A resilient economy in a precarious region

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Although political tensions and security clashes intensified in the region during 2011, and Europe was going through a severe debt and financial crisis, the Lebanese economy showed a remarkable resilience. Lebanon managed to register a growth rate of 3% as per BLOMINVEST estimates (official estimates, however not the final ones, put the growth rate at 5.2%) in 2011. The decline of the growth rate from the high-gear recovery period, where economic growth averaged 8.2% over the past four years, was due to reasons related to both political and economic issues. On one side, domestic and regional tensions are still weighing on investors' confidence. On the other side, and concerning the closure of the output gap during the previous years, the government's inability to undertake the necessary public infrastructure investments and structural reforms to increase potential output, continues to limit investment opportunities in the Lebanese economy.

The year 2011 kicked off on a low with the collapse of the Lebanese national unity government on January 12, along with external headwinds stemming from the outbreak of the Arab Spring early in the year. The local political stalemate lasted until June with the country running without a governmental body and missing by that a window of opportunity, that of being perceived as a safe haven for the MENA region. Conversely, regional developments, coupled with local political paralysis, have functioned as a hindrance for Lebanon in terms of economic growth, wiping off Lebanese confidence in the market and pressuring economic activities. The slowdown became a well-established fact for the country over the first half of the year with an estimated mere 1.4% economic growth rate.

The second half of 2011 proved more promising, with the establishment of a new government in June. This broke the deadlock observed earlier in the year and paved the way to promising governmental developments that brought in relative domestic strengths. The financing of the energy investment plan to provide 24 hours of electricity supply within the next four years was finally agreed upon. In the communications sector, the government approved a bill opening the door for faster internet connection speeds and reduced prices. The parliament also passed the capital markets law after five years of wait. The law insures a regulatory framework for the markets, paving the way to a potential expansion of activities on the Beirut Stock Exchange. However, deteriorating regional developments have prevented a stronger economic rebound despite encouraging local developments.

CONSUMER SPENDING

Major consumption indicators ended the year on a positive note with their performance over the second half of the year more than compensating their sluggish evolution in the first half. On the private expenditure and private investments fronts, claims on the private sector recovered in the second half of the year, increasing by 13.3% y-o-y in 2011, after having recorded an increase of 6.9% y-o-y over the first half of 2011. Growth in the value of cleared checks rose by 5.4% y-o-y to US$71bn up to December, and their number followed suit, going up by 1.25% y-o-y to 13.06 million.

The continuous acceleration of food and energy prices during the year offset the decline in prices of other consumption items that were impacted by the weak global demand. Consumer Price Index (CPI) increased by 4.77% up to December 2011, up by 0.78 percentage points from a year earlier due to imported inflation.

TOURISM SECTOR

The direct impact of internal political tensions and neighbouring social upheaval reached first and foremost the two-pillar sectors of the Lebanese economy, tourism and real estate. Before the eruption of the Arab Spring, the former sector had been expanding rapidly and significant private investments were being made in the upgrading and expansion of restaurants, hotels and other tourism-related services to meet and satisfy the surge in demand. The government has also invested efforts on that front through several agreements with Turkey and China to ease visa requirements and boost the number of flights with these countries. In 2009 alone, there were over 1.9 million visitors, recording a 39% rise from a year earlier, the highest rate of growth in the world.

This, however, compares with the decline of the sector over 2011. The number of tourists fell by a sharp 24% y-o-y in 2011 to 1.4 million tourists while the number of arrivals at the Beirut International Airport remained flat over the same period, mostly dragged by regional instability as Arab tourists account for the bulk of visitors to Lebanon. The downfall continued despite the stability brought in on the local front with the formation of the government back in June.

REAL ESTATE SECTOR

The performance of the real estate sector falls along comparable lines. In the post 2006 July war period, Lebanon witnessed a boom in the sector which was dependent to a great extent upon the demand of Lebanese expatriates, as they acquired over 60% of the residential and commercial projects, and of Arab investors who faced a surge in liquidity during the period and were incentivised by several decrees facilitating foreign ownership in Lebanon. The growth was hence a healthy one, driven by fundamental factors, and accentuated by a promising political climate brought in by the Doha accord in 2008.

Investments in the real estate sector account for the bulk of Lebanon's FDI, out of which the Arab contribution is on average 96%, which emphasizes the susceptibility of real estate in Lebanon to Arab demand that is largely determined by regional economic and political developments.

Thus, severe regional political pressures over 2011, led to a sharp drop in real estate sales in Lebanon. The value of real estate transactions declined by 6.7% y-o-y up to December to US$8.8bn. The share of sales to foreigners made up a mere 2.02% of total sales transactions.

This has consequentially created a shift in the type of buyers from people coming from abroad, namely Lebanese expatriates and Gulf Arabs, to local residents who are usually on a smaller budget. Hence, the demand for luxury Lebanese property and extravagant apartments has been substituted for more affordable spaces in terms of size and location. Also, the geographic distribution for demand has shifted from expensive areas such as the capital to lower priced areas such as Mount Lebanon.

The fall in property sales was not met with a weakening construction activity. Cement deliveries were up 5.8% y-o-y during the year as they represent ongoing construction activity for which permits have been issued in the past, most probably before the eruption of the Arab Spring.

Yet looking forward, the outlook for activities in the sector does not look as resilient as it is showing today. Construction permits, which echoes the level of upcoming supply in the construction sector, plunged by 6.8% over the considered period, bringing down prospects for the sector.

EXTERNAL SECTOR

The jump in oil and food prices weighed heavily on both the trade and capital balances. Oil prices have undergone a 40% spike over the first half of the year before reversing gradually their upward trend. The hike in prices, along with unstable political conditions, led to the stagnation in volume of total imports while their value grew by 12.2% y-o-y to US$20.16bn. Lebanon's exports also struggled to get products to the markets as most delivered goods transit through Syria, but the stimulus plans introduced in several Gulf countries encouraged demand abroad with exports managing to remain constant during the year at US$4.3bn. Overall, the trade deficit was up by 15.9% y-o-y to US$15.9bn in 2011.

The overall regional turmoil and internal tensions put downward pressures on capital inflows. The slowdown led to a negative balance of payments of -US$2bn in 2011, down from a surplus of US$3.3bn a year earlier. Yet the heavy orientation of the economy towards the GCC countries which are benefiting from relatively high oil prices and large government stimulus packages should help keep remittances and banking sector deposits inflows high.

FISCAL POLICY

By contrast to the external sector's performance and in spite of the regional unrest, the fiscal position of Lebanon improved over the year. While public spending rose on several factors among which were higher allocations to Electricite du Liban, the rise was counteracted by higher fiscal revenues, being backed by an additional transfer of US$865m (over the 2010 level) worth of proceeds from the Ministry of Telecom. The outcome was a narrower budget deficit that contracted by US$553m to close at US$2.3bn or 5.9% of GDP. The primary balance registered a surplus of US$1.7bn or 4.2% of GDP, up by 35% from a year earlier. Overall, the debt-to-GDP ratio fell to 134% in 2011 from 137% in 2010.

Gross public debt reached around US$53.6bn by the end of 2011, 2% higher than its level a year earlier. Both, foreign currency and local currency debt, experienced a rise although the latter was more accentuated reaching around US$32.7bn by the end of the year. The largest subscribers of treasury bills and bonds during the year were the Central Bank of Lebanon with a 50% share, the commercial banks with a 31% of subscription, , followed by public institutions with a 17% share.

On the foreign currency debt front, the total reached US$21bn at the end of the year. The Ministry of Finance issued successfully during the year three series of Eurobonds. The first transaction occurred in May 2011 and was run by Byblos Bank, Fransa Invest Bank, and HSBC.

It consists of a US$1bn double-tranche offering; the first amounts to US$650m, maturing in May 2019 and carrying a coupon rate of 6.00%; the second part of the issue, amounting to US$350m, is a reopening of the 6.10% coupon Eurobond due October 2012 at a yield of 6.475%; and with international orders accounting for 29% of subscriptions. The second transaction was jointly led by BLOM Bank S.A.L. and Citi Bank in July 2011. The first tranche of which carries a value of US$500m, maturing in 2016 with a coupon of 4.75%; the second tranche, amounting to US$700m, matures in 2022 with a 6.20% yield. The third Eurobond issue occurred in November 2011, managed by Standard Chartered, Deutsche Bank, and Fransa invest Bank. The issue consists of a triple tranche offering; the first amounts to €445m, maturing in November 2018 with a coupon rate of 5.35%; the second amounts to US$500m maturing in November 2019 with a coupon rate of 5.45%; and the third amounts to US$375m maturing in November 2026 with a coupon rate of 6.60%.

THE EUROBONDS MARKET

Lebanon's market for foreign currency denominated debt, or Eurobonds, remained relatively stable due to sustained support from local lenders and an overall conservative monetary policy. But while the confidence from financial institutions succeeded in shielding Lebanese debt from external pressures, domestic and regional political uncertainties muted Eurobonds market gains.

In Lebanon, markets recovered in the second half of 2011 after suffering a blow early on in the year following the resignation of the Cabinet. Both equities and bonds recorded substantial losses due to a panic-driven sell-off and sudden foreign capital outflows. The BLOM Bond Index (BBI) lost 2.8% to reach 108.91 points by January 21, 2011 driving the portfolio's average weighted yield up to 5.65% from 4.78% and widening the spread against the US benchmark yield from around 300 bps to 400 bps. As the initial fear-driven reaction subsided, institutional investors that customarily hold papers until maturity seized the opportunity to buy into the undervalued and high-yielding Eurobonds. The market was thus quick to recover, regaining most of its losses by year end.

The BBI ended 2011 at 110.94 points with a mere 1% annual loss, while the average weighted yield on holding Lebanese Eurobonds slid back to its year start value of 4.78%.

MONETARY POLICY

Despite a negative balance of payments, the ample stock of currency reserves at the Central Bank was adequate enough to absorb the net outflow of capital, caused by shocks coming from the internal political bickering in the first half of the year and regional instability throughout the whole year. Hence, monetary stability was maintained and the peg preserved with the exchange rate fluctuating within the set range of L.L.1,500; L.L.1,515. The foreign assets of the Central Bank (excluding Gold) reached US$32.3bn by the end of 2011, rising by 5.2% from end-2010. The good management and prudential policies adopted by the Central Bank were perceived as successful by the International Monetary Fund (IMF) and other major international agencies. To note that Mr. Riad Salameh's term as the Central Bank's Governor, was renewed in June 2011 for another six years.

Money Supply (M3) rose by 6.5% y-o-y at end-December 2011 to US$98.2bn on higher demand deposits. Good monetary management helped pressure down the dollarisation rate of broad money, as it fell by 7bps to 59.57%. The overnight interbank rate stood at 2.75% by end of December.

BANKING SECTOR

The Lebanese banking sector showed robust balance sheet in 2011 despite the deceleration in economic and business activity, and the increasing tensions among local political parties as well as the ongoing regional protest movements. In fact, the consolidated balance sheet of commercial banks recorded a yearly growth of 9.04% in 2011 to reach US$140.58bn, compared to a 12% growth recorded in 2010. As a percentage of the nation's gross domestic product (GDP), total assets accounted for 346.5% in 2011, up from 328.9% in 2010. Resident and non-resident private sector deposits at commercial banks rose by 7.94% y-o-y to attain US$115.71bn. Claims on resident and non-resident private sector grew at a faster pace than deposits reaching 97.05% of GDP compared to 89.1% in 2010. The dollarisation rate of resident and non-resident private sector loans fell to 78.4% in 2011 from 80.28% in 2010 as the Central Bank continued to encourage lending in the local currency. Claims on public sector edged 0.31% down to US$29.22bn as treasury bills in Lebanese pounds held by banks dropped 6.19% to US$16.48bn.

LOOKING INTO 2012

The first few months of 2012 showed an economic rebound from the previous year. The increase in wages and salaries at the beginning of the year in addition to increased capital inflows boosted domestic demand, with imports jumping by 30% in the first quarter of the year compared to the same period last year. Exports registered also an increase of 21% during the same period. Other indicators of economic activity like government revenues, cleared checks, and loans to the private sector were on the upside. Moreover, the real estate activity is showing signs of resilience with the value of real estate transactions increasing by 4% in the first four months of the year.

However, it remains difficult to assess the outcome of the year 2012 in terms of economic growth. The tourism sector has not yet recovered as the ambiguity over the political prospects in the region and the internal political bickering are still hindering its recovery. In the construction sector, the area approved by construction permits declined by 2.7% in the first quarter of 2012 compared to the same period last year. Hence BLOMINVEST expects the economy to grow gently at a rate within the range of 3.5% to 4.5%, depending on the degree of political stability. The growth would arise from a gradually recovering tourism sector starting in August, a resilient real estate sector, a strong banking activity, and trade.

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