Financial Stability Report 2013

Preface

The objective of achieving financial stability has become one of the most important objectives of the central banks in the world, especially after the global financial crisis. For this purpose, the Central Bank of Jordan (CBJ) established the Financial Stability Department (FSD) as an independent department at the beginning of 2013 to follow up on the developments in the financial conditions of the banking system and other financial institutions at macro level and their linkages and suitability to the economic conditions and developments. Financial stability aims at strengthening and enhancing the capacity of banks and other financial institutions to withstand risks and curb any structural imbalances. To clarify any ambiguity, financial stability is not related to analyzing the government budget and attaining its stability which is considered a key objective for the fiscal policy that is managed by the Ministry of Finance.

The issuance of Financial Stability Report for 2013 (**JFSR2013**) as the second released report after the established of the FSD aims at highlighting the developments in the banking and financial sector in Jordan and the efforts exerted to develop them and enhance the resilience of the financial system, as well as evaluating its performance and identifying the risks that it might encounter. The **JFSR2013** revealed that the size of the banking system comprises approximately 94.0% of the size of the financial sector, and hence, the banks are considered the main component of the financial sector in Jordan. In this regard, **JFSR2013** showed that Jordan has a sound and safe banking system that is generally capable of withstanding shocks and high risk due to its high levels of capital that is almost the highest in the Middle East and North Africa (MENA) region. In addition to banks having comfortable levels of liquidity and profitability, there has been a substantial improvement of most of the financial soundness indicators for banks such as NPLs, coverage, capital adequacy and liquidity and profitability ratios.

The **JFSR2013**analyzed the operational efficiency in the banking system and concluded that the operational efficiency of the banks in Jordan has witnessed an improvement through the decline in the percentage of operating expenses and provisions to gross income and the increase in productivity per employee. Despite this improvement, the interest rate margin is still high in Jordan relative to many other countries. Efforts are taken by CBJ to reduce the interest rate margin of banks by urging banks to continue to improve their operational efficiency and reflect this improvement on lowering interest rates and consequently increasing the contribution of banks in stimulating the economy through financing various economic activities at a reasonable cost.

As for the non-banking financial institutions (e.g. insurance companies, microfinance companies, financial leasing companies and currency exchange companies), the **JFSR2013**touched on the key financial developments in these institutions. In addition to that, the **JFSR2013** studied the developments in the Amman Stock Exchange(ASE) and the main developments that took place in 2013 as compared to 2012. In this regard, the **JFSR2013**found that ASE witnessed a varied performance in 2013 compared to 2012, where the trading volume increased by 53.0% and the stock price index weighted by free stocks increased by 5.5%. On the contrary, the market value of shares listed in Amman Stock Exchange decreased by 4.7% to reach JD 18.2 billion.

The **JFSR2013**also included an in-depth analysis of real estate price index that was developed jointly by the CBJ and the Department of Lands and Survey for the first time in 2013. The index aims

at evaluating real estate prices and the banks' exposure to the risks in this market. The analysis revealed that the rise in the real estate prices in Jordan is considered normal and consistent with the general inflation rates. The credit extended for or guaranteed by real estate formed 35.0% of total credit extended by banks. Despite this large share, the estimated value of the mortgaged real estate exceeds the amount of extended credit by a comfortable margin, where the value of real estate guarantees approximated 141.0% of real estate loans, which enhances the bank's ability to confront the risks of these loans.

Regarding household debt, the **JFSR2013** revealed that there is an increasing tendency of banks to extend credit to households, the share of household debt to total credit reached 38.0% in 2013 compared to 36.0% in 2012. The **JFSR2013** also revealed that the ratio of household debt to income witnessed an increasing trend to reach 60.0% in 2013. Household debt to GDP, on the other hand, reached 32.0% in 2013. These ratios are relatively acceptable when compared with the other countries in the MENA region and the world.

The **JFSR2013** sheds the light on CBJ's policies and measures to enhance financial inclusion by focusing on the following measures:

- Enhancing financial stability: The CBJ created the FSD with an objective to identify, monitor and manage the risks that the financial and banking sectors face at the macro level. It also started working on setting a comprehensive framework for banking crises management to reduce their impact on financial stability in case they occur.
- Consumer Protection: In this regard, the CBJ issued **Treating Customers Fairly** instructions No. 56/2012 in 31/12/2012 in an objective to enhance transparency and fairness by banks in the different transactions with their customers to protect them, enhance the competitiveness of the banking sectors, and protect banks from legal and reputation risks. In addition, the CBJ created a division, which was assigned the task of consumer protection. Studies are ongoing to extend the consumer protection to incorporate the customers of other financial institutions in the protection measures.
- Enhancing the financial literacy: In this context, the CBJ, in consultation with the parties involved in the financial literacy, designed a comprehensive action plan to initiate a program to include the financial education in schools. In this regard, two committees were established under the approval of the Prime Minister to prepare and implement the financial education program (Steering and Technical Committees).
- Providing the necessary infrastructure to enhance financial inclusion: The first credit bureau is expected to be licensed in 2014. The company plans to build a comprehensive credit information database about the customers of banks and other financial institutions that extend credit, which will help rationalize the credit decisions of these institutions as they will be able to make the accurate credit decision relying on a precise evaluation of the customers' ability to pay their debt, and to price financial products based on customer-specific risks. Consequently, this will enhance the effectiveness of risk management at banks and other financial institutions and improve the access of clients to credit, particularly SMEs to finance. The CBJ also issued a set of instructions to develop payment, clearance and settlement systems.
- Improving the access to finance, especially by SMEs: The CBJ in collaboration with the Ministry of Planning and International Cooperation and some regional and international

financial institutions exerted substantial efforts to provide the SMEs with their financial needs at reasonable cost and maturities. However, the CBJ believes that more work and efforts are still needed to support this sector.

The **JFSR2013** also included the stress testing results that are used to assess the ability of banks to withstand risks. The results revealed that the banking system in Jordan is generally capable of withstanding shocks and high risks. They also revealed the improvement in bank's capacity to confront these risks in 2013 compared to 2012. These improvements are due to the substantial increase in banks' profitability in 2013 and the possession of high levels of capital that are considered of the highest in the MENA region. The CBJ will continue its policy to improve these tests taking into consideration the developments of risks at local, regional and global level to ensure the safety and soundness of the banking sector in Jordan.

Regarding the economic developments in Jordan, the **JFSR2013**revealed that most economic and monetary indicators improved in 2013 compared to 2012.

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Governor

Dr. Ziad Fariz

Chapter One: Local and International Economic and Financial Developments and Outlook

Introduction

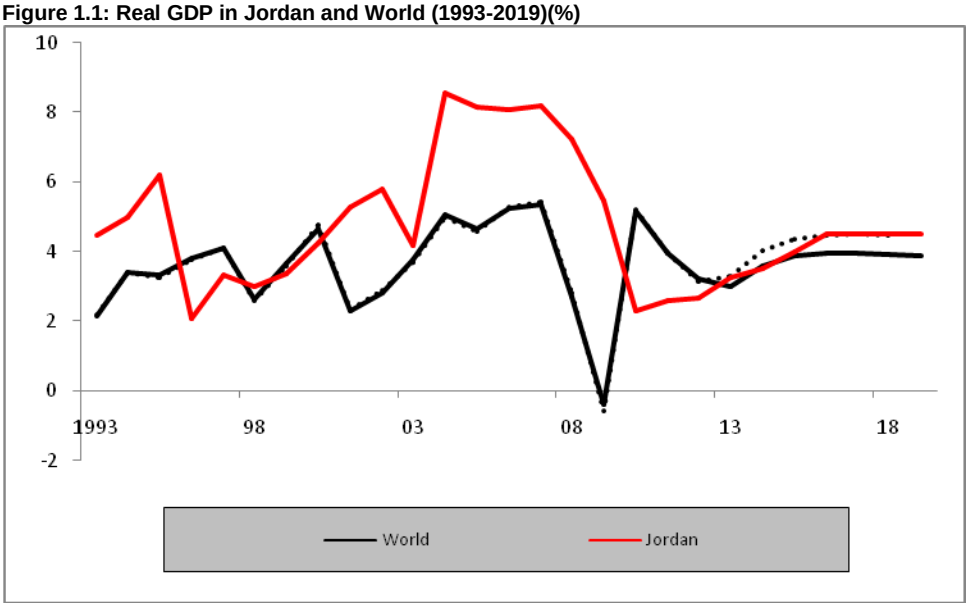
The global financial system witnessed an improvement in its stability, where the credit risks declined and market, liquidity and macroeconomic risks stabilized. However, emerging market risks increased as indicated by the IMF in its April 2014 Financial Stability Report.

The increase in the emerging markets risks is due to three main factors: the US monetary policy trending towards curbing the quantitative easing, the pressures on some EMEs that face macroeconomic imbalances that negatively impacted their economic growth outlook, and political instability in the MENA region and Europe that adversely affected the economic and financial condition in the countries of these regions and hence the entire region.

Regarding the economic developments, the world GDP grew by approximately 3.0% in 2013, declining by 0.2% from its level in 2012.

Jordanian economy realized a slight improvement in economic activity in 2013 and attained a GDP growth rate of 2.8% compared to 2.7% in 2012.

Figure 1.1: Real GDP in Jordan and World (1993-2019)(%)



Source: IMF, WEO April 2014.

Whereas GDP growth expectations decreased for the five-years ahead as shown in the updated forecasts released by the IMF in its April 2014 WEO report (for the period 2014-2019) compared to its previous forecasts in its October 2013 WEO report (for the period 2013-2018), these expectations did not change for Jordan which indicates that the economic environment where the financial system functions is relatively stable.

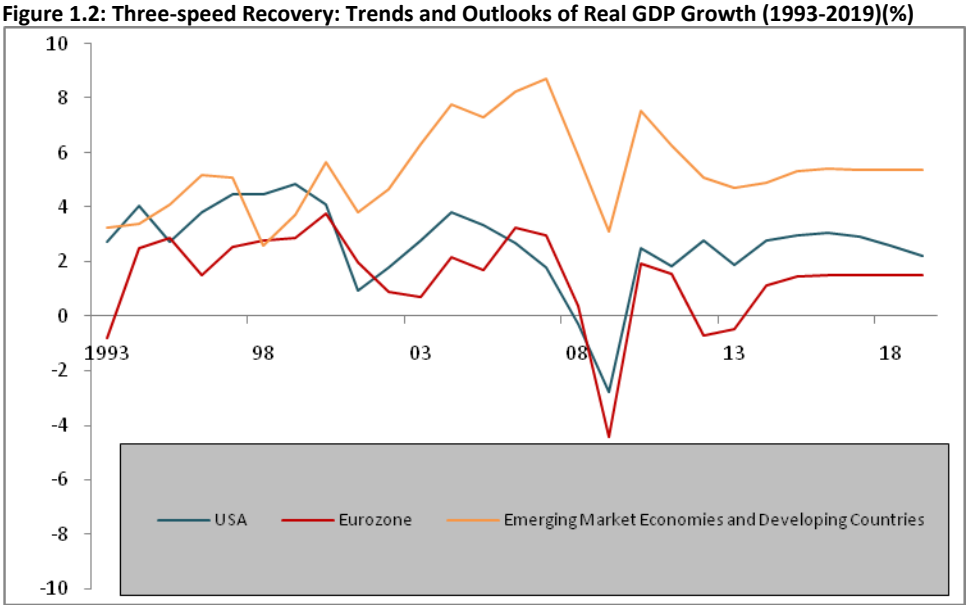
International Economic and Financial Developments and Outlook

International Economic Developments

The world economy witnessed a growth of GDP of 3.0% in 2013, and is projected to reach 3.6% in 2014 due to the reduction of the key factors that weakened the global activity.

Primary data of the April 2014 WEO report indicated that it is expected that growth rates outlook will improve in the world in 2014 as a whole compared to its counterparts in 2013. It is also expected for economic growth to strengthen in the advanced economies during 2014 and 2015 benefiting from the abundance that took place in 2013. In USA, for example, the growth rate is expected to exceed its long-term trend. Growth rate in Japan is expected to improve as well.

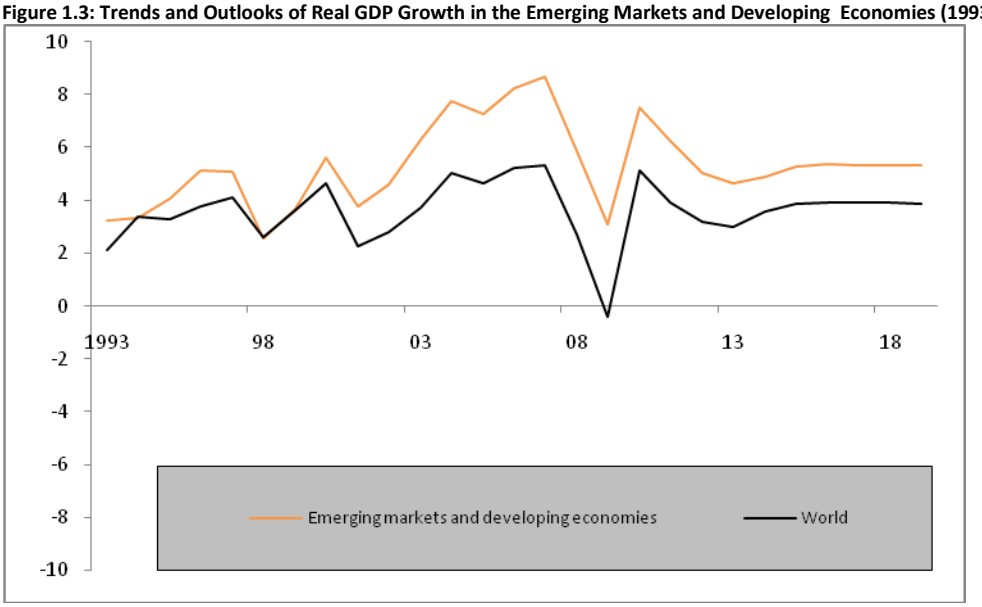
Figure 1.2: Three-speed Recovery: Trends and Outlooks of Real GDP Growth (1993-2019)(%)



Source: IMF, WEO April 2014.

The three-speed recovery (the varying growth rate among USA and the Eurozone) is expected to prevail as the recovery is expected to continue to be uneven among these countries. Projections indicate that the average expected GDP growth rate for USA and Eurozone for the years 2014-2018 is 2.85% and 1.45% respectively.

Figure 1.3: Trends and Outlooks of Real GDP Growth in the Emerging Markets and Developing Economies (1993-2019)(%)

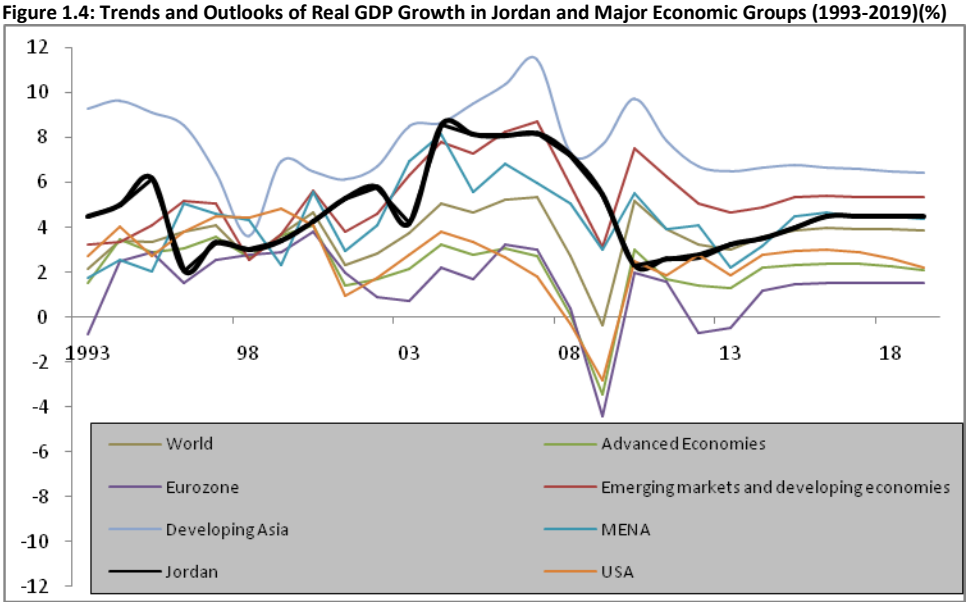


Source: IMF, WEO April 2014.

In the emerging market economy and developing countries, the growth rate reached 5.5% in 2013; in that the supportive governmental policy stimulus was the core impetus of the economic growth. However, the growth rates are not expected to return to the high rates that were attained in 2010, despite the accelerated pace in economic activity that took place recently in many emerging market economies.

The weak economic activity in advanced economies is expected to adversely impact external demand, as well as the terms of trade in the primary commodities exporting countries. In addition, it has narrowed the space for further policy stimulus, while supply bottlenecks and uncertainty surrounding policy obstructed economic growth in some economies, such as Brazil and India.

Figure 1.4: Trends and Outlooks of Real GDP Growth in Jordan and Major Economic Groups (1993-2019)(%)



Source: IMF, WEO April 2014.

Regarding the economic outlook, the April 2014 WEO updates, the GDP growth rate in the USA reached 2.0% in 2013.The improvements in the financial markets along with the positive developments in housing market helped improve the household balance sheet, which in turn reflected positively on improving consumption levels in 2013.

For the Eurozone, the published figures indicated that the economy contracted by 0.2% in 2013, contrary to the previous growth forecasts of the same percent. This contraction is due to the delayed impact of the cut of interest rates on sovereign bonds and the improvement in liquidity and credit conditions for the private sector, in addition to uncertainty that is still high. The European Central Bank has recently cut the interest rates in order to further improve credit conditions for the private sector.

The growth outlook for Japan in the near term has not been mitigated despite the recession, as the numbers revealed a contraction in economic activity by 0.2% in 2013. It is expected, however, that the growth will get momentum, at least in the short term, after implementing a set of financial stimulus measures and quantitative easing supported by the boom in the external demand and the devaluation of Japanese Yen.

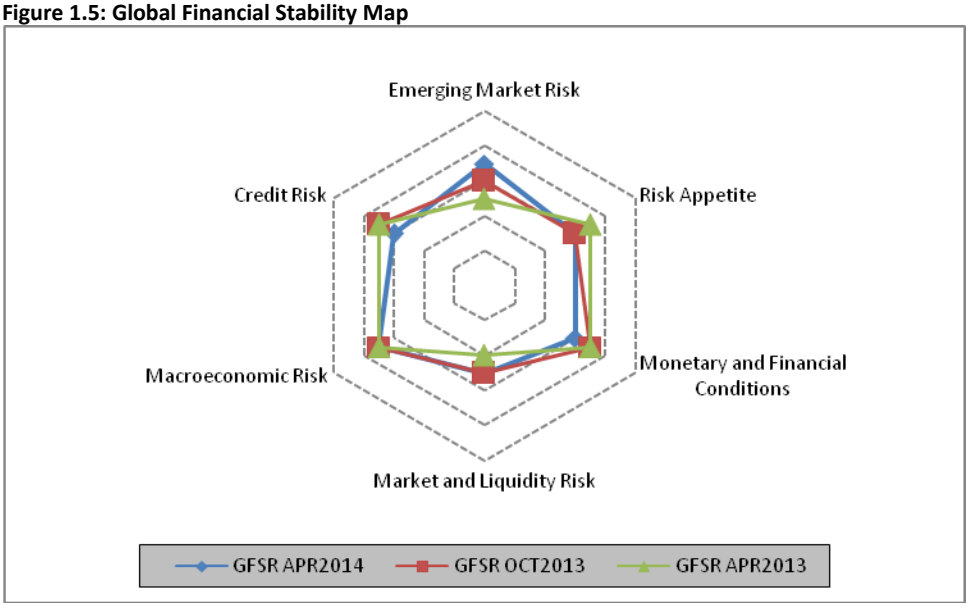
Global Financial System Stability

Global Financial Stability

As mentioned in the introduction of this chapter, the global financial system witnessed a relative stability as shown in the global financial stability map.

As mentioned earlier, three out of six dimensions of the components of the financial stability map were relatively stable, two components worsened and only one component improved - credit risks component, the last being the most important dimension for the financial system stability.

Figure 1.5: Global Financial Stability Map



Source: IMF, GFSR April 2014.

A comparison of the Jordanian Financial System Relative to the Global Averages

Figure 1.6 shows the characteristics of the financial system in Jordan compared to MENA region countries and world average in terms of four main indicators for each of financial institutions and financial markets. These indicators are:

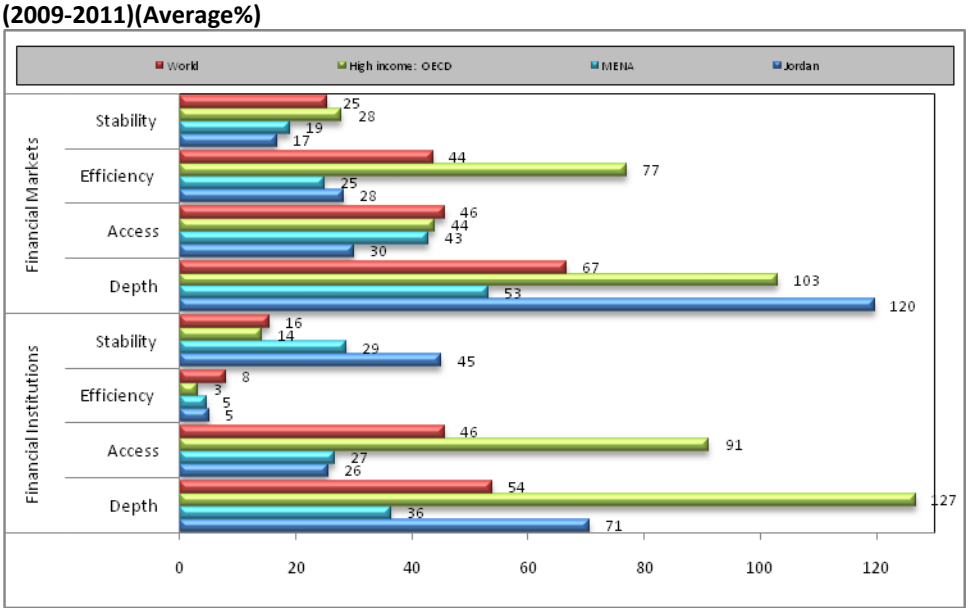
1- Stability: The financial system in Jordan is relatively stable. The financial stability indicator for financial markets reached 17.0%, slightly higher that the MENA region average and below the World average by 39.3%. For financial institutions, the financial stability index reached 45.0%, about 50.0% higher than MENA region average and three times the world average almost (45.0% vs 16.0%).

2- Efficiency: Market efficiency in Jordan approached 28.0% on average, a little above MENA region average, but it is lower than the World average, as it slightly exceeded half this average. Regarding the financial institutions, the average efficiency of financial institutions in Jordan was 5.0%, which is equal to the MENA region average, but less than the World average. In this regard, Chapter Four includes a detailed analysis of operational efficiency of Jordanian banks.

3- Access to Financial Services: The indicator used to measure the access to financial services reached 26.0%, slightly lower in comparison with MENA region average, but substantially lower than its counterpart for the World and the OECD-high income countries. This implies that enhancing financial inclusion in Jordan is an issue that needs to be addressed, an issue that CBJ started to work on, particularly in the last two years. Chapter Two details the CBJ's measures in this regard. Regarding financial markets, the access to financial services approximated 30.0%, which is lower than its counterpart for MENA region countries, high-income OECD countries and the World, the groups that were close, and reached 43.0%, 44.0% and 46.0%.

4- Financial Depth: For this indicator, Jordan is one of the highest countries. The relevant indicator approximated 71.0%; a percentage that doubled its counterpart for the MENA region average, but lower by 56.0 percentage point than the OECD high-income countries. Regarding the financial markets, Jordan supersede all averages, where the financial depth indicator stood near 120.0% compared to 53.0%, 103.0% and 67.0% relatively for MENA region countries, OECD high-income countries and the World respectively.

Figure 1.6: Characteristics of Financial System: Jordan Compared to MENA Region Countries and world (2009-2011)(Average%)



Source: World Bank, Global Financial Development Report 2014.

Domestic Economic and Financial Developments and Outlook

Domestic Economic Situation and Outlook

As stated in the Financial Stability Report for 2012 and the annual report for 2013 issued by the CBJ, the global economic and financial developments and prospects have had a clear impact on Jordan as an oil-importer small open emerging economy country that is being exposed to severe shocks since about six years. The major shocks include the repercussion of the global financial crisis, the Arab Spring and the accompanying disruption of the Egyptian natural gas inflow, and the conflict in Syria, which was accompanied by a large influx of Syrian refugees, not to forget the high price of oil and food. These shocks have been impacting Jordan in many ways. Despite that, the tight fiscal policy associated with the accommodative monetary policy helped maintain economic and monetary stability through maintaining positive economic growth rates and comfortable levels of foreign reserves, and maintaining stable price levels and stable financial system as well, these achievements did result from the adoption of prudent supervisory and regulatory policy on the banking system and the conservative banking system in Jordan that is endowed with high levels of capital, acceptable levels of liquidity and low exposure to European sovereign bonds and high-risk investment tools. Furthermore the political stability has helped promote stability in other aspects. In light of the improvements of economic and monetary stability, the CBJ cut interest rates twice by 25 basis points each time during the 2013 in order to stimulate credit supply to the private sector, and thus stimulate economic growth. And a continuation of the same approach, the CBJ cut interest rates twice in 2014, the first cut was at the beginning of the 2014, and the reduction was 25 basis points, while the second reduction was conducted in mid-2014 by 50 basis points.

Despite these substantial challenges, Jordan succeeded in enhancing economic and financial stability in 2013 in a better stance than 2012. Of the main indicators on this improvement are:

1- The slight improvement in the economic activity. As seen in the increase in the growth rate from 2.7% in 2012 to 2.8% in 2013.
2- The decline in the budget deficit from 8.3% of GDP in 2012 to 5.5% of GDP in 2013.

3- The decrease in the current account deficit from 15.2% of GDP in 2012 to 10.0% of GDP in 2013.
4- The rise in the non-commodity exports by 8.5%.
5- The decline in the energy imports by 11.5%.
6- Monetary stability through the increase in the foreign reserves by 81.0% to exceed US$ 12.0 billion in 2013, and maintaining inflation rate within the reasonable limits – the rate reached 5.6% in 2013 compared to 4.7% in 2012.

Stand-by Arrangements

At the conclusion of its last visit to Jordan, the IMF stated that the performance of Jordanian economy was satisfactory as Jordan was capable of confronting the challenges that has intensified the pressures on the Jordanian economy through the prudent economic policies.

The Fund's review concluded that there were several indicators that signaled the improvement in the performance of the Jordanian economy. The IMF team indicated that the financial sector reform in progressing gradually. Also, the banking sector is sound and generally stable. The CBJ in undergoing the necessary policy actions that help make this sector more resilient through improving the collection of supervisory data and enhancing the regulatory and supervisory framework. The government continued its policy in 2013 that aimed at curbing the external and financial imbalances. The CBJ was capable of improving the foreign reserves level to cover more than six months of imports as per the 2013 numbers. The import coverage exceeded seven months at the end of July 2014, a period that is relatively comfortable within the international standards that are used to judge on the foreign reserves coverage. The improvement in these levels is attributed to the satisfactory monetary stance, the improvement in the current account, the increased in dinar-denominated savings at the expense of dollar-denominated savings (motivated by the increased confidence), the increase in remittances of expatriates and the announcement of the issue of two US dollar guaranteed domestic bonds collateralized by the US government.

It is expected that the economic situation will improve in the medium term as well. The growth rate is expected to increase to 3.5% in 2014 and 4.5% over the medium term. It is also forecast that the inflation rate will step down to 2.5% at the end of 2014 and 2.0% in the medium term. Regarding to the current account deficit, it is expected to improve gradually to get to 4.5% of GDP in 2014 over the medium term reflecting the decline the energy bill. However, still present are risk expectations arising from the Syrian crises and continuing vulnerability in the energy imports.

On a policy level, the IMF team stated that it is crucial for the government continue to protect the stability from external events, curb the vulnerabilities, improve labor market and continue in its efforts to consolidate fiscal stance. The focus should be on achieving a fair distribution of the burden resulting from reform and protecting the most vulnerable.

Table 1.1 shows the main indicators for the domestic economy and their outlook for the period 1990-2019. Given that the estimations for the years 2014-2019 were extracted from the IMF World Economic Outlook Database.

Year	GDP*	Inflation (Period average)*	Imports of Goods and Services*	Exports of Goods and Services*	Unemployment Rate (% of Labor Force)	Population (Million)	Revenues**	Expenditures**	Net Debt**	Gross Debt**	Current Account**
1990	-0.3	16.2	13.9	-4.1	16.8	3.5	36.7	44.2	213.0	219.7	-15.7
1991	1.6	8.2	-5.9	6.4	18.8	3.7	35.0	45.2	192.0	200.6	-14.9
1992	14.4	4.0	29.9	7.7	17.6	3.8	37.6	35.7	143.5	149.7	-14.4
1993	4.5	3.3	6.1	2.3	19.6	4.0	34.8	37.0	129.7	137.0	-11.6
1994	5.0	3.5	-2.6	7.1	15.8	4.1	32.6	35.0	116.8	126.3	-6.4
1995	6.2	2.4	-3.1	8.7	15.4	4.3	34.4	36.1	107.6	114.9	-3.8
1996	2.1	6.5	7.7	-2.7	13.1	4.4	33.6	36.9	103.1	113.8	-3.2
1997	3.3	3.0	-2.3	6.8	14.4	4.5	31.5	34.6	95.2	106.6	0.4
1998	3.0	3.1	-5.5	2.8	13.5	4.6	30.4	36.0	104.4	109.7	0.3
1999	3.4	0.6	-1.2	2.9	14.4	4.7	30.9	33.7	101.3	108.0	5.0
2000	4.3	0.7	20.8	7.9	13.7	4.9	30.0	33.8	88.2	100.5	0.7
2001	5.3	1.8	3.2	23.1	14.7	5.0	30.3	33.3	92.6	96.5	0.1
2002	5.8	1.8	3.0	15.0	15.3	5.1	29.6	33.6	95.0	99.7	5.7
2003	4.2	1.6	2.2	7.4	14.4	5.2	34.7	36.8	98.1	99.6	11.5
2004	8.6	3.4	22.6	22.5	14.7	5.4	36.6	37.7	88.7	91.8	0.1
2005	8.1	3.5	16.2	-2.5	14.8	5.5	33.3	38.8	84.0	84.3	-18.0
2006	8.1	6.3	0.6	2.5	14.1	5.6	32.4	36.4	68.9	76.3	-11.5
2007	8.2	4.7	3.2	8.0	13.1	5.7	32.3	37.0	67.6	73.8	-16.8
2008	7.2	13.9	-0.3	18.3	12.7	5.9	30.1	34.4	54.8	60.2	-9.3
2009	5.5	-0.7	-1.7	-15.3	12.9	6.0	26.5	35.0	57.1	64.8	-3.3
2010	2.3	5.0	-0.7	9.5	12.5	6.1	24.9	30.4	61.1	67.1	-5.3
2011	2.6	4.4	-0.2	12.2	12.9	6.3	26.4	33.2	65.4	70.7	-12.0
2012	2.7	4.6	2.9	-0.7	12.2	6.4	23.0	31.2	75.5	80.2	-18.1
2013	2.8	5.6	2.3	5.9	12.6	6.5	24.1	29.6	83.5	87.7	-11.1
2014	3.5	3.0	2.5	5.9	12.2	6.7	27.4	31.8	87.4	91.3	-12.9
2015	4.0	2.4	3.0	6.0	12.2	6.8	27.6	31.7	89.3	93.0	-9.3
2016	4.5	1.9	3.5	6.1	12.2	7.0	29.1	31.7	87.9	91.3	-8.2
2017	4.5	1.9	3.5	6.2	12.2	7.2	29.5	31.6	85.0	88.2	-7.6
2018	4.5	1.9	3.6	6.2	12.2	7.3	30.1	32.0	82.0	85.0	-7.2
2019	4.5	1.8	3.6	6.2	12.2	7.5	30.1	32.1	79.2	82.1	-6.1

Source: IMF World Economic Outlook Database, April 2014. * Y-o-Y growth rates in percent. ** Percent of GDP.

Challenges to Stability

Syrian Refugees Problem

The continuous influx of Syrian refugees to Jordan and the pressures it poses might be the major challenge that Jordan faces in the short and medium terms. These pressures do go beyond economic aspects to touch social, political and cultural life in Jordan. The size of the challenge and the risk are clear from the United Nations numbers (Figure 1.7). Per these numbers, the expected cost of relieving about 600 thousand Syrian refugees is US$ 870 million.

Cost of Energy

The second major challenge is energy subsidizing, especially electricity. The prices of electricity are much lower than the cost of production that increased substantially because of irregularities in the Egyptian natural gas inflow. The electricity losses pose a serious pressure on the balance of payments due to the need to import the necessary input to generate energy - an option that is more costly than the natural gas option. In addition, the electricity sector competes with the other economic activities in getting its financing needs. In spite of these challenges, the government policy and the measures it adopted in this context, mentioned previously, helped mitigate the negative consequences of these challenges, even though these challenges are expected to continue.

Chapter Two: Legislative and Supervisory Developments

The CBJ's Procedures and Future Policies to Enhance Financial Inclusion

After the global financial crisis, the focus of economic and financial policy makers shifted towards financial inclusion - the access to financial services by various groups in the community, in particular the deprived group that is targeted by the financial system-. The shift was due to the impact that financial inclusion has on financial, social and political stability and economic development, and to protect financial customers. Several international reports revealed that about 50.0% of the World's population does not deal with banks.[1] Consequently, the issue of financial inclusion became one of the important agendas for the monetary, financial and economic policies makers.

Box 1: Financial Inclusion Concept

Financial inclusion is a "vision that reaffirms the basic tenet that the right access to the right formal financial service helps households, microbusinesses, and the economy as a whole, and a vision that recognizes that financial services are not an end in and of themselves but ultimately must improve household welfare. Access to formal financial services needs to give poor families a broader range of choices to build assets, smooth consumption, manage risks, and as a result make them better off than when they have to use traditional, informal alternatives that are often limited, unreliable, and costly".[2] Where the informal channels are a path for those whom could not access the formal services- the channels usually include unfair terms and conditions for granting credit to potential customers which in turn deepen the financial problem of this group that cannot access the formal financing channel. The G20 adopted indicators to measure the financial inclusion that are composed of three dimensions: access to financial services, use of financial services and the quality of banking products provided.

The CBJ believes that expanding financial inclusion in a deliberate and prudent manner and providing the necessary infrastructure needed to help support the comprehensive and sustainable growth and enhance financial, social and economic stability in Jordan. To attain this goal, the CBJ's policy to enhance financial inclusion is based on the following pillars:

- Enhancing financial stability
- Consumer protection
- Spreading financial and banking literacy
- Providing the necessary infrastructure
- Improving access to finance especially for small and medium size companies

Enhance Financial Stability

Enhancing financial stability helps sustain financial conditions of banks and other non-bank financial institutions enhance financial markets and guarantee the availability of efficient and advanced payment systems. This in turn enhances the ability of the financial system to provide financial services to customers with high efficiency at a reasonable cost, and expanding the scope of these services. Consequently, the financial inclusion in Jordan is enhanced. In this regard, in order to enhance the financial inclusion in Jordan, the CBJ did the following:

1- Creating the Financial Stability Department. The establishment of the FSD in the CBJ was done at the onset of 2013. In a goal to identify, evaluate and control systemic risks through

[1] The percentage of population who does not deal with banks in Jordan approximates 75.0% per the published data by the World Bank in 2011.
[2] Consultative Group to Assist the Poorest (CGAP). Annual Report. November 2011.

implementing the macroprudential policy tools necessary to curb risks that the financial system might face at the macro level and enhancing the ability of the financial system to withstand shocks.

2- Financial Crisis Management: In order to enhance financial stability in Jordan and keep pace with the best international standards and practices in this context, a guidance committee and a technical committee were established to set a comprehensive and efficient framework for crises management to confront and mitigate its impact on financial stability in case it materialized.

Consumer Protection

The issue of consumer protection acquired a considerable attention because of its positive impact on financial inclusion. The leaders of the Group of Twenty summit, which was held in Toronto in 2010 has identified the protection of financial customers through financial education as one of nine principles of financial inclusion based on creativity and innovation.

In this regard, the CBJ issued **Treating Customers Fairly** instructions No. 56/2012 in 31/10/2012 and it was implemented in 15/5/2013 as an objective to enhance transparency and fairness by banks in the different transactions with their customers to protect them, enhance the competitiveness of the banking sectors, and protect banks from legal and reputation risks. In turn, this helps maintain the soundness and resilience of the banking system which reflects positively on the stability of the financial system.

These instructions enrich the ethics in dealing with customers fairly and transparently as a key issue in the culture of the operating banks in Jordan at all levels, in a way that ensures that the provided banking services or products to the customers is accompanied by clear and coherent terms and conditions that enable banks' customers to understand the features and cost of the offered financial products, along with the associated risks, in addition to spreading the financial knowledge over various groups in the community.

It is worth mentioning that the CBJ started the necessary procedures to establish a division specialized in financial consumer protection. There are future plans to expand the protection scope to incorporate the customers of other financial institutions.

Box 2: Treating Customers Fairly Instructions No 56/2012 Dated 31/10/2012

These instructions addressed a set of pillars that included (1) transparency and credit controls for the retail portfolio, (2) limits on some fees and commissions that are charged to retail customers in return for banking services, (3) protection of customers' accounts that are inactive and, (4) processing customer complaints effectively.

Regarding transparency and credit controls for the retail portfolio; the enforcement of these instructions is expected to reflect positively on the ability of customers to compare various products among banks, as well as on the cost of credit and choice of the product that matches the customer's needs. The instructions requested the banks to make the ads about their financial products very clear so that they do not include promises, unclear and misleading phrases or exaggerations. The instructions stress on the clarity of credit contracts and disclosure of the applied effective interest rate (the interest rate that includes all costs related to credit). The **effective interest rate** concept is implemented for the first time in Jordan and could be used to compare the cost of credit among various banks with high accuracy.

The instructions stressed the right of the customer to obtain a copy of all documents that he signed, and requested the banks to limit excessive borrowing by small borrowers. These instructions requested the banks also to apply the retail credit ceilings in their retail credit policy with respect to the total deductions from income for any customer or sponsor for all credit facilities granted and/or approved to be granted [Debt Burden Ratio (DBR)], including credit cards ceilings, for each type of retail portfolio credit facility, with a disclosure of the calculation method.

With regards to organizing the issue of dealing with multiple credit cards, the instructions set an upper limit for the monthly interest rate of 1.75% per month, in addition to the obligation to inform the customers about their card transactions immediately, and to outline the process of object to any incorrectly executed transactions.

Regarding the commissions and fees charged by banks on retail customers, the instructions set upper caps on some of these fees and commissions that reflect the cost of banking services and protect consumers against paying exaggerated fees or fees that were not included in the credit contract.

The instructions also identified the principles of dealing with customer accounts that are marked as inactive in order to enhance the protection of the rights of the owners of these accounts, and protect banks from the risks associated with them.

In order to protect banks' customers and enhance their confidence in the banking system, and to ensure that the banks conduct their business based on sound financial and banking principles, the new instructions requested the banks to establish an independent unit assigned the task of addressing customer complaints and setting clear action plans to deal with customer complaints.

To promote competitiveness among licensed banks, besides guiding individuals in choosing the banks that meet their needs in terms of banking services and banking products, the CBJ published on its website, www.cbj.gov.jo, links to the commissions and fees that are imposed by banks on the accounts and on their banking services, in addition to interest rates on credit facilities associated with an illustrative example of interest calculation method. The CBJ is certain that the implementation of these instructions helps create a balanced relationship between the banks and their customers and ensure that the rights of all parties are protected.

Spreading Financial and Banking Literacy

Financial Literacy is considered one of the most important factors that help expand the financial inclusion and enhance the consumers' protection. In this regard, the CBJ consulted with the parties involved in the financial literacy. Besides, it set a comprehensive action plan in collaboration with INJAZ (a Jordanian non-profit entity) to establish a program to include the financial education in schools. In May 2014 the CBJ communicated with the Prime Ministry and obtained an approval by the Prime Minister to formulate two committees to prepare and implement a national plan to spread the financial knowledge in the community (Guidance and Technical committees), this is done through preparing and implementing financial education in the curriculum of the Ministry of Education in schools and other programs to expand the financial knowledge. The Guidance committee is headed by the CBJ, as is the case in most countries that started and currently implementing successful program in this regard. The committee includes as representatives members of the relevant parties, particularly the Ministry of Education, the Ministry of Planning and International Cooperation, INJAZ and the Association of Banks in Jordan. The Prime Minister approved the formation of these committees, and the project will be moving forward.

Providing the Necessary Infrastructure

Credit Information Agency

It is expected that the first private credit information company will start its business in Jordan during 2014. The company will be the first company to provide a comprehensive credit information database about the customers of banks and other financial institutions that extend credit. This is expected to help these entities rationalize the credit decision making so that a right and fair decision is made based on a precise evaluation of the customers' abilities to repay their loans. It will also help these entities price their financial products (loans) based on customers' risks. This in turn will enhance risk management effectiveness at banks and other financial institutions and improve the chances of the customers (particularly SMEs) to access potential finance. The establishment of this company is expected to positively reflect on sustaining financial inclusion and, hence, enhancing financial stability in Jordan.

Improving payment, clearance and settlement systems

The Global Financial Development report for the year 2014 issued by the World Bank revealed that mobile banking and the other advances in the banking business help extend the financial services to includes the poor, women and other groups that have limited access to financial services since these innovations help reduce the cost of financial services to facilitate the access of the poor, women and rural residents groups, in particular those living in remote low-population locations that do not have access to onsite banking and financial services, to financial services.

The CBJ initiated a process of developing and restructuring payment, clearance and settlement systems in Jordan in association with operating banks in Jordan and the other relevant partners. The process aims at maintaining the strength and efficiency of national payment system through intra-systems operations and mitigating systemic and credit risks, besides facilitating the circulation of money in the economy to enhance economic efficiency. The CBJ led this process supported by the commercial banks that are represented in the national payment council.

The vision of the national payments council's payment and settlement systems for the period 2013-2016 was designed in a way that keeps pace with the developments and enables a wider participation in the payment and clearance systems and builds a secure and efficient national payment system that supports the implementation of the monetary policy effectively and contribute in sustaining financial stability. In addition to enhancing financial inclusion in Jordan.

Realizing the importance of enhancing financial inclusion and in order to advance the national payment system in Jordan to keep pace with best international standards and best practices, the CBJ undertook the following tasks:

- Setting comprehensive retail payment systems enable moving from paper dominated payment environment to non-paper (electronic) environment in a way that attains the CBJ's goals in expanding the financial inclusion in Jordan. Both the CBJ and National Payment Council do support this move through encouraging the modern attainable payment initiatives, and exploring the possible opportunities to increase investment in advancing the electronic payment process, and facilitating and framing the use of new and creative payment tools. The CBJ works also on transferring the government payments from paper-dominated to electronic ones due to the substantial transactions in quantity and volume and because most of the beneficiaries are unbanked. This will make the improvement process more feasible and robust (Robust Reform).
- Issuing the **Mobile Payment** instructions for the year 2013 that came into force in 01/03/2014 including the mobile payment framework to help develop and enhance the national payment system to include a wider portion of the population. In this regard, it has established a new electronic payment window by use of the mobile phones in settling payments. This window helps attain efficiency and security and contributes to providing the proper environment to reduce the reliance on paper money in settling payments and helps decrease the costs and help a wider portion of customers.

Box 3: Mobile Payment Service Instructions for 2013

These instructions determine how to subscribe to the national switch, (an electronic system operated and regulated by the CBJ; in which the banks, companies and beneficiaries of service are registered for the purpose of exchanging financial transactions; and through which the net financial positions is worked out and credited, as appropriate, to the accounts of banks or settlement banks or debited to the accounts of banks or settlement banks; and all transactions effected through which are documented, can be done). It also determines how the connectivity to the service is approved, besides the method and requirements for the provision of mobile payment service by banks and companies. The instructions also set the obligations of the different parties involved in the process to enable the mobile phone users to execute their payment transactions using their mobile phones with maximum security and confidentiality.

These instructions and the **Operational Framework** aim to clarify the structure of processes, techniques and operational environment of the mobile phone payment and settlement service, besides the quality of services provided. It also aims to enable the customers to carry out some of their banking operations (mobile shopping, paying bills, cash unit payments) so that these services are instant, secure and with ceilings for every customers for a determined period.

These instructions also included consumer protection. Per these instructions, the service provider shall provide the general provisions of benefiting from the service so that these provisions are made available either in the form of booklets or published on the service provider's website. The instructions also mandated that the relationship between the service providers and customers must be built on a formal contractual agreement stipulating the conditions of benefiting from the mobile payment service, and incorporates at least the roles and responsibilities of service providers and customers and the minimum charges (fees and commissions) that are to be imposed on the customers, besides providing the customers with sufficient learning material about the service implementation process and the mechanism of dealing with customer complaints and suggestions.

The instructions also included details about monitoring and supervising the operations of the service provider, service terms and conditions, dispute resolution mechanism and customers' complaints addressing.

- Issuing **the International Bank Account Number (IBAN)** instructions No. 22/2013 dated 13/06/2013, accompanied by a guide and an action plan for using the IBAN in Jordan. These instructions came into force on operating banks in Jordan starting from 2/2/2014 in order to unify the pattern of account number amongst the operating banks in Jordan to comply with the international standards to enhance the efficiency of national payment system and help improve the payment systems in Jordan to keep pace with the updates in the international standards and improve the efficiency, speed, precision and quality of operations and facilitate the automation of domestic and international transfers in a way that benefits the operating banks in Jordan and their customers.

Box 4: The International Banking Account No. 22/2013 Dated 13/6/2013

The International Banking Account Number (IBAN) was designed by the International Standardization Organization. It is based on international standards in accordance with ISO 13161. The IBAN number includes enough space for entries that cope with any bank account number in Jordan, which in turn help simplify settling banking transfers and passing them through the electronic systems, besides improving the fast automatic depositing of the transfers. In this respect, the beneficiary's account number is precisely identified, known and quickly located. Consequently, this will enable the transferring bank to validate the beneficiary's account number to avoid returning the transfers with incorrect account numbers that needs substantial time and effort to amend. The most important benefits from using the IBAN are:

- Helps implement direct automatic execution of transfers, which in turn cuts down the manual work to execute them.
- Includes all the information required to facilitate the transfer execution for local and international transfers.
- Avoids the mistakes stemming from the income account number.
- Simplifies the execution of financial transfers for the customers through all banking channels available to them.
- Decreases cost and improves the operational efficiency in processing financial transfers.

Announcing a system to view and pay bills electronically called (eFAWATEERcom) as an efficient and comprehensive central system to help view and settle bills and other payments electronically for individuals and corporates, regardless of whether they have bank accounts or not, and the providers of payment services, banks and issuers of bills. The National Payment Council in its decision No 6/2013 dated 13/12/2013 enforced the mandatory connection of operating banks in Jordan with eFAWATEERcom, and determined the connectivity and release of service deadline to be 22/06/2014 as was agreed in the Council's meeting.

Box 5: Regulatory Framework for eFAWATEERcom System

The eFAWATEERcom system is one of the retail payment systems. It is a centralized system for viewing and collecting bills and other payments electronically that combines government institutions (billers) on the one hand, and banks and payment service providers on the other hand, to get to customer service (consumers) and promote financial inclusion. This system aims at facilitating and accelerating the process of viewing and collecting invoices and other payments across all banking channels in Jordan (bank branches, ATMs, phone banking, Internet banking, and payment through a mobile phone, and payment kiosks, etc.). eFAWATEERcom system surpasses the services provided by existing systems as it provides a mechanism for viewing and collecting bills for various entities in the public and private sector (insurance, health, education, tourism, technology and communications, public services, and government payments, etc.) in addition to e-commerce.

When it established this system, the CBJ aimed at bridging the gaps in bill payment services that are offered by some banks and payment service providers; mainly the absence of integrated central linkage with the bill issuers, all banks and payment service providers. This system came to provide easy technical solutions for all parties through shortcutting multiple links to one link. The eFAWATEERcom system works as a mediator between the parties involved and provides a mechanism to view the bills, inquire about them, pay them and report the direct payment.

The system came as a response to the need for financial regulations and distribute costs and benefits. At the same time, the system encourages the users to switch to electronic payment channels that contain a broader list of due financial payments.

In order to achieve the goals envisaged from eFAWATEERcom system. The CBJ undertakes the responsibility of supervising and controlling the system, and setting its regulatory framework. In this regard, a regulatory framework was already set. It encompasses the necessary arrangements for the viewing and collection of bills electronically and determines the responsibilities of the parties involved to enable them to carry out viewing and billing processes electronically with highest levels of safety, efficiency and reliability.

Improving the Access to Finance, especially by SMEs

In the context of its commitment to support the SMEs as an important player in enhancing economic growth, increasing employment and fighting poverty, and in order to enable them to get access to the necessary medium and long-term finance needed for the continuity of their businesses with low interest cost, the CBJ undertook the necessary measures in collaboration with the Ministry of Planning and International Cooperation and regional and international finance corporations to attract financing to SMEs and guarantee the loan extended to them (SMEs). These actions include:

1. Signing a loan agreement with the World Bank of US$ 70.0 million. The loan money were allocated to twelve commercial banks (including two Islamic banks) that were engaged in an agreement to reuse the loan money to extend credit to SMEs with competitive interest rates and for medium and long-term maturities. It is worth mentioning in this regard that the outcome of the loan utilization in the first quarter of 2014 was highly positive and surpassed all targets. The utilization rate approximated 74.0% of the total loan amount allocated to banks. A total of 4,112 customers benefited from the loans with 63.0% are located outside Amman (the Capital of Jordan). Regarding the allocation of credit by beneficiary groups, the credit extended to the SMEs owned by women formed 58.0% of total credit extended, whereas the SMEs owned by youth (less than 35 years) formed approximately 45.0%.
2. Signing a loan agreement with Arabic Fund for Economic and Social Development of US$ 50.0 million to be used for extending credit to SMEs.
3. Negotiating with the European Bank for Reconstruction and Development (EBRD) to extend credit directly to banks in an amount of US$ 100.0 million to be used for extending credit to SMEs and providing technical assistance in this context, in addition to loan guarantees.
4. Promoting the already-activated CBJ's special program that is oriented towards industrial, tourism and renewable energy sectors, and aims at providing medium-term credit to these sectors, including SMEs, at a reasonable cost. The number of loans granted to these sectors were 87 loans in mid-July 2014; approximating JD 92.0 million, and allocated to industrial, tourism and renewable energy sectors in the amounts of JD 64.0 million , JD 12.0 million and JD 16.0 million respectively.

Moreover, the CBJ made a strategic decision to expand its supervisory umbrella to encompass microfinance sector in order to enhance the chances of small and mini size companies of obtaining the necessary financing and, hence, sustaining financial inclusion. A suggestion was put forward to prepare a bylaw to legalize supervisory role of the CBJ over this sector. The bylaw gives the CBJ the authority to determine the access requirements to this sector, besides determining the other supervisory requirements. The bylaw was sent to the Prime Ministry to complete the constitutional requirements to be issued.

It is worth mentioning that the activity of the microfinance aims at providing financing and financial activities and services for low income individuals and individuals who are unable to access the financial services from the banking sector partially or completely whether they are individuals or micro or mini companies for developmental goals or in order to improve their economic situation in

compliance with the measures set by the CBJ in the instructions are targeted be to be issued in the future.

Regarding providing the necessary collateral to finance small and medium size firms, the Jordan Loan Guarantee Corporation has been restructured recently and its operations and functions were enhanced and expanded so that the corporation could provide the necessary guarantees to finance small and medium size firms through a set of agreements related to special credit programs that were developed in collaboration with licensed banks and financial leasing companies. The International Financial Corporation (IFC) provided technical assistance to advance the work of the corporation. The corporation is negotiating a loan guarantee arrangements with the EBRD.

Amending the Central Bank of Jordan's Law and Banks' Laws

Central Bank of Jordan's Law

In light of its pursuit to do a comprehensive review of the Central Bank of Jordan's Law of 1971 to keep pace with the latest developments and best international practices and cases regarding the role of the central banks in attaining monetary stability and financial stability in its broad definition. To enhance the independence of the CBJ in implementing its tasks and attaining its goals, the CBJ formed a committee in 2013 to review the Central Bank of Jordan's Law and recommend the required amendments. The committee is expected to finalize its work by the end of 2014.

Bank's Law

Regarding Bank's Law, the CBJ formed a committee to review the Banks' law and suggest the necessary amendments to keep pace with the latest developments and best international practices and experiments regarding banking supervision. The committee is expected to finalize its work by the end of 2014 as well.

Announcing the ban of Bitcoin

The CBJ issued its memo No 1/1/5/2451 dated 20/2/2014 to the licensed banks, financial institutions, exchange companies and payment cards companies announcing the illegality of dealing with bitcoin in any way. Bitcoin is a hypothetical illegal currency as there are no obligations on any central bank or government in the world to exchange the value of this currency with currency issued by any of these governments, or in exchange for any international tradable good or gold. Dealing with this currency is highly risky because of the very high volatility of its value, besides financial crimes, electronic hacking and the large possibility for this coin to lose its value in the absence of any guarantee from any legal entity to cover its value, besides unavailability of matching assets.

Memo Concerning the Reliability Examination of the Business Continuity Plan

The CBJ issued its memo No. 10/1/10740 dated 28/8/2013 to the licensed banks regarding assigning their external auditors to examine the reliability of the business continuity plan and provide the CBJ with the examination results and the recommendations and measures needed to comply with the agreed on recommendations regarding the automatic check clearance. The test must include information technology and communications, encompassing communication networks, the host computers, database, backup, retrieval, applications, operating programs and the alternative operating locations. In addition to testing the suitability of the plan in terms of organization, decision making procedures, assembly points, human resources, logistics and service providers along the life cycle of the plan (planning, testing and continuous update).

Chapter Three: Financial Sector Developments

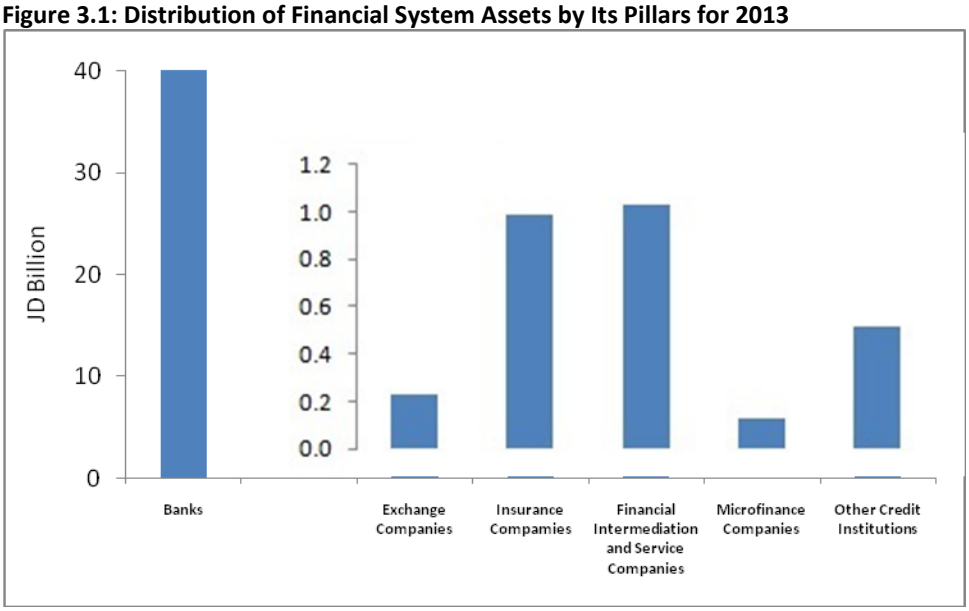
Introduction

The financial system in Jordan encompasses banks, insurance companies, financial intermediation and service companies, exchange companies, microfinance companies, specialized credit institutions and other credit institutions.

The CBJ undertakes the responsibility of monitoring and supervising the banking sector. Whereas the Ministry of Industry and Trade and Amman Stock Exchange are responsible for monitoring and supervising insurance companies and financial intermediation companies respectively. Regarding microfinance companies, there is no agency responsible for supervising and monitoring its works. However, the CBJ is expected to take this role in the future as it prepared a bylaw for microfinance companies and sent it to the Prime Ministry in early June 2014 to proceed with the required constitutional procedures to put it into force. Similarly, there is no agency responsible for supervising and monitoring the works of the other credit institutions. However, the Ministry of Industry and Trade is responsible for registering these institutions.

The assets of the financial system reached JD 45.1 billion at the end of 2013, of which the assets of licensed banks formed 93.9%. This clearly makes the licensed banks the major components of the financial system (Figure 3.1).

Figure 3.1: Distribution of Financial System Assets by Its Pillars for 2013



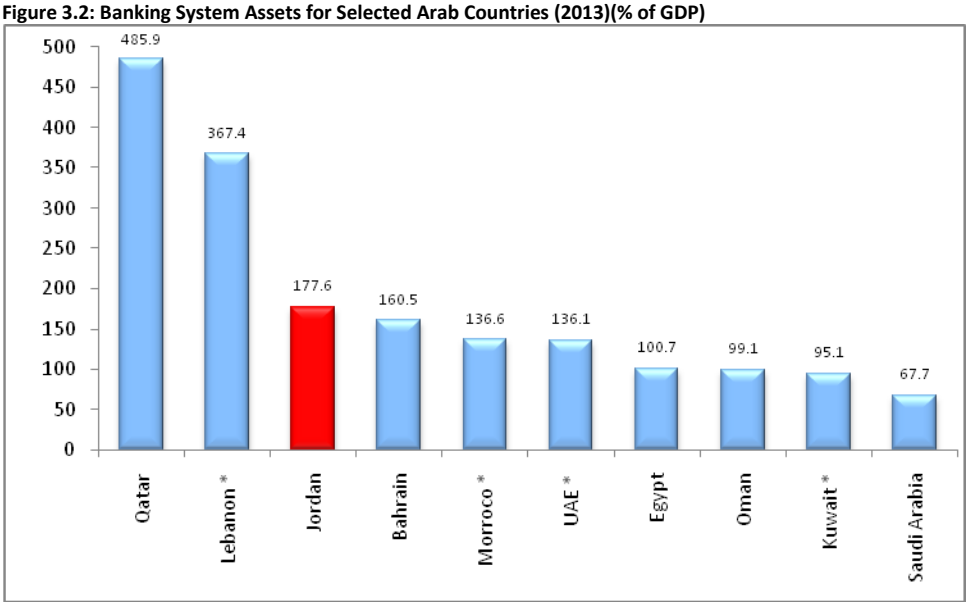
Source: Data for Banks, Exchange companies and Other Credit Institutions is From CBJ. Remaining Data is From Their Concerned Authority.

First: The Most Important Developments in the Banking System

Jordan's Braches Level

Compared to the other countries in the region, the relative size of the banking system in Jordan to the size of the economy is considered large. The licensed banks' assets reached JD 42.4 billion at the end of 2013, forming 178.0% of GDP compared to 177.0% at the end of 2012 – the third highest ratio amongst selected Arab countries after Lebanon and Qatar (Figure 3.2).

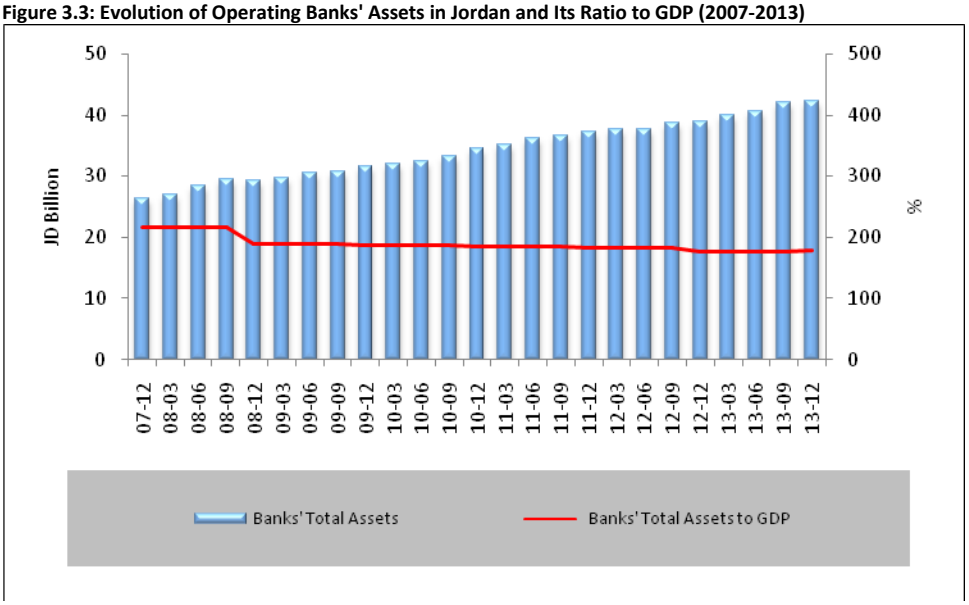
Figure 3.2: Banking System Assets for Selected Arab Countries (2013)(% of GDP)



* Data goes back to 2012

Despite this high ratio in Jordan, it followed a declining trend during the last seven years. It reached 217.2% at the end of 2007 and decreased to 178.0% at the end of 2013. The reason for this trend is attributed to the higher growth rate of GDP than the growth of banks' assets (Figure 3.3).

Figure 3.3: Evolution of Operating Banks' Assets in Jordan and Its Ratio to GDP (2007-2013)

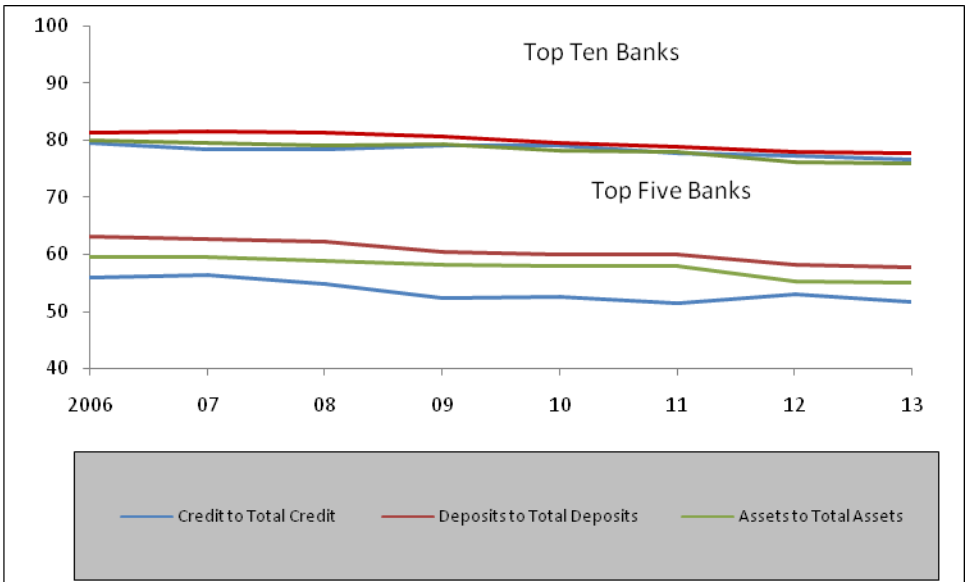


Source: Central Bank of Jordan

Regarding the market share of banks (concentration), the assets of the largest five banks out of 26 banks approximated 55.0% of total assets of the licensed banks at the end of 2013. Whereas the assets of the largest ten banks out of 26 banks approximated 75.9% of total assets of the licensed

banks at the end of 2013. It is worth mentioning that the market share of the largest five and ten banks is witnessing a continuous decline, as they reached 59.6% and 79.9% respectively in 2006. Therefore the concentration ratios of the licensed banks are following a downward trend (Figure 3.4), although the concentration level of the banking sector remains high in Jordan.

Figure 3.4: Concentration Ratio for Banking Sector in Jordan for Top Five and Top Ten Banks (2006-2013)(%)

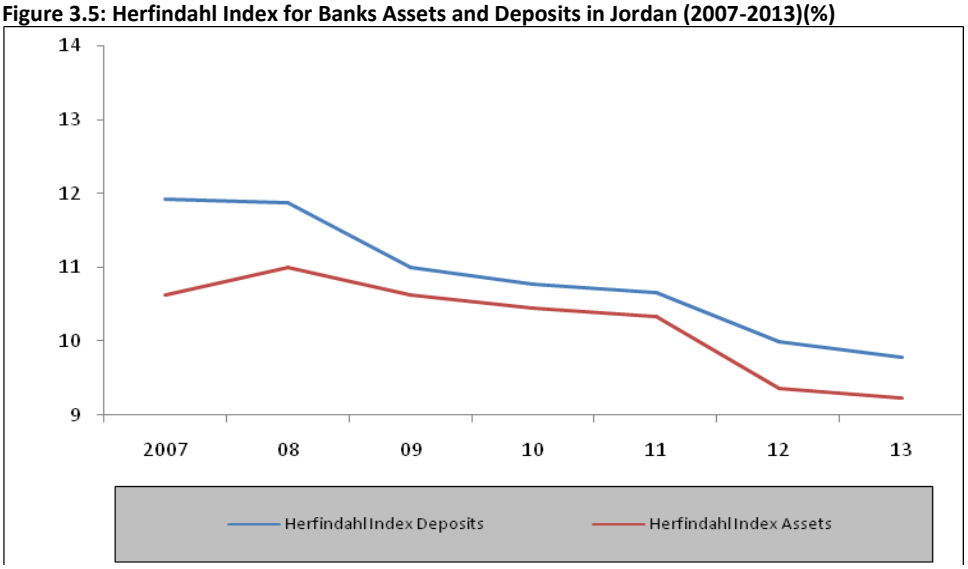


Source: Central Bank of Jordan

Regarding competitiveness and based on Herfindahl Index (HHI), there was an improvement in the competitive stance of the banking sector in Jordan. The value of HHI reached 11.9% at the end of 2007 and declined to 9.8% at the end of 2013, lower than its level at the end of 2012 of 10.0%. This suggests that the competitiveness of the banking sector is continually improving.

The reason for the improvement in this competitiveness indicator is the licensing of three new banks during 2009, besides the improvements and developments in banks' products to increase their competitive capabilities. It is worth mentioning that the decline in the concentration ratios and the increase in the competitiveness in the banking sector in Jordan have a positive impact on the financial stability in Jordan (Figure 3.5).

Figure 3.5: Herfindahl Index for Banks Assets and Deposits in Jordan (2007-2013)(%)



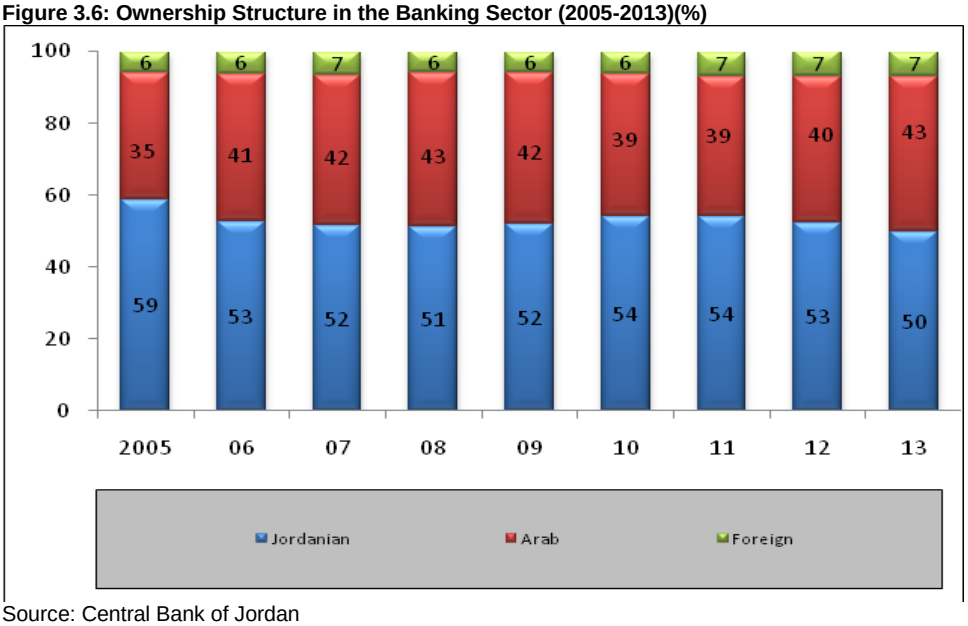
Source: Central Bank of Jordan

Ownership Structure in Banks

The capital share of foreigners in the total capital of licensed banks approximated 50.0% at the end of 2013. This foreigners' ownerships share is considered one of the highest in the MENA region due to the absence of any kind of restrictions on these ownerships. It is worth mentioning that this share declined in 2010 and 2011.

However, the share returned to rise in 2012 and continued to do so in 2013, reflecting the increased confidence of investors in the banking system in particular, and the Jordanian economy in general. Given that most of these properties are stable strategic contributions (Figure 3.6).

Figure 3.6: Ownership Structure in the Banking Sector (2005-2013)(%)



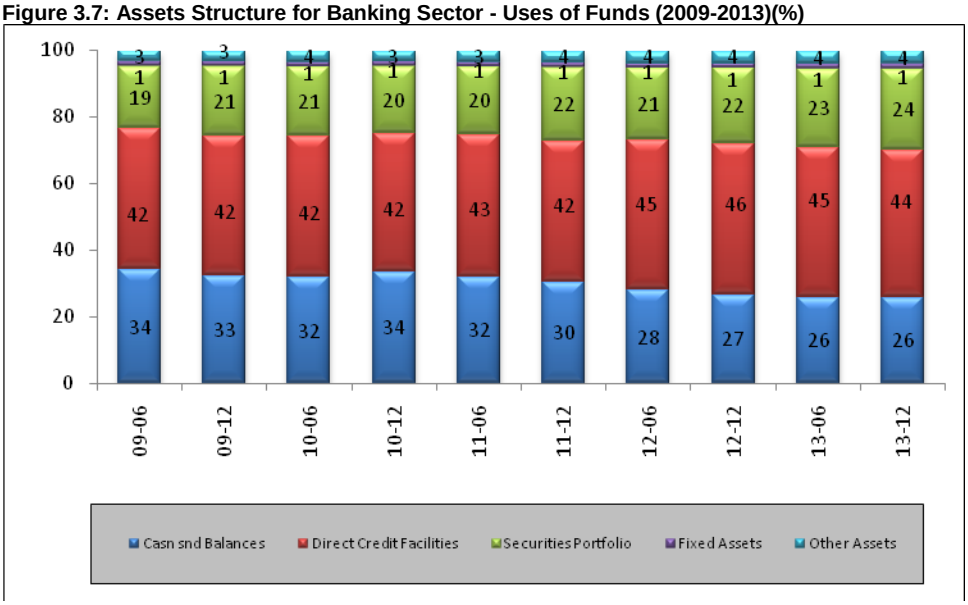
Source: Central Bank of Jordan

Use of Funds (Assets)

Reviewing the structure of the assets of operating banks in Jordan (uses of funds) revealed that the credit facilities portfolio is still the largest component of the banks' assets which composed about 44.5% of banks' total assets at the end of 2013, in spite of its decline from the 2012 number, where it represented 45.6% of banks' assets.

This decline in the relative importance of credit facilities is due to the expansion of government borrowing from banks through the issuance of government bonds and the willingness of the banks to invest in these bonds, as they provide a reasonable return with low risk. It is worth mentioning that the year 2014 witnessed a significant decline in the government competition with the private sector on domestic liquidity due to the improved economic conditions and the government tendency to borrow from external markets through the issuance of US dollar denominated bonds that are guaranteed by the US government in order to reduce the cost of borrowing and reduce crowding out of the private sector, which will reflect positively on economic growth in Jordan (Figure 3.7).

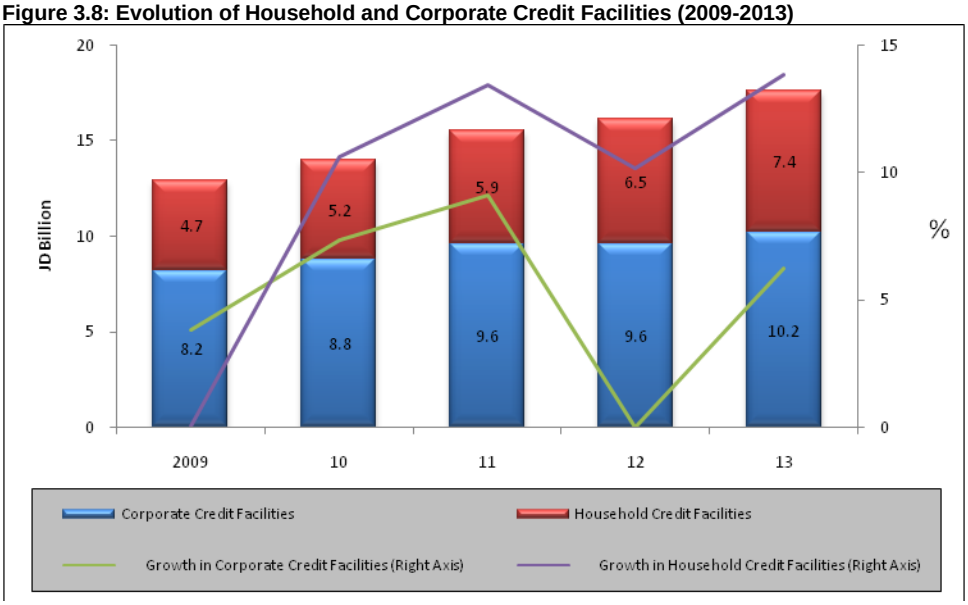
Figure 3.7: Assets Structure for Banking Sector - Uses of Funds (2009-2013)(%)



Source: Central Bank of Jordan

Although the credit facilities extended to companies are still the largest component of credit facilities that accounted for 44.8% of the total banks' credit facilities, this share has started to decline since 2009, when it was 61.4% at the end of 2009, and declined to 44.8% at the end of 2013. Regarding the credit facilities granted to households (individuals and real estate), they accounted for 38.4% of the total facilities at the end of 2013, compared to 36.8% at the end of 2012. It is worth mentioning that the growth rate of the household credit facilities (individuals and real estate) approximated 13.8% in 2013, while the growth rate of corporate facilities amounted to 6.3%. This means that there is a tendency in the banking sector to increase lending to households (Figure 3.8). The developments of debt of household in Jordan will be discussed later in this chapter in detail.

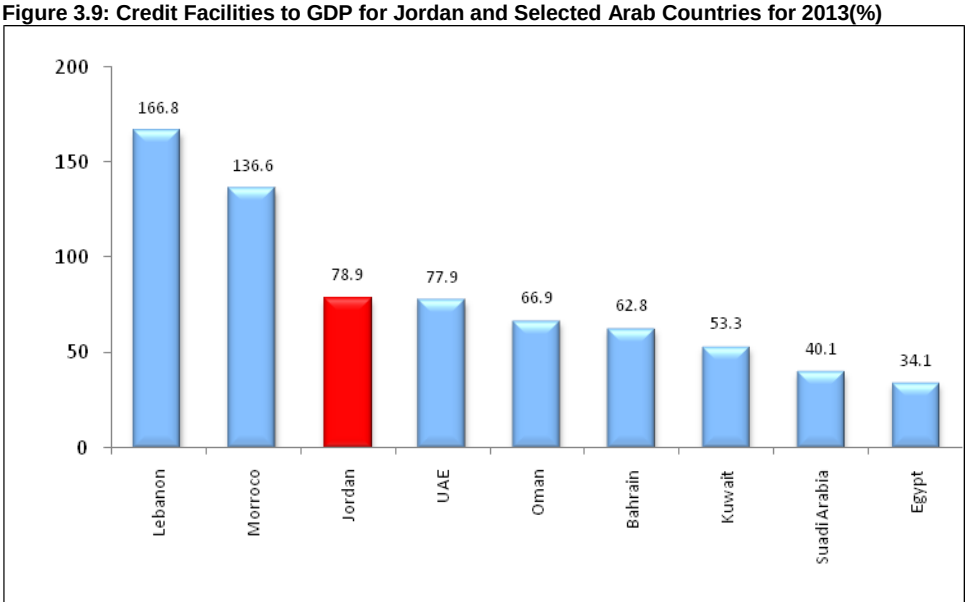
Figure 3.8: Evolution of Household and Corporate Credit Facilities (2009-2013)



Source: Central Bank of Jordan

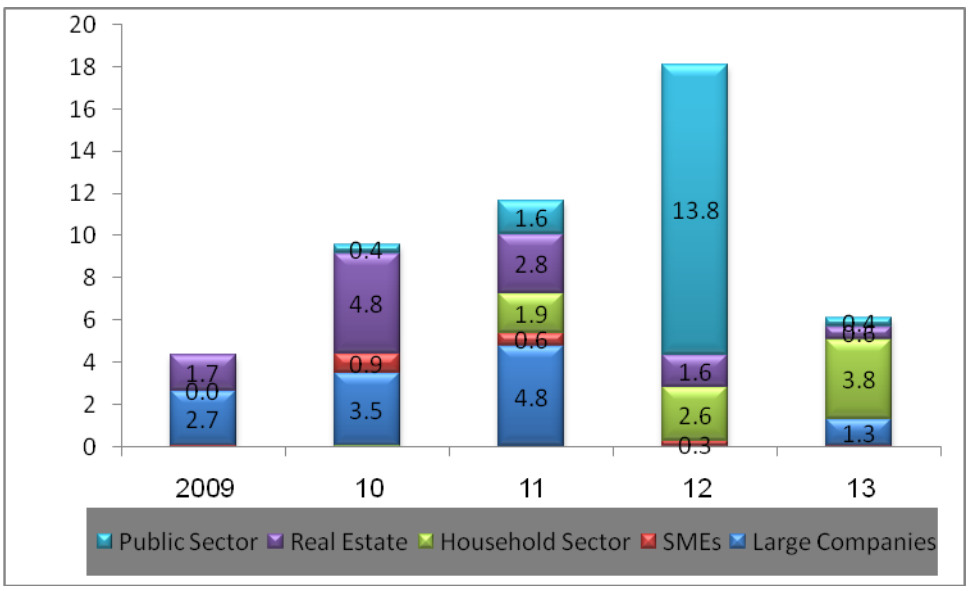
Credit facilities grew by 6.3% at the end of 2013to reach JD 18.8 billion. Given that the growth rate in 2012 was 12.6%. It is worth mentioning that the ratio of credit facilities to GDP approximated 78.9% at the end of 2013 compared to 80.6% at the end of 2012. Despite the decline in this ratio in 2013, it is still considered high compared with several selected countries in the MENA region, where Jordan ranked the third highest after Lebanon and Morocco (Figure 3.9).

Figure 3.9: Credit Facilities to GDP for Jordan and Selected Arab Countries for 2013(%)



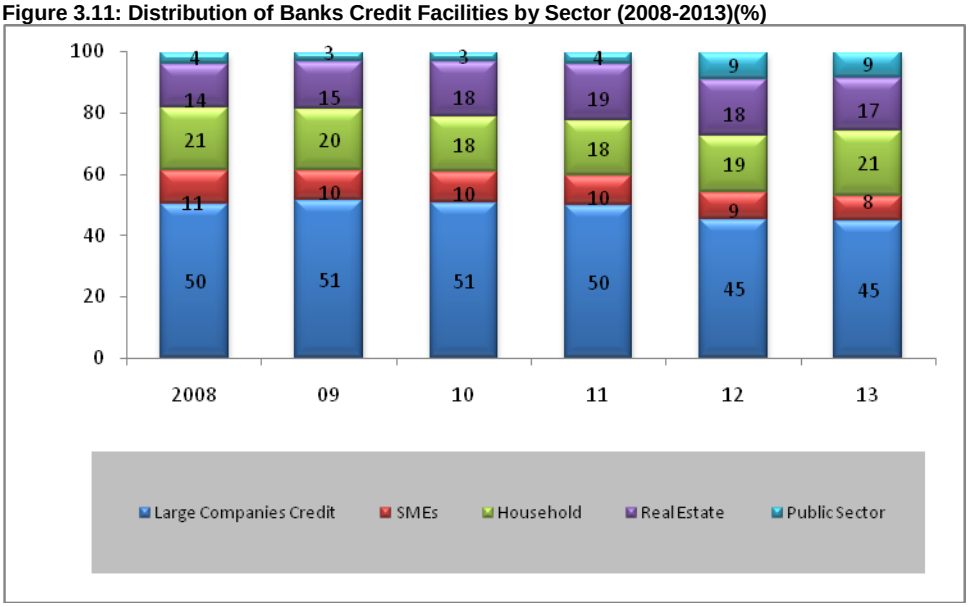
Source: Countries' Central Banks.

Regarding the growth of credit facilities of the banking sector, it stemmed mostly from the growth of the credit extended to households, which contributed to about 3.8 percentage points, followed by the corporate sector, which contributed to about 1.2 percentage points of this growth. It is worth noting that the growth in credit facilities extended to the Jordan Petroleum Refinery Company and the National Electric Power Company (NEPCO) contributed about 0.17 percentage points only to the growth in credit facilities in 2013, contrary to 2012; where most of the growth in the facilities was originated from the credit extended to Jordan Petroleum Refinery Company and NEPCO, in addition to the government sector (Figure 3.10).



With regards to the distribution of credit facilities, as mentioned earlier, credit facilities extended to the large companies still account for the largest percentage of the total facilities, but took a downward trend since 2010 when it was 50.7% and decreased to reach 44.8% at the end of 2013. Whereas the facilities extended to the government and the public sector increased from 4.1 % in 2008 to 8.5% in 2013. Concerning the credit facilities extended to the SMEs, they are still modest, and its contribution ranged between 8.2% and 10.9% during the years 2008 to 2013. Regarding household debt (including individuals and real estate) it composed about 38.4% of total credit facilities at the end of 2013 compared to 36.8% at the end of 2012 (Figure 3.11).

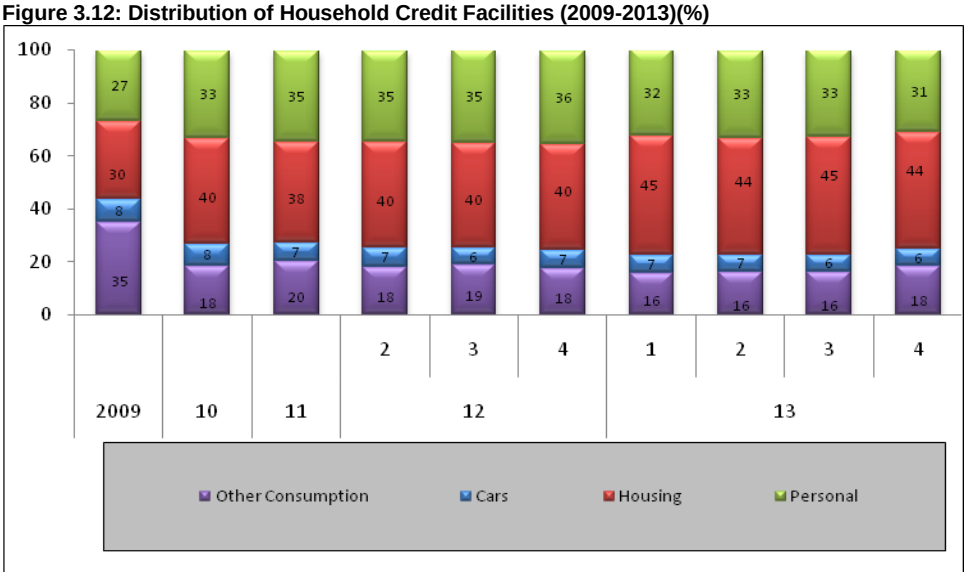
Figure 3.11: Distribution of Banks Credit Facilities by Sector (2008-2013)(%)



Source: Central Bank of Jordan

With regard to credit extended to household sector, the largest share of the credit was in the form of household mortgage loans, which formed 44.1% of household debt at the end of 2013 compared to 39.9% at the end of 2012. The second largest share was for the personal advances that formed 31.0% of total household debt, compared to 35.6% at the end of 2012. Auto loans accounted for 6.5% at the end of 2013, compared to 6.9% at the end of 2012 (Figure 3.12).

Figure 3.12: Distribution of Household Credit Facilities (2009-2013)(%)

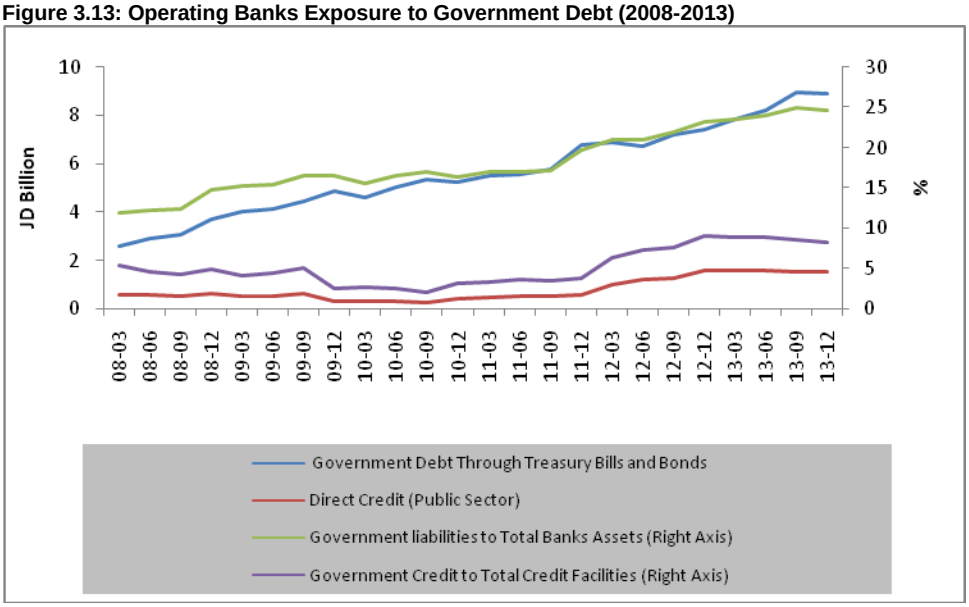


Source: Central Bank of Jordan

Concerning banks' exposure to government debt, through investing in government bonds or lending some public institutions with government guarantee, it is realized that there is a rise in the government debt to banks through bonds and direct credit facilities, that reached about JD 10,447 million at the end of 2013 accounting for 24.7% of the total banks' assets, compared to JD million 9,009 at the end of 2012, representing about 23.2% of the banks' total assets. It is worth mentioning that the amount for the year 2013 consists of JD 8,903 million in the form of government bonds and JD 1,543 million in the form of facilities granted mostly to NEPCO and guaranteed by the government.

The banks' exposure to government or government guaranteed debt as a percentage of bank assets rose from 11.8% at the end of 2008 to 24.7% at the end of 2013, due to the increased government demand for funding from banks to bridge its financing gap as a result of the difficult economic conditions that Jordan experienced, especially during the year 2012, which in turn led to the government crowding out of the private sector. As previously mentioned this competition has witnessed a big decline during 2013 (Figure 3.13).

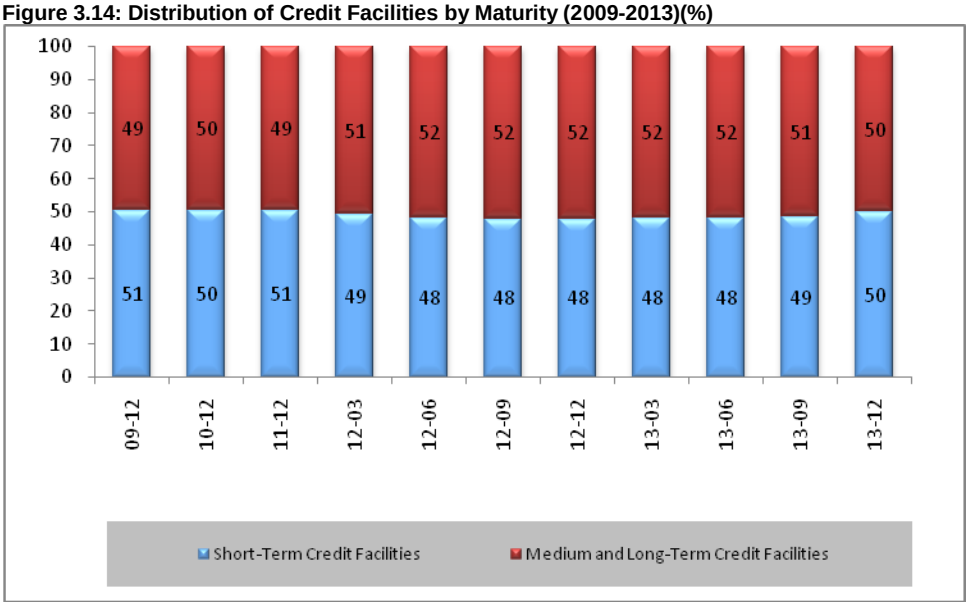
Figure 3.13: Operating Banks Exposure to Government Debt (2008-2013)



Source: Central Bank of Jordan

Regarding classification of the facilities by maturity, the short-term credit facilities (facilities that mature within one year) increased from 48.6% at the end of 2012 to reach 50.0% of total credit facilities at the end of 2013 and thus equated the share of medium and long-term credit facilities (credit facilities with a maturity of one year or more). The high proportion of short-term credit facilities increases the matching with the maturities of deposits, thereby reducing the liquidity risk for banks (Figure 3.14).

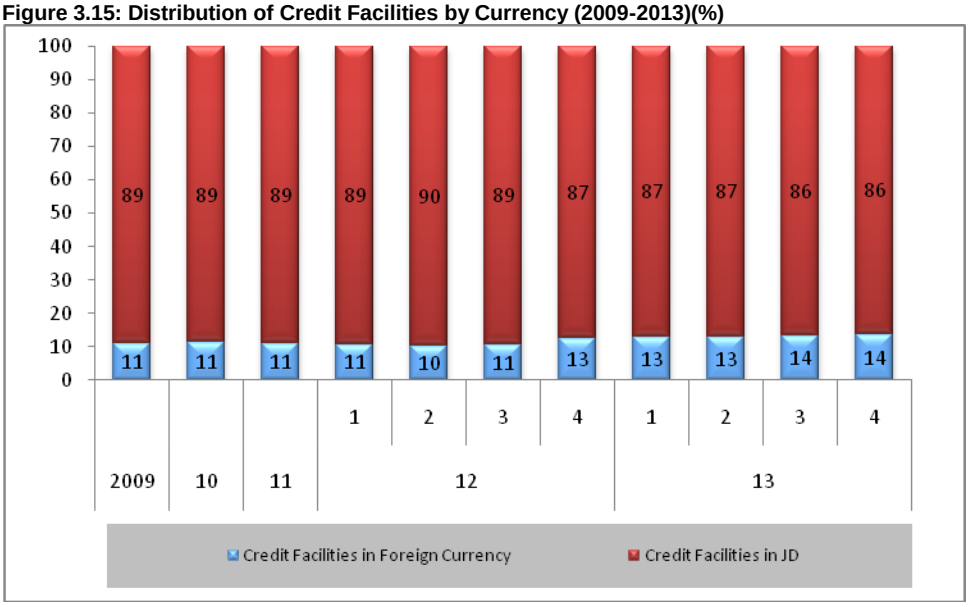
Figure 3.14: Distribution of Credit Facilities by Maturity (2009-2013)(%)



Source: Central Bank of Jordan

Regarding the classification of the facilities by currency, the facilities denominated in Jordanian dinars are the major component of the credit facilities, composing approximately 86.2% of total credit facilities at the end of 2013, recording a slight decline from the proportion attained at the end of 2012 of 87.4%. It is worth mentioning that the low proportion of facilities denominated in foreign currency is mainly due to the restrictions imposed by the CBJ on the facilities extended in foreign currency, which *must be* extended *only* to the sectors that raise income in foreign currency (Figure 3.15).

Figure 3.15: Distribution of Credit Facilities by Currency (2009-2013)(%)

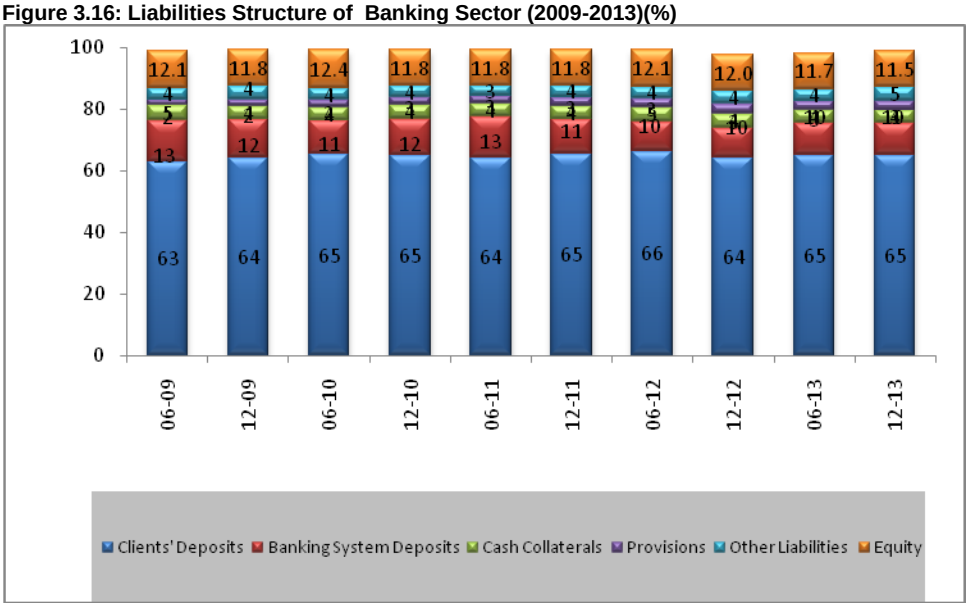


Source: Central Bank of Jordan

Sources of Funds (Liabilities)

Analyzing the sources of funds in the banking sector reveals that deposits represent the major source of funding, forming about 65.2% of total sources of funds at the end of 2013. Given that this proportion was relatively stable during the past few years, which reveals the stability of the funding sources for the operating banks in Jordan, in general (Figure 3.16).

Figure 3.16: Liabilities Structure of Banking Sector (2009-2013)(%)

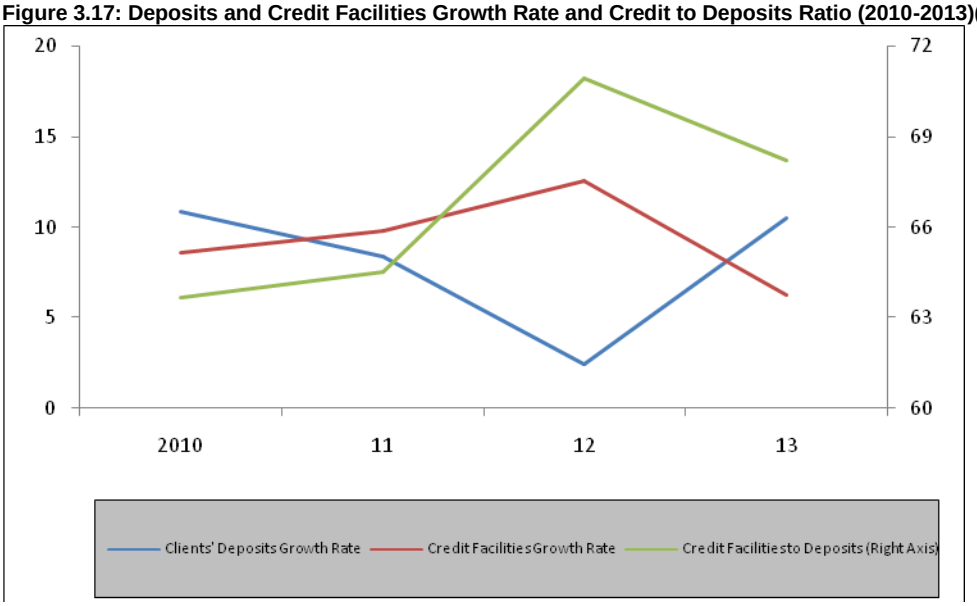


Source: Central Bank of Jordan

Regarding the evolution of deposits in the banking system, the customers' deposits increased by 10.5% at the end of 2013 to reach about JD27.6 billion, surpassing the growth in credit facilities at the end of 2013, which amounted to 6.3% nearly. It is worth mentioning that the situation in 2013 was contrary to that in 2012, where the growth rate of deposits was less than the growth of the credit facilities, implying that the volume of available liquidity to banks in 2013 was relatively high compared to 2012, which is due to the significantly higher growth of deposits than the growth of credit facilities, especially after the decline of facilities extended to NEPCO, which contributed significantly to the growth of credit facilities in 2012. Regarding the second source of funds, shareholders' equity, it has increased from JD 3.0 billion at the end of 2007 to reach JD billion 4.9 at the end of 2013. Comparing shareholders' equity of licensed banks between 2012 and 2013, it has attained a growth rate of 4.0%.

The third source of funds in terms of importance is banks' deposits, which have taken an upward trend since June 2012 to reach 10.2% of the total sources of funds for banks at the end of 2013. Moreover, the ratio of credit facilities to deposits at the Jordanian banks rose from 65.0% at the end of 2009 to 68.2% at the end of 2013. However, it decreased in comparison with its value in 2012 that approximated 70.9%. This gives a positive indication on the improvement in the liquidity position of licensed banks in Jordan (Figure 3.17). It is worth mentioning that the ratio of credit facilities to deposits continued its downward trend during 2014, reaching 65.0% at the end May 2014.

Figure 3.17: Deposits and Credit Facilities Growth Rate and Credit to Deposits Ratio (2010-2013)(%)



Source: Central Bank of Jordan

Compared with selected Arab countries, Jordan is the fourth highest country among ten Arab countries in terms of the ratio of deposits to GDP in 2013. It succeeded Qatar, Lebanon and Bahrain. This confirms the fact of the big size of the banking system in Jordan relative to the size of the Jordanian economy.

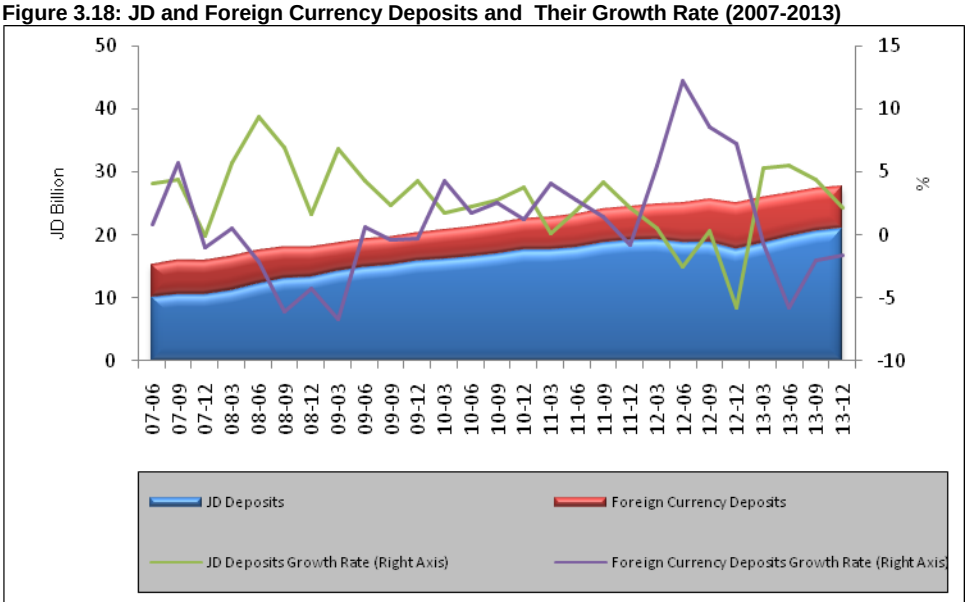
Table 3.1: Selected Financial Indicators for Jordan and Selected Arab Countries for 2013*

	Assets	Deposits	Credit	Credit-to-Deposit (%)
Qatar	485.9	290.1	306.6	105.4
Lebanon*	367.4	258.3	167.0	64.6
Bahrain	160.5	130.8	62.8	48.0
Jordan	177.6	115.7	78.9	68.2
Morocco*	136.6	110.7	136.6	NA
Emirates*	136.1	88.6	78.0	87.8
Egypt	100.7	73.8	34.1	46.3
Kuwait*	95.1	69.1	53.0	77.1
Oman	99.1	66.4	66.9	100.6
Saudi Arabia	67.7	50.2	40.1	79.9

Source: Relevant Central Banks, except Morocco, whose numbers were obtained from IMF for 2012. *2012 Data.

Regarding the structure of deposits in terms of currency, the JD-denominated deposits occupied the largest share of deposits. It reached 76.0% at the end of 2013. Analyzing the changes in the share of JD-denominated deposits to total deposits reveals that this share witnessed an evident increase in March 2007 which approximated 66.0% and reached 78.0% at the of 2011. However, the share returned to its declining trend and reached its minimum of 71.0% at the end of 2012 due the tough economic conditions that Jordan faced in 2012. However, following the improvement in the economic situation and conditions as shown by most economic and monetary indicators, the share of JD-denominated deposits returned to the upward trend to reach 76.0% of total deposits, which reflects positively on enhancing the confidence in the Jordanian dinar as a saving currency and enhances financial and monetary stability in Jordan. It is worth mentioning that this share continued its upward trend during 2014 and reached 78.0% of total deposits at the end of May 2014 (Figure 3.18).

Figure 3.18: JD and Foreign Currency Deposits and Their Growth Rate (2007-2013)

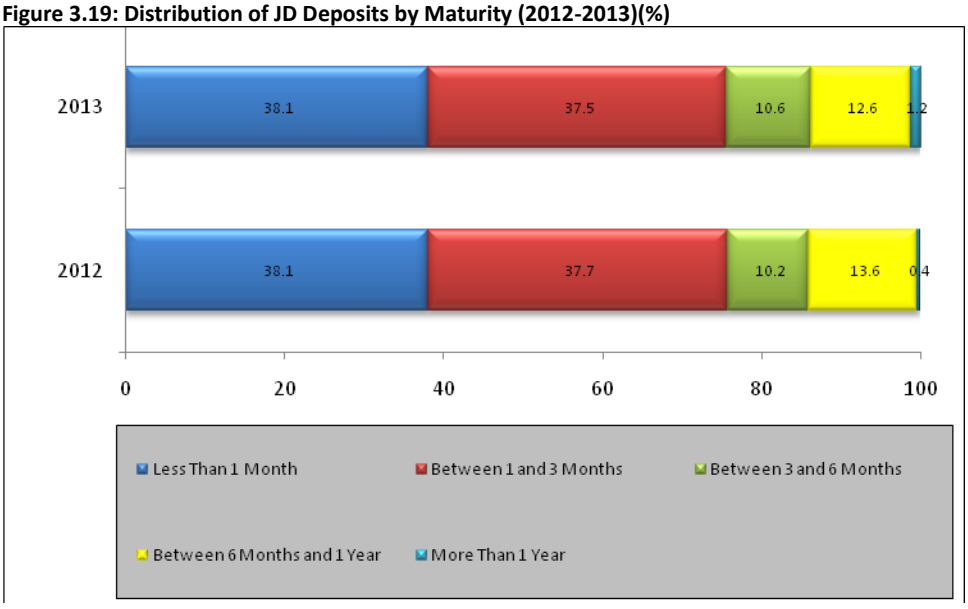


Source: Central Bank of Jordan

Regarding the maturities of JD-denominated deposits, about 75.6% of these deposits are deposited for three months or less as of the end of 2013, very close to its percentage at the end of 2012.The deposits for periods of three months to less than six months increased from 10.2% to 10.6%, whereas the deposits maturing in six months to less than a year decreased from 13.6% to 12.6% (Figure 3.19).

In general, about 98.8% of deposits mature in less than one year, where 50.0% of credit facilities are medium and long term (for a maturity of a year or more). This entails on the banks to improve their assets and liabilities management to mitigate the mismatch risks. It is worth mentioning that the CBJ monitors such risks through the **Liquidity by Maturity** instructions. It is expected that the implementation of BASEL III Guidelines will have a positive impact on liquidity management by banks.

Figure 3.19: Distribution of JD Deposits by Maturity (2012-2013)(%)

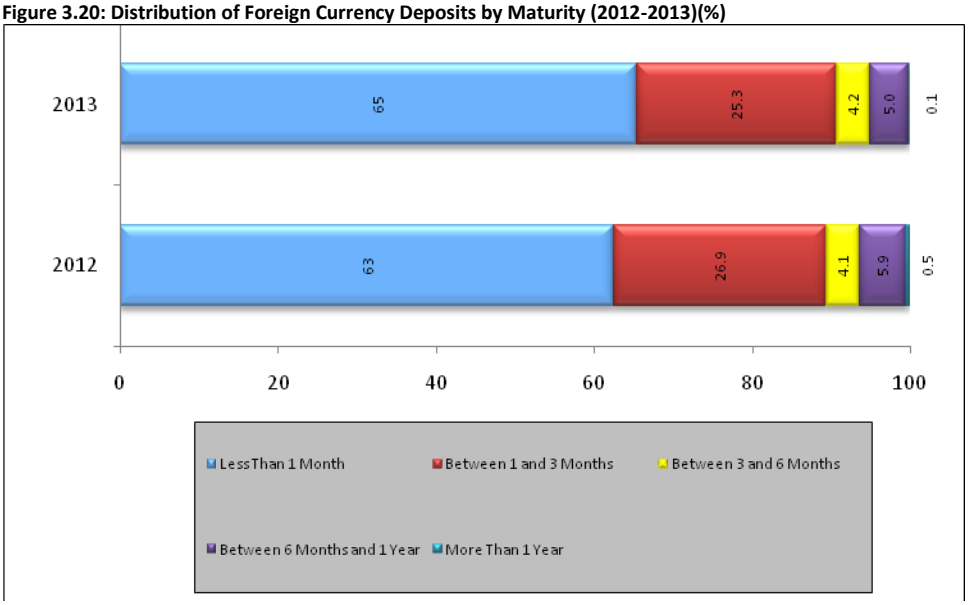


Source: Central Bank of Jordan

Sources of Funds (Liabilities) in Foreign Currency

Regarding the maturity of foreign currency deposits, about 65.4% of them are for less than a month as the end of 2013 compared to 62.5% at the end of 2012, which gives an indication that most of the customers' foreign currency deposits at banks are unstable (Figure 3.20).

Figure 3.20: Distribution of Foreign Currency Deposits by Maturity (2012-2013)(%)

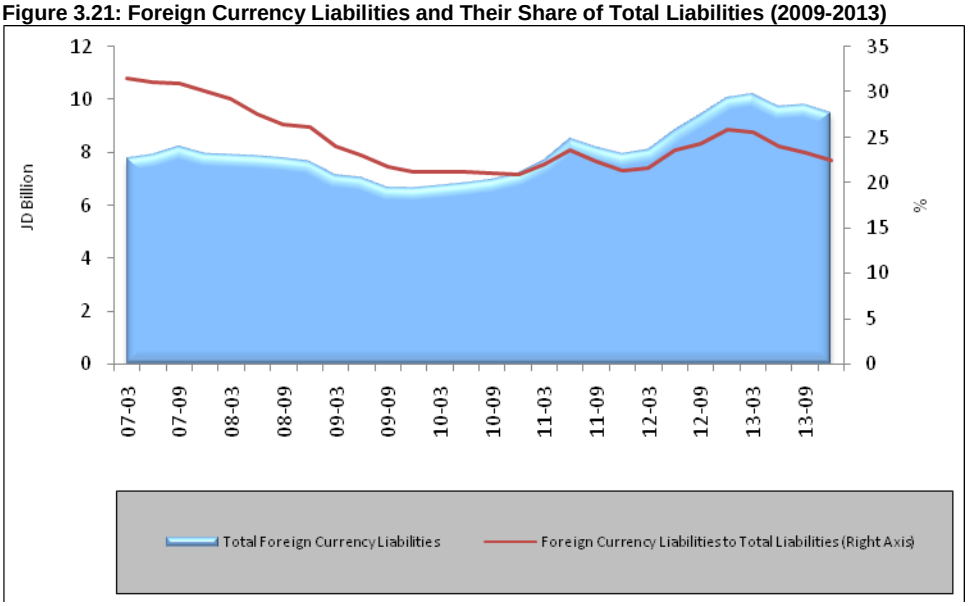


Source: Central Bank of Jordan

Concerning the balance of liabilities in foreign currency at the banking system, it stood at JD 9.5 billion at the end of 2013, accounting for 22.4% of the total liabilities of the banking system. It is worth mentioning that the ratio of total liabilities in foreign currency to total liabilities followed a downward trend during the period 2007-2010 impacted by the repercussions of the global financial crisis and the accompanied significant decline in interest rates on foreign currencies. After that, it followed an increasing trend, especially during the year 2012.And then returned back to a declining trend in 2013.

The reason for the increase in foreign currency deposits during 2012 is due to the significant surge in the foreign currency deposits during this year at the expense of deposits in Jordanian dinar because of the economic hardship that Jordan passed in 2012. However, as a result of the CBJ's policy decision of raising the interest rate on the JD-denominated instruments and makes available the foreign currency freely with no restriction, in addition to floating oil prices and the improvement in most economic indicators at the end of 2012. The foreign currency deposits declined in 2013, which led to the decline in the share of foreign currency-denominated deposits. In light of this improvement in the economic and monetary indicators, the CBJ cut interest rates four times starting from August 2013 by 25 basis points for the first three cuts and by 50 basis points in the fourth cut in a goal to stimulate economic growth in Jordan. The decline in foreign currency deposits decreased the banks' exposure to exchange rate risk, which consequently reflects positively on financial and monetary stability in Jordan (Figure 3.21).

Figure 3.21: Foreign Currency Liabilities and Their Share of Total Liabilities (2009-2013)



Source: Central Bank of Jordan

Consolidated Level

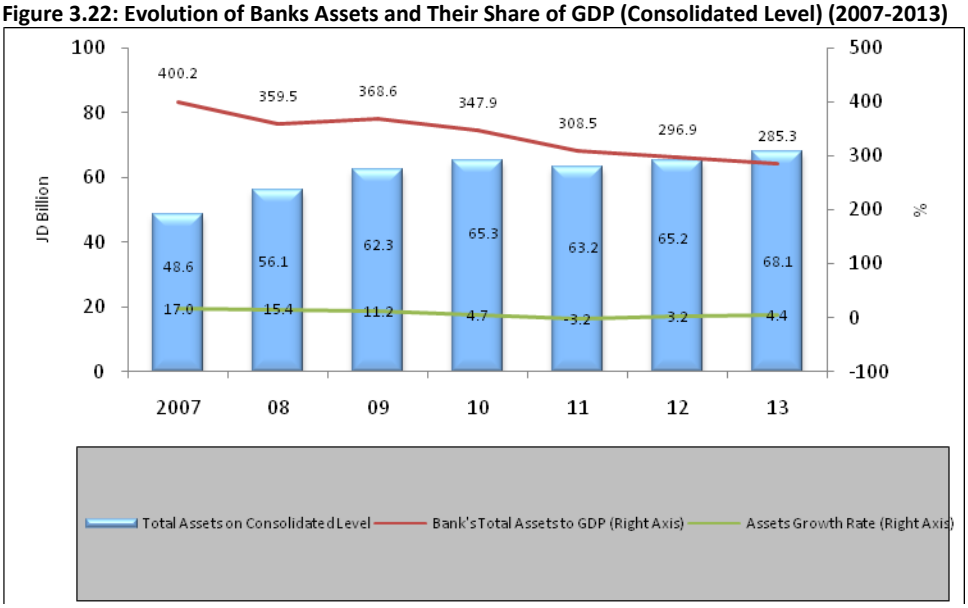
Assets

The number of Jordanian banks that have affiliations outside Jordan are nine, with the major being for Arab Bank, whose deposits outside Jordan formed about 74.0% of total deposits.

The total assets of the banking system at the consolidated level approximated JD 68.1 billion at the end of 2013, compared to JD billion 65.2 at the end of 2012, attaining an increase of JD 2.9 billion or 4.4% growth rate. The banking system assets inside Jordan formed about 62.0% of total assets at the consolidated level; the remaining percentage is mostly for affiliations of the Arab Bank outside Jordan. Despite the increase in the banking system assets at the consolidated level from JD 48.6 billion at the end of 2007 to JD 68.1 billion at the end of 2013, the growth rate of these assets followed a clear downward trend as it declined from 17.0% approximately in 2007 to 4.4% in 2013 (Figure 3.22). This result is expected as it is one of the repercussions of the global financial crisis, the euro sovereign debt crisis and Arab Spring situation on the Jordan banks' branches located outside Jordan.

The ratio of the banking system assets at the consolidated level to GDP reached 285.3% at the end of 2013, compared to 296.9% at the end of 2012. However, it was much higher back in 2007 and reached 400.2%. It is noticed that this ratio follows a downward trend due the faster growth in the GDP compared to the growth of assets (3.22).

Figure 3.22: Evolution of Banks Assets and Their Share of GDP (Consolidated Level) (2007-2013)

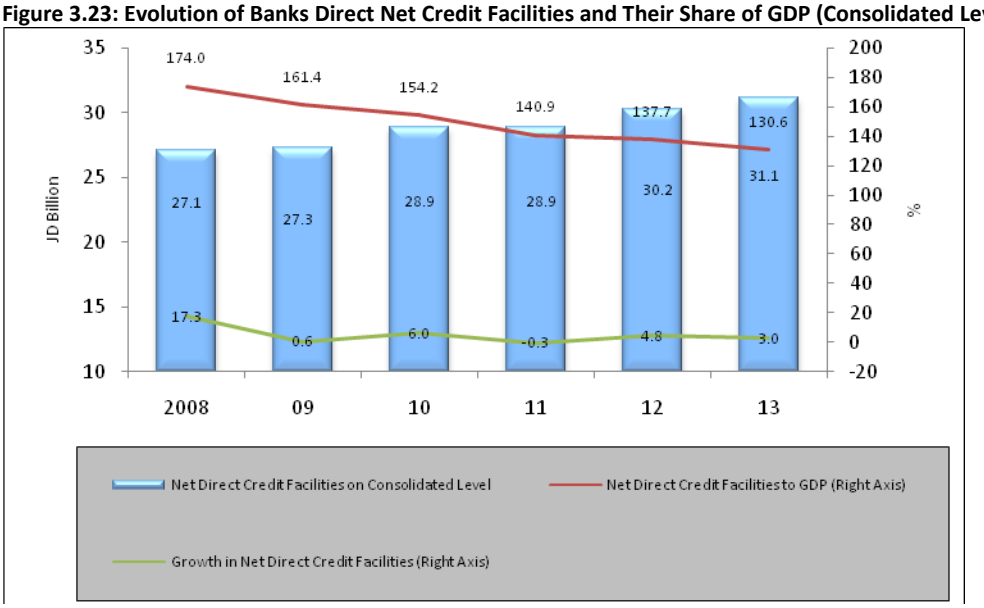


Source: Central Bank of Jordan

Credit Facilities

The balance of credit facilities of the banking system at the consolidated level reached approximately JD 31.1 billion at the end of 2013, compared to about JD billion 30.2 at the end of 2012, or a growth of 3.0%. Realizing the growth in credit facilities, it is noticed that the growth of these facilities follows a downward trend since 2008; it declined from 17.3% at the end of 2008 to 3.0% at the end of 2013. Regarding the ratio of credit facilities of the banking system at the consolidated level to GDP, it declined from 190.7% at the end of 2007 to 130.6% at the end of 2013 (Figure 3.23).

Figure 3.23: Evolution of Banks Direct Net Credit Facilities and Their Share of GDP (Consolidated Level)(2008-2013)

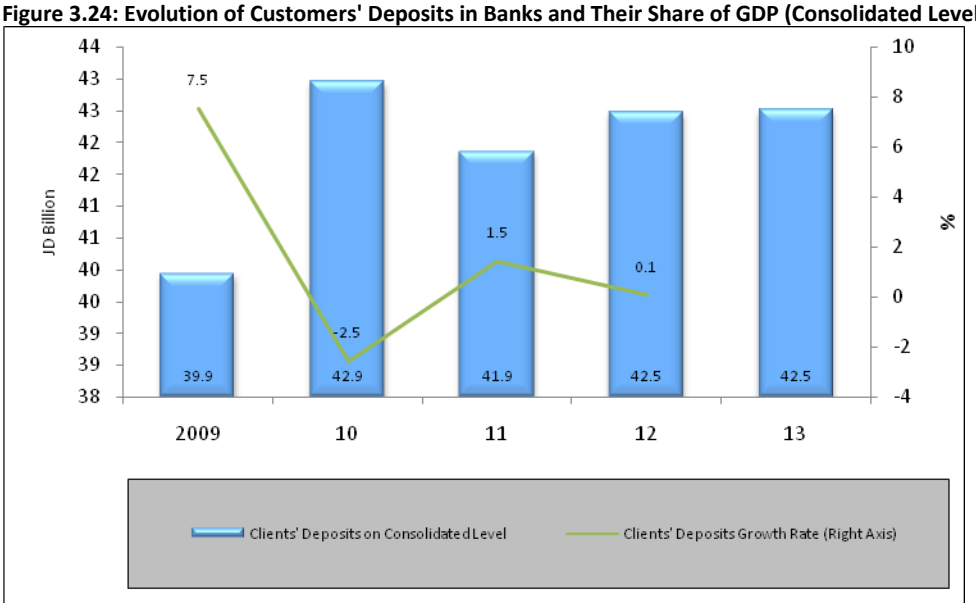


Source: Central Bank of Jordan

Deposits

customers' deposits in the banking system at the consolidated level reached JD 42.5 billion at the end of 2013, attaining a Y-o-Y growth rate of 0.1% from 2012. It is worth mentioning that there was a decrease in the growth rate during the years 2010-2013, where it decreased to 7.5% at the end of 2010 to 0.1% at the end of 2013 (Figure 3.24).

Figure 3.24: Evolution of Customers' Deposits in Banks and Their Share of GDP (Consolidated Level)(2010-2013)

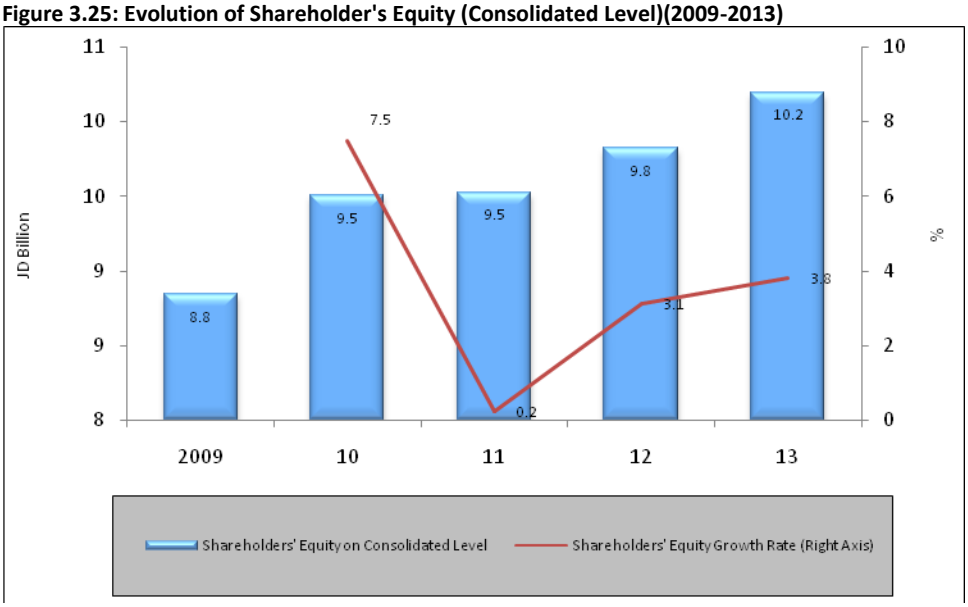


Source: Central Bank of Jordan

Shareholders' Equity

The shareholders' equity at the banking system at the consolidated level reached JD 10.2 billion at the end of 2013, compared to JD 9.8 billion at the end of 2012. It is worth mentioning that the balance of shareholders' equity followed an upward trend since 2009, which in turn reflected positively on banks' solvency and capacity to confront risks and enhanced financial stability (Figure 3.25).

Figure 3.25: Evolution of Shareholder's Equity (Consolidated Level)(2009-2013)



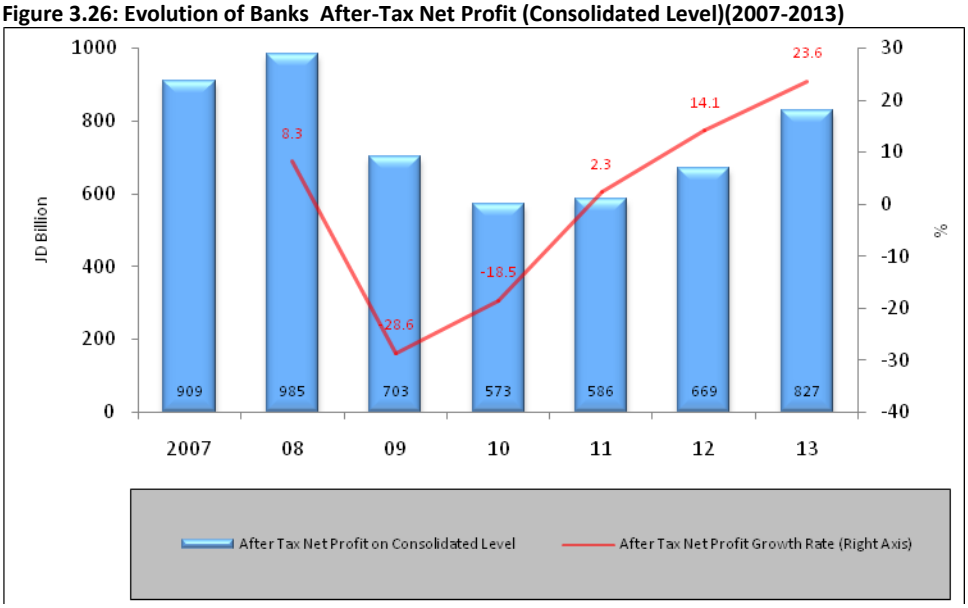
Source: Central Bank of Jordan

Net profit after tax rate of return on assets and return on equity

Net profit after tax

Net profit after tax of the banking system at the consolidated level at the end of 2013 amounted to JD 827.2 million, compared to JD 669.3 million at the end of 2012; with a growth rate of 23.6%. It is worth mentioning that the net profit after tax has taken a downward trend in 2009 and 2010 as a result of the global financial crisis, but returned to take an upward trend during the years 2011-2013 (Figure 26.3).

Figure 3.26: Evolution of Banks After-Tax Net Profit (Consolidated Level)(2007-2013)

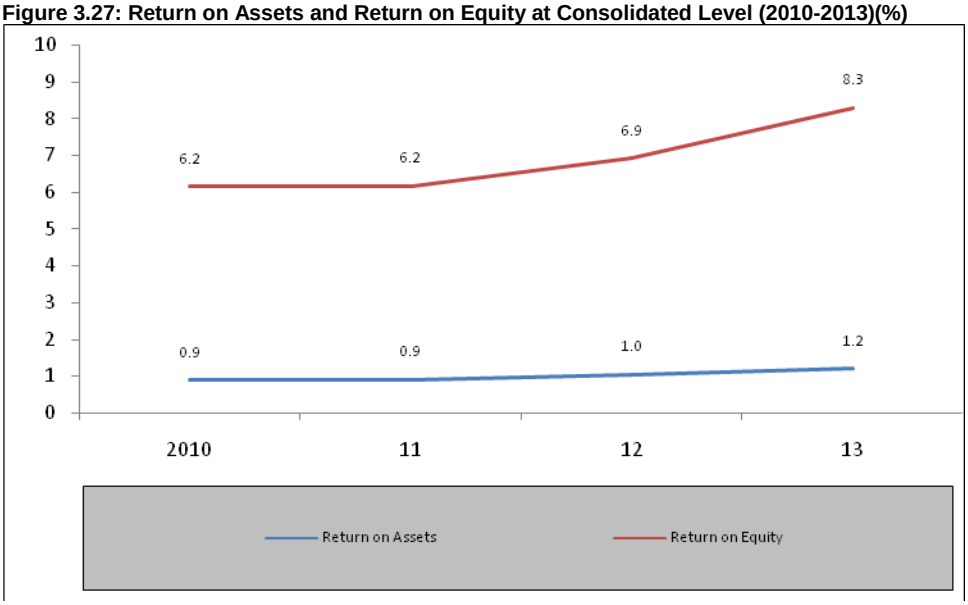


Source: Central Bank of Jordan

Return on Assets and Return on Equity

The return on assets of the banking system at the consolidated level was 1.2% at the end of 2013, compared with 0.9% and 1.0% in 2011 and 2012 respectively. The return on equity of the banking system at the consolidated level reached 8.3% at the end of 2013, compared with 6.2% and 6.9% in 2011 and 2012 respectively (Figure 3.27).

Figure 3.27: Return on Assets and Return on Equity at Consolidated Level (2010-2013)(%)



Source: Central Bank of Jordan

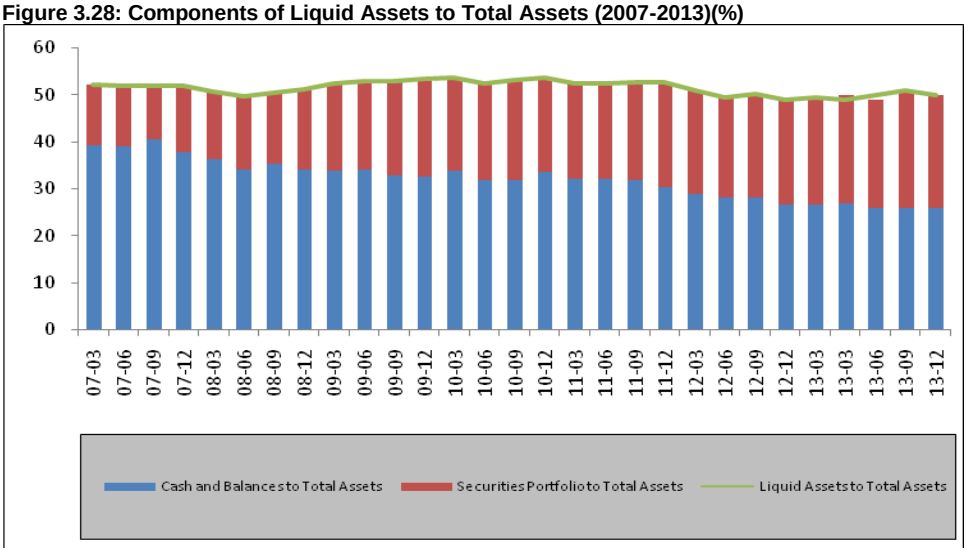
Financial Soundness Indicators

In spite of the successive repercussions of the global economic and financial crisis, in addition to the Arab Spring conditions and the associated risks and significant challenges, the banking system in Jordan was generally capable of maintaining the resilience and the soundness of its financial and administrative positions. Next is a brief discussion of the main developments in the financial ratios and indicators for banks.

Liquidity

Jordanian banking system enjoys a safe liquidity position. The liquidity ratios at the end of 2013 indicated that the liquidity position of the banking system is safe and sound. In this regard, the share of cash and cash balances to total assets reached 26.0%, while the share of securities portfolio (highly liquid) to total assets amounted 24.0%. Consequently, the highly liquid assets totaled about 50.0% of total assets at the end of 2013 compared to 49.0% at the end of 2012, reflecting a slight improvement in the level of banks' liquidity in 2013 (Figure 3.28).

Figure 3.28: Components of Liquid Assets to Total Assets (2007-2013)(%)

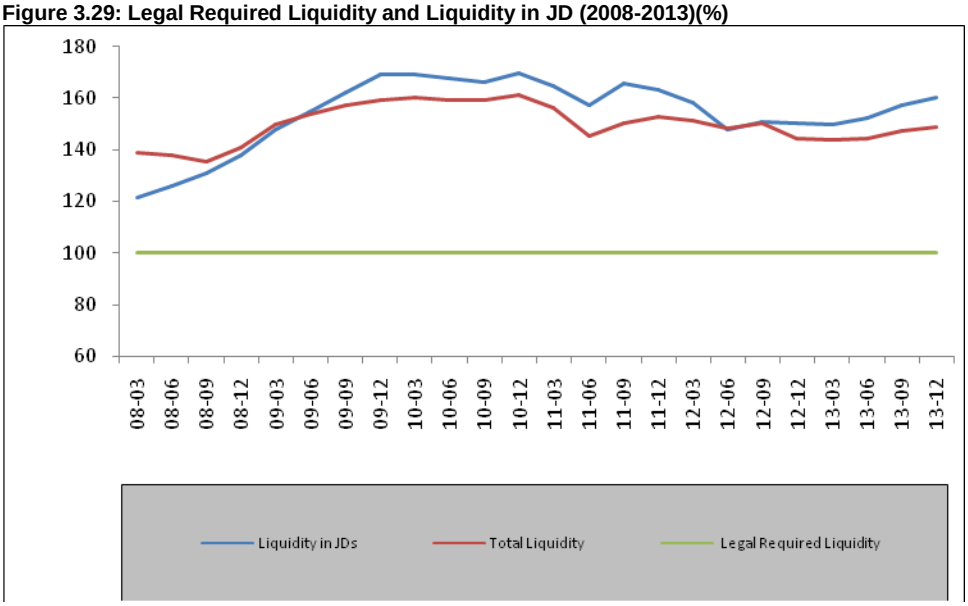


Source: Central Bank of Jordan

Regarding legal liquidity ratios both in Jordanian dinars and in total currencies that are enforced by the CBJ on banks (70% in dinars and 100.0% total), the liquidity ratio in JD and the total foreseen a remarkable rise from mid-2008 to the end of 2009. The main reason for this rise is the banks' decision to redirect their investments to liquid assets at the expense of the credit facilities as a standard reaction of licensed banks to the repercussions of the global economic and financial crisis. But during the period from the end of 2009 until the third quarter of 2010, the liquidity ratios were relatively stable (about 160.0% for the total). However the latter began to decline and reached about 145.0% at the end of 2012, and increased at the end of 2013 and reached 149.0%, as a result of the substantial growth in deposits during 2013 that exceeded the growth in credit facilities.

In general, the liquidity position in the banking system is comfortable and exceeds the limits set by the CBJ (Figure 3.29). However, at the same time, the excess liquidity is concentrated and applicable *only* to large banks. Small and Medium-size banks do not enjoy this situation despite their compliance with the legal liquidity requirements. Aware of the risks that might accompany this situation; the CBJ restructured the operational framework of its monetary policy in a way that helps small and medium-size banks improve their liquidity management and allocates the excess liquidity amongst banks in a more modest way.

Figure 3.29: Legal Required Liquidity and Liquidity in JD (2008-2013)(%)



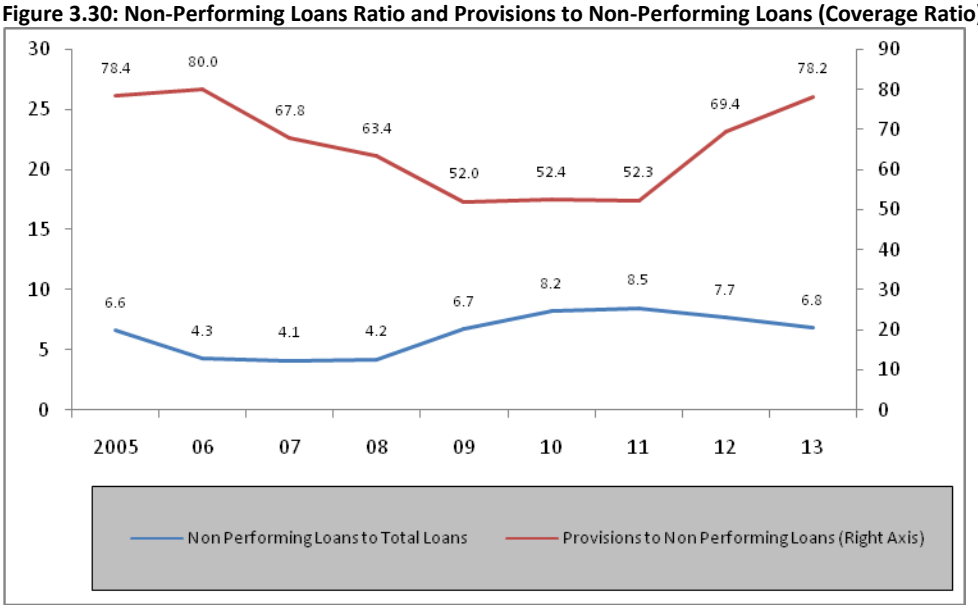
Source: Central Bank of Jordan

Asset Quality

Concerning the ratio of non-performing loans to total loans, it continued its downward trend at the end of 2013 to touch 6.8% compared to 7.7% and 8.5% at the end of 2012 and 2011 consequently. This decline came as a result of the decline in credit facilities (denominator) and the decline in the size of non-performing loans. This decline is attributed to the improvement in the economic conditions in Jordan that reflected positively on the ability of banks' customers to repay their debt. In addition to, most of the customers who were negatively impacted by the repercussions of the global financial crisis declaring bankruptcy during the period 2009-2011 and do not exist in the system. This reflects an improvement in the quality of banks' assets and in turn enhances financial stability in Jordan.

Regarding the coverage ratio for the non-performing loans, it continued its upward trend that started in 2011 to reach 78.2% at the end of 2013. This trend is attributed to the decline in the size of the non-performing loans and the increased attention of the CBJ and banks towards allocating a reasonable amount of provisions to face the non-performing loans. This in turn enhanced the capacity of banks to confront credit risk through increasing their returns, protected banks' capital and enhanced the financial stability in Jordan (Figure 3.30).

Figure 3.30: Non-Performing Loans Ratio and Provisions to Non-Performing Loans (Coverage Ratio)(2005-2013)(%)

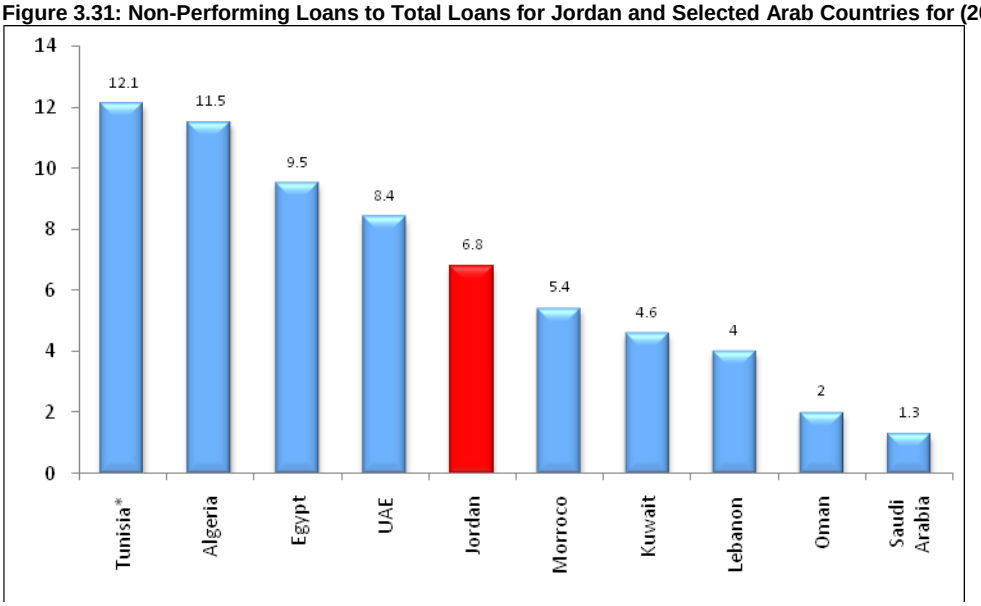


Source: Central Bank of Jordan

The balance of non-performing loans at the banking system reached JD 1,621.3 million at the end of 2013, registering a decline by JD 73.8 million, at the end of 2012 the balance of NPLs was JD 1,695.1 million.

Comparing the NPLs ratio in Jordan with some Arab countries reveals that Jordan occupied a medium rank amongst almost ten Arab countries, where ranked fifth highest in terms of the non-performing loans ratio. The ratio was lower in Jordan than Tunisia, Algeria, Egypt and the UAE, and higher than Kuwait, Lebanon, Morocco, Oman and Saudi Arabia (Figure 3.31).

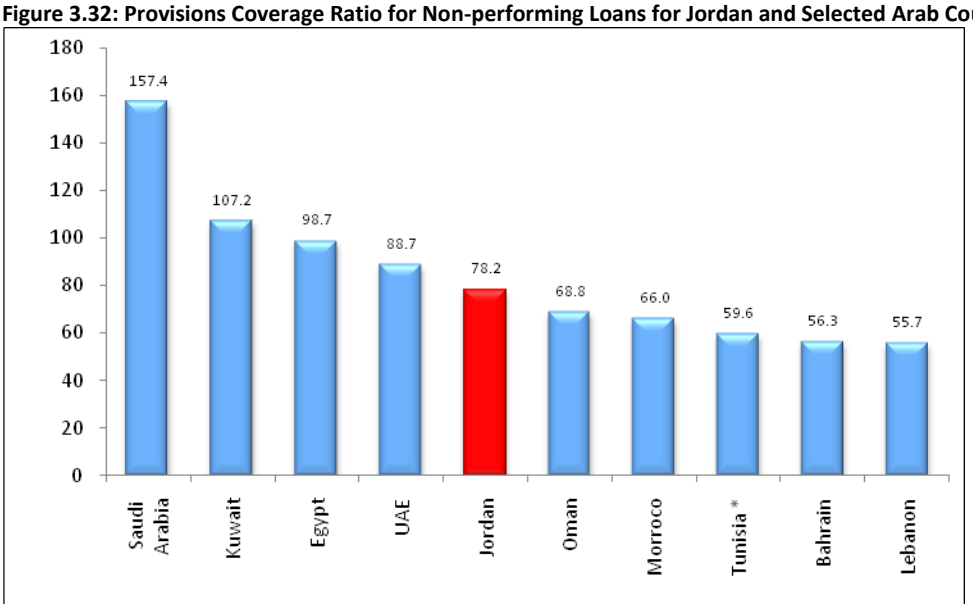
Figure 3.31: Non-Performing Loans to Total Loans for Jordan and Selected Arab Countries for (2013)(%)



Source: Jordan: Central Bank of Jordan. Other Countries: IMF. *2012

Regarding coverage ratio of non-performing loans, the Jordanian banks ranked higher than Tunisia, Oman, Lebanon, Morocco and Bahrain, and lower than Saudi Arabia, Kuwait, UAE and Egypt; which implies that this ratio in Jordan is relatively better than most of the Arab countries that are similar to Jordan in their economic characteristics (Figure 3.32).

Figure 3.32: Provisions Coverage Ratio for Non-performing Loans for Jordan and Selected Arab Countries for (2013)(%)

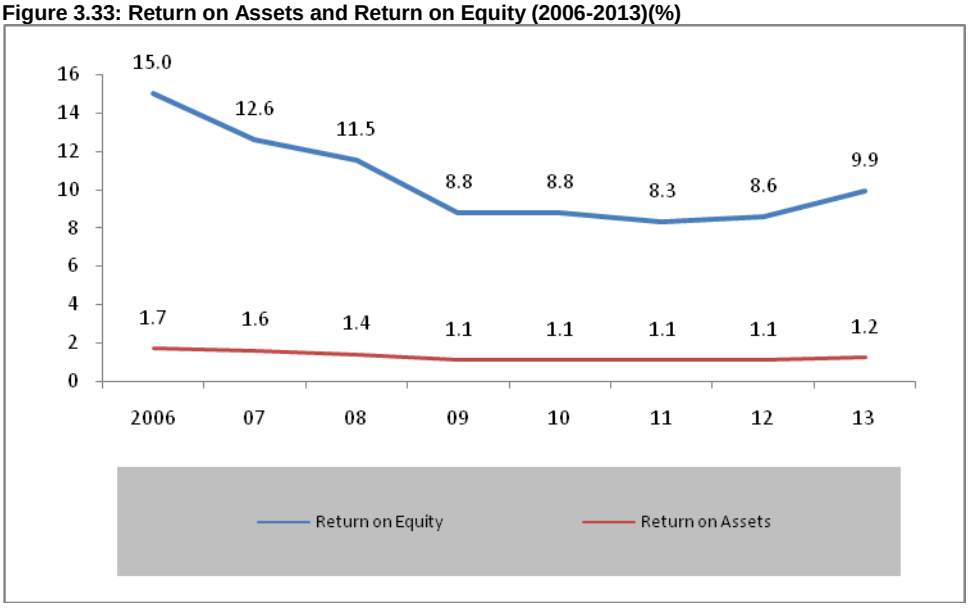


Source: Jordan: Central Bank of Jordan. Other Countries: IMF. *2012

Profitability

The rate of return on assets in the banking system in Jordan witnessed a decrease during the years 2006-2009; it reached 1.7% at the end of 2006 and declined to 1.1% at the end of 2009 as a result of the repercussions of the global financial crisis on banks' profits. This rate kept its level until the end of 2012, to resume the increase at the end of 2013 to reach 1.2% as a result of the significant growth of banks' profits by 21.0% (Figure 3.33).

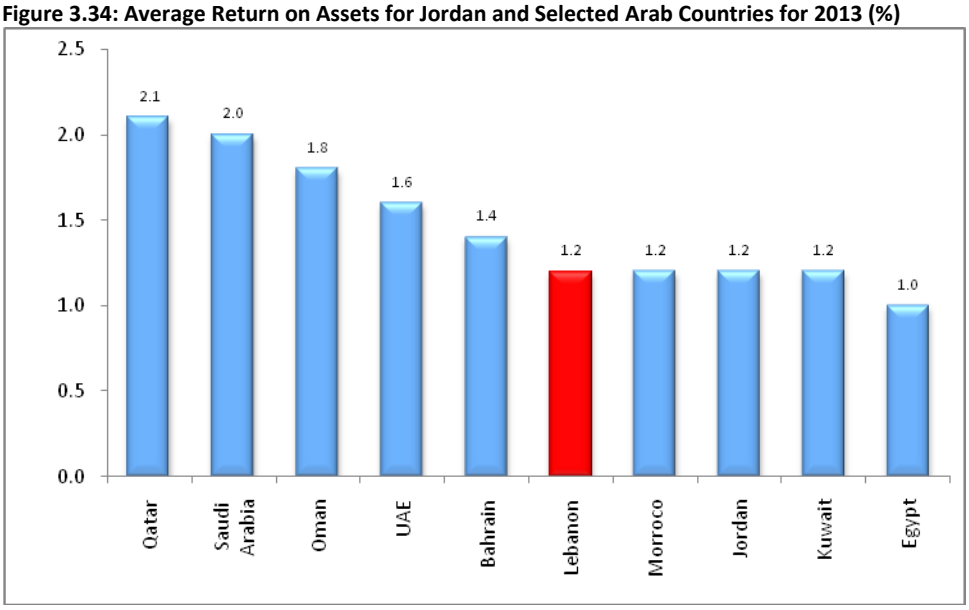
Figure 3.33: Return on Assets and Return on Equity (2006-2013)(%)



Source: Central Bank of Jordan

Comparing Jordan with some Arab countries, it is realized that Jordan, Lebanon, Morocco and Kuwait share the second rank as the lowest countries - among the selected countries – in terms of the rate of return on assets of 1.2%. Whereas Qatar had the highest rate of return on assets, that touched 2.1% (Figure 3.34).

Figure 3.34: Average Return on Assets for Jordan and Selected Arab Countries for 2013 (%)

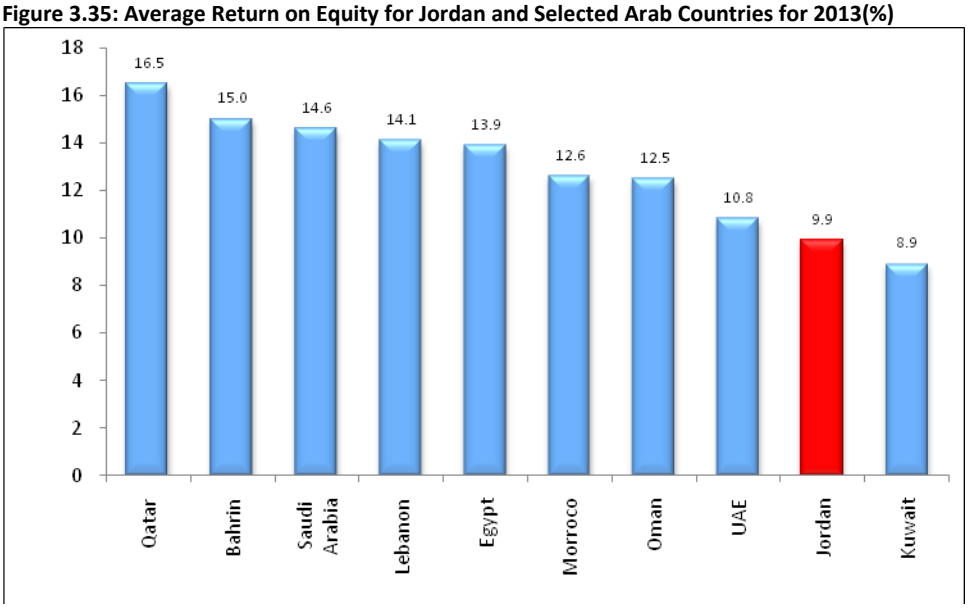


Source: Jordan: Central Bank of Jordan. Other Countries: IMF.

Regarding the return on equity, it followed a trend that is similar to the trend of the rate of return on assets. It declined during the period 2006-2011 from 15.0% at the end of 2006 to 8.3% at the end of 2011, and then resumed the increase at the end of 2012 to reach 8.6%. It continued its upward trend at the end of 2013 and reached 9.9% (figure 3.33).

In comparison to selected Arab countries, Jordan is the second lowest country in terms of the rate of return on equity after Kuwait, whose ratio was 8.9%, whereas Qatar had the highest rate of 16.5% (Figure 3.35). The low rate in Jordan compared to most Arab countries is generally attributed to the characteristics of the banks in Jordan that are conservative and risk averse, in addition to their relatively high levels of capital and high income tax rates, particularly when compared to the GCC countries. However, this gives an indication of the weakness of the effectiveness of the banks in investing its funds. Nevertheless, it demonstrates the capability of these banks to withstand risks through their high levels of capital, which enhances the financial stability in the Jordan.

Figure 3.35: Average Return on Equity for Jordan and Selected Arab Countries for 2013(%)

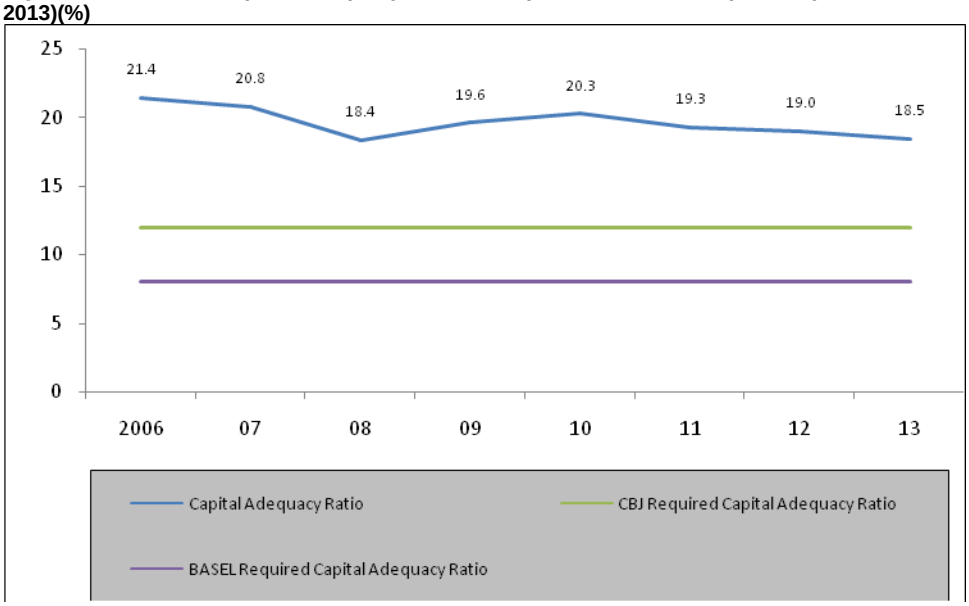


Source: Jordan: Central Bank of Jordan. Other Countries: IMF.

Capital Adequacy

The banking system in Jordan has high capital adequacy ratio that is the highest in the MENA region (after the United Arab Emirates). Capital adequacy ratio in the banking sector in Jordan ranged between 18.0% and 20.0% during the years 2007-2013. It is generally higher, and by a comfortable margin, than the limit set by the CBJ of 12.0% and the limit specified by Basel Committee of 8.0%. It is worth mentioning that capital adequacy ratio and the share of the tier one core capital are very close, which means that most of the banks' capital in Jordan is composed of tier one core capital that is the highest quality component of capital and the most capable of absorbing losses; thereby enhancing financial stability in Jordan. It is worth mentioning also that in spite of high capital adequacy ratio in the banking system in Jordan, there is a disparity in the ratio among banks. In this context, the ratio exceeded 20.0% in 12 banks out of 26 banks, ranged between 14.0% and 20.0% for 11 banks and approached the minimum limit in three banks. In this regard the CBJ continually monitors the developments, and requests the banks to enhance their capital and undertake corrective measures and actions in event of the decline of this ratio or its convergence to the minimum limit dramatically.

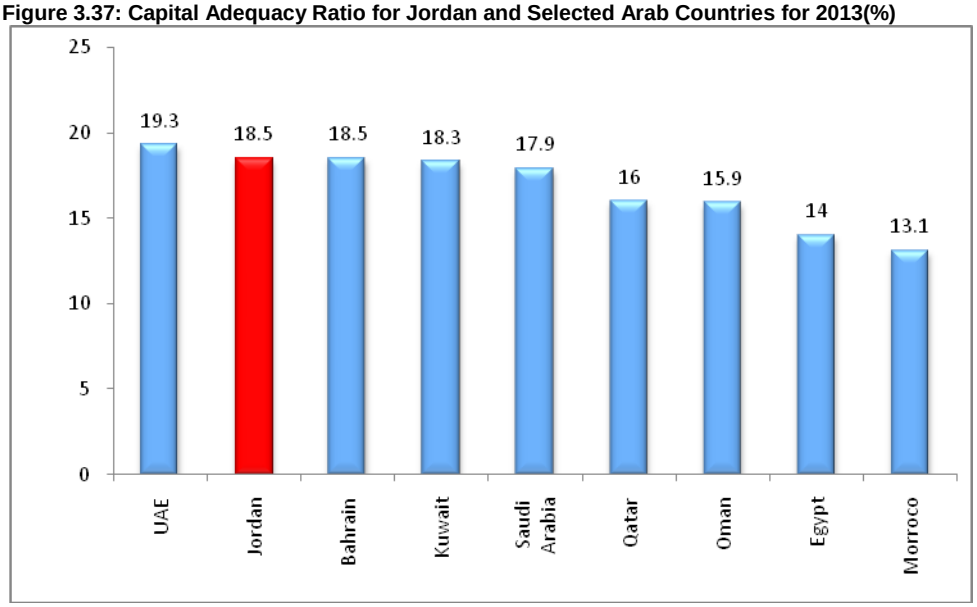
Figure 3.36: Actual Capital Adequacy Ratio Compared with the Required by CBJ and BASEL Committee (2006-2013)(%)



Source: Central Bank of Jordan

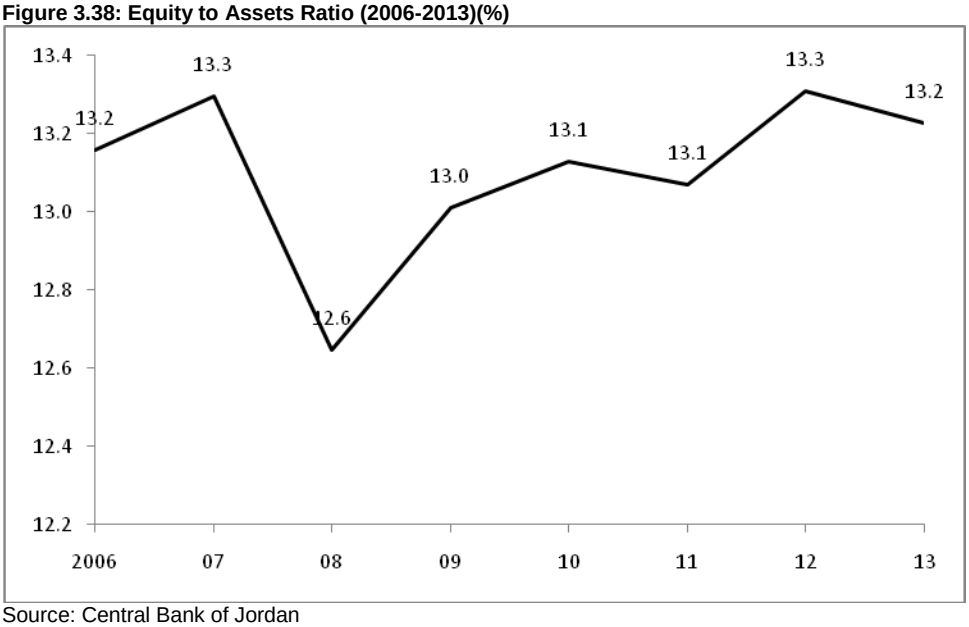
The high capital adequacy ratio at the banking sector in Jordan is mainly due to the fact that most of the banks in Jordan are conservative and risk averse. The banks' investments in Jordanian government bonds that are risk free approximated JD 8,903 million, and represented 21.0% of the total banks' asset, besides the high levels of capital in the banking system and the modest distribution of profits to shareholders, where the distributed profits (dividends) did not exceed, in most cases, 20.0%. This in turn supported banks' capital and enhanced capital adequacy for them (Figure 3.36). Regarding the leverage ratio (ratio of equity to total assets), it has taken an upward trend since 2009 until the end of 2012, reaching 13.3%. Thereafter, it witnessed a slight decline in 2013 to reach 13.2%. However, this ratio is high compared to the minimum limit set by the CBJ of 6.0%. This relatively high ratio is attributed to banks' decisions to increase their capital and keep high percentage of their profits, which is a positive indicator on the solid capital base of the licensed banks (Figure 3.38).

Figure 3.37: Capital Adequacy Ratio for Jordan and Selected Arab Countries for 2013(%)



Source: Jordan: Central Bank of Jordan. Other Countries: World Bank.

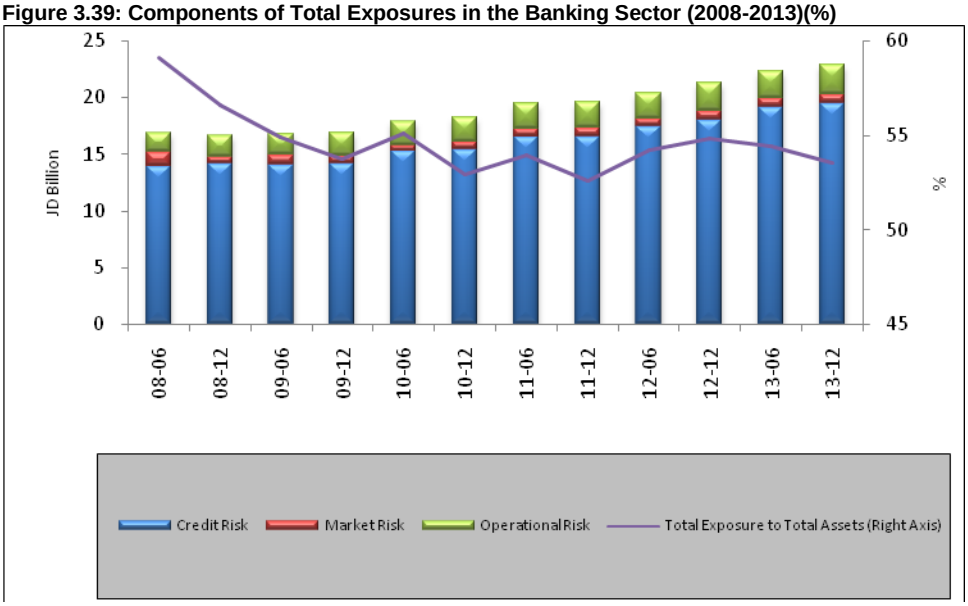
Figure 3.38: Equity to Assets Ratio (2006-2013)(%)



Source: Central Bank of Jordan

As for the main risks faced by banks, the credit risk is in the forefront of these risks and constituted 86.0% of total risks, followed by operational risk, which constituted 12.0%, and market risk, which constituted 2.0% of the total risk (Figure 3.39)

Figure 3.39: Components of Total Exposures in the Banking Sector (2008-2013)(%)



Source: Central Bank of Jordan

Household Debt

In the course of the follow-up of the developments in the household debt, the ratio of household debt for the year 2013 was calculated using the same methodology that was outlined in the 2012 Financial Stability Report. Where the household debt to the banking sector was the driving factor used in the calculation due to the dominance of this sector over other sectors in the financial system in terms of extended credit. In addition, information has been obtained for the microfinance sector, the public shareholding companies that extend loans and financial leasing companies.

Household Debt to Banks and Other Financial Non-Banking Institutions

Table 3.2 shows the evolution of household debt with banks and non-banking financial institutions during the period 2010-2013. As noted from the table, the household debt rose from JD 6,967.2 million at the end of 2012 to JD million 7,602.7 at the end of 2013, at a growth rate of 9.1% compared to 16.4% at the end of 2012.

Table 3.2: Household Debt at Banks and Non-Banking Financial Institutions (2010-2013) (JD Million)*

Debt Household	2010	2011	2012	2013
Banking Sector	4,863.0	5,446.0	6,374.0	6,958.0
		(12.0)	(17.0)	(9.2)
Non-Banking Financial Institutions	501.0	540.5	593.2	644.7
		(7.9)	(9.8)	(8.7)
Total	5,364.0	5,986.5	6,967.2	7,602.7
		(11.6)	(16.4)	(9.1)

Source: CBJ. * Numbers in parenthesis are growth Y-o-Y growth rates in percent including housing loans.

As for the details of the household debt with non-banking financial institutions, Table 3.3 includes them. As noted from the table, the household debt with non-bank financial institutions increased from JD 593.2 million at the end of 2012 to JD 644.7 million at the end of 2013, a growth rate 8.7% compared to a growth rate of 9.8% at the end of 2012.

Table 3.3: Household Debt at Non-Banking Financial Institutions (2010-2013) (JD Million)*

	2010	2011	2012	2013
*Microfinance Institutions	65.0	79.5	101.8	122.9
**Companies Listed in ASE	71.5	78.3	89.6	99.8
***Financial Leasing Companies	364.5	382.7	401.8	421.9
Total	501.0	540.5	593.2	644.7

Sources: * Annual Report of the Microfinance Institutions Network (Tanmiya). ** Amman Stock Exchange. *** A study by International Financial Corporation.

Household Debt-to-Income Ratio

Table 3.4 details the developments in the household income and debt over the period 2007-2013, Figure 3.40 shows the movements in household debt-to-income ratio.

Table 3.4: Household Debt to Income and GDP (2007-2013) (JD Million)*

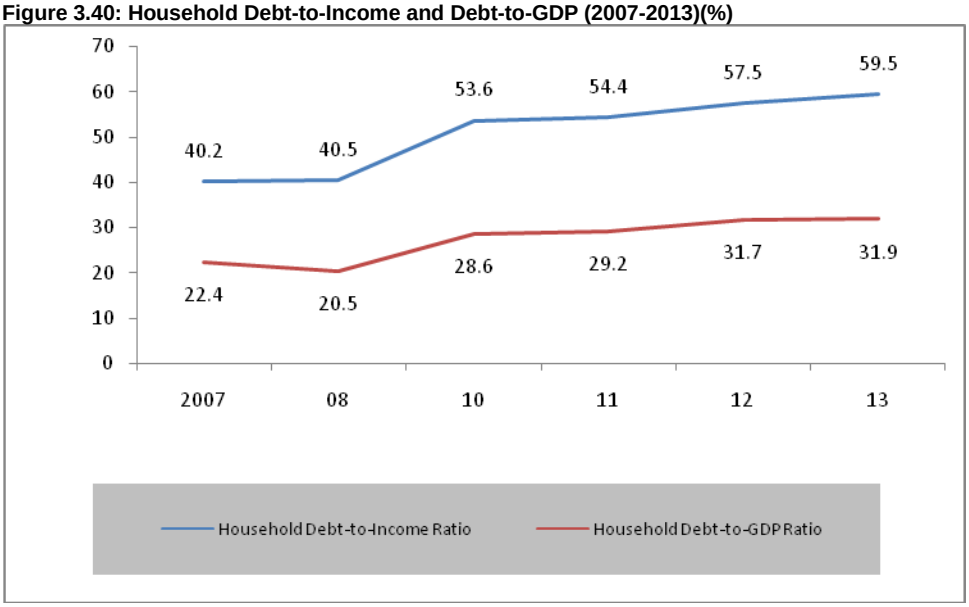
Year	Household Debt	Household Income	GDP	Household Debt-to-Income (%)	Household Debt-to-GDP (%)
2007	2,713.00	6,753.00	12,131.00	40.2	22.4
2008	3,196.00	7,882.00	15,593.00	40.5	20.5
2010	5,364.50	10,008.00	18,762.00	53.6	28.6
2011	5,987.20	11,008.00	20,476.00	54.4	29.2
2012	6,967.30	12,109.00	21,965.00	57.5	31.7
2013	7,602.70	12,775.50	23,851.60	59.5	31.9

* Unless otherwise indicated.

However, the actual household-to-income ratio in Jordan might be higher than the ratios calculated in Table 3.4 since the proportion of individual borrowers in Jordan is much lower than its counterpart in the developed countries that have high rates of access to finance that ranges between 80.0% - 90.0%, while this ratio does not exceed 25.0% in Jordan.

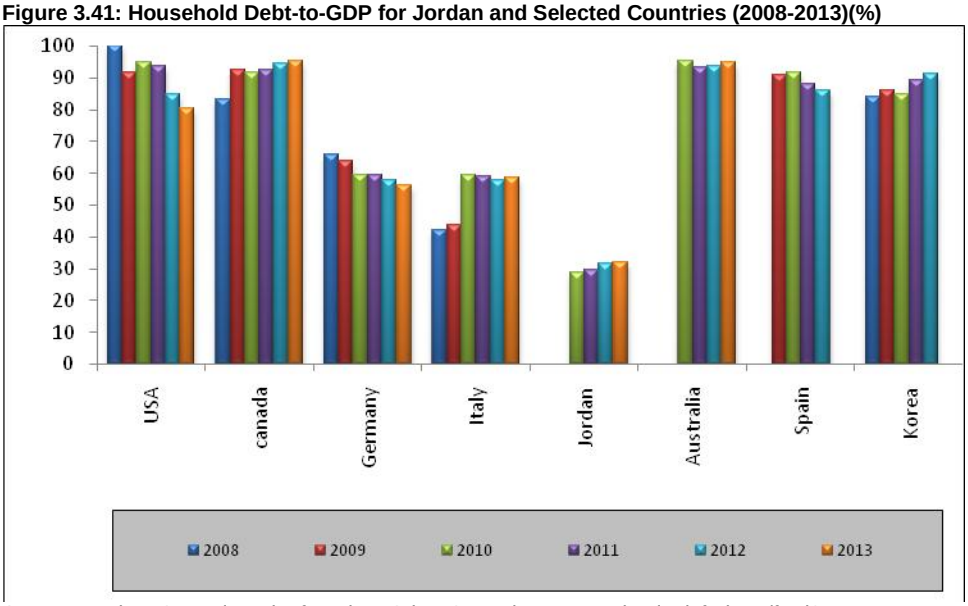
Regarding household debt-to- GDP in Jordan in a comparison with a number of European countries and USA, the debt-to-GDP ratio is considered low (Figure 3.41).

Figure 3.40: Household Debt-to-Income and Debt-to-GDP (2007-2013)(%)



Source: Central Bank of Jordan

Figure 3.41: Household Debt-to-GDP for Jordan and Selected Countries (2008-2013)(%)

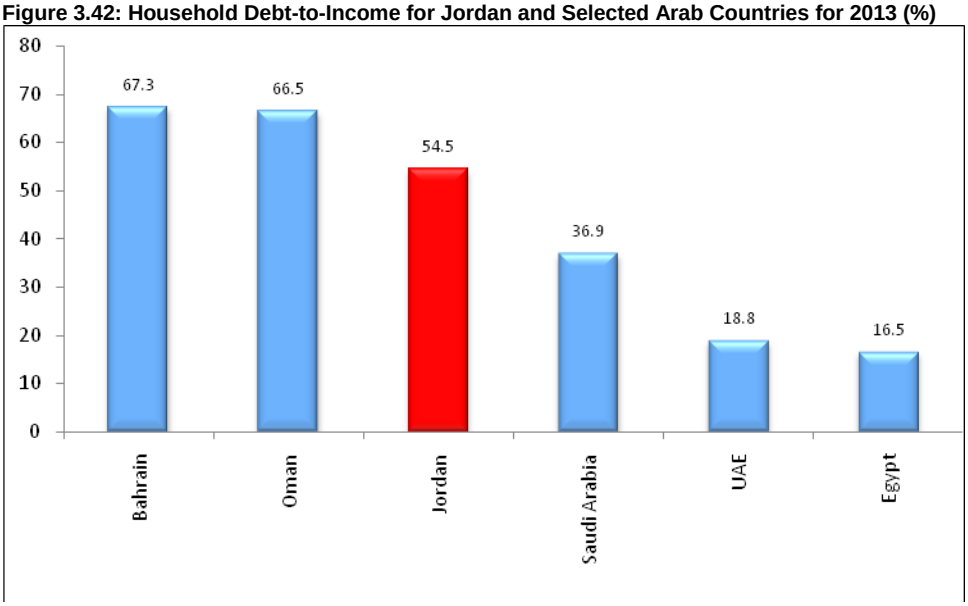


Source: Jordan: Central Bank of Jordan. Other Countries: research.stlouisfed.org/fred2

Household Debt for Selected Arab Countries

As for household debt in some selected Arab countries, there is limited information in this regard. However, using the available data, the ratio of household-debt to income was calculated for some Arab countries.

Figure 3.42: Household Debt-to-Income for Jordan and Selected Arab Countries for 2013 (%)

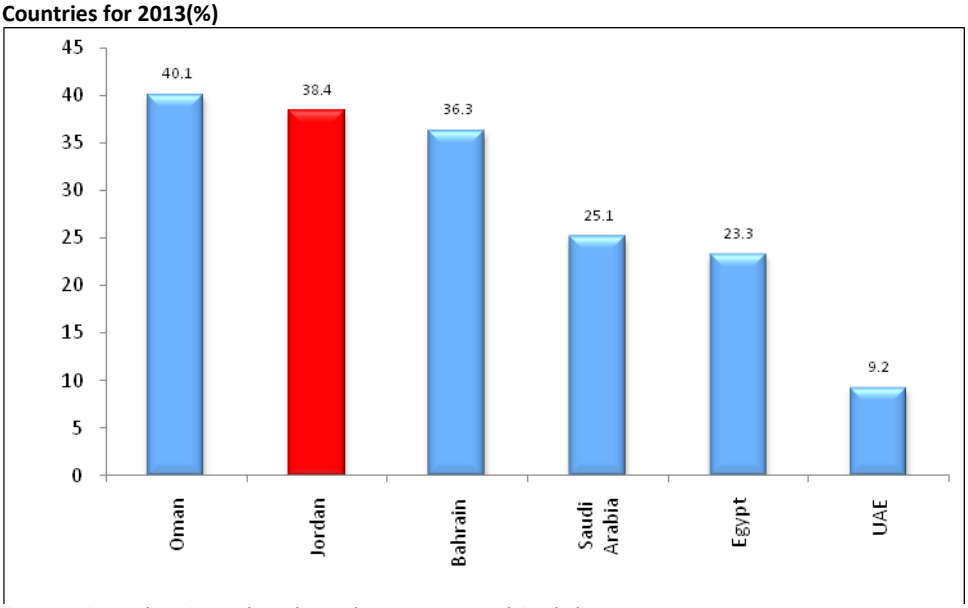


Source: Countries' Central Banks

It can be noted from Figure 3.42 that this ratio in the Sultanate of Oman and Bahrain is higher than in Jordan, while Egypt and Saudi Arabia and the UAE has lower ratios of household debt-to-income than Jordan.

Regarding the proportion of credit facilities granted to households to total credit facilities granted by the banks in Jordan, the ratio is about 38.4%. Compared with the ratios in a number of Arab countries, it is one of the highest proportions as it is less in Jordan than Oman and higher than Bahrain, Saudi Arabia, UAE and Egypt (Figure 3.43).

Figure 3.43: Proportion of Households Credit Facilities to Total Credit Facilities Granted by Banks of Selected Arab Countries for 2013(%)



Source: Countries' Central Banks and Departments of Statistics

Household Sector Balance Sheet in Jordan

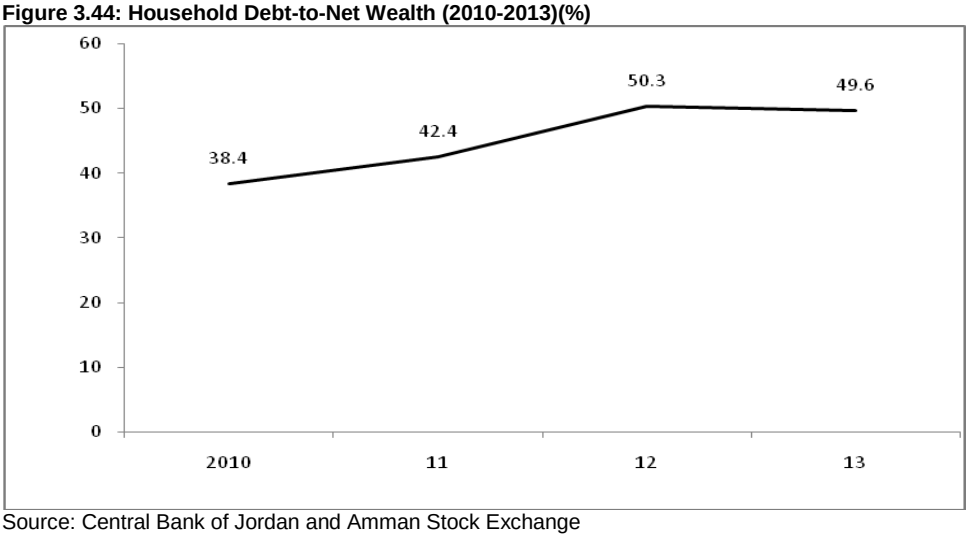
Household balance sheet on the assets side is made up mainly of deposits, real estate and financial assets. On the liabilities side, the key component of liabilities is household debt. To build the household balance sheet in Jordan, it has been relied on the data available at the CBJ (household deposits in domestic and foreign currency) and on the data available at the Securities Depository Center on the securities held by households. Whereas no information was obtained about the assets of the household real estate, therefore, information was available about the household sector financial assets (deposits, shares and bonds). As can be noted from Table 3.5 and Figure 3.44, household debt-to-wealth followed an upward trend since 2010 - as was the case of household debt-to-income. However it declined slightly at the end of 2013.

Table 3.5 Household Balance Sheet and Debt-to-Wealth (2010-2013)

Year	Assets*	Debt	Net Wealth	Debt-to-Wealth
2010	19,349.0	5,364.0	13,985.0	38.4
2011	20,092.0	5,987.0	14,105.0	42.4
2012	20,810.0	6,967.0	13,843.0	50.3
2013	22,923.0	7,602.0	15,321.0	49.6

* Household assets include deposits, shares and bonds.

Figure 3.44: Household Debt-to-Net Wealth (2010-2013)(%)



Source: Central Bank of Jordan and Amman Stock Exchange

There are no standard international benchmarks for household debt-to-income ratio. However, using historical data for some countries; the average of this ratio approximates 60.0% and, hence, the household debt-to-income ratio in Jordan does not warn of the existence of a problem at the moment. As mentioned at the beginning of Chapter Four of the 2012 Financial Stability Report, the tendency of banks to extend credit to households had many positive aspects, but at the same time, the dramatic rise of this debt compared to the household disposable income and wealth might have negative repercussions on the stability of the financial sector. The debt-to-income ratio witnessed a realizable rise in Jordan in the recent years. However, they are still lower than their counterparts in the developed countries and, hence, they do not warn of the existence of a problem at the moment- as previously stated. Especially in light of conservative policy of banks in granting credit. The CBJ will continue to supervise the developments in this ratio and take the necessary actions and measures accordingly. It is expected that the recent CBJ measures represented by the issuance of the instructions of **Treating Customers Fairly** – that came into force on the licensed banks in May 2013 – will have a positive impact on the protection of consumers and the reduction of the risk associated with their debt to banks.

Second: Developments in Financial Non-Banking Sector (Financial Non-Bank Institutions)

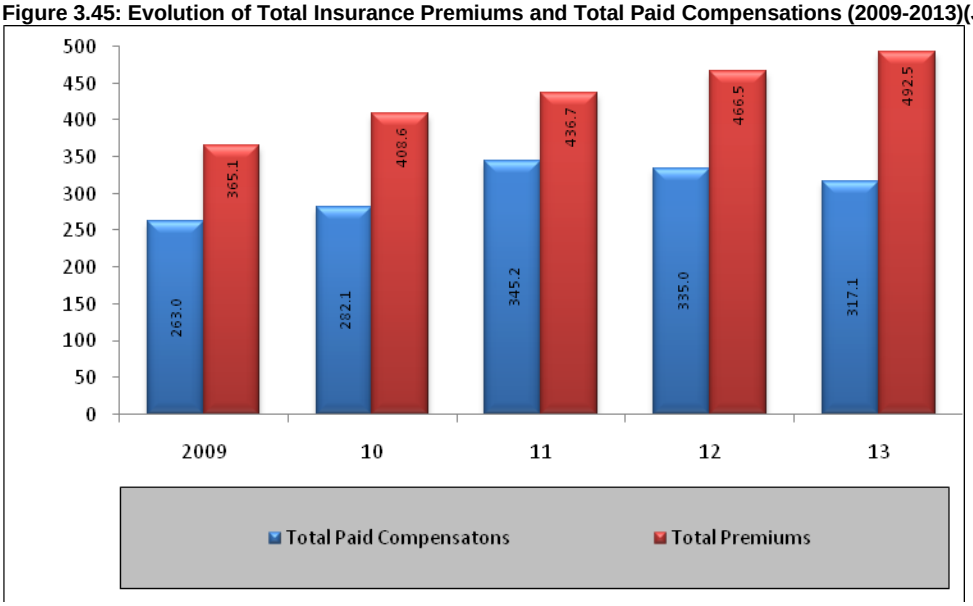
Insurance Sector[3]

The number of insurance companies operating in Jordan is 25 companies, with total assets of JD 798.0 million at the end of 2013, compared to JD 764.0 million at the end of 2012; a growth rate of 4.5%. These companies practice insurance business inside Jordan, including one licensed life insurance company; nine companies are licensed to practice general insurance business and 15 companies are licensed to practice both types of insurance business (general insurance and life insurance).

Preliminary data from the Department of Insurance in the Ministry of Industry, Trade and Supply shows that the total premiums implemented inside Jordan reached JD million 492.5 at the end of 2013, at an Y-o-Y growth of 5.6% from the end of 2012. In contrast, the total compensation paid decreased to JD million 317.1 at the end of 2013 by 5.3% from the total paid compensation at the end of 2012 (Figure 3.45).

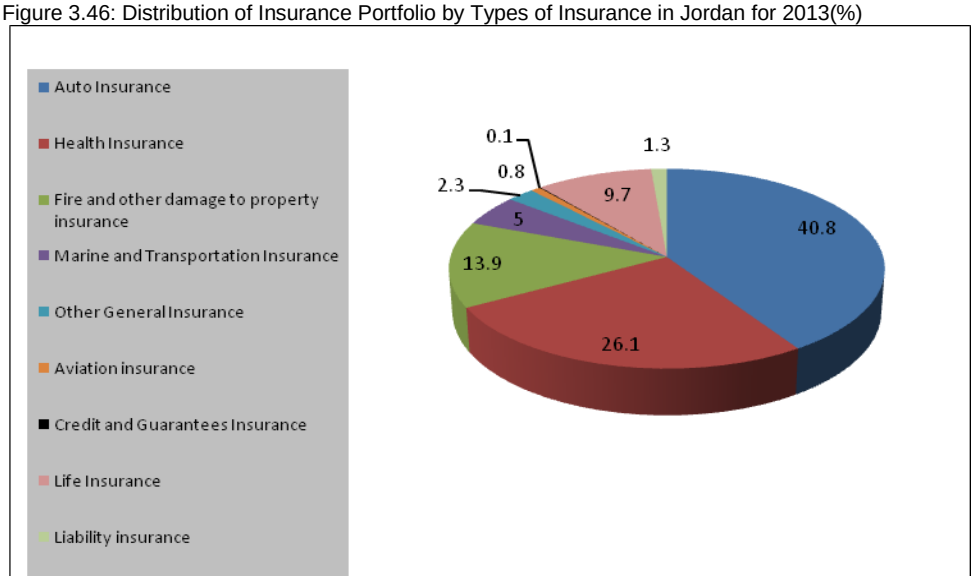
[3] The data related to the insurance sector in this section are preliminary.

Figure 3.45: Evolution of Total Insurance Premiums and Total Paid Compensations (2009-2013)(JD Million)



A review of the distribution of the insurance portfolio in Jordan by type of insurance in 2013 is illustrated in Figure 3.46. As appears from the figure, auto insurance accounted for 40.8% of the total portfolio, followed by health insurance that accounted for 26.1% of the total. Moreover, total investment of insurance companies achieved an increase at the end of 2013 to reach JD 503.6 million, compared to JD 488.6 million at the end of 2012, an increase by 3.1%.

Figure 3.46: Distribution of Insurance Portfolio by Types of Insurance in Jordan for 2013(%)



Regarding the ratio of net underwritten premiums to gross underwritten premiums (retention rate) in the insurance market, it reached 63.0% at the end of 2013, compared to 61.0% at the end of 2012. Concerning the outcome of the insurance companies business, the 2013 data shows that the insurance sector attained a net before tax profit of JD 25.9 million. Moreover, insurance companies achieved a 3.0% rate of return on assets and 8.0% rate of return on equity.

It is worth mentioning that the initial outcomes of the financial statements of insurance companies during the first half of 2014 revealed that 18 insurance companies were subject to losses that approximated JD 7.2 million as disclosed by Jordan Insurance Federation. This outcome entails the need for restructuring and regulating the insurance market to enhance and strengthen the financial positions of the insurance companies.

Table 3.6: Insurance Sector Developments (2009-2013) (JD Million)

	2009	2010	2011	2012	2013
Total investments	484.6	473.9	455.0	488.6	503.6
Total Assets	695.5	718.7	722.5	764.0	798.0
Technical Provisions	216.3	237.3	259.9	293.0	327.2
Property Rights	359.1	353.6	310.9	306.4	318.5
Total premiums written in Jordan	365.1	408.6	436.7	466.5	492.5
Total premiums written in the Jordan-life insurance	34.9	38.0	40.8	44.4	43.1
Total compensation of premiums written in Jordan	263.0	282.1	345.2	335.0	317.1
Net profit before tax	7.3	15.9	-12.3	5.6	25.9

Table 3.7: Financial Indicators of the Insurance Sector (2009-2013) (%)

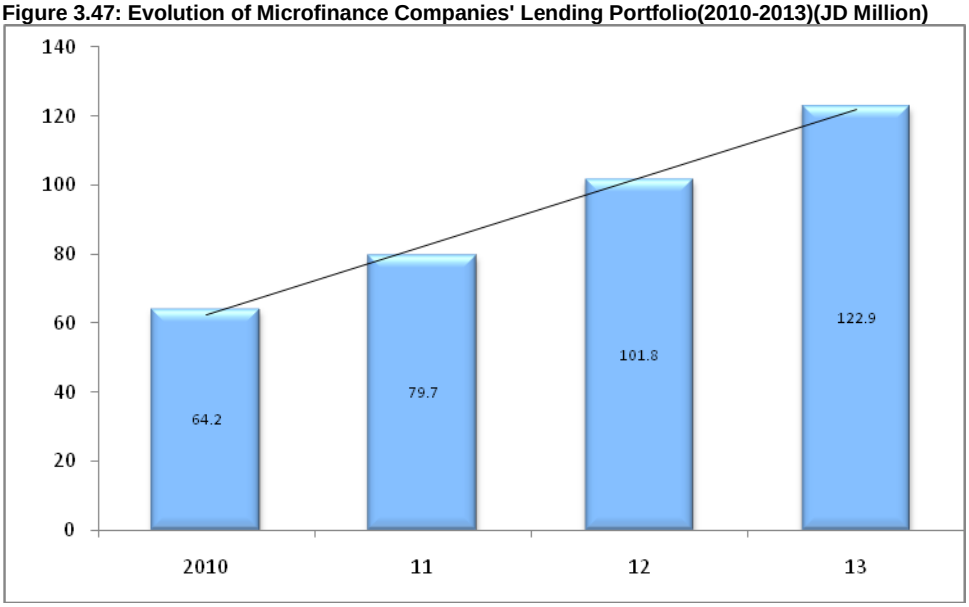
	2009	2010	2011	2012	2013
Solvency margin	293.5	280.9	223.2	233.5	211.5
Retention Ratios (total)	59.6	62.0	59.2	60.6	63.0
Retention Ratios (without auto and health insurance)	24.9	26.0	25.8	26.6	26.0
Loss Ratio (general insurance)	89.0	85.4	96.6	96.6	84.0
Expenses Ratio (general insurance)	10.3	13.1	9.7	9.7	11.0
Return on Assets	1.1	2.2	-1.7	0.7	3.0
Return on Equity	2.0	4.5	-4.0	1.8	8.0
Technical Provisions / Property Rights	166.1	149.0	120.0	105.0	97.0

Microfinance Sector

Providing financial services to the low income group and to those who do not have access to financial services from the banking sector, which is usually channeled through microfinance sector, is an issue that has played a central role in human and economic development, as the provision of funding for these groups helps achieve economic and social security through converting these groups from aid recipients into productive and income-generating groups, thereby reducing poverty and unemployment rates.

Microfinance sector started its business in Jordan since about twenty years and grew rapidly at an average annual rate of about 28.0% until it reached approximately 283 thousand borrowers with a lending portfolio of JD 123.0 million at the end of 2013 (Figure 3.47).

Figure 3.47: Evolution of Microfinance Companies' Lending Portfolio(2010-2013)(JD Million)



With respect to the assets of the microfinance institutions, it approximated JD 30.0 million at the end of 2013, compared to JD million 118.2 at the end of 2012. Microfinance loans achieved promising growth rates during the past three years (2011-2013) amounted to 24.0%, 28.0% and 21.0% respectively. These high growth rates are a clear indication of the size of the demand for products and services of the microfinance industry that (the products and services) has been developed and improved to meet the actual needs of its customers (Figure 3.47).

Performance Indicators of the Microfinance Institutions in Jordan

Microfinance institutions use and apply a set of international supervision standards to measure its performance and disclose the potential risks in its operations; the most important of these indicators are highlighted next.

Asset Portfolio Quality

This indicator measures the quality of microfinance institutions loans. In general, microfinance institutions has high-quality portfolio, as follows:

Bad Debt. Bad debt formed 0.8% of total assets of the microfinance institutions at the end of 2013, which is one of the lowest percentages in the world.

Portfolio at Risk (i.e., the balance of late premium payments for 30 days or more). Although the international standards consider 6.0% as reasonable limit, this percentage amounted to 2.0% for microfinance institutions, which helped sustain the stability of this sector and enhanced the resilience of microfinance industry.

Provision Coverage Ratio. This ratio reached 325.0% at the end of 2013, which is a comfortably high percentage far above the internationally accepted benchmarks of approximately 200.0%, which indicates that the microfinance institutions in Jordan have sufficient provisions to deal with credit risk.

Efficiency and Productivity

The indicator measures the ability of the microfinance institutions to invest their assets optimally through the optimal utilization of their sources of funds. The following are the most important measures that are used by the microfinance sector:

1. Operating Expenses Ratio. This ratio measures the cost of loans and other services extended by the microfinance institutions, i.e., they reflect the cost of operations of the microfinance institutions. This ratio ranged between 20.0% and 30.0%, close to the MENA region's ratio. Although operating expenses ratio for the microfinance institutions in Jordan is close to its counterparts in the MENA region, it is considered high relative to the other financial sectors. This explains the reason for the high interest rates on the loans extended by the microfinance institutions.
2. Productivity per Loan Officer. The productivity per loan officer in Jordan leveled 354 loans per loan officer - a ratio that is higher than its counterpart in the MENA region countries- without adversely impacting the quality of portfolio.

Financial Management

These indicators measure the level and cost of loans that the microfinance institutions obtain in order to possess the necessary liquidity for maintaining the continuity of their businesses and meeting the loan repayment needs for its creditors. The most common measures under this category are:

- Cost of Financing. In order to satisfy the growing financing needs of the microfinance institutions to meet their custoemrs' needs, these institutions need commercial loans to maintain their expansion and continuity. The cost of commercial funding approximated 9.0%.

Debt-to-Equity Ratio: This ratio measures the leverage of the microfinance institution. The ratio is lower at the microfinance institutions compared to the commercial banks. Given that it reached 162.0% in Jordan compared to 110.0% in the MENA region countries on average.

Solvency

Capital Adequacy Ratio.[4] This ratio reached 49.0% for the microfinance institutions, confirming the capacity of these institutions to meet their financial obligations and withstand unexpected losses.

Equity-to-Assets Ratio. This ratio measures the capacity of microfinance institutions to meet their obligations and absorb losses. It reached 41.0% in Jordan, which is lower than its counterpart for MENA region countries of 48.0%.

Debt-to-Asset Ratio. The debt portfolio ratio is the main income-generating asset for the microfinance institutions. It amounted 87.0% in Jordan compared to 77.0% for the MENA region. This high ratio in Jordan is attributed to the limited services that the microfinance institutions offer other than loans.

Financial Leasing Institutions

Total assets of leasing companies in Jordan approximated JD 288.4[5] million at the end of 2013, compared to JD 262.6 million at the end of 2012, representing a growth rate of 9.8%. Total tradable assets increased to JD 137.3 million at the end of 2013 compared to JD 129.9 million at the end of 2012. The driving factor for the increase in the total current assets is the increase in net investments in lease contacts that mature within one year from JD 96.3 million to JD 112.1 million, while total non-tradable assets of increased from JD 132.7 million to JD 151.1 million because of the increase in the net investments in lease contacts that mature after more than a year from JD 124.2 million at the end of 2012 to JD 134.9 million at the end of 2013.

Concerning the business outcome of the leasing companies in Jordan, the revenue of these companies increased from JD 25.1 million at the end of 2012 to JD million 30.2 at the end of 2013, attaining a growth rate of 20.3%. Revenues from lease contracts formed 87.0% of total revenue at the end of 2013, which is equal to proportion attained at the end of 2012. Property leasing income acquired 61.2% of the total financial leasing revenues at the end of 2013, followed by transportation leasing income of 17.9%, and then the revenue generated from leasing industrial equipment of 12.5%. The revenue from the other forms of leasing, such as medical and office devices, construction equipment and computer leasing, accounted for 8.4% of the total revenues from financial leasing contracts.

The increase in the financial leasing contracts revenue led to an increase in the net after tax profit from JD 11.9 million at the end of 2012 to JD 14.3 million at the end of 2013, forming a growth rate of 20.2%.

[4] CAR for the microfinance institutions is computed by dividing equity by outstanding debt after deducting provisions (outstanding debt)
[5] Data includes six financial companies that are subsidiaries of banks that accounted for the bulk of the financial leasing activity in Jordan, besides one company that is not a bank subsidiary. The financial leasing provided by the Islamic banks was not included in the data.

It is worth mentioning that the number of financial leasing companies reached 24 companies, including six subsidiaries of banks that accounted for the bulk of the financial leasing activity in Jordan; according to Companies Control Department at the Ministry of Industry, Trade and Supply.

Exchange Sector

The exchange sector witnessed a remarkable development in terms of coverage and size of business, where the number of exchange companies licensed in Jordan reached 141 companies operating through headquarters at the end of 2013, in addition to 96 branches are distributed across all governorates in Jordan - a total of 237 exchange entities as at the end of 2013 (Table 3.8).

Table 3.8: Foreign Exchange Companies and Their Branches (2013)

Governorate	Companies	Branches	Total
Capital	93	67	160
Zarqa	13	9	22
Irbid	8	4	12
Aqaba	7	5	12
Other Governorates	20	11	31
Total	141	96	237

The Currency Exchange Law number 26 of the year 1992 represents the legislative framework that regulates the activity of the exchange sector in Jordan through determining the legal forms of exchange companies and their capital and supervisory tools (both onsite and offsite) as well as the identification of types of transactions that the exchange companies are allowed to perform, in addition to specifying the sanctions in the event of any violation of the law. A set of instructions and decisions were released under the Law to determine the requirements and the detailed procedures for organizing the exchange industry profession in Jordan.

In light of the passage of more than twenty years since the issuance of the said law and the economic changes and the remarkable development in the activities of exchange companies and the diversity of offered services, and in order to provide an appropriate capital base to increase the solvency of exchange companies and protect the dealers, the minimum capital of licensed exchange companies determined under the law has been amended and raised by 200% above the minimum level that was set before. According to gradual procedures, geographical locations of these companies were taken into consideration for the purpose of enhancing the safety and soundness of the currency exchange sector and strengthening the ability of exchange companies to compete locally, regionally, and internationally to offer exchange services of high quality to keep pace with the latest international developments in this field, in addition to increasing the amount of liquidity available to these companies- to enhance their ability to improve their performance, and, hence, eventually reflect positively on the profitability indicators of the exchange sector as a whole.

The CBJ practices its supervision on the currency exchange sector onsite and offsite. The offsite supervision mainly entails studying and analyzing the periodic statistical data and the audited financial statements of the exchange companies and proposing recommendations to policy makers (Table 3.9). Whereas the onsite supervision conducted through the on-ground inspection teams verifies the compliance of the companies operating in the exchange sector with all laws and instructions in force, in addition to the role of external auditors of the exchange companies and related parties as per provisions of the law.

Table 3.9: Selected Indicators for the Currency Exchange Sector in 2013 (JD Million)*

Indicator	JD Million
Business size*	218.0
Capital	60.0
Financial guarantees offered	19.6
Purchase of foreign currency	5,410.0
Sales of foreign currency	5,431.0
Return on capital (%)*	7.0
Return on assets (%)*	2.0

*Data goes back to 2012

Third: Amman Stock Exchange

Amman Stock Exchange witnessed a varied performance in 2013 compared to 2012. Trading volume and the stock price index weighted by free stocks increased in 2013 by 53.0% and 5.5% respectively. Yet, the market value of shares listed in Amman Stock Exchange decreased by 4.7% to reach JD 18.2 billion, forming 76.4% of GDP. Net trading of non-Jordanian investors registered a net inflow in the amount of JD 146.9 million. Next is a brief of the most important indicators for Amman Stock Exchange for 2013.

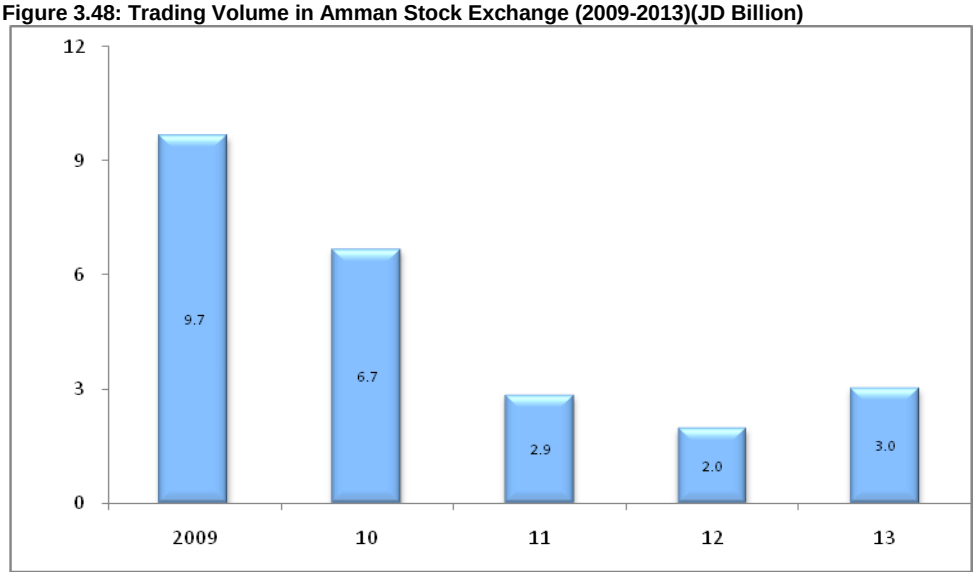
- The trading volume increased during 2013 by JD 1.0 billion to reach JD 3.0 billion at the end of the year, compared to a decline by JD 0.9 billion in the previous year, this significant increase is attributed to the following reasons:
    a. The increase in the trading volume for the financial sector by JD 1,031.9 million (Table 3.10).
    b. The increase in the trading volume for industry and services sectors by JD 12.3 million and JD 4.2 million respectively (Figure 3.48).

Table 3.10: Relative Importance of Trading Volume by Sectors (2009-2013) (%)

Sector	2009	2010	2011	2012	2013
Financial	65.6	62.4	62.6	60.1	73.4
Services	21.1	26.0	18.0	20.4	13.5
Industry	13.3	11.6	19.4	19.5	13.1

1. The market value of the shares listed on the stock exchange during 2013 decreased by nearly JD 0.9 billion to reach JD 18.2 billion forming about 76.4% of GDP at the end of the year, compared to a decline of JD 0.1 billion in the previous year.

Figure 3.48: Trading Volume in Amman Stock Exchange (2009-2013)(JD Billion)



Source: Amman Stock Exchange

2. The number of traded shares increased by 321.7 million shares in 2013 compared to a decline of 1,688.2 million shares in the previous year. In addition, the number of contracts executed increased by 99.4 thousand contracts to reach approximately 1.1 million contracts at the end of 2013. As for the distribution of shares traded by sector, the acquisition of the financial sector is evident; it accounted for 69.4% of the shares traded during 2013, followed by the services sector, composing about 16.5% of shared traded, followed the industrial sector that acquired 14.1% of total shares traded.
3. The activity of non-Jordanian investors in the Amman Stock Exchange recorded a positive net inflow of JD 146.9 million at the end of 2013, compared to JD 37.6 million in the previous year. The value of shares bought by non-Jordanian investors during 2013 reached about JD 939.5 million, while the value of shares sold by them was JD 792.6 million (Table 3.11).

Table 3.11: Shares Trading at ASE by Non-Jordanian Investors (2009-2013) (JD Million)

	2009	2010	2011	2012	2013
Shares purchase	**2,135.4**	**1,036.6**	**555.8**	**322.9**	**939.5**
Arab	1,896.3	801.2	364.8	227.7	818.5
Foreigners	239.1	235.4	191.0	95.2	121.0
Shares Sale	**2,139.2**	**1,051.2**	**477.2**	**285.2**	**792.6**
Arab	1,889.4	919.6	335.4	225.8	693.2
Foreigners	249.8	131.6	141.8	59.4	99.4
Net investment	**-3.8**	**-14.6**	**78.6**	**37.7**	**146.9**
Arab	6.9	-118.4	29.4	1.9	125.3
Foreigners	-10.7	103.8	4 9.2	35.8	21.6

Price-Weighted Stock Price Index by Free Stocks

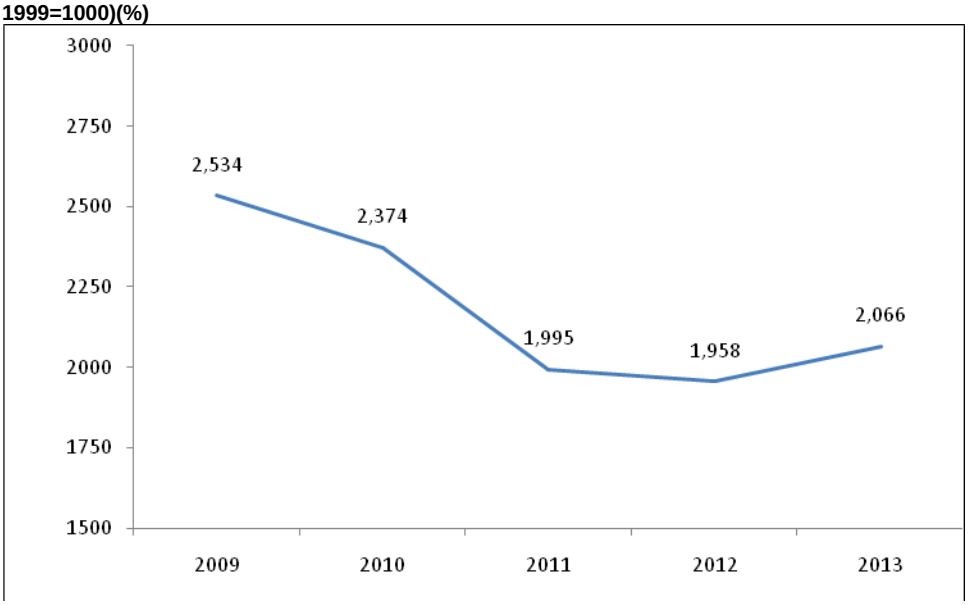
Stock price index weighted by free stocks approximated 2,065.8 points at the end of 2013, attaining a rise of 108.2 points from its level at the end of the previous year, compared to a decline of 37.5 points at the end of 2012. This surge in the index was the outcome of the *rise* in the stock price index of financial and services sectors by 340.3 points and 13.7 points respectively at the end of 2013; compared to a decline by 80.3 points and 42.6 points respectively at the end of 2012, and the *decrease* in the stock price index of the industry by 211.7 compared to a rise of 26.7 points at the end of 2012.

Market-Capitalization Weighted Stock Price Index

Capitalization-weighted stock price index decreased by 257.2 points at the end of 2013 from its level at the end of the previous year to reach 4,336.7 points, compared to a decline of 54.5 points at the end of 2012. This decline in the stock price index weighted by market capitalization was the outcome of the decrease in the stock price index of the industry and insurance sectors and increase in stock price index of the banking and services sectors as follows:

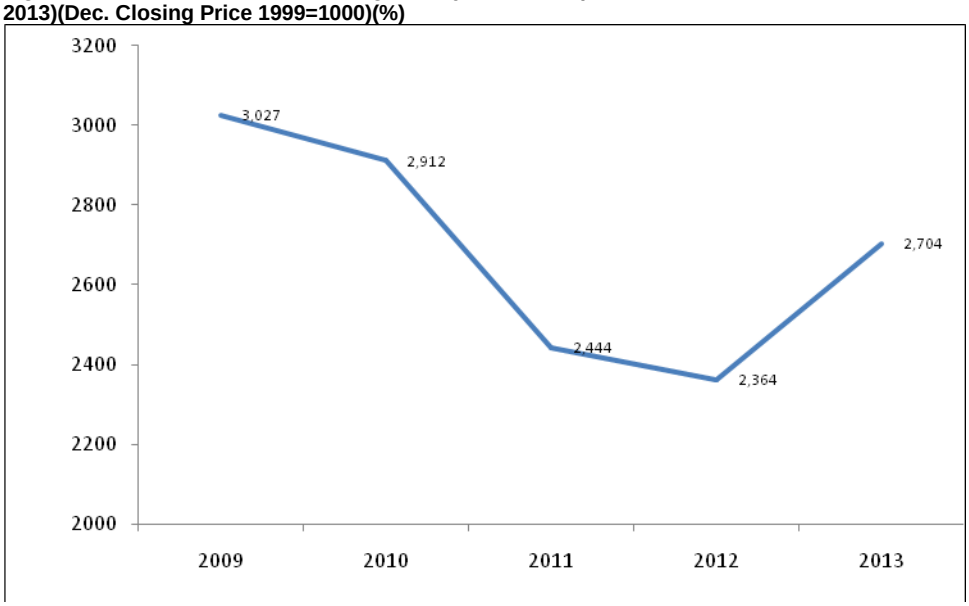
1. The stock price index of the industry sector decreased by 1,396 points at the end of 2013 compared to an increase by 179 points at the end of 2012. In addition, the stock price index of the insurance sector decreased by 36.9 points at the end of 2013 compared to a decline by 452.7 points at the end of 2012.
2. The stock price index of the banking sector increased by 737.8 points at the end of 2013 compared to a decline by 244.9 points at the end of 2012. Similarly, the stock price index of the services sector increased by 14.7 points at the end of 2013 compared to a decrease by 61.7 points at the end of 2012.

Figure 3.49: Share Price Index Weighted by Market Capitalization of Free Float Shares (2009-2013)(Dec. Closing Price 1999=1000)(%)



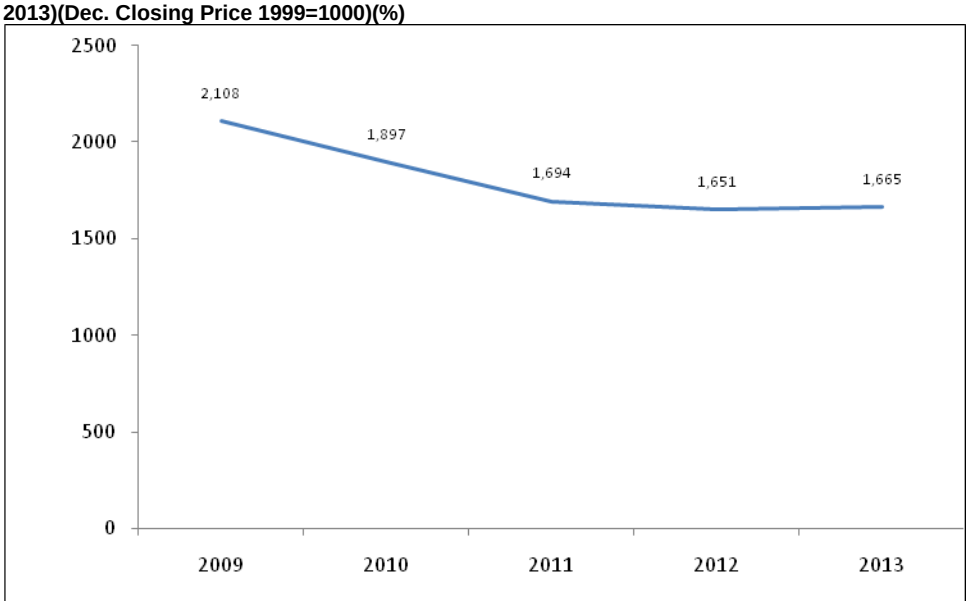
Source: Central Bank of Jordan, Monthly Report.

Figure 3.50: Share Price Index Weighted by Market Capitalization of Free Float Shares for Financial Sector (2009-2013)(Dec. Closing Price 1999=1000)(%)



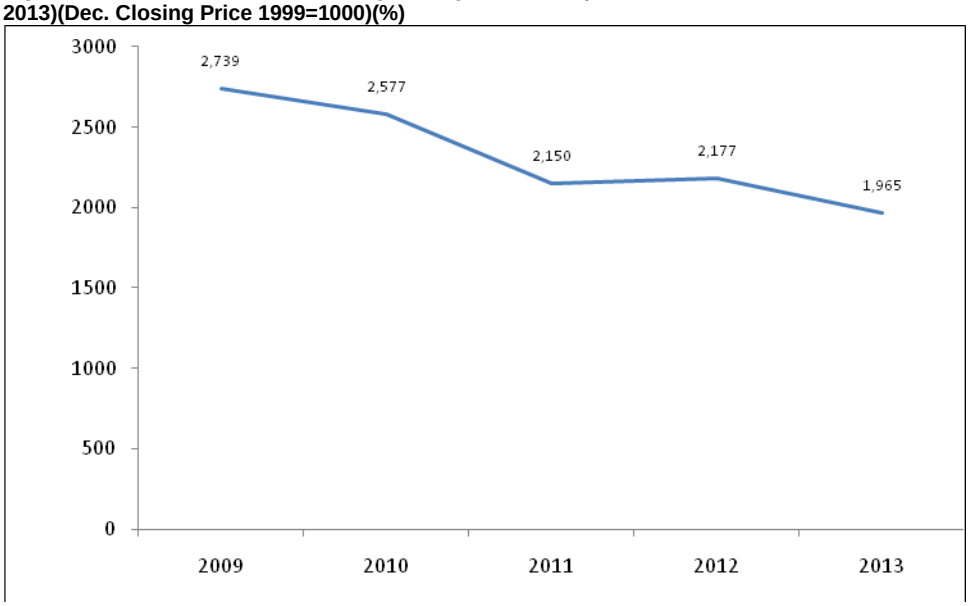
Source: Central Bank of Jordan, Monthly Report.

Figure 3.51: Share Price Index Weighted by Market Capitalization of Free Float Shares for Service Sector (2009-2013)(Dec. Closing Price 1999=1000)(%)



Source: Central Bank of Jordan, Monthly Report.

Figure 3.52: Share Price Index Weighted by Market Capitalization of Free Float Shares for Industry Sector (2009-2013)(Dec. Closing Price 1999=1000)(%)



Source: Central Bank of Jordan, Monthly Report.

Chapter Four: Operational Efficiency of the Banking System in Jordan

Introduction

Operational efficiency is defined as: "the optimal utilization of production capacity at the institution level, and directing available resources toward achieving the maximum return potential at the lowest possible cost. In other words, operational efficiency implies the successful control of the institution's physical, financial and human possibilities to ensure the best performance with the economic, social and political environment under which the institution exists". The importance of operational efficiency comes from the reduction of waste of resources and the increase in the efficiency of the available resources in order to supply cost-effective high-quality products and services.

The subject of operational efficiency in banks is an important issue and is vital in assessing the effectiveness and efficiency of management in the utilizing its resources and controlling its expenses. According to a study by Deloitte, the US banks that are highly efficient in their operations had a greater capacity to withstand shocks and continue in the business during the credit crisis in the USA. The measurement of banks' operational efficiency is an important factor in reassuring the investors and attracting them to direct their savings towards the banking sector. The concern of supervisory authorities and bankers in the operational efficiency is attributed to several reasons, of which the reason that the efficiency numbers signal the success or failure potentials of banks being the most important reason. Operational efficiency at banks is measured from two perspectives: bank's ability to generate income with the limited sources available (revenues) and its ability to control its expenses.

This chapter discusses in detail the most important indicators that are used to measure operational efficiency of the operating banks in the Jordan. More specifically the indicators detailed next are cost-income ratio, productivity, profitability and interest rate margin.

Analyzing Operational Efficiency of the Jordanian Banking System

Cost-Income Ratio

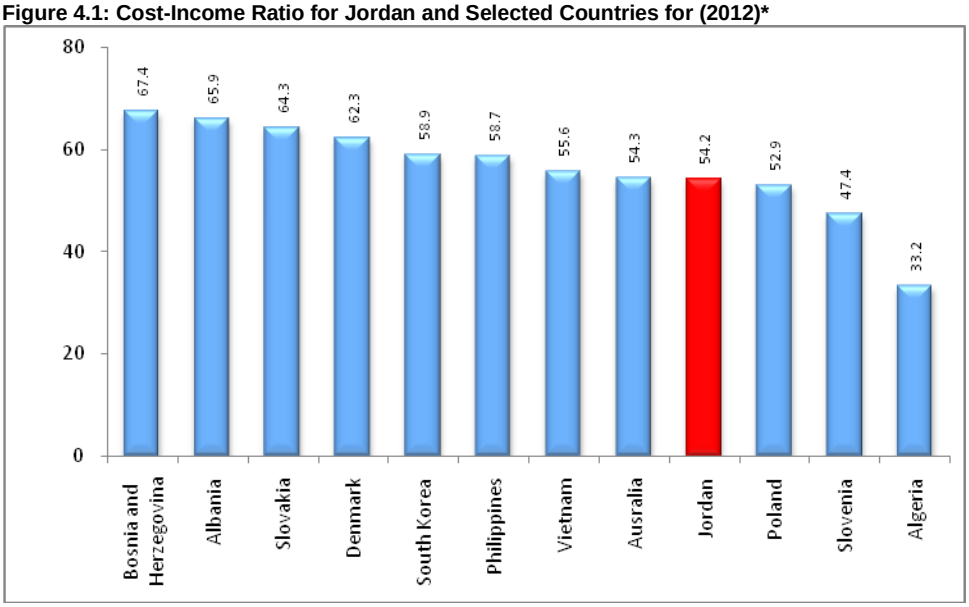
Cost-Income Ratio (CIR) is *the most important* ratio that measures the operational efficiency of the banks. A study conducted by Mckinsey & Co Consultants Company showed that the banks whose CIR exceeds 55.0% suffered from operational efficiency weaknesses in terms of their ability to generate income while controlling expenses. Based on this study, a CIR number that precedes 55.0% gives a positive indicator of the operational efficiency of the banks.

The CIR for the banking system in Jordan approached 54.2% at the end of 2013, which is lower in 2013 relative to the years 2012 and 2011 of 60.3% and 61.5% respectively. This movement in the CIR in 2013 and the preceding two years is an indication of the improvement in the level of banks' operational efficiency in Jordan. The driving reason for the decline in the CIR is the decline in total expenses due to the evident decrease in the total provisions in 2013 sustained by the increase in total income of the operating banks in the Jordan. In other words, the improvement in the quality of banks' assets, reflected by the decrease in the non-performing loans ratio and the reduction in the size of the provisions withheld during 2013, and the rise in banks' income, particularly from the investment in government bonds all had a positive impact on banks' operational efficiency. The

decline in the CIR enhances the banks' ability to control expenses and sustain profitability. This was the case for the banking system as a whole. At the individual level, there were evident variations between banks in operational efficiency, where the CIR ranged between 55.0% and 60.0% for three banks, exceeded 60.0% for six banks, and was less than 55.0 % for 17 banks. This means that about 65.0% of banks in Jordan enjoyed a relatively good level of operational efficiency.

In comparing the ratio of total expenses to total income for the operating banks in the Jordan with some other countries, it is realized that Jordan is the fourth lowest country among the 12 selected countries (Figure 4.1). This is another indication of the enjoyment of the banks working in Jordan a satisfactory level of operational efficiently in comparison with some other countries.

Figure 4.1: Cost-Income Ratio for Jordan and Selected Countries for (2012)*



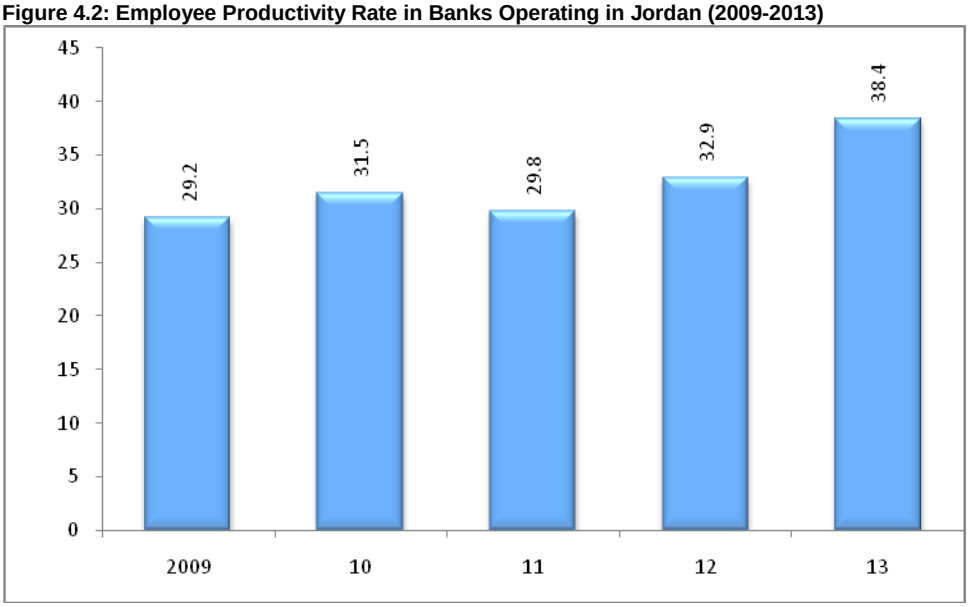
Source: Jordan: Central Bank of Jordan. Other Countries: www.Helgibilibrary *Countries' Data (But Jordan) 2012.

Productivity per employee

Despite the notable rise in personnel expenses in the banking sector from about JD 315.2 million at the end 2012 to JD million 344.7 at the end of 2013, or a growth of 9.4%, employee productivity achieved a remarkable growth. This is an evident indication of the improvement in the banks' ability to optimally utilize their human resources, and, hence, enhance their resource management effectiveness. While productivity leveled at JD 29.0 thousand at the end of 2009, it increased to approximately JD 39.0 thousand in 2013 (Figure 2.4).[6]

[6] Employee productivity (or, simply, productivity) is measured by dividing net revenues in a given year by the number of employees in that year.

Figure 4.2: Employee Productivity Rate in Banks Operating in Jordan (2009-2013)



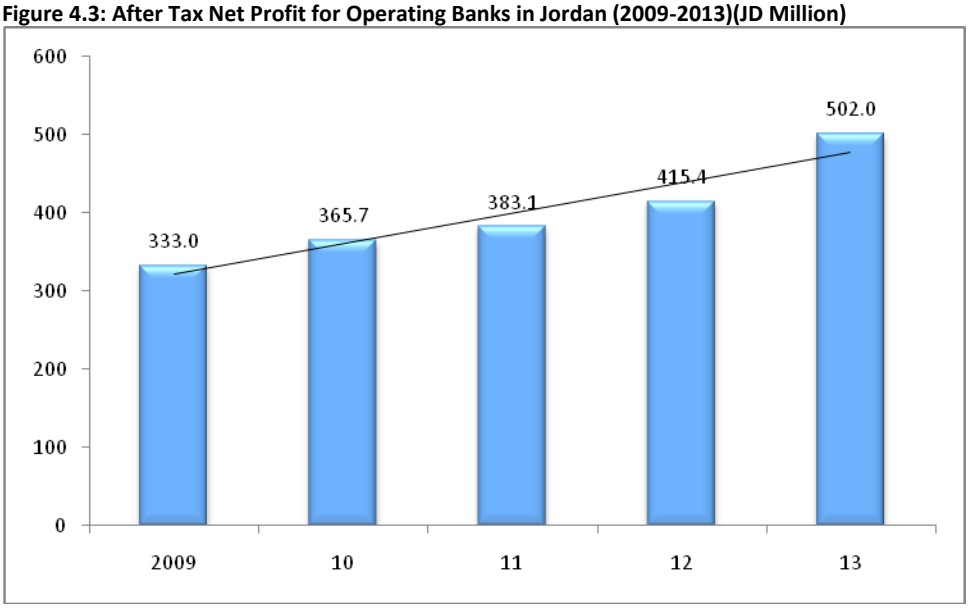
Source: Central Bank of Jordan

Profitability

Annual Profit after Tax

Net profit after tax for the operating banks in Jordan increased from JD 415.4 million at the end of 2012 to JD million 502.0 at the end of 2013, achieving a growth rate of 20.8%, which is a relatively high rate. It is also higher than its counterpart at the end of 2012 as well, where net after tax profit grew by 8.4% from 2011 (Figure 4.3).

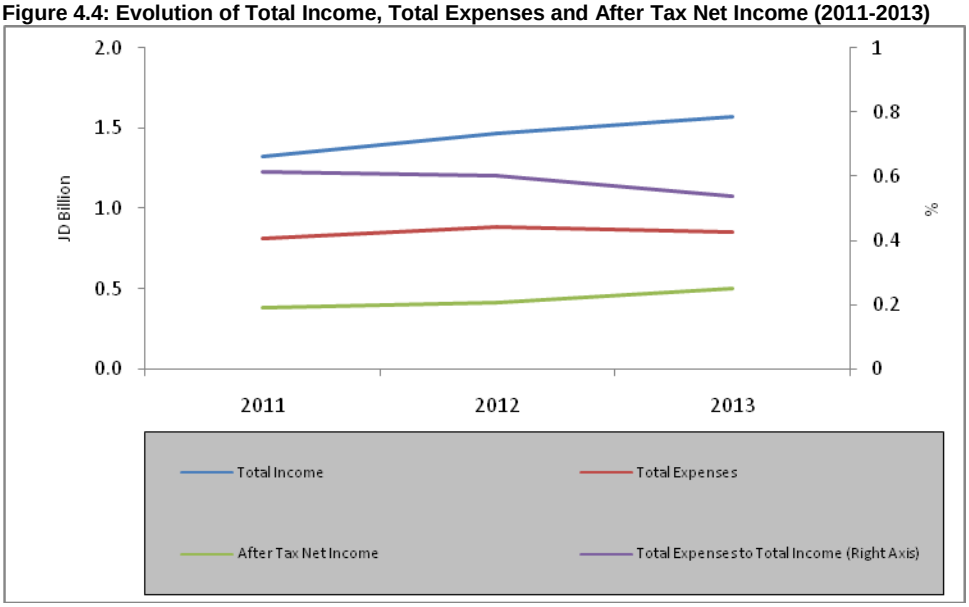
Figure 4.3: After Tax Net Profit for Operating Banks in Jordan (2009-2013)(JD Million)



Source: Central Bank of Jordan

The main reason for the rise in banks' profits during the year 2013 is the increase the banks' interest income, particularly from their investment in government bonds accompanied by the decrease in total expenses, particularly provisions expenses. Figure 4.4 depicts the evolution of total income, total expenses and net after tax profit for the operating banks in Jordan during the period 2011-2013.

Figure 4.4: Evolution of Total Income, Total Expenses and After Tax Net Income (2011-2013)



Returns on Assets and Equity

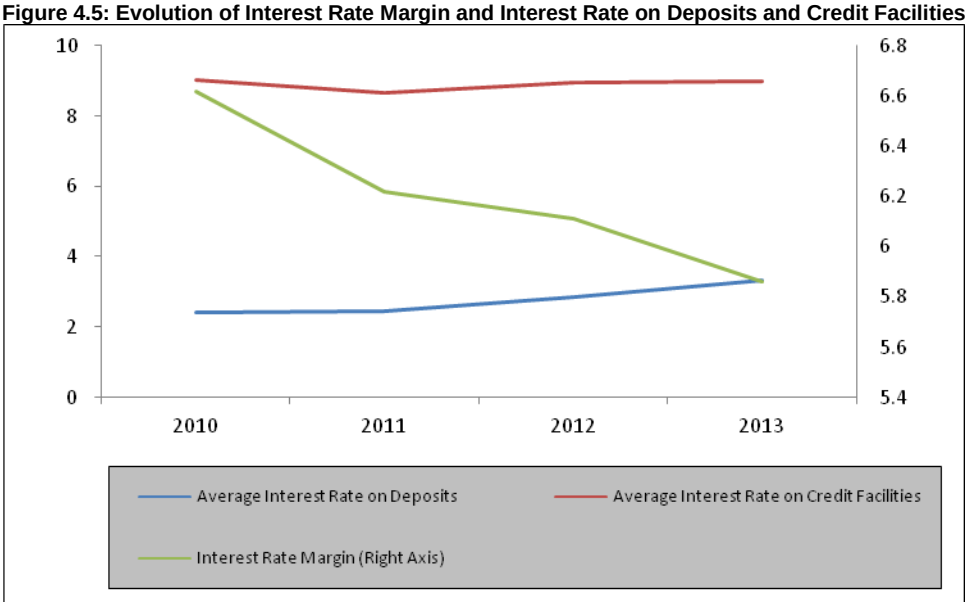
As mentioned in Chapter Three, both the rate of return on assets and the rate of return on equity improved during 2013 as a result of the significant growth of banks' profits. They reached 1.2% and 9.9% respectively. However, these rates are still lower than their counterparts in most Arab countries because of the conservative and risk aversion behavior of the operating banks in Jordan, in addition to the high levels of capital.

Interest Margin[7]

Interest rate margin followed a downward trend during the past four years, as it fell from 6.62% at the end of 2010 to 5.68% at the end of 2013. This decline is due to the rise interest rates on deposits and the slight fall in the interest rates on credit facilities. The average interest rate on deposits was 2.42% at the end of 2010, after that it followed an upward trend until it reached 3.33% at the end of 2013. In contrast, the average interest rate on credit facilities was 9.04% at the end of 2010, and then decreased to reach 8.68% at the end of 2011 before following a positive trend at the end 2012 and 2013, as it increased to 8.96% and 9.01% respectively. Figure 4.5 illustrates the evolution of interest rates on deposits, interest rates on credit facilities and interest rate margin during the period 2010-2013.

[7] Islamic banks were excluded from the calculations in this section.

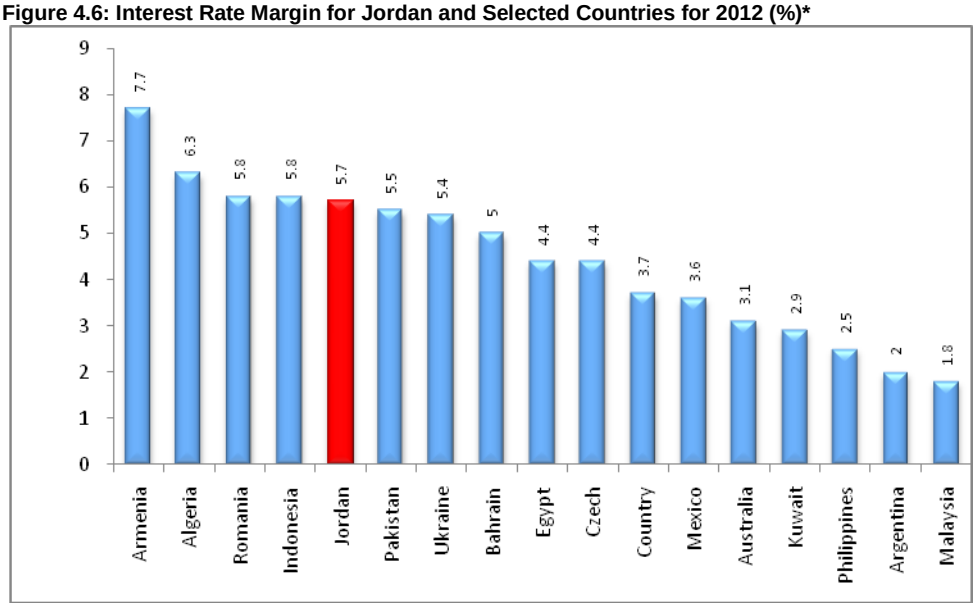
Figure 4.5: Evolution of Interest Rate Margin and Interest Rate on Deposits and Credit Facilities (2010-2013)(%)



Source: Central Bank of Jordan

In spite of the low interest margin during the period 2010-2013, it is still high compared to several other countries. As appears from Figure 4.6, Jordan was the fifth highest country in terms of interest margin among 16 countries selected from different continents.

Figure 4.6: Interest Rate Margin for Jordan and Selected Countries for 2012 (%)*

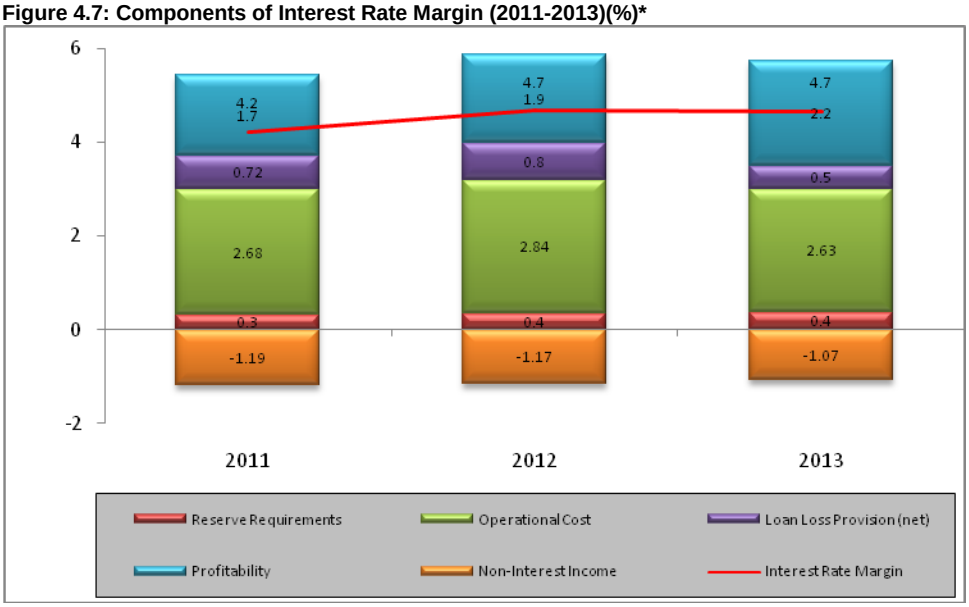


Source: Jordan: Central Bank of Jordan. Other Countries: World Bank. *Jordan for 2013

An analysis of the components of the margin using a methodology used in a working paper conducted by Tigran Poghosyan[8] and published by the International Monetary Fund in 2012, summarized in Box 6 and Figure 4.7, implies that the interest rate margin must cover the operating expenses of the banks, the cost of debt provisions, the cost of required reserve ratio deposited in the central bank and profits (Box 6 and Figure 4.7).

[8] Tigran Poghosyan. 2012. Financial Intermediation Costs in Low-Income Countries: The Role of Regulatory, Institutional, and Macroeconomic Factors. WP140. IMF.

Figure 4.7: Components of Interest Rate Margin (2011-2013)(%)*



Source: Central Bank of Jordan
*Interest Rate Margin Equals Non-Interest minus the sum of other four components

Using this method, the share of the operating expenses of banks (general and administrative expenses except provisions) in the margin were nearly 2.63 percentage points, representing 46.0% of the margin. Given that, according to the IMF WP140/12, the average share of operating expenses in the margin was approximately 58.0% in the emerging market economies approximately, which means that the net interest margin in Jordan is reasonable and is within the acceptable levels.

Comparing the components covered by the interest rate margin for the licensed banks during the years 2011-2013, it is noted that there was an improvement in operational efficiency amongst banks, as previously mentioned, where the share of the operating expenses in the margin decreased from 2.84 percentage points in 2012 to 2.63 percentage points in in 2013.

The cost of debt provisions declined from 0.75 percentage points in 2011 to 0.50 percentage points in 2013. At the same time, the share of bank profits from the interest rate margin increased from 1.71 percentage points in 2011 to 2.23 percentage points in 2013. It is expected that the improved operational efficiency at banks – if continued - will lower interest rates.

Box 6: The Calculation of Net Interest Margin[9]

Net interest margin, per an IMF working paper, Reserve requirement costs, operational costs, loan loss provision costs, profitability, non-interest income. Therefore the net interest margin is calculated as follows:

Table 4.1 shows the results of applying the above equation to calculate the net interest rate margin on banks operating in Jordan during the period (2011-2013).

Table 4.1: Results Of The Application Of The IMF Equation For Calculating Net Interest Margin On The Banks Operating In Jordan (2011-2013) (%)

Components	2011	2012	2013
Reserve requirement costs	0.31	0.35	0.37
Operational costs	2.68	2.84	2.63
Loan loss provision costs	0.72	0.80	0.50
Profitability	1.71	1.87	2.23
Non-interest income	1.19	1.17	1.07
Net Interest Margin	4.22	4.68	4.66

Therefore, net interest margin covers the banks' cost and profitability components as follows:

- Reserve requirement costs: High reserve requirements impose additional costs on banks, since they have to pay a market interest rate to depositors but have to hold a fraction of these deposits in the central bank at a zero rate. Banks normally pass these additional costs on to their borrowers.
- Operational costs: This determinant measures the impact of bank efficiency on the margin. More efficient banks are able to maintain lower operational costs relative to their less efficient counterparts. Therefore, the lower the share of operational cost in the margin, the most efficient banks in terms of operational efficiency.
- Loan loss provision costs: This determinant proxies the impact of credit risk on the margin. Banks with riskier lending portfolio are required to transfer a larger amount of funds to maintain adequate loan loss provision reserves, which weighs on the margin.
- Profitability: This factor defines the part of the margin that banks add up to their costs to maintain an adequate level of profitability.
- Non-interest income: Banks' earning funds from nontraditional banking activities (such as, fee-based activities, licensing, insurance, etc.) may maintain an adequate level of profitability while operating at lower margins. This explains why this factor enters the above decomposition with a negative sign.

Conclusion

The analysis of operational efficiency of the banking system in Jordan during 2013 revealed that there is an improvement in operational efficiency at banks as the proportion of operating expenses and provisions to total income during 2013 declined and became within the international acceptable levels. In spite of this improvement, the interest rate margin in Jordan is still considered high compared to many countries - even though it recently declined. The improvement in the operational efficiency at banks is expected to lower interest rates if it continued its trend and, hence, to enhance the contribution of banks in financing various economic activities at reasonable cost.

[9] Text for this box was obtained from the AM IMF WP140/2012.

Chapter Five: The Exposure of the Banking System to Real Estate Market Risks and the Real Estate Price Index

Introduction

The real estate sector is an important driver for the economic growth in Jordan; it contributes to about 4.4% of GDP. It is also considered one of the most important components of real investment as an important share of the savings of Jordanians goes to this sector. This sector has a direct influence on various economic sectors and creates jobs for the labor market, and creates a remarkable activity for support services such as: iron markets, cement, wood, glass, aluminum, sanitary ware. It also helps develop infrastructure sectors and various housing and investments projects. In this regard, banks play an important and essential role in financing real estate investments, whether it was for residential or commercial purposes. Real estate collateral constitutes an important portion of the banking system guarantees that are required for the granting of credit.

The focus on the real estate sector market risk and its financing increased after the global financial crisis that began by the real estate market bubble in the USA in 2007, as known, and the subsequent repercussions that affected most world economies, including Jordan.

The real estate market in Jordan witnessed successive jumps during the last two decades mainly fueled by the economic and political developments in Jordan and the region and the subsequent abnormal growth of the population in Jordan, in addition to the influx of large numbers of refugees from Iraq and Syria.

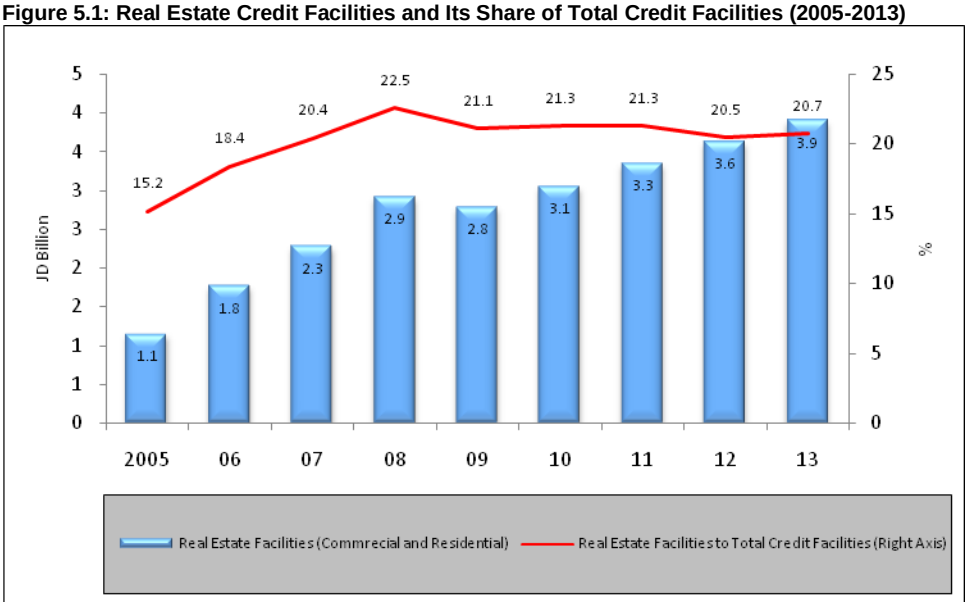
This chapter sheds the light on the real estate sector in Jordan and the exposure of operating banks in Jordan to the risks of this sector. The chapter also analyzes the evolution of real estate prices in Jordan through the analysis of the real estate price index that has been very recently developed in cooperation between the CBJ and the Department of Land and Survey.

Bank's Exposure to Real Estate Sector

Total credit facilities granted to the real estate sector for commercial and residential purposes reached JD 3.9 billion at the end of 2013, accounting 20.7% of the total facilities granted by banks, compared to JD 3.6 billion at the end of 2012, at a growth rate of 7.5%. It is worth mentioning in this context that the annual rate of growth during the years 2006-2013 amounted to 17.7% (Figure 5.1).

Regarding the ratio of credit facilities extended to the real estate sector to the GDP, it approximated 16.4% at the end of 2013, whereas it formed 12.8% in 2005. Figure 5.2 depicts the ratio of credit facilities granted to the real estate sector to GDP during the period 2005-2013.

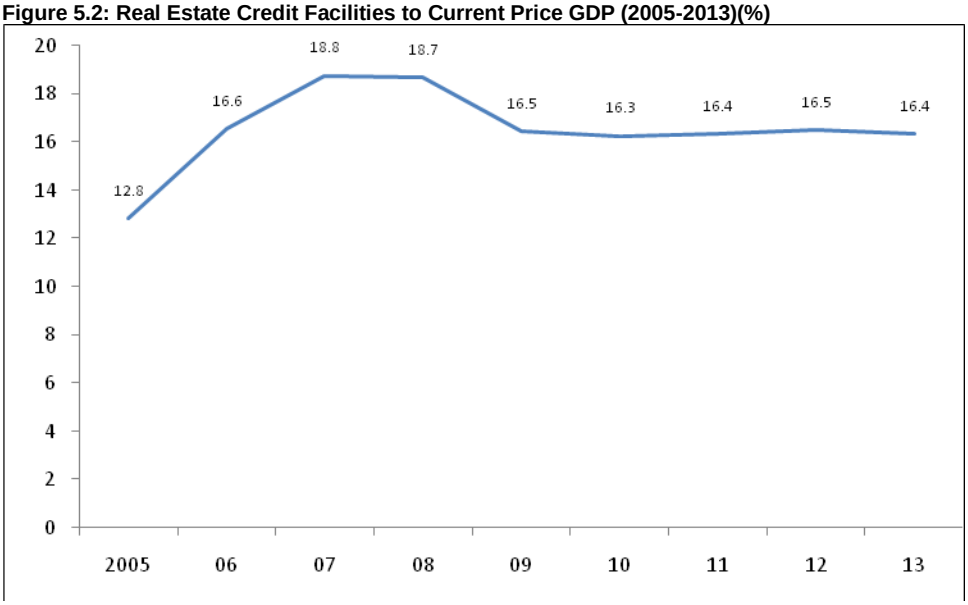
Figure 5.1: Real Estate Credit Facilities and Its Share of Total Credit Facilities (2005-2013)



Source: Central Bank of Jordan

As can be noted from Figure 5.2, the ratio of credit facilities granted to the real estate sector to GDP witnessed a remarkable increase during the period 2006-2008. It reached 18.7% at the end of 2008. After that it dropped and leveled slightly above 16.0% during the period 2009-2013 impacted by the global financial crisis and the situation in the MENA region.

Figure 5.2: Real Estate Credit Facilities to Current Price GDP (2005-2013)(%)

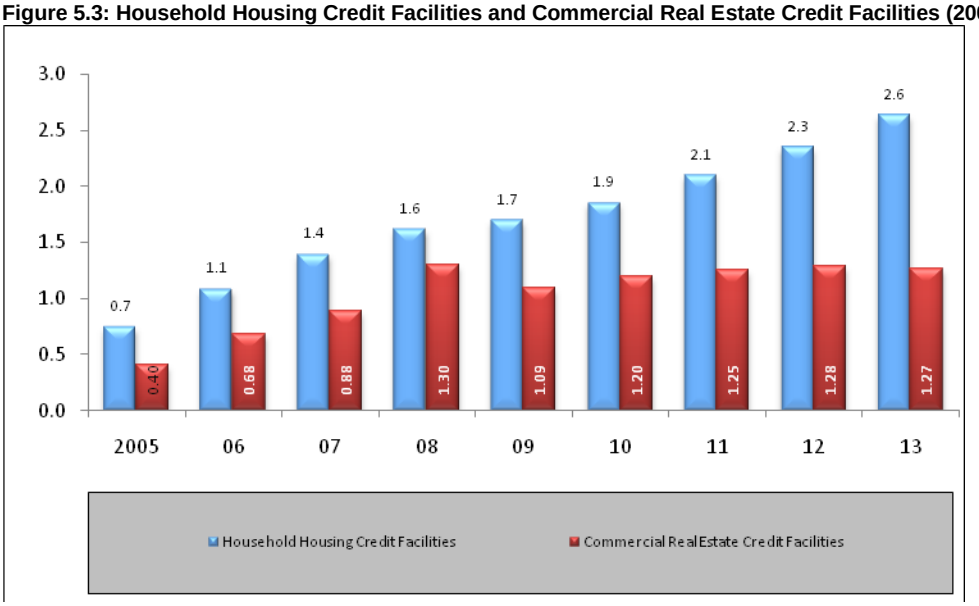


Source: Central Bank of Jordan

Components of Real Estate Credit

Household housing credit formed 67.5% of total credit extended to real estate sector, whereas corporate real estate credit formed 32.5% (Figure 5.3).

Figure 5.3: Household Housing Credit Facilities and Commercial Real Estate Credit Facilities (2005-2013)(JD Billion)



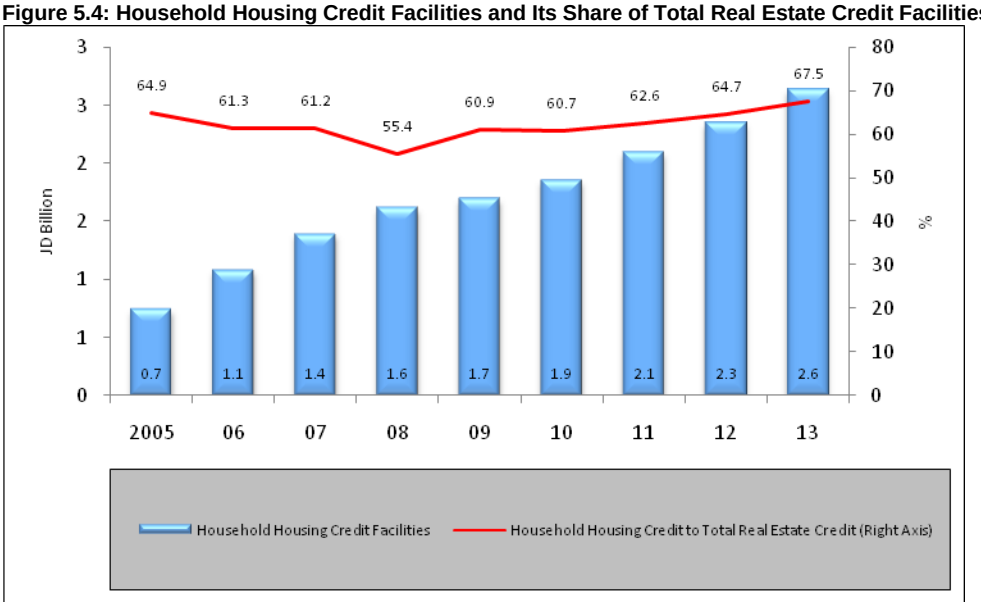
Source: Central Bank of Jordan

Household Real Estate Credit

The total real estate extended to households reached

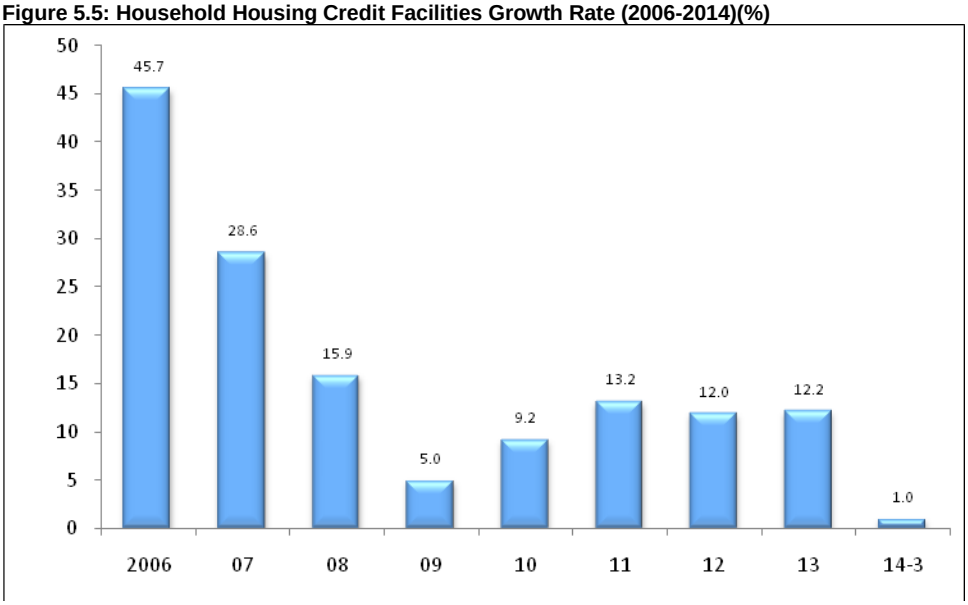
The total housing loans granted to individuals by banks reached JD 2,632.0 million at the end of 2013, compared to JD 2,346.0 million at the end of 2012; at a growth rate of 12.2%. Back to 2005, the size of this type of credit was JD 744.0 million; which means that they doubled more than three times during the last eight years. The bulk of this growth was during the period 2005-2008 (the period preceding the global financial crisis) which realized a substantial demand for real estate, especially from non-Jordanians, with an average growth in housing loans during this period of approximately 30.0%. After this period, during the period 2009-2010, the growth pace significantly slowed due to the repercussions of the global financial crisis and the accompanying uncertainty and the reluctance of banks in the granting of mortgage loans. The real estate credit resumed its positive growth during the period 2011-2013 after the fading of the impacts of the global financial crisis and the improved market conditions that led to the rise in the demand for real estate. However, this growth did not touch pre-global financial crisis percentages; with an average growth of real estate credit during this period of approximately 12.4%. It is worth mentioning that the first quarter of 2014 realized a low growth in real estate loans, as they increased by JD 26.0 million at a growth rate of only 1.0% as appears in Figure 5.4 and Figure 5.5.

Figure 5.4: Household Housing Credit Facilities and Its Share of Total Real Estate Credit Facilities (2005-2013)



Source: Central Bank of Jordan

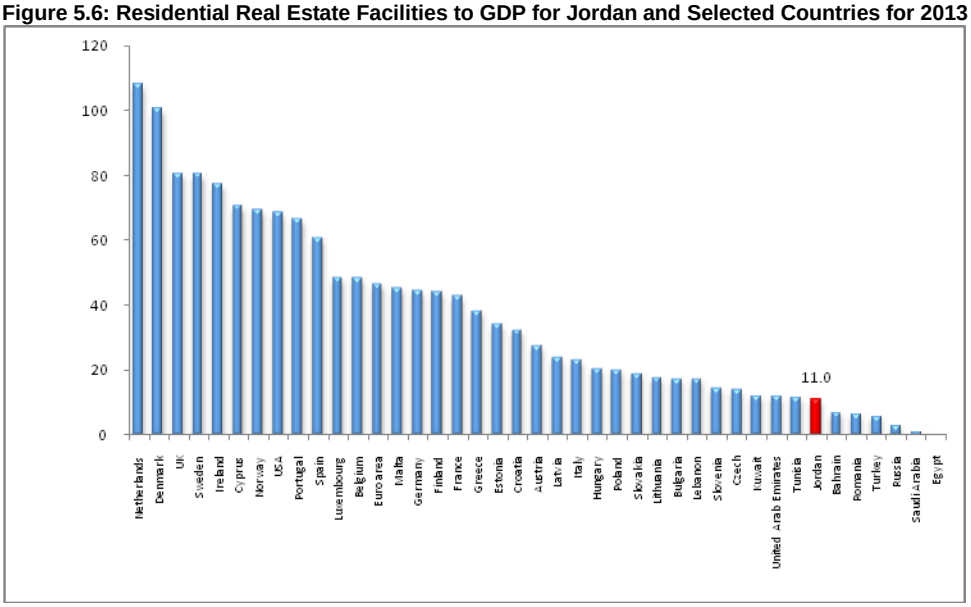
Figure 5.5: Household Housing Credit Facilities Growth Rate (2006-2014)(%)



Source: Central Bank of Jordan

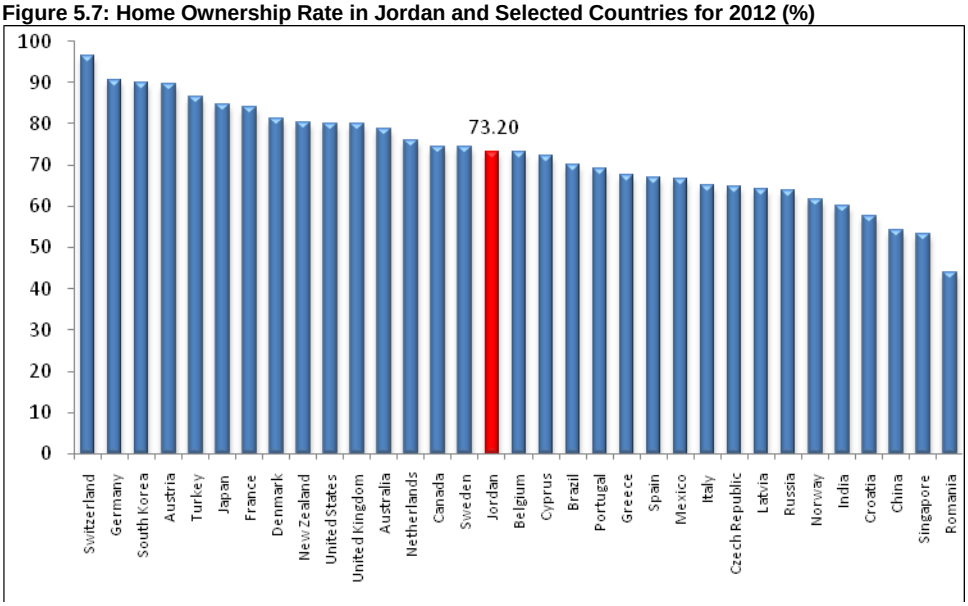
As for the ratio of household housing loans to GDP, they reached approximately 11.0% at the end of 2013. In this regard, Jordan is considered one of the lowest amongst the selected countries as appears in Figure 5.6. The main reason behind this low share is that about **73.0% of Jordanians own their living places**, furthermore; there are other alternatives to obtain credit that the Jordanians use. Of these are employee housing loans and loans from institutions; funds and cooperative societies; such as Housing and Urban Development Corporation figure 5.7.

Figure 5.6: Residential Real Estate Facilities to GDP for Jordan and Selected Countries for 2013 (%)



Source: Arab Countries: http://www.hofinet.org/countries Other Countries: http://www.hypo.org

Figure 5.7: Home Ownership Rate in Jordan and Selected Countries for 2012 (%)



Source: http://www.hofinet.org/countries Jordan: Housing and Urban Development Corporation

Corporate Real Estate Loans

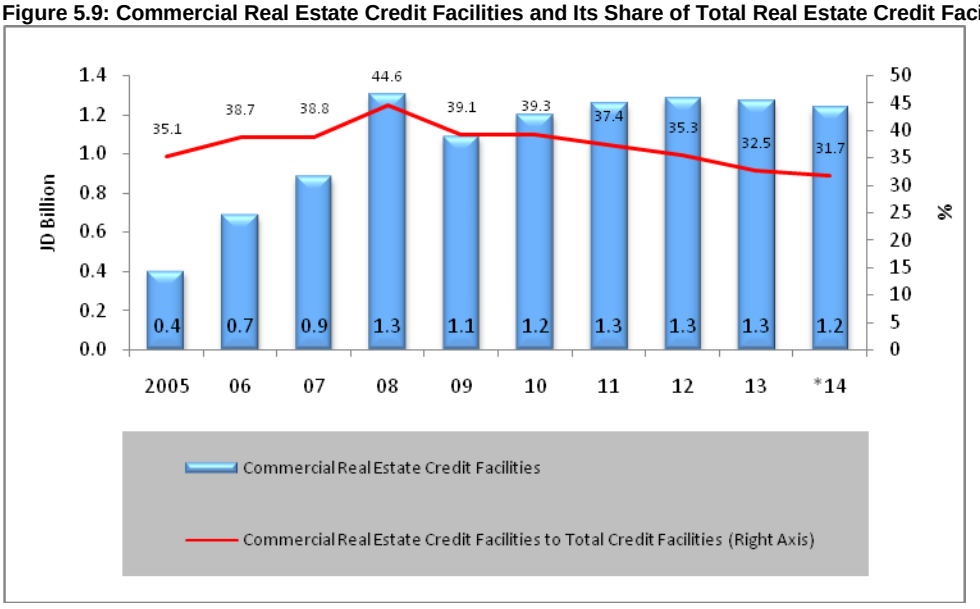
The total corporate real estate credit facilities granted by banks at the end of 2013 reached JD 1,269 million, forming about 32.5% of the total credit facilities to real estate sector, which is 1.0% lower than the level attained at the end of 2012, which approximated JD 1,282 million. The period preceding the global financial crisis (2005-2008) witnessed a significant growth in corporate real estate loans, as they rose during this period from JD 400 million to approximately JD 1,300 million; at an average annual growth rate of 49.0%. After that, these loans declined significantly during 2009 to reach about JD million 1,089 at the end of the year as a result of the significant adverse impact of the global financial crisis on the commercial real estate market. The trend of loans returned to the positive path by attaining positive, but slight, movements during the period 2010-2012. However, they declined again in 2013 and in the first quarter of 2014 (Figure 5.8 and Figure 5.9). The global financial crisis and its repercussions, besides the subsequent economic and political conditions in

Jordan and the MENA region, had a clear and a substantial impact on the commercial real estate market compared with the residential property sector. This result is expected, however, as the adverse impacts of the economic and political hardship has hit the commercial real estate market more severely than the residential property market, especially in light of the abnormal population growth, as with the case in Jordan.

Figure 5.8: Commercial Real Estate Growth Rate (2006-2014)(%)

Source: Central Bank of Jordan *First Quarter

Figure 5.9: Commercial Real Estate Credit Facilities and Its Share of Total Real Estate Credit Facilities (2005-2014)



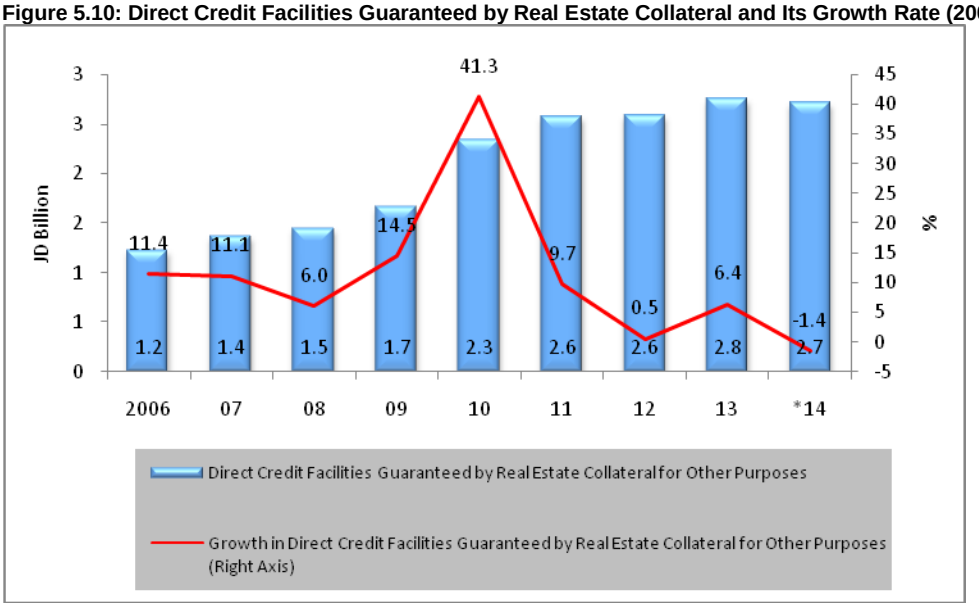
Source: Central Bank of Jordan *First Quarter

Direct Credit Facilities Guaranteed by Real Estate Collateral

In addition to their direct exposure to the real estate market risk through the credit facilities granted to finance the purchase or construction of residential or commercial properties, which (the credit) is usually guaranteed by these properties, there is another real estate market risk that the banks face through the use of real estate as collateral to guarantee the credit facilities granted by banks for other purposes than real estate. The decrease in real estate prices negatively impacts the value of the collateral and, hence, reduces the ability of banks to recover their money in case of borrowers'

default and failure to repay the debt. In this regard, total credit facilities granted by banks against real estate collaterals approximately reached JD 2,754.0 million at the end of 2013 (Figure 5.10).

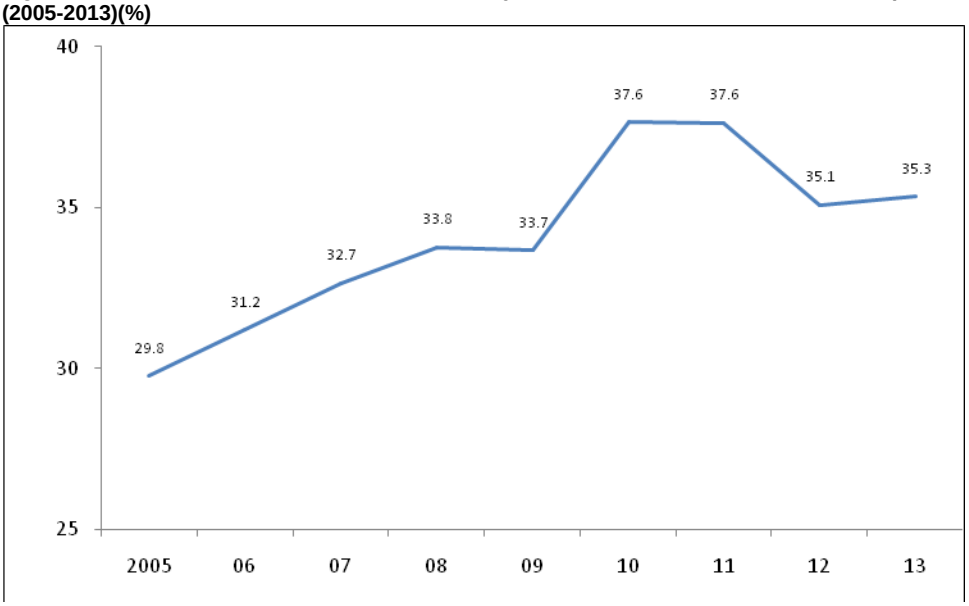
Figure 5.10: Direct Credit Facilities Guaranteed by Real Estate Collateral and Its Growth Rate (2006-2014)



Source: Central Bank of Jordan *First Quarter

Adding direct credit facilities guarantees granted against real estate collaterals for other purposes than real estate to the credit facilities granted for residential and commercial real estate purposes, the total direct credit facilities granted against real estate collateral reached JD 6,654.0 million at the end of 2013, composing about 35.3% of total credit facilities, and attaining an increase of 7.1% from its counterpart at the end of 2012. The ratio of total credit facilities granted against real estate collateral decreased from 37.6% at the end of 2010 to 35.3% at the end of 2013 (Figure 5.11).

Figure 5.11: Direct Credit Facilities Guaranteed by Real Estate* Collateral for Other Purposes to Total Credit Facilities (2005-2013)(%)



Source: Central Bank of Jordan *(Residential and Commercial)

Real Estate Price Index

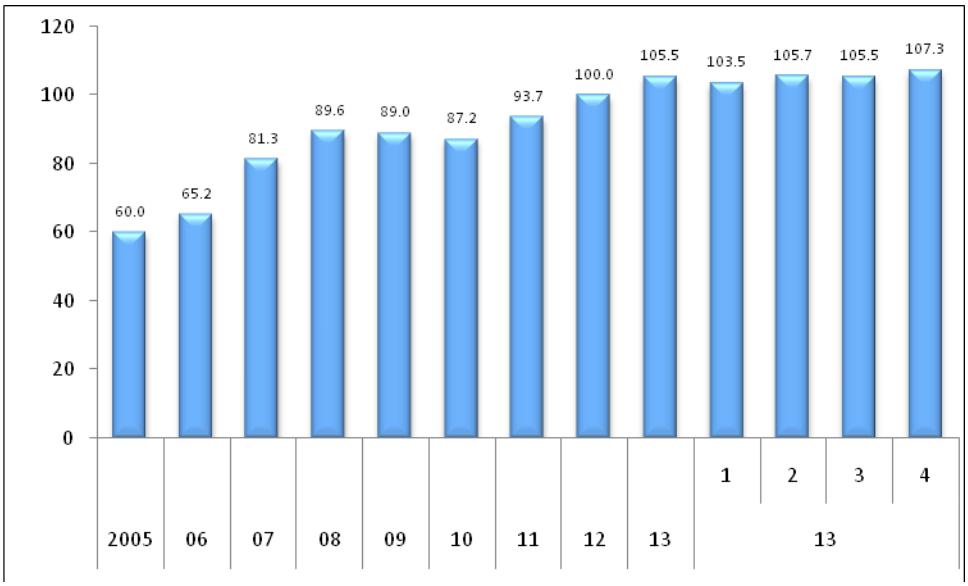
The value of real estate assets is a core driver of the investment activities in any economy, due to their significant inter-linkages with other investment sectors and the implications of the real estate asset price developments on inflation and, hence, monetary and financial stability. The importance of obtaining figures about the movements in real estate prices (real estate price index) calculated by the CBJ and the Department of Land and Survey as a joint team, for Jordan at the beginning of 2014 using the best internationally applied methodologies in the calculation of this indicator and taking into consideration the available data at the Department of Land and Survey. This index has significant and important implications; such as monitoring real estate asset price bubbles; thus evaluating real estate market risk, forecasting economic growth, estimating the value of houses as a form of wealth and conducting comparison with international trends.

Real Estate Price Index in Jordan

Figures 5.12 to 5.17 illustrate different aspects related to real estate price index in Jordan and the change in the index during the period 2005-2013. Appendix 1 discusses the index calculation methodology.

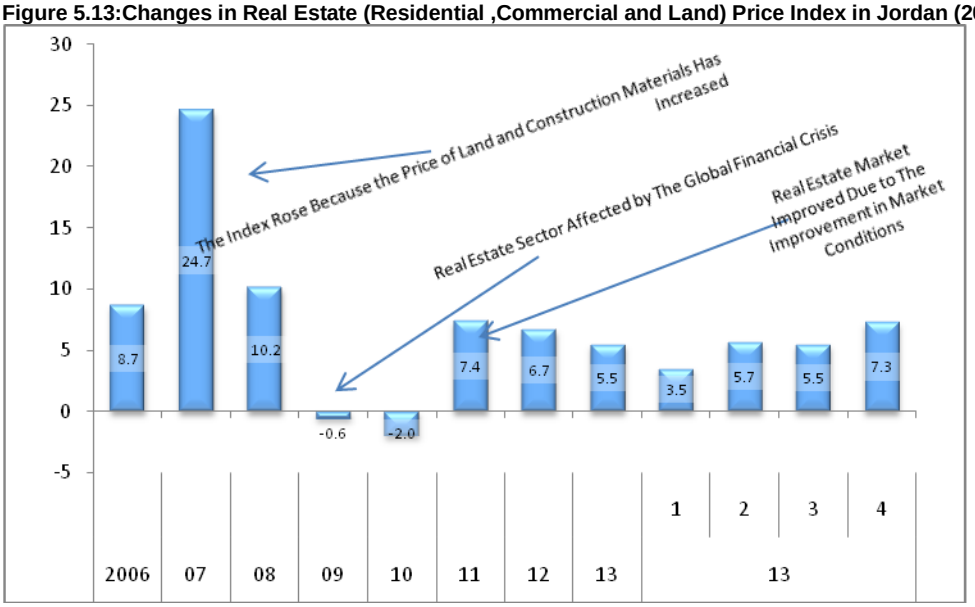
The index passed different phases that can be summarized in three phases: the first phase is the **pre-global financial crisis phase (2005-2008)**. This phase witnessed a significant demand for real estate, especially from non-Jordanians, in addition to the large hikes in the prices of residential and non-residential real estate assets. The second phase is the **repercussions of the global financial crisis phase (2009-2010)**, where caution and uncertainty dominated and made banks cut down credit. Consequently, the demand for real estate assets declined, and thus their prices went down. To deal with the contraction and activate the real estate market, the government, through its fiscal policy, expanded tax reliefs to include the purchase of apartments and land. The third phase is the **recovery phase (2011-2013)**, where real estate investments resumed its upward trend, though at a slower pace than the levels that prevailed in **pre-global financial crisis phase**. This improvement was due to the improvement in economic activity and market conditions. Consequently, the demand for real estate increased. It is worth mentioning here that the government announcement of its plans to remove the tax exemptions by the end of 2011 raised the index due to the increase in demand for real estate to benefit from these exemptions before the deadline.

Figure 5.12: Real Estate (Residential ,Commercial and Land) Price Index in Jordan (2005-2013)



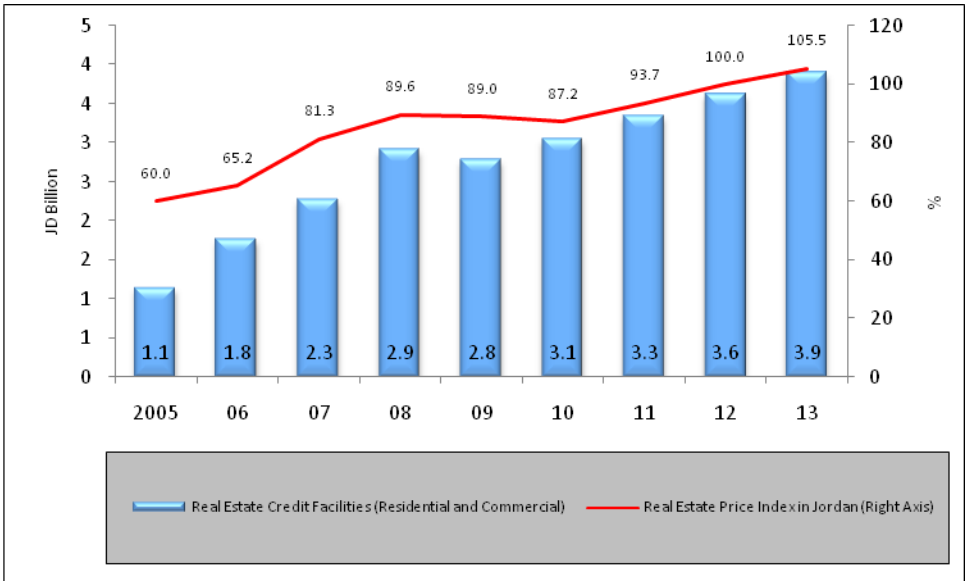
Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.13:Changes in Real Estate (Residential ,Commercial and Land) Price Index in Jordan (2006-2013)(%)*



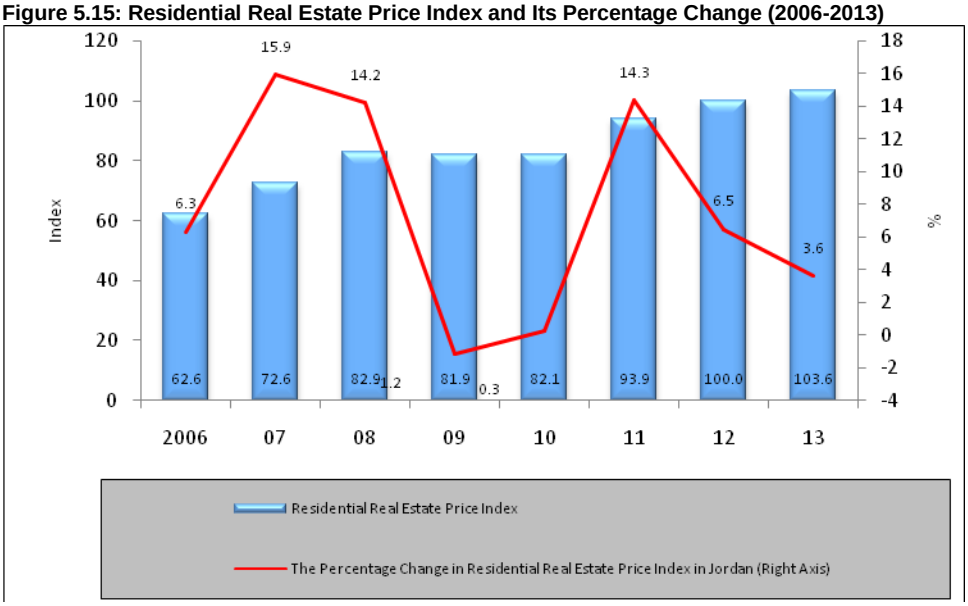
Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.14: Real Estate Price Index (Residential ,Commercial and Land) and Total Credit Facilities in Jordan (2006-2013)(%)



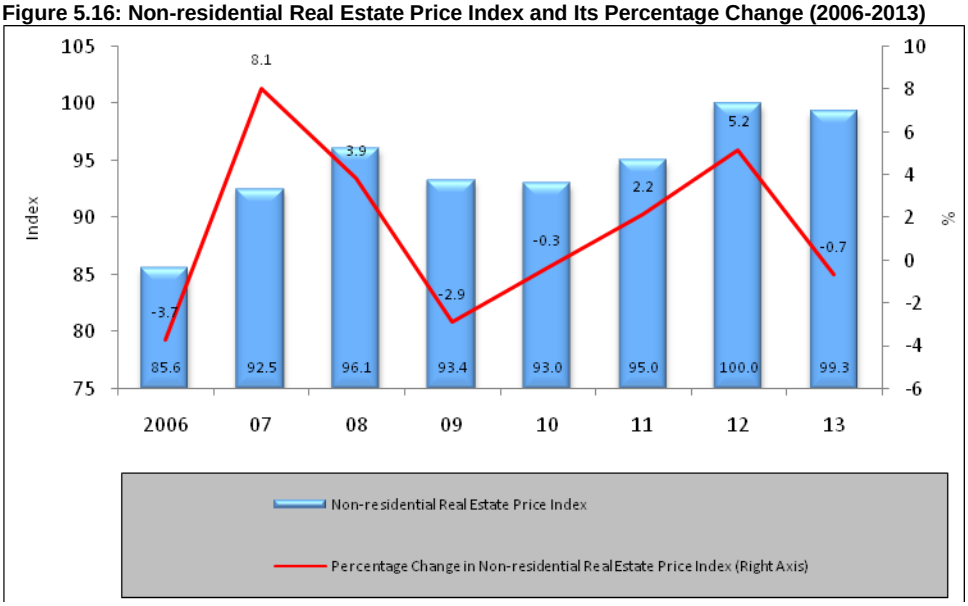
Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.15: Residential Real Estate Price Index and Its Percentage Change (2006-2013)



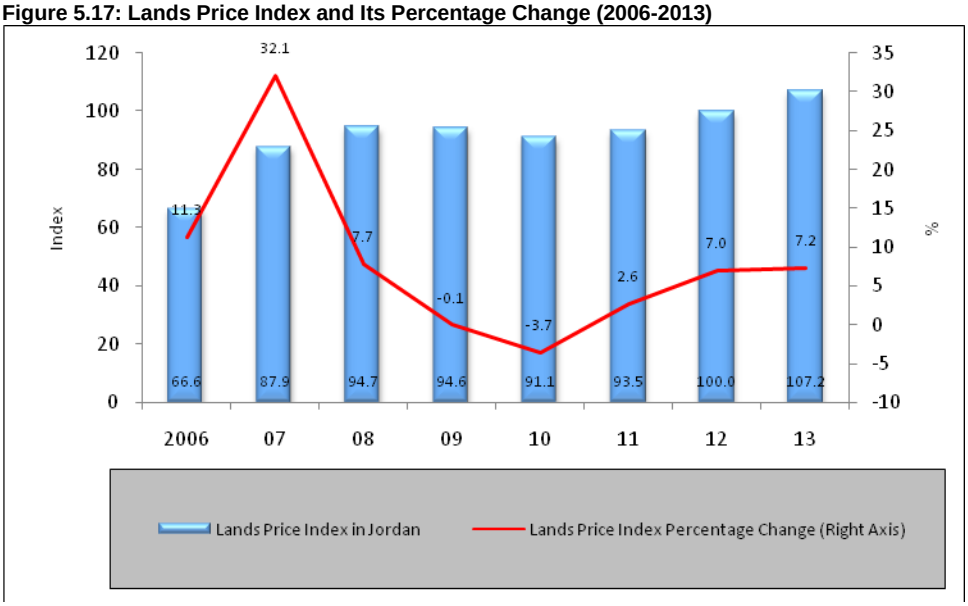
Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.16: Non-residential Real Estate Price Index and Its Percentage Change (2006-2013)



Source: Central Bank of Jordan and Department of Land and Survey

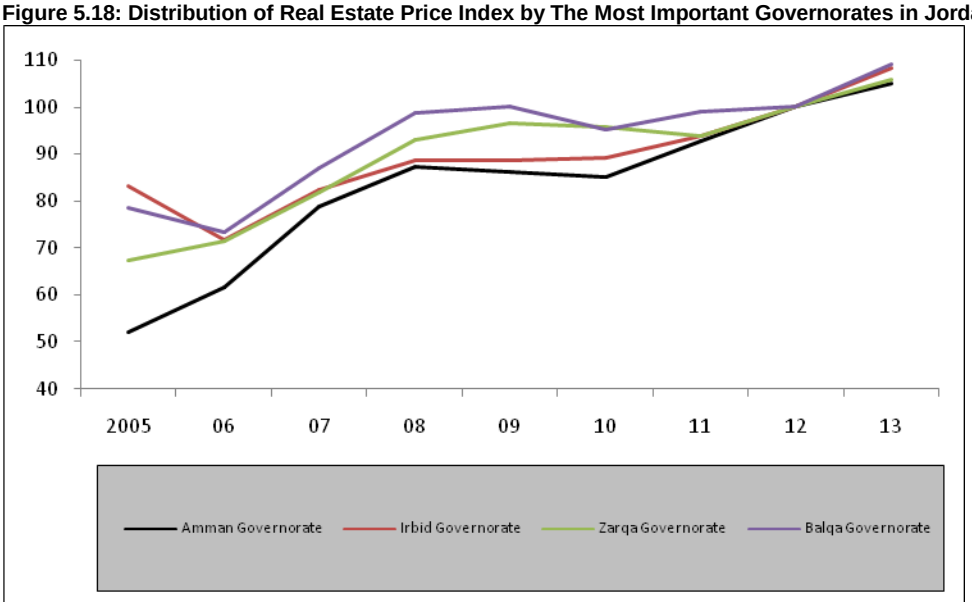
Figure 5.17: Lands Price Index and Its Percentage Change (2006-2013)



Source: Central Bank of Jordan and Department of Land and Survey

Regarding the real estate price index for Amman, the index witnessed an apparent growth during the years 2005-2013. Where the value of the index was 52.1 in 2005 and reached 105.1 in 2013 at an growth rate of 101.7%. Therefore, the real estate price in Amman has doubled over the last eight years. Regarding the other governorates, the index witnessed a positive trend as well, but at a slower pace than Amman. For Irbid, the index increased from 83.2 points in 2005 to 108.3 points in 2013 at a growth rate of 30.2%. While for Zarqa, the index increased from 67.5 points in 2005 to 105.9 points in 2013 at a growth rate of 56.9%. For Balqa, the index increased from 78.6 points in 2005 to 109.1 points in 2013 at a growth rate of 38.7% (Figure 5.18).

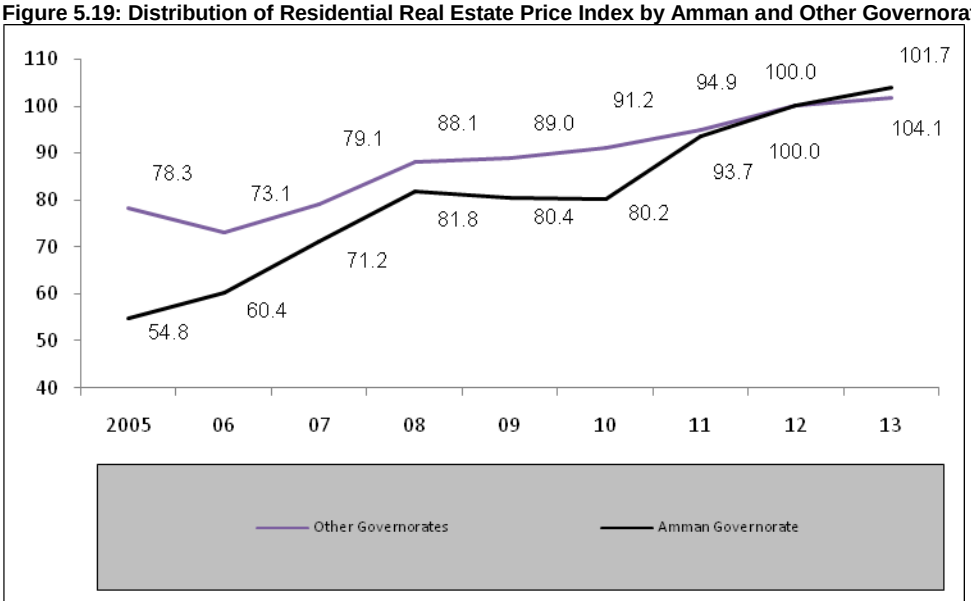
Figure 5.18: Distribution of Real Estate Price Index by The Most Important Governorates in Jordan (2005-2013)



Source: Central Bank of Jordan and Department of Land and Survey

Regarding the residential real estate price index, Figure 5.19 shows that the increase in the prices of houses was higher in Amman than in the other governorates.

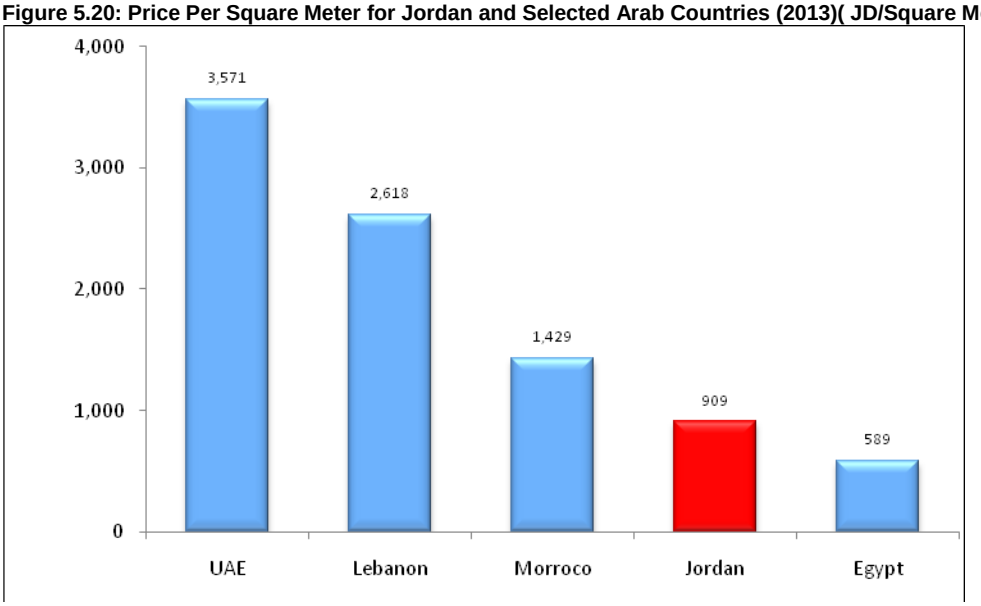
Figure 5.19: Distribution of Residential Real Estate Price Index by Amman and Other Governorates (2005-2013)



Source: Central Bank of Jordan and Department of Land and Survey

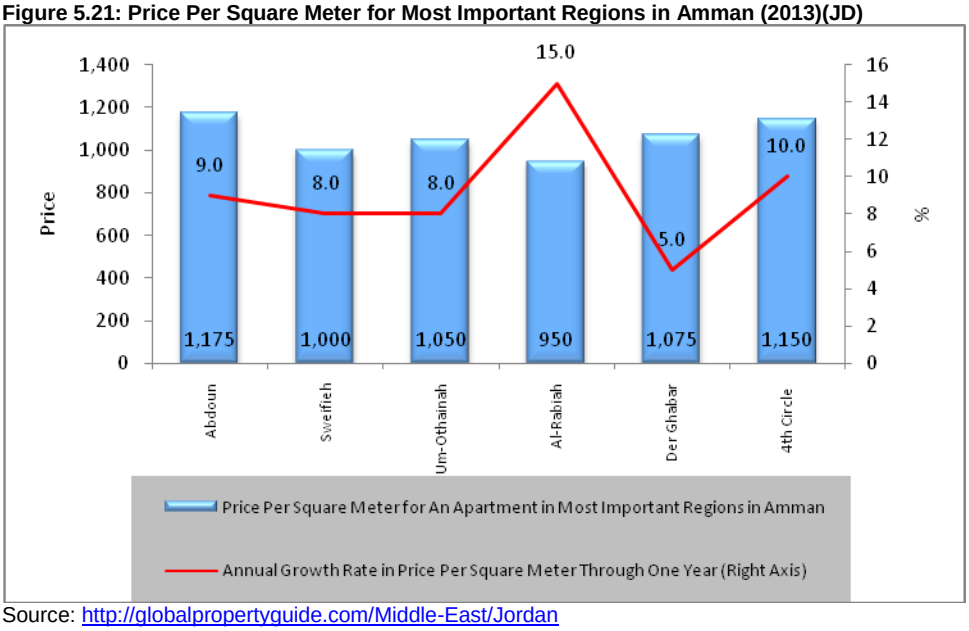
Concerning average price per square meter in Amman, as per the available information on Western Amman region (the most investment-attracting area), the average real estate price per square meter was JD 909.0. Even though it is relatively high when compared to domestic averages, it is lower than its counterpart in several Arab countries including Morocco, Lebanon and United Arab Emirates (Figure 5.20 and Figure 5.21).

Figure 5.20: Price Per Square Meter for Jordan and Selected Arab Countries (2013)(JD/Square Meter)



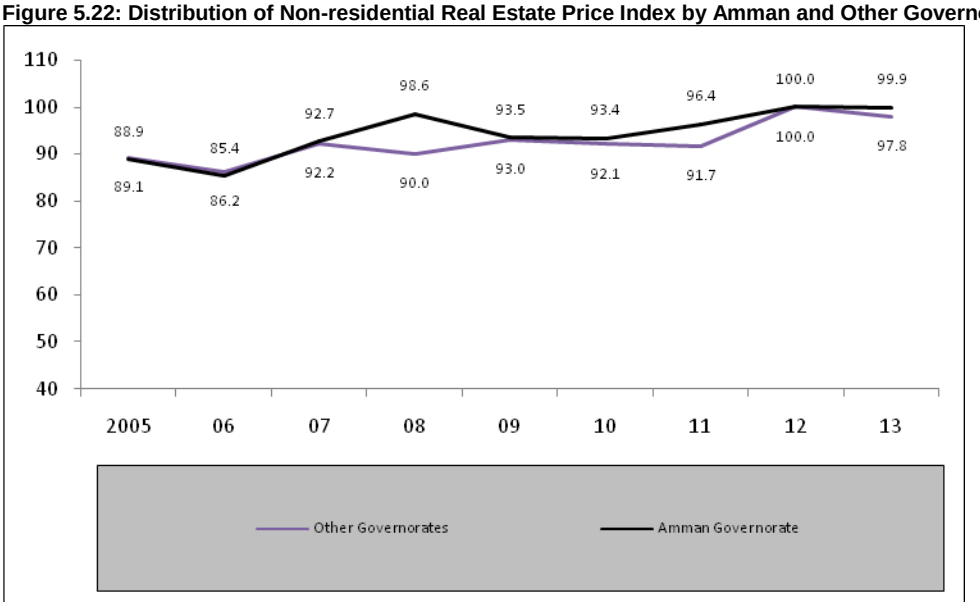
Source: http://globalpropertyguide.com/Middle-East/Jordan

Figure 5.21: Price Per Square Meter for Most Important Regions in Amman (2013)(JD)



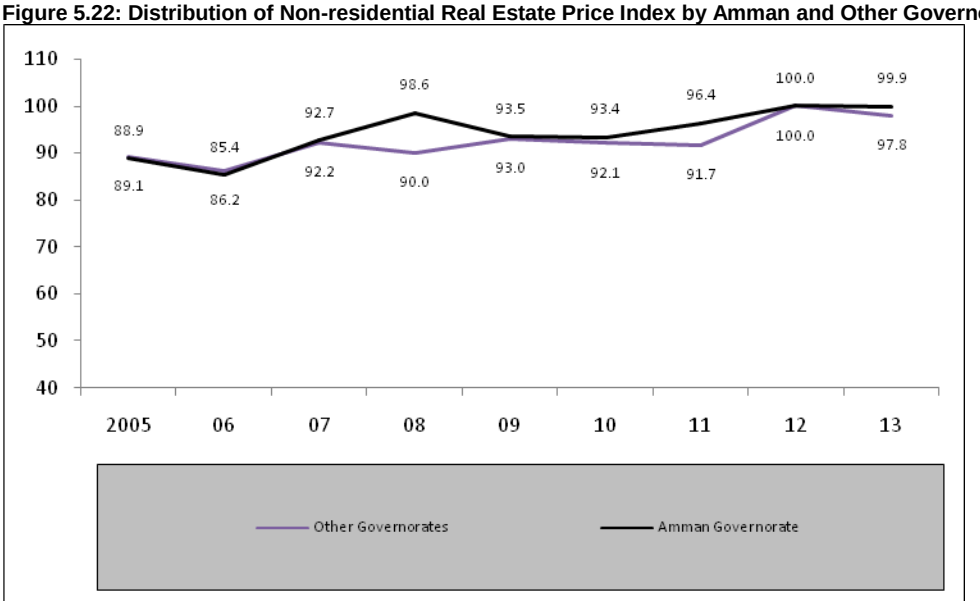
Source: http://globalpropertyguide.com/Middle-East/Jordan

Figure 5.22: Distribution of Non-residential Real Estate Price Index by Amman and Other Governorates (2005-2013)



Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.22: Distribution of Non-residential Real Estate Price Index by Amman and Other Governorates (2005-2013)

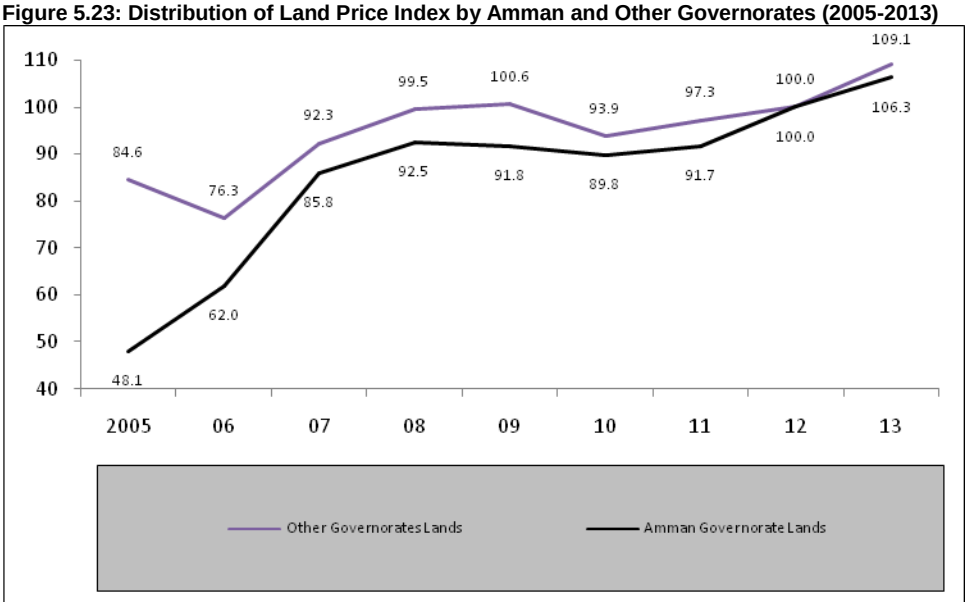


Source: Central Bank of Jordan and Department of Land and Survey

Regarding the non-residential real estate price index, Figure 5.22 shows that the fluctuations in the prices of non-residential real estate were lower in Amman than in the other governorates.

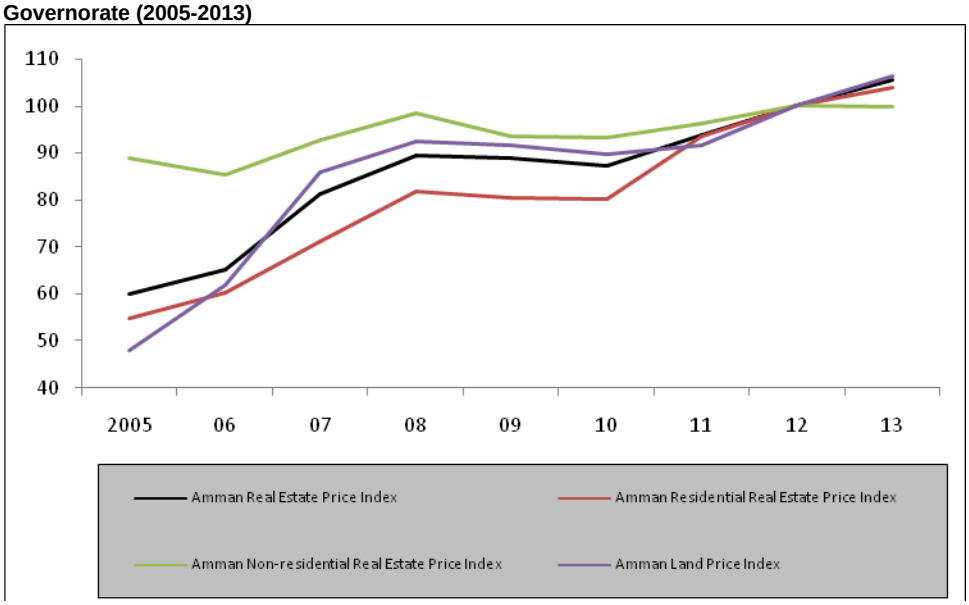
Regarding lands price index, Figure 5.23 reveals that Amman governorates witnessed a jump in land prices during the period 2005-2013. The index increased from 48.0 points in 2005 to 106.0 points in 2013. For the other governorates, the lands price index was 84.6 points at the end of 2005 and increased to 109.1 points at the end of 2013.

Figure 5.23: Distribution of Land Price Index by Amman and Other Governorates (2005-2013)



Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.24: Residential, Non-residential and Land Price Index Compared to Real Estate Price Index for Amman Governorate (2005-2013)



Source: Central Bank of Jordan and Department of Land and Survey

Figure 5.25: Distribution of Residential Real Estate Price Index by Type of Residence (2005-2013)

Source: Central Bank of Jordan and Department of Land and Survey

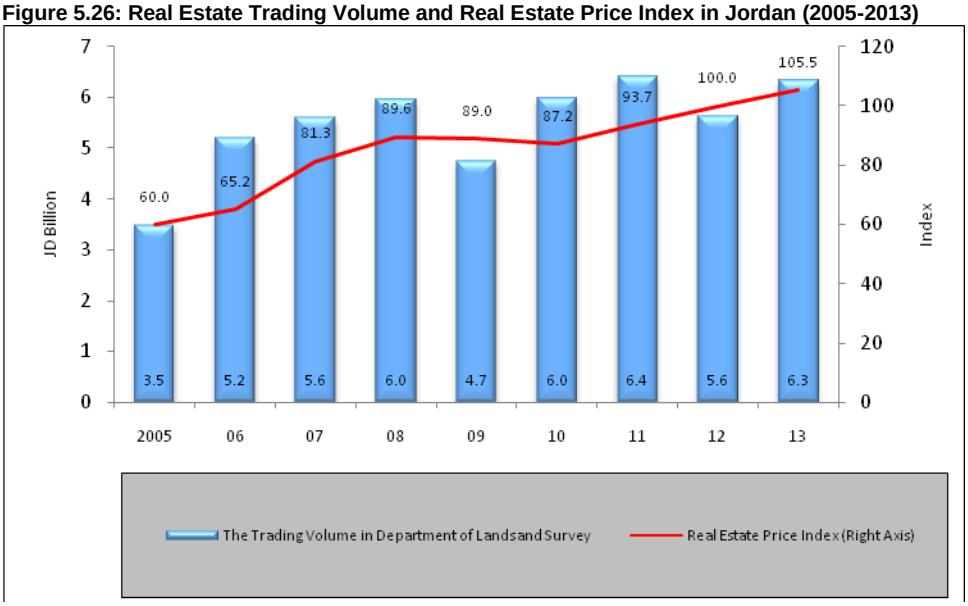
In general, the real estate price index in Jordan increased during 2013 by 5.5 points, or 5.5% compared to its value in 2012. It also increased in the post-crisis recovery phase by 11.8% and attained an average annual growth rate of 6.5% during the period. This upward trend in the index in Jordan in the recovery period was in line with the general inflation rates.

Regarding the impact of the influx of Syrian refugees on the real estate prices, particularly in the northern regions in Jordan, the impact on the real estate prices was not realizable. However, rental rates witnessed a notable jump, especially in the northern cities that are close to Syrian borders.

Trading volume in the real estate market

The semi-annual report published by the Department of land and Survey for first half of 2014 stated that the trading volume in the real estate market increased by 23.0% during the first half of 2014 compared to the first half of 2013 to reach approximately JD 3.84 billion. It is worth mentioning that the real estate trading volume in 2013 amounted to JD 6,344 million, an increase by 12.8% from its counterpart in 2012. Figure 5.26 illustrates the historical movements in the real estate trading volume during the period 2005-2013.

Figure 5.26: Real Estate Trading Volume and Real Estate Price Index in Jordan (2005-2013)



Source: Central Bank of Jordan and Department of Land and Survey

Regarding the real estate sales to non-Jordanians, it reached JD 265.0 million at the end of the first half of 2014, composing only 6.9% of total real estate trading volume. Iraqis accounted for the highest share in this market, where their purchases composed 50.4% of the total sales to non-Jordanians during 2013 (Table 5.1).

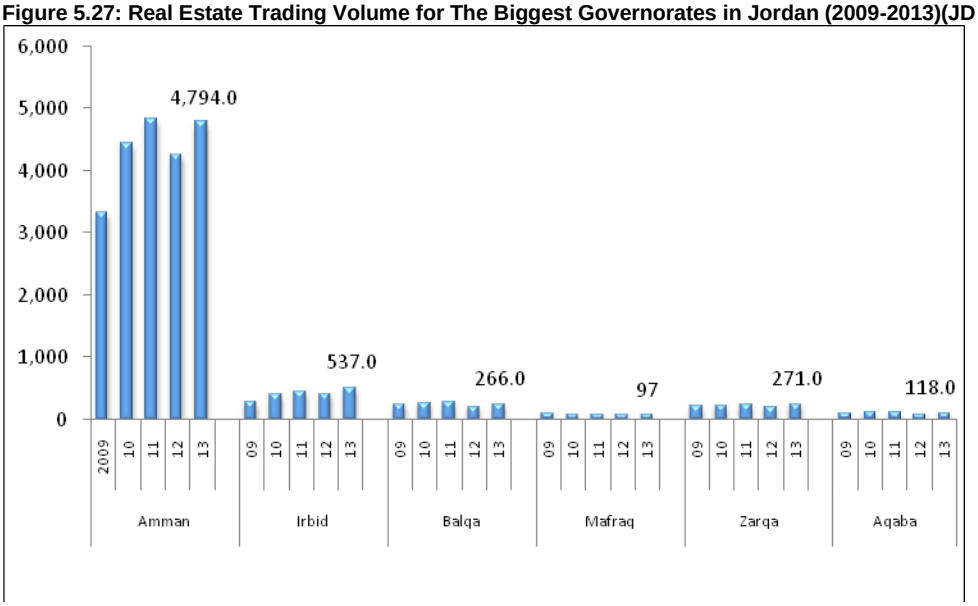
Table 5.1: Real Estate Sales to Non-Jordanians (2012-2014) (JD million)

Country of Citizenship	2012	2013	2014 *
Iraq	224.7	205.0	156.6
Saudi Arabia	51.6	58.6	24.6
Syria	17.0	23.7	16.7
USA	13.8	22.0	NA
United Arab Emirates	NA	NA	13.9
Other	121.9	97.0	53.5
Total	429.0	406.5	265.3

Source: Department of Land and Survey. * First half.

Comparing the trading volumes in 2013 for selected governorates, it is evident that the Amman governorate had the highest trading volume of JD 4,790 million, composing 75.0% of total trading volume in the real estate market, followed by Irbid governorate, with a trading volume of JD 537.0 million and a share of 8.5% from the total, then followed by Zarqa governorate, with a trading volume of JD million 271.0 and a share of 4.3% of the total, and lastly Balqa governorate, with a trading volume of JD million 266.0, composing 4.2% of the total trading volume (Figure 5.27).

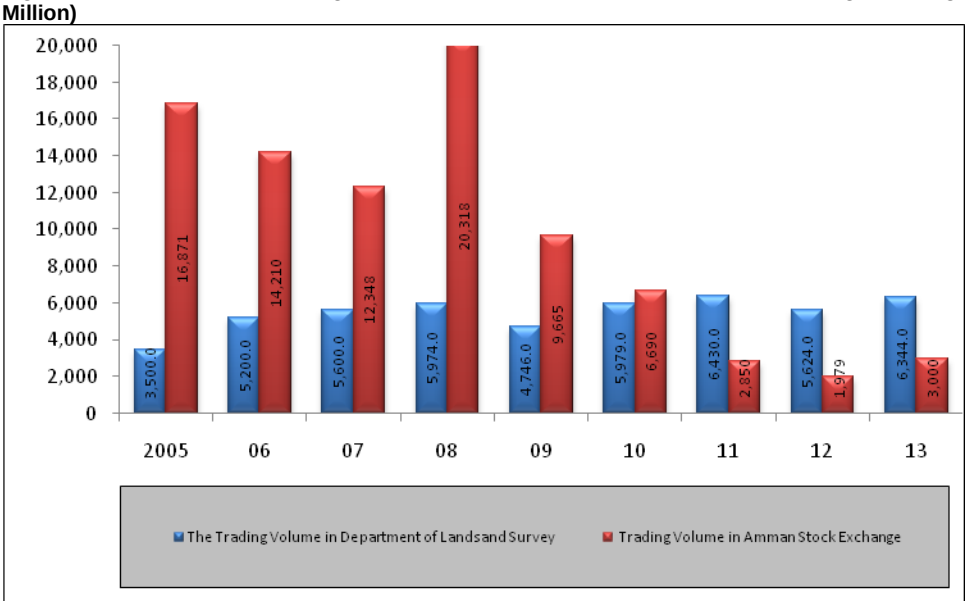
Figure 5.27: Real Estate Trading Volume for The Biggest Governorates in Jordan (2009-2013)(JD Million)



Source: Central Bank of Jordan and Department of Land and Survey

By comparing trading volume in real estate market with that in the Amman Stock Exchange, it is noted that it was much larger in the financial market than the real estate market during the period 2005-2009 due to the boom that prevailed in the financial market during this period and the associated large inflow of liquidity in the market by Arabs, especially the Iraqis, that led to the dramatic increase in prices in the financial market, which consequently helped attract more investors and, hence, boost the prices faster. However, after the deepening of the repercussions of the global financial crisis and fall in stock prices in the financial market, the trading volumes sharply declined in the financial market and become far lower than its counterpart in the real estate market, as real estate asset is less risky compared with financial assets (Figure 5.28).

Figure 5.28: Real Estate Trading Volume for Jordan and Amman Stock Exchange Trading Volume (2005-2013)(JD Million)



Source: Department of Land and Survey, Amman Stock Exchange.

The ratio of real estate loans to the value of the mortgaged property, known as loan-to-value (LTV) ratio is one of the most important ratios and indicators that should be monitored in order to assess the level of banks' exposure to the real estate market risk. The higher this ratio, the more the exposure of banks to the risks in case real estate prices went down; as it limits the ability of banks to recover their loans in case of customers' default as a result of the devaluation of the real estate collaterals for these loans.

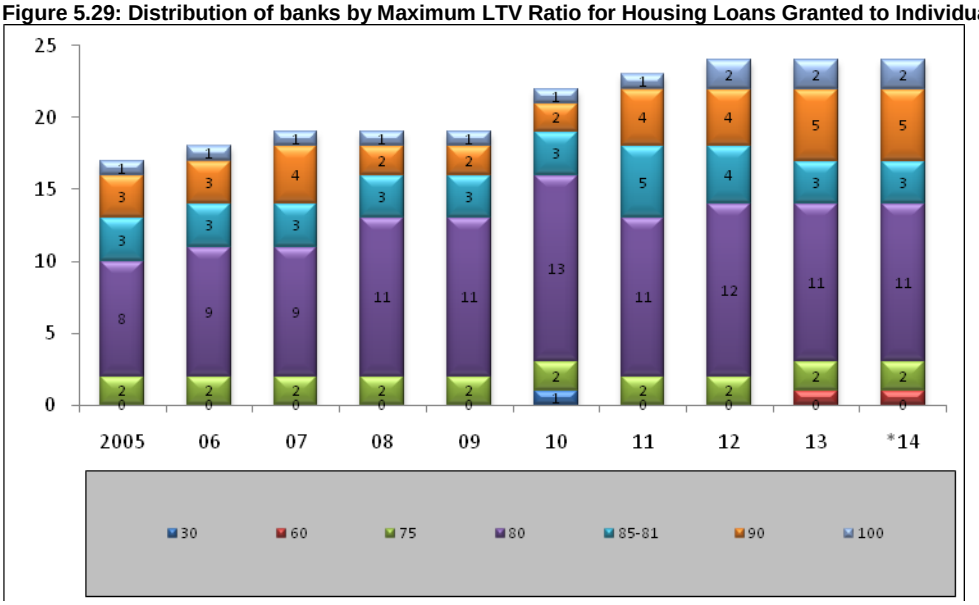
Some countries set limits for this ratio when there are indications of a real estate bubble in order to curb the bubble, diminish the bankruptcy likelihood in case of the decrease in the house prices, and reduce losses by increasing the value of the collateral. Thus enhances the ability of banks to protect against these risks.

LTV Ratio Limits for Individual Housing and Commercial Loans in Jordan

To explore and monitor the LTV ratio in Jordan, the CBJ continuous collects data from banks about the maximum and average of LTV ratios.

Figure 5.29 shows the LTV ratio for housing loans granted to individuals, as appears from the figure, the LTV for 14 banks out of 26 banks (composing 58.0% of licensed banks in Jordan) did not exceed 80.0%, despite the ratio ranging from 81% to 85% for three banks and it was 90.0% for five banks and 100.0% for two banks.

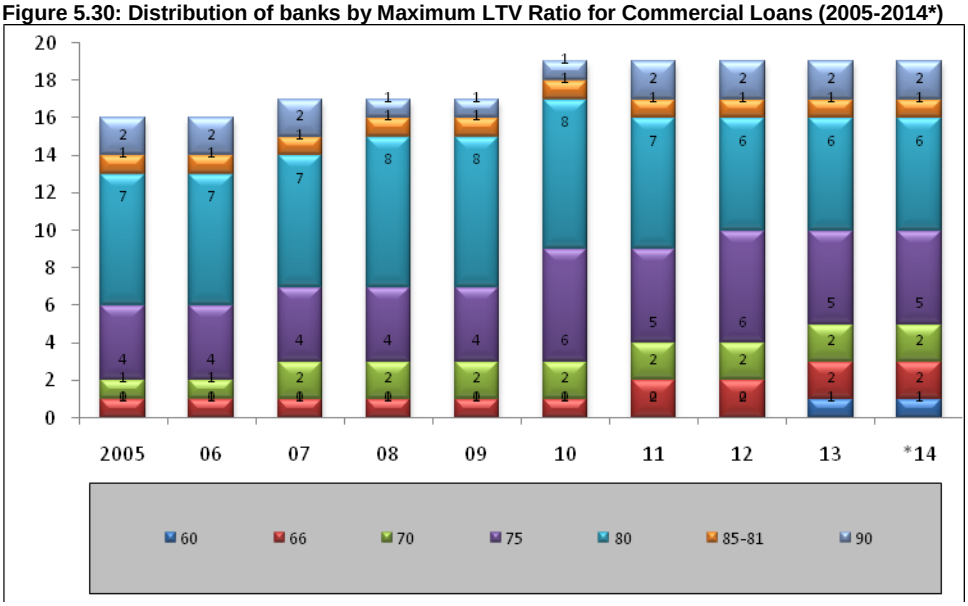
Figure 5.29: Distribution of banks by Maximum LTV Ratio for Housing Loans Granted to Individuals (2005-2014)



Source: Central Bank of Jordan

Regarding the maximum LTV ratio, it is lower than its counterpart for the individual housing loans in the majority of banks, as 52.0% of banks extended commercial loans with an LTV ratio less than 75.0% (Figure 5.30).

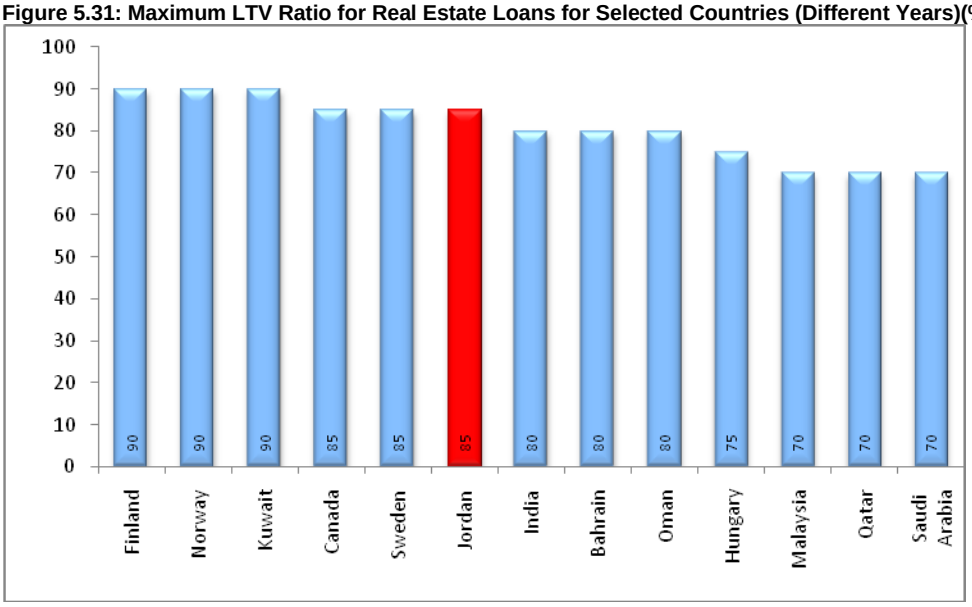
Figure 5.30: Distribution of banks by Maximum LTV Ratio for Commercial Loans (2005-2014*)



Source: Central Bank of Jordan *First Quarter

The LTV ratio limit varied amongst selected countries and ranged between 70.0% and 90.0%. In the banks in Jordan, this limit averaged 85.0% as most of the Jordanian banks' LTV ratio ranged between 80.0% and 90.0% (Figure 5.31).

Figure 5.31: Maximum LTV Ratio for Real Estate Loans for Selected Countries (Different Years)(%)

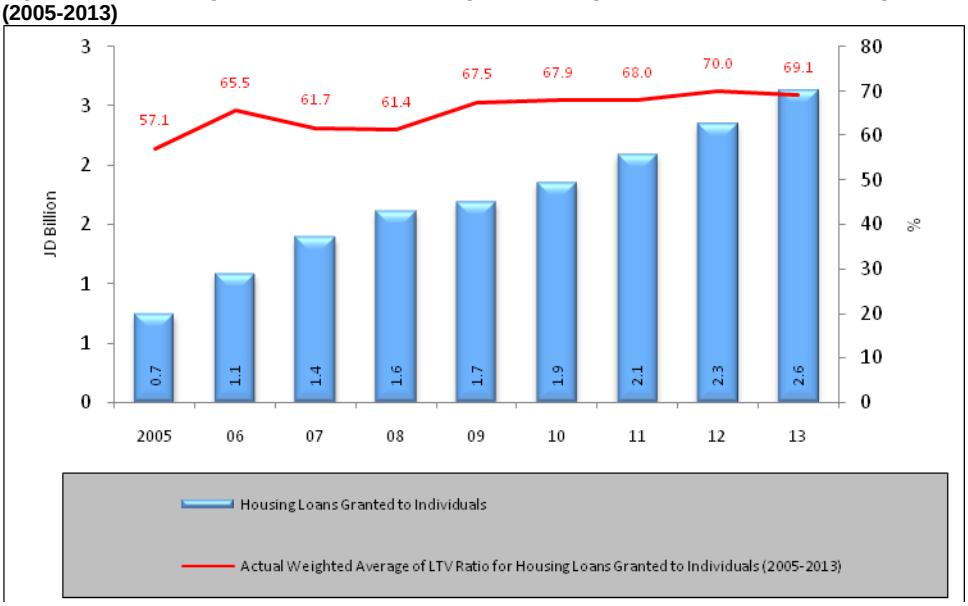


Source: Arab Countries: IMF UAE: selected issues 2013. Foreign countries: Crowe et al.

Actual Average LTV Ratio for Individual Housing and Commercial Loans in Jordan

Despite the high LTV ratio for individual housing loans in some banks relatively, the actual average LTV ratio is lower than the maximum limit. The actual weighted average of LTV ratio was 69.0% at the end of 2013 and increased to 71.0% at the end of the first quarter of 2014.

Figure 5.32: Housing Loans and Actual Weighted Average of LTV Ratio for Housing Loans Granted to Individuals (2005-2013)

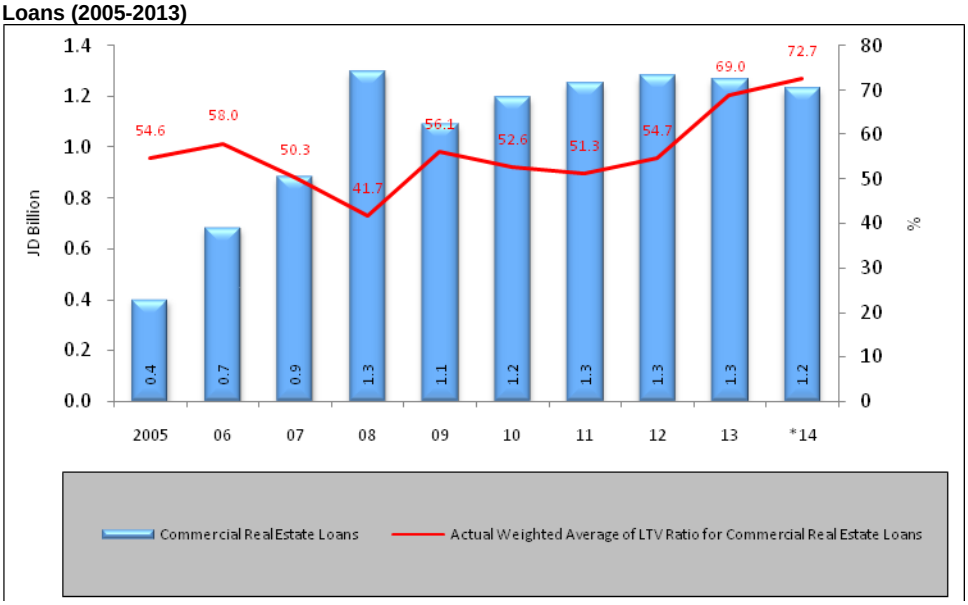


Source: Central Bank of Jordan

It can be noted from Figure 5.32 that there is an upward trend in actual average LTV ratio for individual housing loans. But it is still lower than the limit set by banks in their credit policies.

For the actual average of the LTV ratio for the commercial real estate loans, it is close to its counterpart for the individual housing loans – it hit 69.0% at the end of 2013 (Figure 5.33).

Figure 5.33: Commercial Real Estate Loans and Actual Weighted Average of LTV Ratio for Commercial Real Estate Loans (2005-2013)

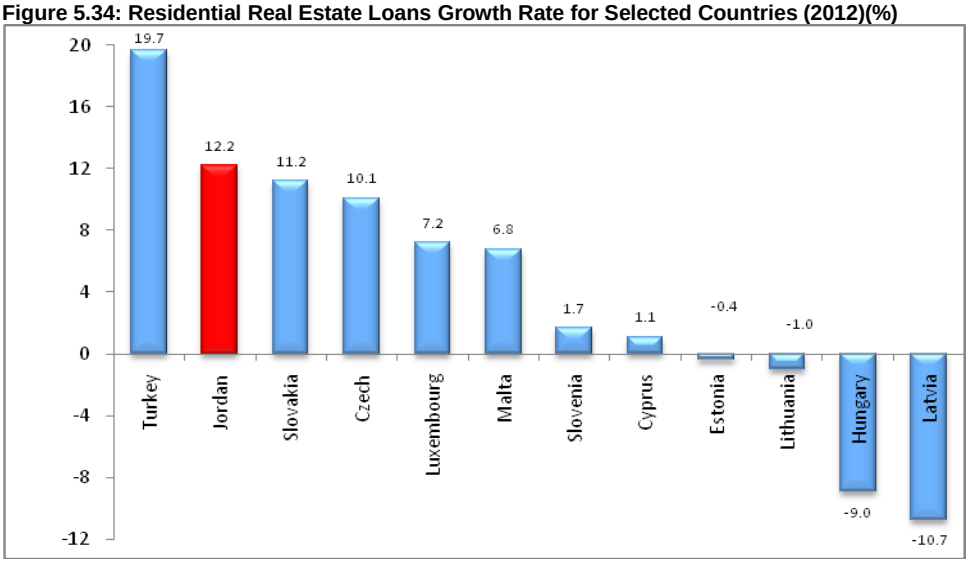


Source: Central Bank of Jordan *First Quarter

Housing Loans in the World

By comparing the growth rate of housing loans in Jordan with selected countries, it can be noted that this rate is higher in Jordan than most of these countries (Figure 5.34).

Figure 5.34: Residential Real Estate Loans Growth Rate for Selected Countries (2012)(%)



Source: HAYPOSTAT 2013 A review of Europe's mortgage and housing markets * Jordan's data 2013

CBJ Measures to Mitigate Banking Sector's Exposure to Real Estate Market and Enhance the their Capacity to Confront them

The CBJ decided to set some limits for the purpose to mitigate the exposure of the banking system to real estate market risk and sustain the banks' ability to deal with this risk in case it materialized. These measures include the following:

1. A cap on real estate loans. **Credit Concentration** instructions No.9/2001 enforced in 1/08/2011 set a cap on the total direct credit extended for constructing or buying homes. The loan must not exceed 20.0% of total customers' deposits in Jordanian dinar.
2. A cap on loan-to-value ratio. **Capital Adequacy** instructions (in compliance with Basel II guidelines) No. 39/2008 that took effect in 24/03/2008 set the risk weighting for housing loans with LTV ratios not exceeding 80.0% to be 35.0%. The risk weighting increases to 100.0% in case LTV ratio exceeded 80.0%. In other words, for any loan, if the LTV ratio exceeds 80.0%, then these loans entail higher capital levels, that consequently enhances the banks' ability to protect them against risk and, hence, sustain the stability of the financial system in Jordan.

Conclusion

The credit facilities extended for, or guaranteed by, real estate composed more that 35.0% of total credit facilities extended by banks. Even though this share is considered high relatively, the assessed value of the mortgaged property exceeds with a comfortable margin the granted credit, as the real estate collaterals cover 141.0% of total credit extended for real estate purposes. Inevitably, this enhances the banks' capacity to confront credit risks.

At the same time and through monitoring the development, we found that the increase in the index is in line with the consumer price index path, which implies that the increase in real estate prices in Jordan is normal and does not warn of the existence of any problem to date. The CBJ will keep on monitoring the developments in the real estate market prices and the exposure of banks to its risks.

Chapter Six: Stress Testing of the Banking System

Introduction

Stress testing is one of the risk management tools that aim at measuring the ability of the banking system to withstand shocks and high risks. The importance of stress testing increased after the global financial crisis. The results are used to determine the capital and liquidity levels that banks are required to maintain to be able to withstand shocks and high risks.

As was indicated in the Financial Stability Report for 2012, the CBJ issued the **Stress Testing** instructions No. 46/2009 in 30/9/2009. In these instructions, the banks were asked to conduct a set of tests on the various risks faced by them, such as credit risk, concentration risk and market risk, among other risks. The CBJ will keep on improving these instructions in the future to keep pace with the relevant updates. The improvement process started during 2013 through improving stress testing methodology based on implementing the one developed by the IMF in 2011, called Next Generation Balance Sheet (NGBS) Stress Testing. This methodology is considered as one of the best methodologies used in this context. The CBJ used this methodology, partially, to conduct the following stress tests.

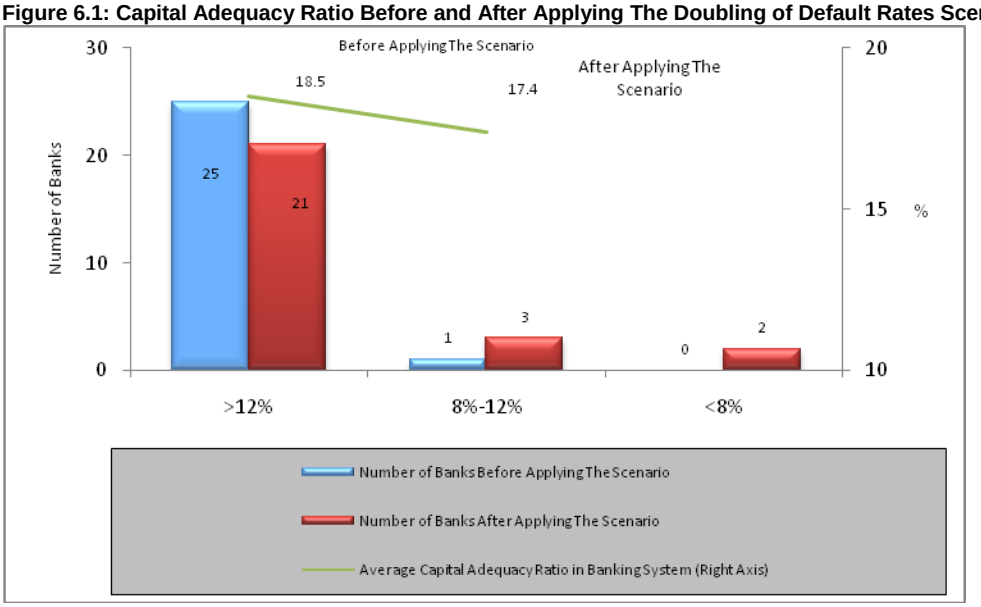
Single-Factor Stress Testing

Scenario One: The Doubling of Default Rates

This scenario assumed that credit losses doubled in banks (doubling default rates) due to the worsening of political conditions in the region and its consequent impact on economic conditions and banks in Jordan. In this case, the CAR in the banking system will drop from approximately 18.5% to 17.4%. Which means that the banking system is in general able to withstand a shock of this type as the CAR after the shock remains well above the minimum required CAR in Jordan of 12.0% by a comfortable margin. The reason behind this limited impact of this type of shock is the high profits that the banks attained at the end of 2013 that helped enhance their capability to cope with the increase in the cost due to increased provisions and the additional losses that take effect in case the shock materialized without them impacting banks' capital level that in turn protect banks' capital and enhance financial stability.

At the individual bank level, CAR was above 12.0% in 21 out of 26 banks. The resultant CAR is well above the minimum international number of 8% in the remaining five banks. This implies that banks, individually and collectively are able to withstand this shock (Figure 6.1).

Figure 6.1: Capital Adequacy Ratio Before and After Applying The Doubling of Default Rates Scenario

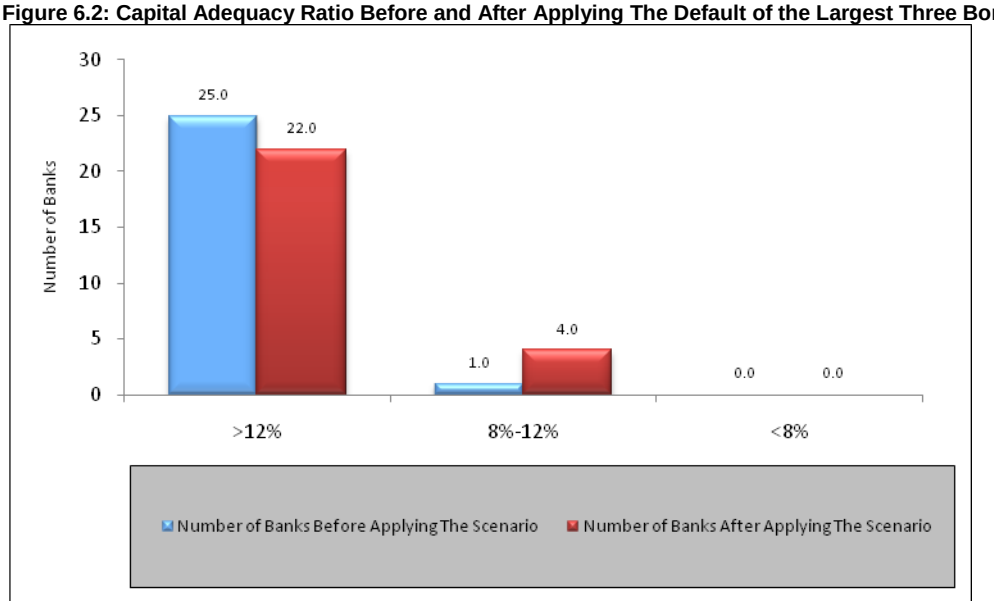


Source: Financial Stability Department Calculations, CBJ

Scenario Two: The Default of the Largest Three Borrowers

Regarding the credit concentration risks; and assuming the default of the largest three borrowers at individual bank level. In this case, the CAR in the banking system will be above the minimum limit applied in Jordan, of 12.0%, for 22 banks. It will drop below 12.0% in four banks only, where the CAR ranged between 9.3% and 11.3%. Therefore, it will not drop significantly below the minimum limit applied in Jordan. In addition, the resultant CAR is well above the minimum international number of 8% (Figure 6.2).

Figure 6.2: Capital Adequacy Ratio Before and After Applying The Default of the Largest Three Borrowers Scenario

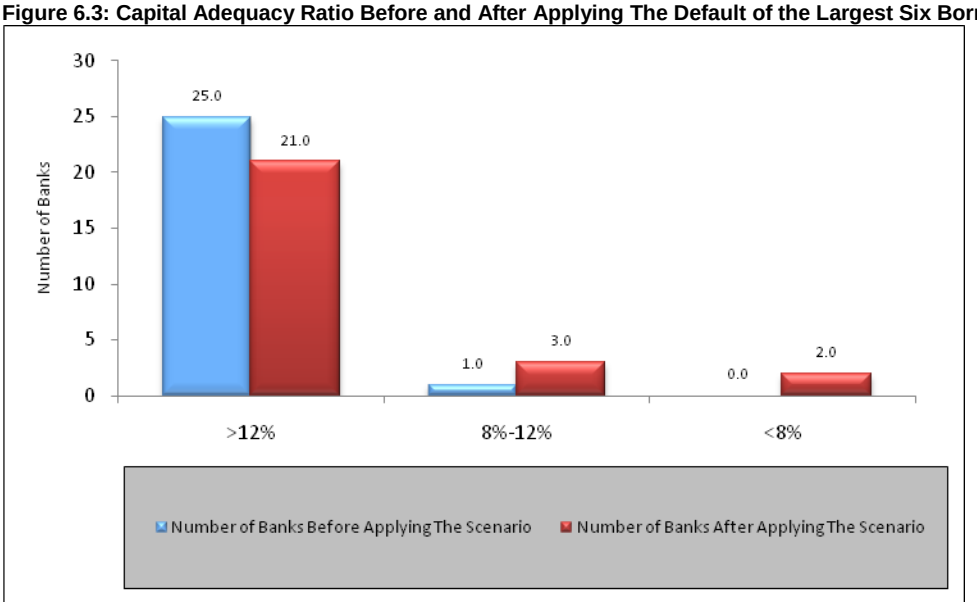


Source: Financial Stability Department Calculations, CBJ

Scenario Three: The Default of the Largest Six Borrowers

As for the default of the largest six borrowers at individual bank level. The CAR in the banking system will drop below 12.0% in five banks; of which three banks had capital adequacy ratios that were still above the minimum international number of 8% (Figure 6.3).

Figure 6.3: Capital Adequacy Ratio Before and After Applying The Default of the Largest Six Borrowers Scenario



Source: Financial Stability Department Calculations, CBJ

Multi-Factor Stress Testing

Multi-factor stress testing aims at measuring the possible impacts of more than one type of risks that the banks face. In this multi-factor scenario it was assumed that the credit losses double, the exchange rate of the Jordanian Dinar against foreign currencies depreciates by 50% and the market interest rates drop by 100 basis points. In this case, the CAR in the banking system will drop from 18.5% to 16.9%. This implies that the banking system is in general capable of withstanding these three shocks.

Conclusion

Stress testing results showed that the Jordanian banking system in Jordan is generally capable of withstanding shocks and high risks and that the ability of banks to withstand these risks based on the 2013 numbers compared to 2012. The main reason for this resilience is the high level of capital that most banks hold - the highest in the MENA region. The CBJ will continue developing, improving and updating these tests qualitatively and quantitatively in the light of the evolution of risks on the domestic, regional, and international levels to ensure the safety and soundness of the banking system.