SGBL EcoNews

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INFRASTRUCTURE, UPBEAT CONSUMER TO DRIVE GROWTH IN 2018

- **Swap transactions with MoF lift BdL's foreign assets to a record $45.3bn in May**
- **Coincident indicator rose by 3.9% yoy in the first quarter of 2018**
- **PPP advisory contracts signal progress towards CEDRE objectives**

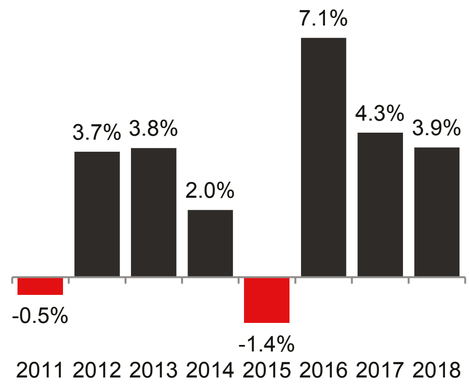
Lebanon concluded in early May its first Parliamentary elections since 2009, a key milestone towards reinvigorating the country's democratic process in the post-Syrian conflict period. The current Prime Minister Saad Hariri secured the support of 111 out of 128 deputies in his bid to form the next Cabinet. His agenda is expected to be centered on overhauling the country's infrastructure by tapping into soft loans pledged by the international community at April's CEDRE conference, as well as commitment to a policy of disassociation from regional conflicts agreed among governing parties in late 2017.

The forthcoming Cabinet will face a range of international risks that challenge the country's economic and financial prospects. Monetary tightening by the Fed and the US pullout from the 2015 Iran nuclear deal are adding to risk perception in the region, resulting in a surge in Lebanese bond yields that started in April 2018. However, Lebanese sovereign Eurobonds across all maturities remain "undervalued" as of the end of April, stated Goldman Sachs, a US-based investment bank. Capital Intelligence also affirmed in May Lebanon's short-term and long-term foreign currency "B" ratings with a stable outlook, citing adequate international liquidity, a reliable investor base, and strong donor support.

The Ministry of Finance (MoF) had raised in mid-May $5.5bn through a private placement with Banque du Liban (BdL), giving it sufficient liquidity to settle maturing Eurobonds and to cover its foreign currency obligations in the remainder of 2018. New issues were swapped by MoF for an equivalent amount of local currency Treasury bills held by the Central Bank, with the expectation that the latter would also subscribe to LBP8,250tn ($5.5bn) in Treasury bills maturing in 3 to 10 years and yielding 1%.

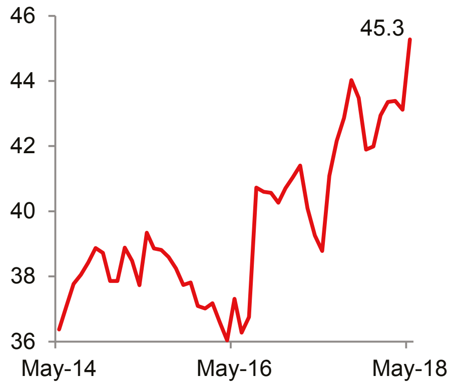
BdL has since on-sold $3bn of its portfolio of Eurobonds to local banks, leaving it with $4.7bn worth of sovereign foreign currency debt, equivalent to 8.2% of its dollar assets. As a result, BdL's non-gold foreign assets hit a record $45.3bn at the end of May, an increase of $3.2bn in the first five months of the year. Eurobonds transactions with MoF and banks will contribute

BdL Coincident Indicator (1Q, % yoy)



Source: BdL, Economena, SGBL Research

BdL foreign assets, excluding gold ($bn)



Source: BdL, Economena, SGBL Research

to an upswing in the balance of payments in the second quarter of the year, as per BdL's methodology, after posting a deficit of $207.5m in the first quarter.

MoF plans on tapping into international markets for its next round of bond issurances in late 2018 or early 2019.

MoF also plans on tapping into international markets for its next round of bond issuances in late 2018 or early 2019 subject to conditions in emerging markets. Lebanon's 2018 budget law had increased the ceiling on foreign currency debt by $6bn over the next 30 years, and authorized the refinancing of maturing obligations throughout the period.

The government relies on deposit inflows to the banking system to finance its chronic deficits. Moody's Investors Service, a credit ratings agency, stated in May that deposit inflows under its base scenario would remain sustainable despite recent political headwinds, citing the Central Bank's stabilizing policies and higher deposit rates. Customer deposits were indeed buoyant at the start of 2018; commercial banks grew their private sector deposits by $2.1bn to $170.7bn in the first quarter, compared with growth of $1.9bn over the same period in 2017, BdL data showed.

Meanwhile, real economic activity appears better than financial markets suggest, with the exception of the real estate and construction sectors which were hit hard by the Central Bank's decision to cut back on its stimulus for housing loans. BdL's Coincident Indicator, a composite index of main economic indicators, increased by an average of 3.9% yoy in the first quarter of 2018.

With real estate and construction lagging behind, consumers have taken the lead in driving economic growth in recent months. Consumer confidence levels are running high on stable security, normalized political processes, and income growth following the approval of a new public sector salary scale in late 2017. Household incomes will not reflect the full effects of the new salary scale until the end of 2018 and possibly into 2019 with the government regularly expanding the number of beneficiaries to include workers at various government-owned enterprises.

The index of retail sales compiled by the Beirut Traders Association grew by 3.3% yoy in first quarter of 2018, its fastest pace since 2012, reflecting strength in personal consumption spending activity in the capital. Consumers are also pulling the trigger on big-ticket items; new registered passenger vehicles, a proxy for private spending, increased by 2.4% yoy to 36,753 vehicles in the 12 months through April 2018, data by the Association of Car Importers showed.

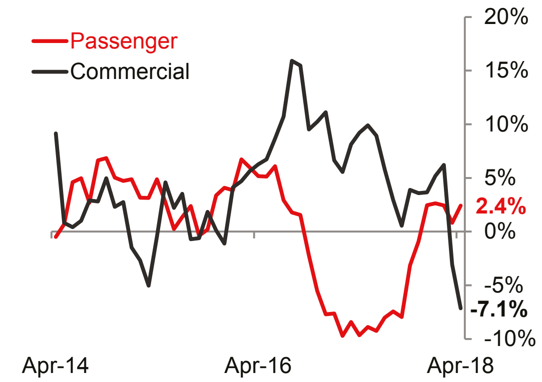
Rebound in tourist activity and in expatriate remittances adds to positive prospects for consumption in 2018. Tourist arrivals increased by 5% yoy to 362,398 visitors in the first quarter, their second highest level on record. At the same time, remittance inflows rose to a record $8bn in 2017 on the back of higher oil revenues in the GCC and faster economic growth in the US and Europe which host sizeable populations of Lebanese expatriates.

Lebanon signed advisory contracts for three major infrastructure projects at an estimated cost of $4bn.

Investment in infrastructure is also slated to make a comeback under the government's Capital Investment Program. Lebanon signed in May advisory contracts for three major infrastructure projects at an estimated cost of $4bn, a swift move by the outgoing Council of Ministers (CoM) to capitalize on concessional loans from April's CEDRE conference. The three projects - the expansion of Beirut airport, a Beirut-Okaibeh highway, and a national datacenter - will be tendered as Public Private Partnerships with advisory support from international multilateral institutions.

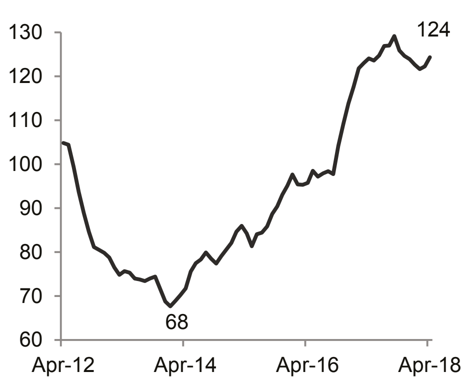
The CoM also cleared the way in May for the addition of nearly 1,150MW in power to the electricity grid over the next three years, the latest attempt to eliminate power outages and reduce the burden of electricity subsidies on the state's budget. In particular, it gave the nod for the conversion of a 540-590MW power plant project into a 20-year Power Purchase Agreement, potentially ending a five-year standoff with the contractor. The government is looking to reduce power outages to no more than 3 hours per day as a precursor to raising electricity tariffs, unchanged since 1996, and reducing subsidies to the state's electricity company.

New passenger car sales (12m average, % yoy)



Source: AIA, Economena, SGBL Research

Consumer confidence (12-month average)



Source: ARA, Economena, SGBL Research

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CABINET CLEARS WAY FOR A SUBSTANTIAL EXPANSION IN POWER SUPPLY

- **Deir Ammar plant project to be turned into 20-year Power Purchase Agreement**
- **MoEW plans four new wind power farms at a combined capacity of 400MW**
- **Electricity production hit a record high of 3.6bn kWh in the first quarter of 2018**

Lebanon's Council of Ministers (CoM) cleared the way for the addition of nearly 1,150MW in power to the electricity grid over the next three years, the latest attempt to eliminate power outages and reduce the burden of electricity subsidies on the state's budget.

The CoM gave the nod in May for the conversion of a 540-590MW power plant project into a 20-year Power Purchase Agreement (PPA) under a "Built-Own-Transfer" model at a rate of 2.95 cents per KwH, subject to the contractor's approval.

The project was awarded to Greek-Cypriot firm J&P-Avax in 2013, but had been stalled by a dispute between the company and the government over the Value Added Tax. The new combined cycle power plant, which would be located in Deir Ammar near Tripoli, was originally expected to be delivered within 25 months at an estimated cost of $470m.

The CoM simultaneously gave its approval for a 3-year extension of the contract for two power ships with Turkish energy group Karadeniz at a cost of 4.95 cents per KwH. The two ships have an installed capacity of 406MW, supplying up to 370MW of power to Electricité du Liban since 2013. A third power barge by the same company is slated to provide an additional 200MW during the peak summer months, according to the Ministry of Energy and Water (MoEW), reducing daily electricity rationing by an average of 1.5-2 hours.

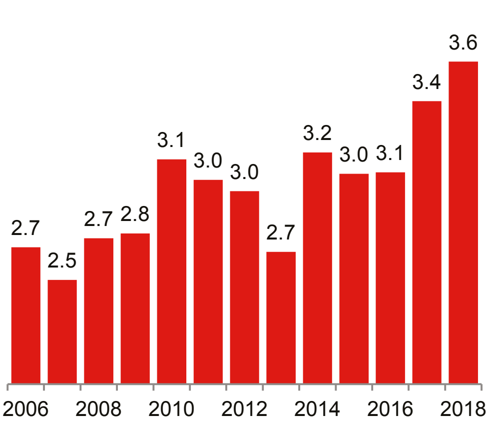
Meanwhile, MoEW received expressions of interest from 42 local and international consortia for the construction of four wind energy farms at a combined capacity of up to 400MW. Successful bidders will be awarded 20-year PPAs to help meet the country's goal of generating at least 12% of its energy needs from renewable sources in 2021-2025.

In the meantime, the CoM announced plans to launch a tender for the supply of an additional 850MW of temporary power to cover the country's electricity deficit. The government is looking to reduce power outages to no more than 3 hours per day as a precursor to raising electricity tariffs, which have been unchanged since 1996, and reducing subsidies to the state's electricity company.

The government is looking to reduce daily power outages to less than 3 hours as a precursor to raising electricity tariffs.

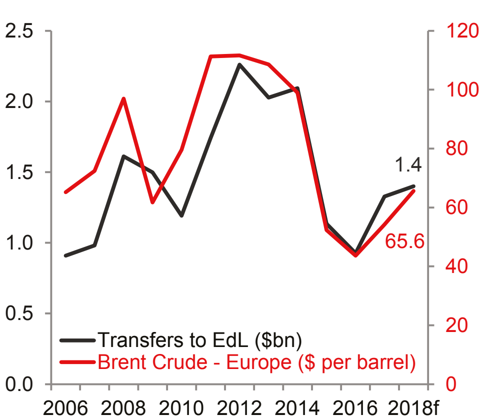
Electricity production reached a record high of 3.6bn kWh in the first quarter of 2018 as new plants come online. As a result, daily power outages outside Beirut decreased by 12.5% yoy to 7.3 hours in the first five months of 2018, but remained unchanged at 4.5 hours in the capital over the same period. Government transfers to EdL are projected in the 2018 budget law to grow by $100m to $1.4bn during the year as a result of higher oil prices.

Electricity production (1Q, kWh, bn)



Source: BdL, Economena, SGBL Research

Government transfers to EdL and oil prices



Source: MoF, EIA, Economena, SGBL Research

BANK DEPOSITS BUOYANT, LOAN GROWTH STALLS IN 1Q 2018

- **Private sector deposits grew by $2.1bn in the first quarter of 2018**
- **Deposit inflows sustainable despite political headwinds – Moody's**
- **BdL sold $3bn in Eurobonds to local banks, discounted the equivalent in CDs and deposits**

Customer deposits were buoyant at the start of 2018, but Lebanese banks still shrank their private sector loan portfolios after the Central Bank scaled back its stimulus package for housing and other sectors. Commercial banks grew their private sector deposits by $2.1bn to $170.7bn in the first quarter of 2018, compared with growth of $1.9bn over the same period in 2017, data by Banque du Liban showed.

Deposits in foreign currencies grew by $1.4bn through March, while local currency deposits rose by $725.5m, reflecting a greater level of risk averseness among depositors. The Central Bank had raised local currency rates in November 2017 to stem a wave of conversions to foreign currencies in the aftermath of the PM Hariri-Saudi Arabia crisis, but wider spreads between local currency and US dollar rates have yet to make a meaningful impact on deposit dollarization rates.

Moody's Investors Service, a credit ratings agency, stated in May that deposit inflows under its base scenario would remain sustainable despite recent political headwinds, citing the Central Bank's stabilizing policies and higher deposit rates.

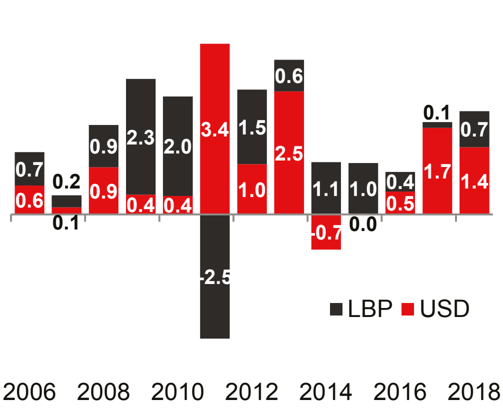
Credit activity, however, is likely to be subdued during the year after the Central Bank cut its interest incentives for housing loans and for credit to productive sectors. Claims on the private sector decreased by $954.7m to $58.6bn in the first quarter of the year, compared with a drop of $805.3m, according to revised figures released by the Central Bank based on International Financial Reporting Standards (IFRS) 9 accounting standards.

Claims on the private sector decreased by $954.7m to $58.6bn in the first quarter of the year.

The slump in subsidized housing loans is likely to weigh on real estate and construction activity and on demand for financing by contractors, while rising lending rates will add further headwind to credit activity. Average interest rates on local currency and foreign currency discounts and loans surged to 9.0% and 7.9% respectively, their highest levels in a decade on higher risk and a rising policy rate in the United States. Still, consumer, energy, and retail and wholesale trade finance may help offset some of the negative contributions from real estate activity on loan portfolios.

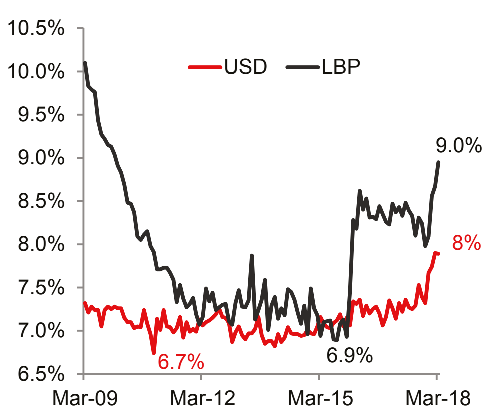
Nevertheless, banking activity will be unevenly tilted in favor of financing the government during the year. Lebanese banks acquired in May $3bn in sovereign Eurobonds from the Central Bank's portfolio and discounted an equivalent amount of deposits and US dollar Certificates of Deposit (CDs) held at BdL. Eurobond maturities ranged between 10 and 16 years at yields of 7% to 8.25% compared with maturities of under 3 years and yields of 6% to 7% for the discounted deposits and CDs.

Private sector deposits (change in 1Q, $bn)



Source: BdL, Economena, SGBL Research

Average rates on discounts and loans



Source: BdL, ABL, Economena, SGBL Research

GOVERNMENT SECURES SUFFICIENT FOREIGN CURRENCY FOR THE REMAINDER OF 2018

- **MoF raised $5.5bn from BdL, sufficient to cover foreign currency obligations in 2018**
- **Bond yields surged after US pullout from Iran deal, Eurobonds are undervalued - GS**
- **Capital Intelligence affirmed Lebanon's sovereign ratings with stable outlook**

Lebanon's Ministry of Finance (MoF) raised in mid-May $5.5bn through a private placement with Banque du Liban, enabling it to settle maturing Eurobonds and to cover its foreign currency obligations in the remainder of 2018.

The government has a 5.15% $700m bond coming due in June and another 5.15% $1.6bn bond maturing in November 2018, both of which will be fully settled in cash, according to statements by MoF and BdL. The government also has close to $1.5bn in dollarized debt service obligations in 2018 as of the end of March.

The transaction between MoF and BdL involved the issuance of two new Eurobonds maturing in 2033 and 2034 at 8.2% and 8.25% respectively, and two new tranches due in 2028 and November 2031 offering 8% and 8.1% coupons respectively.

New issues were swapped by MoF for an equivalent amount of local currency Treasury bills held by the Central Bank, with the expectation that the latter would also subscribe to LBP8,250tn ($5.5bn) in Treasury bills maturing in 3 to 10 years and yielding 1%. BdL has since on-sold $3bn of its portfolio of Eurobonds to local banks, leaving it with $4.7bn worth of sovereign foreign currency debt, equivalent to 8.2% of its dollar assets.

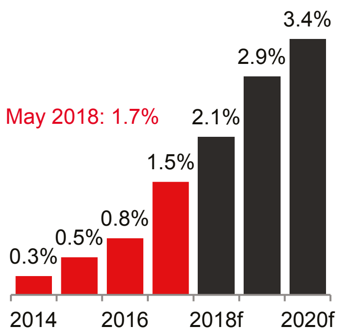
Higher interest rates in the United States and Europe are expected to raise Lebanon's debt financing costs in coming years, but the country's low levels of external debt would mitigate liquidity pressures in case of shock, according to Moody's Investor Services, a US-based credit ratings agency. Lebanon's foreign currency debt is projected to hover around a relatively moderate 57.4% of GDP at the end of 2018.

The target Fed Funds Rate has already increased by 1.6% to 1.7% since the Fed began tightening in late 2015, and may double to 3.4% by 2021, according to median projections by the Federal Open Market Committee, the body responsible for setting policy rates.

Prospects of faster tightening and the US pullout from the 2015 Iran nuclear deal added to regional risk perception, resulting in a surge in Lebanese bond yields in May 2018. However, Lebanese Eurobonds across all maturities remain "undervalued" as of the end of April, stated Goldman Sachs, a US-based investment bank.

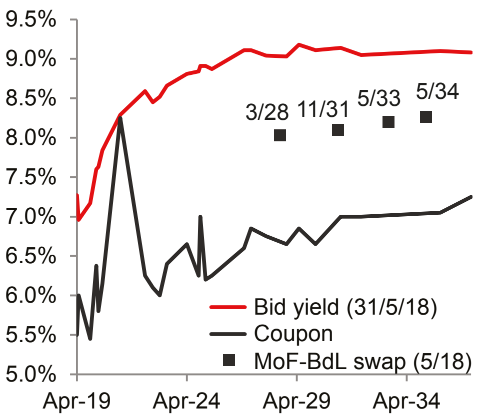
Capital Intelligence also affirmed in May Lebanon's short-term and long-term foreign currency "B" ratings with a stable outlook, citing adequate international liquidity, a reliable investor base, and strong donor support.

Target Fed Funds Rate (median projections of FOMC members)



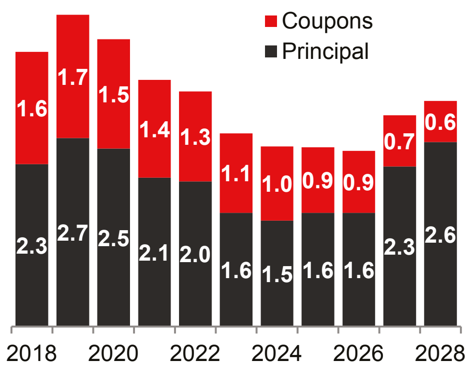
Source: FRED, Economena, SGBL Research

Primary and secondary market Eurobond yields



Source: Bloomberg, MoF, Economena, SGBL Research

Lebanon Eurobond maturities ($bn)



Note: Estimates as of May 2018

Source: ABL, MoF, Economena, SGBL Research

CAS PUT LEBANON'S REAL GDP GROWTH AT 1.7% IN 2016

- **Financial services and construction were fastest growing sectors in 2016 - CAS**
- **Government's CIP may further prop up water, waste, transport, and electricity sectors**
- **Wholesale and retail trade, economy's largest sector, shrank by 5.2% in 2016**

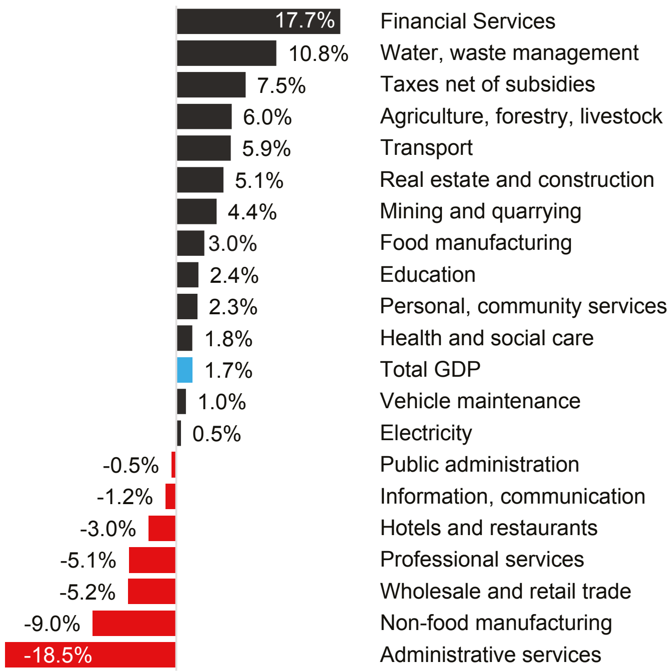
Lebanon's real Gross Domestic Product (GDP) grew by 1.7% in 2016 led by a fast-growing financial services sector and by a rebound in real estate and construction, while nominal GDP increased by 3.2% to $51.5bn during the year, according to official national accounts prepared by the Central Administration of Statistics (CAS).

CAS revised downward its estimates for real economic growth in 2015 from 0.8% to 0.2%, but raised its estimates for the nominal size of the economy in each of the years since 2012. As a result, GDP at current prices was revised upward to $49.9bn in 2015 from a previous estimate of $49.5bn.

Financial services output, which measures the value added by banks and insurance companies, surged by 17.7%, its fastest pace since 2006, and contributed to a record 9.2% of real output. Higher interest spreads in 2016 and the Central Bank's financial engineering operations likely provided much of the uplift in the sector during the year.

Construction and real estate, which together accounted for 16.6% of Lebanese economic activity, grew by 9.8% and 3.8% respectively after slumping the year before. Cement deliveries grew by 4.4% to 5.3 million tons in 2016 as improved security and political conditions and Central Bank incentives for housing loans buoyed investor confidence. BdL cut back its stimulus for housing finance in late 2017, boding ill for both sectors in 2018.

GDP growth by sector in 2016 (constant prices)



Source: CAS, Economena, SGBL Research

Real output from the water supply and waste management sector grew by 10.8% in 2016, with nominal output hitting a record $636.8m, according to estimates based on Value Added Tax data. The influx of close to 1.5 million Syrian refugees since 2011 has strained public water and waste infrastructure and contributed to growing demand for supplementary private sector services.

The resumption of trash collections in 2016 also contributed to increasing sector activity after the closure of the country's main dumpsites led to the break out of a trash crisis in Lebanon starting in the summer of 2015. The government has since opened new temporary seaside landfills, but has yet to approve a permanent solution for the garbage collected.

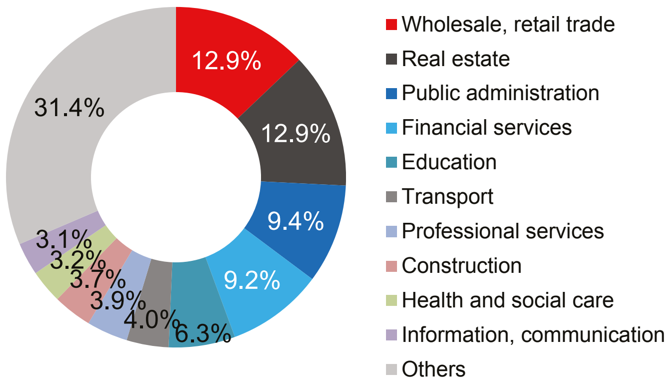
An estimated $3.7bn are earmarked for water and waste infrastructure in the Lebanon's Capital Investment Plan approved by the Council of Ministers in March 2018, covering 209 projects or 75% of the total number of projects in the plan.

Meanwhile, defensive sectors such as education and healthcare continued to fare well into 2016 with real output growth reaching 2.4% and 1.8% respectively. By contrast, value added in the hotels and restaurants sector resumed its decline, reflecting a drop in the number of visitors from the GCC in the aftermath of the Syrian conflict in 2011.

Wholesale and retail trade, the economy's largest sector at 12.9% of GDP, shrank by 5.2%, its sharpest downturn since 2006 when the country faced a month-long conflict with Israel. The size of the public sector also contracted by 0.5% in 2016 given stalled fiscal policy amid vacancy in the country's top post during the first 10 months of the year .

Real GDP growth reached 1.2% in 2017, according to estimates by the IMF, but is projected to accelerate to 1.5% in 2018 on reduced spillovers from the conflict in Syria.

GDP by sector (constant prices, % of total)



Source: CAS, Economena, SGBL Research

LATEST DATA

Key indicators	Unit	2017	Jan-18	Feb-18	Mar-18	%Y/Y	YTD	PYTD
Cleared cheques	$bn	68.25	5.50	5.58	5.74	-7.06	16.83	17.11
Real estate transactions	$bn	9.96	0.68	0.63	0.70	-34.96	2.01	2.34
Construction permits	Sqm, m	11.73	0.82	0.96	0.90	-27.40	2.67	3.14
Cement deliveries	Tons, m	5.15	0.27	0.34	0.44	5.77	1.05	1.07
Tourist arrivals	m	1.86	0.11	0.11	0.14	8.35	0.36	0.35
Airport traffic	m	8.24	0.60	0.50	0.63	20.77	1.73	1.52
Balance of payments	$bn	-0.16	0.24	-0.08	-0.36	-	-0.21	0.55
Money supply: M3	$bn	138.62	138.62	139.34	139.74	3.59	1.12	2.10
BSE volumes	m	83.86	5.51	5.48	34.63	1,104.69	45.62	10.02
Passenger car sales		37,222	2,489	2,256	2,901	-7.49	7,646	8,118
Hotel occupancy (average)	%	63.91	49.1	61.3	63.5	0.40	57.97	62.70

Indices	Unit	2017	Feb-18	Mar-18	Apr-18	%Y/Y	%YTD
Consumer Confidence Index - ARA		123.92	122.00	118.00	129.00	24.04	-16.77
Consumer Price Index		100.55	104.14	104.99	105.56	5.80	1.61
Purchasing Managers' Index		46.60	47.30	46.50	46.20	-2.74	0.22
BdL Coincident Indicator		305.87	313.00	321.40	n.a.	4.96	0.97

Trade	Unit	2017	Jan-18	Feb-18	Mar-18	%Y/Y	YTD	PYTD
Imports	$bn	19.58	1.71	1.44	1.67	-1.76	4.81	4.95
Exports	$bn	2.84	0.28	0.25	0.28	3.03	0.81	0.73
Trade balance	$bn	-16.74	-1.42	-1.19	-1.39	-2.68	-4.00	-4.22
Port of Beirut volumes	TEUs, m	1.31	0.11	0.11	0.10	5.38	0.32	0.29

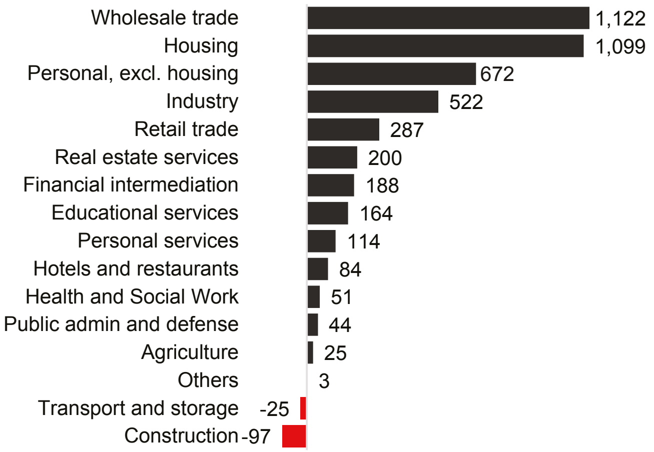
Financial and monetary	Unit	2017	Jan-18	Feb-18	Mar-18	%Y/Y	YTD	%YTD
Commercial bank assets	$bn	219.86	222.59	223.07	224.57	9.14	4.71	2.14
Claims on the resident private sector	$bn	53.45	53.05	52.35	52.27	2.91	-1.18	-2.21
Claims on the non-resident private sector	$bn	6.07	5.78	6.22	6.30	7.46	0.23	3.72
Claims on the public sector	$bn	0.16	0.16	0.20	0.19	47.33	0.03	22.47
Resident private sector deposits	$bn	133.51	133.77	134.52	134.69	3.50	1.18	0.89
Dollarization rate (average)	%	61.54	63.30	63.10	63.11	2.46	63.17	-0.51
Non-resident private sector deposits	$bn	35.16	35.37	35.48	36.05	5.38	0.89	2.54
Dollarization rate (average)	%	87.32	87.89	n.a.	n.a.	1.15	87.89	0.04
Private sector deposits with commercial banks	$bn	168.39	168.82	169.33	170.06	3.68	1.67	0.99
Private loans / deposits	%	39.34	39.80	39.26	39.15	0.13	39.40	-0.76
Public sector deposits	$bn	10.20	10.80	11.15	10.64	-2.66	0.44	4.29
BdL foreign assets	$bn	47.77	47.64	46.56	46.51	2.50	-1.26	-2.64
BSE market capitalization	$bn	11.47	11.77	11.65	11.85	-4.98	0.38	3.32
Gross public debt	$bn	79.54	80.39	81.52	81.87	6.07	2.34	2.94

Public finance	Unit	2016	Oct-17	Nov-17	Dec-17	%Y/Y	YTD	PYTD
Revenues	$bn	9.92	1.21	0.64	1.37	69.45	11.62	9.92
Value Added Tax	$bn	2.15	0.36	0.12	0.12	8.43	2.31	2.15
Telecommunications	$bn	1.27	0.18	0.00	0.57	203.97	1.28	1.27
Income taxes	$bn	2.00	0.18	0.09	0.09	17.27	2.79	2.00
Customs taxes	$bn	1.40	0.13	0.12	0.12	2.83	1.43	1.40
Expenditures	$bn	14.87	1.71	1.52	1.75	29.74	15.38	14.87
Transfers to EdL	$bn	0.93	0.18	0.07	0.18	66.09	1.33	0.93
Debt service	$bn	4.77	0.43	0.70	0.36	-9.16	4.99	4.77
Primary balance	$bn	0.02	-0.05	-0.13	-0.01	-89.94	1.43	0.02
Fiscal balance	$bn	-4.94	-0.49	-0.88	-0.38	-29.58	-3.76	-4.94

YTD: year-to-date, PYTD: previous year-to-date. Source: MoF, BdL, BSE, ARA, Customs, Markit, EY, RHIA, CAS, Economena, SGBL Research

Utilized credit by sector (change in 2017, $m)

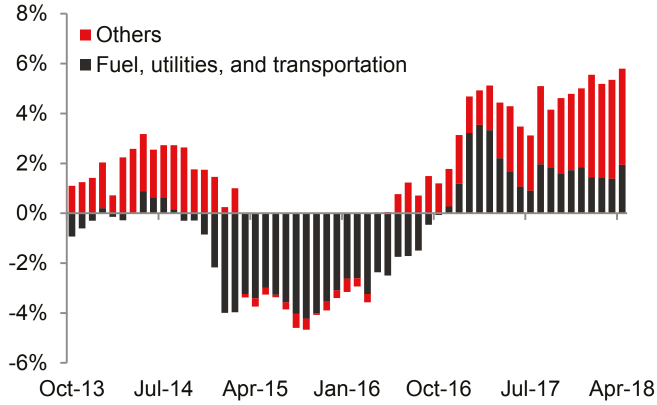
Banks rotated their loan portfolios towards consumer lending in 2017 amid weakening prospects for the construction sector. Utilized credit by individuals, including housing, increased by $1.8bn, representing 39.8% of growth during the year, while credit to the construction sector shrank by $97.5m.



Source: BdL, Economena, SGBL Research

Contributions to CPI %yoy growth

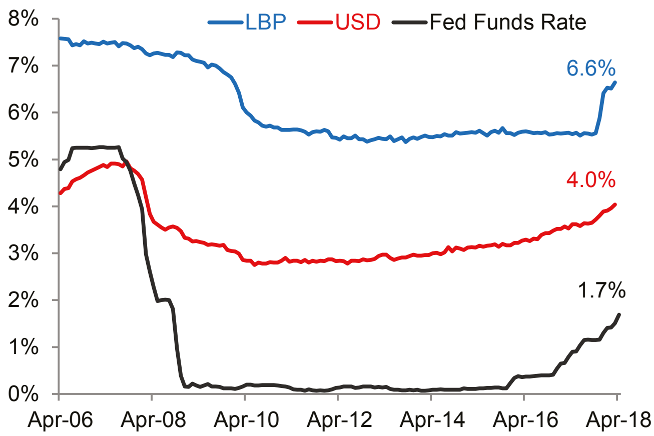
Higher fuel prices have only partially contributed to faster inflation in recent months. Consumer price indices of fuels, utilities, and transportation contributed to only a third of inflation in the 12 months through April 2018, while the majority of inflation emanated from other components, particularly clothing and footwear, health, and housing.



Source: CAS, Economena, SGBL Research

Average deposit rates in Lebanon and target FFR

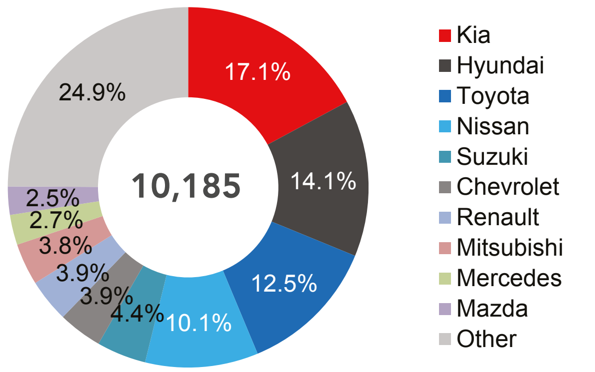
The spread between LBP and USD deposit rates in Lebanon widened to 260 basis points (bps) in March 2018, up from 204 bps a year earlier, reflecting efforts by the Central Bank to encourage savings in local currency. The average rate on domestic deposits in USD reached 4% in March 2018, its highest level since February 2008.



Source: BdL, ABL, FRED, Economena, SGBL Research

New passenger vehicle registrations (Jan-Apr, 2018)

Four brands dominated Lebanon's new car market in the first four months of 2018. Sales of new Kia passenger vehicles reached 1,745 units through April, equivalent to 17.1% of total sales during the period, data by the Association of Car Importers showed. Hyundai, Toyota, and Nissan followed with 14.1%, 12.5%, and 10.1% of sales respectively over the period.



Source: AIA, Economena, SGBL Research