

State of Palestine

Ministry of Finance

**Fiscal Developments & Macroeconomic Performance:
Third Quarter Report 2013**

Macro Fiscal Unit

November 4th, 2013

Section 1: Palestinian Territory Macroeconomic Performance in 2013:

GDP: According to preliminary estimates published by PCBS¹, real GDP in Palestine has increased by 1.2% during the second quarter of 2013 compared to the 2nd quarter of 2012, and it showed an increase of 7.9% compared to the 1st quarter of 2013.

Real GDP in West Bank amounted to USD 1288.1 million in Q2 2013, a slowdown of 0.3% over Q2 2012 and a growth of 9.1% over Q1 2013. GDP in Gaza reached USD 487.3 million in Q2 2013, growing by 3.5% over Q2 2012, and by 4.9% over Q1 2013 (Table 1A).

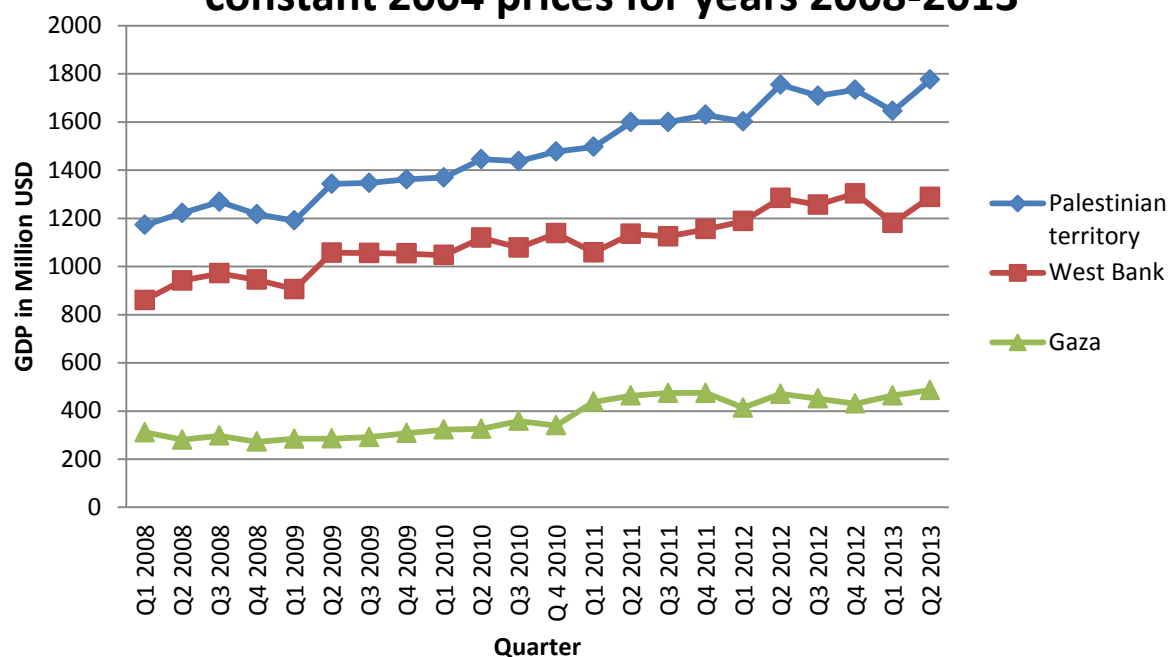
During the first half of 2013 real GDP in Palestine has increased by 1.9% over the first half of 2012 and amounted to USD 3420 million. Real GDP in west bank amounted to USD 2468 million in the first half of 2013 (a decline of 0.1%), while Gaza real GDP amounted to USD 951.4 million, growing by of 7.6% over the first half 2012. (Table 2A)

| | Real GDP value in Q2 2013 | % Change in Q2 2013 from Q2 2012 | % Change in Q2 2013 from Q1 2013 |
|------------------------|---------------------------|----------------------------------|----------------------------------|
| Palestinian Territory* | 1775.4 | 1.2% | 7.9% |
| West Bank | 1288.1 | 0.3% | 9.1% |
| Gaza | 487.3 | 3.5% | 4.9% |
| *Base year 2004. | | | |

| | 1st half 2013 | 1st half 2012 | % growth |
|-----------|---------------|---------------|----------|
| Gaza | 951.4 | 884.6 | 7.6% |
| WB | 2468.4 | 2471.6 | -0.1% |
| Palestine | 3419.8 | 3356.2 | 1.9% |

¹PCBS, Press Report, Preliminary Estimates of Quarterly National Accounts (Second Quarter 2013) Main Results

Chart 1: Quarterly GDP in Palestinian territory at constant 2004 prices for years 2008-2013



The overall Consumer Price Index in Palestine The overall Consumer Price Index (CPI) for Palestine during September 2013 increased by 0.45% compared with August 2013 (increased by 0.80% in the West Bank, and by 0.27% in Jerusalem J1*, and by 0.15% in Gaza Strip). The CPI during September 2013 increased by 0.42% compared with September 2012 (1.16% in the West Bank, and by 0.87% in Jerusalem J1*, while it decreased by 1.97% in Gaza Strip).

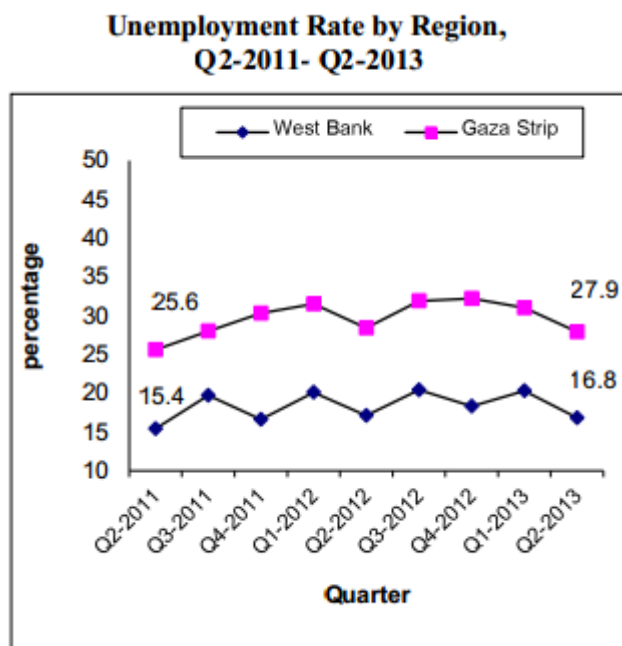
The total population in Palestine at mid-2013 was about 4.42 million, a growth of 3% over 2012. The population was 2.72 million in the West Bank, and 1.7 million in Gaza.

The Unemployment rate in Palestine reached 20.6% during the second quarter of 2013. The Unemployment rate in West Bank reached 16.9% during Q2 2013 compared to 20.3% during Q1 2013. In Gaza, unemployment reached 27.9% during Q2 2013, compared to 31% during Q1 2013. The highest unemployment rate in the 2nd quarter 2013 was 37.2% among youth aged 20-24 years.

The number of employed persons from the West Bank employed in Israel and Israeli settlements increased from 93 thousand in the 1st quarter 2013 to 96 thousand in the 2nd quarter 2013².

²PCBS, Press Report, Palestinian Central Bureau of Statistics, 2013. Labour Force Survey: (April- June, 2013) Round, (Q2/2013). Press Report on the Labour Force Survey Results. Ramallah - Palestine.

| Region | Labor Force | Unemployment | | Employment | |
|------------------------------|--------------|--------------|---------|------------|---------|
| | Total number | % | Number | Percentage | Number |
| Palestinian Territory | 1,133,000 | 20.6% | 234,000 | 79.3% | 899,000 |
| West Bank | 746,000 | 16.9% | 126,000 | 83.1% | 620,000 |
| Gaza | 387,000 | 27.9% | 108,000 | 72.1% | 279,000 |



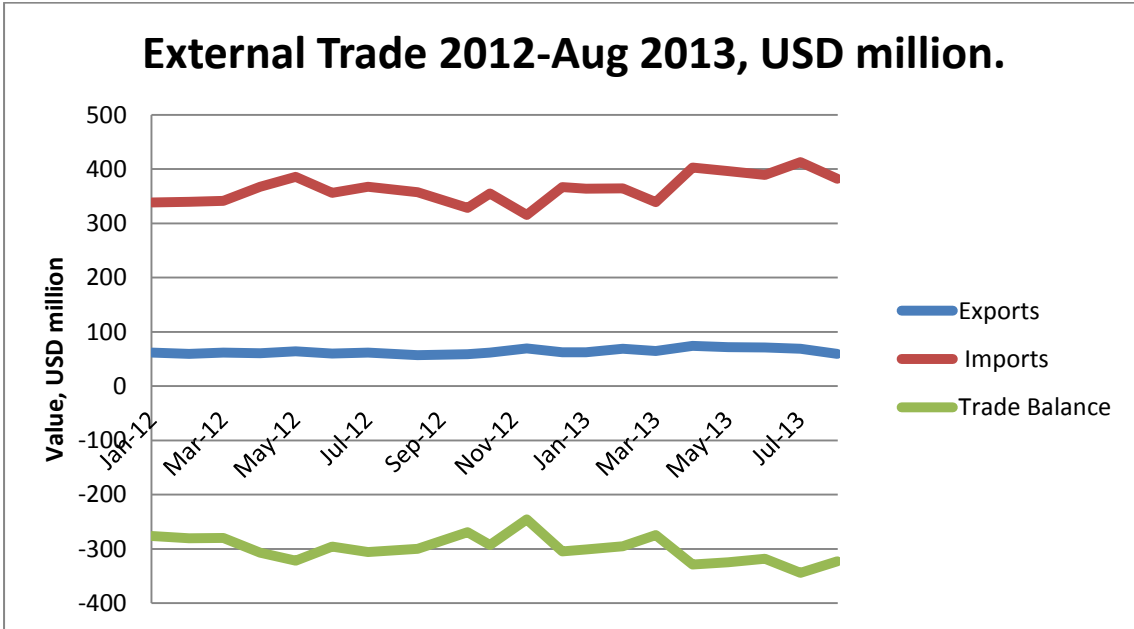
External Trade: Exports for the period Jan-Aug 2013 showed a growth of 11.2% compared to the same period of 2012. Exports amounted to USD 541 million with a monthly average of USD 67.6 million in Jan-Aug 2013 compared to USD 486.6 million for the same period 2012. Exports to Israel represented almost 91.7% of total exports in August 2013.

On the other hand, imports during Jan-Aug 2013 amounted to USD 3.05 billion with a monthly average of USD 381 million, compared to USD 2.85 billion for the same period 2012, a growth of 6.9%. Imports from Israel represented almost 64.4% of total imports in August 2013. The trade deficit reached USD 322.6 million in August 2013 for a total trade deficit for Jan-Aug 2013 of USD 2.51 billion. When compared to the same period of 2012, the total trade deficit increased by 6%.

| | Jan-13 | Feb-13 | Mar-13 | Apr-13 | May-13 | Jun-13 | Jul-13 | Aug-13 | Jan-Aug 2013 |
|----------------|---------------|---------------|---------------|---------------|---------------|-------------|---------------|---------------|----------------|
| Exports | 62.3 | 68.9 | 64.6 | 74.2 | 71.8 | 71.1 | 68.6 | 59.4 | 540.9 |
| Imports | 363.6 | 364.3 | 339.2 | 402.7 | 396.2 | 389.1 | 412.7 | 382 | 3049.8 |
| Balance | -301.3 | -295.4 | -274.6 | -328.5 | -324.4 | -318 | -344.1 | -322.6 | -2508.9 |

Table 3B: External Trade, USD million

| | Jan-Aug 2012 | Jan-Aug 2013 | % change |
|----------------|----------------|----------------|-------------|
| Exports | 486.6 | 540.9 | 11.2% |
| Imports | 2853.4 | 3049.8 | 6.9% |
| Balance | -2366.8 | -2508.9 | 6.0% |



Section 2: Fiscal Operations for Jan-Sep 2013

A. Budget execution highlights:

- **The Total Budget Deficit** during Jan-Sep 2013 amounted to NIS 4.67 billion, an increase of 8% over the same period of 2012. The total balance exceeded its budget target³ by NIS 787 million (20%). **The recurrent budget deficit** for the first three quarters of 2013 amounted to NIS 4.02 billion, exceeding its budget target by NIS 1.1 billion (38%). This increase can be attributed to a shortfall in net revenues and an increase in total expenditures and net lending over their budget targets by NIS 839 million and NIS 268 million, respectively.
- **Gross revenues** for the first three quarters of 2013 amounted to NIS 6.72 billion, falling below the budget target by NIS 523 million due to shortfalls in domestic tax, nontax and clearance revenues by NIS 46 million and NIS 97 million and NIS 381 million, respectively. **Total net revenues** reached NIS 6.07 billion during Jan-Sep 2013, falling short of the budget by NIS 839 million (12%). The larger shortfall in net revenue than in gross revenue was due to the lowering of diesel fuel prices, beginning of April and resulting in larger unbudgeted tax refunds which were above the budget target by NIS 316 million (92%).
- **The wage bill** by the end of the third quarter of 2013 amounted to NIS 5.16 billion and was 1% below the nine month budget, mainly due to the decline in the number of PA employees during 2013.
- **Nonwage expenditures** during Jan-Sep 2013 amounted to NIS 4.37 billion and were on track with the budget target.
- **Net lending** amounted to NIS 550 million during Jan-Sep 2013, and was above the budget target by NIS 325 million, reaching 183% of the annual budget target. This was mostly due to a slower pace of shifting the responsibility of electricity bill collection from municipalities to NEDCO, which the budget assumed would occur at a faster pace.
- **Budget support** disbursement was 89% of its full year budget target while the **development projects financing** was only 18% of the budget target.
- **The Domestic debt stock** declined to NIS 4.46 billion in September 2013, as the Treasury managed to decrease its **domestic debt** by NIS 685 million during the first nine months of 2013.
- **Total net accumulation of arrears** during Jan-Sep 2013 reached NIS 2.2 billion, including development expenditures arrears of NIS 179 million and tax refund arrears of NIS 647 million. Arrears to the private sector, including the "other/VAT" component of tax refunds arrears, amounted to NIS 790 million.

³ The budget target is 9/12 of the 2013 full year budget.

Table 4. Consolidated Fiscal Operations Analysis of Q3 and Jan-Sep 2013 (Commitment Basis)

| | Jan-Sep 2013 | % Jan-Sep 2013/Jan-Sep 2012 | Q3 2013 | %Q3 2013/Q3 2012 | %Q3 2013/Q2 2013 | 2013 Approved Budget | 9 months approved budget | Deviation from the budget target | % of deviation from approved budget | % of 2013 full year budget |
|--|--------------|-----------------------------|--------------|------------------|------------------|----------------------|--------------------------|----------------------------------|-------------------------------------|----------------------------|
| Budget Classification | NIS mill. | % | NIS mill. | % | % | NIS mill. | NIS mill. | NIS mill. | % | % |
| Gross Revenues | 6724 | 6% | 2259 | 3% | 9% | 9662 | 7247 | -523 | -7% | 70% |
| Total Net Revenue | 6066 | 0% | 1996 | -6% | 7% | 9207 | 6905 | -839 | -12% | 66% |
| Domestic Tax | 1614 | 16% | 467 | 10% | -1% | 2214 | 1661 | -46 | -3% | 73% |
| Income Tax | 540 | -1% | 113 | -14% | -7% | 760 | 570 | -30 | -5% | 71% |
| Value Added Tax | 600 | 26% | 198 | 26% | -2% | 734 | 551 | 49 | 9% | 82% |
| Customs | 143 | 16% | 55 | 58% | 41% | 250 | 187 | -45 | -24% | 57% |
| Excises on tobacco | 313 | 40% | 93 | -2% | -13% | 450 | 338 | -24 | -7% | 70% |
| Excises on beverage | 5 | -26% | 3 | -46% | 200% | 9 | 7 | -1 | -20% | 60% |
| Property Tax | 13 | 43% | 5 | 438% | 579% | 11 | 8 | 5 | 61% | 121% |
| Nontax Revenues | 712 | -7% | 204 | -37% | 10% | 1078 | 809 | -97 | -12% | 66% |
| Domestic fees and charges | 712 | 9% | 204 | 1% | 10% | 918 | 689 | 23 | 78% | 78% |
| Civil Registration Fees | 23 | -39% | 2.0 | -77% | -78% | | | | | |
| Health Insurance | 133 | 2% | 43 | 4% | -5% | | | | | |
| Transportation | 71 | 1% | 24 | 11% | -1% | | | | | |
| Licenses | 156 | 5% | 46 | -4% | 85% | | | | | |
| Other charges and fees | 329 | 25% | 90 | 7% | 9% | | | | | |
| Investment Profits | 0 | -100% | 0 | -100% | | 160 | 120 | -120 | -100% | 0% |
| Clearance Revenue | 4398 | 5% | 1587 | 9% | 12% | 6371 | 4778 | -381 | -8% | 69% |
| Customs | 1514 | 4% | 562 | 8% | 14% | 2270 | 1703 | -189 | -11% | 67% |
| Value Added Tax | 1468 | 5% | 521 | 14% | 14% | 2140 | 1605 | -137 | -9% | 69% |
| Petroleum Excises | 1405 | 5% | 503 | 8% | 7% | 1934 | 1451 | -46 | -3% | 73% |
| Purchase Tax | 3 | -59% | 1 | -78% | -125% | 17 | 13 | -10 | -76% | 18% |
| Income Tax | 8 | 46% | 0 | | -100% | 10 | 8 | 1 | 9% | 81% |
| Other | 0 | | 0 | | | | 0 | 0 | | |
| Tax refunds (-) | 658 | 134% | 263 | 229% | 23% | 456 | 342 | 316 | 92% | 144% |
| Total Expenditure and Net lending | 10087 | 3% | 3497 | 3% | 4% | 13092 | 9819 | 268 | 3% | 77% |
| Wage Expenditure | 5163 | 1% | 1727 | -2% | 0% | 6956 | 5217 | -54 | -1% | 74% |
| Social Contribution | 479 | 4% | 159 | -2% | 0% | 608 | 456 | 23 | 5% | 79% |
| Use of goods and services | 1584 | 8% | 624 | 14% | 34% | 1906 | 1430 | 154 | 11% | 83% |
| Transfers | 2205 | 8% | 729 | 11% | -2% | 3055 | 2291 | -86 | -4% | 72% |
| Minor Capital | 19 | 10% | 10 | 40% | 43% | 77 | 58 | -39 | -67% | 25% |
| Interest | 87 | -30% | 19 | -34% | -31% | 190 | 143 | -55 | -39% | 46% |
| Domestic | 75 | -32% | 13 | -51% | -48% | 169 | 127 | -51 | -40% | 45% |
| Foreign | 12 | -15% | 6 | 100% | 98% | 21 | 16 | -4 | -25% | 57% |
| Net Lending | 550 | 5% | 229 | -9% | 4% | 300 | 225 | 325 | 144% | 183% |
| Current Balance | -4021 | 9% | -1501 | 16% | 1% | -3885 | -2914 | -1107 | 38% | 104% |
| Development Expenditure | 651 | 0% | 193 | -22% | -31% | 1295 | 971 | -320 | -33% | 50% |
| Balance | -4672 | 8% | -1694 | 10% | -4% | -5180 | -3885 | -787 | 20% | 90% |
| Financing | 4672 | 8% | 1694 | 10% | -4% | 5180 | 3885 | 787 | 20% | 90% |
| Budget Support | 3617 | 62% | 1349 | 86% | 197% | 4070 | 3053 | 565 | 19% | 89% |
| Development Financing (1) | 204 | -48% | 62 | -70% | -13% | 1110 | 833 | -628 | -75% | 18% |
| Net Domestic Bank Financing | -811 | | -209 | | | | | | | |
| Expenditure Arrears (Net Accumulation) | 1553 | | 588 | | | | | | | |
| Net Clearance (2) | 2 | | 39 | | | | | | | |
| Tax Refunds (Arrears) | 647 | | 254 | | | | | | | |

B. Revenues

Gross revenues in Q3 2013 amounted to NIS 2.26 billion, an increase of 3% over Q3 2012.

Total net revenues were around NIS 2 billion during the 3rd quarter of 2013, declining by 6% over the parallel quarter last year. The decline in net revenues during Q3 2013 is attributed to higher tax refunds in 2013 relative to Q3 2012, due to the government's efforts to reduce the transportation cost burden stemming from high fuel prices to the Palestinian public. Also, domestic taxes (specifically income tax, tobacco excises) underperformed and declined during Q3 2013 when compared to Q3 2012.

Domestic tax revenues amounted to NIS 467 million during the third quarter of 2013, an increase of 10% over Q3 2012. This increase could be attributed to the increase in domestic value added tax and domestic customs during Q3 2013 over the last year's parallel period.

Value added tax reached NIS 198 million during Q3 2013, an increase of 26% over Q3 2012. This increase is mainly due to NIS 43 million received from Arab Bank in September to settle old dues to the treasury.

Domestic customs, which is purchase tax and customs levied on cars that are reevaluated and collected by the PA, performed well during Q3 2013 and amounted to NIS 55 million, a significant 58% increase over the same period last year. During the first six months of 2013, customs were collected from 300 used cars, while customs were collected on another 300 used cars during the third quarter alone, justifying the 58% increase. **Income tax** amounted to NIS 113 million during the third quarter of 2013, a 14% decline over the same period last year. This decline is due to the continued decline in economic growth during Q3 2013.

Excise on tobacco revenue collection slowed down in Q3 2013 after a good run during the first half of 2013. Tobacco excises amounted to NIS 93 million during Q3 2013, a decline by 2% over Q3 2012. This is mainly due to substitution from commercial cigarettes to hand-rolled (roll ups) cigarettes, which are planted in Northern West Bank areas and sold under the counter. This substitution is mainly due to the successive increases in the excises on tobacco, specifically on the "Victory" domestic brand, which is "subsidized" by the PA. The price of victory was raised from NIS 10 in January 2013 to NIS 11, from NIS 11 to NIS 14 on May 14th, and raised again from NIS 14 to NIS 16.5 on August 20th, 2013.

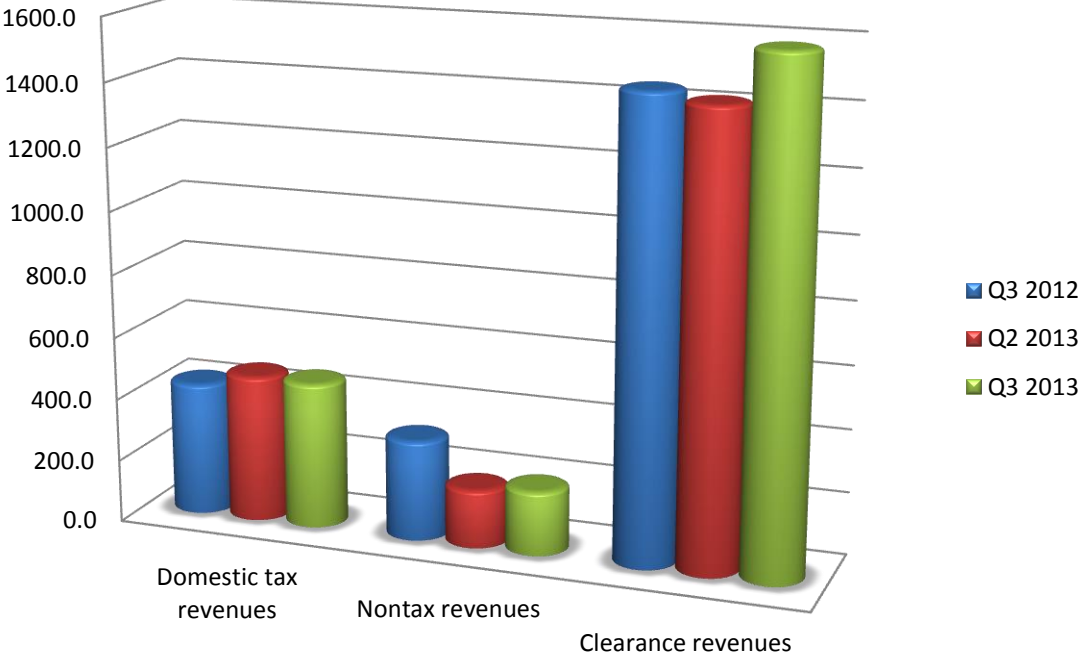
Nontax revenues amounted to NIS 204 million during Q3 2013, a 37% decline over Q3 2012. This decline is mostly related to investment profits, as no dividends were received from the

PIF during Q3 2013, while NIS 119 were received during Q3 2012. Excluding investment profits, **domestic fees and charges** reached NIS 204 during Q3 2013, an increase of 1% over the parallel period of last year. The 2013 budget assumed NIS 160 million in investment profits from PIF, an amount which may not be obtained, since only NIS 62.8 million were received from the PIF in the first quarter of 2013, and receiving additional dividend payments during the remainder of 2013 is highly unlikely.

Clearance revenues, which account for two thirds of PA revenues, amounted to NIS 1.59 billion during Q3 2013, a 9% increase over Q3 2012. The major components of clearance revenues performed better in Q3 2013 relative to the same quarter of 2012. **Value added tax** amounted to NIS 521 million, a 14% increase over Q3 2012. This increase is mainly due to the VAT rate increase to 16% implemented in June 2013. **Petroleum excises** amounted to NIS 503 million, an 8% increase over Q3 2012 due to the increased consumption of petroleum in the West Bank. Also, The PA began receiving petrol excises from Gaza in the clearance revenues, as Gaza shifted to importing from Israel due to the closure of tunnels with Egypt.

Tax refunds amounted to NIS 263 during Q3 2013, a significant 229% increase over Q3 2012, due to the government's policy efforts in 2013 to reduce the transportation cost burden stemming from high fuel prices to the Palestinian public. Diesel fuel prices were reduced during the first half of the year, resulting in large increases in tax refunds from about NIS 40 million per month during the first quarter of 2013, to NIS 70 million per month in May and June 2013. In an effort to reduce tax refunds, the PA decided on July to reduce the "subsidy" on fuel to around NIS 60-65 million per month. The PA began "subsidizing" petroleum products during August 2012 due to social unrest, but the amount of the initial subsidy did not reach the high levels reached in 2013, explaining the significant increase between the parallel quarters.

Major revenue types



C. Total Expenditures

Total expenditures and net lending during Q3 2013 amounted to NIS 3.5 billion, an increase of 3% from the expenditure level in Q3 2012, exceeding the budget target by NIS 268 million mainly due to net lending and use of goods and services. In an attempt to protect the social services provided to the population, particularly education and health, and to improve the quality of expenditure, recurrent allocations for Ministries of Education, Health, and Social Affairs have been increased in the 2013 budget by 2% over 2012. This reflects the government's priorities to achieve greater income equality and social justice.

| Sectors | Recurrent Total Expenditures | 2013 Sector Budget | % of Sector Budget |
|--------------------------------------|------------------------------|--------------------|--------------------|
| Central Administration | 586,128 | 871,669 | 67% |
| Security and Public Order | 2,976,454 | 3,932,917 | 76% |
| Financial Affairs | 921,966 | 1,522,728 | 61% |
| Foreign Affairs | 186,040 | 251,137 | 74% |
| Economic Development | 170,282 | 313,586 | 54% |
| Social Services | 3,853,527 | 5,570,295 | 69% |
| Cultural and Information Services | 134,386 | 234,477 | 57% |
| Transport and Communication Services | 80,507 | 95,310 | 84% |
| Total | 8,909,289 | 12,792,119 | 70% |

Wage expenditure in Q3 2013 amounted to NIS 1.73 billion, a decrease of 2% over the wage bill in Q3 2012. The decline in the wage bill in Q3 2013 compared to Q3 2012 is mainly attributed to the reduction in total number of PA employees in Q3 2013 compared to the parallel period of 2012 by an average of 670 employees. When projected for the full year 2013, the wage bill is expected to remain within its budget target of NIS 6.96 billion. There has been an effective freeze on net hiring in the PNA, in addition to a limited increase in the wage bill by 2%. This is a major retrenchment measure towards controlling PA's expenditures in an effort to lower the recurrent fiscal deficit.

| Sectors | Wages and Salaries | 2013 Sector Budget | % of Sector Budget |
|--------------------------------------|--------------------|--------------------|--------------------|
| Central Administration | 282,765 | 379,061 | 75% |
| Security and Public Order | 2,295,916 | 3,171,500 | 72% |
| Financial Affairs | 165,599 | 234,434 | 71% |
| Foreign Affairs | 104,206 | 138,618 | 75% |
| Economic Development | 135,427 | 187,946 | 72% |
| Social Services | 2,038,448 | 2,654,519 | 77% |
| Cultural and Information Services | 90,164 | 120,250 | 75% |
| Transport and Communication Services | 50,649 | 70,164 | 72% |
| Total | 5,163,174 | 6,956,492 | 74% |

Social contributions in Q3 2013, the social contributions amounted to NIS 159 million, a decrease over Q3 2012 by 2%. The decline in social contribution in Q3 2013 compared to Q3 2012 is mainly attributed to the reduction in total number of PA employees. Social contributions were above budget in the social services administration, specifically in the Ministry of Education. This is due to the rehiring of teachers who were suspended by court order due to security reasons. The number of these employees is around 700.

| Sectors | Social Contribution | 2013 Sector Budget | % of Sector Budget |
|--------------------------------------|----------------------------|---------------------------|---------------------------|
| Central Administration | 21,908 | 30,446 | 72% |
| Security and Public Order | 218,838 | 303,811 | 72% |
| Financial Affairs | 15,715 | 17,618 | 89% |
| Foreign Affairs | 2,164 | 2,839 | 76% |
| Economic Development | 13,009 | 17,708 | 73% |
| Social Services | 193,610 | 217,772 | 89% |
| Cultural and Information Services | 8,547 | 11,129 | 77% |
| Transport and Communication Services | 4,873 | 6,871 | 71% |
| Total | 478,665 | 608,194 | 79% |

Use of goods and services amounted to NIS 624 million during the third quarter of 2013, an increase over Q3 2012 by 14%. Use of goods and services were significantly high for Transport and Communication Services, mainly due to the payment of arrears accumulated from previous years to the Ministry of Communications and Information Technology for an amount of NIS 15.5 million. The Ministry of Health is severely affected by the liquidity crisis the PA is facing, but despite the crises, the government repaid arrears in July to hospitals, mainly in Jerusalem, an amount of NIS 97 million.

| Sectors | Use of Goods& Services | 2013 Sector Budget | % of Sector Budget |
|--------------------------------------|-----------------------------------|---------------------------|---------------------------|
| Central Administration | 182,024 | 307,213 | 59% |
| Security and Public Order | 248,243 | 323,125 | 77% |
| Financial Affairs | 37,751 | 65,060 | 58% |
| Foreign Affairs | 66,699 | 90,980 | 73% |
| Economic Development | 21,093 | 48,932 | 43% |
| Social Services | 481,593 | 963,072 | 50% |
| Cultural and Information Services | 34,384 | 91,528 | 38% |
| Transport and Communication Services | 24,691 | 16,025 | 154% |
| Total | 1,096,477 | 1,905,935 | 58% |

Transfers in Q3 2013 amounted to NIS 729 million, an increase over Q3 2012 by 11%. When projected for the full year, transfers are likely to reach the full year budget target of NIS 3.05 billion.

| Sectors | Transfer Expenditure | 2013 Sector Budget | % of Sector Budget |
|--------------------------------------|-----------------------------|---------------------------|---------------------------|
| Central Administration | 98,765 | 149,000 | 66% |
| Security and Public Order | 211,576 | 120,000 | 176% |
| Financial Affairs | 591,682 | 1,008,900 | 59% |
| Foreign Affairs | 10,079 | 13,600 | 74% |
| Economic Development | - | 53,500 | 0% |
| Social Services | 1,136,425 | 1,709,733 | 66% |
| Cultural and Information Services | - | 300 | 0% |
| Transport and Communication Services | - | - | |
| Total | 2,048,527 | 3,055,033 | 67% |

Minor capital expenditures in Q3 2013 amounted to NIS 10 million. This amount reached only 25% of its 2013 budget target by the end of the third quarter of 2013. This is mainly due to the liquidity crisis the PA is facing.

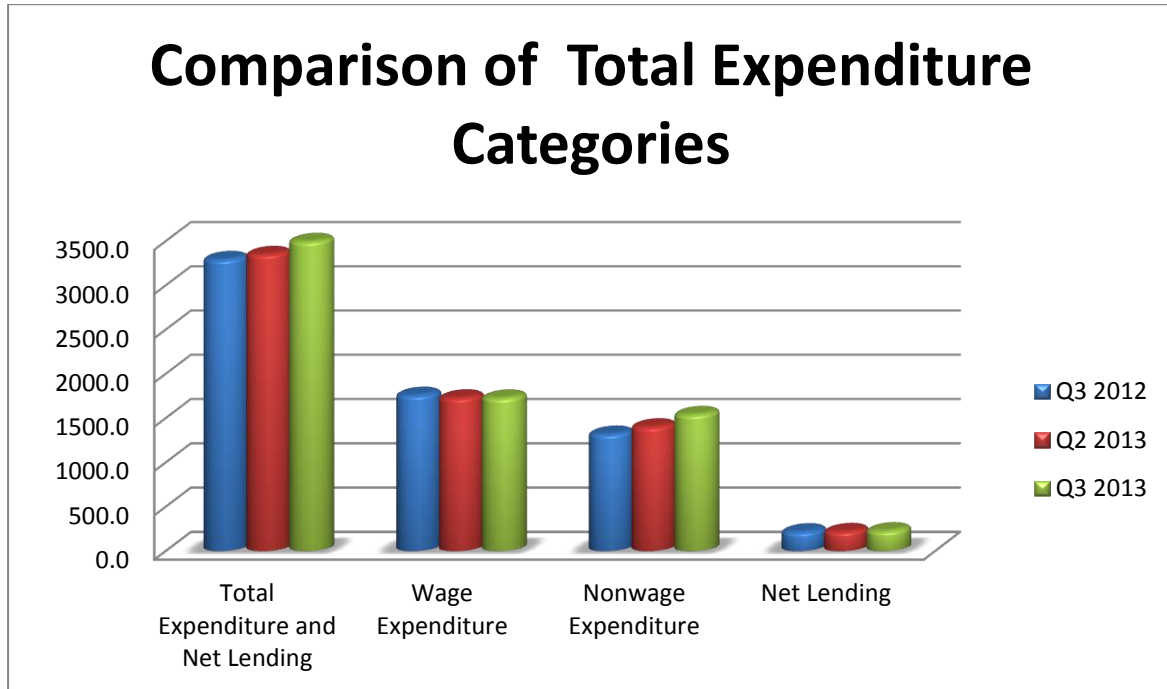
Interest (both domestic and external) in Q3 2013 amounted to NIS 19 million, a decline over Q3 2012 by 34%. For the first three quarters of 2013, interest payments amounted to NIS 87 million, a 30% decline over interest payments during the same period of 2012. Interest during Jan-Sep 2013 reached 46% of the annual budget target falling short by NIS 55 million.

Net lending amounted to NIS 229 million in Q3 2013, a decline of 9% over Q3 2012. Net Lending during Jan-Sep 2013 amounted to NIS 550 million, an increase of 5% over the same period of last year, mainly due to Israeli deductions in Q3 2012 to repay electricity debts to the Israeli Electric Company (IEC).

Net lending was above its budget target by NIS 325 million. The 2013 budget assumed that progress to reduce net lending would be made by increasing the number of customers for the Northern Electricity Distribution Company (NEDCO), installing additional prepaid meters and limiting deductions at source by the Israeli authorities. The impact of these policies assumed in the budget did not materialize at the expected pace.

Development expenditures, on a commitment basis, channeled through the PA Treasury amounted to NIS 651 million during Jan-Sep 2013, remaining at the same level of the parallel period of 2012. Development expenditures during Jan-Sep 2013 were below the

budget target by NIS 320 million. Development expenditures amounted to NIS 193 million during Q3 2013, which is lower than the levels disbursed in Q3 2012 by 22%. This is mainly due to large shortfalls in external financing for development projects. Development expenditures were only 50% of the full year budget.

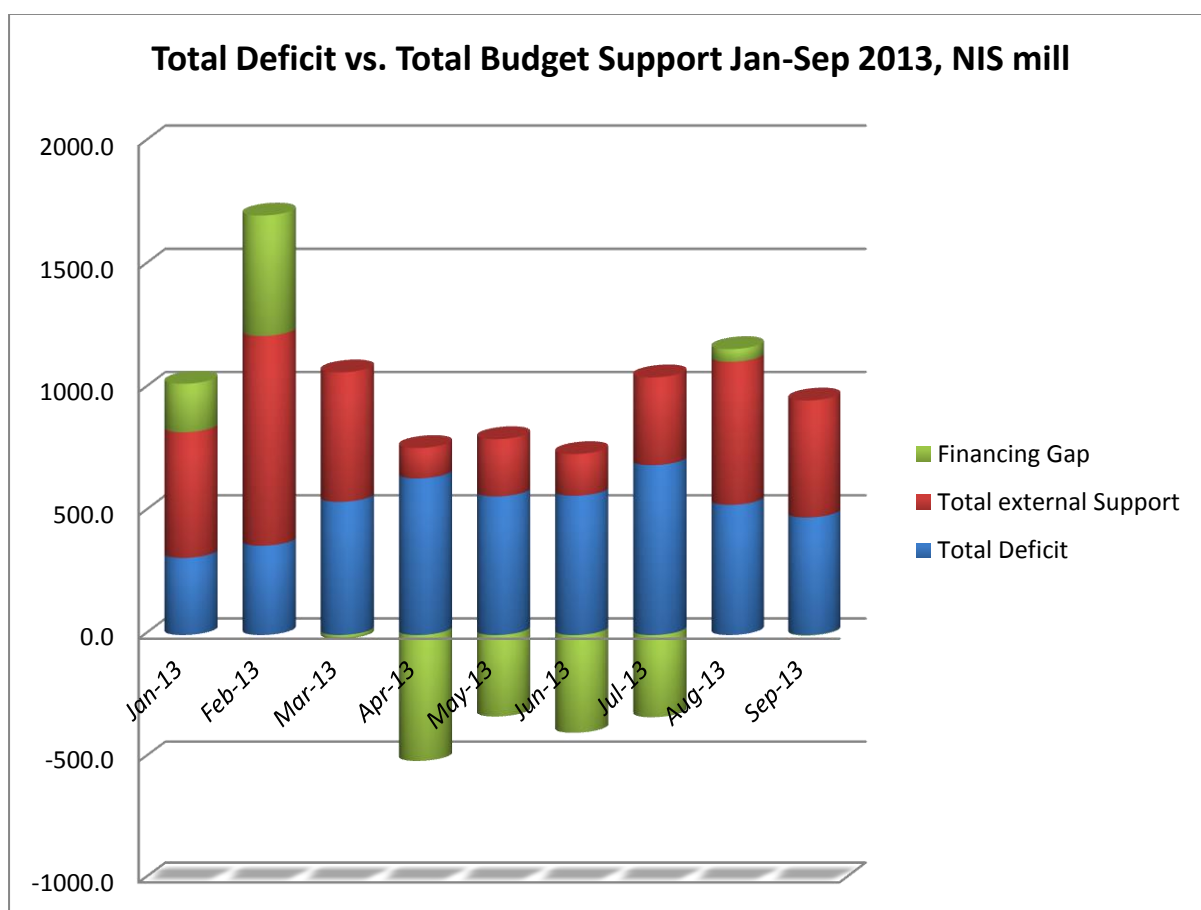


D. Balance and Financing

Balance: during the third quarter of 2013, the recurrent budget deficit amounted to NIS 1.5 billion, a 16% increase over the third quarter of 2012. The total deficit during Q3 2013 amounted to NIS 1.7 billion, an increase of 10% over the Q3 2012.

Financing: During the third quarter of 2013, external budget support amounted to NIS 1.35 billion (USD 374.8 million), an 86% increase over the same period of 2012. External budget support reached 89% of the full year budget target, while it exceeded its 9-month budget target by NIS 565 million. This is mainly due to large contributions made by Saudi Arabia and the USA during the first 9 months of 2013.

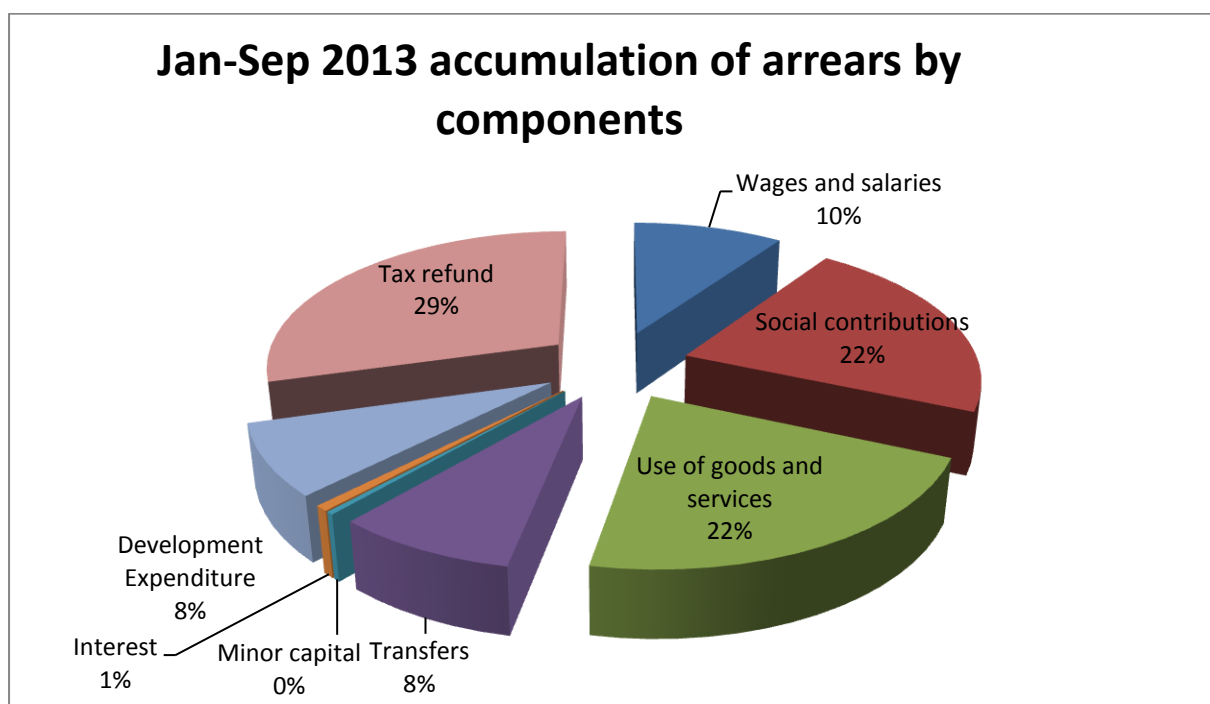
Development financing amounted to NIS 62 million (around USD 14 million) during the third quarter of 2013, which is 70% lower than the amount disbursed during the same period last year. The Development financing amount received during the first nine months of 2013 was only 18% of the annual budget for development financing.



E. Arrears

Total net accumulation of arrears during the first nine months of 2013 amounted to NIS 2.2 billion including development expenditures arrears of NIS 179 million and tax refund arrears of NIS 647 million. Payment arrears to the private sector⁴ have accumulated to NIS 790 million. The accumulated monthly wage arrears of NIS 50-55 million are the employee share not transferred to the pension fund.

| Budget Classifications | NIS mill |
|---------------------------|-------------|
| Wages and salaries | 214 |
| Social contributions | 478.7 |
| Use of goods and services | 474.5 |
| Transfers | 184.8 |
| Minor capital | 7.6 |
| Interest | 14.1 |
| Development Expenditure | 179.3 |
| Tax refund * | 647 |
| Total | 2200 |



⁴ Payment arrears to private sector include use of goods and services, minor capital, development, interest, and the "other"/VAT component of Tax Refunds