



# WEST BANK AND GAZA

## REPORT TO THE AD HOC LIAISON COMMITTEE<sup>1</sup>

April 14, 2023

### KEY ISSUES

**The Palestinian economy faces myriad economic policy challenges and risks abound.** The political and security situation continues to deteriorate. Public finances remain unsustainable, despite a contained 2022 fiscal deficit. The banking system has adequate capital and liquidity buffers, with stable non-performing loans, but there are signs of asset quality deterioration and weaker deposit growth, as Palestinians' real incomes continue to erode.

**This IMF report puts fiscal and structural reforms into a broader context.** It discusses key elements of the Paris Protocol on Economic Relations and their implications for Palestinian growth and income convergence with Israel. It then outlines necessary and sufficient conditions for the customs and *de facto* currency union to work as intended, including contributions from the Palestinian Authority (PA), Israel and the international community. The report also discusses labor market issues, outcomes, and policies for faster economic growth and job creation.

### Key Recommendations

- Work with the Government of Israel (GoI) to facilitate the movement and access of goods and people and investment in Area C.
- Address the fiscal crisis by formulating detailed fiscal reform policies to reduce the public sector wage bill, net lending, and health spending and, with the GoI, resolving the outstanding fiscal files.
- Continue to improve the AML/CFT framework, further strengthen financial reporting standards and supervision, and, working with the Bank of Israel (BoI), operationalize an alternative mechanism for shekel correspondent banking relations.

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<sup>1</sup> The IMF provides technical services to the West Bank and Gaza, including policy advice in the macroeconomic, fiscal, and financial areas, as well as technical assistance, with a focus on tax administration, public expenditure management, banking supervision and regulation, and statistics (Annex III). See [www.imf.org/wbg](http://www.imf.org/wbg) for previous reports.

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## RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

### A. Palestinian Economic Growth is Decelerating...

#### 1. Economic activity weakened in 2022 and inflation rose but remained contained.

Spillovers from Russia's war in Ukraine on the Palestinian economy were modest. Growth is estimated to have moderated to 4 percent in 2022 from 7 percent in 2021, as domestic fiscal challenges and high political, security and social tensions weighed on economic activity, while the post-COVID recovery slowed. Inflation increased to 3.7 percent on average over 2022, up from 1.2 percent in 2021, as PA subsidies and tax breaks cushioned the impact of increased food and fuel import prices, which decelerated during the second half of the year.

#### 2. Unemployment fell to 23.4 percent on strong West Bank employment gains but remains very high in Gaza.

At end-2022, unemployment in the West Bank stood at 12.1 percent, its lowest level since 2015, even as labor force participation increased to 47.3 percent. This was in part due to an increase in the number of West Bank Palestinians working in Israel and the settlements. At 44 percent at end-2022, unemployment remained stubbornly high in Gaza, resulting in more than 60 percent of the population living below the poverty line, compared to 19 percent in the West Bank.<sup>2</sup> This was despite a limited number of Palestinians from Gaza being allowed to work in Israel.

#### 3. The external current account deficit remained persistently high, mainly reflecting structural factors.

Restrictions on economic activity—notably on access to productive resources and the movement of goods, capital, and people, thereby hindering production—result in high imports (estimated at 64 percent of GDP in 2022) relative to exports (17.3 percent of GDP). In 2022 the trade balance is estimated to have deteriorated mainly because of higher oil import prices.<sup>3</sup> As a result the external current account deficit reached an estimated 12.2 percent of GDP, up from 8.2 percent of GDP in 2021. The real effective exchange rate appreciated by a modest 0.3 percent.

#### 4. The political and security situation continues to deteriorate.

Tensions have further escalated, while Palestinian casualties during Israeli security forces' operations in the West Bank and Palestinian attacks on Israelis continue to increase and settlement expansion continues. The November Israeli elections yielded a return to power of Prime Minister Netanyahu's rightwing block, which includes far-right parties with staunch anti-Arab views. The new Israeli government has implemented measures against the PA in response to it pursuing a case on the legitimacy of the Israeli occupation at the International Court of Justice, including increasing deductions from Palestinian clearance revenue. Elections for the Palestinian Legislative Council (the parliament) and president remain indefinitely postponed.

#### 5. Growth prospects are modest while inflation is projected to ease.

Growth is forecast to slow to 3.5 percent in 2023 and gradually decrease to its long-term potential rate of 2 percent over the

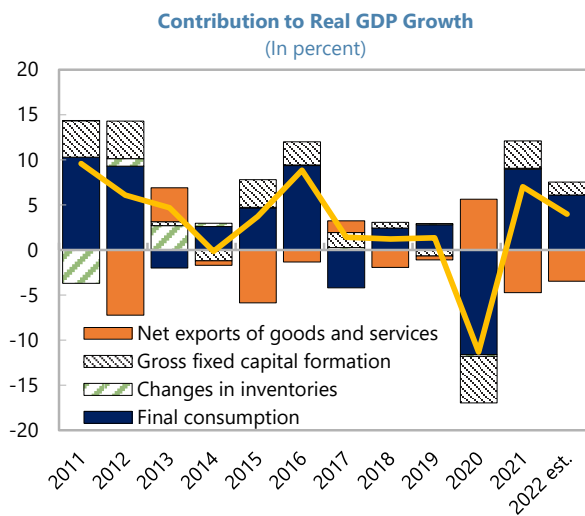
<sup>2</sup> World Bank [Report to the May 2022 AHLC](#).

<sup>3</sup> No external sector assessment was undertaken.

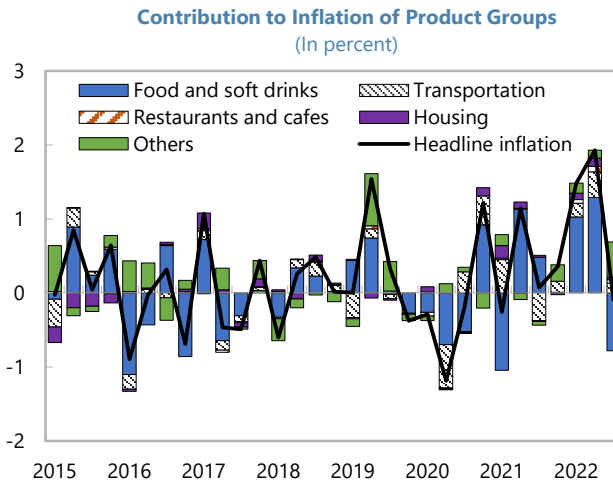
medium term, reflecting Israeli-imposed restrictions on the movement of goods and people (including access to Area C), weak labor market outcomes, and low public and private investment. Inflation is projected to fall to 3.4 percent in 2023 and 2 percent over the medium term as international commodity prices decrease further and global inflationary pressures abate.

**Figure 1. West Bank and Gaza: Recent Economic Developments, 2011–22**

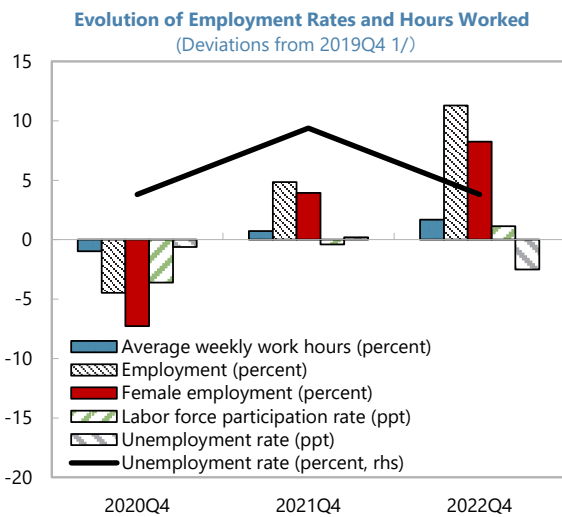
*Growth moderated in 2022 as domestic demand weakened.*



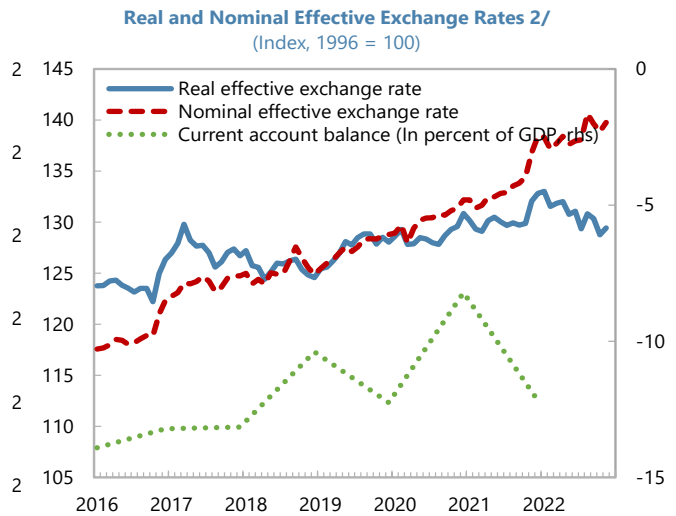
*Inflation decreased in 2022H2 as food and fuel prices fell.*



*Unemployment hovered around pre-pandemic level despite strong employment gains...*



*...and the current account deficit remained stubbornly high, mainly reflecting structural factors.*



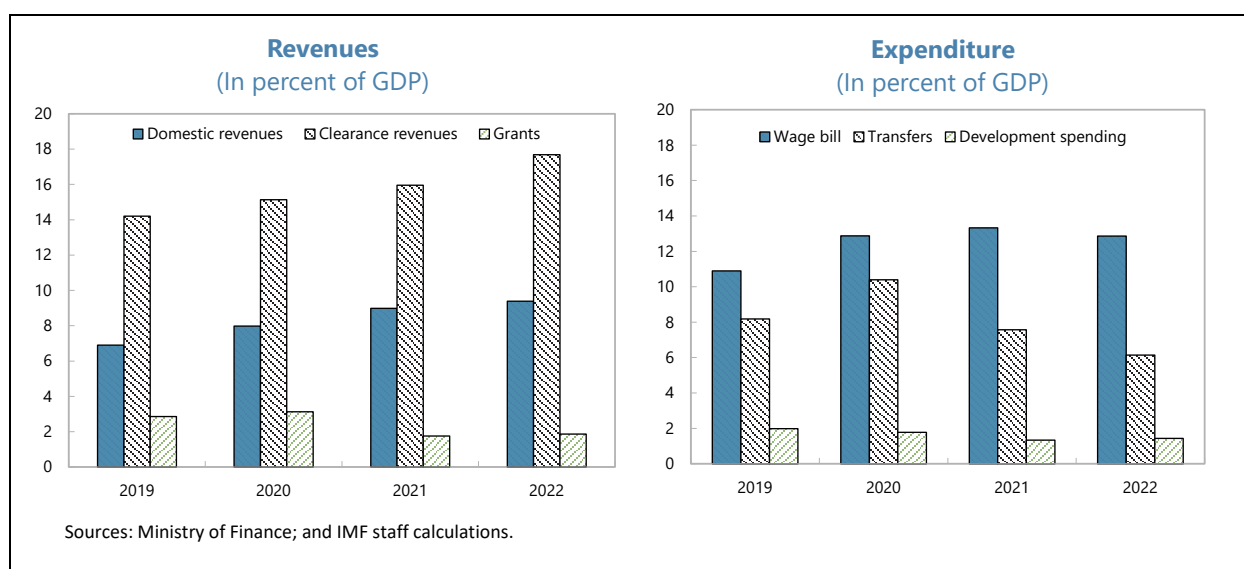
Sources: Palestinian Central Bureau of Statistics; Haver Analytics; and IMF staff calculations and estimates.

1/Average weekly work hours, employment, and female employment indicators are levels and are shown as percent deviations from 2019Q4 level. Labor force participation rate and unemployment rate are ratios and are shown as percentage points deviations from 2019Q4. The unemployment rate in the solid line is actual observations instead of deviations.

2/ The REERs are calculated as the products of trade-weighted exchange rate movements and inflation differentials (foreign currency per national currency). Increases in REER reflect appreciations and loss of competitiveness.

## B. ...And the Fiscal Crisis Continues...

**6. The Palestinian authorities have made efforts to contain the fiscal deficit in 2022 through a combination of commendable revenue gains and undesirable expenditure cuts.** The fiscal deficit in 2022 was a modest 0.9 percent of GDP, compared with 5.2 percent in 2021.<sup>4</sup> This included measures to contain the passthrough of food and fuel import prices to consumers through temporary VAT exemptions on flour and bread and an increase of fuel subsidies to 1.1 percent of GDP (from 0.4 in 2021). The authorities were successful in mobilizing domestic tax revenues by broadening the tax base, mainly through efforts to expand their revenue task force and improve coordination with the customs police. The launch in March 2022 of the e-VAT pilot under which Palestinian and Israeli traders issue invoices digitally also helped boost revenue. At the same time, the authorities missed some payments on the (partly donor-funded) cash transfer program for poor and vulnerable households, while development spending has remained well below pre-COVID levels. The authorities have been paying public sector employees and pensioners 80 percent of their salaries/pensions (except the lowest earners whose earnings were not cut) since November 2021 to manage liquidity pressures, but have yet to define a full menu of sustainable policies to contain the wage bill. Similarly, while they have set up a portal to collect data on crossclaims between the Ministry of Finance (MoF) and local governments, no specific policy measures to contain net lending have been announced.<sup>5</sup>



**7. Under unchanged policies, public finances remain unsustainable.** Without access to international capital markets, and bank financing constrained for prudential reasons, the authorities continued to accumulate arrears to suppliers, contractors, and public sector employees and retirees

<sup>4</sup> A change in the way security sector pensions are recorded contributed around 1.2 percent of GDP to the decrease. The fiscal accounts projections presented in this report reflect this change.

<sup>5</sup> Net lending refers to the system by which Israel deducts payment for unpaid electricity, water and sewage services provided to Palestinian consumers from the clearance revenues it collects on behalf of the PA.

(net 1.5 percent of GDP in 2022), leading to creeping deterioration of economic activity.<sup>6</sup> Government debt (including arrears) increased from 34.5 percent of GDP in 2019 to 50.2 percent of GDP in 2021. While fiscal consolidation in 2022 led to a decline in debt to an estimated 48.1 percent of GDP at end-2022<sup>7</sup> (19.9 percent of GDP excluding arrears and promissory notes, see Figure 2), under unchanged policies government debt (including arrears) will continue to rise over the medium term, reaching 54.4 percent of GDP by 2028. Although liabilities to the pension fund will only come due over the long term, debt will remain unsustainable (Annex II), largely because of structural fiscal issues related to the occupation. Specifically, the PA raises virtually no revenue from Gaza and East Jerusalem, while it spends about a third of its budget in these areas (on, e.g., health care and education), and neither does it raise any significant revenue from Area C in the West Bank. Moreover, the PA and Israel disagree on the amount of revenues that the GoI should transfer to the PA under the Paris Protocol (with the difference between the two known as fiscal leakages), and unilateral Israeli deductions for so-called “prisoner payments.”<sup>8</sup> Finally, international community donor grants are not projected to increase.

### C. ...While the Banking Sector Has Generally Remained Stable...

**8. The banking sector remained generally stable but private sector deposit growth is weakening.** The system is reportedly well-capitalized with regulatory capital at 16.3 percent of risk-weighted assets at end-2022 (Figure 3), and Basel III compliant. Banks’ increasing interest income boosted profitability significantly above pre-pandemic levels. Liquidity remained ample at 44 percent of short-term liabilities at end-2022, as deposit growth fell significantly below credit growth. Nonperforming loans remained low at 4 percent, while high provisioning (101 percent of NPLs) provided a significant buffer. Still, watchlist, substandard and doubtful loans have increased on the back of the expiration of COVID loan moratoria, partial payment of public sector salaries and interest rate hikes, indicating proliferation of risks to asset quality.

### D. ...And Risks Are Increasing.

**9. Socioeconomic risks are rising in tandem with security risks.** Inflation has eroded real incomes and unemployment rates remain high, especially in Gaza and among the youth. The partial payment of public sector wages and pensions since November 2021 and scaled back social transfers further contributed to a deterioration of socioeconomic conditions which in turn may exacerbate security risks. Public sector strikes have become frequent, centered on the education sector and closing public schools.

<sup>6</sup> The accumulation of new arrears amounted to 4.6 percent of GDP in 2022, while 3.0 percent of GDP in old arrears were repaid.

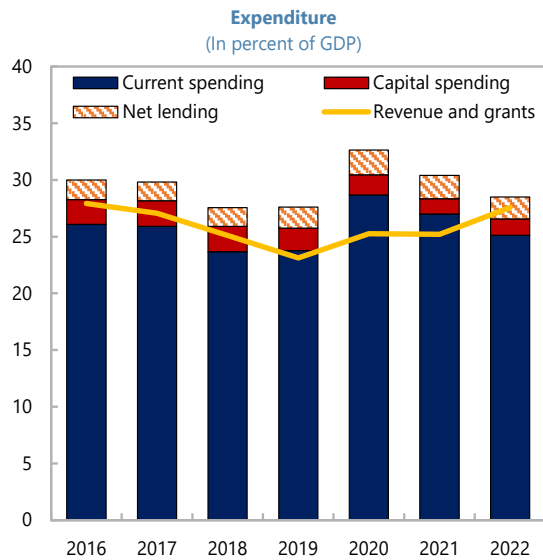
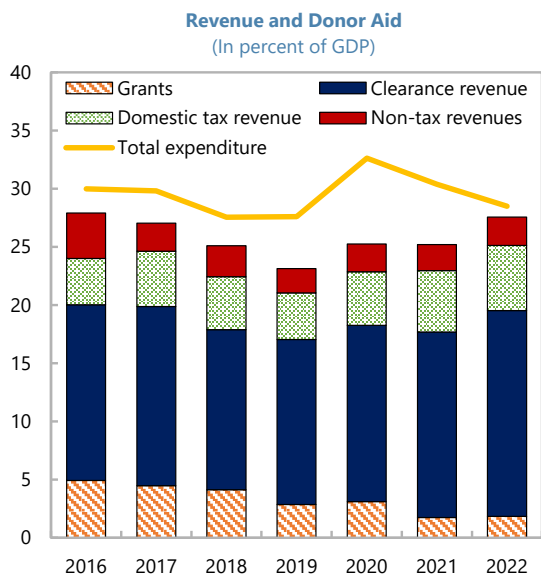
<sup>7</sup> The 48.1 percent of GDP end-2022 debt stock number includes an estimated 1 percent of GDP in promissory notes, which the authorities do not record as part of their debt and the issuance of which they have discontinued.

<sup>8</sup> The Israeli Palestinian Prisoners Law from 2018 mandates withholding CR of an amount equivalent to the GoI’s estimate of PA payments to families of Palestinians imprisoned or killed for alleged terrorist offences under Israeli law.

**Figure 2. West Bank and Gaza: Fiscal Sector Indicators, 2016–22**

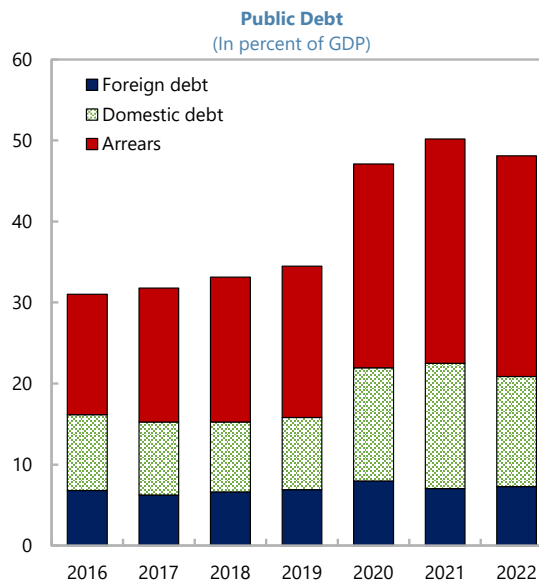
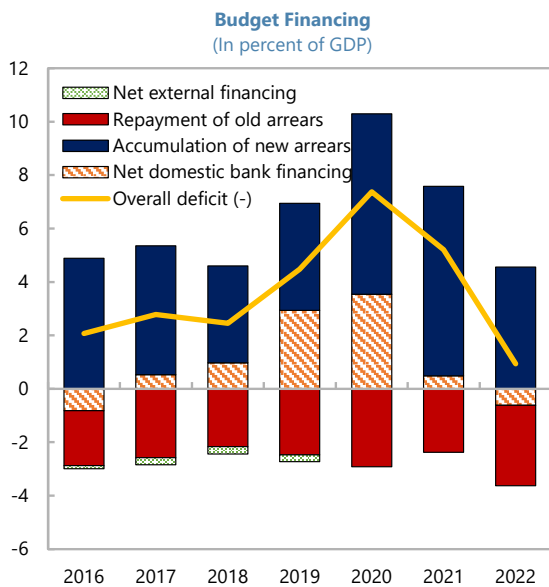
Revenues have grown strongly in recent years...

... and combined with spending restraint...



...led to a sharp decline in the fiscal deficit which continued to be financed mainly with domestic arrears.

As a result, public debt has declined slightly in 2022.



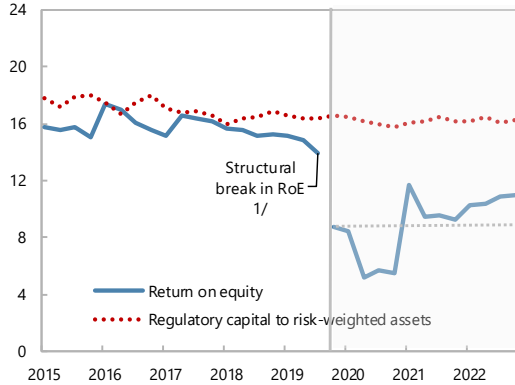
Sources: Ministry of Finance; and IMF staff calculations and estimates.



**Figure 3. West Bank and Gaza: Financial Sector Developments, 2015–22**

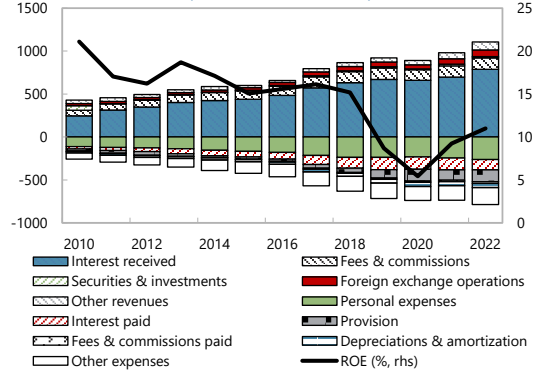
Capital remained adequate and profitability exceeded pre-pandemic level..

**Capital Adequacy Ratio and Profitability**  
(In percent)



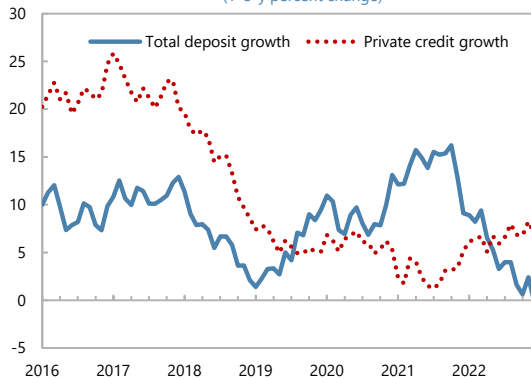
...on account of significantly higher interest income.

**Income Statement of Banking Sector**  
(In millions of U.S. dollars)



Deposit growth fell below credit growth..

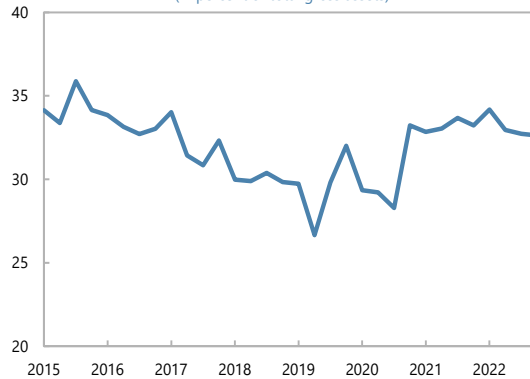
**Deposit and Credit Growth**  
(Y-o-y percent change)



...slightly lowering bank liquid assets to total assets.

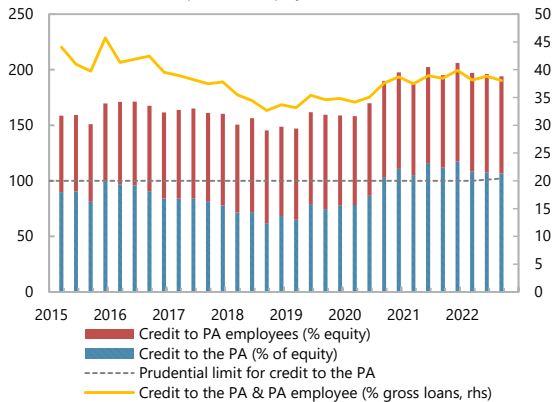
**Liquid Assets**

(In percent of total gross assets)



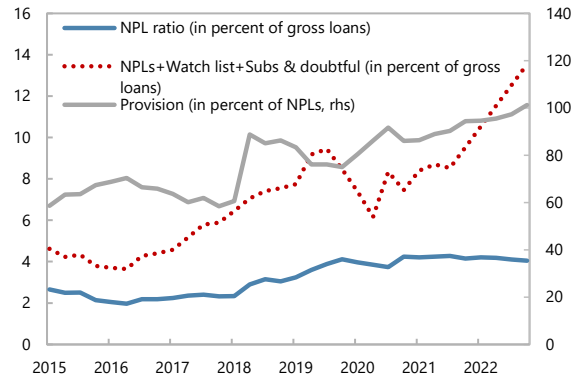
Banks' direct and indirect exposure to the PA has decreased.

**Credit to the PA and PA Employees**  
(in percent of equity or loans)



Non-performing loans stayed stable, but watchlist, substandard and doubtful loans sharply increased in 2022, while provisioning also increased.

**Non-Performing Loans and Provisions**



Sources: Palestine Monetary Authority (PMA); and IMF staff calculations and estimates.

1/ Return on equity (ROE) follows the 2019 IMF Financial Soundness Indicators Compilation Guide for 2019Q4 onwards. Figures for earlier years follow the 2006 Guide and are thus not comparable.

**10. The protracted fiscal crisis presents risks to the banking sector and the real economy.**

The authorities' continued accrual of arrears to employees, suppliers and contractors impacts employees' ability to service loans and complicates businesses' cash flow management, potentially threatening the solvency of key economic sectors and banks' corporate loan portfolios. At 20.2 percent of loans (end-2022Q3), banks' direct sovereign exposure has decreased somewhat but remains high, while loans to PA employees comprise an additional 17.3 percent of loans.<sup>9</sup> Worsening of the PA's fiscal position would weaken its ability to meet these obligations, which could endanger financial stability.

**11. The threat of disruption of shekel correspondent banking relations (CBRs) and asset quality deterioration are further significant risks to financial stability.** The GoI letters of immunity and indemnity to the two Israeli correspondent banks that offer clearing and settlement to Palestinian banks were renewed, allowing shekel CBRs to continue uninterrupted for now, as the Palestine Monetary Authority (PMA) and the BoI work towards a longer-term solution. Liquidity management continues to be hampered by the limit imposed on the transfer of shekel cash from the West Bank to Israel, with banks holding NIS 4.5 billion (equivalent to 6.4 percent of assets) of excess shekel cash at end-2022Q3. Lastly, further interest rate increases or other shocks may lead to deterioration of banks' asset quality (¶8).

**12. The authorities broadly agree with staff's 2023 outlook and assessment of risks.** They viewed the recent uptick in watchlist, substandard and doubtful loans in the banking sector as presenting manageable risks that they are closely monitoring. They point to their success containing the 2022 fiscal deficit, but are worried about Israel's retaliatory increase in deductions from clearance revenues. They recognize the need for sustained fiscal reforms to restore the sustainability of public finances over the medium term and prevent potential spillovers to the banking sector.

## CONVERGENCE: THE ELUSIVE PROMISE OF THE PARIS PROTOCOL

**13. The Paris Protocol on Economic Relations created a customs union and *de facto* currency union between Israel and the Palestinian territories.** This agreement, signed in 1994 for an interim period envisaged to be five years, set the contours of (and still governs) economic relations between Israel and the Palestinian Authority in six major areas: customs and taxes, labor, agriculture, industry, tourism, and monetary, financial and insurance issues. The Protocol requires the Israeli shekel to serve as a means of payment for all purposes in WBG, including official transactions. It also requires that Palestinian imports and exports from and to third countries transit through Israeli ports or border crossings with Jordan and Egypt that are under Israeli control, subject to Israeli supervision and quantitative restrictions. The Protocol allows limited deviation from Israeli trade policy (quotas, customs and tax rates, and product quality standards). While explicit

<sup>9</sup> Banks have further indirect exposure through loans to PA suppliers, data on which is available only for loans with a direct guarantee from the PA.

risk-sharing mechanisms or fiscal transfers are not part of the Protocol, it foresaw the free movement of goods and normal labor movement between the Israeli and Palestinian economies.<sup>10</sup>

**14. The close trade and financial integration between Israel and the Palestinian territories envisaged in the Protocol would be expected to lead to gradual income converge.** Since they eliminate trade policy differentiation and exchange rate adjustments, customs and currency unions require other mechanisms to deal with shocks. In addition to reasonably flexible labor, financial and goods markets, these entail a combination of the free flow of capital and goods and labor mobility within the union. Such arrangements are expected to lead to gradual income convergence, by encouraging capital to flow from more advanced to “catching-up” economies with lower capital--output ratios and higher marginal product of capital (and access of the produced goods to both markets) and encouraging labor to flow in the other direction where wages are higher. Business cycles would also be expected to become more synchronous over time.

**15. This convergence has not materialized.** The gap in standards of living has not significantly narrowed since the signing of the Protocol. Palestinian per capita income (in PPP terms) is still 1/15th that of Israel (Figure 4). The ratio between average wages in Israel and West Bank and Gaza has hovered around 4.5 (3 for the West Bank and East Jerusalem) for the past decade. With an annual population growth rate of 2.5 percent and long-term growth potential of 2 percent, raising Palestinian growth potential is the main policy challenge to achieve and sustain convergence with the far more advanced Israeli economy.

**16. Current economic arrangements, fundamentals and policies are insufficient to achieve convergence.** WBG and Israel’s business cycles remain highly asynchronous, rendering Bol monetary policy inadequate to manage short-term aggregate demand in WBG (Figure 4). Labor, capital and goods do not move freely due to the Israeli permit system, closures, checkpoints, roadblocks, import and investment restrictions, and a limit on the shipment of shekel cash to the Bol. Palestinian competitiveness is further constrained by the need to adhere to Israeli trade and customs policies on which the PA has little say, and lack of access to productive inputs, including land in Area C.<sup>11</sup>

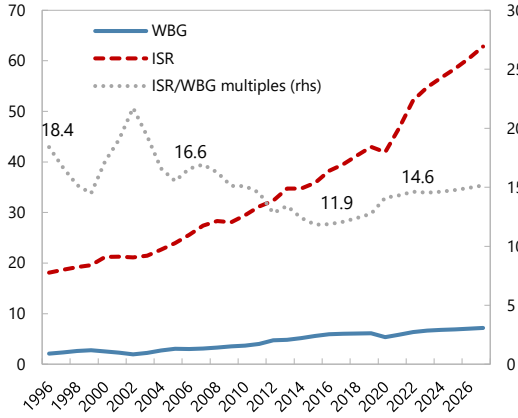
<sup>10</sup> Protocol on Economic Relations, Articles [VII.1](#) and [IX.1](#).

<sup>11</sup> The overall economic costs of these restrictions is large, estimated in Area C alone at a cumulative US\$50 billion over the last two decades ([UNCTAD Report to the UN General Assembly, August 2022](#)). This is consistent with [Van der Weide et. al. \(2018\)](#), who find significant reductions in West Bank per capita GDP due to market access constraints resulting from checkpoints and road closures.

**Figure 4. West Bank and Gaza: Lack of Convergence with Israel, 1996–2027**

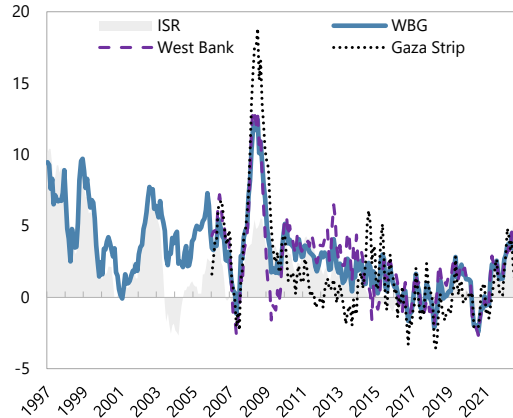
*The gap in standards of living has not significantly narrowed.*

**Nominal Gross Domestic Product per Capita**  
(In thousands of PPP dollars)



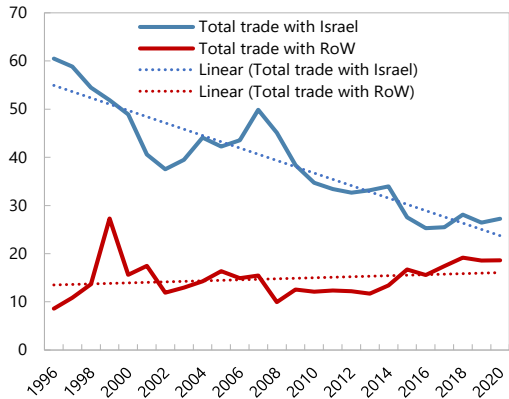
*Inflation in WBG and Israel have generally moved in lockstep...*

**Inflation**  
(Y-o-y percent change)



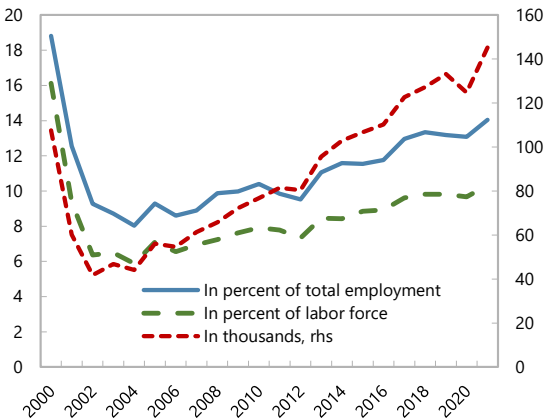
*...but trade with Israel has decreased overtime...*

**Trade**  
(In percent of GDP)



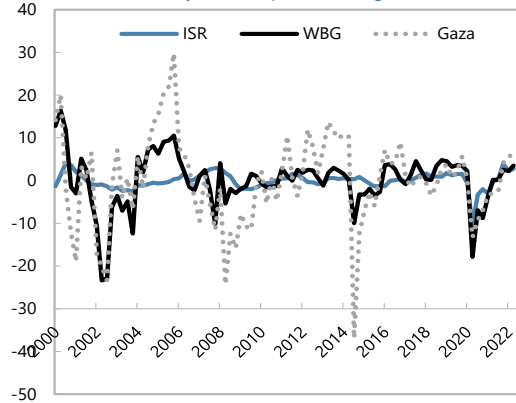
*...labor mobility is lower than in the early 2000s...*

**Palestinian Workers in Israel**



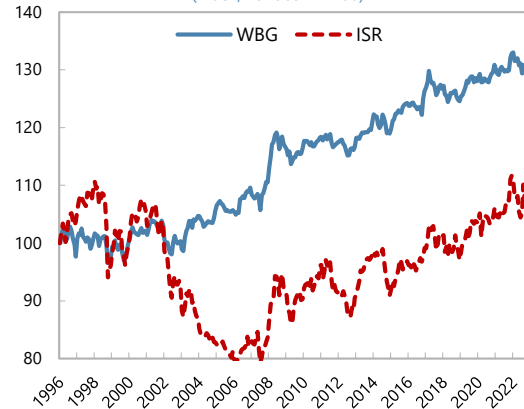
*... WBG and Israel's business cycles are highly asynchronous...*

**Business Cycles**  
(Index, cyclical components of log GDP)



*... and WBG has become less competitive over time.*

**Real Effective Exchange Rate**  
(Index, 2016 Jan = 100)



Sources: PCBS; Haver Analytics; IMF Information Notice System (INS); and IMF staff calculations and estimates.

## REFORM AGENDA

*Income convergence will only occur if the Palestinian economy's potential and actual growth rate rises above current levels and that of the more mature Israeli economy. Achieving this would require important contributions from the PA, Israel, and international community donors. First, fuller labor, capital and goods mobility is needed, including facilitation of investment in Area C. Faster Palestinian growth also requires resolving the fiscal crisis and dealing with the accumulated stock of arrears. Additional donor flows could facilitate the reform process, including by supporting the most vulnerable.*

### A. Structural Reform

**17. Israeli-imposed movement, access, and investment restrictions and the near-total blockade of Gaza weigh heavily on growth.** IMF staff's [May 2022 Report to the AHLC](#) discussed that the growth impact of loosening of most Israeli restrictions is nearly three times larger than the effects of improvement to the Palestinian business climate and electricity and water supply. To build and sustain a higher growth momentum, significantly easing Israeli-imposed restrictions on movement, access, and investment—including regarding Gaza and Area C in the West Bank—would be critical, as these are the main obstacles to an expansion of WBG's private sector activity. In this regard, the increase in the number of permits for Palestinians from both the West Bank and the Gaza Strip to work in Israel is a positive step towards more free movement of labor.

**18. Further improvements to the Palestinian business climate are warranted.** The recently adopted companies and telecom laws include provisions for faster, easier and more affordable business registration and licensing, stronger protection of minority investors, and establish a new telecom regulator. The companies' law removed regulatory barriers to formalize home-based businesses, facilitating female-headed business registration, while the telecom law is intended to boost competition in the sector, thus accelerating digital transformation. The PA has also set up a task force on intellectual property protection. However, a debt settlement law, including clear procedures for foreclosure and reorganization, a competition law, and improvements to the consumer protection law are also needed to revitalize the private sector. These would lower barriers to entry in emerging sectors, and prevent capture, collusion and predatory pricing.

**19. Policies to improve the domestic labor market are also needed to support economic activity.** Labor force participation rates remain stubbornly low, and among the lowest in the world for Palestinian women. Increasing female labor participation requires further action by the PA. While the removal of regulatory barriers to formalize home-based businesses in the new companies law should increase formal female employment, other barriers to female employment remain. The PA should revise labor laws and regulations to make them gender neutral, introduce legislation against sexual harassment in the workforce and allow and encourage women to file claims in court, and explicitly prohibit gender discrimination in hiring, promotion, and pay.<sup>12</sup> Improved access to safe transportation and affordable childcare are also needed. For both sexes, there are high disparities in

<sup>12</sup> A new draft labor law reportedly includes these provisions.

labor market outcomes across governorates and cities, reflecting geographic fragmentation of the Palestinian labor market and spatial mismatch between labor force and employment growth. As these are in part due to Israeli-imposed barriers to labor mobility, easing these restrictions on the movement of people would improve Palestinian labor market outcomes. In addition, further facilitation of private sector job creation in high-productivity tradable services sectors could help absorb well-educated labor market entrants. Overall, a high elasticity of jobs to growth of 0.7 suggests improved labor market outcome and higher growth go hand in hand. Donor funding of the PA's National Employment Strategy would be opportune, as would further donor support for poor and vulnerable households.

**20. The authorities largely concur with staff's views.** They agree that Israeli-imposed restrictions are the main structural bottleneck to economic development, but see no counterpart to engage in substantive discussion on easing them. In addition, they argue that the recent adoption of the long-awaited companies and telecom laws and approval of the framework agreement to develop the gas field off the coast of Gaza are a testament to their resolve to implement key structural reforms and pursue investment opportunities. The authorities plan to continue to increase domestic electricity generation capacity by investing in renewable energy projects and further develop the electricity transmission infrastructure, partly with donor funding. They welcome the GoI's approval in principle to provide broadband frequencies necessary to roll out 4G in the West Bank that will facilitate the digitalization of the economy, but are concerned that the Gaza Strip—which is still only allowed 2G frequencies—will be left further behind. Despite these plans, they believe that, ultimately, economic reforms cannot substitute for a political solution to the conflict.

## B. Fiscal Reform

**21. The 2023 budget is likely to feature a continuation of current policies but lack details on specific expenditure reforms.** The budget should be based on realistic expenditure and financing forecasts and create fiscal space for development spending and gradual normalization of public sector wage payments. As it is legally due only end-March, preparation is under way. It will be supported by continued efforts to broaden the tax base, increasing domestic revenues slightly more than nominal GDP growth. With financing remaining tight, the authorities plan to continue efforts to contain spending. They envisage modest cuts in health expenditure, but concrete supporting reforms remain elusive at this stage. However, the wage bill will increase, as the authorities negotiated substantial wage hikes with the teachers', doctors' and engineers' unions that will likely set a precedent for other sectors, and despite their commitment to hire only 1 new employee for every 2 employees that leave public service (a 1-for-2 rule), which could save 0.2 percent of GDP in the first year if fully implemented.<sup>13</sup> If implemented, these wage increases will further worsen public finances, exacerbating arrears accumulation that damages the economy. The envisaged fiscal deficit is likely to be somewhat higher than the 2022 level.

<sup>13</sup> See [World Bank 2022 Report on Wage Bill and Employment Diagnostics](#).

**22. There are limits as to how much additional revenues the government can generate from tax administration reforms.** The Ministry of Finance has been implementing their revenue strategy with good results. Their main efforts now focus on bringing liberal professions into the tax net. The MoF considers access to taxpayer bank account information as crucial. However, the banking law requires a court order for sharing of bank client information with tax authorities. The banking law should be amended to allow automatic exchange of basic bank information, with requests for more detailed information (upon a suspicion of fraud or tax evasion) requiring a court order. Appropriate procedures and systems should be put in place to ensure that any information provided to the tax authority is stored securely and used only for legitimate tax enforcement purposes.

**23. Putting public finances in order will require deep reforms to the wage bill.** In 2022, the wage bill accounted for 45.1 percent of total spending and 50 percent of total revenues (excluding grants), or above 90 percent of net revenues when including certain transfers.<sup>14</sup> As noted in IMF staff's [September 2022 Report to the AHLC](#), in the short term, the authorities should suspend salary increases and promotions, while over the medium term policies should center on reforming the generous system of allowances, automatic salary increases and promotions based on seniority, containing new hiring to the 1-for-2 rule, and limiting future wage increases. This should be followed by broad-based civil service reform guided by a functional review of public sector employment.

**24. Net lending, health referrals, pensions and fuel subsidies also constitute considerable fiscal drags but reducing them will be difficult.** Net lending is estimated at 1.9 percent of GDP in 2022. As outlined in IMF staff's [September 2022 Report to the AHLC](#), reducing it will hinge on strengthening transparency and accountability (including with respect to Israeli deductions) in the short term, while implementing ambitious reforms in intergovernmental fiscal relations, and reforming the electricity and water sectors over the medium term. There is a need to reduce the cost of medical referrals to private hospitals in the West Bank and Israel (which consume 90 percent of non-wage health spending), but this will require beefing up capacity in public hospitals, likely offsetting much of the savings. Overly generous pension benefits should be eliminated, and parametric reforms implemented to ensure that the system is actuarially sound. In the medium term, the authorities should reassess the current policy of providing fuel subsidy to the General Petroleum Authority to cover its losses from setting fuel prices below the purchase price, and consider instead more targeted support to the most vulnerable.

**25. Reaching agreement on outstanding fiscal files is key to strengthen public finances.** Annual fiscal leakages are estimated at about 1.8 percent of 2022 GDP. They comprise Allenby bridge exit fees not transferred to the PA, high import handling fees (including for fuel which is not subject

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<sup>14</sup> The authorities treat some transfer items as part of their wage obligation and label them "semi-wages". They include monthly social assistance (e.g., support to vulnerable families, unemployment benefits), social contributions, as well as pension payments to civilian and security personnel for which the MoF is directly responsible.

to any administrative costs),<sup>15</sup> and under-recorded VAT due to missing invoices. The launch of the e-VAT pilot last March is a good first step to tackle this VAT leakage. While the participation of Israeli traders has increased over time, looking forward there is a need to make use of e-VAT mandatory for them, as is the case for their Palestinian counterparts. Exempting fuel imports from excise and VAT rather than the current practice of charging and subsequently refunding the tax to the PA subject to the 3 percent handling fee seems opportune. In addition, it would be important to ensure that the PA receives the corresponding share of additional revenues following the Gol's prior decisions to increase bridge exit fees.

<b>Main Fiscal Leakages, 2022</b>	
Annual flows, percent of 2022 GDP	
Total	1.8
VAT 1/	0.8
Allenby crossing fees	0.1
Handling fee	0.5
<i>of which</i> : Fuel	0.2
Other	0.4

Source: IMF staff estimates.

1/ Losses largely due to missing invoices.

Revenues withheld unilaterally by Israel because of prisoner payments are considerable.<sup>16</sup> Other solutions should be found to support families in need, which should be accompanied by the cessation of these deductions and the release of the stock of withheld funds. Lastly, transferal of the tax revenue on economic activity in Area C (outside settlements and military locations) to the PA in line with the Paris Protocol would have further positive impact on revenue.

**26. The authorities should strengthen public financial management and start a stocktaking of outstanding arrears.** The authorities have enhanced transparency and accountability by improving the timeliness of the audit of financial accounts by the State Audit and Administrative Control Bureau, which recently completed its joint 2020–21 audit. Once the current liquidity crisis has been dealt with, the authorities should gradually move toward a medium-term budget framework, including multi-annual commitment controls, consistent with a medium-term macro-fiscal framework. This would facilitate improved public investment management, allowing the authorities to boost and sustain public investment for development. The authorities should also undertake a comprehensive stocktaking of arrears and adopt a strategy to gradually clear them over time. The strategy can include both cash payment and securitization through the issuance of government bonds, which could serve as a first step in the development of a government bond market that could ultimately facilitate government borrowing. Nevertheless, they should proceed cautiously, as bond market development is contingent on fiscal consolidation and strengthened debt management capacity.

**27. The authorities recognize the need to formulate detailed realistic fiscal reform policies to reduce spending, in particular on the public sector wage bill.** They reiterated their commitment to ambitious fiscal reforms and emphasized the priority placed on reducing the wage bill, explaining they adopted a decree mandating a 1-for-2 hiring rule. Over the medium term they

<sup>15</sup> The 3 percent handling fee currently finances a disproportionately high share of the Israeli customs and VAT department's total budget when compared to the share of Palestinian imports out of total imports handled by the department. See the [World Bank \(2016\) Economic Monitoring Report to the Ad Hoc Liaison Committee](#).

<sup>16</sup> Since 2019 Israel has withheld an estimated US\$630 million (3.7 percent of 2022 GDP) in clearance revenues related to prisoner payments.



plan to consider further reform options, informed by ongoing World Bank technical assistance. They clarified that, under pressure from public sector employee strikes, they agreed to substantially increase 2023 public sector wages, pending available liquidity. They stressed their continued good revenue performance and success containing the fiscal deficit in 2022. However, they point to the still limited take-up of the e-VAT among Israeli traders, the Gol's recent decision to increase deductions from clearance revenue, and the difficulty to reform given the current fragile social and political conditions. They stress the need to resolve these fiscal issues, but fear that significant discussions between the Israeli and Palestinian Ministries of Finance are unlikely given the new Israeli government's firm anti-Palestinian views and actions. Given these challenges, they are considering adopting an emergency cash-based budget.

## C. Financial Sector Policies

**28. Continued implementation of the 2019 Financial Sector Stability Review's key recommendations will support financial sector stability and help mitigate banking sector vulnerabilities.** Key priorities are supported by IMF capacity development (CD) and include enhancing risk-based supervision, continuing to strengthen stress testing capabilities and ensuring that buffers remain sufficient to manage liquidity, credit, and concentration risks, and deploying new macroprudential tools where necessary. The PMA should intensify its efforts to operationalize its emergency liquidity assistance framework, progresses in revising the risk-based supervision framework, including AML/CFT risk-based supervision, and continues to strengthen the legal and operational bank resolution, crisis management and financial safety net frameworks. In this regard, MENAFATF's further delay of its planned onsite visit that would help inform AML/CFT reforms is unfortunate. The PMA should also prepare for an NPL increase by issuing instructions that include more explicit supervision guidelines on collateral revaluation, particularly estimation of liquidation costs, and by employing moral suasion to convince banks to retain part of their current high profits to increase buffers.

**29. The PMA has promoted the use of cashless means of payment to boost financial inclusion and reduce ML/TF risks.** The authorities' recent measures to boost financial inclusion and promote digital payments as a reliable and safe alternative to checks and cash are welcome and they should continue to pursue their reform agenda (Box 1). These reforms can help reduce excess shekel cash in the banking system, which would also benefit from the Bol increasing its limits on regular shekel cash shipments. The recent Israeli measure requiring Israeli employers to pay their Palestinian workers electronically should also help reduce excess cash.<sup>17</sup>

**30. Finally, the Palestinian authorities should continue to work closely with the Bol to operationalize an alternative mechanism for shekel CBRs.** The main points that require resolution are a commitment from Israel to connect its correspondent company to all licensed Palestinian banks on equal terms and Israeli legislation needed to operationalize its correspondent company. In this

<sup>17</sup> See [IMF Country Report 2022/299](#) for details and policy recommendations on the excess cash issue. In 2022, the Bol allowed total cash shipments of NIS 25.5 billion.

regard, the due diligence should start as soon as possible, especially on banks that do not currently have shekel CBRs.

### Box 1. Digitalization and Financial Inclusion

The PMA has launched several initiatives to promote digital payments and foster greater financial inclusion. It lowered regulatory barriers to entry into the digital payment market, limited interchange and credit card fees, and licensed new digital payments and e-commerce service providers. It also organized financial awareness campaigns to encourage the use of credit and debit cards and e-wallets and launched a regulatory sandbox to test innovative financial solutions and technologies.

The PMA recently upgraded the national payment switch system to allow it to process point-of-sale and other non-bank payment service provider transactions, in addition to ATM withdrawals. It is also developing an instant electronic payment and bill presentment system to better support retail payments and facilitate electronic billing and payment. This is supported by the recent adoption a new payments law, which allows for the creation of financial digital IDs and aids the development of a digital government services platform.

**31. The authorities remain committed to safeguarding financial stability and strengthening their AML/CFT framework.** They expressed disappointment with the further postponement of the MENAFATF onsite visit, and reiterated that they intend to follow up on MENAFATF recommendations quickly once they come out, likely asking for further IMF CD assistance. They believe that upgrading domestic and cross-border payment infrastructure and setting up adequate oversight remains key to increasing the standardization and interoperability of WBG's payments systems, improving access to points of sale, and making e-payments faster and more efficient, secure, and resilient than cash and cheques. The PMA intends to continue working with the Bol to operationalize an alternative mechanism for shekel CBRs and carefully monitor the impact of global and domestic interest rate hikes.

## STAFF APPRAISAL

**32. The outlook for the Palestinian economy remains grim amidst rising risks.** Growth is set to moderate further, as the post-COVID recovery loses steam while Israeli-imposed restrictions on the movement of people, goods and capital endure and the security situation worsens. While unemployment decreased, driven by Palestinians finding employment in Israel and the settlements, poverty remains widespread, especially in Gaza. Longer-term growth is projected below population growth, implying a gradual erosion of Palestinian living standards. The fiscal outlook remains precarious, despite good revenue performance and the new 1-for-2 hiring policy, as the recently announced public sector wage increases will further strain already fragile public finances. Without further change in policies, public debt will continue its unsustainable gradual increase over the medium term, largely driven by domestic arrears that undermine public service delivery and confidence. All this against the backdrop of myriad downside risks. The PA's fiscal situation creates risks to the banking sector through its high but stable PA exposure and to the real economy through its arrears financing. Disruption of shekel CBRs and asset quality deterioration comprise further risks to the banking sector. This in an environment of omnipresent risks from the worsening security, political and socioeconomic conditions.

**33. Economic developments over the last two and half decades are in sharp contrast to what was envisaged in the mid-1990s.** The 1994 Paris Protocol on Economic Relations foresaw the free movement of goods and normal labor movement between the Israeli and Palestinian economies. The envisaged close trade and financial integration between Israel and the Palestinian territories should have led to gradual income convergence, implying higher per-capita growth of Palestinian incomes than has been seen. But the conditions for such growth were not realized and income convergence has not happened.

**34. The prospects for a better economic outlook going forward crucially depend on transformational reform, with efforts required from the PA, Israel and the international donor community.** In order to create more fiscal space for public investment in development and for social support, the PA should develop a comprehensive macro-fiscal adjustment strategy. It should include deep wage bill and other expenditure reforms and build on the MoF's successful revenue performance, while seeking progress on the outstanding fiscal files with Israel. The 2023 budget provides an opportunity to articulate policies leading in this direction. On the structural reform side, the PA should build on its recent achievements by pursuing further improvements to the business climate and domestic labor market. Still, a critical structural reform to boost economic growth remains the easing of Israeli-imposed movement, access and investment restrictions, which calls for stepped up dialogue going forward. Together with efforts to anchor a sustainable macroeconomic stance and the PA structural reforms discussed above this would facilitate private sector growth and job creation. Meanwhile, the PMA should focus on intensifying supervisory and regulatory oversight in light of risks to banks asset quality, strengthen the AML/CFT regime by addressing MENAFATF recommendations once they come out, and, together with the Bol, operationalize the alternative correspondent banking mechanism and work towards resolving the excess cash problem. The reform process could be supported by additional donor grants. Such flows could help unleash the potential for private-sector-led economic growth, thus reducing unemployment and poverty, contribute towards restoring public debt sustainability, and support the most vulnerable.

**Table 1. West Bank and Gaza: Selected Economic Indicators, 2019–28**  
 (Per capita GDP: \$3,647; 2022 est.)  
 (Poverty rate 14 percent in the West Bank and 53 percent in Gaza Strip; 2017 est.) 1/

	2019	2020	2021	Est. 2022	2023	2024	Projections			
							2025	2026	2027	2028
<b>Output, Employment and Prices</b>										
	(annual percentage change)									
Real GDP (2015 market prices)	1.4	-11.3	7.0	4.0	3.5	2.7	2.4	2.0	2.0	2.0
West Bank	1.6	-11.0	7.6	3.8	3.6	2.8	2.5	2.1	2.1	2.1
Gaza	0.4	-12.6	4.2	5.0	3.0	2.2	1.9	1.5	1.5	1.5
Unemployment rate (period average)	25.4	25.9	26.4	24.4	24.2	24.0	24.0	24.0	24.0	24.0
CPI inflation rate (end-of-period)	1.3	0.1	1.3	3.7	2.8	2.5	2.2	2.3	2.0	2.0
CPI inflation rate (period average)	1.6	-0.7	1.2	3.7	3.2	2.7	2.5	2.2	2.0	2.0
	(in percent of GDP)									
Gross capital formation	26.8	24.3	25.5	26.8	24.7	24.1	23.7	23.5	23.0	22.7
Gross national savings	16.4	12.1	17.2	14.6	12.9	12.9	12.4	12.5	12.2	12.2
Saving-investment balance	-10.4	-12.3	-8.2	-12.2	-11.8	-11.2	-11.3	-11.0	-10.8	-10.5
<b>Public Finances 2/</b>										
	(in percent of GDP)									
Total revenues and grants	23.1	25.3	25.2	27.6	27.2	26.7	26.7	26.7	26.7	26.7
Revenues	20.3	22.1	23.4	25.7	25.4	24.9	24.9	25.0	25.0	25.2
Grants	2.9	3.1	1.8	1.9	1.9	1.8	1.7	1.7	1.6	1.6
Total Expenditure	27.6	32.6	30.4	28.5	29.5	29.7	30.0	30.3	30.5	30.8
Current expenditures and net lending	25.6	30.8	29.1	27.1	28.0	28.2	28.4	28.7	29.0	29.3
Development expenditures	2.0	1.8	1.3	1.4	1.5	1.5	1.5	1.5	1.5	1.5
Overall balance (commitment, before external support)	-7.3	-10.5	-7.0	-2.8	-4.1	-4.8	-5.1	-5.3	-5.5	-5.7
Overall balance (commitment)	-4.5	-7.4	-5.2	-0.9	-2.2	-3.0	-3.3	-3.6	-3.9	-4.1
Identified financing	4.2	7.4	5.2	0.9	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Financing gap/residual 3/	0.3	0.0	0.0	0.0	4.9	5.7	6.0	6.3	6.6	6.8
Financing gap/discrepancy (in millions of U.S. dollars) 3/	45.1	-0.1	0.6	2	951	1142	1247	1342	1460	1580
Total external support	2.9	3.1	1.8	1.9	1.9	1.8	1.7	1.7	1.6	1.6
Public debt 4/	34.5	47.1	50.2	48.1	47.2	47.7	48.8	50.4	52.3	54.4
<b>Monetary Sector 5/</b>										
	(annual percentage change)									
Credit to the private sector	5.3	5.6	5.6	6.7	6.5	6.8	6.4	5.9	5.4	5.0
Private sector deposits	10.0	13.9	8.3	-0.3	5.0	5.7	6.2	5.9	5.4	5.5
<b>External Sector</b>										
	(in percent of GDP)									
Current account balance (excluding official transfers)	-13.3	-14.5	-9.2	-13.4	-12.9	-12.3	-12.3	-12.0	-11.7	-11.3
Current account balance	-10.4	-12.3	-8.2	-12.2	-11.8	-11.2	-11.3	-11.0	-10.8	-10.5
Exports of goods and services	15.5	15.4	17.6	17.3	16.8	16.8	16.6	16.3	16.1	15.9
Import of goods and services	53.5	51.9	56.6	64.0	62.6	62.0	61.6	61.2	60.8	60.3
Primary income account, net	17.7	16.0	18.8	20.9	21.0	21.2	21.3	21.6	21.8	22.0
Secondary income account, net	9.9	8.3	12.0	13.7	13.0	12.7	12.5	12.3	12.1	12.0
Private transfers	7.0	6.0	11.0	12.4	11.8	11.6	11.5	11.3	11.2	11.1
Official transfers	2.9	2.3	1.0	1.2	1.2	1.1	1.0	0.9	0.9	0.8
<b>Memorandum Items:</b>										
Nominal GDP (in millions of U.S. dollars)	17,134	15,532	18,109	19,530	20,901	22,045	23,138	24,120	25,095	26,109
Per capita nominal GDP (U.S. dollars)	3,443	3,045	3,464	3,647	3,815	3,934	4,039	4,121	4,198	4,278
Al Quds stock market index (annual percentage change)	-0.6	-10.4	-5.8	...	...	...	...	...	...	...

Sources: Palestinian authorities; World Bank; and IMF staff estimates and projections.

1/ Using the national poverty line.

2/ Commitment basis.

3/ In the absence of additional donor support, the projected financing gap will be closed through the accumulation of domestic arrears.

4/ Data beginning in 2021 include the estimated stock of promissory notes.

5/ End-of-period; in U.S. dollar terms.

**Table 2a. West Bank and Gaza: Central Government Fiscal Operations, 2019–28**  
(GFS2001, commitment basis, in percent of GDP, unless otherwise indicated)

	2019	2020	2021	2022	Projections					
					2023	2024	2025	2026	2027	2028
Revenue and Grants	23.1	25.3	25.2	27.6	27.2	26.7	26.7	26.7	26.7	26.7
Tax revenue	17.7	19.1	20.4	22.4	22.0	21.6	21.6	21.7	21.7	21.8
Direct taxes	1.2	1.2	1.2	1.5	1.6	1.6	1.6	1.6	1.6	1.6
Indirect taxes	3.3	3.5	4.3	4.6	4.7	4.7	4.7	4.7	4.7	4.7
VAT on domestic purchases	1.8	2.0	2.1	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Excises	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Customs duties	1.1	1.0	1.6	1.7	1.8	1.8	1.8	1.8	1.8	1.8
Clearance revenues 1/	14.2	15.1	15.9	17.7	16.8	16.3	16.3	16.4	16.4	16.5
Income Tax	0.4	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
VAT on imports	3.5	3.4	3.5	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Petroleum Excise	4.3	4.4	4.4	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Customs	6.0	7.2	7.7	8.4	8.4	8.4	8.4	8.4	8.4	8.4
Other	0.0	0.0	0.0	0.7	-0.2	-0.8	-0.7	-0.8	-0.8	-0.7
Tax refunds	1.0	0.7	1.0	1.4	1.0	1.0	1.0	1.0	1.0	1.0
Non-tax revenues	2.1	2.4	2.2	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Earmarked revenues 2/	0.5	0.6	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	2.9	3.1	1.8	1.9	1.9	1.8	1.7	1.7	1.6	1.6
External budgetary support	2.9	2.3	1.0	1.3	1.3	1.2	1.1	1.1	1.0	0.9
Total Expenditure and Net Lending	27.6	32.6	30.4	28.5	29.5	29.7	30.0	30.3	30.5	30.8
Current spending	23.8	28.7	27.0	25.1	26.0	26.2	26.5	26.8	27.0	27.3
Wages and salaries	10.9	12.9	13.3	12.9	13.5	13.6	13.7	13.9	14.1	14.2
Goods and services	3.8	4.2	4.5	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Interest payments	0.3	0.4	0.7	0.8	1.0	1.1	1.2	1.4	1.5	1.6
Domestic	0.3	0.3	0.7	0.6	0.9	1.0	1.1	1.2	1.3	1.5
Foreign	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Transfers	8.2	10.4	7.6	6.1	6.1	6.1	6.1	6.1	6.1	6.1
Social assistance	3.0	3.8	2.3	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Transfers to the pension fund	5.4	6.0	5.0	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Other transfers	-0.2	0.6	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Earmarked payments 2/	0.5	0.6	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Development spending	2.0	1.8	1.3	1.4	1.5	1.5	1.5	1.5	1.5	1.5
Net lending	1.9	2.2	2.1	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Overall Balance	-4.5	-7.4	-5.2	-0.9	-2.2	-3.0	-3.3	-3.6	-3.9	-4.1
Financing	4.2	7.4	5.2	0.9	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Net domestic financing	4.5	7.4	5.2	0.9	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Net domestic bank financing	2.9	3.5	0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Accumulation of new arrears 3/	4.0	6.8	7.1	4.6	0.0	0.0	0.0	0.0	0.0	0.0
Arrears repayment (old)	-2.5	-2.9	-2.4	-3.0	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Net external financing	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Borrowing, net	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual/Financing Gap	0.3	0.0	0.0	0.0	4.9	5.7	6.0	6.3	6.6	6.8
Memorandum Items:										
Overall balance (before external support)	-7.3	-10.5	-7.0	-2.8	-4.1	-4.8	-5.1	-5.3	-5.5	-5.7
Domestic revenues 4/	5.5	6.4	6.7	7.1	7.7	7.7	7.7	7.7	7.8	7.8
Central government debt (incl. arrears)	34.5	47.1	50.2	48.1	47.2	47.7	48.8	50.4	52.3	54.4
Foreign debt	6.9	8.0	7.0	7.3	6.8	6.5	6.2	5.9	5.7	5.5
Domestic debt	27.6	39.1	43.1	40.8	40.4	41.3	42.6	44.5	46.6	48.9
of which : Stock of promissory notes 5/	n.a.	n.a.	2.0	1.0	0.5	0.0	0.0	0.0	0.0	1.2
of which : Stock of arrears	18.6	25.1	27.7	27.2	...	...	...	...	...	...
of which: Arrears to the pension fund	11.6	14.1	14.1	12.7	...	...	...	...	...	...
Nominal GDP (in billions of shekels)	61.1	53.5	58.5	63.1	67.5	71.2	74.7	77.9	81.1	84.3

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Revenue collected by Israel on behalf of and transferred to the Palestinian Authority.

2/ Earmarked revenues and payments are collections from taxes and revenues due to local government units.

3/ In the absence of additional donor support, the accumulation of new arrears is likely to equal the projected financing gap.

4/ Revenues administered by the Palestinian authorities. Excludes clearance revenues.

5/ Data beginning in 2021 include the estimated stock of promissory notes.

**Table 2b. West Bank and Gaza: Central Government Fiscal Operations, 2019–28**  
(GFS2001, commitment basis, in millions of U.S. dollars, unless otherwise indicated)

	2019	2020	2021	2022	Projections					
					2023	2024	2025	2026	2027	2028
Revenue and Grants	3,964	3,923	4,563	5,170	5,232	5,338	5,528	5,716	5,940	6,195
Tax revenue	3,024	2,970	3,701	4,197	4,232	4,311	4,476	4,642	4,836	5,059
Direct taxes	210	187	224	279	298	315	325	340	363	377
Indirect taxes	557	546	774	863	895	933	970	1,003	1,041	1,091
VAT on domestic purchases	304	306	371	423	439	458	475	491	511	531
Excises	63	86	108	107	106	111	115	119	123	129
Customs duties	186	150	290	328	344	359	374	387	400	426
Clearance revenues 1/	2,433	2,350	2,888	3,316	3,227	3,258	3,385	3,508	3,649	3,817
Income Tax	63	22	81	0	0	0	0	0	0	0
VAT on imports	602	534	627	760	779	813	843	875	910	947
Petroleum Excise	737	687	798	859	880	919	953	989	1,029	1,071
Customs	1,034	1,112	1,388	1,568	1,606	1,677	1,740	1,805	1,878	1,954
Other	-4	-4	-6	128	-38	-151	-152	-162	-169	-156
Tax refunds	175	114	184	261	187	195	202	209	217	226
Non-tax revenues	358	370	402	457	468	487	506	522	543	565
Earmarked revenues 2/	92	98	142	167	171	178	185	191	198	207
Grants	490	486	318	349	362	362	361	361	362	363
External budgetary support	498	354	186	243	243	239	234	229	224	220
Total Expenditure and Net Lending	4,731	5,068	5,506	5,346	5,665	5,940	6,216	6,479	6,798	7,148
Current spending	4,071	4,452	4,891	4,713	4,996	5,244	5,494	5,734	6,023	6,339
Wages and salaries	1,866	2,001	2,413	2,412	2,587	2,723	2,847	2,976	3,132	3,297
Goods and services	643	657	807	810	829	863	896	925	962	1,006
Interest payments	53	56	125	142	198	219	259	293	326	369
Domestic	48	50	119	116	171	191	231	265	298	341
Foreign	5	6	6	25	27	27	28	28	28	28
Transfers	1,402	1,615	1,371	1,153	1,180	1,229	1,275	1,316	1,369	1,425
Social assistance	511	591	420	402	412	429	445	459	478	497
Transfers to the pension fund	932	936	899	695	712	741	769	794	826	859
Other transfers	-42	88	51	55	57	59	61	63	66	68
Other	16	27	33	30	30	32	33	34	35	37
Earmarked payments 2/	92	98	142	167	171	178	185	191	198	207
Development spending	341	277	242	270	295	308	319	329	343	359
Net lending	319	339	374	364	373	388	403	416	433	450
Overall Balance	-767	-1,145	-943	-176	-432	-602	-687	-764	-859	-954
Financing	722	1,145	942	175	-519	-540	-560	-578	-602	-626
Net domestic financing	766	1,145	942	175	-519	-540	-560	-578	-602	-626
Net domestic bank financing	504	551	88	-116	-119	-124	-128	-132	-138	-143
Accumulation of new arrears 3/	686	1,049	1,285	854	0	0	0	0	0	0
Arrears repayment (old)	-424	-454	-431	-564	-400	-416	-432	-446	-464	-483
Net external financing	-44	0	0	0	0	0	0	0	0	0
Borrowing, net	-44	0	0	0	0	0	0	0	0	0
Residual/Financing Gap	45	0	1	2	951	1,142	1,247	1,342	1,460	1,580
Memorandum Items:										
Overall balance (before external support)	-1,257	-1,631	-1,261	-525	-794	-963	-1,049	-1,124	-1,220	-1,317
Domestic revenues 4/	949	989	1,216	1,337	1,473	1,540	1,598	1,656	1,730	1,807
Domestic tax revenues (percent change)	-9	-8	28	19	9	6	5	5	5	5
Clearance revenues (percent change)	8	-7	15	20	2	2	5	5	4	5
Total expenditure and net lending (percent change)	5	7	9	-3	6	5	5	4	5	5
Central government debt (incl. arrears)	6,057	7,751	9,372	8,688	9,008	9,494	10,078	10,748	11,603	12,553
Foreign debt	1,211	1,312	1,313	1,319	1,302	1,286	1,273	1,261	1,261	1,261
Domestic debt	4,846	6,439	8,058	7,369	7,705	8,207	8,805	9,487	10,342	11,292
of which: Stock of promissory notes 5/	n.a.	n.a.	372	179	88	0	0	0	0	0
of which: Stock of arrears	3,277	4,137	5,171	4,917	...	...	...	...	...	...
of which: Arrears to the pension fund	2,046	2,327	2,636	2,289	...	...	...	...	...	...
Nominal GDP	17,134	15,532	18,109	19,530	20,901	22,045	23,138	24,120	25,095	26,109

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Revenue collected by Israel on behalf of and transferred to the Palestinian Authority.

2/ Earmarked revenues and payments are collections from taxes and revenues due to local government units.

3/ In the absence of additional donor support, the accumulation of new arrears is likely to equal the projected financing gap.

4/ Revenues administered by the Palestinian authorities. Excludes clearance revenues.

5/ Data beginning in 2021 include the estimated stock of promissory notes.

**Table 2c. West Bank and Gaza: Central Government Fiscal Operations, 2019–28**  
(GFS2001, commitment basis, in billions of shekels, unless otherwise indicated)

	2019	2020	2021	2022	Projections					
					2023	2024	2025	2026	2027	2028
Revenue and Grants	14.1	13.5	14.7	17.4	18.4	19.0	19.9	20.8	21.6	22.5
Tax revenue	10.8	10.2	12.0	14.1	14.9	15.4	16.1	16.9	17.6	18.4
Direct taxes	0.7	0.6	0.7	0.9	1.0	1.1	1.2	1.2	1.3	1.4
Indirect taxes	2.0	1.9	2.5	2.9	3.1	3.3	3.5	3.6	3.8	4.0
VAT on domestic purchases	1.1	1.1	1.2	1.4	1.5	1.6	1.7	1.8	1.9	1.9
Excises	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Customs duties	0.7	0.5	0.9	1.1	1.2	1.3	1.3	1.4	1.5	1.5
Clearance revenues 1/	8.7	8.1	9.3	11.2	11.3	11.6	12.2	12.8	13.3	13.9
Income Tax	0.2	0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
VAT on imports	2.1	1.8	2.0	2.6	2.7	2.9	3.0	3.2	3.3	3.4
Petroleum Excise	2.6	2.4	2.6	2.9	3.1	3.3	3.4	3.6	3.7	3.9
Customs	3.7	3.8	4.5	5.3	5.6	6.0	6.3	6.6	6.8	7.1
Other	0.0	0.0	0.0	0.4	-0.1	-0.5	-0.5	-0.6	-0.6	-0.6
Tax refunds	0.6	0.4	0.6	0.9	0.7	0.7	0.7	0.8	0.8	0.8
Non-tax revenues	1.3	1.3	1.3	1.5	1.6	1.7	1.8	1.9	2.0	2.1
Earmarked revenues 2/	0.3	0.3	0.5	0.6	0.6	0.6	0.7	0.7	0.7	0.8
Grants	1.7	1.7	1.0	1.2	1.3	1.3	1.3	1.3	1.3	1.3
External budgetary support	1.8	1.2	0.6	0.8	0.9	0.8	0.8	0.8	0.8	0.8
Total Expenditure and Net Lending	16.9	17.4	17.8	18.0	19.9	21.2	22.4	23.6	24.7	26.0
Current spending	14.5	15.3	15.8	15.9	17.6	18.7	19.8	20.9	21.9	23.1
Wages and salaries	6.7	6.9	7.8	8.1	9.1	9.7	10.3	10.8	11.4	12.0
Goods and services	2.3	2.3	2.6	2.7	2.9	3.1	3.2	3.4	3.5	3.7
Interest payments	0.2	0.2	0.4	0.5	0.7	0.8	0.9	1.1	1.2	1.3
Domestic	0.2	0.2	0.4	0.4	0.6	0.7	0.8	1.0	1.1	1.2
Foreign	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Transfers	5.0	5.6	4.4	3.9	4.1	4.4	4.6	4.8	5.0	5.2
Social assistance	1.8	2.0	1.4	1.4	1.4	1.5	1.6	1.7	1.7	1.8
Transfers to the pension fund	3.3	3.2	2.9	2.3	2.5	2.6	2.8	2.9	3.0	3.1
Other transfers	-0.1	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Earmarked payments 2/	0.3	0.3	0.5	0.6	0.6	0.6	0.7	0.7	0.7	0.8
Development spending	1.2	1.0	0.8	0.9	1.0	1.1	1.1	1.2	1.2	1.3
Net lending	1.1	1.2	1.2	1.2	1.3	1.4	1.5	1.5	1.6	1.6
Overall Balance	-2.7	-3.9	-3.0	-0.6	-1.5	-2.1	-2.5	-2.8	-3.1	-3.5
Financing	2.6	3.9	3.0	0.6	-1.8	-1.9	-2.0	-2.1	-2.2	-2.3
Net domestic financing	2.7	3.9	3.0	0.6	-1.8	-1.9	-2.0	-2.1	-2.2	-2.3
Net domestic bank financing	1.8	1.9	0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.5
Accumulation of new arrears 3/	2.4	3.6	4.2	2.9	0.0	0.0	0.0	0.0	0.0	0.0
Arrears repayment (old)	-1.5	-1.6	-1.4	-1.9	-1.4	-1.5	-1.6	-1.6	-1.7	-1.8
Net external financing	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Borrowing, net	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual/Financing Gap	0.2	0.0	0.0	0.0	3.3	4.1	4.5	4.9	5.3	5.7
Memorandum Items:										
Overall balance (before external support)	-4.5	-5.6	-4.1	-1.8	-2.8	-3.4	-3.8	-4.1	-4.4	-4.8
Domestic revenues 4/	3.4	3.4	3.9	4.5	5.2	5.5	5.8	6.0	6.3	6.6
Domestic tax revenues (percent change)	-8.8	-7.7	27.7	19.2	9.2	6.0	5.0	4.8	4.6	4.6
Clearance revenues (percent change)	7.7	-6.7	15.3	19.6	1.7	2.3	5.1	4.6	4.0	4.6
Total expenditure and net lending (percent change)	4.7	3.5	1.9	1.1	10.7	6.2	5.9	5.2	4.9	5.2
Central government debt (incl. arrears)	21.1	25.2	29.4	30.3	31.9	34.0	36.5	39.3	42.4	45.8
Foreign debt	4.2	4.3	4.1	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Domestic debt	16.8	20.9	25.2	25.7	27.3	29.4	31.9	34.6	37.8	41.2
of which: Stock of promissory notes 5/	n.a.	n.a.	1.2	0.6	0.3	0.0	0.0	0.0	0.0	1.0
of which: Stock of arrears	11.4	13.4	16.2	17.2	...	...	...	...	...	...
of which: Arrears to the pension fund	7.1	7.6	8.3	8.0	...	...	...	...	...	...
Nominal GDP	61.1	53.5	58.5	63.1	67.5	71.2	74.7	77.9	81.1	84.3

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Revenue collected by Israel on behalf of and transferred to the Palestinian Authority.

2/ Earmarked revenues and payments are collections from taxes and revenues due to local government units.

3/ In the absence of additional donor support, the accumulation of new arrears is likely to equal the projected financing gap.

4/ Revenues administered by the Palestinian authorities. Excludes clearance revenues.

5/ Data beginning in 2021 include the estimated stock of promissory notes.

**Table 3. West Bank and Gaza: Financial Soundness Indicators, 2017–22**  
(In percent)

	Dec-17	Dec-18	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
<b>Capital Adequacy</b>															
Tier I capital to risk-weighted assets	15.5	16.0	15.6	15.5	15.2	15.0	13.9	14.1	14.3	14.6	14.4	14.3	14.7	14.3	14.6
Regulatory capital to risk-weighted assets	16.6	16.8	16.6	16.4	16.1	15.9	15.7	16.0	16.2	16.4	16.2	16.1	16.5	16.1	16.3
<b>Asset Quality 1/</b>															
Nonperforming loans (percent of total loans)	2.3	3.0	4.1	4.0	3.9	3.7	4.2	4.2	4.2	4.3	4.2	4.2	4.2	4.1	4.0
Nonperforming loans net of provisions to capital	5.2	2.2	5.7	4.4	3.1	1.9	3.8	3.7	2.9	2.6	1.4	1.5	1.2	0.7	-0.3
Coverage ratio (provisions as percent of nonperforming loans)	58.4	86.2	75.0	80.4	86.2	91.7	86.1	86.4	89.0	90.3	94.4	94.6	95.6	97.3	101.2
Loan to deposit ratio	67.0	69.0	67.5	69.5	69.9	70.4	66.6	66.9	65.9	64.6	65.1	65.2	65.4	65.7	65.5
<b>Earnings and Profitability 2/</b>															
Return on assets (ROA)	1.5	1.5	1.3	1.1	0.8	0.8	0.8	1.4	1.3	1.3	1.2	1.4	1.4	1.5	1.5
Return on equity (ROE)	16.1	15.2	8.7	8.4	5.2	5.7	5.4	11.7	9.5	9.5	9.2	10.3	10.3	10.9	11.0
Interest income to gross income	70.9	72.1	72.5	71.6	72.2	73.9	74.4	72.0	71.5	72.3	72.7	71.3	73.6	74.4	75.1
Non-interest expenses to gross income	62.0	63.3	63.4	63.5	65.7	64.1	63.7	59.5	59.6	59.5	59.9	59.4	59.1	57.8	57.3
<b>Liquidity</b>															
Liquid assets to total assets	32.3	29.8	32.0	29.3	29.2	28.3	33.2	32.8	33.0	33.7	33.2	34.2	33.0	32.7	32.6
Liquid assets to total deposits	41.6	38.6	40.9	37.7	37.2	36.9	42.1	41.9	41.9	42.7	42.0	42.9	41.8	42.1	42.0
Liquid assets to short-term liabilities	43.0	42.2	45.5	43.0	42.2	41.4	47.5	46.3	46.8	47.4	47.2	48.4	46.3	43.4	44.1

Source: Palestine Monetary Authority.

1/ Nonperforming loans includes loans more than 90 day overdue.

2/ ROA and ROE follow the 2019 IMF Financial Soundness Indicators Compilation Guide for 2019Q4 onwards. Figures for earlier years follow the 2006 Guide and are thus not comparable.



Annex I. Risk Assessment Matrix<sup>1</sup>

Nature/Sources of Risk	Relative Likelihood	Expected Impact If Realized	Policies to Mitigate Risks
<b>Domestic Risks</b>			
<b>The PA's fiscal trajectory remains unaltered.</b>	<b>High</b>	<b>High</b> Significant fiscal deficits persist, financed by an increasing stock of arrears. Cascading arrears cause all-round liquidity shortages, damaging growth and financial stability. Debt (including arrears) is unsustainable.	Pursue gradual fiscal consolidation, centered on expenditure reform. Take stock of arrears and devise a strategy to clear them. Ensure the banking system remains well capitalized.
<b>Fiscal crisis spilling over to the banking sector</b>	<b>Medium/High</b>	<b>High</b> The PA's fiscal trajectory, if unchecked, could hurt banks' asset quality given the banking sector's high direct and indirect exposure to the PA, potentially undermining financial stability and harming economic growth.	Ensure that the banking system remains well capitalized. Gradually reduce banks' exposure to the PA. Strengthen bank supervision and crisis management capacity.
<b>Reduced financial services by Israeli correspondent banks</b>	<b>High</b>	<b>High</b> Loss of Israeli-Palestinian correspondent bank relations would lead to trade and financial disruption which would encourage a further shift into cash/informality. As a result, WBG's financial system would suffer, harming growth.	Work with the Israeli authorities to adopt a long-term alternative for the current CBRs. Strengthen the AML/CFT framework and build implementation capacity, including with technical assistance. Work with Israeli counterparts to strengthen cross-border payment systems.
<b>Escalating social and security tensions due to lack of opportunities or prospects for peace</b>	<b>High</b>	<b>High</b> Unemployment, poverty, frustration with the lack of progress on the peace process, dissatisfaction with domestic politics and Israeli government policies affecting Palestinians may increase civil unrest or lead to another military confrontation with Israel in Gaza. This would undermine growth and worsen the humanitarian crisis in Gaza.	Sound macroeconomic management and economic reform could help instill confidence and alleviate economic strain at the margin. However, economic policies can do little to mitigate discontent with the political situation and the lack of progress on the peace process.

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Nature/Sources of Risk	Relative Likelihood	Expected Impact If Realized	Policies to Mitigate Risks
<b>Domestic Risks</b>			
<b>Israel tightens restrictions on movement of good and people further</b>	<b>Medium/High</b>	<b>High</b> In response to unrest or renewed conflict, Israel may shut the border to people and constrain goods traffic further. Economic growth would be hit hard and quickly. Many Palestinian guest workers would lose their income, lowering income transfers into WBG.	The authorities could try to seek additional grants to be able to partially compensate the population for the associated additional hardship.
<b>Donor support remains low or declines further</b>	<b>High</b>	<b>Medium</b> Donor support remains at its current low level or declines further. A decline would impact support for poor and vulnerable households and would make PA reform efforts more difficult. Given that donor grants already are at historic lows, a further decrease would worsen the growth outlook only modestly.	Pursue a comprehensive reform agenda that improves the macroeconomic situation. Entice donors to contribute to this turn around through increased grants.
<b>Global Risks</b>			
<b>Abrupt global slowdown or recession.</b>	<b>Medium</b>	<b>Medium</b> This results in lower exports due to weakened external demand, slower growth, and job losses, adversely impacting public finances, and could undermine bank asset quality.	Provide temporary targeted support to those in need by shifting spending away from lower priority areas. Strengthen banking sector crisis management capacity.
<b>Intensifying spillovers from Russia's war in Ukraine and commodity price shocks.</b>	<b>High</b>	<b>Medium</b> Further sanctions resulting from the war and related uncertainties exacerbate trade and financial disruptions and commodity price volatility. This may lead to price and real sector volatility, food insecurity, social unrest, and acute food and energy crises.	Provide targeted and temporary support, provided the fiscal situation allows it.

## Annex II. Sovereign Stress Assessment and Debt Sustainability Analysis<sup>1,2</sup>

*West Bank and Gaza is in debt distress as evidenced by the accumulation of domestic arrears of almost 30 of GDP. Without policy changes, its public debt is unsustainable and arrears accumulation to suppliers, the public pension fund, and civil servants is likely to continue. Debt coverage is limited to the central government and there is uncertainty over the total amount of arrears, increasing risks. Several political economy considerations further heighten risks, including Israeli restrictions on the movement of goods, capital and people, weak institutions, political and social instability, and the possibility of military conflict. Risks will remain high in the absence of political peace settlement, uncertainty surrounding economic reforms, and increasing climate change pressures.*

### Introduction

**1. The Sovereign Risk and Debt Sustainability Framework (SRDSF) for market access countries assesses the risk of debt distress in the near (1-2 years)<sup>3</sup> and medium term (5-years)<sup>4</sup> against relevant comparator groups.** The framework is designed to act as an early warning system for debt distress in the context of macroeconomic surveillance.<sup>5</sup> If a country already experiences stress, the framework can determine if the stress can be resolved via a mixture of adjustment policies and new financing, typically in the context of a Fund-supported program, or if exceptional measures (e.g., debt restructuring) are needed to achieve medium-term debt sustainability. The SRDSF provides two outputs: a sovereign risk assessment, and debt sustainability assessment. The results of the tools are combined into an overall assessment across different time horizons and complemented by IMF staff judgement. The new framework includes several “realism tools” to detect overly optimistic debt, fiscal and macroeconomic projections.<sup>6</sup>

<sup>1</sup> Prepared by Iacovos Ioannou, Antonio Bassanetti, and Jiayi Ma.

<sup>2</sup> The analysis is based on the 2022 Market Access Countries Sovereign Risk and Debt Sustainability Framework (SRDSF) template developed by the IMF. The SRDSF replaces its predecessor, the Debt Sustainability Analysis for Market Access Countries (MAC DSA).

<sup>3</sup> The near-term analysis (logit model) assesses risks based on indicators of a country’s quality of institutions and stress history; cyclical position; debt burden and buffers; and global conditions. These variables are transformed into a single risk metric index, with a higher index value representing higher risk of sovereign stress.

<sup>4</sup> Medium-term risk analysis combines the results of two modules that capture solvency and liquidity risks implied by medium-term projections and simulations. The Debt Fanchart module focuses on solvency risks stemming from a country’s debt burden. The Gross Financing Needs (GFN) module focuses on a country’s ability to meet its gross financing needs over the medium term. The Debt Fanchart and GFN module indices are combined into an aggregate Medium-Term Index (MTI) using simple averaging. In addition to these two modules, additional stress tests can be used to assess specific vulnerabilities.

<sup>5</sup> Stress or distress refers to an event where market and/or fiscal pressures related to debt become acute.

<sup>6</sup> The framework also includes tools for the assessment of longer-term risks such as climate change, demographics, and exhaustion of natural resources.

## Structure of Government Debt and Recent Developments

### 2. In West Bank and Gaza, government debt refers to central government liabilities (Tables 2 and 3), with most of it in the form of domestic arrears.

Government debt includes loans from commercial banks to the Palestinian Authority (PA), overdraft by the Palestine Monetary Authority (PMA), and promissory notes held by the private sector, accounts payable and pension liabilities. Domestic debt (including arrears and promissory notes) represented 85 percent of total debt at end-2022. Arrears are the largest component of domestic debt, representing more than double the amount of bank debt. Almost half of the arrears are to the public sector pension fund, resulting in unfunded liabilities. Formal debt to the banking sector declined in 2022 as banks sought to constrain lending to the PA to comply with prudential limits. External debt represented about 15 percent of total debt, with the Al Aqsa Fund, the World Bank, and the Qatar National Bank being the main creditors. There is considerable uncertainty about the size of government debt because the stock of arrears (suppliers, contractors, civil servants) is not audited and there is limited information on the stock of outstanding promissory notes.

**West Bank and Gaza: Total Debt Liabilities of the PA**  
(In percent of GDP)

	2019	2020	2021	2022
Gross Debt Liabilities	34.5	47.1	50.2	48.1
Domestic debt	27.6	39.1	43.1	40.8
Loans and overdrafts	8.9	14.0	13.5	12.6
Promissory notes 1/	...	...	2.0	1.0
Arrears 1/	18.6	25.1	27.7	27.2
External debt	6.9	8.0	7.0	7.3

Sources: Ministry of Finance; and IMF staff estimates.

1/ Figures are estimates due to insufficient official data.

## Baseline Scenario Projections

**3. The macroeconomic outlook will remain difficult under unchanged policies.** Economic growth is expected to decrease to 2 percent per year over the medium term, while inflation is expected to gradually converge to near 2 percent, broadly in line with Israel's inflation target. Under unchanged policies, public finances are expected to worsen, with the fiscal deficit expected to rise to around 4 percent of GDP. There are considerable risks associated with the baseline forecast. These include the possibility of an escalation of the political and security unrest that would harm growth, higher than currently expected Israeli deductions from clearance revenues, and a stock of arrears that may be larger than currently estimated.

### 4. Over the medium term, new financing is assumed to be mainly in the form of arrears.

Domestic bank financing is assumed to be limited because banks already have a high exposure to the PA, preventing them from extending significant amounts of new loans, even as the PA remains current on its payments to the domestic banking sector. The PA also does not issue government securities in domestic or international markets. Reflecting these limited financing options, the authorities have been accumulating domestic arrears on a regular basis to cover deficits. The authorities are assumed to continue to rely on arrears as the main source of new financing.

**5. Under unchanged policies, gross public debt will continue to increase over the medium term (Table 4).** The baseline projections provide information on the evolution of debt and gross financing needs before the framework's risk tools are applied. Under unchanged policies, gross public debt is projected to increase to about 54 percent of GDP by 2028 and then rise further to 68 percent of GDP by 2032. The increase in debt is driven mainly by the primary deficit combined with weak economic growth. West Bank and Gaza has a narrow revenue base, and a considerable share of its revenues is collected on its behalf by Israel and subject to unpredictable and sometimes arbitrary deductions. Moreover, donor support has been declining over the years. Other debt dynamics (e.g., real interest rates and the inflation differential relative to the U.S.) play a modest role.

**6. Medium-term debt projections are based on conservative assumptions.** The realism tools under the SRDSF aim to scrutinize drivers of public debt using cross-country and historical performance (Table 5).

- *Projections vs realizations of public debt drivers (Table 5A).* This tool compares the cumulative contributions of key debt drivers over the past five years to the 5-year projection period. In the case of West Bank and Gaza, the projected increase in debt is smaller than in the past, with real GDP growth projected to bring down debt ratios more than in the past.
- *Optimism of debt projections (Table 5C).* This tool shows a cross-country distribution of observed changes in debt-to-GDP ratios over a three-year horizon and places WBG's projected change (red diamond) in this distribution.<sup>7</sup> A projected debt reduction greater than the 75<sup>th</sup> percentile of all reductions in the sample is interpreted as signaling overoptimistic projections.<sup>8</sup> Similarly, if the projected change in debt is larger than the largest historically observed downward change in the debt-to-GDP ratio (red triangle), this could also signify overoptimism. The analysis suggests there are no overoptimism concerns regarding WBG's debt projections, as the projected three-year debt reduction (red diamond) is modest in a cross-country context (in the blue region) and to the left of the red triangle which shows the largest historical reduction in WBG.
- *Optimism of fiscal adjustment (Table 5D).* This tool compares West Bank and Gaza's projected fiscal adjustment (three-year change in cyclically adjusted primary balance) to fiscal adjustments in other countries during 1990–2019 (data from October 2020 WEO). It also shows the maximum historical adjustment in WBG during this period. As staff projects a moderate fiscal relaxation for WBG (red diamond), the analysis suggests there are no overoptimism concerns.
- *Consistency of fiscal adjustment and growth assumptions (Table 5E).* This tool examines the impact of the planned fiscal adjustment on growth under different fiscal multipliers (0.5, 1, 1.5). Large discrepancies between the baseline growth and growth under different multipliers would be a reason for further scrutiny. For WBG, the figure suggests the projected baseline growth path is broadly consistent with plausible fiscal multipliers.

<sup>7</sup> The sample includes data from the October 2020 WEO between 1990 and 2019.

<sup>8</sup> A negative debt reduction in the horizontal axis means an increase in debt.

- *Optimism of baseline real GDP growth (Table 5F).* The tool compares real GDP growth projections to potential growth projections, output gap, and historical average growth. In the case of West Bank and Gaza, projected growth is consistent with the 10-year average and potential growth, and the output gap is close to zero after five years.

### Near-Term Risk Assessment

**7. West Bank and Gaza is already experiencing debt distress.** The PA has been accumulating arrears to suppliers and contractors for some time, and to public sector employees and retirees since November 2021.

### Medium-Term Risk Assessment

**8. Risks from the evolution of indebtedness over the medium term are significant.** The debt fanchart module (Table 6) simulates possible debt trajectories using a debt dynamics equation and randomly drawn shocks to key variables and presents the outcome in the form of a debt fanchart (Table 6B). The information contained in the fanchart is summarized by three metrics (Table 6A): 1) the fanchart width (spread between the 95<sup>th</sup> and 5<sup>th</sup> percentile), 2) the probability of debt not stabilizing, and 3) the terminal debt level adjusted using an institutional quality index. The three metrics are then combined into a Debt Fanchart Index (DFI). For WBG, the fanchart width is 59.4, which is higher than in most other countries, underscoring the considerable uncertainty around the baseline linked in part to fluid political and social conditions. Also, the probability of debt not stabilizing is high.<sup>9</sup> Finally, the terminal debt level interacted (multiplied) with an institutional quality index is relatively high (50–75<sup>th</sup> percentile) suggesting a low debt carrying capacity and limited options to absorb shocks. West Bank and Gaza's Debt Fanchart Index is pointing to high solvency risks. Table 6A depicts a graphical comparison of the components of the DFI relative to peers, and suggests that the fanchart width and probability of debt not stabilizing are greater than the 75<sup>th</sup> percentile, while the terminal debt level interacted with institutional quality in the 50–75<sup>th</sup> percentile. Taken together, these medium-term risks suggest the need for additional fiscal consolidation measures beyond those envisaged in the baseline.

**9. Liquidity risks over the medium term are assessed as moderate (Table 6) but the model may underestimate them.**<sup>10</sup> The Gross Financing Needs (GFN) module assesses whether creditor composition and debt structure pose risks. The GFN Financeability index is calculated to measure risk along three dimensions (Table 6A): 1) the average GFN-to-GDP ratio in the baseline; 2) the initial (current) bank exposure to the government (to assess room for banks to act as residual financier amid funding shocks); and 3) the change in bank claims on the government resulting from the stress scenario (to measure potential demand on the banking system if stress materializes). The index is then compared with thresholds levels to indicate high, moderate, or low risks. The GFN module

<sup>9</sup> If the primary balance at the final year of the projection period for each trajectory is higher than the debt-stabilizing level, then debt is said to stabilize. The probability of stabilization is determined by the number of trajectories resulting in a debt-stabilizing primary balance divided by the total number of trajectories.

<sup>10</sup> Gross financing needs are estimated as the sum of the primary deficit, debt service, realization of contingent liabilities, minus interest revenue.

includes a stress scenario under which the country is exposed to macro-fiscal shocks (e.g., reduced growth for two years, higher interest rate, one-off depreciation), and debt holder shocks (e.g., reduced rollover by foreign private creditors and no new financing, shortening of maturities). WBG's GFN Financeability index is moderate, as most public debt is in domestic currency and nonmarketable, which minimizes exchange rate risk. Moreover, most of the debt is in the form of accounts payable (domestic arrears) which gives the authorities flexibility to decide on the payment schedule. Still, projected GFNs are steadily increasing over the medium term (more so under a stress scenario), driven primarily by higher debt service rather than fiscal balances, suggesting the need for restructuring arrears. The module may underestimate liquidity risks since it does not take account of the frequent episodes of political and social instability WBG faces. Moreover, given the limited financing options, satisfying financing needs is likely to be more difficult than currently assessed by the GFN tool.

**10. Uncertainty about liabilities presents an additional risk not captured by the fanchart and GFN tools.** These uncertainties exist because of uncertainty over the size of accumulated arrears and the limited central government coverage of official debt statistics. The possible impact of these uncertainties is modeled as a contingent shock to the debt stock. Not surprisingly, the shock leads to a permanent increase in the stock of debt pushing it to the 75–95<sup>th</sup> percentile of possible trajectories (Table 6B). It would also lead to a temporary spike and permanently higher GFNs (Table 6C).

### Debt Sustainability Assessment

**11. Without policy changes, public debt is unsustainable.** The large and growing stock of arrears indicates debt distress. Moreover, public debt is projected to continue to rise over the long term in the absence of adjustment policies. Putting debt on a sustainable trajectory will require coordinated transformative reform by the Palestinian Authority, Israel, and donors, as documented in IMF staff's [May 2022 Report to the AHLC](#).

**Table 1. West Bank and Gaza: Risk of Sovereign Stress**

Horizon	Mechanical Signal	Final Assessment	Comments
<b>Overall</b>	...	<b>High</b>	The overall risk of sovereign stress is high, reflecting a high level of vulnerability in the near- and medium-term.
<b>Near Term</b>	n.a.	n.a.	Not applicable
<b>Medium Term</b>	<b>High</b>	<b>High</b>	Medium-term risks are assessed as high because of limited access to finance, Israeli restrictions on the movement of goods, capital, and people and weak institutions. Moreover, a narrow debt coverage and weak subnational governments pose contingent liabilities to the central government. Political and social instability further heighten medium term risks.
Fanchart	<b>High</b>	...	
GFN	<b>Moderate</b>	...	
Stress test	...	...	
<b>Long Term</b>	...	<b>High</b>	Long-term risks are high in the absence of political settlement. The risks arise mainly from lack of access to productive resources, uncertainty surrounding economic reforms, and increasing climate change pressures.
<b>Sustainability Assessment</b>	...	Unsustainable	The large and growing stock of arrears indicates debt distress. Moreover, public debt is projected to continue to rise over the long term in the absence of adjustment policies.
<b>Debt Stabilization in the Baseline</b>			No
<b>DSA Summary Assessment</b>			
<p>Commentary: Restoring debt sustainability is contingent on the implementation of reforms and financial contributions by Israel and donors. Medium-term liquidity risks, as analyzed by the GFN Financeability Module, may be underestimated because of political uncertainty and social tensions. Over the longer run, West Bank and Gaza should continue reforms to generate jobs for a growing population and mitigate risks from climate change.</p>			
Source: IMF staff.			

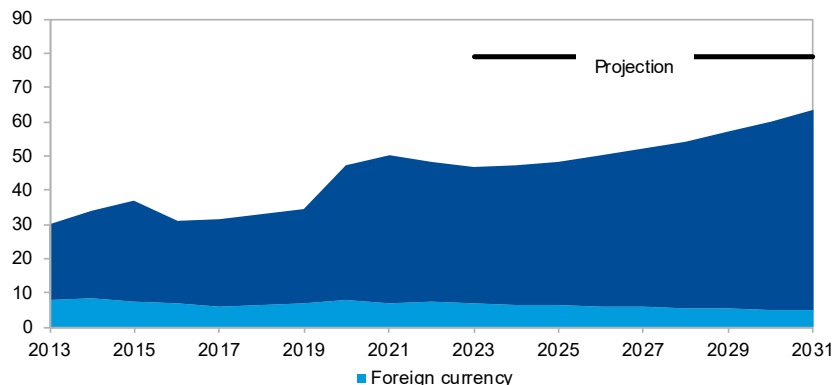


Table 2. West Bank and Gaza: Debt Coverage and Disclosures

						Comments	
<b>1. Debt coverage in the DSA: 1/</b>		CG	GG	NFPS	CPS	Other	
<b>1a. If central government, are non-central government entities insignificant?</b>						No	
<b>2. Subsectors included in the chosen coverage in (1) above:</b>							
Subsectors captured in the baseline						Inclusion	
CPS	NFPS	CG: expected	CG	1	Budgetary central government	Yes	Includes debt to the pension authority
				2	Extra budgetary funds (EBFs)	No	
				3	Social security funds (SSFs)	No	
				4	State governments	NA	
				5	Local governments	No	
				6	Public nonfinancial corporations	No	
				7	Central bank	No	
				8	Other public financial corporations	No	
<b>3. Instrument coverage:</b>		Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	
<b>4. Accounting principles:</b>		Basis of recording		Valuation of debt stock			
		Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/	
Source: IMF staff.							
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.							
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.							
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.							
4/ Includes accrual recording, commitment basis, due for payment, etc.							
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).							
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.							
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.							
<p>Commentary: Fiscal accounts for the central government include transfers to local government units and the pension fund. Government debt includes estimates of arrears to the private sector, pension fund, public sector employees and retirees.</p>							

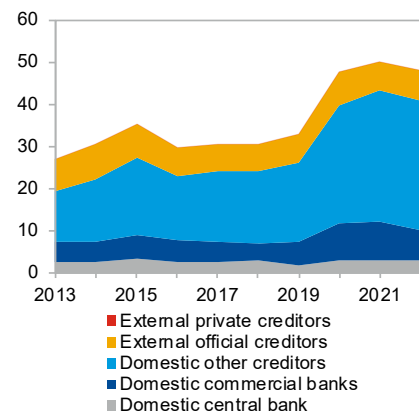
**Table 3. West Bank and Gaza: Public Debt Structure Indicators**

**Debt by Currency (Percent of GDP)**



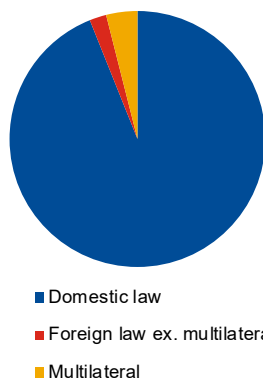
Note: The perimeter shown is central government.

**Public Debt by Holder (Percent of GDP)**



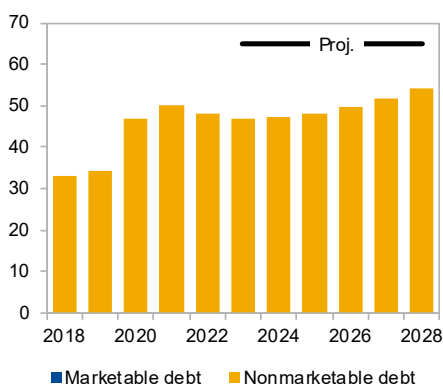
Note: The perimeter shown is central government.

**Public Debt by Governing Law, 2022 (Percent)**



Note: The perimeter shown is central government.

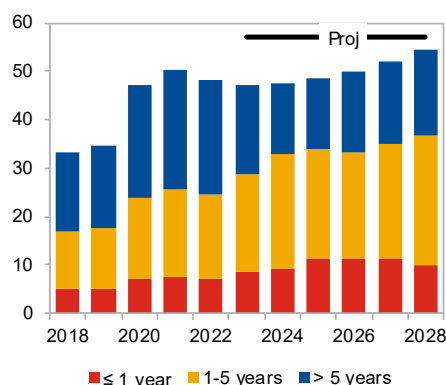
**Debt by Instruments (Percent of GDP)**



Note: The perimeter shown is central government.

Source: IMF staff.

**Public Debt by Maturity (Percent of GDP)**



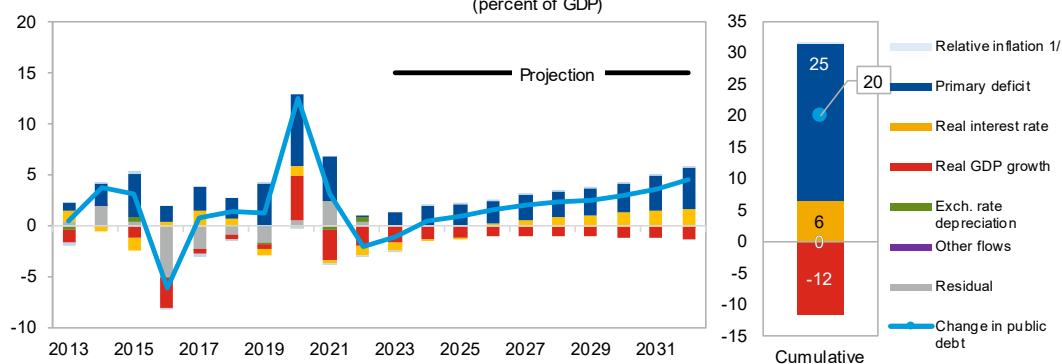
Note: The perimeter shown is central government.

Commentary: Domestic debt includes central bank advances, bank loans, loans from the Petroleum Authority and other public institutions, promissory notes, and estimates of arrears to the private sector, pension fund, public sector employees and retirees.

**Table 4. West Bank and Gaza: Baseline Scenario**  
(Percent of GDP unless indicated otherwise)

	Actual	Medium-term Projections						Extended Projections			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public Debt	48.1	47.0	47.4	48.4	50.0	52.0	54.4	56.9	60.0	63.7	68.2
Change in Public Debt	-2.1	-1.1	0.5	1.0	1.6	2.0	2.4	2.6	3.1	3.7	4.5
Contribution of identified flows	-2.4	-1.2	0.4	0.9	1.6	2.0	2.4	2.6	3.1	3.7	4.5
Primary deficit 1/	0.2	1.2	1.9	2.1	2.2	2.4	2.5	2.5	2.9	3.4	4.0
Noninterest revenues	27.6	27.2	26.7	26.7	26.7	26.7	26.7	26.9	26.9	26.8	26.8
Noninterest expenditures	27.8	28.5	28.6	28.7	28.9	29.0	29.2	29.4	29.7	30.2	30.8
Automatic debt dynamics	-2.6	-2.4	-1.5	-1.1	-0.6	-0.4	-0.2	0.0	0.2	0.3	0.5
Real interest rate and relative inflation	-1.2	-0.8	-0.3	0.0	0.3	0.6	0.9	1.1	1.3	1.5	1.7
Real interest rate	-1.0	-0.8	-0.3	-0.1	0.3	0.6	0.9	1.1	1.3	1.5	1.7
Relative inflation 2/	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-1.9	-1.6	-1.2	-1.1	-0.9	-1.0	-1.0	-1.1	-1.1	-1.2	-1.2
Real exchange rate	0.5	...	...	...	...	...	...	...	...	...	...
Other identified flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Financing Needs	4.5	10.4	10.8	14.1	16.7	17.4	17.9	17.8	19.8	22.0	23.7
of which: debt service	4.3	9.2	8.9	12.0	14.5	15.0	15.3	15.3	17.0	18.6	19.7
Local currency	4.2	9.0	8.8	11.9	14.4	14.9	15.2	15.2	16.9	18.5	19.6
Foreign currency	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Memo:											
Real GDP growth (percent)	4.0	3.5	2.7	2.4	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Inflation (GDP deflator; percent)	3.7	3.4	2.7	2.5	2.2	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	7.8	7.0	5.5	5.0	4.2	4.0	4.0	4.0	4.0	4.0	4.0
Effective interest rate (percent)	1.6	1.7	2.0	2.4	2.8	3.3	3.7	4.1	4.4	4.6	4.8

**Contribution to Change in Public Debt**  
(percent of GDP)



Source: IMF staff.

1/ Primary deficit is measured on a commitment basis.

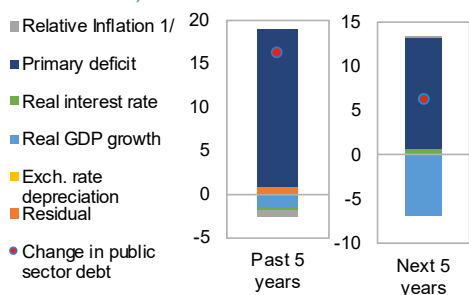
2/ Relative inflation refers to the inflation differential between West Bank and Gaza and the US.

Commentary: Weak economic growth combined with persistent primary deficits are driving the steady increase of public debt over the medium and long term.

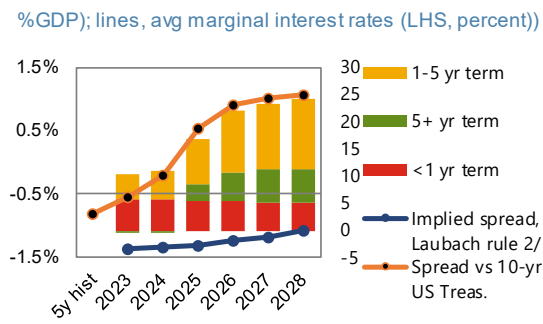
**Table 5. West Bank and Gaza: Realism of Baseline Assumptions**

**5A. Public Debt Creating Flows**

(Percent of GDP)

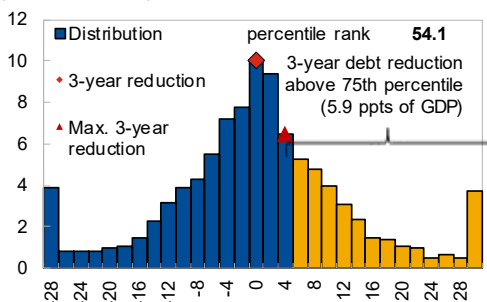


**5B. Debt Issuances** (Bars, debt Issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))

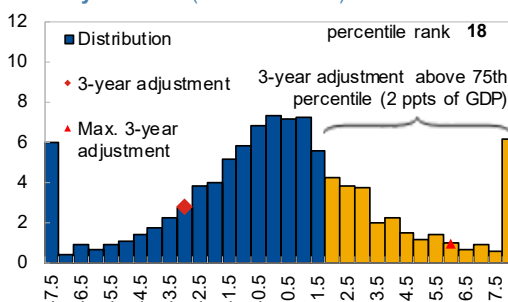


**5C. 3-Year Debt Reduction**

(Percent of GDP)

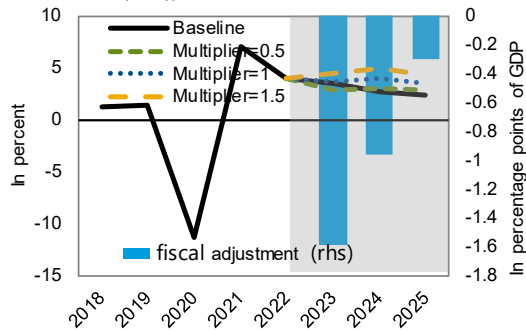


**5D. 3-Year Adjustment in Cyclically-Adjusted Primary Balance** (Percent of GDP)



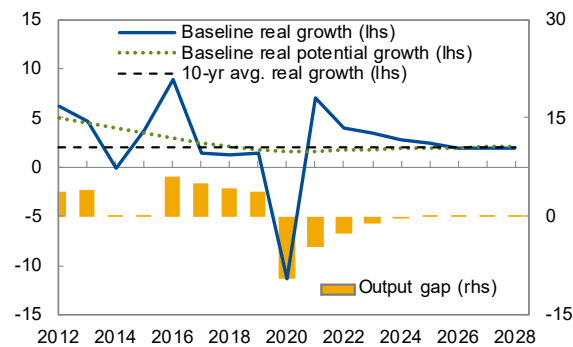
**5E. Fiscal Adjustment and Possible Growth Paths**

(Lines, real growth using multiplier (LHS); bars, fiscal adjustment (RHS))



**5F. Real GDP Growth**

(In percent)



Source : IMF Staff.

1/ Relative inflation refers to the inflation differential between West Bank and Gaza and the US.

2/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Commentary: Spreads to US treasury are not very relevant since West Bank and Gaza does not have market access. The three-year debt reduction and projected fiscal adjustment are within norms. Comparators may not be suitable because of West Bank and Gaza's special circumstances.

**Table 6. West Bank and Gaza: Medium-Term Risk Analysis**

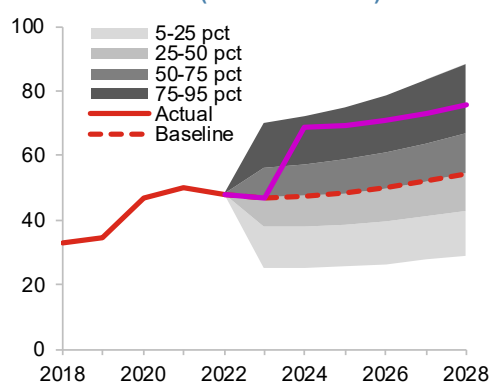
**6A. Debt Fanchart and GFN Financeability Indexes**

(Percent of GDP unless otherwise indicated)

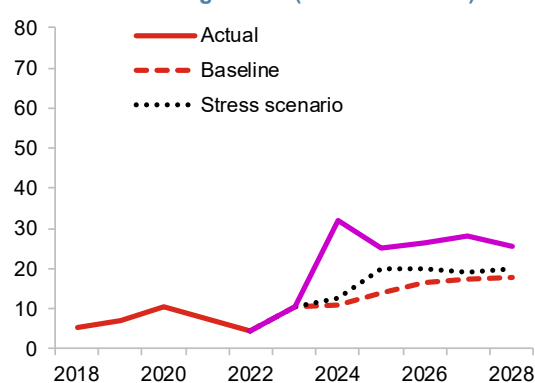
Module	Indicator	Value	Risk Index	Risk Signal	Emerg. Mrkt., Non-Com. Exp, Surv				
					0	25	50	75	100
Debt Fanchart Module	Fanchart width	59.4	0.9	...	[Bar chart showing interquartile range and West Bank and Gaza position]				
	Probability of debt not stabilizing (pct)	94.9	0.8	...	[Bar chart showing interquartile range and West Bank and Gaza position]				
	Terminal debt level x institutions index	38.0	0.8	...	[Bar chart showing interquartile range and West Bank and Gaza position]				
<b>Debt fanchart index</b>		...	<b>2.5</b>	<b>High</b>					
GFN Financeability Module	Average GFN in baseline	14.5	5.0	...	[Bar chart showing interquartile range and West Bank and Gaza position]				
	Bank claims on government (pct bank assets)	12.2	3.9	...	[Bar chart showing interquartile range and West Bank and Gaza position]				
	Chg. in claims on govt. in stress (pct bank assets)	16.6	5.5	...	[Bar chart showing interquartile range and West Bank and Gaza position]				
<b>GFN financeability index</b>		...	<b>14.4</b>	<b>Moderate</b>					

Legend: [Grey bar] Interquartile range [Red bar] West Bank and Gaza

**6B. Final Fanchart (Percent of GDP)**



**6C. Gross Financing Needs (Percent of GDP)**

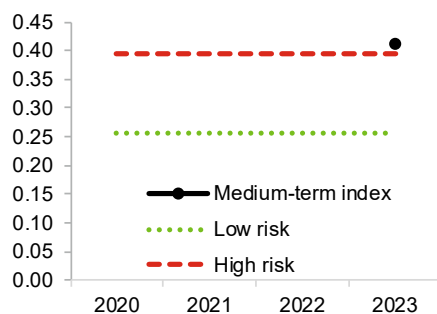


Triggered stress tests (stress tests not activated in gray)

Banking crisis    Commodity prices    Exchange rate    **Contingent liab.**    Natural disaster

**6D. Medium-term Index**

(index number)



**6E. Medium-term Risk Analysis**

	Low risk threshold	High risk threshold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.6
GFN financeability index	7.6	17.9	0.5	0.3
Medium-term index (MTI)	0.3	0.4	...	0.4, High

Prob. of missed crisis, 2023-2028 (if stress not predicted): 54.5 pct

Prob. of false alarm, 2023-2028 (if stress predicted): 9.1 pct.

Source: IMF staff.

Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to high level of risk while the GFN Financeability Module to a moderate level of risk. Data on amortization are estimates. GFN needs may nevertheless be underestimated because it is unclear if the private sector will accept continued accumulation of arrears. Also, GFN may be underestimated because of contingent liabilities from local governments and the pension fund.

## Annex II. IMF Technical Assistance to the Palestinian Authority, 2019–23

*The IMF has provided technical assistance (TA) to the West Bank and Gaza (WBG) on public financial management (PFM), revenue administration, banking regulation and supervision, stress testing, anti-money laundering and combating the financing of terrorism (AML/CFT), national accounts, and external sector statistics. Technical support was also provided to the Ministry of Finance's macro-fiscal unit in 2019. Priorities for capacity building over the medium-term include banking supervision, the development of the national payments system, and AML/CFT. Periodic review and assistance to improve the quality of external sector and national accounts statistics are also needed. The Fund's legal, monetary and capital markets, and statistics departments (LEG, MCM, and STA) will continue to provide TA on these topics, with support from the Middle East Regional Technical Assistance Center (METAC). FAD, the Fund's fiscal affairs department is re-assessing current fiscal sector TA needs and priorities but stands ready to deliver TA on key critical areas, including expenditure reform, taxation, macro fiscal planning and cash management.*

Mission Date	Mission	Date of TA Report
<p><b>Fiscal Sector:</b> Significant progress was made in PFM in 2007–16: Legal frameworks were drafted, a Treasury Single Account was adopted, debt management and cash planning units were created, the budget classification and Chart of Accounts were modernized, a computerized financial management information system was developed, accounting and reporting were strengthened, and internal audit departments in ministries as well as an independent external audit agency and a macro-fiscal unit at the Ministry of Finance were created. A medium-term PFM reform plan was agreed in 2011 and updated for 2014–16. IMF Fiscal TA's key objectives in 2019 were to consolidate the progress made, strengthen macro-fiscal forecasting and the macro-fiscal unit, and boost revenue mobilization by helping modernize tax administration. FAD TA resumed in 2022, after a three-year hiatus.</p>		
February 17–28, 2019	Supporting the Development of the Macro-Fiscal Unit's Capacity	April 2019
March 10–21, 2019	Revenue Administration/Large Taxpayer Office	March 2019
February 18–25, 2022	Training on Improving Tax Compliance in Digital Economy	n.a.
March 14–17, 2022	Virtual Regional Workshop on Public Sector Debt Statistics	n.a.
May 10–June 7, 2022	Review of Revenue Administration Reform Strategies	September 2022
June 7–12, 2022	Strengthening Macro Fiscal Planning and Quarterly Reporting	September 2022
November 27–December 9, 2022	Improving Compliance in the Large Taxpayer Department	n.a.
<p><b>Monetary and Financial Systems:</b> MCM TA priorities during 2019–23 were informed and guided by the findings and the recommendations of the Financial Sector Stability Review conducted in 2018 (and the associated technical assistance roadmap). During 2019–23, TA centered on bolstering crisis management arrangements, strengthening banking resolution provision and tools, and improving stress-testing to better reflect specificities of WBG's financial sector and test for multi-factor shocks.</p>		

<b>Mission Date</b>	<b>Mission</b>	<b>Date of TA Report</b>
March 3–7, 2019	CFT framework	n.a.
March 24–28, 2019	Basel III	n.a.
December 3–12, 2019	FSSR Follow-up: Contingency Planning for Crisis Preparedness and Management*	July 2020
January 3–31, 2021	FSSR Follow-Up: Financial Institution Restructuring & Resolution	July 2021
April 26–May 6, 2021	Macro Stress-Testing	n.a.
June 18–September 29, 2021	Macro Stress-Testing*	December 2021
May 3–7, 2021	FSSR Follow-Up: Financial Institution Restructuring & Resolution	July 2021
January 9–February 6, 2022	Developing a Crisis Management Plan*	May 2022
March 2–17, 2022	Bank Resolution Law Reform*	n.a.
March 21–April 29, 2022	National Payment Systems	August 2022
May 8–11, 2022	AML/CFT*	December 2022
June 26–July 5, 2022	Strengthening On-Site Risk Based Supervision	October 2022
February 19–27, 2023	IFRS 9 Implementation Review	n.a.
<p><b>Statistics:</b> TA on statistical issues has focused on implementing and aligning existing statistical compilation and dissemination systems with the latest international statistical standards for national accounts and external sector statistics (ESS) datasets. In general, the transparency and timeliness of the data produced by the Palestinian Central Bureau of Statistics, the Ministry of Finance, and the Palestine Monetary Authority are on par with those of countries that maintain good data management and dissemination standards, but additional work is needed to improve data consistency in ESS and produce quarterly and annual chain-linked national accounts.</p>		
February 10–14, 2019	National Accounts	April 2019
December 13–15, 2019	National Accounts	February 2020
June 8–11, 2020	Residential Property Price Indices	August 2020
August 9–13, 2020	Compilation of Input-Output Tables	September 2020
February 21–25, 2021	Re-Chain Linking the National Accounts	April 2021
August 22–September 2, 2021	Institutional Sector Accounts – Sequence of Accounts	November 2021
February 27–March 10, 2022	Institutional Sector Accounts – Sector Accounts	April 2022
June 26–July 7, 2022	External Sector Statistics	August 2022
July 24–August 4, 2022	Annual National Accounts	October 2022
October 2–13, 2022	GDP – Administrative Data Sources	December 2022
<p>n.a. – not applicable. * Reports classified as confidential or strictly confidential.</p>		