

PALESTINIAN TERRITORIES

Key conditions and challenges

Table 1 **2020**

Population, million	5.1
GDP, current US\$ billion	15.1
GDP per capita, current US\$	2980.4
Upper middle-income poverty rate (\$5.5) ^a	21.9
Gini index ^a	33.7
School enrollment, primary (% gross) ^b	97.7
Life expectancy at birth, years ^b	73.9

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2016), 2011 PPPs.

(b) WDI for School enrollment (2019); Life expectancy (2018).

After a successful containment of the COVID-19 first outbreak in the spring of 2020, the second and third waves have been more challenging. Q2 2020 witnessed one of the largest economic contractions on record, but activity has slightly improved since. The fiscal position has worsened not only due to the outbreak but also due to a political stand-off that has disrupted the flow of revenues for half of 2020. The outlook remains precarious and subject to numerous political, security and health risks.

Before the onset of the COVID-19 pandemic, the Palestinian economy was stagnant and the overall socio-economic situation was difficult, due to recurrent hostilities and violence, a deteriorating relationship with Israel, and falling aid inflows. During 2017-19, annual GDP growth averaged 1.3 percent, lower than the population growth rate, resulting in decreasing per capita incomes and increasing poverty. Decomposing growth historically makes it evident that it was driven by accumulation of factors (both capital and labor) and not improvements in productivity. During the 2015-19 period, gross investment averaged about 25-26 percent of GDP, but the bulk of this has been channeled into activities in the non-tradable sectors – not sectors that have served as escalators for growth in other countries. Likewise, Foreign Direct Investment (FDI), at a mere 1 percent of GDP, is very low. Potential sources of growth will be very limited going forward even in the post-COVID environment.

COVID-19 has exacerbated existing economic and social challenges. The West Bank is currently going through a third wave with no sign of a flattened curve anytime soon and the daily cases in Gaza also continue to be high. If this continues and given that the vaccination campaign is still nascent, further stringent lockdowns may become necessary, amid

eroding compliance, adversely affecting the outlook.

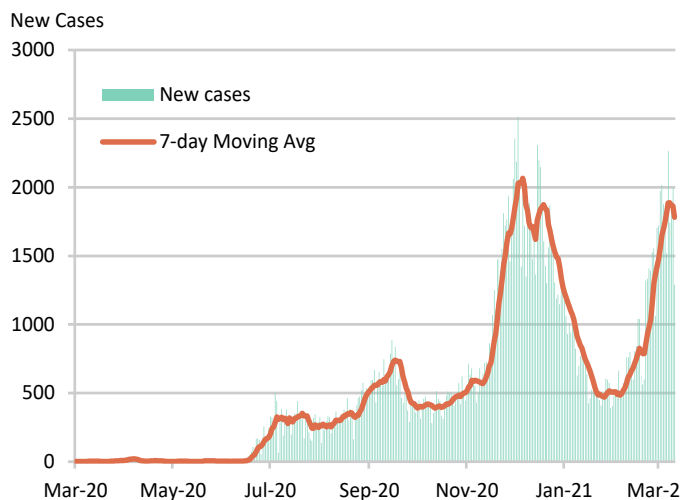
Recent developments

With limited fiscal space and monetary policy tools (due to the lack of a national currency) to mitigate the crisis impact, the economy bore the brunt of the pandemic and containment measures. The decline in activity from March 2020 was rapid and broad, with GDP contracting by 3.4 percent (y/y) in the first quarter of 2020 and then by 19.5 percent (y/y) in the second quarter, one of the largest contractions on record. There was a rebound in the third quarter as the economy grew by 12 percent (q/q), but nonetheless, it was still nearly 12 percent lower than the same quarter of 2019 with private consumption and capital investment continuing to record significantly lower levels. In total, the economy shrank by 11.5 percent in 2020, in real terms.

Growth in consumer prices had been modest prior to the outbreak of COVID-19, where prices generally moved in the 1-2 percent range. But since April 2020, growth in prices has turned negative and by December, prices were 1.5 percent lower than in the same month of 2019, reflecting weak demand by consumers.

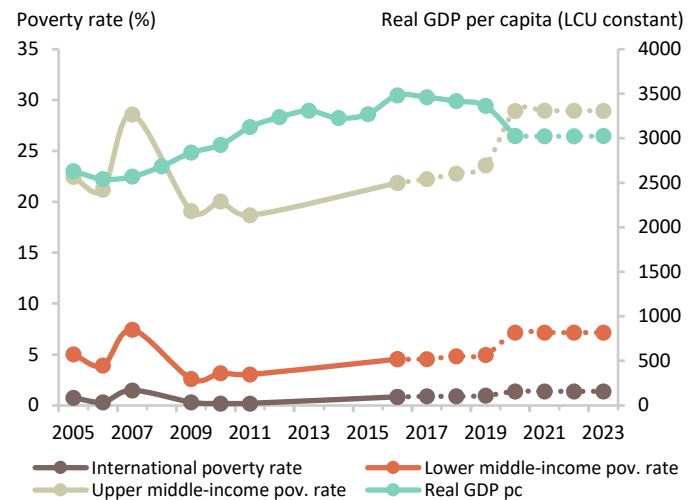
The PA's fiscal stress heightened in 2020 due to the economic slowdown and the decision to halt coordination with Israel. The PA's decision in May 2020 to stop coordination with the Government of Israel (GoI) in response to the proposed

FIGURE 1 Palestinian territories / New daily COVID-19 infections



Sources: John Hopkins University CSEE and World Bank staff calculations.

FIGURE 2 Palestinian territories / Actual and projected poverty rates and real GDP per capita



Sources: World Bank. Notes: see Table 2.

annexation plan resulted in a suspension of clearance revenue receipts for six months, compounding the liquidity impact of the Covid-19 crisis given that they constitute the majority of public income. On the expenditure side, public spending increased mainly due to a rise in social assistance to the new poor and affected businesses and increased medical spending. The financing need (deficit after grants) amounted to US\$1.1 billion in 2020 forcing the PA to increase its domestic borrowing and accumulate more arrears to the private sector.

During the peak closures of activity in the second quarter, some 121,000 people lost their jobs. Of this, some 96,000 people have lost a job in the Palestinian territories, especially in sectors that have been affected by social distancing measures, such as tourism, restaurants, and construction, while some 25,000 Palestinian workers that cross to Israel lost their job in the second quarter of 2020. Both the third and fourth quarters saw an improvement with some 50,000 people regaining their jobs. This put the unemployment rate at 23.4 percent at the end of the fourth quarter of 2020. In Gaza, 43 percent of those in

the labor force were unemployed in the fourth quarter of 2020, while the West Bank recorded an unemployment rate of 15 percent during the same time.

Based on the most recent official data, about 22 percent of Palestinians lived below the upper-middle income poverty line (US\$5.5 2011 PPP a day) in 2016/17, a 2.8 percentage points increase with respect to 2011. There is a significant regional income disparity, with 46 percent of the population in Gaza below the poverty line in 2016/17, compared to just 9 percent in the West Bank.

Outlook

Uncertainty about the rollout of COVID-19 vaccinations implies that the ongoing “lockdown-open-surge-lockdown” dynamic will disrupt the economic activity until enough population is vaccinated to achieve herd immunity. Accordingly, a modest bounce back is expected in 2021 with growth returning to around 3.5 percent, reflecting in part the base year effect from a sharp contraction in 2020. Upside

risks arise from the signs of renewed engagement by the US with the PA and the potential for the announced Palestinian elections to ease the internal divide between the West Bank and Gaza.

Domestic revenue collections are projected to rise given that full lockdowns and severe disruptions to economic activity are not anticipated. Clearance revenues, whose transfer is now resumed, are projected to decline as deductions by Israel are expected to increase by US\$180 million in 2021. Despite additional spending to reinstate wages of Gaza employees as recently decided by the President, overall expenditure as a share of GDP will slightly decline in 2021 as social assistance is expected to drop. Put together, the government balance (deficit after aid) is expected to remain high at 6.4 percent of GDP in 2021 – down from 7.6 percent in 2020.

Projections based on GDP per capita growth suggest that the poverty rate has been increasing since 2016, reaching 28.9 percent in 2020—a significant increase of approximately 7 percentage points in the last four years. This represents approximately 1.4 million people living in poverty in 2020.

TABLE 2 Palestinian territories / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	1.2	1.4	-11.5	3.5	3.2	3.0
Private Consumption	1.1	3.8	-11.0	2.4	2.5	2.5
Government Consumption	7.3	-6.1	8.2	6.5	2.3	2.7
Gross Fixed Capital Investment	2.5	0.9	-31.8	8.4	9.3	5.1
Exports, Goods and Services	2.5	2.0	-9.6	3.8	3.0	3.0
Imports, Goods and Services	4.5	1.4	-12.0	5.0	4.0	3.0
Real GDP growth, at constant factor prices	1.9	1.4	-11.5	3.5	3.2	3.0
Agriculture	1.6	0.0	-3.6	2.2	1.9	1.6
Industry	2.2	-0.9	-19.9	5.0	4.4	3.7
Services	1.8	2.2	-9.7	3.2	3.0	3.0
Inflation (Consumer Price Index)	1.2	0.8	-0.7	0.7	0.9	0.9
Current Account Balance (% of GDP)	-13.2	-10.4	-6.5	-8.1	-8.3	-8.9
Net Foreign Direct Investment (% of GDP)	1.7	1.1	0.9	0.8	0.8	0.8
Fiscal Balance (% of GDP)	-2.5	-4.5	-7.6	-6.4	-5.7	-5.2
Debt (% of GDP)	14.5	16.3	24.2	25.7	26.4	26.9
Primary Balance (% of GDP)	-2.1	-4.2	-7.3	-6.0	-5.2	-4.7
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	0.9	1.0	1.4	1.4	1.4	1.4
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	4.8	5.0	7.1	7.1	7.1	7.1
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	22.8	23.6	28.9	29.0	29.0	28.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate. f = forecast.

(a) Calculations based on 2016-PECS. Actual data: 2016. Nowcast: 2017-2020. Forecast are from 2021 to 2023.

(b) Projection using neutral distribution (2016) with pass-through = 1 based on GDP per capita in constant LCU.