

# THE LEBANON BRIEF

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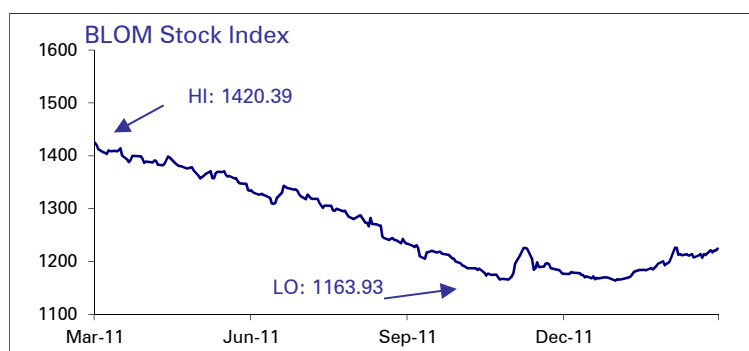
# FINANCIAL MARKETS

## Equity Market

### Stock Market

	30/03/12	23/03/12	% Change
BLOM Stock Index*	1224.31	1212.20	1.00%
Avg Traded Volume	584,566	273,658	113.61%
Avg Traded Value	3,964,880	946,827	318.75%

\*22 January 1996 = 1000



### Banking Sector

	Mkt	30/03/12	23/03/12	% Change
BLOM (GDR)	BSE	\$7.98	\$7.90	1.01%
BLOM Listed	BSE	\$7.65	\$7.65	0.00%
BLOM (GDR)	LSE	\$8.05	\$7.80	3.21%
Audi (GDR)	BSE	\$6.70	\$6.49	3.24%
Audi Listed	BSE	\$6.50	\$6.21	4.67%
Audi (GDR)	LSE	\$6.72	\$6.50	3.38%
Byblos (C)	BSE	\$1.72	\$1.66	3.61%
Byblos (GDR)	LSE	\$79.00	\$79.00	0.00%
Bank of Beirut (C)	BSE	\$19.29	\$19.30	-0.05%
BLC (C)	BSE	\$1.90	\$1.90	0.00%
Fransabank (B)	OTC	\$28.00	\$28.00	0.00%
BEMO (C)	BSE	\$2.20	\$2.20	0.00%

	Mkt	30/03/12	23/03/12	% Change
Banks' Preferred Shares Index *		\$105.29	\$105.28	0.01%
BEMO Preferred 2006	BSE	\$100.00	\$100.00	0.00%
Audi Pref. D	BSE	\$10.50	\$10.50	0.00%
Audi Pref. E	BSE	\$100.50	\$100.40	0.10%
Byblos Preferred 08	BSE	\$105.10	\$105.10	0.00%
Byblos Preferred 09	BSE	\$103.10	\$103.10	0.00%
Bank of Beirut Pref. D	BSE	\$26.25	\$26.25	0.00%
Bank of Beirut Pref. E	BSE	\$26.00	\$26.00	0.00%
BLOM Preferred 2011	BSE	\$10.30	\$10.30	0.00%
Bank of Beirut Pref. H	BSE	\$25.00	\$25.00	0.00%

\* 25 August 2006 = 100

The BLOM Stock Index (BSI), Lebanon's leading index, increased by 1% over the course of the week to reach 1,224.31 points establishing a 4.05% rise since year start. Market capitalization grew by \$94M to \$9.52B with an average daily traded volume of 584,566 shares valued at \$3,964,880 compared to last week's 273,658 shares worth \$946,827. This jump in volume and value traded is due to the crosstrades on Bank Audi GDR and BLOM Bank listed shares.

The Lebanese benchmark outperformed the Morgan Stanley (MCSI) Emerging Index that declined by 0.77% to 1032.6 points. However, it failed to beat the S&P Pan Arab Composite LargeMidCap Index and the S&P AFE40 that jumped by 1.81% to 120.99 points and 1.79 % to 58.52 points respectively. Saudi Arabia was the most notable country pulling the index forward with a 3.22% increase followed by Qatar's 1.59% rise. On the other hand, Oman suffered a 4.49% fall with Egypt and Kuwait also retreating by 2.46% and 1.26% correspondingly.

The banking sector maintained its dominance over the market possessing 95% of total volume traded but dropping to 67% when excluding crosstrades. In details, BLOM Bank GDR increased by 1.01% to \$7.98 and Bank Audi GDR jumped by 3.24% to \$6.70 while its listed stock also rose by 4.67% to record \$6.50. Byblos Bank listed stock surged by 3.61% to stand at \$1.72. On the other hand, Bank of Beirut was the only financial stock to witness a negative change decreasing slightly by 0.05% to \$19.29. Moreover, the BLOM Bank Preferred Shares Index (BPSI) inched upwards by 0.01% to 105.29 points characterized by Audi Preferred E's slight increase of 0.10% to \$100.50.

As for the real estate sector, Solidere stock retreated over the week with a 1.11% decrease in class A shares to \$14.28 and a 2.34% fall in class B shares to \$14.17.

## Real Estate

	Mkt	30/03/12	23/03/12	% Change
Solidere (A)	BSE	\$14.28	\$14.44	-1.11%
Solidere (B)	BSE	\$14.17	\$14.51	-2.34%
Solidere (GDR)	LSE	\$14.15	\$14.73	-3.94%

In the industrial sector, cement producer Holcim Liban maintained its price at \$16.50.

Finally, the Lebanese banking sector performed well this week as large banks are starting to declare their dividends. However, maybe some profit taking in the coming weeks will reduce the realized gains on stocks over the past month.

## Manufacturing Sector

	Mkt	30/03/12	23/03/12	% Change
HOLCIM Liban	BSE	\$16.50	\$16.50	0.00%
Ciments Blancs (B)	BSE	\$3.15	\$3.30	-4.55%
Ciments Blancs (N)	BSE	\$3.10	\$3.10	0.00%

## Funds

	Mkt	30/03/12	23/03/12	% Change
Beirut Preferred Fund	BSE	\$102.20	\$102.20	0.00%
BLOM Cedars Balanced Fund Tranche "A"	-----	\$6,723.58	\$6,715.36	0.12%
BLOM Cedars Balanced Fund Tranche "B"	-----	\$5,264.82	\$5,258.38	0.12%
BLOM Cedars Balanced Fund Tranche "C"	-----	\$5,106.61	\$5,100.36	0.12%
BLOM Bond Fund	-----	\$10,016.99	\$10,016.99	0.00%

## Retail Sector

	Mkt	30/03/12	23/03/12	% Change
RYMCO	BSE	\$2.13	\$2.13	0.00%
ABC (New)	OTC	\$16.50	\$16.50	0.00%

## Tourism Sector

	Mkt	30/03/12	23/03/12	% Change
Casino Du Liban	OTC	\$550.00	\$550.00	0.00%
SGHL	OTC	\$4.50	\$4.50	0.00%

## Foreign Exchange Market

### Lebanese Forex Market

	30/03/12	23/03/12	%Change
Dollar / LP	1502.00	1502.00	0.00%
Euro / LP	2010.85	1998.79	0.60%
Swiss Franc / LP	1668.88	1658.05	0.65%
Yen / LP	18.35	18.24	0.60%
Sterling / LP	2411.70	2391.50	0.84%
NEER Index**	98.51	98.82	-0.31%

\*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. The NEER represents the approximate relative price a consumer will pay for an imported good.

### Nominal Effective Exchange Rate (NEER)



The exchange rate between the Lebanese Pound and the US dollar remained at the lower end of the peg on the local exchange market this week or at \$/LP 1,500.5 - \$/LP 1,503.5 with a mid-price of \$/LP 1,502. The central bank's (BdL) foreign assets (excluding gold) diminished by 0.39% to \$32.28B by mid-March compared to a month earlier while the dollarization rate of private sector deposits was 65.92% in January 2012, unchanged from the previous month.

The euro swayed this week with changing expectations of a new ceiling to be set for the Eurozone's bailout fund, eventually closing above last week's value after EU finance ministers agreed on Friday to beef up emergency support to 700 billion euros. The single currency thus closed at \$/€ 1.3339 by Friday 12.00 pm Beirut time, causing the dollar-pegged Lebanese Pound to depreciate by 0.6% to LP/€ 2010.85. The Nominal Effective Exchange Rate slipped 0.31% to 98.51 points.

## Money & Treasury Bills Markets

### Money Market Rates

	30/03/12	23/03/12	Change bps
Overnight interbank	2.75	2.75%	0
BDL 45-day CD	3.57%	3.57%	0
BDL 60-day CD	3.85%	3.85%	0

Broad money M3 rose by LP240B (\$159.2M) during the week ending March 15 to attain LP149,735B (\$99.33B). Hence, M3 increased by 7.53% y-o-y and 2.16% from end of December 2011. M1 dropped during the week by LP149B (\$98.84M) as money in circulation and demand deposits dropped by LP111B (\$73.63M) and LP38B (\$25.21M) respectively. Total deposits (excluding demand deposits) jumped by \$258.71M following a \$124.71M increase in term and saving deposits and a \$134M rise in deposits denominated in foreign currencies. As for the dollarization rate of broad money, it advanced by 4 basis points (bps) on a weekly basis to 59.08%. The overnight interbank rate stood at 2.75% during the month of January, according to the Association of Lebanese Banks.

### Treasury Yields

	30/03/12	23/03/12	Change bps
3-M TB yield	4.38%	3.89%	49
6-M TB yield	4.87%	4.40%	47
12-M TB yield	5.06%	4.61%	45
24-M TB coupon	5.82%	5.34%	48
36-M TB coupon	6.48%	5.94%	54
60-M TB coupon	6.74%	6.18%	56

Interest rates on Treasury Bills surged in the past two weeks after the International Monetary Fund announced that rising interest rates on T-bills with maturities of less than 7 years would compensate for higher risks and make them attractive to banks, decreasing the Treasury dependence on the BdL. During the March 29 auction, the average discount rate for the 3M and 6M papers and the average coupon rate for the 60M paper rallied by a respective 49 bps, 47 bps, and 56 bps to 4.38%, 4.87%, and 6.74%. Moreover, during the March 22 auction, demand from Lebanese lenders for higher return on Lebanese Pound denominated papers lifted the average discount rate for the 12M paper 45 bps to 5.06%, while the average coupon rate for the 24M and 36M papers surged 48 bps and 54 bps to 5.82% and 6.48% respectively. On March 22, the Ministry of Finance raised LP916.21B (\$607.77M) through the issuance of Treasury Bills. Demand was mainly observed on the 36M paper that captured 76.55% of total subscriptions. The 12M and 24M papers accounted for 16.93% and 6.52% respectively. To note that the MoF continues to undertake all accepted bids.

## Eurobond Market

## Eurobonds Index and Yield

	30/03/12	23/03/12	Change	Year to Date
BLOM Bond Index (BBI)*	111.240	111.390	-0.13%	0.27%
Weighted Yield**	4.53%	4.55%	-2	-25
Weighted Spread***	369	360	9	-37

\*Base Year 2000 = 100; includes US\$ sovereign bonds traded on the OTC market

\*\* The change is in basis points

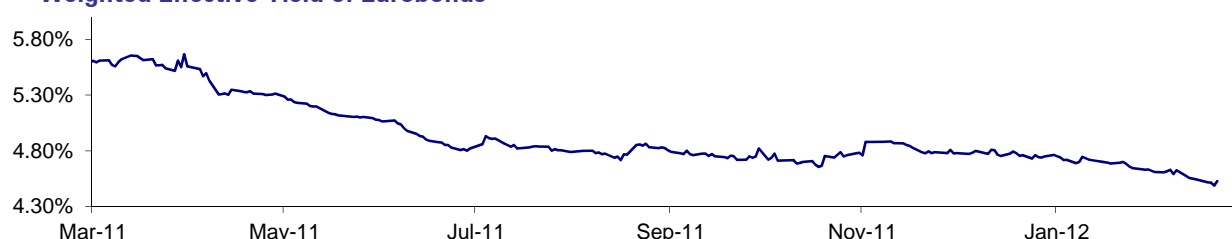
\*\*\*Against US Treasuries (in basis points)

## Lebanese Government Eurobonds

Maturity - Coupon	30/03/12 Price*	23/03/12 Price*	Weekly Change%	30/03/12 Yield	23/03/12 Yield	Weekly Change bps
2012, Sep - 7.750%	100.50	102.63	-2.07%	1.79%	1.76%	3
2013, Mar - 9.125%	106.25	107.00	-0.70%	1.80%	1.71%	9
2013, Jun - 8.625%	107.31	107.31	0.00%	2.46%	2.53%	-8
2014, Apr - 7.375%	107.88	108.00	-0.12%	3.33%	3.30%	3
2014, May - 9.000%	111.25	111.50	-0.22%	3.35%	3.27%	8
2015, Jan - 5.875%	104.50	105.25	-0.71%	4.14%	3.87%	27
2015, Aug - 8.500%	114.10	114.10	0.00%	3.95%	3.97%	-2
2016, Jan - 8.500%	115.00	115.00	0.00%	4.18%	4.19%	-2
2016, May - 11.625%	127.50	127.50	0.00%	4.25%	4.27%	-2
2017, Mar - 9.000%	119.25	119.25	0.00%	4.61%	4.63%	-1
2018, Nov - 5.150%	100.38	100.50	-0.12%	5.08%	5.06%	2
2020, Mar - 6.375%	106.50	106.50	0.00%	5.36%	5.36%	0
2021, Apr - 8.250%	119.25	119.45	-0.17%	5.51%	5.49%	2
2022, Oct - 6.100%	102.50	102.50	0.00%	5.78%	5.78%	0
2024, Dec - 7.000%	108.50	108.50	0.00%	6.03%	6.03%	0
2026, Nov - 6.600%	102.25	103.50	-1.21%	6.36%	6.23%	13

- Mid Prices ; BLOMINVEST bank

## Weighted Effective Yield of Eurobonds



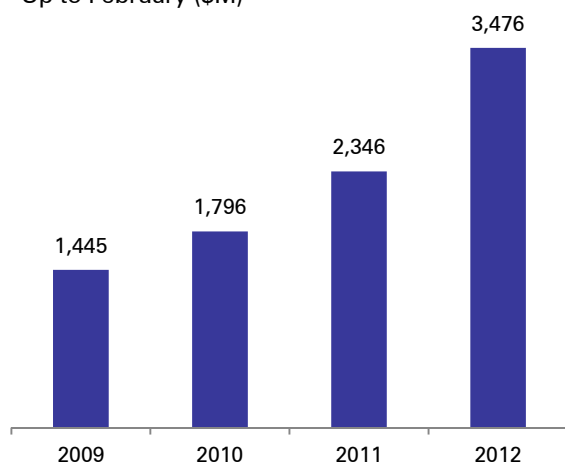
Eurobonds fluctuated between gains and losses over the past week, sliding with diminishing global appetite for high-return assets against sustained support from domestic demand. The BLOM Bond Index (BBI) closed down by 0.13% to 111.24 points while the portfolio's average weighted yield still slid 2 basis points (bps) to 4.53%. Appeal for riskier assets in emerging markets waned as Europe reconsidered its emergency bailout fund while higher demand was recorded for safe haven Treasuries over the week. The spread between Lebanese and US yields thus increased by 9 bps to 369 bps. The BBI's performance fared better than JP Morgan emerging markets' bond index that retreated 0.5%.

Lebanon's credit default swap for 5 years (CDS) widened an average 6 bps to 441-471 bps. In regional economies, 5 year CDS quotes in Dubai and Saudi Arabia also slightly broadened to 331-344 bps and 116-121 bps respectively. The case was similar in emerging countries, where 5 year CDS quotes in Brazil and Turkey rose to 122-125 bps and 230-234 bps from 120-123 bps and 221-224 bps respectively.

## ECONOMIC STATISTICS & INDICATORS

### Lebanon's Trade Deficit

Up to February (\$M)



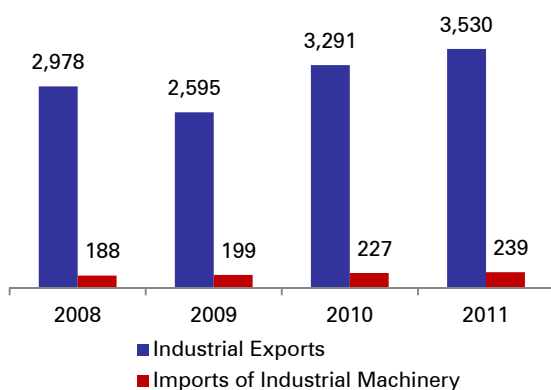
Source: Lebanese Customs

### Trade Deficit at \$3.5B in the first two months of 2012

February's trade deficit reached \$2.3B, an increase of 139% y-o-y and 114% from the previous month's \$1.1B. This jump was caused by annual change of 130% in imports recording \$2.8B compared to last year's \$1.2B. Imported mineral product took an annual leap of 143% forming 44% of 2012 total imports compared to 18% in January. This was mainly due to rising oil prices and a larger volume of imports following the subsidization of fuel by the Lebanese government. Moreover, pearls, precious or semi-precious stones formed 8% of total imports while chemical product and machinery & mechanical appliances amounted to 7% each. The main source of imports was the U.S.A, being the main exporter of minerals to Lebanon, forming 27% of 2012 total imports with an annual increase of 245%. Italy followed at 7% while France and Germany stood at 6%. On the other hand, February exports recorded an annual change of 41% to \$429M making the year to date balance \$777M. The main exported products were pearls, precious or semi-precious stones marking an annual increase of 61% and forming 42% of 2012 total exports while Base metals and articles of base metal followed at 10% and machinery & mechanical appliances at 9%. Switzerland was the primary destination of exports marking a 21% share of total exports with an annual change of 90% while UAE and Saudi Arabia followed at 7% and 6% respectively. Furthermore, February monthly customs revenue amounted to \$116.75M dropping by roughly 7% compared to January but increasing by 8% y-o-y resulting in a year to date revenue of \$242.12M. Finally, the first two months of 2012 recorded a trade deficit of \$3.5B increasing by 48% y-o-y.

### Industrial Exports and Imports of Industrial Machinery

In millions of \$



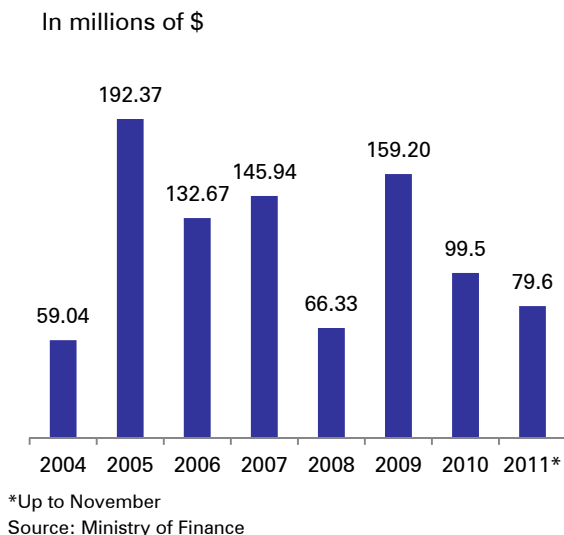
Source: Ministry of Industry

### Industrial Exports Rose 7% in 2011

Lebanon's industrial exports, which accounted for 83% of total exports in 2011, increased by 7% during last year to reach \$3,530M compared to a year earlier, according to statistics released by the Ministry of Industry. Pearls, Precious or semi-precious stones (excluding Gold Ingots) captured 26.37% of overall industrial exports followed by base metals with 14.88%, and machinery and mechanical appliances with a stake of 14.71%. With respect to Imports of industrial equipment and machinery, they increased by 5.05% in 2011 to \$238.63M compared to \$227.15M in 2010. Italy continued to be the first exporter of industrial machinery to Lebanon with a market share of 28.44%, tracked by Germany and China with respective stakes of 17.6% and 14.3%. For the month of December alone, industrial exports attained \$296M, rising by 1% from \$293M recorded in December 2010. Imports of industrial equipment and machinery jumped 38.92% y-o-y to reach \$24.72M in December 2011.

## ECONOMIC AND FINANCIAL NEWS

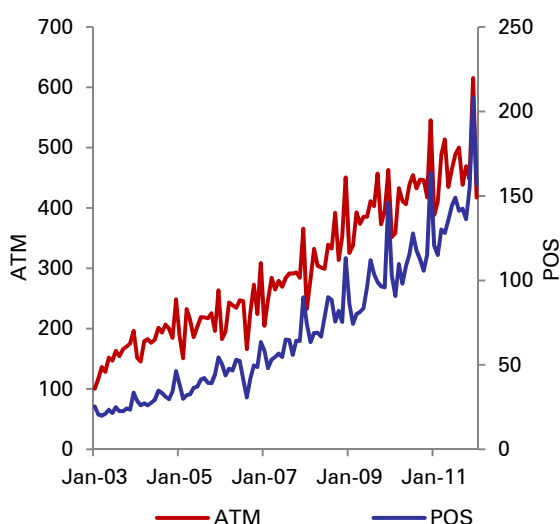
### Government Transfers to NSSF



### Increase in NSSF Imbursement Rates to Hospitals to Cost an Additional \$90 Million

Lebanese hospitals staged a protest this week following a dispute with the National Social Security Fund (NSSF) over the low rates it is paying to health institutions. Hospitals declined to admit patients covered by the government-run fund, maintaining that the current rates have not been adjusted for either inflation or wage increases since 1995. The Lebanese cabinet in 2009 had issued a decree that would raise NSSF rates for a wide range of standardized hospital fees. However, the new imbursement fees that would have cost the NSSF an additional \$53 million annually did not go into effect due to the fund's inability to take up new expenses. Following the wage increase this year, health institutions are demanding an 18% increase on the rates of the 2009 decree, and negotiations are currently underway between responsible parties. The total cost on the NSSF is estimated to reach LP 135 billion (\$90 million), according to the fund's General Director Mohammed Karaky. The government will take up 25% of the new cost as per its share while employers will have to cover the remaining amount.

### PoS Purchases and ATM Withdrawals



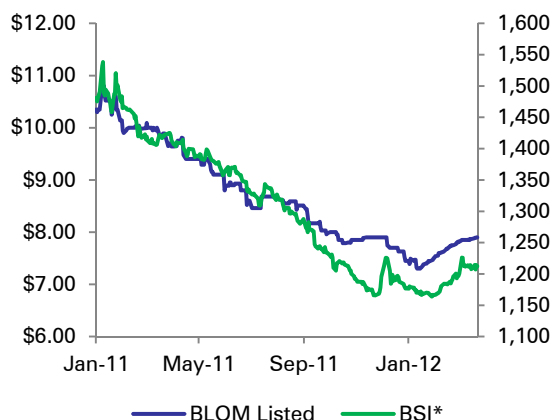
Source: BdL

### Outstanding Payment Cards Touch the 1.8 million in January

The number of payment cards issued in Lebanon reached 1.8 million by the end of January 2012, climbing by 0.9% from the previous month and by almost 7% from the previous year, according to data from the Central Bank (BdL). Annual growth rates according to card types were preceded by prepaid and charge cards that jumped 13.6% y-o-y to 194,203, and followed by credit cards that increased almost 10% y-o-y to 430,640 or around 24% of total cards. Debit cards increased by 5% y-o-y to 1.17 million, but continued to account for the bulk of outstanding plastics or 65% of the total. On a monthly basis, prepaid and charge cards rose 1.2%, debit cards increased by 1.1%, while the number of issued credit cards edged up by a mere 0.14%. Points of Sale (PoS) purchases expanded by a considerable 30% to \$156 million while ATM withdrawals increased by 7.4% to \$417 million from January 2011. On a monthly basis, both ATM PoS purchases and ATM withdrawals dropped 25% and 32% respectively, following an upsurge in spending during the holiday season in December.

## CORPORATE DEVELOPMENTS

### BLOM Listed Stock vs BLOM Stock Index



\*BLOM Stock Index

Source: BSE- Research Department, Blominvest Bank

### BLOM Bank Calls for Ordinary General Assembly

BLOM Bank's board of directors calls its shareholders for an ordinary general assembly that will be held at the bank's headquarters in Rashid Karamah Street, Verdun, Beirut on April 19, 2012, 11 am. The meeting's agenda will include hearings of the board's report and the comptroller's findings, approval of the financial statements of end 2011, clearing the chairman and boards' administrative duties for the financial year 2011, and agreement on the remunerations of the bank's chairman and board for the year 2012. Other diverse subjects are also on the meeting's schedule. Shareholders will be able to review the related documents and reports 15 days ahead of the meeting at the bank's headquarters during working hours.

### BLC Bank Financial Highlights (\$M)

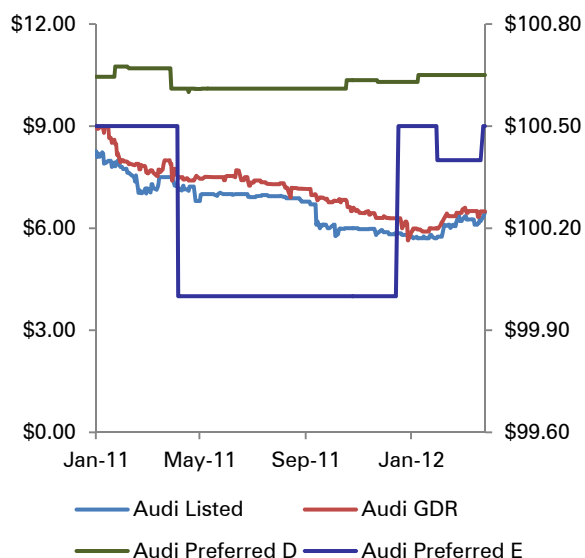
	2011	2010	% change
Total Assets	4,415.83	3,101.02	42.40%
Customers' Deposits	3,615.25	2,602.01	38.94%
Loans and Advances	1,532.66	687.47	122.94%
Net Profits	48.09	45.30	6.16%

Source: BSE- Research Department, Blominvest Bank

### BLC Bank Reports 6.16% Rise in 2011 Profits

BLC Bank published its financials for the year 2011 revealing an annual increase of 6.16% in net profits to \$48.09 million compared to \$45.3 million recorded a year earlier as the increase in income was partly offset by a significant rise in expenses following the acquisition of USB Cyprus. Net interest income and net fees & commission income registered a respective growth of 31.38% and 47.81% to \$83.83 million and \$16.94 million, while net financial revenues reached \$117.92 million, up by 42.51% from a year earlier. Moreover, staff costs rallied considerably in 2011, jumping by 61.33% to \$44.91M, while administrative expenses increased 48.56% to \$3.11M. The bank also registered allowance for Impairment of Loans and Advances of \$14.61M compared to only \$1.28M recorded in 2010. With respect to the bank's balance sheet, total assets grew by 42.4% from end of 2010 to \$4.42 billion with net loans to customers surging by 122.94% to \$1.53 billion. The bank's portfolio of performing loans rallied by 120% to \$1.48 billion by the end of 2011 compared to \$672 million a year earlier, mainly as a result of increased lending activities and due to the acquisition of USB Cyprus. Total retail and small loans rose by 89% to \$694 million, while total corporate loans increased by 157% to reach \$783 million. On the liabilities side, customers' deposits jumped 38.94% y-o-y to \$3.62 billion. Return on Average Assets reached 1.28% by the end of 2011 compared to 1.59% a year earlier. Return on Average Equity attained 15.42% as opposed to 18.45% in 2010, mainly due to the issuance of \$55 million preferred shares on December 29, 2011.

### Performance of Audi Stocks



Source: BSE- Research Department, Blominvest Bank

### Bank Audi Calls for an Ordinary and an Extraordinary General Assemblies

Following the Board of Directors meeting held on March 15, 2012, the bank announced that it is going to propose to the Annual Ordinary General Assembly a dividend distribution of LBP 603 or \$0.4 per share. The amount to be paid after the deduction of the 5% tax rate will be LBP 572.85 or \$0.38 per common share. In case of approval by the General Assembly, the dividends are set to be paid on or about April 12, 2012 to the holders of common share at April 5, 2012 (Record Date) according to the records of Midclear S.A.L. Separately, the Board of Directors of Bank Audi s.a.l – Audi Saradar Group invited all holders of ordinary shares to attend an Ordinary General Assembly Meeting to be held at 10:30 a.m. on the 10<sup>th</sup> of April at the bank's head office, Audi Plaza, Beirut Commercial Central District, in order to listen to the Board and External Auditors reports concerning the company's activity and accounts for the year 2011. The agenda to be examined will consist of the approval of the bank's accounts, particularly the balance sheet and the profit and loss statement for the year ended December 31, 2011 and to discharge the Chairman and members of the Board of Directors of the bank in respect of activities performed during 2011. Other diverse subjects are also on the meeting agenda. Moreover, Bank Audi's Board of Directors invited all holders of Common Shares to attend an Extraordinary General assembly to be held at 12:00 noon, on the 10<sup>th</sup> of April at the Bank's head Office to examine the increase of the bank's capital through the issuance of a number of Preferred Shares and the determination of their amount, terms, conditions and the listing of such newly-issued Preferred Shares on the Beirut Stock Exchange.

### Performance of Byblos Common Shares



Source: BSE- Research Department, Blominvest Bank

### Byblos Bank to Distribute Dividends on 2011 Profits

The Board of Directors of Byblos Bank held on 16 March 2012, announced to the holders of its common shares that it will propose to the Ordinary General Assembly arranged to meet on the 10<sup>th</sup> of April 2012 at the Bank's Headquarters, the distribution of dividends on 2011 profits as of LBP 200 per share or LBP 190 Net of 5% withholding tax.

## Alpha Banks Financials for 2011

	2011	2010	% change
Total Assets	143.28	127.91	12.01%
Customer Deposits	117.08	104.59	11.95%
Loans & Advances	39.61	33.31	18.90%
Shareholders' Equity	11.8	11.6	1.97%
Net Profit	1.48	1.46	1.16%

Source: BankData Financial Services

## Alpha Banks Net Profit Up by 1.16% in 2011

Lebanon's largest 12 banks, branded as Alpha banks, registered a consolidated net profit of \$ 1.47B in 2011, up by 1.16% from 2010, according to the latest report by Bankdata Financial Services noting that Societe Generale did not communicate its income statement this year. This rise was characterized by a 5.45% increase in net interest income and a 13.85% surge in net fee & commission income. Bonds & other financial assets and net loans & advances to customers jumped by 217.50% and 18.90% to reach \$2.8B and \$39.6B causing a 12.01% increase in total assets to \$143.3B. Societe Generale topped the group in terms of assets growth due to its acquisition of the Lebanese Canadian Bank with a 105.44% yearly growth while Bank of Beirut followed developing resources by 21.74% after its acquisition of Beirut Hellenic Bank Ltd (formally Laiki Bank Australia Ltd.). Moreover, Societe Generale also led total loan growth recording a 106.17% increase, followed by the approximate 41.4% increase in Fransabank and Bank of Beirut. Finally, Audi, BLOM and Byblos Bank maintained their positions as market leaders carrying cumulative assets of \$68.5B making up 47.81% of the consolidated total assets.

## FOCUS IN BRIEF

IIF Research Note:

"Lebanon: Navigating an Uncertain Political Environment"

Lebanon: Main Economic Indicators

	2010	2011e	2012f*		2013f
			Scenario A	Scenario B	
Real GDP growth, %	7.0	1.8	3.0	2.1	3.7
CPI, average, % change	4.4	5.7	6.7	6.0	4.0
Current account bal., % GDP	-21.0	-23.6	-23.4	-22.5	-20.1
Fiscal deficit, % GDP**	-5.5	-5.7	-8.0	-8.2	-7.7
Primary surplus, % GDP**	5.3	4.1	1.3	1.1	1.6
Government debt, % GDP	137.0	132.0	131.0	133.0	129.0
Nominal GDP, \$ billion	38.3	40.7	43.7	43.1	47.0

e = IIF estimate ; f = IIF forecast

\* Scenario A assumes that the draft 2012 budget is approved by the parliament, and a sharp increase in capital spending. Scenario B assumes no approval of the budget and thus no tax measures to raise additional revenues that could be used to increase capital spending.

\*\* Includes all due Telecom profits in nontax revenue.

Source: the Institute of International Finance (IIF)

### Real GDP by Expenditure Components

% change at constant price

	2010	2011e	2012f*	
			Scenario A	Scenario B
Real GDP growth, %	7.0	1.8	3.0	2.1
Private Consumption (80%)	5.3	3.5	3.6	3.5
Government Consumption (16%)	6.4	1.0	10.2	9.6
Private Investment (28%)	3.5	-4.0	-1.8	-2.4
Government Investment (2%)	16.5	-12.0	43.3	-6.7
Exports, goods & Services (23%)	7.0	-6.4	3.2	2.9
Imports, goods & Services (49%)	5.8	-3.7	5.0	4.1

e = estimate ; f = IIF forecast

Source: the Institute of International Finance (IIF)

### Monetary Survey, 2009-2013

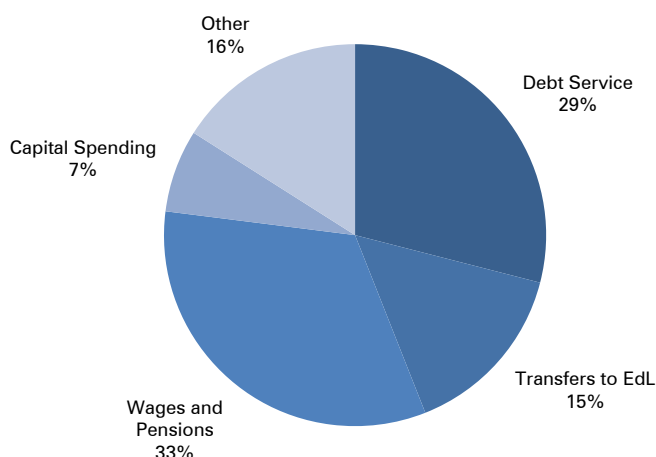
Trillions of Lebanese pounds, unless otherwise indicated

	2009	2010	2011e	2012f	2013f
Net Foreign Assets	51.5	60.9	59.4	59.6	62.3
Banque du Liban	47.7	56.8	61.7	62.0	64.7
Commercial Banks	3.8	4.1	-2.4	-2.4	-2.4
Net Claims on Government	47.4	48.8	51.3	55.3	59.4
Claims on Private Sector	38.4	47.8	54.0	60.4	65.6
Other Items (net)	-13.7	-18.7	-18.1	-18.1	-18.1
Broad Money (M3)	123.7	138.9	146.6	157.2	169.2
Velocity of M3 (GDP/M3)	0.42	0.42	0.42	0.42	0.42
Private Credit, % Change	14.8	24.4	12.9	11.8	8.6
M3, % Change	19.5	12.3	5.5	7.2	7.6

e = IIF estimate ; f = IIF forecast

Source: the Institute of International Finance (IIF)

## Breakdown of Projected Expenditures in 2012



Source: the Institute of International Finance (IIF)

The Institute of International Finance (IIF) released in early March a research note on the Lebanese economy titled "Lebanon: Navigating an Uncertain Political Environment". Below is an overview of the paper.

### The Economy in 2011

The IIF estimates a strong deceleration in real GDP growth for Lebanon, from 7% in 2010 down to 1.8% in 2011; and expects real GDP growth between 2% and 3% for 2012. While the institution perceives the economic performance over the second half of the year to be more active than the first half, with real GDP growing by 2.8% over H2, compared to only 0.8% over H1, it cites many hurdles that remain present and prevent a bounce in output. A leading one is the continuous unrest witnessed in Syria which adversely impacts the Lebanese economy through "lower transit trade, tourism receipts, and foreign direct investment". Another main factor that contributed to the strong slowdown in economic activity in 2011 is the internal political tension, which took its toll on private investments and the latter three indicators. Statistically, private investments and exports of goods and services were down 4% and 6.4% respectively in 2011.

While a slowdown was unpreventable, the Lebanese economy showed relative resilience to shocks, supported by strong deposits growth and steady remittances. Deposits were up 2.7% y-o-y in 2011, although slowing from a 7.8% growth registered in 2010; private credit also grew by 6.8%. This drove up private demand, the main driver of growth in 2011, by an estimated 3.5%.

The fiscal position of Lebanon has slightly deteriorated with fiscal deficit rising by a mere 0.2% of GDP to 5.7% of GDP in 2011. Yet major factors boosted up the fiscal performance in spite of the overall increase in deficit, they include the transfers of Telecom profits, which led to a 22% rise in taxes on profits. This, however, was counteracted by a 1.4% decline in tax revenues, infected by the domestic economic activity and a 50% reduction in excise tax on gasoline, and a 48% rise in transfers to Electricite du Liban (EdL). Interest payments on local currency debt fell by 5% in 2011, compared to 2010, as rates on Treasury Bills (TBs) have continued their downward trend. Also, capital spending, crucial for economic bounce, fell by 8% "from already low levels". Overall, government spending grew by 3.2% in 2011.

Rising fiscal deficit in light of weaker economic growth did not interrupt the so far sustainable down track of debt-to-GDP ratio, but kept the concern of high debt alive. Most of the domestic financing of the deficit was by the Central Bank as local banks were disinclined to participate in the debt auctions view the economic and political settings, pushing by that the holding of government debt by the Central Bank to a new peak. Debt to GDP ratio fell gradually from the highs of 180% at end-2006 to 137% at end-2010, and 132% in 2011. In terms of potential costs, measured by debt/M3 rather than debt/GDP<sup>1</sup>

<sup>1</sup> along with the stability of bank deposits.

according to the IIF, Lebanon's standing has improved slightly in 2011, with the ratio falling from the highs of 70% in 2007, to 57.5% in 2010, and 56% in 2011.

Regional unrest and local political conditions did not take their toll on the confidence over the Lebanese pound due to the Central Bank's healthy management. Deposit dollarization remained roughly stable, increasing merely from 63% at end-2010 to 65% at end-2011. Domestic interest rates, although continuing their downward trajectory, are still well above global rates. The IIF does not expect any further reduction in interest rates over the short term "given an inflation rate of around 6% and the narrowing spreads between domestic and global rates. Liquidity conditions and the decrease in interest rates have put downward pressure on bank profits. The interest rate spread between 36-month TBs in LL and the average deposit rate in dollars has narrowed from 5.9 percentage points in 2008 to 3.2 percentage points in 2011". Also, Credit Default Swap (CDS) spreads were up from 291 bps at end-2011 to 480 bps as of March 6 2012, yet they still rate much lower than those of Portugal, Egypt, and Ireland.

The Banking System remained healthy and resilient to shocks, owed to the conservative approach adopted by the Central Bank in its funding practices. Liquidity levels are adequate, and way above the regulatory minimum. The ratio of nonperforming loans (NPLs) to total loans has been falling towards low single digits in recent years and reached an estimated 3.8% in 2011. The Central Bank is stepping up its efforts to preserve the soundness of the banking system. It aims "to introduce supervisory guidelines to strengthen the oversight of cross-border activities of the largest banks, including annual group audits and strengthened risk management. The ratio of private sector loans to total deposits was only 28% at end-2011, one of the lowest among emerging and mature economies". The resilience of the banking sector, in spite of the strong presence of Lebanese banks in regional countries, paved way to a rise in the Central Bank's gross international reserves (excluding Gold) to \$32.8 billion by end-2011.

### Lebanon's Regional Positioning

Relative to regional and emerging economies, Lebanon stands behind other countries. Global Growth Competitiveness Index of the World Economic Forum 2011-2012 ranks Lebanon 89<sup>th</sup> out of 142 countries. While Lebanon scores high on quality of education, financial services, and business sophistication; it ranks low in categories related to "quality of public institutions, government instability, inadequate supply of infrastructure, inefficient government bureaucracy, and corruption".

### The Economy in 2012

#### Scenario A

Looking forward, the IIF initiated two scenarios. The first one, Scenario A, based on the adoption of the budget and the implementation of the intended substantial increase in government capital spending mostly in the electricity sector, forecasts a GDP growth of 3% in 2012<sup>2</sup>, boosted by consumption and public investment. The scenario considers a substantial rise in spending on infrastructure, mostly allocated to the rehabilitation of the electricity sector aiming to double production within four years. Also, on the expenditure side, Scenario A considers the government recent commitment to raise the minimum wage by 35% and an average of 20% for income brackets above \$500. According to IIF, total expenditure is forecasted to rise by 3.3% of GDP relative to 2011. "The projected breakdown of expenditure components are as follows: wages and pensions 33%; debt service 29%; electricity transfers 15%; capital spending 7%; and other spending 16%."

On the revenues front, Scenario A considers the implementation of three tax measures that would bring in additional revenues equivalent to 1.5% of GDP: raising the VAT rate from 10% to 11%<sup>3</sup>, increasing taxes on interest earned from 5% to 8%, and increasing taxes on real estate sales. Under this scenario, the fiscal deficit will widen to 8% of GDP, mainly due to the rise in public wages and capital spending that offset the rise in tax collection. The primary balance will remain in positive territory hovering around 1.3% of GDP. The IIF observes that the forecasted fiscal deficit for 2012 "is smaller than in each of the years from 2007-2009, yet the primary deficit is also smaller than in each of the years of the same period. This is due to the fact that interest payments on government debt have been declining steadily from 12.4% of GDP to a projected

<sup>2</sup> Under Scenario A, the increase in government investment would account for on third of this growth

<sup>3</sup> "The current VAT rate of 10% is well below the OECD average of 18% and one of the lowest among comparable emerging countries"

8.7% of GDP in 2012. This decline, despite the continued rise in debt in nominal terms, is explained by the steady and significant decline in domestic interest rates.”

Under this scenario, government debt will unarguably remain high at 131% of GDP<sup>4</sup>, but the risks imposed by the latter would be offset by the Central Bank’s ample foreign assets and the high liquidity of the banking system.

### Scenario B

While Scenario A holds a potential probability of occurrence, the IIF considers the likelihood of the budget getting rejected by the Parliament. The latter case, Scenario B, projects government’s revenues without the implementation of tax reform measures and so considers capital spending at about the same low level as in 2011, equivalent to 1% of GDP. Consequently, Scenario B yields a 2.1% GDP growth over 2012, and a fiscal deficit of 8.2% of GDP. Primary Balance will remain positive at 1.3% of GDP. Government debt will thus remain relatively unchanged at about 133% of GDP.

### The Much-Needed Reforms

It is thus of utmost importance for the government to adopt the budget and pave way to reforms and allow raising capital spending to upgrade the infrastructure in the energy, telecommunications, transportation, and water sectors; and invest in new projects boosting by that the potential growth of Lebanon. The challenge however would be “to find the right balance between the planned substantial increase in capital expenditure and the need to further reduce its debt.” The IIF suggests Lebanon’s partnership with the private sector. Also, aside from the adoption of the budget and the much needed implementation of infrastructure upgrade, a stable political environment is a must for higher growth. Thus, unfolding events in Syria pose a substantial downside risk for Lebanon’s economy. Aside from regional events, the IIF believes the mild recession in the Euro Area to have a marginal impact on the Lebanese economy in 2012, through trade and tourism linkages: Lebanese exports to the Euro Area made up 6% of Lebanon’s total exports in 2010, and tourists’ arrivals from the Euro area stood at 24% of total tourist arrivals. If Lebanon addresses successfully the several bottlenecks in infrastructure, it could catch the opportunity to reposition itself as the financial and trade hub of the region.

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<sup>4</sup> Down from 132% of GDP at end-2011



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