PALESTINIAN TERRITORIES

Table 1	2018
Population, million	4.8
GDP, current US$ billion	14.7
GDP per capita, current US$	3058
Upper middle-income poverty rate ($5.5)[a]	23.6
Gini index[a]	33.7
School enrollment, primary (% gross)[b]	93.9
Life expectancy at birth, years[b]	73.5

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

The Palestinian economy did not witness any real growth in 2018 due to a steep deterioration in Gaza and a slowdown in the West Bank. Living conditions have worsened with almost 1 in every three in the labor force unemployed and 24 percent of Palestinians living below the US$5.5 2011 PPP a day. Given the ongoing constraints to economic competitiveness, medium term growth is projected between 0.5 -1.6 percent. Further reductions in transfers and an increased possibility of conflict pose significant downside risks.

Recent developments

Real GDP growth in the Palestinian economy was barely positive in 2018 due to a steep deterioration in Gaza and a slowdown in the West Bank. Gaza's economy has been kept afloat in recent years by large transfers including donor aid and spending through the budget of the Palestinian Authority (PA), both of which amounted to 70-80 percent of Gaza's GDP. However, these two sources have significantly declined recently resulting in economic activity in Gaza shrinking by 8 percent in 2018. In the West Bank, real growth has declined to around 2 percent in 2018, lower than its average in previous years as the decrease in aid inflows and the recurring clashes with the Israeli forces have impacted economic activity.

Overall prices dropped by 0.2 percent between January and December 2018 (year-on-year) as the Israeli Shekel (which circulates in the Palestinian territories) continued its appreciation in 2018 with a deflationary effect on the prices of imported goods. In addition, the prices of food products (most of which are produced domestically or in Israel) remained stable.

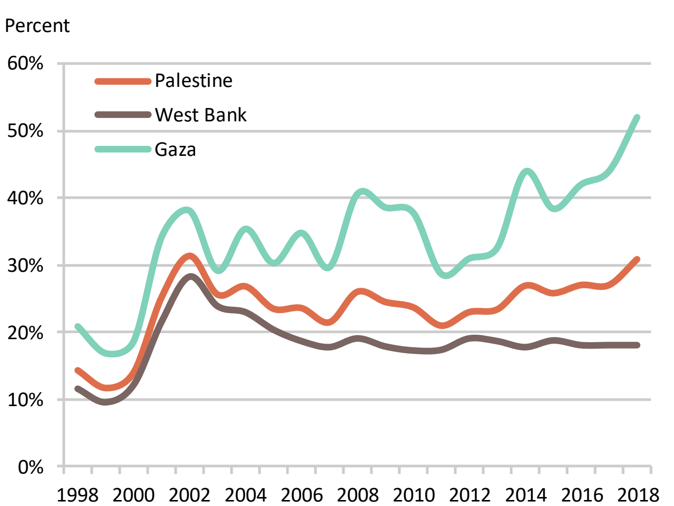
Domestic revenues grew by 9 percent in 2018 (year-on-year) due to the PA's efforts to widen the tax base, while spending cuts in Gaza were the main contributor to a 7.6 percent decline in public spending. Put together, this resulted in a one percentage point decline in the deficit (before grants) as a share of GDP to 7.5 percent. Nevertheless, the financing mix remained suboptimal due to insufficient aid. The total deficit (before grants) amounted to US$1.08 billion while aid received was US$676 million (US$516 million in budget support, and US$160 million for development financing), resulting in a financing gap of around US$400 million (2.8 percent of GDP). To fill the gap, the PA resorted to accumulating further arrears to the pension fund and the private sector.

The external current account deficit (including official transfers) is estimated to have widened in 2018 to 12.2 percent of GDP due to an increase in imports and a drop in transfers. Exports continue to be constrained by the ongoing trade restrictions and have remained stagnant at around 19-20 percent of GDP, while imports increased by about 3 percentage points of GDP in 2018 and reached 58 percent of GDP. Current transfers as a share of GDP dropped due to a decline in both private and official transfers.

The unemployment rate continues to be very high. It reached 30.8 percent in 2018, which is 2.4 percentage points higher than its average in 2017. The increase is due to a strong jump in Gaza where 52 percent of those in the labor force were unemployed in 2018. Unemployment amongst Gaza's youth exceeded 67 percent. In the West Bank, unemployment has stagnated at around 18-19 percent over recent years.

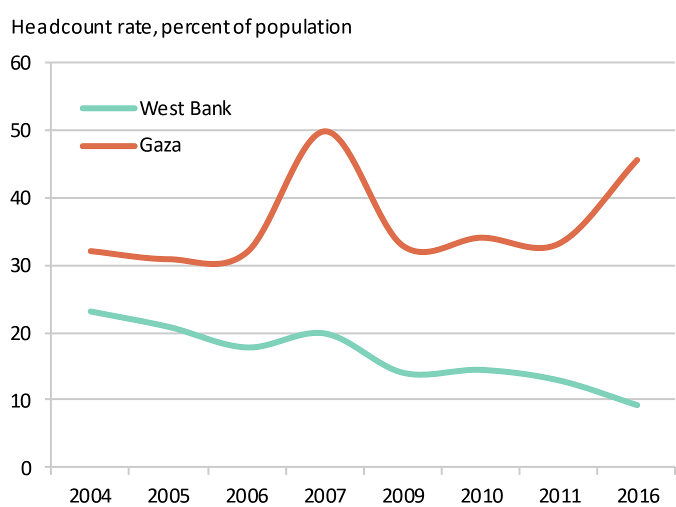
Around 24 percent of Palestinians lived below the US$5.5 2011 PPP a day poverty line in 2016/17—2.9 percentage points higher compared to 2011. The gap between

FIGURE 1 Palestinian territories / Unemployment rate



Sources: Palestinian Central Bureau of Statistics (PCBS).

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



Sources: PECS, World Bank staff calculations.

the West Bank and Gaza has increased substantially in 2016/17 with 46 percent of the population below the US$5.5 poverty line in Gaza, compared to 9 percent in the West Bank. Monetary living standards in both regions remained fragile. In the West Bank, poverty status is sensitive to even small shocks in household expenditures, while in Gaza any change in social assistance flows can significantly affect the population's wellbeing.

Outlook

Under a baseline scenario that assumes a continuation of the Israeli restrictive regime and the persistence of the internal divide between the West Bank and Gaza, private sector activity is not expected to pick up and real GDP growth of the Palestinian economy is projected to hover around 0.5-1.6 percent between 2019 and 2021. This growth level implies a yearly decline in real per capita income by around 2-3 percent. Inflation will remain subdued with inflation hovering around 2 percent in 2019-2021.

Despite the PA's efforts to increase revenues and rationalize spending, the Israeli decision to reduce transfers of VAT and import duties collected on behalf of the PA (clearance revenues) will negatively impact the PA's fiscal situation in the coming years. A continued decline in foreign aid is also expected, hence, the fiscal deficit (after grants) is projected to reach 6.5 percent of GDP in the forecast period. As in previous years, the PA will resort to domestic sources of financing including debt from local banks and arrears to the private sector and the pension fund, crowding out the private sector.

The current account deficit—including official transfers—is projected to stay high through 2021, with exports constrained by the restrictions system to around 19-20 percent of GDP. The Palestinian territories will continue to heavily depend on imports to meet even some basic needs, and hence the imports share is expected to rise to 62 percent in 2021. In addition to official transfers, the current account deficit financing will continue to depend on informal private capital transfers and possibly further drawdowns of foreign exchange.

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

Risks and challenges

In the West Bank, a downside risk could materialize if the PA reacts to the Israeli decision to reduce clearance revenues by refusing to accept these transfers altogether. Given that these transfers comprise 65 percent of the PA's revenues, such a decision could result in severe cuts in current spending including on wages and transfers. Also, recent trends indicate an overall decline in the amount of development assistance to be received by the Palestinian economy in the coming years. With private sector activity constrained by the externally imposed restrictions, potential sources of growth in the West Bank will be very limited going forward. Finally, if clashes between the Palestinians and the Israeli forces in the West Bank witnessed in 2018 continue, this may adversely impact confidence and economic activity.

In Gaza, if transfers through the PA's budget continue to decline and the United Nations Refugee and Works Agency's (UNRWA) funding gap persists, this will have a severe impact on economic activity, service provision and social conditions in the Strip. Consequently, the Gaza economy is not expected to recover from the current recession, further raising the potential for unrest.

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

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.7	3.1	0.0	0.5	1.0	1.6
Private Consumption	3.3	3.0	0.5	0.6	0.6	0.6
Government Consumption	1.8	0.9	1.0	-2.7	-0.8	-0.8
Gross Fixed Capital Investment	-0.9	2.2	1.2	-4.5	0.0	6.2
Exports, Goods and Services	1.9	5.0	3.0	4.5	3.2	3.8
Imports, Goods and Services	0.2	4.7	2.6	-1.3	-0.1	1.4
Real GDP growth, at constant factor prices	4.2	2.8	0.0	0.5	1.0	1.6
Agriculture	-8.1	-5.7	0.4	0.5	0.6	0.7
Industry	7.5	3.5	1.0	1.2	1.3	1.6
Services	3.9	3.0	-0.3	0.3	0.9	1.6
Inflation (Consumer Price Index)	-1.0	0.0	-0.2	0.0	0.7	1.5
Current Account Balance (% of GDP)	-13.9	-10.6	-12.2	-10.3	-9.1	-8.4
Net Foreign Direct Investment (% of GDP)	-2.5	-1.5	-1.5	-1.5	-1.5	-1.4
Fiscal Balance (% of GDP)	-2.5	-3.2	-5.2	-6.5	-6.5	-6.5
Debt (% of GDP)	18.5	17.5	18.6	20.9	23.0	25.2
Primary Balance (% of GDP)	-2.0	-2.7	-4.7	-6.0	-5.9	-5.8

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