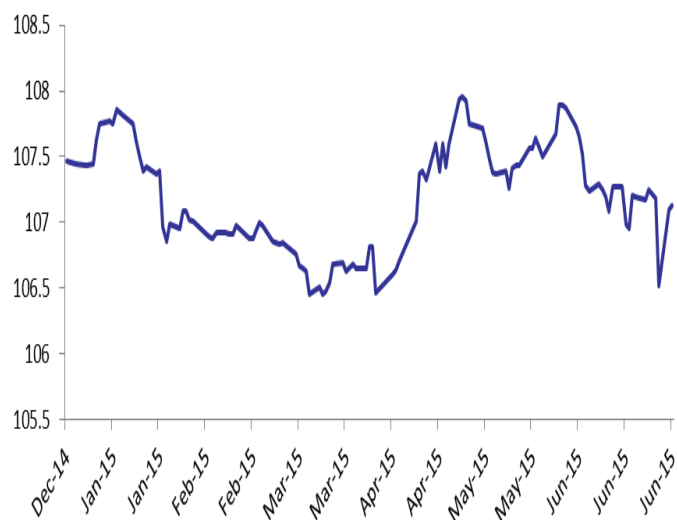


Performance of the BLOM Bond Index (BBI) in H1 2015



Source: Blominvest Research Department

August 21, 2015

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The year 2015 still portrayed key problems for Lebanon on the political and economic fronts. Parliamentary sessions for the election of a new President were and, are still, regularly postponed, rendering legislation and decision making ever more difficult. On the economic front, external and fiscal deficits have persisted, pushing the public debt further up.

The performance of the Lebanese Eurobonds' market in the first six months of 2015 was rather subdued, but remained relatively resilient in the face of the sour economic and political scenes. In fact, the BLOM Bond Index (BBI) ended the first half of 2015 at 107.13 points, down by 0.31% year-to-date and down by 0.89% year-on-year. The weighted average yield of Lebanese Eurobonds, which is in an inverse relationship with the price, rose in H1 2015. After ending the year 2014 at 5.24%, the weighted yield surged to 5.49% at the end of June 2015.

The subdued performance of the BBI mainly came about due to lower demand for shorter term maturities as demand for medium and long-term maturities seemed to have been strong in H1 2015. The yields on the Lebanese Eurobonds maturing in 5 Years and 10 Years declined from 5.30% and 6.16% at the end of 2014 to 5.20% and 6.06% at the end of June, respectively.

In spite of Lebanon's economic issues, investors are still confident as shown by the successful Eurobonds issuance in February. In February, the Ministry of Finance launched a Eurobond issuance of \$2.2B, the largest in history, with BLOM Bank, Citi, and Société Générale des Banques au Liban (SGBL) as lead managers. The issue was divided into two categories: the \$800M of 10Y Eurobonds maturing in 2025 and yielding 6.20%, and \$1.4B of 15Y Eurobonds yielding 6.65%.

The issuance was successful with strong appetite from both local and foreign investors. The issuance was 5 times oversubscribed with bids hovering around \$4.9B. International orders were promising as they were around 15%, which could be partly due to the overflowing cash in the global financial markets following the decreasing oil prices.

Details of Lebanon's Largest Eurobonds Issuance

	\$800M Issuance	\$1,400M Issuance
Issuer	Republic of Lebanon	Republic of Lebanon
Type	Bond	Bond
Coupon	6.65%	6.20%
Maturity Date	2030	2025

The ministry of Finance however noted that the amount of Eurobonds it is entitled to issue falls short of its 2015 needs. Parliament authorized only a \$2.5B Eurobonds issuance for 2015, leaving the Ministry with leeway to issue only \$300M worth of Eurobonds in 2015. However, the foreign financing needs of the government for the remainder of the year are at \$2.2B.

In the US, the treasuries' market has proven its resilience even as an increase in federal fund rates looms ahead. The US Treasury Bond Index compiled by Bloomberg ended the year 2014 at 114.77 point, only to increase by 5.23% to 120.87 at the end of June 2015. The yield on the US Treasury notes maturing in 5 years slid from 1.68% at the end of 2014 to 1.63% at the end of June 2015. However, the yield on the benchmark 10 Year notes increased from 2.20% to 2.35% over the same period, indicating lower demand for those papers.

The US Treasury market continues to benefit not only from uncertainties regarding the date of the hike in interest rates but also from "worrisome" factors in the global economy. In fact, the Federal Reserve had initially announced that the interest rate liftoff would take place in June 2015 only to postpone that event to September 2015. Even for September, some market participants remain skeptical which in turn preserves the "safe asset quality" offered by US treasuries and keeps demand for them robust. Second, the "zero-risk" aspect of holding US treasuries continue to be appealing amidst global headwinds such as the Greek crisis and the economic slowdown in China in addition to the strong U.S. Dollar.

Lebanese Eurobonds Still Benefitting from Investor Confidence in H1 2015



Major Foreign Holders of Treasury Securities, In Billions of US Dollars

Country/Date	Jun-15	Dec-14	Jun-14
China, Mainland	1,271.20	1,244.30	1,268.40
Japan	1,197.10	1,230.90	1,219.30
Caribbean Banking Centers	318.50	272.40	250.60
Oil Exporters	296.70	285.90	262.10
Brazil	256.30	255.80	253.70
Ireland	217.70	202.00	177.10
Switzerland	217.10	190.10	175.90
United Kingdom 2/	214.70	188.90	173.60
Belgium	207.70	335.40	364.10
Luxembourg	184.00	171.80	145.30
Hong Kong	181.30	172.60	157.60
Taiwan	175.60	174.40	179.40
India	117.00	83.00	72.90
Singapore	113.70	110.00	98.10
Mexico	86.30	84.80	72.80
Korea	76.70	68.30	57.50
Turkey	75.80	77.00	52.80
Germany	75.30	72.70	68.00
Russia	72.00	86.00	113.90
Canada	68.60	69.00	66.20
France	67.80	79.20	63.10
Norway	66.10	81.60	87.10
Sweden	40.00	39.60	34.90
Philippines	39.90	40.60	34.60
Colombia	37.80	34.70	33.50
Netherlands	36.80	36.20	36.30
Australia	34.10	34.50	35.30
Italy	33.00	31.90	31.30
Spain	31.60	27.70	23.20
Thailand	31.40	33.20	41.30
Chile	29.00	25.50	27.20
Kazakhstan	28.40	31.60	35.10
Poland	28.20	27.70	29.50
Israel	20.00	25.20	26.10
Denmark	17.10	16.70	16.00
Vietnam	13.60	14.00	14.40
Peru	11.60	10.90	12.80
All Other	185.70	189.90	208.20
Grand Total	6,175.20	6,156.00	6,018.70

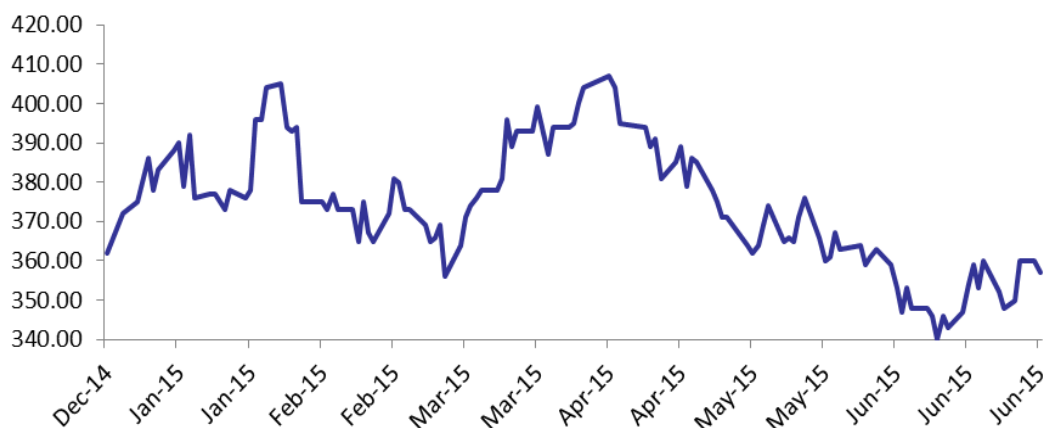
Source: Department of the Treasury/Federal Reserve Board

Despite the ongoing political deadlock, investors' confidence in Lebanon's fixed income papers seems to have strengthened, which could be due to the stable security situation. The spread between the yield on the 5 Year Lebanese Eurobonds and their US comparable narrowed from 362 basis points (bps) at the end of December 2014 to 357 bps at the end of June 2015. The same goes for the 10 Year spread, which narrowed from 396 at the end of December 2014 to 371 bps at the end of June 2015.

Lebanese Eurobonds Still Benefitting from Investor Confidence in H1 2015



5Y Spread between Lebanese Eurobonds and their US Comparable



Source: Blominvest Research Department

The notion of confidence and resilience on the Lebanese Eurobonds market is cemented further by the narrowing of the country's 5 Year Credit Default Swaps (CDS) quotes. The 5 Year CDS quotes, which reflect how investors perceive the government's risk of default, narrowed from 362-396 bps with a mid-price of 379 bps at the end of 2014 to 352-378 bps with a mid-price of 365 bps at the end of June 2015. This sign of increased confidence may have been brought about as the security situation in 2015 remained under control.

However, when compared to regional economies, Lebanon's CDS quotes remains quite high. At the end of June 2015, the 5Y CDS quote of Saudi Arabia stood at 58.04 bps, that of Dubai at 319.04 bps and that of Egypt at 303.67 bps.

When benchmarked against the emerging bonds market, the BBI was outperformed by the JP Morgan Emerging Markets Bond Index. The latter registered a 2.53% year-to-date increase to reach 674.99 points at the end of June 2015. As long as the low-interest rate environment persists, emerging bond markets will remain attractive to investors. Moreover, fears of any future volatility have been eradicated by some market players which believe that the outflows that could have been brought about by a potential Fed rate hike have already retreated from the market. According to the International Institute of Finance's Emerging Market (EM) Portfolio Flows Tracker, "EM Bond flows rose marginally to \$1.2 billion in June, continuing a five month streak of subdued inflows (averaging \$2 billion per month, compared to \$15 billion per month in 2012-2014)."

Lebanese Eurobonds Still Benefitting from Investor Confidence in H1 2015



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