BLOMINVEST BANK SAL

Your Investment Reference

THE LEBANON BRIEF

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FINANCIAL MARKETS

Equity Market

Stock Market

	22/08/2014	14/08/2014	% Change
BLOM Stock Index*	1,191.76	1,200.83	-0.76%
Average Traded Volume	576,459	76,059	657.91%
Average Traded Value	3,960,873	1,048,577	277.74%

*22 January 1996 = 1000

BLOM Stock Index

Banking Sector

	Mkt	22/08/2014	14/08/2014	% Change
BLOM (GDR)	BSE	$9.35	$9.35	0.00%
BLOM Listed	BSE	$8.74	$8.75	-0.11%
BLOM (GDR)	LSE	$9.35	$9.30	0.54%
Audi (GDR)	BSE	$6.50	$6.50	0.00%
Audi Listed	BSE	$6.10	$6.35	-3.94%
Audi (GDR)	LSE	$6.30	$6.50	-3.08%
Byblos (C)	BSE	$1.62	$1.63	-0.61%
Byblos (GDR)	LSE	$73.00	$73.00	0.00%
Bank of Beirut (C)	BSE	$18.39	$18.39	0.00%
BLC (C)	BSE	$1.70	$1.70	0.00%
Fransabank (B)	OTC	$28.00	$28.00	0.00%
BEMO (C)	BSE	$1.82	$1.82	0.00%

	Mkt	22/08/2014	14/08/2014	% Change
Banks' Preferred Shares Index *		104.64	104.59	0.05%
Audi Pref. E	BSE	$100.70	$100.70	0.00%
Audi Pref. F	BSE	$100.50	$100.50	0.00%
Audi Pref. G	BSE	$100.50	$100.00	0.50%
Audi Pref. H	BSE	$100.00	$100.00	0.00%
Byblos Preferred 08	BSE	$101.00	$100.70	0.30%
Byblos Preferred 09	BSE	$100.50	$100.50	0.00%
Bank of Beirut Pref. E	BSE	$25.80	$25.80	0.00%
Bank of Beirut Pref. I	BSE	$25.60	$25.70	-0.39%
Bank of Beirut Pref. H	BSE	$25.70	$25.70	0.00%
BLOM Preferred 2011	BSE	$10.20	$10.20	0.00%
BLC Pref A	BSE	$100.00	$100.00	0.00%
BLC Pref B	BSE	$100.00	$100.00	0.00%
BLC Pref C	BSE	$100.00	$100.00	0.00%
Bemo Preferred 2013	BSE	$100.30	$100.30	0.00%

* 25 August 2006 = 100

Lebanon's ongoing political deadlock related to the presidential vacuum and the unresolved public sector wage scale kept on paralyzing activity on the Beirut Stock Exchange (BSE). The BLOM Stock Index (BSI) mirrored the impasse and revealed a 0.76% weekly downtick to 1,191.76 points. As for the market capitalization, it narrowed by $72.70M to stand at $9.55B. The average volume of traded shares significantly increased over the week by 658% to 576,459 and the average traded value by 278% to reach $3.96M as more than 500.000 Audi shares were cross traded on Thursday's and Friday's sessions.

The BSI was outperformed by some of its regional peers. The S&P Pan Arab Composite Large Midcap index and the S&P AFE40 index edged up by 1.26% and 1.47% to 161.77 points and 74.05 points, respectively. The Morgan Stanley Emerging index (MSCI) also added 1.03% to 1,081.93 points.

The BSE was the worst performer this week amongst the Arab Bourses and was followed by Abu Dhabi stock market that shed by a weekly 0.11%.

In contrast, all the remaining Arab markets posted positive performance and were headed by Dubai's bourse that added 2.11%. The Qatari and Kuwaiti stock exchanges followed, rising by 2.00% and 1.92%, respectively.

Back to Lebanon, the banking sector grasped 95.66% of total traded value on the BSE this week. As for the real estate and the industrial sectors, they posted timid weekly contributions of 4.14% and 0.20%, respectively.

In the banking sector, the listed shares of BLOM, Audi and Byblos inched down by 0.11%, 3.94% and 0.61% to $8.74, $6.10 and $1.62, respectively.

However, the BLOM Preferred Shares Index (BPSI) managed to show positive weekly performance as it increased by 0.05% to 104.64 points. The gauge was supported by the 0.50% and 0.30% respective weekly rises of Audi preferred G shares And Byblos Preferred 08 shares that ended the week standing at $100.50 and $101.00, respectively. However, the preferred shares of Bank of Beirut class "I" closed at $25.60, down by 0.39% from last week's closing.

Real Estate

	Mkt	22/08/2014	14/08/2014	% Change
Solidere (A)	BSE	$12.70	$12.88	-1.40%
Solidere (B)	BSE	$12.68	$12.61	0.56%
Solidere (GDR)	LSE	$12.51	$12.75	-1.88%

Manufacturing Sector

	Mkt	22/08/2014	14/08/2014	% Change
HOLCIM Liban	BSE	$14.50	$14.05	3.20%
Ciments Blancs (B)	BSE	$3.50	$3.50	0.00%
Ciments Blancs (N)	BSE	$2.75	$2.75	0.00%

Funds

	Mkt	22/08/2014	14/08/2014	% Change
BLOM Cedars Balanced Fund Tranche “A”	-----	$7,344.34	$7,337.78	0.09%
BLOM Cedars Balanced Fund Tranche “B”	-----	$5,249.95	$5,245.15	0.09%
BLOM Cedars Balanced Fund Tranche “C”	-----	$5,578.08	$5,573.09	0.09%
BLOM Bond Fund	-----	$9,637.73	$9,637.73	0.00%

Retail Sector

	Mkt	22/08/2014	14/08/2014	% Change
RYMCO	BSE	$3.40	$3.40	0.00%
ABC (New)	OTC	$33.00	$33.00	0.00%

Tourism Sector

	Mkt	22/08/2014	14/08/2014	% Change
Casino Du Liban	OTC	$380.00	$380.00	0.00%
SGHL	OTC	$7.00	$7.00	0.00%

On the London Stock Exchange (LSE), BLOM GDR shares gained a weekly 0.54% to settle at $9.35. Meanwhile, Solidere and Audi GDRs lost 1.88% and 3.08% to $12.51 and $6.30, respectively.

The real estate sector showed mixed performance this week. Solidere A shares lost 1.40% to close at $12.70, while its B counterpart gained 0.56% to $12.68.

In the industrial sector, HOLCIM shares rose by 3.20% to $14.50.

In the coming period, any political consensus over the nomination of a new president to fill the current vacuum or any agreement related to the public sector’s wage scale dilemma will certainly give a boost to the BSE. Yet, security uprisings on the local and regional fronts will remain one of the crucial barometers of trading activity on the Lebanese stock market.

Foreign Exchange Market

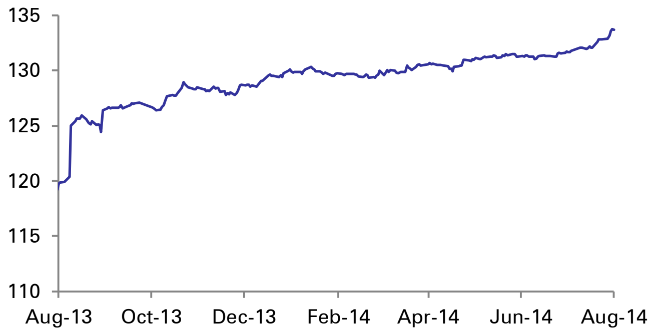
Lebanese Forex Market

	22/08/2014	14/08/2014	% Change
Dollar / LP	1,507.00	1,507.00	0.00%
Euro / LP	2,002.11	2,015.98	-0.69%
Swiss Franc / LP	1,654.23	1,663.54	-0.56%
Yen / LP	14.53	14.71	-1.22%
Sterling / LP	2,500.94	2,514.81	-0.55%
NEER Index**	133.68	132.85	0.62%

*Close of GMT 09:00+2
**Nominal Effective Exchange Rate; Base Year Jan 2006=100
**The unadjusted weighted average value of a country's currency relative to all major currencies being traded within a pool of currencies.

Stable demand for the dollar was seen over the past week as reflected by the Lebanese pound's peg against the dollar that steadied at $/LP 1,505-1,509 with a mid-price of $/LP 1,507, unchanged from last week's quote. Foreign assets (excluding gold) at the Central Bank rose by a monthly 2% from $37.07B by June to $37.77B by end-July. Meanwhile, the dollarization rate of private sector deposits stood at 66.02% in June compared to 66.13% in December 2013.

Nominal Effective Exchange Rate (NEER)



The euro lost 0.69% against the dollar, closing at €/$ 1.3281 on Friday, where the dollar recorded its highest weekly increase versus the euro since March. This stemmed from the positive economic results in the US signaling that interest rates might rise sooner than predicted. Moreover the low interest rates in Europe are driving European traders to invest their money abroad in search of higher returns.

Due to the diverging monetary policies in the States and in Europe, triggering a strong dollar, demand for gold abated, where its price declined by 2.72%, from $1,312.74/ounce last week, to $1,276.99/ounce on Thursday.

By Friday August 22, 2014, 12:30 pm Beirut time, the dollar-pegged LP appreciated against the euro going from €/LP 2,015.98 to €/LP 2,002.11. The Nominal effective exchange Rate (NEER) gained 0.62% to 133.68 points, while its year-to-date gain reached 3.58%.

Money & Treasury Bills Market

Money Market Rates

	22/08/2014	14/08/2014	Change bps
Overnight Interbank	9.00	9.00	0
BDL 45-day CD	3.57	3.57	0
BDL 60-day CD	3.85	3.85	0

Treasury Yields

	21/08/2014	13/08/2014	Change bps
3-M TB yield	4.39%	4.39%	0
6-M TB yield	4.87%	4.87%	0
12-M TB yield	5.08%	5.08%	0
24-M TB coupon	5.84%	5.84%	0
36-M TB coupon	6.50%	6.50%	0
60-M TB coupon	6.74%	6.74%	0

During the week ending August 7 2014, broad Money M3 declined by LP 483B ($320.20M), to reach LP 173,853B ($115.33B). M3 growth rate reached 7.24% year-on-year and 3.75% since year start. Likewise, M1 regressed by LP 221B ($146.42M) due to the drop in demand deposits by LP 218B ($144.61M), and in money in circulation by LP 3B ($1.99M).

Total deposits (excluding demand deposits) fell by LP 261.98B ($173.78M), given the contraction in deposits denominated in foreign currencies by $299M. However, term and saving deposits in domestic currency advanced by LP 83B. Over the above mentioned period, the broad money dollarization went down from 59.17% to 59.14%. According to the Central Bank, the overnight interbank rate swelled from 2.75% end of May 2014 to 9.00% end of June.

In the TBs auction held on the 14th of August 2014, the Ministry of Finance raised LP 320.31B ($212.48M), through the issuance of bills maturing in 3M and 6M, and 5Y notes. The highest demand was achieved on the 5Y notes that took a share of 79.24%, while the 3M and 6M bills accounted for 10.94% and 9.82% respectively. The 3M and 6M bills yielded 4.39% and 4.87%, respectively. Meanwhile the average coupon rate for the 5Y notes stood at 6.74%. New subscriptions exceeded Maturing T-bills by LP 36.12B ($23.96M).

Eurobond Market

Eurobonds Index and Yield

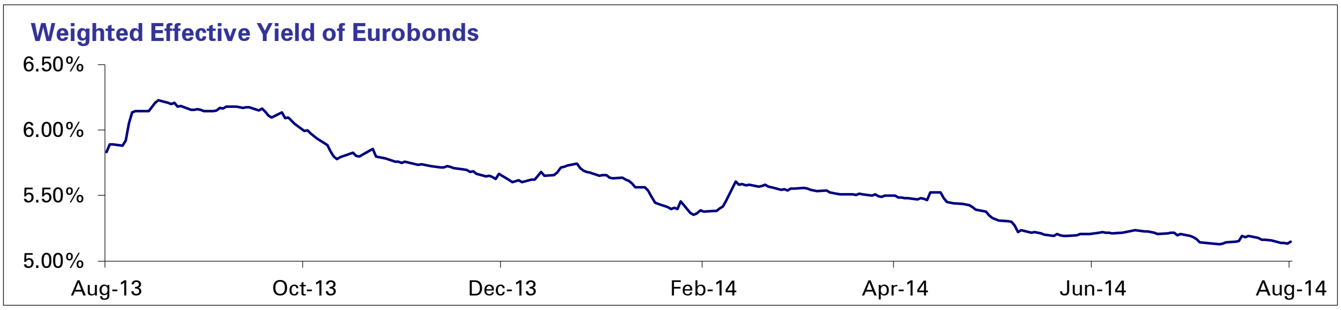
	21/08/2014	13/08/2014	Change	Year to Date
BLOM Bond Index (BBI)*	108.241	108.176	0.06%	2.46%
Weighted Yield**	5.15%	5.16%	-2	13
Weighted Spread***	356	362	-6	-74

*Base Year 2000 = 100; includes US$ sovereign bonds traded on the OTC market
** The change is in basis points ***Against US Treasuries (in basis points)

Eurobonds Lebanese Government

Maturity - Coupon	21/08/2014 Price*	13/08/2014 Price*	Weekly % Change	21/08/2014 Yield	13/08/2014 Yield	Weekly Change bps
2015, Jan - 5.875%	101.211	101.26	-0.05%	2.80%	2.84%	-4
2015, Aug - 8.500%	104.733	104.88	-0.14%	3.43%	3.40%	4
2016, Jan - 8.500%	106.609	106.601	0.01%	3.65%	3.72%	-8
2016, May - 11.625%	112.909	113.068	-0.14%	3.80%	3.80%	0
2017, Mar - 9.000%	111.749	111.854	-0.09%	4.15%	4.15%	0
2018, Jun - 5.150%	101.633	101.45	0.18%	4.67%	4.73%	-5
2020, Mar - 6.375%	104.834	104.75	0.08%	5.36%	5.38%	-2
2021, Apr - 8.250%	115.149	115.027	0.11%	5.49%	5.52%	-3
2022, Oct - 6.100%	101.827	101.678	0.15%	5.81%	5.84%	-2
2023, Jan - 6.000%	100.737	100.634	0.10%	5.89%	5.90%	-2
2024, Dec - 7.000%	106.195	105.958	0.22%	6.18%	6.21%	-3
2026, Nov - 6.600%	102.157	101.907	0.25%	6.34%	6.37%	-3
2027, Nov - 6.75%	102.968	102.753	0.21%	6.41%	6.44%	-2

*Bloomberg Data



The Eurobonds Market remained on its uphill path for the second week in a row. The BLOM Bond Index (BBI) gained 0.06% from its value the prior week, to 108.24 points, with a 2.46% increase since year start. Besides, the 5Y and 10Y yields on the Lebanese Eurobonds dropped 2 basis points (bps) each, to settle at 5.07% and 6.18%, respectively.

The Chinese Purchasing Managers Index in August which came lower than expected, in addition to the drop in the Chinese yuan, the Philippine peso, and the Malaysian ringgit lifted demand for government bonds. Accordingly, the JP Morgan emerging countries' bond index outperformed the BBI, advancing by 0.74% to 687.57 points.

In the U.S, treasuries underwent the worst weekly drop in 7 weeks due to predictions that the strong economic growth in the U.S will push the Fed to increase interest rates next year. Over the past week the 5Y treasury yield edged up by 5 bps to 1.64% while the 10Y yield lost 2 bps to 2.41%.

As a result, the 5Y spread between the Lebanese Eurobonds and their U.S benchmark narrowed by 7 bps to reach 343 bps. Meanwhile the 10Y spread against the U.S treasury benchmark steadied at 377 bps.

Lebanon's credit default swap for 5 years (CDS) contracted to 335-365 bps, from last week's quote of 345-375 bps. In regional economies, 5Y CDS quotes of Saudi Arabia narrowed from 52-62 bps to 50-55 bps. Dubai 5Y CDS widened from 155-166 bps to 159-169 bps. Meanwhile, the 5Y CDS of Brazil and Turkey went down from 152-154 bps and 185-188 bps, to 138-140 bps, and 181-183 bps, respectively.

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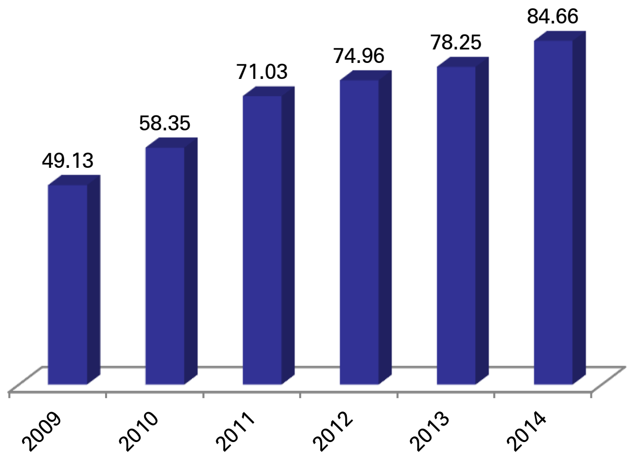
ECONOMIC AND FINANCIAL NEWS

BdL total Assets by Mid-August

(In $B)



Source: BdL

BDL's Total Assets Edged Up to $84.66B by Mid-August

The Central Bank's (BDL) balance sheet, recorded a 1.77% monthly rise in total assets to $84.66B by mid-August, mainly due to the 1.81% increase in its holding of foreign assets.

Foreign assets (excluding gold), grasped a share of 44.68% of total assets and settled at $37.83B by Mid-August. Similarly, gold reserves grew by 0.10% since mid-July to reach $12.09B. Worth mentioning that during this period, the price of gold increased by 0.80% to $1,304.30/ounce.

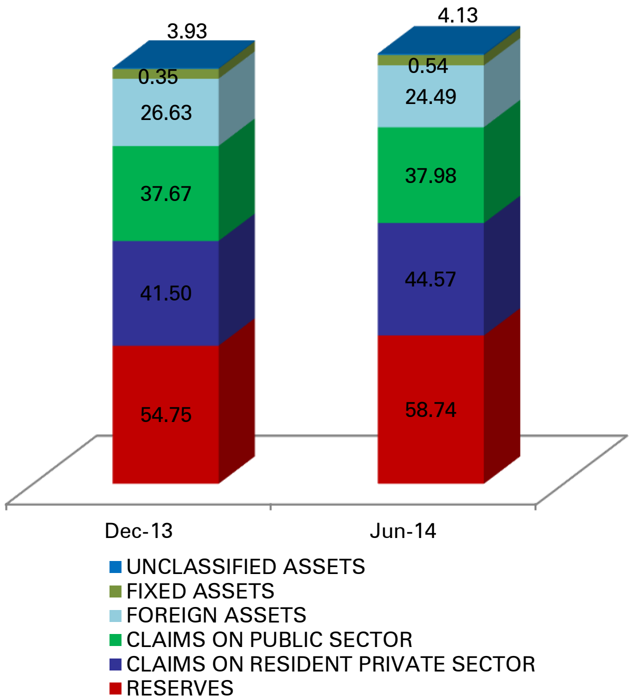
The central bank's securities portfolio and loans to the local financial sector inched up by 1.32% and 9.72% in month-ago terms to reach $12.89B and $3.75B, respectively.

On the liabilities side, financial sector deposits expanded by 2.51% from mid-July's value to reach $63.52B in mid-August.

Lebanon's Commercial Banks Assets Surged to $170.45B by June

Commercial Banks' Assets

(In $B)



Source: BdL

The consolidated balance sheet of commercial banks revealed a 3.42%year-to-date (y-t-d) rise in total assets to $170.45B by June, and a progress of 7.92% year-on-year.

Reserves, which grasped a share of 34.46% of total assets, increased by 7.29% since year-start to stand at $58.74B. Claims on resident private sector followed, (with a share of 26.15% of the total) swelled by 7.39% since the beginning of the year, to $44.57B. The Dollarization of private sector loans went from 76.54% in December, down to 76.47% at the end of the first half of 2014. During this period, foreign currency loans grew by 7.89% to $32.79B, while loans in the local currency rose at a slower pace of 5.99% to $11.78B.

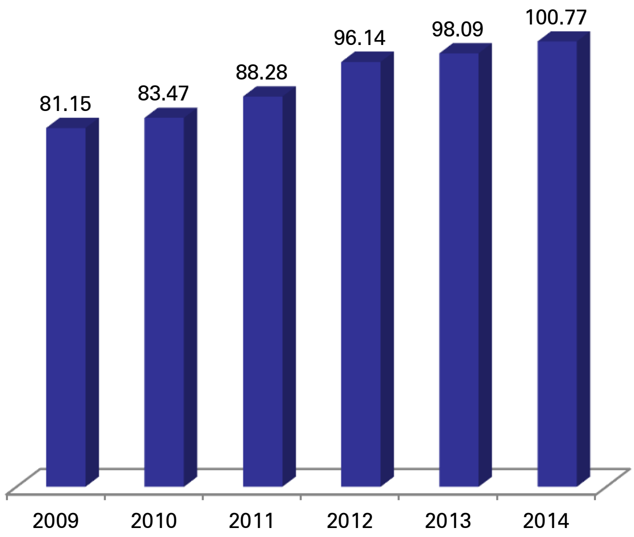
Moreover, commercial banks' holdings of government securities inched up by 0.80%, to settle at $37.88B. Eurobonds holdings declined by 3.70% to $16.96B, while treasury bills in local currency increased by 4.77% to $20.93B.

On the Liabilities side, resident private sector deposits edged up by 3.72% y-t-d to $111.73B. In fact, deposits denominated in Lebanese pounds augmented by 3.30% to $44.18B, less than the 4.00% increase in resident foreign currency deposits to $67.56B.

Similarly, non-resident private sector deposits added 0.47% y-t-d to reach $28.61B by June, due to the increase in L.P deposits by 4.46%. Hence the dollarization rate of private sector deposits went from 66.13% end of December 2013, down to 66.02% by June 2014.

Consumer Price Index Reached 100.77 in July

CPI in July



Source: CAS

Inflation rate reached 2.73% year-on-year (y-o-y) as the Consumer Price Index (CPI) increased in July 2014 to 100.77, compared to 98.09 in the same month last year (noting that this level is adjusted on the new base of 100 in December 2013). Out of all sub-indices, "Communication" was the only one to register a yearly plunge of 24.04%, reaching 75.96. This was due to the drop in telecommunications prices that occurred beginning of June.

On the other hand, "Food and non-alcoholic beverages" sub-index, with a weight of 20.6% of the CPI, increased by 2.59%, y-o-y to 99.12. Whereas "Water, electricity, gas, and other fuels" index saw a yearly rise of 6.39%. The "Transportation" sub-index ticked up by an annual 1.87%. Likewise, "Clothing and footwear" component added 6.12%. The "Alcoholic beverages and tobacco" sub-index, which accounts for 1.6% of the CPI, recorded the highest y-o-y surge of 12.34% to 105.79 points, mainly caused by the rise in the price of tobacco.

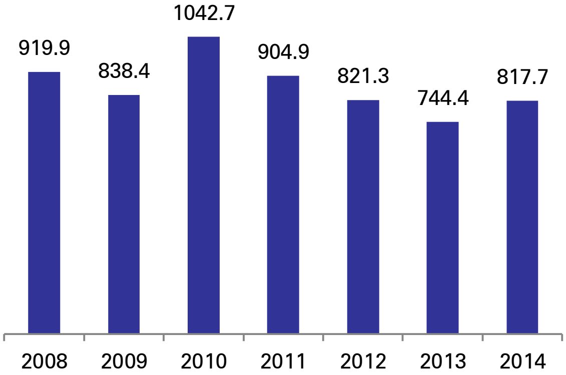
On a month-to-month basis, the month of July recorded 0.16% inflation from 100.61 points in June.

On a regional level, all districts witnessed a monthly increase in price, except Beirut with a 0.15% monthly drop. The highest regional monthly rise in price is 1.63% in Nabatieh.

Construction Area Authorized by Permits Increased by 9.6% y-o-y by July

Average area per Permit up to July

(In sqm/permit)



Source: Order of Engineers in Beirut and the North

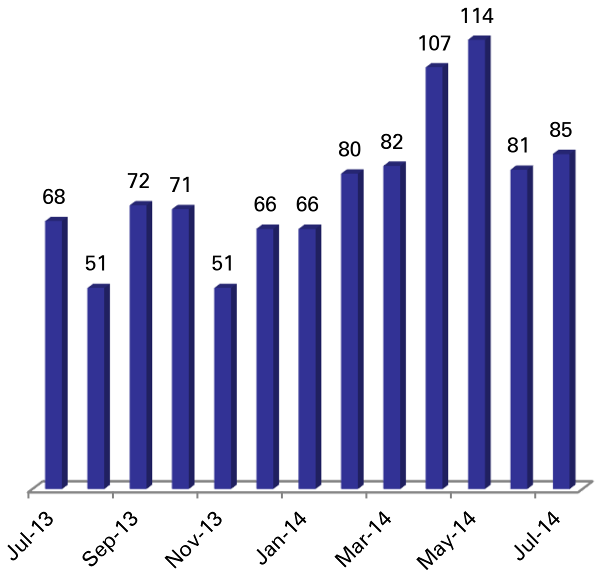
Construction activity kept on revealing positive performance by July this year despite the barely changing number of construction permits. In details, the number of permits posted a marginal 0.2% y-o-y downtick to 10,092 compared to 10,113 in 2013. With respect to the construction area authorized by permits (CAP), it registered a 9.6% y-o-y growth by July to reach 8.25M sqm. Accordingly, the average area per permit stood at 817.75 sqm/permit by July 2014 compared to 744.44 sqm/permit by July 2013. This partly confirms the potential twist in investors' trend in favor of larger plots for their projects by the beginning of the year, noting that permits are usually issued at least six months after applications are filed.

However, the number of permits in July alone stood at 1,311, a 16.0% y-o-y drop from July 2013's level. This decrease is mainly attributed to the persisting economic slowdown that loomed over Lebanon in February amid a stressed political atmosphere and a regional chaos. Accordingly, demand for real estate weakened in the second month of the year despite the long awaited Cabinet formation that took place during the month. In addition, fears of the Syrian war spillovers or a new political development on the domestic front also triggered down the CAP in July 2014 by 22.3% compared to the same month last year.

Worth mentioning that construction remained concentrated in Mount Lebanon with 550 permits or 42.0% of the total, while the South region posted 221 permits or 16.9% share.

Consumer Confidence Index (CCI) Settled at 85 in July

CCI Historic Levels



Source: ARA Marketing Research and Consultancy

According to ARA Marketing Research and Consultancy, the Consumer Confidence Index (CCI) displayed a 4 points monthly rise to 85 points in July, partly offsetting June's drop. This improvement came as a result of the advent of Eid E-Fitr and the beginning of the summer festivals.

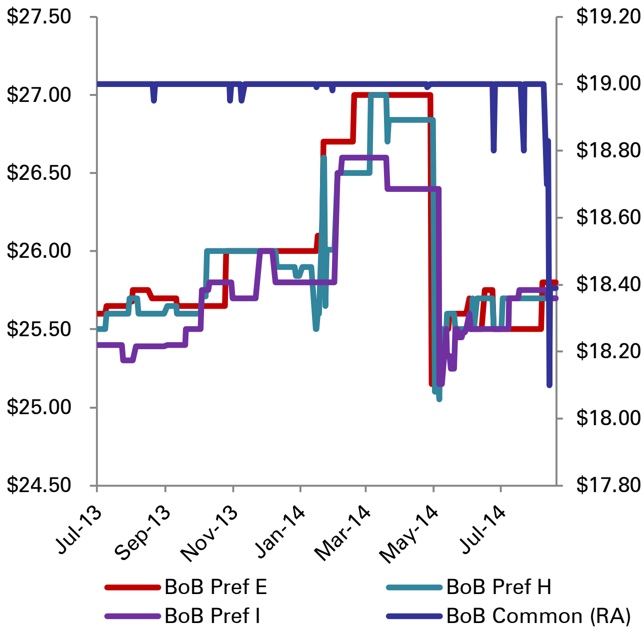
The Purchase of Durable Goods Index grew by 19 points to 181 points in July, being the only index progressing for the past 6 months. This is due to the improvement in the purchasing power of most Lebanese.

The Current Economic Situation Index surged by 44 points to reach 139 points. Likewise, the Current Personal Income gained the 13 points it had lost in June, reaching 91 points in July.
Looking at the security front, the country's stability did not get affected by the rockets fired from Lebanon to Gaza. The Security Situation Index added 39 points to hit 194 points at the end of July.

On the other hand consumer sentiment for the coming period was pessimistic, The Expected Economic Situation Index and the Expected Personal Income Index lost 4 points and 6 points, to settle at 53 points and 60 points, respectively. This reflects the lack of citizens' confidence in the future.

CORPORATE DEVELOPMENTS

Bank of Beirut Shares Performance



Source: BSE, BLOMINVEST Research Department

Bank of Beirut Issues Priority Shares Class 2014

Following the extraordinary general assembly that took place on the 22nd of May 2014, Bank of Beirut (BoB) issued 4,762,000 priority shares class 2014. The share's subscription price is $21 consisting of LP 1,350 as nominal value and a premium which makes up the rest of the value. Subscription will take place at all branches of BoB from the 18th till the 28th of August 2014.

Furthermore, the common shareholders will have a priority right to subscribe in these shares, on a non-reducible basis, according to the percentage of common shares they hold, and on a reducible basis, according to their contribution and within the limit of their reducible demands.

The holders of preferred shares classes E, F, G, H and I, the public and holders of common shares are entitled to subscribe in the remaining priority shares class 2014 as long as they subscribe a minimum of 12,000 priority shares class 2014 and a maximum of 2,400,000 shares.

An error occurred in the past issue whereby the table had the wrong title and source. Kindly find below the amended title and source from last week's story, issue number 881.

ODEABANK's Financial Highlights in H1 2014

(In $B)

	Jun-14	Dec-13	%change
Customers' Deposits	6.94	5.72	21.32%
Loans and Receivables	6.78	5.37	26.22%
Total Assets	9.68	7.66	26.36%
Shareholders' Equity (In $M)	624.09	632.72	-1.36%
Net Profit (In $M)	-14.74	-37.25*	-60.42%

(*): Value of June 2013

Source: Bank Audi

ODEABANK registers a $14.74M Net Loss in H1

ODEABANK, Bank Audi's Turkish subsidiary, recorded a $14.74M net loss in the first half (H1) of 2014, compared to a loss of $37.25M in the same period the prior year. This was mostly due to $43.89M losses on derivative financial transactions.

On the balance sheet, total assets rose by 26.36% from end of December 2013, to $9.68B as of June's end. This surge is accredited to the fact that loans and receivables amplified by 26.22% year-to-date (y-t-d) to $6.78B up to June.

On the liabilities side, and during the abovementioned period, total deposits increased by 21.32% to $6.94B.

However, shareholders' equity dropped by 1.36% since year start to $624.09M.

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FOCUS IN BRIEF

Lebanon, a Commodity Producer: What Frameworks to Explore?

With 25 trillion cubic feet (cf) of potential gas resources, Lebanon is set to become a commodity producer in the next decade. These reserves will reap substantial revenues starting from 2020 at the earliest but it is way before that authorities must review their fiscal assessment tools, decide what shares of these revenues to save or/and invest and to make sure that institutions will guarantee efficiency and transparency in the resource exploitation process.

The exploitation of Lebanon's resources raises multiple questions. Should Lebanon create a sovereign wealth fund (SWF) to handle its hydrocarbon resources? If the answer is yes, would it serve intergenerational equity, infrastructure projects, the government's pension liabilities or reducing public debt? How should Lebanon design its fiscal framework to absorb the stream of resource-revenues? Is it possible to reconcile intergenerational equity with fiscal stabilization and debt reduction? Based on World Bank and IMF reports, the first section of this report discusses the establishment, objectives, challenges and benefits of a SWF while the second part scrolls through several fiscal frameworks, each offering different specificities.

Prior to answering these questions, it is interesting to know how much revenues we can reap from our hydrocarbon wealth, when will these revenues materialize and how long will our resources last.

The IMF drafted a baseline scenario for Lebanon. It assumes recoverable reserves of around 13 trillion cf and production to start in 2021. Production is expected to last for 35 years with full capacity reached by 2036, a fast decline after 2043 and eventually low production by 2055. By the end of the next decade, revenues are estimated to reach 4% of GDP and represent 14% of total revenues. Lebanon could benefit from these streams of income to rehabilitate its infrastructure in terms of electricity, telecommunications, water and transportation.

In the alternative scenario, recoverable reserves are estimated at 25 trillion cf, production shall start in 2021 but the reserves last more than 35 years, reach full capacity in 2036 and are preserved until 2050. Revenues are projected at around 7% of GDP and are estimated to represent almost 25% of total revenues by 2030.

Establishing a Sovereign Wealth Fund

Various Types of Sovereign Wealth Funds (SWF)

	Stabilization Funds	Savings Funds	Development Funds	Pension Reserve Funds
Goal	Shielding the budget and the economy from the effects of commodity price volatility	Achieving Intergenerational equity	Allocating the funds to socio-economic projects such as infrastructure	Meeting the government's future liabilities related to pensions
How?	Implementing Counter-cyclical fiscal policy	Transforming non-renewable assets into diversified financial assets	Supporting local or national development through filling the gaps in private sector investment capacity	Aligning the fund's objective with the government's future liabilities
Where?	Chile, Russia, Timor-Leste, Iran	Abu Dhabi Investment Authority, Libya, Russia's National Wealth Fund	UAE, Iran	Chile, Australia, Ireland and New Zealand
Investment Horizon	Short Term , Invest in highly liquid portfolios so small return	Long Term, High risk return profile	Long Term	Long Term
Chosen By Lebanese Authorities	NO	YES	NO	NO

Source: World Bank, Lebanon Economic Monitor, "A Sluggish Economy in A Highly Volatile Environment

In 2010, the Offshore Petroleum Law was passed by Parliament. The law encompasses the establishment of the Lebanese Petroleum Administration (LPA), which went through in 2012, and the establishment of a SWF which still hasn't materialized.

In their report entitled "A Sluggish Economy in A Highly Volatile Environment", the World Bank draws pertinent conclusions regarding the purpose, the challenges, the benefits and the risks associated with a SWF for Lebanon's hydrocarbon resources.

What is a SWF? The World Bank defines a SWF as a pool of savings that could stem from balance of payments and fiscal surpluses, revenues from privatization and/or revenues from commodity exports. The fund is owned by the government and follows an investment strategy serving its main purpose and achieving a certain financial return.

The World Bank revisits the several types of SWFs identified by the International Monetary Fund. The Stabilization Fund's main goal is to protect the budget and the economy from the commodity's price volatility through implementing a counter-cyclical fiscal policy. The Stabilization Fund will therefore shield fiscal revenues from any exogenous shock related to volatile commodity prices. The Development Fund is oriented towards investments serving socio-economic projects such as infrastructure. As for the Pension Reserve Fund, it is designed to meet the government's future pension related liabilities. The Savings Fund, the type of SWF chosen by Lebanon in the 2010 Petroleum Law, seeks intergenerational equity. Since the gas reserves are finite and non-renewable, the fund ensures that this wealth is transformed into diversified financial assets benefitting the current generation and the ones to come. The risk associated with this kind of SWF is that inter-generational equity would not be guaranteed if the fund fails to meet its real return target.

Adapting the Savings Fund to the Lebanese context raises the critical issue of cohesion between the SWF vision and the fiscal policy. Lebanon suffers from a large fiscal deficit, which represented 10% of GDP in 2013, and from one of the largest debt to GDP ratios in the world. By opting for a Savings Fund, the World Bank warns that this SWF cannot be used for fiscal stabilization purposes as this would incur heavy financial losses for the country. The Savings Fund operates by investing in assets with high risk-return profiles and usually low liquidity. If during a recession, authorities tap into the Fund's resources to finance a fiscal stimulus program they would be selling their assets at very low prices and therefore record losses.

By only taking into account financial considerations[1], the World Bank however notes that Lebanon can exploit its hydrocarbon resources to repay some of its public debt. Repaying sovereign debt will ease the elevated debt to GDP ratio and reduce Lebanon's risk premium and therefore the cost of its debt. According to the World Bank, if the debt to GDP ratio is reduced to 100% thus leading to a drop in interest cost and to a reduction in the risk premium by 100 basis points, the budget can save $4.4B every year based on 2014's GDP. Moreover, a higher sovereign rating might lower interest rates, allowing the private sector to borrow for less and paving the way for higher growth and competitiveness.

Based on the Lebanese context, establishing a SWF presents institutional and governance challenges. Lebanon is endowed with weak institutions, a poor regulatory framework and high corruption levels. In 2013, Lebanon was ranked 127th amongst 177 countries on the Corruption Perception Index issued by Transparency International, which raises concerns over governance of a potential SWF.

A Lebanese SWF also faces institutional risk factors. The SWF might be used for purposes different than the ones intended initially and would therefore be facing the risk of direct raiding. As for the risk of indirect raiding, it would present itself once excessive debt will accumulate on the back of the fund's resources. Inevitably, the high corruption levels might expose the SWF to poor and inefficient management as individuals are appointed on a basis other than meritocracy.

To address these risks and challenges, a Lebanese SWF must respect certain criteria. First, fiscal decision making must remain in the hands of the Ministry of Finance and SWF revenues must directly pour into the budget so as to maintain the alignment with the overall fiscal framework. Second, operational rules should have limited flexibility. Since Lebanon selected the type of SWF that seeks to save the resource-wealth for generations to come, withdrawals from the SWF should only be allowed in exceptional circumstances to avoid the risk of the fund's depletion. Third, the investment policies

[1] The quick repaying of public debt is only based on the financial factor. The World Bank notes that once other elements are taken into account (economic, institutional and governance), this option might not be the most suited for Lebanon.

of the SWF and of Lebanon must be on the same wave length: A situation where the country is indebted at a cost higher than the financial returns of the SWF should be avoided.

Aligning the SWF strategy and fiscal policy is crucial for Lebanon. The Ministry of Finance and the SWF management should remain independent as stated by the World Bank all while preserving a cooperative relationship. However, as Lebanon opted for a Savings Fund seeking intergenerational equity and at the same time has the need to reduce its fiscal deficit and its public debt, the challenge is to reconcile these two visions.

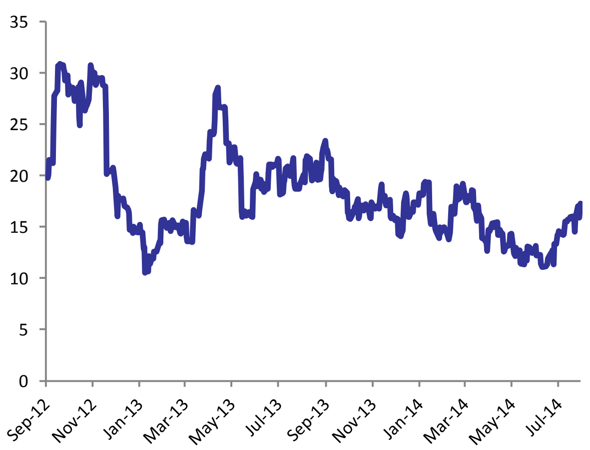
After having discussed the establishment of a SWF in the Lebanese context previously, we now delve into the various fiscal frameworks that Lebanon can adopt to manage its resource-wealth and that were presented in the IMF's selected issue entitled "Designing a Fiscal Framework for a Prospective Commodity Producer: Options for Lebanon". These fiscal frameworks provide an answer as to how the authorities can establish fiscal sustainability and intergenerational equity at the same time in a high fiscal deficit and public debt environment.

Fiscal Anchors for Commodity Producers

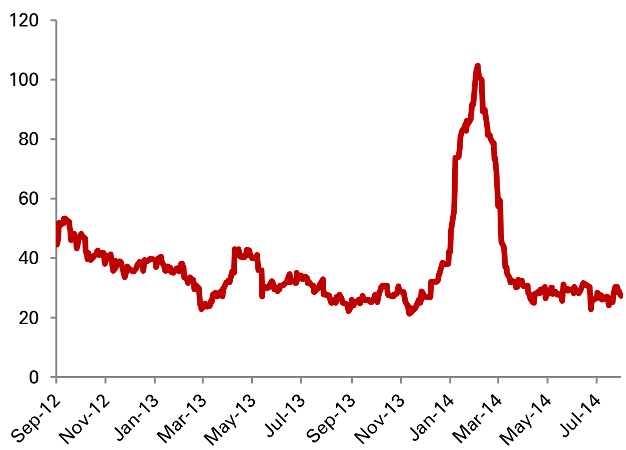
A commodity producer uses particular tools to obtain a reliable assessment of fiscal stance. If the commodity-rich country has a high reliance on resource revenue, the overall fiscal balance and the primary balance are not reflective of the real fiscal position. If the authorities decide to increase spending as a result of increased revenues due to a surge in hydrocarbon prices while keeping the fiscal balance constant, the latter will show a neutral fiscal policy, while in fact there is an expansionary fiscal policy. This is due to the increase in revenue being generated by an external factor, which is the jump in hydrocarbon prices, rather than coming from the tax base. Therefore, excluding resource revenue and counting on the non-hydrocarbon primary balance is what delivers a proper view on where the country stands fiscally and separates fiscal policy from the volatility of commodity prices. The non-hydrocarbon primary balance will allow fiscal authorities to differentiate between spending that was financed by levied taxes and spending that was financed by exogenous revenue sources such as oil and gas.

Fiscal policy should be separated from the commodity's volatility in order to ensure stability too. The budget ought to be shielded from swings in the commodity's price and from the effects of procyclicality. Procyclicality exists when a surge in resource-revenues leads to a surge in government spending and vice-versa. If commodity producers mis-evaluate their resource wealth, they might over-spend, face sustainability issues and jeopardize intergenerational equity.

1 Month Volatility Crude Oil WTI



1 Month Volatility Natural Gas



Source: Reuters

A way to avoid boom-bust cycles and ensure fiscal sustainability is to target a structural primary balance. The first step is to decompose the resource revenues into structural revenues and cyclical ones. The structural component is the chunk of revenues that is somewhat certain and likely to be there for a while and the cyclical chunk will be determined by using either backward-looking prices, future prices or a patchwork of the two. According to the IMF, "the Mongolia rule" which adopts 12 years of historical prices, a current year forecast and 3 years of futures prices, is the best price-based smoothing rule for Lebanon. This rule allows the highest level of savings and expenditure smoothing. Once this is done, the structural primary balance, equal to the non-hydrocarbon primary balance plus the structural component of resource revenues, can be calculated and can serve as anchor for fiscal policy.

Procyclicality can also be reduced by putting a cap on expenditure growth. Expenditure growth could be capped to 3-7% per year in real terms and would allow Lebanon to accumulate savings of around 70% of non-resource GDP by 2050.

Various Fiscal Frameworks

The following frameworks all prioritize long-term sustainability and intergenerational equity but allow the exploitation of hydrocarbon-related revenues to different extents.

The first proposed framework (Permanent Income Hypothesis) is designed to keep the resource wealth constant and never depleted. If the stock of oil and gas reserves lasts for 35 years, this scheme ensures that it won't be depleted before the full 35 years. To achieve this, fiscal authorities must exploit no more and no less than the annual return from resource revenues.

Unlike the conservative first scenario, the second scenario allows a looser spending path. The Modified Permanent Income Hypothesis (MPIH) allows authorities to exhaust more of the resource wealth for a few years only if they overcompensate later on with a longer period of fiscal adjustment. For example, if assets are drawn down for a period of five years, spending will have to be readjusted for a period of ten years.

The third scenario (fiscal sustainability approach FS) gives the most leeway to fiscal authorities in terms of exploiting hydrocarbon resources. Although this scheme reduces hydrocarbon related revenues, it states that the high front-loaded investments do not endanger fiscal sustainability since they will generate higher growth and will increase non-resource related revenues in the future.
So, which framework is the most viable option for Lebanon? The IMF concludes that the second and third scenarios (MPIH and FS) frameworks are the most relevant for Lebanon. The reason behind this selection is that they allow front-load spending into physical and human infrastructure, areas where efforts are needed. Moreover, these frameworks are optimal since they both ensure intergenerational equity and fiscal sustainability, therefore reconciling the SWF strategy and the fiscal needs of the country.

Regardless of the adopted fiscal approach, benefitting fully from our hydrocarbon wealth requires the establishment of strong fiscal institutions. Creating a public financial management system (PFM) should guarantee transparency for resource and non-resource revenues as well as sustainability of the fiscal strategy.

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