EBS/89/57

CONFIDENTIAL

March 27, 1989

To: Members of the Executive Board

From: The Acting Secretary

Subject: Jordan - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Jordan dinar.

Mr. Acquah (ext. 8661) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

JORDAN

Real Effective Exchange Rate - Information Notice

Prepared by the Middle Eastern Department
and the Exchange and Trade Relations Department

(In consultation with the Legal Department
and the Research Department)

Approved by A.S. Shaalan and S. Kanesa-Thasan

March 24, 1989

Recent developments in the real effective exchange rate of the Jordan dinar, as measured by the standard index developed in connection with the information notice system, are set out in the attached table and chart. Based on this index, as of January 1989, the Jordan dinar had depreciated in real effective terms by 18.8 percent since the last occasion on which the Executive Board had the opportunity to discuss developments in Jordan's exchange rate, the 1988 Article IV consultation in June 1988. 1/

Since mid-1985, the thrust of exchange rate policy in Jordan has been to encourage economic diversification and enhance external competitiveness. Although since early 1975 the Jordan dinar had been pegged formally to the SDR at the rate of JD 1 = SDR 2.5790 within margins of 2.25 percent, the exchange rate was allowed to move within a wider band since late 1984. In pursuit of a flexible exchange rate policy, financial institutions were allowed, effective February 1986, to quote their own exchange rates, using the central bank rate, at which no transactions were taking place, as a guide. This practice was discontinued on June 6, 1988, when the authorities began to require the financial institutions to quote the central bank rate, which was at about JD 0.34 per U.S. dollar on that date, for their transactions. In the face of a heavy loss of reserves and pressure on the currency, the authorities withdrew support to the foreign exchange market beginning October 16, 1988, thereby effectively floating the Jordan dinar. It depreciated from an average JD 0.41 per U.S. dollar in October 1988 to JD 0.49 per U.S. dollar in January 1989, and there emerged different exchange rates for transactions carried out by the Central Bank of Jordan, the commercial banks, and exchange companies.

In a move to deal with the resulting volatility and increasing speculation, on February 8, 1989, the Central Bank and the commercial bank rates were unified at the rate of JD 0.54 per U.S. dollar, and the

1/ The Chairman's summing up circulated as SUR/88/53 (6/27/88).

activities of the exchange companies were suspended. Currently all transactions are carried out at this rate but the Central Bank of Jordan is not required to intervene to support the Jordan dinar. The authorities believe that the present rate will balance the demand and supply of foreign exchange. The Central Bank of Jordan intends however to keep the situation under continuous review, taking into account developments in the balance of payments and the underlying trends in the competitiveness of Jordanian goods and services.

Jordan has been experiencing increasing economic and financial difficulties in recent years, precipitated in part by a worsening of the external economic environment. Economic slowdown in the region following the oil price decline reduced flows of official aid and private transfers and contributed to a weakening of export demand. These developments exposed structural weaknesses in the budget and the balance of payments, both of which had relied to a significant extent on external financial flows. In order to sustain economic activity, the authorities resorted to foreign commercial borrowing, a drawdown of reserves, and increased reliance on domestic bank financing of the budget. The deficit of the current account widened from US$46 million in 1986 to US$350 million in 1987, while the overall balance of payments recorded a deficit of US$129 million. The external position is estimated to have weakened further in 1988, and the level of foreign exchange reserves declined from over US$400 million at the beginning of the year to a range of US$20-70 million since mid-year. In these circumstances, it became increasingly difficult for the Central Bank to defend a fixed rate of exchange. Since mid-1988, the authorities have taken a wide range of measures in addition to the floating of the exchange rate. In the area of monetary policy, a number of steps have been taken to increase interest rates which were virtually freed in September 1988, and credit policy has been selectively tightened. A number of measures have also been taken to raise new revenues and contain government expenditures, while wages and salaries and the prices of certain essential goods have been frozen. These measures have been accompanied by the imposition of a ban, until 1990, on the import of cars, electrical goods, and other luxury items.

Staff Appraisal

The recent depreciation of the dinar in real effective terms is consistent with the authorities' efforts to foster economic diversification and facilitate external adjustment. This policy thrust was broadly endorsed by the Executive Directors in concluding the 1988 Article IV consultation with Jordan in June 1988. At the same time, Directors were of the opinion that given the uncertain outlook for foreign demand and for private transfer receipts, corrective measures were needed to resume sustainable growth, rectify the structural weaknesses in the budget and the balance of payments, and lessen the vulnerability of the economy to external developments. The large loss of reserves further underscores the need for such adjustment.

Medium-term fiscal and balance of payments projections for Jordan indicate that the authorities will have to maintain tight fiscal and monetary policies over a number of years in order to reduce the existing financial imbalances to sustainable levels. While the authorities recognize the need for continued adjustment and are contemplating further measures, they would favor a gradual approach extended over three to four years and, for this purpose, intend to seek international support in the form of debt relief and balance of payments assistance. During a recent staff visit to Amman to participate in a Bank mission, the authorities expressed the hope that this assistance will include policy-based lending by the Bank, a stand-by arrangement with the Fund, 1/ with parallel lending by bilateral creditors, and debt rescheduling by the Paris Club and other creditors.

1/ The Jordanian authorities have requested a Fund mission to visit Amman during March 28-April 6, 1989 to discuss a stand-by arrangement and to hold the 1989 Article IV consultation discussions; exchange rate policy and developments will be further examined in the course of the mission.

Table 1. Jordan: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate 1/ 2/	Nominal Effective Exchange Rate 1/	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars 1/	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
II	105.7	107.6	98.2	85.6	117.6	116.9
III	107.9	109.5	98.5	83.5	120.2	118.7
IV	109.9	110.6	99.4	82.8	123.1	124.3
1983						
I	107.4	111.5	96.4	84.0	120.9	121.9
II	108.5	113.2	95.9	82.8	122.1	121.4
III	108.3	115.5	93.7	81.1	121.5	120.2
IV	107.3	116.8	91.9	80.7	121.3	122.5
1984						
I	108.4	117.6	92.1	80.0	123.5	124.3
II	109.4	117.8	92.8	79.3	126.1	125.3
III	111.1	120.8	92.0	76.8	126.8	125.5
IV	110.9	121.1	91.5	74.4	128.1	129.6
1985						
I	112.6	124.1	90.7	72.4	129.0	129.4
II	110.1	122.7	89.7	73.9	129.5	128.7
III	109.1	121.7	89.6	76.6	130.8	129.7
IV	105.6	119.9	88.1	79.7	130.3	131.9
1986						
I	103.3	118.6	87.1	82.9	130.2	130.4
II	101.8	117.7	86.4	84.9	129.5	128.7
III	99.6	115.6	86.2	86.6	129.8	128.8
IV	98.3	114.6	85.8	86.5	130.1	131.9
1987						
I	93.7	111.2	84.3	88.1	129.2	129.2
II	92.0	110.3	83.4	89.0	129.9	129.1
III	90.5	109.1	82.9	86.5	130.8	129.8
IV	85.4	106.1	80.5	88.5	128.3	130.1
1988						
I	84.6	104.8	80.7	88.5	130.2	130.1
II	83.1	103.4	80.4	86.5	131.7	131.0
III	79.8	100.9	79.1	78.9	132.3	131.3
IV	68.5	83.3	82.4	67.0	140.6	142.5
Monthly						
1988						
Jun. 3/	81.4	101.7	80.1	83.4	132.1	130.2
Jul.	81.1	102.4	79.2	81.0	131.5	129.5
Aug.	77.7	98.5	78.9	76.7	132.0	130.8
Sep.	80.6	101.8	79.2	79.2	133.3	133.6
Oct.	73.1	92.2	79.3	73.0	134.5	135.5
Nov.	66.8	79.9	83.6	65.0	142.6	144.3
Dec.	65.5	77.8	84.2	63.2	144.6	147.8
1989						
Jan.	66.1	77.9	84.9	61.4	146.8	
Percentage change						
June 1988–Jan. 1989	-18.8	-23.4	6.0	-26.4	11.2	

Source: Information Notice System.

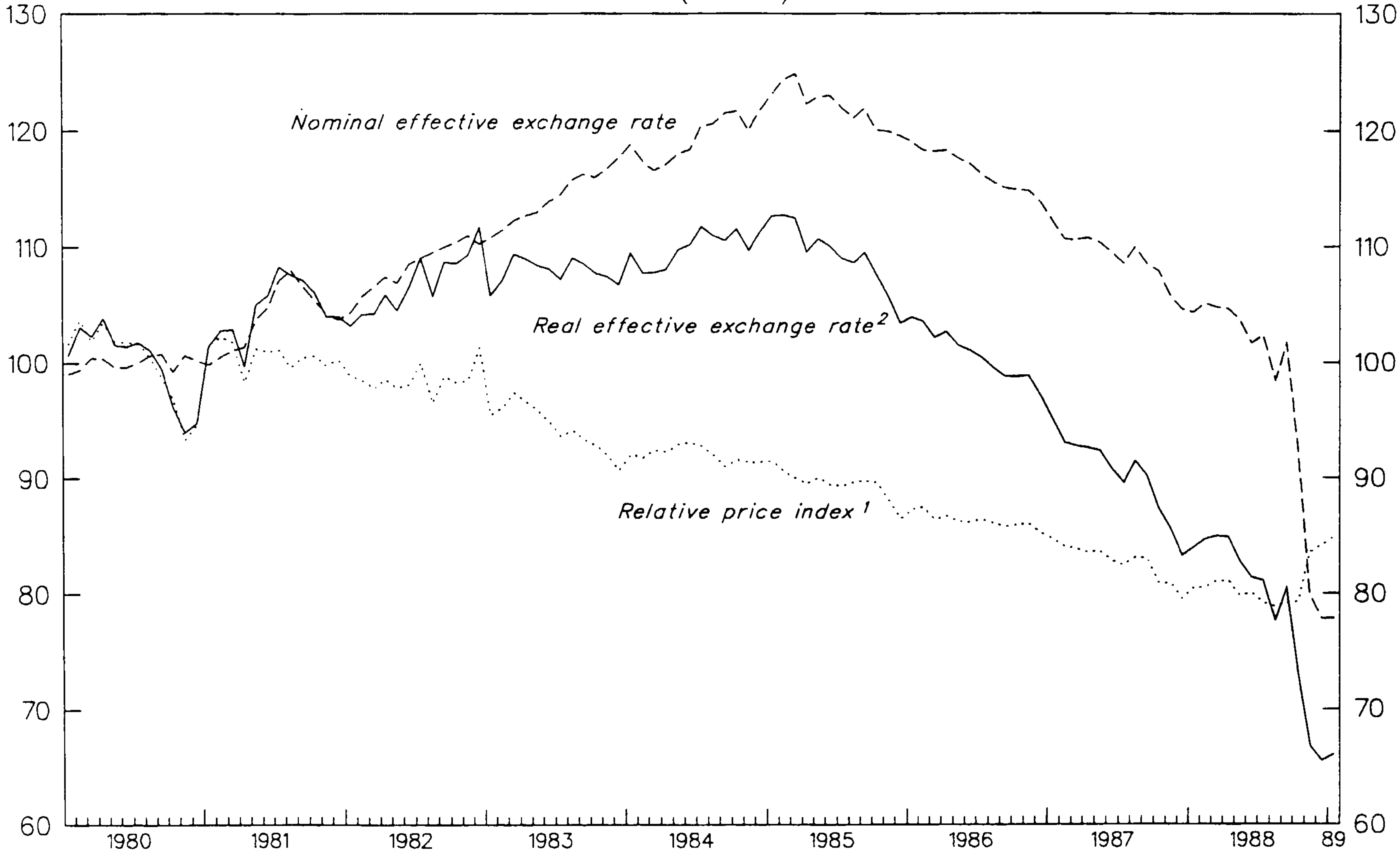
1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

CHART

JORDAN

INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE

(1980=100)



Source: Information Notice System.

[1]Seasonally adjusted.

[2]Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices, increases mean appreciation.