PALESTINIAN TERRITORIES

Table 1	2018
Population, million	4.8
GDP, current US$ billion	14.6
GDP per capita, current US$	3046
Upper middle-income poverty rate ($5.5)[a]	23.6
Gini index[a]	33.7
School enrollment, primary (% gross)[b]	95.2
Life expectancy at birth, years[b]	73.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2017).

Despite signs of a bounce back in early 2019, the Palestinian economy is expected to fall into negative growth starting 2020 due to an ongoing standoff over the transfer of Palestinian taxes collected by Israel on top of the long-lasting constraints to economic competitiveness. Living conditions have worsened with a quarter of the labor force unemployed and 24 percent of Palestinians living below the US$5.5 2011 PPP a day. A further decline in aid and increased possibility of conflict pose significant downside risks.

Recent developments

The Palestinian economy witnessed minimal real growth in 2018 due to a steep deterioration in Gaza while the West Bank economy continued to grow, albeit at a slower pace. The most recent national accounts data for the first quarter of 2019 reveals a bounce back with the Palestinian economy growing by 3.8 percent year-on-year: 4.2 percent in the West Bank and 2 percent in Gaza.

This growth is mostly due to a base effect as the first quarter of 2018 was especially weak. Also, the Palestinian Authority's (PA) fiscal crises started in March 2019, so its impact was not yet reflected in the first quarter's GDP data.

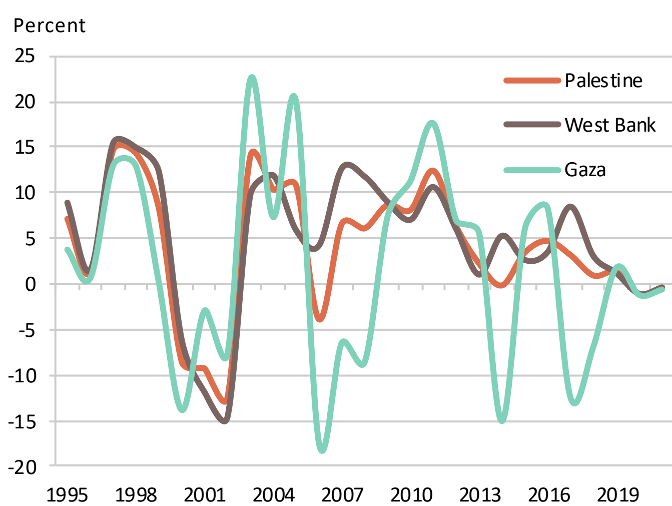
Overall prices increased by 1.4 percent between January and July 2019, year-on-year. The increase was mainly driven by a rise in the West Bank where prices rose by 1.7 percent compared to 0.5 percent in Gaza. The majority of the rise in the West Bank is due to an increase in the prices of food and beverages, which represent a large part of the Palestinian consumer basket.

Following a law enacted in 2018, the Government of Israel (GoI) started in March 2019 making deductions of nearly US$12 million per month from the tax revenues it collects on behalf of the PA (clearance revenues). According to the GoI, the deductions are made to offset payments by the PA to Palestinian prisoners in Israeli prisons and families of those deceased as a result of violence. In response, the PA has refused to accept these transfers altogether. Given that clearance revenues constitute 65 percent of the PA's total revenues and 15 percent of GDP, their loss has resulted in a severe liquidity squeeze. To make ends meet, the PA had to accrue large arrears to its employees, private suppliers, local government units and the public pension fund in the amount of US$686 million in the first half of 2019. The PA also resorted to additional borrowing from the domestic banking sector, raising its stock of debt to US$1.6 billion, as of June 2019.

The external current account deficit (including official transfers) is estimated to have widened in 2018 to 11.4 percent of GDP due to an increase in imports and a drop in transfers. Exports continue to be constrained by the ongoing trade restrictions and have remained stagnant at around 19-20 percent of GDP, while imports increased by 4 percentage points of GDP in 2018 and reached nearly 60 percent. Current transfers as a share of GDP dropped due to a decline in both private and official transfers.

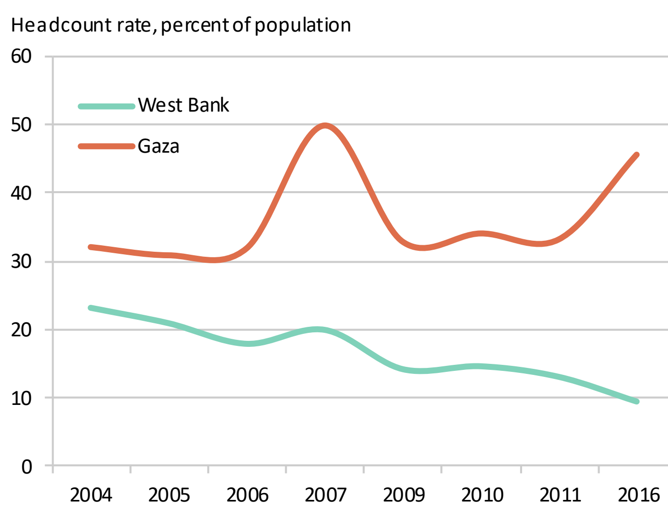
The unemployment rate in the Palestinian territories continues to be high. It reached 26 percent in the second quarter of 2019—almost the same (revised) level it was in 2018. In the West Bank, unemployment reached 15 percent in the second quarter of 2019—2 percentage points lower than its 2018 average mostly due to more jobs created in domestic commerce, hotels and restaurants. The decline in the West Bank was offset by an increase in Gaza where extremely high as it reached 64 percent in the second quarter of 2019.

FIGURE 1 Palestinian territories / Real GDP growth rate



Source: Palestinian Central Bureau of Statistics (PCBS).

FIGURE 2 Palestinian territories / Poverty rate at 5.5 dollars per day (2011 PPPs)



Sources: PECS, World Bank staff calculations.

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 46 percent of the population below the US$5.5 poverty line in Gaza, compared to 9 percent in the West Bank. Monetary living standards in both regions remained fragile. In the West Bank, poverty status is sensitive to even small shocks in household expenditures, while in Gaza any change in social assistance flows can significantly affect the population's wellbeing.

Outlook

A one-off clearance revenue transfer of fuel taxes (USD560 million) was made by Israel in August 2019. This is expected to enable the PA to muddle through 2019, with reduced spending. Various economic indicators show that the decline in public spending has not resulted in a significant downward adjustment in consumption and investment patterns so far in 2019, as the crisis has been perceived as a liquidity rather than a solvency problem. As a result, real GDP growth is expected to be 1.3 percent in 2019. But uncertainty about a comprehensive resolution for the clearance revenue standoff remains high. Under a baseline scenario which assumes a continuation of the Israeli restrictive regime, persistence of the internal divide between the West Bank and Gaza and a decline in aid levels, the Palestinian economy is expected to slip into negative growth in 2020 and 2021, even if additional one-off transfers from clearance revenues are made. This is mainly due to the high level of uncertainty around a resolution, which would eventually exact a toll on private spending behavior. The decline in growth implies a sizable decline in real per capita income and a rise in poverty.

The future fiscal outcome likewise hinges on the clearance revenue standoff. If not resolved, the PA would embark on the year 2020 with severe fiscal conditions. If donor support levels remain similar to 2019, the PA could be facing a financing gap after aid, on a commitment basis, exceeding US$2 billion.

The PA would have almost fully exhausted its domestic sources of financing including borrowing from domestic banks. The accumulation of extremely high arrears to public employees and the private sector may eventually result in a collapse in economic conditions and create social unrest.

Given the prevailing policy uncertainty, poverty is not forecasted in this MPO round. However, declining aid flows, expected shrinking of GDP per capita and a potential reduction in donor funding are expected to have a negative impact on people's wellbeing and incomes.

Risks and challenges

There are significant downside risks to the outlook. A second general election in Israel in the span of six months and a new government on the Palestinian side indicate that the political environment is highly uncertain. Furthermore, uncertainties emanate from international initiatives for economic integration. Also, recent trends indicate an overall decline in the amount of development assistance to be received by the Palestinian economy in the coming years. With private sector activity constrained by the externally imposed restrictions, potential sources of growth will be very limited going forward. Further, if recent clashes between Palestinians and the Israeli forces in the West Bank continue or Gaza suffers a further escalation in violence, there is little room left to absorb such shocks.

TABLE 2 Palestinian territories / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	4.7	3.1	0.9	1.3	-1.1	-0.4
Private Consumption	3.3	-1.8	1.5	0.8	-0.8	-0.8
Government Consumption	1.8	0.9	0.9	-3.6	-0.7	-0.8
Gross Fixed Capital Investment	-0.9	2.1	3.5	4.2	-5.8	0.5
Exports, Goods and Services	1.9	12.4	7.9	2.0	-1.0	-2.0
Imports, Goods and Services	0.2	-0.8	7.0	0.6	-1.5	-0.5
Real GDP growth, at constant factor prices	4.2	2.8	1.6	1.3	-1.2	-0.5
Agriculture	-8.1	-5.7	7.2	0.3	0.6	0.7
Industry	7.5	3.5	2.4	0.7	-1.6	-0.8
Services	3.9	3.0	1.0	1.5	-1.2	-0.5
Inflation (Consumer Price Index)	-1.0	0.0	1.2	0.0	0.7	1.5
Current Account Balance (% of GDP)	-14.5	-10.8	-11.4	-10.6	-9.9	-9.7
Net Foreign Direct Investment (% of GDP)	-2.5	-1.5	-1.5	-0.9	-0.9	-0.9
Fiscal Balance (% of GDP)	-2.4	-3.5	-2.8	-12.4	-11.9	-11.4
Debt (% of GDP)	18.5	17.5	16.1	18.0	20.3	22.5
Primary Balance (% of GDP)	-1.8	-3.0	-2.3	-12.0	-11.3	-10.8

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