LEBANON ECONOMIC PERFORMANCE

ANNUAL REPORT 2014

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EXECUTIVE SUMMARY

Lebanon's economic growth remained positive in 2014 despite the challenging political, security, and external environment. The Lebanese economy went through difficult times in 2014 except for the formation of a cabinet towards the end of the first quarter. The spillovers from the Syrian conflict were also having an ongoing negative impact on Lebanon estimated at $7.5 billion by the World Bank.

Thus, real Gross Domestic Product (GDP) registered a 2% growth rate in 2014, slightly better than the 1-1.5% growth registered in 2013. The slowdown in domestic demand and consumption mostly lies behind the weaker GDP growth. This was coupled with a subdued inflation rate as the consumer price index increased at an average rate of 1.86% over the year.

Disparate trends characterized the Lebanese core sectors tourism, real estate and construction. The former managed to show a relatively better performance in the first half of 2014 mainly after the long-awaited Cabinet formation and the security plan that took place by the end of the first half. However, the latter kept on suffering the mismatch between demand and supply with prices continuing to decline.

Business activity of the private sector, measured by the Purchasing Managers' Index for Lebanon (BLOM PMI), remained below the 50 benchmark separating expansion from contraction for the whole year of 2014.

On the external front, the Balance of Payments (BoP) deficit broadened at a faster pace in 2014 to $1.41B. This was mainly the result of worsening current account deficit, BOP's largest constituent, despite the progress of the capital and financial account and that of the unrecorded transactions. In details, the current account balance remained under the strains of the dwindling tourism activity as frail levels of receipts heavily impacted the balance of services.

As for trade balance, it managed to tighten its deficit during 2014. This has followed a higher slump in imports' value than that of exports. The slight 2.0% narrowing of deficit was mainly the result of bearish oil prices hand in hand with the depreciation of the euro. Exports covered 19.0% of imports in 2014, compared to 19.6% in the previous year.

When it comes to public finance, Lebanon's fiscal balance significantly improved in 2014. In details, the deficit tightened by 27% over the year following a 15.5% jump in total revenues versus a marginal 2% yearly rise in expenditures. Thus, the share of the fiscal deficit in the GDP retracted from 9.3% in 2013 to 6.4% in 2014.

On the brighter side, the primary balance, referring to the fiscal balance excluding debt service, recovered after two years of being in the red. Accordingly, the share of the primary balance in GDP recovered from a deficit of 0.53% in 2013 to a surplus of 2.73% in 2014.

In details, both tax and non-tax revenues boosted total budget revenues in 2014, while treasury receipts almost doubled to $1.1B. As for expenditures, the effect of lower oil prices has not been materialized in lower transfers to EDL since the transfers of 2014 correspond to a previous consumption period. Accordingly, the 11% annual growth in the value of interest payments along with the 18% y-o-y upturn in domestic interest payments and, to a lesser extent, the uptick in foreign interest payments constituted the main increase in public expenditures.

However, Lebanon's gross public debt rose by 5% y-o-y compared to the 10.1% rise in 2013. In specific, the value of domestic debt almost increased by an annual 10% in 2014 simultaneously with the 2% yearly drop of foreign debt. In addition, interest payments on both domestic and foreign debt have increased more than the increase in the stock of debt while interest rates did not change.

To support economic growth and price stability, monetary policy has remained highly accommodative during 2014. The central bank kept the interest rates stable as witnessed by T-bills rates, maintained the exchange rate peg at its current level, pumped money into the system through subsidized loans and added to its sizable holdings of government securities.

As security and political situations had their toll on the economy since 2011, the central bank's aim remained to

support progress toward price and exchange rate stability and economic growth. In this context, the central bank implemented an $800M economic stimulus package in 2014, which targeted start-up companies and some other sectors of the economy including housing, tourism, and manufacturing. It also initiated the "Knowledge Economy"- "an economy in which information is invested to create new and improved products and services with a high added value that constitutes a main component of the production process and generation of wealth".

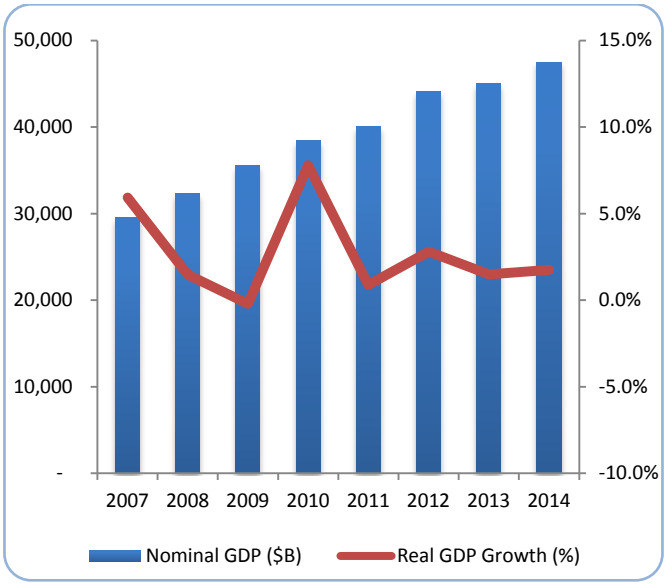
Lebanon's financial markets kept on mimicking the political and security dynamics that characterized the country over 2014. While both the Lebanese stocks and Eurobonds' markets witnessed a relatively prosperous first half in 2014, the worsening developments that painted the second half of the year triggered down investors' appeal for the Lebanese securities. This has led to flat, yet leaning to positive, outcomes over the mentioned financial markets.

From one side, the Lebanese stock exchange revealed a 1.75% timid yearly upturn in its BLOM Stock Index. This was coupled with an improving trade activity that totaled 38.67M shares worth $297.55M being traded over the year, compared to a volume of 93.92M shares worth $576.26M the previous year.

On the other side, Lebanon's Eurobonds market finally took off and recovered in 2014 following 3 years of negative performance. In fact, the relationship binding Lebanese Eurobonds to the local scene was stronger than the impact of the international trend driven by the U.S. Treasuries. Thus, the BLOM Bond Index (BBI) mirrored the dwindling local market's performance and added a mere 1.7% y-o-y.

01. REAL SECTOR

Figure 1: Lebanon's Nominal GDP & Real GDP Growth



Source: International Monetary Fund

Economic growth managed to recover some of the slowdown witnessed in 2013 recording 1.8% in 2014. Following the long awaited Cabinet formation and the implementation of a security plan during the first half of 2014, real GDP growth managed to offset the negative factors that took place in the second half. Growth is expected to reach 2% by the end of 2015. In 2013, the Lebanese economy grew by 1% only, the slowest recorded progress rate since 1999. The slightly improving performance in the real sector during 2014 was mainly related to the low base reached in 2013.

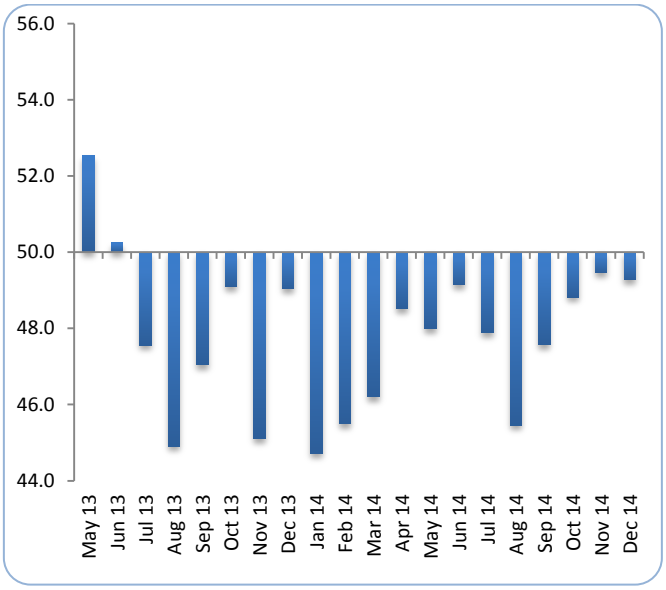
The economic performance would have been better if not for the security incidents that took place during the year. Lebanon continued suffering from the Syrian civil war spill-over effects and numerous bombings. This was topped by clashes between the Lebanese army and rebels in Arsal, where the militants were able to take at least 30 soldiers and police captive during their retreat, keeping the security situation shaky in the region.

Moreover the failure to elect a president and a parliament did not help growth. All of the parliamentary meetings to elect a president were fruitless and the presidential void lingered. Accordingly, and with no president of the republic being elected since the 25th of May 2014, the Lebanese Parliament extended its mandate by 2 years and 7 months, in November 2014. The extension was coupled with a law stating that parliamentary elections would occur after the presidential election.

Social developments regarding the salary scale and the strikes of civil servants also had their toll on the economy and particularly on the fiscal situation. On the salary scale issue, public school teachers' and civil servants' strikes were trying to pressure parliament members to approve the salary scale. Each day of strike was estimated to cause the treasury an $18M loss in tax revenue.

The World Bank predicted unemployment to have reached 20% in 2014 due to low growth and competition from Syrian refugees. The impact of the Syrian war on the unemployment rate is divided in two-fold: first, Lebanon remained the major host for Syrian refugees, of which 1.5M were registered by the end of 2014. This situation led to the competition between the Lebanese citizens and Syrian refugees over job opportunities. Second, the decline in growth rate as a result of the spill-over led to the lack of creation of high quality jobs by the economy.

Figure 2: BLOM Lebanon PMI Monthly Performance



Source: BLOMINVEST Research Department, Markit

Furthermore, the private sector was dealt a tough-hand as shown by the BLOM Lebanon PMI which averaged 47.6 points during 2014. The index remained below the 50 - points mark, separating economic contraction from economic recession for the entire year. In details, economic contraction within the private sector persisted on the back of continuous falls in the companies output and incoming new orders, although at a slower pace than that registered in 2013. Employment steadied in H2 2014 as it stood at 50, after having slightly progressed in H2 2013.

A. INFLATION

Inflation was subdued in 2014 due to lower oil prices, reduction in communication prices, and depreciating Euro as around half of Lebanese imports originate from European countries. According to the Central Administration of Statistics (CAS), 2014's consumer prices rose by an average 1.9% in 2014 compared to higher levels of 4.7% and 4.8% in 2012 and 2013, respectively.

Table 1: Composition of the CPI

	Weight	
Sub-Index	Old	New
Food and non-alcoholic beverages	19.9	20.6
Alcoholic beverages, tobacco	2.1	1.6
Clothing and footwear	6.2	5.4
Housing, water, electricity, gas and other fuels	25.7	28.5
▪ **Housing**	16.2	16.6
▪ **Water, electricity, gas and other fuels**	9.5	11.9
Furnishings, household equipment and routine household maintenance	3.9	3.6
Health	6.8	7.0
Transportation	12.3	14.8
Communication	4.8	5.4
Recreation, amusement, and culture	3.7	2.0
Education	7.7	6.5
Restaurant & hotels	2.7	2.5
Miscellaneous goods & services	4.2	3.8

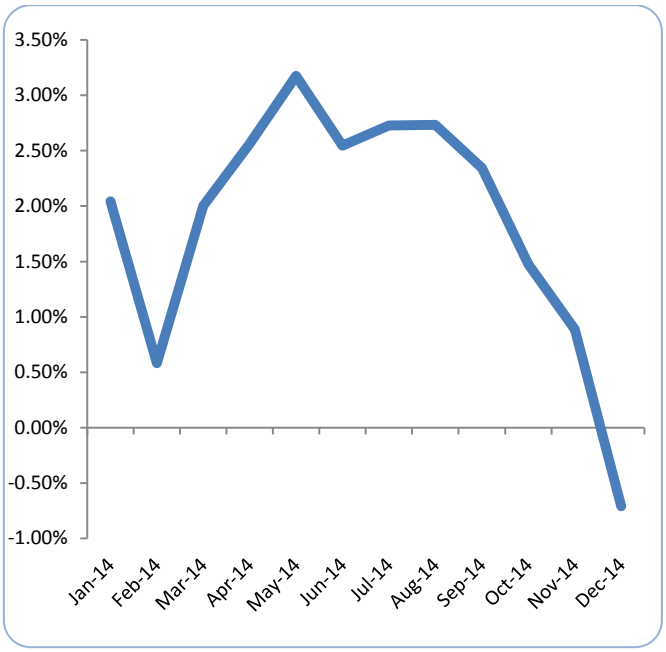
Source: CAS

Out of the 13 sub-indices, only transportation and communication items declined in 2014, but they were enough to bring down inflation. The international slump in oil prices starting June 2014 negatively impacted transportation costs, which account for 13.1% of the CPI, as they dropped by an average of 3.1%. Communication prices revealed a yearly 13.7% slump in 2014, due to the decision by the Ministry of Telecom to slash prices in May 2014.

The other sub-indices showed some increases, except for housing that stabilized. Food and non-alcoholic beverages expenditures, with a weight of 20.6% in the CPI, rose by 3.7% in 2014. As for alcoholic beverages and tobacco, they saw a 13.6% jump in 2014. Housing prices (constituting 16.6% of the CPI) mainly steadied in 2014, according to the latest figures published by CAS, as they increased by a marginal 0.1% on average. CAS started conducting housing surveys once per month in 2014, in addition to detailing the housing sub-component into Actual Rent (comprising Old and New Rent) and Owner Occupied.

As a matter of fact, CAS updated the Consumer Price Index (CPI) in early 2014 by switching the reference month from December 2007 to December 2013 and by modifying the weights of the respective sub-indices.

Figure 3: Year-on-Year Monthly Inflation Rates in 2014

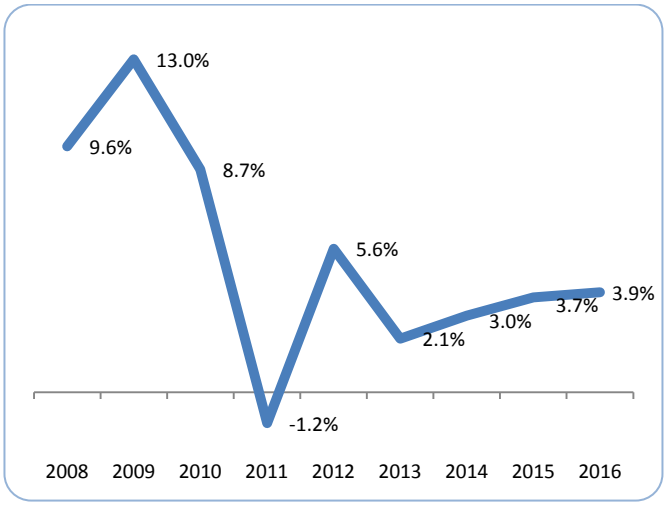


Source: CAS

B. CONSUMPTION AND DEMAND

The slowing increase in consumer prices was coupled with slightly improving levels of consumption and demand. The spending of Lebanese residents kept on being affected by the economic, political and social conditions of the country during 2013, leading consumption to grow by 2.1% in 2013 compared to 5.6% in 2012. Syrian refugees played a large role in the consumption growth of 2012, even though their demand was concentrated on primary goods. In 2014, the private final consumption managed to improve, after reaching a low level in 2013, and rose to 3.0%. However, Business Monitor International (BMI) expects levels to increase even more in 2015 and 2016 to reach the 3.7% and 3.9%, respectively.

Figure 4: Real Year-on-Year Growth of Private Final Consumption



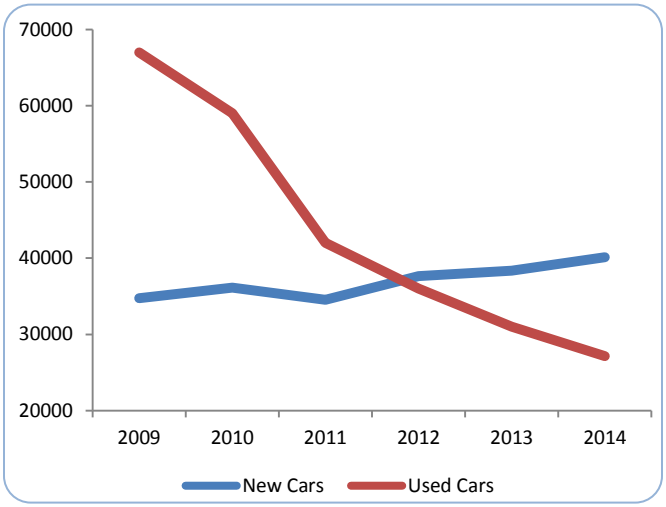
Source: Business Monitor International

In the same context, and as a proxy for local consumption, to a certain extent, the "new orders" sub-indicator of the BLOM PMI showed a slowing decline during 2014. Foreign demand was partly behind the slowing contraction of new orders. New export orders kept on contracting in 2014, however they managed to reach the 50 expansion-contraction frontier in December, and even exceed it in April and November of the same year.

The Lebanese Car Market in 2014: Still Suffering from the Poor Economic Backdrop

Car sales, an additional indicator of consumption, reported another sour year. The Association des Importateurs d'Automobiles au Liban (AIA) stated that the profits of car importers dropped despite the continuous efforts poured into advertising and promotional campaigns.

Figure 5: New and Used Cars' Registration Number (Passenger and Commercial)



Source: AIA

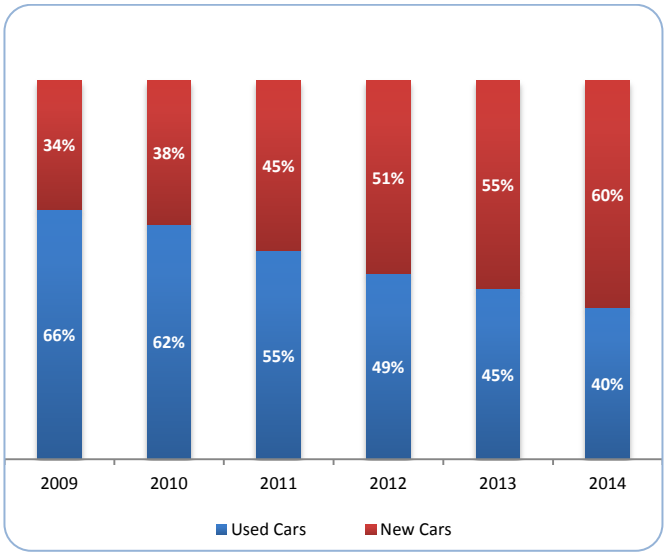
As was the case in 2013, the tough economic times compelled Lebanese consumers to purchase the cars with low price-tags. The AIA asserts that a crushing 90% of registered car are small cars whose price is less than $15,000. Luxury cars, with a selling price above $100,000, account for only 3.5% of total newly registered cars. Also according to the AIA, the preference for small cars stems from the absence of an adapted and structured public transport network and from the very strong competition between the makes.

Accordingly, the total number of registered new and imported used cars, the proxy for durable goods purchases, has dropped, during 2014, by 3% in comparison to 2013, by 8% in comparison with 2012 and by 11% in comparison to 2011. The downtrend in car registration has been continuous for the past four years and AIA expects this trend to continue further in 2015. The decrease in 2014 was

partly influenced by the Central Bank's new regulation imposing a down-payment of 25% on car loans, even for new cars.

It was also noticeable that sales of new cars usually increase during the summer season mainly between July and September, while the number considerably declines between March and May.

Figure 6: Yearly New and Used Cars' Shares



Source: AIA

The trend of consumers favoring the purchase of a new, low-price tag car rather than a used car extended into 2014. In fact, the market shares have been reversed as the share of new cars in total cars registration surged from 34% in 2009 to a whopping 60% in 2014 while the share of used cars in the total registered a steep fall from 66% in 2009 to 40% in 2014. This shift from used cars to new cars must have pushed many used cars traders out of the market. Factors contributing to this shift include car rental companies that were hit by the declining number of tourists for the past four years.

The rising share of new cars can be linked to two main factors. First, the interest rate on loans for new cars is lower than that applied on loans for used cars. Second, new cars with low price tags are offering more and more appealing designs, therefore combining both the "look factor" as well as the "price factor".

A Positive Twist of Consumption Observed in Checks' Clearing Activity

2014's sluggish economic performance was reflected by the small increase in checks' activity. In details, the value of checks cleared by Banque du Liban rose by 3.1% year-on-year (y-o-y) during 2014 to reach $74.60B for a volume of 12.99M compared to 2013's value of $72.35B for a volume of 12.24M. Both volume and value of checks denominated in foreign currencies preserved their dominance by December 2014, representing 69.0% and 75.7% 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 1.98%, from 2.03% in the same period of 2013. Similarly, the default rate for the value of checks dropped to 2.24%, from 2.30% in 2013.

On the resources side, the performance of the main drivers of economic growth in the past decade, namely tourism and real estate backed up the estimate of low economic growth in 2014. The latter kept on suffering the mismatch between demand and supply amid persisting prices in the market. However, the former managed to show a relatively better performance in 2014 mainly after the long-awaited Cabinet formation and the security plan that took place by the end of the first half, however from a low base.

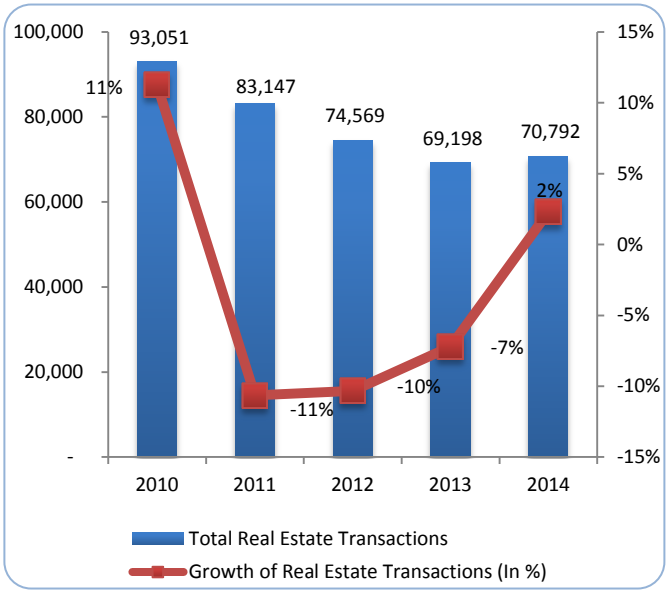
C. REAL ESTATE AND CONSTRUCTION

The contribution of the real estate sector to the country's GDP which was estimated around 14% by 2013. Yet, the lack of data in the sector undermines the valuation of real estate demand and supply. The size of current local demand cannot be assessed accurately as updated income distribution and housing ownerships are not available, noting that remittances from the large Lebanese diaspora contribute substantially to the uphold of domestic demand.

In 2014, mixed political signs shaped the local demand for real estate. In the first half of the year, activity in the Lebanese real estate market got little breathing space, despite the escalating challenges that were undergoing in

Lebanon and the region. Investors revealed optimistic prospects about the year and translated their hopes in both the construction and real estate markets. This resulted from the long-awaited Cabinet formation in February along with a firm security plan that managed to reduce security incidents in several Lebanese regions.

Figure 7: Yearly Evolution of Total Real Estate Transactions



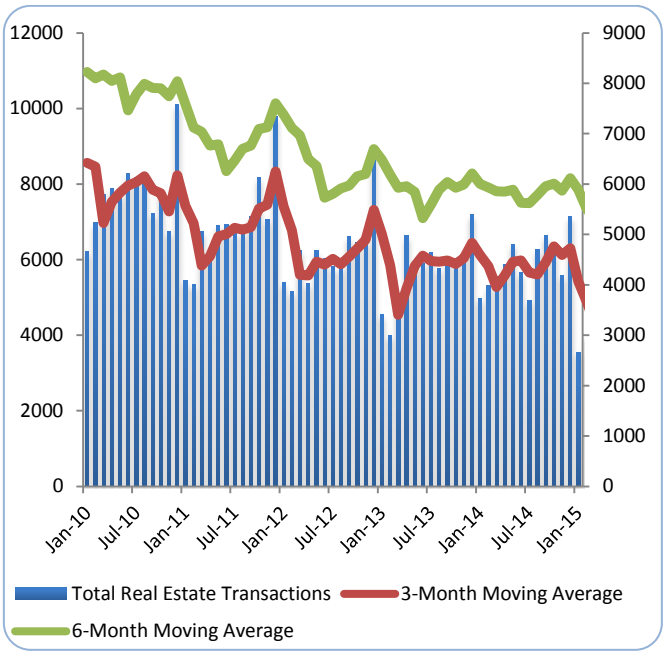
Source: Cadastre

However, the presidential vacuum that started by the end of May painted the second half of the year and was coupled with series of security incidents topped by the hostage of Lebanese soldiers by militants in Arsal in the first week of August.

Thus, the decline in real estate appeal was quite evident following the Arab Spring in 2010, as the six-month moving average by December 2014 had almost declined by 25.7% from December 2010. Moreover, a seasonal effect is depicted as the main drops are noticed in the first 6 months of each year, followed by a subsequent recovery in the second half of the year. This seasonal effect confirms the decline in the real estate with peak points showing a clear drop from one year to another.

The reasons behind the decline in real estate activity are many, starting by the oversupply that landed on the market at the beginning of the Arab spring following a 4-year period of a booming real estate market. In addition, the demand was hit and foreign investors shied away as regional tensions exasperated and domestic political and security situations deteriorated.

Figure 8: Monthly Evolution of Total Real Estate Transactions



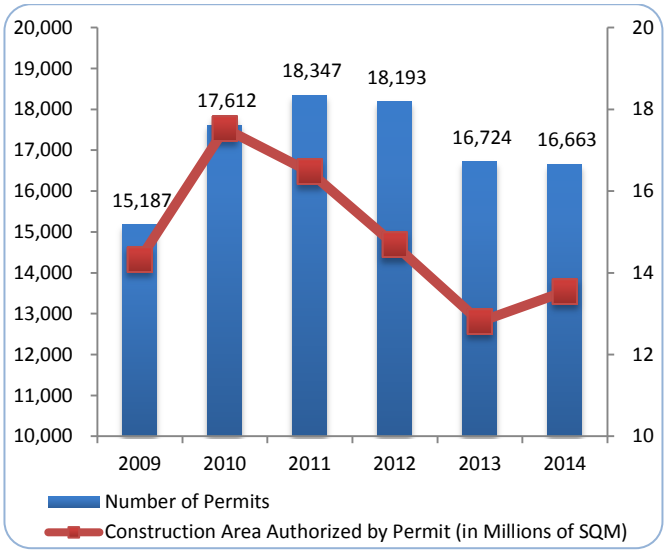
Source: Cadastre

Construction Activity retreats in 2014 despite Global Economic Turmoil

The international bearish trend in oil prices, which reached in 2014 one of their lowest levels since 2010, could have significantly triggered down transportation costs in the construction industry especially when developers' projects are located far from the providers of construction materials. In addition, construction costs were partly impacted by the Euro's depreciation. Noting that Lebanese developers heavily rely on the European building materials for design and decoration purposes (such as ceramic and marble rom Italy and Spain), their imports from the Euro Zone became cheaper. Worth mentioning that, the European official currency almost saw a 12% yearly slump, by the end of 2014, from €/$ 1.37 to €/$ 1.21. In fact, the MSCI World Construction Materials Index dropped 13.6% y-o-y, which could explain the potential drop in Lebanon's construction

costs as the global decline of construction prices was imported to Lebanon.

Figure 9: Evolution of Construction Activity



Source: Orders of Engineers in Beirut and the North

Besides the repercussions of the Syrian crisis on the Lebanese real estate sector, contractors benefitted from the cheaper Syrian labor force. As several Syrian citizens were fleeing the country for employment at low wages, the local workforce was facing fierce competition, while real estate developers were enjoying cheaper labor costs and fewer obligations (when it comes to social security), which contributed in decreasing their construction costs even more.

Yet, Lebanese developers witnessed several challenges in 2014 of which the changing demand, the scarcity of land, the volatility of workforce availability and the economic slowdown. Choosing the location for their units amid ongoing security developments across the country and centralization of projects in the capital was another burden for real estate suppliers. Several developers failed to survive the economic slowdown and were forced to exit the market. This has partly left room to the remaining players, mainly the biggest developers.

Cement deliveries, which are one of the earliest barometers of construction activity, posted a 7.0% y-o-y decline by November 2014 to 5.07M tons. Similarly, 2014 saw the number of authorized construction permits slightly sliding by a yearly 0.36% to 16,663. However, the number of construction permits is not reflective of the precise volume of real estate supply in a specific time, as applications are filed 6 months earlier and the execution of a permit is valid up to eight years from the date of issuance. Still, permits can disclose contractors' sentiments and expectations for the coming period.

Real Demand Remains Stagnant in 2014 despite Increasing Real Estate Transactions

According to official data, the total number of real estate transactions (foreign and local) went up by 2.3% y-o-y by the end of 2014 to 70,792. Even though 2014's yearly increase followed 3 years of continuous drops, the total number of transactions remained well below 2011's and 2012's respective levels of 83,147 and 74,569. This explains that demand did not really improve in 2014 but slightly recovered from the very low base reached a year earlier. In addition, the number of real estate transactions reveals when ownership of the sold entities is recorded with the Cadastre in the Registrar of Deeds.

However, the number of real estate transactions does not show when the transaction really took place, but only when the transfer of ownership is recorded. The time frame to handover a residential unit requires at least 3 years and the majority of sales happens during or before the project is initiated. Thus, the increase in the average value per transaction by the end of 2014 does not necessarily indicate a growing demand or even an increase in the prices of real estate projects.

Luxurious and Spacious Apartments Went Hand in Hand with Fading Foreign Demand

Luxury real estate is the section of the market that was hit the most. Wealthy Lebanese citizens and expatriates, in addition to Arab nationals were the main investors in large and luxurious real estate apartments, mainly in Beirut. As GCC nationals constitute a substantial stake of the demand for luxurious apartments in Lebanon, their demand kept on dwindling following repeated warnings from their governments to avoid Lebanon. In fact, sales to foreigners slumped by a yearly 6.4% to 1,196 transactions in 2014, the lowest level in 6 years.

Even though several Syrian citizens fled from their country heading to Lebanon, their demand was mainly concentrated in rentals and not real estate purchases. This can be explained by the fact that the wealthy Syrians leaving their country were looking for more secure countries, none of which was Lebanon. Thus, the ones targeting Lebanon were the middle-class families and those expecting to go back to Syria when the situation improves. Those could not afford buying real estate units in Lebanon, but rather rented apartments.

Thus, and with supply outpacing the demand for luxurious and spacious apartments, the latter's prices went down around 20% as buyers gained more freedom and time to negotiate their purchases. Worth mentioning that the time needed to sell an apartment has prolonged lately as buyers have the option to choose from the overflowing number of unsold apartments and negotiate for their own best interest.

Small Flats: Steady Demand from Low- and Middle–Income Households

In 2014, demand for real estate was mainly restricted to basic housing on the expense of luxurious accommodation. With local demand being the one to rise over the year and with the majority of spacious apartments remaining unsold, local consumers were looking for small affordable houses. In fact, the average income of a Lebanese household is relatively low and the maximum payment that the latter can settle is one third of its monthly income.

In addition, the subsidy that BDL provides to commercial banks for housing encourages demand for small apartments with area not exceeding 150 Square Meters (SQM). Thus, demand for such apartments is growing and was mainly behind the uptick of housing loans distributed in the financial sector that rose 15.8% y-o-y in 2014 to reach $9.88B.

Given the scarcity of land and its effect on prices, developers were looking for new areas for their investments where they can benefit from larger plots, thus reducing their costs. Despite the slump in the number of construction permits, the construction area authorized by permits (CAP) increased by a yearly 5.8% to reach 13,545,707 SQM in 2014.

The increase in the CAP should not be regarded as an improvement in the construction sector but rather as a partial recovery from 2013's levels when it had shrunk by an annual 13%. In fact, developers became more oriented towards new type of projects to serve the changing demand. Given that only big contractors survived the economic slowdown, they became more interested in large scale projects (as they are built over large plots of land) featuring small apartments with numerous facilities at an affordable price.

What about the Commercial Market in 2014?

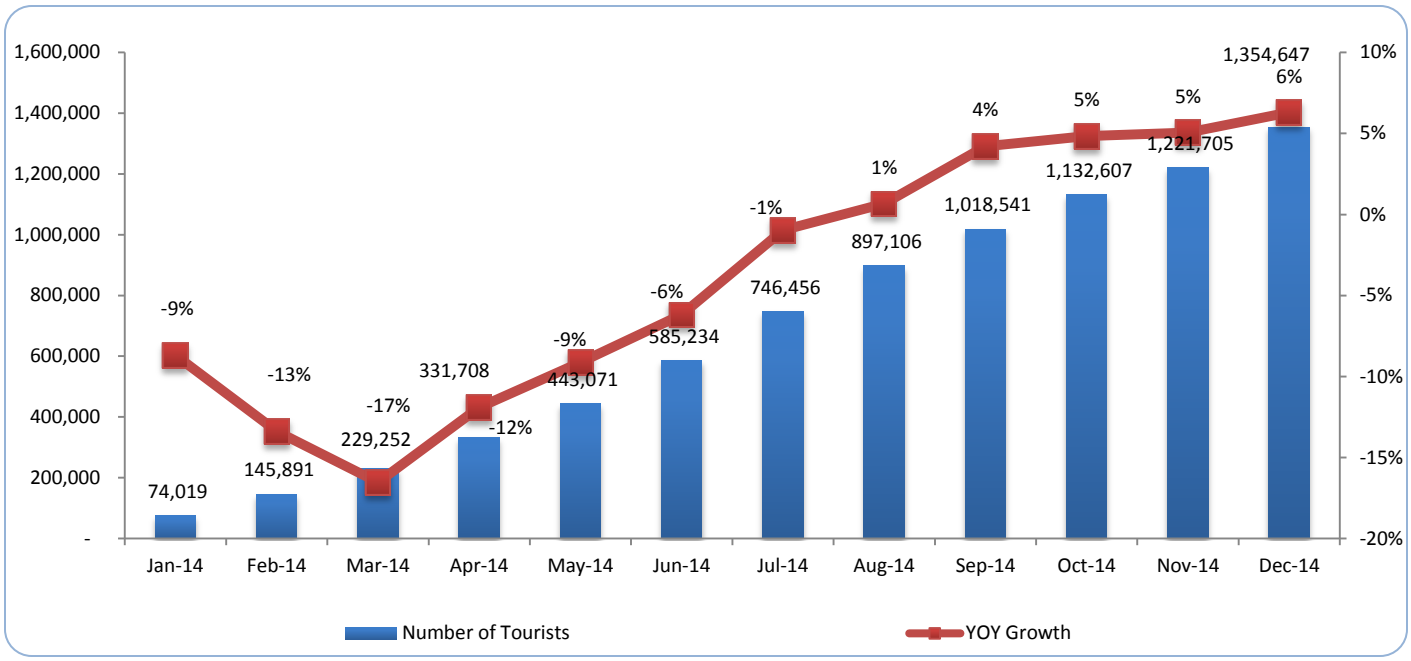
While maintaining their high levels, commercial rentals in Lebanon showed substantial declines in 2014. Cushman & Wakefield annual report showed that retail rents in the main Lebanese locations hovered between $500 - $1,600 per SQM/Year and considerably declined during 2014 around 15%-30%, partly on dropping investment sentiment.

However, this decline masks several different performances of retail locations. ABC Centre Achrafieh, which was 2014's most expensive retail location in Lebanon, preserved 2013's level of $1,583 per SQM/Year. The Lebanese mall ranked 37th among 64 countries. Beirut Central District and Rue Verdun rental prices followed ABC Centre Achrafieh at respective prices of $792 per SQM/Year (a 16.7% yearly decline) and $633 per SQM/Year (a 20.0% y-o-y drop). Rue Hamra and Kaslik ranked fourth in Lebanon with similar rental price of $554 per SQM/Year.

D. TOURISM AND HOSPITALITY

After four years of sluggish performance, tourism and hospitality sectors managed to show progress in 2014 despite the persisting fragile security situation. In fact, the very low base reached in 2013 was mainly behind the 6% yearly rise in the number of tourist arrivals to 1.35M In 2014, the first upturn since 2011.

Figure 10: Cumulative Number of Tourists in 2014



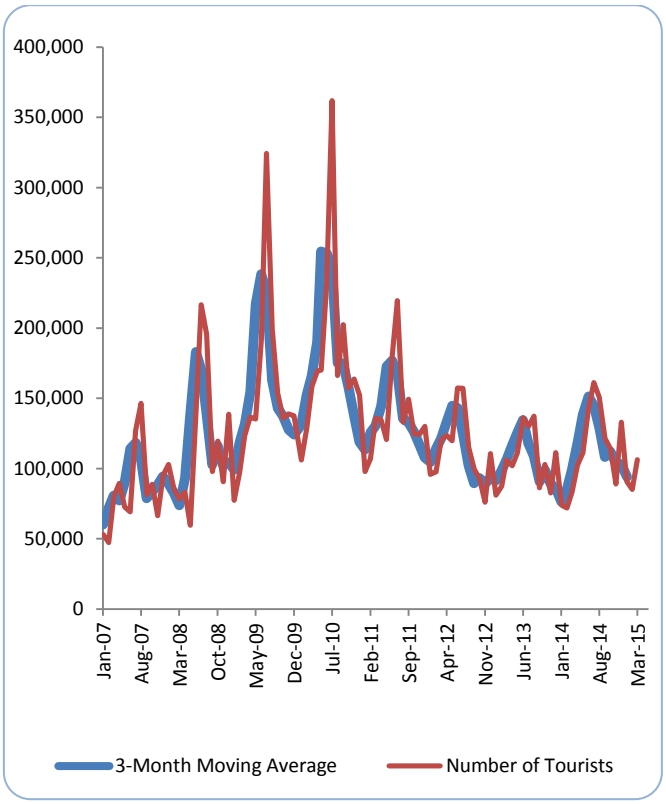
Source: Ministry of Tourism

On another note, the close-up into the 3-month moving average between 2007 and March 2015 revealed that seasonality factors exist and have as well a big influence on tourists' activity. While periods between May and July of every year constitute the peak levels of tourists, a bearish trend was depicted up until 2013. In fact, tourists' number slowed down even during high seasons starting 2010, when the 3-month average hit the 361,934. However, the 3MMA inched up in 2014 mainly between April and June to 142,163 compared to 136,256 during the same period of 2013.

How Did Tourist Activity in Lebanon Evolve during 2014?

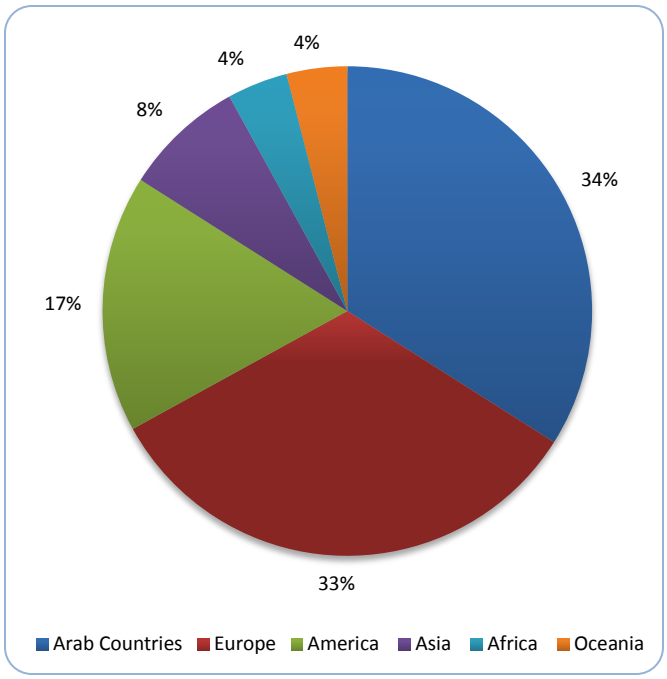
Residual effects from the tumultuous second half of 2013 weighed negatively on tourist arrivals in the first two months of 2014. In January, the number of tourist arrivals recorded a 9% y-o-y decline to 74,109 and by February this decline was amplified to 13% with the number of tourists reaching 145,891. Worth mentioning that H2 2013 witnessed numerous incidents: a bombing in the southern suburb of Beirut, another in the northern city of Tripoli, twin bombings near the Iranian embassy, and the assassination of former minister Mohammad Chatah.

Figure 11: Tourists' Number and 3-Month Moving Average



Source: Ministry of Tourism, BLOMINVEST Research Department

Figure 12: Breakdown of Tourist Arrivals to Lebanon in 2014



Source: Ministry of Tourism

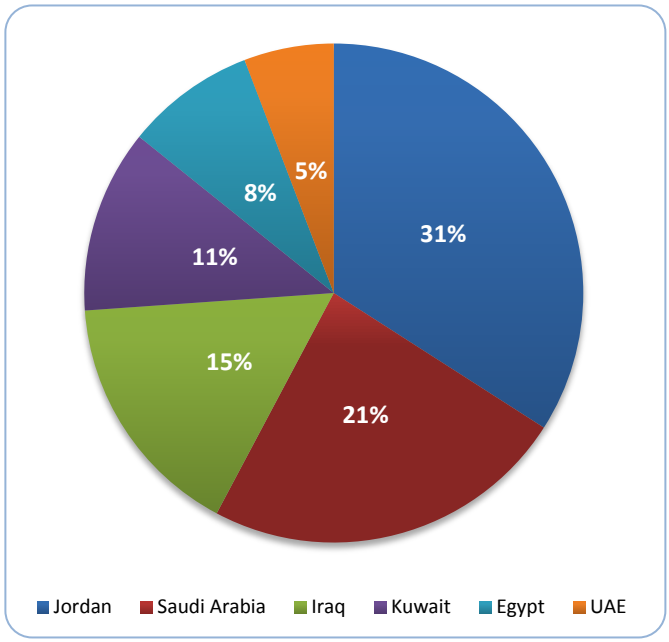
The declining trend in the number of tourist arrivals extended its reach between March and July when a new set of security events emerged. In March, gunmen clashes rattled the city of Tripoli and sent the number of tourist arrivals down by 17% by the first quarter of 2014. In May, the presidential term ended with no successor in sight and June was marked by one bombing in Dahr el Baydar and another in Tayyouneh. By July, the number of tourists visiting Lebanon reached 746,456, still below 2013 levels.

It's only in the period August-December 2014 that the cumulative number of tourists' arrivals started posting limited upturns. This can be explained by the fact that during this period, the frequency of security incidents had receded as the only major development taking place was the clash between militants in Arsal and the Lebanese Army.

Focusing on the Composition of Tourists Landing in Lebanon during 2014

Even though Arab tourists showed progress in 2014, the growth was mainly stemmed from the regional hostilities that turned Lebanon into a refuge for several visitors rather than a leisure destination. In details, the number of Arab tourists in 2014, constituting the largest share of 34% in the total, increased 15% y-o-y to 460,822. This mainly resulted from the 33% upturn in the number of incoming Iraqis to 189,156.

Figure 13: Composition of Arab Tourists in 2014



Source: Ministry of Tourism

However, some of the Arab nationals kept on considering Lebanon as a leisure destination. The number of incoming Egyptians also increased 9% y-o-y to reach 69,179 in 2014. The number of Saudi tourists, representing 10% of total Arab tourists, increased 12% to 45,788.

According to Global Blue's Tourist spending report 2014, the largest spending also emanated from the Arab countries. Saudi, Emirati and Kuwaiti nationals took respective shares of 34%, 14% and 13% during 2014. When comparing to 2013, spending of Saudi and Emirati nationals witnessed respective yearly drops of 2% and 11%, while spending of Kuwaitis inched up in 2014 by a slight 3% y-o-y.

Tourists from the European continent represented the second largest bulk of incomers to Lebanon in 2014 probably due to the relatively improving security situation. The number of European tourists visiting Lebanon in 2014 represented a share of 33% in the total, rose by a yearly 3% to reach 447,668. In detail, the number of French tourists

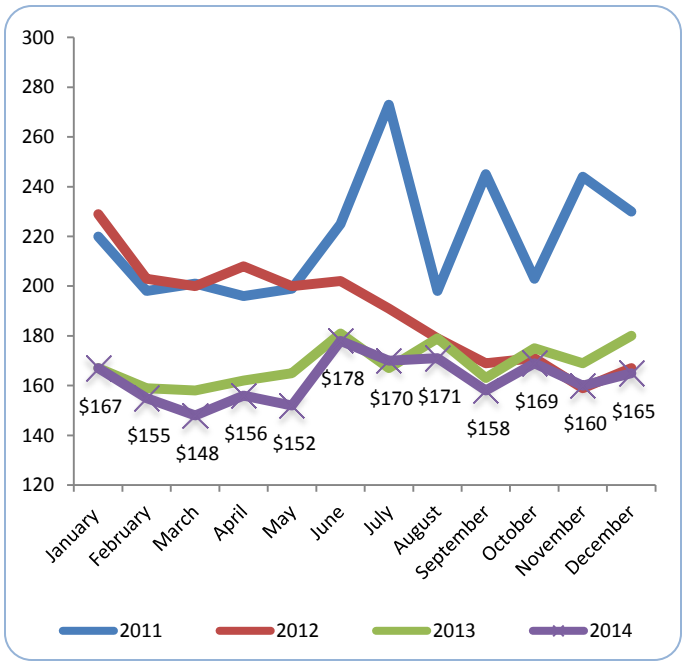
increased by a yearly 3% to 120,710 while their spending edged up by 16% y-o-y which was the biggest rise in the tourist spending of incomers to Lebanon over the year. The number of German tourists also rose by a yearly 11% to 67,988. However, due to tensions at the Turkish-Syrian border, the number of incoming Turks to Lebanon tumbled by a yearly 32% to 16,126.

As for the number of American tourists, representing 17% of the total, it posted a 7% upturn to reach 224,621 in 2014. Similarly, spending of Americans in Lebanon witnessed an annual growth of 14% in 2014.

Beirut's Hospitality Sector Bares the Consequences of Fewer Tourists

The pronounced yearly decrease in the number of tourists during the first four months of 2014 was mirrored by yearly drop in the occupancy rate of Beirut's hotels. In each of the first four months of 2014, occupancy rates, as reported by Ernst and Young's Hotel Benchmark Survey, were the lowest since 2012. Thus, occupancy rate in Beirut's 4- and 5-stars hotels averaged 43% by the end of April 2014 compared to 56% in the same period of 2013.

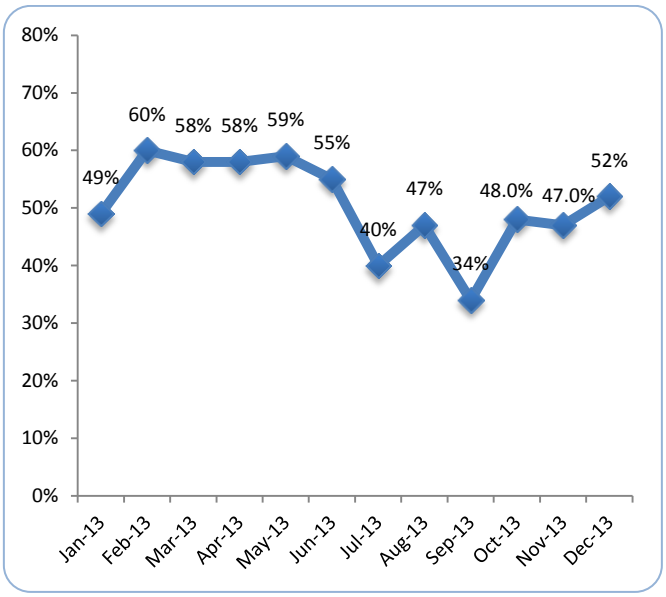
Figure 14: Average Room Rates in Beirut Hotels



Source: E&Y Hotel Benchmark Survey

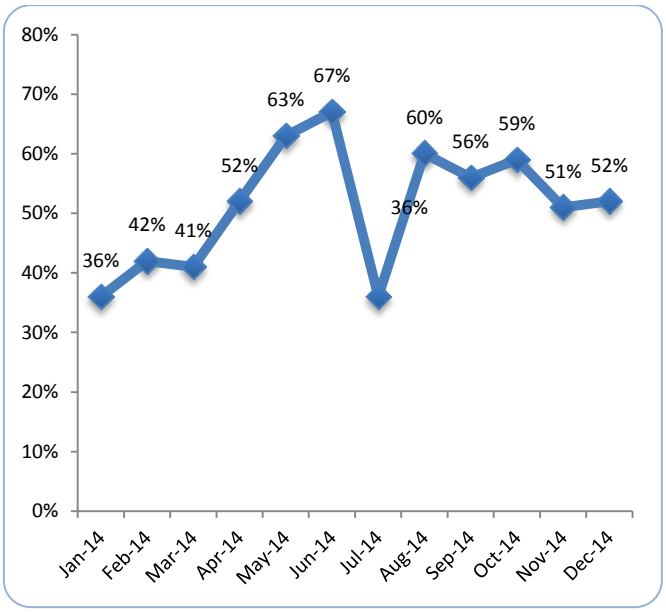
A recovery in occupancy rates during May and June was short-lived. May and June saw occupancy rates recover to 63% in May and 67% in June due to a temporary lift of the KSA travel ban. In July, the occupancy rate dropped to 36%, its lowest level of the year partly due to the celebration of the holy month of Ramadan during that month.

Figure 15: Monthly Occupancy Rates at Beirut Hotels 2013



Source: E&Y Hotel Benchmark Survey

Figure 16: Monthly Occupancy Rates at Beirut Hotels 2014

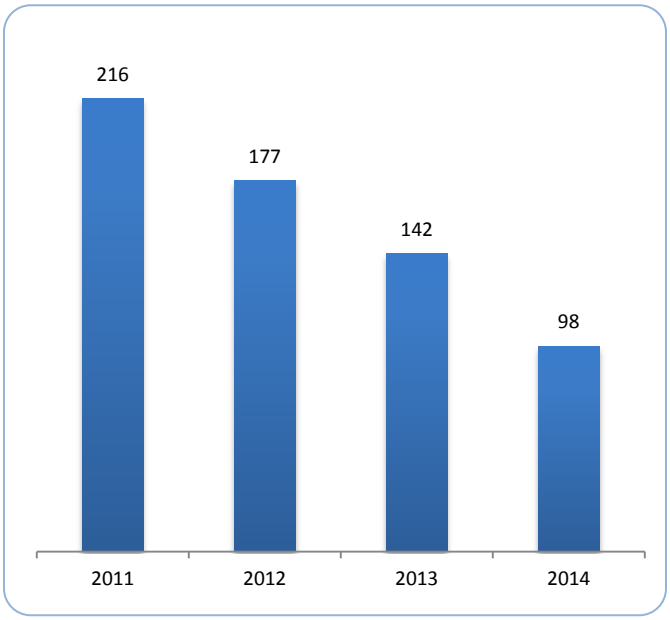


Source: E&Y Hotel Benchmark Survey

The minor upturns in the number of tourist arrivals during the period August-December allowed Beirut hotels to get some breathing space. Due to the relative security stability in the last five months of 2014, occupancy rates ended the year at 52%.

Accordingly, the average occupancy rate in Beirut reached a 6-year low in 2014 at 43% compared to 56% a year earlier. It is a hard plummet from the 72% recorded by December 2009 and the 68% recorded by December 2010.

Figure 17: Kafalat Guarantees for the Tourism Sector in 2014



Source: Kafalat

In the face of slow tourist activity, hotels were compelled to resort to coping strategies. First, hotels relied on group business in the absence of leisure travelers. Second, they launched promotions throughout the year to attract more individual business, targeting 2, 3 and 4 night stayers. Third, they reduced their room rates: Average room rates or average daily rates at Beirut hotels fell 4.1% y-o-y to $162 in 2014, down from $169 in 2013, $190 in 2012 and $219 in 2011.

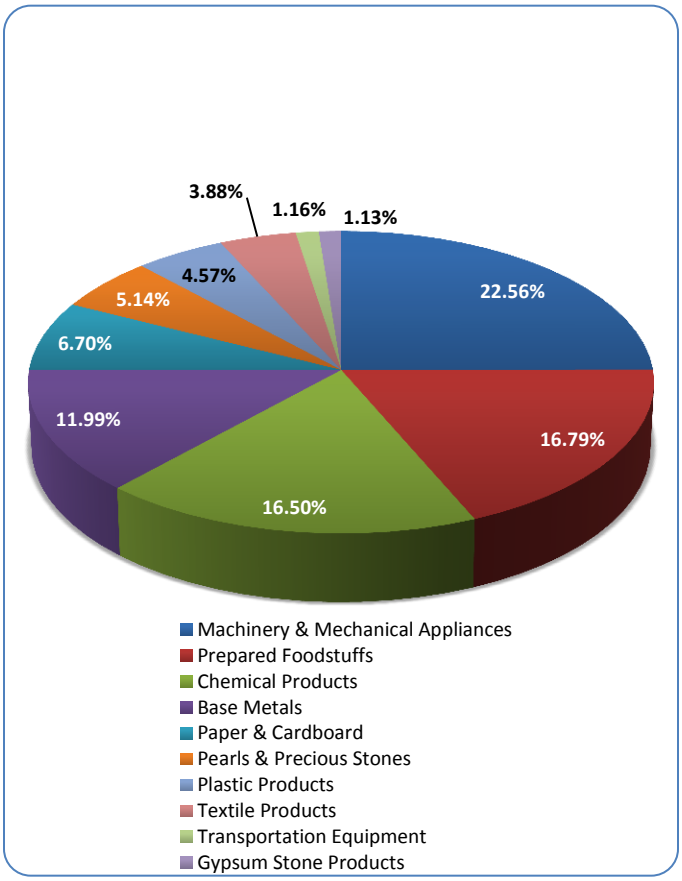
It comes as no surprise that the number of Kafalat guarantees granted for the tourism sector have slumped to their lowest level since 2011. The number of Kafalat guarantees for the tourism sector has consistently dropped since 2011 to eventually reach a low of 98 in 2014.

E. INDUSTRY

The Lebanese industrial sector is the second largest employer after the public sector and ahead of the remaining economic sectors. The number of employees within industrial entities almost reached 140,000 workers, which is almost 25% of the local labor force.

Given that the sector encompasses more than 15 sub-sectors, the number of Lebanese industrial companies, employing 5 workers or above, reached 4,033 factories by the end of 2014. According to the Association of Lebanese Industrialists, the top 4 industrial sectors constitute 65% of total industries and are food, furniture, minerals and metals.

Figure 18: Top 10 Exported Industrial Products in 2014



Source: Lebanese Industrialists Association

With a 7.5% share of the national output, the industrial sector kept facing, during 2014, the series of obstacles and difficulties that have been slackening its improvement for a number of years now. International competition is one of the substantial issues that Lebanese industrialists are suffering especially with the diffusion of globalization and the proliferation of new technologies and advanced equipment. Other recent matters are associated to the Syrian war spillovers as well as the energy crisis resulting from the continuing structural deficits of Electricité du Liban (EdL).

Accordingly, it was noticeable that existing Lebanese industrialists tempered their activity in 2014; undertaking a wait and see approach. Thus, the imports' value of machinery and industrial equipment reached around $269.1M by the end of 2014 as compared to $300.4M in 2013 and $288.1M in 2012. Similarly, the output index of the BLOM PMI also mirrored the situation as it stood at 48.5 in December revealing a decline for 19 months in a row.

The competitiveness of the industrial sector was impacted by two offsetting factors. On one hand, the declining oil prices boosted the competitiveness of the Lebanese products as it reduces production and transportation costs. On the other hand, the depreciation of the Euro and other currencies against the U.S. dollar may have negatively affected competitiveness as the Lebanese pound is pegged to the U.S. dollar. In addition, the instable security situation in Syria has disrupted the land transportation routes to the GCC countries. Hence, the result was that the value of Lebanese industrial exports declined to $3.15B in 2014, from 2013's $3.38B and 2012's $3.57B.

Although the industrial companies are small in size but exports of these companies are much diversified. Machinery and mechanical appliances were the top exported industrial products in 2014 grasping a 22.56% share of total, which is the equivalent of $710.7M. Prepared foodstuffs stood second (16.79% stake) while chemical products grasped a 16.5% share of the total. Base metals and the "paper and cardboard" category came fourth and fifth with respective stakes of 11.99% and 6.70%.

Lebanese industrial exports were mostly imported by countries within the Arab world. Saudi Arabia succeeded in reaching the first ranking during 2014, up from the second position, as the kingdom almost imported $403.29M of Lebanese industrial exports (12.80% of the total). The United Arab Emirates and Iraq followed with respective stakes of 10.23% ($322.28M) and 9.82% ($309.26M). Syria failed to top the list in 2014 similarly to the previous year as its standing deteriorated to 4th with a 6.90% share of the Lebanese industrial exports. This was mainly due to the disruption of trade routes between the 2 countries following the ongoing war on the Syrian territory.

The tightening of Lebanon's exports was translated by a weakening investment sentiment that hindered business initiatives over 2014. In fact, Kafalat guarantees in favor of the industrial sector saw a subdued activity in 2014 as a result of the discouragement among Lebanese in establishing new industrial projects. In this context, the total number of Kafalat loans dedicated to the industrial sector stood at 295 in 2014 compared to 293 in the previous year. However, the share of guarantees issued for the industrial sector widened from 33.6% to 35.20% by the end of 2014, given that the total number of Kafalat guarantees dipped to 838 during 2014 versus 871 in 2013.

Unexpectedly, the industrial sector witnessed an increasing number of new entries in 2014 mostly as investors were encouraged by the tax deduction on industrial export profits. In April 2014, the Ministry of Finance (MoF) introduced a 50% tax cut on the profits generated from Lebanese industrial exports to support the sector and boost its competitiveness as well as attracting new investors to the market.

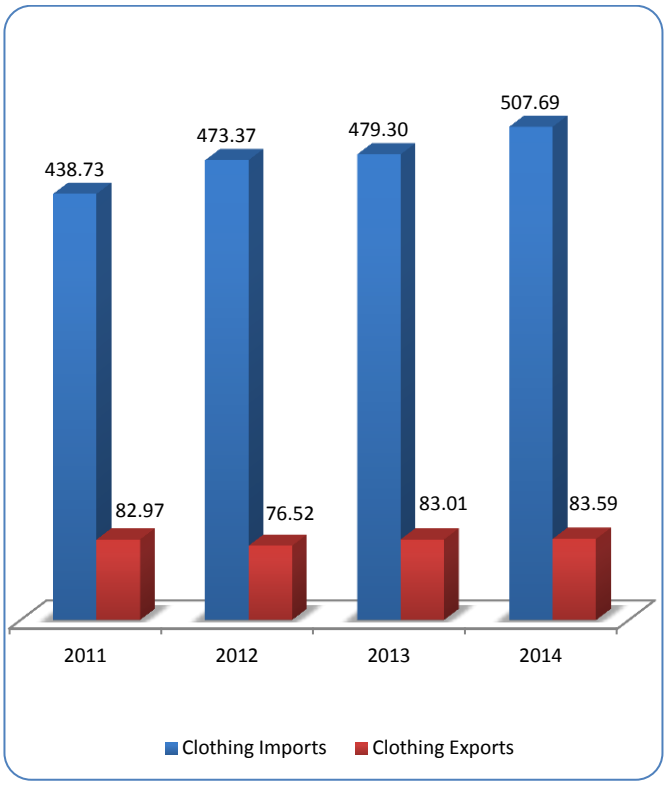
Thus, the number of industrial permits went up from 415 in 2013 to settle at 578 by the end of December 2014. Around 25% of total industrial permits were linked to the food manufacturing sub-sector, while 22% and 9% of the permits were related to the building materials and metal products' activities, respectively.

Round Up on Lebanon's Apparel Sector

Mirroring the economy's path, and following 2 years of bearish activity, the apparel sector revealed a stagnating to declining performance in 2014. This was associated to the country's ongoing instabilities and political stalemates that

severely hit the sector, which is one of the biggest contributors to Lebanon's growth, constituting near 13% of total economic activity in 2013. Accordingly, the ongoing presidential vacuum and the recurring security incidents sent the BTA - Fransabank Retail Index (which takes into account inflation) on average 28.8% lower than 2013. In specific, clothing and footwear sectors also reached "alarming levels" in 2014, according to the latest report of "BTA - Fransabank Retail Index". The slowdown in activity was reported by respective average yearly drops of 10.7% and 23.7% in the clothing and footwear sectors between 2013 and 2014.

Figure 19: Trade Activity in the Clothing Industry (In $M)



Source: Lebanese Customs

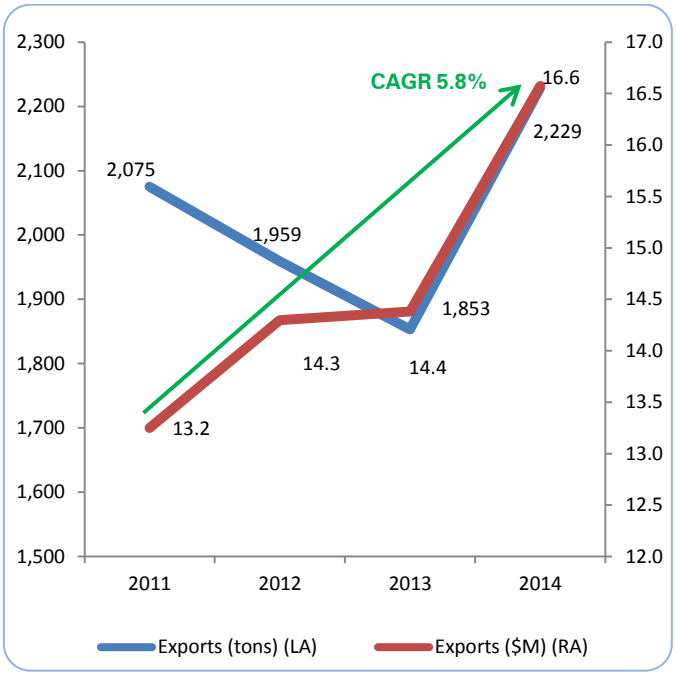
In 2014, the Lebanese apparel industry was mostly dependent on imports, amid weakening input from local production. The US Embassy estimated that total Lebanese apparel market size will remain, for the 3rd year in a row, subdued at $606M in 2014 after a 6.3% yearly rise in 2012. The breakdown of which is as follows: $210M local production, $88M exports, and $484M imports. However, and noting that Lebanese Customs posted that total apparel imports stood at $507.69M in 2014 and total apparel exports reached $83.59M, we estimate that local production might have tightened by 13.3% y-o-y to $181.9M in 2014.

Lebanon keeps on suffering from an ongoing structural deficit on its trade balance of apparel. In details, trade deficit stood at $424.1M in 2014, widening from 2013's deficit of $396.29M. In details, total apparel exports almost steadied in 2014 posting a marginal 0.7% y-o-y increase to $83.59M. However, exports volume went down from 2,837 tons in 2013 to reach 2,449 tons, recording a 13.7% yearly drop. Accordingly, the average price of total apparel exports rose from $29.26 per ton in 2013 to $34.13 per ton.

Overview of the Wine Sector

Considered as an adequate ambassador to Lebanon in foreign countries, Lebanese wine sector has been a net exporter of wine in the past 4 years. Customs data show that the wine trade surplus amounted to $4M in 2014. Wine imports and exports have been gradually increasing, however at different paces, where exports recorded a 15.3% increase from 2013's value while imports edged up by only 4.1%.

Figure 20: Lebanese Wine Exports

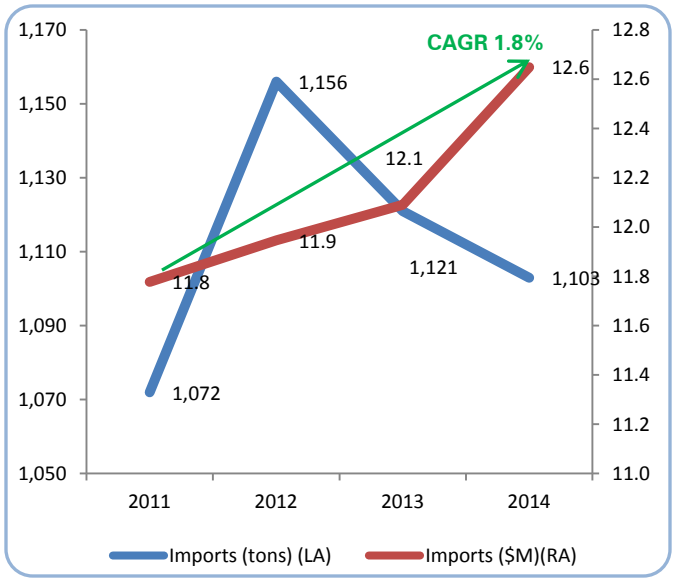


Source: Customs

Wineries in Lebanon have increased sharply since the end of the Civil War. The total number reached 40 wineries in 2015, compared to only 5 after the war.

Heavily relying on exports, the main importers of Lebanon's wine in 2014 were mainly located in Europe and America. Of the 8M bottles that Lebanon's wineries produce, 50% are exported, worth $16.6M, at an average price of $4.2/bottle. The major 3 destinations are UK (30.5%), France (15.0%), and the US (11.3%). In terms of tonnage, France imports 21.2% of the 2,229 tons that Lebanon exports, followed by UK and Iraq with respective shares of 18.1% and 11.1%. Worth noting that in 2011, Syria was the third major destination for Lebanese wine, importing 206 tons worth $748,000. Exports to Syria plummeted to 49 tons worth $128,000 in 2014.

Figure 21: Lebanese Wine Imports



Source: Customs

Despite the foreign appetite for the Lebanese wine, one third of the local consumption relied on imported European bottles. Lebanon consumes 6M bottles of wine yearly, where 33.3% or 2M bottles are imported with an average price of $6.3/bottle. Wine imports, which amount to $12.6M, consist of 65.2% still wine and 34.8% sparkling. 83% of total wine imports, or $10.5M, is imported from France, 8.6% ($1.1M) from Italy, and 2.3% ($294,000) from Spain. In terms of tonnage, Lebanon imports 1,103 tons of wine, of which 68.5% came from France, 12.1% from Italy, and 10.1% from Spain. Worth mentioning that in 2012, Lebanon used to import 38 tons of wine worth $126,000 from Syria. This number plunged to 0 in 2013 and picked up to 25 tons or $72,000 in 2014.

The major obstacle that Lebanese wineries face is competition from imported wine. Imported wine holds an advantage over local wine across different consumer preferences. Foreign wine benefits from greater brand recognition and customer appeal. People who are price-oriented would still prefer the foreign wine because it is cheaper than its local counterpart. This was aided by the gradual reduction of customs on European imports until it was completely cancelled in 2014. According to Union Vinicole du Liban (UVL), French wines were the greatest beneficiaries of this customs reform. Therefore, European wine is preferred regardless of price.

Several hurdles have also emerged from the regional instabilities and the declining tourism activity. Another impediment that Lebanese wineries have been facing is the spill-over effects of the Syrian Civil war with exports to Syria decreasing substantially from 2011 to 2014. Furthermore, tourists have been reluctant to visit Lebanon, which in turn led to the decrease in wine consumption.

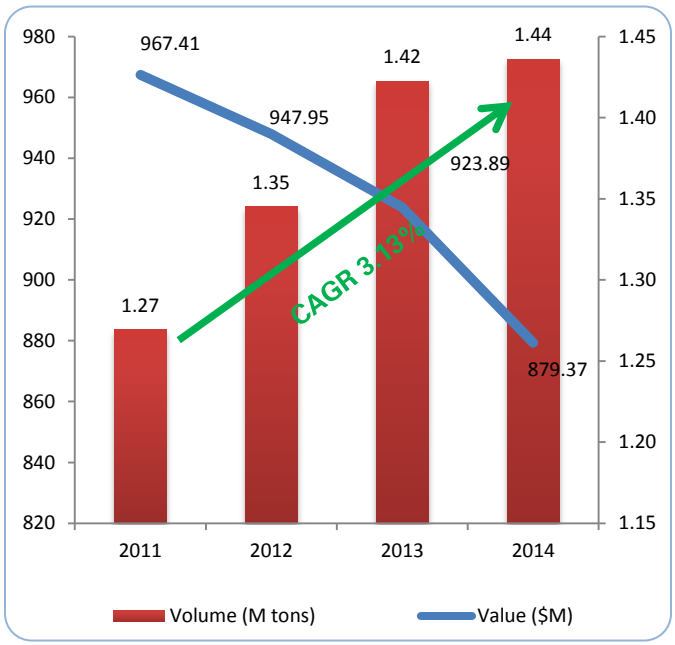
Steel Industry in Lebanon in 2014

Lebanon's steel market is not completely developed and most of the existing steel companies are family businesses. The size of the steel market in Lebanon is around $150M, including steel for industrial purposes. The top market players are DEMCO Steel (24-28% of total volume of steel imported), Al Moussawi Trading Company for Steel and Building Material (20-21% of total volume of steel imported), Société Libanaise pour Les Métaux, Société Jean Yared et Fils , and Zeenni Steel Industries (mostly steel for industrial purposes).

Lebanon does not produce steel and local demand is satisfied through imports. First there is no iron ore in Lebanon, which is the main component of steel. Moreover, the high electricity costs would put Lebanese producers at a competitive disadvantage against other steel makers in the region. So, Demand for steel in Lebanon is fulfilled through imports, owing to the country's limited capacity for

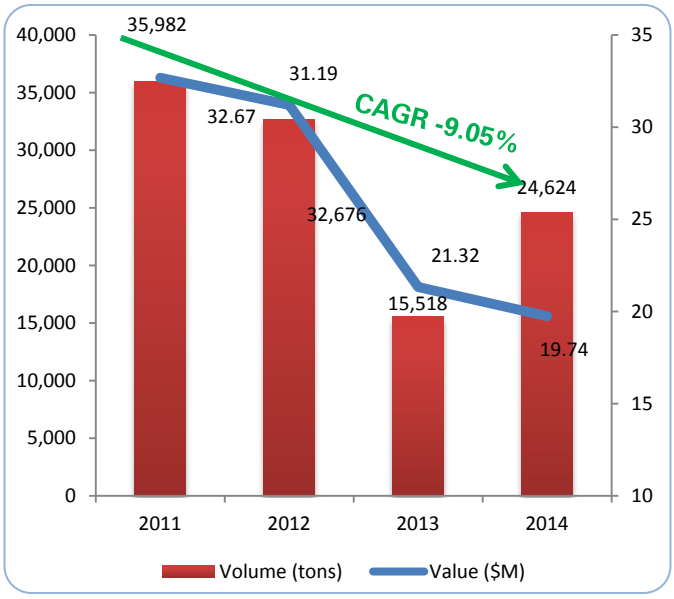
domestic production. 70% of steel demanded goes to construction while 30% to industrial uses. Noting that the main drivers of the steel industry in Lebanon are construction, generators, ducts for air conditioning systems, and hangars.

Figure 22: Lebanese Steel Imports



Source: Customs

Figure 23: Lebanese Steel Exports



Source: Customs

Steel importers witnessed, in 2014, a plunge in the quantity demanded of steel along with an altering requested quality. Even though, the volume of commanded steel went from 360,000 tons in 2013 to 260,000 tons in 2014, a better quality of steel with higher resistance to earthquakes was demanded more in 2014 compared to previous years.

However, the volume of steel imports remained on the rise for more than 4 years, growing at a compounded annual growth rate (CAGR) of 3.13%. The volume stood at 1.44M tons in 2014, recording a marginal 0.95% increase compared to 2013, after posting yearly rises of 5.97% and 5.74% in 2012 and 2013, respectively.

The dropping shipping prices and the depreciating currencies mainly the Euro and the Yuan heavily impacted the value of imported steel. Thus, the imported value of steel recorded respective annual decreases of 2.01% and 2.54% in 2012 and 2013. In 2014, the value of steel imports dropped 4.82% to $879.37M.

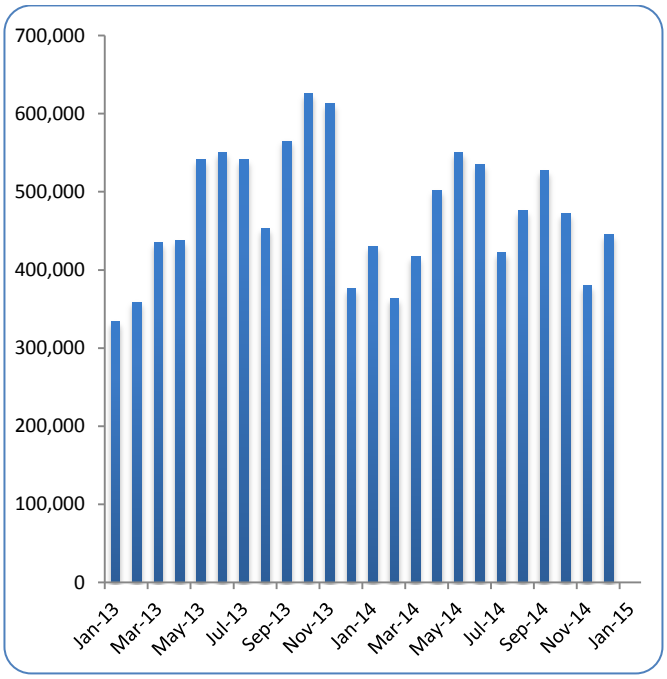
Looking at steel exports in 2014, Lebanese companies benefitted from the Syrian misery after several years of downward trend. In fact, the volume decreased from 35,982 tons in 2011 to 32,676 tons in 2012 and 15,518 tons in 2013. However, the volume more than doubled in 2014 (58.68% y-o-y increase) to stand at 24,624 tons. This was mostly due to higher exports to Syria, the main destination of Lebanese steel exports, which grew from 2,585 tons in 2013 (almost 16.7% of total steel exports) to 4,970 tons in 2014 (almost 20.2% of total steel exports).

2014: A Critical Year for the Cement Industry

The cement market retreated in 2014 mainly due to the regional and local political instability. According to HOLCIM, cement sales registered a 4.5% drop compared to 2013 and the market suffered a lack of solvability, rendering the collection of dues on the market a difficult task. Also, according to central bank figures, the number of cement deliveries dropped by 5.3% in 2014 to reach 5.52 Million tons (Mt).

The move to smaller plots of land seen in the construction sector has also affected the demand for cement. According to HOLCIM, local consumption of grey cement has dropped from 5.74Mt in 2013 to 5.48Mt in 2014 and the local consumption of white cement declined by an annual 3,500 tons to reach 92,000 tons in 2014. In fact, HOLCIM notes that demand and purchasing power remain steered towards small housing projects of 160-170 square meters even in the regions of Beirut and Mount Lebanon, considered as the most appealing in terms of construction and land exploitation.

Figure 24: Cement Deliveries (In Tons)



Source: Banque du Liban

The weak demand was reflected on the prices of grey cement. The price of one ton of grey cement registered a decrease (sold in bags) from $94 in 2013 to $92 in 2014. It is worth noting that the price of grey cement sold in bulk is lower than that sold in bags and stood at $85/ton in 2014, the same as 2013.

In 2014, the division and order of market shares remained identical to that of 2013 and lower sales were felt across all market players. Cimenterie Nationale's market share remained the largest on the market and Ciment de Sibline's market share remained stable. Cimenterie Nationale's market share went from 41.70% in 2013 to 41.49% in 2013. The company's sales slipped from 2.4 Mt in 2013 to 2.29 Mt in 2014. HOLCIM held a market share of 39.2% in 2014, higher than 2014's 36.90%. The company's sales totaled 2.07 Mt compared to 2.13 Mt back in 2013. According to Ciment de Sibline, the company's market share went from 21% in 2013 to 22% in 2014. Ciment de Sibline's sales barely changed from 1.23 Mt in 2013 to 1.22 Mt in 2014.

The low energy prices seen in 2014 did not greatly affect the costs of the Lebanese cement producers. According to market sources, the manufacturers of cement rely on steam coal and petroleum coke and the prices of these energy sources remained in a stable range throughout 2013-2014.

HOLCIM, which also sells ready to use concrete, noted that the concrete market also contracted in 2014. In fact, competition on the concrete market increased which led to a contraction in HOLCIM's concrete sales by an annual 49% compared to 2013. This drop in sales is not only due to increased market competition but is also due to the sale of the Tyr plant in May 2013 and the sale of the Halba plant in March 2014.

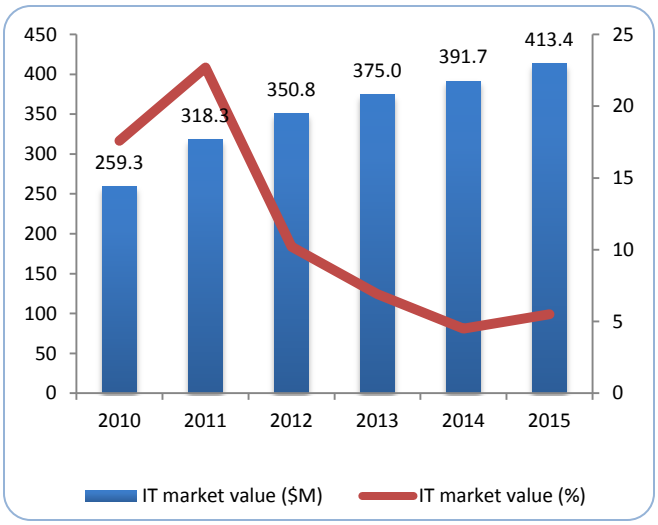
The players on the concrete market, who purchase cement from the three companies operating in Lebanon, confirmed a downtrend in 2014. According to market sources, demand for concrete slumped by 15% in 2014. Concrete producers also used to benefit from substantial exports to Iraq and Syria before turmoil in the region blocked access routes. According to market sources, the public sector's share in terms of concrete demand stands around 17% leaving the big bulk of 83% to the private sector.

F. INFORMATION AND COMMUNICATION TECHNOLOGY

Aside from the heavily weighted sectors, the Information and Communication Technology (ICT) market is one of the newborn industries in Lebanon with substantial growth potential. The sector grew at a Compound Annual Growth Rate (CAGR) of 8.6% to $391.7M between 2010 and 2014 and was expected to hit $413.4M by the end of 2015, according to the Business Monitor International (BMI).

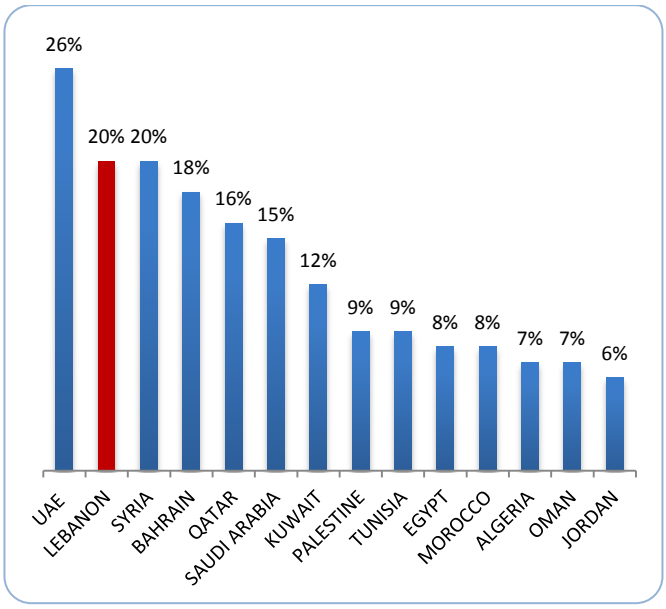
Telecommunication activity kept on posting advances in 2014. Lebanon saw a progress in terms of developing ICT indicators to rank 62nd globally and 6th amongst the Arab countries following the noticeable progress in the usage of telecommunication services. However, the Telecommunications Regulatory Authority (TRA) pointed out that the country witnessed a marginal decline in the indicators of ICT's infrastructure and accessibility.

Figure 25: Evolution of the Information Technology Market Size



Source: Business Monitor International

Figure 26: Regional Fixed Line Penetration Rates



Source: Telecommunications Regulatory Authority, Arab Advisors Group

How to Assess Lebanon's E-commerce Industry?

According to the Organization for Economic Cooperation and Development (OECD), measuring the e-commerce industry must go through the evaluation of three key elements: E-commerce **readiness** measured by the telecommunications infrastructure as a whole, E-commerce **intensity** measured by the intensity and frequency of internet use as well as the internet penetration rate and E-commerce **impact** measured by the effects on a firm's performance and the perceived benefits of e-commerce.

Starting with E-commerce **readiness**, it was noticeable that the cost of accessing the internet and the speed of the internet are hurdles to the e-commerce industry in Lebanon. On the upside, and as mentioned before, the Telecommunication Ministry has set out a plan back in June 2014 to slash prices of DSL services while increasing the speed of this service.

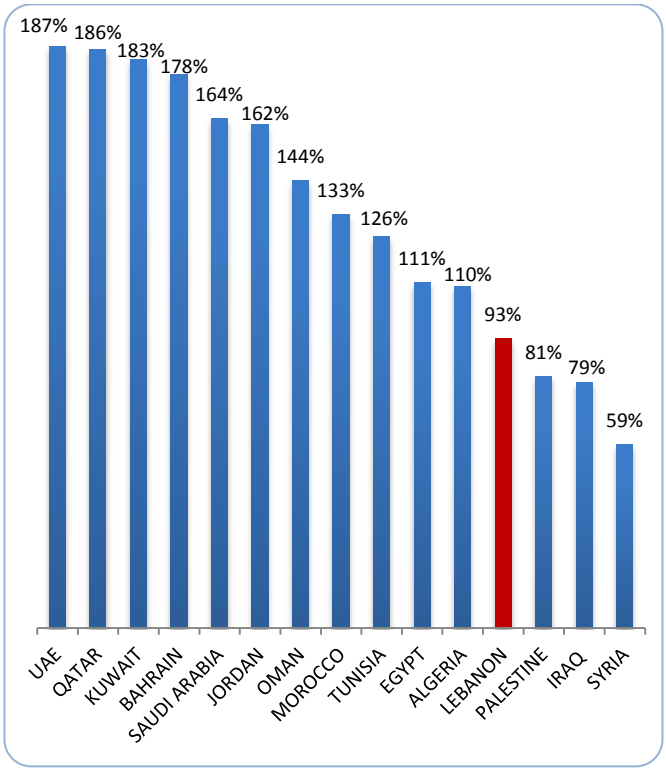
Moving to E-commerce **intensity**, IPSOS stated that the Lebanese internet population totaled 2.1 million in 2014 up from 1.9 million in 2013 and up from 1.7 million in 2012. The internet penetration rate also increased from 56% in 2012 to 61% in 2013 and to 66% in 2014.

As for the E-commerce **impact**, the propagation of e-commerce businesses in Lebanon and the launching of online activity in parallel to physical stores is a clear testimony that Lebanese businesses believe in the benefits of having online presence. The Lebanese businesses going online in parallel to their physical stores have all noted that their online presence opened up new markets and gained them exposure in and beyond the MENA region.

Landline services in Lebanon continued to compare well amongst the other countries in the region. In details, the penetration rate in Lebanon stood at 20%, just below the United Arab Emirates (UAE) and ahead of Bahrain (18%) and Qatar (16%). On a positive note, the Lebanese Ministry of Telecommunications (MoT) slashed prices on international calls from landlines by 50% in April 2014 and those on local calls between 33% and 50%. In July, the MoT canceled initial subscription fees on fixed lines and decreased the monthly payment fees by 25%.

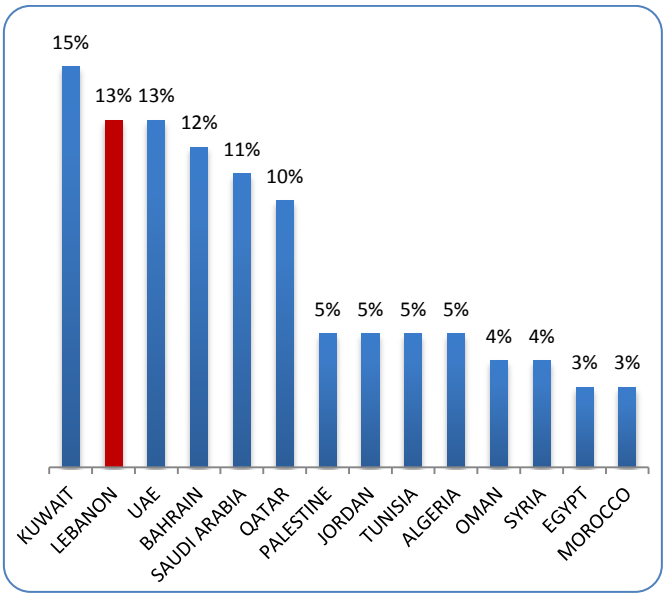
In terms of mobile lines, Lebanon is still well below the region's performance. In fact, the mobile line penetration rate stood at 93% in the 3rd quarter of 2014 compared to the regional penetration rate of 133%. Worth mentioning that Lebanon's penetration rate of mobile services takes into account the number of Syrian refugees residing in the country. Accordingly, the rate will steeply decline when taking into account Lebanese nationals alone to hover around 70%; noting that the registered Syrian refugees touched the 1.5M by the end of 2014, almost constituting one third of the Lebanese population.

Figure 27: Regional Mobile Line Penetration Rates



Source: Telecommunications Regulatory Authority, Arab Advisors Group

Figure 28: Regional Broadband Line Penetration Rates



Source: Telecommunications Regulatory Authority, Arab Advisors Group

The broadband market was on the rise in 2014 with more than 60% of mobile users subscribing to mobile internet services. It is worth mentioning that the average real internet speed stood between 1.6 Megabytes (Mb) and 3Mb, while the average monthly usage reached 19Mb per subscriber. The improvement of this sector mainly resulted from the decision of the MoT to slash tariffs in June 2014 and to launch 3G and 4G new internet generations' services.

Table 2: Lower DSL Prices, Faster Service

DSL Service	Previous Tariffs	Current Tariffs
Entry Level DSL Plan	LBP 24,000 1 Mbps 4 gigabytes data cap	LBP 24,000 2 Mbps 40 gigabytes data cap
2 Mbps	LBP 75,000 20 gigabyte data limit LBP 6,000/extra gigabyte	LBP 75,000 Unlimited download
4 Mbps	LBP 50,000 25 gigabytes	LBP 75,000 50 gigabytes
Charge for Exceeding Data Limit	LBP 6,000	LBP 2,000

Source: Ministry of Telecommunications

What is the state of the e-commerce industry in Lebanon today?

Lebanon has not yet seen its own Amazon or E-bay but numerous e-commerce websites have popped-up in Lebanon over the past few years. Even with only 10% of internet users actually shopping online in Lebanon as opposed to 40% globally, Lebanese e-commerce websites have been thrived in various segments. Online presence is seen in the categories of Fashion and Accessories, Food & Beverage, Electronics, Ticketing (Airline, Concerts), Books, Daily Deals, Classified Ads, and Online Retail.

Actually, IPSOS statistics show that Lebanese use E-commerce the most for e-banking services. The biggest e-commerce usage rate of 49% is attributed to money transfer while 26% goes to paying bills and 18% is attributed to online booking of airline tickets.

Table 3: E-commerce Usage in the MENA region

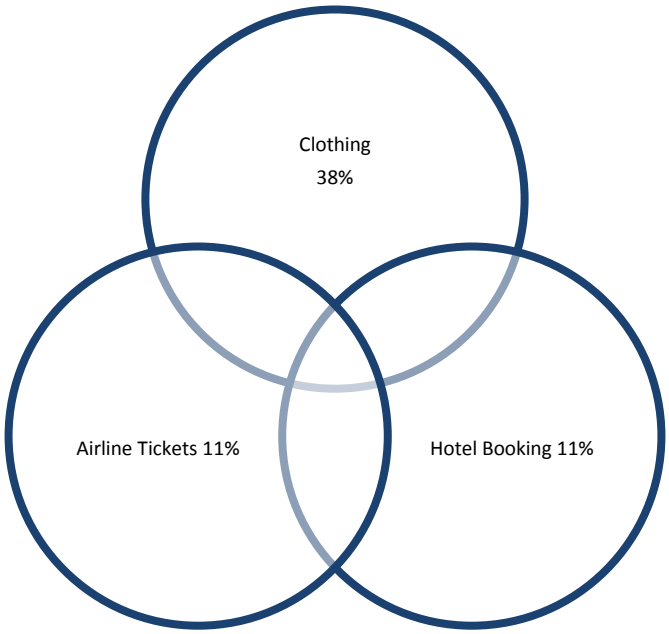
E-commerce Usage in the Past 6 Months	UAE	KSA	Kuwait	Lebanon	Egypt
E-Banking					
Money Transfer	43%	33%	52%	49%	31%
Balance Checking	38%	37%	52%	12%	16%
Paying Bills	43%	45%	13%	26%	36%
Booking Online					
Airline Tickets	54%	23%	34%	18%	12%
Cinema Tickets	27%	6%	13%	4%	15%
Hotel Reservation	9%	12%	5%	6%	9%
Car Rental	3%	9%	1%	7%	3%
Other types of bookings	4%	9%	5%	5%	3%
Selling items and services	3%	2%	2%	7%	4%
Purchasing items and services	6%	10%	19%	16%	5%
Auctions	2%	6%	2%	5%	35%

Source: IPSOS, Data as released at the Arabnet Conference 2013

The popularity of acquiring services online has extended to government services. The e-government experience in Lebanon has been ongoing for two years now and its future prospects are fortunately not dormant.

According to official sources, there are two pre-requisites for the development of e-government services. The first pre-requisite is optimizing the organizational procedures and reducing red tape while the second pre-requisite is preparing the IT infrastructure, which necessitates the proper hardware and the proper database.

Figure 29: Top Products Purchased Online in Lebanon



Source: IPSOS, Data as released at the Arabnet Conference 2013

The biggest challenge to the development of e-commerce in Lebanon remains the need to raise awareness towards the safety of online payments. Lebanese consumers are still wary of revealing their credit card information online and therefore resort to cash-on-delivery payment methods when ordering items/services online. However, this trend is changing as the online sphere becomes more and more integrated into our daily routines and the level of trust in online payments and the use of credit cards for online purchases have increased exponentially.

EXTERNAL SECTOR BALANCE OF PAYMENTS

The Balance of Payments (BoP) was in deficit in 2014. The BoP displayed a $1.41B deficit compared to a smaller deficit of $1.13B in 2013. The higher deficit was probably due to the worsening current account deficit, BOP's largest constituent, despite the progress of the capital and financial account and that of the unrecorded transactions. Thus, Net Foreign Assets (NFAs) of commercial banks narrowed $5.22B, while that of the Central Bank (BdL) grew by $3.82B.

A. CURRENT ACCOUNT

Despite the timidly tightening trade deficit, the current account deficit worsened during the first 4 quarters of 2014 when excluding the unrecorded transactions that improved by a total of $1.31B. Accordingly, the deficit within the current account stood at $12.21B almost 25.7% of GDP by the end of 2014, up from $10.89B (or 24.2% of GDP) in the previous year.

Worth mentioning, that the deteriorating tourism activity (tourists' spending) in 2014 heavily impacted the balance of services. In details, the balance of services tumbled by 25.9% y-o-y to settle at $1.20 that constituted 9.8% of the current account balance. The income sub-category that represents 2.8% of the current account saw a yearly slump of 26.1% to $341.5M, while current transfers went from $2.36B in 2013 to $1.28B in 2014.

B. TRADE BALANCE

Albeit it remained the biggest contributor to the weakening external position of the country, it was noticeable that trade deficit revealed a slight improvement in 2014. First, the trade balance amounted to 50.1% of 2014's GDP compared to a higher share of 59.8% in 2013. Second, and in absolute terms, trade deficit recorded $15.02B in 2014 (or 36.18% of GDP), compared to a higher deficit of $15.33B in 2013 (or 42.32% of GDP). The slight 2.0% narrowing of deficit was mainly the result of bearish oil prices. Exports covered 19.0% of imports in 2014, compared to 19.6% in the previous year.

Table 4: Lebanon's External Position

(In $B)	2013	2014	% Change
Current Account	**-10.89**	**-12.21**	**12.1%**
Goods	*-15.33*	*-15.02*	-2.0%
Services	*1.62*	*1.20*	-25.9%
Income	*0.46*	*0.34*	-26.1%
Current Transfers	*2.36*	*1.28*	-45.8%
Capital and Financial Account	**5.66**	**6.27**	**10.8%**
Capital	*1.56*	*1.44*	-7.7%
Financial	*4.10*	*4.84*	18.0%
Unrecorded Transactions	**5.23**	**5.93**	**13.4%**

Source: BDL

Imports Went Down for the first time in 5 years

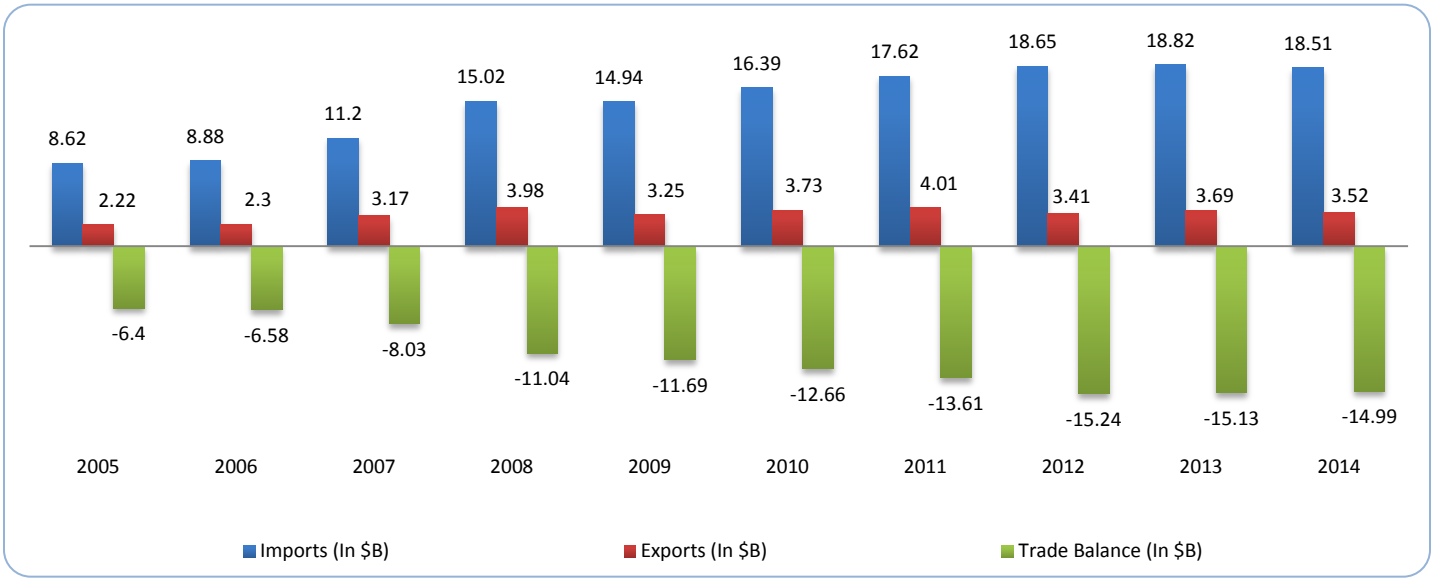
Starting with total Freight on Board (FOB) imports, they declined 1.6% y-o-y to $18.51B in 2014. The depreciation of the Euro against the US dollar was reflected through the appreciation of the Lebanese Pound that is pegged to the dollar and therefore improved the purchasing power of Lebanese consumers. This can be mirrored by the Nominal Effective Exchange Rate (NEER), which increased 14.61% during 2014 to 147.32 points. However, since this occurred during the second half of the year, it did not have a strong impact on Lebanese imports.

In details, Lebanon's first-ranked imports consist of "Mineral Products", with a share of 23.85%, dropping 4.36% y-o-y to $4.89B, in 2014. 97.14% of the mineral products imported

are oil and its derivatives, which decreased by a yearly 5.05% to $4.75B. However, due to the demand inelasticity of oil, the plunge of crude oil by almost 60% in the second half of 2014 caused the volume to inch up faintly by 2.12% to 7.37M tons.

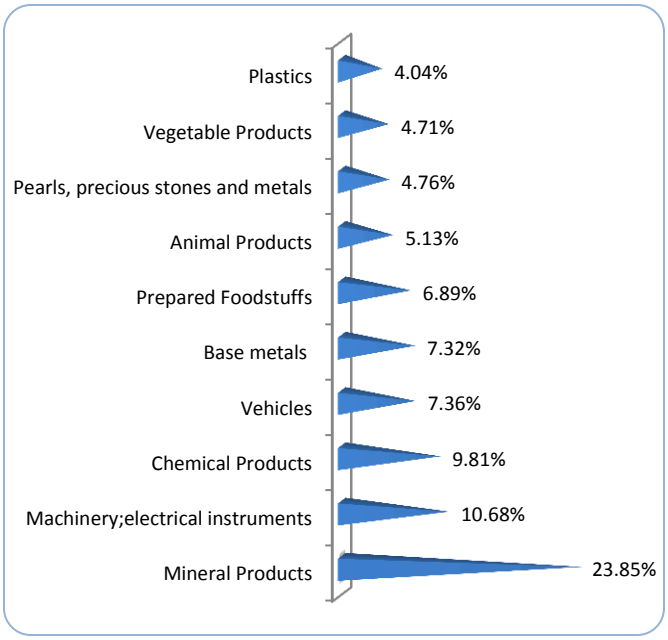
In 2014, due to the slowdown of economic activity, Lebanon imported 15.54% less "machinery; electrical instruments", with a value of $2.19B. Yet it remained the second most imported component, with a share of 10.68%. The decline is partly due to a drop in prices and partly to the volume that fell by 8.89% to 229,407 tons.

Figure 30: Lebanon's External Balance of Goods (FOB)



Source: BDL

Figure 31: Top 10 Lebanese Imports in 2014



Source: Lebanese Customs

Exports from Lebanon Also Declined in 2014, Yet at a Slower Pace

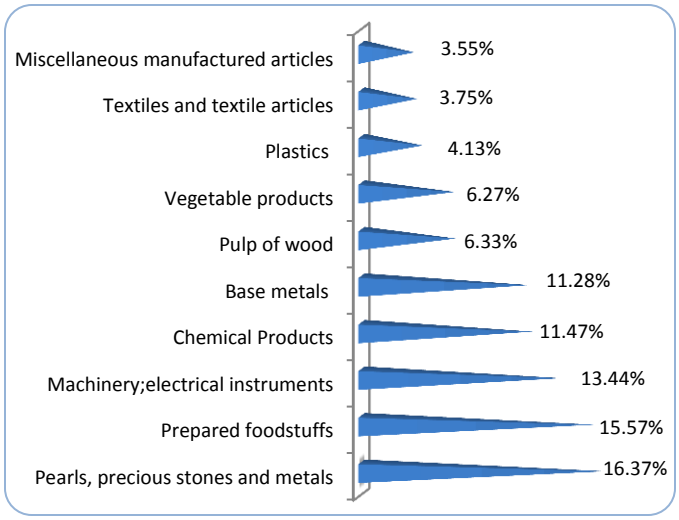
Looking at Lebanese Freight on Board (FOB) exports, they declined by 15.95% to $3.31B, with a 24.17% drop in volume. The main decrease in exports came from mineral products and base metals, with respective plunges in volume of 70.27% and 30.91%.

Mineral products witnessed an 87.89% tumble in value to $43.19M, mainly due to the difficulties in transportation on the Lebanese-Syrian border, as Lebanon re-exports mineral products to Syria. Lebanese exports were not affected by the depreciation of the Euro, since most of Lebanon's exports destinations are in the Middle East, with their currencies mostly pegged to the US Dollar.

"Pearls, precious stones and metals", the major exports with a share of 16.37%, plummeted 29.63% to $541.66M, however with a 41.67% increase in volume to 85 tons. Lebanon mainly exports "pearls, precious stones and

metals" to South Africa (54.35%), United Arab Emirates (16.84%) and Switzerland (14.48%).

Figure 32: Top 10 Lebanese Exports in 2014



Source: Lebanese Customs

"Prepared foodstuffs; beverages, tobacco" came in second, with a share of 15.57%. These exports grew 13.78% to $515.02M. Lebanon exports 14.94% of prepared foodstuffs to Saudi Arabia, 13.94% to Syria, and 12.06% to Iraq.

"Machinery; electrical instruments" ranked third (13.44%), subsiding 12.24% to $444.55M. 'Boilers and machinery' and 'housing machinery, electrical equipment and parts' dropped 9.75% and 14.38% to $223.38M and $221.77M, respectively. These exports are mainly sent to Iraq (14.47%), Saudi Arabia (12.81%), and Nigeria (6.93%).

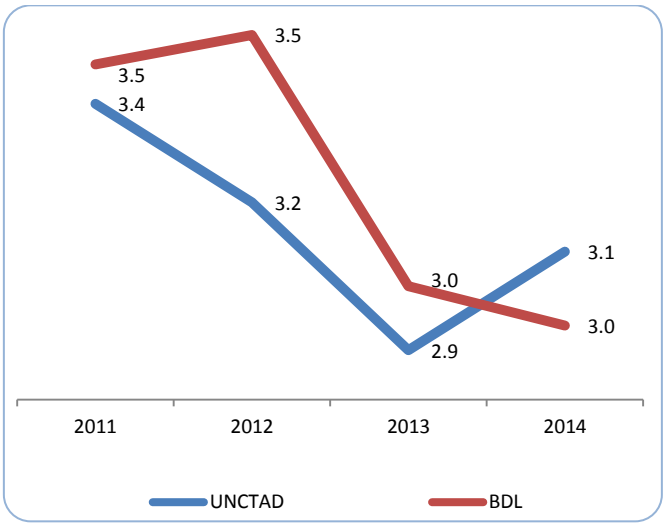
C. CAPITAL AND FINANCIAL ACCOUNT

Capital and financial account went up in 2014 by 10.8% to $6.27, on improving financial inflows that offset the deteriorating capital inflows. In fact, the financial account alone edged up by an annual 18.0% to reach $4.84B during 2014 compared to $4.10B in 2013.

When it comes to the Foreign Direct Investments (FDI), they showed a minimal change in 2014 despite some negative political and security developments in Lebanon during the year to hover around the $3B. In the same context, FDI inflows to Lebanon represented 26.9% of gross fixed capital formation in 2014, up from 25.0% in 2013.

Tracking the official data released by Banque du Liban (BdL) revealed that FDI inflows to Lebanon saw a 2.5% y-o-y decrease in 2014 to $3.0B.

Figure 33: FDI Inflows to Lebanon (In $B)



Source: UNCTAD World Investment Report 2015, BDL

It was noticeable that a divergence exists when it comes to the official data and the figures revealed by UNCTAD mostly due to the lack of information and the absence of accurate tools to estimate the inflows.

This matter is quite evident when skimming through the balance of payments provided by BDL in the "unrecorded transactions" category that almost constitutes 48.6% of the current account and creates near 95% of the capital and financial account.

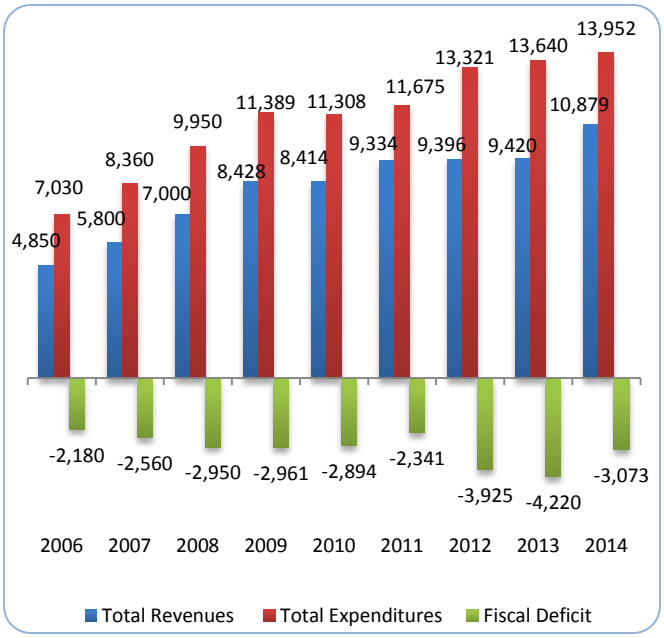
Accordingly, the risk of errors and omissions when calculating the amount of FDIs is considerably high and could affect the whole result that, in turn, may have a direct impact on the trends of the balance of the current account.

However, and according to the United Nations Conference on Trade and Development's (UNCTAD) annual World Investment Report, Lebanon's Foreign Direct Investment (FDI) inflows grew by 6.6% y-o-y to $3.1B in 2014. This comes despite global FDIs falling by 16% to $1.23T, over the same period. The improvement in inflows to Lebanon could be attributed to the low base recorded in 2013, as well as the y-o-y surge in Greenfield investments from $106M in 2013 to $1.2B in 2014.

PUBLIC FINANCE

A. FISCAL BALANCE

Figure 34: Government Revenues, Expenditures and Fiscal Balance (In $M)



Source: Ministry of Finance

Overall Improvement in 2014

Lebanon's fiscal balance recorded a significant progress in 2014. According to the Ministry of Finance, Lebanon's fiscal deficit narrowed 27% y-o-y to $3.07B in 2014. Total revenues grew by a yearly 15.48% to $10.88B and outpaced the 2% yearly growth in total expenditures to $13.95B. The share of the fiscal deficit in the GDP retracted from 9.3% in 2013 to 6.4% in 2014.

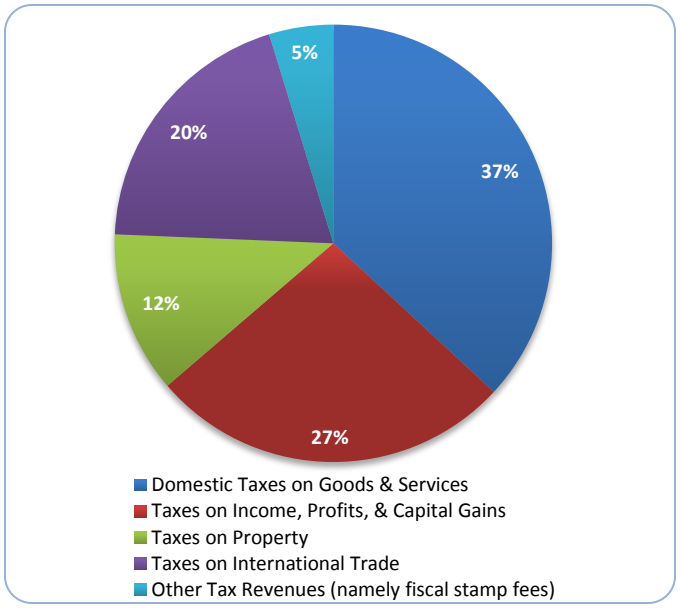
The primary balance, referring to the fiscal balance excluding debt service, also recovered after two years of being in the red. Lebanon's primary balance stood at $1.31B in 2014 as compared to deficits of $239.68M in 2013 and $109.87M in 2012. Accordingly, the share of the primary balance in GDP recovered from a deficit of 0.53% in 2013 to a surplus of 2.73% in 2014.

Revenues Registered Upturns across the Board

Tax Revenues: All on the Up with the Exception of Taxes on International Trade

Overall tax revenues have been subdued ever since economic growth started to slump back in 2011. Double-digit growth rates have gradually turned into either minor single-digit growth rates or into decreases. Tax revenues slightly ticked up by $0.18B to $6.89B in 2014. Three out of four tax revenues' categories recorded increases, namely the Value added Tax (VAT), Tax on income and Tax on property, while taxes on international trade declined.

Figure 35: Composition of Tax Revenues in 2014



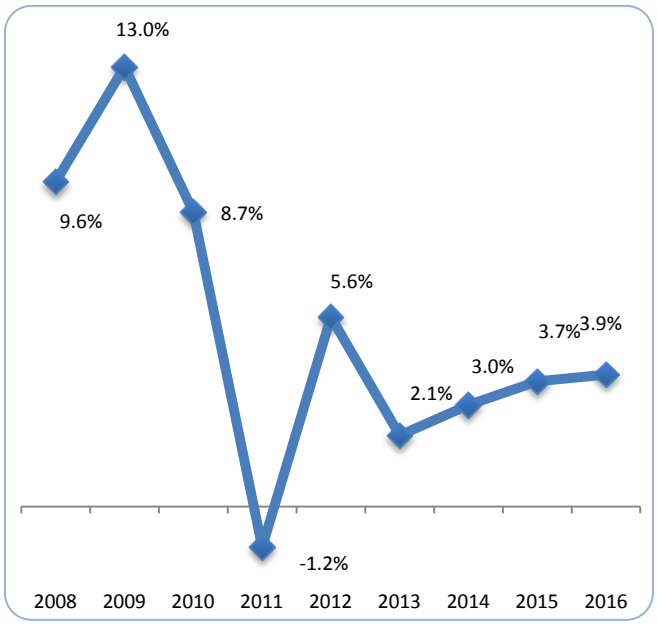
Source: Ministry of Finance

Subdued Performance of Taxes on Domestic Goods and Services

The VAT generated almost the same revenues as in 2013. In details, the VAT generated $2.19B in revenues in 2014 as compared to $2.18B in 2013. The fact that the VAT revenues remained almost steady can be explained by two things: first, the improved collection of VAT along with the adherence of new businesses to the VAT system; second, since the VAT is applied on both domestic and imported goods and since the value of collected customs' fees dropped in 2014, the small uptick in the VAT can be therefore linked to higher consumption of domestic goods.

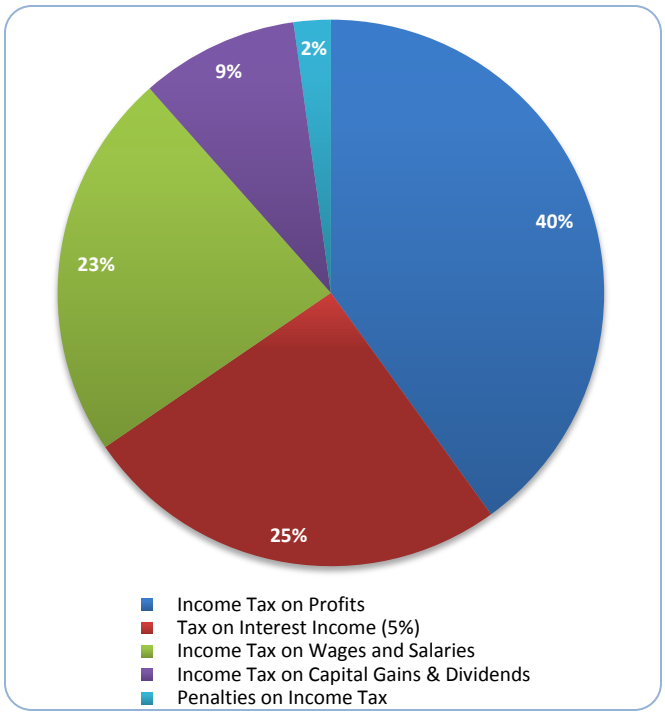
However, 2014's growth in VAT revenues pales in comparison with that of previous years, when the economy was expanding rapidly. The 0.2% upturn in VAT revenues is minor compared to double-digit growths of 11.8% in 2009 and 10.5% in 2010. The slowdown in growth, demand and consumption after 2010 lies behind the weaker evolution of VAT revenues. According to Business Monitor International, the real growth of private final consumption slumped from 8.7% in 2010 to -1.2% in 2011. After recovering from this low base, the real growth of private final consumption settled at a low floor reaching 3.0% in 2014.

Figure 36: Real Year-on-Year Growth of Private Final Consumption



Source: Business Monitor International

Figure 37: Composition of taxes on income, profits and capital gains



Source: Ministry of Finance

Taxes on Income, Profits and Capital Gains Recover in 2014

After falling in 2013, the tax on income and profits (TIP) recovered in 2014 due to the collection of some arrears (uncollected taxes from previous years) and to the administrative and compliance efforts led by the Ministry of Finance. TIP increased by 12% in 2014 to reach $1.85B on account of these extraordinary collections which do not reflect the current subdued economic backdrop.

Other factors also contributed to the increase in TIP. The 5% tax on interest income generated higher revenues in 2014 as deposits in the Lebanese banking sector posted a growth of 6% in 2014 to $144.18B. The income tax levied on wages and salaries, the income tax levied on capital gains and dividends also increased. Taxes on property, which include the built property tax and real estate registration fees, also rose in 2014 because they concern projects that have started three to four years ago, when the real estate sector was still booming, and that are being delivered during 2014. Moreover, efforts in standardizing the valuation of properties and fighting corruption seem to be bearing fruit.

Table 5: Annual Growth Rate of Tax Revenues

	2010	2011	2012	2013	2014		
Tax Revenues	11%	-1%	3%	-1%	3%		
Domestic Taxes on Goods & Services, of which:			10%	3%	2%	1%	1%
Value Added Tax			10.5%	3.3%	-0.7%	0.6%	0.2%
Taxes on Income, Profits and Capital Gains, of which			11%	18%	4%	-1%	12%
Income Tax on Profits			11%	28%	-3%	-3%	15%
Income Tax on Wages and Salaries			8%	20%	15%	12%	9%
Income Tax on Capital Gains and Dividends			19%	14%	22%	-22%	13%
Tax on Interest Income (5%)			13%	4%	-1%	2%	8%
Penalties on Income Tax			8%	80%	6%	16%	25%
Taxes on Property			34%	5%	4%	1%	4%
Taxes on International Trade			5%	-22%	3%	-4%	-5%

Source: Ministry of Finance

Taxes on international trade dipped over the Year

As for taxes on international trade, which include customs, excise on tobacco and cars all registered decreases in 2014 since the overall value of imports declined by an annual 3.48% to $20.49B in 2014. In fact, the purchasing power of Lebanese consumers rose due to the appreciation of the US dollar against the euro and the low oil prices but it might also be that consumers continued to buy the same basket of imports with a lower price tag and directed their excess in purchasing power to domestic goods. The steering of excess purchasing power to domestic goods supports our above assessment of VAT receipts.

Non-Tax Revenues: Boosted by One-Off Telecom Transfers

Non-tax revenues were the major contributor to the increase in total revenues for 2014, as they increased from $2.17B to $2.89B. This improvement was on the back of large increases in telecom revenues and smaller rises in Casino du Liban and Port of Beirut revenues.

Telecom revenues recorded a large jump in 2014, amounting to $2.01B in 2014, up by a substantial 41% from 2013's $1.43B. The increase in telecom transfers in 2014 was the core element ensuring the recovery of the primary deficit and the resorbing of the overall fiscal deficit.

However, the upturn in telecom revenues will be short-lived as it came about due to exceptional one-off transactions: The Ministry of Telecom transferred $1.3B over the period January-August 2014 to the Ministry of Finance. The Ministry of Finance also cashed-in on accrued telecom revenues worth $0.4B for the period January-May 2014 on behalf of municipalities. Since these revenues have not been redistributed to municipalities, they contributed in boosting non-tax revenues. Had it not been for the one-off telecom transfers, the fiscal deficit would have represented 7.6% of GDP rather than 6.4% and the primary surplus would have represented 1.52% of GDP as compared to the actual 2.73%.

Port of Beirut's transfers to the Treasury have increased in 2014. However, the increase is not due to higher Port revenues but rather to low transfers back in 2013, when large investment projects were carried out, as the Port's transfers to the Ministry of Finance represent what is left of the Port's revenues after accounting for its current and investment spending. Notably, government revenues from the Port of Beirut were the second largest constituent in the income from public institutions and government properties.

Total Expenditures Focused on Personnel Costs, Interest Payments and EDL Transfers

Total expenditures grew by a yearly 2.28% to reach $13.95B in 2014. Expenditures are mainly disbursed for Personnel Costs (salaries, wages, retirement and end of service indemnities) which represent 32% of total expenditures and which grew by a yearly 4% to reach $4.46B in 2014. Interest payments (on domestic and foreign debt) represent 30% of total expenditures while transfers to Electricité du Liban (EDL) constitute 15% of total expenditures.

Interest Payments Reveal the Largest Yearly Increase

Interest payments registered an 11% yearly growth to reach $4.19B in 2014. This increase was mainly due to the 18%

upturn in domestic interest payments to $2.61B and was due to a lesser extent to the 0.31% uptick in foreign interest payments to $1.58B. The value of domestic debt increased by an annual 9.7% to $40.96B in 2014 while foreign debt declined by a yearly 2% to $25.61B.

The structure of the government's expenditures reveals the marginalization of capital expenditures. Current expenditures make up 96% of total expenditures while capital expenditures, excluding the foreign financed parts of the projects that are provided directly to the Council of Development and Reconstruction, make up only 4% of total expenditures. The importance of capital expenditures lies in the fact that they are destined for long-term investments aimed at boosting the country's infrastructure: Building roads, airports, water networks…etc. and hence increasing the potential GDP of the economy.

However, with a large fiscal deficit and a substantial debt burden, the government may not have the necessary resources to boost capital spending. That is why Lebanon should resort to structures such as privatization, public-private partnerships (PPP) AND Build-Operate-Transfer (BOT) where the private sector tends to the problem of lack of public funds by financing a given project in exchange for a stake in the future profits.

Interest payments on both domestic and foreign debt have increased more than the growth in the stock of debt while interest rates did not change. Therefore, the increase in interest payments may be due to the fact that banks are favoring long-term higher-yield debt instruments in the face of shrinking profit margins. Longer debt maturities are also serving the debt management strategy of the government that wants to lock interest rates for longer maturities before the expected increase in the Federal Reserve's rates and to reduce its refinancing risk in an unstable domestic political environment. The average maturity of Lebanon's Treasury-bills' portfolio was indeed extended from 1,048 days during July 2012 – June 2013 to 1,221 days in the period July 2013 – June 2014.

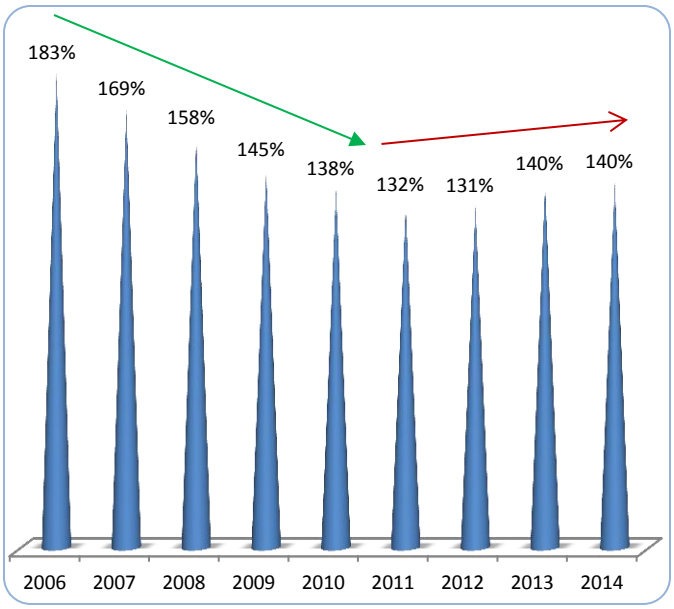
The International Slump in Oil Prices Did Not Hinder Transfers to EDL's Progress

The effect of lower oil prices has not been materialized in lower transfers to EDL since the transfers of 2014 correspond to a previous consumption period. An illustrative example: The January to August 2014 fuel oil bill is related to the consumption period August 2013 – April 2014, during which the slump in oil prices has not yet started. However, in the coming period, the effect of low oil prices is bound to be reflected in lower transfers to EDL.

B. PUBLIC DEBT

The period 2011-2014 was characterized by the debt-to-GDP ratio climbing from 132% in 2011 to 140% in 2014. Real GDP growth tumbled from 8.0% in 2010 to 2.0% in 2011 as spillovers from the Syrian crisis took a heavy toll on the Lebanese economy.

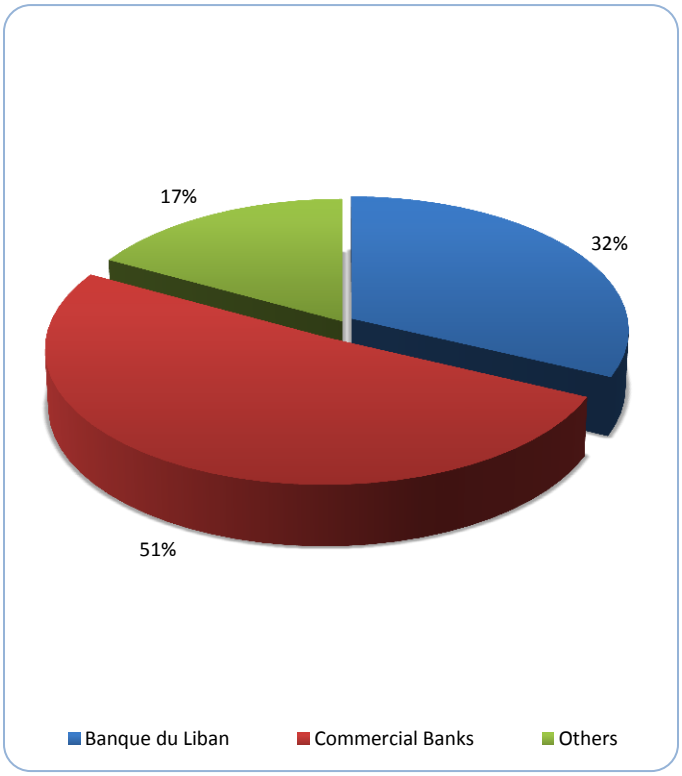
Figure 38: Historical Evolution of Lebanon's Debt to GDP Ratio



Source: Association of Lebanese Banks, Blominvest

The fiscal discipline deteriorated especially with 2012 marking Lebanon's first primary deficit in almost ten years. Like previous years, transfers to the inefficient EDL and wages and salaries of public sector employees grasped the lion share of government spending. However, the novelty about the year 2012 was the approval of the salary increase for public sector employees between which inflated government's spending even more.

Figure 39: Local Currency Debt by Type of Holder



Source: Association of Lebanese Banks

In absolute terms, Lebanon's gross public debt almost doubled from the $32.01B recorded in 2010 to $66.56B in 2014, constituting a 4.8% yearly growth rate compared to a double-digit growth rate of 10.1% in 2013.

Debt denominated in Lebanese pounds grew by 9.66% y-o-y to $40.96B while debt denominated in foreign currency slipped by 2.04% to $25.60B in December 2014.

Net public debt, which excludes public sector deposits at commercial banks and at the Central Bank, reached $57.60B in December 2014, an 8.25% yearly upturn.

MONETARY SECTOR

To support economic growth and price stability, monetary policy has remained highly accommodative during 2014. The central bank kept the interest rates stable as witnessed by T-bills rates, maintained the exchange rate peg at its current level, pumped money into the system through subsidized loans and added to its sizable holdings of government securities.

As security and political situations had their toll on the economy since 2011, the central bank continued to adopt an accommodative stance of monetary policy in order to support progress toward price and exchange rate stability and economic growth. In this context, the central bank implemented an $800M economic stimulus package in 2014, which targeted start-up companies and some other sectors of the economy including housing, tourism, and manufacturing. In addition, hoping that the knowledge sector would become one of the pillars of the Lebanese Economy, BdL initiated the "Knowledge Economy"- "an economy in which information is invested to create new and improved products and services with a high added value that constitutes a main component of the production process and generation of wealth". The central bank encourages banks to invest in this sector's companies, by guaranteeing 75% of the risks born of such investments, and preserving 50% of the profits stemming from the guaranteed investment.

In light of the cumulative progress toward its monetary policy objectives and the outlook for further progress over coming years, the BDL planned another economic stimulus package for 2015 for an amount of $1B. The package encompasses low borrowing rates of 1% for housing and new projects, including renewable energy and environmental projects, and extended loan terms for small and medium-sized businesses.

In particular, the central bank has used large-scale bond purchases to ease financial conditions, more broadly so, as to promote the more rapid achievement of economic growth. BdL's holdings of T-bills and bonds increased 17% during 2014 going from $11.19B to $13.07B.

While stimulating the economy the BDL managed to preserve price stability in 2014. Average inflation rate remained at 1.86%, below but close to 2%. The decline in international energy prices and reduced telecommunications tariffs helped the central bank in maintaining a low inflation rate while adopting an accommodative monetary policy. "Transportation" sub-index and "Communication" sub-index dropped 3.06% and 13.73%, respectively.

The BDL also strengthened the regulatory framework in order to preserve the stability of the banking system and increase its resilience against shocks. The central bank issued, in 2014, new regulations (Intermediate Circular 369) concerning retail loans granted after the 1st of October, 2014. First, Intermediate Circular 369 states that a car or housing loan taken for the purchase of a car or the first house must not exceed 75% of the price i.e., the debtor should pay at least 25% of the good's price as a down-payment. Moreover, BdL restricts the cumulative monthly payments for all retail loans to a maximum of 45% of the household's monthly income, which is the husband and wife's monthly earnings. For housing loans, the cumulative monthly payments must not exceed 35% of the household's income.

A. EXCHANGE RATE

Exchange rate stability was maintained throughout 2014. The BDL was successful in keeping the exchange rate moving within the narrow band it has fixed before of 1500-1515 Lebanese pounds per US dollar. However the exchange rate remained at the higher end of the band, mainly at 1510-1514 LBP per USD, during most of the year, as regional shocks and negative domestic political and security events were always pushing investors towards dollar denominated deposits. However, and despite the rising demand for dollar, the dollarization of deposits slightly inched down from 66.1% by end December 2013 to 65.7% by December 2014.

As a result of the accommodative monetary policy, the balance sheet of the central bank has swollen further since the end of 2013. BdL's total assets surged 11.28% yearly, to stand at $85.70B by the end of 2014. Similarly, its net foreign assets (excluding gold) inched up 7.28% during the same period to a high level of $37.86B, providing it with a comfortable liquidity leeway to protect the currency peg. For comparative purposes, total assets of commercial banks posted a 4.48% increase since year start, to $172.21B by November 2014. Also money supply registered a 5.81% year-on-year growth in 2014.

B. INTEREST RATES

The Lebanese pound yield curve remained stable throughout the year, while that of Eurobonds fluctuated however within a small range. The central bank managed to maintain interest rates at a level that is conducive to economic growth. Interest rates on T-bills didn't change during 2014 with the average yield on the 1-year T-bills at 5.35% while the average yield on the 5-year T-notes stayed at 6.75%.

The average maturity of the government debt securities contracted from 1,274 days in 2013 to 1,193 days in 2014, while slightly pushing up the weighted average yield from 6.86% in December 2013 to 6.89% in December 2014.

On the Eurobonds level, yields on 5-year and 10-year maturities had fallen by 36 basis points and 61 basis points respectively during the year.

Regarding certificates of deposits, interest rates witnessed no change with levels on 45 and 60-day certificates of deposits issued by BDL standing at 3.57 percent and 3.85 percent as of end of December 2014, respectively.

Interest rates on USD deposits ended 2014 at an average of 3.03%, up from 2.92% registered by the end of 2013. As for interests on LBP deposits, they stood at an average of 5.52% compared to the average of 5.44% in 2012. The Lebanese interbank rate went higher in 2014 to reach an average of 3.29% against the 2.75% in 2013.

As of December 2014, granted credits in LBP posted a weighted average interest rate of 7.27% compared to 7.35% in 2013, while loans in dollar average interest stood at 6.95% on average compared to 6.96% in December 2013. The loans' dollarization rate slipped from 75.6% by the end of 2013 to 75.3% in December 2014.

C. TREASURY BILLS

The outstanding treasury securities denominated in the local currency inched up by 9.5% y-o-y from $36.74B to $40.23B. 36-month took again the largest share of the portfolio at 39.6% followed by the 60-month and 84-month maturities that respectively posted 20.2% and 16.9% shares.

The banking sector remained the major holder of Treasury Bills in 2014 with a 51.6% share of the total, compared to the 54.0% stake in 2013. The public sector's share stood at 41.5% accounting for $16.69B in 2014. Individuals and individual institutions saw their share of the portfolio reaching 6.9% and amounting for $2.78B.

BdL's holdings of T-bills and bonds increased 14.4% during 2014 going from $12.22B to $13.98B. As for BDL's portfolio of Eurobonds, it also jumped by 24% from $4.53B to $5.72B. Yields on 5-year and 10-year maturities had fallen by 36 basis points (bps) and 61 bps respectively during the year.

D. MONEY SUPPLY

Over the past year, broad money M3 grew by 5.9% y-o-y to reach $117.68B.

Table 6: Money Supply Components

In ($B)	2013	2014
Currency in Ciculation	2.26	2.41
Demand Deposits L.L	2.79	3.09
M1	5.05	5.51
Other Deposits in L.L	40.55	43.18
M2	45.6	48.69
Deposits in F.X	65.34	68.81
Bonds	0.21	0.18
M3	111.16	117.68
TBs held by Non-Banking Sector	6.13	6.92
M4	117.28	124.59

Source: BDL

LBP and USD denominated deposits grew by 7.36% and 5.35% to $49.52B and $94.90B, respectively. The robustness of the banking sector was also corroborated by the 11.89% annual increase in claims on the private sector denominated in domestic currency to $12.44B in 2014 versus a 6.6% uptick in those denominated in foreign currency to $38.46B.

FINANCIAL MARKETS

A. THE LEBANESE STOCK EXCHANGE

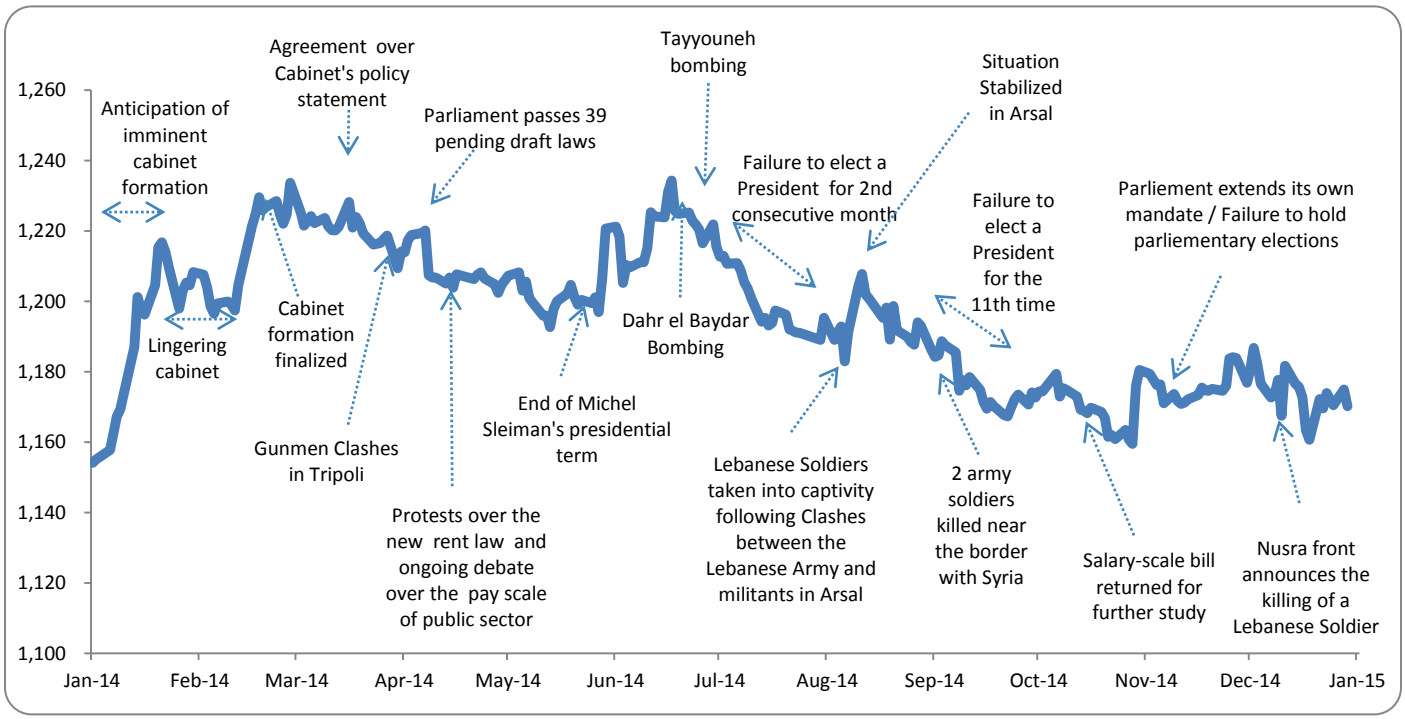
2014 is a live testimony that one event can mean different things in different areas of the globe. The supply glut on the oil market slashed prices by half since June 2014. For the US, this meant lower oil prices at the pump and therefore higher consumer confidence but it also means less pressure on inflation and therefore more time until the Federal reserve decides to increase interest rates.

Listings and de-listings

In the first half of 2014, 200,000 BEMO Bank preferred shares class 2006 were de-listed, 350,000 Bank BEMO preferred shares 2013 were listed and 476,260 additional Audi GDR shares were listed. As of September 30, 2014 /50,000,000/ additional common shares were issued by Bank Audi SAL. As of October 16th, /4,762,000/ Bank of Beirut Priority Shares Class 2014 were listed on the stock market. The Beirut Stock Exchange decided to list, as of December 1, 2014, an additional /1 3,021,942/ GDRs linked to the shares of Bank Audi SAL. These GDRs will be added to the previously listed /102,493,911/ GDRs, therefore, the total number of listed GDRs linked to the shares of Bank Audi SAL becomes /115,515,853/.

2014 has also extended the gaps that were drawn back in 2013. While the Federal Reserve brought its quantitative easing program to a halt in 2014, talks sparked about the ECB starting its own bond-buying program to avoid the risks of deflation. While the US economy has shown signs of a strong recovery with unemployment falling below 6%, Europe continues to struggle to regain economic momentum.

Figure 40: Performance of the BLOM Stock Index amid 2014's Political and Security Developments

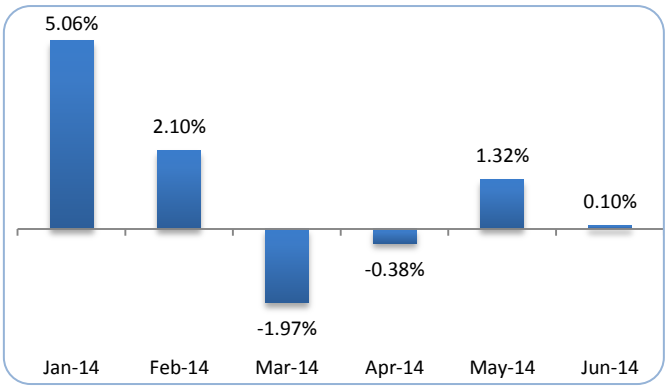


Source: BLOMINVEST Research Department

In Lebanon, the main market movers continued to be the political and security situations. The BLOM Stock Index (BSI) ended the year 2014 at 1,170.26 points, constituting a timid 1.75% yearly upturn. This followed an improving trade activity that totaled 38.67M shares worth $297.55M being traded over the year, compared to a volume of 93.92M shares worth $576.26M the previous year.

The top three performing shares were BLOM GDR, gaining 11.36% to $9.80, BLOM Listed shares, rising by 6.67% to $8.80 and Ciments Blanc Bearer shares with an upturn of 7.14% to $3.75. As for the worst performers, they were Ciments Blanc Nominal with a loss of 15.12% to $2.75, BLC listed shares which shed 12.82% to $1.70 and Rymco's listed shares which declined by 7.71% to $3.23. From a technical point of view, the relative strength index (RSI) for the BSI stood at 48.24 on January 16th 2015. Since the RSI is between the 30 and 70 mark, the BSI is neither overvalued nor undervalued.

Figure 41: Monthly changes in the BLOM Stock Index in H1 2015



Source: Blominvest Bank Research Department

The Promising First Half…

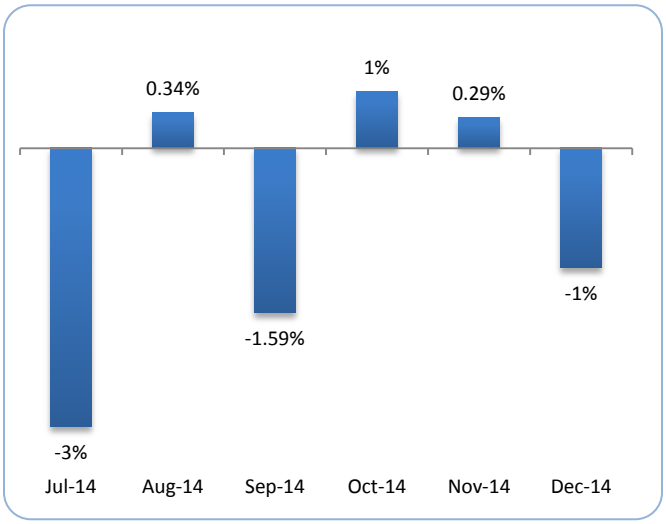
The first half of 2014 (H1 2014) was a positive one for the BSI as it registered a solid 6.24% gain. In details, investors were upbeat in January as an imminent cabinet formation was awaited. Accordingly, the BSI posted a 5.06% monthly upturn during that month, hovering around the level of 1,200 points.

…Was Overshadowed by Negative Performance during the Second Half

Most of the gains recorded in H1 2014 were erased in H2, where the BSI posted a 4% loss. Indeed, the Beirut Stock Exchange suffered from the precarious political, security and economic backdrops

The index closed in the red for the last month of 2014 with a monthly loss of 1.15% and a value of 1,170.26 points. As the year came to a close, givens have not changed but were worsened. The presidential seat remained vacant and the security situation continued to be threatened and fragile. On December 6th, Al Nusra front announced the killing of a Lebanese soldier in captivity. The presidential seat and the issue of the Lebanese soldiers held hostage by extremists remain unresolved at the time of writing.

Figure 42: Monthly changes in the BLOM Stock Index in H2 2015



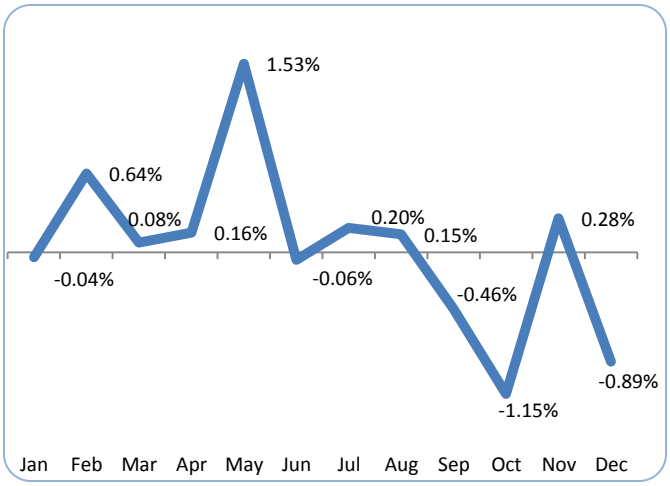
Source: Blominvest Bank Research Department

By the end of 2014, 29 stocks were listed on the Beirut Stock Exchange as compared to 28 stocks the past year. The market capitalization rose by a yearly 6.25% to end the year at $9.78B. In 2014, the number of outstanding shares amounted to 1,552,168,084.

B. THE LEBANESE EUROBONDS MARKET

Despite the overall flat outcome, Lebanon's Eurobonds market finally took off and recovered in 2014 following 3 years of negative performance. The Lebanese safe assets have proven over the year to be highly correlated with the country's political and security environment. The relationship binding Lebanon's Eurobonds market to the local scene was stronger than the impact of the international trend driven by the U.S. Treasuries. Thus, the BLOM Bond Index (BBI) mirrored the local market's performance and added a mere 1.7% y-o-y compared to the respective 0.90%, 1.79% and 3.13% yearly losses recorded in 2011, 2012 and 2013.

Figure 43: BBI Month-ago Performance in 2014 (End of Period)



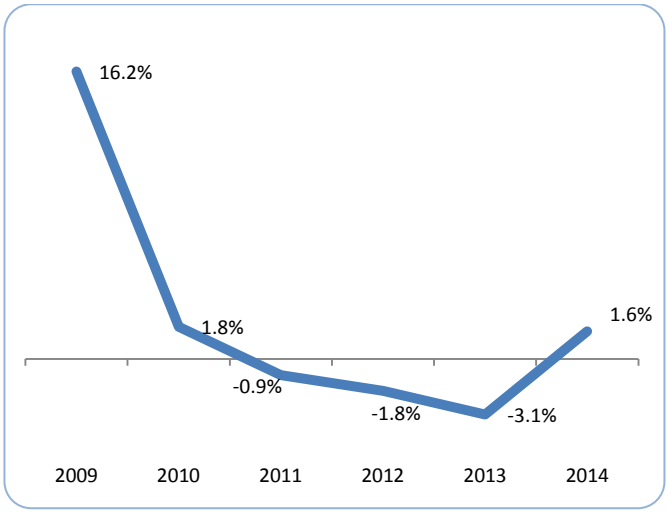
Source: BLOMINVEST Research Department

However, demand for the Lebanese safe assets was partially influenced by the positive performance of the US Treasuries and its implications on the international bond markets in the developing and emerging countries. With political and economic turbulences spreading around the globe, overseas investors preferred investing in U.S. Treasuries on the expense of equity markets and emerging junk bonds. Accordingly, the increasing demand for U.S. Treasuries over the year sent their yields lower with those of the 5Y notes and 10Y bonds decreasing by 10 bps and 87 bps to 1.65% and 2.17%, respectively.

In Lebanon, Eurobonds witnessed a relatively prosperous first half in 2014, while the worsening political and security developments that painted the second half of the year triggered down investors' appeal for the Lebanese bonds market. This explains the BBI's yearly increase after hovering between a lower band of 105 points and a higher band of 109 points to end the year near the middle band at 107.47 points.

Summing up 2014, rising demand characterized the Lebanese market during January-June 2014, leading the weighted average yield on holding the Eurobonds to tumble by 40 bps from December 2013 to 5.22%. However, the latter managed to add 2 bps in the next six months of 2014 to reach 5.24%. As for the 5Y and 10Y Lebanese Eurobonds' yields, they tumbled over the year by 30 bps and 49 bps to 5.30% and 6.16%, respectively.

Figure 44: BBI Yearly Performance (End of Period)



Source: BLOMINVEST Research Department

Lebanese Eurobonds Were Positively Impacted by the Overall Improving Situation in the First Half

The first six months of 2014 saw a rebound in the Lebanese safe assets market on improving security and political conditions. In fact, and after 10 months of political stalemate, the Lebanese new Cabinet was finally formed in February 2014 and a consensus over the controversial policy statement was also reached by the end of March, which spurred a positive market sentiment on the Eurobonds' market. The security plan implemented by the new Cabinet similarly boosted Eurobonds' activity in April and May despite the failure to elect a president and the state of presidential vacuum that did not deter investors' interest on the short term. Accordingly, the BLOM Bond Index (BBI) revealed a 2.33% y-o-y uptick to settle at 108.10 points by end of June 2014, up from 2013's level of 105.64 points.

The deteriorating Security and Political Conditions Sparked Demand for Lebanon's Eurobonds in the Second Half of 2014

Unfortunately, Lebanon went back to its chaotic state on both the security and political fronts as of the second half of 2014, triggering down the Lebanese Eurobonds' market. In this context, H2 2014 started with a political stalemate since parliamentary sessions failed to elect a consensual president placing the country in a presidential vacuum state that continued till the year end. In addition, Lebanon had its share of the regional turmoil, where the first week of August started with clashes between the Lebanese Army and militants in Arsal that ended with jihadists capturing around 29 Lebanese soldiers and policemen. Even though a ceasefire went into effect after almost a week, threats of hostages' execution amounted over the last six months of 2014 worsening security situation and confidence among Lebanese and foreigners. The poor political and security situation were coupled to continuing arguments over the public salary scale sending the BBI down by 0.58% to end the year standing at 107.47 points.

The performance of the medium and long term Lebanese Eurobonds reflected investors' demand that altered between H1 2014 and H2 2014. Each of the 5Y bond and the

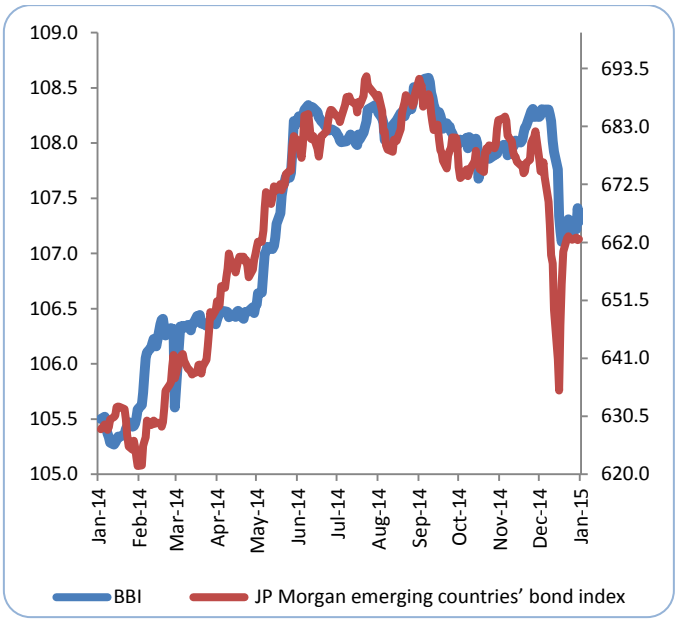
10Y bond saw their yields respectively declining by 57 bps and 44 bps to 5.07% and 6.21% by the end of the first half on improving investors' sentiment. In contrast, H2 that was overshadowed by political and security instabilities pushed the 5Y yield up on negative prospects over the medium term, while expectations of a potential improvement of the situation on the long run triggered the 10Y yield down. In details, the former jumped 23 bps to 5.30% by the end of December 2014, while the latter slipped by 5 bps to 6.16%.

Besides the impact of foreign demand on the Lebanese bonds market, several external factors influenced, to a certain extent, the Lebanese Eurobonds performance in 2014. The international bullish trend in global markets led by the U.S definitely had its partial effect over the Lebanese market.

A debt exchange offer took place by the end of March helping the Lebanese debt market maintain its positive performance. The exchange offer was completed on notes maturing in April 2014 against new longer-dated ones. In details, the Lebanese government's offer and additional notes gathered a participation rate of 79.84%, and resulted in aggregate new issues of $1.4 billion maturity of 2020 and 2026. The new 2020 issues amounting to $600 million yielded 5.8% with an issue price of 100. As for the $800 million tap on 2026 maturities, bonds' prices were quoted at 99.147 yielding 6.7%. The new cash from the 2020 maturities stood at $341.43 million while that from 2026 maturities stood at $354.71 million. The reported allocations were 88.5% on 2020 & 66% on 2026 for local investors, while international orders were around 25% on both tranches.

In the first half of 2014, and despite the irregular global economic growth and the geopolitical tensions in Ukraine and Iraq, many emerging borrowers drew the attention of high-risk investors due to their considerably greater yields. In particular, the JP Morgan emerging countries' bond index edged up by 9.10% on a year-to-date basis by June 2014 to reach 684.97 points. Lebanese Eurobonds could also have been part of the shift of international investors towards bond markets especially the relatively high Lebanese returns offered to foreign investors and funds.

Figure 45: BBI and JP Morgan Emerging Markets Bond Index Year-to-Date Performance



Source: Bloomberg, BLOMINVEST Department

Lebanese Eurobonds vs U.S. Treasuries

In the first half of the year, Lebanese medium-term bonds fared relatively better than their US counterparts. This was revealed by the shrinking spread between the two notes maturing in 5 years. A comparison shows that the spread between the Lebanese 5Y bond yield and its US comparable narrowed from 389 bps to 345 bps by June 2014. However, 10Y U.S. Treasuries slightly outperformed their Lebanese comparable as revealed by the spread between the 2 securities, which broadened by 7 bps to 368 bps.

As for the second half of 2014, the worsening situation of Lebanon and the robust progress of U.S. bonds market widened spreads between the mentioned markets. Correspondingly, the 5Y and 10Y spreads between the Lebanese bond yields and their US comparable widened by respective 24 bps and 41 bps to settle at 371 bps and 409 bps by the end of 2014.

What about the relationship between the 5Y spread and the 5Y Credit Default Swaps (CDS)?

The 5Y Lebanese Credit Default Swaps (CDS) which reflect the perceived default risk of the government, steadied at 394 bps by the end of December 2014 compared to the previous year. Specifically, the 5Y Lebanese CDS witnessed a 48 bps tightening in the first half of 2014 but reverted back by the end of 2014 to its original level.

Given Lebanon's country risk, its CDS remained higher than other regional economies such as Saudi Arabia, Dubai, and Egypt at 67 bps, 227 bps and 282 bps, respectively. The Lebanese credit default risk was also greater than that of numerous emerging markets such as Brazil and Turkey at respective levels of 201 bps and 183 bps. However, the 5Y Lebanese CDS remained respectively lower than the average 5Y Ukrainian and Greek CDS of 2,199 bps and 1,272 bps.

Hence, the 5Y Lebanese CDS (394 bps) was mainly trading in 2014 at higher levels than the 5Y spread between the Lebanese Eurobonds and their U.S comparable (371 bps) for a considerable period. This reveals that there are additional risk factors perceived by international issuers of CDS, not taken into consideration by the domestic investors, the main holders of Eurobonds.

With such a controversial year, the Lebanese Eurobonds' market succeeded in posting positive performance even after following the domestic and regional trends mainly in terms of politics and economy. However, the country' stability remains the main barometer in the bonds market as revealed over 2014 when Lebanese Eurobonds returned several times to positive territories in times when the global trend went against safer assets. This is mainly due to the faithful base of local investors, noting that the major share of government bonds is held by the Lebanese banking sector.

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