Hashemite Kingdom of Jordan

Ministry of Finance

MEDIUM TERM DEBT MANAGEMENT STRATEGY (2017-2021)

Public Debt Directorate

Statistics and Strategies Division

2017

Introduction

A debt management strategy presents a plan of the government's debt policy which it intends to implement over the medium term in order to achieve an optimal composition of the government public debt portfolio, which captures the government's preferences with regard to the cost-risk tradeoff.

The strategy applies to central government debt (budgetary) and publicly guaranteed debt of independent public institutions.

This document represents the first update of debt management strategy, which was formulated and published in 2016 and covering the years from 2017 to 2021 and **it will be updated annually**. The proposed strategy is based on a detailed analysis of the cost and risk of alternative borrowing strategies and explicitly takes into account the macro-economic framework, including the high debt level, as well as the limits stipulated by the Public Debt Management Law no.26 of 2001[1].

The proposed strategy is in line with the Vision 2025 which was adopted by the government as a national strategy, in addition to the fiscal and structural reform program adopted by the government with the support of IMF in 2016 which aims at putting the public debt to GDP ratio on a downward trajectory whereby public debt growth rate is lower than GDP growth rate.

The Public Debt Management Directorate (PPD) of the Ministry of Finance has developed this strategy in coordination with the Central Bank of Jordan (CBJ) and Ministry of Planning and International cooperation. The debt management strategy has been approved by the Higher Ministerial committee[2].

[1] According to articles no. 21,22 and 23 of the public debt management law, the ceiling of domestic and external debt to GDP (60%) for each and (80%0 of GDP for public debt. The date of entry into force of the provisions of these articles was postponed until end of 2024.

[2] Higher Ministerial Committee (headed by the Minister of Finance and comprised of the Minister of Planning and International Cooperation and Governor of the Central Bank of Jordan).

Objective of Debt Management

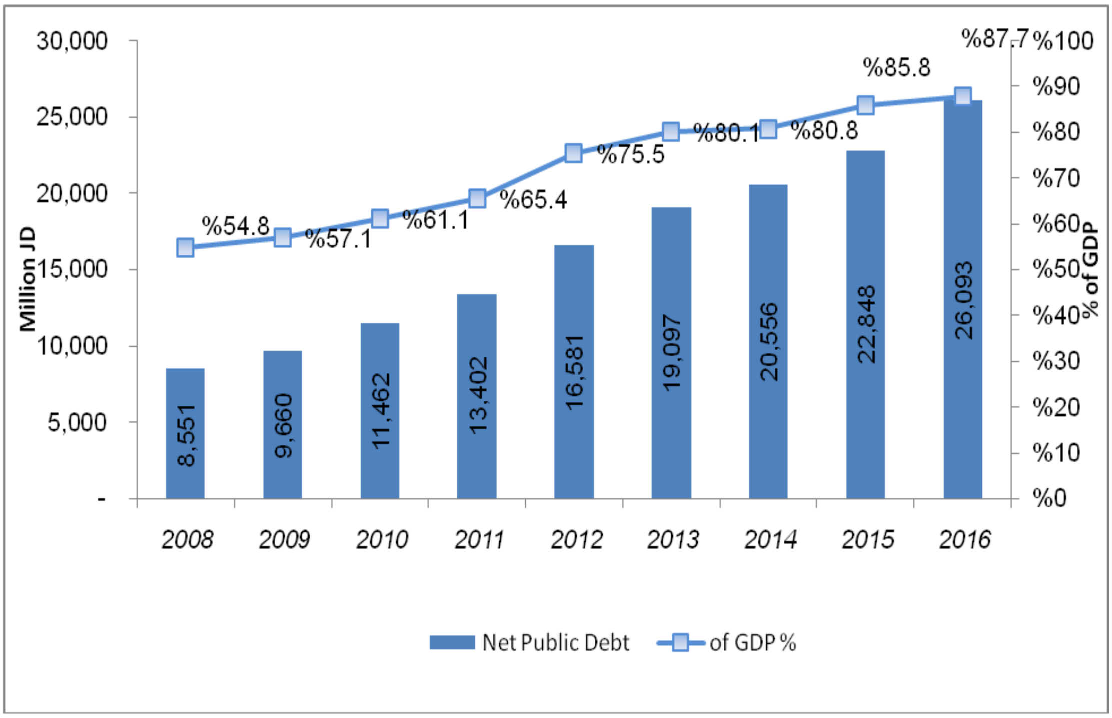
The main objective of public debt management is to ensure that the government's financing needs and its payment obligations are met at all times, at the lowest possible cost over the medium to long run and consistent with prudent, acceptable degree of risk.

A secondary objective is to enhance the primary market of government securities by expanding the investor base and diversifying debt instruments, thereby supporting the development of an active market for domestic debt instruments.

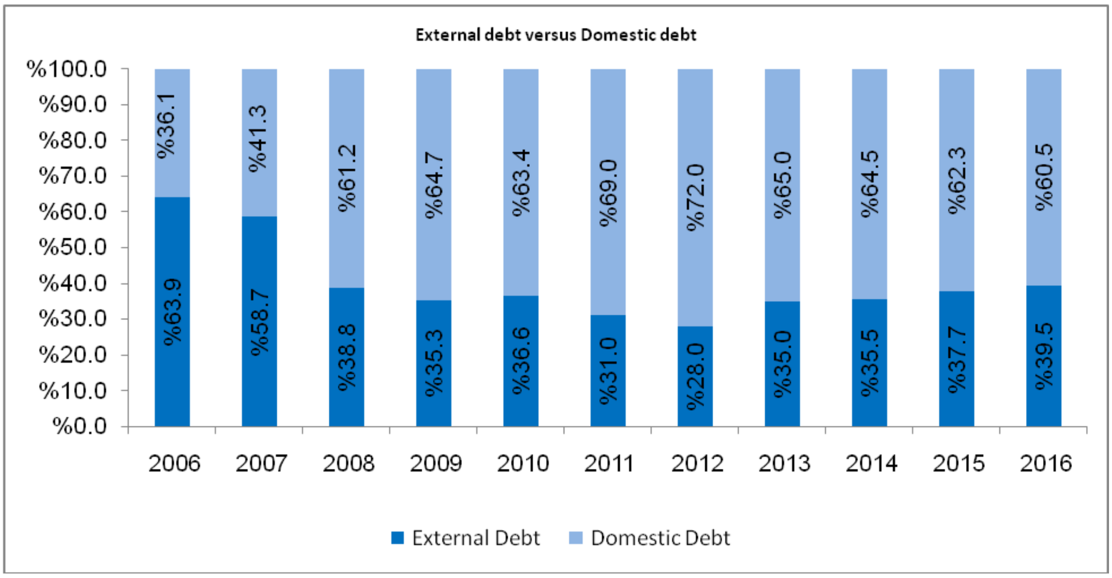
Existing Debt

By the end of 2016, the Gross Public Debt increased and reached JD (26 092.7) million or 95.1% of GDP compared to JD (24 876.8) million or 93.4 % of GDP at the end of 2015.

The total government's cash deposits are subtracted from Gross Debt to calculate the Net Public Debt. The net public debt to GDP reached 87.7% of GDP at the end of 2016 compared to 85.8% at the end of 2015.



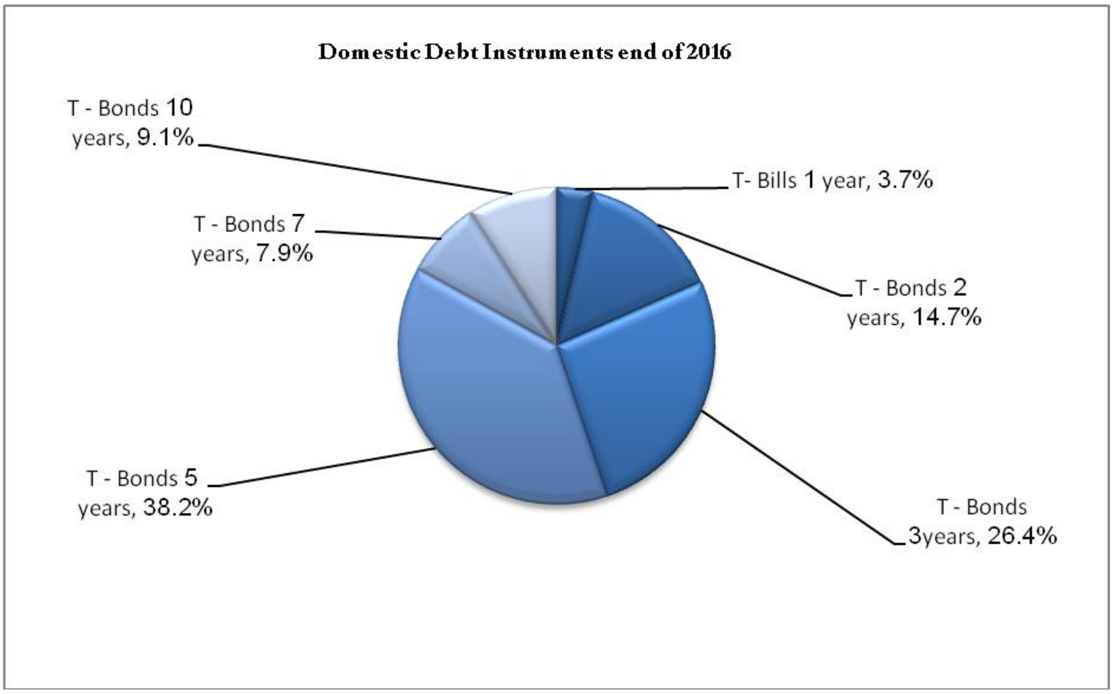
The domestic debt constitutes the main portion of debt portfolio reaching 60.5% at the end 2016, while the external debt was 39.5% at the same period.



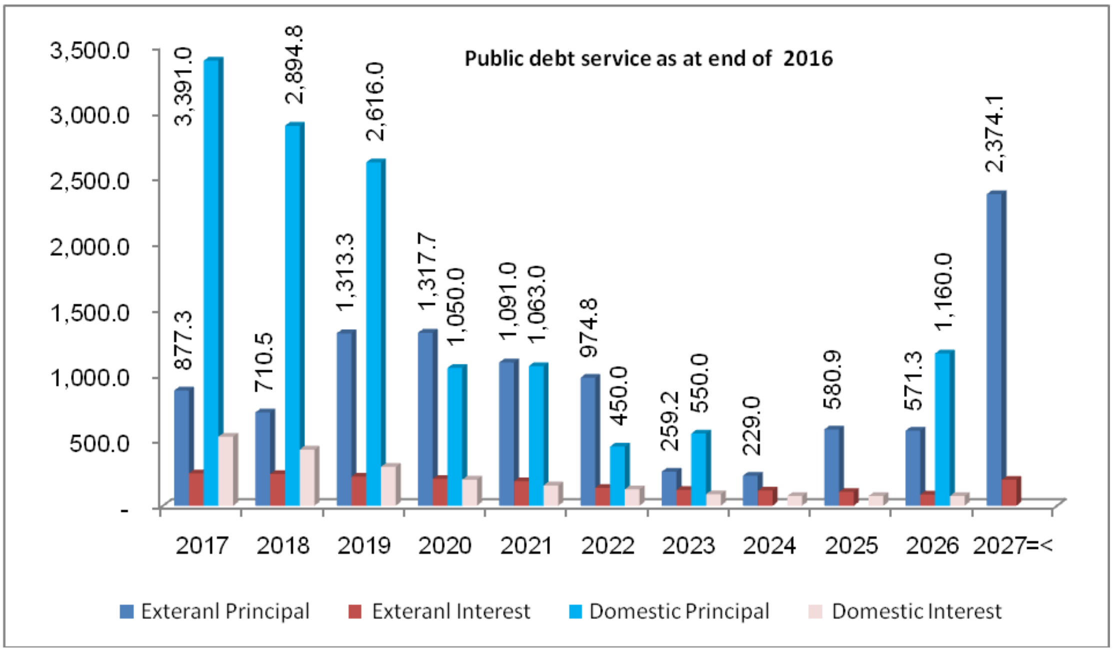
*The distinction between domestic and external debt is according to currency denomination, not residency of the investor.

By currency, Gross Public Debt is composed of 60.5% in JD, 30.7% in USD, 5.5% in EUR and 3.3% in JPY.

The Treasury bills and bonds with tenor of 2, 3 and 5 years represent the largest portion of public debt.



Amortization schedule of public debt as of end -2016:



The main characteristics of the debt portfolio and the cost and risk indicators of the existing debt as follows:

End of 2016	Gross Domestic Debt	External debt (FX)	Gross public debt	*Comments*
Gross Debt in million JD	15,793.7	10,299.0	26,092.7	• *Domestic debt dominates the debt portfolio*
% of GDP	57.6	37.5	95.1	
Refinancing risk				
Average Time to Maturity (years)	3.0	6.7	4.2	• *The domestic debt profile has a short ATM & ATR which means that debt serving payments and consequently budget deficit are highly exposed to domestic interest rates*
Debt maturing in one year	25.3	8.7	18.7	
Debt maturing in 2 years	45.9	15.6	33.9	
Interest rate risk				
Average time to re-fixing (ATR) (years)	3.0	6.0	4.2	• *Low cost on external debt, relatively high cost on domestic debt*
Weighted average of interest rate	4.1	2.4	3.5	
FX risk				• *The main portion of FX is in USD and the JD is pegged to USD.*
FX debt as % of Gross debt		39.5		
Short term FX debt as % of reserves		8.7		

Analysis of alternative financing strategies

Based on the existing debt portfolio and assumption about the primary deficit, the financing needs of the central government and government guaranteed debt to own budget agencies, several borrowings strategies were tested through simulation against market shock scenarios. The impact of these shocks are compared to a baseline strategy and the difference is used as the measure of risk.

Susceptibility to risk	**Gross domestic debt**	**External Debt**	**Gross Public Debt**	***Comments***
Exchange rate risk exposure to the budget	Low	Low	Low	Low interest rate means that even a substantial depreciation will have limited budget effect
Exchange rate risk exposure to the size of debt	Low	Low	Low	The pegged exchange rate policy means that the exchange rate risk is low
Refinancing risk	High	Low	Medium	External portfolio has longer redemption profile. Domestic debt repayments are concentrated in the short to medium term.
Interest rate risk	High	Low	Low	Vulnerability to domestic debt stems primarily from the short maturities.

With stability of macroeconomic projections and relatively inactive domestic secondary market unchanged, the main risk factors are the refinancing risk which is addressed by re-profiling the short-term nature of short-term domestic bonds into medium to long term ones and issue more international bonds with long term tenor, decrease the percentage of debt due in one year and maintaining comfortable levels of foreign currency reserves.

Environment for debt management 2017 - 2021

The domestic market

Domestic interest rates have increased significantly since December 2016. The Central Bank of Jordan has raised interest rates on its instruments on four occasions for a total of 125 basis points, this in line with both local and international monetary and economic developments, most notably the US Federal Reserve Bank having raised policy rates in the United States on three occasions for a total of 75 basis points.

Regarding expectations for the remainder of 2017 and for 2018-2021, interest rates are expected to continue to rise, in line with US Federal Reserve policy, who will continue to tighten its monetary policy in line with economic developments, raising interest rates in the US Dollar markets.

Macroeconomic environment

The protracted political and security unrest in the region, especially events that have led to a rather complete shutdown of borders with Iraq and Syria have negatively affected performance on several economic indicators, including those pertaining to the external sector such as national exports, tourism and foreign direct investment, causing economic growth to slow down by 2.0% in 2016 compared to 2.4% in 2015. In addition, the general price level as measured by the consumer price index dropped by 0.8% due to the decrease in fuel and food prices. Budget deficit (after grants) saw a decrease by 0.3 percent points, reaching 3.2% of GDP in 2016 compared to 3.5% in 2015. The current account in the balance of payments registered a deficit of 9.3% of GDP in 2016 compared to 9.1% in 2016.

On the monetary and banking level, monetary and banking policy of the Central Bank by the year 2016 has been marked flexibility and responsiveness to local, regional and global economic developments, in order to maintain the pillars of monetary and financial stability, including stability of the Jordanian dinar and the strength of the banking system. Foreign reserves, which maintained comfortable levels at around USD 12.9 billion and by adding the balance of gold ($ 1.5 billion) and Special Drawing Rights ($ 95.6 million), the total balance of foreign central bank reserves at the end of the year 2016 becomes amounted to USD 14.5 billion.

The debt management strategy is based on the macroeconomics context as at the end of 2016 and is in line with IMF's latest expectation for GDP growth, inflation, budget deficit and other fiscal indicators agreed upon with the Government.

The strategy

The debt management strategy 2017-2021 can be summarized as follows:

- Continue reliance on external debt sources especially borrowing in USD to cover the portion of the borrowing needs with target to increase the FX as % of total debt to reach 45.5% of total debt in 2021.
- Extend the average maturity of domestic debt by issuing debt instrument with long term maturity (3, 5, 7, 10 and 15 years) taking market conditions into consideration.
- Decrease the share of debt maturing within one year.
- Issue Islamic Sukuk to diversify the financing sources and expand the investor base in government debt securities.

Targets of the debt strategy end of Year five 2021(1)

	Current	**2021 (2)**
Gross debt to GDP	95.1	81.7
Net debt to GDP	87.7	75.9
Refinancing risk		
ATM external debt (years)	6.7	5.6
ATM domestic debt(years)	3.0	4.2
ATM public debt	4.2	4.7
Interest rate risk		
Debt maturing in 1 year as % of total debt	18.7	17.6
FX risk		
FX debt as % of total	39.5	45.5
Short term FX debt as % of reserves	8.7	11.1

(1) The estimates above are subject to market conditions and large number of assumptions about the dynamics of macroeconomic and financial variables in the next five years.

(2) The Gross debt to GDP includes the JD 504 million extended debt facility agreement signed with IMF in 2016. If excluded, the ratio drops to 80%.