BankMed Economic and Market Analysis

بنك البحر المتوسط
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LEBANON
ECONOMIC UPDATE

May 2011

Nominal GDP (2010): $39.2 billion	Inflation (December 2010): 4.60%	Exports (2010): $4.25 billion
Population (2009): $4.2 million	Exchange Rate (2010): LL:US$: 1507.5	Imports (2010): $17.96 billion
GDP per Capita (2010): $10,044	Total Bank Assets (Feb-2011): $130.18 billion	Reserves (March-2011): $30.4 billion

Political Scene in Lebanon in Light of Recent Development

With the start of the second decade of the 21st century, rapid political developments in the Middle East and North Africa region which started in January 2011 have placed the region in the international spotlights. The ousting of Ben Ali in Tunisia and Mubarak in Egypt has resonated all across the region, threatening the stability of regimes from the East to the West. No doubt that, this instability is not only confined to one place, on the contrary, it is spreading fast suggesting prolonged periods of unrests across the region.

Lebanon has been witnessing an extended period of political unrest since 2005, interjected with phases of reconciliations. Arab countries such as Qatar, Saudi Arabia and Egypt have played a major role to end civil unrest in Lebanon during this period. Lebanese political leaders met in Doha, Qatar and signed an agreement (the Doha Accord). The Doha Accord, which ended an extended period of political stalemate. It also set the framework for the formation of a national unity government, based on the inclusion of all political parties and sectarian factions. The post-Doha unity government was led by P.M. Fuad Siniora and succeeded in carrying out the parliamentary elections in June 2009.

Following the 2009 elections, a second national unity government was formed headed by P.M. Saad Hariri, the son of late P.M Rafic Hariri. Yet the, heavy debates over a plethora of issues such as UN-backed Special Tribunal for Lebanon (STL) and the issue of the so-called false witnesses had hastened its collapse, in an abrupt violation of the Doha Accord. Pushed by the March 8 Coalition, 11 out of 30 ministers (more than the one-third needed to topple it) resigned from the national unity government in January 2011.

In light of recent development, Lebanon has faced once again a rendezvous with a new political stalemate. The length of time needed to form a new government is demonstrative of the complexities of the Lebanese political landscape. The new government is expected to encounter many challenges, the most important of which is the handling of the indictment issuance from the STL. Add to this, the regional instabilities, which created an added burden to Lebanese policy makers as no one is able to predict their effects and magnitudes. Lebanon's geographic location, relatively small-size and its affiliation with its Arab neighbors makes it susceptible to volatilities emerging from its neighboring countries.

Economic Overview

After a growth that is expected to have ranged between 7-8% in 2010, the current year will probably witness a slow-down of growth to around 4% given the effects of the regional tensions, the domestic political situation, and the lower consumer and investor confidence that will also be affected by higher commodity prices. Inflation is expected to tick up to around 5%, which is less than the global rise due to the domestic excess capacity in the Lebanese economy.

Domestic political tension and regional unrests, once again, are testing the country's ability to achieve high levels of growth, after four years (2007-2010) of real economic growth rates which were among the best in the world and not just in the region. Sadly, these high growth rates were not coupled with bold actions to implement reforms that tackle key sectors such as power and telecom. In addition, the recent increase in oil prices and rise in foodstuff prices have placed additional strain on consumer confidence, compounding the political draw backs.

On the other hand, the country's financial sector remains solid; and despite a deposit decrease in January, mainly caused by the repercussions of the government's collapse, the subsequent rise in February has shown that the reversal was temporary, and that deposits are on their way to achieve an increase that is enough to fund both the private and the public sector in 2011. Foreign reserves at the Central Bank (BDL) remain high, and when coupled with the gold stock, cover more than 100% of the local currency money supply, which suggest a solid footing of the exchange rate peg.

Sectoral Performance

The recently released official data of Lebanon's National Accounts show that the service and trade sectors were the highest contributors to GDP in 2009. Trade as well as transportation and communications recorded the highest year-on-year growth growing by 17% and 13.1% respectively.

Sectors (in 2009)	As percentage of GDP	Percentage Growth rate
Services	31	5.2
Trade	28	17.4
Construction	13	10.0
Public Administration	9	7.4
Transport & Communications	8	13.1
Industry	8	-4.2
Agriculture	5	-6.9
Energy and Water Supply	-1	...
Total	**100**	**8.5**

Source: Ministry of Finance

	2006 Act.	2007 Act.	2008 Est.	2009 Proj.	2010 Proj.
Nominal GDP (in Billions USD)	22.4	25	28.9	31.3	39.2

Source: IMF

The table below shows the contribution of the components of GDP in the past 10 years. The service and trade sectors are the highest contributors to GDP followed by the construction and public administration sectors. It is worth noting that it was not until 2007 that the construction sector started to rank as the third contributor to GDP as it was traditionally preceded by the public administration's contribution.

Components of GDP % of GDP	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Services	34	33	33	33	33	33	36	35	34	31
Trade	20	20	22	22	24	23	22	23	25	28
Construction	8	8	8	7	7	8	9	11	12	13
Public Administration	13	13	13	12	11	11	10	9	9	9
Transport & Communications	7	7	7	7	7	7	9	8	8	8
Industry	12	12	12	12	12	12	10	10	8	8
Agriculture	6	6	6	6	5	5	6	6	6	5
Energy and Water Supply	1	1	1	1	0	-1	-1	-1	-2	-1

Source: Ministry of Finance

Economic Sectors growth rate from 2005 to 2009 are presented in the table below:

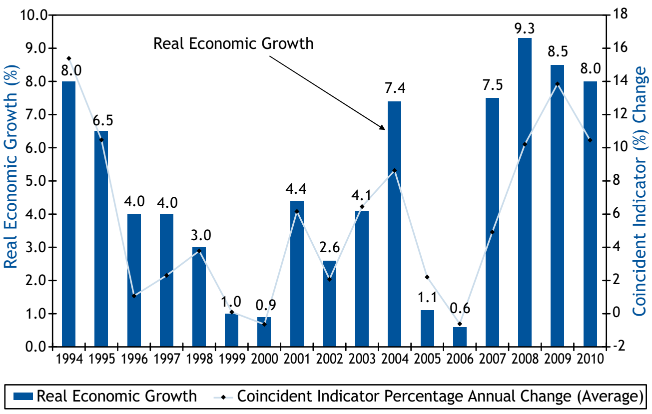
	2005	2006	2007	2008	2009
Services	3.1	6.1	5.6	5.4	5.2
Trade	-4.2	-4.9	11.6	20.1	17.4
Construction	4.9	4.2	16.8	17.1	10
Public Administration	3.1	1.2	5.2	2.8	7.4
Transport & Communications	4.9	-1.3	6.3	9.9	13.1
Industry	0.3	-6.7	7.2	-0.4	-4.2
Agriculture	-0.5	-0.7	-4.6	10.3	-6.9
Energy and Water Supply	...	...	...	...	...
Total GDP	**1.1**	**0.6**	**7.5**	**9.3**	**8.5**

Source: Ministry of Finance

Economic Activity in 2010 – 2011

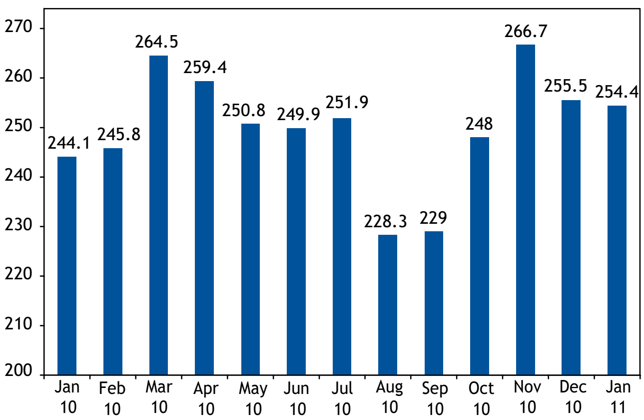
The BDL Coincident Indicator, an index of many variables that measures economic activity and that is compiled and updated periodically to monitor economic activities, has reflected the increase in real economic growth.

Real Economic Growth (%) vs. Coincident Indicator Percentage Annual Change (Average)



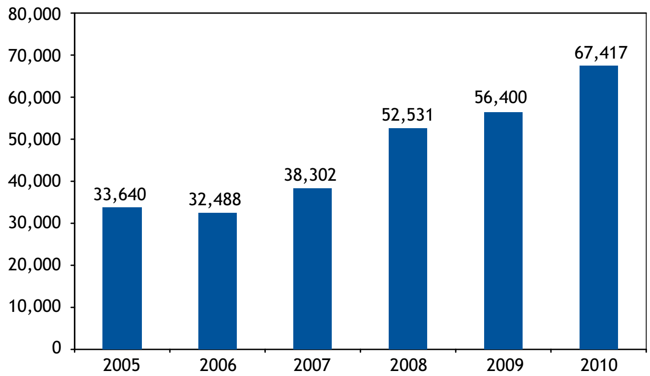
The monthly changes in the BDL Coincident Indicator, shown below, reveals that the indicator dropped in first month of 2011 to 254.4 from 255.5 registered in December, a 0.4% decrease, but still 4.2% higher than the level recorded in January 2010.

BDL Coincident Indicator Monthly



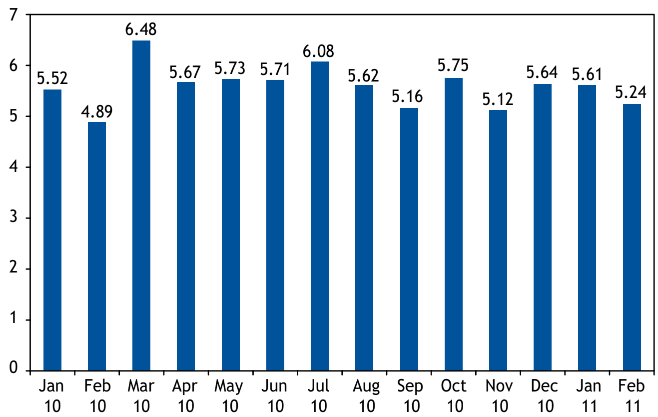
Meanwhile, the total value of cleared checks in the banking sector, another indicator of the ongoing business activities in the economy, continues to show an increase, albeit at a lower rate. The total value of cleared checks in 2010 was $67,417 million, up from $56,400 million reported in 2009, an increase of 20%.

Value of Cleared Checks in the Banking System in Million USD



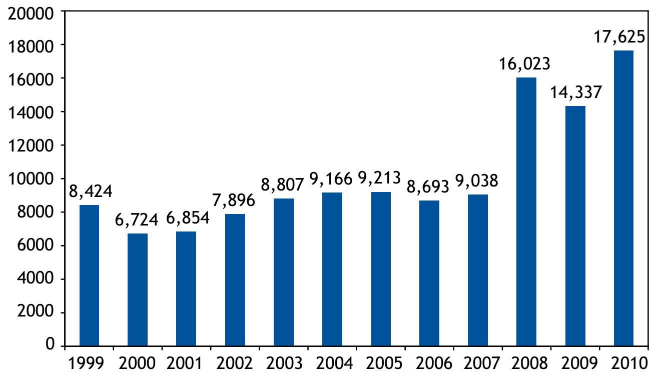
In 2011, the value of cleared checked increased in January-February 2011 to $10.85 billion from $10.41 billion registered in January-February 2010, a modest increase of 4.2%.

Total Value of Cleared Checks in the Banking Sector Monthly (Billion USD)



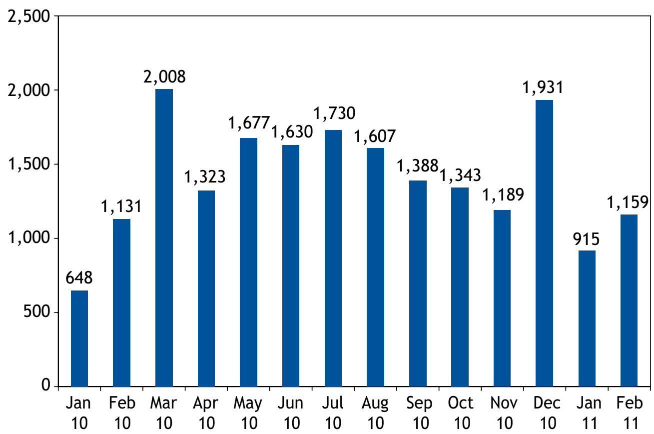
The construction sector which contributed 13.3% to GDP in 2009 grew by 10% in the same year. The total number of construction permits issued until the end of 2010 reached 17,625 thousands square meters up by 23% when compared with the same period last year.

Construction Permits
Thousands of Meter Square



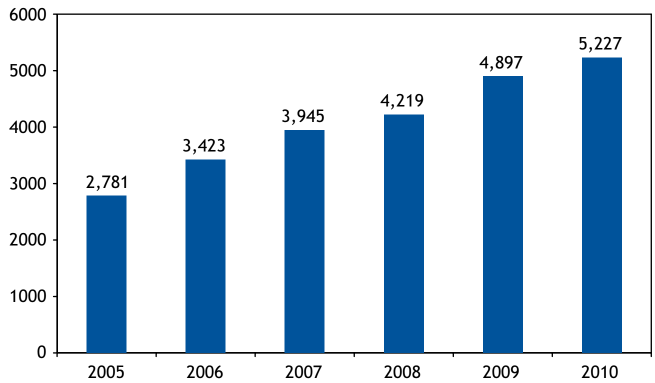
Permits in square meters issued in January-February 2011 increased to 2,074 from 1,779 reported in the same period in 2010, reflecting an increase of more than 16%, and pointing to continued strength in the construction activity.

Construction Permits sq.meters
Thousands (Monthly)



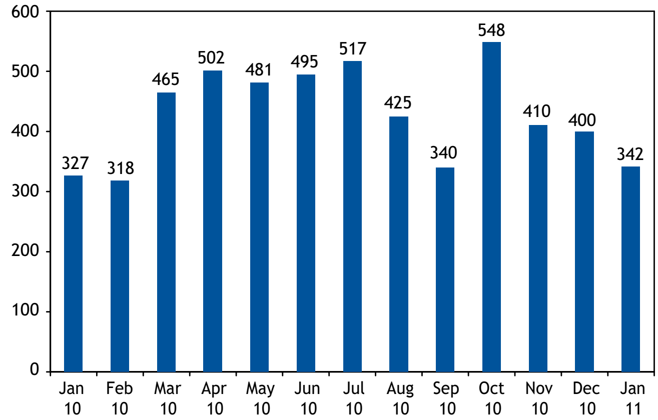
In 2010, cement delivery increased to 5,227 thousand tons up from 4,897 thousands delivered in 2009 or a y-o-y increase of 6.7%.

Cement Delivery (Thousand Tons)



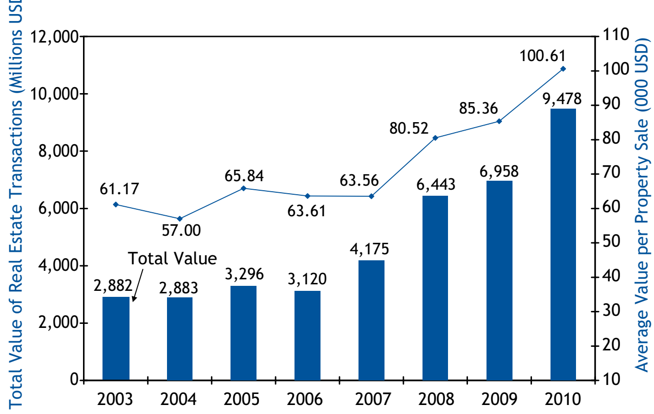
In January 2011, cement delivery dropped to 342 thousand tons from 400 thousand delivered in December 2010; a 14.5% decrease. On the other hand and when compared with same period in 2010, cement delivery increased by 4.5% in January 2011.

Cement Delivery Thousand Tons (Monthly)

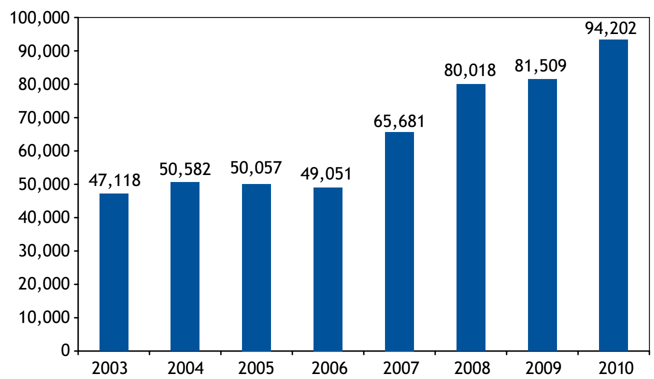


The total value of real estate transactions increased to \$9.478 billion by the end of 2010 up from \$6.958 billion recorded in 2009; an increase by more than 36%. The average value of real estate transactions rose to more \$100,000 in 2010 from around \$85 thousand recorded in 2009; an increase of more than 17%. The number of real estate transactions increased to 94,202 in 2010 from 81,509 recorded in 2009; an increase by more than 15%.

Real Estate Indicators

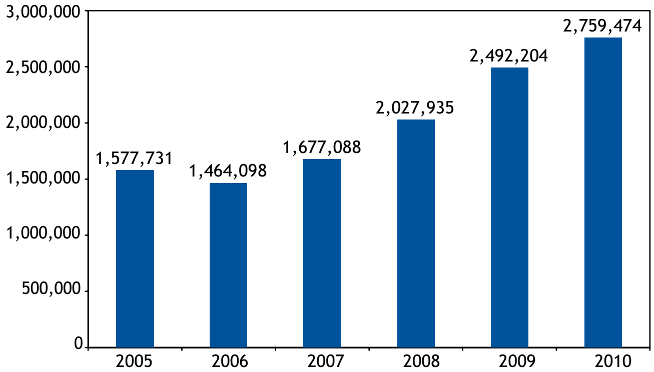


Number of Real Estate Transactions



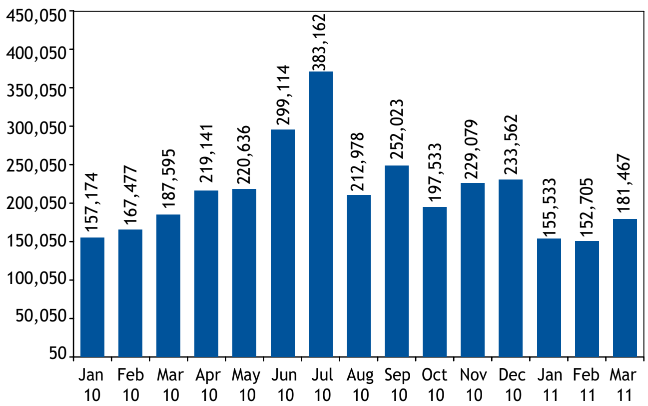
The total number of tourists visiting Lebanon in 2010 reached 2.16 million up from 1.85 million recorded in 2009; up by more than 16%. As for the total number of arrivals at Rafic Hariri International Airport, the total number of arrivals reached 2.75 million in 2010 up from 2.49 million recorded in 2009; 10.7% increase. Political tensions witnessed in the past few years did not discourage visitors, be it Lebanese expatriates or Arab national and others, from visiting Lebanon. On the contrary, since 2007 the number of tourists increased and registered a record every year. The ongoing political unrest in Lebanon might not dissuade tourists from visiting Lebanon. However, civil unrest in the Arab world is expected to pose as a potential threat to the tourism industry in general. The situation in the region might persuade many tourists and particularly Arab nationals to hold-off traveling plans, opt to stay at home and enjoy the stability or seek alternative destinations.

Arrivals at Rafic Hariri International Airport



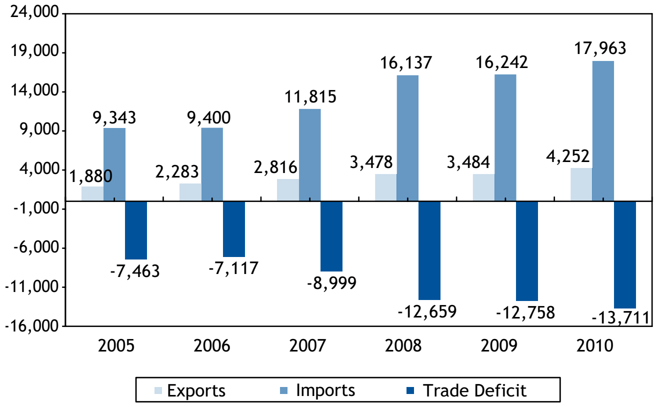
As for the first quarter of 2011, the total number of tourists reached 340,670 down from 393,212 when compared with the first quarter in 2010; a decrease by more than 13%. Looking at the arrivals at Rafic Hariri International Airport, the arrivals during the first quarter of 2011 decreased to 489,705 from 512,246 when compared with the first quarter in 2010; a decrease by 4.4%.

**Arrivals at Rafic Hariri Airport
Monthly**



As for trade, the value of exports continued to rise even in the midst of exchange rate volatility (Euro vs. US$). Both the value and volume of exported goods increased by 22% and 5% respectively. As for imports, the value of imports continued to rise as it was mainly driven by high local demand. Respectively, the value and volume of imported goods grew by 10.6% and 2.5% in 2010. The rise in the value of imported goods is driven to a large extent by the increase in the price of oil.

**Exports, Imports and Trade Deficit
in Millions USD**



Major Trading Partners (2010)

Exports' Destination	Value (Million USD)	Imports' Destination	Value (Million USD)
Switzerland	$502	United States	$1,909
United Arab Emirates	$418	China	$1,638
France	$348	Italy	$1,394
South Africa	$344	Germany	$1,259
Iraq	$267	France	$1,196

Source: Lebanese Customs

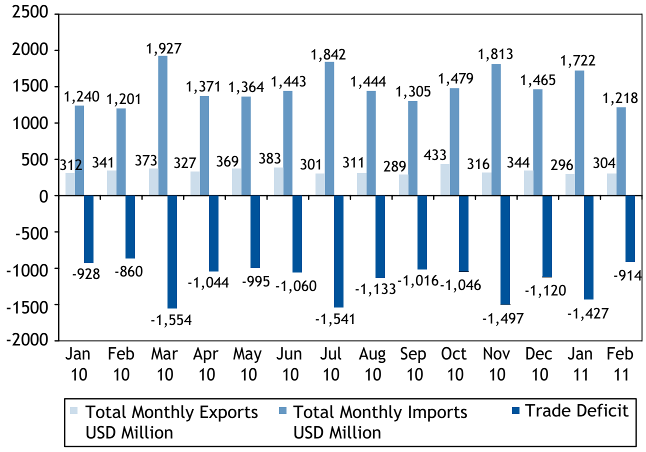
Major Traded Goods (2010)

Main Exports	Value (Million USD)	Main Imports	Value (Million USD)
Pearls, Precious Stones and Metals	$1,109	Mineral Products	$3,791
Machinery; Electric Instruments	$742	Machinery; Electric Instruments	$2,169
Base Metals and Articles of Base Metals	$460	Vehicles, Aircrafts, Vessels, Transport Equipments	$1,936
Vehicles, Aircrafts, Vessels, Transport Equipments	$361	Products of Chemical or Allied Industries	$1,550
Prepared Foodstuffs; Beverages, Tobacco	$324	Base Metals and Articles of Base Metals	$1,271

Source: Lebanese Customs

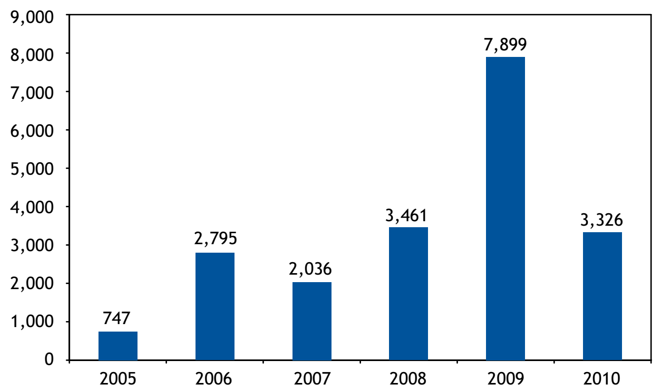
The total value of exports in the first two months of 2011 reached $600 million down from $653 million recorded during the same period in 2010; a decrease by 8.1%. The total value of imports in the first two months of 2011 reached $2.94 billion up from $2.44 billion recorded during the same period in 2010; an increase by more than 20%.

Exports, Imports and Trade Deficit in Millions USD (Monthly)



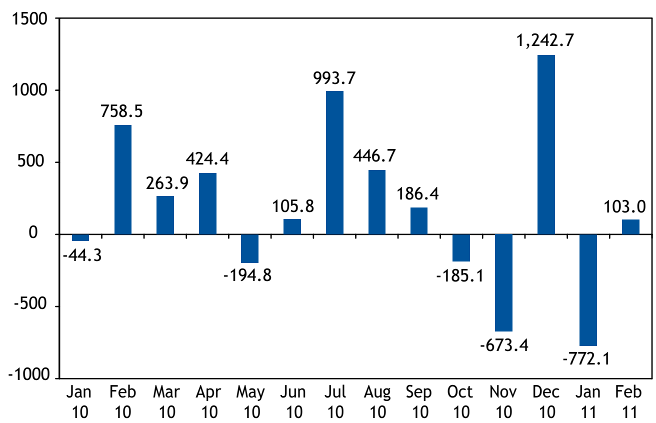
Despite the fact that Lebanon continues to have high trade deficit, remittances and capital inflows into the country's financial system created a surplus in Lebanon's balance of payments. The $3,325 million balance of payments surplus reported in 2010 was mainly driven by $3,201 million increase in net foreign assets of the Central Bank and a $123 million increase in net foreign assets of banks and financial institutions. In addition, World Bank estimates that in 2010 remittances increased to $8.2 billion or up by 8% and foreign direct investments dropped by 3.2% to $4.65 billion.

Balance of Payments in Million USD



Despite the fact that the first month of 2011 recorded a balance of payments deficit of -$772.1 million, the balance of payments recorded a surplus of $103 billion in February 2011. This brings the total deficit in the first two months of the year to $669.1 million, compared to a surplus of $714.2 million in the same period in 2010.

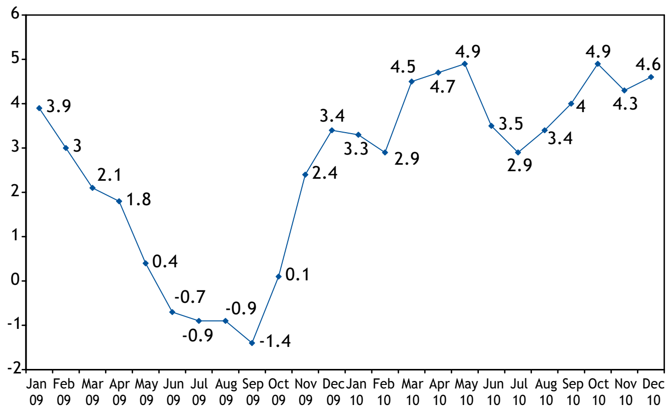
Balance of Payments in Millions USD (Monthly)



The growth during 2010 and the high capital inflows were not inflationary. The Central Bank intervened, when necessary, through sterilization using certificates of deposits issued to commercial banks to absorb excess liquidity. Inflation rate as of December 2010 was 4.6%.

The global increase in the prices of oil, foodstuff and commodities would increase the risk of imported inflation. This is because food and non-alcoholic items, housing water electricity gas and other fuels and transportation constitute more than 56% of the basket used by the Central Administration of Statistics in calculating inflation in Lebanon. The risk of internally driven inflation is minimal as the Central Bank can intervene and control the liquidity.

Inflation Year on Year in Percent



Expenditure Divisions	Weights	Inflation rate December 2010 / December 2009
Food and non-alcoholic beverages	19.9	6.8
Alcoholic beverages, tobacco	2.1	0.8
Clothing and footwear	6.2	20.3
Housing water, electricity, gas and other fuels	25.7	
Housing	16.2	0.0
Water, electricity, gas and other fuels	9.5	8.1
Furnishings, household equipment and routine household maintenance	3.9	0.9
Health	6.8	-2.6
Transportation	12.3	4.8
Communication	4.8	-0.1
Recreation, amusement, and culture	3.7	2.1
Education	7.7	6.7
Restaurants & hotels	2.7	6.3
Miscellaneous goods & services	4.2	2.0
Consumer price index (Reference month December 2007)	**100**	**4.6**

Source: Central Administration of Statistics

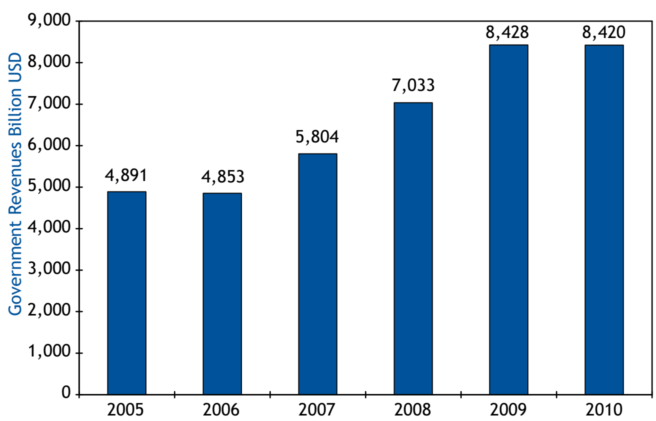
Public Finances

Lebanon's fiscal performance has been remarkable despite the refusal of the Minister of Telecommunication to transfer the receipts to the Treasury. This was made possible due to prudent macroeconomic policies that have kept the fiscal deficit relatively stable in nominal terms. Combined with high nominal growth, the debt to GDP ratio has declined significantly.

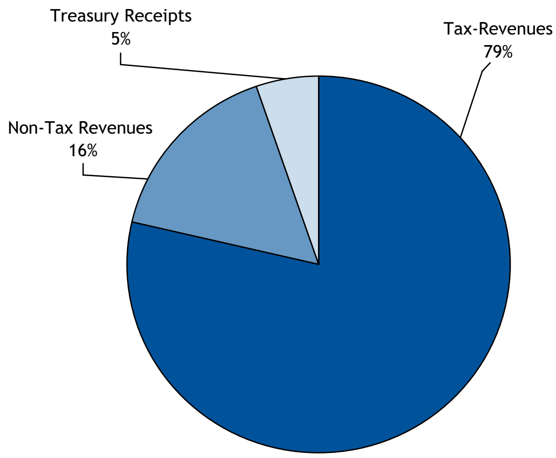
Government revenues have increased by an average of 11.7% a year from 2005 to 2010 allowing the government to meet its domestic and international obligations. The 0.14% decrease in revenues witnessed in 2010 was due to a 33% decrease in non-tax revenues caused by a 44% decrease in income from public institutions and government properties. Transfer from the Telecom surplus fell from $1.36 billion reported in 2009 to $635 million reported in 2010. The main reason behind this drop was because the minister refused to transfer funds to the treasury. If the transfer of the Telecom to the Treasury had taken place with the equivalent amount as in 2009, which is the bare minimum, government revenues would have increased by more than 8%. The sharp drop was compensated by an 11.2% increase in tax revenues generated mainly from taxes on property by 34%; taxes on income profits and capital gains by 11%; domestic taxes on goods and services by 10%.

In 2010, total government revenues were distributed as follows:

Revenues in Million USD



Distribution of Total Tax Revenues for 2010 (Percentage)

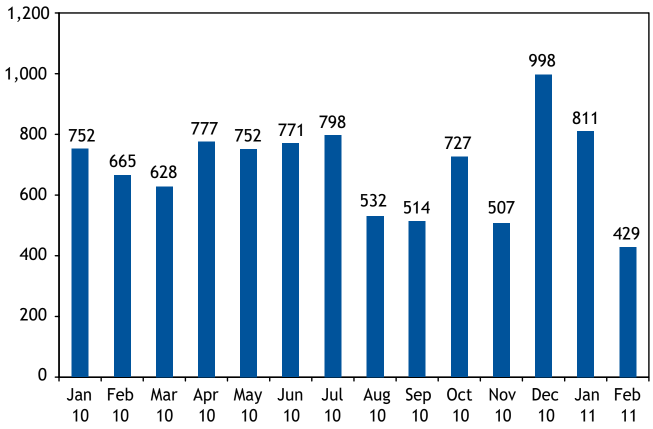


Government Revenues (in Billions of LL)	2006	2007	2008	2009	2010
Tax and non-Tax Revenues	**6,867**	**8,094**	**9,795**	**12,036**	**12,018**
Tax Revenues	4,922	5,583	7,182	8,967	9,976
Tax Revenues other than customs and VAT	2,190	2,333	3,011	3,415	3,981
Customs Revenues	1,074	1,247	1,588	2,664	2,802
VAT Revenues	1,659	2,003	2,584	2,889	3,193
Non-Tax Revenues	1,945	2,511	2,613	3,069	2,043
o/w Transfers from Telecom Sector	1,298	1,660	1,734	2,055	957
Treasury Receipts	**427**	**655**	**758**	**669**	**666**
Trust accounts/Guarantees	69	109	88	84	144
Municipalities	137	156	207	239	269
Deposits	74	78	81	94	104
Other	147	313	381	252	148
Total Budget and Treasury Receipts	**7,295**	**8,749**	**10,553**	**12,705**	**12,684**

Source: Ministry of Finance

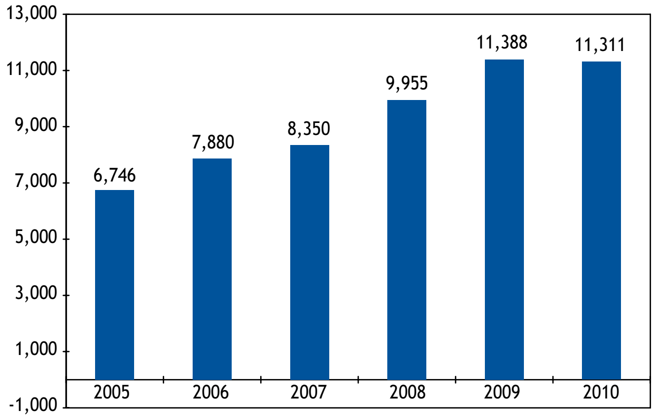
The total government revenues received in the first two months of 2011 reached $1.24 billion down from $1.42 billion recorded during the same period in 2010; a decrease by more than 12%.

Total Revenues USD Million (Monthly)



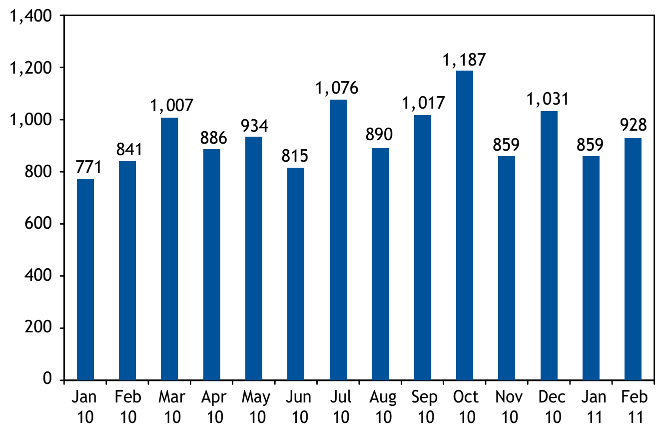
Government expenditures grew by an average of 12% a year from 2005 to 2010. Government expenditures are disbursed mainly on: interests on domestic and foreign debt (more than 30%), salaries of government's employees (more than 20%) and transfers to Electricite du Liban (EDL) (more than 10%). The growth was mainly cushioned by an increase in government revenues and state borrowing. It is worth noting that in 2010, total government expenditure decreased by less than 1% due to decrease in transfers to EDL from $1.5 billion in 2009 to $1.19 billion in 2010.

Expenditures in Million USD



Total government expenditures in the first two months of 2011 reached $1.79 billion up from $1.61 billion recorded during the same period in 2010, an increase of more than 11%. The 11% increase is mainly stemming from a 20% increase in overall government expenditures excluding debt.

Total Government Expenditure Millions (Monthly)

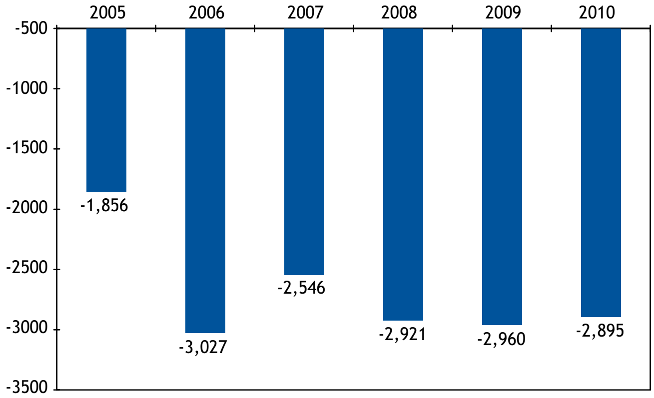


Government Expenditures (in Billions of LL)	2006	2007	2008	2009	2010
Expenditures	**8,641**	**10,070**	**10,984**	**13,028**	**15,186**
Expenditures excluding debt service	4,084	5,130	5,679	6,942	8,969
of which EDL	1,370	1,479	2,430	2,259	1,797
Debt Service	4,557	4,940	4,957	5,784	5,893
Domestic Debt	2,368	2,515	2,847	3,663	3,763
Foreign Debt	2,189	2,425	2,110	2,121	2,131
Treasury Payments	**3,236**	**2,517**	**3,973**	**4,139**	**1,860**
Trust accounts/Guarantees	504	246	289	491	98
Municipalities	405	306	527	456	734
Deposits	60	84	84	90	106
Other	2,267	401	643	843	920
Total Budget and Treasury Payments	**11,877**	**12,587**	**14,957**	**17,167**	**17,047**

Source: Ministry of Finance

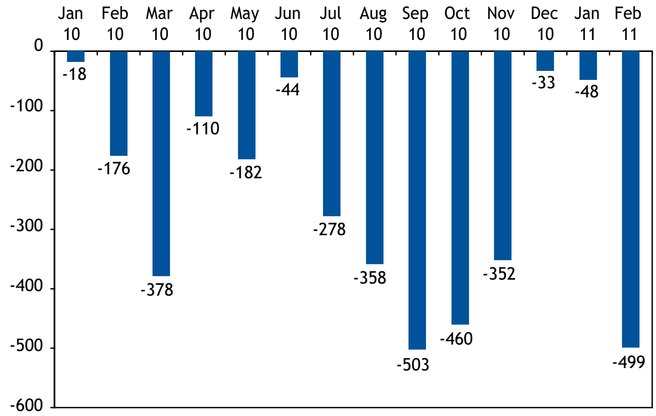
The overall fiscal deficit retracted from $2.96 billion in 2009 to $2.89 billion in 2010.

Fiscal Balance in Million USD



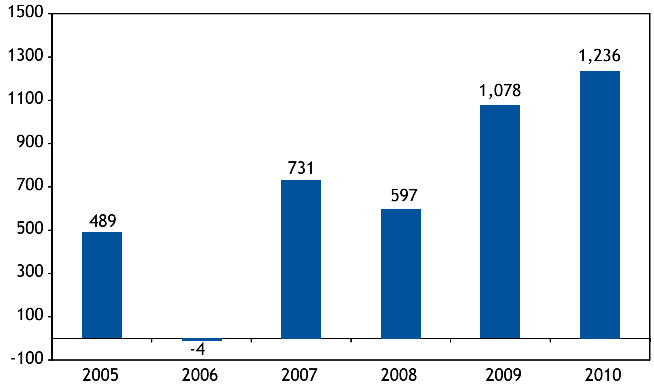
The fiscal balance in the first two months of 2011 recorded a deficit of $547 million up from $194 million recorded during the same period in 2010; an increase by more than 180%. This, however, is mostly due to lack of transfer of telecom receipts to the Treasury in the first two months of 2011 in comparison with the first two months of 2010 when receipts were transferred.

Fiscal Balance in Millions USD (Monthly)



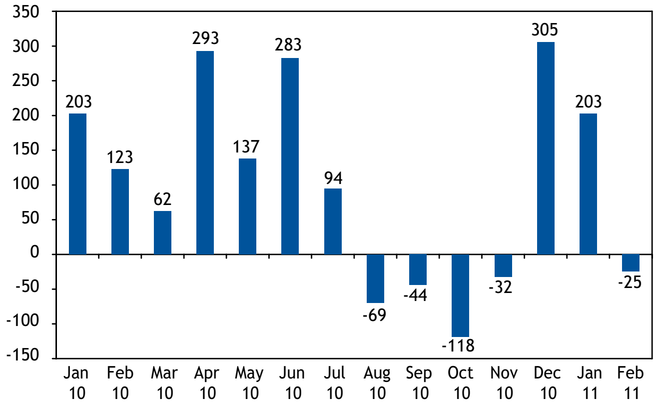
From 2005 to 2010 the primary balance, i.e. fiscal balance minus interest payments on the debt, recorded a surplus averaging at $687 million. Except in 2006, when the primary balance recorded a deficit of -$4 million due to the devastating effects of the war with Israel. The primary surplus increased to $1.23 billion in 2010 from $1.07 billion reported in 2009; a 14.6% annual increase.

Primary Surplus in Millions USD

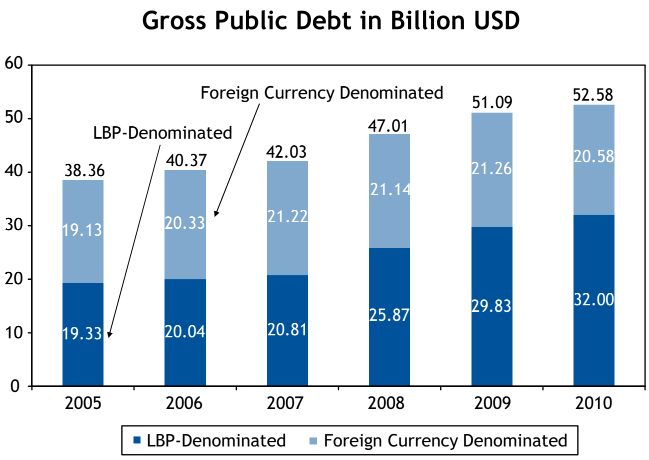


The primary balance in the first two months of 2011 recorded a surplus of $178 million down from a surplus of $326 billion recorded during the same period in 2010; a decrease by more than 45%.

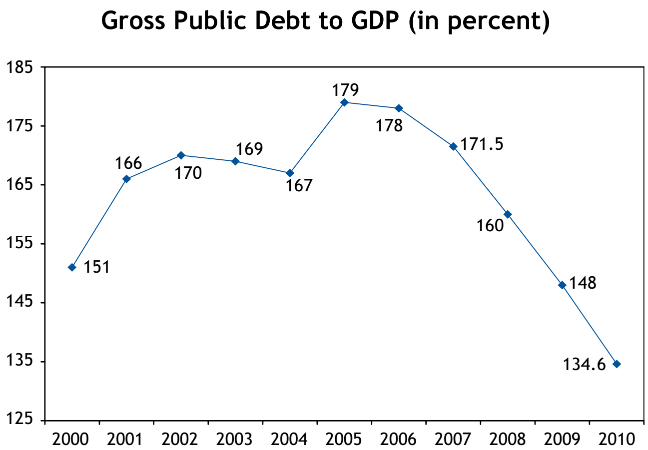
Total Primary Deficit / Surplus Millions USD (Monthly)



The debt level increased to $52.6 billion in December 2010 from $51.1 billion in December 2009. It was mainly driven by an increase in Lebanese currency debt. Gross public debt in domestic currency increased by more than 7% in 2010. Local-currency debt rose from $29.83 billion in December 2009 to $32 billion in 2010. Foreign-currency debt retracted by more than 3% in 2010 to $20.53 billion from $21.26 billion reported in December 2009. It is worth noting that in 2010 debt in local currency constituted more than 60% of the gross public debt. The foreign-currency debt is equivalent to only 67.7% of the Central Bank's gross reserves (excluding gold estimated at $13 billion).

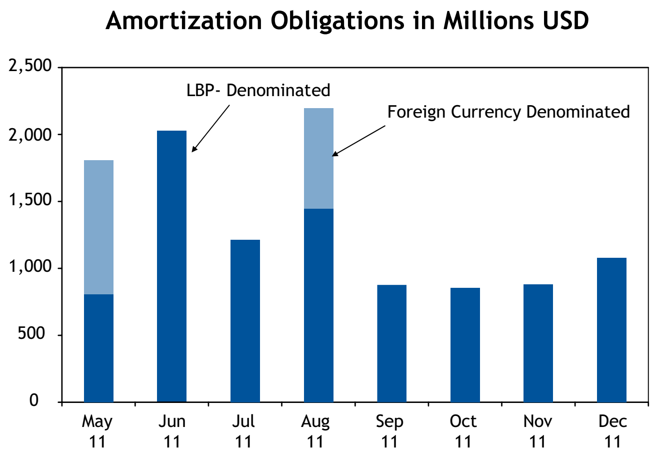


Although debt has been increasing in nominal terms, debt-to-GDP ratio continued to decline. The debt-to-GDP ratio declined from 148% in 2009 to an estimated 134.6% in 2010.



Lebanon's fiscal performance will face some challenges in 2011. The projected deceleration in economic growth for 2011 to 4% is a set-back for the Lebanese economy as it is succeeding an average growth of 7-8% in the past 5 years. The deceleration in economic growth would be accompanied with a decline in tax revenues leading to a higher public deficit. The decline in tax revenues would be stemming from a reduction in gasoline excise tax and value-added-tax which consisted 20% and 32% respectively of government tax revenues in 2010.

The monthly amortization payments show the equivalent of around $11.33 billion in LBP-denominated (Treasury Bills) and around $1.75 billion in foreign currency debt falling due by the end of 2011.



Banking Sector

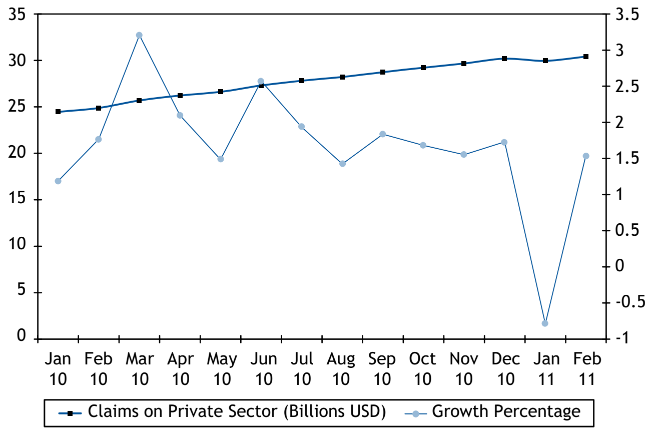
The banking sector has built a solid reputation on the back of its ability to shield the banking industry from internal and external shocks, attracting large inflows over the last few years. This has allowed the sector to maintain high liquidity and continue to support the private sector and the public sector financing needs. Its ability to weather the effects of the global financial crisis awarded the industry global recognition. In this context, prudent banking regulations which strongly discouraged exposure to structured products and limited banks' exposure to real estate speculation have supported the steady growth in the sector.

Banking Sector Balance Sheet

Total assets reached $128.8 billion in 2010 up from $115.25 billion in 2009; an 11.75% increase. Credit to the private sector increased to $30.33 billion up from $24.26 billion; a 25% increase. Increase in lending was mainly driven by strong economic activity and relatively stable political and security conditions.

Despite the fact that 75% of total claims on private sector are in US dollars, lending in local currency continued to grow at a much faster rate. The various initiatives that were introduced by BDL to encourage the lending in Lebanese Lira and that were endorsed by the Lebanese government, take large credit for this growth. In addition, the total claims on the private sector increased by 21.59% in February 2011 when compared with February 2010.

Claims on Private Sector (Billions USD) v.s. Growth in Claims (%)(Monthly)



Claims on the public sector increased to $29.32 billion up by only 0.9% in 2010 up from $29.06 billion recorded in 2009. Foreign assets increased to $25.74 billion up from $23.68 billion recorded in 2009. The abundance of liquidity in the banking sector has been a main feature of the Lebanese sector. It is worth noting the 32.6% loans-to-deposits ratio is one of the lowest in emerging markets.

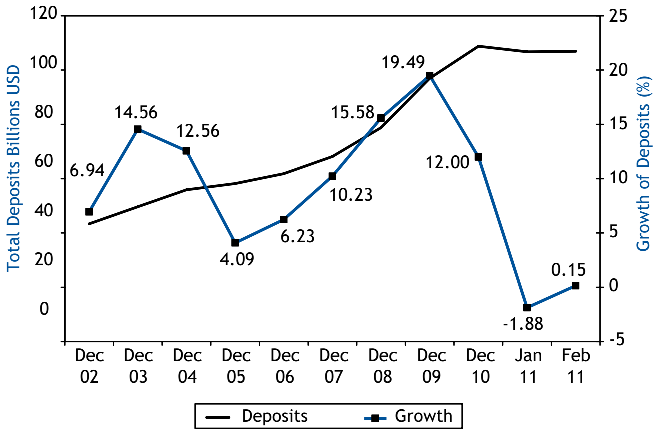
Consolidated Balance Sheet of Lebanese Commercial Banks (USD Billion)

	Dec-09	Feb-10	Dec-10	Feb-11	Dec-10/Dec-09 (%)	Feb-11/Feb-10 (%)
Assets						
Deposits at BDL	35.31	36.31	40.33	42.06	14.22	15.84
Claims on Private Sector	24.26	25.01	30.33	30.41	25.01	21.59
in LBP	4.54	4.85	6.89	7.04	51.87	45.15
in USD	19.72	20.16	23.44	23.37	18.83	15.92
Claims on Public Sector	29.06	30.20	29.32	27.53	0.90	-8.84
in LBP	17.50	18.10	17.58	15.83	0.46	-12.54
in USD	11.57	12.10	11.70	11.70	1.13	-3.31
Foreign Assets	23.68	23.40	25.74	25.91	8.68	10.73
Claims on Non-Residents Banks	15.02	13.90	15.85	15.76	5.52	13.38
Liabilities						
Resident Private Sector Deposits	79.19	81.04	88.34	89.04	11.55	9.87
in LBP	31.67	33.06	36.35	34.49	14.79	4.33
in USD	47.53	47.98	51.99	54.55	9.39	13.69
Public Sector Deposits	1.05	1.09	1.40	1.55	32.50	42.20
Non-Residents Private Sector Deposits	16.57	16.12	18.41	17.85	11.08	10.73
in LBP	2.37	2.32	2.89	2.32	21.93	
in USD	14.20	13.80	15.52	15.53	9.25	12.54
Deposits of Non Residents Banks	4.60	5.19	4.50	5.73	-2.18	10.40
Capital Account	7.94	7.90	9.20	9.40	15.80	18.99
Balance Sheet (Assets=Liabilities)	**115.25**	**118.38**	**128.88**	**130.18**	**11.83**	**9.97**

Source: Association of Banks in Lebanon

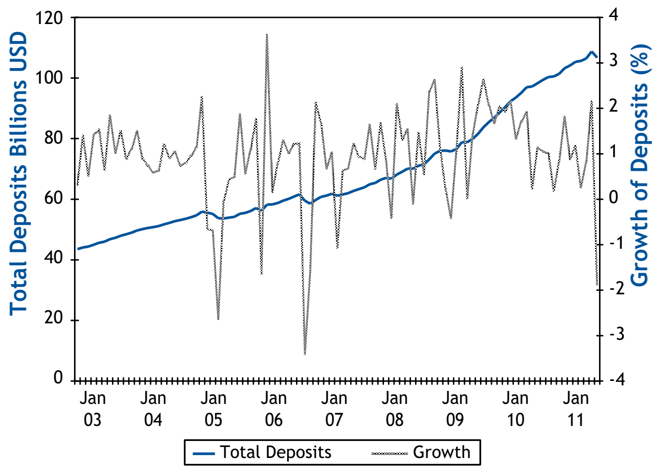
The total private sector deposits (resident and non-resident) increased to $106.75 billion in 2010 up from $95.76 billion recorded in 2009; an increase by 11.47%. In February 2011, total private sector deposits increased by 10% when compared with total private sector deposits recorded in February 2010. Capital Accounts increased to $9.2 billion in 2010 from $7.94 billion in 2009. The year-on-year change in February 2011 in capital accounts was an increase by 19% when compared with February 2010. Deposit dollarization rate decreased from 64.5% in 2009 to 63.2% in 2010.

Total Deposits (Resident and Non-Resident) vs. Deposit Growth (%)(End-of-Period)



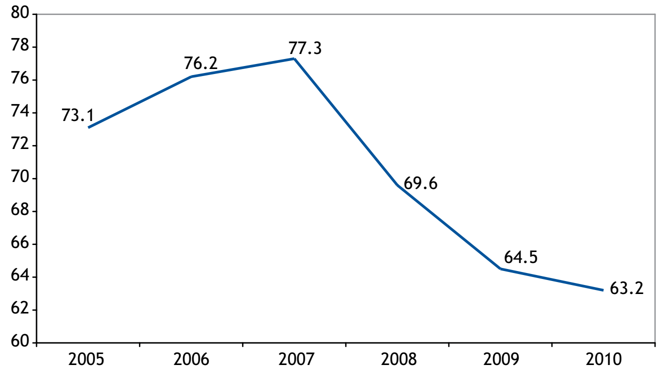
Despite the fact that the total deposits declined by 1.88% in January 2011, total deposits in February 2011 increased by 0.15% when compared with the previous month. It is worth noting that the decline in deposits in January 2011 in percentage terms, as the below graph suggests, was the largest decline since July 2006. Following the July 2006 War, total deposits decreased by 3.4%.

Total Deposits (Resident and Nonresident) vs. Deposits' Growth(%) Monthly

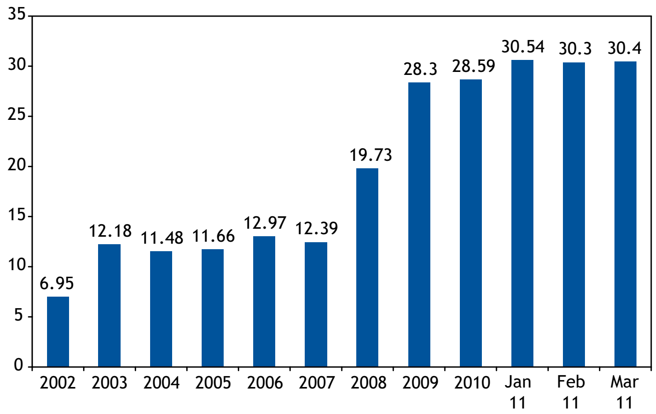


The collapse of the government in January 2011 caused dollarization rate to increase to well above 70%. Yet the dollarization rate in February 2011 fell to 65.5%. It is worth noting that the Central Bank has accumulated end-of-March 2011 $30.4 billion in foreign reserves covering more than 70% of the local money supply. When the gold reserves are added, the BDL total reserves cover over 100% of the local money supply, which reflects that even in the worst case scenario, the Central Bank will be able to defend the currency.

Dollarization of Private Sector Banks' Deposits (%)



BDL Gross International Reserves in Billion USD (end-of-Period)



The Bottom Line

We estimate real economic growth to decelerate to around 4% in 2011, on the back of slower tourism, lower domestic consumption, and a cooling down of the construction sector. This will have some negative impact on the fiscal deficit due to the lower growth in tax receipts, which will be further compounded by higher transfer to the loss-making electricity company (EDL) due to higher oil prices. Still, the accumulated liquidity at the banks, with a slower growth in lending to the private sector, will allow the government to meet its funding requirement without any problems. The outlook in 2012 will depend on many factors, the most important of which is the political situation with strong uncertainty engulfing two main issues: the STL and the outcome of Arab revolts and revolutions and their influence on Lebanon.

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