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Report | **Lebanon's Macro Economy For The Year 2019**

I. General Introduction

The Lebanese economy experienced several adverse developments on the political, financial, economic, and social fronts in 2019. On the political front, the government resigned, and a new (technocrat) government was formed, which is striving to handle an unprecedented socio-economic crisis. On the financial front, the fiscal deficit and indebtedness continue their growth trajectory. In addition, the year 2019 saw a strong bank run due to negative economic prospects and loss of confidence on all levels. In addition, capital inflows declined, still with a high level of trade deficits, thus fueling further deficits in the balance-of-payments. On the social front, civil protests have emerged against the domestic authorities and politicians, corruption and waste of public funds, increased poverty and unemployment, and growing youth immigration and brain drain.

The current aggregate crisis on all fronts has caused the national economy to go into deep recession, with a negative real growth recorded in 2019 following 2018.

To halt these deteriorating socio-economic conditions in Lebanon, the current government must implement, quickly, radical economic, financial and social reforms in order to restore overall confidence, recover the national economy, stabilize and grow the banking sector, support economic sectors which are suffering, control the growth of fiscal deficits and debt, downsize the country's huge trade deficit, attract foreign capital and aid, and lessen the prevailing social unrest.

II. Macroeconomic Performance

Lebanon's macroeconomic system was under unprecedented pressures in 2019, due to the above-mentioned political, economic, social, fiscal and banking conditions.

A- Economic Growth

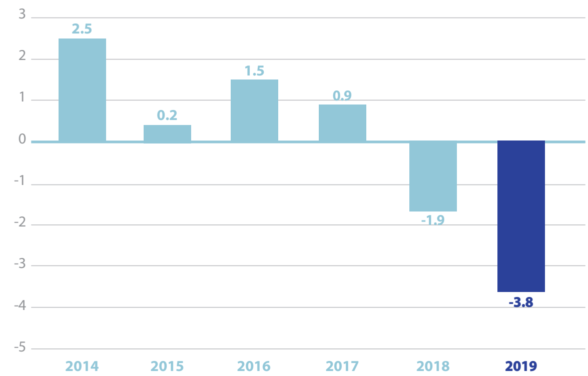
Lebanon experienced a contraction in its economic activity in 2019, with the real growth rate of GDP estimated at a negative of nearly 3.8%, following a lower economic contraction of nearly 1.9% in 2018, according to the estimates of the Institute of International Finance (IIF).

This negative real GDP growth was driven mainly by the shrinking private consumption spending (nearly 3.3%), and private investment spending (nearly 6%). This reflects a deteriorating performance on the part of the private sector, due to deteriorating business conditions during 2019, and especially during its fourth quarter. Economic activity is estimated to have regressed by nearly 10% during that quarter.

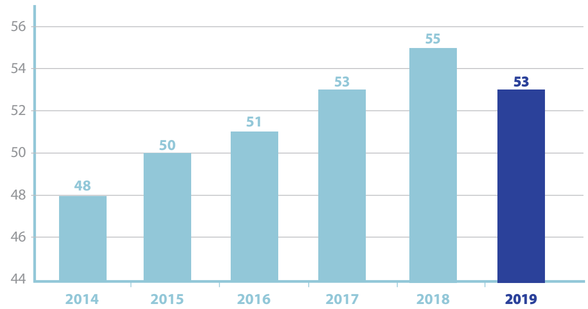
In 2019, public consumption and investment spending decreased by nearly 1.1% and 33.1% respectively, reflecting a weakened public sector performance. Net exports were also negative in 2019 (estimated at nearly USD 15.5 billion). In other words, the contraction of economic activity in 2019 was influenced by a deteriorating performance of the private and public sectors and the foreign sector as well.

The nominal GDP of Lebanon is estimated at nearly USD 53 billion in 2019, down from USD 55 billion in 2018. However, it remains higher than its level in 2014 and 2015 (with an average of USD 49 billion, and its level in 2016 and 2017 (with an average of USD 52 billion), according to IIF estimates.

Real GDP Growth (%)



Nominal GDP (USD, billion)



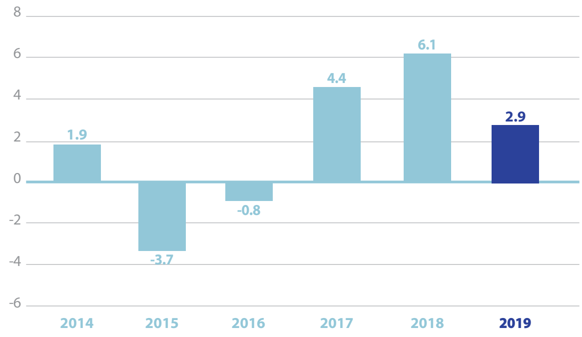
B- Labor and Social Conditions

During the first three quarters of 2019, the business sector was facing difficult operating and financial conditions that have weakened its surviving capabilities. During the fourth quarter of 2019, the business conditions have become more severe and intolerable, especially with the growing conflict between the civil protestors and the government. Under such unprecedented pressures, some private businesses started to downsize their activity, while others seized their operations, thus leading to a growing discharge of workers or to cutting their wages by almost half. The inability of several businesses to have access to financing from the banking sector, besides the cash Dollar crisis, and the related increase in price inflation, have all resulted in a weakening business sector.

In this context, the social and living conditions have aggravated during 2019, leading to worrying social and labor indicators. Today, almost one-third of the Lebanese population are under the poverty line. Also, unemployment has risen to historic records, reaching nearly 30% in general and 40% among the youth population. Immigration of the youth and the associated brain drain is on a growth trajectory. 66,806 persons of young university graduates and work seekers have left Lebanon during 2019, relative to 33,841 persons during 2018. Between 1992 and 2018, nearly 601,227 persons left Lebanon with no return according to Al-Daoliyah Lil-Maaloumat statistics.

Price inflation recorded; according to official and private estimates to nearly 3% in 2019 (6% in 2018). Inflation could be estimated at a higher rate given the great divergence of the official USD/LBP exchange rate (1,507.5) and the parallel rate (above 2,000). This fact is behind the deterioration in the real purchasing power of the Lebanese incomes and savings.

• | **Evolution of Average Annual Inflation Rate (%)**



• Major Macro Economic Indicators

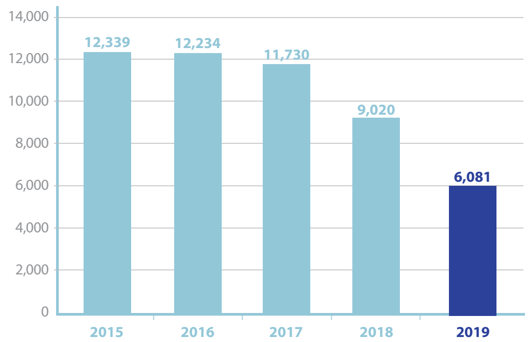
Indicators	2018	2019	% Change
GDP (in nominal terms, USD billion)	55.0	53.0	(3.6)
Real GDP growth (%)	(1.9)	(3.8)	-
Inflation rate (%)	6.1	2.9	-
Share of population under poverty line (%)	25.0	33.3	-
General unemployment (%)	20.0	30.0	-
Unemployment among the youth (%)	30.0	40.0	-
Immigrated Lebanese	33.841	66.806	97.4

Sources: Estimates of Domestic and International Institutions, IIF, and Al-Daoliyah Lil-Maaloumat

C- Performance of Economic Sectors

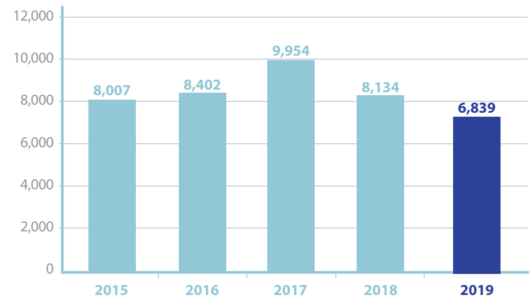
The majority of the productive and services sectors of the Lebanese economy recorded a declining performance in 2019, when compared to 2018. The **construction sector** experienced a retarding activity, with the number of construction permits falling by an annual rate of 19.8% to 10,991 permits, and its surface area shrinking by 32.6% to 6,081,333 sqm in 2019. Also, cement deliveries fell by 30.9% between November 2018 and November 2019.

• | **Area of Construction Permits** (Thousand SQM)



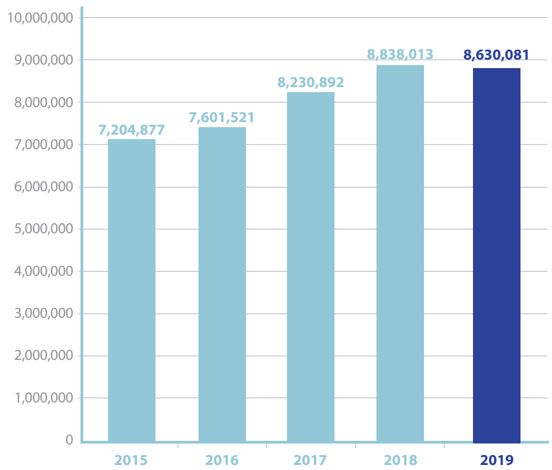
The **property sector** also witnessed a downtrend, with the numbers of sales operations declining by an annual rate of 17.1% to 50,352 operations, the sales to foreigners decreasing by 18.2% to USD 993 million, and the value of property sales transactions falling by 15.9% to USD 6.8 billion in 2019.

• | **Value of Real-Estate Transactions** (USD, million)

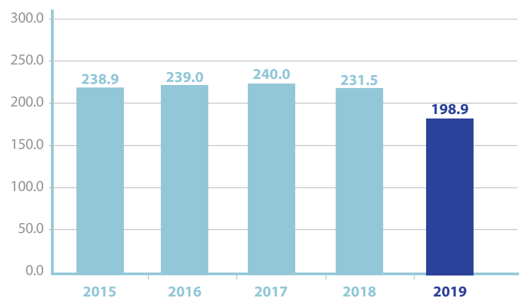


The performance of the **transport sector**, both air transport and maritime transport, was inferior in 2019 relative to 2018. Passengers via Beirut - Rafic Hariri International Airport declined in number by an annual rate of 1.8% to nearly 8.7 million passengers, and in its aircraft activity by 1.8% to 72,279 planes in 2019. The Port of Beirut's revenues fell by an annual rate of 14.1% to USD 198.9 million. The number of containers, number of ships and the quantity of goods all declined by an annual rate of 16.5%, 6.7% and 18.3% respectively in 2019.

• | **Passengers at the Airport**

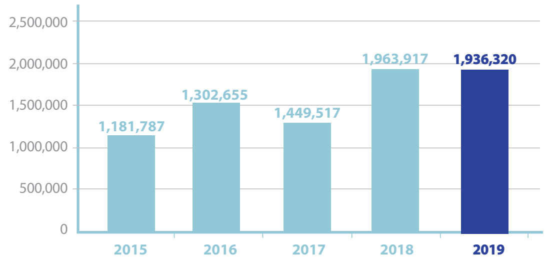


• | **Port of Beirut Revenues** (USD, million)



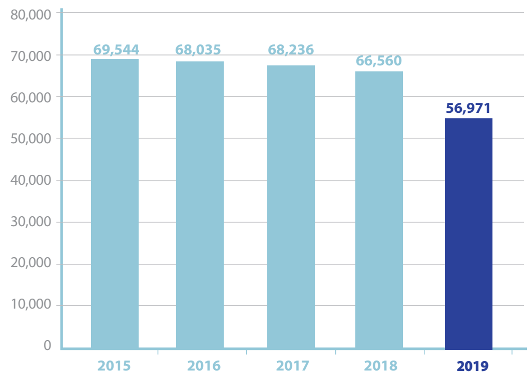
The **tourism sector** experienced a weak performance in 2019, with the number of tourists dropping by an annual rate of 1.4% to 1.94 million visitors, and their spending was 1.8% lower than its 2018 level (+6.5%). In parallel, the **hotel sector** was negatively affected by a retarding tourism activity, wherein the occupancy rate of Beirut 4 and 5 stars hotels was at nearly 65%, the room rate at USD 202, and the rooms' yield at USD 132 for the first 11 months of 2019.

Tourists Activity in Lebanon



The **internal trade sector** witnessed a contraction in its activity, with the number of cleared checks dropping by an annual rate of 16.4% to 9.9 million checks and its value by 14.4% to USD 66 billion in 2019. These two indicators also reflect a declining private consumption and investment spending in 2019.

Clearing Activity (USD, million)



The **power sector** has continued its weak performance, with electricity production decreasing from 13,884 million kWh in 2018 to 13,650 million kWh in November 2019, i.e. nearly 1.7%.

The **automobile sector** also witnessed a retarding performance, with the number of newly registered cars dropping by 33.4% on annual basis to 21,991 cars in 2019.

The **insurance sector**, according to a Fitch Ratings report, is estimated to record a growth in total gross premiums written by 6.4% in 2019 following a similar growth in 2018 (6.8%).

However, the **export sector** recorded a better activity in 2019, with total industrial and agricultural exports surging by 26.5% on an annual basis to reach USD 3.7 billion.

• Real-Sector Indicators

Indicators	2018	2019	% Change
Construction permits surface area (sqm)	9,019,565	6,081,333	(32.6)
Value of property sales transactions (USD, billion)	8.1	6.8	(15.9)
Passengers activity via HIA (million)	8.8	8.7	(1.8)
Port of Beirut revenues (USD, million)	231.5	198.9	(14.1)
Number of tourists (million)	1.96	1.94	(1.4)
Hotel occupancy rate (%)*	64.6	65.2	-
Value of cleared checks (USD, billion)	66.6	57.0	(14.4)
Electricity production (million, kwh)*	13,884	13,650	(1.7)
Newly registered cars	33,012	21,991	(33.4)
Insurance premiums written growth (%)	6.8	6.4	-
Total exports (USD, billion)	3.0	3.7	26.5

*First 11 months
Source: Official Directorates

III. Fiscal Conditions

The aggravating fiscal conditions, due to the absent will by the State to implement radical reforms, remains the major source of Lebanon's current economic crisis.

A- Fiscal Deficit

Lebanon's fiscal balance remains negative to a large extent, due to weakened public revenues, which fell by an annual rate of 5.5% to nearly USD 9.4 billion, and also weakened public spending which dropped by 8.6% to USD 13.4 billion in November 2019. Public revenues only represent 70% of public spending.

As a result, the fiscal deficit remained high at nearly USD 4 billion in November 2019 although declining by 15% from November 2018.

It is believed that the fiscal imbalance has deteriorated sharply in the last quarter of 2019, in parallel with the sharp decrease in public revenues by at least 40% due to the seizure of payment of taxes, duties and fees on the part of some citizens in line with the protestors' request and lower incomes. The fiscal deficit is estimated to run at USD 5-6 billion for the whole of 2019, to represent at least nearly 10% of GDP.

• Public Finances Indicators (USD, million)

Indicators	November 2018	November 2019	% Change
Public revenues:	9,923	9,378	(5.5)
Tax revenues	7,492	7,189	(4.0)
Non-tax revenues	2,432	2,189	(10.0)
Public spending:	14,657	13,402	(8.6)
General spending	9,037	8,107	(10.3)
EDL transfers	1,378	1,306	(5.2)
Debt service	4,332	4,241	(2.1)
Others	1,288	1,054	(18.2)
Fiscal balance	(4,734)	(4,024)	(15.0)
Primary deficit or surplus	(402)	217	-

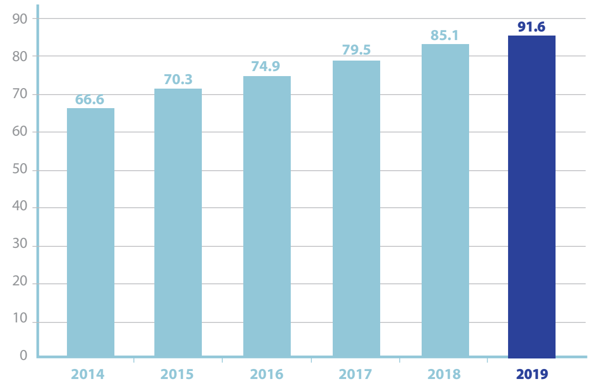
Sources: Ministry of Finance

B- Public Indebtedness

The State's public indebtedness remains on growth, fueled by the continued fiscal deficits and debt servicing.

Lebanon's gross public debt grew by a rate of 7.6% between the end of 2018 and the end of 2019, reaching USD 91.6 billion, thus representing more than 170% of GDP in 2019.

• | **Evolution of the Gross Public Debt** (USD, billion)



The composition of this gross public debt up till the end of 2019 reveals a domestic debt component of USD 57.9 billion which grew annually by 12.1%, and foreign debt component of USD 33.7 billion which grew modestly by 0.8%. The net public debt went up by 11.1% from the end of 2018 to reach USD 81.2 billion at the end of 2019.

• **Public Debt Indicators** (USD, billion)

Indicators	2018	2019	% Change
Gross Debt:	85.1	91.6	7.6
Domestic Debt	51.6	57.0	12.1
Foreign Debt	33.5	33.7	0.8
Net Debt	75.0	81.2	11.0

Sources: Ministry of Finance and Central Bank of Lebanon

In March 2020, the State has to pay some USD 1.2 billion in debt (Eurobonds). Other payments are also due during this year. The government is thinking of debt restructuring measures, focusing on decreasing interest rates and extending the maturity of the due payments. The State has a view of having a support from the banking system (Central Bank and commercial banks) to support the State's objective of lowering debt servicing. The Central Bank is asked to extend a financial support of USD 4 billion, and banks are asked to contribute with an amount of USD 500 million.

The major challenge the State is facing today on the fiscal front is to restore collection of its duties, fees and taxes, to enhance its public revenues and, hence, with austerity on the spending level, the fiscal deficit growth in 2020 is hoped to be controlled.

IV. Financial Conditions

During 2019, mainly its fourth quarter, pressures have mounted on the financial sector, especially the banking sector, and on the exchange rate of the LBP vis-à-vis the US dollar and other foreign currencies. A growing control on capital was implemented in October 2019 in line with the US Dollar crisis.

A- Monetary Situation

Following the unfavorable socio-economic and fiscal conditions during 2019, besides the degradation of confidence on all levels, the country experienced a major bank run which resulted in conversions from the LBP to US dollar and hence a shortage of US dollars in the money market, besides also a large demand for the LBP. This has caused a wave of capital controls, with exceptional banking measures on cash withdrawals and foreign transfers. This was accompanied by controls on organizing foreign-currency financing of imports of vital goods on the part of the Central Bank.

Besides the officially pegged exchange rate of the US dollar vis-à-vis the LBP at 1,507.5 at banks, a new, higher parallel rate was operated at exchange houses with one US dollar in excess of LBP 2,000, reaching 2,400 or 2,500 at some times during December 2019.

In this context, the Central Bank intervened in the foreign-exchange market to maintain the stability of the official exchange rate. This resulted in declining foreign-currency assets from USD 37.3 billion at the end of 2018 to USD 36.7 billion at the end of 2019, i.e. by 1.6% on annual basis.

In addition, the Central Bank issued a circular to commercial banks to drop down interest rates on deposits to a ceiling of 5% on the US dollar and to 8.5% on the LBP.

B- Banking Situation

The year 2019, mainly its last quarter, witnessed a strong bank run, in line with the deteriorating socio-economic and financial conditions in Lebanon. Commercial banks implemented tight controls on cash withdrawals in US dollar and LBP, and on transfers abroad. These measures were necessary to control the extensive demand for cash, and conversions from the US dollar to the LBP protect depositors, and secure the financial stability of the banking sector.

This bank run resulted in a decrease in deposits, nearly USD 15.4 billion in 2019, with USD 11.4 billion alone in its fourth quarter. Such deposit decrease was reflected in a contraction by USD 13.1 billion in LBP, and USD 2.3 billion in foreign currencies. In this context, deposit dollarization went up to 76% in 2019, relative to 70.6% in 2018.

With unfavorable business, economic and banking conditions, commercial banks ceased the extension of loans to economic agents (individuals and businesses), thus producing a contraction in bank credit to the private sector by nearly USD 9.6 billion to USD 49.8 billion at the end of 2019. In this sense, loan dollarization was nearly USD 68.7% at end-December 2019.

In parallel, commercial banks decreased their lending to the public sector, mainly via their subscription in TBS, by nearly USD 4.9 billion in both foreign currencies and LBP.

The Central Bank directed commercial banks to raise their capital by 20% up till June 2020 so as to enhance its current capitalization. This capital increase would raise the current equity by almost USD 4 billion, up to USD 24.7 billion, keeping in mind that banks' capital increased by 2.8% in 2019.

• Banking Indicators

Indicators	% change in 2018	% change in 2019
Total assets	29.6	(32.7)
Total deposits	5.6	(15.4)
Total credits	(0.3)	(9.6)
Total equity (amount in USD, billion)	20.1	20.7

Sources: Central Bank of Lebanon and Association of Banks in Lebanon

C- Capital Market

The Beirut Stock Exchange (BSE) was affected by the deteriorating economic conditions in Lebanon during 2019. The contraction in its activity was visible across all its indicators.

The market capitalization of BSE dropped by 17.3% from 2018 to reach USD 7.5 billion at the end of 2019. Similarly, the total trading value of BSE fell by 47.6% to USD 197 million during the same period. The market's price index declined from 83.9 to 69.7 during this period.

• BSE Indicators

Index	2018	2019	% Change
Market capitalization (USD, million)	9,117	7,540	(17.3)
Total trading value (USD, million)	376	197	(47.6)
Price Index	83.9	69.7	(16.9)

Source: BSE

D- Financial Institutions

The performance of financial institutions operating in Lebanon in 2019 was inferior to that recorded in 2018.

The total balance sheet (or consolidated assets) fell by 10.2% from 2018 to reach USD 1.4 billion at the end of 2019. The claims on resident customers dropped also by 7.5% to USD 624.1 million during this period. However, the resident customer deposits witnessed an increase of 8.5% to USD 171 million during the same period.

• Indicators of Financial Institutions (USD, million)

Indicators	2018	2019	% Change
Balance sheet	1,538	1,383	(10.2)
Claims on resident customers	674.8	624.1	(7.5)
Deposits of resident customers	157.6	171.0	8.5

Source: Central Bank of Lebanon

E- BTA-Fransabank Retail Index

BEIRUT TRADERS ASSOCIATION
FRANSABANK
RETAIL INDEX
4th Quarter 2019
33.96

The last quarter of 2019 was characterized with developments that were – to date, unfamiliar and unprecedented on the Lebanese scene, neither in economic terms nor in financial or monetary or political or even social terms.

Only one week after the symbolic and successful call of BTA for all traders to stop work for one hour and stand in front of their place of work throughout the Lebanese territory on the 10th of October (a call that was followed by more than 100,000 persons), as a sign of protest against the prevailing economic situation and the announced new tax measures,

Massive protests took place in the streets and on the roads across Lebanon to express the population's refusal of the new package of measures that the government was about to enforce. This movement pushed the government of Mr Hariri to resign, and the search for a new prime minister began.

These protests were accompanied by a very heavy pressure on the monetary and banking scene, with bank agencies facing excessive demand for cash withdrawals that pushed them to formalize the withdrawal operations, especially in light of the very high demand on US Dollars and other F/Cs, while people started collecting as much cash at home as possible and while households' consumption was restricted to basic necessities.

Obviously, consumption turnovers fell sharply in almost all trading sectors, especially during the second half of this quarter, as spending became very tight and focused on essentials only.

This strong recessionary pressure pushed a certain number of traders and companies to give up and decide to cease activities in an attempt to stop the financial hemorrhage they have been trying to confront for a long period of time.

The most important consequence of these closures was the termination of employees whose numbers reached – according to a very recent survey conducted by INFOPRO at the end of 2019 and early 2020, the dramatic number of 220,000.

This of course comes on top of shops, stores and companies that remained in activity but were forced to either apply cuts on their employees' salaries and/or cuts in working hours.

Either case, the result was the same: a dramatic fall in Lebanese households' purchasing power while the Consumer Price Index was surging rapidly.

It should be noted that the CPI between the fourth quarter of 2018 and the fourth quarter of 2019 as per the official CAS figures, posted as much as + 6.96 % increase, a development that should warn about the very negative impact of the correlation between falling purchase power and escalating CPI.

Moreover, if sectoral inflation levels are scrutinized, it should be noted that inflation did reach some higher levels in few sectors, during the period under review as compared to Q4 2018, as per the following:

+ 26.75 in the Liquor, Spirits and Tobacco sector,
+ 17.96 % in the Furniture & decoration sector,
+ 17.36 % in the Clothing and footwear sector,
+ 14.95 % in the Transport sector,
+ 11.53 % in the Recreation, amusement, and culture sector,
And even in the Supermarkets & Food Shops sector, where an inflation level of 9.77 % was reported.

CPI (as per CAS official results)	
Q4 '14 / Q4 '13	(0.71 %)
Q1 '15 / Q1 '14	(3.38 %)
Q2 '15 / Q2 '14	(3.37 %)
Q3 '15 /Q3 '14	(4.67 %)
Q4 '15 / Q4 '14	(3.40 %)
Q1 '16 / Q1 '15	(3.57 %)
Q2 '16 / Q2 '15	(0.98 %)
Q3 '16 / Q3 '15	1.03 %
Q4 '16 / Q4 '15	3.14 %
Q1 '17 / Q1 '16	5.12 %
Q2 '17 / Q2 '16	3.48 %
Q3 '17 / Q3 '16	4.15 %
Q4 '17 / Q4 '16	5.01 %
Q1 '18 / Q1 '17	5.35 %
Q2 '18 / Q2 '17	7.61 %
Q3 '18 / Q3 '17	6.53 %
Q4 '18 / Q4 '17	3.98 %
Q1 '19 / Q1 '18	4.08 %
Q2 '19 / Q2 '18	1.69 %
Q3 '19 / Q3 '18	1.09 %
Q4 '19 / Q4 '18	**6.96 %**
Q4 '14 / Q3 '14	(1.49 %)
Q1 '15 / Q4 '14	(0.98 %)
Q2 '15 / Q1 '15	(1.12 %)
Q3 '15 / Q2 '15	(1.18 %)
Q4 '15 / Q3 '15	(0.16 %)
Q1 '16 / Q4 '15	(1.15 %)
Q2 '16 / Q1 '16	1.54 %
Q3 '16 / Q2 '16	0.82 %
Q4 '16 / Q3 '16	1.93 %
Q1 '17 / Q4 '16	0.74 %
Q2 '17 / Q1 '17	(0.04 %)
Q3 '17 / Q2 '17	1.47 %
Q4 '17 / Q3 '17	2.78 %
Q1 '18 / Q4 '17	(1.06 %)
Q2 '18 / Q1 '18	2.10 %
Q3 '18 / Q2 '18	0.45 %
Q4 '18 / Q3 '18	0.32 %
Q1 '19 / Q4 '18	1.16 %
Q2 '19 / Q1 '19	(0.25 %)
Q3 '19 / Q2 '19	(0.14 %)
Q4 '19 / Q3 '19	**5.99 %**

As a result, the consolidated real retail turnover figures (i.e. after applying the inflation rate weight on the nominal results) have posted a decline of – 27.38 % between the fourth quarter of 2018 and the fourth quarter of 2019, in comparison to the – 6.18 % posted for the previous quarter.
By excluding the fuel sector results (where a drop of – 2.63 % in volume was reported between the levels of Q4 '18 and Q4 '19), the real consolidated turnover drop reaches – 33.59 % in comparison to the Q4 '18 figures (also excluding fuel), against – 7.19 % for the previous quarter.

• Yearly Variation between 4th Quarter '18 and 4th Quarter '19

	Q4 2018	Q4 2019	
Nominal Year to Year Variation (incl. Liquid Fuels)	100.00	78.40	
Nominal Year to Year Variation (excl. Liquid Fuels)	100.00	71.86	
CPI between Dec '18 and Dec '19 (as per the official CAS figures)		**(6.96%)**	
Real Year to Year Variation (incl. Liquid Fuels)	100.00	72.95	**(27.05%)**
Real Year to Year Variation (excl. Liquid Fuels)	100.00	66.85	**(33.15%)**

* CAS – CPI – Dec '19

The above figures clearly display a sharp deterioration in consumption levels, with the already prevailing negative factors undermining the commercial activity further reinforced by the recent events on the Lebanese scene, mainly the popular upraise and roads blocking, as well as monetary and banking pressures. All the above has evidently sharply tightened the levels of trading and consumption in particular, and the whole economy in general. Let alone the forced shutdown of shops, stores and companies as a result of road closures and the difficulty of commuting between regions.

The analysis of the performance during the fourth quarter of this year, and of the various retail trade market sectors, clearly translates the dramatic fall in all turnover figures.

As a result, real figures (i.e. weighed with the respective CPI figures for every sector of the retail trade activities) posted by the main sectors where declines were registered during the fourth quarter of 2019 in comparison to the fourth quarter of 2018 included (in addition to the fuel sector where a drop in volume by – 2.63 % was recorded):

> Cellular Phones (- 77.10 % against - 41.24 %)
> Sports Items & Equipment (- 72.57 % against – 3.72 %)
> Silverware and Decoration (- 63.90 % against – 3.27 %)
> Household Electrical Equipment (- 59.25 % against – 12.16 %)
> Carpets and Antiques (- 58.98% against – 6.54 %)
> Home Accessories (- 55.60 % against – 5.88 %)
> Clothing (- 52.80 % against – 13.36 %)
> Shoes and Leather Products (- 52.07 % against - 23.92 %)
> Commercial Shopping Centers (- 48.72 % against – 11.21 %)
> Liquor & Spirits (- 45.89 % against – 3.97 %)
> Used Cars Dealers (- 44.03 % against – 1.01 %)
> Toys (- 41.51 % against - 19.77 %)
> Optical and Hearing Aid Instruments (- 40.87 % against – 4.57 %)
> Musical Instruments (- 38.07 % against – 6.83 %)
> Perfumes and Cosmetics (- 34.89 % against + 0.18 %)
> Medical Equipment (- 34.16 % against – 0.03 %)
> Watches and Jewelry (- 33.41 % against – 8.69 %)
> Bakeries & Pastries (- 23.90 % against + 4.43 %)
> Pharmaceuticals (- 23.90 % against – 8.51 %)
> Furniture (- 20.88 % against – 42.57 %)
> Tobacco (- 18.62 % against + 12.86 %)
> Restaurants and Snacks (- 17.80 % against + 0.28 %)
> Construction Equipment (- 16.69 % against - 16.41 %)
> Books & Stationery & Office Supplies (- 10.84 % against + 11.14 %)
> Supermarkets and Food Shops (- 8.37 % against – 4.19 %)

The lack of any sector posting an even slight positive result is noticeable.
On the other hand, the CPI between Q3 '19 and Q4 '19 also indicated a sharp increase in prices (+ 5.99 %), and the overall consolidated real result for the fourth quarter also displayed a sharp decline in all sectors because obviously of all factors mentioned that have resulted in a strong and unexpected drop in consumption levels in the lapse of only one quarter, whereas seasonal factors such as the festive season and year end considerations did not have any impact this year and the markets were in a semi paralysis situation.

As a result, the consolidated real figures (i.e. weighed with the respective CPI figures for every sector of the retail trade activities) for all retail trading sectors (with the exception of the Supermarkets & Food stores sector) posted a heavy decline and stood at – 28.14% as compared to the real figures of Q3 '19, excluding the Fuel sector (where a sharp – 18.28% was registered for this period).
The declines in the main sectors where as follows:

- Silverware and Decoration (- 61.71 %)
- Cellular Phones (- 50.24 %)
- Household Electrical Equipment (- 50.15 %)
- Clothing (- 45.63 %)
- Sports Items & Equipment (- 43.39 %)
- Optical Instruments (- 41.04 %)
- Tobacco (- 37.25 %)
- Shoes and Leather Products (- 35.95 %)
- Commercial Shopping Centers (- 35.25 %)
- Restaurants and Snacks (- 34.57 %)
- Bakeries & Pastries (- 34.44 %)
- Perfumes and Cosmetics (- 33.75 %)
- Used Cars Dealers (- 32.51 %)
- Toys (- 26.76 %)
- Watches and Jewelry (- 24.44 %)
- Furniture (- 21.68 %)
- Liquors (- 21.37 %)
- Construction Equipment (- 19.32 %),
- Books & Stationery & Office Supplies (- 17.21 %)
- Pharmaceuticals (- 8.56 %)

Only Supermarkets and Food Shops achieved a + 1.55 % increase in their turnover figures.

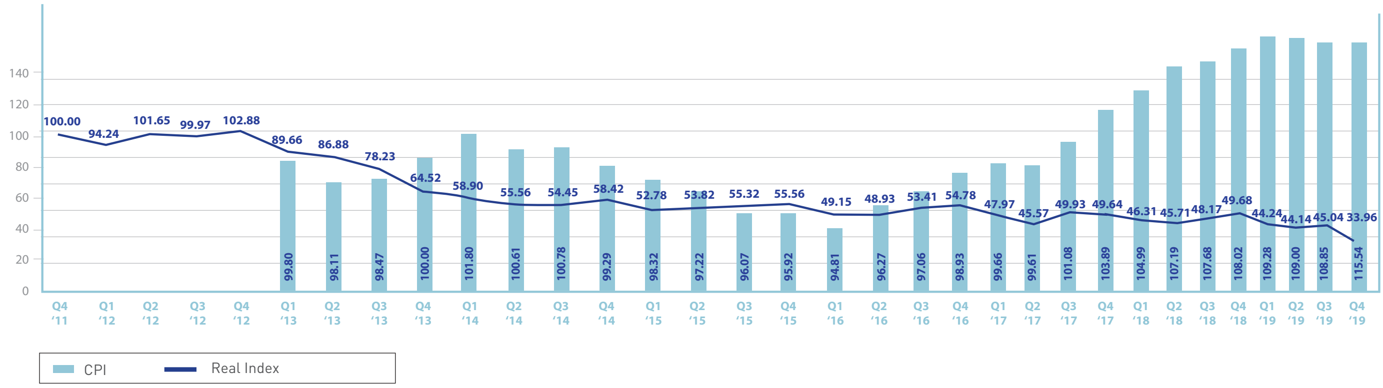
As a result, with the base index 100 fixed at the fourth quarter of 2011, and with a quarterly inflation rate of + 5.99% for the fourth quarter of 2019, as per the official CAS report, the "BTA-Fransabank Retail Index" (with all sectors included) registered 33.96 for the fourth quarter of the year 2019. This figure compares to the level of 45.04 for the third quarter of 2019.

• BTA - Fransabank Retail Index for Q3 - 2019 (Base 100 : Q4 - 2011)

	2011	2012				2013				2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real Index - w/out inflation	100	95.77	100.55	108.54	112.66	90.83	87.85	78.60	65.87	59.68	55.30	55.22	57.57	51.51	51.94	52.77	52.91
Real Index - w/ inflation	100	94.24	101.65	99.97	102.88	89.66	86.88	78.23	64.52	58.90	55.56	54.45	58.42	52.78	53.82	55.32	55.36
CPI						99.80	98.11	98.47	100.00	101.80	100.61	100.78	99.29	98.32	97.22	96.07	95.92

	2016				2017				2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real Index - w/out inflation	46.27	46.79	51.49	53.86	47.51	46.76	52.00	53.17	49.09	49.49	52.38	54.25	48.88	48.65	49.57	39.76
Real Index - w/ inflation	49.15	48.93	53.41	54.78	47.97	45.57	49.93	49.64	46.31	45.71	48.17	49.68	44.24	44.14	45.04	33.96
CPI	94.81	96.27	97.06	98.93	99.66	99.61	101.08	103.89	104.99	107.19	107.68	108.02	109.28	109.00	108.85	115.5

• **Evolution of the BTA - Fransabank Retail Index** (Base 100 - Q4 - '11)



The "BTA-Fransabank Retail Index" for the fourth quarter of 2019 displays an unprecedented drop to its lowest level since inception, mainly attributed to the prevailing political and economic situation in the country.

V. Foreign Sector Conditions

Influenced by the country's economic contraction and lower real incomes, foreign trade experienced a decline in its overall activity, stimulated mainly by lower imports. Capital inflows were lower in 2019 than in 2018, thus resulting in a substantial balance-of-payments deficit in 2019 like in 2018.

A- Trade Balance

The total value of foreign trade exports plus imports stood at USD 22.9 billion at end-2019, down from USD 23 billion at end-2018. Imports went down by 3.7% from 2018 reaching USD 19.2 billion at end-2019, while exports rose by 26.5% to USD 3.7 billion during the same period.

Because of such trade exchanges, the country's trade deficit shrank by 8.9% between 2018 and 2019, reaching USD 15.5 billion in 2019. As such, the exports-to-imports ratio improved from 14.8% in 2018 to 19.4% in 2019. The trade deficit as a ratio of GDP decreased from nearly to 31% in 2018 to 29.2% in 2019.

B- Capital Balance

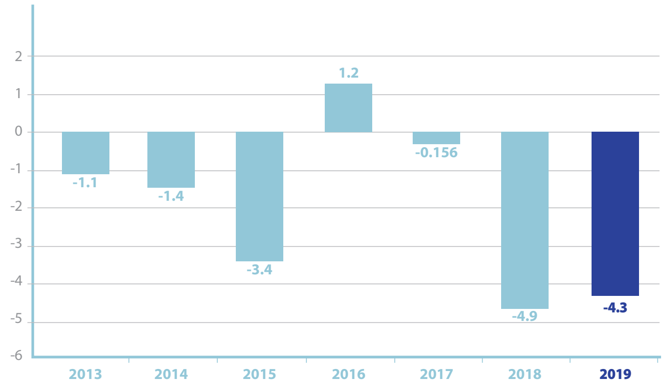
The year 2019 saw a decline in the transfers of the Lebanese expatriates to their relatives in Lebanon by nearly USD 2 billion. Total capital inflows were lower by 7.2% from 2018 reaching USD 11.2 billion in 2019. This is due to sharp deterioration in economic activity in Lebanon, besides the critical banking conditions, and the degrading loss of confidence in the country's economic future.

C- Balance-of-Payments

Given the aggravating conditions on the trade balance and capital balance fronts, the balance-of-payments continued to record a substantial deficit in 2019, just like in the previous years.

The year 2019 saw a deficit in the balance-of-payments that amounted to USD 4.3 billion, relative to a higher deficit of USD 4.9 billion in 2018, based on the drop in net foreign assets of both the Central Bank and commercial banks.

• | **Balance-of-Payments** (USD, billion)



• **Balance-of-Payments Components** (USD, million)

Indicators	2018	2019	% Change
Trade balance:	(17,000)	(15,000)	(8.9)
Imports	20,000	19,200	(3.7)
Exports	3,000	3,700	26.5
Capital balance	12,062	11,192	(7.2)
Balance-of-Payments	(4,938)	(4,308)	(12.7)

Sources: Central Bank of Lebanon and Higher Customs Council

VI. Economic Prospects

With a new government in the country and its Policy Statement with both getting the confidence of the Parliament, the domestic authorities are now urgently called to implement radical fiscal, sectoral and economic reforms to reverse the current economic contraction path and stimulate overall confidence and stability of the economic, banking, and social systems.

The government's major priorities should focus on:

1- Enforcing revenue collection and controlling the growth of spending, fiscal deficit and debt.

2- Seeking fast external financial aid to enhance liquidity in the domestic market and to stimulate economic expansion as well as job creation.

3- Controlling further the level of imports and encouraging further export growth, to decrease the trade deficit.

4- Moderating the severity of current monetary and banking conditions, mainly by controlling the parallel Forex market and harmonizing measures across all banks.

5- Building up the degrading confidence in the national economy, Lebanese Pound, banking sector and economic prospects. This is largely correlated with deep and effective reforms on all levels.

If the Lebanese government implements reforms in line with the Cedre Conference commitments, then it will be able to release part of the financial aid pledged by international donors. This will move the national economy from its current recession to an expansion phase. In this sense, real economic growth could be restored. Otherwise, in case the government implements no reforms, then recession could be deeper and the socio-economic conditions could worsen further.

Study – Securitization in Lebanon: An Effective Tool for Enhancing the Liquidity of Banks

I. Introduction

Securitization refers to the process of converting debt (assets, usually illiquid assets) into securities, which are then bought and sold in the financial markets. We call debt an asset, because debt is a liability for the borrower, but for the lender it is an asset. Hence, securitization is a process where a bank or financial company combines several of its assets into consolidated financial instruments or securities. Then, the bank or the financial company issues these securities to the investors, who earn interest.

For Lebanon, during the current difficult economic, monetary and financial conditions that have aggravated over the last years, securitization could be used as a major economic tool to lessen the severity of these conditions. Securitization could help in boosting liquidity in the financial market, and mainly for banks. It also helps banks and financial companies raise funds. If a bank or a financial company has already exhausted its funds by giving loans but wants to give more loans, then it can use securitization to raise more funds. This bank or financial company can club its assets in the form of a financial instrument or securities and then issue them to the investors. Therefore, the process helps banks and financial companies to raise funds and give more loans. For the investor, such instruments help them diversify their portfolio and earn quality returns as well. In addition, securitization will result in an active financial market which will support the depressed economy, and will also ease the bank-run burden on banks experienced in recent months in Lebanon.

This study sheds light on the concept of securitization, its process, advantages and disadvantages to the related parties. It will focus on the opportunities which securitization paves for the Lebanese banking sector, financial market, and the national economy in surviving the current problems on all levels and start a partial recovery period.

II. Securitization Defined

Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations (or other non-debt assets, which generate receivables) and selling their related cash flows to third party investors as securities. Investors are repaid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing. Securities backed by mortgage receivables are called "Mortgage-Backed Securities" (MBS), while those backed by other types of receivables are called "Asset-Backed Securities" (ABS).

The securitized assets can mitigate the credit risk of individual borrowers. If the transaction is properly structured and the pool performs as expected, the credit risk of all tranches of structured debt improves; if improperly structured, the affected tranches may experience dramatic credit deterioration and loss.

The securitization process starts with the entity that holds the assets, the Originator, selling the assets to a legal entity, the "Special Purpose Vehicle" (SPV). The SPV issues the bonds directly or pays the originator the balance on the debt that is sold, which increases the liquidity of the assets. The debt is then divided into securities (such as bonds), which are sold on the open capital market.

One of the main advantages of securitized debt instruments is that they allow banks to offer bonds at different levels of risk. The bonds can then be divided into risk tranches where one class of the bonds receives less money but will not suffer any consequences should, for instance, the homeowner default on the loan payments. In addition, a second bond class will receive a higher payment but will face a loss in the case of foreclosure of the home. The different bond class offerings allow investors to choose the level of risk they want to invest in.

III. Types of Assets that can be Securitized

There are many different types of assets that can be securitized. Any income-generating asset can be securitized. Following are some asset-backed securities that can be securitized, and which provide a steady income for investors and access to capital for the principals.

1- Home Equity Loans

Home equity loans represent the largest portion of asset-backed securities. They are a natural extension of mortgage-backed securities. Home equity lenders usually take advantage of the real estate recovery to increase their lending. This increased lending requires additional capital. Home equity backed securities are providing that capital. The securities are backed by the underlying collateral and the creditworthiness of the borrowers. Then income is provided by the regular payments of principal and interest.

2- Auto Loans

The rise of the auto loan industry in recent years has been punctuated with a rise in the securitization of these loans. Such securitization has provided lenders with increased access to capital.

Auto lenders can make loans to individuals with a variety of credit backgrounds. They will then bundle loans with similar credit profiles and issue them as an asset-backed security.

Asset-backed securities are financial instruments backed by their underlying assets (i.e. by income-producing assets, where incomes provide the returns on investment).

Auto lenders are able to sell the loans to investors who receive returns from the loan payments and auto lenders can use the funds to increase their own lending.

3- Students Loans

With the growing demand for education, the student loan industry has been on growing over the past years. Students utilize the loans to pay for education and pay for the loans when they enter the workforce.

When private lenders securitize their student loans, they gain the capital to issue new student loans. Investors gain a steady return on their investment from the aggregate principal and interest paid on these loans as well as other loan collection efforts.

4- Solar Projects

Solar projects make their money by producing electricity that is sold to power companies. These solar projects are income-producing assets and provide a relatively stable income over the life of the project.

Since solar projects are capital intensive investments that yield steady returns over a long-term basis, these steady returns are perfect for those looking for a long-term investment. By securitizing these solar projects, investors get the long-term investment returns they are looking for and the solar companies get the capital needed to build new green solar projects.

5- Equipment Leases

When companies lease equipment, the leasing company needs to buy the equipment it leases. The leasing company ties up a lot of capital to fulfill the leases. The leasing company receives the interest/ rent portion of the lease. While the returns are good, it ties up a lot of capital and limits the number of leases that can be written.

Securitizing these equipment leases allows leasing companies to turn their lease agreements into usable capital for their business. They do not need to seek out a bank to provide them with loans. Investors are able to invest in a lease-backed security that provides them with a steady income from a variety of leases that minimizes risk and maximizes returns.

6- Account Receivables

Businesses have long used factoring companies to handle their account receivables. Instead of trying to collect on these debts, they will sell them to a factoring company at a discount (2-10%). Factoring companies receive the payments while business get quicker access to funds without needing to wait 30-60 days for payment.

Factoring companies need capital to do these deals and traditional sources of capital can be too expensive. By securitizing these account receivables, factoring companies can complete more deals. Investors in these securitized receivables get returns that are higher than they would get in a bank or other traditional investment.

In this sense, asset-backed securities are changing the way businesses access credit markets and the way investors are making investments. Asset-backed securitization could grow as more and more industries see the opportunity to convert their assets into capital for business expansion and investors see increased opportunities for investment returns.

IV. Motives for Securitization

There are several key motives or advantages to both issuers and investors under a securitization process. In addition, both may incur risks or face disadvantages from such a process:

A- Advantages to issuers

Securitization can afford issuers several advantages. The following are the basic ones.

1. Reduces funding costs: Under a securitization process, a company or financial institution with a specific rating but with a higher rating for worthy cash flow would be able to borrow at the higher rating degree. This is the number one reason to securitize a cash flow and can have tremendous impact on borrowing costs.

2. Reduces asset-liability mismatch: Depending on the structure chosen, securitization can offer perfectly matched funding by eliminating funding exposure in terms of both duration and pricing basis. Essentially, in most banks and finance companies, the liability book or the funding is from borrowings. This often comes at a high cost. Securitization allows such banks and finance companies to create a self-funded asset book.

3. Lower capital requirements: Some firms, due to legal, regulatory or other reasons, have a limit or range that their leverage is allowed to be. By securitizing some of their assets, these firms will be able to remove assets from their balance sheets while maintaining the "earning power" of the assets.

4. Locking in profits: For a given block of business, the total profits have not yet emerged and thus remain uncertain. Once the block has been securitized, the level of profits has now been locked in for that company, thus the risk of profit not emerging, or the benefit of super-profits, has now been passed on.

5. Transfer risks: Securitization makes it possible to transfer risks (credit, liquidity, prepayment, reinvestment, asset concentration) from an entity that does not want to bear it, to one that does. Similarly, by securitizing a block of business (thereby locking in a degree of profits), the company has effectively more profitable business.

6. Earnings boost: Securitization makes it possible to record an earnings bounce without any real addition to the firm. When a securitization takes place, there often is a "true sale" that takes place between the Originator (the parent company) and the SPV. This sale has to be for the market value of the underlying assets for the "true sale" to stick and thus this sale is reflected on the parent company's balance sheet, which will boost earnings for that quarter by the amount of the sale. While legal in any respect, this does not distort the true earnings of the parent company.

7. Better liquidity: Future cash flows may simply be balance sheet items, which currently are not available for spending whereas once the book has been securitized, the cash would be available for immediate spending or investment. This also creates a reinvestment book which may well be at better rates.

B- Disadvantages to Issuers

Securitization can have some disadvantages to issuers. Following are the key ones:

1. May reduce portfolio quality: If the high-rating risks are being securitized out, this would leave a materially worse quality of residual risk.

2. High costs: Securitizations are expensive due to management and system costs, legal fees, underwriting fees, rating fees and ongoing administration costs. Additional costs may emerge, especially in cases of an atypical securitization.

3. Size limitations: Securitizations often require large scale structuring, and thus may not be cost-efficient for small and medium transactions.

4. High risks: Since securitization is a structured transaction, it may include par structures as well as credit enhancements that are subject to risks of impairment, such as prepayment, as well as credit loss.

C- Advantages to Investors

Securitization can produce certain advantages to investors. These are the major ones:

1- High return: Securitization can have the opportunity to potentially earn a higher rate of return (on a risk-adjusted basis).

2- Investment in high quality assets: Due to the stringent requirements for corporations to attain high ratings, there is a dearth of high rated entities that exist. Securitizations, however, allow for the creation of large quantities of high-rating bonds, and risk averse institutional investors, or investors that are required to invest in only highly rated assets have access to a larger pool of investment options.

3- Portfolio diversification: Depending on the securitization, hedge funds as well as other institutional investors tend to like investing in bonds created through securitizations because they may be uncorrelated to their other bonds and securities.

4- Isolation of credit risk from the parent entity: Since the assets that are securitized are isolated (at least in theory) from the assets of the originating entity, under securitization it may be possible for the securitization to receive a higher credit rating than the "parent", because the underlying risks are different. For example, a small bank may be considered more risky than the mortgage loans it makes to its customers; were the mortgage loans to remain with the bank, the borrowers may effectively be paying higher interest (or, just as likely, the bank would be paying higher interest to its creditors, and hence less profitable).

D- Risks to Investors

Securitization can expose investors to several types of risks. These are the basic risks.

1- Liquidity Risk:

- Credit / Default: Default risk generally emerges due to a borrower's inability to meet interest payment obligations on time.

2- Event Risk:

- **Prepayment / reinvestment / early amortization:** This risk stems from early amortization events or payout events that cause the security to be paid off prematurely. Payout events include insufficient payments from the underlying borrowers, a rise in the default rate on the underlying loans above a specified level, and bankruptcy on the part of the sponsor or servicer.

- **Currency / interest rate fluctuations:** Fluctuations in interest rates affect floating rate ABS prices less than fixed rate securities. In addition, such fluctuations may affect the prepayment rates on underlying loans that back some types of ABS, which can affect yields. Home equity loans tend to be the most sensitive to changes in interest rates, while auto loans, student loans, and credit cards are generally less sensitive to interest rate.

3- Contractual Agreements Risks:

- **Moral hazard:** Investors usually rely on the deal manager to price the securitizations' underlying assets. If the manager earns fees based on performance, there may be a temptation to mark up the prices of the portfolio assets.

- **Servicer risk:** The transfer or collection of payments may be delayed or reduced if the servicer becomes insolvent. This risk is mitigated by having a backup servicer involved in the transaction.

V. Benefits of Securitization for Banks

Banks in Lebanon may securitize debt for several reasons including risk management, balance sheet issues, greater leverage of capital, profit from origination fees, and also fees for selling the new debt security.

Banks may benefit from moving the default risk associated with the securitized debt off their balance sheets to allow for more leverage of their capital. By reducing their debt load and risk, banks can use their capital more efficiently.

The securitization process creates additional liquidity for debt instruments. Since this process involves taking an illiquid assets (or group of assets) and consolidating with other assets in an effort to create a more liquid asset that can be sold to another party without affecting its price, then securitization increases liquidity both for banks and the capital market.

For example, a bank can use securitization to convert a portfolio of mortgages (which individually are illiquid assets) into cash (a very liquid asset). When a bank underwrites a mortgage, it owns the rights to the future stream of income provided by the borrower repaying the loan. Effectively, it creates an asset on its balance sheet.

However, a mortgage is a relatively illiquid asset for the bank. The repayment of principal and interest occurs over long periods, often 15 to 30 years for residential mortgages. Further, it is difficult to attract a market of buyers looking to purchase a single mortgage due to the risk of the borrower defaulting on the loan. If the bank wants to liquidate this asset, it will have to offer a substantial discount to compensate for the higher degree of risk.

The bank could avoid a deep discount on selling its assets to improve liquidity through securitization. If the bank pools its mortgage assets, combining many existing mortgages into one stream of income, it will mitigate the risk of defaulting and make the asset more attractive to a larger market of prospective buyers. It can then divide and sell the rights to the future stream of income from this pool of mortgages for cash.

This process improves the bank's liquidity position by reducing its position in illiquid assets (in this example, the portfolio of mortgages) and increases its position as a more liquid asset (cash, in this example).

VI. The Securitization Experience in Lebanon

In Lebanon, the Parliament approved the Law No. 705 of December 9, 2005 called the "Asset Securitization law". Following this law, some banks and companies launched some securitization processes.

A- Legal Framework of Securitization

The ultimate aim of this law is to encourage and promote securitization of assets (asset-backed or mortgage-backed) in the country.

The Law defines securitization as the financial process resulting from the assignment of assets by the Originator to a Legal Entity established for this propose, with or without the assistance of a financial intermediary.

The law stipulates that a mutual securitization fund must be established. This Fund has the missions of:

- Acquiring the assets assigned by the Fund through the securitization process.

- Issuing securitization certificates that represent joint shares in the ownership of the Fund's estate, or debentures that are wholly or partly backed by this estate.

- Paying to the originator the agreed consideration for the assignment of these assets.

The Fund must have a Manager. He/she establishes the Fund and sets the details of its by-laws. The Fund and the by-laws are subjected to a prior approval by the Central Bank.

The assets of the Fund must be deposited with a Custodian that meets the conditions of the Central Bank, whether it is a bank, a financial institution, or any other institution. The Custodian takes all measures concerning the normal management of the Fund's assets.

B- Securitization Experiences

Lebanon's first securitization activity dates back to October 2007. BSEC, the structured finance arm of Banque BEMO, closed the October USD 13.14 million revolving automobile-loan securitization for Rasamny Younis Motor Company (Rymco). BSEC also arranged a similar securitization for another Lebanese automobile franchise operator, Bassoul-Heneiné, amounting to about USD 15 million.

Also, BESEC and LUCID successfully launched in 2017 a USD 12.48 million securitization fund for Tamer Frères SAL, a prominent company in the field of promotion and distribution of healthcare equipment, luxury products, chemical and raw material, tobacco products, banking, and IT solutions.

Med Investment Bank SAL and Kurban Group SAL, announced on October 31, 2017 the successful closing of the first Rental Fleet Securitization in Lebanon and the Levant region and the largest non-mortgage securitization in Lebanon to date. The transaction consisted of securitizing the rental fleets of the Kurban Group of companies operating in the automotive sector, namely Middle East Car Rental (MECAR), Fleet Management Company (FMC), and Allo Transport.

In addition, Solidere has completed a USD 185 million mortgage-backed securitization transaction lead arranged by BLC Bank and BSEC. Solidere planned to use the raised funds to provide part of the needed financing to continue with its real-estate development activity and infrastructure on the waterfront.

Moreover, BSEC established a securitization investment fund for Dima Healthcare with an amount of USD 12.9 million.

VII. Conclusions and Recommendations

Securitizations are still in the early stages of development in Lebanon. The existing law and the current difficult conditions on the economic, financial, and banking fronts should encourage and stimulate further securitizations.

The growth of securitization in Lebanon's economy could lessen the aggregate economic recession, enhance the liquidity of banks, increase financing to the private sector, and expand the activity of the local capital market due to the introduction of securitization certificates.

Securitization could also result in a diversification of risks faced by banks in the country, besides a liquidity boost.

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