

TABLE OF CONTENTS

| | |
|---------------------|----|
| Executive Summary | 1 |
| Introduction | 2 |
| Economic Conditions | 3 |
| Real Sector | 3 |
| External Sector | 5 |
| Public Sector | 7 |
| Financial Sector | 8 |
| Concluding Remarks | 11 |

IN ORDER TO MOVE FROM A PRELIMINARY STAFF-LEVEL AGREEMENT TO A FULL PROGRAM WITH THE IMF

Economy on an uncertain mode

A number of important developments characterized the country in the first half of 2022, namely the realization of a Staff-level agreement with the IMF, the end of the diplomatic crisis with GCC, the completion of the Parliamentary elections and the countdown for presidential elections. Such developments had considerable effects on economic activity, though considerable macro/monetary challenges weigh significantly on the country's outlook amid noticeable politico-economic uncertainties looking forward.

Market value of public debt lower than the country's GDP

The public debt data just published by the Ministry of Finance showed that the country's gross debt reached US\$ 100.6 billion at end-March 2022, up by 3.5% from the level seen at end-March 2021. It is yet worth mentioning that the market value of debt, when considering a 15% recovery for Eurobonds and when assessing the LL debt at the Sayrafa rate rather than the official rate, stands at slightly less than US\$ 10 billion, which is lower than the country's GDP.

Marginal fluctuations in LP/US\$ black market rate in first half along with rising cost of LL cash, driven by BDL's exceptional measures

Lebanon's monetary conditions saw over the first half of the year 2022 marginal fluctuations in the LP/US\$ black market rate, a shortage in local currency liquidity on the money market that resulted into quadrupled cost of LP cash, and a continuous FX reserves burn. This came within the context of BDL circular No. 161 and the Bank's exceptional measures, which allowed banks to buy US dollar banknotes from the Central Bank in exchange for LP held in their accounts at the "Sayrafa" rate. Subsequently, BDL's foreign assets contracted by US\$ 2.5 billion over the first half, reaching US\$ 15.3 billion at end-June 2022, which brought total contractions since October 2019 to US\$ 22.6 billion. When excluding BDL's Eurobond holdings estimated at US\$ 5.0 billion and foreign currency facilities provided by the Central Bank to Lebanese banks, BDL's liquid FX reserves are estimated to have fallen below the US\$ 10 billion level at end-June 2022.

Noticeable surge in Lebanese equities on hedging activity, sovereign bond prices at new record lows on cabinet and reform uncertainties

Lebanon's equity market registered a significant surge in prices over the first half of the year 2022, mainly supported by strong price gains in Solidere shares, as market players continued to add realty stocks to their holdings on hedging activity against crises. On the other hand, Lebanese Eurobond prices reached new record lows at end-June 2022, mainly weighed down by worries about a political vacuum that may be extended till Presidential elections, and on growing concerns about the new fragmented Parliament's ability to deliver key reform laws, which are preconditions to unlock much-needed international financial support.

Nine prior actions behind a final agreement with the IMF

A final Program with the IMF is much needed as it is the only way out for Lebanon to exit its lingering economic and financial crisis. After the government ensured the ratification of a Staff-level agreement with the Fund, the real challenge lies in the provision of the nine required prior actions on behalf of the Lebanese authorities (analyzed in the conclusion of this report) that would enable Lebanon to have a final agreement with the IMF, opening the door for direct facilities and inciting donor countries at large.

Challenges facing legislation and political milestones

All fingers are crossed so that the prior actions materialize, though we believe it won't be easy ratifying all those actions in a near future, especially within the context of a fragmented Parliament. The parliamentary elections lead to a much fragmented parliament, with no one being able to call the majority and with the presence of a large number of blocks and Independent MPs. While such a new reality is good for checks and controls, it yet also means that it would be difficult to have agreement on major political milestones and legislation at large.

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A number of important developments characterized the country in the first half of 2022, namely the realization of a Staff-level agreement with the IMF, the end of the diplomatic crisis with GCC, the completion of the Parliamentary elections and the countdown for presidential elections. Such developments had considerable effects on economic activity, though considerable macro/monetary challenges weigh significantly on the country's outlook amid noticeable politico-economic uncertainties looking forward.

The evolution of real sector indicators over the first half-year were at the image of a mixed economy on the overall, though tending to extended sluggishness. Among indicators with negative growth, we mention cleared checks with a contraction of 18.0%, imports of petroleum derivatives with a decline of 20.7% and electricity production with a fall of 66.0%. Among indicators with positive growth, we mention construction permits with a surge of 440.0%, the number of tourists with a rise of 155.8%, the number of passengers at the airport with a rise of 81.4%, the new car sales with a rise of 37.5%, the value of property sales with an expansion of 26.2% and merchandise at the Port with a rise of 0.2%.

At the external level, the first half of 2022 was characterized with a growing deficit in the balance of payments that recorded US\$ 2.6 billion, against US\$ 1.8 billion in the same period of 2021. This year's six-month deficit was totally driven by the drop in net foreign assets of the Central Bank, while banks' net foreign assets stabilized over the period. The drop in BDL's net foreign assets comes within the context of a significant intervention on the Sayrafa platform to contain the exchange rate drift, while the subsidy component has been reduced to a minimum this year.

At the monetary level, inflation continued its ascent in the first few months of 2022. The Consultation & Research Institute's index of consumer prices has surged by 193.7% in June 2022 compared to results of June 2021. All nine main indices registered increases this May. The highest increase was registered by the "Transportation and Telecommunications" category (301.0%), followed by the "Housing" category (226.5%), then by the "Food and Beverages" category (200.1%) then by "Recreation" category (195.1%) and the "Durable Consumer Goods" category (164.7%).

At the banking level, the first six-month period was characterized by a moderate decline in deposits when compared with the same period last year. Indeed, customer deposits contracted by US\$ 2.3 billion over the first six months of 2022, against a contraction of US\$ 4.9 billion over the same period in 2021. In parallel, banks continued their deleveraging process. Banks loans to the private sector contracted by US\$ 3.7 billion over the first 6 months of 2022, against a decline of US\$ 4.3 billion over the same period in 2021. With respect to capitalization, bank shareholders' equity contracted from US\$ 17.8 billion at end-December 2021 to US\$ 17.0 billion at end-June 2022 as a result of net bank losses over the period.

At the capital markets level, equity markets continued the spectacular surge of last year. The BSE price index rose by 37.6% in the first half of the year, following a 48.1% increase in the index in 2021 driven by the rise in Solidere shares. This year's rise in prices occurred within the context of a 3.2% annual increase in trading volume year-on-year, moving from US\$ 188 million in the first half of 2021 to US\$ 194 million in the first half of 2022. Consequently, the turnover ratio (annual trading value to market capitalization) decreased from 4.0% to 2.7% between the two periods.

The developments in the real sector, external sector, public sector and financial sector for the first half of the year 2022 will be analyzed thereafter while the concluding remarks are left to an assessment of the challenges for a final program with the IMF in the aftermath of the observed Staff-level agreement between the Lebanese government and the Fund.

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1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Lebanon's primary and secondary sector increasingly pressured by the increase in raw material prices

The activity of Lebanon's primary sector benefited from a favorable weather for farming activities this year despite the lasting impact of the economic crisis that somewhat hindered the farmers' production ability. The Ukraine-Russia conflict has also significantly affected the global supply prices of key commodities, such as oil and gas and fertilizer. This price increase is already feeding through into higher consumer prices.

According to the Food and Agriculture Organization of the United Nations, as incomes from different economic sectors retreated, dependence on agriculture has grown.

At the level of inputs, plant protection material are available on the market, yet at high prices. As most agricultural inputs are imported, the currency depreciation on the parallel market increases their cost in local currency. Huge increases of international prices of fertilizers, denominated in US dollars were under pressure due to the currency devaluation.

The prices of fuel, following the withdrawal of the subsidies, had also a negative impact on mechanized agricultural operations as well as access to markets.

While most of agricultural inputs are paid in US dollars, sales of agricultural products remain denominated in local currency. The volatility of the currency minimizes any gains. Limited purchasing power of the population has capped the increases of retail prices.

At the level of the industrial sector, manufacturers are facing several problems. Supply chain issues and bottlenecks are resulting in consumer goods shortages, feeding through into supply-side inflation. The increase in prices is pushing manufacturers to encounter shortages of key components and higher raw materials costs, as per Fitch Solutions.

In order to support the sector, the United Nations Industrial Development Organization (UNIDO), supported by the Ministry of Industry (MOI) and in close collaboration with the Association of Lebanese Industrialists (ALI), the Association of North Metn Industrialist (ANMI), assessed the situation of several sectors. The assessment affirms that adopting more resource-efficient production practices could directly support companies in meeting the imperative need for cost savings and strategically re-position their resilience in resource consumption to face current challenges and meet future demands.

In conclusion, it is clear that the agriculture and industry sector are under pressure due to their heavy reliance on raw material, the spillovers of the depreciation of the currency and the increase in prices globally.

1.1.2 Construction

Lebanon's construction sector moves forward with its growth this year

Lebanon's property and construction sector reported a positive performance in the first few months of 2022, extending the growth reported in 2021. The various sectoral indicators for construction and real estate confirm an improvement in activity, despite the extended economic crisis taking over the country.

According to the latest statistics published by the General Directorate of Land Registry and Cadastre, the number of sales operations went up from 22,580 operations in the first four months of 2021 to 32,288 operations in the first four months of 2022. The number of transactions expanded by 29.7% year-on-year to stand at 60,200 in the aforementioned period of 2022.

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Furthermore, the value of property sales transactions edged up by 26.2% year-on-year to reach a total of US\$ 4,477.6 million during the same period of 2022. Most regions recorded increases in the value of sales transactions, with the most significant movements coming from the North, Nabatiyeh and South.

On a side note, the average property sales value contracted from US\$ 157,088 in the first four months of 2021 to US\$ 138,676 in the corresponding period of this year.

In a look at the breakdown of the value of property sales, Beirut continued to capture the highest share over the period with a share of 29.0%, followed by the South with 19.4%, Keserwan with a share of 13.7% and Baabda with a share of 8.9%.

On a similar note, property taxes improved from US\$ 172.6 million in the first four months of 2021 to US\$ 348.6 million in the corresponding period of this year, an annual increase of 102.0%.

On the supply side, construction permits, a proxy indicator of forthcoming construction projects saw a huge rise. The latest statistics released by the Order of Engineers of Beirut and Tripoli revealed that construction permits continued the growth posted in 2021 though at a faster pace during the first two months of 2022. In details, construction permits posted a rise of 440% annually. Moreover, cement deliveries reported a 156.8% expansion in the first month of 2022 relative to January 2021.

As such, the real estate and construction sectors continue to represent a significant cornerstone against the headwinds hitting different sectors of the Lebanese economy at large.

1.1.3. Trade and Services

Tertiary sector sees a mix of positive and negative indicators in 1H2022

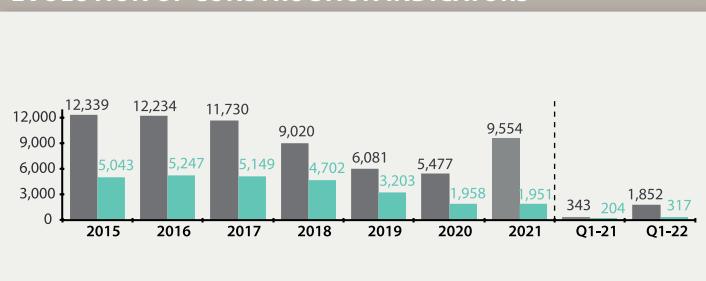
Lebanon's tertiary sector saw a mixed performance in the first half of 2022. While airport activity and hotel occupancy offered a ray of hope, average daily room rates and the value of tax-free spending were still under performing. At the level of domestic spending, cleared checks continued to post negative indicators, again impacted by the pressure on the purchasing power due to the depreciation of the local currency, in addition to the spillovers of rising global inflation which is notching up the prices.

At the level of airport traffic, figures released by the Rafic Hariri International Airport revealed that the total number of passengers rose by an annual 81.4% in the first half of 2022. The number of aircraft expanded by 49.7% year-on-year in the previously mentioned period. In details, the number of arriving passengers rose by a yearly 78.5% and that of departing passengers by 84.4% to reach 1,304,545 and 1,261,568 respectively in the first six months of 2022. The number of transiting passengers contracted by an annual 50.9% to 13,645 passengers in the first half of 2022. When including the latter mentioned category, the total number of passengers using the airport attained 2,579,758, up by 78.8%. Looking at the aircraft activity, landings

CONSTRUCTION

| | Q4-21 | 2021 | 4M-21 | 4M-22 | Variation |
|---|--------|---------|--------|--------|-----------|
| | | | | | 4M/4M |
| Value of property sales (in millions of US\$) | 5,005 | 15,550 | 3,547 | 4,478 | 26.2% |
| Number of property sales | 38,514 | 110,094 | 22,580 | 32,288 | 43.0% |
| o.w. Sales to foreigners | 466 | 1,467 | 316 | 311 | -1.6% |
| Average value per property sale (in US\$ 000) | 130 | 141 | 157 | 139 | -11.7% |
| Property taxes (in millions of US\$) | 283 | 788 | 173 | 349 | 102.0% |

EVOLUTION OF CONSTRUCTION INDICATORS



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and take-offs increased by around 50% year-on-year each, with the former amounting to 11,266 planes and the latter reporting 11,265 in the first half of 2022. Regarding the freight movement in the airport, 13,766 thousand tons were imported and unloaded during the first six months of 2022 while 14,272 thousand tons were loaded and exported.

At the level of hospitality and according to Ernst & Young's "Middle East Hotel Benchmark Survey", the performance of Lebanon's four and five stars hotels witnessed an improvement in occupancy rate and room yields while the average rooms rate contracted during the first four months of 2022. In details, the occupancy rate of four and five-star hotels within the capital increased by around 11 percentage points to 40% in the first four months of 2022, against 29% in the same period of last year. Average room rate decreased by 19.4% year-on-year to stand at US\$ 57.5 in the aforementioned period.

Furthermore, as per Global Blue, the firm that reimburses VAT to tourists at Lebanese border points, purchases by tourists in Lebanon whose VAT was claimed and which gives a fair view about tourists' shopping trends, declined by 48% during the first half of 2022 compared to the same period of 2021. This was mainly due to the vast decline during the second quarter of 2022.

At the level of the Port, the latest statistics released by Port of Beirut revealed that the number of ships revealed a contraction of 8.0% year-on-year to reach 483 vessels in the first five months of 2022. The quantity of goods edged up minimally by 0.2% to 2,067 thousand tons in in the first five months of 2022, following a rise of 2.4% reported in the same period of 2021.

At the level of local spending, total value of cleared checks, an indicator of consumption and investment spending in the Lebanese economy, declined by 18.1% year-on-year in the first half of 2022, revealing a continuous decline in the purchasing power amidst unending politico-economic uncertainties. The value of cleared checks reached US\$ 16,878 million in the first half of 2022, down from US\$ 20,603 million in the same period of 2021. A breakdown by currency shows that the banks' clearings in Lebanese Pounds amounted to LP 16,583 billion (+19.3%) in the aforementioned period of 2022, while those in US\$ amounted to US\$ 5,878 million (-48.3%). Moreover, the number of cleared checks registered 1,013,924 in the first six months of 2022, down by 46.1% from 1,881,673 checks in the first half of 2021. Moreover, the value of returned checks registered US\$ 148 million in the aforementioned period retreating by an annual 46.2%. The number of returned checks stood at 6,997 in the first half of 2022, down from 15,361 in the same period of last year.

1.2. EXTERNAL SECTOR

Trade deficit still unsustainable despite its net contraction

Despite the decrease in the trade deficit in Lebanon during the past two years, it is still noticeable and unsustainable.

In fact, the imports of goods amounted for around US\$ 14 billion in 2021, while exports did not exceed

TRADE AND SERVICES

| | 2021 | | | 2022 | | | Variation | |
|---|-------|--------|--------|--------|--------|--------|-----------|--------|
| | Q1 | Q2 | H1 | Q1 | Q2 | H1 | Q2/Q2 | H1/H1 |
| Number of ships at the port* | 311 | 214 | 525 | 283 | 200 | 483 | -6.5% | -8.0% |
| Number of containers at the port (in 000s) | 124 | 124 | 248 | 131 | - | - | - | - |
| Merchandise at the Port *(in 000 tons) | 1,271 | 792 | 2,063 | 1,256 | 811 | 2,067 | 2.4% | 0.2% |
| Planes at the Airport | 6,492 | 8,560 | 15,052 | 10,261 | 12,270 | 22,531 | 43.3% | 49.7% |
| Number of passengers at the Airport (in 000s) | 537 | 878 | 1,415 | 1,098 | 1,469 | 2,566 | 67.3% | 81.4% |
| Cleared checks (in millions of US\$) | 9,997 | 10,606 | 20,603 | 8,526 | 8,352 | 16,878 | -21.3% | -18.1% |

* Figures are for the first five months of the year

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US\$ 4 billion, i.e. the ratio of exports to imports does not exceed 29%. Therefore, the trade deficit in Lebanon reaches at around US\$ 10 billion annually, knowing that it decreased relatively after the economic crisis in 2019. In fact, imports decreased by 29.1% during the past two years, while exports increased by 4.2% over the period.

It is worth mentioning that the ratio of imports to GDP in Lebanon still reaches 50%, which is considered one of the highest rates globally, as this ratio reaches 37% in the Middle East and North Africa, 24% in emerging markets and 28% in the world.

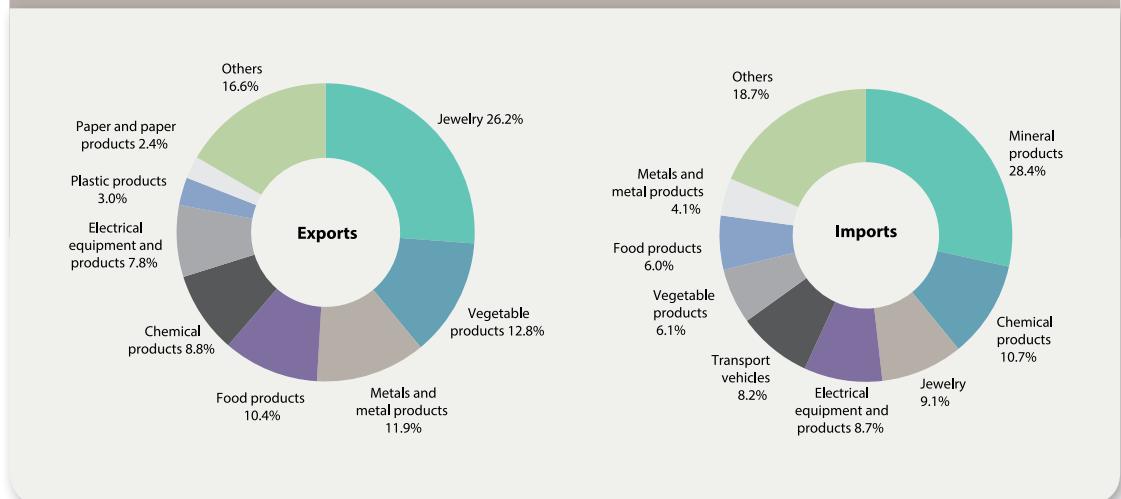
Adjusting the external sector that is characterized by persisting imbalances is key, noting that the current model of offsetting trade deficits with foreign inflows of capital is no longer sustainable given the considerable contraction of the latter. It is possible to reach an equilibrium in the balance of payments position by reducing further imports, boosting exports and fostering financial inflows. Hence, the importance of reviving Lebanon's ability to entice incoming financial flows amid a gradual return of the confidence factor, boosting domestic production and exports by subsidizing high value added sectors and imposing restrictions and taxes on imports that erode the Lebanese financial system's foreign assets.

Within those realms, it would be interesting to have a look at the breakdown of imports and exports of Lebanon (by product and country) according to the latest data that are available for foreign trade, i.e those of the full-year of 2021, since the High customs Council did not issue data since then.

As per the latest figures released by the customs, the breakdown of imports by product reveals that mineral products represents the biggest constitution of 28.4% of the totals, followed by chemical products constituting 10.7%, jewelry (9.1%), electrical equipment and products (8.7%), transport vehicles (8.2%), vegetable products (6.1%), food products (6.0%), metals and metal products (4.1%), livestock and animal products (3.7%) and plastic products for (3.6%). The breakdown of imports by country of origin shows that among the major partners, imports from Turkey represent the highest of the totals for 10.6%, followed by imports from Greece (10.0%), China (9.3%), USA (5.6%), Italy (4.6%), Germany (4.5%), Russia (4.5%), UAE (2.5%), Ukraine (2.5%), France (2.5%), Egypt (2.4%) and Switzerland (2.4%).

In parallel, the breakdown of exports by product reveals that jewelry represents the highest constitution of exports for 26.2%, followed by vegetable products displaying 12.8% of total exports, metals and metal products (11.9%), food products (10.4%), chemical products (8.8%), electrical equipment and products (7.8%), plastic products (3.0%), paper and paper products (2.4%), transport vehicles (1.7%), textiles and textile products (1.2%) and live animal and animal products (1.0%). The breakdown of exports by major

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY (2021)



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countries of destination suggests that exports to UAE constitute the highest share for 22.2%, followed by Switzerland (10.9%), Qatar (5.1%), Egypt (4.5%), USA (3.3%), Saudi Arabia (3.2%), Iraq (3.2%), Greece (2.4%), Syria (2.3%), South Korea (2.3%), Kuwait (2.3%) and Jordan (2.2%).

1.3. PUBLIC SECTOR

Market value of debt lower than the country's GDP

The debt data just published by the Ministry of Finance showed that the country's gross debt reached US\$ 100.6 billion at end-March 2022, up by 3.5% from the level seen at end-March 2021. Domestic debt increased by 1.2% from end-March 2021 to reach a total of LP 92.4 billion. Lebanon's external debt rose by 7.3% from end-March 2021 to stand at around US\$ 39.4 billion at end-March 2022, yet bearing in mind that Lebanon defaulted on its FX debt in March 2020.

In the same context, the public sector deposits at the Central Bank rose by 102.3% from end-March 2021 to register US\$ 9.6 billion at end-March 2022. The public sector deposits at commercial banks contracted by 28.4% from end-March 2021 to end-March 2022, registering US\$ 4.1 billion. As such, net public debt, which excludes the public sector deposits at the Central Bank and commercial banks from overall debt figures, rose negligibly by 0.2% from end-March 2021 to reach a total of US\$ 86.9 billion at end-March 2022.

It is yet worth mentioning that the market value of debt, when considering a 15% recovery for Eurobonds and when assessing the LL debt at the Sayrafa rate rather than the official rate, stands at less than US\$ 10 billion, which is lower than the country's GDP.

In parallel, according to public finance figures just released by the Ministry of Finance for the first ten months of 2021 (latest available figures), the overall fiscal balance reported a net surplus of LL 1,418 billion, against a deficit of LL 4,224 billion in the same period of 2020. When deducting debt service, the primary balance recorded a surplus of LL 3,740 billion in the first ten months of 2021, against a primary deficit of LL 1,738 billion in the same period of 2020.

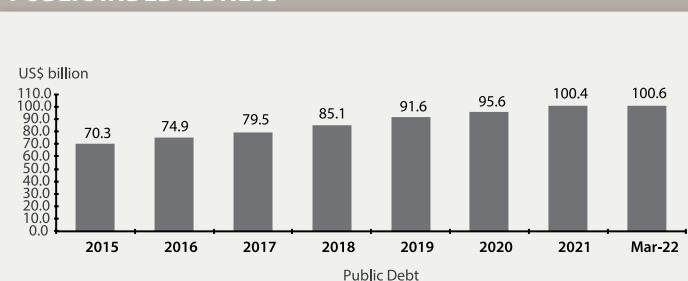
The surplus comes as a result of a 34.2% surges in revenues, against a 9.4% decline in expenditures over the first ten months of 2021 relative to the same period in 2020. Public finance revenues moved from LL 12,024 billion to LL 16,139 billion. Public finance expenditures dropped from LL 16,247 billion to LL 14,721 billion.

The rise in public finance revenues is the result of a 40.3% rise in budget revenues, while Treasury revenues dropped by 14.1%. In turn, the rise in budget revenues is driven by a 44.2% increase in tax revenues, while non-tax revenues surged by 25.3%. The rise in tax revenues is driven by a 147.3% rise in VAT revenues, a 21.1% rise in customs revenues and a 16.7% increase in property taxes, while miscellaneous tax revenues rose by 23.6% over the period. On the other hand, the surge in non-tax revenues is totally due to Telecom revenues that increased by 61.3% between the two periods.

SUMMARY OF FISCAL PERFORMANCE

| LP million | 10M-20 | 10M-21 | Var10M/10M |
|--|------------|------------|------------|
| Total public revenues | 12,023,482 | 16,139,062 | 34.2% |
| Total public expenditures | 16,247,069 | 14,721,259 | -9.4% |
| Total Cash Deficit / Surplus | -4,223,587 | 1,417,803 | - |
| In % of Total Expenditures | -26.0% | 9.6% | 35.6% |
| Total Primary Deficit / Surplus | -1,737,888 | 3,740,155 | - |
| In % of Total Expenditures | 10.7% | 25.4% | - |

PUBLIC INDEBTEDNESS



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The decline in public finance expenditures is the result of an 8.0% drop in budget expenditures, while Treasury expenditures dropped by 18.7%. The drop in budget expenditures comes as a result of the 37.4% decline in Treasury advances to EDL in addition to a 7.0% drop in interest payments. FX interest payment actually fell by 76.9% (mainly tied to the State's default as of March 2020), while LL interest payment increased by 0.4%.

It is within this environment that the Parliament is discussing the 2022 budget law proposal transferred from Cabinet end-February. The country is under pressure to finalize its budget law the soonest possible, as it falls among prior actions requested by IMF. It is worth mentioning that the 2022 budget should be accompanied by a long-term vision for fiscal adjustment targeting a gradual decline in public financing needs, in addition to debt restructuring at large.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Marginal fluctuations in LP/US\$ black market rate in first half of 2022, helped by BDL's exceptional measures

Lebanon's monetary conditions saw over the first half of the year 2022 marginal fluctuations in the LP/US\$ black market rate, a shortage in local currency liquidity on the money market that resulted into quadrupled cost of LP cash, and a continuous FX reserves burn. This came within the context of BDL circular No. 161 and the Bank's exceptional measures, which allowed banks to buy US dollar banknotes from the Central Bank in exchange for LP held in their accounts at the "Sayrafa" rate.

In details, the LP/US\$ exchange rate fluctuated marginally on the black FX market during the first half of the year 2022, reaching LP/US\$ 28,500 at end-June 2022 as compared to LP/US\$ 27,500 at end-2021. This occurred despite dire domestic economic and financial fundamentals, dwindling FX buffers, a standstill in the cabinet formation process, and growing concerns about the new fragmented Parliament's ability to reach an agreement on political, legislative and economic reform issues. Contained currency swings on the parallel FX market can be mainly explained by the Central Bank's heavy intervention on the FX market via the "Sayrafa" platform to meet demand for cash US dollars, and the continuous inflow of hard currency during the summer tourist season.

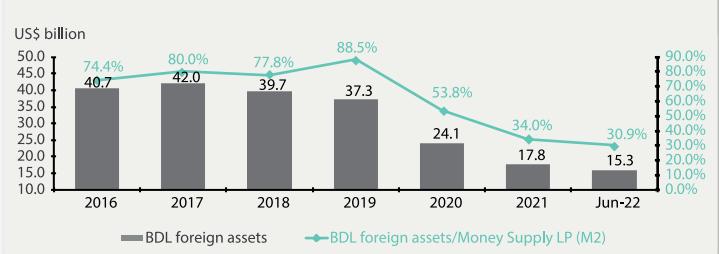
While BDL's exceptional measures helped cubing strong currency swings on the black FX market, they were a drag to BDL's FX buffers. BDL's foreign assets contracted by US\$ 2.5 billion over the first half of 2022, reaching US\$ 15.3 billion at end-June, which brought total contractions since October 2019 to US\$ 22.6 billion. When excluding BDL's Eurobond holdings estimated at US\$ 5.0 billion and foreign currency facilities provided by the Central Bank to Lebanese banks, BDL's liquid FX reserves are estimated to have fallen below the US\$ 10 billion level at end-June 2022.

Concurrently, BDL's exceptional measures resulted into a shortage in local currency liquidity on the money market. Figures released by the Central Bank of Lebanon show that the "currency in circulation outside BDL" contracted by circa LP 7 trillion during the first half of 2022, moving from LP 46 trillion at end-2021 to LP 39 trillion at end-June 2022. This allowed the cost of LP cash to rise four-fold on the money market, moving from

MONETARY SITUATION

| Flows in US\$ million | H1-21 | H1-22 | Progression |
|---|--------|---------|-------------|
| | Vol | Vol | Vol |
| Net foreign assets (excluding gold) | -1,844 | -2,570 | -726 |
| Net claims on the public sector (excluding valuation adjustments) | -1,790 | -4,648 | -2,858 |
| Claims on the private sector | -3,835 | -3,396 | 439 |
| Uses=Sources | -7,469 | -10,614 | -3,145 |
| Money (M3) | 1,450 | -6,208 | -7,658 |
| Valuation adjustment and other items | -8,919 | -4,406 | 4,512 |

EXCHANGE MARKET INDICATORS



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5% at end-2021 to circa 20% at end-June 2022.

In parallel, the financial system's total subscriptions in LP Treasury bills amounted to LP 6,530 billion during the first half of 2022, fully allocated to the Central Bank of Lebanon, and compared to total maturities of LP 6,451 billion, resulting into a nominal surplus of LP 79 billion over the covered period.

As to Certificates of Deposits, the total LP CDs' portfolio remained relatively stable during the first half of 2022, moving slightly from LP 43,177 billion at end-December 2021 to LP 43,159 billion at end-June 2022. This followed a large contraction of LP 2,034 billion in 2021.

In the coming period, Lebanon would be facing the tough task of implementing IMF's prior actions, including the unification of multiple exchange rates by BDL. Should Lebanon meet IMF requirements, this would pave the way for a final agreement with the Fund, opening the door for much-needed international financial support.

1.4.2 Banking activity

Moderate decline in deposits over the first half-year coupled with continued deleveraging

At the banking sector level, the first 6-month period was characterized by the following trends:

Moderate decline in deposits when compared with the same period last year: Indeed, customer deposits contracted by US\$ 2.3 billion over the first six months of 2022, against a contraction of US\$ 4.9 billion over the same period in 2021. This year's decline was mainly due to resident deposits that dropped by US\$ 1.6 billion while non-resident deposits contracted by US\$ 0.7 billion.

Declining deposit dollarization: With respect to the currency breakdown of deposits, it is worth mentioning that FX deposits contracted by US\$ 4.1 billion since the beginning of the year, while LL deposits rose by US\$ 1.8 billion. As such, deposit dollarization went down from 79.4% at end-December 2021 to 77.6% at end-June 2022.

Continued deleveraging process: Banks loans to the private sector contracted by US\$ 3.7 billion over the first six months of 2022, against a decline of US\$ 4.3 billion over the same period in 2021. This year's decline was mostly due to FX loans which contracted by US\$ 2.6 billion, while LL loans dropped by US\$ 1.1 billion. Consequently, loan dollarization continued its contraction to reach 54.0% at end-June 2022, against 56.3% at end-December 2021.

Contracting Eurobond portfolio: Banks Eurobond portfolio continued its net contraction amid provisioning efforts required by monetary authorities. The net value of Lebanese sovereign Eurobonds held by banks

BANKING ACTIVITY

| in millions of US\$ | 2020 | 2021 | 1H-21 | 1H-22 |
|----------------------------|----------------|----------------|---------------|---------------|
| Var: Total assets | -28,739 | -13,105 | -6,964 | -3,897 |
| % change in assets | -13.3% | -7.0% | -3.7% | -2.2% |
| Var: Total deposits | -19,723 | -9,671 | -4,904 | -2,297 |
| o.w. LP deposits | -10,772 | -671 | -827 | 1,839 |
| o.w. FC deposits | -8,952 | -9,000 | -4,078 | -4,137 |
| % change in total deposits | -12.4% | -7.0% | -3.5% | -1.8% |
| Var: Total credits | -13,601 | -8,456 | -4,302 | -3,746 |
| o.w. LP credits | -959 | -2,491 | -1,367 | -1,102 |
| o.w. FC credits | -12,642 | -5,965 | -2,935 | -2,643 |
| % change in total credits | -27.3% | -23.4% | -11.9% | -13.5% |

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reached US\$ 4.0 billion at end-June 2022, contracting by US\$ 0.4 billion since the beginning of the year. As a percentage of FX deposits, net Eurobond holdings amount today to 4.0% (0.24 times equity), against 11.9% on the onset of the crisis in October 2019 (0.72 times equity).

Contracting equity amid net losses: With respect to capitalization, bank shareholders' equity contracted from US\$ 17.8 billion at end-December 2021 to US\$ 17.0 billion at end-June 2022 as a result of net bank losses over the period. Comparatively, bank shareholders' equity stood at US\$ 20.6 billion at the time of the crisis onset in October 2019. The losses incurred by Lebanese banks come as a result of noticeable FX costs (rate differential between the BDL circular 151 rate and the official exchange rate), the effects of mark-ups, the rising operating expenses tied to the surging inflation, in addition to significant provisions to face private and sovereign risks at large.

Growing balance of payments deficit amid BDL intervention on Sayrafa platform: The first six months of 2022 were characterized with a growing deficit in the balance of payments that recorded US\$ 2.6 billion, against US\$ 1.8 billion in the same period of 2021. This year's six-month deficit was totally driven by the drop in net foreign assets of the Central Bank, while banks' net foreign assets stabilized over the period. The drop in BDL's net foreign assets comes within the context of a significant intervention on the Sayrafa platform to contain the exchange rate drift, while the subsidy component has been reduced to a minimum this year.

1.4.3. Equity and Bond Markets

Noticeable surge in Lebanese equities on hedging activity, sovereign bond prices at new record lows on cabinet and reform uncertainties

Lebanon's equity market registered a significant surge in prices over the first half of the year 2022, mainly supported by strong price gains in Solidere shares, as market players continued to add realty stocks to their holdings on hedging activity against crises. On the other hand, Lebanese Eurobond prices reached new record lows at end-June 2022, mainly weighed down by worries about a political vacuum that may be extended till Presidential elections, and on growing concerns about the new fragmented Parliament's ability to deliver key reform laws, which are preconditions to unlock much-needed international financial support.

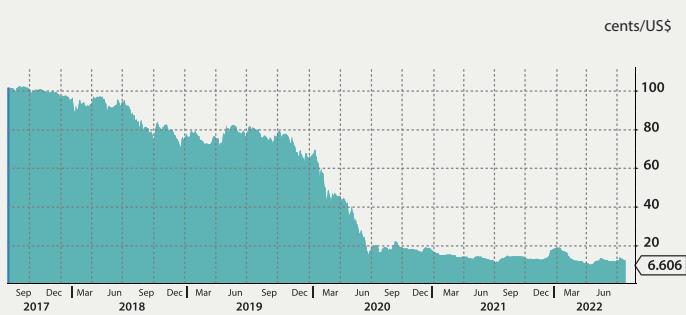
In details, Lebanon's equity market closed the first half of the year 2022 with strong price gains of 37.6%, following a 48.1% increase in prices in 2021, mainly driven by a significant rise in Solidere "A" and "B" share prices of 81.8% and 79.9% respectively to touch the US\$ 60 level at end-June 2022, mainly as market players fled to realty stocks to avoid haircuts on their placements. On the other hand, banking stocks recorded an average price decline of 7.6% over the first half of the year 2022. A closer look at individual stocks shows that Bank Audi's "listed" shares, BLC Preferred "D" shares, Bank Audi Preferred "I" shares, Byblos Bank's "listed" shares, Byblos "Preferred 2008" shares, BLOM's "listed" shares and GDRs registered price drops

FINANCIAL SECTOR (NON BANKS)

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Jun-22 |
|---|--------|--------|--------|--------|--------|--------|--------|
| Beirut Stock Exchange | | | | | | | |
| Market capitalization (In millions of US\$) | 10,951 | 10,578 | 9,117 | 7,540 | 7,176 | 10,625 | 14,618 |
| Total trading volume (In millions of US\$) | 885 | 608 | 376 | 197 | 233 | 354 | 194 |
| Annualized trading volume/Market capitalization | 8.1% | 5.8% | 4.1% | 2.6% | 3.2% | 3.3% | 2.6% |
| Price index | 106.9 | 98.2 | 83.9 | 69.7 | 63.5 | 94.0 | 129.4 |
| % change in index | 2.1% | -8.1% | -14.6% | -16.9% | -8.9% | 48.1% | 37.6% |
| Lebanese Eurobonds | | | | | | | |
| Total volume (In millions of US\$) | 26,123 | 26,123 | 30,964 | 28,314 | 31,314 | 31,314 | 31,314 |
| Average yield | 6.5% | 6.5% | 10.0% | 30.0% | 57.0% | - | - |
| Average life (In number of years) | 6.2 | 6.7 | 7.8 | 7.5 | 7.1 | 6.2 | 5.7 |
| 5-year CDS spreads variation (bps) | 57 | 42 | 229 | 1,649 | - | - | - |

CAPITAL MARKETS PERFORMANCE

Long-term sovereign bond prices



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ranging between 2.3% and 36.7%, while Bank Audi's GDRs and BEMO's "listed" shares posted price gains of 4.7% and 9.1% over the first half of the year. Amongst industrials, Holcim Liban's shares posted strong price gains of 42.3%, followed by Ciments Blancs Nominal's shares with +37.3%.

Strong price increases on the BSE during the first half of 2022 were coupled with increased price volatility. The price volatility, measured by the ratio of the standard deviation of prices to the mean of prices, reached 17.5% during the first half of 2022 as compared to a lower price volatility of 10.4% over the same period of 2021.

In line with strong price gains and in the absence of any listing or delisting activity over the first half of the year, as the delisting of RYMCO shares took place on the 1st of July 2022, the BSE market capitalization expanded similarly by 37.6%, moving from US\$ 10,625 million at end-December 2021 to US\$ 14,618 million at end-June 2022. The BSE total trading value amounted to US\$ 194.0 million during the first half of 2022 as compared to US\$ 187.9 million during the same period of 2021, up by 3.2%, noting that Solidere shares captured the lion's share of activity (94.3%), followed by the banking shares with 5.1% and the industrial shares with 0.6%. Accordingly, the BSE total turnover ratio, measured by the annual trading value to market capitalization, reached 2.7% during the first half of 2022 as compared to 4.0% a year earlier.

On the other hand, Lebanese Eurobond prices dipped further into the red during the first half of 2022, reaching new record lows of 6.0-6.50 cents per US dollar at end-June 2022 as compared to 9.88-10.63 cents per US dollar at end-2021, which marks price contractions of 3.50 pts to 4.25 pts. This is mainly explained by a clouded cabinet formation outlook and growing concerns about the new fragmented Parliament's ability to reach an agreement on key reform laws, which are preconditions to any IMF financial support. Within this context, Bank of America said in a recent note that recovery rates above 15c reflect relatively optimistic economic assumptions or restructuring outcomes, while Lebanese Eurobonds may not be recoverable without an IMF program.

Looking forward, all market players' eyes would remain focused on the launching of long-overdue reform laws and the implementation of the IMF's prior actions, which would pave the way for a final agreement with the Fund and help unlocking much-needed financial support, while concomitantly laying the groundwork for constructive negotiations with bondholders.

CONCLUSION: THE CHALLENGES FOR A FINAL AGREEMENT WITH THE IMF

A final Program with the IMF is much needed as it is the only way out for Lebanon to exit its lingering economic and financial crisis. After the government ensured the ratification of a Staff-level agreement with the Fund, the real challenge lies in the provision of the required prior actions on behalf of the Lebanese authorities that would enable Lebanon to have a final agreement with the IMF, opening the door for direct facilities and inciting donor countries at large. Those 9 prior actions revolve around the following:

- Cabinet approval of a bank restructuring strategy that recognizes and addresses upfront the large losses in the sector, while protecting small depositors and limiting recourse to public resources (Government responsibility). It was actually ratified in the last Cabinet meeting of May 20th before the government turned into a care taker cabinet, bearing in mind that the Plan was objected by economic associations, banks and syndicates, as it involved a major haircut, without letting the State assume a significant part of the national losses despite its crisis responsibility.

- Parliament approval of an appropriate emergency bank resolution legislation which is needed to implement the bank restructuring strategy and kickstart the process of restoring the financial sector to health (Parliament responsibility). This is the most challenging milestone on the back of a US\$ 73 billion loss estimate in the financial sector at large.

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- Initiation of an externally assisted bank-by-bank evaluation for the 14 largest banks by signing the terms of references with a reputable international firm (BDL responsibility). Concerned authorities actually launched talks with international firms for that purpose, bearing in mind that this is quite a complex assessment in view of the three distinct balance sheets run by banks, namely the LL balance sheet, the local dollar balance sheet and the fresh dollar balance sheet. In all events, the assessment has to be based on the CAMELS approach that consists of analyzing capital adequacy, Asset quality, Management efficiency, Earning power, Liquidity and sensitivity to market forces for every bank.
- Approval of a reformed bank secrecy law (Parliament responsibility), bearing in mind that the government transferred to parliament a law proposal at end-April and the Parliament ratified a law at end-July for that purpose, which is considered critical to improve transparency, compliance and governance.
- Completion of the special purpose audit of the BdL's foreign asset position (BDL responsibility), bearing in mind that the State committed to finalize this audit by end-July. This is actually considered a prerequisite for any country resorting to the IMF for credit facilities.
- Cabinet approval of a medium-term fiscal and debt restructuring strategy (Government responsibility), which lies on the burden of the forthcoming cabinet that is to be appointed shortly.
- Parliament approval of the 2022 budget, to start regaining fiscal accountability (Parliament responsibility), bearing in mind that a number of questioning is arising regarding the so far non-ratification of Parliament of the budget law that was transferred from Cabinet to Parliament end-February.
- Unification by BdL of the exchange rates for authorized current account transactions (Government/BdL responsibility), which is believed to be a tough task within the context of six distinct exchange rates in vigor in Lebanon nowadays.
- Implementation of formal capital controls (Parliament responsibility), bearing in mind that the Cabinet presented a draft law to Parliament end-March and still non-ratified, as has been actually the case for several versions of the law that have been debated by Parliament over the past couple of years.

All fingers are crossed so that the prior actions materialize, though we believe it won't be easy ratifying all those actions in a near future, especially within the context of a fragmented Parliament. The parliamentary elections lead to a much fragmented parliament, with no one being able to call the majority and with the presence of a large number of blocks and Independent MPs. While such a new reality is good for checks and controls, it yet also means that it would be difficult to have agreement on major political milestones and legislation at large.