

LEBANON ECONOMIC PERFORMANCE

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I. EXECUTIVE SUMMARY

Despite high hopes, 2013 failed to show recovery signs taking the economy into deeper pits. On one side, the magnitude of the Syrian war and its spillovers on the Lebanese economy became more pronounced and noticeable. On the other side, the political deadlock and the recurrence of instability developments aggravated the situation and took the economy into lower levels, the worst since several years.

The following report will wrap up the 2013's economic performance by dissecting each of its sectors' activity and yearly outcomes. The main findings of the report are:

In the **Real Sector**, economic growth in 2013 reached its lowest base since 1999 at 1.0% following 2012's slowdown of 1.5%. The slight growth rate was mainly due to the public sector as 2013 saw the deterioration in business conditions of the private sector. This was confirmed by the level of BLOM's Purchasing Manager's Index (PMI) that remained below 50 from June till the end of 2013.

Accordingly, slow economic growth painted the scene as it was coupled to a slowing inflation rate of 1.1%, considerably lower than the 4.7% in 2012 and the 4.1% in 2011.

In fact, consumers' demand was seen dwindling over the year. This was clearly reflected in the Consumer Confidence Index (CCI) that dipped from 108 points in 2012 to 66 points by the end of 2013. Yet, Syrian refugees partly compensated the Lebanese loss of appetite. The increasing number of Syrian refugees' boosted demand for first necessity products thus enhanced the level of imports. However, the overall impact remained negative as revealed by the different economic sectors that failed to end the year in the green.

Tourism was the biggest victim of 2013's economic downfall. Tourists avoided Lebanon fearing the ongoing security instabilities that kept on slashing the country. Tourists' number tumbled to a 6-Year low and settled at 1.27M. This was mainly due to the lower number of Arab visitors, especially from the GCC countries that issued travel-warnings against Lebanon.

In an attempt to boost tourism, Lebanon promoted campaigns such as the "50% for 50 Days" in addition to slashing airfares and hotel rates. Yet, the dismal state of the country naturally resulted in lower tourist spending, which fell 9% compared to 2012 and a worsening occupancy rate in Beirut hotels, which lost 3 percentage points (p.p) in 2013 to 51%, ranking among the bottom 3 countries in the MENA region, and faring only better than Cairo and Manama.

When it comes to **Real Estate**, developers faced several challenges in 2013: the local and regional turbulences, the scarcity in land, volatility in workforce availability, lower demand from the GCC residents who switched to more secure areas, financial sustainability concerns, legal and logistic delays in delivery, and construction material price sensitivity.

On the demand side, Lebanese properties seemed less appealing in 2013. The number of transactions slid 7.2%, while total value of property sales transactions retreated by 2.6% y-o-y to reach \$8.71B by December 2013. Thus, the number of transactions edged down at a faster pace than transactions' value sending the average value of a real estate transaction higher to \$125,841 compared to \$119,838 in 2012.

Sales to foreigners also registered a sharp decrease of 9.0% in the volume of sales as they were also impacted by the repeated warnings of GCC governments calling their citizens to avoid Lebanon due to the high degree of political uncertainty and security developments.

The number of issued construction permits during 2013 reflected an 8.1% considerable yearly decrease. However, the Construction area Authorized by Permit (CAP) plummeted by 12.8% in 2013 to 12.82M sqm following a 10.8% yearly fall in 2012.

Accordingly, the average area per permit has decreased by 5.1% to 765.40 sqm/permit in 2013 compared to 806.78 sqm/permit recorded a year earlier. This would mainly imply the spreading of projects over lower sized investments, and the shift of supply to serve a more selective demand.

However, and despite the economic slowdown and the complications on the Syrian front that weakened investors' confidence in 2013, property prices

remained resilient in Lebanon. Beirut residential streets revealed variation in the prices of sqms depending on the location. Prices averaged \$3250-\$3,500 per sqm hitting \$7,500 at the sea front. This could be partly due to the Syrian crisis that has cast a multitude of consequences on the Lebanese real estate sector, as citizens fleeing their country were looking for purchases or rents thus helping to maintain prices.

Separately, the Syrian war propagated positive flows to the **Agricultural Sector** that revealed shy signs of recovery in 2013.

Although exports through the Syrian border were hit by the 3-Year war, numerous Lebanese farmers profited from the Syrian misfortune: some importing markets of Syrian agricultural products shifted their demand to neighboring countries, such as Lebanon. Hence, Lebanese agricultural exports almost constituted 0.5% of 2013's estimated GDP and 5.5% of the year's total exports that reached 638,369 tons worth \$215.70M. This was 17.0% higher than 2012's level of 545,639 tons worth \$171.24M.

However, and despite the improving standing of exports in 2013, the country still suffered an ongoing structural deficit on its trade balance of agricultural products that stood at \$707.09M, widening from 2012's deficit of \$696.38M.

Back to the Lebanese market, domestic consumption of agricultural products was estimated around \$1.62B in 2013. Accordingly, almost 88.2% of total agricultural consumption was intended to the local market.

On the **Industrial** front, activity was partly boosted by the increasing Syrian demand in 2013 and the constantly changing taste and preferences of the Lebanese consumers that are more westernized than most of their regional peers.

First, the influx of Syrian immigrants to Lebanon partially limited labor costs in light of the new unregulated abundant low-cost supply.

Second, some industries found a new market in the swift of demand from Syria and benefited from shortages of supply and halts of production to compensate for Syria's regular imports and/or exports. Accordingly, industrial exports reached \$3.08B by the end of 2013 up from \$2.95B in 2012 and \$3.33B in 2011.

Lastly, and given its substantial indirect contribution to the Lebanese economy, the country realized during the past 5 years some major improvements on many **Information and Communication Technology (ICT)** as it is starting from a low base. But, it still has a long way to go in order to be placed with developed countries or even to catch up with many Arab countries. Mobile penetration surged from 35% in 2008 to more than 80% in 2013. However, Lebanon still has several problems when it comes to the quality of the services provided.

Externally, trade deficit broadened at a faster pace in 2013 sending the country's **Balance of Payments** (BoP) towards another deficit. Yet, the partially improving capital inflows managed to tighten the negative BoP's over the year.

In 2013, the BoP recorded a deficit of \$1.13B while the **trade deficit** increased by \$600M and tourists' number tumbled by 7%. Therefore the deterioration in the **current account** balance in 2013 was mainly behind the negative BoP, while **capital inflows** are estimated to have stabilized.

On the **Foreign Direct Investments** (FDI) front, and as political and economic instability weakened investor's appetite, inflows of FDIs to Lebanon are expected to have dropped between 23% and 32% in 2013.

According to UNCTAD, FDIs to Lebanon plunged to \$2.83B in 2013 or 6% of FDI inflows into West Asia, down from \$3.67B or 8% of FDI inflows into West Asia in 2012. However, they are still highly focused on the real estate market, which has suffered from a significant decrease in demand stemming from GCC countries. Moreover, FDI inflows to Lebanon represented 21.6% of gross fixed capital formation in 2013, down from 29.2% in 2012.

Distinctly, **Public Finance** management was up against two major challenges: the Pay scale issue and the influx of Syrian refugees. The latter had a large impact on infrastructure and put an upward pressure on education, health, and social spending. As for the pay scale issue, it was still not clear what will be the exact cost and when it will be approved by the parliament.

Total fiscal deficit grew by 8% or \$294.53M to reach \$4.22B in 2013 taking its share in the GDP from 9.1% in 2012 to 9.3% in 2013. In parallel, **deficit in the**

primary balance also increased from \$110.12M in 2012 or 0.3% of GDP to \$239.47M in 2013 or 0.5% of GDP. 2013 was the first year where the government had a primary deficit in its budget.

The deteriorating public finances came about as the share of **total revenues** in GDP fell by more than 1 pp from 21.9% in 2012 to 20.8% in 2013 while the share of **total expenditures** decreased by only 0.8 pp from 31.0% in 2012 to 30.2% in 2013.

The ever-growing deficit inflated the **debt/GDP ratio**, already one of the highest in the world, from 134.3% in 2012 to 140.5% in 2013. As a result, the ratio reversed trend following six years of decline.

Investors were worried that reigning in the fiscal deficit and public debt does not seem at the forefront of government interests. Political and security issues were overshadowing economic problems.

According to the Ministry of Finance, the Lebanese **gross public debt** reached \$63.46B in 2013, 10% higher than 2012.

The **Net Public Debt**, which excludes the public sector deposits at the Commercial banks and BdL, stood at \$53.25B in 2013, increasing by an annual 8.4%.

2013 was also a challenging year for **Monetary Authorities** as it marked the third year of economic slowdown in Lebanon. Banque du Liban (BDL)'s policy remained true to the objectives it has set upon itself: boosting economic growth, preserving exchange rate stability and maintaining the soundness of the financial system.

In the face of a rough economic climate, the BDL sought to boost economic growth through a \$1.46B package. The Central Bank also addressed the untapped sources of economic growth, providing interest free credit facilities for banks wishing to participate in the equity capital of startups, accelerators and venture capital firms.

Additionally, the Central Bank managed to maintain **exchange rate** stability throughout the year despite a negative balance of payments. Thus, the Lebanese pound's peg to the US Dollar remained around a stable midpoint parity of 1,507.5.

Even if Lebanese **interest rates** are governed by the internal circumstances of the country, 2013 witnessed minor yearly changes.

The Central Bank maintained the coupon rates on all **Treasury Bills** in 2013 except for 3-month maturity that slightly posted a 1 basis point uptick to 4.39%.

The average maturity of the government debt securities extended from 1,105 days in 2012 to 1,274 days in 2013, while slightly pushing down the weighted average yield from 6.83% in December 2011 to 6.54% in December 2012.

Given the low interest rate environment and in spite of the tough economic backdrop, broad money M3 grew by 7% to reach \$111.16B and M5 which includes non-resident deposits advanced by 9% totaling \$139.64B.

In fact, the banking system has proved to be resilient in the face of internal and external hurdles, supported by a loyal depositor base. Over the past year, LBP and USD denominated deposits grew by 5% and 11% to \$46.13B and \$90.08B, respectively.

The widespread Lebanese diaspora and depositors in Arab markets fleeing the unstable environment were the main factors behind the upturn in deposits. The robustness of the banking sector is also corroborated by the 10% annual increase in claims on the private sector from \$39.6B in 2012 to \$43.75B in 2013.

2013's hurdles were priced in **Lebanese Equities**, which registered only marginal and short-lived upturns in times of "relative stability". The BLOM Stock Index (BSI) ended 2013 at 1,150.10 points, a 2% yearly drop.

In terms of stocks, the top three performers were RYMCO, BLOM GDR and BLC Listed. Their closing prices posted yearly upturns of 33%, 11% and 8% to reach \$3.50, \$8.80 and \$1.95, respectively.

Similarly, Lebanon's political stalemate, security uprisings and external headwinds from the Syrian war kept on clouding the **Eurobonds Market** performance in 2013.

Besides local and regional developments, the international bearish trend driven by the US

LEBANON



Treasuries also impacted safe assets' trading in Lebanon. Hence, the BLOM Bond Index (BBI) mirrored the market's negative performance and shed 3.13% y-o-y compared to the 1.79% yearly loss recorded in 2012 .

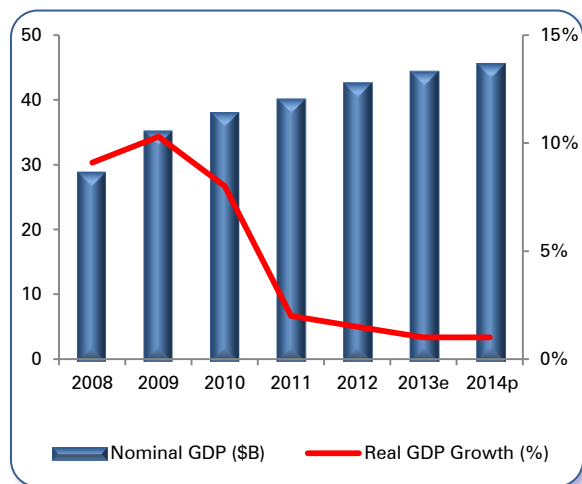
The BBI moved in seesaws over the year, hovering between a lower band of 102 points and a higher band of 111 points to end the year near the middle band at 105.64 points.

II. REAL SECTOR

Lebanon's economic growth remained positive in 2013 despite the difficult political, security, and external environment. However, it reached the lowest base since 1999 at 1.0% following 2012's slowdown to 1.5% (Figure1).

The Lebanese economy suffered from car bombings spreading all over the country, clashes in the northern part of the country, and the resignation of the Prime Minister Nagib Mikati in the first quarter of the year. The spillovers from the Syrian conflict were also having an ongoing negative impact on the Lebanese economy estimated at \$7.5 billion by the World Bank.

Figure 1: Lebanon's nominal GDP & real GDP growth



Source: International Monetary Fund

However, the first half of 2014 was characterized by the formation of the long-awaited Cabinet that managed to install a security plan partly enhancing the economic, political and security situation. This was reflected in the Business Monitor International (BMI) latest report that projected growth to improve moderately over the coming years impeded by political instability and a lack of structural reform. Real GDP is forecasted to rise by 1.8% in 2014 and 2.6% in 2015, triggered primarily by private consumption.

Concerning investment, its growth is expected to remain subdued with an expansion of 2.5% in both 2014 and 2015, amid protracted political instability and an obscure business environment. Worth noting that prospects for investment in the energy industry

are not promising, due to the slow political process that has been delaying bidding auctions for exploration rights numerous times.

In addition, the Purchasing Managers' Index for Lebanon (BLOM PMI) indicated deterioration in business conditions in the second half of 2013 whereby the PMI remained below 50 for 6 months in a row over the year. Tourism, construction, and retail were the most hit sectors in the economy. It is the public sector which contributed the most to growth last year.

The private sector wasn't at bay from the eco-political turmoil as reflected by the BLOM Lebanon PMI readings. The index was tightly hanging on to the 50-points mark separating economic expansion from contraction in December 2013 at 49.0, signaling a slowing deterioration in the rate of contraction of the Lebanese economy compared to May's 2013 level of 52.5, when data collection began.

Yet, the PMI reached a 9-Month low in January 2014 despite the positive expectations of an approaching breakthrough in the long awaited Cabinet formation. However, the two bombings that took place within a three weeks' timeframe pulled down the PMI to its lowest level of data collection at 44.7.

Over the next 4 months, the PMI managed to show a slowing contraction yet the reading still signaled deterioration in the performance of the private sector.

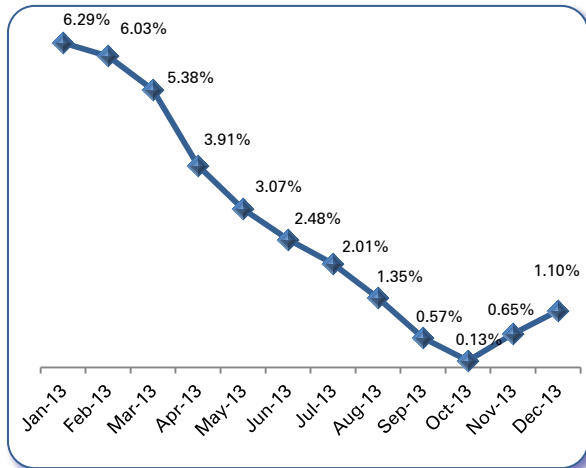
A. INFLATION

Lebanon's Consumer Price Index (CPI) released by the Central Administration of Statistics stood at 130.9 points in December 2013, denoting a 1.1% yearly inflation. The latter is considerably lower than the 4.7% in 2012 and the 4.1% in 2011 (Figure 2).

Out of the 13 sub-indices, 9 increased in 2013, 2 declined and 2 remained unchanged. The food and non-alcoholic beverages sub-index, carrying a weight of 19.9% in the overall index, rose by a yearly 2.9% to 142.0 points. The Housing sub-index, with the second largest weight of 16.2%, remained unchanged. As for transportation, accounting for 12.3% in the CPI, it declined by a yearly 2.5% to 120.9 points underlining the international bearish trend in oil prices that characterized the year. Education, which holds a 7.7% share in the index, registered a 7% upturn to 160.5 points in December

2013. Meanwhile, higher hospitalization costs led to the 2.0% yearly increase in the health sub-index to 109.0 points. The “clothing and footwear” component of the CPI saw a 7.9% yearly drop to 112.7 points as retailers used aggressive marketing strategies through sales and promotions to revitalize the sector.

Figure 2: Yearly Inflation Rates in 2013



Source: The Central Administration of Statistics (CAS)

B. CONSUMPTION & DEMAND

Growing Concerns vs Growing Demand: Disparate Consumption Indicators

Since the beginning of the war in Syria, Lebanon has been absorbing the displaced Syrian refugees which number surpassed the 1.5M in 2013. The following directly weighed on local consumption and inflated importing activity.

However, consumer behavior in Lebanon is inextricably linked to the economic, political and social context of the country. Indeed, consumer confidence and purchasing power were both weakened. ARA Research and Consultancy noted that the Consumer Confidence Index (CCI) dipped from 108 points in December 2011 to 66 points in December 2013. The Current and Expected Personal Income sub-indices drowned by yearly 78 points and 25 points to settle at 110 points and 46 points in December, respectively.

As a proxy for consumption, to a certain extent, the “new orders” sub-indicator was following a declining trend since June 2013. The level of new orders placed with the Lebanese private sector decreased

over the period June 2013-July 2014 as the related index failed to surpass the 50.0 neutral mark. This could be explained by the steep losses witnessed within the tourism and real estate sectors that resulted from the ongoing security and political instabilities.

Foreign demand also had a negative impact on new orders. The 14-month survey indicated that 2 out of 14 months showed an increase in new export orders, while the remaining months saw respective contractions in the incoming new work from foreign clients.

As part of the slowdown in consumer appetite, car sales declined in 2013 especially following the internal conflicts and regional uproars. The total number of registered new and imported used cars, the proxy for durable goods purchases, has dropped by 6% during 2013 in comparison with 2012, by 9.5% in comparison with 2011 and by 27% in comparison with 2010 (meaning from 92,500 cars in 2010 to 67,500 cars in 2013).

The Lebanese car demand pattern tipped over from favoritism of luxury brands to domination of cost-friendly models. This change is predictable in a country where a precarious economy paired with poor public transport networks compel citizens to rely solely on automobiles .

On a positive note, checks activity maintained an upward trend in 2013 conversely to numerous other economic indicators. The number of checks cleared by Banque du Liban rose by 1.2% during 2013 to reach 12.24M worth \$72.35B compared to a total of 13.08M checks valued at \$71.01B registered a year earlier. Both volume and value of checks denominated in foreign currencies preserved their dominance by December 2013, representing 70.4% and 76.4% of the total, respectively.

Worth noting that the rate of defaults which is the number of returned checks from the total number of checks, slightly declined to 2.03%, from 2.13% in the same period of 2012 signaling an improving liquidity among merchants mainly due to the increasing Syrian demand.

Stepping towards two of the core sectors in Lebanon, and given their high sensitivity to regional and domestic breakdowns, real estate and tourism industries witnessed severe deterioration in their performances over 2013. The two sectors, which

were driving economic growth during the last few years, came to a halt since 2011, thus driving down economic growth.

The direct impact of political tensions experienced in neighboring countries reached first and foremost these two sectors. Before the eruption of the Arab Spring, the tourism and real estate sectors have been expanding rapidly and significant private investments were being made in the upgrading and expansion of restaurants, hotels and other retail, corporate and residential projects. In 2009 alone, there were over 1.9 million visitors, recording a 39% rise from a year earlier, the highest rate of growth in the world. Construction permits also posted a 10.8% jump over the same period confirming the strong relationship between the two sectors.

However, two-digits' declines characterized 2011 and 2012's performances with the number of tourists dipping to 1.66M and 1.36M, respectively. Tourism declined further in 2013 directly hitting the total number of tourists that dropped 6.7% to reach 1,274,362 tourists, the lowest reported annual figure since 2008.

C. TOURISM

Tourism industry had to face in 2013, not only the persistent war in Syria and its spillovers on the local scene, but also beat the ongoing political bickering that hinders its performance. 2013 witnessed the lowest number of tourists in 6 years albeit the Lebanese government has long invested in advertising and marketing to make up for the sector's lost receipts.

Struggling to regain its glory days

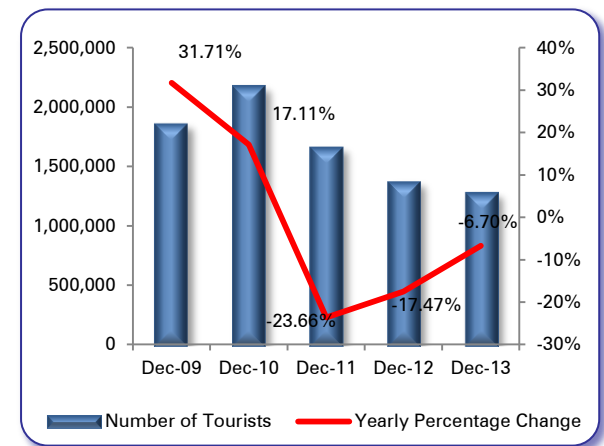
As tourism and hospitality in Lebanon are driven by stability and highly sensitive to socio-political and economic factors in addition to regional developments, those sectors were the biggest losers in 2013. According to the World Travel and Tourism Council (WTTTC), the total contribution of Travel and Tourism (T&T) to the GDP reached \$8.78B (or 19.2% of GDP) in 2013, compared to \$11.14B in 2012 (the equivalent of 26.4% of total GDP). Yet, this still highly compares with the World's average of total tourism contributions to GDP standing at 9.5%.

The tourism sector in Lebanon was hardly hit from 2011 onward after a booming period before the eruption of the Arab Spring. Total incomers reached

1.85M visitors in 2009 alone and 2.17M in 2010, a respective 38.9% and 17.1% yearly rises. Yet, Incomers to Lebanon were highly concerned about the beginning of the Syrian war by March 2011 and its repercussions on the neighboring countries. Two-digits' declines characterized 2011 and 2012's performances with the number of tourists dipping to 1.66M and 1.36M, respectively.

Tourism declined further in 2013 with the total number of tourists falling 6.7% to 1,274,362 tourists, the lowest reported annual figure since 2008.

Figure 4: Number of Tourists and Yearly Changes



Source: Ministry of Tourism

Syrian Travelers behind Air Traffic Progress

However, activity of Rafic Hariri International Airport (RHIA) improved in 2013 mainly on account of higher Syrian travelers and to a lesser extent Lebanese citizens and expats. RHIA reported a 5.7% y-o-y growth in total passengers reaching 6.25M during 2013. This growth was brought by a higher figure of departures, which increased by 6.7% to 3.22M against a smaller rise in total arrivals by 4.6% to 3.03M. This was probably due to the increase in Syrian travelers through Lebanon during the last few years since the majority of airlines suspended their flights to Syria.

Therefore, Syrians abroad found themselves forced to use neighboring countries' airports (such as RHIA) as a transitory route to reach their home land. The overall result was a decline in "tourists to arrivals" ratio. The increase in total arrivals does not reveal a positive performance in the tourism industry. A "tourists to arrivals" ratio can provide insight into the evolution of tourism seekers' stake in total incomers over a defined period. In this context, the ratio

showed a yearly decrease in the arrivals' number to Lebanon for tourism from respective 76.9%, 58.8% and 47.2% in 2010, 2011 and 2012 to 42.1% during 2013.

Is Lebanon the Arab tourists' Magnet? Not Anymore

After the Arab Spring, the fragile situation in Lebanon and the increasing travel warnings from GCC governments to avoid the country for potential security threats sent the number of Arab visitors down by 12.2% y-o-y to 402,080, after hitting 894,724 by the end of 2010.

Visitors from the GCC stepped away from Lebanon as notable incidents, mainly on the security level, kept recurring. Emirati, Saudi and Kuwaiti tourists' number plummeted by yearly 62.2%, 43.6% and 26.2% to 6,709, 40,958 and 29,598, respectively. Jordanian tourists also witnessed a drop affected by rising complications in their own country partly related to their neighboring status to the war-ridden Syria.

Egyptians posted a close figure to that of 2012 with a slight slip of 0.7% y-o-y to 63,578 tourists, while visitors from Iraq were the only nationality to post a yearly increase. Tourists from Iraq grew by 11.8% to 141,986 and accounted for 35.3% of total Arab Tourists. This increase can be explained by the flourishing trade and business activity between Lebanon and emerging cities in Iraq.

Non-Arab Tourists weren't Attracted Either

Incomers from Europe constituted the bulk of tourists grasping a share of 34.1%. Yet, Europeans were also intimidated by the turbulent regional environment and the local instabilities that materialized in bombings and skirmishes during the year. Accordingly, their number decreased by an annualized 2.4% to 433,990.

American visitors to Lebanon accounted for 16.4% of total arrivals by the end of 2013, slipping by a yearly 5.2% to 209,580 visitors. The Asian community also posted a decline of 7.5% y-o-y to 117,703 by 2013, as tourism from Asia is still linked to business travel rather than entertainment and leisure. The diminishing potential for business and the frail security environment discouraged Asian workers from heading to Lebanon.

African tourists were the only group to show an improvement in 2013, from a previous 61,263 in 2012 to reach 64,792 tourists.

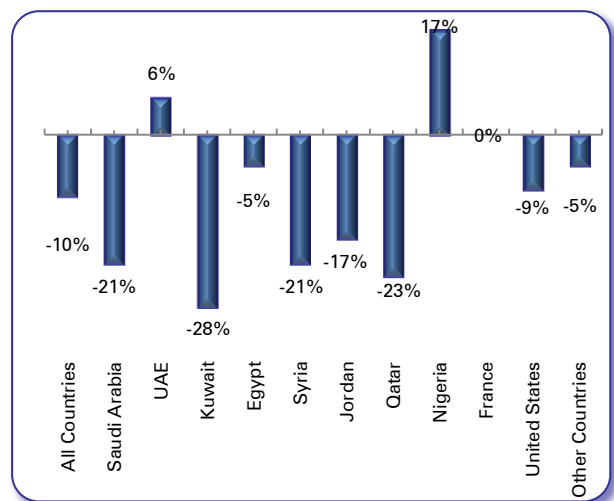
The above tourists' figures exclude the traveling activity of Syrians in accordance with the simplification of border-crossing treaties between the countries. Estimates showed a jump from 265,000 by the end of 2012 to 930,000 refugees (22% of the country's) population) in 2013. Given their deteriorated financial and health situation, refugees represent additional social, environmental and economic costs for the Lebanese government, despite the international support and donations. However, some of the financially satisfied citizens fleeing the violence in Syria contributed into marginally compensating the diminishing revenues from tourism.

...As a result Tourist Spending Deteriorated

In an attempt to boost tourism, Lebanon promoted campaigns such as the "50% for 50 Days" in addition to slashing airfares and hotel rates.

Yet, the dismal state of the country naturally resulted in lower tourist spending, which fell 9% compared to 2012. Particularly, the number of VAT refund transactions revealed a 10% decrease, subsequent to the 28%, 23% and 21% declines by Kuwaiti, Qatari and Saudi visitors, respectively.

Figure 5: 2013 Yearly Evolution of the Number of refund transactions



Source: Global Blue

Refund transactions by Syrians and Jordanians also fell by respective 21% and 17%. In contrast, France

and UAE nationals spent respectively 8% and 5% more in 2013.

However, the Arab visitors remained the main spenders in Lebanon headed by Saudi Arabians at 15% of total refund transactions, and followed by Emiratis and Kuwaitis at 14% and 7%, respectively. Egypt and Syria posted a 6% stake each.

As for categories' breakdown, spending improved in Souvenirs & Gifts and Electronics & Household appliances, while Fashion & Clothing, which accounts for 71% of total spending slipped by a yearly 11% despite the ongoing trials of retailers to improve their drowning sales through discounts and promotions.

As for point of sale distribution, Beirut preserved its leading rank as the biggest tourist spending location capturing 81% of total spending and followed by shares of 13% and 3% for the areas of Metn and Baabda, respectively. Tourist spending in Baabda surged by a yearly 175% partly on the inauguration of Majid Al Futtaim first mall in the Levant, Beirut City Center in Hazmieh area. Spending in Kesserwan and Mount Lebanon dropped 17% while that of Beirut showed an 11% yearly decline.

The Fragile Scheme also Devastated Hospitality

As a result of the slackening economic, political and security conditions, occupancy rate in Beirut fell 3 percentage points (p.p) in 2013 to 51%, ranking among the bottom 3 countries in the MENA region, and faring only better than Cairo and Manama. This has forced some hotels to close their doors, while others dismissed some of their employees in order to reduce their operational costs and maintain their revenues.

Also, revenue per available room (RevPAR) in Beirut, which is a key measure of hotels performance, tumbled by a yearly 20.8% to \$87, in line with the deteriorating tourism activity. Moreover, regular celebrations and festivities couldn't attenuate the cruel year's repercussions on the market that previously enjoyed, by December 2009, a \$185 RevPAR, more than the double of 2013's figure.

As for the Average Daily Rate (ADR), it decreased by 15.7% y-o-y to reach \$169. Lowering the ADR especially that of luxurious hotels reveals hotels desperate trials to boost reservations by adopting

aggressive marketing strategies to attract more tourists, rise occupancy rate and preserve RevPAR.

On a positive note, and despite the violent uprisings that deteriorated the sector's performance in 2013, Beirut managed to rank 20th among the world's best cities and 1st in the Middle East by the Condé Nast Traveler's 2013 Readers' Choice. The city of Byblos was also chosen in April 2013 by the United Nations World Tourism Organization (UNWTO) as the best Arab Touristic city. In addition, Lebanon ranked 69th amongst 140 countries in the Travel and Tourism Competitiveness report for 2013, grasping the first place in terms of Affinity for Travel and Tourism.

Low appetite among the sector's Investors

Touristic projects were negatively influenced as investors were demotivated amid the sluggish performance within the sector. A look at Kafalat's guarantees shows that 109 tourism projects were approved during 2013 compared to 158 projects in 2012. Accordingly, tourism share of total Kafalat projects dropped from 19.4% in 2012 to 16.9% in 2013.

D. CONSTRUCTION & REAL ESTATE

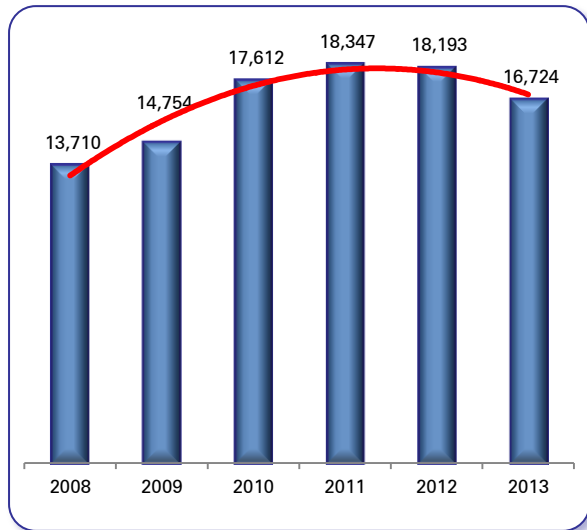
Slackening Demand on Worsening Conditions

Investors faced in 2013 several challenges clarifying the dwindling demand for properties: developers were facing the scarcity in land, volatility in workforce availability, lower demand from the GCC residents who switched to more secure areas, financial sustainability concerns, legal and logistic delays in delivery, and construction material price sensitivity.

In this context, real estate demand mainly faltered in 2013 amid an under stress economy coupled with a fragile internal situation and an ongoing Syrian war spillovers. The number of transactions translated the downturn and slid by 7.2% to 69,198 in 2013, compared to 74,569 transactions in 2012.

Total value of property sales transactions retreated by 2.6% y-o-y from \$8.94B in 2012 to reach \$8.71B by December 2013. Thus, the number of transactions edged down at a faster pace than transactions' value sending the average value of a real estate transaction higher to \$125,841 by December 2013 compared to \$119,838 in 2012.

Figure 6: Average Value per Property Sale (In \$)



Source: Cadastre

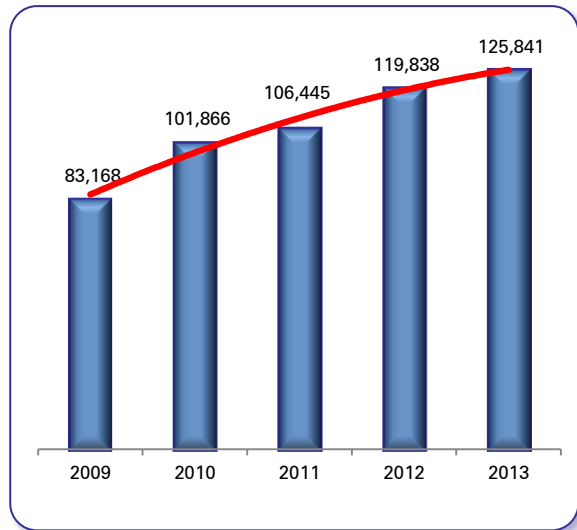
Foreign demand had a predictable declining trend in 2013. Sales to foreigners registered a sharp decrease of 9.0% in the volume of sales following repeated warnings from GCC governments calling their citizens to avoid Lebanon due to the high degree of political uncertainty and security developments. Yet, the Syrian crisis has cast a multitude of consequences on the Lebanese real estate sector, as citizens fleeing their country were looking for purchases or rents thus helping to maintain prices.

Real estate consultant, RAMCO, stated that Beirut residential projects completed in 2013 showed that 277 new apartments remained unsold in 2013 compared to 217 units completed during the course of 2012. Unsold apartments in 2013 represented an 81,773 SQM of built-up residential area worth \$437.58M.

Mixed Indicators Paint the Construction Scene

Cement deliveries in 2013 were unexpectedly higher by 9.8% y-o-y after having recorded a yearly decline of 4.3% in 2012. Total registries were 5.83M tons by the end of 2013 compared to 5.31M tons in 2012, pointing to an improving construction activity. This increase was partly due to the public sector demand (with the ongoing expansion project of the Port of Beirut) and to illegal construction when, during the year, the Ministry of Interior declared that it's not responsible for the crackdown on illegal construction activity.

Figure 7: Yearly Number of Construction Permits



Source: Orders of Engineers in Beirut and the North

Construction loans also went up by 12.8% y-o-y to \$9.18B in 2013. This increase was mainly the direct result of BDL and the financial sector's stimuli to boost demand and consecutively economic growth.

By looking at the number of issued construction permits during 2013, which reflects the investors' expectations of real estate activity in the coming 6 months, a considerable 8.1% yearly decrease to 16,724 permits is observed. However, the Construction area Authorized by Permit (CAP) plummeted by 12.8% in 2013 to 12.82M sqm following a 10.8% yearly fall in 2012.

This would imply the spreading of projects over lower sized investments, and the shift of supply to serve a more selective demand. Accordingly, the average area per permit has decreased by 5.1% to 765.40 sqm/permit in 2013 compared to 806.78 sqm/permit recorded a year earlier.

The housing sector performance is also a core indicator of real estate demand. BDL launched in early 2013 an incentive program to expand lending and revitalize demand with a special focus on housing loans.

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. Accordingly, housing loans reached \$8.53B by December 2013, up by a yearly 17.4%.

Mount Lebanon Remains the Most Attractive Region for Real Estate Investors

Mount Lebanon stayed the top location for new constructions in 2013 capturing 43.1% of total activity in terms of projects number, while the lowest was Beirut reporting 4.7% of total projects. Nabatiyeh, South Lebanon, and Bekaa showed respective stakes of 11.9%, 15.6% and 10.5% by the end of 2013. As for the projects yearly variation, all regions except for Nabatiyeh saw declines in construction permits with the steepest falls in Beirut (-19.1%) and Mount Lebanon (-11.6%) to 790 and 7,302 projects, respectively, mainly due to the scarcity of land.

Price Ranges Hold High, yet Steady

Real estate price trends have been following cyclical increases followed by periods of stability with the scarcity of land remaining the first price influence.

Despite the economic slowdown and the complications on the Syrian front that weakened investors' confidence in 2013, property prices remained resilient in Lebanon. Beirut residential streets revealed variation in the prices of SQMs depending on the location. Prices averaged \$3250-\$3,500 per SQM hitting \$7,500 at the sea front.

According to Global Property Guide, Lebanon stood at the 45th place among 94 countries with a buying price of \$3,591/ SQM for an apartment of 150 SQM. As for the Price/Rent ratio, it reached 28 times which means that a 150 SQM apartment in Lebanon is priced around \$538,650, while its rent per year is \$19,238. It means that rental prices in Lebanon are low compared to other countries where the price reaches 17 to 20 times the yearly rental value.

E. AGRICULTURE

The agricultural sector in Lebanon revealed shy signs of recovery in 2013, yet the realized agricultural production remains below its potential. The dominating moderate weather, fertile soil and relatively abundant water resources are the main strengths of the sector. Still, the sector continues to go through tough times partly stemming from internal deficiencies, local uprisings as well as regional spillovers mainly from the Syrian war.

The agricultural and livestock sector managed to preserve its economic position over the period extending from 2004 to 2011. The contribution of the sector remained subdued at 4.1% of GDP in 2011 despite the economic development across several sectors mainly trade (16% of GDP), professional & administrative services (7% of GDP) and financial services (7% of GDP). The diversification of the Lebanese economy away from agriculture into services did not heavily affect the former sector.

Activity of agriculture and livestock sector increased between 2004 and 2011 revealing a CAGR of 8.5%, when the CAGR of GDP was 9.1% over the same period. The sector posted a value added hovering around \$1.52B in 2011 compared to \$792.70M registered in 2004 .

Agriculture Profits from Syrian Misery

Although exports through the Syrian border were hit by the 3-Year war, the net impact of the latter on the Lebanese exports has been positive. Agriculture exports reached 638,369 tons amounting to \$215.70M in 2013, 17.0% higher than 2012's level of 545,639 tons worth \$171.24M.

Certainly, the war in Syria weighed over agricultural exports starting 2011, noting that a considerable share is transported through the Syrian territory. However, numerous Lebanese farmers profited from the Syrian misfortune.

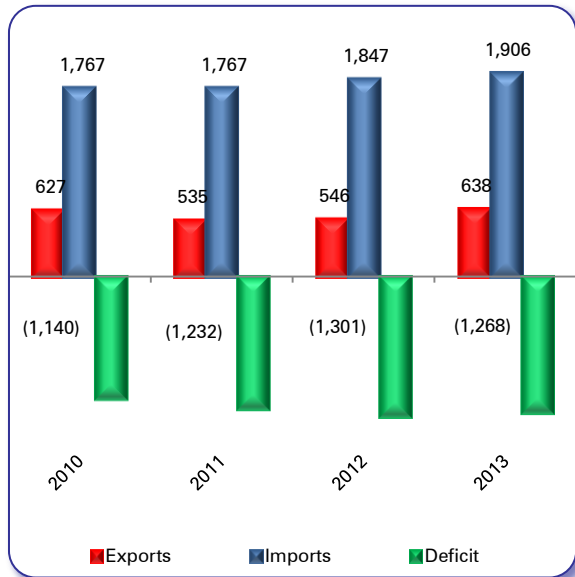
In details, some importing markets of Syrian agricultural products shifted their demand to neighboring countries, such as Lebanon. Hence, Lebanese agricultural exports almost constituted 0.5% of 2013's estimated GDP and 5.5% of the year's total exports. However, the new trend is mainly temporary and will remain highly associated to the war status in Syria.

Despite the improving standing of exports, the country still suffers an ongoing structural deficit on its trade balance of agricultural products. In this context, trade deficit stood at \$707.09M in 2013, widening from 2012's deficit of \$696.38M.

At the same time, Lebanon imported 1.91M tons worth \$922.79M of agricultural products in 2013, compared to the 1.85M tons imported in 2012 priced at \$867.62. Accordingly, imports were about four times the value of exports, while the exports cover

ratio stood at 23.4% in 2013 improving from the 19.7% recorded in 2012. In addition, the average price per ton of Lebanese exports rose by 7.7%, while that of Lebanese imports rose at a slower pace of 3.0% y-o-y.

Figure 8: Agricultural Products External Position (In thousand tons)



Source: Lebanese Customs

Back to the Lebanese market, domestic consumption of agricultural products is estimated around \$1.62B in 2013. Accordingly, almost 88.2% of total consumption was intended to the local market.

The top destinations of Lebanon's agricultural products were mainly concentrated in the neighboring Arab countries, with a small portion associated to remote countries where some of the Lebanese diaspora reside. Syria topped the list with an 18% share of the total volume of exported products in 2013 and was tracked by Jordan and Saudi Arabia with respective shares of 17% and 11% .

Main exports in 2013 were Potatoes (17% of total exports), Flour (9% of the total), Coffee (Re-export, 8% of the total) and Bananas (8% of the total).

The improving performance of agricultural products exports in 2013 remained counteracted by some persisting vulnerabilities due to the lack of a comprehensive and strong strategy to organize and develop the sector. Issues related to quality control, standards, organization are impeding export to markets such as Europe, where labor costs are

significantly higher than in Lebanon. In addition, the high production cost (mainly transport and storage costs) and the lack of cooperatives of production and marketing of products, deepen trade deficit within the agriculture sector.

Government's assistance for the sector in Lebanon is present but minimal. It mainly consists of input subsidies, agriculture credits, tax exemption, subsidized food purchases, price support and export subsidies. However, low priority is attributed to agriculture spending as revealed by the portion of programs benefitting the agriculture sector that barely touch the 0.4% of government budgets, leaving the sector dependent mainly on FAO grant programs, private sector, and foreign investment. This lack of support devoted to the sector has a spillover effect as it brings economic weaknesses, among which higher cost of imported products triggered by higher global food prices, leading to imported inflation.

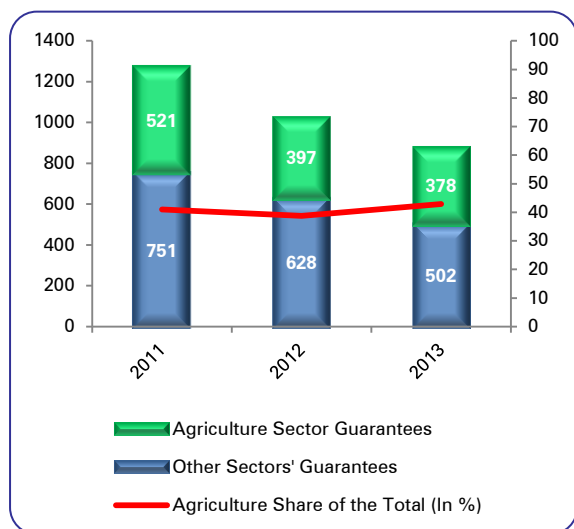
The rising instability in 2013 and the ongoing political deadlock took their toll on total subsidized loans by Banque du Liban (BDL), of which agricultural loans. Despite the 20.6% surge in total outstanding loans of the agricultural sector to \$546.83M by 2013, investors were concerned about the political stalemate related to the Cabinet formation, sending down newly subsidized loans (which are total outstanding loans at end of 2013 minus total outstanding loans at end of 2012) by 14.7% y-o-y to \$35.44M in 2013. However, subsidized loans for agriculture showed the slowest decrease when comparing to the respective 27.0% and 23.8% declines of the industrial (\$214.44M) and Tourism (\$157.77M) sectors.

Kafalat loans to the agriculture sector's Small and Medium Enterprises (SME) also decreased in 2013, yet they saw their share rise. Correspondingly, Kafalat guarantees to the agricultural sector decreased from 397 in 2012 to reach 378 guarantees by the end of 2013. In terms of value, Kafalat loans stood by the end of 2013 at \$37.32M compared to \$37.67M in the previous year. In contrast, the agricultural sector's stake of total guarantees went up to 43.0% in 2013 compared to 38.7% in 2012.

This was the result of respective declines in the majority of Kafalat loans over the year with the advanced technology sector revealing the sole uptick from 16 to 19 guarantees. The decline in Kafalat

guarantees' number is mainly explained by the deteriorating investment sentiment that painted 2013 following the several security incidents and political deadlocks.

Figure 9: Kafalat Guarantees



Source: Kafalat

The Investment Development Authority of Lebanon (IDAL) is another institution aiming the support of the Lebanese agricultural sector by promoting the latter's products regionally and internationally. The introduction of "Agri Plus" in September 2011 had the approval of the Lebanese government and came to replace "Export Plus" program as of 2013. The program, which came in line with the World Trade Organization requirements, has the objectives of improving quality and quantity of the Lebanese agricultural exports, tapping new export markets and increasing consumer confidence in the Lebanese agricultural exports. "Agri Plus", the \$33M program, is constituted of 6 components: Financial incentives, Local and abroad trade fairs, packaging and storage houses' upgrade, training programs, market studies to target potential export markets as well as promotional and marketing strategies.

Subsidized agricultural exports constitute almost 81.9% of total agricultural exports. In fact, the remaining 18.1% represent the volume of exports not subsidized in addition to the re-exports. According to IDAL, exports subsidized by the program jumped 15.0% y-o-y to 522,538 tons by the end of 2013 reflecting the success of "Agri Plus". Potato took the lion share among "Agri Plus" products, grasping 37% of the total, or 193,340 tons

in 2013. Citrus and Malus products followed with 15% each, while Bananas accounted for 11% of total exported AP.

Despite the positive impact of "Agri Plus" on Lebanon's export activity, some suggestions should be taken into consideration related to the selection of agricultural products within the program. In this context, the program should target higher value added products such as organic food that is currently gaining consumers' interest domestically and globally. Second, the selected products should be easily marketable and packaged at a competitive price. Hence, higher are the margins made by the Lebanese farmers on the external market, higher is the competitiveness.

F. INDUSTRY

Encompassing more than 15 sub-sectors, the Lebanese industrial sector was partly boosted by the increasing Syrian demand in 2013 and the constantly changing taste and preferences of Lebanese consumers that are more westernized than most of their regional peers.

First, the influx of Syrian immigrants to Lebanon partially limited labor costs in light of the new unregulated abundant low-cost supply.

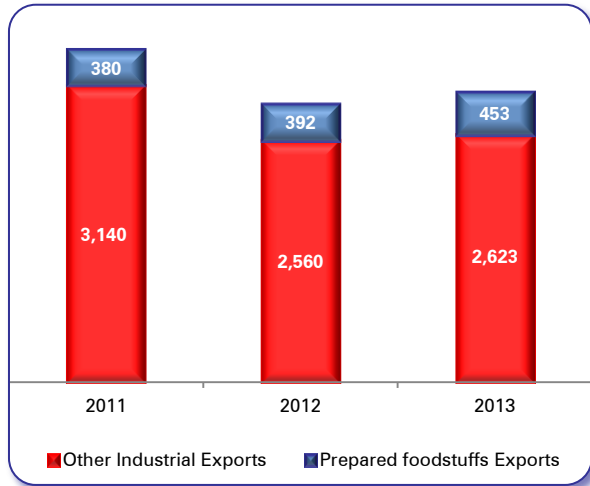
Second, some industries found a new market in the swift of demand from Syria and benefited from shortages of supply and halts of production to compensate for Syria's regular imports and/or exports. Accordingly, industrial exports reached \$3.08B by the end of 2013 up from \$2.95B in 2012 and \$3.33B in 2011.

Base metals stood as the top exported products in 2013 grasping a 17.1% share of total industrial exports. Machinery and mechanical appliances stood second (16.5% stake) while Prepared foodstuffs revealed a 14.7% share of the total. Mineral products and products of the chemical industries came fourth and fifth with respective stakes of 11.6% and 10.7%.

However, investment sentiment and business initiatives kept on dwindling over 2013 discouraging new industrial projects and thus decelerating Kafalat guarantees. In this context, the total value of Kafalat loans dedicated to the industrial sector shed from 311 in 2012 to 262 by the end of 2013. Furthermore, industrial guarantees offered by Kafalat saw its

shares decreasing from 38.30% in 2012 to 35.04% in 2013. The following means that investors were less interested in investing within the industrial sector which was mainly in favor of the agricultural sector, as mentioned before.

Figure 10: Total Industrial Exports (In \$M)



Source: Ministry of Industry

A quick round up over the sub sectors of industry based on output levels, shows that one of the highest prolific sub-sectors is the agro-industrial, contributing to 32% of total industrial output.

Agro-Industrial Activity Remain an Industrial Shield in 2013

Despite the negative spillovers of the Syrian war on the overall Lebanese economy, agricultural products' manufacturing posted satisfactory performance. First, the interruption of exports' transportation through the Syrian border did not negatively impacted agro-industrial external activity as some importing markets of Syrian food products shifted their demand to neighboring countries such as Lebanon to compensate for the decrease of Syrian exports. Second, the Syrian crisis attenuated the Syrian competition in the Lebanese market and boosted Syrian refugees' demand for the Lebanese goods.

With a cemented tradition of commerce and enterprise, the Lebanese food industry offers several strengths and opportunities. Local food producers actually benefit from the widely spread diaspora, which constitutes great export opportunities. In addition, demand for packaged and processed foods is likely to rise along with social changes such as a

higher single-person households and a higher participation rate of women in the workforce.

Given their immunity to local and regional uprisings, agricultural and agro-industrial sectors saw satisfactory performance in 2013 supported by Syrian refugees' consumption. Starting with the food industry, food products exported in 2013 amounted to \$452.80M, almost 46.0% of the year's total estimated production. This leaves the remaining 54% of 2013's estimated production for domestic consumption. In addition, domestic consumption of agricultural products was estimated around \$1.62B in 2013. Accordingly, almost 88.2% of total consumption was intended to the local market.

The Lebanese food industry provides its production to both local and foreign markets. Food products exported in 2013 amounted to \$452.80M, almost 46.0% of the year's total estimated production. This leaves the remaining 54% of 2013's estimated production for domestic consumption.

Lebanon's food manufactured products are attracting foreign demand more than the country's raw agricultural products thus gathering higher revenues. While the Lebanese agricultural exports almost constituted 0.5% of 2013's estimated GDP and 5.5% of the year's total exports, agro-industrial products posted a higher 1.0% stake of the same year's GDP and 11.4% of 2013's total exports.

A Closer Look to the Media Industry Trends

The Lebanese Media industry is versatile in both its constituents and its audience. The industry encompasses multiple media such as: Production and Post-Production, Publishing Houses, Television Broadcasting, Music and the budding digital media segment. Lebanese media also has a wide outreach into the Arab Markets, targeting Arab readers or net surfers. Lebanese media contributes to over 3% of GDP and employs more than 2.11% of the workforce.

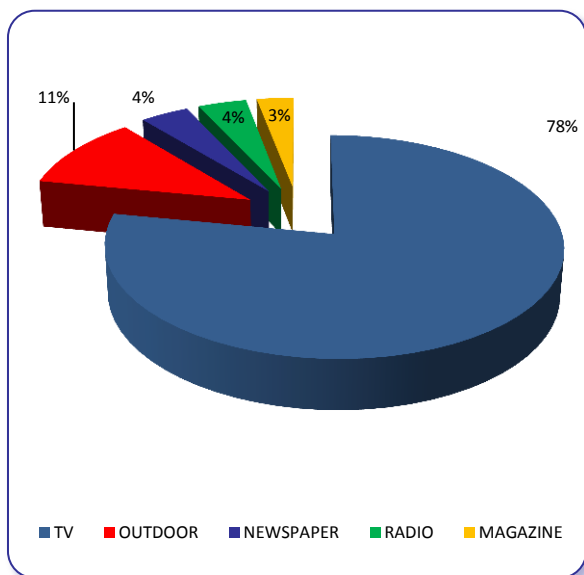
The Lebanese advertising industry, an essential pillar of the media corpus, is also one of the most prominent in the Middle East. Delving into the characteristics of Lebanese advertising and benchmarking them into global and Arab markets not only offers insights on the change in the consumer's tastes but also on the sensitivity of the sector to socio-political instabilities.

In spite of the political instability and after two years of meager growth, advertising expenditures regained the momentum that was last seen in the 2009-2010 period. In 2010, ad expenditures surged by 22% from \$1B in 2009 to \$1.22B in 2010. However, with the onset of the Arab Spring in 2011, they remained flat at \$1.24B for both years 2011 and 2012. Finally in 2013 Lebanese ad expenditures grew by 20% to reach \$1.49B making them the fifth largest in the Pan Arab region.

The trend in total ad expenditures followed the same exact trend as that of TV expenditures.

For the past five years TV has been the largest advertising medium, representing over 70% of total advertising expenditures. The total TV advertising expenditures fared well against the regional and local instabilities dropping by a mere 1% in 2011 and remaining stable in 2012. Remarkably, in 2013 TV ad spending recorded another double digit growth of 24% to reach \$1.17B.

Figure 11: Advertising Expenditures by Media in 2013, Share in the Total



Source: Center for Educational Research and Development (CERD)

Interestingly in the politically-heated year of 2011, IPSOS reported that the highest share of TV advertising was concentrated in Political News Bulletins with 32% of total TV advertising. Politics were also at the forefront of Print advertising with a share of 37% of the total.

Newly produced television commercials in Lebanon followed the Middle Eastern trend and slightly

dropped from 682 in 2012 to 674 in 2013. Although newly produced TV commercials (TVCs) in the drinks category increased from 75 to 89, new TVCs in health and beauty as well as food decreased offsetting the increase in the drinks category.

The top spenders in the brand category was Buzz followed by XXL, Super Star medicines, BankMed and Banque Libano-Francaise. In the ranking by category banks rated first followed by alcoholic energy drinks, coffee, cars and beauty care centers.

Outdoor is the second largest advertising medium representing a consistent share of 10% of the total and increasing by 25% to \$167M in 2013. However, newspaper advertising has been on a consistent downward trend falling by 12% compared to 2009 to reach \$54.6M in 2013.

After dropping by 7% in 2010, radio advertising spending has consistently grown although at a decelerating pace. This might be linked to the fact that the majority of radio ad spending is directed towards music broadcasting stations rather than news stations. For instance, music-broadcasting radio stations overhauled the news stations in terms of advertising in 2011.

As for cinema advertising, it witnessed an outstanding boom of 64% in 2011 which wore off in the two following years dropping by 17% in 2012 and 37% in 2013.

With smart phone penetration in Lebanon, advertisers are likely to have further growth opportunities on mobile and online platforms. As the online community of consumers grows more each day, newspapers, radio stations and television channels are all attempting to keep advertisers interested by being active on social media platforms and by creating user-friendly, vibrant and interactive websites.

Cement Industry: Steady Performance despite the Heightening Turbulences

2013 was one of the most challenging years of the Lebanese cement industry's 80-Year of history. Contrarily to expectations, the cement sector showed a 9.8% yearly growth in the number of cement deliveries to 5.83M tons despite the slowdown in real estate and construction activities.

This is probably explained by higher public spending, previously licensed projects and illegal construction.

Despite the several challenges faced over 2013, the sector was one of the few industries able to survive thanks to the strong fundamentals and the high level of expertise. Total production capacity hovered around 6.47Mt in 2013, compared to a lower 6.32Mt recorded in 2012.

Table 1: Average Price of Cement in Selected Countries

Country	Price (In \$ per ton)
Egypt	105
Jordan	99
Lebanon	92
Kuwait	70
Qatar	70
Oman	69
KSA	64

Source: BLOMINVEST compilation

The Lebanese cement market is fully dependent on local production. Due to the high cost of cement shipment, international firms find it more profitable to build new plants in the targeted countries which help them in reducing their costs and achieving their diversification strategy.

Accordingly, sales to production ratio ranged between 80% and 100% pointing to the fact that the majority of the Lebanese cement supply was liquidated. This can be considered as a healthy sign for the industry's perseverance and productivity.

Contrasting with the improving local demand, Lebanese cement exports were cut in half in 2013. Lebanon exports cement to a number of Arab states, namely Syria. Accordingly, the Syrian war heavily hit Lebanese exports that tumbled 44% to 285,205Mt in 2013, as compared to 509,488Mt in 2012.

Despite the negative performance of cement exports in 2013, local producers managed to liquidate their total production in the domestic market. This helped them in maintaining their profits given that local price is almost the double of export price. Worth noting that cement exports have a much lower value than locally sold products as the big volume of exports helps in reducing the marginal cost

Real Estate and Construction Goes Down, Yet Cement Activity Inched up

Despite the slowdown in real estate activity, cement deliveries managed to rise in 2013 because of the following reasons:

By mid-2013, the Ministry of Interior and Municipalities (MOIM) announcement boosted construction in several regions without permits. In details, MOIM handed over the crackdown of illegal construction activity to the Lebanese municipalities. Given the lack of means within municipalities, illegal activity surged for almost 3 months when the MOIM intervened again to suppress illegal projects.

Government Infrastructure was another driver of cement activity in 2013. The ongoing expansion and restoration project at the Port of Beirut took place over the year definitely contributing in the cement deliveries yearly growth. HOLCIM won the tender and instantly positioned a mobile plant at the site and took immediate action.

Cement prices preserved their average prices supported by the Lebanese government. The price of cement remained almost fixed, with a slight uptick of 2% to \$94 per ton - without VAT - for the grey cement, and almost a 3% slip for the white cement to average \$173 per ton - without VAT -.

Cement prices stood unchanged in 2013 despite the decreasing cost of energy. In 2013, energy prices revealed a declining trend that should have triggered down Lebanese cement prices. Thus, cement production variable cost dropped by an average of 12% y-o-y to settle around \$39. According to HOLCIM, the total cost of production in 2013 has increased, despite the downtick in variable costs, which could be partly explained by respective hikes in raw materials' prices, wages and salaries or even due to inflation.

G. INFORMATION AND COMMUNICATION TECHNOLOGY

During the past 5 years, Lebanon realized some major improvements on many Information and Communication Technology (ICT) indicators as it is starting from a low base but it still has a long way to go in order to be placed with developed countries or even to catch up with many Arab countries. Mobile penetration surged from 35% in 2008 to more than

80% in 2013. Prices of fixed broadband 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. However, Lebanon still has several problems when it comes to the quality of the services provided. For example “a survey by Ookla, a US-based broadband tester, placed Lebanon 151st for download speeds, averaging 2.52Mbps.

Lebanon realized important advances when it comes to several global indicators concerning ICT. For example, Lebanon improved its ranking on the ICT development index (IDI) from a ranking of 61 at end 2011 to 52 in 2012 out of 155 surveyed countries. Lebanon was mentioned by the International Telecommunication Union (ITU) among the most dynamic countries as it improved by 9 places only surpassed by UAE that gained 12 ranks in the global ranking.

Improvements were also achieved regarding the ICT price basket. Lebanon advanced 4 places to rank 60 in 2012 compared to 64 in 2011. Four Arab countries performed better than Lebanon including Saudi Arabia which ranked 50th, Bahrain 34th and UAE 7th. In the global ranking, Lebanon was behind Iran but before Turkey.

However the ITU study deduced that “the relationship between price and penetration is not as strong for mobile broadband as it is for the other ICT services included in the ICT Price Basket (IPB), particularly in countries with relatively low mobile broadband penetration (below 40 per cent, which is the case of Lebanon). This could be explained by the fact that in these countries mobile broadband is an emerging market, with high subscription growth and rapidly evolving price structures.

As a result, 2012 prices will most likely have an impact on future rather than present mobile-broadband uptake. Moreover, the correlation between the mobile-broadband sub-basket and income levels (GNI p.c.) is also weak. This suggests that mobile-broadband affordability greatly depends on other variables apart from income, such as for instance regulation and policy initiatives dealing with licensing, spectrum availability and the promotion of competition”, which are to a certain extent under-developed in Lebanon.

Lebanon was ranked in the bottom half of the list in 2012 when it comes to the NRI, however gaining one

place compared to the previous year. Lebanon was placed 94th at end 2012 compared to 95th in 2011 out of the 142 surveyed countries. Among Arab countries, Lebanon managed only to outpace Syria (129) and Yemen (141). The impact sub-index that is derived from the NRI shows that the latter seems to have less economic and social impacts in the Arab region than it is suggested by the general index.

Lebanon ranking improved six notches between 2010 and 2012 from 93 to 87 when it comes to the e-government development index (EGDI). However the UAE gained an impressive 21 places in the global ranking and replaced Bahrain for the number one spot in the region. From 2011 to 2012, Oman, Saudi Arabia, and Qatar also significantly improved their overall ranking by 18, 17, and 14 places respectively. Bahrain fell by 26 places and Jordan fell 47 places, Egypt and Kuwait also fell by 21 and 13 places respectively. In 2012, 6 Arab countries had a better ranking than Lebanon and 8 had a worse ranking .

The e-participation index “presents valuable indications on the level of usage. Though only from the perspective of potential-not actual- use by citizens”. Lebanon gained an impressive 25 places in the global rankings to sit on the 20th place among 190 countries. In general the whole region managed to achieve a remarkable improvement in the global ranking. Lebanon is still in the bottom half of the region, although its overall ranking is good. Several Arab countries managed to improve their rankings by more than 60 places between 2010 and 2012 .

Analyzing the ICT sector in Lebanon from a human capital perspective, one would think that the country is highly ranked regarding ICT indices as it has the qualified people to develop and manage the sector. However the low ranking of the country seems to be the result of a low quality infrastructure as the sector is not fully liberalized, remains in the hands of the government that fixes the prices, and competition is pretty much non-existent.

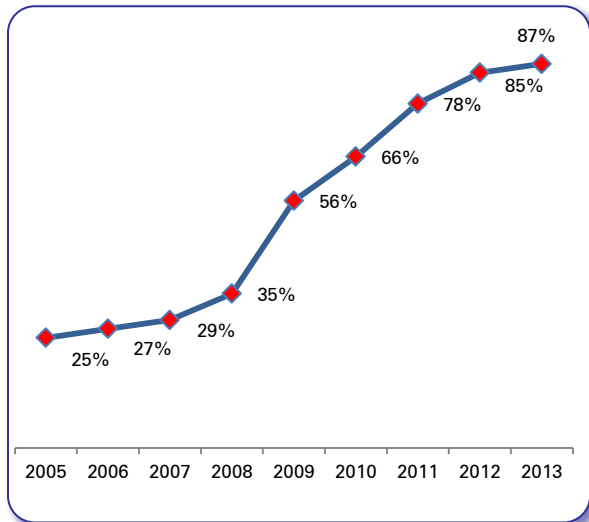
A Zoom-In to the Mobile Sector

In an era of unprecedented technology evolution, mobile technologies are gaining the spotlight. Shopping at ease, getting medical assistance, settling bank bills, streaming a movie or receiving breaking news alerts from around the world is now possible through one device. Consumers have no choice but to embrace mobile broadband given the

enormous facilities that can be available on their smartphones as well as keeping up with the mobile technological boom .

Driven by dynamic progress and rapid adoption, mobile technologies easily navigated through the Lebanese market since 1993. This was revealed by the rising number of mobile subscriptions over the past 5 years when the CAGR grew by 10.9% compared to the 8.1% growth in the World's CAGR over the same period. The following allowed Lebanon to stand as the fastest growing country in terms of ICT Development Index (IDI) (a 0.75 points increase) in 2012 to 5.37, ranking 55th out of 157 countries.

Figure 13: Mobile Penetration Rate Evolution



Source: World Bank, BMI, TRA

Still, the mobile market in Lebanon remains underdeveloped and not performing at full capacity. The poor conditions of the industry comprises the quality of network coverage, the quality of connection, the quality of data and internet services, the customer service, and the speed of technical repairs.

The weak structure of the sector placed Lebanon as the least competitive cellular market amongst the Arab countries in 2013. In details, the Cellular Competition Intensity Index for Lebanon stood at 41% similar to that of Syria and close to the respective 49% and 48% indices of Qatar and Libya. As for the top performers, Saudi Arabia ranked first with 77% and was followed by Jordan (76%), Palestine (72%) and Egypt (68%). In fact, Lebanon's mobile penetration rate remains relatively low.

Spotlight: Steel Industry in 2013

Lebanon is a net importer of steel with the metal's import constituting a share of 4% of total imports in 2013.

Looking at the value of Lebanese steel imports over the years uncovers a downward trend. The value of steel imports reached \$923.88M in 2013 compared to \$947.95M in 2012.

According to market players, this drop should not be relied upon when analyzing the market since it is due to downward price fluctuations on global markets. Importers affirmed that the market price of their most demanded product, reinforcing bars for construction, dropped from around \$725/ton in 2012 to \$660/ton in 2013. The subdued prices are not only the result of lower international prices but also due to the invasion of the Lebanese market by the cheaper Chinese products. The latter represented 35% of total steel imports in 2013, followed by 25% for Ukraine and 17% for Turkey.

Therefore, it is important to track not only the value of steel imports but also the volume of steel imports. The annual growth rate in steel imports tonnage has been steadily hovering around 6% since 2010 and reached a total of 1.42M tons in 2013.

The surrounding and internal conflicts in Lebanon during 2013 have weighed negatively on overall growth, construction activity and therefore the steel market. Construction activity is tightly linked to steel demand as the imported bars and rods mainly used for that purpose constituted 67% of total imports in 2013 .

In spite of its net importer position, Lebanon exports scrap metal. After exporting 400,000 tons of scrap metal at a price of \$402/ton in 2012, Lebanon exported 300,000 tons at the price of \$350/tons in 2013, the main importer of Lebanese scrap being Turkey. .

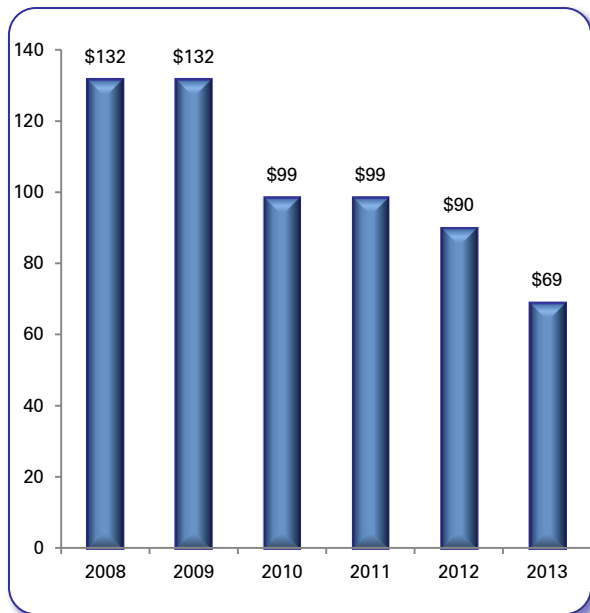
Standing at 87% in 2013, the country's penetration rate is still below the regional average that hovers around 119%.

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. According to the Telecommunications Regulatory Authority (TRA), the Lebanese mobile basket for 100 calls /month ranks second after Palestine's basket that amounted for \$75 as of November 2013. Despite 2013's substantial drop in prices, the Lebanese mobile basket's value remained higher than the \$33 Arab Med average price and the \$23 average price in the OECD countries.

The mobile market in Lebanon is state-owned but operates through 2 private mobile operators, Touch and Alfa. Both of these companies are controlled by the Lebanese Ministry of Telecommunications (MoT) and privately managed by Orascom Telecom of Egypt operating as Alfa and Zain of Kuwait known as Touch, in return for a management fee.

Figure 14: Evolution of Mobile Basket Prices in Lebanon for 100 calls /month



Source: TRA

Mobile subscriptions maintained the upward trend in 2013 to almost touch the level of residents. Mobile subscriptions stood at 3.89 M in 2013. Accordingly, almost 87% of total inhabitants in Lebanon were subscribed on a mobile phone line by the end of 2013.

Telecom revenues are one the largest source of income for the government and are used to service the state's debt. In fact, proceeds to the government

from the telecommunications' sector amounted \$1.43 in 2013, almost 15% of total fiscal revenues.

The Lebanese consumer is paying more for prepaid services than any other Arab countries. Lebanon ranked as the most expensive country in term of average prepaid price at \$0.25 per min and was followed by Qatar and Yemen with respective \$0.18 per min and \$0.16. Egypt stood as the cheapest country in the Arab World for an individual to make a 1 minute call from a prepaid line at \$0.03. Some of low tariffs can be also found in Jordan (\$0.06 per min), Morocco (\$0.06 per min), Sudan (\$0.07 per min), Syria (\$0.07 per min) and UAE (\$0.08 per min).

Technology revolution and new consumer trends have been a double edged-sword for both MTC and Alfa. Besides the decreasing prices, the 2 phone operators are struggling to maintain their profits along the booming of smartphones that furthered demand for mobile broadband on the expense of the SMS service and phone calls. Numerous free applications emerged allowing free text messaging, phone and video calls such as WhatsApp, Viber, Skype etc...

When 3G services were launched in November 2011, the usage of Internet in Lebanon hit new highs. The new technology was extremely appealing to the consumers sending the number of mobile broadband subscribers 158% higher in the first year only (472,000 or 14% of total mobile subscribers). In 2012, mobile broadband services saw another yearly surge in demand by 173% sending the number of subscribers to 1.29M (or 34% of total subscribers). By the end of 2013, more than 50% of mobile subscribers (2.02M) had already a mobile data plan which was facilitated by the introduction of bundles and new type of packages.

Advanced and innovative new mobile services such as the 4G LTE services were launched in May 2013. As of December 2013, there were around 400 sites (200 sites in each company) located in Central Beirut with the number of 4G subscribers reaching 2,000.

III. EXTERNAL SECTOR

When it comes to the external sector, trade deficit broadened at a faster pace in 2013 sending the country's Balance of Payments (BoP) towards another deficit. Yet, the partially improving capital

inflows managed to tighten the BoP's deficit over the year.

A. BALANCE OF PAYMENTS

The evolution of the external sector shows the Lebanese economy's capacity in continuing the finance of both public and private sectors. Between 2007 and 2010, the BoP realized a cumulative surplus of \$16.7B which is way above the absorption capacity of the economy. In the following 3 years, the BOP realized a deficit of \$4.7B, hence leaving the external sector with a net cumulative surplus of \$12B over the period 2007-2013.

Thus, there are enough reserves to finance the economy as witnessed by the low market interest rates and the high liquidity ratios of the banking sector.

It also seems that capital inflows did not decline during last year despite the negative BOP and the drop in foreign direct investments (FDIs) and tourism.

In 2013, the BOP recorded a deficit of \$1.13B while the trade deficit increased by \$600M and tourists' number tumbled by 7%. Therefore the deterioration in the current account balance in 2013 was mainly behind the negative BOP, while capital inflows are estimated to have stabilized.

2013 was the third year in a row for the BoP to close in the red. However, the deficit managed to shrink by a yearly 26.6% to settle at \$1.13B or around 2.5% of GDP compared to the \$1.54B deficit or 3.6% of GDP recorded in 2012. In details, BdL's Net Foreign Assets (NFA) rose by \$1,846.2M, while those of Commercial Banks' dropped \$2,974.9M

In this context, foreign reserves at the Central Bank witnessed a 1.2% yearly downtick to \$35.29B, the first yearly decrease since 2007. Correspondingly, foreign reserves covered around 19.9 months of imports by the end of December 2013, compared to 20.2 months in 2012.

B. TRADE

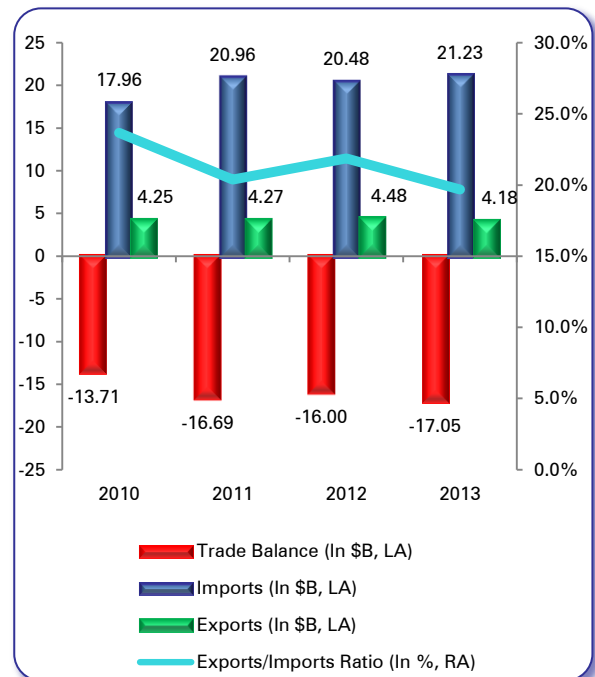
Stepping back in time to the Phoenician era ascertains that external trade of goods and services is embedded in Lebanon's historical DNA. The small country that overlooks the Mediterranean coastal strip used to stand as one of the region's top trading and transit hubs. Starting with cedar logs and glass

trinkets' trade, Lebanese traders continued their ancestors' legacy in external trading activity that was around \$25.41B in 2013 or 55.9% of the GDP.

Unfortunately, its strategic location in the Middle East and the accustomed free trades failed to boost the service-driven economy that posted a structural trade deficit of \$17.05B in 2013. Accordingly, the deficit widened by 6.6% y-o-y and accounted for 37.5% of the GDP, revealing a moderate integration of Lebanon in the international trade activity compared to other economies. This resulted from total exports shedding over the year compared to the parallel growth of Lebanon's total imports.

Worth noting, exports covered 19.69% of imports by December 2013 edging down from 2012's ratio of 21.90%.

Figure 16: Lebanon's Foreign Trade Performance



Source: Lebanese Customs

Imports on the Rise in 2013

The high dependence on imports furthered in 2013 to match the heightening demand for re-export activity, as well as to accommodate the surge in domestic consumption. Accordingly, imported goods edged up by 3.7% y-o-y to amount for \$21.23B.

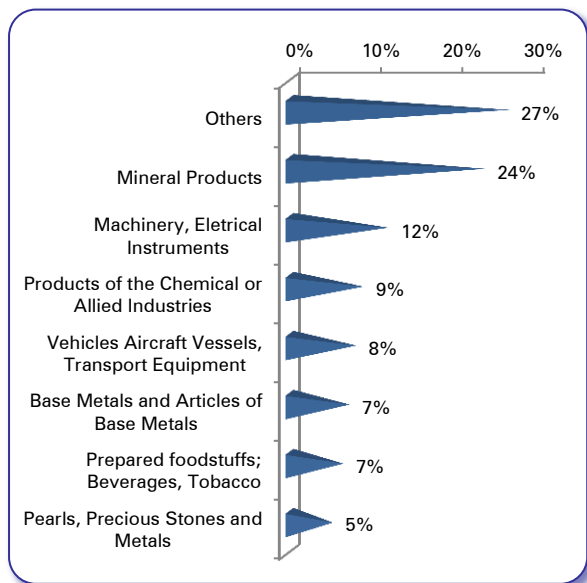
On another note, Lebanese imports went from 37% of GDP in 2003 to almost half of its GDP (48%) in

2013. However, a lower proportion of domestic demand was satisfied by imports as the import penetration rate decelerated from 35.2% in 2012 to 34.4% in 2013. This means that a substantial portion of 2013's imported goods was not allocated for serving the growing local demand but for re-export purposes mainly to the war-ridden Syria.

Upon closer look, demand for energy remained the vital necessity of local individuals and institutional entities. Therefore, oil and its derivatives maintained their leading rank amongst imported products to Lebanon with 24% of the total, representing almost 11.4% of GDP in 2013. Oil imports charged Lebanon \$5.11B in 2013 compared to a higher figure of \$5.23B in 2012. Similarly, mineral products' volume followed suit with a yearly decrease of 13% in 2013, but preserved their substantial 44% share of the total.

Industrial categories showed higher figures in terms of imports. Machinery & mechanical appliances edged up 6% in volume and 25% y-o-y in value to \$2.59B. Imported chemical products saw their volume broadening by a yearly 12%, while their value inched up by 11% to \$1.94B. In addition, vehicles, aircraft, vessels and transport equipment recorded a 15% yearly increase in value to \$1.75B for a 28% surge in volume.

Figure 17: Total Imports Breakdown in 2013

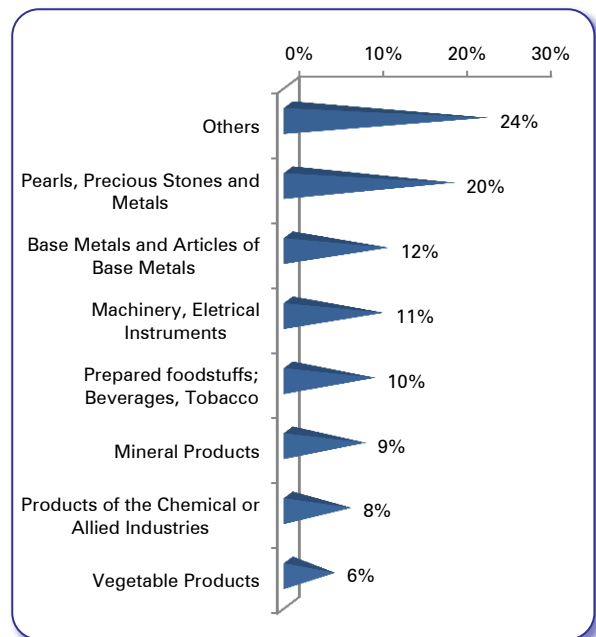


Source: Lebanese Customs

Imported goods for direct consumption products also showed numerous upticks in 2013. The Syrian

crisis enhanced demand for first-necessity products especially food. Accordingly, prepared foodstuff, beverage and tobacco, which accounts for 6.7% of 2013's total imports, increased both in value by 0.7% y-o-y to \$1.41B and in quantity by 11.0%. Imports of vegetable products (at 4.4% of the total) followed suit and added 6.6% to \$922.83M. Live animals and animal products (including animal and vegetable fats and oils) also rose by an average of 7.2% to \$1.81M, accounting for 8.5% of total imports.

Figure 18: Total Exports Breakdown in 2013



Source: Lebanese Customs

In 2013, Lebanon reshuffled its main sources of imports. China made its first appearance in four years among the top 5 exporting countries to Lebanon, grasping the lion share in 2013 with 10.2% of the total. Italy preserved its 2nd rank for the third consecutive year at 5.9%, trailed by Russia and the United States with a similar share of 5.6%. Russia's exports to Lebanon were 18% higher than 2012's level, while the US moved to the 4th place after topping the list for 2 consecutive years (2011 and 2012).

Regional Uprisings Hinder Export Activity

Exported Lebanese products faced more obstacles in 2013 mainly due to the neighboring war in Syria and the regional turmoil. Exports fell by 6.8% in 2013 to register \$4.18B compared to 2012's level of \$4.48B.

Therefore, the degree of reliance of local producers on demand from foreign markets seemed to be deteriorating in 2013, primarily triggered by the internal and regional uprisings. This was displayed in the export propensity index that showed a very low figure in 2013 at 9%, revealing a first-time decrease in 4 years from the static 11% rate.

In fact, 2013's decrease in exports' value appears to be mostly attributed to the performance of the precious metals' industry. Exports of major industrial elements, first-necessity products and oil derivatives to Syria improved, yet failed to compensate the fallback in the precious metals' activity.

The breakdown of exports by items indicates that jewelry topped the list with 20% of total value in 2013. However, volume and value of exported pearls and precious metals were cut in half in 2013. This is mainly due to more intense competition worldwide and lower demand in some Arab and European markets.

Industrial products showed an overall positive performance in 2013. Exported quantities of base metals stood in the 2nd rank with a 12% stake of total imported goods. Their total value reached \$502.01M, up from \$470.73M in 2012. Machinery and electrical instruments were the 3rd highly exported products in 2013 with an 11% share of the total. Their value marginally changed from \$478.33M to \$478.00M, while their total exported volume slipped at a fastest pace of 1.4% from 2012's quantity.

Regarding oil products, they accounted for 9% of total exports in 2013, posting a twofold yearly increase to \$387.12M, partly on higher oil prices as their volume increased at a slower pace of 1.5% from 2012. Yet, the Syrian demand for oil derivatives was satisfied through Lebanon due to the war's negative repercussions on the Syrian gates and ports.

As for major export destinations, the ailing Syria remained the number one importer of Lebanon's exports for the second sequential year, holding the lion's share of 14.7% in 2013. Turkey came second with 11.3%, while Iraq advanced from the 5th rank in 2012 to the 3rd position with a 4.8% stake.

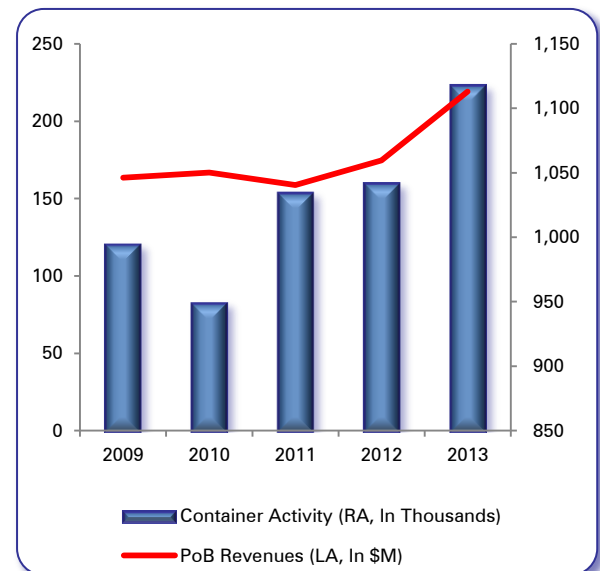
Port of Beirut: Swelling Revenues in 2013

On a positive note, Port of Beirut (PoB) has done record business in 2013 contrasting with other

economic entities. Total container activity (including transshipment) increased by 7.25% y-o-y to 1,117,334 TEU in 2013. Imported and Exported merchandise, passing through the port, grew by 14.44% y-o-y to 8.27M tons. This could be explained by the fact that the disruption of trade routes due to the Syrian war has boosted activity at PoB. The latter became a major alternative shipping hub especially for the delivery of fuel oil and oil derivatives into war-ridden Syria.

Yet, total revenues at the PoB were contradictory with the port's customs revenues that posted negative performance over 2013. In fact, PoB's total revenues revealed a 25.39% y-o-y rise to \$219.11M, while total customs revenues (Customs and Value Added Tax) shed by an annualized 2.3% to \$2.47B. This may be explained by the fact that shipped goods could be mainly constituted of products not subject to customs and VAT taxes like basic necessities, which witnessed higher demand in 2013 following the growing number of Syrian refugees.

Figure 19: Port of Beirut Activity

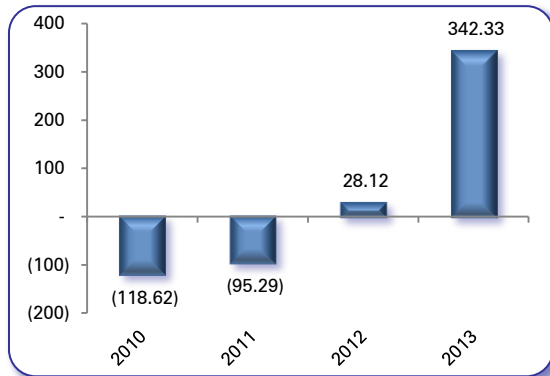


Source: Lebanese Customs

Lebanon-Syria's equation: Trade Still in favor of the former

2013's trading activity between Lebanon and Syria remained in favor of Lebanon. This shift in the trading activity that started in 2012 was enhanced by the escalation of war in Syria making Lebanon the sole open land border to import goods and necessities into Syria.

Figure 20: Lebanon's Trade with Syria



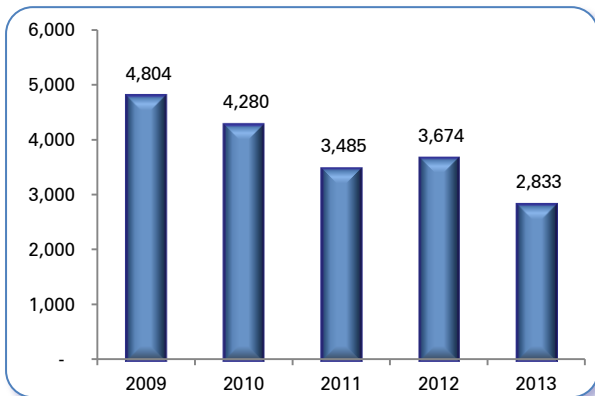
Source: Lebanese Customs

In fact, balance of trade between Lebanon and its troubled neighbor switched from a negative \$95.29M in 2011 to a positive \$28.12M in 2012 as exports to Syria overrode imports. In 2013, the balance enhanced even more on the side of Lebanon and reached \$342.33M. The main drivers were the surge in Syria's need for oil following the sabotage of the majority of its energy plants and the increasing demand of direct consumption products. Exports to Syria thus increased by 78% to reach \$523.65M while imports tumbled by 32% to \$181.31M.

C. CURRENT ACCOUNT

In 2013, the current account deficit (including grants) stood at \$5.80B, up from \$5.47B in 2012 and \$5.14B in 2011. Accordingly, the current account deficit widened from 12.7% of GDP in 2012 to 12.9% of GDP in 2013, severely hit by the growing trade deficit and the plunging receipts from tourism. Worth mentioning that, Lebanon's structural trade deficit used to be basically offset by capital inflows, remittances from Lebanese expatriates, and tourism.

Figure 15: FDI Inflows to Lebanon (In \$B)



Source: UNCTAD World Investment Report 2014

D. CAPITAL ACCOUNT

Despite the fading foreign investments, Lebanon's capital account seemed to maintain the upward trend in 2013 supported by the relatively high interest rates, which were still appealing for international investors, thanks to the banking sector strong reputation and robustness. In fact, total deposits for non-residents in the banking sector surged 18.2% y-o-y in 2013 to \$28.48B indicating the short term branding of most of capital inflows.

Hence, the capital account is estimated to have reached \$4.67B in 2013 compared to \$3.9B in 2012.

On the Foreign Direct Investments (FDI) front, and as political and economic instability weakened investor's appetite, Inflows of FDIs to Lebanon are expected to have dropped between 23% and 32% in 2013. According to UNCTAD, FDIs to Lebanon plunged to \$2.83B in 2013 or 6% of FDI inflows into West Asia, down from \$3.67B or 8% of FDI inflows into West Asia in 2012. However, they are still highly focused on the real estate market, which has suffered from a significant decrease in demand stemming from GCC countries. Moreover, FDI inflows to Lebanon represented 21.6% of gross fixed capital formation in 2013, down from 29.2% in 2012.

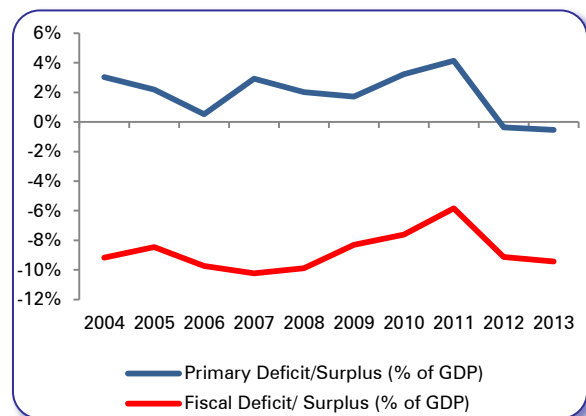
Lebanon also lost some of its appeal for foreign investors as Greenfield investments into the country were slashed by almost half, from \$201M in 2012 to \$104M in 2013. Similarly, Greenfield investments conducted by Lebanese investors slid from \$393M to \$153M in 2013. While Merger and acquisition (M&A) sales and purchases in Lebanon were respectively valued at \$317M and \$80M in 2012, M&A activities were inexistent in 2013.

IV. PUBLIC FINANCE

Public finance management was up against two major challenges: The Pay scale issue and the influx of Syrian refugees. The latter had a large impact on infrastructure and put an upward pressure on education, health, and social spending. As for the pay scale issue, it is not yet clear what will be the exact cost and when it will be approved by the parliament. However, it is not only necessary to find revenue sources to cover the cost of the pay scale, but also to reduce the already high fiscal deficit. This

could be done through a combination of tax increases, spending cuts, and structural reforms.

Figure 21: Fiscal & Primary Balances



Source: Ministry of Finance, Blominvest Research department

A. FISCAL BALANCE

Total fiscal deficit grew by 8% or \$294.53M to reach \$4.22B in 2013 taking its share in the GDP from 9.1% in 2012 to 9.3% in 2013. In parallel, deficit in the primary balance also increased from \$110.12M in 2012 or 0.3% of GDP to \$239.47M in 2013 or 0.5% of GDP.

The deteriorating public finances came about as the share of total revenues in GDP fell by more than 1 pp from 21.9% in 2012 to 20.8% in 2013 while the share of total expenditures decreased by only 0.8 pp from 31.0% in 2012 to 30.2% in 2013.

The ever-growing deficit inflated the debt/GDP ratio, already one of the highest in the world, from 134.3% in 2012 to 140.5% in 2013.

Modest Increase in Revenues:

Overall revenues marginally grew by \$24.54M to reach \$9.42B as compared to \$9.40B last year. The main drivers behind this shallow performance are the slight upturn in treasury receipts and the drop in tax and non-tax-revenues.

On one hand, Tax Revenues Posted Mixed Performance

The overall slowdown in economic activity pulled tax revenues down by an annual \$47M to \$6.71B in 2013.

Table 2: Fiscal Indicators (In \$M)

	2009	2010	2011	2012	2013
Total Revenues	8,428	8,414	9,334	9,396	9,420
Total Expenditures	11,389	11,308	11,675	13,321	13,640
Primary Balance	1,078	1,231	1,661	-110	-240
Fiscal Balance	-2,961	-2,894	-2,341	-3,925	-4,220
Public Debt	51,100	52,589	53,656	57,686	63,462

Source: Ministry of Finance, Association of Banks in Lebanon, International Monetary Fund

Taxes on international trade dropped 4% to reach \$1.43B in 2013 mainly due to a fall in gasoline and tobacco excise.

After collections of tobacco excises recorded double digit growths of 16% and 28% in 2011 and 2012, they fell in 2013 by 23% y-o-y as the imported quantities of tobacco plummeted 17%. The incoming Syrian refugees and re-exports into war-ridden Syria lie mostly behind the higher quantities of tobacco imports in 2011 and 2012. However, the rise in tobacco imports was interrupted in 2013 partly due to Syria regaining its tobacco self-sufficiency.

As for gasoline, excises declined by \$7.96M since the imported quantities inched down 3%. Interestingly, the drop in gasoline excise is not accompanied by a drop in the car excise as the latter, which is linked to the number of imported cars, improved by \$13.27M.

The lower quantities of gasoline imports can be however related to a shift in the preferences of Lebanese consumers. Given the tough economic climate, Lebanese consumers have turned to small and fuel-efficient vehicles. Slower tourist activity may as well be behind some of the decline in the quantity of imported gasoline.

Meanwhile, this drop in excises was partially offset by the 3% increase in customs receipts on the back of a 5% growth in non-fuel imports. Imports of food products increased by 4% over the year, especially that some of the food products are subject to a protectionist policy and therefore incur higher custom tariffs. With one Syrian refugee entering the country each minute according to the UNHCR, the

rising demand for food products is inextricably linked to the influx of Syrians. The same can be said about “pharmaceutical products” and “Engines, appliances & other machinery” which recorded double digit growths of 12% and 13% during the year, respectively. Overall domestic taxes on goods and services remained stable in 2013 reaching \$2.51B by end-2013 compared to \$2.49B in 2012. These are mainly composed of VAT receipts that reached \$2.19B up by 0.6% from last year.

VAT receipts were boosted by the internally collected VAT which outweighed the drop in VAT collected at customs. According to the Ministry of Finance, customs VAT have dropped due to Law 207, dated March 5th 2012, which stipulates an increase in the tax on gasoil. Moreover, Electricité du Liban (EDL)’s fuel imports come in with “special permits” (exempting them from any customs or tariffs), which represents lost VAT revenues for the government, estimated at \$34M in 2010, \$175M in 2011 and around \$100M in 2012.

The slowdown in economic activity weighed on the income tax on profits, collected on the previous year’s earnings. The income tax on profits dropped 3% y-o-y in 2013 to \$646.10M, showing that companies are indeed struggling to remain profitable amidst a rough economic backdrop. While the flowing Syrians into the country might have slightly boosted customs receipts, the spillovers of the neighboring war in terms of instability and lack of investor confidence took the upper hand. The economic hardships brought about by the Syrian spillovers have been translated into lower company profits. In the same line of thought, income tax on capital gains and dividends dropped by a staggering 22% to \$153.23M.

The slowdown in real estate also led to the \$15.26M decline in real estate registration fees, outweighing the \$5.31M upturn in overall taxes on property. The number of properties sold slid by 7% over the year 2013, pulling the total value of property sales down by 3%. Accordingly, construction permits decreased by an annual 8.1% to 16,724 in 2013 .

On The Other Hand, Non-Tax Revenues Followed Telecoms’ Steady Pattern

As for non-tax revenues, they slid by less than 1% to \$2.17B. In this category, Telecom transfers remained unchanged across the year and stood at \$1.43B.

Meanwhile, retirement deductibles, rent of Rafic Hariri International Airport, revenues from Casino du Liban, the National Lottery and the Vehicle Control Fees or “Mecanique” all went down. However, telecom revenues might edge down in the coming year after the Ministry of Telecommunications announced a reform plan that would slash by half the cost of international calls, prepaid cards, Telecarte and Kalam. The plan will also render land line subscriptions free of charge.

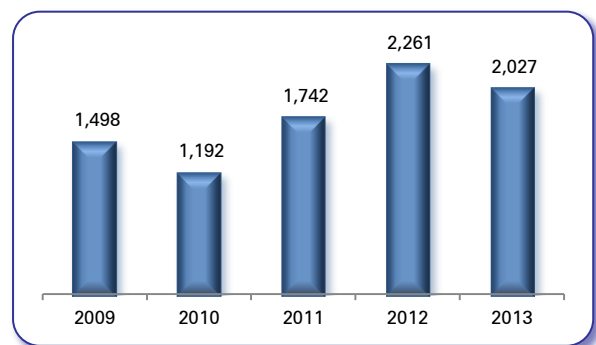
But, Treasury Receipts Triumphed as the Solitary Winner in 2013’s Revenues

The last item on the revenues side is Treasury receipts which rose by 18% in 2013 to reach \$541.29M. Treasury receipts were first boosted by the reimbursement of treasury advances by the Ministry of Economy and Trade. As part of its wheat subsidy plan, the government provided the Directorate General of Cereals and Beetroot (part of the Ministry of Economy and Trade) with a \$65M treasury advance in 2013, which covers the difference between the international price of wheat and the local market price. Treasury receipts were also higher due to \$26.53M worth of accrued interest received in Treasury accounts on the settlement of the \$1.1B dual-tranche offering on April 17th 2013. Once the first coupon payments on the issued notes reach due date, these transitory receipts will be netted out.

Expenditures mounted in 2013

On the other hand, higher interest payments and capital spending lifted total expenditures by 2% to \$13.64B in 2013. Current expenditures (including interest payments), representing 81% of total expenditures, posted a 1.2% uptick to \$11.92B and capital spending grew by 30% to \$654.73M.

Figure 23: EDL Transfers



Source: Ministry of Finance

Foreign Debts Enhance Government Yearly Expenses...

Although current primary expenditures, which exclude interest payment and debt service, declined over the year, they were toppled by higher interest payments in foreign currency and foreign debt principal repayments.

...Despite the Falling Public Sector Wages and Transfers to EDL

Salaries, wages and related items registered a 3% drop to \$2.84B while transfers to EDL slid by 10.3% to \$2.03B.

Salaries, wages and related benefits witnessed a downward correction in 2013 after some exceptional retroactive payments to the education, civil and military personnel were made in 2012.

Transfers to EDL, the second largest component of primary expenditures, were lower in 2013. This came about as average prices of crude oil retracted by 4% to \$109 per barrel and since no treasury advances were made to EDL across the year. Unlike 2013, EDL benefitted from \$145.94M worth of treasury advances in 2012, \$119.40M covering the first three payments for a leasing contract between EDL and Karpowership on two electricity generation barges and \$26.53M for VAT payments.

...Yet Other Current Primary Expenditures Also Augmented

Some other categories of transfers also went up, mainly driven by payments to the National Social Security Fund (NSSF). Payments to the NSSF rose from \$66.33M in 2012 to \$165.84 in 2013, most likely due to higher contributions in 2013 stemming from payments in some government arrears.

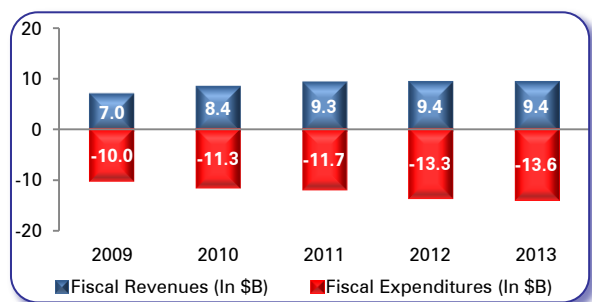
Also pulling expenditures higher are the cost of new medicaments and treatments. The latter surged from \$80.27M in 2012 to \$162.52M in 2013, most likely as a result of the higher number of Syrian refugees which are adding strain to public services and also as a result of the repeated security incidents and clashes in the country. On the same note, transfers to hospitals hiked by 16.2% to \$257.38M in 2013. Higher medicament costs are, to a lesser extent, linked to the 4% appreciation of the Euro against the dollar according to the MoF.

Two other categories of transfers also drove expenditures upwards. First, transfers to the special tribunal for Lebanon went from nil in 2012 to \$38.47M in 2013. Second, transfers to private sector entities, through social ministries (Education, Public Health...Etc.) rose by 31% to reach \$192.37M in 2013 due to higher costs per assisted individual.

As for capital expenditures, they rose on account of higher maintenance costs and payments to the Council of Development and Reconstruction (CDR). Payments to the CDR were \$69.65M higher in 2013 chiefly for the construction of highways and roads. The biggest bulk, \$59.70M, was meant for the construction of highways in Batroun, Tripoli and Zahrani and various other development projects mainly roads' construction. Maintenance costs increased by \$78.28M mostly relating to transfers to the Ministry of Public Works and Transportation for maintenance and restoration of roads and transfers to the CDR for the maintenance of Rafic Hariri University Campus-Hadath.

Regarding the debt service, a \$170.48M increase in interest payments to \$3.79B was registered. This expansion lies mainly on the back of the \$165.17M higher interest rate payments in foreign currency. However, foreign debt principal repayment slid by 2.8% to \$190.38M.

Figure 22: Trends of Revenues & Expenditures



Source: Ministry of Finance

Challenges to Public Finance Management

The first major hurdle to Public finances is responding to the social uprising led by the Union Coordination Committee (UCC) which is demanding higher public sector wages. The reason why this matter remains unresolved to this day is financing. Some suggested taxes on interest from customer deposits, taxes on profits from real estate transactions or even upping VAT from 10% to 15% on certain "luxury items". Others argue that with the

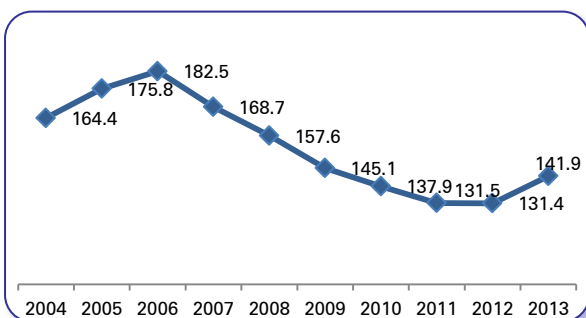
current economic woes, the taxable base would be too narrow to provide proper financing which would compel governments to take on more debt and pay additional interest charges. The key is then to ensure financing through recurrent revenue sources, or sources that provide a steady inflow of cash in order to guarantee that the government has the means to disburse higher salaries in a sustainable way.

Decision makers must also dampen the pay scale's effect on inflation. As the salaries augment, higher purchasing power is bound to increase the money supply and therefore inflation. However, if inflation outpaces growth, the positive effect of higher purchasing power would be eradicated.

On another note, the heavy influx of Syrian refugees, which have now exceeded the 1 million mark, threatens to strain already weak public finances. According to the World Bank, the Syrian conflict is estimated to cut \$1.5B in government revenue collection during 2012-2014 due to a combination of direct impact on key sectors and indirect impacts through weaker economic activity. Budgetary expenditures are also estimated to be up to \$1.1B higher over the period 2012-2014. This combination leaves the country with a sizeable cumulative fiscal deficit of \$2.6B over 2012-2014 and raises interest risk premium since the neighboring Syrian war has halted Lebanon's progress in reducing its debt-to-GDP ratio. Therefore, contribution from international donors is necessary to ease the direct and indirect impact of the Syrian crisis on the Lebanese economy.

For the first time since 2006, Lebanon's debt-to-GDP ratio stopped declining in 2012 and continued its upward trend in 2013. It is therefore clear that addressing these challenges is key to putting Lebanon's debt and fiscal dynamics back onto a sustainable path.

Figure 24: Debt to GDP ratio



Source: Ministry of Finance, Blominvest research department

B. PUBLIC DEBT

In 2013, investors were worried that reigning in the fiscal deficit and public debt does not seem at the forefront of government interests. Political and security issues were overshadowing economic problems. This could result in the reluctance by the private sector to continue lending the government despite having the capacity and the necessary liquidity to finance the sector. In this context, the formation of a new government that puts forward fiscal issues, mainly trying to go back to primary surplus and to put debt-to-GDP ratio on a downward trend, will surely have a positive impact on investors' sentiment.

Regarding the public sector, the risk lies in the increasing fiscal deficit and debt to GDP ratio. 2013 is the first year where the government had a primary deficit in its budget. Debt-to-GDP ratio also reversed trend following six years of decline. This was the result of a combination of factors. First, as economic growth slackened, automatic stabilizers started to work in addition to the increase in minimum wages that boosted expenditures. Second, lower inflation and lower GDP growth rates led to an increase in nominal GDP that is below the increase in public debt. Therefore debt-to-GDP ratio jumped from 131% in 2012 to 142% in 2013.

According to the Ministry of Finance, the Lebanese gross public debt reached \$63.46B in 2013, 10% higher than 2012.

Debt in LBP, accounting for 59% of total gross debt, edged up by 12.2% to reach \$37.35B while foreign currency debt grew by 7.1% to stand at \$26.11B. The Net Public Debt, which excludes the public sector deposits at the Commercial banks and BdL, stood at \$53.25B in 2013, increasing by an annual 8.4%.

V. MONETARY SECTOR

2013 was a challenging year for monetary authorities as it marked the third year of economic slowdown in Lebanon. Syrian spillovers, security incidents and political turmoil negatively impacted consumption, investment, trade, tourism and public finances.

BDL's policy remained true to the objectives it has set upon itself: Boosting Economic Growth,

Preserving Exchange rate stability and maintaining the soundness of the financial system.

Commercial banks remained the largest subscribers of Treasury bills and bonds with a 46% share of the domestic currency debt followed by a 33% stake for the Central Bank and 21% for the non-banking system.

Table 3: Monetary Indicators (In \$B)

	2012	2013	% Chg.
Net Foreign Assets	-1.5	-1.1	-27%
BDL	0.58	1.8	210%
Commercial Banks	-2.1	-2.9	38%
Net Claims on Public Sector	36.22	39.51	9%
Claims on Private Sector	39.6	43.75	10%
Other Items Net	-4.79	-4.03	-16%
Net Domestic Assets	71.03	79.23	12%
M3	104.01	111.16	7%
Non-Resident Deposits	24.09	28.48	18%
Broad Money M5	128.1	139.64	9%
Currency in Circulation	2.41	2.64	10%
Deposits in LBP	43.98	46.13	5%
Deposits in FX	81.02	90.08	11%
Share of FX deposits in total private sector deposits	64.82%	66.13%	-

Source: Banque du Liban

In the face of the rough economic climate, the BDL sought to boost economic growth through a \$1.46B package in 2013. The central bank also addressed the untapped sources of economic growth, providing interest free credit facilities for banks wishing to participate in the equity capital of startups, accelerators and venture capital firms.

A. EXCHANGE RATE

The Central Bank managed to maintain exchange rate stability throughout the year despite a negative

BDL's Incentives to support Lebanon's Resilient Lending Activity

Despite the low growth environment, lending activity still managed to advance in 2013, due to the BDL's stimulus package and due to commercial banks' ample liquidity. Zooming-in on this facet of the economy is a must, especially since Lebanon had the 20th highest loan penetration in the world in 2012, according to the IMF.

The accumulated surpluses in the BoP prior to 2011, allowed Lebanese banks to be endowed with large liquidity and assume their role of chief financiers for both the public and private sectors. In this context, total private loans, representing 29% of total assets, grew by 9% y-o-y to \$47.38B and as claims on the public sector, representing 23% of total assets, advanced by 21% y-o-y to \$37.67B.

*BDL took several initiatives to revive economic growth. On January 14, 2013, BDL issued **Intermediate Circular #313**, announcing a stimulus package worth \$1.47B. The funds were put at the banks' disposition at a 1% interest rate, in order for them to offer further support to housing projects as well as small and medium enterprises.*

*In the **Intermediate circular #340**, legal reserves were scaled down by up to 80% against housing loans from "Banque de l'habitat"/Housing Bank. The circular also it extended the duration of subsidized loans from 7 to 10 years.*

*In late 2012, **Intermediate circular #311** widened the lending scope by raising the permitted ceiling on banks' credit facilities both locally and abroad.*

BDL also sought to boost economic activity through subsidized loans.

*In this line of thought, the BDL issued **Intermediate circular #349** in December 2013, according to which the BDL grants facilities to banks at 1% against various loans subsidized or steered towards productive sectors, environmentally friendly initiatives or housing.*

In spite of these endeavors, 2013 marked a sharp decline in the value of new subsidized loans that fell by 22.3% y-o-y to \$529.66M in 2013 compared to a more pronounced decline of 25.3% in 2011-2012 when the Arab spring erupted.

The BDL branched out and sought to revive the economy via alternative channels. Through Circular #331, the BDL allowed banks to step in to finance startups, venture capital firms, incubators and accelerators working in the knowledge economy, not through usual debt, but this time through equity. Nevertheless, only the year ahead can unravel just how efficient this decision has been.

balance of payments. The latter was in the red for the third consecutive year, recording a deficit of \$1,128.7M in 2013 compared to a deficit of \$1,536.9M in 2012, while the Lebanese pound's peg to the US Dollar remained around stable a midpoint parity of 1,507.5.

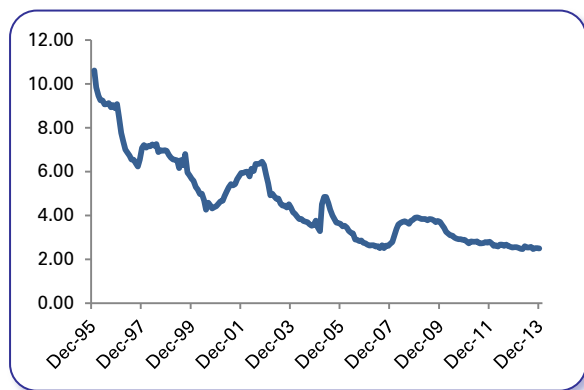
For the past 15 years or so, and through interventions on the foreign exchange market, the BDL succeeded in cementing confidence in the Lebanese pound as shown by the drop in the dollarization rate of private deposits and loans from 76% and 84% in 2006 to 66.1% and 76.5% in 2013, respectively.

In the future, the central bank will remain capable of preserving the exchange rate stability and shielding the economy against any potential shock via its ample international reserves (excluding gold) of \$35.3B in 2013 and covering 20 months of imports.

B. INTEREST RATES

Even if Lebanese interest rates are governed by the internal circumstances of the country, be it on the political or economic front, 2013 witnessed minor yearly changes.

Figure 25: Spread LBP-USD Deposits



Source: BDL

Interest rates on USD deposits ended 2013 at an average of 2.95%, up from 2.86% registered by the end of 2012. As for interests on LBP deposits, they stood at an average of 5.44%, slightly higher than 2012's average of 5.41%. The Lebanese interbank rate preserved the same level throughout the year at 2.75%.

Interest rates on USD deposits maintained their levels during 2012 at an average of 2.84% compared

to the previous year's average of 2.83%, with a tendency to rebound towards the end of the year. As for interests on LBP deposits, they stood at an average of 5.46%, lower than 2011's average of 5.6%. The deposits' dollarization rate ended 2013 at 66.1% up from the 64.8% recorded in 2012, while the Lebanese interbank rate preserved the same level throughout the year at 2.75%.

As of December 2013, granted credits in LBP posted a weighted average interest rate of 7.29% compared to 7.07% in 2012, and loans in dollar average interest stood at 6.88% compared to 6.87% in December 2012. The loans' dollarization rate also shed from 77.6% in 2012 to 76.5% in 2013.

C. TREASURY BILLS

The Central Bank maintained in 2013 the coupon rates on all TB's except for 3-month maturity that slightly posted a 1 basis point uptick to 4.39%.

The average maturity of the government debt securities extended from 1,105 days in 2012 to 1,274 days in 2013, while slightly pushing down the weighted average yield from 6.83% in December 2011 to 6.54% in December 2012.

BdL's outstanding treasury securities edged up by 12.3% y-o-y from \$32.73 to \$36.74B. 36-month took again the largest share of the portfolio at 38% followed by the 60-month and 84-month maturities that respectively posted 21% and 19% shares.

The banking sector remained the major holder of Treasury Bills in 2013 with an 84% share of the total, compared to the 85% stake in 2012. Thus, the public sector preserved its 13% share that accounted for \$4.65B in 2013. Individuals and individual institutions saw their share of the portfolio slightly edging up to 4% (compared to 3% in 2012) and amounting for \$1.28B. Regarding certificates of deposits, the weighted average rate issued by BDL retracted from 9.28% in December 2012 to 8.54% in 2013.

D. MONEY SUPPLY

Given the low interest rate environment and in spite of the tough economic backdrop, broad money M3 grew by 7% to reach \$111.16B, and M5, which includes non-resident deposits, advanced by 9% totaling \$139.64B. In fact, the banking system has proved to be resilient in the face of internal and

external hurdles, supported by a loyal depositor base. Over the past year, LBP and USD denominated deposits grew by 5% and 11% to \$46.13B and \$90.08B, respectively. The widespread Lebanese diaspora and depositors in Arab markets, fleeing the unstable environment, are the main factors behind the upturn in deposits. The robustness of the banking sector is also corroborated by the 10% annual increase in claims on the private sector from \$39.6B in 2012 to \$43.75B in 2013 .

Although money supply grew over the past year, inflation was on a downward trend. Inflation has been steadily dropping over the past 6 years: after climbing to 9.33% in 2007, due to hefty reconstruction spending following the 2006 war; inflation fell to 1.1% in 2013. The subdued inflation rate mirrors the weak levels of demand and consumption especially for the “clothing and footwear” component of the CPI basket, where prices slid by 7.9% in 2013 as retailers were compelled to offer appealing prices to revive a stagnating demand.

Table 4: Money Supply components

(in \$B)	Dec-12	Dec-13
Currency in Circulation	2.13	2.26
Demand Deposits in L.L.	2.58	2.79
M1	4.71	5.05
Other Deposits in L.L.	38.46	40.55
M2	43.17	45.60
Deposits in FX.	60.63	65.34
Bonds	0.21	0.21
M3	104.01	111.16
TBs held by Non-Banking Sector	5.23	6.13
M4	109.24	117.28

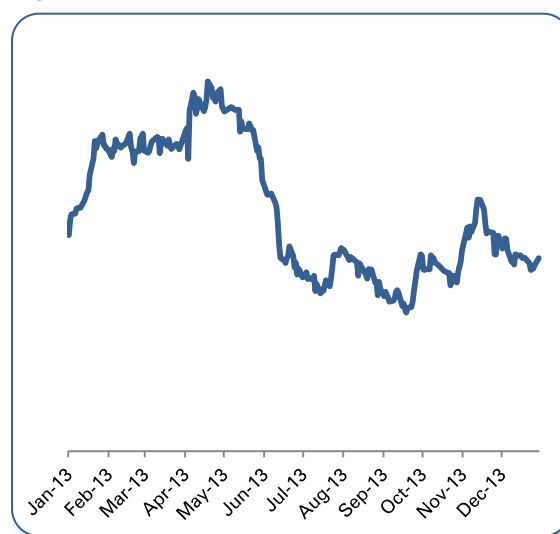
Source: BDL

VI. FINANCIAL MARKETS

A. STOCK MARKET

Over the course of 2013, Lebanon not only had to face its own set of domestic challenges but also suffered the spillovers from war-ridden Syria. These hurdles were priced in Lebanese equities, which registered only marginal and short-lived upturns in times of “relative stability”.

Figure 26: Performance of the BLOM Stock Index in 2013



Source: Blominvest Bank, Beirut Stock Exchange

While Positive Vibes Painted US and Europe's Stock Markets in 2013...

Internationally, stock markets in the US and Europe had a good year. The S&P 500 ended 2013 at 1,848.36 points, a 30% annual jump, which was the largest in 16 years. The Euro Stoxx 50 registered an 18% yearly gain, closing at 3,109 points.

In the US, the economy shook off the strains imposed by the fiscal tightening early in the year and created jobs, elements which allowed the Fed to announce a \$10B monthly tapering in its asset purchases as of January.

In Europe, although the exit from the recession came in late during the month of August, the European Central Bank (ECB) never wavered on its promise to boost the economy through monetary stimulus. The ECB did in fact cut its refinancing rate by 25 bps to a

record low of 0.25% in November in order to ensure the banks' liquidity.

....Local and Regional Upheavals Overshadow Beirut Bourse

As for the Beirut Stock Exchange (BSE), the BLOM Stock Index (BSI) ended 2013 at 1,150.10 points, a 2% yearly drop. In fact, the first half of 2013 saw the BSI falling by 5% to reach 1,145.14 points. The gauge cautiously crept upwards from the 1,160 mark in January, reached a peak of 1,232.73 points in April and hovered close to the 1,200 mark for most of H1 2013. However, as of end-May, the political bickering over a consensual electoral law, the formation of a new government and later on the extension of the parliament's mandate weighed heavily on investor sentiment. Moreover, the security situation, mirrored by clashes in the southern and northern parts of the country, eventually pushed the BSI down to a low level of 1,145 points.

Unfortunately, the regional and local tumults remained unresolved and some even aggravated in the second half of the year. A more pronounced downward trend was triggered as the West debated a punitive military strike on Syria for its alleged-use of chemical weapons. Even when Syria agreed to hand over its chemical arsenal, the ongoing political stalemate took the upper hand and hindered the performance of the BSE.

Furthermore, the BSI dipped to another low base of 1,132 points in August after the bombing in the southern suburb of Beirut, which was followed by another attack in the northern city of Tripoli. Next in September, the BSI hit 1,124.74 points, the lowest level of the year. This was mainly the result of the extended political deadlock which prevented the parliament to convene on several occasions due to lack of quorum and which left over 40 draft laws pending.

September and November's Timid Comebacks fail to sustain

Although the downward trend was dominant on the BSE, some short-lived recoveries were registered. Hopes of Lebanon receiving international donors' support in order to deal with the Syrian crisis sent out positive vibes on the stock market and allowed the BSI to recover 1.4% of its losses at the end of September.

The upturn soon faded away as the deteriorating internal political and security situation took center stage. The national dialogue remained paralyzed,

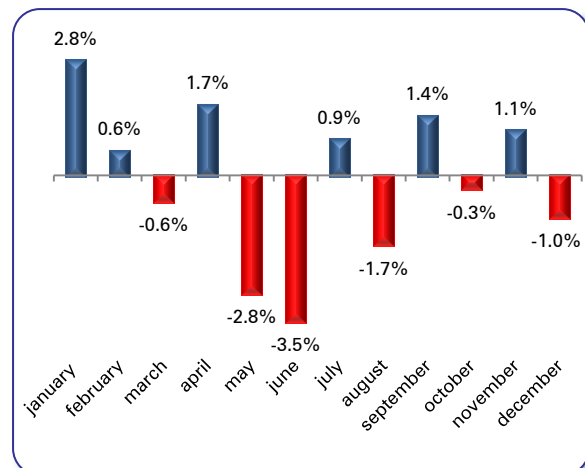
Listings and de-listings

In 2013, the total number of newly listed shares reached 7,600,000 while the number of de-listed shares totaled 12,825,756. In detail, Bank of Beirut listed 5,000,000 preferred (I) shares as of January's end and Bank Audi listed 1,500,000 Preferred Shares Class (G) and 750,000 Preferred Shares Class (H) in July. In September, 350,000 BLC Preferred (C) shares were listed on the official stock exchange. On the other hand, Bank Audi de-listed their 12,500,000 preferred (D) shares in April while in May, and following the maturity date of the Beirut Preferred Fund, trading of the fund's 325,756 shares was ceased. In total, 43M shares, worth \$344.85M, exchanged hands in 2013 compared to 47.22 shares, worth \$362.25M in 2012.

In December, 29 stocks were listed on the BSE, with a market capitalization of \$9.20B compared to \$9.24B in the same month last year.

especially as political factions bickered over the constitutionality of a special cabinet session designed to discuss the exploration of Lebanon's oil wealth. Matters weren't faring better on the security front as week-long clashes in the northern city of Tripoli persisted.

Figure 27: BLOM Stock Index monthly performance



Source: Blominvest Bank, Beirut Stock Exchange

By mid-November, after the cool down in Tripoli, the BSI posted its first year-to-date gain in 5 months. Another improvement eradicated by the twin-bombings near the Iranian embassy, which resulted in over 20 casualties. As we closed in on year-end, the list of security incidents was extended with the assassination of former-minister Mohammad Chatah on the 27th of December. Accordingly, the BSI ended 2013 at 1,150.10 points, a 2% yearly drop.

2013 Best and Worst Performers

In terms of stocks, the top three performers were RYMCO, BLOM GDR and BLC Listed. Their closing prices posted yearly upturns of 33%, 11% and 8% to reach \$3.50, \$8.80 and \$1.95, respectively.

As for Solidere A and B shares and BEMO's listed shares, they were the worst performers as their closing prices shed 15%, 15% and 3% to settle at \$11.05, \$11.02, and \$1.84, respectively.

Besides Real Estate's Decline, Banking and Industrial Sectors Reveal Mixed Performance

In the banking sector, BLOM's listed shares gained 5% to \$8.25 and Audi's listed shares rose by 2% to \$6.24. Contrastingly, Byblos's listed shares lost 3% to \$1.55 and BOB's listed shares maintained the same price of \$19.00.

In the industrial sector, HOLCIM's share price declined from \$15.75 in December 2012 to \$15.58 in December 2013 while Ciment Blancs (Nominal) fell by 2% to \$3.24 and Ciment Blancs (Bearer) gained 7% to \$3.50.

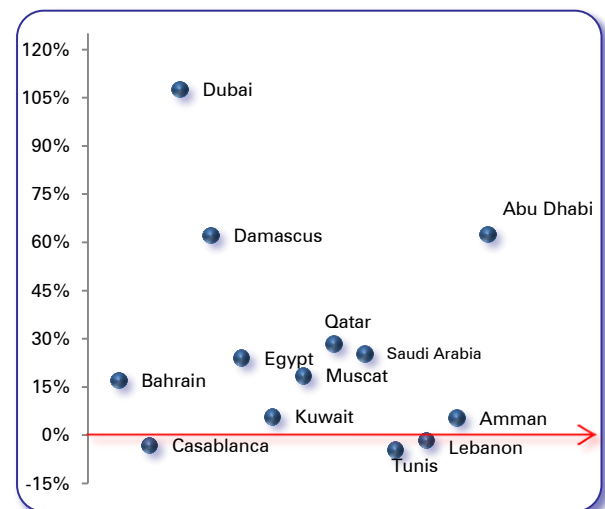
BLOM Preferred Shares Index Barely Moved in 2013

The BLOM Preferred Shares Index (BPSI) slipped by 1% y-o-y to reach 105.19 points in December 2013 compared to 106.53 in December 2012.

Audi's preferred (E) and (F) shares increased by 2% each to end the year at the same price of \$102.50. BEMO's preferred (06) shares and BOB's preferred (E) shares added 0.3% and 1% to settle at \$100.30 and \$26.00, respectively.

Meanwhile, Byblos's preferred (08) and (09) shares slid by 1% each to reach \$101.00 and \$101.50, respectively. Likewise, BOB's preferred (H) shares and BLC's preferred A shares lost 1% each, closing at \$25.84 and \$101.00, respectively. BLC's preferred (B) shares declined by 2% to \$100.00 while BLOM's preferred (11) shares maintained the same price of \$10.17.

Figure 28: Arab Bourses Yearly Growth Rates in 2013



Source: Reuters, Blominvest Research department

Good Year for the Arab Markets

Dubai, Abu Dhabi and Damascus were the year's top gainers. Their indices rose by 108%, 63% and 62%, respectively. Dubai's financial market performance was boosted by the country's win for Expo 2020 and by the overall robust economic trajectory. The latter is enhanced by huge non-oil sector investments and by a booming tourism industry. Meanwhile, investors on the Damascus Securities Exchange (DSE) kept on buying, first as a hedge against inflation and second in the hopes of positive returns in the long run. The favored equities on the DSE were banking shares as banks remain well capitalized and many are subsidiaries of large foreign institutions.

On the other hand, the Tunisian stock exchange was the biggest loser in 2013 as the general index closed at 4,381.32 points, 4% below last year's close. The political instability in the country weighed on overall market sentiment and certainly weakened the essential tourism industry. The BSE (-1.54%) and Casablanca (-2.99%) stock market closed in the red as well.

B. EUROBONDS MARKET

US treasuries had a Bad Year in 2013:

As US economic activity improved, investors shifted their funds from bonds to risky assets. Overseas investors preferred investing in the profitable equity markets on the expense of bonds. In details, the first four months of the year were relatively stable for US bonds with a steady demand, slow economic growth and low inflation. In May, the US economy was seen firmer with strong positive signs of improving labor market, recovering housing sector and enhanced consumer confidence data. In this context, the US Federal Reserve (Fed) chairman, Ben Bernanke announced that the Fed may start tapering its "quantitative easing" program in the coming period. The direct outcome was plainly visible in investors' behavior on the bonds market as they hurried to pocket profits before the Fed cuts its financial stimulus.

Treasury yields soared after the Fed's announcement of its tapering policy. The 5Y and 10Y yields edged up 33 bps and 38 bps to reach 1.05% and 2.16% by May, compared to the respective 0.72% and 1.78% posted rates by the end of December 2012. US bonds kept on drifting over the second half of 2013 with the 5Y and 10Y yields ending the year at 1.75% and 3.04%, respectively.

Emerging Bonds were highly impacted...

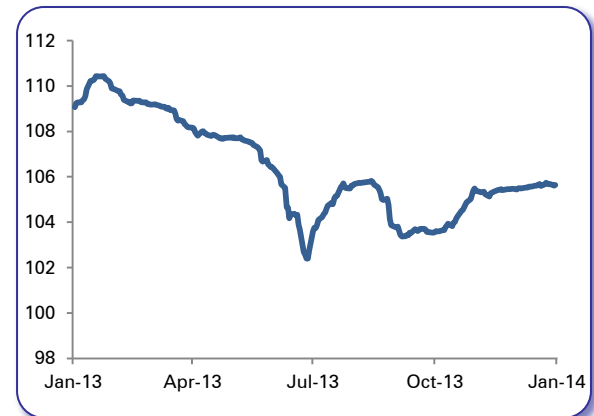
In Emerging countries, bond markets underwent the repercussions of the Fed's tapering decision. The JP Morgan's emerging markets bond index posted a 6.58% y-o-y loss to settle at 627.86 points, down from December's 2012 level of 672.10 points. Besides US Treasuries' influence, emerging markets suffered several political, security and economic difficulties that aggravated their bonds performance, sending their originally high yields towards greater levels. Hence, risk burden became better perceived by investors in the emerging markets which widened spreads between their bonds' yields and those of the US Treasuries. As a result, some of the emerging markets bonds were sent near junk rating grade.

...Lebanon's Market Wasn't Immune either...

Lebanon's political stalemate, security uprisings and external headwinds from the Syrian war kept on clouding the bonds market performance in 2013.

Besides local and regional developments, the international bearish trend driven by the US Treasuries also impacted safe assets' trading in Lebanon. Hence, the BLOM Bond Index (BBI) mirrored the market's negative performance and shed 3.13% y-o-y compared to the 1.79% yearly loss recorded in 2012.

Figure 29: BLOM Bond Index (BBI) Performance



Source: Blominvest Research department

The BBI moved in seesaw over the year, hovering between a lower band of 102 points and a higher band of 111 points, to end the year near the middle band at 105.64 points.

Summing up the year, slowing demand characterized the Lebanese market especially during Feb-August, leading the weighted average yield on Eurobonds to surge by 143 bps to 6.45% by 2013. However, it declined 83 bps in the following 6 months to end the year at 5.62%.

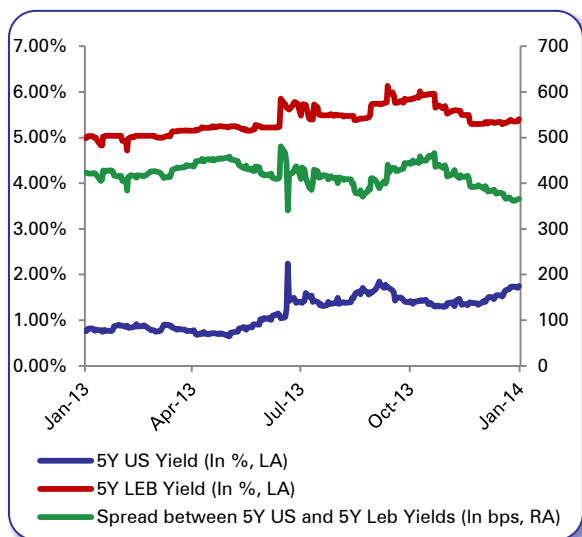
...as it was painted by Investors' Fading Demand

Performance of the medium and long-term Lebanese Eurobonds reflected investors' dwindling demand in 2013. The 5Y and 10Y yields on the Lebanese Eurobonds reached by the end of H1 2013 their highest respective yields of 5.78% and 7.23% after security clashes took place in the southern part of the country.

Demand started picking up in September but instability incidents kept on recurring sending the former levels down. The two benchmark notes ended the year on a considerable change, with the 5Y Lebanese Eurobonds' yield reaching 5.41%, up by

39 bps since year start and the 10Y yield returning to 6.54%, up by 56 bps from the end of 2012.

Figure 30: Yearly Performance of the 5Y Lebanese and US Yields and the 5Y Spread



Source: Bloomberg, Blominvest Research Department

Lebanese bonds fared relatively better than their US counterparts as witnessed by the shrinking spread between the two papers. A comparison shows that the spreads between the Lebanese 5Y and 10Y bonds yields and their US comparable narrowed from 430 bps and 420 bps in 2012 to reach 366 bps and 350 bps by the end of 2013, respectively .

Reading between the CDSs

The 5Y Lebanese Credit Default Swaps (CDS) which reflect the perceived default risk of the government, stood at 393 bps by December 2013, narrowing from 450 bps in December 2012, after peaking to 527 bps during June 2013, following Sidon clashes.

Hence, the 5Y Lebanese CDS kept on trading at lower levels than the 5Y spread between the Lebanese Eurobonds and their U.S comparable for a considerable period. This reveals that there are additional factors perceived by domestic investors, as they are the main holders of Eurobonds, not taken into consideration by international issuers of CDS. In fact, and in addition to the specific risk of the country, Lebanon may also be part of the international investors' shift away from emerging markets towards the safer U.S Treasuries.

When compared to other emerging markets, the Lebanese Eurobonds market outpaced several

countries with similar credit ratings. This was obvious in the yearly variation of their CDS as they posted respective increases in their risk profiles. For example, Egypt 5Y CDS went from an average of 510 bps in 2012 to 605 bps by end 2013. This alludes to the political instability and the continuous security developments that severely hit Egypt's debt profile.

What about the relationship between the spread and the credit default swaps (CDS)?

The Lebanese Eurobonds yield spreads against their US benchmarks should be equal to the CDS, supposedly. Yet, facts showed that many developments dominate each of the 2 instruments sending the spread out of the range.

Accordingly, when the spread is lower than the CDS it alludes to the fact that offered yields on the Lebanese Eurobonds are not fully reflective of the assessed risk premiums seen by international investors. This is mainly due to the stable and dedicated local investors with domestic banks constituting the core base of Eurobonds holders.

Consequently, Eurobonds prices and their spread against the US treasuries reveal much less volatile than CDS spreads. However by the end of 2012, the difference was narrowing, as on one hand the stabilization of the political situation in the country was accommodated by the markets, and on the other, the US yields dropped.

Historically, many political factors impacted the CDS's quotations. Lebanon's CDS edged up from 333 basis points (bps) in 2007 to reach 545 bps in 2008 on political deadlock and escalating internal clashes in the country's different regions. 2011 was another critical year especially after the emergence of Arab Spring and the increasing fears of its influence on the Lebanese scene. Accordingly, the 5Y CDS widened by a yearly average of 167 bps to hit 472 bps.

However, the CDS price managed to tighten between 2011 and 2013, yet maintaining a high quote compared to its low levels reached during previous years.

Yet, Lebanon's country risk remained higher than other emerging markets such as Brazil and Turkey; that saw their 5Y CDS at higher levels by the end of 2013. On one note, Turkey's anti-government demonstrations deteriorated the security status of the country with 5Y CDS reaching 244 bps, up by 113 bps from last year. On another note, Brazil also witnessed several protests against corruption, poor public services and increasing living costs, sending its 5Y CDS 85 bps higher to 193 bps.

New debt issued worth \$2.975B faced with mixed sentiments

The Lebanese government issued Eurobonds in 2013 for a total of \$2.975B through four Eurobonds transactions: \$1.275B were issued on the 23rd of April as part of the debt replacement agreements between the BdL and the ministry of finance, \$600M Eurobonds were issued in June and were subscribed by BdL, and a dual-tranche offering of \$1.1B tapped on the primary market in April 17th including two re-openings of respectively \$600M and \$500M. In details, the first \$600M series were re-opening of 2023 bearing a 6% coupon, and the second \$500M series re-opening of 2027 bearing a 6.7% coupon.

The \$1.1B market offering of April 17, 2013 was received with diverse attitudes; especially that it took place during a critical period. Investors' sentiments were shaken by the political divide about the electoral law and the extension of the term of a top security official amid political bickering on premiership candidates, after the resignation of Mikati's government in March. Yet, the designation of Tamam Salam couldn't help in enhancing the international participation to more than 20% in each of April's 17th Eurobonds issuance that was brought to market for refinancing operations.

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