



PALESTINE MONETARY AUTHORITY

Economic Forecasts for 2015



Research and Monetary Policy Department

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Preface

The Palestinian economy operates within an environment that poses numerous internal and external threats and challenges. External challenges are manifold. These include: (i) numerous restrictions imposed by Israeli occupation on Palestinian economy (internal and external closures) and on freedom of movement and access over years; (ii) vagaries of foreign aid inflows have direct negative consequences on the performance of the Palestinian economy, as foreign aid constitutes a significant source of government revenues.; and (iii) inability of the PMA to implement independent monetary policy, in light of absence of domestic currency and the multi-currency system, which depend on monetary policies pursued by the United States, Jordan and Israel. Internal challenges include uncertainty and absence of clear political and economic prospects, the receding performance of the private sector as an engine of economic growth.

The aforesaid factors are considered responsible for many economic shocks and crises affecting the Palestinian economy, causing clear fluctuations in the movement of trade and investment, and subsequently, in economic activity and growth. Thus, the activity and performance of the Palestinian economy, as is the case with economies of other countries, depend on free movement and access of people, goods and capital.

Growth trends during 2011-2013

In the past few years, the escalating severity of both external and internal shocks has increasingly affected economic performance. During 2013, the Palestinian economy suffered further economic slowdown for a third consecutive year in which real growth noticeably receded to 2.2 percent compared to 6.3 percent in 2012 and 12.4 percent in 2011. The inadequate economic performance comes as a result of the slowdown in growth rates achieved in the West Bank (WB), falling back from 10.7 percent in 2011, to 6.0 percent in 2012, then to around 1.0 percent in 2013. In Gaza Strip (GS), growth

receded from 17.7 percent in 2011, to 7.0 percent in 2012, and to 5.6 percent in 2013. This slowdown resulted in deceleration of real per capita income growth rates (real GDP per capita), recording a decline of growth rates in Palestine from 9.1 percent in 2011 to 3.1 percent in 2012 to -0.8 percent in 2013 and stabilizing at USD 1,793 for the same year.

Likewise, poor economic performance affected the labor market leading to a marked increase in unemployment rates, particularly in GS, where unemployment rates rose from 28.7 percent of total labor force in 2011, to 31.0 percent in 2012, to 32.6 percent in 2013. In the meantime, unemployment rates in the WB increased from 17.3 percent in 2011, to 19.0 percent in 2012, and dropped slightly to 18.6 percent in 2013. At a national level, unemployment rates rose from 20.9 percent of total labor force, to 23.0 percent, and to 23.4 percent respectively for the same comparison period.

On the other hand, the inflation rate in Palestine declined from 2.9 percent in 2011, to 2.8 percent in 2012, and further to 1.7 percent in 2013, mainly due to the influence of changes in costs of import and global prices of food and fuel. Taking into account that food and fuel constitute a share that exceeds 40 percent of the Palestinian individual expenditure, based on the Palestinian consumer's basket.

During that same period, the external sector witnessed notable changes, in view of the decline in export growth from 25.9 percent in 2011 to -0.6 percent in 2012, followed by a rise to 3.3 percent in 2013, as opposed to an increase in imports from 7.7 percent to 14.3 percent in 2012, followed by a decline to 7.2 percent in 2013. These developments resulted in an increase in Palestinian trade deficit by around 0.3 percent in 2011 and around 21.9 percent in 2012, before it narrowed by 11.6 percent in 2013.

Growth projection in 2014

In spite of the improvement witnessed during the first half of 2014 as compared to the same period of the previous year, the Palestinian economy experienced a new relapse during the second half of 2014 due to the latest Israeli attack against GS. Compared to the first half of 2013, the overall growth rate of the Palestinian economy was recorded at 5.1 percent¹, influenced by a hike of 9 percent in final consumption and of 7.5 percent in exports. This growing demand was met with arising growth in the value added of a number of economic sectors, most importantly the trade, service and financial and insurance services sectors, which grew by 24.8 percent, 10.5 percent and 6.4 percent respectively for the same period. The improvement is mainly attributed to the satisfactory economic performance of the WB, which has registered a growth of around 9.3 percent, whereas the economic conditions in GS remained subject to political circumstance and captive of the continued imposition of blockade and closure, which were mainly responsible for the decline in its economic performance by around 6 percent for the same period.

During the second half of 2014, the Palestinian economy is expected to undergo a sharp deterioration. This will come due to the latest Israeli war waged against Gaza, causing a large decline in economic activity due to damage inflicted upon the infrastructure and production bases of main economic sectors, particularly agriculture and fishing, manufacturing, construction and services. The decline is also exacerbated by deteriorating security conditions in the WB and the adverse influence of the Israeli economy on certain economic activities there, especially those directly linked to it, such as exports and workers in Israel. Having affected the Israeli economy itself, the repercussions of these developments, and particularly the war, have led to a decline in

¹ Palestinian Central Bureau of Statistics, Quarterly National Accounts data.

Israeli economic performance, registering a negative growth rate of 0.4 percent during the third quarter of 2014.

Given the aforementioned developments, the PMA builds its 2015 projections of GDP based on several leading indicators, most importantly the PMA Business Cycle Index (PMABCI), indices of construction, external sector and other Israeli-economy associated indices. As such, PMA projections indicate that the Palestinian economy is expected to contract during 2014 to record a -2.7 percent real growth rate, compared to around 2.2 percent in 2013. This is expected to adversely affect real GDP per capita, resulting in around 5.5 percent drop, compared to less than 0.8 percent in 2013. PMA projects also indicate a decline in value added for both the private and public sectors by around 3.5 percent and 2.1 percent respectively, as compared to a growth of 1.8 percent and 5.2 percent in 2013. Furthermore, it is projected that the unemployment rate for 2014 will rise to around 29.0 percent of total labor force², compared to 23.4 percent in 2013, in addition to a rise in inflation to 2.0 percent from 1.7 percent in 2013.

PMA Forecasts for 2015

The forecasts³ for 2015 key Palestinian economic variables have been prepared under a basic scenario (the baseline scenario), associated with risk assessment for different shocks of varying likelihood (an optimistic scenario and a pessimistic scenario), which are expected to have positive and negative repercussions on economic performance. It is acknowledged that the forecasts are sensitive to revisions of actual data of previous

² Based on projections made by the PMA research team.

³ The forecasts for Palestinian economic key variables were based on economic models developed by the PMA using the Reduced Form Equation to compute GDP forecasts on quarterly basis. In concordance with this model, key macroeconomic variables were predicted such as GDP components, employment and wages using the structural model. As for inflation, predictions were made based on the Inflation Forecasting Model which takes into account the impact of internal and external factors on inflation in Palestine through the employment of the Co-integration Analysis methodology and the methodology of Autoregressive Distributed Lag (ARDL) model. For further details concerning these methodologies, check the working papers published on PMA website at www.pma.ps

years issued by the different data-producing agencies. Most important among these are the Palestinian Central Bureau of Statistics and the Ministry of Finance.

1. Growth forecasts

Basic forecasts for Palestinian economic growth for 2015 are founded on a set of basic assumptions (baseline scenario) which are:

- No significant change will affect the political or security conditions (stagnation of the peace process), conducive to repercussions on the economic conditions, particularly in light of the persistence of barriers at crossings and restrictions on freedom of movement, transport and access. Likewise, no change (or only a slight increase) will occur to the numbers of Palestinian workers in Israel, which will hover around the same level of the previous year. Taking into consideration that 2014 was an exceptional year given the impact of the recent war on Gaza, this scenario, therefore, assumes conditions will remain unchanged as it is during the first half of the year;
- At the fiscal level, the government is expected to continue following a fiscal austerity and implement expenditure rationing while growth rates of government revenues and expenditure are expected to remain significantly unchanged at previous-year levels;
- Foreign aid, extended by donor countries to support the Palestinian Authority, is expected to continue flowing to reach USD 1.5 billion;
- Private sector transfers from abroad are expected to rise by 4 percent, as compared to their value in 2014;
- Credit facilities granted to the private sector by banks operating in Palestine are expected to rise by 12 percent, as compared to 2014;

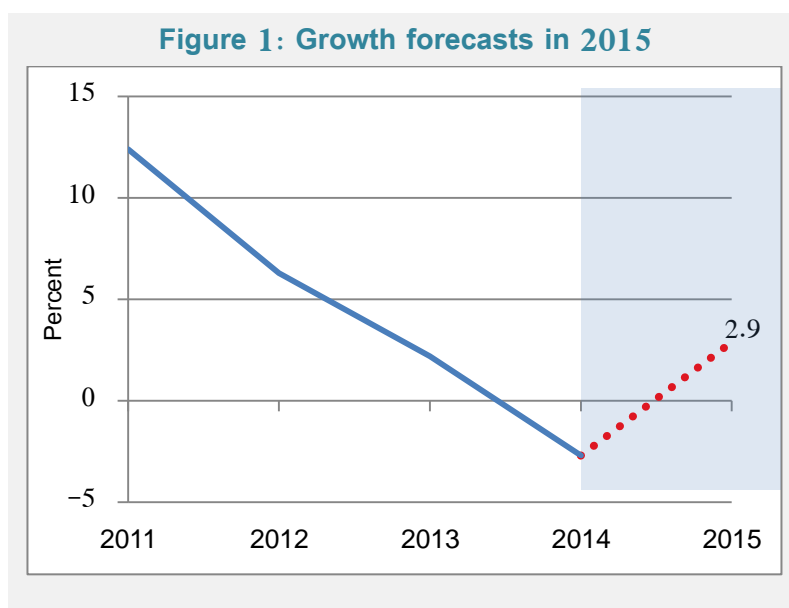
- Palestinian exports to main trading partners are expected to grow as a result of increased demand (real growth rate of exports to Israel is expected to reach 3.0 percent⁴).

Based on such assumptions, PMA forecasts indicate a relative recovery in Palestinian economic performance during 2015. Real GDP is expected to accomplish growth by 2.9 percent, compared to a negative growth of 2.7 percent for 2014, thereby pushing real GDP to around USD 7,485 million⁵. However, the aforesaid rate of growth may be susceptible to drop below the

expected rate as a result of deterioration in political and economic stability. This growth is expected to reflect positively on real GDP per capita, raising it by 0.2 percent, compared to a negative growth of around 5.5 percent in 2014, to reach USD 1,697. In tandem, private

sector and public sector value added is expected to grow by 3.6 percent and 2.4 percent, respectively, compared to 2014.

This growth is associated with the expected improvement in total final consumption, particularly for the private sector, total investment and exports. In this context, PMA forecasts reveal an expected growth in total final consumption by around 6.8 percent in



⁴ Growth rate as predicted by the Bank of Israel.

⁵ The IMF in his latest published report in September 2014 estimated 4.4 percent real growth rate.

2015 (9.2 percent growth for private consumption as opposed to a drop in public consumption by around -2.4 percent due to expenditure rationing).

Total investment is expected to grow by around 15.5 percent. Additionally, in view of the expected increase in total consumption and investment, forecasts point to an expected rise in Palestinian exports by around 22.7 percent, compared to a rise by around 22.4 percent in imports. Consequently, it is predicted that these changes in exports and imports will lead to an increase in trade deficit by around 22.3 percent to constitute around -44.2 percent of forecast real GDP for 2015.

Table 1: Growth forecasts in 2015

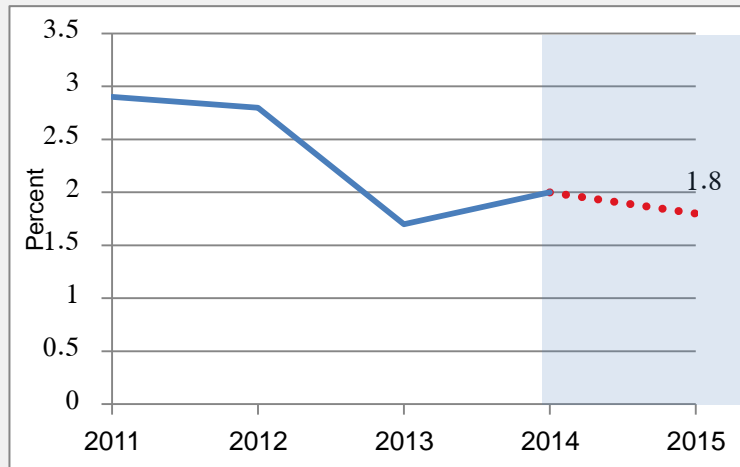
	2011	2012	2013	2014	2015
	Actual			Projection*	Estimation
Annual percent changes					
Real GDP	12.4	6.3	2.2	-2.7	2.9
Real GDP percapita	9.1	3.1	-0.8	-5.5	0.2
Private sector value added	15.8	6.3	1.8	-3.5	3.6
Public sector value added	15.3	7.3	5.2	-2.1	2.4
Unemployment rate	20.9	23.0	23.4	29.0	27.0
Inflation rate	2.9	2.8	1.7	2.0	1.8
Total final consumption	9.9	9.6	-3.5	-1.0	6.8
Public	7.4	3.3	-1.6	-13.1	-2.4
Private**	10.7	11.6	-4.0	2.6	9.2
Total investment	-2.1	19.0	4.2	-5.8	15.5
Net export***	0.3	21.9	-11.6	-0.8	22.3
Total exports	25.9	-0.6	3.3	-14.7	22.7
Total imports	7.7	14.3	-7.2	-4.7	22.4
Memorandum items					
Real GDP (USD million)	6,882.3	7,314.8	7,477.0	7,273.9	7,484.8
Real GDP percapita (USD)	1,752.5	1,807.5	1,793.3	1,694.0	1,697.0
USD/NIS Exchange rate	3.58	3.85	3.61	3.85	3.85
* PMA Projections.					
** Includes NPISH.					
*** Negative sings means decrease in trade balance deficit.					

It is also expected that, in 2015, unemployment rates will drop to around 27 percent of total workforce, in view of the forecast of positive real GDP growth and the subsequent increase in job opportunities and employment.

2. Inflation forecasts

PMA forecasts indicate that the expected inflation rate in Palestine for 2015 will score 1.8 percent on average, compared to around 2.0 percent in 2014. During the first half of the year, inflation rates are expected to rise, while, in the second half, they are expected to drop. These forecasts are made in light of expectations for a slight increase in the cost of import by 0.9 percent and a greater decline in global food prices by -7.0 percent during 2015.

Figure 2: Inflation forecasts in 2015



Risks analysis (shocks)

Regardless of probable statistical or methodological errors, the uncertainty associated with many disparate factors looms. This is particularly so because the Palestinian economy operates within a high risk environment, both internally and externally. These risks are deemed responsible for numerous possible shocks affecting economic performance through influence over consumption modes and the movement of trade and investment.

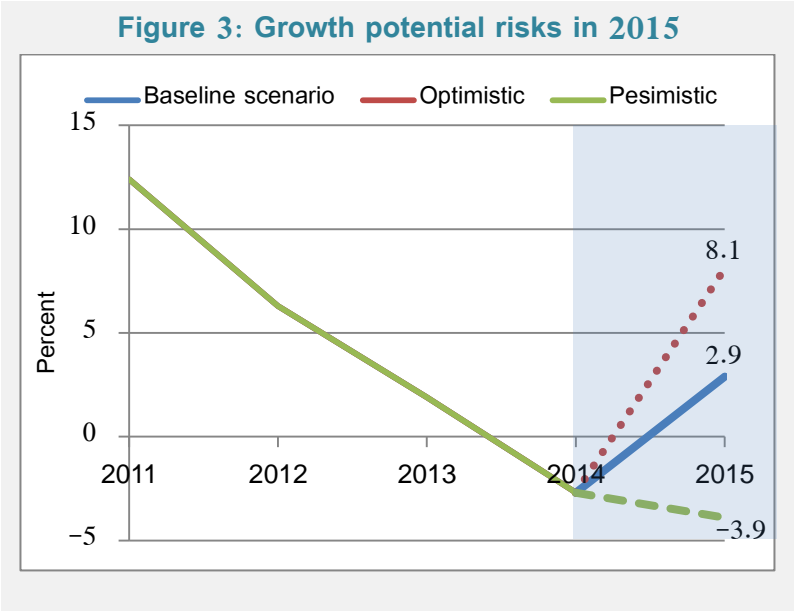
In this context, PMA forecasts for 2015 remain subject to several likely shocks, both positive and negative, which may subsequently affect key economic indicators.

A positive shock to the Palestinian economy (the optimistic scenario) assumes that major advances take place regarding the political track, security conditions and peace talks. It also assumes the commencement of the inflows of funds dedicated for the restructuring Gaza, the launch of major projects and introduction of measures to boost

the economy, in tandem with uplifting the siege and closure of the Strip, the significant easing of restrictions on movement of people and goods, the increase in the number of Palestinians workers in Israel, a rise in donor aid inflows for budget support and development expenditure, as well as an upsurge in private sector transfers from abroad. In the event of such a scenario, PMA forecasts indicate an economic growth by 8.1 percent, pushing real GDP to USD 7,863 million. A consequent increase in GDP per capita of 5.0 percent to USD 1778 is expected. The private sector value added is expected to grow by 8.3 percent while that of public sector is presumed to score 7.2 percent. Such a scenario is also expected to positively affect unemployment rates, as forecasts point to a decline to 23.0 percent of total labor force.

Under such a scenario, total final consumption is expected to increase by around 15.7 percent (of which 16.4 percent is growth in private consumption and 12.7 percent is growth in public consumption). Likewise, total investment is expected to grow by around 26.4 percent. As for trade, forecasts indicate a growth by around 40.0 percent in exports and a higher growth in imports by around 41.5 percent, which will consequently lead to an increase in the trade deficit by 42.1 percent, pushing up real GDP deficit to around -48.9 percent for 2015.

In contrast to the aforesaid scenario, the economy remains susceptible to negative shocks (the pessimistic scenario). Such a scenario assumes a sharp



deterioration of political and security conditions, a decrease in the number of Palestinian workers in Israel, a tightening of restrictions on the movement of people and goods, an increase in days of closure for workers and trade, a proliferation of barriers to import and export, Israel withholding tax revenues, a decline in foreign aid from donor countries to support the budget and development expenditure, as well as a delay in the transfer of funds dedicated to restructuring Gaza.

In the event of such a scenario, the PMA predicts further deterioration of economic conditions, with the Palestinian economy contracting by -3.9 percent (See Figure 3), and a subsequent decline of real GDP to around USD 6,990 million. This is also expected to adversely affect real GDP per capita leading to a decline by -6.7 percent to reach around USD 1,581. Moreover, forecasts point to a decline in private and public sectors value added by -4.5 percent and -3.3 percent

Table 2: Growth forecasts in 2015

	2013	2014		2015	
	Actual	Projection*	Baseline	Optimistic	Pessimistic
Annual percent changes					
Real GDP	2.2	-2.7	2.9	8.1	-3.9
Real GDP percapita	-0.8	-5.5	0.2	5.0	-6.7
Private sector value added	1.8	-3.5	3.6	8.3	-4.5
Public sector value added	5.2	-2.1	2.4	7.2	-3.3
Unemployment rate	23.4	29.0	27.0	23.0	31.0
Inflation rate	1.7	2.0	1.8	--	--
Total final consumption	-3.5	-1.0	6.8	15.7	-5.3
Public	-1.6	-13.1	-2.4	12.7	-20.7
Private**	-4.0	2.6	9.2	16.4	-9.7
Total investment	4.2	-5.8	15.5	26.4	-14.3
Net export***	-11.6	-0.8	22.3	42.1	-14.2
Total exports	3.3	-14.7	22.7	40.0	-11.9
Total imports	-7.2	-4.7	22.4	41.5	-13.5
Memorandum items					
Real GDP (USD million)	7,477.0	7,273.9	7,484.8	7,863.1	6,990.2
Real GDP percapita (USD)	1,793.3	1,694.0	1,697.0	1,778.0	1,581.0
USD/NIS Exchange rate	3.61	3.85	3.85	3.85	3.85

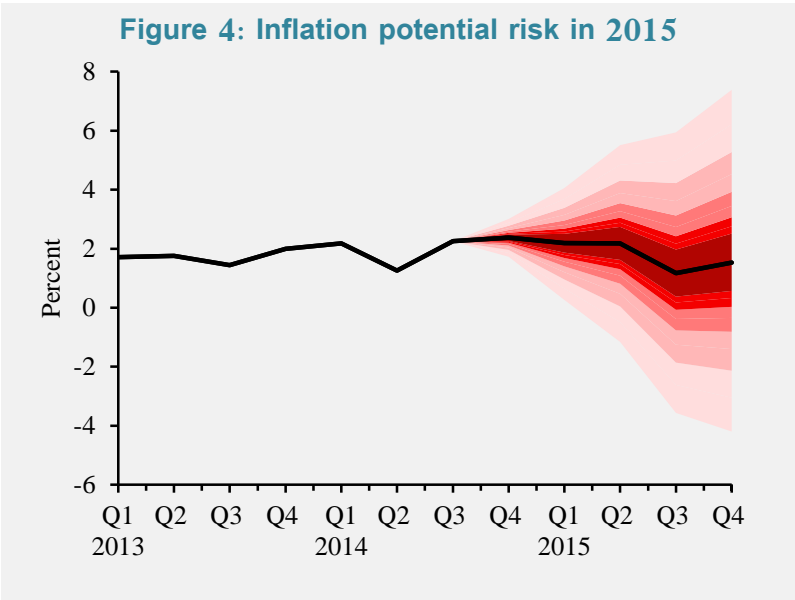
* PMA Projections.
 ** Includes NPISH.
 *** Negative sings means decrease in trade balance deficit.

respectively. Such a scenario is expected to adversely impact unemployment rates pushing them higher to reach 31 percent of total labor force during 2015.

As a result of this scenario, total final consumption is expected to fall back by around -5.3 percent (of which -9.7 percent is private consumption and -20.7 percent is public consumption). Additionally, total investment is expected to drop by around -14.3 percent. At the same time, exports are predicted to decline by around -11.9 percent as opposed to a greater decline in imports by around -13.5 percent. In light of such changes to exports and imports, forecasts indicate a decline in trade deficit by around -14.2 percent and a consequent decline in trade deficit to around -33.2 percent of the forecast real GDP for 2015.

As for inflation risks, they are mainly associated with changes to global prices of food and fuel, in addition to changes in inflation rates of Palestine’s trading partners, particularly Israel. Inflation forecasts in Palestine also depend on potential internal shocks that may affect domestic demand in Palestine. The inflation rate in Palestine during 2015 is illustrated in Figure 4.

It is worth mentioning that the range of likely results is a broad one, as apparent in figures 3 and 4. Of course, this is a reflection of the degree of uncertainty of predictions due to the potential risk factors highlighted earlier. These figures illustrate the expected growth and inflation rates by order of likelihood of occurrence. For example, the darker the shades in Figure 4 are, the higher the possibility is in arriving at the expected inflation rate.



Appendix: PMA forecasts in 2015

	2011	2012	2013	2014		2015	
		Actual		Projection*	Baseline	Optimistic	Pessimistic
Annual percent changes							
Real GDP	12.4	6.3	2.2	-2.7	2.9	8.1	-3.9
Real GDP percapita	9.1	3.1	-0.8	-5.5	0.2	5.0	-6.7
Private sector value added	15.8	6.3	1.8	-3.5	3.6	8.3	-4.5
Public sector value added	15.3	7.3	5.2	-2.1	2.4	7.2	-3.3
Unemployment rate	20.9	23.0	23.4	29.0	27.0	23.0	31.0
Inflation rate	2.9	2.8	1.7	2.0	1.8	--	--
Total final consumption	9.9	9.6	-3.5	-1.0	6.8	15.7	-5.3
Public	7.4	3.3	-1.6	-13.1	-2.4	12.7	-20.7
Private**	10.7	11.6	-4.0	2.6	9.2	16.4	-9.7
Total investment	-2.1	19.0	4.2	-5.8	15.5	26.4	-14.3
Net export***	0.3	21.9	-11.6	-0.8	22.3	42.1	-14.2
Total exports	25.9	0.6-	3.3	-14.7	22.7	40.0	-11.9
Total imports	7.7	14.3	-7.2	-4.7	22.4	41.5	-13.5
As percent of real GDP							
Total final consumption	116.9	120.6	113.9	115.9	120.3	124.0	114.2
Public	28.0	27.2	26.2	23.4	22.2	24.4	19.3
Private**	88.9	93.4	87.7	92.5	98.1	99.6	94.9
Total investment	19.3	21.6	22.0	21.3	23.9	24.9	19.0
Net export	-36.8	-42.2	-36.5	-37.2	-44.2	-48.9	-33.2
Total exports	18.9	17.6	17.8	15.6	18.6	20.2	14.3
Total imports	55.6	59.8	54.3	52.8	62.8	69.1	47.5
Error and omissions	0.6	0.0	0.6	0.0	0.0	0.0	0.0
Memorandum items							
Real GDP (USD million)	6,882.3	7,314.8	7,477.0	7,273.9	7,484.8	7,863.1	6,990.2
Real GDP percapita (USD)	1,752.5	1,807.5	1,793.3	1,694.0	1,697.0	1,778.0	1,581.0
USD/NIS Exchange rate	3.58	3.85	3.61	3.85	3.85	3.85	3.85

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