ECONOMIC Bulletin

THIRD QUARTER 2011

FRANSABANK

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Report - Lebanon's Economic Performance in Q3 2011

Study - The U.S. and European Sovereign Debt Crises, and Their Implications: Is It Possible To Reduce Risks for Arab Economies?

Lebanon's Economic Performance in Q3 2011

Executive Summary

The Lebanese economy has shown a slowdown in the third quarter of 2011 relative to the same period of 2010, due to the regional turmoil in several Arab countries, amid growing domestic political tensions. Lebanon's major economic indicators are presented in the following:

- Construction permits decreased by **5.34%**.
- The number of real-estate sales transactions decreased by **15.60%**.
- The number of tourists decreased by **24.70%**.
- The number of passengers at the Hariri International Airport (HIA) increased by **0.70%**.
- The amount of cleared checks increased by **5.60%**.
- Fiscal deficit decreased by **36.79%**.
- Net public debt increased by **2.60%**.
- Inflation increased by **4.26%**.
- The Central Bank's gross FX assets increased by **5.00%** to USD 32.10 billion.
- The banking sector's total assets increased by **7.40%** to USD 138.40 billion.
- Market capitalization of Beirut Stock Exchange (BSE) decreased by **14.03%** to USD 10.60 billion.
- The trade deficit widened by **9.59%**.
- Capital inflows decreased by **16.38%** to USD 9.65 billion.
- The balance of payments recorded a deficit of **USD 1,539 million**.
- Economic growth is forecasted at **4.00%** in 2011 according to the World Bank

I. General Introduction

In general, the Lebanese economy has witnessed a relative slowdown in its economic activity during the third quarter of 2011 relative to the corresponding period last year.

This is shown by the decrease in most of its main indicators of the real sector, such as construction permits (-5.34%), number of property sales (-15.60%), number of tourists (-24.70%), number of ships via Beirut port (-5.77%), customs receipts (-12.60%), hotel occupancy (-13.00%), car sales (-4.77%), and SMEs loans (-1.42%).

In parallel, inflation rose by 4.26% during the same period, coupled by surging net public debt (2.60%), and trade deficit (9.59%), while the fiscal deficit has declined (-36.79%).

Also, the total trading volume at BSE fell down by 54.20%, coupled by lower capital inflows (-16.38%), and a deficit of USD 1,539 million in the balance of payments.

Moreover, the Central Bank's foreign-currency denominated assets grew by 5.00% to USD 32.10 billion at end-September 2011, while consolidated assets of the banking sector grew by 7.40% to USD 138.40 billion during the same period.

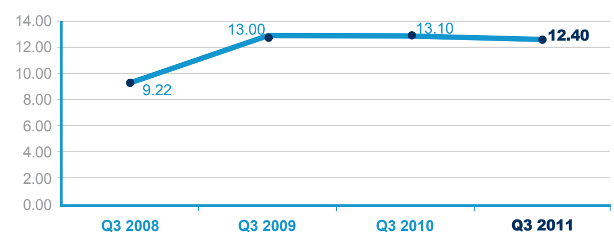
The World Bank revised Lebanon's real GDP growth to be at 4.00% in 2011, down from 7.50% in 2010.

II. Real Sector

1- Construction and Real Estate

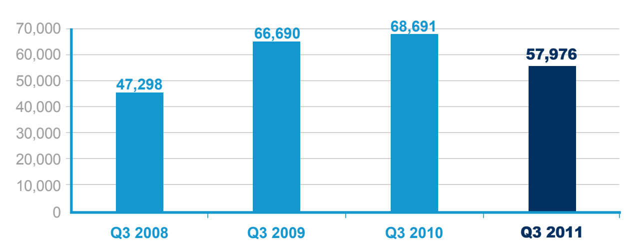
Based on the figures released by the Order of Engineers of Beirut and Tripoli, the construction permits decreased by 5.34% and reached 12.40 million square meters in the third quarter of 2011, compared with 13.10 million square meters in the same period of 2010. Mount Lebanon accounted for 48.60% of the total construction permits, followed by North Lebanon with 15.20%, South Lebanon with 11.60%, and Bekaa with 9.70%.

- Construction Permits (Square meters, million) **-**



On the other hand, the number of sales transactions has decreased by 15.60%, reaching 57,976 transactions in the third quarter of 2011, as compared to 68,691 transactions in the same period of 2010.

- Number of Sales Transactions -

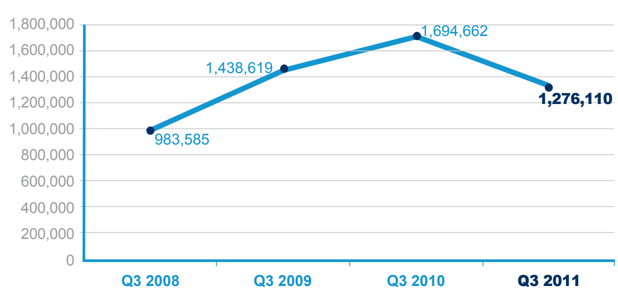


2- Tourism

According to the figures released by the Ministry of Tourism, the number of tourists visiting Lebanon decreased by 24.70% reaching 1,276,110 in the third quarter of 2011, compared with 1,694,662 in the same period of 2010.

As for the distribution of tourists by countries, it shows that the greater part of visitors were from Arab countries with 33.80% of aggregate visitors, followed by visitors from Europe with 29.40%, visitors from Asia with 16.20%, visitors from the Americas with 13.80%, visitors from Africa with 3.50%., and visitors from Oceania with 3.30%.

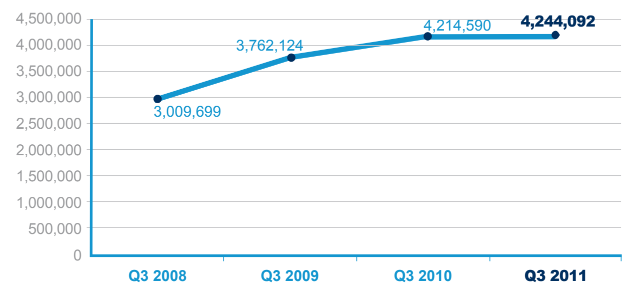
- Number of Tourists -



3- Airport Activity

Based on the figures released by the Hariri International Airport (HIA), the number of airport passengers amounted to 4,244,092 in the third quarter of 2011, an increase of 0.70% year-on-year. The total number of flights reached 47,977 in the third quarter of 2011, a decrease of 2.80% year-on-year.

- Passengers at HIA -



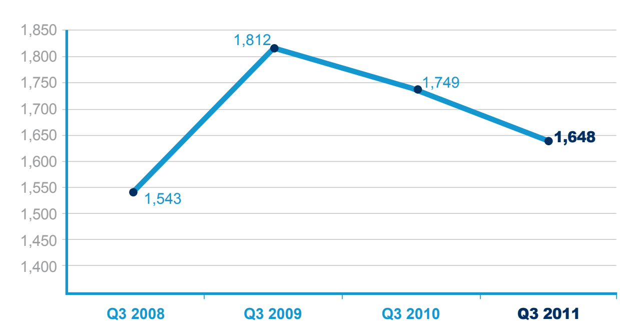
4- Beirut Port

Figures released by the Beirut Port Authority show that the total tonnage of loaded and unloaded merchandise increased by 2.30% reaching 5.025 million tons in September 2011 as compared to the same period of 2010.

The number of containers decreased by 4.10%, reaching 439,220 containers in the third quarter of 2011 compared to the same period of 2010.

Also the total number of ships decreased by 5.77% in the third quarter of 2011, reaching 1,648 as compared to the same period of 2010. Whereas, total transshipments surged by 22.00%, reaching 329,162 containers in the third quarter of 2011, as compared to the same period of 2010.

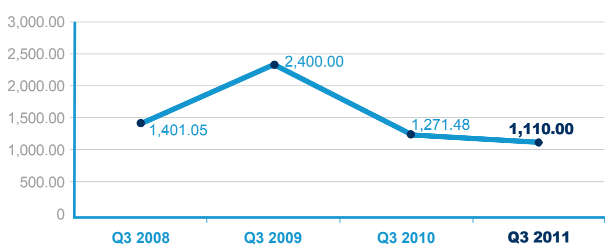
- Number of Ships at Beirut Port -



5. Customs Receipts

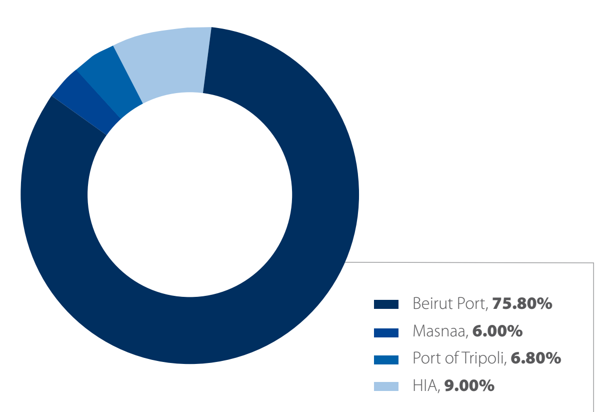
Based on the figures released by the Customs Directorate, customs receipts decreased by 12.60% and reached USD 1.11 billion in the third quarter of 2011, as compared to the same period of 2010.

- Customs Receipts (USD, million) -



The Port of Beirut continues to be the main point of customs revenues, accounting for 75.80% of the total, followed by the Hariri International Airport, the Port of Tripoli, and the Masnaa crossing point with 9.00%, 6.80%, and 6.00% respectively. Overall customs receipts reached USD 2.24 billion in the third quarter of 2011 when including revenues from the value-added tax that amounted to USD 1.13 billion over that period of time.

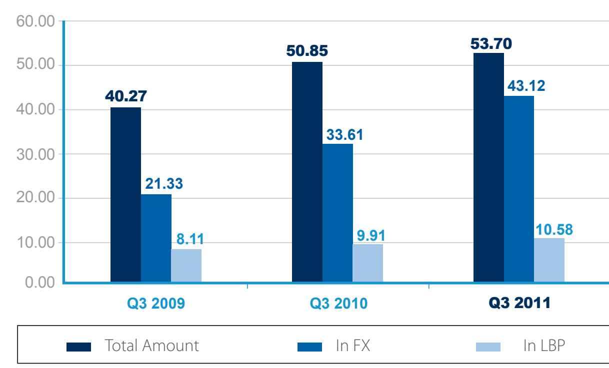
- Points of Customs Receipts -



6- Clearing Activity

Based on the figures released by the Lebanese Association of Banks, the value of cleared checks increased by 5.60% and reached USD 53.70 billion in the third quarter of 2011 as compared to the same period of 2010. The value of cleared checks in Lebanese pounds rose by 6.76% to the equivalent of USD 10.58 billion, and the value of cleared checks in foreign currencies increased by 28.29% to USD 43.12 billion. The dollarization rate of cleared checks declined from 80.50% to 80.20% year-on-year.

- Evolution of Clearing Activity (USD, billion) -

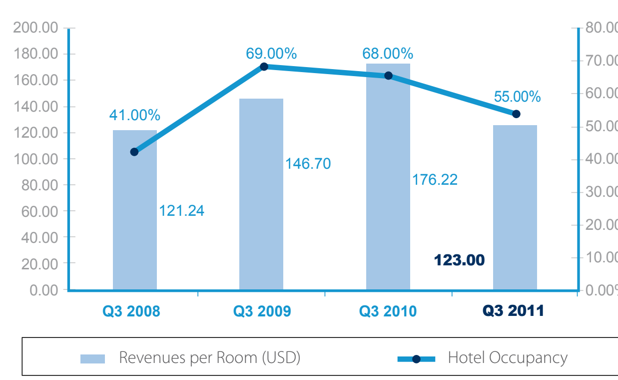


7- Hotel Occupancy

Based on the data issued by the Ministry of Tourism, the occupancy rate at hotels reached 55.00% in the third quarter of 2011, a decrease of 13.00% as compared to the same period last year.

Further, revenues per available room decreased by 30.20% and reached a value of USD 123.00 in the third quarter of 2011 as compared to the same period of 2010.

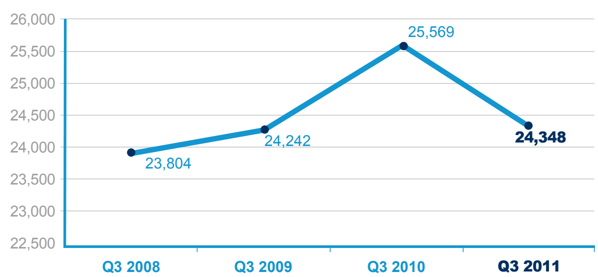
- Hotels Activity Indicators -



8- Cars Sales

Based on the figures released by the Association of Automobile Importers in Lebanon, the number of cars sold during the third quarter of 2011, decreased by 4.77%, reaching 24,348 new cars, compared with 25,569 cars sold in the same period of 2010.

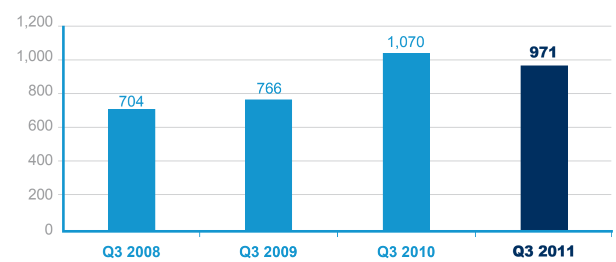
- Number of Cars Sold -



9- Kafalat Loan Guarantees

Based on the figures released by the Kafalat corporation, loans under the guarantee of Kafalat have decreased by 1.42% in the third quarter of 2011, reaching an amount of USD 124.60 million, as compared to USD 126.40 million in the same period of 2010. The number of loan guarantees reached 971 in the said period, as compared to 1,070 in the same period of previous year. Whereas, the average loan size increased by 8.59% to reach USD 128,270 in the third quarter of 2011, as compared to USD 118,115 in the same period of the previous year.

- Number of Kafalat Loan Guarantees -



Real Sector's Indicators

Indicators	Q3 2011	Q3 2010	Variation
Construction permits (Square meters, million)	12.40	13.10	-5.34%
Sales transactions	57,976	68,691	-15.60%
Number of tourists	1,276,110	1,694,662	-24.70%
Number of passengers at HIA	4,244,092	4,214,590	0.70%
Customs revenues (USD, billion)	1.11	1.27	-12.60%
Cleared checks (USD, billion)	53.70	50.85	5.60%
Hotel occupancy rate (%)	55.00	68.00	-13.00%
Number of containers at Beirut Port	439,220	457,998	-4.10%
Number of car sales	24,348	25,569	-4.77%
Amount of Kafalat guarantees (USD, million)	124.60	126.40	-1.42%

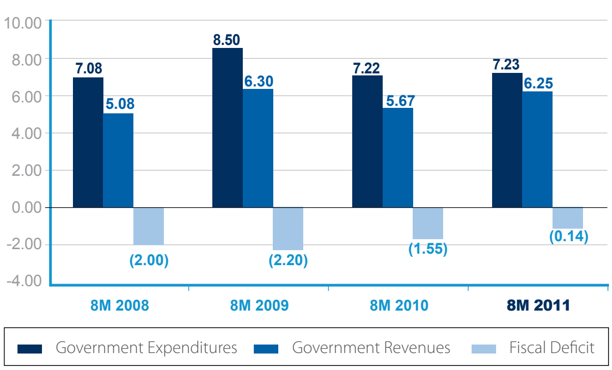
Sources: Official Departments

III. Public Finances

1. Fiscal Deficit

According to the figures released by the Ministry of Finance, the fiscal deficit has decreased by 36.79% reaching USD 976 million for the first eight months of 2011 as compared the same period of 2010.
Overall government revenues which include budget and treasury receipts, increased by 10.23% relative to the same period of 2010, reaching USD 6.25 billion in the first eight months of 2011. Budget revenues increased by 10.70%, reaching USD 5.933 billion due to the increase in non-tax revenues in the same said period. Total tax revenues decreased by 3.60%, reaching USD 4.51 billion also in the same said period.
While on the spending side, total public expenditures, which include budgetary and treasury spending, increased by a yearly 0.14% in the first eight months of 2011, reaching USD 7.23 billion, caused mainly by a rise in budgetary expenditures. after the inclusion of the expenditures to the Lebanese Electricity Company which attained USD 890 million during the period under consideration.

- Public Finance Indicators (USD, billion) -

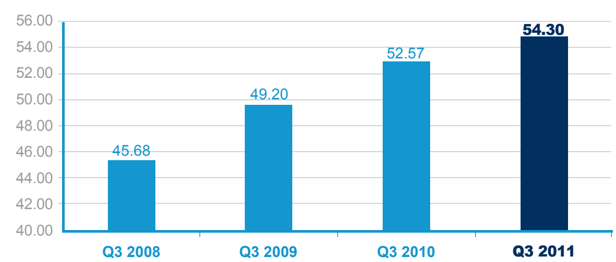


Interest payments on domestic and foreign debt decreased by 7.30% reached USD 2.35 billion in the first eight months of 2011 as compared to the same period of 2010.
When excluding debt service, the level of the primary balance registered a cumulative surplus of USD 1,505 million in the first eight months of 2011, as compared to a surplus of USD 1.72 billion in the same period of 2010.

2. Public Debt

Based on the figures issued by the Ministry of Finance, the gross public debt reached USD 54.30 billion at the end of September 2011, constituting an increase of 3.29% from September 2010.

- Gross Public Debt (USD, billion) -



Domestic debt increased by 11.70%, reaching USD 33.40 billion, while external debt stood unchanged at USD 21 billion. Local currency debt accounted for 61.40% of gross public debt at end-September 2011 compared to 58.70% a year earlier, while foreign currency denominated debt represented 38.60% of the total at the end of September 2011 relative to 41.30% a year earlier.
Net public debt, which excludes the public sector's deposits at the Central Bank of Lebanon and at commercial banks from overall debt figures increased annually by 2.60%, reaching USD 45.80 billion.

Public Finances' Indicators

Indicators	1st eight months 2011	1st eight months 2010	Variation
Public revenues (USD, billion)	6.25	5.67	10.23%
Public expenditures (USD, billion)	7.23	7.22	0.14%
Deficit (USD, million)	976	1,544	-36.79%
Deficit /Expenditures (%)	13.50	21.40	-7.90%
Gross public indebtedness (USD, billion) - 1st nine months	54.30	52.57	3.29%
Net public debt (USD, billion) - 1st nine months	45. 80	44.64	2.60%

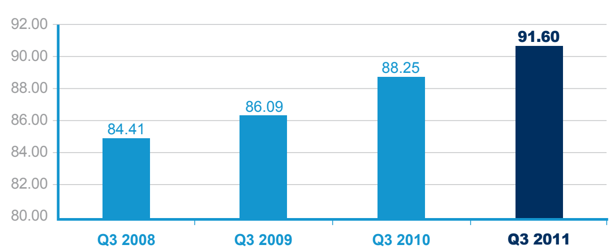
Sources: Ministry of Finance and Central Bank of Lebanon

IV. Monetary Situation

1. Money Supply

Based on the data issued by the Central Bank of Lebanon, Money supply (M3) expanded broadly to reach USD 91.60 billion over the third quarter of 2011, an increase of USD 3.35 billion or 3.79% as compared to its level during the corresponding period of 2010. This resulted from an increase in local currency denominated time deposits of USD 686 million, a rise in foreign currency deposits of USD 3 billion, and a surge in money supply (M1) of USD 51 million.

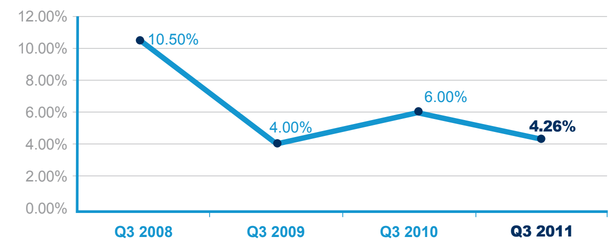
- **Money Supply (M3)** (USD, billion) -



2. Consumer Prices

Based on the figures issued by the Central Administration of Statistics, inflation increased by 4.26% in the third quarter of 2011. This is due to the increase in prices of most commodities in the Lebanese market, such as prices of miscellaneous goods, which increased by 17.11%, followed by prices of apparel (12.95%), transportation and telecommunication (6.53%), healthcare (4.53%), and food and beverages (3.59%).

- **Consumer Price Index** -

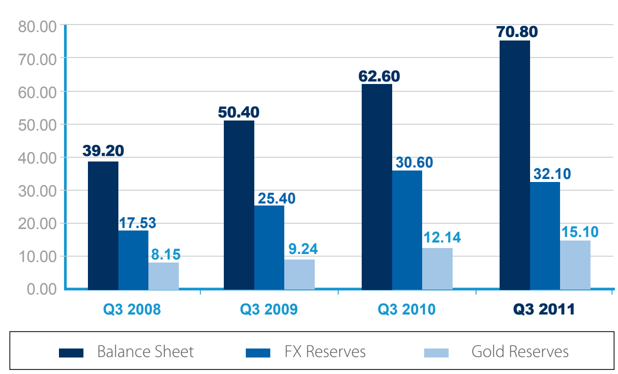


3. Central Bank Foreign Assets

According to the figures released by the Central Bank of Lebanon, its balance sheet reached USD 70.80 billion at the end of the third quarter of 2011 compared to USD 62.60 billion in the same period of 2010. Assets in foreign currencies increased by 5.00%, reaching USD 32.10 billion, as compared to USD 30.60 billion in the same period of 2010. Its gold reserves increased by 24.38% from its value in the same period of 2010, reaching USD 15.10 billion in the third quarter of 2011.

Also deposits of the financial sector increased by 10.30% in the third quarter of 2011, reaching USD 47 billion due to capital inflows into the banking sector.

- **Central Bank's Indicators** (USD, billion) -



Monetary Situation's Indicators

Indicators	Q3 2011	Q3 2010	Variation
USD/LBP exchange rate	1,507.50	1,507.50	0.00%
BDL assets in FX (USD, billion)	32.10	30.60	5.00%
BDL gold reserves (USD, billion)	15.10	12.14	24.38%
Money supply M3 (USD, billion)	91.60	88.25	3.79%
Inflation rate (%)	4.26	6.00	-1.74%

Sources: Central Bank of Lebanon and Lebanese Association of Banks

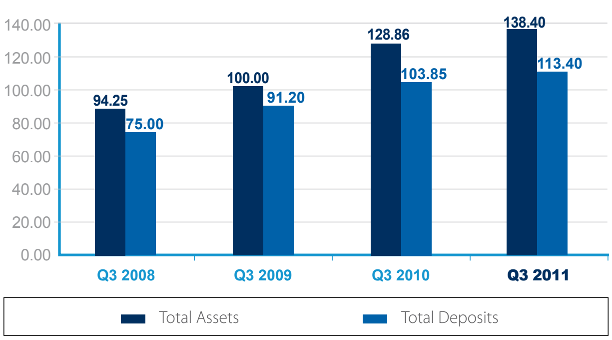
V. Financial Sector:

1. Banking Sector

Based on the figures released by the Central Bank of Lebanon, the banking sector's total assets reached USD 138.40 billion in the third quarter of 2011, an increase of 7.40% as compared to the same period of 2010. Private sector deposits have also increased by 9.20% reaching USD 113.40 billion in the third quarter of 2011 as compared to the same period of 2010.

Deposits in Lebanese pounds decreased by 1.50% from the same period of 2010, reaching USD 38.30 billion, while deposits in foreign currencies increased by 15.60% from the same period of 2010, to reach USD 75.10 billion. Non-resident deposits had increased by 22% from the same period of 2010, to reach USD 24.40 billion. The dollarization rate of deposits increased by 3.70% as compared to the same period of 2010, reaching 66.30% at end-September 2011

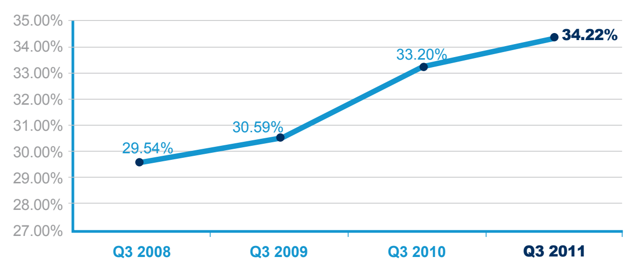
- Banking Assets and Deposits (USD, billion) **-**



Further, loans to private sector have increased by 14.60% in the third quarter of 2011 as compared to the same period of 2010, to reach USD 38.80 billion. Lending in Lebanese pounds increased by 2.82% in the third quarter of 2011 and reached USD 12.41 billion as compared to USD 12.07 billion in the same period of 2010. Lending in US dollars increased by 20.01% in the third quarter of 2011 and reached USD 26.38 million as compared to USD 21.98 million in the same period of 2010.

The ratio of private sector loans to deposits increased from 33.20% in the third quarter of 2010 to 34.22% in the third quarter of 2011. The banks' aggregate capital base has increased by 14.08% in the third quarter of 2011, reaching USD 10.37 billion

- Loans to Deposits Ratio -



Banking Sector's Indicators

Indicators	Q3 2011	Q3 2010	Variation
Total assets (USD, billion)	138.40	128.86	7.40%
Total deposits (USD, billion)	113.40	103.85	9.20%
Total loans (USD, billion)	38.80	33.86	14.60%
Ratio of private sector's loans to deposits (%)	34.22	33.20	1.02%
Banks' capital base (USD, billion)	10.37	9.09	14.08%

Sources: Central Bank of Lebanon and Lebanese Association of Banks

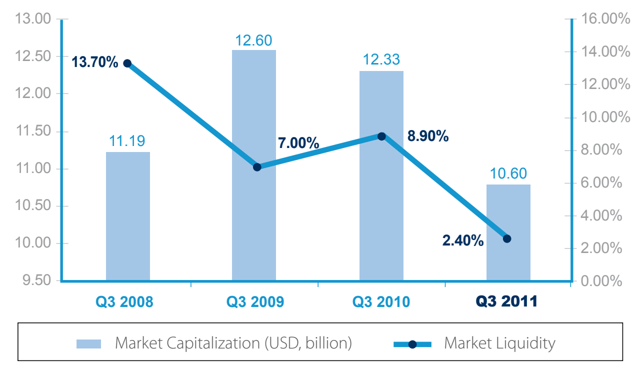
2. Capital Market

Figures released by the Beirut Stock Exchange indicate that the total trading volume decreased by 54.20% in the third quarter of 2011, reaching 64.20 million shares as compared to the corresponding period of 2010. While aggregate turnover decreased by 72.00%, reaching USD 466.20 million for the above said period.

Market capitalization decreased by 14.03% to USD 10.60 billion, of which 72.70% was in banking stocks and 23.50% in real estate stocks. The market liquidity ratio decreased to 4.50%, as compared to 13.40% for the same period of 2010.

The average daily traded volume decreased by 53.50%, reaching 352,776 shares in the third quarter of 2011 as compared to an average daily volume of 758,659 shares in the same said period. The average daily traded value also decreased by 71.50%, reaching USD 2.60 million in the third quarter of 2011 as compared to an average daily value of USD 9.12 million in the same period of 2010

- Stock Market Activity -



BSE Indicators

Indicators	Q3 2011	Q3 2010	Variation
Market capitalization (USD, billion)	10.60	12.33	-14.03%
Total trading volume (Shares, million)	64.20	140.17	-54.20%
Aggregate turnover (USD, million)	466.20	1,665	-72.00%
Average daily value (USD, million)	2.60	9.12	-71.50%

Sources: BSE and Central Bank of Lebanon

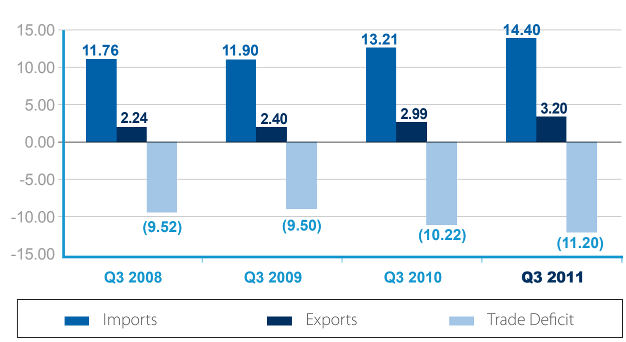
VI. Foreign Sector

1. Foreign Trade

According to figures issued by the Higher Customs Council, imports increased by 9.00%, reaching USD 14.40 billion in the third quarter of 2011, while exports increased by 7.02%, reaching USD 3.20 billion in the same period, leading to an increase of 9.59% in trade deficit, reaching USD 11.20 billion.

The main sources of imports are Italy with 9.80% of total imports, followed by China (8.50%) the United States (7.80%), and Germany (5.80%). While the main sources of exports are Switzerland with 12.20% of total exports, followed by UAE (7.40%), Saudi Arabia (7.20%), Turkey (7.00%), Iraq (5.10%), and Syria (4.60%).

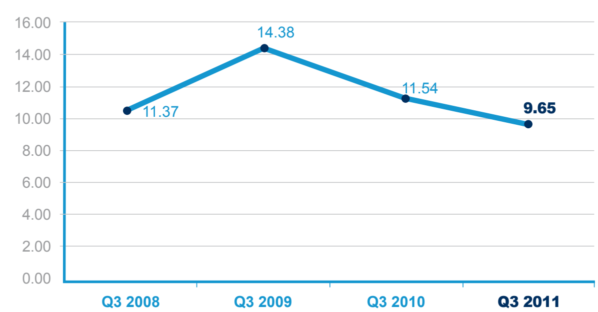
- External Sector Indicators (USD, billion) -



2. Capital Inflows

Capital inflows decreased by 26.42%, reaching USD 9.65 billion as compared to USD 13.12 billion in the same period of 2010, which indicates that Lebanon didn't benefit from the existing regional turmoil, as it did during the last global financial crisis.

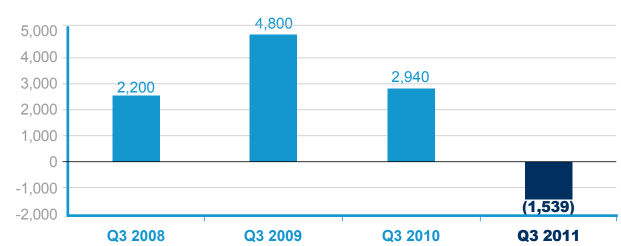
- **Financial Inflows** (USD, billion) -



3. Balance of Payments

Based on the figures issued by the Central Bank of Lebanon, Lebanon's balance of payments posted a deficit of USD 1,539 million in the third quarter of 2011 compared to a surplus of USD 2,940 million in the same period last year. This cumulative deficit over the third quarter of 2011 was caused by a surplus of USD 1,968 million in the Central Bank's net foreign assets and a deficit of USD 3,507 million in those of banks and financial institutions.

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



Foreign Sector's Indicators

Indicators	Q3 2011	Q3 2010	Variation
Trade deficit (USD, billion)	11.20	10.22	9.59%
Exports (USD, billion)	3.20	2.99	7.02%
Imports (USD, billion)	14.40	13.21	9.00%
Capital inflows (USD, billion)	9.65	11.54	-16.38%
Balance of payments (USD, million)	-1,539	2,940	-152.34%

Sources: Higher Customs Council and Central Bank of Lebanon

VII. Economic Prospects

The World Bank revised in its latest country report Lebanon's real GDP growth to be at 4.00% in 2011, down from 7.50% in 2010, and as compared to 4.10% average growth in the MENA. This would make Lebanon the seventh fastest growing economy in the MENA region.

It is also projected that Real GDP growth in Lebanon will stand at 5.00% in 2012, as compared to a growth of 3.80% in the MENA region.

The World Bank also forecasted lower private consumption in the next two years, as compared to its level in 2010, due to the fact that businesses would be less likely to invest in the current situation given weaker consumer confidence in the economy.

Moreover, the World Bank forecasted that Lebanon would record a fiscal deficit of 8.20% of GDP in 2011, and 5.50% of GDP in 2012, as compared to a surplus of 1.40% of GDP in the MENA region.

The U.S. and European Sovereign Debt Crises, and Their Implications: Is It Possible To Reduce Risks for Arab Economies?

Introduction

Once again, following the major global financial and economic crisis in 2008, the world holds its breath towards the sovereign debt crisis in the United States before putting in place a possible solution to avoid the U.S. inability in meeting its internal and external financial obligations. This led to a sharp tension in global markets, in conjunction with a growing European financial crisis caused by a deep sovereign debt in many European countries.

What are the dimensions of this crisis and its repercussions on Arab economies, especially since a significant proportion of Arab investments are abroad, mainly in funds that are greatly affected by the U.S. economy? How can the Arab economies reduce risks, and what alternatives are available? This research will address the various dimensions of this issue and its impacts on the global and Arab economies in order to explore the direct and upcoming consequences, and to identify ways to mitigate the impact of the negative consequences on the Arab economies

The Consequences of U.S. and European Sovereign Debt

1 - Global Economic Trends and Potential Risks

During the first half of 2011, most developed economies witnessed a slowdown in economic growth rates. While some analysts pointed out that what is happening is just a temporary situation, it soon became clear that the global economy was once again so close to enter into another severe recession crisis after the first one in 2008.

The U.S. economic data show a weak growth rate, a low consumption level, and a declining industrial production, in conjunction with the observed slowdown in new job opportunities. The real estate market also continues its downturn, as well as the confidence level in the business and investment sectors which is expected to witness a further decline in the near future.

Similarly the Euro Zone economy is currently experiencing a downturn with a disparity in performance among its countries. Even though some countries have a better situation, but their growth rates were very modest. It seems that the risk of any contraction in the capabilities of Spain or Italy or both to access the global debt markets is becoming currently high. Unlike Greece and Portugal, it is difficult to provide the necessary financial guarantees for the Spanish and Italian economies.

Moreover, the British economy, which is currently witnessing unprecedented disturbances, is hardly growing due to the austerity measures adopted since the major global financial crisis in 2008. The Japanese economy is still in recession as the consequences of the devastating earthquake that occurred in March 2011 are prevailing, and it needs 6-9 months to recover before regaining its balance once again. What also make things worse is that the global industrial production indicators have been dramatically declining, whether in the least affected developed countries by the last financial crisis such as Germany and Australia, or in emerging economies such as China, India and Brazil.

Options seem to be limited given that most countries proceeded since the launch of the major global financial crisis in 2008 to take all available measures and policies to achieve economic recovery, which included a wide range of incentives such as reducing interests to its minimal level, expanding fiscal policies, facilitating credit, providing tax incentives, liquidity and trillions of guarantees to banks and financial institutions.

2 - For the United States

The financial and economic markets didn't show much confidence after the last U.S. fiscal stimulus plan in early August 2011. The main result of the current status was the decline in confidence, where Standard & Poors (S&P) downgraded the credit rating of the U.S. from «AAA» to «AA +», which is unprecedented in the history of the U.S. economy since 1941, the date when the Agency started its credit rating activities. This development was taking place in line with the increased risk on the severe sovereign debt crisis in Europe.

The credit rating downgrade means that the United States will pay higher interest on future debt. It also means that it might not be able someday to repay some or all of its debt on time. This agency has clarified that the last U.S. Fiscal stimulus plan is not sufficient to achieve stability in the government debt-payment mechanisms in the medium term. The U.S. economic agency Bloomberg also noted that this step might increase the U.S. public debt burden by USD 100 billion annually due to possible rise in interest on the indebtedness of the largest economy in the world, by about 0.7%.

This is happening while other rating agencies such as «Moody's» and «Fitch» are reviewing their credit rating assessment of the United States and EU countries. What happened will have a strong impact on the U.S. dollar as a reserve currency. The U.S. government bonds, which have long been considered as the safest investment in the world, have been ranked today lower than other countries' bonds such as Britain, Germany, France and Canada

3 - For the European Union

The financial developments in the United States were accompanied by a rise in the sovereign debt crisis in the European Union, due to fears from its spread to large economies in the Euro-economy with the growing financial difficulties faced by Italy. These fears from losing control on the crisis led to rising interest rates on the Italian Treasury bonds to its highest level in 14 years, in conjunction with the downturn in the Italian stock market.

There fears arose due to the accumulated debt crisis in Italy, which is the third largest economy in the Euro Zone. This might create doubts to implement the rescue plans that aim at helping small countries which suffer from problems such as Greece and Ireland. The Italian government responded quickly by reassuring confidence to the markets through the announcement of early austerity measures and budget balance by the year 2013, which is one year earlier than what had been previously scheduled.

But the situation did not end there. The sharp drop in the French banking shares during the second week of August 2011 had raised new concerns to investors interested in the Euro debt crisis, with doubts from Spain and Italy to France. The French government promptly announced its intention to impose new financial restrictions to avoid the growing concern that France might be on the road to reduce its credit rating.

The Dimensions of the U.S. Sovereign Debt

1 - A Formula to raise the U.S. Debt Ceiling

This adjustable formula allows to raise the U.S. debt ceiling to a new level, after months of negotiations, to increase the public debt ceiling by USD 2.4 trillion in two phases, and to reduce spending by more than USD 2 trillion over ten years. This agreement will save USD 900 billion after limiting expenditures, such as saving USD 350 billion from defense budget, which is almost equal half of the cutbacks, with the exclusion of some programs concerning healthcare, food aid, and social welfare. This agreement allows raising the debt ceiling by a minimum of USD 2.1 billion.

The United States has already reached the debt ceiling limit, which is USD 14.3 trillion in May 2011. This necessitates the raise of this ceiling in order to meet its financial obligations. This adjustable agreement allows the ability to meet financial commitments until the end of 2012.

2 - Impact on Investors' Confidence

Although the creation of a formula to raise the U.S. debt ceiling has prevented the United States and the global economy from witnessing a new crisis that could have severe repercussions, but the economic crisis size, the delay in reaching an agreement to raise the debt ceiling, and the chaos in global markets have raised many questions concerning the future of the U.S. economy and the dollar, the consequences on the global economic system, and the global investment trends that have changed on the U.S. and international levels.

The last incidents shocked the confidence on the part of U.S. and international investors in the U.S. economy that currently leads the global economic system, as many factors doubled the anticipation and uncertainty. Although a solution was created before the maturity date of the U.S. public financial obligations, but the image of the U.S. economy has greatly changed, which will have effects on the assessment level of the U.S. economy and the exchange rate of the dollar, along the liquidity and inflation levels in the global economies, particularly those associated with U.S. currency or have investments in U.S. Treasury bonds.

3 - What Is The Debt Ceiling?

TThe debt ceiling is a legal limit to the government capacity to borrow. The U.S. debt ceiling has been raised about 100 times since 1917, till it rose from a trillion dollars in the eighties to 6 trillion dollars in the nineties, then to the approved ceiling at USD 14.3 trillion in February 2010, and finally to the current ceiling at USD 16.4 trillion in August 2011.

The latest information shows that the U.S. federal public debt reached USD 14.3 trillion, which is equivalent to USD 130 thousand for each U.S. citizen and the equivalent of five times the income per capita rate.

The IMF report indicates that the proportion of U.S. public debt to GDP reached 96.3% by the end of June 2011, which made the United States similar to the Greece situation and in the twelfth place in terms of the level of indebtedness. The interest volume on U.S. debt has reached in 2010 USD 414 billion. These big amounts need a high level of GDP in order to be sustainably met, which might create fears from the ability of the United States to achieve it in the short to medium term.

4 - Causes of Debates and the Effectiveness of the New Agreement

The delay in reaching an agreement to raise the debt ceiling is related to political reasons with respect to the next presidential elections in the United States, and also due to economic reasons stimulated by the debate on economic affairs between Republicans and Democrats. Republicans are demanding a reduction in spending and income tax rates, especially on the rich, and a reduction in insurance benefits and health care. In contrast, the Democrats want to retain these benefits with a limited willingness to reconsider the tax rates.

But the new agreement to raise the debt ceiling contains three basic gaps; two of them oppose each other, while the third threatens more than what the U.S. economy needs in the coming years, namely economic growth. The first gap is related to the time of spending reduction that occurs in the light of the current weakness in the U.S. economy, which raises the risk of falling into a new phase of recession. The second gap is the modest reduction in spending compared to the rise in the budget deficit. The third gap is related to areas that are not encountered by the reduction such as social welfare programs and defense expenditures, which represent the bulk of the spending, at a time where any tax increases on the most rich was excluded. This considers the reduction to be within a small scope that might not exceed 10% of expenditures, and it includes economic support programs, which represents a basic need to stimulate economic growth.

The Repercussions on the Global Economy

1 - The Direct Impact

The immediate results of the conflicts that delayed the agreement to raise the U.S. debt ceiling in the U.S. were reflected in a drop in the USD exchange rate against other major currencies, such as the Euro, Chinese Yuan and Japanese Yen, to reach its lowest level since longtime. The gold price also reached new records with expectations of further increases.

Most importantly, recent developments impacted U.S. debt rating by specialized international institutions. On August 5, 2011, the Standard & Poor's agency announced the removal of the United States from the list of risk-free debt countries. It also noted the possibility of making a further reduction in credit rating if the United States didn't succeed to reduce its federal debt by at least USD 4 trillion over the next decade, which is twice what was recently agreed on in the U.S. Senates Council.

Although there is a relative relief in the market after the last agreement to raise the U.S. debt ceiling, but this will oblige creditors to reduce their new lending to it, as capital markets would raise interest rates as an indicator of high risk on the U.S. debt, in conjunction with the downgrade by credit rating agencies which reduces the safety of the U.S. economy and the confidence in the U.S. dollar.

Several countries have begun to convert foreign currency reserves from USD to Euros, which explains the decline in the USD ratio in international reserves from 60.4% to 60% in 2011.

The U.S. sovereign debt crisis along with the increase and the expansion of European sovereign debt crisis led to higher uncertainties, which were reflected in gold price increases reaching new records, and sharp declines in global capital markets.

2 - The Most Affected Countries

The U.S. crisis resulting from high debt levels makes many creditors face some major problems, since their investments are mainly concentrated in the U.S. Treasury stocks and bonds. Although these investments are still currently reliable, but the U.S. debt downgrade will certainly drop their prices in the secondary capital markets. This means that creditors who wish to liquidate or diversify their investments have to sell some of their U.S. bond portfolios at lower prices relative to the purchased prices, which might expose them to capital losses on their investments.

China, Japan and Saudi Arabia are the U.S. largest creditor countries, whose investment in the United States accounts to nearly USD 3 trillion. China alone holds about 25.8% of the U.S. external debt. This besides other countries, capital markets and foreign monetary markets that lend against interest rates.

There will be other repercussions on the countries which peg their national currencies against the U.S. dollar. These include several Arab countries, countries exporting in U.S. dollars, such as the Arab oil-producing countries. This besides lending countries and those subscribing in U.S. Treasury bonds, and countries depending on foreign aid from the US.

Potential Impacts on Arab Economies

1 - Is there a real problem facing the Arab investments?

Based on the available information, Arab investments in U.S. Treasury bonds by the Arab oil producing countries are USD 400 billion. Also, the Arab public and private investments in USD are estimated to many trillions. The U.S. sovereign debt securities seemed to be more attractive and safer than mortgages and private equity or other financial derivatives that quickly devaluated with the global financial crisis in 2008. Moreover, Saudi Arabia alone has investments from government and semi-government institutions and the banking sector in U.S. bonds and other assets denominated in dollars, amounting to more than USD 2.2 trillion. It is worth noting that this amount will rise if investments of individuals and businesses in U.S. bonds are included.

There will be severe repercussions on the Arab countries due to the current global payment system, where the dollar is the main standard currency. Most currencies of the Arab countries, especially the oil-producing countries, are pegged against to the dollar, which would expose them to losses from the devaluation of U.S. bonds and the U.S. exchange rate, that reached 50% over the past ten years.

The problem is that the United States has reduced the interest rate on the dollar, and it will keep on reducing this rate to reach nearly zero. This means that the proceeds of investments denominated in U.S. dollars don't cover inflation. The same situation also applies on China and Europe in relation to the U.S. debt crisis.

2 - Most Affected Arab countries

The Arab Maghreb countries will be the most affected by the current European sovereign debt crisis, due to an anticipated decline in the demand for energy and its effects on Algeria. This is besides the importance of the European market for the Arab Maghreb countries' exports. Effects will reveal in some sectors, such as foreign trade, tourism and remittances from workers abroad.

As for Tunisia, which is passing in a historic transition phase, after a massive public revolution that occurred in early 2011, the EU provides 76% of the income coming from Tunisian exports of goods, which represents nearly 47% of the Gross Domestic Product. The European Union is also the source of 90% of remittances from Tunisian residents abroad, which represents 5% of the Gross Domestic Product. The European tourism revenues represent 83 per cent of the total tourism revenues, which is nearly 7% of the Gross Domestic Product, besides that the European investments in Tunisia constitute 73% of the total foreign direct investment. Due to the volume of trade exchange, which ranges between 70-80%, the decline in the Euro value will especially impact the balance of payments.

As for Algeria, it is also linked closely to the EU economy. The depreciation of the Euro against the Dollar will have positive effects, since Algeria exports oil and natural gas to the Dollar and Euro regions, and imports of goods and services mainly from the European Union that holds one-third of Algerian exports denominated in dollars. On this basis, it will have positive repercussions on the economy and public finances in terms of its implications on the trade balance. But it will also have negative impact as a result of the decline in remittances from workers abroad, as well as in tourism revenues. But if the Euro crisis continues for a long time, its impact on the Algerian economy will be negative, because the decline in the value of the unified European currency could lead to economic recession, which will certainly result in a slowdown in the demand for oil.

Moreover, the EU is the main partner for Morocco. Official statistics indicate that EU dominates 60% of its trade. Therefore, the negative repercussions will affect the balance of trade with the decline in export values and increase in import values from the fuel denominated in dollar, as well as the current balance with the expected decline in financial remittances and foreign direct investment, in conjunction with the transmission of inflation from the Euro area to the Moroccan economy.

In general, the Arab Maghreb countries are affected by the decline in the Euro value, because its Euro revenues surpass its euro expenses. This means that the value of its revenue decreases with the depreciation of Euro against the Dollar. This happens in conjunction with the increased value of its obligations from the debt denominated in Dollar, if its value appreciates against the Euro, hence leading to a rise in the inflation rate.

3 - Other Arab Countries

As for the rest of the Arab countries, the implications vary depending on their degree of dependence and economic openness. The implications are associated with economic growth rates, foreign direct investments, the price level variation, export sectors, financial and banking sectors, and the availability of government development support.

Areas and Mechanisms to Reduce Risk

1 - Focusing on the Arab Economic Revenues

In light of the current global economic developments, the Arab economy needs to diversify its investments within the possible limits. It might be difficult to re-diversify the investments in sovereign debt securities of developed countries, but new investments could be redirected, especially as the oil price is estimated to remain high with the increased pressure on the Dollar.

Investment portfolios might be enhanced in areas that have more stable values than others, such as gold and other precious metals. But it is better to remain cautious and moderate, because excessive demand will lead to a decline in its price in the future. It is also recommended to diversify foreign exchange reserves to a balanced portfolio, and to promote the alternatives of global Treasury bonds by increasing investment in Islamic bonds and emerging economies bonds such as Turkey, Malaysia and others, besides calculating the capital risk in all circumstances.

The main lesson that could be drawn from the current economic crisis and the negative effects of globalization is the importance of moving forward in promoting Arab economic integration, with the focus on domestic economies of the Arab countries more than investing abroad.

What the Arab countries really need today is to implement adequate policies to develop export bases to provide a value-added, based on two main aspects: the first one is to improve productivity by promoting the use of technology, and the second one is to reduce production costs. Also special focus should be devoted to the infrastructure including roads and utilities. This in addition to those projects which have an integrative dimension among Arab countries such as roads, railways and shipping lines, as well as electrical interconnection and other sources of energy from oil and gas.

The establishment of specialized economic and industrial zones is also important, which will provide the facilities needed by the private sector in production and manufacturing processes and related services. It is important to encourage private investment in innovation and creativity, to diversify Arab economies and expand production basis, to encourage the use of modern technology in the promotion of efficient energy consumption, to optimize the use of water resources, and to encourage the creation of green industries.

Serious work is required to move from rent-based and consumption-based economies to production-based economies that reduce economic exposure to foreign countries, and protect them against volatilities. This will support balanced economic and social development in various sectors for all Arab countries.

It is also important to work on strengthening coordination among Arab financial official authorities to suggest suitable solutions for protecting the Arab economic interests, as well as to enhance the Arab presence in the global economic decision-making institutions such as the International Monetary Fund and the World Bank.

2 - To Avoid the worst at the International Level

Senior economic analysts agree that the United States and other developed countries that suffer from the current sovereign debt crisis should adopt austerity policies in the short run and expansionary ones in the medium term.

In order to avoid the return to a deep recession, it is essential that major countries that still have high credit ratings for the government debt, such as Britain, Japan and Germany, along with the United States, to coordinate greatly with respect to their expansionary fiscal policies in the short term in conjunction with austerity policies in the medium term.

It will be imperative for the western central banks to adopt monetary expansion policies, while the European Central Bank's policies should not be limited to decreasing the interest, but it should reduce it to nearly zero. This should come with a plan to buy treasury bonds from troubled countries such as Italy, Spain and perhaps others, given the serious repercussions of the crisis in these countries, their effects on the global economy, and the future of the European Union and the Euro itself.

Since the liquidation and liquidity problems are at the core of the current crises, it is very important for the United States to work now on the restructuring of its sovereign debt. It must include the reduction of mortgage debt and continue to help the troubled banks. At the European level, it is crucial to extend the maturities of debts of Portugal and Ireland, and perhaps later to Italy and Spain.

Although it is too late now to avoid an international economic slowdown, but it is very possible to avoid a new recession, which is a key reason to move quickly and effectively in the framework of targeted international coordination.