External Trade Sees Ambiguous Activity in H1 2014

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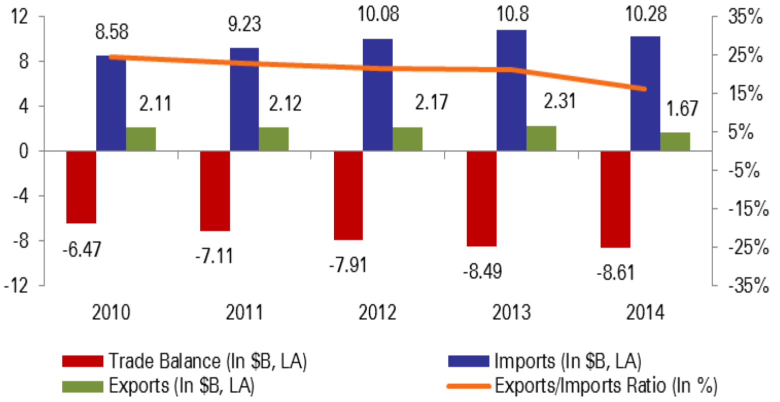
Lebanon's Foreign Trade Performance



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Stepping back in time to the Phoenician era ascertains that external trade of goods and services is embedded in Lebanon's historical DNA. The small country that overlooks the Mediterranean coastal strip used to stand as one of region's top trading and transit hubs. Starting with cedar logs and glass trinkets' trade, Lebanese traders continued their ancestors' legacy in external trading activity that was around $11.95B in the first half of 2014 or 26.3% of the Gross Domestic Product (GDP).

Unfortunately, its strategic location in the Middle East and the accustomed free trades failed to boost the service-driven economy that posted a structural trade deficit of $8.61B in the first six months of 2014, widening by a slight 1.5% y-o-y from the same period last year. Lebanon's trade deficit in H1 2014, which almost accounted for 18.9% of the GDP, barely broadened over the period on frailer external activity resulting from lower levels of imports and exports.

In details, imported goods edged down by a yearly 4.8% to reach $11.98B while exports fell at a faster pace of 28.1% y-o-y to $1.94B in H1 2014. Accordingly, exports covered 16.21% of imports by June 2014, edging down from June's 2013 ratio of 21.44%.

Lower Imports swayed by Global Trends and Developments

Lebanon remained highly dependent on imported goods, yet the degree of reliance seemed to lessen with imports almost 24.37% of GDP in H1 2014 compared to 26.33% of GDP by June 2013. The dwindling import penetration rate[1] in the first half of 2014 is mainly reflecting lower imports and a softening domestic demand especially with the 1.3% decrease in the volume of total imports. In this context, the import penetration rate for the first half of 2014 decreased from 20.45% in H1 2013 to 19.00% by June this year. This could allude to a marginal substitution on the local market in favor of Lebanese products on the expense of imports.

First, oil and its derivatives preserved their leading rank amongst imported goods as the latter is best described as an energy dependent country. However, and despite the considerable demand for energy from local individuals and institutional entities, 2014's international bearish trend in oil prices sent Lebanon's oil imports down depressing H1's total imports as well. In details, mineral products, which constituted 23% of total imports, decreased 11.9% y-o-y to $2.39B. A closer look reveals that mineral fuels, oil and distillation products were behind the previous slip as they lost 12.5% in value to $2.33B. Similarly, mineral products' volume followed suit with a slower yearly decrease of 4.8% in H1 2014 probably due to a lower demand from Syria following the escalation of the turmoil in the country or due to new alternatives.

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[1] *Import Penetration Rate= Imports/ (GDP – Exports + Imports)*100*

Machinery and electrical instruments came second and cost Lebanon $1.13B by June 2013, revealing a 15.2% yearly downtick in value along with a 12.7% slip in volume. The appliances' section is mainly composed of 2 sub-sections: the first contains boilers and machinery while the second covers housing machinery, electrical equipment and parts. The former posted a 5.4% yearly decrease in value to $640.09M, while the latter tumbled by 25.2% to $493.90M on lower imports of electric generating sets.

In contrast, imported chemical products that accounted for 10% of total Lebanese imports managed to rise 4.6% in value to $1.04B and 12.7% in volume to 260.16M tons. Pharmaceutical products, with a 57% share of total chemical products, were at the core of chemicals' rise in H1 2014 as they broadened by 4.6% y-o-y to $588.31M. The volume of pharmaceutical products also increased by 9.0% y-o-y in H1 2014 mainly due to the increased number of displaced Syrian refugees.

Base metals that rank fourth (8% share) also saw improvement in the first half of 2014. Articles of base metals recorded a 9.3% yearly increase in value to $801.25M for a 24.7% surge in volume. Iron and Steel, which constitute 57% of total base metals' imports, recorded a 19.5% y-o-y surge in value to $457.62M, while their volume edged up by a yearly 28.9%.

During the first half of 2014, Lebanon almost preserved its main sources of imports. China topped the list, grasping the lion share with 12% of the total. Electrical instruments, base metals and textiles were the main imported products with respective stakes of 28%, 27% and 10% of total Chinese imports to Lebanon. Italy maintained its 2nd rank for the third consecutive year and mainly exported petroleum products (43% of the total) and electrical instruments (12% of the total) to Lebanon in H1 2014. USA and France followed with a similar 7% stake while German imports took 6% of total Lebanese imports.

Regional Upheavals pull down Lebanese exports in H1 2014

As for exports, the degree of reliance of local producers on demand from foreign markets seemed to be deteriorating in the first half of 2014 mainly due to the internal and regional uprisings. This was disclosed by the export propensity index[2] that showed a very low figure of 3.7% compared to 5.2% in H1 2013.

In fact, the precious metals' industry worsened in 2014 on lower international gold prices, increasing competition worldwide and lower demand in some Arab and European markets. Pearls, precious stones and metals that contributed to 18% of total exports saw their value slash 43.6% y-o-y by June 2014 to 302,946 while their volume tumbled 35.9% from H1 2013's level. As for the yellow metal alone[3], gold exports saw a substantial fall in value of 72.3% y-o-y to $219.55M in the first six months of 2014.

Exports of agro-industrial products were on the rise in H1 2014 along with the deteriorating industrial conditions in Syria. The interruption of exports' transportation through the Syrian border had a positive aspect on agro-industrial external activity as some importing markets of Syrian food products shifted their demand to neighboring countries such as Lebanon to compensate for the decrease of Syrian exports. The paralysis of the Syrian economic sectors was mainly behind the 18.4% jump in prepared foodstuffs, beverages and tobacco section to $265.89M coupled with a 20.2% y-o-y rise in volume from H1 2013's level. In particular, preparations of vegetables, fruits and nuts (25% of total prepared foodstuffs) edged up by 14.7% to $67.44M, while beverages, spirits and vinegars (19% of total prepared foodstuffs) added 11.6% to $50,093. Edible preparations also increased 26.4% to $47,658, noting that they constitute 18% of total prepared foodstuffs.

Machinery and electrical instruments were the 3rd highly exported products in H1 2014 with a 14% share of the total. Their value shed 14.6% to $226.15M, while their total exported volume slipped at a slower pace of 5.7% from H1 2013's quantity. While boilers and machinery exports inched up by 8.9% y-o-y to $121.88M, foreign demand for housing machinery, electrical equipment and parts fell 31.3% to $103.99M.

Exported quantities of base metals stood in the 4th rank with a 12% stake of total imported goods. Their total value reached $192.60M in the first six months of 2014, 37.3% below H1 2013's level.

2 Export Propensity Index = Exports/GDP.

3 including gold plated with platinum

This was the direct result of decreases in the value of iron and steel (-39.6%), copper (-57.8%) and aluminum (-9.4%).

As for major export destinations, South Africa and Saudi Arabia both ranked first with a similar 11% share of total exports in H1 2014. 99.2% of exports to South Africa were pearls, precious or semi-precious stones, precious metals, while Saudi Arabia mainly imported machinery and electrical instruments (16% of the total), products of the printing industry (9% of the total) as well as Preparations of vegetables, fruit, nuts (8% of the total). UAE stood second with a 9% stake as the Emirates mainly imported precious metals and pearls (27% of the total) along with perfumery, cosmetic or toilet preparations (10% of the total).

The critical security developments in Iraq and Syria triggered down both countries into the 4th and 5th ranks in Lebanon's top importers' list. Lebanon mainly exported machinery and electrical instruments (32% of the total) in addition to perfumery, cosmetic or toilet preparations (12% of the total) to Iraq. As for Syria, 30% of Lebanese exports to the war-ridden country were prepared foodstuffs, 13% were vegetable products and 12% were chemical products such as soaps, surface-active agents, waxes and tanning extracts.

Trading activity between Lebanon and Syria witnessed a slowdown in the first half of 2014, yet remained in favor of Lebanon. The shift that started in 2012 was enhanced by the escalation of war in Syria making Lebanon one of the few providers of goods and necessities into Syria. Yet, 2014 saw the intensification of events in Syria which narrowed possibilities of trade between both countries. In fact, the balance of trade between Lebanon and its troubled neighbor stood at a positive $55.78B in H1 2014 compared to $278.12B in H1 2013.

Finally, trade activity saw a retreat in the first half of 2014 hand in hand with the negative overall economic performance and the political instability of the country. Spillover effects of the 3-Year war in Syria also weighed on external activity of the country despite that the war carried some new dynamics to the country's economy. Besides local developments, imports and exports activity will remain highly interdependent with the global events and trends in terms of international commodity prices, security and borders' situation etc..

By the year end, positive prospects could partly offset the first half's negative performance especially with Russia banning European and U.S. products and the possibility of Lebanon exporting agricultural products to the 9th most populous country in the world. Over the long term, and once the ongoing political deadlock painting the country is over, projects to start extraction of oil and gas from the Lebanese shore should be initiated the earliest possible. This action could alter Lebanon's trade structure towards a healthier scheme.

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