PALESTINIAN TERRITORIES

Table 1	2019
Population, million	4.9
GDP, current US$ billion	16.4
GDP per capita, current US$	3337
Upper middle-income poverty rate ($5.5)[a]	23.6
Gini index[a]	33.7
School enrollment, primary (% gross)[b]	98.9
Life expectancy at birth, years[b]	73.7

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

Following a fiscal crisis in 2019, the Palestinian economy was projected to slowly recover in 2020. However, the Covid-19 outbreak seems to be largely weighing on economic activity. Living conditions are difficult with a quarter of the labor force unemployed and 24 percent of Palestinians living below the US$5.5 2011 PPP a day – even prior to the recent outbreak. A larger than expected decline in aid and a further spread of the Covid-19 virus pose significant downside risks.

Recent developments

Economic momentum faltered in 2019 as growth of real Gross Domestic Product (GDP) in the Palestinian territories weakened in the first three quarters of 2019. Specifically, quarter-on-quarter growth was minus 3.3 percent in the first quarter of 2019, followed by negative growth of 2 percent in the second quarter before returning to growth of 1 percent in the third quarter. Notably, the slowdown was driven by a decline in private and public consumption and in investment. Even though official data is not out yet, anecdotal evidence shows that the situation has worsened in 2020 as the Covid-19 outbreak is causing disruptions to economic activity and everyday lives, which is expected to weigh heavily on GDP growth.

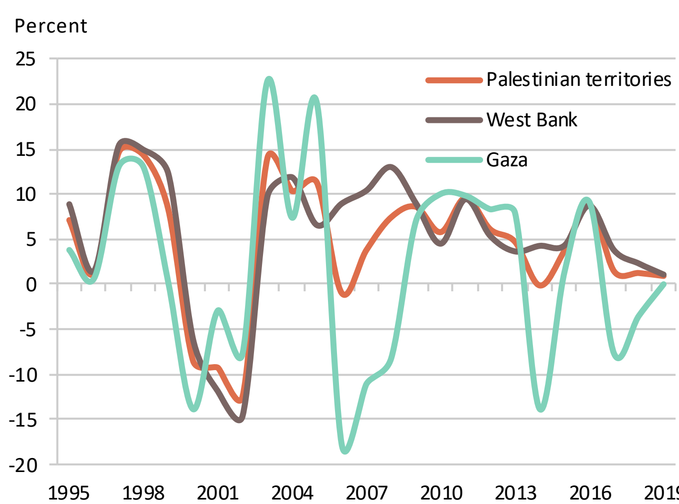
Consumer price inflation has remained low in 2019, in line with developments in Israel given the common circulation of the New Israeli Shekel and import dependence on Israel. Overall prices increased by 1.3 percent (year-on-year) in December 2019 and inflation averaged 1.6 percent for the entire 2019 compared to 2018.

The Palestinian Authority's (PA) fiscal stress significantly heightened starting in March 2019. Following a 2018 law, the Government of Israel (GoI) started making unilateral deductions of almost US$12 million per month from the tax revenues it collects on behalf of the PA (clearance revenues). In response, the PA refused to accept these transfers altogether during March - September 2019. Since clearance revenues constitute 65 percent of the PA's total revenues and 15 percent of GDP, their loss resulted in a severe liquidity squeeze that negatively impacted public and private consumption. The PA started re-accepting these revenues in September 2019, and the fiscal stress then eased allowing the PA to clear most of the arrears it had accumulated during the standoff to its employees, pay some of the arrears to private suppliers as well as pay down the increase in domestic debt. The PA's financing need (deficit before foreign assistance) reached US$1.4 billion while foreign assistance was US$590 million, resulting in a financing gap after aid of around US$0.8 billion—the largest in years.

Despite a widening trade deficit, the current account deficit is estimated to have narrowed in the first three quarters of 2019, by 10 percent, to US$1.4 billion. The trade deficit in goods and services stood at US$4.9 billion in the first three quarters of 2019—up 4 percent compared to the same period of 2018. Exports continue to be constrained by the ongoing trade restrictions. Current transfers amounted to US$3.5 billion, up 11 percent compared to the same period of 2018 as a result of an increase in both private and official transfers. Most notably, compensation of employees working abroad was up 4 percent to US$1.9 billion as a result of a greater number of workers employed in Israel.

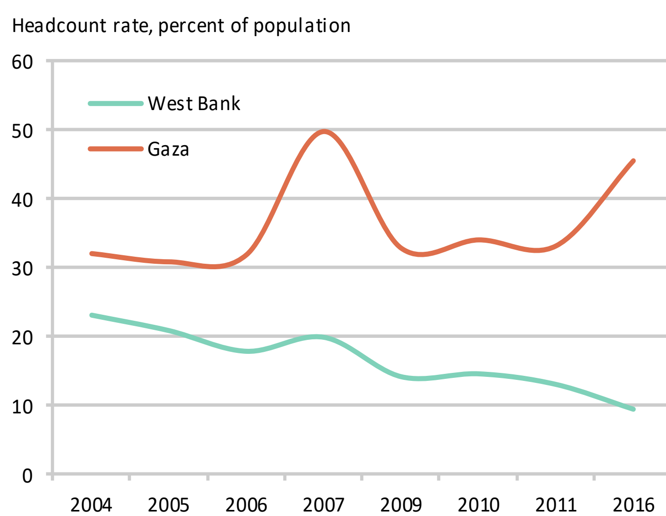
The unemployment rate reached 26.8 percent in the first quarter of 2019, but it has since eased to 24 percent in the fourth quarter due to the remission of the clearance revenues standoff. In Gaza, 43

FIGURE 1 Palestinian territories / Real GDP growth rate



Sources: Palestinian territories Central Bureau of Statistics (PCBS).

FIGURE 2 Palestinian territories / Poverty rates at the $5.5 2011 PPP per day level



Sources: PECS, World Bank staff calculations.

The cut-off date for information in this MPO was April 02, 2020.

percent of those in the labor force were unemployed in the fourth quarter of 2019. The situation in the West Bank has been very different with the unemployment rate stagnating at around 17 percent over recent years. It has even dropped to 14 percent in the fourth quarter of 2019 as a result of an increase in the number of persons employed in Israel.

Around 24 percent of Palestinians lived below the US$5.5 2011 PPP a day poverty line in 2016/17– 2.9 percentage points higher compared to 2011. The gap between the West Bank and Gaza has increased substantially in 2016/17 with 46 percent of the population below the US$5.5 poverty line in Gaza, compared to 9 percent in the West Bank. Monetary living standards in both regions remained fragile. In the West Bank, poverty status is sensitive to even small shocks in household expenditures, while in Gaza any change in social assistance flows can significantly affect the population's wellbeing.

Outlook

Growth in 2019 is estimated to have been weak, reaching 0.9 percent, as economic activity was disrupted for most of the year due to the fiscal crisis. Notably, this outturn is a result of Gaza registering minimal positive growth following a steep recession in 2018 (-3.5 percent), while growth in the West Bank in 2019 is expected to reach the lowest level over the last five years (1.1 percent), down from 2.3 percent in 2018. Going forward, measures put in place by the PA since early March, 2020 to halt the spread of the covid-19 outbreak, while effective in limiting the spread of the virus, seem to have resulted in disruptions in economic activity, especially in the West Bank. As a result, the Palestinian economy is expected to contract by 2.5 percent in 2020.

On the fiscal side, the expected normalization of clearance revenue transfers throughout 2020 is extremely positive. However, additional spending by the PA to respond to the Covid-19 outbreak, estimated at US$120 million, will strain the budget especially as donor funding is expected to reach its lowest point in more than a decade, US$266 million. Even with planned measures to ration some public spending, savings will not be enough to offset the additional Covid-19 related expenditures resulting in a financing gap (deficit after grants) of around US$1 billion.

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

Risks and challenges

There are significant risks to the outlook. If the covid-19 outbreak is not controlled soon, its impact on economic activity and livelihoods is going to be severe. Under this scenario, drastic measures are expected to be put in place including a complete lock down on the West Bank and Gaza and a ban on movement between cities. Private sector representatives have also announced plans to cut pay by fifty percent. The largest impact would be through a decision to stop the entrance of more than 140,000 Palestinian workers to Israel, as those workers and their families account for a third of private consumption given their higher take-home pay. A sharp reduction in the number of tourists is also expected to contribute negatively. The lack of policy tools, such as fiscal stimulus, liquidity injections, or external borrowing could leave the economy vulnerable. The impact on consumption could be severe and the economy could contract by more than 7 percent.

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

	2017	2018	2019 e	2020f	2021f	2022 f
Real GDP growth, at constant market prices	1.4	1.2	0.9	-2.5	2.1	2.4
Private Consumption	-1.1	1.1	1.8	-5.5	1.3	1.3
Government Consumption	-13.7	7.3	1.3	5.5	0.7	3.1
Gross Fixed Capital Investment	6.9	2.5	2.1	-1.3	4.5	4.2
Exports, Goods and Services	13.9	2.5	0.8	-0.6	1.2	1.0
Imports, Goods and Services	1.3	4.5	3.0	-3.0	1.1	1.3
Real GDP growth, at constant factor prices	0.2	1.9	3.8	-2.5	2.2	2.5
Agriculture	-6.0	1.6	0.3	-1.4	1.0	1.1
Industry	11.6	2.2	0.7	-2.9	1.6	1.8
Services	-2.2	1.8	5.2	-2.4	2.5	2.8
Inflation (Consumer Price Index)	0.0	1.2	1.6	1.4	1.4	1.5
Current Account Balance (% of GDP)	-9.7	-10.2	-9.9	-7.3	-6.3	-6.0
Net Foreign Direct Investment (% of GDP)	-1.4	-1.4	-0.8	-0.8	-0.8	-0.8
Fiscal Balance (% of GDP)	-3.2	-2.5	-4.4	-6.1	-3.9	-3.8
Debt (% of GDP)	15.8	14.5	17.3	19.6	20.9	20.5
Primary Balance (% of GDP)	-2.7	-2.1	-4.0	-5.6	-3.5	-3.4

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

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