ECONOMIC Bulletin

SECOND QUARTER 2017

FRANSABANK

ECONOMIC Bulletin
SECOND QUARTER 2017

Report - Lebanon's Macro economy in the First Half of 2017

Study - Is Lebanon Really an Oil and Gas Producing Country?

II. Real Sector

The real sector of Lebanon's economy experienced an improved performance in the first half of 2017 relative to the corresponding period last year. The activity of some leading economic sectors enhanced, thus expanding the aggregate economic activity.

1- Agriculture and Industry

The amount of agricultural and industrial exports grew by 3.7% in the first half of 2017 to reach USD 1.4 billion, relative to USD 1.35 billion a year earlier.

This surge in agricultural and industrial exports would have been greater had insurance and shipping costs were lower, but the war in Syria and the observed instability in the region continues to reflect negatively on these costs.

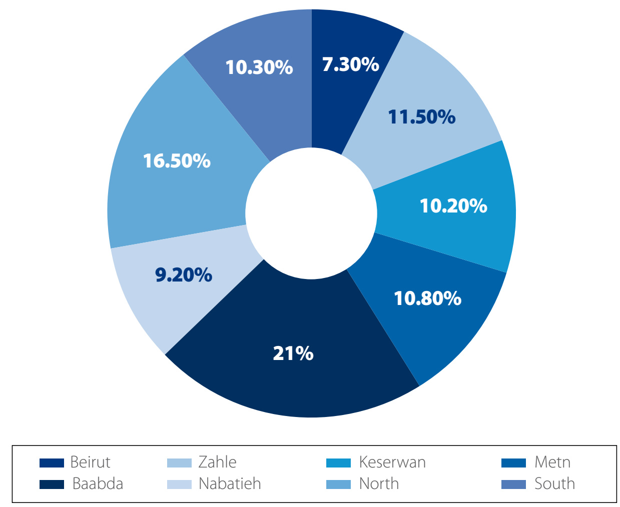
This export growth is fueled by an expanded economic activity and better production operations.

The figures released by the Central Bank show that electricity production, an indicator of industrial production, surged by 10.6% on annual basis in the first five months of 2017 to reach 5,695 million kwh, relative to 5,149 million kwh a year earlier.

2- Real Estate and Construction

According to the figures of the Real Estate Registry and Ministry of Finance, the number of property sales operations increased by 12% on annual basis to reach 33,584 operations in the first half of 2017. Also, the value of property sales transactions rose by 12.3% annually to reach USD 4.5 billion during the same period. The number of property sales to foreigners grew by 22% year-on-year to reach 599 operations in the first half of 2017.

- Value of Real Estate Transactions Distributed in Lebanese Regions
(First Half of 2017) -



These figures reflect a better performing real-estate sector as far as the demand side is considered.

The figures released by the Orders of Engineers and Architects of Beirut and Tripoli show that the number of new construction permits reached 7,135 permits in the first half of 2017, with an annual decrease of 0.03% from end-June 2016. Also, the surface area of the construction permits was 6,369,607 square meters in the first half of 2017, with a decrease of 0.8% from 6,421,252 square meters in the same period last year.

The figures released by the Central Bank indicate that cement deliveries, an indicator of construction activity and real-estate supply, decreased by 3.6% on annual basis to reach 2,006 tons in the first five months of 2017, relative to 2,080 tons in the same period last year.

These figures suggest a curbed supply in the real-estate sector in the first half of 2017 relative to the same period last year.

Lebanon's Macro economy in the First Half of 2017

I. General Introduction

Lebanon's macro economy recorded a relative improvement and better performance during the first half of 2017 relative to the same period of 2016 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 as well as banking conditions, and strong capital inflows.

The real sector's performance improved with a positive growth in the leading indicators of most productive and services sectors, thus reflecting a better 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 money supply and economic activity.

The banking sector of the country recorded a better activity, with an expanding and growing banking market.

The balance of payments achieved a lower deficit due to greater capital inflows and narrowed trade deficit.

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

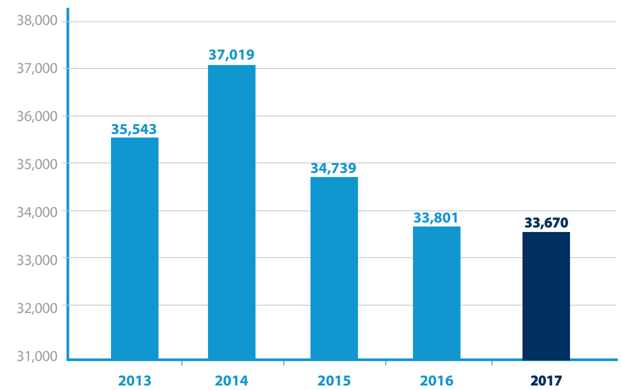
Economic growth is expected to continue in 2017, with enhanced real growth rates. Economic reforms must be the major priority of domestic authorities in order to support economic growth rates in the years to come. This should be accompanied by special efforts to address the continued negative repercussions of the Syrian crisis on the domestic economy and society.

According to the figures of Global Blue, the VAT refund operator for international shoppers, indicate that **total spending by tourists** in Lebanon surged by 6% on annual basis in the first half of 2017. Visitors from Saudi Arabia, UAE and Kuwait accounted for 74% of total tourists spending. Also, the total number of refund transactions by tourists increased by 5% in the first half of 2017 compared to the same period of 2016.

The statistics of the Association of Automobile Importers in Lebanon show that the number of **new sold cars** totaled 18,198 cars in the first half of 2017, with a decrease of 1.3% from 18,444 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 0.3% on annual basis, from USD 33.8 billion in the first half of 2016 to USD 33.7 billion in the first half of 2017. Also, the total value of returned checks dropped by 3.7% on annual basis to reach USD 709 million in the first half of 2017. This reflects a slight decline in private spending during the period under consideration.

- Value of Cleared Checks, First Half (USD, million) -



The Economic and Social Fund for Development (ESFD) reported that it guaranteed 293 loans for a total of USD 5.2 million to **SMEs in Lebanon** in the first half of 2017. Also, the loans extended to SMEs under Kafalat Guarantee reached USD 38.1 million in the first half of 2017, down by 23.6% from the same period last year. SMEs constitute a major pillar of the corporate sector, and a driving force of economic activity and job creation in Lebanon.

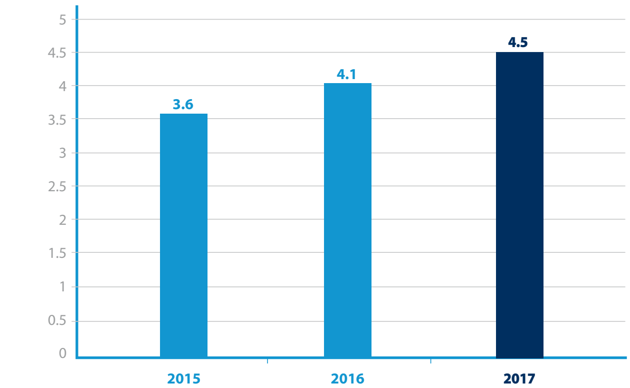
Real-Sector Indicators

Indicators	2017 1st half	2016 1st half	% Change
Agricultural & Industrial Exports (USD, million)	1.4	1.35	3.7
Construction Permits (sqm)*	6,369,607	6,421,252	(0.8)
Cement Deliveries (tons)*	2,006,122	2,080,021	(3.6)
Real-Estate Transactions (USD, million)	4,504	4,010	12.3
Number of Tourists	826,129	723,105	14.2
Number of Passengers at HIA	3,495,711	3,272,167	6.8
Cleared Checks (USD, billion)	33.7	33.8	(0.3)
New Car Sales (number)	18,198	18,444	(1.3)
Hotel Occupancy Rate (%)	61.6	55.1	6.5
Electricity Production (kwh, million)*	5,695	5,149	10.6
Goods Quantity at Beirut Port (tons, million)*	3.6	3.66	(1.6)
Loans to SMEs under Kafalat Guarantee (USD, million)	38.1	49.9	(23.6)
Revenues of Beirut Port (USD, million)*	98.7	101.5	(2.8)

* *First 5 months.*

Sources: Official and Related Directorates.

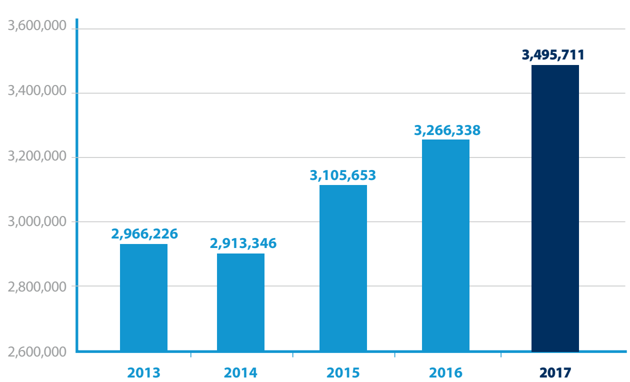
- Value of Real Estate Transactions, First Half (USD, Billion) -



3- Trade and Services

The statistics released by the **Hariri International Airport** indicate that the total number of passengers increased by 7% on annual basis to reach 3,495,711 passengers in the first half of 2017. The total freight handled by the airport grew by 2.43% on annual basis, during the same period to reach 44,257 tons. However, the number of aircraft recorded a decrease of 1.3% on annual basis to reach 32,319 planes during the said period. These figures suggest an improvement in the airport activity and hence the tourism activity.

- Passengers at the Airport - First Half -

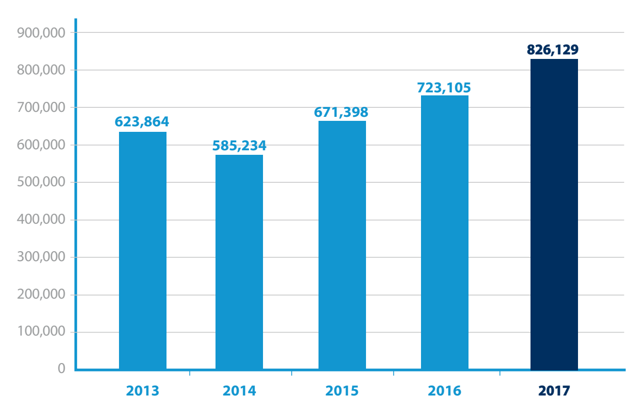


According to the statistics of the **Port of Beirut**, the Port's revenues recorded a decline by 2.8% on annual basis to reach USD 98.7 million in the first five months of 2017. The number of ships recorded an annual decrease of 11.4% to reach 784 ships during the same period. In addition, the quantity of goods declined by 1.5% year-on-year to reach 3.6 million tons during the same period. This figures indicate that the Port of Beirut activity, an indicator of maritime transport and trade, recorded a contraction in its activity during the period under consideration.

According to the Survey of Ernst and Young, the Beirut's **hotel occupancy rate**, an indicator of tourism activity, improved from 55.1% in the first half of 2016 to 61.6% in the first half of 2017. The average room rate at Beirut Hotels increased by 6.6% an annual basis to reach to USD 145, and the rooms yield improved from USD 75 to USD 89 during the same period. These figures reflect an improving hotel activity during the period under consideration.

According to the Ministry of Tourism figures, the **number of tourists** visiting Lebanon, mirroring the tourism activity, reached 826,129 tourists in the first half of 2017, with an annual increase of 14.2% from 723,105 tourists in the same period of 2016. Tourists from the Arab countries constituted nearly 32.1% of the total in the first half of 2017, and the tourists from European countries (32.4%), Asia (11.2%), and Oceania (11.4%).

- Number of Tourists, First Half -



3- BTA – Fransabank Retail Index

At first look, observers may have optimistic expectations in light of the numerous positive developments that occurred during the second quarter of 2017,

- Positive political developments, with the adoption – finally, of a new electoral law endorsed by the various parties, and the encouraging regulatory initiatives undertaken by various ministries and law enforcement agencies,
- Prevailing safe situation in the country, in light of the efficiency and strong stance of the armed and security forces in the country,
- And even positive monetary signals, with the re-conduction of Mr. Riad Salameh as Governor of the Central Bank, with all what such re-conduction entails in terms of assurance of monetary and financial stability for the country,

In addition to the Holy month of Ramadan timing, as well as Easter and Eid al Fitr celebrations.

Yet, one could quickly realize that all such positive elements did not have the desired impact in terms of retail trade markets' activity, nor on the momentum of consumers in the various sectors of these markets. One of the main reasons behind such slow motion in the markets resides in the direct as well as indirect consequences of the Syrian refugee's presence in Lebanon, on its economy and on its infrastructure. Such consequences are translated mainly in the ever-growing level of unemployment within the Lebanese workforce – either because of the lack of work opportunities, or due to the termination of their services because of the prevailing recession and the incapacity of their employers to continue facing the burden of all wages and related employment expenditure, in addition to the heavy charges due to public entities and services: This is obviously resulting in an increasingly deteriorating purchase power of Lebanese households, and a sustained drop in these households expectation of improving their financial conditions in the coming future (continuous drop in consumers' confidence as evidenced by various official reports). Add to this the very low numbers of visitors to Lebanon – especially the Lebanese working or living abroad and their families, but also visitors from the Gulf countries because of the restrictions on travel to Lebanon.

The direct effect is of course an increasing weakness in the level of consumption and a turnover of goods much slower than what is needed in natural trading activities.
Over and above, worries prevailed concerning the new batch of taxes that were expected to be voted and all what this would entail in terms of negative effects on prices of goods and services, and hence on the economy as a whole if enforced. Concerns were also exacerbated by the increased protectionist measures undertaken.
All these developments concurred to create a negative prevailing atmosphere that deterred the readiness and willingness for any new, local or foreign, investments in the Lebanese economy – especially in the trading sector: such situation does not at all offer any elements nor possibilities for the Lebanese economy to achieve any growth, at this crucial moment when growth is the only way out of the prevailing sluggish markets.

In the midst of all such negative factors, the markets continued to witness a very weak level of demand during the second quarter of this year, with low and slow activity, that resulted in further deterioration in turnover results – especially when compared to the already low levels registered during the same quarter one year ago, and also in light of the sustained increase in the CPI that reached - for the period under review, + 3.48 % between Q2 of 2016 and Q2 of 2017 as per the official bulletin issued by CAS in June 2017 – which of course results in even more negative real figures.

The real fears today reside in the fact that, with a sustained increase of the CPI during such period of prevailing economic stagnation, and in the wake of the resulting effects of new taxes that will affect a wide spectrum of goods and services, the Lebanese consumer will gradually evolve into an economic agent who

III. Fiscal Policy and Indebtedness

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 Ministry of Finance figures, public indebtedness of Lebanon increased by 4.9% on annual basis, from USD 72.9 billion at end-June 2016 to USD 76.5 billion at end-June 2017. The public debt in foreign currency reached USD 29.7 billion, increasing by 2.5% from a year later. The public debt in Lebanese Pound totaled USD 46.8 billion at end-June 2017, with an increase of 6.5% from end-June 2016.

Local-currency debt accounted for 61.3% of the total public debt at end- June 2017, against 38.7% for the foreign-currency debt.

At end- June 2017, commercial banks held about 49% of the total public debt, relative to 53.7% a year later.

The net public debt, which excludes the public sector deposits at the Central Bank and commercial banks from overall debt figures, rose by 5.6% on annual basis to reach USD 66.7 billion at end-June 2017.

In this sense, public indebtedness continues its growth trajectory, fueled by continued fiscal deficits due to the firm imbalance between the revenues and spending of the country.

Public-Finances Indicators

Indicators	2017 1st half	2016 1st half	% Change
Gross Public Debt (USD, billion)	76.5	72.9	4.9
Domestic Public Debt (USD, billion)	46.8	43.9	6.5
External Public Debt (USD, billion)	29.7	28.98	2.5
Public Sector Deposits at Central Bank (USD, billion)	5.8	6.2	(6.2)
Public Sector Deposits at Banks (USD, billion)	3.9	3.49	11.8
Net Public Debt (USD, billion)	66.7	63.2	5.6

Sources: Ministry of Finance and Central Bank of Lebanon.

IV. Inflation and Monetary Policy

The monetary authorities have maintained its monetary stabilization policy as well as economic stimulus policy in the first half of 2017. This period experienced the return of inflation following deflation in the past two years.

1- Central Bank

The Central Bank's statistics reveal that its balance sheet increased by 6.1% on annual basis to reach USD 105.2 billion at the end of June 2017, compared to USD 99.1 billion during the same period of 2016. Assets in foreign currencies reached USD 41.1 billion at the end of June 2017, with an increase of 13.3% from USD 36.3 billion at the end of June 2016.

As for the gold reserves, its value declined by 5.5% year-on-year to reach USD 11.48 billion at end-June of 2017.

These figures reflect a better financial status of the Central Bank.

2- Inflation

The Price Index of the Central Administration of Statistics increased by 4.5% on annual basis in the first half of 2017, compared to a decline of 2.6% in the same period of 2016. This reflects the return of inflation in the first half of 2017, following deflation in 2016 and 2015.

The constant deterioration in the local consumption trends has reached a stage where corrective measures have become a must, especially for the re-vitalization of the main generators of markets' activity: political, security, monetary, financial, fiscal, regulatory, investment-related (private and public, local and foreign), employment-related (with all its effects on the purchase power), in addition to finding effective and efficient solutions to the crisis of Syrian migrants – in particular the so-called economic migrants and their impact on the local employment sector.

The government is undoubtedly exerting very serious efforts in all directions and at all levels, and it is not sparing any initiative in terms of studies and reports and programs submitted to international instances, in addition to enforcing field controls and interventions at the local level via multiple public administrations and services; but the challenges are multiple and complicated, and results cannot materialize in the short term, hence the impact on the markets could not be felt soon unfortunately.

The scrutiny of sectorial results displays, as in previous quarters, disparities in performance related to the nature of the sectors under review, and to the nature of the goods and/or services of such sectors.

While most sectors appear to have experienced a slowdown in their turnover figures, few other sectors did perform well and registered better sales figures – especially those sectors where goods and services offered are in high demand on seasonal events and celebrations, as well as sectors related to food and prime necessities, as detailed below:

- Cellular Phones (- 44.87 %)
- Construction Material (- 28.95 %)
- Shoes and Leather Products (- 27.65 %)
- Used Cars Dealers (- 8.71 % after a - 14.03 % in the previous quarter)
- Clothing (continued decline reaching - 8.25 % after a - 11.30 % in the previous quarter)
- Supermarkets and Food Shops (- 5.69 % after a slight - 5.25 % in the previous quarter)
- Household Electrical Equipment (- 4.85 % after a burst of + 15.32 % in the previous quarter)
- Pharmaceuticals (- 4.76 % after having posted + 12.30 % in the previous quarter)
- Optical and Hearing Aid Instruments (- 4.56 %)
- Silverware and Decoration (- 3.62 %)
- Restaurants and Snacks (- 3.35 %)
- Tobacco (- 2.76 % after a - 8.39 % in the previous quarter) and Liquor & Spirits (- 4.18 % after a - 1.39 % in the previous quarter)
- Musical Instruments (- 2.43 %)
- Toys (- 1.25 %)

The sectors that witnessed better results were, in addition to the noticeable improvement in the activity of Commercial Shopping Centers (+ 11.00 %), such sectors where demand is stronger during special feasts and occasions:

- Watches and Jewelry (+ 7.88 %)
- Sports Items & Equipment (+ 2.90 %)
- Books & Stationery & Office Supplies (+ 1.90 %)
- Bakeries & Pastries (+ 1.64 %)
- Medical Equipment (+ 1.32 %)
- Perfumes and Cosmetics (+ 0.48 %)

At the same time, and instead of witnessing an even slight improvement in markets' activity between the first and the second quarter, because of seasonal factors as well as because of the fall of Ramadan and other feasts during this quarter, consolidated figures did decline – albeit moderately.

Whilst consolidated nominal figures displayed a – 1.72 % decline between the first and the second quarter of 2017, the real consolidated figure stands at – 1.68 % after applying the official CPI for this period – which stood at – 0.04 % according to the June CAS bulletin.

By looking at every sector of retail trade on its own, it is noticed that many sectors reported poor performances, but others had more positive results in their turnovers, as detailed below:

- Books and Stationary (- 24.90 %)
- Pharmaceuticals (- 21.75 %)
- Shoes and Leather Products (- 18.12 %)
- Clothing (- 13.49 %)
- Cellular Phones (- 12.52 %)
- Commercial Shopping Centers (- 4.00 %)

focuses mainly on price and does not insist on quality, after having been renowned internationally for being a consumer who looks first for quality before asking for the price, a transformation that will eventually deeply affect the nature and profile of the Lebanese trading markets.

As for final Q2 results, it is noted that the nominal consolidated decline for all retail trading sectors – between the second quarter of 2016 and the second quarter of 2017, has reached – 1.59 %, while the consolidated real figure (i.e. after the application of the CPI for this period) stood at - 5.01 % (despite the increase reported in the fuels sector with a + 8.36 % increase in volume for this

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 %**
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 %**

It is also important to mention that if the variations in the fuels sector are excluded, the real decline in the consolidated turnover of retail trade sectors stands at – 8.40 % in comparison to the levels reported for the second quarter last year (also excluding the fuels sector).

Yearly Variation between 2nd Quarter '16 and 2nd Quarter '17

	Q2 - 2016	**Q2 - 2017**	
Nominal Year to Year Variation (incl. Liquid Fuels)	100.00	98.41	
Nominal Year to Year Variation (excl. Liquid Fuels)	100.00	94.90	
CPI between Jun '16 and Jun '17 (as per the official CAS figures)		**3.48 %***	
Real Year to Year Variation (incl. Liquid Fuels)	100.00	94.99	**- 5.01 %**
Real Year to Year Variation (excl. Liquid Fuels)	100.00	91.60	**- 8.40 %**

* CAS – CPI – Jun '17

same period).

4- Stabilization Policy

The Central Bank of Lebanon has continued its monetary stabilization policy during the first half of 2017, 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.

5- Economic Stimulus Measures

The depressed levels of economic growth over the last years together with the monetary stability measures adopted by the Central Bank has allowed it to continue its stimulus package during the first half of 2017 in the form of subsidized loans to key economic sectors like real estate and startups or venture capital funds targeting the knowledge economy. Also, the Central Bank continues its policy of expanding its macro-prudential tool kit to limit risks in the financial sector, especially with respect to loans extended by banks to car or housing ownership. Banks are asked to build general reserves against their performing commercial loans portfolio, and to build collective provisions against performing retail loans.

Monetary Indicators

Indicators	2017 1st half	2016 1st half	% Change
USD/LBP Exchange Rate	1507.5	1507.5	0.0
Central Bank's Assets in FX (USD, billion)	41.1	36.3	13.3
Central Bank's Gold Reserves (USD, billion)	11.48	12.5	(5.5)
Inflation Rate (%)	4.5	(2.6)	

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

V. Financial Markets

The Banking Sector has maintained its growth in the first half of 2017. However, the performance of the Beirut Stock Exchange was inferior when compared to the first half of 2016.

1- Banking Sector

The statistics of the Association of Banks in Lebanon reveal that the consolidated balance sheet of commercial banks in Lebanon totaled USD 208.2 billion at the end of June 2017, with an annual increase of 9.4% from the same period of 2016.

The banks' lending to the private sector reached USD 58.4 billion, with an annual growth of 4.5% during the same period. The dollarization rate of private sector lending dropped from 74.4% at end-June 2016 to 71.1% at end-June 2017.

The private sector deposits grew by 8.5% on annual basis to total USD 167.7 billion at the end of June 2017. The dollarization rate of deposits was 66.7% compared to 64.9% in the same period last year.

The ratio of private sector loans-to-deposits was 34.8% at end-June 2017, down from 36.1% at end-June 2016.

The banks' aggregate capital base reached USD 18.9 billion in the first half of 2017, up by 3.5% from USD 18.2 billion in the same period of 2016.

These figures clearly reflect a continued growth in the banking sector, and further expansion in the banking activity and market.

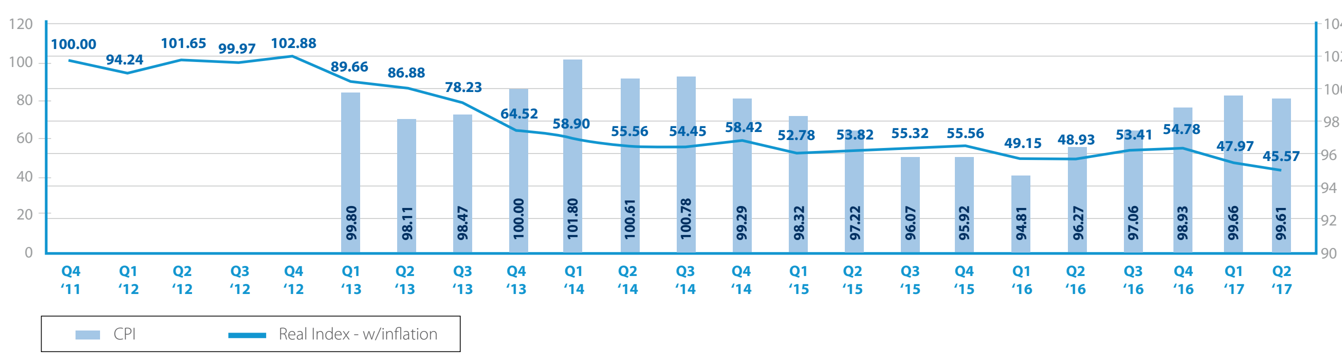
- Watches and Jewelry (- 2.80 %)
- Household Electrical Equipment (- 1.93 %)
- Construction Material (- 1.68 %)
- Silverware and Decoration (- 1.65 %)
- Optical and Hearing Aid Instruments (+ 22.50 %)
- Toys (+ 19.94 %)
- Tobacco (+ 16.40 %)
- Liquors (+ 15.15 %)
- Bakeries & Pastries (+ 10.93 %)
- Furniture (+ 10.42 %)
- Used Cars Dealers (+ 6.13 %)
- Supermarkets and Food Shops (+ 3.61 %)
- Perfumes and Cosmetics (+ 2.41 %)
- Restaurants and Snacks (+ 1.65 %)

As a result, with our base index 100 fixed at the fourth quarter of 2011, and with a quarterly inflation rate of - 0.04 % for the second quarter of 2017, as per the official CAS report, we hereby announce that the "BTA-Fransabank Retail Index" is (with all sectors included): 45.57 for the second quarter of the year 2017. This figure compares to the level of 47.97 for the first quarter of 2017, and means that our index has dropped further below the 50 mark.

BTA - Fransabank Retail Index for Q2 - 2017 (Base 100 : Q4 - 2011)

	2011	2012				2013				2014				2015				2016				2017	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
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**
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**
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**

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



To conclude, it is important to say that such results are additional indicators of a crisis that is becoming more and more acute, quarter after quarter, and that consumption is giving clear signs of weakness, deterioration, and breathlessness.

For this reason, market players do sincerely hope that parliamentary, governmental, and other concerned official parties in the country pay very special attention to the extremely important impact of laws and regulations they are about to endorse – especially those amending the fiscal, financial and regulatory terms currently applied, because of the very harmful consequences that such new laws and regulations will have on the economy as a whole, and more so on market activity and on the propensity for fresh investments.

Beirut Stock Exchange Indicators

Indicators	2017 1st half	2016 1st half	% Change
Market Capitalization (USD, billion)	11.6	11.1	4.8
Total Trading Value (USD, million)	85	279	(69.6)
Aggregate Turnover (USD, million)	346.1	393.5	(12)
Total Trading Volume (shares)	41,187,432	44,260,192	(6.9)
Market Liquidity Ratio (%)	3.0	3.4	(0.4)

Source: BSE.

VI. Foreign Sector

The balance of payments, mirroring the aggregate foreign sector activity, was in deficit in the first half of 2017 relative to the same period of 2016, where the increase in capital inflows was not enough to offset of the trade deficit.

1- Trade Balance

For the first half of 2017, the value of total imports reached USD 9.4 billion, with a decrease of 0.2% a year later. In parallel, total exports surged by 3.7% to reach USD 1.4 billion during the same period. As such, the trade deficit narrowed by 0.8% to nearly USD 8 billion during the same period.

The export-to-import coverage ratio was 14.9% in the first half of 2017, relative to 14.3% in the same period last year, thus reflecting an increase in this coverage ratio due to greater exports and lower imports.

The decrease in imports during the first half of 2017 was due to the decreases in machinery and mechanical appliances, textile products, and some manufactured articles.

The rise in exports during the same period was stimulated by the increases in jewelry products, base metals, and mineral products.

These figures indicate a better trade activity for Lebanon, during the said period, due mainly to the growth in exports.

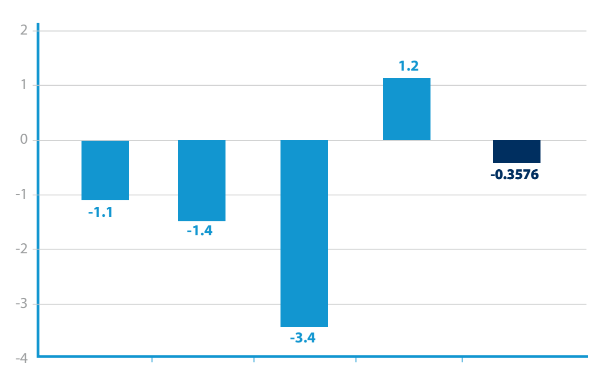
2- Capital Balance

According to the Lebanese Customs and Central Bank figures, financial inflows to Lebanon totaled USD 6.8 billion in the first half of 2017, relative to USD 6.3 billion a year earlier, thus growing annually by 7.9%. This mirrors an inflow of financial funds from foreign markets, in light of the observed political and security stability, as well as the observed economic recovery.

3- Balance-of-Payments

The statistics announced by the Central Bank show that Lebanon's balance of payments recorded a deficit of USD 1.12 billion in the first half of 2017, relative to a larger deficit of USD 1.77 billion in the same period last year. The recorded deficit was due to a decrease of USD 769 million in the net foreign assets of banks and financial institutions, and a decrease of USD 346.6 million in the net foreign assets of the Central Bank.

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



Banking Sector Indicators

Indicators	2017 1st half	2016 1st half	% Change
Total Assets (USD, billion)	208.2	190.3	9.4
Total Deposits of Private Sector (USD, billion)	167.7	154.6	8.5
Total Loans to Private Sector (USD, billion)	58.4	55.9	4.5
Bank's Capital Base (USD, billion)	18.9	18.2	3.5

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

2- Financial Institutions

Figures released by the Central Bank reveal that the total balance sheet of financial institutions reached USD 1506.1 million at end-June 2017, growing by 6.8% from the end of 2016. Liabilities to the private sector grew by 42.4%, from USD 220.1 million at end-December 2016 to USD 313.4 million at end-June 2017. But the liabilities to the financial sector dropped by 1% to USD 570.3 million during the same period.

The capital base of financial institutions increased from USD 468.5 million at end-December 2016 to USD 496 million at end-June 2017, a surge by 5.9%.

The claims on the private sector dropped in the first half of 2017 by 3.6%, from USD 726.3 million at end-December 2016 to USD 700.3 million at end-June 2017. Also, the claims on the public sector fell modestly by 0.66% to USD 135.8 million during the same period.

Financial Institutions Indicators (USD, million)

Indicators	June 2017	Dec 2016	% Change
Balance Sheet	1506.1	1410.2	6.8
Liabilities to Private Sector	313.4	220.1	42.4
Liabilities to Financial Sector	570.3	576.1	(1.0)
Capital Base	496.0	468.5	5.9
Claims on Private Sector	700.3	726.3	(3.6)
Claims on Public Sector	135.8	136.7	(0.66)

Source: Central Bank of Lebanon.

3- Beirut Stock Exchange

The figures announced by the Beirut Stock Exchange (BSE) indicate that total trading volume reached 41,187,432 shares in the first half of 2017, with a decrease of 6.9% from 44,260,192 shares in the same period last year.

Aggregate turnover decreased by 12% in the first half of 2017 from USD 393.5 million in the first half of 2016 to USD 346.1 million in the first half of 2017.

Market capitalization of BSE increased by 4.8% on annual basis to reach USD 11.6 billion at end-June 2017.

The market liquidity ratio dropped from 3.4% in the first half of 2016 to 3% in the same period of 2017.

Study - Is Lebanon Really an Oil and Gas Producing Country?

I. General Introduction

Over the past fifteen years or even more, there have been news about the possibility of Lebanon having oil and gas reserves. This has encouraged some oil and gas multinational companies to visit Lebanon and have talks with the Lebanese authorities concerning the launching of drilling and extraction projects.

The seismic studies conducted in 2002 and 2006 by the British Spectrum Company and Norwegian Petroleum Geo-Services Company, as well as the U.S. Geological Survey conducted in 2010, in the territorial waters of Lebanon, pointed to the presence of offshore gas and oil reserves in the country.

These studies indicated that there is nearly 1.7 billion barrels of technically recoverable oil and 122 trillion cubic feet of technically recoverable gas in the Levant Basin, of which part of each is found in Lebanon.

Oil and Gas Reserves in the Levant Basin

Commodity	Reserves
Oil	1.7 billion barrels
Gas	122 trillion cubic feet

Sources: Spectrum, Geo-Services and US Geological Survey Companies.

According to these studies, and based on the figures announced by the Ministry of Energy and Water (MEW), the 10% of surveyed Lebanese waters show some 30 trillion cubic feet of gas, and 660 million barrel of liquid oil.

Oil and Gas Reserves in the Lebanese Waters*

Commodity	Reserves
Oil	660 million barrels
Gas	30 trillion cubic feet

* The 10% surveyed Lebanese waters.
Sources: Spectrum, Geo-Services, US Geological Survey Companies, and MEW.

To cope with this promising development, the Lebanese government approved in August 2010, the "Offshore Petroleum Resources Law" to manage the country's wealth of oil and gas. Very recently, the government approved the decrees to launch the exploration activities. The political tension continues to be a major impediment to start the exploration process.

If Lebanon proves to be an oil and gas producing country, this will certainly reflect positively on the country's economic growth, public finances, trade, and social conditions.

A major issue in the gas-oil file is how Lebanon would manage the gas and oil resources: a savings fund for future generations or offsetting a part of the existing high public debt.

II. Legal and Implementation Measures

In the Legal and implementation frameworks, the "Offshore Petroleum Resources Law" 2010/132 was ratified by the Parliament in August 2010. This Law is supplemented by 28 decrees for its implementation.

The Law paved the way for the establishment of the "Petroleum Administration Board" (PAB) to supervise and control the prequalification, and bidding and licensing functions. On December 2012, the Cabinet appointed the six members of the PAB, thus enabling to proceed with its first round of licensing.

The pre-qualification requirements were included in a special decree issued in February 2013 which was approved by the government.

The MEW announced on February 13, 2013 the pre-qualification process for oil companies to bid on offshore oil and gas exploration.

Foreign Sector Indicators

Indicators	2017 1st half	2016 1st half	% Change
Trade Deficit (USD, billion)	8	8.07	(0.8)
Exports (USD, billion)	1.4	1.35	3.7
Imports (USD, billion)	9.4	9.42	(0.2)
Capital Inflows (USD, billion)	6.8	6.3	7.9
Balance of Payments (USD, billion)	(1.12)	(1.77)	(36.4)

Sources: Higher Customs Council and Central Bank of Lebanon.

VII. Growth Prospects

Real economic growth is expected to continue during 2017, at rates better than the one recorded in 2016. This will be stimulated by the currently observed political and security stability, expanding aggregate economic activity, continued monetary stabilization policy, and growing capital inflows.

The IMF projects the real GDP growth rate of Lebanon at 2% in 2017, up from 1% in 2016. The World Bank projects the real GDP growth rate at 2.5%, up from 1.8% during the same period.

Inflation is estimated at 2.6% and 3.8% in 2017 according to the IMF and World Bank respectively.

lowering unemployment by creating job opportunities for the local Lebanese besides drawing on the expertise of many Lebanese expatriates.

The discovered and produced gas can help Lebanon decrease the pollution of fuel-oil powered electricity generation as it moves to a gas-fired power generation. By this, Lebanon could develop its potential in the field of renewable energies whose utilization is globally increasing.

IV. Estimated Size of the Oil-Gas Reserves and Economic Contribution

According to the "Energy Information Administration" (EIA)•, the total estimated value of Lebanon's gas reserves is nearly USD 163.91 billion between 2020 and 2039. Also, the estimated value of Lebanon's oil reserves is nearly USD 90 billion for the same period.

Estimated Value of Oil and Gas Reserves in Lebanon between 2020 and 2039

Commodity	Estimated Value (USD, billion)
Oil	90
Gas	163.91

Source: EIA.

According to "Beicip Franlab", Lebanon's total oil reserves is likely to range between 440 and 675 million barrels, or an average of 557.5 million barrels. If the country's daily production is uniformly distributed over twenty years, its daily oil production is estimated at 76,370 barrels. This ranks Lebanon at 52nd worldwide (out of 102 oil producing countries) and at 13th in the region in the list of CIA's world fact book.

With regard to its natural gas reserves, "Spectrum" estimates Lebanon's offshore gas reserves between 12-25 trillion cubic feet, or even 20 trillion cubic feet. If production is uniformly distributed over twenty years, then the country's annual gas production is estimated at 1 trillion cubic feet. This places Lebanon in the 30th rank worldwide, and 8th in the region in the list of CIA's world fact book.

Lebanon's Ranking in Daily Production of Oil and Gas

Commodity	International Ranking	Regional Ranking
Oil	52	13
Gas	30	8

Source: CIA's world fact book.

Under such figures, the average annual gas reserve is estimated at nearly USD 8.2 billion, and that of oil at USD 4.5 billion. These estimates of the values of gas and oil reserves will definitely contribute to an increase in the GDP and economic growth of Lebanon over the assumed twenty years.

As for the public finances of Lebanon, the government's revenues are expected to be boosted from the exploitation of oil and gas: 15% corporate income tax, 60% profit share on hydrocarbon production, 4% royalty fee on gas production, and 5-12% royalty fee on oil production.

With such figures, the estimated average annual revenues from oil and gas is nearly USD 5.7 billion over twenty years. This will enhance the government's public revenues and keep the average ratio of fiscal deficit to GDP at a depressed level of 4-5% per annum. Consequently, the government would be better able to control the growth of its public debt, and perhaps lowers it to below 100% if radical fiscal reforms are adopted to curb public spending and enhance public revenues.

Regarding the country's current account balance, the production of oil and gas is expected to lower Lebanon's hydrocarbon imports, thus reflecting positively on the balance, where one can expect the balance to record a surplus that could reach nearly 1-1.5% of GDP over twenty years.

Also, the exploration and production of oil and gas will require substantial investments from the international companies. This means more FDI inflows to Lebanon, thus enhancing the capital account.

With an enhanced position of both the current and capital

• It is the statistical and analytical agency within the U.S. Department of Energy

The MEW announced on April 18, 2013 that 46 international oil companies were selected to bid to explore for oil and gas in the Lebanese offshore waters. 12 of these companies were selected as operators and the other 34 as non-operators in the licensing period.

The licensing and bidding contracts were planned to be signed between the government of Lebanon and the winning companies in February 2014.

Also, the development phase was planned to be launched this year, and the first extraction operation of oil and gas was expected between 2018 and 2020. Unfortunately, the political conflict on the oil and gas file still hampers such plans and expectations.

The MEW is still awaiting the ratification of the "Exploration and Production Agreement", which gives the selected oil companies the right to explore oil and gas reserves in Lebanon's "Exclusive Economic Zone" (EEZ)•, as well as the approval of the block delineation decree which specifies the number of blocks to be explored, knowing that there are 10 blocks with a total area of 17,901 square meters with an average block area of 179 square meters.

Concerning the exploration and extraction of oil and gas contract, which specifies the share of revenues for each of the Lebanese government and the companies, it is not yet disclosed. In fact, the agreement is based on some sort of a production sharing system, whereby the international companies would be retained by the government of Lebanon to invest in exploration. If discovery is achieved, the investments made by the companies then will be recovered up to a certain ceiling, and then some royalty will be paid to the government in terms of revenue sharing. The production will be divided between the government and the companies on the basis of a certain ratio, as indicated by the "Exploration and Production Agreement".

In fact, the regulations needed to implement the Law are mostly ready. Some are approved, and others are on the way which all are important for the first licensing round.

III. Oil and Gas Benefits

If the estimates of oil and gas wealth in the Lebanese offshore waters are real or even chose to real, then Lebanon would become an energy independent country in the end.

Lebanon will get a share of oil and gas revenues as per the agreements with international companies. These oil-gas reserves will depend on four major factors. The first factor is the real volume of gas and oil that can be economically extracted and produced. The second factor is the country's ability to monetize the oil and gas it produces, which will depend on the government's planning, efficient building and operation of LNG facilities as well as coherent policy for exportation. The third factor is the development of global and regional oil and gas prices, which will affect Lebanon's exports of these two commodities. The fourth factor is ensuring the proper control and use of oil-gas revenues which depend on halting illegal smuggling, fraud and trading in the black market.

Real explorations and production of oil and gas in Lebanon would transfer Lebanon into a self-sufficient country in oil and gas, and a net exporter of these two commodities, or even of natural gas. This is expected to reflect positively on the electricity sector, public finances, trade balance and GDP, and the economic outlook of the economy will be completely changed.

The oil and gas revenues would decrease Lebanon's imported energy needs (which stand today at about 90%), thus improving its balance-of-payments, reducing its public deficits and indebtedness, increasing its foreign-currency reserves, enhancing infrastructure investments, and increasing job opportunities.

Also, the oil and gas production will enhance the construction activity in the country, as it will launch a large-scale hydrocarbon facilities like ports, pipelines, and compounds for workers.

In addition, public-private investments will grow in the years to come, thus stimulating economic growth and

• Lebanon's EEZ is an integral part of the Levant region. It is a 22,730km2 region bordering Syria, Cyprus and Israel Waters

V. Risks vs. Opportunities

The launching and growth of the hydrocarbon industry in Lebanon faces specific obstacles and risks, both on the political level, as well as on the economic level.

On the political level, and as indicated earlier, the oil and gas reserves in the Levant region belongs to Lebanon, Cyprus and Israel. Today there is a dispute between the three countries concerning an 874 square kilometers maritime area, which delays the exploiting of the potential energy resources of this area.

Also, on the political level, the major obstacles are the ongoing domestic political bickering on the petroleum laws and decrees, the continued conflict in Syria, and the observed political instability in the Arab region caused mainly by the Arab Spring.

The security threat remains clear in Lebanon, given the Israeli's bad intentions towards Lebanon and its potential gas and oil reserves.

As for the economic obstacles, the first one is the expected long period of extraction of oil and gas which could extend to some 7-10 years in minimum. Also, there is the large cost of exploration which could reach USD 100 million per well. Since exploration is costly, the international companies have to form consortiums between themselves to share the 10 blocks.

A major obstacle or issue concerning the hydrocarbon industry in Lebanon is related to the management of oil and gas resources in the future.

As stipulated by the "Offshore Petroleum Resources Law", and according to the MEW, the government's share of oil and gas revenues will be kept in a sovereign fund set for future generations. Officials at the MEW say that such fund will not be used for paying the public debt, which will be paid as the country's GDP grows due to the impact of oil and gas on the economy. It is also said by some politicians that the proceeds of the fund will not be included in the balance sheet of the government.

Some policy makers in Lebanon have been debating the utilization of the fund's proceeds in reducing the public debt to nearly 60% of GDP, from the current 135%, before fulfilling other expenditures.

But actually this fund has not been created yet, and there is no separate law for the fund yet too. It is not clear how the fund will be governed and how it will be managed. In fact, a stabilization fund could be needed also to cushion the economy and avoid deep cuts in the government's oil and gas revenues in case of sharp decline in international prices of these two commodities.

In fact, the "Offshore Petroleum Resources Law", in its Article 3, stipulates that "the statute regulating the fund, the rules for its specific management, the principles of investment, and use of proceeds shall be regulated by a specific law, based on clear and transparent principles for investment and use of proceeds that shall keep the capital and part of the proceeds in an investment fund for future generations, leaving the other part to be spent according to standards that will guarantee the rights of the state and avoid serious, short, or long-term negative economic consequences".

This article paves the way for the use of the potential proceeds of oil and gas resources in three main directions: The first for future generations; the second for reducing the fiscal deficit and paying part of the debt to reduce its ratio to GDP; and the third to deal with any potential short and long-term negative economic consequences. This is an ideal opportunity, measure, and policy to manage the oil and gas wealth of Lebanon once the extraction and production processes take place.

Paying off part of the public debt is a necessary and significant step. This is crucial to improve the sovereign rating of Lebanon, and hence to lower the interest rates at which the private sector can borrow further to expand its business, to improve the competitiveness of the economy, and to boost overall economic growth.

accounts, the country's balance-of-payments is expected to record a substantial surplus.

Given these positive contribution of the oil and gas extraction and production on one hand, one can expect some negative repercussions on the other hand mainly the "Resource Curse" and "Dutch Disease".

In fact, the revenues derived from exhaustible resources such as oil and gas have three special features. The first feature is that such resources are depletable and are only temporary in nature. Second, these revenues are highly volatile due to the high volatility in oil and gas prices on the international markets. Third, rents from oil and gas are typically larger than those for other commodities, and reflect monopolistic powers. These special features present the Lebanese government with challenges and difficult policy alternatives.

Economic Literature and evidence links dependence on natural resources (such as oil and gas) to poor economic performance (the so-called "resource curse"). In fact, many oil producing countries witnessed major economic setbacks once they started exploiting the oil and gas resources. This happens as the higher price volatility exerts a negative impact on economic growth, acting through a lower accumulation of physical and human capital. If the size of the hydrocarbon industry in Lebanon proves to be large and no prudent and effective measures are put in place to strengthen institutions, governance structures, fiscal accountability and transparency, then one can expect the "resource curse" and corruption are likely to occur in full force.

Another related concern is the "Dutch Disease". This means that strong capital inflows can cause real exchange rate appreciation of the Lebanese Pound, and can trigger a boom in the non-tradable sector – mainly the construction and banking sectors – by lowering import prices or stimulating external credit. Such a development can undermines financial resilience of the country and exposes its economy to high risks when the world oil and gas prices and revenues fall. Furthermore, the higher inflation rates and appreciation of the local currency stimulated by larger capital inflows and increased money supply affects the entry of firms into the tradable sector, thus limiting diversity in production and hindering firms from developing their export capability. The recent experience of Lebanon clearly shows that while its banking sector has shown high resilience in the face of many political and financial crises, its economy is still exposed to volatility and instability caused by real estate ups and downs, a relatively weak tradable sector and persistent current account and budget deficits.

In fact, Lebanon's national currency is already showing signs of over-valuation as the IMF indicates in one of its 2012 reports. A specific concern is that a potential sharp real appreciation of the Lebanese Pound could weaken the competitiveness of its export and tourism sectors, resulting in employment losses and hence higher unemployment.

The route in which oil and gas production could boost inflation is as follows: oil and gas production is expected to enhance Lebanon's current account balance as well as capital account balance. This implies increased capital inflows and money supply in circulation, and consequently inflation would rise.

Another source of increased inflation is the expected increase in public revenues and also public spending, thus raising aggregate demand in the local economy and hence inflation.

The route in which oil and gas production could cause real exchange rate appreciation of the Lebanese Pound is as follows: The oil and gas resources will increase the country's exports, thus causing an appreciation of the Pound. Consequently the prices of domestic goods are expected to increase relative to those of foreign goods, which will hinder Lebanese exports.

To avoid the appreciation of the Lebanese Pound, and given the Central Bank's policy of exchange-rate pegging of the Lebanese Pound to the US Dollar, then the Central Bank should increase the supply of Lebanese Pounds. This could lead to further inflation, unless the Central Bank buys U.S. Dollars.

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