



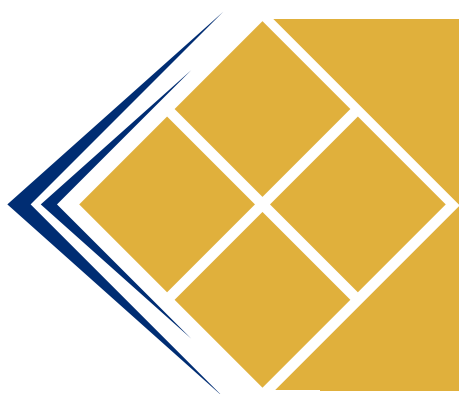
PALESTINE MONETARY AUTHORITY



# Annual Report 2013



PALESTINE MONETARY AUTHORITY



# Annual Report 2013

Research and Monetary Policy Department  
September, 2014



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## **Our Vision**

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




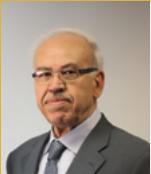

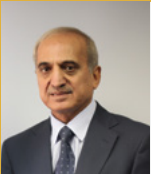



## **Our Mission**

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







	<b>Dr. Jihad Alwazir</b>	Governor and Chairman
	<b>Dr. Shehadah Hussein</b>	Deputy Governor
	<b>Mr. Ibrahim Barham</b>	Board Member
	<b>Dr. Ismail Elzabri</b>	Board Member
	<b>Dr. Bashir Rayyes</b>	Board Member
	<b>Dr. Taalib Sarie</b>	Board Member
	<b>Dr. Samir Abdullah</b>	Board Member
	<b>Mr. Issa Kassis</b>	Board Member
	<b>Mr. Farid Ghannam</b>	Board Member



## Foreword

On behalf of the PMA, I am honored to present the current issue of the Annual Report, which PMA publishes to fulfill its duty to: make data and well-documented information based on analysis and monitoring of economic performance available, and carry out its macroeconomic role to secure financial and monetary stability and contribute to the promotion of sustainable economic growth.

The Report is issued during a period marked by many regional and international economic and political developments that adversely affect economic performance of many countries worldwide. There are also concerns over the effectiveness of policies to stimulate economic growth and fears that new crises may erupt with serious negative consequences for the world economic system.

Locally, the sluggish national economy has been affected by international and regional developments, but was mainly buffeted by restrictions and impediments imposed by occupation, the financial and liquidity crises of the Palestinian government, and the continued political impasse. All these raise concerns over the Palestinian economy's ability to achieve sustainable growth rates. However, the banking system is considered an exception. Its performance indicators reveal PMA's success in maintaining overall financial stability, particularly the stability of banks operating in Palestine within a high-risk environment.

This Annual Report comprises four sections dealing with (i) developments and prospects of the local and global economies; (ii) the Palestinian public finance sector; (iii) the external sector, including developments in Palestine's foreign trade, balance of payments and the status of foreign investment; and (iv) the Palestinian financial sector, including PMA's most important achievements, and developments of all institutions under PMA's direct monitoring and supervision.

It is my hope that with this Report, the PMA has succeeded in addressing the most important developments in 2013 via an analytical framework that is based on accurate data and supported by numerous statistical time series tracking the most prominent global and regional economic indicators.

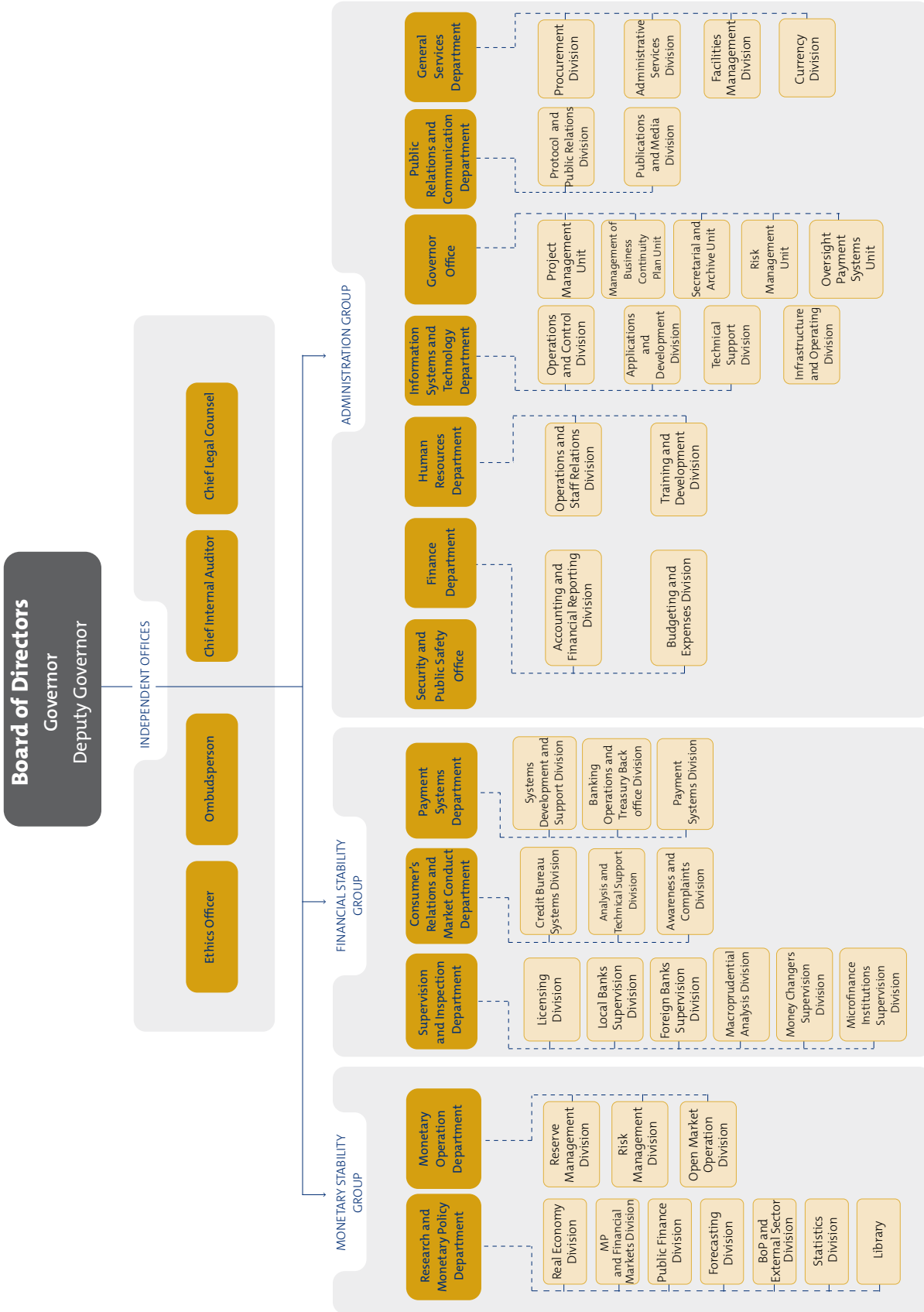
Finally, I would like to extend my gratitude to the board members of the PMA and all its employees for their diligent efforts to realize the PMA's goals and its aspirations to become the central bank of a sovereign and independent Palestinian state. I would also like to express my gratitude to Arab, regional and international institutions for their continuous support to the PMA and the local financial and banking system, thereby bolstering the Palestinian citizen's steadfastness and adherence to his/her land and fostering the process of sustainable development in Palestine.



  
Governor

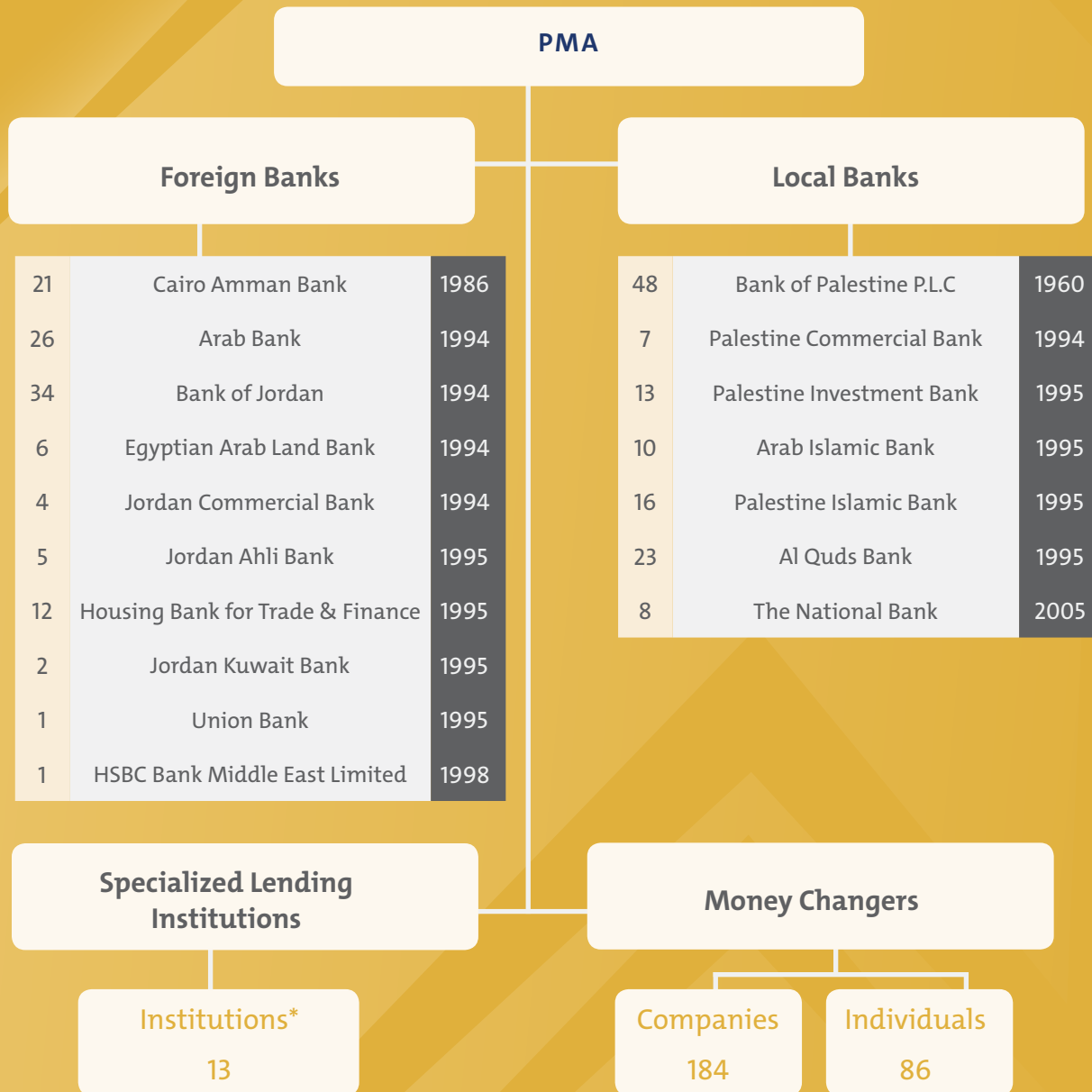
Dr. Jihad Khalil Alwazir

# PMA organization chart





## Palestinian banking system institutions 2013



\* Number of institutions and programs operating in Palestine, of which 6 has got a preliminary license from the PMA.

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

# Abbreviations

AEs	Advanced Economies
AFI	Alliance for Financial Inclusion
BoD	Board of Directors
BoP	Balance of Payments
CPI	Consumer Price Index
ECB	European Central Bank
EDEs	Emerging and Developing Economies
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GS	Gaza Strip
IBAN	International Bank Account Number
IIP	International Investment Position
IMF	International Monetary Fund
JD	Jordanian Dinar
MENA	Middle East and North Africa
MoF	Ministry of Finance
NIS	New Israeli Shekel
PA	Palestinian Authority
PBI	Palestinian Banking Institute
PCMA	Palestine Capital Market Authority
PCBS	Palestinian Central Bureau of Statistics
PDIC	Palestine Deposit Insurance Corporation
PEX	Palestine Exchange
PMA	Palestine Monetary Authority
RTGS	Real-Time Gross Settlement System
USD	United States Dollar
WB	West Bank
WEO	World Economic Outlook
WIR	World Investment Report



During 2013 the Palestinian economy continued to suffer as economic slowdown persisted for the second consecutive year. Growth recorded a distinct decline to 2.1 percent compared with 5.9 percent in 2012 and 12.2 percent in 2011. Underlying this economic slowdown is the notable decline in growth rate in the West Bank (WB), which fell from 5.6 percent to 0.7 percent between 2012 and 2013. The growth rate in Gaza Strip (GS) fell from 6.6 percent to 6.3 percent for the same period. The slowdown in growth in the WB can be attributed to a set of factors, most prominent among which are the persistent weakness in the public sector and the inability of the private sector to support national economic development. Additional factors include the Israeli measures, restrictions and impediments, the continuous construction of settlements, not to mention the political uncertainty and its impact on investor confidence. With regard to GS, the socio-economic situation remains unchanged, and the ongoing siege and blockade continue. Additionally, closure of Rafah crossing continues, which adversely affects commercial exchange between Gaza and Egypt. The slowdown resulted in the reduction of real GDP per capita in Palestine to USD 1,664.8, reflecting a 2.0 percent decline in the WB and a relative improvement by 2.7 percent in GS, recording USD 2,051.4 and USD 1,103.9, respectively.

Likewise, world economy underwent a slowdown driven by the failure of the euro area to avoid economic contraction and the sluggish economic growth in the USA, both negatively impacting global economic performance. Weak demand in advanced economies (AEs) has also resulted in deceleration of economies of emerging markets and developing economies (EDEs), which negatively impacted global economic growth. Data reveal that world economy slowed down during 2013 to 3.0 percent from 3.2 percent in 2012, reflecting deceleration of economic growth of AEs from 1.4 percent in 2012 to 1.3 percent in 2013. Similarly, EDEs slowed down from 5.0 percent in 2012 to 4.7 percent in 2013. Economic slowdown was accompanied by a drop in global inflation rate to 3.3 percent in 2013 down from 3.6 percent in 2012. The drop in inflation for AEs between 2012 and 2013, from 1.9 percent to 1.3 percent, led to decline in global inflation, despite the increase in prices in EDEs from 6.2 percent to 6.3 percent during the same period. On the other hand, unemployment levels exhibited different trends across countries. Whereas unemployment declined in USA, levels of unemployment increased across the euro area (EA) and stabilised around their previous levels across EDEs.

Despite the improvement of world economy in the second half of 2013, economic decline risks loomed, especially given increasing uncertainties regarding the efficacy of monetary policies and continued decline of prices in the EA, in addition to US economy's inability to attain the desired economic recovery. At the same time, EDEs are challenged with numerous risks that raise fears of further economic slowdown, particularly in light of weak monetary policy performance and deteriorating investor confidence in economic recovery. Yet, it is expected that the world economy will start to recover gradually with the beginning of 2014, particularly in developed countries and specifically in the EA, ultimately reflecting positively on world economy as a whole.

In the region, Israeli economy slowed down from 3.4 percent in 2012 to 3.3 percent in 2013. The current events in Egypt and ensuing political instability weakened the Egyptian economy slightly as growth fell from 2.2 percent in 2012 to 2.1 percent in 2013. Meanwhile, the Jordanian economy witnessed a slight improvement following economic reforms as the growth rate increased from 2.7 percent in 2012 to 3.5 percent in 2013.

On the other hand, prices in Palestine sustained low and relatively contiguous levels of inflation in the past five years, albeit dropping notably in 2013. Inflation rate decreased to 1.7 percent during 2013, compared with 2.8 percent in 2012. Geographically, inflation rate in the WB declined from 4.1 percent to 3.1 percent between 2012 and 2013, whereas in GS it fell to -0.8 percent in 2013 from 0.5 percent for 2012. The disparity in inflation rates between the WB and GS causes a regional difference in purchasing power. Purchasing power of real wages earned by workers in the WB declined by approximately 0.9 percent during 2013, while in GS despite price decreases, a larger decrease in workers' nominal wages resulted in a decline in their

purchasing power by around 1.2 percent in 2013. The disparity in the inflation rate between the WB and GS led to variation in purchasing power of both the new Israeli shekel and the US dollar in both areas. Thus, the purchasing power of the new Israeli shekel in the WB dropped by 3.1 percent compared to a drop of 9.4 percent for the US dollar; whereas in GS, the purchasing power of the new Israeli shekel rose by 0.8 percent compared with a 5.5 percent rise for the dollar.

Unemployment rates continued to climb during 2013 for the second consecutive year, following a relative recovery in 2011. The unemployment rate rose to 23.4 percent (of total labor force) compared with 23.0 percent in 2012, owing to an unemployment rate increase in GS between 2012 and 2013 from 31.0 percent to 32.6 percent combined with an unemployment rate decrease in the WB from 19.0 percent to 18.6 percent for the same period.

The balance of payments (BoP) current account recorded a deficit of USD 1,317.4 million in 2013, thereby constituting 11.0 percent of gross domestic product (GDP), compared to a deficit of 27.5 percent of GDP in 2012. The decline in the current account deficit is mainly attributed to a decline in the trade balance deficit, which recorded USD 4,877.0 million constituting 41.0 percent of GDP in 2013, compared with 51.1 percent in 2012. In addition, a rise in the value of current transfers contributed to the decline of the current account deficit, financing around 46.2 percent of the trade deficit in 2013, compared to 26.2 percent in 2012. Financial and capital account achieved a surplus of USD 1,265.5 million during 2013, and constituting 11.0 percent of GDP as compared to 28.0 percent in the previous year. The drop can be mainly attributed to a decline in net flows of other investment (currency and deposits).

On another note, deficit of fiscal balance (before subsidies) recorded an increase of around 2.2 percent in 2013 because of the marked increase in the volume of tax refunds and wages and salaries expenditure. Moreover, accumulated government arrears rose by around 30.2 percent between 2012 and 2013 mainly because of increase in the value of non-wage expenditure arrears. On the other hand, public debt fell by around 4.3 percent during 2013 as compared to the previous year to reach around USD 2,376.2 million. Likewise, public debt fell from 24.2 percent of GDP in 2012 to 19.9 percent in 2013.

In 2013, the Palestine Monetary Authority (PMA) continued to make notable achievements in many areas, which positively affected the performance and stability of banks operating in Palestine amid international and regional political and economic crises and in a high-risk local environment. PMA continued to support the infrastructure of the banking system and maintain client confidence, including by passing the Palestine Deposit Insurance Corporation (PDIC) Law, commencing implementation of the second phase of the IBAN project, extending the Real-Time Gross Settlement (RTGS) to settle net transactions in the financial market (PEX) through BURQA system, founding a Payment Systems Monitoring Unit, developing the Clearing System and opening an account for the Palestinian government with the PMA in order to prepare for issuance of government bonds. As a result of these measures, financial indicators for the Palestinian banking system improved noticeably. Thus, banks' assets increased, customer deposits grew, credit facilities rose in size and quality, and the capability of the system to confront anticipated risks developed.

Financial indicators for banks operating in Palestine reveal that banks' total assets have increased to USD 11,190.7 million by end of 2013, indicating an increase of 11.4 percent over end of 2012. Credit facilities portfolio recorded a rise of around USD 281.1 million, increasing by 6.7 percent from end of 2012 to reach USD 4,480.1 million. This indicated the enhanced role of intermediation between surplus and deficit units of the economy and the increased provision of financing opportunities, thereby contributing to economic development. Moreover, customer deposits reached USD 8,303.7 million, increasing by 10.9 percent over 2012, while bank system equity rose by 8.2 percent to USD 1,359.9 million.

Overall, PMA maintained concerted efforts to become a modern full-fledged central bank. In that respect, PMA bolstered its capital for the purpose of enhancing its risk management capabilities and to overcome risks pertaining to exercising its authorities and responsibilities. PMA equity rose by 2.2 percent at the end of 2013 to reach USD 94.1 million because of an increase in paid-in capital by around 3.2 percent and the transfer of its realized profits to the capital account.



## Main Indicators of Palestinian Economy, 2009-2013

Indicator	2009	2010	2011	2012	2013
Output and Prices	(Annual percent change)				
Real GDP (2004 market prices)	7.4	9.3	12.2	5.9	2.1
Real Per Capita GDP	4.3	6.1	8.9	2.7	-0.9
Inflation rate, Palestine	2.8	3.7	2.9	2.8	1.7
West Bank	0.6	4.2	3.5	4.1	3.1
Gaza Strip	4.4	1.7	0.6	0.5	-0.8
Unemployment Rate	(Percent of labor force)				
Palestine	24.6	23.7	20.9	23.0	23.4
West Bank	17.7	17.2	17.3	19.0	18.6
Gaza Strip	38.6	37.8	28.7	31.0	32.6
Broad definition, Palestine	30.1	30.0	25.8	26.7	27.0
West Bank	23.4	23.4	22.3	23.0	22.4
Gaza Strip	43.8	43.7	33.1	34.1	35.7
Consumption, Investment and Saving	(Percent of real GDP)				
Final Consumption	127.7	118.7	120.7	128.3	125.0
Public	105.6	95.6	93.1	98.5	95.7
Private	22.1	23.1	27.6	29.8	29.3
Gross Fixed Capital Formation	21.7	19.1	16.6	15.8	14.3
Public	11.6	9.7	10.9	11.2	9.9
Private	9.8	8.2	9.2	8.7	8.4
Domestic Saving	-27.8	-27.6	-19.7	-28.3	-25.0
Public Finance	(Percent of nominal GDP)				
Total Net Revenue and External Aid	43.9	38.1	32.3	31.0	30.8
Domestic Revenue (net)	23.0	22.8	22.3	21.9	19.4
Tax	4.5	5.7	4.9	4.7	5.0
Non-tax	4.2	3.2	2.3	2.3	2.1
Clearance Revenue	16.2	14.9	15.2	15.4	14.2
Tax refund (-)	1.9	1.0	0.1	0.5	1.9
Foreign Aid	20.9	15.3	10.0	9.1	11.4
Total Expenditures	46.3	39.2	33.3	31.8	28.7
Current Expenditures and Net Lending	43.5	35.9	30.3	29.7	27.3

Indicator	2009	2010	2011	2012	2013
Wage Expenditure	21.2	18.8	17.2	15.2	15.2
Non-Wage Expenditure	17.0	13.9	11.7	11.8	10.3
Net Lending	5.3	3.2	1.4	2.7	1.8
Development Expenditures	2.8	3.3	3.0	2.1	1.4
Current Balance	-20.4	-13.0	-8.0	-7.9	-7.8
Overall Balance (Excl. Foreign Aid)	-23.2	-16.3	-11.1	-9.9	-9.2
Overall Balance (Inc. Foreign Aid)	-2.3	-1.0	-1.1	-0.8	2.2
Government Public Debt	25.8	22.6	22.6	24.2	19.9
<b>External Sector</b>	<b>( Percent of nominal GDP)</b>				
Exports of Goods and Services	18.0	18.0	22.6	18.5	19.1
Imports of Goods and Services	75.4	65.6	73.0	69.9	60.0
Income From Abroad, net	13.0	13.2	11.7	10.5	10.9
Of which: compensation of employees	12.4	12.9	11.4	10.3	10.8
Current transfers, net	33.7	26.1	13.8	13.5	18.9
Of which: to public sector	22.1	14.6	7.4	5.1	9.0
Current Account	-10.7	-8.3	-24.9	-27.4	-11.1
<b>Monetary Sector</b>	<b>(Annual percent change)</b>				
PMA Assets	8.9	-9.9	-11.2	7.8	6.7
Banks Assets	6.0	8.7	6.1	7.7	11.3
Direct Credit Facilities	22.2	29.2	23.0	18.3	6.7
Of which: to the private sector	23.3	28.3	19.6	14.0	11.4
Customer Deposits	2.3	8.0	2.5	7.3	11.0
Of which: from the private sector	9.1	6.8	4.4	7.5	11.1
Balances Abroad	-13.8	-7.2	-5.9	-6.6	16.4
Ownership Equity	12.4	13.9	8.4	6.2	8.1
Of which: paid-up capital	15.3	10.9	8.0	2.3	3.7
<b>Memorandum Items</b>					
Real GDP (USD Million, 2004 = 100)	5,239.3	5,724.5	6,421.4	6,797.3	6,942.7
Nominal GDP (USD Million)	6,719.6	8,330.6	9,775.3	10,254.6	11,942.9
Al-Quds Stock Market Index (point)	493.0	490.0	476.9	477.6	541.5
Average Exchange rate (USD/NIS)	3.92	3.73	3.58	3.85	3.61



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## **Chapter One**

### Local and Global Economic Developments





## Part I

### Local Economy

#### Overview

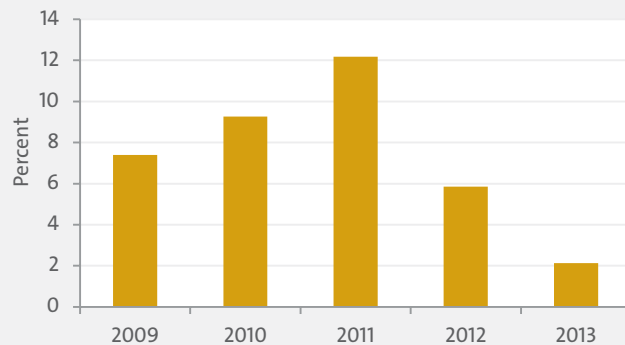
The Palestinian economy operates within an environment that poses numerous internal and external threats and challenges. External challenges are manifold. These include: (i) numerous restrictions by Israeli occupation on Palestinian trade (internal and external closures) and on freedom of movement and access (as related to Palestinian workforce in Israel, and fluctuations in Israel's economic growth and level of demand, Israel being the main trading partner for Palestine); (ii) vagaries of foreign aid inflows; and (iii) a multi-currency financial system dependent on monetary policies pursued by USA, Jordan and Israel and the exchange rate of the Israeli currency. Internal challenges include uncertainty and absence of clear political and economic prospects, the faltering performance of the private sector as an engine of economic growth, especially in view of the limited role of the public sector and its inability to serve as key driver of long-term growth.

These factors gave rise to many economic shocks and caused notable fluctuations in trade, investment flows, and economic activity and growth. Thus, Palestinian economic performance momentum, like in all economies, heavily depended on freedom of movement and access for individuals, goods and capital.

In recent years, the increased intensity of these shocks aggravated their impact on economic performance, particularly during 2013 when the Palestinian economy witnessed further slowdown of growth, and higher unemployment rates and inflation. Yet, PMA forecasts indicate better prospects for 2014, with a slight improvement in economic performance, concurrent with an increased inflation rate and a persistent high level of unemployment.

Palestinian economy experienced a slowdown for the third consecutive year, following a period of steady growth that started in 2007. Data published by the Palestinian Central Bureau of Statistics (PCBS) show that the slowdown intensified during 2013, with real growth rate of just 2.1 percent against 5.9 percent in 2012 and around 12.2 percent in 2011. As a result, real GDP rose to around USD 6,942.7 million<sup>[1]</sup>. The resultant slowdown reflected divergent tracks of growth in the WB and GS. In the WB, economic activity suffered a sharp decline, falling from 5.6 percent in 2012 to around 0.7 percent, with real GDP of about USD 5,064.4 million. In the GS, the slowdown was less notable falling from 6.6 percent in 2012 to 6.3 percent, with real GDP of around USD 1,878.3 million.

Figure 1- 1: Real economic growth rates, 2009-2013



Source: Palestinian Central Bureau of Statistics (PCBS), national accounts.

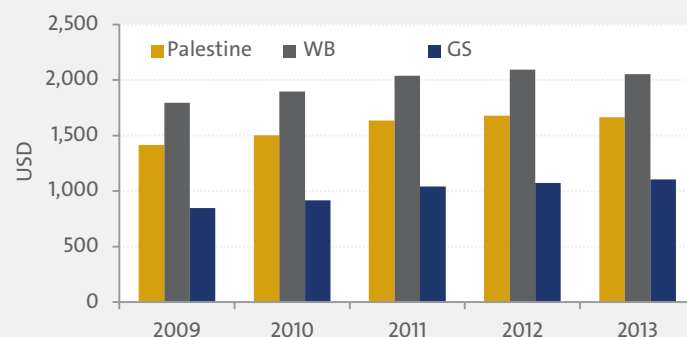
This slowdown is attributed to a number of factors. The most prominent among these in the WB are political and economic instability, and a weak private sector unable to support economic growth in view of the declining performance of the public sector. Additional factors include the Israeli measures which curbed economic capability, and prevented achievement of high and sustainable levels of economic growth. As for GS, in addition to the ongoing economic siege imposed by Israel, the slowdown is attributed to the deterioration of relations with Egypt, which impacted mostly adversely trade (the destruction of a large number of tunnels and the repeated closure of the border crossing) but also all aspects of the GS economy at large.

Changes in the level of GDP per capita are used to indicate welfare levels in a given country, as they reveal the real effect of economic growth on individual income, taking population growth rate into account. In that context and as a result of the economic slowdown, real GDP per capita retreated during 2013 by around 0.9 percent below 2012 to reach USD 1,664.8.

Despite an increase in real GDP per capita in GS and a decrease in real GDP per capita in the WB

during 2013, the inter-regional income gap persisted. In GS, real GDP per capita reached USD 1,104.0 recording an increase of 2.7 percent over the previous year, whereas GDP per capita in the WB reached USD 2,051.4 (almost twice the figure of GS) declining by about 2.0 percent below 2012.

Figure 1- 2: Per capita real GDP, 2009-2013



Source: PCBS, national accounts.

Narrowing the expanding income gap between the WB and GS, which persistently grew over the years, entails that the GS economy achieve sufficiently higher economic growth rates than those attained in the WB. This can only be realized if the GS adopted and implemented appropriate strategies and development plans.

[1] PMA estimates based on unpublished PCBS preliminary data for 2013, subject to change and revision.

## Box 1: Most significant challenges facing the Palestinian economy

The National Development Plan for the years 2014-2016 exposed manifold internal and external challenges impeding Palestinian development endeavors. Most prominent of these are:

### Israeli occupation

Israeli occupation is the most dangerous threat to Palestinian development endeavors. The occupation continues to impose both a strict siege on Gaza and restrictive controls on vast areas of the Palestinian land in the WB, especially on Area “C” and East Jerusalem. It continues to uphold the separation wall, construct settlements, confiscate land and seek to isolate and Judaize East Jerusalem and the holy sites. The occupation also controls the Palestinian people’s resources including borders, agricultural land, natural wealth and skies. It tears land apart, restricts trade and movement and subordinates Palestinian economy to the Israeli economy.

In this context, a report published recently by the World Bank noted that more than half the land in the West Bank, mostly agricultural lands and lands rich in natural resources and heritage sites, is inaccessible to Palestinians, which leads to losses estimated at about USD 3.4 billion. On the other hand, the report estimated GDP would rise by an additional 35 percent if businesses and investment were to be allowed to develop in Area “C”, which would reduce aid dependency, transform the economy as well as improve prospects for sustainable development.

### Internal Political and Administrative schism

Despite the relative easing of tension as a result of the termination of the split between the WB and GS in the second quarter of 2014, the legacy of the schism continues to cast its shadows on the economy, making the realization of progress towards independence and sovereign statehood more difficult. Tackling many complicated and interrelated problems concerned with achieving balanced development in all regions of Palestine, combating poverty and providing social services were rendered extremely arduous by the schism. Also the legacy of the schism has resulted in confused planning and murky financial responsibilities, thus jeopardizing the interests of the Palestinian community as a whole. Moreover, the paralysis of the Legislative Council prevented the adoption by both regions of the country of a modern and unified legislative system that is in compliance with international standards.

### Deterioration of general economic situation and the financial crisis

In light and as the result of the political situation, Palestine has witnessed a deterioration of general economic conditions, as evidenced by a decline of growth rates, rise in unemployment and poverty, impoverishment of a large stratum of Palestinian people, drop in investment and a rise in trade deficit. This deterioration resulted from Israeli policies and measures, including restrictions and curbs imposed on the movement of individuals and goods, control of crossings, and obstruction of access and investment of natural and heritage resources located in Area “C” and East Jerusalem. Furthermore, a strict siege has been imposed on GS since 2008 which obstructed trade exchange between GS and the WB, (particularly imports of construction material vitally essential for GS economic activity). Indicators showed large fluctuations in overall economic growth rates. Thus real GDP in Palestine achieved a growth of 12.2 percent in 2011 but plunged to 5.9 percent in 2012. The strong growth during 2011 is attributed to a high growth rate in GS which registered 23.0 percent mainly as a result of donor-funded construction projects, compared to 5.2 percent in the WB, mainly driven by the growth in the services sector rather than the productive sectors. On the other hand, the decline in growth rates in 2012 was mainly the result of the fluctuation in foreign aid to Palestine and the drop in private investment. Moreover, the external current deficit for 2012 rose to around 44 percent of nominal GDP, denoting the degree of exposure of the Palestinian economy to foreign economies, particularly Israel’s. Data published by PCBS indicate the continued decline in growth of GDP to around 2.1 percent in 2013 as compared to 2012, as a result of the stagnant political and economic situation in Palestine. PMA forecasts a growth rate of 2.4 percent, 1.8 percent and 1.5 percent for 2014, 2015 and 2016, respectively.

The economic slowdown has aggravated the government's money liquidity difficulties and inability to settle its financial obligations and accumulating arrears. It also led to a rise in the level of indebtedness, which reached USD 4.265 billion by the end of 2013 representing 35 percent of nominal GDP. On one hand, the indebtedness increase was a consequence of the abusive Israeli policy of arbitrarily withholding tax revenues, and on the other, the insufficiency of foreign aid flows and funding (the Arab financial safety net included) for development projects. Likewise, the economic slowdown adversely affected revenues collected for the Palestine's treasury including local tax, customs, VAT and non-tax revenues. In order to rectify the situation, the government sought short-term loans from banks operating in Palestine leading to the allocation of a large fraction of donor funds to service these debts. The accumulation of arrears gravely affected the Palestinian economic growth as it froze cash liquidity flows, undermined trust in the government and increased purchase costs.

### Poverty and unemployment

The existent political and economic situation had a negative impact on the living standards of the population. Efforts have been exerted to reinforce social cohesion, realize social and economic justice and equality of opportunity, bridge the inequality gaps between gender and age population groups on one hand and various communities and geographical regions on the other. Yet, poverty, unemployment and a widening social gap continue to pose major challenges to comprehensive and sustainable development of the Palestinian society. Based on monthly consumption patterns, poverty levels among individuals remain high at 25.8 percent, with a huge disparity between the WB and GS with levels of 17.8 percent and 38.8 percent, respectively. Amongst the poor, 12.9 percent suffer extreme poverty at 7.8 percent in the WB and 21.1 percent in GS, which multiplies the burden of social protection programs and intensifies the demand for basic social services.

There is a strong correlation between unemployment and poverty. During 2013, unemployment rate among work force participants reached 23.4 percent, revealing a wide discrepancy between the WB and GS, where rates recorded for the same period were 32.6 percent and 18.6 percent respectively. Furthermore, the gender unemployment gap remains substantial. While male unemployment reached 20.6 percent, female unemployment recorded 35.0 percent. The highest unemployment rate is seen in the 15-24 age group, males and females alike, reaching 41.0 percent, at 36.9 percent for males and 64.7 percent for females. This induces a large fraction of this group to contemplate emigration, with possible dire consequences in loss of youthful human resource potential, a pillar of the Palestinian society and a cornerstone of economic growth. Women's participation in the work force is also low, necessitating concerted efforts to reduce the discrepancy, be it due to gender, age, or various population aggregations. As for poverty levels, a significant discrepancy exists between families in which household heads are workforce participants and families of non-participant household heads. For families whose household heads are non-participants, poverty levels, based on monthly consumption patterns, was 33 percent, whereas for families whose household heads were participants, poverty rate was at 24.2 percent. Comparing employed and unemployed workforce participants, poverty rate for individuals in families whose heads were unemployed reached 48.4 percent, greatly surpassing the rate for individuals in families whose heads were employed which stood at 21.9 percent.

In conclusion, the most prominent challenges facing the Palestinian policy-maker lie in combating economic slowdown and promoting economic growth in view of the government's financial weakness and the current economic difficulties.

Sources:

The National Development Plan 2014-2016-, Ministry of Planning and Administrative Development, January 2014.

Palestine Monetary Authority (PMA)

Access to Area C Key to Economic Recovery, World Bank, December 13, 2013.

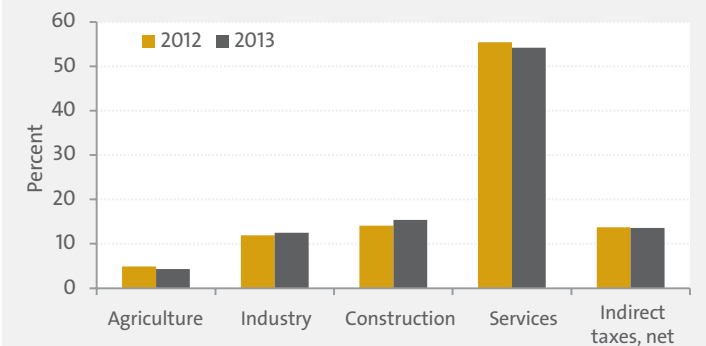
The Palestinian economy is a service economy, controlled by services activities<sup>[2]</sup> which account for a large portion of GDP. Moreover, the performance of the services sector broadly affects and characterizes total economic performance. During 2013, this sector contributed around 54.2 percent to real GDP, while productive sectors contributed 32.2 percent (15.4 percent for construction, 12.5 percent for manufacturing, and 4.3 percent for agriculture) and indirect taxes<sup>[3]</sup> 13.6 percent of GDP.

On the supply side of GDP, the performance of the industrial sector witnessed an improvement at 7.2 percent compared to 2012, and the construction sector grew by 12.1 percent, while performance of the agriculture sector dropped by 10.1 percent and likewise the service sector saw a slight decline by 0.2 percent. Performance analysis of service activities indicates that certain activities achieved growth: around 10.3 percent for transport and storage sector and 7.5 percent for financial and insurance activities. By contrast, the performance of other activities slowed down, by 1.4 percent for wholesale and retail trade and by 5.7 percent for information and communication as compared to 2012. The decline in the performance of wholesale and retail trade and information and communication constitutes the main cause for the decline of the overall performance of the services sector<sup>[4]</sup>.

In this context, the contribution of economic activities to the growth rate<sup>[5]</sup> was, to some degree, consistent with their contribution to GDP. Analysis shows that manufacturing and construction activities constituted the main growth drivers during 2013, with 80 percent of the 2.1 percent achieved is attributable to construction, 40 percent to manufacturing and 9 percent to net indirect taxes. In contrast, agricultural and services activities thwarted growth by 23 percent for the former and 6 percent for the latter.

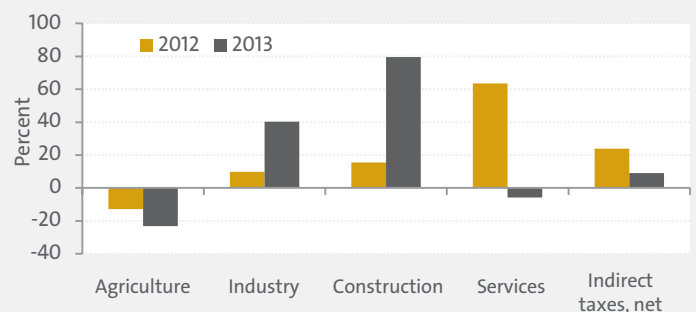
A clear discrepancy appears in the sectoral contribution to growth rates for the years 2012 and 2013, particularly for industrial activities, construction and services. In 2013, while the contribution of industry and construction

Figure 1- 3: Contribution of economic activities to real GDP, 2012 & 2013



Source: PCBS, national accounts.

Figure 1- 4: Contribution of economic activities to growth, 2012 & 2013



Source: PCBS, national accounts.

[2] Includes productive services (such as wholesale and retail trade, transportation and storage), and non-productive services (such as financial and insurance activities, information and communication, public administration and defense, and others).

[3] Includes customs duties, and value added tax (VAT) on imports (net).

[4] These activities constitute about 20.0 percent of real GDP and about 36.6 percent of service sector in 2013.

[5] The contribution of economic activities to growth rate = the growth rate<sub>t</sub> x the contribution of the activity in GDP<sub>t-1</sub>.



increased significantly, service activities shifted to a negative contribution to growth. As for agriculture, negative growth persisted for the second consecutive year, mainly due to climate fluctuations which adversely affected agricultural production, in addition to the rising costs of agricultural production as a result of numerous restrictions and impediments.

### Box 2: Estimation of output gap in Palestine

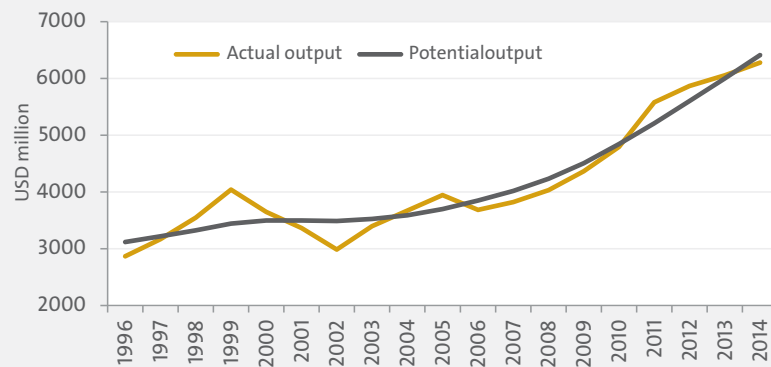
Central banks and governments rely on various indicators in the assessment and analysis of the current economic situations and the forecast of economic prospects in order to formulate appropriate general fiscal and monetary policies. The output gap is an indicator that usually receives considerable interest from central banks as it designates the difference between real and potential domestic output (percent of potential output). It also denotes the attainable level of domestic output under optimal utilization of available resources (workforce, capital and technology) of the economy. Most importantly, it is an indicator of the business cycle and an early warning of inflationary pressures, as a positive output gap relates to an increase in actual output which may signal inflationary pressures in the economy, whereas a negative output gap indicates a surplus in potential output over actual output and thereby an inefficient or suboptimal use of available resources. In both cases, monetary and fiscal policies should interact complementarily to safeguard desired levels of key economic indicators.

Several methods can be used to estimate the potential output and output gap, some relying on statistical techniques using univariate filters or multivariate filters, where a time-trend or a linear actual-output trend are computed, or actual output is analyzed into numerous series representing its various sources of change. However, these methods do not rely on economic theory nor do they take into account structural changes of the economy. Some methodologies rely on economic theory to estimate the output gap and these take into account shocks from the demand and supply side. The Cobb-Douglas production function estimation, which is based on the supply side of economics, is regarded as a most important tool to estimate the output gap under this methodology. The use of this method allows for the interpretation of the growth in actual and potential output based on the behavior of factors of production (labor, capital and technology). Moreover, this method is able to analyze the contributions of each of the components of production to the increase in potential output. However, estimation of the output gap using this method suffers from drawbacks, most important of which is the uncertainty regarding actual data which are subject to revision and alteration from time to time.

To gauge the potential output and the output gap in the Palestinian economy, the PMA carried out estimations based on statistical and economics-based methods. In view of the fact that the Palestinian economy has sustained numerous “structural change” shocks as a consequence of past political and economic circumstances, the explanation of the behavior of the potential output and the output gap solely by using statistical methods becomes difficult. Consequently, a total output function has been used to make the estimations, in order to distinguish between effects of shocks from the demand and supply side, and the effect of external shocks.

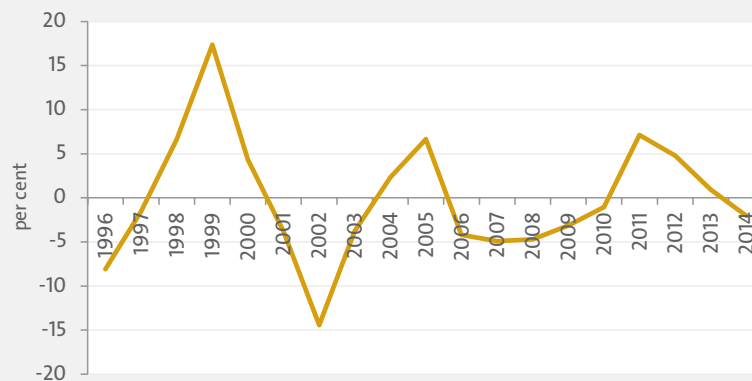
The figure below illustrates the volume of actual and potential output using factor cost in Palestine during the period (1996-2014). It is noticeable that actual output exceeds potential output during periods of political and economic stability and falls below potential output during periods of instability. In 2013, the value of potential output was estimated at around USD 6,000.8 million, while the value of actual output at factor cost stood at around USD 6,056.4 million. The value of potential output is estimated to rise to USD 6,411.5 million in 2014.

### Actual and potential output at factor cost by using production function methodology, 1996-2014



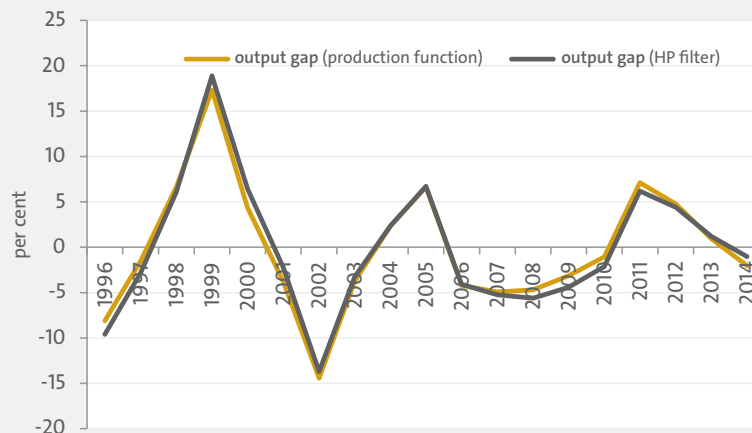
The following figure demonstrates that the volume of output gap in the Palestinian economy reached around USD 309.2 million during periods of stability, i.e. at 7.5 percent of potential output. During periods of instability, the output gap reached USD -214.8 million at 5.7 percent of potential output. In 2014, the output gap is expected to record around USD -131.1 million at 2.0 percent of potential output.

### Output gap by using production function methodology, 1996-2014



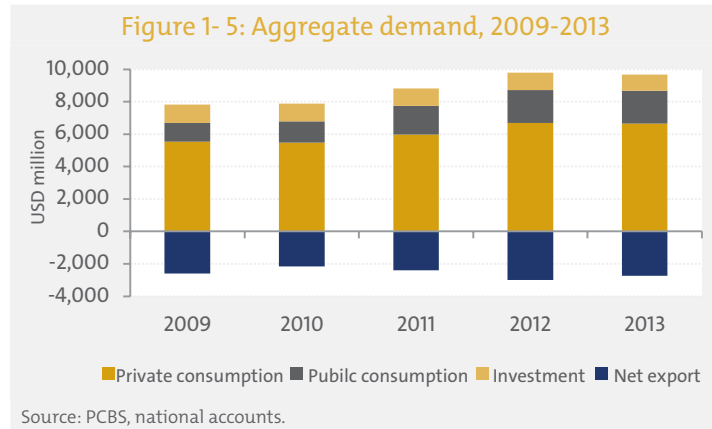
The following figure compares the output gap using production function methodology and (HP Filter) method, demonstrating that results for the two methods match to a great extent for periods during which output gap recorded negative and positive values. For 2013, output gap value was 0.9 percent using output function methodology, whereas it reached around 1.2 percent using HP Filter method. For 2014, the output gap is expected to amount to -2.0 percent and -1.0 percent for the two methods, respectively.

### Output gap by using production function and HP Filter methodology



## Aggregate demand

The year 2013 witnessed a decline in real aggregate demand of the Palestinian economy as a result of the drop in domestic demand (final consumption and investment), despite the improvement of external demand (net exports). Real expenditure on final consumption (public and private) declined by 0.5 percent against 12.0 percent growth in 2012, influenced by a 0.7 percent drop in private consumption (as a result of a 29.2 percent decrease in Non-Profit Institutions Serving Households (NPISH) final consumption and a modest increase by 0.4 percent in household consumption). In contrast, public final consumption rose slightly by 0.2 percent against 14.4 percent in 2012.



Analysis indicates that the decline in final consumption can be ascribed to the WB, in which consumption declined by 1.6 percent as a result of a 2.1 percent drop in private consumption driven by the increasing uncertainty and absence of political and economic prospects and a weak growth of public consumption by 0.1 percent. In GS, final consumption grew by 2.0 percent as a result of about 2.7 percent increase in private consumption and a 0.4 percent rise in public consumption.

During 2013, real investment dropped by 7.6 percent against around 0.7 percent in 2012, influenced by around 7.5 percent decline in investment in the construction sector in contrast to a growth in investment in other sectors by 1.2 percent. It is worth mentioning that investment in the WB and GS dropped by 6.1 percent and 16.4 percent respectively.

Likewise in 2013, private and public investment declined, with private investment falling back to around 9.9 percent of real GDP and public investment to 8.4 percent of real GDP. Additionally, inventory dropped to around 4.0 percent of real GDP.

In general, investment in Palestine experienced a slowdown over the past years specifically since 2000. Unstable political and security conditions as well as Israeli restrictions and obstacles weakened the public sector and undermined the private sector's capacity to act as a key driver of Palestinian economy, leading to foot-dragging of investors and capital flight, and hence declines and fluctuations of investment.

In the same context, it appears that the decline in real domestic demand during 2013, for consumption and investment, came in response to increasingly growing risks of uncertainty and absence of political and economic prospects. These prompted many Palestinians to reconsider their investment and consumption plans, including by postponing or replacing them with savings that may help alleviate future adverse developments.

On the other hand, poor domestic demand compelled Palestinian producers to look for new alternative markets, which resulted in a significant rise in exports by 21.7 percent and a decline in imports by 0.9 percent compared with the previous year. In summary, net exports (i.e. trade balance deficit) improved by 9.1 percent, positively impacting the domestic resource gap<sup>[6]</sup>, which fell to 39.3 percent of GDP during 2013 against 44.1 percent in 2012. Moreover, changes in external demand resulted in a decrease in imports as a share of real GDP from 60.2 percent in 2012 to around 58.4 percent in 2013 against an increase in exports share of real GDP to 19.1 percent from 16.0 percent in 2012.

It is worth mentioning that the reduction of Palestinian exports as a share of GDP is associated with several factors, mostly the weak competitiveness of Palestinian products in external markets due to high costs of production as a result of occupation, and blockade and restrictions imposed on the freedom of movement and access. To propel growth and sustainable economic development, it is imperative that appropriate measures are taken to boost the volume and value added of Palestinian exports, and increase penetration to international markets, other than the Israeli market.

Figure 1- 6: Investment as a percent of real GDP, 2009-2013

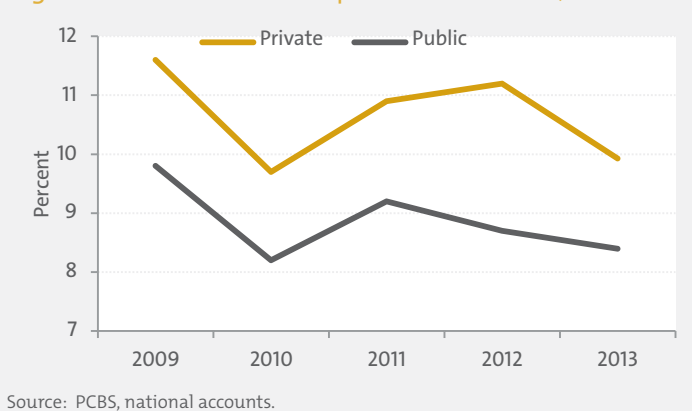


Figure 1- 7: Net exports as a percent of real GDP, 2009-2013



## Inflation, prices, and purchasing power

Analysis of consumer price index, denominated in Israeli Shekel, revealed a significant lull in price levels in Palestine during 2013 leading to a drop in inflation rate to 1.7 percent from 2.8 percent in 2012. This decline followed the same trend of decreasing inflation levels witnessed during recent years. This trend reflected mainly the decrease in the cost of imports and the falling global prices of certain goods, especially food, in addition to weak local demand in view of increased political and economic uncertainty.

Given global economic developments and price fluctuations of basic goods, inflation rate in Palestine is considered relatively low compared to international and regional inflation figures. For in 2013, inflation rate stood at 1.3 percent in developed countries, 5.8 percent in EDEs and 10.5 percent in the MENA countries. As for neighboring countries, inflation rates amounted to 5.5 percent in Jordan, 6.9 percent in Egypt and 1.5 percent in Israel.

[6] Domestic resource gap = Net export (exports – imports) as a percent of GDP.

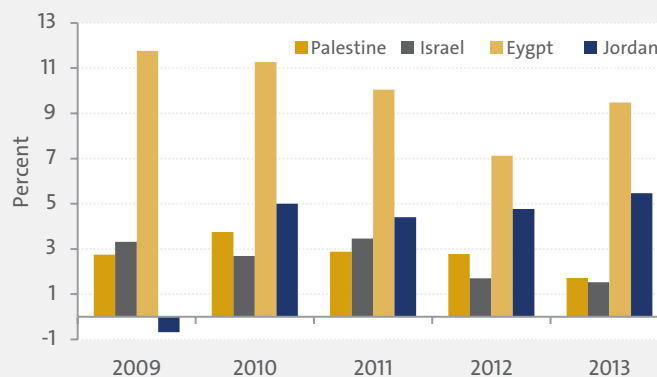
However, the inflation rate registered in Palestine in 2013 conceals regional differences. For although the price level in the WB increased by around 3.1 percent (and in Jerusalem by around 1.8 percent), it fell in GS by 0.8 percent.

The disparity in the inflation level between the WB and GS reflects the degree of inter-regional variation in economic and political conditions. For while commodity prices in the WB are primarily linked to corresponding price levels and cost of imports in Israel, prices in GS depend on the economic situation and on the prices of goods entering from Egypt. GS price levels are especially subject to fluctuations and inconsistency of inflow of goods, considering that no alternative goods come from the Israeli side due to the siege imposed on GS.

The regional price disparity also reflects the extent of fluctuations in consumer price indices of groups of goods and services within the Palestinian consumer basket. During 2013, alcoholic beverages and tobacco recorded the highest increase among all 12 categories for the second consecutive year, registering 12.4 percent (18.8 percent in WB and only 2.9 percent in GS). The rise largely reflected the decision to raise taxes on tobacco and alcoholic beverages. Likewise, the price index for education continued to surge for the second consecutive year, coming second and rising by 7.0 percent (4.0 percent for WB and 3.6 percent for GS) due to the rise in prices of all components of education services, especially university fees. Price indices also rose for housing and housing necessities and for restaurants, cafes and hotels by 3.8 percent and 3.7 percent respectively.

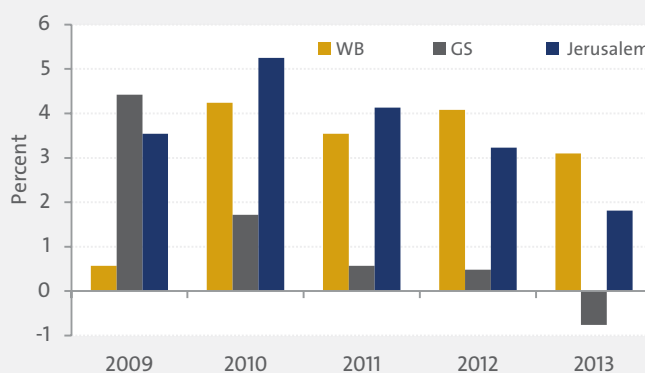
Generally, food products, housing, transport and communications groups continued to carry the largest weights for both regions, accounting for almost 60 percent of the overall weights<sup>[7]</sup> of the Palestinian consumer basket. These groups, which are classified under basic goods, account for around 60 percent of the total Palestinian

Figure 1- 8: Inflation rates, selected countries, 2009-2013



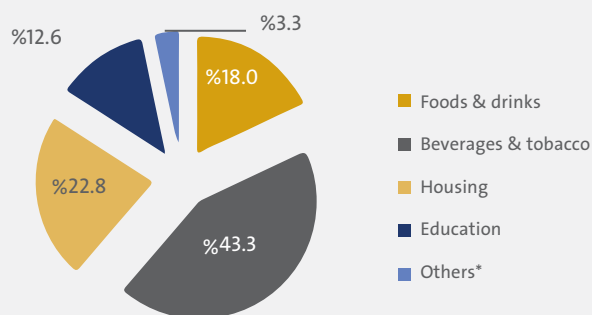
Source: PCBS, consumer price indices (CPI). IMF, WEO database.

Figure 1- 9: Inflation rates, 2009-2013



Source: PCBS, consumer price indices (CPI).

Figure 1- 10: Contribution of CPI groups to inflation, 2013



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

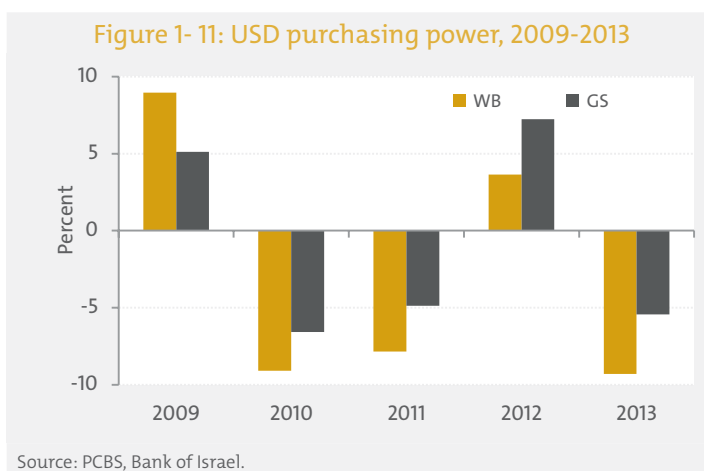
Source: PCBS, CPI.

[7] Representing the relative importance of goods and services in the consumer basket, or in the economy in general, and used to calculate the Consumer Price Index-CPI.

consumer expenditure. During 2013, food price index rose by 0.8 percent, whereas transport and communications index dropped by 0.7 percent affected by a decline in global fuel prices. The latter decline is considered the sharpest drop among all groups, followed by the decline in textile, clothes and footwear by less than 0.7 percent. The remaining groups witnessed slight or insignificant changes.

Analysis of price levels shows that of all 12 groups, four groups contributed around 96.7 percent to the rate of inflation during 2013: alcoholic beverages and tobacco (43.3 percent), housing and housing necessities (22.8 percent), food products (18.0 percent), and education services (12.6 percent). The remaining groups together contributed a mere 3.3 percent to the inflation rate in 2013.

One of the adverse effects of inflation is the decline of the purchasing power of the currency unit. Changes in inflation rates, levels of nominal wage and exchange rates (in Palestine, due to different currencies for wages and salaries) augment the effect of inflation, and act as major determinants of the purchasing power of the currency unit.



In light of the successive declines of the US dollar (or the Jordanian dinar which is pegged at a fixed exchange rate to the dollar), individuals receiving their wage in dollars (or dinars) suffered from a more considerable decline in their purchasing power, as compared to those receiving their wages in Israeli shekel. During 2013 alone, the dollar declined by about 6.2 percent with a subsequent loss of dollar purchasing power by about 7.9 percent (same applies to Jordanian dinar)<sup>[8]</sup>. Conversely, the decline in the purchasing power of the Israeli shekel was restricted to the extent of inflation rate only, i.e. 1.7 percent.

Likewise, and in view of the disparity in inflation rates in WB and GS, varying changes to the purchasing power of the currency unit appeared in both regions. The purchasing power for the shekel in WB dropped by 3.1 percent in contrast to GS, where it rose by 0.8 percent. The purchasing power of US dollar (dinar) dropped by around 9.3 percent in WB against a milder drop of 5.4 percent in GS.

## Labor force and productivity

Palestine's population in 2013 stood at about 4.4 million (2.7 million in WB and around 1.7 million in GS), an increase of about 3.0 percent over 2012; 60 percent of the population are aged over 15 (labor force). Because of the high proportion of the young in the population, the rate of labor force in Palestine is lower than in neighboring countries: for example, around 74 percent in Israel, and over 80 percent in some developed countries.

[8] Purchasing power of US dollar (or Jordanian Dinar) = inflation rate + FX change against the Israeli Shekel.

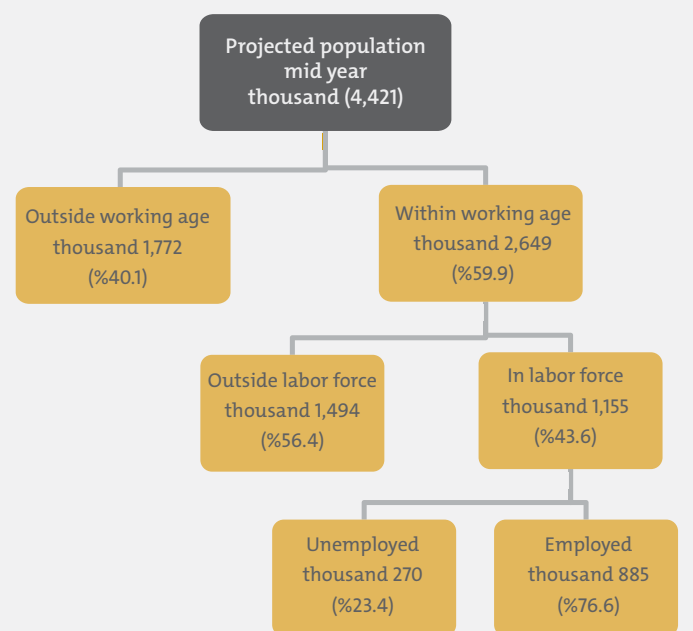
The largely young population of Palestine does not only affect the labor force rate, but also influences the participation rate in the labor market. A high student population (more than one third of the population) contributes to the high number of individuals outside the labor market, thus depressing the participation rate to around 43.6 percent (45 percent for WB and 41.2 percent for GS) during 2013, which indicates that more than half of the Palestinian society does not actually contribute to economic activity.

The low participation rate in labor force is not confined to a specific gender, location, age group or education, although some concentration appears in certain categories. As a matter of fact, female participation fell behind male participation. This disparity is evident in age 35-44 category, and is less apparent in the age group of 65 and above. During 2013, male participation rate rose slightly to 69.3 percent compared to 69.1 percent in 2012, whereas female participation declined slightly to 17.3 percent as compared to 17.4 percent in the previous year.

Male and female labor force participation rates are also influenced by age category and years of schooling. In 2013, the highest male participation rate appears in the age 35-44 category, while the highest female participation rate appears in the age 25-34 category with rates of 92.8 percent and 29.1 percent respectively. Generally, it can be said that individuals (male and female) from the 25-54 age category display the highest participation rate.

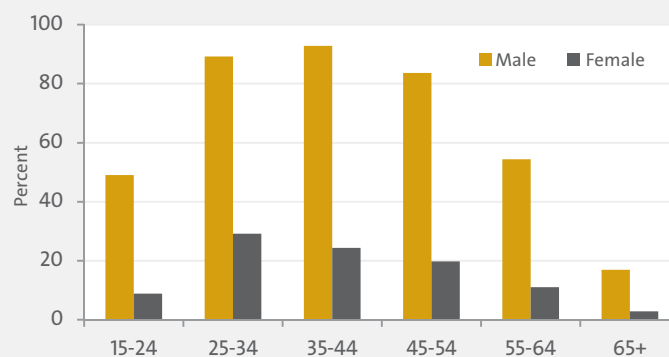
The participation rate is also affected by the level of educational achievement. Accordingly, it declines among individuals who have not attained any education to 9.9 percent and rises to 57.8 percent amongst individuals with years of schooling above 13, which is a clear indication of the correlation between educational achievement and labor force participation rate.

Figure 1- 12: Labor force framework, 2013



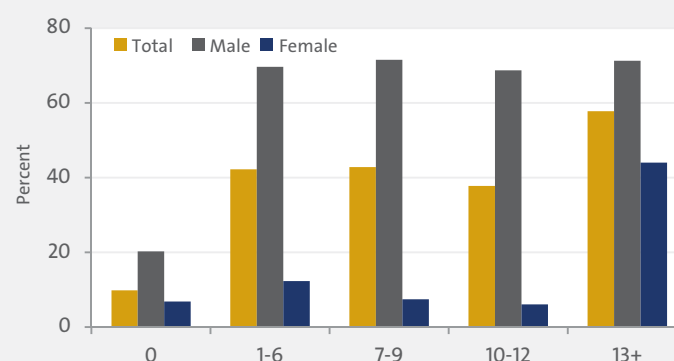
Source: PCBS, labor force reports.

Figure 1- 13: Participation rates by age and gender, 2013



Source: PCBS, labor force reports.

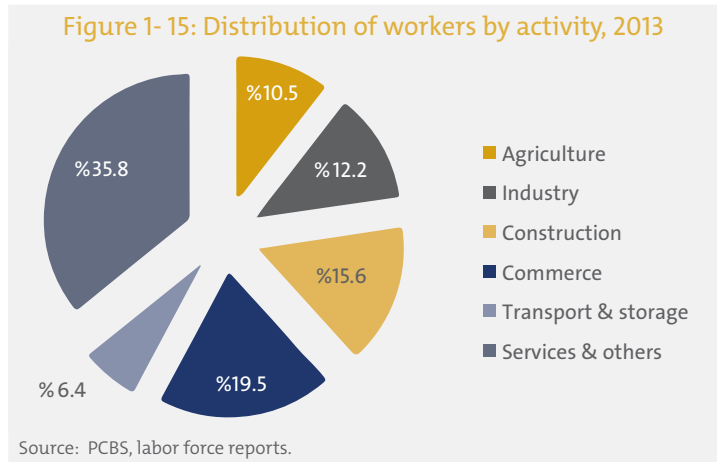
Figure 1- 14: Participation rates by sex and years of schooling, 2013



Source: PCBS, labor force reports.

## Employment

During 2013, the number of workers increased by 3.1 percent, as compared to 2.5 percent in 2012 to reach 885 thousand workers (70 percent in WB and 30 percent in GS). The public sector absorbed around 23.1 percent in WB or 103 thousand workers, compared to 37.8 percent in GS or 101 thousand workers. Meanwhile, the private sector remained the major employer, employing 65.8 percent which is equivalent to 582 thousand workers (71 percent in WB and the rest in GS). The labor market in Israel and settlements employed around 11.2 percent of total number of Palestinian workers, equivalent to 99 thousand workers, all residing in the WB; as workers from GS are still officially banned from joining the Israeli labor market since mid-2005.

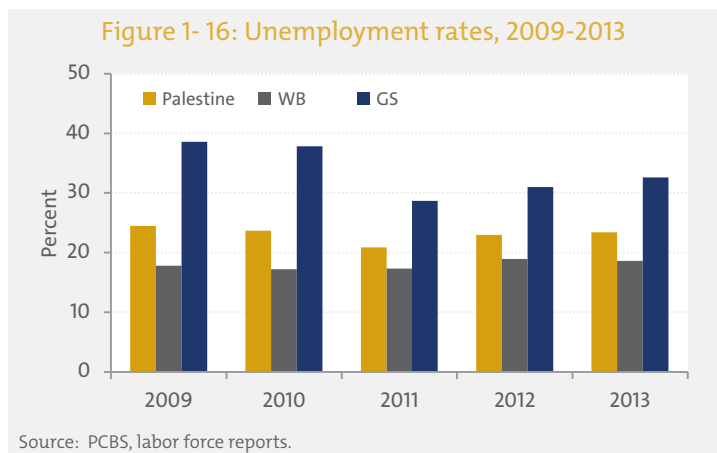


No major changes occurred during 2013 to the distribution of workers by economic activity. The general workforce structure maintained its long-standing relative stability in which the services sector retained its position as the most attractive employer with 35.8 percent of the employed. The rest were distributed across the various sectors and economic activities.

## Unemployment

Unemployment is regarded as one of the main (the most dire) challenges of economic development, particularly in developing countries. The challenge is not limited to generation of job opportunities to entrants to the labor market, but also requires the clearing of the accumulated unemployment backlog. This mission, which requires enormous efforts, is made more difficult in Palestine given the limited production capacities and low investment levels, in addition to a high population growth rate and the associated high number in the workforce.

The unemployment rate in Palestine continued to rise during 2013 reaching 23.4 percent of total labor force, compared to 23.0 percent during 2012<sup>[9]</sup>. It is worth mentioning that unemployment rate declined in WB from 19.0 percent to 18.6 percent, while it rose in GS from 31.0 percent to 32.6 percent between 2012 and 2013. The high unemployment rate in GS is attributed to the faltering economic performance as a result of the persistent siege imposed by Israel and its implications for the entire economic situation. Additionally, tensions



[9] In 2013, out of 41 thousands new entrants to the labor market, only 27 were offered job opportunity, while the remaining are became unemployed.



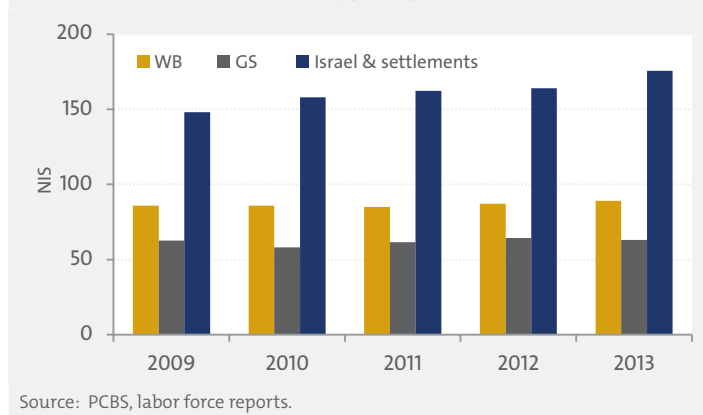
with Egypt, concomitant with a frequent closure of the Rafah border crossing, contributed to crippling the transport and commercial activity between the two sides.

Generally, the unemployment rate in Palestine remains relatively high when compared to other countries in the region, as almost one fifth of the labor force is unemployed, compared with 12.2 percent in Jordan, 13.0 percent in Egypt and 6.4 percent in Israel. It is noteworthy that unemployment rates are significantly high among females (35.0 percent) and in refugee camps, 31.5 percent (23.3 percent in WB refugee camps and 37.1 percent in GS camps).

### Average daily wage

Nominal daily wage in Palestine rose during 2013 by 4.5 percent to about 97.2 NIS on account of a rise in daily wages in the WB by 2.2 percent and in wages of workers in Israel and Israeli settlements by 7.0 percent; in contrast wages in GS dropped by around 2.0 percent. However, these changes to wages cannot be addressed in isolation from price developments and their effect on real wage.

Figure 1-17: Nominal wages for Palestinian workers (daily average), 2009-2013



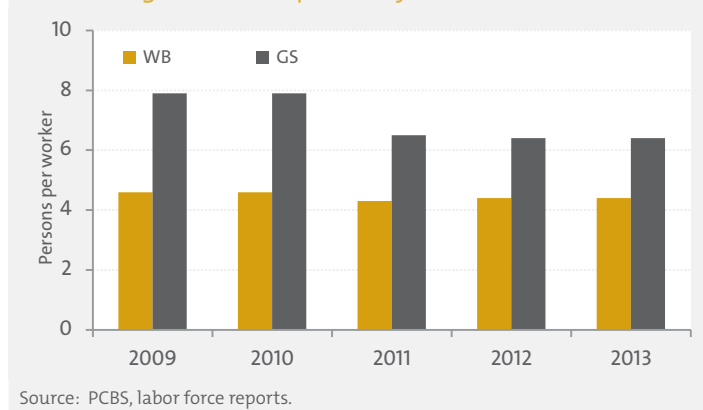
With a change in inflation rate that was less than the increase in nominal wage in 2013, real wage in Palestine increased by 2.8 percent. Nonetheless, clear regional disparities continued, with real wage erosion in the WB by around 0.9 percent due to a nominal wage increase by about 2.2 percent against a price increase of about 3.1 percent. As for workers in Israel and settlements, and in view of the larger increase in nominal wage than in inflation rate in the WB, real wage increased by around 3.9 percent. In GS, as the decrease in nominal wage was larger than the price decline, real wage eroded by around 1.2 percent.

Generally, the gap between wages in the WB and GS persisted, indicating the extent of economic disparity between the two regions where the wage of GS worker is lower by 29 percent than for his WB counterpart and by around 64 percent than for the Palestinian worker in Israel and its settlements.

### Dependency rate

The dependency ratio (the number of individuals sustained by every employed individual) is an indicator of the economic burden incurred by employed individuals. This ratio is mainly affected by the labour force number and the natural rate of population increase, since a larger increase in the former will alleviate the economic burden incurred by the employed individual.

Figure 1-18: Dependency rates, 2009-2013

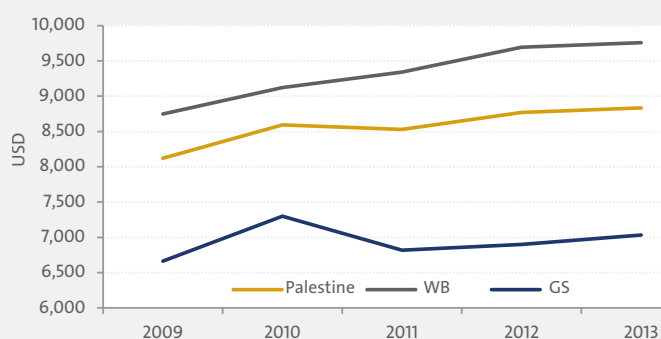


As the labor force number increased by almost the same as the natural rate of population in 2013, the dependency ratio remained unchanged from the previous year at 5.0 individuals per employed person (every employed person sustains himself in addition to four others), noting that the figure in was 6.4 in the GS and 4.4 in the WB. The lower figure for the WB reflects the decreased fertility levels<sup>[10]</sup> and therefore a decrease in the ratio of dependent individuals outside employment age, rather than the greater ability of the WB labour market to absorb workers.

## Productivity

Productivity of the Palestinian worker<sup>[11]</sup> witnessed a slight improvement by 0.7 percent during 2013 (reaching around USD 8,833 per worker), reflecting the achieved growth and the increasing number of workers. This represents a continuation of the trend of increasing Palestinian worker productivity during recent years. It is worth mentioning that the productivity of WB workers reached USD 9,758 compared to USD 7,035 for his GS counterpart, meaning that GS worker productivity stands at 72.1 percent of WB worker productivity.

Figure 1-19: Labor productivity, 2009-2013



Source: PCBS, labor force reports.

### Box 3: Social security project for private sector

Social security is a concept that is stated in the Universal Declaration of Human Rights, which in article 22 affirmed that every individual, “as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each state, of the economic, social and cultural rights indispensable for his dignity and the free development of his personality”. This means that signatories have agreed that society should support its individuals to develop their personality and enjoy maximum utilization of all benefits (education, work and social care) offered to them by their country.

From the aforesaid definition, it can be concluded that social security is a way to protect the individual against risks that threaten his/her livelihood including retirement, work injuries, old age, sickness, disability, death of the breadwinner and unemployment. In some countries, this includes family burdens as a result of marriage or having children. In other countries, the social security system targets specific risks, as in the USA which limits its social security program to the retired and disabled only. It is worthy to note that the concept of social security is distinguishable from programs like public and private insurances, as social security is a broader concept covering multiple goals and not restricted to a single threat.

[10] The average number of children that would be born to a woman over her lifetime, calculated by dividing the number of newborns in a given year over the number of women in child-bearing age (15-44 years).

[11] Productivity = Value added/number of workers.

From a Palestinian perspective, in addition to administering the existing system of public pensions, the Palestinian government, represented by the Ministry of Labor, in co-operation with the International Labor Organization (ILO) and upon consultation with employers and workers' organizations, has launched in early December 2013 a social security system aiming at adoption of a comprehensive public sector social security system by 2015. The system suggests coverage of pensions, maternity pay and work injury compensations to be financed by employers and workers. The proposal is based on the public pension system as per Law of Public Retirement No. (7), 2005, the Labor Law No. (7), 2000, ILO Social Security (Minimum Standards) Convention, 1952 (No. 102), and good international practices.

For this purpose, a national team has been formed and is currently preparing a social security draft law to be approved by the cabinet in 2015. The team encompasses all three parties: government, employers and workers and NGOs. The team's mission includes the establishment of an independent institution for social security, to include the government, the employers and representatives of the workers and NGOs for the purpose of implementing the law. The team has conducted an actuarial assessment to determine the sustainability of the system. The system proposes that workers participation should come to 7.7 percent of their monthly income, while employers contribute 10.4 percent. The system covers old age, disability, pension death benefits, death relief benefits, maternity pay and work-related injury compensations for all workers in the Palestinian private sector. The system sets retirement age at 60 years and proposes a retirement income of 45 percent of the average wage, following 30 years of paid subscription, provided that it does not fall below 50 percent of the lowest wage or twice the poverty threshold figure for a single person.

The economic importance of social security emanates from payments to beneficiaries, which form a source of income to many households, who then spend this income on goods and services. Consequently, these payments affect various aspects of the economy. Their effect is not restricted to their actual value but gets multiplied beyond their direct impact through the volume of trading exchange they generate. So these payments are akin to government spending and have similar accumulated multiplier effects.

Moreover, a social security system reinforces income stability at a national level, and positively affects production inputs, as workers who are economically secure enjoy higher productivity and increased incomes. The system also affects capital since income stability leads to stability of demand, which favourably affects investment and ultimately income.

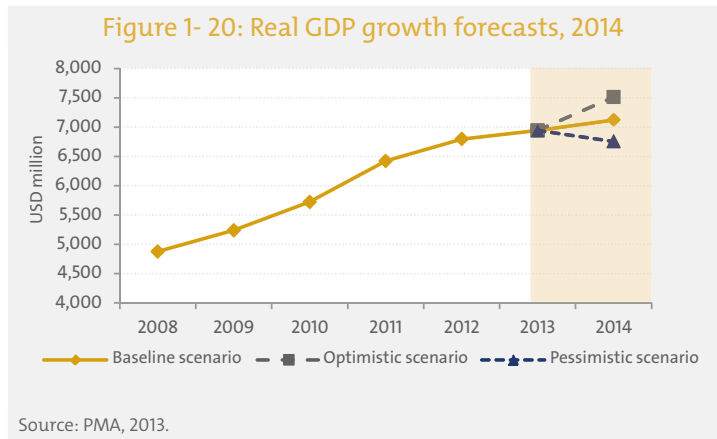
To summarize, the significance of a social security system is not merely social but also economic. Its adoption promotes social equality and welfare and contributes to rising living standards and development.

Sources:

- Palestinian Ministry of Labor, [www.mol.pna.ps](http://www.mol.pna.ps).
- Ma'an news site, [www.maannews.net](http://www.maannews.net).
- [www.ar.wikipedia.org](http://www.ar.wikipedia.org).

## Economic outlook

The PMA conducted a set of forecasts<sup>[12]</sup> for the Palestinian economy in 2014 based on three different scenarios of varying likelihoods: a baseline, an optimistic scenario and a pessimistic scenario. According to these scenarios (except for the pessimistic), the performance of the Palestinian economy is expected to see a slight improvement during 2014, following a slowdown that extended over the past three years and bottomed in 2013.



The baseline scenario assumes political and economic conditions would remain unchanged from a year earlier. The political impasse, the lack of progress in negotiations, the ongoing closure of GS crossings, the continuing restrictions on the movement of individuals and goods (including workforce in Israel and domestic and foreign trade), and the persistent fiscal policy of austerity adopted by the government in light of level of aid are the key economic woes expected to affect the outcome for 2014.

Under this scenario, PMA estimates point to a growth in real GDP by around 2.6 percent during 2014 to reach USD 7,124 million (compared with 2.1 percent growth in 2013). However, this growth will not be sufficient to improve per capita income or even sustain previous per capita levels. It is expected that real GDP per capita will diminish by around 0.4 percent during 2014 to USD 1,665 (compared with a decrease of 0.9 percent during 2013). Total consumption during 2014 is expected to rise to 126 percent of GDP (94 percent for private consumption and around 32 percent for public consumption), as compared to 125 percent in 2013. In tandem, the contribution of total investment to GDP is expected to rise to 17.7 percent (13.5 percent for private investment and 4.2 percent for public investment), as compared to 14.3 percent in the previous year. The trade deficit is expected to rise to 43.2 percent of GDP compared with 39.9 percent in 2013, as a result of the diminishing exports share (to 16.6 percent of GDP) against an increase in imports share (to 59.8 percent of GDP). The unemployment rate is expected to increase slightly to 23.9 percent of total labor force as compared to 23.4 percent for 2013. The inflation rate is expected to reach 2.2 percent as compared to 1.7 percent in 2013.

In the optimistic scenario, it is assumed that the political and economic conditions would improve substantially. In particular, it is assumed that the peace process gains momentum, peace talks make significant progress, projects are launched, restrictions on movement of individuals and goods are eased, the blockade on GS is relaxed and days of closure of GS crossings diminish, the number of workers in Israel increases, and the inflow of donor aid to fund the budget and development projects surges.

Under the optimistic scenario, real GDP in 2014 is anticipated to grow by about 8.2 percent to reach USD 7,512 million and average GDP per capita to increase by around 5.0 percent to reach USD 1,749. It is also forecasted that total consumption will drop to 121.0 percent of GDP (90.3 percent for private consumption and 30.7 percent for public consumption). At the same time, the investment share in GDP will rise to 18.4 percent (13.7 percent for private

[12] Forecasts are sensitive to any change in the official actual figures of PCBS and the Ministry of Finance.

investment and 4.7 percent for public investment). The trade deficit is expected to recede to around 39.0 percent of GDP as a result of an increase in exports share in GDP to 20.6 percent, and imports share in GDP would rise to around 59.6 percent. Unemployment rate is expected to drop slightly to 22.3 percent of total labor force while inflation rate is expected to reach 3.3 percent.

Under the pessimistic scenario, it is assumed that the political and economic situation falters notable adverse effects on economic activity. In particular, there would be a decline in the number of Palestinians working in Israel, a tightening of restrictions on movement of individuals and goods, a surge in days of closure for workers and trade, proliferation of barriers to exports and imports, withholding of tax revenues by Israel as well as a decline in foreign aid from donor countries to support the budget and development projects. Under the aforementioned scenario, real GDP in 2014 is expected to fall by 2.7 percent to around USD 6,755 million and GDP per capita would decline by 5.5 percent to USD 1,573. Total consumption is expected to fall to 123.5 percent of GDP (96.2 percent for private consumption and 27.3 percent for public consumption). Likewise, investment is expected to drop to 10.5 percent of GDP (8.4 percent for private investment and 2.1 percent for public investment). The trade deficit is expected to fall back to around 38.2 percent of GDP as a result of the drop in exports share of GDP to 15.8 percent and a drop in imports share in GDP to around 54.0 percent. The unemployment rate is expected to rise slightly to 25.3 percent of total labor force, while inflation rate is expected to reach 2.2 percent.



## Part II

# Global Economy

### Overview

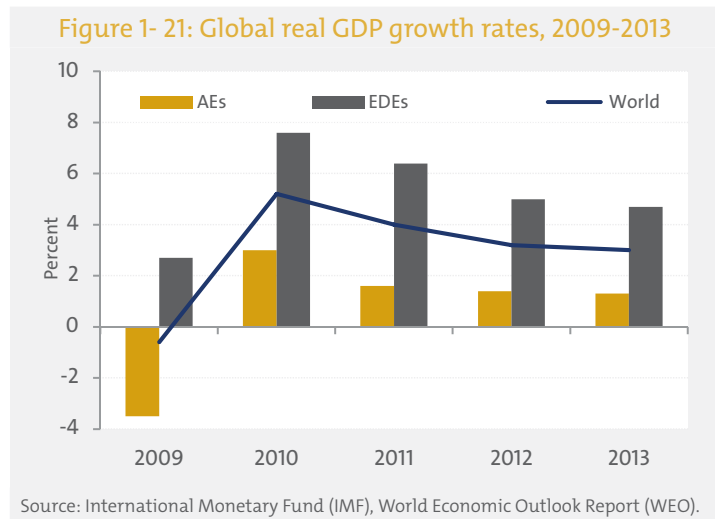
During 2013, recovery of the global economy remained fragile and vulnerable to numerous threats, as a result of the performance of US and Euro economies, which affected economies of rest of the world, particularly EDEs. Overall, developed countries appeared more capable of attaining economic recovery than EDEs, which were still struggling to recover from the economic slowdown. While the endeavors of many developed countries to rectify economic conditions succeeded to renew investor confidence (albeit not to desired levels), In EDEs, investor unease persisted, as these countries failed to arrest economic slowdown. Overall global economic performance continued to raise several concerns. In the Euro area, concern pertained to the monetary policy stance and the persistent price deflation; whereas in Japan, doubt hanged over the effectiveness of the new economic policies, which showed mixed signals of success over the year. Fears also persisted over the flexibility of EDEs' government policies and their adverse impact on domestic demand. Nevertheless, the economic outlook for 2014 stayed optimistic. Global economy is anticipated to recover gradually, supported by the recovery of developed economies, particularly in the EA, which is expected to positively impact emerging economies.

### Economic performance

Global economic performance during 2013 was affected by a number of economic and political developments. In developed countries, the USA managed to avert the fiscal cliff crisis and devise a temporary solution for its government debt ceiling crisis, which arose in the second half of the year. The Euro economy hesitantly signaled a coming out of recession. However, concerns grew over growth in EDEs, which were increasingly affected by developed countries' performance and the stagnation of external demand. Political unrest shocked many countries in the Middle East and the economic scene remained captive to political turmoil, which forced decision-makers to implement appropriate economic measures to stimulate growth.



Global economic performance followed two distinct paths during 2013: recession and stagnation in the first half of the year, and signs of recovery for many countries in the second. However, this recovery was not sufficient to curb global economic decline. Global growth averaged 3.0 percent during 2013, compared to 3.2 percent in the previous year, reflecting the economic performance of both developed countries and EDEs. Growth in developed countries declined from 1.4 percent in 2012 to 1.3 in 2013; EDEs growth also suffered, dropping to 4.7 percent from 5.0 percent in the previous year.



This growth differential affected subgroups. Among developed countries, US economy shrank to 1.9 percent from 2.8 percent in the previous year, affected by a number of crises which started with fears of the fiscal cliff and ended with the government debt ceiling crisis. In contrast, the Euro economy revealed signs of recovery, with the recession easing from -0.7 percent in 2012 to -0.5 percent, specifically driven by a picking up of the French economy. In addition, contraction in countries suffering from sovereign debt crises eased. Japan’s economy saw a slight recovery to 1.5 percent from 1.4 percent in 2012 as a result of implementing Abenomic policies<sup>[13]</sup> that aimed to stimulate economic growth, raise the inflation rate and reduce public debt.

EDEs economic performance was especially affected by the performance of the Indian and Mexican economies, compounded by the inability of the Chinese economy to accelerate its growth rate, and the sharp decline in the MENA countries’ economies because of political turmoil. Indian and Mexican economic growth rates decelerated to 4.4 percent and 1.1 percent from 4.7 percent and 3.9 percent respectively in 2012. Chinese economic growth rate averaged 7.7 percent in both 2012 and 2013, while the MENA countries could not manage to raise their growth beyond 2.2 percent, compared with 4.1 percent in 2012.

At a regional level, the Israeli economy witnessed a slight slowdown to 3.3 percent from 3.4 percent in 2012, affected primarily by a decrease in exports, due largely to an increase in the shekel value against US dollar. Similarly, the Egyptian economy slowed down to 2.1 percent from 2.2 percent in 2012, as a result of the ongoing political unrest. In contrast, the Jordanian economy showed some recovery (to 3.5 percent versus 2.7 percent in 2012), as a result of government reforms under an IMF-directed reform program.

[13] New Japanese Prime Minister” Shinzo Abe” who arrived in power at end 2012, and led a new philosophy of change geared to expansionary economic reform in Japan.





There are several economic policy instruments (both monetary and fiscal) that countries can employ to achieve the goals of stimulating the economy and maintaining low and stable levels of inflation and unemployment. The impact of these policies varies from one country to another, depending on degrees of integration and interconnection among respective economies. In this context, 2013 saw painstaking efforts by many countries to reinvigorate recovery and achieve higher levels of economic growth. In the USA and in light of low levels of interest rates, the Federal Reserve implemented, for the second consecutive year, a third round of quantitative easing program to stimulate the American economy. Against the backdrop of economic recovery in the second half of the year, the Federal Reserve reduced its monthly bond purchases and expected to end the bond-buying program by end 2014.

In the Euro Area, the adopted economic policies continued to stir debate amongst observers. On the one hand, countries maintained austerity measures in an attempt to narrow budget deficit, adversely affecting levels of expenditure and unemployment rates. On the other hand, the European Central Bank (ECB) reduced interest rates twice during 2013, which led to a drop of inflation rate below the targeted level and subsequently sparked debate concerning the ECB's role in the continuous price deflation in the Euro Area.

As for Japan, new economic policies “Abenomics” have been implemented to stimulate growth, raise inflation rates and lower sovereign debt. In comparison, China embarked on structural reforms relying on long-term growth instead of fiscal stimulus policy.

### Box 4: Japan: Abe economic policies (Abenomics)

For the past two decades, Japan suffered a number of economic woes following the early-nineties crisis known as asset price bubbles. As a result, Japan was faced with ongoing persistent stagnation, a decline in price levels, and increased external debt. By 2010, Japan had already lost its place as the world's second largest economy to China, falling to third place.

The Japanese decision-maker was forced to finally adopt a new philosophy and advocate hitherto un-attempted policies to stimulate economic growth and salvage the Japanese economy, which had been stagnating for one and half decades when Prime Minister Shinzo Abe took office in 2012. Hence, the new economic policies were collectively termed Abenomics. Abenomics were based upon three “arrows”: intensified fiscal stimulus; radical expansionist monetary policy; and structural reforms that foster the private sector, stimulate local demand and revive Japan's industrial competitiveness. The new strategy targeted a number of sectors, foremost of which was the private sector, through the introduction of a set of stimuli, particularly corporate tax cuts and infrastructure promotion to support investment. The strategy also aimed at boosting employment levels and female labor force participation. It also sought to develop the energy, agriculture, and medical care sectors. By advocating these policies, the government intended to achieve an average annual growth rate of 2 percent over a 10-year period in addition to lifting the inflation rate to 2 percent by March 2015.

Following the announcement of the new strategy, the Central Bank of Japan adopted a radical quantitative easing program and monetary base expansion and injected money in the markets in order to weaken the yen and lift inflation to the desired level. At the same time, the government undertook numerous investment projects to





reinvigorate growth. Income tax was concomitantly raised from 5 percent to 8 percent by April, to be raised again to 10 percent by end of the current year, as a means to increase domestic revenue and face budget deficit and high levels of public debt.

Upon the implementation of the new strategy, drastic changes ensued. The value of the yen against major currencies dropped significantly to its lowest level since 2008, enhancing the competitiveness of Japanese goods. Japan also succeeded to push up the inflation rate, which had been stagnating for the past 15 years; inflation thus achieved a positive value for the first time since the financial crisis. Additionally, it managed to achieve accelerating annual growth rates. As observers noted, it appears that the plan managed to enhance consumer confidence to levels that were the highest in years, thus securing an obvious increase in the popularity of the Prime Minister as leader of the reform process.

However, the optimism was not long-lived. Observers' fears over increases in income tax and raising inflation rates have materialized. They had warned that raising income tax could adversely affect levels of private expenditure, thereby reducing tax revenues, which in turn can impede growth and push the economy back into recession, in a manner similar to 1997.

Initial data for the current year show that all measures that the government undertook to evade the adverse impact on the expenditure level failed to induce consumers to increase their spending. Subsequently, the achieved restoration of consumer confidence has come under threat. The government was now confronted with the difficult decision to increase expenditure in order to counter the negative impact of private consumption decline, which will increase its already high financial burdens and expose it to a new wave of criticism over the advantages of the income tax increase.

On a different note, observers were skeptical about the source of inflation achieved in the preceding period, regarding it as a "cost-push inflation" reflecting increase in production input prices and not a consequence of increased demand for commodities and services. Consequently, its sustainability was in doubt. Furthermore, an inflation increase, which is not accompanied by a corresponding increase in real wage, will increase damages to expenditure and consumer confidence levels. Yet, it remains too early to evaluate the effectiveness of the new policies, since they are of the type that takes longer periods, usually years, to produce tangible and long-term economic effects.

In the same context, the Japanese government remains highly confident of its ability to overcome obstacles to the new strategy. However, such assurance alone will not suffice, if not backed up by investor and consumer confidence in the ability of fiscal and monetary policies to accomplish their long-term goals.

## Economic risks

The global economy's fragile recovery faced persistent and diverse risks, which had different effects across countries, depending on those countries' economic structures and development phase. In that context, IMF has observed receding risk levels in AEs, due to their economic recovery during the second half of the year, versus increasing risk levels in EDEs, owing to their failure to break out of an economic slowdown spiral.

The persistent decline in inflation levels was regarded with great concern in AEs, as price slides below desired levels can frustrate economic activity rates. Hence, countries were prompted to cut interest rate further, but even this was

considered an ineffective measure given already very low rates. On the other side, EDEs' economies faced the risk of growth continuing to slowdown, which adversely impacted investor confidence and foreign investment inflows. Also EDEs were challenged with the risk of capital flight, which could trap their economies in a vicious cycle of sluggish growth.

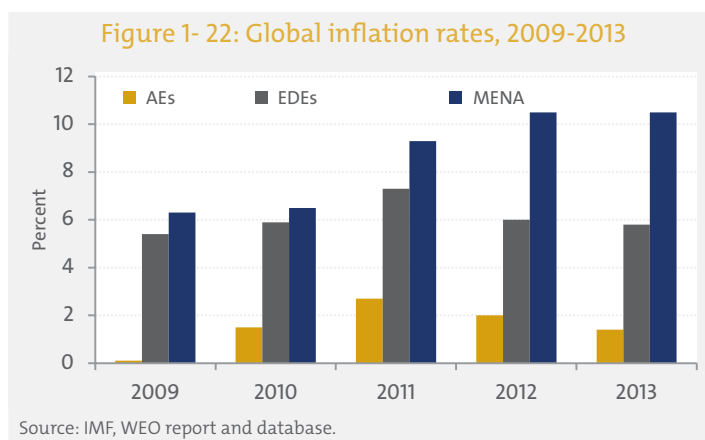
The current Russia-Ukraine crisis poses another threat to world economy. For if Russia cuts off gas supply to AEs, particularly Europe, a stiff price shock and a significant hike in production costs will ensue. This will further strain budgets of highly industrialized countries, especially Germany. Furthermore, given that Ukraine is a world top exporter of wheat and corn, the crisis would spill to EDEs as grain world prices would soar.

## Prices and inflation

The slowdown of global economy during 2013, affected world price developments. Generally, global prices reflect changes in world oil and food prices, but are also affected by several other factors like changes in levels of growth and demand, variation in countries' economic structures<sup>[14]</sup>, and different policies implemented by different country groups and the respective disparate inflation rates. Although downward trending in both AEs and EDEs, inflation rates in these groups fell by varying degrees.

During 2013, inflation rate in AEs dropped to 1.4 percent from 2.0 percent in 2012. This rate fell short of the targeted level of many AEs, particularly in the Euro Area and USA, thereby posing a challenge. Meanwhile, EDEs saw a decline in inflation rate to 5.8 percent from 6.0 percent in 2012.

For the MENA region, although inflation rates stabilized at around 10.5 percent during 2012 and 2013, they remained relatively high, influenced by political turmoil and ongoing tensions in many of the region's countries. Inflation rate exceeded 36 percent in Syria and registered 6.9 percent in Egypt, 6.1 percent in Tunisia, and 11.1 percent in Yemen. Jordan price rose by 5.5, affected by unstable conditions in both Egypt and Syria. In particular, the cut-off in Egyptian gas to Jordan pushed up fuel prices dramatically, while the burden of hosting large numbers of Syrian refugees weighed heavily on the country's resources and prices.



[14] Variation in economic structure does not solely reflect difference in composition and volume of sectors involved, but also differences in development stages. While AEs have attained maturity, and therefore have less potential to achieve high levels of growth and inflation, EDEs are still at a take-off stage, where markets and prices move actively allowing relatively high growth and inflation rates.

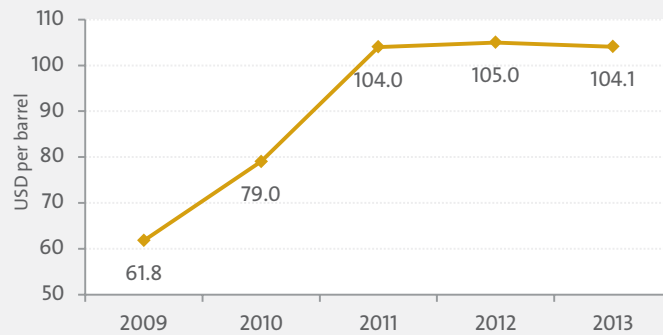
## Oil prices

Due to the economic and political developments in oil exporting and importing countries alike in 2013, global oil prices<sup>[15]</sup> witnessed profound fluctuations. With poor global economic performance and declining demand during the first half of 2013, oil price fell to about USD 99 per barrel by mid-year. However, prices soared again during the second half of the year, as political tensions in certain MENA countries (Libya for example) mounted, sparking fears of oil exports cut-offs or irregular supplies from the region.

Moreover, concerns escalated due to USA threats to wage war against Syria, and the increased demand in the Northern hemisphere during its very cold winter of 2013.

In summary, the drop in oil prices during the first half of 2013 alleviated the effect of the price rise during the second half of the year. Subsequently, prices during 2013 stabilized at a level quite similar to that of the previous year, having dropped by less than 1 percent, to around USD 104.1 per barrel.

Figure 1- 23: Crude oil prices (period average), 2009-2013

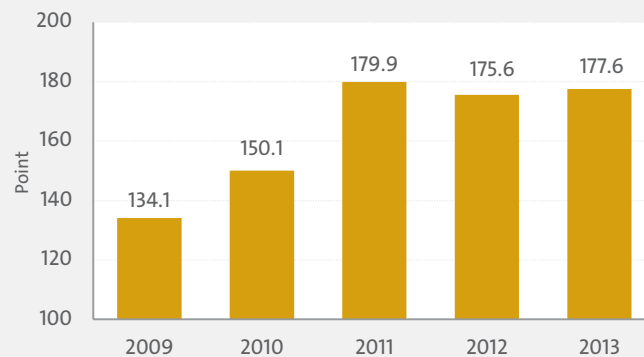


Source: IMF, IFS report and database.

## Food prices

Global food prices increased again during 2013 due to unstable weather conditions, especially during the first half of the year. The rise also reflected certain domestic policies of food producers including procurement policies and consumer price subsidies<sup>[16]</sup>. However, prices started to fall gradually during the second half of the year due to higher production and increasing food stocks; this throttled further price climb. Overall, the global food price index recorded a slight increase of 1.1 percent, compared to 2.4 percent in the previous year.

Figure 1- 24: Global food price index, 2009-2013



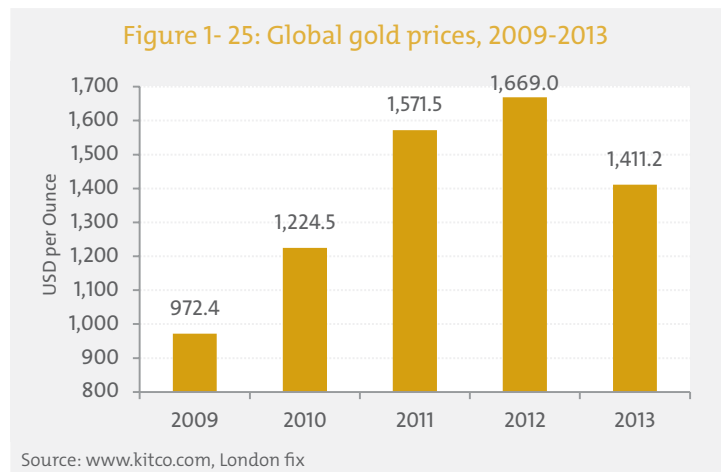
Source: IMF, WEO report and database.

[15] Average of UK Brent, Dubai Fateh and West Texas.

[16] Food Price Watch, IMF, 2013.

## Gold prices

Gold price gradually but significantly dropped over the year 2013, hitting its lowest level in December. This decline came against the backdrop of optimistic USA forecasts of growth and interest rates as well as widely shared optimism over markets at large. This prompted many investors to turn from gold to stocks and currency markets, especially with the rise in the early part of the year of USD exchange rate against other currencies. Gold prices continued to fall after mid-year, chiefly because some central banks, principally China's Central Bank and the Central Bank of India, ceased expanding their gold reserves. As a result, gold prices dropped by around 15.4 percent to USD 1,411.2 USD per ounce, compared to 2012.



## Labor market and unemployment

Global slowdown cast dim shadows on labor market indices in 2013. Principally in highly indebted economies, realized growth rates remained too low to generate enough job opportunities for new entrants into the labor force, and thus restrain unemployment increases.

The picture varied across AEs groups. The US unemployment rate dropped to 7.4 percent compared with 8.1 percent in the previous year. Similarly, unemployment rate in Japan dropped to 4.0 percent from 4.3 percent in the previous year. However, in the Euro Area, unemployment rates continued their upward trend, which started with the onset of the sovereign debt crisis. Thus the region's unemployment rate overstepped 12 percent, compared with 11.4 percent in 2012, affected by the austerity measures adopted by many member states. Greece and Spain continued to record the highest unemployment rates within the region, with unemployment rates in Greece rising to 27.3 percent and in Spain to 26.4 percent, compared to previous year's 24.2 percent and 25.0 percent, respectively.

As for EDEs, data showed unemployment rates stabilizing around the previous-year level of 4.1 percent in China, while dropping slightly in Brazil and Mexico to 5.4 percent and 4.9 percent, respectively. In our neighboring region, unemployment rate rose in Egypt to 13.0 percent, compared to 12.3 percent in 2012, in view of the ongoing political and economic instability. In Jordan, the unemployment rates was relatively stable, at around 12.2 percent, while receding in Israel to 6.4 percent from 6.9 percent in the previous year.

## Balance of payments (BoP)

Current account of the balance of payments (BoP) of AEs improved moderately during 2013. For the first time since the onset of the financial crisis, AEs managed to realize a current account surplus in BoP, due to Germany's high current account surplus, alongside an improved current account of the Euro Area's heavily indebted countries. Italy, Spain and Greece achieved current account surpluses for the first time since the start of the financial crisis. On the other side, EDEs continued to show a high current account deficit because of poor foreign demand and low exports, particularly in China, Brazil and Mexico.

At regional level, both Egypt and Jordan succeeded in reducing the current account deficit by around 45 percent and 33.2 percent of GDP, respectively, compared with 2012. At the same time and despite weakened competitiveness of Israeli products and hence subdued export levels, Israel succeeded to achieve a surplus amounting to around 6.5 times the 2012 deficit, equivalent to 16.1 percent of GDP, compared to -7.7 percent of the previous year. This sharp improvement is primarily attributable to the production of natural gas from Tamar Filed in the Mediterranean Sea.

During 2013, international trade, which is pivotal to the current account, witnessed a moderate improvement, as trade volume grew by 3.0 percent, compared to 2.8 percent in 2012. Yet, this rate remains modest as compared to rates of prior years. The volume of international exports of goods and services reached USD 23.2 billion, rising by around 2.5 percent compared to 2012. Similarly, international imports of goods and services increased by around 2 percent to reach around USD 22.5 billion by end 2013.

In addition, terms of trade<sup>[17]</sup> reflected developments in trade volume and prices during 2013, dropping yet again in EDEs by around 0.3 percent, while recovering in AEs for the first time since 2009 by around 0.8 percent.

Figure 1- 26: Current account balances as a percent of GDP, 2009-2013

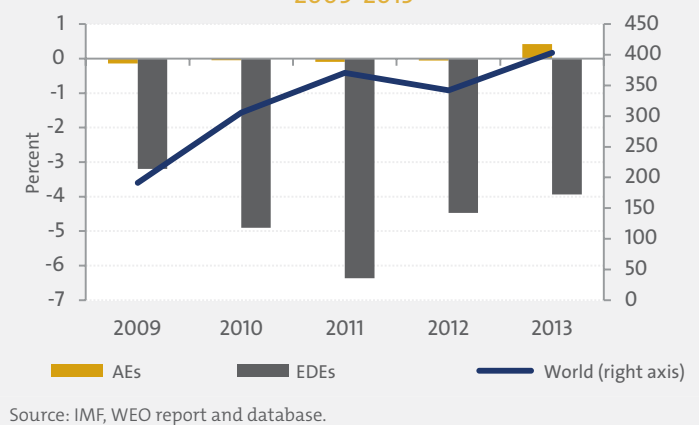


Figure 1- 27: World trade volume (growth rates), 2009-2013

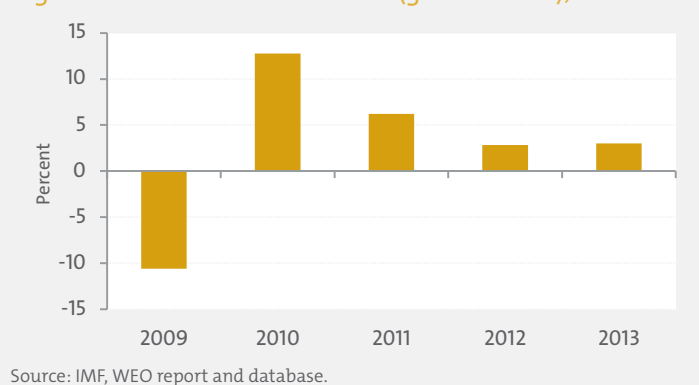
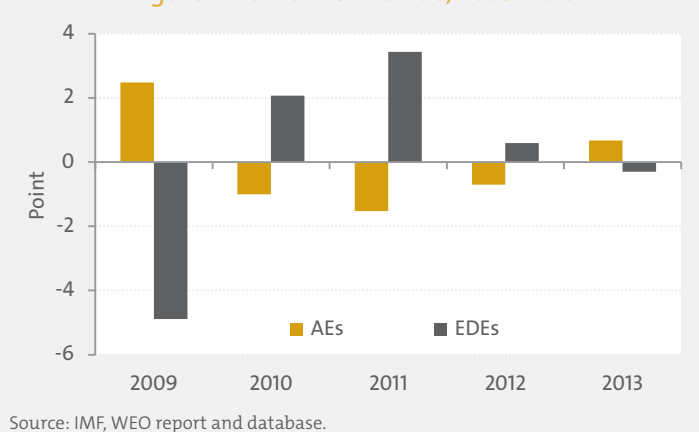


Figure 1- 28: Terms of trade, 2009-2013



[17] A term of trade is the ratio of a country's export price index to its import price index.

## Foreign direct investment (FDI)

During 2013, foreign direct investment (FDI) flows improved as compared to the previous year, due to the adoption by many countries of policies to stimulate investment. However, this improvement is to be regarded cautiously given fears of global economic slowdown. Data showed an increase in global FDI by 9.1 percent to reach USD 1.45 trillion, compared to 2012.

AEs saw a rise in the volume of FDI flows to 9.5 percent. Likewise, EDEs showed an increase in inflows by 6.7 percent, compared to 2012. In spite of the increased flows to AEs, their share of total FDI flows remained unchanged at 39 percent. On the other hand, EDEs share fell from 55 percent to 54 percent during 2013, in favor of transition economies whose share increased to 7 percent from 6 percent in the previous year.

As for AEs, inflows in 2013 rose by 16.8 percent in the USA and by 14.0 percent in the European Union, except for France and the United Kingdom where inflows retreated by 80.6 percent and 19.0 percent, respectively. Moreover, Japan witnessed a continuous inflow of foreign investment, reaching USD 2.3 billion at a growth rate of 33.0 percent, compared to the previous year. The European Union continued to enjoy the highest share of global FDI flows with a share of 17.0 percent, followed by the USA with a share of 12.9 percent.

Concerning EDEs, China and Hong Kong saw slight improvements in FDI inflows, each showing an increase of 2.3 percent compared to 2012. Inflows also grew in Singapore by 4.3 percent, while inflows to Brazil and Turkey dropped by 1.9 percent and 2.7 percent, respectively. For 2013, China still held the largest share of 8.5 percent of global FDI inflows among EDEs, followed by Hong Kong with 5.3 percent and Brazil with 4.4 percent.

As for Arab countries, unstable political conditions adversely affected FDI inflows, which fell back during 2013 by 9.5 percent to constitute 3.2 percent of global FDI inflows or around 6 percent of EDEs' total inflows.

Following a noticeable improvement during 2012, Egypt's and Tunisia's FDI inflows experienced sharp declines in 2013 by 19.3 percent and 31.6 percent, respectively. In view of its geographic proximity and high sensitivity to ongoing events in the Gulf region, Saudi Arabia's FDI inflows receded for the second consecutive year, plummeting by 23.7 percent in 2013. As a result, United Arab Emirates (UAE) replaced Saudi Arabia as the country with the largest share of FDI

Figure 1- 29: Foreign direct investment (FDI), 2009-2013

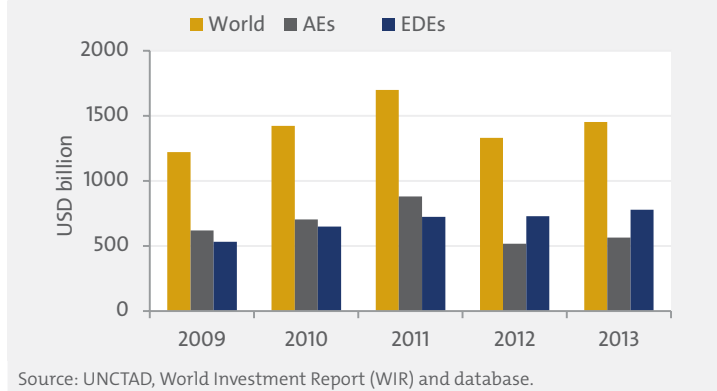
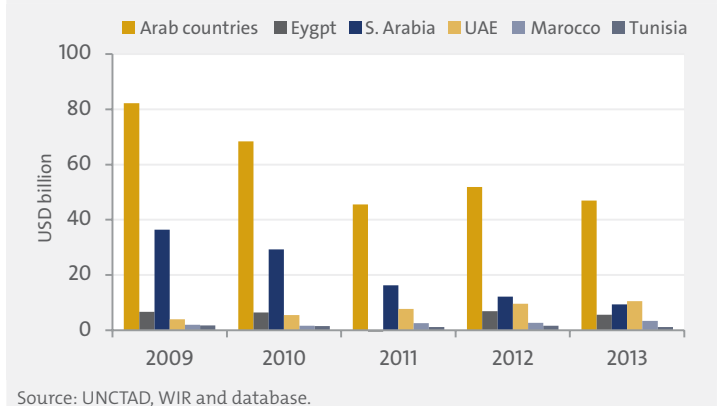


Figure 1- 30: FDI in some Arab countries, 2009-2013



inflows amongst Arab countries. Hence while UAE's share of FDI inflows to Arab countries grew by 9.2 percent to 22.4 percent, Saudi Arabia's share dropped to 19.3 percent. As for Jordan, inflows improved by 20.1 percent due to the financial reform program it undertook under IMF supervision. As far as Lebanon is concerned, the ongoing turmoil in neighboring Syria as well as domestic political unrest left an evident adverse impact on investment, culminating in a 22.9 percent decline in the volume of FDI inflows during 2013.

## International official reserves

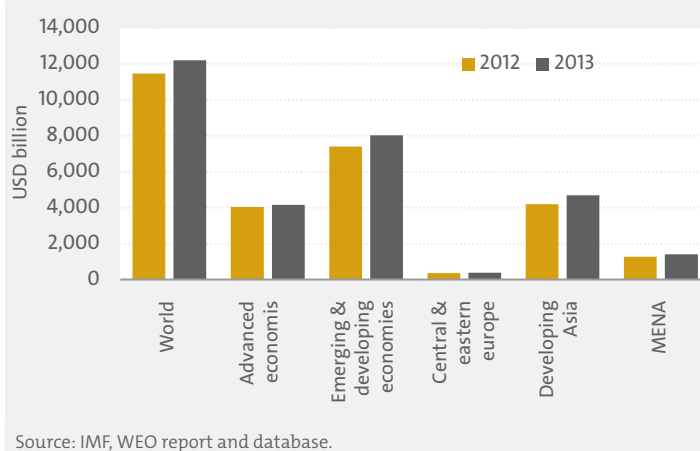
Changes in international official reserves correlate closely with capital flows and trade balances. Improvement in exports and capital flow to countries is usually associated with a rise in their official reserves of foreign currencies. During 2013, the decelerated growth of trade cast its shadow on the build-up of such reserves. Recording a total of USD 12.2 trillion, official reserves rose by 6.4 percent, compared to 7.0 percent in 2012, influenced by changes in the composition of reserves elements, particularly foreign currencies and gold.

The picture varied across country groups. Whereas AEs suffered further slowdown in the build-up of reserves, growing at a mere 2.8 percent against 7.9 percent in 2012, EDEs' reserves enjoyed accelerated growth by around 8.3 percent, compared to 6.5 percent in 2012. Developing Asia countries<sup>[18]</sup> represented the major driver of growth in reserves, which grew by 11.7 percent, compared to 3.7 percent in 2012; China's reserves alone made up one third of global reserves by end of 2013.

In MENA countries, official reserves grew at 9.5 percent compared to 15.4 percent in the previous year, mainly as a result of sharply decelerated growth of Saudi Arabia's reserves, which rose by 10.5 percent, compared to 21.4 percent in 2012. Official reserves developed differently across the region's countries. Oil exporting countries achieved high rates of growth, ranging from 10.5 percent for Saudi Arabia (which possesses over half the region's reserves) with a total of USD 725.8 billion, to 27.9 percent for Qatar with a total of USD 41.6 billion, and 45 percent for UAE with a total of USD 68.2 billion.

In oil importing countries of the MENA region, official reserves in Egypt and Jordan picked up moderately in 2013 after a drastic fall in the previous year. The Central Bank of Egypt reserves grew by around 16.8 percent, benefiting from aid provided by the Gulf states, to reach USD 13.7 billion at end 2013, albeit at lower levels than those attained prior to January 2011 revolution. Similarly, official reserves of the Central Bank of Jordan grew by over 80 percent reaching around USD 12 billion, with the help of Gulf States' aid, the moderate recovery of remittances from workers abroad, and the increase in tourism revenues<sup>[19]</sup>.

Figure 1- 31: Official reserves for Emerging & Developing Economies, 2012 & 2013



[18] Developing and emerging Asia countries consist of 29 countries, including China, India and Indonesia.

[19] Central Bank of Jordan, 2014.

## Global financial developments

### Interest rates

As part of their monetary policies for 2013 to motivate economic activity and recovery from the global and local crises, some central banks continued to move policy rates. The major move came from the ECB, which lowered policy rate in May to 0.5 percent, in an attempt to push recovery forward. However, the move resulted in lowering the inflation rate below the targeted level of 2.0 percent.

In a second attempt to spark economic recovery, the ECB reduced the policy rate in November to 0.25 percent, which adversely affected the inflation rate causing it to dip further. As a consequence, ECB policies faced a barrage of criticism over the seminal role of ECB in entrenching falling prices in the Euro Area. In contrast, other central banks maintained policy rates unchanged and relatively low. The Federal Reserve maintained the rate at 0.25 percent since 2009. Similarly, the Central Bank of Japan kept the rate around 0.1 percent since 2010, while the policy rate for the British pound remained unchanged at 0.5 percent since 2009.

At a regional level, the Bank of Israel resorted to lowering the policy rate twice during May and a third time at end-September, each time by 25 basis points to hit 1.0 percent in 2013, down from 1.75 percent in 2012. The repeated lowering of rates came as an attempt to invigorate exports and promote the competitiveness of Israeli commodities, which had been adversely affected by recurrent hikes in the value of the Israeli shekel against the US dollar and the euro.

In trying to curb the rising inflation rates, the Central Bank of Egypt raised the policy rate to 9.75 percent, but lowered it again thrice: in August, September and finally in December to 8.25 percent. The rate cutbacks came in view of poor growth rates and the persistence of downside economic risks, which also ultimately affected the inflation rate.

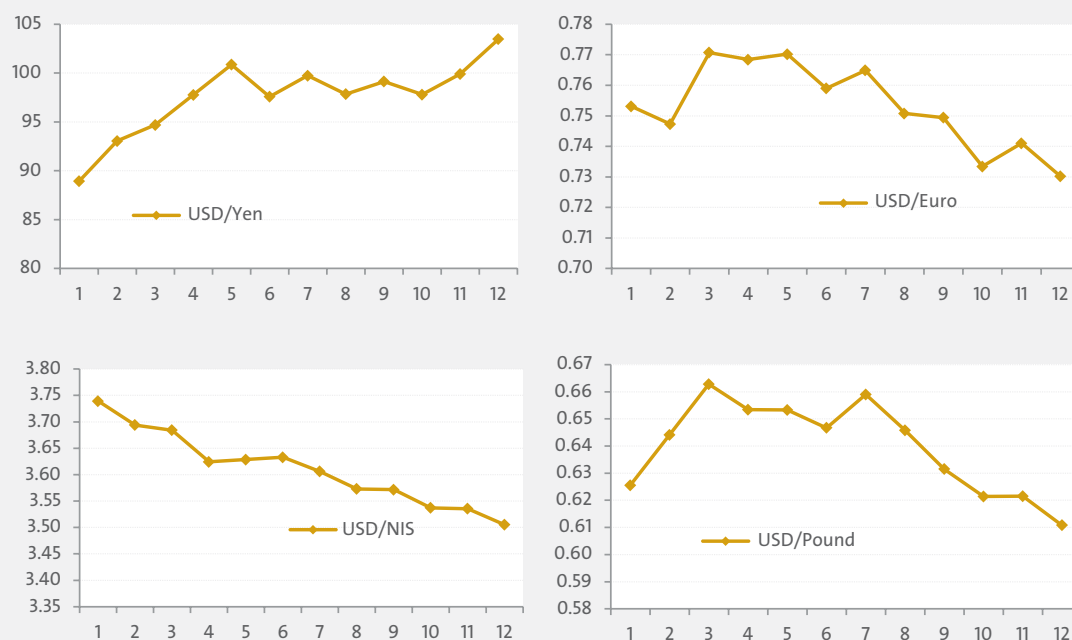
### Exchange rates

Exchange rates are influenced by countries' economic policies (monetary and fiscal); they in turn influence the shaping of international trade relations and direction of capital flows. During 2013, exchange rates of major currencies (euro, sterling pound, and yen) displayed large fluctuations, reflecting crises facing AEs on one hand and, on the other, the policies these countries implemented to deal with the crisis. In that context, the US dollar wavered considerably against major currencies, affected, basically, by the debate over the quantitative easing program and the conflicting statements outlining that program's end-dates.

Despite pumping cash into the markets in a third round of quantitative easing, the Federal Reserve reduced its bond purchase by around USD 20 billion during Q4 2013, which led to a drop in US dollar exchange rate against the euro and the British pound.



Figure 1- 32: USD exchange rate against major currencies (monthly basis), 2013



Source: www.oanda.com.

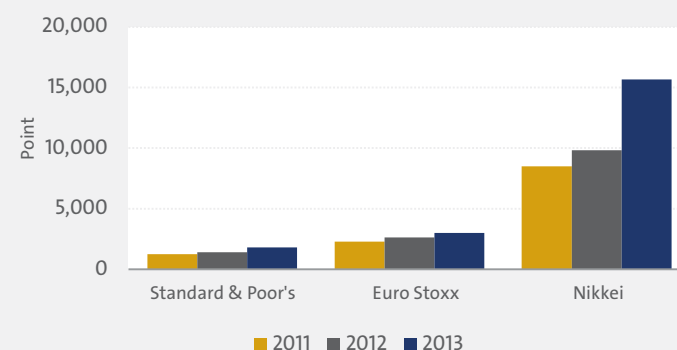
As the Central Bank of Japan lowered the yen exchange rate against other currencies in order to curb the decline of global demand for Japanese commodities, the USD surged above ¥100.0 for the first time since 2008. On another note, the USD continued its descent against the NIS, as Israeli gas production from Tamar field in the Mediterranean Sea commenced.

## Capital markets

Financial markets are highly sensitive to crises and most indicative of investor confidence in the crisis-management policies adopted by different countries. During 2013, global financial markets showed tangible improvement as compared to the previous year. Despite crises facing the USA in 2013, investors still found American stocks attractive. Standard & Poor's 500 Index closed above 1,800 point by end of the year, climbing by around 27 percent compared to the previous year. On the other hand, the performance of the Euro area financial markets came poorer than that of

American counterparts, and showed characteristic fluctuations reflecting risks afflicting the euro area. Euro Stoxx gained around 14.6 percent rising to 3,010 point at end-year compared to 2012. Likewise, Japan's Nikkei index suffered manifest fluctuations in light of the debate over Japan's new expansionary monetary and fiscal reform policies. Nevertheless, the index surged to 15,655 point by end of the year, growing by over 59 percent over 2012.

Figure 1- 33: Financial markets indicators (period end), 2011-2013



Source: ECB, statistical pocket book, 2014.



IMF forecasts<sup>[20]</sup> suggest that global activity has gradually strengthened during 2014. It is projected that global growth will rise to 3.6 percent, compared to 3.0 percent in 2013, with disparities in growth between AEs and EDEs. Thus, IMF expects AEs to grow at 2.2 percent compared to 1.3 percent in 2013, influenced by the recovery of both USA's and the Euro Area's economies. The US economy is forecasted to grow at 2.8 percent, compared with 1.9 percent in the previous year, and the Euro Area economy is expected to grow at around 1.2 percent compared with -0.5 percent in the previous year. The improved performance of AEs is projected to be accompanied by a slight rise in inflation rate to 1.5 percent from 1.4 percent in the previous year.

As to EDEs, growth is expected to rise to 4.9 percent, compared to 4.7 percent in 2013, with China achieving a growth of 7.5 percent to remain the engine of growth for this group. The inflation rate is expected to drop for EDEs to 5.5 percent from 5.8 percent in 2013.

In the MENA countries, growth is expected to rise to 3.2 percent compared with 2.4 percent in the previous year, while the inflation rate is expected to fall to 8.4 percent, compared to 10.5 percent in the previous year, amidst persistent political and economic instability.

For neighboring countries, economic growth in Israel is expected to hover around the 3.4 percent level achieved during 2013, driven primarily by the increased momentum of gas production and increased local demand due to an expansionary monetary policy. Inflation rate is expected to reach 1.6 percent, compared to 1.5 percent during 2013, accompanied by a timid increase in unemployment to around 6.7 percent.

The Jordanian economy is expected to recover further, registering a growth to 3.5 percent, compared with 3.3 percent in the previous year, as a result of the improved performance of the construction, tourism and services sectors, and the drop in energy costs. Inflation rate is expected to drop to 3.0 percent, compared to 5.5 percent in 2013, amidst economic challenges posed by a curb on government expenditure, and a decline of foreign investment.

The Egyptian economy is expected to realize growth at a rate of 2.3 percent in 2014, compared to 2.1 percent in the previous year. Inflation rate is expected to climb to 10.7 percent, compared with 6.9 percent in the previous year, with unemployment rate maintained at previous-year levels of 13 percent, while political risks dominate the economic scene and future prospects.

World trade is expected to strengthen in 2014, picking up by 4.3 percent in comparison to 3.0 percent in the previous year. The projected increase would reflect an expected decrease in relative prices in AEs by 0.7 percent and in EDEs by 0.2 percent, in parallel with a continued decrease of non-fuel basic commodities prices by 3.5 percent.

[20] IMF, WEO, April 2014.







## **Chapter Two**

### Public Finance Developments



## Overview

The new Palestinian government, formed in 2013, applied a different approach to the Palestinian Authority (PA) liquidity and financial crisis than that of its predecessor. Not only did it seek to limit and lower government arrears, but it also worked to rationalize and control government spending, particularly non-wage expenditure. The approach was helped by the continuous and regular inflow of clearance revenues, in addition to the influx of massive amounts of foreign grants and aid.

On the revenue side, despite a slight decline in clearance revenues (in NIS), still the major component of public revenue, government succeeded in increasing both domestic revenue and foreign grants and aid. On the expenditure side, the government managed to cut its spending except for wages and salaries, which continued to account for more than half of public expenditure.

Buoyed by the surge in foreign grants and aid, the increase in total public revenue accompanied by the decrease in public expenditure brought about a surplus in government's fiscal stance. The surplus was mainly utilized to pay off accumulated government arrears to the private sector and reduce government debt to Palestinian banks.

### Total revenue and grants

Over the past years, former successive governments sought to increase dependence on available non-debt financial resources. However, scarcity of these resources and poor ability to tap and control them has continued to foil governments' efforts in this regard. It is noteworthy that financial resources are limited to local revenue (tax and non-tax), clearance revenues (collected by Israel on behalf of the PA), and foreign grants and aid.

Given the meagerness of available financial resources, successive governments sought to utilize, prioritize and allocate them to suit political and economic conditions and serve specific goals, as was the case in 2013. In this context, the Palestinian government appears to have set a goal of reducing its exposure to the private sector and banks operating in Palestine by paying off accumulated arrears and curbing bank borrowing. Despite its partial success in that pursuit, government could not attain a sustainable stance, as influencing factors beyond its control (regularity in the influx of foreign grants and aid and the transfer of clearance revenue) outweighed factors under its control (rationalizing and controlling expenditure).

Analysis indicates that total revenues and grants rose in 2013 by around 13.3 percent compared to the previous year, to reach NIS 14,082.7 million<sup>[21]</sup> or 94.9 percent of the budgeted amount. The rise has resulted mainly from an increase in domestic revenue (12.1 percent) and in foreign grants (37.0 percent). A part of this increase was used in covering tax refunds. These refunds amounted to four times their 2012 value, reaching NIS 806.5 million, or about double the budgeted amount of NIS 456 million. This demonstrates adamant government efforts to settle such arrears and prevent their accumulation.

[21] Shekel was used as a currency unit in the analysis of the developments cited in this chapter (instead of the dollar) in order to offset the huge impact of changes in the exchange rates. In addition, data listed in this chapter are on cash basis, unless noted otherwise.

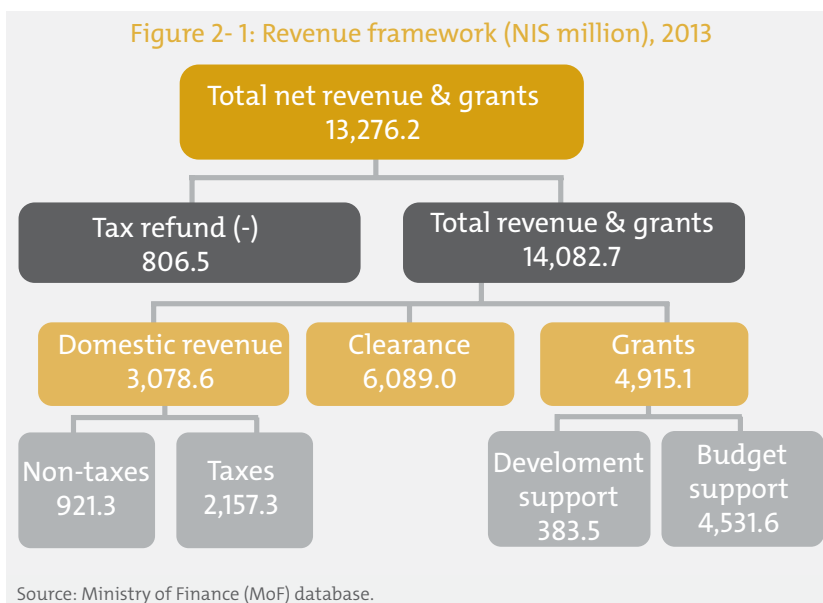
Despite doubling of tax refunds, total net revenue and grants increased by around 8.5 percent over 2012 to reach NIS 13,276.2 million, constituting around 92.3 percent of the budgeted amount and equivalent to 30.8 percent of GDP for both 2012 and 2013.

Comparison with 2012 reveals that all components of total revenue and grants rose, except for clearance revenue, which stood at approximately the same level as the previous year (a slight decrease). Hence, domestic revenue constituted around 21.9 percent of total revenues and grants, clearance revenue around 43.2 percent and foreign grants around 34.9 percent.

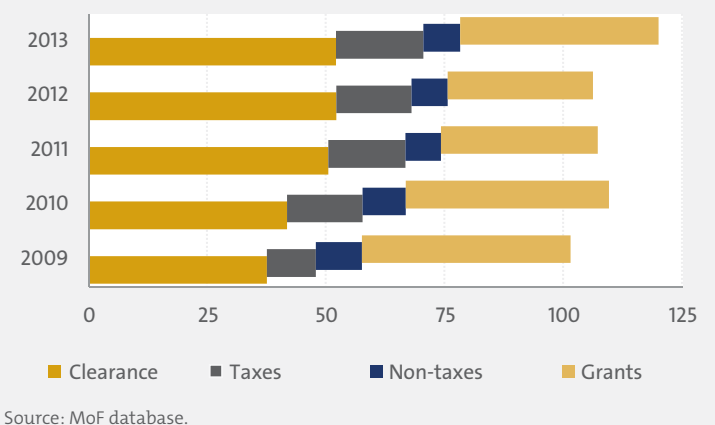
Domestic revenue rose by 12.1 percent during 2013 to reach NIS 3,078.6 million or 93.4 percent of the budgeted amount. The increase is attributed to a tangible improvement in tax and non-tax revenue, where the former rose by 16.5 percent to reach NIS 2,157.3 million, due to the increase in VAT revenue, excise tax on tobacco, customs and income tax revenue<sup>[22]</sup>. The rise in tax revenue raised its contribution to domestic revenues to 70.1 percent, compared to 67.7 percent in 2012. Likewise, non-tax revenue rose by around 2.9 percent compared to the previous year to reach NIS 921.3 million, due to investment profits in addition to increased revenue from some domestic fees charges. However, despite the increase in volume, the contribution of non-tax revenue to domestic revenue dropped to 29.9 percent, compared to 32.4 percent in 2012.

It is worth mentioning that VAT increased to 16 percent from 15 percent in June 2013, following a previous rise from 14.5 percent to 15 percent in September 2012, in-line with an increase in Israeli VAT.

In view of the previously mentioned developments, the domestic revenue's share in current expenditure and net lending rose from around 23.4 percent in 2012 to 26.2 percent in 2013. This can be primarily attributed to the increase in tax revenue, which contributed around 18.4 percent to current expenditure and net lending, compared to 15.8 percent in 2012. Meanwhile, the non-tax revenue's share stood at around 7.8 percent for the past two years. Domestic revenue as a share in wages and salaries (expenditure's main item) also rose to



**Figure 2- 2: Total revenue and grants as a percent of current expenditure, 2009-2013**



[22] VAT revenue rose by about NIS 182.2 million (on accrual basis) compared to 2012, to reach NIS 852.5 million. Likewise, excise tax on tobacco and customs rose by NIS 40.9 million and NIS 34.4 million to reach NIS 378.1 million and NIS 193.1 million respectively. Income tax revenue also rose during the same period by around NIS 25.2 million to reach NIS 714.3 million.

around 47 percent, compared to 45.8 percent in 2012, because of an increase in tax revenue share from 30.9 percent to 32.9 percent in 2013. In contrast, the share of non-tax revenue in wages and salaries dropped from around 14.9 percent to 14.1 percent between the two periods.

Clearance revenue totaled around NIS 6,089 million, dropping slightly (by NIS 7 million) from the amount recorded in 2012. In addition, clearance revenues was less than the targeted by around NIS 282 million to account for 95.6 percent of the 2013 budgeted amount. Nonetheless, monthly transfers of clearance payments were regular in 2013, contrary to 2012 during which such payments fluctuated, and undermined government's ability to meet its obligations including occasional delays in paying employees' salaries.

Although contributing around 51.9 percent of current expenditures and net lending in 2013 (similar to a contribution of 52 percent in 2012), clearance revenue's contribution to salaries fell back to around 93 percent, compared to 101.7 percent during 2012. This is attributed to a hike in salaries and wages by 6.2 percent compared to the previous year, with clearance revenue remaining relatively unchanged. It is worth mentioning that the main components of clearance revenue are customs, VAT and petroleum excise. In 2013, customs contributed around 34 percent to clearance revenue, VAT around 33 percent, and petroleum excise around 32.3 percent, with the remaining taxes (income and purchase tax) contributing 0.7 percent<sup>[23]</sup>.

In all, the contribution of domestic revenue (tax and non-tax) and clearance revenue in total public expenditures stood at 74.2 percent (of which 24.9 percent was the share of the former and 49.3 percent the share of the latter), compared to 70.5 percent in 2012. As such, tax burden (including clearance revenue) as a percent of GDP, reached 21.3 percent, compared to 22.4 percent in the previous year.

Foreign grants saw a notable increase to NIS 4,915.1 million during 2013, rising by 37 percent over 2012. Foreign grants were a major source for financing government's fiscal deficit, contributing 39.8 percent of public expenditure and 41.9 percent of current expenditure and net lending during 2013. Overall, foreign grants accounted for 34.9 percent of total revenue and grants, compared to 28.9 percent in 2012.

It is noteworthy that the major part (92.2 percent) of grants provided were channeled to support the budget's current expenditure, amounting to NIS 4,531.6 million, compared to NIS 2,985.6 million in 2012. On the other hand, the share of grants provided for development projects did not exceed 7.8 percent of the total sum, amounting to NIS 383.5 million, compared to NIS 601 million in 2012.

Despite its professed intention to reduce its reliance on grants, government continued to depend largely on such grants to finance its deficit. Grants even helped turn deficit into surplus in 2013, when a NIS 3,980.1 million total deficit excluding grants, equivalent to -9.2 percent of GDP, was transformed into a surplus of NIS 934 million, equivalent to 2.2 percent of GDP. It is noted that, over the past five years, grants have helped to fully cover current expenditure and net lending.

Obviously, the rise in total revenue and grants during 2013 resulted from changes in their principal components. In particular, foreign grants contributed 10.7 percent of this increase, while tax and non-tax revenue contributed 2.5 percent and 0.2 percent, respectively. In comparison, decreased clearance revenue left a negative impact equivalent to about 0.1 percent on growth of total revenue and grants.

[23] Stated contributions of taxes calculated on commitment and not cash basis, as relevant details for the latter were not available.



## Total expenditure

Total expenditure fell by around 1.9 percent in 2013 totaling NIS 12,342.2 million. The fall reflected cutbacks in non-wage expenditure by around NIS 236.9 million, net lending by around NIS 312 million, and development expenditure by around NIS 205.6 million, against an increase in wages and salaries by around NIS 552.5 million, compared to the previous year.

As in previous years, current expenditure and net lending predominated total expenditure in 2013, contributing 95.1 percent, of which 53 percent went to wages and salaries, 35.9 percent to non-wage expenditure and 6.2 percent to net lending. In comparison, development expenditure remained small and decreased to account for 4.9 percent of total expenditure. Undoubtedly, the problems of liquidity and scarcity of available financial resources accounted for the modest share of development spending in total expenditure. This was notwithstanding the significance importance of development expenditure in achieving sustained economic development and generating new jobs, thereby increasing government revenue in the medium and long term.

It is worth noting that total expenditure represented around 85.5 percent of the 2013 budgeted amount, accounting for 28.6 percent of GDP, compared to 31.8 percent in 2012. The decline in the latter ratio signaled a diminishing role for government in bringing about economic change through social assistance or development projects.

Figure 2- 3: Expenditure framework (NIS million), 2013

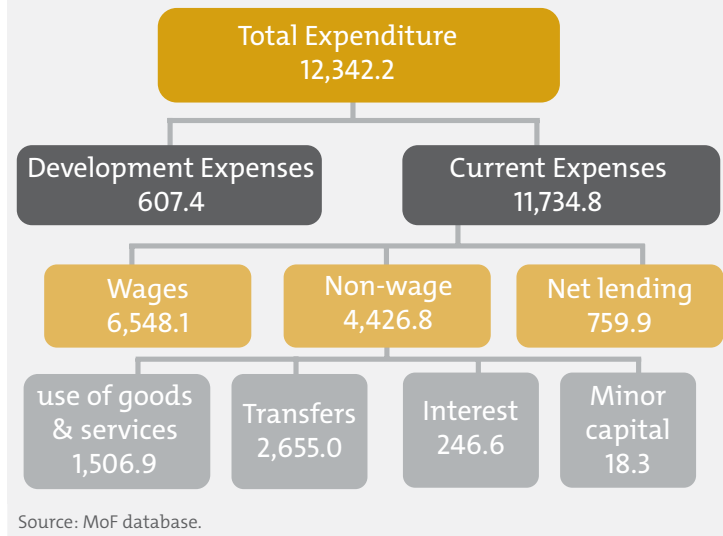
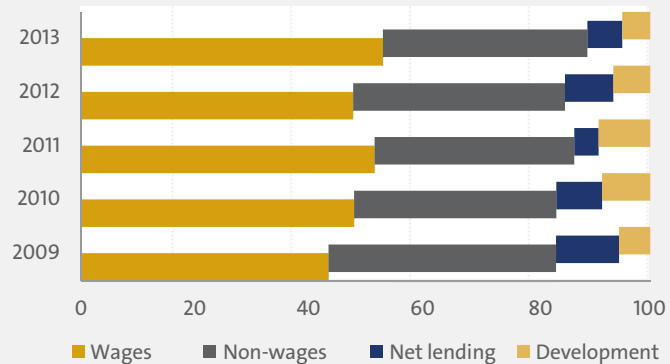


Figure 2- 4: Spending by items as a percent of total expenditure, 2009-2013



## Current expenditure and net lending

Analysis reveals that current expenditure and net lending stabilized during 2013 at around NIS 11,734.8 million, representing 89.6 percent of the budgeted amount. It is noteworthy that changes to current expenditure items were contrary to those of the previous year, particularly for wages and salaries which increased remarkably in 2013 but dropped in 2012.

Wages and salaries rose by around 9.2 percent to around NIS 6,548.1 million, equivalent to 94.1 percent of the budgeted amount, and 94.5 percent of amounts due from the government<sup>[24]</sup>.

It is noteworthy that wages and salaries constituted 55.8 percent of current expenditure and net lending, compared to 51.1 percent in 2012. The escalation of wages and salaries largely reflected the increase in cost of living allowances and promotions, in addition to the effect of understandings that government made with labour unions<sup>[25]</sup>.

Non-wage expenditure (use of goods and services, transfers, interest paid, and minor capital) dropped by about 5.1 percent in 2013, reaching NIS 4,426.8 million, or 75.9 percent of the budgeted amount, and about 78.4 percent of the amount due from government. This expenditure accounted for 37.7 percent of current expenditures and net lending, compared to 39.7 percent in 2012. The cutback in non-wage expenditure reflected the drop in all spending items. Goods and services expenditure declined by around NIS 379.9 million, or by 20.1 percent, to NIS 1,506.9 million. Transfers expenditure also declined by around NIS 101.2 million, or by 3.7 percent, to NIS 2,655.0 million. Transfers were distributed between social security transfers (civilian and military pensions) for NIS 997.0 million, social assistance benefits for around 1,218.0 million (social assistance NIS 443.3 million, assistance to vulnerable families NIS 560.7 million, and unemployment benefits NIS 214.0 million), assistance for prisoners and detainees for around NIS 233.9 million, and other kinds of transfers that include payments to NGOs and civil society & Universities, educational subsidies & scholarships, compensation for damages & emergency expenditures and others together received NIS 206.1 million.

Likewise, minor capital expenditure fell by around 1.3 percent to reach NIS 18.3 million in 2013, compared to NIS 19.6 million in the previous year. On the other hand, interest paid on sovereign debt, both domestic and external, reached NIS 246.6 million, of which NIS 223.0 million was paid as interest on domestic debt and NIS 23.6 million on external debt.

Net lending during 2013 declined notably by more than 29 percent, to reach NIS 759.9 million, representing about 6.5 percent of current expenditures and net lending, compared to 9.1 percent in the previous year. Despite this drop, actual amounts disbursed (representing total amount due from government) were more than twice the budgeted amount of NIS 300 million.



[24] Actual amounts represent the amounts already paid by the government, whereas amounts due are amounts owed by the government and due within a certain period of time, usually a year, which the government does not fully pay. Targeted amounts are amounts allocated by the government when preparing the budget.

[25] Data indicates that on accrual basis wages and salaries expenditure in social services sector (education, health, prisoners and freed prisoners, women affairs, and the Ministry of Labor) rose in 2013 by around 4.6 percent to reach NIS 6,904 million.

In summary, current expenditure and net lending in 2013 stabilized at NIS 11,734.8 million, reflecting combined effects of changes in its key components. Whereas the increase in wages and salaries pushed current expenditure and net lending up by 4.7 percent, the drop in non-wage expenditures and net lending reduced it by around 2.0 percent and 2.7 percent, respectively.

## Development expenditure

Development expenditure dropped for the third consecutive year to reach NIS 607.4 million during 2013, compared to NIS 813 million in 2012, a decrease of 25.3 percent. It is worth mentioning that the actual amounts disbursed (NIS 607.4 million) did not exceed 46.9 percent of the budgeted amount, with the treasury financing more than a third of the amount (NIS 223.9 million), and foreign grants covering the rest (NIS 383.5 million).

## Budget deficit

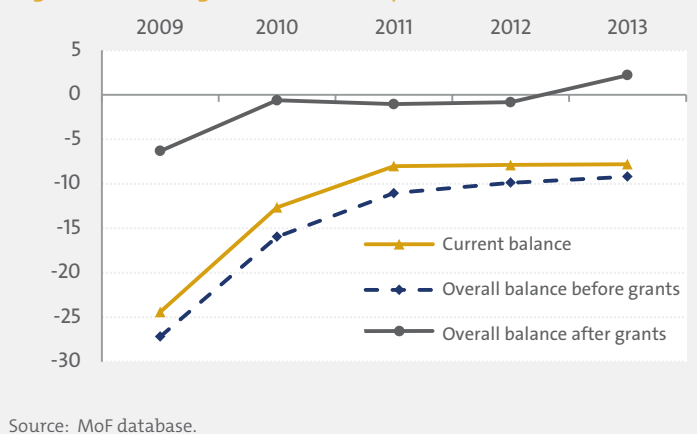
The current balance deficit for 2013 rose by 9.5 percent (which amount to NIS 292.3 million) to a total of NIS 3,373.7 million, primarily driven by the marked increase in tax refunds and wages and salaries. Despite its increase in 2013, the current account deficit as percentage of GDP remained unchanged at around 7.8 percent, and tracked a steadily diminishing trend since 2009.

Despite its increase, the current deficit fell short (at 86.6 percent or by NIS 511 million) of the 2013 budgeted target. However, this shortfall from targeted level did not indicate a successful rationalizing of current spending, but was rather a result of unpaid amounts due on wage and non-wage expenditure.

The amount of wages and salaries due was around NIS 6,927.9 million in 2013, of which NIS 6,548.1 million were paid off, while NIS 379.8 million remained outstanding. Likewise, NIS 5,647.7 million was due as non-wage expenditures, of which NIS 4,426.8 million were paid off, while NIS 1,220.9 million remained unpaid.

Despite the drop in development expenditure, overall fiscal balance (including development expenditure) before grants recorded a deficit of NIS 3,981.1 million, a rise of about NIS 86.7 million compared to 2012. The increase in overall deficit is attributed to the same causes that underlie the current deficit. It is worth to note that overall deficit constituted 9.2 percent of GDP in 2013, compared to 9.9 percent in 2012. In comparison, overall fiscal balance after grants achieved a surplus of NIS 934 million against a deficit of NIS 307.8 million in 2012, due to the significant increase in grants. The government utilized part of the above-mentioned surplus to pay off NIS 895 million of outstanding debt to banks operating in Palestine. Overall, the influx of grants during 2013 resulted in a surplus that accounted for 2.2 percent of GDP, compared to a deficit of 0.8 percent of GDP in 2012.

Figure 2- 6: Budget balance as a percent of GDP, 2009-2013



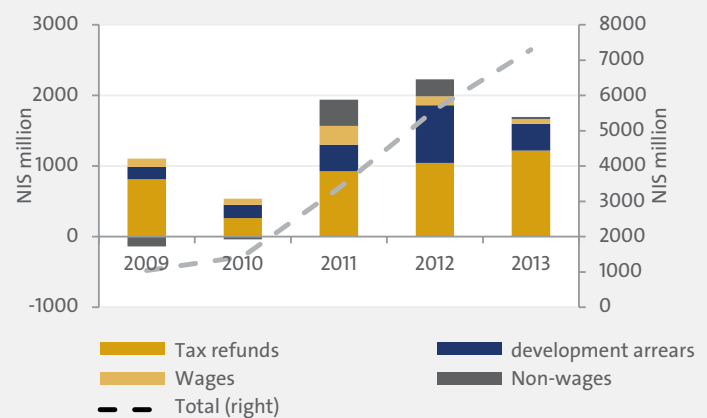
## Government arrears

Despite a regular flow of foreign grants and an increase in total revenue coupled with a decrease in total expenditures, the government could not meet all its obligations during 2013. It failed to pay off around NIS 1,693.4 million, which accrued to arrears amounting to NIS 7,294.4 million for the period 2009–2013. Data for 2013 show that the government had reduced arrears on tax refunds, on wages and salaries and on development expenditures, but accumulated non-wage arrears as compared to 2012. Wages and salaries arrears fell to NIS 379.7 million in 2013, compared to NIS 816.4 million in 2012. Likewise, tax refund arrears fell to NIS 26.9 million, compared to NIS 239.4 million in 2012, while development expenditure arrears fell to NIS 66.0 million, compared to NIS 124.2 million, during the same period.

In contrast, non-wage arrears recorded NIS 1,220.8 million compared to NIS 1,046.3 million in 2012. These arrears consisted of delayed contributions to pension and welfare funds for NIS 638.4 million, operating expenses (goods and services) arrears for NIS 309.6 million, transfers' expenditure for NIS 183.8 million, and interest arrears for NIS 77.9 million<sup>[26]</sup>.

It is worth mentioning that government arrears in 2013 constituted around 12.8 percent of total net revenues and grants, and around 13.7 percent of total expenditure. Consequently to get rid of 2013 arrears, the government ought to have increased net revenues by around 12.8 percent, or decreased total expenditure by around 13.7 percent.

Figure 2- 7: Outstanding arrears payments, 2009-2013

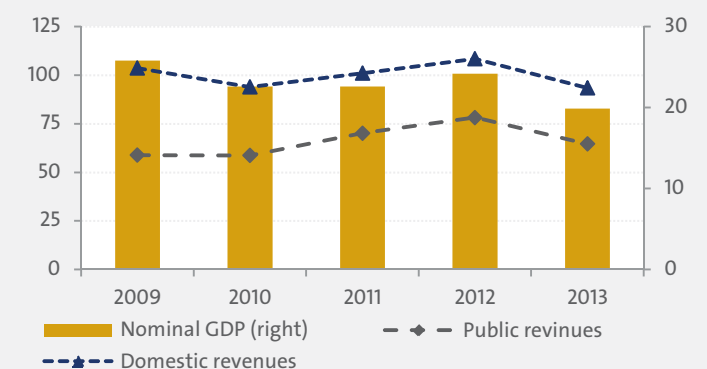


Source: MoF database.

## Government public debt

The overall government public debt in 2013 shrank by around 4.3 percent to reach USD 2,376.2 million, representing 19.9 percent of GDP, compared to 24.4 percent in 2012. Government domestic debt constituted around 10.6 percent of GDP during 2013, whereas government external debt constituted 9.3 percent of GDP. The Palestinian citizen's share of the government public debt reached USD 569.9 during 2013, compared to USD 613.5 in the previous year. However, government public debt as a percent of GDP remains low

Figure 2- 8: Government public debt as a percent of government revenue & GDP, 2009-2013



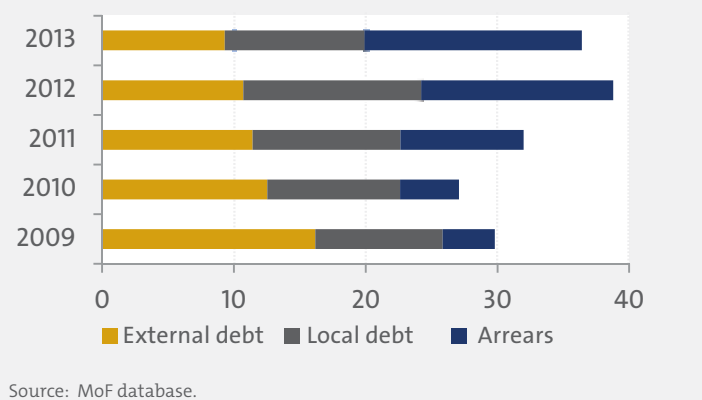
Source: MoF database.

[26] It is worth mentioning that the government owes NIS 83.2 million as outstanding domestic interests, while it has paid off NIS 5.3 million of arrears of the external debt interest. As such, the total interest arrears amount to NIS 77.9 million (NIS 83.2 million – NIS 5.3 million).

compared to other neighbouring countries. In Jordan, for example, public debt reached 86.7 percent of GDP at end 2013, according to the Public Debt Department in Jordanian Ministry of Finance. In comparison, Israel's public debt/GDP ratio stood at 66.2 percent at end 2013, according to data published by the Israeli Bureau of Statistics.

Despite the low ratio of government public debt to GDP in Palestine compared to other neighboring countries, the local economy continues to be vulnerable to several risks. These include meager and highly scarce financial resources, exchange rate fluctuations, and government's inability to fully meet its obligations towards the private sector, banks and even public employees. Moreover, government public debt is mostly directed to consumption rather than investment, and hence financial return on expenditure remains low and short-term. In particular, government loans go mainly to pay public servants' wages and salaries, and to defray other expenditures like transfers and interest expenses. Generally, government fiscal policy remains vulnerable and unsustainable.

Figure 2- 9: Government public debt as a percent of GDP, 2009-2013



Analysis of debt indicators for 2013 reveals that government public debt amounted to around 64.6 percent of total net revenues and grants, compared to 78.3 percent in 2012. It has also averaged 93.5 percent of clearance and domestic revenues, compared to 108.4 percent in 2012. This clearly indicates that government's financial situation continues to be vulnerable and heavily dependent on foreign grants, which remain irregular. In fact although still low compared to other neighboring countries, government public debt/GDP ratio has approached the maximum limit set forth in the Palestinian Public Debt Law<sup>[27]</sup>. This holds true provided accumulated arrears, which now make 36.4 percent of GDP, compared to 38.8 percent in 2012, are taken into consideration. The continuous and steady increase in arrears reflect the difficulties that government faces in securing necessary funding, which ultimately gives rise to accumulation of arrears and outstanding obligations to private sector, importers and others.

Government public debt was distributed between domestic debt (53.3 percent) at USD 1,267.6 million, and external debt (46.7 percent) at USD 1,108.6 million. The diminishing share of external debt in overall government public debt over the past few years reveals the increasing dependence of government on domestic borrowing to finance its public expenditures. This poses a threat to the banking sector given the absence of alternative local debt instruments. Banks have contributed around 98.8 percent of overall government domestic debt, which comes to around USD 1,253.0 million according to Ministry of Finance data<sup>[28]</sup>; the remaining 1.2 percent was funded by other public institutions, like the Palestinian Pension Agency and the Zakat Committee. Government debt from banks was distributed as 70.8 percent in loans (of which 18.0 percent were loans to the Palestinian Petroleum Commission guaranteed by the Ministry of Finance), and 29.2 percent as overdraft facilities. PMA data show that the Israeli shekel was the dominant currency of domestic debt, with 80.9 percent, versus 13.9 percent for USD and around 5.2 percent for Jordanian dinar. The predominance of Israeli shekel is attributed to the fact that the bulk of government expenditure, particularly current spending, is usually denominated in Israeli shekels.

[27] Article (30) of Palestinian Public Debt Law states that the public debt outstanding balance shall not exceed at any time 40 percent of GDP at current prices for the last year for which data is available.

[28] The consolidated data for banks operating in Palestine published by the PMA indicate that the value of loans granted to the public sector totaled NIS 1,373.2 million by end of 2013.

Three main creditors contributed to external debt. First, Arab financial institutions contributed around USD 630.1 million distributed between al-Aqsa Fund with around 83.1 percent, Arab Fund for Economic and Social Development with 9.2 percent, and Islamic Development Bank with 7.7 percent. Second, international and regional foundations contributed USD 342.5 million distributed between the World Bank with 82.8 percent, the European Investment Bank with 10.5 percent, OPEC with around 5.8 percent and the International Fund for Agricultural Development with 0.9 percent. Third, bilateral loans, which amounted to USD 136.0 million, were distributed between Spain with 70.6 percent, Italy with 25.4 percent and China with 4.0 percent.

Data shows that debt service reached around USD 363.1 million in 2013, of which principal payments constituted USD 294.8 million and interest about USD 68.3 million. The major part of principal payments went to pay off domestic debt, indicating government's keenness to reduce its dependence on banks as a major source of funding. Debt service on domestic debt constituted 96.6 percent of the total, while the remaining 3.4 percent serviced external debt. Interest on domestic debt amounted to 90.5 percent of overall paid interest. Interest on government public debt amounted to 2.4 percent of domestic and clearance revenues in 2013, which indicated that a small but significant part of revenues was used to finance interest debt service.





## **Chapter Three**

### Foreign Sector Developments





## Overview

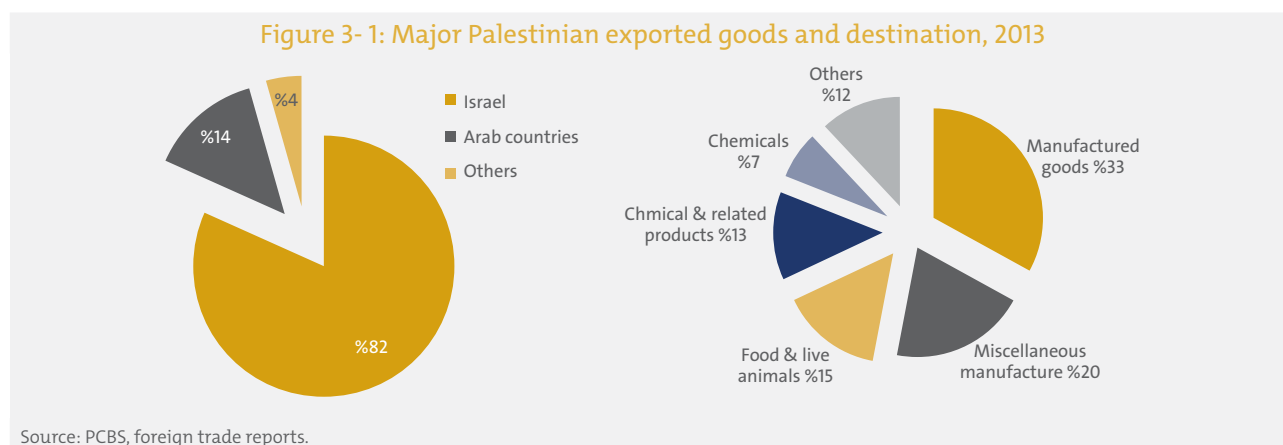
Relative scarcity is a key question in international trade, originally arising from differences between countries in production capacity and costs on one hand, and from disparities in technical standards and abilities to attain self-sufficiency and dispose of production surplus, on the other hand. In addition, international trade is motivated by realized profits and their subsequent impact on standard of living. Hence, international trade assumes a special significance as an indicator of a country's production capacity, competitiveness in international markets, and possession of foreign currency reserves. It also directly impacts a country's balance of trade, national income growth, technology transfer, and satisfaction of local consumer needs, in addition to developing countries' international political and economic relations.

In Palestine in 2013, registered foreign trade data and balance of payments (BoP) statistics reveal a decline in the trade deficit as a percent of GDP, resulting from some growth of exports and a slight decline in imports, which remain substantially higher than exports. The latter fact underlies a rapidly growing consumption pattern of the economy, and increasing reliance on imported goods. In comparison, data shows a relative increase in the ratio to GDP of income from abroad, which is a most important source for financing trade deficit in Palestine. Likewise, current transfers, the most important BoP component financing trade deficit, have witnessed a significant rise due to the considerable increase in official aid to government, as well as a rise in transfers from other sectors.

### Registered foreign trade in goods

In 2013, registered foreign trade in goods reached around USD 5,420 million, a decline of 1.0 percent compared to the previous year, due to increased exports and decreased imports. Exported goods rose by 6.9 percent to USD 840 million, while imported goods dropped by 2.7 percent to USD 4,580 million, leading to a decline in trade deficit to USD 3,740 million, equivalent to 31 percent of GDP, as opposed to 38 percent in 2012. Basic manufactures (wood, paper and metal products, textiles and others) accounted for the largest share (33 percent) of exported goods, followed by miscellaneous manufactured goods (furniture, clothes, footwear and others) with 20 percent, food and livestock products with 15 percent, raw materials (except fuel) with 13 percent and chemicals with an 11 percent.

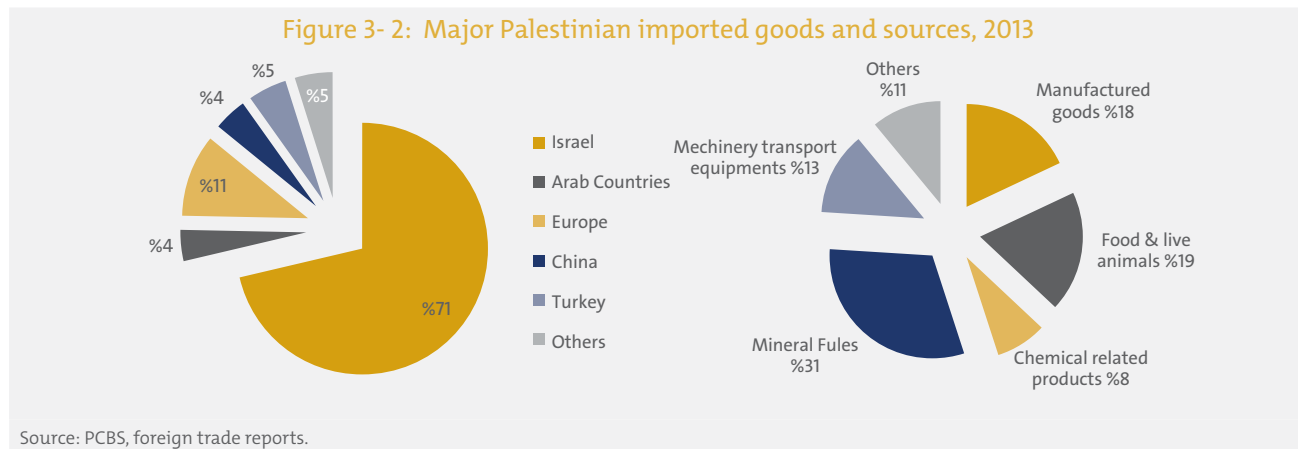
Figure 3- 1: Major Palestinian exported goods and destination, 2013



Source: PCBS, foreign trade reports.

Israel was the main importer of Palestinian exported goods, as a result of the direct relation between Palestinian and Israeli markets. Accordingly, 82 percent of overall exports were directed to the Israeli markets, 14 percent to Arab countries (intra-regional trade) and only 4 percent to the rest of the world.

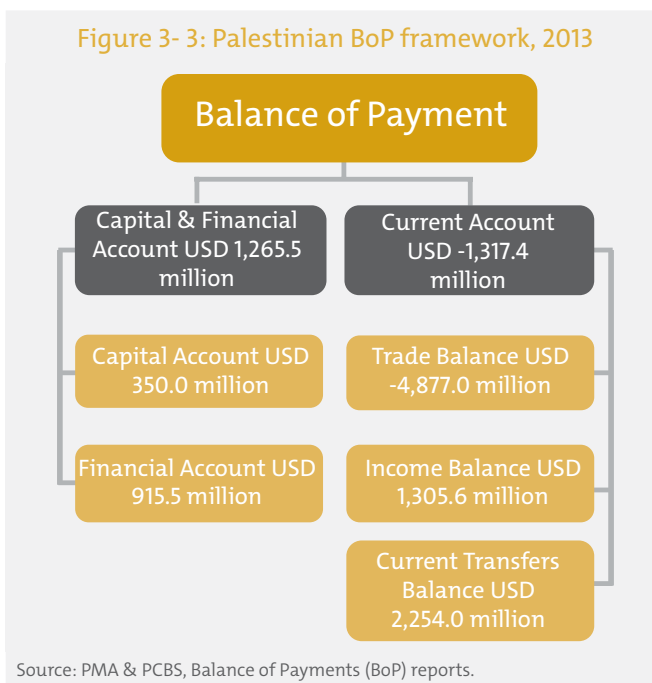
On the other hand, mineral fuels held the largest share (31 percent) of imported goods, followed by food and livestock with 19 percent, manufactured goods with 18 percent, machinery and transport equipment with 13 percent and chemicals with 8 percent. Israel accounted for 71 percent of total imported goods, followed by European Union with 11 percent, Turkey with 5 percent, China with 4 percent and the Arab World (intra-regional trade) with only 4 percent.



In general, the analysis of the structure and direction of foreign trade confirmed the dependence of the Palestinian economy on its Israeli counterpart. Overall, Israel’s economic and commercial policies have a deep impact on Palestinian economic performance, with Israel being both the key source of goods consumed in the Palestinian market, and the main controller of flow of goods and commodities to and from Palestine.

## Balance of payments (BoP)

Central banks have developed an increasing interest in economic analysis of the BoP, which has become a key gauge of a country’s economic performance vis-a-vis the rest of the world, and an indicator of economic strength and adaptability to developments in global economy. BoP analysis also shows the size and structure of a country’s imports and exports and reveals relevant influencing factors like the volume of investment, degree of utilization and price and cost levels. It thus provides economic policy makers with an effective planning and guidance tool to formulate monetary and fiscal policies, and forge national foreign economic relations, such as foreign trade planning by goods category and geographical area. Following are the most significant developments of key items in Palestinian BoP for 2013.



## Current account

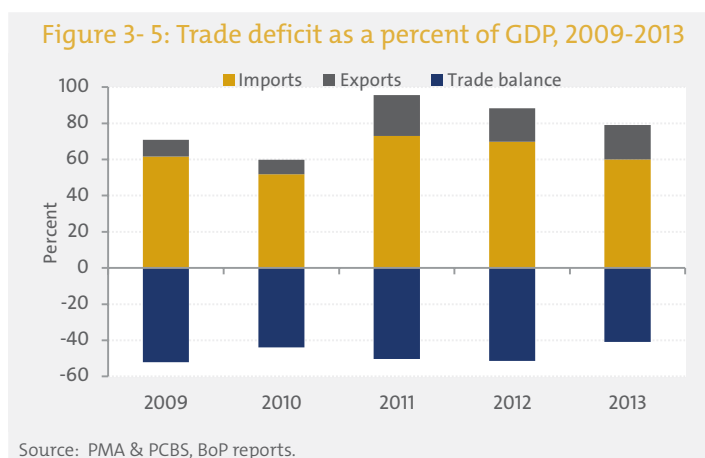
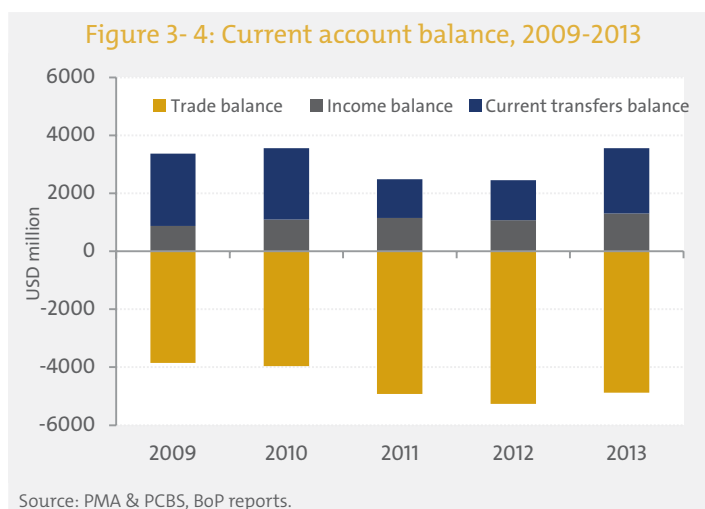
The current account (goods and services, income, and current transfers) balance recovered remarkably in 2013. Its deficit of USD 1,317.4 million marked an improvement by 114 percent over 2012, and constituted 11 percent of GDP, compared to 27.5 percent in 2012. However, the aforesaid improvement remains unsustainable under current conditions, and therefore warrants a closer look at the current account's major components, in order to discern the causes of deficit and propose appropriate remedies. These could include implementing certain policies wherever possible, or resorting to reform programs with sustainable financing methods for the current account deficit. Following is an analysis of the main components of the current account.

- **Trade balance**

The trade balance recorded a deficit of USD 4,877.0 million during 2013, equivalent to 41 percent of GDP, compared to 51 percent in 2012. Chronic structural deficit of the trade balance is considered the main cause of the current account deficit.

The trade deficit largely reflects the balance of trade in goods, which suffers a steady and chronic deficit; the deficit in traded goods amounted to USD 4,447 million, compared to USD 4,884 million in 2012, and represented 37 percent of GDP, compared to 47 percent in 2012. The aforementioned decline in the traded goods deficit is attributed to a nearly unchanged level of imported goods since 2012, and an increase by 25 percent in exported goods, compared to 2012. Despite their high growth rate, the low value of exported goods compared to imports limits their effect on the trade balance.

Additionally, imported goods constituted around 51 percent of GDP, compared to 60 percent in 2012, whereas exported goods constituted around 14 percent of GDP, compared to 12 percent in 2012. Consequently, the export-import coverage ratio improved to 27.4 percent from 20.4 percent in the previous year.



The services trade balance was the second most influential determinant of the current account deficit; it also recorded a deficit of USD 430 million, a rise by 11 percent over 2012. The rise reflected a fall in exports of services by 7 percent to reach USD 607.7 million, against a rise in imports of services by 1 percent to reach USD 1,037.7 million. Travel services represented the largest share of this account, amounting to 70 percent of total exports of services and 60 percent of total imports of services.

Trade balance is of prime importance for current account analysis, as it constitutes the main determinant of the current account deficit. Examination of the trade balance unveils the economy's various vulnerabilities including when production capacity is insufficient to satisfy citizens' needs, inevitably leading to reliance on imports to meet such needs. What types of materials are imported reveals the nature of the production base and structure. For example, heavy food imports indicate an inability to provide food security; machinery and equipment imports show incompetence of industry; and extensive energy imports indicate inability to fulfill domestic energy needs. More importantly, a chronic current account deficit would deplete foreign reserves, necessitate foreign borrowing, and eventually cause potentially serious economic and social crises. A chronic trade deficit usually reflects weaknesses of the industrial sector and inadequate general policies. In case of Palestine, to correct the imbalance of the trade balance would require enhancing the competitive features of the Palestinian product by greater reliance on know-how, technology and research and development. Ensuring the availability of manufacturing inputs would also be needed. Poor products that do not meet the local consumer needs, and unfair competition from similar foreign products are considered the main reasons causing or aggravating the trade deficit.

The massive trade deficit shows that the Paris Protocol and subsequent trade agreements and protocols (particularly with European Union and Arab countries) have not only failed to rectify Palestine's poor foreign trade position but have even aggravated an entrenched adverse situation. In particular, Israelis have exploited the clauses of the Paris Protocol and rendered them void by preventing any amendments or improvements to suit Palestinian economic developments. This effectively impaired the economy's ability to promote foreign trade and undermined the role of the PA especially by denying it control over border crossings and natural resources.

Israeli measures have driven the Palestinian economy into increased dependence on Israel, thereby exacerbating its already chronic trade deficit. Not only did the Paris Protocol prevent the expansion and diversification of the national economy and production base, but it has also precipitated the deterioration in competitiveness of the Palestinian product as a result of disproportionate developments in factors of production and adopted technologies.

Therefore, serious efforts to amend and improve the Paris Protocol should be made. Any future agreement should accord the economy top priority, particularly in relation to the movement of goods and opening of international trade crossings. It should specifically ensure that full guarantees are provided for the free movement of goods and services as well as individuals. In particular, freedom for imports and exports of goods, which constitute the cornerstone of foreign trade development, should not continue to be compromised by the provisions of the Protocol. A clearly formulated trade policy should be adopted to alleviate the impact of the trade deficit on the current account and the balance of payments at large.

- **Income from abroad**

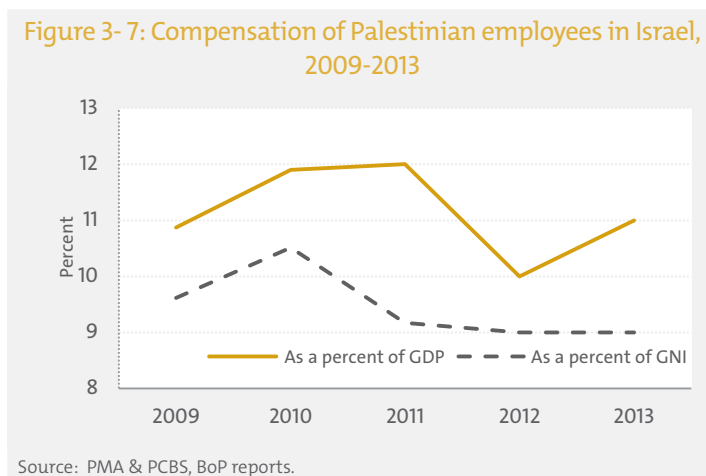
Because Palestine is a predominantly a labour exporter, income from abroad (compensation of employees and investment income) represents a major source of financing its trade deficit. During 2013, the income account achieved

a surplus amounting to USD 1,305.6 million, rising by more than 18.0 percent, compared to 2012. The improve surplus mainly reflected a hike in employees' compensation following an increase in the number of Palestinian workers in Israel, a rise in their nominal wage, and a surge in the exchange rate of US dollar against the shekel. Yet, the ratio of income from abroad to GDP remained low at around 11 percent, compared to 10 percent in 2012. It is worth mentioning that the larger part of surplus in this item primarily relates to compensation of employees, constituting around 91 percent of net income from abroad. The remaining part relates to return on Palestinian investments abroad (direct, portfolio and other investments), which is normally small since it is mainly composed of "other investments", specifically deposits abroad. Such deposits are subject to low levels of interest worldwide reflecting the effect of expansionary monetary policies adopted by many central banks in their effort to overcome the global financial crisis.

The income from abroad account is of major significance to the Palestinian trade balance,

which faces a chronic and accumulating deficit. In 2013, this account has financed around 26.8 percent of trade deficit, compared to 20.8 percent in the previous year. In the case of Palestine, compensation of employees is closely linked to the number of Palestinian workers in Israel, which has gradually increased in the past two years, following a significant decline for many years following 2000. The decline in this workforce reflected the blockade, siege and restrictions Israeli authorities imposed on workers' movement, resulting in a corresponding decline in their money transfers. Additionally, the value of these remittances fluctuated over the years not only due to fluctuation in the number of Palestinian workers allowed to work in Israel, but also because of the wavering exchange rate of the US dollar against the Israeli shekel.

Palestine has opted for workforce export to the Israeli labor market as one of few alternatives available to provide workers with a source of income and alleviate unemployment. Experience, however, proved that such a policy was largely inefficient. Whether to provide income or alleviate unemployment, workforce export was subject to Israeli measures and restrictions, which caused a notable decline in the number of Palestinian workers in Israel over the past years and ultimately a decrease in the significance of their compensation. Since 2006, the situation deteriorated further, as workers from Gaza were prevented from entry to Israel. It is noteworthy that during the period from 2000 to 2013, the compensation of employees in Israel constituted around 10 percent of the GDP and around 9 percent of the Gross National Income (GNI), as against more than 20 percent of GNI in the years preceding 2000.

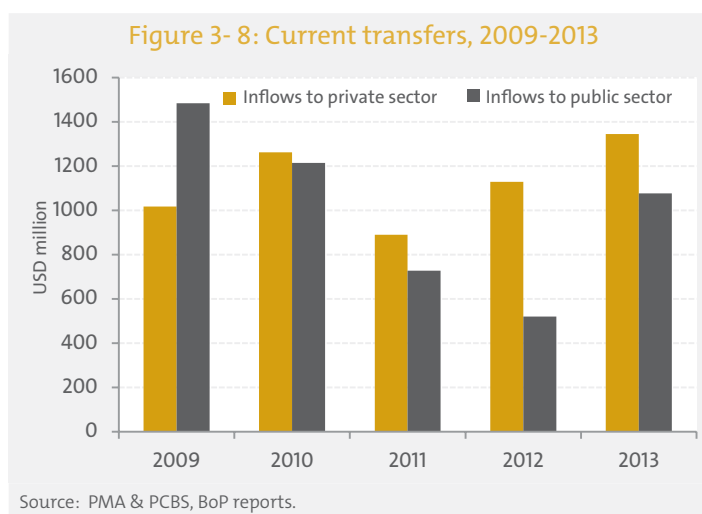


As a consequence of the limited market size and the weak production base, the Palestinian economy continues to face difficulties absorbing Palestinian workers who usually work in Israel. The obvious disparity in wages between Palestinian workers in Israel and their counterparts in Palestine sustained the workforce supply in Israel. Although Palestinian workforce participation in the Israeli market has the advantages of securing income, transferring expertise, positively affecting the Palestinian economy's business cycle, mitigating unemployment, and financing the trade deficit (22 percent on average), it simultaneously fosters heavy dependence on the Israeli economy. Furthermore, Palestinian workers are liable to extortion and exploitation by their Israeli employers, considering their high productivity and low level of wages, compared to any other foreign workforce. To tackle these problems best, effective measures and policies should be implemented to alleviate unemployment in Palestine. Finally, the growing dependence on workforce export to Israel can undermine the competitiveness of the Palestinian industry and exports, and subsequently adversely affect economic growth rates in the long run.

- **Current transfers**

Current transfers provide a significant source for financing the Palestinian trade deficit. Although they are important for funding both of the public and the private sectors, current transfers benefit the private more than the public sector. Current transfers have financed around 46.2 percent of trade deficit in 2013, compared to 26.2 percent in 2012.

The increased contribution of current transfers to financing the trade deficit was indicated by their significant rise (39 percent) in 2013, to a total of USD 2,254 million. This resulted mainly from official transfers to government which totalled USD 1,077.3 million, increasing by 52.0 percent compared to 2012. Migrant labour's transfers came second to official transfers, increasing by 10 percent to USD 996 million, compared to USD 896 million in 2012. Although relatively significant, migrants' transfers remained modest, in part because authorities paid scant attention to formulate appropriate mechanisms to organize and collect them. In fact, they could be rendered an optimal alternative to donor transfers, particularly as they provide a form of financing that is costless to the economy and immune to political pressures. Additionally, migrants' transfers could promote direct investment (including in land and construction) and contribute to poverty alleviation and financing of consumption, health and education.



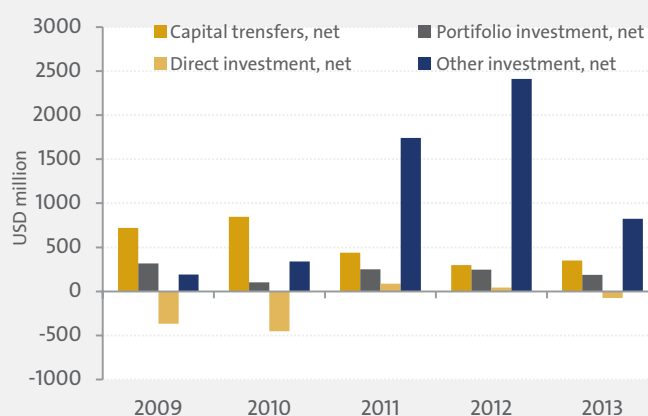
Hence, most countries currently pay special attention to migrants' statistics and remittances, with a view to organize and regulate them, and conclude relevant agreements with donor counterparts. Unlike other types of transfers, migrants' remittances tend to grow increasingly and steadily and show a high degree of regularity. Observers of such transfers note that private flows surpassed all official flows worldwide, while in many countries, they outstripped direct investment flows.

Current transfers also represent a source of foreign currency revenue and could spur savings, capital formation and funding of imports. They also stimulate aggregate demand and subsequently much-needed economic growth. It is therefore imperative that Palestinian authorities deploy means and methods to closely monitor migrants' numbers, geographical distribution and transfers, and take appropriate measures to direct such transfers as much as possible through official channels, mainly banks. Such means and methods will not only ensure a continuous inflow of such transfers, but also a growing one. It is noteworthy that current transfers into Palestine as a percent of GDP have risen from 13 percent in 2012 to 19 percent in 2013.

## Financial and capital account

The capital and financial account (including reserve assets) achieved a surplus of USD 1,265.5 million in 2013, dropping by 124 percent and constituting 11 percent of GDP, compared to 28 percent in 2012. The drop in this surplus is mainly attributed to the decline in other investment (net) flows to USD 825.1 million, falling by 192 percent compared to 2012. However additionally, direct investment (net) flows fell to USD 186.5 million, marking a 32 percent decline, and portfolio investment (net) flows also dropped (to USD 75 million), a 159 percent decline from 2012. As a result, the financial account (reserve assets excluded) has financed around 67 percent of the current account deficit in 2013, whereas the capital account (represented by capital transfers of USD 350 million) financed 27 percent of that aforementioned deficit. Overall, the capital transfers item has grown by around 17 percent during 2013 due to a rise in donors' transfers to fund public sector development projects. In sum, the net change in PMA reserve assets increased in 2013 by USD 21.3 million, compared to a rise of USD 166 million in 2012. These reserves reflect BoP's overall balance and consequently the overall financing level, given that there is no domestic currency and no other financing sources.

Figure 3- 9: Capital and financial account components, 2009-2013



Source: PMA & PCBS, BoP reports.

## Current account sustainability

Countries are concerned about their BoP current account deficit not solely because of the volume of that deficit, but also regarding its underlying causes and the ways to tackle it in order to attain a more sustainable stance, particularly that the current balance ultimately reflects broad economic trends over a specific time period.

To gauge current account sustainability, countries use various indicators, most prominently the trade deficit as a percent of GDP; in Palestine, this ratio is high, averaging around 48 percent over the past years. The second indicator is the national savings to GDP ratio, which correlates positively with current account sustainability; in Palestine, this



ratio is considered low, with an average of about 25 percent. The third indicator is the ratio of net direct investment flows to GDP, which also correlates positively with current account sustainability; in Palestine, this ratio does not exceed 10 percent on average. The external debt and debt service to exports ratio constitutes the fourth indicator of sustainability, and, on average, exceeds 100 percent in Palestine. In summary, all of the aforementioned indicators point to a weak current account sustainability of the Palestinian BoP.

A trade deficit (especially when it is the main reason behind a current account deficit) essentially indicates a country's poor competitiveness. However in Palestine, because of obstacles such as Israeli restrictions on access and free movement of goods and people, lack of control on border crossings, and absence of a national currency and therefore inability to implement an exchange rate policy to stimulate exports, it is difficult to ascribe the trade deficit to poor competitiveness alone, although it remains the most important factor. Other contributing factors include the small size of the Palestinian market, its fragmentation and poor structural framework. All of the aforementioned factors render the economy unable to satisfy all of society's basic needs. Consequently, heavy imports of specific commodity groups would account for the bulk of the imports bill and indicate specific structural economic problems. For example, high food imports indicate a poor and generally neglected agricultural sector, and inability to ensure food security. Heavy imports of machinery and equipment reflect a weak industrial sector. Poor creativity, low technical expertise and inadequate research and development combine to reduce competitiveness. Also, a chronic fiscal deficit usually closely linked to current account deficit (both termed as the Twin Deficits) further confounds the current account sustainability issue. Finally, a current account deficit would also indicate the economy's excessive consumption propensity and a low level of national savings relative to investment.

Normally, mechanisms for financing the current account deficit relate primarily to external debt and its maturity profile (short or long-term), which, in turn, reflect the real interest rate, economic growth pace and the current debt level. Generally, there are three options to finance the current account deficit. The first, equity or direct investment (as opposed to incurring external debt) is the best way to finance current account deficit. This is so because direct investment flows are usually more sustainable than other flows (such as portfolio flows), and are non-debt generating and therefore do not add up to external debt burden. The second option is financing by short-term external debt (as opposed to long-term external debt). The third alternative is financing by running down a country's net foreign assets (either by withdrawal from banks foreign deposits, i.e. from net foreign assets of the banking system, or by reduction in the net foreign assets of the central bank); obviously this will lead to a decline in a country's foreign assets or an increase in its foreign liabilities.

In the case of Palestine, financing the current account deficit relies primarily on withdrawals from the foreign assets of the Palestinian banking system and utilizing capital transfers, which together financed 65 percent of the current account deficit in 2013. A further 15 percent has been financed by equity investment. External borrowing (i.e. financing by incurring external debt) has not been tapped to fund the current account deficit. Instead, external debt has been used to finance public current expenditure, particularly salaries. At the same time, financing using PMA reserve assets has been rarely used and hence of an insignificant impact.

From the perspective of the relationship between current account and national savings, a current account deficit will occur whenever a country overspends without enough income or absorbs more than it produces. In other words, a current account deficit mirrors an excess of absorption (local demand or total local consumption) over income. Accordingly, regardless of the underlying cause of current account deficit, it is mandatory to seek a remedy. Normally, the remedy entails increasing reserve assets, resorting to a set of various other methods, or taking measures to

rectify the BoP status (in cases when it is not possible to rely on private and official resources to sustainably finance the current account deficit, and, therefore, mandatory corrective actions must be taken to attain a viable external payments position).

## International investment position (IIP)

International investment position (IIP) is a statistical statement that shows at a point in time the value and composition of (i) financial assets of residents of an economy that are claims on non-residents, and gold bullion held as reserve assets, and (ii) liabilities of residents of an economy to non-residents. The difference between an economy's external financial assets and liabilities is the economy's net IIP, which may be positive or negative<sup>[29]</sup>. The sum of IIP and nonfinancial assets represents the total wealth or total net worth on the national balance sheet. There is a strict interrelation between the IIP and the BoP. The BoP registers all financial and non-financial transactions with non-residents during the period they occur, whereas the IIP registers the results of financial transactions with non-residents at a certain point in time, adding in changes in prices and exchange rates as well as other revaluations, i.e. transactions that contributed to changing the IIP which are registered in the financial account of the BoP.

Assets and liabilities in the IIP are divided into direct investment (an investment equal to or exceeding 10 percent of a non-resident corporation's capital); portfolio investments (an investment that is less than 10 percent of a non-resident corporation's capital, in addition to investment in bonds); other investments (trade credit balances, loans, currencies, deposits and others); and reserve assets of the central bank, which are used to rectify BoP imbalances.

IIP has assumed increased significance for compilation and analysis of international accounts data, and for comprehending the sustainability and vulnerability of financial situations. This includes foreign currency matching, debt composition by sector and interest rate, measurement of rates of return, analysis of economic structure, and the study of the relation of international accounts to domestic sources of financing.

For Palestine, end-of-2013 preliminary results showed that the IIP (external assets – external liabilities) has totaled USD 1,161 million, which means that, across all sectors, the Palestinian investments abroad have exceeded non-residents' investments inside Palestine. Palestinian banks' deposits abroad together with foreign currencies in the Palestinian economy have constituted the major share (59.6 percent) of the total value of external assets.

The Palestinian economy's overall external assets (Palestinian residents' investments abroad) reached around USD 6,101 million by end of 2013, with the banking system's share at around 73.2 percent. These assets were composed of 5.2 percent in foreign direct investment, 18.8 percent in foreign portfolio investment, and 64.8 percent for other foreign investments. In comparison, overall foreign liabilities or claims on Palestinians (balances of non-residents invested inside Palestine) have totaled USD 4,940 million by end 2013, of which 33.3 percent were invested in the banking sector. Foreign direct investment in Palestine accounted for 49.6 percent of these liabilities, foreign portfolio investments for 16 percent, and other foreign investment for 34.4 percent.

Palestine's external debt amounted to around USD 1,717 million, of which 64.4 percent was central government debt, 31.9 percent was banking system debt, whereas the remaining sectors (financial and insurance companies, NGOs and households) accounted for around 2.5 percent.

[29] Balance of Payments and International Investment Position Manual-BPM6, sixth edition, IMF, 2009.





## **Chapter Four**

### Financial Sector Developments





## Part I

# Palestine Monetary Authority (PMA)

### Overview

Throughout 2013, the PMA continued to step up its concerted efforts, encompassing all aspects related to its strategic goals including fulfilling the requirements to convert to a full-fledged and modern central bank.

On one hand, the PMA sought to reinforce the legal and organizational framework of the banking system by issuing the PDIC Law. Likewise, it published numerous supervisory instructions to institutions which fall under its oversight and supervisory authority. The PMA also strived to reinforce the financial infrastructure for the banking system and the financial sector at large through the implementation of several essential projects. On the other hand, the PMA maintained its efforts to strengthen cooperation with public and private institutions, while developing international relations, for example by signing the Memorandum of Understanding (MoU) with the Ministry of Development Planning in Bolivia.

The PMA continued to gradually augment its capital in order to enhance its financial position and improve its capacity to overcome risks that threaten its exercise of its authority and responsibilities.

## Relations with banks operating in Palestine

### Laws and legislations

- **Laws**

The PDIC Law was issued by Presidential Decree-Law No. (7)<sup>[30]</sup> of 2013 on May 29, 2013. It was followed on September 17 of the same year by the Presidential Decree No. (68) of 2013 which established the Board of Directors (BoD) of the PDIC, composed of seven members and presided over by the PMA's Governor<sup>[31]</sup>. On September 26, 2013, the BoD held its first meeting, in which it commenced its activities and approved the corporation's work strategy<sup>[32]</sup>. The PDIC law stipulated that (i) customers' bank accounts up to a ceiling of USD 10,000<sup>[33]</sup> would be fully insured (i.e. paid) in case of liquidation of a licensed bank; (ii) subscribing banks would make annual contributions to be paid quarterly in the amount of 0.003 percent of their deposits subject to insurance; (iii) banks would also pay one-time subscriptions in the amount of USD 100,000 per bank; and (iv) government will contribute USD 20 million towards the PDIC capital.

The PDIC aims at reinforcing the financial safety net and protecting depositors, thereby maintaining financial stability and promoting economic growth in Palestine. Pursuant to the aforesaid law, the PDIC is responsible for paying back depositors immediately for their deposits within the limits of the insurance cap, in case of the liquidation of a bank. Other monetary claims would be settled in accordance with the appropriate law and the liquidation procedures.

It is worth mentioning that, during the meeting of donor countries held in New York on September 26, 2013, the IMF commended the PMA for establishment of the PDIC and recognized its positive implications to reinforce the financial safety net and financial stability in Palestine. The establishment of PDIC comes at a time when the banking system enjoys robustness, creditworthiness and capital adequacy, at levels far better than specified by international standards. Relatedly, the PMA obtained membership of the International Association of Deposit Insurers (IADI) in November 2013, and will inevitably take advantage of the practical expertise of the IADI members (75 deposit insurance corporations worldwide).

- **Supervisory instructions**

During 2013, the PMA sustained its efforts to develop relations with banks, through holding consultative meetings to discuss the banking business conditions, the associated challenges and the necessary corrective actions. The PMA has strived to engage banks in the process of developing banking instructions, in a manner that would maximize benefits of regulatory provisions.

The PMA also continued to make use of off-site and on-site supervision tools to enhance banking performance. In this regard, a number of procedures aimed at promoting governance were undertaken to ensure compliance with the standards and principles of corporate governance in banks. These were especially geared to avoiding conflicts of

[30] The Law was published in the Palestine Gazette, issue (101), on August 20, 2013.

[31] Members of the Board are: Dr. Jihad Al Wazir, Governor of the PMA and Chairman of the Board of Directors as per law, Mr. Ahmad Al Sabah (representative of the Ministry of Finance and nominated by the Minister), Mr. Hatem Sarhan (companies controller as per Law), Dr. Basem Khoury, Mr. Ali Safarini, Dr. Said Haifa and Mr. Mohammad Al Aidi

[32] In May 2014, Mr. Zaher Al Hmouz was appointed as first Director of the PDIC, by decision of the BoD of the corporation.

[33] This ceiling covers around 93 percent of depositors in banks operating in Palestine.

interests and authorities between BoDs and the executive management, improving the representation of minority shareholders and BoDs independent members, and addressing the issue of concentrated ownership in certain banks.

Also during 2013, most banks have established specialized risk management departments, and separated the duties of risk management from those of compliance control, in accordance with regulatory requirements. Moreover, the PMA continued to encourage banks to adopt advanced tools for identifying, quantifying, and controlling risks, thus reducing their adverse impact on the financial position of the bank. Additionally, the PMA set forth the minimum qualifications for the position of the director of a bank's risk management department.

As to boosting bank capital, the PMA continued to raise banks capital requirements, in a manner that corresponds with the respective levels of potential risks, and fosters banks' robustness and capacity to absorb shocks.

In light of the Banking Law No (9) of 2010, the PMA maintained its work to revise comprehensively all previously issued supervisory instructions, in order to ensure compliance with the law's amendments. The PMA also issued new supervisory instructions that regulate and control banking activities, in view of national and international legal and supervisory developments. In sum, the PMA issued the following instructions:

- **Instructions No. (1/2013)** concerning risk reserve, by which the risk reserve ratio was amended to 2 percent, instead of 1.5 percent, for net direct credit facilities, whereas the 0.5 percent ratio for indirect credit facilities remained unchanged. This instruction, which enforced the amendments as of December 31, 2012, was later amended by **Instructions No. (3/2013)** to change the enforcement date from December 31, 2012 to 1 January 1, 2013.
- **Instructions No. (2/2013)** concerning organizing the work of external auditors, by which the condition of the external auditor rotation was cancelled. Instead, banks became obliged to put in place a suitable mechanism to ensure the appointment of a different responsible partner of the external auditor, be it a local auditing firm or an international firm affiliate, at least once every five years. In case a different responsible partner cannot be appointed, then a different firm or affiliate has to be chosen at least once every five years.
- **Instructions No. (4/2013)** concerning liquidity ratios, by which the liquidity of the dollar in banks is to be increased in two stages, from 3 percent to 6 percent. The first stage will raise the liquidity ratio of the dollar for banks from 3 percent to 4.5 percent, and for branches from 2 percent to 3 percent. This stage has been implemented as of May 1, 2013. However, instructions **(8/2013)** later cancelled the second stage, which were to raise the liquidity ratio of the dollar from 4.5 percent to 6 percent for banks, and from 3 percent to 4 percent for branches, originally planned to take place on November 1, 2013, to finally fix the liquidity ratio of the dollar at 4.5 percent for banks and 3 percent for branches.
- **Instructions No. (5/2013)** concerning Islamic Banks and Sharia' supervision system, by which the scope of activities and businesses of Islamic banks are specified, alongside the financing controls, real-estate and equity investment controls, special or restricted investment controls, as well as the profit and loss allocation policy, illegal gains and reserve organization. The instructions also address the issues of the Sharia' supervisory board and the resident Sharia' controller, in addition to other aspects of Islamic banking. The instructions come as part of the PMA effort to strengthen and organize Islamic banking in accordance with the provisions of the Sharia' law.



- **Instructions No. (6/2013)** concerning the American citizen's account under the Foreign Account Tax Compliance Act (FATCA), by which measures to be implemented by banks are accordingly specified, in a manner that does not contradict banking secrecy rules yet avoids the risk of non-compliance. These instructions come in the context of the protection of soundness and stability of the Palestinian banking system and safeguarding against any reputational risk it may be exposed to.
- **Instructions No. (7/2013)** concerning money, precious metals and valuable documents' transfer, which specify the necessary controls, conditions and measures to be undertaken concerning such transfers from banks. The instructions also address the responsibility of outsourcing transport services and supplying the PMA with monthly reports on money transfers to and from Israeli banks and banks abroad. These instructions come as part of the PMA effort aimed at reducing the associated operational risks and staying up-to-date with the best practices in that respect.
- **Instructions No. (9/2013)** concerning Guide to Bank Governance Codes of Best Practices in Palestine, pursuant to which a new Guide to Bank Governance has been issued, in place of the Guide published in 2009, as part of the PMA policy to ensure continued compliance with the best international practices in banking. It is worth mentioning that the implementation of the Guide, in both the obligatory and optional guidelines, will promote governance and guarantee the good operation of banking activities and their sustainability.
- **Instructions No. (10/2013)** concerning banking account depositor data, by which banks are compelled to verify the identity of a depositor who is a non-account owner, in the event of a deposit equal to or exceeding USD 3,000, or the equivalent in other currencies, being paid into a customer's account. Banks are also obliged to amend banking systems in a manner to guarantee the implementation of these instructions.

On a related note, the PMA has published numerous circulars which regulate new standard procedures and other developments in the banking business. In that context, Circular No. (53/2013) was issued to encourage banks to expand facilities to SMEs by offering the benefits of the motivating measures implemented by the PMA. These include the waiver of the requirement of an advance 10 percent payment in cash of the SME outstanding debt balance, when scheduling debt, under certain conditions. They also include exemption of banks from the 2 percent risk reserve requirement for facilities given to SMEs.

The PMA has also published Circular (58/2013) which allows banks, as of August 2, 2013 to raise by a maximum of USD 5, the fees on received transfers credited to a beneficiary's account, which do not contain the international bank account number (IBAN), in case this recurs more than three times. The Circular extends the period of time which allows banks to accept inward transfers that do not contain the beneficiary's IBAN until February 2, 2014, after which the bank is entitled to reject any such inward transfer.

In addition, the PMA issued Circular (123/2013) addressing instructions issued by the PCMA which permit banks, upon prior authorization from the PMA, to act as insurance brokers or agents, in accordance with relevant governing terms and provisions.

Circular (113/2013) established a database for loans granted to SMEs, to support these enterprises and facilitate access to sources of funding. It is worth mentioning that the PMA had organized the Palestine International Banking

Conference, 2013, in partnership with the International Finance Corporation (IFC) and the Association of Banks in Palestine (ABP). The Conference, which was held in Jericho on February 4, 2013, was entitled “Empowering Small and Medium Enterprises in Palestine through Enhancing Access to Finance”. The main goal of the conference was raising awareness about the SME sector, as a significant contributor to sustainable social and economic development, and facilitating its access to lending and financing sources of financial and banking institutions. The conference also aimed at supporting dialogue and encouraging partnership with institutions from the public and private sectors, as well as overcoming obstacles and easing banking standards on lending to SMEs.

#### Box 5: The PMA’s role in supporting SMEs

The PMA has dedicated special attention to the SMEs sector, given its role as a key agent for: the development of the national economy, the generation of job opportunities, the alleviation of unemployment, the diversification of income resources, and the promotion of entrepreneurship. SMEs are a major contributor to the labor market, constituting around 91 percent of total number of enterprises in Palestine and contributing around 55 percent of GDP.

In February 2013, the PMA held the Palestine International Banking Conference, 2013 in the city of Jericho, under the theme of ‘Empowering Small and Medium Enterprises in Palestine through Enhancing Access to Finance’.

The conference mainly aimed at raising interest in, and supporting awareness of the significance of, the SME sector, as an important driver of sustainable economic and social development. The conference also purported at empowering SMEs in Palestine and building enterprise readiness through the provision of proper means of access to lending and financing sources at financial and banking institutions. The conference focused on: supporting dialogue and partnership with institutions of the public and private sectors, and overcoming obstacles and easing banking lending standards to SMEs.

The conference was attended by international experts from the World Bank, the International Finance Corporation and the Standard Bank of South Africa, in addition to local experts.

Conference sessions addressed the subject of SMEs in both regional and international contexts. The themes covered included: the role of loan guarantee funds in facilitating access to financing resources, bank strategies for SME classification, introduction to relevant real world experience, the role of investment funds in developing the SMEs sector in Palestine, the integration between banks and investment funds, and SMEs banking relations management.

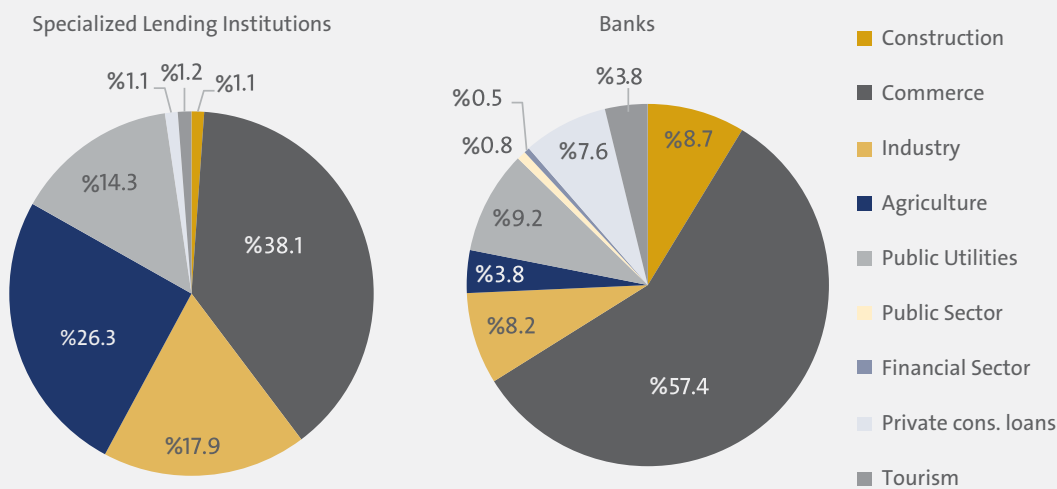
A main outcome of the conference was the establishment of a technical committee comprised of the PMA, the ABP and members from the public and private sectors and the civil society. The committee held its first meeting on June 9, 2013, during which the terms of reference (TOR) for its work were formulated. The committee’s duties shall focus on capacity building and technical and administrative qualification of SMEs. The committee shall also seek to activate the role of innovative projects through the creation of a specific system to serve as a SME consultancy body. This system will serve to improve access to financing sources, and revitalize the role of all of the chambers of commerce, the civil society organizations and the financial and banking institutions as main financiers of SMEs. Based on conference recommendations, the PMA introduced certain incentivizing measures aimed at promoting and developing Palestinian SMEs’ capacities, and improve their access to sources of financing and credit. In particular, the PMA waived the precondition of an advance cash payment set earlier at 10 percent when rescheduling SME non-performing loans; it also exempted banks from the 2 percent general risk reserve on facilities they grant to such enterprises.

The PMA also established an advanced SMEs database centre. The centre will serve lending institutions by offering a comprehensive and up-to-date database on SMEs; it will also help SMEs by facilitating their borrowing, thereby enhancing their activities and performance.

The value of facilities granted to SMEs in 2013 amounted to around USD 715 million, of which USD 540 million remain outstanding. Out of this total, the banks contributed USD 631 million, while specialized lending institutions provided USD 84 million.

The facilities were distributed to SMEs across various economic sectors, with the commercial sector acquiring the largest share (55.1 percent), followed by the public services and utilities sector with 9.8 percent. The following diagram represents the sectoral distribution of facilities granted to SMEs.

Credit granted to SMEs by economic sector, 2013



SMEs database

The PMA has created a comprehensive and up-to-date SMEs database, which includes full information on SME debt-finance portfolios. The SME database was created as part of the PMA's efforts to promote mechanisms, systems, and monitoring work tools for the purpose of developing the SME sector and facilitating its access to lending sources. In doing so, the PMA enables SMEs to carry out investment projects, which will ultimately improve social welfare and prosperity by alleviating unemployment and poverty in Palestine. The SMEs database will also help PMA monitor risks which surround various economic sectors.

The SMEs database initiative was originally proposed by the PMA. In order to maximize its benefits, the initiative was discussed with many local and international authorities to ensure development of a relevant and comprehensive vision and identify necessary pre-requisites. The initiative was also discussed during the meetings of the technical committee for the development of the SME sector, which undertook all necessary pre-arrangements and prepared a document of necessary actions, to be officially approved by the PMA's governor.

The database will allow automatic collection of financial and demographic data on loans granted to SMEs, with a view to develop and enhance their capabilities, and better analyse and manage the sector's credit portfolios and attendant credit risks.

The database is closely linked to the Credit Bureau (CB), where the financial data related to SMEs are automatically uploaded from the CB to the new system, and the sector's demographic data are generated in due course. To ensure the success of the project, the PMA, in agreement with the banking system, has formulated a unified definition of SMEs that fits the nature of the Palestinian banking environment. In sum, establishment of the database will have the following benefits:

1. Expanding the Credit Bureau's coverage by increasing the ratio of the adult population included, as the CB will now carry additional credit information on SMEs. This will reflect positively on the ranking of Palestine in the Doing Business Report published by the World Bank.
2. Empowering the SME sector and enhancing its capability to access lending at financial and banking institutions.
3. Promoting principles of financial inclusion through provision of easy access to banking services to a larger portion of enterprises.
4. Enabling SMEs in Palestine and enhancing their readiness through better access to new markets.
5. Reaping maximum benefits from loan guarantee institutions operating in Palestine and activating their role by allowing for more new loans to SMEs.
6. Boosting the operational competence of the local work force, thereby alleviating unemployment and poverty in the Palestinian society.
7. Improving management of credit risks surrounding the SME sector, thereby reducing the probability of default.
8. Enhancing the penetration ratio into financial institutions through proper legislation on conditions and pre-requisite guarantees and rights of all parties involved, and compliance with the best practices in finance risk management. This will help activate the role of the Credit Bureau, whose main duty is to overcome sector-related obstacles.
9. Bringing into the current financial system the largest possible number of productive and financial enterprises, thereby raising their owners' competence.

Many other parties can take advantage of this database and its benefits, including the PMA, banking system, specialized lending institutions, the ABP, the SME sector, NGOs working with SME sector, local and international financial institutions, academics, and researchers.

## Supervisory follow-up

Striving to enhance its efficiency, the PMA seeks to keep abreast of international standards and best practices in the area of banking supervision, specifically the standards published by the Basel Committee on Banking Supervision. As part of its efforts to comply with the Basel Committee standards, the PMA commenced a project to implement the Basel II requirements and subsequent revisions, in accordance with a schedule starting early 2013 and expected to end in late 2014. For that purpose, the PMA's Supervision and Inspection Department has formed a technical team to lay down the necessary plans and help banks prepare for implementation of the project. Likewise, bank committees have been formed to follow-up the implementation of the Basel II requirements<sup>[34]</sup>. By implementing the Basel II resolutions and related amendments, the PMA seeks to promote governance and risk management in the Palestinian banking system, in order to enhance its creditworthiness and ability to confront risks, and maintain soundness and stability of the banking system and protect the public's money.

The PMA has continued to monitor banks which did not fulfill the paid-up capital requirement of USD 50 million in effect. Time schedules were set up for banks to fulfill the requirement, with a deadline in mid-2014. Banks have also been advised to separate the credit-granting department from the credit-monitoring department. Also, they have been encouraged to adopt improved tools to identify measure, check and control risks, in order to mitigate their adverse effects on the bank's financial position.

As for bank inspection and follow-up visits, the Supervision and Inspection Department has continued to carry out such visits to secure bank compliance with rules and regulations. Furthermore, stress test results presented by banks have been studied and reviewed on regular basis. In the same context, the Financial Soundness Indicators (FSI), are normally employed by local and foreign banks as tools of early warning, have been followed up.

## Branching and financial inclusion policy

The number of licensed banks by end 2013 in Palestine stood at 17 banks, out of which 7 are local and 10 are foreign banks (8 Jordanian, one Egyptian and one foreign). The banks operate through a network of branches and offices spread across the different areas, constituting a total of 237 branches and offices, of which 125 are branches and offices of local banks and 112 are branches and offices of foreign banks, with 5 new branches and offices opened during 2013 (Al-Quds Bank branch, Palestine Islamic Bank branch, National Bank branch, Palestine Commercial Bank office and Bank of Jordan office).

The PMA has been keen to make banking services available across Palestine, while giving priority to rural and distant areas in order to facilitate trade and economic activity and allow access to all kinds of financial transactions to all citizens.

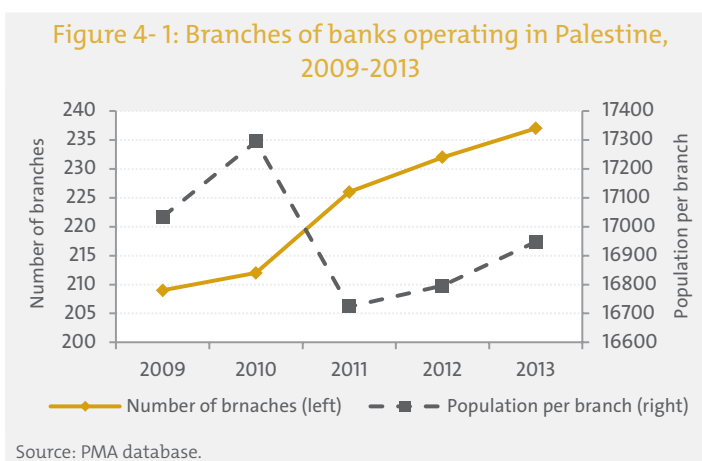
The PMA branching policy aims at reducing the population per bank branch in order to enhance the quality of service offered to customers, and to come nearer to international standards of branch densities of 10,000 individuals per branch. The branch density in Palestine stands at around 16.9 thousand per branch or office (or 9.9 thousand adults above 18 of age per branch or office), which theoretically indicates a potential for further branching in future.

[34] On a subsequent date to the year of this report, the second stage of implementation of the Basel II/III resolutions commenced.

In the same context, the PMA maintained efforts to promote financial inclusion and banking awareness, with a view to enable citizens of medium and limited incomes to open banking accounts. Citizens would thus be enabled to make use of banking services at reasonable rates, which are affordable to various targeted groups; they would also be encouraged to deal with banks on the basis of an “account per person/ basic account”.

The PMA also encouraged the usage of automated teller machines (ATMs) in order to ease the work pressure caused by customers’ visits to branches, and to remain up-to-date with the ongoing developments in e-banking services. Hence, advanced ATMs in branches and offices of banks were installed to provide citizens with all kinds of banking services. Additionally, the text-message service to customers has been provided for free with the purpose of mitigating the operating risks of banking transactions posed by customer account fraud. These services enable customers to follow-up on and verify their accounts’ activity. Moreover, these e-banking services were provided free of charge to all customers, who are thus enabled to verify and validate their account activity and execute various banking transactions permitted through this advanced internet service.

The PMA endeavors to encourage and promote the practice of e-banking services to reduce the usage of cash money. Indeed, Palestine witnessed a marked increase in the use of electronic banking services, including ATMs, ATM cash withdrawal cards, points of sale, credit cards and credit transfers via the internet or mobile phones. Not only does this development offer an easier way of performing various kinds of transactions, but it also lowers the costs and time needed to execute such transactions, thereby expediting economic activity at large.



## Banking systems developments and updates

The PMA continued to exert concerted efforts to develop a modern banking system in accordance with the best international practices, with a view to founding a robust and broad infrastructure that will mitigate risks to both the banking sector and the financial system, at large. To that end, in 2013 the PMA made several improvements to various banking systems that had been initiated in past years, and started new projects to be finalized in due course. Following are details of the aforementioned system developments:

### 1. The international bank account number (IBAN)

In May 2013, the PMA launched phase two of the IBAN project, which includes the application of the IBAN for processing personal transfers between local banks through the BURAQ payments system. To increase the efficiency of the project implementation, several illustrative meetings were held with the Ministry of Finance, the PCMA, and banks operating in Palestine.

The IBAN constitutes a major component of improving the efficiency of the Palestinian financial payments system. The system ensures the standardization of the identification system of account numbers between banks in various countries around the world. Usage of the IBAN is aimed at: keeping abreast of current developments in domestic and cross-border personal transfers, and complying with the best international standards issued by ISO. Moreover, the use of IBAN format supports the implementation of the direct automated application of Straight-Through Processing (STP) of credit transfers, which reduces manual processing and limits credit transfer errors resulting from faulty account numbers; this makes the execution of credit transfers through the various permitted channels easier to all bank customers.

## **2. Settlement of financial transactions through (BURAQ) system**

The project of cash settlements of stock market trading through (BURAQ) was launched in February 2013 with the signature of a mutual cooperation agreement between the PMA and the Palestine Stock Exchange (PEX) for that purpose. The agreement will enhance financial stability by ensuring the soundness of the clearing and settlement of large financial transactions, in compliance with recommendations of the IMF, the International Organization of Securities Commissions (IOSCO) and the Bank for International Settlements (BIS). It will also ensure that the PMA assumes its central bank role and is provided with the appropriate oversight tools that safeguard the settlement of all financial transactions through (BURAQ). Allowing settlement of PEX financial transactions through BURAQ helped upgrade the classification of PEX Counterparty Risk to “A” by the international company, “Thomas Miri”.

With the signature of the abovementioned agreement, PEX became an indirect member of the BURAQ system. Thus, the Clearing, Depository and Settlement Center, acting as PEX clearing agent for financial settlement, is authorized on behalf of brokerage firms to settle their financial obligations through PMA's BURAQ system. This arrangement will encourage investment in the stock exchange. Besides, it will also reduce associated risks, given that transaction values traded on PEX can be high and systemically significant, and therefore may impair financial stability in the absence of sufficient precautions or good and reliable risk management. This achievement is a strategic step in development of the Palestinian financial market and a significant addition to the up-to-date systems undertaken by the PMA.

## **3. Establish a unit for important payments system oversight**

Pursuant to a decision by the PMA Board of Directors, a payments system oversight unit, reporting directly to the Governor's Office, was established in 2013. The unit essentially aims at (i) ensuring the soundness and effectiveness of existing and planned payment systems in Palestine, and (ii) establishing cooperation mechanisms with relevant local bodies, with a view to jointly operate payments system oversight. The ultimate objective is to promote financial stability and protect the financial system through oversight and assessment that are in line with updated standards. The oversight process will also cause system changes as needed to ensure both safety and competence and comply with best international practices.

## **4. Electronic national switch**

This project aims at developing electronic payment methods in Palestine. Objectives include creating an electronic national switch, encouraging Palestinian banks to issue ATM and credit cards at relatively low costs, increasing



Points of Sale (PoS) and prepaid cards, and promoting the use of all those instruments. Additionally, the project will support the implementation of interbank clearing operations through the BURAQ system.

The bid for the project was awarded to BPC Banking Technologies<sup>[35]</sup>, which signed an agreement with the PMA for implementation of the National Switch electronic payments system and launched the project in July 2013. The project is expected to be completed in 2014. The new scheme is considered a vital instrument for the development of retail payments and an essential pillar of the plan for a PMA-designed national payments system in Palestine.

#### **5. Automated transfer system-ATS clear**

This project aims at developing new interbank payments technology, which provides automated and monitored clearing and settlement of payments in checks between member banks in the Check Clearing System. The project will provide an alternate and secure platform for operations of the clearing sessions' inward and outward files. The project is expected to be launched following an experimental period in banks and after completion of necessary training to the clearing employees.

#### **6. Opening government account with the PMA**

This program aims at mitigating risks associated with government transactions, and promoting PMA's role as the financial advisor and bank of the government, in line with the strategic plan to transform the PMA to a full-fledged central bank. To that end, an agreement to open a Ministry of Finance account with the PMA was signed, by which the account will receive any external transfers forwarded to the Palestinian government. The account can also be used to help issue government bonds, as needed. It is worth mentioning that the PMA is a member of the team commissioned with supervision of a government bond issue, for which special relevant instructions have been drafted.

#### **7. Standardization of systems used by the credit bureau (existing and new)**

As part of ongoing updating of Credit Bureau systems, the first phase has been completed regarding the standardization of the credit information systems within a single automated platform. The platform will feature system screen settings, system inspection and extracted reports, all to ensure satisfaction of work requirements.

The system development process included the following: Credit Information System, Bounced Checks System, Suspended and Lost Checks System, consolidation of personal information databases of Credit Registry and Bounced Checks systems, Credit Reports System, consensual settlement system, Revenue and Expenditure Control Program used by the Consumer Relations and Market Conduct Department, and the Complaints System. It is worth mentioning that the Palestinian experience in the development of credit information systems has been showcased in several international venues, particularly in Bolivia and Algeria.

#### **8. Unified query system**

The Unified Query System screens have been designed (including the query and answer screens) and linked to the Bounced Checks System, after two items were added to the query report concerning the customer's conduct

[35] An international company specialized in electronic payment systems in the MENA region.



in relation to default and borrowing. Queries are available to private sector companies, which joined the Credit Information System through a MoU.

The system allows companies to enjoy the following five key features: to check customer score on the Bounced Checks System, to ask for a clarification of the customer's rating, to know whether the customer is a recipient of banks' or lending institutions' loans, to know whether he/she has unpaid due installments, and finally to get the customer's history in dealing with the banking system. These features will enable companies to make more informed customer-relations decisions, and accordingly set customer-specific terms and conditions of agreement.

It is expected that the Unified Query service will be made available to citizens (non-member individuals and corporations in the Credit Information System), in order to enable the verification of a customer score on the Bounced Checks System. The service will also allow the verification of the conduct of a check-issuing individual or corporation before accepting a check. The service is likely to be launched later in 2014.

## 9. Updates on the credit scoring system

As part of the regular review of the Credit Scoring System, the third version of the system was launched in December 2013, following a detailed revision of variables which determine risk levels, in coordination with the software developer, and in a way that suits the Palestinian banking environment.

## 10. The PMA's business continuity

The PMA efforts to complete and develop the Business Continuity Project continued in 2013. The project aims at ensuring the availability of all banking services in emergency situations. The project has been launched within the appropriate framework of strategies and policies of business continuity. Relevant data, plans and procedures in the different PMA departments have been updated accordingly. All necessary requirements to implement the project have been provided, including at the alternative site, for various personnel needs, or as needed by various departments to bolster their business continuity abilities. Several workshops have been organized to raise awareness and spur relevant discussions.

The Business Continuity Unit (BCU) maintained ongoing supervision over business continuity testing, whereby, in coordination with various PMA departments, the alternative site was regularly inspected, as well as the disaster recovery site. Moreover, the internal and external contact data of respective departments were compiled in special booklets, to be regularly reviewed and updated.

In the same context, the BCU issued a pamphlet on business continuity, its significance and intersection with banking sector operations and the PMA-adopted methodologies. The pamphlet was distributed internally as well as to other financial and banking institutions, to promote awareness and support training in this area.

## Relation with other financial institutions

### Specialized lending institutions

As part of its efforts to organize and control the specialized lending institutions' state of affairs, the PMA issued Instructions No. (1/2013), which permitted them to offer conventional or Islamic lending or both, thereby amending Instructions No.(1/2012), which had allowed them one kind of lending only. The amendment comes in light of PMA's strategy of financial inclusion, which is recognizant of both the impact of specialized lending institutions on development and their characteristic role given Palestine's special circumstances.

It is worth mentioning that special lending institutions practice both conventional and Islamic lending in accordance with PMA's regulations and standards of accounting, auditing and control of Islamic financial institutions.

In addition, the PMA pressed with the implementation of its strategic plan for the supervision and control of specialized lending institutions for 2013-2015 in cooperation with the the Deutsche (Gesellschaft für Internationale Zusammenarbeit-GIZ). To get better acquainted with their conditions, the PMA made several visits to various specialized lending institutions. Furthermore, the PMA collaborated with various concerned parties in order to adjust these institutions' situations in accordance with the PMA's instructions. In the same context, the PMA held a workshop in the city of Jericho, which addressed strategic issues pertinent to the specialized lending sector.

PMA's follow-up with these institutions continued in order to help them introduce the necessary in-house amendments in compliance with the new rules and instructions issued in that regard. Accordingly, six institutions were granted tentative license approval as specialized lending institutions, in accordance with the relevant licensing and supervision regulations; five of these are existing and in the process of rectifying their conditions<sup>[36]</sup>, and a sixth (Al-Ibdaa) is being founded.

The period of notice for lending institutions to rectify their conditions was extended until end of 2014 by the PMA Governor's decision. Institutions not abiding by the new requirements are still kept under PMA's supervision, including through correspondences and meetings with their managements.

### Money changers

As part of its efforts to follow up and organize the money changing profession, the PMA has issued the following instructions in 2013:

- **Instructions No. (1/2013)** concerning the determination of standard working hours and days, by which money changers, during official working days, are allowed a maximum of two weekend days a week and a minimum of 7 working hours a day to start before 9:00 a.m.. Money changers are required to announce their working hours and official holidays. Accordingly, they are to commit to prior-notification of the PMA of any closure during official working days, under any circumstance.

[36] These are: Palestine for Credit and Development- Faten, Reef Finance, Reyada for Lending and Financial Services- CHF, Arab Center for Agricultural Development- ACAD and Palestinian Businesswomen's Association- Asala.

- **Instructions No. (2/2013)** concerning the control of agent and sub-agent wire transfer services, specifying requirements to be fulfilled by a wire transfer company, before money changers and money changing companies acquire its agency. The instructions also require the money changers to obtain PMA's pre-approval as a condition to acquire the agency. Moreover, the instructions set out the controls for wire transfer activity by money changers, as well as the eligibility requirements to acquire such agencies, confining the agent money changer to a maximum of 5 subagents.
- **Instructions No. (3/2013)** concerning processing customer complaints, by which money changers are required to provide an on-site complaints box for the use of the public. The complaint shall be stamped by money changer stamp and a copy of the complaint handed to the complainant, who should receive a reply in writing within 10 days of the date of the complaint. A quarterly complaints report shall be submitted to the PMA of all complaints and the corrective actions taken.

On a different note, the Policy for Licensing Money Changers for the Years 2013- 2015 has been formulated and approved. Moreover, the money changers were inspected for their compliance with the minimum capital requirement, as per the relevant PMA instructions, and in accordance with the commitments and time schedules they had previously suggested. In that context, 22 money changing firms have fulfilled the requirement for minimum capital, while 3 other companies have received tentative approval to raise their capital. Meanwhile, the first phase of capital increase for a number of other firms has been delayed to 2014. Coordination also continued with the official security apparatus and the Attorney General Office to put an end to the phenomenon of peddler and unlicensed money changers.

As part of regular follow-up and supervision, the PMA staff conducted 267 on-site visits to check the compliance of money changers to correct the supervisory observations previously indicated. Non-compliant money changers were fined and given final warnings to correct the noted observations, particularly concerning the full application of the accounting system approved by the PMA and the delivery of the required accounting reports through the PMA database.

To ensure soundness of money changing sector, the PMA has issued the Anti-Money Laundering Manual for Money Changers. The manual addresses money laundering and the means to combat this crime, in line with the international recommendations and standards released by the Financial Action Task Force (FATF) and the Palestinian Anti-Money Laundering Decree Law No. (9) of 2007. The manual addresses numerous topics, most prominently: defining the crime of money laundering, its stages, implicating indicators and the relevant preventive measures money changers should adopt.

Moreover, training courses have been developed for the money changers in coordination and collaboration with the Palestinian Banking Institute (PBI). The courses address laws and regulations, securities, currency-associated risks, and the subject of anti-money laundering. In coordination with the PBI, the PMA's Financial Follow-up Unit is to hold a training program for workers in the money changing sector, which will deliver specialized certification in anti-money laundering from the Palestine Anti-Money Laundering Accreditation (PAMLA).



## Relation with the government and other public Entities

The PMA has been keen to strengthen its relations with various PA institutions, as well as local organizations and bodies<sup>[37]</sup>, with a view to promote and encourage sustainable economic development. In that context, the PMA continued to closely follow-up on the PA Strategic Plan concerning public finance management, and monetary, banking and financing policies. The PMA also continued to coordinate with the government and the EU with regard to the sub-committees on economic and financial matters. In addition, the PMA kept its collaboration with the Office of the General Attorney and the judiciary with regards to distraint warrants pursuant to the Law.

Regarding cooperation with the Ministry of Interior, the PMA signed an agreement with the ministry in July 2013, aimed at strengthening cooperative relations and mutual understandings regarding various issues in relation to NGOs engaged in lending or Islamic financing. The two parties have constantly sought to ensure compliance with relevant legislation, as part of their concerted efforts to regulate the operation of NGOs and to help them accomplish their objectives of providing financial services to disadvantaged and under-served social groups. This served to reinforce financial inclusion and sustainable development by way of alleviating poverty and unemployment.

The PMA has also continued to develop its relations with official local institutions, through its membership in several BoDs and active participation in various institutions' activities and meetings, including the PCMA, PBI, ABP as an observing member, the Palestine Investment Fund (PIF), Palestinian Investment Promotion Agency (PIPA), the National Anti-Monetary Laundering Committee, Board of Professional Auditing in which the PMA chairs the examinations committee in addition to its membership in the licensing committee, the Establishment of Management and Development of Orphans Funds, and the Higher National Committee on the Legislative Plan of the Palestinian National Authority.

The PMA has also contributed, through its membership in the Student Loan Fund for Higher Education in Palestine, to preparing the pertinent legislation, drafts of the organizational chart, job descriptions, administrative and financial systems and the Fund's strategy for the coming years. It is expected that the respective draft law will shortly be approved by the Cabinet.

Moreover, the PMA signed a MoU with the Wataniya Mobile in September 2013, by which the company joined the Credit Registry. The agreement will enrich the credit registry database through the provision of data concerning default customers, thereby enhancing the ability of banks to assess their customers and make loan-granting decisions based on correct and precise credit information. Wataniya Mobile also permits the use of the query service using the Unified Query System, in accordance with relevant terms and conditions.

In the context of promoting cooperation and coordination in the field of anti-money laundering, the PMA Financial Follow-up Unit (FFU) signed MoUs with the Ministry of Justice, the Ministry of National Economy, the Ministry of Finance, the Ministry of Interior, PCMA and the Palestinian Land Authority.

[37] It is worth mentioning that the PMA is a member of the following committees: Palestinian Statistical Advisory Council, EU-PA Sub-Committee on Economic and Financial Matters, the National Committee (national and technical teams) for the Accession to the WTO, Cross-Cutting Strategy on Public Finance Management and Monetary, Banking and Financing policies for 2014-2016, Gold Committee, Improving Business Environment Committee, and the Dissemination Data Systems Committee.



These MoUs aim at promoting cooperation between the FFU and national entities in relation to commitment to international standards, with a view to better prepare for membership of the State of Palestine in international organizations. The MoUs were signed<sup>[38]</sup> under the auspices of Dr. Jihad Al Wazir, Chairman of the National Anti-Monetary Laundering Committee. It is worth mentioning that the Law by Decree No. (6) Of 2013<sup>[39]</sup> has been issued, amending the Palestinian Anti-Money Laundering Decree Law No. (9) Of 2007. The amendment states that the PMA shall continue to fund the FFU in accordance to the budgets approved by the National Anti-Monetary Laundering Committee, until a special FFU budget is approved in the PA Public Budget.

The FFU took part in several international conferences and workshops during 2013. The Unit attended the ACAMS conference, held in the United Arab Emirates, the 17th MENA FATF Plenary Meeting held in Sudan, and the workshop on banking fraud detection organized by the Central Bank of Lebanon and held in Beirut. The FFU has also participated in several local and regional training courses, including the “Anti-Money Laundering in Financial Institutions Course” and the “Banking Fraud Course” both held in Jordan, and the “Strategic Planning Course” held at the PBI.

## Relation with the public

The PMA gives special attention to the relation with the public, reflecting its interest in providing citizens with the best possible quality of banking services, at the lowest cost. The PMA also pays special attention to promoting confidence between various segments of the public and banks operating in Palestine. In that context, the PMA exerted concerted efforts to promote financial inclusion and banking awareness<sup>[40]</sup> to enable low, limited and middle-income individuals to open bank accounts and enjoy banking services at encouraging costs affordable to various targeted groups.

To promote banking awareness, the PMA launched the Second Annual Child and Youth Banking Week , during the period 16-21 March 2013, in WB and GS in collaboration with licensed banks, the Palestinian Ministry of Education and Higher Education and the UNRWA. The bank branches employees visited 1,681 schools and distributed around 175,000 informative bulletins that were prepared specifically for the event. Additionally, students conducted visits to several bank branches.

In appreciation of its outstanding efforts in the area of public banking awareness, the PMA received the award for best financial awareness program in the Middle East by the Global Money Week 2013, issued by the organization of Child & Youth Finance International, headquartered in Amsterdam. The award was delivered during the Financial Inclusion Conference events organized in Turkey.

[38] Later to the year of this report, in April 2014, a MoU was signed between the FFU and the National Anti-Corruption Commission (PACC) to strengthen the cooperation between the two parties and reinforce the foundations of transparency, governance and protection of the Palestinian society against the crimes of corruption and money laundering. The MoU also stated that the FFU shall forward its reports pertaining to corruption as a predicate offence to the Assistant Attorney General acting for the PACC, which will help support the efforts to track or prosecute persons suspected of involvement in the crime of money laundering.

[39] The Law was published in the Palestinian Gazette, issue (101), on 20 August 2013.

[40] At a later date to the year of this report, a MoU was signed between the PMA and the PCMA (in February 2014) to establish the National Strategy on Financial Inclusion, with support of the AFI.

## Box 6: Banking awareness campaigns

The PMA efforts to promote banking awareness and literacy of the public continued during 2013, fostering a better understanding of the nature, alternatives and terms of banking services offered by various banks. In this context, the PMA launched several awareness campaigns as follows:

1. Launching the IBAN campaign, with the purpose of acquainting bank customers, with the IBAN project, and accompanying benefits of accuracy, credibility and speed of execution of external bank transfers. The campaign aimed at encouraging customers to get the IBAN number, using educational leaflets and advertisement in the local newspapers, radio and websites, in addition to descriptive essays and articles which detailed the IBAN's components, uses, advantages and the reasons for its adoption by the PMA for usage in the Palestinian banking sector.
2. Launching an awareness campaign on electronic banking services (SMS and e-banking), which focused on their free availability. Allowing customers to follow up and verify their account activities will decrease operational risks in banking operations.
3. Launching an awareness campaign on dealing with private lenders, urging the public to restrict their financial and banking activities to PMA-supervised financial institutions.
4. Organizing banking awareness seminars and workshops for various segments of the public, including school and university students and summer camps in the WB and GS. The main objective was to promote financial literacy and banking awareness among students, through introducing them to the PMA, its tasks, goals, legislative environment, regulatory and organizational framework, regulated and supervised sectors, and features of the automated systems it employs. Moreover, banking awareness seminars were organized for the Palestinian Exporters and Importers Council, National Security and military intelligence officers, the Presidential Guard and the Palestinian Civil Defense.
5. Publishing a collection of banking awareness articles in local newspapers relating to customer rights, guarantors and available banking services.
6. Designing electronic awareness games and sketches uploaded to the PMA website and social media, with the purpose of promoting higher financial and banking awareness and literacy amongst children and youth.

Reflecting its policy to raise the level of banking and financial education and literacy for all social segments, particularly those seeking private residence ownerships, PMA organized several pro bono educational meetings addressing the issues of house purchase and ownership, through the PBI.

It is worth mentioning that the PMA is currently working on creating a banking awareness link on its website aimed at spreading banking and financial literacy across all social segments. The link will acquaint people with banking services and products and highlight their importance. To facilitate access to PMA banking services, a toll free number was assigned for calls to be made to the two PMA public relation halls in Ramallah and Gaza.

## Box 7: The national strategy for financial inclusion

Reflecting the consolidated efforts of all parties involved, the National Strategy for Financial Inclusion aims at formulating a sound basis for the promotion and usage of various financial services and products by members of all social strata. The strategy seeks to acquaint people with the importance of financial services, and with the means to obtain and use available services to improve their social and economic standing and attain social and financial stability. With the collaborative efforts of all parties involved, the strategy will best bridge the financial literacy gap by promoting consumer protection through the formulation of policies and guidelines to introduce current and potential consumers to their financial rights and obligations.

The formulation of the strategy comes at a time of a mounting need to raise awareness and improve financial education of Palestinian financial-service consumers. The strategy will thus reinforce consumer protection and facilitate access to funding resources and financial products and services. The strategy also brings to light the pressing need to unite initiatives and actions in order to avoid redundancy of resources and efforts and enable financial inclusion across the largest swathe of targeted social groups. The PMA and the PCMA will combine efforts to lead the establishment of the National Financial Inclusion Strategy in Palestine, in collaboration with all stakeholders, under a clear and well-developed plan. The plan will conform with the main principles for enhancing financial inclusion endorsed by G20, World Bank, the Alliance for Financial Inclusion (AFI) as well as the OECD Principles on National Strategy for Financial Education.

Building on previous international experience, the National Strategy for Financial Inclusion is expected to be established over a two-year period. Due to the peculiarity of the Palestinian conditions and the paucity of resources and specialized staff, the strategy will be implemented over two phases: the first will last for 5 years and will target the financial sectors supervised by the PMA and the PCMA; the second will be implemented over three years and will target the remaining sectors including the private and public sector and any other pertinent sector.

The Steering Committee for the formulation of the Strategy is chaired by the PMA and the PCMA, with the membership of the PBA, the Ministry of Education and Higher Education, the Banking Services Consumer Society, the Palestinian Network for Small and Microfinance “Sharakeh”, the United Nations Relief and Works Agency (UNRWA), Palestine Exchange (PEX), the Palestine Union of Securities Trading Companies and the Palestinian Insurance Federation. The committee held its first meeting in April 2014.

### The development outcomes of access to financial services and financing

Economic development depends to a great degree on the availability of financing to undertake development and investment projects. The financial sector plays a pivotal role in mobilizing local savings to leverage resources necessary to fund developmental plans and projects. An inclusive financial sector is characterized by its ability to provide broad-based financial services without hindering obstacles, whether as price or non-price barriers. Such sector will also be able to provide maximum benefit from financial services to the poor and deprived segments of society. Without such benefits, individuals will resort to their personal savings to finance their consumption and investment needs, or are, otherwise, excluded from access to financial services. Consequently, improving access to financial services would reduce income inequality between different social strata and stimulate economic activity.

Experimental evidence demonstrates that developing countries, which had attained significantly high economic growth rates, were also able to mobilize local savings and increase saving rates. This has been achieved through



motivating the banking sector to offer attractive domestic saving and investment vehicles, as well as the appropriate financing tools to meet individual and corporate needs.

Recent studies also suggest a correlation between the development of the financial sector and levels of access to finance, on one hand, and the alleviation of income inequality and poverty, on the other. Countries enjoying higher levels of access to banking and financial services have also managed to reduce disparity in income distribution faster than the other countries. This is so since higher levels of financial depth lead to higher economic growth, improved business environments, and increased efficiency of goods and services markets. Studies estimate that this indirect impact accounts for around 60 percent of the change towards the reduction of income inequality, whereas the direct impact of broad-based access to financing accounts for the remaining 40 percent of change. The impact mainly reflects the positive outcome of the increased access to finance for poor households through microfinance institutions.

Also, access to financing and banking services effectively mitigates the fluctuations in consumption and investment expenditure levels, thereby reducing business cycle and GDP fluctuations. Enhanced access to financing and banking services enables individuals and enterprises to overcome cash restrictions and compensate for current income irregularity, thereby limiting consumption and investment fluctuations. Families' access to savings and wealth investment services through the financial sector enables them to manage irregular current income and ensure an almost regular cash flow<sup>[41]</sup> reducing consumption fluctuations, while enterprises' access to banking finance enables them to overcome cash restrictions and thereby reduce investment fluctuations.

### G20 Principles for Innovative Financial Inclusion

Innovative financial inclusion means improving access to financial services for poor people through the safe and sound spread of new approaches. The following principles aim to help create an enabling policy and regulatory environment for innovative financial inclusion. The enabling environment will critically determine the speed at which the financial services access gap will close for the more than two billion people currently excluded. These principles for innovative financial inclusion derive from the experiences and lessons learned from policymakers throughout the world, especially leaders from developing countries. The principles are:

- **Leadership:** Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.
- **Diversity:** Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.
- **Innovation:** Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.
- **Protection:** Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.
- **Empowerment:** Develop financial literacy and financial capability.
- **Cooperation:** Create an institutional environment with clear lines of accountability and co-ordination within

[41] Milton Friedman's "Permanent Income Hypothesis" and Modigliani's "Life-Cycle hypothesis" imply that "permanent income" and not "current income" is the main determinant of the levels of consumption. Over their life-cycle, individuals invest in available material resources to obtain returns, allowing the mitigation of fluctuations in expenditure levels. Returns on assets, whether deposits, stocks or any income-generating asset, are utilized to manage fluctuations in the levels of current expenditure, which reduces fluctuations in business cycles and output.



government; and also encourage partnerships and direct consultation across government, business and other stakeholders.

- **Knowledge:** Utilize improved data to make evidence-based policy, measure progress, and consider an incremental “test and learn” approach acceptable to both regulator and service provider.
- **Proportionality:** Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.
- **Framework:** Consider the following in the regulatory framework, international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime reflecting for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.

These principles are a reflection of the conditions conducive to spurring innovation for financial inclusion while protecting financial stability and consumers. They are not a rigid set of requirements but are designed to help guide policymakers in the decision making process. They are flexible enough so they can be adapted to different country contexts.

Sources:

- Arab Monetary Fund, the Joint Arab Economic Report, 2012.

- World Bank, 2007, “Finance to All: Policies and Pitfalls in Expanding Access”, Policy Research Report.

- Peace, Douglas, 2010, Financial Inclusion in the Middle East and North Africa: Analysis and Roadmap Recommendations, the World Bank.

In light of PMA’s financial inclusion strategy, and banks’ partnership in corporate social responsibility, banks have made concerted efforts to provide banking services for people with special needs. To that end, banks have qualified specialized staff dedicated to communicate and provide services to the deaf, the speech-impaired and the blind, in cooperation with organizations working with these groups.

The PMA also strived to secure cash liquidity in all currencies to all banks, including for branches of banks operating in Gaza. In that context, the PMA’s fruitful efforts helped banks operating in the WB ship shekel surplus cash in their possession to the Israeli Central Bank in line with the Paris Protocol provisions in that regard. Accordingly, an interim mechanism was put in place to ship NIS 120 million on monthly basis from all Palestinian banks that do not have direct relations with their Israeli counterparts. The shipment was raised to NIS 300 million per month as of July 2013 and the sum of NIS 1 billion was shipped (for September, October and November 2013) by special agreement. The amount of shekel cash surplus shipped from banks operating in the WB totalled NIS 9.6 billion in 2013. However as a punitive measure against banks operating in GS, Israel prohibited the transfer of the shekel cash surplus from these branches, allowing the shipment of NIS 200 million only from these branches to their WB counterparts during 2013. Additionally, PMA arranged with the Israeli Central Bank for replacement of spoiled notes as needed, and allowed NIS 54 million worth of coins into the GS in 2013.

Also as part of its commitment to safeguard citizens’ rights and interests and lighten their burdens, the PMA continued to follow up on the cases of aggrieved former Gazan workers in Israel against the National Insurance Institute of Israel.



During 2013, the PMA persevered in developing its international relations through membership in boards of international organizations,<sup>[42]</sup> taking active part in their meetings and activities and seeking to join other organizations. Within this context, the PMA continued 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 a MoU with Bank Al-Maghreb, as part of efforts to strengthen relations between the two countries in financial and banking matters.

On a related note, the PMA signed a MoU with the Ministry of Development Planning in Bolivia<sup>[43]</sup>, in October 2013, aiming at expanding cooperation and exchanging expertise in the areas of monetary policy, financial developments, anti-money laundering, credit registry databases, business continuity and disaster management.

Also, PMA maintained the ongoing relation and cooperation with many international organizations like the Organization for Economic Cooperation and Development (OECD) and the International Finance Corporation (IFC). The IFC had developed a new template with the objective of determining the impact of credit information systems on the creation of new job opportunities. The template was examined using the outputs of the Credit Registry System at the PMA, in accordance to specific conditions and standards. The results showed that the system contributed to the generation of 6,359 job opportunities during 2013.

Within the same context, the PMA strengthened its ties with international financial and banking organizations and committees, most important of which are the OECD International Network on Financial Education (INFE), the Child Youth Finance International (CYFI) and the AFI. Some of the PMA employees have obtained membership of a number of AFI committees including the committee on the AFI permanent headquarters, the Working Group on Consumer Empowerment & Market Conduct, the Financial Inclusion Strategy Peer Learning Group and SME Finance Working Group. The PMA also participated in the AMF regional team working to promote financial inclusion in the Arab countries. The PMA was assigned the preparation of two working papers, one about the PMA experience in the establishment of a national strategy on financial inclusion, and the other on the Child and Youth Banking Week. The two papers were presented to the Council of Governors for official approval, and will be disseminated in other Arab countries to serve as key references for the establishment of a national strategy of financial inclusion and for the launch of child and youth banking weeks across Arab countries.

Furthermore, the PMA continued to chair the sub-committee to establish the guiding standards on “Banking Sales and Marketing Practices”, at the request of AFI. A comprehensive analytical study on this topic covering Palestinian banks and lending institutions was conducted. The study analyzed the results of the questionnaire which was

[42] It is noteworthy that the PMA is a member of the Union of Arab Banks, Islamic Financial Services Board (IFSB), and Arab Committee on Banking Supervision (ACBS) / Arab Monetary Fund (AMF). In that respect, a paper on “the PMA experience in the area of infrastructure development of financial and banking sectors” was presented to the Secretariat of the Council of Governors of the Arab Central Banks and Monetary Agencies in August 2013, following which Dr. Jihad Al Wazir received official letter of gratitude, pursuant to Council Resolution No. (7) For 2013. A second paper was also presented regarding the Palestinian experience in risk management during the Annual Risk Management Forum, held in Beirut in May 2013.

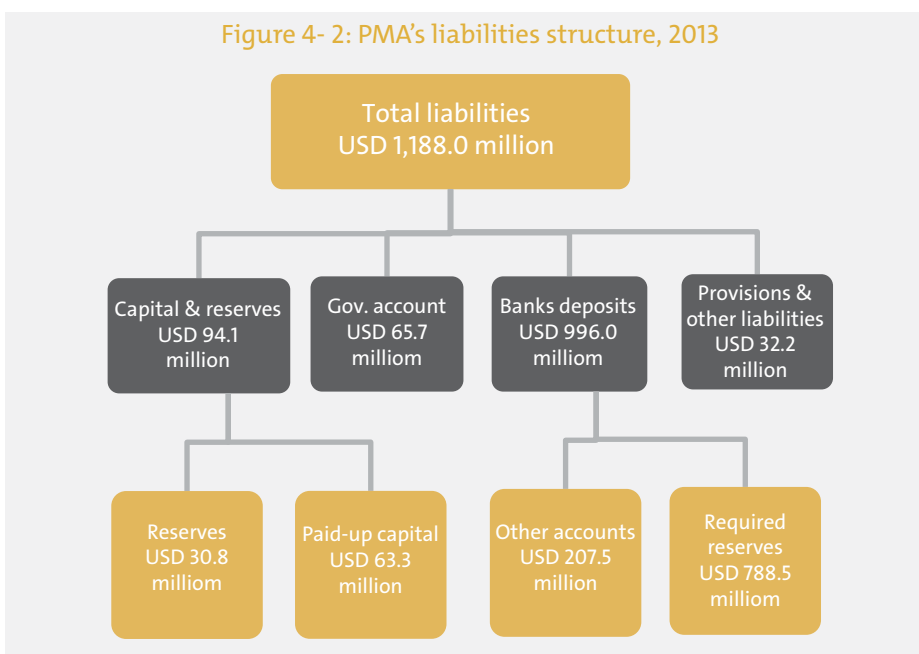
[43] At a later date to the year of this report, a MoU between the PMA and the Bank of Algeria was signed in January 2014, aiming at strengthening bilateral relations and exchange of expertise in areas of mutual interest, particularly regarding banking supervision, credit systems and developing banking and financial activity in Palestine and Algeria. According to the MoU, the PBI and the Higher School of Banking, associated with the Bank of Algeria, will strengthen cooperation ties and exchange expertise. Likewise, a MoU was signed between the PMA and the Central Bank of Sweden (Riksbank) in April 2014 with the objectives of promoting mutual cooperation and expertise exchange in the fields of financial stability, monetary policies, payment systems and market operations. The MoU also touches on the subject of academic visits and consultancies, joint workshops, training and technical support programmes aimed at the work methodology development of central banks.



distributed to banks and lending institutions in accordance with relevant G20 and World Bank international standards. The results of the study were presented to AFI, and formed the basis for issuance of recommendations on sales and marketing practices. Subsequently, guiding standards on this issue were approved and circulated to all member states during the AFI meeting in Malaysia.

## Financial activity of the PMA

PMA's financial activity by end 2013 showed an increase in assets/liabilities by 6.7 percent, to a value of USD 1,188.0 million, compared to 2012. The increase is mainly attributed on the liabilities side to the introduction at PMA of a new PA account item, namely the Ministry of Finance account<sup>[44]</sup>. Funds deposited to this account amounted to USD 65.7 million. Additionally, banks' and financial institutions' deposits rose slightly (0.4 percent) as compared to



2012, reflecting the increase in required reserves by 4.7 percent to USD 788.5 million. This resulted from the regular increase in customer deposits in banks operating in Palestine, which soared by 10.9 percent in 2013, compared to 2012. Despite the increase, the relative importance of banks' and financial institutions' deposits fell to 83.8 percent of total liabilities, as compared to 89.1 percent in 2012.

PMA's paid-up capital rose by 3.1 percent to reach USD 63.3 million, as part of the intended boost to PMA capital to reach gradually to USD 120 million. As a result, capital and reserves in the PMA balance sheet also rose (by 2.2 percent) to reach USD 94.1 million as compared to USD 92.1 million in 2012.

PMA's reserves (general and revaluation reserves) hardly changed in 2013, remaining at around USD 30.8 million. However, provisions and other liabilities grew by 9.2 percent compared to 2012 to reach USD 32.2 million. Provisions are composed of a number of items, including provisions for doubtful loans, indemnity provisions, accruals for employee expenses and administrative expenses, etc... Other liabilities include several items like bank and money changer safe deposits, cash insurances, money changer guarantees, suspended accounts, etc...

On the assets side, PMA's time deposits (both domestic and foreign) increased substantially (by 12.1 percent) to reach USD 839.6 million, compared to 2012. Also PMA's current deposits (domestic and foreign) soared (by 30.1 percent)

[44] A MoU was signed with the Ministry of Finance, by which the Ministry will open an account with the PMA through which it will receive any foreign transfer. Furthermore, the account is to be used in the event of bond issue.

to reach USD 102.0 million. Net fixed assets also increased sharply (by 24.5 percent) to reach USD 12.7 million. The latter increase came in connection with the establishment of several important projects in the field of the payments system, services systems and business continuity. These projects would serve to reinforce Palestinian banks' robustness, keeping them abreast of up-to-date systems used in international banking business. Additionally, PMA financial investments held till maturity (domestic and foreign) rose by 3.8 percent to reach USD 91.8 million, whereas financial investments for trading remained unchanged at around USD 100 million. On the other hand, PMA Islamic investments witnessed a decline by 74.0 percent to reach USD 17.4 million, compared to 2012.

PMA foreign assets constituted 81.4 percent of total assets, compared to 82.3 percent by end 2012. Domestic assets constituted 15.5 percent of total assets compared to 14.9 percent by end 2012, while the remaining assets (fixed assets, government advances and loans and other assets) constituted 3.1 percent, compared to 2.7 percent by end 2012.

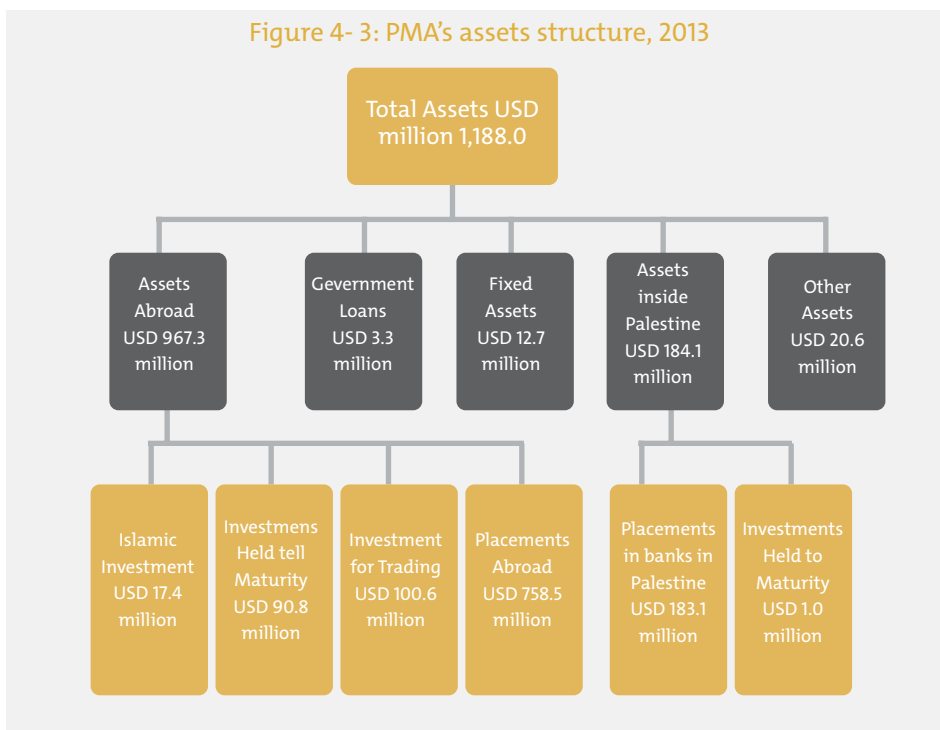
As for profit and loss account, PMA revenues increased by 2.3 percent to USD 17.0 million compared

with 2012, due to a rise in other revenues by 23.1 percent to reach USD 4.8 million. Net interest and investment profits fell back to USD 13.1 million, from USD 13.7 million in 2012, marking a 3.7 percent decline.

PMA's expenditure rose by 10.3 percent to reach around USD 11.0 million, compared to the previous year. The hike reflected an increase in employee expenditure by 8.9 percent to reach around USD 11.0 million, compared to USD 10.1 million in 2012. The increase related to the cost of living index, as well as to employees' salary adjustment, promotions and performance evaluations.

Administrative expenses also rose to USD 2.9 million, compared to USD 2.5 million in 2012, while the provision for doubtful accounts fell by USD 0.8, compared to the previous year.

Net profit declined by 34.5 percent to around USD 1.9 million in 2013, as compared to USD 2.9 million in the previous year. The net profit was transferred in full to PMA paid-up capital.



## Research and development

As in previous years, the PMA continued to expand its research and strengthen its analytical and informational capabilities, covering macroeconomic inputs and outputs and setting the stage to develop elements of a monetary policy. Monetary policymaking entails developing monetary tools and the transition mechanisms that aim to advance the economy. In the event, new tools were developed for monitoring and analytical use, increasingly employing mathematical economic and econometric modeling.

These efforts were manifested in significant research outputs which serve decision makers and researchers. In particular, the data for the Palestinian economy structural model was updated in 2013. Equations used in that model were also revised to better support analytical processes and forecasts of key long-term economic indicators. The financial programming model, designed to capture the linkages between key economic sectors, was used to forecast the Palestinian economy's leading indicators for the years 2013 and 2014.

Also, the reduced form equation model has been further developed to provide quick, short-term and quarter-annual forecasts of GDP in Palestine. The model depends on brief periodic indicators (quarterly or monthly) applied using the autoregressive distributed lag (ARDL) model. This model has been used to predict the quarterly GDP through 2013. The results have been published in PMA's Quarterly Economic Developments Reports and the Inflation Reports. Furthermore, a model has been developed to measure the output gap and the potential output in Palestine.

## Publications

The PMA 2013 publications included several reports on various economic and monetary developments in Palestine and occasionally on the global scene.<sup>[45]</sup> The reports consisted of: (i) annual publications like the Annual Report, Financial Stability Report, Foreign Investment Survey of Palestinian Enterprises; (ii) semi-annual reports like Public Finance Sustainability Report; (iii) quarterly reports like Balance of Payments report, Quarterly Statistical Bulletin, Inflation Report, Quarterly Economic Developments report, Global Financial Markets report, Monetary Developments report and the Economic Monitor; and (iv) monthly publications like the PMA Business Cycle Index, Effective Exchange Rate Bulletin, Monetary Survey and the Monthly Statistical Bulletin. In addition, the PMA prepared several research and working papers in various economic and monetary areas of interest to researchers and economic policy makers.

## Staff and training

During 2013, the PMA continued to develop its staff including by recruiting employees with professional and technical qualifications and expertise required to fill vacancies in various departments, offices and units. The number of employees rose to 346 (including 88 employees in the Gaza office), as compared to 339 in 2012. Beside recruitment, the PMA continued with its efforts to raise the professional and technical competence of its employees through an extensive training program, vocational courses and workshops on a wide range of specialties and topics important to

[45] For more on PMA publications, visit the PMA website [www.pma.ps](http://www.pma.ps).

various PMA departments' work. External training was conducted by renowned local and international institutions.

In 2013, PMA employees benefited from 263 training programs (course/workshop) in comparison to 248 in 2012; 143 programs were held locally and 120 abroad. Employees from PMA departments of the Monetary Stability Group received training in 41 programs, while employees from the departments of the Financial Stability Group obtained training in 154 programs. This reflected PMA's keenness to develop and update staff on various international developments in the banking, financial and monetary aspects related to their work.

In particular, reflecting its strong interest in developing its staff working in the financial and banking sectors, the PMA continued to coordinate with the PBI to develop and launch quality-training programs in various financial and banking topics. Among its many activities, the PBI held an exceptional program in sign language, where several communication methods were used, including the oral method, hand placement and hand shapes to aid speech utterance, lip reading, gesture language, cued speech, changes in intonation, sign language and total communication.

In 2013 also, the PBI inaugurated its special three-stage certification program in anti-money laundering, PAMLA. PBI also conducted a Certified Bank Teller course, which sought to provide bank tellers with up-to-date practical basis for all teller operations in the Palestinian banking sector. The course comprised 6 training parts: communication skills, banking legislature, detecting fraud and counterfeiting, self-services (electronic), training on teller operations (withdrawal, deposit, currency exchange), AML and Code of Conduct and Compliance.

It is also worth mentioning that, for the last three years, the PBI has been distinguished for offering the Six Sigma certification programs (yellow, green and black belts), which focus on the development of quality. The PBI conducts these programs in collaboration with renowned international institutions.

The PBI also signed a MoU with Reef for microfinance services and the Palestinian Network for Small and Microfinance to promote cooperation between the signatories in the area of training, expertise exchange and other related activities in the microfinance field.





## Part II

# Banking Sector

### Overview

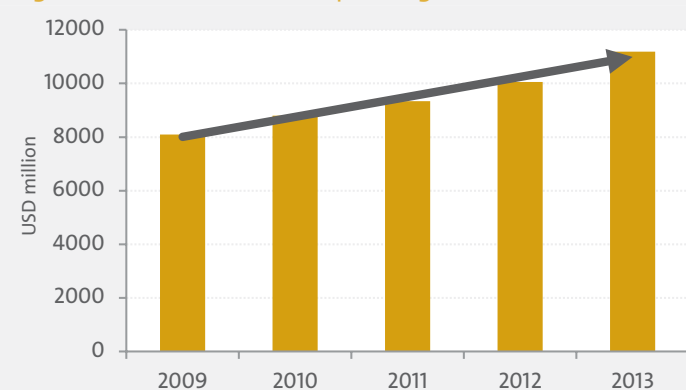
Despite mounting barriers and challenges (both structural and non-structural) to the Palestinian economy during 2013, the banking sector continued to grow, demonstrating a capability to weather many local and regional risks, and firmly establishing itself as a key pillar of the economy of the newly founded State of Palestine.

The uninterrupted record of the banking sector is an indication of its robustness and the increased public confidence it enjoys. This would not have been possible without the efforts the PMA made and the measures it took in many areas. Examples include developing the banking system's infrastructure, reinforcing the financial safety network, instituting supervisory procedures and instructions in line with the best international standards, reforming weak banks, enhancing the Palestinian payments system, and establishing the PDIC. In addition, PMA took several precautionary actions which boosted the banking system's performance, as manifested by various financial indicators. The latter include an increase in the size and quality of banks' assets, a boost to banks' capital and therefore an enhanced capability to cope with expected and unexpected risks, fairly low loan default rates, creation of additional reserve for countercyclical fluctuations, and increased rates of return on both average assets and average core capital.

### Assets of banks operating in Palestine

Assets of banks operating in Palestine increased to total USD 11,190.7 million by end 2013, recording 11.4 percent rise, and equivalent to USD 1,146.1 million, compared with 2012. This hike reflected a rise in most asset components in the banks' consolidated balance sheet. The following outline provides an analysis of the main asset items as of end 2013.

Figure 4- 4: Assets of banks operating in Palestine, 2009-2013



Source: PMA database.



## Direct credit facility portfolio

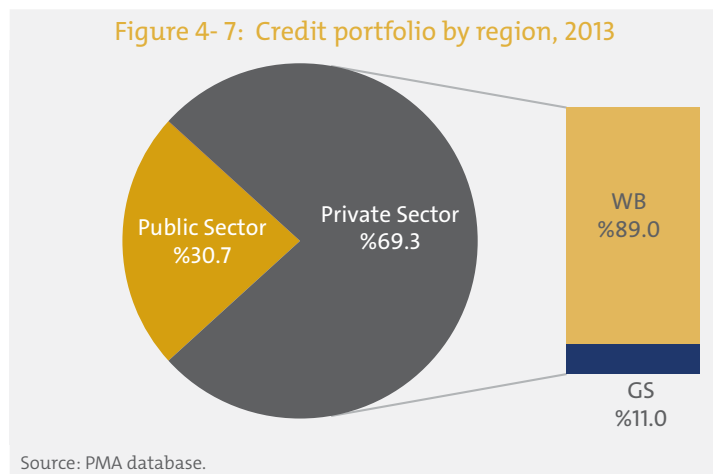
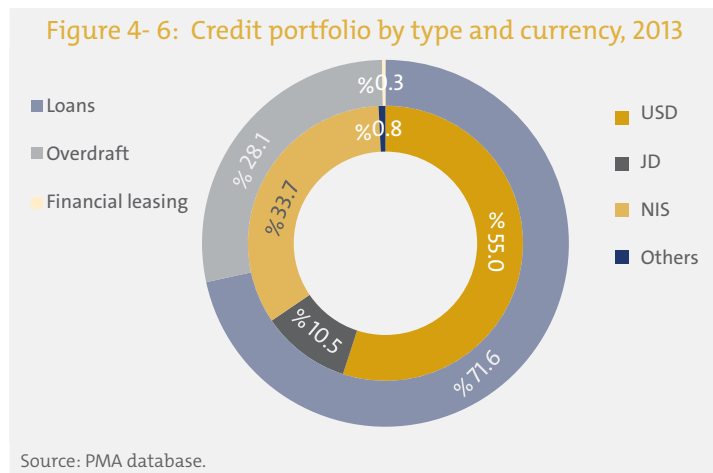
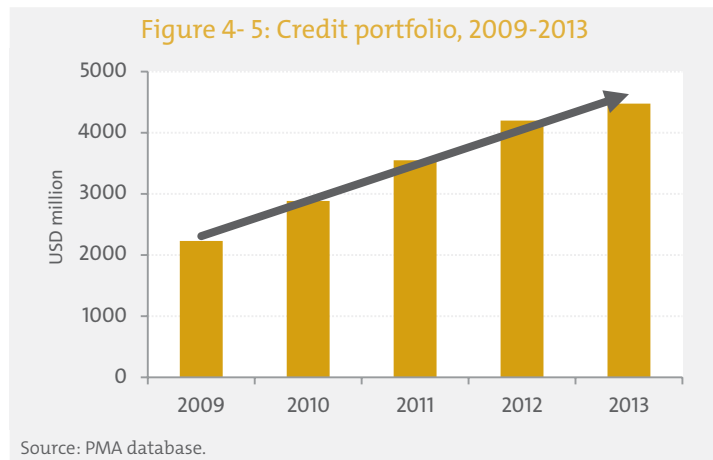
Direct credit facilities, the most important component of banks' assets, constituted 40.0 percent of total assets by end 2013. Changes in this item are of great significance to the banking sector, and economic activity, at large.

During the year, credit facilities increased by USD 281.1 million to reach USD 4,480.1 million, a 6.7 percent rise compared to 2012. This rise clearly indicated a substantial growth in supply and demand for credit, and an increased ability to deploy funds (credit) for, and secure liquidity to, various economic sectors. Despite this increase, the ratio of credit facilities to total assets has dropped by 1.8 percentage points (from 41.8 percent to 40.0 percent) by end 2013 compared to the previous year. The relative significance of credit facilities, however, remained higher than for previous years. However, credit as a percent of GDP fell from 40.9 percent in 2012 to 37.5 percent in 2013, due to a higher growth rate for nominal GDP than for direct credit facilities.

Out of total credit granted, 89 percent was pumped into the WB economy, and 11 percent was channeled to the GS economy, compared to 89.7 percent and 10.3 percent respectively in 2012. Thus the change in WB's and GS's relative shares in credit was insignificant and generally indicative of WB-GS relative weights (i.e. relative importance) in the Palestinian economy.

Loans constituted the largest portion (71.6 percent) of direct credit facilities, while 28.1 percent went to overdrafts and a slight (0.3 percent) was left to leasing finance. Compared with 2012, overdrafts lost 0.5 percentage points for the benefit of loans.

The USD remained the dominant currency of direct credit facilities, with a 55.0 percent share, compared to 53.7 percent in 2012, followed by the NIS with 33.7 percent, the JD with 10.5 percent and other currencies with 0.8 percent.



This distribution showed a decline (by around 2.6 percentage points) in the relative importance of the JD for the benefit of the remaining currencies, (as the US dollar's share rose by around 1.3 percentage point, the NIS by around 1.1 percentage point and the remaining currencies by 0.2 percentage point).

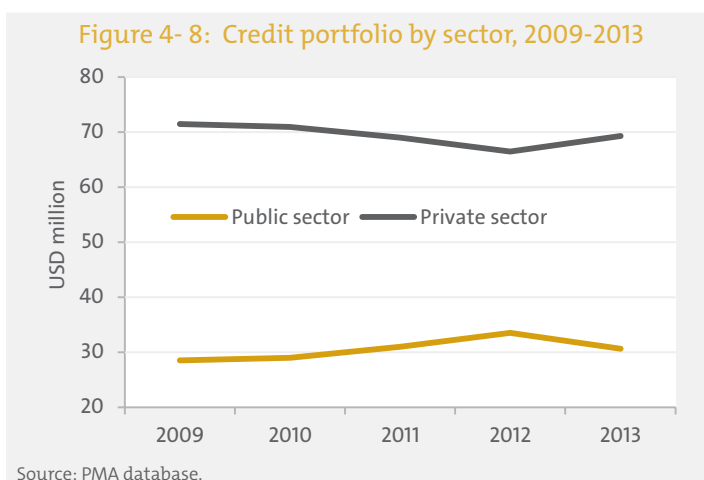
Direct credit facilities extended to the private sector constituted around 69.3 percent of total direct credit facilities against 30.7 percent granted to the public sector. This distribution shows a decline in value and significance of public credit facilities by 2.4 percent compared to 2012, having dropped from USD 1,407.4 million in 2012 to USD 1,374 in 2013. In contrast, private sector's share of direct credit facilities rose to 69.3 percent from 66.5 percent by end 2012.

The decline in the public sector credit came against the backdrop of a government budget surplus during 2013, which was used partly to pay back part of the public debt to the banking sector, and partly to reduce the private sector debt (outstanding arrears to private sector).

The abovementioned decline in credit to the public sector (mostly granted to the Palestinian government) is reassuring from the perspective of the banking sector stability. This is so since this decline, slight as it may be, was accompanied by a sustained growth in total credit facilities. It is notable that 2013 was the first time in five years that credit facilities to the public sector decline, and the entire growth in credit facilities goes to Palestinian private sector (resident and nonresident).

It is noteworthy that in recent years, total bank credit has grown remarkably, lifting the ratio of customer credit facilities to deposits to 53.9 percent by end 2013. Nonetheless, credit volume remained reasonable from the perspective of banking sector stability. Credit gap test results<sup>[46]</sup> for the period 2000 to mid-2013 revealed that the maximum value for this gap (3 percent), recommended by the Basel III regulatory framework, has not been exceeded. In fact, results point to a gap of 0.5 percent for credit granted to public sector and around 1 percent for credit to private sector by mid-2013<sup>[47]</sup> (keeping in mind that this indicator is principally used to monitor credit granted to the private sector).

While it is true that the expansion in direct credit facilities came in response to economic need and increased demand, it couldn't have been possible without PMA's concerted efforts in several areas. These relate mainly to actively promoting banking and financial inclusion, releasing of instructions on fair credit, reducing the ratio of placements abroad, mounting awareness campaigns on significance and utilization of banking services, and developing and/or launching of an array of advanced programs and systems. These efforts enabled banks to make credit decisions with a high degree of professionalism, credibility and transparency.



[46] The credit gap represents the difference between the growth rate of credit as a percent of GDP in the short run, and the growth rate of credit as a percent of GDP in the long run.

[47] PMA, Macroprudential Policies Adopted and Available to the PMA, 2013.

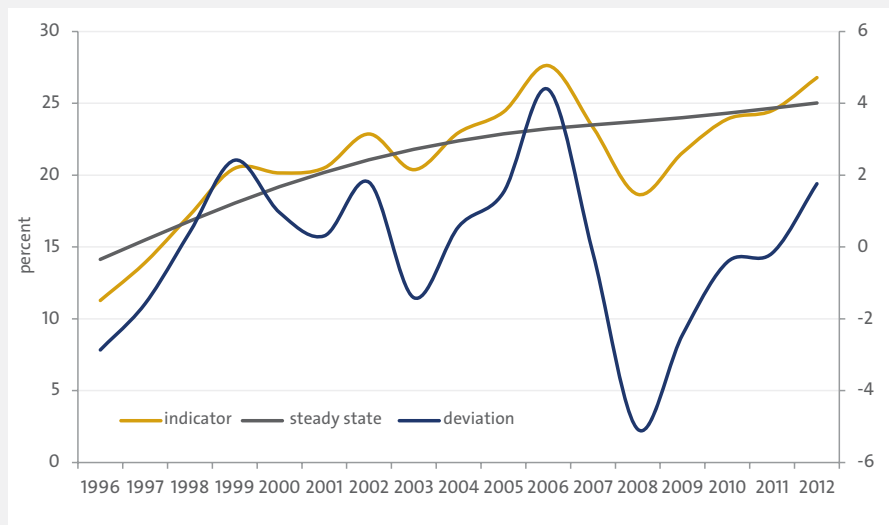
## Box 8: Credit facilities and economic growth

Numerous studies<sup>[48]</sup> have pointed to the direct correlation between credit facilities and economic growth. Credit facilities increase public and private sectors' expenditure (consumption, investment, or both), thus playing a significant role in the rejuvenation of local economies. In fact, many monetary policies rely on credit facilities as an essential stimulant to economic growth.

Studies point to the need for controls to determine the volume and type of credit facilities, and strike a balance between economic growth and the growth of credit facilities. In fact, it was amply noted that high and increasing credit growth had characterized the period prior to the global financial crisis. Accordingly, the Basel Committee on Banking Supervision in 2010 suggested that the ratio of credit facilities to GDP should be considered as key indicator of sustainable/durable lending. Hence, authorities should monitor deviations from the steady-state level of this indicator's long-run trend (credit gap) and adopt suitable policies to restore balance to credit growth and ensure financial crises do not recur due to excessive credit expansion.

It has also been shown that the impact of credit extension on economic growth depends on the type of facility extended (whether consumption or investment), and the economic sectors and activities targeted. The more credit is directed toward investment and productive sectors, the larger the impact on economic growth.

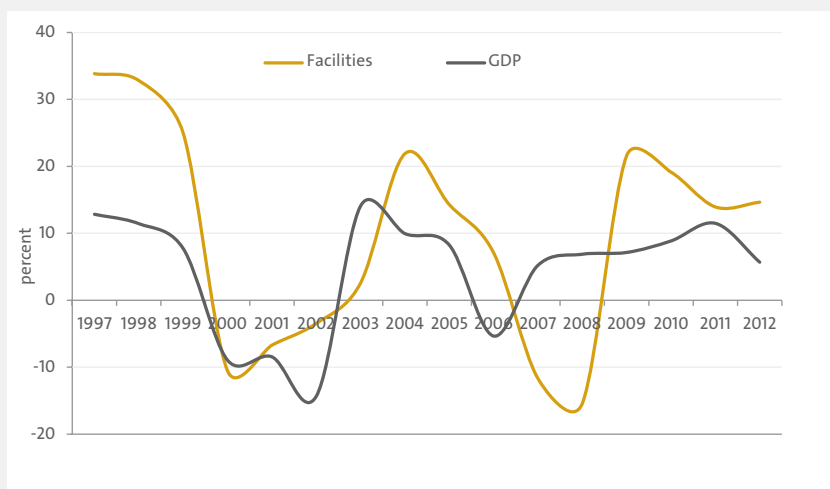
Credit facilities granted to private sector as a percent of GDP



The following figure shows a clear correlation between growth of credit facilities directed to private sector and growth of real GDP in Palestine. The figure clearly illustrates the direct relationship between economic growth and the value of credit facilities.

[48] See for example working papers No. 1150 and 1531 published by the ECB in 2010 and 2013 respectively.

### Growth in credits granted to private sector and real GDP



Regression analysis of the relation between private sector credit and GDP growth shows a proven statistically significant direct correlation. It is worth noting that the periods of crises in Palestine, particularly the years 2002, 2007 and 2008 have been duly considered. The linear regression equation was as follows:

$$g_t = \alpha + \beta_1 \cdot CPS_t + \beta_2 \cdot dummy02 + \beta_3 \cdot dummy0708 + \varepsilon_t$$

Where: -  $g_t$  is the rate of growth of real GDP during the period t.

-  $CPS_t$  is the growth rate of credit facilities to the private sector during the period t.

- dummy02 and dummy0708: are dummy variables created to take account of the effects of the crises of the years 2002, 2007 and 2008.

Analysis of the period 1996-2012 showed that a 1 percentage point increase in credit facilities growth rate directed to private sector was accompanied by a 0.4 percentage point increase in GDP growth rate given otherthings constant. Moreover, t-statistic values confirm the correlation between the two variables:

$$g_t = -0.006 + 0.432 CPS_t - 0.123 dummy02 + 0.125 dummy0708$$

(-0.248) (3.776)      (-2.058)      (2.390)

Adjusted R<sup>2</sup> = 0.62

In order to determine whether the correlation between private sector credit and GDP growth is a long-term relation, cointegration test was conducted. The result showed a long-term correlation between the two variables, suggesting a significant role for credit facilities as a stimulus to economic growth in Palestine.

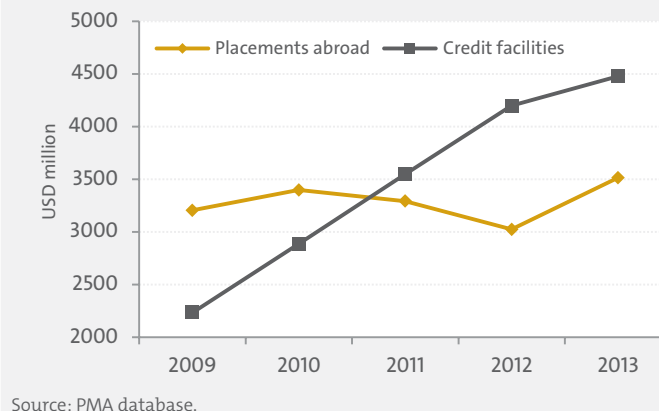
Recently, this indicator (credit gap, private sector credit/GDP ratio) has been regarded as a kind of banking macro-prudential policy. In order to evaluate the impact of credit policies, analysis needs to take a deeper look at the type of credit (consumption or investment) extended, the nature of beneficiary sectors (productive or service), as well as the value of return on credit by economic sector or activity. Other macro-prudential indicators should accompany credit policies, in order to assess the effectiveness of the latter policies.

## Placements abroad

Placements abroad continued to be the second most important component of assets of banks operating in Palestine, with a value of USD 3,514.5 million at end 2013, constituting around 31.4 percent of total banks' assets. Balances placed abroad, the main component of placements abroad, constituted 76.3 percent of the total in 2013, with a value of USD 2,681.1 million, an increase of 16.4 percent over end 2012. Investment in some investment instruments, the second most important component of placements abroad, constituted 22.7 percent with a value of USD 796.6 million, an increase of 17.0 percent over end 2012. Credit facilities granted abroad did not exceed 1.0 percent of total placements abroad with a value of USD 36.9 million, dropping by around 6.4 percent compared to end 2012.

Analysis of placements abroad suggests an inverse (but imperfect) correlation with direct credit facilities discussed above. This relation reflects the fact that banks control placements abroad in light of changes in domestic credit, and in accordance with PMA's instructions as to the ratio of foreign to local placements.

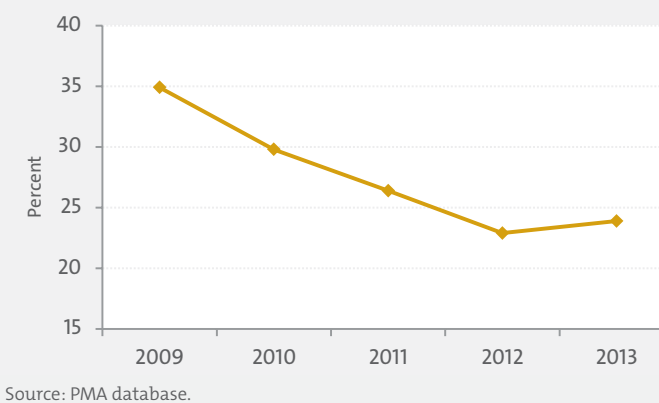
Figure 4-9: Credit portfolio and placements abroad, 2009-2013



## Balances with PMA and banks

Balances with PMA and banks increased by 12.4 percent by end 2013, to USD 457.1 million as compared to end 2012. Banks' consolidated balance sheet indicated that this increase in balances reflected the rise in balances with both Palestinian banks (by 22.2 percent) and banks abroad (by 16.4 percent). With this, the relative significance of placements with banks abroad rises by 1.1 percentage point to 24.0 percent, compared with 22.9 percent by end 2012. This signals the reversal of a five-year long downward trend in the growth of balances abroad. Nonetheless, the increase remains slight and doesn't necessarily indicate a significant turnabout in this item.

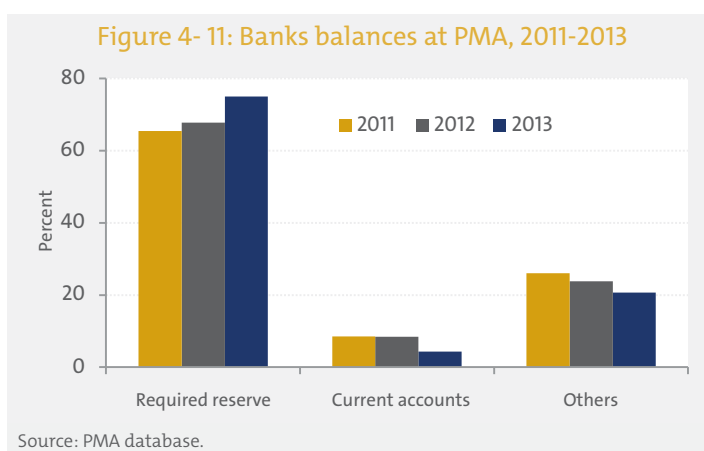
Figure 4-10: Balances abroad as a percent of total assets, 2009-2013



In contrast, balances with the PMA recorded a slight decline (by 0.2 percent or USD 2.4 million) by end 2013 over end 2012. Balances of banks (inside Palestine) with the PMA constituted about 4.0 percent of total bank assets, compared

with 3.7 percent by the end 2012. Required reserves, the major component of bank balances with the PMA, constituted 75.0 percent of the total, whereas bank current accounts represented 4.3 percent, and other accounts around 20.7 percent.

It is noteworthy that the drop in bank balances with the PMA occurred only in the two items: “current accounts” and “other accounts”, excluding required reserves. In fact, required reserves witnessed an increase during 2013, reflecting a remarkable rise in customer deposits in the banking system.



### Investment portfolio

Banks’ securities portfolio (for trading and investment) increased by 15.0 percent or USD 111.6 million to a total of USD 856.9 million by end 2013. In comparison, banks’ investments increased by 4.3 percent or USD 6.4 million to a total of USD 155.1 million for the same period.

### Other items

Other items consist of a number of items which are listed independently on the assets side of banks’ consolidated balance sheet. Cash and precious metals, the principle component of “other items”, totaled USD 956 million by end 2013, rising by 30.8 percent in comparison with end 2012. During the past few years, liquidity displayed a noticeable rising trend, due to the lingering obstacles Israel continued to place on the shipment to its central bank of the shekel cash surplus of Palestinian banks, thus forcing them to accumulate such surplus in their vaults. The second component under “other items” is banking acceptances (accepted by banks inside Palestine and abroad), with a value of USD 7.6 million compared to USD 5.3 million by end 2012. A third component is fixed assets, which rose to USD 362.1 million, compared with USD 346.6 million by end 2012. Other assets amounted to USD 242.7 million against USD 195.4 million by end 2012.

### Liabilities of banks operating in Palestine

Deposits (customer and bank deposits) in addition to net ownership equity constituted the main components of bank liabilities. Following are the main developments in banks’ consolidated balance sheet liabilities, as of end 2013:

## Deposits at banks operating in Palestine

Customer (non-bank) deposits do not only constitute the most important component of total deposits, but are also the largest constituent of bank liabilities. Hence, developments of this component are of prime significance. On one hand, they are indicators of public confidence in the banking sector, and on the other, they are salient determinants of the value of bank credit in the economy at large.

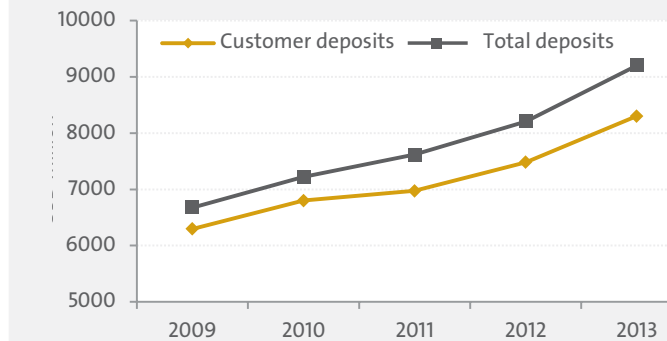
Analysis shows a stark growth (10.9 percent or USD 819.5 million) in customer deposits by end 2013, compared to end 2012. This growth rate is one of the highest rates realized in the past few years, a clear indication of the persistent confidence of the public in the banking sector as a secure and credible haven for their savings. Parallel to the growth in customer deposits, total deposits (banks and non-banks) increased by 12.1 percent or USD 996.6 million for the same period. Naturally, the major part of the increase in total deposits was primarily on the side of customer deposits; in comparison, bank deposits rose by

24.5 percent, equivalent to USD 177.2 million, for the same period. As in the case of credit facilities, despite strong growth in total deposits, their ratio to nominal GDP dropped from 80.1 percent in 2012 to 77.0 percent in 2013, as a result of a higher growth rate for nominal GDP than for total deposits.

Customer deposits constituted 74.2 percent of banks' total liabilities by end 2013, a slight decline (0.3 percent) from end 2012. They thus remained the predominant component of banks' total liabilities, year after year.

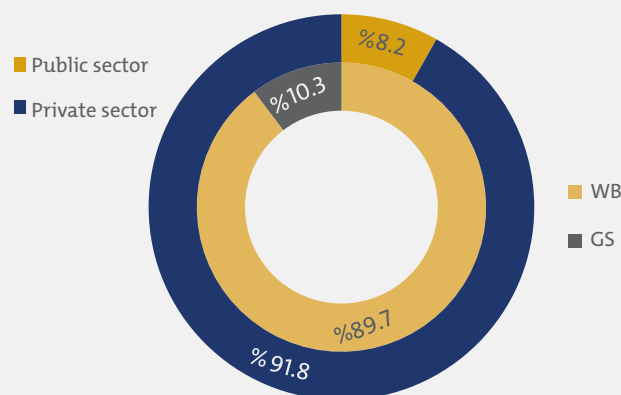
These deposits were distributed between the private sector (91.8 percent) and the public sector (8.2 percent), nearly the same distribution (91.7 percent and 8.3 percent, respectively) for end 2012. West Bank customer deposits constituted 89.7 percent of total deposits, while Gaza deposits made up the remaining 10.3 percent, nearly the same break down (89.5 percent and 10.5 percent respectively) as in the previous year. Naturally, the preponderant share (96.6 percent) of customer deposits belonged to the resident private sector, while non-residents' deposits constituted a meager 3.4 percent.

Figure 4- 12: Total and customer deposits , 2009-2013



Source: PMA database.

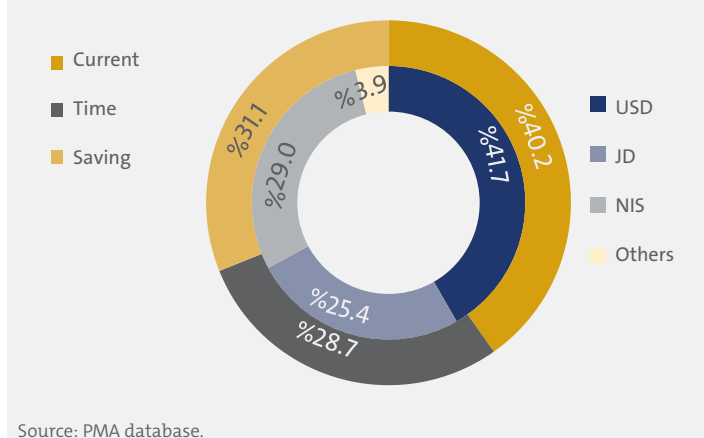
Figure 4- 13: Customer deposits by sector and region, 2013



Source: PMA database.

Current deposits contributed 40.2 percent of customer deposits compared to 39.9 percent at end 2012. Savings deposits came second with 31.1 percent compared to 30.3 percent in 2012, and time deposits constituted 28.7 percent compared to 29.8 percent in the previous year. This distribution indicates a loss of 1.6 percentage points in the relative importance of time deposits, in favour of other types of deposits. Likely, this partly reflected the relatively low interest rates granted on time deposits, and partly represented the effect of marketing programs banks employed in the form of rewards and bonus programs, which mainly target savings deposits. Additionally, instability and absence of clear political, security and economic prospects led customers to favour current deposits, on account of their convenience and fast processing.

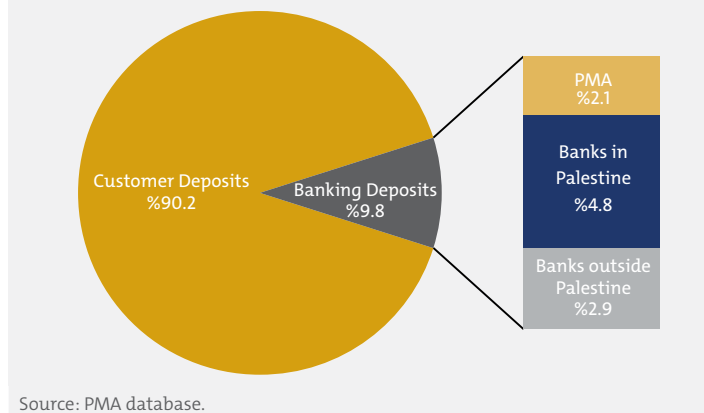
Figure 4- 14: Customer deposits by type and currency, 2013



The USD remained the dominant currency of the customer deposit structure, with a share of 41.7 percent, followed by the NIS with 29.0 percent, the JD with 25.4 percent, and remaining currencies with 3.9 percent. This distribution shows that the dollar and the dinar recovered their shares during 2013 compared to the previous year, with the dollar gaining 0.8 percentage point and the dinar around 2.1 percentage points. The increase came at the expense of the shares of the NIS and the remaining currencies, which dropped by 2.0 and 0.9 percentage points, respectively, during the same period.

Bank deposits, the second component of total deposits, include PMA deposits with banks, interbank deposits, and deposits of banks abroad with local banks. By end 2013, bank deposits reached USD 900.1 million, with a build-up of USD 177.2 million, and an increase of 24.5 percent compared to the previous year. Bank deposits constituted 9.8 percent of total deposits (with PMA deposits with banks at 2.1 percent, interbank deposits at 4.8 percent, and deposits of banks abroad with local banks at 2.9 percent). Furthermore, bank deposits comprised 8.0 percent of total bank liabilities, compared to 7.2 percent at end 2012.

Figure 4- 15: Banking and non-banking deposits structure, 2013





## Ownership equity (net)

The ongoing growth of both assets and liabilities in the banks' consolidated balance sheet mandated a parallel growth in these banks' ownership equity (net), the main safeguard of the soundness and robustness of the banks' financial positions against all kinds of risks. Obviously, ownership equity (net) exhibited a clearly upward trend.

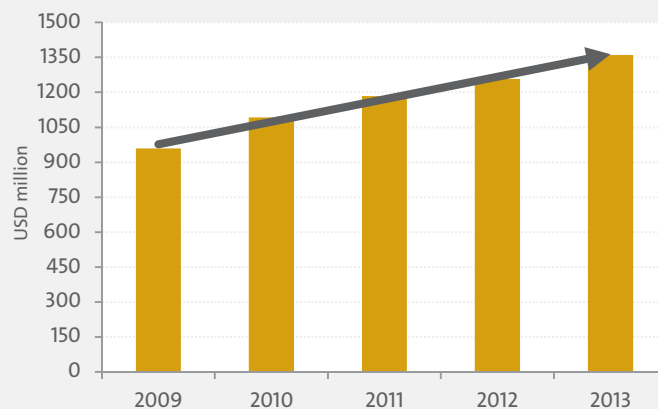
By end 2013, banks' ownership equity (net) reached USD 1,359.9 million, with an increase of USD 103.4 million, equivalent to 8.2 percent, compared to the previous year. Ownership equity (net) formed 12.2 percent of total bank liabilities, compared to 12.5 percent at end 2012.

Paid-up capital, the most significant component of banks' ownership equity, constituted 68.3 percent of the total by end 2013, dropping by 3 percentage points from 2012. Legal reserves came second in significance to paid-up capital, forming 9.1 percent of total ownership equity (net), followed by profits pending approval with 8.8 percent, general reserves for banking operations with 6.9 percent, and declared reserves with 5.1 percent.

## Other items

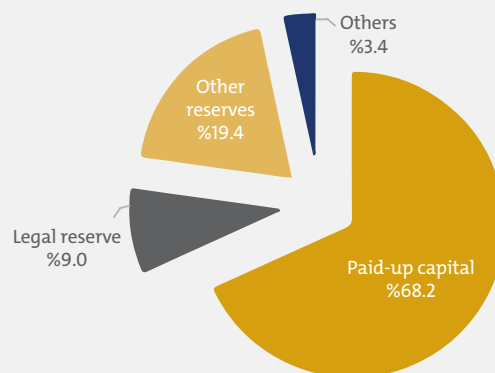
Other items consist of a number of small-value items, which are listed independently on the liabilities side of banks' consolidated balance sheet. In the lead comes the item executed and outstanding acceptances (accepted to banks inside and outside Palestine), with USD 13.8 million (compared to USD 10.0 million at end 2012), representing 0.1 percent of total bank liabilities. A second item, other liabilities, totalled USD 153.2 million (compared to USD 136.4 million at end 2012), comprising 1.4 percent of total liabilities. Provisions (which include tax provisions and other provisions) also a part of this item, totalled USD 194.4 million, representing 1.7 percent of banks' total liabilities.

Figure 4- 16: Ownership equity (net) of banks, 2009-2013



Source: PMA database.

Figure 4- 17: Ownership equity (net) structure, 2013



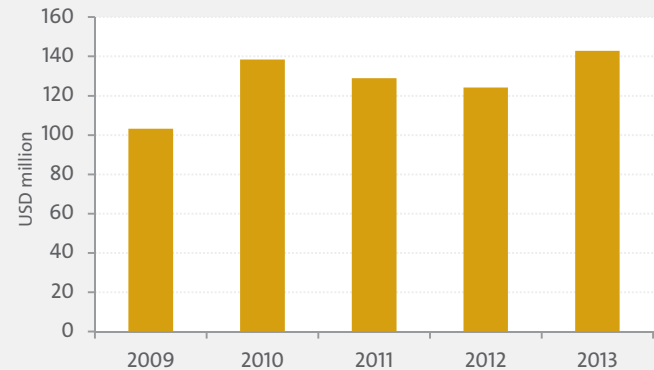
Source: PMA database.

## Profits and losses

Net income of banks operating in Palestine amounted to around USD 142.9 million in 2013, a 15.0 percent or USD 18.6 million gain over 2012. Detailed income statement data shows that net revenues of banks operating in Palestine increased to USD 461.8 million, rising by 10.0 percent or USD 42.0 million in 2013 over 2012. Total expenditures increased (by USD 20.4 million), rising by 8.8 percent for the same period. Thus realized income in 2013 represented, in both rate and value, one of the best results attained by banks in the past few years.

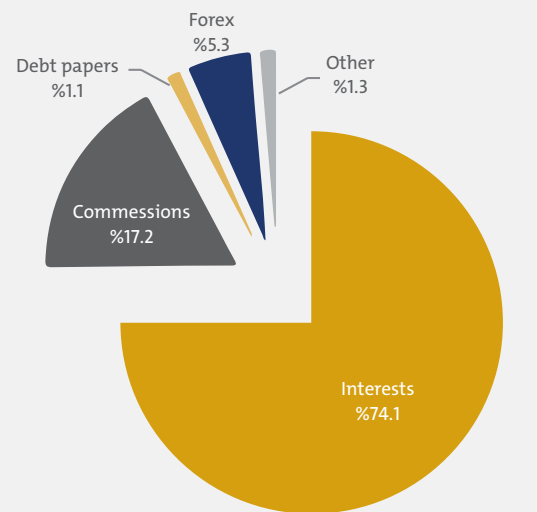
Analysis of revenues structure shows that income mainly depended on earned interest, which captured 74.9 percent of revenues, followed by fee income with 17.3 percent, foreign exchange revenues with 5.3 percent, debt securities with 1.1 percent, and revenues from other operational activities with 1.3 percent. Thus, interest revenue rose by 1.9 percent over 2012. The preponderance of interest revenue clearly shows that banks derive the bulk of their income from doing fundamental banking business of financial intermediation between the economy's surplus and deficit units. Obviously, such income consisted with credit facilities growth over the period.

Figure 4- 18: Net income of banks operating in Palestine, 2009-2013



Source: PMA database.

Figure 4- 19: Banking revenues structure, 2013



Source: PMA database.

## PMA-managed payment systems

PMA's launch of the BURAQ payments system by end 2010 was a qualitative stride towards ensuring an efficient and secure environment for financial settlements among banks operating in Palestine. The launch served to promote financial stability in accordance with international best practices and standards for settlement of high-value domestic payments. Also BURAQ mechanisms speeded up the money cycle velocity in Palestine, and provided legal and operational frameworks for settlement finality and risk mitigation.

- **Instant Settlement Transaction Activities through BURAQ System**

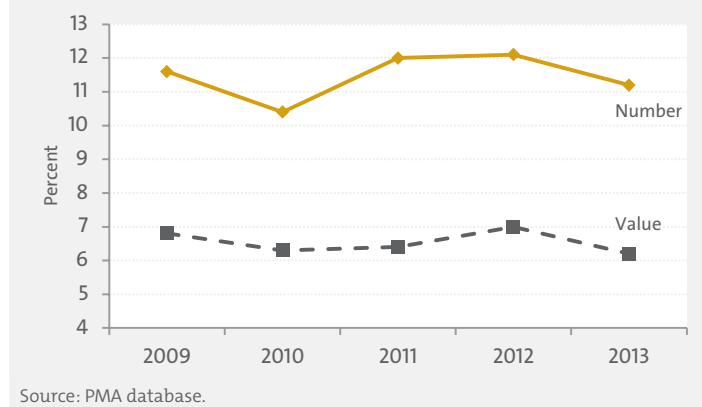
BURAQ-based inter-bank real-time gross settlement (RTGS) transactions in Palestine in 2013 hit a total of 164,170 transfers with a sum of USD 32,111.1 million, a 14.0 percent increase over 2012. Settlement transactions executed between member banks included personal transfers, bank transfers<sup>[49]</sup>, settlements of financial positions resulting from clearing of checks, and settlement of required reserve adjustments. Bank transfers constituted 5 percent of the number of total executed transfers and 46.2 percent of the total value, rising by 13.2 percent to reach USD 14.8 billion, compared to 2012. Personal transfers claimed 87.1 percent of the total number of executed transfers and 19.8 percent of their value, rising by 15.1 percent to reach USD 6.3 billion, compared to 2012. This clearly reveals the modesty of the average value of personal transfers against the average value of bank transfers. Transfers from clearing settlements<sup>[50]</sup> accounted for 4.7 percent of total number of executed transfers and 10.5 percent of the total value of these transfers, rising by 9.9 percent to reach USD 3.4 billion, compared to 2012. Transfers of other transactions accounted for 0.9 percent of the total number of executed transfers and 0.4 percent of their value, rising by 5.1 percent to reach USD 131.2 million, compared to 2012.

The execution of PEX operations through BURAQ commenced in 2013, following the signature of a MoU between the PMA and PEX in February 2013. PEX settlement transfers accounted for 0.7 percent of the total number of executed transfers and 0.2 percent of the total value, equivalent to USD 72.3 million.

- **Clearance house activities**

The PMA continued to offer clearing services through its clearing houses in Ramallah and Gaza in all circulating currencies and to all banks operating in Palestine. Data on clearing activity in all currencies indicates that the year 2013 witnessed a hike of 1.4 percent in the number of checks submitted for clearing. The number of checks submitted for clearance reached 4,346,427, at a total value of USD 10,567.0 million and an increase of 9.7 percent, compared to 2012. In the same time, bounced checks dropped by around 6.1 percent in number and 2.9 percent in value, to reach USD 659.1 million. Thus, the ratio of number of bounced checks to total number of checks submitted for clearance dropped from 12.1 percent in 2012 to 11.2 percent in 2013. A similar ratio for check values also dropped from 7.0 percent to 6.2 percent over the same time period. This is a clear indication of the Credit Bureau's role in curbing the bounced checks phenomenon and preserving the check's legal and practical status as a highly credible redemption tool.

**Figure 4- 20: Bounced checks as a percent of clearance, 2009-2013**



[49] A transfer where payer and beneficiary are banks and it is a result of transactions and activities primarily connected with the internal interbank money market.

[50] Transfers connected to check-clearing settlements.

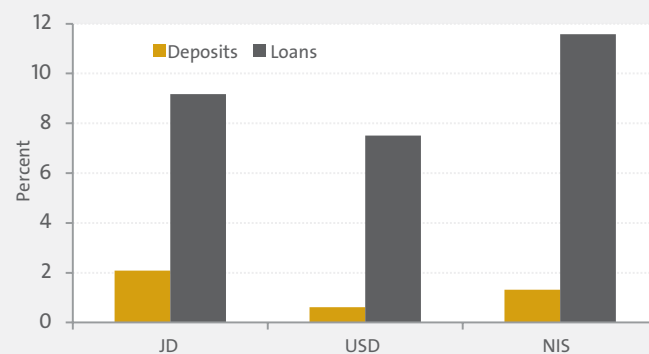
Commonly, clearing activity correlates closely with the level of economic activity. Enhanced clearing activity is clearly evidenced by several economic indicators like the upturn in foreign trade activity, the regular transfer of clearance revenues from Israel, the increase in number of Palestinian workers in Israel, the generous foreign aid to the PA, and a rise in remittances from Palestinians abroad to their families and relatives in Palestine.

## Interest rates

Data on average annual bank deposit and lending interest rates in different currencies reveals certain key developments in 2013. During the year, interest rates on JD increased by 38 basis points for deposits and by 106 basis points for lending, to reach 2.08 percent for deposits and 9.17 percent for lending. Interest rates on USD increased by 54 basis points for deposits and 16 basis points for lending to reach 0.62 percent for deposits and 7.51 percent for lending. Likewise for the NIS, interest rates rose for deposits by around 10 basis points and for lending by 29 basis points, to reach 1.32 percent and 11.58 percent for deposits and credits, respectively.

It is worth to note that certain external and internal determinants play a pivotal role in deciding the value of these rates and their variations. Whereas interest rates in the home countries of foreign currencies used in Palestine are the most important external determinant, fluctuations in local demand and liquidity are among the most significant local determinants of such rates.

Figure 4- 21: Lending and deposit rates by currency, 2013



Source: PMA database.





## Part III

# Non-Banking Financial Institutions

### Overview

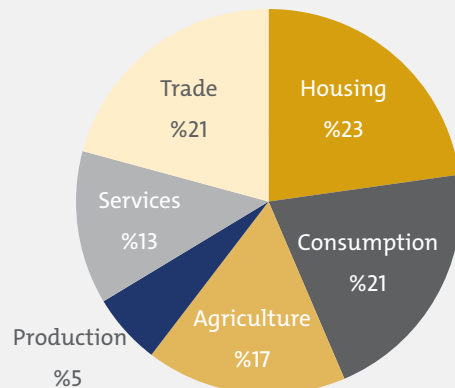
While specialized lending institutions and money changers are subject to the supervision and inspection of the PMA, the PEX, insurance companies, leasing companies and mortgage companies are subject to the supervision and inspection of the PCMA. Despite witnessing some positive legislative and financial developments in the past few years, non-banking financial institutions still need to progress and develop further so as to play a more effective role in advancing Palestine’s financial system and economy at large. Following is a review of the most important developments in these institutions during 2013.

#### Specialized lending institutions

Specialized lending institutions have become subject to PMA’s supervision and inspection since 2011, pursuant to the provisions of Regulation No. (132) for that year. This regulation invested the PMA with authority to supervise and organize these institutions, with a view to enhance their financing capacity and role as a complementary financing conduit to banks.

During 2013, six specialized lending institutions rectified their statuses to consist with the abovementioned regulation, thereby securing PMA’s initial approval<sup>[51]</sup> to do business.

Figure 4- 22: Sectoral distribution of specialized lending institutions’ loans, 2013



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

[51] Institutions with initial approval are: Faten, Asala, ACAD, Reef, CHF, and Ibdaa, keeping in mind that the number of institutions and programs engaged in specialized financing is 13, working through a network of 75 branches, spread over various areas in Palestine.

Specialized lending institutions<sup>[52]</sup> function through a network of 61 branches and have a workforce of 509 employees. During 2013, these institutions granted loans of around USD 84 million<sup>[53]</sup> to more than 54 thousand borrowers, about half (50.4 percent) of whom were women. The average value per loan was USD 1,934.2 as opposed to USD 1,715.0 in 2012.

The loans are spread over various economic sectors and activities, depending on the lender's field of work. Of these loans, the housing sector claimed the largest share (23 percent), followed by consumption and trade sectors with 21 percent each, agriculture sector with 17 percent, services sector with 13 percent, and production sector with 5 percent.

## Money changers

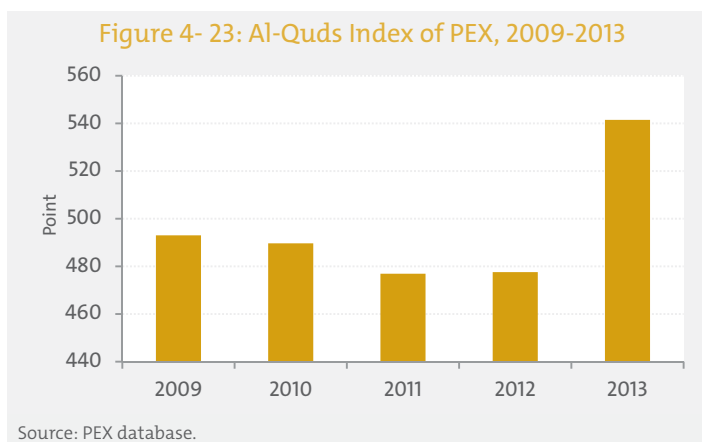
Regulations No. (13) of 2008 on the License and Control of the Exchange Profession, and the relevant instructions and detailed resolutions the PMA issued constitute the regulatory framework organizing money changing activity in Palestine. In 2013, the PMA issued instructions aimed at: (i) organizing activities in the area of agent and sub-agent fast transfers, and (ii) specifying standard working hours and official holidays for money changing shops and firms.

At end 2013, PMA-licensed money changers numbered 270, of which 232 were in the WB and 38 in GS. There were 184 money changing firms as opposed to 86 money changers (individually engaging in currency exchange). The latter are currently working to rectify their legal statuses, pursuant to the provisions of the aforementioned licensing Regulation No. (13).

As to performance, the money changing sector's total assets rose by 0.5 percent to USD 49.6 million by end 2013. Likewise, capital rose by 4.2 percent to USD 44.5 million, compared to USD 42.7 million at end 2012. Nevertheless, ownership equity dropped by 3.5 percent due to closure of a number of money changing firms/money changers. The sector's realized profit fell sharply to USD 0.4 million from USD 1.8 million in 2012.

## Palestine exchange (PEX)

By end 2013, PEX Index (Al-Quds) closed at 541.5 points, a growth of 13.4 percent compared to 2012. Indices of all sectors rose, except for insurance, whose index fell by 4.1 percent; the banking and financial sector index increased by 18.6 percent and the services sector index went up by 4.7 percent. Likewise, the investment sector's index rose by 33.7 percent and the manufacturing sector's index grew by 6.9 percent.



[52] Incoming data in connection here include six lending institutions (members in Sharakeh) which are: Asala, ACAD, Faten, Reef, CHF and UNRWA.

[53] SMEs database of the PMA.

PEX held 241 trading sessions during 2013 (compared to 249 sessions in 2012), during which 202,965,939 shares of listed companies<sup>[54]</sup> were traded, growing by 37.8 percent over 2012. The listed companies' market capitalization rose to USD 3.2 billion, an increase by 13.6 percent compared to 2012. This marked the highest rise in value since 2006. Traded shares' turnover ratio, which is considered an index of liquidity in the market, increased by 13.0 percent, compared to 9.7 percent in 2012. These positive PEX indicators largely reflected the economic boom the market witnessed during the last quarter of the year.

As to sectoral trading, the investment sector accounted for 49.0 percent of total number of traded shares, valued at USD 496.2 million, the equivalent of 15.3 percent of listed companies' total market capitalization. The banking and financial services sector came second, accounting for 27.2 percent of total number of traded shares valued at USD 857.2 million, the equivalent of 26.3 percent of total market capitalization. The services sector followed accounting for 12.8 percent of total number of traded shares, valued at USD 1,516.5 million, the equivalent of 46.7 percent of total market capitalization. The insurance sector claimed 7.6 percent of total number of traded shares, valued at USD 101.1 million, the equivalent of 3.1 percent of total market capitalization. Finally, the industry sector contributed 3.5 percent of total number of traded shares, valued at USD 276.4 million, the equivalent of 8.5 percent of total market capitalization.

At the regional level, PEX ranked 11 among the 12 Arab financial markets which showed growth in 2013; the Dubai market came first, with its index soaring by 107.7 percent, while Libya came last, with its index dropping by 17.1 percent.

From the financial and banking sector's viewpoint, PEX has realized a major confidence-boosting achievement in 2013. This occurred as PEX started using PMA's real-time gross settlement system (BURAQ) for settlement of trading transactions, following the signature of the MoU with the PMA in February 2013.

Figure 4- 24: Sectoral distribution of traded shares volume in PEX, 2013

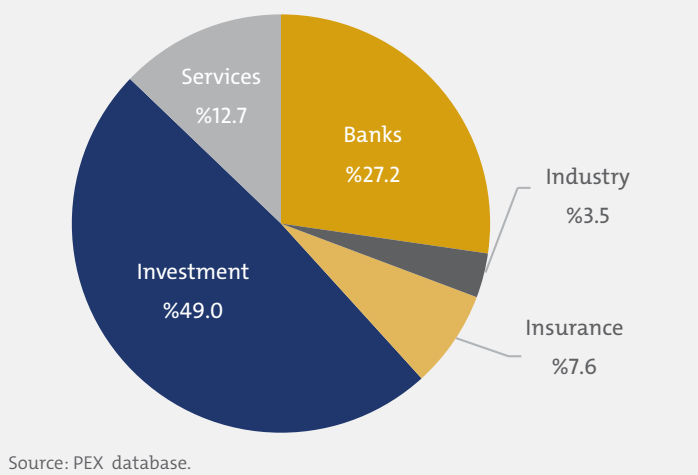
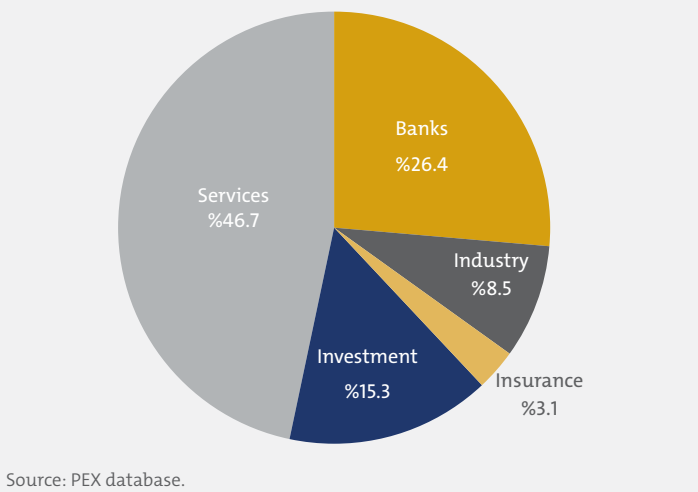


Figure 4- 25: Sectoral distribution of traded shares value in PEX, 2013



[54] During 2013, a new industrial company was listed to raise the number of listed companies to 49, of which 9 were banks and financial companies, 12 industrial companies, 7 insurance companies, 8 investment companies and 13 services companies.



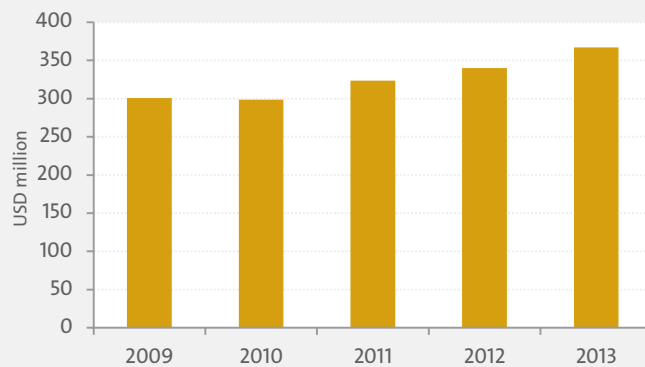
## Insurance companies

By end 2013, there were 10 insurance companies in Palestine, working through 114 branches and representative offices<sup>[55]</sup> and 225 agents and insurance producers. Insurance employees numbered 1,075, and insurance outfits were spread over various areas of the WB and the GS. By end 2013, insurance sector's total assets rose by 7.9 percent to a total of USD 367 million compared to 2012. Shareholders' equity rose by 10.1 percent to USD 119.8 million, while paid-up capital went up by 1 percent to USD 67.9 million. Net profit after taxes soared by 70 percent to reach USD 12.4 million.

Insurance companies collected premiums of about USD 158.7 million, representing a rise of 9.8 percent compared to 2012, as result of an increase in all types of insurances. Motor insurance premiums constituted the largest share (60.8 percent) of total premiums, followed by health insurance premiums with 17.3 percent, general and engineering insurance premiums<sup>[56]</sup> with 15.0 percent, and the remaining types of insurance premiums<sup>[57]</sup> with 9.4 percent.

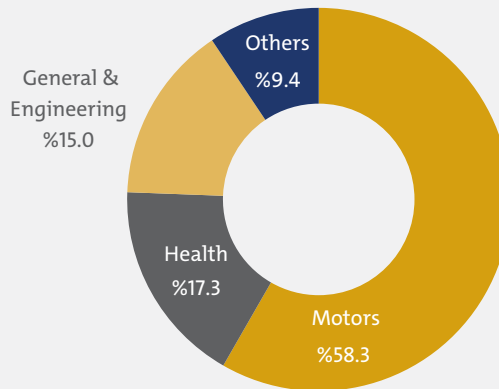
Compensation paid by insurance companies rose by 0.3 percent or USD 280 thousand to reach USD 88.7 million in 2013. Motors insurance compensations accounted for 53.6 percent of total amounts paid, while health insurance compensations claimed 25.8 percent and general and engineering insurance compensations, 14.1 percent. The remainder was paid in other insurance compensation, with 6.5 percent of total amounts paid.

Figure 4- 26: Assets of insurance sector, 2009-2013



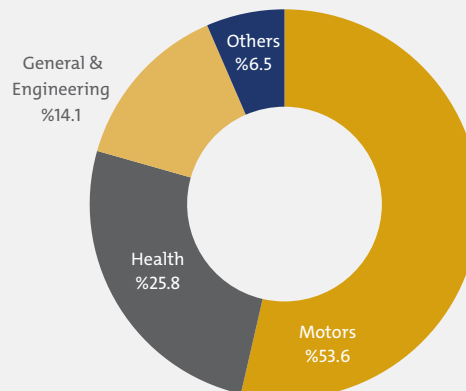
Source: PCMA database.

Figure 4- 27: Insurance premiums by type, 2013



Source: PCMA database.

Figure 4- 28: Insurance paid-up claims by type, 2013



Source: PCMA database.

[55] Three new branches and representative offices were opened during 2013.

[56] Include premiums for workers insurance with a share of 8.7 percent, engineering insurance with 2.6 percent, civil liability with 1.7 percent and other insurances with 2.0 percent.

[57] Include fire insurance with 5.8 percent, life insurance with 2.4 percent, and marine insurance with 1.1 percent of total value of insurance premiums.

## Mortgage and Leasing Companies

The mortgage sector consists of two companies (Palestine Mortgage and Housing Corporation which specializes in the refinance of mortgage loans, and Palestine Housing Finance Corporation which insures against mortgage credit risk due to borrower defaults) and 44 licensed appraisers. By end 2013, the entire assets of this sector totalled USD 42.4 million, a growth of 13.0 percent over to 2012.

The leasing sector comprises six leasing companies<sup>[58]</sup>, licensed under the commercial leasing law<sup>[59]</sup>. Leasing companies work mainly in the area of vehicle leasing. In the coming period, these companies are expected to join the PMA's Credit Bureau; this will promote this sector's growth and stability, and foster its role as an important financing tool and an integral part of the financial system.

[58] Leasing companies licensed by the PCMA include: Pal Lease, Palestine Automobile Company Ltd (Hyundai), Ritz Leasing, Arab Company for Car Trade, Jawwal Company for Car Trade and Good luck Company for Car Trade.

[59] Approved in January 2014.



# Appendices







## **Chapter One**

### **Local and Global Economic Developments**



## Part I: Local Economy

Table (1- 1): Palestine: real GDP by economic activity and GNDI, 2009-2013

(USD Million)

Activity	2009	2010	2011	2012	2013
A) Productive Sectors (1+2+3)	1,370.9	1,509.9	2,050.9	2,098.2	2,238.6
1- Agriculture and Fishing	293.2	287.8	380.6	332.6	298.9
2- Industry	690.0	685.7	773.5	810.5	869.0
Mining and Quarrying	22.6	24.3	49.1	49.2	52.2
Manufacturing	540.6	554.6	625.4	657.6	706.7
Electricity and Water Supply	126.8	116.8	99	103.7	110.1
3- Construction	387.7	536.4	896.8	955.1	1,070.7
B) Service Sector (1 +2)	3,224.9	3,449.8	3,686.4	3,935.9	3,943.2
1- Productive services	1,348.2	1,637.3	1,716.1	1,807.5	1,805.2
Wholesale and Retail Trade	536.3	852.7	905.1	950.8	937.1
Transportation and Storage	513.4	513.2	562.1	592.0	578.3
Financial Intermediation	269.0	202.1	209.5	218.4	234.7
Hotels and Restaurants	29.5	69.3	39.4	46.3	55.1
2- Social Services	1,876.7	1,812.5	1,970.3	2,128.4	2,138.0
Education	426.1	388.6	475.8	529.5	543.5
Health and Social Work	146.5	167.7	215.0	245.2	258.9
Public Administration and defense	750.7	743.6	803.5	809.1	811.8
Others*	553.4	512.6	476.0	544.6	523.8
C) FISIM	-231.9	-165.9	-155.0	-165.5	-181.1
D) Net Taxes	875.4	930.7	839.1	928.7	942.0
Customs Duties	345.5	388.6	362.6	402.8	432.7
VAT on Imports, net	529.9	542.1	476.5	525.9	509.3
<b>Real GDP (A + B + C +D)</b>	<b>5,239.3</b>	<b>5,724.5</b>	<b>6,421.4</b>	<b>6,797.3</b>	<b>6,942.7</b>
Net Income Transfers from Abroad	469.7	364.7	391.4	435.0	n.a
Net Current Transfers	1,979.6	1,289.4	755.9	715.9	n.a
<b>Real GNDI</b>	<b>7,688.6</b>	<b>7,378.6</b>	<b>7,568.7</b>	<b>7,948.2</b>	<b>n.a</b>
Real GDP Percapita (USD)	1,415.2	1,502.1	1,635.2	1,679.3	1,664.8
Real GDI Percapita (USD)	2,076.8	1,936.1	1,927.3	1,963.9	n.a
<b>Nominal GDP</b>	<b>6,719.6</b>	<b>8,330.6</b>	<b>9,775.3</b>	<b>10,254.6</b>	<b>11,942.9</b>
<b>Nominal GDP Percapita (USD)</b>	<b>1,815.0</b>	<b>2,185.9</b>	<b>2,489.2</b>	<b>2,533.5</b>	<b>2,863.8</b>

\* Includes Real estate, Rental and Business Services, Community, Social and Personal Services.  
Source: Central Bureau of Statistics, National Accounts, Different Issues, 2013.



Table (1- 2): Palestine: expenditure on real GDP, 2009-2013

Activity	2009	2010	2011	2012	2013
	USD Million				
Gross Domestic Expenditure	7831.7	7887.0	8816.3	9798.1	9,671.9
Final Consumption	6694.4	7303.5	7686.2	8724.1	8,679.1
Private*	5534.9	5474.2	5977.3	6697.0	6,647.2
Public	1159.5	1322.3	1772.2	2027.1	2,031.9
Gross Capital Formation	1137.3	1090.5	1066.8	1074.0	992.8
Private	605.9	553.5	697.3	759.1	689.1
Public	512.5	468.2	589.8	593.9	582.8
Change in inventories	18.9	68.8	-220.3	-279.0	-279.1
Net Export of Goods and Services	-2592.4	-2162.5	-2394.9	-3000.8	-2,729.2
Exports	822.7	863.9	1075.3	1090.3	1,327.1
Imports	3415.1	3026.4	3470.2	4091.1	4,056.3
Real GDP	5,239.3	5,724.5	6,421.4	6,797.3	6,942.7
	Percent of GDP				
Gross Domestic Expenditure	149.5	137.8	137.3	144.2	139.3
Final Consumption	127.7	118.7	120.7	128.3	125.0
Private	105.6	95.6	93.1	98.5	95.7
Public	22.1	23.1	27.6	29.8	29.3
Gross Capital Formation	21.7	19.1	16.6	15.8	14.3
Private	11.6	9.7	10.9	11.2	9.9
Public	9.8	8.2	9.2	8.7	8.4
Change in inventories	0.3	1.2	-3.5	-4.1	-4.0
Net Export of Goods and Services	-49.5	-37.8	-37.3	-44.2	-39.3
Exports	15.7	15.1	16.7	16.0	19.1
Imports	65.2	52.9	54.0	60.2	58.4
Real GDP	100.0	100.0	100.0	100.0	100.0

\* It includes also NPISH final consumption.

Source: Central Bureau of Statistics, National Accounts, Different Issues, 2013.

Table (1- 3): Palestine: consumer price index (CPI), 2009-2013

(2010=100)

Activity	2009	2010	2011	2012	2013
Main Expenditure Groups					
Foods and Soft Drinks	96.7	100.0	102.4	104.6	105.4
Alcoholic Beverages and Tobacco	89.2	100.0	106.2	114.5	128.7
Textile, Clothing and Footwear	96.2	100.0	104.6	106.0	105.3
Housing	95.1	100.0	102.9	107.0	111.1
Furniture, Household Goods	97.4	100.0	100.0	101.3	103.0
Medical Care	99.1	100.0	101.3	104.4	106.2
Transportation	97.4	100.0	104.8	107.1	106.3
Communications	102.1	100.0	100.4	100.6	100.4
Recreational, Cultural Goods & Services	98.3	100.0	101.2	102.5	101.9
Education	94.3	100.0	102.1	107.7	115.2
Restaurants and Cafés	96.9	100.0	105.9	110.0	114.0
Miscellaneous Goods and Services	95.1	100.0	104.0	109.3	107.8
All-items Index	96.4	100.0	102.9	105.7	107.6
Regions					
WB	95.9	100.0	103.5	103.5	111.1
GS	98.3	100.0	100.6	100.6	100.3
Jerusalem	95.0	100.0	104.1	104.1	109.4
All-items Index	96.4	100.0	102.9	102.9	107.6
Inflation Rates (%)					
WB	0.6	4.2	3.5	4.1	3.1
GS	4.4	1.7	0.6	0.5	-0.8
Jerusalem	3.5	5.3	4.1	3.2	1.8
Palestine	2.8	3.7	2.9	2.8	1.7

Source: Central Bureau of Statistics, Index of Consumer Prices, Different Issues, 2013.

Table (1- 4): Palestine: labor market indicators, 2009-2013

Key Indicators	2009	2010	2011	2012	2013
Population (thousand)*					
Palestine	3,935	4,048	4,169	4,293	4,421
WB	2,448	2,513	2,580	2,649	2,719
GS	1,487	1,535	1,589	1,644	1,702
individuals Over 15 Years (thousand)					
Palestine	2,288	2,376	2,466	2,557	2,649
WB	1,469	1,523	1,577	1,632	1,687
GS	819	853	889	925	962
Labor Force (thousand)					
Palestine	951	976	1,059	1,114	1155
WB	643	665	718	743	759
GS	308	311	341	371	396
Unemployment (thousand)					
Palestine	234	232	222	256	270
WB	115	114	124	141	141
GS	119	118	98	115	129
Unemployment: Percent of Labor Force (%)					
Palestine	24.6	23.7	20.9	23.0	23.4
WB	17.7	17.2	17.3	19.0	18.6
GS	38.6	37.8	28.7	31.0	32.6
Broad/Relaxed Unemployment: Percent of Labor Force (%)					
Palestine	30.1	30.0	25.8	26.7	27.0
WB	23.4	23.4	22.3	23.0	22.4
GS	43.8	43.7	33.1	34.2	35.7
Distribution of Palestinian workers by Region (thousand)					
Total workers	718	744	837	858	885
Workers in Israel	73	78	84	83	99
Workers in Palestine	645	666	753	775	786
Workers in the public sector	178	179	188	195	204
Workers in the private sector	467	487	565	580	582
Distribution of workers by Economic Activity (thousand)					
Agriculture and fishing	85	88	100	98	93
Industry (mining and manufacturing)	87	85	99	102	108
Constructions (build. & constructions)	84	98	116	123	138
Trade, restaurants and hotels	137	143	170	168	173
Trans., storage and communications	41	44	51	56	57
Other services and branches	284	286	301	311	316

Key Indicators	2009	2010	2011	2012	2013
Dependency Ratios (%)					
Palestine	5.5	5.4	5.0	5.0	5.0
WB	4.6	4.6	4.3	4.4	4.4
GS	7.9	7.9	6.5	6.4	6.4
Average Daily wage in (NIS)					
Palestine	91.3	91.7	91.7	93.0	97.2
WB	85.9	85.8	85.0	87.1	89.0
GS	62.7	58.1	62.5	64.4	63.1
Israel and settlements	148.1	158.0	162.2	164.0	175.6

\* Mid-year Estimates

Source: Central Bureau of Statistics, Workforce Survey, various publications.

Table (1- 5): Palestine: economic forecasts, 2014

Indicators	Actual	2014		
	2013	Baseline	Optimistic Scenario	Pessimistic Scenario
	(Annual percent change)			
Real GDP	2.1	2.6	8.2	-2.7
Real Percapita GDP	1.8	-0.4	5.0	-5.5
Private sector Real GDP	6.7	6.1	13.2	-2.4
Public sector Real GDP	0.7	4.1	10.6	-3.8
Inflation rate (%)	1.7	2.2	2.2	2.2
	(percent of GDP)			
Final Consumption	125.0	126.0	121.0	123.5
Private	31.9	32.0	30.7	27.3
Public	93.1	94.0	90.3	96.2
Gross Capital Formation	14.3	17.7	18.4	10.5
Private	3.5	4.2	4.7	2.1
Public	10.8	13.5	13.7	8.4
Net Export	39.9	43.2	39.0	38.2
Exports	19.1	16.6	20.6	15.8
Imports	58.4	59.8	59.6	54.0
Memorandum Items				
Real GDP (USD million, 2004=100)	6,942.7	7,124.0	7,512.0	6,755.2
Real per capita GDP (USD)	1,665	1,659	1749	1573
Unemployment rate (%)	23.4	23.9	22.3	25.3
Exchange rate (USD/NIS)	3.6	3.5	3.5	3.5

Source: PMA estimates.

## Part II: Global Economy

Table (1- 6): Global real GDP growth rates, 2009-2013

(percent)

Country	2009	2010	2011	2012	2013
World	-0.4	5.2	3.9	3.2	3.0
Developed countries	-3.4	3.0	1.7	1.4	1.3
United States	-2.8	2.5	1.8	2.8	1.9
Euro area	-4.4	2.0	1.6	-0.7	-0.5
Germany	-5.1	3.9	3.4	0.9	0.5
France	-3.1	1.7	2.0	0.0	0.3
Italy	-5.5	1.7	0.5	-2.4	-1.9
Japan	-5.5	4.7	-0.5	1.4	1.5
United Kingdom	-5.2	1.7	1.1	0.3	1.8
Canada	-2.7	3.4	2.5	1.7	2.0
Israel	1.2	5.7	4.6	3.4	3.3
Major developed countries	-3.8	2.8	1.6	1.7	1.4
Newly industrialized Asian countries	-1.1	5.8	3.3	1.9	2.3
Emerging and Developing Countries	3.1	7.5	6.3	5.1	4.7
Africa- Sub-Saharan	2.6	5.6	5.5	4.9	4.9
Central and Eastern Europe	-3.4	4.7	5.4	1.4	2.8
Commonwealth of Independent States	-6.4	4.9	4.8	3.4	2.1
Developing Asia	7.7	9.7	7.9	6.7	6.5
China	9.2	10.4	9.3	7.7	7.7
India	8.5	10.3	6.6	4.7	4.4
Middle East and North Africa	3.0	5.5	3.9	4.1	2.2
Egypt	4.7	5.1	1.8	2.2	2.1
Jordan	5.5	2.3	2.6	2.7	3.3
Lebanon	10.3	8.0	2.0	1.5	1.0
Saudi Arabia	1.8	7.4	8.6	5.8	3.8
Latin America and the Caribbean	-1.3	6.0	4.6	3.1	2.7
Brazil	-0.3	7.5	2.7	1.0	2.3
Mexico	-4.7	5.1	4.0	3.9	1.1
Global GDP at purchasing power Parities	70,627	75,099	79,381	83,258	86,995

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

Table (1- 7): Global inflation rates, 2009-2013

(percent)

Country	2009	2010	2011	2012	2013
Developed countries	0.1	1.5	2.7	2.0	1.4
United States	-0.3	1.6	3.1	2.1	1.5
Euro area	0.3	1.6	2.7	2.5	1.3
Germany	0.2	1.2	2.5	2.1	1.6
France	0.1	1.7	2.3	2.2	1.0
Italy	0.8	1.6	2.9	3.3	1.3
Japan	-1.3	-0.7	-0.3	0.0	0.4
United Kingdom	2.2	3.3	4.5	2.8	2.6
Canada	0.3	1.8	2.9	1.5	1.0
Israel	3.3	2.7	3.5	1.7	1.5
Major developed countries	-0.1	1.4	2.6	1.9	1.3
Newly industrialized Asian countries	1.3	2.2	3.1	2.0	1.5
Emerging and Developing Countries	5.4	5.9	7.3	6.0	5.8
Africa- Sub-Saharan	9.7	7.5	9.4	9.0	6.3
Central and Eastern Europe	4.7	5.4	5.4	5.8	4.1
Commonwealth of Independent States	11.2	7.2	10.1	6.5	6.4
Developing Asia	3.2	5.3	6.5	4.6	4.5
China	-0.7	3.3	5.4	2.7	2.6
India	13.0	10.5	9.6	10.2	9.5
Middle East and North Africa	6.3	6.5	9.3	10.6	10.5
Egypt	16.2	11.7	11.1	8.7	6.9
Jordan	-0.7	5.0	4.4	4.6	5.5
Lebanon	1.2	5.1	7.2	5.9	3.2
Saudi Arabia	4.1	3.8	3.7	2.9	3.5
Latin America and the Caribbean	5.9	6.0	6.6	5.9	6.8
Brazil	4.9	5.0	6.6	5.4	6.2
Mexico	5.3	4.2	3.4	3.4	3.8

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

Table (1- 8): Developed economies: unemployment, 2009-2013

(percent)

Country	2009	2010	2011	2012	2013
Developed countries	8.1	8.3	8.0	8.0	7.9
United States	9.3	9.6	8.9	8.1	7.4
Euro area	9.7	10.2	10.2	11.4	12.1
Germany	7.8	7.1	6.0	5.5	5.3
France	9.5	9.7	9.6	10.2	10.8
Italy	7.8	8.4	8.4	10.7	12.2
Japan	5.1	5.0	4.6	4.3	4.0
United Kingdom	7.7	7.9	8.1	8.0	7.6
Canada	8.3	8.0	7.4	7.3	7.1
Israel	9.4	8.3	7.1	6.9	6.4
Major developed countries	5.3	5.2	4.7	4.7	4.6

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

Table (1- 9): Interest rates of major currencies, 2009-2013

(Period end, percent)

Country	2009	2010	2011	2012	2013
United States	0.25	0.25	0.25	0.25	0.25
Euro area	1.00	1.00	1.00	0.75	0.25
United Kingdom	0.50	0.50	0.50	0.50	0.50
Japan	0.10	0.10	0.10	0.10	0.10
Canada	0.25	1.00	1.00	1.00	1.00

Source: www.fxstreet.com, 2013.



Table (1- 10): Growth in world trade volume, 2009-2013

(percent)

Country	2009	2010	2011	2012	2013
Total World Trade	-10.4	12.6	5.8	3.2	4.5
Exports					
Developed Countries	-11.3	12.0	5.3	2.2	3.6
Emerging and Developing Countries	-7.6	13.7	6.5	4.0	5.7
Imports					
Developed Countries	-11.9	11.4	4.4	1.7	3.3
Emerging and Developing Countries	-8.3	14.9	8.8	7.0	6.6
Export of Goods					
Developed Countries	-13.2	14.1	5.7	2.4	3.5
Emerging and Developing Countries	-8.0	14.0	6.6	4.0	5.6
Import of Goods					
Developed Countries	-12.9	13.4	4.9	1.7	3.7
Emerging and Developing Countries	-9.5	15.6	9.8	7.4	6.9
Change in Terms of Trade					
Developed Countries	2.4	-0.9	-1.6	-0.8	0.1
Emerging and Developing Countries	-4.8	2.3	3.5	0.5	-0.4
Total Value of Exported (USD Billion)	15,886	18,908	22,272	22,428	23,297

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

Table (1- 11): Current account balances, 2009-2013

(Percent of GDP)

Country	2009	2010	2011	2012	2013
Developed countries	-0.1	0.0	-0.1	-0.1	0.4
United States	-2.6	-3.0	-2.9	-2.7	-2.3
Euro area	0.3	0.6	0.8	2.0	2.9
Germany	5.9	6.4	6.8	7.4	7.5
France	-1.3	-1.3	-1.8	-2.2	-1.6
Italy	-2.0	-3.5	-3.1	-0.4	0.8
Japan	2.9	3.7	2.0	1.0	0.7
United Kingdom	-1.4	-2.7	-1.5	-3.7	-3.3
Canada	-2.9	-3.5	-2.8	-3.4	-3.2
Israel	3.8	3.1	1.3	0.3	2.5
Major developed countries	-0.6	-0.8	-0.8	-1.0	-0.7
Newly industrialized Asian countries	4.5	4.9	4.3	4.1	4.8
Emerging and Developing Countries	1.4	1.5	1.6	1.4	0.7
Africa- Sub-Saharan	-3.2	-1.0	-1.0	-2.7	-3.6
Central and Eastern Europe	-3.2	-4.9	-6.4	-4.5	-3.9
Commonwealth of Independent States	2.6	3.4	4.3	2.6	0.7
Developing Asia	3.5	2.5	0.9	0.8	1.1
China	4.9	4.0	1.9	2.3	2.1
India	-2.8	-2.7	-4.2	-4.7	-2.0
Middle East and North Africa	2.2	7.1	14.1	13.7	10.3
Egypt	-2.3	-2.0	-2.6	-3.9	-2.1
Jordan	-3.3	-5.3	-12.0	-18.1	-11.1
Lebanon	-12.6	-13.3	-15.7	-15.7	-16.2
Saudi Arabia	4.9	12.7	23.7	22.4	17.4
Latin America and the Caribbean	-0.7	-1.3	-1.4	-1.9	-2.7
Brazil	-1.5	-2.2	-2.1	-2.4	-3.6
Mexico	-0.9	-0.3	-1.1	-1.2	-1.8

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

Table (1- 12): Foreign direct investment (FDI) inflows, 2009-2013

(USD Million)

Country	2009	2010	2011	2012	2013
World	1,221,840	1,422,255	1,700,082	1,330,273	1,451,965
Developed countries	618,596	703,474	880,406	516,664	565,626
United States	143,604	198,049	223,759	160,569	187,528
Euro Union	363,133	383,703	490,427	216,012	246,207
Germany	23,789	65,620	59,317	13203	26,721
France	24,215	33,628	38547	25,086	4,875
Italy	20,077	9,178	34,324	93	16,508
United Kingdom	76,301	49,617	51,137	45,796	37,101
Japan	11,938	1252-	1758-	1,732	2,304
Canada	22,700	28,400	39,669	43,025	62,325
Israel	4,607	5,510	10,766	9,481	11,804
Emerging and Developing Countries	532,580	648,208	724,840	729,449	778,372
China	95,000	114,734	123,985	121,080	123,911
Hong Kong	54,274	82,708	96,125	74,888	76,633
Singapore	23,821	55,076	50,368	61,159	63,772
Brazil	25,949	48,506	66,660	65,272	64,045
Mexico	17,331	23,353	23,354	17,628	38,286
Turkey	8,629	9,058	16,171	13,224	12,866
Arab Countries	82,236	68,406	45,550	51,858	46,910
Egypt	6,712	6,386	483-	6,881	5,553
Morocco	1,952	1,574	2,568	2,728	3,358
Tunisia	1,688	1,513	1,148	1,603	1,096
Sudan	2,572	2,894	2,692	2,488	3,094
Lebanon	4,804	4,280	3,485	3,674	2,833
Saudi Arabia	36,458	29,233	16,308	12,182	9,298
UAE	4,003	5,500	7,679	9,602	10,488
Jordan	2,413	1,651	1,474	1,497	1,798
Palestine	316	103	251	246	187

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

Table (1- 13): Official reserve assets, 2009-2013

(USD Billion)

Country	2009	2010	2011	2012	2013
World	8,594	9,701	10,708	11,461	12,185
Developed countries	3,071	3,391	3,751	4,049	4,162
United States	134	135	151	153	148
Euro area	302	319	335	351	350
Emerging and Developing Countries	5,518	6,305	6,952	7,406	8,018
Africa- Sub-Saharan	161	161	180	202	204
Developing Asia	3,087	3,642	4,040	4,191	4,683
Middle East and North Africa	927	1,009	1,108	1,281	1,399

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

Table (1- 14): Emerging and developing economies: external debt, 2009-2013

Country	2009	2010	2011	2012	2013
	External Debt (USD Billion)				
Emerging and Developing Countries	4,928.8	5,494.5	6,082.0	6,604.8	7,004.1
Africa-Sub-Saharan	226.8	251.7	274.1	300.2	330.2
Central and Eastern Europe	1,119.1	1,146.2	1,181.0	1,203.9	1,246.1
Commonwealth of Independent States	739.4	793.8	846.4	888.2	928.6
Developing Asia	1,227.8	1,483.3	1,788.2	2,042.3	2,271.7
Middle East and North Africa	700.7	743.9	768.5	798.8	765.5
Latin America and the Caribbean	915.0	1,075.6	1,223.9	1,371.6	1,462.0
	Percent of GDP				
Emerging and Developing Countries	27.2	25.4	24.0	24.4	24.1
Africa-Sub-Saharan	25.3	23.4	22.6	23.6	24.5
Central and Eastern Europe	70.3	65.8	62.3	66.5	65.4
Commonwealth of Independent States	45.0	40.0	34.6	34.1	32.9
Developing Asia	15.5	15.5	15.6	16.1	16.3
Middle East and North Africa	34.1	31.2	27.9	27.0	24.6
Latin America and the Caribbean	22.7	22.0	21.8	24.0	24.5
	Percent of Total Exports				
Emerging and Developing Countries	91.0	80.6	72.6	75.4	75.8
Africa-Sub-Saharan	77.4	67.1	59.7	63.8	67.6
Central and Eastern Europe	197.6	178.8	155.1	155.2	154.4
Commonwealth of Independent States	139.9	117.3	94.6	95.2	97.0
Developing Asia	53.8	50.0	50.2	53.9	55.5
Middle East and North Africa	74.1	64.1	52.2	51.9	48.7
Latin America and the Caribbean	114.1	107.7	100.1	109.1	111.0
	External Debt Service Payments (USD Billion)				
Emerging and Developing Countries	1719.2	1741.1	2054.9	2250.3	2508.2
Africa-Sub-Saharan	53.2	45.0	46.1	52.2	57.4
Central and Eastern Europe	404.1	377.4	422.0	425.2	453.4
Commonwealth of Independent States	252.2	242.4	255.2	275.2	291.7
Developing Asia	506.1	559.2	752.7	925.7	1103.2
Middle East and North Africa	183.8	203.1	210.7	209.8	217.5
Latin America and the Caribbean	319.7	313.9	368.3	362.2	385.0

	Percent of GDP				
Emerging and Developing Countries	9.5	8.0	8.1	8.3	8.6
Africa-Sub-Saharan	6.0	4.2	3.8	4.1	4.3
Central and Eastern Europe	25.4	21.7	22.3	23.5	23.9
Commonwealth of Independent States	15.4	12.2	10.4	10.6	10.3
Developing Asia	6.4	5.8	6.6	7.3	7.9
Middle East and North Africa	8.9	8.5	7.6	7.1	7.0
Latin America and the Caribbean	7.9	6.4	6.6	6.3	6.4
	Percent of Total Exports				
Emerging and Developing Countries	31.8	25.6	24.6	25.7	27.2
Africa-Sub-Saharan	18.3	12.1	10.2	11.2	11.9
Central and Eastern Europe	71.5	59.0	55.5	54.9	56.3
Commonwealth of Independent States	47.7	35.8	28.5	29.5	30.5
Developing Asia	22.2	18.9	21.1	24.5	26.9
Middle East and North Africa	19.4	17.5	14.3	13.6	13.8
Latin America and the Caribbean	39.9	31.4	30.1	28.8	29.2

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



## **Chapter Two**

### Public Finance Developments

Table (2- 1): Palestine: fiscal operations (cash basis), 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Total net revenues and grants	2,950	3,178	3,153	3,172	3,678
Total Domestic Revenue, net	586	744	702	715	852
Tax	302	474	482	483	597
Non-tax	284	270	220	232	255
Clearance Revenue	1,090	1,243	1,487	1,575	1,690
Tax Refunds (-)	127	87	14	50	222
Grants and aid (external revenues)	1,402	1,277	978	932	1,358
For Budgetary Support	1355	1147	809	777	1251
For development Financing	47	131	169	155	107
Total public expenditure	3,105	3,259	3,257	3,258	3,419
Current expenditure and net lending	2,919	2,984	2,961	3,047	3,250
Wages Expenditure	1423	1564	1679	1558	1814
Non-wage Expenditure	1142	1156	1143	1212	1225
Net lending	355	264	139	277	211
Development Expenditure	186	275	296	211	168
Funded from Treasury	139	145	127	56	61
Funded from grants	47	131	169	155	107
Current balance	-1,371	-1,083	-785	-807	-931
Overall balance (Excl. grants and aid)	-1,557	-1,358	-1,081	-1,018	-1,099
Overall balance (inc. grants and aid)	-155	-81	-104	-86	259
Financing	155	81	104	86	-259
Net financing from local banks	176	84	101	132	-242
Balance	21	3	-3	46	17
Financial gap	0	0	0	0	0
Exchange rate (USD/NIS)	3.92	3.73	3.58	3.85	3.61

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

Table (2- 2): Palestine: government public debt, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
<b>Total Domestic Debt</b>	<b>649</b>	<b>840</b>	<b>1,099</b>	<b>1,385</b>	<b>1,268</b>
Local banks	640	831	1,090	1,377	1,253
Loans	304	345	506	719	661
Overdrafts	257	391	441	480	366
Petroleum Authority <sup>(1)</sup>	78	95	143	178	225
Other Public Institutions Loans	10	9	9	8	15
<b>Total External Debt</b>	<b>1,087</b>	<b>1,043</b>	<b>1,114</b>	<b>1,098</b>	<b>1,109</b>
Arab financial institutions	551	539	617	629	630
Al-Aqsa Fund	444	444	522	523	524
Arab Fund for Economic and Social Development	55	43	43	57	58
Islamic Development Bank	52	53	52	50	48
International and Regional Institutions	371	348	342	339	343
World Bank	308	303	297	290	284
European Investment Bank	42	23	23	26	36
International Fund for Agricultural Development (IFAD)	4	3	3	3	3
OPEC	17	19	19	19	20
Bilateral loans	165	156	155	130	136
Spain	93	93	93	92	96
Italy	30	31	31	33	35
China	5	5	5	5	5
Sweden	25	27	26	0	0
<b>Total Government Public Debt</b>	<b>1,736</b>	<b>1,883</b>	<b>2,213</b>	<b>2,483</b>	<b>2,376</b>
Nominal GDP (USD million)	6,719.6	8,330.6	9,775.3	10,254.6	11,942.9
Per capita Public Debt (USD)	469	494	564	614	570

(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, 2011-2013

(USD Million)

Year	Interest Paid		Premiums		Debt Service
	Domestic Debt	External Debt	Domestic Debt	External Debt	
2011	63.1	3.1	-156.4	8.1	-82.1
2012	55.8	4.4	433.8	12.7	506.8
2013	61.8	6.5	284.8	10.0	363.1

Source: Ministry of Finance website.

Table (2- 4): Palestine: government outstanding arrears payments, 2009-2013

(NIS Million)

Items	2009	2010	2011	2012	2013
Wages and Salaries	171	185	374	816	380
Non-wage expenses	815	264	926	1046	1,221
Net lending	77	-103	0	0	0
Development projects	118	88	270	124	66
Tax refund	-140	-39	368	239	27
<b>Total</b>	<b>1,041</b>	<b>395</b>	<b>1,939</b>	<b>2,226</b>	<b>1,693</b>

Source: Ministry of Finance website.



**Chapter Three**  
Foreign Sector Developments

Table (3- 1): Palestine: balance of payments, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Current Account (Net)	-712.6	-690.9	-2,429.6	-2,814.8	-1,317.4
Goods (Net)	-3,504.4	-3,652.8	-4,663	-4,884	-4447.0
Exports (Fob)	631.3	666.1	1,524.9	1249.6	1,675.3
Imports (Fob)	4,135.7	4,318.9	6188.3	6,133.6	6,122.3
Services (Net)	-351.8	-312.1	-261.8	-352.5	-430.0
Exports	579.3	830.7	686.3	649	607.7
Imports	931.1	1,142.8	948.1	1,031.5	1,037.7
Income (Net)	876.1	1,098.1	1,148.1	1,072.4	1,305.6
Receipts	955.8	1,213.2	1,207.6	1,174.1	1,415.8
Compensation of employees	831.1	1,077.4	1,117.4	1,051.2	1,286.3
Of which from Israel	730.7	991.2	1,020.6	965	1,200
Investment Income	124.7	135.8	90.2	122.8	129.5
Payments	79.7	115.1	58.7	101.7	110.2
Current Transfers (Net)	2,267.5	2,175.9	1,346.7	1,379.4	2,254
Inflows	2,502.0	2,476.5	1,616.8	1,649.6	2,422.4
To the Public Sector	1,484.3	1,214.2	727.5	520.2	1,077.3
To the Private Sector	1,017.7	1,262.3	889.3	1,129.4	1,345.1
Outflows	234.5	300.6	270.1	270.2	168.4
Capital and financial Account (Net)	870.5	800.3	2,549.4	2,832	1,265.5
Capital Account (Net)	719.0	846.1	438.9	297.9	350
Capital Transfers (Net)	719.0	846.1	438.9	297.9	350
Inflows	719.0	846.1	438.9	297.9	350
Outflows	0.0	0.0	0.0	0.0	0.0
Acquisition of Non-Produced Assets (Net)	0.0	0.0	0.0	0.0	0.0
Financial account (Net)	151.5	-45.8	2,110.5	2,534.1	915.5
Direct Investment (Net)	315.9	103.0	250.9	246.1	186.5
Portfolio Investment (Net)	-367.0	-453.4	86.2	44.0	-74.8
Other Investment (Net)	191.5	341.0	1,739.8	2,410	825.1
Net Errors and Omissions	157.9	109.4	-119.8	-17.2	52.0
Change in Reserve Assets (- = Increase)	11.1	-36.4	33.6	-166.0	-21.3

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

Table (3- 2): Palestine: international investment position, 2010-2013

(USD Million)

Items	2010	2011	2012	2013
International investment position (Net)	1286	721	667	1161
Total external assets	5424	5233	5262	6101
Foreign direct investment abroad	241	192	232	315
Portfolio investment abroad	806	1147	1030	1145
Other investment abroad	3846	3226	3336	3956
Of which: currency and deposits	3671	3671	3234	3862
Official reserves	531	497	664	685
Total foreign liabilities	4138	4512	4595	4940
Foreign direct investment in Palestine	2177	2328	2336	2450
Portfolio investment in Palestine	611	611	676	791
Other investment in Palestine	1350	1573	1583	1699
Of which: loans	1119	1208	1140	1152
currency and deposits	228	359	443	547

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, 2009-2013

Items	2009	2010	2011	2012	2013
	Number of Banks				
Local Banks	10	8	8	7	7
Foreign Banks	10	10	10	10	10
Jordanian Banks	8	8	8	8	8
Egyptian Banks	1	1	1	1	1
British Banks	1	1	1	1	1
<b>Total</b>	<b>20</b>	<b>18</b>	<b>18</b>	<b>17</b>	<b>17</b>
	Number of Branches & representative Offices				
Local Banks	104	110	118	121	125
Foreign Banks	105	102	108	111	112
Jordanian Banks	98	95	101	104	105
Egyptian Banks	6	6	6	6	6
British Banks	1	1	1	1	1
<b>Total</b>	<b>209</b>	<b>212</b>	<b>226</b>	<b>232</b>	<b>237</b>

In 2010, Palestine International Bank and Al-Aqsa Bank was liquidated. In addition, two branches of the Arab Bank were closure in Gaza. In 2012, Al-Rafah Bank merger with Arab Islamic bank for investment, as a result a new bank was licensed under the name of National bank.

Table (4- 2): Palestine: financial inclusion indicators, 2009-2013

Items	2009	2010	2011	2012	2013
Branches & representative Offices (number)	209	212	226	232	237
Large cities	175	176	187	193	106
Urban areas	34	36	39	39	131
Deposit accounts (number)	2,011,242	2,185,779	2,545,459	2,715,338	2,748,387
Customer deposits (USD million)	6,296.8	6,802.4	6,972.5	7,484.1	8,303.7
Personals	4,859.7	5,002.9	5,324.3	5,457.5	6,057.9
Corporates	870.9	1116.9	1063.6	1,406.4	1,568.0
Public sector	566.1	682.7	584.5	620.2	677.8
Credit Portfolios (USD million)	2,234.2	2,885.9	3,552.7	4,199.1	4,480.2
Personals	869.5	1,275.6	1,351.9	1,628.7	1,742.0
Corporates	727.3	772.1	1,099.9	1,163.0	1,364.1
Public sector	637.4	837.3	1,100.8	1,407.4	1,374.0
ATM's (number)	305	335	378	435	488
Point of sales (number)	1,745	2,314	3,658	3,926	4,646
Credit cards (number)	29,082	37,374	47,046	56,835	62,931
Credit cards (number)	285,228	308,962	354,352	410,536	408,636
ATM withdrawal cards (number)	68,185	71,684	101,728	122,379	132,758



Table (4- 3): PMA: assets and liabilities, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Deposits of banks and financial institutions	1,189.7	1,056.1	917.1	992.1	996.0
Required reserves	549.1	615.5	672.7	753.4	788.5
Other accounts	640.6	440.6	244.4	238.7	207.5
Government accounts- Ministry of finance	0.0	0.0	0.0	0.0	65.7
Provisions	13.6	14.2	17.3	18.9	20.3
Capital and reserves	80.9	85.7	89.3	92.1	94.1
Paid capital	50.0	54.7	58.5	61.4	63.3
Reserves	30.9	31.0	30.8	30.7	30.8
Other liabilities	7.7	8.5	9.8	10.6	11.9
<b>Assets = Liabilities</b>	<b>1,291.9</b>	<b>1,164.5</b>	<b>1,033.5</b>	<b>1,113.7</b>	<b>1,188.0</b>
Domestic assets	253.1	195.7	195.9	166.3	184.1
balances with banks in Palestine	200.1	154.4	164.8	165.3	183.1
Current deposits	49.2	14.8	4.2	8.9	8.0
Time deposits	150.9	139.6	160.6	156.4	175.1
Islamic investments	53.0	41.3	30.1	0.0	0.0
Financial investments held to maturity	0.0	0.0	1.0	1.0	1.0
Foreign assets	1,024.4	933.3	807.4	917.0	967.3
Balances with banks abroad	722.5	685.7	450.3	662.4	758.5
Current and demand deposits	14.3	39.3	69.7	69.5	94.0
Time deposits	708.2	646.4	380.6	592.9	664.5
Islamic investments	102.5	99.0	98.7	66.8	17.4
Financial investments held to maturity	199.4	148.6	158.3	87.4	90.8
Investment portfolio for trade	0.0	0.0	100.1	100.4	100.6
Fixed assets*	5.5	7.6	9.1	10.2	12.7
Government loans	4.6	3.5	3.4	3.4	3.3
Other assets	4.3	24.4	17.7	16.8	20.6

\* Includes development projects under processing.

Table (4- 4): PMA: profit and loss statement, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Revenues	15.8	25.6	18.6	17.5	17.9
Net interest and investment revenue	15.3	14.5	15.9	13.6	13.1
Other revenues	0.5	1.1	2.7	3.9	4.8
Payback provisions	0.0	10.0	0.0	0.0	0.0
Expenditure	9.2	20.4	14.5	14.5	16.0
Employee expenses	6.9	7.4	9.5	10.1	11.0
Administrative expense	1.9	2.1	2.1	2.5	2.9
Depreciation and Capital expenses	0.4	0.6	0.5	0.6	1.5
Development projects' expenses	0.0	0.0	0.0	0.0	0.0
Financial Follow-up Office expenses	0.0	0.3	0.4	0.5	0.6
Expenses for doubtful debts	0.0	10	2	0.8	0.0
Excess of revenue over expenditure in regular activities	6.6	5.2	4.1	3.0	1.9
Amendments of previous years	0.1	0.04	-0.03	-0.1	0.0
Expenses of the money seizure case	1.7	0.6	0.2	0.01	0.0
Net excess of revenues over Expenditure	5.0	4.7	3.8	2.9	1.9

Table (4- 5): PMA: employee distribution, 2009-2013<sup>(1)</sup>

Items	2009			2010			2011			2012			2013		
	Ramallah	Gaza	Total	Ramallah	Gaza	Total	Ramallah	Gaza	Total	Ramallah	Gaza	Total	Ramallah	Gaza	Total
Governor's Office	7	2	9	9	2	11	17	3	20	18	2	20	18	1	19
Security and Public Safety Office	10	17	27	8	18	26	8	18	26	8	18	26	13	10	23
Financial Follow-up Unit	6	0	6	7	0	7	10	0	10	11	0	11	10	0	10
Independent Offices	5	4	9	7	4	11	9	3	12	8	3	11	8	4	12
Ombudsman	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ethics	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Legal Counsel	1	1	2	1	1	2	3	1	4	2	1	3	2	2	4
Internal Audit	4	3	7	6	3	9	6	2	8	6	2	8	6	2	8
<b>Core Departments</b>	<b>144</b>	<b>69</b>	<b>217</b>	<b>97</b>	<b>29</b>	<b>126</b>	<b>122</b>	<b>29</b>	<b>151</b>	<b>122</b>	<b>28</b>	<b>150</b>	<b>123</b>	<b>30</b>	<b>153</b>
Monetary Stability Group	16	6	22	16	6	22	27	4	31	26	3	29	29	5	34
Research & Monetary Department	11	1	12	10	1	11	16	2	18	15	1	16	16	3	19
Monetary Operations Department	5	5	10	6	5	11	11	2	13	11	2	13	13	2	15
<b>Financial Stability Group</b>	<b>63</b>	<b>23</b>	<b>86</b>	<b>81</b>	<b>23</b>	<b>104</b>	<b>95</b>	<b>25</b>	<b>120</b>	<b>96</b>	<b>25</b>	<b>121</b>	<b>94</b>	<b>25</b>	<b>119</b>
Supervision and Inspection Department	54	17	71	66	17	83	63	15	78	66	15	81	63	15	78
Payment System Department	9	6	15	15	6	21	17	4	21	14	4	18	13	4	17
Consumer Relations & Market Conduct Department <sup>(2)</sup>	-	-	-	-	-	-	-	15	6	21	16	6	22	6	22
<b>Supporting Departments</b>	<b>65</b>	<b>40</b>	<b>105</b>	<b>71</b>	<b>40</b>	<b>111</b>	<b>66</b>	<b>47</b>	<b>113</b>	<b>81</b>	<b>40</b>	<b>121</b>	<b>86</b>	<b>43</b>	<b>129</b>
External Relations Department	2	2	4	1	2	3	2	2	4	6	2	8	8	3	11
General Services Department	30	20	50	32	20	52	29	21	50	31	21	52	33	24	57
IT Department	12	6	18	15	6	21	16	5	21	20	6	26	22	5	27
Human Resources Department	10	4	14	10	4	14	12	3	15	11	3	14	8	3	11
Finance Department	11	8	19	13	8	21	15	8	23	13	8	21	15	8	23
<b>Total</b>	<b>172</b>	<b>92</b>	<b>264</b>	<b>199</b>	<b>93</b>	<b>292</b>	<b>240</b>	<b>92</b>	<b>332</b>	<b>248</b>	<b>91</b>	<b>339</b>	<b>258</b>	<b>88</b>	<b>346</b>

(1) Consultants or employees with contracts are not included.

(2) Established in 2011.

Table (4- 6): PMA: staffing and training, 2009-2013

Items	2009	2010	2011	2012	2013
Governor's Office	6	10	12	14	7
Security and Public Safety Office	8	15	5	6	4
Independent Offices	11	13	18	22	7
Legal Counsel	-	3	4	4	2
Internal Audit	6	6	9	8	5
Financial Follow-up Unit	5	4	5	10	-
Core Departments	96	95	127	140	195
Monetary Stability Group	16	22	39	55	41
Research & Monetary Department	8	13	23	26	20
Monetary Operations Department	8	9	16	29	21
Financial Stability Group	80	73	88	85	154
Supervision and Inspection Department	43	28	53	47	134
Payment System Department	20	20	17	10	8
Consumer Relations & Market Conduct Department	17	25	18	28	12
Supporting Departments	43	47	68	76	50
External Relations Department	4	3	4	11	12
General Services Department	8	11	15	14	9
IT Department	9	12	17	18	16
Human Resources Department	9	8	8	14	5
Finance Department	13	13	24	19	8
Total	164	180	230	258	263

## Part II: Banking Sector

Table (4- 7): Palestine: Banking sector assets and liabilities, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Total assets	8,091.0	8,798.4	9,337.4	10,044.5	11,190.7
Cash and Precious Metals	534.9	542.8	496.7	731.1	956.0
Due from PMA and Banks (Total):	4185.1	3949.3	3743.7	3673.1	4130.2
Due from PMA	1214.7	1074.8	940.9	998.9	996.6
Due from banks in Palestine	143.6	252.4	335.3	370.5	452.6
Due from banks abroad	2826.8	2622.0	2467.5	2303.7	2681.1
Securities portfolio for trade and investment	554.2	577.4	830.8	745.3	856.9
credit facilities	2234.3	2885.9	3550.7	4199.1	4480.1
Banking acceptances	3.9	3.6	5.9	5.3	7.6
Investment	140.6	355.5	143.6	148.7	155.1
Fixed assets	268.1	282.7	326.1	346.6	362.1
Other assets	170.0	201.3	240.1	195.4	242.7
Total Liabilities	8,091.0	8,798.4	9,337.4	10,044.5	11,190.7
Due to PMA and Banks (Total):	381.4	420.6	646.5	723.0	900.1
Due to PMA	208.8	160.0	178.9	173.1	189.5
Due to banks in Palestine	153.1	204.6	304.7	349.3	445.4
Due to banks abroad	19.5	56.1	162.9	200.7	265.3
Customer deposits	6296.8	6802.4	6972.5	7484.2	8303.7
Executed and outstanding acceptances	12.4	15.3	16.2	10.0	13.8
Equity (net), of which:	958.9	1092.6	1184.5	1256.5	1359.9
Paid-up capital	730.3	809.6	874.6	894.8	928.1
Legal reserve	58.2	82.5	95.8	108.4	123.2
Declared reserves	11.2	29.4	45.0	57.1	70.0
General reserves for banking operations	35.0	46.9	57.7	87.0	94.2
Undistributed profits	16.8	8.6	9.2	4.4	4.0
Unrealized profit (loss) on long-term investment	41.9	9.2	2.3	-6.1	3.0
Tax provisions	73.5	90.3	107.2	111.2	114.1
Other provisions	271.2	268.4	287.6	323.2	345.9
Other liabilities	96.8	108.7	130.0	136.4	153.2

Table (4- 8): Palestine: Banking sector profit and loss statement, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Interest received	234.1	247.2	312.8	349.1	402.7
Interest paid	34.4	26.3	35.3	42.5	56.7
Net interest income	199.7	220.9	277.5	306.6	346.0
Net commission income	52.7	61.9	77.3	73.1	80.3
Net debt securities and investments	16.2	51.7	2.4	8.2	5.1
Net currency exchange and appreciation transactions	29.0	24.7	26.0	24.6	24.6
Net off-balance-sheet items	1.7	0.7	0.4	0.6	0.3
Net expenses and other operating income	4.2	8.5	8.6	6.7	5.6
Total non-interest income	103.8	147.5	107.0	113.2	115.9
Total income from all operations	303.5	368.4	384.5	419.8	461.8
Operating expenses	184.7	201.3	218.6	231.1	251.5
Net Provisions	-15.5	-4.7	2.1	20.2	9.1
Net extraordinary profit and loss	0.0	0.7	0.0	0.0	0.0
Net income before taxes	134.3	171.1	163.8	168.5	201.2
Taxes	31.1	32.6	34.9	44.3	58.3
Net income after taxes	103.2	138.5	128.9	124.3	142.9

Table (4- 9): Palestine: Banking sector customer deposits, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
	Depositing Party				
Public sector, of which:	566.1	682.6	584.5	620.2	677.0
Palestinian National Authority	413.2	534.1	473.1	473.3	531.3
Private sector, of which:	5,730.7	6,119.8	6,388.0	6,864.0	7,626.8
Resident	5,412.4	5,947.8	6,192.3	6,621.3	7,345.4
	Region				
WB	5,370.9	6,019.6	6,194.2	6,696.7	7,447.2
GS	925.9	782.8	778.3	787.5	856.6
	Type				
Current deposits	2,353.8	2,680.6	2,773.0	2,984.4	3,339.2
Savings deposits	1,669.8	1,844.2	2,027.1	2,266.7	2,582.9
Time deposits	2,272.2	2,277.6	2,172.4	2,233.1	2,381.7
	Currency				
USD	2,697.4	2,853.4	2,718.5	3,063.2	3,460.6
JD	1,786.7	1,852.5	1,801.4	1,740.4	2,106.0
NIS	1,465.8	1,728.9	2,115.8	2,323.5	2,409.8
Others	346.9	367.6	336.8	357.1	327.3
<b>Total</b>	<b>6,296.8</b>	<b>6,802.4</b>	<b>6,972.5</b>	<b>7,484.2</b>	<b>8,303.7</b>

Table (4- 10): Palestine: Banking sector direct credit facilities, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
	Beneficiary				
Public sector, of which:	637.4	837.2	1,101.1	1,407.5	1,374.0
Palestinian National Authority	627.2	821.2	1,098.9	1,402.9	1,372.2
Private sector, of which:	1,596.9	2,048.7	2,449.6	2,791.6	3,106.1
Resident	1,449.0	1,990.8	2,326.3	2,749.2	3,070.1
	Type				
Loans	1,562.9	1,978.0	2,531.7	2,950.2	3,213.1
Overdrafts	663.6	900.4	1,010.3	1,238.0	1,253.0
Finance lease	7.8	7.5	8.7	10.9	14.0
	Region				
WB	2,059.2	2,680.8	3,251.3	3,767.6	3,987.1
GS	175.1	205.1	299.4	431.5	493.0
	Currency				
USD	1,427.1	1,756.6	2,245.9	2,255.0	2,464.2
JD	218.7	246.2	420.9	549.6	471.1
NIS	579.0	866.7	863.7	1,367.6	1,510.7
Others	9.5	16.4	20.2	26.9	34.1
<b>Total</b>	<b>2,234.3</b>	<b>2,885.9</b>	<b>3,550.7</b>	<b>4,199.1</b>	<b>4,480.1</b>

Table (4- 11): Palestine: Banking sector direct credit facilities provisions, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Loans	44.2	34.7	37.6	48.3	51.7
Overdrafts	32.0	27.0	31.5	28.7	23.7
Finance lease	0.0	0.6	0.6	0.6	0.6
Total Provisions	76.2	62.3	69.9	77.6	76.0
Direct Credit Facilities, net	2,158.1	2,823.6	3,480.8	4,121.5	4,404.1
Total Direct Credit Facilities	2,234.3	2,885.9	3,550.7	4,199.1	4,480.1
Outstanding interests	24.0	13.7	14.4	16.1	19.3
Non-Performing Loans	92.0	88.5	103.9	98.6	106.9



Table (4- 12): Palestine: Banking sector sectoral distribution of private sector's loans, 2009-2013

Items	2009		2010		2011		2012		2013	
	Value USD Million	Percent (%)	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	707.5	22.8
Industry and mining	184.8	11.6	257.9	12.6	303.7	12.3	173.8	6.2	222.3	7.2
General trade	341.3	21.4	392.2	19.1	489.6	20.0	503.2	18.0	612.3	19.7
Agriculture and livestock	38.6	2.4	45.3	2.2	33.7	1.4	35.1	1.3	38.3	1.2
Services	521.3	32.6	576.8	28.2	434.2	17.7	409.3	14.7	372.9	12.0
Consumer goods financing	133.6	8.4	230.0	11.2	535.5	21.8	897.0	32.1	1015.9	32.7
Others	110.9	6.9	138.1	6.8	220.7	9.2	142.4	5.1	136.9	4.4
<b>Total</b>	<b>1,596.8</b>	<b>100.0</b>	<b>2,048.6</b>	<b>100.0</b>	<b>2,451.8</b>	<b>100.0</b>	<b>2,791.7</b>	<b>100.0</b>	<b>3,106.1</b>	<b>100.0</b>

Table (4- 13): Palestine: Banking sector lending and deposit rates, 2009-2013

(Percent)

Period	Lending Rates According To			Depositing Rates According To		
	JD	USD	NIS	JD	USD	NIS
2009	7.45	6.19	10.99	1.91	0.41	0.24
Frist Quarter	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
First Quarter <sup>(1)</sup>	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
2013	9.17	7.51	11.58	2.08	0.62	1.32
Frist Quarter	8.69	7.33	11.65	1.70	0.45	1.09
Second Quarter	9.50	7.90	11.50	2.40	0.80	1.40
Third Quarter	9.53	7.73	11.19	2.11	0.49	1.38
Fourth Quarter	8.98	7.06	11.97	2.09	0.75	1.40

(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.

Table (4- 14): Palestine: Banking sector clearing activities, 2009-2013

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									
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
2013	194,333	2,144.92	105,136	460.65	4,042,570	7,722.40	4,388	235.97	4,346,427	10,566.98
	Bounced checks									
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
2013	23,778	73.30	14,688	24.05	448,749	561.17	129	0.58	487,344	659.10

Table (4- 15): Palestine: RTGS (BURAQ) participants total transactions, 2010-2013

(Value in USD million)

Year	Inter Bank Transfers				Extractions							Total Transfers		
	Bank to Bank Payments		Personal Payments		Clearing Settlement operations		PEX CSD Settlements Operations		Concurrent Banking Operations		Other Operations			
	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value	Number			Value
2010	1,033	728.6	5,999	775.8	453	1,167.6	1,304	495.9			99	23.6	8,888	3,191.5
2011	6,269	3,560.4	86,849	5,750.6	3,067	8,068.7	7,995	3,341.6			1,457	95.4	105,637	20,816.7
2012	7,734	13,093.0	145,844	5,511.5	2,908	6,388.4	7,687	3,055.2			1,447	124.8	165,620	28,172.9
2013	8,223	14,823.0	142,926	6,344.9	2,629	7,383.4	7,758	3,356.3	1,128	72.3	1,506	131.2	164,170	32,111.1

## Part III: Non-financial Institutions

Table (4- 16): Palestine: performing indicators of microfinance institutions, 2009-2013

Items	2009	2010	2011	2012	2013
Institutions (number)	9	10	10	8	6
Branches (number)	69	65	68	62	61
Total credit portfolio (USD million)	57.0	63.6	75.7	84.2	85.4
Loans (number)	30,809	n.a	43,409	32,562	39,898
	Sectoral distributions of credits (%)				
Agriculture	24.0	25.0	26.0	20.2	17.0
Industries and crafts	13.0	13.0	16.0	10.0	6.0
Trade and services	33.0	42.0	42.0	38.5	34.0
Consumption and others	30.0	20.0	16.0	31.3	43.0

Source: website of SHARAKAH.

Table (4- 17): Palestine: money changers, 2009-2013

Items	2009	2010	2011	2012	2013
WB	191	215	240	234	232
GS	45	45	44	42	38
Total	236	260	284	276	270

Table (4- 18): Palestine: Some performing indicators of money changers, 2011-2013

(USD million)

Item	2011	2012	2012
Total assets	37.0	49.4	49.6
Ownership equity	36.5	48.2	46.6
Paid-up capital	35.9	42.7	44.5
Assets	35.1	46.8	47.1
Fixed assets	2.1	2.7	2.5
Total expenditures	3.6	5.2	5.4
Profits	1.9	1.8	0.4

Table (4- 19): Palestine: Palestine Exchange, 2009-2013

(USD Million)

Items	2009	2010	2011	2012	2013
Number of trading sessions	246	249	248	249	241
Number of shares traded (million)	238.9	230.5	184.5	147.3	203.0
Value of shares traded (USD million)	500.4	451.2	365.6	273.4	340.8
Number of executed transactions	88,838	82,625	6,1928	41,442	44,425
Market value of shares traded (USD million)	2,375.4	2,449.9	2,782.5	2,859.1	3,247.5
	Daily Averages				
Value of shares traded (USD million)	2.0	1.8	1.5	1.1	1.4
Number of shares traded (million)	1.0	0.9	0.7	0.6	0.8
Number of transactions executed	361	332	250	166	184
Turnover rate(%) <sup>(1)</sup>	21.1	18.4	12.6	9.7	12.98
Al-Quds index	493.0	490.0	476.9	477.6	541.45

(1) Turnover = turnover value of shares traded / market value of shares traded.  
Source: website of the Palestine Securities Exchange, (www.pse.com)

Table (4- 20): Palestine: performing indicators of the insurance sector, 2009-2013

Items	2009	2010	2011	2012	2013
Companies (number)	10	10	10	10	10
Branches (number)	88	103	99	111	114
Employees (number)	857	1007	1028	1035	1075
Agencies (number)	225	265	239	229	225
Total insurance premiums (USD million)	104.3	125.8	150.5	144.5	158.7
Compensations (USD million)	56.2	66.4	75.6	88.4	88.7
Total assets/liabilities (USD million)	300.5	298.4	323.6	340.0	367.0
Paid-up capital (USD million)	55.6	62.2	63.1	67.2	67.9
Ownership equity (USD million)	84.5	95.6	101.1	108.8	119.8

Source: Capital Market Authority website, ([www.pcma.ps](http://www.pcma.ps))

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