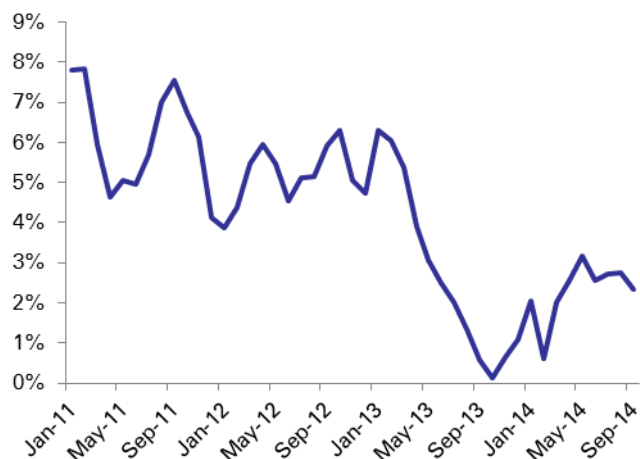




Year-on-Year Monthly Inflation Rates



Source: CAS

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As the country struggles through the economic slowdown, the continuous political deadlocks and the regional upheavals, we hear the term "inflation" getting tossed around. Looking beyond the common definition of "a rise in general prices", inflation is one of the core drivers of investment decisions, consumption trends, unemployment levels etc...

Lebanon, one of the most expensive countries in the region and the world, undergoes international prices transmission for its high reliance on imports and its dollar-pegged currency. Noting that imports almost constituted 47% of its GDP in 2013, any international prices increase will certainly be imported into the local scene. In the same context, and given that the Lebanese economy is highly dollarized¹ and have a fixed exchange rate to the dollar, any global increase in the value of U.S. dollar against major currencies will directly imply a decrease in the prices of the Lebanese products. This was the case in 2014 when the U.S. dollar succeeded to progress amid positive economic indicators, lower unemployment rate decisions and the Federal Reserve's decision to cut its Quantitative Easing.

Still, the subdued demand in Lebanon that resulted from the recurrence of internal security incidents and political deadlocks lessened pressure on prices since 2011. Hence the average yearly inflation rates were seen slower, going from 4% and 5% in 2011 and 2012 to 4% in 2013 and 1% by September 2014.

In this context, the following report will try to discuss the main reasons behind inflation in Lebanon since the emergence of the Arab Spring in 2011 and precisely the war in Syria up until 2013 with a slight glimpse on the first half of 2014.

By means of evolution of the Consumer Price Index (CPI)² provided by the Central Administration of Statistics (CAS) since 2011, prices in Lebanon followed an upward trend mainly boosted by hikes in the prices of food, beverages, tobacco, housing, health and education services as well as water, electricity, gas and other fuels.

Though, it is worth noting that, early this year, CAS updated the CPI by switching the reference month from December 2007 to December 2013 and by modifying the weights of the respective sub-indices. The weight for the "food and non-alcoholic beverages" component rose from 19.9% to 20.6% and that of "Transportation" increased from a previous 12.3% to 13.1%. Similarly, the weight for the "Housing, Water, Electricity, Gas and other fuels" went from 25.7% to 28.5% and the weight for the "Health" component was upped from 6.8% to 7.8%. However, the weight of the "Alcoholic beverages, tobacco" sub-index slid from 2.1% to 1.6%.

¹ The Dollarization rate on private sector deposits hovers around 66%

² Reference month: December 2007 and Weights of 2012

Composition of the CPI

Sub-Index	Weight	
	Old	New
Food and non-alcoholic beverages	19.9	20.6
Alcoholic beverages, tobacco	2.1	1.6
Clothing and footwear	6.2	5.4
Housing water, electricity, gas and other fuels	25.7	28.5
Furnishings, household equipment and routine household maintenance	3.9	3.6
Health	6.8	7.0
Transportation	12.3	14.8
Communication	4.8	5.4
Recreation, amusement, and culture	3.7	2.0
Education	7.7	6.5
Restaurant & hotels	2.7	2.5
Miscellaneous goods & services	4.2	3.8

Source: CAS

Food and Beverages Prices Followed a Bullish Trend

Starting with food prices, they were mainly following international trends and were partly influenced by the domestic and regional developments. Food and non-alcoholic beverages showed an overall 13.5% increase between 2011 and September 2014. In details, the Food and Agriculture Organization's (FAO) annual Food Price Index indicated that 2008 and 2011 were 2 years of noticeable worldwide increases in food prices by 25% and 22%, respectively.

In Lebanon, this was translated by respective 18% increase in food prices in 2008 and a 6% uptick in 2011. The slower increase in 2011 could be explained by the Arab spring emergence that heavily influenced Arab demand for the Lebanese agro-industrial products. However, the substantial inflows of Syrian refugees managed to counterbalance the dropping Arab demand increasing pressure on the prices of the Lebanese food products. Alimentation products kept on increasing in prices over 2012 (+4.2%), 2013 (+2.9%) and 2014 (+0.7% by September), yet at slower pace.

As for alcoholic beverages and tobacco, they saw a 35.2% jump in the period 2011-2013 followed by a 5.9% year-to-date (y-t-d) surge by September 2014. This was mainly the result of successive yearly increases of 11.4% in 2011, 8.3% in 2012 and 12.1% in 2013.

High Demand Pressured Up Prices in the Housing Market

Housing also witnessed considerable rises over the same period resulting from the mismatch of demand and supply on the housing market, Banque du Liban (BDL)'s incentives as well as the increasing number of Syrian refugees looking for accommodation.

As a matter of fact, the official figures added a 44.1% adjustment to the housing index to reflect the rise in prices during the years 2009, 2010 and 2011. This increase in houses prices was incorporated in July 2012 leading to a 10.1% hike in the CPI back then. BLOMINVEST's research department spread the entry over the three years period, using the trends strolled by the real estate price transactions as a proxy to reproduce the actual monthly changes in the housing index during the period. As such, the approximated path of inflation between 2011 and 2013 revealed a 5% comprehensible increase.

2008-2011 was a booming period for the Lebanese real estate market characterized by a pent-up demand outpacing supply levels. The Doha agreement has boosted demand for the Lebanese property sector mainly from the Arabs and the Lebanese expatriates. Yet, supply remained low over the mentioned period as projects need time to be constructed and the majority takes more than a year to be done. Consequently, real estate prices went up after being well below the regional market. However, real estate demand was hindered starting late

2011 by pressures from the war in Syria and the fragile domestic situation that continued through 2013. The period 2011-2013 can be described by an improving supply that took time to adapt to the high demand levels.

On a different front, BDL launched in early 2013 an incentive program³ in hope of expanding lending and revitalizing demand with a special focus on housing loans (56% of total placement). This strategy came as a continuity of BDL's series of stimulation packages that started in 2012 to ease real estate finance for low and medium income households. In this context, banks profited of low-cost funding thus lending at lower interest rates. BDL latest data showed that housing loans reached \$8.53B by June 2014, up by a yearly 8.8%.

Despite the drowning foreign demand for Lebanon's properties, the Syrian crisis has cast a multitude of consequences on the Lebanese housing sector, as citizens fleeing their country were looking for purchases or rents thus helping to maintain prices.

In 2014, CAS started conducting housing surveys once per month and detailing the housing sub-component into Actual Rent (comprising Old and New Rent) and Owner Occupied. Y-t-d results revealed that actual rents rose by 0.3% by September. Similarly, the prices of ownerships saw a 0.3% rise since year start.

Besides housing, prices of water, electricity, gas and other fuels as well as furniture and household equipment (3.7% stake of the CPI) went also up almost by 12% and 7% between 2011 and September 2014 mainly boosted by the moderately increasing demand for these vital products.

Health Indicators Followed Mixed Trends Almost Stabilizing Costs

Healthcare costs also followed the upward trend despite the timid rise revealed during 2011-2013. The Lebanese healthcare system showed a 5% acceptable increase in prices between 2011 and 2013 when compared to the considerably high costs of consultations and hospitalization. Imported inflation is another reason behind the amplifying costs as hospitals, laboratories and healthcare centers ought to import new specialized equipment and technologies to catch up the global progress taking place in the health sector.

However, the Health Ministry slashed, by the beginning of 2012, the price of 670 generic drugs by 15% to 22%, which could be partly behind the contained growth in the health sub-component. Yet, healthcare costs remain subject of a big controversy as almost 45% of Lebanon's residents are estimated not to be covered by any public or private agency.

As for the first nine months of 2014, they recorded alone a 1.2% y-t-d rise in the prices of Health. This could be partly related to the critical financial situation of the Lebanese private hospitals that had been pressuring the government to settle the overdue payments from 2000 and 2011. In the same context, the Syndicate of hospitals urged public insurance institutions to enhance their payments to keep up with the rising prices of medicine, fuel, electricity, wages, nutrition as well as the worldwide prices of medical equipment.

Education Fees Mainly Boosted by the Public Employees Rising Wages

However, when it comes to education in Lebanon, households kept tolerating the expensive additional charges of the private educational system. Noting that the education index contributes by 5.9% to the CPI's constitution, the sub-component edged up by 32% between 2011 and 2013, while it posted a marginal 0.1% y-t-d uptick by September 2014.

This increase is partly due to the increase in the wages of the education personnel in the public sector. In this context, the total amount of basic salaries for the public educational body reached \$572.5M in 2013 compared to \$527.40M⁴ in 2012. Accordingly, public wages saw an 8.6% yearly increase or \$44.44M that is partly explained by the respective rises of \$13.93M, \$25.20M and \$15.08M in the salaries of permanent, primary and secondary trainee teachers and contractual teachers at the Directorate General of Education.

³ BDL placed \$1.46B at the disposal of banks at 1% interest so commercial banks can increase loans to institutions and households at reduced interest.

⁴ Basic salaries excluding retroactive payments

Several reasons may also explain the 8.6% annual increase in 2013 such as the recruitment of new contractual and permanent teachers, the promotion of current workforce, the cost of living adjustment, the increasing number of Syrian students looking for enrolment etc...

Deteriorating Tourism Hit Clothing Industry

The sharp decline in the number of tourists has taken its toll on the apparel industry. Up till September of this year, the country has witnessed a 20.2% decrease in total visitors compared to the first nine months of 2011. Arab tourists, which used to frequent Lebanon and drive retail sales growth, have dropped 24% during the same period. According to the latest data published by Global Blue, the value of VAT refunds on fashion and clothing items within Lebanon slipped 1% year-on-year (y-o-y) by September 2014, while the number of VAT refund transactions on these items fell 5% for the same period. Tourists residing in Kuwait and Syria witnessed the greatest drop in average tourist spending, each having declined by 7% and 3%, respectively.

Consequently, clothing and footwear index, that constitutes 5.4% of the CPI basket, suffered the repercussions of lower demand from tourists and also that of local residents who were undergoing the consequences of the country's economic slowdown, security instabilities and political stalemates. Following a similar 4% growth of prices in 2011 and 2012, the apparel industry failed to maintain the upward trend and finally mirrored the deteriorating activity of the tourism sector posting an 8% y-o-y drop by the end of 2013. This is when retailers used aggressive marketing strategies through sales and promotions even during holiday periods to rejuvenate the sector and liquidate their inventories.

On the brighter side, clothing and footwear prices managed to recover in 2014 and showed a 14.3% y-t-d progress mainly impacted by the Cabinet formation that took place by the mid of February this year. Accordingly, the sector, like many other sectors, is highly dependent from the political, security and regional environment and can easily recover and prosper once positive developments emerge.

Syrian Inflows Mostly Behind the Progress in Restaurant, Hotels and Leisure Prices

Unexpectedly, and despite the narrowing tourism activity, the CPI sub-components "Restaurant and Hotels" and "Recreation, amusement, and culture" managed to grow by more than 17% between 2011 and September 2014.

Yet, when it comes to occupancy rates, Ernst & Young Middle East Hotel Benchmark Survey Report that covers four-and five- stars hotels revealed that Beirut Hotels posted gradual declines in their average occupancy rates from 58% in 2011 and 54% in 2012 to 51% in 2013 and 50% by September 2014. Accordingly, surveyed hotels seem to have slashed their room rates to regain their lost revenues and attract local and foreign customers as revealed by the 26% downfall in their average room rate that went from \$219 in 2011 to \$162 by the end of September this year.

Hence, the substantial increase in "Restaurant and Hotels" took place as the sub-index encompasses a wider sample of hotels either outside the capital Beirut or having a rating below four-stars. Those hotels could have increased their daily room rates as they were hosting mid-income Syrian migrants fleeing their homeland to escape the war.

Transportation Prices Mirrored the Global Dip, while Communication Prices Tumble on Governmental Measures

Transportation prices over the period 2011-2013 followed the international bearish trend in oil prices, yet into a lesser extent. The sub-index which constitutes 13.1% of the CPI's basket barely slipped 3.2% from 2011 to September 2014 when oil prices decreased by more than 10% worldwide.

Lebanon's mobile sector is one of the most expensive markets in the Arab World despite the downward trend in the price of mobile calls that started in 2012. In fact, the price of the cheapest mobile basket for 100 calls /month in Lebanon shed by 9% y-o-y in 2012 to \$90 and by a considerable 23% in 2013 to \$69. As for fixed broadband, prices have been slashed by more than 70% in 2011 with internet usage reaching 38% at the end of 2012 compared to 32% in the previous year.

Even though the facts reveal a bearish trend starting 2011, the communication sub-component which represent 4.6% of the CPI's basket, remained subdued until 2014 when it started showing signs of substantial decreases.

Believing that a reduction in prices would boost subscriptions and raise usage, the government decided to lower tariffs for telecom services again (additional minutes for postpaid mobile subscribers, lower prepaid call tariffs, more efficient internet data plans and HDSL services.

As a result, and after posting no changes in price for 3 years, the CPI of communication revealed a considerable 23.7% y-t-d slump by September 2014.

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