Rabobank

Country report

JORDAN

Summary

Jordan was confronted with some spill-over from the Tunisian democratic revolution, there is strong support among the people for the King. The King is relatively modern, but the country ranks low on the "Democracy Index". Food subsidies were re-introduced to still the unrest. Also, major external political events (Israel and Iraq) could affect Jordan, considering the economic ties with Iraq and resentment among the population against Israel. The fiscal situation is better than it used to be. It will be difficult to bring the deficit further down as political pressures exist to soften the impact on lower income groups. High imports were driven by large FDI inflows and resulted in high current account deficits. FDI will remain strong at 10% of GDP, more than needed to finance the current account deficit. Foreign exchange reserves increased significantly and are now at comfortable levels. Investor confidence is never assured in the current turbulent times, but the banking sector is in a good condition.

Things to watch:

- Domestic political spill-over effects from the Tunisia revolution
- FDI and deposit inflows
- Stability of FX reserves / import ratio

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Jordan

National facts	
Type of government	Constitutional Monarchy
Capital	Amman
Surface area (thousand sq km)	89
Population (millions)	6.3
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)	Maaruf Bakhit
Monetary unit	Jordanian Dinar (JOD)

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	23	0.04
Nominal GDP at PPP	33	0.05
Export value of goods and services	12	0.06
IMF quotum (in mln SDR)	171	0.08
Economic structure	*2010*	*5-year av.*
Real GDP growth	3.2	5.8
Agriculture (% of GDP)	3	4
Industry (% of GDP)	30	30
Services (% of GDP)	66	66
Standards of living	*USD*	*% world av.*
Nominal GDP per head	3570	36
Nominal GDP per head at PPP	5242	45
Real GDP per head	2550	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)	38
Population below $1 per day (PPP)	0.5%

Foreign trade			2009
Main export partners (%)		*Main import partners (%)*	
US	23	Saudi Arabia	14
Iraq	17	China	11
UAE	14	Germany	8
India	9	US	7
Main export products (%)			
Manufactured goods			26
Chemicals			20
Crude materials			13
Food & live animals			11
Main import products (%)			
Machinery & transport equipment			25
Manufactured goods			23
Crude oil & petroleum products			21
Food & live animals			14
Openness of the economy			
Export value of G&S (% of GDP)			52
Import value of G&S (% of GDP)			72
Inward FDI (% of GDP)			10.6

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank (data as per Dec 2010)

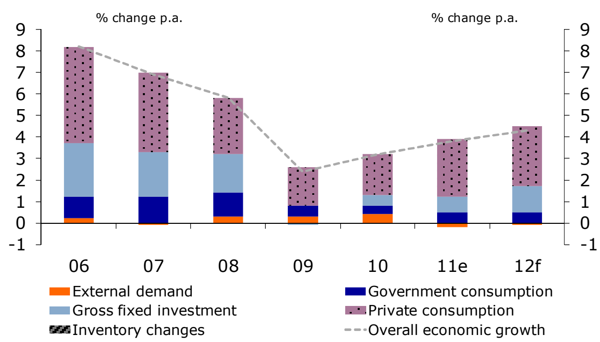
Economic structure and growth

Jordan's population is only 6 million and its GDP of EUR 23bn (in 2010) is among the smallest in the Middle East. There are insufficient supplies of water, no energy (oil) and other natural resources apart from potash and phosphates. Currently, the authorities are exploring nuclear power generation to prevent worsening of the energy shortfalls in the long run. The US are the main export market (supported by bilateral free trade agreements) and merchandise export products are often US dollar priced clothing and basic commodities (fertilizers, potash, phosphates). The Jordanian dinar is also pegged to the dollar. All this makes the US dollar de facto the second currency of the country and the peg of the dinar to the dollar. 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 45% of world average) and relatively high income inequality, such plans will negatively affect the living standards of large segments of the population. Recent events (Tunisia revolution and rising world

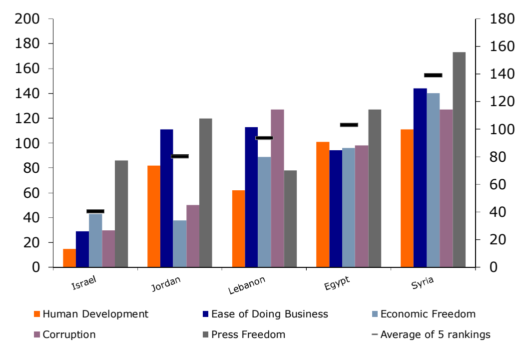
food prices) forced the government to backtrack at least temporarily on its plans to reduce food subsidies.
The global economic slowdown in 2009 and 2010 has depressed Jordan's GDP growth to around 3% p.a., with export-oriented sectors such as manufacturing, mining (phosphates) and transit trade being hit hardest. Real exports and imports shrunk by around 2% in 2009, stabilized in 2010 and are projected to increase only modestly in the next years.
The private consumption driven recovery of 2010 is expected to continue in 2011, which compensates for weak government spending growth and the end of the fixed investment boom of previous years. Fixed investments were fed by strong foreign direct investment, which reached levels of 25% of GDP just a few years ago, especially from the Arab Gulf states. Still respectable inflows of around 10% of GDP, mainly from the Gulf, are expected for some time, although these large investors need to cope with financial set-backs in their home economies.

Chart 1: Drivers of growth



Source: EIU

Chart 2: Social and governance indicators



Source: EIU

Jordan's financial 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 (Basel II) of the banking sector has remained at around 20% of assets over the years.

Political and social situation

Power in Jordan is expected 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. Nevertheless, stability will be tested by periodic outbursts of Islamist violence. These are most likely to be the result of actions of individuals (rather than organized groups) and the general threat to governmental and national security is considered low.
The Islamic Action Front may have strongholds in city slums, but it is internally split between pro-Hamas hard liners and moderates. This leading opposition party severely criticized Jordan's active participation in US-led military missions in Afghanistan. In the aftermath of the Tunisian Jasmine revolution (late January 2011) groups of IAF-protesters and trade unionists peacefully and successfully pushed for the resignation of the pro-business Prime Minister Samir Rifai because of falling living standards. They also demanded a modern electoral law. More recently, the king's wife Rania is targeted and accused of corruption by non-Palestinian tribal chiefs, a traditional support base of the monarch. The new prime minister Maaruf Bakhit, a conservative ex-general, was sworn

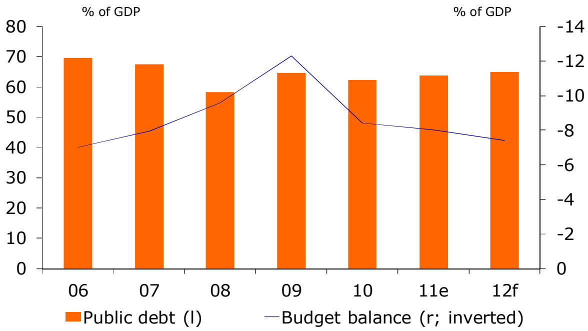
in on February 10. The government now includes a leader of the IAF and some leftists, reflecting a broader political support base, but most ministers are considered uncontroversial.
A parliament elected in 2008 was dissolved by the King in 2009 in the hope of speeding up economic reforms. New elections were held only a year later in November 2010, applying a new electoral law, which discriminates in favour of rural areas and resulted in a legislature dominated by more loyal, but economically conservative, members of parliament. The parliament's lethargy will in the end only slow the government's economic liberalisation programme.
Although Jordan ranks 117 in the Economist Intelligence Unit's democracy index for 2010, out of 167 countries, it is still among the better in the region. Also in other respects, the country 's social and governance indicators (see chart 2) compare favourably to 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.
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, that 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.
Relationships with the IMF and World Bank are favourable.

Economic policy

Government economic policy is generally geared to liberalizing the economy, but the authorities must take account of demands by the population to lower the impact of the economic downturn in 2009-10, rising food prices and the Tunisia spill-over. Last September, the IMF gave Jordan's economy a generally positive assessment, by pointing at the government's efforts to reduce the deficit and debt levels and to general pro-market policies.
The fiscal position improves, but from a high public deficit and debt levels. Just a few years ago, the annual deficits reached 12% of GDP and the reduction to the current deficit of 7% to 8% is a positive accomplishment. On the central government's revenue side (27% of GDP), sales taxes (VAT) provide 40% of total revenues, non-tax incomes 30% and foreign aid grants 7%. Simplifying the tax system for corporations (now the source of 20% of revenues) and for individuals (only 5% of revenues) aims at raising actual taxation and broadening of the tax base.
On the expenditure side of the 2010 and 2011 budgets (around 34% of GDP), spending on social security, food and oil subsidies was planned to be lowered, but these intentions are at risk for 2011. Capital expenditures were already reduced from 30% of spending in 2009 to 20% in 2010. Defence and security will remain the largest items at 30% of total spending. However, some of these fiscal measures have social consequences, causing strong popular opposition also on the streets. Moreover, with slow lethargic decision making in parliament further spending reductions are unlikely.
Overall, Jordan's fiscal deficit-to-GDP ratio is expected to remain at current levels. This will be sufficient to maintain the current government debt-to-GDP ratio, given that nominal GDP in local

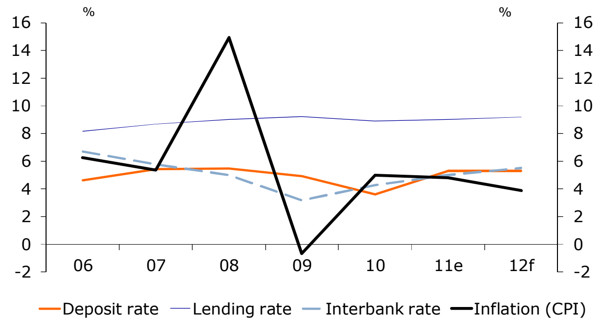
currency also increases by about 7% to 8%. Government debt is at around 65%, down from around 100% of GDP at the turn of the century, but stable since a few years (see chart 3).

Chart 3: Fiscal policy



Source: EIU

Chart 4: Interest rates and inflation



Source: EIU

Monetary policy is tightly geared to maintain the peg of the dinar to the US dollar, which is in place since the early 1990's. Over the years, the interest differential between the interbank rate and the US short term Fed Rate is mostly kept between 300bp and around 400bp, enough to encourage deposit inflows that are reflected in higher FX reserves and bank's foreign assets. Lower US rates of the past years are generally followed and did compensate for the impact of tighter government spending on GDP. A recent IMF statement strongly endorsed the peg as an appropriate nominal anchor for the economy and "the fixed exchange rate regime remains important for financial stability". IMF's analysis of the real effective exchange rate indicated that the dinar remains "broadly aligned with its medium term fundamentals".

In 2009 and 2010, the central bank used non-interest rate instruments failed to stimulate the real economy: less sterilization, lower reserve requirements for banks and a deposit guarantee system keep banks liquid and should encourage them to resume lending to creditworthy clients. Nevertheless, domestic credit growth slowed to an unprecedented 2% in 2009, after growing 15% to 33% in previous years. In 2010, lending growth only moderately recovered to 7%, private sector credit is now at 85% of GDP (2010), after peaking at 95% in 2006.

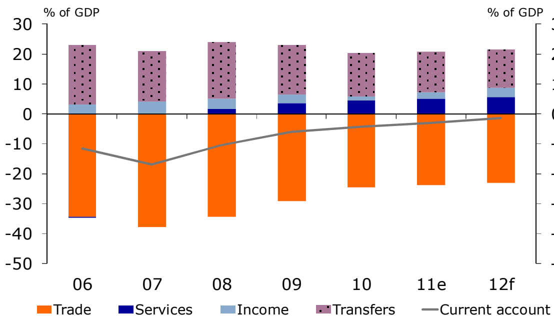
Apart from a global food price hike induced peak in 2008 followed by a slight deflation in 2009, price increases are modest and real lending rates positive. Given the past success and current commitment to maintain the peg to the US dollar, domestic demand-pull inflationary pressures will likely be countered by strong interest and non-interest policy measures to stabilize the real effective exchange rate. Cost push inflationary factors (rising international food and fuel prices) pose a threat to low inflation targets, but are more difficult to counter domestically. However, they should not affect the real effective exchange rate as much since all countries face this problem.

Balance of Payments

Jordan is an open economy, merchandise exports plus imports equal around 90% of GDP, but the export of goods (30% of GDP) covers only half of the material import needs (60% of GDP). The export base is narrow in terms of products (clothing, fertilizers, potash and phosphates) and markets (mainly US and Europe). India is increasingly an important importer of Jordan's minerals. Lacking a manufacturing industry, most processed food and non-basic consumer goods are imported. The trade deficit (see chart 5) is on the decline but remains large.

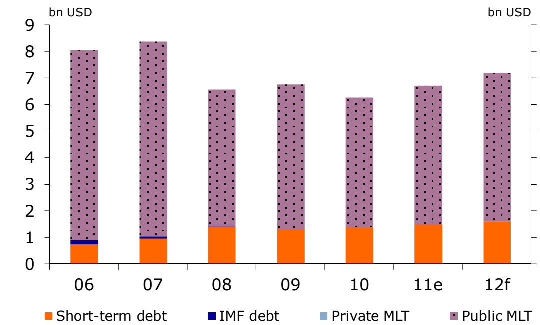
The services balance was in deficit till 2006, but with increasing tourist arrivals over the past years, it is showing increasing surpluses. The income balance is -as usual- also in surplus. Moreover, remittances from expatriate Jordanians mostly working in the Gulf caused the transfer balance to show strong surpluses of up to 31% of GDP in the not so distant past (2003). They are now decreasing, but still high at around 15% of GDP. Incoming transfers include foreign aid grants and debt reduction, which total around 2% of GDP in 2010, down from 6% in 2008. Jordan is likely to use its support for US foreign policies in the region to gain more financial support, although there is of course no mechanical connection with higher aid flows.

Chart 5: Current Account



Source: EIU

Chart 6: External debt composition



Source: EIU

The overall current account remains in deficit but has strongly improved since 2007, when the deficit reached 17% of GDP.

Net foreign investments (FDI) more than covered the current account deficits. In the period 2006-2010, the total of non-debt creating net FDI inflows amounted to USD 13.7bn, while the current account deficits totalled USD 9bn. These five years of abundant non-debt capital inflows caused the stock of official reserves to almost double from USD 6.7bn to over USD 12bn by the end of 2010, while external debt declined by USD 2bn.

The latest political developments in the region could harm tourism inflows and FDI. The turmoil could also lead to rising oil prices and increase the costs of energy imports.

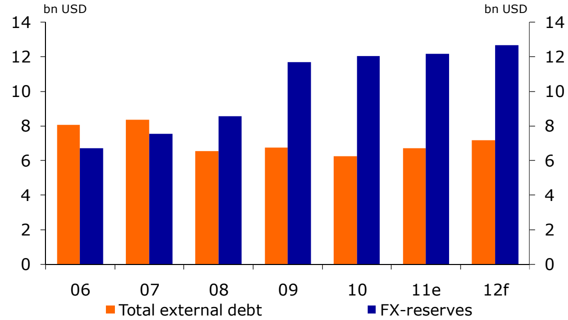
External position

Total external debt was reduced in 2008 as Jordanian authorities used some of its reserves to buy back part of its debt it owed to the Paris Club of official donors. Since then external debt is nominally again modestly increasing, but its value remains below 30% of GDP. Also in terms of total export revenues (38%), external debt can be considered low.

Around 10% of long term debt (now at USD 6.5bn) is repaid annually, indicating an effective average maturity of these debts of 10 years, which is comfortable. Similarly favourable are the effective interest charges of only 4% per annum on total longer term debt. All medium and long term debt is owed by the sovereign or sovereign guaranteed. Private creditors provide only 20% of total debt. The short-term debt rose faster than the value of external trade, but at the modest level of USD 1.4bn (equalling 10% of imports or 20% of exports) at the end of 2010, this rise is of no immediate concern.

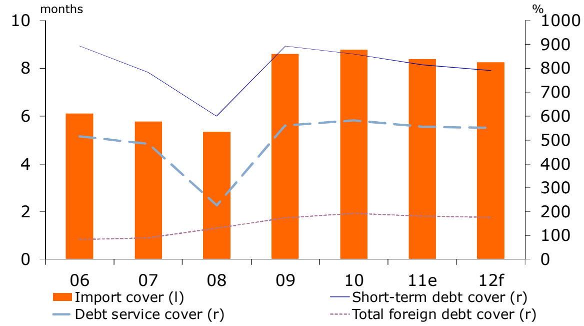
In November 2010, Jordan launched its first-ever sovereign Eurobond with a value of USD 750m and a five-year maturity. The authorities successfully tapped the substantial investor appetite for new sovereigns in general and in Jordan’s in particular. The effective interest costs are around 4.2%.

Chart 7: Reserves and debt position



Source: EIU

Chart 8: Liquidity indicators



Source: EIU

There are still minor (USD 5m) and decreasing arrears to official creditors that need to be settled. These arrears, principal repayments and interest payments due plus the short-term debt are taken into account in the calculated foreign debt service ratio, which amounts to just 13% of total current account revenues.

Overall, the country's liquidity position (see chart 8) can be considered strong: foreign exchange reserves cover 8 months of imports. Also the liquidity ratio (cover for annual expected outflows provided by available reserves of banking system and expected annual inflows) at over 180% points to a favourable position. The present stock of international reserves can be considered sufficient to offset any pressure on the currency stemming from negative political developments, at least for the short-term.

As a result of annual current account deficits, Jordan's net assets are strongly negative at around 100% of GDP (latest data for 2008). A major part of gross liabilities is in the form of the stock of non-debt inward FDIs, that accumulated over the past decade and from which the foreign owners expect to receive dividends. These non-debt liabilities are not reflected in chart 7, which focuses on total foreign debt (interest bearing and for all sectors) and liquid FX assets under control of the central authorities.

Jordan							
Jordan, Nominal GDP in bn USD	14.6	17.0	20.7	21.0	22.8	24.8	26.9
Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	8.2	6.9	5.8	2.4	3.2	3.8	4.3
Consumer prices (average % change pa)	6.3	5.4	14.9	-0.7	5.0	4.8	3.9
Current account balance (% of GDP)	-11.6	-16.8	-10.3	-6.0	-4.3	-2.9	-1.4
Total foreign exchange reserves (mln USD)	6722	7542	8562	11689	12055	12180	12660
Economic growth							
GDP (% real change pa)	8.2	6.9	5.8	2.4	3.2	3.8	4.3
Gross fixed investment (% real change pa)	11.0	9.0	7.6	-0.5	2.0	3.2	5.0
Private consumption (real % change pa)	6.3	5.2	3.8	2.7	2.8	4.0	4.1
Government consumption (% real change pa)	5.5	6.7	5.9	2.5	2.2	2.7	2.7
Exports of G&S (% real change pa)	10.5	9.0	7.2	-2.0	1.1	2.5	5.2
Imports of G&S (% real change pa)	8.2	7.5	5.5	-2.1	0.3	2.4	4.6
Economic policy							
Budget balance (% of GDP)	-7.0	-7.9	-9.6	-12.3	-8.4	-8.0	-7.4
Public debt (% of GDP)	70	67	58	65	62	64	65
Money market interest rate (%)	6.7	5.8	5.0	3.2	4.3	5.0	5.5
M2 growth (% change pa)	14	11	17	9	21	11	11
Consumer prices (average % change pa)	6.3	5.4	14.9	-0.7	5.0	4.8	3.9
Exchange rate LCU to USD (average)	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Recorded unemployment (%)	13.2	13.1	12.7	12.9	13.4	13.1	12.3
Balance of payments (mln USD)							
Current account balance	-1705	-2865	-2141	-1270	-975	-730	-380
Trade balance	-5035	-6442	-7126	-6152	-5622	-5900	-6180
Export value of goods	5204	5732	7937	6366	7333	7920	8620
Import value of goods	10260	12183	15102	12498	12970	13830	14810
Services balance	-63	31	352	747	1035	1260	1530
Income balance	453	683	696	612	309	530	820
Transfer balance	2940	2863	3939	3523	3303	3380	3450
Net direct investment flows	3682	2574	2814	2309	2344	2460	2430
Net portfolio investment flows	-35	840	851	220	356	480	600
Net debt flows	8	-91	-1657	69	1109	440	470
Other capital flows (negative is flight)	-433	491	1122	1893	-2330	-2480	-2680
Change in international reserves	1517	950	989	3222	504	170	440
External position (mln USD)							
Total foreign debt	8055	8368	6550	6766	6272	6720	7190
Short-term debt	754	962	1426	1309	1405	1500	1600
Total debt service due, incl. short-term debt	1309	1561	3793	2090	2073	2190	2300
Total foreign exchange reserves	6722	7542	8562	11689	12055	12180	12660
International investment position	-15455	-21240	-18454	n.a.	n.a.	n.a.	n.a.
Total assets	17138	18530	18658	n.a.	n.a.	n.a.	n.a.
Total liabilities	32593	39769	37112	n.a.	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-34.4	-37.9	-34.5	-29.2	-24.6	-23.8	-23.0
Current account balance (% of GDP)	-11.6	-16.8	-10.3	-6.0	-4.3	-2.9	-1.4
Inward FDI (% of GDP)	24.2	15.4	13.7	11.3	10.6	10.4	9.7
Foreign debt (% of GDP)	55	49	32	32	27	27	27
Foreign debt (% of XGSIT)	64	59	36	42	38	38	37
International investment position (% of GDP)	-105.6	-124.9	-89.2	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	10	11	21	13	13	12	12
Interest service ratio incl. arrears (% of XGSIT)	2	2	2	1	1	1	1
FX-reserves import cover (months)	6.1	5.8	5.3	8.6	8.8	8.4	8.2
FX-reserves debt service cover (%)	514	483	226	559	582	556	550
Liquidity ratio	182	168	146	182	186	185	186

Source: EIU (2011-02-11)