

# ECONOMIC BULLETIN

2018 First Half



**FRANSABANK**



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## Lebanon's Macro Economy in the First Half of 2018

### I. General Introduction

Lebanon's macro economy has continued its weak growth during the first half of 2018, due mainly to continued internal political conflict and unfavorable regional conditions.

Some real-sector activities improved, while others contracted, leading to diverse effects on aggregate demand and supply in the national economy.

The monetary authorities have maintained its monetary stabilization and interest-rate policies. The country recorded inflation due to expanding economic activity and money supply.

The balance of payments achieved a deficit in the first half of 2018, compared to a larger deficit for the same period last year.

The fiscal conditions, however, remain highly unfavorable due to continued fiscal deficits and growing public indebtedness.

Economic growth is expected to continue in 2018, with an enhanced real growth rate. Economic reforms must be the major priority of domestic authorities in order to support economic growth rates in the years to come, especially following the Cedre Conference which allocated a foreign aid of USD 11.6 million for Lebanon. This should be accompanied by special efforts to address the continued negative repercussions of the Syrian crisis on the domestic economy and society.

## II. Real Sector

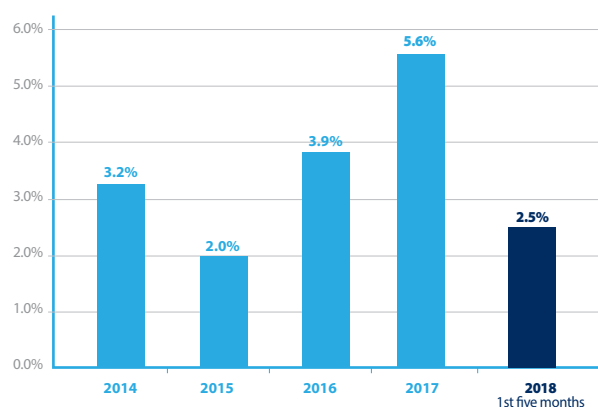
The real sector of Lebanon's economy experienced a sluggish performance in the first half of 2018 relative to the corresponding period last year. The activity of some economic sectors enhanced, while that of other sectors contracted, thus producing diverse effects on aggregate economic activity, both on the demand and supply sides.

The Central Bank's Coincident Indicator, reflecting the overall performance of the real sector (since it comprises 11 real-sector indicators) reported an annual growth of 2.5% for the first five months of 2018. This level is lower than the one recorded in 2017 (5.6%), 2016 (3.9%), 2013 and 2014 (3.2% for each year), but higher than the one recorded in 2015 (2%).

The indicators that registered growth are: airport passengers, exports, electricity production, and tourists. The indicators that registered a decline are: construction permits, property sales, Beirut Port's merchandise activity, new car sales, cement deliveries, imports and cleared checks.

During this period, private consumption has increased, fueled mainly by the rise in wages of the public-sector employees following the ratification of the wage scale. However, private investment remains weak, even on decline, due to the wait-and-see case prevailing in Lebanon.

**- Development of Central Bank's Coincident Indicator (CI) (growth rates) -**



### 1- Agriculture and Industry

The value of agricultural and industrial exports reached USD 1.5 billion for the first half of 2018, relative to USD 1.4 billion for the corresponding period of 2017, with an annual growth of 7.2%. On the other hand, the value of agricultural and industrial imports dropped by 1.7% from USD 8.3 billion to USD 8 billion during the same period.

These figures clearly reflect a better performing export activity against declining import activity, despite the constraints of closed routes especially the Jordan-Syrian border, and high insurance costs. These figures also reflect a positive contribution of the export activity to overall demand in the economy, besides better production operations.

Electricity Production, an indicator of industrial activity, improved by 3.9%, from 6,979 mkw in the first half of 2017 to 7,249 mkw in the first half of 2018.

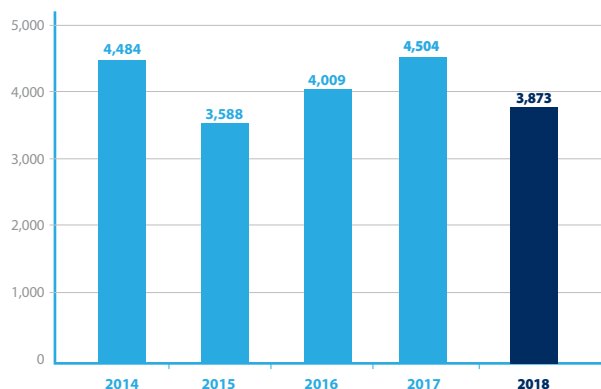
### 2- Real Estate and Construction

According to the figures of the Real Estate Registry and Ministry of Finance, the number of property sales operations decreased by 18.2% on annual basis to reach 27,472 operations in the first half of 2018. Also, the value of property sales dropped by 14% annually to reach USD 3.9 billion during the same period. This is partially affected by the recent seizure of housing loans by the Public Institution for Housing. These figures reflect a declining real-estate activity in the first half of 2018 as far as the demand side is considered.

Construction permits declined by 17.8%, from nearly 6.1 million sqm in the first half of 2017 to 5.0 million sqm in the same period of 2018. This suggests a curbed demand in the real-estate sector.

Cement deliveries dropped by 3.4% on annual basis to reach 2.3 million tons in the first half of 2018. This suggests a curbed supply in the real-estate sector during this period of 2018 relative to the same period last year.

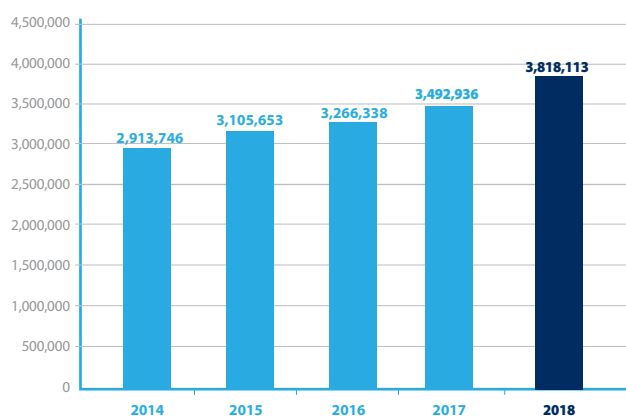
### - Value of Real Estate Transactions, First Half (USD, Million) -



### 3- Trade and Services

The statistics released by the **Hariri International Airport** indicate that the total number of passengers increased by 9.3% on annual basis to reach 3,820,198 passengers in the first half of 2018. The total freight handled by the airport recorded 48,606 metric tons in the first half of 2018. The number of aircraft recorded an increase of 3.1% on annual basis to reach 33,315 planes during the said period. These figures suggest an improvement in the airport activity.

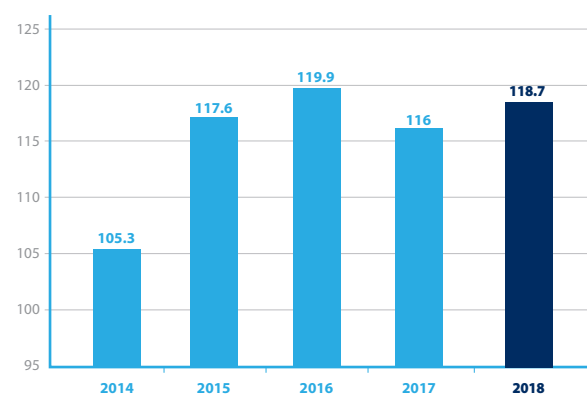
### - Passengers at the Airport - First Half -



According to the statistics of the **Port of Beirut**, its revenues recorded an increase by 2.3% on annual basis to reach USD 118.7 million in the first half of 2018. The number of ships recorded an annual decrease of 0.5% to reach 920 ships in the first half of 2018. In parallel, the number of containers recorded an annual increase of

0.6% to reach 413,674 containers during the same period. But the quantity of goods declined by 7.9% year-on-year to reach 3,916 thousand tons in the first half of 2018. These figures indicate that the Port of Beirut activity, an indicator of maritime transport and trade, was curbed during the period under consideration.

### - Port of Beirut Revenues, First Half (USD, Million) -



The **number of visitors** totaled 853,087 tourists in the first half of 2018, growing by 3.3% from 826,129 tourists in the corresponding period last year. The distribution of these tourists according to nationality shows that visitors from European countries constituted 35.2% of the total number of tourists, followed by visitors from Arab countries (28.7%), Americas (18.2%), Asia (7.6%), Africa (6.2%), and Oceania (4.1%). The spending of tourists grew by 5% in the first half of 2018 against a higher rate of 6% for the same period last year.

According to the Survey of Ernst and Young, the Beirut's **hotel occupancy rate**, an indicator of tourism activity, decreased from 61.9% in the first half of 2017 to 58.9% in the first half of 2018. The average room rate rose from USD 177 to USD 182, and the rooms yield fell by 2.7% to USD 107 during the same period. These figures reflect a declining hotel activity during the period under consideration.

The statistics of the Association of Automobile Importers in Lebanon show that the number of **new sold cars** totaled 17,208 cars in the first half of 2018, with a decrease of 5.4% from 18,198 new cars sold in the same period last year.

According to the statistics of the Association of Banks in Lebanon, the total value of **cleared checks**, mirroring private consumption and investment spending, decreased by 2.5% on annual basis, from USD 33.7 billion in the first half of 2017 to USD 32.8 billion in the first half of 2018. And the total value of returned checks increased by 5.7% on annual basis to reach USD 749 million in the first half of 2018. This reflects a curbed private spending during the period under consideration.

The Economic and Social Fund for Development (ESFD) reported that it guaranteed 217 loans for a total of USD 3.7 million to **SMEs in Lebanon** in the first half of 2018. The Kafalat loans decreased in amount from USD 38.1 million to USD 28.8 million during the same period. SMEs constitute a major pillar of the corporate sector, and supporting it is a driving force of economic activity and job creation in Lebanon.

## Real-Sector Indicators

Indicators	2017 First Half	2018 First Half	% Change
Agricultural & Industrial Exports (USD, billion)	1.4	1.5	7.2
Real-Estate Transactions (number)	33,584	27,472	(18.2)
Real-Estate Transactions (USD, billion)	4.5	3.9	(14.0)
Number of Tourists	826,129	853,087	3.3
Spending of Tourists (% growth)	6.0	5.0	(1.0)
Number of Passengers at HIA	3,495,075	3,820,198	9.3
Aircraft Activity at HIA	32,313	33,315	3.1
Value of Returned Checks (USD, million)	709	749	5.7
Number of Returned Checks	112,500	130,046	15.6
Cleared Checks (USD, billion)	33.7	32.8	(2.5)
Cleared Checks (number in million)	6.1	5.88	(2.9)
New Car Sales (number)	18,198	17,208	(5.4)
Hotel Occupancy Rate (%)	61.9	58.9	(3.0)
Goods Quantity at Beirut Port (000, tons)	4,252	3,916	(7.9)
Numbers of Containers at Beirut Port	429,074	431,674	0.6
Number of Ships at Beirut Port	925	920	(0.5)
Revenues of Beirut Port (USD, million)	116.0	118.7	2.3
ESFD Guaranteed Loans (number)	-	217	-
ESFD Guaranteed Loans (USD, million)	-	3.7	-
Kafalat Loans (number)	310	223	(28.1)
Kafalat Loans (USD, million)	38.1	28.8	(24.4)
Cement Deliveries (tons)	2,388,693	2,307,098	(3.4)
Construction Permits (number)	8,168	7,152	(12.4)
Construction Permits (sqm)	6,107,743	5,023,143	(17.8)
Electricity Production (mkw)	6,979	7,249	3.9

Sources: Official and Related Directorates.

### III. Fiscal Policy and Indebtedness

The fiscal conditions in Lebanon remain highly unfavorable in light of continued fiscal deficits and growing public indebtedness, and the crowding-out effect of private investment fueled by public borrowing.

#### 1- Fiscal Deficit

The figures of the Ministry of Finance show that Lebanon recorded a higher fiscal deficit in the first two months of 2018, reaching USD 865 million, relative to a lower deficit of USD 162 million for the same period last year, pointing to an annual growth of 435.4%. This deficit represents 30.7% of total expenditures as of end-February 2018, compared to 8.1% for the same period of 2017. The total primary deficit for the first two months of 2018 was USD 329.6 million, compared to a surplus of USD 330.9 million for the same period last year.

The total fiscal deficit was the result of a substantial increase in total expenditures by 40.4% between February 2017 and February 2018, and a moderate growth of 5.8% in total revenues during the same period. Total

expenditures stood at nearly USD 2.82 billion and total revenues at USD 1.95 billion as of end-February 2018.

The budget revenues dropped by 4.3% while budget expenditures grew by 28.5% on annual basis to reach USD 1.66 billion and USD 2.38 billion respectively. The tax revenues increased by 11.1%, while non-tax revenues dropped by 46.1% during this period. The Telecom revenues decreased sharply by 72.9% to USD 72 million as of end-February 2018.

The Treasury receipts jumped by 161.8% on annual basis to reach USD 295 million as of end-February 2018, while Treasury expenditures surged by 187.3% to USD 433 million during this period.

Debt servicing totaled USD 535.5 million in the first two months of 2018, growing by 8.7% from the same period last year. It accounted for 19% of total expenditures and 27.4% of total revenues. Transfers to EDL also increased by 3.4% to USD 212 million during the same period.

#### Fiscal Indicators (First Two Months, USD million)

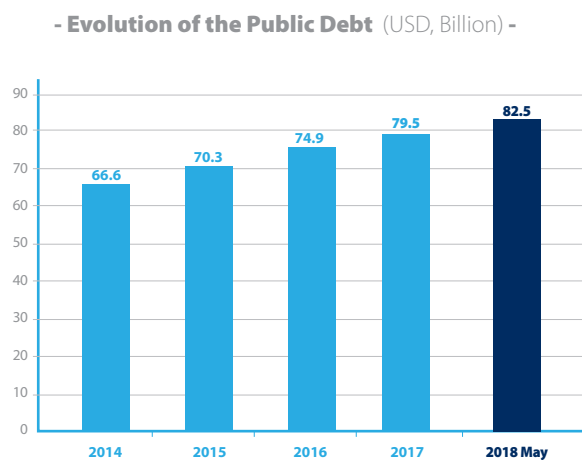
	2017	2018	% change
Budget Revenues	1,732	1,658	(4.3)
Budget Expenditures	1,856	2,384	28.5
Treasury Receipts	113	295	161.8
Treasury Expenditures	151	433	187.3
Total Revenues	1,845	1,953	5.8
Total Expenditures	2,007	2,818	40.4
Total Deficit	(162)	(865)	435.4
Total Primary Surplus Deficit	330.9	(329.6)	(199.6)

Source: Ministry of Finance.



## 2- Public Debt

According to the Ministry of Finance figures, public indebtedness of Lebanon increased by 7.5% in the first five months of 2018, from USD 76.7 billion at end-May 2017 to USD 82.5 billion at end-May 2018. Between the end of 2014 and end-May 2018, the public debt of Lebanon increased by more than USD 15 billion. The debt-to-GDP ratio stands currently at more than 150%.



## IV. Inflation and Monetary Policy

The monetary authorities have maintained its monetary stabilization policy as well as its interest-rate policy, targeting currency stability. This period experienced higher inflation.

### 1- Central Bank

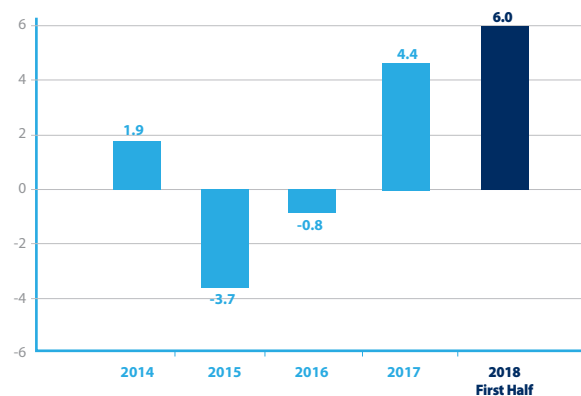
The Central Bank's statistics reveal that its balance sheet increased by 22.9% on annual basis to reach USD 129.2 billion at the end of June 2018, compared to USD 105.2 billion during the same period of 2017. Assets in foreign currencies reached USD 44.2 billion at the end of June 2018, with an increase of 7.5% from USD 41.1 billion at the end of June 2017.

As for the gold reserves, its value grew by 0.5% year-on-year to reach USD 11.5 billion as of end-June 2018. These figures reflect a better financial status of the Central Bank.

## 2- Inflation

The Price Index of the Central Administration of Statistics increased by 6% on annual basis for the first half of 2018, compared to a lower level of 4.6% in the same period of 2017. This reflects the growth of inflation in the first half of 2018, following deflation in 2016 and 2015.

**- Evolution of Average Annual Inflation Rate (%) -**



## 3- BTA – Fransabank Retail Index



The Lebanese economic organizations have been voicing out warnings repeatedly about the deteriorating situation. These warnings were further supported lately by declarations of Beirut Traders Association President, calling upon all concerned parties – official, public and private, to join their efforts in an attempt to salvage the commercial sector in Lebanon – a vital element of the Lebanese economy, which generates more than one third of the country's GDP.

He further called upon all national parties to exert their utmost for the formation of a new government, without any further delay, and for ensuring that the new ministers do have the adequate qualifications and capabilities that ensure their ability to implement immediately all what

is required to stop the ongoing economic deterioration and design a crisis program that aims at revitalizing the agonizing commercial sector alongside all other ailing economic sectors.

The political environment that prevailed during the second quarter of this year, either before or during the parliamentary elections (a period that was usually accompanied by "electoral spending" and its direct effects on the level of consumption in the markets), or after the elections (with all the tensions that go along with the formation of a new government), did not obviously have any positive effects on the markets, especially that these two periods were preceded by the application of new as well as revised taxes and fees, and the rejection by the Constitutional Court of a decision related to tax settlements and penalties reductions. All the above collaborated of course into invalidating any positive effects expected after the application of the new salaries grid.

Add to this the rarity of tourists and visitors, the declining purchase power of Lebanese households for reasons that have become obvious to everybody ranging from competitive pressures in the labor market to an increasing inflation trend and the negative macro-economic figures that do not seem to be set for any improvement in the near future in terms of deficit and debt and the like ... which neutralizes of course any outlooks for even a modest growth in the local economy.

The combination of all these factors, or should it be called accumulation, has led – at the commercial level, to very low levels of activity and to exerting very heavy financial pressures on the companies that are still operational in the trading market.

These companies are today under the threat of stopping their activities in the medium term, closing down and terminating the services of their employees, and hence ceasing to be active tax-payers and collaborators to a major source of income for the treasury.

This situation does not only apply to small or medium companies, but it also applies to some reputed and large companies that have been major players historically in

the Lebanese trading markets, throughout their various sectorial and regional distribution.

Yet, the commercial community is still building hopes that this crisis will eventually recede soon after the formation of the new government, and that solutions will be found for all the problems that are currently being encountered, thanks to the combination of the efforts of all responsible parties, many of whom have been issuing multiple statements lately, whereby they announce that the economic issue should be on top of the priorities that the new government must address, especially after the facilities programs that have been extended to Lebanon during the CEDRE conference.

But, on other hand, current figures and indices are not encouraging: for instance, the CPI for the second quarter of this year has reached, as per the CAS official release, the level of 7.61% in comparison to its level of the same quarter of last year. This is the highest increase for the last 5 years.

The scrutiny of inflation figures for every division of expenditure adopted by CAS for this CPI, reflects an inflation - between Q2 '17 and Q2 '18, of more than 16 % in the prices of clothing and footwear, and also in the cost of water, gas, electricity, and other fuels.

For the same period, transportation has increased by 12 % and prices in the sectors of recreation, amusement and culture have increased by more than 8 %. The food and non-alcoholic beverages division displays an increase of 5.87 %. The major part of this inflation is certainly due to the taxes and fees that were decided by the parliament, in spite of all the warnings issued by the Lebanese Economic Organizations, in light of the current unfavorable economic situation.

The unavoidable result was a hike in the prices of goods and services coupled with a sustained decline in the purchase power of Lebanese households - the prime and essential consumer in the market, with all what derives from such a situation in terms of declining activity in the markets and decreasing turnovers in real figures in the various sectors of the local trading markets.

CPI (as per CAS official results)	
Q4 '14 / Q4 '13	- 0.71 %
Q1 '15 / Q1 '14	- 3.38 %
Q2 '15 / Q2 '14	- 3.37 %
Q3 '15 / Q3 '14	- 4.67 %
Q4 '15 / Q4 '14	- 3.40 %
Q1 '16 / Q1 '15	- 3.57 %
Q2 '16 / Q2 '15	- 0.98 %
Q3 '16 / Q3 '15	+ 1.03 %
Q4 '16 / Q4 '15	+ 3.14 %
Q1 '17 / Q1 '16	+ 5.12 %
Q2 '17 / Q2 '16	+ 3.48 %
Q3 '17 / Q3 '16	+ 4.15 %
Q4 '17 / Q4 '16	+ 5.01 %
Q1 '18 / Q1 '17	+ 5.35 %
<b>Q2 '18 / Q2 '17</b>	<b>+ 7.61 %</b>
Q4 '14 / Q3 '14	- 1.49 %
Q1 '15 / Q4 '14	- 0.98 %
Q2 '15 / Q1 '15	- 1.12 %
Q3 '15 / Q2 '15	- 1.18 %
Q4 '15 / Q3 '15	- 0.16 %
Q1 '16 / Q4 '15	- 1.15 %
Q2 '16 / Q1 '16	+ 1.54 %
Q3 '16 / Q2 '16	+ 0.82 %
Q4 '16 / Q3 '16	+ 1.93 %
Q1 '16 / Q4 '17	+ 0.74 %
Q2 '17 / Q1 '17	- 0.04 %
Q3 '17 / Q2 '17	+ 1.47 %
Q4 '17 / Q3 '17	+ 2.78 %
Q1 '18 / Q4 '17	- 1.06 %
<b>Q2 '18 / Q1 '18</b>	<b>+ 2.10 %</b>

As a result, the consolidated real retail turnover figures have posted a sharp decline between the second quarter of 2017 and the second quarter of 2018, reaching – 9.74 % (i.e. after applying the inflation rate weight on the nominal results), as compared to – 9.31 % in the previous quarter.

By excluding the fuel sector results (where an increase of + 2.50 % in volume was reported), the real turnover drop reaches – 10.73 % in comparison to the Q2 '17 figures excluding fuel.

### Yearly Variation between 2nd Quarter '17 and 2nd Quarter '18

	Q2 - 2017	Q2 - 2018	
Nominal Year to Year Variation (incl. Liquid Fuels)	100.00	97.69	
Nominal Year to Year Variation (excl. Liquid Fuels)	100.00	99.61	
CPI between Jun'17 and Jun'18 (as per the official CAS figures)		<b>+ 7.61 %*</b>	
Real Year to Year Variation (incl. Liquid Fuels)	100.00	90.26	<b>- 9.74 %</b>
Real Year to Year Variation (excl. Liquid Fuels)	100.00	89.27	<b>- 10.73 %</b>

\* CAS – CPI – Jun'18

Hopes are high that the performance of the trading sectors will definitely improve upon the announcement of a new government, with all what such new government bears in terms of positive expectations, starting with the direct effects of the CEDRE programs on the local economy, and the regain of a stable economic and consumption situation in the country, as well as the return of visitors to Lebanon and their impact in the Lebanese markets. Meanwhile, the only option for traders is to face their current situation with resilience, when possible, until changes start to occur.

In the meantime, the analysis of the performance of the various retail trade market sectors shows that the main sectors displaying declines in their turnovers are a clear translation of Lebanese households' shrinking purchase power and selective consumption pattern by channeling main spending to basic necessities. The main sectors where declines were registered include:

- Construction Equipment (- 57.71 %)
- Cellular Phones (- 28.56 %)
- Toys (- 23.58 % after a - 16.50 % in the previous quarter)
- Shoes and Leather Products (- 21.97 % after a - 33.72 % in the previous quarter)
- Silverware and Decoration (- 16.14 %)
- Clothing (continued decline reaching - 14.56 % after a - 15.05 % in the previous quarter)
- Furniture (- 9.95 %)
- Supermarkets and Food Shops (- 9.00 % after a - 5.73 % in the previous quarter)
- Used Cars Dealers (- 8.80 %)
- Optical and Hearing Aid Instruments (- 8.73 %)
- Musical Instruments (- 8.04 %)
- Sports Items & Equipment (-5.21 %)
- Medical Equipment (- 4.83 %)
- Books & Stationery & Office Supplies (- 4.27 %)
- Home Accessories (- 3.88 % after a - 7.42 % in the previous quarter)
- Watches and Jewelry (+ 3.43 %)
- Liquor & Spirits (- 3.24 %)
- Commercial Shopping Centers (- 2.00 %)

- Construction Material (- 1.13 % sustaining a slow but continued drop)
- Pharmaceuticals (- 0.67 %)

The sectors that witnessed better (although modest) results were, in addition to the increase in the volume of fuel (+ 0.82 % in volume) are:

- Tobacco (+ 13.92 %)
- Perfumes and Cosmetics (+5.83 %)
- Bakeries & Pastries (+ 4.58 %)
- Household Electrical Equipment (+ 1.58 %)
- Restaurants and Snacks (+ 1.34 %)

On the other hand, and despite the fact that the CPI between Q1 '18 and Q2 '18 did not exceed + 2.10 %, the second quarter figures display further deterioration in comparison to the first quarter results.

It should be noted here that this deterioration occurred despite the fact the holy month of Ramadan and the Eid Al Fitr fell during this second quarter. Yet, there was disparity between the different sectors, and while a large number of these posted declines, some other sectors witnessed an improvement in their sales results. Nevertheless, the overall consolidated result for the second quarter remained negative, as it shows a real decline of - 1.41 % as compared to the previous quarter (excluding Liquid Fuels, where a + 2.35 % increase was reported in terms of volume). Commercial Shopping Centers also posted a - 12.00 % decline in their figures. Other sectors where declining activity was reported included:

- Shoes and Leather Products (- 18.99 %)
- Books & Stationery & Office Supplies (- 16.38 %)
- Cellular Phones (- 15.61 %)
- Sports Items & Equipment (- 11.20 %)
- Construction Equipment (- 9.68 %)
- Watches and Jewelry (-8.70 %)
- Pharmaceuticals (- 7.62 % , following an increase of +25.19% in the previous quarter)
- Optical Instruments (- 4.17 %)
- Clothing (- 3.07 %)
- Toys (- 2.47 %)

- Home Accessories (- 1.25 %)
- Construction Materials (- 1.13 %)
- Musical Instruments (- 1.08 %)

Positive results were posted in the following sectors:

- Medical Equipment (+ 33.00 %)
- Tobacco (+ 10.44 %)
- Liquors (+ 10.14 %)
- Silverware and Decoration (+ 8.87 %)
- Household Electrical Equipment (+ 8.29 %)
- Restaurants and Snacks (+ 5.60 %)
- Used Cars Dealers (+ 4.04 %)

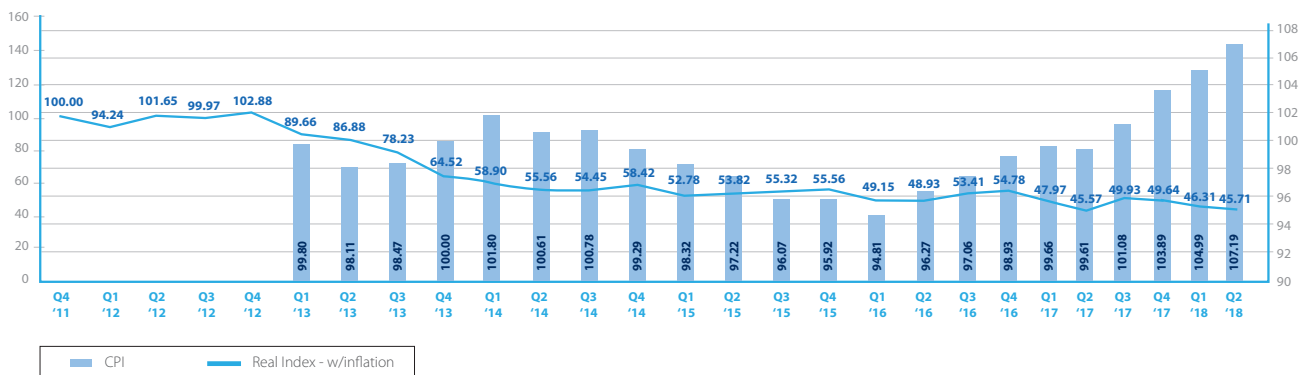
- Bakeries & Pastries (+ 3.29 %)
- Perfumes and Cosmetics (+ 1.84 %)
- Supermarkets and Food Shops (+ 1.19 %)
- Furniture (+ 0.83 %)

As a result, with the base index 100 fixed at the fourth quarter of 2011, and with a quarterly inflation rate of + 2.10 % for the second quarter of 2018, as per the official CAS report, the "BTA-Fransabank Retail Index" is (with all sectors included): 45.71 for the second quarter of the year 2018; this figure compares to the level of 46.31 for the first quarter of 2018.

## BTA - Fransabank Retail Index for Q2 - 2018 (Base 100 : Q4 - 2011)

	2011				2012				2013				2014				2015				2016				2017				2018	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
Real Index - w/out inflation	100	95.77	100.55	108.54	112.66	90.83	87.85	78.60	65.87	59.68	55.30	55.22	57.57	51.51	51.94	52.77	52.911	46.27	46.79	51.49	53.86	47.51	46.76	52.00	53.17	49.09	<b>49.49</b>			
Real Index - w/ inflation	100	94.24	101.65	99.97	102.88	89.66	86.88	78.23	64.52	58.90	55.56	54.45	58.42	52.78	53.82	55.32	55.56	49.15	48.93	53.41	54.78	47.97	45.57	49.93	49.64	46.31	<b>45.71</b>			
CPI						99.80	98.11	98.47	100.00	101.80	100.61	100.78	99.29	98.32	97.22	96.07	95.92	94.81	96.27	97.06	98.93	99.66	99.61	101.08	103.89	104.99	<b>107.19</b>			

## Evolution of the BTA - Fransabank Retail Index (Base 100 : Q4 - 2011)



The "BTA-Fransabank Retail Index" for the second quarter of 2018 should be perceived as a clear warning on the dangerous and fragile situation of the Lebanese retail trade markets in particular and the Lebanese economy in general. What is required today is the urgent formation of a new government that will immediately address the ailing economic situation and make the best out of the benefits and opportunities offered lately by the international community.

### 4- Stabilization Policy

The Central Bank of Lebanon has continued its monetary stabilization policy during the first half of 2018, just like in the previous years. The stability in the exchange rate (USD1 = LBP 1507.5) persists, thus contributing to overall monetary and economic stability.

To support this monetary stability, the monetary authorities have maintained their policy of moderating

growth in money supply. This is crucial also for controlling inflation.

## Monetary Indicators

Indicators	2017 First Half	2018 First Half	% Change
USD/LBP Exchange Rate	1507.5	1507.5	0.0
Central Bank's Balance Sheet(USD, billion)	105.2	129.2	22.9
Central Bank's Assets in FX (USD, billion)	41.1	44.2	7.5
Central Bank's Gold Reserves (USD, billion)	11.44	11.5	0.5
Inflation Rate (%)	4.6	6.0	1.4

Sources: Central Bank of Lebanon, Association of Banks in Lebanon, and Central Administration of Statistics.

## V. Financial Markets

The banking sector has continued its growth in the half quarter of 2018, and the capital market recorded a remarkable improvement in its activity during the same period.

### 1- Banking Sector

The statistics of the Association of Banks in Lebanon and the Central Bank indicate that the total assets of commercial banks stood at USD 234.6 billion as of end-June 2018, with an annual growth of 12.7% from end-June 2017.

The loans extended by commercial banks to the private-sector increased by 2.8% annually to reach 59.6 billion at end-June 2018. The dollarization rate of private sector

lending dropped from 69.7% at end-June 2017 to 67.6% at end-June 2018.

The loans extended to the public sector decreased by 7.7% on annual basis to reach USD 33.2 billion at end-June 2018.

The deposits of commercial banks at the Central Bank reached USD 117.7 billion at end-June 2018, with an annual growth of 30.6%.

The total private-sector deposits grew by 3.3% on annual basis to reach USD 173.3 billion at end-June 2018. The dollarization rate of these deposits increased from 66.7% at end-June 2017 to 68.4% at end-June 2018. The private-sector loans-to-deposit ratio was 34.4% at end-June 2018, compared to 34.6% at end-June 2017.

The commercial bank's capital base expanded by 9.1% year-on-year to reach USD 20.4 billion at end-June 2018.

## Indicators of Commercial Banks (USD, billion)

Indicators	2017 First Half	2018 First Half	% Change
Total Assets	208.2	234.6	12.7
Private-Sector Deposits	167.8	173.3	3.3
Private-Sector Loans	56.0	59.6	2.8
Loans to Public Sector	36.0	33.2	(7.7)
Deposits at Central Bank	90.1	117.7	30.6
Dollarization of Lending (%)	69.7	67.6	(2.1)
Dollarization of Deposits (%)	66.7	68.4	(1.7)
Loans-to-Deposits Ratio (%)	34.6	34.4	(0.2)
Capital Base	18.7	20.4	9.1

Sources: Central Bank of Lebanon and Association of Banks in Lebanon.

## 2- Financial Institutions:

The total balance sheet of financial institutions in Lebanon totaled USD 1.6 billion as of end-June 2018, down by 4.5% from end-2017. The claims on resident customers dropped by 7.3% to USD 667.8 million, and the claims on resident financial sector also decreased by 16.5% during the same period. The claims on public sector shrank by 18.3%, while its deposits regressed by 70.8%.

The resident customer deposits increased by 22.1%

to USD 172 million as of end-June 2018. The resident financial sector liabilities were 13% lower.

The capital accounts of financial institutions declined by a low 1.1%, from USD 484.7 million as of end-2017 to USD 479.4 million as of end-June 2018.

These figures suggest a shrinking activity of the financial institutions operating in Lebanon in the first half of 2018.

## Indicators of Financial Institutions (USD, million)

Indicators	End 2017	2018 First Half	% Change
Total Balance Sheet	1,683	1,590	(4.5)
Claims on Resident Customers	720.4	667.8	(7.3)
Claims on Resident Financial Sector	438.1	365.8	(16.5)
Claims on Public Sector	6.0	4.9	(18.3)
Resident Customer Deposits	140.7	172.0	(22.1)
Resident Financial Sector Liabilities	432.2	376.0	(13.0)
Public Sector Deposits	14.4	4.2	(70.8)
Capital Accounts	484.7	479.4	(1.1)

Source: Central Bank of Lebanon.

## 3- Beirut Stock Exchange:

The figures announced by the Beirut Stock Exchange (BSE) indicate that total trading volume reached 58.5 million shares in the first half of 2018, with a substantial increase of 42.1% from 41.2 million shares in the same period last year.

The total trading value also increased substantially by 22.9% from USD 346.3 million to USD 425.7 million during the same period.

Market capitalization of BSE decreased by 9.8% on annual basis to reach USD 10.4 billion at end-June 2018.

The market liquidity ratio was 4.1% as of end-June 2018, relative to 3% in the same period of 2017.

## Beirut Stock Exchange Indicators

Indicators	2017 First half	2018 First Half	% Change
Market Capitalization (USD, billion)	11.5	10.4	(9.8)
Total Trading Value (USD, million)	346.3	425.7	22.9
Total Trading Volume (Shares, thousand)	41,187	58,522	42.1
<b>Liquidity Ratio (%)</b>	<b>3.0</b>	<b>4.1</b>	<b>1.1</b>

Sources: BSE and Central Bank of Lebanon.

## VI- Foreign Sector

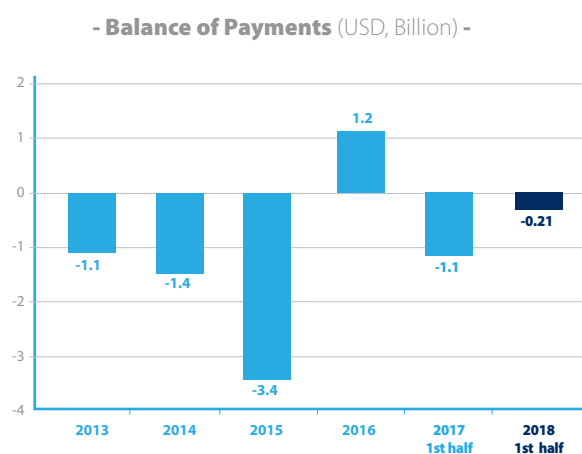
The balance of payments, mirroring the aggregate foreign sector activity, experienced a deficit in the first half of 2018 relative to a larger deficit for the same period of 2017, due to greater capital inflows and narrowing trade deficit.

### 1- Trade Balance

For the first half of 2018, the value of total exports reached USD 1.5 billion, with an increase of 7.2% from a year later. In parallel, total imports dropped by 1.7% to reach USD 9.6 billion during the same period. As such, the trade deficit narrowed to USD 8 billion, declining by 3.6% on annual basis.

The export-to-import coverage ratio was 15.6% in the first half of 2018, relative to 14.4% in the same period last year, thus reflecting an improvement in this coverage ratio due to the growth of exports and decrease of imports.

These figures indicate a better trade activity for Lebanon, fueled by an improving export activity.



### 2- Capital Balance

The financial inflows to Lebanon are estimated at nearly USD 7.8 billion in the first half of 2018, relative to USD 7.2 billion a year earlier, thus increasing annually by 8.3%. This mirrors an improving inflow of financial funds from foreign markets.

According to a recent study conducted by the Institute of International Finance (IIF), the amount of net capital inflows to Lebanon is estimated at USD 6.85 billion in 2018, similar to that of 2017, but lower than the peak level of USD 14 billion in 2009.

These inflows are composed of nearly USD 3.3 billion in FDI, USD 933 million in portfolio investment and USD 2.7 billion in other investments.

### Estimated Net Capital Inflows to Lebanon in 2018

Investment Type	Amount
Net Capital Inflows (USD, billion)	6.85
FDI (USD, billion)	3.3
Portfolio Investment (USD, million)	933
Other Investments (USD, billion)	2.7

Source: IIF.



### 3- Balance-of-Payments

The statistics announced by the Central Bank show that Lebanon's balance-of-payments recorded a deficit of USD 208.3 million in the first six months of 2018, relative to a deficit of USD 1.1 billion in the same period last year. The

recorded deficit was due to a decrease of USD 2.4 billion in the net foreign assets of banks and financial institutions, and an increase of USD 2.2 billion in the net foreign assets of the Central Bank.

### Foreign Sector Indicators (USD, billion)

Indicators	2017 First Half	2018 First Half	% Change
Trade Deficit	8.3	8.0	(3.6)
Exports	1.4	1.5	7.2
Imports	9.7	9.6	(1.7)
Capital Inflows	7.2	7.8	8.3
Balance of Payments	(1.1)	(0.2083)	-

Sources: Higher Customs Council and Central Bank of Lebanon.

### VII- Growth Prospects

Real economic growth is expected to continue during 2018, at a rate better than the one recorded in 2017. This will be stimulated by the currently observed political and security stability, expanding aggregate economic activity, continued monetary stabilization policy, and continued capital inflows.

The IMF projects the real GDP growth rate of Lebanon at 1.5% in 2018, up from 1% in 2017. The World Bank projects the real GDP growth rate at 2% for the same period. The IIF forecasts real GDP growth at 2.3% for 2017 and 3.1% for 2018. The EIU projects real GDP growth at 2.3% in 2018, and Bloomberg at 2.1% for the same year.

#### Real GDP Growth Rates Estimates (%)

	2017	2018	2019	2020
IIF	2.3	3.1	3.8	4.5
World Bank	2.0	2.0	2.0	2.0
EIU	-	2.3	2.9	2.9
IMF	1.0	1.5	2.5	2.5
Bloomberg	-	2.1	2.6	-

## Study - Invest In Lebanon: The PPP Guide for Private Companies

### I. Executive Summary

Fransabank and Fransa Invest Bank have collaborated with the High Council for Privatization and PPP (HCP) for the production of this important Guide for Companies to better understand how a company can propose, bid for, and undertake to design, build, operate, manage or invest in a PPP project.

The 2018 guide is a first such document published and is a useful tool for clarifying the PPP tendering process from A to Z to interested companies, consistent with the PPP law passed last year. The guide details 18 potential projects, which are a part of Lebanon's Capital Investment Program. It also explains the PPP Law and how to establish related project companies, as well as answers frequently asked questions about PPP tendering in Lebanon.

### II. Prospects For Lebanon

Lebanon has set its path on a sustained recovery, following several positive developments in recent years, including the election of the President, the adoption of a new electoral law following the appointment of a national unity government, the passage of PPP legislation, the conclusion of the first oil and gas tenders in the country and the successful holding of parliamentary elections on May 6, 2018. Also significant are the adoption of the budget in 2017 for the first time in 12 years and the subsequent recent passing of the 2018 budget.

However, the economic recovery and long term development of Lebanon have been hindered by structural problems: high fiscal deficit (around 10% of GDP) and a high level of public debt (around 150% of GDP). GDP growth was estimated at 1% in 2017, following a similar rate in 2016, as the spillover from the Syrian conflict continues to weigh on the country.

To address these challenges, the Parliament passed the long-awaited PPP law in 2017 and the government has

embarked on an ambitious Capital Investment Program (CIP). The PPP law endowed the tendering process for PPP projects with transparency and professionalism by mandating the High Council for Privatization and PPP (HCP) as the country's PPP unit. The CIP was unveiled at the CEDRE conference in Paris on April 6, 2018, an international conference aiming at supporting Lebanon's development.

The CIP mainly focuses on infrastructure development and rehabilitation, emphasizing some sectorial priorities of Lebanon's government – transport, energy, water, and waste management. The total cost of the first phase of the CIP (covering 6 years for preparatory works and implementation) is estimated at US \$10.8 billion (including expropriation costs), of which around 35% is expected to come from private investment. As such, it recognizes that concessional financing and private investment are the best instruments to finance infrastructure and create jobs, along with the implementation of a consistent budgetary and fiscal adjustment program.

Earlier in March 2018, a PPP conference was organized in Beirut by the HCP. It showcased three PPP projects for which tendering preparation had been recently approved by the HCP board, namely the expansion of the Beirut Rafic Hariri International Airport, the Khalde – Nahr Ibrahim Expressway and the National Data Center. In addition, information about another 15 potential PPP projects selected from the CIP project list and covering the transport, water, wastewater and solid waste sector, was made available and are included in this guide.

At the same PPP conference, the International Finance Corporation (IFC) stated that successful tendering of initial projects under Lebanon's CIP would set a precedent and a strong track record for future transactions in Lebanon, thus promoting private sector mobilization. The IFC was selected as lead transaction advisor on the airport expansion PPP transaction in May of 2018.

The European Bank for Reconstruction and Development (EBRD) was also quite positive on Lebanon's prospects,

with EBRD President Suma Chakrabarti stating, “Lebanon is a country of immense potential and crucial for regional stability,” on his visit to the country in March of 2018. President Chakrabarti focused on the economic development of Lebanon and on the highly promising steps already undertaken under the country’s new reform programme. He emphasized that EBRD is ready to participate in projects in “infrastructure and municipal infrastructure, as well as renewables and energy efficiency”. Lebanon became a recipient of EBRD investment, policy engagement and technical assistance in September 2017.

In May 2018, EBRD entered into a contract with the HCP to provide advisory services on the expressway PPP transaction, while KPMG and Solon were selected to advise the HCP on the National Data Center project.

### III. Analysis of PPP Law 48 of 2017

The PPP law aims at reforming the PPP tendering process to enhance its transparency and professionalism. As such, it is expected to be instrumental to the success and sustainability of PPP projects, a cornerstone of the development of Lebanon’s crumbling infrastructure, job creation and the growth of the Lebanese economy.

The guide provides a full analysis of the PPP law and English translation of the law text. It provides the general institutional framework which calls for the creation of a project committee and assisting working teams for each project. Such structure, which ensures the involvement of all stakeholders, aims at enhancing the transparency of the tendering process.

#### Lebanon PPP Law: Key Provisions

In general terms, the PPP law details the tendering mechanism for PPP projects, including the general institutional framework which calls for the creation of a project committee and assisting working teams for each project. Such structure, which ensures the involvement of all stakeholders, aims at enhancing the transparency of the tendering process, leading to the selection of the private partner.

The PPP law also details the main elements of the PPP Project Agreement, which will be part of the tender document and which includes, among others, available disputes settlement mechanisms including international arbitration.

This approach would boost the success rate of executing PPP projects, especially since most past failures were due to a flawed tendering mechanism or improper contract structuring.

A summary of the PPP law’s key provisions is set out below.

#### Scope of the PPP Law

The PPP law defines ‘PPP Projects’ as projects of public interest in which the private sector participates through:

- Financing and administration and
- Carrying out at least one of the following activities: designing, building, constructing, developing, restoring, equipping, maintaining, rehabilitating and operating

The scope of application of the PPP law extends de jure to all PPP Projects carried out by the State, public institutions, or any entity considered as ‘public’. This includes without limitation all PPP Projects provided for under the laws governing the telecommunications, electricity and civil aviation sectors. Such scope may also be optionally extended to PPP Projects carried out by municipalities and unions of municipalities, provided certain conditions set out in the PPP law are complied with.

#### PPP Project Agreement

One of the key features of the law is that it defines the ‘PPP Project Agreement’ as a set of contracts, which together with all annexes, undertakings and related guarantees would govern the contractual relationship between the public entity, the project company and all other third parties, including international financial institutions and foreign investors.

The law outlines the key provisions to be included in the PPP Project Agreement, as follows:

- The parties' respective rights and obligations;
- The basis for financing the PPP Project;
- The duration of the partnership, which should not extend beyond 35 years;
- The respective revenues to be received by the project company from the public entity or by the public entity from the project company depending on the nature of the common project, and the corresponding means of payment;
- The fees and dues which the project company can collect on behalf of the public authority and for its account;
- Key performance indicators;
- The reports to be submitted by the project company;
- The allocation of project risks and mitigation measures;
- The rules governing the potential amendment to the basic terms of the contract;
- The guarantees, undertakings, and commitments which may be provided for the fulfillment of the PPP Project;
- The public assets put at the disposal of the project company;
- The transfer procedures, whenever the nature of the PPP project calls for it;
- The procedures guarantying the continuity of the PPP project and its related operations upon termination or expiry of the Project Agreement or breach of its contractual obligations;
- The procedures and remedies in case of breach as well as detailed enforcement procedures in respect to these remedies;
- The dispute settlement mechanism, including mediation as well as domestic and international arbitration.

## Relevant Authorities

The PPP law renames the 'High Council for Privatization' instituted by virtue of the Privatization Law No. 228 dated 31.05.2000 as the 'High Council for Privatization and PPP' and vests in it the authority to:

- Assess and evaluate potential 'PPP Projects' submitted to it by the relevant minister or by the President of the Council of Ministers;
  - Establish a 'PPP Project Committee' for every approved PPP Project;
- Decide on the prequalification outcome and approve the final version of the tender document following consultation with the prequalified bidders; and
  - Confirm the winning bidder who submits the best offer based on the evaluation of the PPP Project Committee.

The PPP law institutes a PPP Project Committee chaired by the secretary general of the High Council for Privatization and PPP and has among its members representatives of the relevant ministry, the Ministry of Finance, and, where applicable, the authority regulating the relevant sector. The PPP Project Committee is in charge of preparing an all-encompassing feasibility study governing the technical, economical, legal and financial aspects of the PPP project, including the pre-qualification criteria, assessment of investors' interest and the likelihood of attracting the required financing. It is assisted in its functions by a team of financial, legal and technical consultants.

The High Council for Privatization and PPP then examines the study and the recommendations of the PPP Project Committee and determines whether to reject or to pursue the project; in the latter case, the President of the Council of Ministers submits the project to the Council of Ministers for approval. In case the project is approved by the Council of Ministers, the PPP Project Committee launches the process of selecting a private partner.

## The PPP Project Committee

In addition to its duties outlined above, the PPP Project Committee is also in charge of:

- Managing and administering the application process.
- Evaluating the prequalification applications and providing its recommendations in relation thereto and in relation to the PPP project in general to the High Council for Privatization and PPP.
- Preparing and sharing the draft tender document with the prequalified candidates, which includes a draft of the Project Agreement and its annexes.
- Consulting with all prequalified candidates and lenders in a transparent and neutral manner in order to reach a comprehensive and final delineation of technical requirements, the technical means and the financial structure most suitable for the project; the PPP law provides that the draft tender document may be amended in light of these consultations.

- Sharing the final tender document with the prequalified candidates.
- Examining and evaluating the submitted bids and making recommendations in respect thereto to the High Council for Privatization and PPP.
- Negotiating with the best bidder to improve the technical aspects of the bid, if mandated to do so by the High Council for Privatization and PPP.
- Announcing the tender results which identify the successful 'private partner' and notifying the non-successful bidders of the reasons why their bids were not retained.

The selected private partner is required to incorporate a Lebanese joint stock company which will be the PPP Project Company and in charge of executing the PPP project. The PPP Project Company will be exempted from the nationality restrictions set out in the Lebanese Code of Commerce as well as from the requirements to appoint an additional auditor or to obtain a work permit for its Chairman should he/she be non-Lebanese.

The PPP law distinguishes between the construction phase and the operational phase of the PPP project and provides that the private partner may not without the approval of the Council of Ministers transfer its shares in the PPP Project Company to third parties before the start of the operational phase.

Exceptionally, the Public Party may participate in the establishment of the PPP Project Company and may contribute to its capitalization; its in kind contributions are exempted from the verification treatment provided for in Article 86 of the Code of Commerce.

#### IV. PPP Tendering Process in Lebanon

The first step of the process for a PPP project involves a proposal which includes a pre-feasibility study to be sent by relevant public entity/ministry to the Secretariat General of the HCP.

The requirements for the feasibility study are summarized as follows:

- Project overview (public entity in charge, name and location of project).
- Identification of the need and benefits of the project (needs assessment quantified, direct and indirect benefits, identify project beneficiaries and stakeholders, contribution to government's goals, expected outcomes and impacts, environmental considerations, mitigation of risks).
- Preliminary technical and operational analysis (technical solution, scope, risks).
- Preliminary analysis of the financial feasibility (estimation of Capex and O&M cost, forecast of revenues, preliminary business plan, financial risks)
- Project readiness and status (land availability, level of demand).

For companies seeking to express interest in bidding for a project that is not currently in consideration with the HCP, the most effective first course of action would be to propose the project to the concerned Ministry and possibly assist with the preparation of a pre-feasibility study, in case the Ministry is interested in putting forward a proposal. This approach, however, should not give this company any competitive advantage over other bidders who might be interested once the project is tendered competitively.

The HCP Secretariat General will review the file submitted by the concerned ministry and issue its recommendations to the HCP Board, which is chaired by the Prime Minister and is composed of four permanent members, as well as the Minister who initially submitted the project to HCP.

Following the HCP Board's approval to proceed with the project, the HCP Board will form a project Steering Committee to review and follow up on the concerned project. The Committee then selects consultants to be retained by the HCP to undertake the full feasibility study and commence preparations for the project tendering, which are submitted back to the HCP Board for approval.

Should the Board approve proceeding further with the PPP Project, the President of the Council of Ministers would forward the project file to the Council of Ministers for its approval. Once approved, the HCP Secretariat

General issues a request for expressions of interest which includes the prequalification criteria for the selection of the potential private partners.

The Secretariat General then proceeds in preparing the tender documents and based on consultations with the prequalified bidders on the draft project agreement, it finalizes the tender documents. They are then submitted to the HCP Board. In the case of approval by the Board, the Prime Minister then forwards the project tender documents to the Council of Ministers for approval.

If approved, the HCP Secretariat General can then proceed to the bidding process and subsequent evaluation of the bids. It then prepares its evaluation report together with its recommendation of the preferred bidder to the HCP Board. The Board can mandate the project steering committee to negotiate with the winning bidder on certain technical aspects.

Following completion of the negotiations with the Winning bidder, the final PPP Contract/Agreement is signed by the concerned Minister or relevant public entity which is then in charge of monitoring the execution of the PPP project.

The average time needed from submission of project file including the pre-feasibility study from the Specialized Ministry to the HCP, up to the beginning of the official Tendering is estimated to range between 12-18 months but would certainly vary depending on the size and complexity of the project.

## V. Potential PPP Projects in Lebanon

The guide provides details for a list of 18 projects that was prepared by the HCP jointly with: The Presidency of the Council of Ministers, The Ministry of Public Works and Transport, The Ministry of Energy and Water, The Ministry of Telecommunications, The Ministry of Environment, The Council for Development and Reconstruction, The Tripoli Special Economic Zone Authority.

Not all the projects are at the same level of development, with some at more advanced levels while others are still in very early developmental stages. They are in various sectors of the economy, including:

- Transport (Expansion of Beirut Rafik Hariri International Airport, Kleiaat Rene Mouawad Airport, Khaldeh-Nahr Ibrahim Expressway, Jounieh Touristic Port, Said New Port).
- Water (El Bared Dam, Ain Dara – Azounieh Dam, Maaser El Chouf dam and Lake).
- Wastewater (Aley Wastewater System, Qortada-Sfaileh-Deir Khouna-Hlaliyeh, Kfarhai Wastewater System, Shabtine Wastewater System).
- Energy (Zahrani and Selaata IPP Projects).
- Telecommunications (National Data Center).
- Waste (Municipal Solid Waste to Energy System, Hazardous Waste Interim Storage).
- Special Economic Zone (Tripoli Special Economic Zone).

## VI. Establishing Operations in Lebanon

The winning bidder of each project will be required to establish a joint stock company to undertake the PPP project. The guide explains the process and considerations for establishing operations in Lebanon for foreign and local investors. It also details the important incentives for foreign and local investors offered by the country, the descriptions of each zone in the country, and their applicable status/benefits.

The applicable conditions for Foreign Direct Investment (FDI) in Lebanon are also covered including entry requirements by sector, repatriation of investment and profits, and foreign ownership of real estate.

Finally, the document presents a list of frequently asked questions and their answers to clarify the tendering process for PPPs in Lebanon.

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The Economic Bulletin is a research document that is owned and published by Fransabank SAL. This bulletin provides the reader with an overview of the most recent developments in the Lebanese economy and the banking sector in general, coupled with a study on the most prominent emerging developments in the banking and finance sectors both on the local, regional and international aspects.

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