ECONOMIC BULLETIN

2018 First Quarter

FRANSABANK

ECONOMIC Bulletin
FIRST QUARTER 2018

Report - Lebanon's Macro Economy in the First Quarter of 2018

Study - Lebanon: Cedre Reforms vs. Economic Imbalances

II. Real Sector

The real sector of Lebanon's economy experienced an improved performance in the first quarter of 2018 relative to the corresponding period last year. The activity of several leading economic sectors enhanced, thus expanding the aggregate economic activity, both on the demand and supply sides.

1- Agriculture and Industry

In the first two months of 2018, the value of industrial exports grew by 20.2% over the same period of 2017, while the value of agricultural exports dropped by 1.9% during the same period.

As for imports, the value of industrial imports decreased by 1.2%, while that of agricultural imports increased by 8% during the above mentioned period.

As such, the value of agricultural and industrial exports reached USD 531 million for the first two months of 2018, relative to USD 456 million for the corresponding period of 2017, with an annual growth of 16.4%. On the other hand, the value of agricultural and industrial imports dropped by 3.4% from USD 3.3 billion to USD 3.1 billion during the same period.

These figures clearly reflect a better performing export activity against declining import activity, despite the constraints of closed routes especially the Jordan-Syrian border, and high insurance costs. These figures also reflect a positive contribution of the export activity to overall demand in the economy, besides better production operations.

2- Real Estate and Construction

According to the figures of the Real Estate Registry and Ministry of Finance, the number of property sales operations decreased by 17% on annual basis to reach 14,181 operations in the first quarter of 2018. Also, the value of property sales dropped by 14% annually to reach USD 2,012 million during the same period. In parallel, the sales to foreigners fell by 3.2% year-on-year to reach 273 operations in the first quarter of 2018.

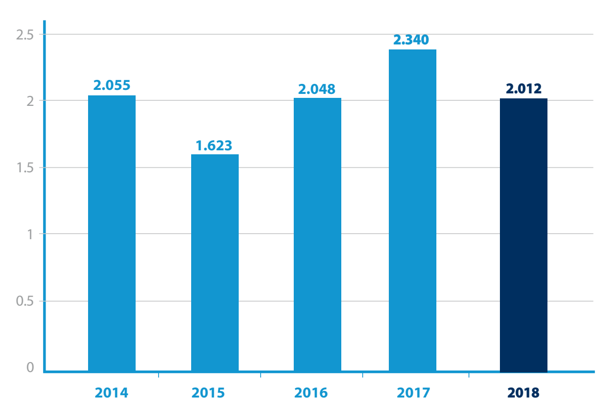
These figures reflect a declining real-estate activity in the first quarter of 2018 as far as the demand side is considered.

The figures released by the Orders of Engineers and Architects of Beirut and Mount Lebanon show that the number of new construction permits reached 3,653 permits in the first quarter of 2018, with a decrease year-on-year of 9.6% from 4,043 permits in the same period last year.

The surface area of the construction permits was 2,669,877 square meters in the first quarter of 2018, with a decrease of 15.1% from 3,144,753 square meters in the same period last year.

These figures suggest a curbed supply in the real-estate sector in the first quarter of 2018 relative to the same period last year.

- Value of Transactions, First Quarter (USD, Billion) **-**



Lebanon's Macro Economy in the First Quarter of 2018

I. General Introduction

Lebanon's macro economy recorded a relative improvement and better performance during the first quarter of 2018 relative to the same period of 2017, due mainly to more favorable domestic political environment and a deceleration of regional turmoil. This was accompanied by an improving real-estate sector and monetary conditions, and continued capital inflows.

The real sector's activity improved with a positive growth in the major leading indicators of most productive and services sectors, thus reflecting a stronger aggregate demand (spending) in the national economy.

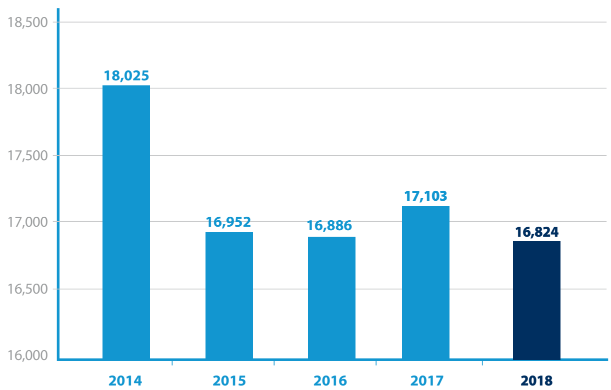
The monetary authorities have maintained its monetary stabilization and economic stimulus policies. The country recorded inflation due to expanding economic activity.

The balance of payments achieved a surplus in the first two months of 2018, but a deficit in the first quarter of 2018.

The fiscal conditions, however, remain highly unfavorable due to continued fiscal deficits and growing public indebtedness.

Economic growth is expected to continue in 2018, with an enhanced real growth rate. Economic reforms must be the major priority of domestic authorities in order to support economic growth rates in the years to come, especially following the Cedre Conference which allocated a foreign aid of USD 11.6 million for Lebanon. This should be accompanied by special efforts to address the continued negative repercussions of the Syrian crisis on the domestic economy and society.

- **Value of Cleared Checks, First Quarter** (USD, Million) -



The Economic and Social Fund for Development (ESFD) reported that it guaranteed 114 loans for a total of USD 1.9 million to **SMEs in Lebanon** in the first quarter of 2018. The Kafalat loans decreased in number from 146 to 113 guarantees in the first quarter of 2018, and also in amount from USD 18.4 million to USD 14.95 million during the same period. SMEs constitute a major pillar of the corporate sector, and a driving force of economic activity and job creation in Lebanon.

The number of startups in Lebanon recorded an increase by nearly 3.5 times from 11 startups in 2013 to 37 startups in 2016. Also, their investments grew from USD 7 million to USD 56 million during the same period, with an increase of 8 times. In this sense, Lebanon was ranked in the second place after UAE, according to a recent study conducted by Arabnet for the Arab region.

Value of Startups Investments in Lebanon (USD, million)

Year	Value
2013	7.0
2014	26.0
2015	30.0
2016	56.0

Source: Arabnet Study.

The value of merger and acquisition deals targeting Lebanon reached USD 115 million in the first two months of 2018. Lebanon ranked in the fifth place among 12 MENA countries, representing nearly 3.7% of the total merger and acquisition deals (USD 3.2 billion). Lebanon came after UAE, Qatar, Egypt and Bahrain, according to a recent study conducted by the Bureau Van Dijk.

Real-Sector Indicators

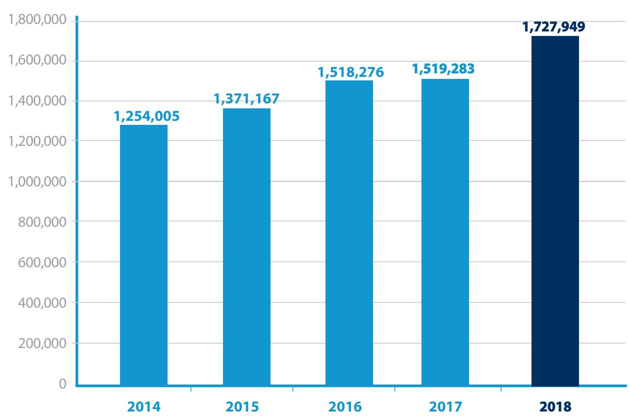
Indicators	2017 Q1	2018 Q1	% Change
Agricultural & Industrial Exports (USD, million)*	456	531	16.4
Construction Permits (sqm)	3,144,753	2,669,877	(15.1)
Construction Permits (number)	4,043	3,653	(9.6)
Real-Estate Transactions (number)	7,081	14,181	(17.0)
Real-Estate Transactions (USD, million)	2,340	2,012	(14.0)
Spending of Tourists (% growth)	8.0	1.6	
Number of Passengers at HIA	1,519,283	1,727,949	13.7
Aircraft Activity at HIA	15,066	15,345	1.9
Freight Activity at HIA	18,789	22,039	17.3
Value of Returned Checks (USD, million)	319	364	14.1
Number of Returned Checks	54,897	63,919	16.4
Cleared Checks (USD, billion)	17.1	16.8	(1.6)
Cleared Checks (number in thousand)	2,973	3,111	(4.4)
New Car Sales (number)	8,118	7,645	(5.8)
Number of Tourists	345,168	362,398	5.0
Hotel Occupancy Rate (%)	62.4	57.9	
Goods Quantity at Beirut Port (000, tons)	2,180	2,060	(5.5)
Numbers of Containers at Beirut Port	199,739	210,325	5.3
Number of Ships at Beirut Port	461	471	2.2
Revenues of Beirut Port (USD, million)	55.3	59.4	7.4
ESFD Guaranteed Loans (number)	-	114	-
ESFD Guaranteed Loans (USD, million)	-	1.9	-
Kafalat Loans (number)	146	113	(22.6)
Kafalat Loans (USD, million)	18.4	14.95	(18.6)

* *First 2 months.*
Sources: Official and Related Directorates.

3- Trade and Services

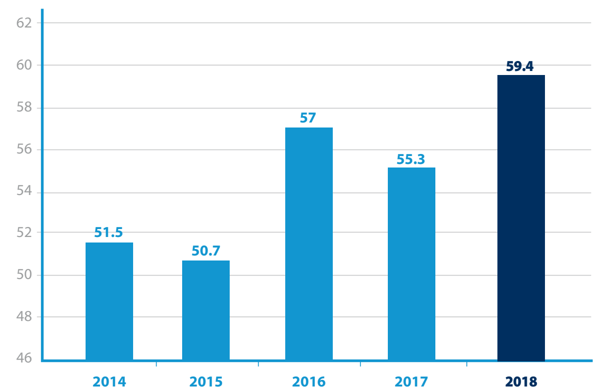
The statistics released by the **Hariri International Airport** indicate that the total number of passengers increased by 13.7% on annual basis to reach 1,727,949 passengers in the first quarter of 2018. The total freight handled by the airport grew by 17.3% on annual basis, during the same period. The number of aircraft recorded an increase of 1.9% on annual basis during the said period. These figures suggest a significant improvement in the airport activity.

- Passengers at the Airport - First Quarter -



According to the statistics of the **Port of Beirut**, its revenues recorded an increase by 7.4% on annual basis to reach USD 59.4 million in the first quarter of 2018. The number of ships recorded an annual increase of 2.2% to reach 471 ships in the first quarter of 2018. In parallel, the number of containers recorded an annual increase of 5.3% to reach 210,325 containers during the same period .But the quantity of goods declined by 5.5% year-on-year to reach 2,060 thousand tons in the first quarter of 2018. These figures indicate that the Port of Beirut activity, an indicator of maritime transport and trade, recorded a better performance during the period under consideration.

- Port of Beirut Revenues, First Quarter
(USD, Million) **-**



The **number of visitors** to Lebanon totaled 362,398 tourists in the first quarter of 2018, growing by 5% from 345,168 tourists in the corresponding period last year. The distribution of these tourists according to nationality shows that visitors from European countries constituted 35.4% of the total number of tourists, followed by visitors from Arab countries (32.4%), Americas (14.2%), Asia (8.1%), Africa (6.4%), and Oceania (3.5%).

According to the Survey of Ernst and Young, the Beirut's **hotel occupancy rate**, an indicator of tourism activity, decreased from 62.4% in the first quarter of 2017 to 57.9% in the first quarter of 2018. The average room rate rose from USD 170 to USD 173, and the rooms yield fell from USD 106 to USD 100 during the same period. These figures reflect a declining hotel activity during the period under consideration.

The statistics of the Association of Automobile Importers in Lebanon show that the number of **new sold cars** totaled 7,645 cars in the first quarter of 2018, with a decrease of 5.8% from 8,118 new cars sold in the same period last year.

According to the statistics of the Association of Banks in Lebanon, the total value of **cleared checks**, mirroring private consumption and investment spending, decreased by 1.6% on annual basis, from USD 17.1 billion in the first quarter of 2017 to USD 16.8 billion in the first quarter of 2018. And the total value of returned checks increased by 14.1% on annual basis to reach USD 364 million in the first three months of 2018. This reflects a curbed private spending during the period under consideration.

IV. Inflation and Monetary Policy

The monetary authorities have maintained its monetary stabilization policy as well as economic stimulus policy in the first quarter of 2018. This period experienced further inflation.

1- Central Bank

The Central Bank's statistics reveal that its balance sheet increased by 3.8% on annual basis to reach USD 122.8 billion at the end of March 2018, compared to USD 118.3 billion during the same period of 2016. Assets in foreign currencies reached USD 43.4 billion at the end of March 2018, with an increase of 3.3% from USD 42 billion at the end of March 2017.

As for the gold reserves, its value grew by 2.2% year-on-year to reach USD 12.2 billion in the first quarter of 2018. These figures reflect a better financial status of the Central Bank.

2- Inflation

The Price Index of the Central Administration of Statistics increased by 5.4% on annual basis in the first quarter of 2018, compared to a lower level of 4.8% in the same quarter of 2017. This reflects the growth of inflation in the first quarter of 2018, following deflation in 2016 and 2015.

3- BTA – Fransabank Retail Index

The first quarter of 2018 was characterized by a very low level of activity. The lowest actually for quite a long period.

It is also possible to state that, in the wake of a relatively stable political situation, undeterred by any tensions and focused on the preparations for the upcoming parliamentary elections during the second quarter of this year after nine years, and also with the prevailing quiet and secure environment on the Lebanese territory under the total control of Lebanese concerned parties, albeit the ongoing regional turmoil in general and the continued conflicts in Syria in particular, it is natural to state that pure economic factors were the only factors behind such state of recession that has been witnessed in Lebanese retail markets – especially the basic necessities sectors such as the Food Products sector and other essential sectors.

The decision of the outgoing parliament to vote for new and complementary tax and excise laws, at a time when the economy was facing extremely heavy pressures, came as a lethal blow to whatever activity was remaining in the retail trade sectors – especially that the new taxes were applied on prices that were already hit by a very high inflation rate posted for the period between the first quarter of 2017 and the first quarter of 2018.

Another factor that should not be overseen is that such new taxes imposed and the high inflation rate were also accompanied by an increase in interest rates. Such combination resulted into further pressure on the Lebanese households purchase power, households that have been for some time now under heavy competition by their Syrian counterparts in the various sectors of the local labor market.

Back to the CPI that was announced by the CAS for the period under review, it is noticed that it points to a general increase in prices between Q1 of 2017 and Q1 of 2018, and increase that stood at 5.35% in comparison with 5.01% for the previous quarter.

While it is not possible to determine the extent of the impact of the inflationary factor on the level of consumption, there is no doubt that it is having a very harmful effect on the overall purchase power of Lebanese households.

III. Fiscal Policy and Indebtedness

1- Fiscal Deficit

The fiscal conditions in Lebanon remain highly unfavorable in light of continued fiscal deficits and growing public indebtedness, and the crowding-out effect of private investment fueled by public borrowing.

According to the statistics of the Ministry of Finance for 2017, the fiscal deficit totaled USD 3.8 billion, due to higher spending (USD 15.4 billion) over revenues (USD 11.6 billion). The largest share of public spending, nearly 91.5%, is current spending consisting of wages and salaries of the public sector, financial transfers to EDL, and interest payments on the public debt. These continued fiscal deficits feed the growth of public indebtedness which stood at USD 80 billion as of end-2017, with an annual growth rate of 5-6%. This results in a crowding out effect, where the public sector competes with the private sector for banking credit and investment. The debt-to-GDP ratio is high at nearly 150%, together with a high fiscal deficit-to-GDP ratio of nearly 8% as of end-2017. In this sense, the internal deficit in the Lebanese economy (i.e. the fiscal deficit) constitutes a major economic imbalance.

The 2018 Budget Law enacted by the Lebanese Parliament in March 2018 estimated public spending at USD 15.9 billion and public revenues at USD 12.4 billion, with a fiscal deficit of nearly USD 3.5 billion. When including treasury transfers to EDL which are estimated at USD 1.4 billion, total public spending would rise to nearly USD 17.2 billion, with an increase of 12% from realized spending in 2017 (USD 15.4 billion). Total public revenues are estimated to rise by 6.6% from realized revenues in 2017 (USD 11.62 billion). As such, the fiscal deficit is projected at USD 4.85 billion or 28.1% of total public spending in 2018, relative to a realized deficit of USD 3.76 billion or 24.4% of total public spending in 2017. In this sense, the fiscal deficit-to-GDP ratio would widen from a realized 7.3% in 2017 to a projected 9% in 2018.

2018 General Budget Figures (USD, billion)

	Realized Figures 2017	Projected Figures 2018
Total Public Revenues	11.62	12.35
Total Public Spending	15.38	17.2
Total Fiscal Deficit	3.76	4.85
Deficit-to-GDP Ratio (%)	7.3	9.0

Source: Ministry of Finance.

2- Public Debt

According to the Ministry of Finance figures, public indebtedness of Lebanon increased by 7.1% on annual basis, from USD 76.2 billion at end-February 2017 to USD 81.5 billion at end-February 2018. The public debt in foreign currency reached USD 30.6 billion, increasing by 7.9% from a year later. The public debt in Lebanese Pound totaled USD 50.9 billion at end-February 2018, with an increase of 6.6% from end-February 2017.

Local-currency debt accounted for 62.5% of the total public debt at end- February 2018, against 37.5% for the foreign-currency debt.

At end-February 2018, commercial banks held about 34.4% of the public debt in Lebanese Pound, relative to 44.7% a year later, and the Central Bank held nearly 51.5% of this debt.

Public Debt Indicators (USD, billion)

Indicators	2017 First 2 Months	2018 First 2 Months	% Change
Gross Public Debt	76.2	81.5	7.1
Domestic Debt	47.7	50.9	6.6
Foreign Debt	28.4	30.6	7.9

Sources: Ministry of Finance and Central Bank of Lebanon.

While such poor results are obviously alarming, they are expected to display an improvement during the second quarter – especially after the parliamentary elections, because of all the optimistic hopes and expectations that are accompanying such elections, and all what they carry in terms of restoration of a long lost confidence in the Lebanese economy, that should lure long awaited investments to the various economic sectors, as well as attract back tourists and visitors to Lebanon, with all what they bear in terms of consumption in the local trade markets in particular and of positive impact on the economic activity in general.

Over and above, a regain in activity should be expected once all concerned internal and external parties re-channel their investments towards all Lebanese economic sectors, with all what results in terms of new job opportunities, improved purchase power, and increased liquidity flow for local consumption.

Until then, unfortunately, the results for the first quarter of this year indicate sharp declines in the turnover figures of many retail sectors in comparison to the same quarter of last year, while few other sectors managed to post relatively better results.

Main sectors where declines were registered include:

- Furniture (- 51.80%)
- Shoes and Leather Products (- 33.72% after a - 29.69% in the previous quarter)
- Cellular Phones (- 25.95%)
- Toys (- 16.50% after a – 13.70% in the previous quarter)
- Optical and Hearing Aid Instruments (- 16.29%)
- Household Electrical Equipment (- 16.17%)
- Pharmaceuticals (- 15.69%)
- Clothing (continued decline reaching – 15.05% after a - 15.70% in the previous quarter)
- Silverware and Decoration (- 13.61%)
- Books & Stationery & Office Supplies (- 11.94%)
- Medical Equipment (- 10.88%)
- Used Cars Dealers (- 9.57%)
- Musical Instruments (- 7.90%)
- Home Accessories (- 7.42% after a – 3.29% in the previous quarter)
- Supermarkets and Food Shops (- 5.73% after a – 8.61% in the previous quarter)
- Sports Items & Equipment (- 3.78%)
- Restaurants and Snacks (- 2.74%)
- Construction Material (- 1.22%)
- Liquor & Spirits (- 0.71%)

In addition to the noticeable improvement in the activity of Commercial Shopping Centers (+ 9.00%) and the increase in the volume of fuel (+ 2.44%), the sectors that witnessed better results were:

- Tobacco (+ 20.73%)
- Construction Equipment (+ 14.11%)
- Perfumes and Cosmetics (+6.20%)
- Bakeries & Pastries (+ 5.23%)
- Watches and Jewelry (+ 3.33%)

After the study of year to year comparative results, another scrutiny is also necessary on the quarterly market and sectorial developments between the last quarter of 2017 and the first quarter of 2018.

The picture is also quite gloomy, with almost all sectors (except the Pharmaceuticals and the Optical Instruments sectors) reporting falls in their real sales (i.e. even after the application of the CPI variation of - 1.06 % between the fourth quarter of 2017 and the first quarter of 2018) with a consolidated decline reaching the level of – 6.70 %. Such decline is naturally expected since end of year seasonal factors do usually fuel for more consumption while the start of the year is usually heavy on households purchase propensity.

It is important to note that the Fuel sector (included in the consolidated figures) has registered a – 4.74 % volume decrease during this period. Commercial Shopping Centers also posted a – 8.00 % decline in their figures.

Other sectors where declining activity was reported included:

- Construction Equipment (-48.18%) while Construction Materials posted + 0.97%
- Furniture (- 38.39%)
- Liquors (- 37.94 %)
- Books & Stationery & Office Supplies (- 29.88%)
- Sports Items & Equipment (- 26.90%)
- Cellular Phones (- 26.42%)
- Antiques (- 24.25%)
- Household Electrical Equipment (- 21.76%)

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 %**
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 '16 / Q4 '17	+ 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 %**

As a result, the consolidated real retail turnover figures have posted a sharp decline between the first quarter of 2017 and the first quarter of 2018, reaching – 9.31% (i.e. after applying the inflation rate weight on the nominal results).

By excluding the fuel sector results (where an increase of +2.44 % in volume was reported), the real turnover drop reaches – 11.47% in comparison to the Q1 '17 figures excluding fuel.

Yearly Variation between 1st Quarter '17 and 1st Quarter '18

	Q1 - 2017	Q1 - 2018	
Nominal Year to Year Variation (incl. Liquid Fuels)	100.00	95.82	
Nominal Year to Year Variation (excl. Liquid Fuels)	100.00	93.53	
CPI between Mar '17 and Mar '18 (as per the official CAS figures)		**+ 5.35 %***	
Real Year to Year Variation (incl. Liquid Fuels)	100.00	90.69	**- 9.31 %**
Real Year to Year Variation (excl. Liquid Fuels)	100.00	88.53	**- 11.47 %**

* CAS – CPI – Mar '18

After deploring such poor results during the first quarter of 2018, it should be noted that attention shall be focusing, during the second quarter, on the extent of the positive impact that the elections are expected to have on the general economic situation in Lebanon, and on the situation in the various commercial sectors in particular. As a result, retailers are placing all their hopes on a quick response of the markets and a gradual – yet prompt, recovery of the consuming pattern.

4- Stabilization Policy

The Central Bank of Lebanon has continued its monetary stabilization policy during the first quarter of 2018, just like in the previous years. The stability in the exchange rate (USD1 = LBP 1507.5) persists, thus contributing to overall monetary and economic stability.

To support this monetary stability, the monetary authorities have maintained their policy of moderating growth in money supply. This is crucial also for controlling inflation.

Monetary Indicators

Indicators	2017 Q1	2018 Q1	% Change
USD/LBP Exchange Rate	1507.5	1507.5	0.0
Central Bank's Balance Sheet (USD, billion)	118.3	122.8	3.8
Central Bank's Assets in FX (USD, billion)	42.0	43.4	3.3
Central Bank's Gold Reserves (USD, billion)	11.9	12.2	2.2
Inflation Rate (%)	4.8	5.4	-

Sources: Central Bank of Lebanon, Association of Banks in Lebanon, and Central Administration of Statistics.

V. Financial Markets

The banking sector has continued its growth in the first quarter of 2018, and the capital market recorded a remarkable improvement in its activity during the first quarter of 2018.

1- Banking Sector

The statistics of the Association of Banks in Lebanon and the Central Bank indicate that the total assets of commercial banks stood at USD 224.6 billion as of end-March 2018, with an annual growth of 9.1% from end-March 2017.

The loans extended by commercial banks to the private-sector increased by 4.2% annually to reach 59 billion at end-March 2018. The dollarization rate of private sector lending dropped from 70.4% at end-March 2017 to 67.9% at end-March 2018.

The loans extended to the public sector decreased by 18.5% on annual basis to reach USD 30.8 billion at end-March 2018.

The deposits of commercial banks at the Central Bank reached USD 110.6 billion at end-March 2018, with an annual growth of 29%.

The total private-sector deposits grew by 3.9% on annual basis to reach USD 170.7 billion at end-March 2018. The dollarization rate of these deposits increased from 66.1% at end-March 2017 to 68.3% at end-March 2018.

The private-sector loans-to-deposit ratio was 34.6% at end-March 2018, compared to 34.5% at end-March 2017.

The commercial banks' capital base expanded by 16.5% year-on-year to reach USD 21.5 billion at end-March 2018.

- Shoes and Leather Products (- 19.72%)
- Perfumes and Cosmetics (- 10.70%)
- Medical Equipment (- 9.00%)
- Home Accessories (- 7.08%)
- Watches and Jewelry (-5.99%)
- Tobacco (- 5.56%)
- Supermarkets and Food Shops (- 5.21%)
- Bakeries & Pastries (- 5.09%)
- Used Cars Dealers (- 4.30%)
- Toys (- 4.18%)
- Clothing (- 3.95%)
- Restaurants and Snacks (- 1.72%)

Positive results were posted in the following sectors:

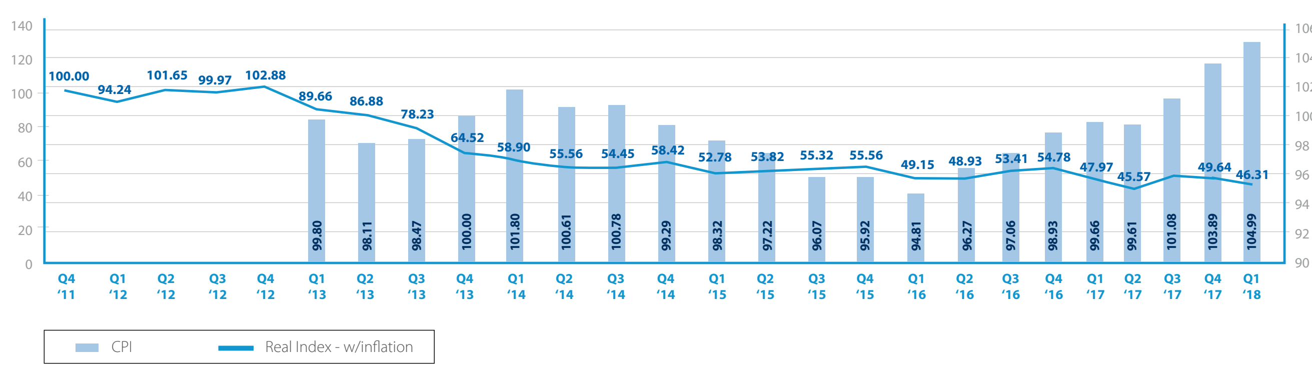
- Pharmaceuticals (+ 25.19 %)
- Optical and Hearing Aids Instruments (+ 9.05 %)
- Silverware and Decoration (+ 3.53 %)
- Musical Instruments (+ 2.72 %)

As a result, with our base index 100 fixed at the fourth quarter of 2011, and with a quarterly inflation rate of – 1.06 % for the first quarter of 2018, as per the official CAS report, we hereby announce that the "BTA-Fransabank Retail Index" is (with all sectors included): 46.31 for the first quarter of the year 2018; this figure compares to the level of 49.64 for the fourth quarter of 2017.

BTA - Fransabank Retail Index for Q1 - 2018 (Base 100 : Q4 - 2011)

	2011	2012				2013				2014				2015				2016				2017				2018
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
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	52.911	46.27	46.79	51.49	53.86	47.51	46.76	52.00	53.17	**49.09**
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	55.56	49.15	48.93	53.41	54.78	47.97	45.57	49.93	49.64	**46.31**
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	94.81	96.27	97.06	98.93	99.66	99.61	101.08	103.89	**104.99**

Evolution of the BTA - Fransabank Retail Index (Base 100 : Q4 - 2011)



VI- Foreign Sector

The balance of payments, mirroring the aggregate foreign sector activity, was better in the first two months of 2018 relative to the same period of 2017, due to continued capital inflows and narrowing trade deficit. But it recorded a deficit in the first quarter of 2018.

1- Trade Balance

For the first two months of 2018, the value of total exports reached USD 531 million, with an increase of 16.4% a year later. In parallel, total imports dropped by 3.4% to reach USD 3.1 billion during the same period. As such, the trade deficit narrowed to USD 2.569 billion, declining by 9.7% on annual basis.

The export-to-import coverage ratio was 17.1% in the first two months of 2018, relative to 13.8% in the same period last year, thus reflecting an improvement in this coverage ratio due to the growth of exports.

These figures indicate a better trade activity for Lebanon, fueled by an improving export activity.

2- Capital Balance

The financial inflows to Lebanon are estimated at USD 2.722 billion in the first two months of 2018, relative to USD 2.975 billion a year earlier, thus declining annually by 8.5%. This mirrors a retarding inflow of financial funds from foreign markets.

According to a recent study conducted by the Institute of International Finance (IIF), the amount of net capital inflows to Lebanon is estimated at USD 6.85 billion in 2018, similar to that of 2017, but lower than the peak level of USD 14 billion in 2009.

These inflows are composed of nearly USD 3.3 billion in FDI, USD 933 million in portfolio investment and USD 2.7 billion in other investments.

Estimated Net Capital Inflows to Lebanon in 2018

Investment Type	Amount
Net Capital Inflows (USD, billion)	6.85
FDI (USD, billion)	3.3
Portfolio Investment (USD, million)	933
Other Investments (USD, billion)	2.7

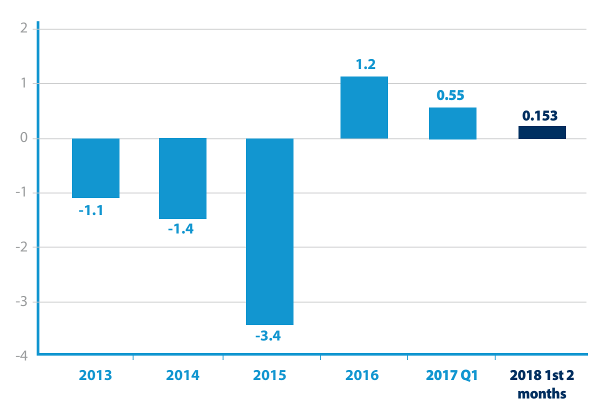
Source: IIF.

3- Balance-of-Payments

The statistics announced by the Central Bank show that Lebanon's balance of payments recorded a surplus of USD 153 million in the first two months of 2018, relative to a lower surplus of USD 131 million in the same quarter last year. The recorded surplus was due to a decrease of USD 1.248 billion in the net foreign assets of banks and financial institutions, and an increase of USD 1.401 million in the net foreign assets of the Central Bank.

The balance of payments recorded a deficit of USD 207 million in the first quarter of 2018, compared to a surplus of USD 554.8 million in the same period last year. This deficit was the result of a decline of USD 1.64 billion in the net foreign assets of banks and financial institutions, and an increase of USD 1.43 billion in those of the Central Bank.

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



Indications of Commercial Banks (USD, billion)

Indicators	2017 First Quarter	2018 First Quarter	% Change
Total Assets	205.9	224.6	9.1
Private Sector Deposits	164.3	170.7	3.9
Private Sector Loans	56.6	59.0	4.2
Loans to Public Sector	37.8	30.8	(18.5)
Deposits at Central Bank	85.7	110.6	29.0
Dollarization of Lending (%)	70.4	67.9	
Dollarization of Deposits (%)	66.1	68.3	
Loans-to-Deposits Ratio (%)	34.5	34.6	
Capital Base	18.5	21.5	16.5

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

2- Beirut Stock Exchange

The figures announced by the Beirut Stock Exchange (BSE) indicate that total trading volume reached 45.6 million shares in the first three months of 2018, with a substantial increase of 3.5 times from 13.12 million shares in the same period last year.

The total trading value also increased substantially by 3.1 times from USD 107.7 million to USD 338.1 million during the same period.

Market capitalization of BSE decreased by 5% on annual basis to reach USD 11.85 billion at end-March 2018.

For the first quarter of 2018, banking shares accounted for 85.2% of the total activity, followed by real-estate shares (11.9%), industrial enterprises shares (2.6%), and trading firms' shares (0.3%).

The market liquidity ratio was 2.9% in the first quarter of 2018, relative to 0.9% in the same period of 2017.

Beirut Stock Exchange Indicators

Indicators	2017 Q1	2018 Q1	% Change
Market Capitalization (USD, billion)	12.47	11.85	(5.0)
Total Trading Value (USD, million)	107.7	338.1	213.9
Total Trading Volume (Shares, thousand)	13,148	45,622	246.99
Turnover Ratio (%)	3.3	3.0	-
Liquidity Ratio (%)	0.9	2.9	-

Sources: BSE and Central Bank of Lebanon.

Study - Lebanon: Cedre Reforms vs. Economic Imbalances

Introduction

The Cedre Conference constituted a great positive shock to Lebanon, since (50) countries and regional as well as international organizations decided on supporting the country with substantial foreign aid. This new international substantial financial support reflected the confidence of the international community in the Lebanon's capability of dealing with the current and future difficulties and challenges.

However, this international financial support was conditioned that Lebanon should implement fiscal, structural and sectorial reforms. Such reforms constitute a real challenge for domestic political authorities.

In fact, the domestic economy suffers, today, from deep and diversified imbalances which the government should deal will to lessen its extent and repercussions. This is a significant prerequisite for strengthening growth rates, expanding job opportunities, and improving fiscal and social conditions in the coming years.

The government of Lebanon should, as well, focus on launching the required operations in the oil and gas sector in the short term. The introduction of gas and oil activities to the Lebanese economy would diversify and increase the country's national income and personal income, as well as improving fiscal conditions.

I. Cedre Conference and its Results

The Cedre Conference was organized with the support of France on April, 6, 2018, with the participation of (37) countries and (14) international and regional organizations. It allocated nearly USD 11.6 billion in financial support to Lebanon, which was distributed as follows:

- USD 10.8 billion in loans, of which 93% is in the form of soft loans.
- USD 800 million in grants, including grants to support loans' interest payments.

The Conference aimed at developing the Lebanese economy, mainly by financing the Capital Investment Program (CIP) of the Lebanese government, and by supporting monetary and fiscal stability. To convince the international community with this CIP, the government presented its vision for stability, growth, and job creation to the Cedre Conference. The vision rests on four main pillars:

1- Enhancing public investment projects in the short term, which will be financed by external loans, especially in the fields of infrastructure which supports economic growth in the long term. This besides increasing the private sector role, which would promote new job opportunities and enhance the overall productivity of the national economy.

2- Maintaining financial and economic stability, mainly through the restructuring of public finances and increasing the scope of public investments, in a framework of viable macroeconomic and fiscal policies.

3- Implementing structural reforms to ensure the sustainability of investments in infrastructure and economic sectors, as well as fostering governance and private sector-led growth. These reforms focus on combating corruption, reform and governance on the fiscal front, restructuring and modernization of the public sector, upgrading the customs administration, reforming the capital markets, and strengthening the private sector role.

4- Adopting an effective strategy to diversify economic sectors, both productive and services, and enhancing export capacity, in an enabling business environment that lifts existing investment barriers and supports macroeconomic and financial stability.

The Cedre financial aid was distributed among countries and organizations as shown in the following table:

Foreign Sector Indicators (USD, billion)

Indicators	2017 First 2 Months	2018 First 2 Months	% Change
Trade Deficit	2.844	2.569	(9.7)
Exports	0.456	0.531	16.4
Imports	3.3	3.1	(6.1)
Capital Inflows	2.975	2.722	(8.5)
Balance of Payments	0.131	0.153	16.8
Balance of Payments (first quarter)	554.8	(207.5)	-

Sources: Higher Customs Council and Central Bank of Lebanon.

VII- Growth Prospects

Real economic growth is expected to continue during 2018, at a rate better than the one recorded in 2017. This will be stimulated by the currently observed political and security stability, expanding aggregate economic activity, continued monetary stabilization policy, and continued capital inflows.

The IMF projects the real GDP growth rate of Lebanon at 1.5% in 2018, up from 1% in 2017. The World Bank projects the real GDP growth rate at 2% for the same period. The IIF forecasts real GDP growth at 2.3% for 2017 and 3.1% for 2018. The EIU projects real GDP growth at 2.3% in 2018, and Bloomberg at 2.1% for the same year.

Real GDP Growth Rates Estimates (%)

	2017	2018	2019	2020
IIF	2.3	3.1	3.8	4.5
World Bank	2.0	2.0	2.0	2.0
EIU	-	2.3	2.9	2.9
IMF	1.0	1.5	2.5	2.5
Bloomberg	-	2.1	2.6	-

consider that the funds would not support growth and job creation due to existing corruption. In addition, they stress that Lebanon may not meet the conditions of international donors as it did in the previous Paris I, Paris II, and Paris III conferences, where some funds are still not utilized. Some opponents see that a new government is on the way, and question if this new government would fulfil the conditions of the Cedre Conference.

The conditions of international donors under the Cedre Conference stress that the financial aid should be directed to:

- Infrastructure projects, projects that generate job opportunities for the Lebanese and Syrians, supporting industrial and agricultural exports, housing projects and development projects in the areas hosting Syrian refugees.
- Public-private partnerships (PPP).

For Lebanon to benefit from the Cedre financial aid, Lebanon is asked to implement several fiscal, structural, and sectorial reforms.

II. Required Reforms

The donor countries and organizations which participated in the Cedre Conference requested several fiscal, structure and sectorial reforms from the Lebanese government.

The reforms are the following:

1- Fiscal Reform, mainly the reduction of the fiscal deficit-to-GDP ratio by 5% for the five coming years, i.e. by 1% for reach year. This should be achieved by the following measures:

a- Enhancing overall collection.
b- Reducing the existing gaps in the public finance system.
c- Rationalizing spending as possible.
d- Reducing the financial transfers from the government to EDL; such transfers exceeded 4% of GDP in recent years.
e- Seizing employment in the public sector.
f- Reconsidering the pension system for the public sector employees.
g- Increasing the rates of some taxes such as VAT and fuel taxes.

2- Structural Reforms, mainly increasing the potentials and productivity of the Lebanese economy, by adopting a private sector-led growth policy, and enhancing social equity. This also includes implementing the EU Compact related to security stability and anti-terrorism, governance, law enforcement, growth enhancement and crating new job opportunities. This in addition to abiding by the international compacts related to sustainable development goals and anti-violence actions and others. Among the required structural reforms, we can mention the following:

a- Anti-corruption actions in line with the international agreements of the UN.
b- Reform and governance in the fiscal and customs sectors.
c- Government digital transformation (e-government).
d- Modernization and restructuring of the public sector.
e- Justice Reforms.
f- Governance in the oil and gas sector.
g- Business enabling environment suitable for the promotion of the private sector activity and initiatives.
h- Reforms in the capital markets.

3- Sectorial Reforms, mainly in the following sectors:

a- Electricity, by creating new production units, modernizing existing production units, upgrading existing infrastructure, PPP projects, and restructuring the EDL and its corporatization to function as a private sector entity.
b- Solid wastes, by creating new factories, and modernizing existing factories to manage such wastes in the direction of producing new energy sources.
c- Water, by modernizing the Law of Water for 2012 so as to better manage and expand the underground water resources, existing water networks, and sewage and dirty water treatment; besides introducing new water tariffs; and enforcing the existing water legal framework.
d- Telecoms, by liberalizing this sector so as to attract private investments. This requires reconsidering the telecoms law number 431, in the direction of assigning a regulatory authority to manage this sector and introduce the private sector philosophy.

Distribution of Cedre Conference Aid (USD, million)

Country or Organization	Value	
World Bank	4,000	soft loans
European Bank for Reconstruction and Development	1,350	soft loans
Saudi Arabia	1,000	soft loans
European Investment Bank	980	soft loans
Islamic Development Bank	750	soft loans
France	500	soft loans
	173	grants
Arab Fund for Economic and Social Development	500	soft loans
Kuwaiti Fund for Economic Development	500	soft loans
Qatar	500	soft loans
Kuwait	180	soft loans
Holland	245	soft loans
	122	ready under specific conditions
Turkey	200	soft loans
European Union	183	soft loans
Italy	147	credit lines
United States of America	115	grants
United Kingdom	56	grants
	28	ready under specific conditions
Germany	61	soft loans
	12	ready under specific conditions
Japan	10	soft loans
Finland	7	soft loans
Total	**11,619**	

In this sense, the shares of donor countries and organizations are as follows:
• World Bank: 34.4% of total aid.
• European countries and organizations: 34.2%.
• Arab countries and organizations: 29.5%.
• Other countries and organizations: 1.9%.

These loans and grants are allocated to finance (280) projects in the infrastructure sectors, projects that stimulate the national economy, and projects that support the Syrian refugees.

The Cedre financial aid came to finance the government's CIP whose estimated total cost is USD 22.9 billion for 8-12 years.

The Cedre aid will finance the first cycle of the CIP which costs nearly USD 10 billion, USD 3-4 billion of which will be utilized under the public-private partnership PPP framework.

There were advocates and opponents to the Cedre Conference. The advocates stress that the Conference promotes international confidence in Lebanon; reflects the international community support to the country; and that the financial aid will support economic growth, infrastructure development, and job creation.

The opponents to the Cedre Conference expect further growth in the public debt (currently USD 80 billion) since the majority of the financial aid is loans. They also growing power demand. Also, private investments in the telecoms sector is highly needed, in order to develop this sector and increase its income which stands today at USD 1.3 billion or 11.2% of total revenues. Liberalization of the telecoms sector is a prerequisite for expanding the scope of competition in this sector, thereby leading to its modernization and better economic contribution.

A fifth source of economic imbalance is the existing Syrian refugees, which are recently counted at nearly 1.5 million persons, and which constitute a substantial pressure and burden on the national economy, public finances, infrastructure, labor market, social conditions, and demographic situation in Lebanon. According to the World Bank estimates, the cumulative loss to Lebanon due to the Syrian crisis since its start, as measured by lower economic growth rates, is estimated at nearly USD 18.2 billion till the end of 2015. This is accompanied by declining public revenues (due to lower growth) of nearly USD 4.2 billion for the period 2012-2015. Also, the Lebanese exports lost one-third of its value due to the loss of some markets and trading routes. There is, besides, an increase of nearly 200,000 persons who entered the poverty line; some 250,000-300,000 persons are now unemployed; and the general unemployment rate in Lebanon has grown up to 20% according to the World Bank estimates, and up to 30% among the youth according to UNICEF forecasts.

A third source of imbalance in the Lebanese economy is the higher economic contribution of the trade and services sector (nearly 70% of GDP), in comparison to the contribution of agriculture (10%) and manufacturing (20%). This means that any negative shock to the trade, tourism, or banking sectors could lead to lower economic activity and growth rate. In this sense, the Lebanese economy remains highly unbalanced. It is hoped that the discovery and production of oil and gas in Lebanon would diversify economic structure and increase national income, thereby stimulating better growth rates in the future.

There is also the imbalance caused by the political and security instability in some countries of the region, which cause economic, financial and social burdens on the Lebanese economy, due to strong mutual interconnections. Such regional developments have negatively affected trade and investment exchanges, foreign direct investment, and financial transfers from the diaspora. It also led to lower exports, lower financial and real-estate investments, and declining Gulf tourism.

Another source of economic imbalance in Lebanon is the high rate of corruption, tax evasion (nearly USD 4 billion or 7% of GDP) lower customs collection, and lower collection of electricity and water funds (nearly 40% only). These uncollected financial resources affect negatively the growth of public revenues and economic growth rates.

IV. Conclusions and Policy Recommendations

If we consider a cost-benefit analysis, one can say that the Cedre reforms could realize significant benefits to the Lebanese economy, mainly: (i) controlling the public finances, (ii) enhancing economic activity, (iii) developing the existing infrastructure, and (iv.) increasing public and private investments. However, the use of Cedre funds in the national economy (in case reforms are implemented) could lead to several costs mainly: (i) the possibility of debt increase, (ii) possibility of an increase in production costs due to the intention of the government to raise the rates of some taxes (VAT, on fuels) besides higher tariffs for electricity and water. This could constitute an additional pressure on the productive and services sectors. Higher costs could lead to higher inflation rates which could also be affected by the supply of new money in domestic markets. It is worth indicating here that the expected investments in infrastructure sectors are, by nature, long-term investments that require longer terms and substantial funds to achieve the desired objectives. This factor will be taken into consideration by the private sector in under taking decisions to enter such sectors. In addition, the new wages and salaries scale which was recently ratified (its real cost is nearly USD 1.8 billion, up from an estimated cost of USD 800 million) in addition to the new introduced taxes, could all lead to direct repercussions on the national economy, public finances, inflation rate, and cost of living in 2019 and beyond.

In fact, there are serious fears against the potential mismanagement and misuse of the Cedre funds, under current political conditions, due to the existing corruption, tax evasion, and customs gaps. This could increase public indebtedness (currently USD 80 billion), because 93% the Cedre foreign aid is in the form of loans.

Hence, Lebanon is challenged today by its ability to fulfil the Cedre obligations, and hence to use its funds, keeping in mind that the funds of the previous Paris I, Paris II, and Paris III conferences are not so far completely utilized.

The required reforms on the part of the international donors of the Cedre Conference should focus on dealing with, and reducing, the existing imbalances in the Lebanese economy on the economic, financial, and social levels.

III. Economic Imbalances

The existing imbalances in the Lebanese economy are diversified and deep. There is, first, the weak economic growth rates which stood, according to the IMF, at 1% for 2017 and is expected to reach 1.5% for 2018. This is highly affected by the weak activity of the leading sectors such as tourism, real estate and construction. This weak growth rate is accompanied by inflation which recorded 5% for 2017, due to higher costs of imports (especially oil imports) besides weaker USD dollar. Hence, stimulating higher growth rates in the coming years requires increasing the activity of agro-industry, tourism, real estate, construction, banking and capital markets sectors.

A second source of economic imbalance is the composition of the country's GDP where the private-sector consumption spending constitutes nearly 70% of GDP for 2017 and is estimated at nearly USD 37 billion. The private investment spending constitutes nearly 42% of GDP or USD 22 billion. The government spending on goods and services (both consumption and capital expenditures) constitutes 26% of GDP or USD 14 billion. This means that the size of the public sector is large in the Lebanese economy and in, in general, non-productive. Also, net exports (the difference between exports and imports) is negative of nearly USD 20 billion and 38% of GDP. Hence, Lebanon's GDP greatly depends on the private investment and consumption spending, keeping in mind that the government's capital spending does not exceed 8.5% of total public spending; and total imports (nearly USD 23 billion) greatly exceed total exports (USD 3 billion). In this sense, the Lebanese economy is consumption-led economy because of the greater size of private consumption and imports. Increasing growth rates in the coming years definitely need better private and government investments in order to diversify the structure of the national economy. This is hoped by the Cedre Conference and the government's CIP.

A third imbalance in the Lebanese economy is the continued fiscal deficits and growth of the public debt. According to the statistics of the Ministry of Finance for 2017, the fiscal deficit totaled USD 3.8 billion, due to higher spending (USD 15.4 billion) over revenues (USD 11.6 billion). The largest share of public spending, nearly 91.5%, is current spending consisting of wages and salaries of the public sector, financial transfers to EDL, and interest payments on the public debt. These continued fiscal deficits feed the growth of public indebtedness which stood at USD 80 billion as of end-2017, with an annual growth rate of 5-6%. This results in a crowding out effect, where the public sector competes with the private sector for banking credit and investment. The debt-to-GDP ratio is high at nearly 150%, together with a high fiscal deficit-to-GDP ratio of nearly 8% as of end-2017. In this sense, the internal deficit in the Lebanese economy (i.e. the fiscal deficit) constitutes a major economic imbalance, together with the foreign deficit (or negative net exports).

A fourth source of imbalance in the national economy is the weak outdated infrastructure, due to low investment rates by the public and private sectors, over the past years. Several infrastructure sectors such as electricity, telecoms, roads, water and others, require substantial investments to enhance the economic contribution of the overall infrastructure sector. The spending on the electricity sector since 1991 has recently reached USD 13 billion and is, thus, contributing to the fiscal deficit. The government's financial transfers to EDL reached USD 1.3 billion or 34% of the total fiscal deficit and 8.4% of total spending in 2017. Therefore this sector need substantial private and public investments, mainly to construct new production units, so as to increase power supply in order to meet the

This is why the Lebanese authorities should strive to optimize the benefits of the Cedre Conference, while, at the same time, should also seek to reduce its costs, so as to achieve the desired fiscal, economic, sectorial and social goals.

Also, the Lebanese authorities should implement the required structural reforms, including reducing or halting the misuse of public money, in order to realize the desired objectives of the Cedre Conference. Without actions to fight corruption, weak collection, tax evasion, customs gaps, the Cedre funds could constitute a new pressure instrument on public finances, economic activity, and social conditions.

The appropriate management of the deliverables of the Cedre Conference should constitute the prime priority of the Lebanese authorities in current and future periods. This requires a serious and responsible implementation of the Cedre reforms.

Hence, the Lebanese authorities face today the challenge of proving its ability to fulfil its international commitments. This is a necessary and prime condition to utilize the Cedre funds, following the recent positive parliamentary elections on the 6th of May 2018.

With a new parliament and later a new government, the country's political and economic bodies should focus on designing and implementing effective action plans to put the Cedre results into implementation. Reforms should be launched, and dealing with the existing imbalances should be a major priority. This is crucial for advancing economic growth rates beyond the recent levels of 1-2%. Achieving growth rates of 7-8% and even 10% is possible and could be achieved like in some previous years. With higher growth rates, unemployment could be reduced, as well as poverty levels.

The domestic authorities should, as well, focus on dealing, effectively, with the Syrian refugees' case, mainly by focusing on their gradual return to their home country. This could basically lessen the current economic, financial and social pressures on the Lebanese. The authorities should take serious actions to benefit from the Brussels Conference related to supporting the Syrian refugees.

The launching of investment projects in the infrastructure sectors (especially electricity, energy, water, telecoms and others), under the PPP model, would constitute a valuable opportunity to increase public and private investments in the national economy. This would stimulate higher economic growth rates and better fiscal conditions, besides upgrading and modernization of existing infrastructure to support the overall economic activity.

Also, the Lebanese authorities should focus on incentivizing private investments in the oil and gas sector. Such investments could lead to a growing economy, a controlled public debt growth, diversification and increase in national income, and better living conditions to the Lebanese.

According to the estimates of the IMF, and without the Cedre reforms and CIP, the debt-to-GDP ratio is forecasted to increase from 150% in 2017 to 157% in 2018 and further to 178% in 2023. This is why expanding the scope of economic activity, via reforms and CIP as well as PPP projects, is a prime priority in order to stabilize and then reduce the debt-to-GDP ratio in the coming years.

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