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LEBANON ECONOMIC REPORT

3RD QUARTER 2022

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AN ALTERNATIVE ECONOMIC MODEL TO BE SOUGHT?

Maritime border demarcation representing noticeable breakthrough, with positive long term effects While the country embarked on presidential elections, yet without a settlement seen at the horizon, Lebanon has finalized on a number of milestones, the most important of which being the Southern border maritime settlement and the ratification of Government Budget 2022. The maritime deal could enhance long-term economic prospects and improve the country's external position which is positive for Lebanon's credit profile but implementation risks remain significant. Having said that, it will take no less than three to four years to start having economic benefits for Lebanon emanating from the new gas deal. A number of phases actually appear on the oil and gas value chain, namely exploration and appraisal, development, production, transport, pipelines, storage, refining and distribution.

Lebanese Parliament ratifies public budget 2022
The Lebanese parliament passed by the end of the third quarter of the year the public budget for 2022, which calculates customs tax revenues at an exchange rate of 15,000 Lebanese pounds per U.S. dollar. The budget calculates public expenditures at 41 trillion Lebanese pounds and revenues at 30 trillion Lebanese pounds. The process for approving this year's 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.

Trade deficit up by 41% in the first seven months of 2022
External sector figures released for the first seven months of 2022 suggest a 40.7% rise in trade deficit amid a 34.1% growth in imports, while exports increased by 12.7% relative to the same period in 2021. The rise in imports is partly tied to global inflation, especially related to oil and commodity prices that surged significantly this year, but also suggests a slight improvement in domestic private demand.

Further currency collapse on black FX market amid large LP money creation
A further currency collapse on the black FX market, a large expansion in the currency in circulation outside BDL, and a continuous FX reserves burn were the main features characterizing Lebanon's monetary conditions this year. Many factors lied behind the continuous deterioration in the Lebanese pound against the greenback on the parallel FX market so far this year, namely the stubborn cabinet formation gridlock, prospects of a Presidential vacuum, the slow progress in implementing reforms requested by the IMF to secure much-needed international financial support, the continuous BDL's FX reserves burn, the gradual fuel subsidy removal initiated towards the end of July 2022 before completely freeing the "Sayrafa" platform from the burdens of financing gasoline imports around mid-September, and the chaos that has characterized the operations of banks since September 2022.

Lebanese equities extend last year's noticeable price rally, bond market dips further into red
Lebanon's equity market pursued during the first nine months of 2022 the noticeable surge of last year, mainly supported by strong price gains in Solidere shares amid hedging activity against crisis. On the other hand, the Eurobond market plunged further into the red, mainly on growing concerns about a long-simmering cabinet gridlock and Presidential vacuum, and given the slow progress in implementing much-needed reforms to unlock international financial support.

An alternative economic model to be sought?
There is no doubt that the previous economic model of offsetting large trade deficits with foreign inflows of capital is no longer sustainable given the considerable contraction of the latter. Lebanon needs to reduce imports, enhance exports and foster domestic production. Having said that, Lebanon should not drift away from its Trade and services sectors that represent its core advantages and competitive edges. Among these rise the health services, the educational services, the engineering services, the touristic services and the financial services. These sectors were and remain important drivers of Lebanon's economy amid the graduation of thousands of Lebanese students every year and that target Lebanon's trade and services sectors in particular. As such, any new model has to continue fostering Lebanon's Tertiary sector as the main drive for growth, while revamping Lebanon's primary and secondary sector in the aim of ensuring a considerable step forward towards self-sufficiency in domestic consumption needs at the detriment of hefty foreign dependence at large.

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While the country embarked on presidential elections, yet without a settlement seen at the horizon, Lebanon has finalized on a number of milestones, the most important of which being the Southern border maritime settlement and the ratification of Government Budget 2022.

In fact, the Maritime border demarcation agreement was finally a done deal. Agreement was based on Line 23 with Lebanon having supremacy over the Qana field while giving the Karish field to Israel. The deal could enhance long-term economic prospects and improve the country's external position which is positive for Lebanon's credit profile but implementation risks remain significant. International Rating Fitch thinks that gas discoveries would generate important economic benefits for Lebanon, first by attracting foreign investment and then by boosting government revenues should the resources prove to be commercially viable. Moody's said the agreement is credit positive for Lebanon because it establishes the necessary geopolitical security conditions for international energy companies to start exploration and the eventual recovery of Lebanon's hydrocarbon resources. Harnessing potential gas resources will help alleviate the country's chronic power deficit and kick-start an economic recovery.

Having said that, it will take no less than three to four years to start having economic benefits for Lebanon emanating from the new gas deal. A number of phases actually appear on the oil and gas value chain, namely exploration and appraisal, development, production, transport, pipelines, storage, refining and distribution.

Meanwhile, challenges remain high. The fragmented nature of the Parliament and the end-of-presidential term makes it difficult for government formation, presidential elections and the passage of reforms. This is pushing back the IMF Board approval of the EFF (Extended Fund facility), which is viewed as an important precursor for Lebanon's emergence from default and potential economic recovery.

A glance on the economic performance of this year suggests that real sector indicators were at the image of a mixed economy on the overall. Among indicators with negative growth over the first nine-month period, we mention cleared checks with a contraction of 12.6% and value of property transactions with a decline of 13.0%. Among indicators with positive growth, we mention construction permits with a surge of 444.6%, the number of passengers at the airport with a rise of 56.9%, the new car sales with a rise of 37.5% cement deliveries with an expansion of 56.0% and merchandise at the Port with a rise of 9.4% year-on-year.

External sector figures released for the first seven months of 2022 suggest a 40.7% rise in trade deficit amid a 34.1% growth in imports, while exports increased by 12.7% relative to the same period in 2021. In fact, imports grew from US$ 7.8 billion to US$ 10.5 billion between the two periods, while exports rose from US$ 1.9 billion to US$ 2.1 billion, thus generating a rise in trade deficit from US$ 6.0 billion to US$ 8.4 billion. The balance of payments recorded a deficit of US$ 3.1 billion over the first nine months of this year, against US$ 1.6 billion over last year's same period. The deficit in the balance of payments this year is the result of a US$ 3.3 billion contraction of BDL net foreign assets, while banks net foreign assets grew by US$ 0.2 billion.

Banking sector statistics for the first nine months suggest a continuation of the trend reported this year, namely a lower contraction in customer deposits relative to the one reported last 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 from US$ 17.8 billion at end-December 2021 to US$ 16.7 billion at end-September 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. In turn, 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.

At the capital markets level, equity markets continued the noticeable surge of last year. The BSE price index rose by 24.7% in the first nine months of the year, following a 48.1% increase in the index in 2021, driven by the rise in Solidere shares. This year's rise in prices occurred within the context of a 5.5% annual increase in trading volume year-on-year, moving from US$ 295 million in the first nine months of 2021 to US$ 312 million in the first nine months of 2022. Consequently, the turnover ratio (annual trading value to market capitalization) decreased from 3.8% to 3.1% between the two periods.

The developments in the real sector, external sector, public sector and financial sector for the first nine months of the year 2022 will be analyzed thereafter while the concluding remarks are left to an assessment of the prerequisites of any alternative economic model to be sought for Lebanon.

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1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Slightly recovering primary and secondary sectors amid emergence from Corona lockdowns

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 last year's Corona lockdowns.

Industrial imports, a mirror image of domestic demand for industrial goods, rose by 38.0% in the first seven months of 2022 relative to the same period of 2021. Industrial exports, a mirror image of foreign demand for domestically produced industrial goods rose by 14.5% over the same period.

Agricultural imports, a mirror image of domestic demand for agricultural goods, rose by 6.9% in the first seven months of 2022 relative to the same period of 2021. Agricultural exports, a mirror image of foreign demand for domestically produced agricultural goods dropped by 5.3% over the same period.

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.

Farmers have been struggling amid Lebanon's financial crisis, due in large part to the rising cost of fuel and the expense of imported inputs such as seeds and fertilizer. The past year also saw another blow to the sector with the Saudi ban on Lebanese produce put in place in April 2021. While the effects of the embargo were largely mitigated by increased exports to other countries, particularly Egypt, the CREAL report noted that the situation for farmers remains precarious.

Favorable climatic conditions have generally resulted in good harvests, with irrigation at a still affordable cost. Although the purchasing power of the Lebanese was very affected, the demand for food products was sustained. Syria, which normally floods Lebanese markets with its vegetables and some of its fruits, was itself suffering a crisis of agricultural production. This reduced the negative impact on farm prices to the benefit of the Lebanese producer.

It is worth also recalling that the Food and Agriculture Organization of the United Nations launched a voucher program in 2020 to provide farmers with funds to buy agricultural inputs. The program began as a US$ 200,000 pilot program distributing vouchers of US$ 200 to 1,000 farmers in Akkar and Baalbeck-Hermel in 2020 to pay for fertilizer, seeds and equipment. The program expanded in the following year, with FAO, in collaboration with the Ministry of Agriculture and the World Food Programme, distributing US$ 300 vouchers to more than 32,000 beneficiaries in 2021 and 2022, with which the farmers could buy seeds, fertilizers, animal feed and fish feed for honeybees.

Finally, despite a recovery in some parts of the primary and secondary sectors, in the absence of effective intervention by the public authorities and without being able to benefit from international aid, the execution of which remains sterile or even negative, the Lebanese farmer is left to himself and remains the weakest link of the food value chain.

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1.1.2 Construction

Property sector at a crossroad mirroring politico-economic outlook

Demand for realty in Lebanon slowed down in 2022 after developers paid off most of their debts to banks and payment by check phased out, and as the country's real estate market became a fully dollarized cash-only or fresh dollars market. The value of property sales transactions, which have peaked in 2020 and expanded by 8% in 2021, posted a yearly contraction of 13% during the first nine months of the year 2022. Concomitantly, the number of sales operations fell by 21% year-on-year during the first nine months of 2022, following a 34% rise in 2021.

Most regions recorded a decrease in the value of sales transactions, with the most significant movements coming as follows: Metn (-78.9%), Baabda (-45.7%), North (-31.1%), Keserwan (-24.4%), Bekaa (-6.5%) and Beirut (-4.3%). As for the breakdown of the value of property sales, Beirut continued to capture the highest share over the first nine months of 2022 with a share of 37.7%, followed by the South with 17.3%, Baabda with 12.0%, Keserwan with a share of 10.4%, North with 7.5%, Nabattiyeh with 4.6%, Metn with 4.0% and Bekaa with 3.9%.

At the level of market supply, the development of new residential buildings has been halted since the beginning of the crisis. In parallel, a number of buildings under construction were interrupted. The few developers trying to complete their construction projects are those who have apartments sold before 2019. Developers are actually falling behind in the projects amid the huge increase in the price of building materials and the reduced purchasing power of both developers and buyers. Within this environment, cement deliveries in 2021 accounted for a mere 1,951 thousand tons in 2021, 39% below the 2019 figures.

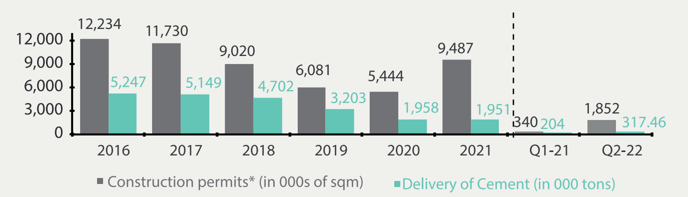
Most of property owners are increasingly seeking to sell the remaining stock in fresh US dollars since they don't have much loans left to settle in local dollars. By end-September, the banks' FX loan portfolio stands at US$ 12.0 billion, against circa US$ 40 billon prior to the crisis onset in October 2019. While the quasi totality of sellable real estate are now being priced in fresh US dollars, the fresh dollar buyers are scarce, which put adverse effects on price trends. This comes after a reduction in real estate prices in fresh dollars by more than 50% since the onset of the crisis back in 2019. The 50% average cut is uneven across regions, as some regions have witnessed a decline by 70% amid the lack of buyers in fresh dollars and some other regions are faring relatively well, with an average decline not exceeding 30% in fresh dollar terms. Beirut is faring relatively better than farther regions that are more impacted by the loss in purchasing power.

Looking forward, the real estate sector is at the mirror image of the overall country outlook. In the event of a positive politico-economic scenario, real estate demand would be considerably up, raising with it property prices. Such a scenario revolves around Presidential elections imminently, forming a Cabinet, to be followed by a full fledge agreement with the IMF on the basis of the Staff-level agreement reached in April. The other scenario is the lingering status-quo scenario, which revolves around the phased postponement of Presidential elections, the failure to agree on Cabinet formation, the absence of reforms, the failure to abide by the IMF prior actions requirements and the lack of a final program with the Fund. This scenario would lead to hefty depreciation of the national currency amid excessive LL money creation, hyperinflation in

CONSTRUCTION

	2021				2022				Variation	
	Q1	Q2	Q3	9M	Q1	Q2	Q3	9M	Q3/Q3	9M/9M
Value of property sales (in millions of US$)	2,300	3,612	4,633	10,545	3,860	1,902	3,410	9,172	-26.4%	-13.0%
Number of property sales	13,182	26,092	32,306	71,580	27,741	12,180	16,579	56,500	-48.7%	-21.1%
o.w. Sales to foreigners	172	411	418	1,001	245	175	161	581	-61.5%	-42.0%
Average value per property sale(in US$ 000)	175	138	143	147	139	156	206	162	43.4%	10.2%
Property taxes (in millions of US$)	96	206	202	505	281	177	196	654	-3.1%	29.6%

EVOLUTION OF CONSTRUCTION INDICATORS



*Figures are for first two months of the year consumer prices and huge socio-economic pressures on households. For the real estate sector, this means excess of supply over demand for property and corollary further contraction of real estate prices in fresh dollar terms in the market.

As to the sector outlook by region, more strain and corollary price contraction is foreseen in the regions that count on domestic income. In fact, in the event of a further currency depreciation in the absence of the favorable scenario, a further erosion is expected in purchasing power for LL income, which might generate more real estate sale to meet basic needs, putting further pressure on property prices. As to regions that attract expatriate investment into their properties, they will be faring better with the relatively sustained inflow of fresh inflows from outside.

1.1.3. Trade and Services

Tertiary sector on a mixed performance this year

Lebanon's tertiary sector witnessed a mixed performance in the first three quarters of 2022 when compared to same period of 2021. While airport activity and hotel occupancy offered a ray of hope, average daily room rates and the value of tax-free spending were still under performing. At the level of domestic spending, cleared checks continued to post negative indicators, again impacted by the pressure on the purchasing power due to the depreciation of the local currency and the financial crisis at large.

At the level of airport traffic, figures released by the Rafic Hariri International Airport revealed that the total number of passengers rose by an annual 56.9% over the first nine months of 2022. The number of aircraft expanded by 37.9% year-on-year in the previously mentioned period. In details, the number of arriving passengers rose by a yearly 59.8% and that of departing passengers by 54.3% to reach 2,362,111 and 2,458,552 respectively in the first nine months of the current year. The number of transiting passengers contracted by an annual 54.2% to 21,662 passengers in the first nine months of 2022. When including the latter mentioned category, the total number of passengers using the airport attained 4,842,325 up by 55.2%. Looking at the aircraft activity, landings and take-offs each rose by 37.9% year-on-year in the aforementioned period, with 19,795 planes and 19,793 planes respectively in the first nine months of 2022. Regarding the freight movement in the airport, 21,474 thousand tons were imported and unloaded during the first nine months of the year, while 22,287 thousand tons were exported and loaded. The first mentioned activity posted a negligible increase of 9.6% while the latter posted a 29.9% decrease on a yearly basis in the first nine months of 2022.

At the level of hospitality and according to Ernst & Young's "Middle East Hotel Benchmark Survey", the performance of Lebanon's four and five stars hotels witnessed an expansion in occupancy rate, room yields and average room's rate during the first seven months of 2022. In details, the occupancy rate of four and five-star hotels within the capital reached 50% in the first seven months of 2022, against 42% in the same period of 2021. Room's rate notably moved up to attain US$ 67 in the first seven months of 2022, up from US$ 57 in the same period of the past year. The rooms' yield rose by 41.7% annually to reach US$ 34 in the first seven months of 2022 compared to US$ 24 in the same period of the previous year.

TRADE AND SERVICES

	2021				2022				Variation	
	Q1	Q2	Q3	9M	Q1	Q2	Q3	9M	Q3/Q3	9M/9M
Number of ships at the port	311	303	271	885	283	278	316	877	16.6%	-0.9%
Number of containers at the port (in 000s)	124	124	121	369	131	139	158	428	30.9%	15.8%
Merchandise at the Port (in 000 tons)	1,271	1,140	1,102	3,513	1,256	1,198	1,390	3,844	26.1%	9.4%
Planes at the Airport	6,492	8,560	13,648	28,700	10,261	12,270	17,057	39,588	25.0%	37.9%
Number of passengers at the Airport (in 000s)	537	878	1,657	3,072	1,098	1,469	2,255	4,821	36.1%	56.9%
Cleared checks (in millions of US$)	9,997	10,606	8,036	28,638	8,526	8,352	8,161	25,039	1.6%	-12.6%

On the other hand, as per Global Blue, the firm that reimburses VAT to tourists at Lebanese border points, purchases by tourists in Lebanon whose VAT was claimed and which gives a fair view about tourists' shopping trends contracted by 31% in the first nine months of 2022 compared to the same period in 2021. In details, the 2022 breakdown of spending by residence suggests that spenders from UAE topped the list with 16%, followed by Saudi Arabia with 6%, Kuwait with 6%, Syria with 6%, Qatar with 5% and Egypt with 4%. The 2022 breakdown of spending by sector suggests Fashion and Clothing topped the list with 71%, followed by Watches and Jewelry with 22%, Department stores with 3%, Sports equipment & clothing with 1% and Home and Garden with 1%. The 2022 breakdown of spending by region suggests Beirut topped the list with 82%, followed by Metn with 16%, Baabda & Aley with 1%, and finally Kesserwan & Jbeil with less than 1%. The 2022 breakdown of spending by town suggests BCD topped the list with 67%, followed by Verdun with 10%, Jal El Dib with 9%, Dbayeh with 5%, and Achrafieh with 4%.

At the level of the Port, the latest statistics released by Port of Beirut revealed that the number of ships revealed a contraction of 0.9% year-on-year following a drop of 13.6% in the same period of 2021, to reach 877 vessels in the first nine months of 2022. The quantity of goods edged up by 9.4% to amount 3,844 thousand tons in in the first nine months of 2022, following a similar rise of 7.5% reported in the same period of 2021.

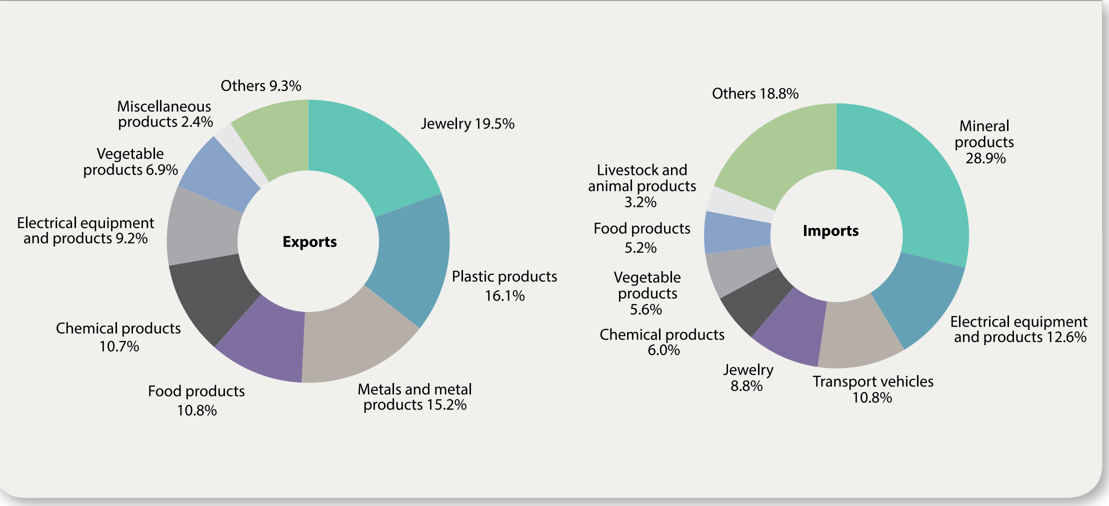
At the level of local spending, total value of cleared checks, an indicator of consumption and investment spending in the Lebanese economy, contracted by 12.6% year-on-year in the first nine months of 2022, revealing a continuous decline in the purchasing power amidst unending politico-economic uncertainties. The value of cleared checks reached US$ 22,603 million in the first nine months of 2022, down from US$ 25,039 million in the same period of 2021. A breakdown by currency shows that the banks' clearings in Lebanese Pounds amounted to LP 25,682 billion (+23.6%) in the aforementioned period of 2022, while those in US$ amounted to US$ 8,003 million (-46.1%). Moreover, the number of cleared checks registered 1,306,237 in the first nine months of 2022, down by 48.9% from 2,555,352 checks in the first nine months of 2021.

1.2. EXTERNAL SECTOR

Trade deficit up by 41% in the first seven months of 2022

External sector figures released for the first seven months of 2022 suggest a 40.7% rise in trade deficit amid a 34.1% growth in imports, while exports increased by 12.7% relative to the same period in 2021. In fact, imports grew from US$ 7.8 billion to US$ 10.5 billion between the two periods, while exports rose from US$ 1.9 billion to US$ 2.1 billion, thus generating a rise in the trade deficit from US$ 6.0 billion to US$ 8.4 billion. It is worth mentioning that the rise in imports is partly tied to global inflation, especially related to oil and

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY (7M- 2022)



commodity prices that surged significantly this year, but also suggests a slight improvement in domestic private demand.

In details, the breakdown of imports by product reveals a rise in electrical equipments and products by 141.1%, followed by transport vehicles with 95.5%, metals and metal products with 49.6%, paper and paper products with 49.4%, cement and cement stones with 44.4%, textile and textile products with 42.0%, mineral products with 40.0%, plastic products with 32.9% and jewelry with 28.2%. On the other hand, the main items that have displayed major decrease in imports were chemical products with -35.9% and livestock and animal products with -2.1% over the first seven months relative to the same period last year.

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 153.7%, followed by Romania with 140.0%, China with 136.5%, Turkey with 80.8%, Italy with 71.7% and Switzerland with 57.1%. On the other hand, imports from Russia dropped the most by -51.8%, followed by France with -28.2%, Ukraine with -26.7% and UAE with -13.9% over the first seven months relative to the same period last year.

In parallel, the breakdown of exports by product reveals a rise in plastic products with 396.5%, followed by paper and paper products with 34.4%, metals and metal products with 31.5%, vegetable products with 22.5%, chemical products with 19.4% and electrical equipments and products with 18.7%. On the other hand, the main items that have displayed major decrease in exports were transport vehicles with -33.3%, jewelry with -29.9%, textile and textile products with -5.7% and food products with -2.7% over the first seven months relative to the same period last year.

The breakdown of exports by major countries of destination suggests that exports to Syria reported the most significant increase of 556.3% over the period, followed by Turkey with 90.9%, South Korea with 76.2% and Ivory coast with 32.4%. On the other hand, exports to Saudi Arabia decreased the most by -100% over the same period, followed by Switzerland with -63.2%, USA with -30.0%, Spain with -16.7% and Qatar with -11.1% over the first seven months relative to the same period last year.

It is worth mentioning that exports through the Port of Beirut represent the bulk of exports with US$ 900 million over the first seven months of 2022, spiking by 8.8% relative to the same period last year, followed by exports through the Airport with US$ 557 million, declining by 24.5% when compared to previous year's corresponding period. Then comes land exports through Syria reached US$ 386 million in the first seven months of 2022, surging by 297.9% relative to the same period of the previous year. Finally comes the exports though Port of Tripoli with US$ 210 million registering a rise of 40.9% over the first seven months relative to the same period last year.

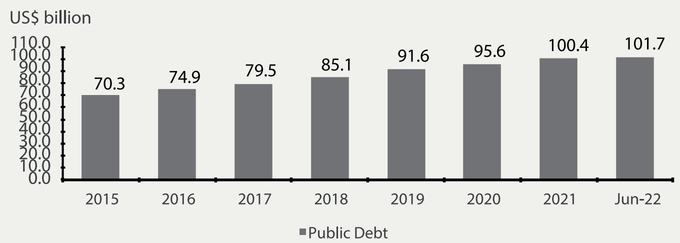
Finally, the balance of payments recorded a deficit of US$ 3.1 billion over the first nine months of this year, against US$ 1.6 billion over last year's same period. The deficit in the balance of payments this year is the result of a US$ 3.3 billion contraction of BDL net foreign assets, while banks net foreign assets grew by US$ 0.2 billion. The year-to-date decline in BDL's net foreign assets is mainly the result of BDL intervention on the Sayrafa platform within the context of BDL Circular 161 initiated at 2021 year-end.

1.3. PUBLIC SECTOR

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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Lebanese Parliament ratifies public budget 2022

The Lebanese parliament passed by the end of the third quarter of the year the public 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.

Parliament members actually met to review the 121 articles of the latest draft submitted to them, the result of a series of nearly two dozen meetings since earlier this year by the Finance and Budget Committee. The process for approving this year's 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 of at most the end of January 2023.

It is worth stressing on the fact that 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,
-Reducing imports and thus trade deficit that are not anymore sustainable given the decline in inflows to Lebanon. Lebanon's trade deficit still amounts to 45% of GDP in 2021 (US$ 10 billion of trade deficit versus US$ 22 billion GDP in 2021), still one of the highest ratios worldwide. This was previously sustained for a long period of time when the massive inflows used to come to Lebanon which is not the case anymore.

-Reducing imports would thus lead to positive impact on the balance of payments which could equilibrate in a medium term horizon. Had this been introduced a few years ago, it would have avoided excessive imports that use up the net foreign assets of the financial system.

-Raising customs dollar would also foster domestic production and support the productive economic sectors such as agriculture and industry.

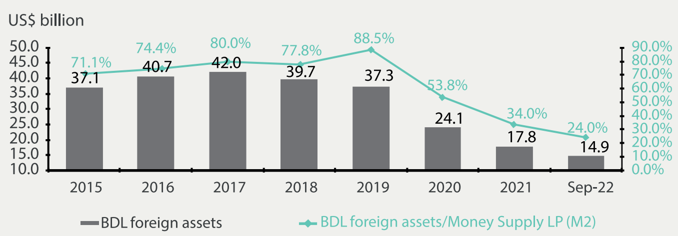
-Raising customs dollar would bring revenues for the Treasury and thus reduce fiscal deficit, which would reduce the monetization volume on behalf of the Central Bank and thus reduce money creation, with potential support to the LL exchange rate.

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, i.e a cumulative price inflation of 1,141% since the onset of the crisis in October 2019. It is estimated that the increase in the customs dollar would generate additional inflation of 20% to 30%. Having said, it is also estimated that an increase in the customs dollar would also reduce the margin of traders that

MONETARY SITUATION

Flows in US$ million	9M-21	9M-22	Progression
	Vol	Vol	Vol
Net foreign assets (excluding gold)	-1,592	-3,043	-1,452
Net claims on the public sector (excluding valuation adjustments)	-3,064	-6,570	-3,506
Claims on the private sector	-5,877	-5,000	877
Uses=Sources	**-10,533**	**-14,613**	**-4,080**
Money (M3)	200	5,072	4,872
Valuation adjustment and other items	-10,733	-19,685	-8,952

EXCHANGE MARKET INDICATORS



are relatively high in Lebanon.

-Raising the customs dollar would increase smuggling and customs evasion, unless it is accompanied by very strict measures to combat evasion at all borders.

In sum, while there are definitely costs associated with the increase in the customs dollar, advantages outpace disadvantages, especially that it helps secure softlanding in the twin deficits, i.e the external deficit and the budget deficit.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Further currency collapse on black FX market amid large LP money creation

A further currency collapse on the black FX market, a large expansion in the currency in circulation outside BDL, and a continuous FX reserves burn were the main features characterizing Lebanon's monetary conditions this year.

In details, the Lebanese pound lost more ground against the US dollar on the black FX market during the first nine months of 2022, reaching an all-time low of LP/US$ 40,000 towards the end of September as compared to LP/US$ 27,500 at end-2021. This occurred despite the ongoing intervention of the Central Bank of Lebanon on the currency trading market via the "Sayrafa" platform in implementation of BDL circular No.161 and the Bank's exceptional measures, which allowed banks to buy US dollar banknotes from BDL in exchange for LP held in their accounts at the "Sayrafa" rate.

Many factors lied behind the continuous deterioration in the Lebanese pound against the greenback on the parallel FX market so far this year, namely the stubborn cabinet formation gridlock, prospects of a Presidential vacuum, the very slow progress in implementing reforms requested by the IMF to secure much-needed international financial support, the continuous BDL's FX reserves burn, the gradual fuel subsidy removal initiated towards the end of July 2022 before completely freeing the "Sayrafa" platform from the burdens of financing gasoline imports around mid-September, and the chaos that have ripped through Lebanese banks in September 2022.

That being said, the Central Bank's foreign assets continued their nosedive over the first nine months of the year 2022 to reach US$ 14.9 billion at end-September, which marks a US$ 2.9 billion contraction since year-end 2021. After deducting BDL's Lebanese Eurobond holdings of US$ 5 billion and FC facilities provided to banks, BDL's liquid FX reserves are estimated to have fallen below the US$ 10 billion level at end-September 2022. This is mainly explained by the Central Bank's intervention on the FX market via the "Sayrafa" platform and a continuous deficit monetization from BDL.

In parallel, the currency in circulation outside BDL grew by LP 13 trillion over the first nine months of 2022 to reach

BANKING ACTIVITY

in millions of US$

	2020	2021	9M-21	9M-22
Var: Total assets	**-28,739**	**-13,105**	**-8,360**	**-7,813**
% change in assets	-13.3%	-7.0%	-4.4%	-4.5%
Var: Total deposits	**-19,723**	**-9,671**	**-6,651**	**-4,512**
o.w. LP deposits	-10,772	-671	-882	1,263
o.w. FC deposits	-8,952	-9,000	-5,769	-5,775
% change in total deposits	-12.4%	-7.0%	-4.8%	-3.5%
Var: Total credits	**-13,601**	**-8,456**	**-6,168**	**-5,432**
o.w. LP credits	-959	-2,491	-2,079	-1,599
o.w. FC credits	-12,642	-5,965	-4,090	-3,833
% change in total credits	-27.3%	-23.4%	-17.1%	-19.6%

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LP 59 trillion at end-September. This was mainly driven by a large expansion of LP 20 trillion during the third quarter of the year, which was marked by a gradual fuel subsidy removal and BDL's intervention via the "Sayrafa" platform. Within this context, it is worth mentioning that the currency in circulation outside BDL continued to expand massively in October 2022 to reach an unprecedented high level of LP 75 trillion at the end of the month.

In parallel, the financial system's total subscriptions in LP Treasury bills amounted to LP 11,066 billion during the first nine months of 2022, fully allocated to the Central Bank of Lebanon, and compared to total maturities of LP 10,578 billion, resulting into a nominal surplus of LP 488 billion over the covered period.

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

In the coming period, prospects of a multilayered political executive vacuum would continue to weigh on Lebanon's monetary conditions, while the country is moving to re-peg its currency for the first time since December 1997, which is a first step towards the progressive unification of multiple exchange rates, one of the prior actions required by the IMF to secure international financial support.

1.4.2 Banking activity

Loan redemption represents 73% of deposit contraction since crisis onset

The three-year banking sector analysis since the onset of Lebanon's financial crisis, i.e between October 2019 and September 2022, shows the following trends:

- A cumulative decline in total deposits by US$ 43.4 billion amid noticeable withdrawals and loan redemption: Customer deposits contracted from US$ 168.4 billion at end-October 2019 to US$ 125.0 billion at end-September 2022, the equivalent of 25.8%. Resident deposits contracted by US$ 31.3 billion, while non-resident deposits dropped by US$ 12.1 billion. FX Deposits contracted by US$ 26.6 billion over the three-year period to reach US$ 97.0 billion, while LL deposits dropped by LL 25.3 trillion to reach LL 42.1 trillion as at end-September 2022. As a result, deposit dollarization went up from 73.4% in October 2019 to 77.7% in September 2022.

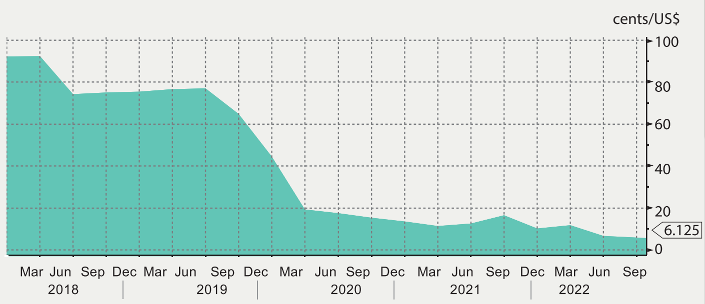
- A cumulative decline in total loans by US$ 31.9 billion amid bank deleveraging efforts: Lebanese banks have been deleveraging significantly since the onset of the crisis. Their loan portfolio dropped from US$ 54.2 billion to US$ 22.3 billion, the equivalent of 58.9%. The loan redemption represents 73% of the deposit contraction over the past three years. FX loans contracted by US$ 26.4 billion, while LL loans dropped by LL 8.3 trillion over the three-year period. As a result, loan dollarization went down from 70.4% in October 2019 to 52.8% in September 2022.

FINANCIAL SECTOR (NON BANKS)

	2016	2017	2018	2019	2020	2021	Sep-22
Beirut Stock Exchange							
Market capitalization (In millions of US$)	10,951	10,578	9,117	7,540	7,176	10,625	13,249
Total trading volume (In millions of US$)	885	608	376	197	233	354	312
Annualized trading volume/Market capitalization	8.1%	5.8%	4.1%	2.6%	3.2%	3.3%	3.1%
Price index	106.9	98.2	83.9	69.7	63.5	94.0	117.2
% change in index	2.1%	-8.1%	-14.6%	-16.9%	-8.9%	48.1%	24.7%
Lebanese Eurobonds							
Total volume (In millions of US$)	26,123	26,123	30,964	28,314	31,314	31,314	31,314
Average yield	6.5%	6.5%	10.0%	30.0%	57.0%	-	-
Average life (In number of years)	6.2	6.7	7.8	7.5	7.1	6.2	5.5
5-year CDS spreads variation (bps)	57	42	229	1649	-	-	-

CAPITAL MARKETS PERFORMANCE

Long-term sovereign bond prices



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- A cumulative decline in LL deposit interest rate by 837 basis points and in US$ deposit interest rate by 652 basis points: The average LL deposit interest rate dropped from 9.03% at end-October 2019 to 0.66% at end-September 2022, while the average US$ deposit interest rate declined from 6.61% to 0.09% over the same period. The spread between US$ deposit rate and 3-month Libor reached close to -3.66% in September 2022, against 4.71% in October 2019.

- A cumulative decline in banks FX liquidity abroad by US$ 4.4 billion: Lebanese banks' claims on non-resident financial sector dropped from US$ 8.4 billion at end-October 2019 to US$ 4.0 billion at end-September 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.

- A cumulative decline of US$ 11.1 billion in banks Eurobonds portfolio amid net domestic sales and provisioning: Lebanese banks Eurobond portfolio reached US$ 3.7 billion at end-September 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.

- A cumulative decline in shareholders' equity by US$ 3.9 billion amid banks' net losses: Shareholders' equity contracted from US$ 20.6 billion at end-October 2019 to US$ 16.7 billion at end-September 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 (rate differential between the BDL circular 151 rate and the official exchange rate), 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

Lebanese equities extend last year's noticeable price rally, bond market dips further into red on mounting political concerns and lingering reform uncertainties

Lebanon's equity market pursued during the first nine months of 2022 the noticeable surge of last year, mainly supported by strong price gains in Solidere shares amid hedging activity against crisis. On the other hand, the Eurobond market plunged further into the red, mainly on growing concerns about a long-simmering cabinet gridlock and Presidential vacuum, and given the slow progress in implementing much-needed reforms to unlock international financial support.

In details, Lebanon's equity market registered robust price gains of 24.7% during the first nine months of 2022, mainly driven by staggering price rises in Solidere "A" and "B" share prices of 56.4% and 55.5% respectively to cross the US$ 50 level at end-September 2022, bearing in mind that equity prices are denominated in domestic US dollars.

On the other hand, banking stocks recorded an average price decline of 9.4% over the first nine months of 2022. A closer look at individual stocks shows that Bank Audi's "listed" shares and GDRs, BLOM's "listed" shares and GDRs, Bank Audi Preferred "I" shares, BLC Preferred "D" shares, Byblos Bank's "listed" shares and Byblos "Preferred 2008" shares posted price drops ranging between 2.3% and 38.7%, while BEMO's "listed" shares registered price rises of 9.1% over the first nine months of the year. As to industrials, Ciments Blancs Nominal's share price jumped by 54.5%, followed by Holcim Liban's shares with + 46.0%.

Strong price gains on the BSE during the first nine months of 2022 were coupled with increased price volatility. The price volatility, measured by the ratio of the standard deviation of prices to the mean of prices, reached 17.0% during the first nine months of 2022 as compared to a lower price volatility of 12.1% over the same period of 2021.

The market capitalization on Lebanon's equity market was at the image of BSE price gains, registering an expansion of 24.7% over the first nine months of 2022, moving from US$ 10,625 million at end-December 2021 to US$ 13,249 million at end-September 2022, noting that the BSE saw on July 1, 2022 the delisting of RYMCO shares, which are illiquid. The BSE total trading value amounted to US$ 311.6 million during the first nine months of 2022 as compared to US$ 295.4 million during the same period of 2021, up by 5.5%,

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noting that Solidere shares captured the lion's share of activity (94.3%), followed by the banking shares with 4.5% and the industrial shares with 1.1%. Accordingly, the BSE total turnover ratio, measured by the annual trading value to market capitalization, reached 3.1% during the first nine months of 2022, down from 3.8% during the same period of 2021.

On the other hand, Lebanon's Eurobond market continued its nosedive over the first nine months of 2022, with prices of sovereigns reaching new record lows of 5.63-6.00 cents per US dollar at end-September 2022 as compared to 9.88-10.63 cents per US dollar at end-2021, which marks price contractions of 4.13 pts to 4.50 pts. This is mainly explained by a protracted cabinet paralysis and mounting concerns about a multilayered political executive vacuum, and as the IMF warned that Lebanon's progress in implementing reforms required to unlock much-needed financial support from the Fund remains "very slow".

In the coming period, Lebanon's capital markets await a full-fledged economic and financial reform program that would address Lebanon's deep-seated challenges and respond to IMF requirements, which would pave the way for a final agreement with the Fund and lay the groundwork for constructive negotiations with bondholders, bearing in mind that Lebanese Eurobonds may not be recoverable without an IMF program.

CONCLUSION: FOR A NEW ECONOMIC MODEL THAT WOULD REVAMP PRODUCTIVE SECTORS WITHOUT DRIFTING AWAY FROM CORE TERTIARY SECTORS

A number of arguments arise across the country about the need to shift to a new economic model for Lebanon following the failure of the model that characterized the economy for decades. Should Lebanon totally forgo the drivers of its previous model? Should it drift away from its Tertiary sector that has been the engine of growth for decades? What could be the alternative in a country that does not have raw materials nor a cheap labor force?

There is no doubt that the previous model of offsetting large trade deficits with foreign inflows of capital is no longer sustainable given the considerable contraction of the latter. Lebanon needs to reduce imports, enhance exports, foster domestic production and enhance capital inflows at large.

It is true that imports contracted by 30% over the past couple of years that followed the outburst of its macro-financial crisis, but they still amount to US$ 14 billion in 2021, while exports do not exceed US$ 4 billion, i.e. the ratio of exports to imports does not exceed 29%. It is also worth mentioning that in the first seven months of 2022, imports rose by 34% relative to the same period last year. As such, the ratio of imports to GDP in Lebanon still reports a high of 65%, which is considered one of the highest rates globally, as this ratio averages 37% in the Middle East and North Africa, 24% in emerging markets and 28% in the world at large.

It is worth recalling that the current real imbalances were driven by maintaining currency stability for long and subsequently assuming a large deal of imports of goods and services in an economy with excessive foreign dependence and lacking domestic productivity amid an excessive spending of an economy. Since 2014, US$ 178 billion were spent on imports and travel expenses abroad (US$ 142 billion and US$ 36 billion respectively), while US$ 120 billion were received from incoming flows (net financial transfers and proceeds of exports, FDI and tourism), leaving a gap of US$ 58 billion, indirectly financed from the financial system's net foreign assets (BDL and banks).

While there is no doubt that there is a shared responsibility across the different economic agents for the emerging crisis, we should not neglect the fact that the real imbalances were driven by the excessive spending of an economy that has been living for decades at above its means amid unconventional domestic policies and acute State mismanagement.

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Adjusting the external sector that is characterized by persisting imbalances is key. It is possible to reach an equilibrium in the balance of payments position by reducing further imports, boosting exports and fostering financial inflows. Hence, the importance of reviving Lebanon's ability to entice incoming financial flows amid a gradual return of the confidence factor, boosting domestic production and exports by subsidizing high value added sectors and imposing restrictions and taxes on imports that erode the Lebanese financial system's foreign assets. Equally important is the promotion of domestic production both locally and in key recipient markets.

Having said that, it is yet worth mentioning that Lebanon should not drift away from its Trade and services sectors that represent its core advantages and competitive edges. Among these rise the health services, the educational services, the engineering services, the touristic services and the financial services. These sectors were and remain important drivers of Lebanon's economy amid the graduation of thousands of Lebanese students every year and that target Lebanon's trade and services sectors in particular. As such, any new model has to continue fostering Lebanon's Tertiary sector as the main drive for growth, while revamping Lebanon's primary and secondary sector in the aim of ensuring a considerable step forward towards self-sufficiency in domestic consumption needs at the detriment of hefty foreign dependence at large.

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