



## Monetary Indicators (In \$B)

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

Source: Banque du Liban

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Promoting economic growth and financial stability appear on nearly every central bank's monetary policy agenda. With these broad themes in mind, the particularities of each economy are what set monetary policies apart. In advanced economies, namely the euro area, Japan, the United Kingdom and the US, fighting the worst recession since the 1930s compelled the major central banks to resort to what the International Monetary Fund (IMF) dubbed as "MP-Plus", a combination of exceptionally low interest rates and unconventional policy measures.

In Lebanon, the central bank or Banque du Liban (BDL)'s policy remained true to the objectives it has set upon itself: Boosting Economic Growth, Preserving Exchange rate stability and maintaining the soundness of the financial system.

2013 was a challenging year for monetary authorities as it marked the third year of economic slowdown in Lebanon. Syrian spillovers, security incidents and political turmoil negatively impacted consumption, investment, trade, tourism and public finances. The BLOM Purchasing Managers' Index (PMI) readings are a testament that the private sector has had a challenging year, remaining below the 50 mark separating economic expansion from recession for most of the survey period on account of low levels of output and new orders.

In the face of the rough economic climate, the BDL sought to boost economic growth through a \$1.46B package in 2013. 2013's package, offering credit facilities to commercial banks at a cost of 1% interest, contributed around 1.5% to real GDP growth. The central bank also addressed the untapped sources of economic growth, providing interest free credit facilities for banks wishing to participate in the equity capital of startups, accelerators and venture capital firms. However, after BDL's subsidized loans grew by 28% in 2011, their growth was halted in 2012 and 2013, falling by 25.3% and 22.3%, respectively and calling for another \$800M stimulus bundle for the year 2014.

The Central Bank managed to maintain exchange rate stability throughout the year despite a negative balance of payments. The latter was in the red for the third consecutive year, recording a deficit of deficit of \$1,128.7M in 2013 compared to a deficit of \$1,536.9M in 2012 while the Lebanese pound's peg to the US Dollar remained around stable a midpoint parity of 1,507.5. For the past 15 years or so, and through interventions on the foreign exchange market, the BDL succeeded in cementing confidence in the Lebanese pound as shown by the drop in the dollarization rate of private deposits and loans from 76% and 84% in 2006 to 66.1% and 76.5% in 2013.

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

A prolonged state of economic slowdown, a widening fiscal deficit in addition to the likelihood of interest rates starting to increase in the first quarter of next year, might induce upward pressure on the cost of refinancing public debt. In 2013, the total fiscal deficit grew by 8% or \$294.53M to reach \$4.22B in 2013 with the primary deficit worsening from \$110.12M in 2012 to \$239.47M. The strained government finances led to the 9% increase in net claims on the public sector, going from \$36.22B in 2012 to \$39.51B in 2013.

It is important to note that Lebanese interest rates are also governed by the internal circumstances of the country be it on the political or economic front. The spread between the yield on the Lebanese Eurobonds maturing in 5 years and its US Treasury comparable, reflecting the risk premium, has historically been conditioned by the series of events that occurred in Lebanon. The spread dipped to a low of 165 basis points (bps) in the first half of 2006 with Lebanese yields decreasing on account of a booming economy and hefty capital inflows. The spread also surged to 1,200 bps after fears of the repercussions of the 9/11 attacks on Lebanon steered investors away from the Lebanese Eurobonds market.

Given the low interest rate environment and in spite of the tough economic backdrop, broad money M3 grew by 7% to reach \$111.16B and M5 which includes non-resident deposits advanced by 9% totaling \$139.64B. In fact, the banking system has proved to be resilient in the face of internal and external hurdles, supported by a loyal depositor base. Over the past year, LBP and USD denominated deposits grew by 5% and 11% to \$46.13B and \$90.08B, respectively. The widespread Lebanese diaspora and depositors in Arab markets fleeing the unstable environment are the main factors behind the upturn in deposits. The robustness of the banking sector is also corroborated by the 10% annual increase in claims on the private sector from \$39.6B in 2012 to \$43.75B in 2013.

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

Drawing from a recent paper by Federal Reserve economist Michael T. Kiley, subdued inflation is one of the outcomes of high unemployment. This somewhat applies to Lebanon's case. According to the World Bank, Lebanese unemployment stands at a high 11% in 2010, mostly affecting those under 35 years of age, and is especially worrying amongst youth (34%) and women (18%).

However more data and statistics regarding the Lebanese labor market are essential for future considerations in monetary policy. If analyses reveal that unemployment is structural, then the monetary policy will have little or no effect on the labor market. On the other hand, if a stagnating economy is behind unemployment, then monetary policy can indeed improve labor market conditions by boosting demand and spurring economic growth.

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