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LEBANON ECONOMIC REPORT

3RD QUARTER 2020

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FOR A STRENGTHENING OF BANKING CAPACITY TO WITHSTAND PRESSURES AMID MACRO TURMOIL

Country falling into severe stagflation

The severe economic crisis that erupted since the last quarter of 2019, the State's default on its foreign debt in the first quarter of 2020, the monetary drift leading to deviation between the official and parallel market exchange rates, the Covid-19 Pandemic crisis which left the country in a lockdown over several weeks and the devastating Beirut Port explosion in mid-summer, all are factors that weighed on economic activity and generated real sector sluggishness. The IMF forecasted Lebanon's growth at -25% for 2020 in its latest October Global Economic Outlook, which along with a triple-digit inflation rate, suggests the country has fallen into severe stagflation.

Foreign trade deficit cut by a yearly 59% this year

During the first eight months of 2020, Lebanon's external sector registered a net contraction in trade deficit by a yearly 59.0%, moving from US$ 11.4 billion to US$ 4.7 billion, according to the latest trade statistics released by Lebanon's Customs Authority. This drop in trade deficit was the result of retreating imports by 50.0% and declining exports by 8.3% over the first eight months of this year. In parallel, amid significantly contracting inflows, the balance of payments reported a deficit of US$ 9.6 billion in the first nine months of 2020, against a full-year deficit of US$ 5.8 billion in 2019.

Double-digit contractions in fiscal revenues and expenditures

The public finance figures for the first seven months of 2020 suggest that both public revenues and public expenditures were down by double-digit contractions, generating a slight decline in fiscal deficit. As a matter of fact, total public expenditures were down by 19.1% over the first seven months of the year, while total public revenues were down by 21.2% over the period, generating a 12.9% contraction in fiscal deficit. Public finances yet remain among most significant macro vulnerabilities with unsustainable deficit and debt ratios relative to the size of the economy.

Multiple exchange rates emerge amid dwindling FX reserves

Lebanon's monetary conditions were marked in 2020 by dwindling foreign currency buffers, excessive money creation in Lebanese pounds, the emergence of multiple LP/US$ exchange rates and first interest rate cuts in ten years. BDL's foreign assets contracted significantly by US$ 11.3 billion during the first nine months of the year to reach US$ 25.9 billion at end-September 2020, including BDL's Eurobond holdings and facilities provided by the Central Bank to banks, bringing BDL's liquid FX reserves below the US$ 20 billion level.

Ongoing bank deleveraging and interest rate contractions to record lows

The Lebanese banking sector continued to operate under very challenging conditions during the first nine months of this year, amid continued political bickering and a lack of tangible actions on behalf of public authorities to move forward in dealing with the acute economic and financial crisis the country is going through. Measured by the aggregated assets of banks operating in Lebanon, sector activity contracted by 11.2% in the first nine months of this year to reach the equivalent of US$ 192.6 billion (at the official exchange rate) at end-September 2020 on the back of deposit and loan contractions.

Lebanon's capital markets nosedive amid crippling financial and economic crisis

Lebanon's equity and bond markets nosedived during in 2020 following the State's unprecedented default and amid worsened socio-economic conditions and the lack of implementation of much-needed reforms, which raised doubts about Lebanon's ability to attract foreign funding. Lebanon's stock market remained in free fall, as reflected by a double-digit drop in the BSE price index of 14.5% during the first nine months of 2020, following a 16.9% contraction in 2019. In parallel, Lebanese Eurobonds fell drastically amid Lebanon's first-ever default on its foreign currency debt on March 9, 2020 with the Lebanese bond curve converging to mid-teens at end-September 2020.

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The severe economic crisis that erupted since the last quarter of 2019, the State's default on its foreign debt in the first quarter of 2020, the monetary drift leading to deviation between the official and parallel market exchange rates, the Covid-19 Pandemic crisis which left the country in a lockdown over several weeks and the devastating Beirut Port explosion in mid-summer, all are factors that weighed on economic activity and generated real sector sluggishness.

The IMF forecasted Lebanon's growth at -25% for 2020 in its latest October Global Economic Outlook, and growth forecasts that were released by international entities in the aftermath of the Beirut Port Explosion were as grim. As a matter of fact, the 2020 real GDP growth is now forecasted at -20.7% by the Economist Intelligence Unit, -22.5% by Moody's, -29.7% by the IIF, -23.8% by Citi, -25.0% by Fitch and -25.0% by Standard & Poor's. In parallel, the year-on-year Consumer Price Index has surged by 107% in September 2020 compared to results of September 2019, suggesting the country has fallen into severe stagflation.

BDL coincident indicator, an average of a number of real sector indicators that coincide with economic activity, reported an average of 200.8 over the first six months of 2020, contracting by 33.4% relative to the first half of 2019. Comparatively, the coincident indicator had grown by an average of 1.7% over the first halves of the previous five years. The contraction in private spending, in both its consumption and investment components, is mainly behind the county's macro sluggishness. In parallel, the net decline in public spending did not help offset the contraction in private spending, as the State was caught in an era of strict austerity requirements driven by its overall public finance imbalances.

The evolution of real sector indicators this year is actually a mirror image of the BDL coincident indicator. Out of 11 real sector indicators, 10 were down and one was up over the first nine months of 2020. Among indicators with negative growth, we mention the number of tourists with a fall of 78.4%, the number of passengers at the Airport with a contraction of 75.4%, new car sales with a decline of 74.1%, cement deliveries with a decrease of 54.4%, total imports with a drop of 50.0%, merchandise at the Port of Beirut with a contraction of 37.0%, construction permits with a fall of 34.0%, electricity production with a decrease of 14.7%, total exports with a drop of 8.3% and cleared checks with downtick of 4.1% year-on-year. The only indicator with positive growth was the value of property sales with an increase of 112.7% over the first nine months of 2020 when compared to the previous year's corresponding period, amid investors search for safe haven refuge.

At the fiscal level, the public finance figures for the first seven months of 2020 suggest that both public revenues and public expenditures were down by double-digit contractions, generating a slight decline in fiscal deficit. As a matter of fact, total public expenditures were down by 19.1% over the first seven months, while total public revenues were down by 21.2% over the period, generating an 12.9% contraction in fiscal deficit. At the monetary level, BDL FX reserves contracted by US$ 11.3 billion in the first nine months of 2020 amid FX market intervention, import financing for basic products and some netting operations between BDL FX assets and FX liabilities.

At the banking sector level, customer deposits, which account for 74% of bank assets, reported a contraction of US$ 16.7 billion over the first nine months of 2020 to amount to US$ 142.2 billion at end-September. The contraction in deposits is mainly tied to a contraction in LP deposits by US$ 10.0 billion year-to-September, along with a decline in FX deposits by US$ 6.7 billion over the period. As to interest rates, they reported a significant contraction over the past year. The average LP deposit rate contracted to 3.35% in September, against a high of 9.40% last November. The average US$ deposit rate contracted to 1.15% in September, against a high of 6.61% last October.

At the capital markets level, equity and debt markets came under pressure. The BSE price index reported a contraction of 14.5% in the first nine months of the year despite the improvement in Solidere prices which more than doubled over the period. This occurred within the context of a 32.3% annual increase in trading volume year-on-year, from US$ 140 million in the first nine months of 2019 to US$ 185 million in the first nine months of 2020. In parallel, eurobond yields and CDS spreads skyrocketed over the period amid the default of the State on the totality of its Eurobond portfolio.

The developments in the real sector, external sector, public sector and financial sector for the first nine months of 2020 will be analyzed thereafter while the concluding remarks are left to an assessment of the banking sector restructuring needs amid the acute economic crisis.

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1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture and Industry

Agricultural and industrial sectors under pressure in 3Q2020

The country's primary and secondary sectors came under pressure during the first three quarters of 2020, as the country suffered from the impact of its economic crisis that surfaced clearly in the last quarter of 2019 and the lockdown imposed due to the spread of the COVID-19 pandemic.

In a look at the agricultural sector, the Centre de Recherches et d'Etudes Agricoles Libanais (CREAL) states that if Lebanon does not take steps to help farmers this year, its agricultural production is likely to collapse. CREAL, which collects data on the agricultural sector, has projected a production drop in agriculture to be around 40% of Lebanon's total share in GDP. Some crops could see a decline of up to 70% in value while others could see a drop of more than 50% in volume, compared to 2018 harvests. The picture becomes extremely concerning when these declines affect common food items including onions and potatoes, which incidentally are among the worst affected crops. It is worth noting that the steep decline in the availability of agricultural produce can be directly traced to the banking and financial sectors.

In fact, agricultural imports notably dropped while exports managed to grow. Agricultural exports increased by 21.8% during the first eight months of 2020. Agricultural imports fell by 29.4% during the same period.

Lebanon's agricultural sector is highly important for self-sufficiency and reducing the need to import food products, hence limiting the need for foreign currencies.

Both industrial exports and imports contracted over the course of the first eight months of 2020 mainly due to the difficulties in importing raw materials used in their production of exported items, and to a weakening local currency. Both imports and exports came under pressure in all products. As a matter of fact, declines in imports products of the industrial sector reached around 69.0% for material like metal and metal products. Externally, industrial exports decreased for nearly all products and the highest decline was of 68.6% for mineral products.

It is worth noting that Lebanon's agricultural and industrial sectors would certainly benefit from reforms targeting the economy as a whole and affecting those sectors. Improvement of these sectors will ensure some kind of self sufficiency and less reliability on imports.

1.1.2 Construction

Demand side of the construction sector posts gains this year

Developments in Lebanon over the past year supported the perception of safe haven investment that the realty market has been known for. The sector is benefiting from some form of relief today that is only bound to be sustained as long as uncertainty does not subside. Soon after the outburst of the October revolution, buyers have started to look for a safe haven placement, and naturally realty has come to their minds. For those buyers, investing in real estate withholds the value of their money.

In details, on the demand side, the number of sales operations went up from 36,952 operations in the first nine months of 2019 to 55,108 operations in the first nine months of 2020, according to the latest statistics published by the General Directorate of Land Registry and Cadastre. In parallel, the value of property sales transactions posted a noticeable rise of 112.7% year-on-year to reach a total of US$ 10,077 million during the same period of 2020. Accordingly, the average sales value increased from US$ 128,228 in the first nine months of 2019 to US$ 182,860 in the first nine months of 2020.

As for the breakdown of the value of property sales, Beirut continued to capture the highest share over the period with a share of 34.1%, followed by Baabda with 17.3%, Metn with a share of 17.0%, Keserwan with

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12.0%, South with 8.3%, North with 4.1%, Bekaa with 3.1% and Nabatiyeh with 2.8%. Furthermore, most of the regions recorded an increase in the value of sales transactions, with the most significant movements coming as follows: Keserwan (+168%), Beirut (+127%) and Baabda (+112%). In parallel, property taxes recorded a hike of 105.7% to reach US$ 448.0 million over the period. Moreover, sales to foreigners increased by 2.4% year-on-year to reach 776 operations in the first nine months of 2020.

On the supply side, construction permits, an indicator of forthcoming construction activity, continue to nosedive. As per the latest figures released by the Orders of Engineers of Beirut and Tripoli, construction permits covered an area of 3,350,129 square meters in the first nine months of 2020, against an area of 5,079,173 square meters in the first nine months of 2019, the equivalent of a yearly drop of 34.0% between the two periods. This followed a yearly contraction of 27.3% registered in the aforementioned period of 2019. The breakdown by region shows that most of the regions reported contractions in construction permits, with Beirut and Bekaa reporting the highest contractions of 80.8% and 39.5% respectively in the first nine months of 2020. As for the breakdown of construction permits, Mount Lebanon continued to capture the highest share in newly issued construction permits in the first nine months of 2020 with a share of 33.2%, followed by South Lebanon with 23.5%, North Lebanon with a share of 19.6%, Nabatiyeh with 12.8%, Bekaa with 8.9% and Beirut with 2.0%.

The supply side developments are explained by the existing stock of residential properties for sale that accumulated over the past few years and which will take time to decrease in addition to the increase in the price of the dollar in the parallel market and which put pressure on construction costs. While the current real estate sales upturn is reducing the stock, the latter remains non-negligible and needs to be absorbed before it makes sense for property developers to think in terms of kick-starting new projects.

In conclusion, the demand side of the sector extended its gains over the first nine months of this year, coupled with a slowdown at the level of supply. Hence, it is clear that realty remains a center of interest for residents and expatriates, and a mean for investment diversification at all times.

1.1.3. Trade and Services

Tertiary sector suffers from spillover effects of COVID-19 and Port blast

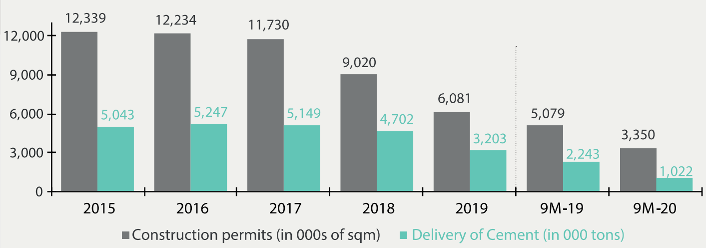
Lebanon's tertiary sector suffered from the impact of a number of negative events of the course of the first nine months of 2020. The worsening of the economic crisis, the increase in the exchange rate in the parallel market, the spread of the COVID-19 pandemic and the explosion at the Port of Beirut left a devastating crater in the sector's already-crumbling performance.

Looking at the performance of the Port of Beirut which was hardly hit, there was a yearly 44.5% decline in the Beirut Port's revenues in the first nine months of 2020 to reach US$ 84.8 million compared to the same period of the previous year. In parallel, the number of containers recorded an annual decrease of 43.9% to attain a total of 330,717 in the first nine months of 2020. The number of ships posted a fall of 23.5% year-on-year to reach a total of 1,024 vessels in the first nine months of 2020. The quantity of goods fell by a yearly 37.0% to 3,267 thousand tons in the first nine months of 2020. Transshipments contracted by 31.3% year-on-year to attain 256,790

CONSTRUCTION

	2019				2020				Variation	
	Q1	Q2	Q3	9M	Q1	Q2	Q3	9M	Q3/Q3	9M/9M
Value of property sales (in millions of US$)	1,625	1,101	2,012	4,738	2,335	3,061	4,681	10,077	132.6%	112.7%
Number of property sales	12,067	9,890	14,995	36,952	14,068	13,148	27,892	55,108	86.0%	49.1%
o.w. Sales to foreigners	234	230	294	758	225	202	349	776	18.7%	2.4%
Average value per property sale (in US$ 000)	135	111	134	128	166	233	168	183	25.1%	42.6%
Property taxes (in millions of US$)	82	62	74	218	99	119	230	448	212.4%	105.7%

EVOLUTION OF CONSTRUCTION INDICATORS



* 8-month figures for 9M-19 & 9M-20 cement deliveries

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containers in the first three quarters of 2020, following a rise of 15.6% in the corresponding period of 2019.

The latest figures released by the Ministry of Tourism showed that the number of tourists posted a 78.4% yearly retreat in the first half of 2020 following an increase of 8.3% in the same period of the previous year. In fact, the number of tourists registered 199,722 in the first half of 2020, compared to 923,820 tourists posted in the first half of 2019. It is worth noting that the sector posted an overall negative performance all throughout the first half of the year, however, the second quarter was hit harder, as a lockdown was imposed on the country after the spread of the COVID-19 pandemic over all that period.

At the level of airport activity, the total number of passengers at the airport registered a yearly contraction of 75.4% in the first nine months of 2020, as released by the Rafic Hariri International Airport. The number of aircraft fell by 65.6% year-on-year in the aforementioned period. Alongside, the total freight handled by the airport dropped by 33.8% year-on-year in the aforementioned period. A detailed look at the activity shows that the number of incoming passengers fell by a yearly 76.8% and that of departing passengers by 74.0% to reach 807,949 and 915,823 respectively in the first nine months of 2020, while the number of transiting passengers fell from 36,759 passengers in the first nine months of 2019 to 32,892 passengers in the corresponding period of this year.

Looking at the aircraft activity, landings and take-offs decreased by a yearly 65.6% each, with the former amounting to 9,762 planes and the latter reporting 9,753 planes in the first nine months of 2020. Regarding the freight movement within the airport, a total of 21,401 thousand tons were imported and unloaded during the first nine months of 2020 while 23,514 thousand tons were exported and loaded. The first mentioned activity posted a decline of 44.8% and the latter posted a 19.1% fall on a yearly basis in the first nine months of 2020. The airport activity was obviously impacted by the economic crisis, the COVID-19 pandemic effects and the Beirut Port explosion spillover effects.

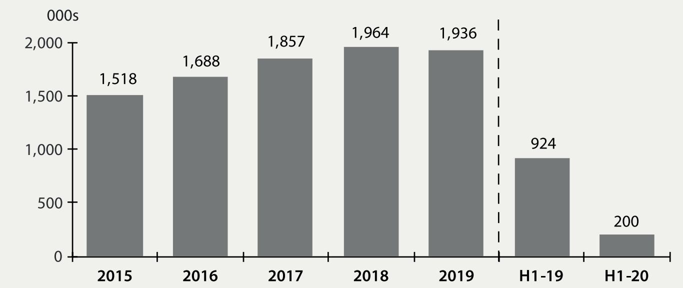
Furthermore, the total value of cleared checks, a coincident indicator of overall spending patterns in the economy, pointed to a decline by 4.1% year-on-year in the first nine months of 2020. The value of cleared checks reached US$ 40,667 million in the first nine months of 2020, against US$ 42,398 million in the same period of 2019, as per the latest figures released by the Central Bank. A breakdown by currency shows that the banks' clearings in Lebanese pounds amounted to LP 21,793 billion (-10.4%) in the first nine months of 2020, while those in FC amounted to US$ 26,211 million, slightly down by 0.2% year-on-year. In parallel, the number of cleared checks registered 4,490,413 in the first nine months of 2020, down by 42.4% from 7,791,506 in the same period of 2019. The average value per check rose by 66.4% year-on-year to stand at US$ 9,056 in the previously mentioned period of 2020. On another hand, the value of returned checks reached US$ 767 million in the first nine months of 2020, against US$ 1,049 million in the same period of 2019, while the number of returned checks registered 96,435 in the first nine months of 2020, down by 50.8% from 196,153 in the same period of 2019. As such, the value of returned check to total value of cleared checks went down from 2.5% to 1.9% between the two periods, while the number of returned checks to total number of cleared checks went down slightly from 2.5% over the first nine months of 2019 to 2.1% over the first nine months of 2020.

In conclusion, it is clear the Port explosion following the stream of negative events of this year took its toll on the tertiary sector. The damages to infrastructure will have high costs to help rebuild and repair housing,

TRADE AND SERVICES

	2019				2020				Variation	
	Q1	Q2	Q3	9M	Q1	Q2	Q3	9M	Q3/Q3	9M/9M
Number of ships at the port	411	450	477	1,338	388	349	287	1,024	-39.8%	-23.5%
Number of containers at the port (in 000s)	184	202	203	590	102	110	119	331	-41.3%	-43.9%
Merchandise at the Port (in 000 tons)	1,766	1,745	1,673	5,184	1,131	1,114	1,022	3,267	-38.9%	-37.0%
Planes at the Airport	15,413	18,133	23,239	56,785	10,805	1,899	6,811	19,515	-70.7%	-65.6%
Number of passengers at the Airport (in 000s)	1,735	2,215	3,052	7,002	1,152	40	532	1,724	-82.6%	-75.4%
Cleared checks (in millions of US$)	14,822	12,669	14,907	42,398	16,075	10,381	14,212	40,667	-4.7%	-4.1%

EVOLUTION OF THE NUMBER OF TOURISTS



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and businesses which suffered damages recover. While these repairs go on, the social impact of the disaster will also put a negative pressure on the country's economy in general and the tertiary sector in particular.

1.2. EXTERNAL SECTOR

Foreign trade deficit cut by a yearly 59% in the first eight months of the year

During the first eight months of 2020, Lebanon's external sector registered a net contraction in trade deficit by a yearly 59.0%, moving from US$ 11.4 billion to US$ 4.7 billion, according to the latest trade statistics released by Lebanon's Customs Authority. This drop in trade deficit was the result of retreating imports by 50.0% and declining exports by 8.3% over the first eight months of this year. Accordingly, the sum of exports and imports went down by 43.7% while the exports to imports ratio reached 32.7% over the period, up from 17.8% over the same period of 2019.

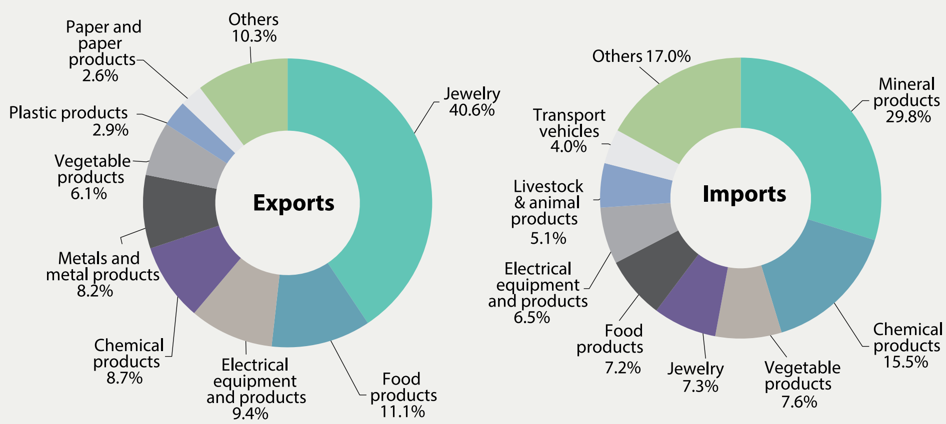
Having said that, additional efforts with substantial new measures are still needed to reduce Lebanon's large external imbalances, mainly the exacerbating deficit in the balance of payments amid the significant drop in financial inflows. In fact, the authorities need to implement the necessary structural reforms to boost domestic productivity to further tackle the external imbalances and mitigate Lebanon's main vulnerabilities.

Going further into details, the breakdown of exports by product suggests that the most significant decline among the major categories was reported by paper and paper products with 43.7%, followed by plastic products with 40.5%, chemical products with 23.3%, electrical equipments with 13.4% and metals and metal products by 12.3% over the first eight months of 2020 when compared to the first eight months of 2019. On the other hand, the main item to have displayed an increase was vegetable products with 34.3% over the same period.

The breakdown of exports by major countries of destination suggests that exports to Syria reported the most significant decline of 51.4% year-on-year, followed by UAE with 23.6%, Iraq with 16.3%, Saudi Arabia with 12.6% and Jordan with 11.3% between the two periods, while exports to Switzerland reported a strong increase of 21.8%, followed by USA with 13.0% over the same period. It is worth mentioning that land exports through Syria continued its negative trend to decrease by 36.3%, moving from US$ 204 million to US$ 130 million. In parallel, exports through the Port of Beirut went down by 4.1% and those through the Hariri international Airport witnessed a relative decrease by 3.4% over the same period.

In parallel, the breakdown of imports by product suggests that the most significant decline was reported by transport vehicle with 68.9%, followed by metals and metal products with 65.4%, textiles and textile products with 64.3%, electrical equipments and products with 63.0%, plastic products with 57.8% and mineral products with 56.3% over the first eight months of 2020 relative to 2019 same period. The breakdown

BREAKDOWN OF EXPORTS AND IMPORTS BY COMMODITY*



* 8M-20

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of imports by country of origin over the same period shows that, among the major partners, imports from Kuwait dropped the most by 73.1%, followed by Russia with 68.1%, Spain with 63.8%, China with 62.7%, France with 60.2%, USA with 59.1%, UK with 49.7% and Germany with 48.5% between the two periods.

1.3. PUBLIC SECTOR

Double-digit contractions in fiscal revenues and expenditures over the first seven months

The public finance figures for the first seven months of 2020 suggest that both public revenues and public expenditures were down by double-digit contractions, generating a slight decline in fiscal deficit. As a matter of fact, total public expenditures were down by 19.1% over the first seven months of the year, while total public revenues were down by 21.2% over the period, generating a 12.9% contraction in fiscal deficit. Public expenditures were actually down by US$ 1.8 billion, moving from US$ 9.4 billion in the first seven months of 2019 to US$ 7.6 billion in the first seven months of 2020. The retreat in public spending is mainly tied to the decline in interest payments primarily due to the State's default in March of this year. In fact, debt service was down by a yearly 53.4% in the first seven months of 2020, moving from US$ 3.0 billion to US$ 1.4 billion, with interest payment on foreign currency debt down by 81.8% and interest payment on domestic debt down by 32.9% year-on-year.

Public revenues were down by US$ 1.5 billion, moving from US$ 7.0 billion to US$ 5.5 billion between the two periods. The retreat in total revenues is mainly tied to the decline in budget revenues by US$ 1.9 billion, while Treasury revenues increased by US$ 0.4 billion over the period. In turn, the significant decline in budget revenues is related to the prevailing macro sluggishness as a result of the prevailing economic crisis, the spillover effects of the Corona Pandemic and the drastic drop in imports amid weakened domestic consumption and investment demand. It is worth mentioning that custom revenues were down by 33.0%, VAT revenues were down by 55.2% and Telecom revenues were down by 56.5%. Paradoxically, property taxes were up by 83.5% year-on-year as a result of significant property transactions within the context of investors fleeing to real estate to escape any possible haircut on their financial investments.

The more significant absolute drop in public spending relative to public revenues lead to small savings in the overall public finance deficit. As a matter of fact, the 2020 first seven months deficit amounted to US$ 2.1 billion, against US$ 2.4 billion over the same period in 2019. However, as a percentage of public spending, fiscal deficit rose from 25.7% to 27.6%, with an even more significant rise relative to GDP that is believed to have significantly contracted this year.

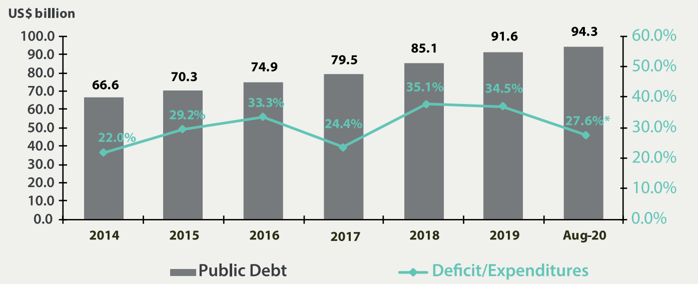
When looking at the primary balance, the primary surplus of US$ 0.6 billion over the first seven months of 2019 (the equivalent of 6.2% of expenditures) turned into a primary deficit of US$ 0.7 billion over the first seven months of 2020 (the equivalent of 9.3% of expenditures), highlighting the unsustainable nature of public finances that require a significant deal of fiscal adjustment to avoid further monetary drift looking forward.

As such, the country's gross debt reached US$ 94.3 billion at end-August 2020, up by 9.2% from the level seen at end-August 2019 and up by 2.9% from end-2019. Domestic debt was higher by 9.8% from end-August 2019 to reach a total of US$ 59.0 billion at end-August 2020. Lebanon's foreign debt went up by

PUBLIC SECTOR DEFICIT FINANCING

in millions of US$	7M-19	7M-20	Progression
	Vol	Vol	Vol
Deficit financing			
Deficit	2,409	2,099	-310
State creditor accounts	-481	-888	-407
Other items	-1,056	887	1,943
Uses=sources	**872**	**2,098**	**1,227**
LP	**1,975**	**831**	**-1,144**
Treasury bills (banking system)	2,029	610	-1,418
Others	-54	221	275
FX	**-1,103**	**1,267**	**2,370**
Sovereign eurobonds (including Paris II bonds)	-1,150	0	1,150
Others	47	1,267	1,220

PUBLIC INDEBTEDNESS



* 7-month figure

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8.4% from end-August 2019 and up by 4.4% from end-2019 to stand at around US$ 35.2 billion at end-August 2020. In this context, net public debt, which excludes the public sector deposits at the Central Bank and commercial banks from overall debt figures, increased by 9.4% from end-August 2019 and up by 4.5% from end-2019 to reach a total of US$ 84.9 billion at end-August 2020.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Multiple exchange rates emerge amid dwindling FX reserves

Lebanon's monetary conditions were marked over the first nine months of 2020 by dwindling foreign currency buffers, excessive money creation in Lebanese pounds, the emergence of multiple LP/US$ exchange rates and first interest rate cuts in ten years.

With Lebanon mired in its worst economic and financial crisis in decades and as much-needed international financial assistance remained stalled by cabinet stalemate and a lack of implementation of long-overdue reforms, the Central Bank of Lebanon's foreign currency reserves have been dwindling over the first nine months of the year 2020 to reach a critically low level. In details, BDL's foreign assets contracted significantly by US$ 11.3 billion during the first nine months of the year to reach US$ 25.9 billion at end-September 2020, including BDL's Eurobond holdings estimated at US$ 5.03 billion and facilities provided by the Central Bank to banks. This brought BDL's liquid FX reserves below the US$ 20 billion level. Within this context, the Central Bank governor said that it cannot use its FC mandatory reserves to finance imports, sparking fears over imminent subsidy cuts.

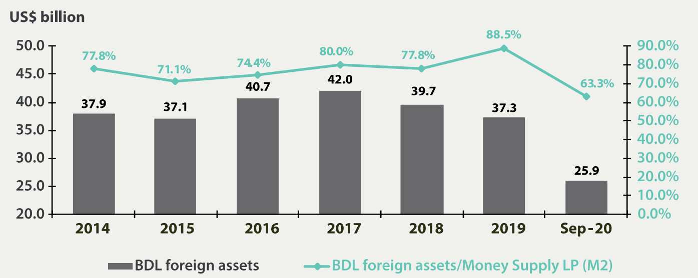
Dwindling FX reserves triggered a deviation between the official and parallel market exchange rates, and allowed the emergence of multiple rates. The Lebanese pound was in total collapse against the US dollar on the black FX market during the first nine months of the year 2020, mainly pressured by a complete loss of confidence, a significant expansion in LP money in circulation, dwindling financial inflows, deficit monetization from BDL and lingering cabinet concerns. The LP/US$ exchange rate plunged to a historical low level of LP/US$ 10,000 on the black FX market early-July 2020, mainly on worsening domestic economic conditions and a halt in IMF talks, yet managed somehow to recover to LP/US$ 8,500 at end-September 2020, and reached LP/US$ 7,000 at end-October 2020, mainly on improved sentiment following the appointment of a new PM-designate and on hopes that a "mission" government would be formed that would carry swift reforms and help unlocking international financial aid. Concurrently, money changers syndicate set the exchange rate at a minimum buying price of LP/US$ 3,850 and a maximum selling price of LP/US$ 3,900. Lebanese banks allowed depositors in US dollars to withdraw part of their deposits in LP at the market rate (currently set at LP/US$ 3,900) until 31st of March 2021, as per a new intermediate circular issued by BDL on October 9, 2020.

Given a significant LP money creation over the first nine months of 2020, as shown by a large expansion in "the currency in circulation outside BDL" of 125% or the equivalent of LP 13,180 billion, the overnight rate remained mostly stable at 3.0% on the money market over this year, noting that its official rate was cut by 200 bps earlier this year to reach 1.90%.

MONETARY SITUATION

Flows in US$ million	9M-19	9M-20	Progression
	Vol	Vol	Vol
Net foreign assets (excluding gold)	-4,414	-11,098	-6,683
Net claims on the public sector (excluding valuation adjustments)	-2,291	-10,431	-8,140
Claims on the private sector	-4,506	-10,108	-5,603
Uses=Sources	**-11,211**	**-31,637**	**-20,426**
Money (M3)	-2,456	-3,625	-1,169
Valuation adjustment and other items	-8,754	-28,012	-19,258

EXCHANGE MARKET INDICATORS



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The financial system's total subscriptions in LP Treasury bills amounted to LP 9,032 billion during the first nine months of the year 2020 against LP 12,100 billion during the same period of 2019, down by 25.4% year-on-year, noting that longer-term higher-yielding tenors of five-year, seven-year and ten-year categories accounted for two thirds of total subscriptions. In parallel, the Central Bank of Lebanon continued to play the role of an intermediary between banks and the sovereign, as reflected by a LP 2,057 billion rise in its LP securities portfolio over the covered period. As to interest rates, LP Treasury bills saw this year their first rate cuts in ten years at a range hovering between 1.8% and 3.0%.

Concurrently, the total LP Certificates of Deposits' portfolio contracted from LP 48,043 billion at end-December 2019 to LP 45,208 billion at end-September 2020, down by LP 2,835 billion, which marks its first contraction since 2016.

Looking forward, should a "mission" government be formed, this could pave the way for much-needed international financial support, including CEDRE funds and a hopefully IMF financial support, which would help restoring confidence, allow the Central Bank of Lebanon to gradually replenish its foreign currency reserves and lead to a gradual elimination of multiple exchange rates.

1.4.2. Banking Activity

Ongoing deleveraging and interest rate contractions to record lows

The Lebanese banking sector continued to operate under very challenging conditions during the first nine months of this year, amid continued political bickering and a lack of tangible actions on behalf of public authorities to move forward in dealing with the acute economic and financial crisis the country is going through. Measured by the aggregated assets of banks operating in Lebanon, sector activity contracted by 11.2% in the first nine months of this year to reach the equivalent of US$ 192.6 billion (at the official exchange rate) at end-September 2020 on the back of deposit and loan contractions.

Customer deposits contracted by 10.5% over the covered period to reach the equivalent of US$ 142.2 billion at end-September 2020, with customers withdrawing their deposits in kind according to monthly limits set by banks and/or seeking to reimbursing their loans by utilizing their creditor accounts. As a matter of fact, 67% of the total deposit base contraction over the covered period of this year could be attributed to loan portfolio contraction.

In details, LP deposits accounted for 60% of the total deposit base contraction amid worries about the depreciating value of the local currency, leaving the remaining 40% for foreign currency deposit decrease amid the stoppage of FX withdrawals since April. As a result, the deposit dollarization ratio rose further to reach a new 28-year high of 80.2% at end-September 2020, exceeding the prior 2006 July war ceiling. Close to 70% of the deposit base contraction is attributed to the resident sector, leaving 30% to the non-resident sector.

Banks also strived to reduce their exposure to the private sector, while some clients sought to reimburse their

BANKING ACTIVITY

in millions of US$	2019				2020			
	Q1	Q2	Q3	9M	Q1	Q2	Q3	9M
Var: Total assets	**3,268**	**3,229**	**6,215**	**12,712**	**-8,231**	**-7,455**	**-8,528**	**-24,214**
% change in assets	1.3%	1.3%	2.4%	5.1%	-3.8%	-3.6%	-4.2%	-11.2%
Var: Total deposits	**-1,758**	**-394**	**-1,828**	**-3,980**	**-9,273**	**-5,088**	**-2,320**	**-16,681**
o.w. LP deposits	-493	-1,645	-2,906	-5,044	-5,093	-3,854	-1,015	-9,962
o.w. FC deposits	-1,265	1,251	1,079	1,065	-4,180	-1,234	-1,305	-6,719
% change in total deposits	-1.0%	-0.2%	-1.1%	-2.3%	-5.8%	-3.4%	-1.6%	-10.5%
Var: Total credits	**-2,057**	**-1,326**	**-1,502**	**-4,885**	**-4,754**	**-3,597**	**-2,816**	**-11,167**
o.w. LP credits	-890	-584	-604	-2,078	-404	-101	-209	-714
o.w. FC credits	-1,167	-742	-898	-2,807	-4,350	-3,496	-2,607	-10,453
% change in total credits	-3.5%	-2.3%	-2.7%	-8.2%	-9.6%	-8.0%	-6.8%	-22.4%

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dues to banks in the currently uncertain conditions. Banks' lending portfolios contracted by a remarkable 22.4% in this year's covered period to reach the equivalent of US$ 38.6 billion at end-September 2020. Almost all of the loan portfolio contraction is attributed to FC loans, pushing the loan dollarization ratio further down to reach a record low of 61.5% at end-September 2020. Around 90% of the loan portfolio contraction was due to the resident sector.

In parallel, and in line with regulatory directives, banks continued to decrease interest rates on both creditor and debtor accounts. The LP deposit rate contracted by 401 basis points so far this year to reach 3.35% and the US$ deposit rate shrank by 347 bps to reach 1.15% (getting closer to international reference rates with the spread between the US$ deposit rate and the 3M US$ Libor rate at a 12-year low of 92 bps). Similarly, the LP discount and loans rate shrank by 120 bps to 7.89% over the covered period and the US$ discount and loans rate declined by 330 bps to 7.54%.

As far as banking sector liquidity is concerned, placements at foreign banks declined by US$ 2.3 billion in the covered period of this year, mainly driven by its noticeable decline in the early months of 2020. Its relative stability since the month of May 2020 was quite remarkable (it registered a slight increase in September, the first since the onset of the domestic financial crisis).

Also, banks' sovereign Eurobond holdings retreated by US$ 3.8 billion so far this year to reach US$ 10.0 billion at end-September 2020, mainly due to sales prior to the State default announcement earlier in the year. Finally, shareholders' equity reached US$ 18.5 billion at end-September, against a year-end 2019 level of US$ 20.7 billion, with the US$ 2.2 billion contraction being driven by the cumulative net losses incurred by the sector at the level of its income statement in the aftermath of the recent crisis in the country.

All in all, banks are continuing to experience difficult and uncertain operating conditions, and are focusing their efforts on provisioning against potential losses tied to their private sector lending portfolios and sovereign Eurobond holdings, while striving to boost capitalization (by a cumulative 20%) and meet liquidity requirements (3% of their FC deposits held in liquid form abroad) by February 2021 as per the latest BDL guidelines.

1.4.3. Equity and Bond Markets

Lebanon's capital markets nosedive amid crippling financial and economic crisis

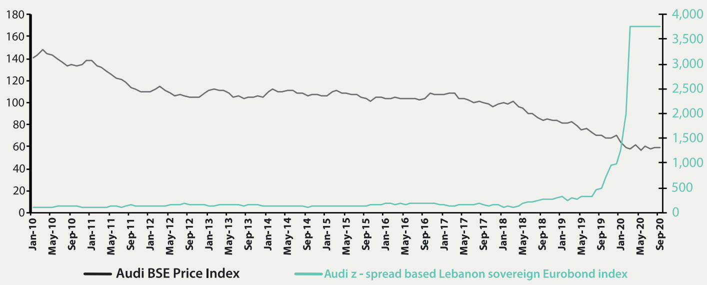
Lebanon's equity and bond markets nosedived during the first nine months of 2020 following the State's unprecedented default on its Eurobonds in March 2020 and amid worsened socio-economic conditions and the lack of implementation of much-needed reforms, which raised doubts about Lebanon's ability to attract foreign funding.

Lebanon's stock market remained in free fall during the first nine months of 2020, as reflected by a double-

FINANCIAL SECTOR (NON-BANKS)

	2015	2016	2017	2018	2019	Sep-20
Beirut Stock Exchange						
Market capitalization (In millions of US$)	10,496	10,951	10,578	9,117	7,540	6,642
Total trading volume (In millions of US$)	498	885	608	376	197	185
Annualized trading volume/Market capitalization	4.7%	8.1%	5.8%	4.1%	2.6%	3.7%
Price index	104.6	106.9	98.2	83.9	69.7	59.5
% change in index	-1.2%	2.1%	-8.1%	-14.6%	-16.9%	-14.5%
Lebanese Eurobonds						
Total volume (In millions of US$)	25,535	26,123	26,123	30,964	28,314	31,314
Average yield	6.1%	6.5%	6.5%	10.0%	30.0%	50.0%
Average life (In number of years)	6.1	6.2	6.7	7.8	7.5	7.3
5-year CDS spreads variation (bps)	26	57	42	229	1,649	-

CAPITAL MARKETS PERFORMANCE



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digit drop in the BSE price index of 14.5%, following a 16.9% contraction in 2019, as Lebanon continued to grapple with its worst economic and financial crisis since the 1975-1990 civil war, and on lingering uncertainties about the formation of a "mission" government that would pull the country out of a myriad of accumulated crises and carry long-overdue reforms to unlock much-needed international financial assistance. A breakdown by sector shows that the banking stocks were the main drag to the BSE price index over the first nine months of 2020, registering large price contractions of up to 71.7%. In contrast, Solidere "A" and "B" shares attracted a decent bid over the covered period, as market players continued to shift from bank placements to real estate stocks seeking safe haven investments. This allowed their prices to more than double, moving from US$ 7.30 and US$ 7.29 respectively at end-December 2019 to US$ 14.96 and US$ 14.90 respectively at end-September 2020. Also, industrial stocks like "Holcim Liban" and "Ciments Blancs Nominal" posted healthy price gains of 30.3% and 46.2% respectively over the first nine months of the year.

A crippling economic and financial crisis, which continued to rattle Lebanon's equity market over the first nine months of 2020, resulted into strong price swings. Accordingly, the price volatility, measured by the ratio of the standard deviation of prices to the mean of prices, reached 31.3% on the Beirut Stock Exchange during the first nine months of 2020 and compared to a much lower level of 6.0% during the corresponding period of 2019.

On the backdrop of significant price falls and additional listings by Bank Audi sal, the BSE market capitalization contracted by 11.9% during the first nine months of 2020, moving from US$ 7,540 million at end-December 2019 to US$ 6,642 million at end-September 2020. The BSE total trading value amounted to US$ 185.1 million during the first nine months of 2020 as compared to US$ 139.9 million during the corresponding period of 2019, up by 32.3% year-on-year, noting that Solidere shares captured the lion's share of activity (74.4%). Accordingly, the BSE total turnover ratio, measured by the annualized trading value to market capitalization, reached 3.7% during the first nine months of 2020 as compared to 2.5% during the same period of 2019.

In parallel, Lebanese Eurobonds fell drastically amid Lebanon's first-ever default on its foreign currency debt on March 9, 2020 and after failure to overcome obstacles hindering the formation of a "mission" government that would implement long-awaited structural reforms to access much-needed international aid, in addition to bets that Lebanon's Eurobond holders would incur large losses. Within this context, Moody's said in a recent note issued in September 2020 that Lebanon's "C" rating, which is the lowest on its rating scale, reflects its expectation that losses incurred by bondholders would likely exceed 65%, adding that the rating is unlikely to move from its current position before the restructuring, given the extent of the macroeconomic, financial and social challenges and its expectation of very significant losses.

That being said, the Lebanese bond curve converged to mid-teens at end-September 2020. Prices of sovereigns maturing between 2020 and 2037 ranged between 14.50 cents per US dollar and 17.50 cents per US dollar at end-September 2020 versus 44.75 cents per US dollar-87.13 cents per US dollar at end-December 2019. Accordingly, the weighted average bond yield reached 50% at end-September 2020 after excluding yields on papers maturing in 2020 and 2021. This compared to a weighted average yield of 30% at end-December 2019.

Looking forward, all eyes remain focused on the formation of a "rescue" government that would carry swift reforms and resume IMF negotiations, which would potentially pave the way for much-needed international financial support and constructive discussions with bondholders.

2. CONCLUSION: ON LEBANON'S BANKING SECTOR RESTRUCTURING

The Lebanese banking sector has been the backbone of the Lebanese economy in the past three decades, prior to the eruption of the financial crisis. The sector actively contributed to the formation of GDP, ensured 60% of the public sector financing needs, 30% of tax revenues, 50% of foreign trade financing, in addition to dynamic private sector financing with loans to GDP exceeding the threshold of 100%. The sector employs nearly 26,000 highly skilled employees, the breed of the middle class in Lebanon.

Where do we stand today? One year after the start of the October 17 revolution, it is pretty clear that the banking sector operating conditions have deteriorated drastically. Confidence is shaken; the State has defaulted on its Eurobond instruments of which US$ 10 billion are held by banks; the banking sector has seen deposits contraction by around US$ 30 billion since beginning 2019 (almost 20%) coupled with loan deleveraging as loans dropped by more than US$ 20 billion since beginning 2019 representing two thirds

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of the deposits contraction. In parallel, the sector has been incurring consequent losses, with shareholders equity dropping by circa US$ 2 billion over the past year.

Within this environment, Lebanon's banking sector still doesn't need a bailout: banks just need the State to pay back its dues. Should this happen, the liquidity position of banks would be apt to improve as the State reimburses part of due liquidity to banks. But what is needed first and foremost is for public authorities and the financial system to have a common view of realized and forthcoming losses. Then, the focus has to turn on claiming back part of those losses and distributing the remainder on stakeholders in a fair and equitable manner.

We think it is unfair to ask the banks to carry all the cost of the years of State mismanagement. There has to be a "fair burden sharing mechanism" whereby the State needs to use many of its tools to carry a large portion of these losses, for example privatization of public entities or potentially asset swap of government assets that can be put in a special sovereign fund to be managed over years and address some of these losses. We believe the banking sector is ready to forego years of potential income but we need to preserve as much as possible the capital of the banks so that in a year or two from now, the sector can support a growth strategy in the country that will be built on a sound macro picture, solid banking sector and the confidence that needs to be regained with time.

At the level of the regulatory framework, what is needed first and foremost is the necessity of unifying capital control measures adopted by banks under a Capital Control law prepared by the government and adopted by Parliament, in order to ensure a fair and equitable treatment for all customers and eliminate legal risks against the banking sector.

With a banking sector nearly 5 times larger than GDP, it is normal to say that the local banking sector is overcrowded. Actually, Lebanon's banking sector is the 3rd largest in the world in terms of assets as a % of GDP. Its size is way above what is needed to fulfill the financing of a productive economy. We believe that post restructuring, total banking sector assets should shrink to circa 150% of GDP, which is in line with countries with similar economic structure.

In the current conditions, banking institutions more hit than others or unable to raise capital in accordance with BDL regulations, might be forced to merge with others, which would ensure the reduction of the number of banks in the sector. Only sound banks would remain in the market. It is difficult at this point in time to precise exactly how many banks would stay, but what is needed first is a reduction by 30%-40% in the size of the branch network which stands today at around 1,000 branches locally.

Obviously, some of the banks might find it difficult in the current environment to adapt and meet requirements, and will have to exit the market. Other banks will be able to survive and continue operating, even if it means having to sell part of their affiliates abroad in order to generate sufficient liquidity and boost their capital. It is worth mentioning that 18 Lebanese banks are present abroad in 32 countries through a foreign network of 329 branches managing total assets of US$ 37 billion.

Reforming the banking system with restructuring efforts to bolster its financial standing, governance and ability to withstand pressures would improve drastically the country's macro-financial context. A smaller and cleaner banking sector would improve cost efficiency and effectiveness and could benefit as well from rising focus on digitalization. Furthermore, the banking sector's overall health has a strong impact on sovereign risks and subsequently any potential sovereign rating for Lebanon. A credible banking sector is likewise key to Lebanon's re-access to international capital markets.

When we talk about the future of banking, it cannot be dissociated from the future of the economy in general in its different components of financial sector, public sector, external sector and real sector. Having said that, Lebanon imminently needs a broad crisis exit strategy to be formed by a credible upcoming government that would launch structural and adjustment reforms. There is no doubt that the prevailing structural and cyclical imbalances the country is suffering from are massive, however exists are still plausible if the will is there, if tough choices are made and if drastic measures are undertaken without delay so that the country goes out of the woods with time.