

The Big Picture

A Message from the Chairman

DEAR
STAKEHOLDERS,



The past year was a mix of challenges and opportunities that allowed the Byblos Bank Group to demonstrate both the strength of its values and the resilience of its strategy. Like the people it serves, Byblos Bank recognizes that while only careful planning can ensure long-term success, the pace of change in the modern world also demands that we be prepared to deal with rapidly shifting circumstances.

As ever, our overriding goal at Byblos is to keep justifying the confidence placed in us by all of our stakeholders. This means living up to a variety of promises about what we do and how we do it, never sacrificing principle for the sake of convenience, and always thinking of new ways to meet or exceed expectations.

Above all else, banking and other financial services are about trust – a fact only reinforced by the crisis that gripped so many economies in late 2008 as the repercussions of lax credit and regulatory standards in some countries began to emerge. We at Byblos Bank are proud to have avoided the direct consequences, thanks in part to a vision of the future that embraces timeless truths from the past. This has enabled us to preserve the interests – and therefore the confidence – of our stakeholders at a time of widespread uncertainty.

Thus it was that in 2008 the Group turned in exceptional performances on a variety of levels. Much emphasis was placed on consolidation after several years of expansion in both our home Lebanese market and in foreign ones. Our medium- and long-term strategies call for precisely such a process in order to ensure that our growth is sustainable, and the exercise only bolstered the parallel work of planning for further expansion in the years ahead. Nor did either task hamper the day-to-day operations of Byblos Bank, which turned in the strongest profit growth among Lebanon's three largest banks.

Going forward, the Group will continue to stand by its clients in Lebanon and abroad. Wherever we operate, our policy is to help foster healthy development of economies, communities and the environment. Business is business, but we also embrace our role as a contributor to society and to preserving the environment for future generations. It is one we have played throughout our existence, not just since it became fashionable to put a human face on corporate activities.

Internally, this emphasis on people manifests itself in the Group's unceasing efforts to provide training and other forms of education for its employees. We also encourage members of our team to adopt a spirit of service in their personal lives as well. All this goes hand in hand with the timeless values that continue to shape everything we do. It also contributes to a collegial style of work, promotes a cooperative relationship between management and staff, and enhances employee loyalty. This harmonious atmosphere is part of a virtuous circle in which the interests of Byblos employees, clients and shareholders are perpetually self-reinforcing. It also drives the very real implementation of our slogan, "Your Bank for Life".

Externally, our environmental and social roles also figure prominently in our corporate decision-making. Our customary concern for the communities we serve, for example, was strengthened in 2008 by careful study of ways and means to support rural development. Byblos Bank also encourages youth to invest in all manner of productive enterprise, from the latest technologies to modernizing traditional businesses like agriculture and artisans' workshops.

On a personal note, this message would not be complete without a salute to Albert Sleiman Nassar, a prolific industrialist and generous philanthropist who has passed away after many years of dedicated service and wise counsel on the Board of Directors of Byblos Bank. Mr. Nassar's contributions to the development of the Byblos Bank Group were too numerous and too extensive to describe or even list here, but suffice it to say that his steady hand – in good times and in bad – was instrumental in making this organization what it is today. His presence will be sorely missed, but his long and productive life left numerous legacies that will continue to be cherished by family and friends alike.

We are in no doubt that just as qualities like imagination, integrity and mettle have allowed the Byblos team to persevere in trying times, so will they enable us, our customers, our shareholders, and the communities we serve to take full advantage of improving conditions in the coming months and years. Our faith in the way we do business is strong because it rests on a foundation of interests shared and commitments honored. As the following pages will make clear, our results speak for themselves.

Sincerely Yours,



François S. Bassil
Chairman and General Manager

The Economic Environment in 2008

OVERVIEW

Lebanon's economic activity was characterized by three stages in 2008.

The first stage spanned the first four and a half months of the year and reflected the political uncertainties that prevailed in 2007, including the vacuum at the presidential level, a closed Parliament and a caretaker Cabinet, and culminated in threats of destabilization and a severe deterioration in security conditions in early May. As such, consumer confidence and investor sentiment continued to be negatively affected, and the economy could not fully benefit from a favorable regional environment of high oil prices and abundant liquidity.

The second phase covered the four months from the middle of May until the middle of September and started with a reduction in political instability, the reopening of Parliament, the election of a new president, and the formation of a national unity Cabinet. As a result, the overall outlook turned positive and the economy resumed normal function, leading to a record tourism season, an increase in capital inflows, remarkable growth in bank deposits, and a rise in consumer confidence.

The third stage began with the global financial meltdown that started in the middle of September and changed the outlook for the economies of the Middle East and North Africa region, particularly the Gulf countries. Lebanon withstood the early shocks of the crisis due to a strong and well-managed banking sector, tight regulations, high liquidity and a stable exchange rate. But as an open economy with strong links to Gulf Arab markets and a dependence on its Diaspora, the Lebanese economy is insulated from the crisis but not immune to it, and the banking sector is resilient but not isolated from its environment. As such, the year ended with a new set of challenges for the Lebanese economy and its financial sector, with expectations that the global recession and a marked decline in economic activity in the Gulf Cooperation Council countries will reduce Lebanon's earnings from tourism, remittances, exports and foreign direct investment, therefore leading to a slowdown in economic growth.

REAL AND EXTERNAL SECTORS

Economic activity was positive overall in 2008, with real GDP growth for the full year estimated at between 7 percent and 8.5 percent, driven mostly by construction, tourism, and financial services. The Central Bank's Coincident Indicator, a proxy for overall economic activity, averaged 198.4 points in 2008 compared to 180 points in 2007, rising by 10.2 percent year-on-year. Further, the trade deficit reached \$12.65 billion in 2008, up 40.6 percent from \$9 billion in 2007. Imports rose by 36.5 percent to \$16.13 billion, while exports increased by 23.5 percent to \$3.48 billion year-on-year. The coverage ratio reached 21.6 percent in 2008, down from 23.8 percent in 2007. Part of the rise in overall imports is attributed to higher commodity prices and a weak U.S. dollar for most of 2008. In parallel, the balance of payments recorded a surplus of \$3.46 billion in 2008, compared to a surplus of \$2.04 billion in 2007, due to an increase of \$7.28 billion in the Central Bank's net foreign assets combined with a decrease of \$3.82 billion in the commercial banks' net foreign assets.

FISCAL SITUATION

The fiscal situation deteriorated but remained manageable in 2008, as the deficit reached \$2.92 billion, up 14.7 percent from 2007. The deficit was equivalent to 29.3 percent of total budget and Treasury expenditures compared to 30.5 percent in the previous year. Overall, government expenditures reached \$9.95 billion in 2008, up 19.2 percent year-on-year, while total revenues increased by 21.2 percent to \$7.03 billion. Debt servicing increased by 5.6 percent year-on-year and totaled \$3.3 billion, accounting for 45 percent of total expenditures and 33 percent of budgetary spending. This absorbed 50.6 percent of overall revenues and 46.8 percent of budgetary receipts. Excluding debt servicing, the primary surplus reached \$2.7 billion, or 36.8 percent of budgetary expenditures, compared to a surplus of \$1.97 billion, or 29.4 percent a year earlier. The fiscal deficit was equivalent to 10.1 percent of GDP in 2008, almost unchanged from 10.2 percent of GDP in 2007.

In parallel, Lebanon's gross public debt reached \$47 billion at the end of 2008, constituting an increase of 11.9 percent year-on-year. Domestic currency debt increased by 24.3 percent to \$25.9 billion, while foreign currency-denominated debt decreased by 0.4 percent annually to \$21.1 billion. Net public debt, which excludes the public sector's deposits at the Central Bank and at commercial banks from overall debt figures, rose by 6.3 percent to \$41.5 billion. Local currency debt accounted for 55 percent of gross public debt at end-December 2008, compared to 49.5 percent at end-December 2007, while foreign currency-denominated debt represented 45 percent of the total at end-December 2008, down from 50.5 percent a year earlier. The gross public debt was equivalent to 162 percent of GDP at end-2008, down from 168 percent at end-2007.

MONETARY SITUATION

Lebanon's monetary authorities have proved highly adept at maintaining stability in times of crisis. Indeed, the Lebanese pound's unofficial peg to the U.S. dollar has been sustained and the Central Bank has accumulated adequate resources to keep the currency stable, as gross reserves increased considerably during the year to reach \$17.06 billion at end-December 2008, equivalent to about 69 percent of money supply (M2), and reflecting the continuing ability of the Central Bank to meet foreign currency demand. Also, foreign reserves were equivalent to 15 months worth of imports, well above the four-month reference and a high level by emerging market standards.

INFLATION

Inflation has been under control for the past 10 years due to the authorities' monetary policy of maintaining a stable exchange rate and low inflation. Inflation averaged 10.4 percent in 2008 and ended the year at 6.4 percent. Inflation reached a peak of 14 percent in July 2008 due to the sharp rise in international commodity prices and a weak U.S. dollar. Lebanon imports most of its oil needs and has an import-based economy, as the value of imports historically has been equivalent to about five times that of exports. However, inflationary pressures receded following the sharp drop in global commodity prices and the relative strengthening of the U.S. currency later in the year.

BANKING SECTOR

The banking sector remains the backbone of the Lebanese economy, and ended the year profitable, highly liquid and well capitalized, unlike most banking sectors in both advanced and emerging economies. Bank assets were equivalent to 326 percent of GDP and deposits equivalent to 269 percent of GDP at the end of 2008, among the highest such ratios in the world. Banks continued to compete aggressively for corporate and retail clients domestically, while the sector continued its asset diversification strategy by expanding regionally and in emerging markets. The sector remained resistant to global financial shocks and proved it can finance the private sector while supporting the public sector's needs, at a time when governments around the world have been forced to bail out their banking systems.

Bank assets reached \$94.25 billion at the end of 2008, up 14.6 percent year-on-year, while bank deposits totaled \$77.8 billion, up 15.6 percent from end-2007, reflecting continued confidence in the sector. Deposits in Lebanese pounds rose by 55.2 percent to \$23.7 billion, while those in foreign currencies increased by 4 percent year-on-year to \$54.1 billion. Non-resident foreign currency deposits reached \$10.6 billion at end-2008, increasing by 16.2 percent from end-2007. In parallel, deposits of non-resident banks reached \$4.3 billion, up by 6.2 percent from the end of the previous year. The dollarization rate of deposits reached 69.6 percent at end-2008, down from 77.3 percent a year earlier, reflecting the decrease in exchange rate risk following the Doha Accord in May and the resulting massive conversion from foreign currencies into Lebanese pounds.

Broad money supply (M3) grew by 14.7 percent in 2008 compared to 12.4 percent in 2007. Loans to the private sector amounted to \$25 billion, up 22.6 percent year-on-year, highlighting the sector's financing of the national economy. The dollarization rate in private sector lending reached 86.6 percent, almost unchanged from a year earlier. The average lending rate in Lebanese pounds was 9.95 percent in December 2008 compared to 10.1 percent a year earlier, while the same average in U.S. dollars stood at 7.47 percent relative to 8.02 percent at the end of 2007. Claims on the public sector stood at \$25.4 billion, up 18.2 percent year-on-year, and accounted for 50.4 percent of the banking sector's total loans.

Capital funds reached \$7.1 billion, a 13.4 percent annual increase, with core capital rising by 14.5 percent to \$6.75 billion. Also, the ratio of loans to deposits in foreign currencies stood at 40.1 percent, well below the Central Bank's limit of 70 percent, and up from 33.9 percent a year earlier. In parallel, the same ratio in Lebanese pounds was 14.2 percent compared to 18.2 percent a year earlier. The ratio of total private sector loans to deposits stood at 32.2 percent, up from 30.4 percent at end-2007.

The net income of the largest 11 banks improved substantially, reaching \$1.067 billion in 2008 compared to \$800 million in 2007. But the sector's profitability stagnated, as net interest margin was unchanged at 2 percent, its net average return on equity slightly improved to 14 percent in 2008 from 12.1 percent in the previous year, and its net average return on assets rose marginally to 1.1 percent from 1 percent in 2007. But given the financial turmoil that swept across banking sectors in advanced and emerging economies, the profit indicators continue to reflect the resilience of the Lebanese banking sector.

REGIONAL OUTLOOK

The Middle East saw economic growth of 5.9 percent in 2008, driven in the first half by continuing positive sentiment, high levels of liquidity, and capital inflows. However, the global crisis has not spared the region, with both oil exporting and non-oil exporting countries feeling the impact of the downturn in the second half of the year. Indeed, oil prices declined, local property and equity markets came under pressure, domestic liquidity conditions deteriorated, and financial system strains emerged in a number of countries. Further, the substantial decline in external demand is likely to reduce export growth, workers' remittances, and tourism revenues.

Within this context, the Lebanese banking sector's regional expansion in the past six years and the strong linkages of the Lebanese Diaspora to the local economy helped Lebanese banks take advantage of opportunities across the region during most of 2008, but also rendered them susceptible to economic and financial developments in the region. As such, Lebanese banks are bound to adjust to the more subdued economic and financial outlook for the region, with growth estimated at 2.5 percent in 2009 and oil prices not expected to return to their record highs in the foreseeable future.