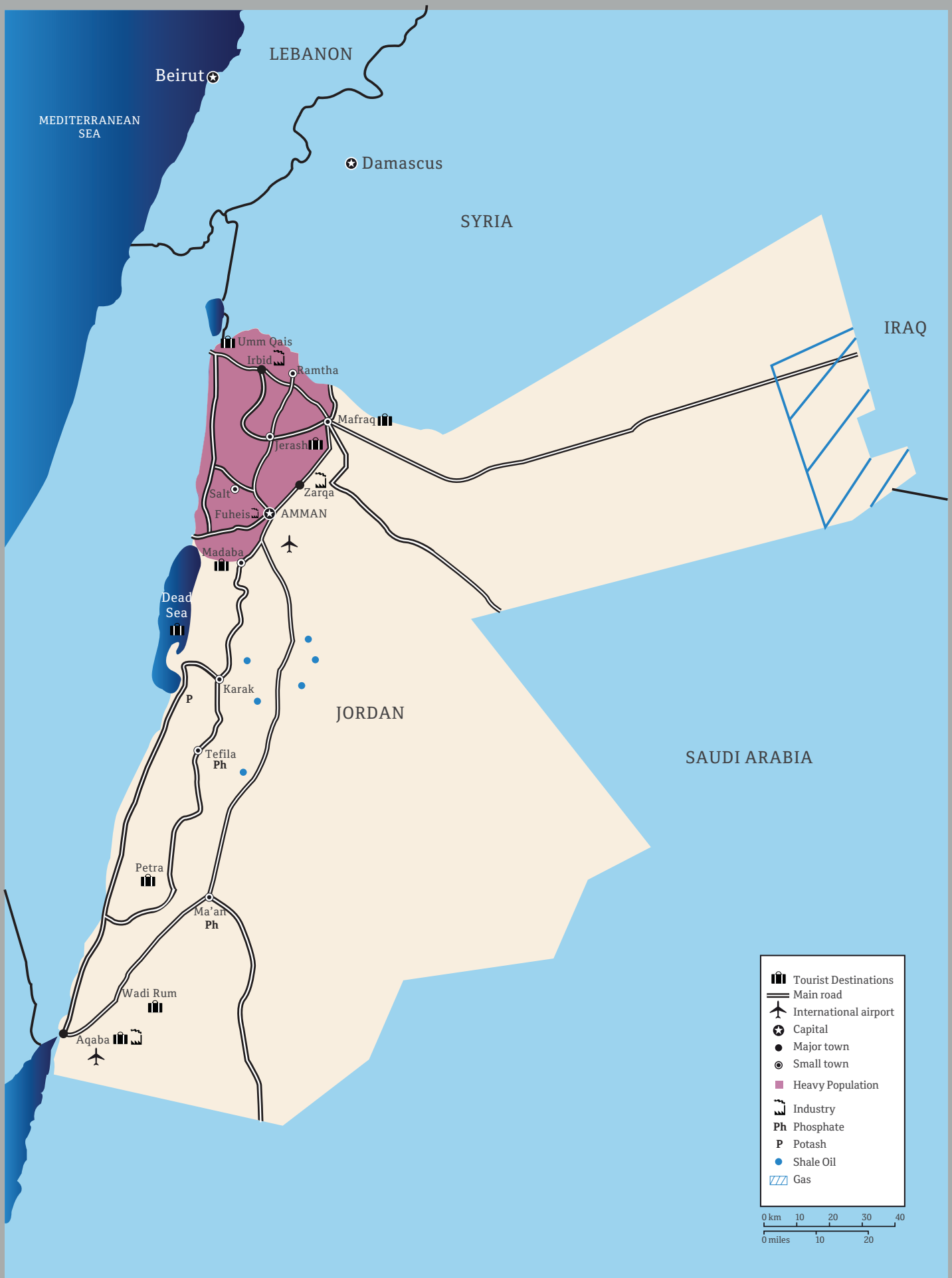
QNB

Jordan Economic Insight 2012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Editorial closing, 15th November 2012

Summary

- Jordan is a diversified economy with a strong services sector. *Real growth of 2.5% is forecast in 2012, and 3.6% in 2013*.
- *GDP per capita was US$4,450* in 2011, ahead of Syria, Egypt and even Iraq.
- The resident population includes many refugees, most recently from Iraq and Syria. Conversely, *about 10% of Jordanians work abroad*, mainly in the Gulf.
- About a *third of jobs are in the public sector*, but given fiscal constraints, it will struggle to sustain recent levels of job creation to tackle unemployment, officially at 11.6% as of Q2 2012.
- There are *serious constraints on energy and water* resources. A *sharp reduction in gas imports from Egypt* has necessitated oil imports, which are much more expensive, to meet power needs. There are long-term plans to develop gas, shale oil, nuclear power and renewable energy.
- *Tourism indirectly drives about a fifth of GDP*. Visitor numbers have been boosted recently as instability in neighbouring countries has diverted tourists to Jordan.
- The main manufactured *exports are textiles, fertilisers and pharmaceuticals*. Raw exports include phosphates, potash and vegetables.
- Rising oil import costs and a decline in foreign direct investment have led to a *fall in Jordan's foreign reserves*, which are forecast to drop further to five months of import cover by end-2013.
- The *dinar's peg to the US dollar* provides monetary stability; interbank rates are about 3% higher than the US.
- *Inflation is forecast at 4.7% in 2012 and 4.0% in 2013*. Rises related to the ending of fuel subsidies in November 2012 will be a main driver of inflation.
- Jordan is *highly dependent on grants, particularly from the GCC*, for both its public finances and current account. The fiscal deficit is forecast to average 12.1% of GDP in 2012-13, but grants should bring this down to 7.1%.
- Fuel and electricity subsidies have contributed to a *significant increase in public debt*, which reached 76% of GDP in August 2012.

1. Overview

Jordan has managed to thrive in a harsh context

Jordan was founded in the 1920s, with a small population, few accessible natural resources and located in the heart of a turbulent region. Its demographics and economy have been repeatedly transformed by refugees, who now comprise the bulk of its population of 6.5m.

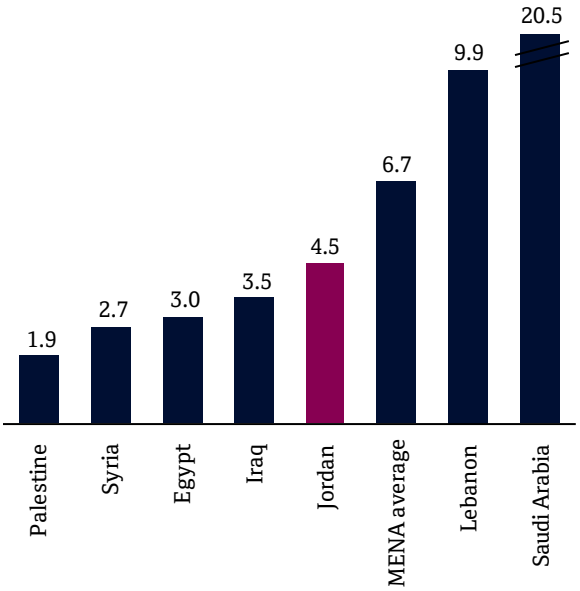
Yet Jordan has survived and even thrived, serving as a haven of stability in the Levant region. Many features of its economy are unexpected and remarkable. It has achieved some of the highest educational levels in the region and has leveraged this human capital in sectors such as pharmaceuticals and business process outsourcing. Other economic activity ranges from phosphate mining to tourism and textiles. The state has managed its international relationships shrewdly, securing substantial grant assistance and developing a strong network of free trade agreements.

There are some serious weaknesses with Jordan's economic model, and much could be improved. Nonetheless, its successes are impressive given its context and constraints.

Income levels are moderate compared to neighbouring countries but living costs are high

Jordan has a higher level of GDP per capita than most of its immediate neighbours. QNB Group estimates that GDP per capita was US$4,450 in 2011 (Fig 1.1).

Fig 1.1: GDP per Capita (2011)
(US$ '000)



Source: IMF, Global Insight; The IMF's figure for Jordan have been adjusted slightly downwards based on QNB Group's higher population estimate

Jordan's GDP per capita is substantially higher than Palestine, Syria, Egypt and even oil-rich Iraq. However, living costs are extremely high in Jordan, partly because of the heavy reliance on imports for many necessities. Also, the concentration of most of the population in a few urban areas tends to inflate property and rental prices compared with a more widely distributed society. This is why, although Jordan's GDP per capita is about 50% higher than Egypt's, the per capita purchasing power is actually lower in Jordan.

Water is limited and most energy is imported, although local generation is set to improve

Longstanding energy constraints have become more acute recently, as affordably priced gas imports from Egypt for power generation have been curtailed. This has forced Jordan to import additional oil in its place and at a much higher cost. This has added to already existing structural deficits in the fiscal and current accounts. Reducing dependence on energy imports is therefore one of Jordan's most urgent strategic priorities. To achieve this, it aims to boost domestic gas production, exploit shale oil and uranium reserves and develop solar and wind power.

The main obstacle to all of these initiatives is financing. Most project financing will need to come from the private sector, particularly through foreign investment, because of the state's serious fiscal constraints. Providing that sufficient investment is available, dependence on energy imports should be considerably reduced. The 2007 Energy Master Plan aims to generate 40% of energy from local sources by 2020. This should be achievable, but the energy import bill will remain a major burden for the next decade, even in the most optimistic scenario.

There is also a serious shortage of water supplies[1], which has the knock-on impact of limiting food production. The utilisation of aquifers is serving as a temporary stopgap, but the only long-term solutions are improving the efficiency of water consumption coupled with desalination of water from the Red Sea. The increasing domestic energy supplies will support this effort to desalinate water and pump it, 350 km north and uphill, to the main population centres.

[1] According to the World Bank, Jordan's annual rainfall was equivalent to just 115 cubic metres per capita in 2009, the 12th lowest in the world. As water consumption is higher than supply, Jordan is one only a few countries with a water deficit, and it is one of the poorest in this group.

High education levels boost Jordan's human development indicators

Jordan has a relatively high level of human development in comparison to peer countries. Aside from Lebanon, Libya and the six Gulf states, which are all considerably wealthier, Jordan is the equal highest-ranking Arab country in the Human Development Index developed by the UN Development Programme (UNDP). In the 2011 edition of the Index, Jordan ranked 95th globally, tied with Tunisia and Algeria, and only just behind Turkey.

Jordan scores most highly in the education dimension of human development, and is the fourth-highest ranking Arab country by this measure. The average length of schooling in Jordan is the third highest in the Arab World, at 8.6 years, a level classified as high human development by UNDP. The level of enrolment in education is also among the highest in the region, at 78%. However, Jordan performs more poorly on healthcare indicators than might be expected, given its reputation as a regional destination for medical tourism.

Frequent changes in government inhibit long term economic planning

Unlike some countries in the region, Jordan lacks an overarching economic vision or development strategy, either for the medium or long term. A wide-ranging 10-year plan was actually developed in 2005, but gained little traction. This is because the average lifespan of a cabinet is less than a year and the rapid turnover in ministers makes it hard to implement development plans. The turnover problem is widely recognised and efforts are being made to ensure greater government stability in the future, following new elections scheduled in January 2013.

One development initiative that has, nevertheless, gained some traction is a network of regional development zones which aim to attract investment and spread economic activity around the country. The first of these was Aqaba Special Economic Zone, launched in 2001. The investment incentives include a 5% flat tax (compared to top corporate rates of 14%-30% elsewhere, depending on the sector) and exclusion from import duties and property taxes. Other development areas have been established in Mafraq, Ma'an, Irbid—in the east, south and north of the country respectively—and in the capital, Amman. In addition, the Jordan Development Zones Company is coordinating tourism investments into sites by the Dead Sea and in Ajloun.

A related initiative is the Qualifying Industrial Zones (QIZs)—including in Irbid, Amman, Zarqa and Karak. These were established to benefit from a special dispensation for tariff and quota free trade access to the US market. Almost all the factories established in the QIZs have been for textiles production. Much of the investment has come from South Asian countries, which now also supply the bulk of the workforce. As a result, while there has been some local job creation, the linkages with the Jordanian economy have not been as great as was originally envisaged.

The business environment has some strengths but there is significant room for improvement

The World Bank's Ease of Doing Business Index ranks Jordan 106th/185 globally. This is the highest ranking in the Levant, and the third highest in the MENA region, aside from the Gulf countries, behind Tunisia and Morocco. Given the importance of foreign investment and regional services to the Jordanian economy, improving the business environment should be a priority. Instead, Jordan's rank has fallen in recent years while other countries in the region have risen. For example it was ranked 80th in 2008 ahead of Tunisia, which has now leapfrogged Jordan to 50th place. Worryingly, Jordan ranks even more poorly in two key categories—protecting investors and enforcing contracts—at 128th and 129th place respectively. Its weakest area is obtaining credit, where it ranks 167th, owing to conservative banking practices.

The World Economic Forum's Global Competitiveness Index gives a more favourable assessment of Jordan, placing it 64th/144. It assigns even higher rankings for education, the strength of institutions and innovation, and ranks Jordan 11th in the world for its availability of skilled scientists and engineers. However, negative areas include investor protection (101st) and trade tariffs (104th). Companies surveyed cited labour regulations, tax rates and access to financing as the most problematic barriers to business.

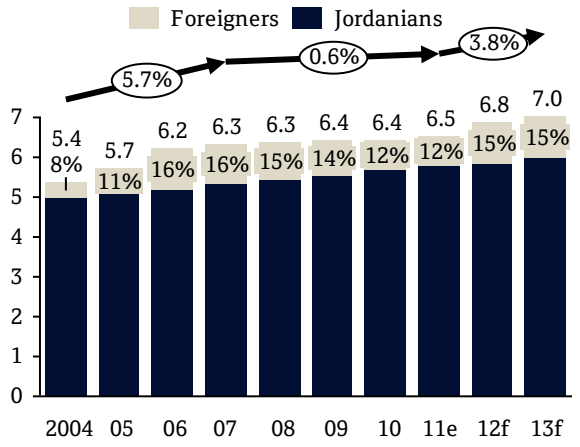
2. Demographics and Labour Force

A. Demographics

Population flows are dominated by refugee arrivals and Jordanian emigration to the Gulf

Jordan's population reached an estimated 6.5m at the end of 2011 (Fig 2.1).

Fig 2.1: Population
(million and % share , CAGRs[2] shown)



Source: Department of Statistics (DoS), Ministry of Labour (MoL), UN Relief and Works Agency (UNRWA), UN Refugee Agency (UNHCR) and QNB Group estimates

Population change has been driven by three main factors. Firstly, the crude growth rate, resulting from births and deaths alone, has been steadily declining in recent decades as women have children later and family sizes decline. It has come down from 4.0% in 1970 to about 2.5% today. Secondly, Jordan receives substantial flows of refugees—most recently from Iraq and Syria—and hosts migrant workers. Thirdly, many Jordanians move overseas for work, particularly to the Gulf. There has been a pickup in emigration to the Gulf since 2004 as those economies have developed rapidly on the back of high oil prices.

The last census was in 2004, before either the latest refugee or emigration trends had properly developed. The next census has been scheduled for 2014, and should clarify the situation. In the meantime, QNB Group has estimated population numbers on the basis of official figures for resident citizens, migrant workers and refugees[3], extrapolating where there are gaps. This reveals a picture of sharp growth during 2005-07, driven by the arrival of Iraqi refugees. This was followed by a period of little growth, as natural growth was offset by the departures of some Iraqis, a decrease in immigrant workers and the continued emigration of Jordanians to the Gulf.

In 2012, Syrian refugee arrivals are forecast to accelerate population growth to about 5.3%. The rate of arrivals, at the time of writing, had increased to about 500 a day, with no sign of an end to the conflict. We assume these Syrian arrivals will continue for the first half of 2013, although some Iraqis will depart. Overall, growth will slow to 2.3%. There is considerable uncertainty in this forecast as it depends largely on the political situation in Syria.

The population is heavily concentrated in the more fertile northwest corner

About 85% of the population, or 5.5m people, live in the northwest corner of the country[4]. This region measures about 6,000 km^2, about 7% of Jordan's total area and just over half the size of Qatar. It contains the three main cities of Amman, Irbid and Zarqa.

If this region was a separate country, it would be the second most densely populated in the world, after Bangladesh, aside from a few small islands and city-states. It has a density of about 970 people/km^2. The rest of the country has an average density of about 10/km^2, although, in reality, most of the remaining 1m population are also concentrated in a few small areas, as about 60% of the land in the east and south is desert and arid hills.

Jordan has witnessed a rapid process of urbanisation and 87% of the population now live in urban areas, up from 44% in 1970. However, outside the three main cities, nearly half of the population is rural.

Jordan's population has been bolstered by refugees throughout its history

In the 1920s, about a third of Jordan's population were semi-nomadic Bedouin and the remainder were mainly farmers. The largest towns, such as Salt, had no more than a few thousands residents. This original settled population was diverse with a number of minorities alongside the majority Arab tribes.

[2] Multi-year growth rates in this report use the compound annual growth rate (CAGR) not the average rate. So growth from 2007-11, as seen in one of the arrows on Fig 2.1, consists of four years of compound growth (from the end of 2007 to the end of 2011).

[3] Most refugees live in cities not camps, often arriving on tourist visas and constantly renewing them or overstaying their term. This complicates the enumeration of the resident population.

[4] This region includes part of the Houran plateau and a chain of hills on the edge of the Dead Sea rift valley. This topography means that the region receives 3-5 times as much rainfall as the national average. It is also fed by the Jordan, Yarmouk and Zarqa rivers. This greater agricultural potential, together with proximity to Palestine and Syria, is the why Jordan's main cities developed in this region historically and in the modern era.

The main minority were Circassians, who came as refugees from the Caucasus in the 19th century. The integration of the Circassians set an early example for Jordan's future hospitality to refugee communities. It also demonstrated the important contribution they can provide to the country's development. For example, the Circassians founded modern Amman in 1878. Smaller minorities included Dom Gypsies, who have lived in the region for centuries, and Armenians, who came as refugees from Anatolia during the First World War.

There have been five subsequent inflows of refugees, including three waves of Palestinians and, more recently, Iraqis and Syrians. The first group of about 100,000 Palestinians refugees came in 1948, following the creation of Israel. A further 400,000 came in 1967, after its conquest of the West Bank from Jordan. Finally, in 1990-91, Palestinian refugees and Jordanian migrant workers left Kuwait during and after the Iraqi invasion, with about 300,000 settling in Jordan. Most Palestinians have been granted Jordanian citizenship.

Large numbers of Iraqi and Syrian refugees have arrived in recent years

Iraqi refugees began coming to Jordan in 1991 and inflows picked up considerably after the 2003 war. Over a twenty year period more than 1m Iraqi refugees came through Jordan, many only temporarily, including a peak of about 0.5m arrivals during 2005-06 when the sectarian conflict in Iraq intensified. Their numbers totalled about 420,000 at the end of 2011[5], about 7% of the population.

The latest group of refugees are from Syria, who began arriving in Jordan in mid-2011 and were estimated to number over 200,000 in early November 2012.

Aside from refugees, there are about 300,000 other foreign residents in Jordan, mostly migrant workers, making up 5% of the population and coming mainly from Egypt and South Asian countries.

About 10% of Jordanians work abroad, mainly in the Gulf

As well as being a destination for refugees and migrants, Jordanians themselves have often emigrated, mainly to the Gulf. Their numbers peaked during the mid-1970s, when nearly a third of Jordanian citizens were living in the Gulf, mainly in Saudi Arabia and Kuwait. Many returned during the 1980s and 1990s. During the second oil boom over the last decade, many Jordanians have once again moved to the Gulf. Current estimates put their numbers at about 600,000, or nearly 10% of the Jordanian citizen population.

[5] Jordanian government figures published by The UN Refugee Agency (UNHCR).

B. Labour Force

The domestic labour force totals about 1.8m

Official figures put Jordan's labour force at 1.7m at the end of 2011, about 16% of whom are registered foreign workers. This excludes those without work permits who are engaged in informal work, particularly Iraqi refugees[6]. If these were included in the tally, this would boost the total labour force to around 1.8m. Unemployment averaged 12.9% in 2011, close to the average over the last decade.

The unemployment rate eased to 11.6% in Q2 2012, the lowest level in five years, although this improvement may be partly due to seasonal employment and is unlikely to be sustained for long. Youth employment is higher at about 31% in 2011. Some Jordanian economists also put the actual overall unemployment rate considerably higher at up to 25%, taking into account underemployment and jobseekers who are not factored into labour force figures.

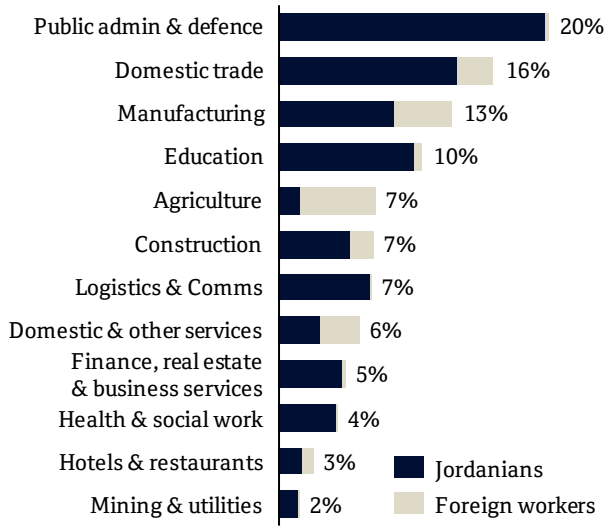
The Jordanian workforce has a mix of skill levels. As of 2010, around 26% of Jordanians in the workforce had a university-level education, up from 22% in 2006. This is despite the fact that many of the most highly skilled Jordanians work abroad.

The public sector provides about a third of jobs

The Jordanian economy is highly diversified, compared with the rest of MENA, which is reflected in employment patterns. About 7% of workers are engaged in agriculture, 22% in industry, mainly manufacturing, and 71% in services. Public Administration and Defence is the largest employment sector, representing about 20% of the total employment of 1.5m in 2011 (Fig 2.2). Overall, the public sector represents about a third of total employment, when public jobs in education, healthcare and other sectors are included. This is a substantial burden given ongoing fiscal deficits (see Chapter 7).

[6] Only 1,100 Iraqis had formal work permits in 2011, less than half a percent of the adult Iraqi population in Jordan. However, a survey in 2007 by the Norwegian think tank FAFO, commissioned by the Jordanian government, found that 22% of adult Iraqis were working.

Fig 2.2: Employees by Sector and Nationality (2010)
(% share of total employment of 1.5m)



Source: MoL and QNB Group estimates

Low levels of female participation limit the size of the labour force

The labour force participation rate is only about 42% of the adult population. This is a low share by international standards. Part of the reason for this is that there are large numbers of Jordanians working abroad. However, the main reason is the low level of female participation. Only 16% of women are engaged in the workforce, compared to about 67% of men. This places Jordan within the bottom five countries in the world for female participation rates, according to the World Bank.

There are also some practical barriers to women working, such as a lack of public transport to urban centres where jobs are available. High unemployment may also discourage women from joining the labour force: almost a third of unemployed Jordanians are women and the official female unemployment rate was 21.2% in 2011, compared with 11.0% for men. However, female unemployment has fallen from 25.6% in 2007, during a period in which male unemployment has risen from 10.3%.

Women make up the majority of the workforce in the education, health and social welfare sectors. Over half of working women are concentrated in these sectors. Their participation in most other sectors ranges from a surprisingly low 4% in hotels and restaurants, to 29% in financial services.

Foreign workers are mainly in low paid jobs that are not attractive to Jordanians

Registered foreign workers filled 18% of jobs in 2011. Given that there are more jobs filled by migrants than unemployed Jordanians, the government has undertaken various initiatives to try and fill some of these jobs with Jordanians. The National Employment Centre has a target of "a Jordanian for every job opportunity" and efforts have been made to equip unemployed Jordanians with relevant vocational skills. Some progress has been made, which may have contributed to the fall in registered foreign workers by 17% since their peak in 2009, and in 2011 they were at their lowest level since 2005.

However, the potential for further replacement of foreign labour[7] is likely to be limited. This is because most of these jobs are poorly paid roles for unaccompanied workers living in shared accommodation, particularly in agriculture, manufacturing and domestic service. 85% of foreign workers earned monthly salaries below JD150 (US$211) in 2011, with many earning below the minimum wage of JD143 (it was increased to JD190 in 2012). Therefore, most of these jobs would not enable Jordanians to support their families given local living costs. Only about 2% of foreign workers were earning above the average national wage of around JD410.

An example of jobs largely occupied by foreigners are those in the textile firms, which were set up within the QIZs. The employment of Jordanians in the QIZs reached 18,700 at end-2004 when they comprised 60% of the workforce. However, as margins in the sector were squeezed and wages became less attractive, the number of Jordanian workers rapidly declined and, by August 2012, their numbers had more than halved and now only account for 22% of QIZ workers.

Job creation has slowed in 2010-11 and migrant workers are departing

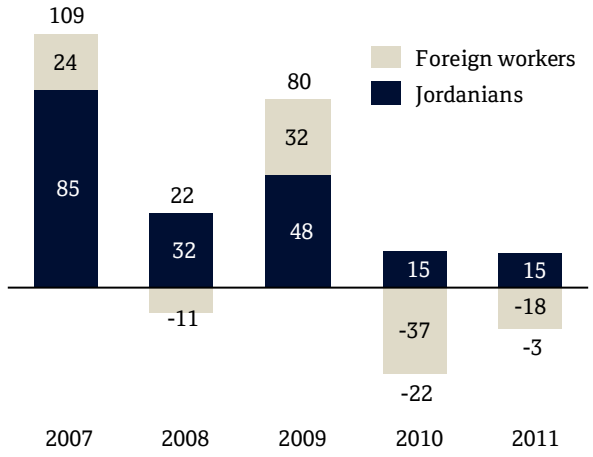
The level of net job creation—the number of new jobs created less existing ones lost—has been fairly volatile in recent years. In 2007-9, an average of over 70,000 extra jobs a year were created. In 2010 and 2011, however, there was a small net reduction in jobs (Fig 2.3).

Examining the breakdown in the employment data shows that there were substantial job losses among migrants in 2010-11, Indeed, the total number of

[7] 68% of foreign workers in 2011 were Egyptian and 29% were Asian, mainly from Sri Lanka, the Philippines, Indonesia and Bangladesh.

migrant jobs fell by 17% over this period. At the same time, there was a small increase in Jordanian employment, although well below the level of job creation seen in previous years. This could be interpreted as Jordanians filling migrant roles. The more likely explanation is that the private sector is shedding migrant jobs as the economy slows while the public sector has continued to hire Jordanians.

Fig 2.3: Net Change in Jobs by Nationality (2007-11)
(thousand)



Source: QNB Group estimates based on MoL data; Note: The employment by nationality and employment by sector series differ slighting in some years

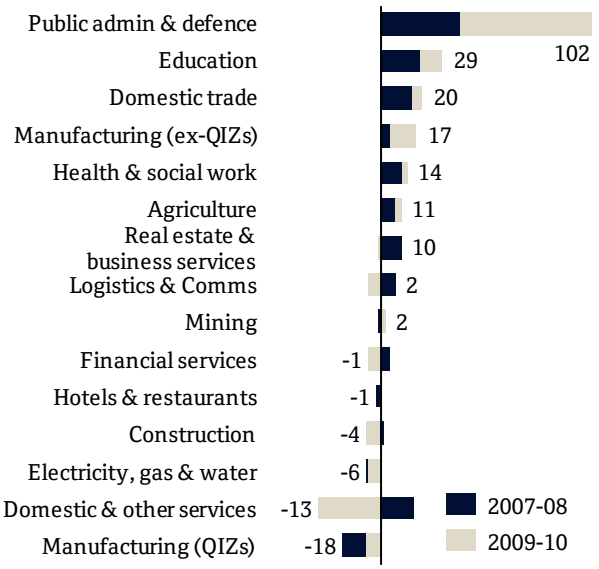
Almost all net jobs created in 2007-10 were in the public sector

Employment data by sector supports the picture that the public sector has been driving employment growth. Public administration and defence was the sector with the fastest rate of employment growth in 2007-10, at 10.9%, compared with an overall growth rate of just 2.9%. It provided 102,000 additional jobs during that period, nearly two-thirds of employment growth (Fig 2.4).

Most of the other jobs created during this period were in education and healthcare, where employment grew at 5.5% and 5.9% respectively. Many of these new jobs were probably also in the public parts of these sectors.

In the private sector, only real estate & business services saw a robust 5.0% rate of job growth in 2007-10. However, all this growth came before the 2009 economic downturn. Indeed, overall there is a clear difference in the job creation trends in 2007-08 compared with 2009-10. In the earlier period, nearly half of the net jobs created were probably in the private sector (as they were in sectors other than public administration, education and healthcare). In the later period, however, the private sector actually shed a considerable number of jobs, particularly in "other services" (a residual that is mainly comprised of domestic services). To be more precise, the trend in the private sector turned negative in 2010, having probably seen a considerable increase in jobs in 2009.[8]

Fig 2.4: Net Change in Jobs by Sector (2007-10)
(thousand jobs)



Source: QNB Group estimates based on MoL data

One interesting trend was in the manufacturing sector, where the QIZs shed a large share of their workforce, while the rest of the sector added a similar number of jobs. Nonetheless, these changes were a net benefit for the workforce because the QIZ jobs are mainly poorly-paid migrants jobs, while the other manufacturing roles are likely to be better-paid roles employing Jordanians.

The economy will struggle to create the 30,000 new jobs required annually for new entrants

The Jordanian labour force typically grows by about 30,000 people a year. In order to provide for the new entrants and also reduce unemployment, the economy would need to create more than this number of Jordanian jobs a year. It easily achieved this in 2007-09, but, in 2010-11, the rate was well below what was required and this trend likely continued in 2012.

However, given the relatively moderate rates of economic growth forecast in the next few years, it is hard to see how the private sector will be able to create the required number of jobs. At the same time, the public sector is unlikely to be able to sustain the pace of its jobs creation programme. This is because of its serious fiscal constraints, which are requiring reductions in spending across most government departments (see Chapter 7).

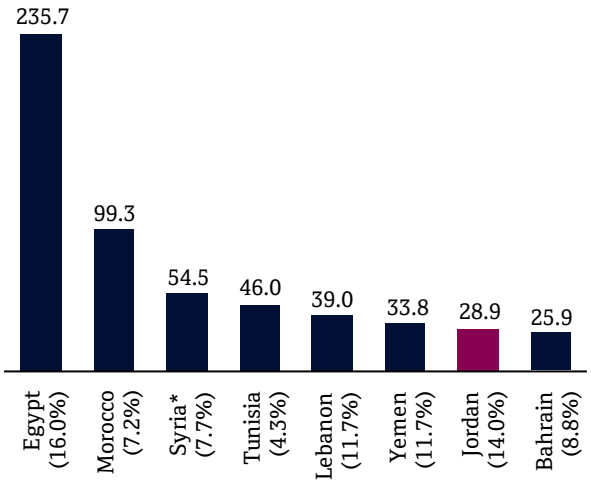
[8] A full breakdown of employment by sector in 2009 does not appear to be available in MoL reports, hence the 2008 to 2010 change has been examined. 2011 was also not yet available at the time of writing.

3. GDP

A. Structure

Jordan is the third smallest MENA economy, after Palestine and Bahrain, with a nominal GDP of US$28.9bn in 2011 (Fig 3.1), though it has more than tripled in size over the last decade.

Fig 3.1: Nominal GDP of Selected Countries (2011)
(US$bn, 2007-11 CAGRs shown in brackets)

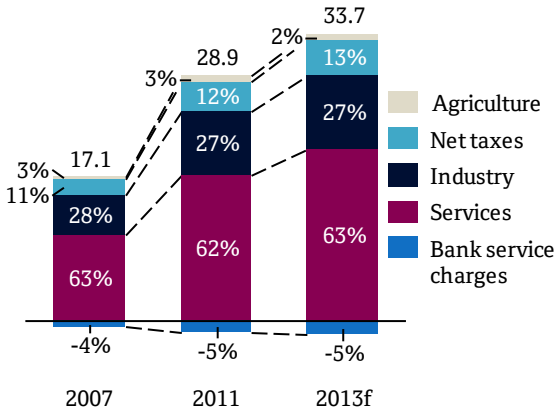


Source: IMF, *Economist Intelligence Unit estimate and QNB Group analysis

Services are more important than in comparable countries and agriculture is less important

The structure of the economy has been relatively stable in recent years, and remains dominated by the services sector (Fig 3.2).

Fig 3.2: Nominal GDP by Sector (2007-13)
(US$bn and % share of sectors)



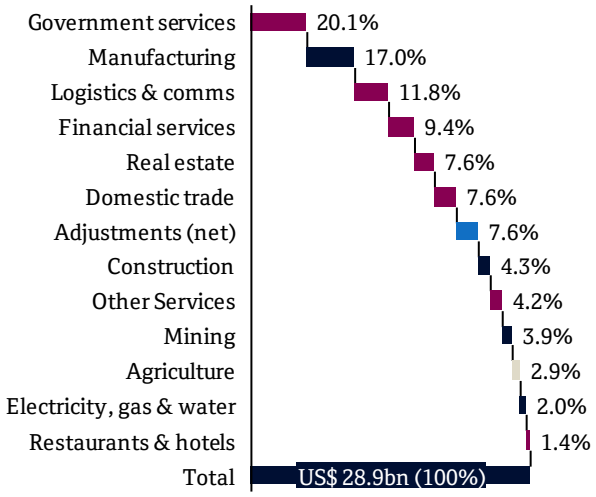
Source: DoS and QNB Group forecasts

Services made up 62% of total GDP in 2011, one of the largest share of any MENA country. By contrast, agriculture, at just 3% of GDP, had a smaller share than in any of the MENA countries outside the GCC. The share of industry, at 27% of GDP, was about average for MENA oil importers.

One area where Jordan differs from other countries in the region is in the size of the cross-sectoral adjustments to GDP. The net taxes on products—which includes import duties and sales taxes less subsidies—were 12% of GDP in 2011, considerably higher than other MENA countries. The reason for this is that product tax rates are higher and subsidies lower in Jordan, given the country's fiscal constraints. Bank services charges[9], a deduction of 5% of GDP in 2011, are also high by regional standards, though not the highest.

Breaking down the sectoral components of GDP in more detail (Fig 3.3) shows that the economy is fairly diversified in comparison, for example, to oil producing states. The structure, evolution and prospects for the individual sectors are examined in more detail in Chapter 4.

Fig 3.3: Economic Sectors' Share of GDP (2011)
(% share of total)



Source: DoS and QNB Group analysis

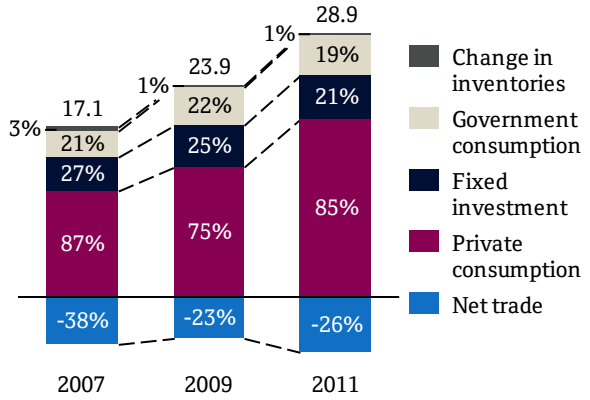
Private consumption and imports dominate GDP

On an expenditure basis, Jordan's economy is clearly dominated by private consumption, which was equivalent to 85% of GDP in 2011, the second highest level in the region (Fig 3.4). Private consumption's share of GDP contracted in 2009, as a result of belt-tightening at the onset of the global recession. This reduced private demand also contributed to the fall in imports and, hence, the narrowing of the trade deficit that year. Both private consumption and imports have since rebounded.

[9] Bank service charges are defined as the difference between the interest received from borrowers and the interest paid to depositors. In the most correct calculation, the charges should be deducted from sectors according to the distribution of loans used by the sectors. However, as this is difficult to do, official statistics usually deduct the adjustment from the services sector or from the overall GDP, as is the case in Jordan.

Fig 3.4: Nominal GDP by Expenditure (2007-11)

(US$bn and % share of sectors)



Source: DoS and QNB Group analysis

The shares of fixed investment and government consumption, at 21% and 19% respectively, are about average for the region[10]. This means that overall domestic demand is high and therefore that net imports are also high (at 26% of GDP in 2011).

The only countries in the region with higher levels of net imports in the region are Palestine and Lebanon. Jordan is also the most import-dependent country in the region, with total imports of 72% of GDP in 2011. Some of these are re-exported, particularly to Iraq and Palestine, but most are for the domestic market.

B. Real growth

Real economic growth has slowed sharply since a boom period in 2004-08

The real growth rate[11] rose sharply to 8.0% during 2004-08 (Fig 3.5). This compared to just 4.2% recorded during the previous decade. Following the onset of the global crisis, however, it dipped to 5.5% in 2009[12] and then to 2.4% in 2010-11. We forecast that it will remain fairly flat at 2.5% in 2012, but pick up to 3.6% in 2013.

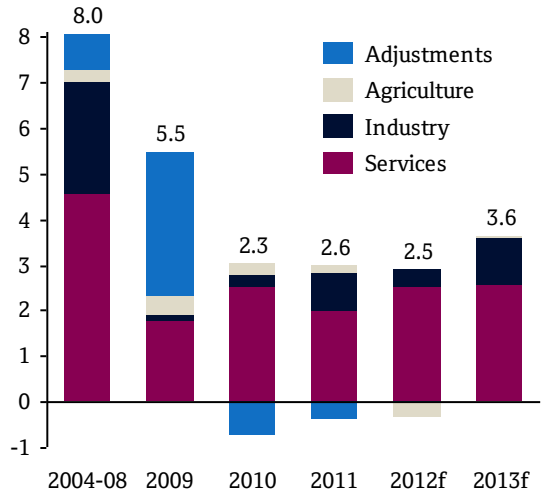
[10] In 2011, Investment ranges from 15%-34% of GDP in the MENA region, and government consumption from 11%-28%.

[11] While nominal GDP tracks the value of economic output, real GDP aims to track the change in the volume of output, by keeping prices constant at a certain arbitrary base year.

[12] The dip in 2009 would have been even sharper without an unusually large increase in net taxes in the adjustments line, which provided more than half of the overall GDP increase. This was particularly surprising because imports and private consumption fell in the year, which would have reduced the real volume of import duties and sales taxes charged. However, the ending of certain subsidies, which normally subtract from the other components of net taxes, may have been the reason for its steep increase.

Fig 3.5: Contributions to Real GDP Growth by Sector (2004-13)

(% annual change, broken down by sectoral contributions)



Source: DoS and QNB Group forecasts

There was a boom in 2004-08, driven by economic ties with the Gulf and Iraq

It is not a coincidence that the boom years corresponded with a period of sharply rising oil prices. Although Jordan suffered from rising oil import costs, this negative was more than offset by indirect benefits from the flourishing Gulf oil economies. These included inflows of remittances, investment and aid, as well as exports of goods and services back to the Gulf.

There were a number of other significant trends driving the real economy during this period. These included Jordan's role as a logistics hub for the multilateral forces in Iraq and as a secure base for international organisations involved in post-conflict relief and reconstruction. These factors bolstered a range of services sub-sectors including transport, hotels and domestic trade. At the same time, the arrival of hundreds of thousands of Iraqi refugees during this period provided a significant boost to consumption.

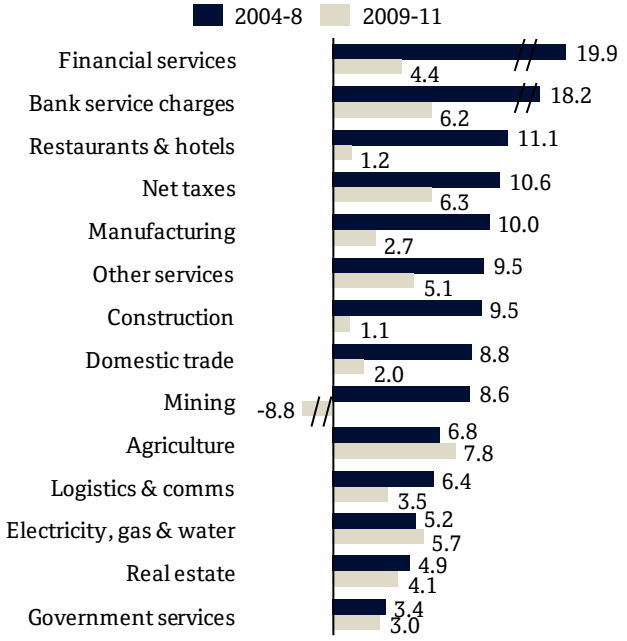
Another factor supporting the boom was the expansion of textile manufacturing in the QIZs which can supply the US market free of tariffs and quotas. Exports were also supported by other free trade agreements, particularly Jordan's joining of the WTO in 2001. Privatisation of certain ailing state enterprises also helped boosted commerce and investment.

Financial services and manufacturing led growth during the boom

On a sectoral basis, the growth during the 2004-08 boom period was broad based, although there was still some significant variation in growth rates. The financial

services sector performed particularly strongly during the boom years, growing at a rate of 19.9% as it financed much of the expansion (Fig 3.6). Manufacturing, expanding at a rate of 10.0%, also made a significant contribution to overall growth. As well as the QIZs, this period saw strong expansion in Jordan's chemical and pharmaceutical manufacturing capacity.

Fig 3.6: Real Growth by Sector (2004-11)
(% annual change, ordered by growth rate in 2009-11)



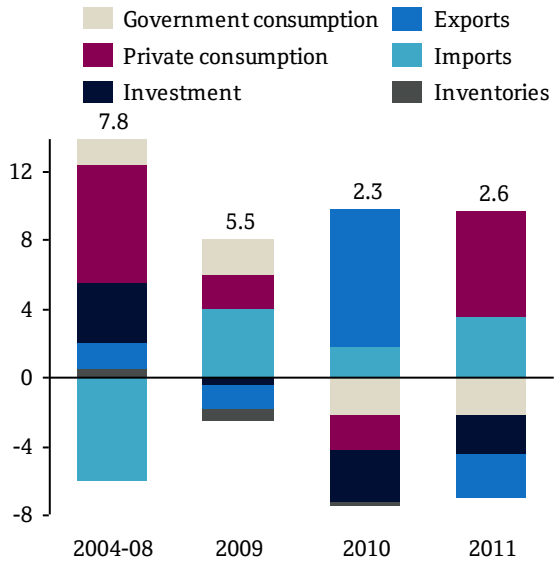
Source: DoS and QNB Group analysis

Conversely, government services expanded more slowly, at a rate of 3.4% in 2004-08, as persistent deficits and pressure for higher wages limited the public sector's ability to expand. Government services was, therefore, a significant drag on overall real GDP growth.[13]

Imports grew even faster than exports during 2004-08

All of the above factors helped to contribute to strong growth during the boom period, particularly in domestic demand. Investment grew at a rate of 15.9% and private consumption at 9.4%. By contrast, net trade was a significant drag on growth because imports grew even faster than exports. Imports subtract from domestic production, and so strong growth in 2004-08 meant that overall GDP growth was 6% lower than it would otherwise have been if imports had been flat (Fig 3.7).

Fig 3.7: Contributions to Real GDP Growth by Expenditure (2004-11)
(% annual change, broken down by expenditure component contributions)



Source: DoS and QNB Group analysis; Note: The expenditure data gives a slightly lower growth rate in 2004-08 than the GDP by sector data

Growth slowed in 2009-11 after the global financial crisis and recession

The global financial crisis, in late 2008, and subsequent recession, undermined Jordan's economic growth in many dimensions, including trade, investment, tourism and general business confidence. All this contributed to a sharp slowdown in 2009-11.

The contraction would have been even steeper if demand for imports, which subtract from GDP, had not fallen. Imports contracted in all three years from 2009-11. Investment also contracted each year, falling at a rate of 8.4% over this period. Lower investment levels were one of the factors contributing to the lower imports, for example, through a reduction in the demand for construction materials.

Private and government consumption held up in 2009. Indeed, government consumption even grew at slightly above trend rates as spending was stepped up to provide a temporary stimulus. However, by 2010, both had slipped into negative territory.

Therefore, growth in 2010 was almost entirely sustained by exports, which grew by nearly a quarter as global demand recovered, particularly for phosphates and potash. Although exports slipped back a little in 2011 and government consumption and investment continued to decline, private consumption revived strongly, which kept the economy out of recession.

[13] The real GDP data uses 1994 as a base year. The DoS is currently rebasing real GDP to 2006 prices, which should significantly boost the weight of government services and show that it has had an even larger drag effect on overall GDP. Conversely, some faster growing sectors, such as mining, are likely see their weight rise from the rebasing while some slower growth sectors, such as real estate, should see their weights fall.

The slowdown affected almost all economic sectors, although to varying extents

Real growth rates have fallen in almost all sectors since 2009. One of the exceptions was agriculture, which actually saw a slight pickup in growth to 7.8% in 2009-11, probably because of better climatic conditions (Fig 3.6). Otherwise, the overall trend has been for slower growth, or even contraction in the case of the mining sector, which fell by 46% in 2009 and has not yet fully recovered.

Some sectors maintained buoyancy in the first year of the downturn, particularly construction and electricity, gas & water, which grew by 13.2% and 15.3% respectively in 2009, but then both contracted in 2010. Even the more strongly performing sectors in recent years have been growing at well below the previous trend. Financial services achieved a 4.4% growth rate in 2009-11, compared to 19.9% in 2004-08.

H1 data for 2012 suggests only modest growth, but we forecast a small pickup in 2013

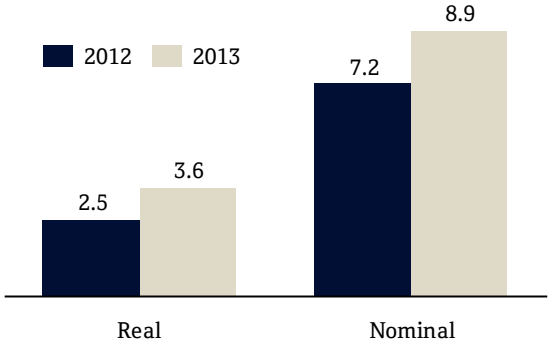
The regional and international environment has remained difficult in 2012. High oil prices have increased the import bill and acted as a drag on economic growth and the conflict in Syria has disrupted trade flows. Year-on-year real growth in the first half of 2012 was 2.9%, according to preliminary data.

Notably, hotels & restaurants rebounded strongly from a small contraction in 2011 to 11.0% year-on-year growth in the first half of 2012. Jordan's relative stability helped attract some of the tourists who would have gone to Syria or Lebanon in the absence of conflict. Lead indicators suggest that this trend continued through the critical summer tourism season.

On the negative side, there were slowdowns in government services, real estate and manufacturing. The worst performance came from mining, which contracted by 15.0% year-on-year, after two years of strong recovery from a crash in 2009. Agriculture also performed poorly, contracting by 5.9% owing to a poor harvest in the second quarter. Most other sectors saw modest pickups in growth rates during the first half.

Our forecast sees a marginal easing in growth rates in most sectors for the second half of 2012, although mining should rebound somewhat. Overall we expect 2.5% growth (Fig 3.8), led by services, at 4.2%, up on 2011. Industry is forecast slow to 1.6% growth and agriculture to contract by 8.7%. The outlook for the various sectors is detailed in Chapter 4.

Fig 3.8: GDP Forecasts (2012-13)
(% change)



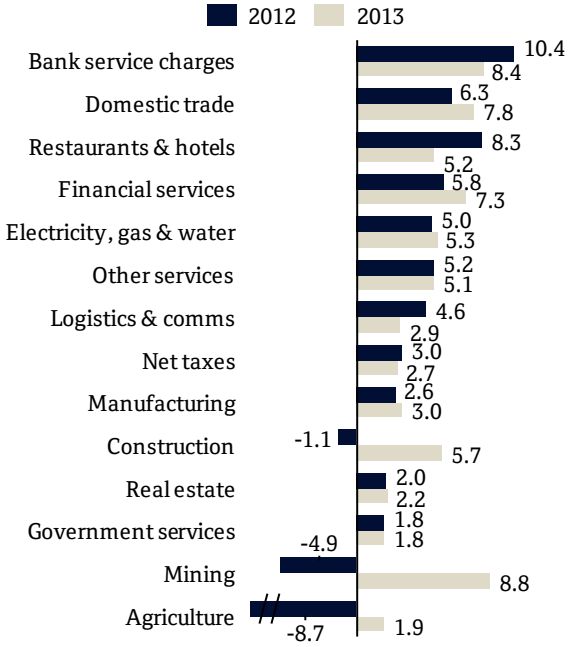
Source: QNB Group forecasts

In 2013, we expect a rebound in agriculture and industry, particularly mining, while most services will grow at similar rates to 2012 (Fig 3.9). Overall therefore, growth should pick up to 3.6%, which is modest but is still the strongest rate seen since 2009.

This scenario assumes a relatively benign international economic climate and no further impacts on Jordan from the Syrian crisis, beyond the current refugee flows.

In nominal terms, taking into account trends in prices in each sector, total GDP is expected to grow by 7.2% to US$31.0bn in 2012 and by 8.9% to US$33.7bn in 2013.

Fig 3.9: Real Growth by Sector (2012-13)
(% annual change, ordered by total growth over the period)



Source: QNB Group forecasts

4. Economic Sectors

This chapter looks in detail at the structure, performance and prospects of the main sectors, grouped according to three basic components of the economy: agriculture (Section A), industry (Section B) and services (Section C). The relative size of the sectors discussed here can be seen in Fig 3.3 (page 8), their relative performance in recent years in Fig 3.6 (page 10) and a summary of our forecasts in Fig 3.9 (page 11).

A. Agriculture

Agriculture contributes little to GDP but more to employment

Agriculture is a small component of the total economy, just 2.9% of 2011 GDP, the lowest share of any MENA country outside the GCC. However, the sector has been gradually growing in importance from a low point in 2001, when its share had declined to under 2% (down from 7% a decade earlier). It has experienced robust real growth of 7.8% in 2008-11, more than double overall GDP growth, as high food prices have spurred investment to expand production. The harvest has been poor in 2012. We forecast that the sector will contract by 8.7% over the year and only recover part of the lost ground in 2013, growing by 1.9%.

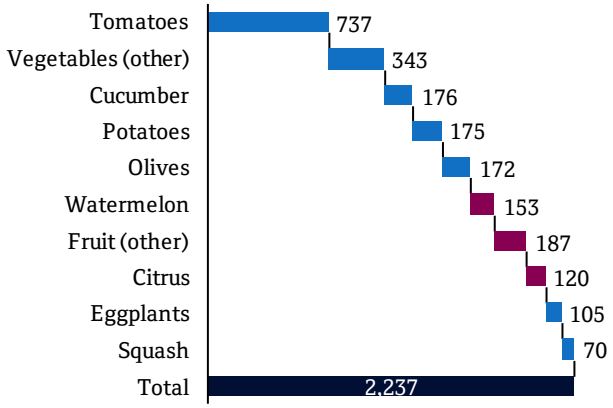
Its share of the workforce is more than double its weight in GDP, at 7.2% in 2010, although, nearly 80% of these workers are very low paid migrants, mainly from Egypt.

Agricultural exports have been growing in importance, increasing to about US$1.0bn[14] in 2011, representing 15% of exports, up from a low of 9% in 2004. In particular, Jordan is a significant supplier of fresh fruit and vegetables to the Gulf, which has limited agricultural production and has seen a rapid growth in population and, hence, demand for food.

The bulk of fruit and vegetable production is concentrated in the Jordan Valley which is fertile, warm all year round and irrigated by the East Ghor canal, enabling about three crop cycles a year. Most of the remaining agriculture is in the northwest highlands, which receive about 300-500mm/year of rainfall compared to about 100mm elsewhere. There is also some irrigation from aquifers in the east and southeast. Livestock, mainly sheep and goats, are grazed on semi-arid lands across the country. In total, there were nearly 3m head of livestock in 2010.

Production in 2010 included 1.9m tonnes of vegetables and 0.3m tonnes of fruit, from about 700 km^2 of cultivated land, and a further 600 km^2 planted with olive trees. Fruit and vegetables comprise more than 60% of agricultural exports by value, although for most kinds, less than 10% of the crop is exported. Tomatoes are the largest crop by both production and export volume, equivalent to over 0.7m tonnes in 2010, as well as being the largest earner with farm gate sales worth around US$165m in 2010. Other sizable crops are cucumbers, potatoes, olives, watermelon, citrus fruits, eggplants and squash (Fig 4.1).

Fig 4.1: Fruit and Vegetable Production (2011)
(thousand tonnes)



Source: DoS and QNB Group analysis

Jordan has been exploring opportunities abroad to address food security concerns

Jordan is comfortably food secure for most major vegetables and is close to self-sufficiency in olives, dairy products, some fruits and chicken. However, for critical foodstuffs, such as cereals, meat and sugar, Jordan is largely or entirely dependent on imports. In the case of cereals, domestic production meets less than 5% of the 1.4m tonnes consumed annually. Although about 1,300 km^2 is cultivated with field crops, much of the production, particularly of barley and clover, is for livestock fodder not human consumption. Production can be volatile as annual rainfall can vary significantly. In total, agricultural imports in 2011 were US$2.9bn, nearly triple the value of exports.

To address food security concerns, Jordan has been exploring opportunities abroad, mirroring initiatives by Gulf countries. The Ministry of Agriculture plans to lease land in Russia and Eastern Europe for wheat production, receiving exemptions on export duties from these countries.

B. Industry

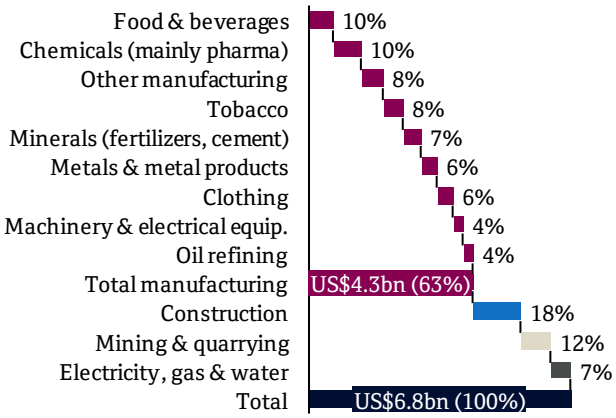
Industry growth should pick up to 4.1% in 2013 from 1.6% in 2012

Jordan has a diverse manufacturing sector, ranging from textiles production to oil refining, which comprises 63%

[14] This figure includes some value-add from food processing, which is included in the manufacturing component of GDP.

of industry (Fig 4.2). The construction sector is of moderate size by regional standards and mining is small but a major export earner.

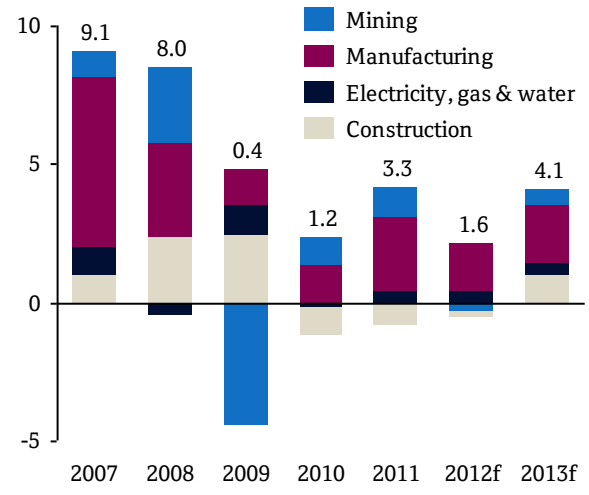
Fig 4.2: Industry GDP by Subsector[15] (2009)
(US$bn and % shares)



Source: DoS and QNB Group analysis

Manufacturing has consistently grown in recent years (Fig 4.3), whereas the other subsectors have been more volatile. In particular, mining contracted sharply in 2009, contributing to lower overall industrial growth that year of just 0.4%. Construction saw strong growth in 2007-09 but contraction in 2010-11. Our forecast is for the industrial sector to grow by 1.6% in 2012, as construction and mining contract. Both sectors should return to growth in 2013, helping to push overall industrial growth up to 4.1%, the strongest rate of expansion since 2008.

Fig 4.3: Contributions to Industrial Real GDP Growth (2007-13)
(% change, contribution of subsectors shown)



Source: DoS and QNB Group forecasts

[15] The figures for the sub-sectors of manufacturing are normalised from the 2009 Industrial Survey, the latest available, to fit the sectors total GDP.

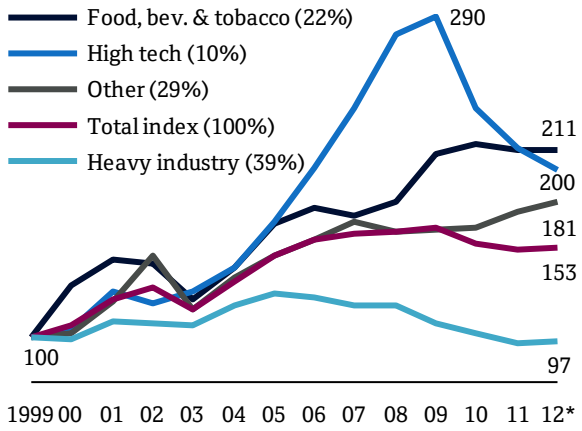
Manufacturing

Expansions in fertiliser and cement production should boost heavy industry in 2012-13

The manufacturing sector grew strongly during the boom years with its real GDP increasing at a rate of 10.0% in 2004-08. It slowed to 2.0% in 2009-10 during the global downturn, but picked up to 4.0% in 2011. We forecast mild expansion of about 2.8% in 2012-13, in line with the wider economy.

The manufacturing component of the Industrial Production Index (IPI) roughly mirrors the trends in the sector's real GDP (Fig 4.4). It provides additional information because it is published monthly and comprised of around 70 sub-indices, which QNB has grouped together into the four thematic indices shown in the graph.[16]

Fig 4.4: Manufacturing Production Index (1999-2012)
(1999=100, legend includes relative weights)



Source: DoS and QNB Group analysis; *January-August

Heavy industry, such as refining and fertilisers, has seen a steady decline in recent years and, in 2011, fell below its 1999 level. By contrast, high-tech manufacturing, such as pharmaceuticals and electrical equipment, saw very strong growth up to 2009, but has fared poorly in subsequent years. Nonetheless, production has still doubled since 1999, something only matched by food, beverages and tobacco. The other components of manufacturing, such as clothing, have also seen reasonable expansion.

One problem the manufacturing sector faces is the difficulty of obtaining domestic financing, according to

[16] Its overall performance, which has declined since 2009, may be a little misleading because the relative sizes of subsectors have changed significantly since the index was constructed in 1999. As an example, tobacco manufacturing was about 12% of manufacturing GDP, according to the 2009 Industrial Survey, but it only has a 2.4% weight in the index.

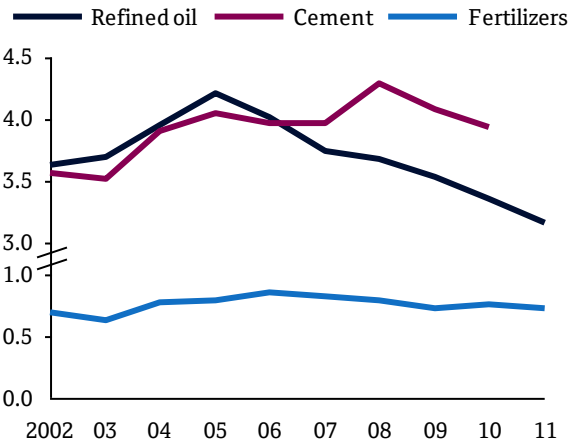
the Chamber of Industry, making it hard to expand without foreign investment. There used to be an Industrial Development Bank, but this was privatised in 2008, becoming Jordan Dubai Islamic Bank and no longer providing particular support to industry.

Expansions in fertiliser and cement production should boost heavy industry in 2012-13

The backbone of heavy industry is the Jordan Petroleum Refining Company in Zarqa, which started operations back in 1961. However, as a result of a lack of investment, production has been falling in recent years, to about 121,000 b/d (3.2m tonnes) in 2011 compared with a peak of 162,000 b/d in 2005 (Fig 4.5). This largely explains the decline in the heavy industry component of the IPI. The company's official monopoly expired in 2009, but there are no current plans to establish other refineries.

Fig 4.5: Heavy Industry Production (2002-11)

(m tonnes)



Source: DoS and QNB Group analysis; 2011 cement data n/a

Fertiliser production is another heavy industry, adding value to Jordan's phosphates and potash. Production began in the 1980s, peaked in 1998 and has been relatively flat since then, recording 0.7m tonnes in 2011. 1.4m tonnes/year (t/y) of the chemical acids that are the precursors to fertilisers are also produced. Almost all of the fertiliser, and any excess acids, are exported.

New investment is coming into the sector. The Jordan Indian Fertiliser Company, a joint venture between Jordan Phosphate Mines and the Indian Farmers Fertiliser Cooperative, is building a 475,000 t/y phosphoric acid plant at Eshidiya, one of the main mining sites. The plant should be complete in 2013. In addition, Al Hamdi Group from Saudi Arabia announced plans in late 2011 to invest US$1.4bn in a 310,000 t/y phosphoric acid plant being planned by the Jordanian Bader Group. Together, these two plants will boost overall fertiliser production by more than a half.

There is even more activity in cement. Until recently, the only producer was Jordan Cement Factories, a local joint venture with Lafarge of France, which has a potential capacity of around 5m t/y. However, two new Saudi-owned firms started production in 2009: Al-Rajhi (2m t/y) and Northern Cement (1m t/y). Their production in 2010 offset a sharp decline in production at Jordan Cement Factories. Data is not available yet for 2011 production, but it is expected to show a strong increase as that decline is reversed.

Three other Saudi firms are also in the process of entering the market: Qatrana Cement, Modern Cement & Mining Company and the Saudi Jordanian Company for Building and Construction Materials. Collectively, they should be adding over 3m t/y of capacity in 2012-13 with about US$1.4bn in investment. Iraq is a prime market for cement as it currently needs to import about 7m t/y, which is one reason for the surge in Jordanian production.

Pharmaceutical and clothing manufacturing are geared towards exports

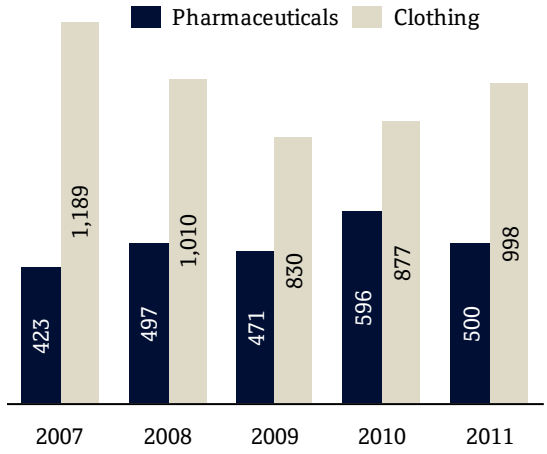
Some of Jordan's manufacturing, such as clothing and pharmaceuticals, is geared largely towards export markets. Other categories, such as food processing and electrical appliances, are more focused on the domestic market.

Clothing is the largest source of manufacturing exports and the sector's largest employer. Clothing employed about 29% of the manufacturing workforce in 2011[17]. Half of these were working in the QIZ factories, which mainly produce tariff-exempt clothes for the US market. The establishment of the QIZ factories had a dramatic impact on Jordan's exports. Clothing exports increased by 25-fold between 1999 to a peak in 2004, when they accounted for 30% of total exports. They have declined since then, in both value and share, but were still the single largest category of exports in 2011 at 15% of the total. Textiles manufacturing has picked up in the last two years with employment in the QIZ's, which had fallen sharply in 2009, partially recovering, although it remains well below its 2006 peak. Other indicators, such as the value of exports (Fig 4.6) and the clothing IPI, have also picked up. However, some local economists question the value of the QIZ factories, given that nearly 80% of the workforce is foreign and there are limited linkages with the rest of the Jordanian economy. Moreover, as US tariffs on Chinese exports have been

[17] Data from the Jordan Chamber of Industry as 2011 employment data by sector was not yet available from the MoL. There were small differences between the series in 2009-10, which may be due to variance in definitions.

lowered, the QIZs are losing some of their competitive advantage.

Fig 4.6: Clothing and Pharmaceutical Exports (2007-11)
(US$m)



Source: DoS and QNB Group analysis

Pharmaceuticals are a highlight of Jordanian manufacturing. Production began in the 1960s and there are now around 16 companies manufacturing drugs, mainly generics, as well as other firms manufacturing medical equipment and supplies. The sector is led by Hikma, the largest Arab pharmaceuticals company which has manufacturing facilities in nine countries and recorded revenue of US$918m in 2011. Although pharmaceuticals companies only employ a total of around 6,000 staff in Jordan, many of these jobs are highly skilled professional positions. There are a growing number of students studying relevant degrees, which is expected to help meet the sector's future staffing demand.

Overall, about 80% of Jordan's pharmaceuticals were exported in 2008[18], mainly within the Arab region. The sector has performed strongly in recent years, providing nearly 10% of Jordan's total exports. However, exports were down by 16% in 2011 (Fig 4.6) and only appear to be picking up slightly, based on data from the first eight months of 2012. In addition, the IPI for the sector has fallen from its peak in 2009. There is particular concern about the Saudi and Algeria markets, which bought over half of Jordan's pharmaceutical exports in 2008, because their governments are looking to support domestic drug manufacturing. This may be part of the reason for the current slowdown in the sector, which faces the short-term challenge of establishing itself in new export markets. However, it should be supported in the medium-term by strong global and regional demand growth for pharmaceuticals.

[18] Data from the Jordan Association of Pharmaceutical Manufacturers.

Mining

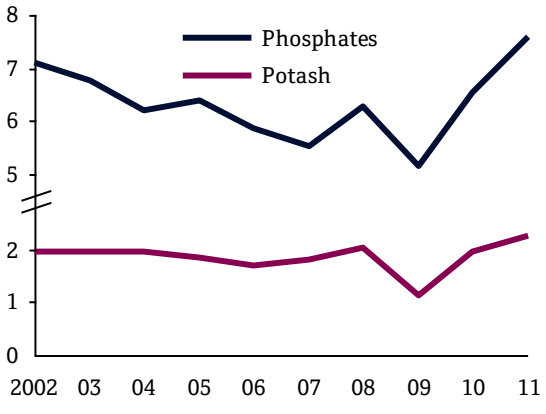
Phosphate and potash production has recovered from a 2009 slump and reached record levels

Mining has averaged about 3.2% of GDP over the last decade, with a slightly higher contribution more recently. Production in the sector can be highly volatile in response to trends in international demand. As a result there was a boom in the sector in 2008, a sharp crash in 2009 and a relatively strong recovery since then. GDP and IPI data for the first half of 2012 were disappointing and suggest that there will be a contraction in the sector this year. However, this is just a blip after a record year of production in 2011, and the lost ground should be recovered in 2013 as a rise in prices stimulates stronger production.

The current focus of mining in Jordan is on phosphates and potash, both used to produce fertilisers. Jordan has about a 4% share in global reserves of both phosphates and potash. Extraction of these is managed by two companies, Jordan Phosphate Mines Company (JPMC) and Arab Potash Company (APC). Other resource extraction underway in Jordan includes stone for use in cement and construction, copper and high-grade silica for glassmaking and electronics.

JPMC produces phosphates from rocks at three active sites. About two thirds of production comes from a mine at Eshidiya, 125 km north of Aqaba, while the remainder comes from Al-Abiad and Al-Hassa mines, both about 75 km further north. Phosphate-rich rock underlies much of Jordan and total reserves are estimated at around 1.5bn tonnes. Production in 2011 hit a new record of 7.6m tonnes, compared with an average of 6.1m over the previous decade (Fig 4.7). This makes Jordan the world's third largest phosphates producer. About two thirds of production is exported raw, with the remainder used to produce fertilisers, as discussed above.

Fig 4.7: Phosphates and Potash Production (2002-11)
(m tonnes)



Source: DoS and QNB Group analysis

APC extracts potash, mineral salts rich in potassium, from water using 150 sq km of solar evaporation ponds to the south of the Dead Sea. APC also achieved record production in 2011 of 2.3m tonnes, up from an average of 1.8m tonnes over the previous decade. About 80% is exported. The production increase was the result of a recent US$250m investment to boost capacity to 2.4m t/y and further expansion is being considered with the aim of eventually reaching 3.2m t/y. Other valuable chemicals are also extracted from the salt waters, particularly bromine, through a joint-venture with Albermarle of the US, which is currently investing US$250m to double production.

The main markets for potash, phosphates and the fertilisers produced from them are India, China and Southeast Asia. The sector was hit hard in 2009, when customers drew on inventories rather than importing, and prices fell by over 50%. Demand and prices have since recovered strongly, barring a slight downwards blip in 2012, and are expected to remain high as regional and global food production increases.

Jordan has significant potential for shale oil and uranium mining

Little in the way of conventional hydrocarbon reserves have been discovered in Jordan, just the Risha gasfield near the Iraqi border. This produces about 18m cubic feet per day (cf/d), meeting less than 5% of Jordan's electricity generation requirements. However, BP has entered a joint-venture with the national petroleum company and began exploratory drilling in the area in June 2012.

By contrast, Jordan has large reserves of shale oil spread across the country, which could be used for power generation and export. Estimates put the total shale reserves at around 300-500bn barrels of oil, although only about 10% might be recoverable. A century ago, this resource was exploited to power the Hijaz railway. However, until recently it was thought that the opencast mining and processing required to extract usable fuel from the shale would be too expensive and would cause environmental impact. However, as global oil prices have risen and technology has improved, the prospects are beginning to look more hopeful. The most promising locations, where there are rich seams of shale close to the surface, are in central Jordan, east of Karak.

Four companies are currently involved in development or exploration of shale resources. Eesti Energia of Estonia, a country which produces most of its power from shale oil, is developing a plant to produce 38,000 b/d from 2017 at Attarat Umm Ghudran. Jordan Energy and Mining, a UK-based company, is also developing a plant to produce 15,000 b/d at Al-Lajjun. Shell, which has an exploration concession covering almost a quarter of Jordan, is potentially the most significant player in the sector. However, it is taking its time to select the most favourable sites and does not expect to begin production until after 2020. A fourth player is Global Oil Shale Holdings of Canada, which signed a memorandum of understanding in September 2012 to develop two blocks with an initial target of 8,000 b/d, rising to 50,000 b/d.

Uranium is another significant resource that Jordan hopes to develop for both export and domestic power generation. It is present in much of the country at varying concentrations. In 2007, the Natural Resources Authority made an initial estimate that the viable deposits contained about 70,000 tonnes of uranium. This was based on deposits with estimated uranium concentration above 0.1% (40 times above the average uranium concentration in the Earth's crust, but at the lower end of what is usually considered to be commercially viable). It also estimated that an even larger amount might be extracted by processing waste rock from phosphate mining. Although this rock has lower concentrations of uranium, it has already been mined and broken up, reducing costs substantially.

However, progress on exploration has been disappointing to date. Anglo-Australian firm Rio Tinto, which had been exploring in the south, withdrew in 2011, deeming the deposits in the region to be unviable. Alliance Resources of Australia also abandoned plans to explore in Jordan at this time. Areva of France began exploring in central Jordan in 2009 and announced in June that it had found about 20,000 tonnes at a concentration of about 0.2% in a 70 km^2 area. However, opposition in parliament led to the expiry of its license in 2012. On the positive side, the China National Nuclear Corporation is still exploring at other sites.

Construction

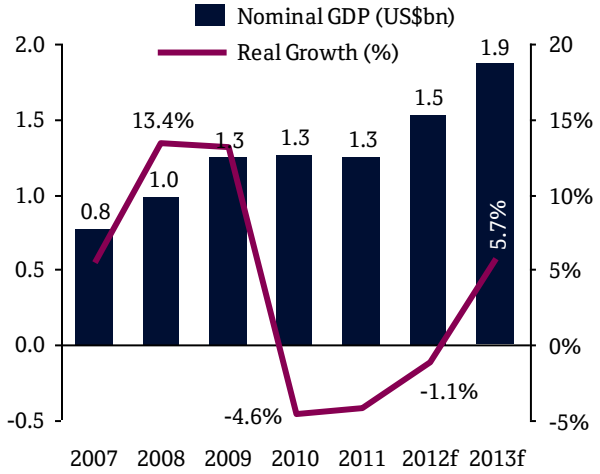
Construction activity has been in decline since 2010, although there are plans for major projects

The construction sector averaged about 4.3% of GDP over the last decade. It outperformed the overall economy during the boom years and in 2009, but has been in decline since them.

First half GDP data and anecdotal reports from construction firms suggest that construction activity will continue contracting for the third year in a row in 2012, albeit at a slower rate. However, we forecast a return to growth in 2013 (Fig 4.9). This is because of the trend in the quarterly GDP figures and an uptick in lead indicators, such as building permits and bank lending. Also work on some of the major projects (detailed

below) should support the sector. The number of building permits issued in the 12 months until August 2012 was up by 12.7% year-on-year. Growth in bank lending for construction has picked up recently, averaging 8.7% in the six month period from April to September 2012, although this is still well below the average rate of growth of 24% during 2005-10 (a period of consistently strong growth). The 5.7% growth that is forecast in 2013 would just be enough to bring the sector back to its 2010 level of real output (nominal construction GDP will be higher than 2010 because of price rises). The growth is more a base effect after three years of contraction, rather than a sign of strong growth prospects in the near future.

Fig 4.9: Construction Sector GDP (2007-13)



Source: DoS and QNB Group analysis

Construction is heavily concentrated in Amman, which accounted for around two-thirds of the land area authorised for construction over the last five years, although significant work is now also underway in Aqaba and Zarqa. The largest project underway in Amman is the Abdali Urban Regeneration, a mixed-use development spanning 0.4 km^2 near the centre of town, which is intended to house about 40,000 people and cost about US$5.0bn. Construction stalled in 2009-11, but has begun to move forward. Jordan's largest planned project is King Abdullah Bin Abdul Aziz City, which is being developed by the state-owned firm Mawared on a 25 km^2 plot of a former military camp east of Zarqa. It aims to accommodate around 0.5m people, mainly in low-income housing.

Gulf developers are focusing efforts on Aqaba

Jordan's narrow 27 km strip of coastline focused on Aqaba has drawn considerable interest from Gulf developers in recent years. A series of major residential and tourism projects are underway, although progress has been mixed. Ayla Oasis, is a development of 4.2 km^2 along the Israeli border, costing about US$2.0bn and featuring a golf course and network of lagoons. Astra Trading of Saudi Arabia launched the project in 2003, flooded the lagoons in April 2012 and expects the first phase to open in 2015. Saraya Aqaba is an adjacent 0.6 km^2 beachfront development which was launched in 2005, but the developer folded in 2011. It is understood that investors from Abu Dhabi are restarting the project.

Meanwhile, Al Maabar International Investments announced an even larger project in 2009, Marsa Zayed, with an estimated cost of about US$10.0bn. The 30-year plan includes 3,000 hotel rooms and 30,000 residential units, built over 3.2 km^2 around a marina and cruise ship terminal. Aqaba port currently occupies much of the site intended for Marsa Zayed. As a result, development work will be limited initially, with total spending of only around US$250m in 2012-14, until the port is relocated 20 km south, near to the Saudi border. The latest development planned for Aqaba is a US$1.5bn theme park, the Red Sea Astrarium, set on a plateau above the city. Elsewhere in the country, other major leisure developments are planned in the development zone around the Dead Sea, such as the Samarah resort being built by Emaar Properties of Dubai.

Electricity, Gas and Water

The energy mix is being diversified to replace diminished Egyptian gas

Electricity, gas and water only accounted for 2.0% of GDP in 2011, close to its average over the last decade. However, meeting the demand for these products is essential for growth in the rest of the economy.

For many years, Jordan was able to rely on its neighbours for fuel at concessionary prices. From the 1980s until 2003, Iraq provided Jordan with most of its oil at about a quarter of the market value[19]. Fortunately for electricity generation, the price shock that would have accompanied the end of this assistance was softened by the start of Egyptian gas exports in 2004, which led to a rapid shift in power plants to burning gas, a much cheaper fuel than oil. At the peak of gas usage in 2009, 86% of electricity generation came from gas.

The fuel mix has now shifted back to oil following a sharp reduction in the volume of gas provided by Egypt[20]. The gas shortage has become even more acute in 2012, and imports from Egypt had fallen to just 39m

[19] More recently Iraq has provided about 10,000 b/d, about 3% of Jordan's current consumption, at about a 20% discount.

[20] This was largely due to pipeline sabotage in Sinai during 2011-12. However, the decline in supplies actually began in 2010, before these attacks began, as Egypt is facing a shortage of gas domestically and so it no longer makes economic sense to export it. It is also now charging Jordan a higher price of US$5/mBtu, up from US$2.15 previously.

cu ft/day, down from 80m cu ft/day in 2011 and a peak of 318m cu ft/day in 2009. This meant that, in 2011, only 25% of electricity generation came from gas, with oil filling the shortfall.

In the coming years, the fuel mix is set to diversify considerably. There are plans to build a liquefied natural gas (LNG) import terminal in Aqaba, with support from Qatar. It would take about 2m tonnes/year of LNG to replace the shortfall in Egyptian gas. Investments are also planned in electricity generation from shale oil, renewables and nuclear power. The latest development is a proposal for pipelines from Iraq. Iraq is expected to tender shortly for a 1m b/d oil pipeline to Aqaba. Most of this will be exported, but it is likely that the allocation of discounted oil for Jordan will be increased as part of the deal. Iraq also has an undeveloped gas field, Akkas, not far from the Jordanian border and might in the future run a pipe from there to Jordan.

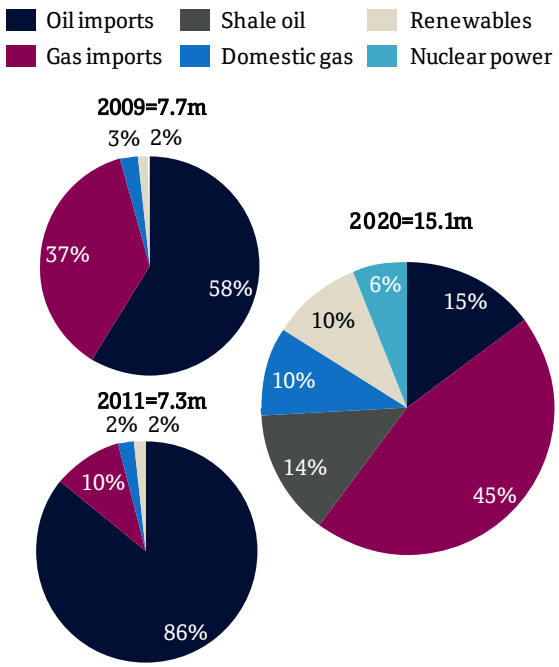
As of 2011, Jordan had about 3.3 gigawatt (GW) of installed electric generating capacity, with a peak demand of about 2.7 GW. Demand is now growing at about 0.25 GW/year. The electricity system involves a network of generation and distribution companies, with the state-owned National Electric Power Company (NEPCO) managing transmission and fuel supplies. The additional cost of using oil over gas, coupled with only small increases in electricity sales prices, has resulted in significant deficits in NEPCO's finances (see Chapter 7).

Most of the power plants are situated in a line along to the east of Amman, along the route of the Arab Gas Pipeline. Recent expansion has been driven through public-private partnerships to finance independent power plants starting with the Amman East power plant in 2009 and the Qatrana Power Plant east of Karak, commissioned in early 2012. Expansions are underway at Amman East and another plant, Samra, and a third IPP was awarded in January 2012 to a Korean-Japanese-Finish consortium. These plans will collectively increase generation by nearly 1 GW.

The 2007 Energy Master Plan envisages that Jordan will meet about 40% of its energy needs (including electricity generation and fuel) domestically by 2020, up from about 4% currently. It envisages that it will meet 10% of demand from domestic gas, 14% from shale oil, 10% from renewables and 6% from nuclear power (Fig 4.8). The remaining electricity and fuel demand would continue to be met by imported oil and gas.

The energy situation has changed considerably since the 2007 plan was developed. On the positive side, the growth in energy usage has been more gradual than had been expected, largely because the economy has slowed and because higher fuel prices have led to lower consumption. This suggests that the forecast consumption of 15.1m tonnes of oil equivalent in 2020 may be an overestimate. Therefore, if the plans domestic energy production do go ahead as planned, then it could potentially account for a larger share of energy demand than the 40% target. On the negative side, the gas component of energy imports will have to be largely provided by more expensive LNG, in place of Egyptian gas, unless Iraqi gas is able to fill the gap.

Fig 4.8: Energy by Source (2009-20)
(m tonnes oil equivalent, % shares by year)



Source: Ministry of Energy & Mineral Resources and QNB Group estimates for 2011 based on DoS data

Two plants fuelled by domestic shale oil have recently been tendered to Eesti Energia and Lajjun Shale Oil Investments, a Chinese-owned firm. They will have a combined capacity of 1.6 GW at an estimated cost of about US$2bn, with the first one scheduled to start operation in 2016.

Jordan has signed nuclear cooperation agreements with a number of key countries and aims to commission the first 1.1 GW nuclear reactor in Mafraq in 2019, cooled with the wastewater from the Samra thermal power plant, at the cost of about US$5bn. Russian, Canadian and Japanese firms have been shortlisted to build the first reactor, and the contract is scheduled to be awarded in 2013. A second reactor is planned for 2022. It is unclear whether the recent difficulties encountered by companies exploring for uranium (see page 16) may delay these plans.

As regards renewables, parts of Jordan have world-class conditions for solar photovoltaic power—sunny, dry and not dusty. Solar power initiatives are focused in Ma'an, where environmental conditions are particularly

advantageous. The World Bank and various Gulf investors have expressed interest in investing in both photovoltaic and solar thermal technologies. The Energy Plan also aims to double household solar heating levels to 30% by 2020. There are a number of locations that are suitable for wind turbines, pending financing, including Fujeij, Al-Harir, Ma'an and Wadi Araba.

Red Sea water could meet shortages, replenish the Dead Sea and support new settlements

The low level of rainfall in Jordan compared with the demand for consumption creates a sizable water deficit. The most significant recent development to address this is the US$1.1bn Disi water conveyance project. It will provide Amman with 100m cubic metres a year (cm/y) of water, about 10% of current national consumption, from a fossil aquifer in the far south. Construction is underway, on build-operate-transfer (BOT) terms, by Turkish firm GAMA Energy and water is expected to be flowing by mid-2013.

A much more ambitious plan is to pump desalinated water from the Red Sea north to the population centres. This initiative is being combined with efforts to mitigate the shrinkage of the Dead Sea (due to the much reduced flow of the Jordan River). The idea of a joint Jordanian-Israeli Red Sea-Dead Sea canal failed to gain traction. However, in 2011 Jordan announced a unilateral plan, combining the replenishment of the Dead Sea, hydroelectric power generation and desalination.

The first phase of the Jordanian plan would pump 400m cm/y of sea water, half of which would be used to refill the Dead Sea and half would be desalinated and pumped mainly to Amman. The eventual goal would be to pump 1.2bn cm/y to replenish the Dead Sea and 930m cm/y to be desalinated, more than Jordan's total renewable freshwater resources and enough to meet the anticipated water deficit by 2055. The plan envisages new settlements evolving along the route of the pipeline, including an industrial city at the south of the Dead Sea. A tender for the first phase is expected to be awarded in 2013 with a seven year construction timescale. The actual scale of the project will depend on the availability of financing.

Aside from aquifers and desalination, reducing wastage in water transport and consumption, and water recycling is also needed. A difficult decision may need to be taken at some point to reallocate water from agriculture to household uses. Currently, the agricultural sector consumes about 65% of water supplies, much of it on low-value but water-intensive crops, such as tomatoes.

C. Services

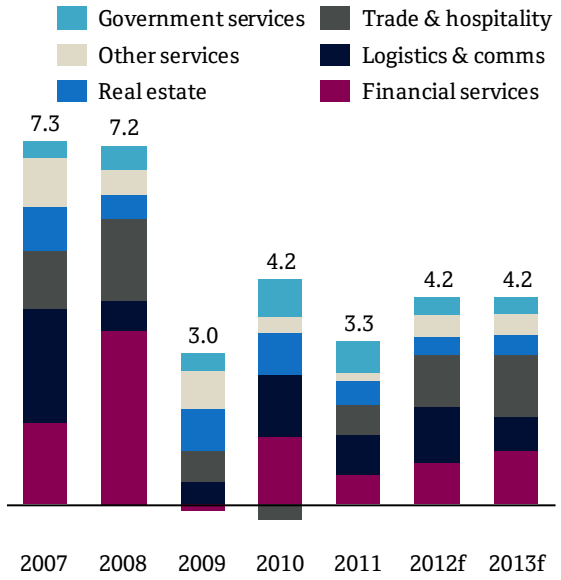
Although growth in services has slowed since 2008, most subsectors post growth every year

In contrast to the industrial subsectors, which often swing from growth to contraction, most of the services subsectors achieve real growth every year. This is partly because a growing population tends to expand the demand for most services each year, whereas much of industry is driven by more volatile external demand.

The rate of growth in services slowed from 7.6% in the boom period of 2004-08 down to 3.5% in 2009-11. The slowdown has been particular marked in financial services and trade & hospitality, which had been two of the powerhouses during the boom. The growth rates in both sectors slowed by more than three quarters, including brief periods of contraction in 2009 for financial services and in 2010 for trade & hospitality (Fig 4.9). Other sectors, such as real estate and government services, have seen little change in their more moderate growth rates.

Fig 4.9: Contributions to Services Real GDP Growth (2007-13)

(% change, contribution of each subsector shown)



Source: DoS and QNB Group forecasts

Tourism

Tourism is one of the most important sectors but its full contribution is difficult to measure

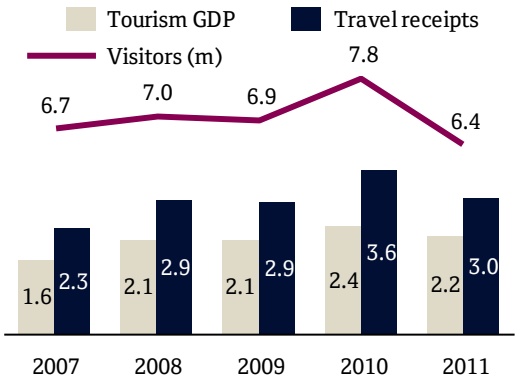
Tourism is perhaps the most visible feature of Jordan's economy, but it is difficult to estimate its precise scale as its contributions span a number of GDP sectors. The

restaurants & hotels line of GDP (just 1.4% of 2011 GDP, grouped with trade in Fig 4.9) is sometimes used as a proxy for tourism, which would imply that it is relatively unimportant. However, this is a misleading measure because tourists purchase many other kinds of goods and services.

The World Travel and Tourism Council (WTTC) estimates[21] that the direct contribution of tourism in 2011 was US$2.2bn or 7.5% of GDP (Fig 4.10) and that, if indirect and induced contributions[22] were also included, its full contribution would total 18.4% of GDP. Moreover, 2011 was a bad year for the sector, and the WTTC average figures for 2006-10 were even higher at 9.3% of GDP directly and 22.6% overall. This would make tourism the most important economic sector, ahead of manufacturing and government services.

Fig 4.10: Tourism indicators (2007-11)

(US$bn unless stated)



Source: Central Bank of Jordan, Ministry of Tourism and WTTC

Travel receipts in the current account are another indication of the scale of tourism, and these peaked in 2010 at US$3.6bn, or 13.6% of GDP. The WTTC estimates that employment directly dependent on tourism was 113,500, 7% of total employment and nearly triple the more narrowly defined estimate employment from the Ministry of Tourism. In addition, WTTC estimated that a further 158,500 jobs (10% of the total) were supported by tourism's induced contribution to the economy.

According to the WTTC figures, the share of tourism in GDP for Jordan is the third highest in the MENA region, after Lebanon and Morocco. Moreover, it is 25th place globally, and one of the only large countries that is so highly dependent on tourism (most of the others in the top 25 are small island nations).

Jordan has three main attributes that attract tourists: cultural heritage, spanning Biblical, Classical, Islamic and Crusader sites; natural beauty, such as the Dead Sea and Wadi Rum; and a cool climate relative to the Gulf.

It should be noted that many of the other foreign visitors to Jordan are not typical leisure tourists. In particular, many of the refugees from Iraq and Syria live on tourist visas, even though their stays may be prolonged. In particular, Jordan's healthcare services attract medical tourists, mainly from the region. For example, Jordan treated thousands of Libyans injured during its revolution. Research by the Private Hospital Association counted 250,000 medical tourists in 2010, about 7% of all visitors (excluding day-trippers).

Unrest in Syria and Lebanon has led to a surge in Gulf tourists visiting Jordan in 2012

The sector has been volatile in recent years. The global downturn in 2009 hit tourism globally, although Jordan was partly insulated from this because visitors from the Gulf were not too impacted by the crisis. There was a decent revival in visitor numbers in 2010, but the regional unrest in 2011 seriously hurt arrivals, which were down 18%, and the Ministry of Tourism estimated that around US$1bn in revenue had been lost.

There have been signs of improvement in the sector during 2012, including a 10% year-on-year increase in overnight visitors during the first half of 2012. This happened as a rise in Gulf tourists—some of whom were coming to Jordan instead of Syria because of the conflict there—more than offset a fall in European tourists, who are more likely to entirely avoid the region when there is conflict nearby. This substitution trend picked up even more strongly in the summer as Gulf countries issued warnings against travelling to Lebanon. In June, overnight Arab visitors to Jordan were up 41% year-on-year. Another indicator of the increased tourism are the travel payments recorded in the current account, which were up by 30% year-on-year in Q2-2012. The increase in tourism is expected to have intensified in July-August, the peak travel months for Gulf tourists.

Some of the major investments planned and underway in the tourism sector in Aqaba have been discussed earlier (see page 17). There is also substantial expansion underway in Amman, with both five-star hotels and shopping malls, and also many smaller projects, such as apartment hotels, restaurants and shops and galleries of interest to urban tourists.

The tourism industry has substantial challenges to address to enable future growth. Firstly, Jordan needs to

[21] The WTTC estimates are made using its global statistical model from available data and therefore may not be too precise, but nevertheless provide a sense of tourism's importance to the economy. The Ministry of Tourism is understood to be preparing official Tourism Satellite Accounts, which should provide more accurate data on tourism's contribution.

[22] An example of an "indirect" contribution is the purchase of agricultural products to feed tourists, while an employee in the tourism sector spending their salary on local goods would provide an "induced" contribution.

market itself more successfully as the sole destination for a holiday, rather than being just a brief stop during wider regional tours. This will become particularly important if regional instability continues and reduces the stock of visitors coming on pan-regional tours. Secondly, many of the medical tourists are lower-middle income visitors, from countries such as Sudan and Yemen, who may not spend a great deal during their stay. Jordan needs to attract more of the wealthier regional medical tourists, who also go to Lebanon or Europe for treatment. It is developing regional specialisms in some areas, such as cancer treatment, which should help attract these wealthier patients. Thirdly, Jordan needs to attract more international conferences as business tourists are the most profitable segment of the sector. This is a priority focus in the 2011 National Tourism Strategy.

Financial Services

Financial services growth is forecast to accelerate to 6.6% in 2012-13

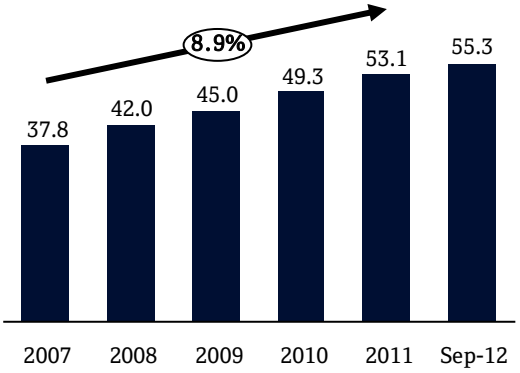
Financial services was the third largest component of the services sector, representing 9.4% of GDP in 2011, and has been a significant contributor to overall services growth in recent years. During the boom period in 2004-08, the sector grew at a remarkable 19.9% in real terms, well ahead of other sectors. Although growth has slowed significantly, to 4.4% in 2009-11, it still leads overall GDP.

Aside from banking, insurance is the main component of the sector. The 28 insurance firms wrote US$615m in premiums in 2011, up 6.9% on 2010. The penetration rate of premiums is fairly high at 2.1% of GDP, above the MENA average of 1.5%. About half of the premiums are transport related and a quarter are medical.

Jordan is heavily banked and assets are 179% of GDP, which is fairly high for the region

Banking assets in Jordan are relatively high at US$55.2bn (179% of GDP) in September 2012 and have been growing steadily at a rate of 8.9% from 2007-11, slowing to 6.4% in the year to September 2012 (Fig 4.11). This level of assets is considerably higher than in the GCC, where assets averaged 106% of GDP, but it is also well below many advanced economies, such as the US, where the ratio is 481%.

Fig 4.11: Banking Assets (2007-Sep 2012)
(US$bn, CAGR shown)

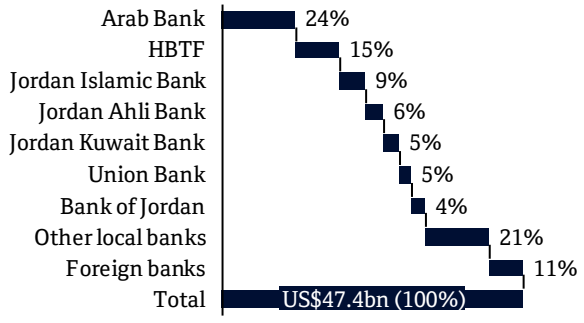


Source: Central Bank of Jordan (CBJ) and QNB Group analysis

Jordan has 26 banks, a high number for a small economy. The 13 local commercial banks represent about three quarters of the market by assets (Fig 4.12). In addition, there are three Islamic banks (conventional banks may not operate Islamic windows) and ten foreign banks, the largest of which, with assets en par with some of the mid-sized local banks, are HSBC of the UK and Bank Audi of Lebanon.

Arab Bank is the oldest and largest bank in Jordan, with about 24% of domestic commercial banking assets in 2010. In addition, it has sizable international operations, having been founded as a pan-Arab bank[23]. The Housing Bank for Trade and Finance (HBTF, 34.5% owned by QNB Group) is second in size by assets, but has the largest branch network, which is particularly strong outside of Amman, and the largest share of savings deposits. Jordan Islamic Bank is also sizable and controls most of the Islamic banking market. The other banks are all relatively small.

Fig 4.12: Share of Domestic Assets by Bank (2010)[24]



Source: Association of Jordanian Banks and QNB Group analysis

[23] Arab Bank's assets in Jordan in 2010 were about US$11.5bn, with another US$1.6bn in its Islamic subsidiary. By contrast the total global assets of the Arab Bank Group were US$45.3bn. In other words, 70% of its assets are outside Jordan.

[24] The most recent period for which data for all banks is available. The total differs slightly from the CBJ asset figure as it excludes the specialised credit institutions such as the Jordan Loan Guarantee Corporation, Jordan Secondary Mortgage Refinance Company and National Microfinance Bank.

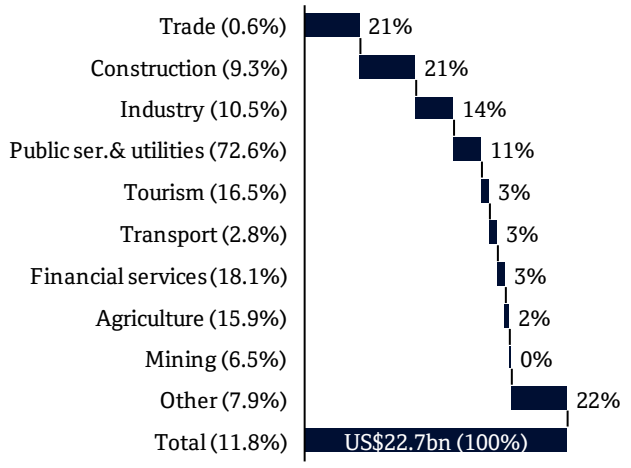
Jordan's banks are largely financed from private sector deposits, with a low ratio of loans to deposits, which was 68.1% in September 2012. Jordanian deposits benefit from some regional flows seeking a safe haven, particularly from the West Bank. The loans/deposits ratio has increased a little recently, because credit has grown at 11.8% over the last year, nearly twice as rapidly as deposits at 6.4%. The strong credit growth is driven by public sector borrowing.

State borrowing to finance the deficit crowds out the private sector

Banking claims on the public sector—including loans, overdrafts and (mainly) bonds—grew by 34.8% in the year to September 2012 as the government has borrowed to finance the rising fiscal deficit (Chapter 7). The public sector offers high yields and so is increasingly crowding out private sector credit, which only grew by 7.0% in the same period. Net new credit to the public sector was US$3.1bn, compared to just US$1.5bn for the private sector.

Looking at credit facilities on a sectoral basis, the largest shares are to the trade and construction sectors (Fig 4.13).

Fig 4.13: Credit Facilities by Sector (September 2012)
(US$bn, year-on-year growth rate shown in parentheses)



Source: CBJ and QNB Group analysis

The banking sector is relatively well capitalised with a risk-weighted capital adequacy ratio of 18.2% in June 2011, according to the CBJ's most recent banking stability report. The liquidity ratio was also healthy at 146%. Standard & Poor's places Jordan in its Banking Industry Country Risk Assessment (BICRA) Group 7, alongside countries such as Morocco, but ahead of Egypt and Lebanon which are considered higher risk. It counts amongst the strengths of the sector its use of retail deposits for financing and its reasonable margins, which should be able to absorb some shocks.

Non-performing loans (NPLs) are, however, a concern. They have increased sharply during the recent years of weaker economic growth, reaching 8.5% of total loans in June 2011, up from 4.2% in 2008. At the same time provisioning rates fell to 56%. The rise in NPLs may not be evidence of systematic problems because a large share of them derive from just a few major companies that borrowed heavily in the boom period and got into problems in the slowdown. In the retail sector, however, NPL rates are anecdotally reported to be considerably lower at around 3%. The aggregate provisioning rates are skewed by a couple of smaller banks with low levels, while the main banks are mostly better provisioned.

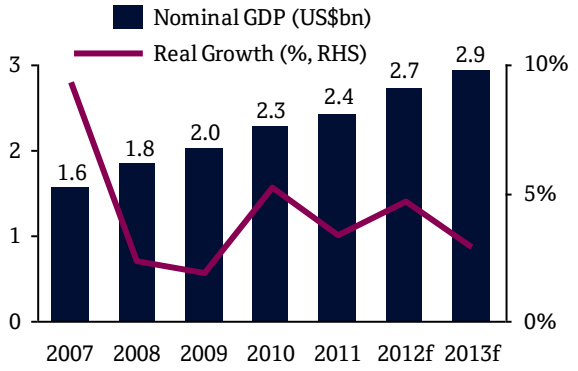
The NPLs have contributed to a decline in profitability, with return on average assets falling to 1.1% in 2010, from a peak of 2.0% in 2005, and return on equity falling from 20.9% to 8.8%. There has been a slight pick up since then. However, parliament is considering an increase in banks' tax rate from 30% to 35%. This is likely to be implemented and thereby dent profitability.

Other Services Subsectors

Jordan has a role as a logistics hub for Iraq and is looking to expand its rail and port infrastructure

Logistics (transport and storage) and communications form a major part of the economy, totalling US$2.4bn, 11.8% of GDP, in 2011 (Fig 4.14).

Fig 4.14 Logistics & Communications GDP (2007-13)



Source: DoS and QNB Group analysis

Much of the sector is related to the normal demands of the domestic market, particularly for mobile phones (Jordan has three operators—Zain, Umniah and Orange, the only one with majority local ownership). Tourism also creates extra demand for transportation services.

In addition, Jordan has a role as a regional logistics hub, particularly for Iraq. The highway from Baghdad to

Aqaba port was particularly active as a supply and export route during the Iran-Iraq war in the 1980s and then in the years immediately following the 2003 invasion of Iraq and is still heavily used. This trucking route is set to be supplemented with a railway under an agreement between the two countries in 2011.

Jordan currently only has two sections of railway, descended from the Ottoman-era Hejaz railway. However, it has ambitious plans to build rail connections to Syria and Saudi Arabia. There is also a plan for a 26 km light rail network connecting Amman and Zarqa. It has been difficult to attract private investment to these projects, but the economic benefits mean that the state is likely to go ahead with them as soon as its capital budget permits. A recent pledge of investment grants from the GCC should enable the first stage of railway development.

Meanwhile, the major project of relocating Aqaba port 20 km south to enable expansion in throughput and storage capacity and to free up the shorefront in the city for tourism development, is in the early stages. Expansion works are underway at King Hussein airport in Aqaba to double capacity to 2m passengers a year. The expansion of the main Queen Alia airport, south of Amman, to a capacity of 9m a year (compared with 5.5m passengers recorded in 2011), is underway and should be complete by early 2013.

Government services is the largest sector and its share of GDP has increased in recent years

The size of the public sector is demonstrated by the government services component of GDP, which constituted 20.1% of the total in 2011, making it the largest sector. It includes public administration, defence, education and healthcare. Its weight in GDP began increasing in 2008, having averaged just 16.8% in the previous decade, and peaked at 20.5% in 2009. It seems that the state has expanded in some areas in response to the ending of the private sector boom in 2008. This is certainly reflected in the employment data, discussed in Chapter 2, which shows that the vast majority of new jobs created in 2009-10 were public ones.

Domestic trade picked up sharply in Q2 2012, perhaps owing to demand from Syrian refugees

Of the remaining services subsectors, the largest are domestic trade, both wholesale and retail, and real estate & business services. Domestic trade has been relatively weak in recent years, including a 2.4% contraction in real terms in 2010. However, it was up by 10.4% year-on-year in Q2 2012, the strongest growth in almost four years. This was probably partly related to a surge in demand from tourists and Syrian refugees. When data is released for the third quarter, which is typically the strongest period for trade, this is expected to confirm the new growth trend.

Meanwhile, real estate & business services tends to grow at around 3-5% a year. On the real estate side, anecdotal reports suggests that property buying by the Iraqi disapora (and more recently by Syrians) has helped to sustain demand in the Amman property market since the economic downturn since 2009. Indeed, the growth rate in real estate, while not high, has slowed less from its boom level than any of the other services sectors.

Business process outsourcing and IT are dynamic new areas of business

Business services includes dynamic areas, such as business process outsourcing and IT. Jordan is leveraging its educated population to serve as a regional centre for these services. A number of multinationals, such as Microsoft and HP, have established outsourcing operation centres in Amman.

There are also an increasing number of local IT start-ups, many focusing on Arabising online content and services. One of the successful start-ups, Maktoob, was bought by Yahoo for US$80m in 2009. Bayt, the MENA region's main jobs portal, is another successful example. Financing is a problem for many start-ups, and so Oasis500, a state-backed incubator, was established in 2011 to provide seed capital and mentoring and link digital entrepreneurs with angel investors.

Demand for private education and healthcare has been growing rapidly

The final services subsector listed on Fig 4.9 is "other services". This category groups together three small components of GDP, which comprised 4.2% of nominal GDP in 2011—domestic services, non-profit services and community, social & personal services. The last of these is largest, and includes private education and private healthcare. It has been one of the fastest growing sectors in recent years, at a rate of 5.5% in 2009-11, as demand for these kinds of services from the wealthier segment of society and medical tourists remains strong, even as the overall economy slows. For this reason, growth is expected to continue at around the same rate in 2012-13.

5. External Sector

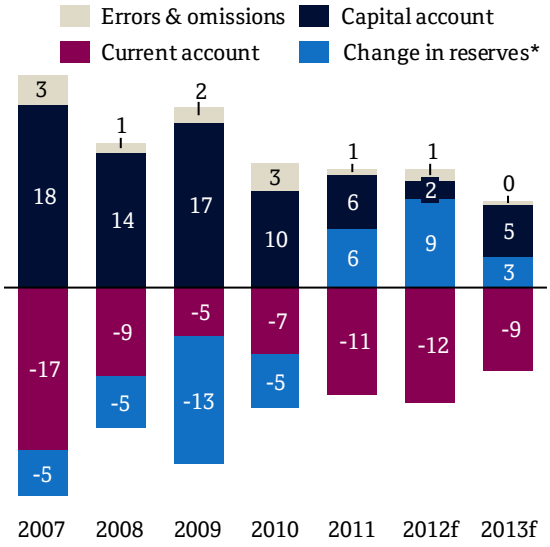
A. Balance of Payments

A widening current deficit and falling capital inflows are causing Jordan to draw on reserves

Jordan's balance of payment position began deteriorating sharply in 2011. This was largely as a result of an abrupt fall in gas supplies from Egypt, forcing it to import oil, which is much more expensive, for electricity generation. At the same time, capital inflows—particularly foreign direct investment—have been falling. The impact of these two trends is that Jordan has drawn down on its foreign reserves.

These trends have continued in 2012—gas imports have fallen further and data for the first half of the year shows that the capital account moved into deficit. The extra energy import costs will continue for the rest of the year, although the capital account is now being bolstered by the initial disbursements of a US$2.1bn 3-year loan approved by the IMF in August. In total, it is expected that international reserves will fall by about US$2.8bn (9.0% of GDP) in 2012 (Fig 5.1).

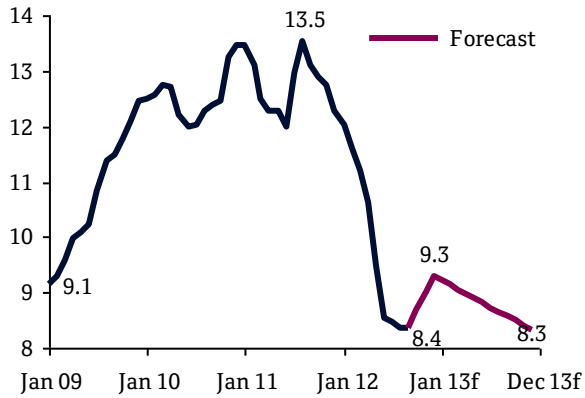
Fig 5.1: Balance of Payments (2007-13)
(% of GDP, + are inflows of foreign currency, - are outflows)



Source: CBJ and QNB Group forecasts; *An outflow from the balance of payments represents an increase in reserves, an inflow corresponds to a fall

Fuel import costs are expected to ease slightly in 2013 following the negotiation of a small increase in Egyptian gas imports coupled with a reduction in fuel consumption, following the ending of fuel subsidies. This—together with some increases in inward current payments, such as grants, and the ongoing disbursement of the IMF loan—should reduce the rate of reserves drawn down to 2.9% of GDP. However, even in this fairly optimistic scenario, Jordan's reserves will have fallen to US$8.3bn (24.7% of GDP) by the end of 2013 (Fig 5.2). This would cover five months of imports, the lowest level in two decades, although still comfortably above the IMF's recommended minimum of three months cover.

Fig 5.2: International Reserves (2009-13)
(US$ bn)



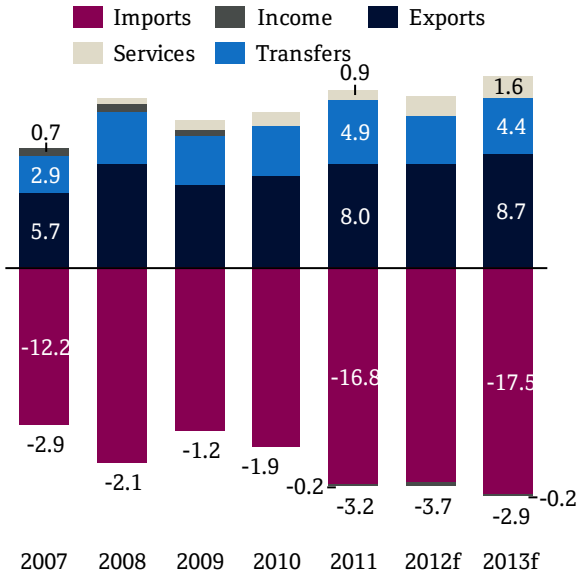
Source: CBJ and QNB Group forecasts

B. Current Account

The structural trade deficit has widened as a result of increased oil imports since 2011

Jordan's current account has consistently recorded a substantial deficit since 2005, largely as a result of its high import bill. The deficit fell to a recent low of US$1.2bn in 2009, but has been increasing since then, to US$3.2bn (11.2% of GDP) in 2011 (Fig 5.3).

Fig 5.3: Current Account (2007-13)
(US$ bn)



Source: CBJ and QNB Group forecasts

Although Jordan has fairly substantial exports, imports are typically about twice as large. This is a long standing structural imbalance, resulting mainly from Jordan's

need to import fuel and food, as well as other goods. The deficit is partly offset by consistently positive current transfers, a mix of remittances and foreign aid. Without these inflows the current account deficit would typically be two to three times larger. Trade in services has also recorded net inflows in recent years. Net income varies between surplus and deficit, but tend to be small in either case.

The widening of the current deficit since 2010 is mainly a result of the additional oil import costs (see below), although there was also about 11% growth in non-oil imports in 2011 and a narrowing of the services surplus. We estimate that the additional cost resulting from the substitution of oil for gas should peak at about US$1.7bn in 2012 (about US$5m/day). Slightly higher gas imports and lower oil prices will bring the cost down in 2013.

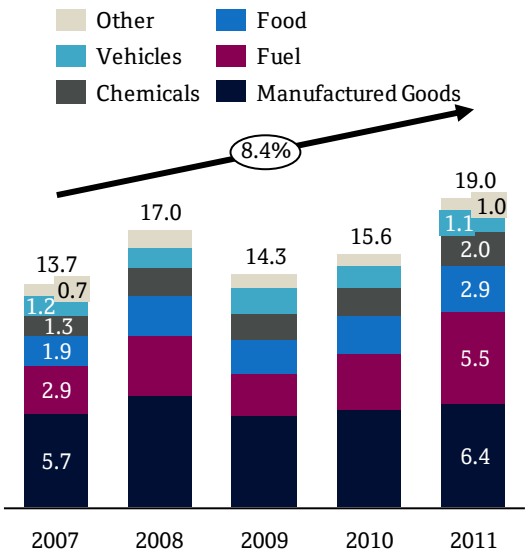
If the gas had continued to flow at 2009 rates, Jordan's current deficit would have remained relatively stable, at about 6.5% of GDP in 2010-13. Instead it increased to 11.2% of GDP in 2011 and we forecast that it will reach 11.9% in 2012. In 2013, the deficit is expected to narrow to 8.7% of GDP owing to a fall in oil imports plus higher inflows from exports, services and transfers.

Imports

Imports have increased at a rate of 8.4% in 2007-11, led by fuel and food

Jordan is heavily dependent on imports, which totalled US$19.0bn (66% of GDP) in 2011. Imports grew at a rate of 8.4% from 2007-11 (Fig 5.4), strong but below nominal GDP growth of 14.0% during this period.

Fig 5.4: Imports (2007-11)
(US$ bn, CAGR shown)

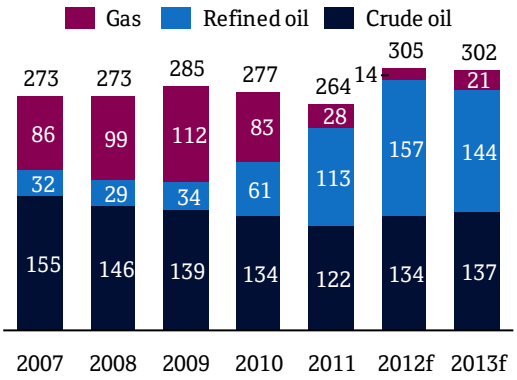


Source: DoS; Note: totals are higher than in Fig 5.3 because freight and insurance components of import costs are included in the services line

Manufactured goods, both commercial and consumer, the largest category of imports, only grew at a rate of 2.7% during 2007-11 and vehicle imports actually declined slightly. However, food imports grew strongly by 11.7% to US$2.9bn, despite relatively slow population growth during this period, owing largely to a surge in international food prices. Even more significantly, the fuel bill rose suddenly in 2011, by 61% to US$5.5bn, as Jordan was forced to import expensive oil to replace falling pipeline gas from Egypt (see Section 4B). Imports are forecasts to grow by 10.3% in 2012 and 4.8% in 2013, mainly driven by trends in fuel imports.

Total fuel imports hardly changed in volume terms during 2007-11, in fact they fell slightly (Fig 5.5). However, the shift in the mix from gas to oil has dramatically raised the cost of these imports. At the peak in 2009, when about 318m cf/d of gas was imported (equivalent, in energy terms, to 112,000 b/d of oil), this fuelled almost all major power plants. Most of the oil imported, mainly in crude form, was used as vehicle fuel or for smaller generators. As gas imports began to be curtailed from 2010, a roughly equivalent amount of refined oil has been imported to fill the gap.

Fig 5.5: Fuel imports (2007-11)
('000 barrels of oil equivalent per day)



Source: Ministry of Energy & Mineral Resources and QNB Group analysis

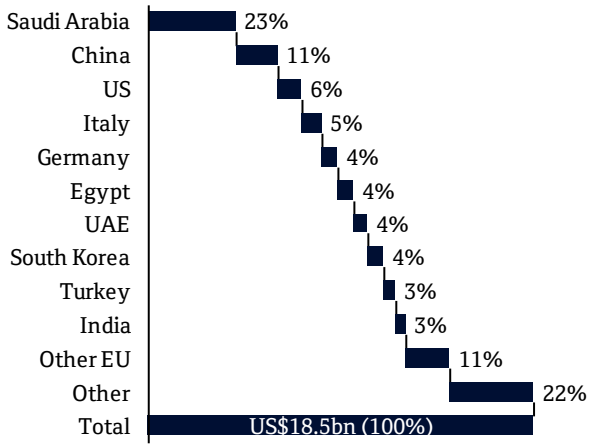
During 2012, gas imports have fallen again, with statements by officials in early November putting them at only about 14,000 b/d of oil equivalent, which will have further boosted oil imports. However, Egypt has recently pledged to increase supplies to about 21,000 b/d of oil equivalent. This, combined with a reduction in demand for vehicle fuel following the ending of subsidies, is expected to bring down oil imports slightly in 2013.

Saudi Arabia supplies most of Jordan's oil and China is the largest source of consumer goods

Saudi Arabia is Jordan's main source of imports, providing 23% of the total in 2011, including most of the oil (Fig 5.6). Non-oil imports come from a relatively

diversified range of sources. China provides the second largest share of imports, 11% of the total, largely composed of consumer goods and up from just 5% a decade ago. Imports from China, as well as South Korea and Turkey, have grown rapidly while the US and EU have diminished in importance as import sources.

Fig 5.6: Import Sources (2011)
(US$ bn, % share)



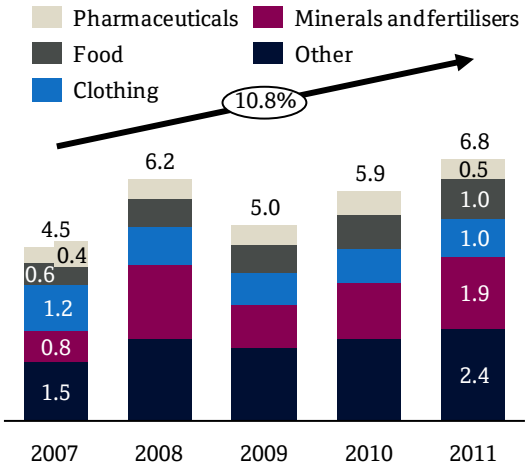
Source: IMF; Note: The total is slightly lower than the DoS figure

Exports

Export growth is led by fertilisers and their precursor minerals

In 2011, Jordan's domestic exports (excluding re-exports[25]) reached a new record of US$6.8bn (Fig 5.7).

Fig 5.7: Domestic Exports (2007-11)
(US$ bn, CAGR shown)



Source: DoS and QNB Group analysis

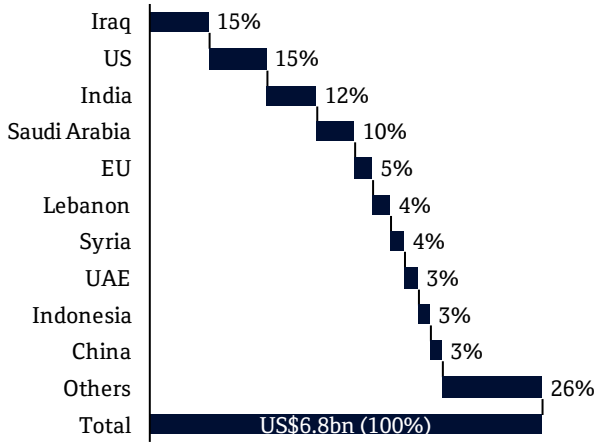
[25] Re-exports totaled US$1.2bn in 2011, 18% the size of domestic exports. This is down from a peak of US$1.7bn in 2008 (27% of domestic exports) according to DoS data. The export figure in the balance of payments is the sum of domestic exports and re-exports.

Much of the growth in recent years has come from exports of potash, phosphates and the fertilisers that are produced from these minerals. These exports have risen as a result of increased production (see Section 4B) as well as higher international prices, which have recovered after a crash during the global recession in 2009. Food exports have similarly benefited from rising prices. Clothing exports are down from a peak in 2007 as the QIZs' comparative advantage in accessing the US market has diminished, but are up from their 2009 low.

Over half of exports go to Iraq, the US, India and Saudi Arabia

Jordan's export destinations are fairly concentrated—more than half of total exports go to just four countries (Fig 5.8).

Fig 5.8: Domestic Export Destinations (2011)
(US$ bn, % share)



Source: IMF and QNB Group analysis

Iraq is currently the largest recipient of Jordan's domestic exports, purchasing a diverse range of goods. In addition, it is also the destination of much of the re-exports coming through Jordan, utilising Aqaba due to the lack of capacity in Iraq's ports. In April 2012, Iraq lifted a two-year ban on vegetable imports, which was intended to support local farmers. However, Jordanian exporters complain about growing non-tariff barriers and bureaucracy in trade with Iraq—exports were down 17% year-on-year in the first half of 2012. A free trade agreement signed in 2009 is awaiting Iraqi ratification.

Most of the exports to the US, the second largest destination, are clothing from the QIZs. The US was Jordan's main export destination for every year in the 2000s, bar 2008. However, in 2011, exports to the US were a quarter below their peak in 2006, as QIZ exports were strongest then.

India, in third place, has long been an important market because of demand for fertilisers and their mineral

precursors. Finally, Saudi Arabia is a market for food and pharmaceuticals. Food exports to Saudi Arabia have been increasing since July 2011 when the country lifted a 21-year ban on Jordanian fruit and vegetables. As a result, exports to Saudi Arabia were up by 18% year-on-year in the first half of 2012.

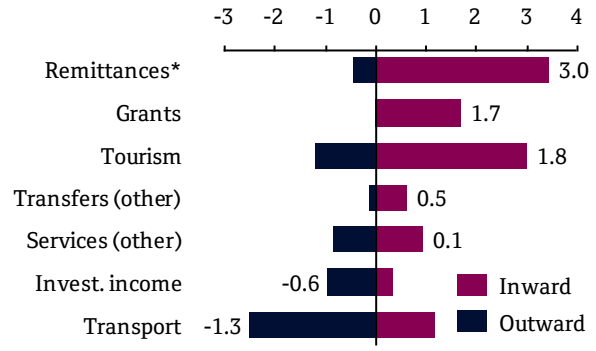
In 2012, the intensifying conflict in Syria has largely blocked Jordanian exports to the north, not just to Syria, the sixth largest export market (down 14% in the first half of 2012), but also the trucking route to Lebanon, the fifth largest market, as well as to Turkey and the EU. Overland exports to these destinations now have to take a much longer route through Iraq.

Non-Physical Balance

Investment income outflows now substantially exceed inflows

Aside from physical trade, the current account includes non-physical payments categorised as income, services and current transfers, each of which have further components. Remittances, grants and tourism are the most important of these components in contributing to Jordan's non-physical surplus, which totalled US$5.6bn (19.4% of GDP) in 2011 (Fig 5.9).

Fig 5.9: Income, Services & Transfer Payments (2011)
(US$ bn, net totals shown)



Source: CBJ and QNB Group analysis; *here this includes "compensation of employees", which is in the income not transfers account

The income balance turned slightly negative in 2010, having been in surplus by an average of 3.0% of GDP in the prior five years. The sharp change was a result of a jump in investment income outflows—dividend and interest payments and profit repatriation—coupled with a decline in foreign income receipts to the banking sector. The deficit in investment income is partly offset by "compensation of employees" inflows, which are defined as remittances paid by Jordanians who have been working abroad for less than a year.

Remittances are relatively flat and predictable but grants can be extremely volatile

Inward remittances themselves, part of current transfers, totalled US$3.0bn in 2011. This implies that migrant workers remit on average about US$5,000/year. Remittances have been essentially flat since 2007—Jordanian migrants did not cut back on their transfers home during the 2009 global downturn, but equally have not increased them since then, despite wage inflation in the Gulf where most work.

The other major component of current transfers are foreign grants. These reached a record US$1.7bn (5.9% of GDP) in 2011, more than double the average over the previous five years as donors stepped in to assist Jordan during the turbulence of the Arab Spring and the fiscal shock from the substitution of oil for Egyptian gas. Jordan's budget assumes a continuation of grants at close to this level in the next few years. Few grants were received in 2012 until October, when US$250m was transferred by Kuwait and an agreement was signed for US$357m in grants from the US. The Kuwait grant was the first payment as part of a pledge made by the GCC in December 2011 to provide Jordan with US$5.0bn over five years for development projects, which should boost grant levels in 2013. Kuwait, Qatar, Saudi Arabia and the UAE will each provide a quarter of these grants, each funding specific projects agreed with Jordan.

Foreign currency inflows from tourism more than offset transport outflows

The largest component of services payments relate to tourism (and other foreign visits). Foreign currency receipts from tourism peaked at US$3.6bn in 2010, having grown at a rate of 20% over the previous five years, before falling back to US$3.0bn in 2011 on account of a dip in visitor numbers. Meanwhile, the transport component recorded US$2.5bn in outflows, mainly due to the freight costs related to imports. These were offset partly by inflows, particularly US$0.9bn in receipts from passenger travel, mainly related to Royal Jordanian Airlines income. Other services inflows and outflows broadly cancelled out.

C. Capital Account

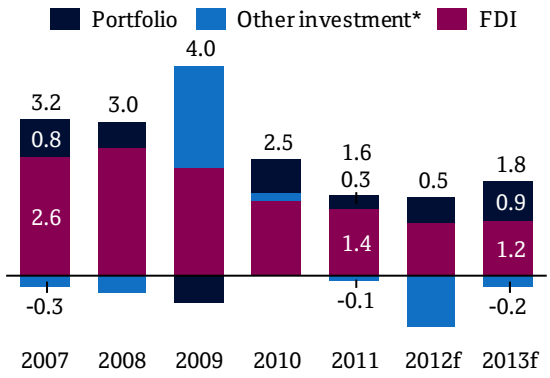
Foreign investment comprises the bulk of the capital account surplus

In recent years, until 2011, Jordan's current-account deficits have been more than offset by capital-account surpluses. The bulk of these funds have come from foreign direct investment (FDI), which peaked at

US$2.8bn in 2008, but has been in steady decline since then (Fig 5.10). The total cumulative stock of inwards FDI reached about US$21.9bn at the end of 2011.

Fig 5.10: Capital Account (2007-11)

(US$ bn)



Source: CBJ and QNB Group analysis; *also includes the small line relating to physical assets

Portfolio investment tends to be fairly volatile as market trends impact the behaviour of foreign investors trading in Jordanian securities and Jordanians trading in foreign securities. Other investment flows mainly relate to loans and deposits and spiked in 2009 as high interest rates attracted substantial deposits. More recently, there has been a drawdown of foreign currency deposits. Disbursements of an IMF Stand-By Arrangement loan in 2013 should narrow the other investment deficit.

D. External Debt

External debt is falling relative to GDP

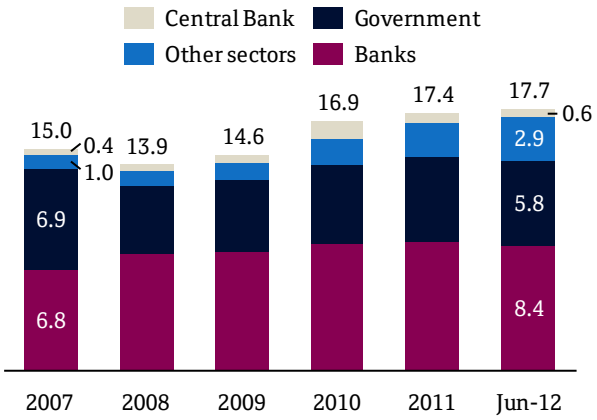
Jordan's total external debt has been growing less rapidly than the overall economy in recent years, and so its size relative to GDP declined from a recent peak of 136% of GDP in 2002 to 60% of GDP, or US$17.4bn, in 2011 (Fig 5.11). As of end-June 2012 the debt had risen to US$17.7bn. However, growth in external debt is picking up as the IMF loan is disbursed.

The banks are responsible for nearly half of the total debt, and the central government about a third. Much of the government debt is on concessional terms from the World Bank, regional development banks, and bilateral creditors. The IMF Stand-By Arrangement loan, signed in August 2012, will total US$2.1bn of which about US$500m is expected to be disbursed during 2012 and perhaps US$600m in 2013.

Most of the increase in debt recently has come in "other sectors", up from US$1.8bn at end-2010 to US$2.9bn in June 2012. This is largely quasi-government debt owed by NEPCO in relation to oil imports.

Fig 5.11: External Debt (2007-Jun 2012)

(US$ bn)



Source: CBJ and QNB Group analysis

E. Qatar-Jordan Economic Relations

Qatar pledges US$1.25bn in grants

According to the DoS, Jordanian exports to Qatar averaged US$91m in 2007-2011, although the Qatar Statistics Authority (QSA) only recorded US$57m of imports from Jordan. The difference may partly be due to re-export categorisation. Similarly, QSA figures for Qatari exports to Jordan averaged US$109m over this period (40% of which were re-exports, mainly of vehicles), while the DoS recorded an average of just US$13m in imports from Qatar. Jordanian exports to Qatar are largely fruit and vegetables. The main Qatari exports to (or via) Jordan in recent years have been mainly ammonia (presumably for use in Jordan's fertilisers plants), polyethylene (for plastics production) and kerosene fuel. Another major current account flow is an estimated US$100m a year remitted to Jordan by about 15,000 Jordanians working in Qatar.

Qatar, together with some of the other GCC states, pledged, in December 2011, to provide Jordan with US$1.25bn in grants for development projects over the next five years. It is understood that part of the Qatari grant will be used by Jordan to build an LNG import terminal in Aqaba, to help fill the gap resulting from the fall in Egyptian gas imports. When this is completed, perhaps as soon as 2014, it is likely that Jordan will begin importing LNG from Qatar, although no agreement is currently in place, which would significantly increase bilateral trade volumes.

There is also a growing level of Qatari private investment in Jordan. One of the earliest and largest investments was by QNB Group in Jordan's second largest bank HBTF in 2004; it is currently the largest shareholder with 34.5% of the stock. More recently the Qatar Electricity and Water Company bought a 23% stake in the Amman East Power Plant in 2012.

6. Money and Prices

The peg to the US dollar is a lynchpin of stability

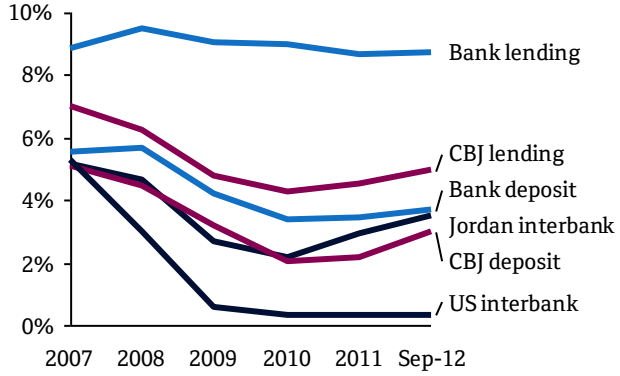
Since 1995, the Jordanian dinar has been pegged to the US dollar at a rate of US$1=JD0.709, a level that was based on the IMF special drawing rights basket at the time. Jordan shares the policy of dollar pegging with its neighbours in the GCC and with Lebanon.

The policy makes sense for a number of reasons: linkages with the GCC and Lebanon; trade with the US; and as important commodities, such as oil and phosphates, are priced in dollars. The peg is also intended to provide a stable monetary environment for foreign investment. As a result, the peg has been described as a "lynchpin of stability" for Jordan and is unlikely to be changed in the near future.[26]

US interest rates influence but do not precisely determine the CBJ's direct monetary policy

The CBJ's monetary policy utilises a range of direct and indirect tools. The peg to the US dollar means that Jordan broadly follows the trends of US rates, although with a premium to account for the greater risk to funds deposited in Jordan. If the premium exceeds what depositors require to account for this risk, then Jordanian banks may attract capital inflows as happened in 2008-09 (see Section 5C) when Jordanian rates fell more slowly than US rates (Fig 6.1).

Fig 6.1: Interest Rates (2007-Sep 2012)



Source: CBJ, IMF and QNB Group analysis

However, CBJ did eventually cut rates in response to the global financial crisis. Its overnight deposit rate came down from 4.50% to 2.00% by February 2010 and the re-discount rate, its benchmark lending rate, was cut by similar increments. Banks' reserve requirements were also eased to boost liquidity. More recently, inflationary concerns have led to a tightening in policy, and the re-discount rate has been increased by 75 basis points since June 2011. CBJ's overnight deposit rate was increased in parallel and then by a further 50 basis points, in May 2012, to 3.25% to bolster the dinar. That move was accompanied by a new policy of open market operations. The IMF has recommended further monetary tightening to combat inflation and retain deposits.

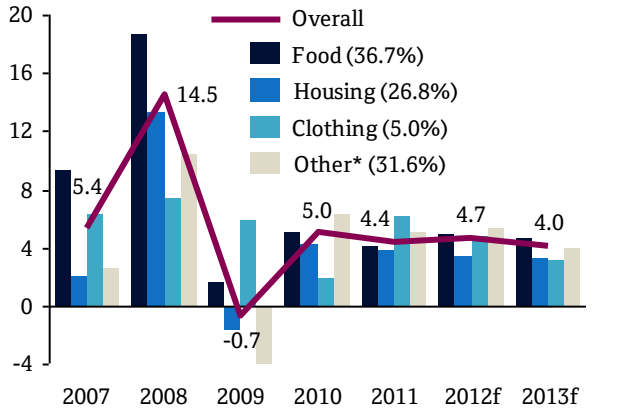
Banks have not passed much of the benefit of lower base rates on to customers. The average spread between banks' time deposit and lending rates widened from 3.8% in 2008 to 5.6% in 2010, although it narrowed a little to 5.0% in the first nine months of 2012. This has led to action by the CBJ, such as imposing maximum interest rates on credit cards in November 2012.

Rising fuel prices are boosting inflation

In recent years, inflation in Jordan has followed a somewhat similar pattern to elsewhere in the region and indeed internationally. Prices spiked in 2008, rising 14.5%, driven by high global food and commodity prices, as well as domestic housing costs. There was deflation in 2009, due to lower rents and transport costs (Fig 6.3).

Fig 6.3: CPI Inflation (2007-2013)

(% change, weights in legend[27])



Source: DoS and QNB Group forecasts; *Transport (11.4%), education (7.0%). communication (4.4%) and other services (8.8%)

Inflation has been relatively steady since then, easing from 5.0% in 2010 to 4.4% in 2011, as a cap on fuel retail prices, introduced in January 2011, limited the impact of a rising oil prices. However, Jordan's fiscal crisis has forced it to increase fuel and electricity prices in 2012. Initial rises helped push up year-on-year inflation to 4.8% in September 2012, from a low of 3.4% at the start of the year. Fuel subsidies were abolished in November, leading to a 50% increase in cooking gas, a 33% rise in diesel and a 14% increase in petrol. The money supply—which we forecast will grow at 5.8% in 2012-13—is also a factor driving inflation. However, lower rental inflation will keep a lid on the overall annual average rate in 2013, which is forecast to slow to 4.0%.

[26] In the IMF's 2012 Article IV review, which argued that the level of the peg is "broadly in line with medium-term fundamentals".

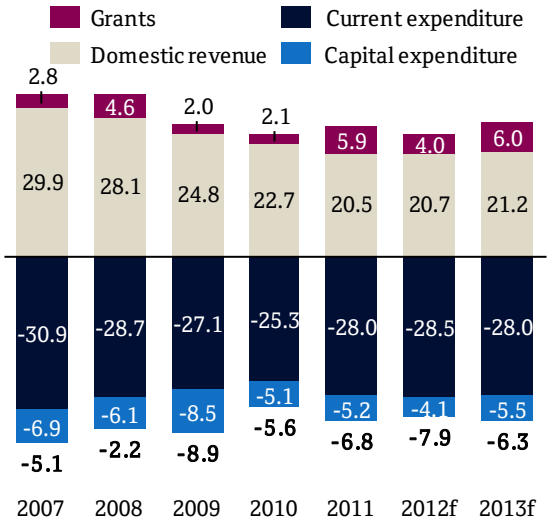
[27] Some local economists have questioned the relevance of the basket, as CPI inflation tends to differ a fair bit from other price indicators in Jordan.

7. Public Finance

The structural deficit is partly offset by grants

Jordan has been running a structural fiscal deficit for many years. Over the last decade, the deficit averaged 4.5% of GDP, though it would have been more than twice as high without support from foreign grants. During the recent boom period, strong growth in domestic revenue brought the deficit before grants down to 6.8% in 2008, the lowest since 1995, and including grants it was just 2.2% (Fig 7.1).

Fig 7.1: Fiscal Balance (2007-2013)
(% of GDP)



Source: Ministry of Finance (MoF) and QNB Group forecasts

The global recession, in 2009, led to a fall in domestic revenue and grants, in both relative and absolute terms, causing the deficit to swell. It narrowed again in 2011, owing to restraint in current spending growth and a sharp cut in capital expenditure. However, in 2011 the combined pressures of the Arab Spring, the introduction of fuel subsidies and the fall in gas imports from Egypt led to a sharp rise in current expenditure. As a result, even though Jordan received record grants, largely from Saudi Arabia, the deficit widened to 7.9% of GDP.

The deficit will widen in 2012 but then narrow in 2013 as a result of austerity and higher grants

The pressures driving growth in current spending have continued during 2012. However, on the positive side, fiscal data for the first eight months of 2012 shows a pickup in tax revenue and strong growth in other domestic revenue. This means that 2012 is likely to see record domestic revenues, although overall revenue will be flat because of a fall in grants. All these factors, together with a cut in capital expenditure, will result in a further widening of the deficit to 7.9%.

The fiscal impact of the Syrian refugee inflow is as yet unclear. The Ministry of Planning has estimated that the annual cost of hosting 180,000 refugees is about US$0.5bn, although most are not living on handouts and will be contributing to fiscal revenues through paying sales tax on purchases.

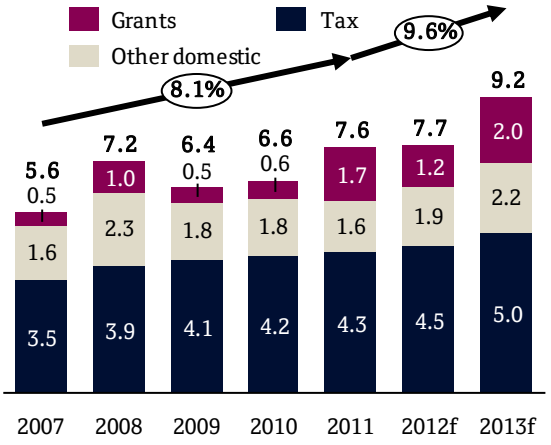
In 2013, a set of new austerity measures will help constrain current expenditure and boost revenue. In addition, grants are expected to rise again, although this includes funds from the GCC earmarked for capital expenditure, which is therefore also set to rise. Overall the deficit is forecast to narrow slightly to 6.3% of GDP.

A. Revenue

Declines in non-tax revenue since 2008 have offset modest growth in tax revenue

Taxes, the main component of Jordan's revenue, have been growing steadily in recent years, even during the downturn in 2009. From 2007-11, they rose at a rate of 5.4%, reaching US$4.3bn, although this was significantly slower than the 14.0% rate of nominal GDP growth over this period. However, the other components of domestic revenue—such as charges for government services and income on investments—have been more volatile. They grew sharply in 2008, but have declined in absolute terms since then. By 2011, they had fallen back to the 2007 level of US$1.6bn. As a result of these contrary trends, domestic revenue was essentially flat in 2009-11 and below the 2008 peak. Overall revenue in 2011 was only higher than previous years because of record grants (Fig 7.2).

Fig 7.2: Revenue (2011)
(US$bn, selected overall CAGRs shown)



Source: MoF and QNB Group analysis

In 2009-10, grants had fallen to their lowest level, relative to GDP, in over two decades as the global recession caused donors to cut aid budgets. However, in

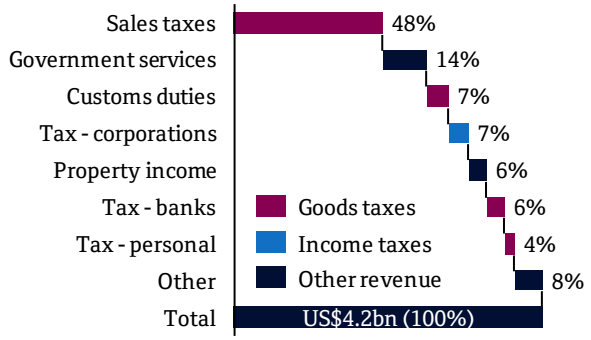
response to the Arab Spring, which in Jordan was rooted in economic hardship, donors stepped up their assistance substantially, providing a record US$1.7bn in aid, including US$1.0bn from Saudi Arabia.

Early data suggest that other domestic revenue has been picking up in 2012. Tax revenue should be substantially higher in 2013 as sales taxes have increased on some luxury goods, and because parliament is likely to increase taxes on banking, mining and telecoms companies. These factors, combined with an increase in grants, mainly from the GCC, should produce a surge in revenue to US$9.2bn in 2013.

Sales tax is nearly half of domestic revenue

The bulk of Jordan's domestic revenue comes from sales taxes on goods and services. Moreover, the share of sales taxes has risen from 41% in 2009 to 48% in 2011 (Fig 7.3). The second largest revenue component is income tax with 12% of total revenue coming from corporate tax, particularly banks, and 4% from personal income tax. Income tax revenue peaked in 2009 owing to a lag in collection against income earned during 2008, and is not expected to exceed this level until 2014. The other major component of revenue, 14% of the total in 2011, are charges for government services, such as land registration. Meanwhile, customs duties have declined in importance, from 10% of the total in 2007 to 7% in 2011, owing to a reduction in tariff rates.

Fig 7.3: Domestic Revenue (2011)
(US$bn and % share)



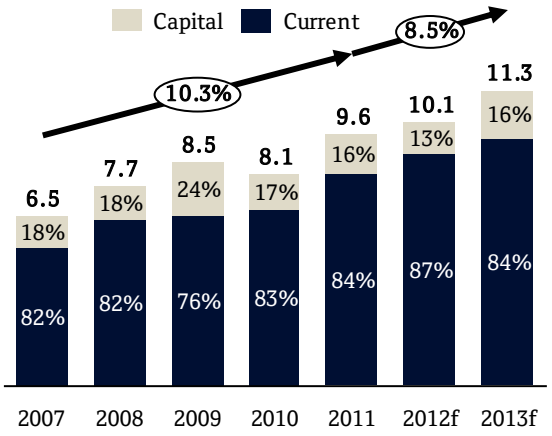
Source: MoF and QNB Group analysis

B. Expenditure

Capital expenditure has been cut back sharply

Jordan's government expenditure has been expanding more rapidly than revenue in recent years, growing at a rate of 10.3% from 2007-2011. Most of this increase came from current expenditure. Capital expenditure briefly spiked in 2009 as a result of an overhang of projects initiated during the boom period, but has since been cut back owing to fiscal constraints (Fig 7.4). It is forecast to be lower in absolute terms in 2012 than it was in 2008; it will also be the lowest in decades as a share of both total expenditure (13%, compared with an average of 20% during the 2000s) and GDP (4.1%).

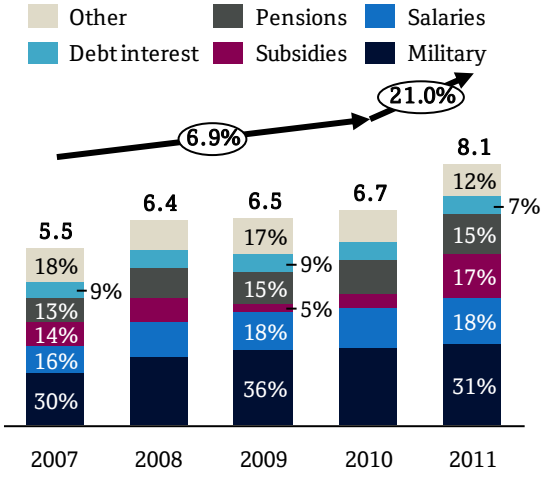
Fig 7.4: Expenditure (2007-13)
(US$bn and % share, selected CAGR shown)



Source: MoF and QNB Group analysis

Current expenditure was nearly flat from 2008-10, as the government exercised restraint in the context of the economic downturn. However, in 2011 it jumped by 21.0%, largely owing to a more than tripling in spending on subsidies, mainly related to fuel and food (Fig 7.5). Wages, pensions and other social spending also increased sharply to help the population during a period of economic hardship, and to mitigate tensions.

Fig 7.5: Current Expenditure (2007-11)
(US$bn and % share, CAGRs shown)



Source: MoF and QNB Group analysis

The largest part of current expenditure still relates to the military and was US$1.8bn in 2011. This represented 9% of GDP, close to the average level over the last decade and in the top five globally. This high level of spending is a response to Jordan's turbulent

neighbourhood. Jordan cannot afford to sustain high military spending in the long run, but the sector is a major employer, which makes attempts to trim its budget extremely difficult. Moreover, short-lived Jordanian governments do not have sufficient influence to attempt this, particularly as the military budget is exempt from examination by the national audit bureau. However, the military has recently made some voluntary cuts in light of Jordan's fiscal hardships, and its spending was down 8.1% in the first eight months of 2012.

The high level of spending on fuel subsidies continued through most of 2012, until they were finally ended in November. Subsidy costs were up by 40% in the first eight months of the year; wages and pensions were also up by 13.9% and 12.5%, respectively. Overall, we expect current spending to grow by about 8.9% over the full year, while capital spending is expected to fall by 14.8% as no new projects are being initiated. So total spending will increase by 5.2% in 2012.

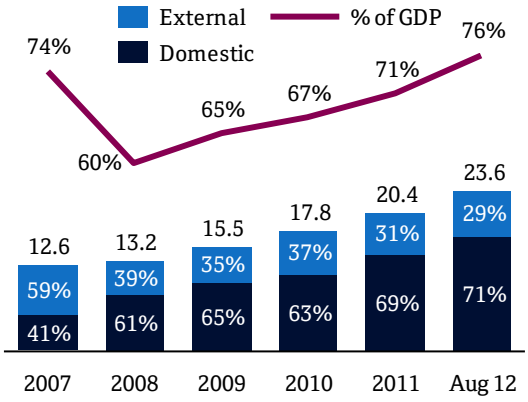
In 2013, however, capital expenditure should surge as some of the GCC-funded development projects—such as the critical LNG import terminal—get underway, while current expenditure growth will slow owing to the ending of subsidies. Overall expenditure growth is forecast to rise by 11.9%, reaching about US$11.3bn.

C. Public Debt

Public debt has spiked owing to oil imports

Jordan's public debt has been growing briskly at a rate of about 12% a year since 2007, reaching US$19.9bn at the end of 2011, equivalent to 71% of GDP (Fig 7.6).

Fig 7.6: Public Debt (2007-Aug 2012)
(US$bn and % of GDP, CAGR shown)



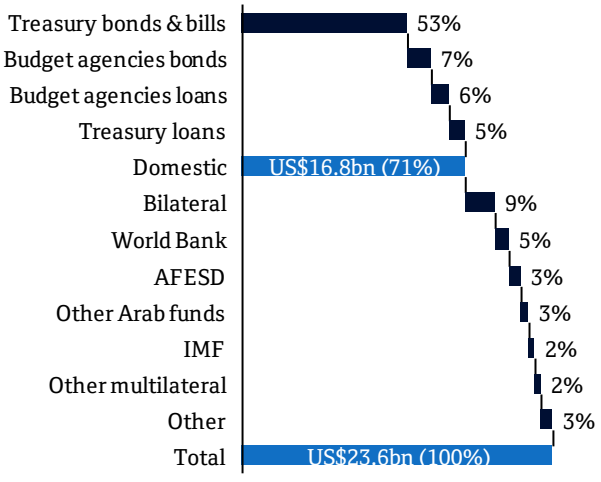
Source: MoF and QNB Group analysis

Although the debt is up from a low of 60% of GDP in 2008, it is not excessively high by international standards. It is also significantly down, in relative terms, since 2002, when it stood at 103% of GDP, prior to debt restructuring by the Paris Club of official creditors. However, the sharp rate of increase in debt during 2012, to US$23.6bn in August, may push it close to 80% of GDP by the end of the year. A large part of the increase has been due to the cost of importing oil for electricity production. NEPCO, which bore the increased costs, borrowed US$1.4bn in 2011 and its total debt reached US$2.5bn in November 2012. About half is guaranteed by the state

Jordan historically relied heavily on international creditors, particularly the Paris Club and multilateral institutions, often on concessionary terms. As a result, the average effective interest rate on foreign debt was only about 2% in 2011, almost a quarter the current yield on 3-year government bonds. However, the absolute level of foreign debt fell sharply in 2008 and domestic debt became the majority, a position that it has retained since then.

Domestic financing mainly and increasingly comes from banks, whose share of domestic debt reached 77% in August 2012, up from 66% in 2010 and 53% in 2005. Foreign debt is now increasing again as the IMF's US$2.1bn loan is disbursed in 2012-15, but domestic debt is likely to increase even more rapidly. When it is fully disbursed, the IMF will be the largest single foreign creditor, ahead of Japan and the World Bank (Fig 7.7).

Fig 7.7: Public Debt Breakdown (Aug 2012)
(US$bn and % share)



Source: MoF and QNB Group analysis

Jordan's long-term foreign currency debt is rated BB by Standard & Poor's and Ba2 by Moody's, an equivalent rating; both agencies have assigned a negative outlook. These ratings place Jordan a few notches ahead of some other oil-importing countries in the region, such as Lebanon and Egypt, but behind Tunisia.

Key Macroeconomic Indicators

	2007	2008	2009	2010	2011	2012f	2013f
Population							
Total (m, year end)	6.32	6.33	6.38	6.42	6.49	6.83	6.98
Growth (%)	2.3	0.1	0.9	0.6	1.0	5.3	2.3
GDP							
Nominal GDP (US$ bn)	17.1	22.0	23.9	26.5	28.9	31.0	33.7
Growth (%)	13.6	28.5	8.5	10.9	9.1	7.2	8.9
Real GDP growth (%)	8.2	7.2	5.5	2.3	2.6	2.5	3.6
Agriculture	1.3	8.6	12.8	6.9	3.9	-8.7	1.9
Industry	9.1	8.0	0.4	1.2	3.3	1.6	4.1
Services	7.3	7.2	3.0	4.2	3.3	4.2	4.2
Fiscal indicators (% of GDP)							
Revenue	32.7	32.7	26.7	24.9	26.4	24.7	27.2
(US$ bn)	5.6	7.2	6.4	6.6	7.6	7.7	9.2
Expenditure	37.8	34.8	35.7	30.4	33.2	32.6	33.5
(US$ bn)	6.5	7.7	8.5	8.1	9.6	10.1	11.3
Balance	-5.1	-2.2	-8.9	-5.6	-6.8	-7.9	-6.3
(US$ bn)	-0.9	-0.5	-2.1	-1.5	-2.0	-2.4	-2.1
Public debt	73.8	60.2	64.8	67.1	70.7	-	-
Current account (% of GDP)							
Balance	-16.8	-9.3	-5.2	-7.1	-11.2	-11.9	-8.7
Trade balance	-37.7	-32.6	-26.3	-25.7	-30.6	-28.0	-26.0
Exports	33.5	36.1	26.8	26.6	27.8	26.0	25.9
Imports	-71.2	-68.8	-53.1	-52.3	-58.3	-53.9	-52.0
Services balance	0.2	1.6	3.1	4.5	3.1	4.9	4.8
Income balance	4.0	3.2	2.1	-0.3	-0.6	-0.7	-0.7
Current transfers balance	16.7	18.5	15.9	14.5	16.9	11.9	13.1
International reserves	46.3	40.5	50.9	51.5	41.8	30.1	21.9
Import cover (months)	7.8	7.1	11.5	11.8	8.9	6.3	4.7
External debt	87.8	63.1	61.1	63.7	60.2	-	-
Monetary indicators (%)							
Consumer price inflation	5.4	14.5	-0.7	5.0	4.4	4.7	4.0
Food	9.3	18.6	1.7	5.0	4.1	5.0	4.6
Housing	2.0	13.3	-1.7	4.2	3.8	3.5	3.3
Wholesale price inflation	8.5	19.4	0.9	3.7	-	-	-
Interbank deposit rate	5.7	4.9	3.3	2.2	2.6	-	-
Broad money growth	10.6	17.3	9.3	11.5	8.1	5.7	5.8
Exchange rate US$:JD (av)	0.709	0.709	0.709	0.709	0.709	0.709	0.709

Source: Dos, CBJ, MoF and **QNB Group estimates and forecasts;** Data as at 15th November 2012

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