

COUNTRY RISK CATEGORY

7/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.



EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 0 MILLION**MEDIUM AND LONG-TERM TRANSACTIONS:** SEK 0 MILLION

DATE

22/1/2015

Gloomy economic outlook without lasting peace

The Palestinian economy will remain weak unless there is a permanent solution to the conflict between Palestine and Israel. The peace process has been suspended and new armed conflicts between Hamas and Israel are constantly flaring up, most recently the war in Gaza in the summer of 2014. Israel continues to occupy the West Bank and is continuing its blockade of Gaza. It is highly uncertain whether an independent and autonomous Palestinian state can be formed in the foreseeable future. The Palestinian economy will continue to be controlled by political events and donor assistance. The economic prospects for Palestine are gloomy, given that the peace process has been suspended and development assistance has been reduced in recent years.

EKN has positive, albeit little, experience of covering payment risks in Palestine. EKN's policy for the provision of guarantees to Palestine is generally very restrictive. Sweden recognised the State of Palestine on 30 October 2014. Consequently, EKN is changing the name of the Palestinian territories from Gaza/West Bank to the State of Palestine.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Historically extensive financial assistance from the international community.
- Healthy banking sector given the difficult operating environment.
- EKN's positive payment experience.

Weaknesses

- Suspended peace process with poor prospects of lasting peace.
- Dependence on development assistance that creates major economic fluctuations.
- A weak business climate, particularly in terms of the legal system, the regulatory environment and underdeveloped public institutions.

EKN'S POLICY

EKN has classified Palestine in country risk category 7 out of 7 – an assessment undertaken in collaboration with the OECD. EKN's policy for the provision of guarantees is restrictive, which is in line with most other export credit agencies. Payment risks on transactions with the Palestinian Authority can be accepted, provided that there is co-financing with multilateral lenders or international banks. Bank of Palestine is recommended for bank risks. Other banks are assessed on a case-by-case basis. Risk-sharing with the guarantee holder and a strong financing structure are required for corporate risks. The exporter's past experience of the buyer is given special consideration.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- A breakthrough in the peace talks with Israel.
- Easing of Israel's trade restrictions on the Palestinian territories.
- Political reforms that improves the conditions for the private sector.

The policy may be made more restrictive in the event of

- New armed conflicts with Israel.
- Exacerbated internal political conflicts.
- A reduction in development assistance that has a negative impact on growth and the public finances.

EKN'S EXPOSURE AND EXPERIENCE

Little but positive experience

EKN has issued guarantees for six export transactions to Palestine in the 2000s. Most of the guarantees were for telecom transactions. The total guarantee amount was over SEK 350 million. EKN's payment experience has been good, without delays or claims. EKN has no outstanding exposure at present.

COUNTRY ANALYST



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DISCLAIMER

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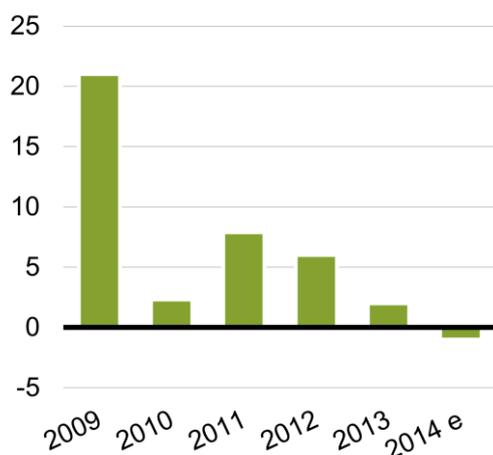
Political risks and aid dependence holding back the economy

Palestinians in the West Bank and Gaza were given the right of partial self-governance when the Palestinian Liberation Organisation (PLO) recognised the right of Israel to exist in 1993. Palestinian rule was split in 2007 between anti-Israel Hamas in Gaza and an increasingly weak PLO in the West Bank. Hamas opposed the peace process aiming to form an independent Palestinian state. Israel then initiated a blockade of Gaza, which has been blocked off ever since. A new round of peace talks began in 2013, but no concrete progress is expected in the short term. In addition, the coalition government between Fatah and Hamas has not resulted in any meaningful progress, neither with respect to strengthening the PLO's control in Gaza nor creating a unified Palestinian negotiating position vis-à-vis the Israelis. The gap between Israelis and Palestinians seems to be insurmountable.

The Palestinian Authority (PA) is the overall political authority in the Palestinian territories. Mahmoud Abbas is the chairman of the PA, even though his term of office ended in 2009. He has remained in office with support of the PLO. The PA and the PLO have no formal connection, but the PLO dominates the administration of the PA. Budgetary assistance for the PA has fallen steadily following record-breaking inflows in 2008. The fiscal austerity enforced to manage this has been insufficient. The already fragile public finances have been weakened even more by the war in Gaza, which is putting the provision of basic public services by the PA in jeopardy.

The Palestinian Monetary Authority regulates the Palestinian banking sector and is an embryo of a future Palestinian central bank. Palestine does not have its own currency. Instead, it uses the Israeli shekel, the Jordanian dinar and the US dollar. Trade in the West Bank is mainly in shekels, while development assistance is received in dollars. Both the shekel and dinar are convertible currencies and there are no formal restrictions on transferring these currencies. The transfer risk in Palestine is largely attributable to Israel and Jordan on account of the currencies of these countries. Given the circumstances, the banking sector functions well and is financially sound. The large exposure of the banks to the PA and limitations on the liquidity management of the banks, as a result of the lack of their own currency, also increases credit risks.

GDP GROWTH (% PER YEAR)



Growth has fallen since 2011. Data: World Bank

The economic outlook is directly linked to the political factors and the inflow of development assistance. The largest economic obstacles continue to be the inability of the Palestinians to get access to land and resources in territories occupied by the Israelis and the import and export restrictions imposed by Israel. Growth was strong until 2011 thanks to large inflows of development assistance. The economic growth has been declining ever since due to increased political turbulence, especially in Gaza where the trade blockade and recurring wars have led to unemployment, poverty and a worsening situation for the export-oriented

private sector. In 2014, the Palestinian economy went into recession, as a result of the war in Gaza. The World Bank estimates that the economy shrank slightly in 2014. The slowdown is not as bad in the West Bank, which accounts for 70% of the Palestinian economy, as in Gaza. The growth prospects for the coming years are weak and uncertain in light of the political conditions.

BUSINESS ENVIRONMENT

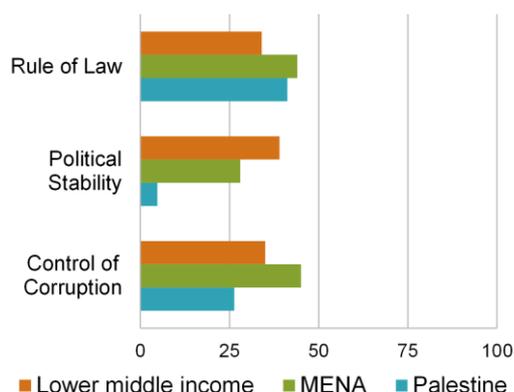
Corruption and weak regulatory environment

The political instability and security problems are holding back the development of a favourable business and investment climate. The World Bank ranks the business climate in the West Bank and Gaza in 143rd place out of 189 countries, which is in the lower half of countries in the Middle East and North Africa. There are problems in relations with government authorities, trade barriers and bankruptcy proceedings.

The legal system is suffering from a lack of independence and is fragmented between the West Bank and Gaza. Many laws are obsolete and there is a lack of formal regulation in several key areas, such as competition and trade. Corruption is a serious problem. Nepotism and the exploitation of contacts or influence to get things done are widespread in Palestinian society, such access to public services and official permits. No significant changes to the

business environment are to be expected in the immediate future.

BUSINESS ENVIRONMENT
Ranking from 0 (worst) to 100 (best)



Political stability is weak. Source: World Bank

The EU has had an interim association agreement with the Palestinian Authority since 1997 which includes trade issues. Israel's occupation and trade restrictions are nevertheless limiting factors for Palestinian trade. Swedish exports to Palestine fluctuate sharply, and were only SEK 13 million in 2013. Telecom equipment is the largest export product.