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ECONOMIC ACTIVITY AWAITS POLITICAL CATALYST

- **Economic activity slowed in Q1 2017**
- **Hospitality industry reaping benefits of growing tourist numbers**
- **Re-appointment of Salameh may ease currency pressures**

Lebanon's economy registered positive growth in the first quarter of 2017, but economic activity was slower than in 2016, reflecting a bumpy start of the year for the newly-formed Cabinet, and political deliberations over a Parliamentary elections law. The Central Bank's Coincident Indicator, a proxy for economic activity, grew by 4.3% yoy in the first three months of the year, compared with growth of 7.2% yoy over the same period in 2016.

Construction activity was softer in the early months of 2017, offsetting gains across other key sectors such as tourism, trade, and electricity. Cement deliveries to construction sites across the country were unchanged at 1.1 million tons in the first quarter, while permits for new construction fell by 3.3% yoy to 3.2 million square meters, indicating persistent cautiousness among developers.

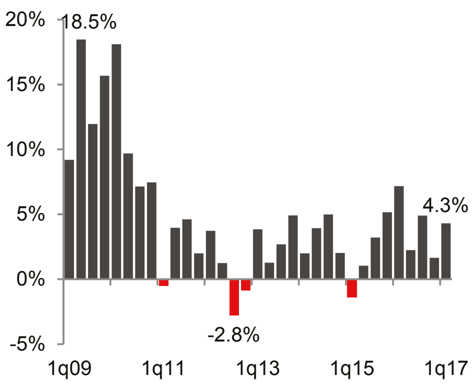
Unlike construction, the property market witnessed most robust activity in the first quarter and into April amid more favorable interest rates on housing loans and bargain buying. Real estate sales jumped by 9% yoy to $3.1bn in the first four months, a two-decade high for the period, including an increase of 13.7% yoy to 382 in the number of sales to foreigners.

Growth in the Lebanese economy is projected to accelerate to 2% in 2017 from an estimated 1% in 2016, according to the IMF. The recovery in tourism is already taking hold, with the number of arrivals up by 17.5% yoy to 503,805 visitors in the first four months, their highest level in at least 15 years. As a result, Beirut's 4- and 5-star hotels reported an increase to 63.6% in their occupancy rates through April, up from 54.9% over the same period in 2016. Room rates, however, have seen more limited improvement as the pickup in Gulf tourism remains timid.

REBOUNDING EXPORTS AND DEPOSITS

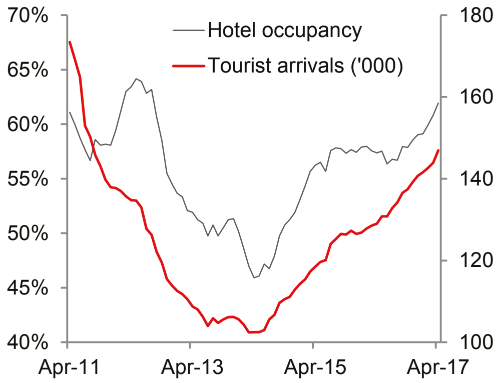
Along with tourism, Lebanon's exports staged a comeback in the first four months of 2017, driven by recovering trade in pearls and precious stones, and growing sales to Syria.

BDL Coincident Indicator (%yoy)



Source: BdL, Economena, SGBL Research

Tourism indicators (12-month moving average)



Source: MoT, EY, Economena, SGBL Research

Total exports grew by 11% yoy to $965.3m in the first four months of the year, equivalent to an additional $95.5m in foreign sales during the period.

Rejuvenated trade activity with Syria was also partially behind the rebound in exports in the first four months. Total sales to Syria grew by 76.3% yoy to $100.1m through April, amid growing shipments of food products and fuel to the country.

A move by the government to subsidize maritime shipping for agricultural products appears to be helping the agriculture sector hold up. Exports of vegetable products reached $48.8m in the first four months of 2017, unchanged from the same period in 2016.

Exports to the six Gulf Cooperation Council countries fell by 5.3% yoy to $226.6m through April.

Meanwhile, the drop in oil prices has led to a slowdown in economic activity in the GCC, weighing on demand for Lebanese products. Exports to the six Gulf Cooperation Council countries fell by 5.3% yoy to $226.6m through April, driven by slumping exports of machinery and electrical equipment.

Similarly, sales to European countries resumed their decline amid unfavorable currency effects in recent years. Lebanese exports to the Euro Area fell by 15.9% yoy to $76.3m through April 2017, nearly half their level over the same period in 2012.

Resurgent trade activity, especially imports, is breathing new life into trade finance products at Lebanon's commercial banks after several years in decline. The value of opened letters of credit (LCs) for import surged by 55.2% yoy to $1.8bn in the first quarter of 2017, reflecting improvement in import orders during the period.

Outside their trade finance, Lebanese banks pulled the breaks on lending in the first quarter of 2017, focusing instead on building up their deposits in Lebanon and abroad, and on meeting the state's foreign currency needs by subscribing to the sovereign Eurobonds issued in March 2017.

Private sector deposits grew by 7.8% yoy to $164.4bn through March, including an additional $1.9bn in the first quarter, a four-year high for the period. On the other hand, net loan production to the private sector grew by a meager $2m in the first three months, compared with an increase of $830.2m over the same period in 2016.

The government's reappointment of Riad Salameh in late May as Governor of the Central Bank for a fifth seven-year term may help ease pressure on financial markets in the near-term. Uncertainty over the renewal of Salameh's term had led to a drop of $2.3bn in the Central Bank's foreign assets between the end of February and the middle of May as a result of currency conversions.

PUBLIC DEBT IS RISKIER BUT MANAGEABLE

Unlike the real economy, which is likely to far better in 2017, Lebanon's swelling debt stock is expected to widen by at least an additional $4.9bn during the year. Gross public debt grew by $2.3bn in the first quarter alone, its second fastest pace for the period in two decades, driven in part by the issuance of 5-year Treasury bills in January as part of the Central Bank's swap operations.

Market debt jumped to an estimated 98.2% of GDP at the end of March 2017, compared with 87.1% of GDP a year earlier.

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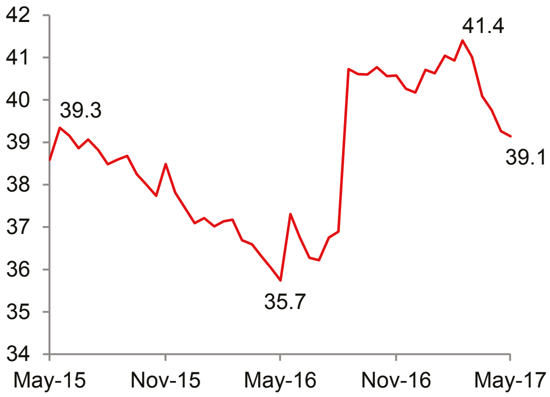
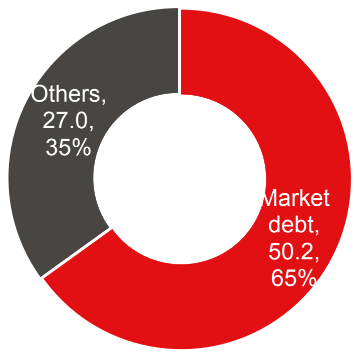
Despite its high debt burden, Lebanon's resilient liquidity position continues to support its creditworthiness, according to Moody's Investor Services which rates Lebanon B2 with a negative outlook. Five-year Credit Default Swap spreads, the cost to insure against default by the Lebanese government, tightened by 181 points since November to 3.81% at the end of April, suggesting a perception of reduced risk of a sovereign default.

Banque du Liban foreign assets ($bn)



Source: BdL, Economena, SGBL Research

Gross market debt (March 2017, $bn)



Source: BdL, Economena, SGBL Research

IRON AND STEEL IMPORTS SIGNAL MORE ROBUST CONSTRUCTION ACTIVITY

- **Iron and steel imports rose by 23.1% yoy to $226.7m through April 2017**
- **Construction permits in Beirut and Tripoli are on the rise**
- **Construction and housing loans climbed to a record high by September 2016**

Construction activity in Lebanon was stable in the first quarter of 2017, with cement companies delivering an estimated 1.1 million tons of cement to construction sites across the country, in line with deliveries over the same period in 2016.

Still, developers appear to have accelerated, and in some cases, resumed their ongoing projects following the political breakthrough in later 2016. Imports of iron and steel, two major raw materials for developers, rose by 23.1% yoy to $226.7m through April 2017, their highest level for the period in three years.

The medium-term outlook also points to relative stability in future development activities. The area of construction permits, a leading indicator of construction, fell by 5% yoy to 4.1 million square meters in the first four months of the year, reflecting persistent cautiousness among developers and investors.

Permits data, however, showed divergent trends across Lebanon. In Beirut and North Lebanon, the area of permits issued rose by 71% yoy to 264,377 square meters and by 20% yoy to 805,645 square meters through April respectively, while demand for permits waned in Mount Lebanon, South Lebanon, Nabatieh, and the Bekaa.

Banks also do not appear to be withholding funding to the demand and supply sides of the property market. Utilized credit by contractors increased by $1.1bn yoy to a record $11.4bn by September 2016, while housing loans rose by the same amount to $11.7bn, latest data released by Banque du Liban showed.

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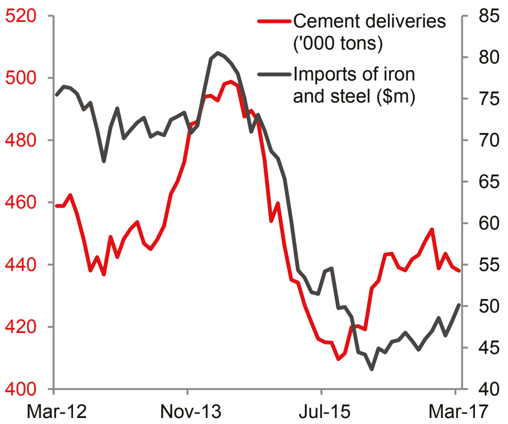
While supportive, banks played a smaller role than usual in driving activity in the property market in early 2017. The value of mortgaged properties fell by 5.4% yoy to $1.4bn in the first four months of 2017, equivalent to 44.8% of total real estate sales transactions, compared with 51.5% of the total in the first four months of 2016.

The Central Bank is offering banks at least $600m in low-interest loans to promote residential lending in 2017, but a meaningful recovery in domestic demand is unlikely in light of sluggish economic activity. The number of marriages in the country fell by 0.9% yoy in the 12 months through February 2017, pointing to a slowdown in fundamental local demand for housing.

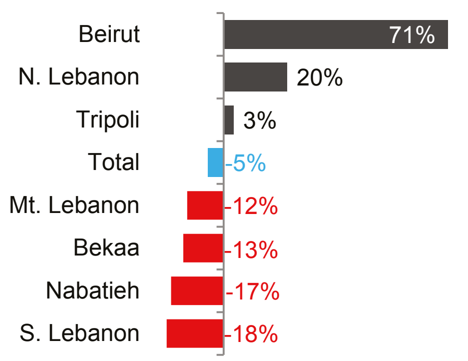
Instead, foreigners are playing a greater role in the local market amid a rebound in tourist arrivals, especially Lebanese expatriates. Real estate sales to foreigners surged by 13.7% yoy to 382 transactions in the first four months of 2017, data by the Real Estate Registry showed.

Construction indicators (12-month average)



Source: MoT, Economena, SGBL Research

Construction permits area (Jan-Apr, %yoy)



Source: MoT, EY, Economena, SGBL Research

LEBANON'S DEBT SWELLS, BUT INVESTORS SEE DIMINISHED RISK

- **Public debt rose by $6.1bn in the 12 months through March 2017**
- **Moody's rates Lebanon B2 negative, projects growth of 2.8% in 2017**
- **CDS spreads have tightened to 3.81% by April**

The Lebanese government borrowed an additional $6.1bn in the 12 months through March 2017, raising its debt stock by 8.6% yoy to $77.2bn by the end of the month. Gross public debt grew by $2.3bn in the first quarter alone, its second fastest pace for the period in two decades, driven in part by the issuance of 5-year Treasury bills in January as part of the Central Bank's swap operations.

Market debt, which excludes debt held by government or semi-government agencies, is estimated to have jumped to 98.2% of GDP by the end of the first quarter, compared with 87.1% of GDP a year earlier.

Public sector deposits at commercial banks and at BdL increased by $1.5bn in the first three months, suggesting the government has yet to spend the bulk of its freshly raised funds. As a result, the country's net public debt, which subtracts government deposits, increased by a moderate amount of $807.3m in the first quarter to reach $66.2bn at the end of March.

Despite its high debt burden, Lebanon's resilient liquidity position continues to support its creditworthiness, according to Moody's Investor Services which rates Lebanon B2 with a negative outlook. The formation of a new Cabinet in late 2016, along with renewed momentum for reforms, is also likely to help lift economic growth to 2.8% in 2017 and to improve investor confidence, stated Moody's.

However, the country's debt burden is expected to increase further amid rising interest rates and a projected fiscal deficit of 9% of GDP during the year. The Lebanese Cabinet put forward to Parliament a budget proposal that foresees a deficit of $4.9bn in 2017, largely unchanged from the record it set in 2016. The state's debt service bill grew by 6.9% to $4.8bn in 2016, representing 48.1% of government revenues during the year.

On the bright side, Lebanon's sovereign debt obligations remain largely denominated in local currency despite a slight uptick in recent months. Foreign currency debt made up 38.7% of gross public debt at the end of March 2017, well within its range of between 37% and 44.1% over the past five years.

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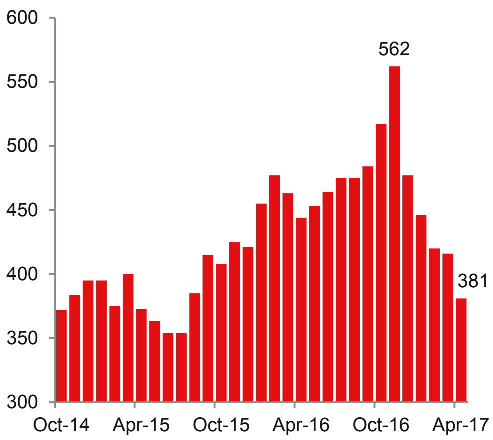
Investors have been warming to Lebanon's Eurobonds since the political breakthrough in late 2016. Five-year Credit Default Swap spreads, the cost to insure against default by the Lebanese government, tightened by 181 points since November to 3.81% at the end of April, 2017, suggesting a perception of reduced risk of a default by the sovereign.

Foreign currency debt (% of total)

Source: BdL, Economena, SGBL Research

Lebanon CDS spreads, 5-year mid (bps)



Source: CAS, Economena, SGBL Research

LENDING TAKES BACKSEAT FOR BANKS IN Q1 2017

- **Credit to the private sector unchanged at $3bn by March**
- **Renewal of Salameh's term may ease financial sector risks**
- **Lebanese banks replenished their deposits abroad after swap operations**

Lebanese banks pulled the breaks on lending in the first quarter of 2017, focusing instead on building up their deposits in Lebanon and abroad, and on meeting the state's foreign currency needs by subscribing to the sovereign Eurobonds issued in March 2017.

Net loan production to the private sector grew by a meager $2m in the first three months of the year, compared with an increase of $830.2m over the same period in 2016. Sluggish economic activity, coupled with rising political uncertainty, was behind the scarcity of investment opportunities at the start of the year, but the outlook has improved since then.

The government re-appointed Riad Salameh in late May as Governor of the Central Bank for a fifth seven-year term, a move that is likely to ease pressure on financial markets in the near-term. Uncertainty over the renewal of Salameh's term had led to a drop of $2.3bn in the Central Bank's foreign assets between the end of February and the middle of May as a result of currency conversions.

Meanwhile, banks remained focused on building up their deposit base, particularly in foreign currencies. As a result, private sector deposits grew by 7.8% yoy to $164.4bn through March 2017, including an additional $1.9bn in the first quarter, a four-year high for the period. Foreign currency deposits accounted for over 93% of the increase in deposits in the first three months, largely reflecting an increased dollarization rate among domestic depositors.

Growth in the deposits of non-residents also accelerated, increasing by $250m in the first quarter to $34.2bn at the end of March 2017, compared with a drop of $72.2m over the same period in 2016. Resurgence in non-resident deposits helped tilt the balance of payments into a surplus of $554.8m in the first quarter, from a deficit of $644.2m in the first quarter of 2016.

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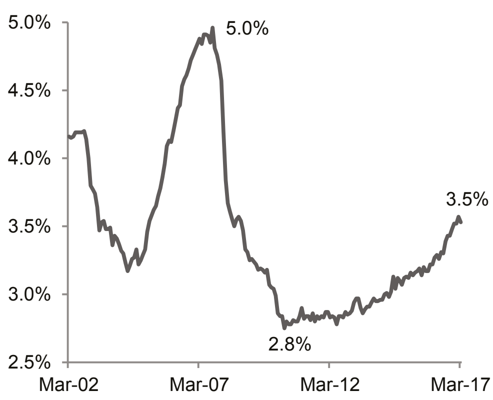
Banks, however, are paying more to attract foreign currency deposits. The average interest on US Dollar deposits reached 3.53% in March 2017, 26 basis points more than in March 2016, according to Banque du Liban. A higher cost of deposits, combined with limited loan production, poses a risk to banks' profit margins during the year.

At the same time, banks were able to replenish their deposits abroad after drawing them down in 2016 to participate in the Central Bank's swap operations. Commercial banks' claims on the non-resident financial sector, which are denominated in foreign currencies, increased to $13.1bn at the end of March 2017 after hitting a multi-year low of $8.5bn in August 2016. Greater deposits among banks abroad increase the Central Bank's ability to successfully implement any future rounds of financial operations.

Bank claims on non-resident fin. sector ($bn)

Source: ABL, Economena, SGBL Research

Average interest rate on USD deposits



Source: BdL, Economena, SGBL Research

TRADE ACTIVITY REGAINED SOME MOMENTUM THROUGH APRIL 2017

- **Exports rose by $95.5m to $965.3m through April 2017**
- **Trade with Syria gained ground while sales to the GCC dipped**
- **Trade finance products rebounded in the first quarter**

Lebanon's exports staged a comeback in the first four months of 2017, driven by recovering trade in pearls and precious stones, in addition to growing sales to neighboring Syria. Total exports grew by 11% yoy to $965.3m by April, equivalent to an additional $95.5m in foreign sales.

Exports of pearls and precious stones surged by 50.2% yoy to $225m through April, but were coupled with a similar uptick in imports of the same products, resulting in a trade deficit of $175.2m from trading in pearls and precious stones.

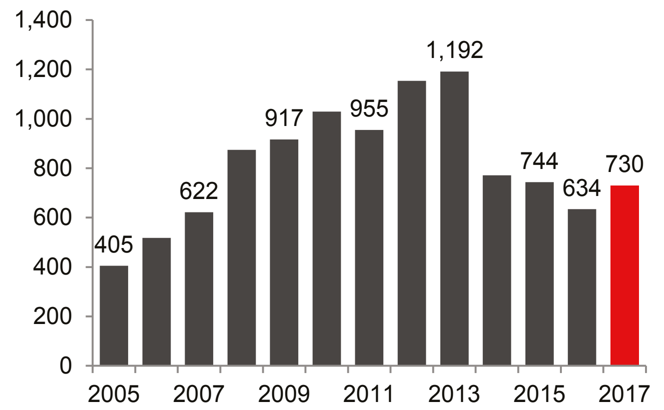
Rejuvenated trading with Syria was also partially behind the rebound in exports in the first four months. Total sales to Syria grew by 76.3% yoy to $100.1m through April, amid growing shipments of food products and fuel to the country.

Meanwhile, exports to the six Gulf Cooperation Council countries as well as to the Euro Area resumed their decline, falling by 5.3% yoy to $226.6m and by 15.9% yoy to $76.3m respectively over the period. The drop in oil prices has led to a slowdown in economic activity in the GCC, weighing on demand for Lebanese products, particularly machinery.

At the same time, the conflict in neighboring Syria has severed shipping routes by land to the GCC and added to transportation costs. However, a move by the government to subsidize maritime shipping for agricultural products appears to be helping the agricultural sector hold up. Exports of vegetable products reached $48.8m in the first four months of 2017, unchanged from the same period in 2016.

Similarly, other exporters are finding ways to keep up their sales abroad. Exports of prepared foodstuffs, beverages, and tobacco, Lebanon's second largest export category, rose by 0.5% yoy to $155.6m in the first four months. Paper, plastics, and rubber manufacturers posted faster export growth of 2.4% yoy during the same period, adding limited, but much-needed support to local Industry.

Exports (Jan-Apr, $m)



Source: Customs, Economena, SGBL Research

The US Dollar has somewhat depreciated against major currencies since start of the year, offering exporters, particularly to the Euro Area, some breathing room, but a meaningful recovery in exports is unlikely in the short-term amid costly shipping logistics in the region and a stronger currency than in recent years.

Instead, imports are likely to swell in coming months, further accentuating the country's trade deficit quandary. Total imports already rose by 2.1% yoy to a three-year high of $6.4bn in the first four months of 2017, leading to a widening in the trade deficit by $37.3m to $5.4bn over the period.

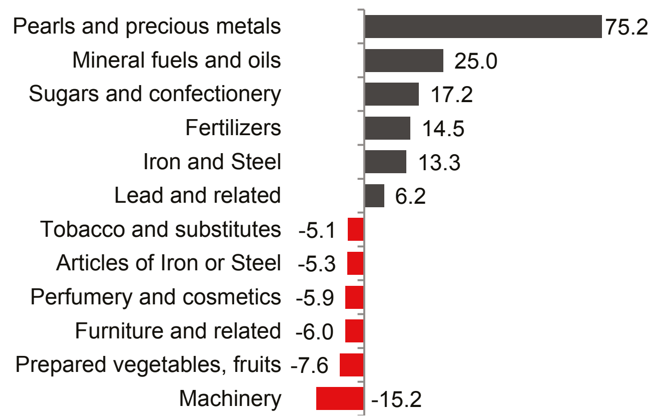
In particular, the drop in oil prices in recent years has been offset by growing domestic demand for petroleum products. Imports of mineral products, including fuel, fell by 11% yoy to $1.4bn through April, but the volume of imports rose by 5.1% yoy to a seven-year high of 3.4 million tons.

Lebanese consumers also imported more food products, vegetables, and live animals in the first four months, reflecting higher levels of private consumption by both locals as well as a higher number of tourists in the country during the period.

Resurgent trade activity is breathing new life into trade finance products at Lebanon's commercial banks after several years in decline. The value of opened letters of credit (LCs) for export tripled to a record of $1.1bn in the first quarter of 2017, amid improvement in export orders during the period.

Outstanding LCs for export had hit a decade low by August 2016, on fading prospects for exports, but they have since staged a massive comeback, rising by 24.7% yoy to $933m by the end of March 2017. Similarly, opened letter of credit for import increased by 55.2% yoy to $1.8bn in the first quarter, and utilized credits surged by 81.1% yoy to a record high of $2.1bn during the same period.

Exports (Jan-Apr, yoy, $m)



Source: Customs, Economena, SGBL Research

LATEST DATA

Key indicators	Unit	2016	Jan-17	Feb-17	Mar-17	%Y/Y	YTD	PYTD
Cleared cheques	$bn	68.14	5.71	5.22	6.18	10.36	17.11	16.91
Real estate transactions	$bn	8.48	0.57	0.70	1.07	49.06	2.34	2.13
Construction permits	Sqm, m	12.23	0.85	1.05	1.27	9.19	3.16	3.27
Cement deliveries	Tons, m	5.27	0.31	0.34	0.42	-3.65	1.07	1.08
Tourist arrivals	m	1.69	0.11	0.11	0.13	13.21	0.35	0.31
Airport traffic	m	7.61	0.54	0.46	0.52	-3.07	1.52	1.52
Balance of payments	$bn	1.24	0.17	0.34	0.05	-	0.55	-0.64
Money supply: M3	$bn	132.80	132.88	133.83	134.27	7.84	1.48	0.89
BSE volumes	m	120.47	4.06	3.08	2.87	-88.23	10.02	33.86
Passenger car sales		36,326	2,420	2,562	3,136	12.56	8,118	7,990
Hotel occupancy (average)	%	58.98	57	67	62	11.00	61.80	54.57

Indices	Unit	2016	Jan-17	Feb-17	Mar-17	%Y/Y	%YTD
Consumer Confidence Index - ARA		113.83	161.00	134.00	111.00	14.43	-32.32
Consumer Price Index		96.24	98.47	99.00	99.66	5.12	0.74
Purchasing Managers' Index		45.68	47.70	47.70	46.90	4.22	-0.21
BdL Coincident Indicator		289.54	297.20	305.30	306.20	3.83	4.79

Trade	Unit	2016	Dec-16	Mar-17	Apr-17	%Y/Y	YTD	PYTD
Imports	$bn	18.71	1.54	1.70	1.41	-12.20	6.26	6.23
Exports	$bn	2.98	0.24	0.27	0.24	-0.13	0.97	0.87
Trade balance	$bn	-15.73	-1.29	-1.42	-1.18	-14.27	-5.40	-5.36
Port of Beirut volumes	TEUs, m	1.15	0.10	0.10	0.10	-6.12	0.39	0.38

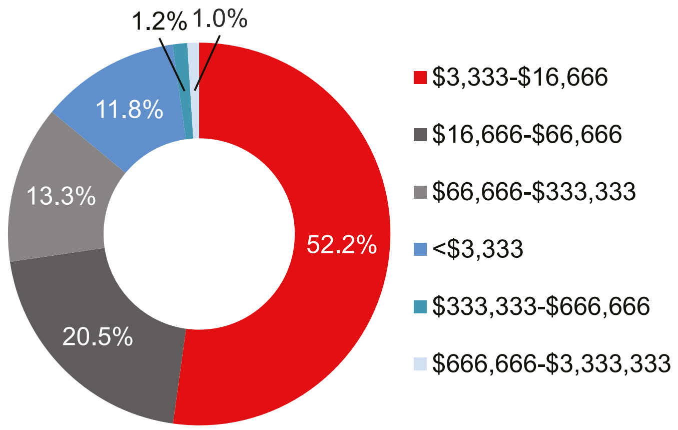
Financial and monetary	Unit	2016	Jan-17	Feb-17	Mar-17	%Y/Y	YTD	%YTD
Commercial bank assets	$bn	204.31	204.38	204.93	205.76	9.64	1.44	0.71
Claims on the resident private sector	$bn	51.04	50.84	51.05	51.20	5.38	0.16	0.31
Claims on the non-resident private sector	$bn	6.14	6.11	5.96	n.a.	-6.27	-0.18	-2.96
Claims on the public sector	$bn	34.72	36.15	36.41	37.75	-1.11	3.02	8.71
Resident private sector deposits	$bn	128.53	128.76	129.70	130.14	7.86	1.61	1.25
Dollarization rate (average)	%	59.36	60.33	60.36	60.65	1.45	60.45	1.02
Non-resident private sector deposits	$bn	33.96	33.97	34.16	34.21	7.63	0.25	0.73
Dollarization rate (average)	%	86.12	86.74	86.96	87.00	0.89	86.90	1.01
Private sector deposits with commercial banks	$bn	162.49	162.73	163.86	164.35	7.81	1.86	1.14
Private loans / deposits	%	40.23	39.48	39.36	39.34	-0.92	39.39	0.98
Public sector deposits	$bn	9.46	10.84	10.26	10.93	29.43	1.46	15.45
BdL foreign assets	$bn	44.73	46.13	46.99	45.37	8.67	0.64	1.42
BSE market capitalization	$bn	11.90	12.21	12.38	12.47	10.04	0.57	4.81
Gross public debt	$bn	74.89	76.17	76.13	77.17	8.61	2.28	3.05

Public finance	Unit	2015	Oct-16	Nov-16	Dec-16	%Y/Y	YTD	PYTD
Revenues	$bn	9.58	0.93	0.66	0.81	15.25	9.92	9.58
Value Added Tax	$bn	2.10	0.33	0.11	0.11	9.58	2.15	2.10
Telecommunications	$bn	1.23	0.10	0.09	0.19	182.89	1.27	1.23
Income taxes	$bn	1.92	0.16	0.07	0.08	11.61	2.00	1.92
Customs taxes	$bn	1.37	0.13	0.12	0.12	5.37	1.40	1.37
Expenditures	$bn	13.53	1.11	1.74	1.35	-4.62	14.87	13.53
Transfers to EdL	$bn	1.14	0.08	0.11	0.11	34.25	0.93	1.14
Debt service	$bn	4.46	0.43	0.62	0.39	10.30	4.77	4.46
Primary balance	$bn	0.72	0.27	-0.41	-0.14	-59.26	0.02	0.72
Fiscal balance	$bn	-3.95	-0.18	1.08	-0.54	-24.15	-2.79	-3.95

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

Number of beneficiaries by credit amount (Sep 16)

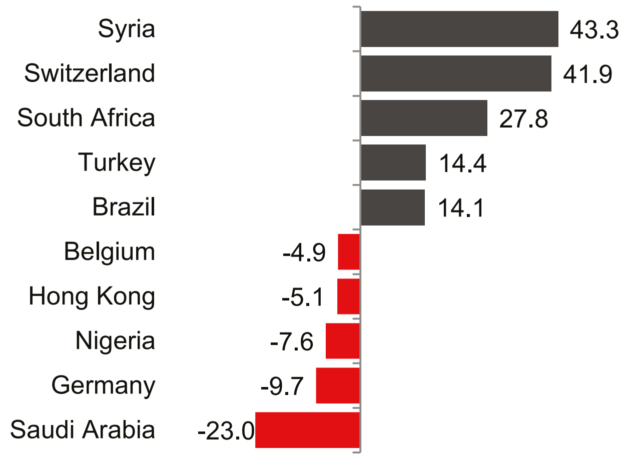
An estimated 52% of all borrowers in Lebanon had an outstanding credit balance of between $3,333 and $16,666 as of September 2016. Over 84% of all beneficiaries had a balance of less than $66,666, reflecting the prevalence of personal loans among bank borrowers in Lebanon.



Source: BdL, Economena, SGBL Research

Exports by destination (Jan-Apr, yoy change, $m)

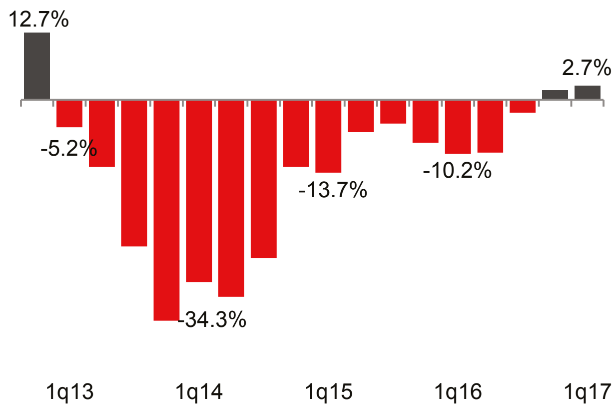
Lebanese exports to Syria surged by 76.3% yoy to $100.1m in the first four months of 2017, the second largest foreign market after South Africa. By contrast, sales to Saudi Arabia declined by $23m amid difficult shipping logistics and waning demand.



Source: Customs, Economena, SGBL Research

Beirut retail trade index (% yoy)

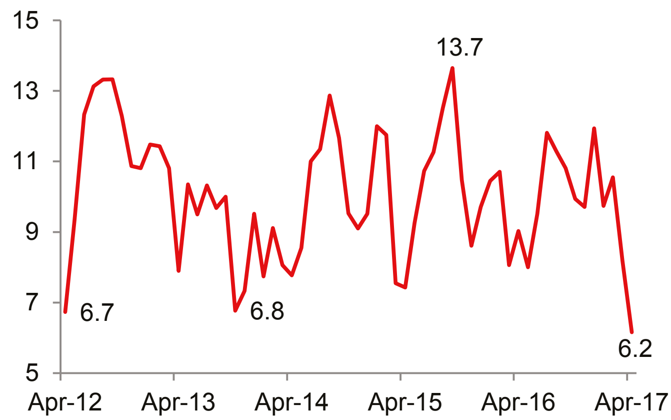
Retail sales in Beirut picked up in the first quarter of 2017 for the second period in a row after almost four years of decline, data by the Beirut Traders Association showed. The increase was largely driven by rising prices while volume sales appear to have remained subdued.



Source: BTA, Economena, SGBL Research

Average daily hours of electricty outage outside Beirut

Electricity production hit a record high in early 2017, leading to a reduction in the daily average electricity outage outside Beirut to 6.2 hours in April, its lowest level in at least five years. Power outages by the state's electricity company are limited to 4,5 hours per day in Beirut.



Source: MoEW, Economena, SGBL Research