ECONOMIC BULLETIN

2019 First Quarter

FRANSABANK

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II. Real Sector

The real sector of Lebanon's economy experienced a non-uniform development on the level of its economic sectors, in the first quarter of 2019. The activity of several leading economic sectors enhanced, but that of other sectors retarded, relative to the corresponding period last year.

1- Agriculture and Industry

In the first two months of 2019, the value of agricultural and industrial exports reached USD 535.8 million, with an annual growth of 0.9%. On the other hand, the value of agricultural and industrial imports dropped by 11.8% from USD 3.3 billion to USD 2.8 billion during the same period.

These figures clearly reflect a slightly better performing export activity against declining import activity, caused mainly by the opening of Nassib route between Lebanon and Syria whose closure lasted three years and led to a weakening of Lebanon's trade with Syria and Jordan.

As an indicator of industrial activity, electricity production declined by an annual rate of 1.2% in the first two months of 2019 to reach 2,368 million kwh, against 2,396 million kwh for the corresponding period of 2018.

2- Real Estate and Construction

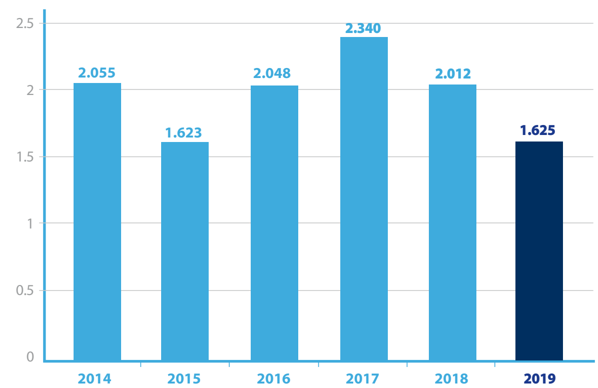
According to the figures of the Real Estate Registry and Ministry of Finance, the number of property sales operations decreased by 14.9% on annual basis to reach 12,067 operations in the first quarter of 2019. Also, the value of property sales dropped by 19.2% annually to reach USD 1,625 million during the same period. These figures reflect a declining real-estate activity in the first quarter of 2019 as far as the demand side is considered.

The figures released by the Orders of Engineers and Architects of Beirut and Tripoli show that the surface area of the construction permits was 1,945,737 square meters in the first quarter of 2019, with a decrease of 27.6% from 2,688,858 square meters for the same period last year.

Also, cement deliveries contracted by 31.3% on annual basis in the first two months of 2019 to reach 420,370 tons.

These figures suggest a curbed supply in the real-estate sector in the first quarter of 2019 relative to the same period last year.

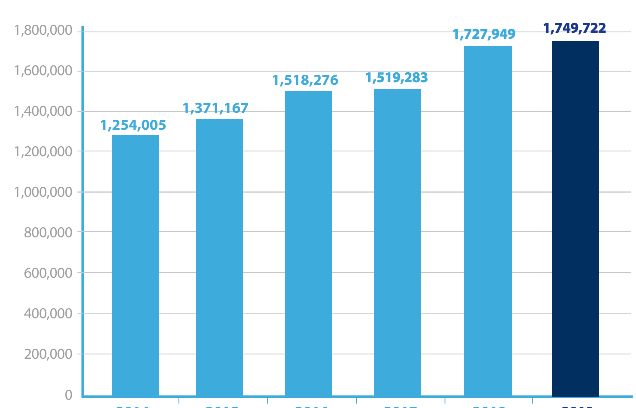
- Value of of Real-Estate Transactions, First Quarter (USD, Billion) -



3- Trade and Services

The statistics released by the **Hariri International Airport** indicate that the total number of passengers increased by 1.2% on annual basis to reach 1,749,722 passengers in the first quarter of 2019. The total freight handled by the airport shrinked by 8.3% on annual basis, during the same period. The number of aircraft recorded an increase of 0.4% on annual basis during the said period. These figures suggest an improvement in the airport activity.

- Passengers at the Airport - First Quarter -



Lebanon's Macro Economy in the First Quarter of 2019

I. General Introduction

Lebanon's macro economy is still suffering from a general slowdown due to weak growth rates, and substantial fiscal and trade deficits.

The performance of some economic sectors during the first quarter of 2019 improved, while other sectors witnessed a contraction in its activity, mainly because of the continued political conflict in Lebanon and political instability in the region.

The monetary authorities have maintained its policies for monetary stabilization, economic stimulation, banking stability, and control of monetary expansion and inflation.

The balance of payments recorded a deficit in the first quarter of 2019, due to lower capital inflows into Lebanon, and continued unfavorable trade conditions due to substantial imports and weak exports.

The fiscal conditions, however, remain highly unfavorable due to continued fiscal deficits and growing public indebtedness.

Economic growth is expected to continue sluggish in 2019. Economic, fiscal, administrative and sectoral reforms must be the major priority of domestic authorities in order to support economic growth rates in the years to come, and to benefit from the Cedre Conference's foreign aid of USD 11.6 million for Lebanon. This should be accompanied by special efforts to address the continued negative repercussions of the Syrian crisis on the domestic economy and society.

Real-Sector Indicators

Indicators	2019 Q1	2018 Q1	% Change
Agricultural & Industrial Exports (USD, million)*	535.8	531.0	0.9
Construction Permits (sqm)	1,945,737	2,688,858	(27.6)
Real-Estate Transactions (number)	12,067	14,181	(14.9)
Real-Estate Transactions (USD, million)	1,625	2,012	(19.2)
Cement Deliveries (tons)*	420,370	612,290	(31.3)
Number of Tourists	375,815	362,392	3.7
Number of Passengers at HIA	1,749,722	1,727,949	1.2
Aircraft Activity at HIA	15,413	15,345	0.4
Value of Returned Checks (USD, million)	364	356	2.2
Cleared Checks (USD, billion)	14.8	16.8	(12.0)
New Car Sales (number)	5,926	7,645	(22.5)
Hotel Occupancy Rate (%)*	65.0	54.9	-
Goods Quantity at Beirut Port (000, tons)	1,766	2,060	(14.3)
Number of Containers at Beirut Port	184	210	(12.4)
Number of Ships at Beirut Port	411	471	(12.7)
Revenues of Beirut Port (USD, million)	49.8	59.4	(16.2)
Kafalat Loans (number)	19	74	(74.3)
Kafalat Loans (USD, million)	2.3	8.1	(71.1)
Electricity Production (million kwh)*	2,368	2,396	(1.2)

* First 2 months.
Sources: Official and Related Directorates.

III. Fiscal Policy and Indebtedness

The fiscal conditions in Lebanon remain highly unfavorable in light of continued fiscal deficits and growing public indebtedness, the crowding-out effect of private investment fueled by public borrowing, and the non-implementation of radical administrative and fiscal reforms.

1- General Budget

The Government of Lebanon has been convening and discussing the 2019 Draft General Budget since 30 April 2019. The estimated total revenues are set at USD 12.1 billion, against estimated total spending at USD 16.8 billion, with a total deficit of USD 4.7 billion.

The estimated spending for 2019 is 2.6% less than the estimated spending of the 2018 budget, but is 10.5% higher than the realized spending in the first eleven months of 2018.

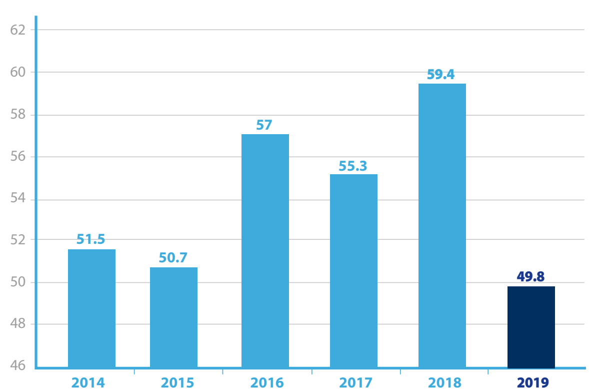
The 2019 estimated spending is distributed as follows:
- Current spending: USD 15.47 billion (92.1% of total spending).
- Capital spending: USD 1.3 billion (7.9% of total spending).

Also, current spending is distributed as follows:
- Debt Service: USD 5.5 billion.
- Financial transfers to EDL: USD 1.1 billion.
- Wages of the public sector and other expenditures: USD 8.8 billion.

It is worth noting here that the debt service for the first eleven months of 2018 reached USD 5.3 billion, and the financial transfers to EDL USD 1.6 billion.

According to the statistics of the **Port of Beirut**, its revenues recorded a decline by 16.2% on annual basis to reach USD 49.8 million in the first quarter of 2019. The number of ships recorded an annual decrease of 12.7% to reach 411 ships in the first quarter of 2019. In parallel, the number of containers recorded an annual contraction of 12.4% to reach 184 thousand containers during the same period. Also the quantity of goods declined by 14.3% year-on-year to reach 1,766 thousand tons in the first quarter of 2019. These figures indicate that the Port of Beirut activity, an indicator of maritime transport and trade, recorded a contraction during the period under consideration.

- Port of Beirut Revenues, First Quarter (USD, Million) -

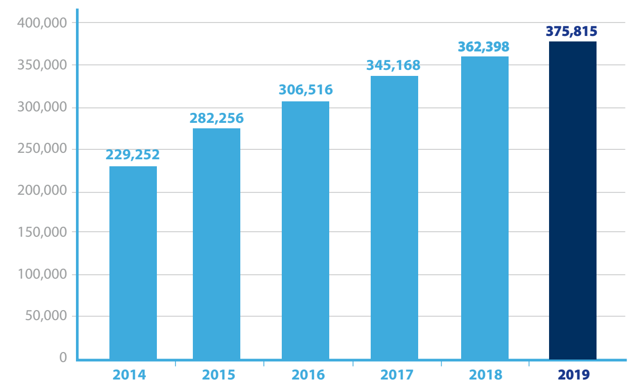


The **number of visitors** to Lebanon totaled 375,815 tourists in the first quarter of 2019, growing by 3.7% from 362,398 tourists from the corresponding period last year. The spending of those tourists increased by 12.2% in the first quarter of 2019, relative to a lower growth of 1.6% for the same period of 2018.

According to the Survey of Ernst and Young, the Beirut's **hotel occupancy rate**, an indicator of tourism activity, improved from 54.9% in the first two months of 2018 to 65% in the first two months of 2019. The average room rate rose from USD 174 to USD 192, and the rooms yield went up from USD 95 to USD 125 during the same period. These figures reflect an improving hotel activity during the period under consideration.

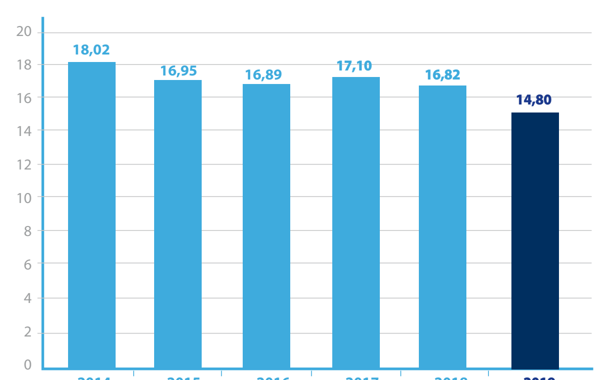
The statistics of the Association of Automobile Importers in Lebanon show that the number of **new sold cars** totaled 5,926 cars in the first quarter of 2019, with a decrease of 22.5% from 7,465 new cars sold in the same period last year.

- Number of Tourists, First Quarter



According to the statistics of the Association of Banks in Lebanon, the total value of **cleared checks**, mirroring private consumption and investment spending, decreased by 12% on annual basis, from USD 16.8 billion in the first quarter of 2018 to USD 14.8 billion in the first quarter of 2019. The total value of returned checks increased by 2.2% on annual basis to reach USD 364 million in the first three months of 2019. This reflects a curbed private spending during the period under consideration.

- Value of Cleared Checks, First Quarter (USD, Billion) -



The **Kafalat loans** decreased in number by 74.3%, from 74 to 19 guarantees in the first quarter of 2019, and in amount from USD 8.1 million to USD 2.3 million during the same period. SMEs constitute a major pillar of the corporate sector, and a driving force of economic activity and job creation in Lebanon.

2- Inflation

The Price Index of the Central Administration of Statistics increased by 4.08% on annual basis in the first quarter of 2019, compared to a higher level of 5.35% for the same quarter of 2019. This reflects the continuity of inflation in the first quarter of 2019, following deflation in 2016 and 2015.

3- BTA – Fransabank Retail Index

Economic activity continued to deteriorate during the first quarter of 2019, and retail trade markets witnessed a noticeable slowdown – a slowdown that was even stronger than in previous quarters, despite a relatively stable political situation, after the formation of the new government, and also with prevailing quiet and secure environment on the Lebanese territory albeit the ongoing regional turmoil in.

However, no signals appeared during the period under review pertaining to any economic salvation measures that would be taken by the new government, apart news from the ministry of finance concerning its preparation of the 2019 budget, a budget that is supposed to respond to the CEDRE conference pre-requisites.

Tourists were also scarce in Lebanon during that period, especially visitors from the Gulf, despite declarations by the Gulf governments that they were levying travel bans to Lebanon. The absence of these visitors did highly affect the levels of activity in many retail trade markets. The above was also topped by the absence of any concrete measures taken to activate the return of refugees to their country and the alleviation of the burden these refugees are exerting on the Lebanese economy as a whole.

Concurrently, Lebanese households continued to experience a drop in their purchasing power, a situation that forced a large majority to refrain from non-priority consumption, and privilege expenditure on basic commodities. At the same time, companies did drastically slowdown hiring new employees while also reducing their existing human resources. On top of all this, transfers of emigrant Lebanese to their relatives in Lebanon have maintained their downward trend, a fact that also contributed in further curbing the levels of consumption in local trade markets.

As a result, the economic crisis situation continued to be the prime responsible factor for the sharp fall that most trade market sectors have continued to experience, especially the basic necessities sectors such as food and other subsistence products, along with sectors such as clothing, household items & equipment, and even snacks & restaurants...

At the same time, the CPI posted an increase of + 4.08 % for the first quarter of 2019 as compared to the first quarter of 2018, as per the official CAS figures, despite the massive sales and reductions that traders did not stop offering to their clients during this period, and more so in response to the "Fakker B Lebnen" initiative that was launched by BTA from the presidential palace around the end of March, with the prime objective of encouraging the Lebanese population for consuming in local markets, for encouraging Lebanese industries and agricultural products, as well as opt for internal tourism and hiring Lebanese human resources.

It should also be noted that sectorial inflation did reach – for this period:

+ 15.77 % in the clothing and footwear sector,
+ 7.05 % in the housing water, electricity, gas and other fuels sector,
+ 6.86 % in the food and non-alcoholic beverages sector,
+ 6.86 % in the recreation, amusement, and culture sector,
+ 5.40 % in the education sector,

The 2019 budget raises the tax on bank interest rates from 7% to 10%, VAT from 11% to 15%, the tax on annual income tranches in excess of LP 225 million from 21% to 25%, in addition to other tax measures.

On the spending side, the 2019 draft budget reduces the wages and salaries of the public sector from 16 months to 12 months in the case of some public institutions, specifies a ceiling of LL 12.5 million for monthly salaries, freezing employment in the public sector for three years, reduces the salaries of the President of the Republic, the House Speaker and current as well as former members of the Parliament by 50% for three years, besides other measures.

It should be noted here that the 2019 draft budget focuses on increasing revenues via tax increases as mentioned above to reach USD 9.46 billion, as compared to realized tax revenues of USD 7.96 billion for the first eleven months of 2018. Non-tax revenues are estimated at USD 2.65 billion (USD 2 billion for the same period).

2019 Draft General Budget (USD, billion)

	Realized Figures 2018*	Estimated Figures 2019
Total Revenues:	9.2	12.1
- Tax Revenues	7.96	9.46
- Non-Tax Revenues	2.0	2.65
Total Spending:	15.2	16.8
- Current Spending:	-	15.47
• Debt Service	5.3	5.5
• Transfers to EDL	1.6	1.1
• Public Wages and Salaries and Others.	-	8.8
- Capital Spending	-	1.3
Total Fiscal Deficit	6.0	4.6
Deficit-to-GDP Ratio (%)	11.0	9.0

* First eleven months.
Source: Ministry of Finance.

2- Public Debt

According to the Ministry of Finance figures, public indebtedness of Lebanon increased by 1.3% on annual basis, from USD 85.1 billion at end-March 2018 to USD 86.2 billion at end-March 2019. The public debt in foreign currency reached USD 33.8 billion, increasing by 0.9% from a year later. The public debt in Lebanese Pound totaled USD 52.4 billion at end-March 2019, with an increase of 1.6% from end-March 2018.

Local-currency debt accounted for 60.4% of the total public debt at end-March 2019, against 39.6% for the foreign-currency debt.

The net public debt reached USD 77.2 billion at end-March 2019, growing by an annual rate of 9% from the same period of 2018.

Public Debt Indicators (USD, billion)

Indicators	Q1 2019	Q1 2018	% Change
Gross Public Debt	86.2	85.1	1.3
Domestic Debt	52.4	51.6	1.6
Foreign Debt	33.8	33.5	0.9
Net Public Debt	77.2	75.8	1.9

Sources: Ministry of Finance and Central Bank of Lebanon.

IV. Inflation and Monetary Policy

The monetary authorities have maintained its monetary stabilization policy as well as inflation-control policy in the first quarter of 2019, mainly by controlling the growth of money supply in the national economy.

1- Central Bank

The Central Bank's statistics reveal that its balance sheet decreased by 1.1% on annual basis to reach USD 124.9 billion at the end of March 2018, compared to USD 122.8 billion during the same period of 2018. Assets in foreign currencies reached USD 38.6 billion at the end of March 2018, with a decrease of 11.1% from USD 43.3 billion at the end of March 2018.

As for the gold reserves, its value dropped by 2.6% year-on-year to reach USD 11.9 billion in the first quarter of 2019.

Yearly Variation between 1st Quarter '18 and 1st Quarter '19

	Q1 - 2018	Q1 - 2019	
Nominal Year to Year Variation (incl. Liquid Fuels)	100.00	96.74	
Nominal Year to Year Variation (excl. Liquid Fuels)	100.00	94.72	
CPI between Mar '18 and Mar '19 (as per the official CAS figures)		**4.08 %**	
Real Year to Year Variation (incl. Liquid Fuels)	100.00	92.79	**- 7.21 %**
Real Year to Year Variation (excl. Liquid Fuels)	100.00	90.85	**- 9.15 %**

* CAS – CPI – Mar '19

Like in previous quarters, retail trade markets tried to face the hard times awaiting with optimism measures that the new government would undertake, and expecting that such measures would send positive messages to the international community concerning the financial and economic reforms that this community is expecting in order to start activating the support measures decided during the CEDRE conference last April, since such measures are highly awaited for the reactivation of the Lebanese economy, and by the same fact the reactivation of consumption and activity in the markets.

Such positive messages are also expected to re-attract local and foreign investments, on one hand, but also to re-attract visitors to Lebanon, among which obviously visitors from the Gulf countries, with their important traditional weight in local markets. There is no doubt that the combination of all the above-mentioned factors will refuel the engines of the Lebanese economy, and result into a U-turn in the growth trend of this economy, growth that would naturally be translated in an improved level of purchase power, and its recurring upward cycle.

The Lebanese consumer is also requested, concurrently, to give preference in his spending choices to buy in Lebanon instead of buying in foreign markets, and the Lebanese employer is requested to give priority to hiring Lebanese, hence contributing in the revitalization of the Lebanese households purchase power, and help in bringing growth back to our economy.

Until this new trend is reached again, the analysis of the performance during the first quarter of this year, and of the various retail trade market sectors, clearly translates the downtrend in the overall turnover figures, and shows that austerity has become normality in the spending pattern of Lebanese households, with selective consumption channeling main spending to basic necessities, based on the classic economic theory of spending based on expected and not current revenue.

The main sectors where declines were registered include:

- Cellular Phones (- 35.03 %)
- Construction Equipment (- 29.97 %)
- Shoes and Leather Products (- 25.59 %)
- Books & Stationery & Office Supplies (- 18.73 %)
- Commercial Shopping Centers (- 18.25 %)
- Toys (- 17.97 %)
- Clothing (- 17.49 % against – 13.28 % in the previous quarter)
- Household Electrical Equipment (- 15.62 %)
- Watches and Jewelry (- 13.41 %)
- Optical and Hearing Aid Instruments (- 13.26 %)
- Pharmaceuticals (- 11.30 %)
- Supermarkets and Food Shops (- 8.41 % against - 7.69 % in the previous quarter)
- Silverware and Decoration (- 7.23 %)
- Musical Instruments (- 6.86 %)
- Furniture (- 6.42 %)
- Bakeries & Pastries (- 5.16 % against + 4.71 % in the previous quarter)
- Home Accessories (- 4.61 %)
- Liquor & Spirits (- 1.68 %)
- Perfumes and Cosmetics (- 1.40 %)

CPI (as per CAS official results)	
Q4 ’14 / Q4 ’13	- 0.71%
Q1 ’15 / Q1 ’14	- 3.38%
Q2 ’15 / Q2 ’14	- 3.37%
Q3 ’15 /Q3 ’14	- 4.67%
Q4 ’15 / Q4 ’14	- 3.40%
Q1 ’16 / Q1 ’15	- 3.57%
Q2 ’16 / Q2 ’15	- 0.98%
Q3 ’16 / Q3 ’15	+ 1.03%
Q4 ’16 / Q4 ’15	+ 3.14%
Q1 ’17 / Q1 ’16	+ 5.12%
Q2 ’17 / Q2 ’16	+ 3.48%
Q3 ’17 / Q3 ’16	+ 4.15%
Q4 ’17 / Q4 ’16	+ 5.01%
Q1 ’18 / Q1 ’17	+ 5.35%
Q2 ’18 / Q2 ’17	+ 7.61%
Q3 ’18 / Q3 ’17	+ 6.53%
Q4 ’18 / Q4 ’17	+ 3.98 %
Q1 ’19 / Q1 ’18	**+ 4.08 %**
Q4 ’14 / Q3 ’14	- 1.49%
Q1 ’15 / Q4 ’14	- 0.98%
Q2 ’15 / Q1 ’15	- 1.12%
Q3 ’15 / Q2 ’15	- 1.18%
Q4 ’15 / Q3 ’15	- 0.16%
Q1 ’16 / Q4 ’15	- 1.15%
Q2 ’16 / Q1 ’16	+ 1.54%
Q3 ’16 / Q2 ’16	+ 0.82%
Q4 ’16 / Q3 ’16	+ 1.93%
Q1 ’17 / Q4 ’16	+ 0.74%
Q2 ’17 / Q1 ’17	- 0.04%
Q3 ’17 / Q2 ’17	+ 1.47%
Q4 ’17 / Q3 ’17	+ 2.78%
Q1 ’18 / Q4 ’17	- 1.06%
Q2 ’18 / Q1 ’18	+ 2.10%
Q3 ’18 / Q2 ’18	+ 0.45%
Q4 ’18 / Q3 ’18	+ 0.32 %
Q1 ’19 / Q4 ’18	**+ 1.16 %**

As a result, the consolidated real retail turnover figures (i.e. after applying the inflation rate weight on the nominal results) have posted a decline of – 7.21 % between the first quarter of 2018 and the first quarter of 2019.

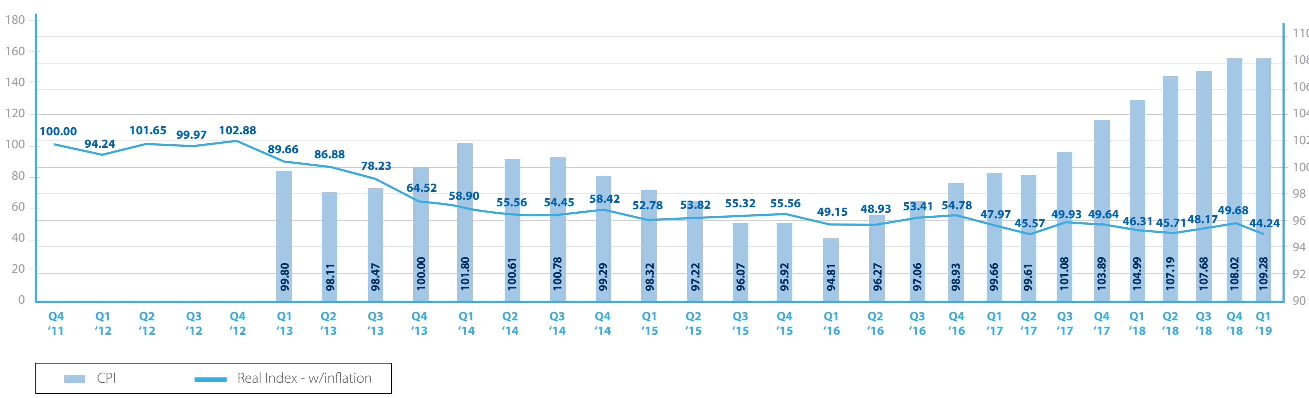
By excluding the fuel sector results (where an increase of + 2.58 % in volume was reported between the levels of Q1 ’18 and Q1 ’19), the real consolidated turnover drop reaches – 9.15 % in comparison to the Q1 ’18 figures (also excluding fuel).

BTA - Fransabank Retail Index for Q1 - 2019 (Base 100 : Q4 - 2011)

	2011	2012				2013				2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real Index - w/out inflation	100	95.77	100.55	108.54	112.66	90.83	87.85	78.60	65.87	59.68	55.30	55.22	57.57	51.51	51.94	52.77	52.911
Real Index - w/ inflation	100	94.24	101.65	99.97	102.88	89.66	86.88	78.23	64.52	58.90	55.56	54.45	58.42	52.78	53.82	55.32	55.56
CPI						99.80	98.11	98.47	100.00	101.80	100.61	100.78	99.29	98.32	97.22	96.07	95.92

	2016				2017				2018				2019
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Real Index - w/out inflation	46.27	46.79	51.49	53.86	47.51	46.76	52.00	53.17	49.09	49.49	52.38	54.25	**48.88**
Real Index - w/ inflation	49.15	48.93	53.41	54.78	47.97	45.57	49.93	49.64	46.31	45.71	48.17	49.68	**44.24**
CPI	94.81	96.27	97.06	98.93	99.66	99.61	101.08	103.89	104.99	107.19	107.68	108.02	**109.28**

Evolution of the BTA - Fransabank Retail Index (Base 100 : Q4 - 2011)



The "BTA-Fransabank Retail Index" for the first quarter of 2019 witnessed, due firstly to seasonal factors, but also due to sustained economic pressures, a noticeable fall, to reach its lowest level since inception.

Expectations are today based on the efforts of the new government to issue a budget that corresponds to the various challenges that the Lebanese economy is currently facing, and to draw a clear economic vision for a long awaited revival, and proceed accordingly with a clearly defined plan as announced in the new government's statement, whereby it will be addressing financial and monetary stability, public investments & expenditure, modernization of the public sector, structural & sectorial reforms, and the submission of a new strategy for productive and services sectors, and the materialization of the objectives of sustainable development.

The sectors that witnessed better results were, in addition to the fuel sector (+ 2.58 % in volume):

- Used Cars Dealers (+ 4.04 %)
- Sports Items & Equipment (+ 1.88 %)
- Tobacco (+ 1.52 %)
- Restaurants and Snacks (+ 1.42 %)
- Medical Equipment (+ 1.26 %)

On the other hand, and despite the fact that the CPI between Q4 '18 and Q1 '19 did not exceed + 1.16 %, the first quarter figures for the majority of retail trade sectors display an unprecedented drop in comparison to the previous quarter results.

The decline was almost generalized, except for the fuel sector, the construction materials sector and finally the footwear sector. Part of this decline was expected, because of classical seasonal factors that boost consumption during the last quarter of the year and weaken it the following quarter.

Yet, it was also noticed that unexpected drops in turnover were reported in basic necessities sectors such as supermarkets and food shops (where a – 14.51 % decline was posted against – 5.21 % in the same quarter of last year), or bakeries (- 9.04 % against – 5.09 %), while it is worth noting that the CPI for the food and non- alcoholic drinks sector did post for this period a + 2.27 % figure, against a consolidated CPI of + 1.16 % as per the official CAS figures.

As a result, the overall consolidated real result for the first quarter was negative, and displayed a real deterioration that reached – 14.45% as compared to the previous quarter (excluding Liquid Fuels, where a + 0.38 % increase was reported in terms of volume).

Sectors where declining activity was reported included, in addition to the 33.14 % decline in commercial malls:

- Liquors (- 41.85 % %)
- Cellular Phones (- 35.10 %)
- Household Electrical Equipment (- 30.73 %)
- Sports Items & Equipment (- 30.21 %)
- Books & Stationery & Office Supplies (- 28.92 %)
- Furniture (- 20.04 %)
- Watches and Jewelry (- 17.31 %)
- Used Cars Dealers (- 16.71 %)
- Perfumes and Cosmetics (- 15.28 %)
- Supermarkets and Food Shops (- 14.51 %)
- Tobacco (- 12.21 %)
- Restaurants and Snacks (- 10.05 %)
- Medical equipment (- 9.99 %)
- Bakeries & Pastries (- 9.04 %)
- Pharmaceuticals (- 8.05 %)
- Clothing (- 5.23 %)
- Toys (- 4.57 %)
- Musical Instruments (- 4.19 %)
- Silverware and Decoration (- 3.31 %)
- Optical Instruments (- 2.92 %)
- Home Accessories (- 1.63 %)

Positive results were posted, in addition to the fuels sector (+ 1.13%), in the following sectors:

- Construction Equipment (+ 34.98 % following a – 33.31 % drop in the previous quarter), with construction materials sector remaining almost stable at – 0.75 %
- Shoes and Leather Products (+ 27.28 % after - 31.66 % drop in the previous quarter)

As a result, with the base index 100 fixed at the fourth quarter of 2011, and with a quarterly inflation rate of + 1.16 % for the fourth quarter of 2018, as per the official CAS report, the "BTA-Fransabank Retail Index" is (with all sectors included) registered 44.24 for the first quarter of the year 2019. This figure compares to the level of 49.68 for the fourth quarter of 2018.

Indications of Commercial Banks (USD, billion)

Indicators	2019 First Quarter	2018 First Quarter	% Change
Total assets	252.8	224.7	12.5
Private sector deposits	172.5	171.1	0.8
Private sector loans	57.3	59.7	(2.9)
Loans to public sector	33.3	33.9	(0.9)
Dollarization of Lending (%)	69.7	67.9	-
Dollarization of Deposits (%)	70.6	68.3	-
Loans-to-Deposits Ratio (%)	33.2	34.5	-
Capital Base	22.1	21.6	2.1

Sources: Central Bank of Lebanon and Association of Banks in Lebanon.

2- Financial Institutions

The activity of financial institutions operating in Lebanon contracted during the first quarter of 2019. Its total assets dropped by 2.5% to reach USD 1.5 billion in the first quarter of 2019 relative to USD 1.53 billion for the same period of 2018.

During This period, obligations on resident customers increased by 4.4% to USD 704.4 million, while resident customer deposits decreased by 9% to USD 143.4 million.

3- Beirut Stock Exchange

The figures announced by the Beirut Stock Exchange (BSE) indicate that total trading volume reached 183 million shares in the first three months of 2019, with a substantial increase of 4 times from 45.6 million shares in the same period last year. This is due to the trade of a substantial block of common shares of one listed bank.

The total trading value also increased substantially by 2.3 times from USD 338.1 million to USD 777.3 million during the same period.

Market capitalization of BSE decreased by 18.8% on annual basis to reach USD 9.63 billion at end-March 2019.

The market liquidity ratio was 8.1% in the first quarter of 2019, relative to 2.9% in the same period of 2018.

Beirut Stock Exchange Indicators

Indicators	2019 Q1	2018 Q1	% Change
Market capitalization (USD, billion)	9.63	11.9	(18.8)
Total trading value (USD, million)	777.3	338.1	129.9
Total trading volume (Shares, thousand)	183	45.6	301.3
Liquidity Ratio (%)	8.1	2.9	-

Sources: BSE and Central Bank of Lebanon.

4- Stabilization Policy

The Central Bank of Lebanon has continued its monetary stabilization policy during the first quarter of 2019, just like in the previous years, despite the heavy transfer from the Lebanese Pound to the US dollar. This policy continues to contribute to overall monetary and economic stability in Lebanon.

To support this monetary stability, the monetary authorities have maintained its policy of moderating growth in money supply in order to curb price inflation. Money supply M3 decreased by only 0.8% on annual basis in the first quarter of 2019 to reach USD 140 billion. This is crucial also for controlling inflation.

Monetary Indicators

Indicators	2019 Q1	2018 Q1	% Change
USD/LBP exchange rate	1507.5	1507.5	0.0
Central Bank's Balance Sheet (USD, billion)	124.9	122.8	1.1
Central Bank's Assets in FX (USD, billion)	38.6	43.3	(11.1)
Central Bank's Gold Reserves (USD, billion)	11.9	11.6	2.6
Inflation rate (%)	4.08	5.35	-
Money supply M3 (USD, Billion)	140.0	141.3	(0.8)

Sources: Central Bank of Lebanon, Association of Banks in Lebanon, and Central Administration of Statistics.

V. Financial Markets

The banking sector has continued its growth in the first quarter of 2019, while the activity of the financial institutions contracted. The BSE recorded a substantial improvement in its activity.

1- Banking Sector

The statistics of the Association of Banks in Lebanon and the Central Bank indicate that the total assets of commercial banks stood at USD 252.8 billion as of end-March 2019, with an annual growth of 12.5% from end-March 2018.

The loans extended by commercial banks to the private-sector decreased by 2.9% annually to reach 57.3 billion at end-March 2018. The dollarization rate of private sector lending dropped from 67.9% at end-March 2018 to 69.7% at end-March 2019.

The loans extended to the public sector decreased by 0.9% on annual basis to reach USD 33.3 billion at end-March 2019, relative to USD 33.9 billion at end-March 2018.

The total private-sector deposits grew by 0.8% on annual basis to reach USD 172.5 billion at end-March 2019. The dollarization rate of these deposits increased from 68.3% at end-March 2018 to 70.6% at end-March 2019.

The private-sector loans-to-deposit ratio was 33.2% at end-March 2019, compared to 34.5% at end-March 2018.

The commercial banks' capital base expanded by 2.1% year-on-year to reach USD 22.1 billion at end-March 2019.

Study - Financial Technology & Lebanese Banks: Opportunities and Challenges

I. Introduction

This study sheds light on the definition of Financial Technology (Fintech); the factors motivating its growth; its covered sectors; its benefits to the banking sector, society and economy; and challenges as well as difficulties facing its growth and expansion. The study also highlights the current position and development of Fintech in Lebanon, the operating companies, growth factors, and its opportunities and challenges to banks. It concludes a set of recommendations necessary for the development of a supportive environment for the growth of the Fintech industry, that would achieve advantages to the country's banking and financial sectors.

II. Fintech: Definition and Institutions

According to the Financial Stability Board, Financial Technology (or Fintech) is defined as "financial innovations using technology which produces operation models or applications or transactions or new products, that have physical effects on financial markets, institutions and services".

Fintech is characterized by its ability to change the existing financial services structure, leading to better, faster, cost-effective, safer, more transparent and more accessible services. Accessibility is a major characteristic of Fintech since it allows a large parts of the population in a country who do not deal with banks due to certain considerations such as high operation costs, long distances, or complicated bank account opening, to access electronic banking services.

Usually, Fintech innovations in terms of products and services are developed by startup companies working in the Fintech sector, whose objective is to improve financial and banking services to consumers, companies and institutions. Such Fintech services could be provided based on cooperation or competition with banking and financial institutions.

The definition of Fintech has expanded over the last years to include all technological innovations or renovations in the financial services sector, which could be provided by banks or Fintech startups. It also includes other areas such as financial education, financial services for consumers and companies, money transfer, investment management, and encrypted digital currencies (such as Bitcoin).

Fintech is now reaching and affecting the life of consumers and businesses, all over the world, starting from the local merchant who seeks funding, to households who plan for pension, and to the foreign worker who sends money to his/her relatives at home country.

The growth of the Fintech industry is influenced by both demand and supply factors. On the demand side, consumers are increasingly looking for priorities such as fast, easy use and low cost services. On the supply side, there is the accelerated development in the ICT sector and the growing use of internet and smart phones, besides the increasing complications in regulatory and supervisory requirements related to banking activities (such as anti-money laundering, combating terrorism financing, FATCA Law, Basel standards and others).

III. Fintech Areas

According to Basel Committee on Banking Supervision, Fintech is related to three major sectors which cover the basic financial services, namely:
1- Credit, deposits, and capital.
2- Management of funds, investments and wealth.
3- Payments, clearing and settlement.

The last years experiences have shown that the banking and financial services that are increasingly linked to Fintech are the following:
1- Private banking services.
2- SMEs services.
3- Corporate banking services.

VI- Foreign Sector

The balance of payments, mirroring the aggregate foreign sector activity, was in deficit in the first quarter of 2019, due to declining capital inflows and increasing capital outflows. The trade deficit level remains quite high.

1- Trade Balance

For the first two months of 2019, the value of total exports reached USD 535.8 million, with an annual increase of 0.9% from a year later. In parallel, total imports dropped by 11.8% to reach USD 2.8 billion during the same period. As such, the trade deficit narrowed to USD 2.23 billion, declining by 14.4% on annual basis.

The export-to-import coverage ratio was 19.1% in the first two months of 2019, relative to 17.7% for the same period last year, thus reflecting an improvement in this coverage ratio due to the growth of exports (USD 4.5 million) and decline in imports (USD 371.3 million).

Foreign-Sector Indicators (USD, billion)

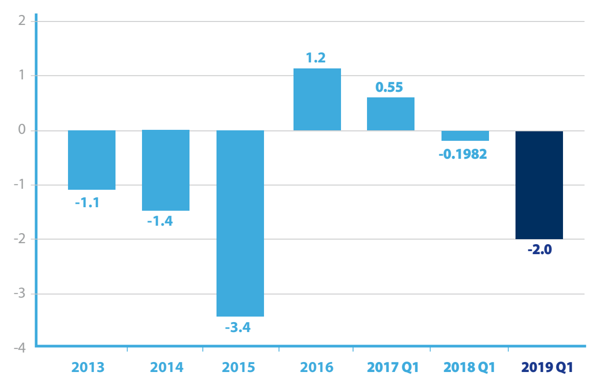
Indicators	2019	2018	%
Trade deficit*	2.2	2.6	(14.4)
Exports*	536	531	0.9
Imports*	2.8	3.1	(11.8)
Balance of Payments (first quarter)	(2.0)	(0.1982)	-

Sources: Ministry of Finance and Central Bank of Lebanon.

2- Balance-of-Payments

The statistics announced by the Central Bank show that Lebanon's balance-of-payments recorded a deficit of USD 2 billion in the first quarter of 2019, relative to a lower deficit of USD 198.2 million for the same quarter last year. The recorded deficit was due to a decrease of USD 899 million in the net foreign assets of banks and financial institutions, and a decrease of USD 1.1 billion in the net foreign assets of the Central Bank.

- Balance of Payments (USD, Billion) **-**



VII- Growth Prospects

The IMF estimates Lebanon's real growth rate for 2019 at 1.3% and for 2020 at 2%. Also, it forecasts inflation at 2% for 2019 relative to 6% in 2018.

This weak growth in Lebanon's economy is caused by sluggish public and private investments, weak exports, while growing public spending and private consumption spending continue to stimulate domestic economy activity.

Raising economic growth rates in the coming years would depend on the implementation of fiscal, administrative, economic and sectoral reforms, in order to lower fiscal deficits, control debt growth, stimulate the activity of economic sectors, decrease the trade deficit, enhance capital inflows, and support monetary and banking stability. The government should enhance its collection of public revenues, especially from the electricity sector, and public maritime properties. It should also seize public financial waste, customs smuggling, and tax evasion. The electricity sector losses are in excess of USD 1.5 billion annually. The cost of tax evasion is more than USD 4 billion. The cost of customs smuggling is in excess of USD 1.5 billion. The collection of electricity tariffs is only 40-50%. Such actions and measures are crucial to avoid economic stagnation in Lebanon.

banking services, and which are currently upgrading its digital financial services by adopting innovative digital policies.

- Limited competent and experienced human resources in the fields of Fintech, and banking and financial sectors.

VI. Current Position of Fintech in Lebanon

According to available statistics for 2015, there are 15 start-up companies working in the Fintech industry in Lebanon, with an increase of 12 companies from 2011. The annual compound growth rate for this period is nearly 50% in the country. This figure represents nearly 14% of the total number of Arab Fintech companies (nearly 105 companies in 2015). Lebanon has established some incubators and accelerators to help in expanding the number of Fintech startups over the past years. Population of Lebanon are interested in Fintech innovations, as 54% of customers with bank accounts are using digital banking services as far as 2017 in concerned, relative to a rate of 38% in 2016.

Fintech has a basic advantage for the banking sector and economy of Lebanon. It supports the growth of financial inclusion, i.e. spreading financial services to larger groups and regions of the country. Domestic available data for 2014 indicate that the share of opened accounts at official financial institutions as a percentage of the mature population over the age of 15 reached 46.9%, ranging between 62.4% for males and 32.9% for females. Also, 53% of the Lebanese do not have banking accounts.

The major start-up companies operating in the Fintech industry in Lebanon are the following:

- **ReAble**, which operates in the field of private financial affair management, especially for special-need people. It provides application and tools to carry on financial and banking transactions in an easy way and under the supervision of custodians.
- **Card Switch**, which operates in the field of credit management in banks. It provides digital banking services based on linking payment cards with smart phones of users.
- **Bluering,** which operates in the field of digital banking services. It provides solutions for credit management to the Middle Eastern banking and financial sector, besides techniques for analyzing and evaluating loan files for individuals and SME companies.
- **PinPay**, which is the first application for payment and financial activities via the mobile phone. It is provided by some Lebanese banks.
- **Zoomal**, which is a platform for collective financing to innovation projects in the Arab region.
- **CMO** is an application for electronic payments via the mobile phone launched by CSC Bank. It also provides other services such as money transfer and cash withdrawals from ATMs.
- **Via Mobile**, which provides payment solutions using the mobile phone to individuals and companies.
- **Risk + Solutions**, which is specialized in developing and implementing IT solutions in the field of financial intelligence and risk management, which are provided to banks and financial institutions.
- **Jelly Fish**, which provides the B2B application for the business sector. It also equips SMEs and NGOs with services such as organization and examination of financial reports and budgets for several sections in real time without the need for accountant consultation.
- **Anzimaty**, which operates in the fields of e-commerce and electronic payment solutions in Lebanon and the Arab region. It designs websites on the internet and apps on smart phones.
- **FOO**, which operates in the fields of e-commerce, electronic payment solutions, and electronic banking operations using smart phone or smart watch apps.

Hence, it is obvious that Fintech companies are active in the fields of payment solutions using smart and mobile phones, e-commerce, collective financing, personal financial affair management and others.

Fintech companies do not tend to compete with Lebanese banks but rather cooperate and partner with them, in order to provide Fintech services to customers. In this sense, both parties benefit when dealing with customers. The Lebanese banking sector accommodates modern developments in the ICT industry, thus developing and diversifying its services, controlling its risks, and enhancing its compliance with local and international banking rules and standards.

4- Investment banking services.
5- Money transfers and payments.
6- Management of investments and wealth.
7- Financial brokerage services.
8- Life and property insurances.
9- Insurance Brokerage.
10- Market and transaction operators.
11- Funds operators.
12- Reinsurance services.

IV. Advantages of Fintech

There are several potential advantages of Fintech in any economy, mainly the following:
1- Decentralization and diversification.
2- Efficiency.
3- Transparency.
4- Easy access and use of financial services.

Decentralization and diversification in the financial system lessens the negative impact of financial shocks and crises, due to a more diversified range of financial service providers.

Efficiency, in turn, increases the degree of competition in the financial system, which supports business models of financial institutions.

Good transparency makes evaluation of financial risks easier, more accurate, with less time and cost.

In addition, Fintech facilitates access to financial services, thereby supporting the growth of financial inclusion for households and institutions, and, hence, economic growth and the ability of institutions to control investment risks.

Therefore, Fintech plays a major role in the domestic economy, by increasing financial inclusion, economic diversification, and controlling risks. Also, it supports stability in the financial system, mainly by using technology to comply with the regulatory and supervisory frameworks related to risk management, fraud, anti-money laundering and combating terrorism financing.

In parallel with Fintech growth "Regtech" is also expanding. Regtech uses IT to support institutions to comply with international regulation and supervision standards.

In addition, Fintech has another significant advantage: it plays a key role in expanding e-commerce in a country especially with the growth of electronic payment services related to the purchase of goods and services.

V. Problems and Challenges of Fintech

Despite the fact that technology use is on growth in the economies of countries, yet there are several problems and challenges facing its fast spread and expansion. International data indicates that 50% of customers of Arab banks have interest in Fintech services; however, less than 5% of them use such services. Also, the failure rate of startups in the Fintech industry reaches 30% in the Arab region.

We can mention the following problems and challenges which face the fast spread and expansion of the Fintech sector in the Arab region:
• Weak financial culture and awareness, which lessens customer confidence in Fintech services, thereby decreasing the ability of Fintech companies in attracting customers.
• Customer preferences for on-delivery service, due to their fears of fraud, hacking and financial crimes which are daily increasing.
• Regulatory and legal restrictions imposed on the establishment of Fintech companies, besides other impediments to its market access.
• Financial opportunities for Fintech companies, because the private equity and venture capital markets are still immature, especially with the declining oil prices and revenues.
• Despite the growing internet and smart phone penetration in some Arab countries, yet the services provided in such sectors are characterized by low quality and slowness.
• Ongoing fierce competition between foreign Fintech companies and banks as well as financial institutions which prefer to develop its own traditional financial and

in the fields of anti-money laundering and combating financing terrorism.

However, the implementation of modern technology in banking and financial services is increasingly producing, according to the Basel Committee, several risks, hence forcing banking and financial institutions to adopt and implement effective strategies and policies for controlling and managing these risks in order to secure its safety and financial stability.

The major risks induced by Fintech expansion in the banking and financial sector are the following:

1- Strategic risks: These risks are produced by the competition of Fintech companies with banks, which usually lead to pressures on banks' profits and its sustainability in the medium and long terms.

2- Systemic risks: These risks are produced by the market interconnection between Fintech companies and banks, so that any IT crisis could lead to a financial systemic crisis and to more complication in the financial system.

3- Operation risks: These are induced by the innovation-led products and services, which complicate the risk-management process as far as operational risks are concerned.

4- Compliance risks: These are induced by the increasing difficulties of compliance with international regulatory and supervisory requirements for AMS, CFT, fraud and privacy of financial data.

5- Outsourcing risks: These risks are produced by the ability of banks to monitor and manage risks of operations implemented by outsourcing parties.

6- Cybercrime risks: these risks are produced by fraud and hacking activities of private data and information, given the increased use of IT in banking activities.

7- Liquidity and Finance risks: These are induced by the degree of loyalty of customers to banks, at times Fintech companies are delivering direct products and services to customers in more dynamic, flexible and easy ways and with low cost. This is causing fluctuations in deposits and finances at banks, thereby increasing liquidity and finance risks.

IX. Requirements of a Supportive Environment for the Growth of Fintech and Banking

It is evident that Fintech is benefiting Fintech companies, banking and financial institutions, and also customers.

It is also evident that Fintech poses several threats or risks that could jeopardize the strength and stability of the banking and financial sector. This could prevail if banks do not upgrade its risk-management potentials, and if IT innovations are transformed into instruments and techniques that support financial crimes, which in turn lead to significant financial losses for banks, financial institutions and its customers.

Hence, creating a sound and sustained balance between Fintech innovations on one hand, and risk management on the other hand becomes a crucial and necessary strategy. This definitely needs a financial and banking environment which is supportive to overall stability. Such an environment should be established and developed based on an effective cooperation between all stakeholders, namely banks and financial institutions, IT companies, Central Bank, and domestic regulatory authorities.

Following are major measures that could strengthen banking and financial stability in light of increased use of Fintech activities:

First: The current regulatory and supervisory frameworks should encourage innovations in the ICT sector, and at the same time increase the scope of instruments and techniques for controlling potential banking and financing risks.

Second: Encouraging cooperation between Fintech companies and banks, in order to provide customers with new and safe products and services that depend on IT innovations.

Due to continued Fintech innovations on one hand, and the strong and growing financial potentials of banks on the other hand, Lebanon has a valuable opportunity to become a major hub for Fintech services in the Arab region. This requires a collaborative effort on the part of concerned ministries, Central Bank, banks and financial institutions, ICT companies and entrepreneurs in order to further develop the Fintech industry in the country.

VII. Driving Forces for Fintech Growth in Lebanon

There are several driving forces for Fintech development in Lebanon, although the number of start-ups operating in this field is still limited. A major driving force is the existence of a strong, large and supportive banking sector whose assets and deposits represent more than four times and three times respectively of the country's GDP. Most Lebanese banks have launched Fintech applications, whether independently or in partnership with Fintech start-up companies.

Also Lebanon enjoys an educated, talented, well trained and experienced human capital in the fields of ICT, finance and business. The Lebanese human resources also enjoy a competitive edge in terms of low cost as compared to other countries such as the GCC countries.

Lebanon is also known for its widespread expansion of the internet service. The World Bank statistics for 2016 show that 76% of the Lebanese use internet relative to 42% for the Arab region. It is also known for the continued growth of smart and mobile phone use, where domestic statistics for 2015 show that 88% of the Lebanese have mobile phones and 52% have smart phones relative to the world rate of 43%. This Lebanese rate increased to nearly 90% in 2017.

In addition, the ICT sector is a growing industry in Lebanon, thereby paving the way for further expansion in the number of IT companies. Lebanon is ranked 6th in the Arab region and 64th worldwide out of 176 countries in terms of the ICT Development Index issued by the International Telecoms Union. It is also ranked 5th and 53th respectively in terms of ICT Use Index.

Furthermore, the Central Bank's regulatory incentives provided to domestic banks constitute another driving force for the growth of the Fintech industry in Lebanon. The intermediary circular nb. 331 issued in December 2013 allows banks and financial institutions to subscribe up to 3% of its private capital in start-ups, and business accelerators and incubators operating in the ICT sector. The Central Bank has allocated nearly USD 400 million for bank investments in this sector. It is worth mentioning here that 8 business incubators/accelerators and 6 venture-capital funds are currently operating in Lebanon.

However, there is a major factor impeding the fast growth of the Fintech industry in Lebanon, namely the increasing threats of the cybercrime activities. Lebanon's efforts in this respect are still below the regional and international standards. It is ranked 15th in the Arab region and 119 worldwide among 165 countries for 2017 in terms of cybercrime security efforts according to the International Telecoms Union.

VIII. Opportunities and Challenges of Fintech for Lebanese Banks

There are several opportunities which Fintech allows for the banking and financial sector in Lebanon. Firstly, it enhances the scope of financial inclusion in the country, since it increases the access of several sectors of the society and several regions to financial services.

Also, Fintech provides better and more appropriate banking services to individuals, companies and institutions, depending on cooperation schemes between Fintech companies and banking and financial institutions, especially in the fields of money transfer and payments within or across borders.

In addition, Fintech increases competition in the local market, between Fintech companies themselves or with banks or even among banks, thereby lessening the scope of financial risks and increasing domestic financial stability.

Furthermore, Fintech helps in the automatization of regulatory reports and compliance and regulatory requirements, whether local or international, especially

Third: The development of Fintech is strongly connected with the development of ICT infrastructure, especially the increase of internet penetration and use of mobile and smart phones that involve high speed and low cost.

Fourth: Enhancing electronic financial knowledge and awareness among consumers. Also, increasing their demand for electronic financial services, mainly by strengthening security and safety measures for personal data.

Fifth: Supporting the establishment of Fintech companies and conducive environment for its growth. Also, care should be taken concerning the soundness and safety of its innovations and applications in the financial-services industry.

Sixth: The necessity of Central Bank's supervision on all banking-based electronic systems and applications to ensure its soundness, safety and privacy measures.

Seventh: The necessity of developing the existing anti-cybercrime mechanisms, so that Fintech produces the desired benefits to financial and banking markets.

Eighth: Encouraging banks and financial institutions to increase its investments in Fintech applications, in order to meet the growing needs of customers for new and diversified services and products.

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