Key Points to the Press by Oussama Kanaan
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Summary of Findings of IMF Mission
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Key points:

- *Macroeconomic conditions in the West Bank have improved, reflecting a relaxation of Israeli restrictions on internal trade and improved security conditions. Continuation of the relaxation of the restrictions could result in real GDP growth in the West Bank of 7 percent for 2009 as a whole. This would represent the first significant improvement in living standards in the West Bank since 2006. However, if the relaxation of Israeli restrictions does not continue in the remainder of the year, real GDP per capita would decline further in 2009, along the same trend started in 2006.*

- *Gaza's situation remains difficult given the persisting blockade on a wide range of non-humanitarian goods. Unless the blockade is substantially relaxed, real GDP per capita in Gaza will continue its downward trend, with further increases in poverty and unemployment.*

- *Over the medium-term, sustainable increases in real GDP per capita will require not only the removal of internal trade restrictions, but also the removal of trade restrictions between the Palestinian territories and Israel.*

- *Steady progress has been made by the Palestinian Authority (PA) in institution-building and reforms. The Palestinian Authority also has made impressive strides in strengthening the Public Financial Management System, which has helped prioritize and raise the quality of public expenditure. The PA's economic and financial reforms have complemented its security reforms to bolster confidence of both the private and public sectors. Furthermore, the strengthening of public finance transparency and accountability by the ministry of finance since the advent of Prime Minister Fayyad in mid-2007 has greatly facilitated the disbursement of donor aid directly to the PA budget.*

- *The 2009 budget which the PA has been implementing is characterized by a substantial retrenchment in recurrent spending on the wage bill and utility subsidies. The Gaza war has resulted in additional emergency expenditures not foreseen in the budget (which was prepared before the Gaza war).*

- *There is a pressing need for donors disburse timely and adequate aid to finance the recurrent budget deficit in 2009. Failure to do so could result in major financial problems to the PA this year.*

1. **Conditions in Gaza remain difficult in the aftermath of the war, while the macroeconomic situation in the West Bank has improved.** While the Gaza blockade has been relaxed somewhat compared to the situation before the war last January, including on the transfer of cash to banks, restrictions on a wide range of non-humanitarian goods remain tight. Unemployment remains high, at about 20 percent in the West Bank and 34 percent in Gaza. For 2009, with continued relaxation of trade restrictions, overall real GDP growth in the West Bank and Gaza is projected at 5 percent and inflation at 3 percent. In the West Bank, two key factors have bolstered confidence and growth so far in 2009. First, there has been a substantial improvement in security conditions in West Bank cities reflecting security reforms by the PA. Second, Israeli restrictions on internal trade and the passage of people have been relaxed significantly. In addition, inflation has continued to fall, reflecting lower world food and fuel prices.

2. **The liquidity situation of Gaza banks has improved because of a modest easing of restrictions on the passage of cash into Gaza.** However, decisions by the Israeli authorities on cash entry are still being undertaken on an ad hoc basis. The PA is working with the Bank of Israel to ensure predictable passage of adequate cash from West Bank banks to their branches in Gaza.

3. **Steady progress has been made by the Palestinian Authority (PA) in institution-building and reforms.** The Palestinian Authority also has made impressive strides in strengthening the Public Financial Management System, which has helped prioritize and raise the quality of public expenditure. These economic and financial reforms have complemented the PA's security reforms to bolster confidence of both the private and public sectors. The 2009 budget which the PA has been implementing is characterized by a substantial retrenchment in recurrent spending on the wage bill and utility subsidies. The Gaza war has resulted in additional emergency expenditures not foreseen in the budget (which was prepared before the Gaza war).

4. **There is a need to secure adequate donor aid to finance the recurrent deficit of \$1.6 billion for 2009.** Of the latter amount, in January to June about \$0.3 billion has been financed through commercial bank loans, and \$0.4 billion with donor aid, leaving \$0.9 billion in external financing requirements for the second half of 2009. The mission's discussions with donors indicate that about \$0.6 billion could be disbursed by donors in the remainder of 2009, leaving a gap of about \$0.3 billion. However, the gap could be much higher if donors, especially Arab donor countries, do not fulfill their commitments.

5. **The mission discussed with the authorities the medium-term outlook.** In line with the tripartite action agenda, the PA would continue with reforms and a prudent fiscal policy, Israel would ease trade restrictions, and adequate donor support would be provided. Over the medium-term, sustainable increases in real GDP per capita will require not only the removal of internal trade restrictions, but also the removal of trade restrictions between the Palestinian territories and Israel. On that basis, real GDP growth would gradually rise to about 8 percent and the recurrent deficit on a commitment basis would decline to 10 percent of GDP by 2012. This scenario is subject to the risk that the easing of Israeli trade restrictions would not continue. In the latter scenario, real GDP growth would remain low, representing a continued erosion in Palestinians' living standards. Budgetary revenue would be lower, while emergency spending and arrears accumulation would be high, thus slowing the pace of fiscal adjustment, with the deficit projected at 20 percent in 2012.