WEST BANK & GAZA

Table 1	2017
Population, million	4.7
GDP, current US$ billion	14.5
GDP per capita, current US$	3102
Upper middle-income poverty rate ($5.5)[a]	23.6
Gini index[a]	33.7
School enrollment, primary (% gross)[b]	93.9
Life expectancy at birth, years[b]	73.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2016)

Real GDP growth reached 2 percent in Q1 2018 driven by activity in the West Bank while Gaza continues to deteriorate. Living condi-tions have worsened with almost 1 in every three in the labor force unemployed and 24 percent of Palestinians living be-low the US$5.5 2011 PPP a day. Given the ongoing constraints to economic com-petitiveness, medium-term growth is pro-jected at below 2 percent. Further reduc-tions in transfers to Gaza and possible Israeli cuts to revenue transfers pose sig-nificant downside risks.

Recent developments

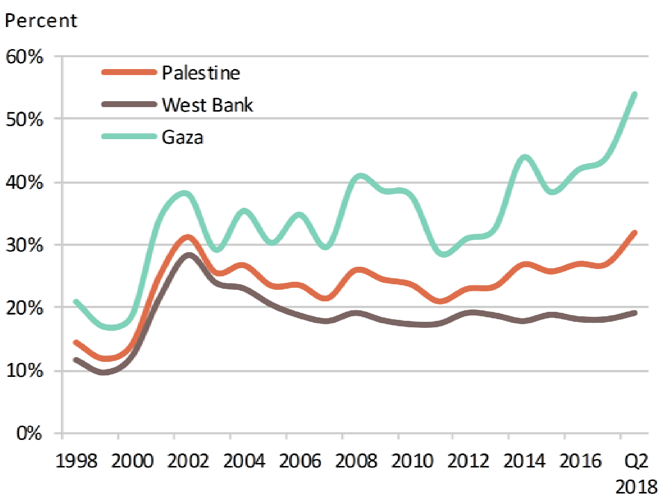
Real GDP growth of the Palestinian economy reached 2 percent in the first half of 2018, masking a steep deterioration in Gaza. Gaza's economy has been kept afloat in recent years by large transfers including donor aid and spending through the budget of the Palestinian Authority (PA), both of which amounted to 70-80 percent of Gaza's GDP. However, these two sources have significantly declined recently resulting in economic activity in Gaza shrinking by 6 percent in the first quarter of 2018. In contrast, the West Bank economy grew by 5 percent during the same period, mainly driven by public consumption. On the supply side, growth was concentrated in wholesale and retail trade and construction as these activities remain less affected by the restriction system.

Overall prices dropped by 0.8 percent between January and June 2018 (year-on-year). The Israeli Shekel, which is the main currency in circulation in the Palestinian territories, appreciated by more than 6 percent in 2017 against the currencies of Israel's main trading partners and continued this trend in early 2018 supported by Israel's export pattern. This had a deflationary effect on import prices. In addition, the prices of food products (most of which are produced domestically or in Israel) remained low in 2018.

Domestic revenues grew by 9 percent in the first half of 2018 (year-on-year) due to the PA's efforts to widen the tax base, while spending cuts in Gaza were the main contributor to a 7 percent decline in public spending. Put together, this resulted in a 20 percent reduction in the total deficit (before grants) in the first half of 2018. Nevertheless, the financing mix remained suboptimal due to insufficient aid. The total deficit (before grants) amounted to US$403 million while aid received was US$240 million (US$183 million in budget support, and US$57 million for development financing), resulting in a financing gap of around US$160 million. To fill the gap, the PA resorted to further arrears to the pension fund and the private sector. Despite repaying some dues from previous years, net accumulation of arrears in the first half of 2018 reached US$177 million, or 2.4 percent of GDP.

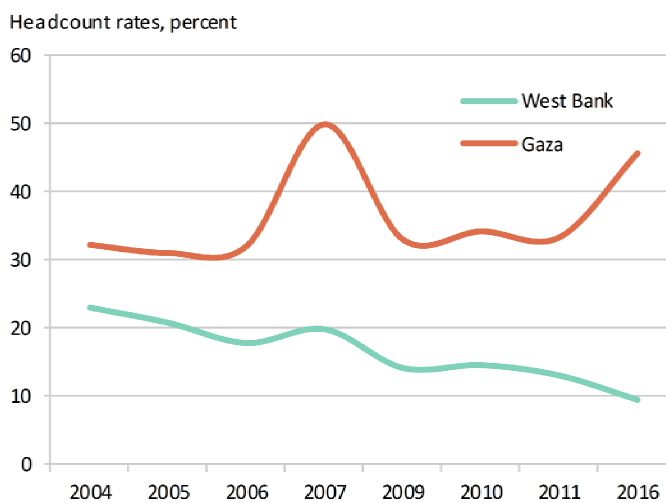
Despite a small decline in the trade deficit (to 37 percent of GDP), the external current account deficit (including official transfers) is estimated to have widened in 2017 to about 11 percent of GDP mainly due to a drop in transfers. Exports continue to be constrained by the ongoing trade restrictions and have remained stagnant at around 18 percent of GDP. Current transfers as a share of GDP dropped due to a decline in both private and official transfers. The unemployment rate in the Palestinian territories reached a new high at 32.4 percent in the second quarter of 2018, which is about 5 percentage points higher than its average in 2017 and the highest rate in two decades. The increase is due to a large jump in Gaza, where 53.7 percent of those in the labor force were unemployed in the second quarter of 2018. The situation in the West Bank has been very

FIGURE 1 West Bank & Gaza: Unemployment rate



Sources: Palestinian Central Bureau of Statistics (PCBS).

FIGURE 2 West Bank & Gaza: Poverty rate at 5.5 2011 PPP poverty line



Sources: PECS, World Bank staff calculations.

different with the unemployment rate remaining stable at around 18-19 percent over recent years.
The latest poverty trend suggests that around 24 percent of Palestinians lived below the US$5.5 2011 PPP a day poverty line in 2016/17– 2.9 percentage points higher compared to 2011. The gap between the West Bank and Gaza has increased substantially in 2016/17 with poverty leaving 46 percent of the population below the US$5.5 line in Gaza, compared to 9 percent in the West Bank. In both regions, poverty rates are vulnerable to external shocks including a drop in expenditures in the West Bank or a further decline in social assistance and transfers in Gaza.

Outlook

Under a baseline scenario that assumes a continuation of the Israeli restrictive regime and the persistence of the internal divide between the West Bank and Gaza, private sector activity is not expected to pick up and real GDP growth of the Palestinian economy is projected to hover around 1.7-1.9 percent between 2018-2020. This growth level implies a decline in real per capita income by more than 2 percent and an increase in unemployment to 35 percent by 2020.
Given the expected trends in Israeli prices, prices in the Palestinian territories are expected to remain subdued with inflation hovering around 2 percent in 2019-2020.
By 2020, despite the PA's efforts to increase revenues and reduce spending, the fiscal deficit (after grants) is expected to reach 2.6 percent of GDP due to insufficient foreign aid. As in previous years, the PA will resort to domestic sources of financing including debt from local banks and arrears to the private sector and the pension fund. This could eventually choke the economies of both the West Bank and Gaza.
Due to the persistently high trade deficit, the current account deficit - including official transfers - is projected to stay in double-digits through 2020, with exports constrained by the restrictions system to around 18 percent of GDP. The Palestinian territories will continue to heavily depend on imports to meet even some basic needs, and hence the imports share in the economy will hover around 55 percent by 2020. In addition to official transfers, the current account deficit financing will continue to depend on informal private capital transfers and possibly further drawdowns of foreign exchange in cash and savings.
Given the recent official update of poverty estimates and the prevailing uncertainty, poverty is not forecasted in this MPO round. However, declining aid flows, negative expectations of GDP per capita growth, cuts in public sector wages and a potential decline in donor funding for health and education services in Gaza are expected to have a negative impact on monetary welfare.

Risks and challenges

In the West Bank, a downside risk would materialize if the Israeli legislation to reduce revenue transfers to the PA, equivalent to PA allowances for prisoners' families, is implemented starting in 2019. This is expected to result in larger than expected financing gaps approaching US$1 billion (6.5 percent of GDP) and a drop in public consumption resulting in lower growth. In Gaza, if transfers through the PA's budget continue to decline and the United Nations Refugee and Works Agency's (UNRWA) funding gap is not offset, this will have a severe impact on economic activity, service provision and social conditions in the Strip. Consequently, the Gaza economy is expected to slip into deep recession, significantly raising the potential for unrest.

TABLE 2 West Bank & Gaza / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2015	2016	2017	2018 e	2019 f	2020 f
Real GDP growth, at constant market prices	3.4	4.7	3.1	1.7	1.9	1.9
Private Consumption	6.2	3.3	3.0	2.6	2.9	3.0
Government Consumption	5.8	1.8	0.9	1.8	2.5	2.6
Gross Fixed Capital Investment	9.0	-0.9	2.2	-0.8	-1.3	-2.2
Exports, Goods and Services	2.6	1.9	5.0	3.0	1.5	1.2
Imports, Goods and Services	9.5	0.2	4.7	2.6	2.4	2.2
Real GDP growth, at constant factor prices	1.5	4.3	2.6	1.7	1.9	1.9
Agriculture	-7.2	-8.1	-5.7	0.7	1.0	1.2
Industry	-3.0	7.5	3.5	3.2	3.5	3.5
Services	3.5	4.0	2.8	1.2	1.4	1.3
Inflation (Consumer Price Index)	1.4	-1.0	0.0	1.2	1.8	2.2
Current Account Balance (% of GDP)	-16.3	-13.9	-10.6	-11.9	-12.4	-12.6
Net Foreign Direct Investment (% of GDP)	0.2	-2.5	-1.5	0.5	0.5	0.5
Fiscal Balance (% of GDP)	-5.1	-4.0	-3.1	-3.7	-3.1	-2.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.