BYBLOS BANK

THE LEBANESE ECONOMY IN 2017

BYBLOS BANK ECONOMIC RESEARCH AND ANALYSIS DEPARTMENT

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THE LEBANESE ECONOMY IN 2017

ECONOMIC POLICY: MISSING GROWTH-SUPPORTING MEASURES

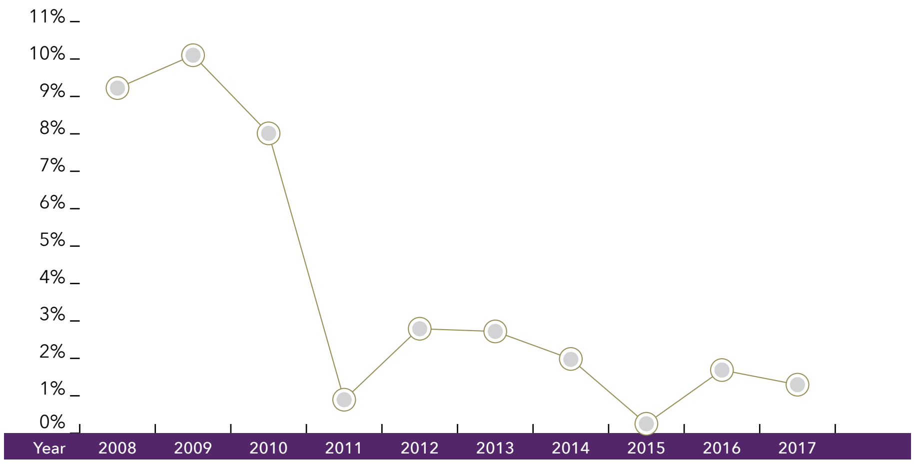
The year 2017 started with improved prospects for the Lebanese economy, following the election of General Michel Aoun as President in October 2016, the swift nomination of Mr. Saad Hariri as Prime Minister in November, and the formation of a government of national unity in December of the same year. The positive political developments during the fourth quarter of 2016 ended a presidential vacuum and an institutional paralysis that started in May 2014, and improved the prospects for policy-making.

However, the optimistic outlook was short-lived, mainly due to consumers' widespread disappointment about the priorities of the government. In fact, Lebanese households had high expectations that the government would put the priorities and needs of citizens, such as improving their quality of living and economic well-being, at the top of its agenda. Instead, the authorities raised taxes on consumption, income and profits, and increased fees on a large number of public services to help finance increases in the salaries and pensions of public sector workers and retirees, which weighed on consumer confidence as well as on the already stretched budgets of households.

Still, policy-making improved during the year: in January 2017, the Council of Ministers approved the long-delayed decrees relating to the exploration of Lebanon's offshore oil and gas resources; in June, Parliament ratified a new parliamentary electoral law but delayed the elections until May 2018; in September, Parliament endorsed the Petroleum Tax Law; in October, Lebanon concluded its first licensing round for offshore oil and gas exploration and production; and also in October, Parliament ratified the 2017 Budget Law, the country's first budget since 2005. More importantly, in May 2017, the Council of Ministers renewed the mandate of Banque du Liban (BDL) Governor Riad Salamé for a fifth consecutive six-year term. The renewal of Governor Salamé's term reinforced confidence in the stability of the currency and in the banking system and, therefore, in overall economic and social stability. In addition, BDL and the Ministry of Finance maintained their coordination to secure the government's financing needs and to help manage the public debt.

Political risks receded even further in August, following the swift and decisive victory of the Lebanese Armed Forces against remnants of terrorist groups in the Eastern part of the Bekaa region, which helped consolidate security conditions across the country. But Lebanon's political scene took an unexpected turn of events with the sudden resignation of Prime Minister Saad Hariri on November 4, 2017. However, the monetary and financial markets' reaction to this short-lived political event was contained and was in line with previous episodes of political instability.

REAL GDP GROWTH (%)



Source: National Accounts, Institute of International Finance, Byblos Research

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In parallel, the Lebanese economy benefited from a USD 1 billion stimulus package from BDL in 2017, which supported activity in several key sectors, especially real estate. This constituted BDL's fifth consecutive package since 2013. Also, the estimated inflows of USD 7.1 billion in remittances from Lebanese expatriates in 2017, equivalent to USD 1,500 per capita, sustained household spending for day-to-day needs.

However, the inadequate investment climate and business environment prevented a rebound in economic activity, despite the political settlement. In fact, the World Economic Forum's 2017-18 Global Competitiveness Index shows that 77% of ranked countries have a more competitive economy than Lebanon does and the World Bank Group's Doing Business 2018 survey indicates that 70% of countries around the world have a better business climate than Lebanon; while the weak statistical base in the country continued to limit the transparency of the economy. As a result, Greenfield foreign direct investments, which cover cross-border new projects that lead to the direct creation of jobs and capital investment, were equivalent to just 0.2% of GDP in 2017.

In addition, the presence of more than one million displaced Syrians in Lebanon continued to put strains on the country's infrastructure, but this did not justify the deterioration in the quality of public-service delivery throughout the year. Further, the amount of disbursed grants related directly or indirectly to Syrian refugees in Lebanon totaled USD1.12 billion in 2017, equivalent to 2.15% of GDP, according to the European Union's financial tracking mechanism. Most of the grants were earmarked towards education, economic infrastructure and recovery, food assistance, as well as healthcare, water and sanitation.

Further, the unchecked expansion of the public sector and its increasing burden on the private sector took their toll on economic activity. In fact, the tax increases on consumption, income and profits, combined with the massive raise in the public sector's wages and salaries, constitute a broad redistribution of income from the private sector to a bloated and inefficient public sector, irrespective of the original intent of the two measures. Further, even though the two related laws began to be gradually implemented in the fourth quarter of 2017, their impact started to affect economic activity in the latter part of the year.

ECONOMIC ACTIVITY: HIGH OPERATING COSTS LIMIT ACTIVITY

Consumer sentiment is a key indicator of the trends in economic activity in Lebanon, given that household expenditures represent about 88% of overall spending in the economy. As such, the trend and fluctuations in household sentiment reflect consumer behavior. The Byblos Bank/AUB Consumer Confidence Index increased by 47.1% in 2017, constituting the fourth annual expansion since 2009. However, the increase of the Index was from a low base, as the outcome for 2016 was the fifth lowest since the Index's inception in July 2007. Further, most of the increase of the Index occurred during the first quarter, as the Index rose by 16% in the first quarter of 2017, regressed by 6.3% in the second quarter, grew by 6.6% in the third quarter, and expanded by 5.9% in the fourth quarter of 2017.

The receding momentum in household sentiment was mainly due to the diverging priorities of the government on one hand, with those of the private sector and households on the other hand. Further, the negative impact of the tax measures on sentiment has been a lot more significant than any potential positive impact of the public sector wage increase. In fact, the positive impact of the wage increase on household sentiment was limited to public sector employees, as the value of the Byblos Bank/AUB Consumer Confidence Index for this segment of the population jumped by 72% in July, when the Parliament endorsed the raise, while it contracted across the remaining segments of the population. In addition, public sector employees posted the highest level of confidence among all segments of the population during the second half of the year.

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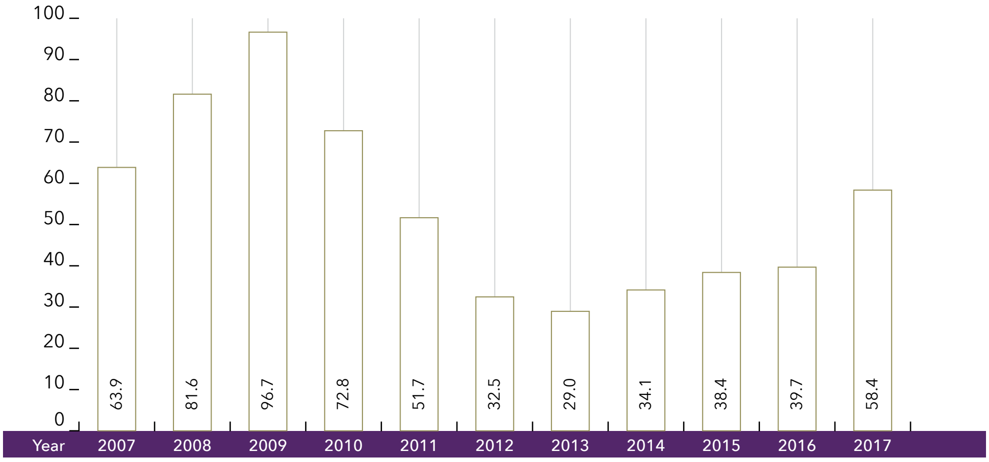
Household sentiment was affected in the fourth quarter of the year by the sudden resignation of Prime Minister Saad Hariri in early November. The unexpected resignation triggered a political crisis that reverberated across Lebanon, as the massive flow of rumors about the circumstances and consequences of the resignation weighed on consumer confidence in the first three weeks of the month and risked a significant slide of the Index. But the resolution of the crisis toward the end of November 2017, as well as Lebanon's renewed commitment to the "dissociation policy" from regional conflicts, eased the political crisis and economic uncertainties that prevailed during the month and supported household sentiment during the final quarter of 2017.

Despite the resolution of the political crisis, the results of the Index's survey continued to reflect the prevailing skepticism of Lebanese households, as only 11% of Lebanese polled in the fourth quarter of 2017 expected their financial conditions to improve in the coming six months, while 63% of them believed that their financial situations would deteriorate. Also, the level of consumer sentiment in 2017 remained 40% lower than the Index's peak year of 2009, even though it was 8% higher than the Index's monthly trend average since July 2007.

Further, the Byblos Bank/AUB Expectations Index posted higher values than the Present Situation Index in each month of 2017. However, the spread between the two indices quickly narrowed from 17.8 in January 2017 to 7.7 in February and ended the first quarter at 4.7, the second quarter at 3.6, the third quarter at 0.8, and the fourth quarter of 2017 at 3.8. The narrowing of the spread throughout the year reflects consumers' reduced optimism about the future.

BYBLOS BANK/AUB CONSUMER CONFIDENCE INDEX



Source: Byblos Bank Economic Research and Analysis Department

In parallel, the BDL's Coincident Indicator, a proxy for overall economic activity in Lebanon, increased by 5.6% in 2017, which still reflects slow economic activity, given that the change in the components of the indicator are not adjusted for inflation. Further, the BLOM Lebanon Purchasing Managers' Index (PMI), a measure of the performance of the private sector increased by 2% in 2017. Lebanon's PMI remained below the 50-point mark throughout the year, which means that activity continued to decline last year, but the increase in the PMI's average value shows that activity regressed at a slightly slower pace than in the preceding year. The PMI averaged 47.4 in the first quarter of 2017, its highest quarterly value during the year, and gradually declined afterward to 46.7 in the second quarter, 46.2 in the third quarter, and 46 in the fourth quarter of 2017.

Overall, the economy performed at a sub-par level, as it expanded by 1.9% in real terms in 2017 compared to a real GDP growth rate of 1.7% in 2016. Further, the size of the Lebanese economy reached USD 52 billion in 2017, with the informal economy representing about 30% of the total.

AGRICULTURE: SMUGGLING AND DUMPING AFFECT SECTOR

The agricultural sector was affected in 2017 by high operating costs, an inadequate infrastructure, the smuggling of products, unfair competition through dumping from some countries in the region, and by the fact that a significant part of the sector operates in the informal economy. In addition, the sector's exports regressed for the third year in a row, despite being subsidized, due to the ongoing closure of land borders between Syria and Jordan.

Agricultural exports through the Agri Plus subsidy program totaled 344,621 tons in 2017, down from 349,497 tons in 2016 and from a high of 527,000 tons in 2014. The Investment Development Authority of Lebanon launched the program in January 2012 with the aim to develop agricultural exports by providing financial incentives to exporters and farmers in Lebanon. However, the closure in April 2015 of the Nasseeb border crossing on the Syrian-Jordanian border, which was the only remaining open land route for the transport of goods from Lebanon and Syria to Jordan and Gulf Cooperation Council (GCC) countries, negatively affected exports. In response, the government started subsidizing in August 2015 the additional cost of maritime exports of Lebanese agricultural and industrial products to Arab countries through the Maritime Lebanese Exports Bridge (M.LEB) program. The M.LEB covers part of the additional costs that Lebanese exporters would incur when shipping their products through sea, rather than via traditional land routes. Even though the program, which aims to ensure the flow of Lebanese products specifically to GCC countries and Jordan, was operational throughout 2017, agricultural exports suffered from the extra time and cost through the maritime route.

In parallel, utilized bank credit by the agricultural sector reached USD 789 million at the end of 2017, up from USD 764.2 million a year earlier. The amount of loans to agriculture accounted for 1.14% of total utilized credits in the Lebanese economy and for 1.7% of utilized credits when excluding consumer loans. As such, lending to the agricultural sector was close to the sector's size in the economy, which is 2% of GDP. However, the expansion of bank lending to the sector continued to face a major obstacle, which is the informal nature of a large size of the agricultural sector.

Also, the Kafalat Corporation extended 210 loan guarantees to SMEs in agriculture in 2017, down from 328 guarantees in 2016 and from a high of 609 in 2010. The number of loan guarantees to SMEs in agriculture accounted for 39% of total guarantees in 2017, down from 46% in 2016 and 43% of the total in 2010.

Further, the agricultural sector received USD 35.1 million in subsidized interest loans in the first nine months of 2017, the latest available figures at the time of publication, accounting for 10% of subsidized loans by BDL and Kafalat. In comparison, subsidized loans to the sector totaled USD 68 million in 2015 and USD 81 million in 2016, accounting for 14% and 14.3%, respectively, of aggregate subsidized loans to productive sectors in the covered years.

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INDUSTRY: RESILIENT DESPITE CHALLENGES

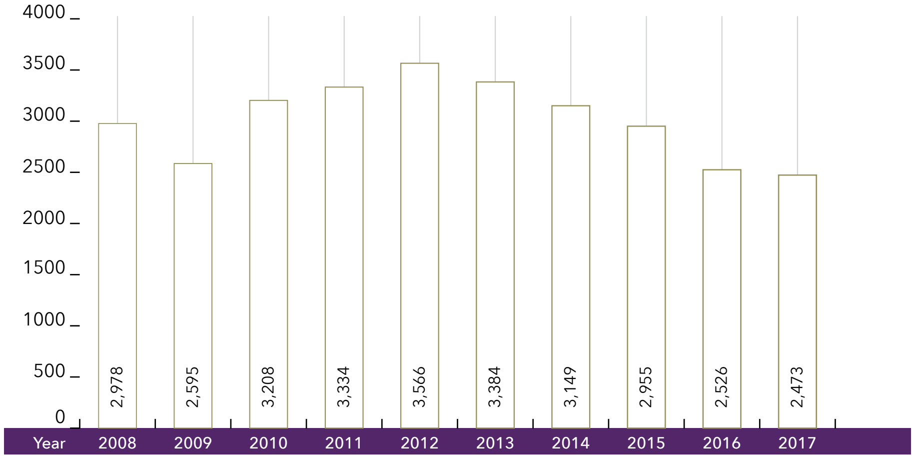
The performance of the industrial sector was subdued during the year, as it was affected by elevated operating costs, the deteriorating quality of infrastructure, a weak logistics environment, as well as by unfair competition from manufacturing operations in the informal economy. Further, the low growth environment in the country affected the sector, given that the domestic market accounts for 82% of the sales of Lebanese manufactured products, according to the Association of Lebanese Industrialists (ALI).

BDL's periodic survey of the opinions of business managers shows that industrial production regressed in the first and fourth quarters of 2017, remained steady in the second quarter, and improved in relative terms in the third quarter of the year compared to the same quarters, respectively, of the previous year. Further, registered orders declined in each quarter of the year relative to the same quarter of 2016; while total demand for industrial products slightly improved in the first quarter, declined in the second and fourth quarters, and was unchanged in the third quarter of the year. Moreover, the volume of investments in the sector was unchanged in the first quarter, improved modestly in the second and third periods, and dropped in the fourth quarter of 2017. The survey shows that the majority of business managers considered that overall industrial activity deteriorated sharply in the fourth quarter of the year.

Further, the high operating costs and the continued closure of the Nasseeb crossing point between Syria and Jordan, which was the main land outlet of Lebanese products to Gulf countries and to Iraq, took their toll on the exports of manufactured products. As such, figures released by the Ministry of Industry show that industrial exports totaled USD 2.47 billion in 2017, constituting a decrease of 2.1% from USD 2.53 billion in 2016 and compared to an annual average of USD 3 billion during the 2008-2017 period. Industrial exports have declined annually from their peak of USD 3.57 billion in 2012, due to the increase in transportation and safety risks in Syria following the eruption of the conflict in that country, given that Syria constitutes the only land outlet for Lebanese exports.

Still, Lebanese industrial exports remained diversified both structurally and geographically, and continued to compete internationally as, according to the ALI, Lebanon exports 337 "highly competitive" products. Exports of machinery & mechanical appliances totaled USD 485.1 million and accounted for 19.6% of aggregate industrial exports in 2017, followed by prepared foodstuffs & tobacco with USD 471.4 million (19.1%), chemical products with USD 396.7 million (16%), base metals with USD 341.3 million (13.8%), plastics & rubber with USD 156.8 million (6.3%), paper & paperboard with USD 142.2 million (5.8%), and pearls & precious or semi-precious stones & metals with USD 141 million (5.7%).

INDUSTRIAL EXPORTS (USD MILLION)



Source: Ministry of Industry

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Further, Arab countries continued to generate the majority of demand for Lebanese manufactured products sold abroad, as they were the destination of 56% of Lebanese industrial exports in 2017, followed by European economies with 14.1%, Asian countries with 12.2%, African economies with 11%, countries in the Americas with 5%, and markets in Oceania with 0.6%. On a country basis, Saudi Arabia was the main destination of Lebanese industrial exports and accounted for 10.2% of the total in 2017, followed by the UAE with 10%, Iraq with 8.8%, Syria with 8.4%, Turkey with 4.8% and Qatar with 3.7%. In addition, the economies of the Gulf Cooperation Council remained a vital market for Lebanese manufacturing, as they accounted for 27.5% of total industrial exports and for 49% of industrial exports to the Arab world in 2017. The importance of the GCC market has increased in recent years, as Lebanese industrial exports to the GCC totaled USD 733.5 million in 2012, the peak year for Lebanese manufacturing exports, and accounted for 24.8% of such exports. In comparison, they reached USD 679 million in 2017 but increased as a share of total industrial exports.

The banking sector continued to support Lebanese industry, as utilized bank credit by the manufacturing sector reached USD 5.84 billion at the end of 2017 compared to USD 5.56 billion a year earlier. The amount of loans to manufacturing accounted for 8.5% of total utilized credits in the Lebanese economy and for 12.3% of utilized credits when excluding consumer loans. As such, lending to the manufacturing sector was equivalent to the sector's size in the economy, which is 9% of GDP, and exceeded it when accounting for all non-consumer loans.

Also, the Kafalat Corporation, the state-sponsored organization that provides financial guarantees to small and medium-size enterprises (SMEs) in productive sectors, extended 182 loan guarantees to SMEs in manufacturing in 2017, down from 220 guarantees in 2016 and from a peak of 543 in 2010, reflecting the economic slowdown. The number of loan guarantees to SMEs in manufacturing accounted for 37% of the total in 2017, up from 31% in 2016 and compared to 39% of the total in the peak year of 2010.

REAL ESTATE: HOUSING DEMAND DRIVEN BY SMALL UNITS AND SUBSIDIZED MORTGAGES

The real estate market, which contributes nearly 15% of economic output in Lebanon, continued to be affected by adverse domestic and external conditions in 2017. The surface area of construction permits for new buildings issued by the Orders of Engineers and Architects of Beirut decreased by 9% in 2017, with the surface area of construction permits for new residential buildings regressing by 12%. In contrast, the surface area of construction permits for general purpose buildings, which include buildings for official administrative, social and cultural agencies, surged by 51% in 2017, while that for general service buildings, such as hospitals and schools, increased by 39.5% last year. New commercial buildings & offices followed with a rise of 18% in 2017, then hotel- and tourism-related buildings (+10.3%), and industrial- and agricultural- related buildings (+3.5%).

Residential buildings account for the bulk of the surface area of construction permits, as they represented 80% of the total during 2017. The supply in this segment has been trending towards small-size residential units since 2012 to adapt to new market fundamentals, with 81% of residential building licenses going for units with a surface area of 200 square meters or smaller.

On the demand side, the amount of housing loans outstanding reached USD 13.1 billion at the end of 2017, up from USD 12 billion a year earlier, as BDL's stimulus packages and other measures continued to support demand for housing. However, most of the demand for mortgages was in a specific segment of the market that consists of small-size apartments, with this demand generated from limited-income citizens who meet the requirements for subsidized loans of the Public Corporation for Housing (PCH). In fact, about 80% of the number of mortgages extended in 2017 were for individuals who qualified for the conditions of the PCH, and constituted the main driver of the mortgage market.

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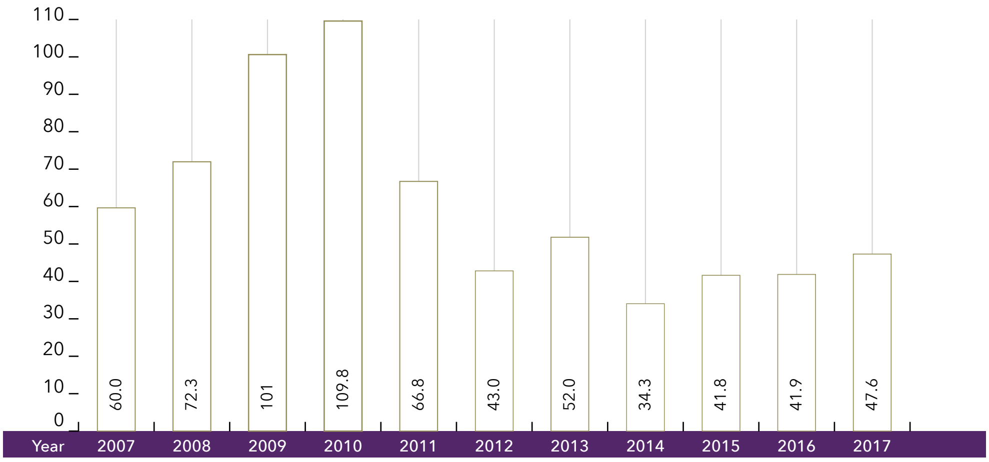
Further, the Byblos Bank Real Estate Demand Index, which reflects the intentions of the Lebanese to buy or build a home in the near future, posted an average monthly value of 47.6 in 2017, constituting an increase of 13.7% from a low base of 41.9 in 2016, with the value of the Index regressing in three out of the four quarters in 2017.

Accommodative policies of low interest rates on mortgages in Lebanon, the renewal of BDL Governor Riad Salamé's term that increased confidence in the stability of the currency, and relative political stability constituted factors that supported the near-term plans of potential buyers in the second quarter of last year, the only quarter to register an increase in the value of the Index. However, these positive factors were offset in part by the authorities' decision to increase various taxes and fees, which had an impact on an already sluggish real estate sector. The increase in taxes and fees negatively affected Lebanese residents' disposable income and purchasing power, impacted their already-stretched budgets, and raised real estate transaction costs. These measures have weighed on demand in the sector as potential buyers require a conducive environment to translate their intentions into actual sales. In fact, 5.4% of Lebanese residents, on average, had plans to either buy or build a residential property within a six-month horizon last year, compared to an average of 6.9% of respondents between July 2007 and December 2018, and to a peak of nearly 15% in the second quarter of 2010. Overall, the average monthly score of the Index for 2017 constituted a decline of 56.7% from the peak registered in 2010 and was 22% lower than the monthly trend average score since the start of the Index calculation in July 2007.

In parallel, in its efforts to increase the transparency of the real estate sector, the General Directorate of Land Registry and Cadastre at the Ministry of Finance launched in October 2017 six electronic services that allow local and international investors, as well as other stakeholders, to access the land deed registry, track real estate transactions and determine the fees that they would have to pay for a specific real estate transaction. The e-government services include email and mobile phone alerts that will notify investors and stakeholders about any changes in land deed registers or the issuance of new title deeds on the land deed registry. In addition, the services allow property owners to view and follow up on the status of their title register, and on paid invoices for their last transaction on the property.

BYBLOS BANK REAL ESTATE DEMAND INDEX



Source: Byblos Bank Economic Research and Analysis Department

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TOURISM: TIMID IMPROVEMENT CENTERED ON EXPATRIATES

The tourism sector, which used to be a main driver of economic activity in the country, started to show some recovery signs in 2017 amid a better political environment and due to initiatives from the Ministry of Tourism and stakeholders in the private sector. The number of incoming visitors to Lebanon totaled 1.86 million in 2017, increasing by 10% from 1.69 million tourists in 2016 but constituting a decline of 14.4% from the peak of 2.17 million visitors in 2010.

The composition of visitors to Lebanon in 2017 was broadly similar to that in 2016, as the number of European visitors accounted for 34.4% of the total and continued to surpass the number of Arab tourists (30.2%). Visitors from the Americas accounted for 17.6% of total tourists, followed by visitors from Asia (7.4%), Africa (5.9%), and Oceania (4.4%). The number of visitors from European countries increased by 13.3% in 2017, followed by visitors from the Americas (+10.3%), Oceania (+9.2%), Asia (+8.9%), the Arab region (+7.3%), and Africa (+5.9%). On a country basis, visitors from Iraq accounted for 12.2% of total visitors in 2017, followed by visitors from the United States (9.2%), France (8.9%), Canada (5.8%), Germany (5.2%), Jordan (4.9%), and Egypt (4.4%).

Further, the number of incoming visitors from the Gulf Cooperation Council (GCC) countries reached 125,802 in 2017 and accounted for 6.8% of Lebanon's total tourist arrivals in 2017, up from 5% in 2016 but down from 18% in 2010.

Source: Ministry of Tourism

In parallel, the amount of value-added tax (VAT) refunds claimed by visitors in Lebanon increased by 5.5% in 2017, following a decrease of 9% in 2016, supported in part by improved tourism activity. But the increase in tourist receipts was below expectations, given the still modest number of GCC nationals who visited Lebanon last year. In fact, visitors from Saudi Arabia accounted for 14% of total VAT refunds claimed in 2017; followed by visitors from the UAE with 12%; Kuwait with 7%; Syria with 6%; Egypt, France, and Jordan with 5% each; and Canada, Qatar, and the United States with 4% each. Spending by visitors from Syria grew by 32.1% in 2017, followed by spending by tourists from Kuwait (+28.5%), Saudi Arabia (+15.4%), the United States (+10.6%), Qatar (+7.2%), and France (+3.4%). In contrast, spending by visitors from Egypt decreased by 18.5% last year, followed by spending by tourists from the UAE (-9%), Canada (-0.8%) and Jordan (-0.5%).

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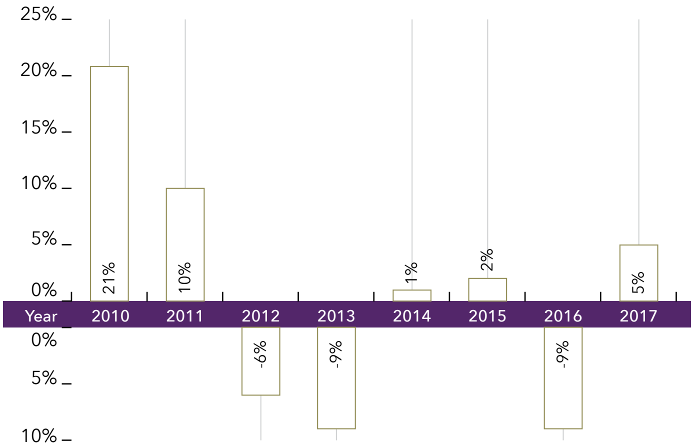
YEARLY CHANGE IN TOURIST SPENDING*



** Based on the change in VAT refunds*
Source: Global Blue

The improved political conditions in the country and the presence of visitors from GCC countries, although limited, positively affected the performance of the hospitality sector. According to the EY's Middle East Hotel Benchmark Survey, the average occupancy rate at hotels in Beirut increased from 59.4% in 2016 to 63.7% in 2017, and was above the average rate of 62.2% in 14 main Arab markets. The average occupancy rate at Beirut hotels was the sixth highest in the region last year, while it was the sixth lowest in 2016. The average rate per room at Beirut hotels was USD 151 in 2017, ranking the capital's hotels as the fourth least expensive in the region. The average rate per room at Beirut hotels increased by 6.9% year-on-year. Further, revenues per available room reached USD 96 in Beirut in 2017, increasing by 14.5% year-on-year.

Still, the Lebanese hospitality sector has a long way to recover to pre-2011 levels. The World Travel & Tourism Council (WTTC) estimated that the travel and tourism industry had a direct contribution to economic activity equivalent to 6.5% of GDP in 2017, relative to 7% of GDP in 2016, and down from more than 10% of GDP in 2010. Also, the WTTC indicated that the industry's direct and indirect impact was equivalent to 18.4% of overall economic activity in Lebanon last year, compared to more than 35% of GDP in 2010. The sector's overall contribution to GDP declined by 0.9% in real terms in 2017, relative to a year-on-year contraction of 2.7% in 2016.

In May 2017, the Ministry of Tourism launched the Visit Lebanon 2017 initiative, which is a forum to promote Lebanon as a tourism destination to foreign companies and operators in the tourism sector. The initiative consisted of inviting 150 tour operators, event organizers, and incentive houses from countries in Asia, Europe, the Middle East, North Africa, North America, and South America to Lebanon to meet with local players. Visiting companies had the opportunity to evaluate the country's tourism infrastructure, hotel industry, touristic sites, and prevailing prices, and to explore the possibility of offering packages to attract foreign visitors to the country. In addition, stakeholders in the sector took steps to raise Lebanon's profile as a destination for cultural and religious tourism.

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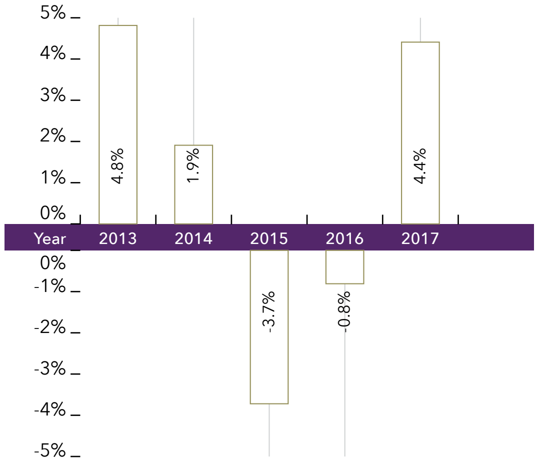
INFLATION: UPWARD PRESSURE MATERIALIZES

The Consumer Price Index (CPI) increased by 4.4% in 2017 compared to declines of 0.8% in 2016 and 3.7% in 2015, according to the Central Administration of Statistics. The increase in prices was across the board and was due mainly to the local transmission of the rise in global oil prices, the weakening of the US Dollar against major currencies, and the market's anticipation of the increase in public sector wages. The CPI increased by 1.1% month-on-month in August 2017, the month that followed the enactment of the public sector salary increase and the tax law, and by 1.4% in October 2017, when Parliament ratified the revised version of the tax law. This shows that the two decisions contributed to inflationary pressures even prior to the full enforcement of the tax measures. Further, gasoline prices increased in the local market by about 9% in 2017 and the prices of diesel and gasoil surged by about 18% last year, which contributed to the increase in the CPI.

INFLATION RATE (%)



Source: Central Administration of Statistics

MONETARY POLICY: STEADY AND CLEAR

The BDL continued its policies of maintaining the stability of the exchange rate, of preserving economic and monetary stability, and of safeguarding the soundness of the banking sector throughout 2017. As such, BDL deemed it necessary to conduct special financial operations with the Ministry of Finance and commercial banks to help attract foreign currency deposits, accumulate foreign currency reserves, support the balance of payments, and address mismatches in commercial banks' balance sheets.

Between June and August 2017, commercial banks placed long-term deposits in Lebanese Pound at BDL with a return of 1% above the yield curve, provided that they placed the equivalent amount in US Dollars at BDL with a return of 0.5% above the yield curve. Starting in September 2017, BDL provided banks with credit facilities in Lebanese Pound at 2%, provided that the funds are used to buy Lebanese Treasury bills from the primary or secondary markets. In exchange, commercial banks have to place the equivalent amount of the credit facility at BDL in US Dollars. Commercial banks sourced foreign currency from their own liquidity with correspondent banks, from new customer deposits and from selling part of their holdings of Lebanese Eurobonds. The volume of BDL's swap operations with commercial banks totaled about USD 10 billion in 2017 compared to nearly USD 15 billion in 2016. Following the 2017 swap operations, BDL's gross foreign currency reserves reached a record high of USD 36.77 billion at the end of October 2017, increasing by USD 2.74 billion, or 8.1%, from USD 34 billion at end-2016.

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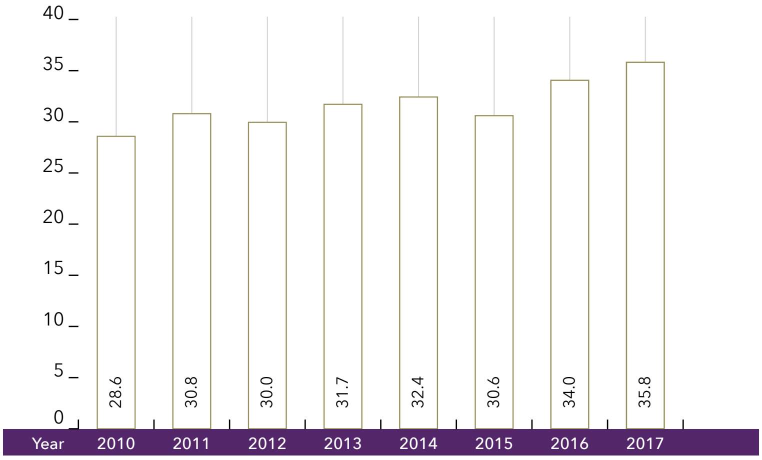
The BDL's efforts in the first 10 months of 2017 were temporarily affected by deposit outflows that were triggered by the November 2017 political crisis. In fact, total deposits at commercial banks decreased by USD 2.6 billion in November, and foreign currency reserves at BDL declined by USD 1.1 billion. However, capital flights were reversed in December, with the banks' stock of deposits rising by USD 1.86 billion during the month. Also, the November political crisis did not lead to significant pressure on either the currency peg to the US Dollar or on the stability of the Lebanese Pound. In this context, foreign currency reserves ended the year at USD 35.81 billion, equivalent to 68.2% of money supply (M2) and to about 14 months' worth of next year's imports, well above the four-month reference for emerging markets.

GROSS FOREIGN CURRENCY RESERVES (USD Billion)



Source: Banque du Liban

In addition, BDL's overall assets in foreign currency increased by USD 1.3 billion to reach USD 42 billion at the end of 2017. Further, the value of BDL's gold reserves reached USD 12 billion at the end of 2017, constituting a rise of 11.7% from end-2016, due to a recovery in global gold prices. The BDL's combined assets in gold and foreign currencies were equivalent to about 100% of GDP at the end of 2017. Lebanon held 286.8 tons of gold as at the end of 2017, the 19th highest level of gold reserves globally and the second highest among Arab countries.

Further, the interbank rate in Lebanese Pounds was stable at between 3% and 4% from September 2015 to October 2017. But it surged to 125% during the month of November because of shortages of liquidity in Lebanese Pounds at some banks, following the resignation of Prime Minister Hariri, as these banks needed local currency to convert into US Dollars in order to meet clients' needs. However, the interbank rate regressed to 15% at the end of November before returning to 4% by around mid-December 2017. The repo rate was unchanged at 10% throughout the year.

In addition, some banks offered higher interest rates on deposits in Lebanese pounds in order to attract funding in local currency to counterbalance their liquidity shortages, as an alternative to borrowing from the interbank market. As such, the average deposit rate in Lebanese Pounds, which was stable at between 5.51% and 5.57% in the first 10 months of 2017, increased to 5.88% in November and reached 6.41% at the end of 2017. The same rate in US Dollars gradually increased during the year, from 3.5% at the end of 2016 to 3.65% in September 2017, 3.72% in October, 3.8% in November, and 3.89% at the end of 2017. What started as an increase in interest rates because of liquidity shortages in November became the norm, as other banks followed suit and offered higher interest rates on deposits in Lebanese Pounds to avoid deposit flights to competing banks. Still, BDL's measures during the months of November and December helped maintain the relative stability of interest rates on deposits in US Dollars, while they contained the upward pressure on interest rates on deposits in Lebanese Pounds.

In parallel, broad money supply (M3) grew by 4.2% in 2017, down from growth rates of 7.4% in 2016, 5.1% in 2015, 5.9% in 2014, and 6.9% in 2013, while money supply (M2) declined by 4% in 2017, compared to increases of 4.8% in 2016, 7.1% in 2015, 6.8% in 2014, and 5.6% in 2013.

In addition, BDL used monetary policy tools to manage excess liquidity in the market, to secure the government's financing needs and to help manage the public debt. In this context, subscriptions to Lebanese Treasury bills totaled LBP 27,168 billion in 2017, while the coupon rate of the issued T-bills was stable throughout the year on the primary market. Aggregate T-bills issuances were oversubscribed by LBP 1,197 billion last year. Further, the face value of Certificates of Deposits (CDs) that it issued in Lebanese Pounds increased from LBP 34,631 billion at the end of 2016 to LBP 35,865 billion at end-2017. Also, the face value of CDs in US dollars grew from USD 21,857 billion in 2016 to USD 23,165 billion in 2017.

EXTERNAL SECTOR: FOREIGN DIRECT INVESTMENTS AND REMITTANCE INFLOWS REGRESS

The balance of payments posted a deficit of USD 155.7 million in 2017, following a surplus of USD 1.2 billion in 2016, constituting the sixth annual deficit since 2011. The 2017 deficit was caused by a decline of USD 1.77 billion in the net foreign assets of banks and financial institutions, which was partly offset by an increase of USD 1.61 billion in those of BDL. Also, the current account deficit reached USD 12.4 billion, or 22.8% of GDP in 2017, compared to USD 10.5 billion, or 20.3% of GDP in 2016.

The trade deficit reached USD 16.7 billion in 2017, widening by 3.7% year-on-year, as the value of imported goods increased by 2.4% to USD 19.6 billion and the value of exports decreased by 4.5% to USD 2.8 billion. The rise in imports mainly reflects an increase of USD 142.6 million, or 3.4%, in the value of imported oil and mineral fuels to USD 4.3 billion in 2017, and an increase of USD 320.5 million, or 2.1%, in the value of non-hydrocarbon imports to USD 15.3 billion in 2017. Imports were equivalent to 36.2% of GDP and exports to 5.3% of GDP in 2017, leading to a trade deficit of 32.5% of GDP last year.

The value of imported chemical products reached USD 2.1 billion in 2017, increasing by 5.2% year-on-year. Imports of machinery and mechanical appliances followed at USD 1.93 billion (+2.9%); vehicles, aircraft, vessels, and associated transportation at USD 1.88 billion (+6.2%); prepared foodstuff at USD 1.4 billion (-2.3%); and base metals at USD 1.3 billion (+8.7%).

Further, the drop in exports in 2017 was driven mainly by a decline of USD 242.3 million, or 29.3%, in jewelry exports, which was partially offset by growth of USD 87.1 million, or 34.4% in the value of exported base metals and by an increase of USD 29 million, or 2.5 times, in the value of exported mineral products in 2017.

In parallel, the inflows of expatriates' remittances to Lebanon totaled USD 7.1 billion in 2017, constituting a decrease of 7% from USD 7.6 billion in 2016. Remittance inflows to Lebanon in 2017 reached their seventh highest level during the 2002-2017 period, compared to a high of USD 7.6 billion in 2016 and a low of USD 2.54 billion in 2002. Further, remittance inflows to Lebanon were equivalent to 13% of GDP in 2017 compared to 14.8% of GDP in 2016. In comparison, aggregate remittance inflows to Lebanon were equivalent to 16.5% of GDP between 2008 and 2017.

In addition, remittance outflows from Lebanon amounted to USD 4.45 billion in 2017, up by 6.8% from USD 4.17 billion in 2016, their fourth highest level during the 2002-17 period. They were equivalent to 8.2% of GDP in 2017, their second lowest level on record. As such, net remittance inflows to Lebanon reached USD 2.6 billion in 2017, constituting a decrease of 23.6% from USD 3.4 billion in 2016. They were equivalent to 4.8% of GDP in 2017. In comparison, aggregate remittance outflows from Lebanon were equivalent to 10.3% of GDP between 2008 and 2017.

THE LEBANESE ECONOMY IN 2017

Further, foreign direct investment (FDI) in Lebanon totaled USD 2.56 billion in 2017, nearly unchanged from USD 2.57 billion in 2016. FDI inflows to Lebanon in 2017 reached their fourth lowest level during the 2002-2017 period, compared to a high of USD 4.4 billion in 2009 and a low of USD 1.3 billion in 2002. They were equivalent to 4.7% of GDP in 2017, their second lowest level on record relative to 4.3% of GDP in 2015. Also, FDI outflows from Lebanon amounted to USD 1.06 billion in 2017, up by 5.9% from USD 1 billion in 2016. They were equivalent to 2% of GDP in 2017, unchanged from the previous year and reaching their fifth lowest level on record.

As such, net FDI inflows to Lebanon reached USD 1.49 billion in 2017 and represented a decline of 4.4% from USD 1.56 billion in 2016. They were equivalent to 2.7% of GDP in 2017, the second lowest level during the 2002-2017 period.

In parallel, non-resident capital inflows to Lebanon totaled USD 8.3 billion in 2017, down by 28.7% from USD 11.6 billion in 2016, and compared to flows of USD 3.2 billion in 2015. They were equivalent to 15.3% of GDP in 2017 relative to 23% of GDP in 2016 and 6.9% of GDP in 2015. The decrease in non-resident net private capital inflows to Lebanon is mainly due to the normalization of portfolio inflows following the financial engineering operations that BDL conducted in 2016. As such, portfolio inflows are estimated to have dropped by USD 2.9 billion, or 47.4%, to USD 3.2 billion in 2017. Also, other flows, which include non-resident deposits regressed by USD 421 million to USD 2.5 billion last year.

PUBLIC FINANCES: NARROWER FISCAL DEFICIT FROM ONE-OFF TAX REVENUES

Lebanon's public finance imbalances persisted in 2017, even though the fiscal deficit narrowed from 9.6% of GDP in 2016 to 6.9% of GDP in 2017. The narrowing of the deficit was mainly due to one-off revenues and the normalization of spending following the 2016 municipal and mayoral elections, rather than to fundamental fiscal changes.

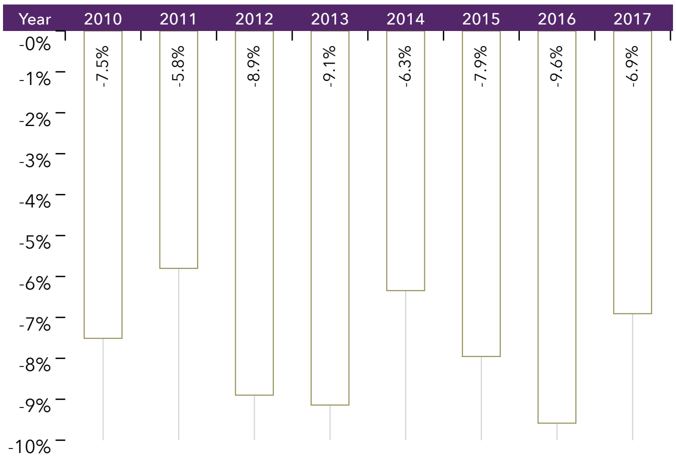
Budgetary spending, which includes public personnel cost, debt servicing, and transfers to Electricité du Liban (EDL), increased from 25.1% of GDP in 2016 to 25.9% of GDP in 2017. Public personnel cost, which consists of salaries, wages, transfers to public institutions to cover salaries, end-of-service indemnities, and retirement benefits, reached the equivalent of 10% of GDP in 2017, up from 9.5% of GDP in 2016. Also, debt servicing stood at 9.5% of GDP in 2017, nearly unchanged from 9.6% of GDP in 2016. Further, transfers to the state-owned and money-losing EDL were equivalent to 2.4% of GDP, up from 1.8% of GDP in 2016 due to the increase in global oil prices. Public personnel cost was the fastest-growing component of budgetary spending over the past seven years, as it expanded by an estimated CAGR of 7.2% during the 2010-2017 period compared to a growth rate of 3.3% for debt servicing, and a CAGR of 1.6% for Treasury transfers to EDL.

In addition, Treasury transfers to municipalities declined from 2% of GDP in 2016 to 0.8% of GDP in 2017, following spending related to municipal and mayoral elections in 2016. As such, overall public spending, which consists of budgetary spending and Treasury transactions, regressed from 28.9% of GDP in 2016 to 28.3% of GDP in 2017.

THE LEBANESE ECONOMY IN 2017

In parallel, public revenues increased from 19.3% of GDP in 2016 to 21.4% of GDP in 2017. Tax revenues were equivalent to 15.1% of GDP last year, up from 13.7% of GDP in 2016, mainly because of the additional income tax that banks paid on the one-off revenues they generated from the swap operations that they conducted with BDL in 2016. As such, income tax receipts rose from 3.9% of GDP in 2016 to 5.1% of GDP in 2017, while receipts from the value-added tax were equivalent to 4.2% of GDP in 2017, unchanged from 2016. In addition, non-tax receipts represented 4.7% of GDP in 2017, up from 4.4% of GDP in the preceding year, while Treasury revenues were equivalent to 1.6% of GDP last year relative to 1.2% of GDP in 2016.

FISCAL BALANCE (% of GDP)



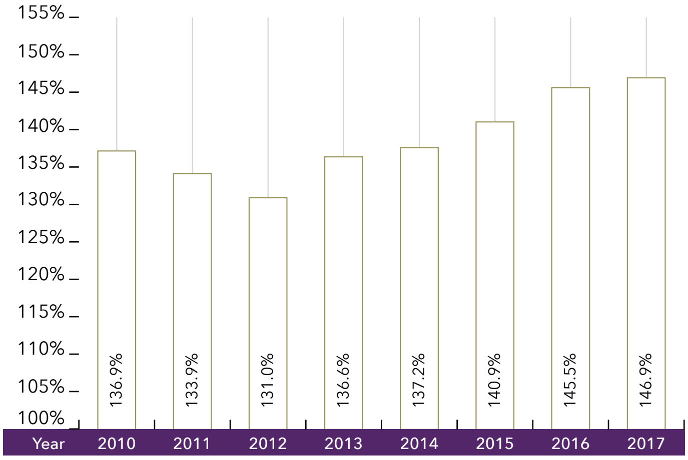
Source: Ministry of Finance, Central Admnistration of Statistics, Institute of International Finance

Further, Lebanon's primary budget posted a surplus of 2.6% of GDP in 2017 following a balanced primary budget in 2016.

The improvement in the fiscal balance was not enough to prevent an increase in Lebanon's debt level from 145.5% of GDP in 2016 to 146.2% of GDP in 2017. The gross public debt reached USD 79.5 billion at the end of 2017, constituting an increase of 6.2% from end-2016 and compared to rises of 6.5% in 2016 and of 5.6% in 2015. The gross public debt grew by USD 4.62 billion in 2017 relative to increases of USD 4.56 billion in 2016, USD 3.75 billion in 2015, and USD 3.1 billion in 2014. Debt denominated in local currency expanded by 5% to the equivalent of USD 49.1 billion, while debt in foreign currency grew by 8.1% to USD 30.4 billion at the end of 2017. Foreign currency-denominated debt represented 38.2% of gross public debt at the end of 2017 relative to 37.5% a year earlier. Commercial banks held 40.2% of the gross public debt at the end of 2017, down from 46.4% of the total debt at end-2016.

The structure of the public debt shows that BDL held 48% of the Lebanese Pound-denominated public debt at the end of 2017 compared to 42.7% a year earlier. Commercial banks followed with 37.5%, down from 42% at end-2016, while public agencies, financial institutions, and the public held the remaining 14.5%. Also, Eurobond holders and holders of special Treasury bills in foreign currencies accounted for 92.7% of the foreign-currency denominated debt, followed by multilateral institutions with 4.4% and foreign governments with 2.9%. Commercial banks held about 50% of Lebanon's Eurobonds at the end of 2017. In addition, the net public debt, which excludes public sector deposits at BDL and at commercial banks from overall debt figures, grew by 6% annually to USD 69.3 billion at end-2017, equivalent to 127.5% of GDP. In parallel, the gross market debt accounted for 60% of total public debt and was equivalent to 87.7% of GDP at the end of 2017. Gross market debt is the total public debt less the portfolios of the BDL, the National Social Security Fund, bilateral and multilateral loans, and Paris II-related debt.

GROSS PUBLIC DEBT (% of GDP)



Source: Ministry of Finance, Central Admnistration of Statistics, Institute of International Finance

CAPITAL MARKETS: ACTIVE FIXED INCOME MARKET, DORMANT EQUITY MARKET

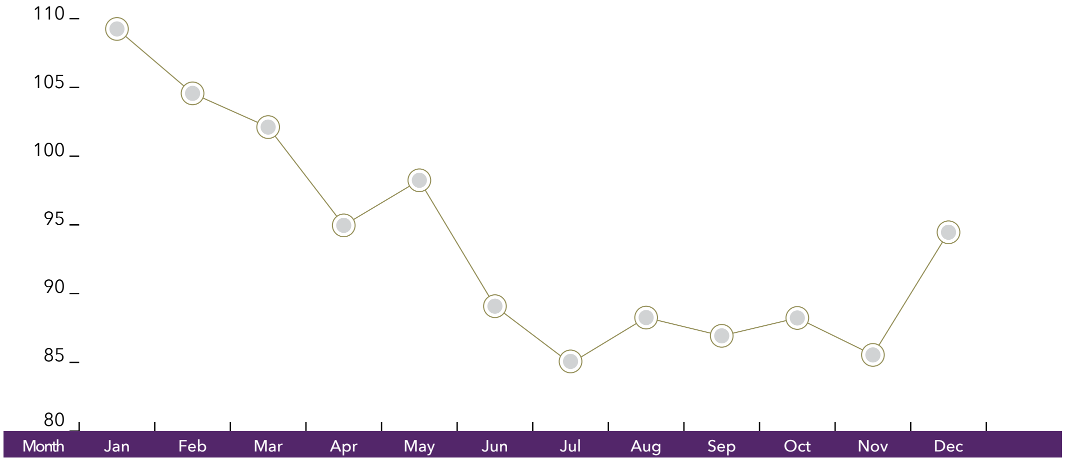
EQUITIES

The Beirut stock market continued to suffer from low liquidity and a lack of interest from privately held and family-owned firms to list their shares on the local bourse. Total trading volume on the Beirut Stock Exchange (BSE) reached 87 million shares in 2017, constituting a decline of 27.8% from 120.5 million shares in 2016, while aggregate turnover amounted to USD 762.1 million, down by 21.6% from a turnover of USD 971.6 million in 2016. Market capitalization regressed by 3.6% from the end of 2016 to USD 11.47 billion, with banking stocks accounting for 85.6% of the total, followed by real estate shares (11.5%), industrial firms (2.6%), and trading stocks (0.3%). The market liquidity ratio was 6.6% compared to 8.2% in 2016. Further, market capitalization was equivalent to 21.2% of GDP in 2017, the fifth lowest level among 15 Arab markets, and accounted for about 1% of the aggregate market capitalization of Arab equity markets at end-2017.

Banking stocks accounted for 59.8% of the aggregate trading volume in 2017, followed by real estate equities with 35.5%, the stocks of trading firms with 3.6%, and industrial shares with 1.1%. Also, banking stocks represented 63.3% of the aggregate value of traded shares, followed by real estate equities with 34%, industrial stocks with 1.4%, and shares of trading firms with 1.3%. The average daily traded volume for 2017 was 359,460 shares for an average daily value of USD 3.1 million.

The figures reflect year-on-year decreases of 27.2% and 20.9%, respectively, in volume and value. In parallel, the Capital Markets Authority's Market Value-Weighted Index for stocks traded on the BSE regressed by 9.9% in 2017, while its Banks Market Value-Weighted Index improved by 15.6% last year.

MARKET VALUE-WEIGHTED STOCK INDEX (2017)



Source: Capital Markets Authority

FIXED INCOME

Lebanon's external debt posted a return of 5.64% in 2017, constituting the seventh lowest return among 43 markets in the Central and Eastern Europe, Middle East and Africa region, as well as the 13th lowest return among 75 emerging markets, according to Intercontinental Exchange's External Debt EM Sovereign Index. Lebanon underperformed the overall emerging markets return of 8.96% during 2017 and posted the fifth lowest return among 25 countries in the Middle East and Africa region, due to domestic and external factors.

Further, in its valuation of the sovereign credit of 56 emerging markets, global investment bank Goldman Sachs indicated in December 2017 that Lebanon's Eurobonds are "undervalued". Lebanese Eurobonds were the only "undervalued" bonds among B-rated sovereigns included in Goldman Sachs' emerging markets' universe.

The Ministry of Finance issued a total of USD 4.7 billion in Eurobonds in 2017.

In March 2017, the Ministry of Finance issued a USD 3 billion triple-tranche Eurobond under the Republic of Lebanon's Global Medium Term Note Program to refinance debt maturing in 2017. The first series consisted of a 10-year USD 1.25 billion Eurobond that matures in March 2027 and carries an annual coupon rate of 6.85%, the second series was a 15-year USD 1 billion Eurobond that matures in March 2032 and carries an annual coupon rate of 7%, and the third series consisted of a 20-year USD 750 million Eurobond that matures in March 2037 and carries an annual coupon rate of 7.25%. The proceeds of the issuance were mainly used to replace a USD 1.5 billion Eurobond that matured on 20 March 2017 and to cover principal payments of other foreign currency debt that matured during the year.

The final order book totaled USD 17.8 billion, with 214 orders across the three tranches. According to the Ministry of Finance, local investors – including commercial banks, investment banks, and insurance companies – subscribed to 80% of the issuance, while foreign investors, including foreign banks and financial institutions, subscribed to the balance of 20% across the three tranches.

In November 2017, the Ministry of Finance issued USD 1.7 billion in Eurobonds that it exchanged with LBP 2,563 billion worth of Lebanese Pound-denominated Treasury bonds from the BDL portfolio. The newly issued Eurobonds consisted of a USD 1 billion tranche that matures in 2031 with a coupon rate of 7.15% and another USD 700 million tranche due in 2028 with a coupon rate of 7%. The November 2017 swap helped lengthen the average debt maturity without increasing the amount of the public debt stock or BDL's share of the public debt. In addition, the swap provided BDL additional monetary tools in order to manage liquidity in the market. As part of the deal between the Finance Ministry and BDL, the ministry issued LBP 1,500 billion 2-year Treasury bills in November and LBP 1,500 billion 3-year Treasury bills in December at a 1% yield, which were both subscribed in full by BDL.

RISK METRICS: AGENCIES AFFIRM SOVEREIGN RATINGS AND OUTLOOK

Spreads on five-year credit default swaps (CDS) for Lebanon ended 2017 at 522.2 basis points (bps), up from 492 bps at the end of 2016. The spreads narrowed during the first nine months of 2017, as they averaged 486.7 bps in the first quarter, 442.4 bps in the second quarter, and 372 bps in the third quarter of the year. In fact, the spreads were 492 bps on January 2, 2017, then narrowed to 472.1 bps at the end of March and 371.6 bps at end-June, and stood at 374 bps at the end of September 2017. They were relatively stable in October 2017, but started to widen in November following the political shock that the resignation of Prime Minister Hariri generated. As such, Lebanon's CDS spreads jumped to 514.1 bps on November 7 from 376.7 the preceding day, and ranged between 514 bps and 554.6 bps from November 7 until the end of December. Overall, Lebanon's CDS spreads averaged 465.1 bps daily during the fourth quarter of 2017.

Rating agencies expressed concern during the year about fiscal and external imbalances in Lebanon, but they remained confident in the strength and stability of the banking sector. In August 2017, Moody's Investors Service downgraded Lebanon's long-term issuer ratings from 'B2' to 'B3' and changed the outlook from 'negative' to 'stable'. The downgrade aligned Moody's ratings with those of S&P Global Ratings and Fitch Ratings. Moody's also lowered the foreign currency deposit ceiling from 'B2' to 'B3' and the foreign currency bond ceiling from 'ba3' to 'B1', while it kept the short-term foreign currency deposit ceiling at 'NP'. In addition, it downgraded Lebanon's senior unsecured Medium Term Note Program from '(P)B2' to '(P)B3'. Further, it maintained Lebanon's local-currency bond and deposit ceilings at 'Ba2'. The agency attributed the downgrades to the increase in the country's public debt level since 2011 due to the wide fiscal deficits. In parallel, Moody's indicated that the 'stable' outlook reflects the political consensus reached at the end of 2016 and the return to a fully functioning government. It added that Lebanon has a strong track record of servicing its debt under stressed conditions, and that its external buffers have continued to improve in recent years. Also, it noted that substantial financial inflows, especially foreign currency deposits, continue to more than offset the current account deficit and to strengthen BDL's foreign currency reserves.

In September 2017, S&P Global Ratings affirmed Lebanon's short- and long-term local and foreign currency sovereign credit ratings at 'B/B-', and maintained a 'stable' outlook on the ratings. It indicated that the 'stable' outlook reflects its expectations that deposit inflows to the financial system will remain sufficient to support the government's borrowing requirements and the country's external deficit over the next 12 months. It considered that the ratings are supported by Lebanon's external profile, as the country's liquid external assets, which consist of foreign currency reserves and the assets of the financial sector held abroad, exceed its external debt.

THE LEBANESE ECONOMY IN 2017

In September 2017, Fitch Ratings affirmed Lebanon's long-term local and foreign currency Issuer Default Ratings (IDRs) at 'B-' and maintained the 'stable' outlook on the ratings. It also affirmed the Country Ceiling and the ratings on Lebanon's senior unsecured local and foreign currency bonds at 'B-', and maintained the short-term local and foreign currency IDRs at 'B'. The agency indicated that the ratings are supported by Lebanon's strong external liquidity and resilient banking sector, as well as by other structural strengths, such as the country's GDP per capita and broader human development indicators that are well above similarly rated peers and that are more in line with the median of 'BBB'-rated sovereigns. In contrast, it said that the ratings are constrained by elevated political and security risks, weak public finances, and slow economic activity. It considered that the domestic political and policy-making environments have improved since the presidential election in October 2016 and the formation of a new government in December of that year.

In October 2017, Capital Intelligence Ratings affirmed at 'B' Lebanon's short- and long-term local and foreign currency sovereign ratings, and maintained the 'stable' outlook on the long-term ratings. It attributed the affirmation of the ratings to the relative decline of domestic political risks following the end of the political deadlock that lasted more than two years, and the endorsement of an electoral law that paved the way for parliamentary elections in May 2018. Also, it noted that policy-making has improved with the Parliament's ratification of the 2017 budget, the first since 2005. It added that the ratings' affirmation takes into account the country's stable buffer of foreign currency reserves that provides adequate coverage to the external debt. In April 2017, Capital Intelligence Ratings revised the outlook on the long-term ratings from 'negative' to 'stable' due to the stabilization of the domestic political climate and improvements in the policy-making environment.

In parallel, S&P Global Ratings' Credit Default Swap (CDS) Market Derived Signal Score, an indicator of risk appetite by foreign investors, shows that the market considered Lebanon's sovereign debt to have a lower risk level than the risk associated with the S&P sovereign rating throughout most of 2017. The CDS Market Derived Signal Score fluctuated between 'B' and 'B+' in the year-to-October 18, 2017, which are one notch and two notches, respectively, above the S&P sovereign rating, and has been on par with the sovereign rating since October 19. As such, even during the elevated political uncertainty in November, market perception did not deteriorate beyond the risk level captured by the sovereign rating.

BANKING: ANCHOR OF CONFIDENCE AND STABILITY, FEWER LENDING OPPORTUNITIES

The banking sector faced a challenging operating environment in 2017 due to several converging factors, including slow economic activity in Lebanon, higher and arbitrary taxes, tighter margins, and fewer lending opportunities domestically and in the banks' main foreign markets, as well as the elevated borrowing needs of the Lebanese government. Still, the sector remained solid, profitable, liquid, and able to meet the financing needs of the private and public sectors. Rating agencies continued to restrain the banks' ratings to the sovereign ceiling, citing the banks' elevated exposure to the sovereign as the latters' most important risk factor.

The aggregate assets of commercial banks reached USD 220 billion at the end of 2017, constituting an increase of 7.6% from end-2016 and relative to increases of 10% in 2016 and 5.9% in 2015. The sector's assets were equivalent to 404% of GDP, one of the highest such ratios in the world, which reflects the continuing ability of the banking sector to meet the borrowing needs of the Lebanese economy, as well as to maintain high levels of liquidity and capitalization.

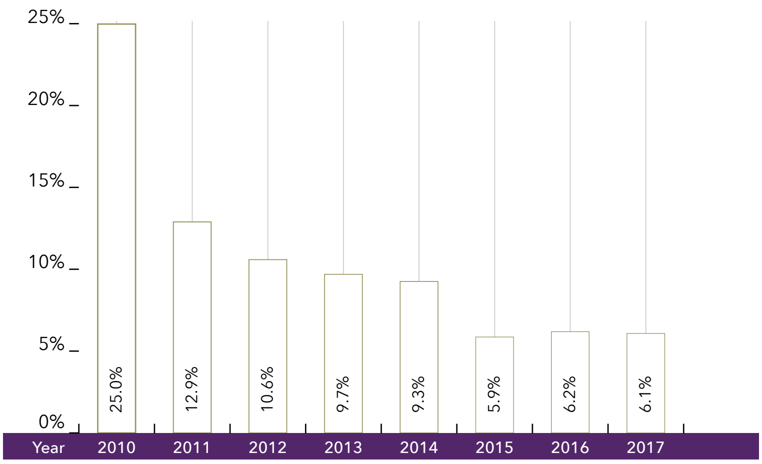
Loans to the private sector reached USD 60.3 billion at the end of 2017 and accounted for 27.4% of total assets. They increased by USD 3.1 billion, or 5.5%, from end-2016 relative to a rise of USD 3 billion, or 5.5%, in 2016. Lending to the resident private sector grew by USD 3.1 billion in 2017 relative to a rise of USD 3 billion in 2016. Also, credit to the non-resident private sector was unchanged year-on-year at USD 6.15 billion, while they regressed by USD 39.8 million in 2016.

As such, credit to the resident private sector was equivalent to nearly 100% of GDP in 2017, with 31.2% of utilized credit consisting of consumer loans. The dollarization rate in private sector lending reached 71% at end-2017, down from 72.6% a year earlier. The average lending rate in Lebanese Pounds was 8.09% at end-2017, while the same rate in US Dollars was 7.67%.

Private sector lending activity during the year shows that utilized credits in the wholesale and retail trade sectors expanded by 12% and 8%, respectively, in 2017. Further, used credits by hotels and restaurants increased by 5.3%, and utilized consumer loans expanded by 9%, while those for educational services surged by 16%. Also, utilized credits by the industrial and agricultural sectors rose by 8.3% and 3%, respectively. However, utilized credits by the construction sector, which covers contractors, sub-contractors and developers, tightened by 0.8% for the year; while credits for real estate services grew by 5.6%. Also, the aggregate number of loan beneficiaries grew by 3.7% from the end of 2016 to 615,602 at end-2017; while 69.7% of beneficiaries had loans ranging from LBP 5 million to LBP 100 million at the end of 2017.

The distribution of credit by type shows that advances against real estate totaled USD 25.9 billion and accounted for 37.7% of private sector utilized credits at the end of 2017. Overdrafts followed with USD 18.9 billion (27.5%), then advances against personal guarantees with USD 12.6 billion (18.4%), advances against cash collateral or bank guarantees with USD 7.8 billion (11.3%), advances against other real guarantees with USD 2.2 billion (3.2%) and advances against financial values with USD 1.2 billion (1.8%).

RESIDENT PRIVATE SECTOR LENDING GROWTH (% Change)



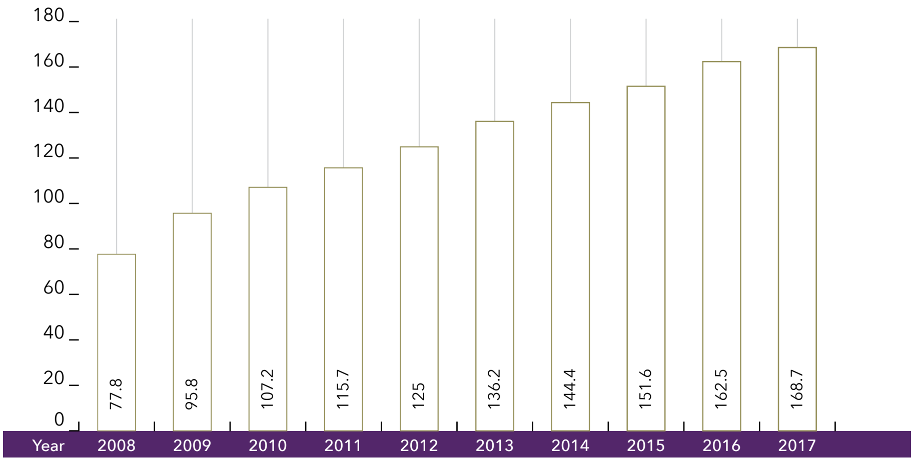
Source: Association of Banks in Lebanon, Byblos Bank Economic Research and Analysis Department

Further, claims on the public sector stood at USD 31.9 billion, down by 8% year-on-year, and accounted for 14.5% of the banking sector's total assets. Further, commercial banks' deposits at BDL totaled USD 103.4 billion at end-2017, increasing by 15.8% from a year earlier, and accounting for about 47% of the sector's aggregate assets.

Deposits of the private sector totaled USD 168.7 billion at the end of 2017, constituting an increase of USD 6.2 billion, or 3.8%, from end-2016, relative to a growth of USD 10.9 billion, or 7.2%, in 2016. Private sector deposits increased by USD 5.2 billion in the first half of 2017 and by USD 933 million in the second half of the year. The growth in the banks' deposits decelerated as a result of outflows in November 2017. In fact, deposits decreased by USD 2.6 billion in November, with deposits in local currency regressing by the equivalent of USD 2.9 billion and deposits in foreign currency growing by USD 333.4 million. However, deposit outflows reversed the following month as the stock of deposits rose by USD 1.86 billion in December, with foreign currency deposits growing by USD 1.6 billion. The November political crisis constituted another episode of political volatility during which deposits at Lebanese banks proved to be resilient.

THE LEBANESE ECONOMY IN 2017

PRIVATE SECTOR DEPOSITS (USD Billion)



Source: Association of Banks in Lebanon, Byblos Bank Economic Research and Analysis Department

Private sector deposits were equivalent to 310% of GDP in 2017, one of the highest such ratios in the world. Deposits in Lebanese Pounds reached USD 52.8 billion, down by 5% from end-2016 and compared to an increase of 4.3% in 2016, while deposits in foreign currencies totaled USD 115.9 billion, constituting a rise of 8.4% from end-2016 and relative to an increase of 8.8% in 2016.

Non-resident foreign currency deposits totaled USD 30.9 billion at end-2017, increasing by 4.9% from end-2016 relative to a rise of 7.3% in 2016. The dollarization rate of deposits reached 68.7% at end-2017, up from 65.8% a year earlier, with most of the increase in the dollarization rate occurring in the fourth quarter of the year. In parallel, deposits of non-resident banks reached USD 7.5 billion, and rose by 19.1% from end-2016.

The Lebanese banking sector maintained a high level of liquidity in 2017, as the ratio of private sector loans to deposits in foreign currencies stood at 36.9% at end-2017, well below BDL's limit of 70%, and compared to 38.8% a year earlier. In parallel, the same ratio in Lebanese Pounds was 33.2% at the end of 2017, up from 28.2% at end-2016. The ratio of total private sector loans to deposits was 35.8% at the end of 2017, relative to 35.2% a year earlier. Further, the banks' capital base stood at USD 19.1 billion at the end of 2017, up by 4.9% from a year earlier, with core capital growing by 5% to USD 17.9 billion.

In parallel, the unaudited consolidated net profits of the top 15 banks by deposits reached USD 2.4 billion in 2017, constituting an increase of 6% from net earnings of USD 2.3 billion in 2016. Net operating income regressed by 9.6% year-on-year to USD 5.9 billion, with aggregate net interest income rising by 6.1% to USD 4 billion and net fees and com missions declining by 42.5% to USD 893.6 million. In addition, net gains on financial assets at fair value decreased by 51% to USD 596.3 million in 2017. Non-interest income accounted for 34.3% of total income in 2017, down from 46.4% in the preceding year, with net fees and commissions representing 39.6% of non-interest income compared to 43.9% in 2016. Also, the banks' cost-to-income ratio was 47.65% in 2017, up from 43.2% in 2016. Further, the banks' return on average assets was 1.06% in 2017 relative to 1.07% in the preceding year, while their return on average equity was 11.4% in 2017 compared to 11.6% in 2016.

BYBLOS BANK GROUP

LEBANON

Byblos Bank S.A.L

Achrafieh - Beirut
Elias Sarkis Avenue - Byblos Bank Tower
P.O.Box: 11-5605 Riad El Solh - Beirut 1107 2811- Lebanon
Phone: (+ 961) 1 335200
Fax: (+ 961) 1 339436

IRAQ

Erbil Branch, Kurdistan, Iraq

Street 60, Near Sports Stadium
P.O.Box: 34 - 0383 Erbil - Iraq
Phone: (+ 964) 66 2233457/8/9 - (+ 964) 66 2560017/9
E-mail: erbilbranch@byblosbank.com.lb

Sulaymaniyah Branch, Kurdistan, Iraq

Salem street, Kurdistan Mall - Sulaymaniyah
Phone: (+ 964) 773 042 1010 - (+ 964) 773 041 1010

Baghdad Branch, Iraq

Al Karrada - Salman Faeq Street
Al Wahda District, No. 904/14, Facing Al Shuruk Building
P.O.Box: 3085 Badalat Al Olwiya – Iraq
Phone: (+ 964) 770 6527807 - (+ 964) 780 9133031/2
E-mail: baghdadbranch@byblosbank.com.lb

Basra Branch, Iraq

Intersection of July 14th, Manawi Basha Street, Al Basra – Iraq
Phone: (+ 964) 770 4931900 - (+ 964) 770 4931919
E-mail: basrabranch@byblosbank.com.lb

UNITED ARAB EMIRATES

Byblos Bank Abu Dhabi Representative Office

Al Reem Island - Sky Tower - Office 2206
P.O.Box: 73893 Abu Dhabi - UAE
Phone: (+ 971) 2 6336050 - (+ 971) 2 6336400
Fax: (+ 971) 2 6338400
E-mail: abudhabirepoffice@byblosbank.com.lb

ARMENIA

Byblos Bank Armenia CJSC

18/3 Amiryan Street - Area 0002
Yerevan - Republic of Armenia
Phone: (+ 374) 10 530362
Fax: (+ 374) 10 535296
E-mail: infoarm@byblosbank.com

NIGERIA

Byblos Bank Nigeria Representative Office

161C Rafu Taylor Close - Off Idejo Street
Victoria Island, Lagos - Nigeria
Phone: (+ 234) 706 112 5800 - (+ 234) 808 839 9122
E-mail: nigeriarepresentativeoffice@byblosbank.com.lb

BELGIUM

Byblos Bank Europe S.A.

Brussels Head Office
Rue Montoyer 10
Bte. 3, 1000 Brussels - Belgium
Phone: (+ 32) 2 551 00 20
Fax: (+ 32) 2 513 05 26
E-mail: byblos.europe@byblosbankeur.com

UNITED KINGDOM

Byblos Bank Europe S.A., London Branch

Berkeley Square House, Berkeley Square
GB - London W1J 6BS - United Kingdom
Phone: (+ 44) 20 7518 8100
Fax: (+ 44) 20 7518 8129
E-mail: byblos.london@byblosbankeur.com

FRANCE

Byblos Bank Europe S.A., Paris Branch

15 Rue Lord Byron, F- 75008 Paris - France
Phone: (+33) 1 45 63 10 01
Fax: (+33) 1 45 61 15 77
E-mail: byblos.europe@byblosbankeur.com

CYPRUS

Limassol Branch

1, Archbishop Kyprianou Street, Loucaides Building
3602 Limassol - Cyprus
P.O.Box: 50218
Phone: (+ 357) 25 341433/4/5
Fax: (+ 357) 25 367139
E-mail: byblosbankcyprus@byblosbank.com.lb

ADIR INSURANCE

Dora Highway - Aya Commercial Center

Jdeidet El Metn - 1202 2119 Lebanon
P.O.Box: 90-1446
Phone: (+ 961) 1 256290
Fax: (+ 961) 1 256293

BYBLOS BANK ECONOMIC RESEARCH
AND ANALYSIS DEPARTMENT

research@byblosbank.com.lb

WWW.BYBLOSBANK.COM