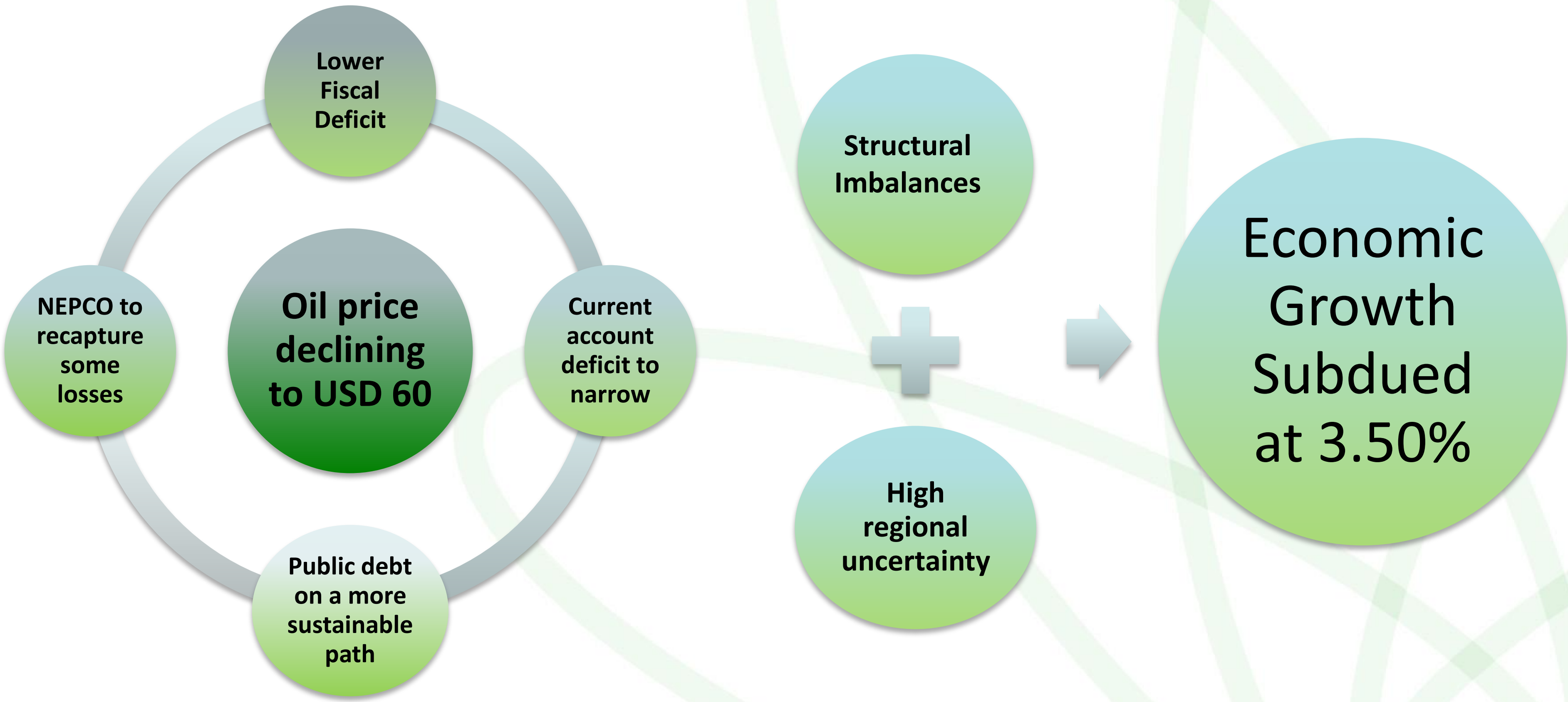
Local Economic Themes - 2015

December 2014

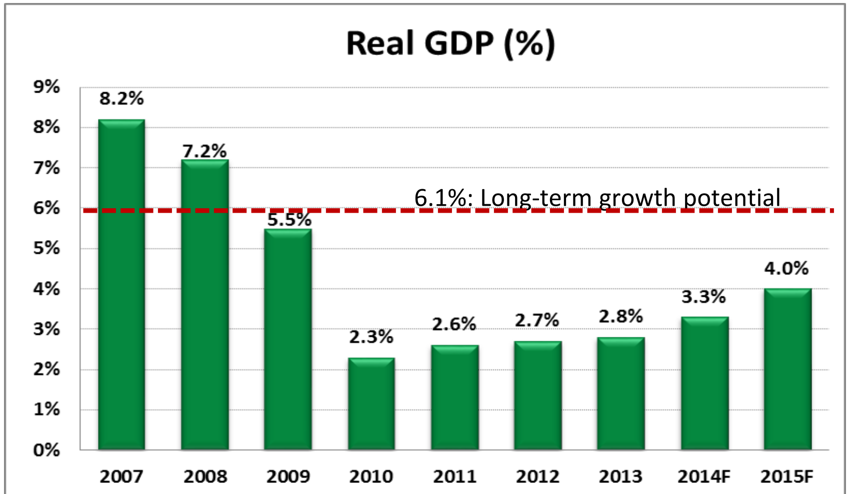
بنك القاهرة عمّان
CairoAmmanBank

2015 LOCAL ECONOMIC THEMES

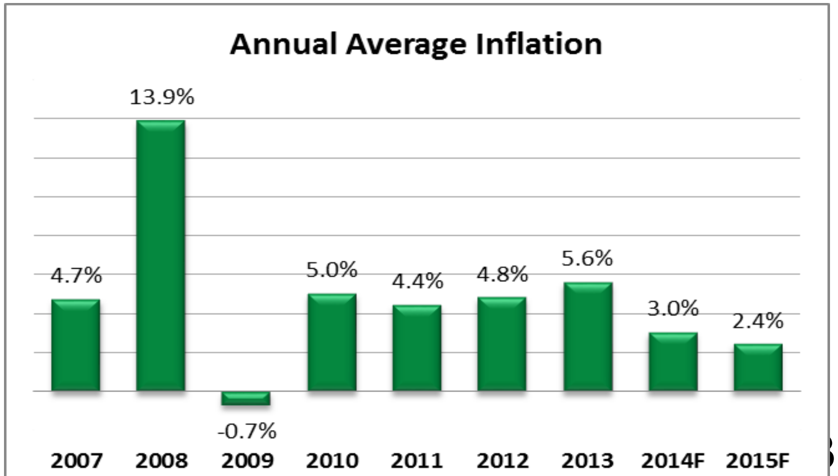


Drop in oil price will increase demand, but economic performance will remain below potential

- For Jordan, who historically has ran fiscal and current account deficits, a $60 - 65 per barrel oil price environment would reduce inflation rates, raise disposable income and spur economic growth.
- The Jordanian economy continued its moderate recovery, as GDP growth is expected to increase to 3.3% in 2014 from 2.8% in 2013.
- The economy is expected to continue its positive expansion in 2015. Official forecasts foresee growth at 4% in 2015, despite government spending freeze compared to 2014.
- The government expects average consumer price inflation to decelerate from 3% to 2.4% in 2015.
- Meanwhile, core inflation seemed to have increased to 5.5% by August, driven by rents reflecting additional demand from Syrian refugees.
- The deviation between core and nominal inflation indicates the lower effect new oil prices will have on boosting economic growth, since extra spending by Jordanians is mostly directed towards imported goods and services.



Sources: Central Bank of Jordan; IMF staff estimates



Source: Department of Statistics

Structural reform in the energy sector

- Egyptian gas imports are estimated to have averaged 30 million cubic feet per day in 2014, about one third the expected level for the year (100 million cubic feet per day). The disruptions in gas supplies led to increased NEPCO losses of around JD 400 million, with losses projected at JD 1.4 billion for 2014.

- For 2015, Egyptian gas flows are projected to average 50 million cubic feet per day.

- Despite the continued gas disruptions, the outlook seems brighter in part due to the drop in oil prices and the new Aqaba LNG terminal, expected to become operational in June 2015. The terminal, according to IMF estimates, should provide about 20% of Jordan's consumption.

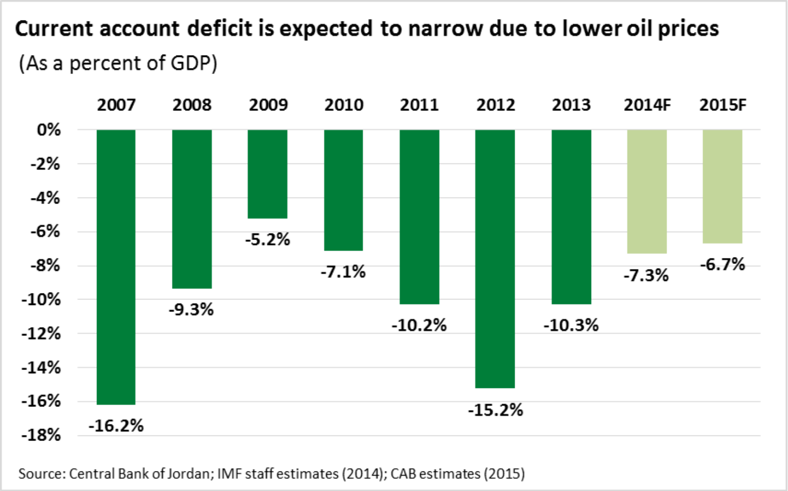
- Moreover, the government has signed an agreement with NOBEL energy to start importing gas as of 2018. This gas supply from the Mediterranean would be about 30% cheaper than LNG and could cover up to 30% of consumption, according to IMF estimates.

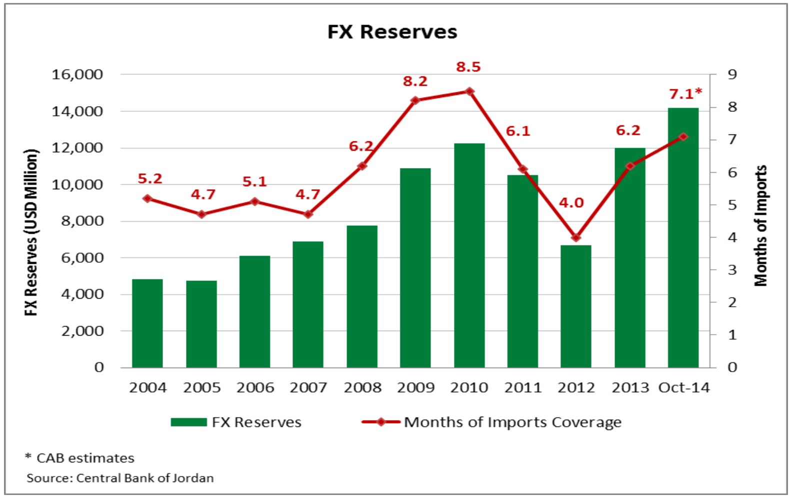
- In addition, focus on renewable energy projects continues under the support of the Central Bank of Jordan, and international donors. The renewable energy should ultimately compose about 10%-15% of Jordan's energy mix.

- The government will also continue its efforts in reforming electricity tariffs starting from the beginning of 2015.

External environment to benefit from oil price drop

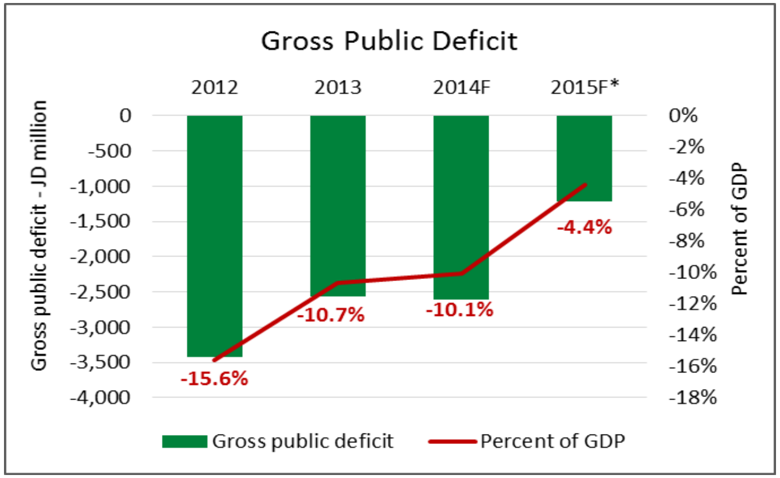
- The recent decline in international oil prices should ease pressure on Jordan's external balances.
- The 2014 current account deficit is projected at 7.3% of GDP, down from the original estimate of 10%, as higher-than-programmed grants more than offset higher energy costs.
- The 2015 current account was projected at 8.1% of GDP, however, if the drop in oil prices is sustained then the deficit should narrow to around 6.7% according to CAB estimates, on the back of a significant drop in the oil bill (around JD 1.3 billion).
- Meanwhile, FX reserves reached $14.2 billion as of October 2014. The drop in oil prices is likely to reduce pressures on foreign reserves demand, which indicates that foreign reserves will remain stable in 2015, around the $14 billion level with coverage above 7 months of imports according to CAB estimates.





Additional fiscal savings

- A $60 - $65 per barrel oil price environment would help support the government's financial balances and their ability to undertake structural reforms, for example by reducing energy subsidies.
- Energy targeted subsidies were estimated to be around JD 180 million in the government's 2015 Budget. Such subsidies will be suspended under current oil prices environment.
- However, the drop in oil prices would also reduce revenues from sales tax on gasoline. According to CAB calculations, the drop in oil prices will lead to a drop of up to JD 110 million in tax revenues.
- Accordingly the government may be able to make a saving of JD 70 million.
- Moreover, the drop in oil price is expected to reduce NEPCO annual losses by around JD 400 million.



JD million	2014F	2015F	2015F Re-estimated
Central government deficit	1,114	700	630
Percent of GDP	4.3%	2.5%	2.2%
Public entities deficit	1,500	1000	600
Percent of GDP	5.8%	3.6%	2.2%
Gross public deficit	**2,614**	**1,700**	**1,230**
Percent of GDP	**10.1%**	**6.1%**	**4.4%**

Lower External Borrowing – Utilizing Islamic Banks' Local Liquidity

- According to the government's forecasts from the preliminary 2015 Budget Law, the government expects to finance most of its budget balance deficit in the coming years by domestic borrowing, mainly due to decreasing external borrowing capacity, higher principle payments and redemptions of outstanding external debt.

- External borrowing has increased significantly in the last couple of year, though it is likely to reach lower levels in 2015.

- The Jordanian government expects to receive total loans of $1.9 billion in 2015**,** including from the EU ($105 million), as well as Eurobond issuances of at least $1.75 billion for which they are seeking U.S. guarantees. However, there are large redemptions, including a $750 million Eurobond. This will bring the expected increase in external borrowing to around $ 1,000 million in 2015.

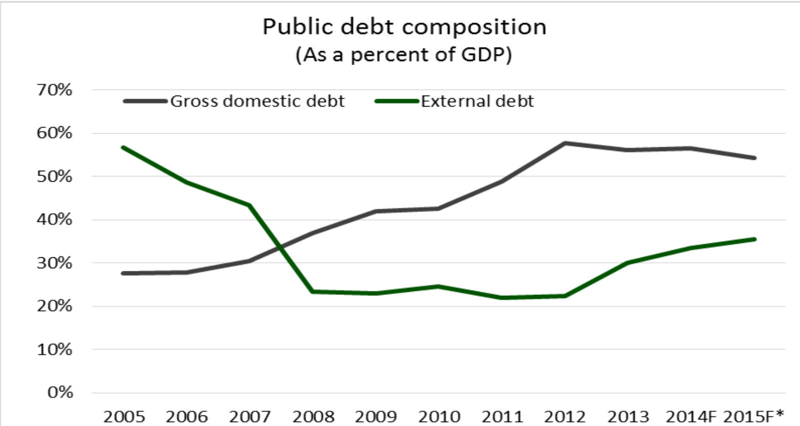
- It is noteworthy that the government is considering an extension for IMF standby agreement.

- Meanwhile, despite high projected levels, pressures on internal borrowing will likely ease in the coming year. The drop in oil prices could lead to a drop in NEPCO losses by around JD 400 million from 2015 Budget estimates, and a net drop in energy subsidies of around JD 70 million.

- Moreover, the emergence of the Sukuk market in 2015 will provide a new source of funding for the government and may contribute to stabilizing interest rates in the market. The government is expected to issue Sukuks between JD 350 – 500 million in 2015.

- As of the end of October, excess liquidity with Islamic banks stood around JD 1,300 million.

More sustainable debt path



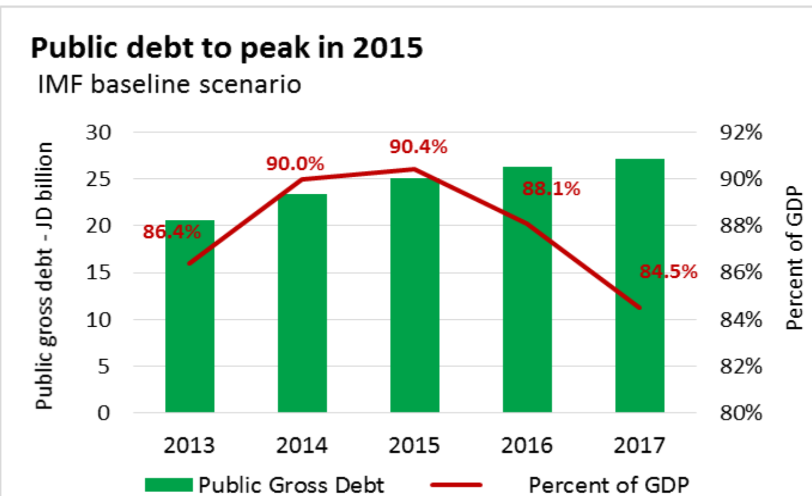
* After taking into consideratio the effect of the drop in oil prices

Source: Ministry of FInance; CAB estimates (2014 & 2015)

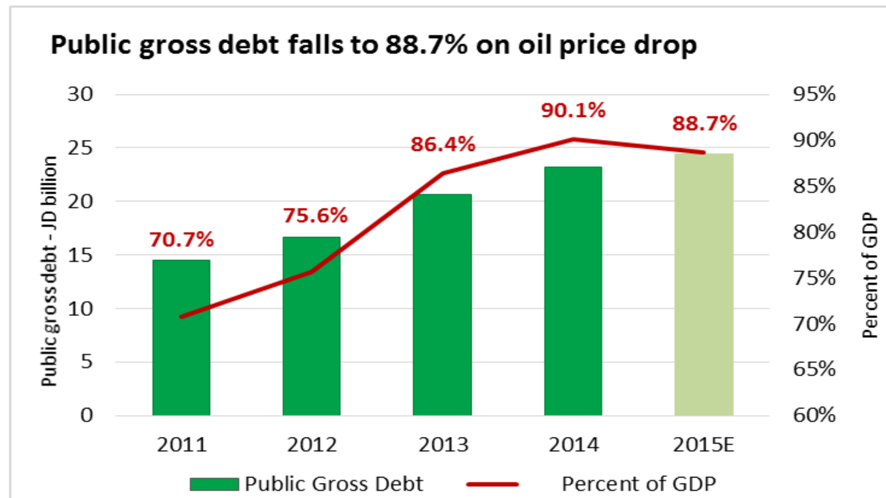
JD million	2014	2015	2015 Re-estimated
Increase in internal borrowing	1,100	1,001	531
Increase external borrowing	1,400	699	699
Increase in public debt	**2,500**	**1,700**	**1,230**

* After taking into account drop in NEPCO losses of JD 400 million and a reduction in energy subsidies of JD 70 million

Public gross debt was projected to peak in 2015 at 90.4% of GDP. However, in a $60 - $65 oil price environment, there is a possibility the public debt will fall from projected figures to around 88.7% of GDP, according to CAB estimates.



Source:Ministry of FInance; IMF staff projections



Source: Ministry of Finance, CAB estimates (2015)

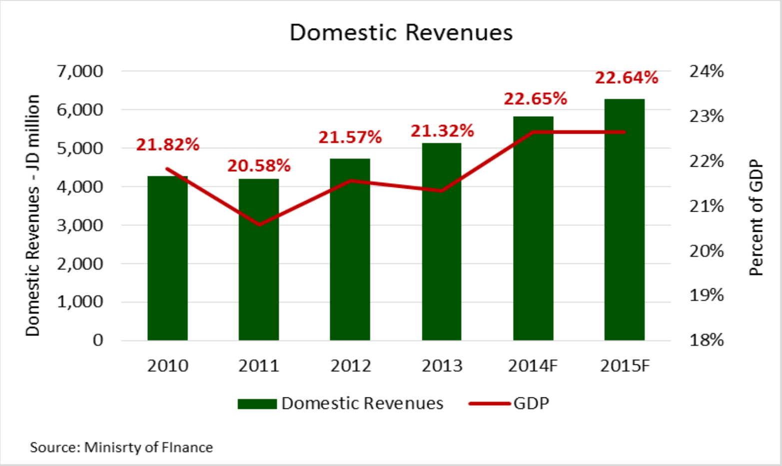
New Income Tax Law

- Passage of the new income tax law is expected to be approved before year end.
- The amended income tax law would lead to a 0.4% of GDP revenue effect from the Corporate Income Tax and 0.15% of GDP from the Personal Income Tax.
- The full-year revenue gain is estimated at 0.6% of GDP, but only 0.3% of GDP would come in 2015, as companies will pay next year's tax at the beginning of 2016.
- The passage of the new income tax law supports the industrial sector through lower tax rate of 14%, and encourages tax filing through an extra JD 4,000 exemption for families against invoices of major living costs.
- Domestic revenues are expected to have increased by JD 712 million during 2014 partly due to receipts from a telecommunication license sale. For 2015, domestic revenues are projected to increase by around JD 450 million.

Sector	Proposed Tax Rate
Banks	35%
Telecommunication, Electricity generation and distribution, mining, financial, brokerage, leasing, and insurance companies	24%
Industrial Sector	14%
Other Companies	20%

	Exemptions	Proposed Tax Rate
Individual	up to JD 12,000 Annually	1st JD 10,000 7%, 2nd JD 10,000 14%. Higher 20%
Family	Up to JD 24,000 Annually + JD 4,000 against invoices for major living costs	

**Latest figures in the media



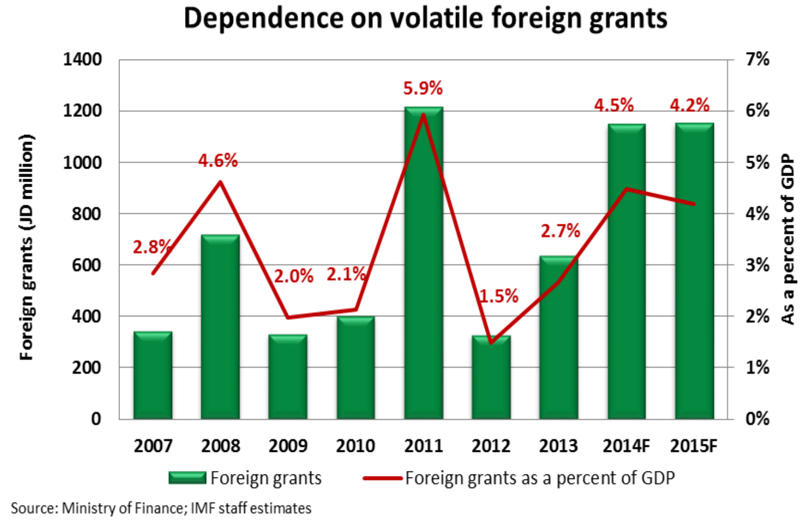
Regional risks indicate that foreign grants remain critical

Regional risks facing the country in 2015:

I. Uncertainty surrounding gas flows from Egypt continues; a complete stop lead to additional fiscal gaps of about 1% of GDP according to IMF staff estimates.

II. The Syrian conflict continues and an escalation would weigh on Jordan's already-strained resources.

III. An escalation in the Iraqi conflict could further affect exports, transit trade, energy imports, and investor confidence. Also an influx of refugees is also possible which would further strain Jordan's resources.



- In view of the regional risks, grants from donors remain critical, not only to help cover further expected shortfalls in gas from Egypt, but also mitigate the impact of external shocks.
- The government identified grants up to $2.1 billion from the last quarter of 2014 through end-2015, including from the GCC ($1 billion), the U.S. ($622 million), and the EU ($67 million)—and additional grants from our international partners to cope with the regional instability.
- According to IMF estimates, foreign grants to GDP are expected to remain relatively high around 4.2% of GDP, but further grants are likely to be required. The government is also expected to receive around $1.9 billion in external loans.

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