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LEBANON ECONOMIC REPORT

4TH QUARTER 2022

TABLE OF CONTENTS

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LEBANON'S ECONOMY AT A CROSSROAD BETWEEN RECOVERY AND COLLAPSE

Real GDP growth slightly positive after severe contraction

Following the significant 33% contraction in real GDP in the first two years of the crisis, Lebanon is back to a slightly positive real GDP growth in 2022. BDL and the government announced a 2% real GDP growth for the past year. The analysis of real sector indicators show that out of 17 indicators 11 were up last year. The touristic season was particularly strong in 2022 with 65% more tourists relative to the year 2021, while flight and hotel reservations were close to full during summer and Christmas holiday. Remittance inflows amounted to US$ 6.8 billion in 2022, against US$ 6.4 billion in 2021, growing by 7% year-on-year. In addition, a large number of companies are increasingly paying salaries in fresh dollars which is supporting domestic consumption.

Imports up by 40% and exports down by 10% in 2022

External sector figures released for the year of 2022 suggest a 59.5% hike in trade deficit amid a 39.7% growth in imports, while exports decreased by 10.1% relative to the year 2021. In fact, imports grew from US$ 13.6 billion to US$ 19.1 billion between the two years, while exports decreased from US$ 3.9 billion to US$ 3.5 billion, thus generating a rise in the trade deficit from US$ 9.8 billion to US$ 15.6 billion. It is worth mentioning that the rise in imports is partly tied to global inflation, especially related to oil and commodity prices that surged significantly last year, but also suggests a slight improvement in domestic private demand.

LP on downward spiral amid darkened political outlook and tough reform challenges

The past year saw the Lebanese pound plummet to new lows against the US dollar on the parallel FX market, which compounded with a large expansion in the money in circulation outside BDL and continuous FX reserves burn. This occurred despite all exceptional measures adopted by the Central Bank of Lebanon since late 2021 to curb currency collapse, allowing banks to purchase US dollar banknotes from BDL at the "Sayrafa" rate. The Lebanese pound's unchecked nosedive against the greenback on the parallel market is mainly explained by a protracted multilayered political vacuum, worsened domestic political outlook, the slow progress in implementing IMF prior actions to secure much-needed international financial support, the full fuel subsidy removal since mid-September 2022, the shortage in foreign currencies because of the weakness in inflows, a large money creation and dwindling FX reserves.

Extended equity price rally in 2022 on hedging activity, bond prices plunging to mid-single digit levels on prolonged institutional vacuum and tough reform road

Lebanon's equity market continued to register strong price gains in domestic US dollar terms in 2022, as market players continued to flock to realty stocks to hedge against crisis. On the other hand, the Eurobond market plunged deeper into the red amid a protracted multilayered institutional void and tough reform challenges to reach a full fledge agreement with the IMF and unlock much-needed international financial support.

Looking forward, the country seems on a crossroad

In case of a positive political-economic scenario, the economic and social pressures would start to ease, and the country would begin to recover from its acute depression to register circa 5% of real GDP growth in 2023 and an inflation rate of less than 30% amid relative stability in the exchange rate. Such a positive scenario revolves around the election of a new President shortly, and the formation of a credible and efficient cabinet, followed by a full fledge agreement with the IMF on the basis of the Staff-level agreement reached last April, after meeting the prior actions to secure the Fund's Board of Directors approval. As for the adverse scenario, it supposes that the political stalemate would continue to prevail, which would lead to deepened economic recession with negative real GDP growth, a severe currency collapse amid dwindling foreign exchange reserves, a large LP money creation, hyperinflation in consumer prices, and severe socio-economic pressures on Lebanese households. Between the two scenarios rises the Medium scenario, based on the election of a president, the formation of a new cabinet, yet with no implementation of reforms and no conclusion of a final agreement with the IMF. Within this scenario, economic and monetary forecasts for 2023 revolve around a real GDP growth close to that of last year, i.e in the vicinity of 2%, an inflation rate of 80%, a slight decline in BDL reserves and a moderate balance of payments deficit.

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Following the significant 33% contraction in real GDP in the first two years of the crisis, Lebanon is back to a slightly positive real GDP growth in 2022. BDL and the government announced a 2% real GDP growth for the past year.

The analysis of real sector indicators show that out of 17 real sector indicators 11 were up last year, involving Port activity, airport activity, number of tourists, cement deliveries, construction permits, the number of car sales and imports. May be the 40% growth in imports over the past year is a proof of the improving domestic demand, in addition to the effects of global inflation (19% of imports growth is due to imported inflation and 21% is due to improving domestic demand). Imports actually amounted to US$ 19.0 billion in 2022, very close to the US$ 19.2 billion recorded in 2019 prior to the crisis.

The touristic season was particularly strong in 2022 with 65% more tourists relative to the year 2021, while flight and hotel reservations were close to full during summer and Christmas holiday. Remittance inflows amounted to US$ 6.8 billion in 2022, against US$ 6.4 billion in 2021, growing by 7% year-on-year. A large number of companies are increasingly paying salaries in fresh dollars which is supporting consumption.

Of course, the economy is far from bridging the gap created over the past two years which requires deep reforms, IMF agreement and international assistance to ultimately lessen the huge socioeconomic pressures on households.

At the monetary level, the Lebanese Pound continued its downward spiral against the US dollar on the black FX market in 2022, reaching new historical lows of LP/US$ 43,300 at year-end as compared to LP/US$ 27,500 at end-2021, despite all exceptional measures adopted by the Central Bank of Lebanon to curb currency swings, a Staff-Level Agreement reached with the IMF last April and the historic maritime border agreement signed last October. This is mainly explained by a darkened domestic political outlook, a multilayered political vacuum, a large expansion in the money in circulation, a continuous FX reserves burn and as BDL completely freed the "Sayrafa" platform from the burdens of financing gasoline imports.

At the banking sector level, banking sector statistics for 2022 suggest a lower contraction in customer deposits relative to the one reported in the previous year, a continuing deleveraging of banking sector loans to the private sector, a further contraction in banks' Eurobond portfolio and an additional retreat in shareholders' equity amid persistent bank losses. Shareholders' equity went down to US$ 18.3 billion at end-December 2022, bearing in mind that they had reached a peak of US$ 20.6 billion in October 2019 at the onset of the crisis. The drop in equity is the result of banks' net losses over the period. Losses are related to the FX costs, the surge in operating expenses as a result of inflation and the significant provisions against private and public sector risks at large.

With respect to capital markets, performance was uneven in 2022. On the equity market, the BSE continued to register strong price gains of 37% in 2022 amid investor tendency to avoid haircuts on their financial placements, noting that equity prices are denominated in domestic US dollars. At the level of the Eurobond market, sovereign prices plunged deeper into the red amid a protracted institutional void that is expected to delay an agreement on crisis resolution and much-needed reforms, in addition to bets of low recovery rates below 20%.

The developments in the real sector, external sector, public sector and financial sector for 2022 will be analyzed thereafter while the concluding remarks are left to a preliminary assessment of the 2023 macro outlook under various politico-economic scenarios.

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1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Slightly recovering primary and secondary sectors

The agriculture and industry sectors, which have been under pressure due to their heavy reliance on raw material, the spillovers of the depreciation of the currency and the increase in prices globally, took a relative respite recently due to a slightly recovering demand component amid the emergence from the previous year's Corona lockdowns.

Industrial imports, a mirror image of domestic demand for industrial goods, rose by 42.6% in the year 2022 to report US$ 17.3 billion. Industrial exports, a mirror image of foreign demand for domestically produced industrial goods fell by 4.5% over the same year to register US$ 3.1 billion.

Agricultural imports, a mirror image of domestic demand for agricultural goods, rose by 16.7% in 2022 to report US$ 1.8 billion. Agricultural exports, a mirror image of foreign demand for domestically produced agricultural goods dropped by 37.7% over the same year to circa US$ 0.4 billion.

According to data gathered by the Lebanese Center for Research and Agricultural Studies (CREAL) released in the third quarter of 2022 but for full-year 2021, the total value of Lebanon's agricultural production—meaning the amount that farmers earned from selling their produce — currently stand at about US$ 1.3 billion, though down from more than US$ 1.9 billion in 2018 and 2019.

A development with important spillovers on the primary and secondary sectors is the raising of the customs dollar. The budget 2022 entailed raising the customs dollar from the official exchange rate to around LL/US$ 15,000. The customs dollar refers to the LL/US$ exchange rate used to compute the customs duties on imported products.

In our opinion, there are pros and cons to this customs dollar measure. At the level of pros, we mention reducing imports and thus trade deficit (that are not anymore sustainable given the decline in inflows to Lebanon) foster domestic production and support the productive economic sectors such as agriculture and industry and bringing revenues for the Treasury and thus reducing fiscal deficit, which would reduce the monetization volume on behalf of the Central Bank and thus reduce money creation. At the level of cons, raising the customs dollar would create further inflation in Lebanon that is already at a three-digit rate for the past three rates, in addition to increasing smuggling and customs evasion, unless it is accompanied by very strict measures to combat evasion at all borders.

Finally, Lebanon's primary and secondary sectors are still operating well below potential, despite the relative improvement in the year 2022. A tangible revitalization of the productive sectors requires conducive overall operating environment and supportive policies on behalf of the State that has neglected for long the domestic productive apparatus while favoring imports that gradually dampened the stock of net foreign assets of the financial system across years.

1.1.2 Construction

Realty sector majorly affected by the increased real dollarization of the market

The realty market in Lebanon noticed a substantial decrease in demand in 2022 as the sale of property has become fully valued in fresh cash dollars. In the years prior, buyers could utilize bank checks in the banks' FX rate for the purchase of realty but this has almost stopped in 2022. With the dollarization of the market, the number of interested buyers dwindled due to the scarcity of fresh dollar buyers. The total value of property

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sales in 2022 was recorded at LP 21.7 trillion (US$ 14.4 billion at the official FX rate of LP 1,507.5/US$). This figure denotes a 7.6% decrease year-on-year from total value of property sales of LP 23.4 trillion (US$ 15.6 billion) recorded in 2021. Number of transactions during 2022 were recorded at 147,038 which shows a 26.2% decrease year-on-year from figures in 2021. This in turn leaves the average value per property in 2022 at US$ 179,542 which marks an inflation of 27.1% year-on-year from the year prior. In parallel, sales operations in 2022 showed a 27.3% decrease year-on-year reaching 79,990 down from 110,094 in 2021.

The majority of regions in Lebanon saw a yearly increase in the value of sales transactions with the most significant movements being from the South (73.1%), Beqaa (38.7%), Beirut (37.8%) and Nabattiyeh (12.1%).

Beirut captured the biggest share of value of property sales with 39.4%, with the South (19.9%) and Baabda (10.9%) in second and third place respectively. Then follows Keserouan with 8.2%, Beqaa with 5.9%, Nabattiyeh with 4.3%, North Two with 3.5%, North One with 2.8% and Metn with 2.6%.

In parallel, market supply for residential buildings has been sluggish with the halting of construction projects following the start of the crisis in 2019, with a number of construction projects being interrupted. Amid construction cost inflation the purchasing power of both developers and buyers has been reduced. That being said, cement deliveries in the first nine months 2022 have increased by 10.0% against the level seen in the first nine months of 2021 reaching 1,547 thousand tons. This figure is still lower than the one noticed before the crisis but marks the first increase following the downward trend seen since 2019.

It is worth noting that the supply in the market is still somewhat increasing as some developers are continuing their work due to apartment sales that were executed prior to the start of the crisis.

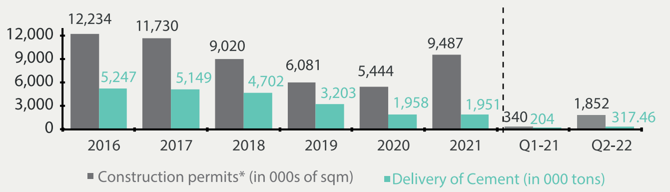
It is worth mentioning that Lebanon's banks' portfolio of loans in foreign currency has noticed a massive drop since the start of the economic crisis in October 2019. Total FX loans in banks dropped by 73.3% reaching US$ 10.2 billion at end-December 2022 down from US$ 38.1 billion at end-October 2019. This is due to loan holders' settlement of debt in local dollars, which includes property owners as well. Within this context, realty sellers in Lebanon are increasingly seeking to sell their remaining property in fresh US Dollars.

The aforementioned fact along with the scarcity of interested buyers willing to pay in fresh dollars has created a disparity between the supply and demand in the realty market. In turn, this has put adverse effects on price trends which led to a reduction in real estate prices in fresh dollars by more than 50% since the onset of the crisis back in 2019. It is worth also noting that the 50% average cut is uneven across regions as some regions have witnessed a decline of 70% amid the lack of buyers in fresh dollars. On the other hand some other regions are faring relatively better, with an average decline not exceeding 30% in fresh dollar terms, mainly in Beirut and direct suburbs.

CONSTRUCTION

	2021		2022		Variation	
	Q4-21	2021	Q4-22	2022	Q4/Q4	22/21
Value of property sales (in millions of US$)	5,005	15,550	5,190	14,362	3.7%	-7.6%
Number of property sales	38,514	110,094	23,490	79,990	-39.0%	-27.3%
o.w. Sales to foreigners	466	1,467	249	830	-46.6%	-43.4%
Average value per property sale(in US$ 000)	130	141	221	180	70.0%	27.1%
Property taxes (in millions of US$)	283	788	390	1,045	38.1%	32.6%

EVOLUTION OF CONSTRUCTION INDICATORS



*Figures are for first two months of the year 2021 & 2022

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1.1.3. Trade and Services

Tertiary sector on an improving trend in 2022

Lebanon's tertiary sector has seen an improved performance in 2022 as compared with 2021. This comes amid the resumption of economic activity in the country as well as an increase in tourism. Figures from the Beirut International Airport (BIA), Port of Beirut (PoB) and Port of Tripoli (PoT) have posted positive variations in activity year-on-year. Tourism has also shown a trend of improvement during the year with increases year-on-year in occupancy rate and revenue per room in Lebanon's 4 and 5 star hotels.

Number of aircraft landings and take-offs from BIA has shown a year-on-year increase of 32.0% reaching 52,495 in 2022, up from 39,777 in the previous year. Arrivals and departures have also witnessed a 48.0% hike year-on-year reaching 6,329,747 passengers in 2022, up from 4,276,847 passengers in 2021. This surge in activity is the best performance seen in the airport since 2019. The main driver standing behind the improvement of BIA's performance is a successful tourism season in summer and during the Christmas season. Arrivals and departures during the summer season (from June to September) in addition to those in December reported a number of 3,380,240 passengers or 53.4% of the total activity throughout 2022.

At the level of the ports, PoB posted an increase of 2.1% year-on-year in the number of ships reaching 1,193 in 2022, up from 1,168 in 2021. In parallel, PoT has noticed a significant increase in the number of ships reaching 825 ships in the first 11 months of 2022, up from 677 ships in the same period of 2021 showing a 21.9% jump.

Freight activity in PoB has increased in 2022 by 9.1% against 2021 reaching 5,069 thousand tons of merchandise. PoT freight activity has hiked by 38.7% year-on-year reaching 3,194 thousand tons in the first 11 months of 2022 against 2,303 thousand tons in the same period of the previous year. On the other hand, BIA has recorded a 12.0% decrease in freight activity in 2022 reaching 59.7 thousand tons down from 67.9 thousand tons in 2021.

At the level of tourism, as per GlobalBlue, the firm that reimburses VAT to tourists at Lebanese border points, transactions by tourists in Lebanon whose VAT was claimed and which gives a fair view about tourists' shopping trends has negligibly increased by 0.5% in 2022 as compared with 2021. Although the number of transactions has slightly improved, the spending of tourists has decreased significantly by 19% due to the fact that the majority of transactions (57%) are worth less than EUR 300. Tourists coming from the UAE were the highest spenders in the country and accounted for 17% of spending during the year, followed by Saudi Arabia and Kuwait with 6%, Syria and Qatar with 5% and Egypt with 4%. Fashion & clothing was the category that captured the highest amount of transactions with VAT reimbursed and accounted for 75% of the total. Beirut saw the highest amounts of transactions in the country with 62%, followed by Metn with 30%, Baabda & Aley with 6% and Kesserwan & Jbeil with 1%. Beirut was also the region that saw the biggest share of the spending with 82% of the total tourist spending with VAT reimbursed.

In more details, the hospitality sub-sector in Lebanon showed improved figures in the first 11 months of

TRADE AND SERVICES

	2021		2022		Variation	
	Q4-21	2021	Q4-22	2022	Q4/Q4	22/21
Number of ships at the port	283	1,168	316	1,193	11.7%	2.1%
Number of containers at the port (in 000s)	112	481	141	572	26.3%	19.0%
Merchandise at the Port (in 000 tons)	1,133	4,646	1,226	5,069	8.2%	9.1%
Planes at the Airport	11,077	39,777	12,907	52,495	16.5%	32.0%
Number of passengers at the Airport (in 000s)	1,205	4,277	1,509	6,330	25.2%	48.0%
Cleared checks (in millions of US$)	7,779	36,418	12,396	37,435	59.3%	2.8%

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2022 as compared with the same period of 2021, according to Ernst & Young's Middle East hotel benchmark survey for November 2022.

According to the survey, hotel occupancy rate for Beirut's 4 and 5 star hotels reached 49.6% in the first 11 months of 2022, with this figure showing a 7.1 percentage point increase year-on-year from the first 11 months of 2021. The average rate per room has also witnessed a negligible increase of 3.1% reaching US$ 46 in the first 11 months of 2022, up from US$ 45 in the same period of the last year. This lead the yield per available room (RevPAR) to increase by 20.3% in the aforementioned period of 2022. RevPAR reached US$ 23/available room in the first 11 months of 2022, up from US$ 19/available room in the same period of the previous year.

At the level of local spending, total value of cleared checks, an indicator of consumption and investment spending in the Lebanese economy expanded negligibly by 2.8% in 2022 against the previous year. The value of total clearing activity was noted at US$ 37,434 million in 2022, up from US$ 36,418 million in the previous year. In details, the breakdown of clearing activity by currency shows that cleared checks in local currency increased by 45.6% year-on-year to reach LP 40.9 trillion (US$ 27.1 billion) in 2022. On the other hand, cleared checks in foreign currency dropped by 42.1% to reach US$ 10.3 billion in 2022.

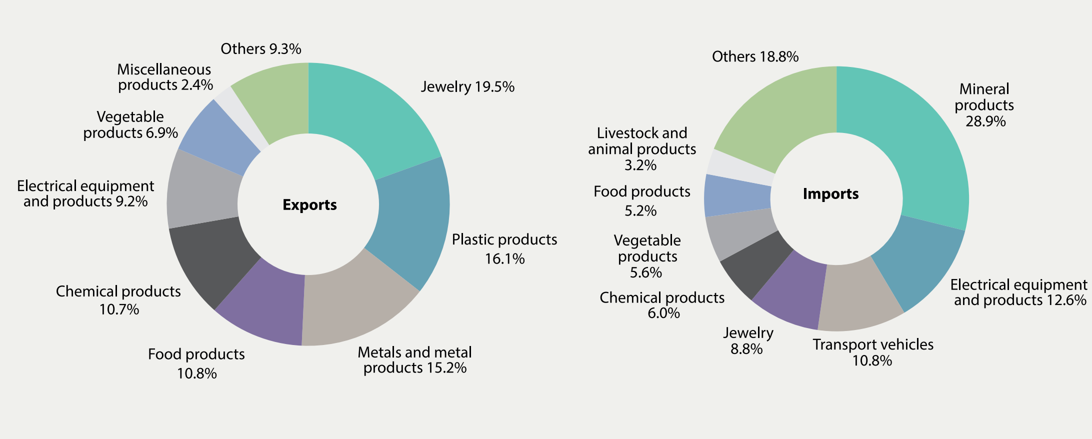
It is worth noting that, during 2022, the tertiary sector saw the reopening of famous hotels such as the Hilton hotel in Beirut. Also, the year 2022 saw the signing of an agreement between Cyprus and Lebanon for the former to build an underwater internet cable (CADMOS-2). This improving performance is expected to last in 2023 as more tourist attractions open back up, such as the sursouk museum which will reopen in the first half of the year. Having said that, if activity in the country picks back up again, it will be reflected positively on the trade and services sector performance at large.

1.2. EXTERNAL SECTOR

Imports up by 40% and exports down by 10% in 2022

External sector figures released for the year of 2022 suggest a 59.5% hike in trade deficit amid a 39.7% growth in imports, while exports decreased by 10.1% relative to the year 2021. In fact, imports grew from US$ 13.6 billion to US$ 19.1 billion between the two years, while exports decreased from US$ 3.9 billion to US$ 3.5 billion, thus generating a rise in the trade deficit from US$ 9.8 billion to US$ 15.6 billion. It is worth mentioning that the rise in imports is partly tied to global inflation, especially related to oil and commodity prices that surged significantly last year, but also suggests a slight improvement in domestic private demand.

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY (2022)



In details, the breakdown of imports by product reveals a rise in electrical equipment and products by 107.9%, followed by transport vehicles with 78.1%, shoes, hats and feathers with 66.4%, wood and wood products with 63.4%, paper and paper products with 55.0%, leathers and furs with 50.2%, metals and metal products with 45.9%, textiles and textile products with 44.3% and mineral products with 43.9%. On the other hand, the only item that has displayed a major decrease in imports was chemical products with -20.2% over the year 2022 relative to the year prior.

The breakdown of imports by country of origin over the same period shows that among the major partners, imports from India rose the most by 130.9%, followed by China with 111.8%, South Korea with 103.8%, UAE with 98.8%, Switzerland with 93.0% and Saudi Arabia with 79.2%. On the other hand, imports from Kuwait dropped the most by -85.7%, followed by Russia with -43.6%, Belgium with -20.6% and France with -11.1% over 2022 relative to last year.

In parallel, the breakdown of exports by product reveals a rise in plastic products with 230.8%, followed by shoes, hats and feathers with 68.7%, mineral products with 55.8%, cement and stone products with 30.1%, audiovisuals with 29.2% and weapons and artillery with 24.2%. On the other hand, the main items that have displayed major decrease in exports were miscellaneous products with -74.9%, live animal and animal products with -72.2%, antiques with -41.7% and vegetable products with -36.5% over the year 2022 relative to the year 2021.

The breakdown of exports by major countries of destination suggests that exports to Syria reported the most significant increase of 291.2% over the period, followed by Turkey with 73.3%, Congo with 30.2% and Iraq with 30.1%. On the other hand, exports to Saudi Arabia decreased the most by -100% over the same period, followed by Switzerland with -63.3%, Spain with -26.4%, Qatar with -25.9% and USA with -21.5% over the year 2022 relative to 2021.

It is worth mentioning that exports through the Port of Beirut represent the bulk of exports with US$ 1.6 billion over 2022, dropping by 21.7% relative to last year, followed by exports through the Airport with US$ 1.0 billion, declining by 19.6% when compared to previous year. Then comes land exports through Syria which reached US$ 479 million in 2022, surging by 164.6% relative to the previous year. Finally comes the exports though Port of Tripoli with US$ 308 million registering a rise of 5.8% over 2022 relative to 2021.

1.3. PUBLIC SECTOR

Delay in passing the 2022 budget does not bode well for a potential 2023 budget

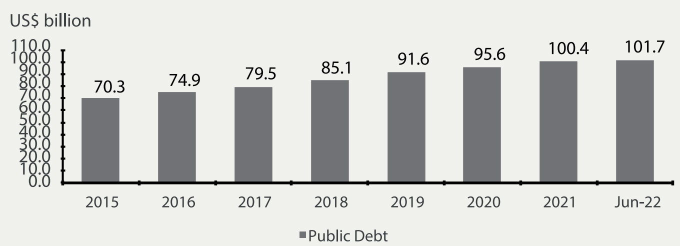
While no public finance figures are available yet for 2022, this section addresses the recently released 2021 public finances and the 2022 budget law. According to public finance figures released by the Ministry of Finance for year 2021, the overall fiscal balance reported a net surplus of LL 2,197 billion, against a deficit of LL 4,083 billion in year 2020. When deducting debt service, the primary balance recorded a surplus of LL 5,009 billion in 2021, against a primary deficit of LL 977 billion in 2020.

The surplus comes as a result of a 32.1% surge in revenues, against a 7.0% decline in expenditures over year 2021 relative to full year 2020. Public finance revenues moved from LL 15,342 billion to LL 20,263 billion.

SUMMARY OF FISCAL PERFORMANCE

LP million	2020	2021	Var 2021/2020
Total public revenues	15,341,876	20,262,795	32.1%
Total public expenditures	19,425,187	18,065,962	-7.0%
Total Cash Deficit / Surplus	-4,083,311	2,196,833	-
In % of Total Expenditures	-21.0%	12.2%	33.2%
Total Primary Deficit / Surplus	-977,129	5,009,435	-
In % of Total Expenditures	-5.0%	27.7%	32.8%

PUBLIC INDEBTEDNESS



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Public finance expenditures dropped from LL 19,425 billion to LL 18,066 billion.

The rise in public finance revenues is the result of a 37.4% rise in budget revenues, while Treasury revenues dropped by 11.8%. In turn, the rise in budget revenues is driven by a 45.5% increase in tax revenues, while non-tax revenues surged by 11.0%. The rise in tax revenues is driven by a 158.0% rise in VAT revenues, a 19.9% rise in customs revenues and an18.0% increase in property taxes, while miscellaneous tax revenues rose by 21.9% over the year 2021. On the other hand, the surge in non-tax revenues is totally due to Telecom revenues that increased by 21.1% between the two mentioned years.

The decline in public finance expenditures is the result of an 8.4% drop in budget expenditures, while Treasury expenditures rose negligibly by 3.5%. The drop in budget expenditures comes as a result of the 41.9% decline in Treasury advances to EDL in addition to a 10.6% drop in interest payments. FX interest payment actually fell by 71.1% (mainly tied to the State's default as of March of the previous year), while LL interest payments haven't witnessed any change.

It is within this environment the Parliament passed in November the budget for 2022, which calculates customs tax revenues at an exchange rate of 15,000 Lebanese pounds per U.S. dollar. The budget also calculates public expenditures at 41 trillion Lebanese pounds and revenues at 30 trillion Lebanese pounds. It is worth noting that the process for approving the 2022 budget has far exceeded the normal deadlines. Still, adopting a 2022 budget is one of the International Monetary Fund's preliminary offer of a multi-billion-dollar assistance package to Lebanon. Parliament did not pass a budget for the fiscal year 2021, and the delay in passing the 2022 budget does not bode well for a potential 2023 budget, which is approaching its constitutional deadline.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

LP on downward spiral amid darkened political outlook and tough reform challenges

The year 2022 saw the Lebanese pound plummet to new lows against the US dollar on the parallel FX market, which compounded with a large expansion in the money in circulation outside BDL and continuous FX reserves burn.

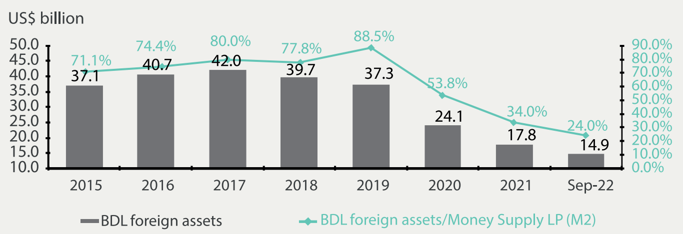
In details, the Lebanese pound continued its downward spiral on the black FX market over the year 2022, losing more than 50% of its value against the US dollar to reach LP/US$ 43,300 at year-end as compared to LP/US$ 27,500 at end-2021, and extended its free-fall early this year, topping the LP/US$ 60,000 level by the time of writing this report. This occurred despite all exceptional measures adopted by the Central Bank of Lebanon since late 2021 to curb currency collapse, allowing banks to purchase US dollar banknotes from BDL at the "Sayrafa" rate.

The Lebanese pound's unchecked nosedive against the greenback on the parallel market is mainly explained by a protracted multilayered political vacuum, worsened domestic political outlook, the slow progress in implementing IMF prior actions to secure much-needed international financial support, the full fuel subsidy removal since mid-September 2022, the shortage in foreign currencies because of the drop in inflows, a large money creation and dwindling FX reserves.

MONETARY SITUATION

Flows in US$ million	2021	2022	Progression
	Vol	Vol	Vol
Net foreign assets (excluding gold)	-1,992	-3,193	-1,201
Net claims on the public sector (excluding valuation adjustments)	-5,497	-11,384	-5,887
Claims on the private sector	-7,495	-7,049	446
Uses=Sources	**-14,984**	**-21,627**	**-6,643**
Money (M3)	682	18,900	18,218
Valuation adjustment and other items	-15,666	-40,527	-24,861

EXCHANGE MARKET INDICATORS



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In fact, the money in circulation outside BDL expanded significantly by LP 34 trillion over the year 2022, moving from LP 46 trillion at end-2021 to LP 80 trillion at year-end, fueling the free-fall of the Lebanese pound. The strong correlation between the black FX market rate and the currency in circulation is mainly reflected by a coefficient of determination of 71% between the two variables in 2022. Concurrently, the Central Bank of Lebanon's liquid FX reserves fell below the US$ 10 billion level at end-2022, on the back of a US$ 2.6 billion contraction in BDL's foreign assets over the year, which is mainly explained by the Bank's intervention on the FX market via the "Sayrafa" platform and a full deficit monetization on behalf of BDL.

In parallel, the financial system's total subscriptions in LP Treasury bills amounted to LP 12,155 billion in 2022, fully allocated to the Central Bank of Lebanon, and compared to total maturities of LP 13,928 billion, which resulted into a nominal deficit of LP 1,773 billion, the first since 2003. Despite BDL's continuous intervention on the Treasury bills primary market, the Central Bank's LP securities portfolio registered a LP 1,586 billion contraction over the year 2022, reaching LP 60,634 billion at year-end.

As to Certificates of Deposits, the total LP CDs' portfolio remained relatively stable in 2022, moving slightly from LP 43,177 billion at end-December 2021 to LP 43,147 billion at end-December 2022. This followed a large contraction of LP 2,034 billion in 2021.

In the coming period, should Lebanon witness a political breakthrough with the election of a new President and the formation of an efficient and functioning cabinet, and should all IMF prior actions be met to secure the Fund's Board of Directors approval of a US$ 3 billion facility, this would provide a relief to Lebanon's monetary conditions and help curbing currency swings, especially within the context of a unified multiple exchange rate regime.

1.4.2 Banking activity

FX deposits and FX loans both drop by US$ 28 billion since crisis onset

The cumulative banking sector analysis since the onset of Lebanon's financial crisis, i.e between October 2019 and December 2022, shows that FX deposits contracted by US$ 28.0 billion and FX loans dropped by US$ 28.0 billion respectively, while banks FX liquidity dropped by US$ 4.2 billion within the context of a cumulative balance of payment deficit of US$ 15.4 billion.

In details, total customer deposits contracted by US$ 42.7 billion amid noticeable withdrawals and loan redemption. They actually contracted from US$ 168.4 billion at end-October 2019 to US$ 125.7 billion at end-December 2022, the equivalent of 25.4%. FX Deposits contracted by US$ 28.0 billion over the three-year period to reach US$ 95.6 billion, while LL deposits dropped by LL 22.0 trillion to reach LL 45.4 trillion as at end-December 2022. As a result, deposit dollarization went up from 73.4% in October 2019 to 76.1% in December 2022.

BANKING ACTIVITY

in millions of US$

	Q1-21	Q2-21	Q3-21	Q4-21	2021	Q1-22	Q2-22	Q3-22	Q4-22	2022
Var: Total assets	**-1,780**	**-5,184**	**-1,396**	**-4,859**	**-13,219**	**-2,127**	**-1,771**	**-3,916**	**2,046**	**-5,767**
% change in assets	-0.9%	-2.8%	-0.8%	-2.7%	-7.0%	-1.2%	-1.0%	-2.3%	1.2%	-3.3%
Var: Total deposits	**-2,191**	**-2,713**	**-1,747**	**-3,020**	**-9,671**	**-1,368**	**-930**	**-2,214**	**760**	**-3,751**
o.w. LP deposits	-256	-571	-55	211	-671	661	1,179	-576	2,188	3,451
o.w. FC deposits	-1,935	-2,142	-1,692	-3,231	-9,000	-2,028	-2,109	-1,638	-1,428	-7,203
% change in total deposits	-1.6%	-2.0%	-1.3%	-2.3%	-7.0%	-1.1%	-0.7%	-1.7%	0.6%	-2.9%
Var: Total credits	**-1,965**	**-2,338**	**-1,866**	**-2,284**	**-8,453**	**-1,753**	**-1,992**	**-1,686**	**-2,232**	**-7,664**
o.w. LP credits	-675	-692	-712	-411	-2,490	-545	-558	-496	-638	-2,237
o.w. FC credits	-1,290	-1,646	-1,154	-1,873	-5,963	-1,208	-1,435	-1,190	-1,594	-5,427
% change in total credits	-5.4%	-6.8%	-5.9%	-7.6%	-23.4%	-6.3%	-7.7%	-7.0%	-10.0%	-27.7%

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In parallel, a cumulative decline in total loans by US$ 34.1 billion was reported amid bank deleveraging efforts. Lebanese banks have been deleveraging significantly since the onset of the crisis. Their loan portfolio dropped from US$ 54.2 billion to US$ 20.1 billion, the equivalent of 62.9%. The loan redemption represents 80% of the deposit contraction over the past three years. FX loans contracted by US$ 28.0 billion, while LL loans dropped by LL 9.3 trillion over the period. As a result, loan dollarization went down from 70.4% in October 2019 to 50.7% in December 2022.

LL deposit interest rate contracted by 843 basis points and US$ deposit interest rate dropped by 655 basis points since the onset of the crisis. The average LL deposit interest rate dropped from 9.03% in October 2019 to 0.60% in December 2022, while the average US$ deposit interest rate declined from 6.61% to 0.06% over the same period. The spread between US$ deposit rate and 3-month Libor reached close to -4.71% in December 2022, against +4.71% in October 2019.

A cumulative decline in banks FX liquidity abroad by US$ 4.2 billion was also reported. Lebanese banks' claims on non-resident financial sector dropped from US$ 8.4 billion at end-October 2019 to US$ 4.2 billion at end-December 2022. This comes as a result of the significant foreign liquidity usage by Lebanese banks to pay in cash for customers withdrawals at the beginning of the crisis period and more recently under BDL Article 158.

The decline in banks Eurobonds portfolio by US$ 11.9 billion since October 2019 comes amid net domestic sales and provisioning. Lebanese banks Eurobond portfolio reached US$ 2.9 billion at end-December 2022, against US$ 14.8 billion at end October 2019. The portfolio contraction is tied to banks net sales of Eurobonds at loss, mainly at the early months of the crisis, in addition to high provisioning requirements imposed by monetary authorities on bond portfolios.

Shareholders' equity contracted from US$ 20.6 billion in October 2019 to US$ 18.3 billion in December 2022 as a result of net bank losses over the period. The losses incurred by Lebanese banks come as a result of noticeable FX costs, the rising operating expenses tied to the surging inflation, in addition to significant provisions to face private and sovereign risks.

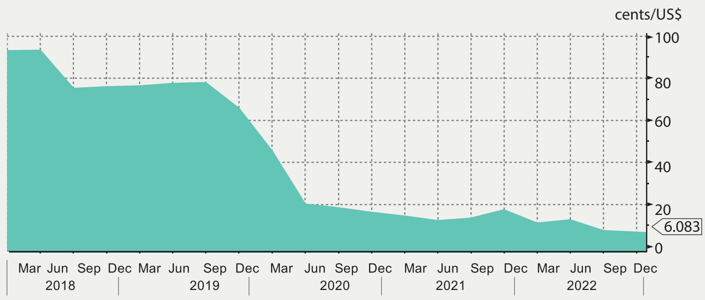
Finally, the balance of payments reported a cumulative deficit of US$ 15.4 billion over the past three years between October 2019 and December 2022. The deficit in the balance of payments is mainly tied to the decrease in net foreign assets of BDL over the period. The decline in BDL's net foreign assets is in turn related to the subsidy policy of the Central Bank for oil, pharmaceuticals and the food basket in the first couple of years, while it is related to its FX market intervention in the third year especially within the context of the Circular 161 since the beginning of the year.

FINANCIAL SECTOR (NON BANKS)

	2017	2018	2019	2020	2021	2022
Beirut Stock Exchange						
Market capitalization (In millions of US$)	10,578	9,117	7,540	7,176	10,625	14,578
Total trading volume (In millions of US$)	608	376	197	233	354	440
Annualized trading volume/Market capitalization	5.8%	4.1%	2.6%	3.2%	3.3%	3.0%
Price index	98.2	83.9	69.7	63.5	94.0	129.0
% change in index	-8.1%	-14.6%	-16.9%	-8.9%	48.1%	37.2%
Lebanese Eurobonds						
Total volume (In millions of US$)	26,123	30,964	28,314	31,314	31,314	31,314
Average yield	6.5%	10.0%	30.0%	57.0%	-	-
Average life (In number of years)	6.7	7.8	7.5	7.1	6.2	5.3
5-year CDS spreads variation (bps)	42	229	1,649	-	-	-

CAPITAL MARKETS PERFORMANCE

Long-term sovereign bond prices



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1.4.3. Equity and Bond Markets

Extended equity price rally in 2022 on hedging activity, bond prices plunging to mid-single digit levels on prolonged institutional vacuum and tough reform road

Lebanon's equity market continued to register strong price gains in domestic US dollar terms in 2022, as market players continued to flock to realty stocks to hedge against crisis. On the other hand, the Eurobond market plunged deeper into the red amid a protracted multilayered institutional void and tough reform challenges to reach a full fledge agreement with the IMF and unlock much-needed international financial support.

In details, following robust price gains registered in 2021 (+48.1%), Lebanon's equity market continued to follow an upward streak over the year 2022, as reflected by a 37.2% surge in the BSE price index, mainly driven by a strong price rally in Solidere shares, bearing in mind that equity prices are denominated in domestic US dollars.

A closer look at individual stocks shows that Solidere "A" and "B" share prices skyrocketed by 86.5% and 81.1% respectively in 2022, topping the US$ 60 level to close at US$ 60.90 and US$ 60.35 respectively at year-end. This brought total price gains in Solidere shares to 1,017.4% and 987.4% respectively since the onset of the crisis, as market players continued to seek to hedge against crisis and avoid haircuts on their financial placements.

On the other hand, banking stocks recorded an average price decline of 9.1% in 2022. In fact, Bank Audi's "listed" shares and GDRs, BLOM's "listed" shares and GDRs, Bank Audi Preferred "I" and "J" shares, Bank of Beirut's "listed" shares, BLC Preferred "D" shares, Byblos Bank's "listed" shares and Byblos "Preferred 2008" shares posted price drops ranging between 2.3% and 36.7%, while BEMO's "listed" shares registered price rises of 9.1% in 2022. Amongst industrials, Ciments Blancs Nominal's share price jumped by 109.1%, followed by Holcim Liban's shares with +60.4%.

Strong equity price gains on the Beirut Stock Exchange over the year 2022 were coupled with increased price volatility. In fact, the price volatility, measured by the ratio of the standard deviation of prices to the mean of prices, reached 15.0% in 2022 as compared to a lower price volatility of 11.2% in 2021.

The market capitalization on Lebanon's equity market was at the image of BSE price gains, registering an expansion of 37.2% in 2022, moving from US$ 10,625 million at end-December 2021 to US$ 14,578 million at end-December 2022, noting that RYMCO shares whose market capitalization represents less than 1% of the total BSE market capitalization were delisted on July 1, 2022.

As to trading volumes, the BSE total turnover amounted to US$ 440.0 million in 2022 as compared to US$ 354.1 million in 2021, up by 24.2%, noting that Solidere shares captured the lion's share of activity (95.2%), followed by the banking shares with 3.9% and the industrial shares with 0.9%. Accordingly, the BSE total turnover ratio, measured by the annual trading value to market capitalization, reached 3.0% in 2022, down from 3.3% in 2021.

On the other hand, Lebanese Eurobond prices converged to mid-single digit levels of 5.50-5.88 cents per US dollar at end-2022 as compared to 9.88-10.63 cents per US dollar at end-2021. This followed large price drops registered in 2020 after Lebanon has defaulted on its foreign debt payment on March 9, 2020. The uncurbed free-fall in Lebanese Eurobonds came within the context of a long-simmering institutional void, fragmented Parliament, lingering reform uncertainties, and bets about low recovery rates of less than 20%. In fact, Lebanon still needs to meet IMF prior actions to unlock much-needed international financial support, namely unifying exchange rates, securing the final vote of the Parliament on the long-awaited capital control draft law after the Joint Parliamentary Committees have approved it mid-January 2023, and enacting an appropriate emergency bank resolution legislation to implement the bank restructuring strategy.

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Under these conditions, Goldman Sachs said in a recent report released late 2022 that it could be many months before a functioning government is restored, and even then, its ability to push through Parliament the necessary prior actions to secure an IMF deal is doubtful, adding that the slide of the pound and the ongoing economic uncertainties make estimates of recovery values exceptionally uncertain. Based on a scenario in which the IMF program is finalized in 2023, Goldman Sachs thinks restoring debt sustainability in Lebanon would require a deep haircut of around 80% of the face value of the outstanding Eurobonds.

CONCLUSION: WHERE DO WE GO FROM HERE?

It was normal that the cumulative developments of the past three years, on the back of large structural and financial imbalances in the country amid bad State management for decades, severely impact economic, banking and financial conditions in the country and plunge Lebanon into an acute financial crisis that the World Bank characterized as the third worse crisis at the global level since the mid 19th century.

As a result of all those developments, the following trends were actually reported since the onset of the crisis:

Lebanon's real economy contracted drastically over the past three years, with GDP moving from US$ 53 billion in 2019 to US$ 22 billion today, i.e a nominal contraction of 58.5%, resulting in one of the sharpest contraction in income per capita worldwide in decades. The evolution of Lebanon's real sector indicators, of which lagging, coincident and leading indicators, mirrors the sluggish economic conditions over the period. The evolution of BDL coincident indicator (59.4% average contraction since 2019), which is a weighted average of a number of real sector indicators that are believed to coincide with economic activity, likewise mirrors the acute contraction in real economic activity over the three-year period.

The downturn in the real economy had adverse effects on labor market conditions. With the economy slowing down, then entering into recession and then depression, increasing levels of unemployment started to materialize. According to the Central Administration for Statistics, unemployment reported a peak of 30% in 2022 (up from 11.4% pre-crisis), with the youth unemployment rate (47.8%) almost twice the adult unemployment rate (25.6%). Should economic conditions worsen further in the domestic market, there is a risk of even more elevated unemployment, which would quickly feed through into a weaker spending outlook.

At the monetary level, the Lebanese Pound depreciated by 97% since October 2019. Significant money creation, full deficit monetization on behalf of the Central Bank, scarcity of US dollars in the market because of the drop in inflows, all lead to severe currency depreciation along with a drastic decline in FX reserves at the Central Bank. The Currency in circulation got multiplied by eight times over the past three years, moving from below LL 10 trillion to above LL 80 trillion. In the absence of structural reforms that reestablish the equilibrium between the LL Stock and US Dollar stock, the exchange rate is likely to maintain its volatile behavior.

It is worth mentioning that the depreciation of the exchange rate has very significant inflationary spillovers, which increased the proportion of households below the poverty line to around 74% today against a global average of around 28% (36% live below the "extreme" poverty line in Lebanon against a global average of 9%). The cumulative inflation reached circa 1,500% since October 2019. While the World in general has seen a noticeable rise in inflation over the past year driven by the release of excess savings accumulated during the pandemic which fueled private spending compounded with the spillover effects of the Russian-Ukrainian war, Lebanon is definitely an outsider at the global level, with Lebanon's inflation reporting three-digit rates. Comparatively, global inflation stood at 8.8% in 2022 according to the IMF's World Economic Outlook.

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Looking forward, the country seems on a crossroad, either recovery or collapse.

In case of a positive political-economic scenario, the economic and social pressures will start to ease, and the country will begin to recover from its acute depression to register circa 5% of real GDP growth, an inflation rate of less than 30% amid relative stability in the exchange rate. Such a positive scenario revolves around the election of a new President as soon as possible, and the formation of a credible and efficient cabinet, followed by a full fledge agreement with the IMF on the basis of the Staff-level agreement reached last April, after meeting the prior actions to secure the Fund's Board of Directors approval. This scenario would be reinforced in the medium and long-term with the prospects of gas production (especially with the completion of the maritime border demarcation), which improves Lebanon's external position, its fiscal deficit, and its economic prospects at large.

As for the adverse scenario, it supposes that a status-quo would continue to prevail, hinging upon the lingering postponement of Presidential elections, a persisting cabinet formation gridlock, the absence of reforms, and the failure to meet IMF requirements and reach a final program with the Fund. This scenario would lead to deepened economic recession with negative real GDP growth, a severe currency collapse amid dwindling foreign exchange reserves, a large LP money creation, hyperinflation in consumer prices, and severe socio-economic pressures on Lebanese households.

Between the two scenarios rises the Medium scenario, based on the election of a president, the formation of a new cabinet, yet with no implementation of reforms, no conclusion of a final agreement with the IMF and inconclusive results for gas exploration. Within this scenario, economic and monetary results for 2023 suggests a real GDP growth close to that of last year, i.e in the vicinity of 2%, an inflation rate of 80%, a slight decline in BDL reserves and a moderate balance of payments deficit.

In light of this paradox, it is hoped that political authorities would rise above their narrow interests, foster their common grounds, reduce differences and bickering, and embark onto settlement and reforms at large.

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