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The Economy Has Slowed

According to the Central Administration of Statistics (CAS), Lebanon's real GDP growth reached its lowest since 2011. Real GDP growth continued its decline reaching 0.8% in 2015, after a real growth of 2.8% in 2012 and 2.6% in 2013 and 2% in 2014. The GDP deflator had reached 6.5% in 2012 and dropped to 2.2% in 2013 and 1.9% in 2014 to later increase to 2.6% in 2015.

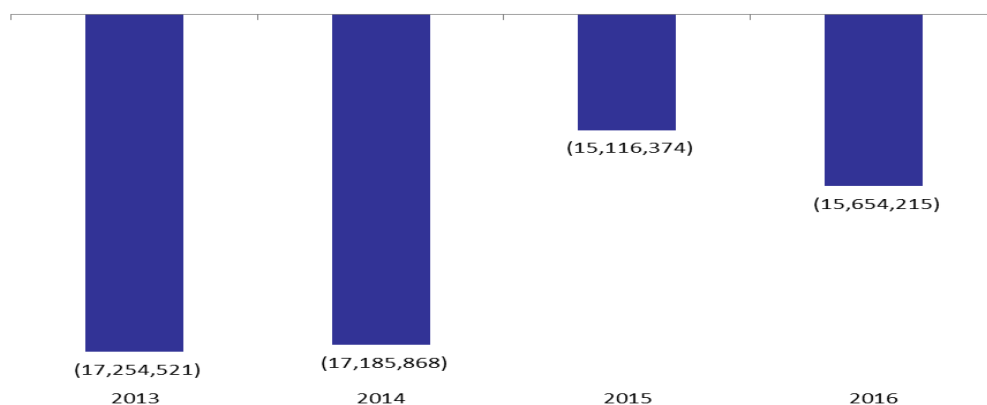
The GDP deflator remained positive in 2015 while the average inflation rate measured by the Consumer Price Index (CPI) turned negative that same year standing at -3.76%. In fact, 2015's negative average inflation rate was due to the decline in oil prices and the depreciation of the euro. The main difference between CPI-measured inflation and the GDP deflator is that the former does include imported goods while the latter measures only domestically produced products.

The Gross National Disposable Income (GNDI) exceeded GDP in 2015. The reason behind this is that the GNDI includes net transfers from abroad (mainly remittances). Net transfers from abroad reached \$2.25 billion in 2015 up by 43% from \$1.57 billion in 2014. Furthermore, the GNDI, which includes factor income and net transfers, reflects the income available to the total economy for final consumption and gross savings.

Lebanon's External Position Remains Weak

The deficit in the balance of trade aggravated. Lebanon has chronically suffered from a deficit in its trade balance which reached \$15.65B in 2016, up by an annual 3.56%. According to CAS, "Exports of goods had decreased in volume by 10% in 2014 and by 1% in 2015. Export of services had decreased by 9% in 2014 but increased by 11% in 2015. The Net exports balance is negative, equal to -20% of the GDP." The CAS report adds "Lebanon exports services (19% of GDP) more than goods (8%) while it imports goods (35%) more than services (12%)."

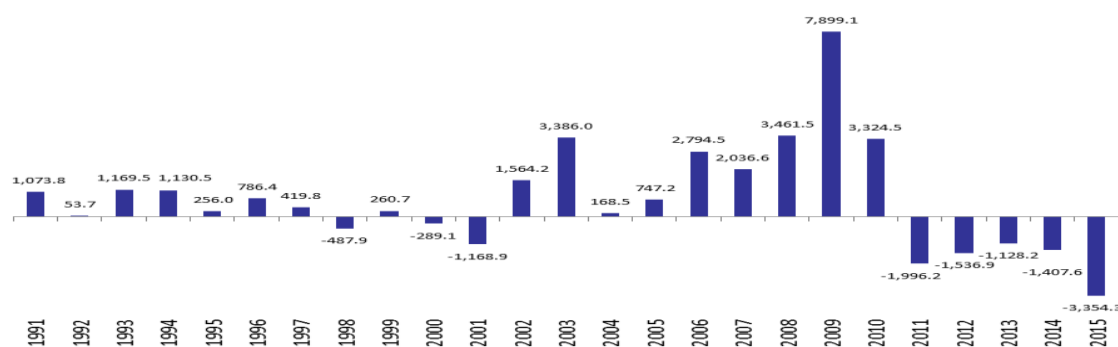
Lebanon's Trade Deficit, In Thousands of USD



Source: Lebanese Customs

The fragility of a country's external position is best represented by its balance of payments. The 2015 external position indicators make it easy to predict that the balance of payments would reach its highest deficit in over two decades of \$3.35 billion during that year. It also corroborates the Central Bank's need to boost its foreign currency position by engaging in a swap operation with the commercial banks which allowed the Balance of Payments to return to positive territory in 2016 with a surplus of \$1.24 billion and of \$508.5 million by the first two months of 2017.

Lebanon's Balance of Payments, In Millions of USD



Source: Central Bank of Lebanon

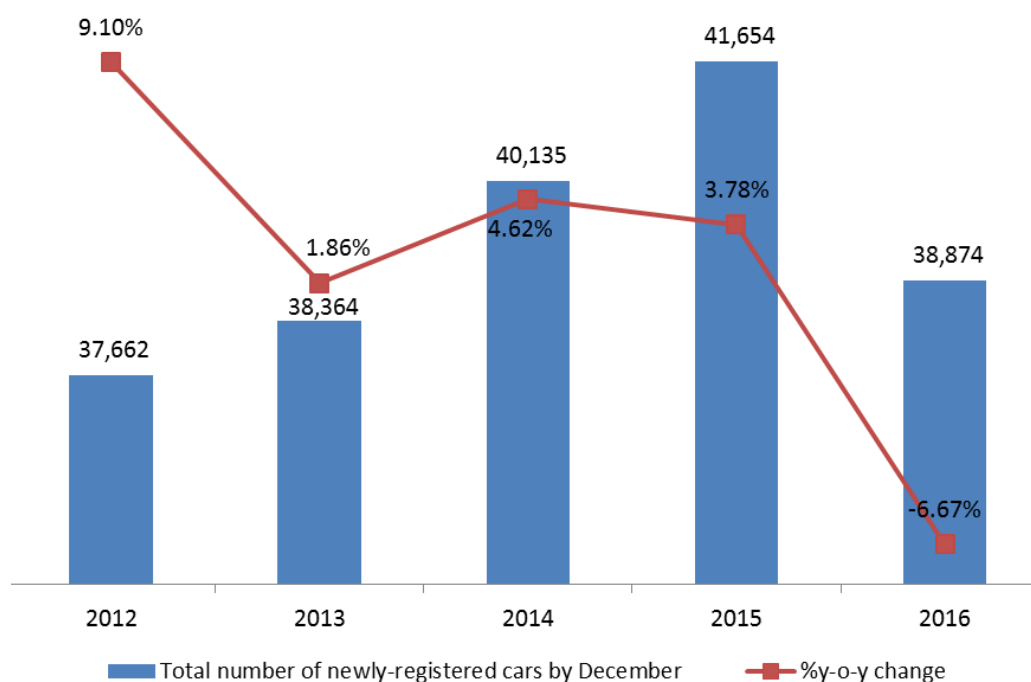
Low Growth Negatively Impacted Private and Public Investment and Consumption

The GDP seen from the expenditure approach reveals the large gap between the capital formation of the public sector and that of the private sector. Public gross fixed capital formation (GFCF) represents only 1% of GDP as opposed to 20% of GDP for the private gross fixed capital formation. With a chronic deficit in the fiscal balance, the government lacks the funds to carry out much needed infrastructure investments. Overall, the capital formation declined both in volume and value terms; in volume terms by 7% in 2014 and 4% in 2015 and in value terms by 2.9% in 2014 and 4.6% in 2015.

The consumption expenditure, by both households and government, which accounts for 99% of GDP, has increased in real terms but at a slower pace. While the consumption expenditure registered a real growth rate of 7% in 2014, it only grew by 3% in 2015. The fact that even the consumption expenditure of both households and government has slowed, indicates how deep the economic slowdown ran in 2014 and 2015. This means that the economic slowdown not only impacted the decisions to venture in large, long-term investments but also has impacted short-term spending and investment rationales.

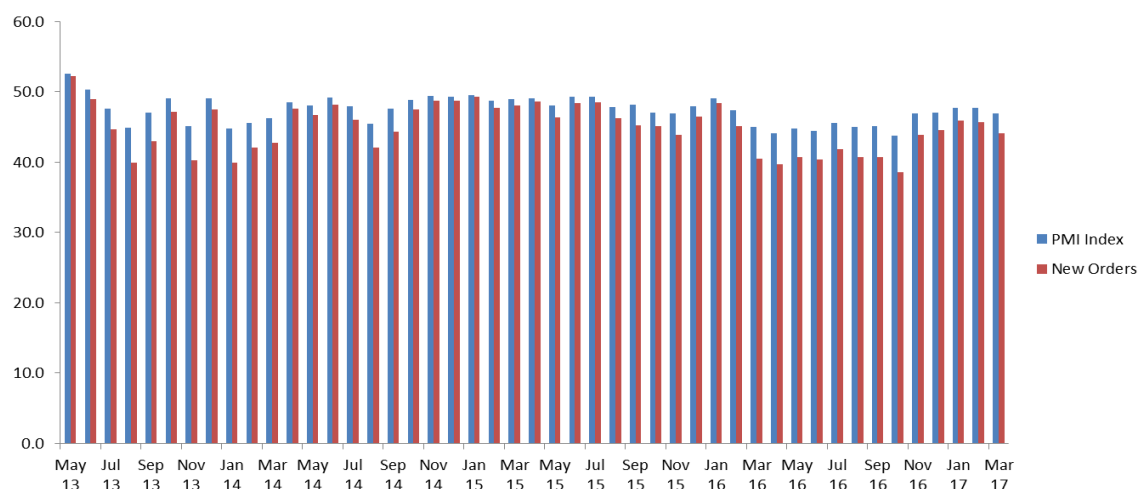
The slowdown in consumption was reflected by the BLOM Lebanon PMI and new car registrations have reflected. The BLOM Lebanon PMI, which tracks the activity of the private sector economy, has been below the 50-points mark separating economic expansion from recession for almost the entirety of its computation and that is in big part a result of the poor performance of the "New Orders Sub-Index" which indicates the level of local demand. New car registrations have also been subdued, pointing to a weak durable goods demand.

New Car Registrations

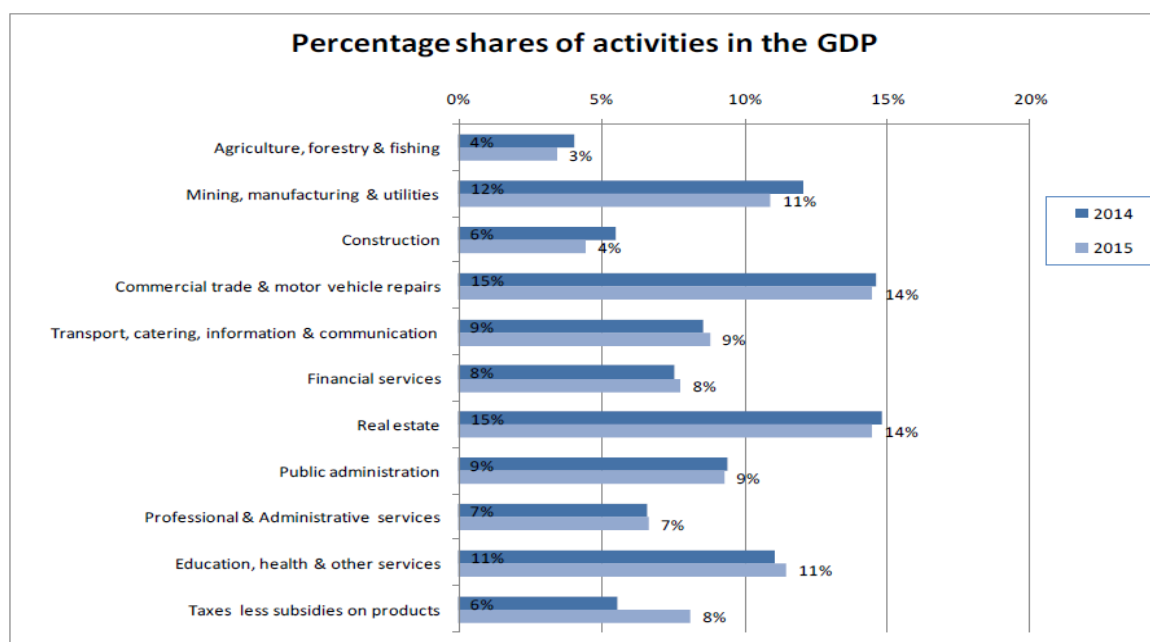


Source: AIA

BLOM Lebanon PMI + New Orders Sub-Index



Source: Markit, Blominvest Bank



Source: CAS

When assessed from a growth perspective, three sectors registered the highest increases in 2015. In terms of volume, the financial services sector registered a 10% upturn in 2015 after growing only by 3% in 2014. The financial services sector in Lebanon is mostly dominated by banks whose assets are around 4 times the country's GDP. The information and communication sector grew by 7% in 2015, up from a growth of 4% in 2014. The transport sector also grew by 9% in 2015 compared to 6% in 2014.

The information and communication sector, not a traditional strong point for the Lebanese economy, was the second fastest growing sector in 2015. This may very well be due to the growing knowledge economy in Lebanon, fostered by the Central Bank's 331 circular. The circular allows banks to invest directly in the capital of startups or in Venture Capital funds with the Central Bank guaranteeing 75% of the banks' investments. The circular, aimed solely for Lebanese startups, has and is still encouraging talented Lebanese expatriates to return to their home country, creating much needed job opportunities for Lebanon's youth and creating a new channel for economic growth.

On the other hand, the real estate and tourism sectors, which have long been pillars of the Lebanese economy pursued their downtrend in 2015. In volume terms, the real estate sector decreased by 3% in 2015 compared to a 4% decline in 2014. Hotels and Restaurants did increase by 2% in 2015 but that was after having decreased in volume between 2011 and 2014. The manufacturing of food products, water supply, waste management and construction decreased in 2014 and 2015.

Agriculture and forestry, a sector that has fallen behind even before the economy started to slow in 2011 witnessed a 19% decrease in 2015 in volume terms after a 14% growth in 2014. This sector could benefit from the recent Agrytech program, funded by Berytech and the Embassy of Kingdom of Netherlands, which aims at bringing much-needed innovation to the Lebanese agriculture sector.

Along with the real estate sector, the sector of commercial trade and motor vehicle repairs holds a sizeable share in GDP. The sector of commercial trade and motor vehicle repairs actually represented the same percentage share in GDP as the real estate; both constituting 14% of GDP in 2015 compared to a share of 15% in 2014. The commercial trade and motor vehicle repairs sector in its majority comprises small to medium businesses and its sizeable share in GDP highlights the importance and weight of small and medium businesses in Lebanon. Their size makes them the most vulnerable to fluctuations in the economic cycle and that's why they need to be offered buffers by the financial institutions and by the government. According to the Ministry of Economy, over 90% of enterprises currently active in the economy can be categorized as SMEs.

Consumption and Investments are subdued but also new channels for growth such as the knowledge economy have the potential of creating jobs and boosting growth. However, the need for structural reforms such as fiscal adjustment and debt sustainability remain inescapable challenges that we need to address in order to see a brighter economic picture.

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