AMERICAN UNIVERSITY OF BEIRUT

THE EFFECTS OF THE GLOBAL FINANCIAL CRISIS OF THE YEARS 2000 ON THE LEBANESE ECONOMY

by
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A project
submitted in partial fulfillment of the requirements
for the degree of Master of Arts in Financial Economics
to the Department of Economics
of the Faculty of Arts and Sciences
at the American University of Beirut

Beirut, Lebanon
June 2010

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Date of project defense: June 1, 2010

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ACKNOWLEDGMENTS

I dedicate this project to my family and thank all my friends and professors for their support and help; especially Dr. Simon Neaime and Dr Leila Dagher.

AN ABSTRACT OF THE POJECT OF

Soraya Salomon Haroun for Master of Arts in Financial Economics
Major: Financial Economics

Title: The Effects of the Global Financial Crisis of the Years 2000 on the Lebanese Economy

The financial crisis of the years 2000 has represented serious phenomenon in the world economy. The crisis began in the United States but its effects were international. The globalization and the easy flow of capital all around the world gave the crisis an international aspect.

Europe and the Gulf countries were severely touched by the crisis. Lebanon represents a special case. This study consists of a tentative description of the effects of the financial crisis on the Lebanese economy especially on the companies listed on the Beirut Stock Exchange. It is too early to announce the final results, but the estimations indicate that the Lebanese banking system is immune to the effects of the crisis due to the traditional banking system.

We will first introduce the topic. In the second chapter we will review the theories on financial crisis, their origins and consequences. The third chapter will discuss the subprime financial crisis and its domino effect, consisting from one hand on illustrating the sources of the crisis and its globalization and on the other hand on discussing the impact of the financial crisis on the world economy. The fourth chapter describes the impact of the financial crisis on the Lebanese economy. This chapter will be divided into four subparts; the effects on the local market, the influence of the crisis on the Lebanese enterprises indexed on the Lebanese Stock Exchange Market, the causes of the absence of direct effects of the financial crisis on the Lebanese economy, and what are the future procedures in the Lebanese economy. We will finally conclude and give some recommendations.

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CHAPTER I

INTRODUCTION

The global financial crisis that began in 2007 begins to show its effects in the mid-2008. Stock markets fell across the world, major financial institutions collapsed or were purchased, and governments, even in the richest nations had to find scenarios to save their financial systems.

It is in November 2008 that the financial crisis' severe consequences on large economies began to appear. Global stocks went into freefall, with double-digit losses in Frankfurt, London and Tokyo, on fears that the financial crisis was spiraling out of control, according to the dealers' views. In the Far East, Tokyo suffered the biggest daily drop for two decades after shedding 11% at one stage, while in Europe, Frankfurt and London tipped more than 10% lower[1].

World finance chiefs were preparing an emergency meeting in Washington as a wave of panic selling swept across markets. Interest rate cuts and billions of dollars' worth of cash injections by central banks failed to calm the chaos.

Arab stock markets crashed by more than $158 billion in September, their largest collective monthly loss since they began share dealing some decades ago. GCC bourses emerged as the main victim of the decline as they collapsed by $153 billion, nearly 96% of the total capital loss, showed the figures by the Arab Stocks Data Base at the Arab Monetary Fund in Abu Dhabi.

[1] Executive, November 2008.

Gold prices jumped more than 4$ as investors rushed for safe havens along with the massive assets from abroad into Lebanese banks.

On the one hand, many people are concerned about the fact that companies responsible for these financial problems are those which were helped to overcome the crisis. On the other hand, a world financial crisis will affect the livelihood of almost everyone in a world that became more interconnected. The problem could have been avoided if ideologues that support the current business models are not as vocal and have a limited influence and do not care about views of others.

Three root causes are behind the crisis: the first is based on the public policy partnership, which started in Washington and which includes hundreds of companies, associations and government organizations to improve the availability of “affordable housing” through the use of “creative financing techniques”.

The second cause is due to the fact that federal agencies regulators have actively encouraged the rapid growth of products over-the-counter (OTC) and securities of all types of financial institutions.

The third cause is the adoption of the “fair value” by the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board.

We chose to study the effects of the financial crisis of the year 2008 on the Lebanese market and more specifically the impact of the crisis on the Lebanese firms indexed on the Beirut Stock Exchange and the direct effects of the crisis. This topic seems interesting since the Lebanese case is unique and differs from other markets. Besides this topic is new and studies are still too limited, so I decided to be among the first to do such a research.

In this project, we will tackle two large questions: Have the Lebanese companies indexed on the Beirut Stock Exchange been severely affected by the global financial crisis? What are the effects on the Lebanese Economy in General?

These assumptions are analyzed using a methodology based on descriptive research data, secondary data and ideas well defined. Secondary data are taken from different references on the subject.

To discuss the questions of the project we will divide our research into different chapters. We will first introduce the topic. In the second chapter we will review the theories on financial crisis, their origins and consequences. The third chapter will discuss the subprime financial crisis and its domino effect, consisting from one hand on illustrating the sources of the crisis and its globalization and on the other hand on discussing the impact of the financial crisis on the world economy.

The fourth chapter describes the impact of the financial crisis on the Lebanese economy. This chapter will be divided into four subparts; the effects on the local market, the influence of the crisis on the Lebanese enterprises indexed on the Lebanese Stock Exchange Market, the causes of the absence of direct effects of the financial crisis on the Lebanese economy, and what are the future procedures in the Lebanese economy.

We will finally conclude and give some recommendations.

CHAPTER II

THE THEORIES OF FINANCIAL CRISIS, THEIR ORIGINS AND CONSEQUENCES

A. Overview of the Origins of Financial Crises

In this section we will define the financial crisis and describe the history and its origins.

1. Financial Crisis

One of the first lessons that we can draw from the financial crisis consists of the dangers of overly rigid exchange rate regimes. The fixed exchange rate regimes in developing countries as in industrialized countries, will lead sooner or later to a confrontation between the monetary authorities and the markets. The concern for credibility led the monetary authorities to make the exchange rate a true symbol of their determination and they were defending it in a rigid and fierce way. Sooner or later they will deplete foreign exchange reserves and the crisis is often inevitable.

Excessive rigidity is not only judged in reference to "basic" macroeconomic variables. In many cases, especially when fixing the exchange rates was used as a nominal anchor for disinflation, the exchange rate becomes overvalued, and the speculative attacks will punish an imbalanced economic situation considered costly to the economy, and the impossibility to defend an overvalued parity with foreign exchange reserves which volume is given.

In other cases, however, the "basic" macroeconomic variables appear healthy, the level of the exchange rate is not in itself a problem, but speculation focused on the ability of monetary authorities to continue to defend the exchange if attacked (through an increase in interest rates), while the economy can suffer. Thus, for example, speculative attacks on the franc in 1992 and 1993 were due to doubts about the economy's capacity to bear the costs in terms of interest rates to defend the parity franc-mark. This type of crisis, which involves a crucial investor expectations and beliefs about future changes in economic policies, can be self-fulfilling: speculation that occurs to defend the parity, if it was not unreasonable, is costly to the economy, and which may in fact lead governments to abandon the game.

The experience suggests that during the 90s[2] crisis prevention required appropriate exchange rate policies. It led to the emergence of a consensus that did not leave room for developed countries and emerging nations, except for polar solutions to the exclusion of intermediate forms: either the exchange rate flexibility, recommended by the majority, or, conversely, the “dollarization” or the establishment of a “currency board”, an extreme form of fixed exchange where the central bank limits money creation based on the reserve accumulation.

However, in some emerging countries, it is possible to manage intermediate systems of stable exchange rates, but adjustable, provided they use monetary policy effectively, without making the parity reference goal too rigid, and by constantly adjusting the parity to track the fundamental macroeconomic variables.

As for the industrialized countries, the consensus is silent regarding the coordination of economic policies on the management of exchange rate flexibility. The

[2] Stock exchange crisis in Japan, and increase in stock market prices in the big international stock exchanges. This movement was largely initiated by New York.

subject is complex, political constraints are enormous. But small steps, modest and pragmatic, can significantly improve the situation. In any event, it is important to the future, to avoid maintaining an open window to defend inappropriate exchange parities.

Moral hazard is pervasive in international financial relations. In the 70s, the idea that no sovereign risk (the states do not go bankrupt) has been a source of moral hazard, lead to excessive lending to developing countries, and bears some responsibility of the debt crisis of the 80s.

Thus it is important to mention the agency theory of Jensen and Meckling (1976). They define an agency relationship as a contract in which one (or more), use the services of another agent to act on behalf of any task, which involves a delegation of decisions. They emphasize, however, that the relationship of subordination is a necessary condition and that the definition could apply to any cooperative relationship. The theory rests on two behavioral assumptions: first, individuals maximize their utility function and secondly, they are able to anticipate rationally and without bias the impact of agency relationships on the value of their heritage.

Consequently, individuals in their cooperative activities will seek to take advantage of loopholes in contracts related to the uncertainty and non observables to maximize their utility, possibly at the expense of other parties. This opportunistic behavior induced agency costs (monitoring costs, obligations and residual loss) that agents will seek to minimize in the establishment of appropriate contracts.

During the 90s, the financial crises referred to three types of moral hazard that may have contributed to the rise of uncontrolled hazards.

The first is unfamiliarity with the currency risk and therefore emphasizes, again, on one of the possible negative consequences of fixed exchange rate regimes:

foreign investors analyze the risk they take in reference to constant exchange rates, which leads to excess capital inflows. They will either take the exchange risk, but it is important to note that it is underestimated in this case, or they think they are protected when they refer to the borrower, like banks.

In particular, investors in Thailand and other Asian countries, did not properly take into account the accumulation of risks born by local financial institutions: risk of transformation (deposits in foreign short-term loans to local long term) currency risk (deposits in foreign currency for local currency resources), credit risk (abundance of liquidity due to capital inflows, leading to more careless choice of borrowers). When the Baht was devalued, July 2, 1997, the local banking system was facing bankruptcy.

The second traditional concerns the existence of an implied warranty of banks by the government. For some (Krugman, 1998) the Asian crisis owes much to the excess debt of local financial institutions because of this form of moral hazard.
The answer must be found in the quality of banking supervision and prudential environment. But these, in particular in developing countries (but also in developed countries) are notoriously inadequate.

The third is international. It is based on the idea that the international community, particularly through the International Monetary Fund, as well as the G7, will help countries experiencing payment difficulties. This moral hazard is theoretically in two directions: it discourages countries, who are indebted to adequately monitor the level of debt, but it also encourages international lenders to miss their risk analysis, since they benefit from a sort of implicit guarantee of repayment. If we take the Russian crisis in 1998, for example, it was clear for months that the assistance to Russia was based heavily on a political rationality and that the West was not ready to abandon

Russia. The IMF and the international community, people believed, would react immediately to any crisis, which made countries too comfortable to borrowing excessively without too much worry. Perhaps one of the reasons why investors could not ignore the country's fiscal problems was the continuous accumulation of debt despite the risks of public crisis.

The increased transparency has become the watchword of any debate on the international financial architecture. It is a logical and legitimate attempt to explain the errors of assessment of risks by the lack of available information or by manipulating the information. Countries and systems which can show of the success become overnight criticized for their opacity.

The crises of the 90s have highlighted the importance of better understanding the international financial risks. Financial markets, as well as policies of regulations and supervision, are the headquarters of major dysfunctions, related to phenomena of asymmetric information, adverse selection and moral hazard. The international dimension adds a further degree of complexity and amplification of risk.

2. History and Origins of Financial Crises

From 1924, the United States are experiencing a great period of prosperity, linked to the emergence of new technology (industrialization, radio, telephone) which involve the creation of large groups that target a mass market. The banks, whose lending activities decline, are turning to the stock brokerage. If the price increases is initially justified by fundamental changes in the economy, it gradually turns into a speculative frenzy, pushing an economist at the time to talk about a “new era of prosperity and stock market bullish”.

A phenomenon that amplifies the upward and downward play was the introduction of a leverage system in 1926, which allows investors to buy shares while only depositing a guarantee of 10%. While the U.S. economy showed slowing signs from the beginning of 1929, the stock market finally managed to fall violently in October of that year. What looks like a simple correction in the early days, turns on the 24th of October (the famous "Black Thursday") into a real market crash. The Dow Jones index lost nearly 24% that day. This was the beginning of a very severe economic depression, caused by contamination of the real economy, particularly through the ruins of investors who were indebted to speculate.

In the 80s, Japan, whose industry was triumphant in sectors as diverse as automobiles and electronics, is considered a bit like a utopia, because of its standards of living and longevity of its people. In a booming economy, the stock market flew record after record, and large companies were building skyscrapers. Real estate prices skyrocket, the land prices double between 1986 and 1988. This increase had effects on the real estate market in Tokyo which became more expensive then, than all the United States real estate markets. To restrain speculation, the central bank raises rates in 1990. This marks the bursting of the bubble, causing Japan's economy into a long period of economic inactivity. The stock index, the Nikkei, dropped 40000-8000 points in 2003. The real estate declined for the first time in 14 years. The banks are responsible for the bad debt, accumulated as a result of indiscriminate lending to property developers, to “zombies” (non-viable enterprises supported at arm's length) companies and of the hazardous speculation.

The development of new technologies and the development of the Internet represented a wind of optimism in the global stock exchange markets. This was a major technological revolution, which investors felt it will revolutionize the functioning of all sectors of the economy. The bubble grew as a result of a market already quite optimistic, pushing the chair of the Federal Reserve, Alan Greenspan, to speak in 1996 of “irrational exuberance” of the markets. This is the time when Internet companies emerged in the stock market. They often generate more losses than sales. But they are promising prospects which attract investors.

A true speculative fever develops, catalyzed by speeches on “the advent of a new era”, and developing new ways of valuing companies (the number of members of an Internet portal, the number of unique visitors, etc ....). That optimism faded elsewhere on more traditional societies. Since 1999 the S & P is valued on a PER of 32, against a historical average closer to 16. However, in spring 2000, the enthusiasm began to wane and the market began a decline which destroyed a lot of wealth. Investors gradually returned to reality. The slowing U.S. economy strengthened this phenomenon. Ultimately, the NASDAQ, the U.S. index of leading technology stocks lost up to 80% of its capitalization, while his German counterpart closed its doors.

The financial crises of the 90s – in Mexico, Thailand, Indonesia, Korea, Russia and Brazil – suggested that some of them were the direct and inevitable consequence of globalization. In reality, the question that should be asked is whether, in both advanced economies and in emerging market economies, globalization makes economic management more difficult.

B. The Financial Crisis and its Impact

The crisis that began in 2007 caused a drying up of liquidity, losses for banks, credit contractions, the loss of heritage for households and an economic slowdown.

1. The Different Causes of Financial Crisis

The financial crisis is due to the fragility that had developed in the world economy. A fragility masked by its success: the global liberalization of financial markets, integration of economies, central bankers' action victorious in their fight against inflation. This has all been the consequence of the "paradox of peace".
The "paradox of peace" is a sentence we owe to the American economist Hyman Minsky. The latter developed in the seventies the idea that debt crises are being prepared when things are going well and that economic agents (firms, households and others) benefit from growth and low interest rates to borrow sometimes beyond reasonable. But when interest rates go back up, especially due to tighter monetary debt that seemed tenable, given the moderate rates, it turns and becomes unbearable indebtedness.

For the financial crisis that began in 2007, the "paradox of peace" is doubled by a "paradox of credibility" (Borio and Shim, 2007): the fight against inflation has been very favorable and has strengthened the credibility of central banks. It follows from them-even more research, away from more credibility in the regulatory bodies and accounting practices, while financial innovations continue to grow.

In these imbalances, we must also add microeconomic failures (demands for profitability and relaxation of conditions for granting loans) and the growth of high-risk financial practices.

After the fall of stock prices beginning the year 2000, financial intermediaries have had to satisfy their customers, find other investments with higher returns. When equity markets are lowered, investors traditionally turn to the bond markets. However, due to macroeconomic imbalances discussed above, the actuarial rates were very low.

To meet this requirement of profitability - increased by competition from new financial intermediaries (especially hedge funds) - banks have adopted two types of strategies: they have both increased their business volume by relaxing the conditions allocation of loans and innovated.

The behavior of banks in loan allocation is traditionally pro-cyclical: the criteria softens when times are good and hardens in a rollover. In the case of the subprime mortgage crisis, this effect has been fully confirmed by several recent empirical studies.

One of the pillars on which rests the supervision of the banking system provided for increased loan volume is accompanied by an increase in capital requirements for banks, which has the effect of normally constraining them in their bid loans. But in recent years this stabilizing mechanism has not fully played. Financial institutions are very well adapted to this constraint by innovating, particularly by developing new vehicles.

The technique of securitization is not new, but what is new in question since 2007, is the securitization of new loan products, having their own new guarantees. Thus, there are both permanent logic of securitization and innovations regarding the media and the rules.

There is broad consensus among economists to recognize the benefits of financial innovation. These can, indeed, lower transaction costs and greater flexibility in financial transactions. They are also expected to contribute to market efficiency by improving the price discovery process and allow a better allocation of risks. And even today, if everyone agrees that the securitization has played a key role in the subprime crisis, this practice is not itself questioned. However, this crisis shows clearly the dangers of sophistication to excess.

In theory, the “marketization” of credits is expected to improve the efficiency of the financial system as a whole, allowing a better spread of risk. In practice, the more time passes, the demand for risky funds by external operators rises, and therefore the holding of assets by the originator is no longer needed. Do not keep more risks, even in part; it obviously becomes less strict in the risk analysis and even less in their monitoring. Accordingly, the amount of credits in the system increases, their average quality deteriorates the bank capital guarantee which are relatively weaker and weaker, and risk taken by the purchaser of the paper increases.

This problem is even more obvious that the securitization involves many actors and that transactions are complex and costly. Securitization is a source of many conflicts of interest between: borrowers, originators (transferor), the arranger, the manager, the paying agent, the company's credit enhancement, agencies rating, the regulatory authorities and finally investors. Ashcraft and Schuermann (2007) provide a list of these different sources of conflict of interest: they are at least seven consecutive problems of moral hazard and / or adverse selection.

A final source of concern is the concentration of players likely to cause failure chain. When the financial system works properly, the risks are indeed optimally allocated to those who agree to bear the consequences.

However, this does not prejudice their ability to effectively support risk. The traceability of financial flows is also impossible. Nevertheless, the concentration itself is problematic. There are no comprehensive statistics on the degree of market concentration. But the U.S. Treasury (Office of the Comptroller of the Currency) provides some very illuminating statistics for derivatives. In late 2006, in the United States, the five largest institutions have undertaken more than 98% of the national amounts (79.9 to 81.3 billion dollars). However, the main advantage of derivatives is to enable a better spread of risk.

2. The Effects and Its Impact on the Socio-Economic Cycle

A somewhat unexpected result, initially, of the financial crisis: liquidity has disappeared from some markets (interbank markets for ABS, in some cases market for “covered bonds”), while the overall macroeconomic liquidity continued to grow very rapidly.

From June 2007, information increasingly accurate announces the deterioration of the last wave of subprime loans granted. They show, in 2006, a default rate greatly exceeds that of the previous years. The authorities want to reassure the market. Ben Bernanke, the Fed’s chairman, said June 5, 2007: “The housing market downturn has been sudden (...). However, the fundamentals - including strong growth of incomes and mortgage interest rates are relatively low - should keep the demand for real estate and to the point where we are, it is unlikely that problems in the subprime market spread to the rest of the economy or the financial system”.

Nevertheless, bursts are occurring due to lower ratings by rating agencies that upset at the time, agents' expectations, triggering automatic protections related to the securitization process and drive up rates sharply. In fact, they gave a severe blow to the process by suddenly revealing the price of risk. The “market triggers” then lead to activation of contingency credit lines from banks, while the operators no longer wish to fund the systems securitization. They do not renew their commercial paper and even less want to engage in new operations, even if the offered interest rates rise.

Banks are directly affected in the United States as outlined in the housing sector, but also indirectly because they had acquired such financial products as part of diversifying their investments and seeking high returns.

A dynamic which is potentially very risky and puts in place, more and more refinancing has become mandatory from commercial banks, the banks will be refinanced by the central bank because they cannot do that among themselves, like they usually do. The market for “asset backed commercial paper” (ABCP) is empty; the money market is into crisis. The strong increase in risk aversion and illiquidity led to a sharp drop in the demand for a number of assets such as interbank lending beyond the very short term, all types of Asset Backed Securities (ABS).

Lenders have been disturbed by the losses incurred by banks and the risk of rising defaults on home mortgage. They realized that a lot of ABS were complex, difficult to value, illiquid in the event of financial stress.

The danger in the short term, as regards the financing of the economy, is twofold the danger in terms of quantity (banks ration credit because they find it difficult to refinance and securitize) in terms of price risk (interest rates of loans increases, since this is the case for funding costs of banks). It is certain that the investigations reveal that banks become in a more restrictive state, although it is difficult to measure the exact extent of these restrictions.

The financial crisis has affected the performance of banks through several channels: the rise of home mortgage defaults in the U.S. and to a lesser degree in the United Kingdom and Spain, the attempts to reduce the number of defects are unlikely to be effective. The capital losses on securitized receivables under securitization or those banks had to return to their balance sheets since they can no longer be financed in the vehicles in which they were placed, in particular because of the collapse of the ABCP market. Obviously, U.S. banks are most affected directly by the crisis. The Fed therefore conducts rate cuts policies, intended to support them.

But soon, the movement of distrust of securitized finance spreads. Doubts are created about the ability of banks to cope with losses. To restore confidence calls for greater transparency. Banks belittle a large amount of their non-performing assets at the same time they revert to a share of their assets, off balance sheet. Yet trust does not come back mainly because of the destructive dynamics involved in the valuation of assets at market prices. It follows an effect of cyclicality and volatility than the arrival in power of sovereign funds does calm a part of the market but does not have the desired effect.

That's when the crisis goes beyond the pure and simple subprime. The estimated amount of losses, in fact, continued to deteriorate since the crisis began. In July of 2007, Ben Bernanke, the Fed’s governor, anticipates losses in the U.S. market for subprime mortgages in the order of 50 to 100 billion dollars, a total of about $ 150 billion if we take into account the entire mortgage market.

In late 2007, the banks' forecasts are more pessimistic: between 250 and 320 billion dollars after Lehman Brothers (in case of falling house prices 15 and 30% respectively), between 300 and 400 billion dollars from Deutsche Bank and between 250 and 500 billion dollars after Goldman Sachs and Royal Bank of Scotland.

In the beginning of the year 2008, Bernanke reviews these estimates and announced that the losses will be counted in hundreds of billions of dollars (January 17, 2008). In March 2008, a consensus seems to be around 400 billion dollars. The International Monetary Fund (IMF) estimates its share in April 2008 that the financial crisis would cost $ 565 billion for banks, and around 1000 billion dollars in total for the financial sector. If these projections hold true, subprime crisis could well cost the equivalent of 7 percentage points of GDP in the United States, twice more than the savings crisis in the late eighties. The bill would also be higher than for the banking crisis that cost Japan $ 800 billion in the 90s (but about 15 percent of GDP).

The crisis also affected the demand for credit and creditworthiness of borrowers through the loss of heritage conducted by households, mainly in residential real estate.

In all countries (except Germany and Japan), the fall in housing demand, particularly in the U.S. excess housing supply, led to a reversal of declining prices of residential real estate. Some estimates forecast a decline in property prices in the United States in the order of 15-30% (Goldman Sachs, August 29, 2007) or even the order of 50% (Schiller, 2007). In France, in June 2008, experts expected a price decline of between 3 and 5% in 2008, followed by a decrease of approximately the same magnitude in 2009.

The effect of falling house prices is particularly acute in countries where there is a formal link between housing wealth and debt capacity, that is to say the United States and United Kingdom. The "mortgage equity withdrawal" allow in these countries the households to be indebted again when the value of their home rises from the level of mortgage debt. This is how the U.S. subprime borrowers were paying interest on their mortgage after the initial transition to interest rates. The decline in property prices has obviously greatly reduced the draws in fresh funds of this nature, and has contributed to higher default rates seen earlier.

The risk is here on the demand for credit, therefore the consumption of households and defaults of borrowers, and the banks, but it does not seem very high in continental Europe.

The period before the financial crisis was marked by the growing use and massive leverage: share buybacks by companies, household debt to finance real estate investments, leverage of hedge funds, private funds equity, securitization used by banks to reduce their need for capital, leveraged structured products.

The crisis is a massive reduction in debt leverage, due to several causes: excessive debt, difficulties in the securitization and banks’ behavior, rejection of complexity in financial products, the rise of aversion to risk and higher volatility. This is reflected primarily by a dismantling of structured products which are then sold on the market, pushing spreads upward. The fund LBOs (leveraged buyouts) are also severely affected by the crisis. Then in 2006-2007 they represent one fifth of the mergers and acquisitions, their share is just 8% over the first months of 2008.

Immediate consequence on the world market for mergers and acquisitions, transaction volumes have fallen by one third in the first quarter of 2008. The level is still high at 661 billion dollars, the level of 2005 (Thomson Financial). Not surprisingly, the U.S. market, which suffers most from the crisis, but the UK and French markets also show a sharp decline.

The crisis triggered in summer 2007 has thus a clearly negative impact on consumption and employment. These are already visible effects in the United States and Spain and these effects should be felt soon in other countries with the braking expected growth.

In October 2007, Martin Feldstein, chairman of the National Bureau of Economic Research (NBER) estimated, by considering only the effects related to declining property prices (ignoring thus the multiplier effects), and assuming that a 20% loss for U.S. households would bring about 4000 billion, a decrease in consumption of 200 billion, i.e. 1.5 percentage point of GDP. For the IMF, in April 2008, U.S. growth should be 0.5% in 2008 and 0.6% in 2009.

The crisis grows, moreover, pushes the U.S. administration and the Federal Reserve to pursue expansionary policies: increasing the public deficit, lower interest rates. These policies impede the reduction of the external deficit of the United States, despite the drag on domestic demand, and weaken the dollar, lower interest rates (Dooley, Folkerts-Landau and Garber, 2008). They therefore require central banks to accumulate more reserves to achieve the same stabilization of the dollar, resulting in an increased global liquidity.

The medium-term effects affecting the level of risk premium are (the recovery risk), difficulties of securitization and its effects on credit supply and the need for bank capital and the means to obtain additional capital financing (banks, corporations, investment funds), the liquidity requirement, its impact on financing for households and small and medium enterprises (SMEs) on the role of finance; the resurgence of speculative bubbles.

We have seen in this chapter that the subprime crisis can be explained by a combination of three factors: macroeconomic imbalances, microeconomic dysfunction lined with high-risk financial practices.

CHAPTER III

THE SUBPRIME CRISIS AND THE DOMINO EFFECT

There is no dispute over the fact that we are facing the greatest global financial crisis since the Great Depression. Since September 2008, the world has witnessed unprecedented events that are reshaping the international financial system and challenge the liberal economic orthodoxy, which had been virtually unchallenged since the 1990s, under U.S. leadership. The sub-prime crisis that erupted in August 2007 became a systemic financial crisis whose center is not only the U.S. but has spread to Europe and Japan and has a powerful impact on the growth of emerging economies.

A. Sources of the Financial Crisis and the Globalization

The financial crisis started in the United States and propagated in the world. However, the consequences of the crisis are more severe in some countries as opposed to other countries. In general, the rich countries are more touched by this crisis than the other countries.

1. The Financial Crisis in the U.S.

The U.S. banking industry has been hardly hit as bank loans are backed by sub-prime that were declined in value. According to Whalen (2008), as a result of bad debts the banks were reluctant to give loans which led to a tightening of credit. A slowdown in the real estate industry, which contributes in 15 percent of U.S. production, has had a ripple effect on other sectors including producers of durable goods.

One impact of the financial crisis on the American economy is the support of financial institutions. Before the financial crisis reached its peak in the United States, the Federal Government has helped the investment bank Bear Stearns, with nearly $ 30 billion to avert a major financial failure, it has invested more than 200 billion dollars to fund preferred shares giants Fannie Mae and Freddie Mac and at least $ 5 billion in mortgages and has also provided an emergency loan of $ 85 billion to American International Group (AIG) Inc exchange for a 80% stake in insurance.

Another impact of the crisis is the bankruptcy of Lehman Brothers. Ranked among the largest investment banks, Lehman Brothers in its vision of growth has aggressively invested in properties, including subprime. The subprime crisis and falling home values have forced the company to take huge reductions in the value of these assets and led to the loss of about U.S. $ 14 billion. That forced Lehman to transfer money from their customers to much safer investments, such as investing in government bonds. This has contributed to create a society that seeks protection in bankruptcy and thus its fall. The collapse of the company has put tens of thousands of jobs worldwide in danger. The impact was so enormous in other major economies taking into account the integration of financial markets and the global nature of business today.

It is important to note that house price indicators are generally lagging behind, suggesting that the U.S. housing market bottom is likely hit in 2009. No changes in interest rate by the Fed can change the fact that the recovery of the housing market means that accessibility should restore scores of houses as well; prices should drop significantly in many markets.

Consider the following examples in the American banking sector. These examples are taken from data collected by the FDIC[3] to see if the U.S. banking system is now in the process of adjustment and speculate future levels of defaults.

The banking sector as a whole has slowed dramatically in terms of profitability and increased non-current assets and Other Real Estate Owned "OREO". The performance figures for all banks are clearly deteriorating, but the industry is not yet near a crisis.

	2007	2006	2005	2004	2003	2002	2001
Return on assets (%)	0.86	1.28	1.28	1.28	1.38	1.3	1.14
Return on equity (%)	8.17	12.3	12.43	13.2	15.05	14.08	13.02
Core capital (leverage) ratio (%)	7.98	8.22	8.25	8.11	7.88	7.86	7.79
Noncurrent assets plus OREO (%)	0.94	0.54	0.5	0.53	0.75	0.9	0.87
Net chargeoffs to loans (%)	0.59	0.39	0.49	0.56	0.78	0.97	0.83
Net operating income growth (%)	-23.72	8.5	11.39	4.02	16.39	17.58	-0.48

Fig 3.1: Q4 – US Banking Industry

Source: FDIC – Quarterly Banking Profile, 2008.

[3] Federal Deposit Insurance Cooperation preserves and promotes public confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least $250,000; by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails.

Figure 3.2 below shows the gross loan charge-offs and defaults for Citibank NA and its competitors (Peer). We must note that despite nearly a year of turmoil in respect of the quality of subprime loans, the delinquency rate for big banks is very low. When the default rate of banks reaches and exceeds its long term medium, the banking industry in the United States will face its biggest financial challenge since the early 1990s and possibly in the 1930s.

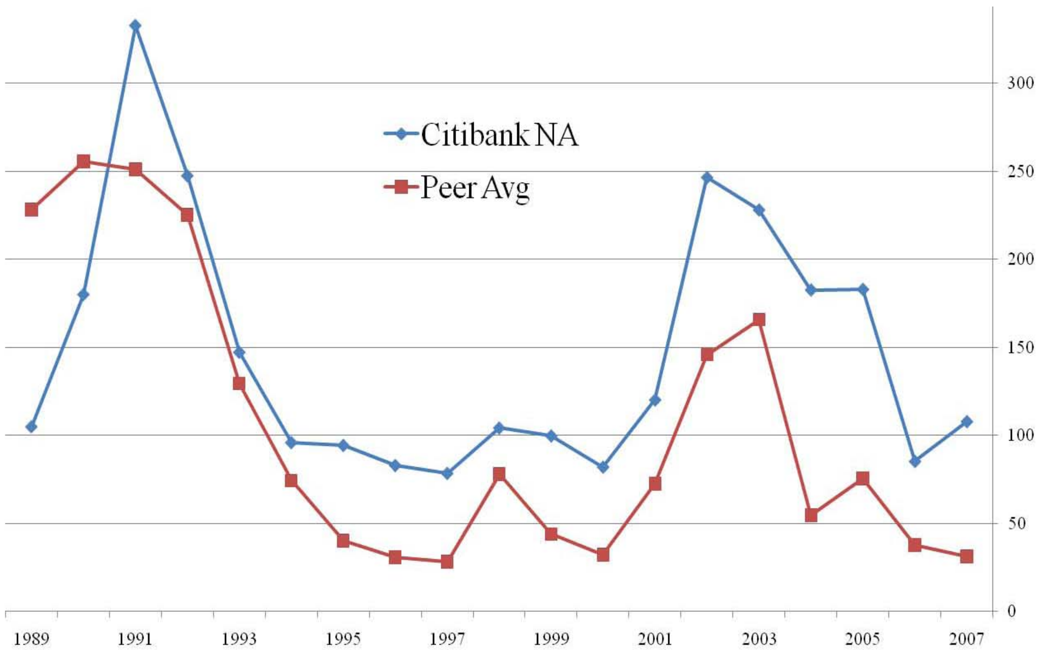

Fig 3.2: Gross Defaults[4] (bp) Citibank and Peer

Source: FDIC/IRA Bank Monitor, 2008.

[4] occurs when a debtor has not met his or her legal obligations according to the debt contract, may occur if the debtor is either unwilling or unable to pay their debt.

Figure 3.3 describes the gross expenses lending agreement or by default for Washington Mutual Bank, FSB large bank (WAMU) and its competitors (PEER) of the same specialization. Note the strong increase in the burden of performance of WAMU in 2005 after the close of the acquisition of the credit card issuer Providian subprime. In 2007, the portfolio of credit card WAMU has reported a load Compromise of 1000 bp to the FDIC.

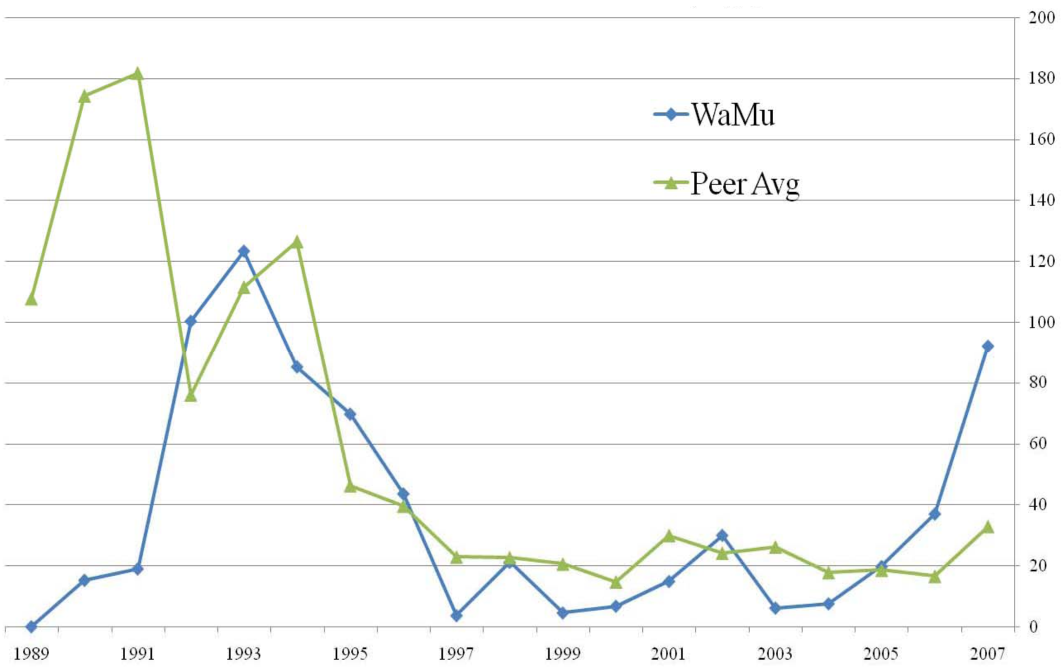

Fig 3.3: Gross Default (bp) WAMU and PEER

Source: FDIC/IRA Bank Monitor, 2008.

Figure 3.4 shows the gross loan charge-offs or default of FIA Card Services, representing $ 170 billion asset credit card Bank of America, which includes the old firm MBIA. Note the huge increase in failure rates of groups of competitors in the period of 2002, which was caused by an 8-10% reduction credits by several other banks.

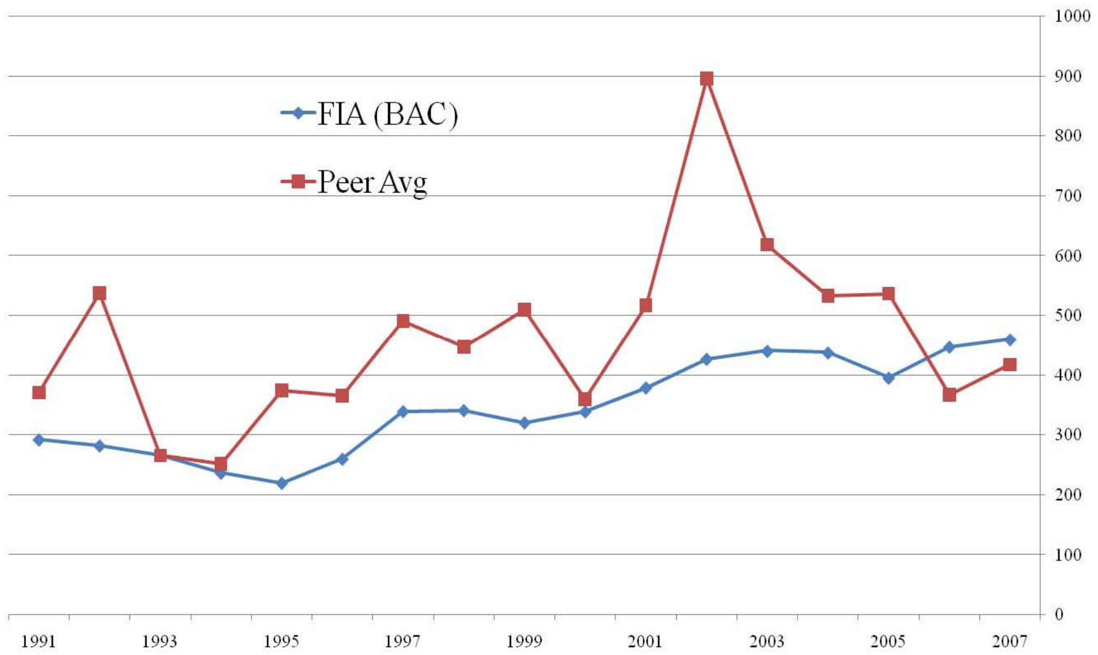

Fig 3.4: Gross Default (bp) FIA (BAC) and Peer

Source: FDIC/IRA Bank Monitor, 2008.

Given the magnitude and duration of depression in bank loan defaults in the period 1993-2001 and 2004-2007, and given the magnitude of the increase in property prices over the past seven years, it seems reasonable to conclude that the upward swing in the current defaults could reach or even surpass the recent highs. The default of 340 bp made by Citibank NA in 1991, has threatened the solvency of the bank, then in

2008-2009 a bank loan of nearly 2 times that of 1991 will create a crisis in the financial system and economic .

2. Financial Crisis vs. World Crisis

According to Husson (2008), the global financial crisis was triggered by the subprime mortgage crisis in the United States. This has unsettled financial markets in developed countries, leading to the collapse of the notable names in the banking sector. Production in these countries was also affected, thus leading to lower levels of production.

Overall, companies and individuals have an ever increasing demand for personal and capital investment companies. Traditionally, banks have been very cautious and strict in their requirements. This makes access to finance for the majority of the population more difficult.

Banks and other financial institutions in the United States have offered during long periods bad loans. This is due to the easing of loan conditions for loans in the wake of the explosion in real estate (housing). Millions of Americans who could not have bought their homes due to their inability to fulfill the requirements of traditional loans have been granted sub-prime. Traditionally, banks use the customers' deposits to finance loans.

With the increase in loan demand, banks have resorted to a new model where loans were issued in the bond market. This led to the development of securities market since the credit brokers are more interested in smaller customers. This proved very profitable for banks who earn a fee for each credit sold and encouraged brokers to increase their sales. The subprime, called “Adjustable Rate Mortgages” (ARM) had a fixed payment for two years.

Then, they were reset to higher rates (double the rate of interest) and suddenly became too expensive for the customers to repay. Millions of Americans sold their homes again because they could no longer repay their mortgages. House prices have been decreasing during last 3 years at an annual rate of 4.5 percent and are expected to fall by at least 10 per cent in 2008.

However, the effect of the global financial crisis has been exacerbated by rising global energy prices and goods that have consequently led to increased inflation. The emerging and developing countries have shown strong price increases reflecting the high weight of food in their consumption baskets.

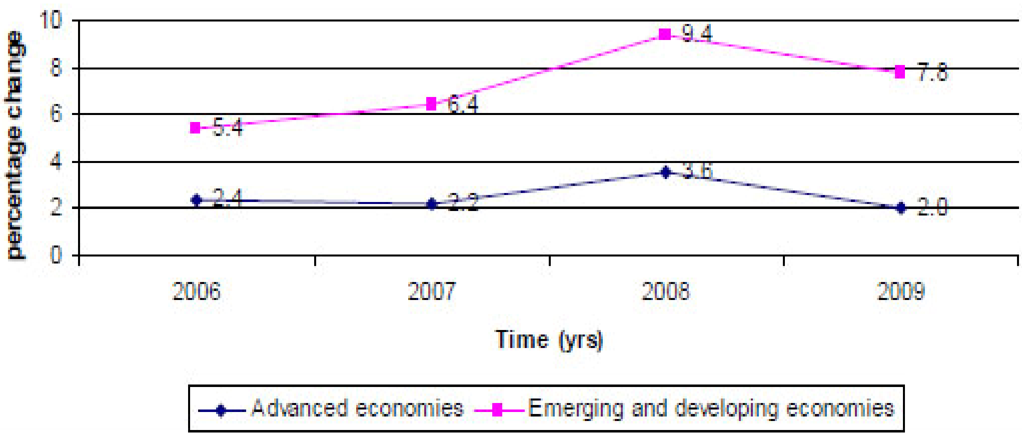

Fig 2.5: Consumer Prices

Source: « The Global Financial Crisis: Impact on the World Economy » by Mvula, R, 2009.

Financial systems in developing economies have withstood the financial problems in the United States. This amounts to the fact that companies run their businesses in a traditional way, where individuals or businesses must have good credit to acquire loans in these countries, and risk levels are very low. However, the impact would be felt in the real sector of the economy due to lower demand for imports. This is likely to affect the international market prices of these products.

Banks in developing countries will likely see their credit lines from foreign banks tightened and the steady increase of financial flows show that these economies are going dry.

B. The Impact of the Crisis on the World Economy

Financial markets in the developed world were affected by the financial crisis. This has weakened the growth in these economies. IMF projections show that until the beginning of 2009 most developed countries are in the dawn of a recession if not in recession. The emerging economies have largely weathered the global financial crisis. However, the strong growth of these economies has been affected by the global decline in economic activity and thus growth should be moderate.

1. The Domino Effect of Depression on Europe (the European Financial Sector Exhibition)

The crisis in the U.S. economy had a dramatic impact on the world, the Bush administration was not popular and the Europeans have chastised the American laissez-faire for years.

The effects of the crisis has spread beyond housing and disrupted global financial markets as investors were forced to reassess the risks they are taking and consumers lost the ability to finance further consumer spending, this has caused increased volatility in fixed income, equity and derivatives markets.

The impact of this problem on the U.S. economy was also felt in Europe where the European Central Bank has tried to control the crisis by injecting over 205 billion U.S. dollars in European financial markets.

The credit crisis has spread rapidly to Europe, with a number of major European financial institutions on the edge of falling into the collapse, as the Belgian-Dutch bank Fortis, Franco-Belgian Dexia, the mortgage lender Bradford & Bingley, Hypo Real Estate Germany, and the Dutch bank and insurance company ING and the Dutch insurance giant Aegon.

In Iceland, the three largest banks collapsed, causing the country to the brink of bankruptcy since the total external liabilities of three banks accounted for five times the annual GDP of Iceland. The contagion effects quickly spread to emerging economies. Hungary was among the first emerging market to suffer. Iceland and Hungary had to recur to the IMF (and other sources) to ease the immediate financial market stress, and both countries were the first European countries to do so during more than 30 years.

Ukraine has also experienced liquidity problems, as access to international capital markets has been greatly reduced, its currency was sold off and the credit rating agencies downgraded the country's debt. Ukraine has also had to reproduce the IMF for $ 16.4 billion in loans.

Belarus and Serbia have also requested urgent assistance from the IMF. Pakistan was facing severe problems in its balance of payments and has requested and supported by the IMF, as its level of foreign exchange reserves fell broadly.

Since September 2008, the global credit crunch has turned a sharp slowdown in Western Europe into a recession, and the major European economies are technically entered a recession. Having lost its growth momentum, GDP was expected to decline in the first half of 2009, with a low probability of increase in the second half, showing a negative growth rate for the entire year. After a long period of improvement in the labor market, the unemployment rate began to drift upwards since the mid of 2008 and is expected to increase by almost one percentage point average for the whole region in 2009. With the downturn and lower prices below their peaks seen during the mid-2008, inflation is expected to slow significantly, compared to peaks in 2008. The risks are still skewed to the downside, particularly in regards to the effectiveness of current and anticipated political stabilization of financial markets.

After several years of sustained economic growth throughout the entire region, the new Member States of the European Union exhibited different growth patterns in 2008. Domestic demand has weakened in response to higher credit costs and accelerating inflation, and export growth is also likely to decrease. Growth is expected to weaken and inflation should be moderate in 2009.While new EU members are not directly exposed to sub-prime loans in U.S. banking system in the region is subject to shocks generated by the turbulent financial institutions in the European Union. The stock of short-term private debt in foreign currency has already created a serious liquidity crunch in Hungary. The risks for the region include a prolonged slowdown of economies in the European Union, as well as a reversal of capital flows.

2. The Domino Effect of Depression on the Gulf States

The world today faces a financial crisis that has shown its first signs in the U.S. in 2007 and culminated with the collapse of Lehman Brothers, one of the largest mortgage banks, real estate America.

As expected, a domino effect occurred, major financial collapses in European and Asian financial markets, whose impact has been felt strongly in the Arab Gulf countries and financial markets. Despite attempts by the United States to contain the crisis due to massive government intervention, in violation of one of its most fundamental economic ideals, the crisis seems difficult to resolve at this point. Observers expect that this would have very different effects on international and regional levels.

Kuwait has taken measures necessary to support the second largest commercial bank in the country, The Gulf Bank, and protect depositors in national banks. The central bank stopped buying the shares of Gulf Bank because of the heavy losses of these products.

The award of Saudi Arabia - the largest in the region - fell 8.7 percent in October 2008 and is down more than 50 percent since January 2008. Neither the government nor Gulf Bank revealed the size of the losses or their timing.

Because most institutions in the banking sector in the region are owned by the private sector, little is known about the true risk exposure. News of the Gulf Bank also seems to have pushed the Kuwaiti government to take a step, which it has so far resisted - guaranteeing deposits. The country currently does not guarantee deposits.

The Gulf countries have said they are largely covered against the global crisis, in part because of the "cushion" built during the financial years of high oil prices.

The International Monetary Fund said that many countries may still see a GDP growth of about 6 percent come regional average.

Real estate agents in the United Arab Emirates and Dubai have seen a lower price of properties not yet built. The United Arab Emirates was one of the nations of the Gulf's most aggressive in the fight against the impact of the crisis. It has injected liquidity into the economy and a decline in the rate with the U.S. Federal Reserve. But in Kuwait, the government has taken a less practical approach, so the anger of investors has continued but without success, and led to the temporary closure of the purse.

The various Gulf countries have addressed the global crisis in different ways. Some have injected billions into the financial sector, despite assurances of adequate liquidity. Others have repeatedly cut interest rates or guaranteed deposits.

In the first two chapters we have reviewed the financial crises since the early 1900s to the international financial crisis in 2008. This descriptive study will help us understand the different processes of financial crises and what were the causes and effects on different economies. Thus we can estimate the commonalities between the various crises in history. In this chapter we will study the impact of financial crisis on the Lebanese economy since it seems to be an exceptional case.

CHAPTER IV

THE INFLUENCE OF THE CRISIS ON THE LOCAL MARKET

A. Effects of Depression on the Lebanese Market

While some experts believe this year is no different from the past regarding the Lebanese banking sector, others are not so sure. Most agree, however, that conservative policies established by the Central Bank of Lebanon have allowed the banking sector to avoid the principal effects of the global financial crisis.

The Central Bank of Lebanon has banned Lebanese banks to buy subprime U.S., it has increased its foreign reserves to 13 billion dollars (as a preventive measure to ensure the stability of Lebanon ITL), required that banks have a minimum of 30 per cent of their total assets in cash and it has imposed a rigid lending limits for real estate projects. The central bank has been cautious in keeping assets safe and close to the region.

On November 26, 2008 the Governor of the Central Bank Riad Salameh announced that all bank assets in Lebanon totaled more than $ 100 billion - four times the GDP of the country. Bankers in Lebanon have agreed that the central bank is proud to avoid investment complex. Regrettably, the only thing against which the central bank cannot protect the private sector is political instability.

Well known for its social and political instability, Lebanon has made a comeback after the Doha agreements that were signed at the end of May 2008.

Remittances from expatriates have been the best proof that the Lebanese abroad consider local banks as shelters, totaling $ 5.5 billion in July 2008. These remittances have exceeded $ 6 billion at the end of the fourth quarter of 2008.

During only the first nine months of 2008, deposits in Lebanese banks have reached an incredible $ 7.8 billion - up from the previous record of $ 6.6 billion for the whole year 2007.

The Economist Intelligence Unit (EIU) predicted that with the approach of parliamentary elections in June 2009, increased political uncertainty during the year 2009 should have a negative impact on the flow of foreign remittances to Lebanon.

N. Ghobril, head of research and economic analysis of Byblos Bank, believes that the deposits flows are “likely to slow this year because a majority of deposits from the inflow of Lebanese Diaspora”, adding that “the crucial question is, do these expatriates have the same purchasing power and liquidity they had before the global financial crisis?” He concluded, “This year and undoubtedly will be different economically, compared to last year”.

As the Lebanese banking sector was far isolated from the global financial crisis, it is not completely true. Lebanese banks are beginning to feel the inevitable decline in economic growth in coming months.

The EIU (Economist Intelligence Unit) forecasts economic growth in Lebanon, which slowed to 2.7 percent in 2009 - down from earlier forecasts of 3.1 percent - while the Minister of Finance Mohammad Chatah announces projections between 3 and 3.5 percent growth rate, contrary to a previous estimate made in 2008 of five percent. Factors affecting the growth of the country are mainly due to political uncertainty, the economy contracted in the West and the stagnation of growth markets in the Gulf.

These elements are likely to have an implicit impact on tourism Lebanese real estate, construction and financial sectors, according to the EIU. Despite high levels of liquidity, low exposure to home loans, solid deposit foundation and strong support from the central bank, the Lebanese banks could be affected by sudden loud political risk of triggering the conflict that has threatened the country in the past, most recently in 2005, 2006 and 2007.

Starting the year 2009 on uncertain grounds, banks in Lebanon are still awaiting the results of the fourth quarter of 2008. Dr. Mazen Soueid said, “It is clear that from the third quarter of 2008 results (fourth quarter results) do not correspond to the results already obtained. The fourth quarter was more difficult than the third quarter”.

During 2009, banks will be even more cautious, since the global financial crisis has taught banks that they can learn lessons every day. Dr. Soueid has brought to light the increasing competition among domestic banks, the availability of loans “are rare”. In addition Dr. Soueid says, “Banks will be more cautious when they will review their lending opportunities”, especially since “the lending opportunities abroad are likely to decline”.

More fundamentally, the Lebanese banks will need to manage their liquidity. “Another concern is excess liquidity in Lebanese pounds which are accelerated, and where”, he notes, “Although priority on the agendas of the banks this year will undoubtedly be about, besides enjoying a stable liquidity”, adds Dr. Soueid.

Like most stocks on the Beirut Stock Exchange (BSE), bank stocks are vulnerable to the political environment of Lebanon. Thomas Schellenberg - publisher of Zawya Dow Jones - confirms that “the share prices of Lebanese banks have certainly been sensitive to political risk and other developments”. This was most evident in May 2008 after the signing of Doha agreement, the share prices of banks have parachuted but have since fallen. Schellenberg notes that large banks such as BLOM, Audi and Byblos were “experiencing decline” since the middle of last year.

Dr. Mounir Rached said that “equity markets have not really reflected the performance of Lebanese banks list”. Because of the lack of liquidity and the small size of the Beirut Stock Exchange, the bankers seem to ignore the change in share price. Overall, 2009 will be vigilant in the banking sector in Lebanon. Schellenberg said he would prefer “the use of dice or Chinese oracle” to predict what will happen during the year 2009, “because in the current economic environment - globally - it is very unlikely that anyone will predict the targets for 2009.There are so many challenges”.

Without a doubt, the biggest hurdle facing the Lebanese is political uncertainty. Dr. Rashid said he “cannot overemphasize the importance of maintaining political stability”, as it is “essential to build confidence, which in turn encourages new projects, investments and businesses to expand and consumers to borrow”. But with the political history of Lebanon, we can never know.”Since the elections are approaching”, says Dr. Rashid, “it is likely that consumers and investors take an attitude to wait and see”.

Marwan Mikhael, director of research at the Bank BLOMINVEST, believes that until the political situation is stable, “2009 will be a record year for Lebanese banks”. If the environment does not worsen, in addition to slower growth, Mikhael projects “a slowdown in capital inflows into Lebanon”.

Overall, Ghobril trusts that this year will be conservative and prudent, to clarify things nationally - in regards to the political front with the elections - and the region, economically and financially.

With the unpredictability of financial events, global and domestic uncertainties, pragmatic approaches in the whole banking sector are needed this year. Schellenberg believes in the abilities of the banks in the country and concludes that “confidence in the banking sector does not seem to have diminished, from what I heard, over confidence in the banking elsewhere, I think that Lebanese banks have the brilliance”.

B. The Influence of Depression on the Lebanese Companies Indexed on the Beirut Stock Exchange

The Beirut Stock Exchange was created by government decree July 2, 1920. The transactions are mainly concentrated on gold and currency. This market, which was the first in the Middle East, has attracted investment from France and Syria and Lebanon. Includes joint dealers, like Franco-Syrian-Lebanese dealers and utilities, namely electricity in Beirut, electricity Aleppo, Latakia and Asphalt Oil Company Port of Beirut, Damascus and Hama Rail Road Company , Beirut Water Company, Radio Orient, the Board and the Lebanese French Real Estate Company.

All these companies were listed on stock exchanges in Beirut and Paris. The Beirut Stock Exchange has operated for 34 years without any regulations governing its activities, until the Lebanese parliament in 1945, has adopted such a law. The law was amended in 1959, 1961, 1969, 1982 and 1985. The Stock Exchange was closed in 1983 like many other Lebanese institutions after the war. Now, the purpose of trade is to contribute to the reconstruction process in the country.

The market now includes 14 issuers: Bank Audi SAL, Bank of Beirut SAL, Banque Bemo SAL, Beirut Golden Income Fund, Beirut Lira Fund, Beirut Preferred shares, BLC Bank SAL BLOM Bank SAL Byblos Bank SAL, SL of White Cement SAL Holcim (Lebanon) SAL, SAL Rosamny Younis Motors Co., Solidere SAL, SAL UNICERAMIC.

The titles listed may be divided into several sectors listed below.

Real estate and construction sector, which includes 100 million shares of Solidere Class A 65 million shares of Solidere Class B.

The banking sector consists of six banks. Bank Audi, which emits 32,902,309 shares indexed, GDR 9,829,902 shares, 4,000,000 Class C shares and 1.25 million shares of Class D.BLC Bank, 50,900,000 shares listed. Bank of Beirut, which emits 13,535,945 shares registered, 3,000,000 shares of Class B, Class C of 2.92 million common shares, 4,000,000 Class D shares. Byblos Bank, which issues shares to 205,023,723 registered, 1,000,000 preferred shares, 206,023,723 shares of priority. Bemo Bank issuing 5.4 million shares registered, 200,000 preferred shares, 7,389,601 GDR. Blom Bank, which emits 21.5 million shares registered, 750,000 class in 2004, 1,000,000 Class 2005.

The commercial sector includes two companies. Rasamny Younes Motor Co., which emits 10.4 million shares listed. Holcim Lebanon, issuing 19,516,040 shares listed.

The industrial sector comprises two businesses: Cement whites, issuing 6,000,000 bearer shares and 3,000,000 registered shares and 4,290,000 registered shares A to Uniceramic.

The Beirut Stock Exchange, is characterized by three types of markets.

The official market that includes companies incorporated in over three years with a capital equivalent to three million U.S. dollars at least, has distributed a minimum of 25 per cent of their capital to the public and this percentage (25 percent) being detained by at least 50 shareholders.

The secondary market includes the newly established firms with a capital equivalent to at least one million USD, distributed with a minimum of 25 per cent of their capital to the public and this percentage (25 percent) being held by 50 shareholders at least.

Shares of companies with a capital equivalent to USD 100,000 at least are traded without being included in the Beirut Stock Exchange.

The market is open Monday to Friday each week. From 9:00 to 9:30 is the pre-opening, the opening is at 9:30, begins trading sessions 9:30 to 12:30 and closing time is at 12:30.

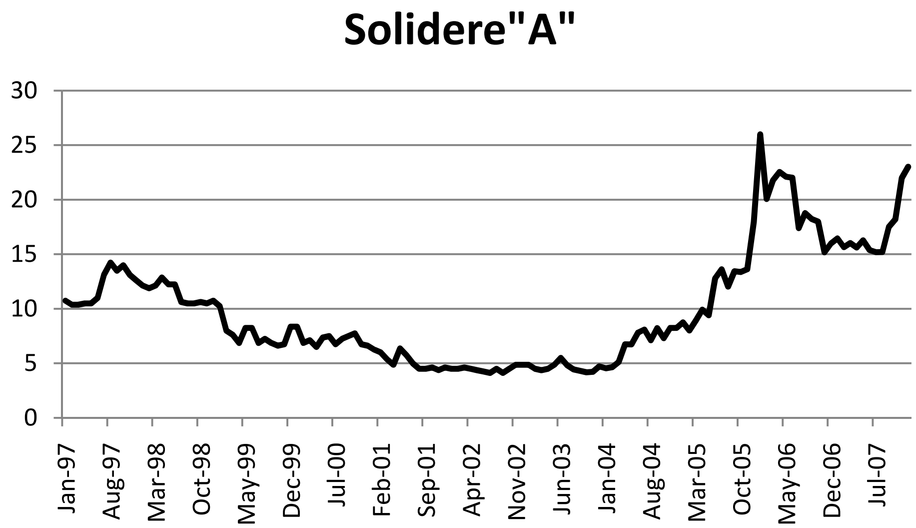

Fig 4.1: End of Months Closing Prices in USD of the Solidere “A” from January 1997 until December 2007.

Source: Beirut Stock Exchange, 2008.

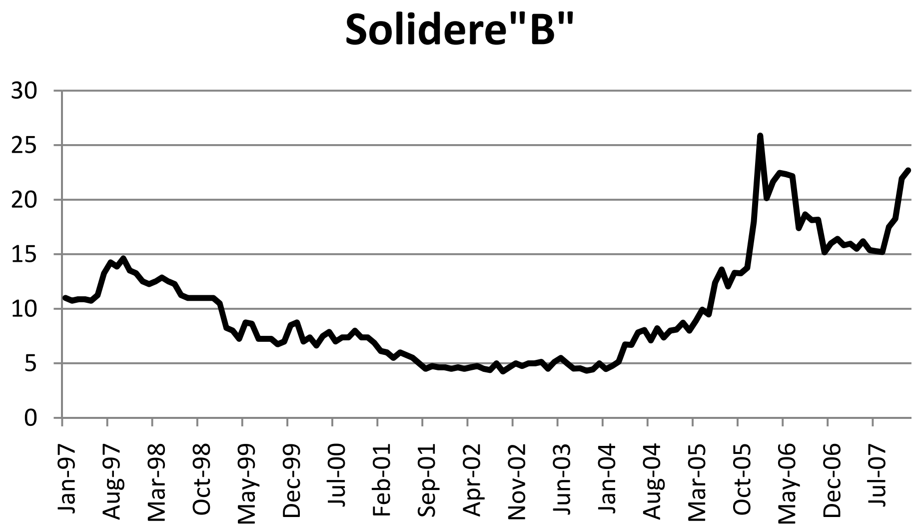

Fig 4.2: End of Months Closing Prices in USD of the Solidere “B” from January 1997 until December 2007.

Source: Beirut Stock Exchange, 2008.

Both Solidere shares, Solidere A and B have similar trends over time. The price has decreased between 1999 and early 2004. Then they rose to their highest price of 26.01 in January 2006. Prices have increased sharply after the assassination of the Prime Minister Rafiq Al Hariri in February 2005. Then, the shares have fallen and risen again at the end of 2007.

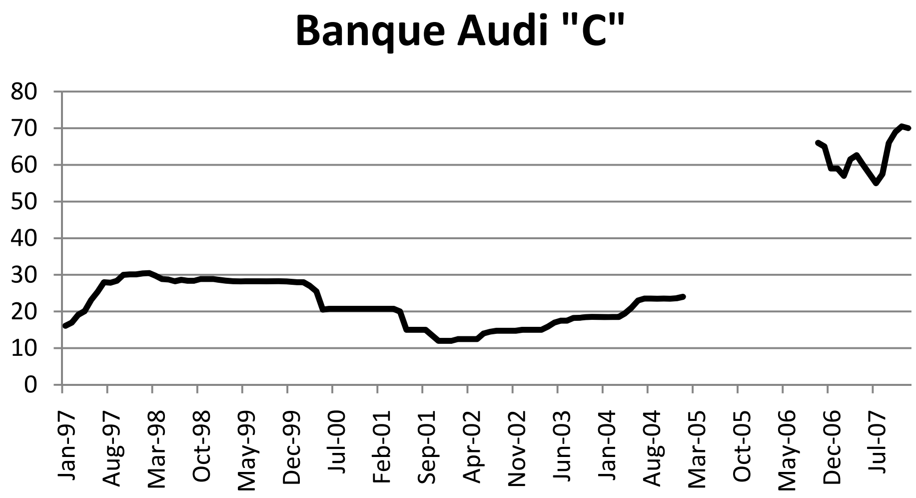

Fig 4.3: End of Months Closing Prices in USD of Bank Audi “C” from January 1997 until December 2007.

Source: Beirut Stock Exchange, 2008.

Bank Audi has two shares traded on the BSE. The share price Audi Bank "C" has evolved between 10 USD and 30 USD between June 1997 and August 2004. The share price is not available between March 2005 and December 2006. In 2007 the share price has reached more than 60 USD.

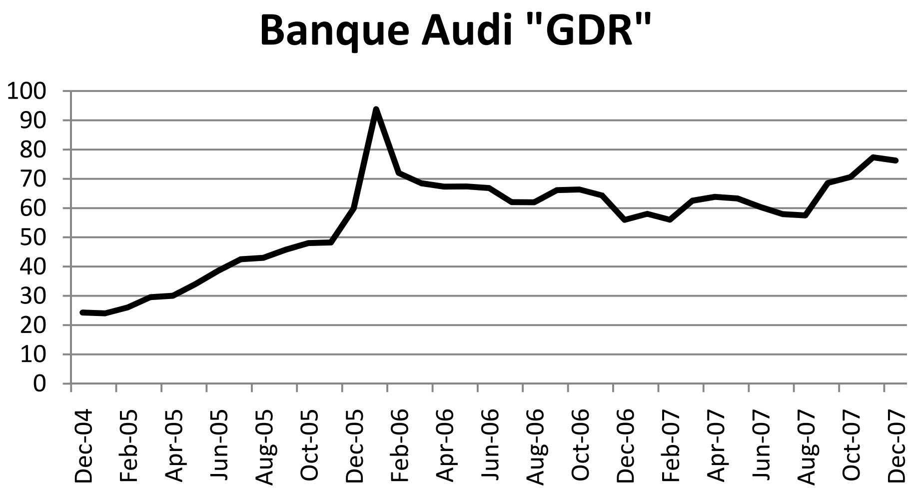

Fig. 4.4: End of Months Closing Prices in USD of Bank Audi “GDR” from December 2004 until December 2007.
Source: Beirut Stock Exchange, 2008.

Bank Audi has introduced a new policy on the market of the "GDR" in December 2004. The evolution of the closing price of the new action is generally expanding. But the price peak is witnessed towards the end of 2005 and early 2006.

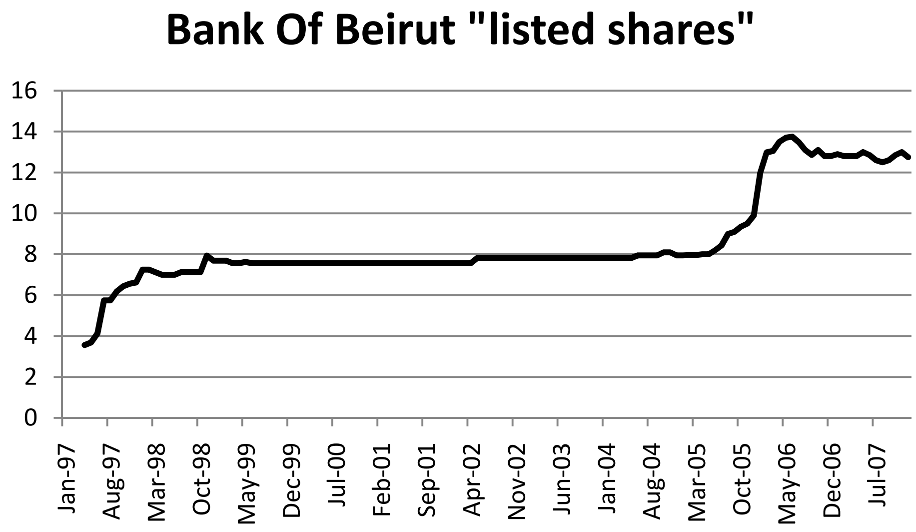

Fig. 4.5: End of Months Closing Prices in USD of Bank of Beirut "Listed Shares" from January 1997 until December 2007.
Source: Beirut Stock Exchange, 2008.

Bank of Beirut has three actions listed on the market. The latest market share is the privileged class C, it also has the highest price.The share price has increased rapidly during the first year and then it stabilized for seven years to increase again in early 2006 and to stabilize by the end of 2006.

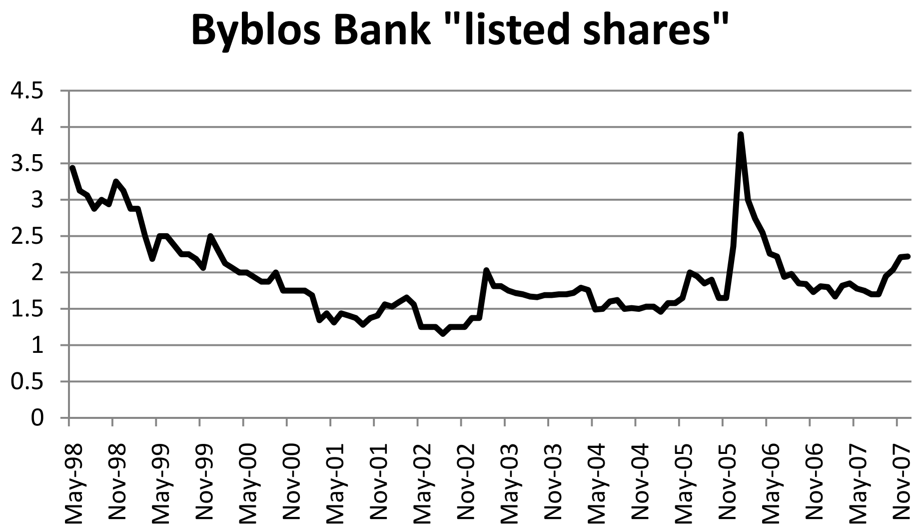

Fig. 4.6: End of Months Closing Prices in USD of Byblos Bank “Listed Shares” from May 1998 until December 2007.

Source: Beirut Stock Exchange, 2008.

Byblos Bank has three actions listed on the market: Byblos “listed shares” Byblos' preferred shares "launched in September 2003 and Byblos Bank priority launched in January 2006.

The share price “listed share” is volatile, but generally declined from its market launch in May 1998 until May 2002 when it began to increase but slowly and suffers a peak towards the end of the year 2005 and early 2006.

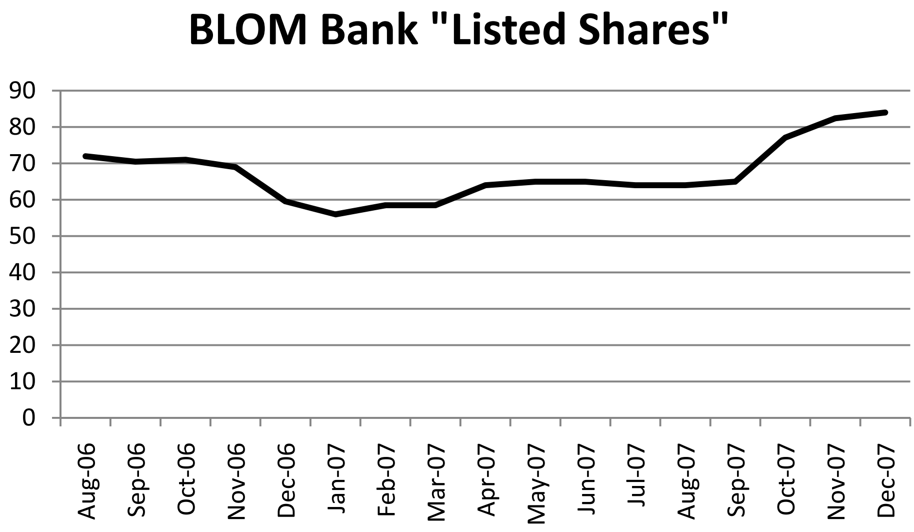

Fig. 4.7: End of Months Closing Prices in USD of BLOM Bank “Listed Shares” fromAugust 2006 until December 2007.

Source: Beirut Stock Exchange, 2008.

BLOM Bank has five shares that traded on the market: BLOM Bank "Listed Shares, BLOM Bank Preferred Class 2002 launched in August 2006, BLOM Bank Preferred Class 2004 launched in August 2006, BLOM Bank Preferred Class 2005 launched in August 2006.

The current price is almost stable during the year but towards the end of 2007 the price increases to more than USD 80 per share.

In January 2008, political power struggle was not a good indicator for investors or even for economic evaluations. After killing the first officer of the army General Francois El-Hajj and the consequences of the assassination on the political situation, the Beirut Stock Exchange could not maintain the BLOM Stock Index (BSI) to 1574.75 points on highest level reached during the year 2007 in December. The exchange is still very positive at the end of 2007 compared to the period of the war in mid-2006 and the internal crisis since the month of December the same year. In the weeks leading up to December 14, 2007, Solidere has provided 85% of the value of trade. Banks could also defend their good ranking, Audi and BLOM GDR respectively to close at $ 76.95 and $93.20 December 18, 2007.

The Beirut Stock Exchange was waking up on different local conditions in January, the BLOM BSI closed at 1462.74 points Jan. 25, 2008, a decrease of 3.1% from one week to another, and a decline 2.6% since the beginning of 2008. With the political discussions futile, another postponement of presidential elections, murder, strikes and threats of worse, panic and recession were a shock to investors who were active on warm Beirut Stock Exchange, despite that the BSI index lost some points during the bad days.

Overall, the situation of the Beirut Stock Exchange is clearly related to the political situation in the country. Solidere has withdrawn its shares in the Kuwait Stock Exchange in early 2008, when the stock of Solidere had been inactive for months. On January 25, 2008, 4 million shares of Bank of Beirut have been launched for trading on the exchange of Lebanon.

Given the continued absence of a president and endless political crisis in Lebanon at that time, the BSI of the Beirut Stock Exchange can be distinguished for its proximity to 1514.9 points March 25, 2008, this represents a real improvement over the 1436.02 points at the end of February 2008. In January and February the total value of total trade was $ 119 million, the crisis has hit the Beirut Stock Exchange in early March when the average daily trading value amounted to about two million dollars a day in the first two weeks month. The parasites came from the merger talks between

Bank Audi and its shareholder based in Cairo, the investment bank EFG Hermes. In mid-March, Standard & Poor's increased the confidence of banks because of their resistance. Reports of 23.6% Growth in 2007 profits of 11 banks and their assets over $2 billion per bank also helped to spread the good mood.

The Beirut Stock Exchange witnesses a good recovery in May 2008 and closed at 1999.36 points BSI May 23, 2008. The prices of Solidere shares have risen to unprecedented levels as soon as the Lebanese political opposition reached a deal to elect a president and public demonstrations in downtown Beirut have ceased. Solidere has increased the limit to 15% and the stocks of three major banks have also increased between 8 and 10%. On May 22, the value of Solidere shares exchanged has exceeded $50 million - well above the average daily value of trade during the year.

The Beirut Stock Exchange was hit by the last act of national policy. Stock prices were steady and the BLOM Bank BSI closed at 2,031.83 points 26 June 2008 depicting an improvement of 35.3% since the beginning of the year. The exchange follows trends diverted to a number of stocks, Solidere has closed the session above $36 per share, BLOM and Audi GDRs at $103 and $99.30 respectively and the banks Audi BoB, Byblos has shown a slight gain over the end of May when the share price remain unchanged and the BLC shares of BLOM appreciated 13.8% between 28 May and 26 June.

The BSI of the Beirut Stock Exchange closed, July 25, 2008, at 2013.55 points, down 38 points from the previous month. After the peak of almost $40 per share, July 7, 2008, following reports a 10% dividend to be paid from the end of August, shares of the estate agency Solidere closed at $36.01 July 25, 2008. The political events seem to have positive consequences. Negotiations between political parties during the second week of disseminated a hope of forming a new cabinet that has led the BSI to a new high of 2119 points. In general, the month of July shows that political will is the cause of the major improvements that unlock the potential of economic growth in the inventory list and the overall economy. The central bank announced that the reserves have reached $15.5 billion in mid-July, a new bond issue was prepared with the help of local and international banks consisting of $339 million of bonds with maturity date approaching August 6.

The BSI is growing at a very slow pace in August, the BSI has risen to 1855 points on August 22, falling below 2,000 points, but still increased by 23.5% since the beginning of the year. The company's real estate market capitalization Solidere has led the market down, falling by 13.43% between the end of July and August 22 On the other hand, the headlines on the Beirut Stock Exchange during the month of August was not entirely dominated by political events. One factor that influenced the market was a repetition of stories on the discussions of a difficult merger between Audi Saradar Group and its shareholder, the investment bank EFG Hermes Egypt. According to media reports in London, the Audi Saradar Group has released a statement Aug. 22 that Geroge Achi, has been named president after the resignation of Raymond Audi who has accepted a governmental post.

The weakness in global equity markets has spread to the Beirut Stock Exchange volume fell to 1.25 million shares during the week ending September 19, 2008. The BSI has closed the period at 1737.6 points against 1794.17 points at the end of August The political concerns are a constant factor in the Lebanese market and investors see them as a fairly basic test market.The real disturber of the exchange was the global financial crisis even though its impact on equity valuations Lebanon was much lower than elsewhere in the area. The central bank reiterated that Lebanon's banking system is affected to a minimum, and that due to the problems of global financial institutions and Fitch Ratings, which gave Lebanon a B minus grade in terms of stability of the country. Solidere, launched a dividend payment of 10% at the end of August, saw a big business September 8, 2008, which briefly raised the price above $31. During the period under review, Solidere has moved from $29.11 to $29.54 on Sept. 22, making the stock of this company one of the best in the region in the real estate sector.

The Beirut Stock Exchange has suffered from the influence of international markets, just like any other exchange. The liquidity and volume of shares traded were reduced towards the end of November and reached 1402.88 points BSI October 24, 2008 decreased approximately 19% from 1732.24 on September 29 until nearly before the holiday of Eid El-Fitr. Solidere's shares also experienced a difficult month and are closed at $21 and $21.06 for both classes of shares in October 24, 2008. The share of the banking sector decreased to $70 for the Audi shares and $83.5 for the BLOM stock, although the banking industry, reported improved third quarter results, which are impervious to the epidemic global financial markets that has decimated banking revenues. Lebanese banks were safe because they were required by central bank not to speculate in derivatives and real estate. Over the years the investment in Treasury bills and Eurobonds were considered risky, such investments seem today the most protected.

The Lebanese market is an exceptional market. The effects of the global financial crisis has been widely estimated but the reality proves different. The direct effects on the Lebanese economy is weak, the Lebanese banking system is proved immune against the crisis. In the next section we will review in detail the reasons for the lack of direct effects of the financial crisis in Lebanon and what would be a domino effect that Lebanon will face after the crisis.

C. The Causes of the Lack of Direct Effects of the Financial Crisis in Lebanon

The state of the Lebanese economy is increasingly linked to domestic and regional factors, notably security and politics, rather than global economic developments. The recent agreements between political parties and increasing trust in cases where it was maintained, should ensure a growth of 4 per cent in 2009 despite the global recession.

The Lebanese banking system is able to withstand the global financial shocks. The banks remained highly profitable, liquid and well capitalized. Stability is supported by a deposit base that is wide and stable and more effective regulations and monitoring system.

International reserves have increased by an amount that covers almost nine months of imports.The current account and budget deficits remain high, at 8 per cent and 10 per cent of GDP, respectively.

The recession in advanced economies and the sharp slowdown in economic activity in the Gulf has reduced earnings from tourism, capital flows and foreign direct investment.

The dollar peg, since 1999, was an effective anchor for financial stability in Lebanon over the persistence of significant vulnerability and repeated shocks. This stability will be maintained.

The government's tax debt remains a crucial economic challenges in Lebanon. However, the high level of public debt is less likely to decrease if it is considered in terms of net debt, given the large amount of foreign assets of the central bank, while the financing is supported by strong liquidity in the banking system.

The conservative nature of the Lebanese banking sector, guided by the central bank governor Riad Salameh, has allowed him and the Lebanese economy to avoid many of the direct effects of the global financial crisis. The strict and conservative investments in Lebanon have avoided the worst of the global financial crisis and maintained financial infrastructure to cope with the situation.

In Lebanon, the regulations concerning restrictions and requirements for structured products, and high levels of deposits are deemed to have crowded the exhibition addressing the global financial crisis. In addition, the model properties of banks in Lebanon has contributed to make a model of more conservative investments. Banks in Lebanon are held partly or wholly by their managers, which means that they often are not looking for short term profits. These owners have an intrinsic interest in the bank.

On the other hand, the commercial bank has restrictions when personal loans, payments of personal loans may not exceed 20% of salary per month. In addition to the Foreign Direct Investment (FDI) were low in recent years as foreign investors were the political and economic security was not sufficient to invest in this country. Thus, the low level of FDI has been a cause of the absence of direct effects of the global financial crisis.

Salameh said the central bank expected a surplus balance of payments during the year 2009, despite the risk that capital flows will decrease. One scenario that the bank has managed, he said, a reduction in imports would do more than offset the impact of a drop of 30% of capital.

So far, the global financial crisis had a limited impact on banks in Lebanon, mainly because the central bank regulations prohibited banks from investing in structured products or derivatives, and limited their exposure to property. The maximum loan value ratio is 60% for a home loan and 50% for a loan to purchase the shares. Banks tend to be well capitalized, in part because they are aware of previous political crises and economic disruption. The capital adequacy ratio of banks in Lebanon is 12%, Salameh said, adding that the minimum requirement after Basel II is 8%.

The banks will also be protected to a certain extent against the slowdown in economic growth because much of their income from loans to the government are at high interest rates. The yield on two-year Treasury bonds has remained above 8%, reflecting the political risk premium and the large budget deficits.

The Central Bankof Lebanon strictly prohibits Lebanese commercial banks to invest in external fellowships and urges them to invest their cash in Treasury bills because the government needed funds. This measure represented a protections to the Lebanese financial system against the direct effects of the global financial crisis.

The rules for granting credit are very strict and demanding in Lebanon, commercial banks can sometimes ask for guarantees that can reach 120% of the total amount of credit for real estate. These regulations are not stringent enough in other countries, these are characteristics specific to the Lebanese banking system. In addition it is impossible to reassess the credit for real estate or even have another long-term credit as if the United States.

Despite a global recession, Lebanon is expected to grow about 6% of real GDP for 2008 and about 5% in 2009, according to figures from the International Monetary Fund in 2009. These rates of growth in global recession, are indicative of the unique situation facing Lebanon. Much of this growth can be attributed to the recent political settlement in Lebanon, which has increased confidence in the board of directors after the elections of the president.

Despite the advantages that come with the unique situation of Lebanon, not all the news is good. Lebanon expects to see lower exports in all sectors, due to lower demand from trading partners. Exports to Europe, whose share is about 30%, will decrease. However, given the relative size of exports is not significant, consequently, the Lebanese economy can handle with relative ease this potential problem which is considered rather high. Past experiences show that the Lebanese are able to adapt their products to markets and prices.

The Central Bank will ensure that the credit market is functioning normally and there will be offers that may help reduce the cost of borrowing, particularly for newly established businesses.The Central Bank does not foresee major changes in the basic model already built over the years. It is not necessary to take a new administrative decision, given the stability and progress in the banking sector. During 2009, the central bank seeks to implement Basel II, to work more in the development of circulars relating to the implementation of Basel II, and improve the payment system. The central bank is now working with the Association of Banks to present the iBank, which is a bank ID for each client. This will improve the transparency and timeliness of payment. There will also be introducing the “City Project”, which links online and in real time the banks with the central bank so they can have direct access to information they need. Of course, it has a secure access. So the Central Bank is interested in a certain improvement, but will not take administrative measures for the moment.

D. What are the Future Procedures?

The domino effect that Lebanon will face and overcome in the months ahead remains uncertain.Many economists and journalists and others have tried to predict the effects, but everyone has an opinion and provides different results, some are positive and some are negative. The Institute of International Finance (IIF) in its Summary for Lebanon Upraisal dated February 13, 2009 considers some consequences. These will be listed below.

Growth should slow to around 4 percent in 2009 compared to an estimated 7 percent in 2008 as economic activity in the Gulf has slowed. Thus, tourism receipts, capital flows and foreign direct investment will be reduced and they will be offset by the continuing positive effects that will affect political stability again.

The primary budget balance is expected to maintain a small surplus. This combined with a growth of about 10 per cent of nominal GDP, is expected to ensure continued declining debt to GDP ratio of 168 percent in 2007 to 152 per cent by 2010. While the debt ratio remains unusually high, the special circumstances of Lebanon have contributed to maintaining high levels of debt.

Bilateral funding abroad should be limited in the current global environment because of tighter credit conditions. Banks will continue to play a key role in providing the necessary funding in the budget and balance of payments. Local banks should continue to attract adequate capital flows, but at a lower rate than in 2008, from a broad base of customers.

The prospects for privatization of the telecommunications sector are low given the difficulty of global credit conditions and lack of political consensus on the issue.

The risk forecast of IIR include the possibility of a sudden or prolonged deterioration of internal security and regional political divisions resulting from internal or external interventions.Thus, following a sharp decline in liquidity in the banking system could pose a major risk with regard to public debt sustainability as the deposits banks must grow by at least 5 percent per year to provide funding budget. Recent indications show that deposits in Lebanese pounds in particular, continue to increase at a rate above the critical threshold, which reflects the political stability.

Despite the negative impact of the recession in the global economy and the financial crisis, the Lebanese economy seems to fill them out. It seems likely, given the relative political stability and sound banking system. While the current global recession could modestly reduce export earnings, tourism, remittances, and FDI capital, the maintenance of political stability in combination with continuing confidence should maintain modest growth. It is likely that the current stability of the political environment continues.

However, the country will continue to be influenced by political developments in the region, given the close links that have some external powers with Lebanon. It remains to be seen how the new U.S. administration in the region play and, consequently, what impact they have on the regional dynamics affecting Lebanon.

Lebanese banks remain healthy and profitable enough to give credit to the private sector and support economic growth. The recent changes in U.S. dollar deposits in Lebanese pounds deposits indicate the confidence in monetary stability, which continues until the mid 2010. The commitments of applicants to Lebanon appear to be motivated by a deep confidence in the financial system and the stability of the regime of fixed exchange rates.

The IIR believes that the deposits then grow a moderate 8.5 percent in 2009, still well above the critical level is necessary to finance the budget deficit, estimated by the IMF at 5 percent . While the central bank (BdL) intends to facilitate lending rates to stimulate economic activity, the continuing budget deficit poses great challenges to the political BdL.

The Central Bank and the Banking Control Commission did a good job in protecting the Lebanese banks and financial institutions against the crisis, placing strict limits. The control was very effective, and protected the Lebanese sector of the international crises. Until now, the major risks seem far. However, since the Lebanese market is not isolated from the rest of the world, and that banks trade products internationally, it is critical for banks to have good warning systems, proper risk management, a risk identification, hazard prevention and measures to ensure that all risks are mitigated.

On the other hand, the central bank conducted a scenario known as the “worst-case scenario, where the funds will decrease by $6 billion - which was the level in 2008, says World Bank - up to $4 billion, representing a decline of almost 30 percent”.

Otherwise, the central bank also calculated the import bill of the country, given the new price of oil - which is a great import for Lebanon - and commodities in general, including building materials and foodstuffs. It turned out that in the worst case, this will affect the balance of payments of around 10-15 percent. In 2008, the balance of payments showed a surplus of 3.4 billion dollars. Therefore, an effect of 10 or 15 per cent on the balance of this payment will not really affect the opportunities for credit in the banking system, either in the public sector or the private sector.

As for the possibility that some Lebanese will return to Lebanon, this may be an opportunity to improve the productivity of the economic sector, because these people have talent, so they have been hired outside. Now they have experience and connections. However, the estimates are too optimistic, the number of Lebanese will return to Lebanon will not be wide enough. Most Lebanese who work abroad have degrees and are employed in administrative positions. In general, during periods of crisis, big business, if they have not gone bankrupt, they'll never send their employees who work in administrative positions. These employees have the experience and skills necessary to help the company overcome the effects of the crisis. Thus the number of Lebanese who will return to Lebanon will be moderated and may be absorbed by the Lebanese market.

The Central Bank, in agreement with the government will take initiatives to facilitate loans for new businesses created in 2009.

Standard & Chartered Bank expects the current account deficit reached 11.5 percent of gross domestic product, down from 15 percent in 2008. It said that in 2009 the external sector will benefit from the deteriorating fixed current account balance, following the high price of oil. He added that the share of oil in total imports rose from 20 percent in 2007 to 23 percent in 2008 and is expected to drop to 14 percent in 2009, it is connected with the contraction of about 40 percent the value of oil imports.

The Bank believes that the relative flexibility of the Gulf economies will prevent the decline of Lebanese exports, since half of Lebanese exports are to the Gulf countries.

According to Standard & Chartered products of agriculture and food industry are the main exports of Lebanon and they tend to be the most affected products. In addition, the bank expects a decline in balance of payments since foreign direct investment, tourism and remittances from expatriates will decline because of the crisis, but this can be offset by lower bills of imports.

Meanwhile, the bank said that despite the sharp drop in U.S. interest rates, domestic interest rates remain the same, except in cases where the political atmosphere does increase the cost of borrowing. It predicted that the difference between interest rates in Lebanon and the United States will encourage lower rates of dollarization, and will contribute to further capital inflows to Lebanon.

With the intensification of the effects of the global financial crisis, employment began to decline gradually, international institutions look at capital flows between migrant workers throughout the United States to measure their weight on the country's total GDP, the potential effects of a contraction of the external balance and the effects on the return of workers and staff, who first hit the big institutions in most countries.

Since flows of Lebanese expatriates capital constitute about 20 per cent of gross domestic product, in other words, more than six billion dollars in 2008, Standard & Poor's and the World Bank published a report each, through which they announce their expectations of capital movements related to high rates of unemployment as the first direct reflection of the global financial crisis.

The agency’s of Standard & Poor has examined the classification of loans, and predicted that a significant drop in capital flows from foreign workers into Lebanon, would be detrimental to the current account balance of payments, and it shows that Economies of the Middle East and North Africa are based on capital flows of expatriates. The agency also noted that remittances from Lebanese represent about 27 percent of current account receipts, “which is the highest share in the region, compared to 19 percent for Jordan and 17 percent for Morocco, and 13 percent for Egypt, and 8 percent for Tunisia”.

According to the scenarios of the economy of affected countries in the region following the fall in remittances from expatriates who emphasize the impact of the global financial crisis, the agency mentioned that the financial crisis is a major challenge for Lebanese expatriates and will increase the risk of a significant decline in remittances, which represent a key factor in the local economy. The decrease of 5 to 10 per cent of capital inflows into Lebanon in 2009, lead to a current account deficit of about 10 per cent of GDP for 2009. In the worst case, the reduction of these transfers of 20 percent would result in a current account deficit of about 13 per cent of GDP, while the reduction rate of 30 percent would result in a deficit of 16 cent of local gross product, and a decrease of 40 percent will widen the current account deficit up 17 per cent of GDP, while a 50 percent contraction in capital flows would result in a deficit on current account19 percent of GDP for the year 2009.

Comparing the case of Lebanon and other states, the agency noted that the declining flow of funds 50 per cent increase on the current account deficit in Jordan to 18 per cent of GDP, and Egypt, 5 5 percent of GDP in Tunisia to 4, 8 percent of GDP, whereas in Morocco the increased deficit would reduce the surplus in the account for 2.7 percent of GDP in 2009.

The study also highlights the vulnerability of the country's external balance may result in lower capital inflows of migrants, based on the deteriorating current account balance and the current level of the current account. "Standard & Poor's" believes that Lebanon is the most vulnerable country in the region. The agency believes that such shipments would decline by almost 50 percent compared to 2008 one of the largest decreases in the region.

Also, Standard & Poor's suggests that this deficit would be one of the highest rates of States subject to the classification of credit in 2009. The agency also noted that in the past Lebanon’s balances have been affected by heavy pressure from a series of political conflicts and economic crises, but has shown remarkable resilience, which leads to the satisfaction of the current classification .

In parallel, the World Bank has re-estimated its forecast of private capital flows to the Middle East and North Africa, it metioned that such flows could decline by 1.4 percent in the best case or about 5.2 per cent in the worst cases during the year 2009.

According to a previous forecast issued in November 2008, the World Bank states that the decline in capital flows to the region would be 6.7 per cent in 2009, in the best case and 13.2 percent in the worst cases. The World Bank report attributes this to the estimates of the revised report, including estimates of the rates of capital from Gulf countries, which shows a decrease of less than 3 percent from the previous estimate, which showed a decrease of less than 9 percent.

The Bank noted that it was important to distinguish between the impact of the crisis on the emirate of Dubai, which is more dependent on trade, finance and real estate compared to other parts of the United Arab Emirates, where other countries of the Gulf Cooperation Council are mainly dependent on oil revenues. The World Bank announced that capital flows from Saudi Arabia were not linked to oil prices in recent years, while many countries of the Gulf Cooperation Council have adopted long-term strategies for infrastructure development, which have large cash reserves accumulated over the years, So it is unlikely that investment in infrastructure is slowing and that the number of migrant workers will be great.

CHAPTER V

CONCLUSION

In this study we have investigated in the first part the origins of financial crises in history, and then their effects on the economies of affected countries. In the third chapter we described the various aspects of the current financial crisis, its sources, its causes and effects, its domino effect on the world. Then on a more practical side we illustrated the influence of the crisis on the Lebanese market and the market characteristics facing the Lebanese crisis.

By collecting the necessary information to complete the research we experienced some limitations on the data on the Lebanese market. Overall statistics on Lebanon are scarce, incomplete and are not recent enough.

The Lebanese market in general is not widely affected by the global financial crisis. This amounts to several causes, Lebanon is a country that imports and exports very little well. In such a case, the crisis must have a negative effect on the economy, but this was not the case. Lebanon seemed the safest place for foreign capital in the traditional banking system and demand of the country.

In addition, the Beirut Stock Exchange admits a very small market compared with other countries in the region, the market now includes 14 listed companies. This was one of the main causes that have protected Lebanon from the effects of the crisis. Lebanese investors and Lebanese commercial banks are not heavily investing in the stock market since the market is still immature.

Another main cause of the lack of effects of the crisis on the Lebanese market is banking regulations regarding the credits. The Lebanese Central Bank has imposed too strict regulations regarding the approval of loans and mortgages more specifically. The guarantees are needed and the payments of personal loans may not exceed 20% of salary per month.

The Bank of Beirut has also banned the Lebanese commercial banks to invest in international financial markets, on the pretext that Lebanon is a country in need of liquidity and that government has an interest in Lebanese debt to banks. As the Lebanese commercial banks have invested most of their liquidity in Lebanese treasury bills, the liquidity share is then given to personal loans which has largely decreased in 2009. But in 2010, the share of personal loans and commercial loans began to increase. Can this be alerting? Especially that Lebanon is still considered as the safest place to for interntaional capital flows.

However, there are some indirect effects on the Lebanese economy, but their magnitudes are uncertain. Some economists are forecasting an increase in the unemployment rate in Lebanon, since there is a large percentage of Lebanese who work outside the country and who will lose their jobs because of the crisis and will return to Lebanon, but the Lebanese market could not hire all the Lebanese, and therefore the unemployment rate will rise. This can be partially true but the level of unemployment did not rise dramatically and the unemployed were absorbed by the lebanese market or opened their own business.

Other economists argue that expatriates capital flows to Lebanon will be lower as these expatriates will lose their jobs and return to Lebanon. This has not yet been totally proven.

In the case of the USA in order to overcome the crisis of subprime several steps must be taken. Rebuild market confidence in structured assets by going back to “original principles” on issues such as market transparency, standardization of contracts and the accounting treatment. By reducing the complexity of the structured exchange of goods, with simple structures, process and provide investors with the information they need to analyze the safeguards, such as requiring registration the pricing of assets, much of the current liquidity problem would be mitigated.

As for Lebanon, the banking system must maintain regulations of the system even if they seem demanding. But we must encourage the development of Small and Medium Enterprises and investment in agriculture and the Treasury. This period represents an opportunity for the Lebanese economy which is the least affected by the crisis countries and the government must take urgent measures to encourage investment in the country and increase the rate of growth and help reduce debt Public.

However, what remains uncertain is the effects of the European financial crisis today on the Lebanese economy. This recent 2010 crisis which is attributed to the US financial crisis can also have effects on the Lebanese economy, but it is still too early to assess these effects especially that the crisis has just begun.

CHAPTER VI.

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