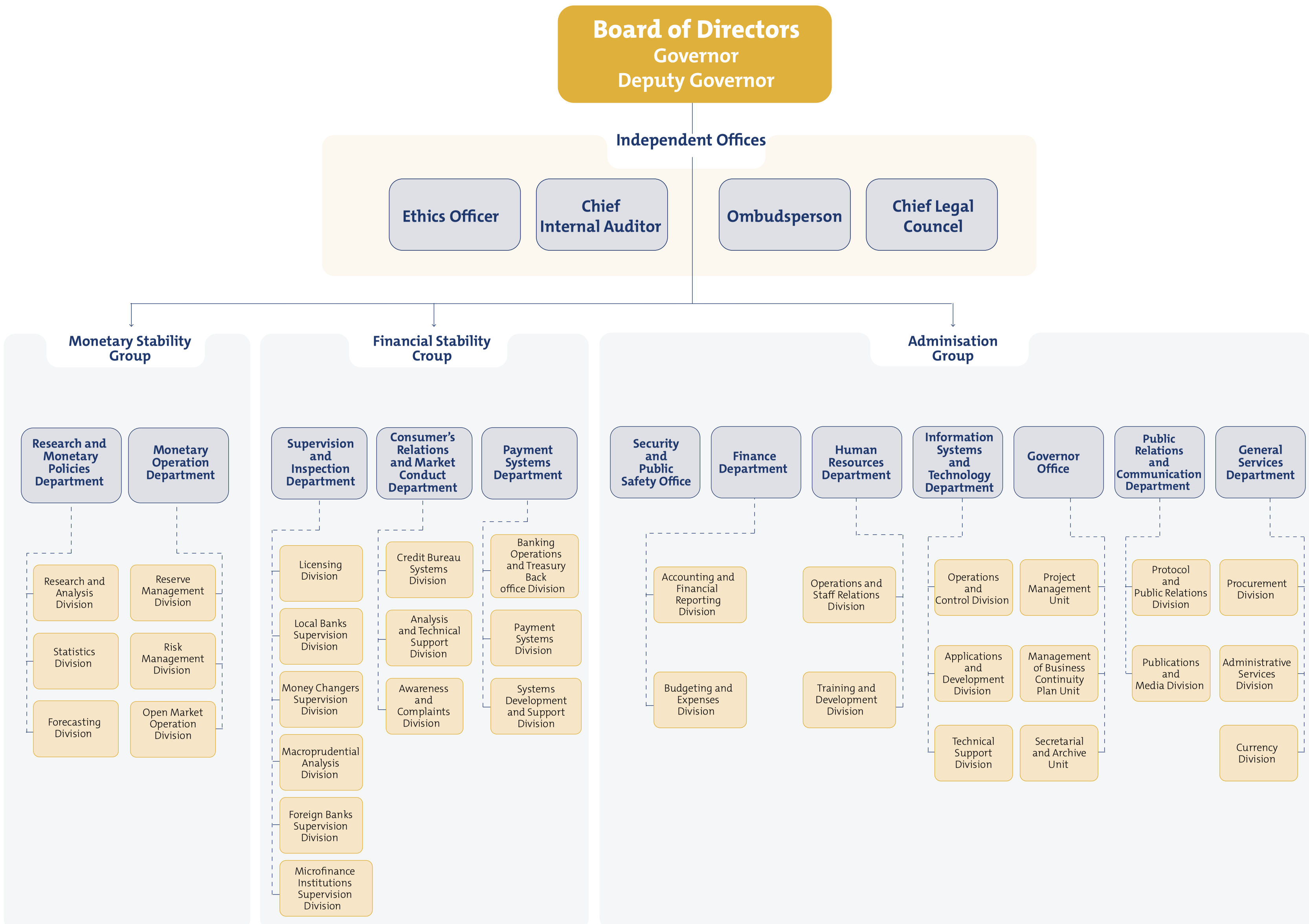
Finally, I would like to extend my gratitude to the board members of the PMA and all its employees for their tireless efforts in realizing the goals of the PMA, as well as its future aspirations to transform into a central bank for a sovereign and independent Palestinian state.

I would also like to extend my grace and gratitude to regional and international institutions for their ongoing contributions of support to the development of the PMA and the financial and banking system. All this, in order to serve the Palestinian citizen in their land and assist the process of sustainable development in Palestine.

Governor

Dr. Jihad Khalil Alwazir

Organization Chart



Palestinian Banking System Institutions 2012

PMA

Foreign Banks

21	Cairo Amman Bank	1986
26	Arab Bank	1994
33	Bank of Jordan	1994
6	Egyptian Arab Land Bank	1994
4	Jordan Commercial Bank	1994
5	Jordan Ahli Bank	1995
12	Housing Bank for Trade & Finance	1995
2	Jordan Kuwait Bank	1995
1	Union Bank	1995
1	HSBC Bank Middle East Limited	1998

Local Banks

48	Bank of Palestine P.L.C	1960
6	Palestine Commercial Bank	1994
13	Palestine Investment Bank	1995
10	Arab Islamic Bank	1995
15	Palestine Islamic Bank	1995
22	Al Quds Bank	1995
7	The National Bank*	2005

Specialized Lending Institutions

Institutions**
11

Money Changing Institutions

Companies
173

Individuals
103

* Based on the decision of the board of directors and the approval of the general assimply, Al-Rafah microfinance bank changed its name to become the National Bank. The name of the company was changed with the Companies Controller in November 2012 and in December 2012 the bank completed the acquisition of the Arab Palestinian Investment Bank.

** Number of institutions working in Palestine, but not licensed from the PMA yet, since the licensee applications are under processing.

Year of establishment for local banks, or re-opening of the first branch for foreign banks.

Number of branches and representative offices.

Abbreviations

ACs	Advanced Countries
AFI	Alliance for Financial Inclusion
BOJ	Bank of Japan
BoP	Balance of Payment
BURAQ	Real-Time Gross Settlement System
ECB	European Central Bank
EDCs	Emerging and Developing Countries
FCE	Final Consumption Expenditure
FDI	Foreign Direct Investment
FED	The US Federal Reserve
FISIM	Financial Intermediation Services Indirectly Measured
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GS	Gaza Strip
IBAN	International Bank Account Number
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
MENA	Middle East and North Africa
NIS	New Israeli Shekel
PBI	Palestine Banking Institute
PCBS	Palestinian Central Bureau of Statistics
PCE	Personal Consumption Expenditure
PCMA	Palestine Capital Market Authority
PEX	Palestine Exchange
PMA	Palestine Monetary Authority
PNA	Palestinian National Authority
US	United States
WB	West Bank
WTO	World Trade Organization

Executive Summary

During 2012, economic and political crises continued to affect the global economy, and contributed to further weakening in global economic growth, all at a time when the effectiveness of fiscal and monetary policies adopted by afflicted economies was still questioned by the financial markets, investors and analysts alike. Despite its current significance, fiscal austerity formed an additional burden on domestic demand and raised further concerns about fiscal stance and budget deficit. Also, slower growth contributed to deepening of problems faced by some banks in many countries, such as Spain and Cyprus.

However, attention is mostly directed to the heavily indebted euro area, and the fragile growth of the United States, as being most influential on the performance of the global economy. The Euro sovereign debt crisis has exacerbated during 2012 affecting the third and fourth largest economies in the euro area, Italy and Spain respectively, and threatening more countries, especially the smaller and less solid ones in the euro area. On the other hand, the mixed signals sent by the U.S. economy and the possibility of falling into a fiscal cliff also promoted fears of a relapse of global growth in 2012.

Moreover, the influence of the Advanced Countries (ACs) crisis on Emerging and Developing Countries (EDCs) become increasingly more obvious; which is reflected by the declining growth rates and levels of foreign trade. On the regional level, some countries in the MENA region, especially the Arab Spring countries, are continue to experience great pressure on their public budgets with the decline in revenue, due to political, economic and social developments. In addition, balance of payments accounts are also facing pressures due to the decline in foreign direct investment, the compensation of employees, and in revenues from tourism and others.

With the backdrop of these risks, global growth slowed from about 4 percent in 2011 to 3.2 percent in 2012, with a clear disparity between different groups. While EDCs have grown by about 5.1 percent, the growth in ACs did not exceed 1.2 percent. This slowdown in growth was associated with a decline in inflation, a rise in unemployment, a drop in demand, and a general reluctance for lending and investment in many ACs.

At the local level, the growth of the Palestinian economy has also slowed during 2012 compared to 2011, as real GDP grew by 5.9 percent, compared with 12.2 percent in 2011. A significant decline in growth was noticed in the WB and GS alike, with growth in the WB declining from 10.4 percent to 5.6 percent between 2011 and 2012, while in GS growth falling from 17.6 percent in 2011 to 6.6 percent in 2012. A further decline in growth is still possible as long as fiscal austerity remains in place, especially with the continuous decline in external support and if restrictions on access and movement remain unchanged. Despite the slowdown in growth, Palestinian per capita real GDP has grown over the past few years by almost a quarter to reach a level of USD 1,679.3 during 2012, surpassing, for the first time, the level achieved in 1999. It should be noted that per capita GDP in both the WB and GS has grown during 2012 by 2.7 percent and 3 percent, respectively.

Prices in Palestine indicated low and relatively close levels of inflation during the last two years. Inflation rate reached 2.8 percent during 2012 compared to 2.9 percent in 2011. Nevertheless, these levels caused a relative erosion in real wages, due to the fact that the inflation rate was still higher than the increase in nominal wages. So, the average daily real wage in Palestine declined by about 1.4 percent in 2012, driven by lower average daily real wage in the WB by 1.7 percent, as well as for workers in Israel by 3 percent, compared with an increase in average daily real wage in GS by 4.1 percent due to the low level of inflation therein.

The disparity in inflation between the WB and GS has also created uneven changes in the purchasing power of the NIS and USD in both regions. The purchasing power of the NIS decreased in the WB by 4.1 percent, while in GS the decline did not exceed 0.5 percent, compared with an increase in the purchasing power of the USD between 7.2 percent in GS and 3.6 percent in the WB, assuming nominal wages remained constant.

Unemployment in Palestine is on the rise again in 2012 after a relative improvement witnessed last year. The unemployment rate rose to 23 percent of total labor force, compared with 20.9 percent in 2011. It rose in the WB from 17.3 percent in 2011 to 19 percent during 2012, while in GS, it increased from 28.7 percent to 31 percent between 2011 and 2012.

On the other hand, the current account deficit in the Palestinian balance of payments reached USD 2,814.8 million in 2012, up by 28.4 percent from what it was in 2011, and accounting for 27.4 percent of GDP, compared with 22.4 percent of GDP during 2011. The main reason behind this increase is the dramatic rise of the chronic deficit in the trade balance, which reached USD 5,236.5 million, or 51.1 percent of GDP in 2012, compared with 48.4 percent in 2011. Meanwhile, the capital and financial account has achieved a surplus of USD 2,832 million during 2012; an increase of 31.4 percent from 2011, with the surplus accounting for 27.6 percent of GDP, compared with 22 percent in 2011. The primary reason behind this is the rise in net inflows of other investments (mainly bank deposits), which amounted to USD 2,410 million in 2012.

Conversely, and as in previous years, the 2012 continued to highlight the Palestine Monetary Authority (PMA)'s efforts and success in maintaining the stability and performance of banks operating in Palestine, notwithstanding the surrounding political and economic crises, and a highly risky domestic environment. The PMA has also succeeded in ensuring banks management according to international best practices, including full commitment to the principles of banking governance, addressing weak banks, strengthening banks' capital, developing financial infrastructure, and maintaining customers confidence in the banking system.

The outcome of the abovementioned actions were reflected positively in the financial indicators of the Palestinian banking system. The most prominent improvements included the rise in assets, growing customer deposits, the improvement in the size and quality of the credit portfolio, and increased banks' ability to cope with expected and unexpected risks.

Milestones have also been achieved both at the legislative and regulatory levels. The most prominent of these was the Payment Systems Law. In addition, other major projects were completed in 2012, such as the International Banking Account Number-IBAN, the Suspended and Lost Checks System, the settlement of Palestine Exchange (PEX) trading through the BURAQ system, national electronic switch for electronic payment instruments, and other projects that have enhanced the stability and performance of banks operating in Palestine.

The financial indicators of banks operating in Palestine show an increase in total assets by the end of 2012 to about USD 10,044.5 million, and by 7.6 percent compared with the end of 2011. Credit facilities have also seen a remarkable increase of about USD 648.4 million, thereby achieving a growth of 18.3 percent from 2011, to amount to USD 4.2 billion by the end of 2012. This, in turn, meant increased activation of financial intermediation between surplus and deficit units in the economy by providing more funding opportunities, which will eventually contribute to economic development. Customer deposits reached USD 7.5 billion, increasing by 7.3 percent compared to 2011. Net equity of the banking system increased by 6.1 percent, to reach USD 1,256.5 million, as a result of increasing paid-up capital, which in turn increased banks' ability to cope with expected and unexpected risks.

On the other hand, the PMA proceeded to strengthen its capital gradually in order to increase its capacity to overcome risks. The PMA's equity grew by 3.2 percent, to reach USD 92.1 million by the end of 2012, as a result of increasing paid-up capital by about 5 percent, and transferring annual profits to the equity account.

Main Economic Indicators in Palestine, 2008-2012

Indicator	2008	2009	2010	2011	2012
Output and Prices	(Annual percent change)				
Real GDP (2004 market prices)	7.1	7.4	9.3	12.2	5.9
Real Percapita GDP	4.1	4.3	6.7	8.3	2.7
Inflation rate	9.9	2.8	3.7	2.9	2.8
WB	9.8	0.6	4.2	3.5	4.1
GS	14.0	4.4	1.7	0.6	0.5
Unemployment Rate	(Percent of labor force)				
Palestine	26.6	24.5	23.7	20.9	23.0
WB	19.7	17.8	17.2	17.3	19.0
GS	40.6	38.6	37.8	28.7	31.0
Broad definition, Palestine	31.7	30.1	30.0	25.8	26.7
WB	25.3	23.4	23.4	22.3	23.0
GS	45.0	43.8	43.7	33.1	34.2
Consumption, Investment and Saving	(Percent of nominal GDP)				
Final consumption	130.8	133.4	123.2	126.4	133.1
Public	20.6	26.1	24.5	29.9	30.3
Private	110.2	107.3	98.7	96.5	102.8
Gross investment	18.6	18.0	17.3	20.7	17.9
Public	7.7	7.4	7.1	8.5	6.7
Private	10.9	10.6	10.2	12.2	11.2
Domestic saving	-30.8	-33.4	-23.2	-26.4	-33.1
Public Finance	(Percent of nominal GDP)				
Total net revenue and foreign aid	60.2	43.9	38.1	32.3	30.9
Domestic revenue	28.5	23.1	22.8	22.3	21.8
Tax	4.4	4.5	5.7	4.9	4.7
Non-tax	7.8	4.2	3.3	2.3	2.3
Clearance revenue	18.2	16.2	14.9	15.2	15.4
Tax refund (-)	1.9	1.8	1.1	0.1	0.6
Foreign aid	31.7	20.8	15.3	10.0	9.1
Total expenditures	55.8	46.2	39.1	33.3	31.8
Current expenditures and net lending	52.4	43.5	35.8	30.3	29.7
Wage expenditure	28.4	21.2	18.8	17.2	15.2

Indicator	2008	2009	2010	2011	2012
Non-wage expenditure	16.9	17.0	13.9	11.7	11.8
Net lending	7.1	5.3	3.1	1.4	2.7
Development expenditures	3.4	2.8	3.3	3.0	2.1
Current balance	-23.9	-20.5	-13.0	-8.0	-7.9
Overall balance (Excl. foreign aid)	-27.3	-23.2	-16.3	-11.0	-10.0
Overall Balance (Inc. foreign aid)	4.4	-2.3	-1.0	-1.0	-0.9
Government public debt	24.9	25.8	22.6	22.6	24.2
External Sector	(Percent of nominal GDP)				
Exports of Goods and Services	18.6	18.0	18.0	19.4	17.6
Imports of Goods and Services	75.9	75.4	65.6	73.3	63.7
Income From Abroad, net	14.7	13.0	13.2	11.0	11.9
Of which: compensation of employees	11.9	12.4	12.9	10.8	12.3
Current transfers, net	54.7	33.7	26.1	14.1	12.9
Of which: to public sector	31.7	22.1	14.6	7.7	5.1
Current Account	12.2	-10.6	-8.3	-28.8	-21.4
Monetary Sector	(Annual percent change)				
PMA Assets	55.2	8.8	-9.9	-11.2	7.8
Banks Assets	10.4	6.5	9.1	6.1	7.6
Direct Credit Faciltities	7.2	22.2	29.2	23.0	18.3
Of which: to the private sector	0.9	23.3	28.3	19.6	14.0
Deposits	14.2	7.7	8.0	2.5	7.3
Of which: from the private sector	13.9	9.1	6.8	4.4	7.4
Balances Abroad	4.1	-13.8	-7.2	-5.9	-6.6
Ownership Equity	22.1	12.0	14.2	8.4	6.1
Of which: paid-up capital	19.4	15.3	10.9	8.0	2.3
Memorandum Items					
Real GDP (USD Million, 2004 = 100)	4,878	5,239	5,725	6,421	6,797
Nominal GDP (USD Million)	6,247	6,720	8,331	9,775	10,255
Al-Quds Stock Market Index (point)	527.3	441.7	493.0	476.9	477.6
Exchange rate (USD/NIS)	3.59	3.92	3.73	3.58	3.85

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Chapter One

Global and Local Economic Developments

Part I
Global Economic Developments

Overview

In 2012, incessant crises that blasted various countries during the past few years extended to inhibit growth globally as well as in most groups of countries during that year. The European officials' failure to contain the European debt crisis, along with the slow recovery in the U.S. obstructed growth in advanced countries, and in turn, influenced economic growth in their trading partners, particularly in emerging economies that rely heavily on exports. Yet, the future of the Euro Area and its monetary union are still questionable in light of the deterioration of economic conditions in member states and the continued spread of the debt crisis.

Despite strenuous efforts made by the concerned states to correct their economic structure and performance, investors' confidence in the global economic performance and the advanced countries economies, in particular, remained relatively weak. Such an impression is notably attributed to the failure of austerity measures and expansionary monetary policies adopted by these states during 2012 to achieve their set objectives. On the contrary, the majority of economists held fiscal austerity liable for the aggravation of the European debt crisis. Consequently, and in light of failing attempts to contain the crisis and the lack of feasible options, decision makers around the world are overwhelmed by the magnitude of crises in various regions of the world and the extent of integration that governs economic and trade relations. This leads to the conclusion that all will eventually be affected by crises of major economies.

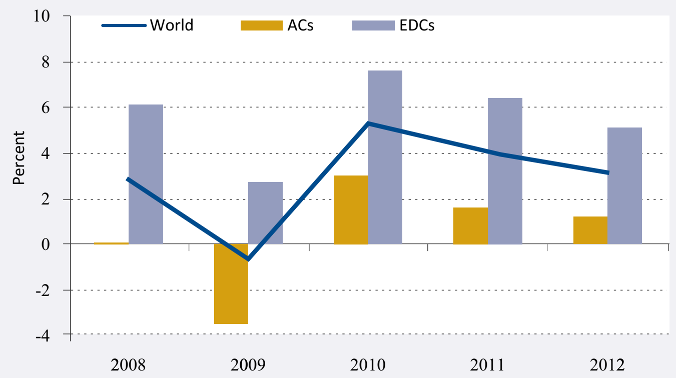
Economic Performance

The year 2012 witnessed a number of economic and political developments that casted their shadow over the global economic performance. As for economics, both markets and politicians greatly focused on the heavily indebted Euro area and the United States, which has been unable to sort out its growth process so far. On one hand, the European sovereign debt crisis aggravated during 2012. It spread and affected third and fourth largest economies in the Euro area, namely: Italy and Spain. Also, it threatened minor and less solid countries to encounter the crises of the Euro area. On the other hand, the mixed signals sent by the American economy to the markets during 2012 and the potential that it would fall into fiscal cliff contributed to promoting fears of the global growth decline in 2012. Furthermore, it became more explicit that EDCs would be affected by the crises of the advanced countries (ACs). That was reflected by the growth rates and levels of foreign trade thereof. As for the MENA region, political crises are still blasting many countries, particularly Arab Spring countries.

Growth

The global economy, which has not recovered from the global financial crisis, experienced more pressures during 2012 as the Euro debt crisis exacerbated. The latter not only contributed to the deterioration of economic conditions in the Euro Area, but extended its impact to include the rest of ACs along with EDCs. Consequently, global growth slowed down to 3.2 percent in 2012, compared to 4.0 percent in 2011, reflecting slowing activity in both country groups despite disparities in their response to crises. For as the EDCs kept expanding and growing at relatively high rates, some ACs, especially the Euro area countries, remained a cause of a high concern. Accordingly, the EDCs achieved a growth rate of 5.1 percent in 2012, compared to 6.4 percent in 2011.

Figure 1-1: Global real GDP growth rates, 2008-2012



Source: International Monetary Fund (IMF), World Economic Outlook Report (WEO).

Meanwhile, the group of the ACs grew by 1.2 percent in 2012 compared to 1.6 percent in 2011.

Of ACs, the U.S. and Japan were the only exception among major economies to achieve accelerating growth. In the U.S., GDP grew by nearly 2.2 percent during 2012, compared to 1.8 percent in 2011. This could be attributed to improvement in private demand together with the partial recovery of the U.S. real estate market. On the other hand, Japan recovered from recession following the natural disasters that hit the country in early 2011. Japan was able to achieve a growth of 2.0 percent in 2012, compared to -0.6 percent in the previous year, as the government expanded its spending and adopted policies to stimulate private consumption during 2012.

As for the Euro area, the region's GDP declined by nearly 0.6 percent during 2012, compared to a growth of nearly 1.4 percent in 2011. Reasons behind the fall were mainly the adoption of strict austerity policies, decline in private demand and financial sector imbalances. Greece was the one to suffer the worst economic performance in the Euro area for the third year in a row where GDP shrank by nearly 6.4 percent. The economies of Portugal, Cyprus, Italy, and Spain experienced similar circumstances. Their economies shrank by 3.2 percent, 2.4 percent, 2.3 percent and 1.4 percent respectively. Meanwhile, Germany and France witnessed a major slowdown. Growth in Germany reached 0.8 percent, and nearly zero percent in France. Such a slowdown undermined the capabilities of the two major economies in the Euro area to push growth in the area.

Likewise, the EDCs witnessed a slowdown in growth, with the exception of the MENA which grew by 4.8 percent in 2012, compared to 4.0 percent in 2011. Developing Asia topped the group with a growth rate of 6.9 percent during 2012, compared to 7.9 percent during 2011. However, Central and Eastern Europe and the Commonwealth of Independent States suffered from a decline in real GDP amounting to 3.6 percent and 6.4 percent respectively. It is worth mentioning that even with the notable EDCs' resilience and ability to cope with the uninterrupted crises, the decline in demand in the ACs, and the Euro area in particular, has plainly affected growth in these countries.

Regionally, Jordan's economy has witnessed a relative rise in growth from 2.6 percent in 2011, to 2.8 percent during 2012. This improvement came despite the political turmoil in the region, the influx of Syrian refugees, and the removal of subsidies on basic commodities during 2012. On the other hand, the Israeli economy experienced a slowdown that reflected poor global performance, particularly in its main trading partner, the Euro area, with a growth rate of 3.1 percent compared to 4.6 percent in 2011.

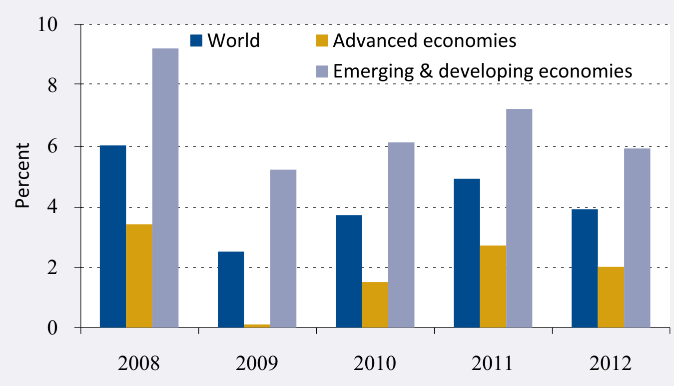
Prices and Inflation

The economic slowdown in most groups of countries had a negative impact on the global and regional price movements. Inflation rates declined during 2012 compared to the previous year. This reflects the changes in the levels of demand in the groups of countries, besides the significant decline in food prices and the relative stability in crude oil prices.

Despite similarities in price trends between different country groups, the unequivocal disparity in the rates of inflation continues to exist. This could be attributed to several factors, including: different levels of demand, growth rates, economic structure[1] and monetary policies adopted in these groups. ACs experienced an inflation of 2.0 percent during 2012, compared to 2.7 percent in 2011. In comparison, CPI grew by 5.9 percent in the EDCs in 2012, compared to 7.2 percent in 2011.

Remarkably, the MENA countries constitute an exception with respect to inflation rates. The growth in prices accelerated to reach 10.7 percent in 2012, compared to 9.2 percent in 2011, as a result of accelerating economic growth therein, and the removal of subsidies on certain basic commodities in a number of countries in the region. In this regard, Jordan sets the best example of this case, where a combination of high import costs, growing government deficit and diminishing financial resources forced the government to remove subsidies on basic commodities. This pushed inflation to 4.8 percent, compared with 4.4 percent in 2011.

Figure 1-2: Global inflation rates, 2008-2012



Source: IMF, WEO report and database.

Despite the different economic structure and surrounding circumstances, Israel experienced a similar rise in price levels as a result of raising taxes on goods several times during 2012 in an attempt to increase government revenues. Thus, the rate of inflation rose to reach 3.5 percent, compared to 2.7 percent in 2011.

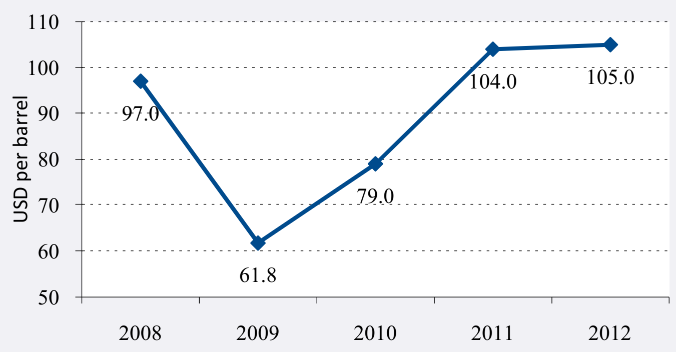
[1] The difference in economic structure does not only mean a difference in the composition and size of various sectors, but also reflects the difference in these countries' location on the growth curve. As by the time ACs have arrived at maturity (where chances for achieving high levels of growth and inflation are limited), the EDCs are still in the rapid growth phase where markets and price movements are active, allowing for relatively high rates of growth and inflation.

Oil prices[2]

Despite the fluctuations in crude oil prices due to economic and political developments in major oil importing and exporting countries, prices remained relatively stable. Crude oil prices increased by less than 1 percent in 2012, reaching nearly USD 105 per barrel, compared to USD 104 in 2011. Political tension between Iran and the U.S. early this year, the persistent instability in the Middle East, the Euro crisis and USD exchange rates fluctuations, all constituted crucial factors in the fluctuations in oil prices over the course of the year. The price of an oil barrel reached USD 112 during the first quarter of 2012 as a result of fears of growing tension in US-Iranian relations (and its subsequent impact on the volume of production and the movement of oil from the Arab Gulf), in addition to expectations of improvement in the U.S. economy and higher fuel demand.

Despite the sensitivity of oil prices to European officials' moves to contain the debt crisis, the sluggish demand in most major economies led to a decline in oil prices during the next three quarters, costing about USD 102 a barrel in the fourth quarter.

Figure 1-3: Crude oil prices (average), 2008-2012



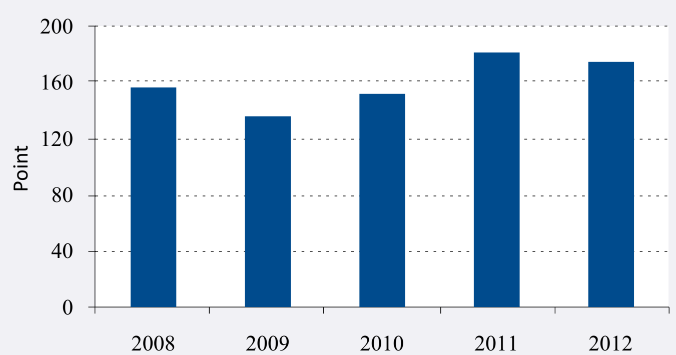
Source: IMF, IFS report and database.

Food Prices

World food prices returned to a gradual increase in 2012 (WFP declined by the end of 2011 after reaching record levels earlier that year) in response to the rising oil prices in the first quarter of the year. This was followed by severe weather conditions in agricultural producing countries during the second and third quarters, in addition to the decline in global stocks of food commodities during the entire year[3]. Despite such a rise, world food prices remained below the high levels that were attained in 2011 as WFP fell 3.6 percent between 2011 and 2012.

It is worth noting that food prices reached record levels during the last five years. In spite of the fluctuations during this period and the relative decline in late 2012, forecasts indicate that climate change and harsh weather conditions in producing countries will result in a decline in supply of basic food commodities versus the steady

Figure: 1-4: Global food price index, 2008-2012



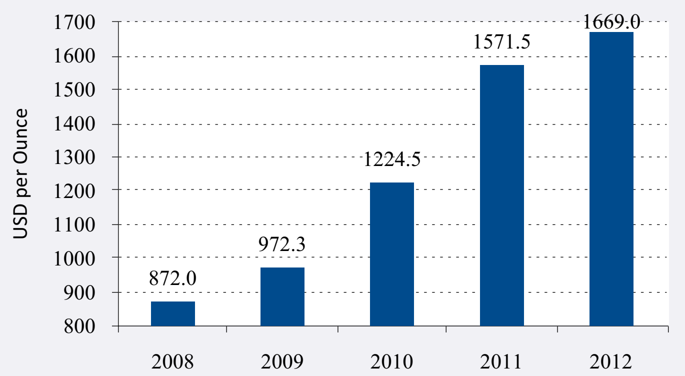
Source: IMF, WEO report and database.

[2] Represents the average of oil barrel price of UK Brent, West Texas, Dubai Fateh.
[3] Food Price Watch, World Bank, 2012.

rise in population. This is not merely a warning of higher prices in the near future, but also of a global food crisis in the long-term. Such a crisis may cause economic, social and political instability worldwide, especially in developing countries.

Gold Prices

Figure 1-5: Global gold prices, 2008-2012



Source: www.kitco.com, London fix

Gold prices continued to climb sky-high in 2012. The ongoing economic crises in major economies and uncertainty in the markets over sustainable recovery undermined investors' confidence in these economies, their currencies and financial markets. At a time when fiscal and monetary policies failed to revitalize these economies, the precious metal had become a safe haven for both investors and central banks, especially in light of the fluctuation of the exchange rate between the Dollar and other currencies throughout the year. In view of this, the average price of an ounce reached USD 1,669, higher by 6.2 percent compared to that in 2011.

Interest Rates

A handful of central banks continued to change their policy interest rate in 2012 as part of their monetary policies. The aim was to stimulate their economies and to drive them towards recovery from the consequences of the global and regional crises. The most important event in this regard is the change of interest rates by ECB. After the ECB insisted on maintaining the official interest rate at 1 percent during the first half of 2012 in order to avoid raising inflation levels beyond the targeted 2.0 percent, it was forced to cut its policy rate to 0.75 percent in July 2012. It became evident that conditions in the Euro area will further deteriorate if the European Union institutions, and the ECB in particular, decide not to intercede and save the area from collapse.

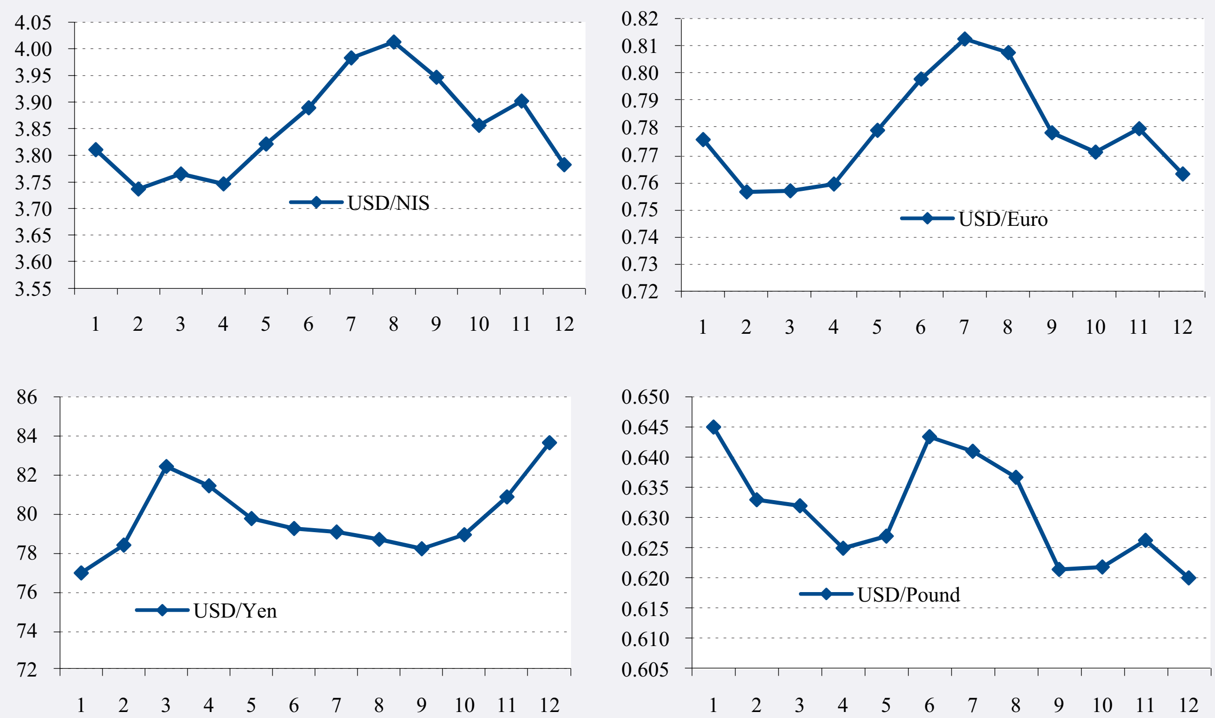
On the contrary, other major central banks maintained relatively low interest rates without any notable changes. The Fed has maintained an interest rate of 0.25 percent since 2009. The same applies to the BoJ, which maintained a rate of 0.1 percent since 2008. Meanwhile, the interest rate on the pound sterling remained unchanged at a rate of 0.5 percent since 2009.

Regionally, Bank of Israel strived to stimulate the economy during the course of the year by gradually changing its policy interest rate from 2.75 percent in late 2011 to 1.75 percent by the end of 2012.

Exchange Rates

Fluctuations in exchange rates often reflect the economic, fiscal and monetary policies of different countries. Moreover, they are an important element in determining the trade relations and the flow of capital among countries. Similarly, fluctuations in the major currencies (Euro, Pound Sterling and Yen), in addition to the Israeli Shekel[4], against the U.S. dollar through-out 2012, reflect the market's reaction to each of the crises encountered by the major economies and the policies that were adopted to contain the crises. In this context, the U.S. dollar experienced a significant fluctuation during the year against the abovementioned currencies as a result of several factors. The most important of these factors are: the FED's announcement of a third facilitating package in September 2012; and the FED's injection of USD 40 billions worth of liquidity per month (the amount had been increased in December of the same year to USD 85 billion per month) which aimed to maintain a low interest rate. At the same time, the Euro exchange rate remained stable without any significant long-term changes. This reflects the immunity of the Euro against the crisis that the region experienced, as well as the prevailing state of uncertainty and the repercussions of the fluctuation in exchange rates.

Figure 1-6: USD exchange rate against major currencies, monthly basis, 2012



Source: www.oanda.com.

[4] Israeli shekel has been added as it is the traded currency in Palestine. Thus, its tangible impact of the change in its exchange rate against the dollar on the livelihood of the Palestinian individual, especially those who receive remunerations in U.S. dollars and the Jordanian dinar.

Box1: Monetary policy between conventional tools and creative solutions

Current monetary policies of major economies are implemented as a response to global crises and developments that have been taking place over the past five years. Successive crises have created new economic realities whereby the global economy and financial system have become more complicated and fragile to the extent that the effectiveness of most traditional financial policies has decreased. Moreover, the interactions between markets and the economic structure these crises have produced have come to defy a number of economic axioms. Following the financial crisis that hit the world in 2008, starting with the US, central banks rushed to save their economies and banking systems from collapsing. They initiated their expansionary policies by reducing their policy rates (which reached levels close to zero in the US), to provide liquidity in the banking system and encourage commercial banks to lend more money. However, the gravity of the crisis and the panic that ensued in the markets prevented them from achieving such an objective, and the US subsequently fell in the so-called "Liquidity Trap", making it, impossible to cut interest rates any further. Likewise, pursued monetary policies and attempts to inject liquidity failed to reduce long-term interest rates and raise inflation expectations in markets.

These challenges prompted major central banks to seek innovative solutions for their crises. Instead of employing conventional monetary policy tools (policy interest rate, open market operations, required reserves), they turned to buying long-term government bonds and directly intervening in markets by buying assets from commercial banks and the private sector. This was done with the aim to reduce long-term interest rates in the market; a process idiomatically known as "Quantitative Easing". This tool aims at lowering the cost of borrowing for the private sector, and encourages enterprises to expand their investment and the consumption of capital goods. It also aims at lowering the interest rate on interbank lending, which would encourage more banks to lend.

Policies and Objectives

The majority of the major central banks adopted the aforementioned innovative policies despite differences in the objectives of their monetary policies, structures of their economies and the imbalances that are currently being resolved. In the US both inflation and employment indicators are pivotal points of monetary policy. Along with its implicit targeting of inflation, the activities of the Fed. in the market were associated with developments in the labor market and the creation of jobs, particularly in its third package of quantitative easing. The Fed endeavored to achieve its objectives through several methods, which included maintaining a near-zero policy rate, injecting liquidity into the banking system and intervening with the government bond market to cut long-term interest rates. However, what draws attention to the policies of the Fed is the extent of its involvement in the housing market, which collapsed in 2009, by purchasing mortgage-backed securities. It seems as though the Fed assumes a more comprehensive role than other central banks. The Fed did not limit its role to just rescuing the banking system, but also extended its support to other sectors of the economy with the belief that improving the housing market and the production of commodities are the basis for further improving economic performance.

Moreover, the expansionary fiscal policies and the margin of freedom granted to the Fed were of great assistance in the advancement of the US economy.

Across the Atlantic, the policies of the European Central Bank (ECB) reveal a vast dissimilarity in European philosophy regarding this matter. Price stability constitutes the primary objective of the ECB, whose policy of inflation targeting is more stringent, limiting the ability to turn to policies that are more expansionary and supportive to the Euro Area's economy and its member states. This is evident in the ECB's insistence, until the end of 2012, against reducing its policy rate to encourage lending, and by doing so, steering clear of exerting pressure on prices. Furthermore, the ECB's involvement in the government bond and mortgage markets is lower compared to their U S counterpart. Instead, the ECB turned to intervening heavily in the interbank market by injecting liquidity and lending to affected banks in member states. Thus, the ECB stands firmly away from intervening in other economic sectors at a time when national governments in member states remain committed to strict austerity measures, which leaves other markets without the support enjoyed by their counterparts in the US.

Japan, on the other hand, embodies a unique case as to the conditions encountered by major economies. Over the past two decades, the Japanese economy suffered from chronically low growth rates and an acute decline in price levels due to the economic recession that transpired in the early nineties and remains an influence until today. Above all this, the global financial crisi, the Euro area debt crisis and the tsunami that hit Japan in 2011 all served to increase the fragility of the economy , especially with the decline in global demand and the strength of the yen against other currencies. Such a situation compelled Bank of Japan (BoJ) to intervene in order to support the expansionary fiscal policies and to safeguard the economy from any further decline.

The main source of concern lies in the fact that the Japanese monetary policy has always been described as shy and insufficient to mobilize markets. The failure of Japanese officials in controlling the economy was evident during the past twenty years. This raised several concerns in the last two years over the current system's ability to contain the effects of the new crises. However, markets still found a light at the end of the tunnel in the midst of the recent elections in Japan: The new Japanese Prime Minister, Shinzō Abe, promised to implement more aggressive fiscal and monetary policies to promote growth, eliminate deflation and depreciate the yen against other currencies with the hopes to support exports.

Such statements raised some opposition from various Japanese officials as they were deemed to be a threat to the independence of the central bank. However, the new BOJ governor shared the same sentiments with the Prime Minister. The Bank hence raised its inflation target to 2 percent, and announced further expansion in their Asset Purchase Program (APP), which targets the market of long-term bonds. Such steps generated positive reactions from markets, although many remain uncertain about the BoJ's ability to achieve its desired objectives.

Despite the presence of such differences in objectives and methods, the common point between the three central banks remains the same: resorting to new, bold and more aggressive solutions to overcome existing challenges. These steps are accompanied, however, by a number of concerns regarding the repercussions of these policies that may ensue in the long-term.

Impact on Inflation

The impact of expansionary monetary policies on prices poses the greatest fear amongst analysts today. Despite the positive impact of these policies on production and labor market growth, the expected consequences of such an intervention are that excess liquidity and growth of money supply will lead to considerable hikes in inflation rates, especially after the economy recovers from the recession and returns to growth. However, it is becoming increasingly evident over the past five years that the sensitivity of inflation to economic recession and the various stimulus packages has faltered in advanced countries. Therefore, even with the deteriorating economic conditions in both the US and the Euro Area, neither one has experienced any price deflation or significant fluctuations in price levels. Likewise, and despite an already chronic deflation in price levels in Japan, such deflation remained within the norm of the past decade. It becomes evident when examining the data that price levels in these economies are more sensitive to supply shocks (fluctuations in world price of oil and food) rather than internal supply and demand pressures.

For their part, analysts hold opposing views when interpreting these observations. Some of them believe that the reason for sticky prices is that current levels of production in these countries are so close to the levels of potential output. Also, unemployment suffered by major economies is seen as more of a structural unemployment rather than cyclical unemployment. Thus, it does not pose any pressure on wages or prices. Meanwhile, others believe that the relative stability in inflation rates is proof of the success of inflation targeting pursued by major central banks. The commitment of these banks to achieve their targeted inflation rates over the past decade led to enhancing the credibility of monetary policy and fostering market confidence in the performance of central banks. This has apparently led markets' inflation expectations to gradually approximate targeted rates. Additionally, a number of studies confirm that, over the past decade, inflation has become less responsive to fluctuations in cyclical unemployment, which is the second factor that influences trends in inflation.

Impact on Financial Stability

The aforementioned remarks indicate that the most important factor to maintain price stability is to guarantee the stability of future expectations of investors markets. Prices are expected to remain close to the targeted levels as long as investors trust the credibility, commitment and performance of central banks. Such confidence may remove pressure from major central banks regarding the impact of their current expansionary policies on inflation.

Nevertheless, these findings may not be enough to declare these policies as risk free. Some believe that the source of greatest concern at present is the impact of intervention by central banks on financial stability and the stability of asset markets, particularly the real-estate market. Therefore, while central banks continue to maintain very low interest rates to support lending, the non-bank financial institutions, such as investment and retirement funds, suffer from a significant decline in profits. This may reflect negatively on the growth and sustainability of this sector. The decline of profitability of these institutions may lead one to search for better returns to look for investments with greater risk; this could threaten the stability of the financial system. It is also possible that the pertinent intervention of central banks in the interbank lending market and leniency in injecting liquidity will reduce the motivation of some of these banks to treat imbalances and delay their consolidation of their balance sheets. Others argue that market sensitivity to the movements of central banks created a state of dependence on, or perhaps even an addiction to, the provided facilities and increased investors' demand for a guarantee that central banks will remain present in the market for extended periods of time. This may contradict with the needs of the overall economy, the foundations of sound monetary policy and even the financial soundness of the central banks themselves.

Similarly, the risk of interference by central banks extends to sectors other than the financial system. Despite the limited impact of current policies on the prices of goods and services in relevant countries, the intervention to cut interest rates in the real-estate market and corporate bonds may lead to the creation of price bubbles in asset markets, and unwise expansion in private sector borrowing.

The circumstances highlighted above confirm that the continued market intervention from central banks may pose a threat to the stability of the financial system and asset markets if such an intervention is not controlled, and if the market-exit methods of the banks are not studied carefully. There is a dire need today for strict regulations from central banks concerning the restructuring and consolidation of the banking system in the relevant countries. On the other hand, central banks must not be lenient when dealing with inflation. This is because current price stability relies on mutual understanding between the banks and markets, and market confidence in the independence and credibility of central banks, as well as the soundness of their monetary policies. Conversely, any indicators that may imply any form of political pressures exerted on these banks, failure to fulfill any of their commitments or ambiguity when communicating with markets regarding their monetary policies would undermine the stability of inflation and increase fluctuation in future expectations. In addition to this, the stability of inflation in periods of recession does not necessarily mean having a similar stability at times of recovery. Such economies may still experience a rise in prices during advanced recovery stages and this may threaten the sustainability of economic growth and stability.

Finally, the sovereign bond market poses another extension of the risks pertaining to miscalculated market-exit. Through quantitative easing programs, central banks strived to buy large amounts of government bonds to cut their interest rates, as the ECB did in Italy and Spain. The hastiness of banks to withdraw from such a market or its tendency to trade bond quantities without careful deliberation may lead to a rise in the cost of sovereign debts once more.

In conclusion, the increased risks faced by central banks as they continue to predominantly interfere in the market are becoming more evident. This is especially true since major economies are increasingly vulnerable, and therefore, unable to bear any errors that may lead to the same problems that triggered the current crises in the first place. These errors could include: creating asset price bubbles, off hand expansion in debts, weak financial systems and high sovereign borrowing costs. Moreover, it seems as though the market-exit has become more complicated than before. Central banks now have to expedite the restructuring of their banking system, and be more stern in implementing financial soundness and governance policies. They must also continue to closely monitor the market in order to avoid creating new imbalances. All of this must be accompanied with the difficult task of pushing markets to work properly and contain the growing dependence of investors on assistance from central banks.

Source: The IMF reports, World Economic Outlook and "Global Financial Stability Report2013; and a collection of articles from The Economist, the New York Times and the Financial Times newspaper.

Unemployment

The growth achieved during 2012 was insufficient to halt the risein unemployment rates, as they continued to increase in a number of countries around the world. In ACs, unemployment increased slightly from 7.9 percent to 8.0 percent despite the decline in unemployment rates in the U.S., Canada, Developed Asia and some European countries. Unemployment dropped by 0.8 percentage points in the U.S. to reach 8.1 percent, reflecting the slight recovery that the U.S. witnessed in 2012.

However, the impact of economic downturn on unemployment rates in the Euro Area, specifically in light of austerity measures implemented by many member states, has become more evident in both the public and private sectors. Unemployment rate accelerated most in Greece, where it climbed to 24.2 percent in 2012 compared to 17.5 percent in 2011, making it the second-highest rate in the Euro area following Spain, where unemployment increased by about 3 percentage points reaching 25.0 percent. Moreover, unemployment rose remarkably in Italy, Cyprus and Portugal to reach nearly 10.6 percent, 12.1 percent and 15.6 percent respectively. As for the core countries in the Euro area, unemployment rate rose in France from 9.6 percent to 10.2 percent in light of worsening economic conditions. Meanwhile, unemployment in Germany fell from 5.9 percent to 5.5 percent.

On the other hand, Developed Asia[5] experienced a relative decline in unemployment rates; unemployment in Japan declined from 4.6 percent to 4.4 percent, and fell by nearly 0.1 percentage point in Hong Kong, Korea, Singapore, and Taiwan reaching 3.3 percent, 3.3 percent 1.9 percent, and 4.2 percent respectively. This improvement in employment conditions came despite the slow growth in production and exports following the fall in global demand, which left these countries vulnerable to poor economic conditions prevalent in the rest of the ACs.

Unemployment in the EDCs, on the other hand, has steadied; in China it reached 4.1 percent for the third consecutive year, whilst in Brazil and Mexico, rates declined by 0.4 percentage points, reaching 5.5 percent in Brazil and 4.8 percent in Mexico. As for the Arab Spring countries, unemployment rates rose in both Tunisia and Egypt in light of the absence of political and economic stability. In Tunisia, unemployment reached 18.9 percent in 2012, compared to the 13.0 percent in 2011. In Egypt, the rate increased from 12.0 percent to 12.3 percent during the same period[6].

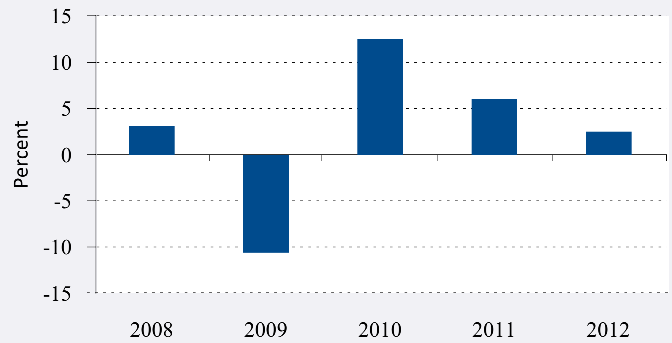
At the regional level, Jordan and Israel have witnessed an improvement in employment levels. The unemployment rate in Jordan declined to 12.2 percent from 12.9 percent in 2011. Likewise, the rate in Israel went down from 7.1 percent to 6.9 percent.

[5] Developed Asia includes Japan, South Korea, Taiwan, Hong Kong and Singapore.
[6] Data on Libya, Syria and Yemen are unavailable.

Foreign Trade

The slowdown in global economic growth, the constantly deteriorating economic conditions in major economies and the poor global demand were accompanied by a slowdown in international trade and cash flows. The volume of world exports of goods and services was estimated to be worth USD 22,413 billion in 2012, a growth that did not exceed 0.6 percent compared to the 17.8 percent increase in 2011.

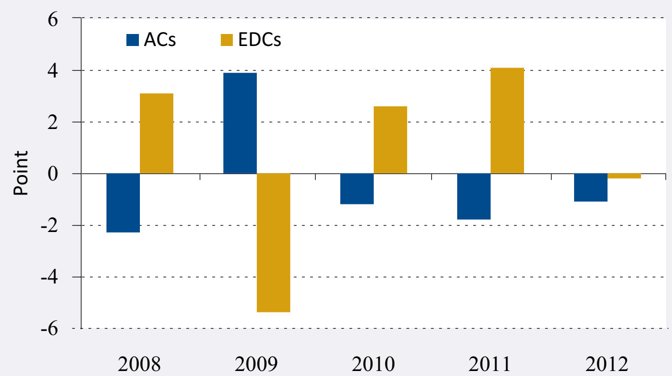
Figure 1-7: Growth in world trade volume, 2008-2012



Source: IMF, WEO report and database.

Considering groups of countries, export growth has declined in both ACs and the EDCs, reaching 1.9 percent and 3.7 percent respectively in 2012 as opposed to 5.6 percent and 6.4 percent in 2011. Meanwhile, imports of the two groups have grown by 1.0 percent and 4.9 percent, respectively in 2012 compared to 4.7 percent and 8.6 percent in 2011.

Figure 1-8: Terms of trade, 2008-2012



Source: IMF, WEO report and database.

It is worth mentioning that the rates of growth in import and export witnessed a greater disparity between the two groups between 2005-2007. Moreover, foreign trade in the EDCs seemed more resilient and immune against crises during the following three years. However, the narrowing gap in growth rates between 2011 and 2012 reflects the increased sensitivity of the EDCs to the constant decline in external demand for goods and services in advanced countries.

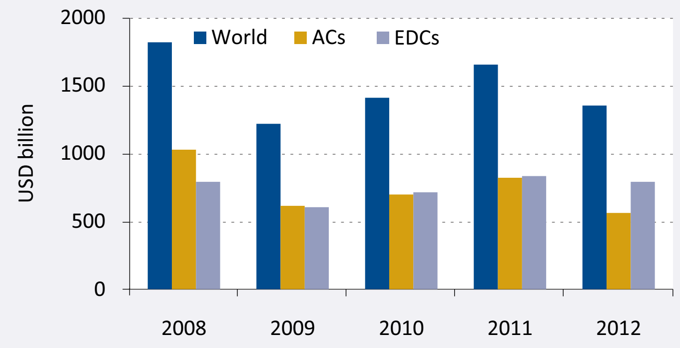
Addionally, terms of trade showed another perspective of developments in trade exchange and prices. Terms of trade declined by 1.1 percent in ACs and by 0.2 percent in the EDCs.

Foreign Direct Investment (FDI)

FDI inflows were affected by the prevailing economic and political conditions in both advanced countries and the EDCs in 2012. These conditions contributed to a fall in such investment by 18.2 percent compared to 2011. Consequently, the value of FDI flows declined worldwide to USD 1.4 trillion. Indeed, the ongoing crises which ACs faced, particularly in the U.S. and the Euro Area, has contributed to a tangible shift in the flow of capital seeking a safe haven into other regions of the world, specifically to the most stable EDCs.

ACs have witnessed a notable decline in the volume of FDI flows by 31.6 percent against a decline of these flows to the EDCs by nearly 5 percent compared to 2011. As a consequence, the share of ACs of total FDI flows declined to 41.5 percent, compared to an increase in this ratio in EDCs to 58.5 percent during 2012.

Figure 1-9: Foreign direct investment (FDI), 2008-2012



Source: UNCTAD, World Investment Report (WIR) and database.

It is worth mentioning that the U.S. and the European Union were the most affected regions by the decline in FDI inflows among ACs. These flows have declined by 26.1 percent in the U.S., and by 41.5 percent in the European Union. In contrast, investments returned to flow steadily to Japan in 2012 following two years of retraction in FDI during 2010 and 2011. However, the European Union still has the highest share of FDI flows in the world at 19.1 percent, followed by the U.S. with a share of 12.4 percent during 2012.

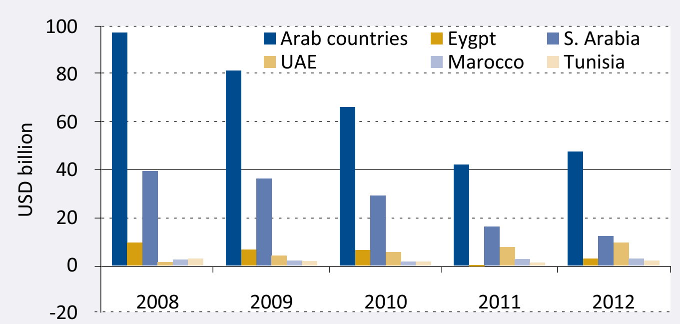
As for the EDCs, China, Hong Kong, Mexico and Brazil experienced a decline in FDI inflows amounting to 2.3 percent, 22.4 percent, 41.1 percent and 2.1 percent, respectively during 2012 compared to 2011. Meanwhile, Singapore witnessed a growth in these flows that reached 1.3 percent during the same period. China continued to remarkably acquire the largest share of FDI flows among other emerging countries with 9 percent of the total FDI inflows in the world followed by Hong Kong with 5.5 percent and Singapore with nearly 4.2 percent during 2012.

Despite the unstable political situation in some of the Arab countries, FDI returned to certain countries in the region. These flows increased during 2012 to 12.6 percent following three consecutive years of decline. Accordingly, FDI inflows to Arab countries averaged 3.5 percent of total world flows, and nearly 6 percent of total flows to the EDCs.

Egypt is one of the Arab Spring countries that experienced a significant increase (679 percent) in the volume of FDI flows, despite the constant withdrawal of these flows during 2011. Likewise, Tunisia witnessed an increase of 67 percent.

By virtue of its proximity to the Gulf region and being affected by the current events there, Saudi Arabia experienced a decline in FDI inflows by 25.3 percent. However, the Kingdom still acquired more than 25 percent of total FDI inflows into the Arab countries. Jordan witnessed a decline in these flows by 4.8 percent due to the direct effects of the ongoing events in Syria and the influx of Syrian immigrants into its territories. As for Lebanon, it seems that the impact of the ongoing events in Syria on investment was limited. It received 8.7 percent more FDI flows during 2012 than in 2011. Moreover, some Arab countries that enjoyed more stable conditions, such as the United Arab Emirates and Morocco, experienced an increase in foreign investment flows by nearly 25 percent and 10.4 percent respectively, compared to 2011.

Figure 1-10: FDI in some Arab countries, 2008-2012

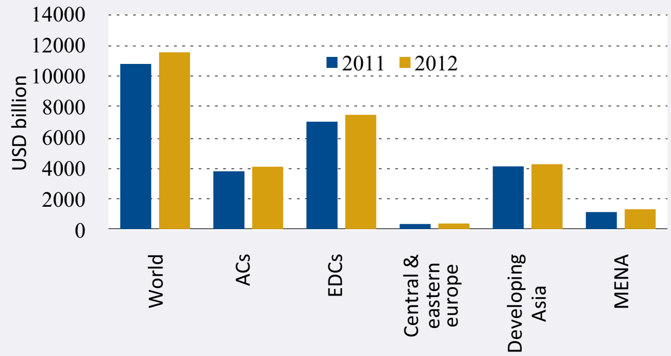


Source: UNCTAD, WIR and database.

International Reserves

Changes in international reserves are closely associated with developments in the trade balances and capital flows of countries. Typically, improvement in exports and capital flows are accompanied by high foreign exchange reserves. Yet, the slowing growth in international trade during 2012 led to a slowdown in the accumulation of world reserves, to finally reach USD 11.2 trillion. This represents a growth by nearly 7.0 percent compared to 10.3 percent in 2011.

Figure 1-11: Official reserve assets of Emerging & Developing Economies, 2011 & 2012



Source: IMF, WEO report and database.

These changes affected the reserves of both advanced countries and the EDCs, as they grew by 7.9 percent in ACs, and 6.5 percent in the EDCs, compared to 10.7 percent and 10.2 percent respectively during 2011. Data show that Developing Asia, including China, experienced the largest slowdown in the EDCs. Growth in reserves did not exceed 3.5 percent during 2012, compared to 10.3 percent in 2011, which implies that these countries are affected most by the low demand in the ACs.

Apart from that, Central and Eastern Europe and the MENA are an exception to the case. Official reserve assets in Central and Eastern Europe witnessed a growth by nearly 9.3 percent during 2012, compared to 2.3 percent in 2011. Meanwhile, MENA countries experienced the highest growth rate among other country groups, growing by 15.4 percent to reach USD 1,278.4 billion, compared to 9.8 percent in 2011. Nevertheless, this growth in reserves was plainly concentrated in the oil-exporting MENA countries. Saudi Arabia's official reserves grew by 21.3 percent to reach USD 657 billion; Kuwait's increased by 11.9 percent to reach USD 29 billion; the United Arab Emirates' increased by nearly 26.2 percent to reach USD 47 billion during. Moreover, reserves doubled in Qatar from USD 16.2 billion to USD 32.5 billion during 2012. As for non-oil exporting countries in the region, official reserves fell in Egypt due to political turmoil and security concerns, which negatively affected many productive and service sectors, including tourism. Also Egyptians' dependency on imports increased and there were forced foreign capital outflows. Consequently, pressure on reserves heightened, forcing them to drop by nearly 21.9 percent during 2012. Similarly, Jordan was significantly affected by the instability in the region. Disrubting gas supply from Egypt led to a substantial rise in Jordan's energy bill and a decline in foreign currency reserves to reach USD 6.6 billion in 2012, compared to 10.5 billion in 2011[7].

Foreign Debt

Sovereign debts of ACs, particularly of the Euro area, continue to be the source of greatest concern and the influential engine of global markets. Following the Greek crisis and the failure of the European officials' persistent attempts to control such virus, the same crisis hit both Italy and Spain during 2012. That crisis hampered the growth in the Euro area as a whole, principally as many member states were forced to resort to strict austerity measures to avoid

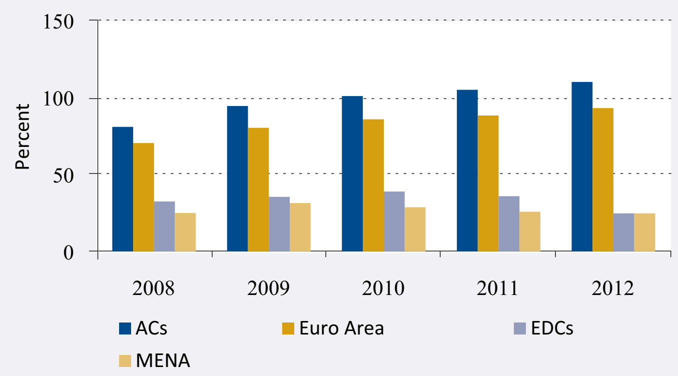
[7] Jordan Central Bank, 2012.

falling into the same pit. In the midst of frequent panic cases experienced by markets during the last two years, the majority of the Euro area countries were obliged to control government spending, increase taxes, and target low levels of deficit. This reassured markets about there countries' debt levels and averted high interest rates on sovereign debts as in the cases of Italy and Spain.

Similarly, high debt levels and the fiscal cliff which the U.S. was about to encounter in late 2012 raised concerns about the ability of the fragile growth to withstand dratic changes to government spending and tax structure if U.S. politicians failed to reach an agreement on these issues. However, attempts made by the U.S. government to control the debt, following the agreement among politicians, was good news for creditors on the one hand, but a source of concern for many investors over the chances of growth during 2013.

On the other hand, 2012 witnessed a decline in the ratio of overall foreign debt to GDP in the EDCs; this ratio reached 34.7 percent, compared to 35.8 percent in 2011. This ratio went down in Developing Asia to 31.9 percent, during 2012 compared to 34.2 percent. Meanwhile, this ratio went up in Latin America and the Caribbean to reach 51.4 percent, compared to 49.9 percent. As for the MENA region, the ratio of total debt to GDP continued to decline, even though less than before, notwithstanding the ongoing political and economic instability; it reached 27.2 percent in 2012, compared to 28.0 percent in 2011.

Figure 1-12: External debt as a percent of GDP, 2008-2012



Source: IMF, WEO report and database.

In this context, it is worth mentioning that debt levels among groups of countries indicate a massive variance between ACs and the EDCs. Indeed, debt levels moved in favor of the latter group, as evidenced by the decline in the debt to GDP ratio during the past three years. Yet, it is necessary to pay closer attention to the fact that the dependency of many of these countries on aid from ACs and international institutions reduces the need to borrow to meet their financing needs. Moreover, the evaluation of debt sustainability for any country does not only rely on the ratio of debt to GDP, but also relies on the political and economic stability of that country, its surrounding environment, economic structure, growth potentials, future wealth and many other factors that might make even low levels of debt a source of concern, if pessimism about the future of a country prevails.

Regionally, Jordan suffered from an alarming accumulation of debt during 2012. The balance of public debt rose from 70.7 percent of nominal GDP to reach 79.5 percent just in one year. Such an increase took place specifically after the International Monetary Fund (IMF) agreed to grant Jordan a loan of about USD 2 billion in 2012 to be paid over three years. This loan followed the deterioration of economic conditions, high levels of unemployment and the growing political tension in the region. The current debt/GDP ratio plainly exceeded the extent permitted by Jordan's Public Debt Law specified at 60 percent of nominal GDP.

In this context, in November 2012 Standard & Poor's downgraded the rating of Jordan's long-term sovereign debt from (BB+) to (BB), while its short-term rating remained fixed at (B) with a negative outlook. The agency indicated that Jordan, like many other countries, is facing great pressures concerning the implementation of political, economic and social reforms. It also warned that it is possible to downgrade the rating of Jordanian debt in the future in case of escalations in the Syrian conflict, increase in oil prices or a sudden drop of Jordanian expatriates' remittances transfers, tourism revenues or foreign direct investment[8]. As for Moody's Investor Service, it kept the rating of Jordan's sovereign debt at (BB 2) with a negative outlook effective since February 2011.

As for Israel, debt levels rose to 74.5 percent of GDP in 2012 compared to 74.0 percent during 2011. The level of debt and the deficit in the Israeli government's budget became the center of attention during the year as the government failed to abide by deficit targets in 2012.

Global Capital Markets

Adding to the usual sensitivity of financial markets to political and economic developments, crises of ACs fueled even more fluctuations and caused a greater decline in the indices of major markets during 2012. An exception of that was the US market, where Standard & Poor's 500 showed improvement during 2012 to approach 1380 points, rising by nearly 9.5 percent compared to 2011. In the meantime, European markets experienced a significant decline due to the worsening debt crisis and climbing risk of sovereign bonds in a number of member states. Dow Jones Euro Stoxx 50 reached 2414 points, which is a 9.3 percent decline compared to 2011. The Japanese stock index, Nikkei, witnessed a similar decline by nearly 9.7 percent, reaching 9110 points during 2012.

Economic Outlook

It is expected that the global economy will experience gradual recovery and improvement during 2013. According to the IMF's World Economic Outlook (WEO)[9] report, such an improvement will advance at a varying pace among the groups of different countries. For while recovery will be rapid and substantial overall in the EDCs, the performance of ACs will exhibit an increasing variance between the U.S. on the one hand, and the Euro Area on the other. Despite the positive outlook, risks of returning to recession and economic slowdown still exist. Accordingly, global growth is estimated at 3.3 percent in 2013, compared to 3.2 percent during 2012, while growth rates will vary between ACs and the EDCs; it is expected that growth in these groups will reach 1.2 percent and 5.3 percent respectively during 2013.

With regard to ACs, it is expected that the U.S. economy will grow at a rate of 1.9 percent during 2013, compared to 2.2 percent during 2012 due to fiscal austerity measures adopted after the "fiscal cliff" agreement singed early 2013. In spite of this growth-inhibiting action, the solidity of private demand, improvement of financial markets and the real estate market, and holding main interest rates low will support growth in real GDP.

Economic performance in the Euro area remains a threat to the stability of the global economy during 2013. It is expected that real GDP will contract by nearly 0.3 percent in 2013, compared to 2012 due to poor performance in both core and periphery Euro area countries. As a matter of fact, this is a reflection of the fiscal austerity policy, poor level of exports, the fragility of the financial system, and the prevailing uncertainty in the region. However, the negative impact of these factors is expected to decline during 2013, provided that planned reform policies to address the crisis are to persist.

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[8] It is noteworthy to mention that while preparing this report, Standards & Poor's has downgraded Jordan's credit rating on the long-term by one point to become (-BB) due to concerns related to economic conditions. S&P's stated that such rating shall be exposed to further downgrading in the future due to the aggravation of the Syrian conflict and oil prices increase. S&P's attributed such a move to the poor performance of trade during the past two years, and the poor financial situation of the Jordanian government following the decline in foreign aid. S&P's indicated that despite fiscal measures taken recently by the government, which helped in avoiding a serious crisis, foreign debt and budget deficit remain greater than in 2012. (See www.aljazeera.net, 05/21/2013).

[9] WEO, April 2012.

As for Japan, its economy is expected to continue to improve due to the structural reforms and fiscal and monetary stimulus. These actions are to be implemented during 2013 with the aim to achieve positive rates of inflation. It is expected that the growth rate of Japan's economy will reach nearly 1.6 percent through 2013. However, setting off quantitative easing, according to experts of the IMF will not achieve the expected results in the absence of a medium-term plan for fiscal consolidation to meet the high levels of public debt.

As for EDCs, their growrh rates are expected to reach 5.3 percent in 2013, compared to 5.1 percent in 2012. It is also expected that the Chinese economy will grow by 8.0 percent in 2013, compared to 7.8 percent during 2012. However, such growth remains governed by structural reforms focusing on the domestic market and private consumption.

In the MENA region, growth is expected to slow down to 3.1 percent, compared to 4.7 percent during 2012. This is basically attributed to the absence of political and economic stability in the Arab Spring countries, in addition to the increase in budget deficits. However, forecasts indicate that there is potential for oil-exporting countries to experience high growth rates in 2013 due to the high global oil prices and domestic expansionary fiscal policies.

Regionally, the Israeli economy is estimated to grow by 3.6 percent, compared to 3.1 percent in 2012. This improvement is expected to occur as Israel initiates natural gas production in 2013, while maintaining low interest rates at 1.75 percent and increasing money supply. It is also expected that the inflation rate in Israel will be around 1.8 percent, compared to 1.6 percent in 2012. As for Jordan, and despite the unsettling economic and social conditions, the economy is expected to overcome these conditions and their negative impact on macroeconomic indicators in 2013. Thus the economy is expected to witness a growth of 3.3 percent in 2013, compared to 2.8 percent in 2012, while inflation will rise to 5.9 percent, compared to 4.8 percent in 2012.

On the other hand, growth in the volume of world trade of goods and services is expected to reach 3.6 percent in 2013, compared to 2.5 percent in 2012. Such a growth could be attributed in part to the expected decline in crude oil prices by 2.3 percent, compared to 2012. Also, commodity prices (other than fuel) will rise by 0.9 percent, compared to 2012.

As for consumer prices, inflation in global prices is expected to go down slightly from 3.9 percent in 2012, to 3.8 percent in 2013. Additionally, prices will remain at their low levels of 1.4 percent in ACs, compared to 5.9 percent in the EDCs.

Part II
Local Economic Developments

Overview

The Palestinian economy is a small open economy, afflicted with a number of risks which threaten and confine its ability to grow and achieve sustainable development. Among these are the continued Israeli occupation and the Palestinian economy's subjugation to its Israeli counterpart, dependence on politically-influenced foreign aid and the ever increasing levels of political and economic uncertainty.

A number of factors resulted in slower growth rates in the Palestinian economy and rising unemployment rates in both the West Bank (WB) and Gaza Strip (GS) in 2012.The most prominent of which are the absence of political prospects, along with Israeli blockades, closures, and restrictions on access and movement, as well as the considerable decline in foreign aid. These adverse developments indicated that the achieved growth rates were no longer sufficient to decrease the growing rates of unemployment.

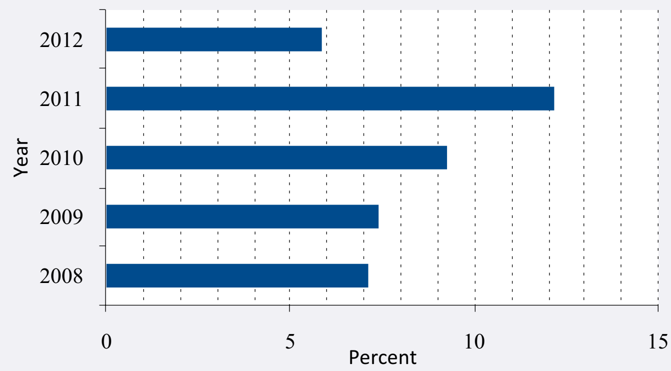
Even though the Palestinian economy has continued to achieve positive growth rates for the sixth consecutive year, these rates have been slowing down, especially over the past two years. The relative recovery realized in GS during the past two years did not succeed in reducing the economic and social gap among the two parts of the country; this gap remained the most prominent characteristic.

Economic Performance

The Palestinian economy returned to sluggish growth in 2012. This came shortly after a steady growth period that began in 2007. Data released by the Palestinian Central Bureau of Statistics (PCBS) indicated that the real GDP had a growth rate of 5.9 percent in 2012, in comparison to a growth rate of 12.2 percent in 2011. This slowdown came as a result of a declining growth rate in the WB (from 10.4 percent to 5.6 percent between 2011 and 2012), in addition to a significant decline in the realized growth rates in GS (decreasing from 17.6 percent to 6.6 percent) during the same period.

It should be noted that the growth realized in GS in 2011 is by far the highest rate ever realized since the establishment of the Palestinian National Authority (PNA). This high growth rate was in response to the reconstruction process taking place after Israel loosened restrictions on the entry of construction materials, especially those required for projects financed by donor countries. Moreover, the value-added for the construction sector increased by more than 177 percent in 2011. The loosening of Israeli restrictions on imports of consumer goods and an increase of imports from Egypt were also contributing factors. Thus, the high level of growth achieved in 2011 is an exception and not the rule. Subsequently, these rates returned to their previous low levels in 2012 due to continued restrictions and Israeli blockade, along with the decline in trade levels with Egypt, which resulted from the deteriorating security conditions in Sinai.

Figure 1-13: Real GDP growth rates in Palestine, 2008-2012

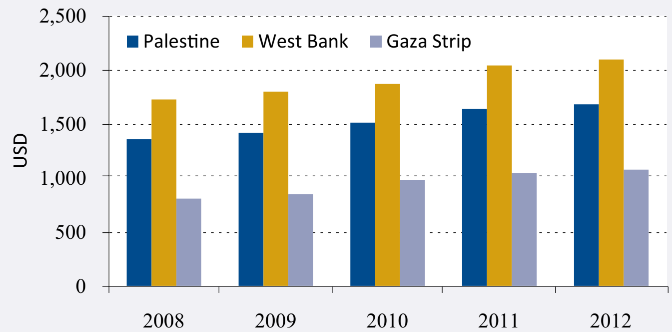


Source: Palestinian Cetral Bureau of Statistics (PCBS), National Accounts.

On the other hand, economic slowdown in the WB can be attributed to the decline in foreign aid and the affiliated aggravation of the PNA's liquidity crisis; the continued restriction on freedom of movement for individuals and goods; a growing atmosphere of political and economic uncertainty; and a slowdown in global economic activity, particularly in Israel. Despite the slowdown in Palestinian growth in 2012, this rate, however, remains high when compared with regional and global growth rates.

Changes in per capita GDP are usually used as an indicator for the level of economic welfare in any given country. It illustrates the actual impact of economic growth on per capita income, taking into account the population growth rate. In this context, the Palestinian real per capita GDP grew more than a quarter during the past few years, reaching USD 1,679.3 in 2012, and exceeding the level achieved in 1999 for the first time.

Figure 1-14: Per capita real GDP in Palestine, 2008-2012



Source: PCBS, National Accounts.

This means that real per capita GDP needed about 12 years to revert back on track after the major setbacks suffered by the Palestinian economy in the wake of the Al-Aqsa Intifada at the end of 2000. However real per capita GDP achieved in 2012 did not exceed 67 percent[10] of what it could have attained if the Palestinian economy continued its natural growth pattern since the year 2000. This is a clear indication of the paucity of the current Palestinian per capita GDP, especially if compared with the Israeli per capita GDP, for example, which is up to 16 times that of Palestine.

[10] Calculated based on the assumption that per capita GDP grew between 1999 and 2012 by the average growth rate realized prior to the year 2000.

Geographically, per capita GDP growth rates in 2012 were similar in both the WB and GS, averaging 2.7 percent in the WB and 3 percent in GS. It is worth mentioning that per capita GDP growth in GS has plummeted after its boom in 2011, as a result of a surge in total GDP during that year.

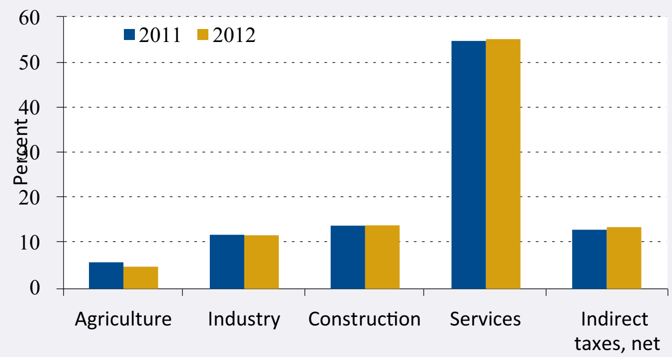
The economic gap is still evident in both regions despite the remarkable similarities in the growth of real per capita GDP in both the WB and GS. The gap had widened as a result of the blockades, closures and repeated Israeli attacks suffered by GS over the past five years, in contrast to the relative stability of the WB. While real per capita GDP amounted to USD 2,093 in the WB, per capita GDP in GS amounted to only 51.3 percent of its WB counterpart in 2012.

Economic Activities

Economic activities witnessed a number of changes since 1995: a revival of the construction industry, following the establishment of the PNA's institutions, the resumed operations of the financial sector (which has been crippled by the occupation), and an improvement in the conditions of private investment and the flow of capital from abroad. Each of these changes has affected the relative importance of the various economic sectors. Tracking the contribution made by economic activities to the creation of value-added during the past 20 years shows a somewhat relative stability in the contributions made by most of the service sectors in comparison with the steady decline in contributions made by the production sectors, specifically the agricultural and manufacturing industries. Taking this into consideration, the service sector's contribution to the real GDP has averaged 56.2 percent between the years 1995-2012, while contribution of the agricultural sector did not exceed 7.5 percent. During the same period, the manufacturing industry contributed 15.5 percent, construction 7.4 percent, and indirect taxes 13.4 percent.

Within the same context, the year 2012 witnessed relative stability in contributions made by economic activities when compared to the previous year, excluding a minor decline (by 1 percent) in the contribution of agriculture. This stability was the result of growth in all sectors, apart from a 12 percent decline in value-added generated by agriculture. Whereas all other sectors grew at rates ranging between 7.6 percent for the service sector and 3.2 percent for the transportation sector, indirect taxes climbed to 10.7 percent during the same period.

Figure 1-15: Contibution of economic activities in real GDP, 2011 & 2012



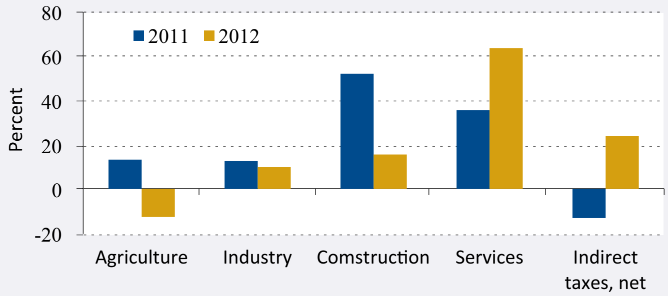
Source: PCBS, National Accounts.

The contribution of economic activities to the growth rate[11] was fairly consistent with their contribution to GDP. Available data indicates that the service and construction sectors were the real force behind growth realized in 2012. Contribution of services exceeded 63 percent of the overall growth in GDP, while that made by construction came up to 15.5 percent. Net indirect taxes had a notable increase in contribution that amounted to 23.9 percent of the growth in GDP in 2012.

[11] Economic activity contribution to the growth rate = percentage growth of economic activity during 2012 x economic activity's contribution to GDP during 2011

With regard to the rest of the commodity-producing sectors, the manufacturing sector contributed 10 percent to growth; in contrast, agriculture's decline served as an inhibitor to overall growth, reducing the rate by 12.7 percent. In conclusion, total contributions to the growth rate by commodity-producing sectors as a whole (manufacturing, agriculture and construction) amounted to 12.6 percent.

Figure 1-16: Contribution of economic activities in real GDP growth, 2011 & 2012



Source: PCBS, National Accounts.

There is an evident disparity in the contribution made to growth rates by the different sectors when comparing the years 2011 and 2012, with this being most applicable to agriculture and construction. In contrast to the positive contribution agriculture made to growth in 2011, its contribution was negative the following year. This is due to unfavorable weather conditions in addition to the frequent power cuts in GS and the resulting impact on water supply. In comparison, the decline in the contribution of construction was associated with the interim reconstruction projects funded by donor countries during the abovementioed two years.

Box 2: Palestinian potential output and output gap

The economic analysis of the output gap draws great interest from central banks as an important indicator of the business cycle and a warning of inflationary pressures in the country. Because of this, central banks seek to obtain reliable estimates of the output gap in order to determine the appropriate monetary policy amongst other issues.

Economic literature defines the output gap as: "the difference between actual output and potential output", with the latter an unobserved value. The potential output - as defined by (Okun, 1962) –" is the output which could be achieved in the long run, when the economy is in a state of equilibrium and at full capacity, in an environment free of distortions (perfect competition)". According to this approach, potential output is defined as: "the maximum level of output which could be produced without generating inflationary pressure." This approach is consistent with the New-Keynesian thoughts that define potential output as: "output that could be produced when wages and prices in the economy are elastic, even if markets are not functioning under perfect competition."

Several methods are used to estimate the output gap and each of them can lead to different conclusions with respect to monetary policy. For example, according to the approach which assumes that potential output represents a 'time-trend' in the actual output in the long run– and since this approach isolates monetary policy tools and measures – the only effect monetary policy tools and measures may have is to decrease the variance between output and its time-trend. On the other hand, these tools and measures (a decrease in interest rate, for example) can also lead to an increase in potential output itself.

According to this approach, it is therefore crucial to take the time factor into account when calculating the output gap, as the existence of certain positive shocks (reduced interest rates) will lead to an accelerated economic activity and inflationary pressures in the short-term. This may cause an increase in investments in the long-run, and in turn increase potential output, as well as the actual output.

In this respect, most studies postulate that permanent, long-term shocks will influence potential output, while short-term shocks may directly affect the output gap. In other words, demand shocks will affect the output gap through their impact on actual output. However, supply shocks will affect potential output. Nonetheless, several practical cases indicate that it is not possible to separate the repercussions of any shocks on economic variables.

The group of methods used to measure potential output and the output gap can generally be classified within two main frameworks:

- The first framework depends on nonstructural statistical methods: under this framework, the potential output is measured as a simple time trend or a Hodrick-Prescott (HP) filter and a Band-Pass (BP) filter to the actual output data. One advantage of using these methods is that they do not require an abundance of information and can be applied to one data series. In contrast, some of their disadvantages are the inability to distinguish between supply and demand shocks and that it does not base its explanation of the change in potential output on an economic framework.

- The second framework relies on structural methods that are based on economic theory: this framework includes a large number of applied methods, but most importantly, estimates potential output by means of the Cobb-Douglas Production Function, which includes the economic factors of production (labor and capital), in addition to changes in technology. The advantage of this method is its ability to measure the contributions of the various factors of production as well as measuring the total productivity that is responsible for the increase in potential output. However, this method requires a relatively large volume of information: data relevant to the technology of production, the inputs of the labor market in relation to employment, unemployment and participation rates, capital stock, capital optimization and total productivity. In practice, most of the data are derived as elasticities to the independent variables of the production function (with the exception of exogenous assumptions regarding the natural rate of unemployment), making it difficult to distinguish between the increase in actual output resulting specifically from cyclicality, and that resulting from the change in potential output.

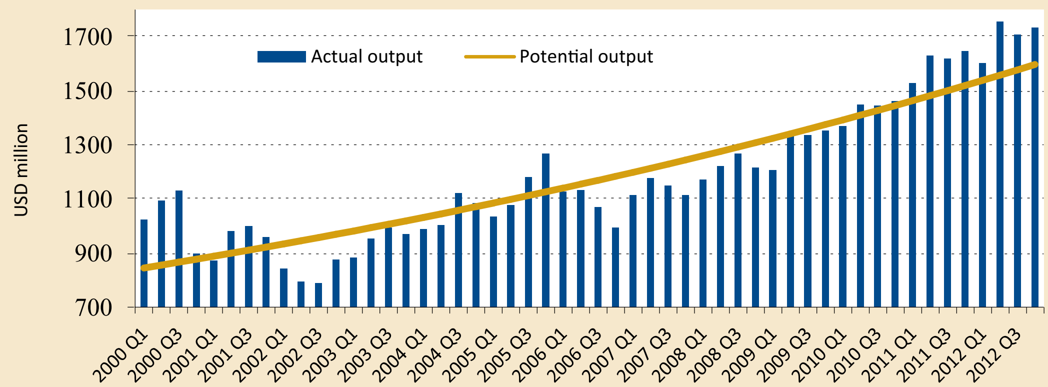
In order to estimate both potential output and the output gap in Palestine in light of the difficulty in dealing with the total production function (mostly due to a lack in comprehensive statistical data that is required for the measurement process), the first framework - using simple statistical methods - has been adopted by using two methods. The first of these assumes that potential output is represented by the simple time –trend for the GDP, while the second assumes that potential output is represented by the HP Filter and BP Filter.

Furthermore, quarterly data for real GDP issued by the PCBS for the period 2000-2012 is being used and processed through the statistical program called E-Views. It is important to note here that results are mainly dependent on the availability and accuracy of required information, which affects the ability to predict the amount of potential GDP.

The following figures summarize the results obtained with respect to potential output and the output gap in Palestine. The figure below illustrates the volume of real and potential GDP from the first quarter of 2000 to the fourth quarter of 2012. The figure indicates that real GDP was lower than that of potential output during the period of unrest between 2000 and 2004 (the beginning of Al-Aqsa Intifada), and similarly during the period of Hamas's victory in the legislative elections and the subsequent siege of the WB and GS.

In contrast, the value of potential output was less than the value of actual output during periods of relative calm or stability, as was the case in the period between the years 2010 and 2012.

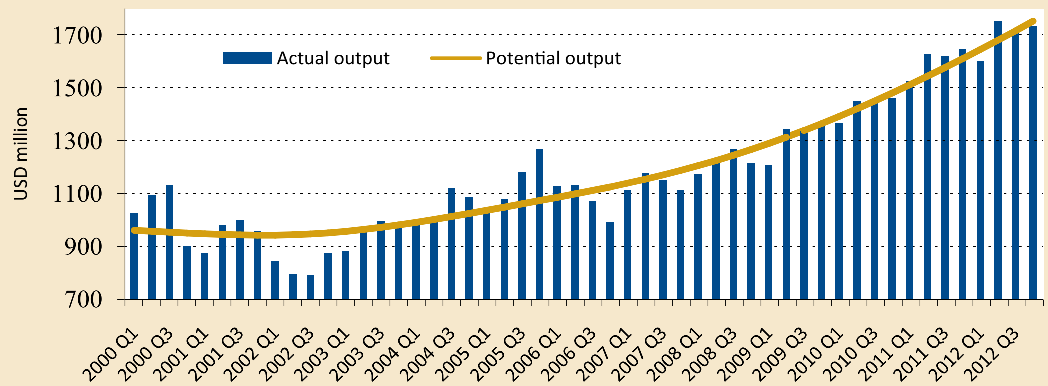
Potentianl output and output gap estimates in Palestine by using Time Trend



The figure shown illustrates that the output gap (the gap between actual and potential outputs), measured according to the HP Filter, was lower than that produced using the time-trend method. This is due to the influence of certain political and economic variables on the HP Filter beyond the temporal factor, as is the case with the time-trend method. The figure illustrates that the value of potential output (according to HP Filter) was USD 1,753 million during the last quarter of 2012, compared to the USD 1,597 million as measured by the time-trend method.

It is imperative to exercise caution when dealing with these results since, and as noted previously, these methods come with inherent disadvantages, namely: their inability to distinguish between supply and demand shocks, in addition to their inability to base their explanation of the change in potential output on an economic framework. For example, the figures indicate that actual output during some quarters in the period between 2011 and 2012 is higher than the potential output (positive output gap). This was at a time when unemployment rates in Palestine exceeded 20 percent of the total workforce and capital optimization diminished due to a number of obstacles. The same applies to the fourth quarter of 2012, where the interruption of public sector employees' remuneration and the decline in foreign aid had a negative impact on economic performance; yet despite this fact, figures indicate that the actual output is higher than the potential output.

Potentianl output and output gap estimates in Palestine by using HP Filter



The existence of such negative elements in methods used to estimate potential output and the output gap calls for the use of alternative methods (structural methods) if more accurate results are to be acquired. These methods should be based, by and large, on economic theory and allow researchers to deal with their results with a high level of reliability to determine appropriate fiscal and monetary policy at any given time. This is especially so since governments are guided by these standards (potential output and the output gap) to determine the nature of required intervention in the economy.

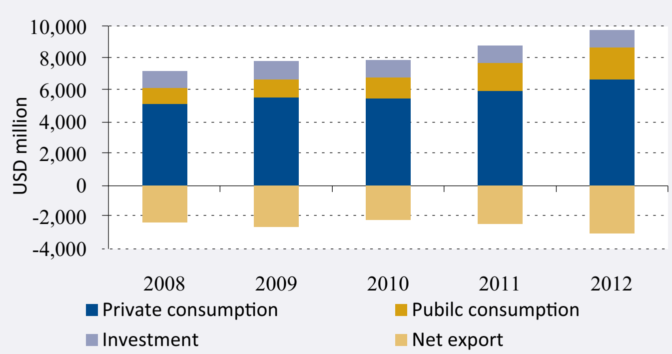
In the event of a recession, for example, many factors of production become idle and untapped by the economy, as indicated by the rising figures of unemployed workers and decrease in production (actual output is less than potential output). In the event of recovery, the increase in the pressures of demand on the factors of production leads to further inflationary pressures (the actual output is higher than the potential output). This aspect is what is in dire need of special attention from central banks in their efforts to maintain low and stable price levels.

Aggregate Demand

In 2012, the Palestinian economy's real aggregate demand (sum of total spending on final goods and services) witnessed varying degrees of growth in its four components. Public and private consumption grew by 14.4 percent and 12 percent respectively. It is noted that growth in government consumption witnessed a slowdown following a significant surge in 2010 (as it grew by more than 31 percent at the time, compared with a 16.4 percent growth rate in 2009) in the milieu of the fiscal austerity policy adopted by the PNA as part of its efforts to address its liquidity crisis.

In contrast, there has been a return to growth in investment after the decline it witnessed in 2011, even though this growth did not exceed 0.7 percent. When examining investments by sector, it is evident that

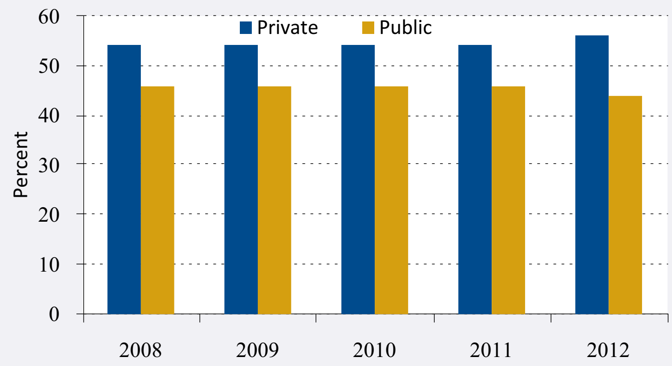
Figure 1-17: Aggregate demand in Palestine, 2008-2012



Source: PCBS, National Accounts.

growth in private sector investment has far surpassed the growth achieved in the public sector (8.9 percent against a 0.7 percent). It should also be noted that in comparison to the decline in public investment, the share of private investment out of total investment rose from 54.2 percent in 2011 to 56.1 percent in 2012. This may be an indication of the government's diminishing ability to serve as a main driver of economic growth after having pursued a policy of financial austerity to some degree. In the meantime, an increasing lack of clarity and uncertainty (both locally and regionally) continue to cast a shadow over private sector's performance.

Figure 1-18: Private and public Investment as a percentage of Gross Investment, 2008-2012



Source: PCBS, National Accounts.

It should be noted that private investment is often higher than public investment. Though this is applicable in Palestine as well, the proportions seem low when compared to other countries. For example, in Israel private investment rates stand at 90 percent against a mere 10 percent for public investment, whilst in Palestine, the percent of private investment of the total investment did not exceed 56 percent against the 44 percent for public investment in 2012.

On the other hand, trade deficit rose by a large margin, reaching 25.3 percent compared to the 10.7 percent increase in 2011. This caused an increase in the domestic resources gap to 44.1 percent of the GDP compared to the 37.3 percent in the previous year. This significant growth in trade deficit is due to an increase in imports worth about USD 621 million, in contrast to the increase in exports, which was only USD 15 million.

Figure 1-19: Exports and imports as a percent of real GDP, 2008-2012

Source: PCBS, National Accounts.

It is also worth mentioning that import's share of GDP is once again on the rise, (reaching 60.2 percent in 2012, compared to 54 percent in 2011), while exports decreased slightly to 16 percent of GDP in 2012, compared to 16.7 percent in the previous year.

Box 3: Doing business in Palestine: current and expectations

Countries around the world, and particularly the EDCs, compete to attract investments, and while the political, legal and legislative environments in advanced countries serve to attract capital, the task is more difficult in emerging economies.

There are various factors that affect the willingness of investors to select an investment destination. Their main concern is political stability, legal framework and investment promotion legislations. Notwithstanding the controversy that regarding the predominance of political stability above all else, other factors are taken into account when investors take this decision, including what is known as 'the legal environment': the set of various governmental regulations an investor must adhere to in order to establish a business or a project. This begins with registration and licensing and the like and ends with an investor's commencement to do business.

Adopting accommodative government regulations does not necessarily mean targeting foreign capital only, rather it is a local incentive to develop small and medium-sized enterprises (SMEs) and to strengthen the spirit of entrepreneurship. It is well known that SMEs are often a major source of job creation in most parts of the world. However, entrepreneurs in developing countries face greater obstacles than their counterparts in high-income countries. Among these obstacles is the inability to attract qualified labor and the lack of infrastructure facilities. These problems are exacerbated by stiff government regulations, an inadequate number of support organizations and the consequent lack of encouragement of business development and expansion of business activities.

Due to the importance of the "legal environment" within what constitutes an investment-promoting environment, the World Bank, in cooperation with the IFC, issues an annual "Doing Business Report," which is one of the most important indicators adopted around the world to compare the ease of doing business between different countries. Palestine (The WB and GS) has, for the first time, been included in the 2006 World Bank report, ranking 125th out of 155 countries. Palestine achieved its best rank in 2008, coming 117th out of 178 countries. During subsequent years, its ranking declined to the 139th in 2010, and stabilizing at 135th for the past three years.

The World Bank's report adopts 10 key indicators when ranking countries in terms of ease of doing business. Some of these are: starting a business, dealing with construction permits, getting electricity, getting credit, and trading a cross borders amongst others. Each indicator is evaluated against three main criteria: the time allotted for providing the service, number of procedures and documents required to provide the service, and the total cost of executing the service.

The following diagram illustrates Palestine's ranking within the 10 key indicators for the years 2012 and 2013. The main aim of this diagram is to clarify key indicators in which Palestine suffers a low ranking, particularly in relation to other countries in the region on one hand, and with Singapore (that occupied the first place in the Ease of Doing Business Report over the years) on the other.

Summary of doing business indicators rank for Palestine, 2012-2013

Source: World Bank, Doing Business report 2012 and 2013

Palestine registered a low ranking in the “dealing with construction permits” indicator, which requires 119 days to issue and costs the business owner around 948 percent of the Palestinian per capita GDP. This matter only worsens when it comes to securing electricity, which costs 1549 percent of the Palestinian per capita GDP (compared to the 86 percent and 13.8 percent of the Israeli per capita GDP for the two indicators, respectively). It is noted that the number of procedures required to obtain construction permits or getting electricity are not the highest when compared with other MENA countries, even in comparison to Singapore, whereby a construction permit requires 17 different procedures in Palestine and 5 for getting electricity .This is contrasted with 11 and 4 procedures required in Singapore for the two indicators, respectively. However, the total time required to complete this process (measured in days) is where the vast gap lies. Whilst it takes an investor up to 26 days to obtain a construction permit in Singapore for example, it takes the Palestinian investor 119 days to do the same. Attainment of construction permits in Palestine is one of the biggest obstacles facing individuals and businesses alike in light of limited building spaces and the difficulty in obtaining it within area (c) that is under Israeli control. This is where the impact of Israeli practices is most evident on such indicators.

Moving away from external factors, there are also a number of internal factors that hinder the ease of doing business in Palestine. In this respect, Palestine registered a low ranking in terms of the “starting a business” indicator. In 2013, it ranked 179th out of 183 countries. According to the report, this can be attributed to the high number of procedures required to start a business, in addition to the length of time needed. The report notes that starting a business in Palestine requires approximately 48 days, compared to 7 days in Egypt, 12 days in Jordan, and 21 days in Israel, whilst in Singapore, only 3 days are required to start-up a business. This is added to the high procedural cost of starting a business, amounting to 91 percent of the average Palestinian per capita GDP, while in Jordan, it registers at 13.8 percent of their per capita GDP, and only 4 percent of the Israeli per capita GDP.

There is a huge discrepancy between the previously quoted numbers and the requirements of the Ministry Of National Economy for business registration (as published on its website). MoNE's data indicate that the actual cost for these procedures ranges from USD 185–227 depending on the type of company registered, where cost – according to the WB's Report – amounts to USD 1,600 (91 percent of Palestinian per capita GDP). These differences could be the result of several factors, such as those related to calculation methods, especially since the "Doing Business Report" relies primarily on investigating the opinions of a number of local applicants operating in various fields by carrying out a survey - a matter that could negatively or positively affect the evaluation results, noting that these estimates are not usually derived from an analytical perspective. Thus, it is expected that there would be a gap between the estimates found in the World Bank's report and the findings from the analysis of procedures that are implemented on the ground.

Despite the causes of discrepancy in the given estimates and the resulting gap, it is not deniable that Palestine holds a very low ranking in this field and is in dire need of improvement. This conclusion was met with genuine support on the ground, where a technical team led by the MoNE was formed and had the sole purpose of improving Palestine's ranking in the World Bank Report. The team is comprised of representatives from ministries and relevant public institutions, including the PMA, in addition to representatives from the private sector. The team has been assigned the task of reviewing and analyzing the World Bank's "Doing Business Report", as well as identifying weaknesses that can be addressed and improved through actions taken on a short, medium, and long-term basis.

This appears to be a highly positive measure in light of the abovementioned data. However, the challenge facing the team remains in its ability to uncover problem areas and in the decision-makers' ability (within the given limitations) to take the necessary steps and decisions that can create real change on the ground. This is a matter to be revealed by the results of the "Doing Business Report", and Palestine's ranking in this report in the years to come.

Institutional Economic Sectors

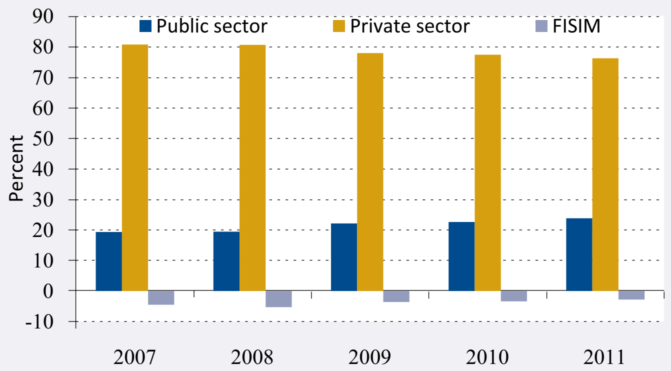
According to the System of National Accounts (SNA) published by the United Nations in 1993, the economy is generally divided into the following institutional sectors: the household sector (including non-profit organizations that provide services to households), the government sector, non-financial firms sector, and the financial sector[12]. This division provides the means to determine public and private sector's contribution to GDP.

In general, the Palestinian public sector contributes an average of 22 percent to the GDP directed mainly to education, health, public administration and defense. The private sector's contribution (averaging about 82 percent of the GDP) is distributed to various sectors and economic activities throughout the household sector, non-financial institutions, and the financial sector. Financial Intermediation Services Indirectly Measured (FISIM) comprise an average of -4 percent of the GDP.

[12] When subtracting FISIM from the total production of institutional economic sectors, collective production of these institutions is equal to GDP at factor cost. When adding indirect taxes to GDP at factor cost, this results is GDP at market price (either real or nominal).

The household sector and the non-financial institutions provide more than 94 percent of private sector's contribution to GDP. The contribution of the non-financial institutions witnessed a significant increase in 2011, rising to 47.9 percent of total private sector contribution after an increase in the sector's value-added by almost one third when compared with the previous year. In contrast, the household sector's contribution decreased from 51.8 percent in 2010, to 46.9 percent in 2011.

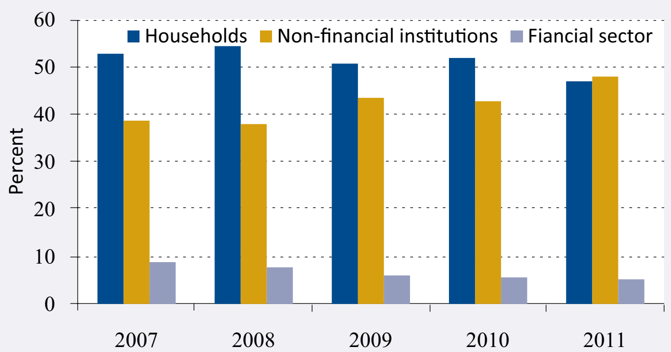
Figure 1-20: Sectoral contributions in nominal GDP at factor cost, 2008-2012



Source: PCBS, National Accounts.

One must note that the contribution of the household sector to GDP is at a steady decline. Prior to the outbreak of the Intifada in 2000, its contribution amounted to approximately 70 percent of the private sector's contribution to GDP. This figure fell to about 61 percent in the wake of the government's financial crisis and the siege on GS back in 2006. In 2011, there was a further decline, causing the private sector's total contribution to GDP to reach about 47 percent. As for the financial sector, its contribution did not exceed 7 percent over the past five years.

Figure 1-21: Private sector contribution in nominal GDP at factor cost, 2008-2012



Source: PCBS, National Accounts.

Available data indicate that nominal GDP at factor cost grew by 21.2 percent in 2011, compared to 23.0 percent in 2010 following a respective growth of 4.1 percent and 11.9 percent in the GDP deflator over the two years. This slowdown in growth is a result of a slower pace of growth in the household sector, which grew by less than 8 percent in 2011. This was in addition to low growth in the financial sector and relative stability in the FISIM's value-added during the same period.

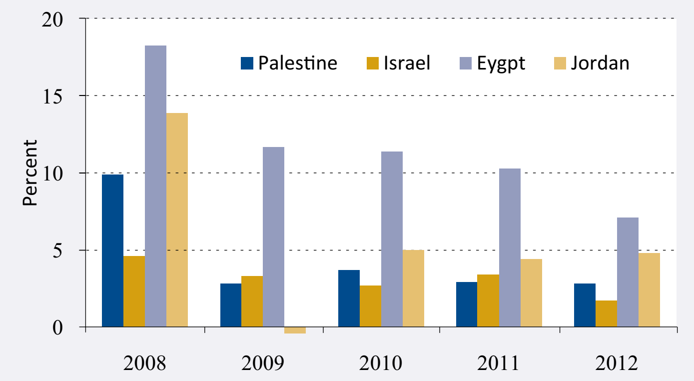
Inflation, Prices, and Purchasing Power

Prices in Palestine indicated relatively equal levels of inflation in the last two years, registering an inflation rate of 2.8 percent in 2012 and 2.9 percent in the previous year. On the whole, price fluctuations experienced in 2012 were at relatively acceptable levels compared with previous years despite the rise in VAT in Palestine by half a percent to reach 15 percent[13]. It seems that in recent years, inflation levels have taken a downward trend.

[13] Note that, the government raised the VAT rate from 14.5 percent to 15.5 percent in September of 2012, in line with the high (VAT) rates in Israel. However, this figure was reduced to 15 percent in October of 2012. At a later date, during this period of this report, particularly in the beginning of June 2013, the rate was raised again to 16 percent.

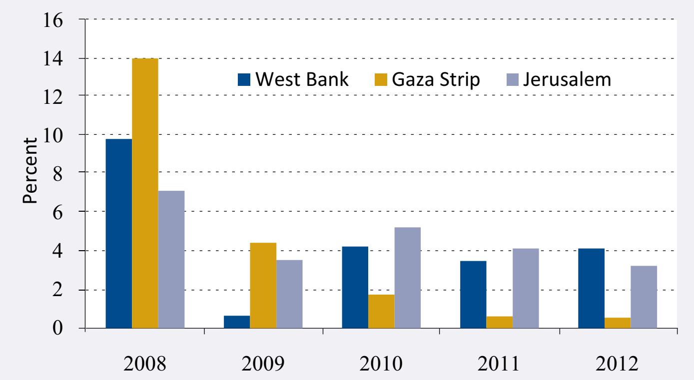
It is noteworthy that inflation in Palestine is relatively low when compared with global and regional rates, especially in light of economic developments and fluctuations in commodity prices in 2012. For example, world price levels rose by 3.6 percent in 2012, while inflation in the MENA region soared to reach 12.3 percent. With regard to neighboring countries, inflation was 4.8 percent in Jordan, while Israel witnessed a marked decline in inflation (reaching 1.7 percent) when compared to 2011. The same applies to Egypt, which saw a similar decline in inflation in 2012; yet it remains one of the countries in the region with the highest rates of inflation, at 7.1 percent.

Figure 1-22: Inflation rates, selected countries, 2008-2012



Source: PCBS, Consumer price Indeces (CPI). IMF, WEO database.

Figure 1-23: Inflation rates in Palestine, 2008-2012



Source: PCBS, Consumer price Indeces (CPI).

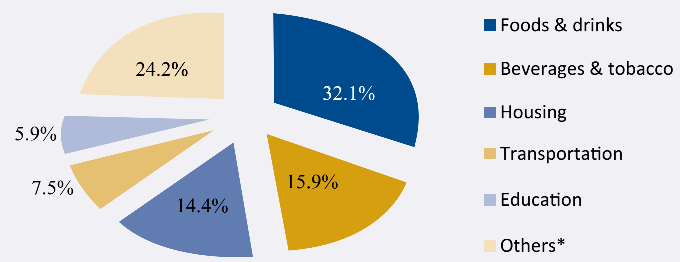
There is a clear disparity in the levels of inflation within the Palestinian territories. Inflation in the WB was calculated at 4.1 percent, even though it rose above that rate in the third quarter of the year. This exceptional rise in the third quarter came in response to rising prices of food commodities (and fuel prices prior to reverting to a gradual decline) due to fuel price increases in Israel. Meanwhile, inflation in GS did not exceed 0.5 percent; it appears that the irregularity in the import of goods from Egypt following unstable security situation in the Sinai did not have such a strong influence on prices.

This disparity in the levels of inflation between the WB and GS reflects the economic, political and social differences between the two regions. While commodity prices in the WB are linked primarily to prices in Israel and to the size of domestic demand, the prices of goods in GS depend on the prices of imported goods (or those entered through tunnels) from Egypt. This smuggling provided fuel and other consumer goods at relatively low prices in GS. Also, the price deflation in GS curbed the inflation rates in the WB.

The current level of inflation in Palestine also reflects the price fluctuations of goods and services groups experienced at close intervals within the Palestinian consumer basket. The tobacco and alcoholic beverages group witnessed the highest rise within the twelve categories in 2012. Prices of tobacco and alcoholic beverages increased by 7.8 percent due to an increase in custom duties applied in the WB. This was a consequence of the price increase in Israel at the end of July 2012. Inflation in this category amounted to 10.6 percent in the WB and 11.4 percent in Jerusalem, whilst it witnessed no change in GS, where prices are not dependent on price levels in Israel.

The second highest increase in terms of prices was found in the education category, which witnessed an increase of 5.5 percent in 2012. This was due to a rise in all components of educational services, particularly university tuition fees, which is considered the main driver of inflation in educational services. It was evident that the effect of the surge in the prices of educational services was greater in GS than in the WB, at rates of 6.4 percent and 5.8 percent, respectively. This was largely due to the different currencies used to pay for university tuitions. While the New Israeli Shekel (NIS) is the primary currency used to pay for university tuitions in GS, tuitions in the WB are paid in Jordanian Dinar (JD) that fell during the course of 2012 against the NIS, which is used in calculating the consumer price index.

Figure 1-24: Subgroups contribution to inflation in Palestine, 2012



* Includes textiles, clothing & footwear, furnitures, households goods, recreational cultural goods & services, restaurants & cafes, and other miscellaneous goods & services.

Source: PCBS, CPI.

The year 2012 also witnessed a surge in the prices of restaurants and cafes, hotels and medical services, whose prices have increased by 3.9 percent and 3.1 percent, respectively. However, the food products, housing, transport and communications groups continued to carry the largest weights, as they accounted for almost 58 percent of the overall weights[14]. Prices of food products increased by 2.1 percent in 2012, whereas housing prices increased by about 3.9 percent. This was due to the incompatibility of supply with the steady rise in demand for rented housing, as well as the incessant rise in the prices of land and real estate in Palestine over the past few years. Furthermore, prices of transport services rose by roughly 2.2 percent, affected by higher international fuel prices and high taxes imposed on fuel by the Israeli government, particularly because Israel is the main supplier of fuel for Palestine. Other groups recorded increases ranging between 0.3 percent and 1.3 percent.

With regard to the contribution of each category to the overall inflation rate, it is clear that the largest contribution was by food and soft drinks amounting to 32.1 percent, followed by tobacco and alcoholic beverages at 15.9 percent, housing at 14.4 percent, and transportation at 7.5 percent.

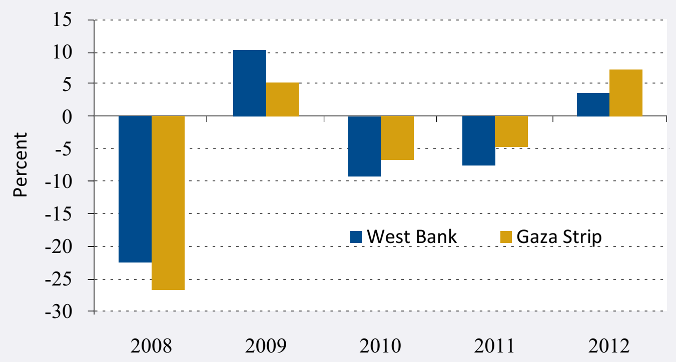
Inflation has a substantial impact on the purchasing power of individuals, which is most commonly associated with the change in nominal wages alongside the change in inflation. In the Palestinian case, the exchange rate is considered an additional key factor in determining the Palestinian citizen's purchasing power as there is a significant number of people who are paid in currencies other than the NIS.

In general, Palestinian wages and salaries are paid in three currencies: the NIS, the USD, and the JD. In light of the successive declines suffered by the dollar since 2006, citizens who earn their wages in USD and JD suffered from a loss in their wages purchasing power, compared to the purchasing power of wages paid in the NIS. However, the dollar's exchange rate recovered and rose by 7.5 percent in 2012 compared to the previous

[14] These reflect the importance of goods and services within the consumer basket or the economy in general, used in calculating the consumer price index.

year, resulting in an improvement in its purchasing power by 4.9 percent. The same applies to the JD because of the fixed dollar exchange rate that is in place. Those who get paid in NIS suffer from a decrease in purchasing power only by the amount of the rate of inflation, which came up to 2.8 percent in 2012.

Figure 1-25: USD Purchasing power in Palestine, 2008-2012



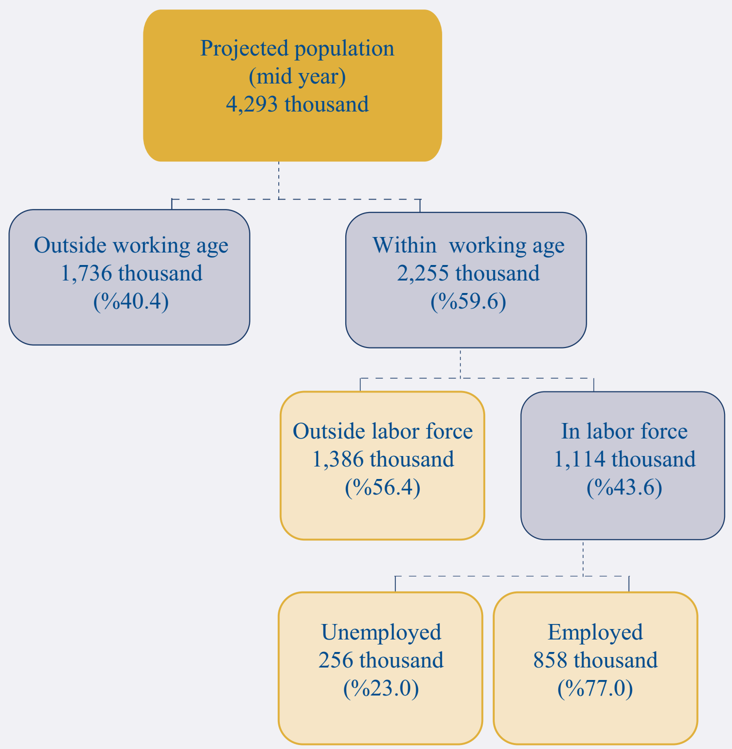
Source: PCBS, Bank of Isael.

Considering the varying rates of inflation in both the WB and GS, it is seen that both regions experienced varying changes in purchasing power. In the WB, purchasing power of the NIS declined by 4.1 percent, while in GS the decline did not exceed 0.5 percent. As a result, the increase in the dollar's purchasing power was also higher in GS than in the WB, as the dollar's purchasing power saw an increase of 7.2 percent in GS, versus 3.6 percent in the WB, holding nominal wages constant.

Labor Force and Productivity

The Palestinian population reached about 4.3 million at mid-2012, of which roughly 2.6 million (60 percent) are within the employment age of 15 and above. This percentage has been constantly growing over the years, where it reached 53 percent in 2007 and 55.4 percent in 2008. It was also higher in 2012 than the level registered in the previous year at 59.1 percent. This increase is a result of a decline in fertility rates in both the WB and GS, thereby lowering the percentage of persons under 15 years of age in total population. Despite the increase in the labor force-to-total population ratio, it is still considered one of the lowest amongst neighboring countries, as it reached 73.9 percent in Israel, 67.4 percent in Egypt and 63.9 percent in Jordan. These ratios differ dramatically in advanced countries, where the ratio reaches

Figure 1-26: Labor force framework in Palestine, 2012

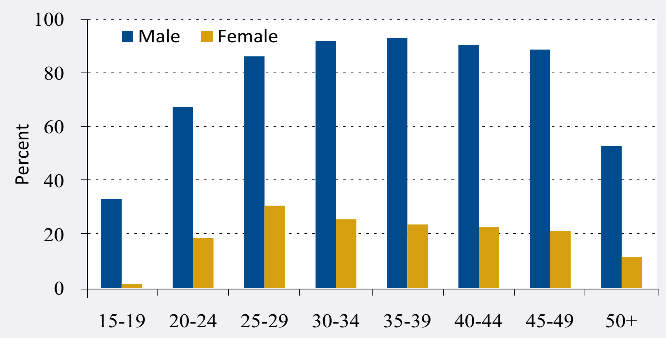


Source: PCBS, Labor Force Reports.

80 percent in the U.S., for example. These notable disparities indicate that the Palestinian society remains relatively young.

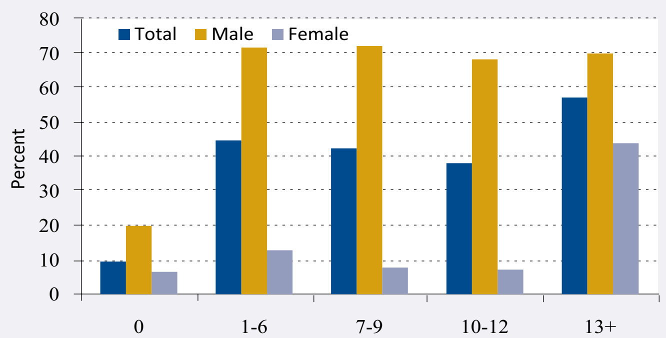
The fact that the Palestinian society is young is not only reflected in the labor force ratio, but also in rates of participation in the labor market. The high percentage of school-aged population (constituting more than a third of the total population) led to a rise in the number of individuals outside the labor market, and thus decreased the participation rate. In 2012, the participation rate in Palestine was approximately 43.6 percent (45.5 percent in the WB and 40.1 percent in GS). This indicates that more than half of the population is incapable of participating in economic activities. Both males and females exhibit low participation rates in Palestine in comparison to neighboring countries. While the differences in male participation are often relatively small and is equal to no more than a few percentage points, differences in female participation are vast and, in some countries, it is equal to many times the rate of participation in Palestine; as these differences amount to more than double in Egypt, and about four folds in Israel. In 2012, the rate of participation by Palestinian males increased from 68.7 percent to 69.1 percent. A relative improvement in the rate of participation by females is also noted at 17.4 percent, compared with 16.6 percent in 2011. This improvement is partially attributed to the increased funding opportunities available to small and micro lending institutions after they have been included in the PMA's database credit registry, especially since some of these institutions primarily target women. This contributed significantly by aiding women to start their own businesses, thereby increasing their participation in the labor force.

Figure 1-27: Paricipation rates in Palestine by age and sex, 2012



Source: PCBS, Labor Force Reports.

Figure 1-28: Paricipation rates in Palestine by sex and years of schooling, 2012



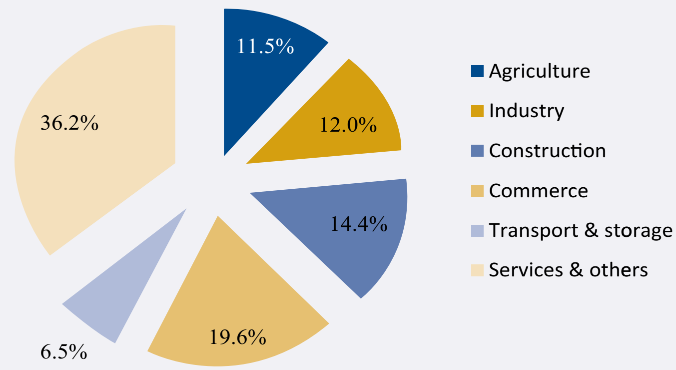
Source: PCBS, Labor Force Reports.

Moreover, the rates of male and female participation in the labor market are affected by a number of variables, such as the age group and years of education. The highest participation rate belongs to males aged 35-39 years, whilst the highest rate for females is in the 25-29 age bracket. In 2012, the rate of male participation within the abovementioned age brackets reached 93.1 percent, while female participation rates were 30.7 percent. Overall, individuals (both male and female) of the 25-49 age groups have the highest participation rate in the labor market.

Employment

The increase in the number of employees in 2012 was low; it did not exceed 2.5 percent, bringing the number of employees to 858,200 workers (with 70 percent in the WB and 30 percent in GS), compared with a rise of 12.6 percent in 2011. As for workers' distribution to the public, private and Israeli sectors, the percentage of workers in the public sector has maintained relative stability and amounted to 22.7 percent of total workers. Taking into account the increased percentage of public sector employees in GS in comparison to the WB, this percentage amounted to 38.8 percent (99.4 thousand employees) in GS in 2012, compared with 15.8 percent (95.1 thousand employees) in the WB. In the same context, the private sector remains the largest employer with a rate of 67.7 percent (about 581 thousand workers) 70 percent of which reside in the WB, and the remainder are in GS. It is noteworthy that the number of workers in the private sector in GS has been on a constant rise due to existing international projects for the reconstruction of the Strip.

Figure 1-29: Distribution of workers by economic activity, 2012



Source: PCBS, Labor Force Reports.

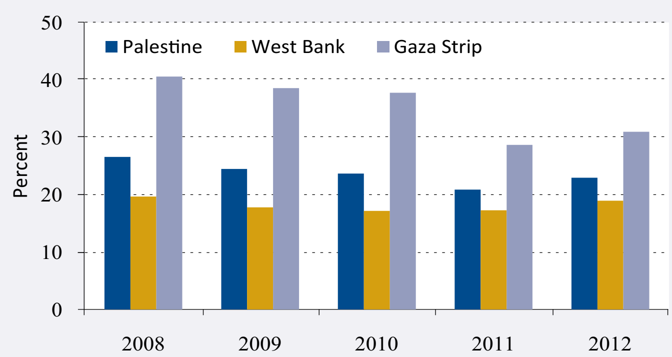
In contrast, the number of workers employed in Israel and the settlements maintained the same levels. In 2012, these figures amounted to about 83,000 workers, constituting 9.6 percent of total workers- all of whom are residents of the WB, as workers from GS are still officially banned from working in Israel or the settlements ever since mid-2005.

With regard to the distribution of workers to economic activities, the services sector continues to hold first position in terms of the number of employees, constituting about 36.2 percent of total workers. The number of workers in agriculture and trade has decreased, in comparison to a rise in this number in manufacturing and construction. Overall, these declines remain limited, and the general workforce structure in various sectors remained relatively stable over the years.

Unemployment

Unemployment poses one of the most significant challenges to economic development in countries around the world, most especially in developing countries. This is a matter that is not limited to the provision of job opportunities for new entrants to the labor market, but extends to accommodate the existing accumulation of unemployment. This is a grave task that requires huge efforts in light of limited productivity, decline in investment levels, and the relatively high population growth rate and the resulting increase in the labor force.

Figure 1-30: Unemployment rates in Palestine, 2008-2012



Source: PCBS, Labor Force Reports.

It is noted that unemployment in Palestine has risen again during 2012, after a relative improvement witnessed in the past year, to reach 23 percent of the total labor force (19 percent in the WB and 31 percent in GS). The rise in unemployment is a clear indication of the Palestinian labor market's inability to provide sufficient job opportunities to new entrants[15] due to the slowing economic activity. Consequently, employment in some sectors such as manufacturing, for example, experience slow growth in view of its declining market share and the limited growth in exports and investment. In addition, the restrictions on the flow of workers to Israel is another cause of accumulated unemployment. Moreover, there is the issue of the slow growth of employment in the interim reconstruction projects, which absorbed large numbers of workers during the last two years. However, these projects are inherently volatile and mostly end at completion, after which a large number of the workers it employs must return to unemployment.

Overall, unemployment rate in Palestine is still very high in comparison with other countries in the region. For as more than one fifth of the labor force remains unemployed in Palestine, unemployment stands in Jordan at 12.2 percent, in Egypt at 12.3 percent and in Israel at only 6.9 percent. It is worth mentioning that the unemployment rate rises significantly amongst females, amounting to 32.9 percent in 2012, a higher level than that in the previous year. Also, the unemployment rate is higher in refugee camps compared to urban and rural areas, reaching 29.5 percent in 2012 (24.4 percent in the camps found in the WB and 33.3 percent in those found in GS).

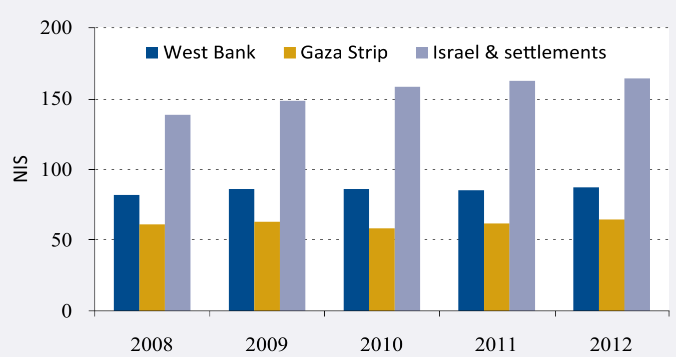
Average Daily Wage

The nominal average daily wage in Palestine rose to reach 93 NIS, increasing by 1.4 percent in 2012 when compared with 2011. This is the result of increased wages in the WB, GS and Israel and settlements, where the largest increase was in GS. Nevertheless, these developments in nominal wages cannot be addressed in isolation from price developments, and the impact on the daily real wage rate.

Because the rate of inflation was higher in 2012 than the increase in nominal wages, real wages dropped by 1.4 percent in Palestine. This was due to a decline in the real average daily wages by 1.7 percent in the WB, as well as a decline in average daily wage for workers in Israel and Israeli settlements by 3 percent. This is contrasted against an increase in the real wages for workers in GS by 4.1 percent, due to the low level of inflation in the GS.

Despite the growth in average daily wages during the past few years for workers in GS, the gap between the wages of these workers compared to the wages of workers in the WB or in Israel persists. This is a clear indication of the size of the economic disparity among the regions, particularly as the Strip is still suffering from the crippling Israeli blockade since 2005. Consequently, wages of workers in GS continue to be lower than those in the WB by 26 percent and from wages of Palestinians working in Israel by 61 percent.

Figure 1-31: Nominal average daily wages for Palestinian workers, 2008-2012



Source: PCBS, Labor Force Reports.

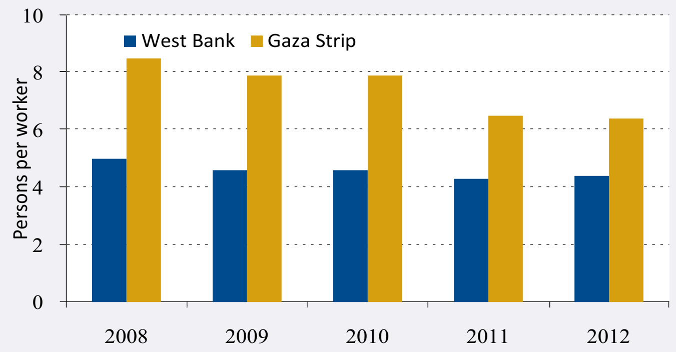
[15] 55 thousand new workers entered the labor market in 2012, of which only 21 thousand were provided with job opportunities, while the rest were forced to join the ranks of the unemployed.

Dependency Rate

The dependency ratio (number of individuals who are dependents of working members of society) is an indicator of the economic burden endured by the working group. This indicator is primarily affected by the number of working individuals and the population's natural growth rate, as an increase in the number of workers by more than the increase in the population's natural rate of growth will ease the economic burden on the working individual.

Despite a population growth rate that ranges around 3 percent, the increase in the number of employed workers was very small, standing at 2.6 percent in 2012, down by 10 percentage points from 2011. Nevertheless, the dependency ratio did not decline below the level achieved in 2011 and settled at 5.0 individuals per employed worker. This means that an employed individual provides financial support to oneself in addition to four other people.

Figure 1-32: Dependency ratio in Palestine, 2008-2012



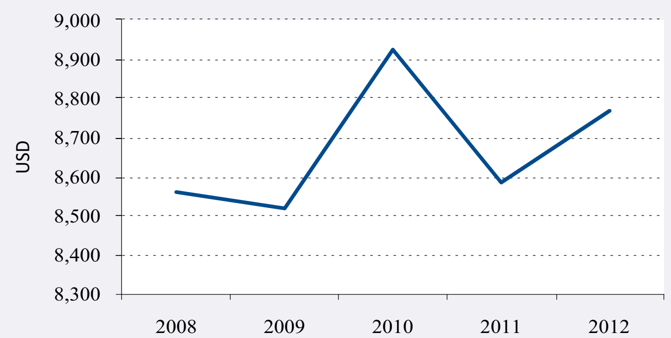
Source: PCBS, Labor Force Reports.

Looking at this ratio from a geographic perspective, from a geographic prospective, er a very high es financial support to oneself in additon the population of workers in Israel by GS continues to suffer from a very high dependency ratio of 6.4 individuals per employed worker, compared with 4.4 for workers in the WB. The low dependency ratio in the WB, compared with the high rate found in GS, is associated more with the decrease in fertility rates[16], and thus a decline in the rate of population below the working age (those who need to be supported by older individuals), than it is associated with an improved ability of the WB's labor market to absorb workers.

Productivity

The productivity of the Palestinian worker[17] witnessed a 2.1 percent growth rate in 2012 as a result of the realized growth in GDP, averaging about USD 8,769 per employed individual. It is worth mentioning that the productivity of the Palestinian worker has often taken an upward, yet volatile trend over the period of 4 years from 2008-2012. This coincides with the volatility of economic growth during the same period. It is also noted that the worker productivity in the WB is much higher

Figure 1-33: Labor productivity in Palestine, 2008-2012



Source: PCBS, Labor Force Reports.

[16] The average number of children a woman bears in her lifetime; it is calculated by dividing the number of births in a given year to the number of women of reproductive age (15-44 years).

[17] Productivity = added value/ number of workers.

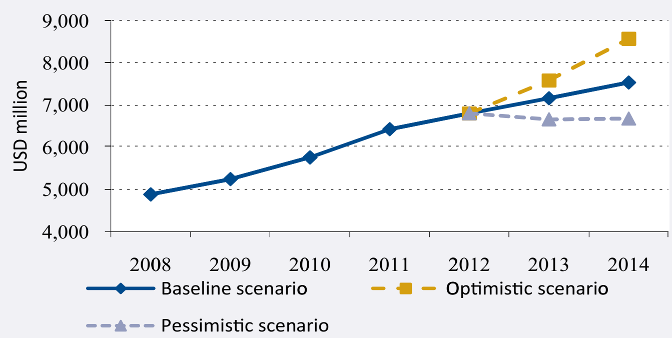
Chapter One: Global and Local Economic Developments than its counterpart in GS, where worker productivity averages about 70-80 percent that in the WB. In 2012, the productivity of one worker from the WB amounted to USD 9,695 versus USD 6,894 for workers in GS.

Economic Outlook

The Palestinian economy is expected to continue its slowdown in the coming years of 2013 and 2014, even after having realized high growth rates over the past few years and its peak in 2011. PMA's forecasts indicate a growth in real GDP by 5.3 percent and 5.2 percent for the years 2013 and 2014, respectively. (Compared to a 5.9 percent in 2012[18]). It is expected that real per capita GDP will grow by 2.3 percent in 2013 and 2.2 percent in 2014, in contrast to a 2.7 percent in 2012. This slowdown is based on the assumption that the political and economic conditions in Palestine will remain the same as those prevalent in 2012.

Over the next two years, the halt in the political process, the continued closure of GS's crossing points, the constant restrictions on the movement of trade and workers in the WB, in addition to very low levels of foreign aid for Palestinian government will all inhibit economic growth.

Figure 1-34: Real GDP growth forecast in Palestine, 2013-2014



Source: Palestine Monetary Authority (PMA), 2013.

According to this scenario (baseline scenario/ status quo scenario), the ratio of final consumption to GDP is expected to decline to about 123.5 percent in 2013 (of which 103.4 percent is private consumption, and 20.1 percent is government consumption), as opposed to a rate of 128.4 percent achieved in 2012. Moreover, it is expected that the contribution made by gross investments to GDP will increase to 18.3 percent in 2013 (13.4 percent private investment, and 4.9 percent government investment), versus the 15.8 percent attained in 2012.

With regard to foreign trade, the ratio of the trade deficit to GDP is expected to decrease from 44.2 percent in 2012 to 41.8 percent in 2013 as a result of a rise in the ratio of exports to GDP to 16.5 percent, and a decline in the volume of imports to 58.4 percent of GDP.

In the optimistic scenario, where political and economic conditions witness positive developments (such as the return to talks and moving forward in the peace process, loosening of Israeli restrictions on the freedom of movement for people and goods, easing the blockade on GS, Israel allowing entrance for more Palestinian workers, as well as a rise in foreign aid for the Palestinian government), real GDP is expected to grow by 11.5 percent and 13 percent in 2013 and 2014, respectively. In addition, per capita GDP is expected to grow to about 8.3 percent and 9.8 percent during the same period.

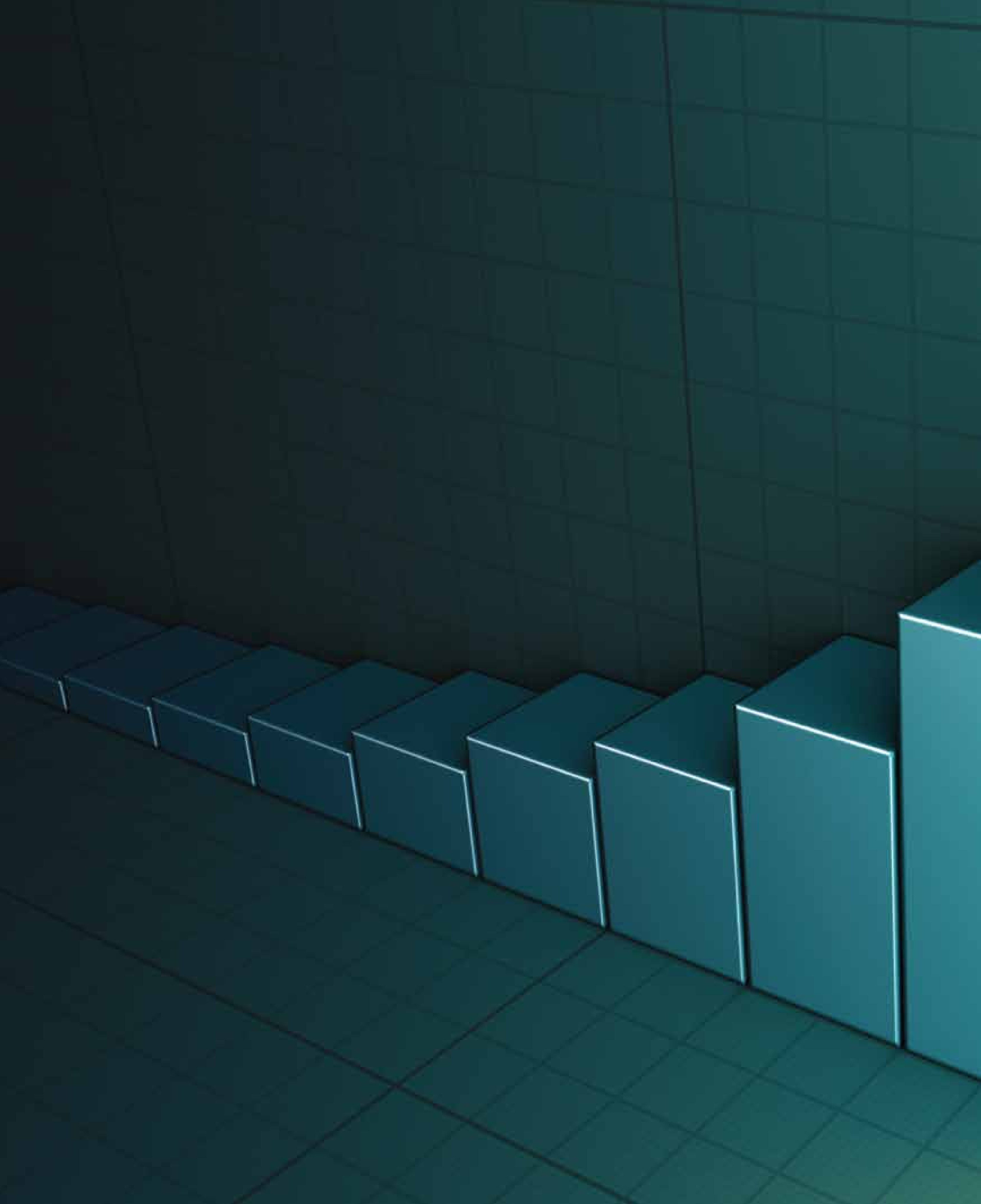
[18] The IMF reduced its real GDP growth expectations for 2013 from 5 percent to 4.5 percent as a result of continuing Israeli blockade imposed on GS, and no change in restrictions on access and movement in the WB, in addition to continuing government austere fiscal Policy.

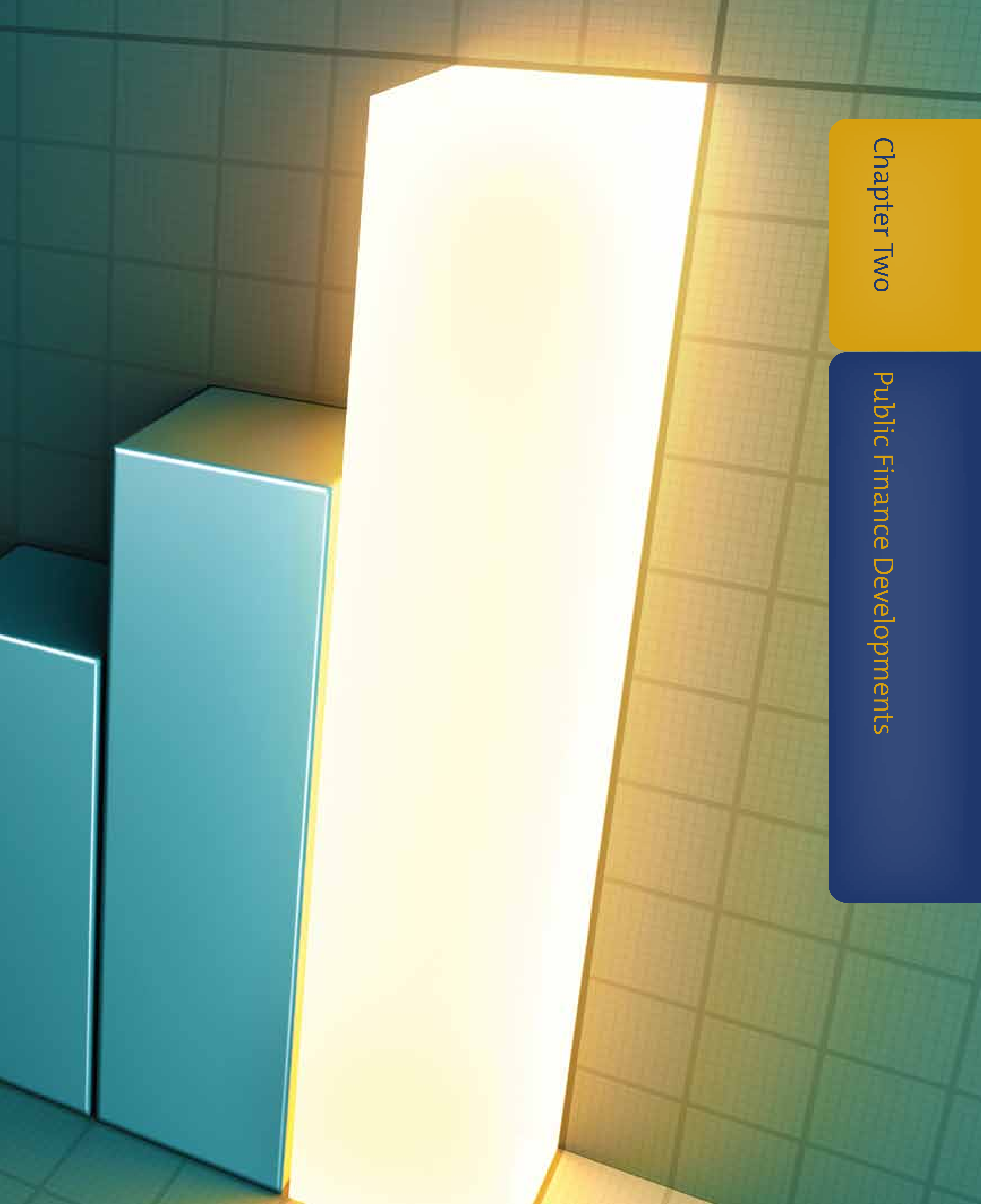
The ratio of the final consumption to GDP is expected – according to this scenario – to decrease to 119.5 percent in 2013 (98.3 percent private, and 21.2 percent public). As for gross investment, its ratio to GDP will increase to 23.1 percent (17.1 percent private investment, 5.9 percent government investment)

With regard to foreign trade, the ratio of exports to GDP is expected to increase to 17.1 percent, while the imports to GDP ratio is expected to decrease to 59.7 percent in 2013. As a result, trade deficit will decrease to 42.6 percent of GDP.

However, in the pessimistic scenario- where political and economic conditions deteriorate- real GDP is expected to decline by 2.1 percent in 2013, whilst it is expected to rise by 0.3 percent in 2014. Per capita GDP is expected to decline in 2013 and 2014 by 4.9 percent and 2.6 percent, respectively.

As for real GDP components according to this scenario, the ratio of the final consumptionto GDP is expected to decline to 126.6 percent in 2013 (107 percent private, and 19.6 percent public). Furthermore, the volume of exports is expected to account for 16.1 percent of GDP, and imports to 56.4 percent of GDP. As a result, trade deficit to GDP will decline to 40.3 percent due to the decline in trade activity and the volume of imports.





Chapter Two

Public Finance Developments

Overview

In 2012, the government faced a number of political and economic difficulties and challenges due to the substantial shortage of foreign aid. Furthermore, performance levels were lower than expected, specifically with regard to revenue. This led to the government's inability to fulfill their financial obligations, especially towards the private sector, suppliers, and employees of the public sector.

The year 2012 also witnessed a series of developments in the financial performance of the government[19]. In regard to revenue, the actual clearance revenues were higher than those projected by the 2012 budget, and conversely, actual tax revenues were less than those projected.

As for expenditure, wage and non-wage expenditures were less than planned in the 2012 budget, while net lending rose significantly, reaching higher levels than projected. It should be noted that this increase was due to Israeli withholding of sums of tax money that the Israeli government should have transferred to the PNA, but instead, redirected to the Israeli Electricity Company to cover for PNA debts.

These developments are reflected in the government's current deficit, forming about 8 percent of GDP in 2012. The majority of the deficit was financed through grants and official aid, despite it being less than that anticipated by the budget. The remaining deficit was financed by borrowing from banks operating in Palestine.

According to the Budget Act of 2012, it is not permissible to borrow from the banking sector, except for the purpose of covering the financing gap, so that the outstanding balance at the end of 2012 does not exceed the amount at the end of 2011. This section of the report highlights the most important developments in the overall performance of public finance in 2012 in comparison to previous periods.

Revenues and Grants

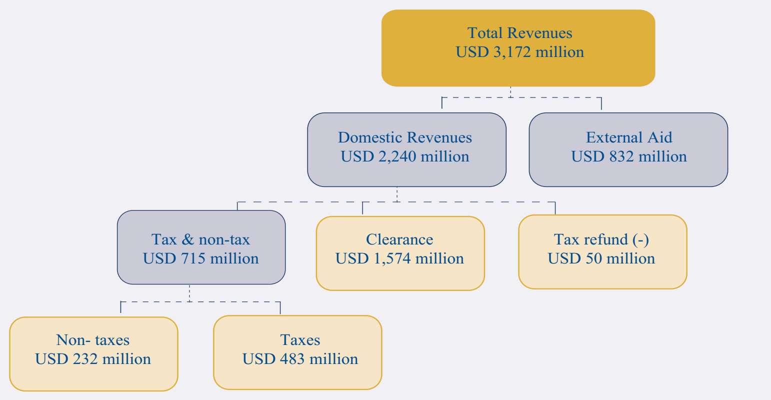
Since its inception, the collection of public revenue has been one of the most important challenges facing the government due to its reliance on more than one source of revenue, some of which are beyond the government's direct and immediate control. Generally, the government depends on three major sources of revenue:

1. Local revenue : tax and non-tax Revenues.
2. Clearance revenues: collected by Israel on behalf of the government, as stated in the Paris Protocol of 1994.
3. Foreign Aid (either to support the budget or to finance development projects), a major source of funding for the government.

[19] Data contained in this report is based on those published on the official website of the Ministry of Finance. Data are presented in NIS and converted to USD using the actual exchange rate published by the Ministry. It should be noted that these data are related to the central government (excluding public institutions and local government authorities). When talking about developments in public finance, it is imperative to take the effects of changes in exchange rate into account, especially since the data are published in NIS, which ultimately cause disparities in growth rates calculated for values in NIS compared to those measured in USD. For example, data indicate an increase in total Public Expenditures by about NIS 891.7 million in 2012 in comparison to the previous year. When measured against the USD, the data indicate that public expenditures rose by about USD 1.3 million. This discrepancy is due to an increase in the exchange rate of the USD against the NIS by 7.5 percent during the two years, with an average exchange rate of about NIS 3.85 to USD 1 in 2012, and NIS 3.58 to USD 1 in 2011.

Despite the financial hardships incurred by the government in 2012, total public revenues (domestic revenues, grants and foreign aid) calculated in USD witnessed an increase of 0.6 percent, compared to the previous year when they were about USD 3,172.3 million.

Figure 2-1: Public revenues structure in Palestine, 2012



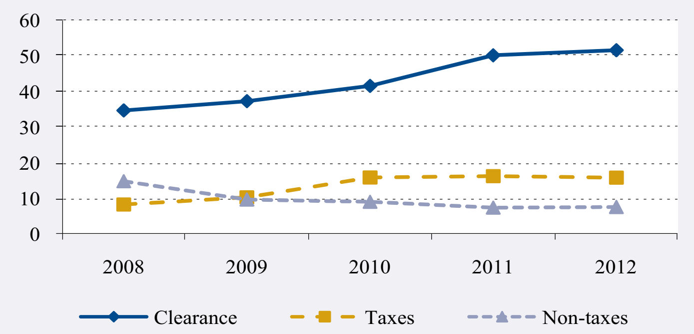
Source: Ministry of Finance (MoF) database.

When taking into account the change in the exchange rate of the USD against the NIS (at 7.5 percent), the rate of increase in total revenues amounted to about 8.2 percent with a value of NIS 12,235.4[20] million in 2012.

The increase in total revenues was the result of an increase in both local and clearance revenue collections, causing total revenues to rise to 30.9 percent of GDP in 2012, as opposed to 32.3 percent in the previous year, of which foreign aid amounted to 9.1 percent and 10 percent in 2012 and 2011, respectively. Total revenues to GDP was higher in Palestine than that in Jordan (which amounted to 25.8 percent of GDP); foreign aid contributed 3.9 percentage points to the latter figure according to IMF projections.

With regard to revenue items, local revenue collections witnessed a notable increase of 9.4 percent in 2012, compared to 2011, reaching NIS 2,747.1 million (cash basis), amounting to 31.8 percent of domestic revenues and 89 percent of the target amount in the 2012 public budget. This increase is attributed to an increase in both tax and non-tax revenues; tax revenues increased by 7.3 percent to NIS 1,851.9 million at the end of 2012, primarily due to the increase in income tax[21]. The contribution of tax revenues to local revenues decreased slightly to 67.6 percent in 2012, compared with 68.7 percent in 2011. The same applies to non-tax revenues, which increased by about NIS 110.4 million from 2011, to roughly NIS 895.2 million in 2012, bearing in mind the dividend payments by the Palestine Investment Fund (PIF), which registered higher levels than those in the 2012 budget. Non-tax revenue contributions to local revenue collections came to about 32.6 percent, versus 31.3 percent in 2011. It is also worth noting that the government increased the VAT from 14.5 percent to 15.5 percent in September of 2012, in line with the VAT increase in Israel. However, this figure was reduced to 15 percent in October of 2012.

Figure 2-2: Domestic revenues as a percent of current expenditure, 2008-2012



Source: Ministry of Finance (MoF) database.

[20] As a result of the great impact of fluctuations in exchange rates over changes in public finance items during 2011 and 2012, the analysis of these items was mainly conducted in NIS, in order to neutralize the effect of the exchange rate.

[21] During 2012, income tax increased by about NIS 187.3 million (commitment basis) compared to 2011, reaching about NIS 661.7 million, against a decline in each: VAT, by about NIS 1.8 million, and customs and excise duty, by about NIS 60.3 million.

One must also consider that during the course of 2012, local revenues contributed about 23.4 percent of total current expenditures (of which 15.8 percent were tax revenues and 7.6 percent were non-tax revenues). In contrast, both tax revenues and non-tax revenues contributed 45.9 percent of wage expenditures (tax revenues were 30.9 percent and non- tax revenues were 14.9 percent) in 2012.

As for tax refunds, the government returned about NIS 194.5 million as tax-refunds in 2012, as opposed to NIS 48.5 million in 2011. According to the 2012 planned (draft) budget, the government was to refund NIS 454 million. This means that the government's commitments to the private sector (including contractors, suppliers, and taxpayers) came up to 42.8 percent of the amount that was included in the budget.

Despite the delay in reaching an understanding with the Israelis in mid-2012 concerning the enhancement of the clearance revenue collection process, as well as the inconsistency in the transfer processes in certain months, clearance revenues registered a higher level than the public budget's target by about NIS 237.2 million.

A number of complications with regard to clearance revenues surfaced in 2012. At times, clearance revenues were transferred in advance by the Israelis, as was the case in July, September, and October. Other times, this revenue was not transferred at all, as was the case in November and December, leading to the partial interruption of public wages during that period. This was somewhat due to the government's request to become a UN non-member observer state, and also because Israel allocated part of these revenues towards the government's outstanding debt to the Israeli Electricity Company, causing the government's liquidity crisis to aggravate. Despite the sharp fluctuations in Israel's commitment to transfer clearance revenues in 2012, they were 14.4 percent higher than the previous year where amounts reached NIS 6.0962 billion, or 104 percent of the amount targeted by the 2012 budget. Clearance revenues contributed about 68.9 percent of local revenues and covered 52 percent of current expenditures in 2012.

Part of this increase in clearance revenues is attributed to the improvement in VAT invoice collection issued in GS. The government began collecting VAT invoices on goods imported through the main crossing between the GS and Israel in January 2012. This contributed about NIS 100 million to revenues, according to IMF estimates.

Consequently, actual clearance revenue covered 101.7 percent of wage expenditures in 2012, which demonstrates the importance of this item as well as Israel's ability to greatly impact the government and Palestinian citizens through its control of this highly important form of revenue.

In conclusion, the rise in local revenue and clearance revenues lead to an increase in domestic revenues to cover about 75 percent of current expenditures and about 70.5 percent of public expenditures in 2012, versus 74 percent and 67.3 percent for 2011, respectively.

Grants and foreign aid that the government receives from donor countries constitute another highly important source of funding to cover public expenditures. This revenue item came to NIS 3,586.6 million in 2012, as opposed to the NIS 3,520.3 million received in 2011. It should be noted that most of the grants and aid extended to the government is primarily geared towards funding current expenditures in the public budget, which came to about NIS 2,985.6 million in 2012, compared to NIS 2,915.3 million in 2011. However, grants to support development projects remained constant at about NIS 600 million in both 2011 and 2012.

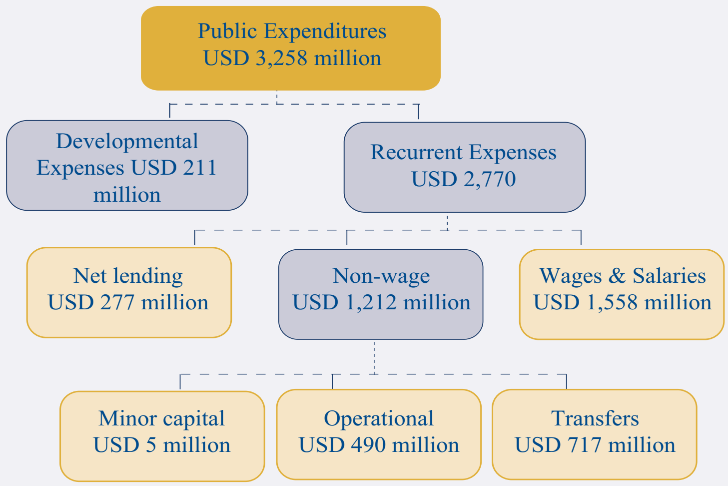
Grants and foreign aid accounted for 29.3 percent of total public revenue in 2012, in addition to covering 28.6 percent of public expenditures. Despite the government's orientation towards reducing its reliance on foreign aid over the past few years, this aid continues to be a main tributary for funding the public budget's total deficit, helping to reduce total deficit for 2012 from about NIS 3,894.4 million (9.9 percent of GDP) to NIS 307.8 million (0.8 percent of GDP).

Public Expenditure

Public expenditures registered an increase of about 7.7 percent, reaching NIS 12,543.2 million 2012. This increase was the result of a rise in both net lending expenditures by NIS 571.1 million, and non-wage expenditures by about NIS 573.4 million. In contrast, development expenditures decreased by about NIS 241.6 million and wage expenditures by about NIS 11.2 million, compared with 2011.

Public expenditures accounted for 31.8 percent of the 2012 GDP versus 33.3 percent[22] of GDP in 2011. Wage expenditures amounted to 15.2 percent of GDP in 2012, while it was 17.2 percent in 2011. Non-wage expenditures settled at 11.8 percent of GDP during the same period.

Figure 2-3: Public expenditures structure in Palestine, 2012

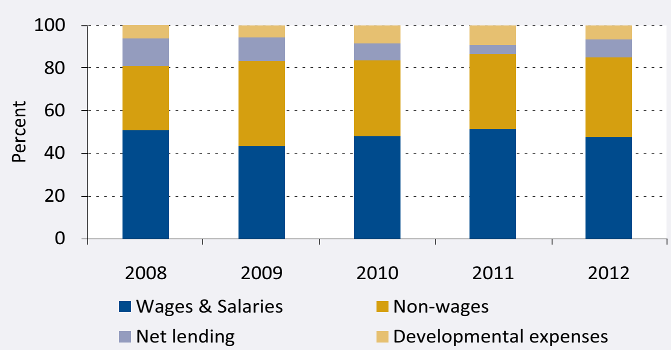


Source: Ministry of Finance (MoF) database.

Despite an increase in actual public expenditure, it only accounted for 93.3 percent of the targeted public expenditures in the planned budget for 2012, to amount to NIS 13,444 million. Current expenditures accounted for 93.5 percent of the total actual Public Expenditures (47.8 percent wage expenditures, 37.2 percent non-wage expenditure, and 8.5 percent net lending), while development expenditures came up to about 6.5 percent of the total actual public expenditure.

Regarding the main items of public expenditure, data indicate that current expenditures rose by about 10.7 percent in 2012 compared with the previous year, registering at NIS 11,730.2 million, and accounting for 96.8 percent of the planned spending (according to the draft budget). This increase is due to an increase in non-wage expenditures by about 14 percent, to amount to NIS 4,662.7 million; This is in contrast to a decrease in wage expenditures by about 0.2 percent which amounts to NIS 5,995.6 million. This may be due to the government's attempt to contain this item by freezing promotions and appointments

Figure 2-4: Spending items as a percent of total expenditure, 2008-2012



Source: Ministry of Finance (MoF) database.

[22] It should be noted that according to the IMF estimates, public expenditure to GDP in Jordan came up to about 31 percent during 2012.

since August 2012. The reason behind the sharp rise in non-wage expenditures is the increase in both the transfer expenditures (economic aid payments, social transfers, and debt service) by about NIS 275.8 million and an increase in operating expenditures by NIS 311.9 million. It should be noted that the increase in transfer expenditures indicates an increase in social benefits, or an increased propensity to borrow. This, in turn, indicates a high degree of economic crisis, high levels of unemployment and poverty, or an increase in spending on debt service. When the size of actual spending on these items is compared with the budgeted spending (as stated in the 2012 draft public budget) the actual non-wage expenditures came up to about 95.1 percent of planned spending while wage expenditures amounted to 88 percent of the spending stated in the planned budget.

Net lending expenditure doubled, from NIS 500.8 million in 2011, to about NIS 1,071.9 million in 2012. This was because of the municipalities' non-payment of outstanding debts. As a result, the net lending to public expenditure ratio increased from 4.3 percent in 2011, to 8.5 percent in 2012. Note that the projected payment according to the planned budget is NIS 400 million. However, the actual payment amount was more than double of this figure (NIS 1,071.9 million) due to the deduction of NIS 443.7 million in a single payment by the Israelis on behalf of the Israeli Electricity Company in November 2012.

Contrary to the rest of the expenditure items, development expenditures declined by about 22.9 percent in 2012 when compared with 2011. It amounted to NIS 813 million, bearing in mind that the planned budget reserved NIS 1,330 million as development expenditures, but what was spent did not actually exceed 61.1 percent of this amount. The Treasury contributed about a quarter of total development expenditures (NIS 212 million), while the remainder, a sum of NIS 601 million, was funded by grants and foreign aid.

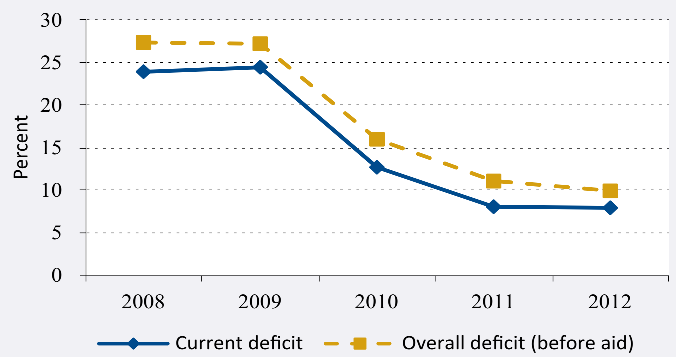
It is evident from the above that the government resorts to reducing development expenditures in favor of current expenditures (wage and non-wage expenditures). This indicates to the lack of clarity in the Palestinian government's performance due to limited available resources and an increase in liabilities. This is expected to lead to a structural deficiency in the long-run as reduced spending on development projects will lead to lower expected revenues in the ensuing periods.

Budget Deficit

The current deficit increased by 9.9 percent to about NIS 3,081.4 million in 2012, compared with 2011. This increase was primarily due to an increase in both net lending expenditures (by NIS 571 million), and non-wage expenditures (by NIS 573 million). Despite the increase in deficit in 2012, the differences in growth rates between both the deficit and the GDP resulted in a slight drop in the deficit to GDP ratio from about 8 percent in 2011, to 7.9 percent in 2012.

Total deficit before aid (including development expenditures) declined by about NIS 35.8 million in 2012, compared to 2011, amounting to about NIS 3,894.4 million. This drop was mainly due to the decline in development expenditures. On the other hand, total deficit after aid amounted to about NIS 307.8 million, compared with the 2011 deficit of about NIS 338.3 million. This deficit was financed by borrowing from banks operating in Palestine, thereby

Figure 2-5: Deficit (before budget support) as a percent of GDP, 2008-2012



Source: Ministry of Finance (MoF) database.

increasing the size of government borrowing (from banks) by about NIS 489.8 million in 2012 compared to 2011.

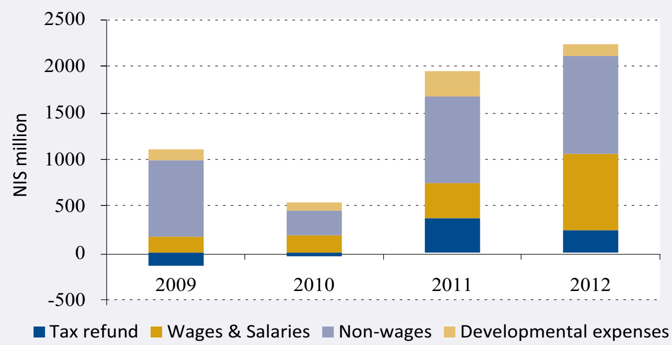
It is worth mentioning that total deficit after aid accounted for 0.8 percent of GDP in 2012. This is low compared to Jordan, where the rate was about 5.2 percent, according to IMF estimates.

Public Arrears

The shortfall in foreign aid, along with increased public expenditures, lead to an incessant deficit in the government's budget; this in turn led to increased accumulation of arrears, as well as increased government borrowing from banks operating in Palestine. The net accumulation of arrears owed by the government.

increased by about 14.8 percent in 2012 compared to 2011, reaching about NIS 2,226.3 million. Non-wage arrears (the private sector, suppliers, and the government's contribution to the pension fund) accounted for about 46.8 percent, or approximately NIS 1,046.3 million, of total arrears in 2012.

Figure 2-6: Outstanding arrears payments, 2009-2012



Source: Ministry of Finance (MoF) database.

A contributing factor to this rise was the government's inability to transfer the contributions of public employees to the pension fund. Consequently, it had to pay about NIS 816.4 million in the current year, or 36.5 percent of total arrears. Tax-refund arrears came up to roughly NIS 239.4 million in 2012, compared with NIS 368.2 million in 2011, while development-projects arrears (development expenditure) amounted to about NIS 124.2 million, compared with NIS 270.4 million in 2011.

Government Debt

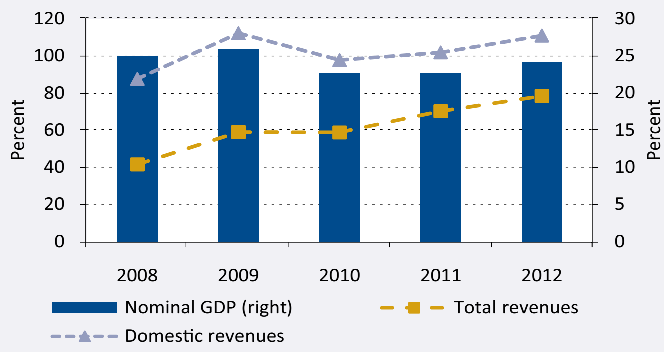
The government's total public debt (both internal and external) increased at the end of 2012 by 12.2 percent compared to 2011, amounting to USD 2,482.5 million. Thus, the public debt-to-GDP ratio increased from about 22.6 percent in 2011, to approximately 24.2 percent in 2012 (of which 13.5 percent internal public debt, compared with 10.7 percent of external public debt)[23].

Despite the low public debt-to-GDP ratio in Palestine, this rate reflects multi-layered risks that may affect the local economy if left unresolved, including: the limited financial resources available to the government, the risk of exchange rate fluctuations, and the government's frequent inability to repay bank loans. Furthermore, these debts are mostly consumption debts _not investment or income_generating debts. All these risks, among other inherent risks, should draw the attention of public officials and should be taken into account when drafting financial and economic policies. On the other hand, the increase in public debt led to an increase in the Palestinian citizen's percapita share of this debt, amounting to about USD 578.2 in 2012, as opposed to USD 530.8 in 2011.

[23] This is a fairly low percentage compared to debt levels in neighboring countries. For example, the public debt-to-GDP in Jordan reached to percent 79.5 during 2012.

Public debt accounted for approximately 78.3 percent of total revenues (including grants and foreign aid) in 2012, while it was 70.2 percent in 2011. Domestic revenue (before grants and foreign aid) was approximately 110.8 percent in 2012 compared to 101.7 percent in the previous year. These notably high ratios are an indication that the government is facing difficulties in servicing debt and is highly dependent on foreign aid, which is an unreliable source of funding.

Figure 2-7: Government public debt as a percent of government revenues & GDP, 2009-2012



Source: Ministry of Finance (MoF) database.

In 2012, public debt was divided between internal debt, at 55.8 percent with a value of USD 1,384.8 million, and external debt at 44.2 percent with a value of USD 1,097.8 million. Note that the internal public debt's share has doubled over the last five years, totaling 28.7 percent in 2007. This is an indication of the government's dependence on domestic borrowing in order to finance public expenditures, which is a source of concern and a threat to the banking sector, in particular, as well as the local economy in general. Banks operating in Palestine are the primary source of financing for internal debt; they provided the government with loans valued at approximately USD 1,376.6 million (equivalent of 99.4 percent of total internal government debt). This amount includes Petroleum Authority loans guaranteed by government, which amounted to approximately USD 177.6 million. In contrast, the contribution of other public institutions did not exceed 0.6 percent of total internal government debt, an equivalent of USD 8.2 million.

External public debt, amounting to about USD 1,097.8 million, was divided between three main parties: Arab financial institutions, international and regional institutions, and bilateral loans. Arab financial institutions contributed with roughly USD 617.4 million of total external public debt. This contribution was divided among the following institutions: Al-Aqsa Fund, with 83.1 percent, the Arab Fund for Economic and Social Development, with 9 percent, and the Islamic Development Bank, with 7.9 percent. International and regional institutions contributed a sum of USD 338.5 million, which accounted for 30.8 percent of total external debt. This sum was distributed among the following institutions: the World Bank, with 85.7 percent, the European Investment Bank, with 7.6 percent, OPEC, with 5.7 percent, and the International Fund for Agricultural Development, with 1 percent. Bilateral loans, on the other hand, declined in 2012 to about USD 130.3 million, compared with USD 155.2 million in 2011. Spain, Italy, and China's contribution to the funding of bilateral loans came up to about 70.5 percent, 25.5 percent and 4 percent, respectively.

According to data published by the IMF, the Palestinian government managed to pay roughly USD 506 million as public debt service in 2012 (interest and amortization), distributed between: interest, estimated at USD 60 million (mostly accrued on internal debt -about USD 56 million); and principle amortization, estimated at USD 446 million (of which, USD 433 million are internal debt amortization and USD 13 million of external debt amortization).

This in contrast to 2011[24], when the government incurred an accumulated debt amounting USD 82.1 million. It should be noted that public debt service accounted for about 22.7 percent of domestic revenues in 2012, which indicates a depletion of almost a quarter of domestic revenues in favor of public debt service.

[24] IMF data indicate that in 2011, the government was able to pay a sum of USD 66 million as total public debt interest payments (of which, USD 63 million covered internal debt interests, and USD 3 million covered external debt interests). It has also managed to pay the sum of USD 8 million as principle on external debt, but was not able to repay its internal debt principle that amounted to USD 157 million.


Trade Pattern - Year overview
Stock Market share

Chapter Three

Foreign Sector Developments

Overview

The foreign sector is one of the most vital economic sectors in any country, as it is the most important link with the outside world. This sector has become a gateway for global communication owing to the expansion and diversification of its activities, through which countries have transformed from isolated entities to become part of an integrated network of mutual relationships, each according to their weight and the diversity of trade partners.

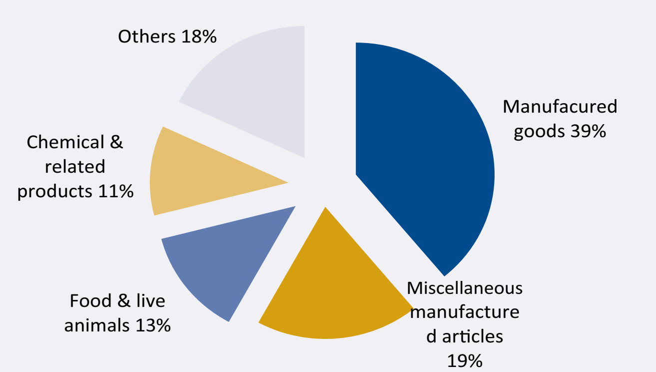
Foreign trade is a lifeline between countries, where a larger trade scope will result in higher economic prosperity. This fact led some countries to put foreign trade high in their list of priorities and include it in their development plans, given that the degree of commercial strength in a given country reflects the volume of its production. This is evidenced in the fact that advanced countries are the largest contributors to world trade, not only because of high consumer income, and thus high demand, but also because the scope of trade is no longer confined to business dealings only. Rather, it is now associated with economic, artistic, cultural, scientific and political cooperation between nations. Furthermore, the exchange of skills between different countries has led to a rise in living standards, the redistribution of domestic and global workforce, and the development of transportation services within a country.

During 2012, both the registered foreign trade data[25] and the balance of payments (BoP) indicate a growth in trade deficit as a percentage of GDP in Palestine. This is due to varying degrees of growth in both imports and exports which illustrates development in the Palestinian economy's consumption pattern, making the Palestinian people more dependent on imports. In contrast, data indicate a relative decline in the ratio to GDP of income from abroad, which is one of the key sources for financing the trade deficit in Palestine. Current transfers, also a main sources for financing deficit, witnessed a significant drop in response to a substantial decline in official aid to the government, in addition to lower remittances from other sectors during the same period.

Registered Foreign Trade in Goods

The volume of registered foreign trade of goods came to USD 5,494 million in 2012, marking 8 percent increase from the previous year as a result of a rise in both exports and imports of goods. Imports of goods increased by 9 percent to reach USD 4,730 million, while exports increased by 6 percent, reaching USD 778 million. This caused an increase in the trade deficit of goods by USD 3,952 million in 2012, amounting to 38 percent of GDP, compared

Figure 3-1: Major Palestinian exported goods, 2012



Source: PCBS, Foreign Trade Reports.

[25] Includes exports and imports of all types of goods traded with the rest of the world, while services are limited to those imported and exported to Israel alone. The source of these data is the clearance records of the Palestinian Ministry of Finance.

with 36 percent in 2011. This indicates a surge in the Palestinian economy's dependency on imports, which renders it vulnerable to external variables such as trade policies, economic shocks, exchange rates, and inflation of trade partners.

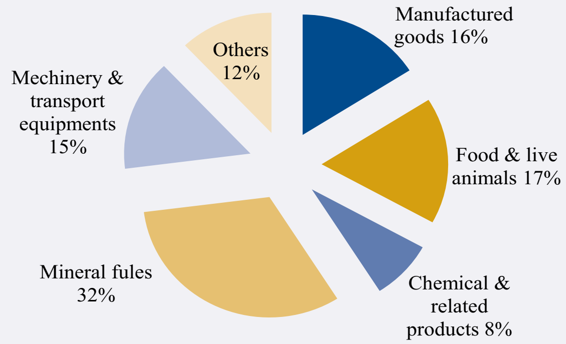
With regard to the structure and trend of Palestinian registered trade in 2012, the main group of manufactured goods (composed of wood, paper, metal, textiles and others) had the largest share of commodity exports, at 39 percent. This is followed by miscellaneous manufactured goods (furniture, clothing, shoes and so on) at 19 percent, food and live animals at 13 percent, and chemicals at 11 percent.

As for the structure of commodity imports, mineral fuel formed the largest portion of total registered imports at 32 percent, followed by food and live animals at 17 percent, primary manufactured goods at 16 percent, machines and transporting equipment at 15 percent, and finally chemicals at 8 percent.

Most of Palestinian exports of goods tend to go to Israel because of the direct connection between Palestinian and Israeli markets, with the latter absorbing about 84 percent of total exports, as opposed to the 12 percent directed to Arab countries (intra-regional trade), and about 4 percent directed to the rest of the world.

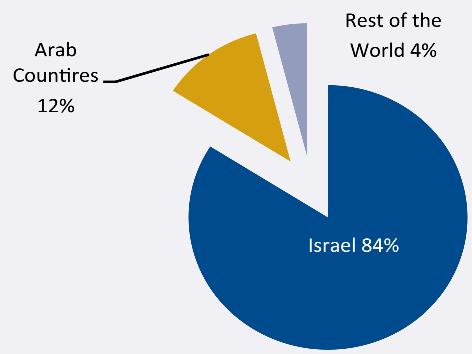
Imports of goods from Israel constitute 70 percent of total imports, 8 percent comes from the European Union, 5 percent from Turkey, 4 percent from china, and only 4 percent from the Arab countries. This confirms the dependency of the Palestinian economy on its Israeli counterpart, and the direct impact that Israel's economic and commercial policies have on the performance of the Palestinian economy, as Israel is the primary source of consumer goods in the Palestinian market, and the party which controls the flow of goods to and from Palestine.

Figure 3-2: Major Palestinian imported goods, 2012



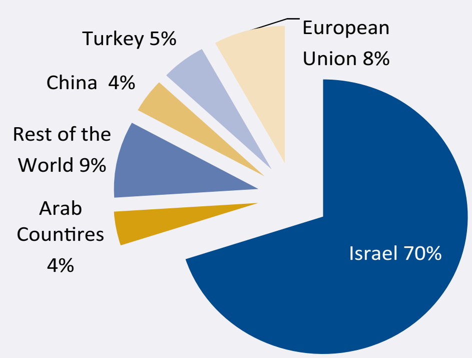
Source: PCBS, Foreign Trade Reports.

Figure 3-3: Palestinian export distenation, 2012



Source: PCBS, Foreign Trade Reports.

Figure 3-4: Palestinian Imports sources, 2012



Source: PCBS, Foreign Trade Reports.

Box 4: Palestine and the World Trade Organization

The WTO is considered one of the main pillars of the global economic system today. It was formed on the basis of the General Agreement on Tariffs and Trade (GATT), and finally replaced it as of 1/1/1995. Moreover, the General Agreement on Trade in Services (GATS), which also became effective as of January 1995, is considered one of the most important WTO agreements, formulating the only set of multilateral rules covering international trade in terms of services.

Palestine recently expressed its desire to join the WTO, and so, a ministerial decree was issued to this end. The decree calls for the formation of a national and technical team, with representatives from both the public and private sectors, including the PMA and civil society institutions. Its core mission is to prepare for the accession of Palestine to the WTO through meeting technical requirements in the public and private sectors, including the compliance of Palestinian laws with the requirements of the global trading system.

This Palestinian initiative aims at achieving further integration into the global trading system and benefiting from the advantages and facilities obtained by the liberalization of global trade. It is part of Palestine's efforts to building competent public institutions that can achieve sustainable development, reducing dependence on donor countries, and gaining more international recognition. This is in addition to the growing Palestinian need for goods, services and development offered by international markets.

Given that the Palestinian economy is small and open, the achievement of sustainable development generally requires an increase in trade exchange (among other requirements) beyond the sphere of the Israeli market, along with an increase in value-added in exports, most especially in goods and services with a competitive advantage produced by relatively low-wage skilled labor.

With the increase in trade volume and global market integration, the Palestinian consumer is given the opportunity to obtain a wide range of products at the lowest prices. It also allows the Palestinian producer an opportunity to benefit from the global market's higher prices. Competition in export markets gives the Palestinian producer an incentive to improve productivity and expand production, thus increasing employment levels, raising wages and reducing poverty.

Palestine's accession into the WTO, along with all the associated agreements including the GATS, is expected to have a multitude of effects, both positive and negative. However, the extent and significance of these effects are dependent on the size of the Palestinian service sector, its degree of growth, the comparative advantages it enjoys, and its ability to compete with similar foreign sectors.

A Palestinian open economy can access international markets, and benefit from increased financial flows needed to fill the domestic resources gap, caused by savings falling short of financing domestic investment. This leads to increased domestic investment and higher economic growth, and will encourage FDI and portfolio investment without resorting to external borrowing, thus reducing the size of external debt. Financial instruments, both conventional (stocks and bonds) and non-conventional (swaps, options and futures) can encourage openness and attract more investors and investment.The liberalization of the services sector could contribute to the sector's development through benefiting from advanced technology and global information systems available, and promote a supportive environment for private sector activity, thereby increasing investments.

Nevertheless, there are risks resulting primarily from sudden short-term fluctuations in FDI, outflow of funds abroad through mobilizing national savings by foreign financial institutions, and possible influx of illicit funds (money laundering); these could adversely affect fiscal and monetary policies.

The Palestinian service sector, as in other developing countries, faces many difficulties that limit its ability to compete internationally in the event of trade liberalization. This is due to the recent emergence of this sector in Palestine, its relatively small size, the lack of adequate financial market development, and the lack of organizational and managerial expertise and competencies, compared to counterparts in advanced countries or even some developing Asian countries.

Under these circumstances, domestic establishments will not be able to withstand the presence of giant conglomerates in domestic markets. They could also lose part of their domestic market share following the establishment of conglomerate branches or subsidiaries in local markets, mainly due to the technological advantage enjoyed by these conglomerates. In addition, the modern and innovative services introduced by conglomerates into domestic markets will be very difficult for local establishments to reproduce, assimilate and incorporate into traditional practices.

Generally, overcoming such problems requires the provision of conditions befitting this task. Therefore, the liberalization process is to be approached gradually and with patience so as to take advantage of the benefits which GATS provides and minimize potential risks.

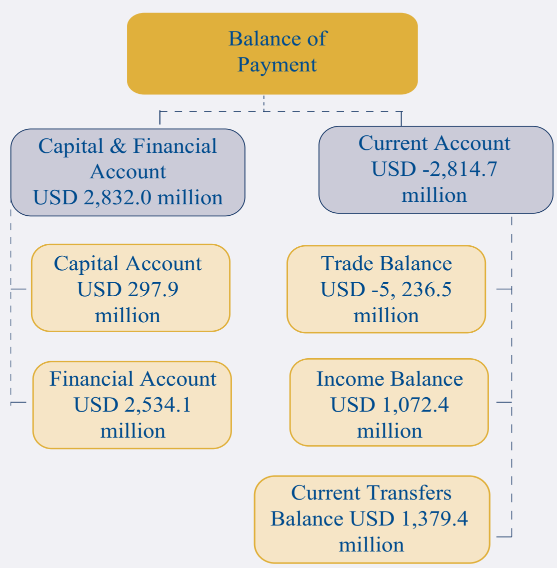
Balance of Payments (BoP)

BoP analysis is increasingly becoming the center of central banks attention, as one of the most vital tools to assess domestic economic performance in relations with the outside world and the impact this has in reserve assets and the country's external debt status. It includes analyzing developments in the flow of payments, the degree of reliance on foreign aid, and the structure of economic relationship with the outside world. With this analysis, it is possible to determine causes of BoP imbalances and the proper economic policies to correct these and achieve sustainable development.

Current Account

In 2012, the current account of the BoP (goods and services, income, and current transfers) had a deficit of USD 2,814.8 million, an increase of 28.4

Figure 3-5: Palestinian balance of payments structure, 2012



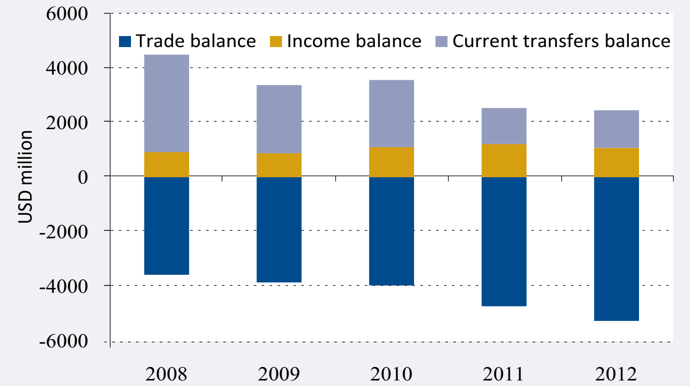
Source: PMA & PCBS, Balance of Payment Reports.

percent from the previous year, and with a ratio of 27.4 percent to GDP, compared to 22.4 percent in 2011.

When analyzing the current account deficit, it is imperative to examine its primary causes as well as its sustainability under current conditions. Furthermore, methods of treatment must be found, whether by adopting certain policies, if possible, or by resorting to a reform program. It is also vital to identify a sustainable mechanism to finance the deficit.

The following is a summary of the current account components:

Figure 3-6: Current account balances of the Palestinian balance of payments, 2008-2012



Source: PMA & PCBS, Balance of Payment Reports.

- ## Trade Balance

The Palestinian trade balance reached a deficit of USD 5,266.6 million, or what constitutes 51.3 percent of GDP in 2012, compared with 48.3 percent in 2011. This chronic trade deficit is considered the main reason behind the continuing deficit in the current account. The following is a breakdown of the Trade Balance in 2012:

First: Goods Balance

The recent rise in trade deficit is mainly a result of the substantial increase in the chronic deficit of the goods balance, reaching USD 4,884 million, compared with USD 4,626 million in 2011, thereby accounting for 47.6 percent of GDP in 2012. This increase came as a result of imports and exports of goods rising at varying degrees, with imports of goods rising by 12.1 percent, and exports by 47.4 percent compared with 2011. Despite the relatively high growth in exports of goods, its diminutive value compared with the value of imports explains the increase in trade deficit.

Imports of goods accounted for an estimated value of 59.8 percent of GDP in 2012, compared with 56 percent in 2011, while exports of goods accounted for 12.2 percent of GDP, compared with 8.7 percent in 2011. Consequently, there was a slight improvement in the imports/ exports coverage ratio, increasing to 20.3 percent compared with 15.5 percent in 2011.

It is usually the case, especially in Palestine, that trade balance analysis is given ample attention as the most fundamental determinant of current account deficit. In this context, it is possible to analyze the contribution of various types of commodities to exports and imports. An analysis of exports and imports according to economic group (consumer goods, capital goods and intermediary goods) can be carried out, along with analysis of trends in the price and volume of exports and imports, and the specific changes in patterns of trade exchange.

Figure 3-7: Trade deficit as a percent of GDP, 2008-2012

Source: PMA & PCBS, Balance of Payment Reports.

Second: Services Balance

The balance of services deficit is the second most significant determinant of current account deficit; it registered a deficit of USD 382.5 million in 2012, increasing by 269.3 percent, compared to its level in 2011. This increase was primarily due to a decline in exports of services by 32 percent, to reach USD 649 million, against a decline in the imports of services by 2.5 percent, to amount to USD 1,031.5 million. Travel services are the key component of exports and imports of services, accounting for 67.6 percent of total exports of services, against 58.8 percent of total imports of services.

The magnitude of the trade deficit indicates that the Paris Protocol (and subsequent agreements and economic protocols with various countries, especially the European Union and Arab countries) has not been successful in changing the reality of the Palestinian foreign trade as much as maintaining its status quo, specifically with regard to Israel. The Palestinian economy has been forced, through Israeli practices, to increase its reliance on Israel, causing a further accumulation of trade deficit. Although the focus of the Paris Protocol was to facilitate the free flow of goods and individuals, Israeli control over border crossings with neighboring countries is a hindrance to Palestinian foreign trade. Moreover, this agreement did not only hinder the ability of the domestic economy to expand and diversify its production base, but it also led to a decline in the competitiveness of Palestinian products due to adverse changes in the factors of production and production technologies. It is worth noting that the openness of the Palestinian economy to the outside world coincides with the absence of a clearly defined trade policy, deepening the trade deficit's impact on the current account in particular, and the BoP balance in general.

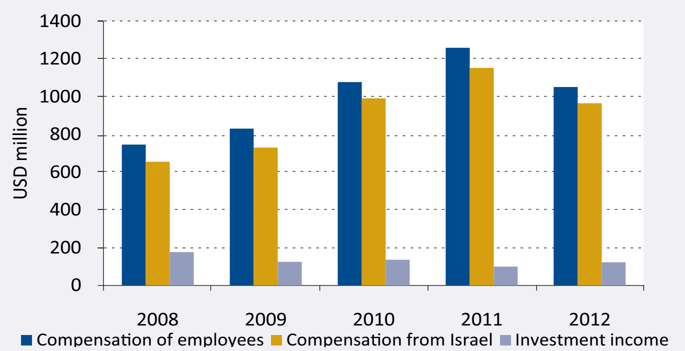
- ## Income from Abroad

With Palestine as an exporter of labor, income from abroad (compensation of employees and investment income) constitutes one of the main sources of funding for the trade deficit. The income account achieved a surplus of USD 1,072.4 million in 2012, at 10.5 percent of GDP, compared with 12.5 percent in 2011. The largest portion of this surplus is directly linked with the compensation of employees, constituting about 90 percent of net income from abroad in 2012. The remaining surplus is associated with returns on Palestinian investments abroad (direct investment, portfolio investment, and other investments) which is a naturally low figure, as the bulk of these investments is in the form of bank deposits abroad with low interest rates. Furthermore, returns on Palestinian investments are held down by low global interest rates, against the backdrop of the expansive monetary policies adopted by a large number of central banks in an effort to tackle the global financial crisis.

The income from abroad account is an important source of funding Palestinian trade balance (which suffers from a chronic and compound deficit in favor of non-residents); it funded an estimated 22 percent of the trade deficit in 2012, compared with 26.3 percent in 2011.

For Palestine, the compensation of employees is mainly linked to Palestinians working in Israel. This account suffered a significant decline over the past few years, particularly post-2000, due to blockades, closures, and restrictions imposed by Israel on the free movement of Palestinian labor. With the decline in the number of Palestinians working in Israel, the amount

Figure 3-8: Income from abroad, 2008-2012

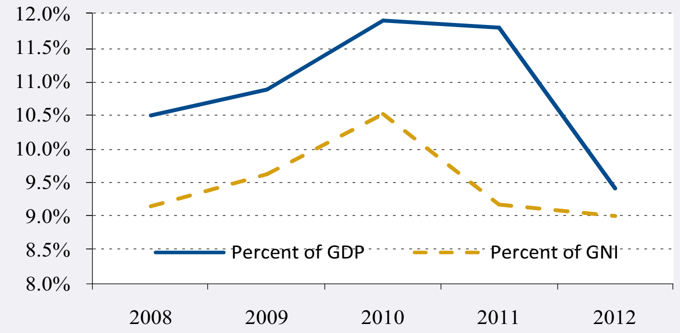


Source: PMA & PCBS, Balance of Payment Reports.

of funds transferred also declined. It is noteworthy that the annual fluctuation in income from Palestinian workers in Israel relates to the fluctuations in both their number as well as in the NIS/USD exchange rate.

Few years back, Palestine relied heavily on exporting Palestinian labor to the Israeli labor market, as this was one of the few alternatives available to generate income on the one hand, and reduce unemployment on the other. However, experience over the years proved this policy ineffective in both generating income and reducing unemployment. This is largely because the policy is subject to Israeli practices and restrictions, which caused a notable decline in the number of Palestinian workers employed in Israel over the past few years. With this decline, the significance of their compensations has also declined. This condition was amplified by the Israeli decision to prevent the entry of workers from GS into Israel since 2007. Compensations of employees working inside Israel between the years 2000 and 2012 accounted for 11 percent of GDP and 10 percent of GNI, on average, whereas prior to the year 2000, this ratio exceeded 20 percent. In addition, this compensation finances a considerable portion (an average of 20 percent) of the trade deficit.

Figure 3-9: Compensation of Palestinian employees in Israel, 2008-2012



Source: PMA & PCBS, Balance of Payment Reports.

Long-term dependency on the policy of exporting labor to Israel has adversely impacted the Palestinian economy through affecting domestic demand, as well as a number of economic and social indicators, such as growth, unemployment, and poverty. This state of affairs requires serious efforts towards finding other alternatives to generate income for Palestinian workers and alleviate unemployment.

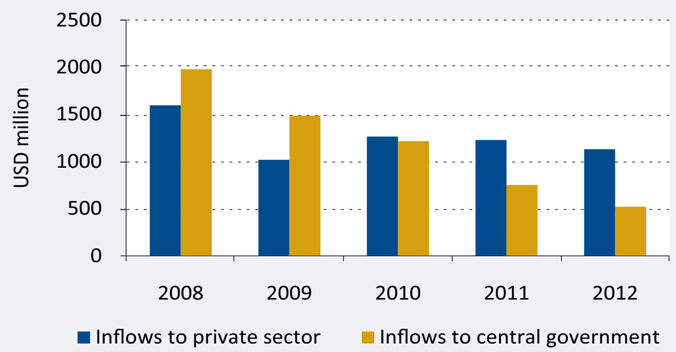
• Current Transfers

Current transfers are of particular importance for the Palestinian economy's both public and private sectors, albeit more crucial to the private sector. The significance of this BoP component stems from its being a key source of funding for the trade deficit, as it financed an estimated 58.6 percent of the trade deficit in 2012, compared with almost 90 percent in 2011.

The decline in the contribution of current transfers towards financing the current account deficit in 2012 occured due to the significant decline in the value of these transfers (16.6 percent) compared with 2011, to reach USD 1,649.6 million. More specifically, this was due to the significant decline in transfers made to government, decreasing to USD 520 million, or about 30.7 percent of its value in 2011. This decline reflected a general trend of donor's transfers, starting in 2007; the trend was for a decrease in current transfers (budget support) redirected in favor of development-oriented capital transfers. This is in addition to the reluctance of several donor countries (lead by the United States) to support the Palestinian economy as a reaction to the Palestinian Authority bid for a UN Non-Member Observer State.

Donor transfers to other sectors have decreased, and likewise, the remittances of Palestinian workers, falling to USD 1,129 million in 2012, or by 0.6 percent compared with 2011. In light of this, the significance of current transfers _as a percentage of GDP_ declined from 20 percent in 2011, to 16 percent in 2012. This calls for procedures and policies that could compensate for the enormous shortage in aid directed to budget support.

Figure 3-10: Current transfers, 2008-2012



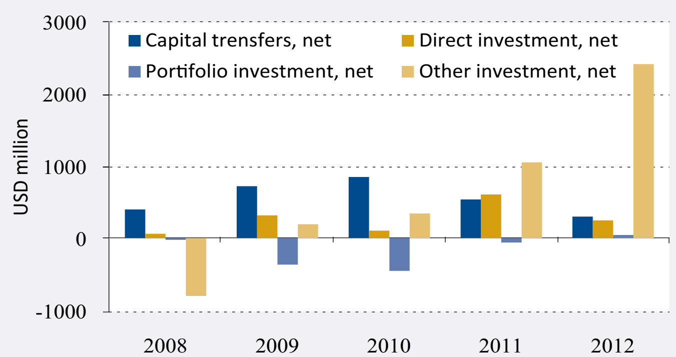
Source: PMA & PCBS, Balance of Payment Reports.

The most important issue regarding transfers that demands attention and further elaboration is the remittances from workers abroad, which are of particular importance in a number of developing countries. Regulation and agreements regarding these transfers have been put in place to direct the flow of this key source of all of: foreign currency, additional savings and gross capital formation, and import financing. All this will serve to stimulate aggregate demand and economic growth, which are both crucial to the Palestinian economy. It is therefore imperative to look for various means and methods to regulate the number of workers, their geographic concentration, and mechanisms that confine remittance transfers through official channels (banks in Palestine). This will not only guarantee continuous flow of these transfers, but will also contribute to their growth.

Financial and Capital Account

The Financial and Capital Account (including reserve assets) registered a surplus of USD 2,832 million in 2012_ a clear increase of 31.4 percent from 2011, and constituting 27.6 percent of GDP, compared with 22 percent in 2011. The rise in net flows of "other investments" into the financial account was one of the primary causes for this surge in surplus, as these reached USD 2,410 million in 2012 at an increase of 129.5 percent. The rise in net flows of direct investments by 53.9 percent to reach USD 246.1 million also contributed to the accumulation of financial and capital account surplus. Conversely, flows of portfolio investments declined to USD 69.5 million, or by 163.3 percent.

Figure 3-11: Capital and financial account balances of the Palestinian balance of payments, 2008-2012



Source: PMA & PCBS, Balance of Payment Reports.

As a result, the financial account (excluding reserve assets) financed about 84 percent of current account deficit in 2012, while the capital account (reflected by capital transfers of USD 297.9 million) financed about 11 percent of current deficit. It should be noted that this item decreased by 44 percent in 2012 because of a decline in donor transfers aimed at financing the public sector's development projects.

It is also worth mentioning that the net change in PMA reserve assets increased in 2012 by USD 166.3 million, as opposed to a decline of USD 33.6 million in 2011. These changes reflect the overall balance in the BoP, and thus, the amount of financing of the balance as a whole, considering the absence of a national currency and other financing resources.

Current Account Sustainability

When discussing the sustainability of the current account, several economic indicators must be examined and the main causes of current account deficit must be identified. Therefore, describe the current account's status (as good or sustainable) because it complies with certain general economic trends within a specific timeframe.

With regard to indicators of current account sustainability, trade balance-to-GDP ratio is considered one of the most important known indicators of sustainability, which is high in Palestine (up to 50 percent of GDP, on average, over the past few years). There is also the national savings-to-GDP ratio, a relatively low ratio in the Palestinian case, with an average of 25 percent. The third indicator is the net direct investment flows to GDP ratio, which does not exceed 10 percent, on average. The external debt and debt service to exports ratio is the fourth indicator of sustainability, amounting to more than 100 percent, on average, in Palestine. Overall, these indicators suggest poor sustainability potential in the current account of the Palestinian BoP.

As previously mentioned, trade deficit in the Palestinian economy is the main source of current account deficit, which usually points towards problems in competitiveness. However, in light of restraints imposed on the Palestinian economy, its lack of control over borders and crossings, the limitations to free flow of trade and absence of an exchange rate policy (due to absence of a national currency), it becomes difficult to conclude that trade deficit is tied only to competitiveness, though it is the most important factor.

Moreover, public finance suffers from a chronic deficit, which is usually linked to current account deficit (Twin Deficit), and which also reflects a gradual erosion of savings without an increase in investment, thus denoting the economy as a whole, as a consumer economy.

The process of financing the current account usually results in a decline in foreign assets, or an increase in external liabilities, especially since there are three methods in which financing can be carried out. Firstly, there is direct investment (owner's equity/stocks) which is generally the optimum way to finance the current account deficit as its flows are more sustainable than others, such as portfolio flows. Moreover, direct investment does not generate debt; therefore, it does not increase the external debt balance. Secondly, there is financing through external debt, and thirdly, financing via net foreign assets (whether by withdrawals from bank deposits, or what is called the banking system's net foreign assets, or a decrease in the central bank's net foreign assets).

Furthermore, when looking at the financial account in the Palestinian BoP, the current account deficit has been financed by withdrawing from the Palestinian banking system's foreign assets and from capital grants (both items financed 83 percent of current account deficit in 2012), and not from investing in owner equity, which did not exceed 8 percent in 2012. As for financing via external debt, external borrowing in Palestine is not customarily used to remedy the current account deficit, but rather to finance current expenditure, particularly wages. As for financing through the PMA's reserve assets, it is practically ineffective under the current situation.

Regarding the interdependence between gross national savings and the current account deficit, it is observed that the latter occurs whenever a given country spends beyond its capacity or consumes more than it produces. This means that the deficit in the BoP reflects a rise in domestic absorption (domestic demand or total domestic consumption) over income. Consequently, regardless of the causes behind deficit, it would be necessary to find methods to address such deficit. This is usually achieved by increasing reserve assets and may require a combination of several methods, or resorting to other measures by adjusting the BoP (in cases where reliance on private and public resources to finance current account deficit on an ongoing basis is not possible, it may be necessary to take corrective measures to cause sustainable foreign payments).


CARD

Chapter Four

Palestinian Financial Sector Developments

Part I
PMA Developments

Overview

Throughout 2012, the PMA continued to make progress with steady achievements in all pertinent fields, seeking to fulfill its responsibilities in maintaining financial stability and managing banks in accordance with international standards and best practices, and thus, boosting growth and sustainable economic development. A number of vital accomplishments were realized in this regard; some were related to regulations, instructions and supervision systems, while others included the completion of key projects such as the IBAN, the launch of the Suspended Checks System and the Settlement of net transactions in the financial market via BURAQ system. This is in addition to the launch of new and vital components such as the establishment of electronic portals for electronic payment instruments, among other projects seeking to promote consumer confidence in banks operating in Palestine.

Moreover, the PMA also continued to conduct a number of tasks, such as: updating supervisory instructions in line with the Banking Law No. (9) of 2010, developing banking supervision systems, promoting banking and financial inclusion, and finally, implementing all instructions of the Basel committee with diligence, along with a number of other supervisory procedures implemented in 2012. This led to gradually fulfilling all the requirements needed to transition to a fully-fledged and modern central bank.

With regard to domestic and international relations, the PMA became an associate member of the International Association of Deposit Insurers (IADI) in late 2012. Moreover, a memorandum of understanding was signed with the Palestine Stock Exchange (PEX) to adopt the Central Securities Depository as a cash settlement agent. The PMA also worked to strengthen its relations with the public by issuing a number of supervisory instructions, which oblige banks to implement greater transparency and disclosure, and to take the circumstances of the citizens into account. Furthermore, the PMA also requested banks to provide certain services, such as electronic banking, free of charge along with other policies aimed at enhancing public relations with and trust in banks operating in Palestine.

In this context, the PMA continued to gradually support its capital in order to increase its capacity to overcome the risks it encounters when exercising its functions, authorities and responsibilities. At the end of 2012, PMA equity grew by 3.2 percent, reaching USD 92.1 million because of the rise in paid-up capital by about 5 percent through the transfer to the capital account of profits yielded by business results and tasks carried out by the PMA.

Relations with Banks operating in Palestine

Laws and legislations

• Payments System Law

The National Payments System Law was passed on 23/11/2012, under the resolution of law No. (17) of 2012. This law represents an integral step towards the implementation of electronic payment methods and also facilitates electronic and final settlement for bank accounts and the financial transactions resulting thereof. It also allows the installation of electronic clearing systems between banks through the scanning feature, recording net operations to the electronic clearing system to settle values electronically with ease and safety, and utilizing the acceptance of electronic signature under certain conditions. Furthermore, the system will link all banks and bank branches through an integrated electronic communication network to reduce the risks found in payment systems, and thereby allowing the PMA to effectively supervise accounts and services.

• The Palestine Deposit Insurance Cororation Law

This law aims to strengthen the financial safety net, protect depositors, and maintain financial stability. It also sets the legal framework[26] for establishing the PDIC in accordance with the best international standards to ensure customers' deposits in the Palestinian banking system, covering approximately 93 percent of bank depositors in the WB and GS. The establishment of the PDIC is expected to result in increased deposits, thus enhancing the vital role played by banks in promoting economic and financial development in Palestine.

In the same context, the PMA has obtained membership in the IADI as an associate member. This membership came prior to the issuance of the Deposit Insurance Corporation Law to allow taking advantage of the practical experiences of members in the IADI, which includes 132 deposit insurance corporations worldwide.

Supervisory Instructions

Throughout 2012, the PMA continued to improve its relations with banks by holding consultative meetings to discuss the conditions of banking operations, challenges, and the corrective measures required to meet them. This was in addition to holding meetings with the boards of directors and executive managements of these banks to discuss recent developments and to conduct inspection visits to evaluate conditions on the ground. The PMA has also involved banks in the process of formulating instructions to achieve the desired outcomes from regulatory requirements.

Similarly, the PMA continued to activate off-site and on-site supervision tools in an effort to enhance banking performance in line with the law and instructions that govern banking activities. In this regard, a number of procedures aimed at fostering governance were undertaken in a manner which ensures harmony with the standards and principles of corporate governance in banks. These procedures were carried out for various reasons, namely, to avoid a conflict of

[26] At a post report date, the Palestine Deposit Insurance Corporation's Law has been issued as a Resolution Act on 29/05/2013.

interests between the boards of directors and the executive managements, to increase minority shareholder, to represent independent members in the boards of directors and finally, to address the concentration of ownership within some banks.

On the other hand, a majority of banks set up specialized risk management departments, and separated the tasks of the risk manager from those of the compliance officer in accordance with regulatory requirements. Moreover, the PMA relentlessly encouraged banks to adopt advanced tools for identifying, quantifying, and controlling risks, thus reducing their negative impact on banks' financial positions. In addition, PMA set up minimum requirements for the director of the risk management department in banks. The PMA also persisted in strengthening and raising banks' capital consistent with the levels of potential risks they face, in a manner which will ensure the endurance of banks and their ability to absorb shocks.

In light of the Banking Law No (9) of 2010, the PMA embarked in 2012 upon a comprehensive review of all previously issued supervisory instructions to achieve more consistency with the amendments and additions made to this law. Moreover, the PMA issued new supervisory instructions which regulate and control banking activities in view of the national and international legal and supervisory developments. In this respect, the PMA issued the following instructions:

- **Instruction No. (1/2012) concerning rules for granting bonuses and incentives.** These instructions come within the context of enhancing governance, and guaranteeing transparency and disclosure when granting bonuses and incentives. According to these instructions, bonuses and incentives must be based on specific standards adopted by the banks boards of directors, and should be linked to the level of performance and risk. These incentives must also comply with the recommendations of the Financial Stability Board and the Basel Committee for Banking Supervision.

- **Instruction No. (2/2012) concerning the Required Reserve Base.** These instructions were put forth in order to strengthen the endurance of our people in the occupied city of Jerusalem. Under these instructions, the outstanding balance of credit extended to certain economic sectors (construction and real estate, land, manufacturing, mining, agriculture and livestock, tourism, restaurants and hotels) is deducted from the required reserve base.

- **Instruction No. (3/2012) concerning the "primary bank account" for each citizen.** These instructions have been issued as part of a PMA policy to enhance the banking sector's participation in promoting financial inclusion among all segments of society, enabling them to benefit from services offered by the banking sector. According to these instructions, banks are required to open savings accounts for every citizen without fees, commissions, or a minimum balance prerequisite.

- **Instruction No. (4/2012) concerning ATM Services.** These regulations come as part of efforts to develop electronic banking products. These regulations encompass the minimum requirements for ATM operations, as well as the safety, security, replenishment, and maintenance standards for these machines.

- **Instruction No. (5/2012) concerning the regulation of external auditor activities.** These instructions are set forth as part of PMA's efforts to preserve the stability and soundness of the banking sector. These instructions also ensure that

Chapter Four: Palestinian Financial Sector Developments external auditors abide by international auditing standards as well as accounting, audit and control standards of Islamic financial institutions when carrying out their daily functions. They must also ensure the preparation of financial statements in accordance with international standards. The instructions list the criteria of selecting and contracting the external auditor, highlighting his duties and responsibilities, choosing a responsible party for his appointment, dismissal and disqualification, along with other provisions pertaining to his functions. This is to be done in a manner which ensures transparency and disclosure and strengthens public confidence in the banking sector.

- **Instruction No. (6/2012) concerning the management of money-changer accounts.** These instructions are issued to organize the management of the accounts owned by money changers in banks operating in Palestine. These instructions include account set up procedures, minimum information required upon account setup, oversight on these accounts, and acceptable business transactions and services that money changers can conduct through banks, among other provisions.

- **Instruction No. (7/2012) concerning the update of the BURAQ system's instructions.** These instructions aim to raise the effectiveness, efficiency and stability of the Real-Time Gross Settlement System (BURAQ). They address the process of bank transfers, processing personal transfers received through the system, as well the system's technical support.

- **Instruction No. (8/2012) determining the requirements of opening accounts for cooperatives, charitable institutions, and civil society bodies.** Some amendments to these instructions have been made and published under instruction No.(9/2012).

- **Instruction No. (10/2012) concerning the launch of the reporting system for lost and suspended checks:** These instructions are issued as an endeavor to develop a reporting system for lost and suspended checks to be published on the Credit Bureau Website, thus, terminating the manual reporting system that was in effect. Moreover, these instructions encompass the operational guidelines of the new system.

- **Instruction No. (11/2012) concerning appointments, transfers, disciplinary actions and resignations.** These instructions regulate procedures governing the appointment, transfer, disciplinary actions and resignation of bank officials and other employees, in addition to contracting consultants and other pertinent rules.

- **Instructions No. (12/2012) concerning counterfeit currency.** These instructions emphasize the PMA's assiduousness to reduce the incidense of counterfeit currency. They include a set of procedures banks must adhere to in order to combat the issue of counterfeiting.

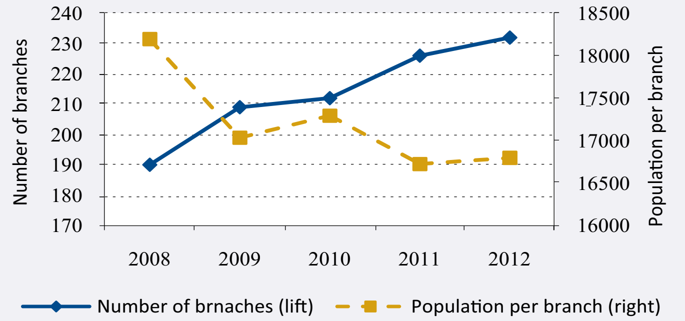
Alternatively, the PMA issued several circulars governing routine procedures and updates in the banking business. For example, circular **No. (7/2012)** prohibits foreign banks from granting credit to an applicant if it leads the exposure to exceed 10 percent of the core capital of foreign bank branches, without a prior approval from the PMA. This is also the case with circular **No. (103/2012),** which requires banks to modify their systems and customer account numbers in accordance with the IBAN code given to Palestine, no later than 31/12/2012. Banks must reject any incoming transfers from abroad if they do not contain the customer's IBAN number, effective as of 3/3/2013. Conversely, they must accept any incoming transfers through the BURAQ system bearing the IBAN number as of 5/5/2013.

Branching and Financial Inclusion Policy

At the end of 2012, bank mergers and restructuring operations resulted in a decrease in the number of banks operating in Palestine to 17 domestic and foreign banks, 7 of which are domestic and 10 are foreign (8 Jordanian Banks,1 Egyptian, and 1 foreign bank). This came following the successful merger between Al-Rafah Microfinance Bank and the Arab Palestinian Investment Bank on 1/1/2012, resulting in a new bank by the name of The National Bank.

These banks operate through a network of branches and offices spread over various areas in Palestine. They amount to 232 branches and offices; 121 are domestic, and 111 are foreign. In 2012, 6 new branches and offices were opened: a branch and an office for Bank of Palestine, a branch for Al-Quds Bank, a branch for the National Bank, two branches for the Arab Bank, and a branch for Bank of Jordan.

Figure 4-1: Branches of banks operating in Palestine, 2008-2012



Source: PMA database.

By licensing new branches and offices, the PMA aims at delivering banking services to all Palestinian cities and villages, prioritizing rural communities and remote regions in order to facilitate the commercial and economic activities of citizens, as well as different financial transactions. This trend was reinforced in the PMA's branching policy adopted in 2007, which resulted in an increase in the number of bank branches and offices allocated to rural areas to reach 39 branches at the end of 2012, compared with 17 branches in 2007.

Through this branching policy, the PMA seeks to reduce the ratio of persons per branch in order to raise the efficiency of services provided, as well as to remain consistent with internationally recognized rates (10,000 persons per branch). With this increase in branches, the ratio of persons per branch has decreased to about 16,800 persons per branch by the end of 2012. This, in theory, indicates the availability of additional branching opportunities. The year 2012 saw a continuation of PMA efforts to accomplish financial inclusion and banking awareness, enabling poor, middle class and limited income families to set up bank accounts and benefit from the financial services offered by the banking system. Services were offered at low costs, matching the target group's financial capabilities, and promoting their participation in the business operations of banks. A special awareness campaign related to this issue has been launched in conjunction with the issuance of the "primary bank account for each citizen" instruction[27] mentioned earlier. The number of beneficiary clients reached a total of 60,000 by the end of 2012.

With the aims of promoting the use of ATM's by citizens to reduce customer visits to bank places, and to stay abreast of global developments in the field of electronic banking, banks were obligated to equip all branches and offices with the latest and most advanced ATM machines. Citizens were provided with various services which include: accepting all ATM cards issued by banks operating in Palestine as well as international credit cards (Visa and MasterCard at minimum) along with other requisites ensuring convenience, confidentiality and security for citizens.

Moreover, banks were also required to provide clients with free SMS banking with the aim of reducing bank operational risks by preventing the manipulation of customer accounts and permitting customers to monitor

[27] In collaboration with the Ministry of Finance, the Ministry of Social Affairs and the banking system, bank accounts were set up for beneficiaries of the Ministry of Social Affairs in the WB and GS, in order to achieve financial inclusion and empower the target group to obtain banking services as applicable by the primary account instructions. A number of meetings were held with pertinent banks, in addition to issuing the necessary instructions for the implementation of the project, where the same mechanism will be adopted to set up bank accounts for families of martyrs.

and validate account movements. In addition, banks were made to provide customers with free internet banking services, as stipulated by circular No. (91/2012), giving them the opportunity to review their accounts and perform banking transactions through this advanced service. Generally, the PMA seeks to stimulate and expand the use of electronic banking services, a result of which Palestine witnessed a striking surge in the use of ATMs, ATM Cards, POS, credit cards, and money transfers through the internet and mobile devices. This facilitates the execution of various transactions, significantly reducing transaction costs and delivery time, and positively impacting economic activity.

To these ends, the PMA embarked upon a number of banking awareness campaigns in the hope to enhance the general public's banking culture (financial inclusion) and to attain a broader understanding of the nature, types and conditions of bank-related financial services available. Banks were furthermore urged to adhere to the highest degree of disclosure and transparency in the banking services provided to the public, giving them a chance to compare and trade-off between these services.

The PMA was later awarded by The Child &Youth Finance International (CYFI) based in the Netherlands) as the "Best Program" organized in the MENA region in raising banking and financial awareness among the children and youth. It was awarded by the CYFI in recognition of the successes achieved by the PMA in terms of banking and financial awareness for the second consecutive year, and for organizing the Child and Youth Banking Week.

Similarly, the PMA declared its commitment to the Maya Declaration for Global Partnership in Financial Inclusion, through its participation in the annual Alliance for Financial Inclusion (AFI) conference held in South Africa. The declaration stated the PMA's support and commitment to promote the principles of empowerment and financial inclusion to all segments of the Palestinian society. This is done by enhancing their level of knowledge and financial awareness, and developing financial products and services to facilitate access to credit, and also promote the principles of consumer rights protection for the consumers of financial services.

Box 5: Banking Awareness Campaigns

Throughout 2012, the PMA continued efforts to raise awareness and a banking culture in the general public so that they may achieve a broader understanding of the nature, types and conditions of financial services offered by banks. Within this context, the PMA launched a range of campaigns which can be summarized as follows:

1. The IBAN Campaign: an awareness campaign aiming to introduce bank clients to the IBAN project, showcasing its accuracy, reliability and speed of bank transfers, as well as encouraging them to acquire an IBAN number. This was done through the publication of educational bulletins and advertisements in local newspapers, radio and websites, in addition to classroom articles that explained the IBAN in detail. These illustrated its components, objectives, benefits and advantages and the causes behind its adoption and implementation in the Palestinian banking sector by the PMA.

2. The "Primary Bank Account for Each Citizen" Campaign: This campaign aims to accomplish financial inclusion and banking awareness, to enable poor, middle class and limited income families to open bank accounts and to benefit from the financial services offered by the banking system. Services were offered at low costs, matching the target group's financial capabilities, and greatly encouraging their participation in the business operations carried out by various

banks. The awareness campaign aims to familiarize citizens with the advantages of the abovementioned primary account and to urge target groups to open such accounts.

3. Banking Awareness Webpage: a webpage designed to raise banking awareness was created on the social networking site, Facebook, in order to enhance the public's level of financial knowledge, targeting the younger generation in particular.

4. Publishing a series of banking awareness articles in local newspapers, pertaining to the rights of customers and their guarantors, the banking services available at financial institutions and ways to benefit from them. This is in addition to the PMA's operational mechanism, specifically the bounced checks system.

5. Organizing banking awareness and financial education seminars that targeted different audiences, including students in the WB and GS schools, judges, National Security Services officers and members of the Presidential Guard. This was in order to increase their financial education and banking awareness by introducing them to the PMA's tasks, objectives, legislative environment, supervisory and regulatory operational framework, the sectors it regulates and supervises, and the properties of the automated systems it has launched. A banking awareness seminar was organized in cooperation with the Palestine Banking Institute[28] at the National Security Services headquarters to raise awareness and banking culture among their staff.

6. The launch of an awareness campaign warning citizens against dealing with loan sharks, urging them to limit their financial dealings to financial institutions operating under the PMA's control, and publishing campaign ads in local newspapers in three phases regarding these issues.

Banking Systems Developments and Updates

The PMA relentlessly pushed forward to develop modern banking systems in accordance with the highest international standards and practices, all within the framework of building a robust and comprehensive banking infrastructure. This infrastructure reduces risks that threaten the banking system in particular and the financial system in general. As such, in 2012 the PMA completed further developmental procedures in some of the banking systems that have been initiated in previous years. It also began the

[28] The Palestinian Banking Institute was founded in 1999 pursuant to the Palestine Monetay Authority Law No. 2 of 1997, and the Banking Law No. (2) of the year 2002. It is an independent, non-profit organization with a general assembly that consists of 19 members, represented by the PMA and public banks in Palestine. Its board of directors, which consists of 9 members, is headed by the governor of the PMA. The institute's objective is to promote a financial and banking culture, as well as train, build, and develop the skills of the Palestinian financial and banking sector's staff.

implementation of new projects expected to be completed in the next two years. The following are detailed developments in these systems:

1. **The International Bank Account Number (IBAN):** The PMA launched the IBAN on 7/7/2012 in compliance with international principles for the standardization of bank account numbers in Palestine. This was a move to facilitate the processing of domestic and foreign bank transfers passing through electronic systems and to reduce the amount of returned transfers due to discrepancies in account numbers. Under this system, funds are transferred electronically between banks operating in Palestine and their counterparts in various countries around the world with ease, accuracy and a high degree of reliability. Banks amended their systems and customer account numbers in accordance with the IBAN code appointed to Palestine_ the code consists of 29 digits (Country code consisting of the two characters: "ps", a check box consisting of two characters, a bank code consisting of the first four letters contained in the bank's Swift code, and the client's bank account number consisting of 21 numbers and/or letters). Simultaneously, the IBAN verification service was launched through the PMA's website on 8/8/2012.

2. **Settlement of net transactions in the financial market via BURAQ:** This project comes within the framework of creating a strong and effective financial infrastructure to support financial stability in Palestine by guaranteeing secure clearing and settlement processes for large financial transactions made in the financial market. This is carried out in accordance with the recommendations of the IMF, the International Organization of Securities Commissions (IOSCO), and the Bank for International Settlements (BIS). This project aims to ensure the settlement of all financial operations through BURAQ system, providing the PMA with the necessary supervisory tools to exercise its full role as a central bank. In 2012, the PMA carried out a range of project-related activities, including organizing workshops, preparing instructions and implementation mechanisms and signing agreements.

3. **Preparing for the launch of the Unified Query System:** This system aims to provide disclosure and allow public access to information regarding the ratings of clients listed on the Bounced Checks System. To this extent, in 2012, the Unified Query System screens were designed, including the query request and answer screens. These screens were linked to the Bounced Checks System, and a final system test was conducted in preparation for its official launch. Banks were asked to acquire authorization from all check-book-bearing clients to provide full legal coverage. Moreover, the system was covered legally through the amendment of the reference text included in the query answer.

4. **Updates on the Credit Scoring System:** In the PMA's continued pursuit to develop tools for reducing credit risks while preserving the quality of the credit portfolio, it is currently working on updating the installed version of the system, following a review of variables determinant of risk levels in a way that suits the Palestinian banking environment. A sample of financial and personal data was analyzed, the weights of risk variables were reviewed, and the 'degree of risk' table was modified. Thereafter, variables were amended according to analysis results, and assessment explanations were adjusted according to the changes taking place in the system. Work is still underway to make final adjustments before launching the system in its completed form, where it will be used (in its amended form) by banks and specialized lending institutions. This is expected to take place in 2013.

5. **Launch of the Lost and Suspended Checks System:** The reporting system for suspended and lost checks was launched via the credit information site as stipulated by Instruction No. (10/2012), dated 19/9/2012. Accordingly, the manual reporting mechanism that was in effect has been discontinued.

6. **Project for implementing Standards II &III of the Basel Committee:** A preliminary roadmap for the implementation of the Basel II & III project has been prepared. Taking into consideration the sensitive Palestinian situation, a detailed plan of action for the project's implementation mechanism and its outputs has also been prepared. The implementation of the project's various stages is still a work in progress.

7. **Establishing an electronic national switch for electronic payment instruments:** The project aims at developing electronic payment methods in Palestine by creating an electronic national switch, encouraging banks operating in Palestine to issue ATM and credit cards at relatively low costs so as to increase Points of Sale (PoS) and prepaid cards, and to encourage their use. This is in addition to the implementation of intra-bank clearing operations through the BURAQ system. The project has an expected completion date of 2013.

8. **Creating a supervisory position for key payment systems:** This projects aims to ensure the security and effectiveness of existing and planned key payment systems in Palestine, and also to establish cooperative mechanisms with local bodies involved in the joint supervision process so as to support financial stability and protect the financial system as much as possible.

9. **The Mobile Banking Project:** This project aims to achieve financial inclusion, and will contribute to economic growth by providing advanced electronic payment methods with minimum risks. These methods comply with the standards of the "know your customer" rule, and are also effective in reaching all segments of the Palestinian society. The project will enable participants to conduct financial transfer within preset ceilings via mobile devices, with the highest security standards and according to the PMA's transfer-related instructions. This will be in cooperation with banks operating in Palestine and Palestinian mobile communication operators.

   Regarding the implementation of this project, a proposal was extended to one of the international donor agencies in 2012 in an effort to gain partial funding over several phases. This project is expected to be completed over the next two years.

10. **The PMA's Business Continuity Project:** As the PMA strives to guarantee the availability of banking services to customers, even in emergency situations. The alternative site set in accordance with the adopted plans of business continuity and the needs of business departments, guaranteeing the availability of a minimum number of capable employees who run the critical processes of the PMA. The site has been examined by the business continuity team, and has met all the requirements of business continuity.

Relation with the Public

The PMA gives special priority to the public, endeavoring to provide banking services of the highest possible quality, at the lowest cost. The PMA also gives special attention to the bonds of relationship and the confidence between the different strata of the public and banks operating in Palestine. It is in this context that the PMA initiated a comprehensive banking awareness campaign, through which, activities of the Child and Youth Banking Week were carried out for the first time in Palestine. March 16th of every year was adopted as the official Child and Youth Banking Day in accordance with circular No. (35/2012). The activities of the Child and Youth Banking Week were launched in all governorates, in collaboration with banks operating in Palestine, the Ministry of Education and the Association of Banks in Palestine. This Week aims at strengthening banking awareness in Children and the Youth-the future generation- and to prepare them for proper dealings with financial institutions.

As part of enhancing transparency, disclosure and protecting client rights, banks are required to have the PMA's consent prior to the launch of award campaigns and any new banking product or its advertising material. These campaigns must adhere to specific instructions and must be consistent with the highest international standards and practices.

Similarly, a public reception hall service has been set up in the GS Office to facilitate the receipt of public requests for credit report copies, bounced checks, credit disputes, and customer complaints, all of which are to be addressed in coordination with relevant parties. In addition, the hall receives requests put forth by heirs of deceased clients, demanding information about bank accounts and safety deposit boxes of the deceased. The hall will also display and distribute materials designed to increase public awareness of banking services and provide advice on bank operations.

The PMA has also shown great flexibility in dealing with bounced checks, as it allowed clients to conduct consensual settlements with the purpose of modifying their rating in the bounced checks system. The number of consensual settlements implemented by the end of 2012 came to 6,236, of which 5,380 were approved, including 557 institutions and corporation settlements and 4,823 individual settlements. However, 856 settlements were not approved due to non-compliance with consensual settlement conditions.

Within its continuous efforts to safeguard the rights of citizens and its unwavering commitment to relieve their burdens, the PMA continues to closely pursue cases of aggrieved workers from GS with the Israeli National Insurance Institute. Likewise, the PMA does not spare any efforts to secure liquidity in all currencies, especially to banks operating in GS. In this context, PMA efforts helped banks operating in the WB to ship their cash surplus through the activation of the Paris Protocol in relation to the Israeli Central Bank. This led to an interim mechanism to ship NIS 120 million on a monthly basis to all Palestinian banks that do not have direct relations with their Israeli counterparts[29]. Furthermore, cash was transferred to GS and damaged money was replaced in order to cover the severe shortage which bank branches in GS are suffering from. Nonetheless, efforts are ongoing to reach a radical solution that would revive the mutual banking relationship between banks operating in Palestine and corresponding Israeli banks, routinely, and without further complications so as to ensure the progress and prosperity of Palestinian banks.

The Financial Follow-up Unit[30] has been active in raising public awareness on combating money laundering in Palestine as part of its effort to protect the Palestinian community against this crime. To this end, the Unit held a number of seminars and training sessions in 2012 to address this issue. They targeted certain segments of the community such as judges, prosecutors, customs officials, specialized lending institutions, and NGOs along with others. The Unit, in collaboration with U.S. Treasury experts, held a training workshop for public prosecution, customs, and law executing agencies regarding electronic evidence and the role it plays in uncovering money-laundering crimes. Moreover, a workshop for guarding civil society institutions against this crime was conducted in collaboration with the Interior Ministry.

Meanwhile, and as part of its social responsibility, the PBI, in cooperation with the PMA, conducted a number of projects and workshops. Three workshops, targeting judges, were held on basic banking culture, foreign banking transactions and the legal aspects of the banking business. These are viewed as an inauguration of a long-term collaboration with the Supreme Judicial Council. Two other workshops addressing the banking culture were also held, specifically for the Palestinian National Security Forces and the Presidential Guard in order to introduce their staff to basic banking information which will enable them to deal with banks and receive banking services more efficiently.

[29] This shipment was raised to NIS 300 million per month around mid 2013.

[30] The Financial Follow-up Unit was established under Anti-Money Laundering Law No. (9) of 2007, as an independent unit, with the PMA as its HQ. The Unit aims to combat money laundering and protect the national economy from the negative impacts of this crime. In addition, it strives to raise the bar for Anti-Money-Laundering Systems and Procedures currently implemented in Palestine, and to facilitate local cooperation with all relevant authorities. The unit operates under the supervision of the National Anti-Money Laundering Committee, which sets policies aimed at combating this crime and founding an effective control system.

Relation with Other Financial Institutions

Relation with Specialized Lending Institutions

As part of efforts to organize and control the conditions of specialized lending institutions, the PMA issued the following supervision instructions in 2012:

- **Instructions No. (1/2012)** concerning the licensing of specialized lending institutions. These instructions were put forth within the context of implementing the "license and supervise of specialized lending institutions" no. (132) of 2011. The instructions prescribe the forms of branching, permissible activities exercised by those institutions, prohibited activities, licensing terms and procedures for the institutions, relocation, ownership of real estate, and other procedures regulating and supervising specialized lending institutions.

- **Instructions No. (2/2012)** concerning the management of specialized lending institutions. These instructions deal with the conditions to be met by members of the Board of Directors, the executive management, Board of Directors committees, general assembly meetings, the special instructions relevant to internal and external auditing, provisions regulating the legitimate control of specialized lending institutions exercising Islamic financing activities, and procedures necessary to ensure the secrecy and security of information.

In addition, the PMA has prepared a strategic plan for the supervision and control of specialized lending institutions for 2013-2015 in cooperation with the GIZ. Moreover, the PMA made several visits to lending institutions and coordinated with other related parties in order to adjust their situation in line with the PMA instructions. Furthermore, the PMA held several training courses in micro-lending.

In another context, the PMA linked the Palestinian Housing Council with the Credit Bureau system in October 2012 in line with PMA's objective to reduce credit and operational risks for banks and lending institutions. This step followed linking all lending institutions with the Credit Bureau.

Relation with Money Changers

As part of it efforts to following up and organize the money changing profession, the PMA has issued the following instructions in 2012:

- **Instructions No. (1/2012)** concerning minimum capital: According to these instructions the minimum capital of general public or limited money changing firms will be USD 250,000 inside city borders and USD 100,000 outside the city borders, while the minimum capital of private shareholding companies will be USD 500,000 inside the city and USD 250,000 outside the city and that of public shareholding companies will be USD 2 million inside the city and USD 1 million outside the city.

- **Instructions No. (2/2012)** concerning wire transfer agencies: These instructions prohibit money changers from acquiring sub-agencies for wire transfers without obtaining the PMA's prior approval. Moreover, the instructions set out conditions for money changing firms eligible to acquire such agencies. For example, the conditions stipulate a minimum capital of USD 250,000; the appointment of a competent compliance controller and confining sub-agencies to function through banks operating in Palestine only.

- **Instructions No. (3/2012)** concerning operational capital and cash insurance: These instructions require that the operational capital (net)[31] is no less than 75 percent of paid-up capital; that the value of "unprocessed" precious metals should not exceed 20 percent of net oprational capital; that fixed assets and intangible assets should not exceed 15 percent the paid-up capital in the case money-changers are legally set-up as corporates. Moreover, the instructions specify the value of cash guaranty, cash deposit and cash insurance which the money changer has to comply with in accordance with the legal form of money-changers.

- **Instructions (4/2012)** concerning counterfeit money: These instructions call on money changers and money changing companies to train their employees on detecting and handling counterfeit money. Moreover, the instructions require all money changing companies to have counterfeit money detectors, notify official authorities in the event of discovering counterfeit money and submit relevant reports to the PMA.

- **Instructions No. (5/2012)** concerning the accounting system which money-changing companies were previously required to apply in aims of guaranteeing the transparency, accuracy and soundness of the financial system in Palestine. According to these instructions, money-changers are obliged to send accounting system reports and special records relevant to the PMA. These reports could be weekly such as the report on ingoing and outgoing transfers and the report on foreign currency exchange from the public. Other reports are issued monthly such as the report on purchased checks and the report on currency exchange from the banks. In addition, reports could be quarterly such as the report on financial position and the report on profits.

The PMA conducted spot check field visits to ensure the compliance of money-changers to the adopted accounting system and warn non-compliant money-changers against failure to apply the system in full. Moreover, the PMA addressed the Attorney-General to shut down unlicensed money-changing stores or those whose license has expired, as well as put an end to the phenomenon of peddler money-changers. Furthermore, the PMA required money-changers to return deposits to their owners and refrain from granting loans and facilities to citizens.

On the other hand, the PMA held several meetings and made visits to different districts in coordination with the Chamber of Commerce. In each of the districts money-changers were invited to talk about their work conditions and suggest mechanisms to support and protect their work. Finally, training material for money-changers has been prepared in coordination with the Palestine Banking Institute to include it in the training plan.

Relation with the Government and Local Public Entities

As part of its support to economic development and the realization of sustainable growth, the PMA is keen on strengthening relations with PNA organizations and local authorities. Therefore, the PMA continues to invest in the government Strategic Plan with respect to the management of public funds, and monetary, banking and financing policies. Coordination between the government and the EU is still ongoing with regard to the Sub-committee on

[31] According to these instructions, net operational capital is defined as current assets (including cash, checks purchased in various currencies, unprocessed precious metals, balances in banks, credit balances of correspondents in various currencies) minus the liabilities (balance of existing facilities received by money-changers from banks and balances of correspondents).

Economic and Financial matters. In addition, the PMA contributed to reviewing several draft laws and regulations of some organizations and ministries, attended their special meetings and shared remarks and recommendations in 2012.

The PMA is also keen on establishing strong relations with local organizations through membership representation as their Boards and active participation in their activities and meetings. Local organizations include the Palestine Capital Market Authority (PCMA), PBI, Association of Banks in Palestine, Palestine Investment Fund, National Anti-Money Laundering Committee, Palestinian Audit Profession Council, Institution for the management and Development of Orphans Funds, Higher National Committee for PA Legislative Plan, Student Loan Fund, as well as others.

Early in 2012, the PMA signed an MoU with PEX to adopt the Central Securities Depository as a cash settlement agent. As a result, PEX has become a third party in the BURAQ system for the settlement of monetary payments resulting from securities exchange in PEX. Through facilitating and simplifying settlement procedures and reducing financial settlement risks, the MoU will contribute to the achievement of fairness, speed and accuracy of bank transfers, coinciding with the transfer of ownership of sold securities in line with the international principle based on delivery versus payment.

The importance of executing settlements through the PMA lies in its direct relation to the IOSCO, and specifically recommendation No. 9, which points to the necessity of carrying out monetary settlement of securities through the Central Bank. This will enhance the trust of investors and create an atmosphere conducive to attracting local and foreign investment in Palestine.

Within the context of increasing the technical and professional capacities of its staff working in the financial sector in general, or in banks in particular, the PMA continues to cooperate with the PBI and to create and develop training programs in different areas of finance and banking.

International Relations

The PMA is keen on developing international relations through membership in the Boards of international organizations[32], taking active part in their meetings and activities and seeking to join other organizations. Within this context, the PMA continues to follow up on the implementation of MoUs signed with the Central Bank of Egypt and the Central Bank of Jordan. In addition, the PMA signed an MoU with Bank Al-Maghrib as an initial step toward strengthening relations between Palestine and Morocco in financial and banking matters.

On the other hand, the PMA was granted the status of an associate member in the International Association of Deposit Insurers (IADI) late 2012 in order to learn from the experience of 132 member international organizations. Furthermore, Palestine has been officially registered in the Society for Worldwide Interbank Financial Telecommunication (SWIFT) and is a member in the IBAN international system since 7 July 2012.

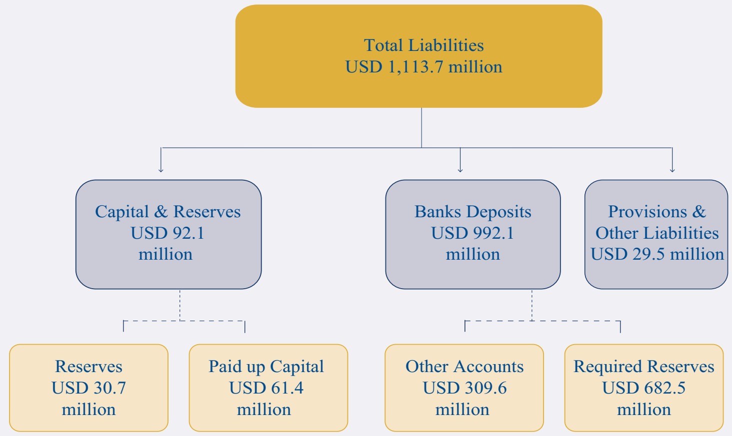
Furthermore, the Global Alliance for Financial Inclusion called upon the PMA to continue to chair the working sub-committee on developing guiding standards for “selling and banking marketing practices.” A comprehensive study on selling and marketing practices in banks and lending institutions in Palestine has been undertaken. Based on international standards issued by the G-20 and the World Bank, a questionnaire was distributed to banks and lending institutions. The results of the study were presented to the AFI and recommendations concerning selling and marketing practices were put forth. The results of the study were later discussed in a meeting for AFI members in South Africa with the view of adopting the recommendations and circulating them to all member countries for the preparation of relevant guiding standards draft.

[32] The PMA is a member in the Arab Monetary Fund (AMF), Union of Arab Banks, and Islamic Financial Services Board.

Financial Activity of the PMA

Data of the PMA's financial activity indicate a rise in assets by 7.8 percent, to reach USD 1,113.7 million by the end of 2012, compared to 2011. The main cause of this increase in liabilities is associated with the rise in the volume of banks deposits at the PMA (by USD 74.9 million, or by 8.2 percent compared with 2011), mainly as a result of a rise in the required reserves by 10.7 percent, to reach USD 682.5 million, resulting from the constant growth in deposits of banks operating on Palestine, which rose by 7.3 percent in 2012, compared to the previous year. Hence, the relative importance of banks deposits at the PMA rose to 89.1 percent of total liabilities at the end of 2012, compared to 88.7 percent in 2011.

Figure 4-2: PMA's liabilities structure, 2012



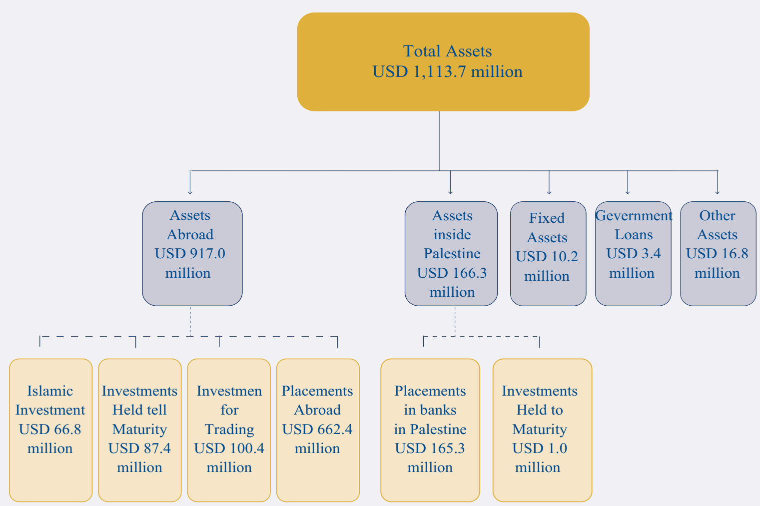
Source: PMA database.

Paid-up capital came second in terms of growth, to rise by 5 percent to reach USD 61.4 million, as part of efforts to raise PMA capital to gradually reach USD 120 million. Consequently, PMA capital and reserves increased by 3.2 percent to reach USD 92.1 million, compared to USD 89.3 million in 2011.

No significant change has taken place in reserves (the general reserves and revaluation reserves), which remained around USD 30.7 million. In contrast, provisions and other liabilities grew by 8.8 percent to reach USD 29.5 million by the end of 2012, compared to the previous year. Provisions are divided into several items, including provisions for doubtful loans, indemnity, accruals for employee expenses and administrative expenses, etc. While other liabilities includes bank and money chagers cash insurances, money-changer sureties, suspense accounts, etc.

As for assets, PMA balances abroad rose by 55.8 percent, to reach USD 592.9 million in 2012, compared to the previous year, while PMA local and foreign current deposits increased by 6.1 percent, to reach USD 78.4 million. Similarly, net fixed assets increased by 12.7 percent, to reach USD 10.2 million, specifically after implementing several important projects in the area of the payment systems, services, and business continuity in a way that helps banks operating in Palestine to cope with the latest banking technology used worldwide. While investment for trading stand stable around USD 100 million during 2011 and 2012.

Figure 4-3: PMA's assets structure, 2012



Source: PMA database.

On the other hand, other major asset items such as PMA local and foreign financial investments held to maturity have witnessed a considerable decline of 44.5 percent, to reach USD 88.4 million by the end of 2012, compared to the previous year. Likewise, PMA Islamic investments at local and foreign banks declined by 48.1 percent, to reach USD 66.8 million.

PMA foreign assets constituted 82.3 percent of total assets by the end of 2012, compared to 78.2 percent by the end of 2011. The percentage of domestic assets (financial investment held to maturity and balances at local banks and placements in banks in Palestine) went down to 14.9 percent of total assets by the end of 2012 compared to 19 percent in 2011.

Profits and losses account showed a decline of 5.6 percent in revenues, reaching USD 17.5 by the end of 2012, compared to 2011. This decline is due to the drop in net interest and investment profits by 14.5 percent, reaching USD 13.6 million in 2012, compared to USD 15.9 million the year before.

As for expenses, they reached USD 14.5 million, remaining within the level achieved during 2011. Still, employee expenses registered a growth of 6.7 percent, to reach USD 10.1 million, as a result of appointing new employees and consultants during 2012. Administrative expenses went up to USD 2.5 million, compared to USD 2.1 million in 2011, while bad and doubtful debts went down by USD 1.2 million in 2012, to reach USD 0.8 million compared to the previous year.

By the end of 2012, net profits declined by 23.7 percent to reach USD 2.9 million, compared to USD 3.8 million the previous year. The whole amount has been transferred to the PMA paid-up capital account.

Research and Development

The PMA assumes a great interest in the field of research and development. It constantly seeks to strengthen and deepen the knowledge of all segments of the Palestinian society whether policy-makers, decision-makers, researchers, or the public through the issuance of periodic reports, studies and statistics related to the Palestinian economy in general, and the financial and banking sectors in particular. This is in addition to the quest to develop human resources through training and local and international participation and engagement.

Publications

The PMA has managed, in the last few years, to develop their own research and information capacities, which include inputs and outputs of the Palestinian economy, and the development of econometric models of the macro-economy. This development was reflected in the high level and professional evaluation which various publications received, such as the annual and quarterly reports, new releases and reports on financial stability, inflation, sustainability of public finances and public debt, which meet international reporting standards. This came in addition to a number of specialized studies in the areas of macro and monetary economy that were published in competent international journals, in addition to the issuance of statistical reports and publications[33].

[33] Further details on the reports, studies and publications are available on the PMA website: www.pma.ps

Within the objective of promoting monetary and financial stability in Palestine, the PMA has managed to develop the business cycle indicator in Palestine in order to monitor fluctuations in economic activity through the manufacturing sector, including production, employment, and related implications on the Palestinian economy. The results of this indicator are published on a monthly basis.

In the context of developing the quality of statistical data and ensuring comprehensiveness and accuracy, the PMA has successfully worked in cooperation with the National Coordination and Follow-Up Committee on the accession of Palestine to “Special Data Dissemination System-SDDS”, which represents the framework for the dissemination and promotion of statistical data through a core set of indicators approved by the IMF. In cooperation with the International Monetary Fund, a Statistical webpage for Palestine was included in the “International Financial Statistics, IFS” report.

With relevance to database development, a temporary database has been developed on the PMA webpage, which includes data and time-series on the various sectors of economy, finance and banking to serve the needs of the PMA and various institutions, as well as researchers, academics and students.

Staff and Training

The PMA has continued during 2012 to develop its staff by attracting qualified professional and technical expertise to work at the various departments and divisions, where the number of employees has increased to 339 to fill in some vacancies. The PMA continued its efforts to raise the efficiency and capabilities of professional and technical capacities of employees according to their specialization through the implementation of various programs and vocational courses and workshops covering various aspects and disciplines related to the operations of PMA departments, and carried out in the most prestigious local and international institutions. The number of programs, courses and workshops that have been held or participated in reached 258 programs in 2012, compared to 230 in 2011.

Employees in monetary stability departments participated in 55 training programs, whereas the group of financial stability staff obtained 85 training sessions. This reflects the keenness of the PMA to develop its human resources and keeping pace with the latest global developments in the banking, monetary and financial aspects related to its work and objectives.

In the same context, the PMA has succeeded in training and developing the capacity of the banking staff in Palestine, through courses, meetings and workshops conducted by the Financial Follow-up Unit and PBI. Through the Financial Follow-up unit, the PMA has succeeded to raise the efficiency and performance of its employees, during 2012, through training courses specialized in the work of the Unit, where the number of training courses and workshops involving staff in the Unit has reached 15 courses and workshops locally and abroad, tackling issues related to money laundering, the application of the U.S. FATCA Act and the revised forty recommendations to combat money laundering and other issues relevant to the work of the Unit.

The Unit has represented Palestine in many international meetings in the field of combating money laundering, where it participated in the 15th and 16th meetings of the Financial Action Task Force in the MENA Region-MENAFATF" as well as in the 1st and 2nd meetings of the Committee assigned by the League of Arab States to prepare a draft Arab guidance law to combat money laundering and the financing of terrorism which was held in Lebanon.

At the local level, the Unit has participated along with the Ministries of Interior, Justice, and Health and the UNDOC in the conference on anti-drugs, crime prevention and criminal justice reform held in Jericho, to discuss the integrated program of cooperation for Palestine. The Unit has also participated in meetings with the public prosecutor in the framework of the Joint Committee, to discuss obstacles and facilitate cooperation mechanism and ways to raise the level of coordination with the public prosecution according to the Unit's legal powers.

The unit has also participated in legal meetings with the legislative plan of the cabinet to discuss the draft of the Electronic Transactions Act, in preparation for submission in its final version to the Palestinian President for endorsement. The Unit continued its collaboration with the Supervision and Inspection Department in the PMA to exchange experiences as per the directives of the President of the National Committee for Combating Money Laundering (the PMA Governor), as well as to coordinate with the PBI to hold trainings to qualify certified personnel in combating money laundering "PAMLA".

With regards to the PBI, the Institute continued its tireless efforts to promote human resources in the financial and banking sector during 2012, where it held 126 training programs, involving 2,459 participants with a total of 1,910.5 training hours.

The Institute has also carried out several diplomas and professional certificates including the Certified Financial Controller- CFC and "Certified Corporate Control Manager-CCCM. These programs were held for the first time in Palestine with the exclusive authorization from the American Certifications Center located in Jordan, and they are two of a group of programs addressing a range of programs and professional certification, which are expected to be held in the coming periods.

The 'SME Lending Program' and "Treasury Products Workshop" as well as a specialized certificate program on anti-money laundering have been organized. The Institute has also held a program for 'pioneers in Finance and banking sciences and investment strategies' with the 'Center for Training and Consulting investment' at Al Quds University which is expected to be completed by end of 2013.

On the local, national and international levels, the Institute has, in collaboration with several local and international institutions, signed agreements in the field of training, including an agreement with the «CHF International» for the implementation of an education program for «home buyers in Palestine», which aims at improving the capacity of Palestinian families to own their own homes by increasing consumer awareness on issues related to home ownership, and improving their knowledge of the procurement process and funding methods. This project is the first of its kind since the establishment of the Institute as it targets several segments of society covering several geographic areas in the WB. Awareness workshops will continue to be held until the completion of the project by the end of 2013.

The Institute also concluded an agreement with the "American Certifications Center" to provide specialized certifications, such as Certified financial Controller-CFC, Certified companies Control manager-CCCM, Certified Teller, Certified Customer Relations Officer-CRO and Certified Junior Credit Officer.

In addition, the institute concluded a memorandum of understanding with "Process Management International-PMI" in Dubai for the aim of conducting specialized trainings on Lean Six Sigma (Yellow, Green, Black) and "Leadership Business Transformation". The institute also signed an agreement with the Jordanian Institute of Banking studies in order to exchange expertise between in the field of training and development of human resources in the areas that serve the financial and banking sectors.

Lastly, several workshops were held on: banking clusters loan programs, Islamic banks, the PMA: origin, development and its relationship with banks operating in Palestine, requirements for the update of bank governance and audit, the principles of corporate governance, corporate governance and its importance in developing the performance of banks in Palestine, and other workshops that aim to raise the work performance of staffs related to financial and banking sectors.

Part II
Palestinian Banking Sector Developments

Overview

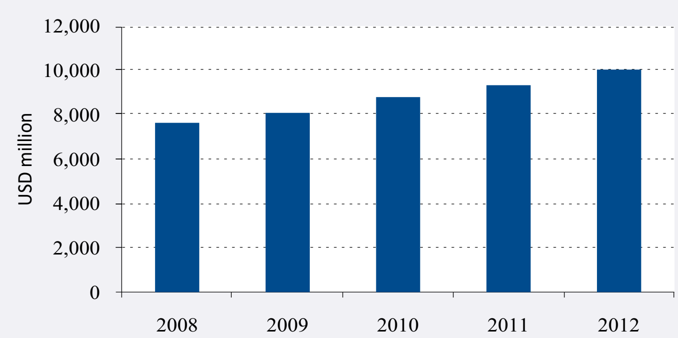
The banking sector in Palestine has evolved into a vital player and value-adding sector in the Palestinian economy, with its direct and indirect contributions to GDP, while helping, through financial intermediation, in promoting economic growth.

In line with the general trend during the past few years, the banking sector's performance has seen quite remarkable developments in 2012, after the PMA succeeded in further promoting growth and effective performance within the banking system despite the considerably risky environment. The PMA introduced several measures to develop the sector's infrastructure, improve the efficiency of the financial safety net, develop oversight procedures and regulations in line with international best practices, develop a national payment systems, establish the Palestinian Deposit Insurance Corporation (PDIC), and improve customers' confidence, along with other appropriate precautionary measures. The result was a tangible improvement in banks' financial indicators, such as improvements in assets in terms of volume and quality, and in the ability of banks to withstand expected and unexpected risks. The following sections present the main banking developments in 2012.

Assets of Banks Operating in Palestine

Assets of banks operating in Palestine in 2012 amounted in value to around USD 10,044.5 million, with an approximate increase of USD 707 million and a growth rate of 7.6 percent compared with 2011. This boost is explained by several key developments, some of which are listed below.

Figure 4-4: Assets of banks operating in Palestine, 2008-2012



Source: PMA database.

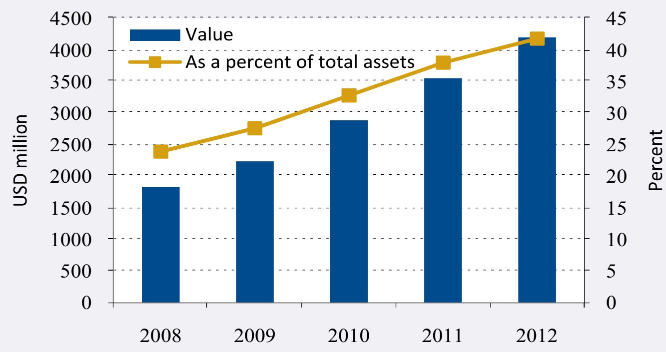
Direct Credit Facility Portfolio

Direct credit facilities usually constitute the most prominent item in the balance sheet of any bank, serving as the most common channel for financial intermediation between those with surplus (deposits) and those with deficit (loans). In Palestine, direct credit facilities amounted to 41.8 percent of total bank assets by 2012, with a total of USD 4,199.1 million, distributed at 89.7 percent and 10.3 percent in the WB and GS respectively. These levels were a result of a boost in the volume of the facilities portfolio of about 18.3 percent compared to 2011.

This bulky increase per se can be taken as an indicator of a rise in credit supply and demand, hence an increased local capacity for the investment of deposits in various economic sectors, expanding their capacity and securing necessary liquidity.

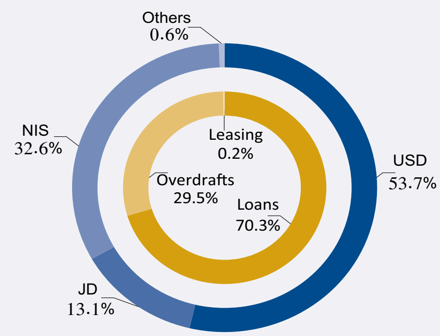
Although the share of loans to total facilities declined in 2012 by one percentage point in favor of overdraft, it still accounts for the largest share of total credit facilities at 70.3 percent, compared with 29.5 percent for overdrafts and only 0.2 percent for lease financing.

Figure 4-5: Direct credit facilities, 2008-2012



Source: PMA database.

Figure 4-6: Direct credit facilities by type and currency, 2012

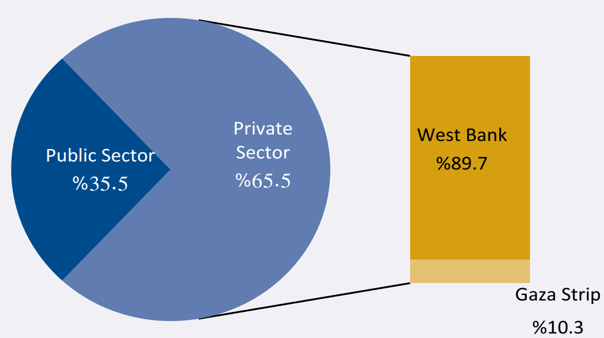


Source: PMA database.

On the other hand, the USD dominated the majority of credit facilities (53.7 percent), followed by the NIS (32.6 percent), the JOD (13.1 percent) and other currencies (0.6 percent) by the end of 2012. The distribution shows a remarkable increase of over 8 percent for the NIS share of total credit facilities compared with its share in 2011, the reason being the huge increase in the volume of credit granted to the public sector in 2012, where the NIS was dominant.

In the same context, credit facilities extended to the public sector went up by 27.8 percent to USD 1,407.5 million; that constituted 33.5 percent of total credit facilities, compared with a rise of 14 percent in credit extended to the private sector, amounting to USD 2,791.6 million, or 66.5 percent of credit facilities by the

Figure 4-7: Direct credit facilities by sector and region, 2012

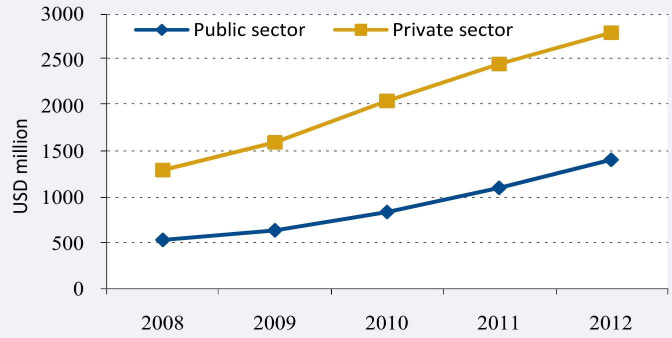


Source: PMA database.

Palestine Monetary Authority (PMA). Annual Report 2012 end of 2012. The distribution indicates an increase in the public sector's share by 2.5 percentage points compared with 2011, at the expense of the private sector.

Generally speaking, the volume of credit directed to both the public and private sectors is on the rise. For the private sector, it increased by 116 percent during the period 2008-2012 at USD 1,496 million, compared with 164 percent at USD 785 million for the public sector (mostly for the central government) in the same period, as the government's financial crisis continued to detriorate in view of declining international aid.

Figure 4-8: Direct credit facilities by sector, 2012



Source: PMA database.

Theoretically, this boost may indicate a crowding-out effect, where businesses are competing with the public sector for necessary resources for funding their economic activities. Nevertheless, given the rise of credit extended to the private sector relative to the size of total private sector deposits (from 27.7 percent in 2008 to 40.7 percent in 2012), it appears that any expansion in credit to the public sector is largely financed through withdrawals from banks' balances abroad rather than by decreasing the private sector's credit share. However, the continuous growth of public sector's credit in such a manner remains alarming.

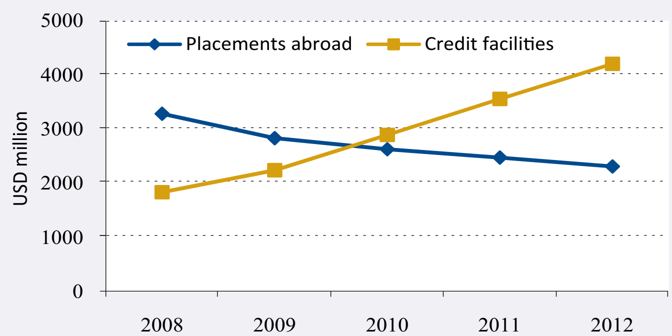
In recent years, local credit has been notably expanding, leading to a rise in the credit-to-deposits ratio from 31.3 percent in 2008 to 56.1 percent by the end of 2012. This suggests banks' rising influence by leveraging the real economy by injecting more liquidity into various economic channels. The result is higher economic growth, strengthened financial depth indicators and cemented links between the banking sector and real economy. Extended credit facilities, thus, increased from 29 percent of GDP (an indicator of financial depth) in 2008 to around 41 percent by the end of 2012.[34]

The latter significant improvement in the volume of extended facilities is attributed to several PMA measures including:[35]

1. Launching a set of advanced programs, systems and services in line with international best practices, most notably the Credit Bureau.

2. Pursuing a policy of reducing

Figure 4-9: Direct credit facilities and balances abraod, 2008-2012



Source: PMA database.

[34] PMA, Research and Monetary Policy Department. Financial Stability Report, 2013

[35] Dr. Jihad Khalil Al-Wazir, The Role of the Banking Sector in Palestinian Economic Development, a paper submitted to the Palestinian Studies Institution, Late Burhan Al-Dajani Seminar, October 2011.

banking placements abroad[36] in favor of reinvesting these funds in the local economy. This policy reduced those placements from 65 percent to 55 percent by the end of August 2009 hence re-injected considerable amounts of cash into the local economy through the credit channel.

3. Promoting greater inclusion of financial and banking service all over the Palestinian areas and the respective roles of the PMA and other related institutions in raising public awareness about the banking culture and clients' rights and duties in banking transactions. There was also the PMA's emphasis on following up on complaints, developing and modernizing banking products, service and prices, and guaranteeing transparency and full disclosure in line with international best practices.

4. Issuing fair-lending regulations, regulations of commissions and fees and other relevant orders to improve banking services and promote economic growth.

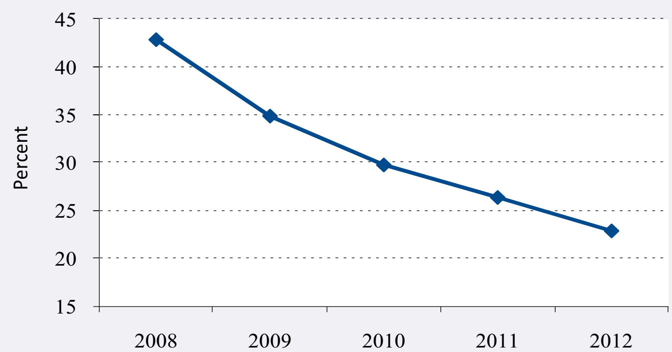
In addition to the abovementioned PMA measures, there was a significant decline in global interest rates in view of the expansionary monetary policies pursued by major central banks to contain the world financial crisis. This contributed to promoting local credit demand, which is highly responsive to interest rate changes, hence injecting more liquidity to various economic sectors and increasing the absorption of local economy.

These developments coincided with relative political and economic stability in Palestine affecting, thereby, economic conditions and growth rates in concurrence with the implementation of the Palestinian Reform and Development Plan (2008-2010) and the National Development Plan: State Creation and Future Building (2011-2013).

Balances With PMA and Banks

By the end of 2012, total balances with the PMA, banks in Palestine and banks abroad receded by 1.9 percent (USD 70.6) from 2011 and stood at USD 3,673,1 as a result of declining balances with banks abroad. Such balances dropped in value by 6.6 percent and in relative significance by around 3.5 percentage points to 22.9 percent of total bank assets by the end of 2012, to reach about USD 2,303.7 million. Data shows a continuous decline of those balances, which are the main component of placements abroad, which also cover banks' foreign investments.

Figure 4-10: Balances abroad as a percent of total assets, 2008-2012



Source: PMA database.

In turn, balances with banks in Palestine rose by 10.5 percent to USD 370.5 million at the end of 2012, accounting for around 3.7 percent of total assets. It should be noted that those balances are prone to continuous changes in view of the daily inter-bank transactions.

[36] PMA instructions No. 5/2008, Article 5/7 define placements abroad as: those monetary balances deposited with financial institutions outside Palestine, in addition to investments, whether in capital markets or in the form of facilities granted for use outside Palestine. They also include deposit certificates, bonds and instruments issued by foreign governments and institutions, in addition to investment in foreign company stocks, foreign investment funds, banking consortium lending and other facilities granted for use outside Palestine."

Bank balances with the PMA amounted to 9.9 percent of total assets by the end of 2012, or around USD 998.9 million, with a rise of USD 58 (6.2 percent) since 2011. Those balances were divided into required reserves (67.8 percent), current accounts (8.4 percent) and other accounts (21.7 percent).

Figure 4-11: Banks balances at PMA, 2011 & 2012

Source: PMA database.

Investment Portfolio

The value of securities portfolio (for trading and investment) at banks operating in Palestine amounted by the end of 2012 to around USD 745.3 million, a decline of USD 85.5 million and at a rate of 10.3 percent compared with the end of 2011. In contrast, the value of investment of banks operating in Palestine in companies' stocks rose by 3.6 percent, that is to USD 148.7 million by the end of 2012.

Other Items

Those items include **cash**, amounting to around USD 731.1 million by the end of 2012, having seen a remarkable growth of 47.2 percent compared with the end of 2011. The blame for this accelerated accumulation of excess liquidity falls on the constrains continuously imposed by Israelis on the transfer of cash surplus in NIS to corresponding Israeli Banks, which forces their Palestinian counterparts to retain this surplus in their vaults.

Other items also include **bank acceptances**, which are those items acceptable for payment by banks inside and outside Palestine. Those amounted to USD 5.3 million, a rise of 6.3 percent during the cited period. **Other assets** also declined by 18.6 percent (USD 195.4 million) compared with the end of 2011, noting that those items still constitute a modest part of total bank assets, which limits the impact their fluctuations have on other components of assets.

Liabilities of Banks Operating in Palestine

Deposits of customers and banks[37] and ownership equity (net) are the main components of liabilities in the consolidated balance sheet of banks operating in Palestine. Here is an outline of the main developments affecting these items in 2012:

Deposits at Banks Operating in Palestine

Customer deposits account for the largest and most prominent share of total deposits. They are the main external financing resources for banks and serve as a significant indicator for savings in the local economy. The accumulation of savings is particularly important as it helps in restoring the balance between local demand (both consumption and investment driven) and savings, necessarily leading to improved economic performance. Of relevance is the fact that banks operating in Palestine have succeeded in attracting increased deposits, particularly customer deposits,

[37] Including those of the PMA, banks in Palestine, and banks outside.

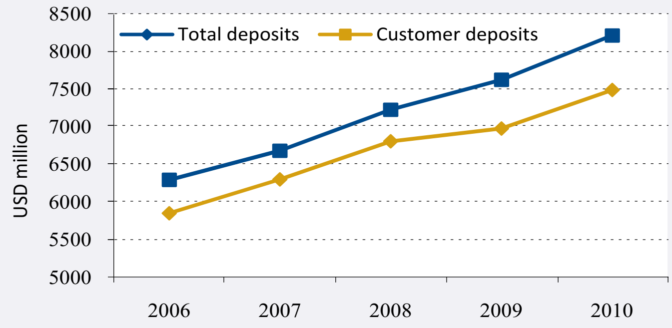
even in times of political disturbances and economic crises. This steady growth has become a prominent feature of deposits, as total bank deposits in Palestine rose by 7.7 percent compared with 2011 to USD 8,207.2 million by the end of 2012. For the same period, customer deposits grew by 7.3 percent to USD 7,484.2 million, most of which belong to the Palestinian private sector, with a percentage of over 90 percent.

Customer deposits amounted to around 73 percent of GDP by the end of 2012. The obvious confidence in banks operating in Palestine has clearly contributed to such remarkable growth in deposits and formation of surpluses necessary for financing transactions in the economy and preventing harmful bottlenecks.

It is notable that customer deposits, particularly of the private sector, continued to rise despite the fall in interest rates during the financial crisis. Contrary to economic theory, this means fluctuations in interest rates are not a decisive factor for depositing in Palestine, or at least, not the main driver of Palestinian private sector's deposits. Other factors, including safety considerations, seem to be more influential on those deposits, particularly given the current political and security conditions, the lack of investment opportunities and growing risks in the local market and the region.[38]

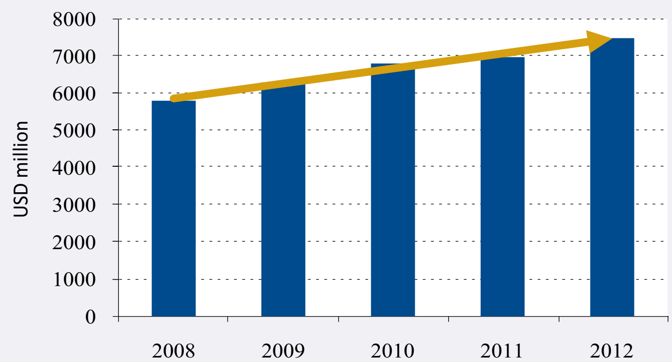
By the end of 2012, customer deposits amounted to around 74.5 percent of total liabilities. Public and private sector deposits accounted for 8.3 percent and 91.7 percent of total customer deposits, respectively, with no changes compared with corresponding figures for the previous year. The WB contributed around 89.8 percent of total

Figure 4-12: Total and customer deposits , 2008-2012



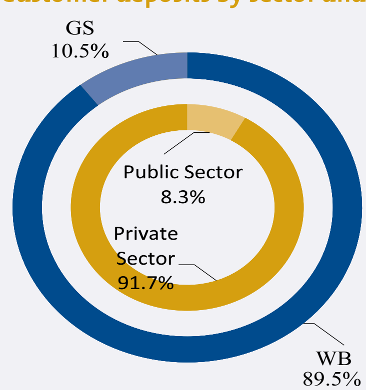
Source: PMA database.

Figure 4-13: Customer deposits, 2008-2012



Source: PMA database.

Figure 4-14: Customer deposits by sector and region, 2012



Source: PMA database.

[38] Dr. Jihad Al-Wazir, op cit.

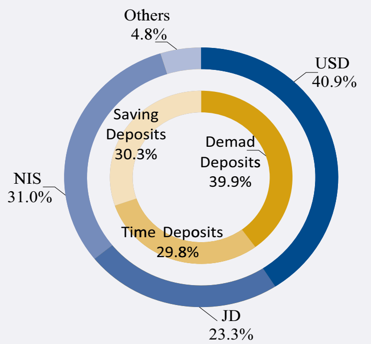
customer deposits compared with 10.5 percent for GS at the end of 2012. It should be mentioned that non-resident private sector deposits did not exceed USD 242.5 million in 2012, that is as little as 3.5 percent of total private sector deposits

Type-wise, current (demand) deposits accounted for 39.9 percent of total customer deposits, compared to 29.8 percent for saving deposits, and 30.3 percent for time deposits. Among currencies, the USD was most dominant (40.9 percent) followed by the NIS (31 percent) and the JD (23.3 percent). Some other currencies, like the Euro, were marginal (4.8 percent).

Bank deposits, totaled around USD 723 by the end of 2012, an increase of 118 percent, or USD 76.5 million compared with 2011. They also accounted for around 7.2 percent of banks' liabilities and around 8.8 percent of total deposits by the end of 2012.

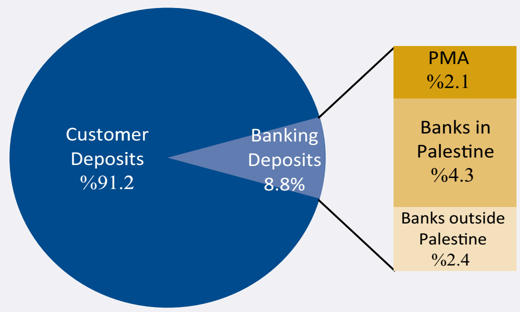
Figures show a slight decline in PMA deposits, falling by around 3.2 percent (USD 5.8 million) during the reporting period. In contrast, deposits of banks in Palestine grew by 15.3 percent, or USD 44.6 million, while deposits of banks abroad rose by 23.2 percent, or USD 37.7 million, in the same period.

Figure 4-15: Customer deposits by type and currency, 2012



Source: PMA database.

Figure 4-16: Banking and non-banking deposits structure, 2012

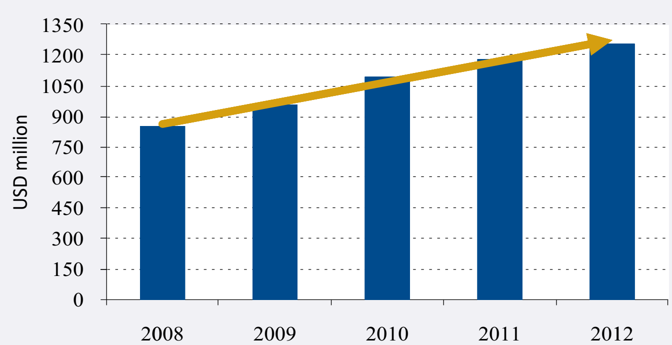


Source: PMA database.

Ownership Equity (net)

An upward trend has become a prominent feature of equities of banks operating in Palestine. Net equity continued rising by 6.1 percent in 2012, to reach USD 1,256.5 milliom by the end of the year, a USD 72 million higher than in 2011, and currently accounting for 12.5 percent of banks' liabilities. The PMA pays special atttnetion to this item, as it is the first line of defence vis-à-vis expected and unexpected risks that may face banks.

Figure 4-17: Ownership equity (net) of banks, 2008-2012

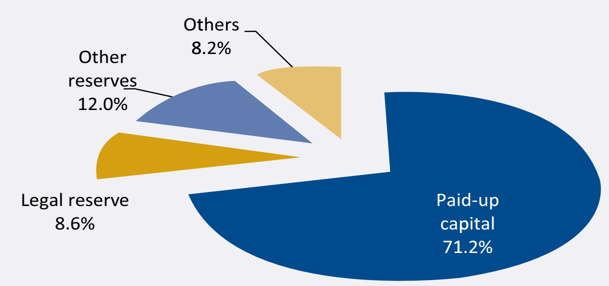


Source: PMA database.

By the end of 2012, net equity rose after a boost in paid-up capital by around USD 20.2 million. Declared and legal reserves grew by around USD 24.7 million in view of rising general reserves for banking transactions by USD 17.6 million in 2012.

Changes affecting the values of equity components usually result in changes in their respective proportional weights. Paid-up capital, however, is still the most dominant, with around 71.2 percent of net equity by the end of 2012.

Figure 4-18: Ownership equity (net) Structure, 2012



Source: PMA database.

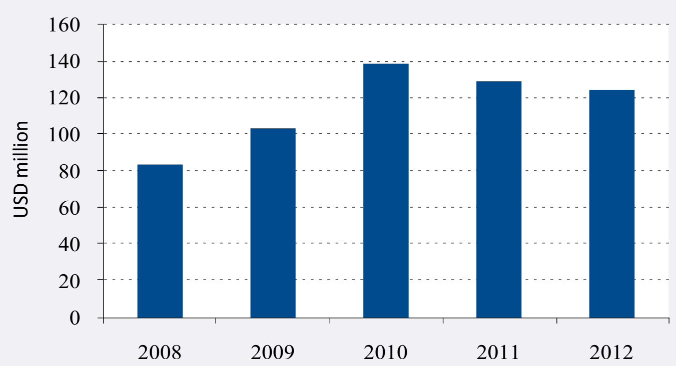
Other Items

Those items refer to **executed and outstanding acceptances**. Such items are accepted for payment to banks inside and outside Palestine. By the end of 2012, they amounted to around USD 10 million, a drop by 37.9 percent compared with 2011. They include, as well, **other liabilities** including: credit items in transition, transactions between banks and branches and accrued interest payable, just to name a few. These liabilities totaled around USD 136.4 million by the end of 2012, a rise of USD 13.6 million, or 11.1 percent compared with 2011. **Tax provisions** also increased to USD 111.2 million by the end of the year, a rise of USD 3.8 million, or 4 percent. **Other provisions** rose by USD 34.6 million, or 12 percent, to reach USD 322.2 million.

Profits and Losses

Net income of banks operating in Palestine amounted to around USD 124.2 million by the end of 2012, a decline of USD 4.7 million, or by 3.6 percent, compared with 2011. Nevertheless, profit attained from interest is the main source of income for banks, which did not decline during the cited period, but rather achieved a remarkable growth of 10.5 percent, at a value of USD 29.1 million.

Figure 4-19: Net income of banks operating in Palestine, 2008-2012



Source: PMA database.

In contrast, operating costs increased by USD 12.5 million (5.7 percent) with net provisions rising by USD 18.1 million to USD 20.2 million and with taxes increasing by 26.9 percent, or USD 9.4 million during the reporting period.

PMA Managed Systems of Payment

The PMA achieved a milestone in the path towards transforming to a modern central bank with the launch of the BURAQ system in 2010. The system provides for an effective and safe environment for financial settlement transactions between member banks, hence, fosters financial stability in Palestine in line with international best practices governing high-value payment settlements. BURAQ has also helped in providing a mechanism for higher turnover of money in Palestine governed by legal and operational frameworks that can guarantee settlement finality and mitigated risks.

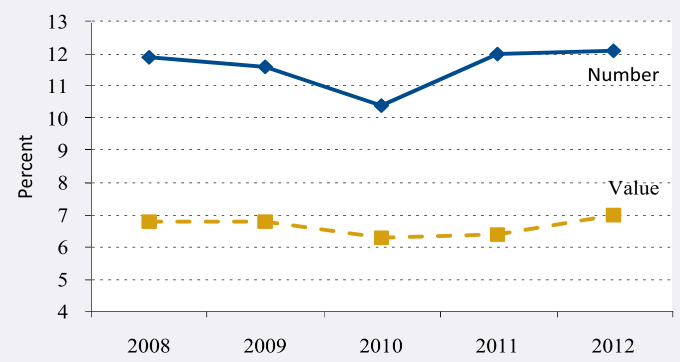
• Instant Settlement Transaction Activities through BURAQ System

In 2012, BURAQ-based inter-bank real-time gross settlement transactions in Palestine rose in numbers by 56.6 percent, and in value by 35 percent, compared with 2011. Transfers in 2012 totaled 165,620 with a gross value of around USD 28,178.9 million. Such settlement transactions include personal transfers, bank transfers, settlements of financial positions induced by check clearance and settlement of differences in required reserves.

• Clearance House Activity

PMA clearance data shows a growth of 5.9 percent in the number of checks presented for clearance in various currencies, in contrast to a decline in their values by 19 percent compared with 2011. Total checks presented for clearance in 2012 amounted to 4,287,605 checks, with a total value of USD 9,629.7 million.

Figure 4-20: Bounced cheques as a percent of clearance, 2008-2012



Source: PMA database.

Along the same lines, bounced checks in various currencies went up by 6.3 percent, though their value decreased by 10.7 percent. This resulted in a relative stability in the ratio of bounced checks to total checks presented for clearance at a level of 12.1 percent for two consecutive years. The value of bounced checks to total value of checks presented for clearance increased by 0.6 percentage point to around 7 percent at the end of 2012.

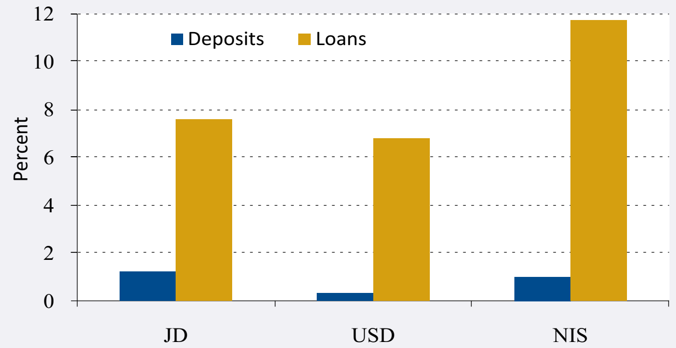
Interest Rates

Annual deposit and lending interest rates in various currencies used by banks operating in Palestine have changed in 2012 compared with those of 2011. Interest rates in JD increased by 52 basis points for depositing and by 48 basis points for lending, to reach 1.7 percent for deposits and 8.11 percent for lending. They increased for USD deposits by 13 basis points and by 18 basis points for lending, to reach 0.46 percent for deposits and 6.97 percent for lending.

As for the NIS, rates rose by 21 basis points for deposits, while they decline by 43 basis points for lending, to reach 1.22 for deposits and 11.26 percent for lending during the same cited period.

In the same context, it is of particular relevance that such rates and changes are contingent upon internal and external factors. Even though interest rates in the home countries of foreign currencies used in the Palestinian market are the most important external determinant, the fluctuation of local demand and liquidity, in addition to profit margins, can be among the most prominent local determinants of deposit and lending rates in Palestine.

Figure 4-21: Lending and depositing rates by currency in Palestine, 2012



Source: PMA database.

Part III
Non-Banking Financial Institutions Developments

Overview

This part tackles the recent developments that occurred to financial institutions outside the scope of the banking system. These institutions fall under the direct supervision of two main authorities in Palestine: all specialized lending institutions and money exchange companies are subject to the control and supervision of the PMA, while the PEX, insurance companies, leasing companies and mortgage companies are subject to the control and supervision of the PCMA.

A closer look at this sector would reveal that despite tangible developments during the past few years, further measures must be taken to guarantee continuous progress, especially in regards to developing the financial system's infrastructure for more efficient markets and solid financial stability and for financial growth and economic prosperity. Below is a review of the most important developments in these institutions during 2012.

Specialized Lending Institutions[39]

Specialized lending institutions operating in Palestine are mostly non-profit organizations, contributing to economic development and alleviation of poverty and unemployment in the Palestinian society. This sector provides basic financial services to a broad segment of the society against easy credit terms and guarantees consistent with the meager economic capabilities of those segments.

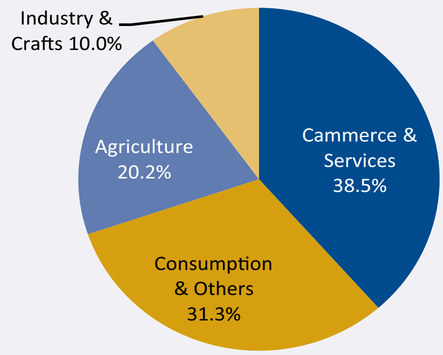
Throughout the past years, the specialized lending sector suffered from a vacant legal context as a result of its novelty and lack of organization. Each of the lending institutions used to operate within a different legal framework until they were embraced in 2011 under the control and supervision of the PMA. During 2012, and with the aim of preserving financial

[39] By the end of 2012, there were 11 specialized lending institutions working in Palestine, including those who are working through "SHARAKEH" network.

stability and the efficient performance of specialized lending institutions, the PMA issued several instructions to regulate this sector and lay grounds for licensing mechanisms and detailing permitted and prohibited operations for these institutions.

By the end of 2012, there were 8 specialized lending institutions members in the Palestinian Network for Small and Microfinance (Sharakeh), operating through 62 branches and offices distributed in the WB and GS. Their net credit portfolio amounted to USD 84.2 million distributed among various economic sectors relevant to the nature and objectives of those institutions. The trade and service sectors acquired around 38.5 percent of the value of extended loans. Consumption loans accounted for 31.1 percent, agriculture 20.2 percent and industry and craft 10 percent.

Figure 4-22: Sectoral distribution of specialized lending instutuitions loans, 2012



Source: The Palestinian network for small & microfinance (SHARAkEH).

Exchange Institutions

In 2012, there were 276 money changers licensed by the PMA to practice the profession, 234 money changers in the WB and 42 in GS. About 173 licensed money changers practice the profession as companies, while 103 as individuals. According to the Regulations on the License and Control of the Exchange Profession No. (13) of 2008, individual institutions are required to convert their legal form to company institutions by the end of grace period extended by the PMA to comply to these regulations, and a set of instructions to organize the work of money changers operating in Palestine.

Palestine Exchange (PEX)

In 2012, Al-Quds Index of PEX registered a growth of 0.7 points compared to 2011 and closed at the end of the year at 477.6 points. This rise is due to the boost in the indexes of the banking and financial sector and the insurance sector by 10 percent and 3.9 percent, respectively. In contrast, the investment sector index dropped by 8.7 percent, manufacturing by 3.3 percent and services sector by 1.9 percent.

PEX held 249 trading sessions during 2012 in which 147,304,208 shares were traded. The number of shares traded decreased by 20.2 percent compared to the previous

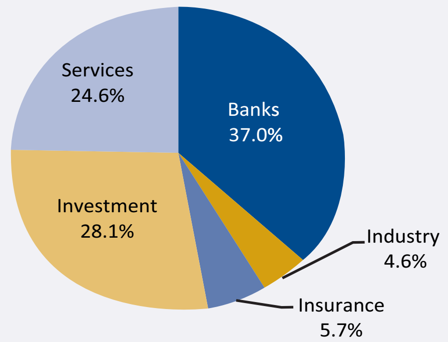
Figure 4-23: Al-Quds Index of PEX, 2008-2012

Source: PEX.

year. In contrast, the market value of listed companies[40] rose by 2.8 percent during 2012, compared to 2011, reaching USD 2,859.1 million.

The turnover ratio of shares traded, which is considered an index of liquidity in the market dropped from 12.6 percent in 2011 to 9.6 percent by the end of this year.

Figure 4-24: Sectoral distribution of shares traded in PEX, 2012

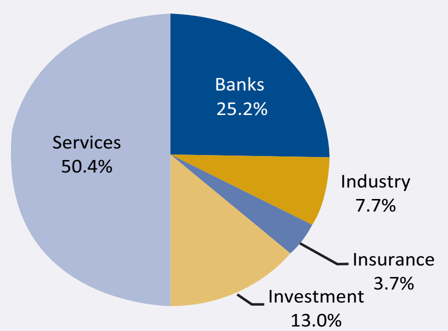


Source: PEX.

In terms of the value of shares traded by sector, the banking and financial sector had highest percentage of shares traded at 37 percent, with a value of USD 0.7 billion, or 25.2 percent of the total market value of listed companies amounting to USD 2.9 billion. The service sector accounted for 24.6 percent of shares traded and about 50.4 percentof total market value for listed companies. The investment sector dominated with 28.1 percent of shares traded and 13 percent of total market value, while manufacturing had 4.6 percent of shares traded and 7.7 percent of total market value. The insurance sector accounted for 5.7 percent of shares traded and 3.7 percent of total market value.

Furthermore, PEX ranked eighth in the Arab world in terms of performance. In 2012, eight Arab markets registered a rise in their index: Egypt, Dubai, Khartoum, Abu Dhabi, Saudi Arabia, Kuwait, Muscat and Palestine. The Egyptian exchange index registered the highest percentage increase of 50.8 percent among Arab indexes in spite of the currently volatile political and security conditions. In contrast, the Moroccan exchange index registered the highest percentage decrease of 15.1 percent, followed by the Damascus and Iraqi Securities Exchanges.

Figure 4-25: Sectoral distribution of the value of shares traded in PEX, 2012



Source: PEX.

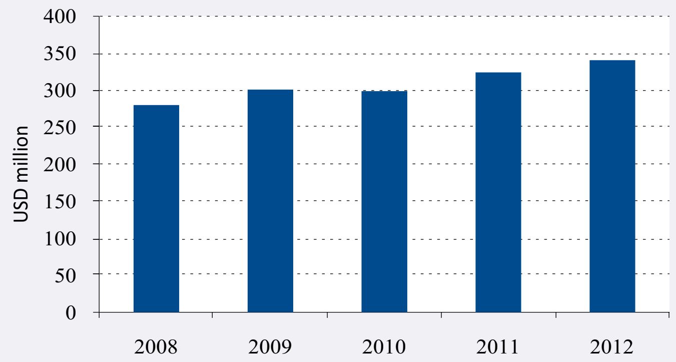
It should be pointed out that a joint cooperation agreement was signed in 2012 between the PMA and PEX on the adoption of the transfer and deposit centre as an agent for cash settlements through the PMA's BURAQ system.

[40] PEX currently has 48 listed companies following the listing of two new companies in 2012, including Palestine Securities Exchange (PSE), thus rating second among Arab exchanges in terms of listed companies after Dubai Financial Market and becoming the only privately-owned Arab exchange. The companies are distributed among the five sectors listed in PEX as follows: 9 banking and financial service companies, 11 manufacturing companies, 7 insurance companies, 8 investment companies, and 13 service companies.

Insurance Companies

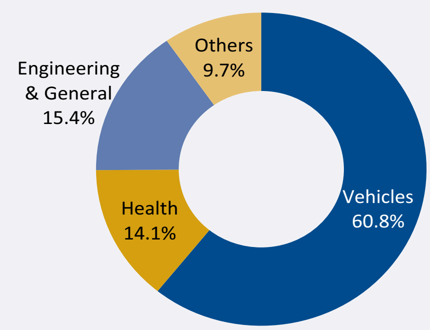
By the end of 2012, there were 10 licensed insurance companies operating through 11 branches and offices[41], distributed in different areas in the WB and GS, and employing about 229 insurance agents and 1,035 employees. Financial indicators and operational performance of the insurance sector point to a tangible growth in this sector during 2012. Indicators also show that the assets /liabilities of insurance companies operating in Palestine rose by 5.1 percent compared to 2011, reaching about USD 340 million. These indicators also point to a rise in shareholders' equity by 7.6 percent amounting to USD 108.8 million and to a rise in the paid-up capital by 6.5 percent amounting to USD 67.2 million by the end of 2012. Likewise, the insurance sector registered profits of USD 4.5 million in 2012, compared to USD 12.5 million in 2011.

Figure 4-26: Assets of insurance sector in Palestine, 2008-2012



Source: PCMA.

Figure 4-27: Insurance premiums by type, 2012



Source: PCMA.

On the other hand, total premiums obtained by insurance companies in 2012 declined by USD 6 million (4 percent), to settle at USD 144.5 million. Noteworthy in this context is that vehicle insurance premiums constitute 60.8 percent of total premiums, while general and engineering[42] insurance premiums were 15.4 percent, and health insurance premiums 14.1 percent. The rest was divided among other insurance premiums with 9.7 percent[43].

In contrast, compensation paid by insurance companies rose by USD 12.8 million, or 16.9 percent. to reach USD 88.4 million in 2012. Vehicle insurance compensations were 58.6 percent of total amounts paid, while health insurance compensations were 23.8 percent and general and engineering insurance compensations 11.2 percent. The rest was divided among other insurance compensations with 6.4 percent of total amounts paid in 2012.

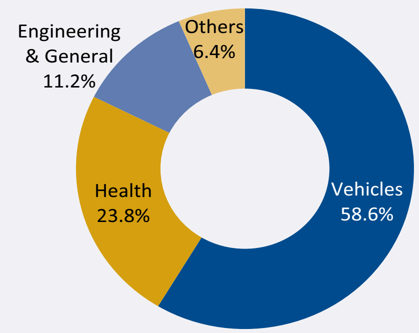
[41] 12 new branches and offices were opened in 2012.

[42] These are distributed among labor insurance premiums (9.5 percent), engineering insurance premiums (2.4 percent), civil liability insurance premiums (1.6 percent), and other general insurance premiums (1.9 percent).

[43] It includes fire insurance premiums (6 percent), life insurance premiums (2.5 percent), and marine insurance (1.2 percent) of total premiums.

In 2012, the PCMA has issued a number of decisions and instructions regulating the insurance sector, such as the decision on the appointment of actuary experts by insurance companies in order to improve their financial and technical performance. Other instructions issued by the PCMA are related to anti-money laundering and the use of the automated system for vehicle insurance and regulating the mechanism of their work.

Figure 4-28: Insurance paid-up claims by type, 2012



Source: PCMA.

Mortgage and Leasing Companies

Both the mortgage and leasing sectors are still suffering from the absence of proper organizational and legislative environment as both have been newly-introduced to Palestine, and therefore, have not yet reached the desired level. However, it must be noted that the PCMA has embarked on developing their organizational and legislative framework in line with international standards.

In 2012, the number of leasing companies has reached 8, all operating in the area of car leasing, while there were only two mortgage companies (Palestine Mortgage and Housing Corporation and its subsidiary Palestine Housing Finance Corporation), with total assets of USD 37.5 million achieving a growth rate of 1.1 percent compared to 2011. In addition, 10 new appraisers have been licensed, raising the number of licensed appraisers to 41 by the end of 2012.

APPENDICES

Chapter One Global and Local Economic Developments

Part I: Global Economic Performance

Table (1-1): Global real GDP growth rates, 2008-2012

(Annual percent change)

Country	2008	2009	2010	2011	2012
World	**2.8**	**-0.6**	**5.2**	**4.0**	**3.2**
Advanced countries	**0.0**	**-3.5**	**3.2**	**1.6**	**1.2**
United States	-0.4	-3.1	2.4	1.8	2.2
Euro area	0.4	-4.3	1.9	1.4	-0.6
Germany	0.8	-5.1	4.0	3.1	0.9
France	-0.1	-3.1	1.6	1.7	0.0
Italy	-1.2	-5.5	1.7	0.4	-2.3
Japan	-1.0	-5.5	4.7	-0.6	2.0
United Kingdom	-1.0	-4.0	1.8	0.9	0.2
Canada	1.1	-2.8	3.2	2.6	1.8
Israel	4.1	1.1	5.0	4.6	3.1
Major advanced countries	-0.3	-3.8	2.8	1.5	1.4
Newly industrialized Asian countries	1.7	-1.0	5.8	3.3	1.8
Emerging and Developing Countries	**6.1**	**2.7**	**7.6**	**6.4**	**5.1**
Africa- Sub-Saharan	5.6	2.7	5.4	5.2	4.8
Central and Eastern Europe	3.1	-3.6	4.6	5.2	1.6
Commonwealth of Independent States	5.3	-6.4	4.9	4.8	3.4
Developing Asia	7.9	6.9	9.9	8.1	6.6
China	9.6	9.2	10.5	9.3	7.8
India	6.2	5.0	11.2	7.7	4.0
Middle East and North Africa	5.2	3.0	5.5	4.0	4.8
Egypt	7.2	4.7	5.1	1.8	2.2
Jordan	7.2	5.5	2.3	2.6	2.8
Lebanon	8.6	9.0	7.0	1.5	1.5
Saudi Arabia	8.4	1.8	7.4	8.5	6.8
Latin America and the Caribbean	4.2	-1.5	6.1	4.6	3.0
Brazil	5.2	-0.3	7.5	2.7	0.9
Mexico	1.2	-6.0	5.3	3.9	4.0
Global GDP at purchasing power Parities	**70,299**	**70,306**	**74,879**	**79,286**	**83,140**

Source: World Economic Outlook, International Monetary Fund, April 2013.

Table (1-2): Global inflation rates, 2008-2012

(Annual percent change)

Country	2008	2009	2010	2011	2012
Advanced countries	**3.4**	**0.1**	**1.5**	**2.7**	**2.0**
United States	3.8	-0.3	1.6	3.1	2.1
Euro area	3.3	0.3	1.6	2.7	2.5
Germany	2.8	0.2	1.2	2.5	2.1
France	3.2	0.1	1.7	2.3	2.0
Italy	3.5	0.8	1.6	2.9	3.3
Japan	1.4	-1.3	-0.7	-0.3	0.0
United Kingdom	3.6	2.1	3.3	4.5	2.8
Canada	2.4	0.3	1.8	2.9	1.5
Israel	4.6	3.3	2.7	3.5	1.7
Major advanced countries	3.2	-0.1	1.4	2.6	1.9
Newly industrialized Asian countries	3.8	1.4	2.4	3.4	2.1
Emerging and Developing Countries	**9.2**	**5.1**	**6.0**	**7.2**	**5.9**
Africa- Sub-Saharan	12.9	9.4	7.4	9.3	9.1
Central and Eastern Europe	8.1	4.7	5.3	5.3	5.8
Commonwealth of Independent States	15.6	11.2	7.2	10.1	6.5
Developing Asia	7.3	2.6	5.6	6.4	4.5
China	5.9	-0.7	3.3	5.4	2.6
India	8.3	10.9	12.0	8.9	9.3
Middle East and North Africa	12.5	6.2	6.5	9.2	10.7
Egypt	11.7	16.2	11.7	11.1	8.6
Jordan	13.9	-0.7	5.0	4.4	4.8
Lebanon	10.8	1.2	4.5	5.0	6.6
Saudi Arabia	9.9	5.1	5.4	5.0	2.9
Latin America and the Caribbean	7.9	5.9	6.0	6.6	6.0
Brazil	5.7	4.9	5.0	6.6	5.4
Mexico	5.1	5.3	4.2	3.4	4.1

Source: World Economic Outlook, International Monetary Fund, April 2013.

Table (1-3): Developed economies: unemployment, 2008-2012

(Annual percent change)

Country	2008	2009	2010	2011	2012
Advanced countries	**5.8**	**8.0**	**8.3**	**7.9**	**8.0**
United States	5.8	9.3	9.6	8.9	8.0
Euro area	7.6	9.6	10.1	10.2	11.4
Germany	7.6	7.7	7.1	6.0	5.5
France	7.8	9.5	9.7	9.6	10.2
Italy	6.8	7.8	8.4	8.4	10.6
Japan	4.0	5.1	5.1	4.6	4.4
United Kingdom	5.6	7.5	7.9	8.0	8.0
Canada	6.2	8.3	8.0	7.5	7.3
Israel	7.7	9.4	8.2	7.0	6.9
Major advanced countries	3.9	5.2	5.0	4.6	4.6

Source: World Economic Outlook, International Monetary Fund, April 2013.

Table (1-4): Interest rates of major currencies, 2008-2012

(period end, percentage)

Country	2008	2009	2010	2011	2012
United States	0.13	0.25	0.25	0.25	0.25
Euro area	2.50	1.00	1.00	1.00	0.50
United Kingdom	2.00	0.50	0.50	0.50	0.50
Japan	0.10	0.10	0.10	0.10	0.10
Canada	1.50	0.25	1.00	1.00	1.00

Source: www.fxstreet.com, 2013.

Table (1-5): Growth in world trade volume, 2008-2012

(Annual percent change)

Country	2008	2009	2010	2011	2012
Total World Trade	**3.1**	**-10.6**	**12.5**	**6.0**	**2.0**
Exports					
Advanced countries	2.4	-11.6	12.1	5.6	1.9
Emerging and Developing Countries	4.3	-7.9	13.3	6.4	3.7
Imports					
Advanced countries	1.0	-12.1	11.5	4.7	1.0
Emerging and Developing Countries	8.4	-8.3	14.8	8.6	4.9
Export of Goods					
Advanced countries	1.8	-13.4	14.1	5.9	1.8
Emerging and Developing Countries	3.6	-8.1	13.9	6.4	4.1
Import of Goods					
Advanced countries	0.4	-13.1	13.3	5.0	0.6
Emerging and Developing Countries	7.8	-9.5	15.4	9.5	4.6
Change in Terms of Trade					
Advanced countries	1.8-	2.5	1.0-	1.6-	0.7-
Emerging and Developing Countries	2.7	-4.8	2.7	3.3	0.2
Total Value of Exportd (USD Billion)					
Goods and Services	19,887	15,889	18,904	22,276	22,413
Goods	16,054	12,489	15,175	18,154	18,255

Source: World Economic Outlook, International Monetary Fund, April 2013.

Table (1-6): Current account Balances, 2008-2012

(percent of GDP)

Country	2008	2009	2010	2011	2012
Advanced countries	**-1.2**	**-0.2**	**-0.2**	**-0.2**	**-0.1**
United States	-4.7	-2.7	-3.0	-3.1	-3.0
Euro area	-0.7	0.2	0.5	0.6	1.8
Emerging and Developing Countries	**3.5**	**1.5**	**1.5**	**1.9**	**1.4**
Africa- Sub-Saharan	0.3	-3.1	-1.3	-1.4	-2.8
Central and Eastern Europe	-8.3	-3.1	-4.7	-6.3	-4.3
Commonwealth of Independent States	5.0	2.6	3.6	4.5	3.2
Developing Asia	5.8	3.7	2.5	1.6	1.1
Middle East and North Africa	14.7	2.5	7.7	14.0	12.5
Latin America and the Caribbean	-0.9	-0.7	-1.2	-1.3	-1.7

Source: World Economic Outlook, International Monetary Fund, April 2013.

Table (1-7): Foreign direct investment (FDI) inflows, 2008-2012

(USD Million)

Country	2008	2009	2010	2011	2012
World	**1,816,398**	**1,216,475**	**1,408,537**	**1,651,511**	**1,350,926**
Advanced countries	**1,026,531**	**613,436**	**696,418**	**820,008**	**560,718**
United States	306,366	143,604	197,905	226,937	167,620
Euro Union	545,325	359,000	379,444	441,557	258,514
Germany	8,109	22,460	57,428	48,937	6565
France	64,184	24,219	33,627	38547	25,093
Italy	-10,835	20,077	9,178	34,324	9,625
United Kingdom	89,026	76,301	50,604	51,137	62,351
Japan	24,426	11,939	-1,251	-1,755	1,731
Canada	61,553	22,700	29,086	41,386	45,375
Israel	10,875	4,607	5,510	11,081	10,414
Emerging and Developing Countries	**789,867**	**603,039**	**712,119**	**831,503**	**790,208**
China	108,312	95,000	114,734	123,985	121,080
Hong Kong	67,035	54,274	82,708	96,125	74,584
Singapore	12,200	24,939	53,623	55,923	56,651
Brazil	45,058	25,949	48,506	66,660	65,272
Mexico	27,853	16,561	21,372	21,504	12,659
Turkey	19,760	8,663	9,036	16,047	12,419
Arab Countries	**97,562**	**81,686**	**66,403**	**42,282**	**47,612**
Egypt	9,495	6,712	6,386	-483	2,798
Marocco	2,487	1,952	1,572	2,568	2,836
Tunisia	2,759	1,688	1,513	1,148	1,918
Sudan	2,601	1,816	2,064	2,692	2,466
Lebanon	4,333	4,804	4,280	3,485	3,787
Saudi Arabia	39,456	36,458	29,233	16,308	12,182
UAE	13,724	4,003	5,500	7,679	9,602
Jordan	2,826	2,413	1,651	1,474	1,403
Palestine	52	301	180	214	244

Source: World Investment Reports, United Nations Conference on Trade and Development (UNCTAD), 2013.

Table (1-8): Offical reserve assets, 2008-2012

(USD Billion)

Country	2008	2009	2010	2011	2012
World	**7,466**	**8,594**	**9,701**	**10,705**	**11,452**
Advanced countries	**2,580**	**3,064**	**3,383**	**3,745**	**4,042**
United States	81	134	136	151	153
Euro area	238	302	319	335	351
Emerging and Developing Countries	**4,881**	**5,524**	**6,312**	**6,954**	**7,404**
Africa- Sub-Saharan	157	161	161	176	199
Central and Eastern Europe	263	303	325	332	363
Developing Asia	2,553	3,101	3,658	4,058	4,201
Middle East and North Africa	930	927	1,009	1,108	1,278

Source: World Economic Outlook, International Monetary Fund, April 2013.

Table (1-9): Emerging and developing economies: external debt, 2008-2012

Country	2008	2009	2010	2011	2012
	External Debt (USD Billion)				
Emerging and Developing Countries	**4684.9**	**4925.3**	**5486.5**	**6005.7**	**6639.2**
Africa-Sub-Saharan	217.4	230.8	256.7	279.9	299.0
Central and Eastern Europe	1022.2	1118.6	1145.0	1165.7	1238.1
Commonwealth of Independent States	731.0	736.3	789.9	838.2	889.5
Developing Asia	1082.0	1178.2	1429.2	1696.8	1986.8
Middle East and North Africa, Afganistan & Pakistan	728.6	746.9	771.6	799.6	843.7
Of which: Middle East and North Africa	680.3	693.4	708.8	732.0	776.8
Latin America and the Caribbean	903.6	914.6	1076.0	1225.4	1382.1
	Percent of GDP				
Emerging and Developing Countries	**24.4**	**27.0**	**24.9**	**23.4**	**24.4**
Africa-Sub-Saharan	23.0	25.8	23.9	23.2	23.7
Central and Eastern Europe	53.4	70.2	65.8	61.8	67.3
Commonwealth of Independent States	33.6	45.0	39.2	33.7	33.5
Developing Asia	14.9	15.2	15.2	15.0	16.2
Middle East and North Africa, Afganistan & Pakistan	28.2	32.1	28.6	25.5	24.6
Of which: Middle East and North Africa	28.3	32.2	28.3	25.2	24.5
Latin America and the Caribbean	21.0	22.7	21.5	21.8	24.0
	Percent of Total Exports				
Emerging and Developing Countries	**67.8**	**90.9**	**79.6**	**71.6**	**76.4**
Africa-Sub-Saharan	55.8	78.7	68.5	60.5	63.6
Central and Eastern Europe	143.2	197.5	178.2	152.8	162.4
Commonwealth of Independent States	92.5	140.0	117.3	94.2	98.1
Developing Asia	40.6	52.2	48.6	48.1	53.4
Middle East and North Africa, Afganistan & Pakistan	54.3	76.8	64.7	52.9	53.3
Of which: Middle East and North Africa	51.8	73.3	60.8	49.6	50.1
Latin America and the Caribbean	89.2	114.1	103.0	100.0	110.8
	External Debt Service Payments (USD Billion)				
Emerging and Developing Countries	**1727.2**	**1680.2**	**1715.1**	**2033.8**	**2253.8**
Africa-Sub-Saharan	59.0	52.9	44.9	48.7	53.1
Central and Eastern Europe	400.3	401.3	393.5	432.8	445.4
Commonwealth of Independent States	317.1	252.1	242.2	254.5	278.1
Developing Asia	473.1	490.4	545.7	748.3	910.7

Table (1-9): Cont.

Country	2008	2009	2010	2011	2012
Middle East and North Africa, Afganistan & Pakistan	190.4	185.2	202.7	206.8	207.4
Of which: Middle East and North Africa	186.4	179.6	197.3	202.7	202.7
Latin America and the Caribbean	287.2	298.2	286.1	342.8	359.2
	Percentage of GDP				
Emerging and Developing Countries	**9.2**	**9.4**	**8.0**	**8.0**	**8.4**
Africa-Sub-Saharan	6.3	5.9	4.2	4.1	4.2
Central and Eastern Europe	21.0	25.3	22.7	23.0	24.3
Commonwealth of Independent States	14.6	15.4	12.0	10.2	10.5
Developing Asia	6.5	6.3	5.8	6.6	7.4
Middle East and North Africa, Afganistan & Pakistan	7.4	8.0	7.5	6.6	6.1
Of which: Middle East and North Africa	7.7	8.4	7.9	7.0	6.4
Latin America and the Caribbean	7.2	8.0	6.2	6.4	6.7
	Percentage of Total Exports				
Emerging and Developing Countries	**25.0**	**31.0**	**25.0**	**24.3**	**26.0**
Africa-Sub-Saharan	15.2	18.2	12.1	10.6	11.4
Central and Eastern Europe	56.2	71.0	61.4	56.9	58.5
Commonwealth of Independent States	40.1	47.9	36.0	28.6	30.7
Developing Asia	17.8	21.7	18.6	21.2	24.5
Middle East and North Africa, Afganistan & Pakistan	14.2	19.0	17.0	13.7	13.1
Of which: Middle East and North Africa	14.2	19.0	16.9	13.7	13.1
Latin America and the Caribbean	28.4	37.2	27.4	28.0	28.8

Source: World Economic Outlook, International Monetary Fund, April 2013.

Part II: Domestic Economic Performance

Table (1-10): Palestine: real GDP and GDI, 2008-2012

(USD Million)

Activity	2008	2009	2010	2011	2012
A) Productive Sectors	**1,361.6**	**1,370.9**	**1,509.9**	**2,050.9**	**2,098.2**
Agriculture and Fishing	286.1	293.2	287.8	380.6	332.6
Industry	761.1	690.0	685.7	773.5	810.5
Mining and Quarrying	21.5	22.6	24.3	49.1	49.2
Manufacturing	539.3	540.6	554.6	625.4	657.6
Electricity and Water Supply	200.3	126.8	116.8	99	103.7
Construction	**314.4**	**387.7**	**536.4**	**896.8**	**955.1**
B) Service Sector (1 +2)	**2,946.7**	**3,224.9**	**3,449.8**	**3,686.4**	**3,935.9**
1- Productive services	1,157.1	1,348.2	1,637.3	1,716.1	1,807.5
Wholesale and Retail Trade	497.5	536.3	852.7	905.1	950.8
Transportation and Storage	345.5	513.4	513.2	562.1	592.0
Financial Intermediation	280.0	269.0	202.1	209.5	218.4
Hotels and Restaurants	34.1	29.5	69.3	39.4	46.3
2- Social Services	1,789.6	1,876.7	1,812.5	1,970.3	2,128.4
Education	398.8	426.1	388.6	475.8	529.5
Health and Social Work	135.0	146.5	167.7	215.0	245.2
Public Administration and defense	685.2	750.7	743.6	803.5	809.1
Others*	570.6	553.4	512.6	476.0	544.6
C) FISIM	**-275.3**	**-231.9**	**-165.9**	**-155.0**	**-165.5**
D) Net Taxes	**845.3**	**875.4**	**930.7**	**839.1**	**928.7**
Customs Duties	328.9	345.5	388.6	362.6	402.8
VAT on Imports, net	516.4	529.9	542.1	476.5	525.9
Real GDP (A + B + C +D)	**4,878.3**	**5,239.3**	**5,724.5**	**6,421.4**	**6,797.3**
Net Income Transfers from Abroad	531.5	469.7	364.7	391.4	435.0
Net Current Transfers	2,898.7	1,979.6	1,289.4	755.9	715.9
Real GDI	**8,308.5**	**7,688.6**	**7,378.6**	**7,568.7**	**7,948.2**
Real GDP Percapita (USD)	1,356.3	1,415.2	1,502.1	1,635.2	1,679.3
Real GDI Percapita (USD)	2,310.0	2,076.8	1,936.1	1,927.3	1,963.9
Memorandom Items					
Nominal GDP	6,247.3	6,719.6	8,330.6	9,775.3	10,254.6
Nominal GDP Percapita (USD)	1,737.0	1,815.0	2,185.9	2,489.2	2,533.5

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

Source: PCBS, National Accounts, Different Issues, 2013.

Table (1-11): Palestine: expenditure on real GDP, 2008-2013

Activity	2008	2009	2010	2011	2012
	USD Million				
Domestic Absorption	**7199.2**	**7831.7**	**7887.0**	**8816.3**	**9798.1**
Final Consumtion	**6138.7**	**6694.4**	**7303.5**	**7686.2**	**8724.1**
Private*	5142.8	5534.9	5474.2	5977.3	6697.0
Public	995.9	1159.5	1322.3	1772.2	2027.1
Gross Investment	**1060.5**	**1137.3**	**1090.5**	**1066.8**	**1074.0**
Private	555.9	605.9	553.5	697.3	759.1
Public	470.2	512.5	468.2	589.8	593.9
Change in invetories	34.4	18.9	68.8	-220.3	-279.0
Net Export of Goods and Services	**-2320.9**	**-2592.4**	**-2162.5**	**-2394.9**	**-3000.8**
Exports	793.0	822.7	863.9	1075.3	1090.3
Imports	3113.9	3415.1	3026.4	3470.2	4091.1
Real GDP	**4,878.3**	**5,239.3**	**5,724.5**	**6,421.4**	**6,797.3**
	Percent of GDP				
Domestic Absorption	**147.5**	**149.5**	**137.8**	**137.3**	**144.2**
Final Consumtion	**125.8**	**127.7**	**118.7**	**120.7**	**128.3**
Private	105.4	105.6	95.6	93.1	98.5
Public	20.4	22.1	23.1	27.6	29.8
Gross Investment	**21.7**	**21.7**	**19.1**	**16.6**	**15.8**
Private	11.4	11.6	9.7	10.9	11.2
Public	9.6	9.8	8.2	9.2	8.7
Change in invetories	0.7	0.3	1.2	-3.5	-4.1
Net Export of Goods and Services	**-47.5**	**-49.5**	**-37.8**	**-37.3**	**-44.2**
Exports	16.3	15.7	15.1	16.7	16.0
Imports	63.8	65.2	52.9	54.0	60.2
Real GDP	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

* It includes also NPISH final consumption.

Source: PCBS, National Accounts, Different Issues, 2013.

Table (1-12): Palestine: consumer price index (CPI), 2008-2012

(Annual Percent change)

Activity	2008	2009	2010	2011	2012
	Main Expenditure Groups				
Foods and Soft Drinks	135.0	139.9	144.6	148.1	151.3
Alcoholic Beverages and Tobacco	123.2	135.4	151.8	161.2	173.9
Textile, Clothing and Footwear	101.2	105.0	109.2	114.2	115.7
Housing	121.9	121.0	127.2	131.0	136.1
Furniture, Household Goods	104.8	112.3	115.3	115.3	116.8
Medical Care	114.1	113.7	114.8	116.3	119.9
Transportation	120.8	117.6	120.7	126.5	129.3
Communications	110.1	109.2	106.9	107.3	107.6
Recreational, Cultural Goods &Services	99.0	101.2	103.0	104.2	105.5
Education	99.8	104.2	110.5	112.8	119.0
Restaurants and Cafés	126.6	132.6	136.9	144.9	150.6
Miscellaneous Goods and Services	109.3	114.2	120.1	124.9	131.2
All-items Index	**121.0**	**124.3**	**129.0**	**132.7**	**136.4**
	Regions				
WB	120.8	121.5	126.7	131.2	136.5
GS	124.1	129.6	131.8	132.6	133.2
Jerusalem	118.1	122.3	128.7	134.1	138.4
All-items Index	**121.0**	**124.3**	**129.0**	**132.7**	**136.4**
	Inflation Rates				
WB	9.8	0.6	4.2	3.5	4.1
GS	14.0	4.4	1.7	0.6	0.5
Jerusalem	7.1	3.5	5.2	4.1	3.2
Palestine	9.9	2.8	3.7	2.9	2.8

Source: PCBS, Index of Consumer Prices, Different Issues, 2013.

Table (1-13): Palestine: labor market indicators, 2008-2012

Key Indicators	2008	2009	2010	2011	2012
Population (thousand)*					
Palestine	**3,826**	**3,935**	**4,048**	**4,169**	**4,293**
WB	2,385	2,448	2,513	2,580	2,649
GS	1,440	1,487	1,535	1,589	1,644
individuals Over 15 Years (thousand)					
Palestine	**2,118**	**2,288**	**2,376**	**2,466**	**2,557**
WB	1,374	1,469	1,523	1,577	1,632
GS	744	819	853	889	925
Labor Force (thousand)					
Palestine	**875**	**951**	**976**	**1,059**	**1,114**
WB	591	643	665	718	743
GS	284	308	311	341	371
Unemployment (thousand)					
Palestine	**227**	**234**	**232**	**222**	**256**
WB	112	115	114	124	141
GS	115	119	118	98	115
Unemployment: Percent of Labor Force					
Palestine	**25.9**	**24.6**	**23.7**	**20.9**	**23.0**
WB	19.0	17.7	17.2	17.3	19.0
GS	40.5	38.6	37.8	28.7	31.0
Broad/Relaxed Unemployment: Percent of Labor Force					
Palestine	**31.7**	**30.1**	**30.0**	**25.8**	**26.7**
WB	25.3	23.4	23.4	22.3	23.0
GS	45.0	43.8	43.7	33.1	34.2
Distribution of Palestinian workers by Region (thousand)					
Total workers	**648**	**718**	**744**	**837**	**858**
Workers in Israel	75	73	78	84	83
Workers in Palestine	573	645	666	753	775
Workers in the public sector	160	178	179	188	195
Workers in the private sector	413	467	487	565	580

Table (1-13): Cont.

Key Indicators	2008	2009	2010	2011	2012
Distribution of workers by Economic Activity (thousand)					
Agriculture and fishing	87	85	88	100	98
Industry (mining and manufacturing)	78	87	85	99	102
Constructions (build. & constructions)	71	84	98	116	123
Trade, restaurants and hotels	131	137	143	170	168
Trans., storage and communications	32	41	44	51	56
Other services and branches	249	284	286	301	311
Dependency Ratios (%)					
Palestine	**5.9**	**5.5**	**5.4**	**5.0**	**5.0**
WB	5.0	4.6	4.6	4.3	4.4
GS	8.5	7.9	7.9	6.5	6.4
Daily Average wage in NIS					
Palestine	**87.0**	**91.3**	**91.7**	**91.7**	**93.0**
WB	85.5	85.9	85.8	85.0	87.1
GS	60.9	62.7	58.1	62.5	64.4
Israel and settlements	139.7	148.1	158.0	162.2	164.0

* Mid-year Estimates
Source: PCBS, Workforce Survey, various publications.

Table (1-14): Palestine: Economic forecasts, 2013-1014

Indicators	Actual	Baseline		Optimistic Scenario		Pessimistic Scenario	
	2012	2013	2014	2013	2014	2013	2014
	(Annual percent change)						
Real GDP	5.9	5.3	5.2	11.5	13.0	-2.1	0.3
Real Percapita GDP	2.7	2.3	2.2	8.3	9.8	-4.9	-2.6
Private sector Real GDP	6.7	5.4	5.5	12.5	14.4	-3.0	-0.1
Public sector Real GDP	0.7	4.4	2.9	11.0	11.1	-3.5	-2.3
Inflation rate (%)	2.8	2.4	2.5	2.4	2.5	2.4	2.5
	(percent of GDP)						
Final Consumption	**128.4**	**123.5**	**121.4**	**119.5**	**121.6**	**126.6**	**125.3**
Private	29.8	20.1	19.5	21.2	20.4	19.6	19.1
Public	98.5	103.5	101.9	98.3	101.2	107.0	106.1
Gross Investment	**15.8**	**18.3**	**21.1**	**23.1**	**22.3**	**13.7**	**14.2**
Private	4.7	4.9	4.9	5.9	5.3	3.0	3.0
Public	11.1	13.4	16.2	17.1	17.1	10.7	11.2
Net Export	**-44.2**	**-41.8**	**-42.5**	**-42.6**	**-44.0**	**-40.3**	**-39.5**
Exports	16.0	16.5	16.3	17.1	16.8	16.1	15.9
Imports	60.2	58.4	58.8	59.7	60.8	56.4	55.4
Memorandum Items							
Real GDP (USD million, 2004=100)	6,797.0	7,157.2	7,529.4	7,578.7	8,563.9	6,654.3	6,674.2
Real per capita GDP (USD)	1,679.3	1,717.5	1,755.2	1,818.6	1,996.3	1,596.8	1,555.8
Unemployment rate (%)	23.0	23.3	23.4	21.4	21.0	24.6	24.2
Exchange rate (USD/NIS)	3.85	3.70	3.75	3.70	3.75	3.70	3.75

Source: PMA.

Table (2-1): Palestine: fiscal operations (cash basis), 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Total net revenues and grants	**3758**	**2950**	**3178**	**3153**	**3172**
Total Domestic Revenue, net	**1780**	**1549**	**1900**	**2176**	**2240**
Tax	273	302	474	482	483
Non-tax	486	284	270	220	232
Clearance Revenue	1137	1090	1243	1487	1574
Tax Refunds (-)	116	127	87	14	50
Grants and aid (external revenues)	**1978**	**1402**	**1277**	**978**	**932**
For Budgetary Support	1763	1355	1147	809	777
For development Financing	215	47	131	169	155
Total public expenditure	**3488**	**3105**	**3259**	**3257**	**3258**
Current expenditure and net lending	**3273**	**2919**	**2984**	**2961**	**3047**
Wages Expenditure	1771	1423	1564	1679	1558
Non-wage Expenditure	1055	1142	1156	1143	1212
Net lending	447	355	264	139	277
Development Expenditure	**215**	**186**	**275**	**296**	**211**
Funded from Treasury	0	139	145	127	56
Funded from grants	215	47	131	169	155
Current balance	**-1493**	**-1371**	**-1083**	**-785**	**-807**
Overall balance (Excl. grants and aid)	-1708	-1557	-1358	-1081	-1018
Overall balance (inc. grants and aid)	**270**	**-155**	**-81**	**-104**	**-86**
Financing	-270	155	81	104	86
Net financing from local banks	-277	176	84	101	132
Balance	43	21	3	-3	46
Financial gap	**0**	**0**	**0**	**0**	**0**
Exchange rate (USD/NIS)	3.59	3.92	3.73	3.58	3.85

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

Table (2-2): Palestine: government public debt, 2009-2012

(USD Million)

Items	2009	2010	2011	2012
Total Domestic Debt	**649**	**840**	**1099**	**1385**
Local banks	640	831	1090	1377
Loans	304	345	506	719
Overdrafts	257	391	441	480
Petroleum Authority[1]	78	95	143	178
Other Public Institutions Loans	10	9	9	8
Total External Debt	**1087**	**1043**	**1114**	**1098**
Arab financial institutions	551	539	617	629
Al-Aqsa Fund	444	444	522	523
Arab Fund for Economic and Social Development	55	43	43	57
Islamic Development Bank	52	53	52	50
International and Regional Institutions	371	348	342	339
World Bank	308	303	297	290
European Investment Bank	42	23	23	26
International Fund for Agricultural Development (IFAD)	4	3	3	3
OPEC	17	19	19	19
Bilateral loans	165	156	155	130
Spain	93	93	93	92
Italy	30	31	31	33
China	5	5	5	5
Sweden	25	27	26	0
Total Government Public Debt	**1736**	**1883**	**2213**	**2483**
Per capita Public Debt (USD)	441	465	531	578

(1) It represents the value of loans provided by the Ministry of Finance to support the Petroleum Authority.
Source: Ministry of Finance website.

Table (2-3): Palestine: government public debt service, 2011-2012

(USD Million)

Year	Interest Paid		Premiums		Debt Service
	Domestic Debt	External Debt	Domestic Debt	External Debt	
2011	63	3	8	-156	-82
2012	56	4	13	434	507

Source: - Ministry of Finance website.

Table (2-4): Palestine: government outstanding arrears payments, 2009-2012

(USD NIS)

Items	2009	2010	2011	2012
Wages and Salaries	171	185	374	816
Non-wage expenses	815	264	926	1046
Net lending	77	-103	0	0
Development projects	118	88	270	124
Tax refund	-140	-39	368	239
Total	**1041**	**395**	**1939**	**2226**

Source: Ministry of Finance website.

Table (3-1): Palestine: balance of payments, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Current Account (Net)	**764.4**	**-712.6**	**-690.9**	**-2,193**	**-2,814.7**
Goods (Net)	**-3,234.4**	**-3,504.4**	**-3,652.8**	**-4,626**	**-4,884**
Exports (Fob)	668.4	631.3	666.1	848	1249.6
Imports (Fob)	3,902.8	4,135.7	4,318.9	5473.9	6,133.6
Services (Net)	**-340.3**	**-351.8**	**-312.1**	**-103.6**	**-352.5**
Exports	496.1	579.3	830.7	954.6	649
Imports	836.4	931.1	1,142.8	1058.2	1,031.5
Income (Net)	**919.2**	**876.1**	**1,098.1**	**1217.2**	**1,072.4**
Receipts	922.6	955.8	1,213.2	1,358.1	1,174.1
Compensation of employees	746.2	831.1	1,077.4	1,258.9	1,051.2
Of which from Israel	655.3	730.7	991.2	1,152.7	965
Investment Income	176.4	124.7	135.8	99.3	122.8
Payments	3.4	79.7	115.1	140.9	101.7
Current Transfers (Net)	**3,419.9**	**2,267.5**	**2,175.9**	**1,319.8**	**1,379.4**
Inflows	3,572.8	2,502.0	2,476.5	1,976.9	1,649.6
To the Public Sector	1,977.8	1,484.3	1,214.2	750.5	520.2
To the Private Sector	1,595.0	1,017.7	1,262.3	1,226.4	1,129.4
Outflows	-521.2	234.5	300.6	189.4	270.2
Capital and financial Account (Net)	**521.0**	**870.5**	**800.3**	**2,155.7**	**2,832**
Capital Account (Net)	**398.8**	**719.0**	**846.1**	**536.2**	**297.9**
Capital Transfers (Net)	397.5	719.0	846.1	536.2	297.9
Inflows	397.5	719.0	846.1	536.2	297.9
Outflows	0.0	0.0	0.0	0.0	0.0
Acquisition of Non-Produced Assets (Net)	1.3	0.0	0.0	0.0	0.0
Financial account (Net)	**-920.8**	**151.5**	**-45.8**	**1,619.5**	**2,534.1**
Direct Investment (Net)	59.8	315.9	103.0	605.2	246.1
Portfolio Investment (Net)	-24.7	-367.0	-453.4	-69.5	44
Other Investment (Net)	-802.2	191.5	341.0	1,050.2	2,410
Net Errors and Omissions	**-243.2**	**157.9**	**109.4**	**36.9**	**-17.2**
Change in Reserve Assets (- = Increase)	**-152.9**	**11.1**	**-36.4**	**33.7**	**-166.0**

Source: PMA, Central Bureau of Statistics (PCBS), data series of balance of payments.

Chapter Four: Palestinian Financial Sector Developments

Part I: Palestine Monetary Authority (PMA)

Table (4-1): Palestine: banks and branches by nationality, 2008-2012

Items	2008	2009	2010	2011	2012
	Number of Banks				
Local Banks	10	10	8	8	7
Foreign Banks	11	10	10	10	10
Jordanian Banks	8	8	8	8	8
Egyption Banks	2	2	1	1	1
British Banks	1	1	1	1	1
Total	**21**	**20**	**18**	**18**	**17**
	Number of Branches & representative Offices				
Local Banks	89	104	110	118	121
Foreign Banks	101	105	102	108	111
Jordanian Banks	93	98	95	101	104
Egyption Banks	7	6	6	6	6
British Banks	1	1	1	1	1
Total	**190**	**209**	**212**	**226**	**232**

Source: PMA.

Table (4-2): Palestine: financial inclusion indicators, 2008-2012

Items	2008	2009	2010	2011	2012
Branches & representative Offices (number)	190	209	212	226	232
Large ceties	166	175	176	187	193
Urban areas	24	34	36	39	39
Deposit accounts (number)	1,947,265	2,011,242	2,185,779	2,545,459	2,715,338
Customer deposits (USD million)	5,486.9	6,296.8	6,802.4	6,972.5	7,484.1
Personals	4,705.7	4,859.7	5,002.9	5,324.3	5,457.5
Corporates	546.2	870.9	1116.9	1063.6	1,406.4
Public sector	595.0	566.1	682.7	584.5	620.2
Credit Portifolios (USD million)	1,828.2	2,234.2	2,885.9	3,552.7	4.199.1
Personals	930.2	869.5	1,275.6	1,351.9	1,628.7
Corporates	365.3	727.3	772.1	1,099.9	1,163.0
Public sector	532.7	637.4	837.3	1,100.8	1,407.4
ATM's (number)	240	305	335	378	435
Point of sales (number)	1,248	1,745	2,314	3,658	3,926
Credit cards (number)	18,017	29,082	37,374	47,046	56,835
Credit cards (number)	233,795	285,228	308,962	354,352	410,536
ATM withdrawel cards (number)	62,180	68,185	71,684	101,728	122,379

Source: PMA.

Table (4-3): PMA: assets and liabilities, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Deposits of banks and financial institutions	1091.3	1189.7	1056.1	917.1	992.1
Required reserves	537.7	549.1	615.5	672.7	753.4
Other accounts	553.7	640.6	440.6	244.4	238.7
Provisions	12.8	13.6	14.2	17.3	18.9
Capital and reserves	79.6	80.9	85.7	89.3	92.1
Paid capital	45.0	50.0	54.7	58.5	61.4
Reserves	34.6	30.9	31.0	30.8	30.7
Other liabilities	3.6	7.7	8.5	9.8	10.6
Assets = Liabilities	**1187.4**	**1291.9**	**1164.5**	**1033.5**	**1113.7**
Domestic assets	**194.5**	**253.2**	**195.7**	**194.9**	**166.3**
balances with banks in Palestine	145.1	200.2	154.4	164.8	165.3
Current deposits	21.5	49.2	14.8	4.2	8.9
Time deposits	123.6	150.9	139.6	160.6	156.4
Islamic investments	49.5	53.0	41.3	30.1	0.0
Financial investments held to maturity	0.0	0.0	0.0	1.0	1.0
Foreign assets	**977.0**	**1024.4**	**933.3**	**808.4**	**917**
Balances with banks abroad	688.6	722.5	685.7	450.3	662.4
Current and demand deposits	9.4	14.3	39.3	69.7	69.5
Time deposits	679.2	708.2	646.4	380.6	592.9
Islamic investments	182.0	102.5	99.0	98.7	66.8
Financial investments held to maturity	106.5	199.4	148.6	158.3	87.4
Investment portfolio for trade	0.0	0.0	0.0	100.1	100.4
Fixed assets*	**5.5**	**5.5**	**7.6**	**9.1**	**10.2**
Government loans	**5.7**	**4.6**	**3.5**	**3.4**	**3.4**
Other assets	**4.7**	**4.3**	**24.4**	**17.7**	**16.8**

* Includes development projects under processing.

Source: PMA.

Table (4-4): PMA: profit and loss statement, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Revenues	**24.8**	**15.8**	**25.6**	**18.6**	**17.5**
Net interest and investment revenue	24.1	15.3	14.5	15.9	13.6
Other revenues	0.7	0.5	1.1	2.7	3.9
Payback provisions	0.0	0.0	10.0	0.0	0.0
Expenditure	**8. 6**	**9.2**	**20.4**	**14.5**	**14.5**
Employee expenses	6.6	6.9	7.4	9.5	10.1
Administrative expense	1.4	1.9	2.1	2.1	2.5
Depreciation and Capital expenses	0.4	0.4	0.6	0.5	0.6
Development projects' expenses	0.1	0.0	0.0	0.0	0.0
Financial Follow-up Office expenses	0.0	0.0	0.3	0.4	0.5
Expenses for doubtful debts	0.0	0.0	10	2.0	0.8
Excess of revenue over expenditure in regular activities	**16.2**	**6.6**	**5.2**	**4.1**	**3.0**
Amendments of previous years	0.0	0.1	0.04	-0.03	-0.1
Expenses of the money seizure case	0.8	1.7	0.6	0.2	0.01
Net excess of revenues over Expenditure	**15.4**	**5.0**	**4.7**	**3.8**	**2.9**

Source: PMA.

Table (4-5): PMA: employees distribution, 2009-2012[1]

Items	2009			2010			2011			2012		
	Ramallah	GS	Total	Ramallah	GS	Total	Ramallah	GS	Total	Ramallah	GS	Total
Governor's Office	7	2	9	9	2	11	17	3	20	18	2	20
Security and Public Safety Office	10	17	27	8	18	26	8	18	26	8	18	26
Financial Follow-up Unit	6	0	6	7	0	7	10	0	10	11	0	11
Independent Offices	**5**	**4**	**9**	**7**	**4**	**11**	**9**	**3**	**12**	**8**	**3**	**11**
Ombudsman	-	-	-	-	-	-	-	-	-	-	-	-
Ethics	-	-	-	-	-	-	-	-	-	-	-	-
Legal Counsel	1	1	2	1	1	2	3	1	4	2	1	3
Internal Audit	4	3	7	6	3	9	6	2	8	6	2	8
Core Departments	**144**	**69**	**217**	**97**	**29**	**126**	**122**	**29**	**151**	**122**	**28**	**150**
Monetary Stability Group	16	6	22	16	6	22	27	4	31	26	3	29
Research & Monetary Department	11	1	12	10	1	11	16	2	18	15	1	16
Monetary Operations Department	5	5	10	6	5	11	11	2	13	11	2	13
Financial Stability Group	63	23	86	81	23	104	95	25	120	96	25	121
Supervision and Inspection Department	54	17	71	66	17	83	63	15	78	66	15	81
Payment System Department	9	6	15	15	6	21	17	4	21	14	4	18
Consumer Relations & Market Conduct Department[2]	-	-	-	-	-	-	15	6	21	16	6	22
Supporting Departments	**65**	**40**	**105**	**71**	**40**	**111**	**66**	**47**	**113**	**81**	**40**	**121**
External Relations Department	2	2	4	1	2	3	2	2	4	6	2	8
General Services Department	30	20	50	32	20	52	21	29	50	31	21	52
IT Department	12	6	18	15	6	21	16	5	21	20	6	26
Human Resources Department	10	4	14	10	4	14	12	3	15	11	3	14
Finance Department	11	8	19	13	8	21	15	8	23	13	8	21
Total	**172**	**92**	**264**	**199**	**93**	**292**	**240**	**92**	**332**	**248**	**91**	**339**

[1] Consultants or employees with contracts are not included.
[2] Established in 2011.
Source: PMA.

Table (4-6): PMA: staff training courses, 2008-2012

Items	2008	2009	2010	2011	2012
Governor's Office	5	6	10	12	14
Security and Public Safety Office	12	8	15	5	6
Independent Offices	**10**	**11**	**13**	**18**	**22**
Legal Counsel	1	-	3	4	4
Internal Audit	4	6	6	9	8
Financial Follow-up Unit	**5**	**5**	**4**	**5**	**10**
Core Departments	**77**	**96**	**95**	**127**	**140**
Monetary Stability Group	20	16	22	39	55
Research & Monetary Department	15	8	13	23	26
Monetary Operations Department	5	8	9	16	29
Financial Stability Group	57	80	73	88	85
Supervision and Inspection Department	33	43	28	53	47
Payment System Department	11	20	20	17	10
Consumer Relations & Market Displent Department	13	17	25	18	28
Supporting Departments	**72**	**43**	**47**	**68**	**76**
External Relations Department	5	4	3	4	11
General Services Department	20	8	11	15	14
IT Department	14	9	12	17	18
Human Resources Department	15	9	8	8	14
Finance Department	18	13	13	24	19
Total	**176**	**164**	**180**	**230**	**258**

Source: PMA.

Part II: Banking Sector

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

(USD Million)

Items	2008	2009	2010	2011	2012
Total assets	**7,640.4**	**8,091.0**	**8,798.4**	**9,337.4**	**10,044.5**
Cash and Precious Metals	346.2	534.9	542.8	496.7	731.1
Due from PMA and Banks (Total):	4674.0	4185.1	3949.3	3743.7	3673.1
Due from PMA	1110.7	1214.7	1074.8	940.9	998.9
Due from banks in Palestine	285.7	143.6	252.4	335.3	370.5
Due from banks abroad	3277.7	2826.8	2622.0	2467.5	2303.7
Securities portfolio for trade and investment	217.9	554.2	577.4	830.8	745.3
credit facilities	1828.2	2234.2	2885.9	3550.7	4199.1
Banking acceptances	6.2	3.9	3.6	5.9	5.3
Investment	133.3	140.6	355.5	143.6	148.7
Fixed assets	237.3	268.1	282.7	326.1	346.5
Other assets	197.3	170.1	201.3	240.1	195.4
Total Liabilities	**7,640.4**	**8,091.0**	**8,798.4**	**9,337.4**	**10,044.5**
Due to PMA and Banks (Total):	442.9	381.4	420.6	646.5	723.0
Due to PMA	157.8	208.8	160.0	178.9	173.1
Due to banks in Palestine	266.0	153.1	204.6	304.7	349.3
Due to banks abroad	19.0	19.5	56.1	162.9	200.6
Customer deposits	5846.9	6296.8	6802.4	6972.7	7484.2
Executed and outstanding acceptances	21.0	12.4	15.3	16.2	10.0
Equity (net), of which:	853.0	958.9	1092.6	1184.5	1257.5
Paid-up capital	633.3	730.3	809.6	874.6	894.8
Legal reserve	40.6	58.2	82.5	95.8	108.4
Declared reserves	11.2	11.2	29.4	45.0	57.1
General reserves for banking operations	29.3	35.0	46.9	57.7	75.3
Undistributed profits	12.8	16.8	8.6	9.2	4.4
Unrealized profit (loss) on long-term investment	37.7	41.9	9.2	2.3	-6.1
Tax provisions	51.0	73.5	90.3	107.2	111.2
Other provisions	290.5	271.2	268.4	287.6	322.2
Other liabilities	135.2	96.8	108.7	122.8	136.4

Source: PMA.

Table (4-8): Palestinian banking sector: profit and loss statement, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Interest received	299.1	234.1	247.2	312.8	349.1
Interest paid	75.5	34.4	26.3	35.3	42.5
Net interest income	223.6	199.7	220.9	277.5	306.6
Net commission income	40.1	52.7	61.9	77.3	73.1
Net debt securities and investments	-3.9	16.2	51.7	2.4	8.2
Net currency exchange and appreciation transactions	29.1	29.0	24.7	26.0	24.6
Net off-balance-sheet items	1.9	1.7	0.7	0.4	0.6
Net expenses and other operating incomee	2.3	4.2	8.5	8.6	6.7
Total non-interest income	69.5	103.8	147.5	107.0	113.2
Total income from all operations	293.1	303.5	368.4	384.5	419.8
Operating expenses	173.8	184.7	201.3	218.6	231.1
Net Provisions	3.1	-15.5	-4.7	2.1	20.2
Net extraordinary profit and loss	0.5	0.0	0.7	0.0	0.0
Net income before taxes	115.7	134.3	171.1	163.8	168.5
Taxes	32.2	31.1	32.6	34.9	44.3
Net income after taxes	**83.5**	**103.2**	**138.5**	**128.9**	**124.2**

Source: PMA.

Table (4-9): Palestinian banking sector: customer deposits, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
	Depositing Party				
Public sector, of which:	595.0	566.1	682.6	584.5	620.2
Palestinian National Authority	467.9	413.2	534.1	473.1	473.3
Private sector, of which:	5251.9	5730.7	7119.8	6388.0	6864.0
Resident	5121.0	5412.4	6947.8	6192.3	6621.3
	Region				
WB	4955.7	5370.9	6019.6	6194.2	6696.7
GS	891.2	925.9	782.8	778.3	787.5
	Type				
Current deposits	2064.0	2353.8	2680.6	2773.0	2984.4
Savings deposits	1389.6	1669.8	1844.2	2027.1	2266.7
Time deposits	2393.3	2272.2	2277.6	2172.4	2233.1
	Currency				
USD	2600.5	2697.4	2853.4	2718.5	3063.2
JD	1588.0	1786.7	1852.5	1801.4	1740.4
NIS	1290.8	1465.8	1728.9	2115.8	2323.5
Others	367.6	346.9	367.6	336.8	357.1
Total	**5846.9**	**6296.8**	**6802.4**	**6972.5**	**7484.2**

Source: PMA.

Table (4-10): Palestinian banking sector: direct credit facilities, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
			Beneficiary		
Public sector, of which:	532.7	637.4	837.2	1101.1	1407.5
Palestinian National Authority	515.9	627.2	821.2	1098.9	1402.9
Private sector, of which:	1295.5	1596.9	2048.7	2449.6	2791.6
Resident	1165.9	1449.0	1990.8	2326.3	2749.2
			Type		
Loans	1114.2	1562.9	1978.0	2531.7	2950.2
Overdrafts	703.7	663.6	900.4	1010.3	1238.0
Finance lease	10.3	7.8	7.5	8.7	10.9
			Region		
WB	1626.5	2059.2	2680.8	3251.3	3767.6
GS	201.7	175.1	205.1	299.4	431.5
			Currency		
USD	1190.2	1427.1	1756.6	2245.9	2255.0
JD	147.5	218.7	246.2	420.9	549.6
NIS	474.3	579.0	866.7	863.7	1367.6
Others	16.2	9.5	16.4	20.2	26.9
Total	**1828.2**	**2234.3**	**2885.9**	**3550.7**	**4199.1**

Source: PMA.

Table (4-11): Palestinian banking sector: direct credit facilities provisions, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Loans	57.4	44.2	34.7	37.6	48.3
Overdrafts	54.1	32.0	27.0	31.5	28.7
Finance lease	0.0	0.0	0.6	0.6	0.6
Total Provisions	111.5	76.2	62.3	69.9	77.6
Direct Credit Facilities, net	1716.6	2158.1	2823.6	3480.8	4121.5
Total Direct Credit Facilities	1828.2	2234.3	2885.9	3550.7	4199.1
Outstanding interests	46.1	24.0	13.7	14.4	16.1
Non-Performing Loans	148.0	92.0	88.5	103.9	98.6

Source: PMA.

Table (4-12): Palestinian banking sector: sectoral distribution of private sector's loans, 2009-2012

Items	2009		2010		2011		2012	
	Value USD Million	Percent (%)	Value USD Million	Percent (%)	Value USD Million	Percent (%)	Value USD Million	Percent (%)
Real estate, constructions, and lands	221.5	16.7	331.6	19.9	411.5	17.5	631.1	22.6
Industry and mining	184.8	11.6	257.9	12.6	303.7	12.3	173.8	6.2
General trade	341.3	21.4	392.2	19.1	489.6	20.0	503.2	18.0
Agriculture and livestock	38.6	2.4	45.3	2.2	33.7	1.4	35.1	1.3
Services	521.3	32.6	576.8	28.2	434.2	17.7	409.3	14.7
Consumer goods financing	133.6	8.4	230.0	11.2	535.5	21.8	897.0	32.1
Others	110.9	6.9	138.1	6.8	220.7	9.2	142.4	5.1
Total	**1596.8**	**100.0**	**2048.6**	**100.0**	**2451.8**	**100.0**	**2791.7**	**100.0**

Source: PMA.

Table (4-13): Palestinian banking sector: lending and depositing rates, 2008-2012

(Quartarly average, Percent)

Period	Lending Rates According To			Depositing Rates According To		
	JD	USD	NIS	JD	USD	NIS
2008	**9.04**	**7.47**	**12.04**	**1.98**	**0.8**	**1.04**
Frist Quarter	9.15	7.66	12.10	3.17	1.38	1.60
Second Quarter	9.01	7.22	12.19	1.76	0.76	0.98
Third Quarter	8.98	7.38	11.84	1.68	0.72	1.02
Fourth Quarter	9.04	7.63	12.04	1.32	0.36	0.58
2009	**7.45**	**6.19**	**10.99**	**1.91**	**0.41**	**0.24**
First Quarter(1)	8.93	6.82	11.92	2.04	0.54	0.21
Second Quarter	7.95	6.57	11.55	2.04	0.38	0.24
Third Quarter	6.31	5.59	10.33	1.86	0.36	0.27
Fourth Quarter	6.60	5.78	10.15	1.69	0.34	0.23
2010	**7.54**	**6.33**	**10.93**	**1.15**	**0.29**	**0.30**
Frist Quarter	7.53	6.30	10.79	1.22	0.29	0.25
Second Quarter	7.42	6.05	11.02	1.19	0.30	0.29
Third Quarter	7.59	6.29	10.88	1.13	0.30	0.30
Fourth Quarter	7.64	6.71	11.03	1.05	0.27	0.34
2011	**7.59**	**6.79**	**11.72**	**1.22**	**0.33**	**1.01**
Frist Quarter	6.8	6.27	12.85	1.11	0.3	0.58
Second Quarter	7.87	6.84	11.26	1.18	0.3	1.06
Third Quarter	7.91	6.84	11.15	1.22	0.31	1.10
Fourth Quarter	7.80	7.19	11.60	1.37	0.4	1.29
2012	**8.11**	**6.97**	**11.29**	**1.7**	**0.46**	**1.22**
Frist Quarter	7.70	7.08	11.53	1.55	0.41	1.02
Second Quarter	7.74	6.98	11.28	1.66	0.46	1.26
Third Quarter	7.58	6.37	11.09	1.58	0.43	1.25
Fourth Quarter	9.40	7.44	11.28	2.01	0.53	1.37

(1) Until 1st quarter 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, 2008-2012

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)
checks presented for clearing										
2008	156,694	1,804.84	93,695	614.04	2,392,999	5,706.09	5,145	143.34	2,654,224	8,268.31
2009	171,838	1,945.32	91,182	532.42	2,798,708	5,554.51	6,669	71.23	3,068,397	8,103.48
2010	192,309	2,193.16	103,848	579.54	3,322,381	6,671.10	6,880	107.50	3,625,508	9,551.30
2011	196,789	2,743.26	112,551	915.00	3,734,636	8,001.42	6,279	235.00	4,050,255	11,894.68
2012	187,928	1,918.36	106,938	596.21	3,987,948	7,058.57	4,791	76.53	4,287,605	9.629.67
Bounced checks										
2008	16,085	69.25	14,425	26.02	285,448	463.12	247	1.95	316,205	560.34
2009	16,386	79.72	12,882	30.05	326,611	439.20	162	1.51	356,041	550.48
2010	17,233	71.21	13,001	29.11	345,058	496.70	164	1.78	375,456	598.80
2011	21,196	76.00	15,653	32.00	451,160	650.00	153	1.00	488,162	758.00
2012	24,272	72.44	16,062	33.59	478,561	570.05	179	1.06	519,074	677.14

Source: PMA.

Part III: Non-Banking Financial Insititutions

Table (4-15): Palestine: performing indicators of specialized lending institutions, 2008-2012

Items	2008	2009	2010	2011	2012
Institutions (number)	9	9	10	10	8
Branches (number)	68	69	65	68	62
Total credit portifolio (USD million)	47.2	57.0	63.6	75.7	84.2
Loans (number)	26,763	30,809	N.A	43,409	32562
	Sectoral distributions of credits (%)				
Agriculture	23.4	24.0	25.0	26.0	20.2
Industries and crafts	11.7	13.0	13.0	16.0	10.0
Trade and services	30.1	33.0	42.0	42.0	38.5
Comsumption and others	34.8	30.0	20.0	16.0	31.3

Source: website of SHARAKAH.

Table (4-16): Palestine: money changers, 2008-2012

Items	2008	2009	2010	2011	2012
WB	154	191	215	248	234
GS	43	45	45	44	42
Total	197	236	260	292	276

Source: PMA.

Table (4-17): Palestine: palestine Exchange, 2008-2012

(USD Million)

Items	2008	2009	2010	2011	2012
Number of trading sessions	244	246	249	248	249
Number of shares traded (million)	339.2	238.9	230.5	184.5	147.3
Value of shares traded (USD million)	1185.2	500.4	451.2	365.6	273.4
Number of executed transactions	152319	88838	82625	61928	41442
Market value of shares traded (USD million)	2123.1	2375.4	2449.9	2782.5	2859.1
	Daily Averages				
Value of shares traded (USD million)	4.9	2.0	1.8	1.5	1.1
Number of shares traded (million)	1.4	1.0	0.9	0.7	0.6
Number of transactions executed	624	361	332	250	166
Turnover rate(%) [1]	**55.8**	**21.1**	**18.4**	**12.6**	**9.7**
Al-Quds index	**441.7**	**493.0**	**490.0**	**476.9**	**477.6**

[1] Turnover = turnover value of shares traded / market value of shares traded.

Source: www.pse.com.

Table (4-18): Palestine: performing indicators of the insurance sector, 2008-2012

Items	2008	2009	2010	2011	2012
Companies (number)	9	10	10	10	10
Branches (number)	79	88	103	99	111
Employees (number)	795	857	1007	1028	1035
Agencies (number)	220	225	265	239	229
Total insurance premiums (USD million)	94.3	104.3	125.8	150.5	144.5
Compensations (USD million)	51.3	56.2	66.4	75.6	88.4
Total assets/liabilities (USD million)	279.5	300.5	298.4	323.6	340.0
Paid-up capital (USD million)	53.3	55.6	62.2	63.1	67.2
Ownership equity (USD million)	75.7	84.5	95.6	101.1	108.8

Source: www.pcma.ps.