

# Jordan Economic Report

## THE CHALLENGE OF MAINTAINING THE ECONOMIC EXPANSIONARY TREND

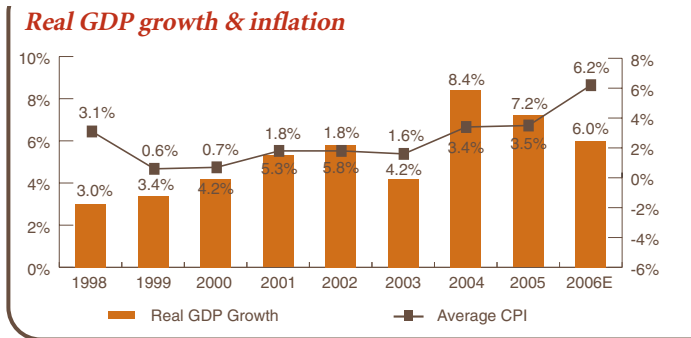
- ▶ The Jordanian economy has witnessed in 2006 yet another year of solid economic activity. The Kingdom has benefited from strong domestic private sector demand at large and accrued capital inflows within the context of increased investments in the Kingdom, thus outweighing the still high oil prices that have affected the external and public accounts.
- ▶ Real GDP growth was estimated at 6.0% last year, as per International Monetary Fund (IMF) figures, in line with the 6.4% annual average growth recorded over the previous four years. Within such a favorable context, inflation has surged to 6.2% year-on-year, but pressures remained contained by the Central Bank, thanks to its prudent and efficient monetary policy.
- ▶ Real estate demand persisted, in spite of signs of slowdown as compared to the previous buoyant years. Construction permits grew by a slight 2.6% in 2006 to reach 12.5 million square meters, and the number of permits retreated 9.1% to 23,355, yet the average area per permit progressed by 12.8% year-on-year to 537.2 square meters, reflecting a relatively larger size of real estate development projects underway.
- ▶ The tourism sector, one of the Kingdom's important contributors to economic growth, benefited from the favorable economic conditions, in spite of the occasional adverse security conditions. Tourist arrivals are estimated at 6.57 million last year, and increased by a yearly 13%. Cleared checks went up by 16.4% in value to reach JD 25,725 million, while bank credits to the sector progressed by an important 34.3% to JD 1,560.8 million.
- ▶ The external sector continued to grow in line with the positive developments and dynamic activity characterizing the Jordanian economy over the past years. Exports moved up by 20.1% to JD 3,663 million in 2006, and imports progressed by 9.0% to JD 8,116 million. The trade deficit nonetheless slightly widened to JD 4,453 million, yet the upbeat activity in the Kingdom ensured sufficient capital inflows to offset a negative current account, with the balance of payments surplus at US\$ 1.4 billion, as per IMF estimates.
- ▶ Jordan's strong economic activity gave a boost to public revenues, offsetting the pressures on the expenditures side, namely the climbing oil prices and the diminishing foreign aid. Public revenues rose by 8.9% to JD 2,862 million in the first ten months of the year (latest statistics available), while total expenditures rose by 3.9% to JD 2,994.3 million over the same period. The overall fiscal balance posted a lower deficit of JD 132.3 million, snatching 4.4% of total spending versus 8.8% in the corresponding period of 2005. Public debt was reduced to 74% of GDP in 2006 from 83% in 2005, as per IMF estimates.
- ▶ Banking activity, measured by total assets, grew by 14.9% to JD 24.2 billion at year-end 2006. Total deposits progressed by 11.2% to JD 14.6 billion, while direct credit facilities, within the context of increased financing to the economy, rose by 26.1% to JD 9,762 million. Similarly, shareholders' equity progressed by a substantial 41.3% year-on-year.
- ▶ In spite of the robust economic activity, Jordan's capital markets were affected by the stock market price correction that spared none of the region's bourses as of the end of the first quarter of 2006. The Amman Stock Exchange's general weighted price index reported a 32.6% decline to 5,518.1 points at year-end. Total bonds traded on the fixed income market dropped by around 39% to JD 1.9 million.

Year  
2006

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## 1. ECONOMIC CONDITIONS

### 1.1. Real Sector

#### 1.1.1. Agriculture and Industry

The primary and secondary sectors enjoyed, like the rest of the economy, a good year. Both domestic and foreign demand fuelled agricultural and industrial activity in Jordan. According to the Central Bank of Jordan, agricultural and industrial exports increased by almost 13% year-on-year to total JD 2,902 million and account for 80% of aggregate exports that include re-exports.

Agricultural exports accounted for 9.8% of total domestic exports and totaled JD 360 million in 2006, up by 3.7% from 2005. Banks' credits to the sector reflect as well a growth in agricultural activity. They reached JD 141 million in 2006, up by 27% year-on-year, yet they remain minimal when compared to the total lending portfolio with a share of 1.4%. Companies operating in agriculture have likewise increased in 2006 from 100 to 221 companies, with an important capital augmentation from JD 82.8 million to JD 265.5 million, thus the sector is moving further towards modernization.

Jordan has been benefiting from recent free trade agreements with the European Union, the US, and other neighboring countries, allowing free access for almost all its products. However, Jordan's agricultural sector remains significantly underdeveloped. Characterized by small scale production in rural areas that are hit by poverty, Jordan's agricultural sector accounts for no more than 3% of GDP, yet employs a quarter of the labor force. Agriculture suffers from water shortages, weak farming knowledge and skills, inadequate regulation to manage the production process and meet market demand, and high production inputs' prices. The government has thus put a strategy for agricultural development four years ago stretching to the year 2010, tackling all the previously-mentioned challenges and suggesting, as solutions, the strengthening of agricultural training, promotion of crop diversification, and the involvement and institutionalization of the private sector in decision-taking.

The industrial sector, likewise, reported a healthy growth, as reflected by a number of indicators. Industrial exports, that

account for 90.2% of total domestic exports, amounted to JD 2,542 million in 2006 up by 14.4% year-on-year. Banking credits also expanded by 9.4% to reach JD 1,135.9 million. Companies operating in the industrial sector have similarly increased in 2006, from 1,127 to 1,430 companies, with a notable capital augmentation, from JD 88.1 million to JD 177.0 million.

The industrial sector consists mainly of manufacturing activity (19.2% of GDP) and to a lesser extent mining and quarrying (3.3% of GDP). Jordan has benefited from the Qualified Industrial Zones (QIZ) started in 1996 and allowing free access of manufactured goods, mainly clothing and textiles, to the US. These industrial free zones attracted foreign investors that wanted to evade import quotas imposed in their countries. The 13 QIZs, with less than half their labor force Jordanian, gave a significant boost to clothes manufacturing. Clothes' exports have been increasing by an annual average rate of 50% over the period 2000-2006 to account for 30% of total domestic exports at present, notwithstanding the impact of the expiration, in January 2005, of the WTO's Multi-Fiber Arrangement (MFA) and the introduction of similar QIZs in neighboring countries.

The QIZs' success remains however abridged because of weak linkages with the rest of the domestic economy in terms of technological and managerial know-how spillovers. More recently, the QIZ came under scrutiny due to labor rights' violations, which led the government to reconsider their role and relevance to the Jordanian economy. The Jordanian government's assessment focused on the need to safeguard QIZ-created jobs while at the same time diversifying production, increasing value added, and improving work conditions.

The authorities will thus need to focus their efforts to develop the manufacturing sector, as it can be a potential important source of economic growth in Jordan, provided that productivity is increased. A diversified and skilled labor force that is flexible and sensitive to market demands is needed to upgrade and expand industrial activity.

#### 1.1.2. Construction

The construction and real estate sectors showed signs of a slowdown in 2006 as compared to the buoyant previous years. Real estate demand, however, was still present, stemming from huge public infrastructure projects, persistent local and foreign -mainly regional Arab private demand as all other neighboring countries have been politically unstable lately- and a revival of the tourism industry.

Construction permits - in terms of area covered - increased slightly from 12,231 thousands of square meters to 12,546 thousands of square meters, the equivalent of 2.6% year-on-year. This compares to an annual growth rate during the previous five years of 20%, signaling a deceleration in the momentum of developers.

The number of construction permits declined by 9.1%, moving from 25,683 in 2005 to 23,355 in 2006, which marks an interruption with an upward trend over the previous five years

### Agriculture and Industry

JD million	2005				2005	2006				Variation		
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	2006	Q4/Q4 2006/2005	
Agricultural exports	87	91	89	81	347	107	88	65	101	360	25.4%	3.7%
Bank credit facilities to agriculture	24.6	-12.4	-3.5	-11.4	-2.7	-5.3	24.0	7.0	4.3	30.0	-137.7%	-1211.1%
Industrial exports	497	549	605	572	2,223	566	623	680	673	2,542	17.7%	14.4%
Bank credit facilities to industry	33.7	51.8	-4.0	17.3	98.8	102.5	97.9	-39.3	-63.3	97.8	-466%	-1.0%
Phosphate (tons 000s)	1,557	1,611	1,585	1,622	6,375	1,539	1,462	1,497	1,372	5,871	-15.4%	-7.9%
Potash (tons 000s)	447	473	440	469	1,829	439	423	406	432	1,699	-7.9%	-7.1%
Fertilizers (tons 000s)	156	202	227	206	790	191	228	225	218	862	5.9%	9.0%
Refined Petroleum Products (tons 000s)	1,104	866	1,170	1,074	4,214	1,136	906	1,005	970	4,017	-9.7%	-4.7%
Electricity and Water (Mill.K.W.H.)	2,036	2,375	2,628	2,321	9,359	2,060	2,221	2,691	2,256	9,227	-2.8%	-1.4%

when the average annual growth rate was 7.5%. However, the average area per permit was 537.2 squares meters in 2006, versus 476.3 square meters in 2005, a 12.8% growth, to reflect a relatively larger size of real estate development projects currently in the pipeline, yet still lower than the yearly growth of 13.8% during the five previous years. Also, cement production fell slightly by 1.9% and reached 3.97 million tons in 2006, versus a yearly increase of 8.9% during 2000-2005 period. Within this context, construction and building material prices nudged up, as reflected by the modest 1.0% increase in the wholesale price index of construction materials.

Building activity was mainly concentrated in the capital Amman, which accounted for 45% of total construction permits and 69% of construction areas. Residential construction represented the bulk of construction activity, as it accounted for 88% of permits and 75% of construction areas. The capital Amman, aiming to become a hub for business and tourism, is in shortage of accommodation and office space to meet the needs of an expanding economy and growing population. This further compounded by the lack of land for development drove authorities to reconsider the city's urban planning and look into the introduction of high-rise developments. The local authorities are actually considering a new urban growth strategy and regulatory framework to meet the uprising challenges.

### 1.1.3. Trade and services

The performance of the trade and services sectors was generally favorable in 2006, despite the adverse security conditions in neighboring countries, the September incidents targeting tourists, and the previous year's hotel bombings.

Cleared checks, an important indicator of aggregate spending, mirrored the upbeat activity. The number of checks increased by 14.0% in 2006 to reach 10,932 and their value went up by 16.4% to reach JD 25,725 million. The distribution of cleared checks by region shows the high concentration of activity in Amman, which accounted for about 94% of total clearing activity.

The number of newly registered companies in trade and services totaled 6,736 in 2006, up by 7.3% from 6,277 firms in 2005, while aggregate capital invested in these companies barely changed from JD 658.6 million in 2005 to JD 644.3 million in 2006, following last year's remarkable growth of 152%. This was accompanied by a growth of 21% in banking credits to the trade and services sectors to reach JD 3,282.1 million in 2006.

The detrimental security conditions prevailing over the last two years did not hamper tourism activity from expanding.

Year  
2006

#### Construction

JD million	2005					2006					Variation	
	Q1	Q2	Q3	Q4	2005	Q1	Q2	Q3	Q4	2006	Q4/Q4	2006/2005
Construction permits in volume	5,388	8,262	6,974	5,059	25,683	5,227	7,056	6,243	4,829	23,355	-4.5%	-9.1%
New construction permits in 000s of m2	2,375	3,917	2,945	2,995	12,232	2,813	3,419	3,159	3,155	12,546	5.3%	2.6%
Production of cement (tons 000s)	767	1,213	1,121	945	4,046	779	1,123	1,092	974	3,968	3.1%	-1.9%
Bank credit facilities to construction	41	74	67	27	209	59	181	77	83	399	205.6%	90.8%
Number of registered companies	49	61	51	41	202	78	68	74	46	266	12.2%	31.7%
Capital of new registered companies	3.0	2.6	13.5	1.7	20.8	5.6	4.8	5.3	3.9	19.6	129.4%	-5.8%

These sectoral developments were accompanied by the 32% rise in new firms established. A total of 266 new construction-related companies were established in the covered period compared to 202 new firms in 2005, yet the aggregate capital of new firms reached JD 19.6 million, slightly lower than JD 20.8 million the previous year. Domestic bank credits extended to construction during 2006 surged by 34.3% to JD 1,561 million.

Construction projects span across many sectors. Among the most important is Jordan's upgrading of its transport network. These include a rail link between the capital Amman and the industrial city of Zarqa, the upgrade of the port of Aqaba, and the expansion of the Queen Alia International Airport. Local and Arab private sector developers are also investing in gigantic commercial and residential projects. The Jordanian Company for Real Estate Development is planning in 2007 to spend US\$ 1 billion on new residential and tourism projects to be followed by other similar endeavors. Other already launched projects include the US\$ 1.0 billion Royal Metropolis and the US\$ 700 million second stage of the Saraya Aqaba developments. A Kuwaiti based company also announced new projects to develop a comprehensive industrial zone with a total area of 1,502 thousand square meters on the outskirts of Aqaba.

Preliminary figures released by the Ministry of Tourism reported an increase of 13% in visitors that totaled 6.57 million in 2006 up from 5.81 million in 2005. Gulf tourists, who have continued to form the majority of arrivals to Jordan for the past four consecutive years, again topped the list at 1.91 million visitors, an increase of 8.4% from 2005. Jordan also witnessed large numbers of tourists from America last year, with 163,917 visitors compared to 111,976 in 2005, an increase of 46.4%. Meanwhile, visitors from Europe rose by 8.4%, from 391,847 visitors in 2005 to 424,584 visitors last year. Overall arrivals in 2006 generated JD 1.16 billion in tourism revenues compared to JD 1.02 billion in 2005, an increase of almost 14%.

Tourism is of critical importance to the economy of Jordan. It accounts for approximately 10% of GDP and is the largest export sector, the second largest private sector employer, and a major producer of foreign exchange. The Jordanian authorities, indeed, have a clear vision on the development of this promising industry. The plan is to double the size of the tourism sector by 2010 and generate employment and entrepreneurial opportunities. More specifically, the government's national strategy, set in 2004, aims at achieving revenues of more than US\$ 1.8 billion by 2010 and creating more than 50,000 additional jobs.

#### Trade and services

JD million	2005					2006					Variation	
	Q1	Q2	Q3	Q4	2005	Q1	Q2	Q3	Q4	2006	Q4/Q4	2006/2005
Foreign trade	2,314	2,671	2,781	2,726	10,493	2,769	2,860	3,108	3,043	11,779	11.6%	12.3%
Number of vessels at the Aqaba Port	778	754	669	732	2,933	694	663	-	-	-	-	-
Merchandise at the Aqaba Port (tons 000s)	4,947	5,264	5,226	4,993	20,430	4,944	4,962	-	-	-	-	-
Bank credit facilities to trade and services	74	30	10	209	323	214	179	18	156	566	-25%	75%
Number of new registered companies in trade	1,770	1,688	1,621	1,198	6,277	1,212	931	807	647	3,597	-46.0%	-42.7%
Capital of new registered companies	86.0	129.2	110.4	333.0	658.6	31.0	36.4	38.5	36.8	142.7	-88.9%	-78.3%

Indeed, such a clear cut vision and strategic planning, translating into aggressive marketing campaigns by the Jordanian authorities, have buttressed the industry during the past critical months, when major security threats could have reversed positive trends.

The private sector likewise showed significant interest in this sector, with major investment coming from Gulf States during the past few years. The latest, and Jordan's largest ever property and tourism development, is a joint project between Saudi construction firm Saudi Oger and Saraya Aqaba for a US\$ 995 million complex on the Red Sea near Aqaba. The project, to be built around a man made lagoon will feature shopping, dining, entertainment, hotels, freehold accommodation and cultural facilities.

In line with this firm orientation to develop the tourism sector, the transport sector is developing as well. The Jordanian government is upgrading the national transport infrastructure with two ambitious projects leading the way. In 2006, the government announced plans to build a light railway link from Amman to Zarqa and a new terminal building at Queen Alia International Airport.

The proposed 28 kilometer light rail link from Amman to the industrial city of Zarqa is expected to cost up to US\$ 140 million, and will be offered on a build, operate and transfer basis. Once the scheme is on track, plans are in place to extend the rail link up to the Syrian border and also to Queen Alia International Airport (QAIA). The second major project is a US\$ 284 million 900,000 square foot terminal of QAIA alongside the existing one, with a targeted completion date in 2010. Jordan as such, building on its strategic location, clear vision, and long-term planning aims to become a transport and business hub.

## 1.2. External Sector

The external sector continued to grow in line with the positive developments and dynamic activity characterizing the Jordanian economy over the past years. Trade of merchandise in 2006 benefited from strong aggregate domestic and foreign demand. The simultaneous growth in imports and exports in 2006 resulted in a slight widening of the trade deficit in absolute terms from JD 4,394 million in 2005 to JD 4,453 million in 2006 (a 1.4% year-on-year growth), yet when compared to a growing GDP, the ratio moved from 49% in 2005 to an estimated 44% in 2006.

Exports moved up 20.1% to reach JD 3,663 million, mainly originating in the Qualifying Industrial Zones' textile and retail clothing industries. Indeed, the government's efforts to move into a market-oriented economy with significant reliance on the private sector translated into increases in factor productivity and improved Jordanian products competitiveness around the world. Jordan particularly benefits from the free trade agreement with the US, the Qualified Industrial Zones and the Generalized System of Preference.

Jordan is also part of the Greater Arab Trade Zone, which is the source of most of its imports. In 2006, total imports amounted to JD 8,116 million, up by 9.0% on account of rising oil prices. Economic growth also fuelled other non-oil consumption and investment imports.

The breakdown of domestic exports by country of destination reveals that the United States retained the lion's share in domestic exports with JD 905.1 million, or a 31.2% share in domestic exports. It was followed by Iraq with JD 326.6 million (11.3% of total), India with JD 279.9 million (9.6%), Saudi Arabia with JD 251.0 million (8.6%), and the UAE with JD 172.9 million (6.0%). These five export destinations accounted for around 67% of total domestic exports in the year 2006. The breakdown of imports to

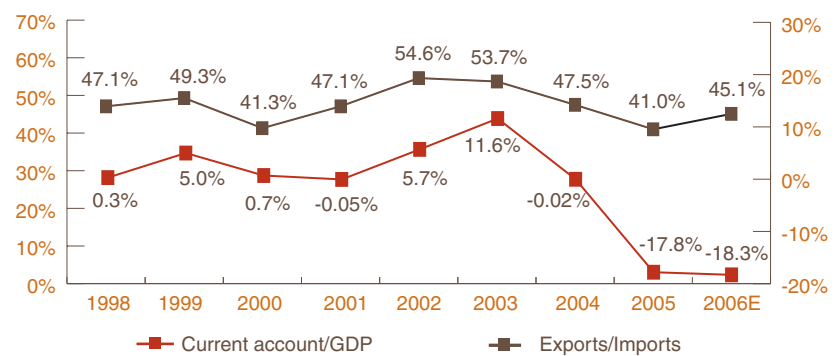
Jordan by country of origin shows that Saudi Arabia ranked first with JD 2,080 million, or 25.6% of total imports. It was followed by China with JD 848 million (10.4% of total), Germany with JD 632 million (7.8%), the United States with JD 385 million (4.7%), and South Korea with JD 256 million (3.2%). Aggregate imports from these countries accounted for almost half of total imports in 2006.

As to the breakdown of exports by type, clothes exports totaled JD 879.8 million, or 30.3% of total domestic exports, followed by chemicals with JD 626.6 million (21.6% of domestic exports), crude materials (inedible, except fuels) with JD 353.5 million (12.2%), food and live animals with JD 298.9 million (10.3%), and manufactured goods with JD 217.9 million (7.5%). These top five categories constituted 82% of Jordan's domestic exports. In parallel, imports of machinery and transport equipment reached JD 1,994.6 million, i.e. 24.6% of total imports, followed by mineral fuels and lubricants with JD 1,928.5 million (23.8%), manufactured goods with JD 1,522.3 million (18.8%), food and live animals with JD 884.3 million (10.9%), and chemicals with JD 709.2 million (8.7%). These top five categories represented 87% of total imports to the kingdom.

The growing trade deficit, thus, constrains the current account, especially with waning official foreign aid. The current account deficit was estimated by the IMF to reach 18.3% of GDP in 2006, up from 17.8% in 2005, despite a significant growth of workers' remittances relative to the previous years. However, the recent real estate boom and the unprecedented inward foreign direct investments are all together ensuring significant capital inflows to offset the negative current account. According to IMF estimates, the balance of payments surplus is expected to end the year at US\$ 1.4 billion, against much lower levels in the previous years.

In short, it seems the outlook of the external sector would highly

Foreign Sector Indicators



depend on the regularity of capital flows since Jordan's trade deficit remains notable, exacerbated by probable hikes in oil prices. For this purpose, the authorities need to maintain foreign investors' interest, especially as security threats loom in the region, and at the same time improve the business environment to develop the private sector to attract investments. In this respect, the IMF suggests reforms mainly at the level of property registration, investor protection, and access to credit information, labor market flexibility, and works on basic infrastructure.

## 1.3. Public Sector

Jordan's public finances witnessed increased macroeconomic pressures this year, yet remained under control. Foreign official aid was diminishing while international crude oil prices were climbing and bloating subsidies. This pushed government

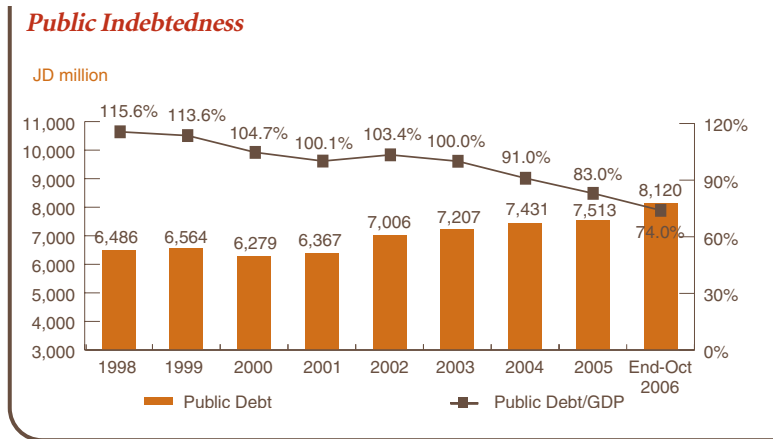
expenditures up, although by April 2006, a decision was taken to gradually lift oil subsidies. Strong economic activity, in parallel, gave a boost to tax revenues. As a result, the year ended with a slight improvement, as the overall fiscal balance (including grants) went down from 5.0% of GDP in 2005 to 4.3% of GDP in 2006 and when excluding grants, it went down from 10.0% of GDP in 2005 to 7.5% in 2006, according to IMF estimates.

Jordan has made significant progress in 2006 as earlier efforts to rationalize and improve the efficiency of the tax regime and institutions, and introduce new anti-corruption legislation, began to yield favorable results. The government also worked in 2006 on major good governance programs, and based on such achievements, the year 2007 is expected to see new tax laws to rationalize the system further.

According to official government statistics, total revenues and grants amounted to JD 2,862 million in the first ten months of 2006 (latest official statistics available), up by 8.9% from the corresponding period of the previous year. Domestic revenues, which account for 93.8% of overall revenues, rose by a significant

expenditures. Total expenditures rose by 3.9% to JD 2,994.3 million, compared to the same period of 2005. Current expenditures grew by 2.7% only to JD 2,445.9 million in the first ten months of 2006 and accounted for 81.6% of aggregate spending. Capital expenditures increased by 9.5% to JD 548.4 million.

As a result, the overall fiscal balance (commitment basis) posted a deficit of JD 132.3 million, equivalent to 4.4% of expenditures in the year-to-October period, compared to a larger deficit of JD 254.1 million, or 8.8% of spending, in the same period of 2005. When excluding grants, the deficit reached JD 308.3 million over the first ten months of 2006, or 10.3% of total spending, against JD 712.8 million, or 24.7% posted in the same period of the previous year. A notable primary surplus of JD 113.7 million was registered in the first ten months of 2006 compared to previous years characterized by either deficits or insignificant surpluses. However, this surplus turns negative when excluding grants and amounts to JD 62.3 million in the first ten months of 2006, but still much lower than the deficit reported over the same period of 2005 amounting to JD 518.5 million.



23.8% to JD 2,686 million relative to the same period of the previous year.

Tax receipts were the main driver of the higher revenues, as they increased by 20.8% to JD 1,814.4 million and accounted for 63.4% of aggregate revenues. The General Sales Tax (GST), which represents 57.5% of tax income, posted a 19.2% growth during the covered period. Increased consumption spending in a buoyant economy triggered the growth in tax receipts. Customs revenues, in contrast, barely increased as a result of increased trade liberalization.

Non-tax revenues also improved, rising by 32.8% to reach JD 841.4 million. However, foreign grants were drastically slashed by 61.6% year-on-year, depicting their lower contribution to total revenues this year and mirroring the important effect of economic growth on fiscal performance. They reached only JD 176 million over the first ten months of 2006. Indeed, foreign grants have been declining significantly from their peak level reached in 2003 when they accounted for 13% of GDP to reach last year less than half this rate. The government is thus challenged to look into financing alternatives and consolidate its fiscal position, especially since Jordan faces high spending needs with respect to infrastructure and social spending, in the context of a growing population with high poverty and unemployment rates.

As a matter of fact, in the first ten months of 2006, primary spending was more or less contained as it increased by 2.2% from JD 2,689.5 million in 2005 to JD 2,748.3 million in 2006, after it had been increasing by an annual average rate of 12.6% over the past four years. Interest payments, in contrast, increased during the ten months of 2006 by 26.6% and represented 8.2% of

In short, the public finance situation progressed this year, despite the reduction in official foreign aid and the rising oil prices. The IMF, in its latest article IV mission report, commended the significant fiscal reforms already achieved and highlighted the importance of keeping primary spending constant in the medium term and broadening the tax base and administration in an already-well taxed economy, in the aim of supporting a medium-term public debt reduction.

The total government domestic debt stood at JD 2,957 million and the outstanding external debt stood at JD 5,163.4 million at end-October 2006. Accordingly, the total public debt reached JD 8,120 million, the equivalent of an estimated 74% of GDP by end-2006, down from 83% in 2005. Thus, the Jordanian government outdid the target set in a public debt law of reducing the public debt to GDP to 80% for the year 2006. According to the IMF, public debt to GDP could reach 60% by 2011, if authorities continue through the recommended fiscal adjustment plan.

This was not only the result of aggressive fiscal reforms and consolidation measures, but also the result of a successful privatization program. By November 2006, the Jordanian government had already sold five companies, generating receipts of US\$ 0.6 billion, the equivalent of 4.3% of GDP. The most important transaction, Jordan Telecom, yielded US\$ 0.4 billion (more than 3% of GDP) with additional receipts expected in 2007. Public debt to GDP could thus reach 60% by 2011, if the authorities continue through the recommended fiscal adjustment program, according to IMF projections. Privatization is also expected to continue as it is considered by the authorities an important ingredient to advance the economic development process. The Jordanian private sector has significant untapped potential to make it a major driver of economic activity.

## 1.4. Financial Sector

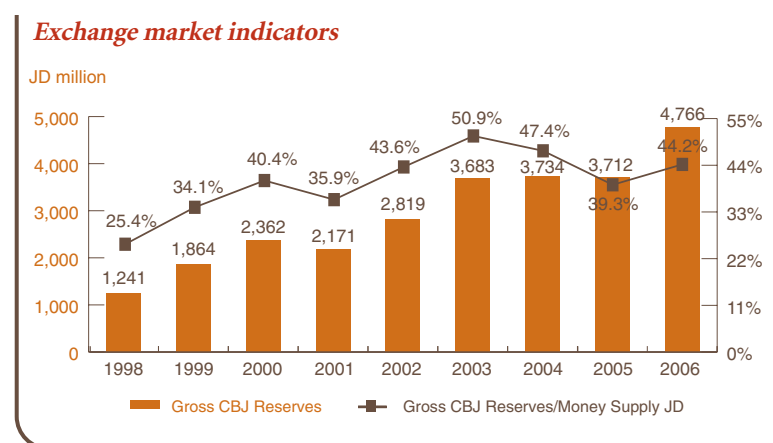
### 1.4.1. Monetary Situation

The favorable economic conditions reigning over the Kingdom in 2006 have had opposite effects on the monetary situation, translating into a surge in foreign exchange reserves on one hand and into increased inflationary pressures on the other hand, yet the Central Bank once again kept the situation under control, through its prudent and efficient monetary policy.

The Central Bank's foreign exchange reserves (excluding gold)

reached a record-high level in 2006, surging from US\$ 5.2 billion at year-end 2005 to US\$ 6.7 billion at year-end 2006, thus progressing by 28.2% year-on-year and covering around one third of money supply. The Bank's increase in foreign exchange reserves last year actually proved to be much higher than its 10.6% average growth over the 2000-2005 period. The increase in international reserves was mainly triggered by an unprecedented level of private capital inflows in 2006, especially foreign direct investment. Such a stock of reserves bolsters the Bank's ability to defend the local currency's peg to the US Dollar, potentially offsetting any short-term pressures that could arise.

The buoyant activity and increased flows of capital to the



Kingdom similarly translated into accrued money supply. The latter (M2) reached JD 14.1 billion at year-end 2006, growing by 14.1% from JD 12.4 billion in the previous year. The analysis of the monetary situation in terms of flows reflects a situation of high liquidity growth. Indeed, the JD 1,746 million increase in money supply last year compares to a money creation of JD 2,999.6 million, resulting mostly from a JD 1,877.7 million increase of the private sector's borrowing, a rise in net foreign assets of JD 1,409.3 million, and a JD 61.9 million increase in the financial institutions' indebtedness, versus a JD 349.3 million decline in the State's indebtedness towards the banking system. The difference, amounting to JD 1,253.9 million, suggests a demonetization of monetary claims in 2006.

The positive spillovers of economic activity on the monetary sector were yet accompanied by a surge in inflationary pressures.

The Consumer Price Index (CPI) reported a 6.2% rise year-on-year in 2006, mostly due to a 7.5% progression in the prices of food items, with the latter category contributing to around half of the reported inflation figure. The CPI increase could also be attributed to a progression in fuel prices since the cut in fuel price subsidies in the previous year, and the subsequent increase in the cost of transportation and distribution. Other categories witnessed an increase in prices as well, with housing reporting a 5.6% yearly increase, clothing and footwear registering a 2.8% progression, and prices of other goods and services recording a 5.6% increase.

Within this context, the Central Bank continued to adopt a prudent monetary tightening policy to dampen inflationary pressures, through lifting further the re-discount rate, from to 6.50% at end-2005 to 7.50% at end-2006, and through using Certificates of Deposits (CDs) to control local liquidity levels. The Bank, according to the IMF, is likely to continue absorbing the banks' excess liquidity through issuing CDs, in order to curb down the progression in credits to the economy, and its consequent pressures on prices. Simultaneously, such operations are bound to enhance the interbank market by encouraging banks to grant loans to one another rather than using the Bank's overnight deposit window. The IMF believes that an increased frequency of such CDs auction would also facilitate the banks' liquidity management.

As such, the Kingdom's important level of aggregate demand and healthy economic growth, as well as the expected maintaining of the currency peg, should allow the Central Bank to further bolster its forex reserves. At the same time, the Bank could continue to focus its sound monetary policies on countering the incumbent inflationary pressures, thus providing the Kingdom with sustained monetary stability.

### 1.4.2. Banking activity

The Kingdom's banking sector reported in 2006 another year of solid growth, in line with the healthy overall economic activity. All major aggregates and indicators registered a strong progression relative to the year 2005, within the context of large capital inflows to Jordan, increased credit activity on the part of banks, and the local banks' regional expansion policies. Banking activity, measured by total assets, grew by a notable 14.9% year-on-year to reach JD 24.2 billion at year-end 2006.

Such a growth in assets was mainly driven by a progression in total deposits and a steep rise in credits facilities to the economy. Total deposits grew by 11.2% to JD 14.6 billion, with deposits of the resident private sector, accounting for more than three quarters of total banking deposits, rising by a yearly 15.7%. Similarly, credit activity witnessed a pronounced expansion, within the context of growing lending opportunities in a steadily improving business environment. Total direct credit facilities stood at JD 9,762 million, up by 26.1% from JD 7,744 million in 2005. In parallel, total shareholders' equity of the banking system progressed by an outstanding 41.3%, amounting to a record high of JD 3,183.3 million at year-end 2006, in line with the intensifying regional expansion strategy that local Jordanian

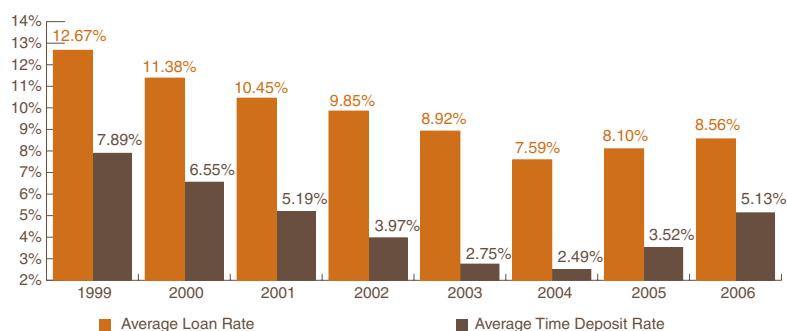
### Monetary situation

Flows in JD million	2005		2006	
	Vol	Share	Vol	Share
Net foreign assets	168	7%	1,409	47%
Net Claims on the Public Sector	467	19%	-349	-12%
Claims on the Private Sector	1,784	72%	1,878	63%
Claims on Financial Institutions	58	2%	62	2%
<b>Uses=Sources</b>	<b>2,477</b>	<b>100%</b>	<b>3,000</b>	<b>100%</b>
Money (M2)	1,793	72%	1,746	58%
Net other items	684	28%	1,254	42%

### Monetary indicators

	2005					2006					Variation	
	Q1	Q2	Q3	Q4	2005	Q1	Q2	Q3	Q4	2006	Q4/Q4 2006/2005	2006/2005
Var. M2 (JD million)	256	690	515	331	1,793	-112	1009	188	661	1,746	99.5%	-2.6%
Consumer price index (average annual inflation)	3.1%	1.2%	4.2%	5.6%	3.6%	4.4%	7.9%	6.3%	6.2%	6.2%	0.7%	2.6%
Cleared checks (JD million)	4,431	5,717	6,024	5,933	22,105	6,370	6,581	6,323	6,451	25,725	8.7%	16.4%
Velocity (Cleared cheques to average deposits)	1.53	1.91	1.92	1.84	1.79	1.96	1.98	1.82	1.80	1.86	-1.7%	3.7%

### Banking sector interest rates in JD



banks have embarked upon a few years ago.

One of the main drivers for the said regional expansion plans of local banks is the banking sector's accrued dimension relative to that of the domestic economy. Indeed, bank assets stood at 2.4 times the Kingdom's estimated GDP in 2006, the deposits to GDP ratio reached 1.4 times, while total credit facilities almost equaled the estimated GDP figure for 2006, with all such ratios comparing favorably to regional, emerging and international benchmarks. The Jordanian banking sector is thus one of the Arab banking sectors with the largest dimension relative to its economy, which drove banks to look beyond the Kingdom's borders in an aim to capture the numerous growth opportunities in the Middle Eastern region at large.

The analysis of banking activity by currency shows that the year 2006 turned out to be rather in favor of the local currency, mostly owing to the continued confidence in the Jordanian dinar. In fact, with both local currency deposits and credits progressing at a higher pace than those in foreign currency, the deposit dollarization rate retreated by 0.8% to 35.6% at year-end 2006, while that of loans dropped by 0.6% to 9.5%.

The strong growth in banking aggregates translated into an improvement in banking coverage ratios. The ratios of deposits per branch and deposits per resident both registered an improvement year-on-year to attain record high levels, with the former reaching JD 28.4 million, versus a lower JD 25.6 million in 2005, and the latter totaling JD 2,606, versus a lower JD 2,397 in the previous year. With close to 11,000 residents per branch, the Kingdom has anew witnessed strong retail banking policies in domestic and foreign banks which have been increasingly targeting the cross selling of a wide range of retail products and services to their customers at large.

Within such a favorable context, financial soundness indicators have continued to improve last year, with banks displaying ameliorated asset quality, high liquidity, increasing profitability, and good capital adequacy ratios. Jordanian banks have indeed held on to their high liquidity status, with the total primary liquidity to deposits ratio at a strong 60% at year-end 2006. Banks have also managed to strengthen their capitalization ratios, with shareholders' equity accounting for a larger share of total assets, as the latter ratio progressed from 10.7% at year-end 2005 to 13.1% at year-end 2006, and representing 32.6% of total credit facilities,

up by 3.5% over the same period.

Although non performing loans have declined, the IMF, in its latest report on the Kingdom, stresses on the necessity of monitoring prudent regulations strictly, especially margin and non-collateralized loans to households, in light of the rapid expansion of credit activity. On the other hand, the IMF welcomed the Jordanian authorities' introduction of prompt corrective action framework and corporate governance and risk management guidelines, in addition to the ameliorated supervision at large. All such reform measures are bound to give a further boost to the sector's activity.

Last but not least, the Kingdom is increasingly witnessing the entry of foreign banks, which represented circa one third of total banks at year-end. These banks are deemed to contribute to the enhancement of competition within the sector and to the accrued diversification of banking products and services. Such an increase in competition, coupled with the above-mentioned reform measures on the part of Jordanian authorities, and the numerous opportunities owed to the enlargement of the size of the domestic economy, actually provide the Kingdom's banks with good perspectives in terms of growth and profitability at large.

Year  
2006

### 1.4.3. Equity and Bond Market

In spite of the robust economic activity, the Kingdom's capital markets were affected by the stock market price correction that spared none of the region's bourses as of the end of first quarter of the year, leading to a slowdown in the yearly activity in 2006.

All major trading activity indicators witnessed more or less sharp declines, as compared to the previous year's substantially accrued stock market activity. The Amman Stock Exchange (ASE)'s general weighted price index reported 5,518.1 points in 2006, down by 32.6% from 8,191.5 points in the previous year. The breakdown of the index by sector shows that the insurance sector witnessed the sharpest yearly drop in prices with -43.7%, followed by the banking sector with -36.6%, the services sector with -31.4%, and the industrial sector with -13.6%.

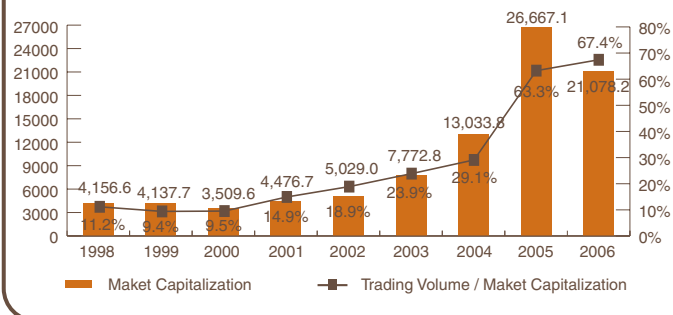
Similarly, the trading value recorded JD 14,209.9 million last year, 15.8% lower than the previous year's JD 16,871.0 million. The stock market capitalization also retreated, from JD 26,667.1 million at year-end 2005 to JD 21,078.2 million at year-end 2006. Notwithstanding the reported declines, the turnover ratio, measured as the ratio of the total trading value to stock market capitalization, stood at a strong 67.4% in 2006, depicting an adequate level of stock market liquidity. Further, the ratio of market capitalization to GDP stood at 233.9%, as per ASE figures, thus mirroring strong market depth, and compared quite favorably to regional, emerging and global averages, confirming the important intermediation role played by the stock market in providing the Jordanian economic agents with adequate financing needs.

The stock market price correction that started in the first quarter

### Banking Activity

In JD million	2005					2006					Variation	
	Q1	Q2	Q3	Q4	2005	Q1	Q2	Q3	Q4	2006	Q4/Q4 2006/2005	2006/2005
Var. Total assets (JD million)	799	999	879	588	3,265	780.5	995.2	754.7	620.7	3,151	5.6%	-3.5%
% change	4.5%	5.4%	4.5%	2.9%	18.3%	3.7%	4.6%	3.3%	2.3%	14.9%	-0.6%	-3.4%
Var. Total deposits (JD million)	63	678	432	382	1,555	-269	932	234	576	1,473	50.7%	-5.3%
% change	0.5%	5.8%	3.5%	3.0%	13.5%	-2.1%	7.3%	1.7%	4.1%	11.2%	1.1%	-2.3%
Var. Total credit facilities (JD million)	341	417	361	436	1,555	1,122	384	312	200	2,018	-54.2%	29.8%
% change	5.5%	6.4%	5.2%	6.0%	25.1%	14.5%	4.3%	3.4%	2.1%	26.1%	-3.9%	1.0%

## Capital Markets Performance



of the year 2006 somehow lowered valuation ratios to more sustainable levels, but the latter remained strong in absolute terms and compared favorably to regional and emerging markets benchmarks. The ASE's price to earnings ratio (P/E) stood at 16.7 times in 2006, versus a much higher 44.2 times in 2005, and compared favorably to the MENA countries average of 14.4 times and the emerging markets average of 13.7 times. Likewise, the price to book value ratio (P/BV) reached 2.9 times, versus 3.2 times in the previous year, thus standing lower than the MENA countries average of 4.0 times but higher than the emerging countries average of 2.5 times.

Late last year, the Securities Depository Centre of Jordan, the ASE and the Abu Dhabi Securities Market signed a central depository agreement to allow companies to cross-list on the two exchanges, according to an Economist Intelligence Unit (EIU) report. Such a facility on both Arab exchanges is deemed to contribute to the widening of the Jordanian listed companies' investor base, while providing such investors with the opportunity of diversifying their portfolios, ultimately enhancing the stock market activity at large.

In line with the equity market developments, the fixed income market reported a slowdown in activity last year. The total value of Jordanian debt papers traded over the year 2006 amounted to JD 1.9 million, significantly lower than the JD 3.1 million registered during the year 2005 (a drop of around 39%), while the number of traded bonds decreased as well to around 1,200 from circa 3,400 in the previous year.

Within the context of forecasted medium-term budget financing needs, the IMF, in its latest note on the Kingdom, recommends the development of secondary domestic debt markets. To that effect, the Fund believes that Jordanian authorities should consider issuing long-term JD denominated bonds on regional markets as a supplementary means of financing. Also, Jordanian authorities are presently exploring the possibility of issuing Islamic financial instruments for shorter term budget financing needs, which should contribute to reducing excess liquidity in Islamic banks. According to the IMF, the local Ministry of Finance's plans to extend bond maturities to 15-20 years would also promote the expansion of the non-bank financial sector, an important player in the mobilization of longer-term savings. Anyhow, such developments are bound to give a boost to the fixed income market, which, in parallel with the new happenings on the

equity market, would allow for the development of the Kingdom's capital markets, and their increased contribution to economic activity at large.

## Conclusion:

Jordan is nowadays economically one of the most stable non-gulf states in the Middle East. If we were to summarize the economic performance of Jordan in 2006, we would say that the country's economy was subject to challenging developments and outcome. Real growth was reported at around 6%, a strong level though below that of the previous year, with inflation appearing well contained. Unemployment has slightly declined, parallel to a strong economic performance, although the rate is still high at 14 percent. Broad money increased in line with nominal GDP mainly due to net foreign assets growth.

The effects of high oil prices were counterbalanced by a surge in foreign direct investment and privatization efforts that provided support to the balance of payments. The downturn in financial markets reduced equity inflows, yet with no significant adverse effects on the Kingdom's balance of payments at large. The current account deficit has recently begun to narrow and is being financed by long term capital inflows. The IMF estimates the unprecedented level of capital inflows to have been triggered by US\$ 2.8 billion of foreign direct investment in sectors like banking, mining, real estate and telecommunications.

The fiscal position has improved relative to the year before. Government revenues have benefited from larger income tax and sales tax receipts reflecting improved tax administration and strong economic activity, as well as higher grants from Saudi Arabia and the Gulf enabling the government to compensate for the large increase in domestic fuel prices. The deficit has been easily financed without adding to macroeconomic pressures, and the public debt ratio is estimated to have declined to a more satisfactory level of 74 percent of GDP. The IMF recommended, in its last Article IV Consultation report, a debt to GDP ratio of 60% in a 5-year horizon.

The Jordanian authorities have so far shown a strong determination to address emerging challenges. In the eyes of international observers, Jordan's medium term reform agenda is broadly appropriate, as it strikes the right balance between short term macroeconomic goals and long-term growth objectives. It is the government's ability to push ahead with its reform agenda and build on the recent achievements that would determine the country's economic outlook in the short to medium term.

Within this environment, notwithstanding some considerable achievements that characterized Jordan's economic performance in 2006, there is a significant need to sustain strong policies as the economy remains quite vulnerable to external shocks and security concerns. In a relatively difficult geo-political situation, significant progress has been made in macroeconomic stabilization, but long standing vulnerabilities remain. Within the context of a rapidly growing work force, issues like job creation and poverty reduction are also re-emerging as important challenges for policy makers at large.

This publication is undertaken in the aim of informing and should not be considered as an encouragement to any form of financial or commercial activity. Although Bank Audi Sal considers the contents very reliable, it declines any responsibility for any action or decision based on contents herein. Major data sources are Jordan's Ministry of Finance, Ministry of Planning, Department of Statistics, Central Bank of Jordan (Monthly Statistical Bulletin), Amman Stock Exchange, The Ports Corporation-Aqaba, the Economist Intelligence Unit, the International Monetary Fund, in addition to Bank Audi's Research Department.