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IMPACTS OF THE CONFLICT IN THE MIDDLE EAST ON THE PALESTINIAN ECONOMY

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May 2024 Update

This report is a product led by the Equitable Growth, Finance, and Institutions (EFI) Practice Group of the World Bank's Middle East and North Africa (MENA) Region. Visit www.worldbank.org/en/country/westbankandgaza for more information.

SYNOPSIS

The conflict in the Middle East centered in Gaza continues to have a devastating impact on the Palestinian economy. In addition to the tragic loss of life, the conflict has had devastating effects on both infrastructure and living standards. The conflict has led to a severe humanitarian crisis in Gaza, with essential services being disrupted and all economic sectors being impacted. Official end-2023 data shows that the Gazan economy contracted by 22.6 percent on a yearly basis, while the West Bank experienced a contraction of 1.9 percent.

The conflict has resulted in a severe blow to growth rates and to the already weak labor market in the Palestinian territories, resulting in close to 0.5 million jobs lost. While prior to the war, the consensus projection for 2023 GDP rate was hovering around 3.2 percent growth, the year closed with a deep recession of –5.5 percent: a deviation of 8.7 percentage points in only a few months. This rapid and substantial contraction has left a visible mark on the job market, with an estimated loss of over 200,000 jobs in the Gaza Strip, 148,000 commuters from the West Bank losing access to their jobs in Israel and the loss of 144,000 jobs also in the West Bank due to escalating violence and its repercussions on supply chains, production capacity, and breadwinners' ability to access their workplace. The consequence loss of income is estimated by the International Labor Organization (ILO) to total around US$21.7 million per day, which increases to US$25.5 million when accounting also for the decline in income for public employees and that of the broader private sector (reflecting cratering economic activity).

Widespread unemployment and underemployment combined with inflation have caused a rapid decline in purchasing power for households in both Gaza and the West Bank. Inflation witnessed its first decline in Gaza in April following an increase in humanitarian aid which pushed down prices by 5.4 percent compared to March 2024. Nevertheless, prices remain much higher than their pre-October7 levels with the consumer price index (CPI) increasing by 153.3 percent in April 2024 compared to the same period in 2023.

The fiscal situation of the Palestinian Authority (PA) has dramatically worsened, heightening the risk of disorderly adjustments and a potential imminent fiscal collapse. A significant decrease in clearance revenue[1] transfers and shrinking domestic resource mobilization, coupled with a rigid current expenditure envelope, are the main cause behind the worsening fiscal crisis. The PA's financing gap after aid for 2023 reached

[1] "Clearance revenues" are revenues collected by the Government of Israel (GoI) and transferred to the PA after certain deductions have been made. Most clearance revenues are VAT and import duties, and they should be remitted on a monthly basis according to the Paris Protocol.

US$682 million or 3.9 percent of GDP, and the situation is expected to worsen further in 2024, with a potential financing gap of up to US$1.2 billion. A focus on fiscal policies, especially those improving spending efficiency (particularly regarding the unsustainable wage bill and enhancing tax mobilization, must remain a top priority in the reform agenda.

The output contraction in Gaza is forecast to worsen further, with a projected GDP drop exceeding 50 percent in 2024 (year-on-year), on top of the steep contraction at end of 2023, as the effects of the capital destruction linger. The West Bank economy is also expected to remain under pressure during 2024, as the security situation has deteriorated and heightened restrictions on movement remain in place, choking private sector activity, and as the PA continues to grapple with a spiraling fiscal crisis.

The Palestinian economy is projected to contract anywhere between 6.5 and 9.4 percent during 2024. The economic outlook of the Palestinian territories for the full year of 2024 remains highly uncertain, depending on the severity and duration of the conflict, changes in Israeli policies in the West Bank, including those related to access to the Israeli labor market, and the outcome of the clearance revenue dispute. Depending on the outturn of these factors, the Palestinian economy is estimated to contract in a range of 6.5 to 9.4 percent this year.

The latest findings from the 2023 household survey indicate that poverty was already on the rise prior to the conflict, further increasing the potential challenges of addressing poverty in the aftermath of the conflict. The latest nationally representative data for the West Bank and Gaza is from the Palestinian Expenditure and Consumption Survey (PECS) survey conducted in 2023. Before the start of the current conflict, national poverty (covering the Palestinian population in Gaza, the West Bank and east Jerusalem) stood at 32.8 percent—a significant increase from the poverty rate in 2017 which was 29.2 percent. However, the overall number hides large differences between the West Bank and Gaza, where pre-October 7 poverty rates were around 11.7 percent and 63.7 percent, respectively.

In the wake of the conflict living standards plummeted, accentuating the stark divide between the West Bank and Gaza, with the latter reporting its lowest-ever income per capita in 2023. Nearly every Gazan is currently poor. GDP per capita[2] in the Palestinian territories stood at US$3,360 in 2023, which is 12 percent less than in 2022. In Gaza, GDP per capita abruptly declined in 2023 (by 28 percent y/y) reaching US$1,084 and representing just a fifth of the West Bank's. In real terms, Gaza's income per capita in 2023 was the lowest on record.

The northern governorates of Gaza are experiencing a full-blown famine,[3] with food insecurity reaching catastrophic levels[4], particularly in the northern areas and extending southward. At least one in four Gazan is experiencing catastrophic hunger, and 95 percent of the population is suffering from food insecurity. Famine has erupted in the north of Gaza currently, and it is moving south.[5] Most children are at risk of stunting.[6] In addition to the short-term and tragic human consequences, food insecurity carries significant long-term costs. Children who suffer from malnutrition early in life are particu-larly vulnerable to enduring adverse effects on their health, educational outcomes, and employment pros-

2 In nominal terms.

3 WFP Executive Director remarks as of May 3rd, 2024. Visited on May 7, 2024. Website: https://apnews.com/article/gaza-famine-world-food-program-israel-hamas-war-476941bf2dc259f85a706408b2a665ff.

4 The World Bank is a partner of the Integrated Food Security Phase Classification (IPC) initiative, which provides the globally recognized standard on the severity of food insecurity in Gaza and across the world. The IPC report issued on March 18, 2024, provided latest evidence that famine is imminent in the northern governorates of Gaza, and that the entire population of Gaza is facing acute or severe food insecurity.

5 WFP: 1 https://www.wfp.org/news/gaza-grapples-catastrophic-hunger-new-report-predicts-famine-if-conflict-continues , March 5, 2024; and https://www.nbcnews.com/politics/politics-news/world-food-programme-director-cindy-mccain-gaza-full-blown-famine-rcna150644.

6 UN-WB Interim Damage Assessment, April 2024 https://thedocs.worldbank.org/en/doc/14e309cd34e04e40b90eb19afa7b5d15-0280012024/original/Gaza-Interim-DamageAssessment-032924-Final.pdf, accessed on April 2, 2024.

pects, which can detrimentally affect their overall quality of life and future productivity. Estimates indicate that if the current trajectory continues, there will be an excess mortality of 58,000 to 66,000 individuals, including deaths from epidemics exacerbated by famine and the collapse of the healthcare system[7].

In the face of rapidly increasing risks, the banking sector is well regulated by the Palestine Monetary Authority (PMA), which has steadily been building the capabilities and resilience of local banks. The Palestinian banks' behavior displays a general risk aversion, and the system remains profitable due in part to low funding costs. Presently, the banking system is well capitalized, liquid, and compliant with the Capital Adequacy Requirements set by the PMA. At the same time, institutional and economic difficulties are tilting the risks upward for the financial sector. Actively avoiding further instability is crucial to allow the financial sector to maintain its established function as a stable pillar during periods of economic challenges.

Safeguarding correspondent banking relationships between Palestinian and Israeli banks is paramount to avoid systemically negative effects on the economy. Correspondent Banking Relationships (CBRs) play a crucial role in facilitating financial transactions between the Palestinian economy, Israel, and the outside world. The recent challenges surrounding the extension of the "Indemnity letters"[8] have highlighted the potential risks for the Palestinian banking system if it loses its connection to the Israeli banking sector. Any CBRs severance is expected to rapidly disrupt a large portion of essential banking services and have significant adverse economic impacts on the Palestinian real sector, due to the use of the Israeli Shekel as the primary de facto currency in circulation. A CBRs severance could also generate negative effects on the Israeli economy, including disruptions in trade and payment settlements, increased transaction costs, and a general decline in economic confidence, as well as potential surge in informal or unregulated financial transactions, which could pose challenges for financial oversight.

Beyond the spiraling fiscal crisis exacerbated by the ongoing conflict, it's important to also focus on the long-term fiscal sustainability of the PA—continuing to rely on arrears and aid as sources of deficit financing is unsustainable. By the end of 2023, the PA had accumulated arrears amounting to approximately 40 percent of GDP. It is worth underscoring that the fiscal situation can hardly ever be sustainable as long as the PA allocates a significant portion of its expenditure (around 30 percent) to expenses related to Gaza while generating minimal revenue from the Strip. Over the short term, coordinated and integrated humanitarian and development aid will be irreplaceable to address the extensive damage caused by the conflict. Such support is especially needed to provide relief to the most vulnerable individuals affected by the conflict, which is nearly all families in Gaza in the short term. However, the severe destruc-tion in Gaza also poses significant medium-to-longer term challenges, emphasizing the ongoing need for international assistance likely for several years, in addressing the broader requirements for reconstruction once a ceasefire is established.

7 Zeina Jamaluddine, Zhixi Chen, Hanan Abukmail, Sarah Aly, Shatha Elnakib, Gregory Barnsley et al. (2024). Crisis in Gaza: Scenario-based health impact projections. Report One: 7 February to 6 August 2024. London, Baltimore: London School of Hygiene and Tropical Medicine, Johns Hopkins University. The higher end is based on assumptions of infectious disease epidemics. https://gaza-projections.org/.

8 For several years, the Israeli Ministry of Finance has issued "letters of indemnity and immunity" to shield the Israeli banks that operate CBRs, from potential risks and legal repercussions concerning money laundering and terrorism financing offenses related to services provided to Palestinian banks in the Palestinian territories.

ASSESSMENT

The conflict in the Middle East, centered in Gaza, has lasted for over 200 days, inflicting profound suffering on the people of Gaza, the West Bank, and Israel, with the most vulnerable individuals facing the gravest consequences. Heavy fighting in densely populated areas coupled with the severe disruption of essential services, including access to food and water, has resulted in an extreme humanitarian crisis in Gaza. Most of Gaza's population of 2.2 million has been displaced—in some cases more than once.[10] The conflict has affected all economic sectors and ruined vital infrastructure, including housing, schools, healthcare facilities, water and sanitation services, and the electricity grid. The conflict has significantly worsened Gaza's already severe poverty and pervasive unemployment, and the territory's socio-economic outlook is dire.

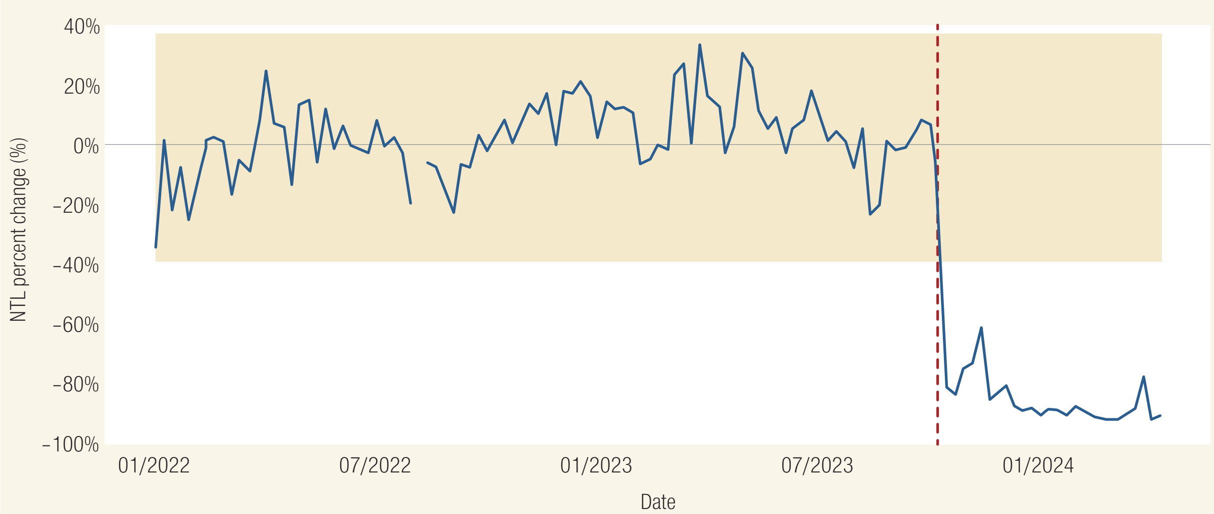
Despite ongoing international efforts to broker a temporary ceasefire and a hostage/prisoner exchange, at present the conflict shows no signs of abating,[11] and the risk of regional escalation remains high. As of early May 2024, negotiations failed to yield an agreement acceptable to both sides on a 'day after' scenario, raising questions about the feasibility of achieving a durable cease-fire. It is currently impossible to predict when the conflict will end or how Gaza will be governed in the following weeks, months and years. It is unclear whether the displaced Palestinian civilians will be allowed or able to return to their homes, especially in northern Gaza, whether border restrictions will be lifted to allow international and regional economic aid, or how the international community will approach post-conflict reconstruction and development.

Due to the conflict, 2023 was one of the worst years on record for the Palestinian economy, only behind the years of the second Intifada and COVID-19. Latest official data by the Palestinian Central Bureau of Statistics (PCBS) confirm that the economy contracted by 5.5 percent in 2023, year-on-year (y/y). This is equal to a loss of 1.8 billion in nominal US dollars. As expected, the Gaza economy bore most of the decline as the conflict resulted in a near complete halt of economic activity in the Strip causing its economy to shrink by 22.6 percent in 2023, y/y. The fourth quarter of 2023 alone, saw an astounding decline of over 80 percent in Gaza's GDP, compared to the same period in 2022. Services, trade and agriculture—some of the largest contributors to Gaza's GDP, dropped by 63 percent, 91 percent, and 93 percent, respectively, in Q4 2023 (Table 1). Using nighttime lights as a proxy for economic activity, the output

10 UN Population Fund as of March 2024 (https://www.unfpa.org/occupied-palestinian-territory).

11 The draft is based on events as of mid–May, 2024.

FIGURE 1 • Gaza - Nighttime Light (NTL) radiance
Weekly percent change (2022 baseline) in NTL radiance



Source: World Bank staff, based on NASA, Black Marble Nighttime Lights.

decline in Gaza has been in a range of approximately 90 percent, since immediately after October 7th. To date—it has not rebounded (Figure 1).

In the West Bank, the knock-on effects of the conflict continue to weigh heavily on economic activity. These ripple effects manifested through additional restrictions on movement within and across cities imposed by the Government of Israel (GoI) and denied access for Palestinian workers to the Israeli labor market, weighing heavily on economic activity. This, compounded with increased deductions by the GoI from clearance revenues, vastly deepened the PA's fiscal crisis, and caused the West Bank economy to contract by 1.9 percent in 2023. In the final quarter of 2023 alone, the economy contracted by 18.8 percent compared to the same quarter in 2022. The decline was mostly felt in the manufacturing and construction sectors. Looking at the expenditure side of GDP, consumption witnessed a 20 percent decline in Q4 2023 compared to the last quarter of 2022. This reflected a cutback in spending, as Palestinian workers lost their incomes amidst job losses in the Israeli market and in the private sector and only partial salary payments in the public sector. Exports also decreased by 20 percent following a slowdown in the Israeli economy—the Palestinian territories's largest trading partner.

TABLE 1 • Percentage Change in Economic Sectors; Q4-2023 vs. Q4-2022

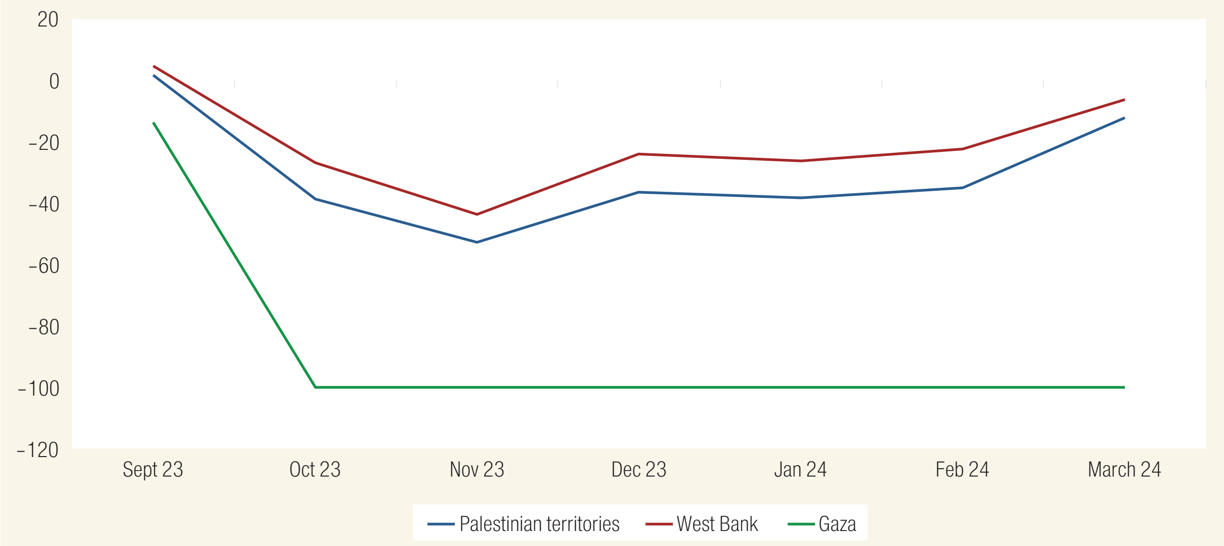
Sector	Gaza	West Bank
Agriculture, forestry and fishing	−93.4	−13.3
Mining, manufacturing, electricity and water	−92.1	−26.7
Construction	−96.2	−26.8
Wholesale and retail trade	−90.8	−17.7
Transportation and storage	−90.3	−20.7
Financial and insurance activities	−95.1	−7.2
Information and communication	−90.0	−10.4
Services	−62.8	−12.7
Others (including public sector)	−83.4	−22.3
Total	**−81.3**	**−18.8**

Source: PCBS.

The conflict has negatively affected living standards and created further divergence between Gaza and the West Bank. GDP per capita[12] in the Palestinian territories stood at US$3,360 in 2023, which is 12 percent less than in 2022. In Gaza, GDP per capita abruptly declined in 2023 (by 28 percent y/y) reaching US$1,084 and representing only just a fifth of the West

[12] In nominal terms.

FIGURE 2 • Business Cycle Index



Source: PMA.

Bank's. In real terms, Gaza's income per capita in 2023 has been its lowest on record.

The Palestinian economy has continued to be under a massive shock in the first months of 2024, as the severity of the conflict remains unchanged, and its effects continue to linger. The economy is projected to contract anywhere between 6.5 and 9.4 percent during 2024. According to the joint EU-UN-World Bank's Interim Damage Assessment[13], the cumulative estimated cost of damages incurred from the conflict as of late January 2024 amount to over US$18 billion. Based on this data and assuming that reconstruction will not start before 2025, the economic contraction in Gaza is forecast to worsen significantly in 2024, exceeding 50 percent (y/y) as the effects of fixed capital destruction linger. The West Bank economy is also expected to remain under pressure through 2024, as heightened restrictions on movement and access remain in place and as the PA continues to grapple with a deep fiscal crisis. The Palestine Monetary Authority's (PMA) Business Cycle Index[14] for the West Bank in Q1 2024 continues to be significantly lower than in September 2023, despite a minor and temporary improvement in March due to increased production and sales, likely attributable to the celebration of Ramadan (Figure 2). It is important to stress that the economic outlook of the Palestinian territories for the full year of 2024 remains highly uncertain as it hinges on a number of assumptions related to the severity and timeline of the conflict in Gaza, changes in Israeli policies in the West Bank, including those related to access to the Israeli labor market, and the outcome of the clearance revenue dispute. Depending on the outcomes, the Palestinian economy is projected to contract anywhere between 6.5 and 9.4 percent in 2024.

The continued conflict in Gaza resulted in extensive damage to private sector infrastructure, effectively annihilating production capacity in many private sector establishments. Business activity in Gaza continues to be generally paralyzed with main economic sectors experiencing a complete cessation of production and sales, barring some activities in the areas of humantarian relief, health, bakeries, and internal trade focused on food and medicine.

13 https://thedocs.worldbank.org/en/doc/14e309cd34e04e40b90eb19afa7b5d15-0280012024/original/Gaza-Interim-Damage-Assessment-032924-Final.pdf

14 The BCI is represented as a diffusion index, which means that it gives a central tendency within the group of businesses surveyed. A value of zero indicates unchanged conditions, a positive value indicates improving conditions (up to 100) and a negative value indicates deteriorating conditions (up to −100). Since October 2023, the Gaza index is estimated to be at its lowest.

TABLE 2 • Value of Economic Sectors Losses of Production from October 2023 to January 2024 in West Bank and Gaza
(Value in USD million) – Source PCBS, 11 March 2024

	Value of typical production (Four months)			Value of production since eruption of conflict (Four months)			Value of losses from October 2023 to January 2024		
Sector	West Bank	Gaza Strip	West Bank and Gaza	West Bank	Gaza Strip	West Bank and Gaza	West Bank	Gaza Strip	West Bank and Gaza
Industry	1,934	221	2,161	1,383	6	1,389	557	215	773
Construction	74	11	85	50	0	50	24	11	35
Services (and residual)	3,512	712	4,224	2,607	128	2,735	905	583	1,488
Total	**5,526**	**944**	**6,470**	**4,040**	**134**	**4,174**	**1,486**	**810**	**2,296**

The majority of private sector establishments in Gaza have been destroyed or partially damaged as a result of the conflict. As of end of January 2024, an estimated 62 percent of establishments were assessed to have been destroyed and 17 percent were assessed to have been partially damaged[15]. Damages to the structures of private sector establishments in the commerce, industry, and services sectors through the end of January have been estimated at US$1.655 billion. Given the continuation of hostlitilies at the time of writing, and factoring in the lost equipment, machinery, and inventory, damage estimates to the private sector are expected to increase.

Half of private sector establishments in the West Bank and Gaza either ceased production or reported a decline in production. This is a direct result of the near-complete cessation of business activities in Gaza and reduced operations in the West Bank. An estimated 29 percent of West Bank establishments ceased production or experienced a decline in production capacity[16]. Accumulated losses in the West Bank and Gaza from October 2023 to January 2024 are thus estimated to have reached US$2.3 billion or around US$19 million per day[17]. The construction sector has been notably affected, with returned checks in the sector reaching as high as 60 percent of total. Prominent real estate developers are experiencing dire financial challenges, placing some of them on the verge of bankruptcy[18].

Damage to Gaza's electricity infrastructure was estimated at nearly US$280 million as of the latest full assessment, in January, which is currently being updated, with estimates expected to exceed US$400 million, underscoring the urgent need for repair and—where repair is not an option—replacement. The damages to the electricity sector in Gaza primarily involve: (i) the electricity distribution network[19]; (ii) ground-based utility scale and off-grid distributed rooftop solar photovoltaic (PV) electricity supply systems[20]; (iii) specific equipment like demineralized water tanks and switchgear in the Gaza Power Plant; (iv) some of the ten high voltage electricity connection points through which electricity is imported from the Israel Electric Corporation; and (v) Gaza Electricity Distribution Company's (GEDCO) warehouses, offices, vehicles and cranes. Initial reports from the Palestinian Electricity and Natural Resources Authority (PENRA) and GEDCO suggest that due to the sever-

15 Source: Source: World Bank, EU, and UN Interim Damage Assessment. Visited online at https://thedocs.worldbank.org/en/doc/14e309cd34e04e40b90eb19afa7b5d15-0280012024/original/Gaza-Interim-Damage-Assessment-032924-Final.pdf.

16 PCBS: Press Release on the Losses of the Palestinian Private Sector – 11 March 2024.

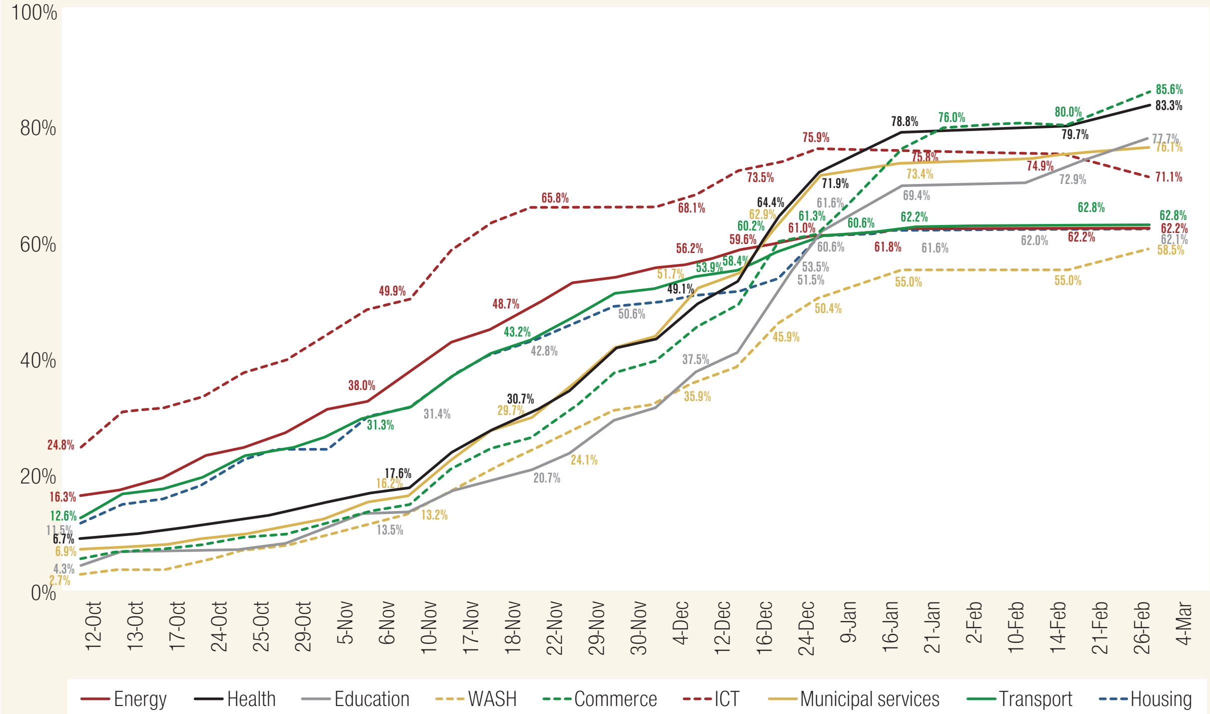
17 Ibid.

18 World Bank staff consultations with private sector and banking sector representatives – April 1st, 2024.

19 This also includes all the associated electricity sector assets, such as transformers, cables, switchgears, poles, accessories, smart meters, Supervisory Control and Data Acquisition – SCADA systems, warehouses, etc.

20 These are deployed across Gaza in public buildings including schools, hospitals and health facilities, water supply and wastewater treatment facilities, residential buildings.

FIGURE 3 • Gaza; Estimates of Damage by Sector
Impact (Damaged and Destroyed) Percentage by Sector
12 October-04 March 2024



Source: IPSOS data.

ity of impacts from targeted strikes, much of the electricity supply equipment may not be repairable—with the exception of some cables—so replacement will be required. As of present, the cost of electricity infrastructure damaged or destroyed in Gaza is estimated to largely exceed US$ 400 million[21].

The agri-food sector has also been severely impacted, exacerbating not only unemployment and poverty, but also food insecurity. Prior to the conflict, primary agriculture contributed roughly 6 percent of the GDP in the West Bank and Gaza, with the wider agri-food sector representing about 15 percent. The sector has been a significant source of employment[22] and has played a crucial role in ensuring food security, both through local food production and by enhancing the socio-economic conditions of Gazans. According to IPSOS data, between 81 to 96 percent of agricultural assets in Gaza have been damaged or destroyed[23], amounting to US$629 million in damages. This includes different production assets, such as irrigation infrastructure, livestock farms, orchards, agricultural holdings, machinery, storage facilities, and research stations. More than 60 percent of damage is concentrated in the North Gaza and Khan Younis governorates[24]. The sector's functionality and service delivery are severely compromised, threatening livelihoods and worsening food access of the entire population.

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21 Based on data triangulated from IPSOS bi-weekly damage assessments, along with the information from the Palestinian Energy and Natural Resources Authority (PENRA) and GEDCO.

22 Source: Center for Economic and Policy Research (CEPR), CEPR, "Agriculture in Palestine: a post-Oslo analysis", 2017. Approximately 13.4 percent of the formal labor force and over 90 percent of total informal employment is absorbed by the agricultural sector.

23 as of late January 2024.

24 Source: World Bank, EU, and UN Interim Damage Assessment. Visited online at https://thedocs.worldbank.org/en/doc/14e309cd34e04e40b90eb19afa7b5d15-0280012024/original/Gaza-Interim-Damage-Assessment-032924-Final.pdf.

Food insecurity has reached catastrophic levels[25], and the northern governorates of Gaza are in a full-blown famine[26]. Acute food insecurity is pervasive—at least one in four Gazan is experiencing catastrophic hunger. Famine has erupted in the north of Gaza in recent weeks, and it is moving south.[27] Most children are at risk of stunting.[28] It is worth underscoring that food insecurity has long-term costs. A child experiencing malnutrition early in life, even in utero, can face poor long-term health, education, and employment consequences. Research has shown that early exposure to famine in China[29], Germany[30], the Netherlands[31], and Ethiopia[32] resulted in adults with reduced height, fewer years of schooling, lower cognitive scores, and reduced earnings. To use a recent regional analytical comparator, four months of high food inflation—in the aftermath of Russia's invasion of Ukraine in 2022—are estimated to have increased the risk of children stunting in the developing MENA region between 17 and 24 percent[33].

The energy, water, transport, and ICT sectors have faced large disruptions, resulting in the cessation of basic service delivery and severely impacting communication. The number of people without a home also continues to rise. Satellite damage data[34] indicate an increase in housing damages, resulting in 1.1 million homeless individuals. Transport and energy infrastructure have been compromised, with approximately two thirds of roads, ports, and feeder lines being affected. While the Gaza Power Plant's main generation equipment remains operational, its auxiliary systems have been partially damaged. Over 83 percent of health facilities are estimated to be damaged or destroyed, and the education sector is similarly afflicted, with nearly 78 percent of facilities damaged or destroyed, leaving schools non-functional. Over 59 percent of the WASH sector infrastructure is estimated to be damaged, leaving water and sanitation services in a dire state. Access to clean water remains a critical issue, particularly in northern Gaza and among internally displaced persons, with over 81 percent of households lacking clean water. Lastly, the ICT sector has seen over 70 percent of its assets damaged or destroyed, resulting in widespread communication outages and only partial functionality of voice communications due to network congestion and the destruction of local operators' telecommunications towers.

Against this backdrop, the already-weak Palestinian labor market took a hit from both the conflict in Gaza and the economic contraction in the West Bank, resulting in a sudden and large unemployment surge at the end of 2023. Based on recent reports by the PCBS[35] and the International Labor Organization[36], it is estimated that unemployment in Gaza soared to 75 percent in Q4 2023, and that more than 201,000 jobs have been lost in the Strip, as of the end of January 2024. Furthermore, 148,000 workers from the West Bank who previously worked in Israel and the settlements have lost their occupation, due to rescinded or suspended

25 The World Bank is a partner of the Integrated Food Security Phase Classification (IPC) initiative, which provides the globally recognized standard on the severity of food insecurity in Gaza and across the world. The IPC report issued on March 18, 2024, provided latest evidence that famine is imminent in the northern governorates of Gaza, and that the entire population of Gaza is facing acute or severe food insecurity.

26 WFP Executive Director remarks as of May 3rd, 2024. Website: https://apnews.com/article/gaza-famine-world-food-program-israel-hamas-war-476941bf2dc259f85a706408b2a665ff.

27 WFP: 1 https://www.wfp.org/news/gaza-grapples-catastrophic-hunger-new-report-predicts-famine-if-conflict-continues , March 5, 2024; and https://www.nbcnews.com/politics/politics-news/world-food-programme-director-cindy-mccain-gaza-full-blown-famine-rcna150644.

28 UN-WB Interim Damage Assessment, April 2024 https://thedocs.worldbank.org/en/doc/14e309cd34e04e40b90eb19afa7b5d15-0280012024/original/Gaza-Interim-DamageAssessment-032924-Final.pdf, accessed on April 2, 2024.

29 Chen and Zhou, 2007.

30 Jürges, 2013.

31 Lindeboom et al., 2010.

32 Dercon and Porter, 2014.

33 Gatti et al. , 2023.

34 Source, IPSOS, March 2024.

35 PCBS, https://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_InterWorkDay2024E.pdf.

36 https://www.ilo.org/publications/impact-war-gaza-labour-market-and-livelihoods-occupied-palestinian.

work permits, and only around 24 thousand continued working in the Israeli economy in Q4 2023. Given that the average daily salary of these workers is more than twice as high as that paid in the West Bank, the impact of their job losses on demand in the West Bank has been severe. In addition, 144,000 jobs were also lost in the West Bank due to escalating violence and its repercussions on supply chains, production capacities, and breadwinners' ability to access their workplace. As a result, unemployment in the West Bank has increased from 12.9 percent in Q3 2023 to 32 percent in Q4 2023—the highest on record. In total, estimates of labor income losses in the Palestinian economy amount to US$21.7 million per day. When considering also the loss in income for public employees due to partial salary payments by the PA and the decline in income earned by the broader private sector, the estimated daily loss in labor income against the baseline increases to US$25.5 million.[37]

Prices in Gaza witnessed their first decline in April 2024 since the eruption of the conflict but continue to be significantly higher than their pre-October 7 levels. According to data by the Palestine Central Bureau of Statistics, the consumer price index (CPI)) in Gaza declined by 5.4 percent in April 2024 compared to the previous month following an increase in humanitarian aid delivery to Gaza in April. In fact, food prices declined by 20.7 percent In April compared to March. However, on an annual basis, prices in Gaza increased by 153.3 percent in April 2024 compared to the same month last year. This is primarily due to disruptions in the supply chain resulting from the conflict. Widespread shortages of essential goods have significantly constrained the purchasing ability of hundreds of thousands of households, regardless of their financial means. Food prices were 138 percent higher in April 2024 compared to April 2023, driven by challenges in accessing food, increased transportation costs, and decreased volumes of aid. In contrast, the CPI in the West Bank experienced only a marginal annual increase of 2.5 percent during the same period.

The PA's already challenging fiscal situation has transformed into a full-blown and ongoing crisis since October 2023, with the risks of systemic collapse on the rise. This is mainly due to the GoI's decision to increase monthly deductions from revenues it collects on behalf of the PA (clearance revenues[38]) to around NIS500–600 million, up from the previous NIS200 million. According to Israeli authorities, their decision to withhold the PA's revenues reflects the amount that the PA spends in Gaza and offsets the debt owed by the Jerusalem District Electricity Company (JDECO) to the Israeli Electricity Company (IEC). The legal basis for these deductions is contested. As a result, clearance revenue transfers, the PA's main source of income, shrank by over 50 percent in the conflict's aftermath. In response, the PA decided to decline several of these transfers in 2023. These developments came on top of the decline in domestic revenue mobilization due to the economic contraction and continued low levels of foreign aid. Since October 2023, in consideration of lower revenues, the PA has further reduced payments to civil servants to 50–70 percent of their total salaries, and in May to 50 percent. Official data by the Palestinian Ministry of Finance shows that the PA's financing gap for 2023, after aid and taking into account clearance revenue deductions, reached US$682 million or 3.9 percent of GDP. The gap was mostly filled with borrowing from domestic banks and increased arrears to the private sector, public employees and the pension fund. Recent Israeli media reports indicate decisions by GoI to withhold the March clearance revenues, totaling NIS170 million after all the deductions[39]. If confirmed this raises the stakes and the risk for a potential systemic collapse.

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37 Ibid.

38 "Clearance revenues" are revenues collected by the GoI and transferred to the PA after certain deductions have been made. Most clearance revenues are VAT and import duties, and they should be remitted on a monthly basis according to the Paris Protocol.

39 Visited on May 20, 2024, website: https://www.timesofisrael.com/liveblog_entry/report-smotrich-holding-nis-170-million-in-pa-tax-revenue-over-un-statehood-bid-possible-icc-arrest-warrants/

In early March 2024, an agreement was reached to set up a 'escrow account' entrusted to Norway, which has been collecting the part of increased clearance revenue deductions related to "Gaza payments". This mechanism led the PA to accept the transfer of the residual amount of clearance revenues from Israel after deductions. Assuming that the situation remains unchanged, and that the clearance revenue deductions continue at the same level throughout 2024, the PA's financing gap (after aid) could reach as high as US$1.2 billion, despite maintaining partial salary payments at only roughly 65 percent. The severity of the fiscal situation cannot be overstated. Given the extremely limited sources of domestic financing, covering such a gap is expected to prove almost impossible for the PA and may pose an actual risk of systemic collapse. This risk would rise substantially if media reports of a decision to withhold all of the PA's clearance revenues prove correct.

New results from the 2023 household survey show that poverty was increasing already before the conflict. The latest nationally representative data for the West Bank and Gaza is from the PECS survey conducted in 2023. Before the start of the current conflict, national poverty (covering the Palestinian population in Gaza, the West Bank and east Jerusalem) stood at 32.8 percent—a significant increase from the poverty rate in 2017 which was 29.2 percent. However, the overall number hides large differences between the West Bank and Gaza, where pre-October 7 poverty rates were around 11.7 percent and 63.7 percent, respectively.

As a result of the conflict, nearly every Gazan now lives in poverty—at least over the short term—with the West Bank's households also suffering from detrimental repercussions. A combination of heightened restrictions, job and income losses, and a steep drop in demand, has deeply impacted the wellbeing of the Palestinian population. Impacts on welfare have also been felt because of increased constraints on social spending, reflecting a worsening public financial position.

Disruptions to remittances are predicted to add to the negative impacts on the population's disposable income and the overall economy. The West Bank and Gaza rank amongst the top jurisdictions in the world in terms of remittance contribution to GDP (equivalent to roughly 20 percent)[40]. The COVID-19 pandemic experience showed that the West Bank households' poverty status is very sensitive to very small shocks: thus, in a context of fewer jobs, incomes and remittances, a large number of vulnerable households are expected to fall into poverty during 2024. With this background, there is a need to increase the transparency and efficiency of international remittances, making them less costly, speedier, and more accessible, while continuing to carefully address de-risking and monitoring requirements, including AML/CFT regulations[41].

Despite facing increasing risks, the banking system remains stable. The financial sector had performed relatively well in the preceding three years, which positioned it well against times of economic distress. The Palestinian banking sector has continued to act cautiously, with modest levels of lending. Q1 2024 data indicated an incremental uptick in customer deposits in the Gaza Strip, signaling, among other considerations, continued trust in the resilience of the system. The relative financial stability thus far is critical to weather and mitigate the impact of the current shock. At the same time, the financial sector has been significantly affected, both directly (as damaged or destroyed financial sector facilities in Gaza are estimated at over US$8 million) and indirectly (as there is a significant impact from worsening economic conditions on the banking sector's portfolio). Digital payments can play a key role in facilitating transactions during cash shortage and the PMA's recent investments in payments infrastructure are expected to be beneficial in that regard. The PMA has been investing heavily in the digital payment infrastructure to reduce cash usage, working for instance on fast payments and e-KYC (electronic Know Your Customer). These services are expected to help citi-

[40] World Bank staff estimates based on IMF balance of payments data, and World Bank and OECD GDP estimates 2022.

[41] Anti-money laundering (AML) and countering the financing of terrorism (CFT) policies are designed to prevent and combat these crimes, playing a vital role in protecting the integrity and stability of global financial markets.

zens, businesses, and the financial sector through the current crisis.

The banking sector is well regulated by the PMA, which has steadily been building the capabilities and resilience of local banks. Palestinian banks' behavior points to a limited appetite for risk, and the system remains profitable due in part to low funding costs. The current escalation of the conflict in Gaza and economic crisis in the West Bank comes on the back of a period of post-COVID financial sector growth and profitability. In the period leading up to the conflict, the banking system was well capitalized, liquid, and compliant with the Capital Adequacy Requirements set by the Palestine Monetary Authority (in line with Basel III). The banking system's aggregate exposure to Gaza in terms of credit and deposits is very small compared to that of the West Bank. However, institutional and economic difficulties are tilting the risks upward for the financial sector. Preventing it from becoming an additional source of instability is imperative.

Safeguarding correspondent banking relationships between Palestinian banks and Israeli banks is essential. The Palestinian economy operates primarily using the Israeli shekel as its de facto currency. This makes the Palestinian economy reliant on ties to Israel for its financial transactions both with Israel (its main economic counterpart) and the broader international community. These transactions are facilitated through the Bank of Israel and private Israeli banks. For years, the Government of Israel has issued timebound "letters of indemnity and immunity" to shield the Israeli banks from any risks or legal repercussions in Israel concerning real or perceived risks of money laundering and terrorism financing related to their services provided to Palestinian banks in the Palestinian territories. These indemnity letters have been consistently renewed—usually for six months or a year by the Israeli Finance Minister. The indemnity period that concluded on March 31st, 2024, was extended at the last minute, and only by three months. The Palestinian banking system would be critically at risk if the renewal of CBRs with Israeli banks was not secured in a stable fashion. Losing this connection to the Israeli banking system would disrupt essential banking services such as check clearing, fund transfers, and card transactions. A more stable arrangement for cross-border payments was being jointly developed by the Bank of Israel (BoI) and the PMA, although progress toward implementation has been slow and seems to have stalled.

The banking system's exposure to the public sector remains elevated, and the growing number of returned checks indicates a potential rise in the macrofinancial risk profile. The banking system's significant exposure to the public sector—US$2.3 billion in Q1 2024—necessitates careful and active management by authorities to safeguard overall macroeconomic stability. In recent months the percentage of returned checks has continued to rise, reaching 9 percent of the value of checks in Q1 of 2024, and in some cases up to 25 percent, significantly exceeding the 2023 pre-conflict average of 4–5 percent per quarter. These developments likely reflect a rise in instances of non-payment of wages to both public and private sector employees. At the same time, the volume of checks has been decreasing significantly, as 19 percent fewer checks were issued in Q4 of 2023 (y/y). Further, the microfinance sector has been experiencing significantly less liquidity than the banking system—as it does not offer deposit-taking services—which jeopardizes the sustainability of several local microfinance companies.

Arrears accumulation and foreign aid continue to remain the only two sources of funding to manage the widening fiscal and humanitarian crises, as well as to ensure the continuation of basic services. The release of humanitarian aid funds, largely overseen by UN agencies, is predicted to be an essential support for those affected by the extensive damage of the war. Nevertheless, the severe destruction in Gaza presents major hurdles to the recovery and reconstruction efforts, highlighting the critical need for preparedness and ongoing international assistance to tackle the immediate effects and the broad requirements for rebuilding once a ceasefire is agreed upon. This situation underscores the need for focusing on the medium-to-long-term fiscal sustainability of the PA, as continuing to rely on arrears and aid as sources of deficit financing is unsustainable.

In the aftermath of the conflict, the revival and rebuilding of the electricity sector will rely on

the restoration of the electricity distribution network's functionality. This will include repairing the Gaza Power Plant's damaged water tanks, step-up transformers, and other equipment, as well as ensuring a reliable supply of diesel and heavy fuel oil to power its turbo-generators. Additionally, efforts will focus on rehabilitating or replacing damaged main feeders at high-voltage connection points with the Israel Electric Corporation to renew electricity imports, reconstructing the distribution network, including cables and meters for low voltage customers, and repairing off-grid rooftop and utility-scale solar generation equipment. Immediate humanitarian relief measures will provide backup generators, diesel fuel for essential services like hospitals and schools, and mobile solar kits to quickly resume basic energy services.

The recovery of the private sector in the West Bank and Gaza will require comprehensive, coordinated, well-financed, and flexible programming. The unprecedented wholesale damage to private sector establishments in Gaza as well as increased movement and access restrictions between West Bank governorates have instilled an increased level of instability for Palestinian businesses. In Gaza, due to widespread damage and destruction of private sector infrastructure, post-conflict recovery will need to be prioritized, phased, and focused on critical economic sectors which could contribute to humanitarian relief efforts in the immediate term. In the West Bank, programs to support small- and medium-sized enterprises (SMEs) through patient capital and technical assistance are needed, especially with the reduced appetite of the banking sector to loan to even the most established businesses for fear of further exposure.

Rapidly addressing fiscal and financial challenges will be paramount to embark on a path of recovery. This includes the settlement of the clearance revenue dispute, the implementation of comprehensive fiscal reforms, and the safeguarding of the banking sector's stability and independence. The urgent resolution of the ongoing clearance revenue dispute is critical, alongside addressing the volatility of revenues collected by Israel for the PA, which hampers predictability of fiscal policy implementation. Equally important will be—over time—the materialization of a comprehensive reform plans that tackle the large and unsustainable wage bill, the public pension system, health sector expenses, and net lending[42], in order to optimize public expenditure and expand the tax base to enhance public revenues, thus creating much-needed fiscal space, overall. Of note, since the last Economic Update, a new PA's Cabinet has taken office and outlined a reform plan. Policymakers in the West Bank and Gaza should also continue to safeguard the autonomy of the Palestine Monetary Authority as the banking system's supervisor and prudential regulator. Avoiding further instability in the financial sector is crucial to allow it to maintain its established function as a stable pillar during periods of economic challenges. Finally, finding a permanent and stable resolution to the correspondent banking relationships issues is a priority.

In sum, the priorities to avert an even more dramatic recession, a larger uptick in poverty, and a continued shock to the Palestinian economy remain the same as highlighted in our previous Economic Updates:

- First, the cessation of hostilities would pave the way for significant changes on the ground. Primarily, by arresting the severe human toll of the conflict and allowing economic and social recovery and reconstruction to start;
- Second, resume as soon as possible the transfer of Clearance Revenues, by reversing recent decisions on deductions to ensure the PA can meet critical budget expenditures such as salaries, pensions and social services;
- Third, and alongside the above, the international community needs to urgently provide funding to secure the provision of essential public

[42] Net lending occurs when Palestinian local authorities accrue arrears with Israeli service/utilities suppliers. In these cases, Israel deducts payments for unpaid electricity, water, and other services provided to Palestinian municipal entities, from the sums that Israel transfers monthly to the Palestinian Authority (known as "Clearance Revenues"). Net lending is calculated by subtracting the net acquisition of non-financial assets from the net operating balance. It represents a major component of the Palestinian central government budget.

services and to start planning for recovery and reconstruction;

- Fourth, facilitate trade and private sector activity in the West Bank and Gaza, to allow income generation.
- Finally, it is important that the new Palestinian government stays the course in implementing its reform plan, with focus on governance and fiscal sustainability.

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