

Statement at the End of an IMF Mission to the West Bank and Gaza

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End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. This mission will not result in a Board discussion.

An International Monetary Fund (IMF) mission led by Christoph Duenwald visited East Jerusalem and Ramallah from January 21-29, 2015, to assess recent economic developments in the West Bank and Gaza and the financial situation of the Palestinian Authority (PA). The mission met with Deputy Prime Minister Mohammad Mustafa, Finance Minister Shukry Bishara, Governor Jihad Al Wazir, and other Palestinian officials. At the end of the mission, Mr. Duenwald issued the following statement:

"Economic activity contracted in 2014, following the war in Gaza in the summer and mounting political tensions in the West Bank and East Jerusalem. The mission estimates that real GDP fell by nearly one percent, the first contraction since 2006, with GDP declining by about 15 percent in Gaza but rising by 4.5 percent in the West Bank with a sharp slowdown in the third quarter. Unemployment rates remain at high levels, reaching an estimated 41 percent in Gaza and 19 percent in the West Bank. Despite last year's difficult economic and political situation, the PA maintained its efforts to keep the fiscal deficit in check, helped by strong revenue performance.

"A high degree of uncertainty and various headwinds will likely prevent a strong economic recovery in 2015. Most notable is the non-transfer to the PA of clearance revenues collected by Israel on goods imported into the West Bank and Gaza. These represent about two-thirds of net revenues and are essential to the PA's budget and to the Palestinian economy. Reduced wage payments and other public spending cuts necessitated by the suspension of clearance revenues in the presence of financing constraints will likely cause a sharp reduction in private consumption and investment. In addition, Gaza reconstruction after the war is proceeding more slowly than expected, reflecting insufficient progress on national reconciliation and unfulfilled donor pledges. Real GDP in 2015 is therefore set to rise only modestly, with a pickup in Gaza from a low base and a drop of nearly 2 percent in the West Bank, although the sharp fall in oil prices provides some relief to energy consumers. Medium-term growth will remain modest, unless there is an improvement in the political climate that would lead to a lifting of restrictions in the West Bank and the blockade in Gaza.

"The ongoing fiscal crisis exacerbated by the withholding of clearance revenue could deepen over the next few months. The absence of clearance revenue will need to be compensated by curtailment of wages and allowances, cuts in non-wage spending, further borrowing from the banking system, or additional arrears accumulation. In this context, reduced salary payments should be differentiated so as to minimize the impact on lower income earners. Front loaded assistance from donors is needed to provide bridge financing in the absence of clearance revenues. For 2015 as a whole, even assuming a resumption of clearance revenue transfers in a few months, we project a large financing gap that calls for a prudent fiscal stance, with strict restraint on public sector wages. We recommend safeguarding transfers to poor and vulnerable households, and social assistance in Gaza, where the humanitarian situation is particularly dire. Moreover, contingency measures should be in place in case the suspension of clearance revenue extends beyond a few months. Moves toward a more sustainable fiscal position should be buttressed by renewed emphasis on fiscal structural reform, particularly in the areas of public financial management and revenue administration, including by developing a simplified tax regime for small businesses.

"In this volatile environment, safeguarding financial stability will remain a priority. The Palestine Monetary Authority has made considerable progress in risk-based supervision and enhancing crisis preparedness. While the financial system is sound and well capitalized, the high exposure of the banking system to the PA and its employees calls for vigilance, especially given the clearance revenue suspension.

"Strong efforts by the PA can only go so far to contain the crisis for a few months. The situation could become untenable, with a growing risk of social unrest and strikes that could lead to political instability. These serious risks could be mitigated if Israel quickly resumed transfers of clearance revenue and donors front loaded their aid."

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