Sept. 13th 2019

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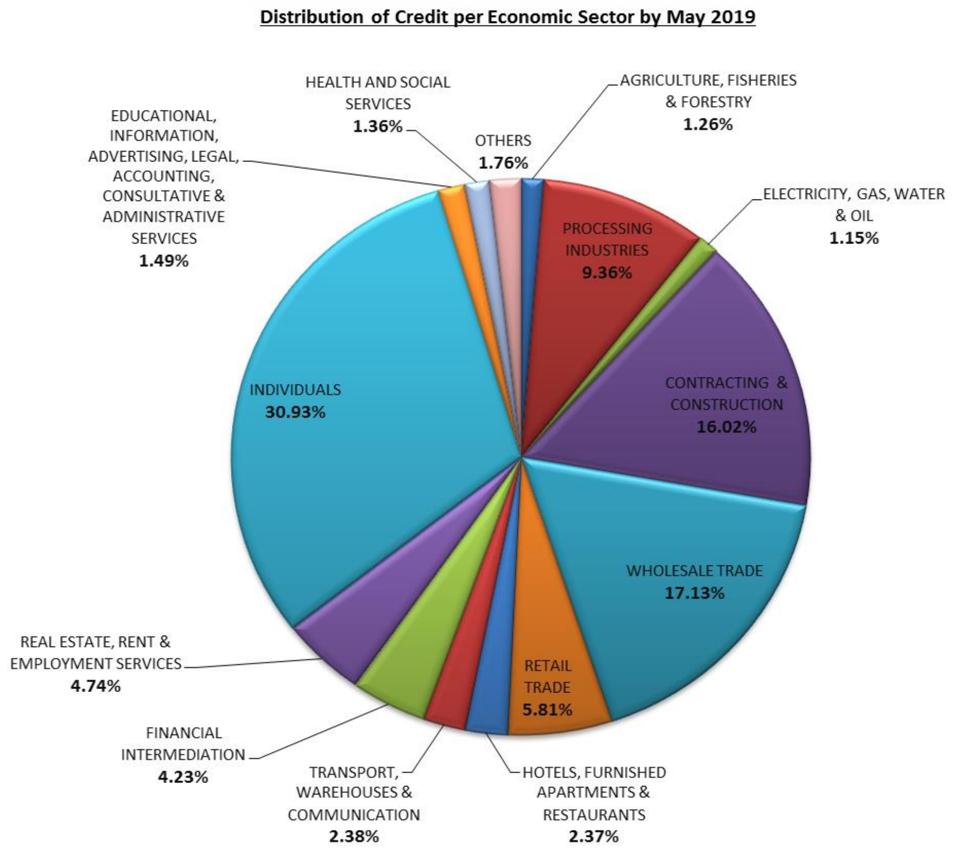
Overview

Growth in the Lebanese economy was capped in H1 2019 whilst Lebanon's private sector continued to be crowded out. Lebanon is known for its ability to maintain financial stability despite political and economic turmoil. Nonetheless, the environment of high interest rates pushed the country into sectorial slowdowns in the first half of the year, amid a persistent crowding-out of the private sector. Actually, BDL's data reveals average interest rates on loans in LBP and USD reached highs of 10.75% and 9.54% by May 2019, compared to 9.97% and 8.57%, respectively, in December 2018. While the country attempted to form a new government and approve a draft budget for 2019 after years of their lack thereof, prolonged parliamentary negotiations and austerity measures sparked social rioting. As a result, the PMI score, a predictive power for economic growth, had averaged 46.6 by May 2019, down from 46.7 in the same period last year. Accordingly, economic growth remained subdued, ranging between 0% and 0.5%.

The lower value of utilized loans extended to the private sector pointed towards a challenging year. Total credit by banks amounted to $63.55B by May 2019 (excluding loans to financial intermediation), down by 4.33% since year start noting that these loans are "utilized" and therefore differ from the total outstanding loans reflected on banks' consolidated balance sheet. The utilized loans extended to all 18 economic sectors in BDL's dataset witnessed downticks, except those allocated to the sectors of "agriculture, fisheries, & forestry" and "health & social services" (constituting a combined 2.63% of the total credit). The composition of total loans remained largely similar to past years'. However, for the first time in years, loans to "construction and contracting" ranked 3rd, outweighed by loans to "trade activities" which came in 2nd largest after loans to "individuals" by May 2019.

Moreover, non-performing loans (NPLs) grew since year start. The 2019 slowdown spread across the country's economic sectors noting that banks' total NPLs rose by a substantial 20.92%YTD by May 2019, as per BDL's latest data. It is worthy to highlight that "Construction & contracting" and "Wholesale trade" grasped the major stakes of 23.95% and 23.45% of total NPLs, respectively.

Scrutinizing banks' financing in Lebanon can reveal the least (most) active economic sectors of 2019. Capital markets in Lebanon still contribute marginally to the financing of the economy. As such, the lending activity by the bank remains the primary indicator of the sectors which actively sought financing in the first five months of 2019. In details, credit to "Individuals" grasped the lion's share (30.93%) of total loans, followed by 22.94% for "Wholesale and retail trade" combined, and 16.02% of total loans for "Construction and contracting". In addition, the sectors of "Processing industries", "Real estate, rent & employment services" and "Financial intermediation" grasped the respective shares of 9.36%, 4.74%, and 4.23% of total loans over the same period.



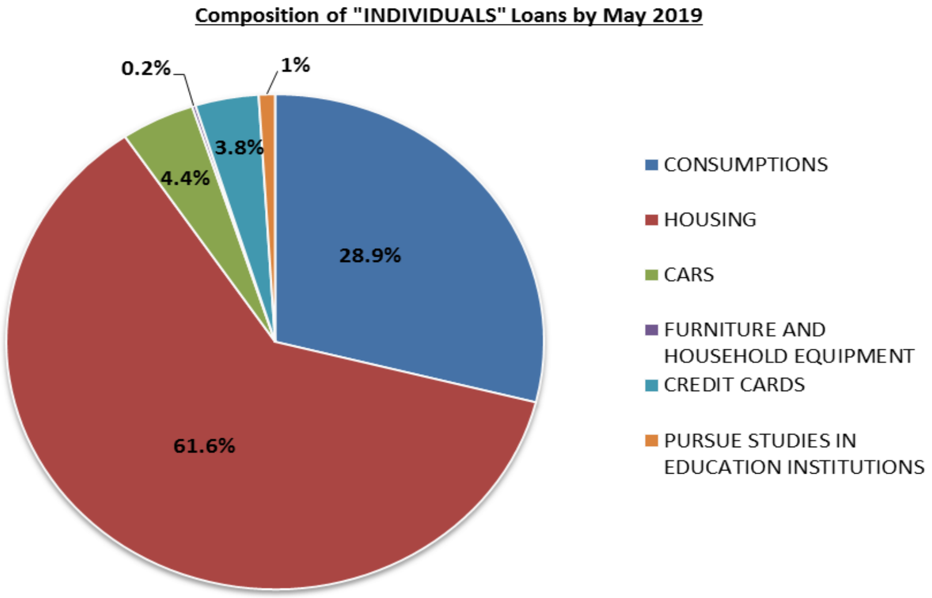
Source: BDL; BLOMInvest Bank

Loans to Individuals: Downticks across the Large Sub-components

Housing constituted a significant stake of bank lending to "individuals". In the first 5 months of 2019, banks granted a total value of $20.5B in loans to "individuals" (inclusive of: housing, consumption, car, and credit card loans), down by 2.95% since year start. Housing Loans grasped the largest credit allocation of the category, constituting 19.1% of total utilized bank loans over the period. These loans decreased by 1.84% year-to-date (YTD) to stand at $12.65B by May 2019, noting that BDL withdrew the housing loans subsidy scheme by end 2018. BDL then issued Circular #515 in January 2019 by which it aimed to re-activate subsidizing housing loans. However, the total allocation for the 2019 housing subsidy program only amounted to LBP300B[1], with a loan ceiling set at LBP450M per loan. This most probably explains why demand for housing loans in the first few months of 2019 is not being met, given the limited supply of housing loans for the people despite BDL's 2019 initiative. In addition, the tighter terms of the loans with

[1] BDL's initiative essentially allocated a total of LBP790B ($524M) to subsidize housing loans in 2019, of which LBP490B was reserved to settle 2018 dues, thereby leaving LBP300B for 2019 housing loans.

higher interest rates and limited supply weighed down on the banking sector, such that housing NPLs by May 2019 rose by 14.28% since year start.

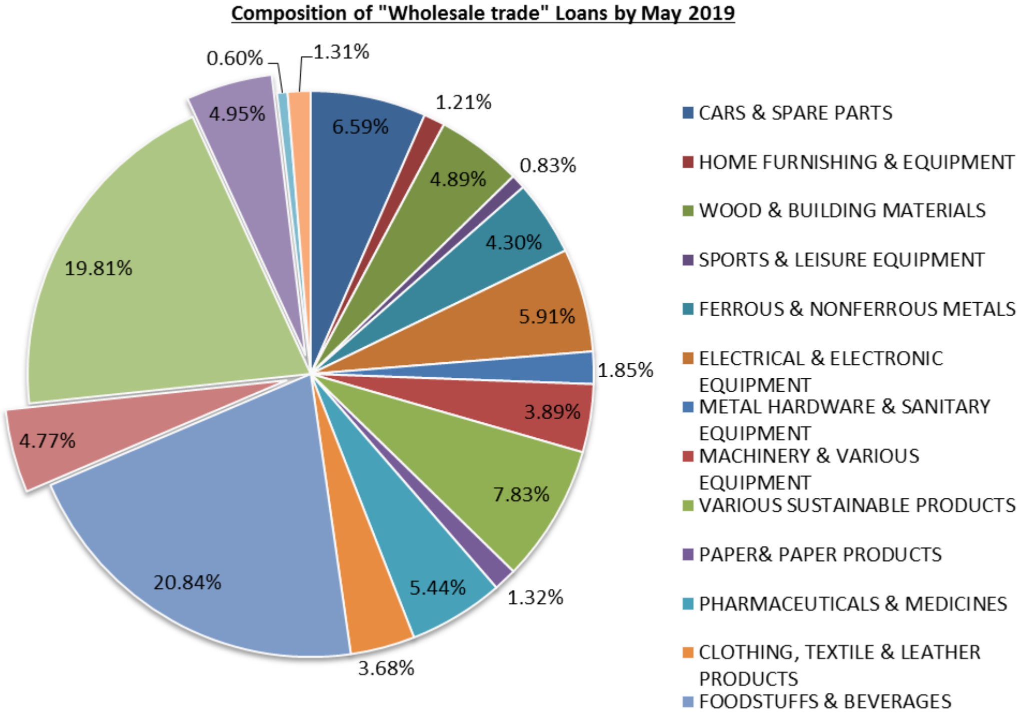


Source: BDL; BLOMInvest Bank

Loans to "consumption" and "cars" came in second and third largest, respectively. As the pie chart reflects, consumption loans witnessed a 5.16% YTD decline and amounted to $5.94B by May 2019. The decline in consumption loans is an eminent indication of the lack of people's appetite for loans that can help finance their daily needs, largely due to the burdening interest rates on those loans in the current state of the economy as mentioned at the beginning of the study. In their turn, car loans witnessed a sharper contraction, slipping by 11.2% since year start and totaling $909.18M which goes hand-in-hand with the slowdown witnessed in the sector since early 2018. In fact, the Association of Lebanese (AIA) car importers attributed 2019's consecutive drops in the registration of new passenger and commercial cars partly to, *"[…] the banks' imposing a down payment of 25% and rais[ing] the interest rate from 3.9% to 8.5% on car loans […]"*. This also reflects that cars have become secondary needs to the people during such times of high uncertainty.

In turn, credit card loans witnessed a 7.98%YTD upturn, but their NPLs also shot up. Credit cards accounted for 3.8% of total loans to individuals and grew to reach $780.74M by May 2019. The increase can be partly attributed to the 0.16%YTD and 0.7% yearly uptick in the number of outstanding credit cards in May 2019 which stood at 580,838. However, the uptick is not entirely a positive indication, given that the NPLs on credit card loans jumped by 25.95% YTD.

Wholesale Trade: 2nd Largest Recipient of Bank Credit

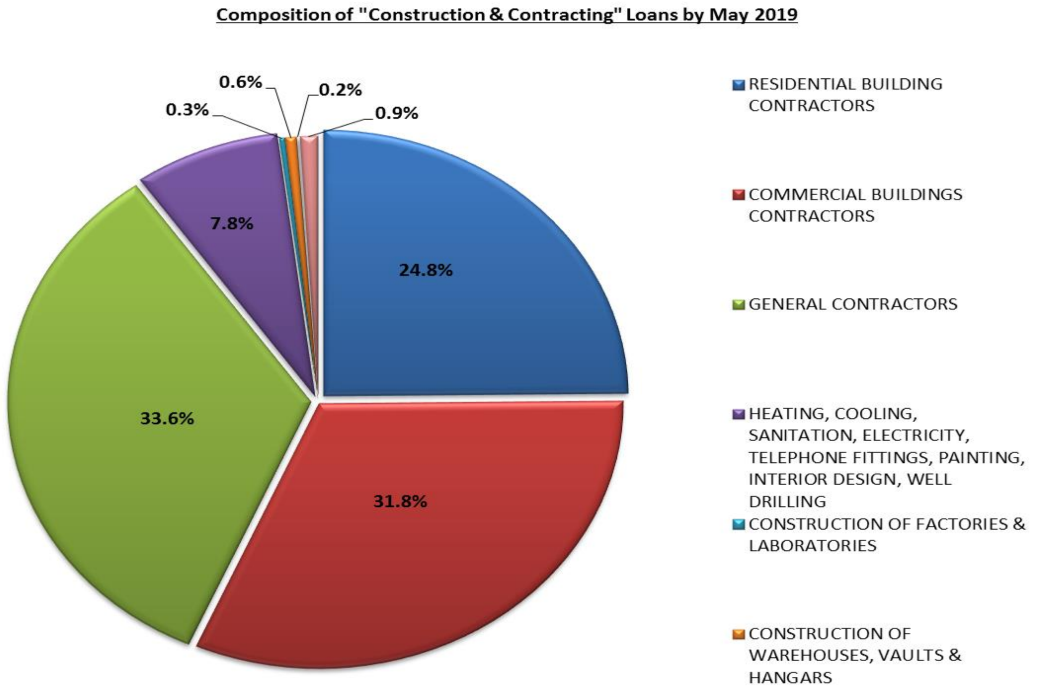


Source: BDL; BLOMInvest Bank

Credit to "foodstuffs & beverages" and "oil products" were the biggest loan recipients of wholesale trade. For the first time in years, the "wholesale trade" sector in Lebanon grasped the 2nd largest stake (17.13% of total utilized bank loans) from January to May 2019, followed by "construction" (16.02% of total utilized loans) which is considered to be one of the country's key growth drivers. Nonetheless, credit to "wholesale trade" slipped by 1.88%YTD to settle at $11.37B over the same period. In fact, the biggest loans recipient was "foodstuffs and beverages" which is one of the largest Lebanese product-categories set for export. This last grasped 20.84% of total wholesale loans. Nevertheless, loans to foodstuffs fell by 7.71%YTD to stand at $2.37B. Meanwhile, loans to "oil and oil products" (19.81% of total wholesale trade) reached $2.25B by May 2019, up by 0.76%YTD, partly owing it to the price of oil growing by 19.8%YTD to $64.5/barrel by end-May 2019.

Interestingly, banks' utilized credit to "cars & spare parts" grew, which may reflect higher demand for used cars or car repairs. Loans to wholesale traders dealing with cars and their spare parts added 4.21%YTD to **$**749.77M by May 2019. Given the difficulty and costs of obtaining car loans for new cars, consumers may be demanding and preferring price friendly used cars or resorting to repair their own at affordable costs within the economic uncertainty.

Construction & Contracting: Evident Sectorial Slowdown, Rising NPLs



Source: BDL; BLOMInvest Bank

Investors' diminished appetite for new real estate projects capped banks' credit to construction and contracting. Bank loans to the construction sector constituted 16.02% of total utilized loans between January and May 2019. In fact, these amounted to $10.63B, compared to December 2018's $11.15B, noting that their NPLs rose by 9.44% YTD. The slower lending activity was in-line with the 19.2% annual decline registered in construction permits by May 2019, which further corroborates the lack of investment appetite in the sector. In addition, the number of real estate transactions fell by a yearly 16.2% to 19,024 valued at $2.44B by May 2019. It is important to note that banks are tightening the terms of real estate loans, to reduce large costs and free their portfolios from big positions in RE.

In details, the value of utilized bank loans to general contractors, commercial buildings contractors, and residential contractors within the category slumped. Credit to these top 3 loan recipients composed 90.2% of total loans' value within the category and the sub components registered the respective downticks of 3.59%, 5.11%, and 8.37% since year start and totaled $3.6B, $3.4B, and $2.6B by May 2019.

Future Outlook

Banks' lending activity clearly diminished in the first 5 months of 2019 and we don't expect an immediate reverse in the trend. The slower lending can be partly attributed to banks' precautionary measures. In addition, credit to the private sector is contracting as the domestic and regional political-economic pressures further contribute to the environment of high interest rates. It is noteworthy to add that the persistent crowding out of the private sector caps national consumption and investment, noting both must be top priorities.

BDL has played a critical role in fostering the credit cycle, but other measures are needed. BDL has enabled banks to extend loans to certain sectors in the past few years to nurture growth through its various incentives and subsidies. In fact, the central bank relaunched the housing loans subsidy program in January 2019, yet alone, it was not enough to lift the sector or boost investors' appetite and confidence in the country. While BDL's financial tools so far managed to safeguard the peg and financial stability, a national reform agenda to discipline Lebanon's fiscal deficit and growing debt levels remains a necessary condition to restore confidence.

Involving the private sector in the government's plans can further boost investors' confidence in the country. Besides the central bank's and authorities' roles, other business-targeting measures can help raise awareness on the importance of developing capital markets, which in turn can integrate Lebanon's SMEs and offer them alternate financing sources. In its turn, attracting foreign investment also remains a high priority.

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