Growth:

Challenging environment; but upside potential stems from GCC funded capital projects
Economic activity remains subdued

- The repercussions of unstable regional and global conditions continued to affect the performance of the Jordanian economy.

- Real GDP growth is recovering gradually, with GDP forecast to grow at 3-3.5% in 2013-14, supported by higher government capital spending financed by GCC grants, improvement in construction and consumption sectors, according to the latest IMF note on Jordan.

- Real GDP grew by 2.6% during the first quarter of 2013 compared to 3.0% during the same quarter in 2012.

- However, growth recovered slightly to 3.1% in the second quarter 2013, due to resilient demand and relatively better performance of various economic sectors.

- Nevertheless, uncertainty due to the civil war in Syria has impacted Jordan’s trade channels, and explains part of the recent economic slowdown.
Growth in 2013 driven by trade, finance, manufacturing, and construction

• On the demand side, key growth drivers were public and private consumption expenditures. Private consumption remained resilient in the first half of the year, since rising utility input costs did not pass through completely to consumers, and since the added number of Syrian refuges boosted consumption figures.

• From the production side, growth was driven by a rebound in trade, finance, manufacturing, and a recovery in construction.
The balance of risks to the outlook remains tilted to the downside

- While GDP growth is projected to rise to 3.3% in 2013, the balance of risks to the outlook remains tilted to the downside.

- The country’s growth prospects have slowed to 2%-3% since 2010, which is significantly lower than the 7.6% average Jordan recorded between 2004 -2009.

- GDP growth remains below its long-term potential due to a drop in exports and a drop in the purchasing power of consumers, which mainly results from the government fiscal-consolidation measures implemented in 2012 and 2013.

- Additionally, capital spending by the government has not kicked in yet. Such capital projects are estimated to boost GDP growth once started to take effect later this year.
The external environment continues to be challenging

- Lower global demand, high competition in international markets, and the situation in Syria, continued to weigh on Jordanian exports; especially in the mining sector.

- Higher oil prices due to tensions in the region is also a factor that is adversely affecting consumption power and economic growth in Jordan.

- At the same time, the large number of Syrian refugees - 560,000 according to the UN, but the authorities believe that the actual number is 1.3 million – are placing mounting pressures on the labor market and infrastructure; weighing on GDP through more imports, and on GDP per capita due to an abnormal increase in population.

- Moreover, the political situation in Egypt and the resulting disruption in Egyptian gas is weighing on fiscal balances and therefore limiting government’s room to spend on capital projects.

<table>
<thead>
<tr>
<th>Export Item</th>
<th>Percentage change in the first 8 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cloths</td>
<td>10%</td>
</tr>
<tr>
<td>Potash</td>
<td>-10%</td>
</tr>
<tr>
<td>Vegetables</td>
<td>-22%</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>15%</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>-17%</td>
</tr>
<tr>
<td>Phosphate</td>
<td>-30%</td>
</tr>
<tr>
<td>Others</td>
<td>12%</td>
</tr>
</tbody>
</table>
Internal pressures are also present

- High oil prices and removing fuel subsidies have pushed inflation levels above 7% in May 2013 from an average of 4.8% in 2012, though inflation has eased slightly in recent months.

- Unemployment is reported at 14%, while lower growth prospects and competition by Syrian labor are likely to place extra pressures on the country’s job market.

- The reported 532,000 Syrians refugees have also added to the existing pressure on public infrastructure and government fiscal balances.

- High uncertainty and short-lived governments are factors that reduced public and private investment expenditure.
Inflation: Inflation remained above 6.0% up to end of third quarter, effect of fuel prices liberalization starting to fade
Inflation remained above 6.0% in 2013

• Annual average Inflation rate stood at 6.1% during the first 9 months of 2013, compared to the same period last year, after it had reached a high of 7.4% in March of this year.

• The abovementioned drop in inflation is due to the fading effect of fuel prices liberalization in 2012.

• Fuel and electricity remain to be the main contributors to the CPI increase with an increase of 24.3%, mainly due to the impact of the fuel prices’ liberalization in late 2012.

• Other main contributors include transportation (13.60%), fruits and vegetables (10.90%), and meat and dairy (5.90%).

• As for September, inflation reached 5.50% compared to the same month in 2012; mostly driven by fuel and electricity group.
Global oil prices have recently spiked in response to escalating tensions in the region and are expected to remain above $110pb till the end of 2013.

Meanwhile, the conflict in Syria continues to weigh on Jordan, with the refugees placing upward pressure on consumer aggregate demand.

Additionally, hikes in electricity tariffs for industrial and commercial outlets have just gone into effect in August, which according to official sources are likely to push the consumer price index higher by around 1%.

Therefore, average annual inflation is expected to maintain its current high rates in the upcoming months.
Fiscal policy developments:

Consolidation efforts against inflexible budget structure
Major deterioration in fiscal balances in 2012

- Jordan’s public finances have deteriorated markedly since 2009, with the central government deficit, including grants, reaching 8.2% of GDP in 2012.

- Existing oil subsidies coupled with the disruptions in gas supplies from Egypt, led to historical deficits in the National Electric Power Company (NEPCO) in 2012, such that NEPCO losses reached JD 1.2 billion in 2012.

- Adding NEPCO losses to the central government deficit, the fiscal deficit would have reached JD 3 billion, or 13.6% of GDP in 2012.

- Moreover, in 2012, Jordan received only $460 million in foreign grants, down from $1,711 million in 2011.

- The dependence on foreign grants, untargeted subsidies, and 2012 government restructuring are key vulnerabilities, which are being addressed through fiscal-consolidation efforts.
Fiscal deficit expected to narrow in 2013, in line with IMF program

- This year, Jordan is expected to face a fiscal deficit of JD 1,310 million (5.4% of GDP) including foreign grants, and JD 2,160 (8.9% of GDP) if we exclude grants.

- Following their visit in the beginning of September, the IMF released a statement this month approving the disbursement of the $285 million third tranche of the IMF loan to Jordan.

- The IMF cited the Jordanian authorities “strong commitment to implement their national program despite an increasingly difficult external environment, including the tragic situation in Syria.”

- The statement said that the country’s IMF-supported program has stayed broadly on track for the first half of the year as the central government fiscal performance has been in line with expectations, and with the higher levels of Egyptian gas flow, the NEPCO losses were lower than expected through June.

- However, the IMF also noted that NEPCO’s losses may be higher than expected for the year, if the disruption of Egyptian gas supplies which started in July 2013 continues.
Fiscal deficit narrows over the first 8 months of the year, but pressures remain

The budget balance remained in the negative during the first 8 months of the year, with a deficit of JD 492 million, though the deficit has narrowed by around JD 379 million from the same period of the previous year.

<table>
<thead>
<tr>
<th>JD Million</th>
<th>Jan – August 2013</th>
<th>Jan - August 2012</th>
<th>2012 Preliminary</th>
<th>2011 Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenues and Grants</td>
<td>3,888.20</td>
<td>3,168.50</td>
<td>5,054.40</td>
<td>5,413.80</td>
</tr>
<tr>
<td>Domestic Revenue</td>
<td>3,363.60</td>
<td>3,143.30</td>
<td>4,727.30</td>
<td>4,198.80</td>
</tr>
<tr>
<td>Foreign Grants</td>
<td>542.6</td>
<td>25.2</td>
<td>327.1</td>
<td>1,215.00</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>4,380.60</td>
<td>4,039.80</td>
<td>6,862.10</td>
<td>6,796.60</td>
</tr>
<tr>
<td>Current Expenditures</td>
<td>3,917.70</td>
<td>3,679.00</td>
<td>6,186.20</td>
<td>5,739.50</td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>462.9</td>
<td>360.8</td>
<td>675.9</td>
<td>1,057.10</td>
</tr>
<tr>
<td>Fiscal Deficit/Surplus Including Grants</td>
<td>-492.4</td>
<td>-871.2</td>
<td>-1,807.70</td>
<td>-1,382.70</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(-8.2% of GDP)</td>
<td>(-6.8% of GDP)</td>
</tr>
<tr>
<td>Fiscal Deficit/Surplus Excluding Grants</td>
<td>-1,017.00</td>
<td>-896.5</td>
<td>-2,134.80</td>
<td>-2,597.70</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(-9.7% of GDP)</td>
<td>(-12.7% of GDP)</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

** However, NEPCO losses are expected to be around JD 840 million in the first eight months of the year (difference between government borrowing and deficit)
Analyzing Revenues

Revenues helped as inflow of grants compared to last year

• The budget balance has improved and likely to fall in line with the expected budget of a 5.4% deficit to GDP.

• The reason for the improvement was due to an increase in foreign grants by JD 499 million in the first 8 months, compared to an overall drought of grants last year.

• In fact, fiscal deficit before grants remains significant at JD 1,017 million during the first 8 months of the year.

• While domestic revenue have increased this year, mainly due to an increase in tax revenue, pressures from a drop in mining revenue and property income has placed downward pressure on the revenue side of the budget.

• Nevertheless, revenue generating measures that included a mobile phone tax and a proposed income tax law, that is expected to be a major revenue raiser for 2014.
Analyzing expenditures

Central government budget continues to be tightly managed

- While capital and current expenditures have increased this year, the central government budget has been tightly managed.

- This was mainly through the elimination of the highly sensitive fuel subsidy, while at the same time providing cash transfers to compensate low- and middle-income Jordanians.

- The government proved its commitment to curb fiscal spending, as it raised fuel prices in November 2012; in line with the stand by agreement signed previously with the IMF.

- This brought almost all fuel products back to cost recovery. In addition, at the start of 2013, the authorities introduced a monthly adjustment to market fuel prices mechanism.

- Furthermore, the government undertook selective cuts in non-priority domestically financed capital projects, while focusing on growth-enhancing developmental projects that are financed by GCC grants.
Analyzing the expenditures further: the budget remains constrained with irreversible expenditures

- Despite addressing the issue of subsidies, the central government budget remains plagued by irreversible expenditures, in particular the continued increase in civil employee wages.

- Our analysis shows that nearly 72% of expenditures are irreversible.

- These expenditures present increases in wages, pension, military expenditures and interest payments of loans and treasuries.

- This situation indicates lower flexibility in government expenditure, and high exposure to external volatilities.

<table>
<thead>
<tr>
<th>JD Million</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation of employees</td>
<td>883.8</td>
<td>1,013.5</td>
<td>1,176.4</td>
<td>1,281.8</td>
</tr>
<tr>
<td>Wages, salaries and allowances</td>
<td>829.6</td>
<td>950.2</td>
<td>1,109.0</td>
<td>1,201.7</td>
</tr>
<tr>
<td>Social security</td>
<td>54.2</td>
<td>63.3</td>
<td>67.4</td>
<td>80.1</td>
</tr>
<tr>
<td>Interest payments</td>
<td>397.5</td>
<td>429.5</td>
<td>582.9</td>
<td>800.0</td>
</tr>
<tr>
<td>Internal</td>
<td>310.9</td>
<td>333.9</td>
<td>483.1</td>
<td>628.0</td>
</tr>
<tr>
<td>External</td>
<td>86.60</td>
<td>95.60</td>
<td>99.9</td>
<td>172.0</td>
</tr>
<tr>
<td>Social benefits</td>
<td>969.6</td>
<td>1,097.4</td>
<td>1,206.4</td>
<td>1,487.0</td>
</tr>
<tr>
<td>Pensions and compensation</td>
<td>744.6</td>
<td>861.9</td>
<td>982.4</td>
<td>1,068.0</td>
</tr>
<tr>
<td>Social assistance</td>
<td>225.0</td>
<td>235.5</td>
<td>224.0</td>
<td>419.0</td>
</tr>
<tr>
<td>Military expenditures</td>
<td>1,699.3</td>
<td>1,797.7</td>
<td>1,756.8</td>
<td>1,767.2</td>
</tr>
<tr>
<td>Total Irreversible expenditures</td>
<td>3,950.2</td>
<td>4,338.10</td>
<td>4,722.50</td>
<td>5,336.00</td>
</tr>
<tr>
<td>Percent of GDP</td>
<td>20.2%</td>
<td>21.3%</td>
<td>21.5%</td>
<td>22.2%</td>
</tr>
<tr>
<td>Percent of total expenditures</td>
<td>69.2%</td>
<td>63.8%</td>
<td>68.7%</td>
<td>71.6%</td>
</tr>
</tbody>
</table>
The government has started to tackle losses at the state-owned National Electric Power Company (NEPCO), with ongoing steps in the reduction in electricity subsidies.

The tariffs will be raised over the course of five years to bring the state-owned NEPCO to cost recovery.

NEPCO has been incurring losses (worth 5.2% of GDP in 2012, around JD 1.16 billion) and arrears due to high energy costs and low subsidized end prices.

In August, electricity tariffs were increased for major economic sectors, by around 10-15% on average, as part of the National Economic Reform Program with accordance from the IMF.

Also, additional natural gas inflow from Egypt helped lower the cost of electricity production.

However, the IMF estimated in its Article IV report that the clearing up of arrears and losses will require a transfer of JD 1.037 billion (or 4.3% of GDP) in 2013.
NEPCO losses remain a problem

- In its latest program note, the IMF stated that NEPCO losses are expected to decrease following increases in electricity tariffs for most economic sectors on August 15 of this year.

- The decent flow of Egyptian gas in the first half of the year has also contributed positively by reducing the costs incurred by NEPCO.

- However, pressures on NEPCO remain as the government backed away from raising electricity tariffs on households till next year, and Egyptian gas supply shortages in the last couple of months has likely forced Jordan to import oil at higher prices to meet electricity needs.

- The disruption in gas flows may once again raise Jordan’s oil bill and trade deficit, widen the fiscal deficit and create bigger losses for Jordan’s national electricity company.

- This may hinder the IMF’s target of reducing NEPCO losses as a percentage of GDP to 0% in 2016.
“The issue of energy efficiency continues to hamper Jordan’s growth prospects, as the country remains dependent on hydrocarbon imports, especially Egyptian natural gas. Thus, the main challenge continues to be achieving cost recovery in the energy sector:

• Diversifying energy sources. The liquid natural gas terminal in Aqaba needs to be completed, to reduce the dependence on Egyptian supplies, and this is expected to be operating by end-2014.

• Increasing energy efficiency through legal framework.

• Gradually raising electricity tariffs while protecting the poor.

• Further fiscal consultation is needed, but it should be gradual as to not jeopardize growth prospects.

• Meanwhile, if both challenges were addressed then this would place public debt on a downward trend.”
General government debt continues to accelerate upwards

- The continued large fiscal deficit and social spending pressures are expected to push government debt-to-GDP ratio above 80% in 2013 from 75% in 2012.

- Given the large fiscal deficit we expect continued pressure on current debt levels. NEPCO’s debt, which is guaranteed by the government and included in the figures, reached 9% of GDP in 2012.

- Meanwhile, public debt reached around JD 17.9 billion by the end of August 2013, around 75% of 2013 GDP according to calculations by the Ministry of Finance; increasing by around JD1,333 million during the year.

- Domestic debt increased by around JD 400 million during the first 8 months of the year, compared to the end of 2012, and external debt increased by around JD 931 million during the same period.

<table>
<thead>
<tr>
<th>JD Million</th>
<th>August 2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>External Debt</td>
<td>5,864.0</td>
<td>4,932.4</td>
<td>4,486.8</td>
</tr>
<tr>
<td>Percent of GDP</td>
<td>24.4%</td>
<td>22.5%</td>
<td>21.9%</td>
</tr>
<tr>
<td>Internal Debt</td>
<td>12,049.0</td>
<td>11,648.0</td>
<td>8,915.0</td>
</tr>
<tr>
<td>Percent of GDP</td>
<td>50.2%</td>
<td>52.7%</td>
<td>43.5%</td>
</tr>
<tr>
<td>Public Debt</td>
<td>17,913.0</td>
<td>16,581.0</td>
<td>13,401.8</td>
</tr>
<tr>
<td>Percent of GDP</td>
<td>74.7%</td>
<td>75.5%</td>
<td>65.4%</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance
Debt structure is quite favorable

- Despite its relatively large size, the structure of Jordan’s government debt is quite favorable.
- Around 28% of the gross debt is external with low servicing costs and long maturities.

Source: Ministry of Finance
Domestic debt

- On the other hand, the domestic portion of the government's debt has a shorter average maturity of around 1.7 years, according to the IMF’s Fiscal Monitor.

- However, the short average maturity of the domestic debt is not fully translated into a high refinancing risk, since Jordanian banks, who are considered stable creditors, hold 81% of this debt.

- Meanwhile, during the first 10 months of the year, net government “JOD bond” borrowing reached JD 1.4 billion, reflecting more pressure placed by the government on local liquidity.

<table>
<thead>
<tr>
<th>Jan - Oct</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sum of new issuances</td>
<td>4,338</td>
<td>4,140</td>
</tr>
<tr>
<td>Sum of redeemed</td>
<td>3,220</td>
<td>2,779</td>
</tr>
<tr>
<td><strong>Net Issuances</strong></td>
<td><strong>1,117</strong></td>
<td><strong>1,361</strong></td>
</tr>
</tbody>
</table>
Monetary Developments:

Higher FX Reserves, Increasing JOD Deposits, and Lower Dollarization Levels Supported Recent Cut in Interest Rates
Summary of monetary developments

- Most monetary developments were positive in 2013, mainly due to lower dollarization levels and higher FX reserves.

- In 2013, the increase in JD deposits has surpassed the drop witnessed in the same category of deposits in 2012.

- Credit to private sector continued to increase, though at lower than historical average growth rates.

- Despite withdrawing about 50% of CBJ liquidity stimulus, excess liquidity jumped by about JD 1 billion in 2013, reflecting lower dollarization, and lower current account deficit.

<table>
<thead>
<tr>
<th>Growth (%)</th>
<th>2012</th>
<th>First 8 months of the year</th>
<th>Current Figure</th>
</tr>
</thead>
<tbody>
<tr>
<td>JD Deposits</td>
<td>-7.30%</td>
<td>15%</td>
<td>JD 20.4 billion</td>
</tr>
<tr>
<td>FC Deposits</td>
<td>38%</td>
<td>-6.60%</td>
<td>$9.5 billion</td>
</tr>
<tr>
<td>JD Private Credit</td>
<td>5.70%</td>
<td>4.50%</td>
<td>JD 14.7 billion</td>
</tr>
<tr>
<td>FC Private Credit</td>
<td>8.80%</td>
<td>12%</td>
<td>$3.50 billion</td>
</tr>
<tr>
<td>CBJ FX Reserves</td>
<td>-37%</td>
<td>62%</td>
<td>$10.7 billion</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>JD Liquidity Indicator</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess Liquidity</td>
<td>JD 1.9 billion</td>
<td>JD 2.8 billion</td>
</tr>
<tr>
<td>CBJ Repos</td>
<td>JD 800 million</td>
<td>JD 375 million</td>
</tr>
<tr>
<td>USD / JOD Swaps</td>
<td>$1.2 billion</td>
<td>$1.6 billion</td>
</tr>
</tbody>
</table>

Most monetary developments were positive in 2013, mainly due to lower dollarization levels and higher FX reserves.
The Central Bank of Jordan (CBJ) responded to higher reserve levels, lower dollarization, and subdued growth rates by cutting interest rates by 25 bps in August and another 25 bps in October 2013.

<table>
<thead>
<tr>
<th>Instrument</th>
<th>2012</th>
<th>October 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Window Rate</td>
<td>4.00%</td>
<td>3.50%</td>
</tr>
<tr>
<td>O/N Repo</td>
<td>4.75%</td>
<td>4.25%</td>
</tr>
<tr>
<td>Weekly Repo</td>
<td>4.25%</td>
<td>3.75%</td>
</tr>
<tr>
<td>Monthly Repo</td>
<td>4.25%</td>
<td>3.75%</td>
</tr>
<tr>
<td>Rediscount Rate</td>
<td>5.00%</td>
<td>4.50%</td>
</tr>
<tr>
<td>2 Y Treasury Bond</td>
<td>7.95%</td>
<td>5.79%</td>
</tr>
<tr>
<td>3 Y Treasury Bond</td>
<td>8.60%</td>
<td>6.10%</td>
</tr>
<tr>
<td>Time Deposit Rates</td>
<td>4.19%</td>
<td>4.98% (Aug 2013)</td>
</tr>
</tbody>
</table>
Foreign reserves increased by more than $4 billion

- CBJ Foreign Reserves increased from $6.6 Billion end of December 2012 to $10.7 billion in August 2013.

- The increase in reserves is attributed to the following:
  
  - Approximately $2 billion in grants (including GCC deposits at CBJ).
  
  - The second-tranche of the IMF loan in the amount $385 million
  
  - Two internal USD denominated government bonds in the total amount of $1.15 billion
  
  - CBJ has executed USD/JOD swap agreements with Jordanian banks in the amount $1.6 billion.
  
  - Foreign currency deposits at licensed banks have fallen by $595 million up to June of this year; reflecting reversal trend towards local currency.
Excess liquidity jumped by JD 1 billion in 2013

- Excess liquidity increased significantly this year as a result of growing JD deposits in the banking system, lower current account deficit, two USD denominated bonds, and lower dollarization levels.

- However, the increase in JOD excess liquidity represented less than 50% of the increase in gross JOD deposits in the banking system.

- The lower than expected increase in JOD excess liquidity can be attributed to the withdrawal of CBJ extraordinary repos by JD 425 million, lower CBJ holdings of government bonds, and lower than expected decrease in trade deficit.

- Despite the major decrease in oil bill, Syrian refugees upward effect on imports kept trade deficit close to its levels in 2012; resulting in strong levels of JOD conversion to meet external obligations.

- Recent disruptions of Egyptian gas may also place more pressure on excess liquidity levels.
In the IMF’s April review, IMF staff requested monetary authorities to start withdrawing liquidity stimulus once economic conditions start to improve substantially.

In order to face the dollarization wave that started in 2012, CBJ started purchasing government bonds, conducting weekly and monthly repos with banks, and forward USD/JOD contracts.

However, starting from early 2013, CBJ reduced its repos with commercial banks by around JD 425 million, and reduced its local government bonds holdings by JD 500 Million.

On the other hand, there is no updated figure about CBJ USD / JOD forwards. However, it is expected that the outstanding amount of these contracts did not witness any significant decrease since the beginning of year.
Reversal towards local currency: Higher reserves, higher liquidity

- Reversal towards local currency can be seen through higher JOD deposit levels and lower foreign currency deposits.

- Till August 2013, JOD deposits increased by JD 2.66 billion compared to a JD 1.40 billion drop in 2012.

- Reversal back to the Jordanian Dinar was a result of higher interest rates differential with the green currency, and better FX reserves levels at the Central Bank (mainly due to GCC grants).

- This has helped CBJ to build higher FX reserves, and better levels of excess liquidity, and afterwards to reduce interest rates aiming at supporting growth levels.

- On the other hand, FC deposits decreased since the beginning of 2013 by $687 million; reflecting lower appetite towards safer US Dollar in the market.
Below average credit growth due to limitations on supply & demand

- Till August 2013, credit grew by 5%; lower than a growth average of 15% for the period between 2000 and 2008.

- The lower than average growth is due to supply and demand pressures in the market.

- On the supply side, government borrowing is still crowding out private sector loans through lower liquidity and higher interest rates.

- However, the CBJ attempted last year to ease pressure on liquidity available to use, through a stimulus package; part of is still outstanding till today,

- On the demand side, subdued economic growth and lower purchasing power of consumers are discouraging new businesses to be established and therefore reducing demand for loans.

- In addition, high uncertainty is placing pressure on investments, and thus reducing demand by businesses on credit facilities.
CBJ Cut Rates By 50 Bps ; Signaling The End of 2012 Dollarization Wave

- CBJ Open Marker Committee decided to cut rates on basic monetary tools by 25 bps in October 2013 after a similar 25 bps cut earlier in August.

- The decisions were a result of lower dollarization, better excess liquidity and FX Reserves levels, in addition to lower market rates on government bills and bonds.

- Monetary authorities may have also used the rate cuts as a signal that the dollarization wave that started in 2012 was over.

- Other arguments anticipated that the CBJ is trying to stimulate growth and reduce debt burden on borrowers through cutting benchmark rates; especially after applying transparency regulations that aimed at linking loans’ rates to benchmarks.

- CBJ cuts were much lower than the decrease seen on treasury bonds’ yields in 2013; which almost decreased by 200 bps.

- Gradual CBJ cuts reflect CBJ worries of uncertainly and high inflation levels.
Proposed Eurobonds expected to increase FX reserves & boost excess liquidity levels

- The government is expected to tap international market this month in order to issue $1.25 billion Eurobonds under the guarantee of the US government.

- The 7 years bonds will reduce the government debt service due to the guarantee, while also reduce pressure by the government on local liquidity.

- The bonds will also bolster FX reserves at CBJ by the same amount borrowed; which will enhance confidence of the economy.

- The bonds will also push JOD excess liquidity by a new injected JD 800 Million.

- Earlier, there were fears that Jordan might not be able to issue the bond if the IMF did not approve the disbursement of the third tranche, or if the U.S. government failed to raise the debt ceiling, but now both issues have been resolved.
Upside Risks on Interest Rates Remain; Though at a Minimal Scale

Upside risks to JOD interest rates are:

- Continued disruption on Egyptian gas supplies, that may place pressure on liquidity and foreign reserves, and thus interest rates.
- The possibility of breaking the IMF standby agreement due to lack of performance; which will reduce external support to the country.
- More Syrian refugees that will place extra pressure on fiscal and external imbalances.
- The slight possibility of a delay in Eurobonds issuance towards 2014.
- The increase in US treasury yields witnessed in 2013, has reduced the interest differential between the Dollar the Jordanian Dinar, and may limit the CBJ room for more JOD rate cuts in the future.
- An aggressive withdrawal of monetary stimulus.
External Sector Developments:

Despite significant drop in oil bill, imports increased and trade deficit widened. However, current account deficit narrowed in H1 2013 due to inflow of grants.
Trade deficit up by 8.30% during first 8 months

- The trade deficit grew to JD 6.5 billion in the first eight months of the year, compared to JD6 billion for the same time period in 2012, despite a JD 597 million drop in oil import bill.

- The increase in deficit was caused by both a drop in exports by 0.2% and an increase in imports by 5.1% for the same time period.

- The drop in exports was led by a decline in vegetable, fertilizer, and phosphate exports.

- On the other hand, despite a drop in Jordan’s oil bill by 19.1%, or JD 597 million, Jordan’s overall import bill increased during this time period, probably due to the influx of Syrian refugees.

- The rise in imports was led by an increase in machinery and electronics, metal and its products, and other items.

Source: Central Bank of Jordan

<table>
<thead>
<tr>
<th>Major Change in Import Bill (in million JD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil</td>
</tr>
<tr>
<td>Machinery + Electronics</td>
</tr>
<tr>
<td>Metal and its Products</td>
</tr>
<tr>
<td>Other Imports</td>
</tr>
</tbody>
</table>
Composition of Jordan’s imports and exports

**Composition of Exports (% of total exports)**
- Machinery and Transport Equipment: 25%
- Manufactured Goods: 10%
- Food: 16%
- Clothes: 15%
- Phosphates and Potash: 6%
- Other: 8%

**Composition of Imports (% of total imports)**
- Fuel: 26%
- Manufactured Goods: 16%
- Food: 15%
- Other: 14%
- Chemicals: 10%
- Machinery and Transport Equipment: 19%

Source: Department of Statistics
Jordan Oil bill down by JD 597 million

- Jordan’s oil bill had been constantly decreasing in the beginning of the year, due to an increase in Egyptian gas supplies, a source much cheaper than oil for the government to generate electricity.

- Though an improvement from last year, Jordan’s oil bill comprises around 26% of imports, making fluctuations in the price of oil and gas a heavy burden on the budget.

- Moreover, following the ousting of President Mursi in Egypt in July and the political unrest, Jordan’s supply of natural gas was cut off due to attacks on the pipeline, pushing July’s oil bill up by JD 125.8 million as the government resorted to oil to generate electricity.

- This increase reverses a trend of a decreasing oil bill since the beginning of the year.

- Moreover, comparing Brent oil prices in August 2012 to August 2013, we find that the average barrel price decreased by $2.23 to reach $109, indicating that the actual quantity increase in oil imports is higher.

- In the coming months, the average of forecasts by international agencies on Bloomberg expect crude oil prices to remain above $110pb; slightly higher than the average seen in the last 3 months of 2012.

A breakdown of Jordan’s monthly oil bill (JD million):

<table>
<thead>
<tr>
<th>Month</th>
<th>2012</th>
<th>2013</th>
<th>Nominal Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>488.7</td>
<td>262.3</td>
<td>-225.9</td>
</tr>
<tr>
<td>February</td>
<td>334.0</td>
<td>387.7</td>
<td>+53.7</td>
</tr>
<tr>
<td>March</td>
<td>482.9</td>
<td>358.9</td>
<td>-124</td>
</tr>
<tr>
<td>April</td>
<td>560.2</td>
<td>213.5</td>
<td>-346.7</td>
</tr>
<tr>
<td>May</td>
<td>345.4</td>
<td>253.9</td>
<td>-91.5</td>
</tr>
<tr>
<td>June</td>
<td>274.4</td>
<td>251.0</td>
<td>-23.4</td>
</tr>
<tr>
<td>July</td>
<td>302.4</td>
<td>428.2</td>
<td>+125.8</td>
</tr>
<tr>
<td>August</td>
<td>339.0</td>
<td>373.9</td>
<td>+34.9</td>
</tr>
</tbody>
</table>

Total: 3,127.0 JD million (2012) vs. 2,529.9 JD million (2013) with a decrease of 597.1 million.
Current account deficit narrows during 1H 2013

• Despite a widening trade deficit, Jordan’s current account deficit narrowed from JD 2.6 billion in the first half of 2012, to JD 884.6 million in the first half of 2013.

• According to the IMF, the current account deficit dropped from 16.8% of GDP to 9.7% of GDP in the same time period.

• The current account deficit dropped by around JD 1.7 billion, due to an increase in the public and other current transfers account, with an inflow of grants and aid this year compared to a drought last year.

• Total grants in the current account jumped to JD 1.4 billion in the first half of this year, compared to only JD 138 million for the same period in 2012.

• Grants by Arab countries accounted for the bigger part of the sum, with a JD 1.1 billion in loans.

• Moreover, workers’ remittances grew by JD 50 million in the same time period.

Source: Central Bank of Jordan
Moving forward,
**Strengths**

- Improved monetary stability with more cushion of FX reserves.
- Political stability and higher level of international support.
- Narrower fiscal imbalances after grants.

**Weaknesses**

- Wider trade deficit despite decreasing oil bill.
- High dependence on Egyptian gas in generating electricity.
- Widening fiscal imbalances before grants coupled with high level of irreversible expenditures.
- Weak economic growth coupled with possibility of more austerity measures in the coming years, and high level of uncertainty.
- High unemployment and social challenges.

**Opportunities**

- Diversifying energy sources. The liquid natural gas terminal in Aqaba is expected to be operating by end-2014.
- GCC funded capital projects.
- Better working remittances and more tourism income.
- A possible return to previous FDI levels, mainly due to political and economic stability.

**Threats**

- Further deterioration in the Syrian situation; resulting in increased number of refugees weighing on government balances and infrastructure.
- External shocks including oil prices’ volatilities and lower regional and global demand for Jordanian exports.
- Accelerating public debt, likely to reach above 80% of GDP by end of 2013.
- Negative social and economic impacts that may result from increased austerity and decreasing purchasing power of individuals.
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