BYBLOS BANK

THE LEBANESE ECONOMY IN 2019

BYBLOS BANK ECONOMIC RESEARCH
AND ANALYSIS DEPARTMENT

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ECONOMIC POLICY

The year 2019 started with a political breakthrough that saw the formation of a new government in late January after eight months of deadlock and bitter wrangling among political factions. The new government pledged fiscal, economic and structural reforms to address public finance imbalances, improve economic activity, as well as to strengthen the business environment and fight corruption. It also committed to the swift implementation of reforms that would help unlock the US$ 11 billion that the international community pledged at the CEDRE conference in April 2018, as well as improve confidence and encourage capital inflows. However, the country faced a quasi-financial shock prior to the government's formation, when the caretaker Minister of Finance at the time was indirectly quoted in a newspaper interview in the first week of the year about the need to restructure the public debt. This triggered wide speculations and affected market sentiment, as risk indicators worsened and led to significant deposit outflows and an abrupt downgrade of the sovereign ratings in January, which put Lebanon at a crossroads early in the year.

The government's formation provided an opportunity to implement reforms and improve the economic and financial outlook, but pledges of reforms stalled amid the lack of a vision to address the structural challenges that the economy is facing and to shore up confidence. For instance, Parliament approved in April a plan to reform the electricity sector and reduce its cost on the Treasury, but wide skepticism prevailed about the resolve of the executive branch to enact the plan. The resulting delays in reforms led not only to opportunity costs for Lebanon, but also exacerbated risk perceptions about the country, especially that the international community has repeatedly expressed its willingness to support the economy and facilitate capital inflows, in case Lebanese authorities implement reforms, rather than just talk about them. As a result, deposit inflows, which have been critical to finance the budget and external deficits, slowed down during the first half of the year, therefore reducing the monetary authorities' room for maneuver. The monetary and banking sector had managed to maintain the stability of the currency peg to the US dollar and to finance the fiscal and current account deficits. However, this effort became increasingly costly and less effective, amid the lack of a political consensus and, therefore, of credible efforts by the executive branch to reduce public finance imbalances.

Further, political divisions within the government resurfaced early in the second half of the year, after a security incident paralyzed the executive branch for more than four weeks, at a time when market signals were increasingly pointing to a steady decline in confidence amid the indifference of political parties in power about glaringly pressing economic and financial issues. Also, the protracted negotiations on the 2019 budget, as well as the policies that the political class discussed at length in the Cabinet and in Parliament, produced in August a budget for 2019, nearly eight months after the start of the fiscal year, in breach of the constitutional deadline. The budget increased tax rates, tariffs and fees, and included some timid and unconvincing measures to reduce spending, at a time when public finances required in-depth measures and the private sector expected bold moves to stimulate the economy, reduce operating costs and boost confidence. As such, these decisions did not succeed in shoring up confidence and in supporting capital inflows, and further worsened the prevailing imbalances in the economy.

The turning point came towards the end of August, with three events that took place in 10 days. The downgrade of the sovereign ratings by yet another agency, the blacklisting of a commercial bank by the United States Department of the Treasury, and an Israeli drone attack on Beirut's southern suburb damaged sentiment and threatened to destabilize an already weak economy. In an attempt to limit the damage, the government declared a "State of Economic Emergency" following a much-hyped meeting in early September of the leaders of most political parties in the country to address the growing challenges. But, unsurprisingly, there was no concrete follow up or measures to match this lofty declaration. As a result, the deteriorating landscape resulted in the emergence in September of a parallel exchange rate market for the first time in more than two decades, as well as of rumors about the impending shortages of basic products, such as fuel, wheat and medicine. In turn, this triggered capital outflows and accelerated the ongoing conversions of Lebanese pounds deposits into foreign currency.

Legacy policy inaction, citizens' increased dissatisfaction at the failure of the political class to address longstanding challenges in the country, worsening socioeconomic conditions, and preparations for a new round of tax increases triggered nationwide protests on October 17, 2019 and led to the resignation of the government 12 days later under popular pressure. But prior to its resignation, the government tried to salvage its propsects by abrupty devising a set of reform measures, which put on display the disconnect between the people on one side and the political parties in power on the other side, as the government delved into technicalities at a time when citizens were demanding in-depth political change.

ECONOMIC POLICY

The collapse of confidence in the Lebanese political system and economy resulted in a sudden stop in capital inflows and in a bank run, which forced the banking sector to take temporary measures to restrict deposit outflows, amid expectations that the executive and legislative branches would move swiftly to enact official capital control measures. But rather than realizing the urgency of the situation and seizing the opportunity to calm panicking depositors and angry citizens, the political establishment abdicated its responsibilities, even though enacting capital control measures are a very basic tenant that accompanied similar crises around the world. As a result, the vacuum exacerbated the crisis and ended up pitting depositors against banks. This trend was amplified by a systematic campaign against the banking system to pin the entire responsibility of the crisis on Banque du Liban and on commercial banks, in an attempt to absolve the political class from any accountability and to maintain the bloated public sector as a tool for political nepotism and cronyism. Rather than responding to the virulent campaign, BDL and the Association of Banks in Lebanon decided not to provide a counter narrative, which encouraged the campaign's initiators to fill the vacuum by escalating the attacks.

In parallel, the onset of the nationwide protests raised hopes for genuine political change and accountability, as the demonstrations were sparked by the accumulation of grievances about worsening socioeconomic conditions, as well as by a build-up of anger over the perceived corruption in the public sector and the mismanagement of public finances.

However, the legitimate demands of citizens became a conduit for rampant populism and for anarchists who proceeded to destroy private and public property. Also, hopeful citizens were caught between a wave of opportunists who were trying to ride the winds of change and who were indifferent to the legitimate demands of the people, and strident advocates of income and wealth redistribution who were aiming to change the identity of the Lebanese economy. In turn, this trend overshadowed the popular calls for political change, improved governance, and genuine reforms. Further, the open confrontation between protestors who demanded real change, and political parties in power who aimed to maintain the status quo, signaled that the country has entered a new phase of heightened uncertainties.

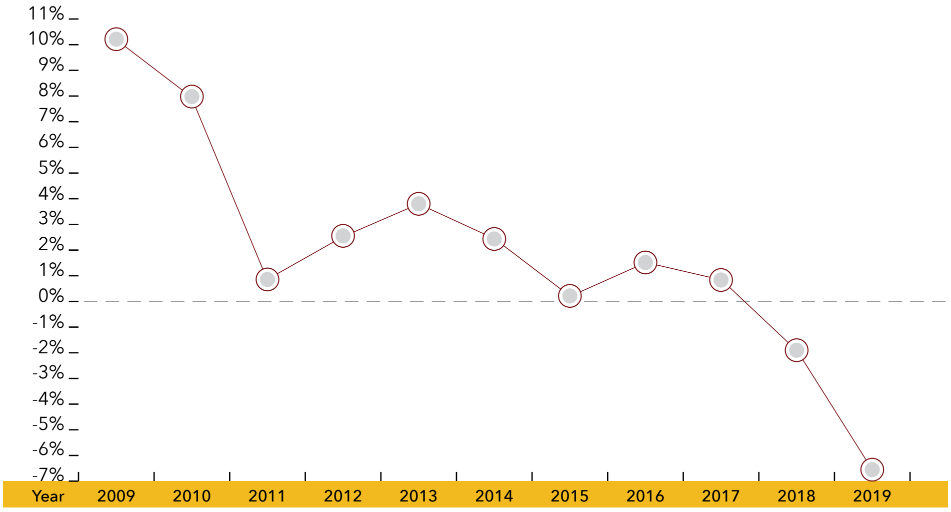
The confluence of these developments resulted in a re-pricing of Lebanese financial assets, as the stock market index declined by 18% and the Eurobonds price index regressed by 43% during the year. However, real estate, which has been traditionally a store of value and was increasingly a buyers' market in recent years, shifted towards the end of the year into a sellers' market, as some depositors redeployed their funds from the banking sector to real estate after banks took temporary measures to restrict deposit withdrawals.

In addition, the Lebanese economy continued to suffer from an inadequate level of competitiveness, a poor investment climate and a weak business environment. The World Economic Forum's 2019 Global Competitiveness Index shows that 62% of ranked countries worldwide and 71% of ranked Arab countries have a more competitive economy than Lebanon does. Also, the World Bank Group's Doing Business 2020 survey indicates that 75% of countries around the world and 59% of Arab economies have a better business climate than Lebanon. In addition, the World Bank's World Governance Indicators for 2019 show that 80% of countries and territories around the world implement their laws better than Lebanon does and 72% of them have a more effective government, while the quality of regulations in 64% of countries worldwide is better than in Lebanon. Moreover, the Property Rights Alliance's International Property Rights Index for 2019 shows that 93% of countries around the world and 93% of ranked Arab economies protect intellectual property rights better than Lebanon does. The challenging operating environment, as well as a bloated and inefficient public sector, took their toll on the image and performance of the economy. For instance, 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 0.5% of GDP in 2019 relative to 0.3% of GDP in 2018.

Economic activity suffered from the accumulation of negative shocks and contracted in each of the first three quarters of the year, but developments in the fourth quarter and the resulting disruptions to activity led to a steep contraction in the last three months of the year and produced in the country's worst annual economic performance since the end of the 1975-1990 conflict, despite steady remittance inflows of US$ 7.4 billion, a successful tourism season, and nearly US$ 17 billion, or 31.5% of GDP, in public spending in 2019, the highest level of public expenditures among oil-importing economies in the Middle East and North Africa region..

In parallel, the presence of more than one million Syrian refugees in Lebanon exacerbated the pressure on the country's infrastructure, although this alone 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 US$ 1.43 billion in 2019, equivalent to 3% of GDP, according to the United Nations' financial tracking service. Most of the grants were earmarked towards food security, basic assistance, education, healthcare, livelihoods, the water sector, shelter, social protection and stability, and the energy sector. Also, spending by Syrian refugees in Lebanon averaged US$ 105 per month in 2019, down by nearly 6% from US$ 111 per month in 2018, based on the United Nations' 2019 Vulnerability Assessment for Syrian Refugees in Lebanon.

REAL GDP GROWTH (%)



Source: National Accounts, Byblos Research

ECONOMIC ACTIVITY

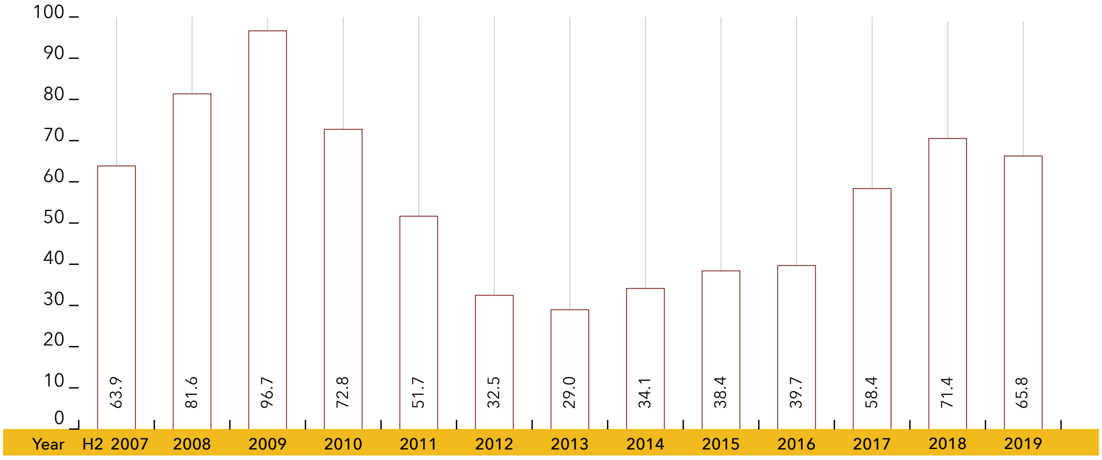
Household sentiment is a key indicator of trends in economic activity in Lebanon, given that private expenditures represent about 85.5% of overall spending in the economy. The Byblos Bank/AUB Consumer Confidence Index averaged 65.8 in 2019, decreasing by 8% from 71.4 in 2018 and constituting the first annual retreat since 2014. Also, the Index's outcome for 2019 was the eighth lowest since the Index's inception in 2007. Further, most of the Index's decrease occurred during the fourth quarter of the year, driven by the eruption of nationwide protests on October 17. The Index regressed in seven out of 12 months during the year, as it was almost unchanged in the first quarter of 2019, decreased by 6.1% in the second quarter, declined by 2.7% in the third quarter, and dropped by 31% in the fourth quarter of the year.

The formation of the government in late January 2019 was a positive development that affected household sentiment in the first quarter of the year. However, citizens soon realized that the so-called reform measures in the 2019 budget consisted of another wave of tax and fee increases that would end up reducing their disposable income and purchasing power, which sapped any momentum in confidence, and led the Index to decline during the second quarter of the year. In addition, the mounting frustrations of citizens and their sustained skepticism about the seriousness of the political class to implement measures that would improve their quality of living and economic wellbeing were the major factors that reduced households' expectations and led the Index to further decline during the third and fourth quarters of the year. The lengthy delays and procrastination in the formation of a new Cabinet, the apparent lack of political appettite for credible reforms, the rising cost of living, worsening socioeconomic conditions, mounting uncertainties, and the onset of nationwide protests on October 17 led to the decline of consumer sentiment in 2019.

The detailed results of the Index's monthly survey clearly reflect the level of frustrations of Lebanese households and the weakening of their expectations throughout 2019, specifically in the fourth quarter of the year. In fact, only 2.9% of the Lebanese polled in December 2019 considered that their personal financial conditions had improved from six months earlier, while 78.3% of respondents said that their financial situation had deteriorated from June 2019. In parallel, 3.7% of the Lebanese surveyed in December 2019 considered that economic conditions in Lebanon had improved from six months earlier, while 91.3% indicated that economic conditions had deteriorated from June 2019.

Further, the Byblos Bank/AUB Expectations Index posted higher values than the Byblos Bank/AUB Present Situation Index in each month of 2019, which means that consumers are more optimistic about the future than they were at the time of the survey. The spread between the two sub-indices has been in double digits since the second half of 2018. It reached a high of +16.5 in March 2019, then gradually narrowed to +10.7 in July 2019, as the euphoria that followed the government's formation subsided and as the economic situation continued to worsen, before ending the year at +14.7. The two sub-indices decreased significantly at the end of the year, but the decline of the Byblos Bank/AUB Present Situation Index was steeper than the fall of the Byblos Bank/AUB Present Situation Index, which explains the widening of the spread in December.

BYBLOS BANK/AUB CONSUMER CONFIDENCE INDEX

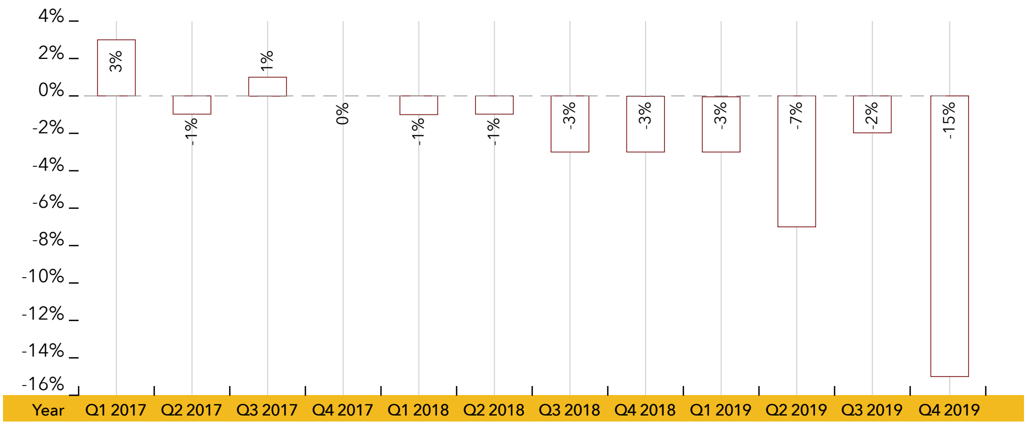


Source: Byblos Bank Economic Research and Analysis Department

In parallel, BDL's Coincident Indicator, a proxy for overall economic activity in Lebanon, decreased by 4.9% in 2019, which shows a significant slowdown in economic activity. The annual drop in the indicator is the steepest on record since BDL launched the indicator in 1993. In addition, the BLOM Lebanon Purchasing Managers' Index (PMI), a measure of the performance of the private sector, regressed by 0.7% in 2019. Lebanon's PMI fluctuated between a high of 48.3 in October 2019 and an all-time low of 37 in November 2019. The PMI remained below the 50-point mark in 2019, which means that business conditions in the Lebanese private sector continued to deteriorate during the year. Also, BDL's periodic survey of the opinions of business managers shows that the volume of commercial sales regressed in each quarter of the year. The balance of opinions is the difference between the proportion of surveyed managers who consider that there was an improvement in an indicator and the proportion of those who reported a decline in the same indicator. The balance of opinions for the volume of commercial sales in the fourth quarter of 2019 reached its third lowest quarterly level during the 2004-19 period, after the first quarter of 2005 following the assassination of Prime Minister Rafic Hariri and the third quarter of 2006 as a result of the Israeli war on Lebanon. The plunge reflects the disruptions to economic activity following the eruption of nationwide protests on October 17, and the worsening of economic and financial conditions, which affected demand.

The Lebanese economy contracted by 6.7% in 2019, following a contraction of 1.9% in 2018, largely due to a sharp decline in economic activity in the fourth quarter of the year. Real GDP retreated by 3% in the first quarter, by 7% in the second quarter, by 2% in the third quarter and by 15% in the fourth quarter of 2019. In turn, this resulted in output losses of about US$ 15.7 billion for the year, which is equivalent to 22.7% of GDP In fact, the longstanding political bickering, along with the absence of political will to implement the much-needed reforms, a highly inefficient and unproductive public sector, and geopolitical uncertainties, have severely weakened the Lebanese economy and led to the prevailing crisis. As such, the cumulative challenges curbed consumer demand, increased domestic prices, and weighed on business activity in the country.

QUARTERLY REAL GDP GROWTH RATES (Year-on-Year)



Source: National Accounts, Byblos Research

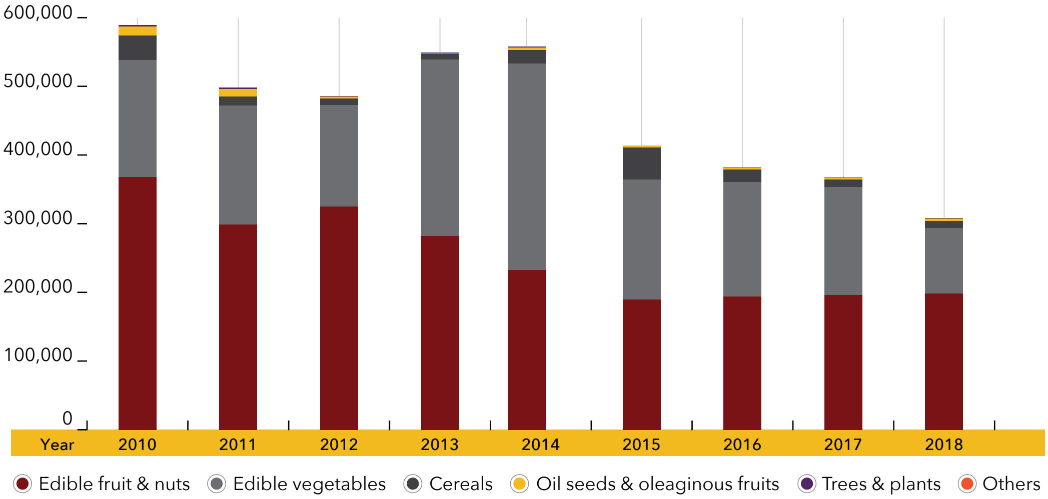
In parallel, the rising political rhetoric, mixed with emerging populism, led to misleading, unreliable and politically-motivated figures on unemployment rates in the country. But official figures produced by the Central Administration of Statistics provided a credible and scientific picture of the local labor market, which mirrored economic conditions in the country at the time. A survey conducted between April 2018 and March 2019 showed that the official unemployment rate in the country was 11.4% and the youth unemployment rate, or unemployment among individuals in the 15 to 24 year-old bracket, was 23.3% in the covered period. The figures are the only official source of data on the labor market in Lebanon, and are bound to be updated to better reflect the changes in the labor force throughout 2019.

AGRICULTURE

The agricultural sector was affected throughout 2019 by high operating costs, an inadequate infrastructure, the smuggling of agricultural products, and by sustained violations of the agricultural calendar for exports to Lebanon, as well as by the fact that a significant part of the sector operates in the informal economy. As a result, the contribution of the agriculture, livestock, forestry and fishing sector to economic output has gradually regressed from 3.8% in 2011 to 3.2% in 2019. Also, when measuring activity by constant 2010 prices, the sector's activity expanded by 6% in 2019 following a contraction of 4% in 2018 and growth rates of 13.4% in 2017 and of 6.3% in 2016. However, the agriculture, livestock, forestry and fishing sector, along with the real estate sector, were the only sectors to post an increase in output in 2019.

Lebanon's agricultural exports continued to suffer in 2019 despite the reopening of the Jaber-Naseeb crossing point on the Syrian-Jordanian border, and some government measures to facilitate and promote export activity through the Maritime Lebanese Exports Bridge (M.LEB) program. Agricultural exports, which mostly include trees, vegetables, fruit, nuts and cereals, totaled 272,109 tons in 2019, down by 11.8% from 308,413 tons in 2018, and constituting the lowest exported volume since the onset of the Syrian conflict in March 2011. The drop in the volume of exported agricultural products in 2019 is due to a year-on-year decrease of 19.5% in fruits and nuts exports and to a decline of 6.2% in the export of cereals. Overall, the volume of agricultural exports decreased by 51% between 2014 and 2019. Agricultural exports accounted for 16.2% of total exports in 2019, down from 16.8% in 2018 and 25% in 2014.

EXPORTS OF AGRICULTURAL PRODUCTS (Tons)



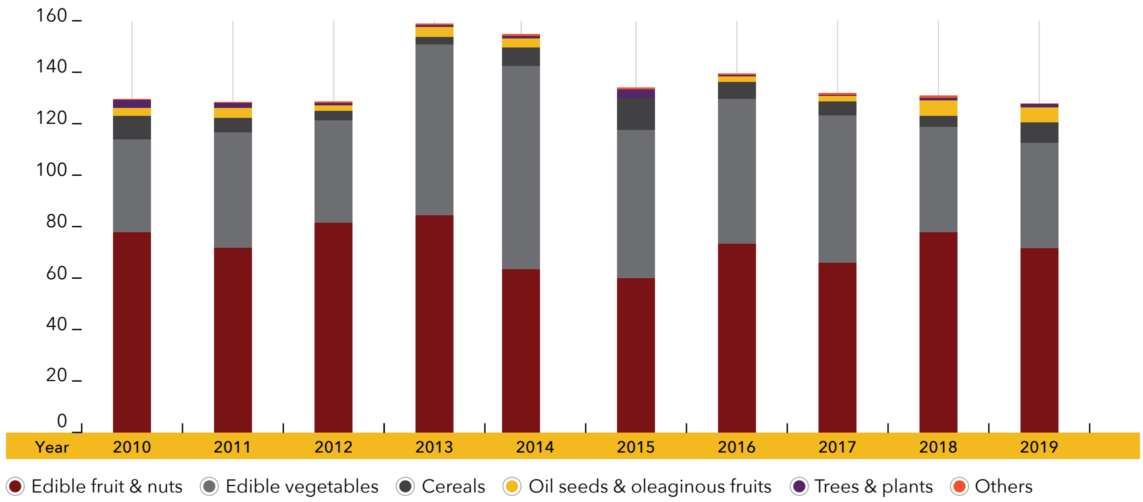
Source: Lebanese Customs, Byblos Research

Kuwait was the recipient of 18.5% of Lebanon's agricultural exports in 2019, followed by Saudi Arabia (17%), Egypt (13.4%), Syria (12%), and the UAE (11.8%). The Port of Beirut was the exit point for 51% of agricultural products in 2019, followed by the Masnaa crossing point (38.4%), the Hariri International Airport (5%), and the Port of Tripoli (3.3%). Agricultural exports through the Masnaa crossing point nearly doubled in 2019 following the reopening on October 15, 2018 of the Jaber-Naseeb crossing point on the Syrian-Jordanian border, and reached their highest level since 2014. In fact, the Masnaa crossing point was the main exist point for about 60% of agricultural products in 2010 and for 65% of such products in 2014, the year preceding the closure of the Jaber-Naseeb junction.

The closure in April 2015 of the crossing point, which was the only remaining open land route at the time for the transport of goods from Lebanon and Syria to Jordan, Iraq and Gulf Cooperation Council (GCC) countries, negatively affected overall exports, including those of agricultural products. In turn, this shifted agricultural exports from land to maritime transportation, especially from the Beirut port. 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 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 2019, agricultural exports continued to suffer from the extra time through the maritime route, which offset in part the rise in export through the land route.

The amount of agricultural exports totaled US$ 128.1 million in 2019, down by 2.2% from US$ 131.1 million in 2018. For instance, the amount of exported fruits and nuts decreased by 7.8% or US$ 6.1 million in 2019, while the amount of cereals exported rose by 77% or US$ 3.4 million in 2019. Further, Lebanon's exports of edible vegetables were nearly unchanged in 2019, following sustained annual declines during the 2014-18 period. In fact, they dropped by 70% in terms of volume and by 48% in terms of value between 2014 and 2019.

EXPORTS OF AGRICULTURAL PRODUCTS (US$ Millions)



Source: Lebanese Customs, Byblos Research

In parallel, utilized bank credit to the agricultural sector reached US$ 753.7 million at the end of 2019, down by 4.5% from US$ 789.1 million at the end of 2018, and accounted for 1.3% of total utilized credits in the Lebanese economy. Also, utilized bank credit by the agricultural sector represented 1.8% of utilized credits when excluding consumer loans, compared to the sector's contribution to economic output of 3.2% 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 portion of the agricultural sector. Also, the Kafalat Corporation extended 16 loan guarantees to small- and medium-sized enterprises (SMEs) in agriculture in 2019, down from 117 guarantees in 2018 and from a high of 609 guarantees in 2010. The number of loan guarantees to SMEs in agriculture accounted for 31.4% of total guarantees in 2019, down from 37.4% in 2018 and 43.4% of the total in 2010.

INDUSTRY

The performance of the industrial sector was subdued in 2019, as it was affected by elevated operating costs, the deteriorating quality of infrastructure, a weak logistics environment, as well as by smuggling, foreign dumping, and illegal and unfair competition from manufacturing operations in the informal economy. Further, the recession in the country, as well as the unstable political environment, the eruption of nationwide protests and the subsequent economic paralysis 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). In addition, the reduced access to foreign currency and the emergence of a parallel exchange market in the second half of the year disrupted industrial production, as the ALI estimated that the sector requires US$ 3 billion in imports of raw materials annually, or US$ 8 million per day, which would allow industrial firms to produce the equivalent of US$ 10 billion in products for the Lebanese market and about US$ 3 billion in exports, leading to a total of US$ 13 billion in industrial products.

The business environment for the manufacturing sector worsened despite the private sector's efforts to fill the gap left by the authorities' inaction to improve domestic conditions. In late March 2019, the ALI declared "a State of Emergency" for the manufacturing sector, due to dumping, smuggling, and the presence of unlicensed factories, as well as to the challenging economic conditions. It also signed a Memorandum of Understanding with the Port of Beirut in order to reduce duties by about 50% on raw materials that industrial firms import through the port. Further, at the end of July 2019, the Ministry of Industry, in cooperation with ALI, launched an initiative named "Support the Nation by Buying Local Products", which is a national campaign to promote the Lebanese industrial sector. The campaign aimed to raise awareness about the quality and competitiveness of locally-produced products, and to encourage the population to prioritize these products in their purchases. The initiative included a media campaign about the industrial sector and locally-manufactured products, as well as exhibitions in several regions across Lebanon.

INDUSTRY

According to the most recent national accounts for Lebanon, the manufacturing, mining and utilities sectors' contribution to GDP at current prices stood at 10.2% in 2019, down from 10.4% in 2018 and compared to 11.5% in 2008. When using constant 2010 prices, the sectors' activity has been contracting since 2014, as it regressed by 13% in 2019 and by an annual average contraction rate of 2.9% between 2014 and 2018, which reflects declining output.

Also, BDL's periodic survey of the opinions of business managers shows that industrial production regressed in the first, second, third and fourth quarters of 2019 compared to the same quarters, respectively, of 2018. The balance of opinions for the level of industrial production in the fourth quarter of 2019 reached its second lowest quarterly level during the 2004-2019 period, after the third quarter of 2006 due to the Israeli war on Lebanon at the time. The decline reflected the disruptions to economic activity following the eruption of nationwide protests on October 17, and the worsening of economic and financial conditions, which negatively affected the overall performance of the industrial sector. Further, registered orders, demand for industrial products and the volume of investments in the sector decreased year-on-year in all four quarters of 2019. The survey shows that the majority of business managers considered that the deterioration of overall industrial activity intensified gradually throughout 2019, and posted the steepest decline in the fourth quarter of the year.

In parallel, industrial exports totaled US$ 2.5 billion in 2019, and declined by US$ 50.7 million, or by 2%, from US$ 2.55 billion in 2018. The disruption to activity following the eruption of nationwide protests in October had a limited impact on industrial exports, as such exports in the last three months of the year were in line with the monthly trends in the first nine months of 2019. Still, industrial exports were below the annual average of US$ 3.1 billion during the 2010-2018 period. They declined from their peak of US$ 3.57 billion in 2012 due to the increase in transportation and safety risks in Syria following the onset of the conflict in that country, given that Syria constitutes the only land outlet for Lebanese exports.

Source: Ministry of Industry, Byblos Research

Exports of machinery & mechanical appliances totaled US$ 491.8 million and accounted for 19.7% of aggregate industrial exports in 2019, followed by chemical products with US$ 475.3 million (19%), foodstuffs & tobacco with US$ 389.8 million (15.6%), base metal exports with US$ 310.4 million (12.4%), plastics & rubber with US$ 159.1 million (6.4%), pearls or semi-precious stones with US$ 149.5 million (6%), and paper & paperboard with US$ 144 million (5.8%).

In addition, Arab countries generated the majority of demand for Lebanese manufactured products sold abroad, as they were the destination of 53.2% of Lebanese industrial exports in 2019, followed by European economies with 18.6%, African countries with 11%, Asian economies with 10.8%, countries in the Americas with 4.8%, and markets in Oceania with 0.7%. On a country basis, the UAE was the main destination of Lebanese industrial exports and accounted for 10% of the total in 2019, followed by Saudi Arabia with 9.2%, Iraq with 8.1%, Syria with 6.7%, Qatar with 4.6%, Jordan with 3.6%, and Turkey with 3.5%. In addition, the economies of the GCC continued to be a vital market for Lebanese manufacturing, as they accounted for 27% of total industrial exports and for 50.6% of industrial exports to the Arab world in 2019.

In parallel, utilized credits by the manufacturing sector reached US$ 5.7 billion at the end of 2019, down by 11.8% from US$ 6.45 billion at the end of 2018, in line with the financial deleveraging across economic sectors since the start of the year. The amount of loans to manufacturers accounted for 9.6% of total utilized credits in the Lebanese economy and for 14% of utilized credits when excluding consumer loans.

Also, the Kafalat Corporation extended 17 loan guarantees to SMEs in manufacturing in 2019, down from 117 guarantees in 2018 and from a peak of 543 in 2010, reflecting the economic recession, the challenging operating environment, in addition to BDL's suspension of the mechanism that subsidized loans through freeing the reserve requirements of commercial banks at BDL. The number of loan guarantees to SMEs in manufacturing accounted for 33.3% of total Kafalat guarantees to all sectors in 2019, down from 37.4% in 2018 and compared to 39% of the total in the peak year of 2010.

TRANSPORTATION

The car sector in Lebanon faced significant challenges in 2019, which include the contraction in economic activity, an uncertain jobs market, the decline in consumer confidence, political volatility, and an unclear outlook. Also, the increase in domestic interest rates that raised the cost of car loans and the banks' risk aversion to extend loans weighed on car demand. In addition, the onset of the October 17 uprising significantly reduced car sales in the fourth quarter of the year, as uncertainties and repeated closures disrupted the automotive market in the country.

Further, the car sector continued to suffer from elevated customs and value-added taxes, as well as from high registration and mécanique fees. According to Lebanese customs, the custom tax on imported used cars valued at LBP 20 million is LBP 500,000, the excise tax is LBP 4.5 million and the VAT is LBP 2.75 million. As such, the aggregate amount of taxes on such vehicles, excluding registration fees, is LBP 7.75 million or 39% of the car value.

In parallel, utilized bank credit for the purchase of cars in Lebanon reached US$ 773.8 million at the end of 2019 compared to US$ 1 billion at the end of 2018, and accounted for 4.2% of utilized consumer loans and for 12% of consumer loans, when excluding housing loans, at the end of 2019. However, the non-performing loans ratio on car loans deteriorated from 5.2% at end-2018 to 10.8% at the end of 2019, reflecting both the decline in the volume of car loans, as well as the emergence of difficulties of some car owners to repay their loans on time.

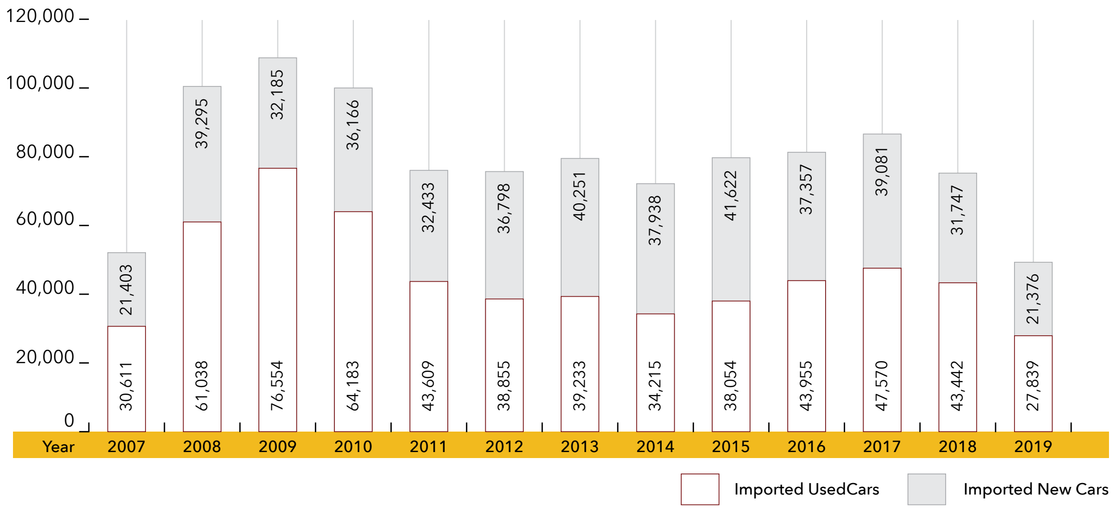
The intentions of consumers to buy cars in Lebanon decreased in 2019 amid rampant economic and financial rumors, an uncertain labor market, and the absence of encouraging signals. Byblos Bank has been collecting data on a monthly basis about Lebanese consumers' plans to purchase new or old cars since July 2007 through the monthly Byblos Bank Consumer Confidence Survey. The survey's results show that, on average, 6.2% of resident Lebanese citizens polled monthly in 2019 had plans to purchase a car in the coming six months, compared to an average of 7.3% in 2018. The share of resident Lebanese citizens who were planning to buy a car in 2019 was the second lowest since Byblos Bank started collecting data in 2007, following the 5.8% share in 2017.

Also, the proportion of consumers who had plans to purchase a car in 2019 declined gradually from an average of 7.4% in the first quarter to 6.6% in the second quarter, to 5.9% in the third quarter and to 4.7% in the fourth quarter of the year. In fact, the percentage of consumers who had plans to purchase a car in the next six months regressed from 9.5% in February to 4.1% in December 2019, the lowest monthly level on record. The decrease was mostly due to the deterioration of socioeconomic conditions in the country that led to the eruption of nationwide protests on October 17, which, in turn, weighed on consumer confidence and on the decisions of potential car buyers. As such, the share of consumers who had plans to purchase a car in 2019 was significantly below the peak level of 15.7% in 2009 and the monthly average of 8.9% between July 2007 and December 2019. As such, 92% of respondents surveyed in 2019 did not plan to buy a vehicle in the coming six months. In addition, 55% of consumers who planned to purchase a car in 2019 preferred to buy a new car, while 40.6% wanted to buy a used automobile.

TRANSPORTATION

The confluence of unfavoarble circumstances adversely affected car sales in the country. Lebanon imported 49,215 passenger cars in 2019, constituting a decrease of 34.5% from 75,189 vehicles in 2018, and compared to an annual average of 80,723 cars imported per year between 2010 and 2018. It imported 27,839 used cars in 2019, down by 36% from 2018, while it imported 21,376 new passenger cars in 2019, reflecting a decline of 32.7% year-on-year. Used cars accounted for 57% of total car imports in 2018, while new cars represented the balance of 43%.

EVOLUTION OF NUMBER OF IMPORTED CARS



Source: Lebanese Customs, Byblos Research

In parallel, car dealers sold 21,991 new passenger cars in 2019, constituting a decline of 33.4% from 33,012 cars sold in 2018. Individuals and institutional clients purchased 5,934 new cars in the first quarter, 7,242 new vehicles in the second quarter, 6,689 new automobiles in the third quarter, and 2,126 new cars in the fourth quarter of last year.

There are about 80 different passenger car brands available for sale in Lebanon from China, Europe, Japan, South Korea and the United States. Japanese cars accounted for 39.2% of total car sales in 2019, followed by Korean vehicles with a 25% share, European automobiles (22.8%), American cars (9%), and Chinese vehicles (3.9%). Demand for Korean cars dropped by 41.3%, the sales of Japanese vehicles decreased by 35.7%, demand for new American automobiles declined by 30.1%, the sales of European vehicles regressed by 21.8%, and the number of Chinese cars sold fell by 10.8% in 2019.

Further, consumers have shown a preference for buying small-engine cars in recent years and this trend continued in 2019. In fact, the market share of smaller-engine cars has remained stable at around 90% of new vehicles sold since 2011. The sustained demand for smaller-engine cars is mainly due to the high demand for fuel-efficient cars, lower overall car prices that entail relatively lower tariffs than large engine vehicles, as well as due to lower taxes, registration fees and mécanique fees. Other factors that supported this trend include the lower cost of maintenance and spare parts for smaller-engine cars than for larger ones.

INSURANCE

The Lebanese insurance sector, similar to other sectors in the economy, suffered from the protracted period of challenging economic, monetary and financial conditions in the country during the year.

The number of licensed insurers declined from 50 in 2018 to 47 in 2019. The Insurance Control Commission (ICC) suspended in August 2019 the license of an insurance firm due to the latter's repeated breaches of Lebanese insurance regulations. Consequently, it prohibited the company from issuing or renewing any policy contract, but the insurer continued to service its existing portfolio and to settle its obligations to policyholders. In addition, two insurers, one active in the life segment and the other in the non-life segment, were affected by the U.S. decision to blacklist their parent company. The ICC took the necessary measures to ensure that obligations to policyholders will continue to be settled.

The gross written premiums of the 47 licensed insurance companies reached US$ 1.61 billion in 2019, constituting a decrease of 4% from US$ 1.68 billion in 2018 compared to a rise of 3.2% in 2018. Premiums reached US$ 471.4 million in the first quarter, US$ 400.4 million in the second quarter, US$ 387.5 million in the third quarter, and US$ 352 million in the fourth quarter of 2019. After adjusting for inflation, insurance premiums regressed by 6.7% in real terms in 2019, following a contraction of 2.7% in 2018.

The nominal decline in insurance premiums in 2019 is the first such decrease, following annual growth rates in insurance premiums in the single-digits since 2010 and double-digit growth rates in premiums in almost every year between 2002 and 2010. The slowing activity in many sectors, the drop in household confidence, the decline in the disposable income and purchasing power of individuals, and higher inflation rates affected the insurance sector throughout 2019.

Non-life premiums reached US$ 1.14 billion and accounted for 70.8% of the sector's aggregate premiums in 2019, while life insurance premiums amounted to US$ 471.1 million and represented 29.2% of the total. Non-life premiums regressed by 1.6% and life premiums declined by 9.2% in 2019.

The distribution of non-life premiums shows that medical insurance premiums totaled US$ 539.8 million in 2019 and accounted for 33.5% of the sector's aggregate premiums, followed by motor premiums with US$ 334.3 million (20.8%), and property & casualty insurance premiums with US$ 266 million (16.5%). Further, medical insurance premiums grew by 5.6% in 2019, while motor premiums declined by 11.8%, and property & casualty insurance premiums regressed by 1.1% from 2018.

The insurance penetration rate in Lebanon, or premiums relative to the size of the economy, was 3.01% of GDP in 2019, nearly unchanged from 3.05% of GDP in 2018. The life insurance penetration rate reached 0.88% of GDP in 2019 compared to 0.94% in 2018, while non-life premiums posted a penetration rate of 2.13% of GDP in 2019, nearly unchanged from 2.11% of GDP in the preceding year.

Further, the insurance density in Lebanon, or premiums per capita, was US$ 337.8 in 2019, up from US$ 335 in 2018. Also, insurance density for the life branch reached US$ 98.8 in 2019, compared to US$ 103.6 in 2018, while the insurance density for the non-life category was US$ 239 in 2019, relative to US$ 231.4 in 2018.

Among the active insurance companies in Lebanon, 28 firms provided life and non-life insurance products, 14 offered non-life insurance and five insurers provided only life insurance products in 2019. The sector remained concentrated, as the top five firms in terms of life and non-life premiums accounted for 37% of aggregate premiums, while the top 10 firms controlled 62.6% of the sector's premiums during the year. Also, the top five firms in terms of life premiums accounted for 66.4% of the branch's aggregate premiums, while the top 10 firms controlled 87.3% of life premiums. Further, the top five firms in terms of non-life premiums accounted for 39.7% of the category's aggregate premiums, while the top 10 firms controlled 63.4% of non-life premiums.

In parallel, gross claims settled by insurance companies stood at US$ 1.05 billion in 2019, constituting a rise of 10.5% from US$ 949 million in 2018. Claims reached US$ 248.3 million in the first quarter, US$ 251.3 million in the second quarter, US$ 274.8 million in the third quarter, and US$ 274.3 million in the fourth quarter of 2019. Gross claims paid for the medical segment amounted to US$ 417.1 million and accounted for 40% of total claims settled by the insurance sector last year. Claims disbursed for the life insurance category followed at US$ 336.4 million (32%), then the motor segment at US$ 200.6 million (19%), and the property & casualty category at US$ 94.6 million (9%). Also, life insurance claims rose by

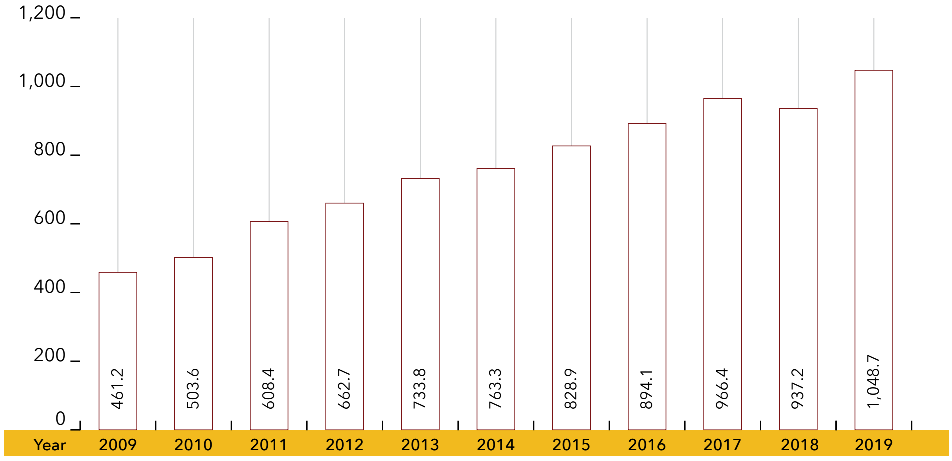
16.3% in 2019, medical claims grew by 15.2%, and property & casualty claims increased by 5.1%, while motor insurance claims regressed by 3.4% last year.

The sector's acquisition and administration costs reached US$ 472 million in 2019, down by 2.8% from US$ 485.3 million in the previous year. Also, net investment income totaled US$ 197.1 million last year and increased by 27.2% from US$ 155 million in 2018.

In addition, the ratio of gross claims settled to gross written premiums stood at 65% in 2019, up from 57% in 2018. Further, the ratio of expenditures for acquisition and administration to gross written premiums reached 29% last year, unchanged from 2018; and the ratio of net investment income to gross written premiums stood at 12% in 2019 compared to 9% in 2018.

In parallel, the Ministry of Economy & Trade prohibited insurance companies in Lebanon from distributing dividends to shareholders for the financial year 2019, or any dividends accumulated in previous years. It also asked insurers to refrain from settling any payments to related parties without the approval of the ICC, regardless of the nature and type of the payment, or whether or not the payment is justifiable. The ministry issued the decision based on a proposal from the ICC to preserve the solvency of insurers amid the prevailing challenges facing the country.

TOTAL CLAIMS PAID (US$ Millions)



Source: Insurance Control Commission, Byblos Research

REAL ESTATE AND CONSTRUCTION

The real estate market, which contributes 16.4% of economic output in Lebanon, was negatively affected throughout most of the year by adverse economic and social conditions, as well as by elevated interest rates, reduced purchasing power, weak consumer confidence, and the absence of a comprehensive housing policy.

The housing market continued to suffer in 2019 following the setback in 2018 when BDL's two stimulus packages were rapidly exhausted amid the spike in demand generated by the massive increase in the public sector's wages and salaries at the time. In addition, pent-up demand for mortgages led to the rapid exhaustion of BDL's interest rate subsidies on US$ 248 million worth of mortgages early in 2019.

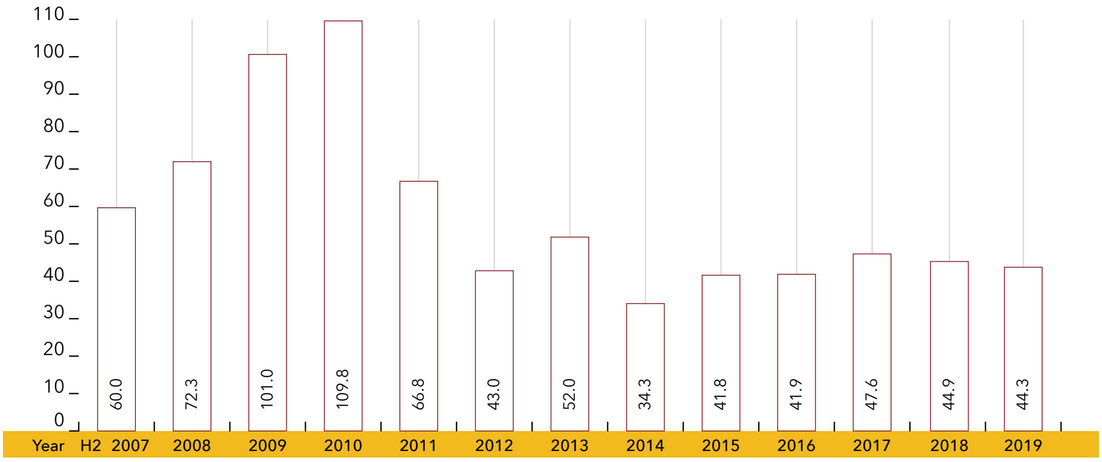
Amid the worsening of economic and financial conditions in the fourth quarter of 2019, demand for real estate increased towards the end of the year as some sought to purchase real estate using their bank deposits; while sellers, including developers, benefited from the emerging trend to settle their obligations towards the banking sector. The migration of some deposits out of the banking sector to real estate targeted land and built property, but this trend did not have a significant impact on the residential market. In addition, some bank clients used their deposits to settle their mortgages ahead of maturities.

Consequently, the amount of housing loans reached US$ 12.2 billion at the end of 2019 compared to US$ 12.9 billion a year earlier and US$ 13 billion at the end of 2017. Most of the demand for mortgages has been for small-size apartments and came from limited-income individuals who met the requirements for subsidized loans from the Public Corporation for Housing. BDL, in cooperation with commercial banks, has been subsidizing interest rates on housing loans since 2009 to support the residential market, even though such support should come from the government rather than from the banking sector. However, after the funds allocated to housing dried up, BDL couldn't provide the same incentives and banks stopped offering subsidized housing loans.

Further, the Byblos Bank Real Estate Demand Index, which reflects the intentions of the resident Lebanese to buy or build a home, posted an average monthly value of 44.3 in 2019, constituting a decrease of 1.3% from 44.9 in 2018. The value of the Index regressed in three out of the four quarters in 2019. Real estate demand increased by 9.6% in the first quarter after BDL launched its US$ 1.1 billion economic stimulus package for 2019 that included US$ 248 million in subsidies on new housing loans. However, the Index regressed by 17% in the second quarter of the year, given the vague measures related to the housing segment in the 2019 budget and the inconsistent statements by opportunistic politicians about mortgage subsidies, which led potential buyers to remain hesitant and follow a wait-and-see approach.

Also, the Index decreased by 10% in the third quarter of the year amid the absence of a clear and comprehensive housing policy that would revive demand for all segments of the residential market in Lebanon and allow citizens to have access to affordable housing. The relevant authorities did not make any concrete progress on such a policy, which, along with the mounting frustrations of Lebanese citizens at the worsening socioeconomic conditions that culminated with the onset of nationwide protests, depressed sentiment in the fourth quarter of 2019. Specifically, the Index retreated by 22% in the last quarter of the year and reached its lowest level since the first quarter of 2015. Overall, the Index's average monthly score for 2019 constituted a decline of 64% from the peak registered in 2010 and was 24% lower than the average monthly score since calculation of the Index began in July 2007.

BYBLOS BANK REAL ESTATE DEMAND INDEX



Source: Byblos Bank Economic Research and Analysis Department

On the supply side, the surface area of construction permits for buildings decreased by 37.6% in 2019, according to the Order of Engineer and Architects of Beirut. The surface area of construction permits for new residential buildings regressed by 37.2% last year, the area for new commercial buildings and offices contracted by 47.8%, and the surface area for general service buildings, such as hospitals and schools, decreased by 16.7%. The three segments accounted for 90.4% of the total surface area of construction permits for new buildings in 2019.

Construction activity in Lebanon continued to be skewed towards the residential segment, with residential buildings accounting for 78% of the surface area of construction permits in 2019. The supply in this segment has been trending towards small-sized residential units since 2012 to adapt to the new market fundamentals.

Further, the Order of Engineers & Architects of Beirut issued 4,396 authorizations to start construction work in 2019, constituting a decrease of 20% from 5,497 authorizations in 2018 and relative to a decline of 13% in 2018. Applications for the authorization of construction permits for new buildings, as well as for the modification or extension of buildings and for their restoration, have to be filed during a period of up to one year after receiving the construction permit, depending on the surface area of the project. The surface area of issued authorizations reached 3.58 million square meters (sqm) in 2019, constituting a decrease of 39% from 5.86 million sqm in 2018 and compared to a decline of 15.6% in 2018. The surface area of issued authorizations for new residential units consisted of 2.1 million sqm for residential buildings and 867,769 sqm for individual houses last year, equivalent to 59% and 24.3% of the total, respectively. Commercial buildings & offices followed with 310,089 sqm, or 8.7% of the total, then industrial-and agricultural-related buildings with 139,385 sqm (3.9%), general purpose buildings with 50,060 sqm (1.4%), general service buildings such as hospitals and schools with 39,777 sqm (1.1%), and hotel- and tourism-related buildings with 35,390 sqm (1%).

In parallel, the construction sector contributed to 2.6% of economic output in 2019, down from 3.8% in 2018, 4.2% in 2017 and from a high of 6.1% in 2013. Also, when measuring activity by constant 2010 prices, the sector's activity contracted by 29% in 2019, following contractions of 10% in 2018 and 5.2% in 2017.

Further, utilized bank credits by the construction sector have been declining since 2017, as they reached US$ 9.88 billion at the end of 2019, down from US$ 11.15 billion at the end of 2018 and a high of US$ 11.6 billion at the end of 2016. The decline in utilized bank credit by the construction sector has been mainly driven by the slowdown in real estate activity and the banks' already high exposure to the sector. More recently, the migration of some deposits towards built property helped developers settle their loans. Utilized bank credits by the construction sector accounted for 16.6% of total utilized credits in the Lebanese economy at the end of 2019 and for 24.2% of such credits when excluding consumer loans. Both shares were significantly higher than the sector's contribution to economic output.

In addition, BDL's periodic survey of the opinions of business managers shows that general construction activity was subdued during the first, second, third and fourth quarters of 2019. In fact, the balance of opinions about construction activity regressed in the first quarter of 2019 relative to the same quarter of the previous year. It then improved slightly but remained weak in the remaining quarters. In parallel, the balance of opinions about public works was unchanged year-on-year in the first quarter of 2019, then increased marginally in the second quarter and declined in the third and fourth quarters of the year. Moreover, the portfolio of construction projects in the sector dropped in the first quarter, improved slightly in the second quarter, and regressed in the third and fourth quarters of 2019, while construction costs were unchanged annually in the first quarter, dropped in the second quarter, and increased in the third and fourth quarters of 2019.

TOURISM

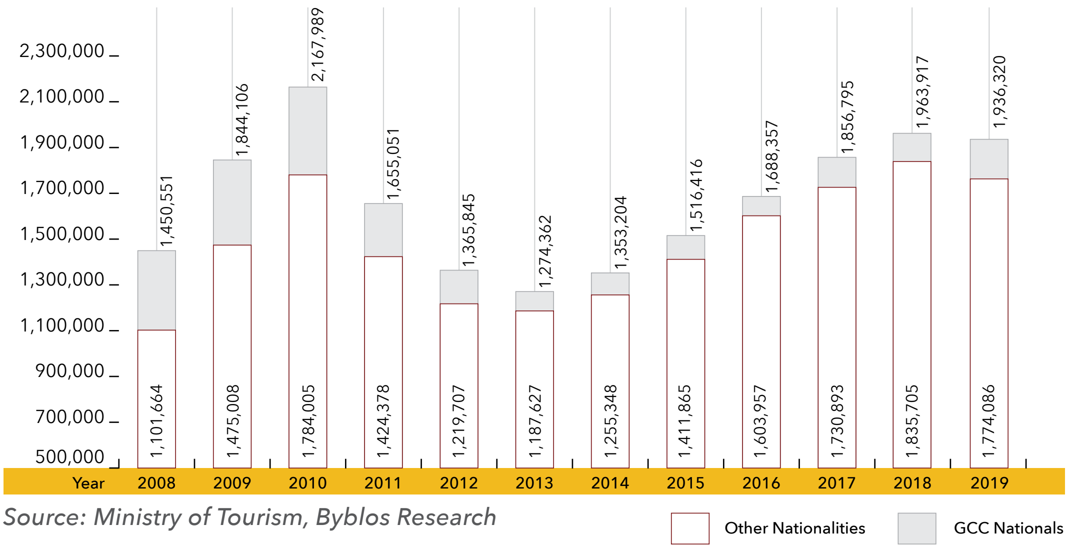
The tourism sector, which used to be a main driver of economic activity in Lebanon prior to 2011, posted a strong performance in the first nine months of 2019, similar to the level of activity during the peak year of 2010. Activity was supported by increased tourist arrivals, especially from GCC countries, amid greater political stability in the country, as well as by favorable winter and summer seasons. In addition, the tourism sector was underpinned by the Ministry of Tourism's initiatives to boost tourist numbers and spending, including the organization of the Visit Lebanon International Forum, a platform to promote Lebanon as a tourist destination to foreign companies in the sector. However, the onset of protests in the fourth quarter of 2019 significantly disrupted the tourism sector and led the number of tourist arrivals to decline sharply in the last quarter of the year.

The number of incoming visitors to Lebanon totaled 1.94 million in 2019, decreasing by 1.4% from 1.96 million in 2018 and constituting a decline of 10.7% from the peak of 2.17 million visitors in 2010. The number of tourist arrivals reached 375,815 in the first quarter, then increased to 548,005 in the second quarter and to 689,246 in the third quarter of 2019, its second highest quarterly level on record. However, the number of incoming tourists to Lebanon dropped to 323,254 in the fourth quarter of the year, with arrivals in November 2019 constituting their lowest level for that month since 2008.

The number of European visitors accounted for 37.2% of the total and continued to surpass the number of Arab tourists (29.7%). Visitors from the Americas represented 18.8% of total tourists in 2019, followed by visitors from Asia (7%), Oceania (4%), and Africa (3.3%). Most of the decline in the number of tourists is attributed to fewer incoming visitors from African economies, as well as from countries in Oceania and Asia. Specifically, the number of visitors from Arab countries increased by 2.1% in 2019, followed by visitors from Europe (+2%) and the Americas (+1.7%), while the number of visitors from Africa contracted by 40.3% last year, followed by those from Oceania (-11%), and Asia (-4.4%).

Further, the number of incoming visitors from GCC countries reached 162,234 in 2019, and accounted for 8.4% of Lebanon's total tourist arrivals, compared to a share of 6.5% in 2018 and of 17.7% in 2010. The number of incoming visitors from GCC countries increased year-on-year, reflecting the lifting of travel restrictions to Lebanon from some GCC economies in the early months of 2019, as well as the strong tourism activity throughout the first nine months of the year.

TOURIST ARRIVALS



Source: Ministry of Tourism, Byblos Research

TOURISM

In parallel, figures released by BDL show that revenues generated by tourism activity in Lebanon, defined by BDL as ''Travel Services'', totaled US$ 8.6 billion in 2019, their highest level since 2002, and increased by 2.3% from US$ 8.4 billion in 2018. They amounted to US$ 1.8 billion in the first quarter of the year, US$ 2.3 billion in the second quarter, US$ 2.9 billion in the third quarter and US$ 1.55 billion in the fourth quarter of 2019. Tourism receipts were equivalent to 16.8% of GDP in 2019 compared to 15.3% of GDP in 2018.

Tourism receipts in the first three quarters of 2019 reached their highest level for the first nine months of a year between 2002 and 2019. This was due to the increase in the number of incoming visitors to Lebanon in the first nine months of last year, which reached their highest level for the first nine months of each year since 2010. However, tourist revenues declined by 46% quarter-on-quarter and by 29% annually in the fourth quarter of 2019 following the adverse developments in the covered quarter.

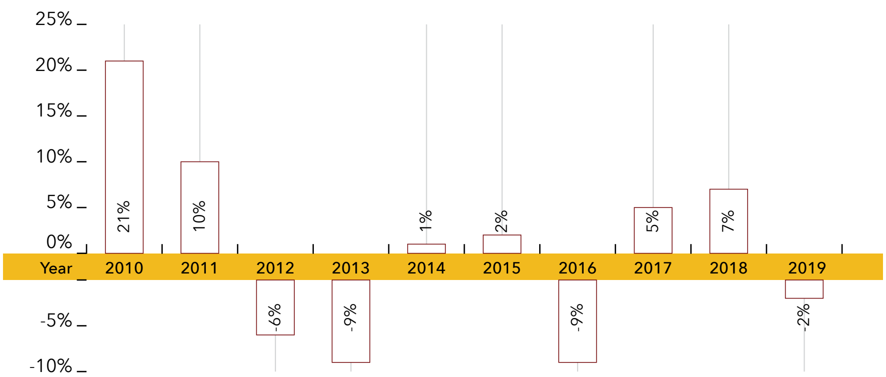
In parallel, tourism spending abroad by Lebanese citizens amounted to US$ 6.7 billion in 2019, its highest level since 2002, and increased by 6.6% from US$ 6.3 billion in 2018. It totaled US$ 1.4 billion in the first quarter, US$ 1.6 billion in the second quarter, US$ 2.2 billion in the third quarter and US$ 1.4 billion in the fourth quarter of 2019. In addition, outbound tourist spending was equivalent to 13% of GDP in 2019 relative to 11.4% of GDP in 2018.

As such, net revenues generated by tourism activity in Lebanon totaled US$ 1.9 billion in 2019, down by 10.3% from US$ 2.1 billion in 2018. Net tourism receipts in Lebanon in 2019 constituted their third lowest annual level between 2002 and 2019.

In parallel, spending by tourists in Lebanon, measured by the evolution of purchases on which visitors claimed value-added tax refunds, declined by 1.8% in 2019 compared to an increase of 6.5% in 2018. Spending by tourists in Lebanon rose by 12.2% year-on-year in the first quarter of 2019, by 10.7% in the second quarter, and by 5% in the third quarter of the year, while it dropped by 41% in the fourth quarter. Visitors from Saudi Arabia accounted for 14% of total spending in 2019 compared to a share of 12% in 2018, followed by visitors from the UAE with 11%, Kuwait and Syria with 8% each, Qatar with 7%, Egypt with 6%, France and the United States with 4% each, and Jordan and Iraq with 3% each. As such, visitors from Saudi Arabia, the UAE and Kuwait accounted for 33% of total tourism spending in 2019 relative to 43% in 2010. Specifically, visitors from Saudi Arabia accounted for 23% of total purchases in 2010, followed by visitors from Kuwait and the UAE with 10% each, Syria with 8% and Egypt with 7%, while other countries accounted for the remaining 42% of the total in 2010.

Further, spending by visitors from Iraq increased by 27% in 2019, followed by spending by tourists from Saudi Arabia (+21.2%), Qatar (+19.2%), and Kuwait (+6.4%). In contrast, spending by visitors from Jordan decreased by 23.7% last year, followed by spending by tourists from France (-15.7%), Syria (-14.3%), the United States (-10.7%), Egypt (-3.7%), and the UAE (-2.9%).

YEARLY CHANGE IN TOURIST SPENDING*



Source: Global Blue

* Based on the change in VAT refunds

TOURISM

The hospitality sector mirrored the evolution of tourist arrivals in 2019, with a divergence of trends between the first nine months of 2019 and the fourth quarter of the year. According to the EY Middle East Hotel Benchmark Survey, the occupancy rate at Beirut hotels averaged 71.6% in the first nine months of 2019, up by eight percentage points from 63.6% in the same period of 2018, supported by the increase in tourist arrivals. However, the developments in the fourth quarter of 2019 offset the improvement in the hospitality sector in the first three quarters. Consequently, the occupancy rate averaged 32.3% in the fourth quarter of the year, down by 37 percentage points from 69.3% in the same quarter of 2018, with rates of 54.7% in October, 18% in November and 24.2% in December 2019.

The average occupancy rate at hotels in Beirut was 61.7% in 2019, relative to 65.1% in 2018, the fourth lowest rate among 14 main Arab markets last year. The average rate per room at Beirut hotels increased by 6.8% to US$ 201 in 2019, while revenues per available room reached US$ 124 in Beirut compared to US$ 122 in 2018.

INFLATION

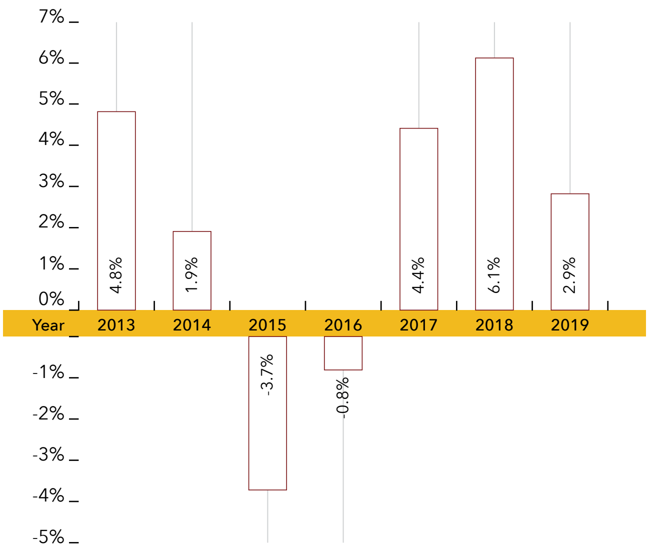
The Consumer Price Index (CPI) increased by 2.9% in 2019 compared to a growth rate of 6.1% in 2018, according to the Central Administration of Statistics. Most components of the CPI increased during 2019, except for the costs of healthcare and communication, the prices of water, electricity, gas and other fuels, as well as transportation cost, which were nearly unchanged from 2018. The increase in the CPI in 2019 mainly reflected a rise in the prices of clothing and footwear, furnishings and household equipment, recreation and entertainment costs, the cost of education, and the prices of alcoholic beverages and tobacco.

Specifically, the prices of clothing & footwear grew by 14.2% in 2019, followed by the prices of furnishings & household equipment (+7.6%), recreation & entertainment costs (+7.3%), the cost of education (+4.8%), the prices of alcoholic beverages & tobacco (+4.3%), and the prices of food & non-alcoholic beverages (+4.1%). Also, the cost of miscellaneous goods & services increased by 3.2% in 2019, actual rents rose by 2.7%, imputed rents grew by 2.2% and prices at restaurants & hotels increased by 1.6%. The distribution of actual rents shows that old rents grew by 3.8% in 2019, while new rents rose by 2% year-on-year. In parallel, gasoline and diesel prices decreased in the local market by about 7.5% in 2019.

Further, the CPI increased by 6.1% between September and December 2019, compared to a growth rate of 0.3% in the same period of 2018. The prices of alcoholic beverages & tobacco rose by 26.5% between September and December 2019, followed by the prices of furnishings & household equipment (+14%), food & non-alcoholic beverages (+11.8%), clothing & footwear (+11%), transportation (+9.6%), and recreation & entertainment costs (+6%). In addition, the cost of miscellaneous goods & services increased by 5%, education fees grew by 4%, the prices of water, electricity, gas and other fuels rose by 2.7%, prices at restaurants & hotels increased by 1.8%, communication costs grew by 1.4%, imputed rents rose by 0.8%, and actual rents increased by 0.7%. Healthcare costs were unchanged in the covered period.

Inflationary pressures intensified towards the end of 2019, with the CPI expanding by 7% in December 2019 from the same month of 2018. The increase in domestic prices that emerged toward the end of the year was due to the shortages of US dollar liquidity in the market, which led importers to source US dollars from money dealers, as well as to the insufficient monitoring by the authorities of some opportunistic merchants who took advantage of the market situation to increase their prices disproportionately.

INFLATION RATE IN LEBANON (%)



Source: Central Administration of Statistics

INFLATION

In parallel, the 2020 Cost of Living Index, which covers 2019 and is produced by crowd-sourced global database Numbeo, ranked the cost of living in Beirut as the 184th highest among 440 cities around the world and the third highest among 24 Arab cities. Also, the cost of living in Beirut was the highest among 108 cities in upper middle-income countries (UMICs) included in the survey. Based on the same set of cities included in the 2019 and 2020 surveys, Beirut ranked in 164th place in the 2020 survey relative to 172nd place in 2019, reflecting a relative increase in the cost of living. The Cost of Living Index is an indicator of the prices of consumer goods, such as groceries, meals & drinks at restaurants, transportation, and utilities. Numbeo benchmarks the Index against New York City. It also issues a Rent Index, which is an estimation of apartment rents in a city compared to New York City rents.

According to the index, rent in Beirut was 73.8% less expensive than in New York City, and was the seventh highest among Arab cities and the fifth highest among cities in UMICs in 2019. Also, prices of groceries in Beirut are 54.7% less expensive than in New York City, making Beirut the seventh most expensive city in the region and the 10th most expensive among cities in UMICs in terms of grocery prices in 2019. Prices of meals and drinks at restaurants and pubs in Beirut were 36.8% less expensive than they are in New York City, which makes the capital the fourth most expensive among Arab cities and the most expensive among cities in UMICs in terms of prices at restaurants and pubs for the year.

MONETARY POLICY

BDL increased its efforts in 2019 to maintain the stability of the exchange rate and of the economy, as well as safeguard the soundness of the banking sector. Challenges started to emerge early in the year following a statement attributed to the Minister of Finance about debt restructuring that caused outflows equivalent to about 1.3% of deposits from the banking sector in January. Pressure persisted in the following months amid political bickering, the government's increasing financing needs and limited policy action, persisting geopolitical tensions, successive downgrades of Lebanon's sovereign ratings, and the imposition of U.S. sanctions on a commercial bank, which increased deposit outflows from the banking sector throughout the first nine months of the year. In addition, the challenging conditions exerted some pressure on the foreign currency market and on the currency peg to the US dollar, as a parallel market started to emerge in the third quarter of the year. BDL's operations with commercial banks tried to offset the outflow of deposits, to contain the decrease in its stock of assets in foreign currencies, and to cover the government's foreign currency refinancing and debt-servicing needs, as well as the deficit of the country's external balance.

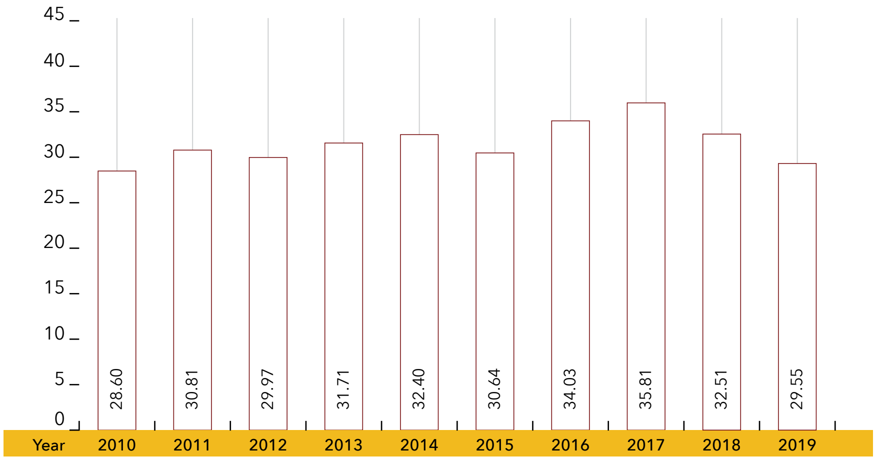
However, the eruption of the nationwide protests on October 17 and the accompanying uncertainties further weakened confidence. Consequently, deposit outflows and withdrawals accelerated, the spread between the official and the parallel exchange rates began to widen, and inflationary pressure started to build.

BDL's foreign assets reached US$ 36.4 billion at the end of June 2019, and decreased by US$ 3.3 billion, or by 8.3%, from US$ 39.7 billion at the end of 2018. The decline in foreign assets was due in part to BDL's payment on behalf of the government of US$ 2.15 billion to cover maturing principal and coupons on Lebanese Eurobonds in the first five months of 2019, including US$ 1.25 billion for maturing principal and coupons in May 2019, US$ 500 million for a Eurobond that matured in April 2019, and US$ 402 million for maturing coupons in the first four months of 2019.

BDL's incentives for commercial banks to attract deposits from abroad helped increase foreign assets by US$ 2.3 billion, or 6.3%, from end-June 2019 to US$ 38.7 billion at the end of August. However, the increase in BDL's foreign assets was short-lived following Fitch Ratings' downgrade of Lebanon's sovereign ratings on August 23, 2020, an Israeli drone attack on Beirut's southern suburbs on August 25, and the aforementioned imposition of U.S. sanctions on a commercial bank on August 29. In addition, Moody's Investors Service placed Lebanon's sovereign rating on review for possible downgrade on October 1 and subsequently downgraded it on November 4, while nationwide protests erupted on October 17. The political class failed to calm the streets and contain the collapse of confidence in the economy and financial system. As a result, BDL's foreign assets ended the year at US$ 37.3 billion and included US$ 5.7 billion worth of Eurobonds. Excluding Lebanese Eurobonds, BDL's assets in foreign currency stood at US$ 31.6 billion at the end of 2019. They decreased by US$ 264.2 million in September, by US$ 683.1 million in October, by US$ 2.1 billion in November, and by US$ 826.4 million in December, resulting in a cumulative decline of US$ 3.9 billion between the end of August and the end of the year. The decrease in BDL's assets in foreign currency since September was largely due to deposit outflows, the financing of basic imports, and the fact that BDL paid US$ 2.1 billion in external debt payments on behalf of the government in the second half of November 2019.

Overall, BDL's assets in foreign currency declined by US$ 2.4 billion in 2019, while the value of its gold reserves increased by US$ 2.2 billion to US$ 13.9 billion. The growth in the value of gold reserves was due to the increase in global gold prices during the year. BDL's combined assets in gold and foreign currencies were equivalent to about 89.3% of GDP at the end of the year. Lebanon held 286.8 tons of gold at the end of 2019, giving it the 20th largest gold stock in the world as well as the second largest among Arab countries.

GROSS FOREIGN CURRENCY RESERVES (USD Billions)



Source: Banque du Liban

Further, the interbank rate in Lebanese pounds ended each of the first eight months of 2019 at between 4% and 6%. However, it reached 25% at the end of September and 50% at the end of November, before ending the year at 5%. The fluctuations in the interbank rate, even in ranges that are not captured by the end-of-month values, reflect shortages of liquidity in Lebanese pounds at some banks following conversions of deposits to US dollars. The repo rate was unchanged at 10% throughout 2019.

Lebanon's worsening risk profile and deteriorating creditworthiness, the government's elevated financing needs, as well as higher global and regional interest rates, led to the increase in the interest rates on deposits in both local and foreign currencies. As such, the weighted interest rate on deposits in Lebanese pounds increased from 8.3% in December 2018 to 9.4% in November 2019, while the weighted interest rate on US dollar deposits rose from 5.15% in December 2018 to 6.31% in November. However, in response to the challenging conditions in the country since October 2019, BDL issued Intermediate Circular No. 536 on December 4, which capped the interest rates on bank deposits at 5% for foreign currencies and at 8.5% for Lebanese pounds. Consequently, the weighted interest rate on deposits in Lebanese pounds decreased to 7.36% in December 2019, while the same rate in US dollars declined to 4.62% in December 2019.

In parallel, money supply M1, which includes currency in circulation and demand deposits in Lebanese pounds, reached LBP 16,620 billion at the end of 2019, constituting a rise of 42.5% from LBP 11,661 billion at end-2018. Currency in circulation stood at LBP 9,818 billion at the end of 2019, up by 96% from LBP 5,008 billion at end-2018. Also, demand deposits in local currency stood at LBP 6,802 billion at the end of 2019, constituting an increase of 2.2% from end-2018. The substantial increase in currency in circulation took place in the fourth quarter of the year, with a rise of LBP 1,996 billion in November and of LBP 1,667 billion in December. This is due to the shift to a cash-based economy, the emergence of a parallel exchange market that allowed arbitrage opportunity, the monetization of the fiscal deficit, and restrictions on withdrawals from foreign currency-denominated deposit accounts.

In addition, money supply M2, which includes M1 and term deposits in Lebanese pounds, reached LBP 63,484 billion at the end of 2019, constituting a decrease of 17.4% from LBP 76,828 billion at the end of 2018. Term deposits in Lebanese pounds totaled LBP 46,864 billion at end-2019, down by 28.1% from LBP 65,167 billion at the end of 2018. The decline in term deposits in local currency is mostly due to the conversion of these deposits to US dollars. Further, broad money supply M3, which includes M2, deposits in foreign currency and debt securities issued by the banking sector, reached LBP 202,831 billion at the end of 2019, constituting a decrease of 4.8% from LBP 212,993 billion at the end of 2018. Deposits in foreign currency totaled LBP 138,910 billion at end-2019, up by 2.2% from end-2018. The increase in deposits in foreign currency is due the conversion of Lebanese pounds-denominated deposits into US dollars, and was limited by cash withdrawals in US dollars as well as by foreign transfers.

EXTERNAL SECTOR

The current account deficit reached US$ 11.5 billion, and was equivalent to 22.5% of GDP, in 2019, compared to a deficit of US$ 13.4 billion, or 24.3% of GDP, in 2018. The current account balance consists of the trade balance, which covers the exports and imports of merchandise, as well as the services balance that covers the export and import of transportation services, tourism, insurance and other services. The current account balance also includes remittance inflows, investment income and general government transfers. The current account deficit reached US$ 2.9 billion in the first quarter of 2019, US$ 3.1 billion in the second quarter, US$ 3 billion in the third quarter and US$ 2.5 billion in the fourth quarter.

The current account balance, a component of the balance of payments, has historically posted deficits due mostly to the deficit in the trade in merchandise goods. However, the trade deficit narrowed in 2019 and net remittance inflows surged, which supported the improvement in the balance of payments. In addition, the financial account improved in 2019, as net portfolio investments shifted from outflows in 2018 to inflows in 2019.

The trade deficit reached US$ 15.5 billion in 2019 and narrowed by 9% year-on-year, as the amount of imported goods decreased by 3.7% to US$ 19.2 billion and the value of exports grew by 26.4% to US$ 3.7 billion last year. The decline in imports was mainly due to a decrease of US$ 3.2 billion, or 20%, in non-hydrocarbon imports to US$ 12.6 billion in 2019. It was offset in part by an increase of US$ 2.4 billion, or 58.5%, in the imports of oil and mineral fuels to US$ 6.6 billion in 2019. The Ministry of Energy and Water claimed that the increase in the imports of mineral fuel and oil is due to a surge in fuel imported on behalf of Electricité du Liban (EDL), which reflected quantities that were imported in the past few years but that were officially registered as imports in 2019. According to the latest available figures, the ministry claimed that actual fuel imports in the first 10 months of 2019 totaled 2.25 million tons, while 3.63 million tons that were additionally registered to EDL during the same period consisted of fuel imports from previous years. Imports were equivalent to 37.5% of GDP and exports to 7.3% of GDP in 2019, leading to a trade deficit equivalent to 30.2% of GDP.

In parallel, the inflows of expatriates' remittances to Lebanon reached US$ 7.4 billion in 2019, constituting an increase of 6.2% from US$ 7 billion in 2018. Further, remittance inflows were equivalent to 14.4% of GDP in 2019 compared to 12.7% of GDP in 2018. In addition, remittance outflows from Lebanon amounted to US$ 4.3 billion, or 8.4% of GDP in 2019, down by 13.5% from US$ 5 billion, or 9.1% of GDP in 2018. As such, net remittance inflows to Lebanon reached US$ 3.1 billion in 2019, constituting a jump of 56% from US$ 2 billion in 2018. They were equivalent to 6% of GDP in 2019, compared to from 3.6% of GDP in 2018. Remittance inflows totaled US$ 1.6 billion in the fourth quarter of the year, their lowest level since the fourth quarter of 2012, while they averaged US$1.9 billion per quarter in the first three quarters of the year. Remittance outflows reached US$ 861 million in the fourth quarter of 2019, their lowest level since the third quarter of 2007, and compared to average outflows of US$ 1.2 billion in the first three quarters of the year.

In addition, tourist receipts amounted to US$ 8.6 billion in 2019, their highest level since 2002, constituting an increase of 2.3% from US$ 8.4 billion in 2018. They were equivalent to 16.8% of GDP in 2019, up from 15.3% of GDP in 2018 and relative to an annual average of 20% of GDP during the 2007-11 period. Further, outbound tourist spending reached a record high of US$ 6.7 billion in 2019, and increased by 6.6% from US$ 6.3 billion in 2018. The spending of Lebanese visitors abroad was

EXTERNAL SECTOR

equivalent to 13% of GDP in 2019 compared to 11.4% of GDP in 2018. As such, net tourist receipts totaled US$ 1.9 billion in 2019, and declined by 10.3% from US$ 2.1 billion in 2018. They were equivalent to 3.8% of GDP in 2019, slightly lower than 3.9% of GDP in 2018, and down from an annual average of 9.7% of GDP between 2002 and 2011.

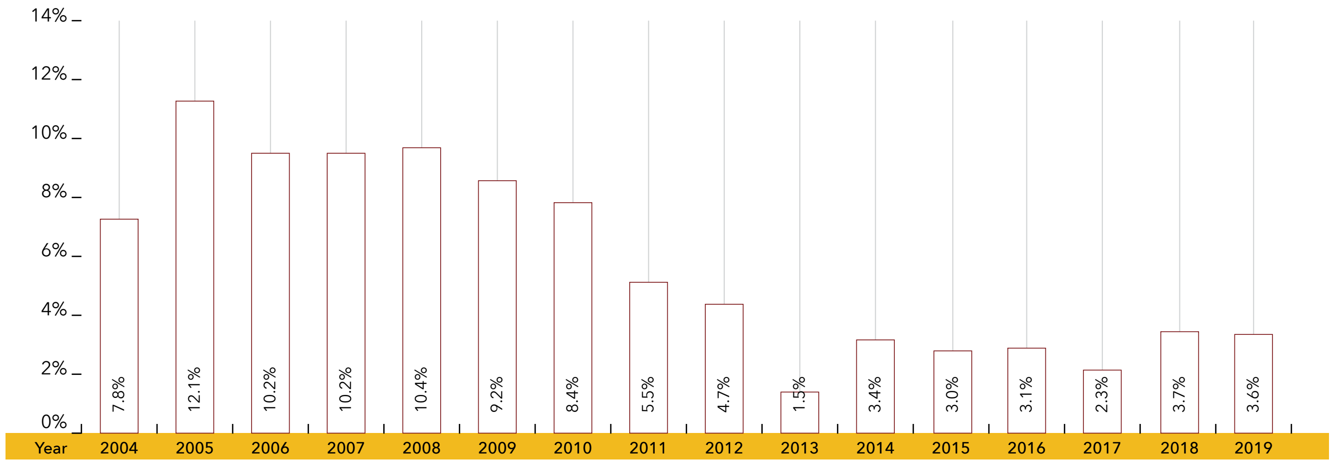
In parallel, Lebanon's capital account balance, which includes foreign grants, posted a surplus of US$ 998 million in 2019, down by 31% from a surplus of US$ 1.4 billion in 2018, and representing the lowest surplus since the US$ 179.2 million registered in 2012. It was equivalent to 1.9% of GDP in 2019 compared to 2.6% of GDP in 2018. Lebanon's capital account surplus averaged US$ 1.5 billion annually between 2013 and 2019 due to grants received to support Syrian refugees and host communities in the country, compared to an annual average of US$ 157.4 million between 2009 and 2012. The decrease in Lebanon's capital account surplus in 2019 is due in part to a decline in the inflows of cash grants to the country.

Further, Lebanon's financial account balance, which includes net foreign direct investment, net portfolio investments and other net investment, posted a surplus of US$ 7.7 billion in 2019, constituting an increase of 3.2 times from a surplus of US$ 1.8 billion in 2018. It was equivalent to 14.9% of GDP in 2019 compared to 3.3% of GDP in 2018. The improvement in the financial account is due to a shift in net portfolio investments from outflows of US$ 3.6 billion in 2018 to inflows of US$ 2.7 billion, or 5.3% of GDP, in 2019.

In contrast, foreign direct investments (FDI) in Lebanon totaled US$ 2.2 billion in 2019, constituting a decrease of 16.2% from US$ 2.7 billion in 2018. FDI inflows to Lebanon in 2019 reached their third lowest level on record, and remained below the peak of US$ 4.4 billion reached in 2009. They were equivalent to 4.3% of GDP in 2019, their lowest level on record. Also, FDI outflows from Lebanon amounted to US$ 354 million in 2019, down by 42% from US$ 611.3 million in 2018. They were equivalent to 0.7% of GDP in 2019 relative to 1.1% of GDP in 2018 and reached their second lowest level on record. As such, net FDI inflows to Lebanon totaled US$ 1.9 billion in 2019 and represented a decrease of 8.5% from US$ 2 billion in 2018. They were equivalent to 3.6% of GDP in 2019, nearly unchanged from 3.7% of GDP in 2018. In addition, the inflows of other investments declined by 9.8% from US$ 3.4 billion, or 6.2% of GDP, in 2018 to US$ 3.1 billion, or 6% of GDP, in 2019. Other investments include deposit flows to the banking sector.

In parallel, unrecorded transactions, or errors and omissions, stood at US$ 500 million in 2019 relative to US$ 7.8 billion in 2018. According to BDL, unrecorded transactions are in part due to the inadequate sources of data on some economic sectors. They include time and other adjustments for external trade payments, insurance services, migrants' transfers, travel services, transportation services, private sector direct investment, and portfolio investment. Finally, BDL's net foreign assets regressed by US$ 2.4 billion, or 4.6% of GDP, in 2019 relative to a decrease of US$ 2.3 billion, or 4.2% of GDP, in 2018.

NET FOREIGN DIRECT INVESTMENT (% of GDP)



Source: Banque du Liban, National Accounts, Byblos Research

PUBLIC FINANCES

Lebanon's public finance imbalances persisted in 2019, as the decline in public expenditures was in part offset by a decrease in public revenues. Spending items that continue to add to fiscal imbalances consist mainly of the compensation of public-sector employees, debt-servicing costs, and transfers to the state-owned and money-losing Electricité du Liban (EDL). As a result, the fiscal deficit narrowed from US$ 6.2 billion, or 11.4% of GDP in 2018, to US$ 5.8 billion, or 10.9% of GDP in 2019. The deficit was equivalent to 34.5% of total budget and Treasury expenditures relative to 35.1% of spending in 2018.

Public expenditures declined by 5% to US$ 16.9 billion in 2019, mostly due to a drop of US$ 643.5 million in general expenditures, including Treasury transfers to EDL, amid lower global oil prices. The decrease in public spending follows several cuts in major expenditure categories agreed on in the 2019 Budget Law. The compensation of public-sector personnel represented the largest component of the government's overall expenditures, as it accounted for 40% of fiscal spending in 2019, compared to 36% in 2018. In addition, debt servicing accounted for about 33% of total expenditures in 2019, while transfers to EDL represented nearly 9% of the total. The public sector's personnel cost expanded by US$ 283.3 million or 4.4% to US$ 6.7 billion in 2019, debt servicing regressed by 1.1% to US$ 5.55 billion, and transfers to EDL declined by 14.3% to US$ 1.5 billion. In parallel, capital expenditures decreased by 25.6% to US$ 682 million in 2019 mainly due to a drop in the expenditures on the "construction in progress" item, and accounted for 4% of total spending; while Treasury expenditures regressed by 8.4% to US$ 1.08 billion in 2019 (4.2% of total spending).

The compensation of public sector personnel reached the equivalent of 12.6% of GDP in 2019 relative to 11.7% of GDP in 2018, while debt servicing cost was at 10.4% of GDP, unchanged from 2018. Also, transfers to EDL were equivalent to 2.8% of GDP in 2019 relative to 3.2% of GDP in 2018. Public personnel cost was the fastest-growing component of fiscal spending over the past nine years, as it expanded by 100% between 2010 and 2019, compared to a growth rate of 26.3% for Treasury transfers to EDL and of 34.2% for debt servicing. Overall, public spending regressed from the equivalent of 32.4% of GDP in 2018 to 31.5% of GDP in 2019.

In parallel, public revenues regressed by 4.2% to US$ 11.1 billion in 2019, mostly due to weakening economic activity, tax evasion, and poor revenue mobilization. The decline in government revenues took place despite the authorities' revenue-raising measures adopted in the 2019 Budget Law, which include raising the tax on interest income from 7% to 10% and a 3% tax on imports, with some exemptions on specific imported products. In fact, the new tax measures backfired as they exacerbated tax evasion in the country, increased operating costs for companies and further depressed domestic consumption and overall economic activity. As such, the decrease in public revenues was mainly the result of a drop in the value added tax and cars excise tax, as well as lower receipts from telecommunications services. In contrast, the receipts from the tax on interest income significantly increased but were not enough to offset the decline in the other tax categories. Consequently, public revenues regressed from 21% of GDP in 2018 to 20.6% of GDP in 2019.

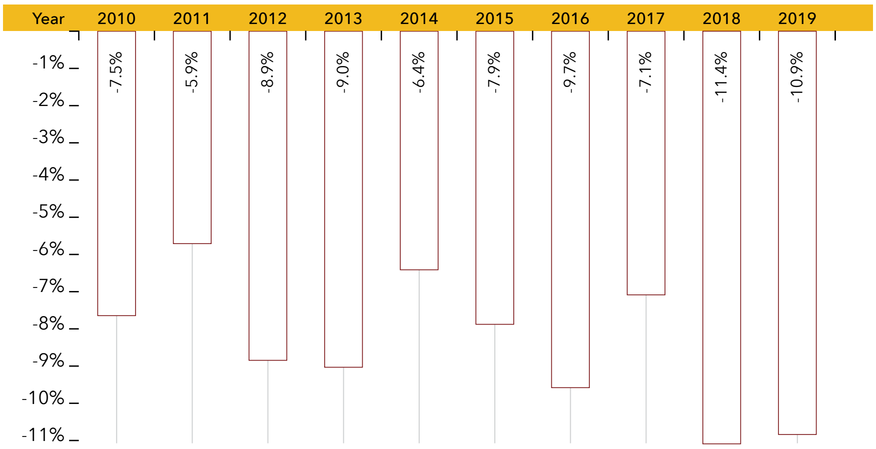
Tax revenues decreased by 1.8% to US$ 8.3 billion in 2019, of which 26%, or US$ 2.2 billion, were in value-added tax receipts that increased by 15.2% year-on-year. Taxes accounted for 79% of budgetary revenues and for 75.1% of Treasury and budgetary income for the year. The distribution of other tax revenues shows that receipts from taxes on income, profits & capital gains rose by 21% annually to US$ 3.6 billion in 2019, while revenues from customs regressed by 11.1% to US$ 1.2 billion. Also, receipts from property taxes dropped by 24.6% to US$ 569.4 million; while revenues from taxes on goods & services regressed by 4% to US$ 420.1 million and proceeds from stamp fees declined by 10.8% to US$ 356.4 million.

In addition, the distribution of tax receipts from income, profits & capital gains shows that the tax on interest income accounted for 51.5% of income tax revenues in 2019, followed by the tax on profits with 25.3%, taxes on wages & salaries with 16%, and the capital gains tax with 6.6%. Receipts from the tax on interest income surged by 56% in 2019, and accounted for 22.3% of total tax revenues. Tax on interest income was one of the few taxes that posted an increase in revenues, mostly as a result of the increase in the corresponding tax rate from 7% to 10% in the 2019 budget. Also, revenues from taxes on profits expanded by 1.4% last year, while revenues from taxes on capital gains declined by 13.2% and proceeds from taxes on wages & salaries were unchanged in 2019.

Tax revenues were equivalent to 15.5% of GDP in 2019, nearly unchanged from 2018. In comparison, aggregate tax receipts were equivalent to 15% of GDP during the 2010-18 period, which demonstrates that the across-the-board and arbitrary tax hikes that went into effect in 2018 failed to generate additional revenues and hurt economic activity.

Further, non-tax budgetary receipts decreased by 2% to US$ 2.2 billion in 2019. They mainly included US$ 1.4 billion in revenues generated from government properties that regressed by 1.5%, as well as US$ 564.8 million in receipts from administrative fees and charges that declined by 10% annually. Also, receipts from telecommunication services dropped by 11.5% from 2018 to US$ 947.2 million, and accounted for 66.2% of income from government properties and for 42.6% of non-tax budgetary revenues. Non-tax budgetary receipts were equivalent to 4.2% of GDP in 2019, unchanged year-on-year.

FISCAL BALANCE (% of GDP)



Source: Ministry of Finance, Central Administration of Statistics, Byblos Research

The widening of the fiscal deficit exacerbated Lebanon's debt dynamics, as the gross public debt reached US$ 91.6 billion at the end of 2019, constituting a rise of 7.1% from US$ 85.1 billion at the end of 2018 and compared to increases of 7% in 2018 and 6.2% in 2017. In nominal terms, the gross public debt grew by US$ 6.5 billion in 2019, relative to increases of US$ 5.6 billion in 2018 and of US$ 4.64 billion in 2017. The public debt level was equivalent to 179% of GDP in 2019 relative to 155% of GDP in 2018. Further, the net public debt, which excludes public sector deposits at BDL and at commercial banks from overall debt figures, grew by 7.3% annually to US$ 81.2 billion at end-2019, and was equivalent to 158% of GDP.

Debt denominated in Lebanese pounds totaled US$ 57.9 billion at the end of 2019, growing by US$ 6.25 billion or by 12.1% from end-2018; while debt denominated in foreign currency stood at US$ 33.7 billion, constituting an expansion of US$ 249.4 million or 0.7% from end-2018. The increase in local-currency debt was mostly due to the Ministry of Finance's issuance in November and December of LBP 1,500 billion and LBP 3,000 billion 10-year Treasury bonds, respectively, at a rate of 1%, which were entirely subscribed by BDL. The two issuances were part of a deal between the MoF and BDL, which stipulated that the MoF issues U$ 3 billion worth of Eurobonds to BDL to cover external debt payments that the latter made on behalf of the government throughout the year, while BDL would subscribe to LBP 4,500 billion worth of Treasury bonds.

The distribution of outstanding Treasury securities denominated in Lebanese pounds at end-2019 shows that 15-year Treasury bonds accounted for 1.7%, or LBP 1,417 billion, of total securities in Lebanese pounds; 12-year Treasury securities represented 3.6% of the total (LBP 3,076 billion), and 10-year Treasury bonds had a share of 35.4% (LBP 30,312 billion). Also, the share of eight-year Treasury securities was 2.1% (LBP 1,832 billion), seven-year Treasury bonds represented 18.2% (LBP 15,555 billion), five-year Treasury securities accounted for 23.4% (LBP 20,086 billion), the share of three-year Treasury bonds was 10.6% (LBP9,086 billion), two-year Treasury bills represented 3.8% (LBP 3,299 billion), one-year T-bills accounted for 1.1% (LBP 939 billion), the share of six-month T-bills was 0.1% (LBP 72 billion), and three-month T-bills represented 0.03% (LBP 26 billion). As such, 61% of outstanding Treasury securities had seven-year maturities or longer and 84.3% had five-year maturities or more as at the end of 2019.

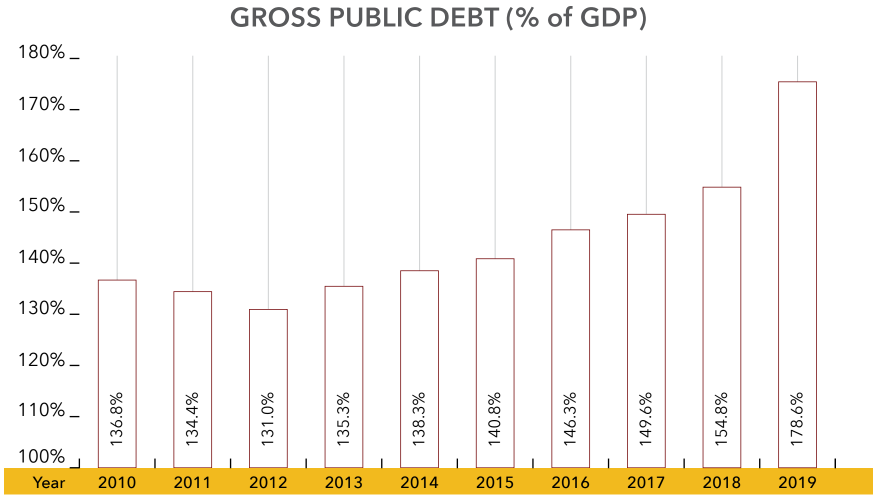
PUBLIC FINANCES

According to the Association of Banks in Lebanon, LBP 11,245 billion, or the equivalent of US$ 7.5 billion in outstanding Treasury bonds in Lebanese pounds, will mature in 2020; while LBP 8,832 billion (US$5.9 billion) will come due in 2021.

Local currency debt accounted for 63.2% of the public debt at end-2019 compared to 60.7% a year earlier, while foreign currency denominated debt represented the balance of 36.8% relative to 39.3% at end-2018. The local currency debt stood at 110.9% of GDP, while foreign currency denominated debt would represent 64.6% of GDP at the end of 2019. The weighted interest rate on Lebanese Treasury securities denominated in Lebanese pounds was 6.44% in December 2019 compared to 6.11% in December 2018. Also, the weighted life of Treasury bills and bonds was 1,772 days at the end of 2019 compared to 1,628 days a year earlier.

The structure of the public debt shows that BDL held nearly 43% of the public debt at the end of 2019, followed by commercial banks (33.4%), and non-bank resident financial institutions (8.1%), while other investors, including foreign investors, held 13.3% of the debt, and multilateral institutions and foreign governments held 2.2%. In addition, BDL held 58% of the Lebanese pound-denominated public debt at the end of 2019 compared to 50% a year earlier, while commercial banks held 29% of the local debt compared to 35.2% at end-2018. Also, public agencies, financial institutions and the public held 13% of the local debt at end-2019 relative to 14.7% at end-2018. Further, holders of Eurobonds and special T-bills in foreign currencies accounted for 94% of foreign currency-denominated debt holders at the end of 2019, followed by multilateral institutions with 4.1% and foreign governments with 1.9%. The banking sector, including BDL, held nearly 62% of Lebanon's Eurobonds at the end of 2019. The weighted interest rate on Eurobonds was 7.38% in December 2019 relative to 6.81% in December 2018. Also, the weighted life of Eurobonds was eight years at the end of 2019 relative to 7.83 years at end-2018.

Lebanon's gross market debt accounted for nearly 54% of the total public debt at the end of 2019. Gross market debt is the total public debt less the portfolios of BDL, the National Social Security Fund, bilateral and multilateral loans, as well as Paris III related debt. As such, the gross market debt was equivalent to about 97% of GDP compared to a gross public debt level of 179% of GDP in 2019.



Source: Ministry of Finance, Central Administration of Statistics, Byblos Research

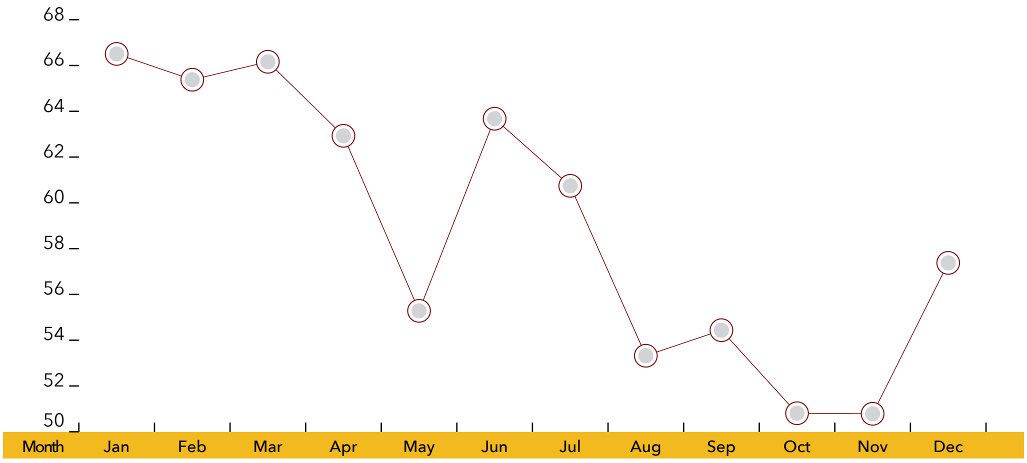
CAPITAL MARKETS

The Beirut stock market continued to suffer from low liquidity and a lack of interest from privately-held and family-owned firms in listing their shares. In addition, stock prices maintained their downward trend in 2019, mainly due to reduced investor sentiment caused by heightened uncertainties, which prompted a wave of selling by shareholders. Total trading volume on the Beirut Stock Exchange (BSE) reached 199.6 million shares in 2019, constituting an increase of 121.7% from 90 million shares traded in 2018, while aggregate turnover amounted to US$ 901.6 million, up by 42.3% from a turnover of US$ 633.6 million in 2018. However, the surge in trading volume and turnover was mostly due to two block trades amounting to US$ 563.2 million in the shares of two listed banks.

Market capitalization regressed by 19.8% from the end of 2018 to US$ 7.8 billion at end-2019, with banking stocks accounting for 81.3% of total market capitalization, followed by real estate shares (15.5%), industrial firms (2.8%), and trading stocks (0.5%). The market liquidity ratio was 11.6% in 2019, up from 6.5% in 2018. Further, market capitalization was equivalent to about 15% of GDP in 2019, the third lowest level among 14 Arab markets, and accounted for about 0.2% of the aggregate market capitalization of Arab equity markets at the end of the year.

Banking stocks accounted for 96.7% of the aggregate trading volume in 2019, followed by real estate equities with 3.2% and industrial shares with 0.05%. Also, banking stocks represented 95.6% of the aggregate value of traded shares, followed by real estate equities with 4.3% and industrial stocks with 0.1%. The average daily traded volume for 2019 was 879,255 shares for an average daily value of US$ 4 million. The figures show an increase of 2.3 times in the average volume and a rise of 50.4% in the average value of traded shares in 2019. In parallel, the Capital Markets Authority's Market Value-Weighted Index for stocks traded on the BSE dropped by 18.2% in 2019, while its Banks Market Value-Weighted Index regressed by 36.8

MARKET VALUE-WEIGHTED STOCK INDEX (2019)



Source: Capital Markets Authority

RISK METRICS

According to Intercontinental Exchange's Credit Market Analysis, spreads on five-year credit default swaps (CDSs) for Lebanon ended 2019 at 3,432 basis points (bps), up from 774.5 bps at the end of 2018. The spreads ranged between 600 bps and 900 bps in the first seven months of 2019, before breaking the 1,000 bps barrier towards mid-August. Investor and market concerns started to increase significantly in September 2019 following a series of domestic and external events that negatively affected confidence. These events include repeated increases in taxes on interest rates on deposits, the listing of a local bank on the OFAC list of the U.S. Department of the Treasury, as well as increased tensions with Israel. Also, higher demand for US dollars, especially at money dealers, which led to the emergence of a parallel exchange rate, as well as deposit withdrawals from the banking sector as depositors started to hoard cash in their homes, reflected a rise in perceived risks. The widening of the spreads accelerated in the aftermath of the October 17 protests, with the one-year CDS for Lebanon reaching about 7,000 bps at the end of 2019.

The worsening of fiscal and external imbalances, inadequate policymaking, as well as deposit outflows and the eruption of nationwide protests on October 17 led to successive downgrades of the sovereign ratings. Talks about debt restructuring towards the end of the year further exacerbated the pressure on Lebanon's creditworthiness. As a result, Moody's Investors Service downgraded Lebanon's issuer rating from 'B3' to 'Caa1' in January 2019, then to 'Caa2' in November 2019, and kept the rating on review for possible downgrade. Also, Fitch Ratings lowered in August 2019 Lebanon's long-term foreign and local currency Issuer Default Ratings from 'B-' to 'CCC', and then to 'CC' in December 2019. In addition, S&P Global Ratings downgraded in November 2019 Lebanon's long-term sovereign ratings from 'B-' to 'CCC' with a 'negative' outlook on the ratings. Further, Capital Intelligence Ratings reduced in November Lebanon's long-term foreign currency ratings from 'B-' to 'C+', and maintained the 'negative' outlook on the ratings.

BANKING SECTOR

The banking sector faced heightened challenges in 2019, including declines in consumer and investor confidence, the deteriorating creditworthiness of the sovereign, and U.S. sanctions on a commercial bank, as well as delays in reforms and a systematic campaign against banks, which resulted in deposit outflows, the conversion of deposits in local currency to US dollars, and the hoarding of cash at households. These factors converged simultaneously towards the end of the year and culminated in a liquidity crisis for banks. In addition, the banking sector was adversely affected by the slow economic activity in Lebanon, the impact of higher and arbitrary taxes that included the double taxation of the banks' income, tighter margins, and fewer lending opportunities domestically, as well as the elevated borrowing needs of the Lebanese government. In addition, the contraction in economic activity since 2018, along with the challenging operating environment and the uncertainties that followed the October 17 protests, started to have a negative impact on the quality of the banks' loan portfolios. Further, the banks' exposure to the sovereign, in terms of their holdings of Treasury bills, Eurobonds, and Certificates of Deposits issued by BDL, entailed increasing provisions amid the weakening credit profile of the sovereign.

In response to the intensifying challenges, banks operating in Lebanon took temporary measures on banknote withdrawals, on foreign transfers, and on some other banking operations, as they were hoping the executive branch to take the initiative to implement the necessary measures such as enacting a capital controls law, and reassure the markets. Banks had to take these measures to cope with the liquidity challenges in the financial sector that resulted from the drop in confidence in the Lebanese economy and political system. The new limits applied only to existing deposits at banks, and exempted incoming transfers or new cash deposits.

There were 47 commercial banks operating in Lebanon at the end of 2019, down from 49 banks at end-2018, with 1,058 branches across Lebanon at end-2019 relative to 1,080 branches a year earlier. A such, there were 101 branches of commercial banks per 1,000 square kilometers in Lebanon in 2019, compared to 103 branches per 1,000 square kilometers in 2018. Also, there were 22.1 bank branches per 100,000 individuals in Lebanon in 2019, unchanged from 2018. The challenging operating environment affected the number of bank employees, as there were 24,886 persons employed at banks operating in the country at the end of 2019, constituting a decrease of 1,022 individuals from 25,908 persons at end-2018, according to the Association of Banks in Lebanon.

The aggregate assets of commercial banks in Lebanon reached US$ 216.8 billion at the end of 2019, constituting a decrease of US$ 42.9 billion from the end of November 2019, and relative to US$ 249.5 billion at the end of 2018. The decline in assets is mainly due to the ''netting" on the assets and liabilities sides of the consolidated balance sheet of commercial banks as part of the implementation of the new international accounting standard IFRS 7. As such, banks have offset the loans in Lebanese pounds that they took from BDL with their corresponding placements in Lebanese pounds at BDL that carry the same maturities. The sector's assets were equivalent to 423% of GDP at the end of the year, one of the highest such ratios in the world.

Loans to the private sector reached US$ 49.8 billion, or 97% of GDP, at the end of 2019, constituting a decline of 16.2% from end-2018 and accounting for 23% of total assets. Loans to the resident private sector totaled US$ 44.2 billion (86% of GDP), and declined by 15.4% from the end of 2018, while credit to the non-resident private sector reached US$ 5.6 billion at end-2019, down by 21.7% from a year earlier. In nominal terms, credit to the private sector contracted by US$ 9.6 billion in 2019, as lending to the resident private sector retreated by US$ 8.1 billion and credit to the non-resident private sector regressed by US$ 1.5 billion during the year. The decline in lending to the private sector was mostly due to clients' decisions to settle their loans prior to maturity, and to the banks' risk aversion amid the challenging conditions in the country. In addition, lending to the private sector continued to be adversely impacted by the limited lending opportunities in the local market, the elevated interest rates that discouraged customer demand for credit, and some companies reducing their credit exposure. In fact, subdued activity in the country weighed on the cash flows of companies and affected their ability to service credit facilities. Lending to the private sector was equivalent to 91.2% of GDP at the end of 2019 relative to 108.1% of GDP a year earlier.

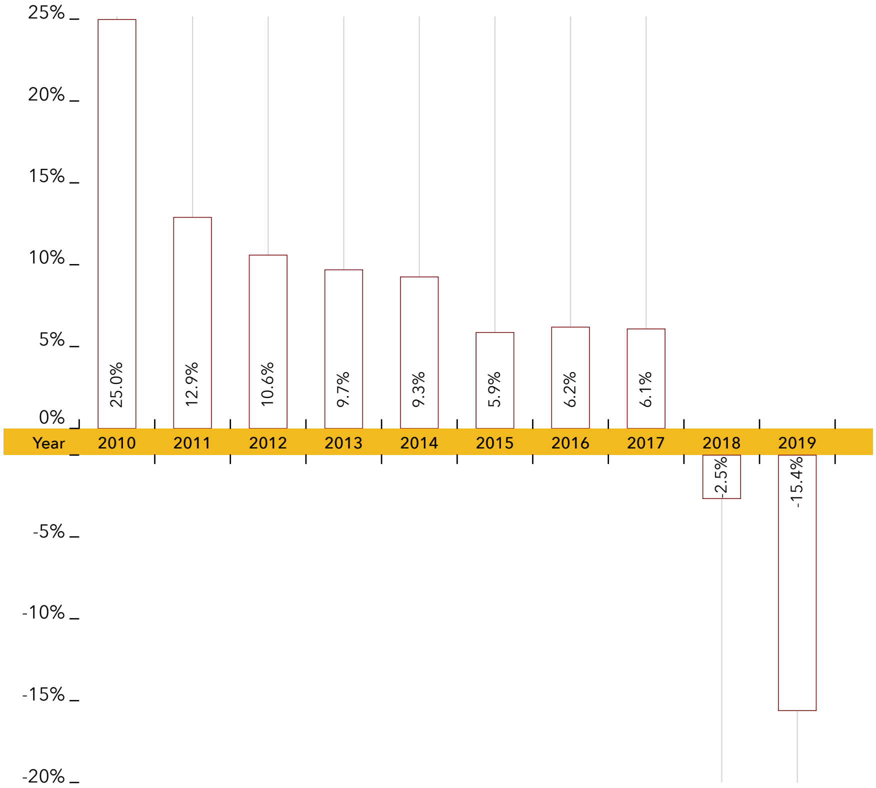
The weighted average lending rate in Lebanese pounds was 9.09% in December 2019 compared to 9.97% a year earlier, while the same rate in US dollars was 10.84% relative to 8.57% in December 2018. The decrease in the banks' lending rates follows the same trend of the interest rates on deposits. Also, the dollarization rate in private sector lending declined from 69.2% at end-2018 to 68.7% at end-2019 mostly due to BDL's introduction in August 2018 of a 25% ceiling on the banks' loans-to-deposits ratio in Lebanese pounds. In fact, banks encouraged their customers to convert their loans in Lebanese pounds to US dollars in order to comply with BDL's new requirements. Also, BDL allowed customers to reschedule loans that were extended under BDL's stimulus packages if the loan was originally granted in Lebanese pounds and the client converted it to US dollars.

Private sector lending activity during the year shows that utilized credits for trade & services reached US$ 19.65 billion and accounted for 33% of aggregate credit at the end of 2019; followed by personal loans with US$ 18.67 billion (31.3% of the total) that include mortgages with US$ 12.17 billion (20.4% of total utilized credits); construction with US$ 9.88 billion (16.6%); industry with US$ 6.4 billion (10.8%); financial intermediaries with US$ 2.47 billion (4.1%); and agriculture with US$ 753.75 million (1.3%); while other sectors represented the remaining US$ 1.7 billion (2.9%). Also, the distribution of utilized credits in trade & services shows that wholesale trade accounted for 50.2% of overall trade & services credits at the end of 2019, followed by retail with 17%; real estate, rent & employment services with 14.1%; hotels & restaurants with 7.6%; transport & storage with 6.7% and educational services with 4.4%.

In addition, utilized credits by financial intermediaries declined by 20.4% in 2019, followed by utilized credits for trade & services (-17%), industry (-16%), personal loans (-11.7%) that include mortgages (-5.6%), construction that covers contractors, sub-contractors and developers (-11.4%), and agriculture (-4.5%), while utilized credits for other sectors decreased by 15.4% annually in 2019.

However, the non-performing loans ratio on utilized credits deteriorated from 13.8% at end-2018 to 19.6% at the end of 2019, reflecting the deleveraging process that led to the decline in the volume of loans, as well as the emergence of difficulties of borrowers in several sub-sectors to repay their loans on time.

RESIDENT PRIVATE SECTOR LENDING GROWTH (% Change)



Source: Association of Banks in Lebanon, Byblos Research

Further, the banking sector's claims on the public sector stood at US$ 28.7 billion at the end of 2019, down by US$ 4.9 billion or 14.6% from a year earlier, and accounted for 13.2% of the banking sector's total assets. Also, commercial banks' deposits at BDL totaled US$ 117.7 billion at end-2019, as they decreased by US$ 37.5 billion from end-November 2019 following the netting operation and by US$ 12.5 billion or by 9.6% from a year earlier, and accounted for 54.3% of the sector's aggregate assets.

In addition, the banks' immediate liquidity, which includes claims on non-resident financial institutions and deposits with non-resident central banks, stood at US$ 7.36 billion at the end of 2019, down by US$ 5.62 billion, or by 43.3%, from end-2018, reflecting a decrease in the banks' foreign currency buffers. The decline in the banks' deposits abroad is due to the fact that banks have been using their own liquidity to meet their clients' requests for foreign transfers foreign transfers amid sustained cash withdrawals.

In parallel, aggregate deposits of the private sector totaled US$ 158.9 billion at the end of 2019 and decreased by US$ 15.42 billion, or 8.8%, from end-2018, relative to a growth of US$ 5.62 billion, or 3.3%, in 2018. The socioeconomic crisis that intensified during the fourth quarter of 2019 led to significant deposit outflows from the banking sector and increased the pressure on the banks' liquidity. As such, private sector deposits regressed by US$ 4 billion in the first nine months of 2019, while they dropped by US$ 11.4 billion between October and December 2019. The decline in private sector deposits was mainly due to deposit outflows and to the hoarding of banknotes at households, amid the exacerbating confidence crisis. Still, private sector deposits were equivalent to 310% of GDP in 2019, one of the highest such ratios in the world.

Deposits in Lebanese pounds reached the equivalent of US$ 38.1 billion, and regressed by 25.6% from end-2018, while deposits in foreign currencies totaled US$ 120.8 billion, and decreased by 1.9% from end-2018. The decline in Lebanese pound deposits was mostly due to the drop in depositors' confidence that triggered conversions to US dollars. Resident deposits totaled US$ 126.4 billion at the end of 2019 and decreased by US$ 10.1 billion, or 7.4% from the end of 2018. Also, non-resident deposits reached US$ 32.5 billion at end-2019, and dropped by US$ 5.3 billion or 14% from end-2018. In nominal terms, private sector deposits declined by US$ 2.18 billion in January, by US$ 133 million in

February, by US$ 1.86 billion in May, by US$ 2.24 billion in September, by US$ 1.94 billion in October, by US$ 5.77 billion in November and by US$ 3.7 billion in December; while they increased by US$ 550.6 million in March, by US$ 186.4 million in April, by US$ 1.28 billion in June, by US$ 220.6 million in July and by US$ 190 million in August 2019. As such, aggregate private sector deposits regressed by US$ 15.4 billion in 2019 relative to an increase of US$ 5.6 billion in 2018, with deposits in Lebanese pounds dropping by US$ 13.1 billion and foreign-currency deposits declining by US$ 2.3 billion.

The distribution of bank deposits at commercial banks in Lebanon shows that term deposits in all currencies reached US$ 149.7 billion while demand deposits in all currencies stood at US$ 22.9 billion at the end of 2019. Term deposits in all currencies declined by 10.5% from US$ 167.3 billion at end-2018. Term deposits were the preferred type of account for resident and non-resident depositors in Lebanese pounds and in foreign currency at the end of 2019, as they accounted for 86.7% of total deposits in Lebanese pounds and in foreign currency at end-2019 relative to a share of 89.1% at end-2018.

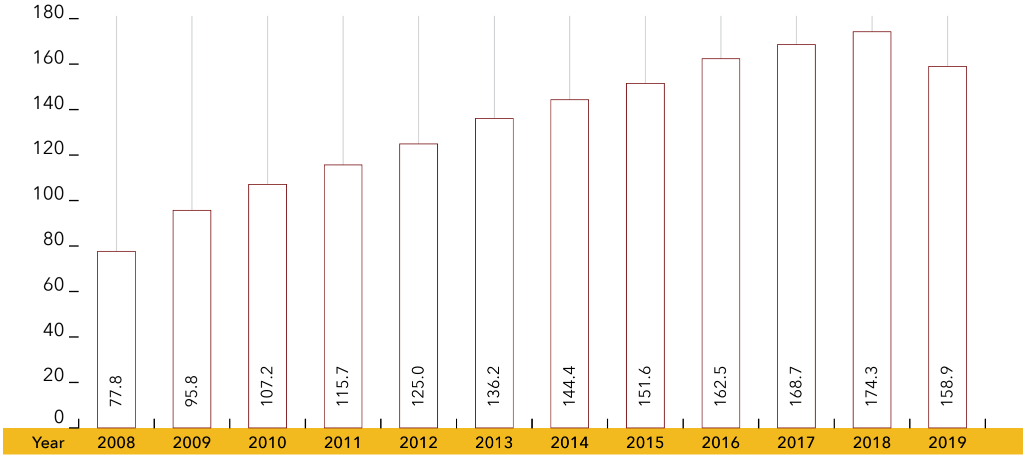
The decrease in term deposits was due to a year-on-year drop of 28.6% in term deposits of the resident private sector in Lebanese pounds, a 15% decline in term deposits of non-residents, a 4.2% fall in term deposits of the non-resident financial sector and a 0.8% retreat in term deposits of the resident private sector denominated in foreign currency. This was partly offset by a surge of 102.3% in term deposits of the public sector in foreign currency and an 11.4% increase in term deposits of the public sector in Lebanese pounds. Also, aggregate term deposits fell by US$ 17.6 billion in 2019, with term deposits of the resident private sector in Lebanese pounds falling by US$ 12.1 billion and term deposits of non-residents declining by US$ 5.2 billion. The drop in terms deposits of the resident private sector in Lebanese pounds reflects cash withdrawals, deposit conversion from local to foreign currency and the migration of funds from term to demand deposits.

Term deposits of the resident private sector denominated in foreign currency amounted to US$ 78.9 billion and accounted for 45.7% of total deposits at the end of 2019. Term deposits of the resident private sector in Lebanese pounds followed with US$ 30.2 billion (17.5%), then term deposits of non-residents with US$ 29.3 billion (17%), term deposits of the non-resident financial sector with US$ 6.8 billion (4%), term deposits of the public sector in Lebanese pounds with US$ 4.1 billion (2.4%), and term deposits of the public sector in foreign currency with US$ 321 million (0.2%).

In parallel, demand deposits in all currencies rose by 11.5%, or by US$ 2.37 billion, from US$ 20.5 billion at end-2018. They accounted for 13.3% of total deposits in Lebanese pounds and in foreign currency at end-2019 relative to a share of 10.9% at end-2018. The increase in demand deposits was due to a growth of US$ 2.43 billion in demand deposits of the resident private sector denominated in foreign currency and a rise of US$ 145.3 million in demand deposits of the resident private sector in Lebanese pounds, which were partly offset by a drop of US$ 130.3 million in demand deposits of the non-resident financial sector and a decline of US$ 117.2 million in demand deposits of non-residents.

The dollarization rate of private sector deposits rose throughout the year, with most of the increase occurring in the fourth quarter of 2019 amid the economic and financial crisis facing the country. In fact, the dollarization rate of private sector deposits stood at 72% at end-August, 72.9% at end-September, 73.4% at end-October, 74.7% at end-November 2019 and reached 76% at the end of 2019 relative to 70.6% at end-2018. In parallel, deposits of non-resident financial institutions reached US$ 8.8 billion at the end of 2019, constituting a drop of 4.7% from end-2018.

PRIVATE SECTOR DEPOSITS (USD Billions)



Source: Association of Banks in Lebanon, Byblos Research

The ratio of private sector loans to deposits in foreign currencies stood at 28.3% at the end of 2019, well below BDL's limit of 70%, and compared to 33.4% a year earlier. In parallel, the same ratio in Lebanese pounds was 40.9% at end-2019 relative to 35.7% at the end of 2018. As such, the total private sector loans-to-deposits ratio reached 31.3% at end-2019, down from 34.1% at end-2018. Further, the banks' aggregate capital base stood at US$ 20.7 billion at the end of 2019, up by 2.8% from a year earlier, with core capital growing by 3.7% to US$ 19.4 billion.

Commercial banks declare their income in full to tax authorities. They also pay all of their taxes and the taxes dues on the wages and salaries of their employees, as part of their full compliance with laws, rules and regulations. This has exposed the level of tax evasion in the economy, as revenues from the corporate tax that the banking sector pays account for about 60% the government's receipts from the corporate income tax. Also, the banking sector generates 33% of public revenues from the capital gain tax. In addition, the tax on wages and salaries of employees in the banking sector accounts for nearly 20% of the Treasury receipts from this tax, according to the calculations of the Association of Banks in Lebanon. As such, the decline in the number of bank employees and the decrease in the income of commercial banks resulted in a drop in the government's tax receipts and in overall public revenues, which limited the narrowing of the fiscal deficit in 2019.

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