MOODY'S
INVESTORS SERVICE

CREDIT OPINION
24 May 2019

Update

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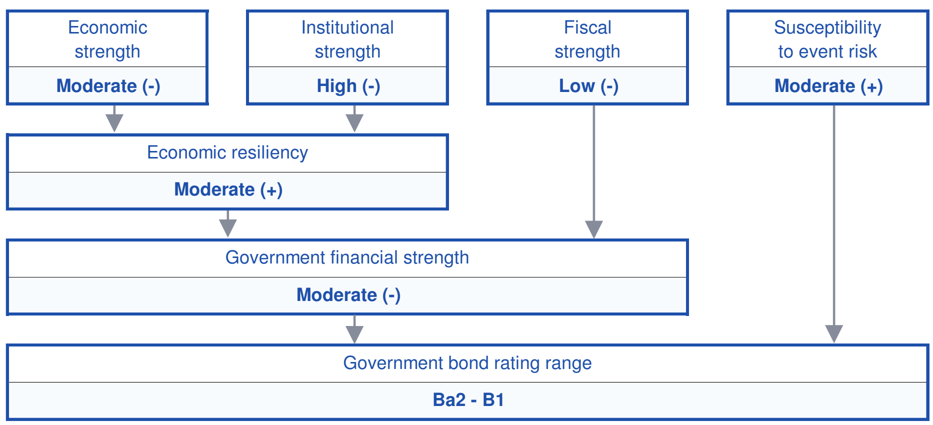
Government of Jordan – B1 stable

Regular update

Summary

Our credit view of Jordan reflects credit challenges posed by high debt levels, persistently large external deficits, and rising domestic social pressures in the context of low growth and high unemployment. It also takes into account credit supports such as the government's proven commitment to fiscal consolidation, strong and broad-based international support, and ongoing reforms in Jordan's energy sector.

Exhibit 1
Jordan's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» Track record of implementing structural reforms and commitment to fiscal consolidation

» Strong and broad-based international support

» A robust banking sector providing access to domestic funding sources

Credit challenges

» High, but stable, government debt burden

» Weak growth, high unemployment, and security/refugee-related demands on the budget

» External vulnerability due to persistently large current account deficits

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Rating outlook

The stable outlook balances our view that the planned fiscal reforms will set the government's elevated debt-to-GDP ratio on a gradually declining path in the next several years against the risk that weak growth and high unemployment cause delays or reversals in the government's fiscal consolidation strategy. It also balances better prospects for growth in merchandise exports and tourism receipts, due to the improving security situation in Iraq and Syria, against the external vulnerability to potential increases in oil prices.

Factors that could lead to an upgrade

A sustained downward trend in the government's debt burden, with a reduced sensitivity to potential increases in interest rates, would likely lead us to upgrade the rating. Over time, the rating would also come under upward pressure if Jordan's external position strengthened markedly through increased trade and a durably lower energy import bill.

Factors that could lead to a downgrade

A weakening of the government's commitment to further fiscal consolidation would likely lead to a downgrade should it also point to a renewed and lasting increase in government debt. Such weakening could be a result of rising domestic social and political pressures, due to elevated unemployment and weak growth.

A significant erosion of Jordan's foreign exchange reserves would also likely exert downward rating pressure, in particular if it pointed to a likely loss of investors' confidence that raised pressure on government liquidity. A reversal of the improvements in the security situation in Iraq and Syria or other negative geopolitical developments in the region could be factors leading to a weaker external position and falling foreign currency reserves.

Key indicators

Exhibit 2

Jordan	2013	2014	2015	2016	2017E	2018E	2019F	2020F
Real GDP (% change)	2.8	3.1	2.4	2.0	2.1	2.0	2.2	2.6
Inflation (CPI, % change, Dec/Dec)	3.1	1.7	-1.6	0.8	3.2	3.6	2.5	2.5
Gen. gov. financial balance/GDP (%)[1]	-10.2	-8.6	-8.5	-3.7	-3.7	-4.6	-4.1	-3.4
Gen. gov. primary balance/GDP (%)[1]	-7.1	-5.0	-5.1	-0.7	-0.7	-1.3	-0.7	-0.1
Gen. gov. debt/GDP (%)[1]	85.5	87.8	92.1	93.8	94.3	94.4	94.0	92.9
Gen. gov. debt/revenues (%)[1]	359.0	319.4	373.6	372.1	367.3	361.1	360.9	356.8
Gen. gov. interest payment/revenues (%)[1]	12.8	13.1	13.7	11.9	11.5	12.8	12.9	12.8
Current account balance/GDP (%)	-10.3	-7.2	-9.0	-9.4	-10.6	-7.0	-6.0	-5.9
External debt/CA receipts (%)[2]	106.1	102.3	125.0	138.9	144.9	144.6	145.0	145.8
External vulnerability indicator (EVI) [3]	143.7	106.4	94.3	93.7	95.4	103.3	129.3	131.2

[1] Central government up to 2012. Starting in 2013, the government balance includes operating balance of NEPCO and overall balance of the public water sector.
[2] Current Account Receipts
[3] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves

Sources: Jordan's Department of Statistics, Ministry of Finance, Central Bank of Jordan, IMF, and Moody's Investors Service

Detailed credit considerations

Jordan's "Moderate (-)" **economic strength** reflects the economy's growth potential, supported by its diversity and openness, and its relatively high level of per-capita income despite its small size. However, Jordan's actual growth performance over the past several years has been very weak with the average real GDP growth of only 2.4% during 2010-2018, significantly below the rate of 6.5% during the previous decade. Since 2009, Jordan's growth rate has been negatively impacted by the sharp slowdown in foreign direct investment (FDI) inflows and credit growth in the wake of the global financial crisis, increases in energy costs due to disruptions of traditional supplies, and the closure of borders with neighboring Syria and Iraq, which weakened export growth. Moreover, the large influx of refugees from neighboring countries increased Jordan's population by 35%, exerting pressure on infrastructure, public services, and the labor market, weighing on the country's economic strength. The government's already elevated debt burden and the required increases in security and defense spending have limited the fiscal space to absorb these shocks.

Our assessment of Jordan's **institutional strength** as "High (-)" is supported by the Kingdom's strong institutions and debt repayment history. The country's scores in the Worldwide Governance Indicators (WGIs), which are the starting point for our assessment of sovereign's institutional strength, are consistently high and outperform Jordan's regional peers. In particular, its scores for government effectiveness and control of corruption have been on an improving trend since 2013. Jordan also has a positive track record of fiscal and structural reform implementation under a series of IMF programs, despite some setbacks during 2018 when the government had to withdraw a proposed draft income tax law from parliament in response to widespread street protests. An amended law was subsequently passed in December 2018 and the IMF concluded the second review of the ongoing program in May 2019.

Jordan's **fiscal strength** is assessed as "Low (-)" reflecting the government's high debt burden of around 94% of GDP in 2018. However, large fiscal deficits, rising to over 14% of GDP in 2012 after inclusion of losses from the state-owned utility companies, have reduced sharply to below 5% since 2016 and we expect them to decline further below 4% during 2019-2020, which will be sufficient to stabilize government debt to GDP at around the current level. Further fiscal consolidation, which we expect to proceed at a gradual pace and which will include the implementation of the amended income tax law, a further removal of goods and services tax exemptions and improvements in tax administration – will set the government debt ratio on a gradually declining path over the medium term.

The final fiscal strength score is above the scorecard-indicated outcome of "Very Low (+)" to take into account the credibility of the exchange rate peg to the US dollar, which has been in place since 1995 and reduces the exposure of the government's balance sheet to adverse foreign exchange movements. The peg is supported by the reserve buffer that covered about 6.4 months of imports of goods and services as of April 2019. It also takes into account a significant share of concessional debt (around 30% of GDP) which partly mitigate the size of the government's debt burden.

Our assessment of Jordan's **susceptibility to event risk** is driven by the banking sector risk, considered as "Moderate (+)". The banking sector risk score is set above the scorecard-indicated outcome of "Moderate" given that our baseline credit assessment (BCA) of ba3 only captures 42% of the country's banking system, and that in reality the majority of Jordan's banks would be rated b1 or lower. The large size of the banking system at around 170% of GDP in 2018 exposes the sovereign to potentially significant contingent liabilities due to the systemic importance of banks in channeling funding to the government. Banks' exposure to government and public sector entities accounted for 143% of total banking system capital as of December 2018. However, financial stability is supported by the Jordanian banks' sound capitalization, stable funding sources and high liquidity buffers, which offset the risks related to rising interest rates, high consumer indebtedness and significant cross-border exposures that are, nevertheless, fully provisioned for.

Political risk is assessed at "Moderate" to reflect Jordan's high and rising unemployment rate of more than 18% and a growing popular opposition to fiscal austerity measures, which manifested itself in the wave of street protests in May 2018 and subsequently led to a cabinet reshuffle and delays in the implementation of planned fiscal measures. Weak growth combined with the large influx of refugees over the past several years have had a significant negative impact on the country's labor market performance, particularly in the lower-skilled segment and in the informal sector, where many refugees compete with Jordanians for a limited number of positions. The political risk score also reflects Jordan's volatile regional political environment, including in neighboring countries, despite some recent improvements.

Jordan's government liquidity risk is assessed as "Moderate (-)" based on the high gross borrowing requirements at around 22% of GDP in 2018. Although global borrowing costs have increased in recent years, the government's debt affordability is currently better than for most similarly-rated sovereigns with comparable debt loads, reflecting the share of concessional loans as well as guaranteed Eurobonds. The assessment also reflects the ownership of a portion of domestic debt by the Social Security Corporation (17% of GDP), which reduces the refinancing risk despite a relatively short average maturity of debt, at around 5 years.

External vulnerability risk is "Moderate", reflecting persistently large current account deficits since 2005, which are only partially funded by FDI, a significant drawdown of the foreign currency reserves in the absence of sovereign external borrowing, as in 2018, which was only partly offset by deposits at the central bank from Saudi Arabia (A1 stable), Kuwait (Aa2 stable) and the UAE (Aa2 stable) pledged under the $2.5 billion support package announced in May 2018. Our external vulnerability risk assessment also reflects the build-up of a very large negative net investment position at 108% of GDP in 2018 and an elevated external vulnerability indicator (129% in 2019), which compares the sum of short-term external debt and currently maturing long-term external debt to the available foreign exchange reserves of the central bank.

Recent developments

Fiscal consolidation stalled in 2018

Narrowly measured, the government's fiscal position improved marginally during 2018. Although domestic revenues were significantly lower than budgeted (by around 2.8% of GDP, owing to lower than assumed nominal growth, a reversal of some tax increases introduced in early 2018, lower fuel imports and weaker than anticipated tax compliance), this was at least partly compensated by higher than budgeted foreign grants (adding 0.6% of GDP of revenues) and additional spending cuts (producing savings equivalent to 1.5% of GDP) compared to the budget. As a result, central government budget deficit narrowed to 2.4% of GDP in 2018 from 2.6% in 2017, and gross government debt remained broadly unchanged at around 94.4% of GDP. Even so, the central government deficit was materially higher than the budget target of 1.7% of GDP.

However, a broader and more comprehensive look at government finances instead points to a reversal of fiscal consolidation during 2018. According to the IMF estimates published in the staff report in May 2019, Jordan's overall public deficit (which includes off-budget spending and losses of the public water and electricity utility companies) widened to 4.5% of GDP in 2018 from 3.3% in 2017. This is because spending cuts relative to the budget plan were mostly offset by unplanned off-budget cash transfers to local governments, universities, and other public agencies (around 1.1% of GDP) and because the national electricity company (NEPCO) posted another operating loss (around 0.3% of GDP), due to an uneven application of the automatic tariff adjustment mechanism throughout the year and a decline in electricity consumption as an increased number of high-paying business and industrial customers chose to self-generate. This was in addition to further losses in the water sector, which were around 1% of GDP. Meanwhile, an increase in gross government debt during 2018 was partly avoided by a drawdown of treasury deposits with the local banking system (around 1.1% of GDP).

This fiscal slippage during 2018 reflects a difficult political environment that the government faced during last year, which triggered street protests in May in response to rising electricity and fuel prices and the announcement of the proposed new income tax law. This in turn has led to a change of prime minister, and a comprehensive cabinet reshuffle.

IMF program is back on track, extended until March 2020

After initial good progress during 2016 and most of 2017, Jordan's performance under the IMF Extended Fund Facility program (signed in August 2016) slowed substantially after a number of planned reform measures were delayed, diluted or even reversed due to rising social and political pressures triggered by rising energy prices and high and rising unemployment. This, in turn, delayed the second review of the program until May 2019 from the original target of September 2017 envisaged at the time of the first review. The amendments to the income tax law (a major structural benchmark under the program) were only passed by parliament in late 2018 and in a slightly diluted form than originally planned (the IMF estimates a yield of 0.8% of GDP over medium term compared to the original target of 1% of GDP).

Despite these delays, the IMF has commended the authorities for progress on advancing structural reforms: a new organic budget law, a draft inspections law, and amendments to the deposit insurance law were all submitted to parliament; parliament approved amendments to the secured-lending law and the insolvency law; and the Ministry of Finance published an updated debt management strategy and finalized the restructuring of the debt management directorate.

The second review makes available $167 million (0.4% of GDP) of financing to the government. But, more importantly, the government and the IMF have agreed to extend the existing 3-year program (which was due to expire this summer) until March 2020 and to begin negotiating a new, follow-up program in the meantime. This again demonstrates the government's commitment to the ongoing reform agenda and its commitment to the IMF program as an important policy anchor. The revised program envisages the third review in mid-June this year and the fourth review in the first quarter of 2020.

As indicated in the recently published staff report, for 2020 and beyond the government has agreed with the IMF to strengthen tax administration and reduce tax evasion by implementing several initiatives, including: (i) enhancing the Pay As You Earn system for large taxpayers; (ii) increasing compliance among self-employed persons; (iii) introducing transfer pricing regulations; and (iv) enhancing the access to third party information. The new income tax law, approved last year, will support these initiatives through significantly tougher penalties for delays in compliance and tax evasion.

Structural reforms set to continue, including restructuring of NEPCO

On the structural reform side, the government has also committed to strengthen the Public-Private Partnership (PPP) framework by removing the current exemption of the water and energy sectors from the PPP law, to submit to parliament amendments to the law by December 2019, and to hire an accounting firm to complete a detailed study to identify and quantify major direct and contingent liabilities stemming from PPPs by end-December 2019.

Separately, the government agreed with the World Bank to launch a comprehensive restructuring of NEPCO with the aim to eliminating operating losses and reducing the high cost of energy, which has been one of the key impediments to faster economic growth. The elements of the restructuring plan include rationalization of the cross-subsidized tariff structure (to reduce the burden on high-paying large industries, ports, and the commercial sector); upfront revenue and cost-savings measures (including a review of the existing power purchasing agreements); strengthening of the quarterly automatic tariff adjustment mechanism linked to NEPCO's overall cost structure; and the reprofiling of NEPCO's debt with the help of external donors in order to smooth the debt service profile and potentially remove NEPCO debt accumulated due to disruptions of Egyptian gas supplies during 2011-2017, from the company's balance sheet. Almost all of NEPCO debt (other than accumulated advances from the Ministry of Finance) is guaranteed by the government and already included in government debt ratios.

Strong international donor support helps secure government financing needs for 2019-2020

Enduring strong support of the international community for Jordan was evidenced (again) this February at the London Initiative conference, during which the government managed to secure a raft of new budget grants and concessionary financing from a wide range of international bilateral and multilateral donors to support Jordan's reforms and its growth and debt sustainability agenda. In addition to budget support grants and loans, the European Union (Aaa stable) will provide around €1.6 billion extra funding for small and medium enterprises.

As of the time of writing, the government has secured JOD 820 million (2.6% of GDP) of foreign budgetary grants for 2019, which is 0.7% of GDP more than had been budgeted. This increase is primarily due to the additional support for Jordan appropriated by the US Congress above and beyond the levels agreed in the memorandum of understanding in early 2018.

Moreover, against $2 billion (4.5% of GDP) of external government debt principal repayments due in 2019 (including a $1 billion US-guaranteed Eurobond due in June), the government has already secured new external concessional financing of $1.9 billion, including $1.45 billion of development policy loans from the World Bank and a number of other bilateral and multilateral budget support loans, in addition to $0.6 billion of expected disbursements from previously agreed budget support facilities.

The grants and loans mentioned above include commitments made under the "Mecca Pledge" from the GCC countries in May 2018. These commitments include $250 million of budget grants from each Saudi Arabia and the UAE over 2018-22; $500 million of concessional loans from Kuwait over 2019-23; $100 million of loans from Saudi Arabia and the UAE in 2019, and $200 million of guarantees from each Saudi Arabia and the UAE, which will be blended with IBRD loans. Finally, $333 million from each Saudi Arabia and the UAE, and $500 million from Kuwait have been deposited with the Central Bank of Jordan last year to support Jordan's external buffers, but could be converted into concessional loans.

Rating methodology and scorecard factors

Rating factors grid - Jordan

Rating factors	Sub-factor weighting	Indicator	Indicative factor score	Final factor score
Factor 1: Economic strength			M-	M-
Growth Dynamics	**50%**			
Average real GDP growth (2013-2022F)		2.5		
Volatility in real GDP growth (standard deviation, 2008-2017)		1.7		
WEF Global Competitiveness index (2017)		4.3		
Scale of the economy	**25%**			
Nominal GDP (US$ billion, 2017)		40.7		
National income	**25%**			
GDP per capita (PPP, US$, 2017)		9,232		
Automatic adjustments	**[-3; 0]**	Scores applied		
Credit boom		0		
Factor 2: Institutional strength			H-	H-
Institutional framework and effectiveness	**75%**			
Worldwide Government Effectiveness index (2017)		0.1		
Worldwide Rule of Law index (2017)		0.3		
Worldwide Control of Corruption index (2017)		0.3		
Policy credibility and effectiveness	**25%**			
Inflation level (%, 2013-2022F)		2.3		
Inflation volatility (standard deviation, 2008-2017)		4.4		
Automatic adjustments	**[-3; 0]**	Scores applied		
Track record of default		0		
Economic Resiliency (F1xF2)			**M+**	**M+**
Factor 3: Fiscal strength			VL+	L-
Debt burden	**50%**			
General government debt/GDP (2017)		94.3		
General government debt/revenue (2017)		367.3		
Debt affordability	**50%**			
General government interest payments/revenue (2017)		11.5		
General government interest payments/GDP (2017)		3.0		
Automatic adjustments	**[-6; +4]**	Scores applied		
Debt trend (2014-2019F)		0		
Foreign currency debt/general government debt (2017)		-4		
Other non-financial public sector debt/GDP (2017)		0		
Public sector assets/general government debt (2017)		0		
Government financial strength (F1xF2xF3)			**M-**	**M-**
Factor 4: Susceptibility to event risk	**Max. function**		M	M+
Political risk			*M*	*M*
Worldwide voice & accountability index (2017)		-0.7		
Government liquidity risk			*M-*	*M-*
Gross borrowing requirements/GDP		22.5		
Non-resident share of general government debt (%)		43.5		
Market-Implied Ratings		Ba3		
Banking sector risk			*M*	*M+*
Average baseline credit assessment (BCA)		ba3		
Total domestic bank assets/GDP		170		
Banking system loan-to-deposit ratio		100		
External vulnerability risk			*M*	*M*
(Current account balance + FDI Inflows)/GDP		-5.6		
External vulnerability indicator (EVI)		129.3		
Net international investment position/GDP		-101.8		
Government bond rating range (F1xF2xF3xF4)			**Ba1 - Ba3**	**Ba2 - B1**
Assigned foreign currency government bond rating		**B1**		

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. For more information please see our Sovereign Bond Rating Methodology.

Footnotes: (1) Indicative factor score: rating sub-factors combine with the automatic adjustments to produce an Indicative factor score for every rating factor, as detailed in Moody's Sovereign Bond Methodology. **(2) Final factor score: w**here additional analytical considerations exist, Indicative factor scores are augmented to produce a Final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Bond Methodology; details on country-specific considerations are provided in Moody's research. **(3) Rating range:** Factors 1: Economic strength, and Factor 2: Institutional strength, combine with equal weight into a construct we designate as Economic Resiliency or ER. An aggregation function then combines ER and Factor 3: Fiscal strength (FS), following a non-linear pattern where FS has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's susceptibility to event risk, is a constraint which can only lower the preliminary government financial strength rating range as given by combining the first three factors. **(4) 15 Ranking categories:** VH+, VH, VH-, H+, H, H-, M+, M, M-, L+, L, L-, VL+, VL, VL- **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Moody's related publications

- **Outlook**: Sovereigns - Levant & North Africa: 2019 outlook stable, but global headwinds and slowing reforms point to downside risks, 22 January 2019
- **Issuer In-Depth**: Government of Jordan - B1 stable: Annual credit analysis, 3 December 2018
- **Rating Action**: Moody's affirms Jordan's B1 ratings, maintains stable outlook, 8 November 2018
- **Rating Methodology**: Sovereign Bond Ratings, 27 November 2018

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