الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

# ECONOMIC & BANKING SECTOR OVERVIEW

## The Hashemite Kingdom of Jordan

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TRUST . TRANSPARENCY . INDEPENDENCE

## Economy Overview – The Hashemite Kingdom of Jordan

Jordan is a strategically located Arab Kingdom, which has borders with Saudi Arabia, Iraq, Syria and Israel. Jordan is also an active member of the Arab League and a founding member of Organization of Islamic Cooperation ("OIC").

Jordan has a population of 7.7m[1] and a GDP (PPP) of US$85.57b[2]. The country's economy is challenged by high unemployment and weak growth, mainly due to global uncertainties as well as effects of the Syrian crisis at its doorstep, causing high influx of Syrian refugees. The economy had demonstrated uplift during 2010 – 2014 during which period, economic growth reached 3.09% in 2014 (2010: 2.31%) however, it has tapered off again to 2% during 2016 (2015: 2.39%). The decline in GDP growth is mainly because of decline in the output of agriculture and mining sectors. Closure of export routes to Iraq and Syria and decrease in tourism due to security reasons also played a significant role in slower growth.

Higher unemployment rate and lower labour force participation is also a major challenge faced by Jordan as unemployment rate reached its 10 year high of 16% being even higher for women and youth. To cater this, National Committee for Human Resource Development ("NCHRD") developed a National Strategy for Human Resource Development covering a 10 year plan with the aim of addressing skill mismatches, unlocking potential of women and reforming public sector hiring practices. Income inequality in the country indicated by its GINI coefficient[3] is 33.7 as of 2010 which is in line with other emerging economies.

Notwithstanding the economic headwinds, Jordan had adopted monetary easing during 2015 – 2016 which assisted credit growth. Decrease in discount rates promoted business activity as credit growth was fuelled by excess liquidity in the market. Major areas of funding included promotion of small and medium sized enterprises ("SMEs"). Since then Federal Reserve has initiated monetary tightening, raising its policy rate twice in 2017 in the range of 1% to 1.25% in June 2017 due to stable economic growth and declining unemployment rate.

Changes in US monetary policy has also impacted Jordan as it has already started monetary tightening to support its currency peg and maintain adequate reserves. In June 2017, Jordan increased its policy rate further by 25 basis points reaching one week repurchase rate of 3.75% which is 100 basis points higher since February 2017 as CBJ increased policy rate by 50 basis points and 25 basis points in February 2017 and March 2017 respectively citing stability of Jordanian dinar and provision of adequate volume of loanable funds, as the basis of its policy action. Inflation has also risen during February 2017, reaching 4.6% due to resurgence in oil and food prices vis-à-vis increased fuel excises and removal of general sales tax ("GST") exemption.

Monetary easing during 2015 – 2016 resulted in better performance of banking sector in Jordan which remained well capitalized and profitable during the period, however, monetary tightening in 2017 will have a negative impact on credit off take and in turn economic growth in Jordan. Capital adequacy ratio of banks stood at 18.5% during 2016 which is well above the regulatory capital requirement. While credit to household sector including mortgages and retail increased during the recent years, NPL ratio has remained low owing to stable to upwardly inclined housing prices. CBJ has also taken various regulatory measures to strengthen financial sector including issuance of Basel III implementation guidelines and AML/ CFT framework.

Jordan has deployed a policy of fiscal consolidation to curtail its debt which had reached 95.1% of GDP as at December 2016. Overall fiscal deficit has however improved significantly, reaching 3.2% of GDP in 2016 (2014: deficit of 10.3%) owing to various revenue related structural reforms such as removal of exemptions related to general sales tax and custom duties. Jordan has envisaged to further increase its tax base through amendments to the tax exemption framework, income tax imposition and new automatic electricity tariff adjustment mechanism. The government curtailed its expenditures mainly

[1] *Source: IMF Country Report – Jordan – July 2017*

[2] *Source: World Bank Dataset for Jordan*

[3] *A statistical measure of the degree of variation represented in a set of values. It is based on the comparison of cumulative proportions of the population against cumulative proportions of income they receive. Ranges between '0' in the case of 'perfect equality' and '1'for'perfect inequality'.*

through cuts to capital expenditures and lower repayments of health and fuel arrears. While the latter is temporary relief, the former is also detrimental to long-term development. On a positive note, energy and water utilities including Electricity Company ("NEPCO") and Water Authority of Jordan ("WAJ") have posted operating profits during 2016 which contributed to containing its fiscal deficit.

Jordan's current account deficit has increased to 9.3% of GDP in 2016 (2015: 9.1% and 2014: 7.3%). Major reason behind increasing current account deficit is decline in exports owing to close of borders with Jordan's major trading partners Syria and Iraq. Exports to Iraq account for almost 20% of Jordan's overall export which has decreased by around 50% post closure of borders. Conflict in Syria has also impacted exports to other markets including Lebanon, Europe, Turkey and Central Asia which were routed through Syria. Current account deficit is also impacted by increase of non-oil imports precipitated by the rising number of Syrian refugees.

Changing global uncertainties and US policies, global geo-political situation, Syrian crisis, disturbance in GCC due to decrease in oil prices as well as diplomatic tensions, weakening global economy and subdued trade, coupled with Jordan's domestic challenges of unemployment and Syrian refugee management, pose threats to the economy. Various economic and structural reforms supported by effective monetary and fiscal policies should assist Jordan in achieving its economic targets as IMF has projected[4] a growth of 2.3% and 2.5% in 2017 and 2018 respectively.

## BANKING SECTOR OVERVIEW

Owing to the domestic macroeconomic environment, Jordan's banking sector showed some signs of slowdown during 2016 driven by deposits, with the total assets growth registered at 2.6% compared to 5% in 2015. Overall credit facilities grew at about 8.9% during the year; the proportion of these in total assets has increased to about two-thirds from 65% in 2015. As noted earlier, Jordanian banking sector's exposure remains concentrated towards the public sector with government securities and public sector lending altogether being JD11.1b (breakdown as JD8.5b as government bonds and JD2.6b as loans) at 2016 corresponding to 24% of total banking sector assets (2015: JD11.6b; 25.5%). Overall the proportion of government and public sector lending by banks in the country slightly reduced to 11.4% of total loans in 2016 from 12.3% in 2015.

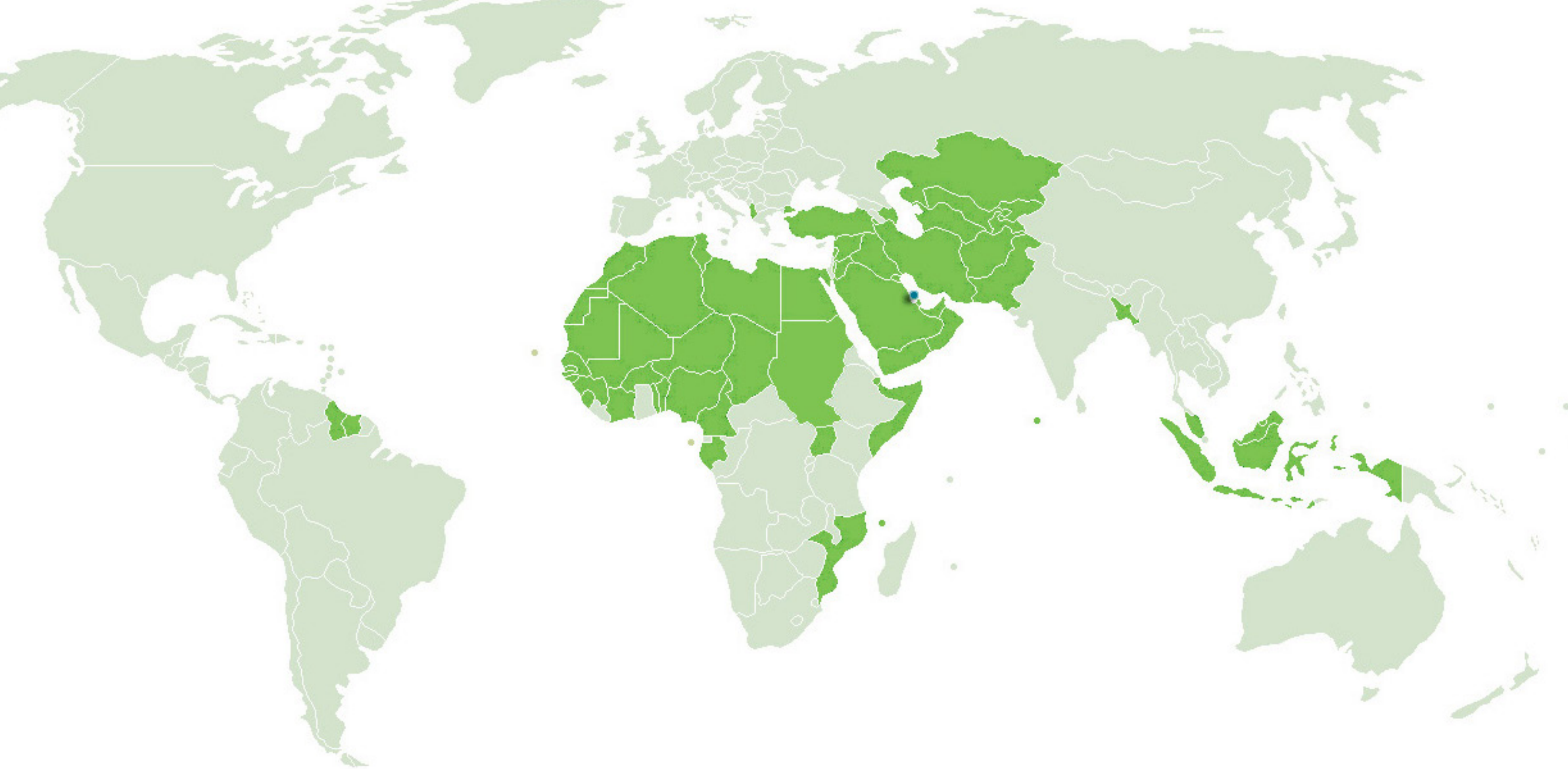
**Table 1: Jordan – Banking Sector Trends**

| %; unless otherwise stated | 2014 | 2015 | 2016 |
|---|---|---|---|
| Non-performing Loans/Total Loans | 5.6% | 4.9% | 4.3% |
| Coverage Ratio | 77.6% | 74.7% | 77.9% |
| NPLs (net of provisions)/Equity | 4.3% | 4.5% | 3.6% |
| Capital Adequacy Ratio | 18.40% | 19.1% | 18.5% |
| Leverage Ratio | 12.5% | 12.7% | 12.9% |
| ROE | 11.0% | 10.3% | 8.9% |
| ROA | 1.4% | 1.3% | 1.1% |
| Interest Margin/Gross Income | 77.9% | 77.4% | 79.0% |
| Net Profits After Taxes (JD'm) | 596.0 | 582.0 | 522.2 |
| Liquidity Ratio | 152.2% | 149.0% | 137.8% |
| | | | |

(Source: JIB; CBJ – Financial soundness indicators and Jordan economy in figures)

The financial soundness indicators of Jordan's banking sector generally continued to improve in 2016 as shown in the Table 4; however some decline was noted in earnings.

[4] *Source: IMF Country Report – Jordan – July 2017*



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