

BankMed Economic and
Market Analysis

LEBANON IN 2007

AT A CROSSROAD

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A WORD FROM THE CHIEF ECONOMIST

We present to you the first annual economic and market analysis report from BankMed. In a world where decision making is increasingly becoming a high-pace process, we are cognizant that information is a very valuable asset. Information, that is well filtered, carefully analyzed, and easily presented, could be a powerful tool as you scheme through your personal, business, or corporate choices. This is what our report is essentially about: a lean, focused and user-friendly update on how 2006 unfolded and on how 2007 is shaping up to evolve. But since trees are only parts of a larger forest, we also provide an overview of the Lebanese economy, putting the recent developments in a broader historical context, so that a deeper comprehension is achieved. We hope that you will find this document useful and informative.



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LEBANON FACTS AND FIGURES- GENERAL

Geography

Location: Middle East, bordering the Mediterranean Sea, adjacent to Syria

Area: total 10,452 sq km, **land** 10,282 sq km, **water** 170 sq km

Land boundaries: total: 454 km, of which 375 Km with Syria

Coastline: 225 km

Climate: Mediterranean; mild to cool, wet winters with hot, dry summers; Lebanon mountains experience heavy winter snows

Elevation extremes: **lowest point:** Mediterranean Sea 0 m, **highest point:** Qurnat as Sawda' 3,088 m

People

Population: 3,874,050 (July 2006 est.)

Age structure:

0-14 years: 26.5% (male 523,220 / female 502,372)

15-64 years: 66.6% (male 1,235,915 / female 1,342,540)

65 years and over: 7% (male 122,155 / female 147,848) (2006 est.)

Median age: total: 27.8 years (male: 26.7 years, female: 28.9 years) (2006 est.)

Population growth rate: 1.23% (2006 est.)

Life expectancy at birth: 72.88 years (male: 70.41, female: 75.48)

Language: Arabic (official), French, English, Armenian

Literacy rate (age 15 and over can read and write): 87.4% (male: 93.1% female: 82.2% (2003 est.)

Political System

Government type: Republic

Capital: Beirut

Administrative divisions: 8 governorates: Aakkar, Baalbek-Hermel, Beirut, Beqaa, North Lebanon, South Lebanon, Mount Lebanon, Nabatiye

Independence: 22 November 1943 (from French administrative mandate)

Legal system: mixture of civil law (inspired by Napoleonic code), Ottoman law, and in some instances canon law

Executive branch: President elected by the Parliament for a six-year term (may not serve consecutive terms), the prime minister appointed by the president in consultation with the Parliament, cabinet chosen by the prime minister in consultation with the members of the Parliament

Legislative branch: Parliament of 128 seats; members elected by popular vote to serve four-years terms; Speaker of the House elected by members to serve four-years term

Judicial branch: Four Courts of Cassation (three courts for civil and commercial cases and one court for criminal cases); Constitutional Council (called for in Ta'if Accord - rules on constitutionality of laws); Supreme Council (hears charges against the president and prime minister as needed).

LEBANON FACTS AND FIGURES- ECONOMY AND BUSINESS

Economy

GDP: \$22.1 billion at official exchange rate (2005)

GDP per capita: \$5700

GDP composition: agriculture 12%, industry 18%, services 70% (2000)

GDP growth rate (real): 1% (2005)

Inflation rate: 0.3% (2005)

Exchange rate: 1507.5 LBP per \$

Labor force: 2.6 million (in addition, there are as many as 1 million foreign workers) (2001 est.)

Unemployment rate: 8.2% (2005 est.)

Population below poverty line: 24.6% (2005 est.)

Agriculture products: citrus, grapes, tomatoes, apples, vegetables, potatoes, olives, tobacco

Industries: banking, tourism, food processing, jewelry, cement, textiles, mineral and chemical products, wood and furniture products, metal fabricating

Exports: \$1.880 billion f.o.b. (2005)

Export commodities: authentic jewelry, inorganic chemicals, miscellaneous consumer goods, fruit, tobacco, construction minerals, electric power machinery and switchgear, textile fibers, paper

Export partners: Syria 9.9%, Iraq 9.5%, UAE 8.2%, Saudi Arabia 7.4%, Switzerland 6.6%, Turkey 6.5% (2005)

Imports: \$9.340 billion c.i.f. (2005)

Import commodities: petroleum products, cars, medicinal products, clothing, meat and live animals, consumer goods, paper, textile fabrics, tobacco

Import partners: Italy 10.4%, France 8.4%, China 7.9%, Germany 7%, US 5.9%, Russia 5.5% (2005)

Business

Sovereign Credit Rating: B- (S&P)

Electricity production: 10.58 billion kWh (2005)

Electricity imports: 750 million kWh (2005)

Oil production: 0 bbl/day (2005 est.)

Oil consumption: 102,000 bbl/day (2005 est.)

Telephones landlines in use: 990,000 (2005)

Telephones mobile cellular: 990,000 (2005)

International country code: 961

Internet users: 700,000 (2005)

Internet country code: .lb

Pipelines: gas 43 km (2006)

Roadways: 7,300 km (paved: 6,198 km, unpaved: 1,102 km) (1999)

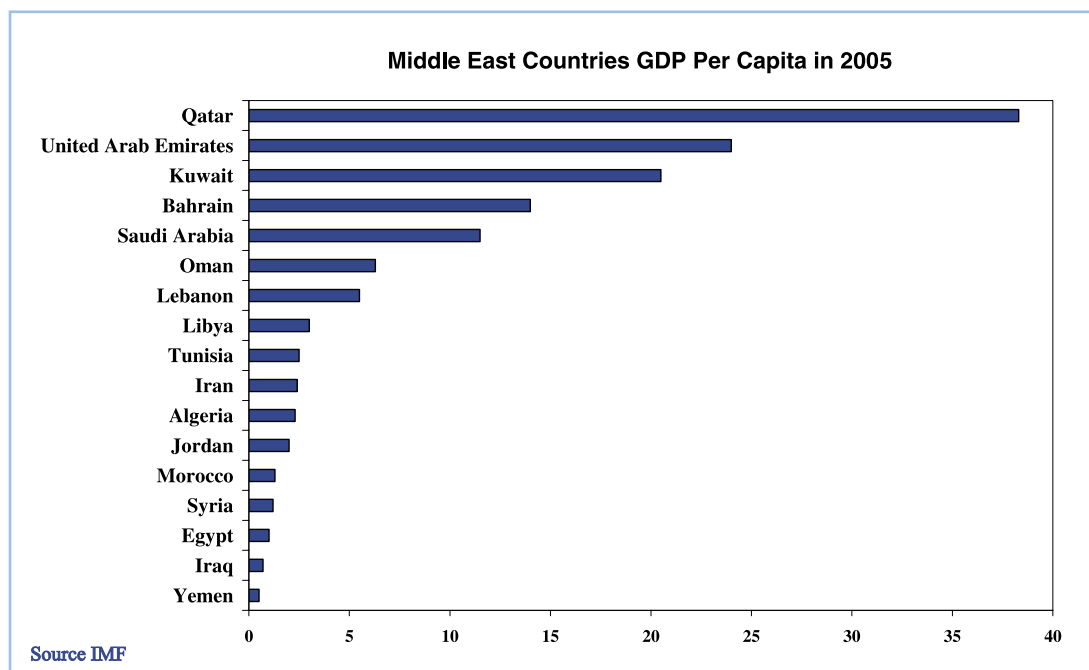
Ports and terminals: Beirut, Chekka, Jbeil, Jounie, Saida, Tripoli, Tyr

Merchant marine: 39 ships (bulk carrier 4, cargo 18, livestock carrier 10, refrigerated cargo 1, roll on/roll off 3, vehicle carrier 3)

LEBANESE ECONOMY STRUCTURE AND SECTORS

Lebanon has a small, open, services-based economy. Its population is estimated to be close to 3.9 million and GDP is around \$22 billion, hence a GDP per capita around \$5700, the highest among non-GCC Arab countries (see Figure). This stems from a highly literate, multilingual workforce with education having long been one of the country's strengths. According to the UNDP, overall adult literacy rate stood at over 87% in 2003. The ratio stood at 96% in the 15-24 age group, suggesting that the overall literacy figure will improve further in the coming years.

The country's most prominent area of economic activity is services, which accounts for around 70% of GDP. Trade has been historically vibrant, which explains why most economic activity is generated in the coastal cities, and why domestic consumption is biased towards imported items. Tourism contributes significantly to economic activity, and a rapidly growing, high-end industry is catering mostly for Arabs mainly from Gulf countries.



The industrial sector, accounting for around 18% of GDP, has traditionally been small, owing largely to the relatively tight domestic market. However, the sector has been showing great potential recently, especially for the exports market. Among the sector's most significant exports are cement, processed food and beverages, and jewellery—with the latter showing strong growth over the past two year.

Manufacturing and Industrial Sector 2002 Figures

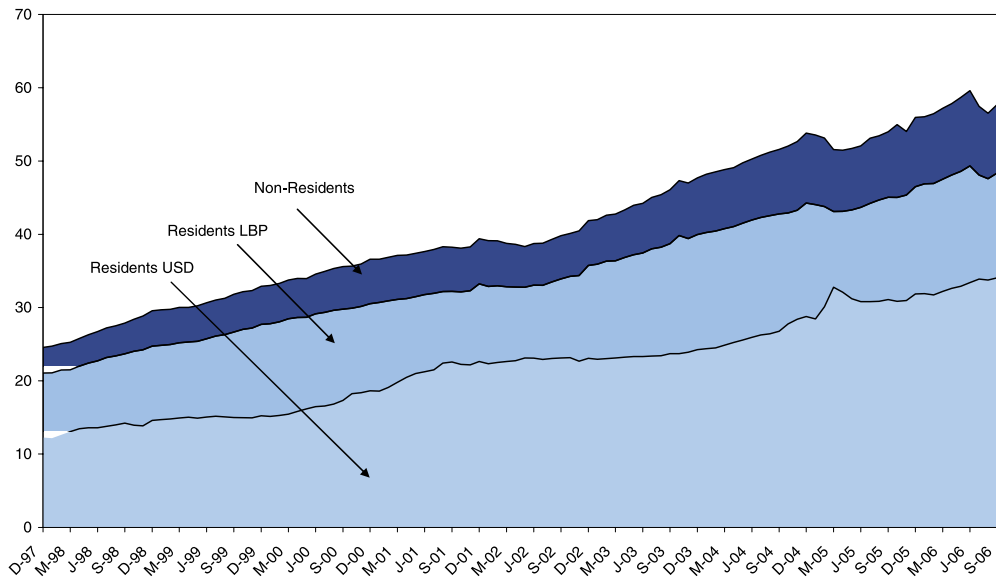
| | No. of firms | Workforce |
|-------------------------------|---------------|----------------|
| Food Products and Beverages | 4,482 | 26,389 |
| Metal Products | 3,554 | 14,492 |
| Textiles and Clothes | 3,066 | 14,230 |
| Non-metallic mineral products | 2,528 | 13,377 |
| Furniture | 2,350 | 11,068 |
| Wood products (non-furniture) | 2,246 | 6,933 |
| Leather and products | 1,292 | 6,481 |
| Other | 2,687 | 21,138 |
| Total | 22,205 | 114,108 |

Source: Ministry of Industry

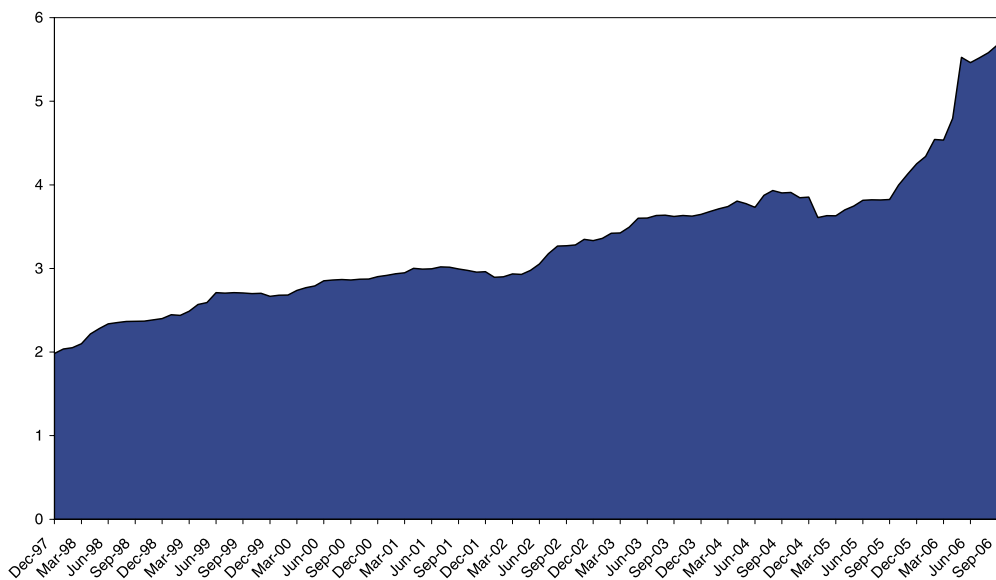
The agriculture sector, constituting 12% of the economy, has the potential to be one of the most productive in the region, owing to plentiful sunshine, abundant water supplies and fertile land. Instead, it is underdeveloped, poorly managed, inefficient, and suffers from dumping by neighboring countries. According to the UN Food Agriculture Organization, Lebanon has 330,000 ha of agriculture land, of which 170,000 ha is used as arable land. Around one-third of this is estimated to be irrigated. Products include root vegetables, some cereals, tobacco, and fruits such as bananas, melons, and apples.

The Lebanese financial system, the oldest in the region, boasts a strong banking industry, which has constituted the vertebral column of the economy. A strong resident deposit base as well as substantial capital inflows from a vast expatriate community and wealthy Arabs has generated a highly liquid financial system with total private sector deposits (residents and non-residents) of around \$60 billion, almost 300% of GDP (see Figure). Capitalization has also grown significantly, especially in the last two years (see Figure). Dollarization of deposits, at around 75%, reflects the openness of the system, and has provided a buffer in times of financial turbulence, together with a closely managed exchange rate regime. The Lebanese financial system is estimated to hold around \$23 billion in primary liquidity in foreign currency against a foreign currency deposits base of \$46 billion in the domestic banking system, resulting in a primary liquidity ration of 50%.

Total Commercial Banks' Private Sector Deposits Residents and Non-Residents- in Billion USD



Commercial Banks' Capital in Billion USD

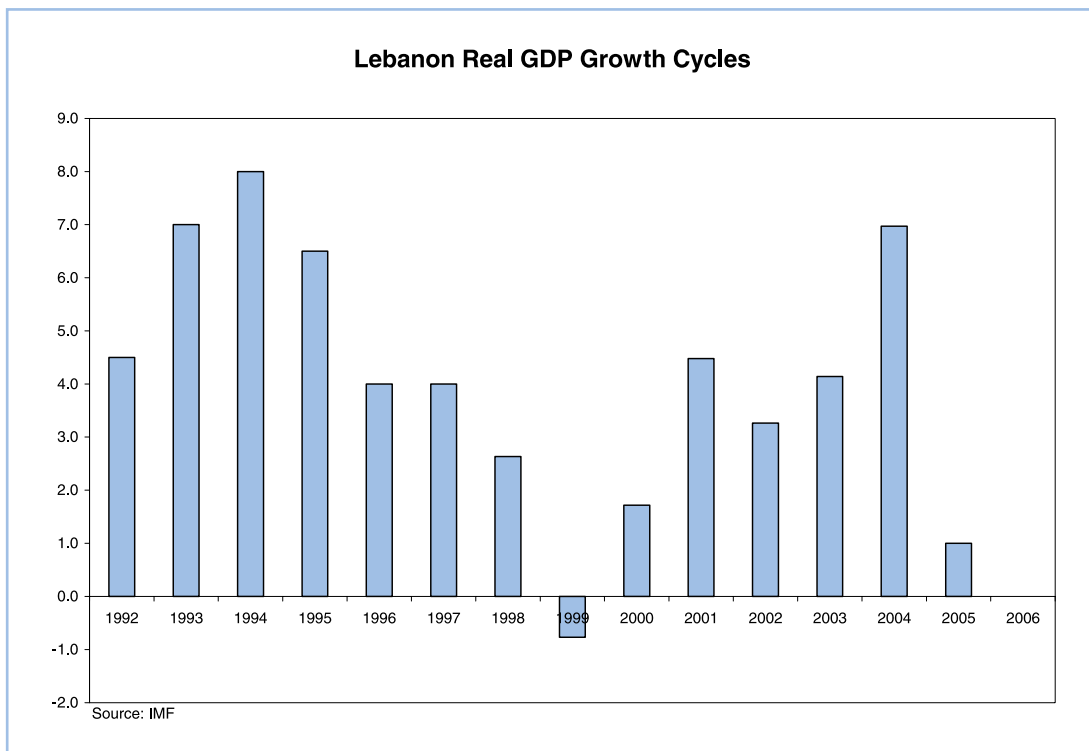


HISTORICAL CONTEXT OF GROWTH

Between 1975 and 1991 a staunch civil war seriously damaged Lebanon's economic infrastructure, cut national output by half, and all but froze the country's position as a Middle Eastern focal point and banking hub. Since the end of the civil war, Lebanon has gone through four major phases of economic activity: 1991-1996, 1997-2000, 2001-2004, and 2005-present. We are just entering the third year of the last phase, which by all means has been the most turbulent, challenging and volatile. But before we embark on drawing the economic picture of this phase, it will be useful to remember the last three episodes, in an attempt to put economic growth in the broader historical context.

The first phase was between 1992 through to 1996 when the economy saw consistently strong levels of growth, averaging some 6.5% a year. The expansion was largely driven by inward investment in the construction sector, as damaged infrastructure and housing needed to be rebuilt and Lebanese expatriates and Gulf investors poured funds into apartment buildings in the expectation that the country would soon recoup its position as a regional tourist destination. In addition to direct private-sector investment, foreign funds were also attracted into Lebanese T-bills. Together, these two forms of inward investment accounted for a large part of the net capital inflows of some \$6 bn a year during this five-year period.

The second phase, between 1996 and 2000, was a shaky period. First, by 1996 concerns began to emerge over the sustainability of both rapid growth and the government's fiscal deficit. Second, Israel's two-week military assault in April of that year marked a turning point, bursting the optimism mood, with investors beginning to question whether the country is, after all, a stable field for investment, which in turn led to a slowdown in private investment and capital inflows. State spending also fell as the government began to address the fiscal deficit. This overall decline in consumption and investment began an economic slowdown, which was compounded in 1998 and 1999 by the new government which introduced austerity measures that deepened the recession further, ensuring that there was little increase in the total tax yield.



The third phase, between 2000 and 2004 marked strong hopes which gathered momentum as soon as PM Rafic Hariri came back to power on the back of a landslide electoral victory. Economic growth began to recover at the end of 2000, rising to over 7% in 2004. The pick-up was driven in large part by external demand, which saw demand for tourism services expand at double-digit rates, kick-started by the end of the Israeli occupation and by the September 11th attacks the following year, which led many wealthy Arab tourists to travel to destinations in the region rather than the West, increasing arrivals into Rafic Hariri (Beirut) International Airport from 1.1 million in 2001 to 1.6 million by 2004. The increase in tourism demand also had an important knock-on effect on other parts of the economy, notably the construction sector with the building of new hotels and apartments. Demand for Lebanese goods rose strongly, with export earnings more than doubling between 2000 and 2004. In addition, there was also a pick-up in foreign investment (largely into real estate) as well as strong flows of capital into the Lebanese banking sector, where private sector deposits increased from \$37.1 billion in December 2000 to \$54.8 billion by December 2004. Domestic demand lagged, however, with commercial banks' claims on private sector increasing from \$14.7 billion in December 2000 to \$15.9 billion by December 2004.

The fourth phase started in 2005, and was triggered by the assassination in February of PM Rafic Hariri and the ensuing political turmoil that has yet to finish, and amplified by the Israeli war on Lebanon in the summer of 2006. This period, to which we turn next, has witnessed very strong fluctuation and could be divided itself in three sub-periods underlined simultaneously by low, high then low levels of growth. It is a period that witnessed the brutal physical elimination of one of the most (if not the most important) political and economic Lebanese personality since independence, the largest demonstrations and counter-demonstrations in the history of Lebanon, the withdrawal of the Syrian troops, first free parliamentary elections in decades, assassinations of major political and cultural figures, and last but not least a ferocious Israeli war on the country with all the human suffering it has caused as well as the assault against the physical infrastructure, productive plants, and residential neighborhoods.

YEARS OF POLITICAL TRANSITION

In the political and economic history of nations, there are periods that are so turbulent and volatile that they cannot be identified but as transition eras. Wars, revolutions, demolition of old institutions and emergence of new ones, implementation of major reforms, are all events that can cause a state to enter into a political or economic transition era. This transition can be short or it can last as long as a decade or more. The transition period defines a structural break, sharply separating what is before it from what comes afterwards. In other words, a country in general, and its economy in particular, is not the same after a transition period.

Lebanon has gone through several transition periods in its history. It is clear that since the assassination of PM Rafic Hariri, the country, and evidently the economy entered a new transition period, in which it searches for a new equilibrium as it moves from one equilibrium to another.

The economy was climbing on an upward trend in 2004, supported by a surge in tourism, construction activity and strong exports, generating a GDP growth of 7% in 2004. A political earthquake, however, caused by the assassination of PM Rafic Hariri, prompted a serious diversion, and caused private and public demand to contract hence reducing growth to 1% and inflation to around 0.3% in 2005. Pressures on the financial market triggered by the assassination of PM Rafic Hariri quickly built up as reflected by withdrawal of deposits and increase in dollarization in the banking system. Within just two months of the assassination, around \$2 billion, or 3.6% of total deposits, were withdrawn from the banking sector, and around \$5.5 billion were converted into US dollars. The central bank intervened, selling foreign reserves first but then developed financial engineering schemes which included swaps and issuance of 10-year dollar CDs at 10%. Domestic Lira interest rate also increased, contributing to the reduction of the outflow and de-dollarization.

The turmoil that followed the assassination of PM Rafic Hariri started to cool down as parliamentary elections were held, and a new government was formed. These developments caused the financial situation to stabilize by the end of the summer. Deposit flows resumed at a high pace to take advantage of the interest rate differential. The stock market significantly picked up in the summer of 2005, and Eurobond spreads quickly declined, reaching a record low of 180 basis points (by March 2006) and a \$750 million Eurobond issue of October 2005 was oversubscribed. In addition to portfolio investment, foreign direct investment also picked up, especially from private Arab capital which contributed 1.8 billion, in 2005, giving Lebanon the third place as receiver of inward Arab investment after Saudi Arabia and Sudan.

Lebanon was hence gaining substantial momentum towards the end of 2005. The first six months of 2006 were a powerful indication of a substantial pick up in economic activity, and revealed the promising potential of the Lebanese economy: net foreign direct investment reached \$1.68 billion, and foreign portfolio investment reached \$1.72 billion, contributing to a record high surplus of \$2.6 billion in the balance of payments. Meanwhile, bank's deposits increased by around \$3.6 billion, of which \$1.15 billion were by non-residents. Passenger activity at the airport was up to 1.6 million passengers in the first half of 2006, pointing to a promising tourist season of an all-time high 1.7 million visitors. These indicators, among others, were signaling an expected growth rate of 6-8% in 2006. This rate would of course remain an unrealized scenario as a sudden war would one more time test the strengths of the Lebanese economy.

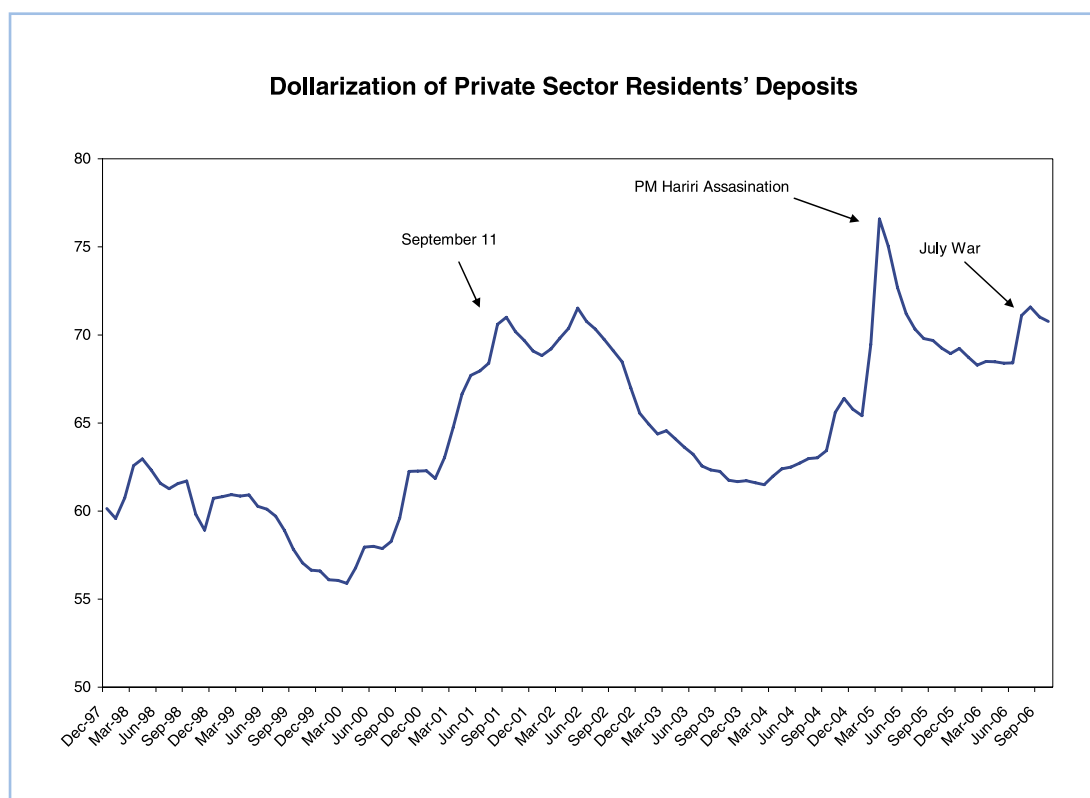
The human as well as the economic consequences of the July 2006 war were severe, by the sheer fact of the systematic destruction of the infrastructure, factories, and residential neighborhoods. A full account is provided in Appendix 1, but here is a quick overview. Estimates of the physical damage put it at around \$2.8 billion (see Table). In addition,

according to the Ministry of Finance, Lebanese GDP would have been \$23.6 billion if there was no conflict in 2006, whereas it is now expected at \$21.7 billion, i.e. a loss of around \$2 billion. This puts the total economic damage (direct and indirect) at around \$4.8 billion, or 22% of GDP which is by all account a significant cost.

| War Damage Assessment (\$ Millions) | |
|--|-------------|
| Housing (replacement cost) | 1700 |
| Industrial/ Commercial Space | 380 |
| Agriculture/ Irrigation | 210 |
| Electricity | 160 |
| Telecommunications | 135 |
| Transport | 120 |
| Education | 45 |
| Water | 40 |
| Health | 15 |
| Total Damage | 2805 |

Source: CDR.

However, if one could see anything positive stemming from the vicious war, it would be the resilience of the financial system, showing one more time an ability to weather the storm. Dollarization of residents' deposits, a gauge of how residents react to political developments, increased by less than when it did upon previous events such as September 11 and the assassination of PM Rafic Hariri, which is the event that triggered most financial panic (see Figure).



The private sector deposit base (residents and non-residents) shrank by 5% (from end-June 2006 till end-August 2006) and dollarization of private sector deposits (residents and non-residents) increased from 72.8% to 75.1%. This caused a total intervention by the central bank of around \$2.4 billion. The trend started to slowly reverse as soon hostilities ended, and end-October 2006 data shows that deposits were almost back from their end-June 2006 levels, but dollarization edged down only marginally and remains high at 74.4%.

Despite all, gross foreign currency reserves at the central bank which had increased significantly from \$9.8 billion at end-2005 to \$11 billion by end-June 2006, were not significantly affected as they were boosted by a generous deposits from Saudi Arabia and Kuwait, and they stood at \$11.2 billion as of end-October 2006. At this level, reserves (excluding gold, which is estimated at around \$6 billion) cover 14 months of imports.

As the government was putting together a plan to deal with the economic consequences of the war, and preparing for Paris III, a donors' conference for the support of the government reform program needed to deal with the structural debt problem, scheduled in late January 2007, political tensions rose again late in 2006. The Lebanese, having suffered for two full years of military, political, and economic instability were hoping by the end of the war in August to focus again on their well being and were bracing for a pick up in economic activity through attracting again the tourists, boosting exports and FDI and attracting maximum donor support in Paris. The increase in political tension towards the end-2006 may have delayed that. The New Year will surely be carrying many developments, to the point that Lebanon in 2007 appears to be at a crossroad. But before we present the main economic challenges of the New Year, we will review, in detail, economic developments in 2006.

2006- YEAR OF PEAK AND TROUGH

No year in Lebanon's recent history carried in it such duality on the economic front as 2006. It was clear by mid-year that the economy was set to achieve one of its highest growth rates in decades. Economic data from various sectors was pointing to a high level of economic activity. Public sector finances were being consolidated and banking sector deposits and profits were reaching record highs, underpinned by strong confidence in the sector and capital flows from Lebanese expatriates and Arab investors. The July war significantly altered the outlook.

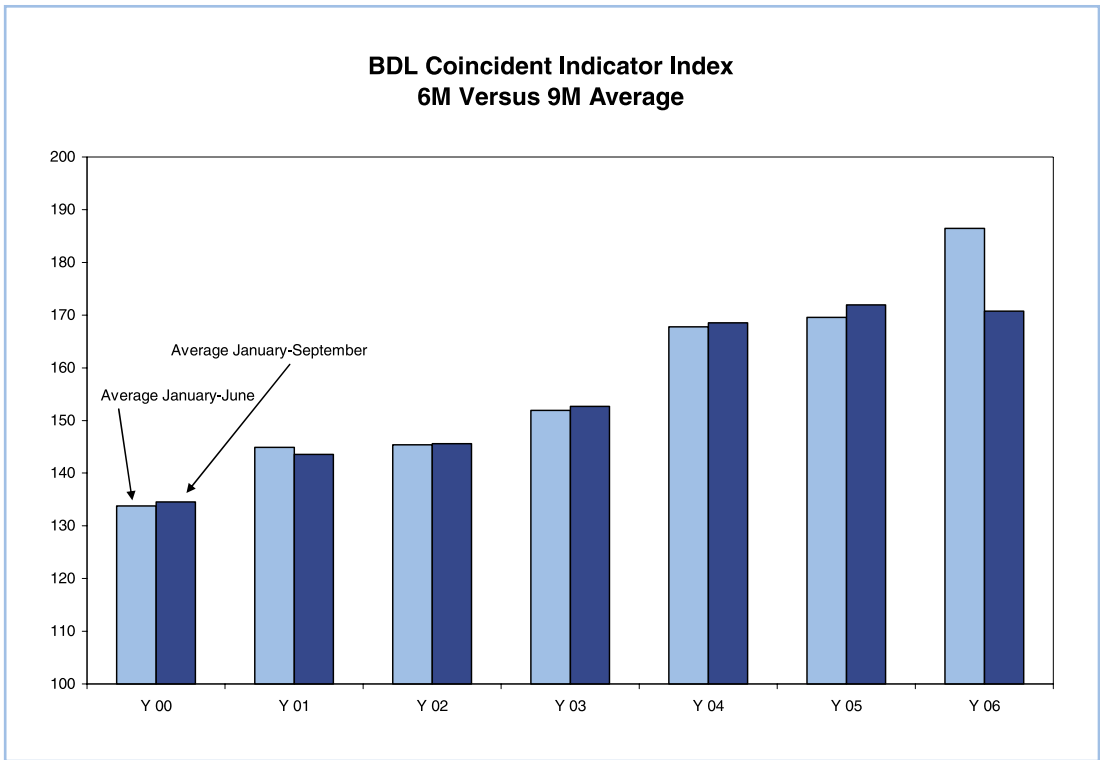
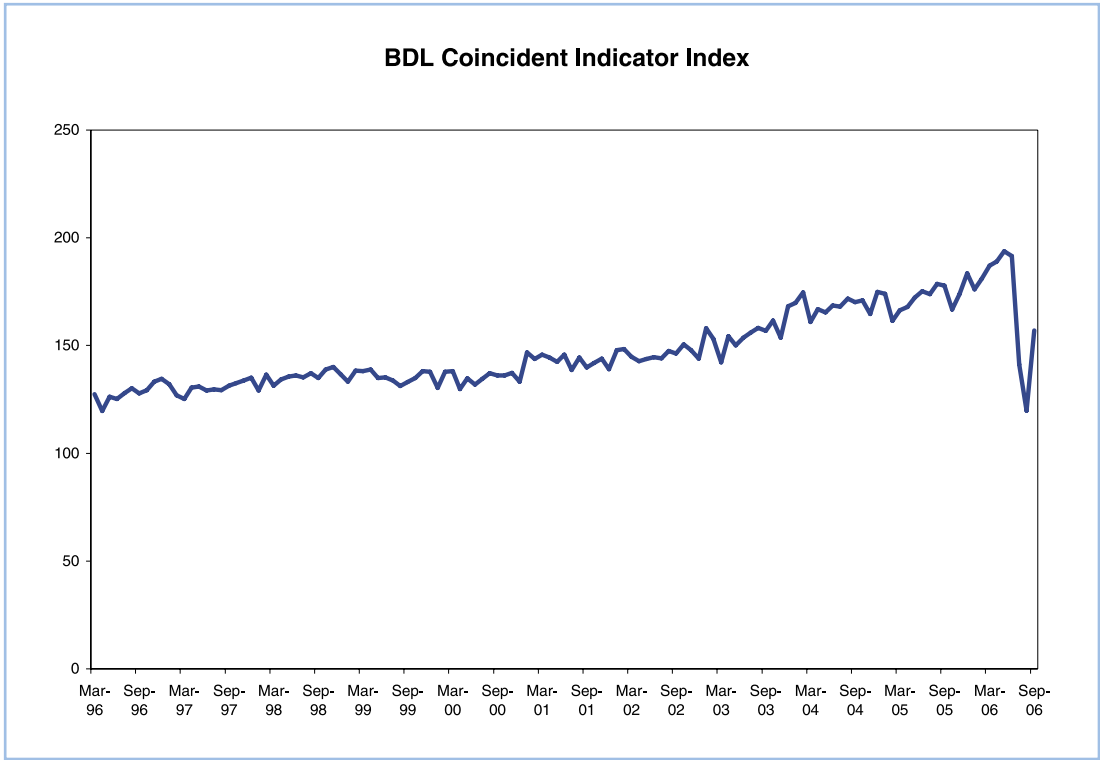
Economic Activity

Prior to the war, all economic indicators were pointing to a very high expected growth rate for 2006, ranging from 5% to 8% according to various estimates. The war was so devastating in terms of loss of human life, displacement, destruction of infrastructure and working physical capital that many agencies, such as the Economist Intelligence Unit (EIU), first revised growth down to -7%. However, the pick up in economic activity seen during the holy month of Ramadan and the speedy response of the international donor community prompted a revision to such extreme pessimism.

The full impact of the war will surely take some time to quantify, and hence there are now several estimates for the realized GDP growth rate in 2006, ranging from -5% to zero.

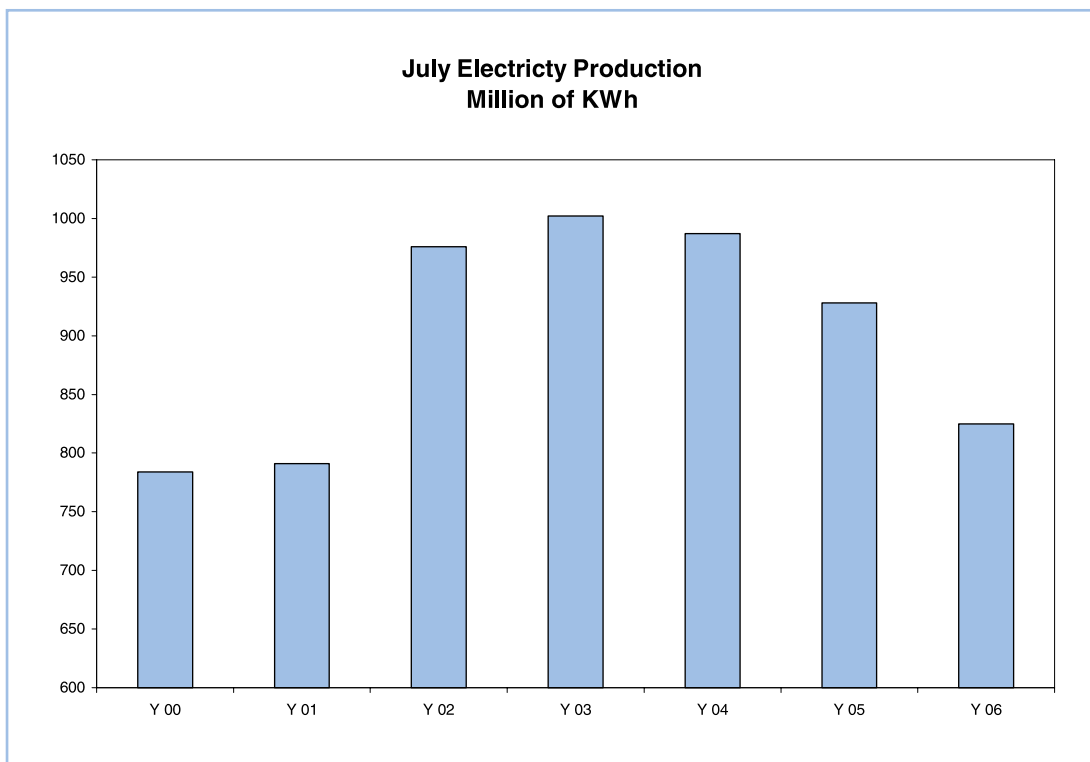
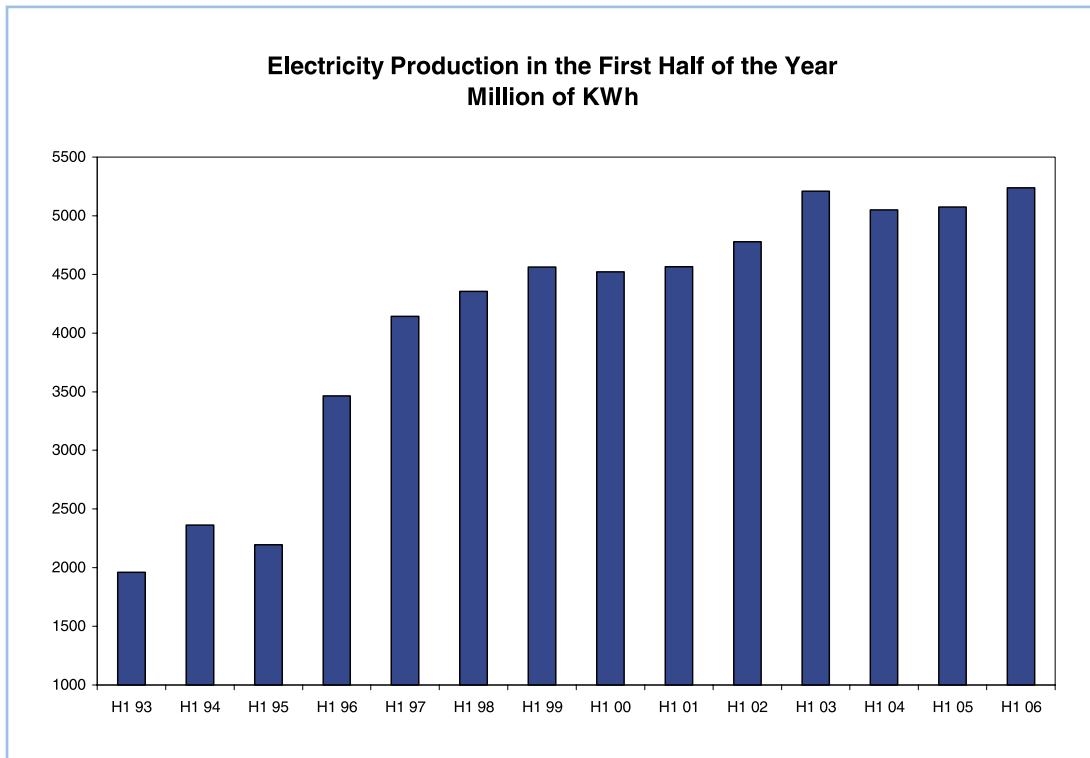
The IMF estimates that growth could be anywhere between -5% and zero, using -3.2% in the world economic outlook report. The government report on "the impact of the July war on the public finances in 2006" published on August 30 estimates the growth rate between -2% and -0.5%. The Central Bank, meanwhile, is expecting zero growth rate. A review of main indicators of economic activity does indeed support an at-most-zero growth rate hypothesis.

The Central Bank's (BDL) Coincident Indicator Index, a monthly gauge of economic activity in Lebanon, recorded very high levels during the year, especially during the spring and early summer of 2006, reflecting extraordinary growth. The index, however, suffered from a sharp drop in July and August, recording a reading of 119.8 in August 2006, which brought back the index to levels last seen in April 1996, i.e. a 10-year low (see Figure). The reading of 157.1 recorded in September was an improvement, but remains much lower than pre-war levels. The potential versus the actual of 2006 can be compared by contrasting the average of first 6 months of the year with the average of the first 9 months. The six-months average, which exceeded 180, was the highest on record, but the average of the first 9 months, which takes into account the most recent data and includes the summer levels is significantly lower and brings back the average to below the average of the first 9 months of 2005, hence suggesting a negative growth in 2006 (see Figure).



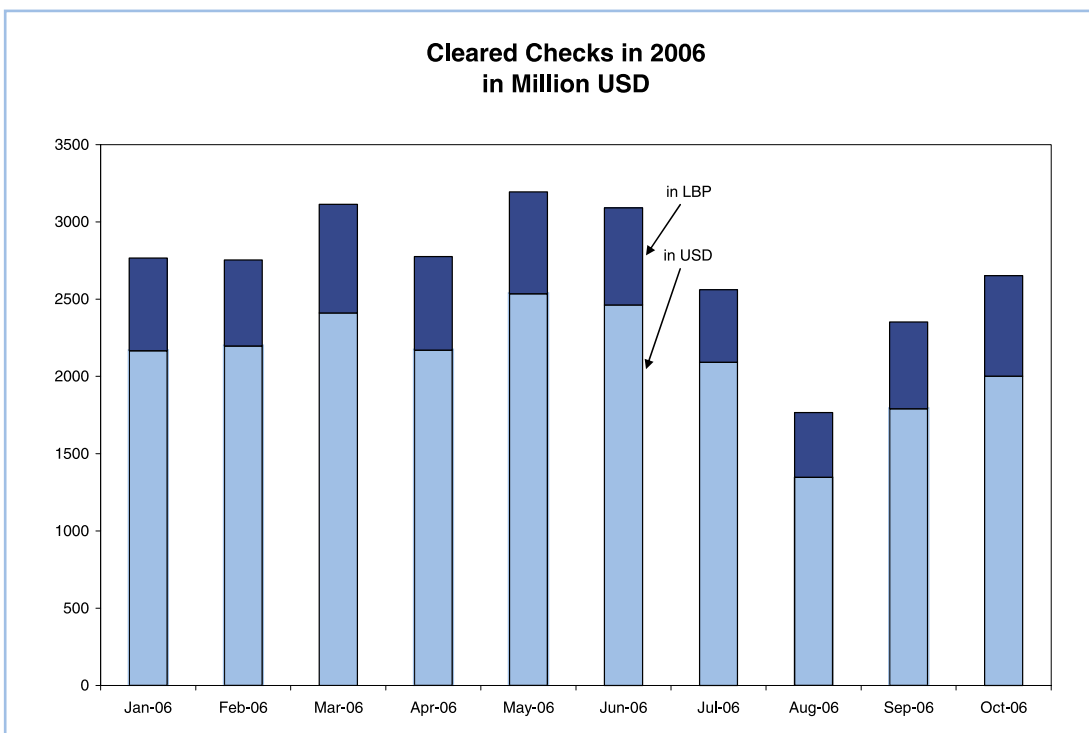
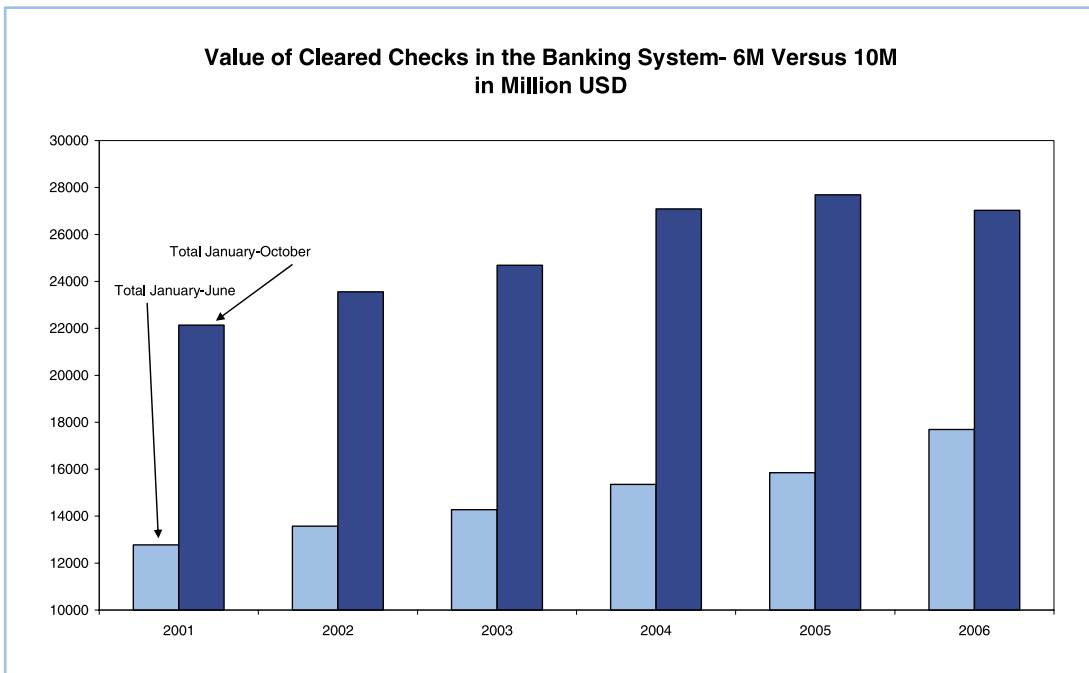
Indicators from both the industrial and the commercial sectors are in line with the BDL Coincident Indicator Index. From the industrial sector, we analyzed data on electricity production and import of industrial machinery, while from the commercial sector, we analyzed data on the value of cleared checks in the banking system.

Electricity production, already at an all-time mid-year high (see Figure) underlining solid economic activity, recorded a very low reading in July, mainly due to damages in the power infrastructure.



Imports of industrial machinery reached a mid-year high of \$71 million, up by 6% from the mid-year 2005 levels, but declined significantly in the third quarter. As of end-September 2006, it totaled \$87.2 million or down 15.4% from the \$103 million recorded in the same period in 2005.

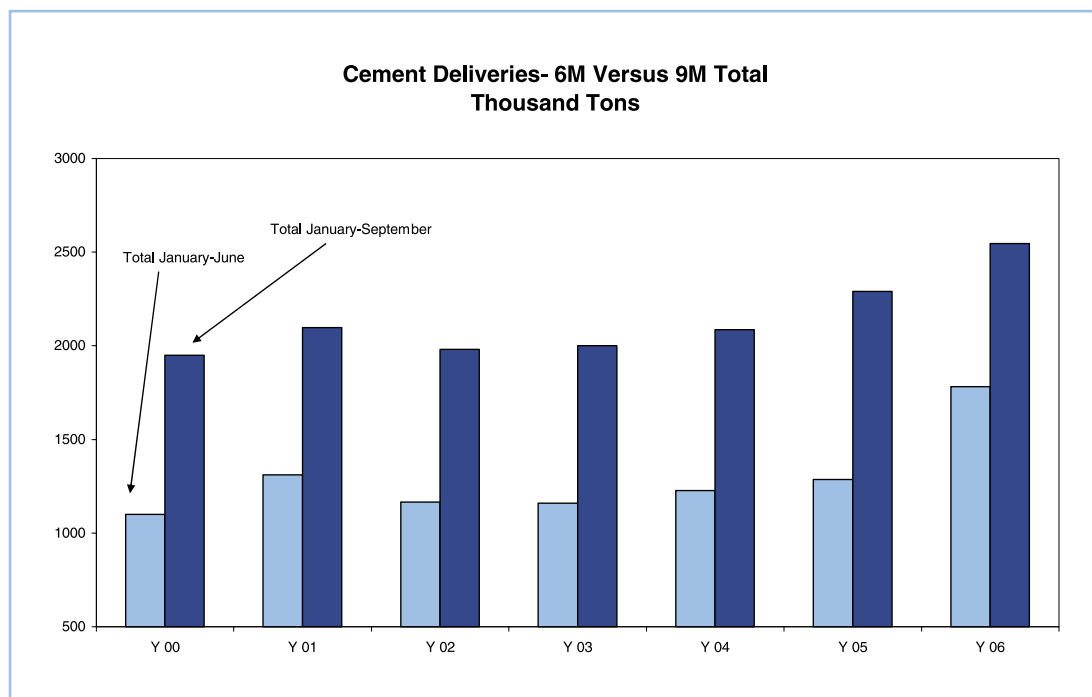
Commercial activity, proxied by the value of cleared checks in the banking system, a gauge of both consumption and investment demand, was at a high of around \$17 billion by mid-year 2006, up 12% from the corresponding period in 2005. It declined significantly in July and August before picking up again in September and October. The total value of cleared checks, in the first 10 months of 2006 totaled \$27,026 million, down 2.4% from the corresponding period in 2005 (see Figure).



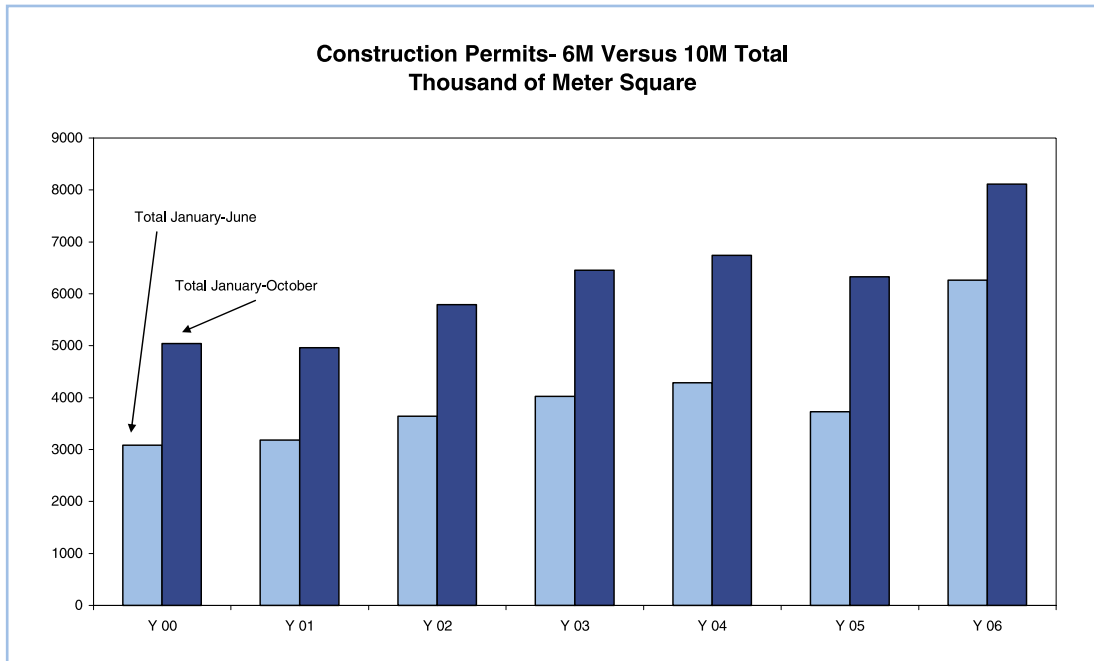
Three key sectors typically highly contribute to growth in Lebanon. These main sectors are construction, tourism, and trade. We track developments in these three sectors, comparing mid-year 2006 to previous years, and then last data available in 2006 to the corresponding period in previous years, again in order to contrast potential versus actual 2006.

Indicators from the construction sector, which typically contributes around 10% of GDP since the end of the civil war in the early nineties, pointed to the same duality. This is clear from data on cement deliveries and construction permits.

Cement deliveries in the first six months of the year were at a high, having increased by 39% in the first six months of 2006 over the corresponding period in 2005. Deliveries significantly dropped in July and August as a result of the war, and while they partially recovered in September, the total of the first 9 months of 2006 is now only 11% up from the corresponding period in 2005 (see Figure).

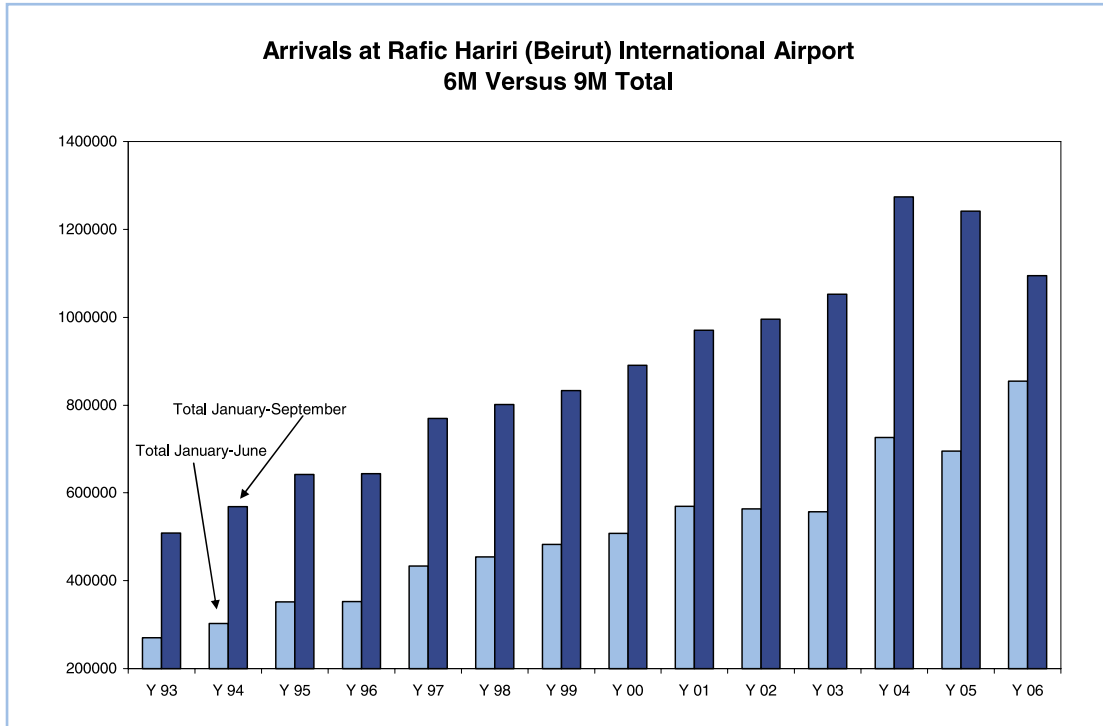


Construction permits were also at a high by mid-year 2006 and also suffered in July and August. While September and October figures showed a small recovery, they were still at levels way below their peaks. In fact construction permits were up 68% mid-2006 on mid-2005, but by the end of October 2006 they were up 28% on the corresponding period (first 10 months) in 2005 (see Figure).

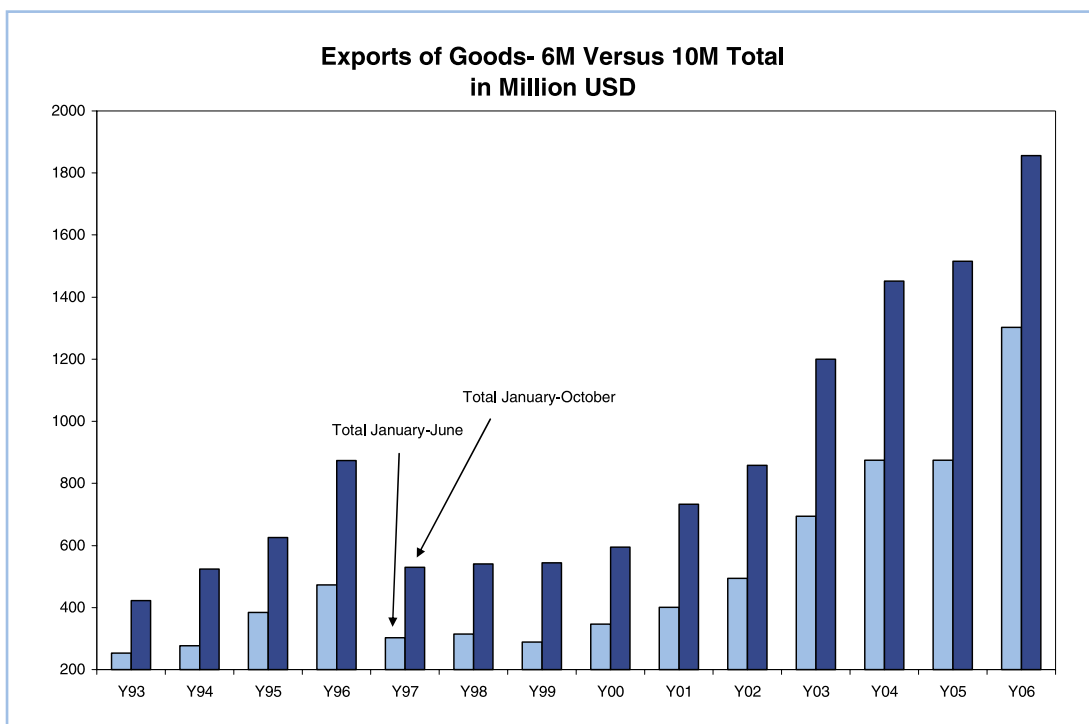


The tourism sector, which has always been the backbone of the Lebanese economy, contributing historically some 20% to growth, was also set for a spectacular year. Arrivals at Rafic Hariri (Beirut) International Airport were poised to record an all time high by the end of 2006, as clearly reflected by the mid-year numbers, which were up by 22.7% from their corresponding period in 2005. The July war, however, turned the situation around. In fact, July and August arrivals were the lowest in more than a decade due to the Airport closure in most of the summer, but started to recover in September which recorded 114 thousands arrivals. Still this puts now the first 9 months of 2006 at -11.8% from the first nine months in 2005.

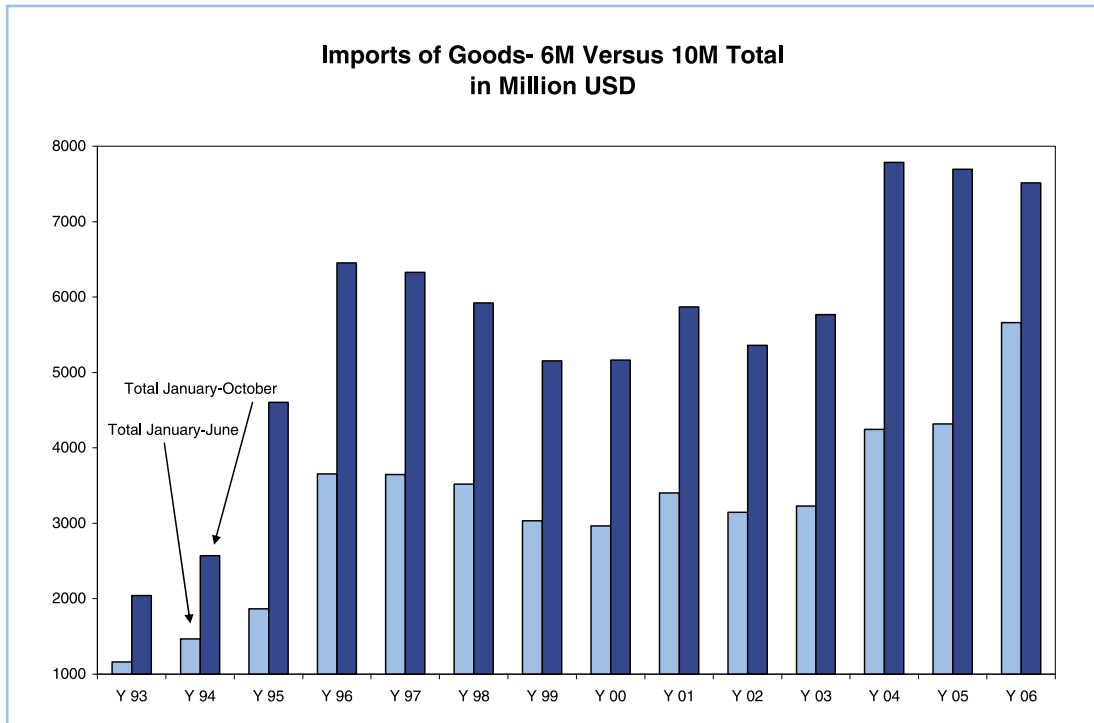




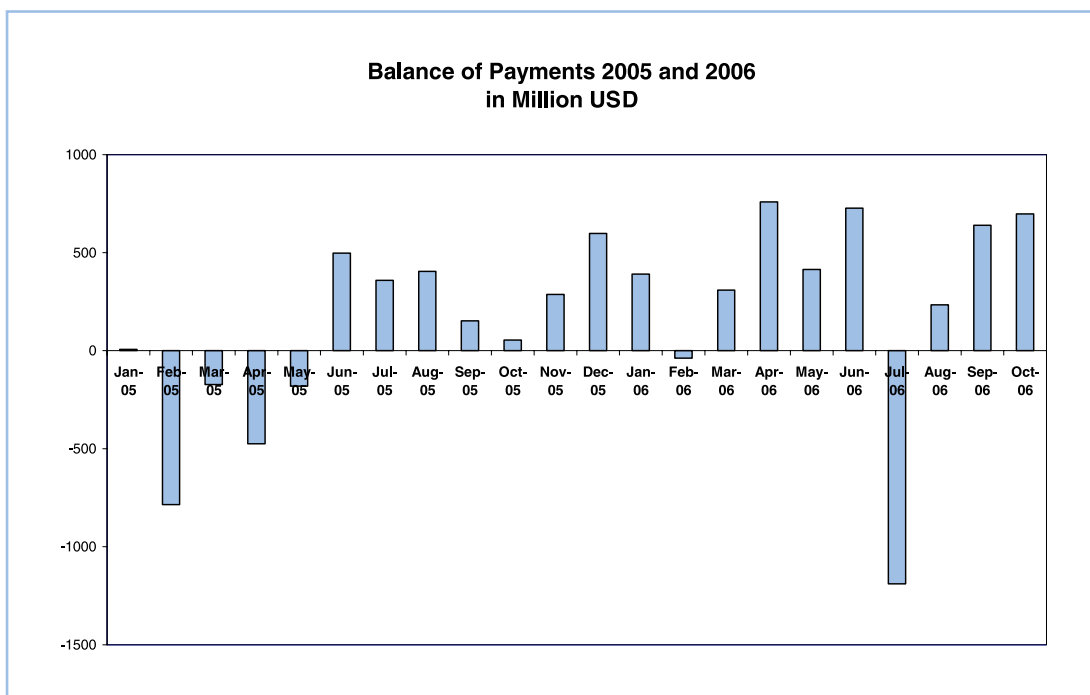
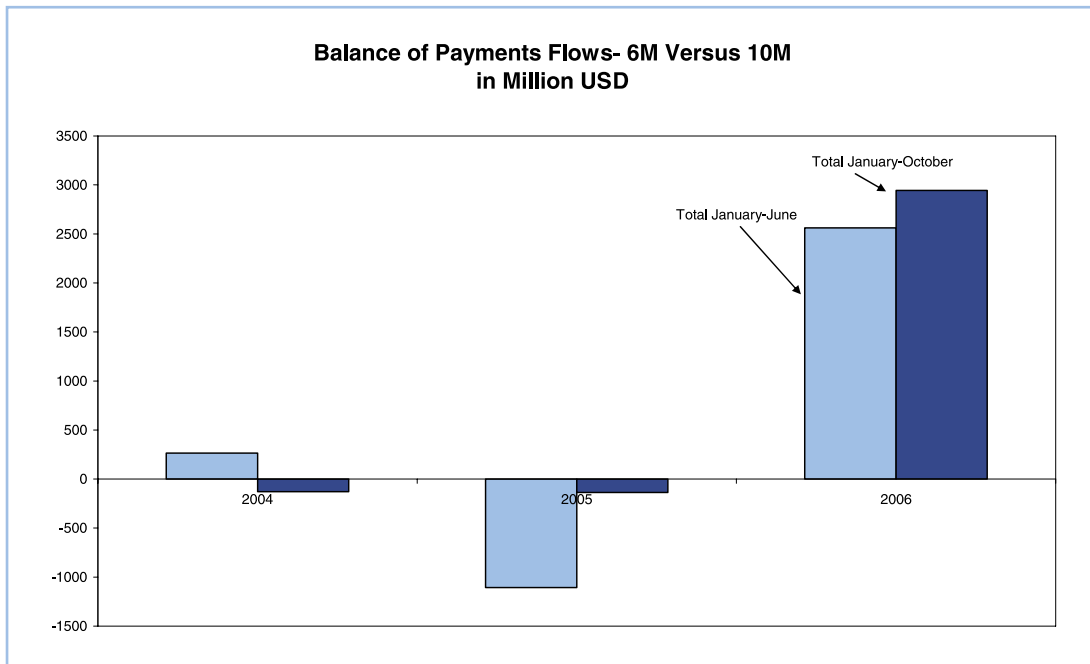
The foreign trade sector, in terms of both exports and imports, mirrors the same duality underlined in construction and tourism data. Export of goods, were also set to reach a record high in 2006, as shown by figures mid-year, when export exceeded \$1.3 billion, an increase of 49% from the corresponding period in 2005. The sector was significantly hit recording very low levels in July and August, mostly due to the halt of economic activity and ports closure. A recovery in September and October dampened the effects of the war, and despite all, exports in the first 10 months of 2006 were at \$1.8 billion compared with \$1.5 billion for the same period in 2005, hence still showing a positive growth of 22% (see Figure).



Imports of goods were set to reach a record high in 2006, as pointed by mid-year figures, when they reached \$5.7 billion, an increase of 31% over H1 2005. Due to low figures in July and August, and despite a mild recovery in September and October, imports in the first 10 months of 2006 totaled \$7.5 billion, compared with \$7.7 billion for the same period in 2005, i.e. a decline of 3%.

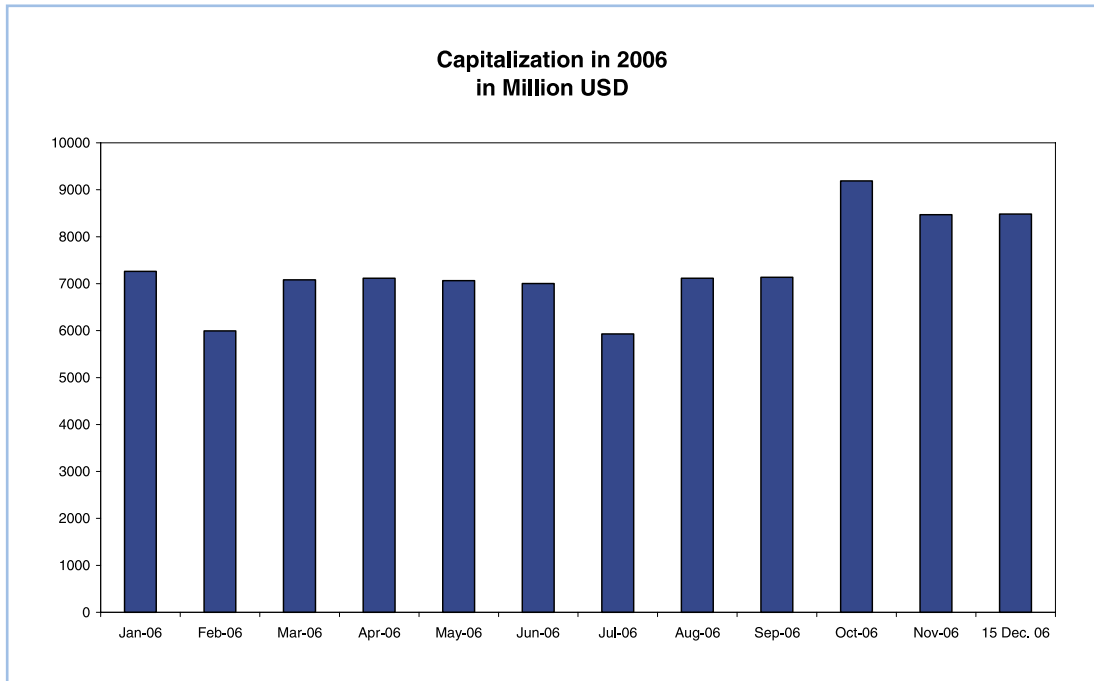


The impact on the balance of payments (BoP) flows was quite muted, due mostly to the generous donors' support especially from Saudi Arabia and Kuwait. As of end-June 2006, BoP results were pointing to an exceptional year, with a recorded surplus of \$2562 million, compared with a deficit of \$1108 million in the first 6 months of 2005, or an increase of 231%. As of end-October 2006, the surplus was up to \$2562 million compared with a deficit of \$137 million in the first 10 months of 2005 (see Figure). This reflects the fact that war-related capital flight in July was partly compensated by donors' support and gradual return of confidence which prompted capital inflows to resume in August (see Figure).



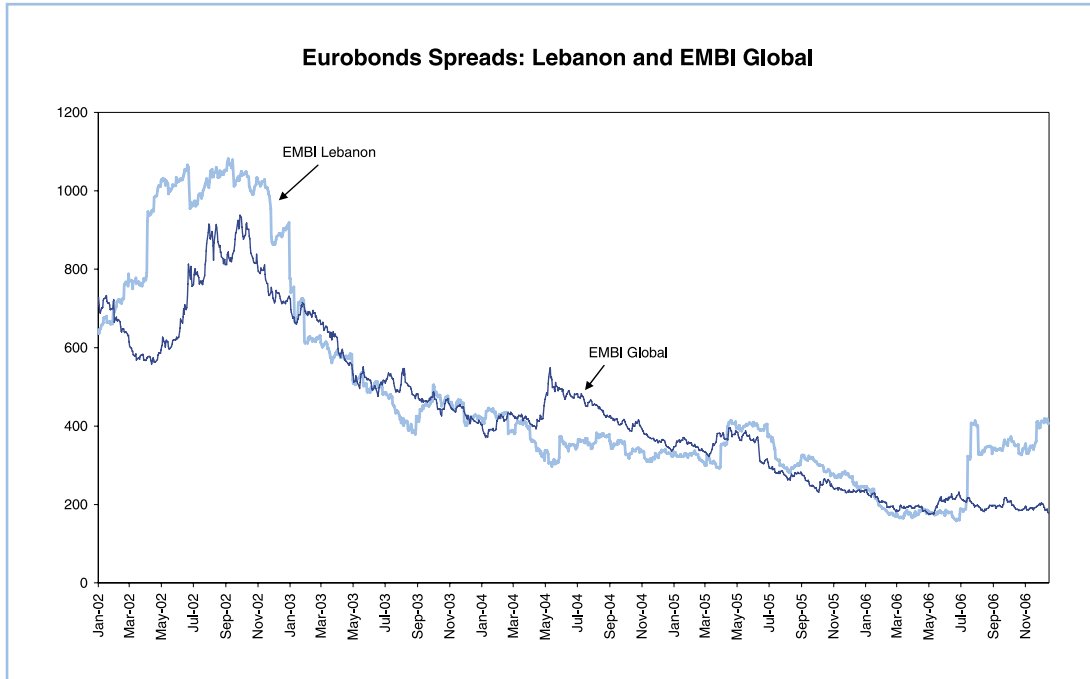
Financial Markets

The effects of the war were most muted on financial markets which held up relatively well. The July war had its toll, but the market quickly recovered, to stabilize again as political tensions increased again in November. By mid-December 2006, stock market capitalization at \$8482 million is up 21% from mid-year level (see Figure).



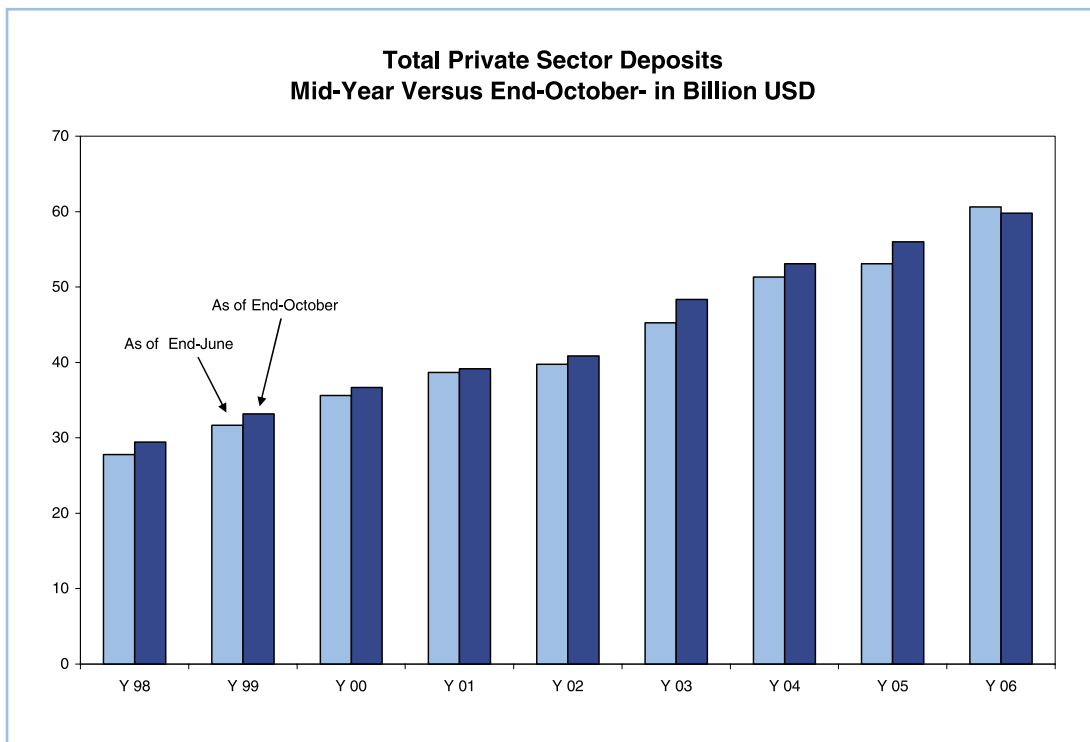
Emerging Markets Bonds Index (EMBI) Lebanon (sovereign) spreads, meanwhile, did widen significantly, by some 200 basis points, rising from 207 bps over comparable US Treasuries to around 410 basis points, and hence diverging from the spreads of the overall EMBI (see Figure). While they did decrease following the cease fire, rising political tensions took their toll again in November and December, and spreads were back up 407 basis points by mid-December 2006.



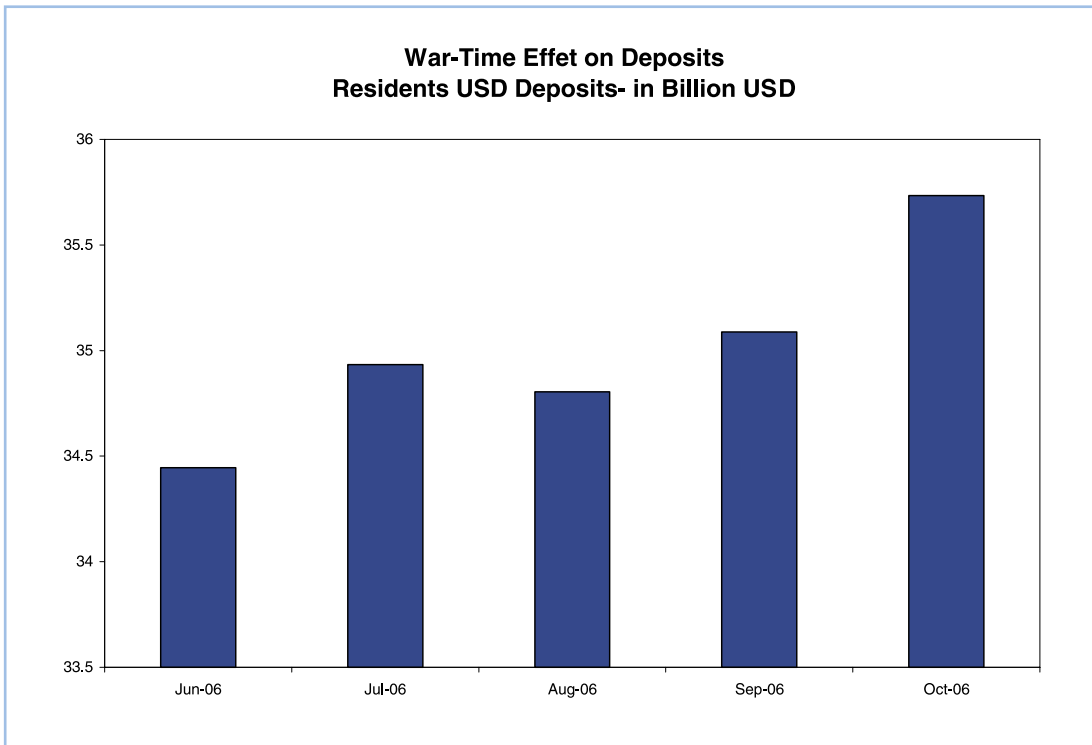


Banking Sector

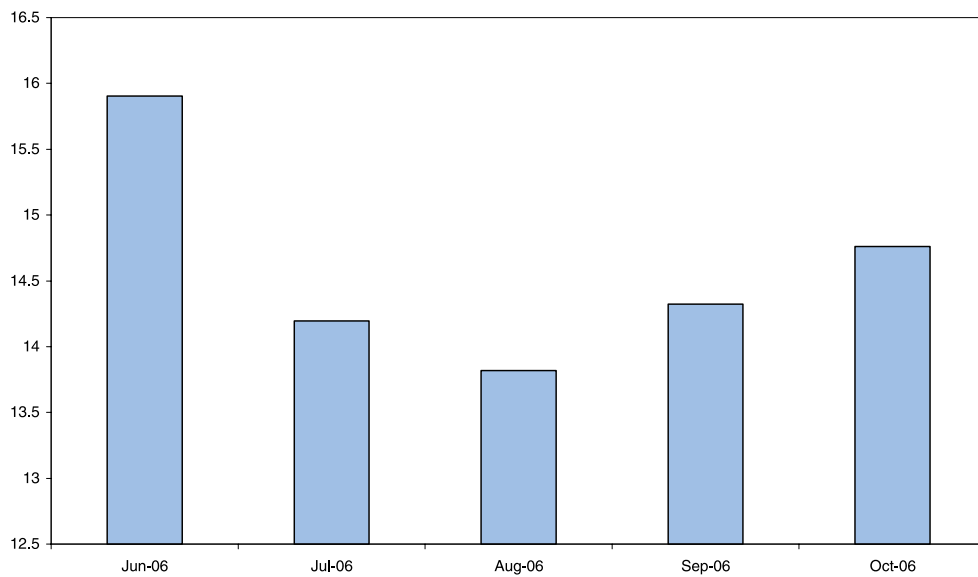
The banking sector, having witnessed significant growth since mid-2005, was set for an exceptional year in 2006. Private sector deposits, which includes both residents and non-residents, had shown a growth of 14% from end-June 2005 till end-June 2006, when they crossed for the first time the \$60 billion mark. The deposit base, however, shrank in July and August, before growing again in September and October. As of end-October 2006, total private sector deposits stood at \$59.8 billion, (i.e. almost completely recouping their war losses), which constitutes a 7% growth from the end-October 2005 level (see Figure).



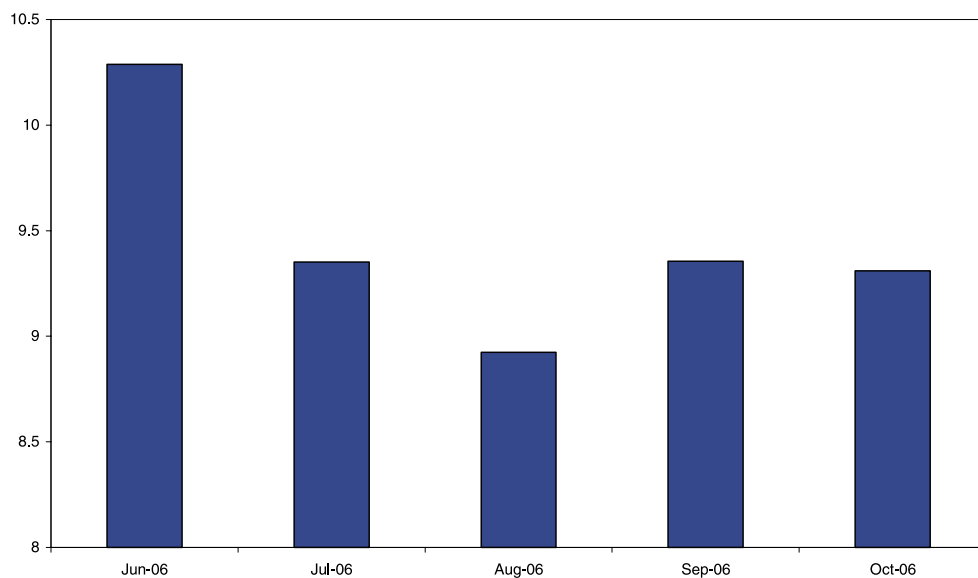
A closer look at deposits behavior during the war reflects that the decline in private sector deposits came mostly from the residents LBP deposits and from the non-resident deposits, each of which declining by around 14% during the war period (end-June to end-August), while residents USD deposits remained relatively stable, increasing by 1% during the same period. Total deposits, as a result, decreased by 5% during the war, but have since gained back most of the losses. Total private sector deposits stood at \$59.8 billion by end-October 2006, i.e. a decline of 1.5% from their end-June 2006 level of \$60.6 billion.



War-Time Effect on Deposits
Residents LBP Deposits- in Billion USD

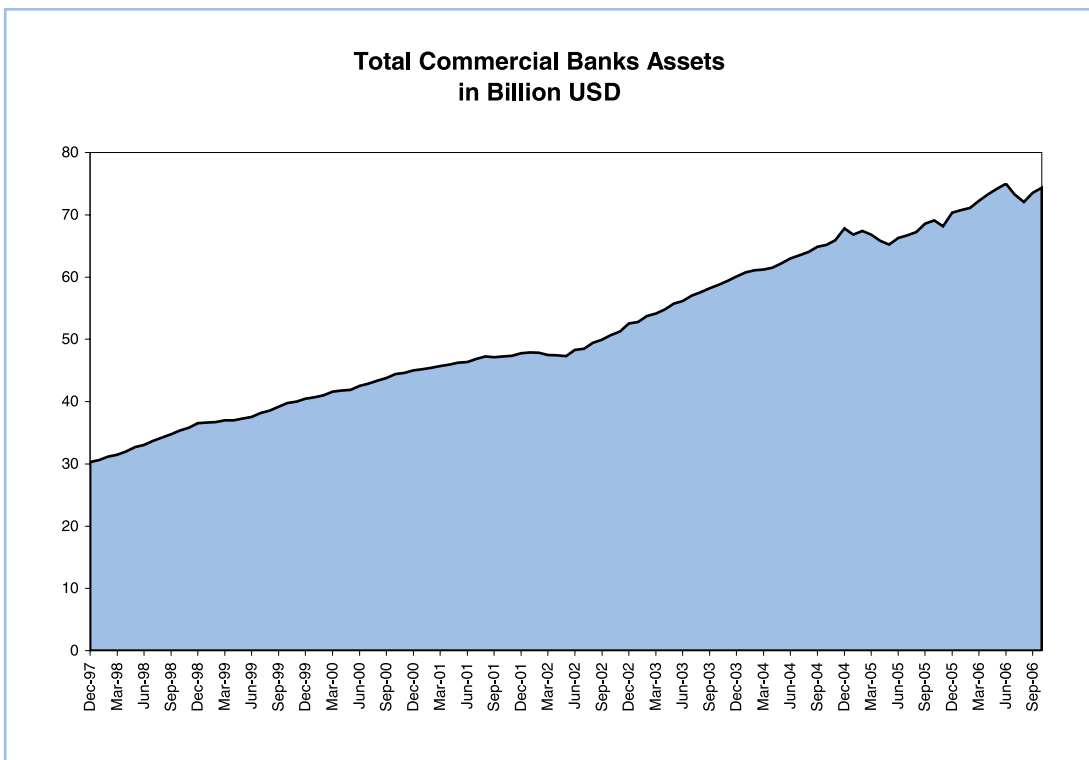
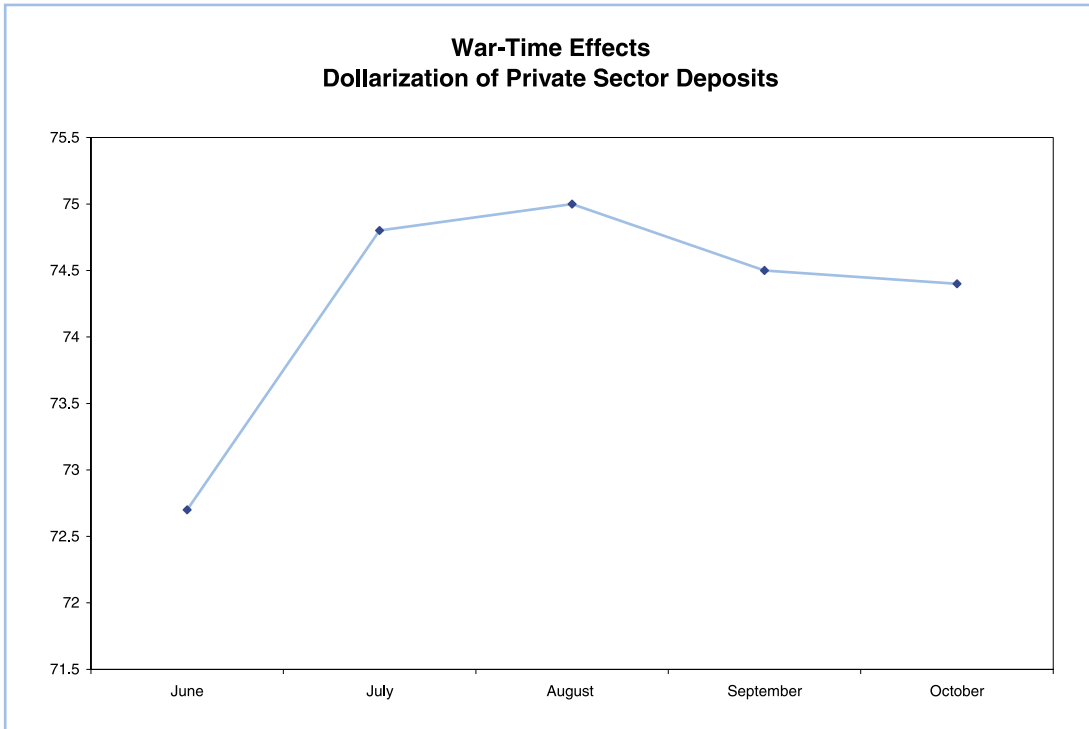


War-Time Effect on Deposits
Non-Residents Deposits- in Billion USD

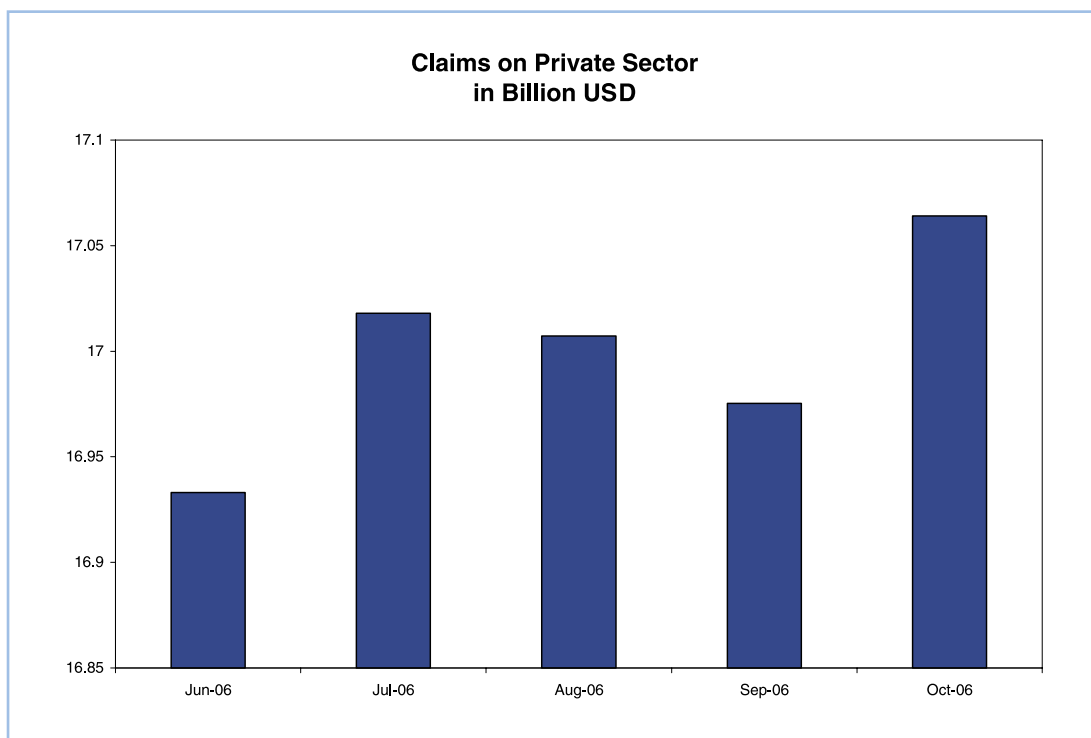
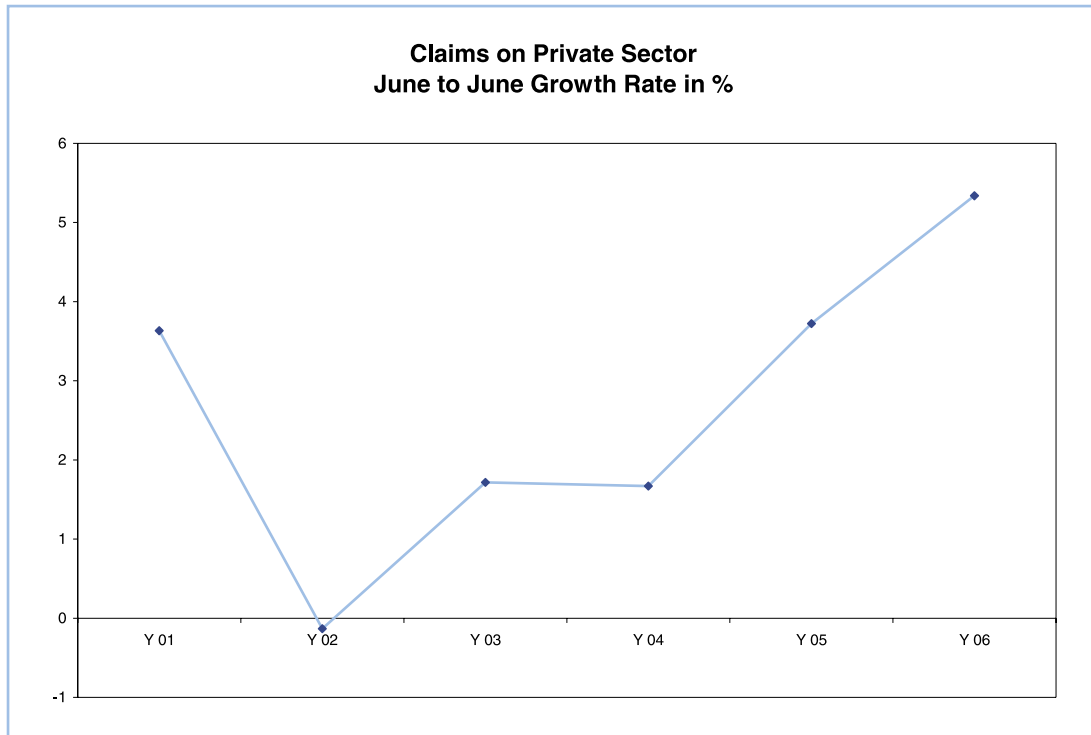


As a result of flight from LBP accounts, dollarization of private sector deposits (residents and non-residents) edged up during the war climbing from 72.7% in June 2006 to 74.8% in July and 75% in August. While it has slightly edged down in September and October, it remains quite high (see Figure).

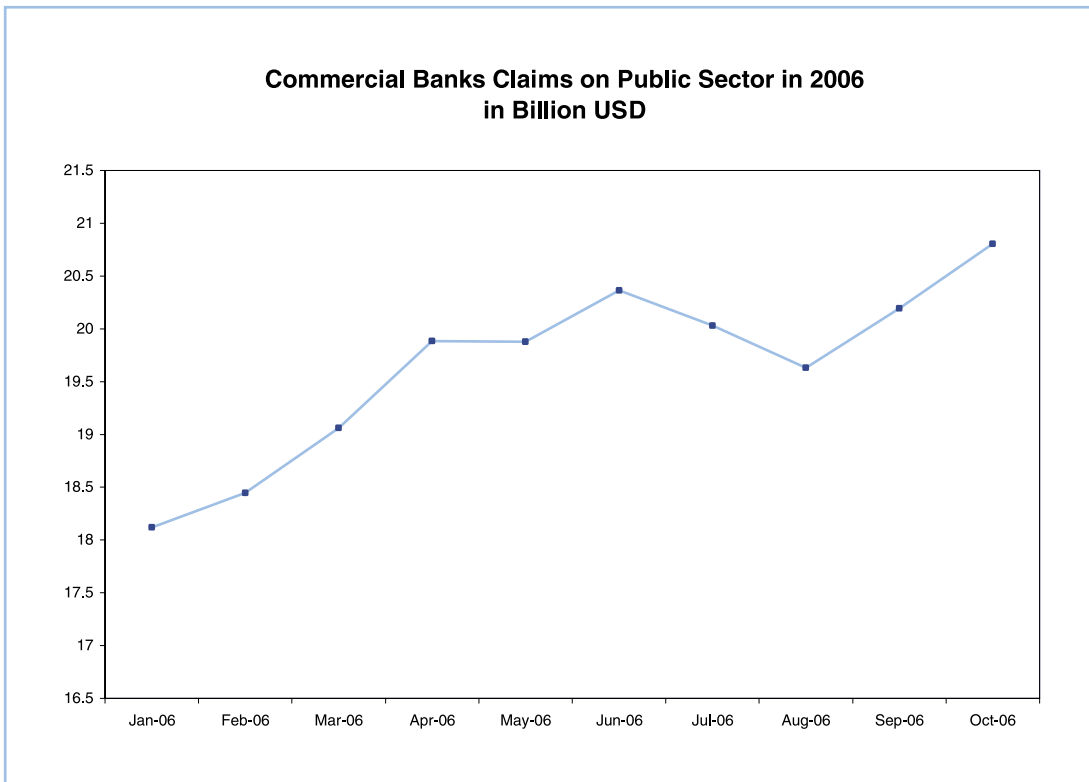
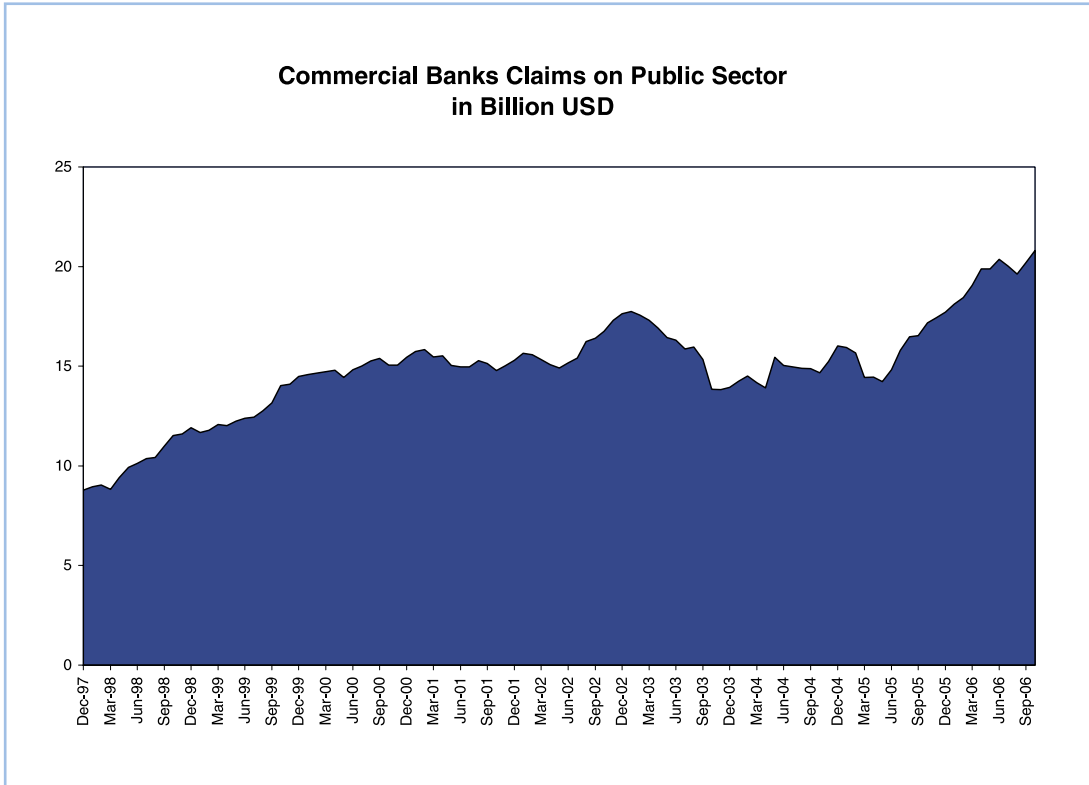
The recovery in deposits has also evidently caused a recovery in total assets, which reached \$74.3 billion as of end-October 2006, still slightly down from their \$75 billion peak by end-June 2006. Total assets, however, are up 7.6% from their end-October 2005 level of \$69 billion.



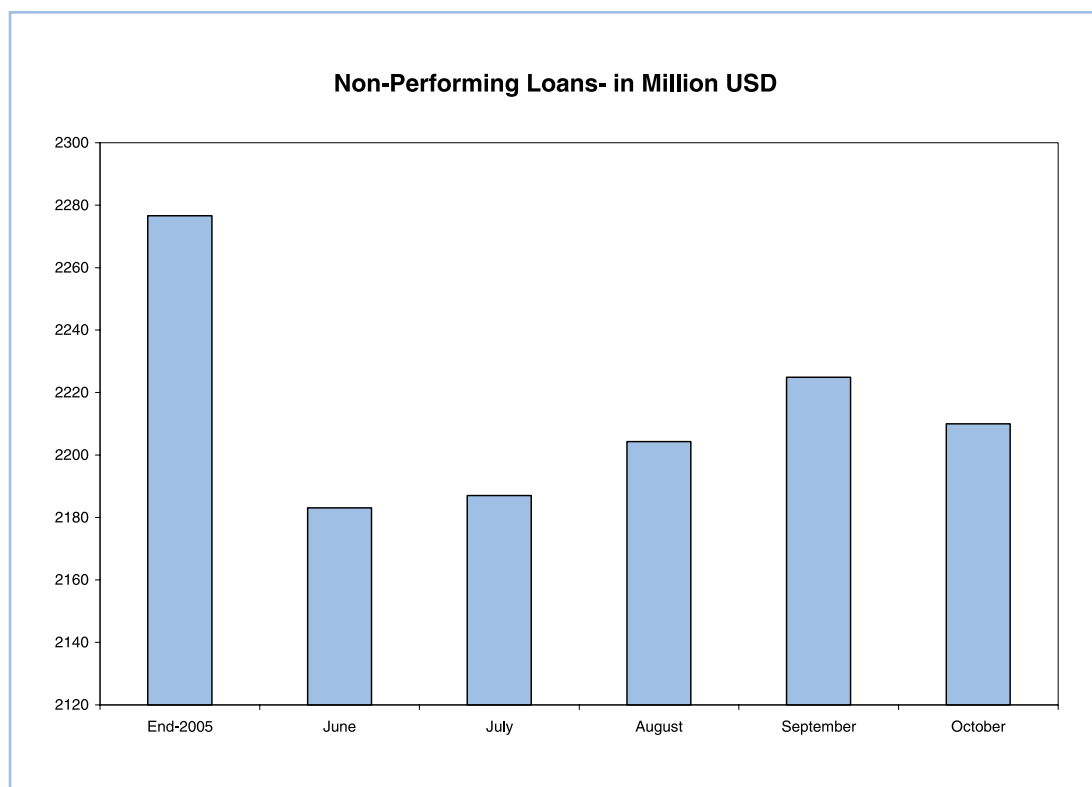
Claims on the private sector, after having recorded by mid-2006 a high growth rate of 5.3% from their mid-2005 level, i.e. one of the highest growth rate since the start of the decade (see Figure), declined because of the war before picking up again in October 2006, and they now stand at around \$17 billion (see Figure).



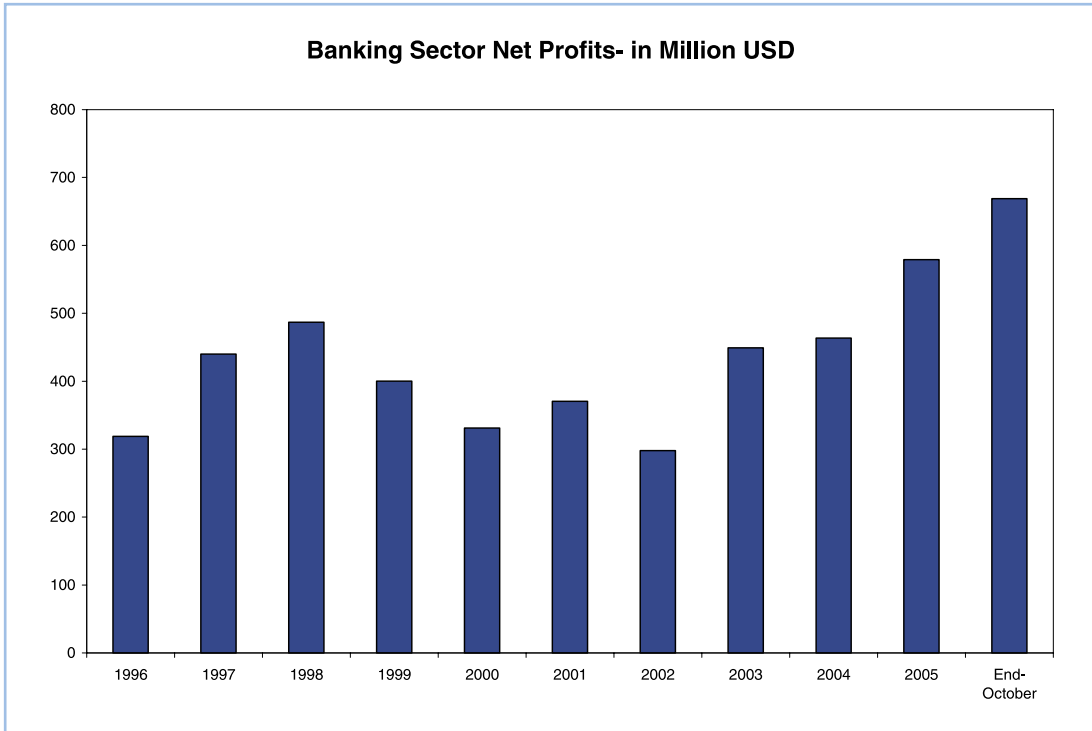
Commercial banks' claims on the public sector have been growing at a high pace for a long time, reflecting banks' financing of the government (see Figure). The high growth accelerated further in 2006, when claims grew from around \$18 billion by end-2005 to \$21 billion by end-October 2006 (see Figure).



Non-performing loans, which have been trending down, edged up again after the war, increasing to \$2225 in September 2006 but declined to \$2210 million in October 2006 (see Figure).



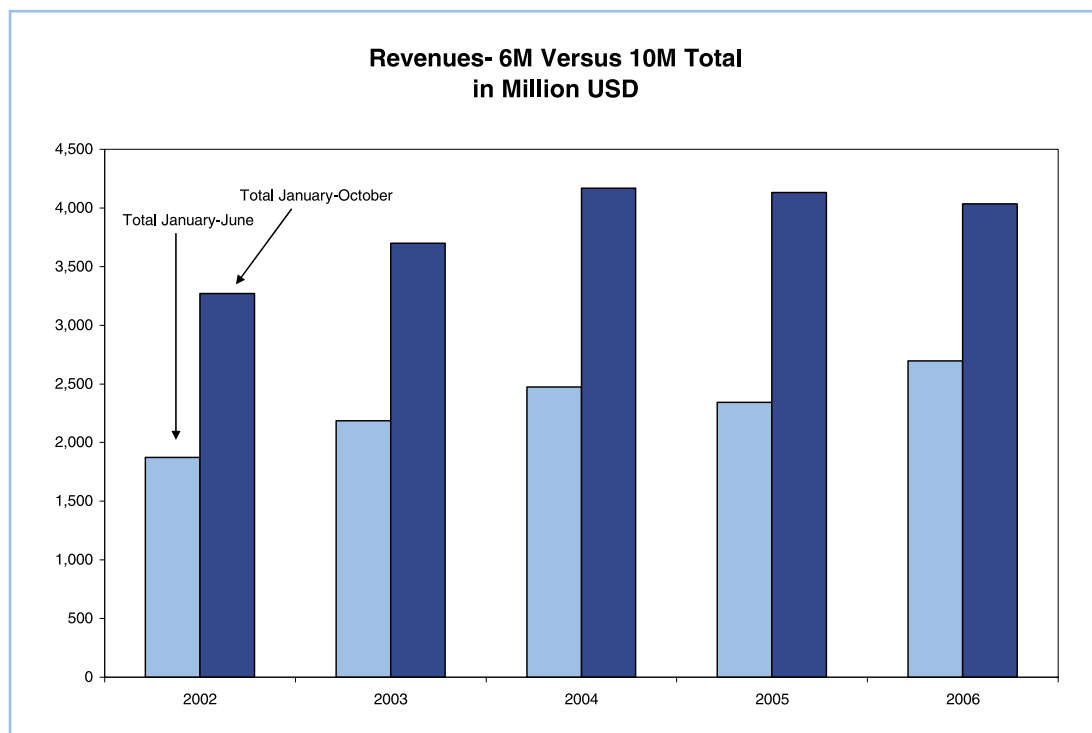
Profitability of the banks did not suffer much because of the war, and it is set to reach all time high in 2006 despite all the tragic events of the year. As of end-October 2006, net profits stood at \$669 million compared with \$475 million in the corresponding period in 2005 (January-October).



Public Finances

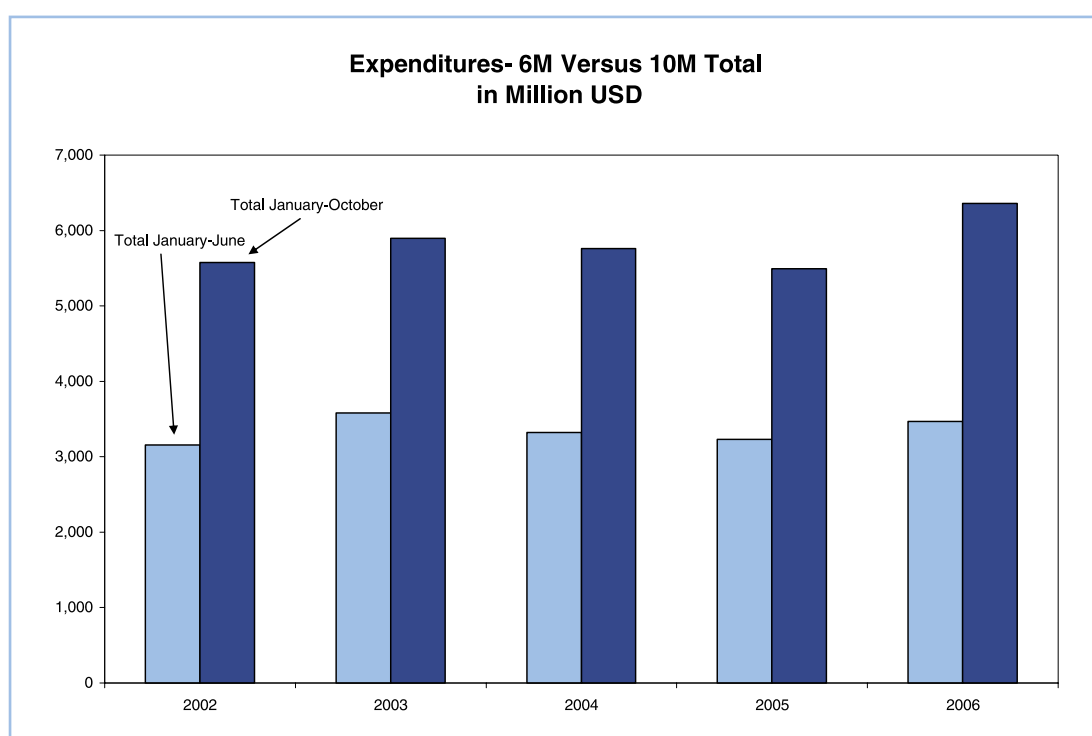
The war caused a major set back on ongoing fiscal reform efforts by the government, as effects on public finances were extraordinary in their magnitude. In line with developments in economic activity and in the banking sector, the public sector was setting itself for good results in 2006. Total revenues, as of end-June, were around \$2.7 billion, up by 17% from the \$2.3 billion collected in the first six months of 2005. The war, however, had a very negative effect on all aspects of revenues from customs receipts to VAT and other receipts. As a result, total revenues totaled \$4 billion as of end-October 2006, down 2.3% from the \$4.1 billion collected in the corresponding period in 2005 (see Figure).



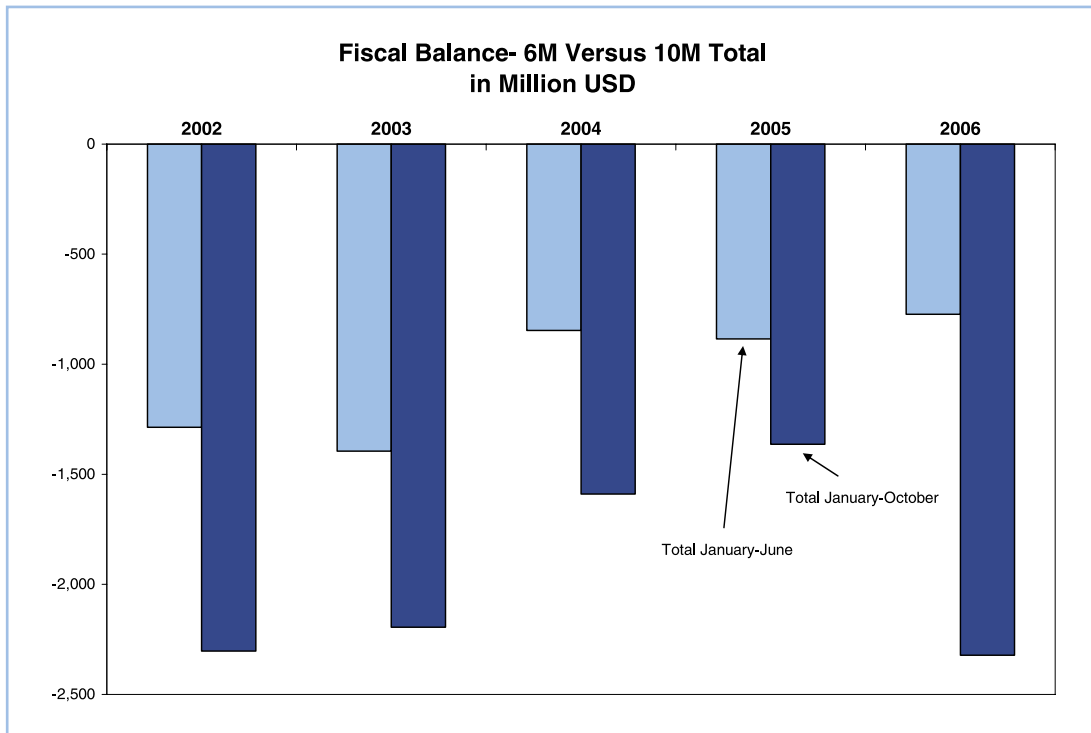


Expenditures, on the other hand, soared due to the war, magnifying further the effect of revenue shrinkage. By end-June 2006, total expenditures were at \$3.5 billion or up 7% from their mid-June 2005 level of \$3.2 billion. By end-October 2006, expenditures totaled \$6.4 billion, or up 15.7% from the corresponding period in 2005 when they totaled \$5.5 billion (see Figure).

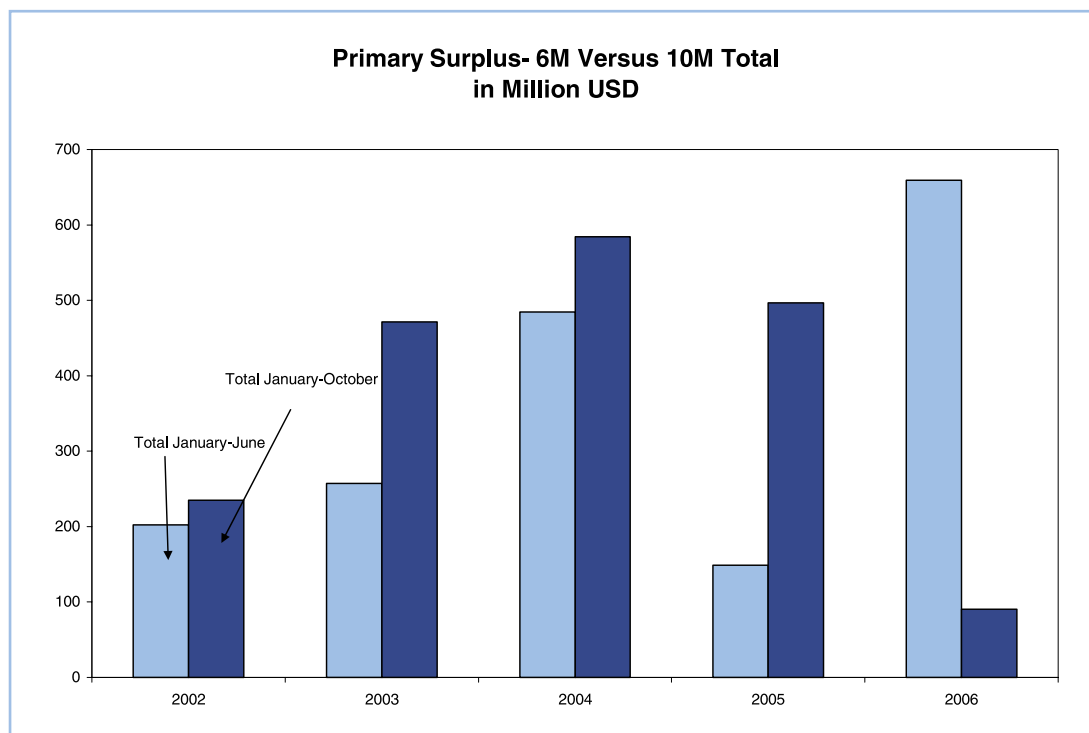
The growth in expenditures was partly caused by a significant increase in the treasury transfer to the state-owned electricity company (EDL) which totaled \$712 million in the first 10 months of 2006 compared with \$442 million in the first 10 months of 2005, i.e. a growth of 61%.



As a result of war-time distortions of both revenues and expenditures, the overall fiscal deficit ballooned. As of end-June 2006 the overall deficit was \$773 million, or down 13% from a deficit of \$885 million, in the first 6 months of 2005. As of end-October 2006, the overall fiscal deficit reached \$2.3 billion or an increase of 170% from the corresponding period in 2005 when it totaled \$1.3 billion (see Figure).

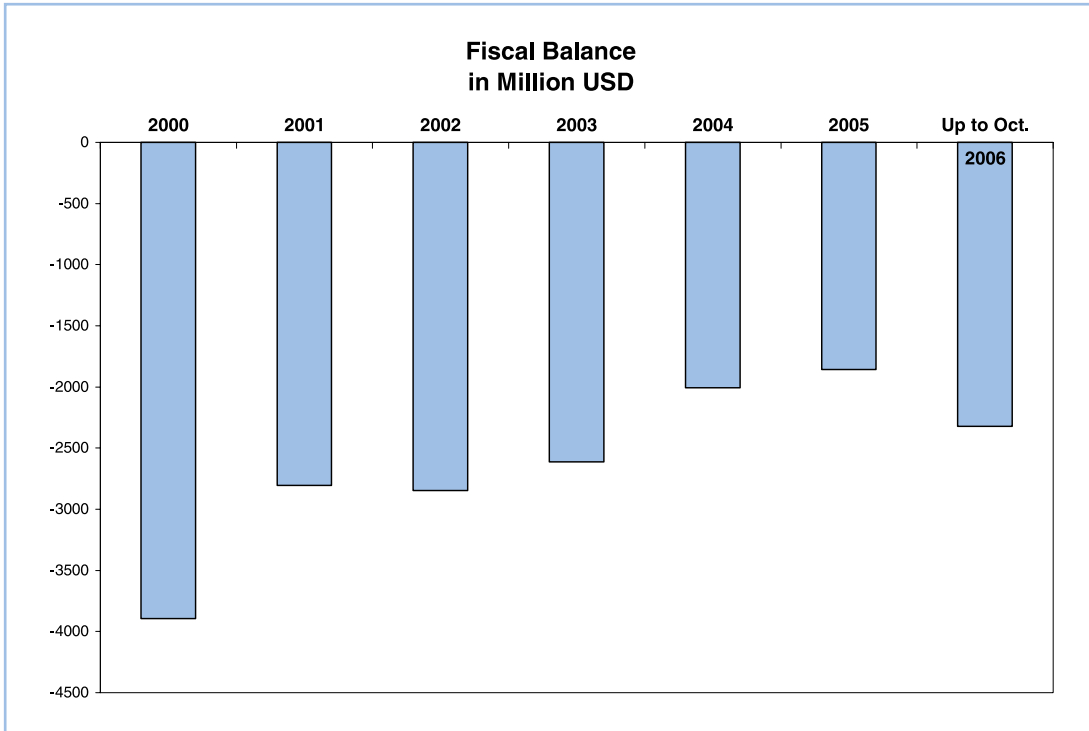


The negative effects on public finances could be seen best through the primary account, i.e. the overall balance without debt service. As of end-June 2006, the primary account showed a surplus of \$659 million, compared with a surplus of \$149 million in the corresponding period in 2005, i.e. an increase of 445%. Due to the war and its effects on the fiscal situation, the primary account as of end-October 2006 showed a surplus of \$90 million, compared with a primary surplus of \$496 million in the corresponding period in 2005, i.e. a decrease of 82%. This is a dramatic turnaround by any account in the primary surplus (see Figure).

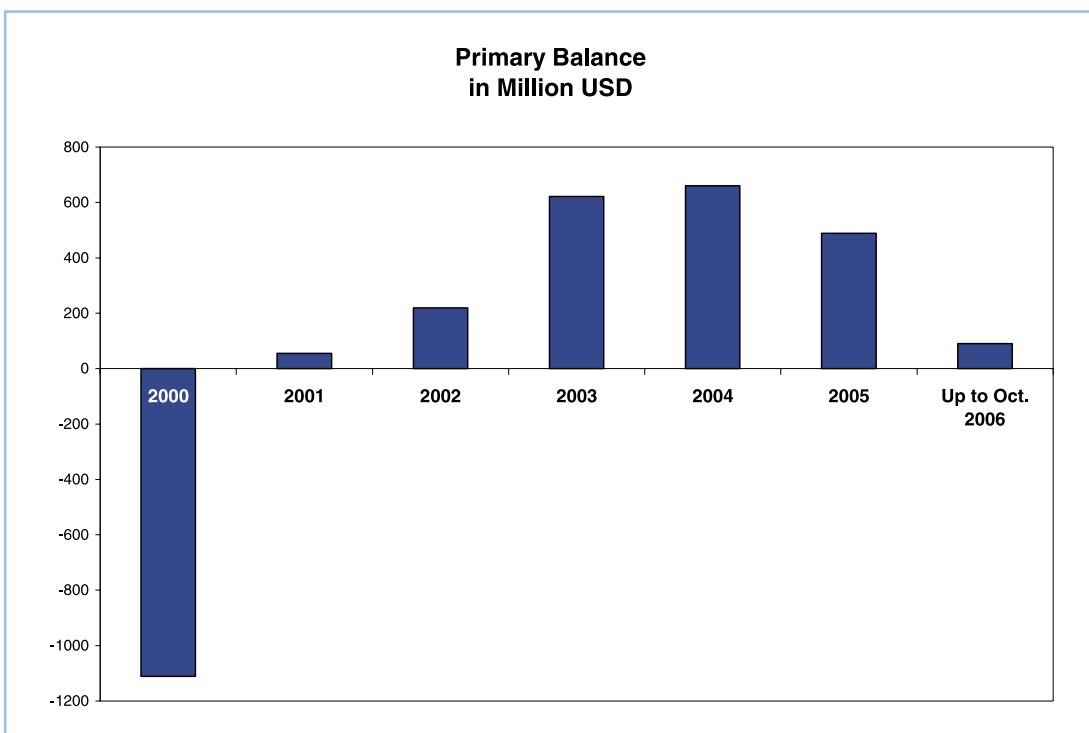


As a result, the fiscal deficit recorded so far in 2006, i.e. for the first 10 months, is already significantly higher from the one recorded for the full previous years. This has undermined significant efforts by the government since 2000 to rein in the deficit, hence turning around the positive trend that was seen since then (see Figure). The deficit of \$2.3 billion recorded for the first 10 months in 2006 is already 27% higher than the deficit of \$1.8 billion that was recorded for the entire year in 2005. The Ministry of Finance had expected in its post-war report the 2006 overall deficit to come in at \$3.8 billion (18% of GDP), i.e. a total increase of 211% from the 2005 deficit, and 172% higher than the \$2.2 billion it was projecting for 2006 prior to the July war.

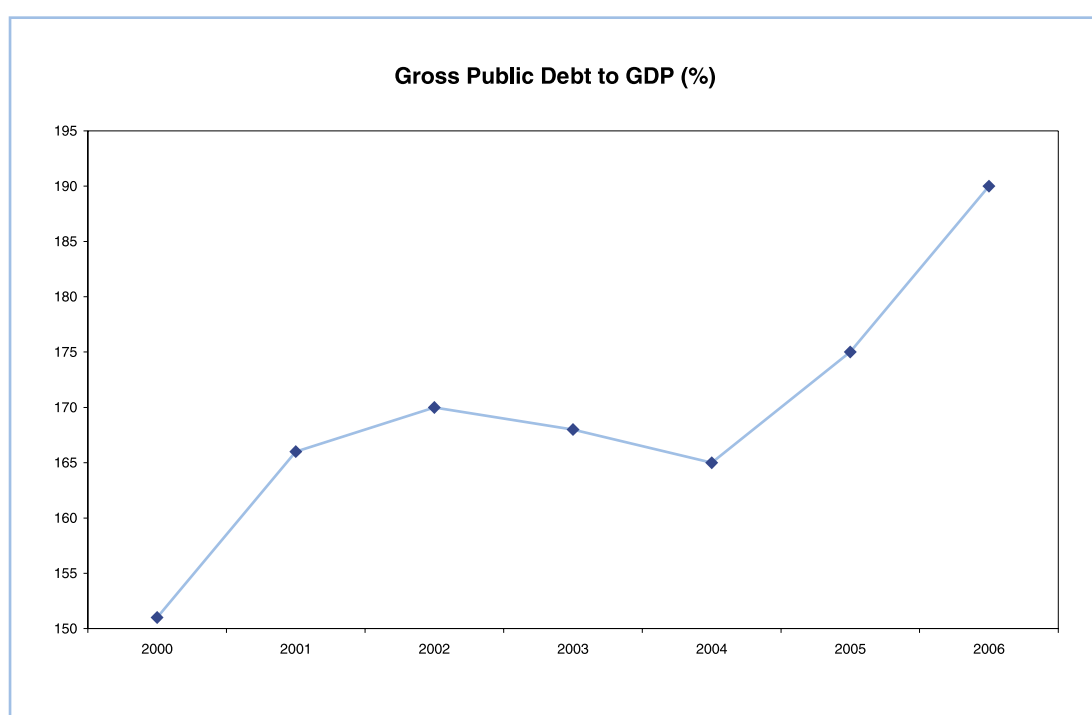
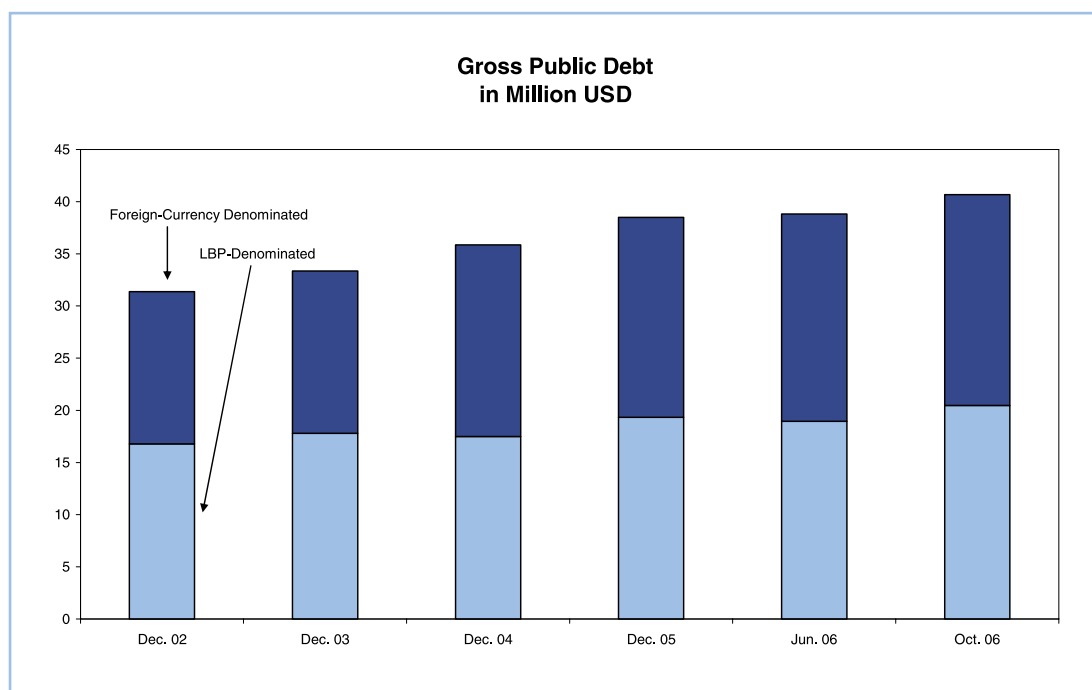
This stems from the fact that the conflict has increased pressure on public spending that was set to continue well after the war ended. The ministry identified four major sources, among others, of this additional spending in 2006: (i) the deployment of 15000 Lebanese troops to the south of the country to ensure compliance with U.N. Security Council Resolution 1701, which will cost \$70 million by end-2006, (ii) relief efforts which will cost \$46 million by end-2006, (iii) capital expenditure related to basic reconstruction needs which will cost \$332 million by end-2006, and higher losses at EDL related to damages to generation, transmission, and distribution facilities, while the company still needs to honor fixed contracts for the supply of energy, which will cost \$200 million by end-2006.



Efforts to boost the primary surplus, which has been showing strong improvement since 2002, were hence significantly undermined by developments in both 2005 and 2006, particularly the July war. After having peaked at \$660 million in 2004, events in 2005 caused the surplus to shrink to \$488 million, and the developments in 2006 makes it stand now at just \$90 million (see Figure). The Ministry of Finance had projected in its post-war report the overall primary account to record a deficit of 800 million by end-2006, the first such deficit since 2000.



Gross public debt increased fast as a result of the higher deficit, exacerbating further the structural debt problem that Lebanon is suffering from. Developments in both 2005 and 2006 compromised the efforts to stabilize the debt dynamics which started in 2002 (see Figure). By end-October gross public debt reached \$40.7 billion, or more than 190% of GDP, an increase of 5.7% over the end-2005 level. Local-currency debt amounted to \$20.5 billion, an increase of 6% from end-2005 level, while foreign-currency debt amounted to \$20.2 billion, an increase of 5.4% from the end-2005 level (see Figure).



2007- ENIGMATIC YET CONCLUSIVE?

There is no doubt that Lebanon is going through a political transition period that started around the end of 2004 and remains in process. How long we are going to remain in this transition period, what are its full economic implications, and whether 2006 was the trough for the economy, are questions that are very difficult to answer, hence the question mark in the title above.

Acknowledging this is a very important doorway to looking at 2007, which will surely carry several challenges. The resolution of the current political stalemate, the unity government, presidential elections, the international tribunal for the assassination of PM Rafic Hariri and possibly 14-related crimes (approved by U.N. Security Council Resolution 1595) and even early parliamentary elections are all connected sources of domestic divisions and ensuing tensions.

It is evidently tough to forecast accurately an economic growth rate in the midst of all these political complications. But forecasts on 2007 from international agencies seem quite upbeat, on the back of a reconstruction boost estimated to be in the magnitude of \$2-3 billion. While the EIU estimates a 6.5% growth rate, the IMF provides a more conservative figure of 5%. This would surely depend a great deal on the political and security developments. But more importantly, it will also depend on the ability of the government to finally implement the long-delayed comprehensive reform agenda, including privatization and public-sector efficiency enhancement. A successful Paris III donors' conference will provide the right framework for reform implementation and debt reduction. In fact the Ministry of Finance has signaled that it is hopeful of securing \$5-8 billion in loans, debt rollover and grants. A high proportion of grants will be essential to dealing with the exploding debt problem, in addition to helping the government meet, as we elaborate below, a high financing need in 2007 without causing an increase in the interest rate structure which would stifle the private sector further.

Debt obligations coming due in 2007 constitute a major bulk of the government financing need. The face value of maturing local currency Treasury bills total 8648 billion LBP, or the equivalent of \$5.7 billion (see Table). The face value of Eurobonds coming due in 2007 total \$1.4 billion, of which \$1000 million in February, \$100 million in July and \$369 million in October. Hence a total amortization of around \$7.2 billion, the largest portion of which is in February 2007 (see Figure).

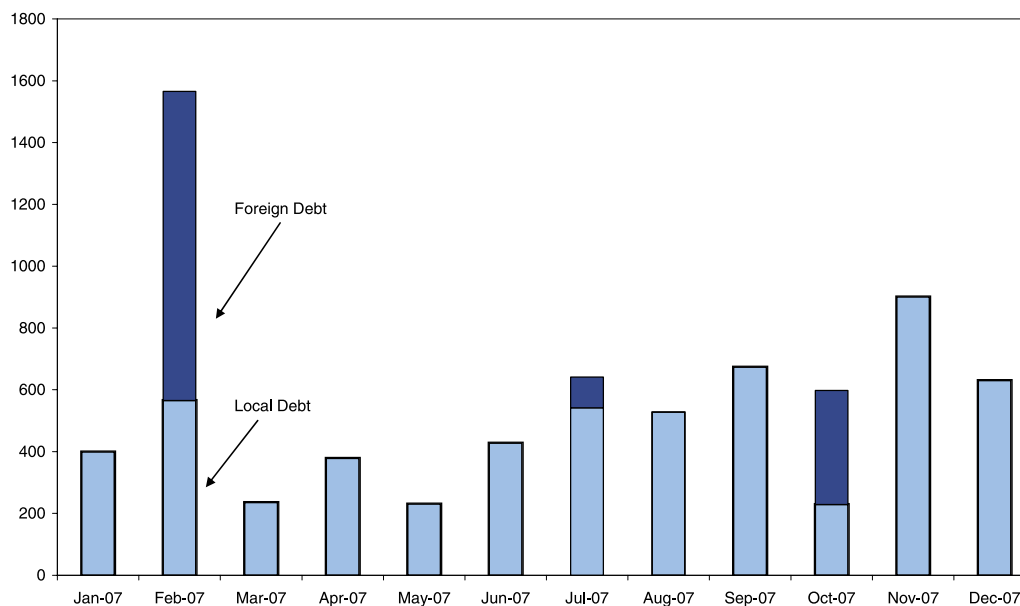
Outstanding Treasury Bills Denominated in LBP as of November 31, 2006 (Billion LBP)

| Year | Month | Category | | | | | Total |
|------|--------|----------|---------|----------|----------|----------|-------------|
| | | 3-month | 6-month | 12-month | 24-month | 36-month | |
| 2007 | Jan-07 | 77 | 123 | 273 | 118 | 10 | 601 |
| | Feb-07 | 40 | 561 | 76 | 73 | 102 | 852 |
| | Mar-07 | | 196 | 110 | 8 | 41 | 355 |
| | Apr-07 | | 174 | 175 | 10 | 211 | 570 |
| | May-07 | | 43 | 58 | 13 | 233 | 347 |
| | Jun-07 | | | 329 | 141 | 174 | 644 |
| | Jul-07 | | | 55 | 169 | 592 | 816 |
| | Aug-07 | | | 246 | 62 | 488 | 796 |
| | Sep-07 | | | 131 | 79 | 805 | 1015 |
| | Oct-07 | | | 84 | 13 | 248 | 345 |
| | Nov-07 | | | 71 | 84 | 1,202 | 1357 |
| | Dec-07 | | | | 56 | 894 | 950 |
| | Total | 117 | 1097 | 1608 | 826 | 5000 | 8648 |

Outstanding Treasury Bills Denominated in LBP as of November 31, 2006 (Million USD)

| Year | Month | Category | | | | | Total |
|------|--------------|-----------|------------|-------------|------------|-------------|-------------|
| | | 3-month | 6-month | 12-month | 24-month | 36-month | |
| 2007 | Jan-07 | 51 | 82 | 181 | 78 | 7 | 399 |
| | Feb-07 | 27 | 372 | 50 | 48 | 68 | 565 |
| | Mar-07 | | 130 | 73 | 5 | 27 | 235 |
| | Apr-07 | | 115 | 116 | 7 | 140 | 378 |
| | May-07 | | 29 | 38 | 9 | 155 | 230 |
| | Jun-07 | | | 218 | 94 | 115 | 427 |
| | Jul-07 | | | 36 | 112 | 393 | 541 |
| | Aug-07 | | | 163 | 41 | 324 | 528 |
| | Sep-07 | | | 87 | 52 | 534 | 673 |
| | Oct-07 | | | 56 | 9 | 165 | 229 |
| | Nov-07 | | | 47 | 56 | 797 | 900 |
| | Dec-07 | | | | 37 | 593 | 630 |
| | Total | 78 | 728 | 1067 | 548 | 3317 | 5737 |

**Amortization Obligations in 2007
in Million USD**



In addition to the amortization obligations, the fiscal deficit is expected by some international agencies such as the EIU to total around \$3.2 billion in 2007, as they expect revenues at \$5350 million and expenditures at \$8565 million.

Debt amortization of around \$7 billion and a deficit of around \$3 billion will imply a total gross financing requirement of the government of around \$10 billion.

Meeting this financing requirement would probably be achieved through a combination of international assistance and additional borrowing. But in the absence of reforms, too much fresh borrowing will exacerbate further the structural debt problem, as the gross debt to GDP ratio has already exceeded 190%. It also leaves Lebanon more vulnerable to shifts in investors' sentiment as it puts more pressure on the willingness and capacity of the domestic commercial banks to rollover existing debt and to provide the extra needed public financing.

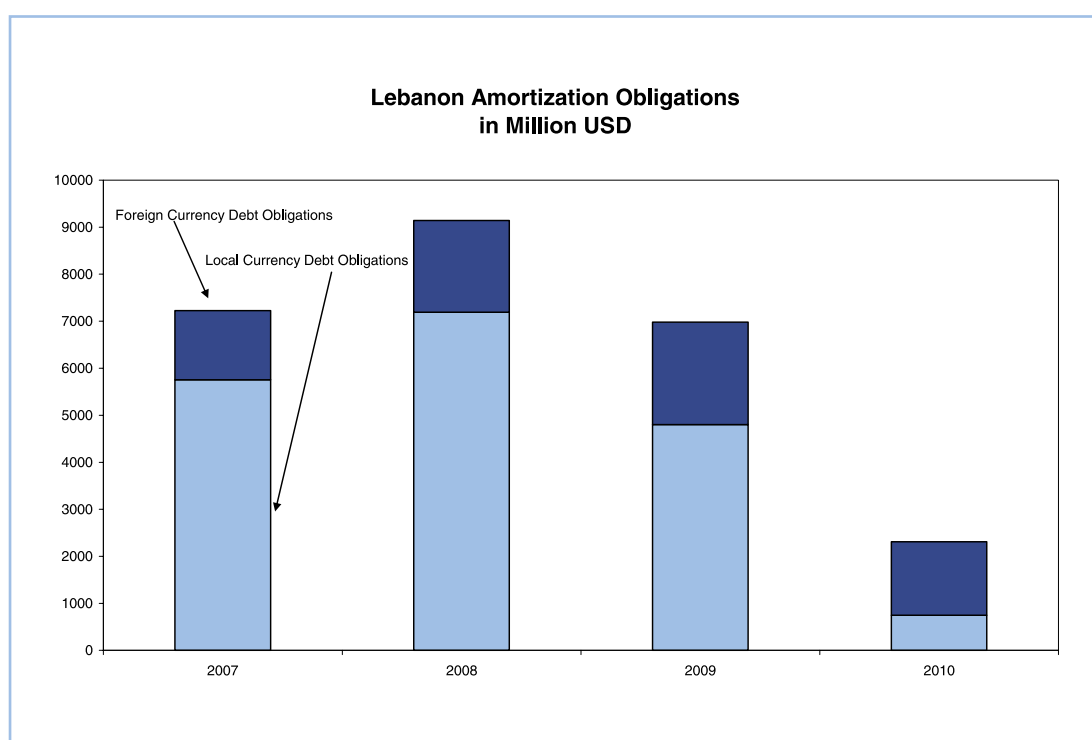
Whether a political détente will finally materialize in 2007, and whether the emergence of a consensus will provide the framework for the long-awaited reform implementation, and whether a successful Paris III will help tackle the structural debt issue, remain all questions as we start 2007. The only sure thing about the New Year is its enigma in the sense of the different scenarios that could be in play and hence their effect on the economy and the business environment. The unsure thing remains whether or not it will be conclusive, or whether or not it will be the third and last year in transition.



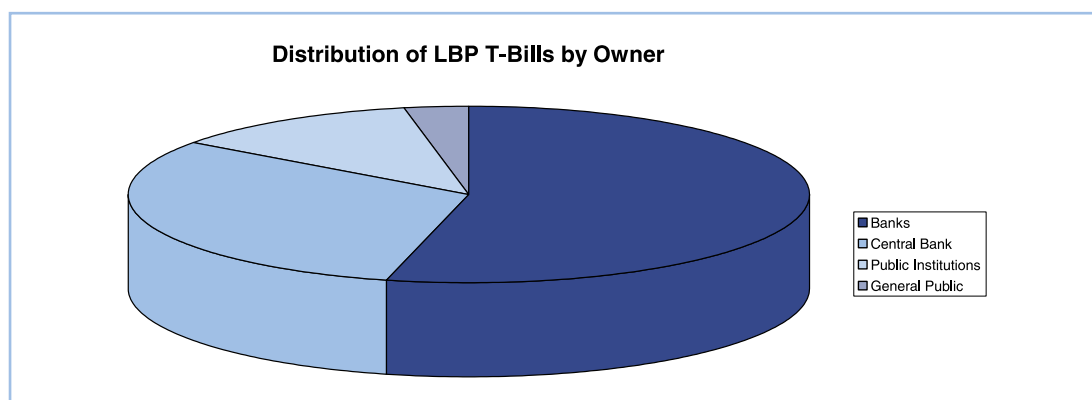
THE WAY FORWARD

Resolution of some or all political issues in 2007 and a successful Paris III is only the doorway to face the challenges ahead in the medium-term, especially on the fiscal deficit and debt fronts, which in turn will be essential to achieve the high potential growth rates of Lebanon.

The debt problem, in terms of both interest payments and amortization obligations will remain the focus of the government's efforts. The report by the Ministry of Finance forecasts the post-war fiscal deficit scenario to be higher than the pre-war deficit scenario by about \$12 billion cumulative for 2006-2010. Interest payments alone absorbed two-third of revenues in 2006. Over \$25 billion of debt will fall due during 2007-2010, of which over \$16 billion during 2007-2008 (see Figure).



The combination of fiscal deficits and debt amortization payments will imply a gross borrowing requirement for 2007-2010 of about \$37 billion, of which at least \$20 billion in 2007-2008. While this includes rollover of current debt, it will evidently require additional financing from the banking sector, which is already heavily exposed to the sovereign risk (see Figure).

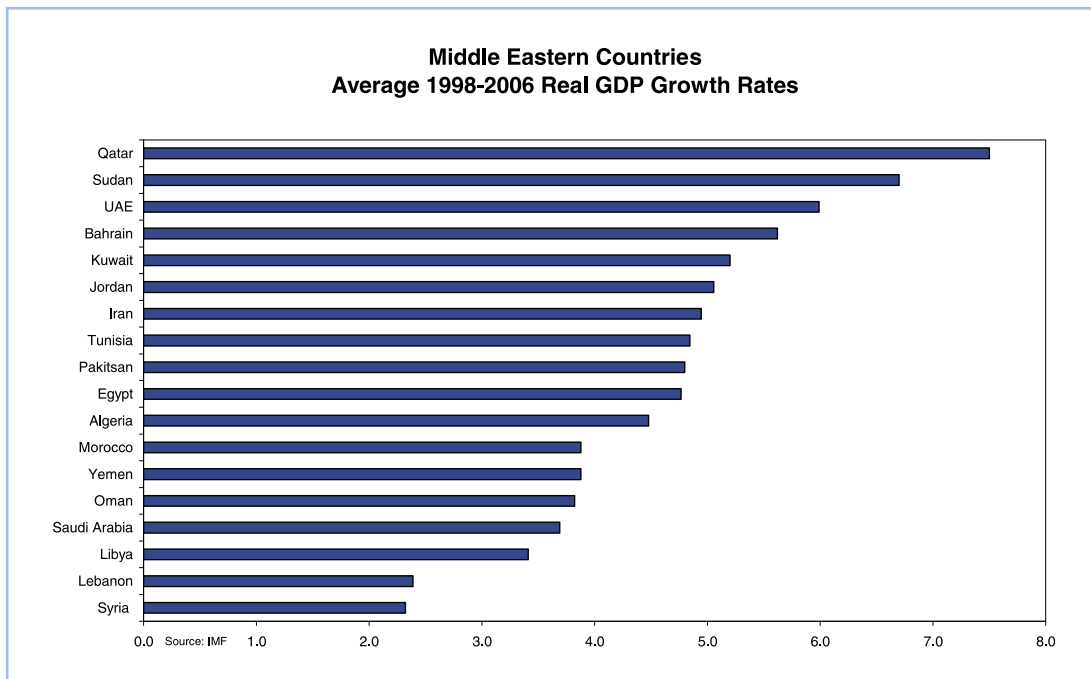


It will also keep interest rates high, stifling private sector growth and development, which is very much needed to absorb a growing labor force. It is in this perspective, that a successful Paris III conference and implementation of long awaited structural reforms is no longer a luxury, but rather a necessity for the Lebanese economy and its ability to meet its potential in the long-term.

This reform agenda, which will be slightly changed from the one proposed earlier (before Beirut I which never materialized) to take into account post-war economic effects, will seek to restore growth with social equity, while bringing down the debt ratio to sustainable levels. The program will include:

- Reforms to improve the business climate, to enhance the economy's competitiveness strengthen capital markets and improve public sector efficiency.
- Social sector support to improve social indicators and strengthen the social safety net.
- Privatization, starting in 2008 with Telecoms.
- Fiscal adjustment, starting with revenue measures in 2008 and *électricité du Liban* (EDL) reforms in 2007.

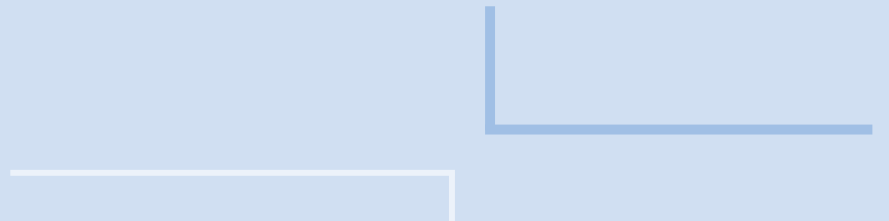
This agenda, if properly implemented, will enable Lebanon to be put on the path to significantly higher growth. Lebanon, which has been growing at sub-optimal rates compared with regional peers over the last decades (see Figure), does indeed need urgent reforms to finally meet its full potential of a country that is rich in both natural and human resources.



Despite all recent events, this potential was clearly manifested in the period between June 2005 and June 2006. The stellar economic performance during this period, underlined by strong capital inflows, high tourist arrivals, and fast exports growth, is only a reflection of what Lebanon could potentially achieve. After all, it does not make sense for Lebanon to be growing slower than most regional economies, when it has one of the highest literacy rates in the region and while being the first choice of most Middle Eastern nationals for tourism, health and education services. Reaching its potential growth rate, which we put at 8%, should be the objective in the long-term.



APPENDICES



APPENDIX 1: THE JULY WAR- FACTS AND FIGURES

Human Toll

- 1191 killed (1/3 of which below the age of 12), including more than 80 in post war period by cluster bombs.
- 4409 injured.
- Almost a million displaced. Loss of shelter to around 200,000.
- More than 200,000 were evacuated out of the country or left. Around 100,000 have not returned yet.
- Unemployment rose from 10% to around 20%.

Direct Damage

- More than 100,000 housing units totally or partially damaged (\$1700 million). More than 2.5 m3 of debris and rubble to be cleared (more than 3 times the annual amount of municipal waste generated in Lebanon).
- 16 hospitals and 65 outpatient facilities totally or partially damaged (\$15 million).
- 612 public schools and 80 private schools totally or partially damaged (\$45 million).
- 97 bridges and 151 road sections damaged or destroyed. Damage to 3 runways and 3 fuel tanks at the Rafic Hariri (Beirut) International Airport. Damage and destruction to all border posts, aggravated by 59 days of land, air, and sea blockades. Total transportation cost \$120 million.
- 15,000 tons oil spill in the waters of Lebanon (\$40 million).
- Physical damage to more than 850 enterprises in the manufacturing and services sectors (\$380 million).
- Direct damages to farming and fishery sectors (\$210 million).
- Direct damages to electricity (\$160 million).
- Direct damages to telecommunications (\$135 million).

Indirect Damage

- Nominal GDP lower by around \$2 billion in 2006 half of which due to lost tourist season.
- Government fiscal deficit will be higher for the period 2006-2010 due to lower revenues and higher expenditures by an estimated cumulative \$12 billion.

Impact on Business

- 62% of companies partially closed during the war.
- Sales lower by 15% in the retail sector. Supermarket sales down by 35%.
- Inflation increased from around 2% to 7% in 2006.
- Lloyd's increased insurance premiums to factor in war risk from 0.025% of the value of goods to 0.25%.
- National carrier, Middle East Airlines reported losses of \$45 million in the period July 12-September 7.

APPENDIX 2: BANKING SECTOR IN LEBANON- FACTS AND FIGURES

There are 63 banks operating in Lebanon. Of these 54 are commercial banks (of which 11 are foreign banks, and 9 are branches of foreign banks) and 9 investment banks.

Commercial banks have 827 branches, while investment banks have 12 branches. Of the total Beirut has 450 branches, Mount Lebanon has 148, Northern Lebanon has 82, Southern Lebanon has 86, and the Beqaa has 61. There are 963 ATM machines. Of the total, Beirut has 515, Mount Lebanon has 189, Northern Lebanon has 102, Southern Lebanon has 85, and the Beqaa has 72.

Below is a consolidated balance sheet of the 54 commercial banks in Lebanon showing October 05, December 05, October 06 and the October 06/ October 05 growth in percent.

Consolidated Balance Sheet of Lebanese Commercial Banks

| | LBP Billion | | | USD Billion | | | Oct/Oct % |
|------------------------------------|-------------|---------|---------|-------------|---------|---------|-----------|
| | Oct. 05 | Dec. 05 | Oct. 06 | Oct. 05 | Dec. 05 | Oct. 06 | |
| Assets | | | | | | | |
| Deposits at BDL | 30363 | 30716 | 29046 | 20.141 | 20.375 | 19.268 | -4.34 |
| Claims on Private Sector | 24264 | 24467 | 25724 | 16.096 | 16.230 | 17.064 | 6.02 |
| in LBP | 4386 | 4306 | 4696 | 2.909 | 2.856 | 3.115 | 7.07 |
| In USD | 19878 | 20161 | 21028 | 13.186 | 13.374 | 13.949 | 5.79 |
| Claims on Public Sector | 25905 | 26697 | 31366 | 17.184 | 17.709 | 20.807 | 21.08 |
| in LBP | 11951 | 12666 | 15593 | 7.928 | 8.402 | 10.344 | 30.47 |
| In USD | 13899 | 14030 | 15773 | 9.220 | 9.307 | 10.463 | 13.48 |
| Foreign Assets | 19431 | 20017 | 21912 | 12.890 | 13.278 | 14.535 | 12.77 |
| Claims on Non-Residents Banks | 15689 | 15791 | 15863 | 10.407 | 10.475 | 10.523 | 1.11 |
| Liabilities | | | | | | | |
| Resident Private Sector Deposits | 69424 | 71632 | 76120 | 46.052 | 47.517 | 50.494 | 9.65 |
| in LBP | 21347 | 22042 | 22251 | 14.161 | 14.622 | 14.760 | 4.23 |
| In USD | 48078 | 49590 | 53870 | 31.893 | 32.896 | 35.735 | 12.05 |
| Public Sector Deposits | 1538 | 1705 | 1353 | 1.020 | 1.131 | 0.898 | -12.03 |
| Non-Residents Deposits | 14999 | 14274 | 14034 | 9.950 | 9.469 | 9.309 | -6.43 |
| in LBP | 1014 | 1038 | 770 | 0.673 | 0.689 | 0.511 | -24.06 |
| In USD | 13985 | 13236 | 13264 | 9.277 | 8.780 | 8.799 | -5.16 |
| Deposits of Non Residents Banks | 2730 | 3263 | 2916 | 1.811 | 2.165 | 1.934 | 6.81 |
| Capital Account | 6026 | 6411 | 8555 | 3.997 | 4.253 | 5.675 | 41.97 |
| Balance Sheet (Assets=Liabilities) | 104156 | 106015 | 112065 | 69.092 | 70.325 | 74.338 | 7.59 |

Source: BDL

The banking sector employment is 15993 persons (2% of Lebanese labor force), of which 56% are holders of university degrees. Meanwhile total sector's contribution to GDP is 4.8% reflecting a high level of productivity.

Total assets were around \$75 billion as of end-October 2006 or 3.5 times GDP, one of the highest ratios in the world. The banking sector is well capitalized, with a capital adequacy ratio of 23.41% (BIS definition), leverage of total capital at 11.93 times, and a capital formation rate of 9.54% (all end-2005 figures) The sector is also quite profitable. Profits in 2005 were \$578 million, and as of end-October 2006, year-to-date profits were \$669 million compared with \$475 million as of end-October 2005.

The sector is highly dollarized which provides a buffer in times of crisis. Private sector deposits (residents and non-residents) were \$60 billion as of end-October 2006, of which \$44.5 billion or 74.5% are in foreign currency. Loans to the private sector were \$17 billion as of end-October 2006, of which \$13.9 billion or 81.7% are in foreign currency. Dollarization reflects in essence the highly open Lebanese economy, and together with the stable exchange rate has constituted a buffer against financial turbulence in times of crisis and high volatility.

The banks are extremely liquid with private sector loans at 28% of private sector deposits (October 2006) and total liquid assets at 85.19% of deposits (end-2005). In addition, the balance of external assets held offshore by the Lebanese commercial banks is \$14.5 billion, i.e. 32.6% of foreign currency deposits and 66% of GDP (October 2006).

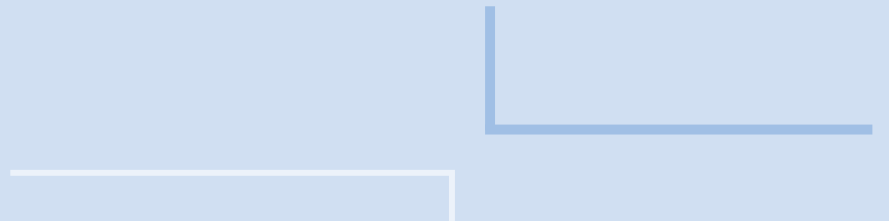
The banking sector in Lebanon is quite concentrated with the top 10 banks, which are highly regarded within the region, holding 76% of the sector's assets. These banks (in assets descending order) are BLOM Bank, Bank Audi, Byblos Bank, BankMed, Fransabank, Banque Libano-Française, Bank of Beirut, Credit Libanais, SGBL, and Lebanese-Canadian Bank.

The table below shows the distribution of loans in the banking sector in percent by (i) sector, (ii) regions and (iii) size of loans, all as of end-2005.

| By Sector | By Region | | By Size of Loans | | | | |
|--------------------|------------|------------|------------------|------------|-----------------|------------|------------|
| | | | in LBP Million | | | | |
| | | | by Users | by Value | | by Users | by Value |
| Trade and services | 42.5 | Beirut | 64.96 | 81.79 | Less than 5 | 2.90 | 0.03 |
| Personal loans | 17.42 | Mount Leb. | 13.45 | 8.23 | 5 to 25 | 47.07 | 2.89 |
| Construction | 15.49 | North Leb. | 8.88 | 3.72 | 25-100 | 35.29 | 7.53 |
| Industrial | 14.84 | South Leb. | 7.08 | 3.05 | 100-500 | 9.96 | 9.16 |
| Financial services | 4.17 | Beqaa | 5.63 | 3.21 | 500-1000 | 1.78 | 5.56 |
| Agriculture | 1.27 | | | | 1000-5000 | 2.24 | 21.74 |
| Others | 4.31 | | | | 5000-10000 | 0.41 | 12.73 |
| | | | | | More than 10000 | 0.35 | 40.36 |
| Total | 100 | | 100 | 100 | | 100 | 100 |

Source: BDL

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—| TABLES



General Economic Indicators

| | 2003 | 2004 | 2005 | 2006 (e) |
|---|-------|-------|-------|----------|
| Real GDP growth (in %) | 5 | 6 | 1.1 | 0 |
| Inflation (in %) | 1.3 | 3 | 0.3 | 7 |
| GDP (in Billion \$) | 19.8 | 21.7 | 22.1 | 22.1 |
| Government Revenues (in Million \$) | 4414 | 4985 | 4912 | 4444 |
| Government Expenditures (in Million \$) | 7026 | 6992 | 6768 | 8292 |
| Deficit (in Million \$) | 2612 | 2007 | 1856 | 3848 |
| Deficit (in % of GDP) | 13.2 | 9.2 | 8.4 | 17.4 |
| Primary Balance (in Million \$) | 621 | 660 | 489 | -796 |
| Primary Balance (in % of GDP) | 3.1 | 3.0 | 2.2 | -3.6 |
| Gross Public Debt (in Billion \$) | 33.36 | 33.85 | 38.48 | 42.10 |
| of Which LBP (in Billion \$) | 17.81 | 17.49 | 19.33 | 21.22 |
| of Which USD (in Billion \$) | 15.55 | 16.36 | 19.15 | 20.88 |
| Gross Public Debt (in % of GDP) | 168 | 156 | 174 | 190 |
| Exports of Goods (in Million \$) | 1525 | 1748 | 1880 | 2053 |
| Imports of Goods (in Million \$) | 7171 | 9400 | 9343 | 9014 |
| Trade Deficit (in Million \$) | 5646 | 7652 | 7463 | 6961 |
| Trade Deficit (in % of GDP) | 28.5 | 35.3 | 33.8 | 31.5 |
| Current Account Deficit (in Million \$) | 3026 | 3969 | 2792 | 2995 |
| Current Account Deficit (in % of GDP) | 15.3 | 18.3 | 12.6 | 13.6 |
| Net Foreign direct investment (in Million \$) | 1558 | 1478 | 2100 | n.a. |
| Balance of Payments Flows (in Million \$) | 3386 | 169 | 747 | 2945 |
| BDL FC Reserves (in Million \$) | 10213 | 9513 | 9845 | 11224 |
| BDL FC Reserves (in % of M2) | 56 | 52 | 61 | 69 |

Source: IMF, BDL, and BankMed.

Economic Activity Indicators

| | Y 2005 | Jan-06 | Feb-06 | Mar-06 | Apr-06 | May-06 | Jun-06 | Jul-06 | Aug-06 | Sep-06 | Oct-06 | YTD 2006 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|----------|
| BDL Coincident Indicator | 172.6 | 176.1 | 181 | 187.1 | 189 | 193.7 | 191.6 | 141.3 | 119.8 | 157.1 | | 170.7 |
| Electricity Production (Kwh) | 10581 | 950 | 842 | 890 | 805 | 841 | 910 | 825 | | | | 6063 |
| Imports of Industrial Equipment (Million \$) | 137.4 | 9.5 | 8.9 | 11.5 | 15.9 | 13.8 | 11.7 | 7.8 | 0.5 | 7.7 | | 87.1 |
| Cleared Checks in FC (Million \$) | 25458 | 2167 | 2197 | 2410 | 2170 | 2535 | 2463 | 2092 | 1348 | 1788 | 2002 | 21172 |
| Cleared Checks in LBP (Billion LBP) | 12338 | 903 | 839 | 1061 | 912 | 995 | 948 | 708 | 631 | 849 | 980 | 8826 |
| Cement Deliveries (000' tons) | 3040 | 166 | 224 | 325 | 311 | 379 | 377 | 197 | 182 | 384 | | 2545 |
| Construction Permits (000' m2) | 8819 | 511 | 795 | 1536 | 871 | 1565 | 982 | 384 | 363 | 574 | 536 | 8117 |
| Arrivals at BIA (000' Passengers) | 1601 | 145 | 96 | 109 | 148 | 140 | 217 | 106 | 21 | 114 | 135 | 1230 |
| Total Exports of Goods (Million \$) | 1880 | 145 | 167 | 206 | 231 | 285 | 270 | 104 | 86 | 186 | 177 | 1856 |
| Total Imports of Goods (Million \$) | 9340 | 642 | 768 | 940 | 849 | 981 | 878 | 601 | 269 | 732 | 852 | 7512 |
| Consumer Price Index | 100.19 | 103.87 | 101.02 | 100.71 | 101.83 | 102.07 | 104.26 | 105.04 | 106.87 | 107.31 | 107.46 | |

Source: BDL and BankMed.

Total Imports & Exports By Product
(Million US Dollars)

| Goods | Imports | | Exports | |
|--|--------------|--------------|--------------|--------------|
| | 2005 | 2006 | 2005 | 2006 |
| | Jan-Oct | | Jan-Oct | |
| Live animals, animal products | 428 | 355 | 9 | 8 |
| Vegetable products | 384 | 287 | 77 | 65 |
| Fats & edible fats & oils | 83 | 77 | 14 | 9 |
| Prepared foodstuffs | 530 | 411 | 191 | 152 |
| Mineral products | 2,226 | 1,877 | 126 | 66 |
| Products of the chemical | 820 | 726 | 163 | 120 |
| Plastic & articles thereof | 357 | 290 | 78 | 70 |
| Raw hides & skins, leather, furskins | 42 | 34 | 14 | 11 |
| Wood & articles of wood | 136 | 101 | 22 | 16 |
| Paper & paperboard & articles thereof | 264 | 189 | 116 | 106 |
| Textiles & textile articles | 486 | 385 | 82 | 72 |
| Footwear, headgear, prepared feathers | 66 | 58 | 18 | 13 |
| Articles of stone, plaster, cement | 163 | 116 | 52 | 39 |
| Pearls, precious or semi-precious stones | 491 | 252 | 224 | 484 |
| Base metals & articles of base metal | 651 | 565 | 276 | 242 |
| Machinery & mechanical appliances | 1,061 | 874 | 314 | 273 |
| Transport equipment | 809 | 636 | 22 | 30 |
| Optical instruments & apparatus | 160 | 145 | 17 | 16 |
| Arms & ammunition | 6 | 2 | 0 | 0 |
| Miscellaneous manufactured articles | 171 | 123 | 58 | 56 |
| Works of art | 7 | 5 | 9 | 8 |
| Total | 9,340 | 7,509 | 1,880 | 1,856 |

Source: Directorate General of Customs

Imports By Origin (Million US Dollars)

| | 2005 | | Jan-Oct 2006 | |
|----------------------|--------------|--------------|-----------------|--------------|
| | | Share % | | Share % |
| USA | 548 | 5.9 | 693 | 9.2 |
| France | 788 | 8.4 | 628 | 8.4 |
| China | 734 | 7.9 | 600 | 8.0 |
| Italy | 976 | 10.4 | 567 | 7.6 |
| Germany | 657 | 7.0 | 529 | 7.0 |
| UK | 323 | 3.5 | 326 | 4.3 |
| Egypt | 303 | 3.2 | 318 | 4.2 |
| Saudi Arabia | 329 | 3.5 | 234 | 3.1 |
| Japan | 307 | 3.3 | 233 | 3.1 |
| Russian Federation | 509 | 5.5 | 226 | 3.0 |
| Other Countries | 3,866 | 41.4 | 3,155 | 42.0 |
| Total Imports | 9,340 | 100.0 | 7,509 | 100.0 |

Source: Directorate General of Customs

Exports By Destination (Million US Dollars)

| | 2005 | | Jan-Oct 2006 | |
|----------------------|--------------|--------------|-----------------|--------------|
| | | Share % | | Share % |
| Switzerland | 125 | 6.6 | 402 | 21.7 |
| Syria | 187 | 9.9 | 139 | 7.5 |
| UAE | 155 | 8.2 | 138 | 7.4 |
| Iraq | 178 | 9.5 | 122 | 6.6 |
| Saudi Arabia | 140 | 7.4 | 122 | 6.6 |
| Turkey | 122 | 6.5 | 87 | 4.7 |
| Jordan | 75 | 4.0 | 68 | 3.7 |
| Kuwait | 81 | 4.3 | 67 | 3.6 |
| Qatar | 36 | 1.9 | 53 | 2.9 |
| USA | 58 | 3.1 | 42 | 2.3 |
| Other Countries | 723 | 38.5 | 616 | 33.2 |
| Total Exports | 1,880 | 100.0 | 1,856 | 100.0 |

Source: Directorate General of Customs

Fiscal Performance Summary (LBP Million)

| | 2003 | 2004 | 2005 | YTD 2006 up to Oct. |
|--|------------|------------|------------|------------------------|
| 1. Budget Transactions | | | | |
| 1.1 Revenues | 6,218,603 | 7,075,268 | 6,984,222 | 5,409,911 |
| 1.1.1 Tax Revenues | 4,501,871 | 5,168,747 | 4,866,834 | 4,135,384 |
| Other than customs and VAT | 1,498,823 | 1,788,976 | 1,905,860 | 1,923,199 |
| Customs Revenues | 1,642,051 | 1,616,573 | 1,267,578 | 826,421 |
| VAT Revenues | 1,360,997 | 1,763,198 | 1,693,396 | 1,385,764 |
| 1.1.2 Non Tax Revenues | 1,716,732 | 1,906,521 | 2,117,388 | 1,574,527 |
| 1.2 Expenditures | 8,809,828 | 8,305,821 | 7,802,216 | 6,987,658 |
| 1.2.1 Non-debt service | 3,935,463 | 4,284,335 | 4,267,913 | 3,351,993 |
| 1.2.2 Debt Service | 4,874,365 | 4,021,486 | 3,534,303 | 3,635,867 |
| 1.2.2.1 Domestic Debt | 3,107,903 | 2,245,915 | 1,532,600 | 2,377,904 |
| 1.2.2.2 Foreign Debt | 1,766,462 | 1,775,571 | 2,001,703 | 1,793,537 |
| 2. Treasury Transactions | | | | |
| 2.1 Receipts | 435,857 | 438,978 | 421,251 | 373,273 |
| 2.1.1 Trust accounts/Guarantees | 180,117 | 94,238 | 74,595 | 62,253 |
| 2.1.2 Municipalities | 116,018 | 108,878 | 187,172 | 162,023 |
| 2.1.3 Deposits | 46,880 | 72,018 | 66,278 | 61,462 |
| 2.1.4 Other | 92,842 | 163,844 | 93,206 | 131,477 |
| 2.2 Payments | 1,782,587 | 2,234,615 | 2,401,059 | 2,594,857 |
| 2.2.1 Trust accounts/Guarantees | 250,757 | 566,869 | 894,486 | 470,930 |
| 2.2.2 Municipalities | 179,763 | 460,664 | 384,188 | 361,685 |
| 2.2.3 Deposits | 81,385 | 69,175 | 73,663 | 48,978 |
| 2.2.4 Previous years appropriations | 609,733 | 526,493 | 647,720 | 468,416 |
| 2.2.5 Previous years/Guarantees | 129,654 | 92,685 | 27,477 | 22,883 |
| 2.2.6 Other | 531,295 | 518,729 | 373,525 | 1,221,965 |
| 3. Total Budget and Treasury Receipts | 6,654,460 | 7,514,246 | 7,405,473 | 6,083,184 |
| 4. Total Budget and Treasury Payments | 10,592,415 | 10,540,436 | 10,203,275 | 9,582,717 |
| 5. Total Deficit/Surplus (cash basis) | 3,937,955- | 3,026,190- | 2,797,802- | 3,499,533- |
| 6. Total Primary Deficit/Surplus | 936,410 | 995,296 | 736,501 | 136,334 |

Source: Ministry of Finance.

Fiscal Performance 2006 Monthly (LBP Million)

| | Jan.06 | Feb.06 | Mar.06 | Apr.06 | May.06 | Jun.06 | Jul.06 | Aug.06 | Sept.06 | Oct.06 | Total |
|--|--------|---------|---------|--------|--------|---------|---------|---------|---------|---------|----------|
| 1. Budget Transactions | | | | | | | | | | | |
| 1.1 Revenues | 689819 | 420806 | 712869 | 811524 | 851538 | 390293 | 510452 | 330752 | 334289 | 357569 | 5409911 |
| 1.1.1 Tax Revenues | 528741 | 303542 | 384241 | 661355 | 669323 | 335093 | 320335 | 135983 | 292379 | 504392 | 4135384 |
| Other than customs and VAT | 207920 | 115768 | 175021 | 349154 | 450330 | 128357 | 172273 | 74227 | 95597 | 154552 | 1923199 |
| Customs Revenues | 100126 | 91433 | 102348 | 87213 | 95069 | 93062 | 42272 | 6640 | 81396 | 126862 | 826421 |
| VAT Revenues | 220695 | 96341 | 106872 | 224988 | 123924 | 113674 | 105790 | 55116 | 115386 | 222978 | 1385764 |
| 1.1.2 Non Tax Revenues | 161078 | 117264 | 328628 | 150169 | 182215 | 55200 | 190117 | 194769 | 41910 | 153177 | 1574527 |
| 1.2 Expenditures | 477334 | 538533 | 689603 | 769643 | 767856 | 853729 | 558854 | 682774 | 710399 | 938933 | 6987658 |
| 1.2.1 Non- debt service | 203580 | 240266 | 316417 | 352907 | 379181 | 444713 | 299595 | 318877 | 330973 | 465484 | 3351993 |
| 1.2.2 Debt Service | 273956 | 298267 | 373186 | 416736 | 388675 | 409016 | 259259 | 363897 | 379426 | 473449 | 3635867 |
| 1.2.2.1 Domestic Debt | 179927 | 157526 | 197375 | 731169 | 155412 | 221336 | 193700 | 185090 | 170044 | 186325 | 2377904 |
| 1.2.2.2 Foreign Debt | 93827 | 141688 | 175811 | 220395 | 233261 | 187680 | 65559 | 178807 | 209382 | 287127 | 1793537 |
| 2. Treasury Transactions | | | | | | | | | | | |
| 2.1 Receipts | 53300 | 27442 | 26795 | 25893 | 27984 | 25057 | 116158 | 12984 | 20144 | 37516 | 373273 |
| 2.1.1 Trust accounts/Guarantees | 9776 | 11231 | 7671 | 3170 | 7804 | 5821 | 5690 | 2618 | 2283 | 6189 | 62253 |
| 2.1.2 Municipalities | 27204 | 7412 | 9326 | 52937 | 10739 | 10179 | 25903 | 1812 | 6563 | 9948 | 162023 |
| 2.1.3 Deposits | 8756 | 4050 | 4670 | 6265 | 5650 | 5240 | 3502 | 4921 | 6336 | 12072 | 61462 |
| 2.1.4 Other | 7564 | 4749 | 5128 | 7463 | 3791 | 3817 | 81063 | 3633 | 4962 | 9307 | 131477 |
| 2.2 Payments | 268721 | 276802 | 286619 | 48034 | 63177 | 189102 | 379737 | 485454 | 330005 | 267206 | 2594857 |
| 2.2.1 Trust accounts/Guarantees | 8622 | 40005 | 27623 | 4970 | 16517 | 25432 | 82611 | 195444 | 15214 | 54492 | 470930 |
| 2.2.2 Municipalities | 57834 | 22226 | 20557 | 1332 | 1140 | 60053 | 55374 | 56718 | 61346 | 25105 | 361685 |
| 2.2.3 Deposits | 3701 | 3852 | 2738 | 8074 | 3607 | 6017 | 2513 | 2932 | 2521 | 13023 | 48978 |
| 2.2.4 Previous years appropriations | 125332 | 148442 | 188762 | 2992 | 1070 | 598 | 474 | 175 | 373 | 198 | 468416 |
| 2.2.5 Previous years/Guarantees | 1576 | 2801 | 8294 | 568 | 2432 | 3693 | 914 | 1364 | 456 | 785 | 22883 |
| 2.2.6 Other | 71656 | 59476 | 38645 | 30098 | 38411 | 93309 | 237851 | 228821 | 250095 | 173603 | 1221965 |
| 3. Total Budget and Treasury Receipts | 743119 | 448248 | 739664 | 837417 | 879522 | 415350 | 626610 | 343736 | 354433 | 695085 | 6083184 |
| 4. Total Budget and Treasury Payments | 746257 | 815335 | 976222 | 817677 | 831033 | 1042831 | 938591 | 1168228 | 1040404 | 1206139 | 9582717 |
| 5. Total Deficit/Surplus (cash basis) | -3138 | -367087 | -236558 | 19740 | 48489 | -627481 | -311981 | -824492 | -685971 | -511054 | -3499533 |
| 6. Total Primary Deficit/Surplus | 270818 | -68820 | 136628 | 436476 | 437164 | -218465 | -52722 | -460595 | -306545 | -37605 | 136334 |

Source: Ministry of Finance.

Gross Public Sector Debt Outstanding

| | Dec. 03 | Dec. 04 | Dec. 05 | Oct. 06 |
|--|---------|---------|---------|---------|
| in LBP Billion | | | | |
| Total Gross Public debt | 50,285 | 54,048 | 58,018 | 61,304 |
| Domestic Debt | 26,843 | 26,371 | 29,141 | 30,865 |
| a. Central Bank (including REPOs and Loans to EDL) | 8,938 | 10,652 | 11,686 | 9,502 |
| b. Commercial Banks | 12,303 | 12,220 | 14,130 | 16,974 |
| c. Other Domestic Debt (T-Bills) | 5,603 | 3,500 | 3,325 | 4,389 |
| o/w Public entities | 2,564 | 2,187 | 2,446 | 3,505 |
| d. Accured interes included in domestic debt | 566 | 356 | 517 | 622 |
| Foreign debt | 23,442 | 27,677 | 28,877 | 30,439 |
| a. Bilateral Multilateral Foreign Private sector loans | 2,934 | 2,970 | 2,822 | 2,940 |
| b. Paris II Related debt (Eurobonds and Loans) | 3,731 | 3,814 | 3,682 | 3,688 |
| c. BDL Eurobond (Paris II) | 2,819 | 2,819 | 2,819 | 2,819 |
| d. Market Eurobonds | 13,631 | 17,686 | 18,729 | 20,143 |
| e. Accured Interest on foreign currency debt | 327 | 388 | 406 | 430 |
| f. Special T-Bills in Foreign currency | | | 419 | 419 |
| in USD Billion | | | | |
| Total Gross Public debt | 33.357 | 35.853 | 38.486 | 40.666 |
| Domestic Debt | 17.806 | 17.493 | 19.331 | 20.474 |
| a. Central Bank (including REPOs and Loans to EDL) | 5.929 | 7.066 | 7.752 | 6.303 |
| b. Commercial Banks | 8.161 | 8.106 | 9.373 | 11.260 |
| c. Other Domestic Debt (T-Bills) | 3.717 | 2.322 | 2.206 | 2.911 |
| o/w Public entities | 1.701 | 1.451 | 1.623 | 2.325 |
| d. Accured interes included in domestic debt | 0.375 | 0.236 | 0.343 | 0.413 |
| Foreign debt | 15.550 | 18.360 | 19.156 | 20.192 |
| a. Bilateral Multilateral Foreign Private sector loans | 1.946 | 1.970 | 1.872 | 1.950 |
| b. Paris II Related debt (Eurobonds and Loans) | 2.475 | 2.530 | 2.442 | 2.446 |
| c. BDL Eurobond (Paris II) | 1.870 | 1.870 | 1.870 | 1.870 |
| d. Market Eurobonds | 9.042 | 11.732 | 12.424 | 13.362 |
| e. Accured Interest on foreign currency debt | 0.217 | 0.257 | 0.269 | 0.285 |
| f. Special T-Bills in Foreign currency | | | 0.278 | 0.278 |

Source: Ministry of Finance

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