

## JORDAN ECONOMIC REPORT

### THE DUAL REQUIREMENT OF FISCAL ADJUSTMENT AND GROWTH ENHANCEMENT IN A TOUGH REGIONAL ENVIRONMENT

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- **Economy operating well below potential**

The Kingdom's economy continued to weather the tough regional environment that carries adverse spillover effects on the domestic economic conditions. The conflicts in Iraq and Syria continued to affect trade, tourism and investor confidence, while the plunge in oil prices supported domestic demand while adversely impacting external demand. Tourism revenue has fallen relatively in 2015 as regional political instability and the impact of a strong dollar have deterred visitors, pushing down services earnings. Within this context, real GDP growth posted 2.5% in 2015, highlighting its sixth year of low economic growth and widening further its cyclical output gap. In parallel, the average unemployment rate rose to 13.1% in 2015, against 11.9% in 2014.

- **Widening fiscal and current account deficits despite contracting trade deficit**

The performance of Jordan's external sector in 2015 was at the image of the difficult regional environment. Foreign trade figures show a contraction in imports by 11.2% alongside a 6.1% decline in exports during the first 11 months of 2015 compared to the same period of 2014, contributing to a 13.6% decrease in the foreign trade deficit. Yet, such a favorable trend was not accompanied by a contracting current account deficit, the latter having reported 9.4% of GDP in the first nine months of 2015, against 7.1% in full-year 2014 as the secondary income surplus fell sharply in 2015, reflecting the lower flow of aids and remittances from Jordanians working abroad, mainly in the Gulf region. Meanwhile, Jordan's public finances were under the effect of falling external grants resulting in higher deficit and remain the most significant vulnerability of the Kingdom's economy.

- **Continuous expansionary monetary stance amidst a deflationary environment**

The monetary situation in Jordan was characterized in 2015 by deflationary conditions with the Consumer Price Index declining by 0.9% on average, primarily due to the effects of lower oil prices and a strong US dollar, while the Central Bank of Jordan continued to follow an expansionary monetary policy, reducing all monetary policy instruments' rates by 50 bps to 125 bps over the year. Meanwhile, readily available foreign exchange reserves maintained a healthy level amidst a steady reduction in dollarization and a stronger confidence in the local currency. The Central Bank of Jordan's readily available foreign exchange reserves remained at a comfortable level of US\$ 15.2 billion at end-2015, the equivalent of 9 months of imports and 40.0% of money supply in Jordanian Dinar.

- **Banking sector witnessing positive albeit moderate growth rates during 2015**

Measured by consolidated assets of banks operating in Jordan, sector activity grew by 5.0% in 2015 to reach US\$ 66.5 billion at end-December 2015, thus pretty much matching the 2014 asset growth. Financial soundness indicators remain strong, with a non-performing loans to total loans ratio of 5.5%, provisions as a percentage of NPLs at close to 80%, a risk-weighted capital adequacy ratio of 18.5% and a return on assets of 1.4% along with a return on equity of 11.1%.

- **Relative stability in equity prices along with increased activity**

Jordan's equity market saw an increased activity in 2015 and relative stability in prices despite regional political instability, mainly supported by a healthy increase in profits before taxes of listed companies and attractive market pricing ratios. In parallel, the fixed income market saw new US-guaranteed bond issues that allowed the Kingdom to access affordable financing from international capital markets and played a role in promoting economic reforms deemed necessary for economic stability.

- **Real economy to remain at the image of regional conditions in the near term**

Looking ahead, consumer and business confidence in the Kingdom will remain constrained in the near term by the impact of regional turmoil and the effect of lower oil prices on regional liquidity, with Syria and Iraq traditionally Jordan's main export market and the Gulf a major source of tourists. While tighter monetary policy and a constrained fiscal position will limit growth potential, real GDP growth is expected at 3.7% in 2016 and could accelerate thereafter, with private consumption remaining the key driver of economic activity.

The Kingdom's economy continued to weather the tough regional environment that carries adverse spillover effects on the domestic economic conditions. The conflicts in Iraq and Syria continued to affect trade, tourism and investor confidence, while the plunge in oil prices supported domestic demand while adversely impacting external demand. Tourism revenue has fallen relatively in 2015 as regional political instability and the impact of a strong dollar have deterred visitors, pushing down services earnings. Within this context, real GDP growth posted 2.5% in 2015, highlighting its sixth year of low economic growth and widening further its cyclical output gap. In parallel, the average unemployment rate rose to 13.1% in 2015, against 11.9% in 2014.

At the monetary level, a deflation was reported in 2015, the first of its kind since 2009, reflecting the weak demand for goods and services, along with the effects of declining oil prices and a strong US dollar, despite the price pressures arising from rent increases which in turn reflect the impact of the refugee influx on housing demand. Consumer price inflation, which had reported 2.9% in 2014, registered -0.9% in 2015. Within this environment, the Central Bank of Jordan has reduced the rediscount policy rate to 3.75%, as prices have fallen last year. The Central Bank has pushed commercial banks to pass on the rate cuts to their customers to help stimulate the economy, but with only partial success. The stock on international reserves stabilized in 2015 at US\$ 15.2 billion, the equivalent of 40% of Money Supply in domestic currency, a relatively sound level by comparative standards.

At the external level, the trade deficit still narrowed significantly in 2015. While exports faltered because of lower potash prices (and reduced production), the far larger size of the import bill has been falling at a faster pace than export earnings owing to slumping oil prices. The ratio of exports to imports, which was at 41.2% in 2014 rose to 43.2%. Yet, such a favorable trend was not accompanied by a contracting current account deficit, the latter having reported 9.5% of GDP in the first nine months of 2015, against 7.1% in full-year 2014 as the secondary income surplus fell sharply in 2015, reflecting the lower flow of remittances from Jordanians working abroad, mainly in the Gulf region.

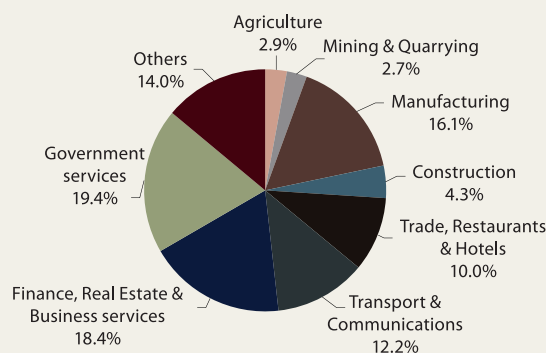
The Kingdom's public finances remain relatively weak. The oil price slump and subsidy reforms have pushed down government spending, but at the same time both domestic tax and foreign grant revenue have weakened. We estimate government expenditures to have contracted by 6.1% in 2015, accounting for 27.2% of GDP, highlighting attempts at fiscal rationalization. In parallel, government revenues have dropped by 14.6% to account for 23.1% of GDP in 2015. As a result, fiscal deficit remained elevated at 4.1% of GDP while public debt reached US\$ 34.7 billion, the equivalent of 91.3% of GDP in November 2015. Although Jordan's regional ties remain strong, the fall in global oil prices is hitting support from traditional backers in the oil exporting GCC countries.

### GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

### GDP BREAKDOWN BY ECONOMIC ACTIVITY\*



\* 9M-2015

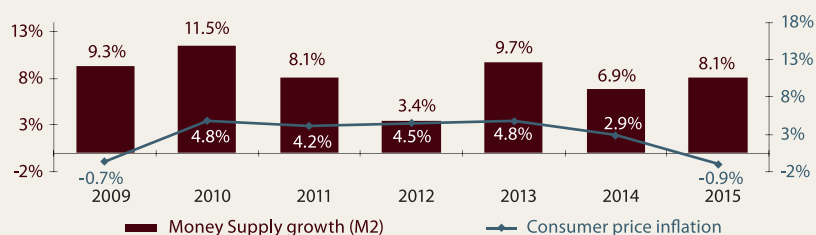
Sources: Central Bank of Jordan, Bank Audi's Group Research Department

At the banking sector level, credit to the banking sector continued to improve and banking sector indicators remained sound. Indeed, loans to the private sector rose by 9.5% in 2015 to reach US\$ 29.8 billion, thus reporting its highest growth since 2012. Customer deposits, which constitute almost 70% of total assets, rose by 7.7% in 2015 to reach US\$ 46 billion, the equivalent of 120% of the Kingdom's GDP. Financial soundness indicators remain strong, with a non-performing loans to total loans ratio of 5.5%, provisions as a percentage of NPLs at close to 80%, a risk-weighted capital adequacy ratio of 18.5% and a return on assets of 1.4% along with a return on equity of 11.1%.

At the capital markets level, the Kingdom's equity market has been mostly weaker in 2015, though comparatively better than many countries markets that suffered from widespread selloffs. The Amman Stock Exchange Index ended 2015 at 0.2% below the end-2014 level, thus contracting market capitalization to GDP from 71% to 66% respectively. As such, market valuation ratios reported one of their lowest values ever, with the average Price to Earnings ratio reaching 14x and the average Price to Book Value ratio reporting 1.3x. Such weak market pricing comes within the context of a market persistently lacking efficiency and liquidity. The annual turnover to market capitalization reported a weak level of 19% in 2015, against a regional average of 69% and a global average of 123%.

The detailed developments in the real sector, external sector, public sector and financial sector are outlined in the sections that follow while the concluding remarks address the Kingdom's near term outlook at large.

#### BROAD MONEY AND INFLATION



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

## 1. ECONOMIC CONDITIONS

### 1.1. REAL SECTOR

#### 1.1.1. Agriculture and Industry

##### *Growth at a slower pace in primary and secondary sectors*

Jordan's agricultural sector grew at a slower pace during the year 2015, following a relatively more favourable performance in the previous year, in line with the deteriorating politico-security conditions taking over the region. In details, the sector grew by 2.0% in 2015, down from an increase of 7.6% registered in 2014. Still, the sector contributed by US\$ 799 million to the GDP at current prices in the first nine months of 2015, up from US\$ 700 million in the aforementioned period of 2014. The sector, which takes over a relatively small share of the country's GDP, contributed by 2.9% in the first nine months of 2015, edging up from 2.7% in the aforementioned period of 2014.

It is worth noting that the agricultural sector took over a share of 1.0% of total credit facilities at end-December 2015, edging down from 1.3% at end-December 2014. Those registered a negative level in terms of flows in 2015.

Furthermore, the number of registered companies classified within the agricultural sector fell from 751 in 2014 to 720 in 2015, a yearly decrease of 4.1%. This came after an increase of 9.3% posted in 2014. Alongside, the agricultural companies' capital adopted a similar trend, falling from US\$ 42.9 million in 2014 to US\$ 17.6 million in 2015.

On a side note, agricultural exports reported a decline in 2015 given the closures of land trade routes between Jordan, Iraq and Syria, along with the heat wave that hit the country during summer months. In this context, the sector's exports fell by 2.9% from US\$ 1,375 million in 2014 to US\$ 1,336 million as 11-month annualized figures for 2015. This followed an increase of 9.3% registered in 2014.

In parallel, the industrial sector grew by a mere 2.0% in 2015, revealing a slowdown from a growth of 3.9% posted in 2014. This growth mainly reflects the positive performance of the three main contributors to the sector, namely mining and quarrying, manufacturing and electricity and water.

In details, mining and quarrying added US\$ 739.5 million to the Jordanian GDP at current prices in the first three quarters of 2015, an increase of 23.5% relative to the same period of the previous year. This surpassed an increase of 10.5% registered in the same period of 2014. The share of mining and quarrying in GDP stood at 2.7% in the first nine months of 2015, up from a contribution of 2.3% posted in the same period of the previous year.

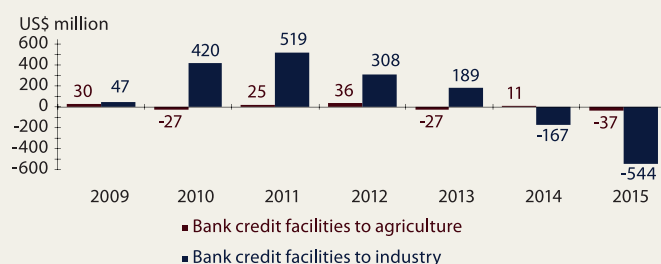
#### AGRICULTURE AND INDUSTRY

US\$ million	2010	2011	2012	2013	2014	2015	Var 15/14
Agricultural exports*	888	1,046	1,130	1,276	1,375	1,336	-2.9%
Industrial exports*	5,060	5,732	5,569	5,501	5,907	5,452	-7.7%
Phosphate (000 tons)	6,529	7,594	6,383	5,274	7,109	8,264	16.2%
Potash (000 tons)	1,934	2,259	1,823	1,728	2,086	2,355	12.9%
Fertilizers (000 tons)	760	723	640	678	886	619	-30.1%
Chemical acids (000 tons)	1,576	1,413	1,291	1,266	1,442	1,206	-16.3%
Petroleum products (000 tons)	3,350	3,158	3,476	3,082	3,007	3,212	6.8%
Electricity and water (Mill.K.W.H.)	7,806	8,160	7,895	7,539	8,148	6,557	-19.5%

\* 11-month annualized figures for 2015

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

#### CREDIT FACILITIES FLOWS TO AGRICULTURE & INDUSTRY



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

Manufacturing, which contributed by 16.1% to the country's GDP, grew by a yearly 2.0% in the first nine months of 2015, following an increase of 4.7% in the first three quarters of 2014. This contribution to GDP stood at US\$ 4,447 million in the first three quarters of 2015, up from US\$ 4,358 million in the aforementioned period of 2014.

The contribution of the electricity and water segment to the GDP grew in 2015. The segment added US\$ 657.8 million in the first nine months of 2015, up from US\$ 591.5 million in the corresponding period of 2014, an annual increase of 11.2%. However, electricity output fell by 19.5% year-on-year from 8,148 million KWH in 2014 to 6,557 million KWH in 2015. This followed an increase of 8.1% registered in 2014. Similarly, the output of fertilizers and chemical acids posted yearly declines of 30.1% and 16.3% respectively, while the output of phosphate, potash and petroleum products grew by 16.2%, 12.9% and 6.8% respectively.

The number of registered companies classified within the industrial sector decreased by a yearly 13.7% from 2,179 in 2014 to 1,891 in 2015. This came after an annual decrease of 3.7% in 2014. The capital of these companies was on a declining path as well, falling from US\$ 81.9 million in 2014 to US\$ 69.3 million in 2015. It is worth noting that credit facilities to the sector stood at 10.2% of the total credit facilities extended at end-December 2015, down from 13.1% at end-December 2014.

Looking at the external sector, industrial exports reported a yearly decline of 7.7% from US\$ 5,907 million in 2014 to US\$ 5,452 million as an 11-month annualized figure for 2015. The drop in exports was mainly due to the closure of the border crossing between the Kingdom and Iraq in addition to the ongoing troubles in Syria.

In conclusion, both the primary and secondary sectors are encountering growth at a relatively slower pace in 2015, with the exports of both sectors posting declines mainly linked to the adverse politico-security situation surrounding the country.

### 1.1.2. Construction

#### *Construction sector contracts in 2015 amidst regional instability and delay in GCC grants*

A contraction in the construction sector in 2015 contributed to the slowdown in growth. As the regional turmoil had negative spillover effects on Jordan's economy and suppressed important growth factors, the Kingdom's construction sector became more dependent on bilateral and multilateral lenders and donors. Despite forthcoming and stable GCC grants to Jordan over the past two years, the size and timing of such grants were unpredictable. Thus, the delay in the disbursement of GCC grants, which fuelled public investment in recent years, led to this deceleration in the construction sector.

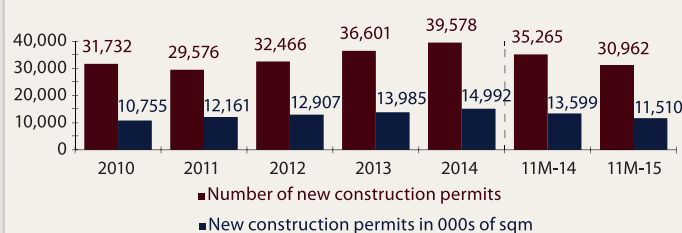
In fact, the Kingdom's construction sector, which made up 4.3% of GDP in 2015, contracted by 2.8% during the first nine months of last year, against an expansion of 7.8% posted in the aforementioned period of

#### CONSTRUCTION INDICATORS

US\$ million	2010	2011	2012	2013	2014	2015	Var 15/14
Clinker production (000 tons)	1,699	1,206	1,026	906	865	653	-24.6%
Bank credit facilities to construction (var)	825	417	309	569	658	496	-24.6%
Number of registered companies	313	341	241	217	224	148	-33.9%
Capital of new registered companies	22	49	23	15	16	11	-30.6%

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

#### EVOLUTION OF CONSTRUCTION PERMITS



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

2014. This deceleration in the construction sector took place in 2015 despite a 7.7% rise in credit facilities to the construction sector which reached US\$ 3.5 billion.

Further reflecting the contractionary trend of the sector, demand for construction permits fell by 12.2% in the first 11 months of 2015 compared to a 9.2% expansion in 2014. Similarly, the country's residential permits, which accounted for 91.9% of construction permits, witnessed a contraction of 12.9% in the aforementioned period of 2015, against a growth of 9.2% in first 11 months of 2014. Moving on to construction permits granted by city, Irbid formed the lion's share of total permits given in 2015 at 29.6%, followed by Amman at 26.2%, and Zarqa at 9.3%.

Moreover, the number of newly registered companies within the construction sector saw a significant decline of 33.9% in 2015, compared to a 3.3% expansion in 2014. The capital of these companies followed suit, declining by 30.6% in 2015 subsequent to a 7.7% expansion in the previous year.

It is worth mentioning that Jordan recently signed agreements with Chinese companies worth US\$ 7 billion. The latter mainly comprised infrastructure projects, such as the construction of new power stations and the expansion of the national railway network. A number of large construction projects are also under way, including housing, transport, energy, and air travel projects alongside the relocation of Aqaba port. For instance, the Jordanian government signed a US\$ 30 million grant agreement with the Saudi Development Fund to finance infrastructure projects for new industrial cities. The industrial cities would be established in the governorates of Tafila, Madaba, Jerash and Balqa. Additionally, although the tourism sector was impacted by low oil prices and security concerns, it would remain a key focus of the Kingdom's development plans with tourism infrastructure to be boosted by major new projects in Aqaba (2016) and the Dead Sea (2017).

To summarize, Jordan's construction sector faced difficulties in the past year amidst political instability in the region and an oil price shock impacting GCC support to the Kingdom. Having said that, a possible recovery in regional political tensions looking ahead alongside prudent government management is expected to drive the construction sector's recovery.

### 1.1.3. Trade and Services

#### *Tertiary sector under the effect of regional uncertainties*

The trade and services sector has been consistently on a slowing down path. Year-on-year real output growth moved from 4.8%, 3.2%, and 2.8% in the first nine months of 2012, 2013, and 2014 to 2.6% in the first nine months of 2015.

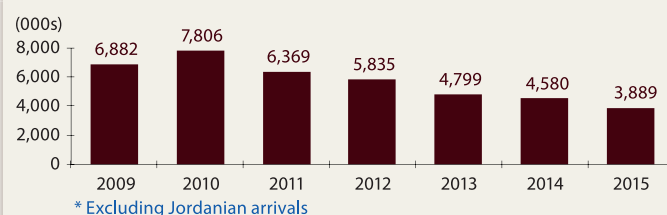
While all components of the tertiary sector managed to report higher activity, growth in trade and services was mainly driven by the following sub-sectors: Transport and communications which reported a real growth of 2.5%; Finance, insurance, real estate and business services which grew by 2.5%; social and personal services which registered a real growth of 2.3%; and producers of government services which grew by 2.3%.

### TRADE AND SERVICES

US\$ million	2010	2011	2012	2013	2014	2015	Var 15/14
Number of vessels at the Aqaba Port	2,369	2,395	2,632	2,441	2,269	2,244	-1.1%
Merchandise at the Aqaba Port (000 tons)	16,851	19,184	19,355	16,316	19,045	18,382	-3.5%
Bank credit facilities to trade and services (var)	388	979	2,146	706	-75	2,701	-
Number of new registered companies	5,004	4,990	4,632	4,687	4,367	3,578	-18.1%
Capital of new registered companies	216	366	180	190	135	127	-6.6%

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

### EVOLUTION OF TOURIST ARRIVALS\*



Sources: Central Bank of Jordan, Bank Audi's Group Research Department



On the other hand, the Aqaba port registered another year of declining trade activity. At the level of passengers, 2015 was another year of negative growth where the number of passengers using the port decreased by 7.4% to 501,139, following another decline of 25.6% reported in 2014. As to the number of vessels, they reached a total of 2,244 in 2015, down by 1.1% year-on-year, following a higher level of negative growth registered in 2014, at -7.0%. When it comes to the quantity of imported and exported goods, it decreased by 3.5% year-on-year to a total of 18.38 million tons during 2015. This is mainly due to a 5.0% drop in the quantity of goods imported through the port. This does actually reverse the trend registered in 2014, whereas the quantity of imported and exported goods had increased by 16.7% over the one registered during 2013.

As to the tourism sector, 2015 witnessed a two-digit decline in the number of foreign incomers, following another year of negative growth. In fact, numbers published by the Central Bank show that arrivals, excluding Jordanians, were down by 15.1% in 2015, following a lower drop of 4.6% in 2014. They reached a total of 3,889 thousand tourists compared to 4,580 thousand tourists in 2014. This is mostly due to a drop in the number of incomers from Syria, Saudi Arabia and Iraq of 55.1%, 16.6% and 30.8%, respectively.

The luxury segment of the hotel sector is in line with the declining tourists' numbers. Accordingly, data published by Ernst & Young show that occupancy within four and five star hotels in the capital decreased by 6% to 56% in 2015, while the average room rate was down by 4.9% to US\$ 155, one of the lowest rates among Middle Eastern cities.

Receipts from the touristic sector registered a decrease of 7.2% to reach US\$ 3.2 billion over the first nine months of 2015, against a rise of 8.8% registered in the 2014 corresponding period. Although tourism has been affected by low oil prices, security risk concerns, and a stronger dollar, it will remain a key focus of government development plans, with tourism infrastructure planned to be boosted by major new projects in Aqaba (2016) and the Dead Sea (2017).

## 1.2. EXTERNAL SECTOR

### *Widening current account deficit despite contracting trade deficit*

The performance of Jordan's external sector in 2015 was at the image of the difficult regional environment with the conflicts in Iraq and Syria continuing to affect trade. Foreign trade figures show a contraction in imports by 11.2% alongside a 6.1% decline in exports during the first 11 months of 2015 compared to the same period of 2014, contributing to a 13.6% decrease in the foreign trade deficit, according to the Central Bank of Jordan. In fact, Jordan's trade deficit contracted from US\$ 14.5 billion during the first 11 months of 2014 to US\$ 12.5 billion during the same period of 2015, to reach the equivalent of 33.0% of Jordan's GDP, from 40.6% of GDP. As such, Jordan's foreign trade activity posted a net contraction in terms of volume, as the sum of exports and imports went down by 10.0% moving from US\$ 27.7 billion to US\$ 25.0 billion during the same period.

Going further into details, imports reached US\$ 18.7 billion during the first 11 months of 2015, compared to US\$ 21.1 billion during the first 11 months of 2014, within the context of the significant drop in oil prices impacting oil imports. The breakdown of imports by category suggests that imports of mineral fuels posted the most significant decline of 41.0% year-on-year to make up 18.5% of total imports, followed by crude materials with a decline of 13.1%, food and live animals with a decline of 10.4%, chemicals with a drop of 7.3% and manufactured goods with a drop of 5.3%. On the other hand, the main item to have displayed a significant increase was machinery and transport equipments with 12.8% over the same period. The breakdown of imports by country of origin shows that most of the inward merchandise during the first 11 months of 2015 came from Saudi Arabia with 15.6% of the total, followed by China with 12.6% of the total, USA with 6.1%, Germany with 4.6%, UAE with 4.1%, Italy and Turkey with 3.7% each.

At the level of exports, a total of US\$ 6.2 billion was registered during the first 11 months 2015, compared to US\$ 6.6 billion during the same period of 2014. Jordan's overland trade has largely been paralyzed by recent border attacks from insurgents in neighbouring Syria and Iraq. The violence has forced the closure of the only Syria-Jordan trade crossing and further disrupted already sharply diminished cargo shipments between Jordan and Iraq. It is worth mentioning that the government of Jordan has negotiated with

Kuwait to facilitate exports via land routes to Iraq. The Ministry of Industry and Trade is also attempting to break into new export markets particularly to Africa to counter the decline of exports to Syria and Iraq in coordination with the Jordan Chamber of Commerce although such measures are expected to take time to materialize. In parallel, the breakdown of domestic exports by commodity shows that the main exports during the first 11 months of 2015 are the exports of clothes, medical and pharmaceutical products, potash, vegetables, phosphate and fertilizers, which accounted for 56.8% of total domestic exports. The geographic distribution of domestic exports indicates that 20.7% of total exports went to USA, followed by Saudi Arabia with 16.4% of the total, Iraq with 10.3%, India with 8.8%, the UAE with 4.8%, and Kuwait with 4.4% of total domestic exports.

Although the pressures on Jordan's trade deficit lessened last year, the current account deficit widened by 36.8% during the first nine months of 2015 relative to the same period of 2014 to reach the equivalent of US\$ 2.7 billion, as per the latest available statistics. The rise in current account deficit is mainly attributed to a significant drop in services account surplus by 34.4%, on the back of a decline in net travel account surplus by 11.1% given the fall in tourism receipts as regional political instability and the impact of a strong dollar have deterred visitors, pushing down services earnings. In addition, net current transfers declined by 23.0% as a result of the decrease in net transfers of public sector (foreign grants) by 59.6% and the decrease in the transfers of other sectors by 12.0%. Within this context, the current account deficit widened from 7.3% of GDP in the first nine months of 2014 to 9.4% in the first nine months of 2015.

In parallel, the financial account has more than doubled during the first nine months of 2015, moving up from US\$ 676 million to US\$ 1.7 billion, which is attributed to a surge in other investment account from US\$ 270 million to US\$ 1.3 billion, alongside a move in reserve assets from -US\$ 2.4 billion to -US\$ 1.8 billion and a moderate increase in portfolio investment by 3.3%, while direct investment declined significantly by 42.7% from US\$ 1.5 billion to US\$ 858 million amid a gloomy regional environment.

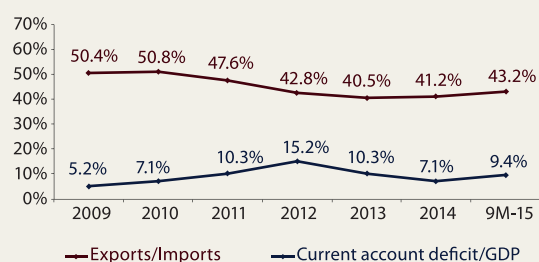
### 1.3. PUBLIC SECTOR

#### *Public finances under further pressure*

Jordan's public finances in 2015 were under the effect of falling external grants resulting in higher deficit as indicated by Central Bank figures for the first 11 months of 2015 and they remain the most significant vulnerability of the Kingdom's economy.

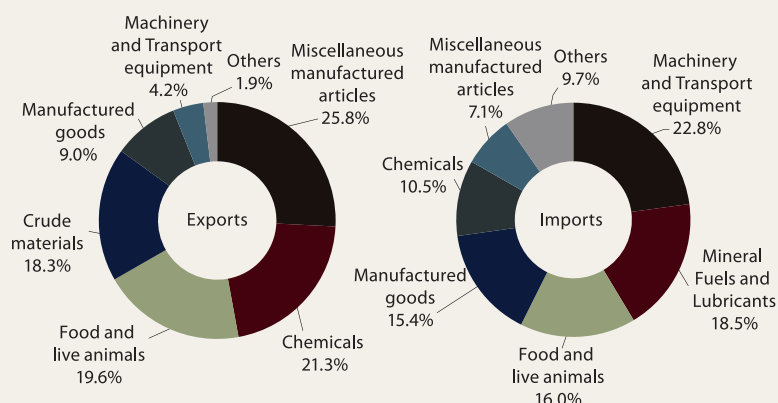
In details, total revenues and grants totaled US\$ 8.1 billion during the first 11 months of 2015, moving down by 5.3% or the equivalent of US\$ 452 million relative to the corresponding period of 2014. This was mainly driven by a stagnation in domestic revenues along with a 40.7% drop in foreign grants. In details, domestic revenues hovered around US\$ 7.5 billion during the first 11 months of 2015 for the second

#### FOREIGN SECTOR INDICATORS



Sources: Central Bank of Jordan, IMF, Bank Audi's Group Research Department

#### BREAKDOWN OF EXPORTS & IMPORTS BY COMMODITY IN 11M 2015



Sources: Central Bank of Jordan, Bank Audi's Group Research Department



consecutive year. As to foreign grants, they went down by US\$ 433 million during the first 11 months of 2015, totaling US\$ 632 million.

Total public expenditures reached a total of US\$ 9.5 billion during the first 11 months of 2015, down by 2.8% or the equivalent of US\$ 274 million from the total registered during the same period of 2014.

Capital expenditures were US\$ 88.3 million below the US\$ 1.2 billion reached during the first 11 months of 2014, equivalent to a decrease of 7.1%. Current expenditures decreased by 2.2% or the equivalent of US\$ 185 million during the first 11 months of 2015, totaling US\$ 8.4 billion. A breakdown of current expenditures by category shows that subsidy spending decreased by US\$ 95 million, or 23.1% from the level spent during the first 11 months of 2014, driven by a 38.2% drop in the value of food and oil subsidies. In addition, social assistance spending decreased by US\$ 118 million, equivalent to a 24.5% drop from the level spent during the first 11 months of 2014.

Moreover, grants were lower by US\$ 112 million or 42.6% of the level spent during the equivalent period of 2014. Interest payments were lower by US\$ 31 million or 2.5% of the level spent during the first 11 months of 2014, while purchases of goods and services were lower by US\$ 5 million, equivalent to 1.2% of the level spent during the first 11 months of 2014. In contrast, military expenditures were up by US\$ 63 million, or an equivalent of 2.5% of the level spent during the first 11 months of 2014. Miscellaneous expenditures of which scholarships and trainings were up by US\$ 31 million or 24.9% of the equivalent period of 2014 level. Also, compensation of employees was up by US\$ 23 million, or 1.3% of the level spent during the first 11 months of 2014.

That being said, the general budget, including foreign grants, recorded a fiscal deficit in the amount of US\$ 1,447.3 million during the first eleven months of 2015, compared to a fiscal deficit in the amount of US\$ 1,268.9 million during the same period of 2014. When excluding foreign grants, at US\$ 632.2 million, the general budget deficit reaches US\$ 2,079.6 million during the first 11 months of 2015 compared to a deficit in the amount of US\$ 2,344.3 million during the same period of 2014.

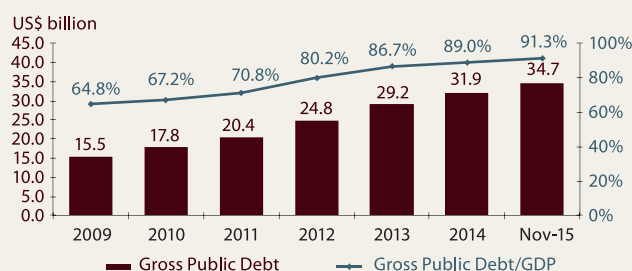
During the same period, gross domestic public debt increased by US\$ 1,038 million at the end of November 2015 compared to its level at the end of 2014, to reach US\$ 21,660 million. Outstanding external public debt (budgetary and guaranteed) increased by US\$ 1,712.0 million at the end of November 2015, compared to its level at the end of 2014, to stand at US\$ 13,038 million. This increase was driven by the issuance of sovereign Eurobonds in international markets in the amount of US\$ 1.5 billion in June, in addition to receiving the seventh tranche of the IMF loan under the stand-by arrangement (SBA) in the amount of US\$ 200.2 million in April, as well as the eighth and final tranche of the loan in the amount of US\$ 396.3 million which was received in August 2015. As a result, gross public debt (domestic and external) reached US\$ 34,697 million at the end of November 2015 compared to US\$ 31,947 million at the end of 2014.

#### SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	2010	2011	2012	2013	2014	2015*
General government revenues	6.6	7.6	7.1	8.1	10.3	8.8
General government revenues/GDP	24.9%	26.5%	23.0%	24.1%	28.6%	23.1%
General government expenditures	8.1	9.6	9.7	10.0	11.1	10.4
General government expenditures/GDP	30.5%	33.2%	31.3%	29.7%	30.9%	27.2%
General government fiscal balance	-1.5	-2.0	-2.6	-1.9	-0.8	-1.6
General government fiscal balance/GDP	-5.6%	-6.8%	-8.3%	-5.5%	-2.3%	-4.1%

\* 11-month annualized figures for 2015

#### PUBLIC INDEBTEDNESS



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

Sources: Central Bank of Jordan, IMF, Bank Audi's Group Research Department

## 1.4. FINANCIAL SECTOR

### 1.4.1. Monetary Situation

#### *Continuous expansionary stance amidst a deflationary environment*

The monetary situation in Jordan was characterized in 2015 by deflationary conditions, primarily due to the effects of lower oil prices and a strong US dollar, while the Central Bank of Jordan continued to follow an expansionary monetary policy, reducing all monetary policy instruments' rates by 50 bps to 125 bps over the year. Meanwhile, readily available foreign exchange reserves maintained a healthy level amidst a steady reduction in dollarization and a stronger confidence in the local currency.

In details, Jordan saw deflationary conditions in 2015, with the Consumer Price Index declining by 0.9% on average, according to the Central Bank of Jordan, mainly reflecting sharp declines in fuel and transportation prices and a US dollar appreciation. This took place despite ongoing upward price pressures arising from rents that mainly mirror the impact of the refugee influx on housing demand. The breakdown of the Consumer Price Index by category shows that "the transportation category" was the largest deflationary impulse, falling by 14.1% on average in 2015 on the back of lower oil prices. In contrast, "the housing category" increased by a shy 0.6%, given a 4.9% increase in the heavyweight "rents" sub-category that more than counterbalanced a 13.3% fall in the "fuels and lighting" sub-category. Also, "the food and non-alcoholic beverages" went up by 1.1% on average. It is worth highlighting that the three aforementioned categories account for more than two thirds of the Consumer Price Index. Within this context, the IMF expects inflation to gradually increase over the year 2016 to reach 3.1%, as the impact of the fall in oil prices wanes.

Given the retreat in inflation, the Central Bank of Jordan maintained an expansionary monetary policy over the year 2015, reducing key interest rates twice in February and July and pushing commercial banks to pass on the rate cuts to their customers in the aim of stimulating economic activity. In details, the CBJ reduced its overnight deposit rate by a cumulative 125 basis points in 2015 to reach 1.50% at the time of writing this report as compared to 2.75% at end-2014. Also, the CBJ cut its rediscount rate by a cumulative of 50 bps to reach 3.75% and lowered its repo rate by a cumulative of 50 bps to reach 3.50% at the time of writing this report.

The Central Bank of Jordan's readily available foreign exchange reserves remained at a comfortable level of US\$ 15.2 billion at end-2015, slightly down by 0.9% or the equivalent of US\$ 137 million relative to end-2014, despite a continued current account deficit and sluggishness in capital inflows. This came within the context of a de-dollarization environment, ongoing IMF disbursements under the US\$ 2 billion program and continuous external borrowing. Accordingly, the CBJ's FX reserves covered around 9 months of imports up from 8 months of imports in 2014. They also covered 40.0% of money supply in Jordanian Dinar at end-2015. This compared to a higher coverage ratio of 43.8% at end-2014. The accumulation of foreign reserves has helped boost confidence in the Jordanian Dinar and ensure the peg to the US dollar is maintained. Within this context, it is worth mentioning that the Central Bank of Jordan remained

#### MONETARY SITUATION

Flows in US\$ million	2010	2011	2012	2013	2014	2015
Net foreign assets	1,688	-999	-3,815	364	1,423	289
Net claims on public sector	455	2,527	3,850	1,430	-148	1,249
Claims on private sector (resident)	1,297	1,851	1,451	1,790	889	1,201
Claims on financial institutions	-21	-26	-1	-53	1	-2
Net other items	-185	-797	-320	-120	482	599
<b>Uses=Sources</b>	<b>3,235</b>	<b>2,556</b>	<b>1,165</b>	<b>3,411</b>	<b>2,647</b>	<b>3,336</b>
Money supply (M1)	720	1,018	-85	1,689	1,161	915
Quasi-money	2,515	1,538	1,250	1,722	1,486	2,421

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

#### EXCHANGE MARKET INDICATORS



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

committed to maintaining the dollar peg which, despite the associated lack of flexibility, supports price stability.

The broader money supply (M2) widened by 8.1% or the equivalent of US\$ 3.34 billion in 2015 to reach US\$ 44.6 billion at the end of the year, following a slower expansion of 6.9% in 2014. The growth in money supply in 2015 compares to a money creation of US\$ 2.74 billion, resulting mostly from a rise in net claims on the public sector of US\$ 1.25 billion, a US\$ 1.2 billion increase in claims on the private sector and a US\$ 289 million growth in net foreign assets. The difference between the growth in money supply and money creation, amounting to circa US\$ 599 million, suggests a monetization of financial claims in 2015.

Looking forward, the monetary policy is set to remain focused on maintaining the attractiveness of the Jordanian Dinar in order to safeguard rebuilt reserve buffers, as per the IMF. Jordanian monetary authorities are expected to maintain an expansionary monetary stance amidst low inflationary pressures before shifting to an anti-inflationary policy as US interest rates move further upwards.

#### 1.4.2. Banking Activity

##### *Pick-up in lending activity and amelioration in asset quality metrics*

Jordan's banking sector activity proved to be more or less in line with economic activity in the Kingdom. As a matter of fact, the sector witnessed positive albeit moderate growth rates during 2015, amidst a troubled regional environment and ensuing repercussions on the domestic economic climate. Measured by consolidated assets of banks operating in Jordan, sector activity grew by 5.0% in 2015 to reach US\$ 66.5 billion at end-December 2015, thus pretty much matching the 2014 asset growth.

On the funding side, most of the growth was once again attributed to a stable and resilient deposit base, the majority of which is composed of resident local currency funds. Total deposits accounted for nearly 70% of total balance sheets at end-2015, and are mostly comprised of stable retail deposits. Banks' deposit base grew by 7.7% last year to reach US\$ 46.0 billion at end-December 2015. The US\$ 3.3 billion increase in deposits at Jordanian banks proved 12% lower than the one registered during the previous year.

Close to 90% of total deposit growth is attributed to the private sector, while the social security corporation and public non-financial institutions contributed the most to deposit growth on the public sector side. Among private sector depositors, 87% of growth was accounted for by the resident sector, with the rest respectively due to higher non-resident and non-banking financial institutions deposits.

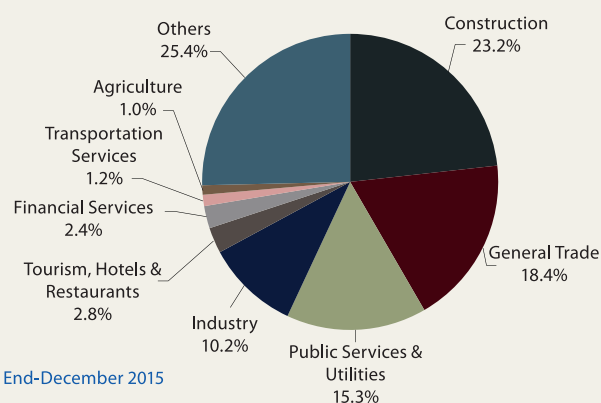
Resident private sector deposits account for almost 80% of the total deposit base, thus providing banks with the capacity to increase lending without reliance on foreign financing. Foreign liabilities indeed

#### BANKING SECTOR INDICATORS

US\$ million	2010	2011	2012	2013	2014	2015
<b>Banking Activity</b>						
Assets	49,326	53,152	55,394	60,369	63,282	66,477
Deposits	31,741	34,383	35,217	38,917	42,680	45,977
Credit facilities	20,382	22,356	25,129	26,713	27,185	29,764
Capital accounts and allowances	6,981	7,612	8,248	8,669	9,554	10,025
<b>Growth rates</b>						
Assets	9.4%	7.8%	4.2%	9.0%	4.8%	5.0%
Deposits	10.9%	8.3%	2.4%	10.5%	9.7%	7.7%
Credit facilities	8.5%	9.7%	12.4%	6.3%	1.8%	9.5%
Capital accounts and allowances	13.1%	9.0%	8.4%	5.1%	10.2%	4.9%

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

#### CREDIT FACILITIES BREAKDOWN BY ECONOMIC ACTIVITY\*



\* End-December 2015

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

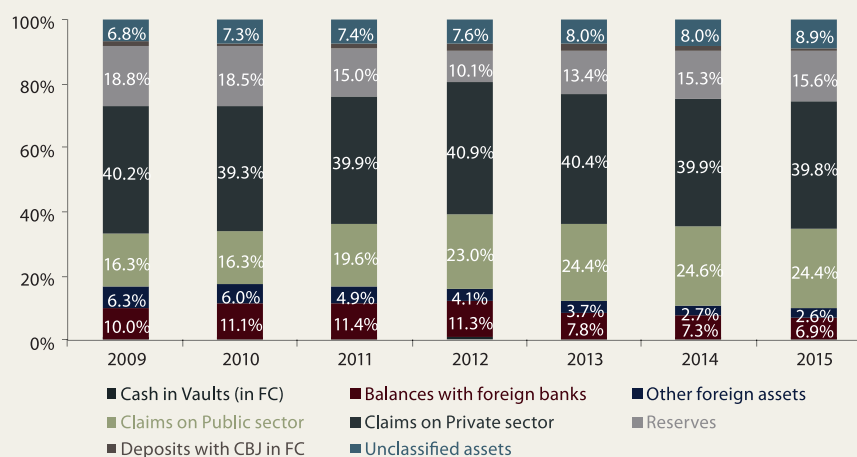
do not account for a significant chunk of the funding base of banks, which shields them from potential swings in global credit market conditions.

A look at deposits from a currency angle shows that foreign currency deposits accounted for only 14% of total deposit growth in 2015, meaning that the bulk was attributed to local currency deposits. Accordingly, the deposit dollarization ratio inched down further to reach a new low of 20.2% at end-2015, reflecting depositors' confidence in the Jordanian dinar despite the troubled regional geopolitical environment.

On the asset utilization side, credit facilities and sovereign exposure, along with reserves in the form of deposits at the Central Bank, took the lead in driving sector activity. On the one hand, lending activity of banks got a boost from both the public sector and the private sector components of the Kingdom's economy. In details, total credit facilities grew by 9.5% in 2015 to reach US\$ 29.8 billion at end-December, against a lower 1.8% rise in the previous year.

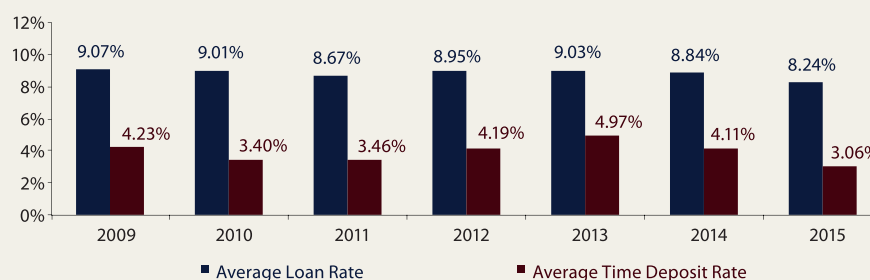
Around 58% of total credit facilities growth was attributed to the central government, partly owing to the government's investment drive. As a matter of fact, public sector entities such as NEPCO are among the banks' largest credit exposures. Resident private sector lending grew by a smaller 5% last year, given a limited number of strong corporate counterparties and the relative lack of lending opportunities amid the currently prevailing conditions. In this respect, the establishment of a credit bureau late last year is likely to contribute to ameliorating SME access to finance and improve underwriting standards.

#### ASSET COMPOSITION



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

#### BANKING SECTOR INTEREST RATES IN JD



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

Among sectors of activity, public services and utilities, along with construction and general trade, were among those that received the largest amounts of new credit. From a currency standpoint, local currency credit facilities were responsible for 86% of total credit facilities growth, noting that both credit facilities in local currency and foreign currencies grew by almost two digits last year.

On the other hand, banks have managed to further increase their core liquidity, with deposits at the Central Bank in local currency rising by 7.3% year-on-year in 2015 and bolstering banks' already adequate liquidity position. The sector's core liquidity (cash and reserves and deposits at the Central Bank and at banks abroad) to total deposits ratio reached 35.0% at end-2015, which compares favorably to regional and global benchmarks. Besides, the ratio of credit facilities to deposits, which stood at 65% at end-2015, provides banks with sufficient flexibility to extend further loans once conditions improve sufficiently and risk appetite fully resumes.

It is true that the sector's liquidity remains adequate, but at the same time an increasing chunk of it is channelled to government securities to help finance the budget gap, thus mirroring banks' notable exposure to the sovereign and to some extent the relative lack of alternative domestic investment opportunities. Claims on the public sector (government and public entities), the bulk of which is comprised of Treasury bills and bonds, rose by a further 4.5% last year to account for around 1.6x capital accounts and allowances, thus highlighting the correlation between banks and their operating environment.

While banks' sovereign exposure is on the rise, they maintain sufficient buffers in order to cover up potential pressures on their capital. Indeed, the sector's capital adequacy ratio stood at 18.5% at end-June 2015 as per the latest published Central Bank figures, practically maintaining its end-2014 level and well above the minimum requirement of the Central Bank (12%), though it is worth noting that there is a zero-risk weighting on government securities when computing this ratio.

In parallel, asset quality metrics of Jordanian banks remain satisfactory, with banks cleaning up their balance sheets from legacy impaired loans. The sector's NPLs/Total loans ratio improved from 7.0% at end-2013 to 5.6% at end-2014 and to 5.5% at end-June 2015 due to write-offs and tighter underwriting standards helping contain NPL formation, though it is worth noting that the ratio remains slightly above regional benchmarks while in line with international averages. Provisioning is adequate, with the coverage ratio of NPLs at close to 80% at end-June 2015.

Last but not least, lower provisioning needs are helping banks achieve a rise in profitability, bearing in mind interest margins, which account for a large chunk of banks' gross income (three quarters almost), are still squeezed by lower interest rates and yields on government securities. It seems banks in Jordan are focusing on fee income mainly from trade financing activities to diversify their income base. Sector-wide statistics reveal that banks operating in Jordan have achieved a 3.7% rise in annualized profitability over 1H2015, leading to an annualized ROA ratio of 1.4% and ROE of 11.1% over the same period. These ratios are deemed to be somewhat satisfactory and similar to those of FY 2014, and are the highest since 2008 but remain below those of the pre-global financial crisis era.

#### 1.4.3. Equity and Bond Markets

##### *Relative stability in equity prices along with increased activity*

Jordan's equity market saw an increased activity in 2015 and relative stability in prices despite regional political instability, mainly supported by a healthy increase in profits before taxes of listed companies and attractive market pricing ratios. In parallel, the fixed income market saw new US-guaranteed bond issues that allowed the Kingdom to access affordable financing from international capital markets and played a role in promoting economic reforms deemed necessary for economic stability.

Lingering regional political uncertainties and heightened geopolitical tensions didn't thwart some market players from adding to their holdings in the Amman Stock Exchange over the year 2015. In fact, non-Jordanian market players became net buyers in 2015, with their net investments posting an increase of US\$ 15 million as compared to a decrease of US\$ 31 million in 2014, and their ownership of market capitalization moved up from 48.8% at end-2014 to 49.5% at end-2015. This came within the context of

healthy financial results, as profits before taxes of the 219 companies that provide the ASE with quarterly results rose by 11.2% year-on-year during the first nine months of 2015.

Under these conditions, the ASE general weighted price index, which followed a downward trajectory since 2008, remained relatively stable in 2015, registering a shy decline of 0.2% (the smallest in eight years), to close at 4,229.90 at end-December. The breakdown of the ASE general weighted price index by sector in 2015 shows that the services sector was the only drag to the index, posting a year-on-year price fall of 5.8% amidst a drop in tourism activity and travel receipts triggered by regional security spillovers and a strong US dollar. All other sectors registered price gains in 2015, with the insurance sector registering a price rise of 2.4%, followed by the industrial sector (+1.5%) and the banking sector (+1.1%).

The number of listed companies on the ASE fell from 236 at end-2014 to 228 at end-2015. This drop coupled with a shy decline in the general weighted price index, resulted into a small retreat of 0.5% in market capitalization, with the latter moving from US\$ 25.5 billion at end-2014 to US\$ 25.4 billion at end-2015, its lowest level in a decade. The ASE market capitalization stood at 66% of GDP at end-2015, down from 71% in 2014, which reflects the declining dimension of the ASE relative to the Jordanian economy.

The ASE total trading value climbed by 51.0% to reach US\$ 4.8 billion in 2015, which is its highest level in five years. The division of the total trading value by sector showed that the financial sector captured 68.7% of activity, followed by the services sector with 21.2% and the industrial sector with 10.1%. The number of traded shares reached 2.6 billion shares in 2015, traded through 899 thousand transactions, compared to 2.3 billion shares traded during the year 2014 through 956 thousand transactions. Given a jump in the total trading value and a shy retreat in market capitalization, the turnover ratio surged from 12.5% in 2014 to 19.0% in 2015, spotlighting the increased activity on the Amman Stock Exchange. As to valuation ratios, the ASE price-to-earnings ratio declined from 15.3x in 2014 to 14.0x in 2015, rendering ASE stock prices more attractive for equity investors. Yet, the dividend yield went down from 4.2% in 2014 to 3.6% in 2015.

At the level of the bond market, the Hashemite Kingdom of Jordan issued in June 2015 US-guaranteed US\$ 1.5 billion bonds that attracted bids of circa US\$ 4.9 billion. The issue, which secures Jordan low-cost financing and helps ease pressure on local banks, was divided into two tranches. The first tranche consisted of seven-year US\$ 1 billion bonds priced at a coupon of 2.578%, while the second tranche comprised ten-year US\$ 500 million bonds priced at a coupon of 3.0%. This is the third bond issue guaranteed by the US government, following a five-year US\$ 1 billion US-guaranteed bond issued in June 2014 and a seven-year US\$ 1.25 billion bond issued in October 2013. Also, Jordan issued early-November

#### CAPITAL MARKETS INDICATORS

	2010	2011	2012	2013	2014	2015
Market capitalization (US\$ billion)	30.8	27.2	27.0	25.7	25.5	25.4
Market cap/GDP	117%	94%	87%	76%	71%	66%
Total value traded (US\$ billion)	9.4	4.0	2.8	4.3	3.2	4.8
Total volume of traded securities (million)	6,989	4,072	2,384	2,706	2,322	2,586
Total number of transactions (000s)	1,880	1,318	975	1,074	956	899
No. of listed companies	277	247	243	240	236	228
% Chg. in ASE general weighted price index	-3.7%	-12.6%	-1.2%	-5.6%	-2.3%	-0.2%
P/E	26.3x	22.6x	15.6x	14.7x	15.3x	14.0x
P/BV	1.7x	1.5x	1.5x	1.3x	1.3x	1.3x
Dividend yield	2.7%	3.3%	4.6%	4.6%	4.2%	3.6%

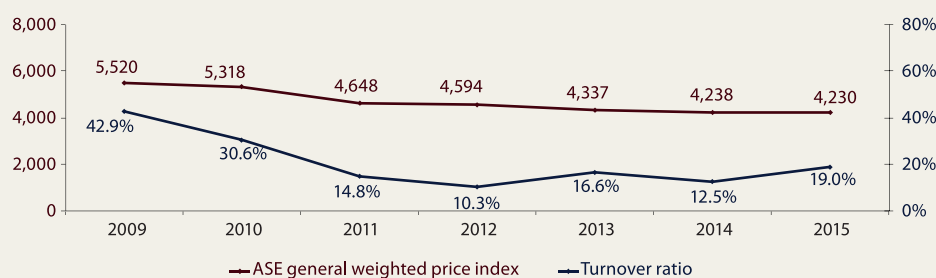
Sources: Amman Stock Exchange, Bank Audi's Group Research Department



2015 a 10-year US\$ 500 million bond in a private placement at a coupon of 6.125%. This issue, which was guaranteed by the Jordanian government, was more than five times oversubscribed.

As to credit rating changes, Standard & Poor's affirmed the long-term and short-term foreign and local currency sovereign credit ratings on the Hashemite Kingdom of Jordan at "BB-/B", with a "stable" outlook. S&P said that significant regional instability related to the ongoing conflict in Syria and Iraq continues to affect Jordan's key credit metrics. Yet, Jordan has made progress on consolidating its public finances, as per S&P, and the low oil price environment should support its fiscal and external performance going forward. Within this context, Moody's said that low global oil prices have had strong positive effects on the sovereign's credit profile in 2015, helping to reign in persistent current and fiscal account deficits, which have contributed to rising external imbalances and debt levels over the last few years.

#### STOCK MARKET PERFORMANCE



Sources: Amman Stock Exchange, Bank Audi's Group Research Department

## 2. CONCLUDING REMARKS

Looking ahead, consumer and business confidence in the Kingdom will remain constrained in the near term by the impact of regional turmoil and the effect of lower oil prices on regional liquidity, with Syria and Iraq traditionally Jordan's main export market and the Gulf a major source of tourists. Although persistently high unemployment will continue to drag on private consumption growth, work on large infrastructure and tourism projects should help to boost employment as long as private sector participation is forthcoming. Still, private investment growth should weaken further over the next couple of years as Jordan feels the impact of low oil prices on inward investment from traditional Gulf investors.

Having said that, a number of large construction projects are underway, including for housing, transport, energy, air travel and the relocation of Aqaba Port, notwithstanding the expansion of the electricity grid and development of both the conventional and renewable energy sectors. Tourism will also remain at the heart of official development plans despite the spillover effects of lower oil prices and security risk concerns. While tighter monetary policy and a constrained fiscal position will limit growth potential, real GDP growth is expected at 3.7% in 2016 and could accelerate thereafter, with private consumption remaining the key driver of economic activity. Should the global oil price rebound, this would erode part of the pick-up in private demand, contribute to higher inflation and put pressure on the twin deficits.

The Central Bank of Jordan is actually expected to maintain an expansionary monetary stance in early 2016 rather than promptly following the lead taken by the US Federal Reserve. However, within the context of the pegged exchange policy relative to the US dollar and as US rates move further upwards, the Central Bank will shift to a tightening cycle later on. It is worth mentioning that the Central Bank should remain committed to maintaining the dollar peg, which, despite the associated lack of flexibility, has helped to instill confidence in monetary policy. Financial support from the GCC countries despite low oil prices and increasingly other donors will help to underpin the level of foreign reserves over the years to come, providing firm support for the currency.

When looking at the Kingdom's outlook, it is important to assess strengths and challenges lying ahead. Among the most significant strengths, we mention long-term domestic political stability, the history of external support, the favorable debt structure which lowers rollover risk and the robust banking sector with good financial soundness. Among weaknesses, we mention the low growth amid weaker regional demand, comparatively high public finance deficit and debt indicators, the persistently weak external position underlined by large current account deficits, the high unemployment and social challenges and the volatile regional political environment with the impact of security spillovers from Syria and Iraq.

Having said that, we believe strengths outpace weaknesses and opportunities outweigh threats. Within this environment, structural reforms bode well for medium-term growth, provided Jordan can weather the challenges of a precarious neighboring security situation. On the business climate front, the authorities have been designing different initiatives to enhance the investment framework by reviewing procedures and related legislation, while additional efforts in this direction are highly welcomed.

According to the International Monetary Fund, striking the right balance between addressing Jordan's economic challenge of raising growth and employment with the need to reduce its high public debt and current account deficit will require both structural reforms to boost jobs and growth and sustained fiscal adjustment to reduce debt to more sustainable levels. In this perspective, ensuring strong, sustained and inclusive growth will require ambitious reforms to address Jordan's long-standing impediments in the realms of business environment, competitiveness, governance, public institutions and labor market reforms at large.

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