

JORDAN ECONOMIC REPORT

SAFEGUARDING MACROECONOMIC STABILITY AMIDST LARGE TWIN DEFICITS

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- Slight economic recovery on the back of a drop in inflation**
 Despite a relatively difficult external environment, characterized by the spillover effects of the Syrian conflict on the Jordanian economy, the Kingdom's economic recovery managed to gain some steam, with real GDP growth improving from 2.7% in 2012 to 3.0% in 2013, while the 12-month inflation rate has dropped from 6.5% in 2012 to 3% in 2013, implying an average inflation of 5.6% within the context of a successful monetary management that bolstered the level of the official reserves cushion.
- Narrowing yet still high current account deficit**
 Jordan's external accounts witnessed a narrowing yet still high current account deficit in 2013 amid higher current transfers related to GCC grants and private receipts for Syrians. Jordan's imports grew by 5.4% while total exports registered a tiny growth of 0.3%. The trade deficit sank deeper into the negative territory to reach the equivalent of US\$ 14.0 billion in 2013, up by 8.5% relative to the previous year. But the pressure on Jordan's external accounts lessened during the year 2013, with the current account deficit contracting by 28.7% to reach the equivalent of US\$ 3.4 billion. The contraction in current account deficit in 2013 is mainly attributed to a significant growth in net current transfers of 53.4% to reach the equivalent of US\$ 6.7 billion.
- Accommodative monetary policy amidst a significant pick-up in foreign reserves**
 Monetary conditions in Jordan were marked in 2013 by a strong pick-up in the Central Bank's foreign currency reserves amidst increased appetite for JD-denominated assets and noticeable de-dollarization, while the money supply registered wider yearly expansion mainly supported by a significant growth in JD deposits. Within this context, the Central Bank of Jordan adopted an accommodative monetary policy, cutting key interest rates twice in 2013, followed by an additional cut in early 2014. The CBJ managed to reverse the sharp drop in foreign exchange reserves observed over the year 2012, with the latter surging by a significant 63.7% in 2013 (the equivalent of US\$ 5.2 billion) to reach a record high of US\$ 13.3 billion. The broader Money Supply (M2) widened by 9.9% in 2013, following an expansion of 3.5% in 2012.
- Challenging public finance imbalances despite external support**
 The turmoil in the region, including the flood of Syrian refugees, has aggravated the fiscal deficit which registered 9.1% of GDP in 2013. While the removal of fuel subsidies was a bold but necessary step, key remaining fiscal challenges are to reform the State-owned National Electric Power Company and contain defense related spending which remains by far the single largest drain on public finances.
- Healthy banking activity growth on the back of satisfactory financial soundness**
 Jordan's banking sector witnessed a healthy activity growth during the year 2013, with total assets of banks operating in the Kingdom growing by a yearly 9% in 2013 to reach US\$ 60.5 billion at end-December 2013. The banks' activity growth picked up some pace last year, proving more than twice higher than that recorded during the previous year. While banks liquidity remains high, an increasing portion of it is invested in claims on the public sector, specifically government securities. But banks in Jordan remain adequately capitalized to face potential pressures on their own funds base. In parallel, asset quality and profitability metrics have shown further improvement last year.
- Price falls on the equity market with more favourable activity on the fixed income market**
 Jordan's stock market saw extended price falls in 2013 that have triggered further declines in market capitalization and sustained weakness in turnover ratios. The Amman Stock Exchange general weighted price index extended in 2013 its prolonged downward trend that has started in 2008, dropping by 5.6% year-on-year. The fixed income market, in parallel, witnessed domestic and global bond issues and further contractions in sovereign spreads over the year.
- Economy set to continue facing a mix of key opportunities and challenges**
 Real GDP growth will remain sluggish in the near term, reflecting the impact of domestic and external demand, though a modest pick up to 3.5% is expected for 2014. The relative recovery in domestic activity will be partly helped by the government's intention of pushing ahead with a series of projects using a US\$ 5 billion GCC grant. Growth will be actually driven by increased Gulf aid and continuing US grants, as well as by stronger domestic consumption and looser monetary policy. But large downside risks remain from the conflict in Syria, developments in Egypt, movements in oil prices and commitment to reform.

The Jordan Economic Report can be accessed via internet at the following web address: <http://www.banqueaudi.com>

Despite a relatively difficult external environment, characterized by the spillover effects of the Syrian conflict on the Jordanian economy, the Kingdom's economic recovery managed to gain some steam, with real GDP growth improving from 2.7% in 2012 to 3.0% in 2013, while the 12-month inflation rate has dropped from 6.5% in 2012 to 3% in 2013, implying an average inflation of 5.6% within the context of a successful monetary management that bolstered the level of the official reserves cushion.

Based on nine-month data, the main sources of growth were construction, transport and communications, financial services and the government sector. The economy has been supported by public investment, aided by GCC funding, and by stronger domestic consumption in part due to demand from Syrian refugees. Notwithstanding the growth in remittances on the back of the strength of the economies such remittances are emanating from.

Having said that, regional instability has continued to hamper the economy. In particular, the impact of the Syrian crisis on tourism, foreign investment, business confidence and the public finances has been substantial, with the arrival of some 1.2 million refugees in the country also adding to domestic security concerns and social tensions. Tourist arrivals have fallen sharply from a 2010 peak and were down a further 17.8% in 2013.

The turmoil in the region, including the flood of Syrian refugees, has aggravated the twin deficits, i.e its large current account and fiscal deficits. While progress is being made to narrow the deficits, much remains to be done to reduce them to sustainable levels. In 2013, the external current account and fiscal deficits registered 9.9% of GDP and 9.1% of GDP respectively. The current account balance partly benefited last year from some softening of world commodity prices, a rise in remittances, improved inflows of gas from Egypt and a surge in official transfers or grants. At the fiscal level, while the removal of fuel subsidies was a bold but necessary step, key remaining fiscal challenges are to reform the State-owned National Electric Power Company and contain defense related spending which remains by far the single largest drain on public finances.

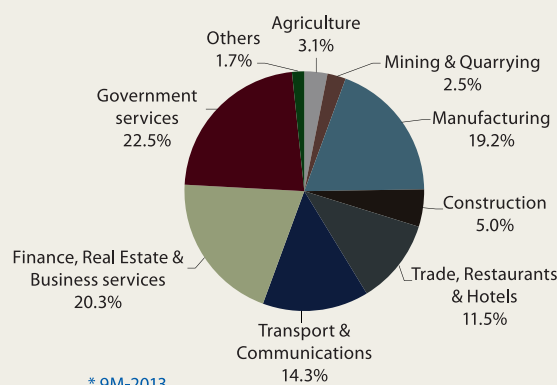
Although remittances by Jordanians working abroad rose by 4.4% in 2013 to US\$ 3.65 billion, the government has indicated that it is keen to tap into more of the financial resources of the country's expatriate population. An estimated 500,000 Jordanians work abroad, with about 80% of them in the GCC countries and substantial numbers in North America. With economic growth in the GCC countries set to remain comparatively robust in 2014, Jordan should benefit from a further increase in inward remittances this year.

GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY*



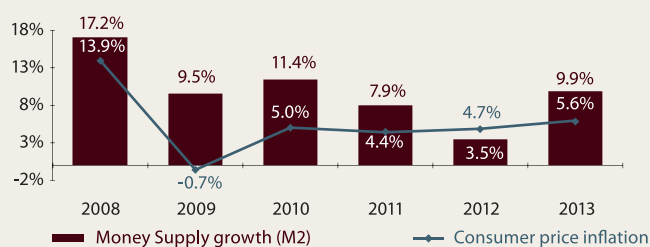
Sources: Central Bank of Jordan, Bank Audi's Group Research Department

At the monetary level, in a move clearly aimed at stimulating a sluggish economy, the Central Bank of Jordan lowered its re-discount rate from 4.75% to 4.5% in October 2013. This represented the second successive 25 basis points rate cut in the space of just two months, and was followed by an additional 25 bps cut to 4.25% in January 2014. The Central Bank of Jordan is also pushing ahead with its program of support for micro, small and medium size enterprises, helped by funding from external donors.

In parallel, gross official reserves rose from US\$ 8.1 billion at end-2012 to US\$ 13.3 billion at end-2013 as a result of grants from GCC countries, successful sovereign bond issues, falling dollarization and rising public transfers. The US has offered a new government-back loan guarantee – amounting to US\$ 1 billion – that will enable Jordan to tap the international capital markets in 2014, following on from a similar US\$ 1.25 billion loan guarantee approved in 2013. The US has also confirmed that work will continue on preparing a new five-year aid agreement as the current agreement, signed in September 2008, is due to expire this year.

The detailed developments in the real sector, external sector, public sector and financial sector are outlined in the sections that follow while the concluding remarks address the Kingdom's economic challenges looking forward.

BROAD MONEY AND INFLATION



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Primary and secondary sectors on marginal yearly declines

Jordan's agricultural activity continues to be affected by the country's adverse weather conditions alongside the region's politico-security events. The sector reported a real contraction of 1.1% in the first nine months of 2013, yet easing its position from a 9.6% contraction in the corresponding period of 2012, as per Central Bank data.

The sector, which constituted 3.1% of GDP in the first nine months of 2013, also witnessed a rise in the prices of vegetables products. The latter rose by 14.3% in 2013, after posting a 5% rise in 2012. The further ascension in the number of Syrian refugees alongside the difficult weather conditions in the country were major factors contributing to the steep rise in the price of vegetable products.

Although the slowdown in the activity of the agricultural sector was felt on the local front within the context of slower production, the external sector saw an improvement in the form of a positive export growth. Exports of agricultural products grew by 13.0% in 2013, against a growth of 8.1% in 2012. More specifically, the exports of vegetable products grew by 2.9% in 2013, subsequent to a 0.6% contraction posted in 2012, as per Central Bank data. It is worth noting that the exports of vegetable products to Arab countries expanded by 12.1% in 2013, following a 2.8% decline in 2012, as per Central Bank data.

The number of newly registered companies classified within the agricultural sector posted a 5% contraction in the first 10 months of 2013, against a steeper 24.7% decline witnessed in the first 10 months of 2012, as per the same source. In parallel, the level of credit facilities to the agriculture sector contracted by 7.5% in 2013, against an 11% expansion seen in 2012.

The industrial sector was also subjected to a slowdown, in the context of a fragile local environment weighing on investors' appetites to initiate projects. Yet, the sector managed to post a slight expansion from the previous year, as it was boosted by the manufacturing component of the economy. Accordingly, the sector's activity, which includes mining and quarrying, manufacturing, electricity and water, posted a real growth rate of 0.6% in the first nine months of 2013, lower than the growth rate of 1.5% achieved in the first nine months 2012.

Moreover, credit facilities extended to industrial activities (excluding mining) saw a higher growth of 5.3%, rising at a slightly weaker pace in contrast to the higher growth rate of 9.5% in 2012. The external component of the industrial sector also witnessed a 1.0% contraction in the exports of industrial products

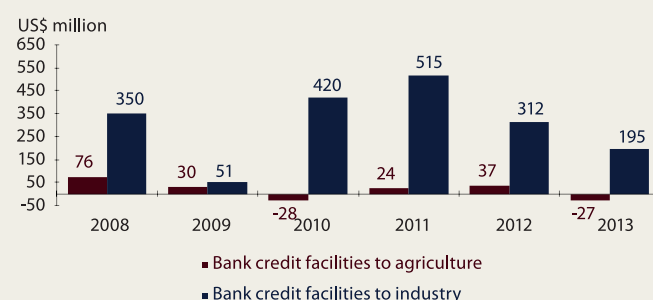
AGRICULTURE AND INDUSTRY

US\$ million	2009	2010	2011	2012	2013	Var 13/12
Agricultural exports	734	889	1,046	1,131	1,278	13.0%
Industrial exports	4,315	5,069	5,732	5,575	5,518	-1.0%
Phosphate (000 tons)*	5,153	6,529	7,594	6,383	5,274	-17.4%
Potash (000 tons)*	1,123	1,934	2,259	1,823	1,728	-5.2%
Fertilizers (000 tons)*	721	760	723	640	678	5.9%
Chemical acids (000 tons)*	1,434	1,576	1,413	1,291	1,266	-1.9%
Petroleum products (000 tons)*	3,539	3,350	3,158	3,476	3,082	-11.3%
Electricity and water (Mill.K.W.H.)*	8,130	7,806	8,160	7,895	7,539	-4.5%

* output

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

CREDIT FACILITIES FLOWS TO AGRICULTURE & INDUSTRY



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

in 2013, against a 2.7% contraction in 2012. This trend is more or less linked to a weaker demand from Arab countries. It is worth mentioning that the industrial production quantity index remained almost constant on a yearly basis, reporting a marginal growth of 1.5% in the first 10 months of 2013.

Manufacturing activities' growth rate improved from a negative 2.3% in 9M2012 to a positive 1.7% in 9M2013, as per Central Bank data. The growth of manufacturing exports saw an 11.0% jump in 2013, following a circa 2.0% growth posted in 2012.

The mining and quarrying segment witnessed a contraction in its growth rate of 10.5% in real terms during the first nine months of 2013, after growing by 16.4% in the first nine months of 2012. Such a drastic change is reflected in the indicators published by the Central Bank. As a matter of fact, the mining and quarrying production quantity index, a gauge of the level of output, recorded a 14.8% decline in the first 10 months of 2013.

As for the electricity and water segment, its activity marginally decelerated in the first nine months of 2013. Accordingly, the real growth of the segment declined by 0.73% in the first nine months of 2013 following an increase of 7.2% in the corresponding period of 2012. The latter was reflected by the fall in the industrial production index, which contracted by 6.8% in the first 10 months of 2013.

1.1.2. Construction

Construction sector posts improvement from previous year

The construction sector, accounting for 5% of GDP, managed to improve its position in 2013 relative to the previous year. Accordingly, Jordan's construction sector posted an expansion of 8.3% in real terms during the first nine months of 2013, against a slight expansion of 0.3% in the corresponding period of 2012.

Furthermore, new credit facilities extended to activities classified under the construction sector witnessed an expansion of 11.0% in 2013, against an expansion of 6.3% in 2012. In contrast, although the sector saw an improvement from the previous year, demand for construction permits was contained in 2013 as growth slowed from a double-digit rate of 14.2% in 2012 to a negative 3% in 2013.

In parallel, the number of new registered companies within the construction sector experienced a slight contraction of 4.8% in the first 10 months of 2013, against a severe contraction of 30.9% in the first 10 months of 2012. The capital of these companies followed the same path, as it edged down by 32.2% in the first 10 months of 2013 subsequent to a 58.8% decline in the first 10 months of 2012.

It is worth noting that large-scale overseas investments, combined with increased State spending on infrastructure projects, resulted in the Jordanian construction industry shifting its focus from the capital Amman, which had long been the centre of building activity, to the port city of Aqaba.

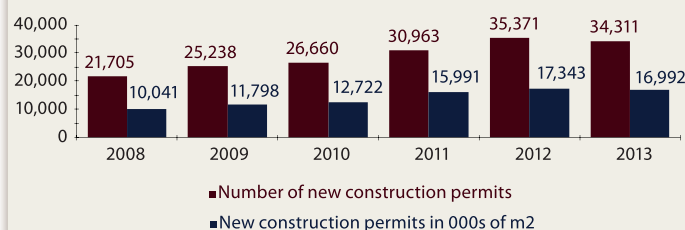
CONSTRUCTION INDICATORS

US\$ million	2009	2010	2011	2012	2013	Var 13/12
Clinker production (000 tons)	3,064	1,699	1,206	1,026	906	-11.7%
Bank credit facilities to construction (var)	409	826	417	309	570	84.5%
Number of registered companies*	294	313	341	241	238	-1.4%
Capital of new registered companies*	29	22	49	23	16	-28.5%

*10-month annualized figures for 2013

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

EVOLUTION OF CONSTRUCTION PERMITS



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

A new committee was set up in order to explore options for the further development of the Aqaba Special Economic Zone (ASEZ). When the ASEZ was established in 2001, the government was hoping it would not only stimulate development in the Aqaba region, but serve as a model for efficient development throughout Jordan. It was intended to be a duty free, low tax, investor-friendly zone with minimal bureaucracy that would encourage transport, industry, real estate and tourism development.

The ASEZ strategic plan for 2001-2020 calls for 50% of investment in tourism, 30% in services, 13% in heavy industry and 7% in light industry. The zone covers 375 sq km, but a great deal of investor interest is focused on its limited 27 km coastline, where the port, minerals related industry and tourism facilities battle for land.

Aqaba is increasingly becoming a focus for energy infrastructure, with a liquefied natural gas terminal currently under construction and plans for a pipeline to bring Iraqi oil to the port. Thus, balancing the competing demands would be as equally important as attracting new projects for the Jordanian government.

1.1.3. Trade and Services

Steady growth in the tertiary sector

The trade and services sector, which contributes to almost two-thirds of Jordan's GDP, has been consistently expanding over the past few years with year-on-year real output growth moving from 4.8% in the first nine months of 2012 to 3.2% in the same period of 2013.

While all components of the tertiary sector managed to report higher activity, growth in trade and services was mainly driven by the following sub-sectors: Transport and communications which reported a real growth of 4.0%; finance, real estate and business services which grew by 3.8%; and trade, restaurants and hotels by 3.6%.

At the level of the transport sector, activity at the Queen Alia International Airport mirrored the expansion in capacity that was put in place in March 2013. As a matter of fact, and according to figures released by the Airport International Group, passengers at the airport grew by 3.7% year-on-year during the first 11 months of 2013, reaching a total of 6,024,078. This total is likely to break the historic record of passengers' numbers registered during the year 2012, where the number of passengers increased by 14.3% to a total of 6,250,048. As to the aircraft movement through the airport, it was almost equal to that registered during the first 11 months of 2012, increasing by a slight 0.8% to a total of 62,504 airplanes using the airport. The same goes for the total cargo, where it was only higher by 0.1% to a total of 85.3 thousand tons handled during the first 11 months of 2013.

TRADE AND SERVICES

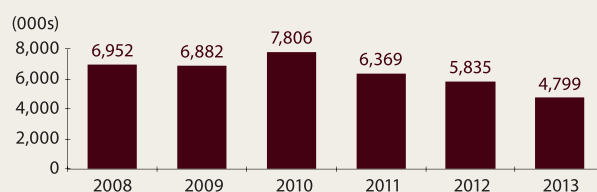
US\$ million	2009	2010	2011	2012	2013	Var 13/12
Number of vessels at the Aqaba Port*	2,331	2,369	2,395	2,632	2,444	-7.2%
Merchandise at the Aqaba Port (000 tons)*	14,201	16,851	19,184	19,355	16,439	-15.1%
Bank credit facilities to trade and services (var)	-117	389	979	2,148	707	-67.1%
Number of new registered companies**	5,424	5,004	4,990	4,632	4,859	4.9%
Capital of new registered companies**	258	217	366	180	180	-0.3%

*11-month annualized figures for 2013

** 10-month annualized figures for 2013

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

EVOLUTION OF TOURISTS ARRIVALS*



* Excluding Jordanian arrivals

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

On the other hand, activity at the Aqaba port was less vibrant. Positive growth at the level of passengers was reversed, whereas trade activity went into decline following an almost flat performance. Indeed, the number of passengers using the port during the first 11 months of 2013 decreased by 17.8% year-on-year, following an increase of 11.4% reported during the same period of 2012. As to the number of vessels, they decreased by 7.1% year-on-year to a total of 2,240 during the first 11 months of the year, following an increase of 10.6% registered during the same period of 2012. As to the quantity of imported and exported goods, it decreased by 17.8% year-on-year to a total of 15.07 million tons during the first 11 months of 2013. This follows a slight increase of 2.0% registered during the equivalent period of 2012.

As to the tourism sector, it continued to mirror adverse regional developments, with the number of foreign incomers declining for the third consecutive year, according to numbers published by the Central Bank of Jordan. In fact, arrivals, excluding Jordanians, were down by 17.8% in 2013. They reached 4,798,700 tourists compared to a low base of 5,834,500 incoming visitors in 2012. This decline was mainly due to lower number of Arab incomers, mainly those of Syrian and Egyptian origins, who reported respective year-on-year declines of 48.6% and 21.9%. The number of Turkish incomers remained on a sliding trail, registering a significant decrease of 76.5% in 2013. Conversely, the number of tourists from Germany and Indonesia were the only ones to report year-on-year increases of 12.2% and 2.2% respectively.

Alternatively, numbers published by Ernst & Young point to a less discouraging reality within the luxury segment of the sector. In fact, occupancy levels at four and five stars hotels within Amman decreased by a single-digit eight percentage points, from 69% in 2012 to 61% in 2013. Moreover, the average room rate increased over the year by 3.3% to US\$ 155. Also, receipts from the sector managed to register an increase of 1.4% in 2013, according to Central Bank figures. This could actually be due to a government effort on tightening the focus of the tourism industry, in order to attract visitors from higher-income brackets who are likely to stay longer and spend more.

1.2. EXTERNAL SECTOR

Narrowing yet still high current account deficit

Jordan's external accounts witnessed a narrowing yet still high current account deficit in 2013 amid higher current transfers related to GCC grants and private receipts for Syrians. The country's trade volume increased by 4.0% year-on-year to reach a total of US\$ 29.9 billion in 2013, following a rise of 6.3% in 2012.

In details, the growth in Jordan's imports saw further deceleration in 2013 despite the influx of Syrian refugees, given a significant contraction in the oil bill. Jordan's imports grew by 5.4% in 2013 as compared to a rise of 9.6% in 2012 and 21.6% in 2011, to reach the equivalent of US\$ 21.9 billion. The slowdown in growth is mainly driven by an 11.5% fall in Jordan's oil bill due to a decrease in quantities and prices, noting that imports of mineral fuels and lubricants account for circa 27% of the overall import bill. The commodity composition of imports shows that "petroleum products", "crude oil", "transport equipments and spare parts", "textile yarn, fabrics, made up articles and related products", "iron and steel", "plastic and article thereof", and "meat, fish and preparations thereof" topped the list of imports in 2013, accounting for 43.2% of total imports, down from 47.4% in 2012. The breakdown of imports by country of origin shows that most of the inward merchandise in 2013 came from Saudi Arabia with 18.4% of the total, followed by China with 10.2%, US with 6.2%, India with 5.1%, Italy with 4.7%, Germany with 3.7%, Turkey with 3.5%, and the UAE with 3.3% of total imports. These countries, which constituted the main source of Jordanian imports in 2013, accounted for 55.1% of total imports, as compared to 58.3% in 2012.

Total exports registered a tiny growth of 0.3% in 2013 to reach the equivalent of US\$ 7.9 billion, following a 1.5% contraction in 2012. The increase resulted from a 1.2% rise in domestic exports to US\$ 6.8 billion and a 4.5% decline in re-exports to US\$ 1.2 billion. The breakdown of domestic exports by commodity shows that the main exports in 2013 were the exports of clothes, medical and pharmaceutical products, potash, vegetables, phosphate and fertilizers, which accounted for 52.2% of total domestic exports, down from 55.2% in 2012. The geographic distribution of domestic exports indicates that 18.4% of these exports went to Iraq in 2013, followed by the United States with 17.6% of the total, Saudi Arabia with 13.6%, India

with 7.3%, the UAE with 4.0%, and Indonesia with 3.4% of total domestic exports. These major recipient countries accounted for 64.3% of total domestic exports in 2013, up from 61.2% in 2012.

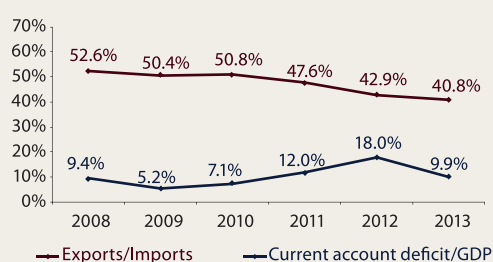
The rise in total imports coupled with a relative stagnation in total exports has led to a wider trade deficit which sank deeper into the negative territory to reach the equivalent of US\$ 14.0 billion in 2013, up by 8.5% relative to the previous year. The trade shortfall as a percentage of GDP remained relatively unchanged year-on-year, reporting 41.1% in 2013, against 41.3% in 2012. The export-to-import coverage ratio has sustained its declining streak to reach 40.8% in 2013, against 42.9% in 2012.

Overall, the pressure on Jordan's external accounts lessened during the year 2013, with the current account deficit contracting by 28.7% to reach the equivalent of US\$ 3.4 billion. The contraction in the current account deficit in 2013 is mainly attributed to a significant growth in net current transfers of 53.4% to reach the equivalent of US\$ 6.7 billion, as a result of an increase in net transfers to the public sector (foreign grants) and a rise in net transfers to other sectors. Meanwhile, the services account registered a contraction in its surplus of 5.0% in 2013 to reach the equivalent of US\$ 1.8 billion, while the income account recorded a 12.9% decline in its deficit to reach the equivalent of US\$ 339 million. Within this context, the current account deficit fell from 18.0% of GDP in 2012 to 9.9% of GDP in 2013.

In parallel, the capital and financial account surplus dropped by 44.4% in 2013, moving down from US\$ 3.7 billion in 2012 to US\$ 2.9 billion in 2013. The fall is driven by a 5.6% decline in the capital account surplus to US\$ 2.4 billion and a 44.4% drop in the financial account surplus to US\$ 2.9 billion. The significant fall in the financial account surplus is attributed to a move in reserve assets from +US\$ 3.3 billion in 2012 to -US\$ 5.2 billion in 2013, a 19.5% rise in direct investment to US\$ 1.8 billion, a five-fold increase in portfolio investment to US\$ 1.6 billion in 2013, and a surge in other investment from US\$ 142 million in 2012 to US\$ 4.8 billion in 2013.

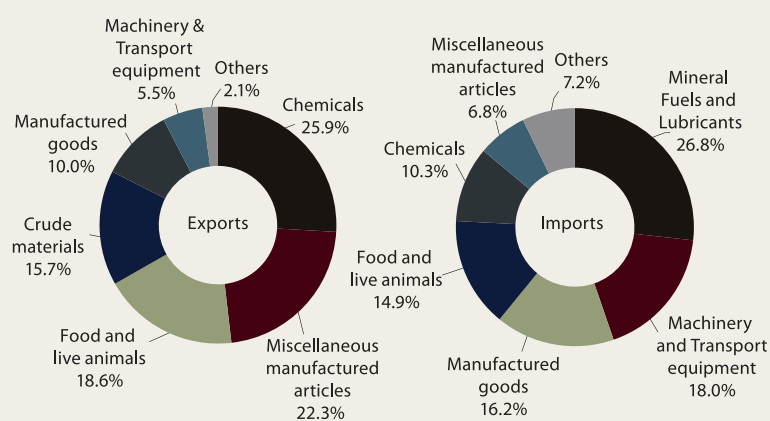
It is worth finally mentioning that the current account deficit-to-GDP is expected to maintain a sustained improvement in the near term, in part helped by lower energy imports. This is predicted on the assumption that the LNG facility in Red Sea port of Aqaba becomes operational in late 2014, which would considerably reduce the energy import bill.

FOREIGN SECTOR INDICATORS



Sources: Central Bank of Jordan, IMF, Bank Audi's Group Research Department

BREAKDOWN OF EXPORTS & IMPORTS BY COMMODITY IN 2013



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

1.3. PUBLIC SECTOR

Deficit supported by grants and subsidy cuts but challenges remain

The public finance picture for the year 2013 seems to be in line with the government planned budget of a US\$ 1.8 billion deficit, including foreign grants. In fact, the fiscal deficit in Jordan registered a level of US\$ 1.6 billion during the first 11 months of 2013, a 22.9% decrease from the same period of 2012. When excluding aid, the figure increases to US\$ 2.4 billion, a 10.3% rise from the first 11 months of 2012.

In details, the shrinking deficit was a result of higher fiscal resources, mainly in terms of grants, overweighing the reported increase in expenditures. In fact, Central Bank data shows that total revenues and grants attained US\$ 7.21 billion during the first 11 months of 2013, up by 13.2% from the US\$ 6.37 billion registered during the same period of 2012. A breakdown by revenues shows that domestic revenues were at US\$ 6.39 billion, a year-on-year increase of 2.6% from the first 11 months of 2012. Tax revenues made up the largest share of this category, at 73% of total domestic revenues. As to grants, Jordan received US\$ 681 million in additional foreign aid during the first 11 months of 2013, totaling US\$ 817 million.

Public expenditures reached a total of US\$ 8.76 billion during the first 11 months of 2013, up by 4.5% from the total registered during the same period of 2012. Capital expenditures exceeded US\$ 1.0 billion up from US\$ 723 million during the first 11 months of 2012, equivalent to an increase of 38.9%. On the other hand, current expenditures remained almost stagnant at a level of US\$ 7.76 billion, up by US\$ 98.8 million (equivalent to 1.3%) from the first 11 months of 2012. A breakdown of current expenditures highlights a year-on-year increase of US\$ 222 million in interest payments to a total of US\$ 935 million during the first 11 months of 2013. Moreover, social benefits increased by US\$ 269 million to total US\$ 1.76 billion during the said period of 2013, within the context of strengthening social protection measures. On the other hand, subsidy spending decreased by US\$ 746 million, down by 64% from the level spent during the first 11 months of 2012. This is in line with the government decision to halt fuel subsidies that was announced in November 2012. Accordingly, the value of subsidies categorized under the "foods and oils" category declined by a drastic 71% year-on-year to just US\$ 317 million during the first 11 months of 2013.

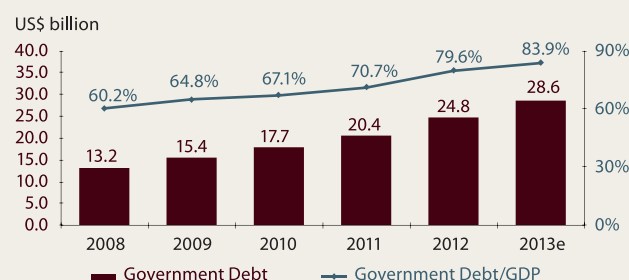
According to latest IMF estimates, debt-to-GDP increased from a level of 79.6% in 2012 to 83.9% in 2013. Fiscal consolidation measures will aim to place debt on a downward trend, but have been slowed down compared to the original IMF program in order to manage the impact of external shocks, specifically from lower Egyptian gas supplies and the Syrian crisis. Looking forward, a better targeting of subsidies and income tax reform are among the key fiscal measures foreseen for 2014.

SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	2009	2010	2011	2012	2013e
General government revenues	6.3	6.6	7.6	7.1	8.9
General government revenues/GDP	26.5%	24.9%	26.4%	22.8%	26.0%
General government expenditures	8.4	8.0	9.6	9.9	12.0
General government expenditures/GDP	35.4%	30.4%	33.2%	31.7%	35.1%
General government fiscal balance	-2.1	-1.5	-2.0	-2.8	-3.1
General government fiscal balance/GDP	-8.9%	-5.6%	-6.8%	-8.8%	-9.1%

Sources: IMF, Bank Audi's Group Research Department

GOVERNMENT INDEBTEDNESS



Sources: IMF, Bank Audi's Group Research Department

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Accommodative monetary policy amidst a significant pick-up in foreign reserves

Monetary conditions in Jordan were marked in 2013 by a strong pick-up in the Central Bank's foreign currency reserves amidst increased appetite for JD-denominated assets and noticeable de-dollarization, while inflationary pressures were relatively contained on a yearly basis as the impact of the removal of fuel subsidies has abated given lower international oil prices, and the money supply registered wider expansion over the year mainly supported by a significant growth in JD deposits. Within this context, the Central Bank of Jordan adopted an accommodative monetary policy, cutting key interest rates twice in 2013, and once in early 2014.

In details, the Consumer Price Index grew by 5.6% on average in 2013, according to the Central Bank of Jordan, against an average of 4.7% in 2012, given the extended effect of the removal of fuel subsidies in late 2012 though the inflationary impact of the latter has somehow subsided, aided by a pass-through of lower oil prices; the implementation of electricity tariff increases in August 2013; and the large Syrian refugee inflow into Jordan. The breakdown of the Consumer Price Index by category shows that the housing category rose by 8.3% on average in 2013, mainly driven by a 19.8% surge in "Fuels and Electricity" costs and a 4.3% rise in "housing and related expenses" as rents increased significantly driven by growing demand from refugees; the other goods and services category increased by 5.8%, mainly supported by a 9.0% rise in transportation and communications costs; the clothing and footwear category went up by 5.7%; and the food items rose by 3.7%. It is worth mentioning that the annual inflation rate decelerated from 6.5% in December 2012 to 3.3% in December 2013 as the effect of fuel prices liberalization has abated, helped by lower international oil prices. Within this context, the IMF expects inflation to decelerate further to 2.4% in December 2014 given lower inflationary pressures from fuel price increases, and as the selected electricity tariff increases implemented in August 2013 and those that are planned for the year 2014 are expected to have only very limited pressures on prices.

The CBJ managed to reverse the sharp drop in foreign exchange reserves observed over the year 2012, with the latter surging by a significant 63.7% in 2013 (the equivalent of US\$ 5.2 billion) to reach a record high level of US\$ 13.3 billion at end-December 2013. The rebound in official reserves came within the context of strong conversions in favour of Jordanian Dinar holdings amidst higher interest rate differential between the Jordanian Dinar and the US Dollar and the inelastic response of customer deposit rates to CBJ benchmark rate cuts in 2013; the issuance of US Dollar-denominated domestic bonds twice in 2013 for a total of US\$ 1.15 billion in addition to the issuance of US\$ 1.25 billion Eurobonds guaranteed by the US government; the mobilization of GCC donor grants; the financial support from the IMF; and the execution of USD/JD swap agreements between CBJ and Jordanian banks. As a result, the CBJ's official reserves covered 41.3% of money supply in Jordanian Dinar at end-2013 as compared to a considerably lower coverage ratio of 29.3% at end-2012.

The CBJ stays committed to the maintenance of the Jordanian Dinar's peg to the US Dollar, despite the associated lack of monetary flexibility, as the peg has instilled monetary confidence and prompted stability in Jordan's increasingly open economy. Within this context, it is worth mentioning that the recent build-up in FX reserves and decline in the dollarization of the economy have strengthened the JD peg.

A pick-up in foreign currency reserve levels, sustained de-dollarization trend, contained inflationary pressures year-on-year, and subdued growth rates prompted the Central Bank of Jordan to reduce interest rates on key monetary policy instruments twice in 2013 by a total of 50 basis points. The re-discount rate was cut from 5.00% at end-2012 to 4.50% at end-2013; the interest rate on repurchase agreements was lowered from 4.75% to 4.25%; the overnight deposit window facility was reduced from 4.00% to 3.50%. These interest rates were further cut by 25 bps in January 2014. The CBJ believes that such a measure is a catalyst to further economic growth through promoting private sector credit expansion, and came in light of the continuous improvement in Jordan's fundamental economic indicators.

The broader money supply (M2) widened by 9.9% or US\$ 3.48 billion in 2013 to reach US\$ 38.7 billion at the end of the year, following an expansion of 3.5% in 2012. The growth in money supply in 2013 compares to a money creation of US\$ 3.62 billion, resulting mostly from an increase of US\$ 1.46 billion in net claims on the public sector, a US\$ 1.83 billion rise in claims on the private sector, a US\$ 53 million decline in claims on financial institutions, and a rise in net foreign assets of US\$ 0.38 billion. The difference between the growth in money supply and money creation, amounting to circa US\$ 139 million, suggests a demonetization of monetary claims in 2013.

Looking forward, renewed confidence in the Jordanian Dinar, comfortable FX reserve levels, reversed dollarization trends, and declining year-on-year inflation rate might prompt accommodative monetary conditions in the near term with the Central Bank of Jordan focusing more on stimulating growth. Within this context, the IMF said that further reductions in interest rates should be considered only when there is clear evidence of a downward trend in core inflation, and the pass-through from tariff increases and potentially higher oil prices is contained.

1.4.2. Banking Activity

Healthy deposit growth but lending activity lags behind as sovereign exposure mounts

Jordan's banking sector witnessed a healthy activity growth during the year 2013, amidst a slight improvement in economic activity, GCC funded infrastructure spending and accommodative monetary stance amidst a tough regional environment. Total assets of banks operating in Jordan grew by a yearly 9% in 2013 to reach US\$ 60.5 billion at end-December 2013. The banks' activity growth picked up some pace last year, proving more than twice higher than that recorded during the previous year.

Total deposits remained the main activity driver of banks in Jordan, accounting for close to two thirds of total balance sheets at end-December 2013. Total deposits progressed by 11% on a yearly basis to reach US\$ 39.0 billion at year-end 2013, after a sluggish growth in the previous year amidst a more difficult macroeconomic backdrop. The 2013 deposit increase in volume turned out to be more than 4 times higher than that registered during 2012, within the context of improving domestic economic growth.

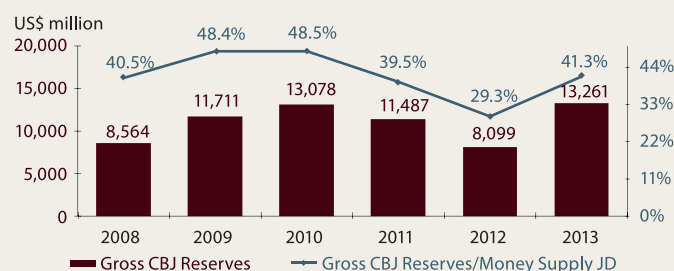
The rise in the depositor base is attributed to both the private and public sectors. While public sector deposits contributed to 12% of the total deposit growth, the private sector was responsible for the bulk of the deposit increase last year (88%) and accounts for more than 90% of the total deposit base. In details, private sector deposits rose by 9.9% last year, mostly driven by the resident private sector with deposits growing by a yearly 8.9% and accounting for the bulk of private sector funds parked at banks in Jordan. The increase in resident private sector deposits can be mostly attributed to additional time deposits. Non-resident private sector deposits grew by 19.2% last year, which was reflected in its demand, saving and time components, to account for about a fifth of total deposit growth in Jordan. It is worth mentioning that the resilient depositor base in Jordan is primarily retail oriented, with banks showing a more or less limited reliance on foreign funding.

MONETARY SITUATION

Flows in US\$ million	2008	2009	2010	2011	2012	2013
Net foreign assets	-1,092	2,532	1,688	-1,023	-3,804	381
Net claims on public sector	2,884	475	454	2,514	3,866	1,458
Claims on private sector (resident)	2,141	256	1,294	1,818	1,476	1,833
Claims on financial institutions	82	-137	-21	-26	0	-53
Net other items	-234	-667	-182	-780	-333	-139
Uses=Sources	3,781	2,459	3,232	2,503	1,205	3,480
Money supply (M1)	1,036	673	719	1,002	-74	1,711
Quasi-money	2,745	1,787	2,513	1,501	1,279	1,770

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

EXCHANGE MARKET INDICATORS



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

As foreign currency deposits, mostly those of the resident private sector, declined by 9.2% year-on-year, the increase in the total deposit base during 2013 is attributed to local currency funds (+18.6%). Accordingly, the deposit dollarization ratio retreated, moving from 29.1% at end-December 2012 to 23.9% at end-December 2013, amidst macro conditions relatively more favorable to the Jordanian Dinar than during 2012.

While banks boasted higher deposits during 2013, lending activity grew more or less satisfactorily but fell short of that during the previous year. As a matter of fact, total credit facilities extended by banks in Jordan progressed by about 7% year-on-year to reach US\$ 26.8 billion at end-December 2013. Yet, the increase in volumes proved to be 44% lower than during 2012 despite the improvement in macroeconomic conditions in the Kingdom. The year 2012 had actually witnessed a significant surge in total credit facilities mostly attributed to strong new lending to the public services and utilities sector. Last year however, the rise in total credit facilities was mostly owed to higher lending to the construction sector, which accounted for 36% of total new credit facilities during the year 2013, followed by lending to the general trade, industry and mining sectors, among others.

A look at credit facilities from a currency angle shows that local currency lending contributed to two thirds of the increase in total lending last year, while those in foreign currencies were responsible for the remaining third. It is worth pointing out that the increase in lending activity throughout 2013 is almost entirely to the benefit of the resident private sector, as lending to the non-resident private sector and central government and public sector entities slightly contracted year-on-year. While the 2013 lending activity grew less than total sector activity, it is likely to be favored in the near term by a pick-up in corporate sector borrowing, amidst Gulf-backed investment expenditures and a supportive monetary policy on behalf of Jordanian authorities.

With deposits progressing at a faster pace than credit facilities, the credit facilities to deposits ratio slightly improved to move back to just under the 70% mark. At the same time, banks' core liquidity ratio, measured as the ratio of cash in vaults and reserves and deposits at the Central Bank and at banks abroad to total deposits, reached 36.5% at end-December 2013. The latter is a relatively favorable level when compared to regional and international benchmarks and reflects banks' adequate liquidity cushions.

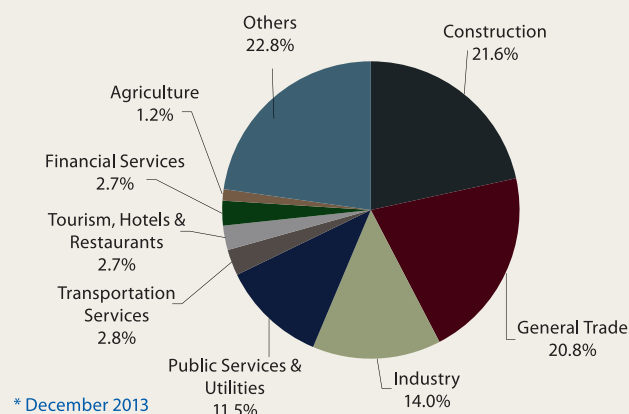
Nonetheless, an increasing portion of banks' liquidity is invested in claims on the public sector, specifically government securities. Claims on the public sector, including the central government and public entities, continued to grow last year (+15.9% relative to 2012) to account for almost a quarter of total assets and 1.7x capital accounts and allowances of banks operating in Jordan. This actually highlights the increasing sovereign exposure and correlation between balance sheet soundness and sovereign risk metrics.

BANKING SECTOR INDICATORS

US\$ million	2008	2009	2010	2011	2012	2013
Banking Activity						
Assets	42,039	45,163	49,411	53,154	55,458	60,541
Deposits	25,540	28,686	31,796	34,384	35,258	39,029
Credit facilities	18,403	18,820	20,417	22,357	25,158	26,789
Capital accounts and allowances	5,367	6,183	6,994	7,612	8,258	8,693
YTD Growth rates						
Assets	11.0%	7.4%	9.4%	7.6%	4.3%	9.2%
Deposits	13.1%	12.3%	10.8%	8.1%	2.5%	10.7%
Credit facilities	15.3%	2.3%	8.5%	9.5%	12.5%	6.5%
Capital accounts and allowances	7.9%	15.2%	13.1%	8.8%	8.5%	5.3%

Sources: Central Bank of Jordan, Bank Audi's Group Research Department

CREDIT FACILITIES BREAKDOWN BY ECONOMIC ACTIVITY*

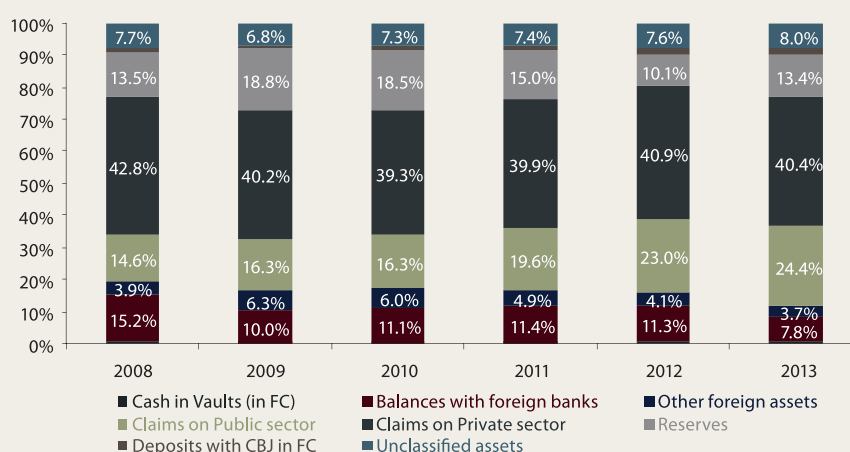


Sources: Central Bank of Jordan, Bank Audi's Group Research Department

Sovereign exposure may be increasing but banks in Jordan remain adequately capitalized to face potential pressures on their own funds base. As a matter of fact, the capital adequacy ratio as disclosed by the Central Bank of Jordan reached 17.9% at end-June 2013 as per the latest available data, higher than the minimum requirement and comparing favorably to global averages. Jordanian authorities' close supervision of banks has contributed to ensuring that capital and liquidity levels on the overall remain comfortable despite the relatively tough domestic operating conditions.

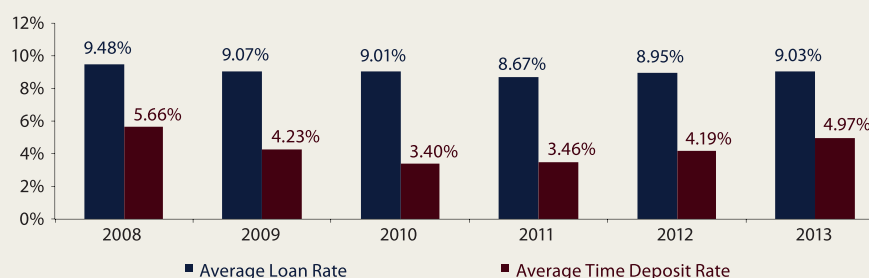
In parallel, asset quality metrics have shown further improvement last year. The stock of non-performing loans has slightly decreased over the first six months of 2013 as per the latest available data, as some banks have started to restructure and write off loans related to a correction in the real estate sector since 2009, to reach 7.4% of total loans (the lowest level since 2009), against 7.7% at year-end 2012. Provisioning levels have increased considerably, with the NPLs coverage ratio reaching an adequate and post-global crisis high of 75.0% at end-June 2013 (69.4% at end-2012). Along the same lines, NPLs net of provisions accounted for only 6.6% of total equity at end-June 2013, down from 8.3% at end-2012 and registering the lowest post-global financial crisis outburst level.

ASSET COMPOSITION



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

BANKING SECTOR INTEREST RATES IN JD



Sources: Central Bank of Jordan, Bank Audi's Group Research Department

Last but not least, profitability is deemed as rather satisfactory and appears to have ameliorated during the first half of the year 2013 (latest figures available), although return ratios remain weaker than in the pre-global crisis period. The interest margin to gross income ratio inched up over the covered period to reach 76.9% at end-June 2013. Along the same lines, the annualized return on assets and return on equity reached around 1.2% and 10.3% respectively, against lower corresponding ratios of 1.1% and 8.6% in full-year 2012 as per official Central Bank statistics on the consolidated figures of banks operating in the Kingdom.

1.4.3. Equity and Bond Markets

Extended price falls on the equity market, further contraction in sovereign spreads on the fixed income market

Jordan's stock market saw extended price falls in 2013 that have triggered further declines in market capitalization and sustained weakness in turnover ratios. The fixed income market, in parallel, witnessed domestic and global bond issues and further contractions in sovereign spreads over the year, added to a credit rating cut by Moody's.

In details, the Amman Stock Exchange general weighted price index extended in 2013 its prolonged downward trend that has started in 2008, dropping by 5.6% year-on-year to close at 4,336.7 at end-December 2013, noting that the highest price falls were observed over the May-September period (-14.6%) due to lingering concerns about the US Federal Reserve tapering plans. Yet, the Jordanian stock market started to see a price rebound over the fourth quarter of 2013 after the US Fed decided on September 18, 2013 not to taper its bond-buying program. The breakdown of the ASE general weighted price index by sector in 2013 shows that the manufacturing and mining companies witnessed the sharpest price fall (-30.3%), followed by the insurance companies (-3.0%), while banks and financial institutions registered a price rise of 10.1%, followed by the services companies (+1.2%).

The number of listed companies at the ASE declined from 243 at end-2012 to 240 at end-2013. The fall in the number of listed companies on the ASE, coupled with a drop in the general price index, resulted into a 4.6% decline in market capitalization to reach US\$ 25.8 billion at end-2013, which is its lowest level in nine years. The ASE market capitalization stood at 76% of GDP at end-2013, down from 87% in 2012, which reflects the declining dimension of the ASE relative to the Jordanian economy. In parallel, non-Jordanians' ownership of market capitalization moved down from 51.7% at end-2012 to 49.9% at end-2013.

The ASE total trading value amounted to US\$ 3.4 billion in 2013, up by 25.6% relative to the previous year. The division of the total trading value by new sector classification showed that the financial sector captured 67.4% of activity, followed by the services sector with 16.7% and the industrial sector with 16.0%. On the backdrop of a decline in market capitalization and an increase in total trading value, the turnover ratio rose slightly from 10.1% in 2012 to 13.3% in 2013, yet compared to a much higher average turnover ratio of circa 38.3% over the past five years, which spots light on the continuous sluggish activity governing the Amman Stock Exchange. As to valuation ratios, the ASE price-to-earnings ratio stood at 14.7x in 2013 as compared to 15.6x in 2012, which renders ASE stock prices somewhat more attractive for equity investors. The dividend yield stood at 4.6% in 2013, with no change relative to the previous year.

At the level of the bond market, Jordan issued a three-year US\$ 500 million domestic bond with a coupon rate of 4.25% in February 2013 and a three-year US\$ 650 million domestic bond with a coupon of 4.75% in August 2013. Also, the Hashemite Kingdom of Jordan issued US\$ 1.25 billion seven-year Eurobonds with a coupon rate of 2.503% in October 2013, fully guaranteed by the US government. The formation of a new cabinet in March 2013 together with the announcement of the US government guarantee for a Eurobond provided a significant confidence-building factor over the year 2013. Under these conditions, the five-year US\$ 750 million bond issued in November 2010 saw contractions in its spread from 434 bps at end-2012 to 310 bps at end-2013, following a 38 bps contraction in 2012.

As to credit rating changes, Moody's downgraded Jordan's government bond rating in June 2013 by two notches from "Ba2" to "B1" with "stable" outlook. Jordan's "B1" rating reflects, according to Moody's, the

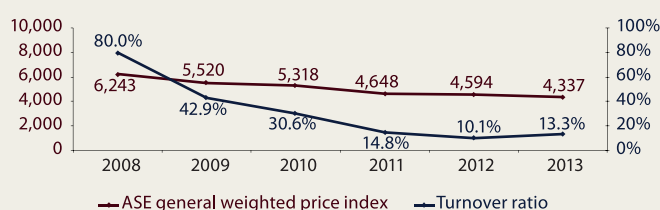
country's relatively low economic wealth and reduced growth prospects, high and rising debt levels and continued fiscal deficits, and increased political and policy risk deriving from regional turmoil. The "stable" outlook reflects Moody's view that the government will pursue fiscal consolidation that should stabilize the high debt numbers in the medium-term. In parallel, Standard & Poor's affirmed in November 2013 its long-term and short-term foreign and local currency sovereign credit ratings on the Hashemite Kingdom of Jordan at "BB-/B" with "negative" outlook. S&P's ratings are supported by the country's geopolitical importance, which underpins strong donor support and finances much of the country's persistently large current account deficit. The "negative" outlook reflects S&P's view of the potential for a downgrade over the year 2014 if adverse developments, particularly emanating from the conflict in Syria, significantly raise financing needs at large.

CAPITAL MARKETS INDICATORS

	2009	2010	2011	2012	2013
Market capitalization (US\$ billion)	31.8	30.9	27.2	27.0	25.8
Market cap/GDP	134%	117%	94%	87%	76%
Total value traded (US\$ billion)	13.6	9.4	4.0	2.7	3.4
Total volume of traded securities (million)	6,023	6,989	4,072	2,359	2,572
Total number of transactions (000s)	2,965	1,880	1,318	975	1,074
No. of listed companies	272	277	247	243	240
% Chg. in ASE general weighted price index	-11.6%	-3.7%	-12.6%	-1.2%	-5.6%
P/E	14.4x	26.3x	22.6x	15.6x	14.7x
P/BV	1.8x	1.7x	1.5x	1.5x	1.3x
Dividend yield	2.8%	2.7%	3.3%	4.6%	4.6%

Sources: Amman Stock Exchange, Bank Audi's Group Research Department

STOCK MARKET PERFORMANCE



Sources: Amman Stock Exchange, Bank Audi's Group Research Department

2. CONCLUDING REMARKS

Looking ahead, the Kingdom's economy is set to continue facing key opportunities along with a mix of challenges. Real GDP growth will remain sluggish in the near term, reflecting the impact of domestic and external demand, though a modest pick up to 3.5% is expected for 2014. The relative recovery in domestic activity will be partly helped by the government's intention of pushing ahead with a series of projects using a US\$ 5 billion grant provided by the GCC. Growth will be actually driven by increased Gulf aid and continuing US grants, as well as by stronger domestic consumption and looser monetary policy. But large downside risks remain from the conflict in Syria, developments in Egypt, movements in oil prices and commitment to reform.

In parallel, the rate of import growth should slow in 2014, helped by subdued global energy and food prices, before picking up again later on the back of a strengthening in domestic demand. Within this environment, inflation is expected to moderate to an average of 3.2% in 2014, in line with subdued global oil and food prices, despite a further planned rise in electricity tariffs.

The Central Bank is expected to keep interest rates low to stimulate domestic demand, and with US rates set to be unchanged until 2015, local rates are expected to remain relatively stable until then. Given the fragility of the economic recovery, it is expected that the Central Bank of Jordan would maintain an expansionary monetary stance throughout 2014/2015, before moving to a more concerted anti-inflation strategy. The Central Bank is expected to remain committed to the maintenance of the Jordanian's Dinar peg to the US Dollar, despite the associated lack of monetary flexibility. The peg has instilled monetary confidence and has not substantially harmed competitiveness.

With public debt now over the legal limit of 80% of GDP, a sustained fall in the deficit – focusing on reduced fuel and food subsidies, implementing a medium term energy strategy, completing income tax reforms and improving tax administration – will be required to stabilize and reduce debt. Some progress on renewable, nuclear and shale oil schemes have been made in recent months but the hard work is still to come.

Having said that, Jordan's economy faces key strengths and challenges. Among the most significant strengths, we mention the history of domestic political stability, the long standing external support, the favorable debt structure which lowers rollover risk and the robust banking sector with a high average capitalization ratio. Among weaknesses, we mention the low growth and income per capita, comparatively high public finance deficit indicators, the persistently weak external position underlined by large current account deficits, the high unemployment and social challenges and the volatile regional political environment at large.

It is important to mention as well that a renewed surge in global oil and food prices and possible slowdown in global or regional economies rise among significant downside risks. These are indeed particular concerns for Jordan's economy, given its fiscal and external vulnerabilities and the openness of the economy. Higher than expected oil prices would drive up the cost of electricity and the level of fuel subsidies. Another downside risk rests on a further delay in implementing the country's energy strategy, which includes raising tariffs while protecting the poor, diversifying energy sources and increasing energy efficiency.

Within this environment, the IMF has recently issued its appraisal and recommendations on the Kingdom's economy. The IMF highlighted that against the backdrop of a very difficult environment, Jordan's fiscal consolidation has been broadly on track and the Central Bank has also forcefully rebuilt reserves. Despite the economic program having been adjusted to help cushion the impact of external shocks, macroeconomic management will remain challenging. Confidence has improved but hinges on continued strong policy implementation. With an uncertain external environment, close monitoring and planning for contingencies are paramount, while maintaining the reform momentum is equally important, as further substantial adjustment is needed over the medium term.

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