




سلطة النقد الفلسطينية
PALESTINE MONETARY AUTHORITY



Annual Report 2014



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In the case of quotation, please refer to this publication as follows:
Palestine Monetary Authority (PMA). Annual Report 2014: September.
Ramallah – Palestine

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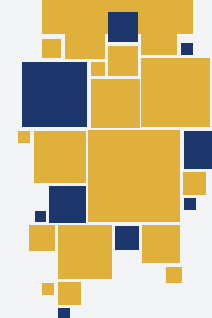
Our Vision

To be a full-fledged and a modern central bank for an independent and sovereign Palestinian state, capable of achieving monetary stability, keeping inflation under control, and maintaining financial stability. Thereby, contributing to further development of the Palestinian financial sector, promoting integration into regional and global economies and, ultimately, fostering high rates of sustainable economic growth in Palestine.

Our Mission

Ensuring monetary stability and keeping inflation under control, by issuing and managing national currency and implementing a sound monetary policy to create an environment conducive to achieve price stability; contributing to maintaining financial stability, through providing safe, sound and secure banking system and national payment system; and exercising the role of economic and financial advisor to the Palestinian government. To these ends, the PMA implements effective policies and employs its financial, human resources, and technical capabilities.

	Dr. Jihad Khalil Alwazir	Governor and Chairman
	Dr. Shehadah Hussein	Deputy Governor
	Mr. Ibrahim Barham	Member
	Dr. Ismail Elzabri	Member
	Dr. Bashir Rayyes	Member
	Dr. Taalib Sarie	Member
	Dr. Samir Abdullah	Member
	Mr. Farid Ghannam	Member



Foreword

On behalf of the PMA, I am honored to present the current issue of the Annual Report, which PMA publishes to fulfill its duty to: make data and well-documented information based on analysis and monitoring of economic performance available, and carry out its macroeconomic role to secure financial and monetary stability and contribute to the promotion of sustainable economic growth.

The Report is issued during a period marked by many regional and international developments that adversely affect economic performance of many countries worldwide. The global level, the year 2014 witnessed disparity in growth, where some developed countries have succeeded to move to recovery far from slowdown circle, others decline again. This situation increase the fears that economic recession back again.



At the same time, regional situation was not in his best conditions; unrest and conflict were continued, especially in Syria, Iraq, and Yamen, which led to continued weak economic performance of the region. At the local level, the Palestinian economy has recorded a decline for the first time since 2006, due to the Israeli aggression on Gaza Strip in summer 2014, which severely damaged the infrastructure and productive base. This suffering has deepened with the continuation of the blockade imposed by Israel on the Strip since 2006.

This Annual Report comprises four sections dealing with (i) developments and prospects of the global and local economies; (ii) the public finance sector; (iii) the external sector, including developments in foreign trade, balance of payments and the international investment position for Palestine; and (iv) the Palestinian financial sector, including PMA's most important achievements, and developments of all institutions under PMA's direct monitoring and supervision.

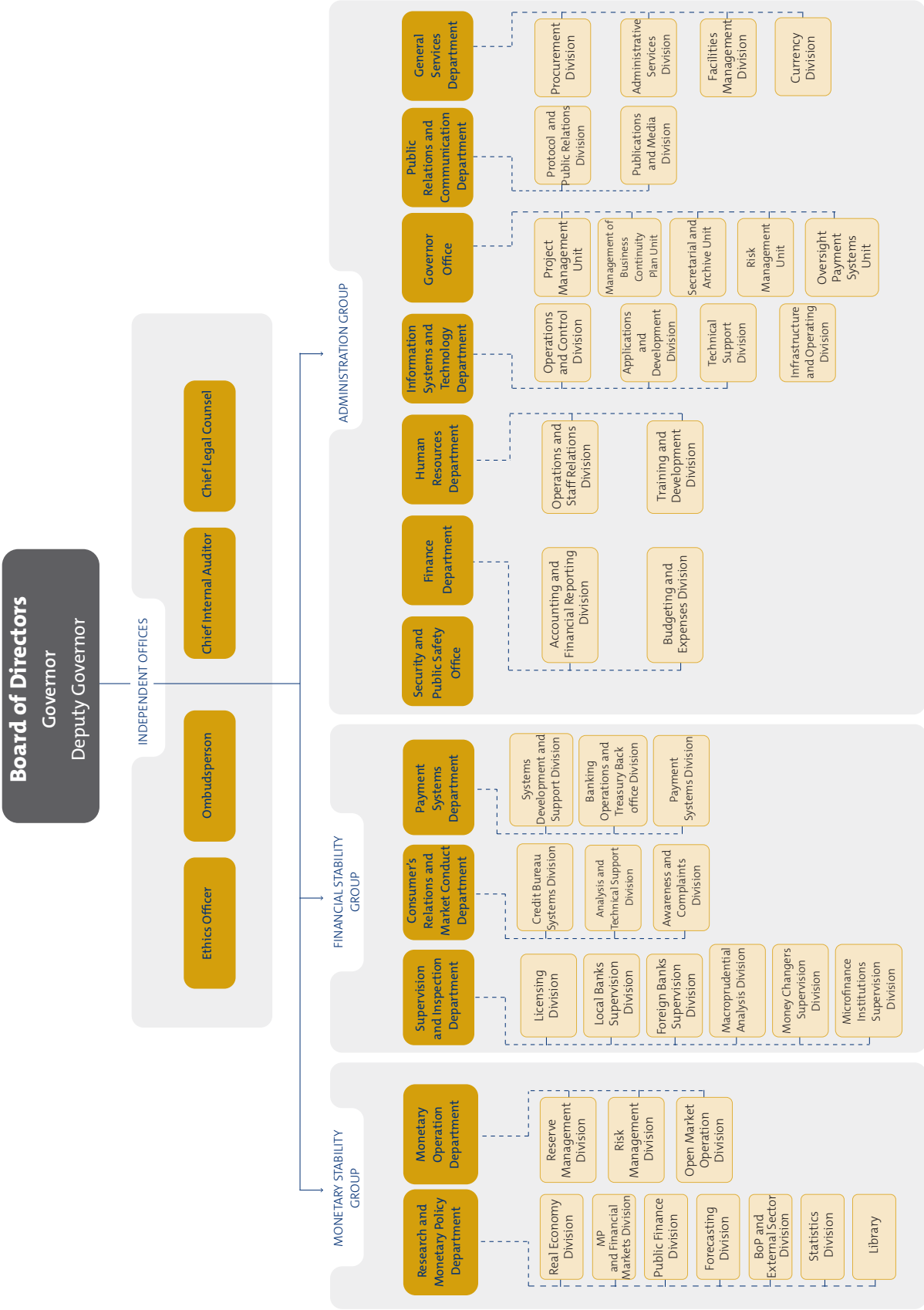
It is my hope that with this Report, the PMA has succeeded in addressing the most important developments in 2014 via an analytical framework that is based on accurate data and supported by numerous statistical time series tracking the most prominent global and local economic indicators.

Finally, I would like to extend my gratitude to the board members of the PMA and all its employees for their diligent efforts to realize the PMA's goals and its aspirations to become the central bank of a sovereign and independent Palestinian state. I would also like to express my gratitude to Arab, regional and international institutions for their continuous support to the PMA and the financial and banking system, thereby bolstering the Palestinian citizen's steadfastness and adherence to his/her land and fostering the sustainable development in Palestine.

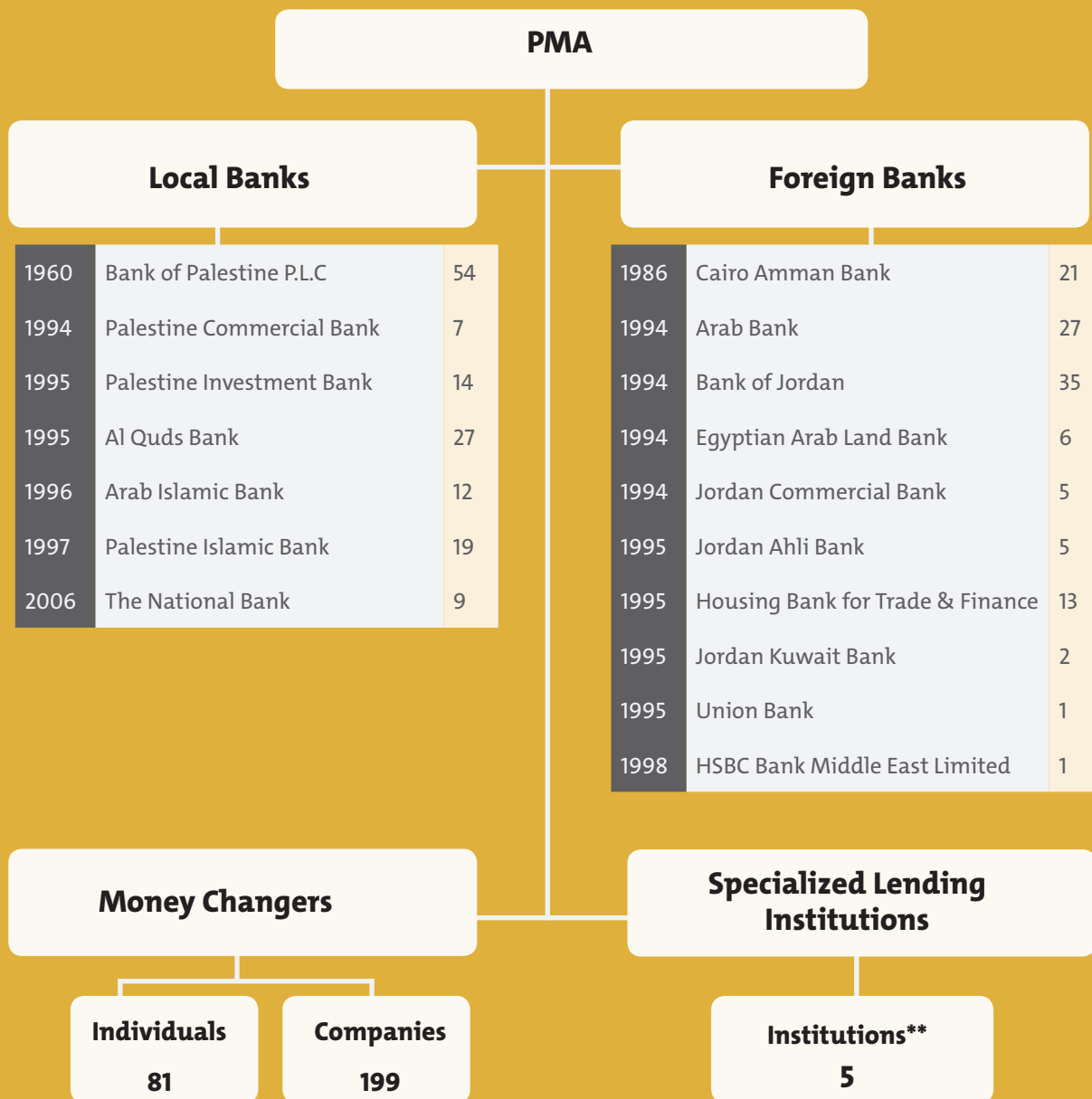

Governor

Dr. Jihad Khalil Alwazir

PMA organization chart



Palestinian banking system institutions 2014*



* Financial institutions under supervision of the PMA.

** Representing the institutions that authorized by the PMA. Later the date of this report, in January 2015 license has granted to additional institution, and work is underway to license another three institutions.

Year of establishment for local banks, or re-opening of the first branch for foreign banks.

Number of branches and representative offices.

Executive Summary

Despite signs of weak performance in major markets emerging in the year's early months, the global economy has managed to escape a new round of slowdown in 2014. A strong U.S. economy and positive signs of acceleration in a number of developed countries in the last quarter of the year have ensured a stable growth rate for the second consecutive year at 3.4 percent. Growth in developed countries as a group accelerated to 1.8 percent in 2014, compared to 1.4 percent in 2013. However, the robust, accelerating expansion in the U.S. has added to disparities in performance within the group, as subdued domestic demand in most developed countries inhibited growth more than previously expected. Meanwhile, Emerging and Developing Countries (EDCs) remained trapped in a cycle of slowdown despite unremitting efforts to restructure the economy, stimulate local demand and reduce dependency on exports in a number of emerging markets. As such, EDCs ended the year with a growth of 4.6 percent, compared to 5.0 percent in 2013.

Despite a relatively stable global economy, general and gradual declines in global prices accelerated in the second half of 2014 on the backdrop of sliding commodity prices, and specifically crude oil. Global inflation slowed to 3.4 percent, compared to 3.9 percent in 2013, mirroring a similar trend in EDCs, where inflation slowed to 5.9 percent, compared to 5.1 percent in 2013. Developing countries, however, maintained a stable rate of inflation for yet another year at 1.4 percent. In contrast, labor market trends seemed more homogenous this year with a general fall in unemployment rates in EDCs, the U.S. and Euro Area alike, despite muted growth in the latter.

It is noteworthy to mention that the promising performance in a number of economies at the end of 2014 has managed to mitigate economic risks on a global scale. Yet the continued fall in prices has spurred concerns about rising deflationary risks, especially in fragile markets. Expectations remain, nonetheless, that developed countries, and especially the Euro Area, will achieve higher rates of growth in 2015, while EDCs will continue to slow down due to sluggish demand and losses incurred to oil-producing countries.

Regionally, the Israeli economy grew to its lowest rate in five years, in the aftermath of Israel's latest aggression on Gaza Strip, as tourism suffered considerably and exports growth remained subdued. Israeli GDP grew by 2.7 percent in 2014, compared to 3.2 percent in 2013. In contrast, activity improved in Jordan in light of an on-going, IMF-sponsored structural adjustment program. This improvement, however, remains below program targets at 3.1 percent. Meanwhile, growth in Egypt settled at 2.2 percent for its second consecutive year.

Locally, latest data portrayed a grim picture for the Palestinian economy in 2014. The economy contracted, for the first time since 2006, by 0.4 percent in the aftermath of Israel's latest aggression on Gaza Strip. Activity in the Strip contracted by 15.2 percent, compared to a growth of 5.6 percent in 2013, after war destroyed most of the region's infrastructure and production facilities, all while the economic siege and boarder closure continued in 2014. In contrast, economic trends differed considerably in the West Bank, as growth accelerated from 1.0 percent to 5.1 percent between 2013 and 2014, mainly due to expanding consumption and fixed investments, and a narrowing deficit in the region's trade balance. These opposing trends have widened the gap in income levels between the two regions; real GDP per capita did not exceed USD 970.3 in Gaza Strip, shrinking by 18.0 percent in 2014, while it grew by 2.3 percent in the West Bank to reach over USD 2,265.4 in 2014, more than double that in Gaza. As a result, real per capita GDP in Palestine contracted by 3.3 percent to USD 1,734.6 during the period of comparison.

During the same period, price levels in Palestine remained relatively stable, growing at 1.7 percent for the second year in a row, despite notable falls in food and oil prices globally. Compensating for that fall was the significant price hikes witnessed in Gaza Strip during the year, especially in the last two quarters of the year. Inflation in Gaza moved from a deflationary trend, contracting by 0.8 percent in 2013, to 2.9 percent inflation in 2014 at the backdrop of a prolonged siege, border closure, destruction of tunnels, and disruption to the flow of goods during the war. Considerable shortages

in commodity supply caused significant jumps in prices in the second half of the year. Price trends in the West Bank, however, managed to offset these jumps, as inflation eased in the region from 3.1 percent in 2013 to 1.2 percent in 2014.

The high and rising levels of unemployment, on the other hand, continued to be one of the main challenges to the economy. In 2014, it rose to reach 26.9 percent, compared to 23.4 percent in 2013. A main contributor was an exceptionally expanding rate in Gaza Strip, where unemployment reached 43.9 percent, compared to 32.6 percent in 2013, while the same rate declined in the West Bank from 18.6 percent to 17.7 percent during the same period. This rise in unemployment did not stop nominal daily wages from rising across different regions. Yet contradictory inflation trends have created discrepancies in real wage growth, as while real average daily wage for workers in the West Bank and Israel and the Settlements improved by 0.9 percent and 5.6 percent, respectively, real wages in Gaza declined by 1.5 percent during 2014.

Public finance data for 2014 indicated a notable rise in government revenues, particularly clearance and non-tax revenue, as opposed to a slight rise in government expenditures, which resulted in a sizeable decline in current deficit. On the other hand, and despite a relative fall in foreign aid and grants, the overall balance (after aid and grants) improved, achieving a surplus of over USD 414.7 million. Contrarily, government arrears grew by over 64.1 percent between 2013 and 2014, as both wage and non-wage arrears expanded during the year. However, public debt (in USD) fell by 6.7 percent to USD 2,216.8 million, or 17.3 percent of GDP, as opposed to 19.9 percent of GDP in 2013.

As for the external sector, current account deficit narrowed by over 41.8 percent, reaching USD 1,386.5, or 10.9 percent of GDP, compared to 11.0 percent of GDP in 2013. Several factors contributed to this fall, most notably, a doubling of current transfers to reach USD 2,715.4 million, compared to USD 1,188.5 million in 2013, in addition to a 19.0 percent rise in net income from abroad to around USD 1,381.3 million. Current account conditions improved despite an expanding trade balance deficit, which amounted to USD 5,483.2 million in 2014, or 43.0 percent of GDP, as opposed to 37.9 percent in 2013. Meanwhile, the financial and capital account surplus declined by 35.0 percent to USD 1,393.6 million, or about 10.9 percent of GDP, compared to 17.2 percent in 2014, mainly as a result of a fall in both foreign grants for development projects, and net inflow of other investments (currency and deposits).

On a different note, the PMA continued its relentless efforts to preserve financial stability during the difficult times the economy faced in 2014. The PMA responded to rising risks by issuing several instructions that aimed to ensure a smooth continuity of bank operations in line with stability requirements. It also worked to further foster the financial infrastructure and public confidence in the banking system through a number of projects including: launching the Electronic National Switch, building the public key infrastructure, the continuous work on the International Bank Account Number (IBAN), developing the Electronic Clearance system, developing the Credit Bureau, and numerous other projects. These efforts reflected positively on the financial indicators of the Palestinian banking system in 2014, as assets rose in value and quality, customer deposits grew, direct credit facilities expanded, non-performing loans decreased, and ability to withstand expected and unexpected risks improved.

Data on banks operating in Palestine indicate a rise of 5.6 percent in total assets in 2014, to reach USD 11,815.6 million, as direct credit facilities grew by 9.3 percent to USD 4,895.1 million. This expansion in credit highlights the active role the banking system plays in intermediating funds between surplus and deficit units within the economy in a manner that contributes to economic growth. Customer deposits, on the other hand, reached USD 9,662.7 million, growing by 5.0 percent compared to 2013. Equity rights also rose by 7.7 percent to USD 1,464.0 million.

Meanwhile, the PMA has maintained its institutional building efforts and continued to foster its own capital to withstand surrounding risks. PMA equity rights grew by 7.0 percent in 2014 to reach USD 100.7 million, as a result of a 10.6 percent rise in paid-up capital, mainly due to transferred profits from PMA operations.

Main economic indicators of the Palestinian economy, 2010-2014

Indicator	2010	2011	2012	2013	2014
Output and Prices	(Annual percent change)				
Real GDP (2004 market prices)	8.1	12.4	6.3	2.2	-0.4
Real Percapita GDP	5.0	9.1	3.1	-0.8	-3.3
Inflation rate, Palestine	3.8	2.9	2.8	1.7	1.7
WB	4.2	3.5	4.1	3.1	1.2
GS	1.7	0.6	0.5	-0.8	2.9
Unemployment Rate	(Percent of labor force)				
Palestine	23.7	20.9	23.0	23.4	26.9
WB	17.2	17.3	19.0	18.6	17.7
GS	37.8	28.7	31.0	32.6	43.9
Broad definition, Palestine	30.0	25.8	26.7	27.0	29.7
WB	23.4	22.3	23.0	22.4	20.8
GS	43.7	33.1	34.1	35.7	46.2
Consumption, Investment and Saving	(Percent of real GDP)				
Final consumption	119.6	116.9	120.6	113.9	120.9
Public	29.3	28.0	27.2	26.2	27.4
Private	90.3	88.9	93.4	87.7	93.5
Gross investment	22.1	19.3	21.6	22.0	18.3
Public	8.2	9.2	8.7	8.4	7.5
Private	13.9	10.1	12.9	13.6	10.8
Domestic saving	-19.6	-16.9	-20.6	-13.9	-20.9
Public Finance	(Percent of nominal GDP)				
Total net revenue and foreign aid	35.7	30.1	28.1	29.5	31.5
Domestic revenue	21.3	20.8	19.9	18.6	21.9
Tax	5.3	4.6	4.3	4.8	4.7
Non-tax	3.0	2.1	2.0	0.2	2.2
Clearance revenue	13.9	14.2	14.0	13.6	16.1
Tax refund (-)	1.0	0.1	0.4	1.8	1.1
Foreign aid	14.3	9.3	8.3	10.9	9.6
Total expenditures	34.8	31.1	28.9	27.4	28.3
Current expenditures and net lending	33.5	28.3	27.0	26.1	27.0
Wage expenditure	17.5	16.0	13.8	14.5	14.9
Non-wage expenditure	13.0	10.9	10.7	9.8	9.9
Net lending	3.0	1.4	2.5	1.8	2.2
Development expenditures	1.3	2.8	1.9	1.3	1.3

Indicator	2010	2011	2012	2013	2014
Current balance	-12.2	-7.5	-7.1	-7.5	-5.1
Overall balance (Excl. foreign aid)	-13.5	-10.3	-9.0	-8.8	-6.4
Overall Balance (Inc. foreign aid)	3.0	-1.0	-0.8	2.1	3.2
Government public debt	21.1	21.1	22.0	19.0	17.3
External Sector	(Percent of nominal GDP)				
Exports of Goods and Services	15.3	17.2	16.6	16.6	18.0
Imports of Goods and Services	59.1	54.7	55.9	54.5	61.0
Income From Abroad, net	6.7	7.2	7.6	9.3	10.8
Of which: compensation of employees	6.5	7.0	7.3	9.1	10.2
Current transfers, net	22.3	10.6	15.5	9.5	21.3
Of which: to public sector	13.2	6.8	5.7	5.9	8.7
Current Account	-14.7	-19.8	-16.1	-19.1	-10.9
Monetary Sector	(Annual percent change)				
PMA Assets	-9.9	-11.2	7.8	6.7	-0.5
Banks Assets	8.7	6.1	7.7	11.3	5.6
Direct Credit Facilities	29.2	23.0	18.3	6.7	9.3
Of which: to the private sector	28.3	19.6	14.0	11.3	17.7
Customer Deposits	8.0	2.5	7.3	11.0	7.6
Of which: from the private sector	6.8	4.4	7.5	11.1	6.9
Balances Abroad	-7.2	-5.9	-6.6	16.4	5.9
Ownership Equity	13.9	8.4	6.2	8.1	7.7
Of which: paid-up capital	10.9	8.0	2.3	3.7	5.2
Memorandum Items					
Real GDP (USD Million, 2004 = 100)	6,122.3	6,882.3	7,314.8	7,477.0	7,449.0
Nominal GDP (USD Million)	8,913.1	10,465.4	11,279.4	12,476.0	12,765.8
Al-Quds Stock Market Index (point)	490.0	476.9	477.6	541.5	511.8
Exchange rate (USD/NIS)	3.73	3.58	3.85	3.61	3.58

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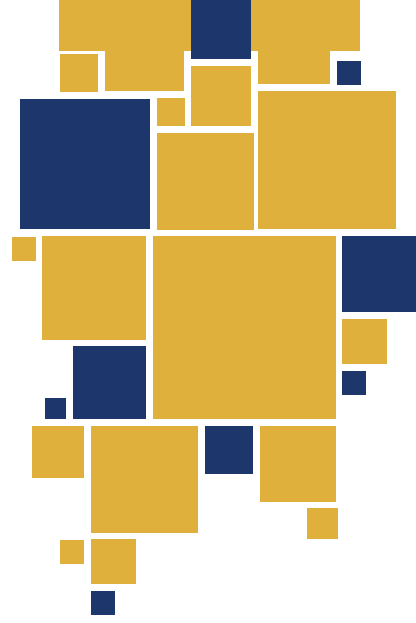
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Chapter One

Global and Local Economic Developments



Part I: Global Economy

Overview

During 2014, the world economy managed to avert a slip back into recession by virtue of the strong performance of the United States' economy, particularly during the second half of the year. With respect to the group of advanced countries headed by the USA, and despite its seemingly stronger capacity to move forward on the road to economic recovery, the strong and accelerating growth of the US economy has deepened inter-country disparity within member economies, especially given the weaker-than-expected performance of most, in view of the weak domestic demand. In contrast, and influenced by the persistently weak foreign demand, the performance of emerging and developing countries remained unchanged having failed to escape the slowdown spiral, despite attempts of economic restructuring through reducing dependence on exports and boosting domestic demand.

As for global economic prospects, recovery is expected to accelerate in most advanced economies, backed by the oil price plunge and US dollar, euro and yen exchange rate fluctuations. However, on the other hand, it is expected that the present state of emerging and developing economies EDCs will worsen in view of the predictions for the Chinese economy to drop to its lowest levels in two decades.

Economic Performance

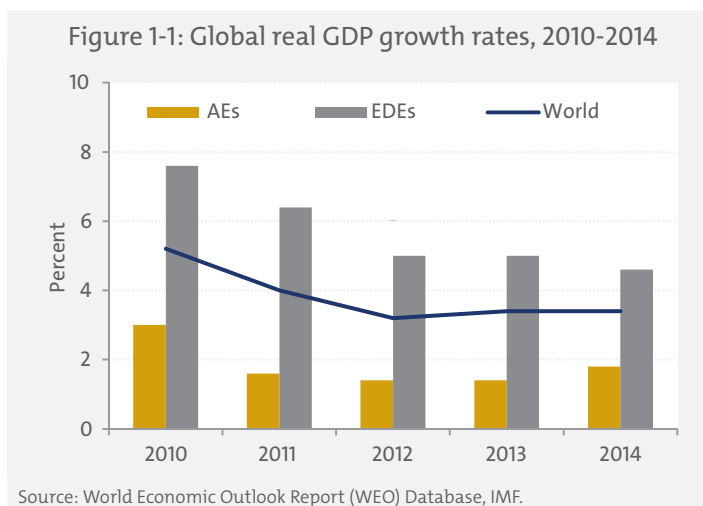
The global economy witnessed two disparate growth trajectories during 2014. In the first half of the year, the performance of most key members of emerging and developing economies (EDEs) and advanced economies (AEs) declined as a result of weak domestic demand. However, owing to a number of developments, most prominent of which were the fall in oil prices and exchange rate fluctuations, the second half of the year saw the global economy recording marked acceleration, thereby averting a slip back into a slowdown course. On one hand, the decline in oil prices since September boosted domestic demand and production. On the other hand, falling oil prices reversed the long-held relation and distribution of benefit between oil exporters and oil importers, as the drop was accompanied by real income shifts from oil-exporting (now losing income) to oil importing countries (now enjoying higher purchasing power). As for exchange rate shifts, they were abnormally large, particularly with respect to the euro and the yen, which signaled clear differences in the monetary policies of these countries. While the US Federal Reserve was expected to raise interest rates, this was not expected in the euro area or Japan which maintained low price stability to avoid a new relapse. Furthermore, the employment of disparate economic policy tools intensified the economic performance gap between the two groups as well as the cross-country differences within the same group.



Growth

At the start of 2014, global growth news drew a grim picture, with most economies suffering from weak growth and the year's first half concluding with a meager economic performance for advanced and emerging countries alike. However, in the second half of the year, the global economy managed to realize growth acceleration; helped by the recovery of the US economy at a higher-than-predicted rate and accompanied by a comparatively modest upturn in the economy of the euro area. Subsequently, the global growth rate stabilized at around the same level of 3.4 percent realized in the previous year.

As a group, AEs saw their combined growth rate accelerate from 1.4 percent in 2013 to 1.8 percent in 2014. Yet, inter-country differences in economic growth levels were still clearly visible. While the US economic growth accelerated as a result of stronger domestic demand from 2.2 percent in the previous year to 2.4 percent, and the Euro Area made its way out of recession, growing by around 0.9 percent after the previous year's contraction by 0.5 percent, reaping the benefits of the oil price drop and the depreciation of the euro. Japan, on the other hand, slipped into the recession spiral, on account of poor domestic demand following the consumption tax hike in April. As a result, the Japanese economy shrank by around 0.1 percent in 2014, down from 1.6 percent growth in 2013.



On the EDEs' side, slowdown prevailed, particularly for China which failed to achieve any acceleration in its growth. Driven by the declining investment levels, the Chinese economy experienced slowdown to 7.4 percent from 7.8 percent in the previous year. Likewise, the Brazilian economy decelerated considerably from 2.7 percent down to 0.1 percent, whereas the Mexican economy succeeded in raising the growth rate from 1.4 percent in 2013 to 2.1 percent in 2014, as a result of the structural reforms undertaken by the government, particularly in the energy and communication sectors. However, the overall result for the EDEs showed a slowdown to around 4.6 percent from 5.0 percent in the prior year.

Across the Middle East, growth rates remained tepid, standing at 2.4 percent compared with 2.3 percent in 2013. This was so as growth was influenced on one hand by the oil price drop and, on the other hand, by the escalating conflicts and the enduring political uncertainty.

Regionally, the growth in the Israeli economy witnessed its largest slowdown in five years. Growth failed to surpass 2.7 percent during 2014, compared to 3.2 percent in 2013, and having been largely affected by the repercussions of the recent Israeli war against Gaza Strip (GS) and the associated drop in tourism revenue, in addition to a persistently sluggish growth in exports. In contrast, Jordan achieved a healthy growth rate of 3.1 percent, having embarked on an economic reform program with the support of the IMF, although achieving lower rates than previously prescribed by the Fund. As for Egypt, the growth rate stagnated more or less around the level of 2.2 percent.



Economic policy

During 2014, most countries made increased use of the different economic policy instruments (fiscal and monetary) for the purpose of achieving the goals of stimulating the economy and maintaining low and stable levels of inflation and unemployment. There appeared a clear focus by most countries on goals targeting inflation, in view of the growing price deflationary pressures, in particular as the year drew to a close. On the other hand, other countries like Russia, for example, suffered sharp escalation of inflation rates.

Deflationary pressures exacerbated during the year owing to a persistently weak demand, both domestically and externally. In addition, the sharp drop in oil and food prices at the end of the year compelled affected countries to adopt expansionary policies, which included interest rate cuts and/or expansion of asset purchase programs. During the year, the European Central Bank (ECB) opted twice for the reduction of the official interest rate and followed up with the launch of its asset purchase program at the end of that year. Conversely, Japan maintained a constant interest rate, but resorted to expanding its quantitative easing program to treat its inflation problem. It is worth noting that the Japanese government had declared a two-stage consumption tax increase. The first stage, which was carried out in April, adversely affected the levels of domestic demand and failed to raise inflation to the desired level, thus compelling the government to delay the implementation of the second stage. On the opposite side of the globe, the US economy displayed a greater ability to maintain sustained growth, prompting the US Federal Reserve to terminate the final package of its quantitative easing program and maintain the same level of interest rate.

As for the EDEs, the Chinese economy, representing the largest economy in the group, opted to lower the interest rate, for the first time since 2012, as a result of the lingering weakness of growth and rising deflationary pressures. In the same context, it is worth noting that, over the year, China had adopted an expansionary fiscal policy and pursued economic restructuring through reducing reliance on exports, increasing investment spending in construction, real-estate and capital-intensive industries, boosting domestic consumption, in addition to greater liberalization of the financial sector and easing of credit conditions.

Conversely, some countries witnessed an escalation of inflationary pressures, given the political and economic crises they experienced, most notably Russia, which suffered from the international sanctions which were imposed upon it. This led to the elevation of inflation rates to record-high levels, which the central bank sought to remedy by cutting the interest rate 6 times in a row during the year.

Economic risks

Economic risks vary from one country to the other, in accordance with each country's specific circumstances, economic structure and stage of economic development. Yet, in general, the level of economic risks confronting the world economy had receded compared to the past year, especially in relation to the economic recession in the Euro Area, as observed by the IMF.

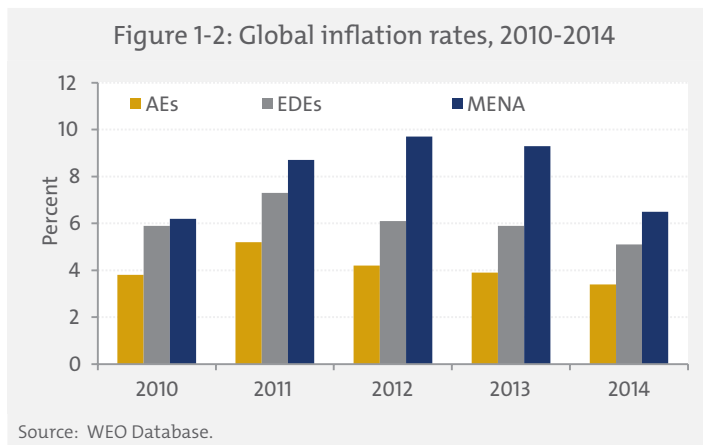
New risks have, however, emerged during the year due to the drop in global prices and the substantial shifts in exchange rates. Falling oil prices in particular were extremely beneficial to importing countries, while on the other hand, it put the official reserves and fiscal stance of exporting countries at greater risks. In addition to continuously changing trends in exchange rates (especially for the US dollar), this may further exacerbate financial risks and for the EDEs, in particular.



With respect to political risks, political tensions in Ukraine and the Middle East remained unresolved. Despite their limited impact on the global economy so far, the risks resulting from the persistence or the exacerbation of these tensions still lingered. This was so due to the global significance of these regions: in the case of the Middle East, as one of the most important oil exporters and in the case of Ukraine, as one of the most important grain exporter.

Prices and inflation

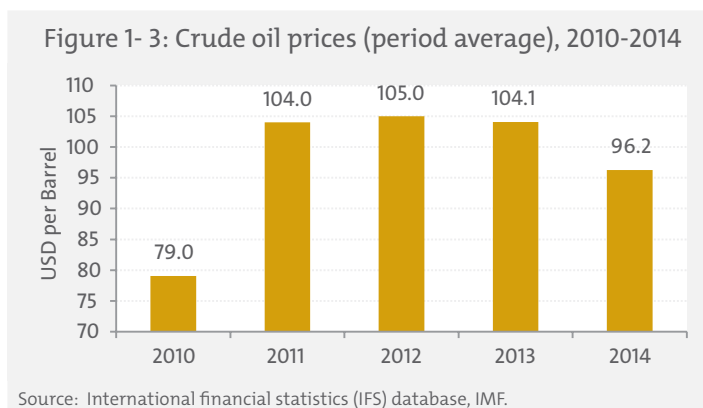
On one hand, price movements reflect changes in the prices of commodities and, on the other hand, changes in the levels of growth and demand, the economic structure and policies implemented by the different country groups. Despite the stable growth of the global economy at 3.4 percent realized in the prior year, global prices plunged sharply in particular during the last quarter of the year. This was especially driven by the drop in the prices of food and oil, in addition to a general weakness in demand which led to a decline in global inflation rates to 3.4 percent in 2014 compared to 3.9 percent in the previous year.



Apparently, the EDEs experienced an even greater drop from 5.9 percent to 5.1 percent for the same period, as a result of China's economic downturn, in addition to the significant decline in the MENA region by about 3 percentage points and a sharp slump in Iran, which was battling one of the highest inflation rates in the world as a result of international sanctions^[1]. On the other side, inflation rates in the AEs remained unchanged around the level of 1.4 percent for the same period, despite the notable rise in inflation in Japan from 0.4 percent to 2.7 percent as a consequence of the Japanese government consumption tax raise. Moreover, the USA registered slight price increases from 1.5 percent in 2013 to 1.6 percent in 2014 owing to the continued expansion of economic activity. Conversely, in the Euro Area, inflation receded by around one percentage point from 1.3 percent to 0.4 percent for the same period.

Oil prices

The second half of 2014 saw a persistent decline in oil prices, reaching their lowest levels by end of the year as a result of diminishing demand levels, on one hand, and ample supply levels, particularly by the USA, on the other. Consequently, the price of crude oil^[2] dropped by 7.5 percent (per barrel) compared to the previous year and average around 96.2 USD during 2014.



[1] Inflation rate in Iran is regarded as one of the highest in the MENA region and worldwide reaching around 34.7 percent in 2013 and receding to 15.5 percent in 2014.

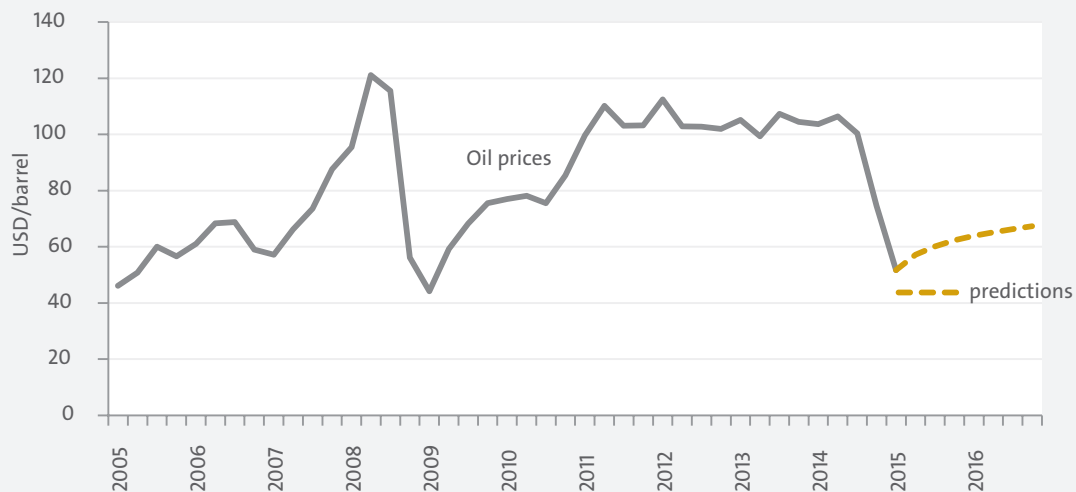
[2] This represents UK Brent, West Texas and Dubai Fateh oil prices per barrel.



Box 1: Oil prices: where to ?

Oil prices suffered a sharp plunge since June 2014, when they stood at around USD 108 per barrel, after which they slipped into a sharp downward spiral approaching USD 47 per barrel during January 2015; a decline by 56 percent and the lowest price level registered ever since the end of 2008 (when it reached USD 41 per barrel).

Many attempts were made to elaborate the causes underlying the oil price shock. Some attributed the crash to economic factors like, for example, the sluggish economic growth in Europe, the slowdown of the Chinese economy and the surging US shale-oil production (which costs USD 75-80 per barrel), in addition to supply/demand imbalances within the oil market. Others gave preponderate weight to political factors, believing that the USA is playing the oil-price card to exert political pressure on countries like Russia, Iran and Venezuela, dependent largely on oil and gas revenues.



Despite attempts by some aggrieved OPEC and non-OPEC producers to push Saudi Arabia and other Gulf countries to cut their production in order to restore balance to oil prices, the Kingdom –producing about 10 percent of global output- had maintained its high output levels estimated at around 10 million barrel/day, in an attempt to recover its global market share which it lost out to other producers in the past few years. Apparently, Saudi Arabia was determined in its pursuit, especially following the decline of US shale oil production. In spite of the fact that the decline in price/barrel caused fiscal deficits, many other factors help Saudi Arabia fulfill its goal, including: high financial surplus and reserves accumulated from oil revenues of past years and low oil-production costs estimated at around USD 20 per barrel.

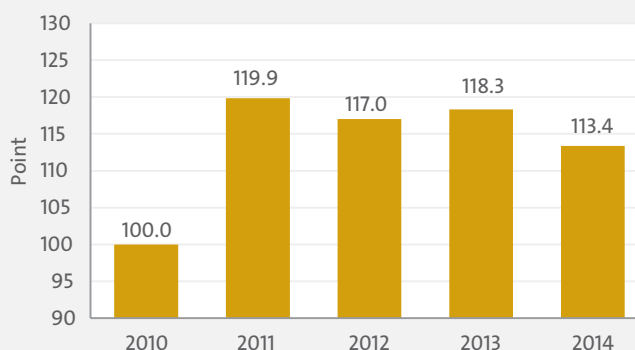
With respect to the outlook for oil prices, according to IMF price forecasts, the price of the barrel is likely to average around USD 50 to USD 70 in 2015 and 2016. These predictions have been supported by the announcement of Saudi Arabia, on numerous occasions, that it is not cutting its production nor does it expect oil prices to return to previous levels of over USD 100 per barrel. Yet, Saudi Arabia has declared its readiness to contribute to the restoration of global oil-market stability and bridge the gap to return prices toward levels that do not harm consumers and also encourage producers continue production to satisfy global demand. However, the kingdom requires that the supply/demand rebalancing does not come at the sole expense of Saudi Arabia or other OPEC members without participation from non-OPEC countries.



Food prices

Global food prices are determined by a set of factors including weather conditions, demand levels and production, transport and storing costs. During 2014, food prices followed a path of change similar to that of oil prices. It witnessed a continuous decline in the second half of the year owing to a drop in production and transport costs, which came as a result of reductions in the price of oil and other raw materials. Additionally, the supply of various crops increased due to favourable weather conditions which have underpinned production levels. Overall, the global food price index has recorded a drop by 4.2 percent to around 113.4 points, as compared to the previous year.

Figure 1-4: Global food price index, 2010-2014

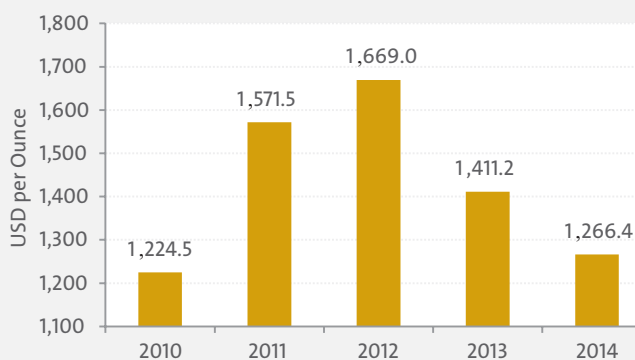


Source: International financial statistics (IFS) database, IMF.

Gold prices

Gold price experienced some fluctuation over 2014. Overall, it showed a downward trend reaching an average price of USD 1,266.4, dropping by about 10.3 percent compared to the previous year. The drop came as a result of weak demand for gold by both Asian central banks seeking to expand reserves and investors fleeing global financial markets to the safe investment haven of gold, following the correction wave of gold prices that began in mid-2012. It is worth mentioning that the rise in USD exchange rate during 2014 did aggravate the decline of gold prices for the same period.

Figure 1-5: Global gold prices, 2010-2014



Source: www.kitco.com, London fix

Labor markets

The relative recovery of the global economy had a positive impact on labor market indicators over the year. In consequence, both the AEs and EDEs managed to further create jobs leading to a drop in unemployment rates. In AEs, unemployment dropped from 7.9 percent to 7.2 percent in 2014, as a result of a drop in most member countries, particularly the USA, where unemployment fell considerably from 7.4 percent to 6.2 percent. The drop also affected most Euro Area economies, and heavily-indebted ones in particular. The unemployment rate in Greece and Spain fell to 26.5 percent and 24.5 percent compared to 27.5 percent and 26.1 percent in the previous year respectively, while climbing to previously unseen levels in Italy to reach 12.8 percent.



Likewise, declining unemployment rates was an obvious feature of the EDEs. Data show that, on hosting the FIFA World Cup, unemployment in Brazil fell from 5.4 percent in 2013 to 4.8 percent in 2014. In Mexico, however, this rate dropped only marginally to stabilize at around 4.7 percent. As for China, data show the unemployment rate remained close to past-year's level of 4.1 percent.

Regionally, unemployment rates in Egypt continued to record a high 13.4 percent during 2014, in light of unabating political and economic instability, while Jordan and Israel saw their unemployment rates decline to 11.6 percent and 6.0 percent compared to the previous-year 12.6 percent and 6.3 percent respectively.

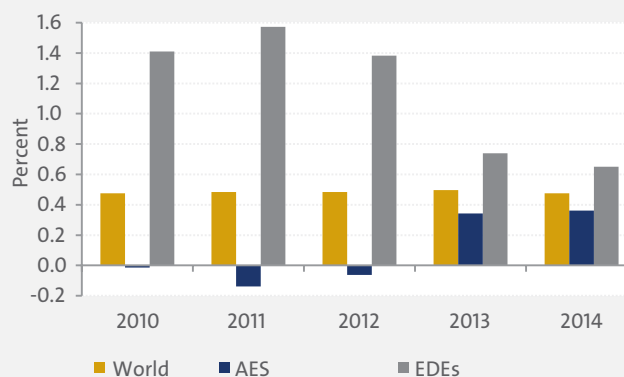
Balance of payments (BoP)

For the second consecutive year, the current account of the balance of payments (BoP) of AEs continued to show improvement as a result of the most member economies realizing current account surpluses. In spite of recording a current account deficit, the USA maintained almost the same current account deficit as percent of GDP. Furthermore, the economies of the Euro Area managed to improve the status of current accounts, in particular Italy and Greece; both previously enduring large deficits.

On the other side, EDEs continued to show a sharp decline in current account surpluses because of poor external demand and low exports. Brazil and Mexico continued to record a cumulative current account deficit, whereas China's current account surplus remained well below previous levels.

Regionally, Egypt managed to reduce its current account deficit by about 63 percent compared to 2013, owing to the enormous financial aid it received from Gulf countries. In Jordan and Israel, export growth helped reduce current account deficit of the former by around 27 percent and achieve a significant increase in surplus for the latter.

Figure 1-6: Current account balances as a percent of GDP, 2010-2014



Source: WEO Database.

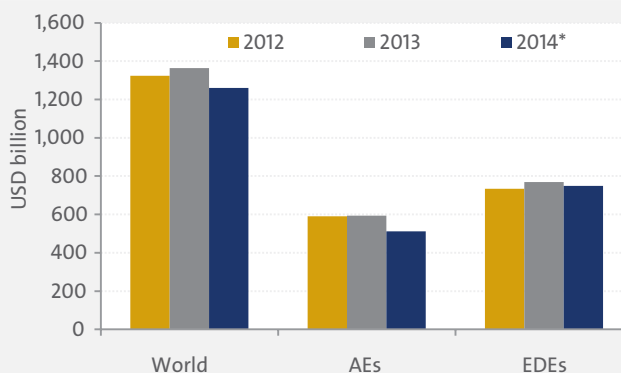
Foreign direct investment (FDI)

FDI inflows declined in 2014 compared to the previous year as a result of political and economic instability. On one hand, the monetary and fiscal policies of many of the large economies were divergent and inconsistent and, on the other hand, political unrest flared in many regions of the world, particularly in the MENA region. In that context, preliminary data point to a decline in FDI flows worldwide by 7.6 percent during 2014 compared to the previous year to reach USD 1.26 trillion.



The decline affected both the AEs and the EDEs, albeit being more pronounced in the former group, recording a drop of around 14 percent, due in particular to the slump in US investment flows. As for EDEs, inflows dropped by around 2.6 percent. Yet the group's larger economies remained attractive to investors, as data showed that China was still the top FDI destination in 2014, totaling USD 128 billion in investment, followed by Hong Kong with an FDI total of USD 111 billion, while Singapore and Brazil ranked fourth and fifth. Overall, out of the 10 most FDI-attractive economies worldwide, 4 were members of the EDEs group, constituting around 54 percent of total FDI volume for all 10 countries.

Figure 1-7: Foreign direct investment (FDI), 2012-2014



* Preliminary Data.

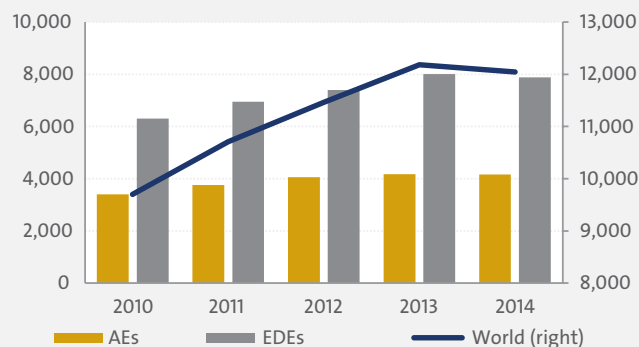
Source: UNCTAD, World Investment Report (WIR) and database.

International official reserves

Changes in international official reserves correlate closely with capital flows and trade balances. Improvement in exports and capital flow is usually associated with a rise in official reserves of foreign currencies. During 2014, the decelerated pace of trade growth cast its shadow on the build-up of such reserves, which fell by 1.1 percent compared to the previous year to reach about USD 12 trillion. The downturn came as a result of the drop in reserves of EDEs, which constituted about two thirds of global reserves, alongside a less pronounced drop in reserves of the AEs.

Data reveal a reduction in reserves of the EDEs by around 1.6 percent during 2014, specifically as a result of the decline or the decelerated accumulation of these reserves in oil-exporting countries given the sharp plunge in oil prices. This was more obvious in the MENA region, which continued to be affected by ongoing political unrest leading to a 2.1 percent drop in reserves. On the other hand, the decline in the reserves in AEs was less pronounced at lower than 0.2 percent during 2014.

Figure 1-8: International official reserves (USD billion), 2010-2014



Source: WEO Database.

With respect to neighboring economies, the Central Bank of Egypt's reserves fell again by around 11.8 percent as exports and tourism revenues shrank, while Jordan and Israel expanded their official reserves by around 17.3 percent and 5.3 percent, respectively.



Global financial developments

Interest rates

As part of efforts to maintain price stability and stimulate economic growth during 2014, some central banks opted for drastic interest rate moves. Most noteworthy in that respect was the ECB's lowering of its official interest rate in June to 0.15 percent in an attempt to control inflation rates, which were clearly deviating from the targeted 2.0 percent level. As inflation rates continued to fall, the ECB resorted to its second interest rate cut in less than three months to reach 0.05 percent. Yet, that proved again insufficient to stop the decrease in inflation rates, leading to severe criticism of ECB's interest rate policy. In the same context, and in an attempt to spur growth and manage deflationary risks, the People's Bank of China announced last November an interest rate cut for the first time since 2012, by 40 basis points, to reach 5.6 percent.

In contrast, other major central banks maintained low interest rates without any significant changes. The Federal Reserve maintained its rate at the same level of 0.25 percent since 2008. Likewise, Bank of Japan maintained its official interest rate at 0.1 percent, unchanged since 2010, while the rate on the sterling pound stood at 0.5 percent, unchanged since 2008.

Regionally, Bank of Israel opted for three consecutive interest rate cuts over the year, each by 25 basis points, resulting in a drop from 1.0 percent in 2013 to 0.25 percent in 2014. The recurring cuts allowed inflation to edge up towards the targeted levels. Additionally they aimed at encouraging export and increasing Israeli product competitiveness, which was adversely affected by the appreciation of the shekel against the dollar at the beginning of the past year. Conversely, in an attempt to curb high inflation rates and inflation expectations, the Central Bank of Egypt raised its official rate by 100 basis points to 9.75 percent last June, while the Central Bank of Jordan kept its rate unchanged at 4.25 percent.

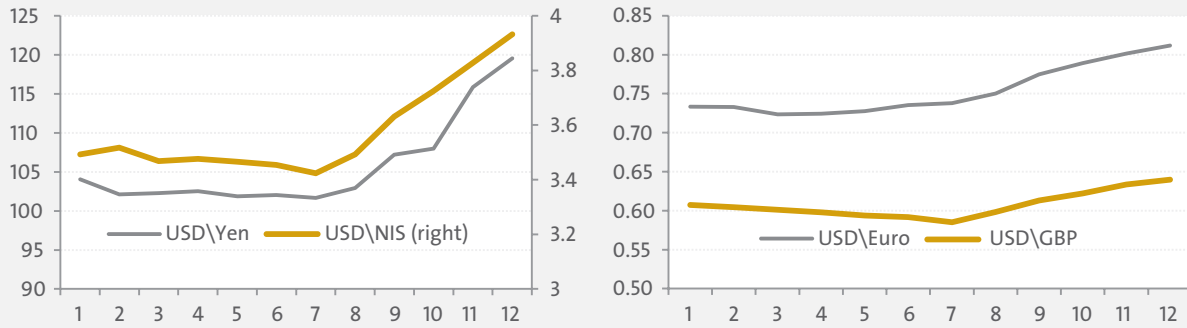
Exchange rates

Exchange rates constitute one of the most important aspects of influence of a country's economic policies (monetary and fiscal) on its relations with the outside world. Oftentimes, these policies act as a key determinant of the form and direction of trade and capital flows across borders. In principal, exchange rates are generally more vulnerable to economic and political events in the issuing country. However, exchange rates moved away from this norm in 2014 as currency markets displayed greater susceptibility to the performance of the US economy and the changes in the monetary policy of the Federal Reserve than to changes in other countries. Anyone taking an interest in historic exchange rates data can discern a general trend of decline in major currencies (euro, sterling pound, and yen) against the US dollar, in spite of the marked differences in the performance and circumstances of the issuing countries.

A key driver behind the notable enthusiasm for trading on the US dollar was the continued recovery in the US economy, which outperformed its generally-stagnant advanced counterparts over the same period. This is in addition to last year's wide-spread expectations about the Federal Reserve ending the quantitative easing program and moving closer to raising interest rates. The US dollar rose firmly against the yen in view of the Japanese poor economic performance and the expansionary monetary policy Bank of Japan has pursued recently. Similarly, it rose against the euro and the pound, albeit at a slower pace.



Figure 1-9: USD exchange rate against major currencies (monthly basis), 2014



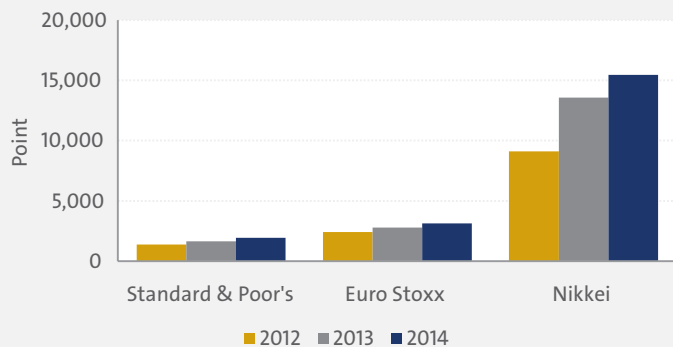
Source: www.oanda.com.

In the same context, signs of weakening significance for the euro as a reserve currency emerged during 2014, as central banks' official reserves denominated in euros fell to their lowest level in ten years, in view of slow economic recovery within the common area and the ongoing debate over adopting a more expansionary policy, especially in the second half of the year. Likewise, the marked growth of the UK economy failed to curtail the decline of the pound against the dollar. On a different note, the US dollar rose against the Israeli shekel^[3], particularly in the second half of the year, influenced by the recent Israeli war against GS and the monetary policy implemented by Bank of Israel during that period.

Financial markets

Financial markets are most vulnerable to crises as well as most indicative of investor confidence in the crisis-management policies adopted by the different countries. During 2014, global financial markets showed growing improvement as investors found their way back to those markets. For example, US stocks continued to attract investors, fostered by the strong performance of the US economy. Over the course of the year, Standard & Poor's 500 Index rose to exceed an average of 1,930 points, climbing by around 17.5 percent compared to previous year's average. Similarly, Japan's Nikkei 225 index showed relative improvement rising by around 13.9 percent compared to the previous year's average to reach 15,460 points. On the other hand, the performance of financial markets in the euro area was weaker than their US and Japanese counterparts, largely fluctuating under the adverse impact of recession and price contraction surrounding the economy in the first half of the year. On average, the Euro Stoxx 50 rose by around 12.6 percent to reach 3,145 points during 2014. It is noteworthy that this index rose tangibly during the last quarter of the year influenced by the ECB announcing the launch of its asset purchasing program.

Figure 1-10: Financial markets indicators (period end), 2012-2014



Source: ECB, 2015.

[3] Despite its limited global significance, the Israeli shekel was considered due to the substantial impact of its fluctuation against the dollar on the livelihood of Palestinian citizens, especially those receiving wages in the US dollar or the Jordanian dinar.



Economic outlook

Several forces collaborate to shape the global economic prospects of the coming years. One of the most prominent forces, whose effects became apparent by the end of 2014, was the oil price crash and its impact on production and consumption. Another such factor was the exchange rate fluctuations pursuant to the changes in actual and expected monetary policies across major world economies.

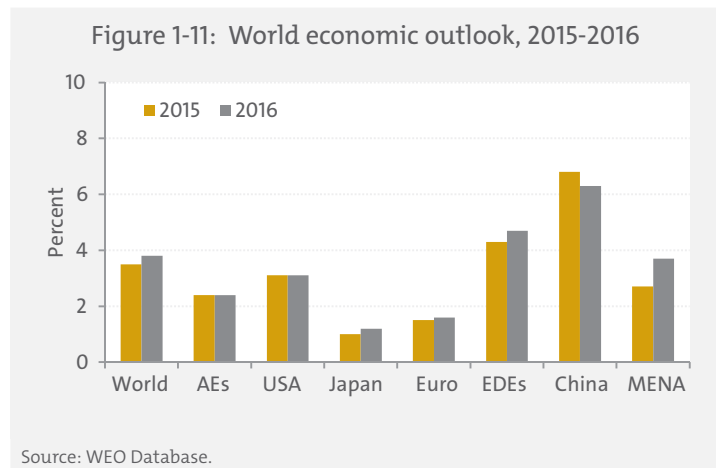
The AEs were apparently more capable than EDEs of making use of these factors. On one hand, as most AEs are oil-importing economies. Falling oil prices contributed to boosting purchasing power and domestic demand thereby fostering growth. On the other hand, the drop in the exchange rates for the euro and the yen stimulated exports. In a recent report, the IMF^[4] predicted improved growth in the euro area owing to the aforesaid factors, in addition to the quantitative easing program recently launched by the ECB, forecasting a growth rate at around 1.5 percent for 2015. Similarly, economic activity in Japan is expected to gradually improve to reach 1.0 percent in 2015 as opposed to its contraction during 2014. The US activity is likewise expected to see further improvement with growth rate accelerating to 3.1 percent by end of 2015. Overall, the IMF predicts AEs growth accelerating to 2.4 percent in 2015.

On the opposite side, while still accounting for three-fourths of global growth, EDEs are increasingly expected to slip deeper into economic slowdown with growth rate falling to 4.3 percent in 2015. This is primarily due to expectations of slowdown in the Chinese economy to reach its lowest levels in two decades, under the influence of weak external demand and ineffective policies aimed at stimulating domestic demand and investment. As a result, forecasts for the Chinese economy point to a decline in growth to 6.8 percent in 2015, which continues further in 2016. Moreover, oil-exporting EDEs are expected to be severely affected by the losses incurred from falling oil prices. As crude oil production is heavily concentrated in the MENA, the region will be most affected by these downside risks. Consequently, growth for the region is not expected to exceed 2.7 percent during 2015, while it is expected to accelerate in 2016 to around 3.7 percent.

Regionally, the Israeli economy is expected to pick up to 3.5 percent in 2015. Forecasts also point to an improved economic activity in Jordan for the sectors of construction, services and tourism -in light of the drop in energy prices-, thereby accelerating growth to 3.7 percent. Likewise, the Egyptian economy is anticipated to move away from the crippling repercussions of political unrest in the past years and to recover appreciably with a growth rate of around 4.0 percent in 2015.

In a different context, the plunge in the costs of production and export is expected to reflect positively on global trade (goods and services), growing to 3.7 percent in 2015 compared to 3.4 percent in 2014. Consumer prices are projected to remain higher in EDEs than in AEs. Prices in 2015 are expected to grow by around 5.4 percent in EDEs and to hover around the same levels of the past years in AEs, increasing by no more than 0.4 percent.

[4] World Economic Outlook, IMF, April 2015.



Part II: Local Economy

Overview

The Palestinian economy experienced extreme hardships during 2014. For the first time since 2006, it registered a decline in activity relative to the previous year (negative growth rate). This relapse comes as a result of the year's political and security episodes, specifically in GS, which suffered, in addition to the ongoing siege since 2006, a new Israeli aggression in the summer of 2014. The recent onslaught severely damaged the larger portion of infrastructure and productive base, and subsequently impacted the performance of the Palestinian economy.

In general, the Palestinian economy operates within an environment that poses numerous internal and external threats and challenges. The most pronounced of external challenge is the Israeli occupation and its imposed measures and their spill-overs. These have deeply rooted the dependence of the Palestinian economy on its Israeli counterpart. Through restricting freedom of movement and access for people and goods alike, the Israeli side has a firm grip on Palestinian trade (internal and external closures) and on the flow of Palestinian workers into Israel. Other external challenges include dependence on foreign grants and aid in addition to adoption of a multi-currency financial system which is vulnerable to the monetary policies pursued by issuing countries.

The most salient internal challenges for the Palestinian economy include uncertainty and absence of clear political and economic prospects, the ongoing internal schism, the weak role played by the private sector as an engine of economic growth, especially in view of the limited role of the public sector and its inability to serve as a key driver of long-term growth. These challenges are to a great extent responsible for many of economic shocks which have caused notable fluctuations in trade, investment flows, and economic activity and growth, considering that Palestinian economic performance and momentum, like in all economies, depends on political and security stability and on the freedom of movement and access for individuals, goods and capital.

The increased intensity of these shocks in recent years have compounded their impact on economic performance, particularly during 2014, when the Palestinian economy witnessed falling rates of growth and soaring inflation alongside record-high poverty and unemployment rates. According to PMA predictions, recovery in 2015 will be limited and will coincide with a modest drop in inflation and unemployment rates. It will also be dependent on the inflows of grants and foreign aid and the reconstruction of GS.

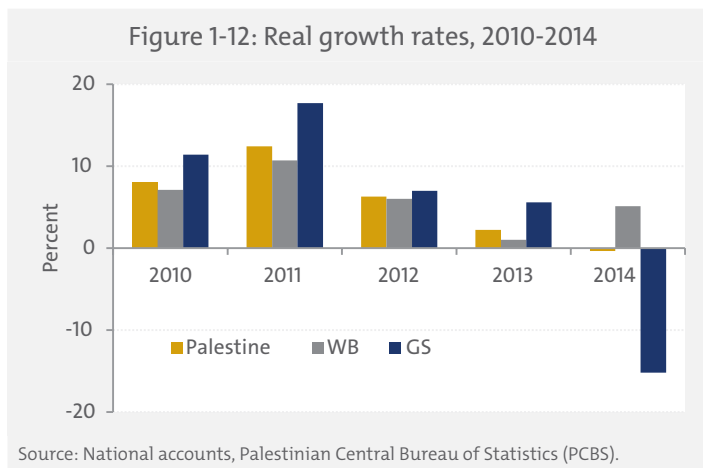
Economic performance

The Palestinian economy experienced its first contraction since 2006, following two years of slowdown. Available data show a drop of about 0.4 percent during 2014 compared to a growth of 2.2 percent for the previous year and about 6.3 percent for 2012. As a result, real GDP fell to around USD 7,449.0 million^[5]. This performance incorporated two

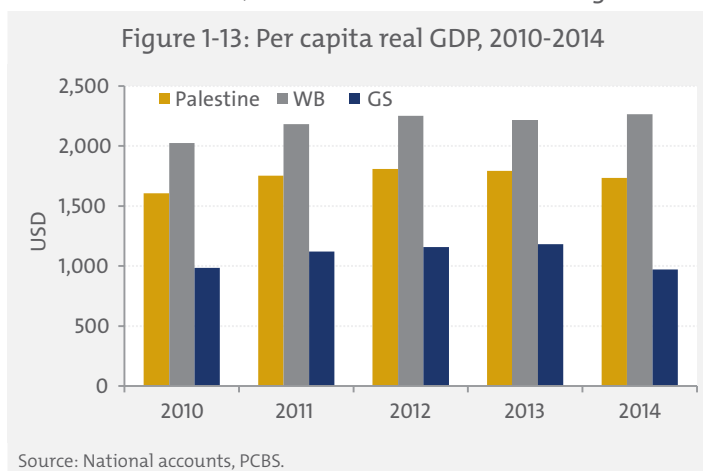
[5] Preliminary PCBS data for 2014 subject to change and revision.



divergent tracks of growth in the West Bank (WB) and Gaza Strip (GS). In the WB, economic activity witnessed notable growth climbing to 5.1 percent from 1.0 percent in 2013, with real GDP of about USD 5,742.5 million. In the meantime, economic performance in GS fell sharply by 15.2 percent as opposed to a growth of 5.6 percent in 2013, bringing real GDP down to around USD 1,706.5 million. In addition to the ongoing economic siege, the closure of checkpoints and recent tensions with Egypt, the recent Israeli aggression during the second half of 2014 augmented the already-harsh economic and social conditions.

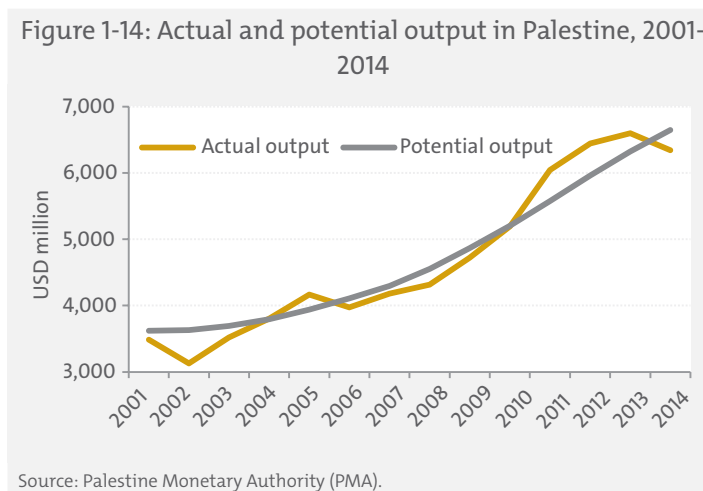


Normally, changes in the level of GDP per capita are used to indicate welfare levels in a given country, as they reveal the real effect of economic performance on individual income. In this context, and as a result of the stumbling economic performance, real GDP per capita retreated during 2014 by around 3.3 percent compared to 2013 to reach USD 1,734.6.



With the growing economic woes of GS, the income gap between GS and WB deepened. In GS, real per capita income reached USD 970.3 recording a drop of 18.0 percent over the previous year, whereas per capita in the WB reached USD 2,265.4 (almost twice the figure of GS), increasing by about 2.3 percent above the previous year.

Narrowing the income gap between the WB and GS, which is persistently growing over the years, requires that the Gazan economy achieves sufficiently higher economic growth rates than those attained in the WB in the coming years. This can only be realized if appropriate strategies and development plans for GS are adopted and implemented.



Amid the conditions currently prevalent in Palestine, estimation of the output gap^[6] revealed that potential GDP at factor cost^[7] rose by 5.1 percent in 2014 compared to the previous year to reach USD 6,645.4, whereas the actual GDP at

[6] The methodology used the production function to estimate potential output.

[7] This represents the GDP in real market prices excluding net indirect taxes.



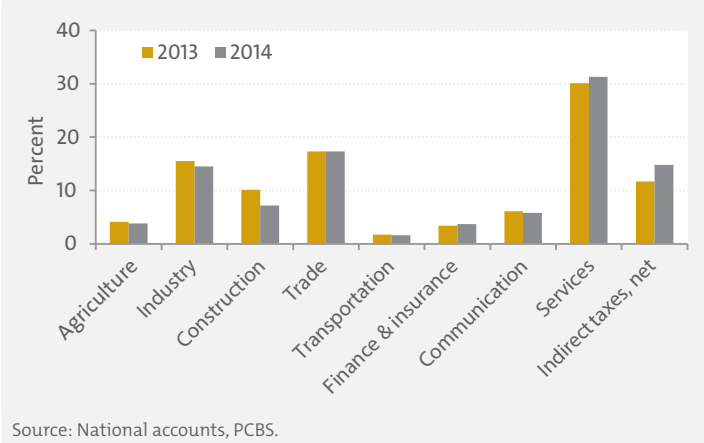
factor cost retreated by 3.9 percent during the same period to reach about USD 6,344.4 million. These results are indicative of a negative output gap, meaning that actual output during 2014 was lower than the potential output by around USD 301.1 million. This gap can be attributable to the hard economic conditions that prevailed in Palestine; in particular in GS.

Economic activities

The Palestinian economy is considered a services-based economy^[8], in which services account for more than one third of domestic product. Hence, the performance of the services sector broadly affects and shapes economic performance. During 2014, service activities have contributed around 31.3 percent of real GDP, while productive sectors collectively contributed 53.9 percent (3.8 percent for agriculture, 14.5 percent for industry, 7.2 percent for construction, 17.3 percent for trade, 1.6 percent for transport and storage, 3.7 percent for financial activities and insurance and 5.8 percent for IT and communication), whereas indirect taxes (customs and net value added tax (VAT) on imports) contributed around 14.8 percent of GDP for the same period.

Performance analysis for 2014 shows a decline in the contribution of the majority of productive activities in real GDP, with the exception of financial and insurance activities which grew from 3.4 percent in 2013 to 3.7 percent in 2014 while the trade sector's contribution remained unchanged at 17.3 percent for the same period. The contribution of agriculture fell from 4.1 percent in 2013 to 3.8 percent in 2014, manufacturing from 15.5 percent to 14.5 percent, constructions from 10.1 percent to 7.2 percent, transport and storage from 1.7 percent to 1.6 percent and IT and communications from 6.1 percent to 5.8 percent for the same period.

Figure 1-15: Contribution of economic activities to real GDP, 2013-2014



In contrast, performance analysis shows an improvement in the contribution of services to GDP, with the exception of real estate and leasing contributing 3.8 percent in 2014 down from 3.9 percent in 2013. The contribution of education increased from 6.9 percent to 7.2 percent for the same period and, likewise, for the sectors of health, from 3.2 percent to 3.5 percent, public administration and defense, from 12.4 percent to 13.0 percent and other services^[9], from 3.6 percent to 3.8 percent for the same period. Consequently, the improvement of these activities constituted the main driver of overall growth of the service sector's share in real GDP.

With respect to the sectoral contribution to growth in 2014^[10], analysis shows that of the contraction in construction and industry served as major driver for the fall in growth; the former causing a drop of around 3.0 points in GDP, whereas the latter caused a drop by around 1.1 points. Likewise, agriculture pushed GDP downwards by around 0.4

[8] Includes services, such as: accommodation and food services; real-estate and leasing services; professional, scientific and technical services; managerial and management support services; education; health and social work; arts; entertainment and leisure services; public administration and defence; household services; Financial Intermediation Services Indirectly Measured (FISIM) and other services.

[9] Including activities of accommodation and food services, professional, scientific and technical services, managerial and management support services, arts, entertainment and leisure services, household services, Financial Intermediation Services Indirectly Measured and other services.

[10] For an activity at time (t), its contribution to growth rate(t) = current year growth rate(t) x previous year contribution in GDP(t-1)

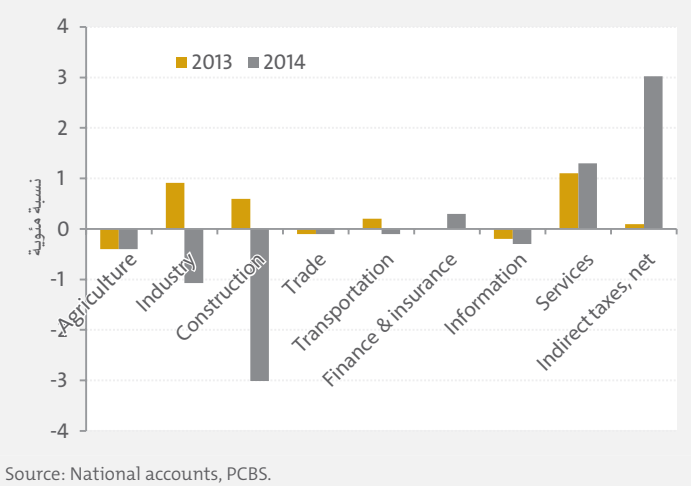


points, trade by around 0.1 point and transport and storage by around 0.1 point. On the other side, the growth in services and net indirect taxes abated the severity of the decline in GDP growth. The services sector contributed by 1.3 points to GDP and the net indirect taxes contributed by around 3.0 points.

Performance analysis demonstrates a clear discrepancy in the sectoral contribution to growth rates between 2013 and 2014, particularly for the activities of industry, construction and transport and storage services, which diverged from a positive contribution to growth in 2013 to a negative one in 2014 (from 0.9 points to -1.1 points for industry, from 0.6 points to -3.0 points for construction and from 0.2 points to -0.1 points for transport and storage).

Meanwhile, the contribution of services in GDP in 2014 picked up (from 1.1 points to 1.3 points) as well as the contribution of net indirect taxes (from 0.1 points to 3.0 points), while the contribution of agriculture stood, as in 2013, at -0.4 percent. The cause behind this shift in the activities of industry, construction and transport was the sharp downturn in the performance of these activities in GS as a result of the ongoing siege and the recent Israeli aggression.

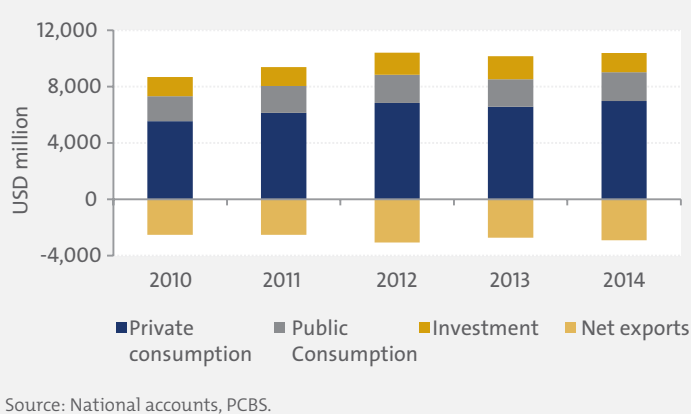
Figure 1-16: Contribution of economic activities to growth, 2013-2014



Aggregate demand

In 2014, the Palestinian economy experienced a decline in real aggregate demand as a result of the reduction of investment expenditure and a drop in net exports. Available data demonstrate that investment declined by 17.1 percent compared to a growth rate of 4.2 percent in 2013. Trade deficit (exports – imports) increased by about 7.5 percent compared to a falling deficit of 11.6 percent in 2013. In contrast, data show a hike in consumption expenditures (private and public) by around 5.7 percent compared to a drop of 3.5 percent in 2013, driven by the improvement in both private and public consumption by 6.2 percent and 4.2 percent, respectively, compared to a drop of 4.0 percent and 1.6 percent respectively in 2013. This increase in expenditure on final consumption has helped mitigate the severity of the decline in aggregate demand.

Figure 1-17: Aggregate demand, 2010-2014



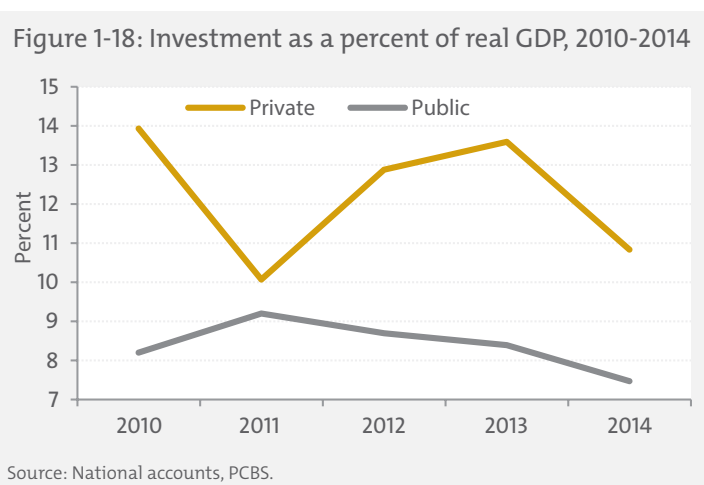
Analysis also reveals that the underlying cause for the decline in investments and trade is attributable to a similar trend in Gaza, where investment plummeted by more than 360 percent (from USD 100.9 million in 2013 to USD -265.8 million in 2014) owing to the continued siege and destruction of infrastructure during the recent Israeli aggression against the Strip. As for the net exports deficit, it rose by around 55.0 percent on the grounds of an increase in imports by around 42.7 percent and a drop in exports by around 18.0 percent. On the other hand, private and public consumption in GS rose by around 19.3 percent and 4.3 percent, respectively, in 2014.



In the WB, the trend was completely reversed as aggregate demand saw growth in all components. Private and public consumption rose by 2.0 percent and 4.1 percent, respectively. Investment rose by about 5.6 percent and the trade deficit retreated by about 2.7 percent as a result of a growth in exports of 13.8 percent, accompanied by growth in imports by about 3.2 percent, which eventually narrowed the deficit in trade for 2014.

Accordingly, these developments impacted the share of aggregate demand components in real GDP. Final consumption as a share of real GDP increased to 120.9 percent from 113.9 percent in 2013 as a result of a notable upturn in GS from 116.1 percent in 2013 to 156.8 percent in 2014. This rise came despite a falling share in the WB from 113.1 percent to 110.2 percent over the same period. The increase in final consumption as a share of GDP in Gaza was a result of severe shifts in public and private final consumption patterns, as private consumption as a share of GDP soared from 78.8 percent in 2013 to 110.9 percent in 2014, alongside a similar increase in public consumption from 37.3 percent to 45.9 percent over the same period, owing to the flows of in-kind aid to GS during and after the latest war in conjunction with a decline in GDP.

As for total investment, analysis points to a drop in its share of GDP from 22.0 percent in 2013 to 18.3 percent in 2014, as a result of the sharp decline in GS from 5.0 percent to -15.6 percent over the same period, as opposed to a slight increase in the WB from 28.2 percent in 2013 to 28.4 percent in 2014. In this context, it is worth noting that the decline in total investment as a share of GDP included both private and public investment, as the share of private investment shrank to around 10.8 percent compared to 13.6 percent in 2013, alongside a decline in public investment as a share of GDP to around 7.5 percent compared to 8.4 percent for the same period.



In general, investment in Palestine endured deterioration and slowdown over the past few years, specifically since 2000. Unstable political and security conditions accompanied by Israeli restrictions and obstacles have severely hindered public sector performance. Additionally, the private sector's inability to act as an engine of economic growth along with investors' reluctance acted to discourage or disrupt investment's growth trajectory.

Box 2: Wages and salaries in the public servant system and its impact on demand

Wages and salaries constitute more than 50 percent of total government expenditures in Palestine. The Palestinian government depends chiefly on clearance revenues (constituting about 70 percent of total revenue) and grants and aid to cover its expenditures, specifically for salaries and wages. Thus, any interruption or suspension of clearance revenues directly and mainly affects employee wages and salaries. On several occasions over the past years, public employees suffered wage suspension or cutbacks after Israel refrained from transferring clearance revenues to the Palestinian government. The latest such incident saw the disbursement of only 60 percent of wages for the period



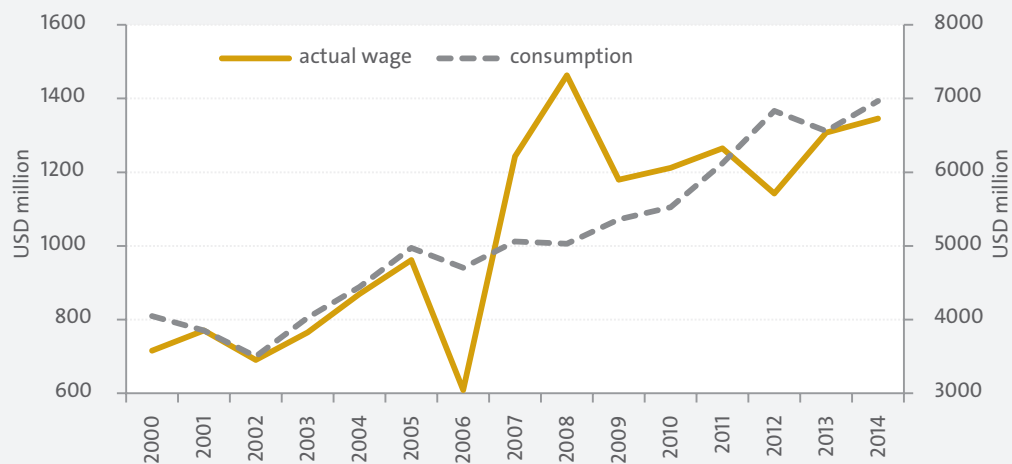
from the beginning of the year until mid-April. This is expected to adversely affect consumption and investment, and subsequently, the PMA has lately revised down its forecasts for economic growth for 2015, from 2.7 percent to 1.9 percent, at the time this report was written.

Three successive monthly cuts for more than 200 thousand employees working in the public sector will inevitably have discernable repercussions on the domestic economy. Past experience shows that the suspension or cutback of employee wages resulted in a noticeable drop in consumption and investment, particularly for the private sector, and subsequently a drop in GDP. Clearance revenues were suspended, for example, in 2006 and early 2007, which coincided with significant cuts to international aid. For that period, the Palestinian government was forced to suspend payment of employee wages, only to resume payment of modest loans, bringing wages down by around 40 percent. This resulted in a drop in consumption and investment by around 5 percent and 8 percent, respectively, and thereafter, a fall in GDP by about 4 percent for that year.

Public Employee Wage and GDP



Public Employee Wage and Consumption



Public Employee Wage and Investment



An econometric analysis for the period 2000-2014 revealed a statistically-significant positive relation between wages of workers in public employment and each of GDP, consumption and investment. The analysis also showed that investment was more susceptible to wage cuts than consumption or GDP. This is so because employees reduce their consumption of luxury goods but resort to borrowing to cover their commodity spending. As for investment, investor confidence in the domestic market plummets as a result of a crisis of the kind described above. Investors refrain, or at least delay, from investing in new projects or developing existing ones. It will also take some time before investors regain their confidence. As a prudential measure, banks will also follow more stringent standards of operation and require some time before regaining confidence in the market and in this particular customer segment.

In contrast, the trade balance deficit (net exports) as a share of GDP witnessed a rise during 2014 to around 39.3 percent compared to 36.5 percent in 2013, as a result of the disparity in the deficit positions of both the WB and GS. Available data indicate a deficit increase in GS from 23.8 percent of GDP in 2013 to 43.6 percent in 2014, due to the marked increase in imports from 28.7 percent to 48.3 percent with exports share remaining almost unchanged (from 4.8 percent to 4.7 percent) of GDP between 2013 and 2014^[11]. On the other hand, deficit as a share of GDP receded in the WB fell from 41.1

Figure 1-19: Net exports as a percent of real GDP, 2010-2014



Source: National accounts, PCBS.

percent in 2013 to 38.1 percent in 2014, owing to the increase of exports as a share of GDP from 22.6 percent in 2013 to 24.5 percent in 2014, and the fall of imports' share from 63.7 percent to 62.6 percent for the same period.

These changes in the exports and imports shares in both the WB and GS produced an upturn in exports as a share of GDP from 17.8 percent to 20.0 percent alongside a rise in imports as a share of GDP to around 59.3 percent in 2014 compared to 54.3 percent in 2013.

[11] The underlying cause for import increase in GS is the rise in in-kind aid in the second half of 2014 in the aftermath of the war.



It is worth noting that the diminishing contribution of Palestinian exports to GDP can be ascribed to a number of factors, most notably the poor competitiveness of Palestinian products in external markets (owing to high costs of production and the Israeli constraints and restrictions on freedom of movement, transport and access) in addition to the deliberate destruction of infrastructure. To push economic growth forward and promote sustainable development, the government must formulate plans to boost and add value to Palestinian products and secure their access to external markets beside the Israeli one, as well as speed up the reconstruction of GS in a manner that reinforces the position of the external sector of the Palestinian economy.

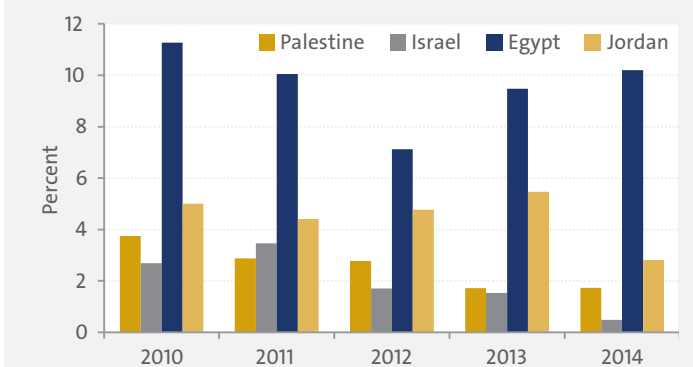
Inflation, prices, and purchasing power

Analysis of consumer price index, denominated in Israeli shekel, revealed a timid increase in price levels in Palestine during 2014, by which inflation rate stood, as in the previous year, at 1.7 percent. The ongoing inflation rate decline over the past years has come as a result of the decrease in the cost of imports and falling global prices of certain goods, especially of food, which has the largest weight in the Palestinian consumer basket. It has also come as a result of weak local demand in view of the growing political and economic uncertainty.

Considering global economic developments and the fluctuations in prices of basic goods, the inflation rate in Palestine is considered relatively low compared to international and regional inflation figures. In 2014, inflation registered about 1.4 percent in advanced countries, 5.3 percent in EDEs and about 8.0 percent in the MENA countries. As for neighbouring countries, inflation rates recorded 2.8 percent in Jordan, 10.2 percent in Egypt and 0.5 percent in Israel. Nonetheless, the recorded inflation rate in Palestine implied opposing trends. Although the rate in the WB receded from 3.1 percent in 2013 to 1.2 percent in 2014, it rose from -0.8 percent to 2.9 percent in Gaza and from 1.8 percent to 3.8 percent in Jerusalem, for the same period.

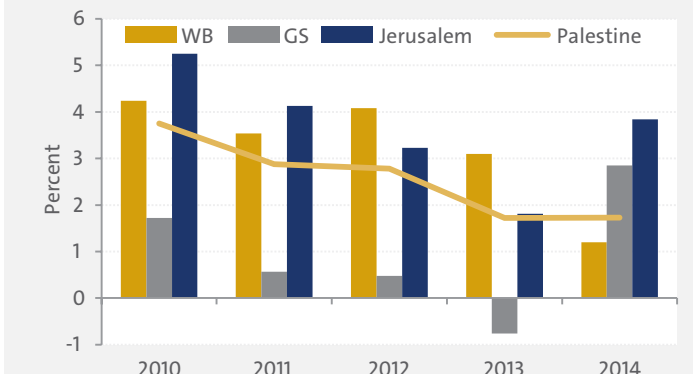
This disparity in the inflation trends in the WB and GS reflects the degree of inter-regional variation in economic and political conditions. While commodity prices in the WB were primarily linked to corresponding price levels and cost of imports in Israel, prices in Gaza were affected by economic conditions, particularly that the activity of the shadow economy^[12] leading to a sharp drop in goods entering from Egypt. Hence dependence on the limited supply of goods permitted by Israel increased, and subsequently prices in Gaza have rocketed during 2014.

Figure 1-20: Inflation rates, selected countries, 2010-2014



Source: PCBS, WEO database, IMF.

Figure 1-21: Inflation rates in Palestine, 2010-2014



Source: consumer price indices (CPI), PCBS.

[12] The relation with the Egyptian side witnessed further deterioration which reflected primarily as constraints on trade (as a result of the destruction of most tunnels and the recurring closure of the border crossing) and negatively impacted all aspects of the economy in general.

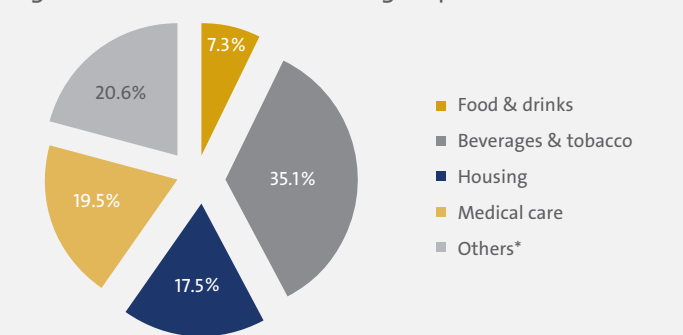


The regional price disparity also reflects the extent of fluctuations in consumer price indices of groups of goods and services within the Palestinian consumer basket. During 2014, for the third consecutive year, alcoholic beverages and tobacco recorded the highest price increase, up to 11.8 percent (11.8 percent in the WB, 16.0 percent in Gaza and 11.4 percent in Jerusalem) within all 12 categories, as a result of the tax hike on tobacco and alcoholic beverages. In second place was the price index for health services, increasing at 8.7 percent (3.7 percent in the WB, 0.5 percent in Gaza and 10.6 percent in Jerusalem). Price indices also rose for restaurants, cafes and hotels and for housing and housing necessities by 4.5 percent and 3.3 percent, respectively.

Generally, and across the entire Palestinian territories, the groups of food products, housing, and transport services continued to acquire about 58 percent of the overall weights^[13] of the Palestinian consumer basket. Classified as basic goods, these groups account for an average of around 58 percent of the total Palestinian consumer spending. During 2014, the food price index rose by 0.4 percent, whereas the transport price index continued its descent, for the second year in a row, by around 2.9 percent under the influence of the drop in global fuel prices. This decline is the sharpest among all other group indices, followed by a decline in the communication services index by around 2.6 percent, in addition to a decline in recreational and goods and services index by 1.8 percent. The remaining indices witnessed slight or negligible changes.

Moreover, the analysis of price levels shows that out of the 12 groups, four groups contributed around 79.4 percent of the rate of inflation in 2014. Alcoholic beverages and tobacco contributed by about 35.1 percent; health services by 19.5 percent; housing and housing necessities by about 17.5 percent and food and beverages by about 7.3 percent. Together, the remaining groups contributed by about 20.6 percent of the inflation rate in 2014.

Figure 1-22: Contribution of CPI groups to inflation, 2014

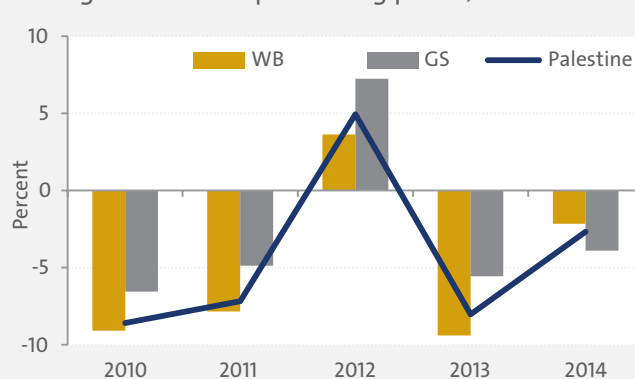


* Includes textiles, clothing and footwear, furniture, households' goods, recreational cultural goods and services, transportation, communications restaurants and cafes, and other miscellaneous goods and services.

Source: CPI, PCBS.

A disadvantage of inflation is that it diminishes the purchasing power of the currency, alongside changes in the levels of nominal wage and exchange rate fluctuations. In view of the successive US dollar value depreciation (and Jordanian dinar depreciation as it is pegged to the US dollar), individuals receiving their wage in dollars (or dinars) suffered from a higher decline in the purchasing power of their wages compared to those receiving their wages in the Israeli shekel. During 2014, the dollar declined by about 1.0 percent with a subsequent loss of dollar purchasing power in Palestine by about 2.7 percent (the same applies to Jordanian dinar)^[14]. In contrast, the decline in the purchasing power of the Israeli shekel corresponded solely to the inflation rate, i.e. 1.7 percent.

Figure 1-23: USD purchasing power, 2010-2014



Source: PMA, PCBS.

[13] Representing the relative importance of goods and services in the consumer basket, or in the economy in general, and used to calculate the Consumer Price Index-CPI.

[14] Purchasing power of US dollar (or Jordanian Dinar) = inflation rate + FX change against the Israeli Shekel.



In view of the disparity in inflation rates in the WB and Gaza, varying changes to the purchasing power of the currency unit appeared in both regions. The purchasing power for the Israeli shekel in the WB dropped by 1.2 percent, and in Gaza, by about 2.9 percent. Holding nominal wages constant, the purchasing power of US dollar (dinar) likewise dropped by around 2.2 percent in the WB, as opposed to a greater drop of 3.9 percent in Gaza.

Labor force

Population in Palestine has grown by 2.9 percent throughout 2014 to about 4.6 million, an increase of 2.9 percent compared to 2013 (2.8 million live in the WB and around 1.8 million in Gaza). About 60.2 percent of the population, making around 2.7 million, is aged 15 and above.

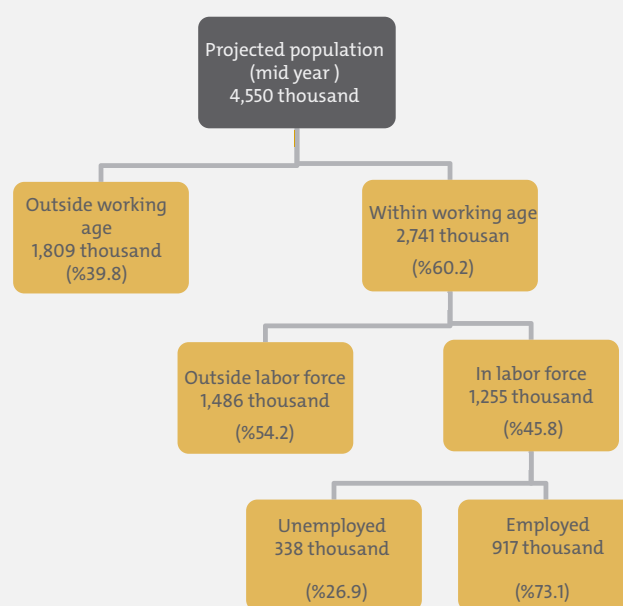
Since the Palestinians society is a relatively youthful one, around one third of the population remain in school, which excludes them from participating in the labour force. As a result, participation in the labor force in Palestine is comparatively low, registering around 45.8 percent for 2014 (46.4 percent in the WB and 44.9 percent in Gaza). As such, more than half the Palestinian population does not actually take part in economic activities.

Levels of labor force participation vary according to gender, location, age group and educational attainment. It can be noted, that female participation is lower than male participation. This disparity is more evident in the 40-44 age category. During 2014, male participation rate rose slightly to 71.5 percent compared to 69.3 percent in 2013, as did female participation which rose from 17.3 percent in 2013 to 19.4 percent in 2014.

The highest male participation rate appears in the 35-39 age category, while the highest female participation rate appears in the 25-29 age category, achieving rates of 94.0 percent and 33.3 percent, respectively. Generally, participation rates are highest in individuals (male and female) within the 20-49 age category.

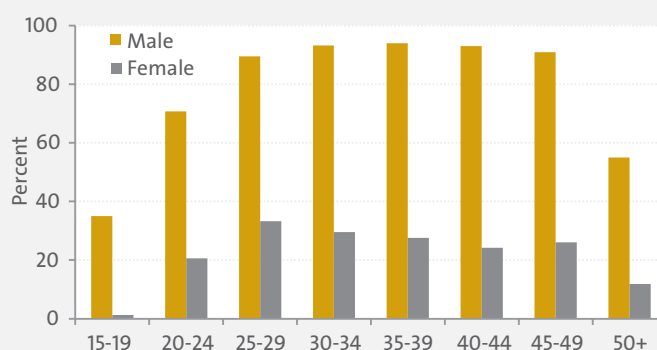
The participation rate is also affected by the level of educational attainment. Hence, it declines among individuals who have not attained any education to 10.7 percent, and rises to 60.2 percent among individuals with over 13 years of schooling. Apparently, and excluding individuals

Figure 1-24: Labor force framework, 2014



Source: labor force reports, PCBS.

Figure 1-25: Participation rates by age and sex, 2014



Source: labor force reports, PCBS.



who are illiterate, male participation remains fairly consistent regardless of the educational level. However, female participation is higher amongst women with 1-6 years of schooling than amongst women with 7-12 years of schooling, noting that participation starts to pick up as attainment progresses from diploma to higher certification.

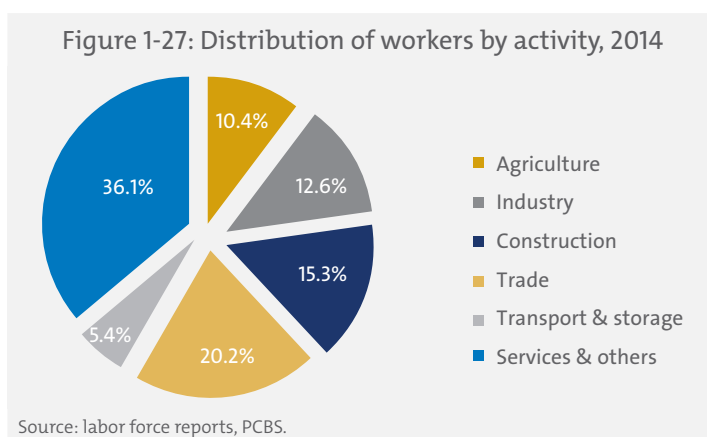
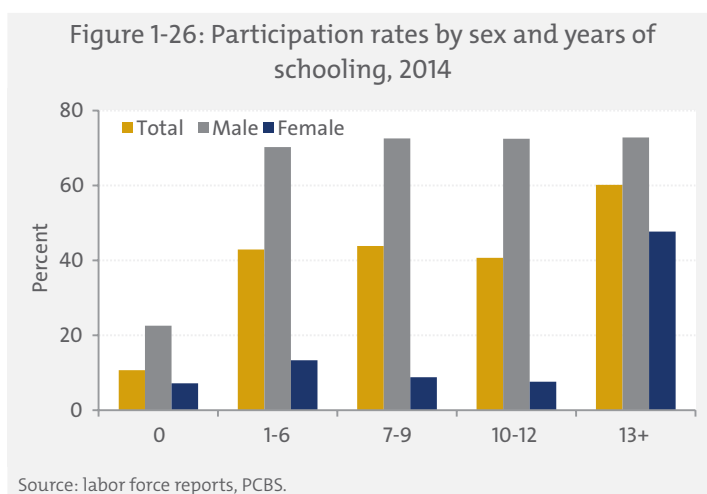
Employment

During 2014, the number of workers increased by 3.6 percent, compared to 3.1 percent in 2013, to reach 917 thousand workers (72.8 percent in the WB and 27.2 percent in Gaza). The public sector absorbed 22.9 percent of the total number of workers (107 thousand workers in the WB and around 103 thousand in Gaza). Yet, the private sector remained the major employer, hiring about 65.4 percent, which is equivalent to 600 thousand workers (75.6 percent in the WB and the rest in Gaza). The labor market in Israel and settlements employed around 11.7 percent of total number of Palestinian workers, equivalent to 107 thousand workers, all residing in the WB; as workers from Gaza are officially banned from joining the Israeli labor market since 2006.

No major changes occurred during 2014 to the distribution of workers by economic activity. The general workforce structure maintained its long-standing relative stability, in which the services sector retained its position as the most attractive recruiter, with a proportion of 36.1 percent of employed individuals. The remaining workers were distributed across various sectors and economic activities. It is worth mentioning that the sectoral contribution to employment coincided reasonably with the contribution to GDP. However, it is fair to say that the sectors of services and industry were the most efficient recruiters. The services sector employed around 36.1 percent of total work force, and contributed with 40.8 percent of GDP, whereas the industry sector employed around 12.6 percent, and recorded 14.5 percent as a share of GDP. Conversely, other sectors recruited at a rate higher than their share of GDP, which is indicative of the low worker productivity in these sectors.

Unemployment

High unemployment is regarded as one of the most difficult challenges to the economy of any country, particularly developing countries. The challenge is not limited to generation of job opportunities to entrants to the labor market, but also necessitates the painstaking work of clearing the accumulated unemployment backlog. This mission is made more difficult in Palestine given limited production capacities and low investment levels, in addition to a high population growth rate, which is subsequently associated with a rise in labor force numbers.



The unemployment rate in Palestine continued to rise during 2014, reaching 26.9 percent of total labor force, compared to 23.4 percent in 2013^[15]. It is worth mentioning that unemployment rate declined in the WB from 18.6 percent to 17.7 percent, while it rose in Gaza from 32.6 percent to 43.9 percent between 2013 and 2014. The high unemployment rate in Gaza is mainly a consequence of the Israeli war against the Strip which took place in the third quarter of the year, after which unemployment jumped to 47.4 percent. In fact, unemployment exceeded 40 percent in all quarters of the year as

a result of the persistent siege imposed by Israel, the almost complete closure of the Rafah crossing border and the faltering shadow economy which previously took on a considerable number of workers.

Generally, unemployment in Palestine remains relatively high when compared to other countries in the region, as more than one quarter of the labor force was unemployed, compared with 11.9 percent in Jordan, 12.9 percent in Egypt and 5.9 percent in Israel. It is noteworthy that unemployment rates were significantly high among females, reaching 38.4 percent (27.4 percent in the WB and 56.8 percent in Gaza) and 37.3 percent in refugee camps (22.5 percent in WB refugee camps and 46.8 percent in GS camps).

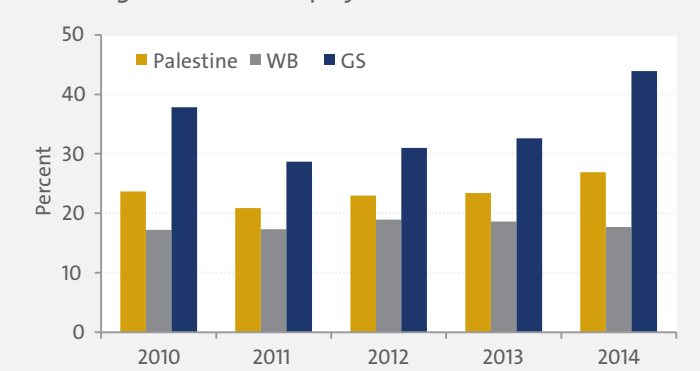
Average daily wage

Nominal daily wage in Palestine rose during 2014 by 5.0 percent to about 102.1NIS on account of a rise in daily wages in the WB by 2.1 percent, in Gaza by 1.4 percent and in Israel and the settlements by 6.8 percent. However, these changes to wages cannot be considered in isolation from price developments and their effect on real wage.

With a change in inflation rate that was less than the increase in nominal wage in 2014, real wage in Palestine increased by 3.3 percent. Nonetheless, clear regional disparities continued to exist. In the WB, real wage increased by around 0.9 percent, whereas in Gaza, and owing to an increase in real wage that is lower than the inflation rate, real wage eroded by around 1.5 percent. For workers in Israel and settlements, real wage increased by around 5.6 percent.

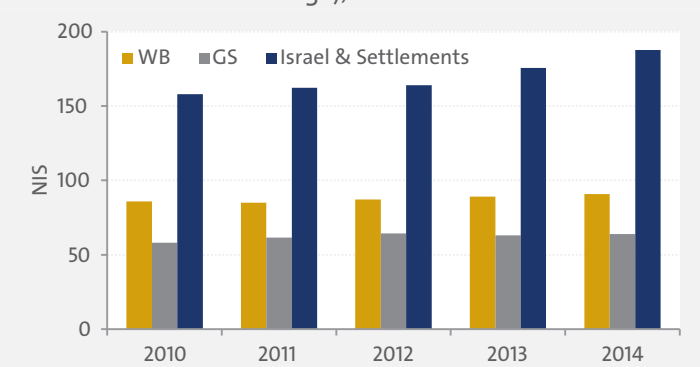
Generally, the gap between wages in the WB and Gaza persisted throughout 2014, indicating the extent of inter-regional economic disparity, with the wage of Gaza worker lower by 29.6 percent than for his WB counterpart and by around 65.9 percent than for the Palestinian worker in Israel and settlements.

Figure 1-28: Unemployment rates, 2010-2014



Source: labor force reports, PCBS.

Figure 1-29: Nominal wages for Palestinian workers (daily average), 2010-2014



Source: labor force reports, PCBS.

[15] In 2014, out of 100 thousand new entrants to the labor market, only 32 thousand were offered job opportunities (8000 working in Israel), while the remaining became unemployed.



Dependency rate

The dependency ratio (the number of individuals sustained by every employed individual) is an indicator of the economic burden incurred by employed individuals. This ratio is mainly affected by the labor force number and the natural rate of population increase, since a larger increase in the former will alleviate the economic burden incurred by the employed individual.

In this context, the dependency ratio remained unchanged from the previous year at 5.0 individuals per employed person (every employed person sustains himself in addition to four others). There is, however, a clear inter-regional disparity, as that figure fell in the WB from 4.4 in 2013 to 4.2 in 2014, while it rose in Gaza from 6.4 to 7.1 per employed individual.

Productivity

Data show that productivity of the Palestinian worker^[16] declined in 2014, for the second consecutive year. Under the impact of falling GDP, productivity dropped by 3.9 percent to reach USD 8,123.2 per worker. Productivity of WB workers fell by around 2.5 percent, reaching USD 8,602.0 and of the GS worker by around 9.7 percent to reach USD 6,841.8, meaning that GS workers' productivity stands at 79.5 percent of their WB counterparts.

Economic outlook

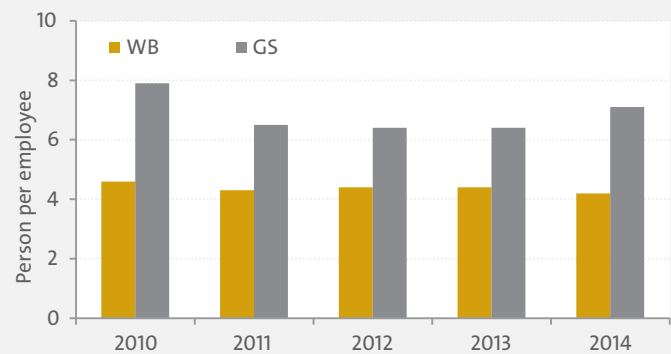
PMA forecasts for the outlook of the Palestinian economy^[17] in 2015 were based upon a set of basic assumptions incorporating analysis of different risks with varying likelihoods. Based on these assumptions (comprising the baseline scenario), the performance of the Palestinian economy is expected to witness a relative improvement during 2015. PMA forecasts indicate a rise in real GDP by about 1.9 percent to reach about USD 7,587 million, compared with a drop of about 0.4 percent in 2014. Despite this hike, the real per capita income (real GDP per capita) is expected to fall by 1.0 percent to reach USD 1,717 compared with a decline of about 3.3 percent in 2014.

The baseline scenario assumes political and economic conditions will remain unchanged from 2014 with regard to the political impasse, the ongoing closure of Gaza's crossings, the continuing restrictions on the movement of individuals and goods (including workforce in Israel and domestic and foreign trade), and the persistent fiscal policy of austerity, while growth in government revenues and expenditures levels remains unchanged from the previous year. It is also

[16] Productivity = Value Added/ Number of workers

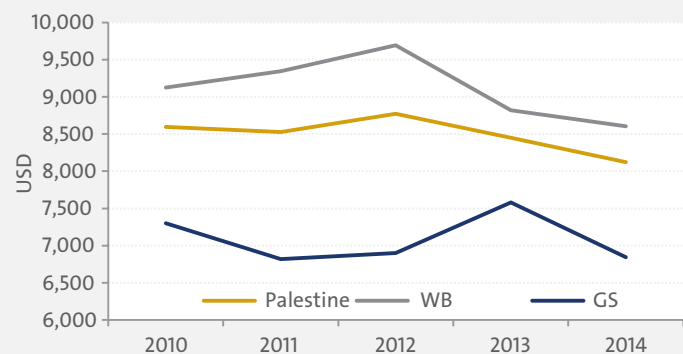
[17] Forecasts are sensitive to any change in the actual official figures of the PCBS and the Ministry of Finance.

Figure 1-30: Dependency rates , 2010-2014



Source: labor force reports, PCBS.

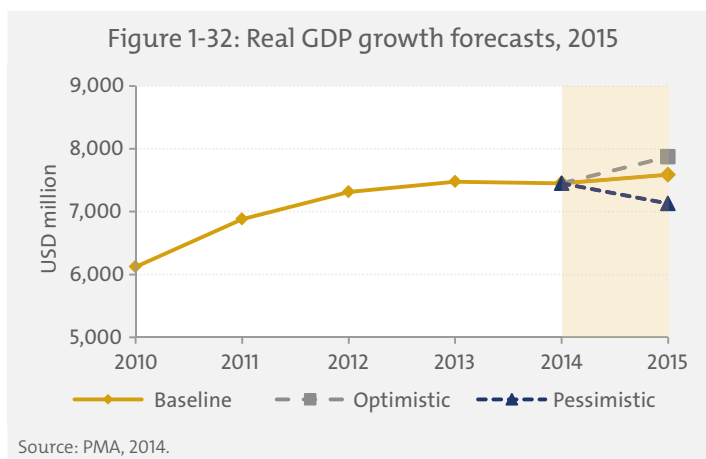
Figure 1-31: Labor productivity, 2010-2014



Source: labor force reports, PCBS.



assumed that aid flows from donor countries into the Palestinian government treasury will continue and will total around USD 1 billion. Additionally, current transfers to the private sector, as well as credit facilities are assumed to stand close to the same levels of the previous year. Furthermore, this scenario assumes an increase in exports owing to a rise in external demand, especially by Israel, as the Israeli economy is expected to grow by around 3.2 percent during 2015^[18].



Under this scenario for 2015, final consumption is expected to grow slightly to 121.3 percent of GDP compared to 120.9 percent in the previous year as a result of a limited increase in private consumption to 93.6 percent, compared to 93.5 percent for the previous year and a similar increase in public consumption to 27.7 percent, from around 27.4 percent in 2014. In tandem, the contribution of total investment to GDP is expected to rise to 18.8 percent, compared to 18.3 percent in 2014.

As for foreign trade in 2015, the trade deficit is expected to rise to 40.1 percent of GDP compared with 39.3 percent in 2014 as a result of an expansion in imports/GDP to 60.6 percent, accompanied by a slight rise in exports/GDP to 20.5 percent.

The unemployment rate is expected to drop to 25.0 percent of total labor force, compared to 26.9 percent in 2014. Similarly, the inflation rate is expected to fall to 1.0 percent, compared to 1.7 percent in 2014, on the basis of the continued decline in the global prices of oil and food.

Risk analysis indicates that these predictions are prone to several shocks of varying likelihoods. An optimistic scenario assumes that the economy experiences positive shocks during 2015 that will lead to a relative improvement in the political process, security conditions and the peace negotiations. It also assumes a speedy transfer of funds for the reconstruction of Gaza Strip and the launch of major projects and measures that stimulate the economy, in tandem with lifting of the siege and closure of Gaza, easing the restrictions on movement of individuals and goods and increasing the number of Palestinian workers in Israel. Additionally, the pace of flow of donor aid to fund the budget and development projects is expected to accelerate concurrently with an increase in private transfers from abroad. As such, real GDP is expected to grow by around 5.7 percent and GDP per capita by around 2.7 percent.

Under this scenario, it is also forecasted that final consumption will rise to 122.6 percent of GDP; 93.8 percent for private consumption and 28.8 percent for public consumption. At the same time, the investment share in GDP will rise to 19.2 percent. The trade deficit is expected to grow to around 41.8 percent of GDP as a result of an increase in imports share of GDP to 63.8 percent, and exports share of GDP to around 22.0 percent. Unemployment is expected to see a significant slump to 22.0 percent of total labor force.

In the case of negative shocks to the economy, a pessimistic scenario can be envisioned in which political and security conditions severely deteriorate, the number of Palestinians working in Israel declines, restrictions on movement of individuals and goods tighten, number of days of closure for workers increase, barriers to exports and imports

[18] This rate is the predicted growth rate by Bank of Israel.



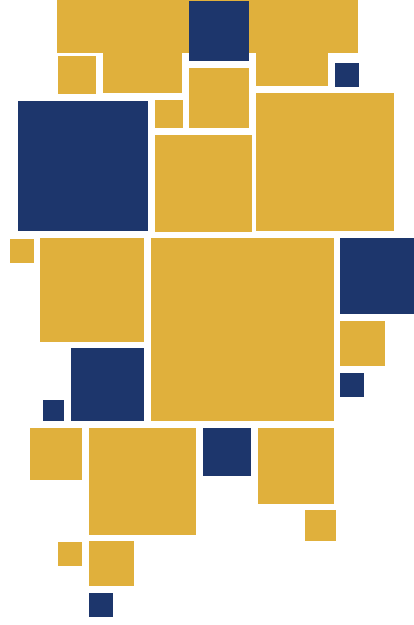
proliferate and transfers of tax revenues are further suspended. This scenario also assumes that foreign aid from donor countries in support of the budget and development projects decline and that the transfer of funds for the reconstruction of Gaza decelerates. Under such a scenario, it is estimated that real GDP will fall by 4.3 percent and average GDP per capita will shrink by 7.0 percent during 2015.

On the basis of the aforementioned pessimistic scenario, it is expected that final consumption will decrease as a share of GDP to 118.0 percent, of which private consumption constitutes 90.8 percent and public consumption 27.2 percent, while investment is expected to recede to 17.3 percent of GDP. As for foreign trade, the trade deficit is to plunge to around 35.3 percent as a result of the drop in imports share of GDP to 54.6 percent and a similar drop of exports share of GDP to about 19.3 percent for 2015. Unemployment is projected to grow to 29.0 percent of the total laborforce for the same year.



Chapter Two

Public Finance Developments



Overview

During 2014, the Palestinian government sought to enhance the efficiency of the public sector by adopting a policy which promotes close collaboration between the public sector, which is regarded as efficient, and the dynamic private sector, which is regarded as the leading driver of sustainable economic growth. Within this framework, the government made efforts to create a suitable environment for the launch of investment projects which makes use of available capacities in an attempt to boost economic activity, and thereby, expand tax revenues. In contrast, the government maintained the policy of rationalization of government spending. These policies were adopted by the government to reduce the budget deficit, achieve sustainable economic growth, fight poverty and unemployment and reduce dependence on foreign aid.

The government policy implemented during 2014 has led to a remarkable increase in public revenues (particularly clearance revenues and non-tax revenues) as opposed to a timid increase in public expenditures (wages and salaries, non-wage expenditures and net lending), which facilitated a fall in current deficit. Despite the relative decline in foreign grants and aid over the year, the overall balance after grants saw a surplus of about NIS 1.5 billion. However, in spite of this surplus, the year witnessed a marked upsurge in accumulated government arrears as opposed to a contraction in government public debt, both domestic and external (USD-denominated).

Total revenue and grants

Over the past years, Palestine witnessed a series of economic and political developments, which had direct and indirect ramifications on public finances. As successive governments with varying strategies and visions were formed, ebb and flow in public revenue and expenditures ensued. Yet, all these governments encouraged the principle of securing autonomous and self-funded revenues and financial sources and tried to discourage dependence on foreign grants and aid. The current government implemented a policy that reduced borrowing from local banks to a minimum and prioritized the repayment of accrued arrears. However, the success of this policy depended chiefly on the regular and uninterrupted flow of clearance revenues and foreign aid, which constituted the major portion of public revenues.

During 2014, total revenues and grants rose by around 5.3 percent compared to the previous year, to reach NIS 14,834.5 million^[19], corresponding to the increase in clearance revenues and non-tax revenues, as opposed to a shortfall in tax revenues and foreign aid. Despite this upturn, the actual volume of revenues and grants accounted for 94.3 percent of the budgeted target in 2014 compared to 94.9 percent of 2013 budget target.

In spite of the increase in total revenues and grants, tax refunds during 2014 fell by about 40.3 percent, to reach NIS 481.3 million, accounting for around 85.9 percent of the budgeted target for 2014^[20]. This decline occurred despite a policy of paying off arrears to prevent their accumulation, which can be attributed to the sharp downfall in foreign aid, directly impacting the government's ability to meet its obligations. With that decline in tax refunds and the rise

[19] The NIS was used as a currency unit in this analysis instead of the USD in order to neutralize the significant impact of changes in the exchange rates. In addition, data listed in this chapter are reported on cash basis, unless noted otherwise.

[20] Tax refunds represent the funds given back by the government following the settlements for customs duties, Value Added Tax, and petroleum excises. Petroleum excises constitute the larger portion of tax refunds, accounting for about NIS 424.0 million, the equivalent of 88.1 percent of total tax refunds for 2014.



in clearance revenues and non-tax revenues, total net revenues and grants^[21] for 2014 saw a pronounced increase by around 8.1 percent compared to the previous year to reach NIS 14,353.2 million, or the equivalent of 94.6 percent of the budgeted target.

Total revenues

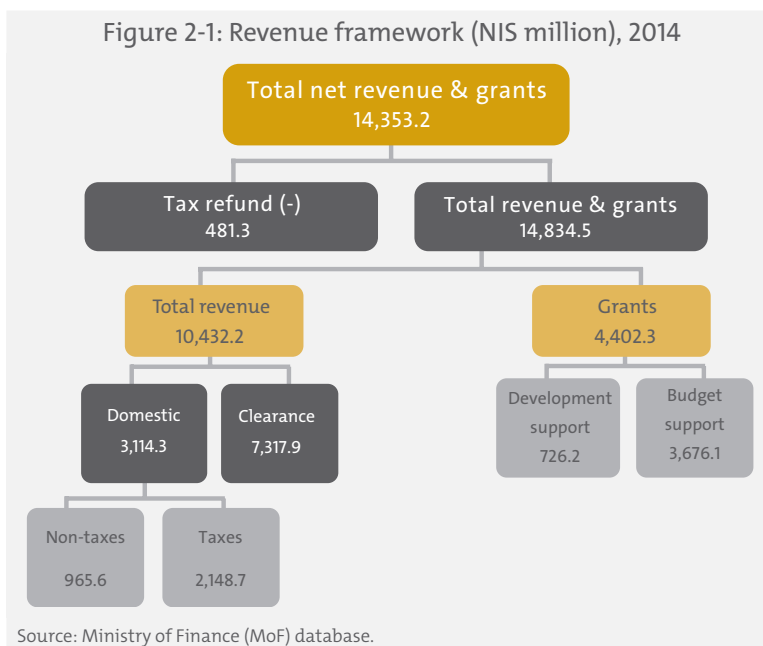
Total revenues are comprised of clearance revenues and domestic revenues (tax and non-tax). For 2014, clearance revenues' share of total revenues was around 70.1 percent, as opposed to a domestic revenues' share of around 29.9 percent (20.6 percent for taxes and 9.3 percent for non-taxes). Total revenues jumped by about 13.8 percent in comparison with the previous year to a total of NIS 10,432.2 million.

With this hike, total revenues exceeded their budget target of 105.7 percent for 2014, compared to 94.9 percent for the previous year. The analysis of total revenue components indicates that the major driver behind this rise is an increase in clearance revenues by about 20.2 percent, alongside an increase in non-tax revenues by about 4.8 percent, and a decrease in tax revenues by about 0.4 percent compared to 2013. As such, the tax burden (including clearance revenues) as a percent of GDP reached 22.9 percent, compared to 20.4 percent in 2013^[22].

Clearance revenues climbed significantly during the year by around 20.2 percent to reach NIS 7,317.9 million, realizing about 111.8 percent of the budget target, compared to about 95.6 percent for 2013. This increase can be attributed to two factors: first, the continuous improvement in the tax collection system and, second, the increase in tax proceeds from Gaza. These proceeds have risen following a contraction in the activity of the shadow economy (owing to the closure of tunnels and the construction of a buffer zone). Subsequently, Gazan merchants have resorted to direct import from Israel which has contributed a Clearance revenues were mainly comprised of Value Added Tax, customs duties and petroleum excise taxes,

contributing by 31.1 percent, 34.4 percent and 33.8 percent, respectively, while the income and purchase tax contributed a mere 0.7 percent to the total sum of clearance revenues in 2014^[23].

Clearance revenues salvaged the government from failure to fulfil its obligations and pay off outstanding dues given its increased contribution to total expenditures, which amounted to 56.9 percent in 2014, compared to 49.3 percent in 2013.



[21] Total net revenues and grants= total revenues and grants – tax refunds.

[22] The tax burden represents the volume of all the different kinds of taxes which governments levy. It is usually higher in industrialized and developed countries than in developing countries.

[23] Stated contributions of taxes calculated on commitment and not cash basis, as relevant cash-based details for the latter were not available.

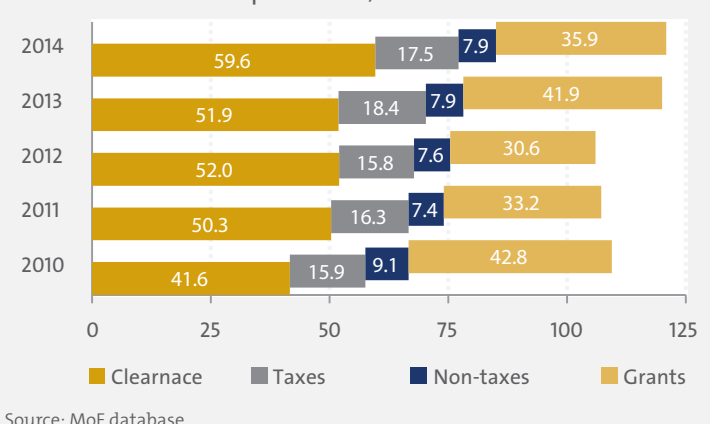


Clearance revenues have also contributed to current expenditures and net lending by about 59.6 percent, compared to 51.9 percent in 2013. Additionally, clearance revenues covered 108.1 percent of wages and salaries expenditures, compared to 93.0 percent in 2013. The regular influx of clearance revenues has been reflected in the government's ability to meet its obligations, especially in wages and salaries, as evident in its advance payment of July and September salaries from the clearance revenues transferred by Israel; a clear indication of the significance of this item of revenues with respect to volume and regular flow.

Domestic revenues (tax and non-tax) increased slightly during 2014, by about 1.2 percent, to reach NIS 3,114.3 million, accounting for 93.6 percent of the budgeted target. Despite this increase, the contribution of this item to total expenditures fell to 24.2 percent compared to 24.9 percent in the previous year. Likewise, this item's contribution to current expenditures and net lending fell to 25.4 percent, from 26.2 percent in 2013, with the share of tax revenues dropping from 18.4 percent in 2013 to 17.5 percent in 2014, and non-tax revenues' share stabilizing at around 7.9 percent for the second consecutive year.

The growth in domestic revenues is attributed in particular to non-tax revenues, given also that tax revenues have somewhat declined in 2014. Non-tax revenues have grown by around 4.8 percent compared to 2013, to reach USD 965.6 million, which accounted for 96.9 percent of the budgeted target. The pick-up in non-tax revenues was mainly due to improvement in the proceeds from fees collected by the Palestine Land Authority. Thus, non-tax revenues' share of domestic revenues expanded to about 31.0 percent, compared to 29.9 percent in 2013.

Figure 2-2: Total revenue and grants as a percent of current expenditure, 2010-2014



Conversely, tax revenues shrank by around 0.4 percent, to reach NIS 2,148.7 million, the equivalent of 92.3 percent of the budgeted target. As such, the tax revenues' share of domestic revenues receded 1 percentage point to a total of 69 percent. The drop is attributed to plunging revenues of tobacco excise taxes, as well as income tax, property tax and beverage excise tax. Tobacco excises sank by about 38.0 percent, to reach NIS 234.4 million. Furthermore, income tax revenues fell during the same period by around 4.2 percent, to reach NIS 684.5 million, while revenues from property tax and beverage excise taxes in 2014 fell to NIS 8.9 million and NIS 3.3 million, from last year's NIS 13.8 million and NIS 5.7 million, respectively. In contrast, VAT revenues soared by about 11.5 percent, compared to 2013, to reach NIS 950.0 million, whereas customs revenue grew by 38.1 percent to reach NIS 266.7 million over the same period.

Foreign aid and grants

During 2014, foreign grants fell by about 10.4 percent to reach NIS 4,402.3 million. It covered 35.9 percent of current expenditures and net lending and about 34.2 of total expenditures. Foreign grants' share of total revenues and grants was about 29.7 percent, compared to about 34.9 percent in 2013, and thus still constitute a major contributor to budget support, and to a lesser extent, to fund development projects. In 2014, the major part of these grants, equivalent to 83.5 percent or NIS 3,676.1 million, was used for budget support, while the smaller part, equivalent to 16.5 percent, was devoted for development expenditures, totalling NIS 726.2 million.

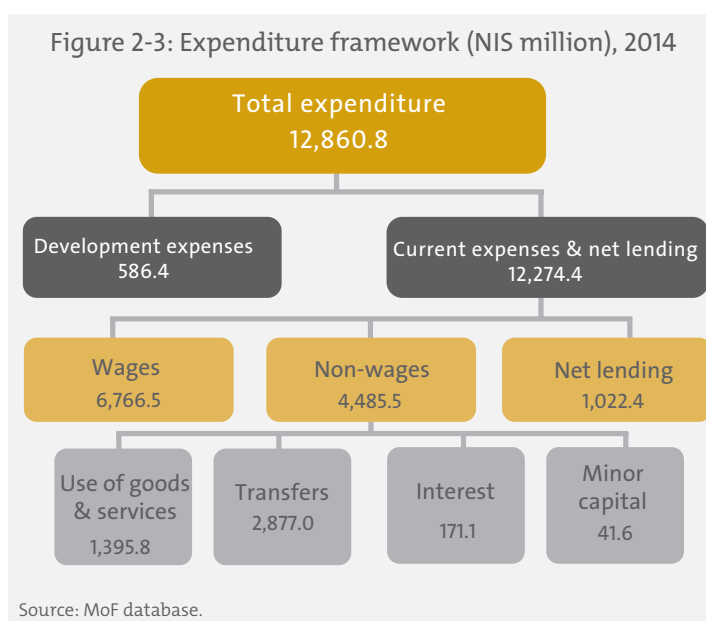
Despite its persistently-professed intention to reduce its reliance on grants, the government continued to depend largely on grants to finance the government’s fiscal deficit. Grants even helped turn deficit into surplus, as was the case in 2013 and 2014. For 2014, donor funds helped transform a NIS 2,909.9 million total deficit excluding grants, equivalent to -6.4 percent of GDP, into a surplus of NIS 1,492.4 million, equivalent to 3.2 percent of GDP^[24].

Total expenditure

During 2014, actual total expenditure rose by about 4.2 percent to reach NIS 12,860.8 million, as a result of the marked increase in net lending (by about 34.5 percent), wages and salaries expense (by about 3.3 percent) and non-wage expenses (by about 1.3 percent). Total expenditures (on commitment basis) rose during the year by 10.6 percent to reach around NIS 15,493.3 million^[25]. The difference between cash-based and commitment-based expenditure signals the accumulation of payment arrears for the current year approximately amounting to NIS 2,632.5 million. Such arrears are accounted for on commitment basis in total expenditures; however, they do not appear under cash-based expenditures.

Current expenditure (wages and salaries, non-wage expenditures, net lending) and development expenditure received 95.4 percent and 4.6 percent of actual total expenditure respectively. Wages and salaries’ share of actual total expenditures was about 52.6 percent; non-wage expenditures’ amounted to about 34.9 percent, while for net lending, it reached about 7.9 percent. Actual total expenditures represented about 84.7 percent of targeted total expenditure as per the 2014 budget plan. Outstanding expenditures (on commitment basis) accounted for about 102.1 percent of the budgeted amount. Actual expenditure (as a percent of GDP) was about 28.2 percent, compared to 27.4 percent in 2013.

Figure 2-3: Expenditure framework (NIS million), 2014



Current expenditures and net lending

Current expenditures and net lending expanded during 2014 by about 4.6 percent, to reach around NIS 12,274.4 million, which represents 88.2 percent of the budgeted amount. This rise comes on the grounds of the growth of all current expenditure and net lending items (wages and salaries, non-wage expenses and net lending).

Actual expenditure on wages and salaries increased by about 3.3 percent, compared to 2013, to record NIS 6,766.5 million, equivalent to 93.1 percent of the budgeted target. It constituted 52.6 percent of actual total expenditures and 55.1 percent of current expenditures and net lending, compared to 53.1 percent and 55.8 percent, respectively, in 2013.

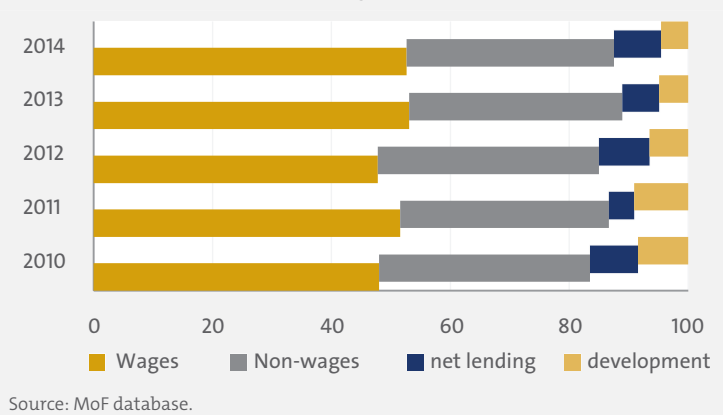
[24] It must be noted that, in line with IMF recommendations, the Ministry of Finance introduced amendments to the 2014 government financial statements, particularly to the expenditure items of “use of goods and services” and “development expenditures”. These amendments devalued both items by a total of about NIS 1,003.8 million, as both were considered outstanding arrears from previous years. When this sum was deducted from the realized surplus (NIS 1,492.4 million), the actual surplus after grants was equal to NIS 488.6 million.

[25] Actual amounts represent the amounts that have been, in effect, paid by the government, whereas amounts due (by commitment) are amounts to be paid within a time-period, usually a year, which the government may not pay in full. Targeted amounts are amounts allocated when the budget is put in place.



Analysis of the wages and salaries according to the government organization reveals that the security and public order sector (in particular the Ministry of Interior and the Palestinian National Security Forces) acquired the largest portion of around 43.8 percent, while the Ministry of Education and Higher Education acquired around 27.7 percent, and the Ministry of Health around 9.4 percent. Public administration's share (Office of the President, Palestinian Liberation Organisation, General Personnel Council (GPC), Ministry of Local Government, Ministry of Finance and embassies) was around 8.4 percent of total wages and salaries. The Ministry of National Economy acquired around 2.6 percent, as opposed to 3.2 percent for social services and religious and cultural services, and around 1.7 percent for transport and other services^[26].

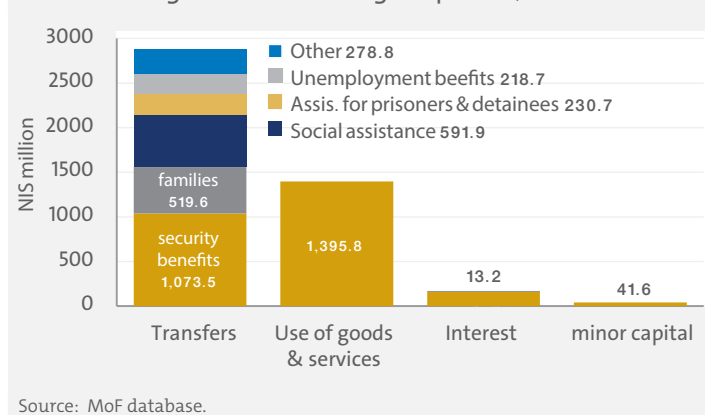
Figure 2-4: Spending as a percent of total expenditure, 2010-2014



Non-wage expenses rose by about 1.3 percent to reach NIS 4,485.5 million, which represents 74.1 percent of the budgeted target. This item accounted for 34.9 percent of total expenditure and about 36.5 percent of current expenditure and net lending compared to 35.9 percent and 37.7 percent in 2013, respectively. Non-wage expenses increased owing mainly to the rise in transfers, which increased by about 8.4 percent, to reach NIS 2,877.2 million, constituting about 64.1 percent of non-wage expenses. Furthermore, minor capital expenses, which normally fall under current expenditure, expanded by about NIS 23.3 million, to reach NIS 41.6 million, in contrast to expenses of use of goods and services^[27] which dropped by about 7.4 percent, and amounted to NIS 1,395.8 million. Likewise, interest expenses declined by about 30.6 percent to about NIS 171.1 million during 2014.

Transfers expenditure distributed between: social security transfers (civilian and military pensions), equal to NIS 1,037.5 million and equivalent to 36.1 percent of all transfers; social assistance of around NIS 591.9 million, equivalent to 20.6 percent; assistance to vulnerable families of around NIS 519.6 million, equivalent to 18.1 percent; assistance for prisoners and detainees in Israeli prisons for around NIS 230.7 million, equivalent to 8.0 percent and unemployment benefits of NIS 218.7 million, equivalent to 7.6 percent. Transfers as payments to universities, NGOs and civil society, educational subsidies and scholarships, compensation for damages and other kinds of expenses together received NIS 278.8 million, equivalent to 9.6 percent of transfers.

Figure 2-5: Non-wage expenses, 2014



Transfers expenditure distributed between: social security transfers (civilian and military pensions), equal to NIS 1,037.5 million and equivalent to 36.1 percent of all transfers; social assistance of around NIS 591.9 million, equivalent to 20.6 percent; assistance to vulnerable families of around NIS 519.6 million, equivalent to 18.1 percent; assistance for prisoners and detainees in Israeli prisons for around NIS 230.7 million, equivalent to 8.0 percent and unemployment benefits of NIS 218.7 million, equivalent to 7.6 percent. Transfers as payments to universities, NGOs and civil society, educational subsidies and scholarships, compensation for damages and other kinds of expenses together received NIS 278.8 million, equivalent to 9.6 percent of transfers.

[26] The shares of the government organization within the wages and salaries item were calculated on commitment and not cash-basis, as relevant cash-based details for the latter were not available.

[27] It must be noted that, in line with IMF recommendations, the Ministry of Finance introduced amendments to the 2014 expenditure items of "use of goods and services" and "development expenditures". The sums of NIS 478.9 was deducted from "use of goods and services" and about NIS 524.9 million from development expenditures and recorded under the item "arrears of use of goods and services and development expenses", which consequently cut down expenses of those two items.

Net lending for 2014 jumped by around 34.5 percent to reach NIS 1,022.4 million, constituting about 170.3 percent, or almost twice the budgeted target. Net lending expenditures accounted for about 7.9 percent of total expenditures, and about 8.3 percent of current expenditures, compared to about 6.2 percent and 6.5 percent in 2013, respectively.

Development expenditure

Development expenditures during 2014 fell by about 3.5 percent to reach NIS 586.4 million^[28], equivalent to about 46.5 percent of the budgeted target. The sum of donor funds received by the Palestinian government to finance development projects amounted to about NIS 726.2 million, of which NIS 586.4 million were used to fully cover development expenses, while the remaining sum equivalent to NIS 139.8 million were used to pay off arrears of development expenses of previous years. It is worth mentioning that the actual value of sums disbursed for development as a percent of GDP has never exceeded 2.8 percent, as for example in 2011, and this figure did not surpass 1.3 percent in 2014. This is an indication of the diminishing role played by expenditures on development in achieving sustainable economic development and creating new job opportunities and, consequently, expanding public revenues over the medium and long terms.

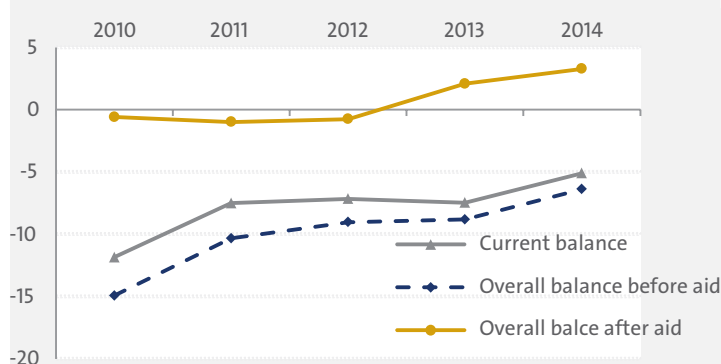
Fiscal balance (Budget)

Current deficit for 2014 receded by 31.1 percent to reach NIS 2,323.5 million, primarily due to the upturn in clearance revenue and non-tax revenues. The drop is also partly due to the amendments made by the Ministry of Finance with respect to the expenditure both items of “use of goods and services” and development, which helped push the deficit down. Based on IMF recommendations, the value of the aforementioned expenditures was cut by about NIS 478.9 million, which contributed to the reduction of current expenditures and consequently lowered current deficit.

Current balance deficit (as a percent of GDP) declined to score an approximate 5.1 percent, compared to about 7.5 percent in 2013. With this drop, the actual current account deficit to the budget target became about 50.5 percent in 2014 compared to about 86.8 percent for the previous year. Nonetheless, this tremendous contraction does not indicate an effective control of current spending, but is rather a consequence of the non-payment of a large part of government outstanding dues, owed particularly to the private sector and as wages and salaries. Over 2014, government debt to the private sector amounted to around NIS 1,711.9 million. Furthermore, the government delayed payment of around NIS 569.7 million of outstanding dues in wages and salaries, in addition to the delay of the payment of about NIS 350.9 million of development expenses and about NIS 146.7 million of tax refunds.

Overall fiscal balance (including development expenditure) before grants recorded a deficit of NIS 2,909.9 million, dropping by about 26.9 percent compared to 2013. As such, overall deficit before grants constituted about 49.6 percent of the budgeted target, compared to about 76.9 percent in 2013. The underlying cause of decline in this item is similar to the aforementioned cause behind the drop in current deficit. Overall deficit (as a percent

Figure 2-6: Budget balance as a percent of GDP, 2010-2014



Source: MoF database.

[28] Check footnote 27.

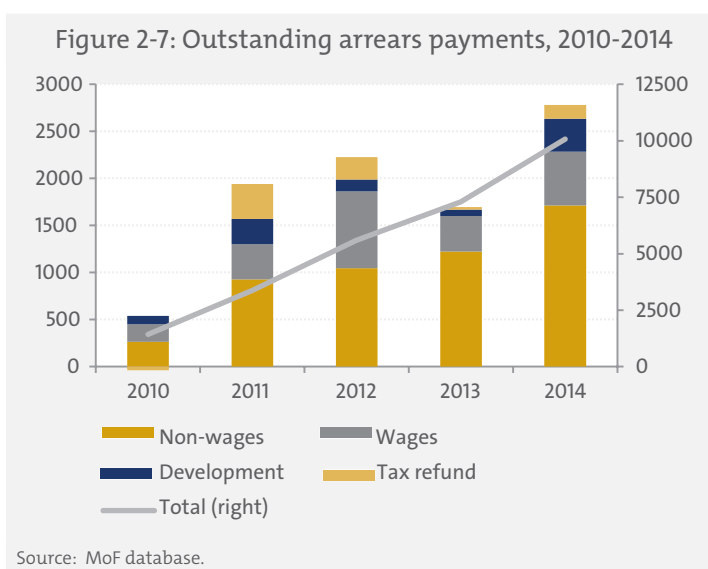


of GDP) was around 6.4 percent, compared to 8.8 percent in 2013. Taking into account the amendments introduced by the Ministry of Finance to the 2014 public financial statements based on the IMF recommendations, in particular to the expenditure items of “use of goods and services” and development expenses (Check footnote 24 above), overall fiscal balance after grants achieved a surplus of NIS 1,492.4 million, compared to a surplus of NIS 934.0 million in 2013.

Government arrears

Despite the appreciable rise in total revenues during 2014, compared with the previous year, the government failed to fully meet its obligations and fell behind on payment of a considerable part of these commitments. Government arrears swelled during 2014 by about 64.1 percent, to reach NIS 2,779.4 million, pushing up arrears accrued over the past years until the end of 2014 to about NIS 10,073.8 million. In 2014 alone, government arrears constituted about 18.7 percent of net total revenues and about 21.6 percent of net total expenditures, as well as about 6.1 percent of GDP.

Data on arrears show that the greater part is owed to the private sector (non-wage arrears), amounting to NIS 1,711.9 million, making the equivalent of 61.6 percent of government arrears for 2014. Arrears consisted of use of goods and services arrears (operating expenses) totaling about NIS 937.0 million, or the equivalent of 54.7 percent; delayed contributions to pension and welfare funds of about NIS 679.6 million, or the equivalent of 39.7 percent; transfers arrears, including transfers for compensation for damages, emergency expenses, and NGOs and local government, and amounted to about NIS 48.6 million, or the equivalent of 2.8 percent. Minor capital arrears amounted to about NIS 19.3 million, or the equivalent of 1.1 percent, whereas domestic and external debt interest arrears amounted to about NIS 25.3 million and NIS 2.1 million, respectively.



Wages and salaries arrears in 2014 rose by 20.5 percent to reach NIS 569.8. Likewise, development expenditure arrears and tax refund arrears increased by about 12.6 percent and 5.3 percent compared to 2013, to reach NIS 351.2 million and NIS 146.5 million, respectively.

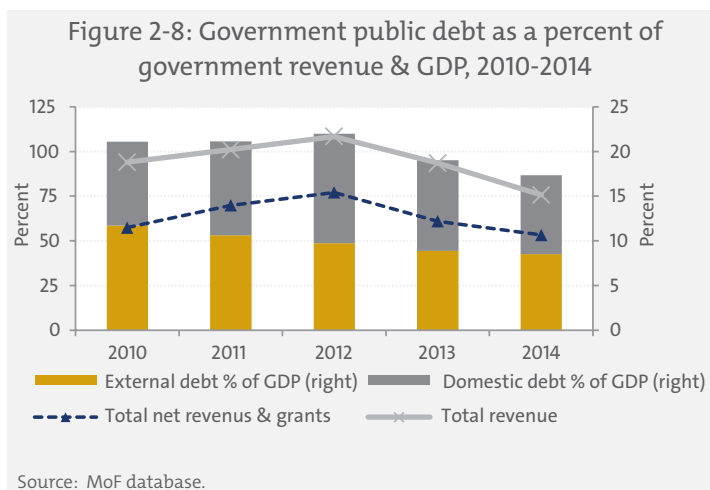
Government public debt

The overall government public debt in 2014, USD-denominated, shrank by around 6.7 percent to reach USD 2,216.8 million, representing 17.3 percent of GDP^[29]. This drop is not an actual drop in commitments, as it is mostly the result of the USD appreciating as-high-as 12.1 percent against the shekel (the USD rose against the NIS from NIS 3.48 end-2013 to NIS 3.90 end-2014). An outcome of receding public debt is a corresponding drop in the Palestinian citizen’s share of the government public debt by about 9.4 percent to reach USD 615.2. The public debt can be broken down into government domestic debt, making 50.9 percent, and government external debt, making 49.1 percent.

[29] It is worth mentioning that public debt during 2014 denominated in shekel rose by about 4.6 percent to reach NIS 8,646.1 million. The disparity in debt growth rates reflects the immense impact of exchange rates.

Public debt as a percent of GDP in Palestine is considered low when compared to other neighbouring countries. In Jordan, public debt reached 80.3 percent of GDP at end 2014, according to the Public Debt Department in the Jordanian Ministry of Finance. Israel's public debt to GDP ratio recorded 67.4 percent for the same period^[30].

Despite the low ratio of government public debt to GDP in Palestine, this ratio is not an accurate reflection of reality, nor does it represent the government payment ability or its borrowing capacity. An analysis of such ratios has to take several precautions in consideration. Meager and highly scarce financial resources represent a major obstacle to the government's ability to pay its dues and meet its obligations, whether towards the private sector, the banking sector or even its own employees. The presence of a multi-currency system, instead of a national currency, places the government at risks associated with exchange rate fluctuations of the currency by which the debt is issued. Moreover, government public debt is mostly directed to consumption rather than investment, and hence financial returns on such expenditures remains low and short-term, particularly that government loans go mainly to pay public wages and salaries, and to defray other expenditures like transfers and "use of goods and services" expenses and net lending. In essence, this is an indication of the fragility of the fiscal policy adopted by the government, which remains unsustainable on the long term, particularly in view of the shortfall in foreign aid.



Moreover, government public debt is mostly directed to consumption rather than investment, and hence financial returns on such expenditures remains low and short-term, particularly that government loans go mainly to pay public wages and salaries, and to defray other expenditures like transfers and "use of goods and services" expenses and net lending. In essence, this is an indication of the fragility of the fiscal policy adopted by the government, which remains unsustainable on the long term, particularly in view of the shortfall in foreign aid.

USD-denominated domestic public debt fell by end of 2014 by around 11.0 percent, to reach USD 1,128.0 million. However, this rate plummeted to -0.2 percent when denominated in NIS to reach around NIS 4,399.5 million. The disparity in debt growth rate illustrated the impact of the USD/NIS exchange rate on the value of domestic public debt, especially that the larger part of that debt was issued in NIS. As the exchange rate tumbled (12.1 percent drop), the value of domestic public debt, USD-denominated, also fell back. Domestic public debt as percent of GDP was about 8.8 percent, compared with 10.2 percent in 2013. Long-term loans comprise about 41.3 percent, or the equivalent of USD 465.3 million of domestic public debt, while short-term loans make for the remaining 58.7 percent, the equivalent of USD 662.7 million.

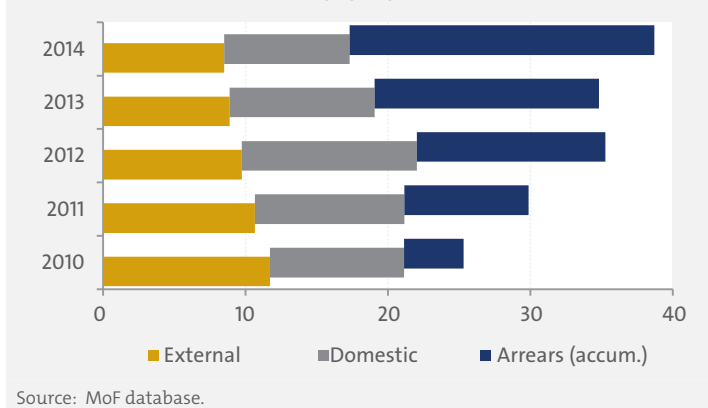
Banks have contributed around 98.8 percent of overall government domestic debt in 2014, which comes to around USD 1,114.6 million according to Ministry of Finance data, as opposed to 1.2 percent, which were funded by other public institutions like the Palestinian Pension Authority and the Zakat Committee. Bank loans comprised about 72.8 percent of domestic public debt (of which 16.2 percent were loans to the Palestinian Petroleum Commission guaranteed by the Ministry of Finance), and 27.2 percent as overdraft facilities. PMA data show that the NIS was the dominant currency of domestic debt, comprising 78.3 percent, versus 10.1 percent for the USD and around 11.6 percent for the JD. The predominance of the NIS as a lending currency is attributed to the fact that the bulk of government expenditures, particularly current spending, are usually denominated in the NIS.

[30] <http://www.tradingeconomics.com/israel/government-debt-to-gdp>



External public debt also declined end of 2014 by about 1.8 percent, to reach around USD 1,088.8 million, amounting to about 8.5 percent of GDP. Arab institutions contributed around 57.0 percent to the external public debt, equivalent to USD 620.9 million distributed between al-Aqsa Fund, with around USD 517.4 million; the Arab Fund for Economic and Social Development, with USD 56.9 million and the Islamic Development Bank, with USD 46.6 million. International and regional organization contributed about 31.9 percent or the equivalent of USD 347.7 million, distributed between the World Bank, with USD 276.7 million; the European Investment Bank, with USD 48.1 million; OPEC with around USD 20.2 million; and the International Fund for Agricultural Development, with USD 2.7 million. Bilateral loans comprised about 11.0 percent of external debt, amounting to USD 120.2 million, and were distributed between Spain with USD 84.4 million, Italy with about USD 30.5 million and China with about USD 5.3 million.

Figure 2-9: Government public debt as a percent of GDP, 2010-2014



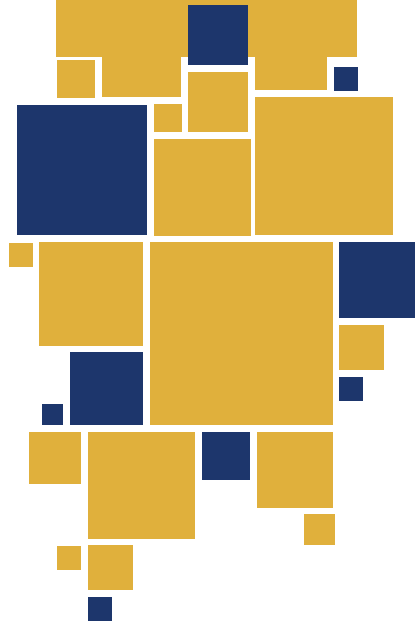
Debt indicators for 2014 reveal that government public debt constituted around 53.3 percent of total net revenues and grants and about 75.5 percent of clearance and domestic revenues, compared to 60.9 percent and 93.5 percent in 2013, respectively. This is clearly indicative of the government's fragile financial position and its heavy dependence on foreign grants, which, despite being irregular, have cut debt-to-revenues ratio by about 22.4 percentage points (from 75.7 percent to 53.3 percent). After the addition of accrued arrears, public debt-to-GDP ratio levels were pushed up close to the maximum permissible level set forth in the Palestinian Public Debt Law^[31]. Accumulated arrears made about 21.4 percent of GDP, raising the debt-to-GDP ratio to around 38.7 percent in 2014, compared to 34.3 percent in 2013. These ratios reflect the magnitude of financial stress facing the government, which ultimately gives rise to accumulation of arrears and outstanding obligations towards the private sector, importers and others.

Public debt service declined in 2014 by around 53.5 percent to reach USD 168.9 million, of which principal payments constituted USD 120.2 million, while interest reached about USD 48.7 million. The major part of debt service was used to pay off domestic debt, which is an indication of the government pursuit to reduce dependence on banks as a major source of funding. Debt service on domestic debt constituted USD 113.8 million as opposed to USD 6.4 million spent to service external debt. Interest on domestic debt amounted to about 92.4 percent of overall paid interest as opposed to 7.6 percent used to service external debt. Public debt service accounted for about 5.8 percent of domestic and clearance revenues in 2014 compared to 14.3 percent in 2013, which points to the depletion of a large portion of such revenues to finance public debt service. Alone, public debt service (as percent of GDP) comprised around 1.3 percent, compared to 2.9 percent in 2013.

[31] Article (30) of the Palestinian Public Debt Law states that the public debt outstanding balance shall not exceed at any time 40 percent of GDP at current prices for the last year for which data is available.

Chapter Three

Foreign Sector Developments



Overview

Taking into account the various benefits it offers, including a wide range of prices and production components, on one hand, and a variety of alternative investment options and satisfied domestic consumption requirements, on the other, the foreign sector is considered one of the main sectors of the economy which contributes to the generation of job opportunities and to the process of economic growth and development. In addition, this sector has great impact on a country's current account in the Balance of Payments (BoP), and on official foreign reserves.

In Palestine, as in many other countries, the foreign sector represents the link between the national economy and the outside world. Yet, at the same time, it represents the channel through which exogenous risks and shocks are transmitted to that economy, primarily via financial flows and through trade (trade transactions, workers' remittances and direct and indirect investment). The outcome of these flows is a result of the degree of interconnection and linkage with the outside world, as well as the country's ability to impact, attract and direct such flows to best serve its various needs.

Yet, it is implausible, after all, for the Palestinian economy to influence such flows. The constraints imposed by the Israeli occupation limiting the freedom of movement and access, restricting control of crossings and borders and implementing a systemic economic subjugation of the Palestinian economy to the Israeli economy in the absence of a clearly-defined trade policy, have impeded making the Palestinian economy an attractive destination and a safe haven for such flows. More than that, these constraints have made the foreign sector the weaker link and a source of exogenous risk and shock and curtailed its ability to cope with and absorb such risks and shocks and their ramifications. Indeed, they were the main cause behind the chronic structural deficit of the current account of the BoP.

During 2014, the status of the current account of the BoP witnessed significant changes, on the grounds of the narrowing of trade deficit, especially that foreign trade (exports and imports) recorded an approximate 79 percent of GDP; exports share of GDP being 18 percent and imports share of GDP being 61 percent; which is a clear indication of an increasingly consumer-driven and import-reliant economy. While data showed proliferating sources for trade-deficit financing (transferred income from abroad and current transfers), it also revealed signs of dwindling financing of the current account deficit, influenced by the decline in capital transfers and in all forms of investment as a result of the unstable political and economic conditions. This chapter brings to light the most significant developments during 2014 affecting the Palestinian foreign trade and BoP.

Balance of payments (BoP)

Central banks have developed an increasing interest in economic analysis of the BoP, which has become a key gauge of a country's economic performance vis-a-vis the rest of the world, a measure of official foreign reserves and an indicator of a country's competitiveness in comparison to other countries. The BoP reveals the impact of external forces and the economy's capability to accommodate and adapt to global economy changes, as analysis thereof shows the size and structure of a country's imports, exports and various other items like investment, degree of utilization



and price and cost levels. It thus provides economic policy makers with an effective planning and guidance tool to forge national foreign economic relations. It additionally serves as a tool to measure the country's external position, given that cross-border financial flows which link a country to the outside world have developed as a consequence of international economic integration, and subsequently capture the country's external position.

Current account

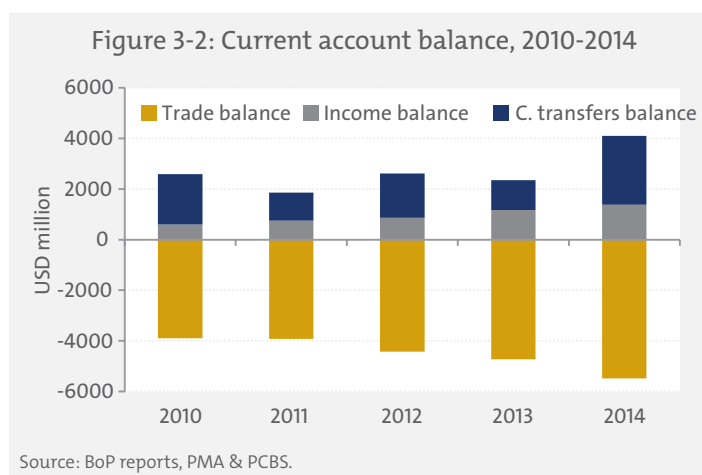
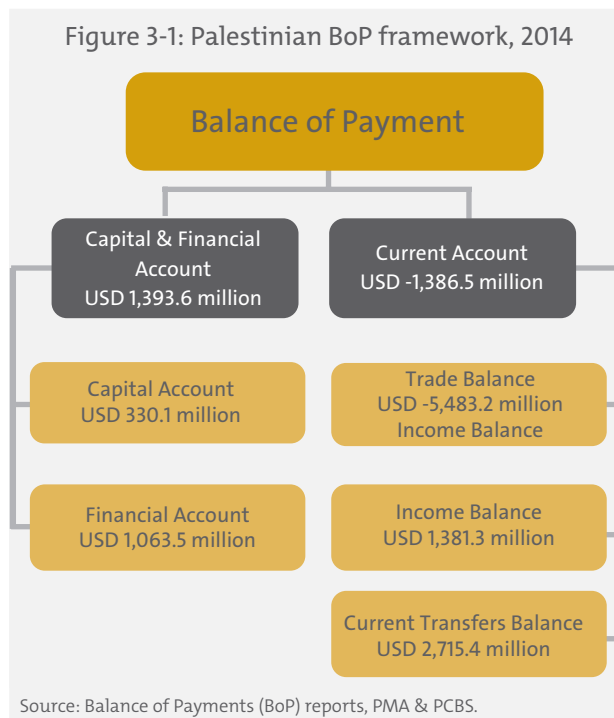
The current account balance (goods and services, income, and current transfers) recorded a deficit of USD 1,386.5 million, which marked an improvement by 41.8 percent over 2013, constituting 10.9 percent of GDP, compared to 19.0 percent in 2013.

To analyze this deficit, it is mandatory to examine the main underlying causes, the deficit's viability given the current conditions and, additionally, explore possible remedies, whether by adopting certain policies or resorting to reform programs. Moreover, the elucidation of the current account mechanisms and financing structures as well as their durability is imperative. Following is a review of the main components of the current account:

Trade balance

Palestinian trade balance recorded a deficit of USD 5,483.2 million during 2014 equivalent to 43.0 percent of GDP^[32], compared to 37.9 percent in 2013. Chronic structural deficit of the trade balance is considered the main cause of the current account deficit.

The trade deficit is attributable to the large and chronic increase in deficit of the balance of trade in goods, which in 2014 rose by 15.2 percent to amount to USD 5,394.3 million, compared to USD 4,682.7 million in 2013, representing 42.3 percent of GDP compared to 37.5 percent in 2013. The aforementioned deficit increase was the result of an upturn in imported goods by 14.4 percent and by 11.0 percent in exported goods compared to 2013 figures. Despite their high growth rate, the low value of exported goods compared to imported goods extremely restricted the effect of the increase effect on the trade balance. Additionally, the rate of growth of imports exceeded that of exports.



[32] Deficit figures that appear in this chapter differ from those in Part 2 of Chapter 1, as the latter are based on real prices, whereas this chapter's figures are based on current prices.



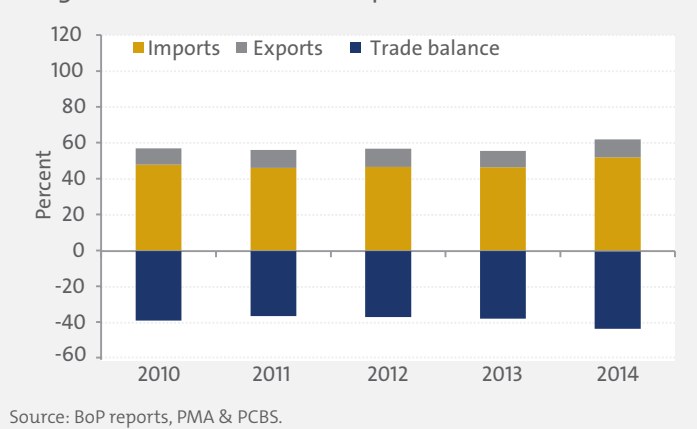
Imported goods constituted around 52.0 percent of GDP, compared to 46.6 percent in 2013, whereas exported goods constituted around 9.9 percent of GDP, compared to 9.0 percent in 2013. The export-import coverage ratio fell slightly to 18.9 percent compared to 19.4 percent in 2013.

Trade balance analysis is of prime importance in current account analysis, as it constitutes the main component and determinant of the current account deficit. Examination of the trade deficit unveils the economy's vulnerabilities including when production capacity falls short of satisfying

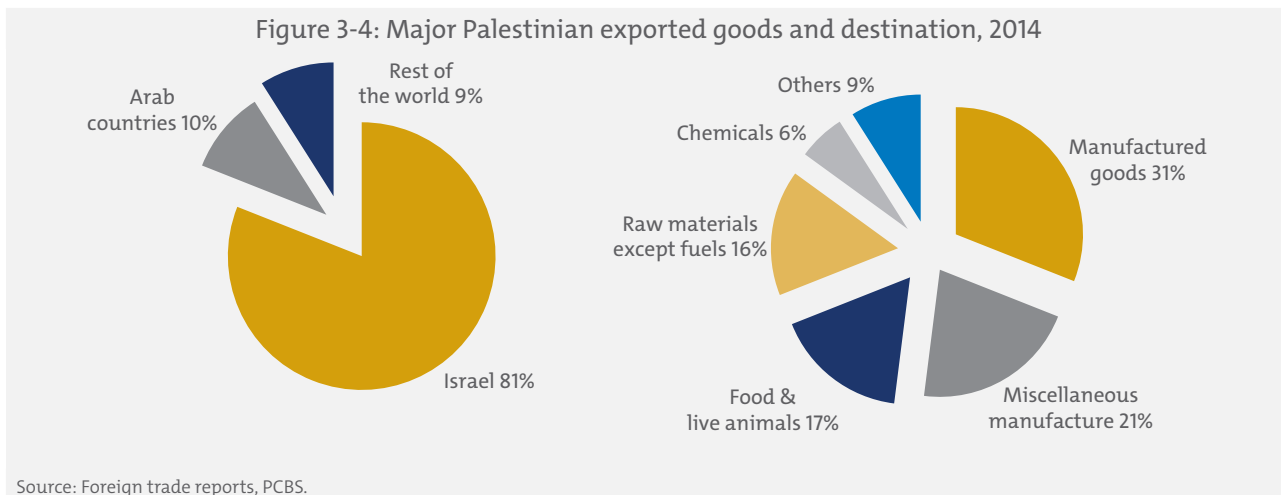
a demanding economy, causing an increased reliance on imports, in order to meet needs. In consequence, the value of imported goods and services rises compared to exports, which is a sign of an economy that is not adequately self-reliant. A persistent deficit is a sign of possible low productivity and swelling unemployment rates, which adversely affect the economy. Furthermore, the type of exported goods reveals the nature of the production structure. Food imports indicate an inability to ensure food security; machinery and equipment imports show incompetence of industry; and extensive energy imports indicate inability to fulfill domestic energy needs (all applicable to the Palestinian economy). More importantly, a chronic current account deficit drains foreign reserves, necessitates foreign borrowing and hinders workforce employment as a result of poor export ability which ultimately hampers capacity-building of local resources to meet domestic needs. This can eventually cause potentially serious economic and social crises. Chronic trade deficit reflects weakness of the industrial sector and underlines inadequate relevant policies. As such, correction of the trade imbalance would require boosting the competitive features of the Palestinian product through greater focus on know-how, technology and research and development. On its own, ensuring the availability of production inputs does not warrant the establishment of a robust industrial base that can provide locally-manufactured products to replace foreign products (import substitution policy). In addition to competition from foreign like products, given the absence of protective policies that favor local products against imported ones, the main causes behind the escalating trade deficit are the poor quality of local products and their inability to meet local needs, thereby precluding a successful substitution by local products.

Structure and trend analysis of Palestinian trade in goods during 2014 revealed that the basic manufactures (wood, paper and metal products, textiles and others) accounted for the largest share of exported goods constituting around 31.0 percent of exports, followed by miscellaneous manufactured goods (furniture, clothes, footwear and others) with 21.0 percent, food and livestock products with 17.0 percent, raw materials (except fuel)^[33] with 16.0 percent and chemicals with 6.0 of total exports. On the other hand, analysis showed that Israel was the main destination of Palestinian export as a result of the direct linkage between the Palestinian and Israeli markets. Consequently, about 81.0 percent of total exports were directed to the Israeli market as opposed to 10.0 percent to Arab countries (intra-regional trade) and only 9.0 percent to the rest of the world.

Figure 3-3: Trade deficit as a percent of GDP, 2010-2014



[33] Stone and crude stone are among the top 10 exported goods constituting around 14.0 percent of exports, while medicinal herbs constitute around 6 percent and nylon bags and scrap around 9.0 percent.



On the other hand, mineral fuels (energy) held the largest share of imported goods accounting for 31.2 percent of imports^[34], followed by food and livestock with 20.3 percent, basic manufactured goods with 17.3 percent, machinery and transport equipment with 12.2 percent and, finally, chemicals with 8.7 percent.



In this context, it is worth noting that imports from Israel accounted for 71.0 percent of total imported goods, from the European Union around 11.0 percent, Asia 5.0 percent, America 5.0 percent, while the Arab World (intra-regional trade) accounted for a mere 4.0 percent of total imports. These figures provide proof of the dependence of the Palestinian economy on its Israeli counterpart and of the direct impact of the Israeli economic and commercial policies on Palestinian economic performance, given that Israel was the main exporter of goods consumed in the Palestinian market and main controller of flow of goods and commodities to and from Palestine.

The services trade deficit was the second most significant determinant of the current account deficit, recording during 2014 a deficit of USD 88.9 million. Owing to a rise in imports of services by 14.4 percent to reach USD 1,129.4 million as opposed to a rise in exports of services by 10.9 percent to reach USD 1,040.5 million, the services trade deficit climbed 79.6 percent over a year earlier. Travel services accounted for the largest share of exports and imports of this account, amounting to 70.0 percent and 60.0 percent of total exports and imports of services, respectively.

[34] Mineral fuels, benzene and [liquefied] gas are among the top 10 imported goods accounting for 21.0 percent of overall imports, whereas electricity accounts for 10.0 percent of imports.



In general, the massive trade deficit (goods and services) unveiled not only the failure of the Paris Protocol and subsequent trade agreements and protocols (particularly with European Union and Arab countries) to rectify Palestine's foreign trade position, but also their collective responsibility for establishing and even aggravating the pre-existing abysmal condition. This was particularly true for the Israeli side, which exploited the clauses of the Paris Protocol and rendered them void by preventing suitable amendments or improvements for the development of the Palestinian economy. As a result, the economy's ability to better develop foreign trade was effectively impaired and control over border crossings and natural resources undermined. Through various Israeli measures, the Palestinian economy was increasingly forced into dependence on Israel, which exacerbated the already chronic trade deficit with Israel, in specific, and with the rest of the world, in general. Not only did the Paris Protocol prevent the expansion and diversification of the production base, but it also precipitated the deterioration in competitiveness of the Palestinian product as a result of disproportionate developments in factors of production and adopted technologies. Therefore, within the framework of any future agreement with the Israeli side, it is imperative that Palestinians look for alternative options to serve their best interests and, pay special attention to the significance of the freedom of movement of goods and control over international trade crossings. A clearly formulated trade policy should be adopted to mitigate the impact of the trade deficit on the current account and the balance of payments at large.

Box 3: Factors affecting the Palestinian external sector

The foreign sector of the Palestinian economy (sum of exports and imports) constitutes about 79 percent of GDP, which, on one hand, indicates the significance of this sector and, on the other, reveals a great impact of exogenous factors on the Palestinian economy, owing to the peculiar Palestinian-economy position subject to the Israeli occupation. Analysis of the foreign sector receives considerable attention in order to grasp the aspects of economic vulnerability. In reality, the Palestinian economy suffers from poor export performance due to a number of reasons; most importantly in view of the Israeli-imposed economic restrictions constraining Palestinian trade, on one hand, and economic policies that aim to boost export competitiveness in foreign markets being absent, on the other. Therefore, in formulating export promotion policies, the study of factors affecting export performance on the short and long terms is a top priority.

In 2014, the PMA published a paper entitled "the Effect of Exogenous Factors on Foreign Sector Performance in Palestine". The paper aimed at identification and analysis of short-term and long-term factors affecting the export sector in Palestine, using a number of endogenous and exogenous variables. Endogenous variables consisted of GDP and aggregate demand represented by the sum of consumption and investment as an indicator of private-sector lending. The correlation between domestic demand and private-sector lending was examined using the methodology based on Granger-causality test. Results show a statistically significant correlation with a correlation co-efficient of about 0.967. Exogenous variables consisted of real GDP in Israel, the number of days of closure in the face of Palestinian trade and the actual exchange rate as an indicator of export competitiveness in external markets.

Economic theory suggests that domestic and foreign income of the most important trading partners and relative prices are key determinants of export performance. A growth in income of a most important trading partner leads to an increase in exports as a result of a rise in foreign demand for goods and services. Additionally, the resultant drop in relative prices with respect to other trading partners leads to a rise in export levels.

The study used descriptive and analytic methodologies to arrive to results. Normal distribution of variables was tested using Jarque-Bera test, while augmented Dicky-Fuller test was conducted to examine the stability of variable time series. Additionally, the Engle-Granger and Johansen-Juselius test was used to test co-integration of variables.



To test for both short-run and long-run equilibrium relationships between exports and independent variables, vector error correction model was applied, which -as Engle and Granger (1987) put it- is one of the most renowned models used to assess short-run and long-run equilibrium relationships between variables and to identify the nature of the relationship between model variables.

The methodology used depends on estimation of equations using the least squares, which aids the interpretation of the dispersion for each variable using historical data as well as for the other variables using current and historical data. The methodology then allows the examination of the error correction coefficient, which indicates the presence or absence of a long-run equilibrium relationship between variables and the pace at which imbalances are rectified on the long run. Additionally, the method allows the examination of the effect of a certain independent-variable shock on export levels using impulse response function. The following model was used to estimate the error correction coefficient and other independent variable coefficients.

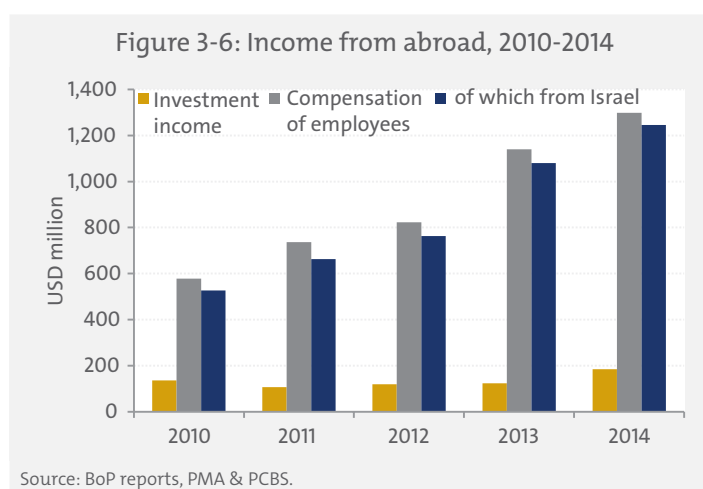
$$\Delta LREXP_t = \alpha + \gamma e_{t-1} + \sum_{i=1}^n a_i \Delta LREXP_{t-i} + \sum_{i=1}^n b_i \Delta LREER_{t-i} + \sum_{i=1}^n c_i \Delta LRGDPI_{t-i} + \sum_{i=1}^n d_i \Delta LRGDPPS_{t-i} + \sum_{i=1}^n f_i \Delta LCPS_{t-i} + \sum_{i=1}^n g_i \Delta LNCD_{t-i}$$

The significance of this study lies in the fact that the results confirmed the long-term impact and correlation existing between exports and the independent variables (GDP in Palestine, GDP in Israel, the actual exchange rate, private sector lending and the number of days of closure facing Palestinian exports). Results indicated a positive effect in the short-term of Israeli GDP growth on exports as opposed to a negative effect of the number of days of closure. An increase equal to 1 percent in growth rate in Israel will lead to an increase in growth rate of exports by 1.6 percent in the ensuing period, whereas a hike of 1 percent in days of closure will lead to a drop in export growth by 0.07 percent.

The study proposed a more effective management and review of trade policy with Israel, in addition to negotiating and concluding trade agreements with neighbouring countries to open borders and crossings and facilitate the export process.

• Income from abroad

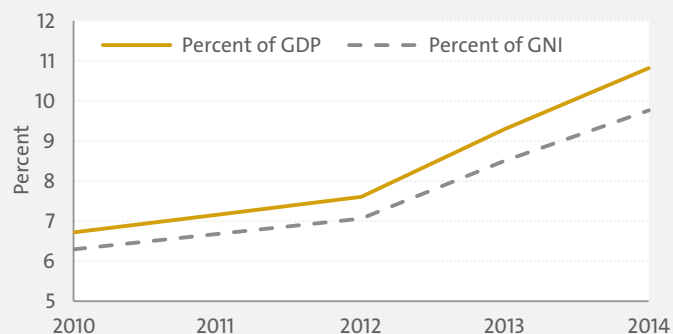
Income from abroad (compensation of employees and investment income) is a main source of financing of the Palestinian trade deficit as Palestine is a labor-exporting country. For 2014, the income account achieved a surplus amounting to USD 1,381.3 million, rising by 19.0 percent compared to 2013. The increase was a result of a rise in the number of workers and a hike in the exchange rate of the US dollar against the shekel. This hike offset the drop in nominal wages and resulted in a similar increase in its share of GDP by 10.8 percent compared to 9.3 percent in 2013.



It is worth mentioning that the larger part of this surplus was mainly associated with compensations of workers in Israel, which constituted about 90.2 percent of the net income transferred from abroad during 2014. The remaining portion related to the return on Palestinian investments abroad (direct, portfolio investment and other investments). Needless to say, this was a small-sized share since it is predominantly composed of deposits abroad which were subject to world-wide low levels of interest.

The income account is of great significance to the Palestinian trade balance, as it financed around 25.2 percent of the trade deficit, compared to 24.5 percent in 2013. In the case of Palestine, the compensations of Palestinian workers have been specifically associated with the labor force in Israel, which has seen some relative increase over the last five years^[35]. It is noteworthy that during the period from 2000 to 2014, the compensations of Palestinian workers in Israel constituted on average about 8.0 percent of GDP and about 6.5 percent of gross national income (GNI); while exceeding 20.0 percent in the years prior to 2000^[36].

Figure 3-7: Compensation of Palestinian employees in Israel, 2010-2014



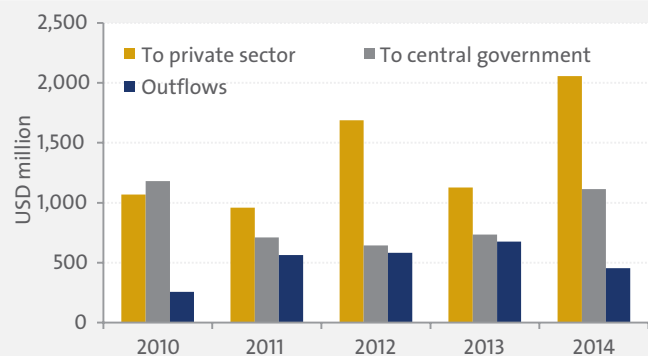
Source: BoP reports, PMA & PCBS.

It is worth noting that the discouraging conditions of the Palestinian economy, namely the limited market size, poverty and unemployment, the inability to adequately generate new job opportunities and low wages, all push the Palestinian labor force, both skilled and unskilled, to seek employment in Israel. More than 51.0 percent of workers joined the construction sector, and many others joined the sectors of industry and agriculture. The income earned by this segment revived and financed the trade deficit (by 20.0 percent on average). However, it concurrently deepened dependence of the Palestinian economy on its Israeli counterpart. Additionally, Palestinian workers have been oftentimes exposed to extortion and exploitation by their Israeli employers. As such, alternative sources of financial flows must be sought and an effective policy to meet the challenge of unemployment must be adopted.

• Current transfers

Current transfers occupy a significant position within the Palestinian economy, at the levels of the public and private sectors alike (although more so to the private sector). The significance of this item in the BoP emanates from the fact that it is a major financier of trade deficit. In fact, current transfers covered about 49.5 percent of trade deficit compared to 25.0 percent in 2013.

Figure 3-8: Current transfers, 2010-2014



Source: BoP reports, PMA & PCBS.

[35] In general, these transfers are related to variation in the number of Palestinian workers allowed to enter and work in Israel as well as to the changes in the exchange rate of the shekel against the US dollar.

[36] Over the past years, and as one of few possible alternatives to generate income on one hand and mitigate unemployment on the other, Palestine employed a policy of labor-force export to the Israeli labor market. However, having fallen victim to Israeli-imposed measures and restrictions, this pursuit proved futile with regards to both goals of income generation and unemployment reduction. With the decline in worker numbers, the significance of worker compensations diminished. The situation worsened even further after 2006 following the Israeli decision to ban workers from Gaza Strip to cross to Israel.

In that context, the value of current transfers has doubled during 2014 to reach around USD 2,715.4 million compared to USD 1,188.5 million in 2013. This was attributed to the upsurge in transfers forwarded both to the private and public sectors and accompanied by a slump in transfer outflows. Transfers to the private sectors jumped by 82.4 percent to reach USD 2,057.2 million, and, similarly, transfers to the public sector by 51.4 percent to reach USD 1,113.0 million^[37] compared to 2013, while, at the same time, transfers abroad dropped to around 32.6 percent.

These transfers are important because they represent foreign currency funds that finance the BoP. Furthermore, they contribute by creating jobs, reviving the different trade sectors and alleviating the problems of poverty and unemployment. In addition to contributing to economic growth, these transfers play a role in providing a social safety net for recipient families. When particularly forwarded to the private sector, they are characterized by continuity and regular flow; albeit swelling in case of political and economic distress and shrinking when political and economic tensions wane, as, in essence, they are sent out by migrants to help relatives cope with hard living conditions and secure basic needs as regards education, housing, healthcare and food, and in doing so, boost trade sectors. It is worth noting that dedicating adequate attention to collecting and organizing these kinds of transfers may constitute an effective substitute to donor transfers, being a form of financing that incurs no cost to the national economy and is immune to political pressures. Additionally, migrants' transfers promote direct investment directed in part to investment in land and construction.

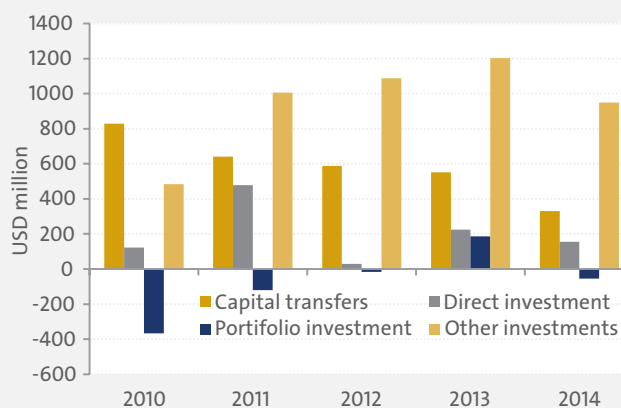
In that light, it is absolutely necessary for the best interest of Palestinian economy to pay special interest to migrants' remittances (as do many developing countries with a large immigrant labor force). Such remittances constitute a source of foreign-currency revenues, as well as a source of additional savings, capital formation and funding of imports. Migrants' remittances also stimulate aggregate demand and subsequently economic growth. It is therefore imperative to seek for the appropriate means and methods to closely monitor migrants' numbers and geographical distribution. Authorities should restrict the direction of such transfers to official channels, mainly banks, in a manner that will not only secure a continuous inflow of such transfers, but also a growing one, as is customary for countries where private flows have surpassed direct investment flows. It is noteworthy that current transfers into Palestine as a percent of GDP have risen from 9.5 percent in 2013 to 21.3 percent in 2014.

Capital and financial account

The capital and financial account (including reserve assets) achieved a surplus of USD 1,393.6 million in 2014, dropping by 35.0 percent over the year and constituting 10.9 percent of GDP from 17.2 percent in 2013. The drop in surplus was mainly attributed to the pronounced decline in the items of each of the capital account and the financial account.

The capital account plummeted during 2014 by 40.1 percent compared to 2013 to reach USD 330.1 million, affected by a decline by 24.1 percent in donor transfers to fund public sector development

Figure 3-9: Capital and financial account components, 2010-2014



All components in net terms.
Source: BoP reports, PMA & PCBS.

[37] The value of current transfers to central government is different from that mentioned in chapter 2 due to the different classification between BoP manual and government finance statistics manual.



in addition to a decline by 25.4 percent in donor transfers to other sectors. Likewise, the financial account fell by around 33.3 percent to reach USD 1,063.5 million, owing to a drop by 21.0 percent in other investment (net) flows (namely currency and deposits) to reach USD 949.9 million; a drop in direct investment (net) by 30.3 percent to reach USD 156.1 million and a drop in portfolio investment (net) flows by 129.6 percent to reach USD 55.3 million. In summary, the capital account financed about 31.4 of the current account deficit, and the financial account (reserve assets excluded) financed around 75.8 percent of that deficit during 2014.

Current account sustainability

In order to examine current account sustainability, several indicators must be explored and, on another hand, the main causes behind the deficit must be determined. In this context, trade deficit as a percent of GDP is regarded as one of the most prominent indicators to gauge sustainability. In Palestine, this ratio is high, averaging around 38.0 percent of GDP over the past years. The second indicator is the national savings to GDP ratio, which has averaged around 4.0 percent of GDP and is considered a humble score when compared to other countries. The third indicator is the ratio of net direct investment flows to GDP, which in Palestine is extremely modest; an almost negligible 1.2 percent. The external debt and debt service to exports ratio is the fourth such indicator of sustainability. It has reached around 68.0 percent in Palestine. In general, all of the aforementioned indicators reveal the weakness of current account sustainability of the BoP.

It is common knowledge that the trade deficit of the Palestinian economy is the main cause behind the current account deficit. Normally, this is a sign of a poor competitiveness. However, in light of the restrictions imposed on the Palestinian economy, the absence of control on crossings and borders and free-trade movement, in addition to the absence of an exchange rate policy, it is difficult to come to the conclusion that the deficit is solely related to competitiveness; albeit a major cause. The deficit is also related to other factors such as the small volume of the Palestinian market, its inability in many instances to meet the basic needs of the society and its weak structural makeup which is apparent in the large import share of specific groups of goods. For example, the high food import bill directly reflects the weakness of the agriculture sector and the little attention it receives to achieve food security, whereas high machinery and equipment import bill indicates incompetence of industry and, additionally; together indicating the modest financing granted to these two sectors. Poor creativity and inadequate research and development, regarded nowadays as the real driver of competitiveness, are also implicated. Moreover, a chronic fiscal deficit, usually closely linked to current account deficit (both termed as the Twin Deficit), further confounds the current account problems. The Palestinian current account deficit is, at the same time, a reflection of the low level of national savings which is coupled with low levels of investment. As such, both low levels foster a consumer economy.

Ordinarily, there are three mechanisms of current account deficit financing. Firstly, equity or direct investment (owners' equity, stocks) is the best way to finance current account deficit. This is so because direct investment flows are usually more sustainable than other flows (such as portfolio flows), and are non-debt generating and therefore do not add up to external debt burden. Moreover, they lead to a growth in GDP of the host country driven by heightened standards of product quality resulting from the establishment of new projects, usually to high standards and economies of large scale. Subsequently, this leads to gaining new world markets, which in turn gives rise to increased economic growth rates and average per capita income, as well as better standard of living. In consequence, economic structural distortions are rectified and domestic investment boosted. Additionally, direct investment flows lead to the development of the economic infrastructure which directly relates to direct investment. In summary, the aforesaid investment-related



developments support economic growth. Direct investment plays a role in alleviating unemployment through providing the labor force with job opportunities, access to technical know-how which is much-needed for manufacturing processes. In addition, it helps the labor force gain new proficiencies, administrative expertise and organizational skills and introduces advanced banking expertise. These benefits can be reaped provided that direct investment is directed towards development projects rather than consumption-oriented projects. However, this kind of investment requires attractive policies and measures to be offered by the host economy, which is what the Palestinian economy needs to introduce in order to correct the financing disorder of the national current account.

The second method to finance the current account deficit is financing of external debt, after taking into account the nature of the debt (short-term against long-term debt), actual interest rates, economic growth rate and the level of domestic debt. The third method is financing by using up a country's net foreign assets (either by withdrawal from banks foreign deposits, i.e. net foreign assets of the banking system, or by reduction in the net foreign assets of the central bank). This type of financing will lead to attrition of a country's foreign assets or the accrual of its foreign liabilities.

In the case of Palestine, the above-mentioned analysis of the BoP financial account revealed that this deficit was financed through withdrawals from foreign assets of the Palestinian banking system and capital transfers, both items having financed about 91.0 percent of the current account deficit in 2014, while direct investment financed a mere 11.0 percent. In general, external borrowing was not used to fund the current account deficit, but rather to finance certain items of current expenditure, particularly salaries. It should be taken into account that the greater portion of this debt is long-term debt. At the same time, financing using PMA reserve assets will have insignificant impact, given the current circumstance.

In general, it is obvious that the current account deficit in Palestine is the resultant of spending levels that exceed production levels, thereby leading to an excess of local absorption (local aggregate demand or total of local consumption and investment) over income. Such a situation necessitates the employment of an array of tools and measures to rectify the status of the BoP, including corrective actions necessary to attain a viable external payments position.

International investment position (IIP)

The international investment position (IIP)^[38] has assumed increased significance in the compilation and analysis of international accounts data. IIP is considered an indicator of the sustainability and risk vulnerability of financial situations. This includes foreign currency matching, the repercussions of debt composition by sector, the interest rate, the rates of return and the analysis of economic structure, and the study of the relation of international accounts to domestic sources of financing. It is also considered an indicator of the degree of economic openness, levels of external debt and of financial stability, giving a clearer perspective of the relationship with the outside world and the changes in inter-country foreign relations, in a manner that allows for better country comparisons.

[38] According to the Sixth Edition of the IMF Balance of Payments and International Investment Position Manual (BPM6), the International investment position (IIP) is a statistical statement that shows at a point in time the value and composition of the financial assets of residents of an economy that are claims on non-residents, and gold bullion held as reserve assets, and the liabilities of residents of an economy to non-residents. The difference between an economy's external financial assets and liabilities is the economy's net IIP, which may be positive or negative.

The IIP correlate strongly with the BoP, where the latter records all financial and non-financial transactions with non-residents during the period they occur, whereas the IIP registers the results of financial transactions with non-residents at a certain point in time, adding in changes in prices and exchange rates as well as other revaluations, i.e. transactions that contributed to changing the IIP are registered in the financial account of the BoP.

Assets and liabilities in the IIP are divided into direct investment (an investment equal to or exceeding 10.0 percent of a non-resident corporation's capital); portfolio investments (an investment that is less than 10.0 percent of a non-resident corporation's capital, in addition to investment in bonds); other investments (trade credit balances, loans, currencies, deposits and others); and reserve assets of the central bank, which are used to rectify BoP imbalances.



Analysis of IIP in Palestine (external assets – external liabilities) showed that IIP (net) has totalled USD 1,234.0 million by end of 2014, meaning that, across all sectors, the Palestinian investments abroad exceeded non-residents' investments inside Palestine. Foreign currencies in circulation and Palestinian banks' deposits abroad together constituted the largest share of total external assets, representing 63.2 percent of these assets. By end of 2014, the Palestinian economy's overall external assets (Palestinian residents' investments abroad) reached around USD 5,950.0 million, with foreign direct investment acquiring 2.8 percent, foreign portfolio investment 19.9 percent, while other foreign investments constituted around 66.0 percent. At the sectoral level, the foreign investment of the banking sector acquired the lion's share, with 74.4 percent of total external assets of the Palestinian economy.

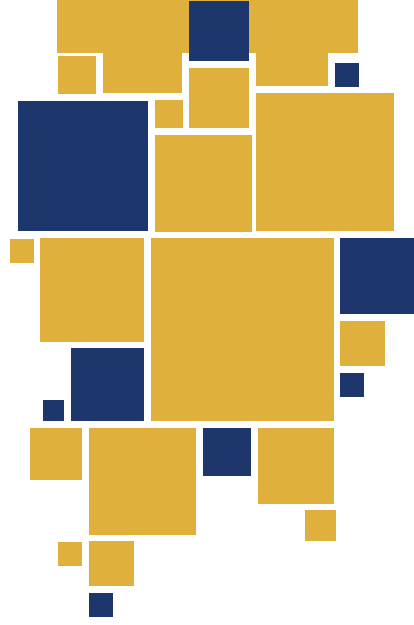
In comparison, overall foreign liabilities or claims on Palestinians (balances of non-residents invested inside Palestine) totalled USD 4,716.0 million, of which 52.0 percent were foreign direct investment, around 15.1 percent were foreign portfolio investments and other foreign investment in Palestine (loans and deposits abroad) were about 32.9 percent. At the sectoral level, foreign investment in the banking sector acquired the highest share of overall foreign liabilities registering 32.0 percent.

Palestine's external debt by end of 2014 amounted to around USD 1,557.0 million, of which 69.9 percent was central government debt, 25.9 percent was banking sector debt, whereas the remaining sectors (financial intermediaries, insurance companies, NGOs, and households) accounted for around 4.2 percent.



Chapter Four

Financial Sector Developments



Part I: Palestine Monetary Authority (PMA)

Overview

In spite of the events witnessed by the Palestinian economy during 2014, particularly last summer's Israeli war against Gaza Strip, the Palestinian banking sector made steady strides towards additional growth, owing to a deep understanding of the various local and regional risks and every precaution taken to guard against them, with the aid of important PMA reforms and achievements that covered the different aspects of the financial sector, in general, and the banking sector, in specific.

Accordingly, banking sector indicators witnessed a marked improvement, particularly in relation to deposits and credit. The results reflected the mounting public confidence, which was supported by a series of continuously developing strategic projects linked to PMA goals in promoting financial and monetary stability and sustainable economic development. In the background, the environment fostering risk-assessment was further reinforced by the use of more advanced mechanisms and methods, in line with the continuous international and regional advances in banking with regards to decision making and risk assessment, employed to fit the peculiarity of the Palestinian situation.

This section throws some light on the progress made by the PMA during 2014 in the numerous domains within the scope of its operation and responsibility, paving the way for the successful achievement of its general goals.

Relations with supervised institutions

Taking into consideration that the banking system is a pillar of financial stability, the PMA was keen to maintain the soundness of this system and render it safe, intact and capable of adapting to the burdens and tasks entrusted to it, through providing the appropriate institutional and organizational environment (upgrade of systems, legislature and infrastructure) to govern its operation. To that end, the PMA continued its efforts during 2014 in various related areas as follows:

Organizational and supervisory frameworks of supervised institutions

- **Banks**

The Banking Law No (9) of 2010 is considered a fundamental cornerstone in the PMA policy to modernize the organizational and supervisory frameworks of banking in Palestine, as it contains various remedies to all aspects related to bank licensing and operation. In view of this Law and in order to ensure compliance with it and stay abreast with developments in banking standards nationally and internationally, the PMA issued the following supervisory instructions during 2014:



- Instructions No. (2/2014)^[39] concerning housing loans and mortgage based on the dynamic LTV ratio^[40], which organizes the process of granting of housing loans and mortgages in a manner that mitigates associated credit risks through linking the conditions of the loan or mortgage, namely the term of the loan and the loan to the real-estate appraised value (LTV Ratio), to the score of credit rating granted to a client following an accurate analysis of the credit behaviour of a consumer. This has encouraged borrowers to conform to the contractual terms of the loan, since a compliant borrower is more likely to attain a higher LTV ratio and a longer term of the loan. Indeed, a loan can be as high as 85 percent of the appraised real-estate value and for a period as long as 25 years, pursuant to certain requirements specified by the instructions. Moreover, such instructions encourage clients with high risk credit scores to adjust their credit positions and upgrade their scores to subsequently improve the chances of getting a loan.
- Instructions No. (3/2014) concerning membership in Real-Time Gross Settlement System (BURAQ). These instructions organize the membership structure of BURAQ and specify the special rules to carry out various procedures by members, direct and indirect membership conditions, the powers of the PMA, the settlement rules, liquidity management and mechanisms for enhancing system liquidity, rules for external transfers and settlement of results of the national clearing house.
- Instructions No. (4/2014) concerning the Real Time Gross Settlement System (RTGS) and the clearing system. The instructions specify the RTGS fixed fees and the fees for each issued transfer. They also specify the fines to be charged in case adequate balances are not available in the member's account to settle the clearing results.
- Instructions No. (5/2014) concerning the official working days and hours for banks. These instructions organize official working days and hours as well as work during vacations, official holidays, emergency leaves, and optional exceptional office hours
- Instructions No. (6/2014) concerning credit granted to relatives. These instructions define kin-related parties and mandatory requirements of the bank credit policy with respect to credit granted to a kin-related party, by defining, in the case of such credit, the granting and renewal conditions. The instructions also state the conditions of loan write-off for relative parties which requires bank BoD and PMA approvals. Additionally, they elaborate periodic and final financial statement disclosure requirements of financing granted to relatives, in order to comply with International Financial Reporting Standards and PMA disclosure requirements.
- Instructions No. (7/2014) concerning bank fees and commissions. These instructions categorize and define permissible ceilings for fees and commissions charged by banks from clients in return for the services offered and set forth operating controls for the instructions, with regard to the mandatory publishing and advertisement thereof, in all bank branches and the bank website. Additionally, the instructions necessitate prior PMA approval for any new fee the bank wishes to charge. The instructions were issued within the frame of protecting client rights and striking a balance between bank profitability and the costs of services presented to the public, as well as meeting the developments of bank services and product. Pursuant to these instructions, the number of fees and commissions was reduced from 119 in 2011 to 94 different kinds of fees and commissions.

[39] There is no mention in the body of the report of Instructions No. (1/2014), as they are provisional. The instructions relate to the transport of money, precious metals and valuable documents and amend Instructions No. (7/2013). The upper limit for the transport of money using non-armoured vehicles was changed to become USD 150 thousand, effective for a year only from the date of the instructions were issued. Other clauses were also amended relating to the procedure of money transfer in general.

[40] It is worth mentioning that during a meeting of the Central Banks and Monetary Authorities of the Organization of Islamic Cooperation (OIC) Member States in 2014, the Governor of Bank Indonesia, Agus Martowardojo, commended the role of the PMA with regards to the macro-prudential measures it adopted and the monitoring of the stability of the mortgage sector by linking borrowing capacities and abilities with the credit scoring system through the Dynamic LTV Ratio, which is a policy unique to the PMA at the level of central banks in the Middle East. This policy has allowed the PMA to adopt a judicious supervisory policy for the risk management of mortgage lending portfolio, which is in line with the relevant international best practices.



- Instructions No. (8/2014) concerning lowering of risk reserves, by which the risk reserve valuation rates are lowered to 1.5 percent for net direct credit facilities instead of 2 percent , and 0.5 percent for indirect credit facilities.
- Instructions No (9/2014) concerning deceased account management which outline the procedures that need to be followed to manage a deceased's accounts
- Instructions No. (10/2014) concerning stress testing. These instructions define the obligations of banks with regard to operating procedures and policies to conduct stress testing. They also elaborate the kind of tests, test conditions and the stress-test shocks including political and economic shocks.

As for the area of supervisory follow-up, as part of PMA efforts to implement the requirements of Basel II and III and following the conclusion of the first phase which started in 2013, the second phase was officially launched. Working papers in the area of credit and market risks, operational risks and the Supervisory Review Process (Pillar 2) were prepared, discussed with banks and their feedback noted^[41]. Several relevant workshops were held, which will be conducive to the formulation of final instructions for the implementation of the Basel II requirements. The first template version of the Quantitative Impact Study (QIS) Form was reviewed, together with the explanatory instructions to fill the form, and distributed to banks. For the sake of an exemplary implementation of the Basel II requirements, the implementation process advocates simplicity, gradual application and good communication, in a manner suited to the peculiar Palestinian situation. Preparations for the third phase, which covers the Risk Assessment System (RAS), have been underway, starting with the drafting of the relevant instructions and the main design features of the automated system to be developed for that purpose.

On a different note, the compliance of banks with the updated governance requirements, as per the amended governance guide issued end of 2013, was followed up. The disbursement of bonuses and incentives to senior management and employees was checked against PMA instructions on governance and the bonus and incentive policy of the bank, to ensure compliance with both. Moreover, an examination of bank compliance to the Foreign Account Tax Compliance Act (FATCA) and an assessment of its anticipated impact were conducted.

Concerning the development of tools for the identification, measurement, control and mitigation of risks to adversely affect bank financial positions, all banks are required to establish risk management departments which are supported by competent staff. Banks are also required to ensure that these departments fulfill their tasks with respect to monitoring, supervision, measurement and control of potential risks. From its side, the PMA will monitor risks to the banking system on the macro and micro levels through conducting stress testing on quarterly basis, in addition to assessing the banking system Financial Soundness Indicators (FSI), which are regarded as early warning signals.

With regard to periodic auditing of banks, and in order to maintain a banking system that is sound, healthy and secure, several comprehensive audit visits to a number of banks were conducted, in addition to many follow-up visits to examine bank compliance with rules and regulations. It is noteworthy that, as per the plan to promote prudential supervisory risk-based tools and modernize the fundamentals of supervisory operation to be in-line with the latest related developments, the PMA is currently working on the compilation of an off and on-site inspection guide that applies a risk-based supervisory approach.

[41] In August 2014, the PMA received a technical World-Bank delegation led special expert Mr. Vaidon Oglo, to assist the PMA in the implementation of the Basel II requirements project with regard to credit and market risks and operating risks.



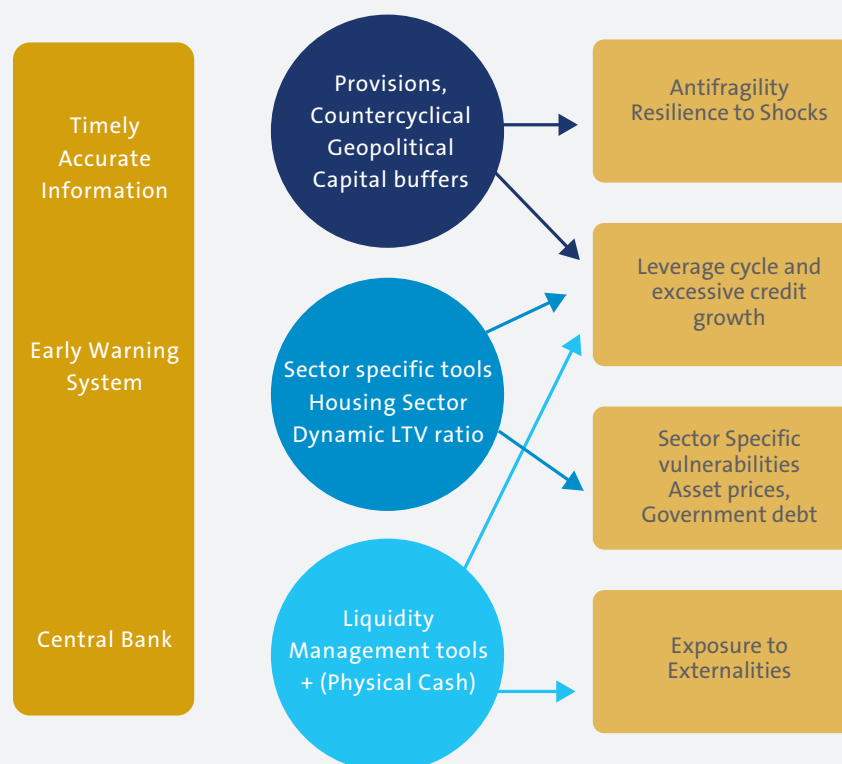
Box 4: Macroprudential Policy of the banking system

Interest in the macroprudential policy in the banking system has recently mounted, considering that it is an important mean of containment of the side effects of the monetary policy on the banking system and financial stability. Macro-prudential tools are employed to mitigate financial-service disruption risks and the possible resulting adverse outcomes affecting the real economy (systematic risks). The aim of such policy is to mitigate the associated systematic risks that can jeopardize macro-economic stability (Bank for International Settlements, 2010) through treating systemic vulnerabilities (IMF, 2011, 2012). That said, it is worth noting that this policy does not replace financial and structural policies to be employed to mitigate the effects of real exogenous and endogenous distortions

Macro-prudential policy measures and procedures are based on three basic principles: firstly, data availability, both promptly and accurately, to policy-makers (the central bank) in order to monitor the accumulation of risks to financial stability; secondly, ensuring necessary arrangements are made to establish the legal authority and analytical capability to employ macroprudential policy tools, when necessary (early warning system); and thirdly, for policy makers, having capacity and courage to take action when required, even when the imposed measures are unpopular. Additionally, it is necessary to have an efficient and balanced communication with the public in order to elaborate the objectives and after-effects of any implemented measures.

In general, the PMA possesses a set of macroprudential tools that are suited to treat disruptions and shocks, including:

- Early warning system, stress tests (leverage cycle database of the mortgage sector)
- Periodic customary follow-up indicators
- Scenario creation and planning
- Follow-up and monitoring of changes to the assumptions of the base-line scenario
- Pursuit to reduce the effects of the heightened likelihood of the capacity-based scenario.
- Engaging active parties in order to contain the resistance to decisions made
- Regular follow-up of measures of alleviating risks.



The PMA macroprudential policy framework is composed of the following:

- Implementing of an effective governance system that ensures compliance to governance principles
- Ensuring system vigilance and response (off and on-site inspections) in a manner which closely coincides with the banking sector.
- Holding regular meetings with bank executive managers and establishing a PMA-banks joint crisis management committee.
- Periodic collection and monitoring of information and analysis of bank reports and data collected by the PMA database (on daily, weekly, monthly and quarterly basis).
- Keeping up the use of scenario generation as an important tool to predict and mitigate risks in addition to developing top down (PMA) and bottom-up (banks) stress testing.
- Development of indicators for each scenario while preparing banks to respond to the various base-line scenarios
- Periodic and regular review of risks and the compilation of a risk table
- Follow-up of any escalation in the likelihoods of base-line scenarios based on the pre-determined indicators for each scenario
- Activating previously-approved response measures to address the escalating likelihood of the base-line scenario.
- Swift and decisive execution of the response measures in light of the different scenarios and crises (avoiding gradualism).
- Activation of the communication protocols to ensure concordance and consensus and build awareness to PMA actions.
- In the aftermath of the crisis, de-escalation and release of system strain while exercising vigilance

• Money changers

As part of PMA efforts to promote the soundness and stability of the money changing business, being a major pillar of the Palestinian financial system, and to enhance customer awareness so as to safeguard them against abuse and falling victims to illegal activities, particularly money laundering, the Anti-Money Laundering Manual for Money Changers was issued and circulated to all money changers as per Circular No. (72/2014). The manual contains an introduction to the concept of money-laundering, its stages, the related adverse impacts on both the money changer and the economy in general, the implicating practices and the relevant preventive measures to be adopted. Workshops were held in all governorates in collaboration with the chambers of commerce to present the Manual in detail to attendee money changers. Within the same context, and in consequence to the joint collaboration of the Palestinian Banking Institute (PBI) and PMA's Financial Follow-up Unit, a Palestine Anti-Money Laundering Accreditation (PAMLA) course was held for compliance officers and supervisors in the field of the money changing business.

Moreover, the PMA issued instructions concerning compliance supervision of money changers. The instructions included an elaboration of the compliance risk concept, procedures and conditions for the appointment of a compliance officer and compliance officer responsibilities. Furthermore, a new draft of the Presidential decree on the organization of the exchange profession was prepared and discussed with money changers and it currently awaits ratification by the President. On a different note, all money changers and money changing companies were notified in Circular No. (167/2014) that they are required to disclose any cash or unrefined precious metals that are brought into or outside the country through border crossings.

In the field of supervisory follow-up of money changers and money changing companies, a manual on on-site inspections was developed to suit the nature of the money changing business and its associated operational risks. It included sections on the accounting systems, standard business hours instructions and instructions on detecting



counterfeit money. Furthermore, in the context of supervisory follow-up, 270 on-site visits were conducted to check the compliance of money changers and money changing companies to the relevant instructions and rules on the soundness of the money-changing operation, which safeguard against possible risks. Additionally some visits were performed for follow-up purposes to verify that adherence of money changers to any correcting the supervisory observations previously indicated.

With respect to follow-up of non-licensed money changers, coordination and cooperation continued with the Attorney General Office to take legal action against unlicensed money changers and included filing lawsuits and charging of fines. Further, on 29 January 2014, the PMA Board of Directors made the decision to delay until further notice the requirement from money changing companies (regular companies) to raise their capital. On another note, the PMA announced that, starting from 10 March 2014, it will no longer receive applications for licensing or branching, following the expiry of the submission grace period for such applications as per the announcement issued by the PMA on 10 September 2013.

• **Specialized lending institutions**

As part of its continuous efforts to organize and control the conditions of the specialized lending institutions, the PMA issued Instructions No. (2/2014) on the classification of loans/financing and the generation of allocated provisions. These instructions require all specialized lending institutions to create a risk reserve equal to 1 percent of the overall credit portfolio or outstanding regular facilities. The instructions also specify different categories for loans and irregular (default) facilities and the corresponding provisions to be set aside, as well as the procedures and conditions of loan and facility scheduling.

Within the context of PMA pursuit to promote their role in the Palestinian financial system, the specialized lending institutions were provided with a standardized financial and statistical report form (Call Report), similar to the one used by banks. From mid-2014 onwards, the institutions started to use this form on quarterly basis according to the manual which was specially compiled in order to facilitate and standardize the completion of financial statement preparation. Another guide on off-site analysis for the inspection of these institutions was also developed, while a guide for on-site inspection is currently being prepared. It is expected that PMA on-site inspection visits to these institutions will commence during 2015.

The PMA maintained communications with the Palestinian Network for Small & Microfinance (Sharakeh), through meetings and periodic sessions to discuss several important issues relating to the operation of these institutions. One such issue concerned final licensing granted so far to five specialized lending institutions. The rest were still in the process of meeting the requirements for final licensing approval, while they remain under PMA follow-up. The key obstacles and constraints facing small and microfinance sector were also discussed alongside the means to overcome them and ultimately create a truly competitive environment that serves the purpose of real development of the targeted sectors.

The financial sector infrastructure

The PMA carried forward its concerted efforts to build and develop financial and banking systems in accordance with international best practices by supporting the establishment of a robust and comprehensive banking infrastructure that will mitigate risks to both the banking sector and the financial system, at large. To that end, in 2014 the PMA took further steps in the development of a number of banking systems that were introduced in past years, and initiated other projects which are to be finalized in due course. Following are details of the aforementioned system developments:



1. The electronic national switch

In cooperation with the banks, the PMA pursued its efforts to accomplish the national switch project, which will further develop the electronic payment methods in Palestine. By creating an electronic national switch, all ATMs and Points of Sale (PoS) will be linked to a unified database while at the same time, the PMA urges all banks operating in Palestine to issue ATM and credit cards at relatively low costs. The national switch is expected to expand the distribution of points of sale, boost the use of prepaid cards and provide needed liquidity. In essence, the project aims at promoting financial inclusion in Palestine by giving all social segments access to banking services, in particular in outlying and remote regions where there are not always branches for all banks. Individuals can make use of the nearest bank branch operating in the region without the need to commute to city centres to carry out their banking transactions.

In this context, the system's operating rules and instructions were approved and the by-laws, instructions and policies which organize the operation of subscribing members were issued. The nature of the relationship with the global payment card companies like Visa and MasterCard was also decided, whereas the provider company commenced training of PMA staff. In the first stage, the system was implemented in three banks only for testing purposes¹. During 2015, it is expected that the system will be commence provisional operation in successive phases. Furthermore, in order to explore the possibility of providing "pay-by-mobile phone" services to pay bills and government payments like taxes, fees and others, the PMA worked with global card payment companies, and has signed MoUs and put implementation action plans in place.

2. Foundation of the Public Key Infrastructure (PKI)

As part of work to modernize the digital environment of the Palestinian banking sector and boost electronic financial transactions, which are considered modern tools that open new horizons for the Palestinian economy and enhances its ability to communicate with the world, the PMA carried out in 2014 the first step to establish the Public Key Infrastructure (PKI). This step consisted of issuing basic certificates and private keys to maintain the safety and independence of the all electronic transactions generated and authenticated using these keys. Transparency and high reliability will be ensured by the creation of unique digital user identities provided to all banking infrastructure users. The public keys and certificates were issued in a ceremony held at PMA headquarters, during which highly controlled and secure technical procedures were performed. System users will be able to electronically communicate using their encrypted identity credentials, which will assure the feature of fixed electronic signature, pursuant to the National Payments Law of 2012.

3. Standardization of the International Bank Account Number (IBAN)

To fulfill its goal to develop the processes for transfers and the automation of automating banking transactions in Palestine, the PMA concluded in 2014 the implementation of the second stage of the IBAN project, which is linked to the regulation of internal and cross border transfer of private remittances. Upon the conclusion of this stage, no internal private remittance will be processed without carrying an IBAN (or if carrying an incorrect IBAN). As for private remittances from a bank abroad which do not carry an IBAN, the foreign bank will be duly notified via swift or any other approved means of communication with foreign banks. While, at the same time, the remittance will be accepted, it will be subject to a fee ranging between USD 2 and USD 5 to be deducted from the remittance sum credited to the account of the beneficiary, who should be notified of the cause of deduction. Incoming and outgoing remittances to and from the Palestinian government and workers' remittances from Israel are exempt from requirements as aforesaid. It is anticipated that during 2015, the PMA will cooperate with 'the banks to automate banking activities linked to Straight Through Processing (STP).



4. Development of the Automated Transfer System (ATS Clear)

During 2014, the PMA successfully launched the new automated clearing system, Perago Clear, which came into operation starting 7 September 2014. Alongside the Gross Settlement System (RTGS), this

system represents the second component of the Automated Transfer System (ATS). The launch was made possible through technical support from the World Bank and the Bank of Italy (Banca d'Italia) and financial aid from the Arab Monetary Fund and the banks in Palestine. The system aims at providing safe and effective systems for the execution of check clearing and other retail payment transactions to service the Palestinian market. The system will assure the automated execution of check clearing operations and other retail payment instruments, in a modern, prompt and more secure manner. This fulfills the requirements to establish the third cornerstone in the foundation of the National Payment System. The system will support the automation of check clearing and other retail payments tools through the provision of direct connection mechanisms to members, through using a secure infrastructure and real-time monitoring of operations. On the medium-term, it will be part of a more comprehensive system to modernize and develop the retail payment instruments, with the possibility of including government payments within the system in the future. In the same context, the PMA commenced the transformation of the clearing system, which is currently in operation, to a fully automated system in preparation for the electronic clearing system infrastructure. As a result, the check clearing period will be cut short to (T+1), that is equal to the clearing day plus another work day for returning the check; that is check collection can be accelerated and the use of paper-based checks diminished. Additionally, check clearing will synchronize with check clearing in the Israeli clearing house. The project is expected to be completed over the coming two years. It is worth noting that the Presidential Decree No. (17) of 2012 on National Payments Law for 2012, issued on 23 November 2012, constitutes the legal basis for the introduction of electronic interbank clearing systems using optical scanning techniques to transfer net transactions to the automated clearing system in order to easily and securely perform electronic settlements between banks upon electronic signature verification under the relevant specified conditions.

5. Automation of incoming transfers from the Israeli Clearing House

This project aims at process automation and reduction of the operational risks associated with recording inward wage remittances of officially registered Palestinian labor force from the Israeli Clearing House. It also provides the appropriate supervisory tools over inward remittances from Israeli banks to banks operating in Palestine and reduces cash inflow to Palestine by transferring the remittances from the Israeli Clearing House to the accounts of banks licensed by correspondent Israeli banks. Consequently, licensed banks will to some degree be relieved from the burden of accumulated Israeli shekel. In the process of preparing for this project, a number of workshops were held in 2014 during which the

demands of banks operating in Palestine were specified as well as the technical prerequisites to complete the connection. It is anticipated that the project will conclude in the first half of 2015, thereby contributing to preserve the rights of Palestinian workers by verifying disbursed salary values against the corresponding work hours.

6. Development of the Credit Registry System (version III)

To preserve the efficiency and performance levels of the Credit Registry System launched in the beginning of 2008, the PMA carried out a comprehensive system assessment against the relevant international best practices. The assessment took into account the quality of service offered to users from the banking system and lending institutions, on one hand, and the effective reinforcement of bank supervisory mechanism, on the other. As a result, various aspects of the system were revamped, including system screens and disclosure mechanisms. Most importantly, for the purpose



of mitigating and managing credit risks associated with borrowers and their guarantors, on one hand, and the expansion of bank lending database, on the other, the diagnosis culminated in an amended borrower credit report to contain broader information with respect to facilities and collaterals of the guarantors and the liabilities of the customers. Another prominent amendment of the revised credit report was the requirement for the disclosure of the main details of facilities granted by public and private companies including mortgage companies, service providers, real-estate developers and retail tradesmen, in addition to the disclosure of court rulings related to banking lawsuits and the Student Loan Fund.

In the same context, and to complete the first stage of the standardization of credit operation systems, the second phase commenced in 2014 and covered the Credit Registry System, the Bounced Cheques System, the suspended and lost checks system, the credit reports system, the consensual settlement system, the Program for Revenue and Expenditure Control of the Consumer Relations and Market Conduct Department and the complaints system as well as the standardization of personal information databases of the credit information systems.

7. Launch of online bank-charges comparison service

To promote transparency, disclosure and fair competition between banks, the PMA commenced at the end of 2014 to design and develop a program to disclose fees and commissions collected by the various banks and conduct cross-bank comparisons. The software is expected to raise competitiveness between banks and contribute to the delivery of exceptional services to the public at fair and competitive prices.

8. The PMA's business continuity

To build its capacity in the area of business continuity of the critical operational activities, the Business Continuity Unit (BCU) followed up the necessary measures and arrangements for business continuity in the PMA. The business continuity program was updated with the participation of PMA departments and the updated version of the program was endorsed (including policy, strategy and various plans). Several in-house workshops were held for a number of PMA departments to review the plans and procedures and raise awareness of business continuity. PMA activities with regard to arrangements, location and employee competencies were tested at the alternative site, alongside the periodic testing of the alternate communication methods. Some departments executed operations remotely from employee homes to test the staff's ability to perform in a state of emergency. In cooperation with departments involved, the Business Continuity Unit (BCU) supervised periodic auditing of the alternative site and subsequently reported to senior management. It also updated the internal and external contact data in connection to critical PMA operations.

Access to financial services

Access to financial services plays a key role in diminishing income inequalities and reducing poverty rates. Several practical experiments reveal that countries with higher levels of access to financial and banking services tend to achieve a faster reduction of income disparity than other countries. Elevated levels of economic depth raise economic growth rates, improve work environment and push up market efficiency levels for goods and services. Access to financing and banking services also plays a role in diluting the impact of fluctuating spending levels, for investment and consumption alike and subsequently attenuates business cycle and GDP fluctuations. For the purpose of improving access levels to financing, the PMA took the following actions:

- **Bank branching and dispersion**

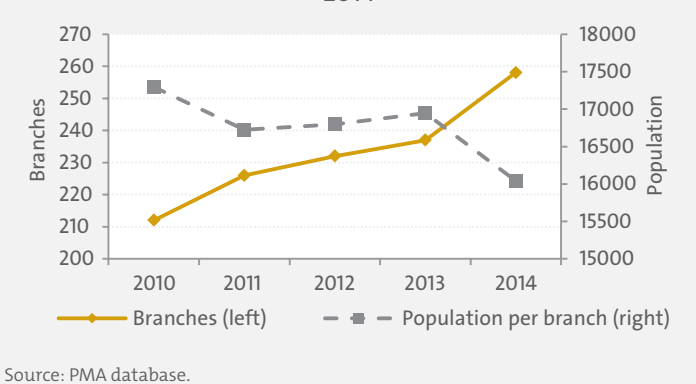
In line with its efforts to facilitate access to financial services and raise rates of economic growth, the PMA was keen on raising local savings and increasing saving rates through mobilising the banking sector to provide saving and



investment channels that are attractive to domestic savings. For this purpose, the PMA worked to expand banking services across Palestine through advocating a bank branching policy and giving priority to rural and distant areas in order to help engage citizens in trade and economic activity and allow them access to all kinds of financial transactions.

In this context, despite the fact that the number of licensed banks by the end of 2014 in Palestine stood at 17 banks^[42], out of which 7 are local and 10 are foreign banks (8 Jordanian, one Egyptian and one foreign), the network of bank branches and offices expanded to 258 which spread across the different areas in the WB and GS. Indeed, the year 2014 saw a noticeable rise in the number of new bank branches and offices, with the addition of 21 licensed branches and offices, of which 3 offices and 1 branch opened in GS.

Figure 4-1: Branches of banks operating in Palestine, 2010-2014



The PMA branching policy aims at reducing the population per bank branch density, and thus enhancing the quality of service offered to customers and approaching international standards of branch densities of 10,000 individuals per branch. The branch density in Palestine dropped from 16.9 thousand per branch or office in 2013 to 16.0 thousand per branch or office in 2014.

• Social Responsibility

The PMA pays special attention to its relationship with the public and is adamant that they receive the highest possible quality banking services at the lowest possible prices. Additionally, the PMA aims at fostering confidence of the various segments of the public in the banks operating in Palestine, toiling continuously to strengthen social responsibility values of both the PMA and the banking system. This has been evident in PMA management of the crisis during and after the latest Israeli war against GS.

Box 5: PMA and crisis management: war on Gaza

The social responsibility role of the PMA has been enhanced through a series of measures implemented during and after the latest Israeli war against Gaza Strip in the summer of 2014. In this context, the PMA adopted a set of exemptions that appeared in the form of circulars to the banks on dealing with borrowers, organizing clearance in GS, suspending the collection of bounced check fees from check issuers, suspending customer rating by the bounced check system and waiving real-estate lending conditions previously linked to credit scoring by the credit rating system (LTV Ratio). Moreover, the PMA suspended credit rating of borrower customers (individuals, companies and institutions) from banks operating in GS.

In an unprecedented step to contribute to the relief of citizens in the Strip, the PMA issued instructions to all banks operating in Palestine requiring them to postpone collection of loan instalments at branches of banks operating in GS, as of the beginning of the war in July 2014 and until end of 2014, provided the delay is requested by the borrower in writing and that no extra fees or additional interest be charged on the delayed loans. Other crisis management measures taken by the PMA included the following:

[42] In February 2015, subsequent to this report, a strategic partnership agreement was signed between The National Bank (TNB) and the union Bank (a foreign Jordanian bank) by which TNB acquired the assets and liabilities of the union Bank in Palestine, while union Bank becomes its strategic partner owning 10 percent of the paid-in capital. As such the number of licensed banks in Palestine falls to 16 as of 1 March 2015.



During the war against GS:

The PMA made noticeable sacrifices to cope with the crisis, in particular in the area of business continuity, generation of scenarios, risk mitigation and disaster recovery, as for example:

- Providing cash required for ATM operation and supporting mobile-phone banking and credit card services
- Securing the supply of cash to all branches upon request and, to that end, taking every measure necessary.

These measures helped branches of all banks operating in Strip to serve their customers even amidst war.

After the war –easing of constraints and provision of credit

- Delay of instalment payments for all borrowers in the Strip until end of 2014
- Cancellation of loan fees and suspension of customer rating by the bounced check system starting from 7 July (first days of the war) and until further notice.
- Reduction of risk reserves from 2 percent to 1.5 percent as a form of financial compensation for the banks in the aftermath of the war.
- Enacting the requirement for a geo-political reserve in cases of emergency and war owing to its clear impact on the speed of response to alleviate financial pressures without aggravation of risks faced by banks.

Collaboration with the World Bank to establish the Credit Guarantee Facility, which is funded by donor countries to provide loans with USD 250 million coverage, of which USD 50 million are dedicated for businesses damaged by the Israeli aggression and USD 200 million for new developmental projects.

In view of the continuous and tireless efforts to address the crisis of cash liquidity in GS and the great attention dedicated to secure cash in all currencies, the PMA managed to deliver NIS 1.9 million of different denominations of coins to the branches of banks operating in GS, in particular for important occasions, when people need cash, as in the holy month of Ramadan and during feasts. Moreover, NIS 200 million worth of spoilt notes held with bank branches in the Strip were replaced, in order to alleviate the people's hardships and make available necessary cash to run banking activities in a normal manner. With respect to helping banks operating in the WB ship the shekel surplus cash in their possession, the shipment to Israel of NIS 8,994.9 million was arranged, of which NIS 4,400 million were shipped back to the Bank of Israel through the Bank of Palestine and NIS 4,594.9 million through Jordanian banks, which can conduct delivery operations directly to the Israeli correspondent banks.

• Financial inclusion

In the area of financial inclusion and banking awareness, the PMA followed through its continuous work starting February 2014, when it signed a MoU with the Palestine Capital Market Authority (PCMA) to establish the National Strategy on Financial Inclusion with support from the AFI. This strategy aims at enabling access to and use of the various financial services and products by people from different social strata, through the joint effort of all parties involved in the formulation of the strategy. Goals include the introduction of the public to the importance and the modes of access and usage of financial services, thus enhancing the capacity to improve their social and economic situation and achieve social and financial stability. With the collaboration of all parties involved, the strategy will bridge the financial literacy gap in the best possible manner by promoting consumer protection through the formulation of policies and guidelines to introduce current and potential consumers to their rights and obligations.

The PMA and the PCMA will partner to lead the establishment of the National Financial Inclusion Strategy in Palestine, in collaboration with all stakeholders and within a clear and well-developed plan based on the main principles for enhancing financial inclusion endorsed by the G20, the World Bank and the AFI as well as the OECD Principles on National Strategy for Financial Education.



The formulation of the National Strategy on Financial Inclusion is expected to extend over a two-year period (2014-2016) and be implemented over two phases: the first will last for 5 years and target the financial sectors supervised by the PMA and the PCMA, and the second will be implemented over three years and will target the remaining sectors including the private and public sector and any other sector for which the strategy is pertinent. The first meeting of the Steering Committee for the Establishment of the National Strategy on Financial Inclusion was held in April 2014. The Steering Committee is presided over by both the PMA and the PCMA, while members of the Committee are: the Association of Banks in Palestine, the Ministry of Education and Higher Education, the Banking Services Consumer Society, the Palestinian Network for Small and Microfinance (Sharakeh), the United Nations Relief and Works Agency (UNRWA), the Palestine Exchange, the Palestine Union of Securities Trading Companies and the Palestinian Insurance Federation.

Box 6: Palestine leading financial inclusion in the MENA region

The Alliance for Financial Inclusion (AFI) published a report in 2014 stating that the efforts of the PMA have positioned Palestine as a pioneer for financial inclusion in the Middle East and North Africa (MENA) region.

The report pointed out that Palestine had successfully established a financial sector composed of banks, a securities market, insurance companies and specialized lending institution; all in a period of two decades, despite on-going restrictions imposed by Israel on the free mobility of individuals and goods, as well as access constraints to natural and financial resources.

The AFI report also noted that the Arab Monetary Fund (AMF) has recognized the outstanding regional rank of the PMA with respect to financial inclusion when it was selected to develop guidelines on formulating national financial inclusion strategies for the Arab countries in the MENA region. It is expected that in 2015 the Arab central bank governors will officially endorse these guidelines to develop national financial inclusion strategies.

Furthermore, the AFI report referred to the fact that the PMA received a Global Money Week Award in 2013 from Child & Youth Finance International for organizing the best money awareness program in the Middle East region. It was also mentioned that the PMA also successfully launched several systems such as the credit registry system, the credit scoring system and the bounced check system.

The report alluded to the leading role of the PMA in the promotion of financial inclusion, which was reason of genuine interest in raising the levels of financial inclusion in the MENA region, specifically through the provision of technical assistance to fellow Arab Central Banks. Subsequently, Arab banks commenced to develop financial awareness and financial literacy policies as well as national financial inclusion strategies following the model of the PMA, and some central banks have even recently joined the global AFI network.

On the same note, under the patronage of H.E. Prime Minister, the Palestine International Banking Conference 2014 was organized by the PMA in partnership with the International Finance Corporation (IFC) and the Association of Banks in Palestine (ABP) under the title “Financial Inclusion: A Path for Growth”. The conference program included the presentation of successful experiences in financial inclusion. The conference themes focused on highlighting the obstacles facing the youth and women and discussing the appropriate mechanisms and tools that can be employed to defeat these obstacles.

In the course of the conference, three sessions were held during which Palestinian and international IFC and GIZ experts spoke. The first session was chaired by Dr. Sabri Saidam, Former Minister of Telecommunications and IT,



and was entitled “Financial Inclusion the Way Forward”. The second session was chaired by Mr. Hayder Al-Bagdadi, the Manager of GIZ project for Promotion of the Microfinance Sector in the MENA Region. It was entitled “Initiatives and Financial Products to Enhance Financial Inclusion”. The third session was chaired by Mr. Hermann Bender, IFC’s Program Manager at the MENA Bank Advisory Services, and was entitled “Channels, Tools and Techniques to Enhance Financial Inclusion”.

In light of the deliberations and discussions which took place at the conference, and to achieve the objectives of the conference in contributing to financial growth through broader financial inclusion, the conference reached the following recommendations:

1. Enable the partnership of public sector, private sector and civil society institutions in order to overcome impediments and barriers related to financial inclusion;
2. In formulating financial legislature, it is necessary to take into account the three dimensions of financial inclusion: access to, use and quality of financial product;
3. Establish the infrastructure, including legal and statutory frameworks, mechanisms and instruments, which strengthen the stature of financial inclusion in Palestine, as for example to expedite the launch of movable assets registry;
4. Support financial awareness-raising campaigns carried out by the PMA and other parties involved, incorporating all sectors and segments of the Palestinian society in accordance to a systemic and purposeful action plan;
5. Engage banks and specialized lending institutions in financial awareness raising of customers through programs designed for this purpose;
6. Harness the capabilities and abilities of both the supply and demand sides to finance Micro, Small & Medium Enterprises MSMEs owners, impoverished and deprived women and youth and people living in rural and remote areas;
7. Develop banking products and channels to suit the needs, requirements and capabilities of targeted segments;
8. Develop non-banking financial services to promote financial inclusion;
9. Boost the stature and the activity of loan guarantee institutions and work towards raising the collateral coverage ratio, in particular for the targeted segments.

On a different note, and as a sequel to the Banking Week activities, the Third Child and Youth Banking Week, held over the period from 16 -21 March 2014, was launched in the WB and GS with the participation of the banks, the Ministry of Education and Higher Education (MoE), the UNRWA and the Association of Banks in Palestine (ABP). In the course of the week, bank-branch employees made 1,681 visits to schools to give awareness-raising lectures to students. During the visits and in order to promote and encourage money awareness among the students, an approximate 150 thousand standard educational pamphlets containing basic banking information were distributed, in addition to 20 thousand carton money boxes, especially made for the occasion. It is worth mentioning that upon the request of the Arab Monetary Fund (AMF), the PMA prepared a working paper on its organizational experience of the Child and Youth Banking Week.

In light of endeavors to encourage citizens to utilize electronic banking services and use ATMs, the PMA instructed banks, as per Circular No (138 /2014), to abstain from opening new bank accounts (both current and saving) unless an ATM card application is requested by the customer, with the exception of illiterate and blind customers. Additionally, banks were instructed to close accounts of customers who already hold ATM cards, in case they request the cancellation of the ATM services. As part of PMA’s keenness to protect citizens’ rights and to ensure transparency pursuant to the



instructions on fair credit which were previously issued in 2009 and in accordance with Circular No (127 /2014), banks will be required to introduce a declaration form to be signed by the borrower and the guarantor that affirms the receipt of a copy of the agreement for the granted facility and the payment schedule. This circular came as a result of the receipt of numerous complaints filed by borrowers and guarantors stating that they did not receive a copy of the facility agreement nor a payment schedule.

Banks were also instructed to coordinate efforts with the Palestinian Banking Institute (PBI) to secure banking services for the customers with special needs (the hearing-impaired, mute and blind), alongside encouraging engagement with the public visiting the Reception Halls. Accordingly, about 6,566 visits were paid by the public to address various issues.

Out of its commitment to the principles of transparency, disclosure and good governance, the PMA launched at the start of 2014 its new website in both Arabic and English. The website is to serve as a source for information and financial and banking data and a tool to support communication with the public. The website will give members of the public an insight into the most important economic, financial and banking developments in Palestine and in the world in general, alongside purposeful analysis aimed at raising the level of financial and banking literacy of the public from all social segments and backgrounds. Within the same context, a special banking awareness link was created within the web page to serve the purpose of disseminating banking and financial literacy and introduce the public to banking services and products highlighting their significance. The website will host video clips on different basic banking themes and electronic games which were uploaded on social media sites and the websites of the PMA and the Ministry of Education. It will also provide awareness-raising pamphlets on the bounced checks system and the credit registry system.

In the same context, several workshops and awareness-raising campaigns were organized including seminars to students in schools, universities and summer camps in the WB and GS. Furthermore, banking awareness seminars were conducted targeting specific social sectors (the judiciary, merchants, and Palestinian security forces employees). The PMA also coordinated the awareness raising campaign launched by the Islamic banks and financial institutions on Islamic banking services, in addition to organizing a campaign and preparing a companion pamphlet on the risks associated with being a loan guarantor. This campaign was provoked by PMA keenness to raise awareness of members of the public to the plausible social and economic risks associated with providing guarantees to personal loans for the purpose of protecting the rights of guarantors of loans, whether with the banking system or the specialized lending institutions, so that they are cognizant of their legal and material obligations. Relevant statistical figures reveal a rise in the numbers of personal loan guarantors in the Palestinian society over the past few years by about 119 percent. Oftentimes in the local community, acting as loan guarantor is regarded from the perspective of social courtesy, despite proving to be quite costly in many instances. The campaign's logo was "Stop, Think Then Decide". It introduced the public to the risks associated with acting as personal loan guarantor and presented verifying instructions for the guarantor-to-be to follow when providing loan guarantees to others.

Similarly, a campaign was launched to raise public awareness to the importance of abstaining from dealing with private money-lenders. In 2014, information was circulated to the public advising against dealing with usurers, or trusting them with investment of savings. The information pointed out that they are outlawed, that their practices are unlawful and implicate citizens while escaping official supervision as they are not licensed by any competent authority.

At the level of boosting public awareness with regards to sound dealing with money changers, relevant awareness-raising bulletins were published in local newspapers, on-line media and PMA web site. Additionally, any complaints



by citizens against specific money-changers and money-changing companies were followed up and necessary action taken to address them, including conducting audit visits to check implementation.

Additionally, a campaign was launched in 2014 covering the WB and GS to introduce all strata and segments of the Palestinian public to the significance and role of the Palestine Deposit Insurance Corporation (PDIC) in protecting citizens' deposits and maintaining financial stability. The campaign was an outcome of the corporation's responsibility towards citizens and depositors in licensed banks.

Sustainable economic development

The financial sector plays an important role in economic development through providing financing for investment and developmental projects by mobilizing local savings, which are the largest contributor to the needed financial resources. Accordingly, the financial sector has the ability to offer financial services with negligible price or non-price constraints. With better access to multiple social segments and groups, the financial sector can narrow income inequality between the various social strata and stimulate economic activity.

With the above-mentioned in mind, the PMA gave particular attention to the SME sector, due to its key role in development of the national economy, creation of job opportunities, alleviation of rising unemployment, diversification of income and fostering of entrepreneurship as a main contributor to the labor market. The sector importance mounts as it constitutes more than 90 percent of all existing projects in Palestine and contributes by around 55 percent to GDP.

To that end, and to complement PMA efforts to support and attend to the SME sector, an advanced SMEs database was launched containing comprehensive information on SME debt finance portfolios. The database allows users access to a number of analytical and supervisory reports, which, on one hand, contribute to better control of the sector and, on the other, help develop SMEs capacities and facilitate their access to financing sources.

Furthermore, a technical committee, which was established to help enhance the capabilities of SMEs, held a number of meetings. Its efforts culminated in several achievements; most importantly the endorsement of a standard definition for SMEs^[43] and the implementation of various measures to stimulate, empower and promote SMEs which took the form of instructions. PMA instructions exempted banks and specialized lending institutions from setting aside the 2 percent general risk reserve on facilities granted to these enterprises and waived the precondition of an advance cash payment set at 10 percent, when rescheduling SME non-performing loans, which was otherwise a requirement of the PMA.

Two working papers^[44] were prepared on the most prominent demand and supply-side obstacles and challenges that confront SME financing. In conclusion, based on the two papers, five main constraints facing this sector were articulated which require attention. These are:

- The inability of banks to access information on SMEs from the Ministry of National Economy with regard to enterprise registration and authorized signers
- The inability of banks to enquire about deferred checks drawn on customer accounts and presented for collection by other banks.

[43] The SME definition which was endorsed stated that it is "an enterprise with a maximum of 25 employees and a turnover that does not exceed USD 7 million".

[44] On this subject, a working paper on the Palestinian expertise in the area of developing the SME sector and access to finance was reviewed by AFI's SME Finance Working Group. The paper was endorsed during the Q1 of 2014 and presented as a case study to the G20 group.



- Poor level of financial statements reporting for SMEs.
- Poor understanding by SME owners of the significance of preparing economic feasibility studies, their objectives and purpose.
- The absence of legislation on security rights on movable assets

The PMA also worked to improve access to mortgage loans, through the establishment of a new database that contains comprehensive information on the debt finance portfolios of the housing and mortgage sector. The data are of high significance for this sector with regards to risk assessment and the determination of the loan to appraised real-estate value (LTV) ratio as well as the study of the leverage cycle. Therefore, a series of supervisory and statistical reports were designed that can be used for the periodic analysis.

As of April 2014, the PMA required mortgage loans to be granted on the basis of the dynamic LTV ratio and in a manner with corresponds to the borrower's capabilities and credit solvency, to mitigate risks of the mortgage loan portfolio as per Instructions No (2/1204). As such, the conditions for mortgage loan granting are currently linked to the credit score of the borrower, with a higher credit score securing better chances of larger loans, longer terms and more affordable interest rates. A loan amount may reach as high as 85 percent of the appraised real-estate value with a 25 year term under certain conditions

Local and international relations

To bring its goals to fruition, the PMA strived to build and cement a network of local, regional and international relations. It participated in various meetings concerned with the economy and the banking business and strived to connect the Palestinian banking system with the global banking system so as to achieve service excellence and progress.

• Local relations

The PMA has continued to develop its local relations with the various PA institutions, and local organizations and bodies^[45] within its goal to support and promote economic growth and achieve sustainable development. Under this title, cooperation and coordination with the Ministry of Finance continued on the subject of bond issue and the designation of the issue mechanisms and conditions and has culminated with the Palestinian Cabinet endorsement in April 2014 of the issue of bonds. This step is regarded as a major achievement of the government and the PMA^[46], particularly that for the first time since 1947, the bonds will bear the name of the State of Palestine. In the first stage, three-year bonds worth USD 200 million will be issued solely to banks. The bond issue will stimulate the interbank market, thereby enhancing financial stability and the steadiness and stability of the interbank payment System (BURAQ). It will also foster better government management of the public debt. The bond issue will restructure and securitize the outstanding sovereign debt to licensed banks and therefore will not augment government indebtedness or expose the government or the banking system to any additional risks. In addition, the bond issue will act in the future as a development tool of monetary policy in Palestine. For the purpose of introducing government bonds and issue mechanisms and conditions, the PMA held a number of meetings with the banks.

[45] It is worth mentioning that the PMA is a member of the following committees: Palestinian Statistical Advisory Council, Official Statistics Technical Committee, EU-PA Sub-Committee on Financial, Trade and Taxation Matters, the National Committee (national and technical teams) for the Accession to the WTO, Committee for Strategy on Public Finance Management and Monetary, Banking and Financing policies for 2014-2016, the Committee for Movable Assets Registry, the Gold Committee, Improving Business Environment Committee, and the Dissemination Data Systems Committee.

[46] It is worth mentioning that the PMA with assistance from the IMF has founded the Open Market Operation Division in preparation for the bond issue process.



Additionally, within the frame of the relation with the Ministry of Finance, a training program was organized for Ministry employees on analysis of financial statements of banks and money changers. In the meantime, the PMA continued to follow up and develop the National Strategy for Public Financial Management and the monetary, banking and financing policies. Cooperation continued with the Office of the General Attorney and judiciary with regards to distraint warrants pursuant to the Law and with the Ministry of Interior with regard to the operation of NGOs.

In July 2014, the PMA signed a MoU with the Supreme Judicial Council to enhance the capacities and abilities of the Credit Registry database. The MoU allows the PMA to become informed with court verdicts related to banking lawsuits and to disclose the information in the credit report for the general public benefit. Pursuant to this agreement, the Supreme Judicial Council will be furnished with automated systems that satisfy the prerequisites of integration with PMA systems, in accordance to the understandings forged between the two parties in that respect. The data from Palestinian court rulings which are related to banking lawsuits will be uploaded on the Credit Registry system and will be continuously updated and amended following full authenticity and accuracy checks.

Similarly, the PMA was keen on developing relations with other official institutions through its continued membership in several boards of directors (BoDs) and active participation in various institutions' activities and meetings, including the PCMA and affiliated committees (governance committee and risk assessment committee), the PBI, the BoD of the Loan Fund for the Undergraduate in Palestine (and the assets and liabilities committee and internal audit committee), the Board of Professional Auditing (the professional conduct committee, the examinations committee, the licensing committee), the National Team on Governance, the National Anti-Monetary Laundering Committee, the BoD of the ABP as an observing member and the Committee to Rebuild Gaza.

In the area of promoting relations with local universities, the PMA signed in March 2014 MoUs with three universities in Gaza: Al-Azhar University, Islamic University of Gaza and the University College of Applied Sciences Gaza. The memoranda aimed at promoting mutual cooperation and work in scientific research in the fields of economics, business administration, libraries and exchange of library materials from different bibliographic sources of knowledge such as publications, books and journals. They also facilitated access to PMA training for the graduates of the schools of economics and business administration. Moreover, it extends cooperation between the two parties in any other regard as seen necessary. With regards to practical applications of the MoU, two-week training programs for students of the aforementioned universities were conducted at the PMA office in Gaza. Additionally, a series of lectures were organized at local universities (in the WB and GS) which addressed the role of the PMA in the development of the financial system, as well as the significance of the PMA published studies and economic reports in acquainting the public with the economic developments in Palestine and the aspirations of the PMA.

• International relations

The PMA continued to develop its international relations over 2014, by continuing to serve on the boards of directors of a number of international organizations^[47] and taking active part in their meetings and activities while in the meantime seeking to join other organizations. In the context of strengthening its relations with other supervisory authorities outside Palestine, in a manner contributing to better organization and operation of the mechanisms of information exchange and the promotion of cross-border supervisory cooperation, the PMA continued to follow up the application of MoUs signed with the Central Bank of Egypt and the Central Bank of Jordan, having initiated communication with the latter to amend the memorandum to be in-line with supervisory developments.

[47] It is noteworthy that the PMA is a member of the Union of Arab Banks, Islamic Financial Services Board (IFSB), and Arab Committee on Banking Supervision (ACBS) / Arab Monetary Fund (AMF).



In April 2014, the PMA signed a MoU with the Central Bank of Sweden (Riksbank). The aim of the agreement was to promote mutual cooperation and expertise exchange in the fields of financial stability, monetary policies, payment systems and market operations through mutual academic visits, consultancies, joint workshops, training and technical support programs aimed at the development of work approach in central banks.

In November 2014, the PMA and the Consulate General of Italy in Jerusalem signed a MoU with the purpose of drawing upon the experience of Italy in the area of specialized bank and studying the application possibilities in Palestine, within the framework of the program “start up Palestine”. The program is a three-year long program which aims at promoting business projects and economic empowerment for the benefit of marginalized social segments through facilitating access to financial services at fair prices. The MoU is a translation of the existing cooperation between the PA and the Republic of Italy in the economic domain and a culmination of PMA’s efforts to learn of the successful global experiences in the field of small loans programs which aim at promoting capabilities of poor and vulnerable households and marginalized and low-income groups. Italy is considered a world pioneer in development of the cooperative banks model, operating particularly in rural and poverty-stricken areas, and moving a long way on the path of comprehensive economic growth being the first financial institutions to meet the needs of SME owners.

In January 2014, the PMA and the Bank of Algeria signed a MoU aimed to strengthening the mutual relations and exchange of experiences in several fields of common interest, in particular banking supervision and credit registry, which will develop the financial and banking business in Palestine and Algeria. The MoU will also strengthen the technical relations through exchange of experiences between Palestine Banking Institute and High Banking School of Algeria. Within this area, the PMA offered technical support to the Bank of Algeria in the field of credit system development. An assigned PMA team assessed the legal, operational and technical environments to support a modern credit registry system in Algeria, similar to the system employed and internally-developed by the PMA. The automated bounced checks system was also presented to help draw upon PMA expertise in systems development.

The PMA strengthened ties with international organizations such as the OECD, the International Network on Financial Education (INFE), the Child Youth Finance International (CYFI), the AFI and the AMF. The PMA participated in many special committees; in particular some affiliated with the AFI including the committee on the AFI permanent headquarters, the Working Group on Consumer Empowerment & Market Conduct, the Financial Inclusion Strategy Peer Learning Group and SME Finance Working Group. The PMA also participated in the AMF-affiliated regional team which works to promote financial inclusion in the Arab countries and the Arab Committee for Credit Information.

The PMA was also committed to attending the various international meetings related to the subjects of the economy and banking. The governor of the PMA participated in the activities of the Arab Banking Conference organized by the Union of Arab Banks in cooperation with the Central Bank of Jordan, and held in Amman over the period from 16-17 April 2014 under the theme “Strategies for the Development of Arab economies”. The Governor also participated in the Meeting of the Central Banks and Monetary Authorities of the Organization of Islamic Cooperation (OIC) Member States which took place from 5 -6 November 2014. The meeting was organized in Surabaya by the Ankara-based Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRTIC), in its capacity as the OIC Secretariat of the annual meetings, in collaboration with Bank Indonesia, the central bank of the Republic of Indonesia. The meeting was held under the theme “Dealing with Financial Stability Risk: Macroprudential Policy and Financial Deepening in OIC countries”. The Governor shared PMA experience in maintaining financial stability using macroprudential instruments in crisis management, particularly during the recent Israeli aggression against



GS mid-2014^[48], elaborating on the success of the banking system in cooperation with the PMA to continue business thus securing protection and soundness of the system and reinforcing the financial system as a whole.

It is worth mentioning that, in a report prepared for the Donor Ad Hoc Liaison Committee (AHLC) at its conference held in New York on 22/9/2014, the World Bank commended again the role of the PMA in the management and organization of the banking sector, particularly in times of crises; last of which was the Israeli aggression against GS. The report stated that in spite of the heavy losses incurred in GS, the banking sector remained intact, thanks to the organizational efforts of the PMA. The sector has been well regulated by the PMA which steadily built central-bank capabilities. The report noted that the PMA was carefully monitoring risks related to credit exposure associated with loans to the Palestinian Authority and public employees. In earlier reports, the World Bank had affirmed the successful implementation by the PMA, over the past few years, of regulatory measures aimed at building a modern banking system and had adopted internationally applied regulatory standards, as for example the standards in relation to loan rating, governance, licensing procedures, risk management and capital adequacy, in addition to the enactment of the Palestinian Anti-Money Laundering Law in accordance with to internationally-accepted standards.

PMA Ant-money laundering procedures

The PMA continued to collaborate with the Financial Follow-up Unit (FFU) over various related business areas, in particular the area of anti-money laundering. The collaboration culminated in the preparation of the final draft amending the Palestinian Anti-Money Laundering Decree Law No. (9) Of 2007, following a legal review and a gap assessment. In addition, an update to incorporate the latest international standards and developments was carried out, a gauge of a country's commitment to anti-money laundering procedures. This final version is currently pending endorsement and issuance.

Along the same lines, the National Anti-Monetary Laundering Committee, chaired by the Governor of the PMA, issued Instructions No (1/2014) on politically exposed persons (PEPs). It also prepared the instructions on precious metals and gems dealers after incorporation of international standards and updates, currently pending publication. Additionally, the precious metals and gems dealer notification form and the specialized lending institution notification form were approved. Bank compliance to anti-money laundering regulations was also improved through the introduction of a suitable mechanism to examine and determine bank compliance to the law and related provisions and to identify shortcomings of the banks in order to take the necessary corrective procedures and measures.

The PMA helped the FFU develop and reinforce collaborative relations with many related national entities to foster joint local efforts in combating the crime of money laundering and to build a national system for combating money laundering, wherein the roles of the various involved parties integrate to fight and reduce this crime. In that respect, the PMA helped the FFU sign the memorandum of understanding (MoU) with the Palestinian Anti-Corruption Commission (PACC) in April 2014 to combat money laundering. Based on the MoU, the FFU shall forward reports pertaining to corruption as a predicate offence to the Assistant Attorney General acting for the PACC. This will strengthen the efforts to track and prosecute individuals suspected of involvement in the crime of money laundering. The PMA also helped the FFU sign a MoU in April 2014 with the National Team to Combat of Economic Crime (the Working Group on

[48] It is worth mentioning that subsequent to the year of this report, the World Bank asked the PMA to collaborate with the Payment Systems Development Group and other central banks to prepare the a Handbook of Crisis Management for Payment Systems, which will serve a reference to monetary authorities and central banks worldwide for banking system maintenance and good crisis management. The request came following the participation of Dr. Jihad Al Wazir, Governor of the PMA, upon invitation from the World Bank, as a speaker in a seminar on the significance of payment systems in the reinforcement of financial stability during crises. The seminar took place within the frame of the Fragility, Conflicts and Violence Forum organized by the World Bank and held in the Washington D.C.



Financial Crimes in Palestine^[49]) to further underpin the FFU role in protecting the society against money laundering and its serious long-term consequences. It is worth noting that the Working Group on Financial Crimes in Palestine aims largely at capacity building; offering aid in investigation of a possible financial crime, determination, tracking, freezing and confiscation of returns of unlawful activity in Palestine, together with the follow-up of investigations and files transferred from the FFU to the Office of the General Attorney and the exchange of expertise with the involved parties. The Unit's contribution is regarded as essential and pivotal to the work of the group.

During 2014 the FFU offered two specialized programs; namely, the Palestine Anti-Money Laundering Accreditation (PAMLA) and the advanced PAMLA accreditation^[50] for the various involved sectors. The total number of participants was 30, of whom 14 were PAMLA interns (6 from banks, 1 from the Palestine Capital Market Authority (PCMA), 2 from insurance companies and 5 from securities and brokerage companies) and 16 were Advanced PAMLA interns (2 from the PMA, 3 from the banks, 1 from the PCMA, 1 from insurance companies, 6 from securities and brokerage companies).

The FFU continued to be a participant in many workshops. It took part in the workshop titled "Anti-Money Laundering in Light of the New International Standards" which was attended by members of the Public Prosecution and the Economic Crime Unit. The FFU also participated with other foreign experts in a workshop for Public Prosecutors held in Ramallah during the second quarter of 2014, as well as a workshop, organized in collaboration with the PBI, on anti-money laundering in light of new international standards which was delivered to the economic security departments in the law enforcement authorities. Furthermore, it was participant to a workshop on anti-money laundering and transfers of cash or tangible assets in partnership with the European Police. The FFU conducted several educational training courses and workshops for involved ministries, and delivered a seminar on the role of competent authorities in combating money laundering for participants from the Ministry of Finance-tax department, Customs and Excise Department, the Legal Advisor, the Public Prosecution-economic crimes prosecution, the Ministry of National Economy and the Customs and Excise Police.

During 2014, the FFU pursued its efforts with the banks to develop operational procedures with the aim of strengthening commitment to the requirements of the GOAML software application for prompt and effective analysis and processing of intelligence reports and report attachments. Work has been ongoing since 2009 to customize the software to serve as the foundation for the Unit's work, since this would allow the processing of investigative reports and incoming and outgoing communications, in addition to using other time and effort saving features of the program.

At the level of international cooperation and within the frame of cooperation in the area of anti-money laundering, sustained efforts were made to promote and activate relations and sign MoUs with counterpart units. On another note, the Unit conducted a training program on the subject of anti-money laundering in the Inspectorate for Supervision at the Bank of Algeria in August 2014, which was attended by 25 inspectors. The Unit also delivered the PAMLA program at the Bank of Algeria to 31 on-site and off-site supervision inspectors of the bank.

[49] The Group is chaired by the Economic Crimes Prosecutor. Membership is comprised of the FFU, Civil Police Force, Preventive Security apparatus, General Intelligence apparatus, Customs and Excise Police Force, Customs and Excise Department.

[50] The Unit continued to collaborate with the PBI to provide the specialized Palestine Anti-Money Laundering Accreditation (PAMLA). The program aims at capacity-building of the following sectors: insurance, banks, brokerage firms, the Palestine Exchange (PEX), the PCMA, and the PMA. In 2011, the PAMLA program was developed and institutionalized by establishment of a specialized administrative committee to supervise development and execution of the program in accordance to international best practices. The membership selection criteria was based upon high professional credentials that took into account the specialization, expertise and international professional accreditation with respect to anti-money laundering, and at that time, the FFU was a member of the committee. The committee started operating during 2012 and held its meeting on program delivery. The program was delivered by FFU experts and other external experts, who met the specialization and expertise criteria, set by the committee to offer the program curriculum. By the end of 2012, the impelling need to stay abreast with developments in international anti-money laundering standards necessitated the provision of supplementary accreditation to effectively enrich the competency and build capacity of holders of PAMLA. The Advanced PAMLA program was approved. As a result, 100 training hours will be delivered for the holders of both anti-money laundering program accreditations.



Financial activity of the PMA

PMA's financial activity by end 2014 culminated in a decline in assets/liabilities by 0.6 percent, to a value of USD 1,181.5 million, compared to 2013. The drop is mainly attributed to the item representing the Palestinian Cabinet accounts with the PMA on the liabilities side. The account was completely emptied by the withdrawal of all funds (current and savings) totalling USD 65.7 million. Additionally, revaluation reserves and other liabilities dropped by 3.1 percent and 1.9 percent respectively. Contrarily, a rise was seen in the remaining liability items. Bank and financial institution deposits rose by 5.2 percent compared to the earlier year, reflecting the increase in required reserves by 12.9 percent to reach USD 890.4 million

due to the persistent increase in customer deposits in banks operating in Palestine by 7.6 percent. Subsequently, the relative importance of bank and financial institution deposits increased to 88.7 percent compared to 83.3 percent of total liabilities in 2013.

As part of the pre-planned build-up of its capital to gradually reach USD 120 million, PMA's paid-up capital increased by 10.6 percent to amount to USD 70.0 million compared to about USD 63.3 million in the previous year. In consequence, capital and reserves in the PMA balance sheet rose by 7.0 percent to reach USD 100.7 million compared to USD 94.1 million in 2013.

As for the PMA reserves (general and revaluation), they remained unchanged standing at around USD 30.7 million. On the other hand provisions and other liabilities grew by 1.6 percent to reach USD 32.8 million compared to the previous year. Provisions include numerous items like provisions for doubtful loans, indemnity provisions, and accrued administrative expenses. Other liabilities include several items like bank and money changer safe deposits, cash insurances, money changer guarantees, and suspended accounts.

On the assets side, the decline was primarily due to a decline in PMA deposits (both domestic and foreign) by 7.9 percent to reach USD 867.2 million compared with 2013, owing

Figure 4-2: PMA's liabilities structure, 2014

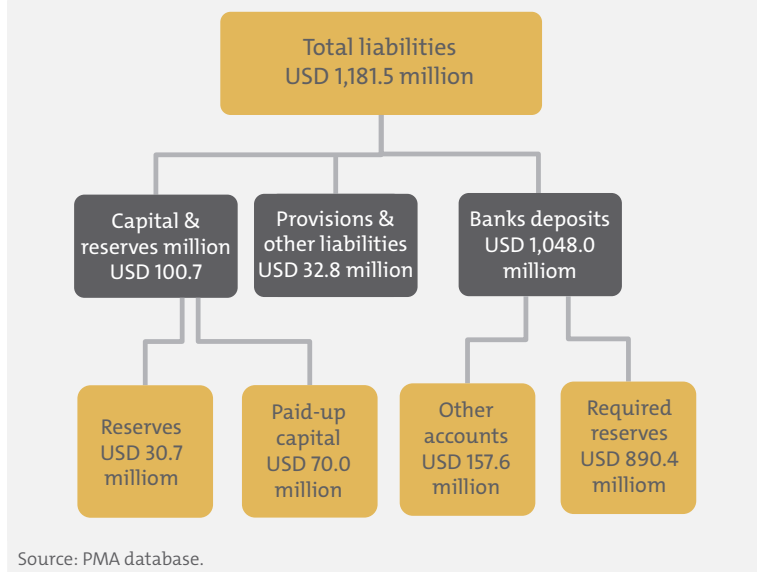
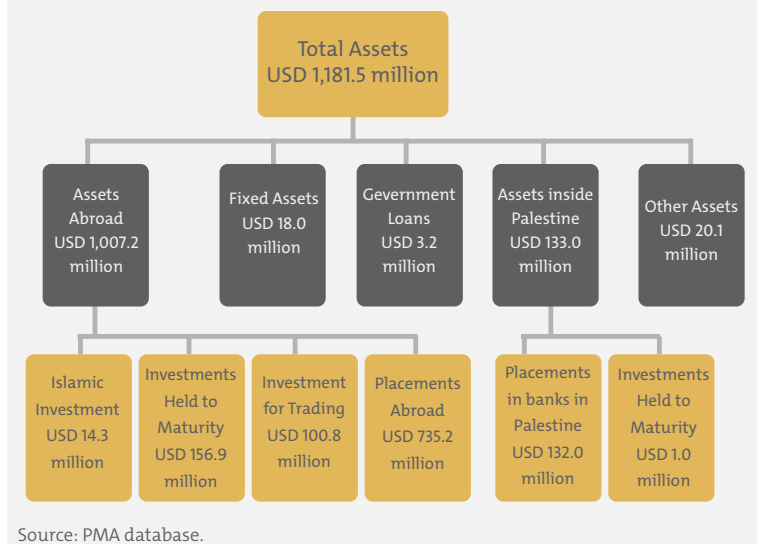


Figure 4-3: PMA's assets structure, 2014



to a decline in domestic time deposits by 38.7 percent to reach USD 107.4 million compared with the previous year. Additionally, PMA foreign current and demand deposits plunged to reach USD 68.9 million falling by 26.7 percent, while PMA domestic current deposits rocketed from USD 8.0 million in 2013 to USD 24.0 million by end of 2014. PMA foreign time deposits also rose from USD 664.5 million to USD 666.3 million by end of the same year.

On the other hand, net fixed assets also increased by 41.7 percent to reach USD 18.0 million by end of 2014, owing to the launch of several important projects in the area of payments systems, services systems and business continuity as well as the financial inclusion strategy project in addition to many others pursued by the PMA. The aforesaid projects were intended to promote the banking system infrastructure and keep abreast with up-to-date systems used in international banking business. Additionally, PMA financial investments held to maturity (domestic and foreign) rose by 72.8 percent to reach USD 157.9 million, whereas financial investments for trading remained almost unchanged from last year at around USD 100,8 million. On the other hand, PMA Islamic investments witnessed a decline by 17.8 percent to reach USD 14.3 million compared to 2013.

PMA foreign assets acquired 85.2 percent of total assets, compared to 81.4 percent by end 2013. Domestic assets constituted 11.3 percent of total assets compared to 15.5 percent, while the remaining assets (fixed assets, government advances and loans and other assets) constituted 3.5 percent compared to 3.1 percent by end 2013.

As for the profit and loss account, PMA revenues rose by 26.3 percent to USD 22.6 million compared with 2013, owing to a rise in net interest and investment profits by 21.4 percent to reach USD 15.9 million and a rise in other revenues by 39.6 percent to reach USD 6.7 million. On the other hand, PMA's overall expenditure hovered at the previous-year level of around USD 16.0 million, with employee expenditure standing at USD 11.0 million unchanged from the previous year and administrative expenditure rising humbly from USD 2.9 million to USD 3.0 million. The FFU expenditure and depreciation expenses remained unchanged from 2013 levels registering 0.6 million and USD 1.5 million, respectively.

End of 2014 net profit results showed a towering increase of net profits to around USD 6.7 million compared to about USD 1.9 million in the previous year. The net profit was transferred in full to PMA paid-up capital.

Research and development

As part of PMA continued efforts to promote research, analytical and information capabilities, the USAID-funded development of the dynamic economic model was concluded end of 2014. The model aims at building analytical capacity in macro-economics, to support the conduct of monetary policy, through the use of Small Calibrated Structural Model, which can provide suitable answers to monetary policy stance and their corresponding response mechanisms in a certain situation, and the use of the Dynamic Stochastic General Equilibrium Model (DSGE) to provide monetary policy predictions. The resultant model will be used alongside other indicators for the determination of future monetary policy and appropriate response mechanism. Likewise, in the second quarter of 2014, with the aid of funds from the World Bank, the output gap model was finalized. Customized to suit the Palestinian case, the model will enable measurement and follow-up of the output gap and the potential output of the Palestinian economy, and will be employed in the future alongside other indicators to determine monetary policy stance at a certain time. It is worth mentioning that output gap analysis is of great significance to central banks, being an important indicator of the business cycles and inflationary pressures in any country.



Publications

During 2014, the PMA publications included reports, studies and periodic bulletins. These consist of annual publications like the Annual Report, Financial Stability Report, Foreign Investment Survey; semi-annual reports like the Public Finance Sustainability Report and the Public Debt Sustainability Report; quarterly reports like Balance of Payments report, Quarterly Statistical Bulletin, Inflation Report, Quarterly Economic Developments Report, Global Financial Markets Report, Monetary Developments Report and the Economic and Social Monitor and monthly publications like the PMA Business Cycle Index, Effective Exchange Rate Bulletin, Monetary Survey and the Monthly Statistical Bulletin. In addition, the PMA prepared several research and working papers in various economic and monetary fields of study^[51].

Staff and training

The PMA, in 2014, continued to develop its staff comprised of 345 employees, of whom 89 employees work at the Gaza office. This took the form of employee participation in programs, specialized professional courses and seminars which covered all aspects and specializations of work in the PMA. The training was carried out at well-established local and international institutions. Accordingly, employees benefited from 138 training programs (course/workshop). Employees from PMA departments of the Monetary Stability Group received training in 29 programs, while employees from the departments of the Financial Stability Group obtained training in 52 programs. This reflected PMA's keenness to develop and update staff on various international developments in the banking, financial, and monetary aspects related to their work.

The PMA pursued collaboration with the Palestinian Banking Institute (PBI) to build and develop staff competency in the financial and banking sectors, through offering and delivering numerous training courses, short and long-term programs and professional certificates and diplomas to bridge the gap between theory and practice in a manner contributing to the improve employee performance in both sectors.

It is also worth mentioning that over the past few years the PBI has been distinguished for offering the Six Sigma certification programs (yellow, green and black belts), which focus on the quality improvement. The PBI conducts these programs in collaboration with many renowned international institutions.

[51] For more details on the full range of PMA publications, please visit the website www.pma.ps



Part II: Banking Sector

Overview

Like any other economic sector, the banking sector was not isolated from the economic circumstances that prevailed in Palestine during 2014, yet it was the least affected. This was thanks to the efforts and measures taken by the PMA, in cooperation and coordination with the banking sector, to fend off the ensuing adverse repercussions.

These efforts and pursuits culminated, as analysis of the consolidated financial statement of banks operating in Palestine shows, in the continued improvement of the performance of this sector. Key indicators revealed good performance levels which reflect the soundness of the sector, on one hand, and the strong public confidence it enjoys, on the other.

The persistent growth and evolution of the banking sector, despite myriad local, regional and international risks endangering the entire national economy, is but an indication of the robustness of the sector and its growing capacity to withstand and cope with these risks, supported by mounting public awareness and confidence and a clearly formulated and strategically focused policy of the PMA. This policy has been devised to maintain the soundness and stability of the sector, making it a pillar of economic growth and sustainable development. This part sheds light on the most important developments of the banking sector during 2014.

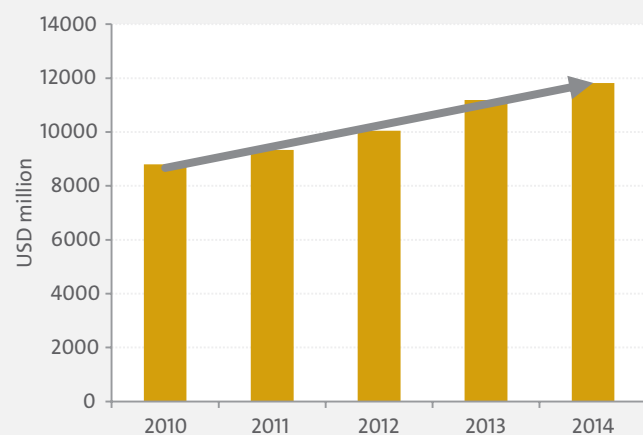
Banking sector performance

Analysis of financial data from the consolidated balance sheet of banks operating in Palestine shows that the efforts and measures made by the PMA, in collaboration and coordination with the Palestinian banking sector, has culminated in a strong performance, clearly evident in numerous financial indicators such as increased and better-quality assets, an enhanced capability to cope with expected and unexpected risks by strengthening of capital, low loan default rates, adequate creation of provisions and increased rates of return; all contributing to the expansion of the role of the banking sector in the national economy.

The banks' consolidated balance sheet for 2014 reveals a rise in assets of the banking system by 5.6 percent compared to end of 2013 to reach USD 11,815.4 million owing to a rise in most of the main components of the consolidated balance sheet.

From the perspective of asset utilization (uses of funds), data shows an elevation in the relative importance of the direct credit facility portfolio growing from 40.0 percent end of 2013 to 41.4 percent of total utilization of funds available end of 2014. Likewise, balances with banks operating in Palestine increased from 4.0 percent to 4.3 percent, Banks' securities portfolio (for trading and investment) from 7.7 percent to 8.3 percent, fixed assets from 3.2 percent to 3.4 percent, and other

Figure 4-4: Assets of banks operating in Palestine, 2010-2014



Source: PMA database.

items from 2.2 percent to 2.8 percent. Contrarily, the relative importance for vault cash shrank from 8.6 percent to 5.6 percent, balances with the PMA from 8.9 percent to 8.8 percent, investments from 1.4 percent to 1.2 percent, while balances with banks abroad stood at the same level of 24.0 percent for the same period.

From a perspective of the asset source (sources of funds), data shows growth in the relative importance of owners' equity to 12.4 percent of total sources of funds end of 2014 compared to 12.2 percent end of 2013; in customers' deposits to 75.6 percent from 74.2 percent; interbank deposits (for banks operating in Palestine) to 4.2 percent from 4.0 percent, and other liabilities to 2.1 percent from 1.4 percent. In contrast, the relative importance of PMA deposits fell to 1.1 percent compared to 1.7 percent and deposits of banks operating abroad to 0.8 percent compared to 2.4 percent, for the same period.

This growth was accompanied by changes in the mechanisms of utilization, whereby banks held around 9.9 percent of total assets in vault cash and in the form of deposits inside the country, compared to 12.6 percent in 2013 while, as in the previous year, 24.0 percent were held in the form of balances abroad. At the same time, bank placements in direct credit facilities increased to 41.4 percent and in securities to 8.3 percent from 40.0 percent and 7.7 percent in the previous year, respectively. In contrast, placements in investments fell to 1.2 percent from 1.4 percent for the same period, due to the unfavorable economic conditions and the lack of political stability in Palestine which took their toll on investment decisions.

Banking system source of funds (liabilities)

Despite the hard economic conditions which prevailed in Palestine during 2014, the unwavering public confidence in the banking system paved the way for the attraction of funds, reinforcing a firm financial basis and owners' equity. In that context, deposits (bank and non-bank) and owners' equity provided the main sources of funds available for banks operating in Palestine. Following is an analysis of the principal sources of funds available to the banking system:

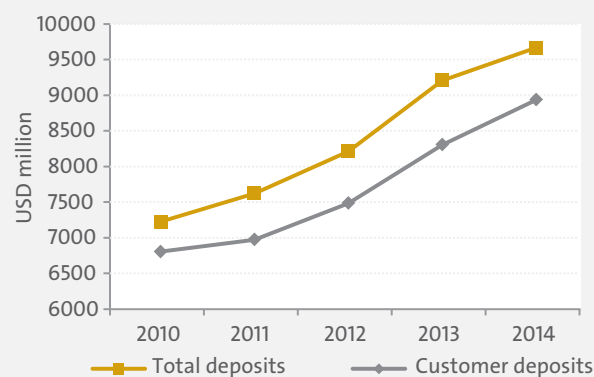
Deposits with banks operating in Palestine

In-depth analysis of deposits with banks operating in Palestine shows growth by 5.0 percent compared to end of 2013, amounting to USD 9,662.7 million. The upturn is totally attributable to the increase in non-bank deposits (customer deposits), whereas bank deposits negatively affected the realized growth in total deposits falling back by 19.1 percent to reach USD 728.2 million, the equivalent of 6.2 percent of total liabilities of the banking system and around 7.5 percent of total bank deposits end of 2014.

As apparent from the consolidated banks' balance sheet, the decline in bank deposits was due to the drop of PMA deposits with banks by about USD 54.8 million and a drop in deposits of banks operating outside Palestine by about USD 171.6 million, as opposed to a hike in deposits of banks operating in Palestine (interbank deposit) by about USD 54.5 million for the same period.

The second constituent of total deposits, and the most important, is customers' deposits which,

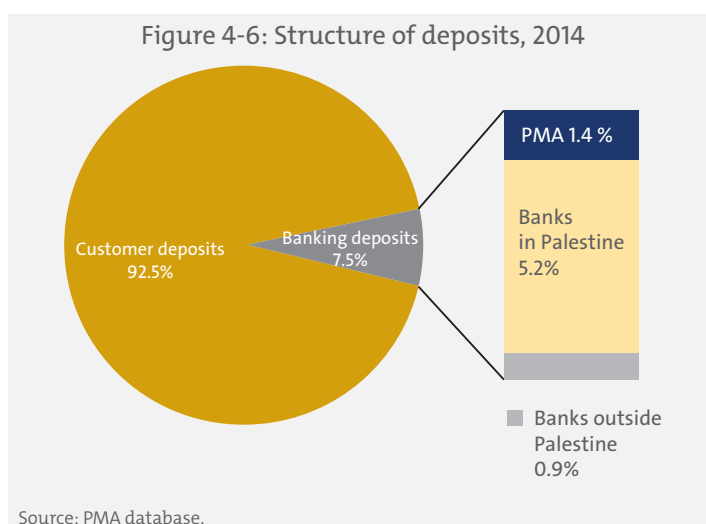
Figure 4-5: Total and customer deposits, 2010-2014



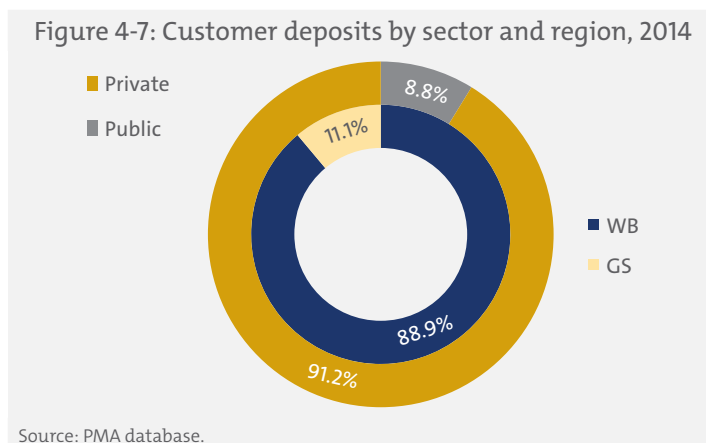
Source: PMA database.



from the liabilities side, continued to hold the largest share constituting 75.6 percent of total liabilities and about 92.5 percent of total deposits with banks by end of 2014. On the other hand, deposits continued to grow rising by 7.6 percent compared to end of 2013 to reach USD 8,934.5 million, which reflects the sustained influx of funds into the banks. The PMA played a pivotal role in the continued flow of funds by conducting awareness campaigns which contributed to promoting depositor confidence in the banking system and endorsing the bank branching policy, in particular in rural and remote areas. Customer deposits were distributed between the private sector at 91.2 percent and the public sector at 8.8 percent, compared to 91.8 percent and 8.2 percent by end of 2013, respectively, which reveals a slight increase with by the public sector. Naturally, the preponderant share of customer deposits belonged to the resident private sector with 96.2 percent, while non-residents' deposits constituted 3.8 percent, compared to 96.6 percent and 3.4 percent end of 2013, respectively. These changes remain negligible and have no significant bearing whatsoever.



As for geographical distribution, analysis indicates that concentration of deposits was higher in the WB, which claimed the largest share of 88.9 percent at a value of USD 7,940.4 million, while GS received 11.1 percent, against 10.3 percent end of 2013, totaling USD 994.1 million. On the same note, it is worth mentioning that GS has been experiencing harsh conditions that caused a stark economic decline, and a surge in unemployment and poverty rates to record levels, in particular in the aftermath of the latest Israeli war in summer of 2014.

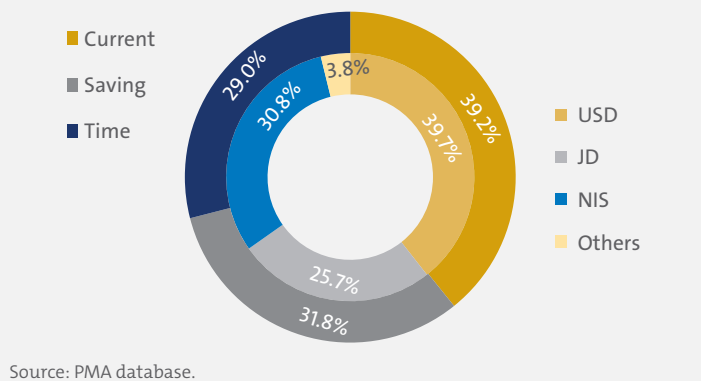


Distribution of customer deposits by type also saw modest changes. Analysis indicates an upturn in the relative importance of saving deposits to 31.8 percent of total customer deposits against 31.1 percent by end of 2013, and, similarly, for time deposits to 29.0 percent against 28.7 percent for the same period. In contrast, current deposits shrank to 39.2 percent from 40.2 percent in the previous year. Despite these developments, current deposits continued to acquire the largest share of customer deposits, followed by saving deposits and finally time deposits. This structure has been dominant for customer deposits distribution throughout the past years. Yet, a greater success for bank endeavors to attract customer deposits, in particular time deposits, may reflect positively on the utilization options, especially for financing and investment purposes on the medium and long terms.

Likewise, customer deposits showed changes with regard to the deposit currency. The USD relative importance receded to 39.7 percent of total deposits against 41.7 percent in 2013, albeit remaining the currency with the largest share.

Apparently, the fluctuations in the interest rate on the USD deposits and the USD exchange rate against the Israeli shekel have affected the shares of both currencies. Conversely, the Israeli shekel share rose to 30.8 percent against 29.0 percent of total deposit end of 2013. Noteworthy is that part of customer deposits in Israeli shekel is used to settle trade transactions with Israeli counterparts, which have picked up slightly over the year. Likewise the relative importance of deposits in Jordanian dinar increased slightly to 25.7 percent from 25.4 percent, whereas the relative importance of deposits in the remaining currencies contracted to 3.8 percent from 3.9 percent end of 2013.

Figure 4-8: Customer deposits by type and currency, 2014



Ownership equity (net)

In tandem with the rise in ownership equity of banks operating in Palestine, both assets and liabilities increased. Banks' consolidated balance sheet showed an increase in ownership equity (net) by 7.7 percent compared to end of 2013 to reach USD 1,464.0 million, constituting 12.4 percent of total fund sources (liabilities) of the banking system compared with 12.2 percent end of 2013.

The paid-up capital is regarded as the most significant component of banks' ownership equity, as it stands in the forefront of defense against expected and unexpected risks. During 2014, it grew by 5.2 percent compared to the earlier year to reach USD 976.0 million, constituting 66.7 percent of total equity (net) by end 2014. Profits pending approval came second in significance constituting about 10.7 percent of ownership equity (net), third came legal reserves constituting about 9.4 percent, then general reserves for banking operations with 5.7 percent, followed by declared reserves with 5.7 percent, and finally other items constituted 1.8 percent of ownership equity (net).

Figure 4-9: Ownership equity (net) of banks, 2010-2014

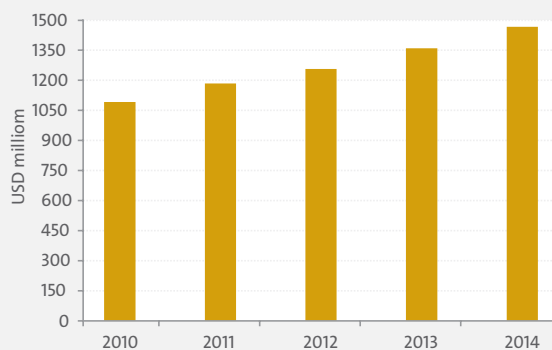
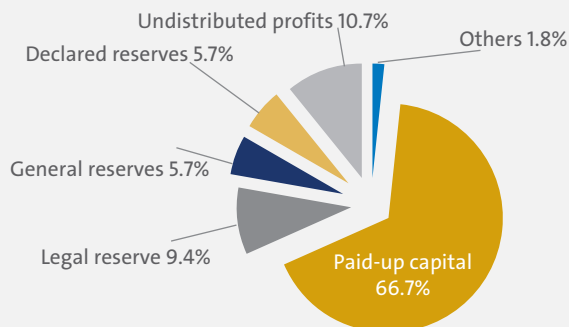


Figure 4-10: Ownership equity (net) structure, 2014



Other items in liabilities

Other items incorporate a number of small-value items, which are listed independently on the liabilities side of banks' consolidated balance sheet. In the lead comes the item executed and outstanding acceptances (accepted to banks inside and outside Palestine) amounting to USD 11.3 million compared to USD 13.8 million at end 2013. The other liabilities item totaled USD 247.6 million compared to USD 153.2 million at end 2013. Additionally, there were items representing various provisions including tax provisions and other provisions.

Banking system uses of funds (assets)

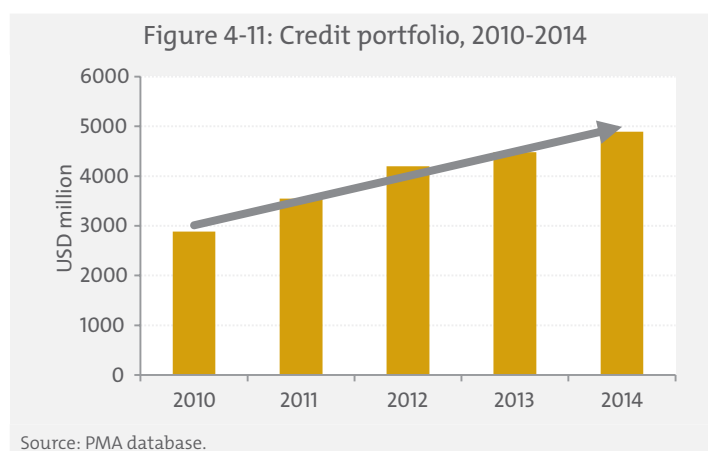
Evaluation of the role of banks and its significance to economic development depends to a large extent on the adopted lending policy and the distribution methodology for available funds across the entire spectrum of methods of fund utilization. Accordingly, and in spite of the peculiar circumstances prevailing in Palestine, a close look at the banking system developments over the past years will disclose the openness of the banking system towards the national economy. As the principal financing channel of the Palestinian economy, banks operating in Palestine have extended financing opportunities to all economic sectors. Following is an analysis of the major utilization methods of funds available to the banking system:

Direct credit facilities portfolio

Analysis of the 2014 banks' consolidated balance sheet shows that the employment of funds in direct credit facilities claimed the lion's share of utilized funds available to banks (components of the assets side) with 41.1 percent of these assets compared to 40.0 percent end of 2013. The direct credit facilities portfolio recorded an increase of 9.3 percent over end of 2013 amounting to USD 4,895.1 million. The sustained growth of the credit facilities portfolio, whether in value or relative importance, is considered an indication of the continued bank tendency towards further utilization of fund sources in the domestic economy despite the associated risks.

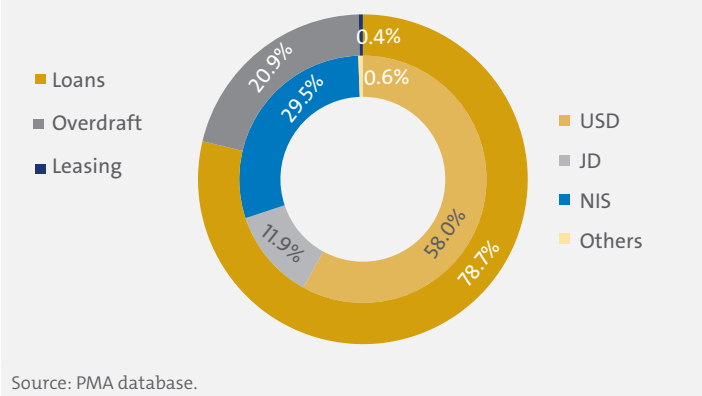
The credit facilities portfolio distributed between the WB and GS with 88.3 percent and 11.7 percent respectively, which is a sign of the growing GS share of total facilities during 2014 when compared to its 2013 share which recorded an 11.0 percent share. This is concomitant primarily with the growth of facilities granted to civil servants.

Analysis of the structure of the credit facility portfolio shows that the share of loans expanded and remained the largest, acquiring 78.7 percent compared to 71.6 percent end of 2013. This expansion came at the expense of overdraft facilities which fell to 20.9 percent compared to 28.0 percent, owing to the drop in overdraft facilities granted to the government. The remaining 0.4 percent was the share of lease financing, which stood unchanged from the previous year.



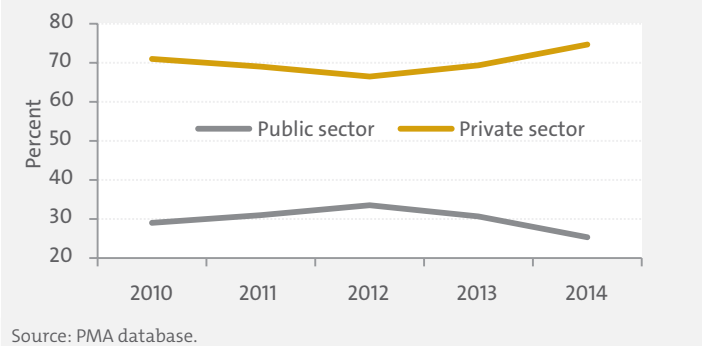
Moreover, analysis shows that during 2014 the USD picked up pace in 2014 enlarged its share, the largest share among currencies, to 58.0 percent of total facilities portfolio compared to 55.0 percent end of 2013. The decline in USD lending rate and a stronger USD against the Israeli shekel may correlate closely to these changes especially that the share of the shekel receded to 29.5 percent of total facilities compared to 33.7 percent end of 2013. The combined effects of the interest rate, the weakened shekel against the dollar, and the drop in the value of facilities granted to the public sector, which is usually in shekels, have pushed down the share of the shekel. The share of facilities granted in Jordanian dinar rose to 11.9 percent of total facilities compared to 10.5 percent end of 2013 on the grounds of a stronger dinar, directly influenced by the changes in the dollar being pegged to it at a fixed rate. The share of the remaining currencies shrank to 0.6 percent compared to 0.8 percent in 2013.

Figure 4-12: Credit portfolio by type and currency, 2014



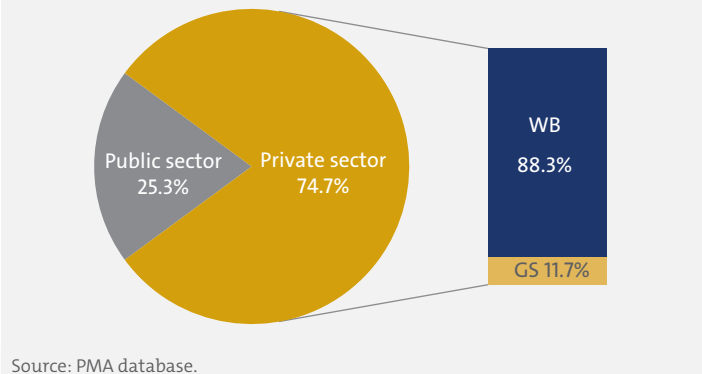
The credit facilities portfolio was divided between the public sector and the private sector at 25.3 percent and 74.7 percent compared to 30.7 percent and 69.3 percent end of 2013, respectively. This distribution reflects a drop in facilities granted to the government during 2014 by about 9.7 percent compared to the previous year to reach USD 1,239.1 million. In contrast, facilities to the private sector increased for the same period by 17.7 percent to reach USD 3,655.3 million. This may signal the diminishing of competition from the public sector over credit facilities, which opens the door for the private sector to benefit from a greater availability of financing opportunities to fulfil goals and carry out economic plans and projects in the different areas of development.

Figure 4-13: Credit portfolio between private and public sector, 2010-2014



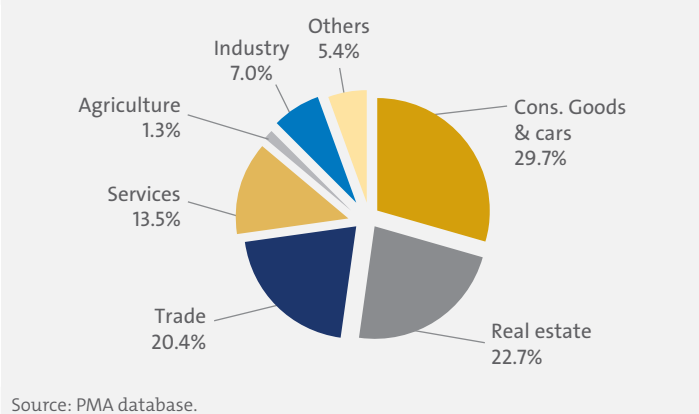
In this context, it is worth noting that facilities granted to the public sector have been declining for the second consecutive year, both in value and in relative importance as percent of total facilities, as opposed to the mounting trend that had prevailed in past years. This may be a sign of some relief in liquidity pressures, which weighed on the government; hence, its need to borrow diminished. In 2014, the government even made payments on accumulated instalments overdue to the banks.

Figure 4-14: Credit portfolio by region, 2014



It is worth mentioning that the private sector used its credit portfolio to fund various economic activities. At the forefront of financed activities were consumption goods and vehicles, collectively acquiring 29.7 percent of total financing granted to the private sector compared to 32.7 percent end of 2013. The second most financed sector was the real estate and construction sector, including land development, which acquired around 22.7 percent compared to 22.8 in the previous year, followed by general trade with 20.4 percent compared to 19.7 percent, and the services sector with 13.5 percent compared to 11.3 percent. As for industry, it received 7.0 percent compared to 7.2 percent, while agriculture received about 1.3 percent compared to 1.2 percent, and the remaining sectors obtained about 5.4 percent compared to 6.1 percent of total financing granted to the private sector for 2013.

Figure 4-15: Credit portfolio to private sector by economic activities, 2014



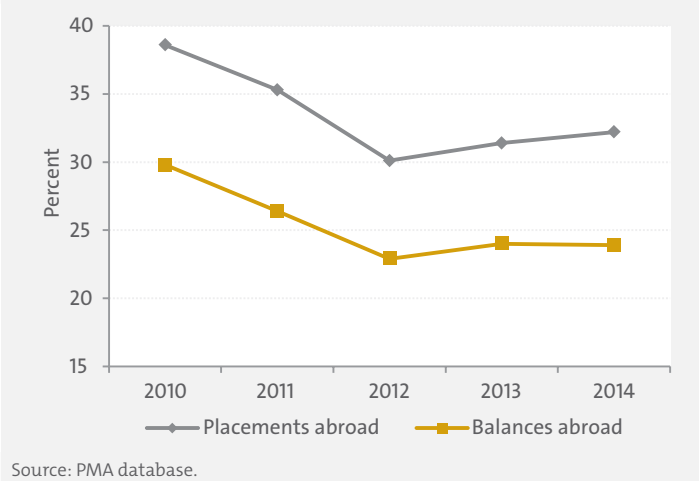
Overall, the swelling of the direct loans portfolio (by 9.3 percent) was accompanied by a distinct quality improvement, with non performing loans ratio dropping by 3.3 percent compared to end of 2013, to reach USD 124.8 million. Banks have also allocated provisions covering about 61.4 percent of these non performing credit facilities.

Placements abroad

Placements abroad are the second most important source for utilization of funds available to banks operating in Palestine. In 2014, they represented 32.2 percent of total fund uses (assets) compared to 31.4 percent by the end of 2013. The value of placements abroad reached USD 3,822.1 million rising by about 8.4 percent compared to end of 2013. Despite this rise, these placements did not exceed 39.6 percent of total deposits, meaning they remained within the PMA-designated limits; set in instructions issued by the PMA at the maximum of 55 percent of total deposits.

Placements abroad are primarily comprised of balances placed abroad, constituting about 74.3 percent of the total placements at a value of USD 2,839.8 million; an increase of 5.9 percent over end of 2013. Investment in some financial instruments, the second most important component of placements abroad, constituted 24.2 percent with a value of USD 926.2 million; an increase of 28.1 percent over end 2013. Credit facilities granted abroad are the third largest component and have not exceeded 1.5 percent of total placements abroad with a value of USD 56.1 million, rising by 52.3 percent over the previous year. In summary, this analysis points out that all components have contributed to the increase in the total value of placements broad, albeit to varying degrees.

Figure 4-16: Placements and balances abroad as a percent of total assets, 2010-2014



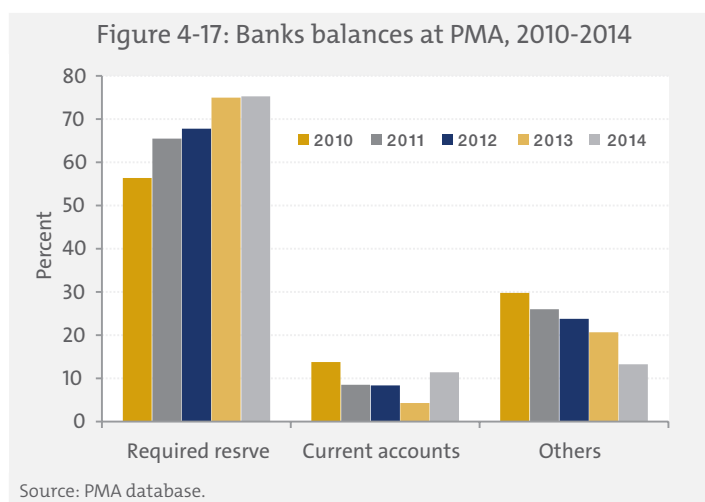
It is worth mentioning that bank investment abroad in all types of securities is bound by PMA approval and restricted to investments that have high credit ratings, while taking into account the degree of concentration per institution and per country, pursuant to Instructions No. (5/2008, clause 5/7).

Analysis of utilization of funds available to banks operating in Palestine indicates an inverse (although imperfect) relation between placements abroad and direct credit facilities. Historical data suggest that one of the two variables moves in the opposite direction of the other. This is so, specifically because banks control placements abroad depending on the changes in the value of credit facilities at home and in accordance with PMA's instructions in force as to the ratio of foreign to local placements. On the other hand, data also suggest that the ratio of placements abroad as percent of total bank assets has been relatively stable during 2013 and 2014, following the decline in the previous years due to the PMA-adopted policy intended to encourage banks to boost utilization of funds domestically.

Balances with PMA and banks

The analysis of the consolidated balance sheet for banks operating in Palestine indicates that the third component for uses of funds available to banks operating in Palestine is balances with the PMA and other banks, which climbed by about 6.3 percent by the end of 2014 to reach USD 4,391.1 million. These include balances with the PMA and interbank balances held among banks operating in Palestine as well as balances with banks abroad.

At the level of balances with the PMA, data analysis shows an increase by 4.5 percent over end of 2013 to reach USD 1,041.5 million. Despite this increase, the relative importance of these balances has declined slightly to 8.8 percent of total assets compared to 8.9 percent end of 2013. The required reserves, the major component of bank balances with the PMA, constituted 74.6 percent of the total balances amounting to USD 776.5 million (stable level for the past few years), whereas bank current accounts constituted 12.1 percent amounting to USD 126.2 million (rose from 4.3 percent end of 2013), and other accounts around 13.3 percent amounting to USD 138.8 million (slumped from 20.7 percent end of 2013).



With regard to interbank balances with banks in Palestine, an increase by 12.6 percent over end of 2013 was noted, to reach about USD 509.8 million; the highest in five years. This may be a sign of greater activation of the interbank market. Balances with banks abroad (the largest and most important component of foreign placements) also recorded a rise of 5.9 percent over 2013, to reach USD 2,839.8 million.

In general, this analysis reveals that about 60.9 percent of the increase in balances with the PMA and other banks is mainly associated with the rise in balances with banks abroad, while 21.9 percent is attributable to rise in interbank balances and about 17.2 percent to a rise in bank balances with the PMA.



Investment portfolio

The general investment environment is affected by the prevailing economic conditions and the current degree of political and economic certainty, reflecting itself on investment decisions, positively or negatively. Ultimately, this will impact the investment portfolio, which is regarded as one of the main channels for the uses of funds available to banks. In Palestine, and in spite of the distinct decline in economic performance alongside an escalation of political and economic uncertainty during 2014, the effects on bank investment decisions appear to be weak, in particular for short-term decisions related to investment in the securities portfolio (certificates of deposit CDs, financial bills and bonds). Available data suggest that banks have utilized around 8.3 percent of assets in securities during 2014, compared to 7.7 percent in 2013, with a total of USD 985.6 million marking a rise of 15.0 percent over the previous year. This is a reflection of the mounting importance of this type of investment with respect to value and relative importance.

Contrarily, however, it was clear that when economic conditions deteriorated and political and economic uncertainty gained ground, both locally and regionally, long-term investment decisions by banks faltered. Such investments included investment in associate, subsidiary or other financial and banking companies and institutions, together having declined by about 6.5 percent compared to end of 2013 to record USD 145.0 million.

Other items in assets

Other items are comprised of a number of independently listed items on the assets side of banks' consolidated balance sheet. Cash and precious metals make the principle component of "other items" and have totaled about USD 658.5 million by end 2014, dropping sharply by 31.1 percent in comparison with end 2013. This was a culmination of PMA efforts which resulted in the resumption of shipment of shekel cash surplus to Israel. It must be noted that this was accomplished following two years during which surplus cash accumulated in the vaults of banks operating in Palestine due to the Israeli-imposed obstacles on cash surplus shipment to its central bank.

The second component under "other items" is fixed assets, which rose to USD 404.4 million, recording a rise equal to 11.7 percent over the previous year. Other assets (the third component) reached USD 329.1 million rising by 35.9 percent over the past year and banking acceptances (accepted by banks inside Palestine and abroad) which totaled USD 6.0 million falling back by 21.0 percent compared to the end of 2013.

Profits and losses

Based on the financial statements of banks operating in Palestine for 2014, banks achieved a net income of USD 145.7 million, equivalent to a 2.0 percent growth from the previous year-end. The 2014 income statement indicates that banks have achieved revenues (net) amounting to USD 492.7 million, an increase of 6.7 percent from the previous year, which consequently gave rise to operational expenses amounting to USD 294.5 million, an increase of 17.1 percent from the previous year.

Analysis of the structure of the various bank activities in the realized net revenue during 2014 shows that the largest contributor was earned interest, which achieved a realized income (net) of about USD 359.9 million equivalent to 73.0 percent of revenues (net) against 74.9 percent end of 2013. The remaining revenue came from non-interest incomes



which contributed around USD 132.8 million, equivalent to 27.0 percent of realized revenue (net) for banks against 25.1 percent by previous end-year.

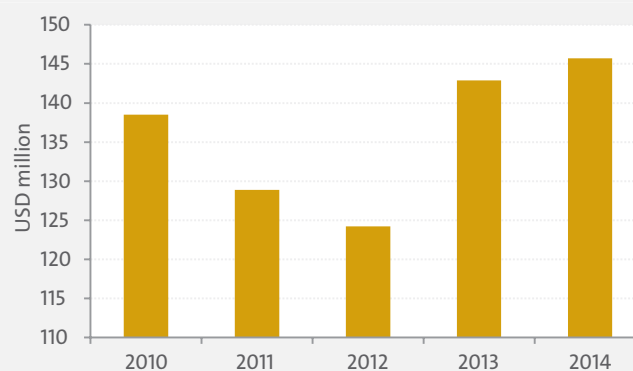
Non-interest income (net) is linked to the net result of banking activities which by end of 2014 was generated by: firstly, fees which amounted USD 86.1 million, and constituted 17.5 percent of net income realized from all activities and about 64.8 percent of realized non-interest income; secondly, foreign exchange revenues amounting to USD 25.4 million constituting 5.1 percent of realized income from all activities (net) and about 19.1 percent of realized non-interest income; thirdly, revenues from other operational activities amounting to USD 13.0 million constituting 2.6 percent of realized income from all activities (net) and about 9.8 percent of realized non-interest income; fourthly, securities and investments amounting to USD 6.5 million and constituting 1.3 percent of realized income from all activities (net) and about 4.9 percent of realized non-interest income and, finally, activities of off balance sheet items amounting to USD 1.9 million, constituting 0.5 percent of realized income (net)

from all activities and about 1.4 percent of realized non-interest income. In general, it is evident from the above analysis that banks remain dependent on one of its most important responsibilities to generate income, namely financial intermediation between the economy's surplus and deficit units.

Interest rates

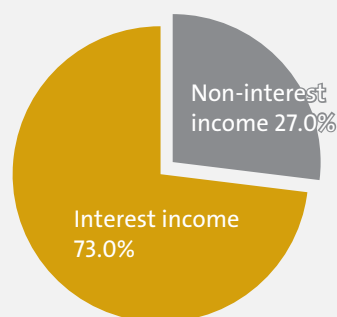
During 2014, slight changes have affected the annual deposit and lending interest rates in the different currencies used by the banks operating in Palestine compared to the previous year. Primarily, deposit interest rates in dinar, dollar and shekel rose, whereas interest rates on facilities granted in these currencies declined. At the level of the dinar, data show that deposit interest rate rose by 7 basis points to reach 2.15 percent as opposed to a drop in the lending interest rate by about 8 basis points to reach 9.10 percent. For the USD, the deposit interest rate increased by 21 basis points to reach 0.83 percent as opposed to a drop in lending interest rate by 110 basis points to fall to 6.41 percent. Along the same

Figure 4-18: Net income of banks operating in Palestine, 2010-2014



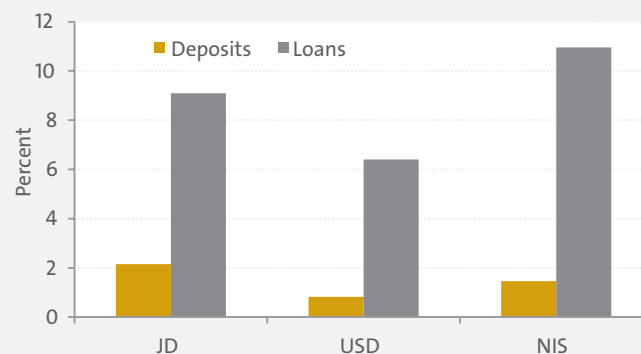
Source: PMA database.

Figure 4-19: Banking revenues structure, 2014



Source: PMA database.

Figure 4-20: Lending and deposit rates by currency, 2014



Source: PMA database.



lines for the shekel, deposit interest rate rose by around 14 basis points to reach 1.46 percent as opposed to a slump in lending interest rate by about 62 basis points to reach 10.96 percent.

In light of these changes, the margin between lending and deposit interest rates declined at the level of all three currencies, with the shekel margin remaining the highest. The margin for dinar dropped from 7.10 points in 2013 to 6.95 points in 2014, for the dollar from 6.89 points to 5.58 points, and for the shekel from 10.26 points to 9.50 points, all over the same period.

Along this line, it is notable that interest rates and associated fluctuations are related to exogenous determinants originating from countries issuing the currencies in circulation in the Palestinian market. The impact of these determinants is greater than many other endogenous determinants related to domestic demand or liquidity.

Payments systems

The launch of the payment system as part of the PMA efforts intending to build and develop banking and financial systems which conform with international best practices, constitute a basic pillar in a robust and comprehensive banking structure and contribute to the mitigation of risks that endanger the banking system and the financial system as a whole.

Activities of BURAQ system

The RTGS transactions for banks operating in Palestine through BURAQ system over 2014 totalled about 175,253 transfers amounting to USD 33,909.4 million with an increase of 6.8 percent in number and 5.6 percent in value over 2013 figures. Settlement transactions executed between participant banks included personal transfers, bank transfers^[52], settlements of financial positions resulting from clearing of checks, Palestine Exchange (PEX) settlement operations, settlement of required reserve adjustments and other transactions.

Bank transfers constituted about 4.5 percent of the number of total executed transfers and 47.2 percent of the total value, rising by 9.1 percent to reach USD 16.2 billion, compared to 2013. Personal transfers constituted 87.9 percent of the total number of executed transfers and 19.9 percent of their value, rising by 6.6 percent to reach USD 6.8 billion, compared to 2013. This is indicative of the modest average value of personal transfers, recording an average of USD 44 thousand, against the average value of bank transfers, recording an average on USD 2 million. Transfers from clearing settlements^[53] accounted for 4.5 percent of total number of executed transfers and 9.5 percent of the total value of these transfers, falling by about 4.0 percent to reach USD 3.2 billion, compared to 2013. Transfers of PEX settlement operations, processed through BURAQ starting from 2013 pursuant to a MoU between the PMA and PEX signed in February of that year, accounted for 0.8 percent of the total number of executed transfers and 0.2 percent of their value, rising by 16.5 percent to reach USD 84.2 million, compared to 2013. Transfers of other transactions accounted for 0.9 percent of the total number of executed transfers and 0.4 percent of their value, rising by 2.9 percent to reach USD 135.0 million, compared to 2013. Finally, transfers forwarded outside the system accounted for 1.3 percent of the total number of executed transfers and about 22.2 percent of their value, rising by 1.9 percent to reach USD 7.5 billion, compared to 2013.

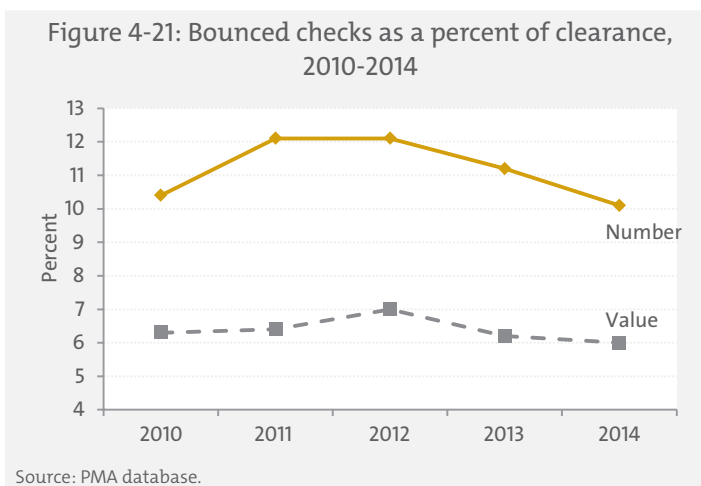
[52] A transfer where payer and beneficiary are banks and it is a result of transactions and activities primarily connected with the internal interbank money market

[53] Transfers connected to check-clearing settlements.



Clearance house activities

Through its clearing houses in Ramallah and Gaza, the PMA provides clearing services to all banks operating in Palestine in all currencies in circulation. Data on clearing activity in all currencies (denominated in USD) indicates that the number of checks submitted for clearing the year 2014 increased by about 6.7 percent to 4,637,772 check at a total value increase of about 9.4 percent to USD 11,055.2 million, compared to 2013. The ratio of number of bounced checks to total number of checks submitted for clearance dropped to 10.2 percent from 11.2 percent in 2013, whereas in value bounced checks to total checks dropped to 6.0 percent from 6.2 percent over the same period. This is a clear indication of the Credit Bureau's role in curbing the bounced checks phenomenon and preserving the check's legal and practical status as a highly credible redemption tool.



Normally, clearing activity correlates closely with the level of economic activity. Enhanced clearing activity is evidenced by several economic indicators like the upturn in Palestinian foreign trade activity (exports grew by about 10.9 percent and imports by about 14.4 percent compared to 2013), the increasing and regular transfer of clearance revenues from Israel (increased by about 20.2 percent from 2013), the rise in compensations for Palestinian workers in Israel as a result of the increase their numbers and wages (rose by about 15.4 percent from 2013), a rise in remittances from Palestinians abroad to their families and relatives in Palestine (increased by about 82.5 percent compared to 2013) and the foreign aid granted to the PA by donor countries (reached about USD 1,230 million).



Part III: Non-Banking Financial Institutions

Overview

In Palestine, non-banking financial institutions are subject to the supervision of two independent authorities. The PMA is responsible for oversight and supervision of specialized lending institutions and money changing firms, whereas the PCMA is responsible for the oversight and supervision of the PEX, insurance companies, leasing companies and mortgage companies.

During the past few years, these institutions benefitted from a number of positive legislative and financial developments, which reflected positively in their financial statements and results. Yet the need still exists for further measures to support the development and progress of these institutions, to enable them to play a more effective role in developing Palestine's financial system and economy at large. This part throws light on the most important developments in these institutions during 2014.

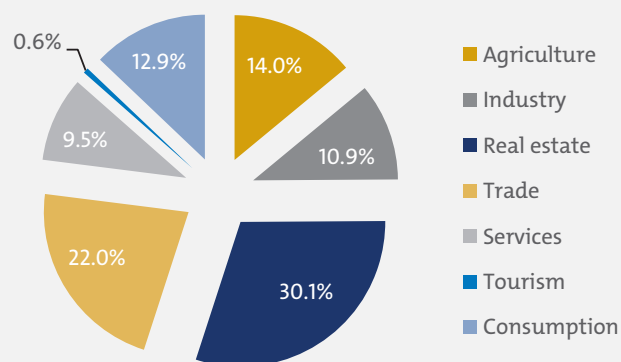
Specialized lending institutions

Specialized lending institutions are subject to PMA's oversight and supervision since 2011, pursuant to the provisions of Regulation No. (132) for that year, which extended the licensing and supervisory remit of the PMA to specialized lending institutions, with the intention to maintain the soundness of their operation, enhance efficiency and competence while preserving financial stability and securing positive contribution to sustainable economic development. To that end, a number of instructions were issued during 2014 to organize the operation of these institutions (instructions on housing loans and mortgage based on the dynamic loan-to-value (LTV) ratio and instructions on the classification of loans/financing and the generation of allocated provisions). Additionally, the PMA designed a standardized financial and statistical report form and prepared an off-site analysis guide for the use of these institutions.

By end of 2014, five specialized lending institutions obtained final licensing from the PMA^[54]. Operational data on specialized lending institutions indicate that they operate through a network of 58 branches (excluding headquarters). The number of beneficiaries of granted loans was about 45,152 with an outstanding loan total value of about USD 97.0 million and an average value per loan of USD 2,148.3.

These loans spread across diverse economic activities and sectors, depending on the institution's goals and scope of work. The real estate sector claimed the largest share of 30.1 percent of the total value of granted loans, followed by the trade sector with 22.0 percent, then agriculture sector with 14.0 percent, then consumption sector by 12.9 percent, then industry with 10.9 percent, services and public facilities with 9.5 percent, and finally tourism sector with 0.6 percent during 2014.

Figure 4-22: Sectoral distribution of specialized lending institutions' loans, 2014



Source: PMA database.

[54] The institutions are: Reef, Faten, Asala, ACAD, and Ibdaa. On a later date to the year of this report, the PMA granted final license to operate as a specialized lending institution to VITAS. Currently, three additional licensing applications are under examination.

Money changers

The activity of money changing constitutes one of the pillars upon which the Palestinian financial system rests and a key constituent of financial stability in Palestine. On that ground, the PMA efforts continued with regard to this vital sector. On the basis of Regulations No. (13) of 2008 on the License and Control of the Exchange Profession, the PMA's work addressed supervising, regulating and protecting the soundness and stability of this sector. For that purpose, the PMA issued several relevant instructions and decisions.

By end of 2014, PMA-licensed money changers in Palestine numbered 280, of which 237 were in the WB and 43 in GS. There were 199 money changing firms as opposed to 81 money changers (individually engaging in currency exchange). 2014 saw a change in the legal form of six money changers, by amending their legal status from individuals to firms, and in line with the License and Control of the Exchange Profession Regulation No. (13) of 2008.

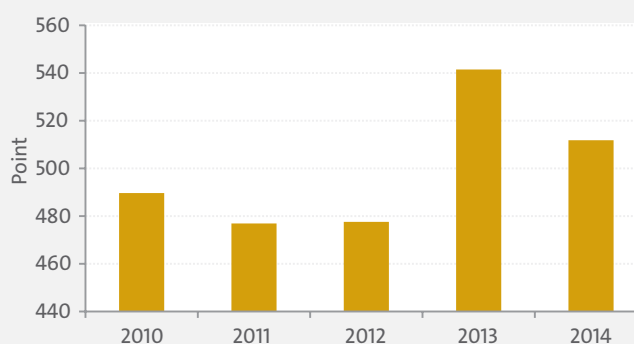
Performance indicators of financial activity for the money changing sector show that, by end of 2014, total assets rose by 6.7 percent to USD 52.9 million. Likewise, capital rose by 4.3 percent to USD 46.4 million, compared to 2013. Nevertheless, ownership equity dropped by 1.1 percent, over the same period, due to the closure of a number of money changers that exited the market.

Securities sector (Palestine exchange-PEX)

By end of 2014, the PEX Index (Al-Quds) declined by 5.5 percent against the previous year closing at 511.8 points. The decline followed the drop in the indices of all sectors, with the exception of the insurance sector which rose by about 2.8 percent to the level of 46.8 points. Sector indices fell for services sector by about 5.8 percent to close at 49.2 points; for banking and financial services by 4.2 percent to close at the level of 119.7 points; the industry by 0.9 percent to close at the level of 67.7 points and the investment sector by 0.3 percent having closed at the level of 25.5 points, compared to the previous year. PEX performance has been adversely affected by the deteriorating general conditions in Palestine, in particular for the second half of the year in the wake of the recent war waged by Israel against GS in summer of 2014, alongside an absence of political and economic favorable prospects.

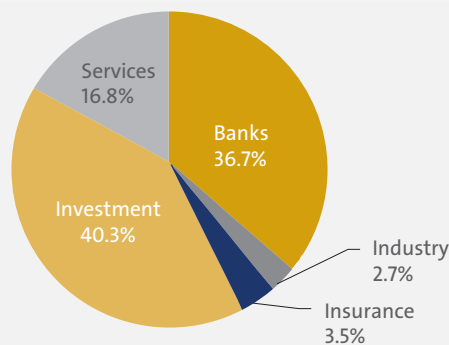
Analysis of PEX performance indicators shows a decrease in the trading volume by 10.6 percent over 2014 compared to the previous year, to reach

Figure 4-23: Al-Quds Index of PEX, 2010-2014



Source: PEX database.

Figure 4-24: Sectoral distribution of traded shares volume in PEX, 2014



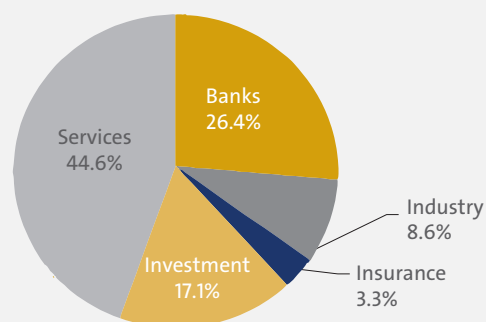
Source: PEX database.



181,545,154 shares of listed companies^[55] totaling about USD 353.9 million, an increase of 3.9 percent over 2013. The number of trading sessions reached 245, compared with 241 sessions in 2013, through which 41,257 deals were carried out, a decline of 7.3 percent over 2013. The market value of these shares amounted to USD 3.2 billion, a drop by about 1.9 percent against the previous year, which led to the decline in the market liquidity levels (the traded shares' turnover ratio reflects the availability of orders to buy and orders to sell over the entire period of trading days).

As for trading by sector, the investment sector continued to rank first acquiring 40.3 percent of total number of traded shares, valued at USD 545.3 million, the equivalent of 17.1 percent of listed companies' total market value. The banking and financial services sector came second, accounting for 36.7 percent of total number of traded shares valued at USD 840.5 million, the equivalent of 26.4 percent of total market value. The services sector followed accounting for 16.8 percent of total number of traded shares, valued at USD 1,422.6 million, the equivalent of 44.6 percent of total market value. The insurance sector claimed 3.5 percent of total number of traded shares, valued at USD 105.2 million, the equivalent of 3.3 percent of total market value. Finally, the industry sector accounted for 2.7 percent of total number of traded shares, valued at USD 273.7 million, the equivalent of 8.6 percent of total market value^[56].

Figure 4-25: Sectoral distribution of market capitalization in PEX, 2014



Source: PEX database.

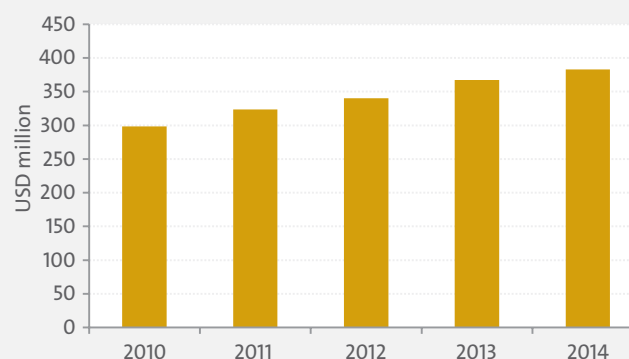
Regionally, PEX ranked third, after Sudan and Saudi Arabia, in the set of financial markets witnessing decline in key indicators. It is worth mentioning that the Egyptian market was the best-performing market amongst Arab markets, achieving the highest index rise of about 13.6 percent, whereas the Iraqi market was the worst-performing market with an index drop of 18.7 percent against its result of 2013.

Insurance sector

Insurance sector operational data show that the sector offered different insurance services through 10 insurance companies licensed by PCMA in Palestine. These companies operated through a network of 111 branches and representative offices, 215 agents and insurance producers and 10 insurance/reinsurance intermediaries, while insurance employees numbered 1,175.

Analysis of end-2014 financial results of insurance companies shows a rise in the sector's total assets

Figure 4-26: Assets of insurance sector, 2010-2014



Source: PCMA database.

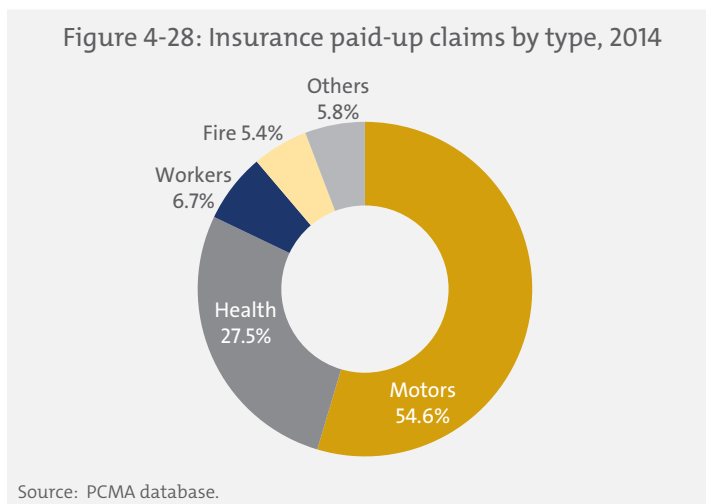
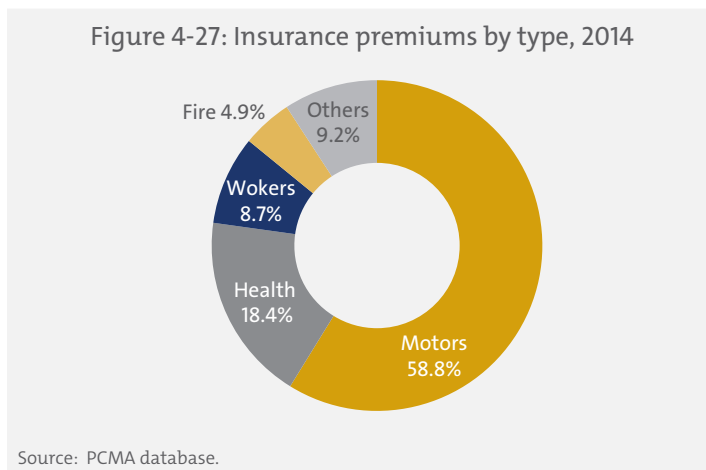
[55] During 2014, Palestine Mortgage & Housing Corporation (PMHC) was delisted following the change in its legal status to become a private shareholding company. Thus the number of listed companies fell to 48 from 49 in 2013, of which 8 were banks and financial companies, 12 industrial companies, 7 insurance companies, 9 investment companies and 12 other companies offering different services.

[56] Since the start of 2013, PEX started to process RTGS settlement transactions through the BURAO, following the signing of a MoU with the PMA in February of that year.

by 7.8 percent to total USD 383.0 million compared to 2013. Shareholders' equity rose by 14.1 percent to USD 136.7 million, while paid-up capital went up by 2.7 percent to USD 69.7 million. Net profit after taxes rose by about 12.9 percent to reach USD 14.0 million, compared to 2013.

The total value of premiums collected by insurance companies amounted to about USD 171.0 million, a hike of about 12.3 percent over 2013, owing to an increase in premiums of all kinds of insurances. Motor insurance premiums constituted the largest share (58.8 percent) of total premiums, being the only compulsory form of insurance in Palestine required by the Traffic Law in force which forbids any vehicle on the road without a valid motor insurance. Health insurance premiums came second with 18.4 percent, workers' compensation insurance premiums with 8.7 percent, fire insurance with 4.9 percent, and the remaining types of insurance premiums with 9.2 percent^[57].

Conversely during 2014, compensation paid by insurance companies grew by USD 19.2 million, a 21.9 percent rise over 2013, to reach USD 108.1 million. Motors insurance compensations accounted for 54.6 percent of total amounts paid, health insurance compensations claimed 27.5, workers' insurance accounted for 6.7 percent, fire insurance 5.4 percent, while the remaining types of insurances claimed about 5.8 percent^[58] of total compensation amounts paid.



Mortgage sector

The mortgage sector is regarded as a key economic sector in Palestine and a preferred destination to many investors. During the past few years, the sector made quality and rapid leaps forward boosted by a marked increase in demand. Despite having attracted a lot of capital, the mortgage sector continues to face myriad impediments at the levels of both primary and secondary markets. The primary market suffers from the absence of specialized mortgage financing companies which restricts the market to banks only. While some banks rely on intrinsic sources to finance mortgage loans, others resort to refinance loans through the secondary market. The secondary market consists of two companies: the Palestine Mortgage and Housing Corporation^[59] and its subsidiary the Palestine Housing Finance Corporation. The secondary market also suffers from limited sources of financing, as a result of the reluctance of refinancing

[57] Included civil liability insurance at 1.8 percent, other general insurances at 1.8 percent, marine insurance at 1.0 percent, engineering insurance at 2.3 percent, and life insurance at 2.3 percent

[58] Included compensation paid for life insurance with 2.3 percent, engineering insurance with 1.8 percent, civil liability insurance with 0.8 percent, other general insurances with 0.8 percent, and marine insurance with 0.1 percent.

[59] The company was founded in 1999 as a public shareholding company with a capital of USD 20 million.



companies to issue corporate bond or bonds backed by real estate holdings due to the absence of a specialized law to regulate the issue of such bonds.

In view of the absence of a mortgage law, the PCMA is currently assigned with the follow-up of this sector through a number of instructions that were drafted with the aid of international expertise, like the instructions on capital adequacy, the instructions on provisions and credit standards for mortgage financing companies. On the other hand, the PCMA is also in charge of the follow-up and licensing of competent and highly professional real estate appraisers. PCMA register shows there are currently 44 licensed appraisers. In collaboration with other stakeholders, the PCMA is also working, to establish a proper reference for land market value in Palestine.

Leasing sector

The leasing sector represents a financing method which was newly introduced to the Palestinian market and which is contributing to stimulate and encourage domestic investment and economic growth and stability. The PCMA has assumed the responsibility for developing this sector and laying down the proper foundations for its operation. PCMA efforts culminated in the endorsement of the Financial Leasing Law by decree in January 2014, in addition to the finalization of a comprehensive review of the instructions on VAT on lease agreements and the instructions on the registration of immovable assets^[60]. Nonetheless, the sector is still challenged by obstacles hindering its development like the high costs of leasing in comparison with the costs of credit facilities offered by banks, in addition to the lack of public awareness of leasing and its importance.

This Law, which was rated MENA region's first-ranking in form as well as content, was founded on the international best practices of lease financing including the model law on leasing developed by the International Institute for the Unification of Private Law (UNIDROIT) in Italy and customized to conform to Palestinian statutes and regulations.

In general, the activity of this sector is still limited to the area of vehicle leasing which claims the largest share thereof. Available data shows that there were 11 leasing companies by end of 2014 in the leasing business^[61].

These leasing companies are expected to join the PMA's Credit Bureau in the coming period, which will promote the sector's stability and augment its role as an important financing tool and an integral part of the financial system.

[60] For the purpose of laying down the proper foundations for operation of this sector in conformance with international best practices, the instructions on VAT on lease agreements were revised in collaboration with the VAT department in the Ministry of Finance and an expert from Jordan, contracted through the IFC, to attain the best-possible version of the instructions and consequently pave the way for their approval and endorsement by the Minister of Finance. Likewise, a final version of instructions on the registration of immovable assets was drafted in collaboration with the Lands Authority, which, as was agreed, will be released in tandem with the issuance of the Mortgage Law.

[61] Leasing companies licensed by the PCMA include: Pal Lease, the Arab Company for Leasing, Ritz Leasing, Lease For You Company, Mina for Leasing, Palestinian Rental Company, Al Murad Rental and Leasing Company, Lease and Go, Good Luck Company for Car Trade, Easy Car for Leasing, and White Stone Company for Leasing.

Appendices

Chapter One
Global and Local Economic
Developments



Part I: Global Economy

Table (1-1): Global real GDP growth rates, 2010-2014

(Annual percent change)

Country	2010	2011	2012	2013	2014
World	5.2	4.0	3.2	3.4	3.4
Developed countries	3.0	1.6	1.4	1.4	1.8
United States	2.5	1.6	2.3	2.2	2.4
Euro area	2.0	1.6	-0.8	-0.5	0.9
Germany	3.9	3.7	0.6	0.2	1.6
France	2.0	2.1	0.3	0.3	0.4
Italy	1.7	0.6	-2.8	-1.7	-0.4
Japan	4.7	-0.5	1.7	1.6	-0.1
United Kingdom	1.9	1.6	0.7	1.7	2.6
Canada	3.4	3.0	1.9	2.0	2.5
Israel*	5.7	4.2	3.0	3.2	2.7
Emerging and Developing Countries	7.6	6.4	5.0	5.0	4.6
Africa- Sub-Saharan	6.7	5.0	4.2	5.2	5.0
Central and Eastern Europe	4.7	5.4	1.3	2.9	2.8
Commonwealth of Independent States	4.6	4.8	3.4	2.2	1.0
Developing Asia	9.6	7.7	6.8	7.0	6.8
China	10.4	9.3	7.8	7.7	7.4
India	10.3	6.6	5.1	7.0	7.2
Middle East and North Africa	5.1	4.5	4.9	2.3	2.4
Egypt	5.1	1.8	2.2	2.1	2.2
Jordan	2.3	2.6	2.7	2.8	3.1
Lebanon	8.0	0.9	2.8	2.5	2.0
Saudi Arabia	4.8	10.0	5.4	2.7	3.6
Latin America and the Caribbean	6.1	4.9	3.1	2.9	1.3
Brazil	7.6	3.9	1.8	2.7	0.1
Mexico	5.1	4.0	4.0	1.4	2.1
Global GDP at purchasing power Parities (Billion)	88,156	93,576	98,191	102,966	107,921

* Israel according to the WEO, that published by the IMF is classified within developed countries.

Source: World Economic Outlook (WEO), International Monetary Fund (IMF), April 2015.



Table (1-2): Global inflation rates, 2010-2014

(Annual percent change)

Country	2010	2011	2012	2013	2014
World	3.8	5.2	4.2	3.9	3.4
Developed countries	1.5	2.7	2.0	1.4	1.4
United States	1.6	3.1	2.1	1.5	1.6
Euro area	1.6	2.7	2.5	1.3	0.4
Germany	1.2	2.5	2.1	1.6	0.8
France	1.7	2.3	2.2	1.0	0.6
Italy	1.6	2.9	3.3	1.3	0.2
Japan	-0.7	-0.3	0.0	0.4	2.7
United Kingdom	3.3	4.5	2.8	2.6	1.5
Canada	1.8	2.9	1.5	1.0	1.9
Israel	2.7	3.5	1.7	1.5	0.5
Emerging and Developing Countries	5.9	7.3	6.1	5.9	5.1
Africa- Sub-Saharan	8.2	9.5	9.4	6.5	6.3
Central and Eastern Europe	5.6	5.4	5.9	4.3	3.8
Commonwealth of Independent States	7.1	9.8	6.2	6.4	8.1
Developing Asia	5.2	6.5	4.7	4.8	3.5
China	3.3	5.4	2.7	2.6	2.0
India	9.5	9.4	10.2	10.0	6.0
Middle East and North Africa	6.2	8.7	9.7	9.3	6.5
Egypt	11.7	11.1	8.7	6.9	10.1
Jordan	4.8	4.2	4.5	4.8	2.9
Lebanon	4.0	5.0	6.6	4.8	1.8
Saudi Arabia	3.8	3.7	2.9	3.5	2.7
Latin America and the Caribbean	6.2	6.8	6.1	7.1	n.a.
Brazil	5.0	6.6	5.4	6.2	6.3
Mexico	4.2	3.4	4.1	3.8	4.0

Source: WEO, IMF, April 2015.



Table (1-3): Developed economies: unemployment, 2010-2014

(Percent of labor force)

Country	2010	2011	2012	2013	2014
Developed countries	8.3	8.0	8.0	7.9	7.2
United States	9.6	8.9	8.1	7.4	6.2
Euro area	10.1	10.1	11.3	12.0	11.6
Germany	6.9	5.9	5.4	5.2	5.0
France	9.3	9.2	9.8	10.3	10.2
Italy	8.4	8.4	10.6	12.2	12.8
Japan	5.0	4.6	4.3	4.0	3.6
United Kingdom	7.9	8.1	8.0	7.6	6.2
Canada	8.0	7.5	7.3	7.1	6.9
Israel	8.3	7.1	6.9	6.3	6.0
Major developed countries	5.2	4.8	4.7	4.6	4.7

Source: WEO, IMF, April 2015.

Table (1-4): Interest rates of major currencies, 2010-2014

(Period end, percentage)

Country	2010	2011	2012	2013	2014
United States	0.25	0.25	0.25	0.25	0.25
Euro area	1.00	1.00	0.75	0.25	0.05
United Kingdom	0.50	0.50	0.50	0.50	0.50
Japan	0.10	0.10	0.10	0.10	0.10
Canada	1.00	1.00	1.00	1.00	1.00

Source: www.global-rates.com.



Table (1-5): Growth in world trade volume, 2010-2014

(Annual percent change)

Country	2010	2011	2012	2013	2014
Total World Trade	12.6	6.8	2.8	3.5	3.4
Exports					
Developed Countries	12.3	6.3	2.0	3.1	3.3
Emerging and Developing Countries	13.6	7.4	4.4	4.6	3.4
Imports					
Developed Countries	11.7	5.5	0.9	2.1	3.3
Emerging and Developing Countries	14.1	9.8	6.0	5.5	3.7
Export of Goods					
Developed Countries	14.8	6.1	1.4	2.6	2.9
Emerging and Developing Countries	14.3	7.5	4.9	4.5	3.5
Import of Goods					
Developed Countries	13.5	5.4	0.1	1.7	2.5
Emerging and Developing Countries	14.9	10.4	6.0	4.9	3.6
Change in Terms of Trade					
Developed Countries	-0.9	-1.7	-0.6	0.7	0.3
Emerging and Developing Countries	2.0	3.6	0.7	-0.3	-0.6
Total Value of Exported (USD Billion)					
Developed Countries	12,011	13,913	13,831	14,252	14,589
Emerging and Developing Countries	6,687	8,270	8,640	8,903	n.a.

Source: WEO, IMF, April 2015.



Table (1-6): Current account balances, 2010-2014

(Percent of GDP)

Country	2010	2011	2012	2013	2014
Developed countries	0.0	-0.1	-0.1	0.3	0.4
United States	-3.0	-3.0	-2.8	-2.4	-2.4
Euro area	0.0	-0.1	1.5	2.2	2.3
Germany	5.7	6.1	7.1	6.7	7.4
France	-0.8	-1.0	-1.5	-1.4	-1.1
Italy	-3.5	-3.1	-0.4	1.0	1.8
Japan	4.0	2.1	1.0	0.7	0.5
United Kingdom	-2.6	-1.7	-3.7	-4.5	-5.5
Canada	-3.5	-2.7	-3.3	-3.0	-2.2
Israel	3.4	1.5	0.8	2.4	3.0
Emerging and Developing Countries	1.1	1.6	1.4	0.7	0.6
Africa- Sub-Saharan	-0.6	-0.7	-1.9	-2.5	-3.3
Central and Eastern Europe	-5.1	-6.5	-4.6	-3.8	-2.9
Commonwealth of Independent States	3.4	4.3	2.5	0.6	2.2
Developing Asia	2.5	0.9	1.0	1.0	1.3
China	4.0	1.9	2.6	2.0	2.0
India	-2.8	-4.2	-4.8	-1.7	-1.4
Middle East and North Africa	6.8	14.0	13.4	10.7	7.0
Egypt	-2.0	-2.6	-3.9	-2.3	-0.8
Jordan	-7.1	-10.2	-15.2	-10.3	-7.0
Lebanon	-20.7	-15.1	-24.3	-26.7	-24.9
Saudi Arabia	12.7	23.7	22.4	17.8	14.1
Latin America and the Caribbean	-1.3	-1.4	-1.8	-2.8	-2.8
Brazil	-2.1	-2.0	-2.2	-3.4	-3.9
Mexico	-0.5	-1.1	-1.3	-2.3	-2.1

Source: WEO, IMF, April 2015.



Table (1-7): Official reserve assets, 2010-2014

(USD Billion)

Country	2010	2011	2012	2013	2014
World	9,701	10,708	11,460	12,182	12,046
Developed countries	3,391	3,759	4,047	4,170	4,163
United States	135	151	153	148	132
Euro area	319	335	351	350	345
Emerging and Developing Countries	6,298	6,944	7,400	8,008	7,878
Africa- Sub-Saharan	161	180	202	204	198
Developing Asia	3,642	4,040	4,191	4,683	4,724
Middle East and North Africa	1,009	1,108	1,281	1,396	1,367

Source: WEO, IMF, April 2015.



Part II: Local Economy

Table (1-8): Palestine: real GDP and GDI, 2010-2014

(USD Million)

Activity	2010	2011	2012	2013	2014
A) Productive Sectors	3,488.1	4,087.6	4,283.1	4,355.1	4,006.6
Agriculture and Fishing	332.9	408.7	339.1	309.9	280.2
Mining, Manufacturing, Electricity & Water	956.6	963.3	1,091.6	1,158.5	1,078.3
Mining and Quarrying	24.3	50.0	25.9	48.3	45.0
Manufacturing	775.8	757.5	890.9	929.1	866.6
Electricity, Gas, Steam and Air Conditioning Supply	111.7	109.1	115.0	120.7	118.4
Water Supply, Sewerage, Waste Mange. & Rem. Activities	44.8	46.7	59.8	60.4	48.3
Construction	533.0	728.5	715.1	758.7	533.4
Wholesale and Retail Trade, Repair of Motor Vehicles	950.5	1,228.1	1,304.9	1,295.1	1,288.5
Transportation and Storage	104.4	108.5	115.1	127.6	118.7
Financial and Insurance Activities	202.1	209.5	249.0	252.6	275.9
Information and Communication	408.6	441.0	468.3	452.7	431.6
B) Services	1,703.6	1,955.6	2,159.9	2,243.4	2,337.8
Real Estate Activities	278.9	246.1	280.9	291.6	280.9
Education	351.6	417.2	509.4	512.5	537.7
Human Health and Social Work Activities	149.1	209.9	237.0	241.4	263.6
Public Administration and defense	785.8	879.9	897.8	928.3	969.4
Others*	139.1	202.5	234.8	269.6	286.2
C) GDP At Factor Costs (A + B)	5,191.6	6,043.2	6,443.0	6,598.5	6,344.4
D) Net Indirect Taxes	930.7	839.1	871.8	878.5	1,104.6
Customs Duties	388.6	362.6	373.3	389.7	458.9
VAT on Imports, net	542.1	476.5	498.5	488.8	645.7
Real GDP (C +D) (2004 = 100)	6,122.3	6,882.3	7,314.8	7,477.0	7,449.0
Net Income Transfers from Abroad	364.6	416.9	476.7	591.2	659.5
Net Current Transfers	1,289.4	670.3	1,062.1	698.9	1,555.9
Real GDI	7,776.3	7,969.5	8,853.6	8,767.1	9,664.4
	Memorandum Items				
Per capita Real GDP (USD)	1,606.4	1,752.5	1,807.5	1,793.3	1,734.6
Per capita Real GDI (USD)	2,040.4	2,029.4	2,187.7	2,102.7	2,250.5
Per capita Nominal GDP (USD)	2,338.7	2,664.9	2,787.2	2,992.2	2,973.4
Nominal GDP	8,913.1	10,465.4	11,279.4	12,476.0	12,765.8

* Includes Accommodation and Food Service Activities, Professional, Scientific and Technical Activities, Administrative and Support Service Activities, Arts, Entertainment and Recreation, Households with Employed Persons, FISIM, and Others.

Source: Palestinian Central Bureau of Statistics (PCBS).



Table (1-9): Palestine: expenditure on real GDP, 2010-2014

Activity	2010	2011	2012	2013	2014
	USD Million				
Gross Domestic Expenditure	8,675.4	9,371.8	10,400.3	10,160.4	10,368.5
Aggregate Consumption	7,320.5	8,045.8	8,822.2	8,516.4	9,005.2
Private*	5,527.1	6,120.2	6,832.3	6,558.8	6,966.0
Public	1,793.4	1,925.6	1,989.9	1,957.6	2,039.2
Aggregate Investment	1,354.9	1,326.0	1,578.1	1,644.0	1,363.3
Private	852.8	693.0	941.4	1,016.1	806.7
Public	502.1	633.0	636.7	627.9	556.6
Change in inventories	-2,523.0	-2,530.5	-3,084.9	-2,725.8	-2,929.5
Net Export of Goods and Services	1,031.6	1,298.3	1,290.4	1,333.4	1,487.0
Exports	3,554.6	3,828.8	4,375.3	4,059.2	4,416.5
Imports	-30.1	41.0	-0.6	42.4	10.0
Real GDP (2004=100)	6,122.3	6,882.3	7,314.8	7,477.0	7,449.0
	Percent of GDP				
Gross Domestic Expenditure	141.7	136.2	142.2	135.9	139.2
Final Consumption	119.6	116.9	120.6	113.9	120.9
Private	90.3	88.9	93.4	87.7	93.5
Public	29.3	28.0	27.2	26.2	27.4
Gross Investment	22.1	19.3	21.6	22.0	18.3
Private	13.9	10.1	12.9	13.6	10.8
Public	8.2	9.2	8.7	8.4	7.5
Change in inventories	-41.2	-36.8	-42.2	-36.5	-39.3
Net Export of Goods and Services	16.8	18.9	17.6	17.8	20.0
Exports	58.1	55.6	59.8	54.3	59.3
Imports	-0.5	0.6	0.0	0.6	0.1
Real GDP	100.0	100.0	100.0	100.0	100.0

* Includes also NPISH final consumption.

Source: PCBS.



Table (1-10): Palestine: consumer price index (CPI), 2010-2014

(2010=100)

Activity	2010	2011	2012	2013	2014
	Main Expenditure Groups				
Foods and Soft Drinks	100.00	102.40	104.58	105.42	105.81
Alcoholic Beverages and Tobacco	100.00	106.22	114.53	128.69	143.88
Textile, Clothing and Footwear	100.00	104.60	105.96	105.26	104.33
Housing	100.00	102.95	106.97	111.08	114.75
Furniture, Household Goods	100.00	99.97	101.26	103.00	101.90
Medical Care	100.00	101.33	104.43	106.21	115.46
Transportation	100.00	104.78	107.08	106.29	103.25
Communications	100.00	100.39	100.64	100.37	97.80
Recreational, Cultural Goods & Services	100.00	101.21	102.46	101.90	100.11
Education	100.00	102.10	107.68	115.16	115.21
Restaurants and Cafés	100.00	105.89	110.02	114.05	119.20
Miscellaneous Goods and Services	100.00	103.99	109.25	107.80	117.01
All-items Index	100.00	102.88	105.74	107.56	109.42
	Regions				
WB	100.00	103.54	107.77	111.11	112.44
GS	100.00	100.57	101.06	100.29	103.14
Jerusalem	100.00	104.13	107.50	109.44	113.65
All-items Index	100.00	102.88	105.74	107.56	109.42
	Inflation Rates (%)				
WB	4.24	3.54	4.08	3.10	1.20
GS	1.72	0.57	0.48	0.76-	2.85
Jerusalem	5.25	4.13	3.23	1.81	3.84
All-items Index	3.75	2.88	2.78	1.72	1.73

Source: PCBS.



Table (1-11): Palestine: labor market indicators, 2010-2014

Key Indicators	2010	2011	2012	2013	2014
	Population (thousand)*				
Palestine	4,048	4,169	4,293	4,421	4,550
WB	2,513	2,580	2,649	2,719	2,790
GS	1,535	1,589	1,644	1,702	1,760
	individuals Over 15 Years (thousand)				
Palestine	2,376	2,466	2,557	2,649	2,741
WB	1,523	1,577	1,632	1,687	1,741
GS	853	889	925	962	1,000
	Labor Force (thousand)				
Palestine	976	1,059	1,114	1,155	1,255
WB	665	718	743	759	811
GS	311	341	371	396	444
	Unemployment (thousand)				
Palestine	232	222	256	270	338
WB	114	124	141	141	143
GS	118	98	115	129	195
	Unemployment: Percent of Labor Force				
Palestine	23.7	20.9	23.0	23.4	26.9
WB	17.2	17.3	19.0	18.6	17.7
GS	37.8	28.7	31.0	32.6	43.9
	Distribution of Palestinian workers by Region (thousand)				
Total workers	744	837	858	885	917
Workers in Israel	78	84	83	99	107
Workers in Palestine	666	753	775	786	810
West Bank	473	510	519	519	561
Public sector	384	419	424	416	454
Private sector	89	91	95	103	107
Gaza Strip	193	243	256	267	249
Public sector	104	147	157	166	146
Private sector	89	96	99	101	103
	Distribution of workers by Economic Activity (thousand)				
Agriculture and fishing	88	100	98	93	95
Industry (mining and manufacturing)	85	99	102	108	116
Constructions (build. & constructions)	98	116	123	138	140
Trade, restaurants and hotels	143	170	168	173	185
Trans., storage and communications	44	51	56	57	50
Other services and branches	286	301	311	316	331



Table (1-11): Cont.

Key Indicators	2009	2010	2011	2012	2013
	Dependency Ratios (%)				
Palestine	5.4	5.0	5.0	5.0	5.0
WB	4.6	4.3	4.4	4.4	4.2
GS	7.9	6.5	6.4	6.4	7.1
	Average daily wage in NIS				
Palestine	91.7	91.7	93.0	97.2	102.1
WB	85.8	85.0	87.1	89.0	90.9
GS	58.1	62.5	64.4	63.1	64.0
Israel and settlements	158.0	162.2	164.0	175.6	187.6

* Mid-year Estimates
Source: PCBS

Table (1-12): Palestine: economic forecasts, 2015

Indicators	Actual	2015		
	2014	Baseline	Optimistic Scenario	Pessimistic Scenario
	(Annual percent change)			
Real GDP	-0.4	1.9	5.7	-4.3
Real Percapita GDP	-3.3	-1.0	2.7	-7.0
Private sector Real GDP	-3.8	2.4	4.0	-5.3
Public sector Real GDP	-4.9	1.2	9.4	-4.7
Inflation rate (%)	1.7	1.2	--	--
	(percent of GDP)			
Final Consumption	120.9	121.3	122.6	118.0
Private	27.3	27.7	28.8	27.2
Public	93.5	93.6	93.8	90.8
Gross Investment	18.3	18.8	19.2	17.3
Net Export	-39.3	-40.1	-41.8	-35.3
Exports	20.0	20.6	22.0	19.3
Imports	59.3	60.6	63.8	54.6
Errors and Omissions	0.1	0.0	0.0	0.0
	Memorandum Items			
Real GDP (USD million, 2004=100)	7,449.0	7,587.4	7,871.7	7,127.8
Real per capita GDP (USD)	1,734.6	1,717.0	1,781.4	1,613.0
Unemployment rate (%)	27.0	25.0	22.0	29.0
Exchange rate (USD/NIS)	3.6	3.9	3.9	3.9

Source: PMA estimates.



Chapter Two

Public Finance Developments

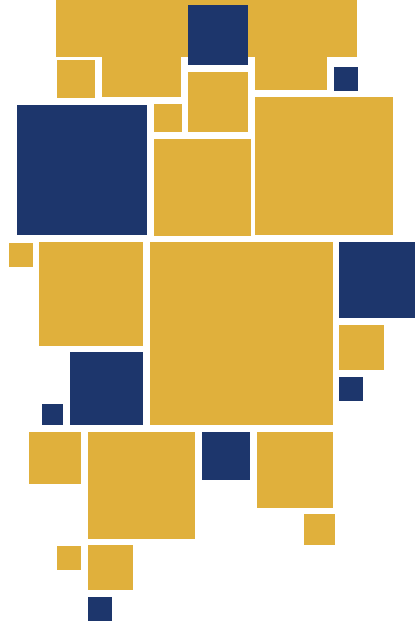


Table (2-1): Palestine: fiscal operations (cash basis), 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Total net revenues and grants	3,178.0	3,153.3	3,172.2	3,678.0	4,021.6
Total Domestic Revenue, net	744.0	701.9	715.3	851.6	874.5
Tax	474.0	481.9	483.2	597.2	604.0
Non-tax	270.0	220.0	232.1	254.4	270.5
Clearance Revenue	1,243.0	1,487.4	1,574.4	1,690.5	2,054.3
Tax Refunds (-)	87.0	13.5	49.6	222.1	137.6
Grants and aid (external revenues)	1,278.0	977.5	932.1	1,358.0	1,230.4
For Budgetary Support	1,147.0	808.7	777.1	1,251.2	1,029.4
For development Financing	131.0	168.8	155.0	106.8	201.0
Total public expenditure	3,259.0	3,256.9	3,258.1	3,419.1	3,606.9
Current expenditure and net lending	2,984.0	2,960.7	3,047.1	3,250.7	3,446.0
Wages Expenditure	1,564.0	1,679.0	1,557.7	1,813.8	1,899.6
Non-wage Expenditure	1,156.0	1,142.7	1,212.2	1,225.7	1,259.0
Net lending	264.0	139.0	277.2	211.2	287.4
Development Expenditure	275.0	296.2	211.0	168.4	160.9
Current balance	-1,084.0	-784.9	-807.0	-930.7	-654.8
Overall balance (Excl. grants and aid)	-1,359.0	-1,081.1	-1,018.0	-1,099.1	-815.7
Overall balance (inc. grants and aid)	-81.0	-103.6	-85.9	258.9	414.7
Financing	81.0	103.4	85.9	-258.5	-134.1
Net financing from local banks	84.0	101.0	132.1	-241.6	-143.5
Balance	-3.0	2.4	-46.2	-16.9	9.4
Financial gap	0.0	0.0	0.0	0.0	0.0
	Memorandum Items				
Deficit (-) before aid as a percent of GDP	-14.9	-10.3	-9.0	-8.8	-6.4
Exchange rate (USD/NIS)	3.73	3.58	3.85	3.61	3.58

Source: - Ministry of Finance Database.

Table (2-2): Palestine: government public debt, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Total Domestic Debt	839.5	1,098.5	1,384.8	1,267.6	1,128.0
Local banks	830.7	1,089.9	1,376.6	1,253.0	1,114.6
Loans	345.0	506.1	718.7	661.3	631.0
Overdrafts	390.7	441.0	480.3	366.3	302.7
Petroleum Authority*	95.0	142.8	177.6	225.4	180.9
Other Public Institutions Loans	8.8	8.6	8.2	14.6	13.4
Total External Debt	1,043.2	1,114.3	1,097.8	1,108.6	1,088.8
Arab financial institutions	539.4	617.2	629.0	630.1	620.9
Al-Aqsa Fund	444.1	522.4	522.5	523.9	517.4
Arab Fund for Economic and Social Development	42.6	43.3	56.8	57.9	56.9
Islamic Development Bank	52.7	51.5	49.7	48.3	46.6
International and Regional Institutions	348.3	341.9	338.5	342.5	347.7
World Bank	302.9	297.0	290.2	283.6	276.7
European Investment Bank	23.4	22.6	25.8	36.1	48.1
International Fund for Agricultural Development (IFAD)	3.4	3.3	3.1	3.0	2.7
OPEC	18.6	19.0	19.4	19.8	20.2
Bilateral loans	155.5	155.2	130.3	136.0	120.2
Spain	92.9	92.9	91.9	96.0	84.4
Italy	31.2	31.3	33.2	34.6	30.5
China	4.9	5.2	5.2	5.4	5.3
Sweden	26.5	25.8	-	-	-
Total Government Public Debt	1,882.8	2,212.8	2,482.6	2,376.2	2,216.8
Per capita Public Debt (USD)	494.1	563.5	613.5	569.9	516.2
Public Debt as a percent of GDP	21.1	21.1	22.0	19.0	17.3

* Represents the value of loans provided by the Ministry of Finance to support the Petroleum Authority.

Source: Ministry of Finance Database.



Table (2-3): Palestine: government public debt service, 2011-2014

(USD Million)

Year	Interest Paid		Premiums		Debt Service
	Domestic Debt	External Debt	Domestic Debt	External Debt	
2011	63.1	3.1	-156.4	8.1	-82.1
2012	55.8	4.4	433.8	12.7	506.8
2013	61.8	6.5	284.8	10.0	363.1
2014	45.0	3.7	113.8	6.4	168.9

Source: Ministry of Finance, Unpublished Data.

Table (2-4): Palestine: government outstanding arrears payments, 2010-2014

(NIS million)

Items	2010	2011	2012	2013	2014
Wages and Salaries	185.0	374.2	816.4	379.7	569.8
Non-wage expenses	264.0	925.9	1,046.3	1,220.8	1,711.9
Net lending	-103.0	-	-	-	-
Development projects	88.0	270.4	124.2	66.0	351.2
Tax refund	-39.0	368.2	239.4	26.9	146.5
Total	395.0	1,938.7	2,226.3	1,693.4	2,779.4

Source: Ministry of Finance Database, and IMF.



Chapter Three

Foreign Sector Developments

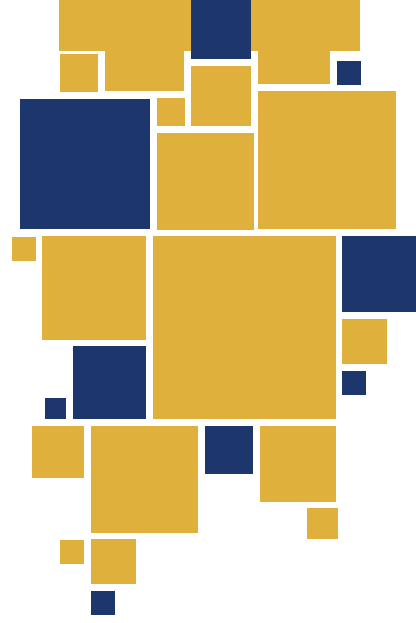


Table (3-1): Palestine: balance of payments, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Current Account (Net)	1,306.9-	-2,069.6	-1,821.0	-2,383.4	-1,386.5
Goods (Net)	-3,452.7	-3,779.2	-4,135.7	-4,682.7	-5,394.3
Exports (Fob)	818.3	1,053.0	1,135.3	1,133.7	1,257.4
Imports (Fob)	4,271.0	4,832.2	5,271.0	5,816.4	6,651.7
Services (Net)	-444.3	-144.6	-293.2	-49.5	-88.9
Exports	549.0	746.4	735.8	938.1	1,040.5
Imports	993.3	891.0	1,029.0	987.6	1,129.4
Income (Net)	599.1	749.5	857.5	1,160.3	1,381.3
Receipts	714.1	843.7	941.4	1,263.8	1,482.4
Compensation of employees	578.3	736.6	823.0	1,140.5	1,298.3
Of which from Israel	526.1	662.8	762.7	1,079.8	1,246.2
Investment Income	135.8	107.1	118.4	123.3	184.1
Payments	115.0	94.2	83.9	103.5	101.1
Current Transfers (Net)	1,991.0	1,104.7	1,750.4	1,188.5	2,715.4
Inflows	2,247.1	1,668.8	2,331.5	1,862.9	3,170.2
To Public Sector	1,179.5	709.1	643.3	735.3	1,113.0
To Private Sector	1,067.6	959.7	1,688.2	1,127.6	2,057.2
Outflows	256.1	564.1	581.1	674.4	454.8
Capital and financial Account (Net)	1,029.7	2,035.5	1,522.5	2,144.6	1,393.6
Capital Account (Net)	828.2	640.0	588.2	551.3	330.1
Capital Transfers (Net)	828.2	640.0	588.2	551.3	330.1
Inflows	828.2	640.0	588.2	551.3	330.1
To Public Sector	705.1	487.9	340.2	280.9	213.1
To Private Sector	123.1	152.1	248.0	270.4	117.0
Outflows	0.0	0.0	0.0	0.0	0.0
Acquisition of Non-Produced Assets (Net)	0.0	0.0	0.0	0.0	0.0
Financial account (Net)	201.5	1,395.5	934.3	1,593.3	1,063.5
Direct Investment (Net)	121.9	477.4	29.3	224.0	156.1
Portfolio Investment (Net)	-367.4	-121.1	-16.2	186.8	-55.3
Other Investment (Net)	483.4	1,005.5	1,087.2	1,203.6	949.9
Net Errors and Omissions	277.2	34.1	298.5	238.8	-7.1
Change in Reserve Assets (- = Increase)	-36.4	33.7	-166.0	-21.1	12.8
Extraordinary Financing	0.0	0.0	28.0	5.6	7.6
Current Account Deficit as a percent of GDP	-14.7	-19.8	-16.1	-19.1	-10.9

Source: PMA and PCBS, data series of Balance of Payments.



Table (3-2): Palestine: international investment position, 2010-2014

(USD Million)

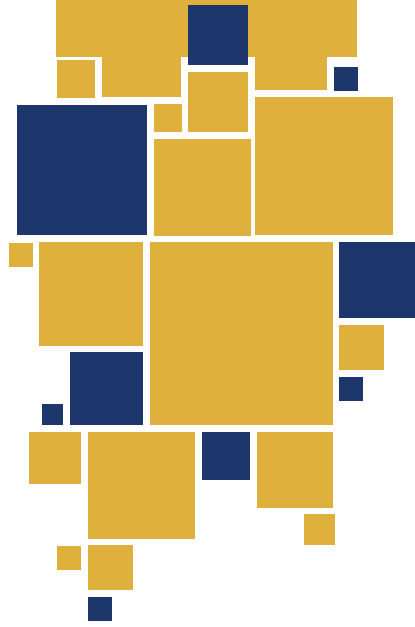
Items	2010	2011	2012	2013	2014
International investment position (Net)	1,286.0	721.0	667.0	1,161.0	1,235.0
Total external assets	5,424.0	5,233.0	5,262.0	6,101.0	5,951.0
Foreign direct investment abroad	241.0	192.0	232.0	315.0	167.0
Portfolio investment abroad	806.0	1,147.0	1,030.0	1,145.0	1,183.0
Other investment abroad	3,846.0	3,397.0	3,336.0	3,956.0	3,929.0
Of which: currency and deposits	3,671.0	3,325.9	3,234.0	3,862.0	3,759.0
Official reserves	531.0	497.0	664.0	685.0	672.0
Total foreign liabilities	4,138.0	4,512.0	4,595.0	4,940.0	4,716.0
Foreign direct investment in Palestine	2,177.0	2,328.0	2,336.0	2,450.0	2,453.0
Portfolio investment in Palestine	611.0	611.0	676.0	791.0	710.0
Other investment in Palestine	1,350.0	1,573.0	1,583.0	1,699.0	1,553.0
Of which: loans	1,119.0	1,208.0	1,140.0	1,152.0	1,147.0
currency and deposits	228.0	359.0	443.0	547.0	404.0

Source: PMA and PCBS, data series of Balance of Payments.



Chapter Four

Financial Sector Developments



Part I: Palestine Monetary Authority (PMA)

Table (4-1): Palestine: banks and branches by nationality, 2010-2014

Items	2010	2011	2012	2013	2014
Number of Banks					
Local Banks	8	8	7	7	7
Foreign Banks	10	10	10	10	10
Jordanian Banks	8	8	8	8	8
Egyptian Banks	1	1	1	1	1
British Banks	1	1	1	1	1
Total	18	18	17	17	17
Number of Branches & representative Offices					
Local Banks	110	118	121	125	142
Foreign Banks	102	108	111	112	116
Jordanian Banks	95	101	104	105	109
Egyptian Banks	6	6	6	6	5
British Banks	1	1	1	1	1
Total	212	226	232	237	258

Source: PMA Database.

Table (4-2): Palestine: financial inclusion indicators, 2010-2014

Items	2010	2011	2012	2013	2014
Branches & representative Offices (number)	212	226	232	237	258
Large cities	176	187	193	106*	117*
Urban areas	36	39	39	131**	141**
Deposit accounts (number)	2,185,779	2,545,459	2,715,338	2,748,387	2,766,635
Customer deposits (USD million)	6,802.4	6,972.5	7,484.1	8,303.7	8,935.3
Personals	5,002.9	5,324.3	5,457.5	6,057.9	6,468.9
Corporates	1116.9	1063.6	1,406.4	1,568.0	1,681.2
Public sector	682.7	584.5	620.2	677.8	785.2
Credit Portfolios (USD million)	2,885.9	3,552.7	4,199.1	4,480.2	4,895.9
Personals	1,275.6	1,351.9	1,628.7	1,742.0	2,158.5
Corporates	772.1	1,099.9	1,163.0	1,364.1	1,497.5
Public sector	837.3	1,100.8	1,407.4	1,374.0	1,239.8
ATM's (number)	335	378	435	488	549
Point of sales (number)	2,314	3,658	3,926	4,646	5,579
Credit cards (number)	37,374	47,046	56,835	62,931	70,029
Credit cards (number)	308,962	354,352	410,536	408,636	419,676
ATM withdrawal cards (number)	71,684	101,728	122,379	132,758	163,074

* Related to cities of Ramallah and al-beireh, Hebron, and Nablus.

** Other areas not mentioned above.

Source: PMA Database.



Table (4-3): PMA: assets and liabilities, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Deposits of banks and financial institutions	1,056.1	917.1	992.1	996.0	1048.0
Required reserves	615.5	672.7	753.4	788.5	890.4
Other accounts	440.6	244.4	238.7	207.5	157.6
Government accounts- Ministry of finance	0.0	0.0	0.0	65.7	0
Provisions	14.2	17.3	18.9	20.3	21.0
Capital and reserves	85.7	89.3	92.1	94.1	100.7
Paid capital	54.7	58.5	61.4	63.3	70.0
Reserves	31.0	30.8	30.7	30.8	30.7
Other liabilities	8.5	9.8	10.6	11.9	11.8
Assets = Liabilities	1,164.5	1,033.5	1,113.7	1,188.0	1181.5
Domestic assets	195.7	195.9	166.3	184.1	133.0
Balances with banks in Palestine	154.4	164.8	165.3	183.1	132.0
Current deposits	14.8	4.2	8.9	8.0	24.6
Time deposits	139.6	160.6	156.4	175.1	107.4
Islamic investments	41.3	30.1	0.0	0.0	0.0
Financial investments held to maturity	0.0	1.0	1.0	1.0	1.0
Foreign assets	933.3	807.4	917.0	967.3	1007.2
Balances with banks abroad	685.7	450.3	662.4	758.5	735.2
Current and demand deposits	39.3	69.7	69.5	94.0	68.9
Time deposits	646.4	380.6	592.9	664.5	666.3
Islamic investments	99.0	98.7	66.8	17.4	14.3
Financial investments held to maturity	148.6	158.3	87.4	90.8	156.9
Investment portfolio for trade	0.0	100.1	100.4	100.6	100.8
Fixed assets*	7.6	9.1	10.2	12.7	18,0
Government loans	3.5	3.4	3.4	3.3	3.2
Other assets	24.4	17.7	16.8	20.6	20.1

* Includes development projects under processing.

Source: PMA Database.



Table (4-4): PMA: profit and loss statement, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Revenues	25.1	18.6	17.5	17.9	22.6
Net interest and investment revenue	28.1	15.9	13.6	13.1	15.9
Other revenues	17.5	2.7	3.9	4.8	6.7
Payback provisions	17.9	0.0	0.0	0.0	0.0
Expenditure	20.4	14.5	14.5	16.0	16.0
Employee expenses	7.4	9.5	10.1	11.0	11.0
Administrative expense	2.1	2.1	2.5	2.9	3.0
Depreciation and Capital expenses	0.6	0.5	0.6	1.5	1.5
Financial Follow-up Office expenses	0.3	0.4	0.5	0.6	0.6
Expenses for doubtful debts	10	2	0.8	0.0	0.0
Excess of revenue over expenditure in regular activities	5.2	4.1	3.0	1.9	6.6
Amendments of previous years	0.04	-0.03	-0.1	0.0	0.1
Expenses of the money seizure case	0.6	0.2	0.01	0.0	0.0
Net excess of revenues over Expenditure	4.7	3.8	2.9	1.9	6.7

Source: PMA Database.



Table (4-5): PMA: employee distribution, 2010-2014*

Items	2010			2011			2012			2013			2014		
	Ramallah	Gaza	Total	Ramallah	Gaza	Total	Ramallah	Gaza	Total	Ramallah	Gaza	Total	Ramallah	Gaza	Total
Governor's Office	9	2	11	17	3	20	18	2	20	18	2	20	19	2	21
Security and Public Safety Office	8	18	26	8	18	26	8	18	26	13	10	23	13	10	23
Financial Follow-up Unit	7	0	7	10	0	10	11	0	11	10	0	10	10	0	10
Independent Offices	7	4	11	9	3	12	8	3	11	8	4	12	7	4	11
Ombudsman	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ethics	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Legal Counsel	1	1	2	3	1	4	2	1	3	2	2	4	2	2	4
Internal Audit	6	3	9	6	2	8	6	2	8	6	2	8	5	2	7
Core Departments	97	29	126	122	29	151	122	28	150	123	30	153	119	30	149
Monetary Stability Group	16	6	22	27	4	31	26	3	29	29	5	34	28	5	33
Research & Monetary Department	10	1	11	16	2	18	15	1	16	16	3	19	16	3	19
Monetary Operations Department	6	5	11	11	2	13	11	2	13	13	2	15	12	2	14
Financial Stability Group	81	23	104	95	25	120	96	25	121	94	25	117	91	25	116
Supervision & Inspection Department	66	17	83	63	15	78	66	15	81	63	15	78	62	15	77
Payment System Department	15	6	21	17	4	21	14	4	18	13	4	17	12	4	16
Consumer Relations & Market Conduct Department	-	-	-	15	6	21	16	6	22	16	6	22	17	6	23
Supporting Departments	71	40	111	66	47	113	81	40	121	86	43	129	88	43	131
External Relations Department	1	2	3	2	2	4	6	2	8	8	3	11	6	3	9
General Services Department	32	20	52	29	21	50	31	21	52	33	24	57	34	24	58
IT Department	15	6	21	16	5	21	20	6	26	22	5	27	23	5	28
Human Resources Department	10	4	14	12	3	15	11	3	14	8	3	11	11	3	14
Finance Department	13	8	21	15	8	23	13	8	21	15	8	23	14	8	22
Total	199	93	292	240	92	332	248	91	339	258	89	347	256	89	345

* Consultants or employees with contracts are not included.

Source: PMA Database.



Table (4-6): PMA: staffing and training, 2010-2014

Items	2010	2011	2012	2013	2014
Governor's Office	10	12	14	7	11
Security and Public Safety Office	15	5	6	4	5
Independent Offices	13	18	22	7	11
Legal Counsel	3	4	4	2	2
Internal Audit	6	9	8	5	3
Financial Follow-up Unit	4	5	10	-	6
Core Departments	95	127	140	195	81
Monetary Stability Group	22	39	55	41	29
Research & Monetary Department	13	23	26	20	19
Monetary Operations Department	9	16	29	21	10
Financial Stability Group	73	88	85	154	52
Supervision and Inspection Department	28	53	47	134	34
Payment System Department	20	17	10	8	5
Consumer Relations & Market Conduct Department	25	18	28	12	13
Supporting Departments	47	68	76	50	30
External Relations Department	3	4	11	12	4
General Services Department	11	15	14	9	6
IT Department	12	17	18	16	10
Human Resources Department	8	8	14	5	5
Finance Department	13	24	19	8	5
Total	180	230	258	263	138

Source: PMA Database.

Part II: Banking Sector

Table (4-7): Palestine: Banking sector assets and liabilities, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Total assets	8,798.4	9,337.4	10,051.9	11,190.7	11,815.4
Cash and Precious Metals	542.8	496.7	731.1	956.0	658.5
Due from PMA and Banks (Total):	3949.3	3743.7	3675.2	4130.2	4,391.1
Due from PMA	1074.8	940.9	998.9	996.6	1,041.5
Due from banks in Palestine	252.4	335.3	372.7	452.6	509.8
Due from banks abroad	2622.0	2467.5	2303.7	2681.1	2,839.8
Securities portfolio for trade and investment credit facilities	577.4	830.8	745.3	856.9	985.6
Banking acceptances	2885.9	3550.7	4199.1	4480.1	4,895.1
Investment	3.6	5.9	5.3	7.6	6.0
Fixed assets	355.5	143.6	150.1	155.1	145.0
Other assets	282.7	326.1	347.1	362.1	404.4
Total Liabilities	201.3	240.1	198.7	242.7	329.7
Due to PMA and Banks (Total):	8,798.4	9,337.4	10,051.9	11,190.7	11,815.4
Due to PMA	420.6	646.5	725.2	900.1	728.2
Due to banks in Palestine	160.0	178.9	173.1	189.5	134.6
Due to banks abroad	204.6	304.7	351.4	445.4	499.9
Customer deposits	56.1	162.9	200.8	265.3	93.6
Executed and outstanding acceptances	6802.4	6972.5	7484.2	8303.7	8,934.5
Equity (net), of which:	15.3	16.2	10.0	13.8	11.3
Paid-up capital	1092.6	1184.5	1257.5	1359.9	1,464.0
Legal reserve	809.6	874.6	894.8	928.1	976.0
Declared reserves	82.5	95.8	107.6	123.2	138.0
General reserves for banking operations	29.4	45.0	56.5	70.0	83.9
Undistributed profits	46.9	57.7	87.0	94.2	83.8
Unrealized profit (loss) on long-term investment	8.6	9.2	9.7	4.0	4.7
Tax provisions	9.2	2.3	-4.6	3.0	-2.7
Other provisions*	90.3	107.2	112.5	114.1	61.1
Other liabilities	268.4	287.6	323.4	345.9	369.9
	108.7	130.0	139.1	153.2	247.6

* Includes provisions for securities, loans, overdraft, finance lease, investment, depreciation, and other provisions.

Source: PMA Database.



Table (4-8): Palestine: Banking sector profit and loss statement, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Interest received	274.2	312.8	349.1	402.7	423.1
Interest paid	26.3	35.3	42.5	56.7	63.3
Net interest income	220.9	277.5	306.6	346.0	359.9
Net commission income	61.9	77.3	73.1	80.3	86.1
Net debt securities and investments	51.7	2.4	8.2	5.1	6.5
Net currency exchange and appreciation transactions	24.7	26.0	24.6	24.6	25.4
Net off-balance-sheet items	0.7	0.4	0.6	0.3	1.9
Net expenses and other operating income	8.5	8.6	6.7	5.6	13.0
Total non-interest income	147.5	107.0	113.2	115.9	132.8
Total income from all operations	368.4	384.5	419.8	461.9	492.7
Operating expenses	201.3	218.6	231.1	251.5	294.5
Net Provisions	-4.7	2.1	20.2	9.1	2.1
Net extraordinary profit and loss	0.7	0.0	0.0	0.0	0.0
Net income before taxes	171.1	163.8	168.5	201.2	196.1
Taxes	32.6	34.9	44.3	58.3	50.4
Net income after taxes	138.5	128.9	124.2	142.9	145.7

Source: PMA Database.

Table (4-9): Palestine: Banking sector customer deposits, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
	Depositors				
Public sector, of which:	682.6	584.5	620.2	677.0	785.2
Palestinian National Authority	534.1	473.1	473.3	531.3	612.3
Private sector, of which:	6,119.8	6,388.0	6,864.0	7,626.8	8,149.3
Resident	5,947.8	6,192.3	6,621.3	7,345.4	7,840.6
	Region				
WB	6,019.6	6,194.2	6,696.7	7,447.2	7,940.4
GS	782.8	778.3	787.5	856.6	994.1
	Type				
Current deposits	2,680.6	2,773.0	2,984.4	3,339.2	3,505.7
Savings deposits	1,844.2	2,027.1	2,266.7	2,582.9	2,837.3
Time deposits	2,277.6	2,172.4	2,233.1	2,381.7	2,591.5
	Currency				
USD	2,853.4	2,718.5	3063.2	3460.6	3,550.4
JD	1,852.5	1,801.4	1,740.4	2,106.0	2,299.4
NIS	1,728.9	2,115.8	2,323.5	2,409.8	2,750.5
Others	367.6	336.8	357.1	327.3	334.2
Total	6,802.4	6,972.5	7,484.2	8,303.8	8,934.5

Source: PMA Database.



Table (4-10): Palestine: Banking sector direct credit facilities, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
	Beneficiary				
Public sector, of which:	837.2	1,101.1	1,407.5	1,373.2	1,239.8
Palestinian National Authority	821.2	1,098.9	1,402.9	1,372.2	1,239.1
Private sector, of which:	2,048.7	2,449.6	2,791.6	3,106.9	3,655.3
Resident	1,990.8	2,326.3	2,749.2	3,070.3	3,631.2
	Region				
WB	2,680.8	3,251.3	3,767.6	3,987.1	4,320.1
GS	205.1	299.4	431.5	493.0	575.0
	Type				
Loans	1,978.0	2,531.7	2,950.2	3,213.1	3,853.8
Overdrafts	900.4	1,010.3	1,238.0	1,253.0	1,021.0
Finance lease	7.5	8.7	10.9	14.0	20.3
	Currency				
USD	1,756.6	2,245.9	2,255.0	2,464.2	2,839.7
JD	246.2	420.9	549.6	471.1	582.7
NIS	866.7	863.7	1,367.6	1,510.7	1,443.6
Others	16.4	20.2	26.9	34.1	30.2
Total	2,885.9	3,550.7	4,199.1	4,480.1	4,895.1

Source: PMA Database.

Table (4-11): Palestine: Banking sector direct credit facilities provisions, 2010-2014

(USD Million)

Items	2010	2011	2012	2013	2014
Loans	34.7	34.6	48.3	51.7	47.8
Overdrafts	27.0	24.5	28.7	23.7	28.8
Finance lease	0.6	0.7	0.7	0.6	0.0
Total Provisions	62.3	59.8	77.7	76.0	76.6
Direct Credit Facilities, net	2,823.6	3,490.9	4,121.4	4,404.1	4,818.5
Total Direct Credit Facilities	2,885.9	3,550.7	4,199.1	4,480.1	4,895.1
Outstanding interests	13.8	14.4	16.1	19.3	21.2
Non-Performing Loans	88.5	98.1	129.2	129.1	124.8

Source: PMA Database.



Table (4-12): Palestine: Banking sector sectoral distribution of private sector's loans, 2010-2014

Items	2010		2011		2012		2013		2014	
	Value USD Million	Percent (%)	Value USD Million	Percent (%)	Value USD Million	Percent (%)	Value USD Million	Percent (%)	Value USD Million	Percent (%)
Real estate, constructions, and lands	331.6	19.9	411.5	17.5	631.1	22.6	707.5	22.8	831.1	22.7
Industry and mining	257.9	12.6	303.7	12.3	173.8	6.2	222.2	7.2	257.2	7.0
General trade	392.2	19.1	489.6	20.0	503.2	18.0	612.3	19.7	744.6	20.4
Agriculture and livestock	45.3	2.2	33.7	1.4	35.1	1.3	38.3	1.2	46.7	1.3
Services	576.8	28.2	434.2	17.7	409.3	14.7	351.7	11.3	493.5	13.5
Consumer goods and cars financing	230.0	11.2	535.5	21.8	897.0	32.1	1016.1	32.7	1086.9	29.7
Others	138.1	6.8	220.7	9.2	142.4	5.1	158.0	5.1	195.3	5.5
Total	2,048.6	100.0	2,451.8	100.0	2,791.7	100.0	3,106.1	100.0	3,655.3	100.0

Source: PMA Database.



Table (4-13): Palestine: Banking sector lending and deposit rates, 2010-2014

(Quarterly average, Percent)

Period	Lending Rates According To			Depositing Rates According To		
	JD	USD	NIS	JD	USD	NIS
2010	7.55	6.34	10.93	1.15	0.29	0.30
Q1	7.53	6.30	10.79	1.22	0.29	0.25
Q2	7.42	6.05	11.02	1.19	0.30	0.29
Q3	7.59	6.29	10.88	1.13	0.30	0.30
Q4	7.64	6.71	11.03	1.05	0.27	0.34
2011	7.60	6.79	11.72	1.22	0.33	1.01
Q1	6.80	6.27	12.85	1.11	0.30	0.58
Q2	7.87	6.84	11.26	1.18	0.30	1.06
Q3	7.91	6.84	11.15	1.22	0.31	1.10
Q4	7.80	7.19	11.60	1.37	0.40	1.29
2012	8.11	6.97	11.30	1.70	0.46	1.23
Q1	7.70	7.08	11.53	1.55	0.41	1.02
Q2	7.74	6.98	11.28	1.66	0.46	1.26
Q3	7.58	6.37	11.09	1.58	0.43	1.25
Q4	9.40	7.44	11.28	2.01	0.53	1.37
2013	9.18	7.51	11.58	2.08	0.62	1.32
Q1	8.69	7.33	11.65	1.70	0.45	1.09
Q2	9.50	7.90	11.50	2.40	0.80	1.40
Q3	9.53	7.73	11.19	2.11	0.49	1.38
Q4	8.98	7.06	11.97	2.09	0.75	1.40
2014	9.10	6.41	10.96	2.15	0.83	1.46
Q1	9.38	6.01	11.35	2.13	0.77	1.40
Q2	8.71	6.18	11.05	2.19	0.85	1.40
Q3	9.35	6.57	10.61	2.13	0.76	1.46
Q4	8.97	6.88	10.82	2.14	0.92	1.59

Source: PMA Database.



Table (4-14): Palestine: Banking sector clearing activities, 2010-2014

Years	USD		JD		NIS		EURO		Total	
	No. of Checks	Value (USD Million)	No. of Checks	Value (USD Million)	No. of Checks	Value (USD Million)	No. of Checks	Value (USD Million)	No. of Checks	Value (USD Million)
2010	192,309	2,193.16	103,848	579.54	3,322,381	6,671.10	6,970	107.50	3,625,508	9,551.30
2011	196,789	2,743.26	112,551	915.00	3,734,636	8,001.42	6,279	235.00	4,050,255	11,894.68
2012	187,928	1,918.36	106,938	596.21	3,987,948	7,038.57	4,791	76.53	4,287,605	9,629.67
2013	194,333	2,144.92	105,136	460.65	4,042,570	7,723.31	4,388	238.85	4,346,427	10,567.70
2014	201,623	2,184.67	118,425	568.29	4,312,778	8,117.00	4,946	185.23	4,637,772	11,055.20
					Bounced checks					
2010	17,233	71.21	13,001	29.11	345,058	496.70	164	1.78	375,456	598.80
2011	21,196	75.52	15,653	31.84	451,160	650.01	153	1.12	488,162	758.48
2012	24,272	72.44	16,062	33.59	478,561	570.05	179	1.06	519,074	677.14
2013	23,778	73.30	14,688	24.05	448,749	561.24	129	0.58	487,344	659.17
2014	23,368	81.85	14,456	25.64	429,481	551.15	131	1.24	467,436	659.88

Source: PMA Database.



Table (4-15): RTGS (BURAQ) participants total transactions, 2010-2014

(Value in USD million)

Year	Bank to Bank Transfers		Personal Transfers		Extractions		Clearing Settlement operations		PEX CSD Settlements Operations		Other Operations		Total Transfers	
	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value
2010	1,033	728.6	5,999	775.8	453	1,167.6	1,304	495.9			99	23.6	8,888	3,191.5
2011	6,269	3,560.4	86,849	5,750.6	3,067	8,068.7	7,995	3,341.6			1,457	95.4	105,637	20,816.7
2012	7,734	13,093.0	145,844	5,511.5	2,908	6,388.4	7,687	3,055.2			1,447	124.8	165,620	28,172.9
2013	8,223	14,823.0	142,926	6,344.9	2,629	7,383.4	7,758	3,356.3	1,128	72.3	1,506	131.2	164,170	32,111.1
2014	7,951	16,179.0	154,075	6,761.9	2,311	7,526.6	7,897	3,222.7	1,455	84.2	1,564	135.0	175,253	33,909.4

Source: PMA Database.



Part III: Non-financial Institutions

Table (4-16): performing indicators of specialized lending institutions, 2010-2014

Items	2014
Institutions (number)	5
Branches (number)	58
Loans (number)	45,152
Total credit portfolio (USD million)	97.0
Gender distributions of credits (USD million)	
Male	70.1
Female	26.9
Geographical distributions of credits (USD million)	
WB	59.7
GS	37.3
Sectoral distributions of credits (%)	
Agriculture	14.0
Industries and crafts	10.9
Real estate	30.1
Trade	22.0
Services and public facilities	9.5
Tourism	0.6
Consumption	12.9

Source: website of SHARAKAH.

Table (4-17): Palestine: money changers, 2010-2014

Items	2010	2011	2012	2013	2014
WB	215	240	234	232	237
GS	45	44	42	38	43
Total	260	284	276	270	280

Source: PMA Database.



Table (4-18): Palestine: Some performing indicators of money changers, 2011-2014

(USD million)

Item	2011	2012	2013	2014
Total assets	37.0	49.4	49.6	52.9
Ownership equity	36.5	48.2	46.6	46.1
Paid-up capital	35.9	42.7	44.5	46.4
Assets	35.1	46.8	47.1	49.9
Fixed assets	2.1	2.7	2.5	2.8
Total expenditures	3.6	5.2	5.4	5.0
Profits	1.9	1.8	0.4	-0.8

Source: PMA Database.

Table (4-19): Palestine: Palestine Exchange, 2010-2014

Items	2010	2011	2012	2013	2014
Number of trading sessions	249	248	249	241	245
Banking and Financial Service Sector					
Listed companies (Number)	7	8	9	9	8
Traded shares (Number)	67,244,164	44,564,832	54,449,352	55,218,127	66,612,640
Traded shares (USD)	86,861,502	68,548,544	85,474,771	89,706,366	111,626,482
Executed transactions (Number)	16,789	13,279	11,674	11,978	8,099
Market value of shares traded (USD)	565,262,816	591,178,656	721,684,139	857,285,505	840,468,008
Insurance Sector					
Listed companies (Number)	5	7	7	7	7
Traded shares (Number)	10,055,424	7,383,592	8,414,778	15,355,249	6,387,299
Traded shares (USD)	8,745,655	7,460,229	8,115,012	10,671,780	4,273,400
Executed transactions (Number)	3,471	2,390	1,811	1,445	1,193
Market value of shares traded (USD)	89,940,720	101,170,817	105,291,000	101,059,750	105,346,000
Investment Sector					
Listed companies (Number)	8	8	8	8	9
Traded shares (Number)	97,224,094	75,668,213	41,465,990	99,390,243	73,144,267
Traded shares (USD)	135,367,292	98,283,998	41,887,995	113,435,799	109,532,601
Executed transactions (Number)	36,755	21,408	10,864	12,726	16,552
Market value of shares traded (USD)	442,790,411	398,695,700	371,606,871	496,241,132	545,274,304
Industrial Sector					
Listed companies (Number)	9	11	11	12	12
Traded shares (Number)	11,196,007	12,194,155	6,740,195	7,057,567	4,820,022
Traded shares (USD)	22,060,387	28,387,306	13,507,153	15,007,175	9,139,003
Executed transactions (Number)	7,112	5,939	3,232	4,261	2,773
Market value of shares traded (USD)	215,985,860	226,198,909	219,022,649	276,351,278	273,684,639



Service Sector					
Listed companies (Number)	11	12	13	13	12
Traded shares (Number)	44,796,681	44,733,583	36,233,893	25,944,753	30,580,926
Traded shares (USD)	198,178,693	162,968,139	124,455,510	111,953,149	119,345,638
Executed transactions (Number)	18,498	18,912	13,861	14,015	12,640
Market value of shares traded (USD)	1,135,921,738	1,465,225,818	1,441,535,716	1,516,540,720	1,422,586,673
Grand Total					
Traded shares (Number)	230,516,370	184,544,375	147,304,208	202,965,939	181,545,154
Traded shares (USD)	451,208,529	365,648,216	273,440,441	340,774,269	353,917,124
Executed transactions (Number)	82,625	61,928	41,442	44,425	41,257
Market value of shares traded (USD)	2,449,901,545	2,782,469,900	2,859,140,375	3,247,478,385	3,187,359,624
Al-Quds index	490.0	476.9	477.6	541.5	511.8

Source: Palestine exchange, www.pex.ps

Table (4-20): Palestine: performing indicators of insurance companies, 2010-2014

Items	2010	2011	2012	2013	2014
Companies (number)	10	10	10	10	10
Branches (number)	103	99	111	114	111
Employees (number)	1,007	1,028	1,035	1,075	1,175
Agencies (number)	265	239	229	225	215
Total insurance premiums (USD million)	125.8	150.5	144.5	158.7	171.0
Compensations (USD million)	66.4	75.6	88.4	88.7	108.1
Total assets/liabilities (USD million)	298.4	323.6	340.0	367.0	383.0
Paid-up capital (USD million)	62.2	63.1	67.2	67.9	69.7
Ownership equity (USD million)	95.6	101.1	108.8	119.8	136.7

Source: Capital Market Authority website, www.pcma.ps

