PALESTINIAN TERRITORIES

Table 1	2017
Population, million	4.7
GDP, current US$ billion	14.9
GDP per capita, current US$	3182
Upper middle-income poverty rate ($5.5)[a]	20.7
Gini coefficient[a]	34.4
School enrollment, primary (% gross)[b]	94.3
Life expectancy at birth, years[b]	73.3

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2011), 2011 PPPs.
(b) Most recent WDI value (2015)

The impetus to growth from the initial recovery following the 2014 war has ended resulting in growth dropping to 2.4 percent in Palestine in Q32017. At 27 percent, unemployment continues to be stubbornly high and about 21 percent of the population lives below US$5.5 2011 PPP a day. Given the ongoing constraints to economic competitiveness, medium term growth is projected at 2.3 percent. Further reductions in transfers to Gaza, lower aid and the possibility of conflict pose downside risks to growth and employment.

Recent developments

Economic conditions in the Palestinian territories deteriorated with growth dropping to 2.4 percent in the first three quarters of 2017, down from 4.7 percent in 2016. The decline was mainly driven by a deterioration in Gaza where the economy is estimated to have grown by a mere 0.5 percent following a large drop in aid for reconstruction and a severe liquidity squeeze as almost a quarter of Gazans have seen their income significantly drop since mid-2017. Meanwhile, growth in the West Bank reached 3 percent in the first three quarters of 2017 - only slightly below its rate in the previous year, and was concentrated in activities less impacted by the Israeli restrictions including construction, wholesale and retail trade in addition to services.

Unemployment in the Palestinian territories continued to be high at 27 percent in 2017. In Gaza, it reached 44 percent compared to 18 percent in the West Bank. In 2017, only 41 percent of those aged between 15 and 29 were active in the labor market, reflecting high pessimism regarding employment prospects. Despite a low participation rate, unemployment amongst this category reached a staggering 60 percent in Gaza. There are also dramatic differences in labor force participation by gender. Male participation rates reached 71 percent in 2017 while women have recent participation rates of 19 percent.

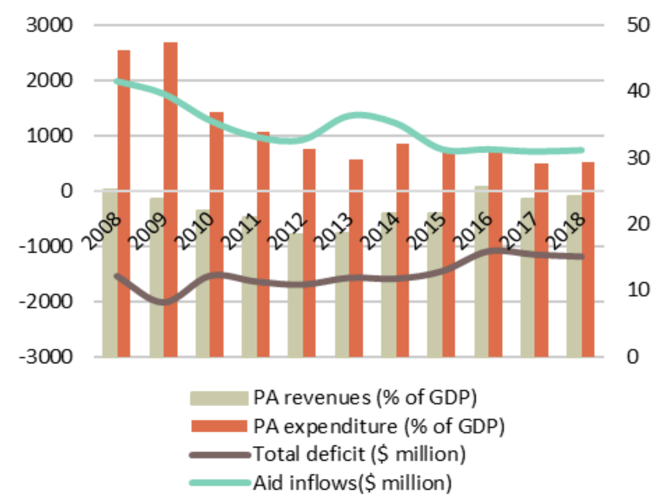
The latest poverty numbers for 2011 suggest that about 21 percent of the Palestinian population lives below the US$5.5 a day poverty line. Poverty is expected to have been volatile in the following years witnessing a strong increase after the war in 2014 before gradually declining to pre-crises levels and then increasing again in 2017 due to the recent decline in incomes in Gaza. Inflation continued to be subdued in 2017 with overall prices increasing by a mere 0.2 percent. The Israeli Shekel, which is the main currency in circulation in the Palestinian territories, continued its appreciation in 2017 and this had a deflationary effect on the prices of imported goods. In addition, the prices of food products (most of which are produced domestically or in Israel) remained low in 2017.

The Palestinian Authority's (PA) fiscal performance improved in 2017 but the fiscal stance remained tight due to lower than needed aid. The total deficit (before grants) amounted to US$1.14 billion in 2017 or 7.7 percent of GDP – down from 8 percent in the previous year. Aid received amounted to US$719 million and was 11 percent lower than in 2016, resulting in a financing gap of about US$420 million. To fill the gap, the PA resorted to domestic sources of financing. It increased its net domestic bank financing by US$85 million resulting in its total domestic debt reaching US$1.5 billion, as of December 2017.

The PA also resorted to arrears accumulation and despite repaying some dues from previous years, net accumulation in 2017 reached US$338 million.

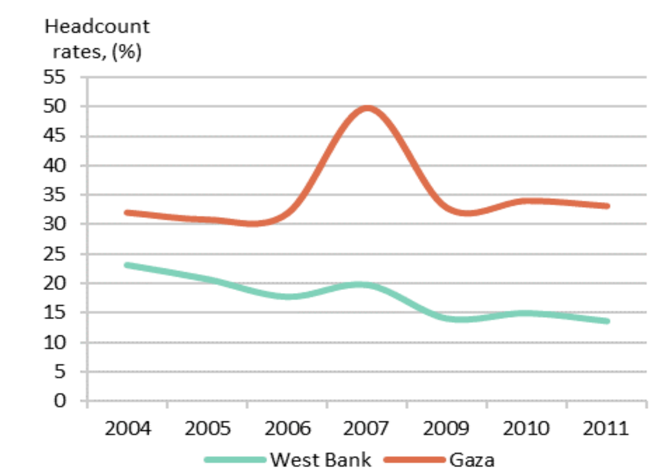
Despite a decline in the trade deficit, the external current account deficit (including

FIGURE 1 Palestinian territories / Estimates and outlook: public finances



Sources: Palestinian MoF and staff estimates.

FIGURE 2 Palestinian territories / 2011 PPP poverty line in the West Bank and Gaza



Source: Palestinian Bureau of Statistics.

official transfers) is estimated to have widened in 2017 to 12 percent of GDP due to a drop-in transfers. The trade deficit stood at 37 percent of GDP in 2017 – 2 percentage points lower than in 2016 following a drop-in imports from Israel. Exports continue to be constrained by the ongoing trade restrictions and have remained low and stagnant at around 18 percent of GDP. Current transfers as a share of GDP dropped from 17 percent in 2016 to 13 percent due to a decline in both private and official transfers.

Outlook

The economic outlook for the Palestinian territories is worrying. Under a baseline scenario that assumes persistence of the Israeli restrictions and the internal divide between the West Bank and Gaza, real GDP growth of the Palestinian economy is projected to decline to 2.3 percent in the medium term. This modest growth implies a decline in real per capita income and an increase in unemployment.

Given the low growth projections, poverty rates are not likely to decline. If the flow of aid revenues is lower than projected or another episode of conflict erupts, poverty will increase sharply in Gaza. New data from the 2016/2017 Expenditure and Consumption Survey will be available shortly and will clarify the picture.

The fiscal deficit (before grants) is expected to remain constant as a share of GDP in 2018, at 7.7 percent, and amount to US$1.18 billion. At the same time, foreign aid is expected to reach US$745 million, leaving a financing gap in excess of US$0.4 billion. If ongoing reconciliation talks between the PA and the *de facto* authority in Gaza progress and result in higher public spending in Gaza, the financing gap could hover around US$0.9 billion. PA actions alone will not be enough to fully close the gap, even prior to reconciliation. Unless donor aid is significantly stepped up, the PA will be forced to exhaust domestic sources of financing including debt from local banks and arrears to the private sector and the pension fund. This would eventually choke the economies of both the West Bank and Gaza and impose large negative consequences on suppliers, banks and ultimately growth and tax generation.

The Palestinian territories' current account is expected to remain unfavorable in the coming years due to the persistently large trade deficit. The share of Palestinian exports in the economy is expected to remain stagnant at 18-19 percent in the medium term due to the ongoing Israeli restrictions on trade. The Palestinian territories will continue to heavily depend on imports to meet even some of their basic needs, and hence the share of imports in the economy will hover around 56 percent. Consequently, the current account deficit is expected to remain high in the coming years at about 12-13 percent of GDP.

Risks and challenges

A sustainable economic recovery in the Palestinian territories is not possible given the stalemate in the peace process, ongoing restrictions imposed by Israel alongside internal political divisions. As a result, downside risks to growth and employment remain significant. In Gaza, if the United Nations Refugee and Works Agency's (UNRWA) funding gap is not offset, this will have a severe impact on its ability to provide education, health services and food parcels to more than one million Gazans and will result in cuts to the income of around 13 thousand UNRWA employees. Consequently, economic and social conditions in the Strip will further deteriorate, significantly raising the potential for unrest. There are also significant downside risks on the West Bank, including if donor support declines faster than expected.

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

	2015	2016	2017 e	2018 f	2019 f	2020 f
Real GDP growth, at constant market prices	3.4	4.7	2.7	2.5	2.3	2.3
Private Consumption	6.2	3.3	4.3	3.8	3.2	3.0
Government Consumption	5.8	1.8	3.5	3.5	3.0	2.8
Gross Fixed Capital Investment	9.0	-0.9	1.6	-1.1	-1.3	-1.1
Exports, Goods and Services	2.6	1.9	6.8	5.0	3.0	3.0
Imports, Goods and Services	9.5	0.2	6.5	4.5	3.0	2.6
Real GDP growth, at constant factor prices	1.5	4.3	2.7	2.5	2.3	2.2
Agriculture	-7.2	-8.1	0.0	0.7	1.0	1.2
Industry	-3.0	7.5	3.5	3.8	4.0	4.0
Services	3.5	4.0	2.6	2.1	1.7	1.7
Inflation (Consumer Price Index)	1.4	-1.0	0.2	1.2	2.5	2.5
Current Account Balance (% of GDP)	-16.3	-10.4	-12.4	-12.6	-12.5	-12.0
Financial and Capital Account (% of GDP)	19.4	8.7	10.3	10.7	10.7	9.4
Net Foreign Direct Investment (% of GDP)	0.2	1.2	1.1	1.1	1.1	1.2
Fiscal Balance (% of GDP)	-5.1	-4.0	-2.8	-2.8	-2.9	-2.9

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