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EBS/92/104  
Correction 1

CONFIDENTIAL

July 10, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Jordan - Staff Report for the 1992 Article IV Consultation and  
Review Under Stand-By Arrangement

The following corrections have been made in EBS/92/104 (6/15/92):

Page 9, last para., line 2: for "On April 13, 1992,"  
read "On April 11, 1992,"

line 8: for "as of May 5, 1992."  
read "in early May 1992."

Page 24, Proposed Decisions, para. No. 2, last line: for "June 8, 1992"  
read "June 9, 1992"

Corrected pages are attached.

Att: (2)

Other Distribution:  
Department Heads

10/10

### 3. Monetary and credit policies

The Fund representatives observed that money supply had expanded by over 7 percent during the first quarter of 1992 as a result of increases in both net foreign assets and net domestic assets. The increase in net domestic assets was fully attributable to a substantial rise in credit to the private sector that had been facilitated by the highly liquid position of the banking system. It appeared to the mission that the situation called for immediate and substantive remedial action.

The Jordanian authorities said that the expansionary impact of net foreign assets had started to decline gradually in the past two months and further slowdown was expected. On the demand side, the authorities explained that, while the economy had remained sluggish through 1991 and banks were quite cautious about lending, demand for credit by several sectors of the economy including industry, construction, and trade picked up during the first quarter of 1992 as confidence had been regained. This development was consistent with the objective of facilitating the resumption of economic growth. Indeed, some thought had been given to the need for liberalizing credit allocations to the private sector to sustain further economic expansion. The authorities added that some of the credit that had been extended for import financing had, in fact, been utilized to finance transit trade and was essentially self-liquidating.

The Fund staff representatives expressed the view that, in principle, the higher than expected monetary expansion in 1991 pointed to the desirability of an even greater tightening of monetary policy in 1992 than had been envisaged in the program. There was no economic justification for an increase in the indicative ceiling on credit to the private sector. A tight credit policy would encourage the private sector to use its own resources rather than use its foreign exchange deposits at the commercial banks as a basis for obtaining credit. The authorities' objective should be to pursue policies that would anchor the recent large inflows in Jordan and reduce the risks of experiencing outflows of funds.

The Jordanian authorities said that action had recently been taken to siphon off excess liquidity from the banking system. On April 11, 1992, the Central Bank raised the reserve requirements by 2 percentage points to 13 percent on commercial banks and to 7 percent on investment banks. These measures were expected to siphon off excess liquidity in an amount of about 2 percent of the money stock. Furthermore, moral suasion was used with the commercial banks to restrain lending. Additional measures were implemented in early May 1992. First, the Central Bank opened a new six-month deposit facility for commercial banks with an interest rate of 4 percent. Previous facilities were for a duration of up to three months, and carried interest rates of 1-2 percent. Excess reserves held at the Central Bank under the previous facilities amounted to about 6 percent of the money stock. The new facility of 4 percent interest is expected to be attractive to commercial banks for the placement of surplus funds; a recent auction of government securities has yielded an interest rate of only 2.5 percent. Second, a capital adequacy ratio of capital (including reserves) to credit ratio of

1 to 10 for all commercial banks was introduced for the first time. Third, a new maximum loan to deposit ratio of 90 percent was established. For the purpose of calculating this ratio, loans would include all loans whether in domestic or foreign currency, but deposits would include deposits in local currency only and would exclude import deposits. All commercial banks were required to observe both the capital adequacy ratio and the loan/deposit ratio. Commercial banks which were in violation of any of these ratios had to consult immediately with the Central Bank on a timetable to achieve compliance. The authorities expressed their confidence that the additional measures would be effective in restraining credit expansion and that the ceilings specified under the program would be observed.

The program for 1992 contained quarterly ceilings on net domestic assets of the banking system and net claims on the public sector by the domestic banking system, which constituted quantitative performance criteria. It was specified in the letter of intent of November 18, 1991 that these ceilings would be reduced if succeeding estimates of net foreign financing to the Government exceeded the level of JD 375 million. Moreover, it was envisaged that allowance would be made under the credit ceilings for cash payments to settle external arrears incurred in previous years for which no provision had been made in the 1992 budget. Based on the revised projections for net foreign financing (JD 475 million) and the actual payments for settlement of external arrears to be made during the first half of 1992 (JD 105 million), the credit ceilings, after these technical adjustments, are as shown in Appendix I, Table 8. These adjusted ceilings constitute performance criteria. Considering the uncertainties in the flow and timing of receipt of foreign aid, another review of net foreign financing to the Government will be undertaken in September/October in the light of which the credit ceilings for end-December 1992 might need to be adjusted. Moreover, the Jordanian authorities have now requested that cash payments for certain official debt buybacks that may materialize during the course of 1992 also be accommodated under the ceilings. As the foreign exchange to finance these buybacks is available, and since these transactions will not affect the domestic economy, this accommodation can be allowed without affecting the objectives of the program. Based on the above programmed increase in net domestic assets, and given the projected increase in net foreign assets from the balance of payments, the rate of monetary expansion is now projected at 8.9 percent in 1992, about the same as the original program target (Table 3).

Regarding interest rate policy, the Jordanian authorities reaffirmed that interest rates were being freely determined by market forces. Nominal lending rates were in the range of 10-13 percent, well above the inflation rate of 6 percent. Most of the deposit rates--0.6 percent on demand deposits, 5.5-7.0 percent on time deposits, and 6.75-9.0 on one-year deposits--were also above the inflation rate. The substantial inflows of foreign exchange into the banking system had contributed to upward stickiness of interest rates. Although the commercial banks were highly competitive, they felt no need to compete for deposits by raising interest rates.

Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

A. 1992 Consultation

1. The Fund takes this decision relating to Jordan's exchange measure subject to Article VIII, Section 2, in concluding the 1992 Article XIV consultation with Jordan and in the light of the 1992 Article IV consultation with Jordan conducted under Decision No. 5392-(77/63), adopted April 29, 1977 as amended (Surveillance Over Exchange Rate Policies).

2. Jordan maintains exchange restrictions on the making of payments and transfers for current international transactions evidenced by limitations on certain invisible payments in accordance with Article XIV, Section 2. In addition, Jordan retains, as described in EBS/92/104, an exchange restriction evidenced by arrears on external debt service payments that is subject to Fund approval under Article VIII, Section 2(a). The Fund welcomes the recent elimination of the advance deposits required on imports and the authorities' intention to eliminate all external payment arrears by December 31, 1992. In the meantime, the Fund grants approval for the retention of this restriction until December 31, 1992 or the completion of the second review contemplated in paragraph 4(c) of the stand-by arrangement, whichever is earlier.

B. Review Under Stand-By Arrangement

1. Jordan has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Jordan (EBS/91/202, Sup. 2) and paragraph 3 of the letter dated November 18, 1991 from the Minister of Finance and the Governor of the Central Bank of Jordan, in order to review progress made in the implementation of the policies and measures described in that letter and annexed Memorandum on Economic Policy of the Jordanian Government, and to reach understandings regarding the circumstances in which purchases under the arrangement can be resumed.

2. The letter from the Minister of Finance and the Deputy Governor of the Central Bank of Jordan, dated June 9, 1992 shall be attached to the stand-by arrangement for Jordan, and the letter of November 18, 1991 with its annex shall be read as supplemented and modified by the letter of June 9, 1992 and its attachment.

3. Accordingly, the limits referred to in paragraph 4(a) (i) and (ii) of the stand-by arrangement on net domestic assets of the banking system and net claims on the public sector by the domestic banking system and the intentions regarding arrears on external debt service payments referred to in paragraph 4(b) of the arrangement shall be as specified and described in Attachment I and paragraph 6 of the letter of June 9, 1992 set forth in EBS/92/104.

4. The Fund decides that the first review contemplated in paragraph 4(c) of the stand-by arrangement is completed, and that, notwithstanding the nonobservance of the performance criterion specified in paragraph 4(b) of the arrangement, Jordan may proceed to make purchases under the arrangement.