Country report **JORDAN**

Summary

The precarious social situation is the largest country risk in Jordan. The fallout from the Arab Spring protests has forced King Abdullah II to dismiss the government in October 2011. While the new, technocratic government is expected to perform better, any failure to implement reforms swiftly will be met with an increase in anti-government street protests. We do expect power in Jordan to remain firmly in the hands of the broadly respected King, who will also retain the loyal support of the army and the security services. A regional risk is that the Jordanian arm of the Muslim Brotherhood could intervene in Syria, where it plays an important part in the opposition movement seeking the overthrow of the Assad regime. The fiscal position is forecasted to worsen in 2012 as social spending to quell any unrest will increase. However, the fact that Jordan can count on significant donor aid partly mitigates this risk. The external position of the country is sound and the liquidity position of the country is very healthy.

Things to watch:

- Success of the new government to implement economic reforms
- Renewal of large-scale anti-government street protests
- Involvement of the Jordanian arm of the Muslim Brotherhood in Syria

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Jordan

National facts	
Type of government	Constitutional Monarchy
Capital	Amman
Surface area (thousand sq km)	89
Population (millions)	6.5
Main languages	Arabic (official)
	English
Main religions	Sunni Muslim (92%)
	Christian (6%)
	Other (2%)
Head of State (president)	King Abdullah II
Head of Government (PM)	Awn al-Khasawneh
Monetary unit	Jordanian Dinar (JOD)

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	28	0.04
Nominal GDP at PPP	35	0.04
Export value of goods and services	12	0.06
IMF quotum (in mln SDR)	171	0.08
Economic structure	*2011*	*5-year av.*
Real GDP growth	2.6	5.3
Agriculture (% of GDP)	4	4
Industry (% of GDP)	30	31
Services (% of GDP)	65	65
Standards of living	*USD*	*% world av.*
Nominal GDP per head	4264	40
Nominal GDP per head at PPP	5405	44
Real GDP per head	2566	32

Social and governance indicators	rank / total
Human Development Index (rank)	82 / 169
Ease of doing business (rank)	111 / 183
Economic freedom index (rank)	52 / 179
Corruption perceptions index (rank)	50 / 178
Press freedom index (rank)	120 / 178
Gini index (income distribution)	37.7
Population below $1 per day (PPP)	1%

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
US	13	Saudi Arabia	20
Iraq	13	China	11
India	11	US	6
Saudi Arabia	9	Germany	6

Main export products (%)	
Manufactured goods	26
Chemicals	21
Crude materials	15
Food & live animals	12
Main import products (%)	
Machinery & transport equipment	20
Crude oil & petroleum products	17
Manufactured goods	15
Food & live animals	12
Openness of the economy	
Export value of G&S (% of GDP)	44
Import value of G&S (% of GDP)	71
Inward FDI (% of GDP)	6.3

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

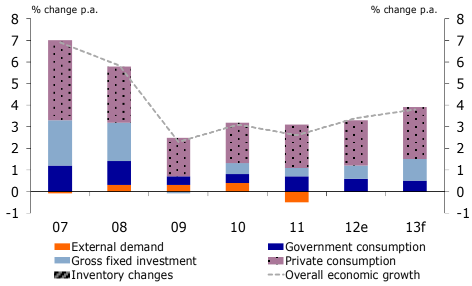
Jordan's population is only 6 million and its GDP of EUR 28bn in 2011 is among the smallest in the Middle East. There are insufficient supplies of water, no oil resources and other natural resources apart from potash and phosphates. Currently, the authorities are exploring nuclear power generation to prevent a worsening of the energy shortfalls in the long run. Social and economic challenges including chronic high rates of poverty, unemployment, vulnerability to drought and shortfalls in infrastructure typify it as a developing country.

For decades, the government and economy were highly reliant on foreign aid and more recently increasingly on foreign direct investment. Since 1999, King Abdullah strongly supported significant economic reforms, such as freer foreign trade, privatizations and cuts on fuel and food subsidies, which has made the country attractive for foreign investors over the past decade and has led to some job creation. But also, with low average per capita price level adjusted incomes at 44% of world average and relatively high income inequality, such plans will negatively affect the living standards of large segments of the population. The Arab Spring uprising and rising world food prices forced the government to backtrack at least temporarily on its plans to reduce food subsidies.

Economic growth is estimated at a mere 2.6% in 2011, as investor confidence in the whole Middle East has been weak and banks have shown cautious lending behaviour. Furthermore, the government has been fixated on extending social welfare programs and subsidies instead of economic development. In 2012, an economic growth rate of 3.4% is expected, slightly higher than in 2011 as Jordanian exports will profit from Iraq's post-war economic rejuvenation. Iraq is Jordan's largest trading partner, along with the US. Trade with the US is supported by bilateral free trade agreements and merchandise export products are often US dollar priced clothing and basic commodities such as fertilizers, potash and phosphates. Jordan's main import partners are Saudi Arabia and China.

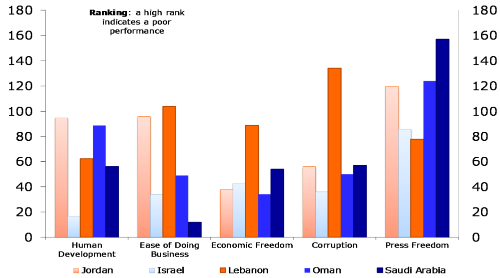
The country's banking sector has been relatively isolated from the international financial crisis because of its strong regulation and limited exposure to overseas capital markets. One of the measures, the government scheme to guarantee all bank deposits introduced in 2008 at the height of the global financial crisis, has recently been removed, signalling greater confidence in Jordan's banking sector. Capital adequacy ratios of the banking sector have remained at around 20% of assets over the years, which are very healthy levels.

Figure 1: Growth performance



Source: EIU

Figure 2: Social & governance indicators



Source: UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Political and social situation

Although Jordan ranks 117th in the Economist Intelligence Unit's democracy index, out of 167 countries, it is still among the better countries in the region. In other respects, the country's social and governance indicators are in line with those of its neighbouring countries with the exception of Israel.

More than half of the total population of 6 million is of Palestinian origin. Some became Jordanian nationals, but still almost 2 million are registered as non-Jordanian Palestinian refugees. Additionally, there are 500,000 refugees from Iraq. These non-nationals represent some 40% of the population and have only limited access to social services.

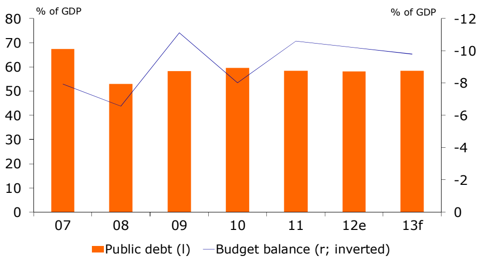
While tensions exist between locals, Palestinians and Iraqi refugees, these were overshadowed by the Arab Spring protests. Early 2011, anti-government protests ensued in the country, as the population demanded better living standards. In response, the King dismissed the Rifai government in February 2011 and proposed constitutional reforms on 14 August. However, the new government failed to implement these reforms and opposition groups were not pleased with the August proposal of the King, as a definite timeframe was lacking and skepticism on the actual implementation prevailed. The failure to implement the reforms led to the dismissal of the government in October. The new, apparently technocratic, government may be more successful than its predecessor, but it will be judged on results rather than good intentions. The King appointed Mr. Al Kasawneh as the new PM, a Cambridge educated legal expert who previously served as vice-president of the International Court of Justice. PM Al Kasawneh's clean reputation is important for his credibility, as his predecessor, Mr. Marouf Al Bakhit, was accused of corruption. The King set clear objectives for the new government, saying its primary mission is to implement a political reform process with "clear milestones, not just arbitrary timetables," and to successfully

hold municipal elections in December. The government must also "create a roadmap to achieve political reform based on clear foundations and criteria. As the government has already missed the deadline to hold municipal elections in December 2011, we expect protests to continue in the forecast period. Even so, we expect power in Jordan to remain firmly in the hands of the broadly respected King, Abdullah II, who will also retain the loyal support of the army and the security services.
The government has tried to restore relations with Hamas, a Palestinian Islamist group. PM Al Khasawneh has said that the decision to expel three Hamas leaders from Amman, the Jordanian capital, in 1999 was a political and constitutional mistake, as they were Jordanian citizens. The leader of Hamas, Khaled Meshaal, was due in Amman for talks, the first high-level meeting between Jordanian and Hamas officials since they were expelled from the country. However, the visit was suddenly postponed with no new date set, and the government insisted that there was no plan to allow them to re-establish their offices in Jordan.
Jordan's pro-Western orientation will remain the cornerstone of the King's foreign policy. In addition, the government seeks maintenance of good relations with all Middle Eastern states, including Israel, in order to prevent regional tensions having a negative effect on the country. However, the Jordanian public is not supportive of the US policies, which are perceived as biased in favour of Israel. Ties with Iraq will continue to improve as commercial links between the two countries deepen. Stability in Iraq should bring increased stability in the region and help Jordan to benefit from the trade between the two countries. Given the leadership's unwillingness to jeopardize the peace treaty with Israel and its reliance on the US and Saudi Arabia for financial aid, Jordan's active influence on the regional conflicts is minimal.
However, risks are that the Islamic Action Front (IAF), the Jordanian arm of the Muslim Brotherhood, could intervene in Syria, where the Muslim Brotherhood is playing an important part in the opposition movement seeking the overthrow of the Assad regime. In November 2011, the group said that standing by the Syrian people was in Jordan's interests and urged the government to withdraw the Jordanian ambassador from Damascus, in line with the Arab League's suspension of Syria's membership of the organisation. If the IAF intervenes in Syria, the risks of economic repercussions from Syria to Jordan are high as Syria is the most important trade partner of Jordan and Syria is an important transit country for most of Jordanian exports.

Economic policy

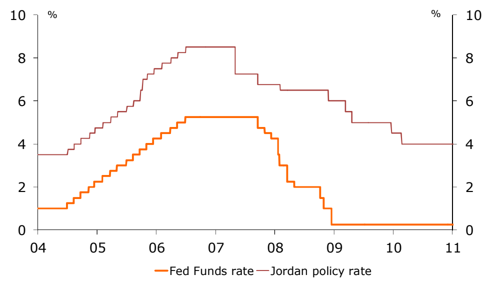
While economic policy is generally directed towards the liberalization of the economy, the government is expected to take the protesters’ demands into account to avoid increased social unrest. PM Al Khasawneh has announced measures to improve the state’s welfare provision. This has increased the budget deficit to a large 10.6% of GDP in 2011, up from a deficit of 8% in 2010. Total expenditure was up 9.1% in the first nine months of 2011. For 2012, higher subsidies for

Figure 3: Public finances



Source: EIU

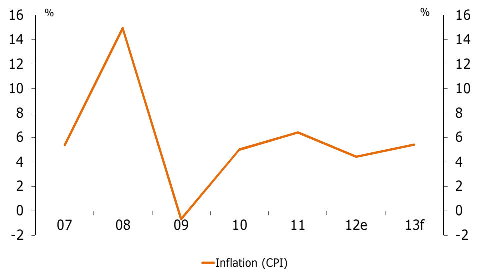
Figure 4: Policy interest rates



Source: EIU

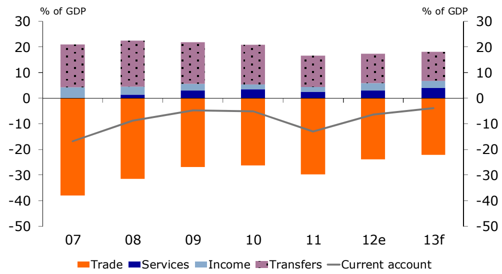
food, oil and other staples are likely to divert spending from capital investment.
Revenue flexibility is modest and the most recent major tax reforms were implemented in 2010. Taxes on petrol, water, cigarettes and alcohol were raised significantly, with increases ranging from 18% to 66%. Efforts to broaden the tax base and increase collection efficiency should pay off in coming years. As a result, the budget deficit is expected to amount to 10.2% of GDP in 2012. The deficit would be larger if Jordan did not enjoy a large amount of donor aid. The government has received USD 2.8bn in donor aid in 2011, made up of cash grants to the budget, development finance, loan guarantees to the private sector and long-term concessional loans with low interest. Public debt is forecasted at a rather high 58% of GDP in 2012. The Central Bank of Jordan (CBJ) maintains a fixed peg of the dinar to the US dollar, which has been in place since the early 1990's. Over the years, the interest rate differential between the interbank rate and the US Fed Funds rate is mostly kept between 300-400bps, enough to encourage deposit inflows that are reflected in higher FX-reserves and in foreign assets of banks in recent years. The policy rate currently stands at 4%. Inflation is forecasted to average 4.4% in 2012, on the back of elevated global food and commodity prices. Jordan is a large importer of food and commodities, since the country has very little resources. We expect inflation to remain high in the coming years as this cost push inflation is very difficult to counter with interest rate hikes.

Figure 5: Inflation



Source: EIU

Figure 6: Current account



Source: EIU

Balance of Payments

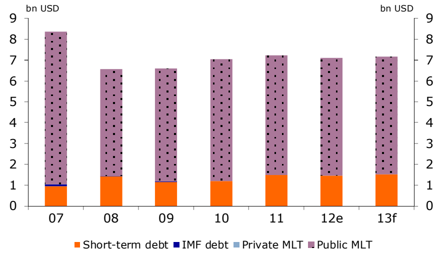
Jordan has an open economy as the export value of goods and services equals 116% of GDP. The export base is narrow, as chemicals and manufactured goods constitute 47% of GDP. While the US and Iraq are Jordan's largest export markets, India is an increasingly important importer of Jordan's minerals. Lacking a sound manufacturing industry, most processed food and non-basic consumer goods are imported.
The current account portrays a high deficit due to the structural trade balance deficits. In 2011, the deficit on the trade balance was a large 30% of GDP, due to the steeply risen global food and petroleum import prices. The services balance had been in deficit until 2006, but with increasing tourist arrivals over the past years, it is showing increasing surpluses and posted a surplus of 3.1% of GDP in 2011. The income balance also showed a small surplus of 2.7%. Moreover, remittances from expatriate Jordanians mostly working in the Gulf caused the transfer balance to show strong surpluses of up to 31% of GDP in 2003. They are now decreasing, but still high at around 12% of GDP in 2011. Incoming transfers include foreign aid grants and debt reduction. Overall, the current account deficit amounted to 13% of GDP in 2011. This is markedly higher than the 5.1% of GDP deficit in 2010, as remittances inflows markedly decreased and the oil import bill soared.
The current account deficit was USD 3.6bn while the net FDI and portfolio inflows only amounted to USD 1.9bn, insufficient to cover the gap. As a result, the level of FX-reserves has fallen from USD 13.1bn at end-2010 to USD 12.6 at end-2011.

External position

As the current account deficit could not be entirely financed via the financial account, total foreign debt has risen from USD 7bn in 2010 to USD 7.2bn in 2011, equivalent to 26% of GDP, which is still a modest level. The tenor structure is also favorable, as only 22% of the total foreign debt is short-term debt. Furthermore, approximately 10% of the country's medium to long-term debt is repaid annually, which indicates an effective average maturity of 10 years, which is comfortable. All medium and long term debt is owed by the sovereign. Also favourable are the effective interest rates of only 4% per annum on total longer term debt.

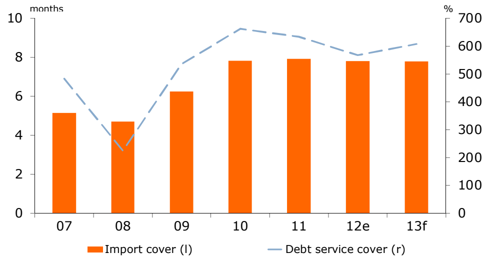
Overall, the liquidity position of the country is very healthy. FX-reserves cover 8 months worth of imports and cover debt service by 633%, both very sound levels.

Figure 7: Foreign debt



Source: EIU

Figure 8: External liquidity



Source: EIU

Jordan

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	6.9	5.8	2.3	3.1	2.6	3.4	3.8
Consumer prices (average % change pa)	5.4	14.9	-0.7	5.0	6.4	4.4	5.4
Current account balance (% of GDP)	-16.8	-8.8	-4.9	-5.1	-13.0	-6.4	-3.9
Total foreign exchange reserves (mln USD)	7542	8562	11689	13057	12600	13100	13760
Economic growth							
GDP (% real change pa)	6.9	5.8	2.3	3.1	2.6	3.4	3.8
Gross fixed investment (% real change pa)	9.0	7.6	-0.5	2.0	1.9	2.8	4.2
Private consumption (real % change pa)	5.2	3.8	2.7	2.8	3.0	3.1	3.5
Government consumption (% real change pa)	6.7	5.9	2.0	2.0	3.9	3.5	2.9
Exports of G&S (% real change pa)	9.0	7.2	-2.0	1.1	2.5	3.6	3.8
Imports of G&S (% real change pa)	7.5	5.5	-2.1	0.3	3.0	3.0	3.3
Economic policy							
Budget balance (% of GDP)	-7.9	-6.6	-11.1	-8.0	-10.6	-10.2	-9.8
Public debt (% of GDP)	67	53	58	60	58	58	58
Money market interest rate (%)	5.2	4.7	2.7	2.2	3.5	3.7	3.9
M2 growth (% change pa)	11	17	9	11	11	11	11
Consumer prices (average % change pa)	5.4	14.9	-0.7	5.0	6.4	4.4	5.4
Exchange rate LCU to USD (average)	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Recorded unemployment (%)	13.1	12.7	12.9	12.5	12.3	12.3	12.1
Balance of payments (mln USD)							
Current account balance	-2865	-1999	-1148	-1301	-3598	-1920	-1280
Trade balance	-6442	-7126	-6286	-6640	-8213	-7130	-7230
Export value of goods	5732	7937	6375	7028	7986	8580	9270
Import value of goods	12183	15102	12641	13679	16212	15730	16510
Services balance	31	352	735	891	705	940	1340
Income balance	683	696	605	507	528	820	850
Transfer balance	2863	4081	3798	3941	3383	3450	3770
Net direct investment flows	1998	1967	2357	1675	1631	1760	1770
Net portfolio investment flows	840	851	220	370	311	410	510
Net debt flows	-88	-1833	9	435	185	-120	70
Other capital flows (negative is flight)	1064	2003	1783	328	1187	480	-660
Change in international reserves	950	989	3222	1506	-284	610	410
External position (mln USD)							
Total foreign debt	8371	6580	6615	7042	7229	7110	7180
Short-term debt	962	1426	1158	1202	1503	1460	1530
Total debt service due, incl. short-term debt	1561	3807	2184	1971	1990	2310	2270
Total foreign exchange reserves	7542	8562	11689	13057	12600	13100	13760
International investment position	-21836	-19690	-17041	n.a.	n.a.	n.a.	n.a.
Total assets	18682	18973	21323	n.a.	n.a.	n.a.	n.a.
Total liabilities	40517	38662	38365	n.a.	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-37.9	-31.4	-26.8	-26.1	-29.6	-23.8	-22.1
Current account balance (% of GDP)	-16.8	-8.8	-4.9	-5.1	-13.0	-6.4	-3.9
Inward FDI (% of GDP)	11.5	8.6	10.1	7.0	6.3	6.4	5.9
Foreign debt (% of GDP)	49	29	28	28	26	24	22
Foreign debt (% of XGSIT)	59	36	40	40	42	38	35
International investment position (% of GDP)	-128.4	-86.7	-72.6	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	11	21	13	11	11	12	11
Interest service ratio incl. arrears (% of XGSIT)	2	2	2	2	2	2	1
FX-reserves import cover (months)	5.1	4.7	6.2	7.8	7.9	7.8	7.8
FX-reserves debt service cover (%)	483	225	535	662	633	567	607
Liquidity ratio	161	146	169	177	171	178	182

Source: EIU