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The political and security developments in Lebanon and the region continued to weigh heavily on the Lebanese economy during 2015. GDP growth declined to 0.5% and could have turned negative if not for the initiatives of the central bank. The activity of the private sector, measured by the Purchasing Managers' Index for Lebanon (BLOM PMI), recorded an average of 47.4 points during the first 11 months of the year, below the 50 mark that separates contraction from expansion.

The balance of payments deteriorated more than last year and recorded a deficit of \$2.17B during the first 10 months of the year compared to a deficit of \$867.7M during the same period last year.

Fiscal policy is constrained by the high public deficit and debt, and by a paralyzed government due to the internal political bickering.

In this contest, of low growth and impotence of fiscal policy to boost economic growth, the central bank took the lead and tried to kick-start the economic engine through monetary policy easing and the use of unconventional instruments.

As a result of the accommodative monetary policy, the Lebanese Central Bank's (BDL) balance sheet swell with its total assets growing by 7.29% y-t-d to \$91.95B by end November. This resulted from the 25.91% and 18.28% increase in its securities portfolio and its loans to the local financial sector to respective amounts of \$17.60B and \$4.99B, by end November. In contrast, the central bank's foreign assets ticked down slightly by 0.13% since year start, remaining however at a high level of \$37.81B by November 2015, a comfortable liquidity cushion to protect the pegged currency. On the liabilities side, financial sector deposits and public sector deposits grew 9.72% and 2.99% to \$74.05B and \$6.23B, respectively. As for money supply, it registered a 3.74% growth from 2014, to \$122.08B, in September 2015.

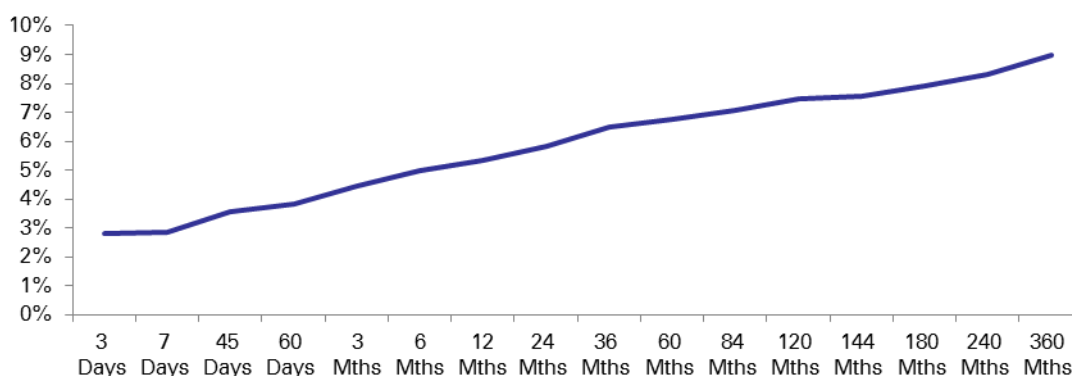
Exchange Rate

Amidst economic and political difficulties in the country, in addition to extreme fluctuations in major global currencies, the Lebanese Central Bank (BDL) managed to keep the exchange rate moving with the narrow band it has fixed before at \$/LP 1,500 – 1,515. Nevertheless, during most of the year, the exchange rate remained at the higher band of \$/LP 1,510 – 1,514. However, the exchange-rate peg remained a major anchor for confidence and stability.

Interest Rates

Similarly, the Lebanese Pound yield curve remained stable throughout the year. Interest rates on T-bills remained at their levels during 2015, with the average yield on the 1 year T-bills at 5.35%, while that of the 5 year T-notes stood at 6.75%. BDL's holdings of Treasury Bills grew 16.21% y-t-d, to \$15.19B, by September 2015. The average maturity of government debt securities denominated in the domestic currency broadened from 1,193 days in December 2014 to 1,228 days as at the end of September 2015, pushing up the weighted average yield from 6.89% end of 2014 to 6.93%, end of September 2015. On the Eurobonds level, yield on 5-year and 10-year maturities surged by 115 basis points (bps) and 68 bps to 6.45% and 6.84%, respectively at the end of November.

Lebanese Yield Curve

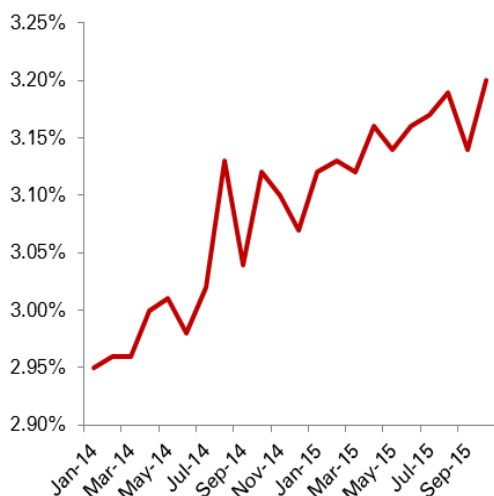


Source: BDL

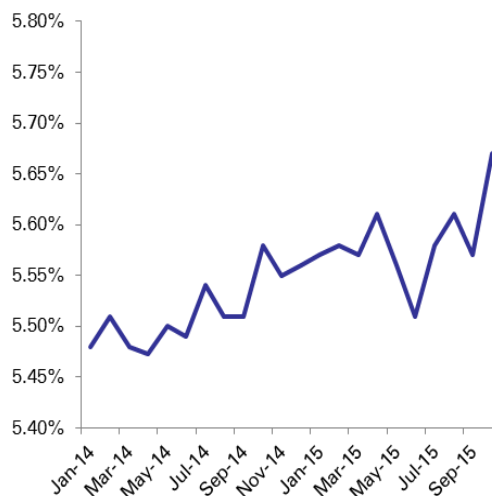
Regarding certificates of deposits (CDs), interest rates on 45-days and 60-days CDs steadied at respective rates of 3.57% and 3.85%, at the end of October 2015. The Lebanese interbank rate decreased from an average of 3.29% in 2014 to 2.83% in 2015.

Moreover, the interest rates on deposits also remained relatively stable. The weighted average rate on LP deposits fluctuated slightly between 5.51% and 5.67% with an average of 5.58% during 2015, while that on \$ deposits oscillated between 3.12% and 3.20% with an average of 3.15%. Private deposits denominated in the Lebanese Pound grew at a pace of 6.54% y-t-d to \$52.76B, faster than the 1.53% y-t-d growth to \$96.35B of private sector deposits in foreign currencies. Hence, the dollarization rate of deposits slid from 65.71% in December 2014 to 64.62% by end October.

Weighted Average Interest Rate on \$ Deposits



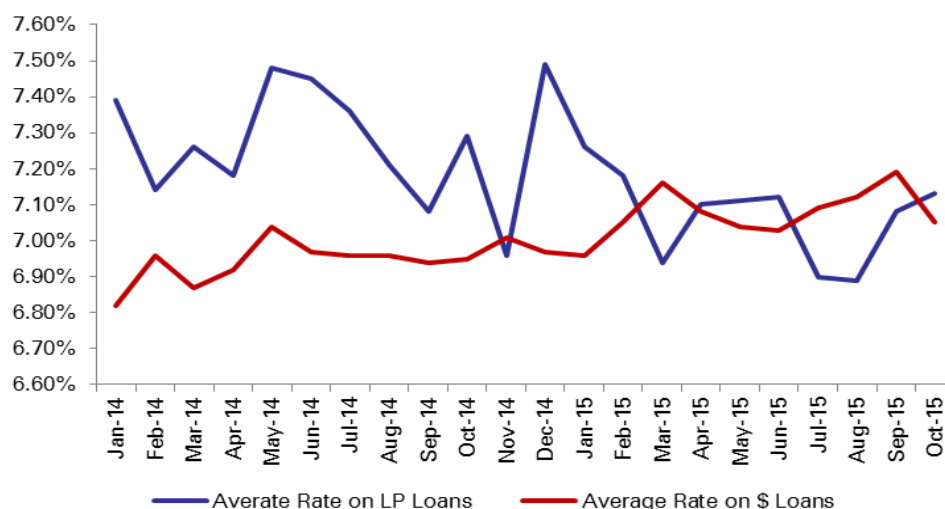
Weighted Average Interest Rate on LP Deposits



Source: BDL

As for the rate on loans, the weighted average rates on loans denominated in the local and foreign currency followed diverging trends. The weighted average rate on loans denominated in the Lebanese Pound went down from 7.49% end of 2014, to 7.13% in October 2015, due to the subsidized loans initiative by the central bank. Thus outstanding private sector loans denominated in local currency surged by 7.27% y-t-d to \$13.34B, by the third quarter of 2015. In contrast interest rate on loans in dollar inched up from 6.97% in December 2014 to 7.05% in October 2015. Outstanding private sector loans denominated in foreign currencies grew by 2.10% y-t-d to \$39.27B, by September 2015. Accordingly, the dollarization rate of private sector loans went down from 75.56% by the end of 2014 to 74.64% by September 2015. As for loans to the public sector, commercial banks holdings of Eurobonds grew 3.44% to \$16.87B, while their holdings of T-bills dropped 2.57% \$20.40B.

Weighted Average Interest Rate on Loans



Source: BDL

State of Commercial Banks

The banking sector remained impervious to the political and security developments, with the consolidated assets growing by 3.21% since year-start to \$181.34B by September 2015.

The solid confidence in the banking sector was highlighted in the ongoing progress of its deposits and lending activity. As a matter of fact, residents and non-residents remained confident in this sector, as their deposits grew 3.25% since year-start to \$149.11B at the end of the third quarter of 2015. Even though deposits kept on posting positive performance, their progress is slackening. In fact, private sector deposits recorded a growth of 7% by September 2013, compared to a lower rate of 4.45% during the same period of 2014. As for loans to the private sector, which constituted 29.01% of total assets of commercial banks, they edged up by 3.36% y-t-d to \$52.61B by September.

Unconventional Monetary Policy

As security and political developments continue to repress the economy, the central bank continued with its monetary stimulus that started in 2013 to ensure new jobs and provide necessary financing for small and medium enterprises. Hence in 2015, BDL launched a third new stimulus package of LP 1,500 B (\$1 B). The Central Bank provided low cost incentives to the private sector through banks to encourage investments in vital sectors such as tourism, agriculture, industry, IT, environment, housing and education. In addition, hoping that the knowledge sector would become one of the pillars of the Lebanese Economy, BdL initiated the “Knowledge Economy”- where information is capitalized for the creation of new goods and services with a high value added. 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. Till now, more than \$250M have been invested in the knowledge economy, contributing to around 1% of GDP.

In this context, the central bank will introduce another \$1.5B incentive package in 2016 and offer these loans to banks with 1% interest only. In return banks will provide loans to different sectors with special emphasis on environmental projects and housing.

Moreover, due to the fragile economic conditions and slowdown in growth in Lebanon, BDL issued a new circular in October 2015, that allows the restructuring of substandard and doubtful debt portfolios (excluding all subsidized and soft loans) of banks and financial institutions upon a mutual consent between the borrower and creditor, under the oversight of the Banking Control Commission. The purpose of this circular is to improve financial markets and reorganize the relationship between debtors and creditors. If the borrower is involved with many banks and financial institutions, the borrower should have the approval of two-thirds of the creditor banks and financial institutions that hold at least 60% of the debtor’s total bank debts.

BDL is also about to issue a circular that will facilitate the creation of real estate fund that can be set up by banks, financial institutions, and individuals to buy properties or invest in projects.

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