LEBANON ECONOMIC REPORT

CONTAINING THE COST OF DELAY IN AN ECONOMY WITH HUGE POTENTIAL

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- Another year of economic sluggishness with low growth

The year 2013 has extended Lebanon's economic sluggishness witnessed since the beginning of the regional turmoil. A continuing economic slowdown is being reported within the context of the adverse spillover effects of the Syrian conflict on investment, tourism and foreign trade. Real GDP has displayed a low, though positive growth for the third consecutive year, estimated at between 1.5% and 2.5% by the IMF and the Central Bank of Lebanon, amidst continuing regional tensions and lingering domestic uncertainties.

- External sector underlined by stagnant imports, declining exports and a lingering BOP deficit

Foreign trade performances show a stagnation in imports alongside a 12% decline in exports for the full year 2013, contributing to a 3% expansion in the foreign trade deficit. In fact, Lebanon's trade deficit rose to US$ 17.3 billion in 2013, the equivalent of 39.8% of Lebanon's GDP. And while financial inflows were higher by 5.9% year-on-year in 2013 to reach US$ 16.2 billion, the balance of payments remained in the red for the third year in a row, with a cumulative deficit of US$ 1,128 million in 2013, though lower than the deficit of US$ 1,537 million reported in the previous year.

- Deteriorating public finance performance exacerbating fiscal challenges

While monetary conditions continue to show resilience on the back of large Central Bank reserves, adverse fiscal performance is back to the fore, with the fiscal deficit increasing by 31.4% during the first ten months of 2013 and the primary balance going back into negative territories. This was due to a 2.2% decrease in public revenues accompanied by a 6.2% rise in public expenditures. Gross public debt surged by 10.0% reaching US$ 63.5 billion at end-2013, compared to US$ 57.7 billion at end-2012. As such, the debt-to-GDP ratio increased from 139.5% in 2012 to 145.9% in 2013, yet remains well below its previous peak of 182% reached in 2006.

- Continued banking activity resilience yet coupled with tough operating conditions

In 2013, customer deposits of operating banks grew by a significant US$ 11.2 billion, against US$ 9.3 billion over the previous year, and loans to the private sector maintained their previous growth of US$ 3.9 billion. Banks operating conditions reported a slight improvement in local currency interest spreads yet from its record low of the previous year, while foreign currency spreads have been somehow stable within the context of a fierce interest rate competition among operating banks. Within an environment of low spreads and mild fee income generation, Lebanese banks' net profits are believed to have stagnated in full-year 2013 at close to their level of 2012.

- Frail activity in equity and bond markets

Lebanese capital markets witnessed downward price movements in 2013 amidst heightened local political tensions and worsened security conditions, lingering worries about the repercussions of the Syrian unrest on Lebanon, and tracking increases in US Treasury yields amidst US Federal Reserve tapering concerns. The total BSE turnover ratio, measured by the annualized trading value to market capitalization, stood at a mere 3.4% in 2013, as compared to 4.1% in 2012, against a regional average exceeding 40% which underlines the weak investment appetite governing the BSE. The BSE price index fell by 3.1% in 2013, while market capitalization rose from US$ 9,982 million at end-2012 to US$ 10,057 million at end-2013. Lebanon's five-year CDS spread shrank by 57 basis points in 2013 to reach 393 basis points at end-December, following a contraction of 21 basis points in 2012.

- A glimmer of hope for an improvement in macro conditions looking ahead

The Lebanese economy could actually see a relative slight growth improvement in 2014 for a number of domestic and regional considerations. According to the simple average of growth rates forecasted by 9 foreign institutions that estimate and forecast Lebanon's GDP, the average real GDP growth rate is likely to slightly improve by an additional 1% in 2014. The possible improvement in growth follows a widening cyclical output gap over the past few years which could provide a favorable base effect for capacity utilization.

The year 2013 has extended Lebanon's economic sluggishness witnessed since the beginning of the regional turmoil. A continuing economic slowdown is being reported within the context of the adverse spillover effects of the Syrian conflict on investment, tourism and foreign trade. Real GDP has displayed a low though positive growth for the third consecutive year, estimated at between 1.5% and 2.5% by the IMF and the Central Bank of Lebanon, amidst continuing regional tensions and lingering domestic uncertainties.

The performance of real sector indicators was mixed throughout the past year. Among indicators that witnessed progressions in 2013, we mention electricity production (+9.9%), delivery of cement (+10.4%), merchandise at the Port (+14.4%), new car sales (+1.8%) and passengers at the Airport (+5.7%). Among indicators that witnessed regressions over the year, we mention construction permits (-10.9%), value of property sales (-2.4%) and number of tourists (-6.7%).

The quantity theory of money confirms the sluggishness in economic growth. The annual increase in money supply (+6.3%) was offset by a contracting velocity of money (-6.1%) and an average price inflation (2.6%). The contracting velocity is the result of a tiny growth in cleared checks of 1.9% within the context of an increase in average deposits by 8.4% in 2013. The moderation of inflation is technically tied to the fact that the Lebanese economy is operating at the flat Keynesian side of the Aggregate Supply curve amidst excess capacity and large output gap.

At the external level, exports dropped by 12.2% in 2013, as exports through Syria dropped by 20.7% year-on-year amid the insecurity of shipping routes for Lebanon's land exports. Imports almost maintained their previous year's figure within the context of a lingering economic slowdown. While inflows were up by 5.9% in 2013, the balance of payments has reported a deficit of US$ 1.1 billion, following a deficit of US$ 1.5 billion during the previous year.

At the fiscal level, the latest released public finance figures underline a 31.4% increase in the overall deficit over the first ten months of 2013, amidst a contraction of revenues of 2.2% and a rise in expenditures of 6.2%. And while debt service barely moved, the rise in the public finance deficit was accompanied by a shift from a primary surplus of US$ 434 million to a primary deficit of US$ 313 million. This has generated a deterioration in public debt to GDP from 139.5% in 2012 to 145.9% in 2013.

At the monetary level, the monetary situation has been reporting considerable resilience, with no pressures on the currency, and with BDL foreign currency assets growing to US$ 35.3 billion by end-December. At the current level of BDL foreign assets, equivalent to 78.3% of LP Money Supply and 20 months of imports, the Central Bank is in a comfortable position to defend the currency peg shall conversion pressures arise.

The Lebanese banking system continues to witness resilience as well favoured by the positive growth in inflows towards the home economy. Over the year 2013, customer deposits grew by US$ 11.2 billion, against US$ 9.3 billion over the previous year, and loans to the private sector maintained their previous yearly growth of US$ 3.9 billion. Activity growth was mainly accounted for by the foreign currency side, with FX deposits growing by US$ 9.1 billion, against US$ 2.1 billion for LP deposits, thus raising the deposit dollarization rate by 1.3% to reach 66.1% at end-2013. Banks operating conditions reported a slight improvement in local currency interest spreads from its record low while foreign currency spreads have been somehow stable. Within this environment, Lebanese banks' net profits almost maintained in full-year 2013 their level of 2012.

At the level of capital markets, activity was rather sluggish. The total trading value on the equity market amounted to US$ 345 million, its lowest level since 2004, while the price index declined by 3.1% and the turnover ratio was quoted at 3.4%, its lowest level ever. On the bond market, papers came under some selling pressures, especially from foreigners, amidst domestic and regional concerns, in addition to rising speculation of the US Federal Reserve tapering its bond-buying program. Still, the average bond spread contracted by circa 38 bps to 301 bps, and the five-year CDS spreads shrank by circa 57 bps to 393 bps.

The detailed developments in the real sector, external sector, public sector and financial sector will be analyzed thereafter while the concluding remarks are left to an assessment of the near term outlook of the Lebanese economy looking forward.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Activity growing at a moderate pace

Lebanon's primary and secondary sectors seem to have coped well with the adverse conditions surrounding the country, with both agriculture and industry recording moderately growing figures.

Agriculture in Lebanon was among the few sectors to overcome the tough operating conditions and to benefit to some extent from increased competitive advantage. In fact, exports of the sector were up by 5.8% in 2013, compared to a growth level of just 1.9% in 2012. According to the Ministry of Agriculture, this growth is primarily due to the effect of the Syrian crisis which opened new markets for Lebanese products as a result of decreased competition in the Iraqi and Jordanian markets in particular. In addition, increased diversity of Lebanese agricultural produce and the opening of new transport possibilities (by air and sea, with sea freight increasing by 40% in 2013) were of good help for Lebanese exports. It is worth mentioning in this regard that exports by land were adversely affected by the doubling of transportation fees in view of the situation in Syria.

As to the industrial sector, a relatively improved activity was reported on the external front, as industrial exports increased by 6.4% during the first eleven months of 2013. This follows a decline of 11.7% registered in the equivalent period of 2012. However, when excluding fuel oil, industrial exports register a year-on-year decrease of 3.0% during the first eleven months of 2013. According to the Ministry of Industry, the main Lebanese-made products exported in 2013 were agricultural foodstuffs, garments, chemicals, minerals, and precious stones. The Arab markets remained the main importers of those goods last year, with the trend expected to continue for the next few years.

In parallel, imports of industrial machinery were on the rise, where they registered a year-on-year growth of 6.6% in the first eleven months of 2013. The bulk of imports originated from Italy, Germany, and China with respective shares of 23%, 16%, and 15%. It is yet worth mentioning that while import numbers signaled a slightly improved industrial activity, financing for SMEs operating in the sector through Kafalat registered a considerable drop, with the number of loans decreasing by 25% during 2013.

1.1.2. Construction

Another year of activity contraction

Lebanon's property sector extended its slowdown in 2013 amidst a wait and see attitude characterizing investors in Lebanon within the context of continuing regional tensions and lingering domestic uncertainties. The number of property sales transactions dropped by 7.2% in 2013, bringing the value of property sales transactions down by 2.4%, while construction permits reported a contraction of 10.9% over the year.

In details, the number of property transactions dropped from 183,400 to 169,506, a decline of 7.6%, with the number of sales operations falling by 7.2% from 74,569 in 2012 to 69,198 in 2013. In parallel, the value of property sales declined from US$ 8.9 billion in 2012 to US$ 8.7 billion in 2013, a decline of 2.4%. This is actually accompanied with an increase in the average value per sale from US$ 120 thousand in 2012 to US$ 126 thousand in 2013.

The breakdown of the value of property sales over the different regions suggests that Beirut, although continuing to account for the largest share in aggregate sales transactions, has seen this share contracting from 30.8% in 2012 to 28.2% in 2013. Such a contraction is tied to the discrepancy between the price of the housing stock available in Beirut and the purchasing power of resident households in general.

This contraction is actually offset by an increase in the shares of Metn from 18.1% in 2012 to 20.6% in 2013 and Keserouan from 11.0% to 11.7%. Baabda, on the other hand, saw its share slightly decreasing from 21.7% to 21.4%. Other regions have likewise more or less maintained their shares, except the South which has witnessed a noticeable drop in share from 5.6% in 2012 to 4.8% in 2013.

Hence, demand has been gradually shifting either to regions outside Beirut or to more affordable, smaller size properties within the capital. In parallel, larger apartments at 400 square meters and above, have witnessed a slump in demand. In fact, sales activity has been favoured by demand for more affordable lodging by Lebanese residents. Arab nationals and Lebanese expatriates, on the other hand, are being more hesitant to invest, as they can manage to postpone their purchase until the situation starts improving. It is worth mentioning in this context that sales to foreigners registered a yearly drop of 8.3% in 2013 from an already low base in 2012.

Having said that, the real estate market continues to show contracting aggregate activity coupled with stable prices. The price stability confirms the flat phase of the staircase phenomenon that the country has known for decades. Indeed, amidst a non-supportive environment such as the one that we are witnessing nowadays, prices tend to be flat subsequent to upward trends under previous more conducive environments. In few words, prices either rise or stabilize but do not practically decrease in Lebanon.

Finally, the slowdown of activity on the demand side has generated less enthusiasm at the level of developers which reported a contraction in construction permits in 2013 relative to 2012. Construction permits covered an area of 12,924,785 square meters in 2013, against 14,501,728 square meters in 2012, a yearly decline of 10.9%. The breakdown of construction permits by Mohafazat shows that Mount-Lebanon accounted for the lion's share with 46.9% (though dropping from 49.2% in 2012), followed by the North with 19.6%, South Lebanon with 10.7%, Bekaa with 10.3%, Nabattiyeh with 7.8% and finally Beirut with 4.8%. It is worth mentioning that 81.4% of total transactions was accounted for by the Order of Engineers of Beirut and 18.6% of transactions was accounted for by the Order of Engineers of Tripoli.

1.1.3. Trade and Services

Tertiary sector at the image of local and regional developments

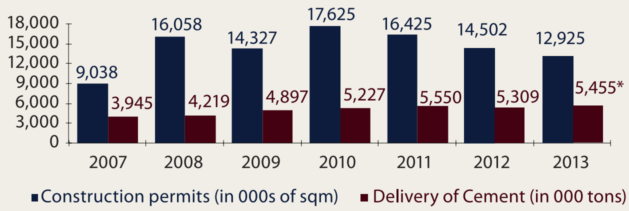
Lebanon's trade and services sector has been at the image of local and regional developments. While foreign trade through the port and passengers through the airport benefited from the redirected activity of land routes, the tourism sector continued to be hindered by adverse local and regional conditions, registering net contraction for the third consecutive year.

A look at the maritime trade activity shows that revenues at the Port of Beirut reached a record high of US$ 219.1 million in 2013, up by 25.4% from a total of US$ 174.8 million recorded in 2012. The growing Port activity mainly reflects the diverted trade activity from other relatively disturbed routes, namely

CONSTRUCTION

	Q4-12	2012	Q4-13	2013	Var. Q4/Q4	Var. 13/12
Value of property sales (in millions of US$)	2,606	8,926	2,673	8,708	2.6%	-2.4%
Number of property sales	21,948	74,569	19,322	69,198	-12.0%	-7.2%
o.w. Sales to foreigners	404	1,394	375	1,278	-7.2%	-8.3%
Average value per property sale (US$ 000)	119	120	138	126	16.5%	5.1%
Property taxes (in millions of US$)	183	619	170	585	-7.0%	-5.4%

EVOLUTION OF CONSTRUCTION INDICATORS



* 11-month figures for 2013 cement deliveries

Arida, Masnaa, Aboudieh and Kaa. Such a growth is even more evident when looking at the tons of goods and the number of containers handled by the Port. In fact, both reported an annual increase of 14.4% and 19.4% respectively, to reach 8,268 thousand tons and 758,058 containers, also the highest levels ever seen.

In parallel, Lebanon's touristic sector has received a hit for the third year in a row. Following net contractions in the number of tourists of 23.7% in 2011 and 17.5% in 2012, they regressed by an additional 6.7% in 2013. Though such a regression is less accentuated than the one witnessed in the previous couple of years, it emanates from a relatively low base already reached in 2012. While the number of tourists had exceeded the 2 million threshold in 2010 to reach 2.168 million tourists over the year, it actually reported a mere 1.274 million tourists in 2013. The retreat in Lebanon's touristic sector has accompanied the adverse regional developments since the beginning of the regional turmoil, and in particular the Syrian turmoil. A considerable part of Arab tourists that used to come to Lebanon by land routes through Syria, had to cancel their trips in view of the insecurity of Syrian routes amid turmoil. Others were affected by the domestic security situation in Lebanon in view of sporadic security drifts in few regions in the country. Also, the warnings issued by a number of countries as to travel to Lebanon left adverse repercussions on the Lebanese touristic sector at large.

The breakdown of tourists by region shows that European countries accounted for the bulk of tourists to Lebanon in 2013 with a share of 34.1%, contrary to the historical trend when Arabs used to account for the lion's share of Lebanon's tourists. As a matter of fact, Arab countries which reported a 12.2% decline in the number of tourists relative to the previous year, accounted for 31.6% of total tourists in 2013, followed by tourists from America (16.4%), tourists from Asia (9.2%), tourists from Africa (5.1%) and tourists from Oceania (3.5%).

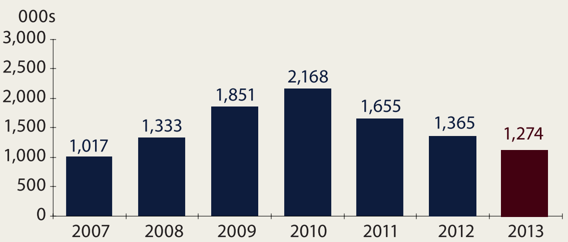
Having said that, the continuing decline in the number of tourists coming to Lebanon is not being accompanied by a similar contraction in the number of passengers at the Hariri International Airport. The number of passengers at the Airport rose by 5.7% in 2013 following a similar growth in the previous year, with the number of the departing ones rising at a higher pace than that of the arriving ones. The number of arriving passengers rose by 4.6%, while the number of departing ones grew by 6.7% The increase in the number of passengers is actually due to two main factors, namely the continuing significant visits of Lebanese expatriates to the homeland and the increasing use of Lebanon's Airport by Syrian nationals fleeing their country by land or by air and transiting through Lebanon amidst the Syrian widespread turmoil.

Last but not least, checks' clearing activity, which is a composite indicator of spending patterns, showed a tiny increase in aggregate spending dynamics, with the value of cleared checks going slightly up by 1.9% to US$ 72,367 million in 2013. This mild rise could be linked to a comparatively contained economic growth as locals are not keen on enhancing their expenditures amidst prevailing uncertainties.

TRADE AND SERVICES

	Q4-12	2012	Q4-13	2013	Var. Q4/Q4	Var. 13/12
Number of ships at the Port	539	2,125	525	2,114	-2.6%	-0.5%
Number of containers at the Port (in 000s)	158	635	181	758	15.0%	19.4%
Merchandise at the Port (in 000 tons)	1,885	7,225	2,090	8,268	10.9%	14.4%
Planes at the Airport	15,111	63,212	15,544	62,980	2.9%	-0.4%
Number of passengers at the Airport (excluding transit)	1,375,644	5,913,305	1,439,093	6,248,744	4.6%	5.7%
Cleared checks (in millions of US$)	18,054	71,020	18,538	72,367	2.7%	1.9%

EVOLUTION OF THE NUMBER OF TOURISTS



1.2. EXTERNAL SECTOR

Balance of payments deficit for the third consecutive year

The performance of Lebanon's external sector in 2013 is at the image of the country's sluggish economy. Foreign trade figures show stagnation in imports alongside a 12% decline in exports for the full year 2013, contributing to a 3% expansion in the foreign trade deficit, according to trade statistics released by Lebanon's Customs Authority. In fact, Lebanon's trade deficit rose from US$ 16.8 billion in 2012 to US$ 17.3 billion in 2013, the equivalent of 39.8% of Lebanon's GDP.

Going further into details, imports reached US$ 21.2 billion in 2013, lower by 0.2% from the previous year. The breakdown of imports by category suggests that machinery and mechanical appliances posted a significant increase of 25%, followed by a 17% rise in arms and ammunition, a 15% increase in transport equipment and an 11% expansion in chemical products. On the other hand, imports of mineral products registered a 15% year-on-year decline to make up 24% of total imports. Imports of jewelry were also down by 28% to account for 5% of the total imports against a share of 7% in the previous year.

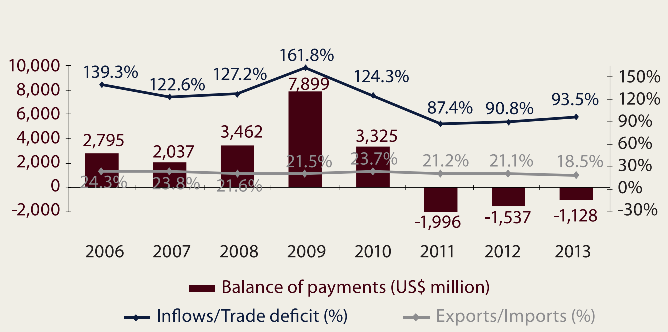
The breakdown of imports by country of origin in 2013 shows that imports from Russia witnessed a 113% growth, to constitute 4% of the country's total imports. Imports from China and Ukraine also registered significant improvements of 29% and 31% respectively, accounting for 11% and 3% of total imports, respectively. In parallel, imports that regressed over the period were mostly from the United States with a 37% drop, and Greece and Syria declining by 32% each.

At the level of exports, a total of US$ 3.9 billion was registered in 2013, down by 12% year-on-year. The breakdown of exports by product suggests a significant growth of 171% in mineral products, followed by a 26% rise in both live animals and animal products, and vegetables. The previously mentioned items were offset by a 55% decline in jewelry goods, the country's most important export item which accounted for 20% of total exports in 2013.

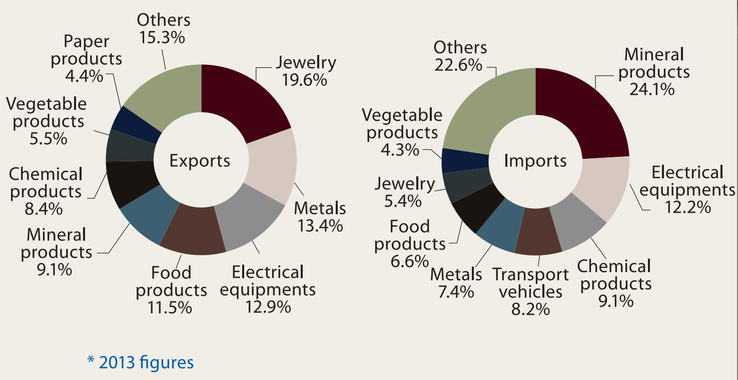
The breakdown of exports by recipient country shows a significant 78% growth in exports to Syria, followed by Nigeria with 70%, Algeria with 38%, Germany with 32%, Iraq with 29%, Turkey with 16% and Qatar with 10%. Conversely, exports that regressed over the year were mostly to Switzerland with a 68% drop, Belgium with a 59% decrease and Spain with a 27% decline.

Last but not least, while financial inflows were higher by 5.9% year-on-year in 2013 to reach US$ 16.2 billion, the balance of payments remained in the red for the third year in a row, with a cumulative deficit of US$ 1,128 million in 2013, though lower than the deficit of US$ 1,537 million reported in the previous year.

FOREIGN SECTOR INDICATORS



BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY *



* 2013 figures

1.3. PUBLIC SECTOR

Challenging year for Lebanon's fiscal accounts

Lebanon's fiscal performance for the year has been at the image of the adverse economic circumstances shaping the country. Deteriorating figures have emerged again with the fiscal deficit increasing by 31.4% during the first ten months of 2013 and the primary balance going back into negative territories. The year 2013 has also registered the highest public indebtedness growth in five years at a level of 10.0% per annum.

Public finance figures show the government deficit rising from US$ 2,677 million in the first ten months of 2012 to US$ 3,518 million in the equivalent period of 2013. This was due to a 2.2% decrease in public revenues accompanied by a 6.2% rise in public expenditures.

In details, revenues dropped from US$ 8,097 million in the first ten months of 2012 to US$ 7,921 million in the first ten months of 2013. This was mainly due to lower telecom revenues (down by US$ 181.1 million year-on-year) along with a drop in customs revenues (down by US$ 55.9 million year-on-year), with the latter mirroring slower import activity. On the other hand, expenditures rose from US$ 10,774 million in the first ten months of 2012 to US$ 11,439 million in the equivalent period of 2013 on the back of both higher general budget expenditures (up by US$ 501.9 million) and Treasury withdrawals (up by US$ 68.9 million). In parallel, debt interest payments, which fall under budget expenditures, rose by US$ 98.9 million within the context of a rising indebtedness along with a stable rate of debt servicing.

In fact, corollary to the rise in government deficit, gross public debt has surged by 10.0% reaching US$ 63.5 billion at end-2013 compared to US$ 57.7 billion at end-2012. Gross local currency debt rose from US$ 33.3 billion to US$ 37.3 billion, an annual rise of 12.2%. Foreign currency debt grew from US$ 24.4 billion to US$ 26.1 billion, up by 7.1% year-on-year. As such, debt-to-GDP has increased from 139.5% in 2012 to 145.9% in 2013, yet remains well below its previous peak of 182% reached in 2006.

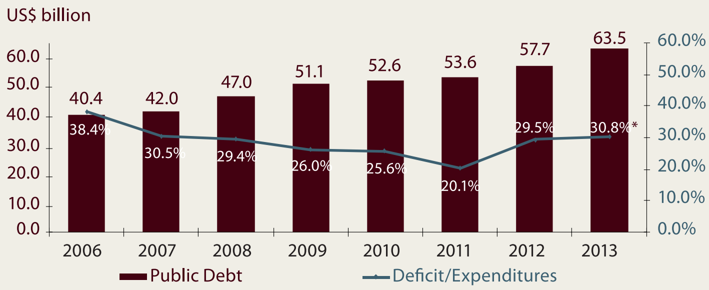
While the country's mounting debt and deteriorating fiscal deficit definitely present a challenge, a number of facts should be taken into consideration when addressing the fiscal imbalances. First, a big share of the public debt, estimated at 90%, is held by domestic players. In fact, both local individuals and institutions are well acquainted with Lebanese risk and do not exit at the first unrest signal. Second, the Central Bank enjoys a sound external position with its foreign assets, including gold, estimated at two times the foreign exchange debt. Moreover, the assets of the Lebanese Republic (including reserves, creditor accounts, and different forms of property) estimated at above US$ 100 billion represent almost double its current level of debt. Other considerations are related to the potential for soft-landing as the public sector that has low resource mobilization in an economy with large output gap, and a potential for spending rationalization. Notwithstanding the room for gradually closing a large fiscal gap resulting from the evasion in income taxes, electricity fees, property taxes, and others.

PUBLIC SECTOR

in millions of US$

Deficit financing	10M-12 Vol	10M-13 Vol	Progression Vol
Deficit	2,677	3,518	842
State creditor accounts	970	1,375	405
Other items	-700	-140	561
Uses=sources	**2,946**	**4,754**	**1,808**
LP	**1,094**	**2,795**	**1,701**
Treasury bills (banking system)	964	1,918	955
Others	130	876	746
FX	**1,852**	**1,959**	**107**
Sovereign eurobonds (including Paris II bonds)	1,828	1,927	99
Others	24	32	8

PUBLIC INDEBTEDNESS



* Figures for 2013 cover the first 10 months

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Significant appetite for high-yielding long-term papers

Lebanon's monetary conditions witnessed small contraction in BDL's foreign assets during the year 2013, moderate growth in LP money supply, tangible expansion in the LP CDs portfolio following the issuance of lucrative long-term categories, and lower subscriptions in LP Treasury bills by banks.

BDL's foreign assets reached US$ 35.3 billion at end-December 2013, covering 77.4% of LP money supply (with this coverage ratio rising to 101.7% when accounting for gold reserves) and 20 months of imports, which continues to underline the BDL's strong ability to defend the currency peg and meet market needs for foreign currencies. It is worth mentioning that the Central Bank's foreign assets registered a slight drop during the year 2013, moving down by US$ 445 million, while bearing in mind the significant contraction in the BDL's eurobond portfolio as a net result of the sale of a large portion of its bonds to banks.

LP Money Supply expanded by LP 3,672 billion in 2013 (the equivalent of US$ 2,436 million) as compared to a much higher growth of LP 6,434 billion (the equivalent of US$ 4,268 million) in 2012. When adding foreign currency deposits, Money Supply in its broad sense (M3) grew by US$ 7,147 million or 6.9% in 2013. This money supply growth compares to a money creation of US$ 6,430 million (US$ 4,518 million in 2012) that resulted from an increase of US$ 4,152 million in net bank lending to the private sector and from a US$ 3,298 million increase in the State's indebtedness towards the banking system (excluding valuation adjustments), within the context of a negative change in net foreign assets (excluding gold) of US$ 1,020 million. The difference between the growth in money supply and money creation amounting to US$ 717 million corresponds to a monetization of financial claims during the year 2013.

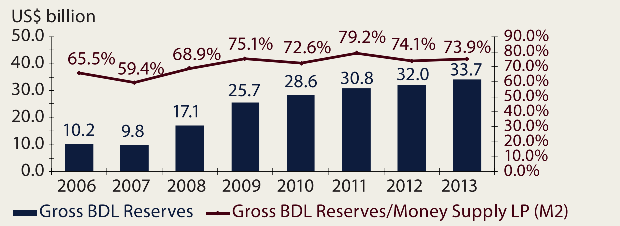
As to Certificates of Deposits, the outstanding LP CDs portfolio held by commercial banks expanded significantly by LP 10,742 billion in 2013 to reach LP 33,815 billion at end-December, following two consecutive years of contractions, mainly supported by heavy cash subscriptions in the 7-year LP CDs category offering a yield of 7.60%, the 8-year category (7.80%) and the 10-year category (8.24%). It is worth noting that the Central Bank of Lebanon has also conducted swap operations between LP CDs maturing in 2013 and 2014 and the aforementioned long-term categories.

In parallel, the primary Treasury bills market was marked by lower investor appetite in 2013 amidst sustained stability in interest rates and heavy subscriptions in high-yielding long-term LP CDs during the first half of the year. This prompted the Ministry of Finance to re-issue the 8-year and 10-year Tbs categories during the second half of 2013 at a yield of 7.80% and 8.24% respectively, and to launch the 12-year category for the first time at a yield of 8.74%, noting that subscriptions in these categories were made in cash or by swapping existing LP Certificates of Deposits issued by the Central Bank of Lebanon and maturing in 2013 and 2014. The lucrative yields on longer-term Tbs contributed somehow to boosting demand on the primary market amidst banks' aim to reduce pressures on their interest spreads. Also, the Central Bank of Lebanon intervened on the primary market in 2013, as reflected by a LP 2,138 billion growth in BDL's LP securities portfolio, noting that the BDL has conducted a swap operation between its LP securities portfolio and its Eurobond portfolio in April 2013. Overall, the aggregate banking system's subscriptions in Tbs (Banks + BDL) decreased to LP 18,529 billion in 2013, with the 8-year, 10-year and 12-year categories accounting for 28% of the total.

MONETARY SITUATION

Flows in US$ million	2012 Vol	2013 Vol	Progression Vol
Net foreign assets (excluding gold)	-1,593	-1,020	573
Net claims on the public sector (excluding valuation adjustments)	2,446	3,298	852
Claims on the private sector	3,665	4,152	487
Uses=Sources	**4,518**	**6,430**	**1,912**
Money (M3)	6,780	7,147	367
Valuation adjustment and other items	-2,262	-717	1,545

EXCHANGE MARKET INDICATORS



1.4.2. Banking Activity

Strong activity growth in a tough operating environment

The Lebanese banking sector witnessed a relatively strong activity growth during the year 2013, in an overall tough operating environment characterized by sluggish economic conditions and ensuing pressures on fee income generation and a low interest rate context pressurizing interest margins and spreads. Total sector activity, measured by the aggregation of assets of banks operating in Lebanon, progressed by 8.5% over the covered period to reach US$ 164.8 billion at year-end 2013.

Banking activity in Lebanon remains favoured primarily by customer deposits, which rose by 9.0% in the year 2013, moving from US$ 125.0 billion at end-December 2012 to US$ 136.2 billion at end-December 2013. The US$ 11.2 billion increase in deposits further reinforces banks' funding base, with deposits accounting for 83% of the aggregate balance sheet, and proved 21% higher than the deposit growth recorded over the year 2012, which is a satisfactory performance given the economic sluggishness and politico-security tensions, and only 3% lower than the prior five-year average growth.

The breakdown of deposits reveals that the growth recorded in the year 2013 is mostly owed to foreign currency deposits, which were responsible for about 81% of total growth in the sector. The growth in FX deposits was almost double relative to the previous year, reaching US$ 9.1 billion in 2013. In parallel, local currency deposits continue to grow, albeit at a more moderate pace than during the previous year, with the equivalent of US$ 2.1 billion in new LP deposits during 2013.

The growth in total deposits was not only owed to higher FX deposits on behalf of residents, but also to additional deposits on behalf of non-residents. While total resident deposits growth in the sector attained US$ 6.8 billion, non-residents contributed to about 39% of total deposit growth with US$ 4.4 billion in 2013, despite erratic monthly fluctuations.

With additional liquidity at hand and relatively low leverage as reflected by a loan-to-deposit ratio at 35%, Lebanese banks had enough financial flexibility to extend new waves of credit throughout the year despite the weak growth momentum across the Lebanese economy. Banks' lending activity grew by 9.0% in the year 2013, with new loans totalling US$ 3.9 billion and almost exclusively to the benefit of the resident sector, almost the same as in the previous year though 15% lower in volumes when compared to the prior five-year average lending growth, thus shedding light on banks' cautiousness and selective approach with regards to new loans.

A look at lending activity from a currency angle shows that banks once again extended more credit in foreign currencies than in Lebanese Pounds, with the former up by US$ 2.5 billion and thus accounting for 64% of lending growth during 2013. Nonetheless, local currency loans practically maintained their share in total loans, within the context of the BDL's stimulus package, subsidizing interest rates in a number of sectors of economic activity.

BANKING ACTIVITY

in US$ million		2012					2013					Var.	
	2011	Q1	Q2	Q3	Q4	2012	Q1	Q2	Q3	Q4	2013	Q4/Q4	13/12
Var: Total assets	11,651	4,151	1,170	2,463	3,523	11,307	3,556	2,506	1,312	5,565	12,938	58.0%	14.4%
% change in assets	9.0%	3.0%	0.8%	1.7%	2.4%	8.0%	2.3%	1.6%	0.8%	3.5%	8.5%	1.1%	0.5%
Var: Total deposits	8,511	2,509	1,660	1,869	3,247	9,285	3,107	3,160	93	4,846	11,207	49.3%	20.7%
o.w. LP deposits	23	1,497	1,037	913	1,098	4,545	634	354	152	1,009	2,149	-8.1%	-52.7%
o.w. FC deposits	8,487	1,012	623	956	2,149	4,740	2,473	2,806	-58	3,838	9,058	78.6%	91.1%
% change in total deposits	7.9%	2.2%	1.4%	1.6%	2.7%	8.0%	2.5%	2.5%	0.1%	3.7%	9.0%	1.0%	1.0%
Var: Total credits	4,446	1,622	707	587	1,161	4,077	1,253	132	1,045	1,499	3,929	29.1%	-3.6%
o.w. LP credits	1,618	338	308	376	194	1,216	238	313	416	428	1,396	120.7%	14.8%
o.w. FC credits	2,827	1,283	398	212	967	2,860	1,015	-181	628	1,071	2,533	10.7%	-11.4%
% change in total credits	12.7%	4.1%	1.7%	1.4%	2.8%	10.4%	2.9%	0.3%	2.3%	3.3%	9.0%	0.5%	-1.4%

Banks also raised their foreign currency sovereign bonds portfolios by acquiring the bulk of the portfolio of the Central Bank of Lebanon. While the ratio of banks' foreign currency sovereign bond portfolio remains high and slightly increased in 2013 to reach 1.24x total equity at end-December, the sovereign risk profile remains on the overall far more favourable than a few years ago when the sovereign exposure ratio as a percentage of total equity crossed the 2x threshold.

Lebanese banks, known for their prudent risk philosophy, are actually keen to maintain their strong asset quality, with a non-performing loan ratio of merely 3.4% of total loans at end-December 2013 as per BDL statistics and with loan loss provisions representing 75% of non-performing loans. In parallel, Lebanese banks also display adequate capitalization ratios, with the total Basel II capital adequacy ratio at 12.2% at end-December 2013 according to BDL figures, higher than the minimum requirement and thus providing banks with adequate buffers to withstand potential pressures on their capital base.

Last but not least, Lebanese banks were able to grow their net profits though at a relatively modest pace year-to-date. Net profits rose to US$ 1,640 million in 2013, growing by 4.1% over the previous year, thus somehow reversing the relative contractionary trend that was prevailing in the past two years. On the basis of average assets of US$ 158.4 billion and average equity of US$ 13.4 billion over the year 2013, ROAA posted an annual ratio of 1.0% and ROAE registered 12.2%, both considered satisfactory returns relative to regional and global benchmarks.

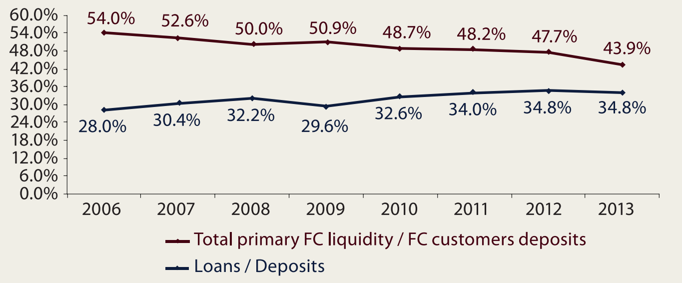
1.4.3. Equity and Bond Markets

Downward price pressures in Lebanese capital markets

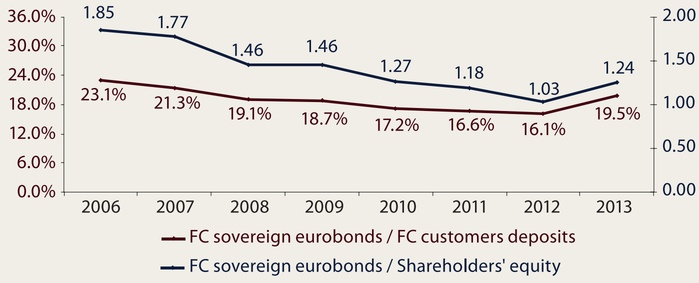
Lebanese capital markets witnessed downward price movements in 2013 amidst heightened local political tensions and worsened security conditions, lingering worries about the repercussions of the Syrian unrest on Lebanon, and tracking increases in US Treasury yields amidst US Federal Reserve tapering concerns.

In details, the Lebanese Eurobond market came under price pressures during the year 2013, amidst local political and security concerns and worries about the deteriorating security conditions in neighboring countries, in addition to speculation that the US Federal Reserve would taper its bond buying program, which effectively took place twice so far in December 2013 and January 2014. Within this context, the weighted average yield widened by 71 bps to reach 5.07% at year-end 2013, while the average spread contracted by 38 basis points to 301 basis points due to a higher rise in international benchmark yields after the US Federal Reserve decided on December 18 to scale back its monthly bond-buying by US$ 10 billion in light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions in the US. As to the cost of insuring debt, Lebanon's five-year CDS spread shrank by 57 basis points in 2013 to reach 393 basis points at end-December, following a contraction of 21 basis points in 2012.

BANKS LIQUIDITY STANDING



BANKS SOVEREIGN EXPOSURE



As to credit rating changes, Standard & Poor's lowered in October 2013 its long-term foreign and local currency sovereign credit ratings on the Republic of Lebanon from "B" to "B-" with "negative" outlook. The downgrade reflects S&P's assessment that Lebanon's macroeconomic fundamentals have slowly but steadily deteriorated since the Syrian crisis began in early 2011. The "negative" outlook reflects S&P's view that credit risks will remain significant while the Syrian conflict remains unresolved. Also, Fitch revised in December Lebanon's outlook from "stable" to "negative", citing heightened political risk, deteriorated public debt dynamics and weak growth prospects. This followed a revision of outlook from "stable" to "negative" by Moody's in May 2013.

At the level of the equity market, local and regional environment concerns weighed on the BSE activity in 2013. The average daily trading value was limited to US$ 1.4 million as compared to an average of US$ 1.7 million in 2012 and an average of US$ 4.7 million during the 2008-2010 period that was marked by a flourishing activity. The total trading value was limited to US$ 345 million in 2013 as compared to US$ 408 million in 2012. The total turnover ratio, measured by the annualized trading value to market capitalization, stood at a mere 3.4% in 2013, as compared to 4.1% in 2012, against a regional average exceeding 40% and a global average close to 200%, which underlines the weak investment appetite governing the BSE.

Also, the equity market saw price falls in 2013 due to some selling operations and as some market participants remained reluctant to add new positions despite attractive market pricing ratios in the Lebanese stock exchange relative to regional benchmarks. The BSE price index fell by 3.1% in 2013, bucking a 21.7% price rise in regional stocks markets, as per the S&P Pan Arab Composite Index, which sheds light on the absence of correlation between the BSE and regional stock markets. As to market volatility, it is worth mentioning that the BSE volatility, measured by the standard deviation of share prices to the mean of prices, reached 2.9% in 2013, as compared to 4.0% in other emerging markets and 5.2% in other Arabian markets at large.

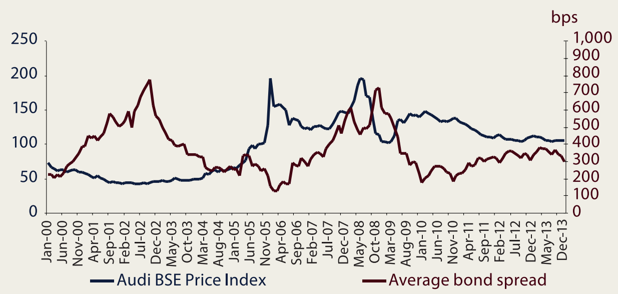
The BSE market capitalization rose from US$ 9,982 million at end-2012 to US$ 10,057 million at end-December 2013, up by 0.7%, despite price contractions, mainly due to new listings of preferred shares for Bank Audi, BLC and Bank of Beirut. Regarding market pricing ratios, the BSE traded at a weighted P/BV of 1.07x in 2013 with some shares trading even below 1.00x, as compared to a much higher P/BV ratio of 1.69x in the region. In addition, the BSE traded at a weighted P/E ratio of 7.4x at end-December 2013 as compared to a P/E of 13.9x in the MENA region. Still, these attractive equity valuation multiples didn't trigger higher demand for Lebanese equities, mainly undermined by local and regional concerns.

FINANCIAL SECTOR (NON-BANKS)

	2008	2009	2010	2011	2012	2013
Beirut Stock Exchange						
Market capitalization (in millions of US$)	9,323	11,982	11,893	9,892	9,982	10,057
Total trading volume (in millions of US$)	1,659	943	820	513	408	345
Annualized trading volume/Market cap	17.8%	7.9%	6.9%	5.2%	4.1%	3.4%
Price index	115.8	144.0	137.7	110.4	108.6	105.3
% change in index	-22.3%	27.3%	-4.4%	-19.8%	-1.6%	-3.1%
P/E ratio*	8.97	10.19	8.82	6.92	7.02	7.42
P/NAV ratio*	1.47	1.51	1.43	1.12	1.10	1.07
Lebanese Eurobonds						
Total volume (in millions of US$)	17,178	17,704	17,736	18,954	19,654	22,331
Average yield	8.7%	5.3%	4.1%	4.4%	4.4%	5.1%
Average spread (bps)	727	290	182	321	339	301
Average life (in number of years)	4.6	4.6	4.7	5.5	5.6	5.4

* for large listed banks

CAPITAL MARKETS PERFORMANCE



2. CONCLUSION: LOOKING AHEAD

In the midst of a prolonging regional turmoil with adverse effects on Lebanon, the Lebanese economy has continued to slow down in 2013, reporting low real GDP growth, mild inflation and a weak capital formation rate. For the third year, the economy remained subjected to heightened political tensions originating from close political and economic linkages to Syria.

Most economic sectors are prolonging their slowdown witnessed since the beginning of the turmoil. The analysis of economic sectors yet report some defensive sectors benefitting from the relative resilience in private consumption which decelerated but maintained a positive growth trend. It is worth mentioning that, on the opposite side, private investment is believed to continue contracting in net real terms within the context of a wait and see attitude postponing major investment decisions amidst political uncertainties.

As a matter of fact, defensive sectors of the economy, or sectors that have been outperforming the overall domestic economy, are actually revolving around food & beverages, pharmaceuticals, energy and education services. Vulnerable sectors are real estate services, cement, building materials, contracting, hotels and media & communications. The rest of the sectors have been in line with overall macroeconomic performance, which means they are slowing down but avoiding net contractions of their activity bases.

Looking ahead, the Lebanese economy could actually see a relative slight growth improvement in 2014 for a number of domestic and regional considerations. According to the simple average of growth rates forecasted by 9 foreign institutions that estimate and forecast Lebanon's GDP, the average real GDP growth rate is likely to slightly improve from 1.1% in 2013 to 2.1% in 2014. Among the nine forecasting institutions, eight institutions foresee improving growth rates in 2014, while one foresee stable growth rate over the year. The possible improvement in growth follows a widening cyclical output gap over the past few years which could provide a favorable base effect for capacity utilization.

Banking forecasts for the year to come suggest moderate deposit growth, but enough to continue financing the domestic economy in its private and public sectors' components. According to our conservative forecast for 2014, based on an IMF real GDP growth rate of 1.5%, an annual budget deficit of US$ 4.2 billion of which US$ 3 billion of bank financing, new bank loans to the private sector of US$ 3.5 billion, and a positive growth in financial inflows, the deposit growth could be forecasted at close to the one reported last year, which suggests no pressure on bank liquidity and interest rates. It is yet worth mentioning that such a deposit growth could rise further in the event of a net improvement in the political situation, locally or regionally.

At the fiscal level, IMF forecasts for the year ahead, which seem likely to materialize, suggest a slight deterioration of deficit and debt ratios. The fiscal deficit is likely to reach 10.9% of GDP in 2014, raising the debt/GDP ratio to 147.9% by year-end. Although such ratios remain well below historical peaks (a previous peak of 23.6% for the deficit ratio and of 181.9% for the debt ratio), they are considered elevated by comparative global standards. According to IMF's World Economic Outlook, the emerging markets average deficit/GDP ratio stands at 2.2% for 2014 and the emerging markets average debt/GDP ratio stands at 33.7% for year-end 2014. Such a divergence between Lebanon's fiscal ratios and their corresponding benchmarks suggests that an alleviation of fiscal drifts is crucial to preserve Lebanon's economic stability.

In a longer run, beyond current temporary setbacks, Lebanon's long term outlook bodes favorable on the overall. As the extraction of oil and gas from its territories will start to materialize, it can move the country from one state to a completely different one. Based on the current gas and oil prices and on the basis of Lebanon's 96 trillion cubic feet of gas reserves and 865 million barrels of oil reserves, net proceeds to the government are estimated at more than US$ 600 billion according to Ministry of Energy sources, the equivalent of ten times the size of its public indebtedness. Such figures highlight the importance of containing and minimizing the cost of delay in an economy that enjoys a huge structural potential. If Lebanon succeeds such a challenge, the extraction of natural resources can put an end to the country's most significant post-war conundrum, which is public finances, while growth could turn into sustainably strong levels for a number of years, rapidly expanding output levels and income per capita at large.

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