LEBANON ECONOMIC REPORT

FOR AN EQUITABLE DISTRIBUTION OF NATIONAL LOSSES AMONG ECONOMIC AGENTS

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- Real economy caught in a stagflationary scenario
The Coronavirus crisis and the State default on its FX debt are having a noticeable impact on the Lebanese economy in general and subsequently the financial and monetary sectors. Real GDP is likely to contract by 12% in 2020, which, coupled with a double-digit inflation as a result of the deviation between official and parallel market exchange rates, is leading to a severe stagflation in the Lebanese economy at large. The so-called defensive sectors of Lebanon's economy now start to lose steam, while the vulnerable sectors went further in the red. In parallel, unemployment has hit unprecedented highs, and is heading towards more alarming levels looking ahead.

- Tough and challenging banking environment
Lebanese banks are operating under quite challenging conditions within the context of the economic and financial crisis the country is going through, accrued socio-political tensions and the recent COVID-19-induced confinement that rendered business even more difficult to conduce. Lebanese banks' deposits contracted by 5.8% in the first three months of the year, or by the equivalent of US$ 9.3 billion (and by US$ 20.7 billion since September 2019). Deposit dollarization reached a new 15-year high of 77.9% at end-March 2020, against 76.0% at end-December 2019 and less than 70% in the years before.

- Capital markets in jeopardy
Lebanon's default on its foreign currency debt for the first time in history sent sovereign debt prices into a free fall during the first quarter of the year 2020, with bond yields hitting historical highs and CDS spreads expanding sharply to unprecedented levels, before a tender for credit risk took place later on in April 2020. Also, Lebanese equities registered double-digit price contractions during the first quarter of the year to reach historical lows amid crippling economic, financial and health crisis. In parallel, the US dollar shortage sent the Lebanese pound into a free fall against the US dollar since the beginning of the year, with the exchange reaching a historical level of LP/US$ 4,000 on the parallel market by the closing of this report.

- Worrisome public finances
Given that public finances represent the most significant vulnerability of the Lebanese economy of nowadays, fiscal adjustment is critically needed to maintain overall economic stability. In fact, Lebanon cannot sustain its monetary and financial stability with a 176% debt to GDP ratio and a fiscal deficit to GDP of 11%, especially that the deposit growth reliant fiscal deficit financing model is now at stake. The State has no choice but reducing its fiscal financing needs looking ahead.

- Government launches its Economic Reform Plan
Within this context, the Government Economic Reform Plan targeted a fiscal softlanding through utmost spending austerity, reinforcement of resource mobilization, improvement of tax collection, cut in debt servicing and reforming the electricity sector, in an attempt to reduce fiscal deficit to below 1% of GDP by 2024 and to restore a clear downward debt trajectory. As such, the medium-term fiscal strategy of the economic plan includes several revenue-enhancing measures (expected to yield up to 3.7% of GDP by 2024) along with expenditure measures (expected to yield 4.5% of GDP by 2024).

- Government Plan under scrutiny
There is no doubt that the leaked Government Economic Reform Plan holds some positive highlights and ambitious fiscal and structural reform actions, but at the same time it contains some woes such as the distribution of national losses across economic agents. The Plan advocates the large national losses to fall mainly on the burden of banks and depositors. Our standpoint here is that before resorting to any type of haircut or bail-in measures that impact depositors, the root of the problem is the public sector that has US$ 90 billion in debt and over which the banking sector is exposed. This public sector that is defaulting today has assets ranging from privatizable entities to real estate property, bearing in mind that those assets offset a large part of its liabilities when assessing its net asset value. What is required is to address a part of those assets and redeem claims on the public sector rather than addressing any measure that curtail depositors.

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The Coronavirus crisis and the State default on its FX debt are having a noticeable impact on the Lebanese economy in general and subsequently the financial sector. The IMF has estimated output growth to be significantly contractionary this year as a result of the decline in confidence in the Lebanese financial environment, in addition to the impact of the Coronavirus crisis on a large number of domestic economic sectors. As a result, real GDP is likely to contract by 12% in 2020, which, coupled with a double-digit inflation as a result of the deviation between official and parallel market exchange rates, is leading to a severe stagflation in the Lebanese economy at large.

As a matter of fact, the Lebanese economy and markets have moved into a high risk arena following the political developments of the last quarter of 2019 and the Coronavirus outbreak of the first quarter of 2020. The real economy has witnessed net contractions of a number of sectors of economic activity, whereby the so-called defensive sectors of Lebanon's economy now start to lose steam, while the vulnerable sectors went further in the red. While private consumption is still witnessing somehow positive growth, its performance is way weaker than previous years. But what is weighing most on growth is the weakness in private investment, with delay or cancellation of most private investment decisions. In parallel, unemployment has hit unprecedented levels, along with a surge in inflation to double-digit levels.

In parallel, fiscal and financial risks are increasing to unprecedented levels. A surge in fiscal debt and deficit ratios is being recorded amid revenue underperformance, excessive spending and a contraction in output. As such, public debt to GDP is set to approach the 170% threshold. As to fiscal deficit, it derailed from its budget target last year (Actual 11% of GDP versus a budgeted ratio of 7.6%), while the 2020 fiscal performance is set to be much worse amid serious revenue lags. At the banking sector level, deposits are contracting at a noticeable pace, losing US$ 15 billion in 2019 and a further US$ 9.3 billion in the first three months of this year, amid limits on bank withdrawals, a defacto capital control implemented by Lebanese banks, and recapitalization needs facing Lebanese banks amid losses on the asset size related to their sovereign placement and the surge of their non-performing loans to the private sector.

At the monetary level, the parallel market exchange rate has skyrocketed to reach circa LP 4,000, against an official rate of LP 1,507.5 per US dollar. In parallel, BDL FX reserves contracted by US$ 2 billion in the first quarter of 2020 amid net conversions from LP holdings to FX holdings and the BDL settlement of FX payments on behalf of the State. By the end of the quarter, BDL FX reserves have reached US$ 35.2 billion, of which US$ 5 billion of sovereign Eurobonds and US$ 8 billion of domestic claims on Lebanese banks, leaving a liquid reserves position of US$ 22 billion.

With respect to the capital markets performance, markets took a hit tied to the State default on its FX debt. The average bond yield on all outstanding Eurobonds rose from 30% at end-December 2019 to 326% at end-March 2020. The 5-year CDS spreads, a measure of market perception of sovereign risks, surged from 2,418 basis points to 14,717 basis points over the same period. In parallel, the stock market index contracted by 17% over the first quarter but some investors preferred to move from bank placements to real estate equities leading to a 30% rise in Solidere prices year-to-date.

The developments in the real sector, external sector, public sector and financial sector for the first quarter of the year 2020 will be analyzed thereafter while the concluding remarks are left to a preliminary assessment of the Lebanese Government Draft Economic Plan.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Primary and secondary sectors start year on rather mixed note

Lebanon's agricultural and industrial sectors started 2020 on a rather mixed note. The exports of the country's primary and secondary segments managed to grow especially after relative weakness in the local currency which made Lebanese goods more competitive. Moreover, the reopening of the Nassib border crossing between Jordan and Syria also positive impacted exports, while imports came under pressure amid sluggish domestic demand.

On the agricultural front, the sector's exports expanded during the first month of the year, while imports decreased. Agricultural exports increased by 15.0% during January 2020, against a rise of 17.6% in the same month of the previous year. Agricultural imports fell by 7.3% during January 2020, compared to a contraction of 16.3% in the same month of 2019.

Moving on to the industrial sector, the performance was somewhat mixed, as imports weakened while exports grew. As a matter of fact, imports of the industrial sector declined by 19.3% annually in the first month of 2020 after falling by 17.7% in January 2019. Externally, industrial exports rose by 42.9% from the previous year's level during January 2020, against a decline of 18.1% in the same month of 2019.

In parallel, figures released by the Kafalat Corporation indicate that loans extended to small and medium sized companies under the guarantee of Kafalat totaled US$ 5.7 million in 2019, down by 85.9% year-on-year. Meanwhile, the aggregate number of guarantees amounted to 51 in 2019, falling from 313 guarantees in 2018.

Last but not least, going forward, the performances of Lebanon's primary and secondary sectors hinge on the economic policies of the Lebanese authorities which should be directed towards supporting and incentivizing domestic production at the detriment of imports.

1.1.2. Construction

Improvement in real estate activity while supply continues to contract

Despite the uncertainty at both the socio-political level and the spread of the COVID-19 pandemic in Lebanon towards the end of February, the demand side of the real estate sector posted a favorable performance during the first two months of this year, following a slowdown in the past two years.

According to the statistics published by the Directorate of Land Registry and Cadastre covering the first two months of 2020, realty markets have undergone an increase in property transactions and sales activity, extending the improvement seen in the last quarter of 2019.

The number of sales operations improved by a yearly 37.9% from 7,859 sales operations in the first two months of 2019 to 10,834 operations in the first two months of 2020. In parallel, sales to foreigners expanded by 11.4% year-on-year to reach 166 operations in the first two months of 2020.

The value of property sales transactions was also on an improving path. It posted a rise of 67.9% year-on-year to attain a total of US$ 1,772.8 million during the first two months of 2020. Accordingly, the average sales value increased from US$ 134,375 in the first two months of 2019 to US$ 163,629 in the first two months of 2020. All the regions recorded an increase in the value of sales transactions, with the most significant movements coming as follows: Kesrouan (+88.4%), Metn (+82.7%) and South (+75.3%).

At the level of supply, the sector started the year on a contractionary note, whereby according to the figures provided by the Orders of Engineers of Beirut and Tripoli, construction permits, an indicator of forthcoming construction activity, posted a 64.6% year-on-year decrease during January 2020, as some developers are slowing down or sometimes halting their construction works.

In fact, construction permits covered an area of 178,775 square meters in January 2020, against an area of 504,819 square meters in January 2019. This followed a yearly contraction of 38.5% registered in January 2019. The breakdown by region shows that most of the regions reported contractions in construction permits with Beirut and Bekaa reporting the highest contractions of 82.4% and 71.6% respectively in construction permits in January 2020. Mount-Lebanon continued to capture the highest share in newly issued construction permits in January 2020 with a share of 35.3%. It was followed by the North with a share of 22.0%, South-Lebanon with 21.7%, Nabattiyeh with 11.7%, Bekaa with 5.2% and Beirut with 4.2%.

Furthermore, Figures released by the Central Bank of Lebanon show that cement deliveries, a coincident indicator of construction activity, declined by a yearly 60.8% in January 2020. Cement deliveries actually reached circa 85,193 tons in January 2020, down from 217,379 tons in the corresponding month of 2019, reflecting a continued slowdown in the construction activity in the country.

It is clear that the liquidity crisis paved a way for the improvement of demand in the real estate sector, though the slowdown remains at the level of supply along with a weakened socio-political situation and a widespread economic uncertainty.

1.1.3. Trade and Services

Lebanon's tertiary sector started the year on a low note

Lebanon's tertiary sector significantly came under pressure during the first quarter of 2020, underperforming at the level of tourist activity and hospitality. It also lost steam at the level of maritime trade and airport activity.

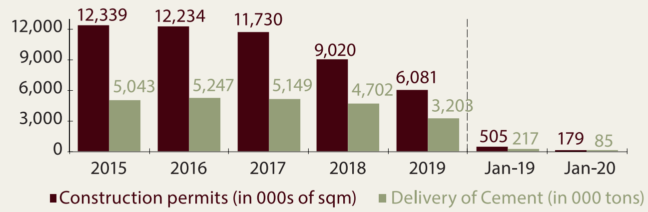
Declining activity on the tourism front was mirrored by weakening airport activity, as the figures released by the Rafic Hariri International Airport revealed that the total number of passengers recorded a yearly 33.6% decrease in the first three months of 2020, amidst country lockdown due to Coronavirus spread to reach 1,152,104 passengers. A detailed look at the activity shows that the number of incoming passengers fell by a yearly 36.1% and that of departing passengers decreased by 31.2% to reach 535,609 and 616,495 respectively in the first quarter of 2020. The number of transiting passengers fell from 13,636 passengers in the first three months of 2019 to 12,990 passengers in the corresponding period of this year. When including the latter mentioned category, the total number of passengers using the airport attained 1,165,094, down by a yearly 33.4%.

Looking at the aircraft activity, landings and take-offs decreased by a yearly 29.9% each with the former amounting to 5,404 planes and the latter reporting 5,401 in the first quarter of 2020. Regarding the freight movement within the airport, a total of 7,651 thousand tons were imported and unloaded during the first three months of 2020 while 6,514 thousand tons were loaded and exported. The first mentioned activity posted a decline of 42.3% while the latter posted a 6.3% fall on a yearly basis in the first three months of 2020.

CONSTRUCTION

	Q4-19	2019	2M-19	2M-20	Variation 2M/2M
Value of property sales (in millions of US$)	2,101	6,839	1,056	1,773	67.9%
Number of property sales	13,400	50,352	7,859	10,834	37.9%
o.w. Sales to foreigners	235	993	149	166	11.4%
Average value per property sale (in US$ 000)	157	136	134	164	21.8%
Property taxes (in millions of US$)	84	302	54	78	45.0%

EVOLUTION OF CONSTRUCTION INDICATORS



Subsequently, and according to Ernst & Young's "Middle East Hotel Benchmark Survey", the performance of Lebanon's hospitality sector witnessed a retreat in occupancy rates, average room rates and room yields. As a matter of fact, the occupancy rate of four and five star hotels within the capital reached 28% in the first two months of 2020, against 65% in the same period of 2019. Beirut's room rate notably moved down from the first two months of 2019 to attain US$ 130 in 2M 2020 from US$ 192 in the past year. The rooms' yield retreated by 71.2% annually to reach US$ 36 in 2M 2020 compared to US$ 125 in the same period of 2019.

Moving on to maritime trade, the Port of Beirut revealed a decline in most of the Port's indicators in the first two months of 2020 compared to the same period of the previous year. The number of containers recorded an annual decrease of 45.4% to attain a total of 66,600 in the first two months of 2020, compared to 122,073 containers in the same period of the previous year. The number of ships posted a fall of 1.5% year-on-year to reach a total of 260 vessels in the first two months of 2020. The quantity of goods fell by a yearly 35.9% to 728 thousand tons in the first two months of 2020, following a fall of 16.5% reported in the first two months of 2019.

Finally, total value of cleared checks, an indicator of consumption and investment spending in the Lebanese economy, rose by 28.4% year-on-year in the first two months of 2020. The value of cleared checks reached US$ 12,522 million in the first two months of 2020, against US$ 9,755 million in the same period of 2019. A breakdown by currency shows that the banks' clearings in Lebanese pounds amounted to LP 6,786 billion (+23.7%) in the first two months of 2020 while those in FC amounted to US$ 8,021 million (+31.1%). Furthermore, the number of cleared checks registered 1,466,336 in the first two months of 2020, down by 14.3% from 1,711,520 in the same period of 2019.

1.2. EXTERNAL SECTOR

2020 starting with a 30% drop in trade deficit in January amid an 18% decline in imports

The latest foreign trade statistics released by Lebanon's Customs Authority for the first month of 2020 suggest a net contraction in imports by a yearly 17.8%, alongside a 41.1% hike in exports, which led to a reduction in the trade deficit by 29.7% in January 2020 when compared to January 2019, a trend that is continuing since late November. State efforts should be further directed to stimulate domestic production at the detriment of imports through providing incentives for sectors that produce import-substitution goods and export-oriented products.

That said, the sum of exports and imports went down by a yearly 9.3% to reach US$ 1.5 billion over the first month of the year, while the exports to imports ratio reached 28.9% over the period, a historical high level.

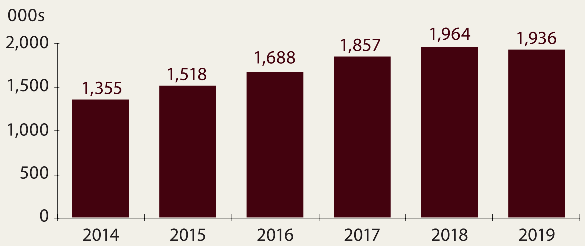
Going further into details, exports reached US$ 333 million in January 2020, compared to US$ 236 million in January 2019, to report its strongest yearly growth in almost a decade. The breakdown of exports by product shows that the main exports over the first month of the year were jewelry with 47.7% of the total (registering a hike of 101% year-on-year), followed by food products and metals with 9.0% each, chemical products with 7.2%, electrical equipments with 6.6% and vegetable products with 5.4% over the month of January 2020 when compared to the same month of 2019.

TRADE AND SERVICES

	Q4-19	2019	2M-19	2M-20	Variation 2M/2M
Number of ships at the Port	408	1,746	264	260	-1.5%
Number of containers at the Port (in 000s)	145	734	122	67	-45.4%
Merchandise at the Port (in 000 tons)	1,340	6,524	1,136	728	-35.9%
Planes at the Airport*	15,494	72,279	15,413	10,805	-29.9%
Number of passengers at the Airport (excluding transit, in 000s)*	1,628	8,630	1,735	1,152	-33.6%
Cleared checks (in millions of US$)	14,574	56,971	9,755	12,522	28.4%

*First quarter figures for 2M-19 & 2M-20

EVOLUTION OF THE NUMBER OF TOURISTS



The breakdown of exports by major countries of destination suggests that Switzerland grabbed the lion's share of total exports with 39.0%, followed by UAE with 11.7%, Saudi Arabia with 6.6%, Iraq with 3.9% and Syria with 3.6%. It is worth mentioning that land exports through Syria registered a negative trend with a relative drop by 9.3%, while exports through the Hariri international Airport witnessed a hike by 78.4% and those through the Port of Beirut went up by 11.0% over the same period.

In parallel, total imports reached US$ 1.2 billion in January 2020, from US$ 1.4 billion in January 2019. The breakdown of imports by product shows that the main imports over the first month of the year were mineral products with 39.7% of the total (registering a hike of 74% year-on-year), followed by chemical products with 10.9%, jewelry with 7.9%, vegetable products with 6.6% and food products with 6.2% over the month of January 2020 when compared to the same month of 2019. The breakdown of imports by country of origin shows that 9.7% of the inward merchandise in January 2020 came from Greece, followed by Italy with 9.1% of the total, Turkey with 8.9%, USA with 6.3%, China with 5.7%, Russia with 5.6% and UAE with 5.4% of total imports over the same period.

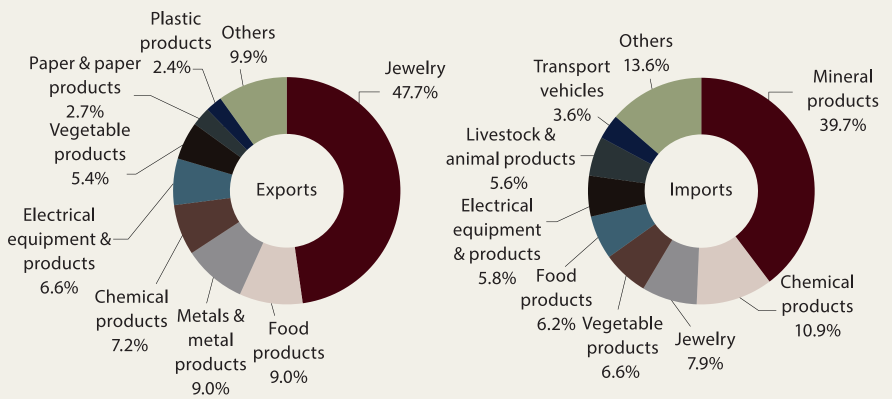
1.3. PUBLIC SECTOR

Government Economic Plan targeting a downward debt trajectory over the medium run

Lebanon's fiscal performance showed a significant expansion in fiscal deficit by 29% over the fourth quarter of 2019 in the aftermath of the recent socio-political developments, reaching US$ 5.8 billion in full-year 2019 or the equivalent of 11.3% of GDP, derailing from its budgeted target of 7.6% in 2019. In parallel, the country's gross debt reached US$ 92.2 billion at end-February 2020, up by 8.2% from the level seen at end-February 2019. Domestic debt was higher by 13.0% from end-February 2019 to reach a total of US$ 58.2 billion at end-February 2020. Lebanon's foreign debt went up slightly by 0.9% from end-February 2019 to stand at around US$ 34.1 billion at end-February 2020. In this context, net public debt, which excludes the public sector deposits at the Central Bank and commercial banks from overall debt figures, increased by 7.8% from end-February 2019 to reach a total of US$ 82.6 billion at end-February 2020.

As such, and given that public finances represent the most significant vulnerability of the Lebanese economy of nowadays, fiscal adjustment is critically needed to maintain overall economic stability. In fact, Lebanon cannot sustain its monetary and financial stability with a 176% debt to GDP ratio and a fiscal deficit to GDP of 11%, especially that the deposit growth reliant fiscal deficit financing model is now at stake. The State has no choice but reducing its fiscal financing needs looking ahead. As such, Lebanon needs first and foremost an imminent debt restructuring plan within the context of a comprehensive plan for debt management and macro softlanding including gradual cuts in public debt and deficits.

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY*



* January 2020

Within this context, the leaked draft of the Government Economic Reform Plan targeted a fiscal softlanding through utmost spending austerity, reinforcement of resource mobilization, improvement of tax collection, cut in debt servicing and reforming the electricity sector, in an attempt to reduce fiscal deficit to below 1% of GDP and to restore a clear downward debt trajectory over the short to medium run. As such, the medium-term fiscal strategy of the economic plan includes several revenue-enhancing measures (expected to yield up to 3.7% of GDP by 2024) along with expenditure measures (expected to yield 4.5% of GDP by 2024).

On the revenue front, the Economic Reform Plan aims at broadening the tax base, improving compliance rate and tax collection, through improving customs and VAT collection, normalizing tax compliance levels, removing profits and capital gains tax exemptions for holdings and offshore companies, removing certain VAT exemptions, and strengthening the tax revenue administration. In addition, the government is planning to increase tax audits, boost tax-related debt collection, and prosecute tax offenders. In a second stage, the government will implement a large overhaul of the tax system aimed at making it fairer and more efficient. It will include several measures targeting an increase in corporate tax rate (gradually from 17% to 20%), in tax on interest income on deposits above US$ 1 million from 10% to 20%, in tax for high salaries (from 25% to 30%), in income tax on capital gains from 10% to 15%, in VAT on luxury goods from 11% to 15%, while setting a LP 25,000 floor price on gasoline and introducing a LP 1,000 excise on gas oil.

On the spending front, the plan includes several expenditure measures, starting with the Electricity sector reform by implementing measures aiming at improving efficiency, expanding capacity, and reducing waste and theft, with an increase in tariffs gradually with the generation. Moreover, spending measures will aim at reducing the wage bill by rationalizing public sector employment with a view to improving efficiency and reducing cost, through the freeze of headcount of military personnel and promotion of military personnel conditioned to empty positions, the reduction of the number of contractuals (5% p.a. over 5 years), along with nominal freeze of salaries for a period of 5 years. In addition, the plan is attempting to reduce pension related expenses gradually to 2.2% of GDP by 2024, from 4.7% of GDP in 2019, with other expenditure reduction measures including mainly the reduction of school allowances, unification of allowances for all public sector employees, and rationalization of other current expenditures to limit waste at large.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Foreign currency shortage sends Lebanese pound into free fall

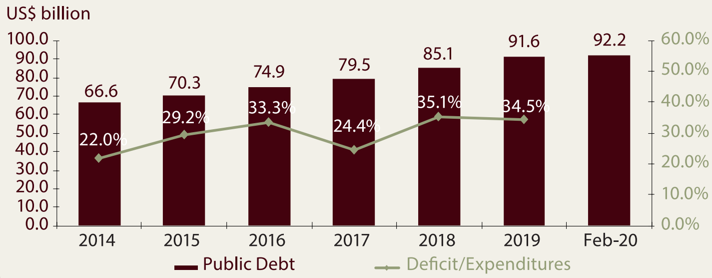
The first quarter of the year 2020 saw dwindling foreign currency reserves, an unprecedented depreciation of the Lebanese pound against the US dollar on the parallel FX market, and first interest rate cuts on LP Treasury bills in ten years.

BDL's foreign assets contracted by US$ 2.1 billion during the first quarter of the year 2020 to reach US$ 35.2 billion at end-March, according to official figures released by the Central Bank of Lebanon. Yet, when

PUBLIC SECTOR DEFICIT FINANCING

in millions of US$ **Deficit financing**	2018 Vol	2019 Vol	Progression Vol
Deficit	6,246	5,837	-409
State creditor accounts	-789	989	1,778
Other items	157	-317	-474
Uses=sources	**5,613**	**6,509**	**896**
LP	**2,504**	**6,253**	**3,749**
Treasury bills (banking system)	1,995	6,196	4,200
Others	509	58	-451
FX	**3,109**	**255**	**-2,854**
Sovereign eurobonds (including Paris II bonds)	3,197	350	-2,847
Others	-88	-95	-7

PUBLIC INDEBTEDNESS



excluding the Central Bank of Lebanon's Lebanese Eurobond holdings (estimated at US$ 5.03 billion at end-March) and the facilities provided by BDL to commercial banks (estimated at US$ 8 billion during the first quarter of 2020), BDL's foreign assets would fall to US$ 22 billion at end-March 2020, noting that they are estimated to have contracted further significantly over the month of April.

The severe shortage in foreign currencies in the financial system has put mounting pressures on the LP/US$ exchange rate in the parallel market, while a BDL's circular issued on March 6, 2020, capping money changers' LP/US$ rate deviation from the official peg at 30%, has attempted to ease these pressures. The Lebanese pound saw a rapid deterioration against the US dollar during the first quarter of the year 2020, with the "Sell Rate" at money changers crossing the LP/US$ 2,800 threshold for the first time since August 1992, to reach LP/US$ 2,825 at end-March 2020. Lebanon's default on its FX debt for the first time in history on March 9, 2020, lingering uncertainties over the country's rescue plan, the heightened domestic political bickering, and the Coronavirus crisis added to the US dollar shortage to send the Lebanese pound into a free fall against the US dollar over the month of April 2020, with the latter reaching a historical low level of LP/US$ 4,000 by the closing of this report.

Also, the foreign exchange market continued to see net foreign currency conversions during the first quarter of the year 2020. This kept the overnight rate at double-digit levels most of the time, while occasionally crossing the 100% threshold, before falling to 3% at end-March 2020 due to discount operations of LP long-term deposits at the Central Bank of Lebanon.

In parallel, the first quarter of the year 2020 bore witness to the first rate cuts on LP Treasury bills in ten years. Lebanon's Ministry of Finance slashed towards the end of March 2020 interest rates on the six-month Tbs category from 5.85% to 4.00%, the three-year category from 7.50% to 5.50%, and the seven-year category from 9.0% to 6.50%. This was followed by successive rate cuts on the three-month, one-year, two-year, five-year and ten-year categories of up to 3.0% in April 2020, to reach 3.50%, 4.50%, 5.00%, 6.00% and 7.00% respectively.

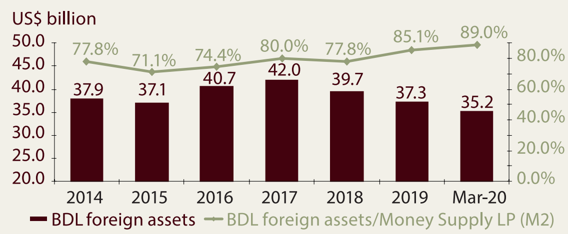
The financial system's total subscriptions in LP Treasury bills amounted to LP 3,394 billion during the first quarter of 2020 against LP 4,515 billion during the same period of 2019, down by circa 25% year-on-year. In parallel, the Central Bank of Lebanon continued to play the role of an intermediary between banks and the sovereign during the first quarter of the year, as reflected by a LP 547 billion growth in its LP securities portfolio. Concurrently, the total LP Certificates of Deposits' portfolio contracted from LP 48,043 billion at end-December 2019 to LP 46,099 billion at end-March 2020, down by LP 1,944 billion, which marks its first contraction since 2016.

In the coming period, the leaked Government Economic Reform Plan suggests the peg to the US dollar (LP/US$ 1,507.5), which has been maintained over decades, should be abandoned, as it resulted in the building-up of a large real overvaluation of the Lebanese pound. The plan believes that the unification of exchange rates would support with time the reconstitution of the international reserves up to adequate levels, enhance transparency and improve liquidity on the foreign exchange market.

MONETARY SITUATION

Flows in US$ million	Q1-19 Vol	Q1-20 Vol	Progression Vol
Net foreign assets (excluding gold)	-2,002	-1,030	972
Net claims on the public sector (excluding valuation adjustments)	1,065	-2,013	-3,078
Claims on the private sector	-1,822	-4,024	-2,202
Uses=Sources	**-2,759**	**-7,066**	**-4,307**
Money (M3)	-1,089	-4,211	-3,122
Valuation adjustment and other items	-1,670	-2,855	-1,185

EXCHANGE MARKET INDICATORS



1.4.2. Banking Activity

Continued deleveraging amid challenging operating conditions

Lebanese banks continued to operate under quite challenging conditions within the context of the economic and financial crisis the country is going through, accrued socio-political tensions and the recent COVID-19-induced confinement that rendered business even more difficult to conduce.

Deposit withdrawals continued, in the form of limited US dollar amounts or in Lebanese pounds (capped monthly amounts) or most noticeably through transferring money to reimburse debt dues. Lebanese banks' deposits contracted by 5.8% in the first three months of the year, or by the equivalent of US$ 9.3 billion (and by US$ 20.7 billion since September 2019). This was mostly attributed to local currency deposits, which accounted for 55% of the total decline in the first three months of this year, leaving the remaining 45% to foreign currency deposits. Accordingly, deposit dollarization reached a new 15-year high of 77.9% at end-March 2020, against 76.0% at end-December 2019 and less than 70% in the years before.

It is worth noting that the Central Bank lately issued a couple of circulars aimed at easing the burden on depositors amid the tough conditions. First, it issued a circular offering the possibility for customers with bank accounts of less than LP 5 million or US$ 3,000 to benefit from a one-off reimbursement of their bank balance in cash in Lebanese pounds at the market rate. Second, it issued a circular asking banks to allow customers to withdraw up to US$ 5,000 from their US dollar accounts per month cash in Lebanese pounds at the market rate.

Around 51% of the deposit contraction in the first three months was actually due to borrowers with creditor accounts reimbursing their loans. Banks continued their deleveraging practices by reducing their exposure to borrowers of the private sector in light of the currently prevailing conditions by the amount of US$ 4.8 billion in the first three months of 2020 (and by US$ 9.5 billion since September, i.e. prior to the crisis outburst). Foreign currency loans' contraction accounted for the bulk of lending contraction (92% share), which triggered a reduction in the loan dollarization ratio to a new low of 66.3% at end-March 2020.

In parallel, the sector's interest rates continued their contraction for the fourth month. In fact, the average LP deposit interest rate, which had reported a recent high of 9.40% in November 2019, dropped to 5.13% in March. Likewise, the average US$ deposit interest rate dropped from 6.31% to 2.53% over the same period. In parallel, the average lending interest rates continued their contraction to reach 9.41% in Lebanese pounds and 8.55% in US dollars.

On another note, banks operating in Lebanon continued their significant Eurobond sales prior to the government default in March. Banks' Eurobond portfolio shrank by US$ 3.0 billion in the first three months to reach US$ 10.8 billion at the end of March. As such, the banks contracted their portfolio by more than

BANKING ACTIVITY

in US$ million	2018	2019	Q1-19	Q1-20
Var: Total assets	**29,628**	**-32,703**	**3,268**	**-8,231**
% change in assets	13.5%	-13.1%	1.3%	-3.8%
Var: Total deposits	**5,617**	**-15,418**	**-1,758**	**-9,273**
o.w. LP deposits	-1,554	-13,119	-493	-5,092
o.w. FC deposits	7,171	-2,301	-1,265	-4,180
% change in total deposits	3.3%	-8.8%	-1.0%	-5.8%
Var: Total credits	**-300**	**-9,617**	**-2,057**	**-4,754**
o.w. LP credits	-482	-2,710	-890	-404
o.w. FC credits	183	-6,907	-1,167	-4,350
% change in total credits	-0.5%	-16.2%	-3.5%	-9.6%

US$ 5 billion over the past year. As a percentage of FX deposits, the Eurobond portfolio held by banks reached 9.2% at end-March, a 22-year low. As a percentage of shareholders' equity, the banks' Eurobond portfolio reached 0.52 times at end-March, the lowest since 1998.

All in all, banks continued to operate in a very tough context, and all eyes are focused on the upcoming government economic plan including a restructuring of the banking sector. Meanwhile, banks are continuing their de-risking measures aimed at alleviating the impact of the crisis on their balance sheets and at shielding as well customers from spillovers of the State default.

1.4.3. Equity and Bond Markets

Lebanon's default on FX debt sends bond prices into free fall

Lebanon's default on its foreign currency debt for the first time in history sent sovereign debt prices into a free fall during the first quarter of the year 2020, with bond yields hitting historical highs and CDS spreads expanding sharply to unprecedented levels, before a tender for credit risk took place later on in April 2020. Also, Lebanese equities registered double-digit price contractions during the first quarter of the year to reach historical lows amid crippling economic, financial and health crisis, while all market players' eyes are focused on the government's economic reform plan.

The first quarter of the year 2020 was a crucial time for Lebanon, as it witnessed the first sovereign default in the country's history. The Lebanese government decided on March 7, 2020 to suspend the payment of a US$ 1.2 billion bond that matured on March 9, 2020 in the aim of safeguarding dwindling foreign currency reserves. Authorities also said that they would discontinue payments on all foreign currency denominated Eurobonds until a comprehensive debt restructuring agreement is reached with creditors.

The State default on its foreign currency debt was accompanied by two credit rating cuts by international rating agencies. On March 11, 2020, Standard and Poor's lowered its foreign currency sovereign ratings on Lebanon to "SD/SD" from "CC/C". On March 18, 2020, Fitch downgraded Lebanon's Long-Term Foreign-Currency Issuer Default Rating (IDR) to "RD" from "C".

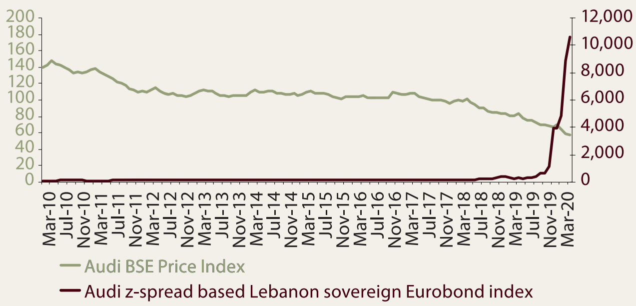
Under these conditions, the Lebanese bond curve converged below 20 at end-March 2020, with prices of sovereigns maturing between 2020 and 2037 ranging between 16.0 cents per dollar and 19.5 cents per dollar. Also, Lebanon's five-year CDS spreads, which is a measure of market perception of sovereign risks, expanded significantly from 2,418 bps at end-December 2019 to 14,717 bps on March 20, 2020, before a CDS auction was triggered. Within this context, it is worth mentioning that a CDS settlement auction took place on April 23, 2020, at which Lebanese sovereigns were given a final value at 14.125%. This means that investors holding debt protection on Lebanon would receive 86% of the amount covered by the instruments, i.e US$ 215 million. As far as yields are concerned, the weighted average bond yield surged from 30% at end-December 2019 to 326% at end-March 2020.

FINANCIAL SECTOR (NON-BANKS)

	2015	2016	2017	2018	2019	Mar-20
Beirut Stock Exchange						
Market capitalization (in millions of US$)	10,496	10,951	10,578	9,117	7,540	6,242
Total trading volume (in millions of US$)	498	885	608	376	197	43
Annualized trading volume/Market cap.	4.7%	8.1%	5.8%	4.1%	2.6%	2.8%
Price index	104.6	106.9	98.2	83.9	69.7	57.7
% change in index	-1.2%	2.1%	-8.1%	-14.6%	-16.9%	-17.2%
P/E ratio*	6.72	6.44	6.38	5.18	5.90	6.05
P/NAV ratio*	0.93	0.91	0.86	0.69	0.57	0.53
Lebanese Eurobonds						
Total volume (in millions of US$)	25,535	26,123	26,123	30,964	28,314	30,114
Average yield	6.1%	6.5%	6.5%	10.0%	30.0%	326.0%
Average life (in number of years)	6.1	6.2	6.7	7.8	7.5	8.1
5-year CDS spreads variation (bps)	26	57	42	229	2,418	14,717

* For large listed banks

CAPITAL MARKETS PERFORMANCE



In parallel, the Beirut Stock Exchange plunged deeply in the red during the first quarter of the year 2020, as reflected by a 17.2% fall in the BSE price index, amid crippling economic and financial crisis, rising concerns over the economic impact of the coronavirus pandemic, and ongoing cabinet discussions on Lebanon's rescue plan. Banking stocks led the decline over the covered period, registering double-digit price contractions of up to 58%, while Solidere shares bucked the trend. Solidere "A" and "B" share prices jumped by 28.8% and 29.9% respectively over the first quarter of 2020 to reach US$ 9.40 and US$ 9.47 respectively at end-March, as some investors sought to move from bank placements to real estate equities.

Double-digit price contractions were accompanied by increased price volatility on the BSE, as the latter, measured by the ratio of the standard deviation of prices to the mean of prices, reached 5.9% during the first quarter of 2020 and compared to a much lower ratio of 1.4% during the corresponding period of 2019.

In light of price falls and in the absence of any listing or delisting activity, the BSE market capitalization contracted by 17.2% during the first quarter of 2020, moving from US$ 7,540 million at end-December 2019 to US$ 6,242 million at end-March 2020. The BSE total trading value amounted to US$ 43.2 million during the first quarter of 2020 as compared to US$ 78.8 million during the corresponding period of 2019, down by 45%, noting that Solidere shares captured 85.6% of activity. Accordingly, the BSE total turnover ratio, measured by the annualized trading value to market capitalization, reached 2.8% during the first quarter of 2020 as compared to 3.5% during the same period of 2019.

In the coming period, as the government is set to engage good faith discussions with Eurobonds holders, debt discussions would be facilitated in the context of an IMF program, as this would provide an anchor for negotiations, with clear sustainability targets and a methodological framework to rely on.

2. CONCLUSION: ON THE RELEASED GOVERNMENT ECONOMIC REFORM PLAN

There is no doubt that the Government Economic Reform Plan holds some positive highlights and ambitious reform actions, but at the same time it contains some woes such as the distribution of national losses across economic agents.

At the positive level, the Plan comprised tangible reforms on the fiscal front coupled with sound efforts to stimulate growth and competitiveness of the Lebanese economy, notwithstanding the social aspect as it targeted the strengthening of social safety nets to protect the most vulnerable part of the Lebanese population. The Plan targeted a fiscal softlanding, attempting to decrease deficit to GDP from 11% today to 0.7% in 2024, through enhancing revenues, fighting tax evasion, rationalizing public spending, decreasing debt servicing and reforming the pension system and the electricity sector, all apt to decrease debt to GDP from 176% to 99% at the 5-year horizon.

It is yet worth mentioning that the Plan rests on foreign assistance for US$ 10 billion, which is today quite doubtful in the current environment. In this context, we believe that the talks with the IMF should go beyond technical assistance towards a full-fledged program that would give credibility to the Government Plan and enhance Lebanon's ability to attract foreign funding. When looking at the spectacular 3-year change in Egypt's pre-IMF and post-IMF, we better understand the criticality of a full-fledge program with the IMF. Egypt has today the highest growth in the Arab World (6%), its foreign reserves tripled from US$ 15 billion to US$ 50 billion, while its inflation rate fell from 33% to below 10%. That said, any macro soflanding in Lebanon hinges upon foreign assistance in general and in particular IMF involvement to bridge the large external gaps Lebanon is likely to suffer from.

The Government Plan estimates large national losses, to fall mainly on the burden of banks and depositors as per the Plan. Our standpoint here is that before resorting to any type of haircut or bail-in measures that impact depositors, let us go back to the root of the problem, which is the public sector that has US$ 90 billion in debt and over which the banking sector is exposed directly or indirectly through the Central Bank. This public sector that is defaulting today has assets ranging from privatizable entities to real estate property, bearing in mind that those assets offset a large part of its liabilities when assessing its net asset value. What is required is to address a part of those assets and redeem claims on the public sector before addressing any measure that curtail depositors. What is required as well is to preserve a minimum level of bank equity needed to restart a new cycle of the economy.

As such, a State fund could be created with public assets as collateral for tens of billions of dollars comprising of real estate assets and privatizable entities, as a share of the Government in the overall national sacrifices. It would reduce the government debt, redeem the claims of the Central Bank on the Government and reduce, in parallel, the banks claims on BDL and the customer deposits by an equivalent amount. Subsequently, large depositors would benefit from an immediate injection freeing up some frozen deposits.

The purpose of any alternative should be to ensure a sustainable restructuring of the government debt with a realistic, fair and equitable allocation of the losses between all stakeholders while maintaining the paradigm of the liberal economy. Subsequently, it should (1) Reduce government debt to a sustainable level while safeguarding the economy and a properly "restructured" banking system, (2) Free-up part of depositors' funds without applying haircuts on funds or "bail ins", (3) Distribute the current "loss" in a fair and equitable way which shows seriousness, good will and commitment from the major stakeholders, and (4) Help re-establish confidence in government actions and the banking sector soundness to be able to attract funds into the domestic economy at large.

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