Research Department

Jordan Economic Report

March 25, 2015

Major Developments:

- **Economic activity has gradually improved, helped by a recovery in mining and strong construction sector. Growth stood at 3% in the first three quarters of the year, and is estimated to increase to 3.1% in 2014, up from 2.8% in 2013.**

- **Growth remains subdued indicating high uncertainty is still weighing on economic activity. Still, savings from oil consumption should boost domestic demand and lower pressure on trade deficit, helping to fuel growth closer to 4% this year. Economic growth in 2015 will solely depend on the private sector, as government expenditures are expected to remain unchanged.**

- **Annual inflation fell to 2.8% in 2014, as the impact of the fuel price liberalization faded. Rent was the main contributor to inflation, as rent prices increased by 6.9% due to the increased demand from Syrian refugees. For 2015, continued low growth rates and low energy prices are expected to keep inflation rates in check.**

- **After resuming in late 2013, gas inflows from Egypt were volatile throughout 2014. This, together with a growing number of Syrian refugees, continue to place pressure on the country's fiscal and external accounts.**

- **According to the 2014 budget, the central government deficit is projected to narrow to around 4.3% of GDP this year. For the first eleven months of the year, the fiscal deficit narrowed by JD 201 million compared to the same period last year.**

- **Meanwhile, the fiscal deficit excluding grants, was projected to widen according to the 2014 budget to around JD 2.3 billion or 8.7% of GDP, highlighting the country's continued dependence on volatile foreign grants.**

- **For this year, the drop in international oil prices will help the government to fully phase out energy subsidies, and play a large role in easing losses incurred by the National Electricity Power Company (NEPCO). This should ease the government's gross deficit to 4.4% of GDP compared to 10.1% in 2014.**

- **Gross public debt continued to trend upwards, and increased to an estimated 90% of GDP in 2014. However, we project that in a $55 oil price environment, the public debt will drop to around 88.7% in 2015. Other energy projects and structural reforms , including the recently approved income tax law, would place public debt on a downward path from 2016 onward.**

- **According to official forecasts, domestic borrowing seems to be increasing over the coming years. However, the projected drop in NEPCO losses and the expected emergence of the local Sukuk market early next year will likely bring some relief to the government, easing pressures on interest rates.**

- **The Central Bank of Jordan (CBJ) continued to restore trust, rebuilding its international reserves buffer to record highs covering about 7.3 months of imports in 2014, around $14.1 billion.**

- **In 2014, the current account deficit declined to an estimated 7.3% of GDP on the back of higher-than-programmed grants, down from around 10% in 2014. The IMF expects the current account to GDP to fall to 5.9% in 2015, mainly due to a drop in the oil bill. Nevertheless, risks to the current account remain high in 2015, mostly due to significant regional risks.**

- **Central Bank of Jordan introduced a new monetary framework in February, aiming at encouraging banks to lend to the private sector and allocate liquidity more efficiently.**

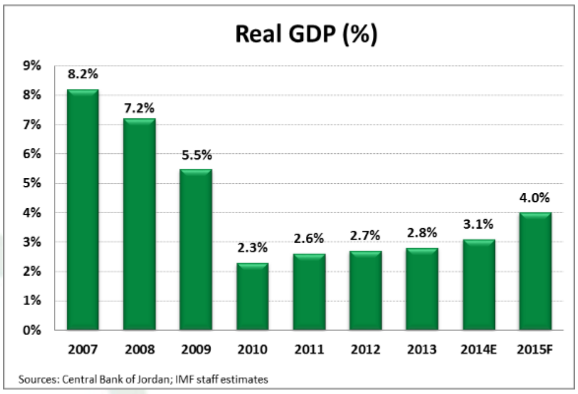
- **CBJ cut the O/N window facility rate by 1%, and introduced weekly Certificate of Deposits worth JD 1 billion. It also cut benchmark interest rates by 25 basis points, as anticipated by CAB in previous reports, pressing ahead with its expansionary policy and reassuring its trust in the economy and political stability, after it previously cut rates by 75bp in 2014, and 50bp in 2013.**

- **Government bond yields plunged significantly since the central bank's announcement, after remaining low throughout 2014.**

- **Interest rates are likely to continue to fall before stabilizing at low levels over the next few months.**

Economic growth expected to remain lackluster in the short-term

Economic activity improved gradually, GDP grew by 3.1% in Q3 of 2014, up from 2.8% in Q2 of the year, according to official data; while growth is estimated to have increased by 3.1% for the full year, up from 2.8% in 2013.



Sources: Central Bank of Jordan; IMF staff estimates

GDP growth remains well below a 7.4% average growth rate witnessed between 2005 and 2009, and below the 6.1% IMF estimate that would be needed to absorb new entrants to the labor market – partly due to ongoing political instability and weakened fiscal metrics.

Growth in the third quarter was driven by growth in the construction, wholesale and retail trade, and quarrying sectors, while the utilities sector was the only sector to contract over the same time period.

The construction sector grew by 12.5% in the third quarter, surpassing average quarterly growth levels of 8.7% in 2013, possibly driven by an increase in capital expenditure by the government and continued demand from the Syrian refugees. The sector had hinted at a slowdown in the first 2 quarters of the year, but has picked up again in Q3.

The wholesale and retail trade sector grew by 4.8% from Q3 2013, as the number of Syrian refugees who have entered the country increase consumption activity, while the sector was also helped due to an increase in tourism activity.

The recent decrease in international oil prices could help elevate growth levels in the sector, as it will improve the purchasing power and disposable income of consumers, which should help offset the hike in electricity prices.

Quarrying registered the highest growth level when compared to Q3 of 2013, growing by 43.7%, and up from 1.6% in Q2. The growth could be attributed to higher exports level in both potash and phosphates, which were up by 0.9% and 24.7% respectively in 2014.

Meanwhile, industrial production indicators show that potash production levels grew by 20% in 2014, while phosphate production levels grew by 35% over the same time period. However, major quarrying companies' aggregate profits for 2014 showed a drop when compared to 2013, indicating higher operation costs, low investment levels, and high international competition.

The tourism sector registered a growth level of 1.9% in Q3 of 2014 compared to Q3 of 2013, down from an average growth level of 5.5% during the first 2 quarters of the year. The drop can be attributed to lower receipts, which grew by 0.6% in Q3, compared to 11.2% and 15.6% in Q1 and Q2 respectively. Moreover, although the overall number of tourist show a growth of 5.1% up to the third quarter of 2014, the number of visitors in Q3 dropped by 17.2% when compared to a year ago, compared to a growth of 9.3% and 17.5% in Q1 and Q2 respectively.

Other reports show that the sector is still threatened in other aspects, as four hotels were forced to close down in 2014 in Petra due to lower number of visitors, highlighting the strain placed on the sector due to political unrest in the region, especially with the recent developments. In addition, recent income tax law and previous fiscal reforms have also increased the burden on the activity and profitability of the sector.

Meanwhile, credit extended to the tourism sector show that investment levels in the sector are accelerating. More recently, an initiative led by the Ministry of Tourism and the private sector provides subsidized trips within Jordan for Jordanians in an effort to revitalize the sector.

On the other hand, the utilities sector was the only sector to contract in Q3, down by 1.1% compared to a year ago, and is likely due to a slowdown in the population growth compared to a year ago, which had generated extra demand for basic needs of water and electricity. The sector has potential to grow, given the recent local and international focus on mega projects and renewable energy.

Unemployment levels remained stubbornly high at around 12% in 2014 due to weak growth, while unofficial estimates place the figure higher at around 25%. The unemployment rate has remained high due to the abnormal growth in the population and a growing labor force resulting from an accelerating number of young Jordanians entering the workforce.

Meanwhile, statistics show that demand for non-Jordanians laborers is increasing, probably due to the influx of Syrian refugees providing cheaper labor, eating away from the number of new Jordanians being employed. Another statistic shows that around 50% of new jobs created do not need university degrees, highlighting the structural mismatch between the jobs required and the skilled-laborers available.

Looking ahead, economic growth in 2015 will be solely dependent on growth in the private sector, as the government's budget show that it fixed its expenditure in 2015 compared to 2014. The private sector should get a boost given the expansionary monetary policy taken by the CBJ, which should result in higher credit to the private sector. Growth will also be dependent on capital inflows, political stability and an increase in disposable income resulting from a drop in international oil prices, which could result in demand-driven growth.

However, the country remains vulnerable to external pressures, such as a rise in international oil prices, a slowdown in foreign aid, and a continued influx of refugees, all of which place stress on fiscal balances. High uncertainty is expected to continue limiting growth levels, as investors remain reluctant to invest given the political climate.

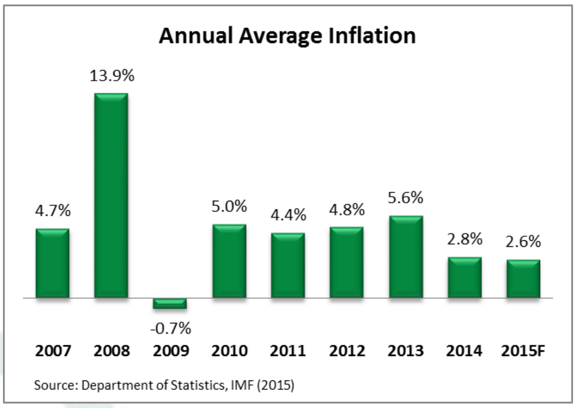
Inflation expected to remain subdued through 2015

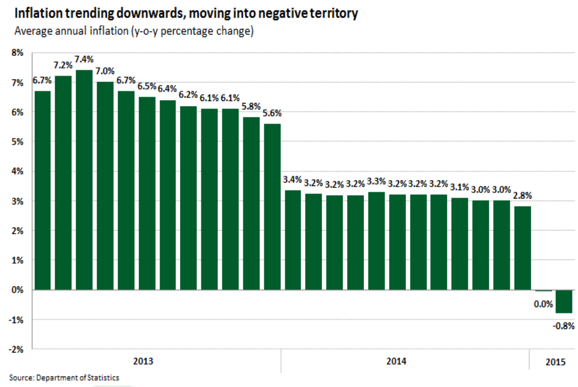
Average annual inflation registered -0.8% during the first two months of 2015, indicating low inflationary pressure for the time being. Nevertheless, the IMF forecasts inflation to grow 2.6% in 2015.

The drop inflation was mainly driven by a drop in transport costs (down 16.5%) and fuel and electricity (down 11.3%), probably due to the significant drop in international oil prices compared to the same time period a year ago. Meanwhile, vegetable prices dropped 8.0%, while drinks and beverage price were down 1.1%.

On the other hand, rent prices are still rising, with an increase of 5.8% over the same time period, driven by demand from Syrian refugees. Moreover, tobacco prices are up 8.2% and fruits up 12.6%.

Looking ahead, if international oil prices remain at current levels or continue dropping, it is expected that inflationary pressures will remain low in Jordan. Moreover, low levels of economic growth are expected to contribute to keeping inflation levels low. On the other hand, the rise in electricity tariffs introduced at the beginning 2015 is expected to place some upward pressure on inflation rates.





Jordan's fiscal metrics improves, helped by drop in oil prices

One of the main challenges facing the Jordanian economy remains its high and rising debt levels and continued fiscal imbalances, however, the country's fiscal metrics have improved recently.

The central government's budget deficit has narrowed over the past couple of years from 8.3% of GDP in 2012 to an expected 4.3% in 2014, around JD 1.1 billion. The improvement was mostly due to a surge in grants, especially GCC grants earmarked for developmental projects, expenditure enhancing measures (including the removal of fuel and other subsidies, electricity tariff hikes) and revenue enhancing measures; especially from licenses for telecom companies.

According to the latest government figures released by the Jordanian Ministry of Finance, the fiscal balance improved in the first eleven months of 2014 compared to the previous year. Jordan's fiscal deficit narrowed by around 18% in the January – November period to reach JD 900 million compared to JD 1,101 million for the same period of 2013.

JD Million	Jan - Nov 2014	Jan - Nov 2013
Total Revenues and Grants	**6,055.0**	**5,111.6**
Domestic Revenue	5,299.4	4,532.2
Foreign Grants	755.6	579.4
Total Expenditures	**6,954.9**	**6,212.4**
Current Expenditures	6,076.4	5,500.5
Capital Expenditures	878.5	711.9
Fiscal Deficit/Surplus Including Grants	**-899.9**	**-1,100.8**
Fiscal Deficit/Surplus Excluding Grants	**-1,655.5**	**-1,680.2**

Source: Minisrty of Finance

JD Million	2012	2013	2014E	2015F
Central Government Fiscal Deficit				
Fiscal Deficit Including Grants	1,824	1,307	1,114	630
Percent of GDP	8.30%	5.40%	4.30%	2.20%
Fiscal Deficit Excluding Grants	2,151	1,946	2,265	1,758
Percent of GDP	9.80%	8.10%	8.70%	6.38%
Gross Fiscal Deficit Including Public Entities				
Fiscal Deficit Including Grants	3,424	2,564	2,614	1,230
Percent of GDP	15.60%	10.70%	10.10%	4.40%
Fiscal Deficit Excluding Grants	3,751	3,203	3,765	2,358
Percent of GDP	17.00%	13.40%	14.50%	8.56%

Source: Ministry of finance; CAB (2015F)

The JD 201 million decrease in the budget deficit was a result of a JD 943 million increase in total revenues and grants which offset a JD 742 million increase in total expenditures.

Domestic revenues increased by around 17% for the same period, covering 87.2% of current expenditures up from 82.3% for the same period the previous year.

One main development in 2014 was an unrepeatable JD 300 million increase in revenues, resulting from licenses sold to telecom and electricity companies. While this development helped to impede further widening in the fiscal deficit, the government will need to come up with new measures for next year if it plans to increase domestic revenues for the year 2015. The approval of the revised income tax reform late 2014, should increase tax revenue in 2015, supporting the country's fiscal metrics.

Overall, the structure of public finances remains dependent on potentially volatile donor support. Grants finance more than a third of the budget deficit.

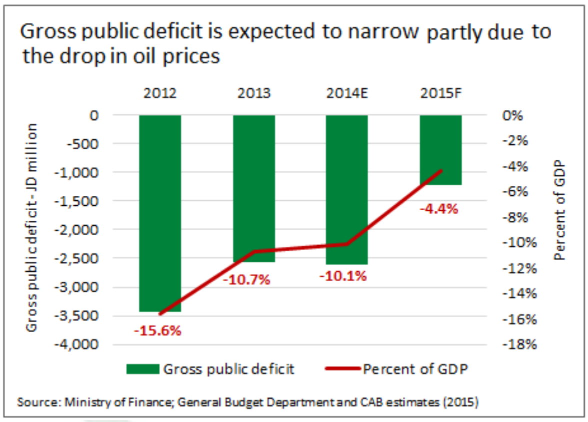
Foreign grants increased by JD 176 million to JD 756 million in the first eleven months of the year, compared to the same period in 2013. This indicates that grants have started to be committed after sluggish growth in the first half of the year.

The fiscal balance excluding grants narrowed by around JD 25 million to reach JD 1,656 million in the first eleven months of the year, compared to the same period last year. This decrease indicates that the deficit before grants seems to outperform official forecasts for 2014. However, the budget deficit excluding foreign grants is estimated to have remained high in 2014 at 8.7% of GDP.

Meanwhile, as Jordan remains highly energy dependent, gas supply interruptions from Egypt have continued to place pressure on the National Electric Power Company - underscoring the country's ongoing vulnerability to commodity and external shocks.

NEPCO, which is supported by the government, incurs large operational losses estimated at 5.5% of GDP in 2014, around JD 1.4 billion. This brings the gross deficit, including public entities, in 2014 up to an estimated JD 2.6 billion or 10.1% of GDP after grants, and JD 3.8 billion or 14.5 % of GDP before grants.

On the upside, low oil prices will help Jordan to fully phase out energy subsidies, with estimates of fiscal savings[1] of around 1-2% of GDP if oil averages around $55 per barrel in 2015.

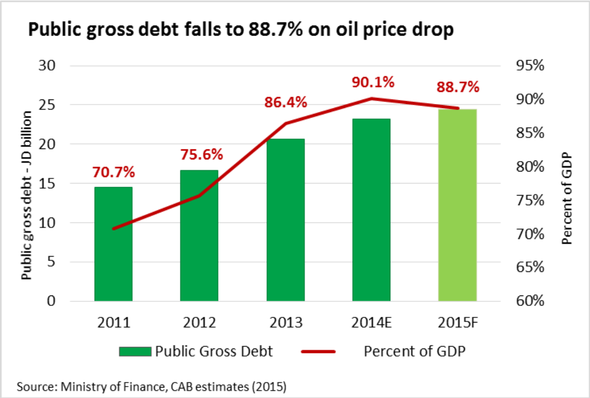


[1] The 2015 budget uses a conservative oil price assumption of $100 per barrel and low income households receive compensation when oil prices are above $100

Moreover, low oil prices will play a larger role in easing losses incurred by NEPCO. That combined with a 7.5% increase in electricity tariffs in January, and the near completion of a liquefied natural gas (LNG) import terminal means that NEPCO's losses will decline in 2015.

Overall we project that the gross deficit will narrow to an estimated 4.4% of GDP in 2015. However, according to IMF estimates, clearing NEPCO's arrears could add 0.8% of GDP to the deficit.

Nevertheless, continued pressures to maintain social spending and the added strains from the Syrian refugee influx will add some pressure on the country's fiscal account.



Debt on a more sustainable path in view of lower oil prices

The country's public debt has been trending upwards, as the public gross debt-to-GDP is expected to have increased to 90.1% in 2014, according to IMF estimates, from 75.6% in 2012.

Preliminary figures by the Ministry of Finance show that gross public debt reached around JD 22.8 billion by the end of November 2014, around 89.0% of GDP; increasing by around JD 2.1 billion in the first eleven months of the year.

Meanwhile, arrears to related government entities and private sector are still significant and there seems to be no major improvement in clearing them, adding pressure on public finances.

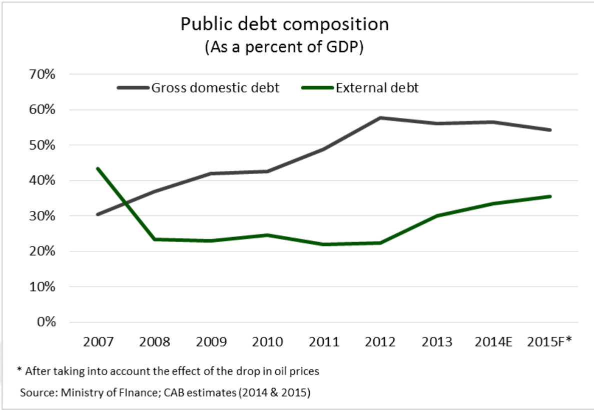
The accumulation of debt projected in the next couple of years seems to be significant, and according to the IMF baseline scenario, it is projected that public debt would peak at 90.4% in 2015.

However, in a $55 - $60 oil price environment, we project that public debt-to-GDP will actually fall to around 88.7% compared in 2015. Moreover, the new electricity tariff, near completion of the LNG terminal, and other prudent measure such as the approved income tax law should place public debt on a more sustainable path from 2016 onward.

Despite the rising public debt, the structure of Jordan's government debt is becoming more favorable. In 2014, around 31% of gross debt was external debt with low servicing cost and long maturities.

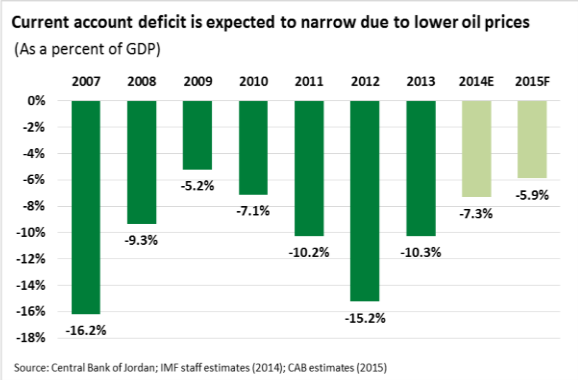
External borrowing has increased significantly in the last couple of year,increasing by around JD 800 million in 2014, though it is likely to reach lower levels in 2015.

Sources of external funding are becoming limited especially in view of high payments and redemptions, which indicates that the government will likely face challenges to increase borrowing from external markets in the next couple of years.



According to the government's forecasts from the 2015 Budget Law, the government expects to finance most of its budget deficit in the coming years by domestic borrowing.

Despite high projected levels, pressure on internal borrowing will likely ease this year. The expected drop in NEPCO losses due to the drop in oil prices will lead to less need of domestic borrowing. In fact according to our estimates, this should bring net domestic borrowing down to around JD 550 million; almost halve what was budgeted in 2015 and down from around JD 1,300 million in 2014.

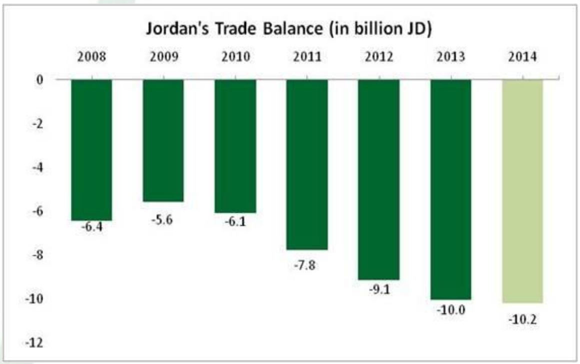


Moreover, the emergence of the Sukuk market of around $500-750 million in 2015 will provide a new source of funding for the government. The Sukuk funding will enable the government to borrow from Islamic banks that have more than JD 1 billion of excess liquidity, at cheaper rates when compared to conventional bonds borrowing from local commercial banks

Therefore, we do not expect any upside pressure on the interest rate outlook from domestic borrowing.

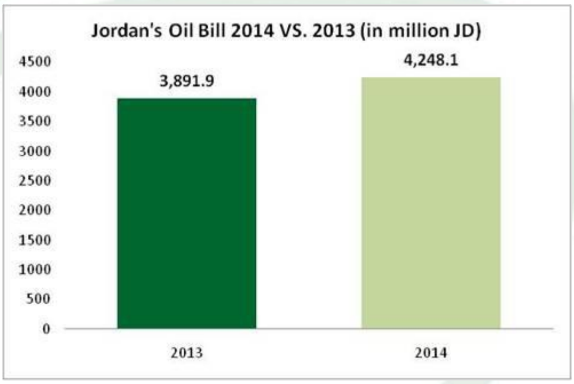
External positions remain under pressure

Jordan's external position continues to be strained by a growing import bill, lower capital inflows and public transfers. The current account deficit was expected to remain high at 10% of GDP for 2014.



However, higher-than-programed grants more than offset higher energy costs, bringing IMF estimates for the current account down to 7.3% of GDP.

In fact, the latest data, show that the current account deficit narrowed to 5.4% of GDP in the first 9 months of 2014, compared to 6.9% of GDP for the same period the previous year.

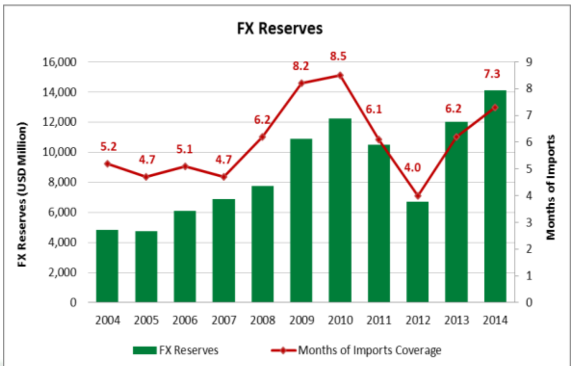


Meanwhile, the decline in international oil prices should ease pressure on Jordan's external balances this year. The 2015 current account deficit is now projected to narrow to 5.9% of GDP, on the back of a significant drop in the oil bill.

Jordan's trade deficit grew by 1.4% in 2014 to reach JD 10.19 billion, despite the significant drop in oil prices towards the end of the year, highlighting the impact of Syrian refugees on Jordan's trade balance.

Oil imports, which made up 26% of Jordan's total imports in 2014, grew by 9.2% in 2014, or JD 356 million, indicating low inflow levels of Egyptian gas and increased domestic consumption.

The government is taking steps to ease the pressure of the energy bill on the Kingdom's trade balance. Last year, the government signed an initial agreement to import natural gas from Noble Energy, though imports are likely to start in 2017 and the deal is still being disputed in Parliament. Meanwhile, Jordan is building a liquid natural gas (LNG) aiming at diversifying the country's energy sources. On the other hand, the recent political unrest in Iraq could hurt bilateral trade relations and the plan to build a proposed oil pipe between Basra and Aqaba, which will bring down transport and oil costs.



Source: Central Bank of Jordan

Moreover, the drop in oil prices should lead to a drop in the oil import bill and reflect positively on the trade balance in 2015.

Meanwhile, total imports grew by 7.6% in 2014, as other imports such machinery equipment and vehicles grew by 13.2% and 20.8% respectively, while electronics imports dropped 29.5% after they grew by 52.1% in 2013.

On other hand, national exports grew by 7.5% in 2014, while re-exports dropped by 2.8% over the same time period. The drop in re-exports could be attributed to a disruption in trade routes, as well as political instability in bordering countries resulting in lower demand from the countries.

The rise in national exports was driven by a 28.8% increase in fertilizer exports, a 12.8% rise in vegetable exports, and a 12.1% increase in clothes exports. Mining exports grew by 10.2%, as phosphate exports grew by 24.7%, while potash exports grew by 0.9%.

Foreign currency reserves grew by $2.1 billion in 2014, reaching record highs within the year, ending at $14.1 billion, enough to cover more than 7.3 months of imports. The continued rise in FX reserves comes on the back of continued external funding to help support the accommodation of Syrian refugees, continued de-dollarization, and the successful issuance of a $1 billion Eurobond in June of 2014. Moreover, tourism receipts showed a 9% increase during the first three quarters of the year, while workers' remittances receipts increased by 2.6% in 2014 to reach JD 2.5 billion.

For 2015, in view of lower oil prices, CAB estimates that FX reserves would increase by around $900 million.

Jordan's economy has been resilient in an increasingly difficult regional environment. However, downside risks have increased with regional risks being the most prominent.

The Syrian and Iraqi conflict, and the resulting influx of refugees weigh on Jordan's already-strained resources. The conflicts have also led to disruptions to trade routes, and an escalation would further affect exports, transit trade and energy imports.

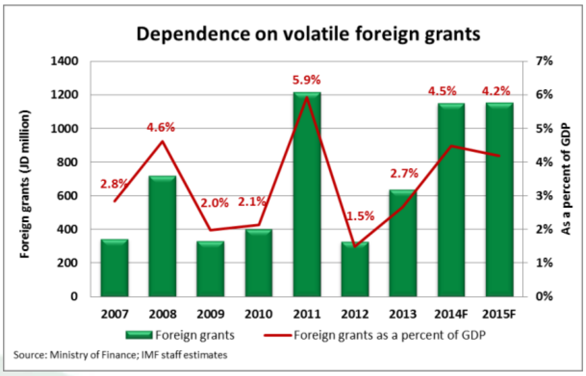
In view of the regional risks, grants from donors remain critical, not only to help cover further expected shortfalls in gas from Egypt, but also mitigate the impact of external shocks.

The government identified grants up to $2.1 billion from the last quarter of 2014 through end-2015 to cope with the regional instability. According to IMF estimates, foreign grants to GDP are expected to remain relatively high this year around 4.2% of GDP, but further grants are likely to be required.

Internally, other risks arise from the uncertainty caused by the political instability on FDI and capital inflows, which could dampen private sector confidence.

Meanwhile, a stronger dollar is unlikely to affect the country's trade balance, as the composition of Jordan's external activities is mostly denominated in USD.

Moreover, a sustained drop in oil prices is likely to reflect on lower donor support and workers' remittances, particularly from the GCC, resulting in a long term balanced effect on the country's external balances.



Benchmark interest rates:

Instrument	2014	Feb 2015
Window rate	2.75%	1.75%
CDs (1-week)	----	2.50% - 2.75%
Weekly Repo (CBJ main rate)	3.00%	2.75%
O/N Repo	4.00%	3.75%
Rediscount rate	4.25%	4.00%

CBJ announces new monetary policy structure and interest rates trend downwards

Most monetary developments were positive in 2014 and up to the first quarter of 2015, due to de-dollarizations trends, better excess liquidity levels, lower market rates on government bonds, and record high FX reserves.

The Central Bank of Jordan (CBJ) announced a new monetary policy structure on February 3rd aimed at stimulating sluggish economic growth through encouraging banks to lend to the private sector and allocate liquidity more efficiently.

Credit facilities extended in 2014 increased by around 1.8%, down from 6.2% in 2013. However, the figure is slightly biased as by the mandatory redemption of Islamic Murabaha and Swap contacts in February the previous year with as estimated amount of JD 560 million, as such transactions were previously classified by the Central Bank as credit facilities.

Meanwhile, the central bank withdrew most of its stimulus liquidity[2] by the end of 2014, yet excess liquidity levels have remained high at around JD 3.5 billion, after increasing by more than JD 1 billion in 2013 – reflecting lower dollarization and lower balance of payment deficit.

[2] In order to tackle the drop in excess liquidity witnessed in 2012, the Central Bank of Jordan introduced a number of monetary measures to help push excess liquidity levels back up, including weekly and monthly Repos and USD/JOD swaps. As monetary indicators improved in 2013, the CBJ began to withdraw those measures on a gradual basis.

In order to absorb part of the excess liquidity in the market, the central bank introduced Certificate of Deposits of JD 1 billion for durations of 1 week, while cutting rates by 1% to 1.75% on its O/N window rate facility.

Moreover, CBJ changed its main policy interest rate from the O/N Deposit Window rate to become the Weekly Repo rate. On its new main refinancing rate, the central bank cut rates by 25bp, as anticipated by CAB in previous reports, continuing its expansionary policy, after cutting rates by 75bp in 2014, and 50bp in 2013.

Following the CBJ policy change, government bond yields plunged significantly, supported by high coverage ratios. Throughout 2014, yields seemed to see-saw, yet mostly remained low.

Outlook for interest rates:

Interest rates are likely to continue to fall before stabilizing at low levels over the next few months.

The drop in international oil prices will ease pressure from the country's external positions and domestic financing needs. Moreover, the government will have an extra source of borrowing from local markets with the emergence of the Sukuk market, the possibility of issuing new USD denominated bonds, and energy projects that are expected to help alleviate Jordan's energy crisis.

Nevertheless there does seem to be some upside risks to the interest rate outlook, particularly when it comes to regional risks. The conflicts in Syria and Iraq have already strained Jordan's resources, through the influx of refugees and increased security spending. Moreover, the uncertainty surrounding the region continues to negatively impact the county's economy and fiscal metrics.

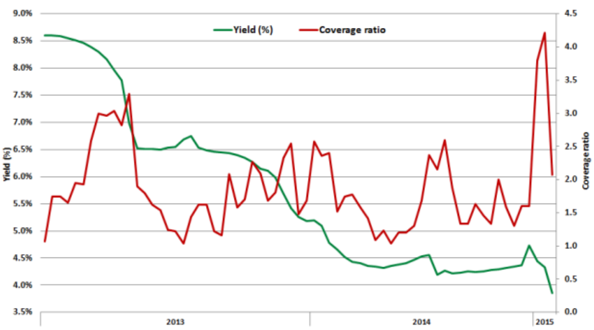
Meanwhile, as the U.S. Federal Reserve is expected to tighten monetary policy this year, we do not expect this to cause an upside pressure on JOD interest rates in 2015. The Central Bank of Jordan has proven historically that it can tolerate low spreads between JOD and USD interest rates. In addition, there is high confidence in the JOD with FX reserves around all-time highs, while the Fed's projected interest rate path has been recently shifted downwards, indicating slower interest rate hikes.

Benchmark interest rates:

Instrument	2012	2013	2014	Mar 2015
Window rate	4.00%	3.50%	2.75%	1.75%
CDs (1-week)	---	---	---	2.50%
O/N Repo	4.75%	4.25%	4.00%	3.75%
Weekly Repo	4.25%	3.75%	3.00%	2.75%
Monthly Repo	4.25%	3.75%	3.00%	
Re-discount Rate	5.00%	4.50%	4.25%	4.00%
1-Year Treasury Bills	6.75%	4.28%	3.45%	2.75%
2-year Treasury Bond	7.95%	4.96%	4.24%	4.20%
3-year Treasury Bond	8.60%	5.19%	4.74%	3.86%
5-year Treasury Bond	7.75%	6.45%	5.58%	4.73%
Time Deposit Rates	4.19%	4.97%	4.11%	---

Source: Central Bank of Jordan

3-year government bond yields trending downwards



Source: Central Bank of Jordan

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