

# Lebanon and Syria Business Forecast Report Q2 2014

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## Abstracts

### Core Views

The ongoing civil war in Syria is having severe repercussions on the Lebanese economy. Moreover, Lebanon's medium-term growth trajectory will settle well below pre-crisis levels owing to a lack of investment in transportation and energy infrastructure.

Despite renewed fears over the economy's gaping external asymmetries, a loyal depositor base in the domestic banking sector, combined with a massive arsenal of foreign exchange reserves, will very likely help to bolster underlying stability through what may turn out to be a potentially prolonged period of political volatility. This will minimize the potential for an unexpected devaluation of the pound in 2014.

### Major Forecast Changes

We have revised our real GDP growth projections and now forecast the economy to expand 2.4% in real terms in 2014, from a previous forecast of 2.5%. We reaffirm our view that elevated political instability and the lack of structural reform to the economy will contribute to below-potential growth over the medium term.

### Key Risks To Outlook

Given Lebanon's reliance on foreign capital to finance domestic demand (as evidenced by its large current account shortfall), a marked deterioration in regional or global capital markets over the coming quarters could slow financial inflows, which would negatively impact growth. As the civil war in Syria shows no signs of abating, tensions between Lebanese political blocs in support of and against Syrian President Bashar al-Assad will remain a key source of instability.

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Risks that Lebanon will find itself in a power vacuum in 2014 are significant given the ongoing political crisis. In our view, the security situation will remain precarious, with highly damaging effects for the economy.

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Political Upheaval Inevitable In The Long Term?

Political stability will remain hard to come by in Lebanon over the coming decade. The ongoing civil war in Syria is deepening sectarian tensions, while another military conflict with Israel could trigger institutional change.

### CHAPTER 1.2 ECONOMIC OUTLOOK - LEBANON

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We project real GDP growth in Lebanon of 2.4% in 2014 and 2.9% in 2015. Elevated political instability and the lack of structural reform to the economy will contribute to below-potential growth over the medium term.

TABLE: Lebanon - ECONOMIC ACTIVITY

PMI Increasing Modestly In 2014

Political instability and slow economic growth will mean that manufacturing activity in Lebanon remains subdued in 2014. Despite the recent formation of a new government, the BLOM Lebanon Purchasing Managers Index will increase only modestly over the next few months.

Banking Sector

Little Prospect For Growth In Islamic Banking

We expect Lebanon to miss out on the rapid growth in the global Islamic banking sector

for the foreseeable future. Despite the country introducing Islamic banking regulations almost a decade ago, government support for the sector is lacking, and thus growth will remain minimal.

## **CHAPTER 1.3 10-YEAR FORECAST - LEBANON**

The Lebanese Economy To 2023

Long-Term Growth Depends On Structural Reforms

Lebanon's economy will face a host of structural challenges in attempting to meet its long-term growth potential, with a massive infrastructure deficit, elevated public debt load and ongoing political risks weighing on our outlook through 2023. That said, a robust banking sector is likely to help to support growth.

TABLE: Lebanon - Long-Term Macroeconomic Forecasts

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Diplomatic Solution To Remain Elusive

A political solution to the civil war in Syria remains elusive following talks between the government and the opposition in Geneva. We reaffirm our view that the conflict will continue over the coming years, with little chance of a negotiated settlement over the medium term.

TABLE: Syria - Political Overview

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Conflict Scenarios Point To Turbulent Decade Ahead

We expect the civil war in Syria to continue for many years. A negotiated settlement following a protracted conflict or a formal breakup of the country appear at this stage the two most likely outcomes, while an outright victory by either the regime or the rebels is less probable. Under any scenario, prospects for a stabilisation of the country over the coming decade are very low.

TABLE: Syria - Long-term scenarios

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##### Prolonged Recession As War Continues

We project real GDP in Syria to contract by 12.5% in 2014 and 8.1% in 2015. Given our view that the civil war will drag on over the coming years, the country's economy will continue contracting over the medium term.

TABLE: Syria - ECONOMIC ACTIVITY

#### Monetary Policy

##### Inflation Declining Modestly In 2014

We project Syrian consumer price index inflation (CPI) to average 60.0% in 2014 and 50.0% in 2015, from our estimate of 80.0% in 2013. Disruptions to trade and production resulting from the civil war will ensure that the headline print remains elevated over the coming years. However, high base effects and potential for a partial stabilisation in the value of the pound will lead to a gradual decline in CPI over the coming quarters.

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#### Weak Human Capital To Constrain Growth

The impact of Syria's ongoing civil war on the economy will be felt over the long term. Under a scenario whereby the conflict ends, private consumption, exports and infrastructure development will drive growth. That said, the effectiveness of these drivers depends in part on the success of structural reforms.

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