PART I:
GENERAL ECONOMIC DEVELOPMENTS

01

I- WORLD ECONOMY

1-1 The world economy witnessed in 2014 and the first four months of 2015 major positive and negative developments. Based on the last reports of the World Economic Outlook issued by the International Monetary Fund (IMF), the major decline in oil prices beginning in the third quarter of 2014 (average price per barrel reaching USD 100) and stabilizing at relatively low levels (reaching less than USD 60 per barrel) had a positive impact on economic growth in oil-importing countries especially the USA, Europe and China even though these benefits came at the expense of the performance of oil-exporting countries in general. Additionally, the large unexpected changes in the exchange rates of major currencies especially the appreciation of the USD versus the Euro and Yen (from 1.30 in September 2014 to 1.13 at the end of April 2015 for the Euro and from 106 to 117 for the Japanese Yen in the two respective dates) contributed to limiting the economic contraction in the Eurozone and Japan.

1-2 In parallel to these positive developments were the continuing negative repercussions of the international financial crisis of 2008 and the Eurozone crisis that followed, as the continuing high debt levels in the private as well as the public sectors and the weakening of a large number of banks contributed and still are a major burden for spending and growth in many countries. Other repercussions are in that the two mentioned crisis contributed to the decline in the average possible growth figures that had started to decline before the beginning of these crisis with the increase in the size of the aging population and the slowdown in productivity growth. In addition to these two pressuring factors on the possible growth rate, the large decline in the size of investments due to the international crisis constituted a third factor reflected in the reduction of capital growth and accumulation. The result was a large decline in future potential growth. Some of the negative impacts for world economic growth are the deterioration in the performance of the Russian economy due to the political and security turbulences in Ukraine and the package of American and European sanctions tied to them, and the performance of the Brazilian economy due to the decline in the prices of the primary products that Brazil exports.

1-3 Based on that, and due to all of these conflicting factors, the previously mentioned source stated that average world economic growth stabilized at 3.4% in 2014 which is the same as 2013. This rate is expected to grow only to 3.5% and 3.8% in 2015 and 2016 respectively. It is noticed for 2014 that the stable average economic growth came as a result of an equation represented in general by the fact that the decline in the average growth rates in China, Russia, Japan and Brazil was faced by an improvement in the growth rates in the USA, the Eurozone, Canada, the United Kingdom and India as appears in the schedule below.

1-4 Concerning 2015 and 2016, expectations show a continuous decline in the rates of growth in the Chinese economy to 6.8% and 6.3% respectively (7.8% and 7.4% in 2013 and 2014) with the slowdowns in credit and investment activities especially in the real estate sector, and in the Russian economy to - 3.8% in 2015 due to the decline in oil prices and the value of the Ruble and the continuing geo-political tensions. It is also expected that the average growth rate in the US economy will increase and stabilize at 3.1% in 2015 and 2016 compared to 2.4% in 2014 and also in the Eurozone (between 1.5% and 1.6% compared to 0.9%). The expected recovery in the USA is due to the facts of the reduction in the unemployment rates and the improvement in domestic demand with the decline in oil prices and the continuing expansionary monetary policy and fiscal adjustments. The decline in oil prices and in the value of the Euro in the latest period would constitute the main reason for a recovery, though slow, in the Eurozone.

1-5 Concerning inflation, the reports of the IMF show that advanced economies are characterized by a low inflation showing signs on the presence of large gaps in production. The IMF expected that the US inflation rate will reach 1.6% at the end of 2014 to gradually increase to 2% which is the specified goal of the Federal Reserve. With the continuous recovery and the narrowing of the gaps between actual and potential output, it is expected that inflation will gradually increase in the Eurozone to 0.9% in 2015 and 1.2% in 2016. This rate will remain lower than the goal of the European Central Bank until the end of 2019 which is 2%. The IMF also expected in its report the decline in inflation in emerging and developing economies in 2014 and its stability in 2015 due to the sharp decline in the prices of primary products especially food products with a high weight in the consumer price index baskets in these countries.

World Economic Output Growth Rate (real GDP) in 2013 and 2014, Estimates for 2015 and 2016 (Percent change)

	Realized		Expected	
	2013	2014	2015	2016
World economy	**3.4**	**3.4**	**3.5**	**3.8**
Developed countries, o/w:	**1.4**	**1.8**	**2.4**	**2.4**
- the US	2.2	2.4	3.1	3.1
- The Euro area	-0.5	0.9	1.5	1.6
- Japan	1.6	-0.1	1.0	1.2
- Canada	2.0	2.5	2.2	2.1
- United Kingdom	1.7	2.6	2.7	2.3

	Realized		Expected	
	2013	2014	2015	2016
Emerging and developing countries, o/w:	**5.0**	**4.6**	**4.3**	**4.7**
- Africa	5.2	5.0	4.5	5.1
- East and Central Europe	2.9	2.8	2.9	3.2
- Commonwealth of independent states CIS, including Russia	2.2	1.0	-2.6	0.3
Developing Asian countries, o/w:	**7.0**	**6.8**	**6.6**	**6.4**
- China	7.8	7.4	6.8	6.3
- India	6.9	7.2	7.5	7.5
- Middle East and North Africa	2.4	2.6	2.9	3.8
- Central and South America and the Caribbean	2.9	1.3	0.9	2.0

Sources: WEO report / IMF

The Middle-East and North Africa (MENA) Region

1-6 In 2014, the growth rate in the MENA region reached 2.4% compared to 2.3% in the previous year under the influence of the conflicts, terrorist acts, and security tensions in addition to the decline in oil prices with clear varying effects of this decline on oil-exporting and oil-importing countries. It is expected that the rate of growth in this region will increase to 2.7% and 3.7% in 2015 and 2016 respectively backed by fiscal reforms and the increase in investments.

1-7 As far as oil-exporting countries are concerned, the growth rate did not register a major change stabilizing in 2014 on 3.6% in the Gulf Cooperation Council Countries (GCC) as in the previous year. The decline in oil prices caused major losses in government revenues weakening the fiscal budget and external accounts (for example, it is expected that the surplus in these accounts will decline in 2015 to 1.6% of GDP in the GCC). However, there exist many protection margins in the form of foreign assets allowing some oil-exporting countries to avoid major general spending cuts and reduce the burden on growth. Countries where protection margins are low or do not exist, face more urgent needs for fiscal corrections such as applying reforms aimed at diversifying economies away from oil through an improvement in work conditions, incentives to raise private commercial projects and increasing employment in the private sector.

1-8 As far as oil-importing countries, growth rates stood at 2.5% in 2014 compared to 2.7% in 2013. Even though the economies of these countries gained many benefits due to the decline in oil prices and thus a decline in the energy import bills, and achieved many gains at the fiscal level, they are faced with negative factors summarized in a slowing domestic demand, weakening in growth outlook by more than expected, in addition to the decline in the prices of primary non-oil products that these countries export. Thus, the results differed concerning growth, public finances, and current accounts, so that it is expected that conditions will improve in some of these countries and worsen in some others. Oil-importing countries will probably be able to save what is possible of the gains achieved from the decline in oil prices.

II- THE LEBANESE ECONOMY

2-1 Lebanon and its economy suffered in 2014 another year of unstable security conditions, political pressure and a slowdown in economic activities. It had to deal first, for the fourth consecutive year, with the challenges and the negative economic and social impacts resulting from the war in Syria in addition to the side effects of the regional conflicts. The Syrian crisis showed one more time its deep and long-term impact on the political and security stability of Lebanon and its economic conditions and outlook. The Syrian crisis continues to stifle growth by affecting tourism, trade, foreign direct investment and other matters. In addition, Syrian refugees in Lebanon approaching 1.5 million constitute a large pressure especially on public expenditure, infrastructure, services, and labor market since the aid and international external donations from government and non-government sources to help the refugees and the Lebanese authorities remain out-of line with the needs. Second, Lebanon and its economy had to deal with the relative political stagnation affecting them and the failure to elect a president for the republic, which negatively affected the confidence of both consumers and investors and thus the size of consumption and investment which constitute the two basic components of GDP.

2-2 Based on this background, the real growth rate slowed down to 2% in 2014 so that nominal GDP reached around USD 49.5 billion. The Lebanese economy would have grown thus during the last three years by an average of 2.5% or by less than its long-term trend of 4% and way below the average annual rate of around 9% during the period 2007-2010. In this context, we mention that the growth rate in Lebanon in 2014 came lower than the average world growth rate of 3.4% and slightly less than the one of the oil-importing countries in the MENA region of 2.5%. It is difficult to expect an increase in the real GDP growth rate in 2015 in light of the absence of any expected changes in the turbulent political situation that remains subject to the regional external conflicts. The remaining presidential void since May 2014 and the political crisis in general will scatter the efforts, prevent the passage of needed legislation and hinder the structural reforms that enhance permanent growth.

2-3 In the midst of these circumstances, the growth rate in Lebanon is expected to remain at its low, however positive, level in 2015 and 2016. The IMF expected this rate to reach 2% and 2.5% in these years respectively with the launching of the dialogue among various political parties and the expectations that oil prices would remain at low levels, which will positively affect the Lebanese economy. We point out that the Ministry of Finance estimated in the budget proposal of 2015 sent to the Council of Ministers that the growth rate in real GDP will reach 1.5% in 2014 and 2.5% in 2015.

GDP, Current Account, Growth & Inflation Rates

	2012	2013	2014
Real Growth rate (%)	2.8	3.0	2.0
Change of the consumer price index (average per annum) (%)	6.6	5.5	1.1
GDP Deflator (%)	7.1	3.9	2.8
GDP (LBP billion)	66,481	71,185	74,642
GDP (USD billion)	44.1	47.2	49.5
Current account deficit/ GDP (%)	-24.3	-26.7	-24.9

Sources: Central Administration of Statistics (CAS) - WEO report / IMF April 2015.

2-4 The available economic indicators in 2014 point out to the weak economic growth mentioned above on one hand and to the divergent levels of economic activities on the other. We cite some of these following indicators:

- The slight increase in the value of cleared checks by 2.6% as an indicator of the weak activity in the trade and construction sectors.
- The decline in the quantities of imported goods by 2.6% as an indicator of the weak household consumption activities, the production of goods, and services and investment in general, without delving into the details of the effect on various imported goods.
- A quasi stability in the revenues from value-added tax (+0.2%)
- A moderate increase in the construction area permits reaching 4.8% in 2014 and an increase in real estate fees by 0.9% only. While the delivered quantities of cement decreased by 5.4% in 2014.
- The increase in the number of arrival passengers via Beirut International Airport by

6.4% and the departure ones by 3.5% and the increase in the number of tourists arriving to Lebanon by 6.3% in 2014, knowing that more than one third of them are from Arab countries.

- A decrease in the exports of goods by 15.8% in 2014 and a decline in merchandize trade deficit though slightly.

2-5 In 2014, the results of public finances were relatively comforting but exceptional, as a large primary surplus was achieved reaching 2.6% of GDP and the total deficit declining to approximate 6.2%. Despite this positive development, the restrictive fiscal policy contributed to the weak economic growth as government spending excluding debt service and transfers to the Electricity du Liban reached 15.1% of GDP. These expenditures also deviate towards current expenditures and other transfers at the expense of expenditure on infrastructure. The ratio of total deficit to GDP remains one of the highest in the world while total public revenues to GDP one of the lowest. Even though the growth in public debt came lower than in the previous two years, its percent to GDP stood at 134% in 2014 as was the case in 2013. It is expected that total debt and deficit will increase in 2015 based on the information available so far especially if an agreement is reached on the issue of salary scales without introducing major reform on the structure of public finances.

2-6 In return, monetary policy contributed to the support of the economic activities and growth by making available an incentives package backing bank lending to provide the financing needs to the private sector including individuals and institutions. It would have been possible to achieve higher rates of economic growth had monetary and fiscal policies been synchronized. In another framework, the coordination among the Ministry of Finance, the BDL and banks helped preserve monetary stability (exchange rate of the LBP and interest rates) and reinforce foreign currency reserves at the BDL which enhance confidence and secures the foreign currency needs of the government.

2-7 As in the case of public finances, the external trade did not raise the level of economic activity. Net exports (exports minus imports) stabilized with a decline in the value of imports, constituting a main component of total demand, by 3.5% and a decline in the value of exports, representing a main component of production, by 15.8% for the same period. The balance of payments recorded an additional deficit despite a quasi stability in the merchandize trade deficit which explains the decline in capital inflows due to the domestic and regional conditions. This deficit did not help in its turn the deposit growth in the banking system. In this respect, the total balance sheet of banks grew by 6.6% approaching the nominal growth of the economy. Banks contributed positively to economic growth by increasing lending to the economy so that loans to the private and public sectors now represent 167% of GDP.

2-8 The banking sector, in its desire to safeguard the economy and the interests of the employers and employees of various economic sectors and activities sees a necessity in giving a priority to the presidential election and the enforcement of the work of the governmental institutions to restore the confidence of investors and consumers, awaiting a solution to the conflict in Syria and the region which will cause a major improvement in the security, political and economic situation in the country. The banks encourage simultaneously the government and the parliament to pass the fiscal budget of 2015 with the desired fiscal reforms which will control public finances, generate permanent primary surpluses, and place the debt one more time in a declining direction. This implies serious and credible fiscal reforms sending a strong signal to the world and domestic communities by fully committing to limiting the existing imbalances in the economy. The absence of budget laws since 2006 and spending based on the one- twelfth rule constitute a stumbling block facing the organization of the fiscal condition and create a large confusion in fiscal estimations and spending mechanisms since the budget determines the economic and social visions of the government. Additionally, the presence of a budget law also improves the image of Lebanon when it comes to transparency and gives the country an opportunity to achieve a higher rating by the international rating agencies.

2-9 In this context, the need arises to change the current course and move public expenditure away from current and into investment spending which is limited and insufficient. Such policy, in addition to the implementation of the broad structural reforms, will support a strong and continuous economic growth. Efforts are also to be intensified to improve the administration of revenues and collection, and to limit tax evasion. Given that the ratio of revenue to GDP is considered low in Lebanon in comparison with many similar countries, there exists a relatively narrow possibility to impose new taxes and adjust some existing ones on condition to study their timing and include the new related revenues in a cohesive tax framework that improves rather than cause a distortion in the price structure and the economy. There is also room to limit the waste in spending public funds and reduce the inflated size of expenditure. Concerning investment spending, banks operating in Lebanon are fully ready and capable to finance and participate in public infrastructural investments through a joint partnership of public and private sectors in the fields of telecommunications, transportation, water and energy. It is to mention that the percent of investment spending in Lebanon reached in the last four years 1.3% of GDP compared to an average of 6% in emerging markets.

2-10 It is also necessary to pass the pending decrees and legislations related to the energy sector (oil and gas) as the reforms and investments in this sector may constitute an important step towards reducing the cost of practicing commercial activities, increasing the expected rate of growth, enhancing per-capita income and improving public finances. There should not be further delays in the treatment of the drilling of oil and gas promising resources in fear that this may hurt the reputation of Lebanon as a trusted investment partner on one hand and the development of many important public utilities that bolster the activities and the economy on the other. This improvement includes the ability to generate energy, moving towards natural gas, increasing the fees while at the same time protecting the consumers with limited income, and enhancing transportation, distribution and collection. Thirdly, the oil and gas revenues and the savings in expenditure related to them contribute in controlling and consolidating public finances. There is also an urgent need to conduct the necessary reforms in the National Social Security Fund and the coverage mechanisms which reduce the operational burdens on the institutions, improve the economic performance and enhance growth opportunities.

III- PUBLIC FINANCES & PUBLIC DEBT

3-1 Public finances witnessed a better situation in 2014 than in the preceding year. This is due to many factors specifically the bolstering of the Treasury by the exceptional revenues from communication, which contributed to achieving a primary surplus reaching LBP 1,970 billion (2.6% of estimated GDP) after a primary deficit in 2012 and 2013 not exceeding 0.5% of GDP. The public deficit decreased to LBP 4,632 billion in 2014 representing 6.2% of GDP compared to deficit approaching 9% of GDP in the previous two years. If the exceptional revenues from communication standing at LBP 1,648 billion were excluded, the public deficit will stand at LBP 6,280 billion (8.4% of GDP) and the value of primary surplus would then fall to LBP 323 billion (0.4% of GDP).

3-2 It is clear that public finances still lack flexibility because of the existing structure of expenditures as transfers to the Electricity du Liban (EDL) represent 15% of total expenditures, in addition to debt service and salaries and wages, representing 30% and 32% respectively out of total expenditures, whereas capital expenditures represent only around 4%. Therefore, there is a need to introduce reforms on the expenditures structure concerning the share of spending on infrastructure and social programs out of total expenditures.

Public Finances
2012 – 2014 (LBP billion)

	2012	2013	2014	Change (%) 2013/2012	Change (%) 2014/2013
Total Revenues (Budget+ Treasury)	14,164	14,201	16,400	0.3	15.5
Total Expenditures (Budget + Treasury)	20,081	20,563	21,032	2.4	2.3
Overall Deficit	5,918	6,362	4,632	7.5	-27.2
Primary Surplus	-166	-361	+1,970		
Overall Deficit / GDP %	8.9	8.9	6.2		
Primary Balance / GDP %	-0.2	-0.5	2.6		

Source: Ministry of Finance.

3-3 Total revenues increased from LBP 14,201 billion in 2013 to LBP 16,400 billion in 2014 or by LBP 2,199 billion and by 15.5%. This large increase did not occur as a result of a prosperous economic situation but mostly as mentioned above due to the exceptional revenues from the Ministry of Communication on previous years. These revenues represent more than half of the registered increase. In addition, an improvement in tax administration is recorded with the introduction of some reforms considered as a modest step on the road to controlling tax evasion operations that are high in Lebanon, especially in the General Administration of Real Estate (Cadastre) and Lebanese Customs. Despite that, the share of total revenues out of GDP remains low in Lebanon as we previously mentioned (22% in 2014) due to the low tax levels and tax evasion, compared to an average of 36% in the MENA region, 29% in emerging markets and 34% worldwide.

3-4 Whereas the non-tax revenues increased by 14% for reasons mentioned above, tax revenues increased only by 2.7%. The most major item contributing to this increase is tax on income, profits and capital gains (+ 11.7%) due to the increase in the collection of arrears on previous years and penalties, the increase in property tax (+ 3.7%), while revenues from value-added tax, representing the primary revenue source to the Treasury, remained quasi-stable (+0.2%) due largely to the decrease in oil prices. Revenues from customs declined by 5.4% despite the increase in gasoline excise by 4.5%.

Total Revenues (LBP billion)

	2012	2013	2014	share (%)
Taxes on income, profits and Capital gains	2,516	2,502	2,795	17.0%
o/w: Tax on interest income	*647*	*660*	*711*	*4.3%*
Taxes on Property	1,193	1,201	1,245	7.6%
Domestic Taxes on Goods and Services	3,749	3,782	3,811	23.1%
o/w: VAT	*3,275*	*3,296*	*3,302*	*20.1%*
Taxes on International Trade	2,251	2,158	2,042	12.5%
o/w : Customs	*796*	*817*	*766*	*4.7%*
Gasoline	*495*	*483*	*512*	*3.1%*
Other Tax Revenues	478	473	495	3.0%
Tax Revenues	**10187**	**10,116**	**10,388**	**63.3%**
Income from public institutions and Government properties	2,530	2,518	3,498	21.3%
o/w : Transfer from the telecom surplus	*2,156*	*2,156*	*3,034*	*18.5%*
Other non-tax revenues	**756**	**751**	**856**	**5.2%**
Non-tax revenues	**3,286**	**3,269**	**5,354**	**26.5%**
Treasury receipts	**691**	**816**	**1,658**	**10.1%**
Total Revenues	**14,164**	**14,201**	**16,400**	**100.0%**

Source: Ministry of Finance

3-5 Total expenditures increased by 2.3% i.e from LBP 20,563 billion in 2013 to LBP 21,032 billion in 2014, representing 28.6% of GDP in 2014 (28.9% in 2013). This resulted primarily from the increase in debt service as primary expenditures and capital expenditures witnessed a slight decline. Debt service increased from LBP 6,001 billion to LBP 6,602 billion or by 10% largely due to interest payments on local currency, despite the systematic and organized effort of banks and the BDL to lower interest rates and control debt service. The issuance of long-term Treasury-bills at relatively high interest rates consistent with long maturities and the nature of risk contributed to the increase in debt service. This latter constituted 31.3% of total expenditures and 40.3% of total revenues in 2014. In return, the primary expenditures, outside debt service, declined by 0.9%: from LBP 14,562 billion to LBP 14,430 billion. This decline was not the result of a decrease in the allowances and salaries of public sector employees or the transfers to the EDL, but from other items out of which capital expenditures. We mention in this context that the average of capital expenditures that was actually spent constituted only 4.2% out of total spending for the period 2011-2014, whereas the item on salaries and wages witnessed a significant increase representing the largest share of primary expenditures reaching 46.6% in 2014 compared to 44.5% in 2013. Salaries and wages represented as a percent of GDP 9% in 2013 and 2014. Concerning transfers to the EDL, the cost of subsidies represents 4.3% of GDP as it has not been affected yet by the decline in oil prices that started in the second half of 2014, due to the nature of the long-term import contracts that Lebanon conducts.

Total Expenditures (LBP billion)

	2012	2013	2014	share (%)
Debt Service	5,752	6,001	6,602	31.4%
Primary Expenditures	14,329	14,562	14,430	68.6%
o/w salaries and other allowances (art. 13)	*6,723*	*6,473*	*6,727*	*32.0%*
transfers to EDL institution	*3,408*	*3,056*	*3,157*	*15.0%*
Capital expenditures	*760*	*987*	*880*	*4.2%*
Total Expenditures	**20,081**	**20,563**	**21,032**	**100.0%**

Source: Ministry of Finance

3-6 The final form of the proposed budget law of 2015 has not been completed by the time this report is being prepared. However, the published data show an amount of total expenditures of LBP 22,001 billion, excluding the cost of the salary scale, compared to LBP 15,053 billion of expected total revenues (out of which LBP 757 billion was initially suggested to finance the salary scale). Based on that, the budget proposal estimates a total deficit of around LBP 6,948 billion representing 31.6% of total expenditures. It is to mention that the actual cost of the Syrian exodus will exacerbate the public finances. This burden will result from many issues especially the use of infrastructure such as roads, electricity, water, communications, schools and hospitals.

The expected tax measures in budget 2015:
- LBP 205 billion due to the increase in the tax on interest income from 4% to 7%.
- LBP 183 billion from the increase in the fees on the financial stamp.
- LBP 88 billion from imposing a gasoline excise on imports by an average of 4%.
- LBP 75 billion from penalties on the use of public property.
- LBP 50 billion from the increase in the fees on travellers in air and sea.
- LBP 30 billion from levying a tax on real estate profit.
- LBP 126 billion from other fees and taxes not detailed.

What follows is a synopsis on Eurobonds and long-term Treasury-bills in LBP that were issued by the Ministry of Finance in 2014:

April: Eurobonds in the amount of USD 1,400 million (out of which around USD 704 million for the exchange of bonds maturing soon) distributed among bonds in the amount of USD 600 million at a coupon rate of 5.8% maturing in April 2020, and bonds in the amount of USD 800 million at a coupon rate of 6.6% maturing in November 2026.
May: Eurobonds in the amount of USD 175 million to finance a maturing amount of USD 178 million in the same month, distributed among bonds in the amount of USD 100 million at a coupon rate of 5.8% maturing in April 2020, and bonds in the amount of USD 75 million at a coupon rate of 6.6% maturing in November 2026.
June: Treasury-bills in LBP of 10 year category in the amount of LBP 967 billion at a coupon rate of 7.98% knowing that the interest rate on the same category was 8.24% in the previous issuances.
November: Treasury-bills in LBP of 10 year category in the amount of LBP 979 billion at a coupon rate of 7.98%. Subscription was in cash or in return for CDs with the BDL approving all the offers from banks. It is to mention that the issuance of long-term Treasury-bills in LBP was made in addition to the weekly issuance of 5-year categories and below.
It is to mention that in February 2015, the Ministry of Finance issued Eurobonds in the amount of USD 2.2 billion distributed among USD 800 million maturing in 2025 and USD 1.4 billion maturing in 2030 after the parliament approved the issuance of Eurobonds in the amount of USD 2.5 billion at the end of 2014. Additionally, the Ministry of Finance issued consecutively in January, February and March of this year long-term Treasury-bills in LBP of the 10-year category (LBP 921 billion), the 7-year category (LBP 522 billion) and the 10-year category (LBP 512 billion).

Public Debt

3-7 Public debt reached LBP 100,363 billion (the equivalent of USD 66.6 billion) at the end of 2014 compared to LBP 95,710 billion at end 2013, thus recording an increase of 4.9% in 2014 in comparison with a 10% increase in 2013. And since the rate of growth of public debt was close to the growth in nominal GDP, the ratio of debt to GDP remained stable at 134% in 2014. It is to mention that the healthy outcome is for this ratio to be on a declining trend, so financial markets can continue financing the maturing debt on acceptable terms.

3-8 However, when market debt is computed, that is, debt excluding the holdings of the BDL, public institutions, bilateral and multilateral debt, and Paris 2 and Paris 3 loans, the debt to GDP ratio decreased to 90% at the end of 2014 compared to 91.9% at the end of 2013.

3-9 Net public debt computed, that is, deducting the public sector deposits in the banking system reached LBP 86,398 billion (USD 57.3 billion) at the end of December 2014, recording an increase of 7.7% compared to 8.3% in 2013 as the government used part of its deposits and accounts at the BDL to finance part of its expenditures. Thus, public sector deposits at the BDL decreased from LBP 11,032 billion at the end of 2013 to LBP 9,123 billion at the end of 2014 or by an amount of LBP 1,909 billion after having increased by LBP 2,124 billion in the previous year. This means that the government account at the BDL remained positive, which allows the financing of future deficits in case capital outflows from abroad, in the form of bank deposits and others slowed down or were reduced.

3-10 At the end of 2014, the local currency debt reached 61,752 billion constituting 61.5% of total public debt (58.8% at the end of 2013) compared to around LBP 38,593 billion of foreign currency debt or 38.5% of total public debt (41.2% at the end of 2013). It is to mention that the distribution of debt and its concentration with domestic holders by 90% reduces its risks since those holders are more tolerant to actual risks given that they are accustomed to the country's conditions.

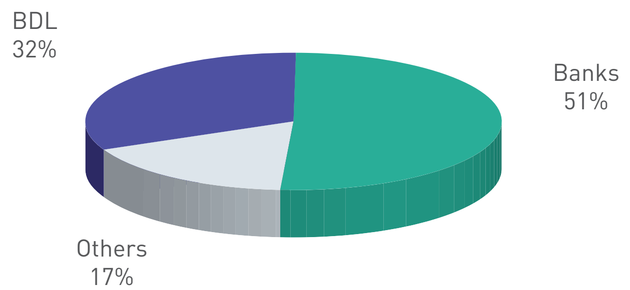
Public Debt 2012-2014
(End of period – LBP billion)

	2012	2013	2014	Change (%) 2013/2012	Change (%) 2014/2013
Gross Public Debt	**86,959**	**95,710**	**100,363**	**+10.0**	**+4.9**
Distribution of Total Public Debt:					
- Debt in LBP	50,198	56,312	61,752	+12.2	+9.7
- Debt in Foreign Currencies	36,761	39,398	38,611	+7.2	-2.0
Deposit of the Public Sector at the Banking System	12,916	15,495	13,965	+20.0	-9.9
Net Public Debt	**74,043**	**80,215**	**86,398**	**+8.3**	**+7.7**
Gross Public Debt Financing: Estimates (%)					
Banks in Lebanon	54.0	59.0	55.9		
Central Bank (BDL) & Public Entities	31.1	26.5	28.5		
Others (resident)	3.7	3.9	2.7		
Non-residents	11.1	10.6	10.7		
o/w : bilateral & multilateral loans	*5.8*	*4.8*	*4.4*		
Others	*5.3*	*5.8*	*6.3*		

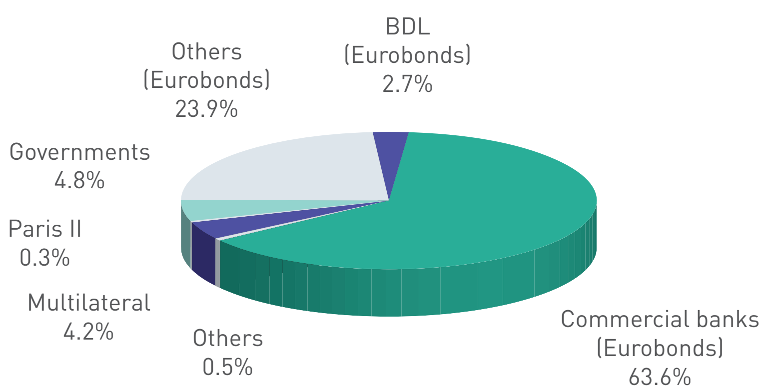
Source: BDL

3-11 As far as financing local currency debt, the share of banks decreased to 51% at the end of 2014 (53.1% at the end of 2013) faced by an increase in the share of BDL to 32.2% (30.5% at the end of 2013) and the share of the non-banking sector to 16.9% (16.4% at the end of 2013). This is due to the weak desire of banks to subscribe to Treasury bills of 3-month to 5-year category and the satisfaction to a certain extent in renewing maturities and subscribing to bills of the 10-year category. The BDL supplied the shortage when needed intervening from time to time in the market to create balance.

Sources of Financing Local Currency Debt end 2014



Sources of Financing Foreign Currency Debt end 2014



Source : BDL

3-12 As far as financing foreign currency debt, the share of banks in the portfolio of Eurobonds also declined by USD 1.3 billion reaching USD 16.31 billion at the end of 2014 compared to USD 17.6 billion at the end of 2013 due to maturing amounts exceeding subscription in these bonds. The share of banks in financing foreign currency debt reached 63.6% at the end of 2014 compared to 67.3% at the end of 2013.

Interest Rates on Treasury Bills in 2014 (last issue)

3-M	6-M	12-M	24-M	36-M	60-M	120-M
4.44%	4.99%	5.35%	5.84%	6.50%	6.74%	7.98%

Source : BDL

3-13 As a result of the developments in the Treasury bills market in LBP, the weighted average interest rate on the total portfolio increased from 6.86% at the end of 2013 to 6.89% at the end of 2014. The weighted average life of the portfolio decreased from 1,274 days (3.5 years) to 1,193 days (3.3 years). Whereas in the Eurobonds market, the weighted average interest rate on this portfolio decreased from 6.5% at the end of 2013 to 6.4%. The weighted average life on this portfolio declined from 5.6 years to 5.35 years in the two consecutive dates.

The Ministry of Finance launched in January 2015 a medium-term strategy to manage public debt in the period 2014-2016. The new calendar to issue Treasury bills in LBP is based on regular issuances of long-term bills of the 7, 10 and 12 year categories. This plan aims at guaranteeing the financing needs of the government and the commitment to pay its dues on time, in addition to reaching various financial markets at the lowest possible cost in the medium and long-terms with a low level of risk and the consolidation of transparency and trust with investors and international rating agencies. Work will be conducted on developing the stated goals and modernizing the medium-term strategy of public debt based on a determined schedule and market developments. In the next stage, the unexpected obligations will be included in the scope of public debt management due to their importance and influence on the debt level. The public debt administration can also contribute to achieving the objectives of monetary policy by improving the yield curve on short and long-term securities in local currency.
It is to mention that the presence of confidence caused the BDL to issue certificates of deposits (CDs) for 20 and 30 years in case of monetary needs in order to preserve currency and lending stability and secure the environment that permits in the future for the government to flexibly manage public debt and distribute its maturities for longer terms, which reduces the pressure on liquidity and contributes to the decline in interest rates.

IV- MONETARY POLICY DEVELOPMENTS

4-1 The monetary situation remained stable to a great extent in 2014 despite the weak economic performance of the Lebanese economy since 2011, the presidential void, the semi-paralysis in various constitutional institutions and the security challenges. The monetary authorities were once again in cooperation with the Ministry of Finance and the banks able to achieve monetary stability that represents the principal goal of monetary policy in Lebanon. What helped in this respect in addition to the confidence in the BDL which is tied to many factors especially its high abilities, is the continuous inflow of capital in adequate sizes supported by the remittances of those working abroad to finance the private and public sectors of the economy and preserve a high level of foreign reserves. The BDL took also in 2014 many measures and made financial engineering attempts detailed in the next sections which helped him secure the necessary liquidity in foreign currency to cover the needs of the government and preserve or even reinforce its foreign currency reserves and the stability of the LBP interest rates.

The BDL will be helped by the passage of the law allowing the government to raise the ceiling of the borrowing in foreign currency which will reduce relying on the BDL to secure foreign currency. This is coupled with the possibility of a decline in the average world oil prices and the value of the Euro in 2015 compared to the previous year which will reduce the deficit in external payments.

4-2 **The Monetary situation: a stable currency market, an increase in the reserves of the BDL, stable interest rates.**

The foreign currency market witnessed in 2014 a balance between demand and supply and stability without pressure. The interbank rate remained for the most at or close to its official level of 2.75%. The BDL was able to preserve a high level of foreign currency reserves raising it to around USD 32.4 billion at the end of 2014 compared to USD 31.7 billion at the end of 2013 excluding its investments in Lebanese Eurobonds and other international securities that have increased according to our estimates to USD 5.5 billion at the end of 2014. Additionally, the Central Bank holds a large stock of gold reserves ranking it as 19th internationally and as 2nd in the MENA region in terms of country reserves according to the list of the "International Gold Council" of March 2015, given that the value of the gold reserves stabilized at around USD 11 billion at the end of 2014 and 2013 with the stability in the price of an ounce of gold internationally. As it is known, foreign currency and gold reserves are some of the most important factors supporting confidence in the national currency. The foreign currency reserves held by the BDL are considered sufficient to face any crisis that may occur. On another level, average interest rates remained stable on all categories of Treasury bills in LBP up to five years with the beginning of decreasing interest rates on long-term securities as will be discussed later on. Additionally, interest rates on Eurobonds issued in 2014 until February 2015 were low compared to the issuance of countries in the same risk classification of Lebanon.

4-3 Operations of lenghting maturity ....for market easing

In the framework of the cautionary strategy followed for the last few years by the monetary and financial authorities which aims at not leaving large sums in LBP and foreign currency mature in a relatively short period, we mention that the BDL allowed banks to subscribe to Eurobonds issued in February 2015 through USD CDs maturing soon[1], which does not put pressure on their liquidity in foreign currency. In April 2014, the Ministry of Finance issued USD Eurobonds aimed partly at replacing some of the ones maturing in 2014. We also mention in this framework that the BDL allowed banks to subscribe in long-term Treasury bills either in cash or through discounting the CDs in LBP issued by the BDL and maturing soon. The BDL had in the first few months of 2013 replaced a part of CDs in LBP maturing in 2013 and 2014 with other CDs with longer maturity. The BDL aims through these operations to diminish the monetization of debt in LBP and to alleviate the pressure on its holdings of foreign reserves as mentioned previously.

4-4 Deposits in foreign currency at the BDL, CDs in USD...to reinforce its reserves

Bank deposits in foreign currency at the BDL reinforce its foreign currency reserves, constituting the basis of monetary stability or the basis of the purchasing power of the LBP.

Commercial bank deposits at the BDL increased substantially in 2014 by an amount exceeding USD 7 billion according to our estimates, which was the primary factor to reinforce the foreign currency reserves of the BDL in this year[2]. Some of these deposits took the form of Repo on CDs. The BDL launched at the beginning of 2014 a new financial engineering measure establishing a platform to operate in short-term deposits up to six months based on instruments owned by it. It is a Repo at interest rates reflecting the USD interbank rate[3] in the Beirut market determined by the BDL to remain under control. This engineering helps the BDL manage the liquidity.

The BDL kept issuing in 2014 CDs in USD[4] in an amount approaching USD 2 billion. However, the portfolio of USD CDs slightly declined from USD 8.3 billion at the end of 2013 to USD 7.8 billion at the end of 2014 because of maturing amounts exceeding new issuances. These measures contribute in preserving a high level of BDL reserves in foreign currency.

---

(1) Euro- CDs issued by the BDL in April 2005 and maturing in April 2015.
(2) The BDL implemented in 2012 and 2013 swap operations of part of its portfolio of LBP Treasury bills with Eurobonds, followed by selling operations of portfolios to banks in 2013 in an amount estimated at USD 4.5 billion which contributed to a great extent in reinforcing the reserves of the BDL in 2013.
(3) There are also Repo operations in LBP.
(4) In their usual form

4-5 CDs in LBP... to control liquidity and preserve average interest rates in LBP

The portfolio of CDs in LBP issued by the BDL decreased from LBP 33,815 billion at the end of 2013 to LBP 29,675 billion at the end of 2014. This decline came after an increase exceeding LBP 10 billion in 2013 given that 2014 witnessed in its turn large issuances of CDs though at a lower pace than 2013. This is due to the maturing of a large amount of CDs that were issued in 2009. The new issuances in 2014 were concentrated in long-term periods in addition to relatively limited amounts of the 45 and 60 days categories. The issuance of the CDs allowed the BDL to control the liquidity in LBP at the financial sector and also helped to stabilize the average interest rates in LBP and on Treasury bills for a period less than 7 years maturity.

In a positive step aimed at motivating banks to subscribe more in Treasury bills issued regularly and thus reducing the intervention of the BDL in the primary market for instruments, the BDL lowered in April 2014 the average interest rate on long-term CDs that it issues by 26 basis points as shown in the table below. For the same reason and in order to reduce long-term interest rates on long-term Treasury bills that are being issued regularly beginning the first month of 2015, the BDL one more time reduced the interest rates on the CDs between 26 and 92 basis points as per the schedule below with an expectation that they would stabilize until the end of 2015.

Interest rates on CDs

	45 days	60 days	7 years	8 years	10 years	12 years
Jan-Mar 2014	3.57%	3.85%	7.6%	7.8%	8.24%	8.74%
Apr 2014	3.57%	3.85%	7.34%	7.54%	7.98%	8.48%
Reduction-basis points	-	-	-26	-26	-26	-26
Jan 2015	3.57%	3.85%	7.08%	7.22%	7.46%	7.56%
Reduction-basis points	-	-	-26	-32	-52	-92

CDs for 30 years- in LBP and USD

In the latest of CD issuance, the BDL started in March 2015 to issue 30 year CDs in LBP and USD. The purpose of such long-term issuances is to complete the concept of the yield curve, to manage liquidity better, and to develop financial markets.

4-6 The intervention of the BDL in the primary market for Treasury bills in LBP and large issuances of long-term categories... to secure the stability of interest rates.

The intervention of the BDL buying Treasury bills in LBP in the primary market as well as the irregular issuance of the Ministry of Finance in 2014 of long-term Treasury bills with the direct coordination with the BDL contributed to securing the large part of the government financial needs in LBP and to a great extent in keeping the interest rates stable on all less than 7 year categories of Treasury Bills. As such, the portfolio of the BDL of Treasury bills in LBP registered an increase to LBP 19,454 billion at the end of 2014 compared to LBP 16,761 billion at the end of 2013. Thus, the BDL's share increased to 31.8% out of the total portfolio of Treasury bills in LBP at the end of 2014 in comparison to 30.1% at the end of 2013.

The Ministry of Finance issued, in coordination with the BDL, Treasury bills in LBP for 10 years as detailed in another part of this report. We mention that the BDL allowed banks to subscribe in long-term issuances either in cash or by liquidating CDs issued by the BDL (maturing soon). This serves many purposes such as allowing the reduction in the size of the closely maturing CDs for the BDL and the reduction of the cost on CDs in LBP for BDL, as well as preventing the withdrawal of additional liquidity from the market.

We mention in this context that the Ministry of Finance decided in January 2015 to issue long-term Treasury bills regularly as previously mentioned. It issued in the first quarter of 2015 bills of the 7 and 10 year categories at interest rates similar to the ones on CDs after their reduction. This is a positive step as it gives banks more incentives to increase subscribing in Treasury bills and rely less on the BDL that was working in return on absorbing bank liquidity by issuing CDs at high rates. With this step, the interest rates on Treasury Bills will reflect in a better manner the market conditions for government finance and make government financing more transparent.

4-7 Monetary Aggregates

The growth of the M3 monetary aggregate slowed down to 5.9% in 2014 compared to 6.9% in 2013 so that the interest rates for 2011-2014 remained relatively moderate compared to the ones registered in the previous years. M3 reached LBP 177,397 billion at the end of 2014 with its dollarization rate decreasing slightly from 58.97% at the end of 2013 to 58.62% at the end of 2014. It is possible to summarize the major components that have contributed to the increase of M3 by LBP 9,826 billion in 2014 as follows:

Evolution of Money Supply and its Counterparts (End of period – billion LBP)

	2012	2013	Change (%) 2013/2012	2014	Change (%) 2014/2013
Money in LBP (M1)	7,104	7,620	+517	8,301	+681
Money and quasi-money in LBP (M2)	65,077	68,749	+3,672	7,340	+4,651
Money and quasi-money in LBP & FC (M3)	**156,797**	**167,571**	**+10,774**	**177,397**	**+9,826**
Counterparts					
Net foreign assets	64,437	56,555	-7,882	53,661	-2,894
o/w : gold	23,083	16,739	-6,345	16,509	-230
foreign currencies	41,354	39,817	-1,537	37,153	-2,664
Net claims on public sector	54,596	59,568	+4,972	63,226	+3,658
Valuation adjustment	-14,708	-8,426	+6,282	-8,146	+280
Claims on private sector	59,690	65,949	+6,259	71,217	+5,268
Other items (net)	-7,219	-6,076	+1,143	-2,561	+3,514

Source : BDL

The loans granted to the resident private sector increased by around LBP 5,268 billion continuing their growth though at a lower rate than in 2013 and becoming the major contributor to the growth of M3. The net loans to the public sector increased in the amount of LBP 3,658 billion by less than its increase in the previous year becoming the second largest contributor to the growth of M3. The other net items on the balance sheet of the banking system increased by LBP 3,514 billion, representing monetizing financial obligations, which contribute positively to money creation. In comparison, the net foreign assets of the banking system excluding gold declined by LBP 2,664 billion in 2014, representing around USD 1.8 billion, had a clear contractionary impact on the monetary aggregate. This caused to a large extent its moderate growth following the continuation of the regressive path of foreign assets recorded in the last three years.

4-8 **Inflation**

The inflation rate was contained at 1.9% in 2014 based on the Consumer Price Index published by the Central Administration of Statistics compared to 4.8% in 2013.

The inflation rate came more moderate in 2014 compared to the previous year based on the weak growth in domestic demand in general (compared to the potential output) and the decline in the prices of food products and oil internationally and the stability in the average Euro-USD exchange rate. In its part, the BDL works continuously at observing and sterilizing liquidity in order to control the inflationary pressures that could be caused by it.

4-9 It is expected that the inflationary pressures caused by external factors will disappear in 2015 as the IMF expects the inflation rate to stand at 1.1%. It is also expected that the average oil prices in 2015 will be lower than the ones in 2014 after the severe decline in these prices from June 2014 until the middle of January 2015. Expectations are for the prices of food products in general to continue declining in 2015 as they actually declined in the first quarter of that year. In addition, it is expected that Euro will stay in 2015 depreciated vis-à-vis the US dollar following its decline in the first quarter of the mentioned year.

Conversely, the inflation rate may increase through the impact on the prices of goods and services caused by possibly passing the salary scale measure.

4-10 The BDL continued to take financial engineering measures to help economic growth by allowing banks to use required reserves for this purpose. It has also provided in the last years an additional stimulating package reflected especially in pumping liquidity at low interest rates to banks to be relent to households and institutions at a time when the economy registers low growth rates. The BDL has thus adopted an expansionary monetary policy conducive for economic growth and employment in line with the expansionary ones of the central banks of the USA, Europe and Japan.

V- EXTERNAL PAYMENTS

Balance of Payments

5-1 The estimated current account deficit slightly decreased in Lebanon to around USD 12.5 billion in 2014 compared to USD 12.7 billion in 2013 according to the report of World Economic Outlook issued by the IMF in April 2015. Its share of GDP decreased to 24.9% from 26.7% in the two respective years. **It is to mention that the IMF largely adjusted the figures of the current account to take into consideration the revision and reduction of the figures of service account for the last few years by the BDL.**

It is estimated that the slight decline in the current account deficit in 2014 was caused by the slight deficit decrease in merchandize trade in this year, and the possibility of an increase in the service account and the current remittances account[5].

Components of the current account balance
Based on the latest figures of the BDL, which cover the first three quarters of 2014, merchandize trade deficit stood at USD 11.6 billion[6] compared to a surplus in service account reaching around USD 2 billion, a surplus in current remittances account close to USD 1.7 billion and a surplus in income account approaching USD 0.1 billion so that the current account deficit reached USD 7.8 billion.

It is possible that the decline in oil and other commodities prices and the value of the Euro against the USD[7] will reduce the current account deficit in 2015. The IMF expected in its last report on the world economy for this deficit to decrease slightly in absolute terms to USD 12.1 billion in 2015 and slightly as percent of GDP to 22.2%.

5-2 Before addressing the balance of trade in detail at the end of this section, we mention in the subject of service trade, the moderate improvement in tourism activity in 2014 after its major decline in the last three years. The number of tourists to Lebanon increased at a rate of 6.3% to reach 1,354,647 tourists in 2014 according to the statistics of the Ministry of Tourism, but this figure stays far below the record level of 2010 standing at 2.2 million tourists. The occupancy rate of Beirut 4 and 5 star hotels stabilized at 52% in 2013 and 2014 compared to 67% in 2010 according to Ernst and Young. The decline in tourist activity in the last years happened in particular due to the security unrest in Lebanon and the previous calls by some Arab governments to their citizens to avoid travel to Lebanon and also due to the decline in land travel because of the increased risk with the deterioration in the Syrian security situation.

(5) Based on the figures of the Balance of Payments until September 2014 issued by the BDL, which are the latest available data.
(6) The deficit in merchandize trade recorded in the balance of payments differs from the deficit published by the Lebanese Customs that adds the following: re-exported goods, goods temporarily exported to be transformed or that are re-exported after being domestically equipped, and reformed goods.
(7) This reduces the bill of imported merchandize from the Euro-zone which represented 33.7% of total merchandize imports in 2014.

5-3 The remittances to Lebanon increased by 13.2% in 2014 to reach USD 8.9 billion based on the latest estimates of the World Bank[8] compared to USD 7.9 billion for 2013 and USD 6.7 billion for 2012 given that they sometimes differ from the figures of the IMF. The World Bank attributed the increase in the remittances of those working abroad in 2014 to the remittances sent to the Syrian refugees in Lebanon by their relatives abroad though some of the funds go back to Syria, and to the fact that the economic activity in countries hosting Lebanese expatriates such as the USA has improved. The remittances to Lebanon constituted 18% of GDP in 2014 compared to 17% in 2013 which is one of the highest figures in the world and the highest in the region. Lebanon occupies the second position in the world in terms of remittances per capita and the 13th position in terms of remittances as a share of GDP. The systematic and level of these remittances reflect the size of the Lebanese diaspora in all parts of the world, its high quality in all respects and its loyalty to its country and people. The remittances of those working in Lebanon to the outside world reached according to the latest available figures of the World Bank around USD 4.7 billion in 2013. Thus, the net remittances to Lebanon would have covered around 18% of the merchandize trade deficit.

5-4 The large current account deficit in Lebanon, which is largely determined by the deficit in merchandize trade, is financed by the surplus in the capital and financial account which works through the inflow of net capital in various forms from direct investments, portfolio investments, the deposits at banks, net loans from abroad to the public and private sectors, and others. Based on the estimated current account deficit expected or estimated by the IMF, which are figures subject to adjustment, and the figures of the balance of payments provided by the BDL, the net capital flowing to Lebanon reached in 2014 around USD 11 billion or around 22% of GDP compared to around USD 11.5 billion in 2013 (24.6% of GDP).

5-5 As for **foreign direct investments** whose size is estimated differently by various sources, several reports unanimously agreed on their decline in the last years due to the internal and regional pressures. The latest report of UNCTAD on world investments pointed out that net foreign direct investments to Lebanon declined to around USD 2.1 billion in 2013 (4.5% of GDP) based on the latest information compared to USD 3.1 billion in 2012 whereas foreign direct investments reached USD 2.8 billion in 2013 (6% of GDP) compared to USD 3.7 billion in 2012. It is to mention that foreign direct investments usually finance a large part of the current account deficit. These investments are largely concentrated in the real estate sector differing from the nature of foreign direct investments in many similar emerging countries where they are diverse affecting several economic sectors.

(8) The World Bank raised its estimates of remittances in 2014 to USD 8.9 billion from previous estimates of USD 7.7 billion. It also revised its estimates for 2013 from USD 7.9 billion to USD 7.6 billion whereas it lowered the estimates of 2012 to USD 6.7 billion from USD 6.9 billion.

5-6 In conclusion and for the fourth year in a row, net capital inflows in 2014 could not cover the current account deficit which is the opposite of the trend prevailing in 2002-2010. This is due to several reasons such as the high level of imported goods, the political tension in Lebanon and the developments in Syria and their negative impacts on tourism and exports, or also on the current account on one hand and on capital account that includes foreign direct investments on the other. This caused a deficit in the balance of payments reaching USD 1.4 billion in 2014 compared to a lower deficit reaching USD 1.1 billion in 2013. This deficit reflects the coincidental and latest developments in the region. In return, Lebanon has accumulated in a previous period a large size of savings in foreign currencies allowing the financing of deficits in the size achieved in the last four years. This does not mean though not to deal with the subject in a new vision and recent policies to avoid weakening or depleting foreign currency reserves and be forced to raise external debt and increase the interest rates.

Foreign Trade

5-7 The value of imported goods according to the High Council of Customs declined to around USD 20.5 billion in 2014 compared to USD 21.2 billion in 2013 or by a decline of USD 734 million or 3.5%. First, this is largely due to the decrease in the world prices of many commodities such as oil, food products and others contributing to the decline in the value of the import bill. We mention here, as an example, that the value of the mineral products imports composed mostly of oil derivatives declined in 2014 by an amount equal to USD 223 million whereas the quantities imported of them increased by 4.6%. Second, this is due to the decline in the value of the imports of machines, tools, and electric equipment (USD -402 million), transportation equipment[9] (USD -238 million), precious stones and valuable metals (USD -160 million), which is related to a certain extent to the decline in their export activity.

The imported quantities registered a decrease of 2.6% to reach 15,452 thousand tons in 2014 compared to 15,868 thousand for the preceding year which was a record. The investigation in the quantities of imported goods shows how the total is influenced by changes in some of their types with a heavy weight, such as "articles of stone, plaster and cement" that declined by 43% (-909 thousand tons) and mineral products that increased by 4.65% (+327 thousand tons). If we exclude, for example, the mentioned products, the imported goods of all other types would have registered an increase of 2.5% in 2014[10].
Based on that, it could be said that the imported goods activity was less negative in 2014 from what it looked like initially, and that the real decline in imports affected especially durable consumption products and products imported for investment purposes as they are affected by the continuing weak economic performance in Lebanon.

(9) The decline in the value of imports of machines, tools, electric and transport equipment was accompanied by a decline in the quantities of imports of these products.
(10) If we exclude in addition to the two mentioned type of products all of: transportation equipment, food products, and tool and electric equipment, the imported quantities of all other goods would have registered an increase of 5.1%.

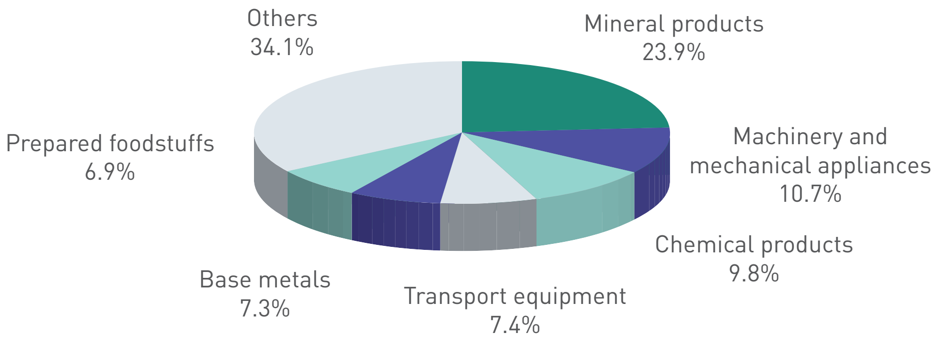
Imports of Goods

	2012	2013	2014
Value – USD million	21,280	21, 228	20,494
Change (%)	+5.6	-0.2	-3.5
Quantities – Thousand tons	15,623	15,868	15,452
Change (%)	+3.8	+1.6	-2.6

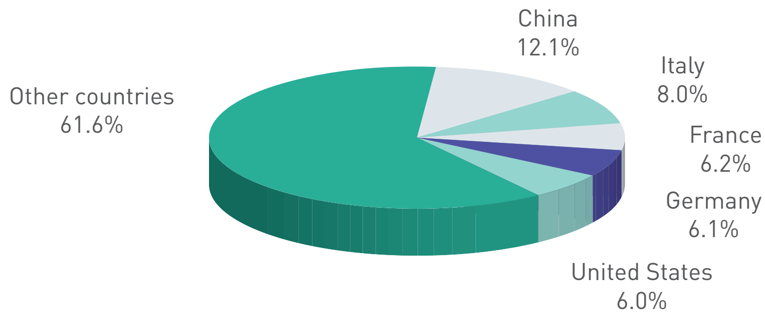
Source: Customs automated center

The two graphs below summarize the distribution of imported goods by type and country of origin in 2014.

Main Imported Products in % of total in 2014



Import by Countries of Origin in % of total in 2014



Source: Customs automated center

5-8 In another context, the value of exported goods clearly decreased for the second year in a row to USD 3,313 million in 2014 compared to USD 3,936 million in 2013, or by an amount of USD 623 million and 15.8%. This large decline in the value of exported goods was specifically due to the major decline in the export value of mineral products (USD -314 million) after it exceptionally increased in 2012 and 2013 due to its export to Syria, and the continuing decline in the export value of precious and semi-precious stones and precious metals (USD -228 million) to South Africa, Switzerland and the United Arab Emirates. It was also due to the decrease in the value of exports of base metal products (USD -153 million), and to a lesser extent due to the decline in the value of exports of machines, tools, and electric equipment (USD -62 million).

Thus, and when we exclude mineral products, precious stones, and precious metals, the value of other export products would have registered a modest decline by 2.9%, under the influence of a decrease in the value (and quantity) of exports of base metal products, and the machines, tools and electric equipment.

The quantity of exports decreased in 2014 substantially by 19.5% to 2,236 thousand tons. The total was affected by the changes in some of the quantities of goods that weigh heavy. The quantity of mineral product exports (or oil derivatives) declined to a great extent by 444 thousand tons. The quantity of exports of base metal and products declined to 164 thousand tons. In return, the quantity of exports of several products increased especially chemical industry products by around 72 thousand tons. Thus, if we exclude mineral products, the quantity of exports of other products would have declined by 4.5% only. If we exclude mineral products and base metal products, for example, the quantity of other exports would have recorded an increase by 4.2%.
In conclusion, getting into the details of the numbers at least shows that the quantity as well as the value of exported goods did not witness in 2014 a dramatic decline, but that they had recorded a more moderate decrease than initially perceived.

Exports of Goods to the Arab World
The value of exported goods to the Arab World, which is considered the primary export market for Lebanon, declined to USD 1,729 million in 2014 compared to USD 2,020 million in 2013 which was a record level, or by an amount of USD 291 million and 14.4%. The exported quantities to the Arab world also substantially declined in 2014 by 20%. But when getting into the details, we find that the decrease in these levels does not represent the real situation as the decline in the value and quantity of exports in 2014 resulted nearly completely from the decrease in mineral exports to Syria. When excluding Syria, the exports to the other Arab countries would have registered a decline by 0.6% in value and 1.7% in quantities exported.

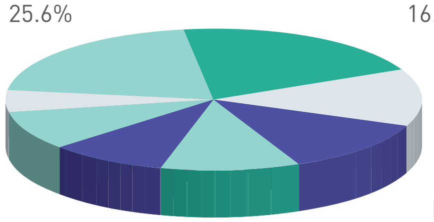
Based on that, it can be said that exports to the Arab countries remained cohesive until the end of 2014 compared to their levels before the Syrian crisis.

Exports of Goods

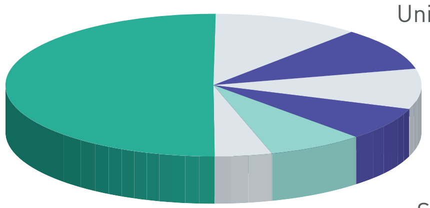
	2012	2013	2014
Value – USD million	4,483	3,936	3,313
Change (%)	+5.1	-12.2	-15.8
Quantities – Thousand tons	2,602	2,776	2,236
Change (%)	-4.2	+6.7	-19.5

Source: Customs automated center

Main exported products in % of total in 2014

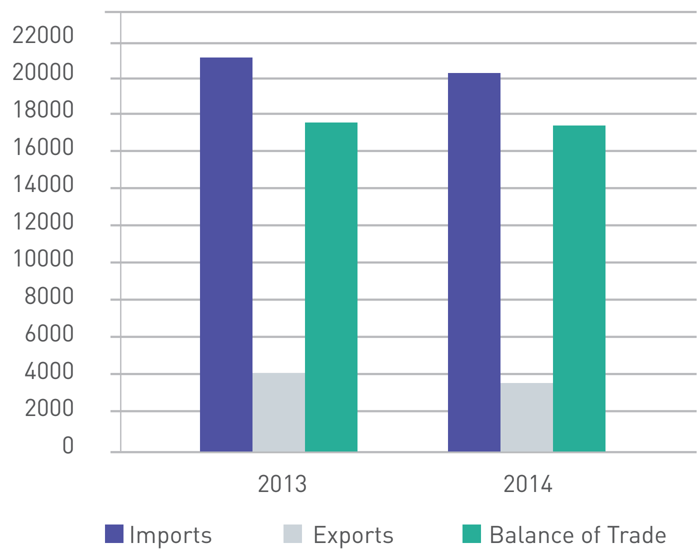


Export by countries of destination in % of total in 2014



Source: Customs automated center

Lebanon Foreign Trade (million USD)



Source: Customs automated center

VI- BANKS AND THE FINANCING OF THE ECONOMY

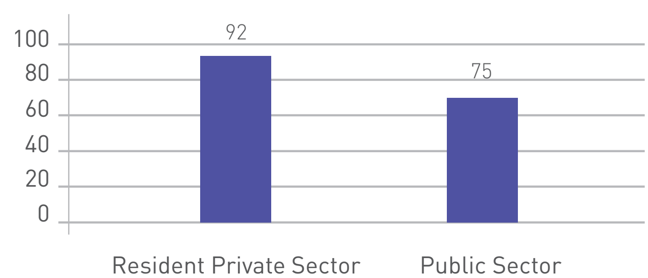
6-1 In a non-convenient work environment, the decline in capital inflows from abroad and the weak economic activity (and thus the weak financing needs) limited the expansion of the total assets of commercial banks operating in Lebanon in 2014. This expansion relies largely on the growth in the deposits of the resident and non-resident private sectors which is financed by capital inflows from abroad and the lending activity to the economy in its private and public sectors. Thus, the contribution of the external factor or capital inflows was weak due to the continuation of the Syrian crisis and its negative internal political and security repercussions and because of the unstable situation in the region as previously mentioned. The contribution of the internal factor, especially the public sector, was also weak due to the restrictive fiscal policy, the absence of the fiscal budget and minimum expenditure especially the investment one, the non-reliance on bank lending in financing the needs of the public sector outside the framework of renewing maturities for many reasons mentioned earlier, the compensation of the BDL through supporting the public sector by 58% of the size of the public deficit, and the usage of the government of its deposits to cover the remaining part or 42% of the deficit. The contribution of the private sector was better even though it remained lower than what could have been achieved in normal circumstances. The internal and external factors mentioned above and the weak internal economic situation necessitated reinforcing the deposits and liquidity at the BDL and thus protecting monetary stability.

6-2 Based on these facts and developments, the consolidated balance-sheet of commercial banks operating in Lebanon reached USD 175.7 billion at the end of 2014, implying an increase in sources/uses of funds amounting to USD 10.9 billion and 6.6% compared to the previous year (8.5% growth in total assets in 2013). The increase in the deposit base by around USD 8.5 billion and 6.1% (compared to a higher increase reaching 9% in 2013) represented alone 78% of the increase in the sources of funds, followed by the increase in total capital by USD 1.5 billion (14% of additional sources) and the deposits of the non-resident financial sector by USD 0.8 billion.

6-3 At the end of 2014, deposits at commercial banks operating in Lebanon reached USD 147.6 billion (20.5% represent deposits of non-residents) without considering the deposits of specialized banks and off-balance sheet fiduciary deposits reaching USD 2.2 billion and USD 2 billion respectively. The growth in deposits was enough to finance the needs of the economy, comply with the precautionary standards and reinforce the foreign currency reserves at the BDL. We also mention that the capital of the commercial banks in Lebanon reached USD 15.7 billion at the end of 2014, representing around 9% of total assets and close to 14% as an international capital ratio computed based on the Basel accord. This capitalization level is considered good based on international standards. The increase in country risk necessitates always the increase in capital size even at the expense of distributing dividends.

6-4 Banks used the increase in their sources of funds to lend the private sector (USD +3.9 billion) or 36% of the uses of funds. The loans to the resident private sector reaching USD 45.4 billion at the end of 2014 represented 91.5% of GDP compared to 88% at the end of 2013. Banks also used part of the growth in their sources of funds to comply with required reserves and the required deposits and liquidity (USD +2 billion). In comparison, loans to the public sector did not increase -but on the contrary slightly declined -as the government did not issue Eurobonds in the absence of a permit to borrow and the lack of interest of banks to hold Treasury bills in LBP of less than 7 year category due to the existing interest rate levels, so they were satisfied in renewing maturing instruments. Banks deposited the remaining parts of their resources at the BDL in CDs in LBP, USD and as free deposits. Banks reinvested placements at the BDL in the amount of USD 2.7 billion which resulted from a decline in the loans to the public sector. Thus, the whole amount of the increase in reserves and assets at the BDL stood at USD 9.1 billion in 2014. We finally mention that fixed and unclassified assets increased by around USD 0.6 billion.

Credits / GDP
end 2014 (%)

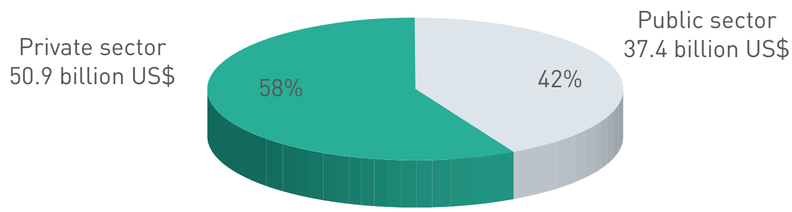


Source : BDL

6-5 Loans to the resident and non-resident private sectors net of doubtful loans reached USD 50.9 billion at the end of 2014 (of which 10.9% to non-resident private sector), registering an increase of 7.4% which is less than the increase of 9% in 2013. This increase resulted largely from the special lending programs offered by the BDL for years especially lately through the incentive package of USD 1.4 billion launched in 2013 at low cost to banks to be relent also at low cost to the private sector. This was followed by a sum of USD 800 million in 2014 and USD 1 billion in 2015. The housing and technology sectors benefitted for the most from these loans. The support of the BDL to the knowledge economy based on circular no 331 started giving the desired benefits in terms of banks investing in this sector with a financing ability of around USD 400 million. We remind that the purpose of this circular is to activate the mechanisms of starting new promising companies that could be transformed in the future to companies capable of enriching the national wealth and creating new job opportunities. At the time of preparing this report, banks had financed investment funds and emerging companies by close to USD 200 million. It is expected that the future of the Lebanese economy will be based to a great extent on the sector of the knowledge economy in addition to the financial sector and the sector of gas and energy.

6-6 At the end of 2014, loans to the public sector amounted to USD 37.4 billion or 75.3% of GDP with a slight decline from the level of USD 37.7 billion reached at the end of 2013. Thus, the share of banks in Lebanon in financing public debt in LBP and foreign currencies, decreased from around 59% in 2013 to around 56% at the end of 2014. Despite that, banks in Lebanon remained the main financier of the public sector, financing the government in spite of its high degree of risk and low credit rating (B-). The financing of banks to the government in Lebanon represents more than 25% of their total deposits whereas this percent does not exceed 15% to 20% in Arab countries, Europe and the USA. Governments in Europe and the USA borrow directly from markets or from the subscription of individuals and firms in sovereign bonds. It is to mention that the share of the private sector has started exceeding the one of the public sector in bank loans since 2010.

Claims on Public & Private Sectors end 2014 (% & USD billion)



Source : BDL

6-7 The banking profession in Lebanon is subject in a continuous and increasing manner to international guiding principles issued by the Basel committee, the IMF and others of the groups setting-up the standards concerning capitalization, liquidity, combatting money laundering and terrorist financing and granting loans to related groups. Complying by these standards represents a necessary condition to join the international markets and deal with correspondent banks. It is through bank dealings with the outside world that remittances are transferred, exports and imports are financed, savings are mobilized, and a large part of foreign reserves at the BDL are provided to serve monetary stability. In 2014, banks embarked on strengthening the capital base, holding high liquidity, and adopting a tight policy of accumulating provisions representing for the most a boost for the confidence that comforts depositors and protects the sector from crisis.

6-8 Banks in Lebanon are accompanying the increasing development witnessed by the banking profession and the modern banking techniques at the levels of legislation, organization, and application. Despite the improvement that Lebanon has achieved at this level, it still needs more efforts in developing the financial and banking legislations. Banks are pressing the Lebanese parliament to pass pending project laws including tax information exchange based on the standards of the Organization for Economic Cooperation and Development to combat tax evasion, cross-border cash transfers (the joint Lebanese parliamentary committees have reached a result concerning the law on declaring cash exceeding USD 20,000 at the ports of entry to Lebanon), and the amendments of Law 318 concerning money laundering and terrorist financing to include new financial crimes such as protecting intellectual property rights in addition to joining the United Nations Convention on terrorist financing. Conditions of the new international financial order are clarity, transparency, information exchange and the complete knowledge of all money transfers for individuals, companies and others. This goes in line with the fact that the top management of Lebanese banks has been committed for years in a clear and strong manner to enforce the instruments, laws and procedures that are necessary to combat money laundering and terrorist financing. Year after year, banks activate the "compliance unit" established in each bank and specialized in these duties, and composed of qualified people that are continuously aware of the international experiences and developments in this domain. Banks also apply all the circulars issued by the BDL and the Special Investigation Commission in addition to all international standards on the subject including rules on Know Your Customers (KYC). In September 2014, basic circular no 83 issued by the BDL was amended to enhance the compliance task at all branches of banks and financial institutions and apply the laws on combatting money laundering and terrorist financing better. The Special Investigation Commission also issued last year several notices concerning the employees of banks and financial institutions that did not warn the suspected and reported clients, the accounts subject to investigation, and sending statements on electronic suspicious transactions.