

## TABLE OF CONTENTS

Executive Summary	1
Introduction	2
Economic Conditions	3
Real Sector	3
External Sector	7
Public Sector	7
Financial Sector	9
Concluding Remarks	12

## MACRO CLOUDINESS AMID POLITICO-ECONOMIC STATUS QUO AND REFORM STAGNATION

### Economic uncertainties, monetary pressures and exchange market drifts

The first few months of the year 2023 were characterized by a continuation of the Presidential Vacuum, the emergency care take nature of Cabinet meetings, the lingering legislation process and the freezing of prior actions needed for an IMF final agreement. Such a politico-economic status quo translated into macro uncertainties and cloudiness, intense monetary pressures and exchange market drifts. Household consumption remained sluggish, though slightly improving as evidenced by the rise in imports. The investment aggregate as a percentage of GDP is at a low unseen for long, as investors are refraining from taking investment decisions amid significant domestic politico-economic uncertainties.

### Surplus in the balance of payments this year

At the external level, the balance of payments recorded a surplus of US\$ 1,175 million over the first three months of 2023, after a deficit of US\$ 3,197 million over full-year 2022. The surplus in the balance of payments over the first three months is the result of a US\$ 2,005 million expansion of banks' net foreign assets, coupled with BDL's net foreign assets contraction by US\$ 830 million. While no foreign trade figures for the first few months of 2023, the year 2022 had seen a significant growth in imports of 20%, while exports have declined by 10%, raising significantly the trade deficit after the relative contraction over the previous couple of years.

### Negative equity recognized by the Central Bank of Lebanon

A negative net equity is now recognized by the Central Bank in its bimonthly balance sheet. While BDL's capital accounts stand at US\$ 700 million, BDL introduced (on the asset side) a Valuation adjustment of US\$ 35 billion and other assets of US\$ 11 billion, leading to negative equity of -US\$ 45 billion, without accounting for potential losses on State lending and eurobond portfolio holdings, thus leading to overall BDL losses of circa US\$ 63 billion.

### Banks' FX Deposits contract by US\$ 30 billion and LP Deposits drop by LP 15 trillion since crisis onset

The cumulative banking sector analysis since the onset of Lebanon's financial crisis, i.e between October 2019 and March 2023, shows FX Deposits contracted by US\$ 29.5 billion over the period to reach US\$ 94.1 billion, while LP deposits dropped by LP 15.0 trillion to reach LP 52.4 trillion as at end-March 2023. FX loans contracted by US\$ 29.1 billion, while LP loans dropped by LP 9.8 trillion over the period. Lebanese banks' claims on non-resident financial sector dropped from US\$ 8.4 billion at end-October 2019 to US\$ 4.1 billion at end-March 2023. Shareholders' equity contracted from US\$ 20.6 billion at end-October 2019 to US\$ 4.9 billion at end-March 2023 as a result of net bank losses over the period.

### Priority for a 2023 fiscal budget on the basis of unified market exchange rate

At the public finance level, the Lebanese Cabinet has recently approved an additional increase in salaries for public sector employees and has increased the minimum wage threshold further to compensate for the Lebanese Pound depreciation. The government actually approved the addition of four salaries per month in addition to the two previous rises that were approved last September. In parallel, a Cabinet decision to raise the customs dollar FX rate was agreed on which increases it from LP 45,000/US\$ to reach LP 60,000/US\$. The customs dollar will be raised again in May to be unified with the "Sayrafa" exchange rate used by Banque du Liban (BDL). Imminent State priority should be towards enacting a 2023 reforming fiscal budget on the basis of unified market exchange rate.

### Electricity sector in focus: many reforms needed to restructure in a sustainable way

Many plans to reform the electricity sector have been put in place since 2010 with no real implementation. It is also clear that there will be no economic recovery without restructuring the electricity sector to provide cheap, clean and sustainable electricity. As at end of 2022, welcome measures were undertaken by the government, notably the tariff increase to 27 \$ cent/kwh. Furthermore, the ministry of energy and water has launched a call to appoint the executive members of the Electricity Regulatory Authority "ERA" in Lebanon. While the above steps are important, many other reforms are needed to restructure the sector in a sustainable way. These can be categorized in five policy action steps: (1) implementing governance and transparency reforms, (2) restoring the financial balance of EDL, (3) restoring EDL electricity supply, (4) supporting decentralized renewable energy and (5) initiating investments in the grid and new generation in a public-private partnership model "PPP".

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The first few months of the year 2023 were characterized by a continuation of the Presidential Vacuum, the emergency care take nature of Cabinet meetings, the lingering legislation process and the freezing of prior actions needed for an IMF final agreement. Such a politico-economic status quo translated into macro uncertainties and cloudiness, intense monetary pressures and exchange market drifts. Household consumption remained sluggish, though slightly improving as evidenced by the rise in imports. The investment aggregate as a percentage of GDP is at a low unseen for long, as investors are refraining from taking investment decisions amid significant domestic politico-economic uncertainties.

A glance on the economic performance of the early months of this year suggests that real sector indicators were at the image of a mixed economy on the overall, though tending to extended sluggishness. Among indicators with negative growth over the first quarter, we mention cleared checks with a contraction of 22.4% and the merchandise at the Port with a retreat of 2.7% year-on-year. Among indicators with positive growth, we mention the number of tourists with a rise of 29.0% the number of passengers at the airport with a rise of 24.0% and the number of aircraft landings and take-offs from BIA with an increase of 19.9%.

At the external level, the balance of payments recorded a surplus of US\$ 1,175 million over the first three months of 2023, after a deficit of US\$ 3,197 million over full-year 2022. The surplus in the balance of payments over the first three months is the result of a US\$ 2,005 million expansion of banks' net foreign assets, coupled with BDL's net foreign assets contraction by US\$ 830 million.

At the monetary level, the decline in BDL's FX reserves by US\$ 775 million over the first quarter is mainly the result of BDL intervention on the Sayrafa platform within the context of BDL Circular 161 initiated at 2021 year-end. A negative net equity is now recognized by the Central Bank in its bimonthly balance sheet. While BDL's capital accounts stand at US\$ 700 million, BDL introduced (on the asset side) a Valuation adjustment of US\$ 35 billion and other assets of US\$ 11 billion, leading to negative equity of -US\$ 45 billion, without accounting for potential losses on State lending and eurobond portfolio holdings, thus leading to overall BDL losses of circa US\$ 63 billion.

The early months of the year were also marked with a significantly rampant inflation. This March, the year-on-year index has surged by 366.3% compared to results of March 2022 according to the Consultation and Research Institute. The exchange rate exceeded for the first time the six-digit threshold amid politico-economic uncertainty, speculative activities and a continuing disequilibrium between the domestic currency mass and the foreign currency mass in the parallel market.

At the banking sector level, customer deposits contracted from US\$ 168.4 billion at end-October 2019 to US\$ 97.6 billion at end-March 2023, the equivalent of 42%. Deposit dollarization went up from 73.4% in October 2019 to 96.4% in March 2023. Lebanese banks have been deleveraging significantly since the onset of the crisis. Their loan portfolio dropped from US\$ 54.2 billion to US\$ 10.0 billion, the equivalent of 81.5%. Shareholders' equity contracted from US\$ 20.6 billion at end-October 2019 to US\$ 4.9 billion at end-March 2023 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 effects of mark-ups, the rising operating expenses tied to the surging inflation, in addition to significant provisions to face private and sovereign risks at large.

At the capital markets level, equity markets continued the noticeable surge of the past two years. The BSE price index rose by 33.3% in the first quarter of the year, following a 37.2% increase in the index in 2022, driven by the rise in Solidere shares. This year's rise in prices occurred within the context of a 138.8% annual increase in trading volume year-on-year, moving from US\$ 51 million in the first quarter of 2022 to US\$ 122 million in the first quarter of 2023. Consequently, the turnover ratio (annual trading value to market capitalization) increased from 2.0% to 2.5% between the two periods.

The developments in the real sector, external sector, public sector and financial sector for the first quarter of the year 2023 will be analyzed thereafter while the concluding remarks are left to an assessment of the electricity sector in its current conditions and challenges.

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## 1. ECONOMIC CONDITIONS

### 1.1. REAL SECTOR

#### 1.1.1. Agriculture and Industry

*Lebanon's primary and secondary sectors pressured by acute economic crisis and sharp currency collapse*

Lebanon's primary and secondary sectors continue to reel under the weight of an acute economic crisis, an uncurbed free-fall in the Lebanese pound against the US dollar, an increase in customs dollar and a heavy reliance on imports.

In details, the local agricultural output continues to suffer mainly from underdevelopment and poor management. Only 55% of the country's productive areas are currently being exploited, and even in these cultivated areas a high percentage of farmer yields are lost because of inadequate storage methods. Consequently, the country still heavily relies on imports. For instance, imports account for 100% of demand for sugar, rice, tea and coffee, while over 90% of meat requirements are met by imports, as per Fitch Solutions.

In parallel, agricultural inputs, which are mostly imported such as seeds and fertilizers, remained pressured by the sustained depreciation of the currency on the parallel FX market. Also, the sharp currency collapse, with the LP/US\$ black market rate topping the LP/US\$ 100,000 level at the end of the first quarter 2023, has been making farmers increasingly preferring to export their products abroad in exchange for hard foreign currencies, rather than selling them in the Lebanese market.

As to the local distribution market, it continues to suffer from the absence of government quality control, a lack of marketing regulations and competition from low-cost imports from neighboring countries. These issues need to be addressed, with the country's agricultural industry potentially able to make a greater contribution to the GDP, as per Fitch Solutions.

At the level of the industrial sector, manufacturers are facing several problems. Supply chain issues and bottlenecks are resulting in consumer goods shortages, feeding through into supply-side inflation. The increase in prices is pushing manufacturers to encounter shortages of key components and higher raw materials costs. This was exacerbated by a weak business environment, as Lebanon suffers from high levels of perceived corruption, burdensome procedures, weak infrastructure and shortages of basic services, including electricity.

A development with important spillovers on the primary and secondary sectors is raising the customs dollar. In fact, the Lebanese government has tripled the customs dollar on March 1, 2023, moving from LP/US\$ 15,000 to LP/US\$ 45,000, and lifted it further to LP/US\$ 60,000 over the April 18-30 period, before unifying it with the "Sayrafa" exchange rate in May 2023.

Looking forward, Lebanon would have to seek to reduce its reliance on imports and introduce initiatives to increase self-sufficiency. Within this context, attracting foreign investment in the agricultural and food processing industries would be a way towards achieving such self-sufficiency.

#### 1.1.2 Construction

*Realty sector performance on a downward trend caused by the dollarization of the market*

While no figures are yet available for the early months of 2023, the realty market in Lebanon had 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 had since 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 sales in 2022 denoted a 7.6% decrease year-on-year from total value of property sales recorded in 2021. Number of transactions

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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 increase of 27.1% year-on-year from the year prior. In parallel, sales operation in 2022 showed a 27.3% decrease year-on-year reaching 79,990 down from 110,094 in 2021.

The regions in Lebanon that saw the highest decreases in the value of sales transactions were the Metn (85.3%), Keserouan (42.9%), Baabda (42.5%) and North Two (32.4%). 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%, Nabattiye with 4.3%, North Two with 3.5%, North One with 2.8% and Metn with 2.6%.

Additionally, the total number of meters registered for new construction transactions reached 3,992,620 meters in 2022 which shows a 4.0% decrease from figures seen in 2021. Meters registered during the year for new construction additionally accounted for 53.7% of all meters registered for all transactions in 2022, against 53.5% in 2021. When dividing the number of meters registered between governorates, we notice that in 2022 Mount Lebanon took the biggest share (35.5%) followed by South Lebanon and Nabattiye with 30.1% and 17.3% of all meters registered for new construction respectively, as per data from the Order of Engineers and Architects of Beirut.

In parallel, the total number of transactions registered for new construction transactions reached 5,100 in 2022 which shows a 13.9% decrease from figures seen in 2021. Transactions during the year for new construction additionally accounted for 30.7% of all meters registered for all transactions in 2022, against 35.6% in 2021.

Concurrently, when it comes to the variation year-on-year in the number of transactions registered by governorate, we can notice that all governorates noticed a decrease. North Lebanon, South Lebanon and Nabattiye saw the largest decline in the number of transactions for new construction of 35.3%, 16.4% and 13.6% respectively when compared to figures from 2021. All the while, Beirut, Mount Lebanon and Bekaa also noticed a decline in the number of transactions for new construction of 13.3%, 11.2% and 8.9% respectively when compared to figures from 2021.

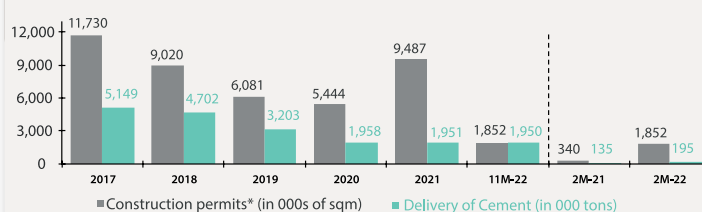
Amid the continued devaluation of the local currency paired with the dollarization of the majority of the Lebanese market, prices for housing have been soaring. In March 2023, the housing price index showed an inflation in prices of 1510.2% against prices in March 2022. This increase in prices discourages consumers from the purchase of property as maintenance, energy costs and water supply costs would burden them further along with the already high cost of buying real estate.

Having said that, 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 11 months of 2022 increased by 7.7% against the level seen in the first 11 months of 2021 reaching 1,950 thousand tons. This figure is still lower than those noticed before the crisis but marks the first increase following the downward trend seen since 2019.

## CONSTRUCTION

					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



\* two-month figures for 2022

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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.

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 76.3% reaching US\$ 9.0 billion at end-March 2023 down from US\$ 38.1 billion at end-October 2019. This is due to loan holders' settlement of debt in local dollars, this includes property owners as well. As such, 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 an average of 50% since the onset of the crisis back in 2019.

## 1.1.3. Trade and Services

### *Tertiary sector shows mixed performance in Q1 2023*

Lebanon's tertiary sector has seen a mixed performance in the first few months of 2023. This comes amid a relative recovery of activity in the country as well as an increase in tourism. Figures from the Beirut International Airport (BIA) posted positive variations in activity year-on-year, while Port of Beirut (PoB) posted negative variations during the period. Tourism has shown a mixed performance during the first quarter of the year with decreases year-on-year in occupancy rate and revenue per room in Lebanon's 4 and 5 star hotels during the period paired with an increase in activity in BIA.

Number of aircraft landings and take-offs from BIA has shown a year-on-year increase of 20.0% reaching 12,307 in Q1 2023, up from 10,261 in the same period of the previous year. Arrivals and departures have also witnessed a 24.0% increase year-on-year reaching 1,360,851 passengers in Q1 2023, up from 1,097,526 passengers in Q1 2022. This surge in activity is the best performance seen in the airport since Q1 2019. The main driver standing behind the improvement of BIA's performance is a successful tourism season in winter amid initiatives by the Ministry of Tourism to increase touristic inflows into the country through several campaigns.

According to the Department of Statistics at the Ministry of Tourism and in cooperation with private sector actor and unions in the field of tourism, arrivals and tourists brought US\$ 6.4 billion in net monetary mass into Lebanon in 2022 with the number expected to grow further. This came amid the reopening of multiple tourist facilities and attractions.

However, the Head of the Federation of Tourism Syndicates & of the National Tourism Council stated that tourism sector performance in the Easter-Eid season was lower than what was expected when it comes to hotel activity. The main drivers behind this sub-expectations performance are the low numbers of Egyptian and Iraqi visitors to the country as well as the fact that expatriates came to visit their homeland and mostly went out solely for domestic tourism in the weekends. In contrast however, the summer season of 2023 is expected to outperform that of 2022, as per the Head of the Federation of Tourism Syndicates & of the National Tourism Council.

At the level of the hospitality sub-sector, it showed a negative performance in the first two months of 2023

### TRADE AND SERVICES

	Q4-22	2022	Q1-22	Q1-23	Variation Q1/Q1
Number of ships at the port*	316	1,193	184	182	-1.1%
Number of containers at the port (in 000s)*	141	572	84	81	-3.4%
Merchandise at the Port (in 000 tons)*	1,226	5,069	818	796	-2.7%
Planes at the Airport	12,907	52,495	10,261	12,307	19.9%
Number of passengers at the Airport (in 000s)	1,509	6,330	1,098	1,361	24.0%
Cleared checks (in millions of US\$)	12,395	37,434	8,526	6,619	-22.4%

\*Two-month figures for the 1st quarter of 2022 and 2023



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as compared with the same period of 2022, according to Ernst & Young's Middle East hotel benchmark survey for February 2023.

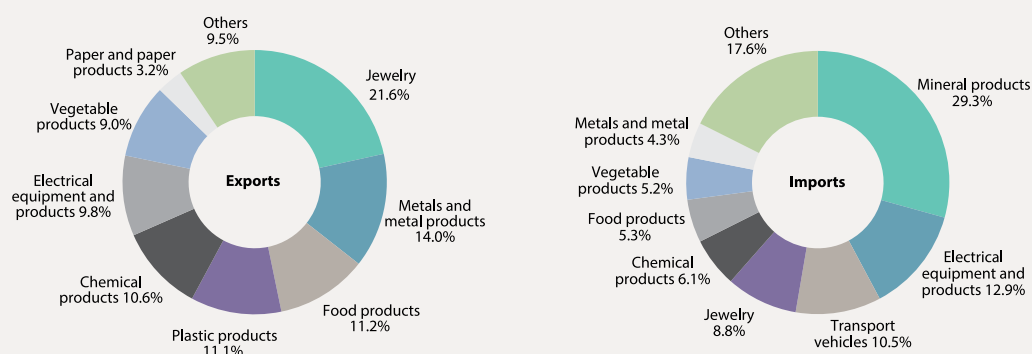
According to the survey, hotel occupancy rate for Beirut's 4 and 5 star hotels reached 36.2% in the first two months of 2023, that is a 2.8 percentage point decrease year-on-year from the first two months of 2022. The average rate per room however, witnessed a sharp decrease of 40.0% reaching US\$ 41 in the first two months of 2023, down from US\$ 69 in the same period of the last year. This led the yield per available room (RevPAR) to witness a 44.3% drop in the aforementioned month of 2023. RevPAR reached US\$ 15/available room in the first two months of 2023, down from US\$ 27/available room in the same period of the previous year.

It is worth noting that the factors that most affect tourism are security, stability, affordability and culture. Lebanon has become an affordable touristic country for foreigners due to the devaluation of the currency, however this has been slightly affected by the dollarization of the market and the increase of the customs dollar. Additionally, Lebanon is known for its hospitable and foreigner-friendly culture which positively affects the performance of the tourism sector. At the level of cons, the country finds itself in a political standstill and at times security drifts which affects the interior situation in Lebanon. Such factors could potentially affect the inflow of foreign travelers into the country while having little-to-no effect on the visit of expatriates or diaspora to Lebanon.

At the level of activity in PoB, a negligible decrease of 1.1% year-on-year was registered in the number of ships reaching 182 in the first two months of 2023, down from 184 in the same period of 2022. Freight activity in PoB has decreased marginally in the first two months of 2023 by 2.7% against the same period of 2022 reaching 796 thousand tons of merchandise. In parallel, BIA has recorded a 1.4% decrease in freight activity in Q1 2023 reaching 13.0 thousand tons down from 13.2 thousand tons in Q1 2022. However, it is worth highlighting that this negative trend in freight activity through BIA has been following a softening trend throughout 2022.

At the level of local spending, total value of cleared checks in LP, expanded sharply by 78.5% in Q1 2023 against the previous year. However, total value of cleared checks in foreign currency recorded a sharp decrease of 48.1% in the first quarter of 2023 against the same period of the previous year. Effective February 1st 2023, the Lebanese Pound noticed a re-peg and was set at LP 15,000/US\$ (up from LP 1,507.5/US\$ prior). In turn, this change in exchange rates has affected the total valuation of cleared checks as checks cleared in LP have to be turned into US\$ for a total valuation. Within this context, the total value of cleared checks, an indicator of consumption and investment spending in the Lebanese economy, recorded US\$ 6,619 million in the first three months of 2023 down by 22.4% from US\$ 8,526 million in the first three months of the previous year.

## BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY (2022)



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## 1.2. EXTERNAL SECTOR

### *Surplus in the balance of payments this year*

At the external level, the balance of payments recorded a surplus of US\$ 1,175 million over the first three months of 2023, after a deficit of US\$ 3,197 million over full-year 2022. The surplus in the balance of payments over the first three months is the result of a US\$ 2,005 million expansion of banks' net foreign assets, coupled with BDL's net foreign assets contraction by US\$ 830 million.

While no foreign trade figures for the first few months of 2023, the year 2022 had seen a significant growth in imports of 20%, while exports have declined by 10%, raising significantly the trade deficit after the relative contraction over the previous couple of years. The noticeable double-digit growth in imports is partly the result of imported inflation from global price pressures, but is also tied to a slight domestic increase in the demand for goods and services.

Looking at the breakdown of imports to Lebanon from other nations during 2022, we notice that China held the lion's share in Lebanon's imports with 14.0% of total imports. Turkey is the second highest exported to Lebanon with a share of 12.7%, followed by Greece (9.6%), Italy (5.6%), USA (5.1%), UAE (3.6%) and Germany (3.5%) in 2022.

When looking at the breakdown of imports by products during 2022, mineral products held the bulk of imports with a share of 29.3% of total imports. The second highest share was held by electrical equipment and products imports (12.9%) followed by transport vehicles (10.5%), jewelry (8.8%), chemical products (6.1%), food products (5.3%) and vegetable products (5.2%).

Looking at the breakdown of exports from Lebanon towards other nations during 2022, we notice that the UAE imported the largest amount of Lebanese products with a share of 21.4% of total exports. Syria is the second highest importer with a share of 10.2%, followed by Egypt (4.8%), Iraq (4.6%), Switzerland (4.5%), Qatar (4.2%) and Turkey (3.7%) in 2022.

When looking at the breakdown of exports by products during 2022, jewelry exports held the highest share with 21.6% of total exports. The second highest share was held by metals and metal product exports (14.0%) followed by food products (11.2%), plastic products (11.1%), chemical products (10.6%), electrical equipment and products (9.8%) and vegetable products (9.0%).

## 1.3. PUBLIC SECTOR

### *Priority for a 2023 fiscal budget on the basis of unified market exchange rate*

At the public finance level, the collapse in budget revenue has forced a drastic and disorderly cut of public spending to minimal levels. Still, the government relies on central bank financing, accumulation of arrears and some donor assistance to support a budget deficit of over 5% of GDP. The deficit could be even higher, if the ongoing quasi-fiscal operations by the central bank—such as provision of FX at subsidized rates—are included.

#### SUMMARY OF FISCAL PERFORMANCE (latest figures available)

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

Source: Ministry of Finance

#### PUBLIC INDEBTEDNESS



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Within the same context, the Lebanese Cabinet has recently approved an additional increase in salaries for public sector employees and has increased the minimum wage threshold further to compensate for the Lebanese Pound depreciation. The government actually approved the addition of four salaries per month in addition to the two previous rises that were approved last September. This entails that public sector employees will receive seven salaries monthly starting in June 2023. An increase in transportation allowance has also been approved and set at LP 450,000/day. However, public sector employees are to attend their work for a minimum of 14 days per month for the raise to apply and attendance should not exceed 18 days per month as to reduce costs incurred by the state through transportation allowance. In parallel, retired public sector employees will receive a further three salaries which in addition to the increase approved in September 2022 will add up to six salaries per month.

In parallel, a Cabinet decision to raise the customs dollar FX rate was agreed on which will increase it from LP 45,000/US\$ to reach LP 60,000/US\$. In parallel, the customs dollar FX rate on the import of used and unused cars, which was kept at LP 8,000/US\$ previously, was also raised to reach LP 15,000/US\$. The customs dollar will be raised again in May to be unified with the "Sayrafa" exchange rate used by Banque du Liban (BDL). It is worth noting that this raise comes following two prior increases, the first came at the start of February with the re-pegging of the LP to the US\$ at the rate of LP 15,000/US\$ which raised the customs dollar to the same level. The second raise, executed at the end of February, increased the customs dollar three-fold reaching LP 45,000/US\$ and increased the customs dollar on imported cars to LP 8,000/US\$.

In the concluding statement of its Article IV Consultation mission, the IMF recommends a medium-term fiscal strategy to restore debt sustainability and create space for increasing social and development spending. The first step should be to adopt a 2023 Budget that uses a unified market exchange rate for customs and tax purposes, adjusts specific taxes to inflation, and makes the first steps toward restoring public administration. The Budget should also provide the necessary funding for essential social spending and initiate important public sector reforms which over time would improve efficiency. In subsequent years, strengthening public finances would require revenue mobilization reforms focused on broadening the tax base, closing existing loopholes, and improving tax compliance across taxpayers through strengthened and modernized tax administration. The revenue mobilization effort is critical to support a gradual scale up of priority social and development spending to more appropriate levels. The overall fiscal strategy should be supported by reforms to eliminate SOE losses and phase out transfers from the budget, particularly to the energy sector, improve public administration, and advance sustainable pension system reforms. Gradual fiscal consolidation will be critical to complement the needed debt restructuring that should aim to reduce public debt to a sustainable level over the medium term.

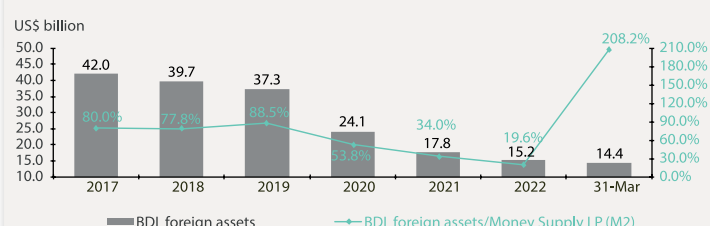
The IMF also recommends strengthening the public finance management (PFM) framework to ensure proper oversight of public finances, enhance fiscal discipline and improve transparency of budgetary process. The introduction of a modern PFM law would provide an overarching strategy for reforms that should include enhancing internal and external controls, formulating a medium-term fiscal framework, restricting the use of treasury advances and establishing a fully integrated treasury single account.

Last not least, the IMF recommends reforming state-owned enterprises to ensure good governance, transparency, financial and operational viability, better provision of services and to contain fiscal risks. Preparing a comprehensive inventory of SOEs and completing and publishing financial audits of the largest

## MONETARY SITUATION

Flows in US\$ million	1Q-22	1Q-23	Progression
	Vol	Vol	Vol
Net foreign assets (excluding gold)	-1,464	1,156	2,619
Net claims on the public sector (excluding valuation adjustments)	-2,196	-15,979	-13,783
Claims on the private sector	-1,679	-10,440	-8,762
<b>Uses=Sources</b>	<b>-5,338</b>	<b>-25,264</b>	<b>-19,926</b>
Money (M3)	-6,881	-71,822	-64,941
Valuation adjustment and other items	1,543	46,558	45,015

## EXCHANGE MARKET INDICATORS





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SOEs would be the first step, followed by development of an ownership strategy that would establish strategic purposes, and oversight and management principles of SOEs. Moreover, it will be critical to address long-standing issues in the electricity sector through swift implementation of sector reforms already approved by the cabinet in March 2022 as per the IMF.

## 1.4. FINANCIAL SECTOR

### 1.4.1. Monetary Situation

*Nosedive in LP amid multilayered institutional vacuum and poor track record in implementing reforms*

The first quarter of 2023 saw the historic devaluation of the currency peg to LP/US\$ 15,000, a nosedive in the Lebanese pound against the US dollar on the parallel market, continuous FX reserves burn and significant contractions in the money in circulation on the backdrop of the Central Bank of Lebanon's heavy dollar injection via the "Sayrafa" platform.

In details, the Lebanese pound continued its downward spiral against the US dollar on the parallel FX market over the first quarter of 2023, topping the LP/US\$ 140,000 level late-March 2023, before relatively recovering to LP/US\$ 107,500 at end-month, and stabilizing around LP/US\$ 97,000 over the month of April 2023 amid continuous BDL's intervention as a seller of cash US dollars to individuals and firms via the "Sayrafa" platform. This compared to a rate of LP/US\$ 43,300 at end-2022.

Lebanon's currency freefall against the greenback over the first quarter of this year came within the context of a prolonged institutional vacuum, growing domestic political uncertainties, and a poor track record in implementing reforms, which casted doubts on Lebanon's ability to secure much-needed international financial support, in addition to dwindling FX buffers. In fact, BDL's foreign assets contracted by US\$ 775 million over the first quarter of 2023, bringing liquid FX reserves down to circa US\$ 9.6 billion at end-March 2023. This is mainly attributed to BDL's dollar injection via "Sayrafa" and a full deficit monetization on behalf of BDL.

On the backdrop of BDL's heavy intervention via "Sayrafa", the money in circulation outside BDL contracted significantly by LP 15.3 trillion over the first three months of 2023 to reach LP 64.9 trillion at end-March. Within this context, it is worth mentioning that the correlation between the black FX market rate and the currency in circulation was quite weak in the first three months of 2023, as reflected by a coefficient of determination of 15% between the two variables.

In line with the rapid currency collapse on the parallel FX market, the Central Bank of Lebanon lifted the "Sayrafa" rate 18 times over the first quarter of 2023, moving from LP/US\$ 38,000 at end-2022 to LP/US\$ 90,000 at end-March 2023. This allowed the spread between the LP/US\$ Sayrafa rate and the black FX market rate to widen to circa LP 17,500 at end-March 2023 against LP 5,300 at end-2022.

In parallel, the financial system's total subscriptions in LP Treasury bills amounted to LP 3,027 billion during

### BANKING ACTIVITY

in millions of US\$				
	2021	2022	1Q-22	1Q-23
<b>Var: Total assets</b>	<b>-13,219</b>	<b>-5,767</b>	<b>-2,127</b>	<b>-53,911</b>
% change in assets	-7.0%	-3.3%	-1.2%	-
<b>Var: Total deposits</b>	<b>-9,671</b>	<b>-3,751</b>	<b>-1,368</b>	<b>-28,092</b>
o.w. LP deposits	-671	3,451	661	-26,606
o.w. FC deposits	-9,000	-7,203	-2,028	-1,486
% change in total deposits	-7.0%	-2.9%	-1.1%	-
<b>Var: Total credits</b>	<b>-8,453</b>	<b>-7,664</b>	<b>-1,753</b>	<b>-10,052</b>
o.w. LP credits	-2,490	-2,237	-545	-8,933
o.w. FC credits	-5,963	-5,427	-1,208	-1,119
% change in total credits	-23.4%	-27.7%	-6.3%	-

# Bank Audi

the first quarter of 2023, fully allocated to the Central Bank of Lebanon, and compared to total maturities of LP 3,209 billion, which resulted into a nominal deficit of LP 182 billion. Given BDL's continuous intervention on the Treasury bills primary market, the Central Bank's LP securities portfolio registered a LP 7,190 billion expansion over the first quarter of the year, reaching LP 67,825 billion at end-March 2023.

As to Certificates of Deposits, the total LP CDs' portfolio contracted by LP 4,601 billion over the first quarter of 2023 to reach LP 38,546 billion at end-March 2023, after remaining stable over the year 2022.

In the coming period, any relief to Lebanon's monetary conditions hinges on the implementation of a package of comprehensive reforms, including the unification of exchange rates, which would help restoring confidence and rebuilding credibility.

## 1.4.2 Banking activity

*FX Deposits contract by US\$ 30 billion and LP Deposits drop by LP 15 trillion since crisis onset*

The cumulative banking sector analysis since the onset of Lebanon's financial crisis, i.e between October 2019 and March 2023, shows the following trends:

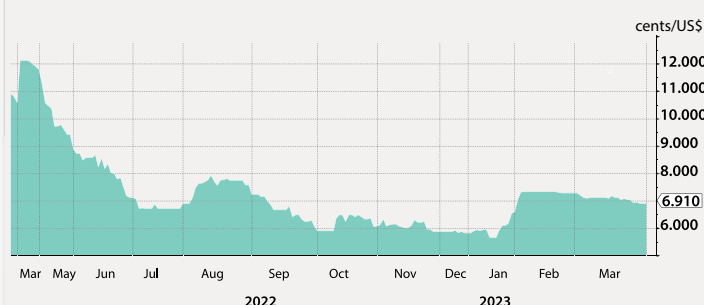
- A cumulative decline in total deposits by US\$ 70.7 billion amid noticeable withdrawals and loan redemption: Customer deposits contracted from US\$ 168.4 billion at end-October 2019 to US\$ 97.6 billion at end-March 2023, the equivalent of 42%. Resident deposits contracted by US\$ 56.7 billion, while non-resident deposits dropped by US\$ 14.0 billion. FX Deposits contracted by US\$ 29.5 billion over the period to reach US\$ 94.1 billion, while LP deposits dropped by LP 15.0 trillion to reach LP 52.4 trillion as at end-March 2023. As a result, deposit dollarization went up from 73.4% in October 2019 to 96.4% in March 2023.
- A cumulative decline in total loans by US\$ 44.2 billion 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\$ 10.0 billion, the equivalent of 81.5%. The loan redemption represents 62% of the deposit contraction over the period. FX loans contracted by US\$ 29.1 billion, while LP loans dropped by LP 9.8 trillion over the period. As a result, loan dollarization went up from 70.4% in October 2019 to 90.5% in March 2023.
- A cumulative decline in LP deposit interest rate by 840 basis points and in US\$ deposit interest rate by 654 basis points: The average LP deposit interest rate dropped from 9.03% at end-October 2019 to 0.63% at end-March 2023, while the average US\$ deposit interest rate declined from 6.61% to 0.07% over the same period. The spread between US\$ deposit rate and 3-month Libor reached close to -5.12% in March 2023, against +4.71% in October 2019.

## FINANCIAL SECTOR (NON BANKS)

	2017	2018	2019	2020	2021	2022	Mar-23
<b>Beirut Stock Exchange</b>							
Market capitalization (In millions of US\$)	10,578	9,117	7,540	7,176	10,625	14,578	19,433
Total trading volume (In millions of US\$)	608	376	197	233	354	440	122
Annualized trading volume/Market capitalization	5.8%	4.1%	2.6%	3.2%	3.3%	3.0%	2.5%
Price index	98.2	83.9	69.7	63.5	94.0	129.0	172.0
% change in index	-8.1%	-14.6%	-16.9%	-8.9%	48.1%	37.2%	33.3%
<b>Lebanese Eurobonds</b>							
Total volume (In millions of US\$)	26,123	30,964	28,314	31,314	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	5.2
5-year CDS spreads variation (bps)	42	229	1,649	-	-	-	-

## CAPITAL MARKETS PERFORMANCE

### Long-term sovereign bond prices



# Bank Audi

- A cumulative decline in banks FX liquidity abroad by US\$ 4.3 billion: Lebanese banks' claims on non-resident financial sector dropped from US\$ 8.4 billion at end-October 2019 to US\$ 4.1 billion at end-March 2023. 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.
- A cumulative decline of US\$ 12.0 billion in banks Eurobonds portfolio amid net domestic sales and provisioning: Lebanese banks Eurobond portfolio reached US\$ 2.8 billion at end-March 2023, 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.
- A cumulative decline in shareholders' equity by US\$ 15.7 billion amid banks' net losses: Shareholders' equity contracted from US\$ 20.6 billion at end-October 2019 to US\$ 4.9 billion at end-March 2023 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 effects of mark-ups, the rising operating expenses tied to the surging inflation, in addition to significant provisions to face private and sovereign risks at large.

## 1.4.3. Equity and Bond Markets

*Equities extend winning streak over the first quarter of 2023, bond prices remaining at record lows on prolonged political vacuum and deep-seated reform challenges*

Lebanon's equity market continued to follow an upward streak over the first quarter of 2023 amid a continuous flight to realty stocks to hedge against crisis. On the other hand, Eurobond prices remained at all-time lows as Lebanon is reeling under the weight of a Presidential vacuum and a caretaker cabinet, and given a very slow progress in implementing long-overdue reforms.

In details, following two consecutive years of robust price gains, the Beirut Stock Exchange pursued its winning streak over the first quarter of the year 2023, bearing in mind that equity prices are denominated in domestic US dollars. This was reflected by a 33.3% surge in the BSE price index and was mainly driven by a strong price rally in Solidere shares, as market players continued to flock to realty stocks to hedge against a multifaceted crisis and an unchecked currency collapse, while seeking to avoid haircuts on their financial placements.

A closer look at individual stocks shows that Solidere "A" and "B" shares remained at investors' radar screen over the first quarter of the year, mainly on hedging activity. Solidere "A" and "B" share prices soared by 44.3% and 42.6% respectively, hitting US\$ 87.85 and US\$ 86.05 respectively at end-March 2023. This brought accumulated price gains in Solidere shares to 1,512% and 1,450% respectively since the onset of the crisis on October 17, 2019.

On the other hand, banking stocks recorded a shy price decline of 0.6% on average over the first quarter of 2023. In fact, Bank Audi's "listed" shares and GDRs, BLOM's GDRs, Byblos Bank's "listed" shares and BEMO's "listed" shares registered price falls ranging between 0.7% and 11.3%, while BLOM's "listed" shares posted price rises of 12.8%. Amongst industrials, Ciments Blancs Nominal's share price jumped by 22.1%, followed by Holcim Liban's shares with +3.2% over the first quarter of 2023.

In line with strong equity price gains, the Beirut Stock Exchange was marked by increased price volatility. In fact, the price volatility, measured by the ratio of the standard deviation of prices to the mean of prices, reached 12.1% during the first quarter of 2023 as compared to a much lower price volatility of 1.2% over the first quarter of 2022.

In parallel, the market capitalization on Lebanon's equity market was at the image of BSE price gains in the absence of any listing or delisting activity, registering an expansion of 33.3% over the first quarter of 2023, moving from US\$ 14,578 million at end-December 2022 to US\$ 19,433 million at end-March 2023.

As to trading volumes, the BSE total turnover more than doubled year-on-year over the first quarter of 2023 to reach US\$ 121.5 million as compared to US\$ 50.9 million over the same period of 2022, noting that Solidere shares continued to capture the lion's share of activity (84.3%), followed by the banking shares

# Bank Audi

with 15.4% and the industrial shares with 0.3%. Accordingly, the BSE total turnover ratio, measured by the annual trading value to market capitalization, reached 2.5% over the first quarter of 2023, up from 2.0% over the first quarter of 2022.

At the level of the Eurobond market, Lebanese sovereigns remained at record lows over the first quarter of 2023, reaching 6.375 cents per US dollar at end-March, as compared to 5.750 cents per US dollar at end-2022. This came within the context of a protracted institutional vacuum, darkened domestic political outlook, bets about low recovery rates, and IMF's warnings that Lebanon would be mired in a never-ending crisis without the implementation of a package of comprehensive reforms revolving around (1) a medium-term fiscal strategy to restore debt sustainability and create space for increasing social and development spending, (2) credible restructuring of the financial system to restore its viability and support economic recovery, (3) unification of exchange rates and tightening monetary policy to rebuild credibility and improve the external position of the economy, (4) ambitious structural reforms to supplement economic policies and create an enabling environment for stronger growth, and (5) enhancing governance, anti-corruption, and anti-money laundering/combating the financing of terrorism frameworks to regain social trust of government policies and promote inclusive growth.

In the coming period, Lebanon's capital markets await a full-fledged reform program that would address Lebanon's deep-seated challenges and respond to IMF prior actions, which would unlock much-needed international financial support and lay the groundwork for constructive negotiations with bondholders, bearing in mind that Lebanese Eurobonds may not be recoverable without an IMF program.

## CONCLUSION: THE ELECTRICITY SECTOR IN FOCUS

We finally leave the concluding remarks to a focus on the power sector given its importance in Lebanon's economy of nowadays. For decades, "Electricité du Liban" (EDL) supply of electricity was reliant on government transfers which have racked up to over US\$ 43 billion over the last 30 years. Since the onset of the crisis, the government ability to support EDL has withered, hindering its ability to import fossil fuels. This has led to the quasi collapse of state electricity generation, with the gap being compensated by expensive and polluting private generators charging tariffs ranging from 50 \$ cent/kwh to 100 \$ cent/kwh in 2022.

Moreover, the heavy reliance on diesel fired private generators has resulted in a threefold increase in pollution levels affecting public health. EDL's collapse has also resulted in an increase in inequalities in the country. A Human Rights' report published in March 2023 estimates that around 45% of the Lebanese population does not have access to private generators due to their unaffordability. For those who have access, about 44% of nationwide monthly average income is spent on generator bills. The ratio increased to 88% for households in the bottom income levels. In other words, electricity has been turned from a basic human right to a luxury product; and consumption of electricity has been suppressed by more than 50% due to the unaffordability of electricity.

The private sector's main challenge today is the cost of electricity. The share of the electricity bill in total operating costs has more than tripled threatening business continuity, jobs, and competitiveness. Therefore, many companies and individuals opted to install solar power. About 600 MW of decentralized solar energy has been installed on rooftops during the crisis, bringing the total installed gross capacity to 690 MW as at end of 2022 according to the Lebanese Center for Energy Conservation "LCEC". This has been achieved without the proper regulatory framework nor significant financing channels, representing a capital investment exceeding \$500 million.

We also estimate that demand has fallen in line with real GDP contraction from an average of 2,700 MW in 2019 to 2,100 MW in 2022. This, alongside the rapid scale up of decentralized renewable energy, will undoubtedly affect sector planning and the resulting least cost energy mix.

Many plans to reform the electricity sector have been put in place since 2010 with no real implementation. It is also clear that there will be no economic recovery without restructuring the electricity sector to provide cheap, clean and sustainable electricity. As at end of 2022, welcome measures were undertaken

# Bank Audi

by the government, notably the tariff increase to 27 \$ cent/kwh. It is worth noting that the tariff had been unchanged since 1996, which was set at an average of 9.6 \$ cent/kwh at the peg rate of 1,500 LBP/USD. Furthermore, in December 2022, the ministry of energy and water has launched a call to appoint the executive members of the Electricity Regulatory Authority "ERA" in Lebanon.

While the above steps are important, many other reforms are needed to restructure the sector in a sustainable way. These can be categorized in five policy action steps: (1) implementing governance and transparency reforms, (2) restoring the financial balance of EDL, (3) restoring EDL electricity supply, (4) supporting decentralized renewable energy and (5) initiating investments in the grid and new generation in a public-private partnership model "PPP".

First, Governance and transparency measures are critical to restore trust and unlock the needed investments in the sector. These measures include the conclusion of an IMF program, the appointment of an independent and competent ERA, the adoption of a least cost generation plan which is updated for the current status of the sector, the application of the public procurement law in contract award and the completion of the audit of EDL.

It is also imperative to secure the financial balance of EDL to restore electricity production. While setting a cost recovery tariff is important, it needs to be accompanied by reforms on collection and billing. Certain example include digitizing billing, rolling out smart meters and prepaid cards, making the collection cycle current and adopting a new distribution model with the support of the private sector, whereby EDL sells to private companies similar to Electricite de Zahle who then on-sell to consumers.

EDL has a net generation capacity of 1,100 MW with its current fleet of power plants; after accounting for 17% technical losses on the grid. With current estimated average demand of 2,100 MW, and when adding 144 MW of net distributed solar energy (assuming a 21% efficiency), EDL plants could supply up to 14 hours of electricity per day. It is therefore imperative to restore EDL's electricity production by securing short term financing lines of credit for the purchase of fuel and payment of maintenance from development banks or the World Bank, which will be repaid from the collection of bills. Moreover, concluding the gas import deal from Egypt and 250 MW electricity purchase from Jordan could increase the hours of supply by 3 hours bringing the total to 17 hours per day.

The surge in decentralized solar installations was a byproduct of the crisis, with consumers looking to reduce and stabilize their cost of electricity and achieve energy security. In order to ensure a proper regulatory governance framework and to further support this scale up, the government should enact the distributed renewable energy law allowing installations up to 10 MW by the private sector, in addition to net metering, power wheeling, private to private power purchase agreements etc. Moreover, there should be more transparency in the environmental and regulatory framework with the setting up of a specialized department within EDL and the ministry of energy to deal with permitting and approvals. Specialized financing envelopes by development banks will also help unlock further investments by the private sector.

Finally is the Investment in the grid and new generation. Lebanon needs to add about 1,500 MW in gas fired power plants to meet its energy demand, to reinforce the grid and invest in new gas import facilities. This investment is critical to manage the intermittency of the large scale renewable energy projects and achieve grid stability. The energy mix would be defined by the updated least cost generation plan, and is expected to include two gas fired power plants and about 4,500 MW of renewable energy power over the next 10 years for a total investment of approximately US\$ 6-7 billion; mostly financed by the private sector and development banks at large.