Economic Commentary

QNB Economics
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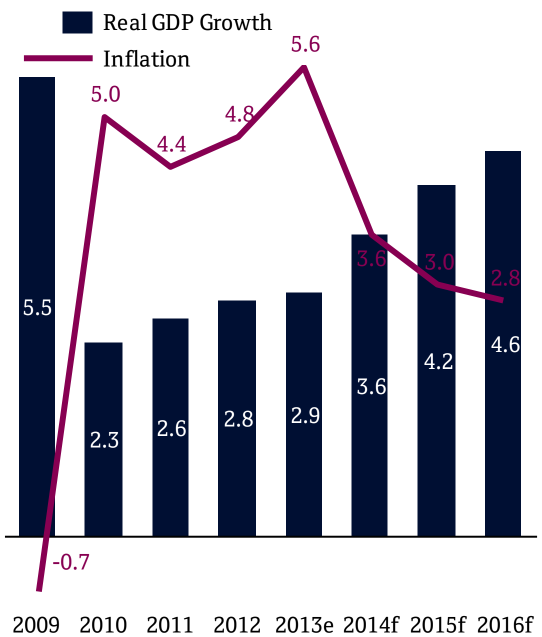
# Construction Projects, Lower Energy Costs and a Recovery in Tourism Should Boost Jordan's Economic Growth

The Jordanian economy is recovering from the crisis in 2012, with support from the IMF and GCC countries. The international reserves of the Central Bank of Jordan (CBJ) have more than doubled in 2013 and economic activity is picking up. On this basis, QNB Group forecasts real GDP growth to accelerate from an estimated 2.9% in 2013 to 3.6% in 2014 and to average 4.4% during 2015-16, driven by private sector led growth in the construction sector, lower energy costs, a recovery in tourism, a normalization of mining exports as well as growth in other services.

**Real GDP Growth and Inflation (2009-16)**
(%)




Sources: Global Insight and QNB Group analysis and forecasts

The large influx of refugees from the Syrian conflict continues to pose a significant economic challenge. Jordan is the second largest recipient of Syrian refugees in the region according to the United Nations High Commissioner for Refugees (UNHCR), with currently nearly 600,000 refugees (9.1% of the total Jordanian population). Domestically, the labor and housing markets are particularly affected, with the refugees putting downward pressure on wages and upward pressure on rents (most live in urban areas and not in camps). With over 44% of the refugees aged 18-59, the domestic labor force is expanding rapidly leading to pressures on the labor market.

In response to the resulting foreign exchange market pressures from the Syrian conflict, the CBJ was forced to raise policy rates repeatedly in 2012. This tightening of monetary policy, combined with an improvement in external financial support (in the form of loans and grants), has helped to restore the confidence in the Jordanian Dinar (JOD) and led to a doubling of foreign exchange reserves in 2013. Going forward, these trends are likely to continue in the near term as higher appetite for JOD-denominated assets grows and overall investor sentiment towards the Jordanian economy improves further, thus spurring higher growth.

The current account deficit has narrowed and reserves are now at comfortable levels. Indeed, lower energy imports and grants have reduced the current account deficit significantly in 2013. Going forward, the current account deficit is expected to continue narrowing due to higher export growth. Key exports, such as phosphates and potash, are expected to accelerate on the back of strengthening global demand. The rate of import growth should moderate in the near term, helped by stabilization in global energy prices. Tourism receipts, particularly from GCC visitors, are projected to rise on the assumption that the geopolitical situation improves. The traditionally–large surplus in current transfers is anticipated to remain intact, reflecting the inflow of remittances from Jordanians employed in the GCC as well as sizeable grant aid from donors, partly in response to the Syrian refugee crisis.

On the inflation front, prices spiked in November 2012 as the government reduced electricity and fuel subsidies to reduce the growing fiscal deficit. Whilst there will be further increases in residential electricity tariffs over the medium term, overall headline inflation is likely to slow to 3.6% this year from 5.6% in 2013.

Higher taxes and foreign grants should further alleviate strains on the fiscal deficit over the medium term. The parliament passed an ambitious 2014 budget aimed at reducing the fiscal deficit to 4.3% of GDP. A new income tax law, to be passed later this year, will significantly raise taxes to support the fiscal consolidation over the medium term. Support from GCC countries in the form of grants and Foreign Direct Investment (FDI) will continue to be essential to keep to a sustainable fiscal position.

The banking sector is expected to remain stable, profitable, liquid and adequately capitalized, with falling non-performing loans in line with a recovery in economic activity. Banks have witnessed a slowdown in asset growth over the last few years, driven mainly by subdued economic conditions. Most of the asset growth has come from retail lending (mortgages and credit cards). Despite rising net interest margins (although the trend is slowing), driven by a large domestic depositor base and high government borrowing, increasing sovereign exposure is a source of concern. Islamic banking is gaining market share by focusing on retail lending.

Looking ahead, prospects for the Jordanian economy look better with real GDP growth expected to recover gradually in 2014-16, mainly driven by private sector growth in the construction sector, lower energy costs and a recovery in tourism. Growth will, however, continue to remain below its long-term potential as investment suffers from the Syrian conflict and the government fiscal adjustment, with the main downside risks stemming from a worsening in the geopolitical situation, higher crude oil prices, and potential delays in implementing structural reforms. Furthermore, a complex bureaucracy and the high cost of doing business in Jordan are major impediments to higher FDI, particularly from GCC countries.

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