February 2012
IMF Country Report No. 12/39

Lebanon: 2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Lebanon

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Lebanon, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 23, 2011, with the officials of Lebanon on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 10, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 23, 2012 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Lebanon.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

LEBANON

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

January 10, 2012

KEY ISSUES

Context. A loss of confidence from domestic political and regional uncertainty has brought an end to a four-year spell of impressive economic growth. Growth is expected to fall to 1–2 percent in 2011 from 8 percent per year in 2007–10. The economy could grow at 3–4 percent in 2012, but the outlook hinges on improvements in the external environment. Downside risks are high, mainly from the uprising in Syria, further escalation of which could have serious political and economic repercussions on Lebanon.

Navigating uncertainty and safeguarding macro stability. The challenging external environment calls for strong domestic policies that instill confidence. The 2012 budget should target a small primary surplus to assure markets that fiscal discipline will be maintained. Embedding the budget in a medium-term agenda would facilitate prioritization. There is also scope for making fiscal policy more equitable over time. Investment in the electricity sector is welcome but should go in parallel with reforms to improve its efficiency. Letting interest rates rise would make government T-bills more attractive to banks and thus allow the treasury to reduce reliance on the Banque du Liban (BdL).

Securing sustained inclusive growth and economic resilience. Faster, sustained, and more inclusive growth in the medium term requires investment and reforms in infrastructure as well as improvements in the business climate and the labor market. Limiting wage increases to productivity gains would safeguard competitiveness. Fiscal policy should be anchored in a sizeable reduction in the debt-to-GDP ratio (one of the highest in the world). The BdL's income position needs strengthening. Bank regulation and supervision should focus on early problem detection.

Approved By
Ratna Sahay and Tom Dorsey

Discussions took place in Beirut during November 8–23, 2011. The staff team comprised Mses. Kostial (head), Kyobe, Luca, Nakhle (local economist), Mr. Sadikov (all MCD), Ms. El-Ganainy (FAD), Mr. Gutierrez (MCM), and Ms. Riad (SPR). Ms. Choueiri (OED) participated in discussions during the second week of the mission. Staff met the Prime Minister, the Governor of the Banque du Liban, the Minister of Finance and several other cabinet members and officials of the administration, members of parliament, and representatives of the private sector, civil society and academia. The mission issued a press release.

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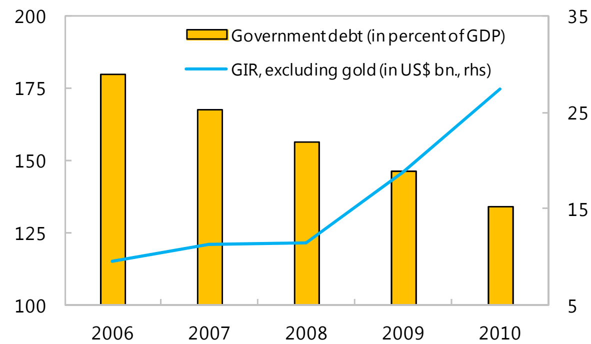
BACKDROP

1. **Lebanon's economy lost momentum in 2011 after four strong years.** Increased polarization of political parties since mid-2010, the fall of the coalition government in January 2011, and prolonged talks over the make-up of the new government until its formation in June shook market confidence. Compounded with the regional unrest, this led to an economic downturn, adversely affecting fiscal balances and financing conditions.

2. **The authorities have so far skillfully managed the downturn.** The Banque du Liban (BdL) relied on its large foreign reserves built up during the upswing to intervene forcefully when the Lebanese pound came under pressure from deposit outflows and currency conversions in the wake of the government crisis in January 2011 (Figure 1). The improved fiscal position—thanks to the marked decline in the debt-to-GDP ratio since 2006 and the sizeable primary surplus in 2010—freed up room for an accommodative fiscal stance in 2011 and allowed the government to maintain favorable access to the foreign currency debt market (Box 1).

Government Debt and Gross International Reserves



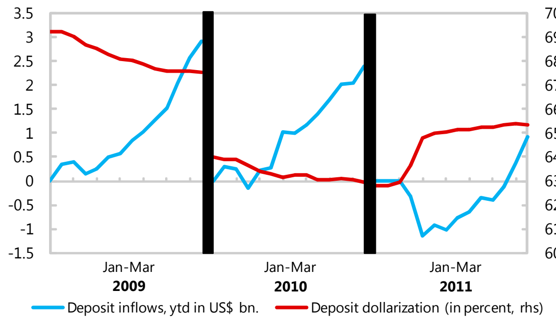
Sources: Lebanese authorities; and IMF staff estimates.

3. **Vulnerabilities have come to the fore.** The downturn exposed Lebanon's high dollarization and short maturity of the deposit base as well as the government's large debt and recurrent financing needs. At the same time, the regional unrest highlighted pressing needs to address unemployment and social inequality, and pressures are high for large wage increases in both the public and the private sectors.

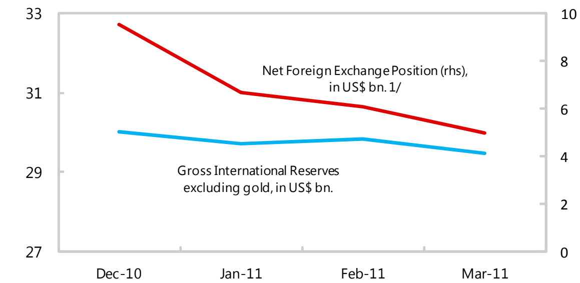
4. **Rising risks call for strong domestic policies.** Lebanon is facing a difficult global, regional, and domestic environment simultaneously for the first time in over a decade. Domestic policies should thus aim at instilling confidence and tackling key policy challenges—preserving macroeconomic stability and paving the way for a more resilient, dynamic, and inclusive economy.

Figure 1. Market Pressures in January–March 2011

The fall of the government in January triggered deposit outflows and currency conversions, which led to pressures on the pound.

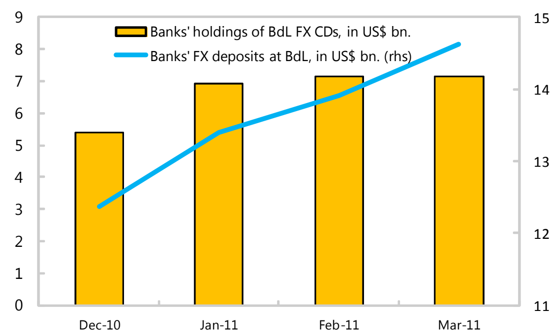


The BdL defended the pound, losing about half of its net foreign exchange holdings, but gross reserves remained unchanged...

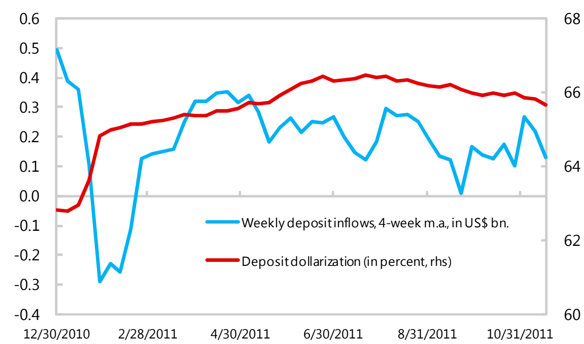


1/ Excluding gold and net claims on the government.

...because the BdL issued foreign currency CDs and banks placed excess reserves with the BdL.



Market pressures subsided and deposit inflows resumed in March, while dollarization started to fall in late summer.



Sources: Lebanese authorities; and IMF staff estimates.

Box 1. Policies Since the 2010 Article IV Consultation

Macroeconomic policies broadly followed staff advice. The 2010 primary surplus surpassed staff's recommended target by almost one percent of GDP. This reflected lower-than-expected capital spending because the budget was not passed (staff supported an increase to address Lebanon's infrastructure deficit). To slow deposit inflows and contain reserve accumulation, the authorities gradually reduced interest rates in 2009–10 and kept them unchanged since mid-2010, in line with staff advice. Starting in late 2010, domestic and external shocks affected Lebanon's economic performance, and the context for staff advice on near-term policies changed significantly.

Progress on structural reforms was mixed. Cabinet approved a reform strategy for the electricity sector, while parliament passed laws on investments in the electricity sector and on the development of capital markets. Banking sector supervision has continued to improve and some progress was made in modernizing tax administration and reforming public financial management, including by extending budget coverage and enhancing transparency. Reforms in other areas have though been slow (e.g., in telecom and statistics) or even stalled (e.g., in introducing a global income tax and implementing a Treasury Single Account).

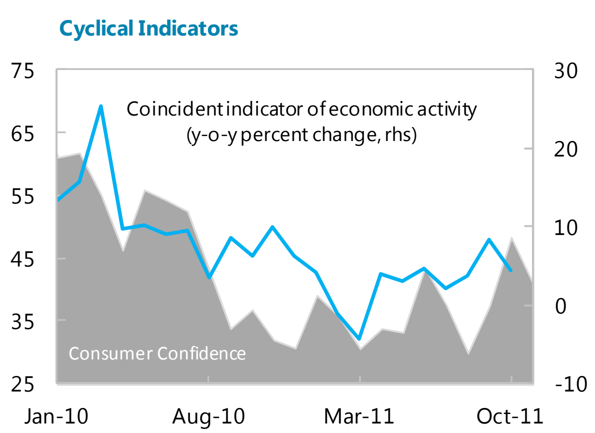
THE ECONOMIC CONTEXT

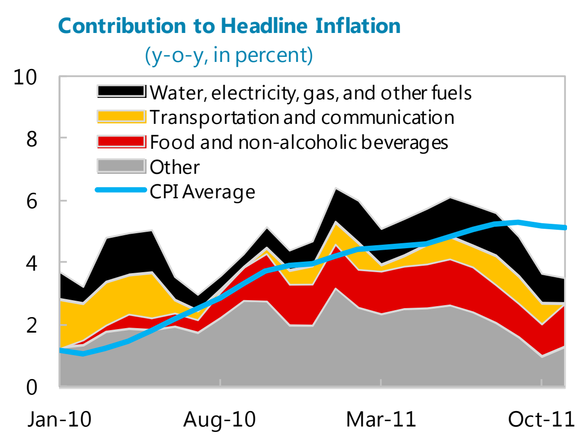
The downturn may be bottoming out, but the road to recovery is yet to emerge. Risks are to the downside, with the conflict in Syria weighing heavily on the outlook. Medium-term growth prospects remain moderate without reforms.

A. 2011—A Lost Year

5. **Growth has virtually come to a halt.** Domestic demand is depressed, slowed down by falling investment, as are exports, hit by regional uncertainty. Real estate (Figure 2), tourism, retail and wholesale trade—key drivers of the recent high growth accounting for more than half of GDP—have been hit hard. With latest indicators pointing to some pick-up in activity, growth could reach 1–2 percent in 2011, markedly below an average of 8 percent during 2007–10.

6. **Inflation is up and the current account has weakened.** Inflation has risen since mid-2010, though the halving of the fuel excise in February 2011 dampened the inflationary impact of higher oil prices. Headline inflation averaged about 5 percent in 2011, but core inflation remained moderate. Despite weak import demand, the current account deficit is set to widen to about 14 percent of GDP in 2011 owing to higher food and fuel prices and a drop in tourism.





Sources: Lebanese authorities; Byblos Bank Group; and IMF staff estimates.

7. **Credit growth is slowing.** The economic downturn, particularly the cooling of the real estate market, led to a slowdown in credit demand. At end-October, annual credit growth stood at 15 percent compared with 25 percent in 2010 (Lebanon—Selected Issues, 2012, Chapter 1). With banks competing for fewer domestic borrowers, lending rates have declined.

8. **Deposit inflows remain robust, but dollarization is up.** Inflows resumed in March following deposit outflows and currency

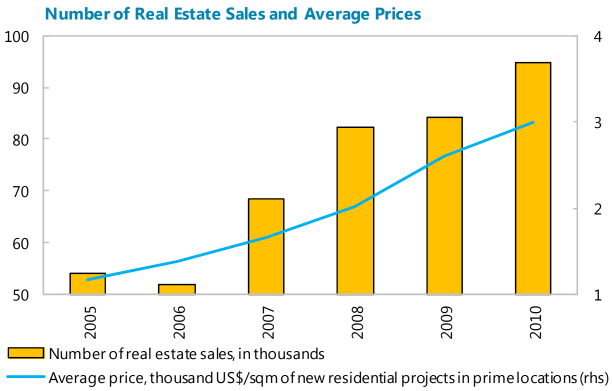
conversions earlier in the year. With domestic interest rates offering an attractive premium over the low global rates, deposits are growing at 9 percent annually. Most of that growth however was in foreign currency deposits, and only recently have pound deposits started to pick up. As a result, deposit dollarization—an indicator of confidence in the pound—is on a downward trend though still above its end-2010 level. Sovereign and CDS spreads have risen and the stock index has dropped sharply, broadly in line with emerging market and regional averages.

9. **Despite interventions, BdL's gross foreign reserves increased.** Interventions in January took a toll on its net foreign exchange position, but BdL recouped reserve losses by issuing foreign currency Certificates of Deposit (CDs) and because banks placed large excess reserves with the BdL. At about $32 billion as of end-November, reserves cover 27 percent of broad money or 43 percent of foreign currency deposits. In staff's view, they would be sufficient to withstand a shock of similar magnitude as the 2006 war with Israel and the 2005 assassination of Prime Minister Hariri.

10. **Fiscal policy was accommodative.** Tax revenue dropped, reflecting the downturn and the reduction in the fuel excise (with an annual loss of almost one percent of GDP). Overall revenue though should increase slightly as a share of GDP because Telecom is expected to resume its transfers to the budget. Primary expenditure was up, owing largely to an increase in military wages and allowances and higher transfers to the electricity company. As a result, the primary surplus is expected to fall to about one percent of GDP from 2.7 percent of GDP in 2010.

Figure 2. Real Estate Sector Developments

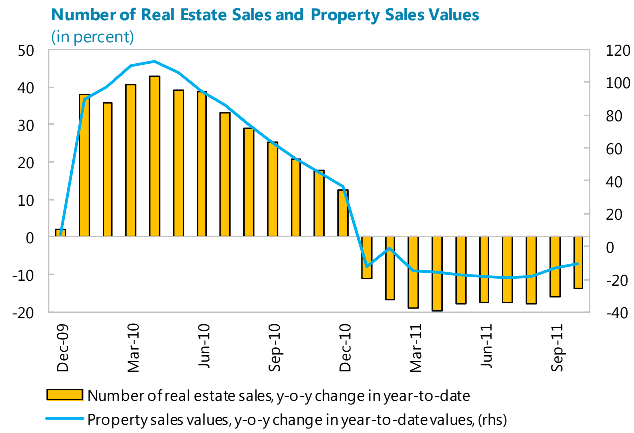
Real estate boomed during 2006–09...



Sources: IMF staff calculations based on data from the Real Estate Registry, Global Property Guide, Credit Libanais, and BdL Statistics Department.

- Lebanese nationals (almost two thirds of which are residents) accounted for 80–90 percent of the market.
- Most of the remaining demand came from the Gulf Cooperation Council countries.

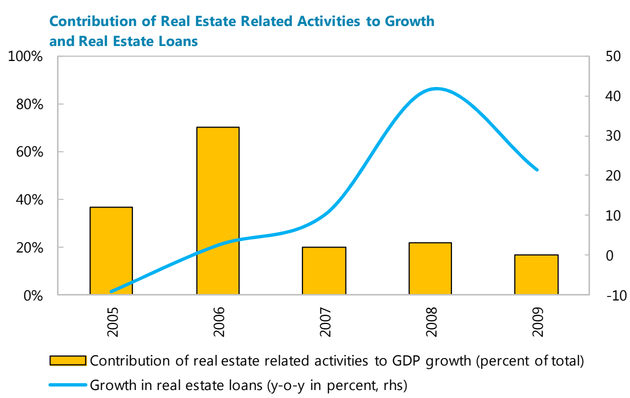
...but the market started to correct in mid-2010.



Source: IMF staff calculations based on data from the Real Estate Registry.

- Prices are now 10–15 percent off their peaks.
- While the boom was driven by the luxury apartment segment, demand has shifted to smaller apartments.

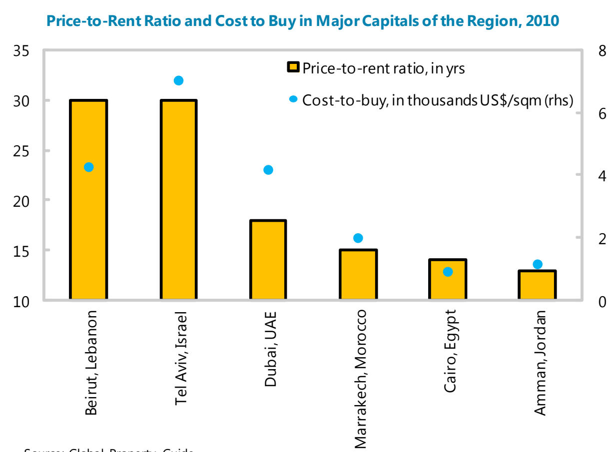
The correction is adversely affecting the economy...



Source: IMF staff calculations based on data from the national accounts and the Real Estate Registry. Starting 2008, real estate loans include construction, housing and real estate related activities loans. Prior to that, only construction loans are included.

- Real estate and related activities contributed one fifth to GDP growth during 2005–09.
- Real estate loans now account for more than a third of all loans, requiring close monitoring of nonperforming loans.

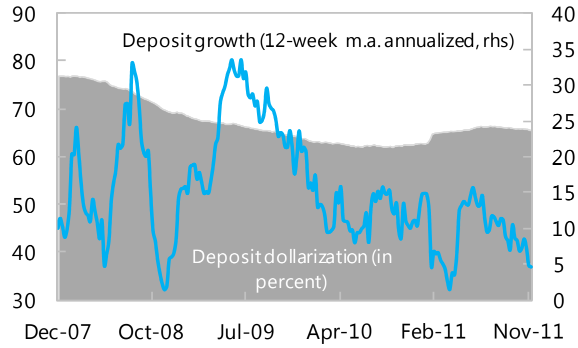
... but could bring prices more in line with the region.



Source: Global Property Guide.

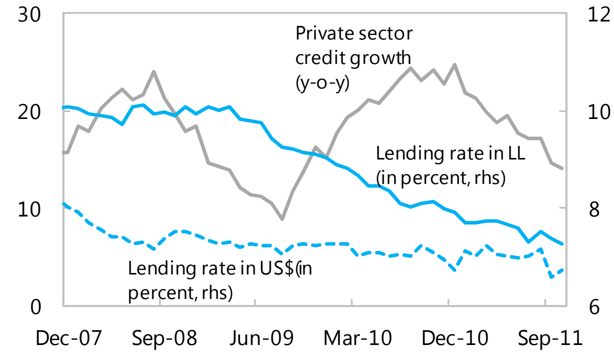
- Beirut's real estate was one of the most expensive in the region in 2010.

Deposit Growth and Dollarization

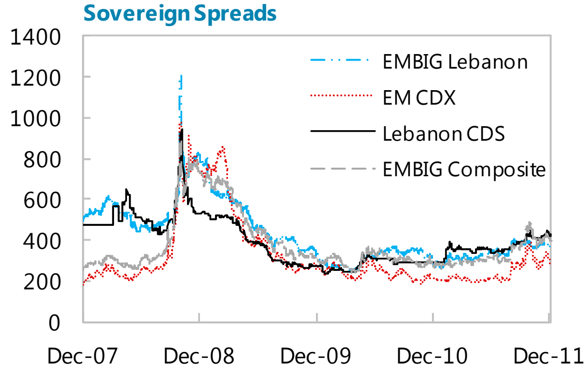


Sources: Lebanese authorities; and IMF staff estimates.

Private Sector Credit and Interest Rates

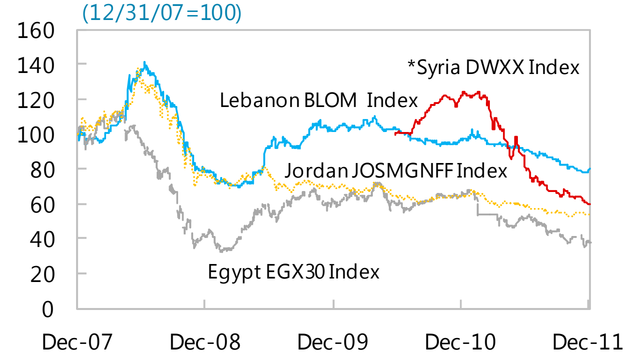


Sovereign Spreads



Sources: Bloomberg; and IMF staff estimates.

Stock Market Indices
(12/31/07=100)



*Syria's DWXX begins on 6/8/2010, set at 100.

B. Outlook and Risks—Regional Uncertainty Looming Large

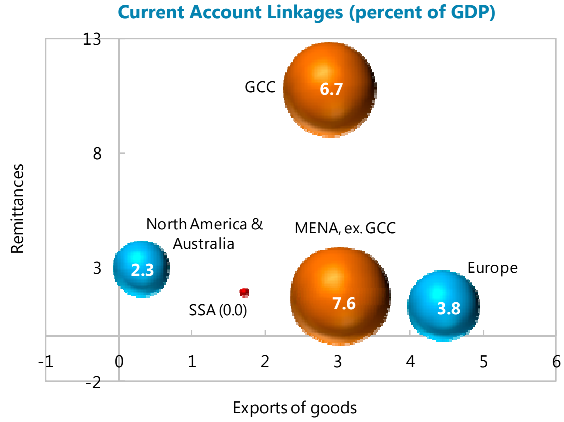
11. Growth could increase in 2012. Assuming that the external environment improves, growth is projected at 3½ percent, supported by a recovery in tourism and retail trade buoyed by an improved domestic environment and continued growth in the Gulf Cooperation Council (GCC) countries (Box 2 and Lebanon—Selected Issues, 2012, Chapter 2). Planned increases in public investment, including a large-scale project in the electricity sector, could provide an additional boost. Headline inflation will stay elevated despite the recent retreat in food and fuel prices because of wage increases and a possible VAT rate hike. With a rebound in exports expected to be largely offset by higher capital imports, the current account deficit would remain broadly unchanged.

12. But near-term risks are large and to the downside, mostly because of Syria. The uprising in Syria keeps Lebanon on edge given their close political and economic ties. It has already affected investor confidence in Lebanon, disrupted tourism, increased costs of bilateral and transit trade, and prompted banks to reduce their exposure to Syria.

Box 2. Lebanon's Interconnectedness

Lebanon is highly integrated with the world. Exports of goods and services amount to about 60 percent of GDP and imports of goods and services to 75 percent. Emigration has been traditionally high, and the Lebanese diaspora is a source of substantial remittances of about 15 percent of GDP. FDI and nonresident deposit inflows each are estimated at 11 percent of GDP on average over the last five years.

Current Account Linkages (percent of GDP)

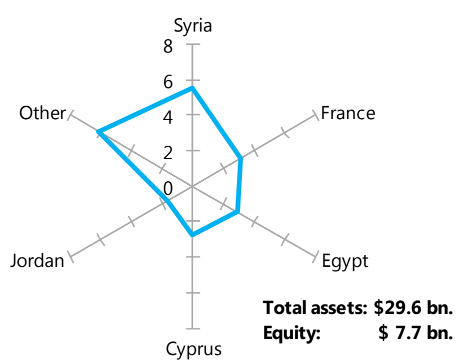


Size of bubble: Tourism receipts.
Color of bubble: 2012 $GDP Growth > 7% = red; 5-7% = orange; <5% = blue.

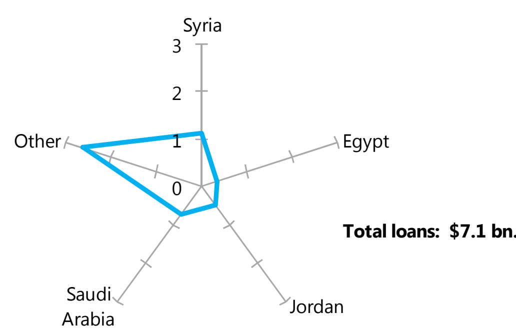
Current account links are strongest with Arab countries, especially the GCC. *MENA* accounts for two-thirds of tourism and remittances inflows and more than 40 percent of goods exports, with the region's oil exporters contributing most. Among countries affected by the Arab Spring, *Egypt, Libya, and Tunisia* make up 4 percent of goods exports and ½ percent of tourism. While bilateral trade with *Syria* accounts for 6–9 percent of goods exports and tourism, transit trade and tourism through Syria from the GCC, Jordan, and Turkey are reportedly more substantial. Exposure to *Europe* stems primarily from exports of goods (4½ percent of GDP), mainly sales of gold items to *Switzerland*. Links to *the U.S. and Australia* have increased in recent years, reflecting higher remittances and tourism.

Financial links are mostly with MENA and Europe. Staff estimates that almost 40 percent of total bank deposits belong to nonresidents, a significant share of which comes from Lebanese living in *MENA*. Wholesale funding is limited and mainly from BIS-reporting banks ($5.5 billion or 4 percent of bank assets). On the asset side, the BdL and commercial banks hold three quarters of their foreign assets in deposits with BIS banks, reportedly most in Europe. Commercial banks have subsidiaries/branches in or direct lending to *MENA, Europe, and Africa*, but equity and loan exposures remain moderate as a share of their assets (see charts). The largest exposure in terms of assets and loans is to Syria, with $7½ billion assets in seven subsidiaries and $1½ billion in direct loans from Lebanon. Exposure to peripheral euro zone countries is small. Foreign banks in Lebanon are small, though some hold minority shares in Lebanese banks. Lebanese nonbanks mostly rely on domestic funding and have limited net claims on BIS banks ($5 billion). Most FDI (90 percent) comes from *Kuwait, Qatar, Saudi Arabia, and the UAE*.

Banks: Assets of Foreign Subsidiaries and Branches (percent of banking sector assets)



Banks: Loans to Nonresidents (percent of banking sector assets)



Sources: Lebanese Authorities; WEO; and IMF staff estimates.

Further escalation of the uprising and sanctions by the Arab League could have far-reaching political and economic repercussions. Lebanon is also facing risks related to the worsening outlook in Europe. While the direct impact would likely be muted, second-round effects could be sizeable if regional oil exporters were affected via a lower oil price or financial losses. Though the recent payment of dues to the Special Tribunal for Lebanon (STL) brought to conclusion a much debated matter, domestic tensions could flare up over other divisive issues, including Lebanon's stance on Syria, future cooperation with the STL, and wage increases. A materialization of these risks could dampen growth prospects and push up the sovereign risk premium and interest rates, thus worsening government debt dynamics, eroding bank profit margins, and exposing maturity mismatches on banks' balance sheets.

13. At unchanged policies, the medium-term growth outlook is moderate. With output at its estimated potential, Lebanon can no longer rely on rapid growth as in the past years. Growth in the medium term must come from new sources, which will be difficult to tap without addressing structural weaknesses. In the absence of reforms, growth is expected to remain modest at 4 percent.

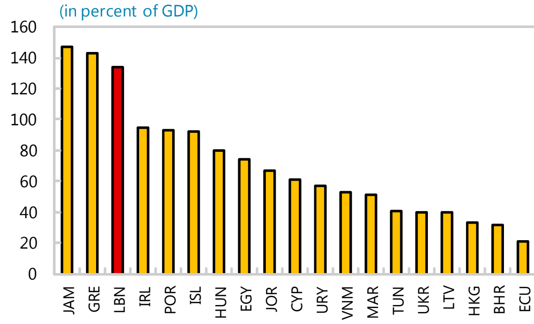
14. Vulnerabilities remain large. The economy has become more resilient in recent years thanks to a marked reduction in the government debt-to-GDP ratio and a build-up of large foreign reserves. Still, government debt at 134 percent of GDP at end-October 2011 (about 40 percent of which is in foreign currency) remains among the highest in the world and gives rise to large recurring financing needs. Financing of the persistent and large current account deficits hinges on continued inflows of nonresident deposits. The banking sector (with assets of 350 percent of GDP) funds itself from short-term deposits, about a quarter of which it intermediates to deposits at the BdL and another quarter to long-term government debt, thus exposing itself to the sovereign and a maturity mismatch (Figure 3). Finally, banks' expanded presence in the region makes them vulnerable to the ongoing unrest.

15. The authorities broadly shared staff's assessment of the outlook and risks. The uprising in Syria, particularly if protracted, presents the most serious risk to the economy. Because the impact from an escalation is impossible to quantify at this point, staff and the authorities discussed broad contingency measures. The authorities emphasized that an assessment of vulnerabilities should factor in Lebanon's proven resilience to withstand past shocks in large part due to loyal depositors (Figure 4). On medium-term growth prospects, they expected investment in the electricity sector to boost potential growth.

Figure 3. Lebanon's Macrofinancial Vulnerabilities

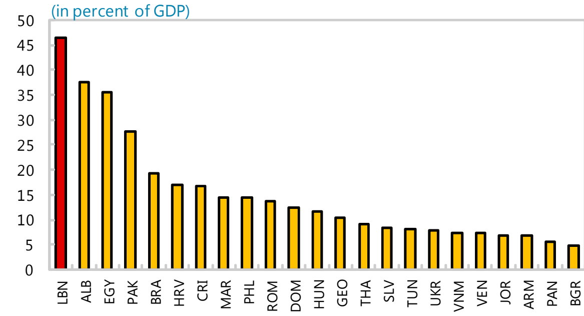
Lebanon's government debt is among the highest in the world...

Government Debt, 2010
(in percent of GDP)



...giving rise to large government financing needs.

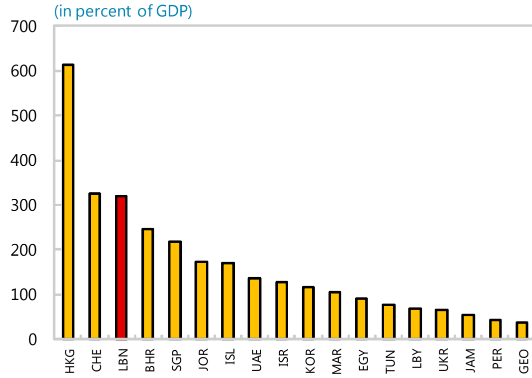
Government Gross Financing Needs, 2011
(in percent of GDP)



Note: Figures for Lebanon include early redemption of 2012 Eurobonds (see paragraph 23).

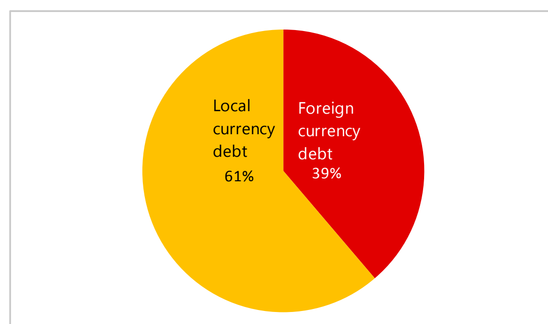
The large domestic banking sector...

Bank Assets, 2010
(in percent of GDP)



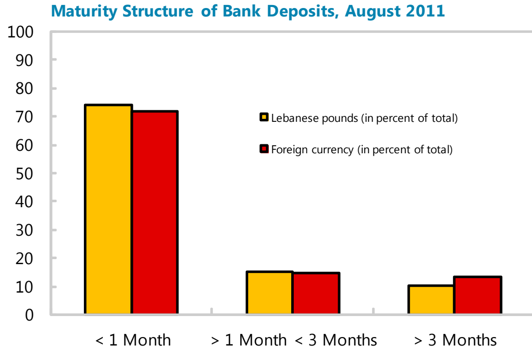
...holds most of the debt, more than one third of which is in foreign currency.

Currency Composition of the Government Debt, October 2011



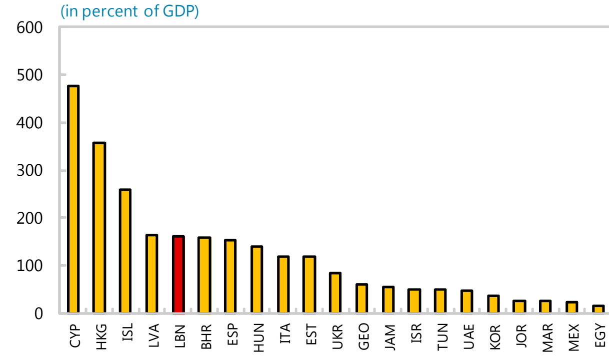
Banks rely largely on deposits for funding, though most are short-term...

Maturity Structure of Bank Deposits, August 2011



...with a significant share coming from nonresidents, resulting in high external debt.

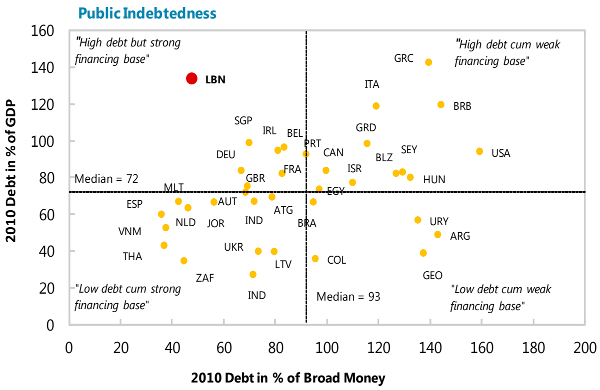
External Debt, 2010
(in percent of GDP)



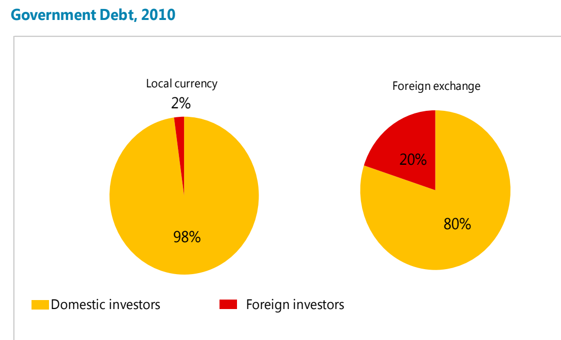
Sources: Lebanese authorities; WEO; IFS; and IMF staff estimates. Comparisons are for selected advanced and emerging countries for which consistent data were available.

Figure 4. Defying Gravity

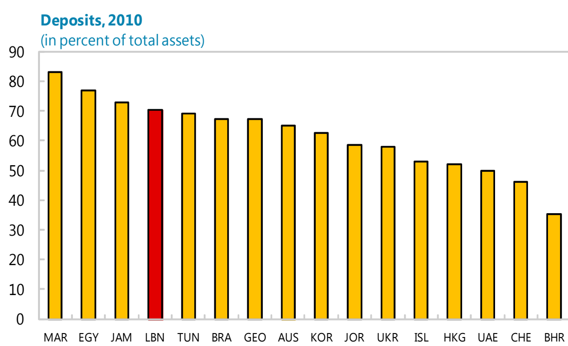
Debt is high, but the large domestic banking sector provides a strong financing base...



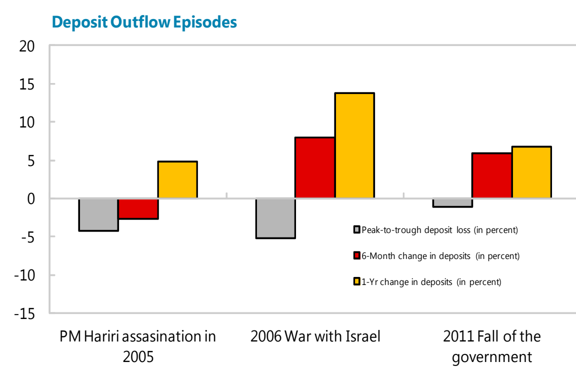
...and thus, government debt is held largely domestically.



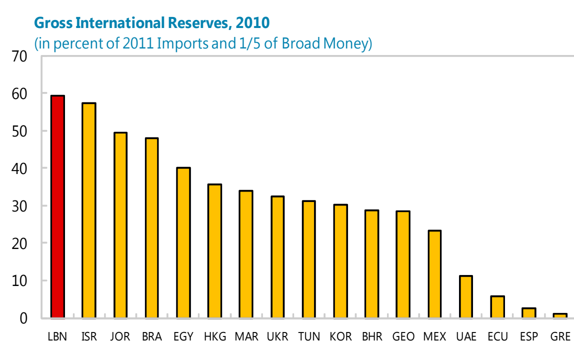
Banks rely on deposits rather than on cross-border wholesale funding...



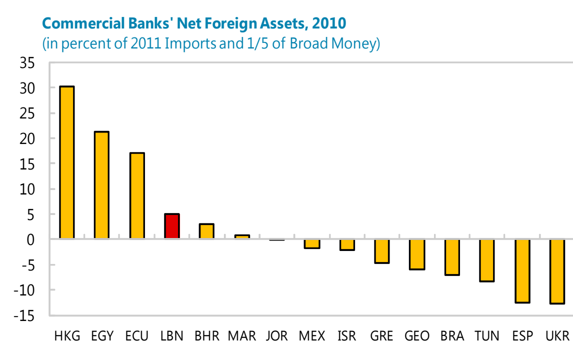
...with depositors, largely the Lebanese diaspora, having demonstrated loyalty during past crises.



BdL foreign reserves are adequate to resist a fairly large shock...



...complemented by net foreign assets of commercial banks.



Sources: Lebanese authorities; WEO; IFS; and IMF staff estimates. Comparisons are for selected advanced and emerging countries for which consistent data were available.

POLICY THEME #1—NAVIGATING UNCERTAINTY AND SAFEGUARDING MACRO STABILITY

The near-term challenge is to instill confidence and preserve macroeconomic stability in the face of uncertainty and spending pressures. This requires above all a prudent 2012 budget. In addition, interest rates should be allowed to rise to reduce government reliance on BdL financing.

A. The 2012 Budget—Supporting Confidence, Growth, and Equity

16. The first draft of the 2012 budget is being revised. The draft budget envisaged an increase in primary expenditure by 4 percent of GDP, largely for capital spending, including investment in electricity generation capacity. Revenue would increase by 1 percent of GDP, reflecting a drop in nontax revenue and substantial tax measures. The latter include primarily an increase in the VAT rate (to 12 from 10 percent), an increase in the withholding tax on interest (to 8 from 5 percent), and a 3 percent fee on real estate sales. Full implementation of the budget[1] would have implied a primary deficit of 2 percent of GDP. The authorities noted that the budget revision will incorporate recently approved public wage increases by keeping the deficit unchanged through further revenue measures or lower expenditure.[2] With the budget containing controversial tax measures, it is not clear if it will be passed.

17. Discussions focused on maintaining fiscal discipline. Staff argued that implementing the budget would interrupt a decade-long record of primary surpluses and a reduction in the debt-to-GDP ratio since 2006. This would send a negative signal to markets at a time when public finances are increasingly coming under scrutiny around the world and thus risk jeopardizing macroeconomic stability. With government already having difficulties in placing local currency debt in the market in 2011, a more expansionary budget would also exacerbate financing pressures. Staff recommended that the budget should target a small primary surplus, which would imply a broadly neutral fiscal stance, and keep the debt-to-GDP ratio on a downward path. This could be achieved by implementing the proposed increases in the VAT rate and the

[1] Including off-budget current spending.

[2] Though cabinet approved increases in wages and allowances for both public and private sector employees in late December, discussions are ongoing. Under the approved scheme, the transportation allowance would be subsumed into the basic wage and become taxable, with the tax rate on social security contributions reduced accordingly. The overall increase in compensation would be up to 30 percent, (continued) depending on the wage bracket (compared to 17 percent cumulative inflation since the last wage increase in 2008). The wage increase could be implemented even if the 2012 budget is not passed.

withholding tax on interest, rescinding the February cut in the fuel excise, and limiting the public sector wage increase while allowing some increase in social and capital spending compared to 2011. The authorities agreed on a primary surplus in principle, but explained that this would be achieved because, as in previous years, capital budget allocations were unlikely to be fully spent due to lags in execution. Staff cautioned that relying on underexecution of spending to control the deficit would undermine the credibility of the budget.

18. Anchoring the 2012 budget in a medium-term agenda is important. Staff agreed that the 2012 draft budget rightly included higher infrastructure and social spending. Achieving a primary surplus though requires prioritization based on a reform agenda and capacity constraints. In particular, while some increase in public wages may have been warranted, the recently approved increase may lead to a crowding out of other spending and a loss in competitiveness. Moreover, given the permanent nature of current spending, any increase should be fully financed by higher recurrent revenue or permanent saving elsewhere. The authorities broadly shared staff's views and noted that work was in progress on embedding priorities in a medium-term fiscal framework.

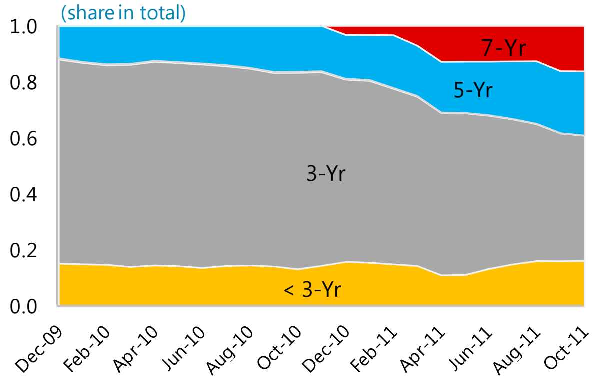
19. The budget presents an opportunity to make fiscal policies more equitable. Staff supported most revenue measures and higher social spending, including to mitigate the adverse social impact of the VAT increase. It recommended postponing the introduction of the real estate fee and an asset revaluation tax, and subsuming them into a comprehensive capital gains tax, which would focus on realized gains. Additional revenue could be raised by increasing excises on alcohol and tobacco and rescinding the reduction in the fuel excise, which disproportionately benefits the well-off. Staff also welcomed progress in introducing a national targeting program for the extreme poor, which could serve as an effective tool to relieve social pressures.

20. Higher investment in the electricity sector is welcome. Parliament approved in September 2011 a 3-year investment of 3 percent of GDP to boost Lebanon's electricity generation by almost half. Staff noted that an increase in generation capacity would imply higher subsidies to the sector unless complemented by reforms. The authorities concurred, noting plans to address sector losses and bring tariffs to cost-recovery levels in the medium term in line with a strategy developed with the World Bank, which envisages substantial private sector participation. Staff highlighted the importance of communicating a comprehensive strategy to the public to shore up support for future tariff increases.

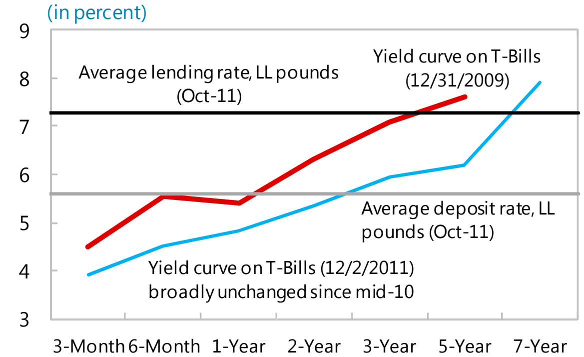
B. Reducing the Government's Reliance on Banque du Liban Financing

21. The government faced difficulties financing itself from the market. Political uncertainty combined with tight pound liquidity reduced banks' appetite for government debt in pounds. Pound liquidity dried up in 2011, and banks cannot use their foreign exchange deposits to lend in pounds given restrictions on open currency positions. Only high-yielding 7-year T-bills draw strong demand, and the government has resorted to them for financing twice this year. Banks largely shy away from T-bills with shorter maturity which yield about the same or less than what banks pay on pound deposits. They instead prefer lending to the private sector or holding cash. The resulting shortfall in demand for T-bills with shorter maturities was picked up by the BdL. This prevented interest rates from rising.

Treasury Bills in Circulation by Maturity
(share in total)

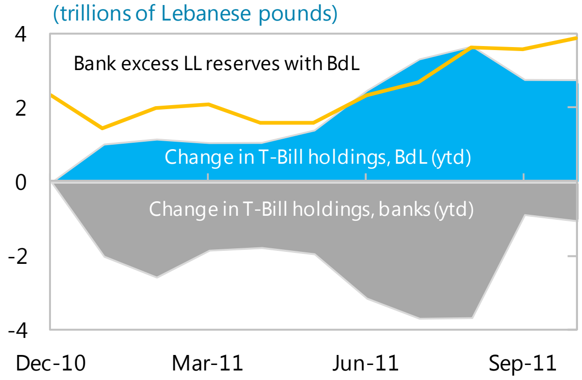


Deposit and Lending Interest Rates and Yield Curve
(in percent)



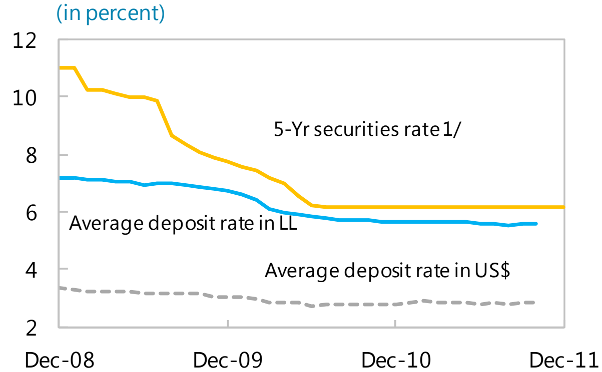
Sources: Lebanese authorities; and IMF staff estimates.

BdL and Commercial Bank T-Bill Holdings
(trillions of Lebanese pounds)



Sources: Lebanese authorities; and IMF staff estimates.

Interest Rates
(in percent)



1/ BdL 5-yr CDs until July, 2009; 5-yr T-bills thereafter.

22. Staff argued for allowing pound interest rates to rise. The authorities felt that holding interest rates steady after the fall of the government in January has helped to prop up confidence. Staff noted that pursuing interest rate stability under the currency peg over an extended period has been costly for the BdL's balance sheet and foreign reserves. It argued that letting interest rates on T-bills with maturities of less than 7 years rise would compensate for higher risks and make them attractive to banks, allowing the treasury to reduce its reliance on the BdL or the 7-year T-bills. This could also lower the average cost of borrowing and allow targeting a smoother maturity profile of government debt. The authorities broadly agreed, but felt that under current uncertainty marginally higher interest rates might not bring investors back while letting rates rise rapidly would risk undermining depositor confidence. They also hoped that a recent pick-up in pound deposit inflows would eventually translate into greater demand for T-bills. Staff supported a gradual move, but noted that the yield curve in the secondary market already shows higher rates for T-bills with lower maturities.[3]

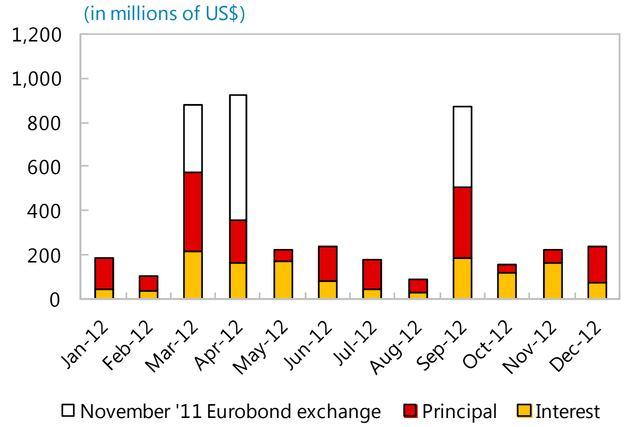
23. Steps to tap the Eurobond market are appropriate. Lebanon successfully placed $1.5 billion 7-, 9-, and 15-year Eurobonds in November 2011 ($1.2 billion of which involved exchanging Eurobonds maturing in 2012). Staff welcomed the reduction in financing needs in 2012. It supported the authorities' intention to seek parliamentary approval for new foreign currency borrowing to take advantage of banks' ample foreign exchange liquidity and globally low interest rates, and to reduce reliance on BdL reserves. Staff noted that financing government spending through additional foreign currency borrowing could increase banks' pound liquidity, which could then be channeled to the local currency T-bill market.

Gross Financing Requirements, 2012

	Q1	Q2	Q3	Q4	Year
A. Primary Deficit ($ mln.)	-130	-489	466	-3	-156
percent of GDP	-0.3	-1.1	1.1	0.0	-0.4
B. Interest ($ mln.)	825	1,071	855	1,054	3,805
On LL debt	521	611	565	590	2,286
On FX debt	304	461	290	464	1,519
C. Amortization ($ mln.)	2,965	2,163	2,959	3,099	11,185
On LL debt	2,405	1,743	2,454	2,839	9,442
On FX debt	559	420	505	259	1,743
Gross Financing Need = B+C-A					
In $ mln.	3,660	2,745	4,280	4,149	14,835
Percent of GDP	8.3	6.2	9.7	9.4	33.7
Memorandum Item:					
GDP ($ mln.)					44,013

Sources: Banque du Liban; and IMF staff estimates.

Monthly Foreign Currency Debt Service
(in millions of US$)



[3] Yields in the secondary market should be treated with caution because the market is thin.

POLICY THEME #2—SECURING SUSTAINED INCLUSIVE GROWTH AND ECONOMIC RESILIENCE

The medium-term challenge is to generate sustainable and inclusive growth while further reducing existing vulnerabilities and preventing a build-up of new ones. This requires implementing long-delayed reforms in infrastructure, improving the business climate and labor market, reducing debt, strengthening the social safety net, and continuing to protect the banking sector from excessive risks.

A. Launching Structural Reforms and Strengthening Competitiveness

24. Growth should accelerate and become more balanced and inclusive. Rapid growth during 2006–10 concentrated in and around Beirut. Anecdotal evidence suggests that employment creation was limited and focused on low-paying jobs in the construction, retail, and hospitality sectors (Box 3). As a result, unemployment, especially among the youth and educated, remains chronic and poverty widespread. There was agreement that achieving higher and more sustained growth and, ultimately, making a tangible dent in unemployment and poverty requires a better infrastructure, business environment, and labor market (Lebanon—Selected Issues, 2012, Chapter 3).

25. Infrastructure is one of the government's priorities (Figure 5). In addition to the electricity sector, reforms of the water sector are under discussion. Ongoing Telecom investments are making information technology services faster and more accessible throughout the country. Unlocking the sector's growth potential, though, requires opening it up to competition and upgrading its regulatory framework; privatization could also be considered. Public-private partnerships could help attract private infrastructure investment, but they should operate within a sound framework that minimizes contingent liabilities for the public sector.

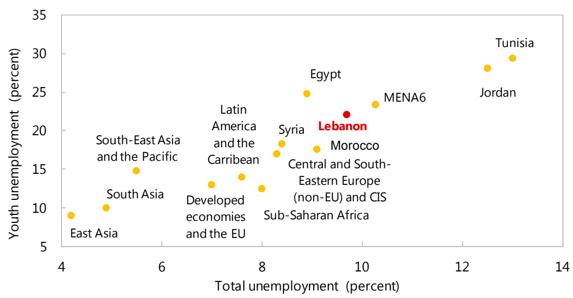
26. Improvements in the business climate and labor market are also needed. While Lebanon's business regulations fare relatively well compared with the region, staff noted that it is equally important to ensure transparent and even enforcement of rules. Labor market efficiency should be improved by attuning education to the needs of the market and reforming the end-of-service indemnity, which impedes labor mobility, while limiting government interference in private sector wage setting.

27. Strengthening competitiveness would support the currency peg.[4] The peg to the U.S. dollar has served Lebanon well and remains the linchpin for financial stability in a highly dollarized economy. Staff estimates

[4] Because the de facto peg has not been announced, Lebanon's exchange regime is classified as a "stabilized arrangement."

Box 3. Labor Market

Unemployment is concentrated among the youth and educated. The unemployment rate was 10 percent in 2007 according to official statistics. The share of youth and that of the highly educated in the unemployed were 45 and 30 percent, respectively.



Sources: International Labor Organization; national authorities; IMF *World Economic Outlook*; and IMF staff estimates.

1/ Or the latest year for which data are available.

Similar to other MENA countries, there is a large difference (almost 50 percentage points) between male and female labor force participation rates. But unlike most of these countries, Lebanon has only a small gender gap in unemployment (of 2 percentage points).

The economy's capacity to generate quality jobs appears weak. From 1998 to 2009, output grew by about 4 percent on average per year. Employment though remained broadly unchanged and concentrated in low productivity sectors. Informal employment appears to have increased, with now more than one third of those employed allegedly in the informal sector. Informal employment relies to a large extent on foreign workers, and remittance outflows are now about twice their size in the early 2000s.

Skill mismatches, labor market rigidities, and high reservation wages cause market inefficiencies. The labor force is highly educated and many work abroad at some point in their career. But there appears to be a skill mismatch as companies identify labor skills as a major constraint to business. Employers also identify labor regulations, including the design of the end-of-service indemnity, as an impediment to employment. With the recently approved wage increase, the minimum wage would be among the highest in the region though, when adjusting for costs of living, broadly in line with the regional average. Lastly, high remittances and education costs contribute to voluntary unemployment by keeping reservation wages high.

Minimum Wage in Lebanon and the Region, 2011

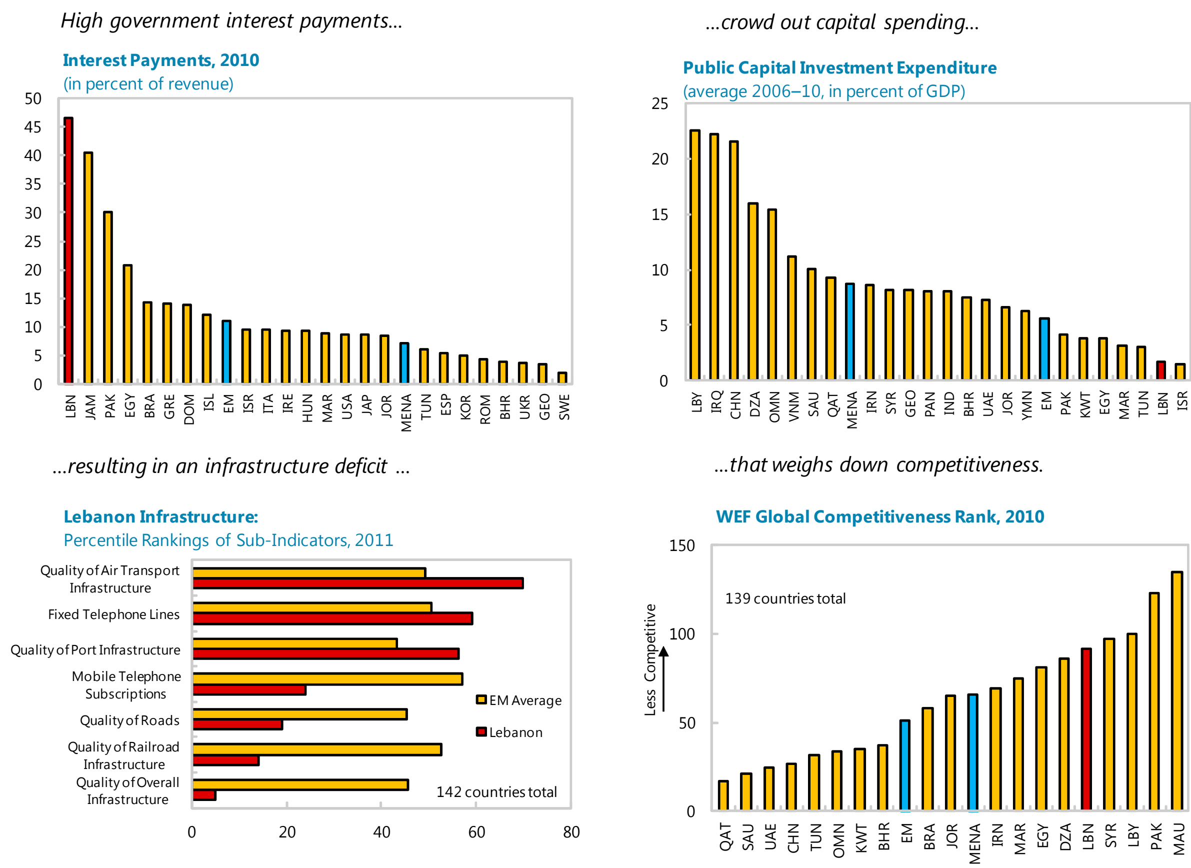
	Minimum wage (US$/month) 1/	Ratio of annual minimum wage to 2009 GDP per capita	Ratio of annual minimum wage to 2009 household final consumption expenditure per capita 2/	Percentage change in the US$ minimum monthly wage from early 2000s to 2011
Egypt	31	0.2	0.2	-9
Jordan	201	0.6	0.7	66
Lebanon	576	0.8	1.2	188
Morocco	273	1.2	2.0	22
Syrian Arab Republic	208	1.0	1.5	197
Tunisia	173	0.5	0.9	15
MENA6 average	244	0.7	1.1	80
World average	305	0.4	0.7	...

Sources: World Bank's *Doing Business* 2011; *World Development Indicators*, April 2011; Kabbani, N., and E. Kothari, "Youth Employment in the MENA Region: A Situational Assessment," World Bank Social Protection Discussion Paper No. 0534, September 2005; and IMF staff estimates.

1/ Data for Lebanon, Morocco, Syria, and Tunisia reflect minimum wage increases of December 2011, July 2011, March 2011, and May 2011, respectively.

2/ Household consumption data for Lebanon is for 2008.

Figure 5. Debt, Infrastructure, and Growth



Sources: IMF's World Economic Outlook; and World Economic Forum (WEF)'s Global Competitiveness Index. Comparisons are for selected advanced and emerging countries for which consistent data were available.

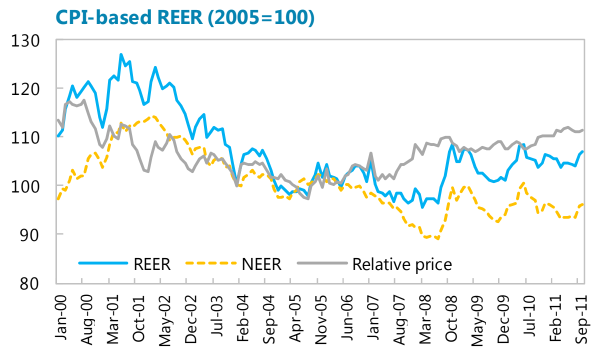
point to a modest overvaluation of the pound relative to its fundamentals (Box 4). The real effective exchange rate has appreciated slightly since early-2010, indicating some loss of competitiveness, and the recently approved wage increases might lead to a further loss. While export performance has been solid so far, competitiveness needs to improve to ensure that the current account is on a sustainable path. Thus, it is important to pursue productivity-enhancing measures.

B. Reducing Debt and Other Vulnerabilities

28. The authorities remain committed to reducing the debt-to-GDP ratio over the medium term. There was consensus that high public debt remains the root cause of Lebanon's macrofinancial vulnerabilities. In addition to substantial rollover needs, it implies large interest payments that absorb much of the budget (40 percent of 2011 revenue) and crowd out priority spending. Because banks are heavily exposed to the

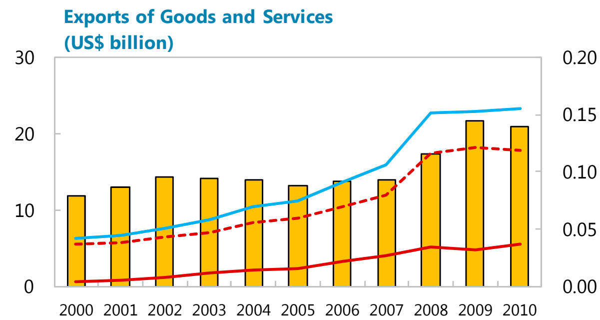
Box 4. Real Exchange Rate Assessment

The real effective exchange rate appreciated slightly since early 2010. This reflects rising inflation differentials with trading partners, while the nominal effective exchange rate (NEER) has depreciated since mid-2010 due to U.S. dollar weakness. The pace of appreciation picked up slightly in September 2011, in line with U.S. dollar strengthening.



Sources: IMF INS; and IMF staff estimates.

Export indicators so far do not indicate competitiveness issues. Lebanon's trade deficit—about 32 percent of GDP per year during 2006–10—is fairly sustainably financed by tourism and remittances inflows. Goods export volumes are estimated to have grown at an average of 17 percent per year during 2006–10 and tourism receipts at 19 percent. Though the share of exports of both goods and services globally has grown steadily since 2000, there was some leveling off in 2010.



Sources: Lebanese authorities; WEO; DOTS; and IMF staff estimates.

Lebanon's exchange rate appears to be modestly overvalued. The macroeconomic balance and the external sustainability approaches point to a modest overvaluation in the range of 11–17 percent, while the equilibrium real exchange rate approach suggests a slight overvaluation of about 3 percent. The variation in the results likely reflects methodological differences and limited data availability.

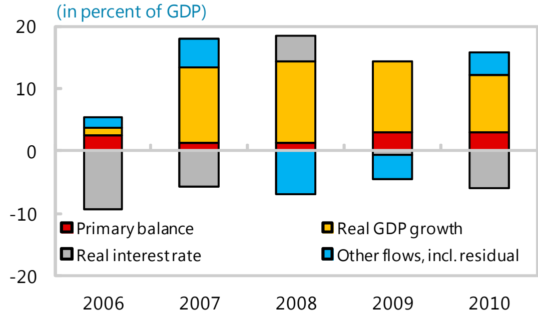
Real Exchange Rate Overvaluation Estimates Using CGER Approaches 1/

	NEAP 1 - IFS 2/		NEAP 2 - BIS 3/	
Macrobalance approach 4/				
Current account norm (in percent of GDP)	-6.4		-5.9	
	Underlying	Steady state	Underlying	Steady state
Current account (in percent of GDP)	-10.8	-10.5	-10.8	-10.5
Overvaluation (in percent)	12.1	11.2	13.3	12.4
External sustainability approach 5/				
Overvaluation (in percent)	12.4		17.2	
Equilibrium real exchange rate 6/	Range			
Overvaluation (in percent)	3.2 - 3.3			

Sources: Lebanese authorities; IFS; BIS; and IMF staff estimates.
1/ Using CGER parameters and a current account elasticity of 0.37.
2/ Net external asset position (NEAP) estimate based on IFS data.
3/ Net external asset position (NEAP) estimate based on BIS data.
4/ For each parametrization, compares the norms with a) the underlying 2010 current account stripped of temporary factors and b) the steady state (2016) current account.
5/ Derived from the net external asset position-stabilizing current account.
6/ Range of estimates obtained using different model specifications at end-2010.

government, stability of the financial system hinges on the state of government finances. Staff observed that the sharp reduction in the debt-to-GDP ratio over the past years was largely a windfall from strong growth. With growth expected to stay moderate, a future reduction in the ratio will have to come from sizeable primary surpluses.

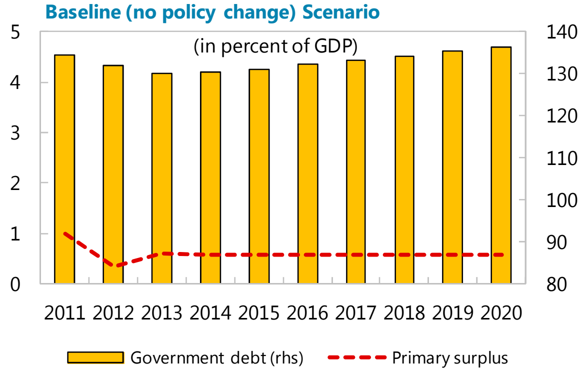
Contribution to the Reduction in the Debt-to-GDP Ratio
(in percent of GDP)



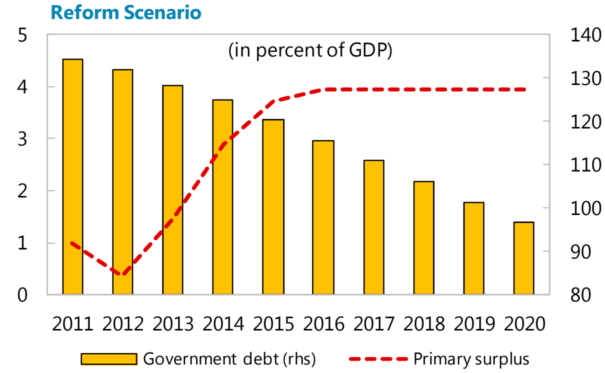
Sources: Lebanese authorities; and IMF staff estimates.

29. An ambitious fiscal strategy could bring the debt ratio to below 100 percent of GDP by 2020. Under the baseline scenario (no policy change), the debt ratio would stay at around 130 percent in the medium term. Staff presented a reform scenario in which revenue measures and electricity sector reform would create fiscal space to reduce the debt-to-GDP ratio while increasing social and capital spending. On the revenue side, specific measures would include a capital gains tax and broadening the VAT base and increasing its rate to 15 percent, which would bring it closer to the regional average. Regarding expenditure, the subsidy to the electricity sector would be reduced as investment and reforms bear fruit and nonpriority spending would be rationalized, while the safety net would be strengthened and capital spending accelerated (Lebanon—Selected Issues, 2012, Chapter 4). Additional gains could come from the ongoing modernization of revenue administration and reforms in public financial management (PFM). As a result, the primary surplus would rise gradually. With buoyed confidence, interest rates would fall and growth would increase, contributing to a substantial reduction in the debt ratio over time.

Baseline (no policy change) Scenario



Reform Scenario



Sources: Lebanese authorities; and IMF staff estimates.

30. BdL's balance sheet needs strengthening. BdL's policy to maintain large reserves—an indicator closely watched by markets—has served Lebanon well in the past and is warranted in the current uncertain environment. BdL's finances though have been weakened by the sterilized accumulation of reserves. Because deposit inflows slowed, there were no sustained sterilized interventions by the BdL since mid-2010, which helped slowing the pace of deterioration in its balance sheet. Nonetheless, the issuance of $1.75 billion foreign currency CDs in early 2011 has been costly, as is the remuneration of banks' excess foreign currency reserves held in longer-term deposits. Looking forward, staff believes that the trend deterioration in BdL's balance sheet should be arrested. Thus, BdL should weigh cost implications of replenishing reserves and develop a strategy to strengthen its income position. Such a strategy could consider reducing the remuneration of banks' foreign currency deposits, and gradually phasing out exemptions from reserve requirements (introduced to stimulate lending in Lebanese pounds) once recovery takes hold.

31. There was consensus that statistics needed upgrading. Lebanon's statistics lag behind those of most middle-income countries. Data gaps encompass many areas, including national accounts, balance of payments, and social and labor market indicators. The authorities' intention to provide a clear legal mandate and appropriate funding to the Central Administration of Statistics (CAS) is encouraging.

C. Safeguarding the Banking Sector

32. The banking sector has accumulated buffers but is facing an increasingly challenging environment. Thanks to prudent management and conservative regulation, banks report capital above the regulatory minimum and high liquidity buffers with low nonperforming loans (NPLs) and stable profits. However, with some of their foreign currency loans extended to unhedged borrowers, banks carry a currency-induced credit risk. Also, their profit margins have been squeezed by the decline in interest margins over the past years. This has encouraged banks to expand their operations abroad as a way to diversify their asset allocation and income sources.

33. The authorities are strengthening bank regulation and supervision. Plans to implement Basel III are welcome (Box 5). Stress tests conducted by the Banking Control Commission (BCC) have shown that banks have sufficient buffers to absorb a moderate deterioration in asset quality. Staff recommended integrating both local and cross-border portfolios in stress tests. Banks' assessment of capital adequacy should factor in results of such stress tests, Basel II Pillar 1 risks (interest rate, liquidity, concentration, and reputation) as well as key Pillar 2 qualitative risks, such as the effectiveness of management and controls. Staff welcomed the authorities'

Box 5. Readiness for Basel III

Lebanon is well placed to implement Basel III. The BCC has developed an action plan focused on strengthening corporate governance; harmonizing definitions, classifications and methodologies for calculating various metrics; adopting forward-looking provisioning; and improving information management systems and further stress testing.

- Most banks will meet Basel III **capital requirements** by 2012. The few that will not (small banks and some foreign bank branches) are required to conform by 2015. On average, ninety percent of banks' capital is Tier 1, mainly common equity (Table 1).

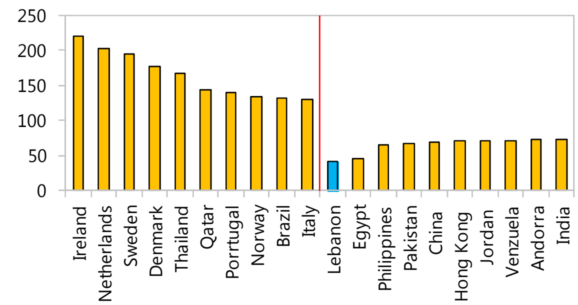
Capital Adequacy Ratios Compared to Basel III Requirements

		Lebanon 2/		Basel III	
	Lebanon 1/	Minimum 2012	Minimum + Capital Buffer 2015	Minimum	Minimum + Capital Buffer 3/
			(In percent)		
Common Equity/Risk Weighted Assets	9.1	5.0	8.0	4.5	7.0
Tier 1/Risk Weighted Assets	11.5	8.0	10.0	6.0	8.5
Total Equity/Risk Weighted Assets	12.1	10.0	12.0	8.0	10.5

Source: Basel III: A Comprehensive Regulatory Response, presented by the BCC at the Basel III Forum, February 2011.
1/ BCC's most recent test uses June 2011 data.
2/ A BdL circular of December 2011 requires banks to hold capital ratios which go beyond Basel III.
3/ The capital conservation buffer is 2.5 percent.

- **Funding risks** are likely not an issue as Lebanese banks have some of the lowest loan-to-deposit ratios in the world. This is partly due to their reliance on deposits, sourced largely from the Lebanese diaspora and the region.

Top Ten Highest and Lowest Loans-to-Deposits Ratios



Source: The Banker 2011, for a selected sample of banks as at end-2010.

- The BCC is revising **liquidity definitions** to align them with Basel III. Banks are currently required to place 15 percent of term and 25 percent of demand deposits in domestic currency with the BdL. For foreign currency deposits, banks have to place 15 percent with the BdL and to maintain a further 10 percent in liquid assets. In practice, banks typically hold substantially more through excess reserves with the BdL and liquid deposits with foreign banks. The funding ratio is quite stable as banks do not rely on wholesale funding. While most deposits are short-term, they behave like long-term deposits thanks to a proven loyal depositor base.

plan to introduce supervisory colleges to strengthen the oversight of cross-border activities of the largest banks through annual group audits and to assess risks, capital, and liquidity within the group. It also would be important to enact laws providing legal protection to BCC supervisors.

34. **Loan classification and provisioning rules should improve.** The rapid credit expansion in the last years calls for tighter rules guiding the classification of NPLs and loan restructuring, including re-aging of overdrafts and arrears. In staff's view, net provisioning has been low during the upswing, and it will be important to introduce forward

looking provisions to account for expected losses.

35. Work is underway to enhance the framework on anti-money laundering and combating the financing of terrorism (AML/CFT). Progress in addressing the recommendations identified by the Middle East and North Africa Financial Action Task Force Mutual Evaluation Report was accelerated after the United States identified the Lebanese-Canadian Bank (LCB) as an institution of money laundering concern. The LCB was subsequently absorbed by another bank. The AML supervision of financial transactions has been strengthened, and the government is reviewing a draft law that will put in place a declaration system for cross-border cash transactions. BdL's decision last month to raise the minimum capital of money exchanges is expected to encourage consolidation, which could improve their capacity to implement AML/CFT preventive measures.

STAFF APPRAISAL

36. A four-year spell of strong economic performance has come to an end. Domestic political uncertainty and regional unrest have eroded market confidence, and the economy has lost momentum. The authorities handled the downturn well, using buffers built during the upswing. But the fiscal position and financing conditions have worsened.

37. Lebanon is facing high risks. In addition to the challenging global and domestic environment, the conflict in Syria is creating a great deal of uncertainty. Further escalation could have major political and economic repercussions for Lebanon given the close ties between the two countries.

38. Vulnerabilities remain large. Lebanon has a persistently high current account deficit, while the government debt-to-GDP ratio is one of the highest in the world, giving rise to large recurrent financing needs. Financial stability of the system rests squarely on continued inflows of deposits, which depend on domestic political stability and a favorable regional environment. Banks' expansion abroad has made them further vulnerable to regional developments. New vulnerabilities could emerge from the slowdown in real estate and if banks take excessive risks to compensate for falling interest rate margins.

39. The outlook hinges on strong domestic policies. With the difficult external environment clouding prospects, domestic policies should aim at instilling confidence. This requires above all maintaining fiscal discipline. Specifically, the 2012 budget should target a small primary surplus, which would keep the government debt-to-GDP ratio on a downward path. Though Lebanon's economy has demonstrated remarkable resilience to past crises, now is the time to stay vigilant, maintain high buffers, and prepare for contingencies.

40. The 2012 budget provides an opportunity to set the stage for the medium term. Embedding the budget in a medium-term agenda would facilitate prioritization. Revenue measures could aim at improving equity and the new targeting program for the extreme poor should pave the way for better targeting of subsidies in the future. Higher capital spending, which has been long delayed, is welcome, but investments must be accompanied by reforms.

41. The government's reliance on BdL financing must be reduced. The BdL's purchases of T-bills to cover shortfalls in demand were appropriate in the aftermath of the government crisis in January to maintain stability. With the situation now stabilized, interest rates on T-bills with maturities of less than 7 years should rise to allow the treasury to finance itself from the market. Parliamentary approval for new foreign currency borrowing would also lessen reliance on the BdL.

42. Lebanon needs inclusive and sustained growth. Reducing Lebanon's unemployment and entrenched poverty requires a dynamic economy that can generate jobs. Tackling infrastructure bottlenecks through investment and reform and improving the business climate and labor market would remove key growth impediments.

43. The currency peg remains the cornerstone of financial stability. It continues to serve Lebanon well in view of the government's high foreign-currency debt and currency mismatch on the balance sheets of nonbanks and households. Lebanon might have lost some competitiveness, which it should regain through productivity-enhancing reforms to ensure that the peg and current account are sustainable. The recently approved wage increases could pose additional problems for competitiveness, and, in this context, future wage increases beyond productivity gains would be counterproductive.

44. A fiscal consolidation strategy should further cut the debt ratio. It should aim at generating sizeable primary surpluses while creating space for permanently higher levels of social and capital spending. This could be achieved by a combination of equitable and efficient tax measures, expenditure rationalization, most importantly by reducing the transfers to the electricity company, as well as improvements in tax administration and PFM.

45. The BdL's balance sheet should be strengthened. The BdL's finances have been weakened by the sterilized accumulation of reserves. Though the pace of deterioration has slowed, BdL should formulate a medium-term plan to improve its income position.

46. Bank regulation and supervision should focus on early problem detection. The regional expansion warrants augmented cross-border supervision, including through integrated stress testing, results of which should be factored into capital buffers and provisions. Efforts to reflect Basel II risks in calculating capital adequacy should continue. In light of recent credit growth, loan classification and provisioning need strengthening. Further enhancing the AML/CFT framework is important for providing continued reassurance about the integrity of the banking sector.

47. Statistics need to improve further. Improvements are underway, but shortcomings in availability, coverage, quality, and timeliness of data in key economic areas continue to impede economic analyses. CAS should be provided with appropriate support, mandate, and funding.

48. It is proposed that the next Article IV consultation takes place on the standard 12-month cycle.

Table 1. Lebanon: Selected Economic Indicators, 2009–16

Population: est. 3.9 million; 2010
Per capita GDP: est. US$9,840; 2010
Quota: SDR 266 million
Poverty rate: 28 percent; 2004–05
Unemployment: 9.7 percent; 2007

	2009	2010	Projections					
	Act.	Prel.	2011	2012	2013	2014	2015	2016
Output and prices			(Annual percentage change)					
Real GDP (market prices)	8.5	7.0	1.5	3.5	4.0	4.0	4.0	4.0
GDP deflator	7.0	3.0	3.7	5.1	3.9	2.2	2.2	2.2
Consumer prices (end-of-period)	3.4	5.1	5.5	5.5	2.2	2.2	2.2	2.2
Consumer prices (period average)	1.2	4.5	5.4	5.3	3.8	2.2	2.2	2.2
Investment and saving			(In percent of GDP)					
Gross capital formation	33.7	28.1	21.4	24.0	25.9	25.9	25.9	25.9
Government	1.4	1.4	1.8	3.3	2.9	2.9	2.9	2.9
Nongovernment	32.2	26.7	19.6	20.7	23.0	23.0	23.0	23.0
Gross national savings	23.9	17.5	7.3	10.2	12.9	13.9	14.7	15.4
Government	-6.8	-6.0	-6.6	-5.0	-5.2	-5.2	-5.5	-5.9
Nongovernment	30.7	23.6	13.8	15.2	18.1	19.1	20.2	21.3
Central government finances (cash basis)			(In percent of GDP)					
Revenue	24.3	22.0	22.4	24.3	24.1	24.0	23.9	23.9
of which: grants	0.3	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Expenditure	32.5	29.4	30.7	32.6	32.1	32.0	32.2	32.6
Overall balance	-8.2	-7.5	-8.3	-8.3	-8.1	-8.0	-8.3	-8.8
Primary balance	2.8	2.7	1.0	0.4	0.6	0.6	0.6	0.6
Total government debt	146	137	134	132	130	130	131	132
Monetary sector			(Annual percentage change, unless otherwise indicated)					
Broad money 1/	23.2	12.2	9.0	10.0	10.0	10.0	10.0	10.0
Deposit dollarization (level)	64.5	63.3	66.0	64.0	64.0	64.0	64.0	64.0
Interest rates (period average, in percent)								
Three-year treasury bill yield	8.4	6.4	6.0	6.5	7.1	7.6	8.0	8.3
Five-year treasury bill yield	9.0	6.6	6.2	...	...	...	...	...
External sector			(In percent of GDP, unless otherwise indicated)					
Exports of goods and services (in US$, percentage change)	0.3	9.0	3.5	7.2	8.1	8.3	8.3	8.3
Imports of goods and services (in US$, percentage change)	1.2	9.0	7.7	6.9	6.9	6.9	6.9	6.9
Balance of goods and services	-16.1	-15.9	-18.9	-18.3	-17.4	-16.7	-16.0	-15.3
Current account	-9.7	-10.6	-14.1	-13.9	-13.0	-12.0	-11.2	-10.5
Foreign direct investment	10.5	9.9	8.3	9.3	9.2	9.4	9.5	9.7
Total external debt 2/	175	161	158	159	163	170	174	178
Gross reserves (in billions of U.S. dollars) 3/	27.4	30.2	30.6	34.4	37.6	41.6	45.1	48.0
in months of next year imports of goods and services	10.6	10.8	10.3	10.8	11.1	11.4	11.6	11.5
in percent of short-term external debt 4/	52.6	56.4	55.4	56.9	55.4	54.8	55.5	53.9
in percent of banking system foreign currency deposits	44.4	44.5	39.4	41.5	41.3	41.4	40.8	39.4
in percent of total banking system deposits	28.6	28.1	26.0	26.5	26.4	26.5	26.1	25.2
Memorandum items:								
Nominal GDP (in billions of U.S. dollars)	34.9	38.5	40.5	44.0	47.6	50.6	53.7	57.1
Foreign-exchange-denominated bank deposits (percent change)	14.1	10.1	14.7	6.7	10.0	10.0	10.0	10.0
Commercial bank total assets	330	335	351	355	361	374	387	401
Real effective exchange rate (annual average, percent change)	3.2	2.6	...	...	...	...	...	...

Sources: Lebanese authorities; and IMF staff estimates.

1/ Defined as currency in circulation plus resident and nonresident deposits.

2/ Includes nonresident deposits.

3/ Excluding gold and encumbered assets.

4/ Short-term debt on a remaining maturity basis, including short-term nonresident deposits.

Table 2. Lebanon: Central Government Overall Deficit and Financing, 2009–16

	2009 Act.	2010 Act.	2011 Proj.	2012 Proj	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(in billions of Lebanese pounds, unless otherwise indicated)							
Revenue and grants	12,802	12,738	13,654	16,135	17,256	18,278	19,339	20,522
Revenue	12,625	12,684	13,543	16,025	17,228	18,250	19,312	20,495
Tax revenue	8,968	9,976	9,556	11,717	12,619	13,355	14,077	14,935
Taxes on income and profits	1,839	2,050	2,404	2,941	3,184	3,390	3,590	3,820
Taxes on property	809	1,088	1,018	1,098	1,187	1,271	1,371	1,457
Taxes on domestic goods and services	3,260	3,583	3,524	4,597	4,955	5,278	5,568	5,933
of which: VAT revenues	2,889	3,193	3,197	4,213	4,541	4,837	5,100	5,435
Taxes on international trade 1/	2,664	2,802	2,172	2,585	2,757	2,847	2,942	3,082
Other taxes	396	453	438	496	536	570	605	643
Nontax revenue	3,065	2,043	3,285	3,582	3,846	4,088	4,343	4,615
Other treasury revenue	592	666	702	727	762	808	891	945
Grants	177	54	111	110	27	27	27	27
Total expenditures	17,095	16,963	18,732	21,637	23,042	24,406	26,097	28,075
Current primary expenditure	10,539	10,229	11,978	13,710	14,782	15,653	16,555	17,576
Personnel cost 2/	4,936	5,062	5,644	6,521	7,040	7,476	7,944	8,455
Transfers to EDL 3/	2,165	1,730	2,725	3,008	3,235	3,369	3,542	3,725
Other current 4/	3,438	3,437	3,609	4,181	4,507	4,808	5,068	5,396
Interest payments	5,799	5,905	5,684	5,736	6,215	6,575	7,233	8,043
Domestic currency debt	3,663	3,763	3,512	3,446	3,636	3,700	3,810	4,054
Foreign currency debt	2,136	2,142	2,172	2,290	2,579	2,875	3,423	3,989
Capital expenditure	757	829	1,070	2,190	2,045	2,178	2,310	2,456
Domestically financed	478	525	640	1,605	1,806	1,911	2,043	1,515
Foreign financed	279	304	430	585	239	267	266	941
Overall balance (checks issued)	-4,293	-4,225	-5,078	-5,502	-5,787	-6,128	-6,757	-7,553
Primary balance (checks issued)	1,506	1,680	606	234	429	447	475	490
Overall balance (cash basis)	-4,321	-4,327	-5,078	-5,502	-5,787	-6,128	-6,757	-7,553
Primary balance (cash basis)	1,478	1,578	606	234	429	447	475	490
Net financing	4,321	4,327	5,078	5,502	5,787	6,128	6,757	7,553
of which: Banking system	4,856	3,002	5,760	3,357	3,924	4,184	4,821	5,637
of which: Government institutions	1,016	190	210	65	67	51	46	216
of which: Other creditors	-1,522	850	-893	2,080	1,796	1,894	1,890	1,700
Memorandum items:								
Primary balance (on a checks issued basis, excluding Telecom revenues)	-549	723	-1,494	-2,049	-2,014	-2,149	-2,283	-2,441
Total government gross debt	77,112	79,298	81,966	87,468	93,255	99,383	106,140	113,693
of which: foreign denominated debt	32,139	31,043	31,548	36,548	41,814	47,552	53,952	59,834
Total government net debt	69,990	73,931	78,969	84,471	90,257	96,386	103,143	110,696

Sources: Lebanese authorities; and IMF staff estimates and calculations.

1/ Includes domestic excises, which are collected at customs and are classified as taxes on international trade.

2/ Includes wages, salaries, related benefits, and pensions.

3/ Excludes principal and interest payments paid on behalf of Electricite du Liban.

4/ Includes transfers to the National social security fund, hospitals, municipalities, Higher Relief Committee, Displaced Fund, Council of the South, bread subsidy, and the interest subsidy.

Table 3a. Lebanon: Central Government Overall Deficit and Financing, 2009–16

	2009 Act.	2010 Act.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(In percent of GDP, unless otherwise indicated)							
Revenue and grants	24.3	22.0	22.4	24.3	24.1	24.0	23.9	23.9
Revenue	24.0	21.9	22.2	24.2	24.0	23.9	23.8	23.8
Tax revenue	17.0	17.2	15.7	17.7	17.6	17.5	17.4	17.4
Taxes on income and profits	3.5	3.5	3.9	4.4	4.4	4.4	4.4	4.4
Taxes on property	1.5	1.9	1.7	1.7	1.7	1.7	1.7	1.7
Taxes on domestic goods and services	6.2	6.2	5.8	6.9	6.9	6.9	6.9	6.9
of which: VAT revenues	5.5	5.5	5.2	6.3	6.3	6.3	6.3	6.3
Taxes on international trade 1/	5.1	4.8	3.6	3.9	3.8	3.7	3.6	3.6
Other taxes	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Nontax revenue	5.8	3.5	5.4	5.4	5.4	5.4	5.4	5.4
Other treasury revenue	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1
Grants	0.3	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Total expenditures	32.5	29.2	30.7	32.6	32.1	32.0	32.2	32.6
Current primary expenditure	20.0	17.6	19.6	20.7	20.6	20.5	20.4	20.4
Personnel cost 2/	9.4	8.7	9.2	9.8	9.8	9.8	9.8	9.8
Transfers to EDL 3/	4.1	3.0	4.5	4.5	4.5	4.4	4.4	4.3
Other current 4/	6.5	5.9	5.9	6.3	6.3	6.3	6.3	6.3
Interest payments	11.0	10.2	9.3	8.6	8.7	8.6	8.9	9.3
Domestic currency debt	7.0	6.5	5.8	5.2	5.1	4.9	4.7	4.7
Foreign currency debt	4.1	3.7	3.6	3.5	3.6	3.8	4.2	4.6
Capital expenditure	1.4	1.4	1.8	3.3	2.9	2.9	2.9	2.9
Domestically financed	0.9	0.9	1.0	2.4	2.5	2.5	2.5	1.8
Foreign financed	0.5	0.5	0.7	0.9	0.3	0.4	0.3	1.1
Overall balance (checks issued)	-8.2	-7.3	-8.3	-8.3	-8.1	-8.0	-8.3	-8.8
Primary balance (checks issued)	2.9	2.9	1.0	0.4	0.6	0.6	0.6	0.6
Overall balance (cash basis)	-8.2	-7.5	-8.3	-8.3	-8.1	-8.0	-8.3	-8.8
Primary balance (cash basis)	2.8	2.7	1.0	0.4	0.6	0.6	0.6	0.6
Net financing	8.2	7.5	8.3	8.3	8.1	8.0	8.3	8.8
of which: Banking system	9.2	5.2	9.4	5.1	5.5	5.5	6.0	6.6
of which: Government institutions	1.9	0.3	0.3	0.1	0.1	0.1	0.1	0.3
of which: Other creditors	-2.9	1.5	-1.5	3.1	2.5	2.5	2.3	2.0
Memorandum items:								
Primary balance (on a checks issued basis, excluding Telecom revenues)	-1.0	1.2	-2.4	-3.1	-2.8	-2.8	-2.8	-2.8
Nominal GDP (in billions of LL)	52,650	58,000	61,024	66,350	71,711	76,209	80,973	86,036
Total government gross debt (in percent of GDP)	146	137	134	132	130	130	131	132
of which: foreign denominated debt (in percent of gross debt)	42	39	38	42	45	48	51	53
Total government net debt (in percent of GDP)	133	127	129	127	126	126	127	129

Sources: Lebanese authorities; and IMF staff estimates and calculations.

1/ Includes domestic excises, which are collected at customs and are classified as taxes on international trade.

2/ Includes wages, salaries, related benefits, and pensions.

3/ Excludes principal and interest payments paid on behalf of Electricite du Liban.

4/ Includes transfers to the National social security fund, hospitals, municipalities, Higher Relief Committee, Displaced Fund, Council of the South, bread subsidy, and the interest subsidy.

Table 3b. Lebanon: Central Government Overall Deficit and Financing, 2009–16

based on GFSM 2001 Classification 1/ 2/ 3/

	2009 Act.	2010 Act.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(In percent of GDP, unless otherwise indicated)							
Revenue	22.6	20.2	20.6	22.5	22.3	22.3	22.2	22.1
Taxes	16.8	16.9	15.3	17.3	17.3	17.2	17.1	17.1
Taxes on income, profits, and capital gain	3.5	3.5	3.9	4.4	4.4	4.4	4.4	4.4
Taxes on property	1.5	1.9	1.7	1.7	1.7	1.7	1.7	1.7
Taxes on goods and services	9.6	9.3	7.7	9.2	9.2	9.2	9.2	9.2
of which: Net VAT revenues	4.9	4.8	4.6	5.7	5.7	5.7	5.7	5.7
Taxes on international trade and transactions	1.5	1.4	1.3	1.3	1.2	1.1	1.0	1.0
Other taxes	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Social Contributions	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Grants	0.3	0.1	0.2	0.2	0.0	0.0	0.0	0.0
Other revenue	5.2	3.0	4.7	4.8	4.7	4.7	4.7	4.7
Expense	29.2	25.9	27.0	27.4	27.4	27.3	27.5	27.9
Compensation of employees	6.3	5.7	6.2	6.5	6.5	6.5	6.5	6.5
Purchase of goods and services	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Interest payments	11.0	10.2	9.3	8.6	8.7	8.6	8.9	9.3
Domestic currency debt	7.0	6.5	5.8	5.2	5.1	4.9	4.7	4.7
Foreign currency debt	4.1	3.7	3.6	3.5	3.6	3.8	4.2	4.6
Subsidies	4.3	3.2	4.7	4.8	4.8	4.7	4.6	4.6
of which: Transfers to EDL	4.1	3.0	4.5	4.5	4.5	4.4	4.4	4.3
Grants	2.5	1.8	1.4	1.5	1.5	1.5	1.5	1.5
Social benefits	3.7	3.7	3.8	4.5	4.5	4.5	4.5	4.5
of which: Pensions	2.4	2.4	2.5	2.8	2.8	2.8	2.8	2.8
Other expense	0.7	0.6	0.9	0.9	0.9	0.9	0.9	0.9
Gross Operating Balance	-6.7	-5.8	-6.4	-4.9	-5.1	-5.0	-5.3	-5.8
Net transaction in nonfinancial assets	1.4	1.4	1.8	3.3	2.9	2.9	2.9	2.9
Acquisition of non-financial assets	1.4	1.4	1.8	3.3	2.9	2.9	2.9	2.9
Domestically financed	0.9	0.9	1.0	2.4	2.5	2.5	2.5	1.8
Foreign financed	0.5	0.5	0.7	0.9	0.3	0.4	0.3	1.1
Disposal of non-financial assets								
Net Lending/Borrowing (Overall Balance)	-8.1	-7.2	-8.2	-8.2	-8.0	-7.9	-8.2	-8.7
Transactions in financial assets and liabilities	-8.2	-7.2	-8.2	-8.2	-8.0	-7.9	-8.2	-8.7
Net acquisition of financial assets	3.7	-3.0	-3.9	0.0	0.0	0.0	0.0	0.0
Domestic	8.8	0.7	-0.6	0.0	0.0	0.0	0.0	0.0
Foreign	-5.1	-3.7	-3.3	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	11.9	4.1	4.3	8.2	8.0	7.9	8.2	8.7
Domestic	11.4	5.7	3.1	0.6	0.6	0.4	0.3	1.8
of which: debt securities 4/	11.5	5.8	3.2	0.8	0.7	0.5	0.4	1.9
Foreign	0.5	-1.6	1.2	7.5	7.3	7.5	7.9	6.8
of which: debt securities 5/	0.7	-1.0	1.7	6.2	6.8	7.1	7.8	6.9
Memorandum items:								
Primary balance (on a checks issued basis)	2.9	3.0	1.1	0.5	0.7	0.7	0.7	0.7
Primary balance (on a checks issued basis, excluding Telecom revenue)	-1.0	1.3	-2.3	-3.0	-2.7	-2.7	-2.7	-2.7
Total government gross debt	146	136	134	131	130	130	130	131
of which: foreign denominated debt	61	54	53	56	59	63	67	70
Total government net debt	132	127	124	123	130	130	130	131
Nominal GDP (in billions of LL)	52,650	58,000	61,024	66,350	71,711	76,209	80,973	86,036

Sources: Lebanese authorities; and IMF staff estimates and calculations.

1/ In accordance with the Government Finance Statistics Manual 2001 (GFSM2001).

2/ Budgetary central government includes data on some extrabudgetary entities, including grants recorded at the Higher Relief Committee (HRC), foreign-financed projects of the Council of Development and Reconstruction (CDR), and currency and deposits of HRC and CDR at the Central Bank.

3/ Preliminary and subject to revisions.

4/ Includes accrued interest on T-bills.

5/ Includes accrued interest on Eurobonds and valuation adjustment.

Table 4. Lebanon: Government Debt, 2009–16 1/

	2009 Act.	2010 Act.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(In millions of U.S. dollars)							
Net debt 2/	46,428	49,042	52,384	56,034	59,872	63,938	68,420	73,431
Gross debt by holder	51,152	52,602	54,372	58,022	61,860	65,926	70,408	75,419
Banking system	37,558	38,318	40,541	42,767	45,370	48,146	51,344	55,084
Treasury bills	24,693	25,735	27,355	27,629	27,912	28,126	28,320	29,232
Other domestic loans	263	196	169	169	169	169	169	169
Eurobonds	12,603	12,388	13,017	14,969	17,289	19,851	22,855	25,682
Nonbanks	13,594	14,284	13,831	15,254	16,490	17,780	19,064	20,336
Treasury bills	4,878	6,080	5,921	5,980	6,041	6,088	6,130	6,327
Government institutions 3/	4,032	4,158	4,297	4,340	4,385	4,418	4,449	4,592
Other	846	1,922	1,623	1,640	1,657	1,669	1,681	1,735
Eurobonds	5,402	5,349	5,236	6,022	6,955	7,986	9,194	10,331
Concessional loans	3,018	2,807	2,621	3,199	3,441	3,672	3,737	3,677
Foreign currency T-bonds	297	49	53	53	53	35	4	0
Government deposits	4,724	3,560	1,988	1,988	1,988	1,988	1,988	1,988
	(In percent of GDP)							
Net debt 2/	133	127	129	127	126	126	127	129
Gross debt by holder	146	137	134	132	130	130	131	132
Banking system	108	100	100	97	95	95	96	97
Treasury bills	71	67	68	63	59	56	53	51
Other domestic loans	1	1	0	0	0	0	0	0
Eurobonds	36	32	32	34	36	39	43	45
Nonbanks	39	37	34	35	35	35	35	36
Treasury bills	14	16	15	14	13	12	11	11
Government Institutions 3/	12	11	11	10	9	9	8	8
Other	2	5	4	4	3	3	3	3
Eurobonds	15	14	13	14	15	16	17	18
Concessional loans	9	7	6	7	7	7	7	6
Foreign currency T-bonds	1	0	0	0	0	0	0	0
Government deposits	14	9	5	5	4	4	4	3
Memorandum items:								
Nominal GDP (in billions of LL)	52,650	58,000	61,024	66,350	71,711	76,209	80,973	86,036
Foreign currency debt (in percent of gross debt)	42	39	38	42	45	48	51	53

Sources: Lebanese authorities; and IMF staff estimates and calculations.

1/ Includes all debt contracted by the treasury on behalf of the central government and public agencies other than the Banque du Liban; accrued interest; and Banque du Liban lending to Electricite du Liban. Excludes possible government arrears to the private sector.

2/ Defined as gross debt less government deposits.

3/ Denominated in domestic currency; mainly to the National Social Security Fund and the National Deposit Insurance Fund.

Table 5. Lebanon: Monetary Survey, 2009–13

	2009 Act.	2010 Act.	2011 Proj.	2012 Proj.	2013 Proj.
	(In trillions of Lebanese pounds)				
Net foreign assets	81.4	93.6	96.2	103.4	111.9
Banque du Liban	52.7	61.6	65.6	71.7	77.0
Commercial banks	28.8	32.0	30.5	31.8	34.9
Net domestic assets	67.4	73.4	85.8	96.8	108.4
Net claims on public sector	46.7	48.7	53.5	56.9	60.8
of which: Net claims on government	48.2	51.3	56.9	60.3	64.2
Banque du Liban	4.4	7.1	11.9	12.0	11.8
Commercial banks	43.8	44.2	45.0	48.3	52.4
Claims on private sector	36.9	46.1	51.1	56.2	61.8
Other items (net)	-16.1	-21.4	-18.8	-16.4	-14.3
Broad money (M5) 1/	148.8	167.0	182.0	200.2	220.2
In Lebanese pounds	55.1	63.8	63.7	74.0	81.4
Currency in circulation	2.4	2.7	2.7	3.0	3.3
Deposits in Lebanese pounds	52.7	61.1	60.9	71.0	78.1
Deposits in foreign currency	93.8	103.2	118.3	126.2	138.9
	(Year-on-year percent change)				
Net foreign assets	37.4	14.9	2.8	7.6	8.1
Net domestic assets	9.5	8.8	17.0	12.7	12.0
Net claims on public sector	12.7	4.4	9.8	6.3	6.9
Claims on private sector	15.1	24.8	11.0	10.0	10.0
Broad money (M5) 1/	23.2	12.2	9.0	10.0	10.0
In Lebanese pounds	42.3	15.8	-0.2	16.2	10.0
Deposits in foreign currency	14.1	10.0	14.7	6.7	10.0
Memorandum items:					
	(In trillions of Lebanese pounds, except where otherwise indicated)				
Banque du Liban:					
Net foreign exchange position 2/	27.2	34.2	26.7	30.9	33.3
Foreign assets	56.8	65.4	69.1	74.7	79.6
Foreign currency liabilities	29.6	31.2	42.4	43.8	46.4
Net foreign exchange position, in billions of U.S. dollars 2/	18.0	22.7	17.7	20.5	22.1
Claims on public sector (net)	4.4	6.6	11.1	11.2	11.0
Claims on commercial banks	-18.4	-25.1	-25.7	-31.0	-34.6
Reserve money	10.8	10.4	10.7	12.2	13.4
Gross international reserves (including gold), in billions of U.S. dollars 3/	37.5	43.2	45.7	49.4	52.7
Gross international reserves (excluding gold), in billions of U.S. dollars 4/	27.4	30.2	30.6	34.4	37.6
in percent of banking system foreign currency deposits	44.4	44.5	39.4	41.5	41.3
in percent of total banking system deposits	28.6	28.1	26.0	26.5	26.4
Share of foreign currency deposits in total private sector deposits (in percent)	64.5	63.3	66.0	64.0	64.0

Sources: Banque du Liban; and IMF staff estimates and projections.

1/ Broad money (M5) is defined as M3 (currency + resident deposits) + nonresident deposits.

2/ Defined as foreign currency assets less foreign currency liabilities. Assets include gold and SDRs, but exclude holdings of government Eurobonds. Liabilities include the exceptional deposits by GCC governments, but exclude liabilities to the government of Lebanon and other official creditors.

3/ Defined as all official foreign currency assets, less encumbered foreign assets.

4/ Defined as all official foreign currency assets, less encumbered foreign assets and gold.

Table 6. Lebanon: Balance of Payments, 2009–16

	2009 Prel.	2010 Est.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(In millions of U.S. dollars, unless otherwise indicated)							
Current account (excl. official transfers)	-3,453	-4,062	-5,707	-6,097	-6,186	-6,060	-6,016	-5,985
Goods (net)	-11,179	-12,258	-13,553	-14,598	-15,658	-16,779	-18,010	-19,334
Exports, f.o.b.	4,716	5,467	6,068	6,553	7,143	7,800	8,487	9,229
Imports, f.o.b.	-15,895	-17,724	-19,621	-21,151	-22,801	-24,579	-26,497	-28,563
Services (net)	5,569	6,142	5,914	6,533	7,365	8,317	9,393	10,581
Income (net)	-870	-1,209	-1,562	-1,671	-1,804	-1,856	-1,992	-2,136
Of which: interest on government debt	-433	-563	-496	-518	-575	-626	-698	-768
Current transfers (net) 1/	3,027	3,263	3,494	3,639	3,911	4,259	4,593	4,904
Capital and financial account	10,129	6,339	6,135	9,742	9,357	9,895	9,450	8,386
Capital transfers (net)	66	36	73	18	18	18	18	73
Direct investment (net)	3,678	3,793	3,360	4,074	4,380	4,734	5,128	5,554
Portfolio investment, loans, other capital	6,385	2,510	2,702	5,649	4,959	5,142	4,304	2,759
Government (net) 2/	-1,055	-158	-184	726	571	633	598	84
Banque du Liban	196	-239	-216	-290	-270	-250	-250	-150
Banks (net) 3/	3,718	1,568	5,196	1,438	144	6	-1,126	-809
Foreign assets of banks 4/	-4,257	-2,147	962	-801	-2,056	-2,125	-3,153	-4,597
Non-resident deposits 3/	7,976	3,715	4,234	2,239	2,200	2,131	2,026	3,788
Non-bank private sector (net)	3,526	1,339	-2,093	3,775	4,514	4,753	5,083	3,634
Errors and omissions	1,506	490	0	0	0	0	0	0
Overall balance	8,182	2,768	429	3,645	3,171	3,835	3,434	2,401
Financing	-8,182	-2,768	-429	-3,645	-3,171	-3,835	-3,434	-2,401
Official reserves (- increase)	-8,636	-2,768	-429	-3,757	-3,283	-3,947	-3,546	-2,849
Exceptional financing	454	0	0	112	112	112	112	448
Memorandum items:								
Current account (incl. official transfers)	-3,401	-4,062	-5,707	-6,097	-6,186	-6,060	-6,016	-5,985
Current account balance (in percent of GDP)	-9.7	-10.6	-14.1	-13.9	-13.0	-12.0	-11.2	-10.5
Gross international reserves 5/	27,405	30,172	30,601	34,358	37,641	41,588	45,134	47,983
External debt (year-end; in percent of GDP) 6/	175	161	158	159	163	170	174	178
Government external debt (in percent of GDP)	23.7	21.1	19.6	19.9	19.9	20.2	20.3	20.0
GDP	34,925	38,474	40,480	44,013	47,570	50,553	53,714	57,072

Sources: Lebanese authorities; BIS; and IMF staff estimates and projections.
1/ Excluding official budgetary transfers.
2/ Excluding budgetary loan disbursements.
3/ Differs from banks' reported data, to include estimated deposit flows by Lebanese nationals living abroad but classified as residents.
4/ Net of nondeposit foreign liabilities.
5/ Excludes gold and encumbered foreign assets.
6/ Includes all banking deposits held by non-residents, including estimated deposits of Lebanese nationals living abroad but classified as residents.

Table 7. Lebanon: Selected Economic Indicators, Summary of Baseline and Reform Scenarios, 2009–16

		Prel.	Projections					
	2009	2010	2011	2012	2013	2014	2015	2016
Output	(Annual percentage change)							
Real GDP (market prices)								
Baseline scenario	8.5	7.0	1.5	3.5	4.0	4.0	4.0	4.0
Reform scenario	8.5	7.0	1.5	3.5	4.5	5.0	5.0	5.0
GDP deflator								
Baseline scenario	7.0	3.0	3.7	5.1	3.9	2.2	2.2	2.2
Reform scenario	7.0	3.0	3.7	5.1	3.9	2.2	2.2	2.2
Central government finances (cash basis)	(In percent of GDP)							
Revenue								
Baseline scenario	24.3	22.0	22.4	24.3	24.1	24.0	23.9	23.9
Reform scenario	24.3	22.0	22.4	24.3	24.6	24.8	25.9	26.0
Expenditure								
Baseline scenario	32.5	29.4	30.7	32.6	32.1	32.0	32.2	32.6
Reform scenario	32.5	29.4	30.7	32.6	31.6	30.0	29.8	29.4
Overall balance								
Baseline scenario	-8.2	-7.5	-8.3	-8.3	-8.1	-8.0	-8.3	-8.8
Reform scenario	-8.2	-7.5	-8.3	-8.3	-7.0	-5.1	-3.9	-3.4
Primary balance								
Baseline scenario	2.8	2.7	1.0	0.4	0.6	0.6	0.6	0.6
Reform scenario	2.8	2.7	1.0	0.4	1.5	2.9	3.7	3.9
Total government debt								
Baseline scenario	146	137	134	132	130	130	131	132
Reform scenario	146	137	134	132	128	125	120	116
Monetary sector	(Annual percentage change, unless otherwise indicated)							
Credit to the private sector								
Baseline scenario	15.1	24.8	11.0	10.0	10.0	10.0	10.0	10.0
Reform scenario	15.1	24.8	11.0	10.0	11.0	11.5	11.5	11.5
Broad money 1/								
Baseline scenario	23.2	12.2	9.0	10.0	10.0	10.0	10.0	10.0
Reform scenario	23.2	12.2	9.0	10.0	9.0	7.0	7.0	7.0
Three-year treasury bill yield								
Baseline scenario	8.4	6.4	6.0	6.5	7.1	7.6	8.0	8.3
Reform scenario	8.4	6.4	6.0	6.5	6.7	6.6	6.7	6.8
External sector	(In percent of GDP, unless otherwise indicated)							
Current account balance								
Baseline scenario	-9.7	-10.6	-14.1	-13.9	-13.0	-12.0	-11.2	-10.5
Reform scenario	-9.7	-10.6	-14.1	-13.9	-12.7	-11.5	-10.4	-9.3
Foreign direct investment								
Baseline scenario	10.5	9.9	8.3	9.3	9.2	9.4	9.5	9.7
Reform scenario	10.5	9.9	8.3	9.3	9.4	9.5	9.7	10.0
Total external debt 2/								
Baseline scenario	175	161	158	159	163	170	174	178
Reform scenario	175	161	158	159	159	156	151	145
Gross reserves (excluding gold), in billions of U.S. dollars								
Baseline scenario	27.4	30.2	30.6	34.4	37.6	41.6	45.1	48.0
Reform scenario	27.4	30.2	30.6	34.4	37.0	39.0	40.1	40.5
Gross reserves (excluding gold), in percent of total banking system deposits								
Baseline scenario	28.6	28.1	26.0	26.5	26.4	26.5	26.1	25.2
Reform scenario	28.6	28.1	26.0	26.5	26.2	25.7	24.7	23.3

Sources: Lebanese authorities; and IMF staff estimates.

1/ Defined as currency in circulation plus resident and nonresident deposits.

2/ Includes nonresident deposits.

Table 8. Lebanon: Central Government Overall Deficit and Financing, 2009–16, Reform Scenario

	2009 Act.	2010 Act.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.
	(In percent of GDP, unless otherwise indicated)							
Revenue and grants	24.3	22.0	22.4	24.3	24.6	24.8	25.9	26.0
Revenue	24.0	21.9	22.2	24.2	24.5	24.8	25.9	25.9
Tax revenue	17.0	17.2	15.7	17.7	18.1	18.3	19.3	19.3
Taxes on income and profits	3.5	3.5	3.9	4.4	4.4	4.7	4.7	4.7
Taxes on property	1.5	1.9	1.7	1.7	1.7	1.7	1.7	1.7
Taxes on domestic goods and services	6.2	6.2	5.8	6.9	6.9	6.9	8.1	8.1
of which: VAT revenues	5.5	5.5	5.2	6.3	6.3	6.3	7.5	7.5
Taxes on international trade 1/	5.1	4.8	3.6	3.9	4.4	4.3	4.2	4.1
Other taxes	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Nontax revenue	5.8	3.5	5.4	5.4	5.4	5.4	5.4	5.4
Other treasury revenue	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1
Grants	0.3	0.1	0.2	0.2	0.0	0.0	0.0	0.1
Total expenditures	32.5	29.2	30.7	32.6	31.6	30.0	29.8	29.4
Current primary expenditure	20.0	17.6	19.6	20.7	20.1	18.9	17.5	17.5
Personnel cost 2/	9.4	8.7	9.2	9.8	9.8	9.8	9.8	9.8
Transfers to EDL 3/	4.1	3.0	4.5	4.5	4.1	2.8	1.4	1.4
Other current 4/	6.5	5.9	5.9	6.3	6.3	6.3	6.3	6.3
Interest payments	11.0	10.2	9.3	8.6	8.5	8.0	7.6	7.4
Domestic currency debt	7.0	6.5	5.8	5.2	4.9	4.4	3.9	3.7
Foreign currency debt	4.1	3.7	3.5	3.5	3.6	3.6	3.7	3.7
Capital expenditure	1.4	1.4	1.8	3.3	3.0	3.1	4.7	4.5
Domestically financed	0.9	0.9	1.0	2.4	2.6	2.7	4.4	3.5
Foreign financed	0.5	0.5	0.7	0.9	0.3	0.3	0.3	1.1
Overall balance (checks issued)	-8.2	-7.3	-8.3	-8.3	-7.0	-5.1	-3.9	-3.4
Primary balance (checks issued)	2.9	2.9	1.0	0.4	1.5	2.9	3.7	3.9
Overall balance (cash basis)	-8.2	-7.5	-8.3	-8.3	-7.0	-5.1	-3.9	-3.4
Primary balance (cash basis)	2.8	2.7	1.0	0.4	1.5	2.9	3.7	3.9
Net financing	8.2	7.5	8.3	8.3	7.0	5.1	3.9	3.4
of which: Banking system	9.2	5.2	9.4	5.1	4.7	3.3	2.7	2.6
of which: Government institutions	1.9	0.3	0.4	0.1	0.0	-0.1	-0.1	0.1
of which: Other creditors	-2.9	1.5	-1.5	3.1	2.3	1.9	1.3	0.8
Memorandum items:								
Primary balance (on a checks issued basis, excluding Telecom revenues)	-1.0	1.2	-2.4	-3.1	-2.0	-0.6	0.3	0.5
Nominal GDP (annual and in billions of LL)	52,650	58,000	61,024	66,350	72,056	77,311	82,935	88,967
Total government gross debt (in percent of GDP)	146	137	134	132	128	125	120	116
of which: foreign denominated debt (in percent of gross debt)	42	39	38	42	45	48	50	51
Total government net debt (in percent of GDP)	133	127	129	127	124	121	117	112

Sources: Lebanese authorities; and IMF staff estimates and calculations.

1/ Includes domestic excises, which are collected at customs and are classified as taxes on international trade.

2/ Includes wages, salaries, related benefits, and pensions.

3/ Excludes principal and interest payments paid on behalf of Electricite du Liban.

4/ Includes transfers to the National social security fund, hospitals, municipalities, Higher Relief Committee, Displaced Fund, Council of the South, bread subsidy, and the interest subsidy.

Table 9. Lebanon: Banking Sector Financial Soundness Indicators, 2007–11

	2007	2008	2009	2010	2011 Aug.
	(In percent, unless otherwise indicated)				
Assets (in millions of U.S. dollars) 1/	82,255	94,255	115,250	128,925	141,891
Capital					
Capital adequacy ratio 2/ 3/	12.5	12.1	13.7	13.3	13.3
Capital to asset ratio	8.9	8.5	7.2	7.3	7.7
Asset quality					
NPLs	10.1	7.5	6.0	4.3	3.8
Provisions against NPLs	56.9	61.3	63.9	62.0	60.1
Total provisions/problem loans	76.8	86.4	99.6	109.3	110.1
Asset concentration					
Share of claims on government 1/	26.1	27.0	25.2	22.7	21.1
Of which: T-bills	12.6	15.9	15.1	13.6	12.1
Of which: Eurobonds	13.5	11.0	10.1	9.1	8.9
Share of claims on BdL 1/	24.7	27.8	30.7	31.3	34.6
Of which: Certificates of Deposit	9.0	12.1	16.3	17.7	18.0
Share of claims on private sector 1/	21.6	22.3	21.0	23.5	23.7
Share of claims on nonresidents 4/	20.9	16.3	16.6	15.9	14.5
Of which: foreign banks 4/	17.7	12.1	13.0	12.3	10.4
Net foreign currency assets as percent of capital	18.4	18.9	15.4	14.2	15.3
Earnings					
Average return on assets (after tax)	1.02	1.11	1.05	1.23	1.00
Average return on equity (after tax)	12.1	13.8	14.3	17.1	13.1
Net interest margin	2.0	2.1	1.9	1.8	1.7
Liquidity					
Net liquid assets/total assets	40.3	42.3	46.5	45.1	41.5
Net liquid assets/short-term liabilities	47.9	50.1	54.2	52.9	50.3
Private sector deposits/assets	70.1	70.3	68.7	68.8	68.8
Nonresident deposits/assets	11.7	12.2	14.4	14.3	14.2
Other indicators 5/					
Change in assets (12 month, in percent)	12.7	14.3	22.3	11.7	7.7
Change in private sector credit (12 month, in percent) 1/	15.9	18.6	15.2	25.0	11.0
Change in deposits (12 month, in percent) 1/	10.8	15.6	23.1	12.1	10.1
FC deposits/total deposits 1/	77.4	69.6	64.5	63.3	66.0
FC loans/total loans 1/	84.3	84.0	81.3	77.3	75.9
FC loans/GDP 1/	59.8	58.8	56.5	60.9	63.1
Memorandum items:					
LL deposit rate (average) 6/	7.5	7.3	7.0	5.9	5.6
LL loan rate (average) 6/	10.3	10.0	9.6	8.3	7.4
FC deposit rate (average) 6/	4.8	3.7	3.2	2.8	2.8
FC loan rate (average) 6/	8.2	8.5	8.3	7.5	6.9
Government's 3-year T-bill rate (marginal) 7/	9.5	9.4	8.6	6.3	6.0
Government's Eurobond rate (marginal) 1/	8.9	9.1	7.7	5.2	4.8
Spread over 5-year U.S. note 1/	4.5	6.3	5.6	3.2	3.2
GDP (in millions of U.S. dollars) 1/	25.1	30.1	34.9	38.5	40.5

Sources: Lebanese authorities; and IMF staff estimates.

1/ Reflects staff projection for 2011.
2/ From 2007: based on Basel II risk weights.
3/ February 2011.
4/ October 2011.
5/ FC and LL stand for "foreign currency" and "Lebanese pound," respectively.
6/ Q3 2011.
7/ Average for January-October 2011.

Table 10. Lebanon: Indicators of Financial and External Vulnerability, 2007–11

	2007 Act.	2008 Act.	2009 Act.	2010 Act.	2011 Proj.
	(In millions of U.S. dollars, unless otherwise indicated)				
Monetary and financial indicators					
Broad money, M5	69,423	80,174	98,737	110,761	120,730
Annual percentage change	10.9	15.5	23.2	12.2	9.0
Private sector credit (annual percentage change)	15.8	18.5	15.1	24.8	11.0
Public finance indicators					
Overall fiscal balance	-2,713	-2,870	-2,867	-2,870	-3,368
In percent of GDP	-10.8	-9.5	-8.2	-7.5	-8.3
In percent of government revenue	-45.0	-40.3	-33.7	-34.0	-37.2
Interest payments	3,139	3,303	3,847	3,917	3,771
In percent of GDP	12.5	11.0	11.0	10.2	9.3
In percent of government revenue	52.1	46.3	45.3	46.3	41.6
Nominal GDP	25,057	30,080	34,925	38,474	40,480
Government revenue	6,026	7,127	8,495	8,453	9,060
Banking-sector indicators					
NPLs 1/	10.1	7.5	6.0	4.3	3.8
Provisions against NPLs (in percent of NPLs) 1/	56.9	61.3	63.9	62.0	60.1
Capital adequacy ratio 2/ 3/	12.5	12.1	13.7	13.3	13.3
Credit to the private sector (in percent of GDP)	70.8	70.0	69.5	78.8	83.2
Debt indicators					
Gross public debt	42,033	47,024	51,152	52,602	54,372
In percent of government revenue	697.5	659.8	602.2	622.3	600.1
In percent of GDP	167.7	156.3	146.5	136.7	134.3
Of which: foreign currency	21,221	21,148	21,319	20,592	20,928
In percent of GDP	84.7	70.3	61.0	53.5	51.7
Gross public debt held by the market	29,206	33,993	36,229	42,132	43,643
In percent of GDP	116.6	113.0	103.7	109.5	107.8
External debt 4/	48,603	52,042	61,089	61,970	63,794
In percent of GDP	194.0	173.0	174.9	161.1	157.6
External public debt (central government and BdL)	11,350	11,503	11,047	10,650	10,249
In percent of GDP	45.3	38.2	31.6	27.7	25.3
Short-term external public debt 5/	1,456	1,401	2,030	2,191	1,689
Short-term foreign currency public debt 5/	2,812	3,064	2,618	3,808	1,743
Short-term external debt 4/ 5/	38,709	41,940	52,072	53,511	55,233
Short-term foreign currency debt 5/ 6/	63,019	65,429	74,158	79,155	85,081
Total foreign currency deposits	52,099	54,175	61,824	68,067	78,069
International reserves					
Gross official reserves 7/	11,496	18,769	27,405	30,172	30,601
In percent of short-term external debt	29.7	44.8	52.6	56.4	55.4
Gross official reserves and commercial banks' foreign assets	32,206	37,896	51,085	55,900	57,493
In percent of short-term external debt	83.2	90.4	98.1	104.5	104.1
In percent of short-term foreign currency debt	51.1	57.9	68.9	70.6	67.6
External current account indicators					
Merchandise exports, f.o.b.	4,067	5,251	4,716	5,467	6,068
Annual percentage change	26.8	29.1	-10.2	15.9	11.0
Merchandise imports, f.o.b.	11,926	16,261	15,895	17,724	19,621
Annual percentage change	27.6	36.3	-2.3	11.5	10.7
External current account balance	-1,698	-2,764	-3,401	-4,062	-5,707
In percent of GDP	-6.8	-9.2	-9.7	-10.6	-14.1
In percent of exports of goods and services	-10.6	-12.1	-14.9	-16.3	-22.1

Sources: Lebanese authorities; Bank for International Settlements; and IMF staff estimates and projections.

1/ August 2011.
2/ February 2011.
3/ From 2007: based on Basel II risk weights.
4/ Includes estimates for public debt and bank deposits held by nonresidents, and nonresident claims on the nonfinancial sector.
5/ On a remaining maturity basis (scheduled amortization over the next year).
6/ Short-term foreign currency debt of the public sector and the banking sector plus external debt of the nonbank sector.
7/ Excludes gold and encumbered assets.

Annex 1. Lebanon: Public Debt Sustainability Analysis

Debt level and structure. Lebanon's gross government debt amounted to 134 percent of GDP (US$ 54.2 billion) at end-October 2011. The share of domestic currency debt is 61 percent with an average maturity of 2.6 years, while the average maturity of foreign currency debt is 5.2 years. Government debt is largely held by domestic banks (54 percent) and the BdL (20 percent).

Baseline scenario. The baseline ("no policy change") scenario assumes that the primary balance would stay broadly unchanged at around ½ percent of GDP from 2013 onward. Annual growth would converge to its potential of 4 percent, while interest rates would increase gradually in line with a projected increase in global interest rates. Under this scenario, the debt-to-GDP ratio would hover slightly above 130 percent throughout the medium term.

Shocks. Stress tests show that a higher interest rate or lower growth would reverse the downward trend in the debt-to-GDP ratio achieved during 2007–10. Specifically, a permanent shock of a ½ standard deviation from past distribution, relative to the baseline, applied to the

- Interest rate would lead to an increase in the debt ratio to 145 percent of GDP by 2016 (Figure 1, panel 2);

- Growth rate would lead to an increase in the debt ratio to 148 percent of GDP by 2016 (Figure 1, panel 3); and

- Primary balance would lead to an increase in the debt ratio to 136 percent of GDP by 2016 (Figure 1, panel 4).

A combined permanent shock of a ¼ standard deviation from past distribution, relative to the baseline, applied to the interest rate, the growth rate, and the primary balance would lead to an increase in the debt-to-GDP ratio to 146 percent by 2016 (Figure 1, panel 5).

Reform scenario. The scenario builds on structural reforms to increase medium-term growth and fiscal consolidation to reduce government debt, which in turn would boost confidence and lead to lower spreads for Lebanon. A combination of revenue and expenditure measures would increase the primary surplus, while creating fiscal space for higher investment and targeted social spending. Revenue measures would include introducing a comprehensive capital gains tax (yield of 0.3 percent of GDP); increasing selected excises (0.6 percent of GDP) and the VAT rate to 15 percent (1.1 percent of GDP); and broadening the VAT and income tax bases. Expenditure measures would include reforming the electricity sector to allow a gradual increase in tariffs to cost recovery and thus a reduction in transfers to the loss-making electricity company by more than two thirds over the medium term. Under this scenario, debt would decline to 97 percent of GDP by 2020 (Figure 1, panel 6).

Table 1. Lebanon: Public Sector Debt Sustainability Framework, 2006–16

(in percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	**Debt-stabilizing primary balance 7/**
1 **Baseline: Public sector debt 1/**	**179.9**	**167.7**	**156.3**	**146.5**	**136.7**			**134.3**	**131.8**	**130.0**	**130.4**	**131.1**	**132.1**	**1.6**
of which: foreign-currency denominated	90.6	84.7	70.3	61.0	53.5			51.7	55.1	58.3	62.4	66.6	69.5	
2 Change in public sector debt	3.9	-12.1	-11.4	-9.9	-9.7			-2.4	-2.5	-1.8	0.4	0.7	1.1	
3 Identified debt-creating flows (4+7+12)	5.9	-1.3	-18.4	-13.5	-6.2			1.5	-2.5	-1.8	0.4	0.7	1.1	
4 Primary deficit	-2.6	-1.3	-1.4	-2.9	-2.9			-1.0	-0.4	-0.6	-0.6	-0.6	-0.6	
5 Revenue and grants	25.1	24.0	23.7	24.3	22.0			22.4	24.3	24.1	24.0	23.9	23.9	
6 Primary (noninterest) expenditure	22.5	22.7	22.3	21.5	19.1			21.4	24.0	23.5	23.4	23.3	23.3	
7 Automatic debt dynamics 2/	8.4	-6.3	-17.0	-10.7	-3.3			2.5	-2.1	-1.2	1.0	1.3	1.6	
8 Contribution from interest rate/growth differential 3/	8.4	-6.3	-17.0	-10.7	-3.3			2.5	-2.1	-1.2	1.0	1.3	1.6	
12 Other identified debt-creating flows	0.0	6.3	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	-1.9	-10.9	7.0	3.7	-3.5			-3.9	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	717.1	697.7	660.0	602.4	622.5			600.3	542.1	540.4	543.7	548.8	554.0	
Gross financing need 4/	...	...	44.9	42.9	42.1			54.2	33.7	25.8	26.9	33.5	31.1	
in billions of U.S. dollars	...	...	13.5	15.0	16.2			21.9	14.8	12.3	13.6	18.0	17.8	
Scenario with key variables at their historical averages 5/								**134.3**	**132.3**	**130.4**	**128.6**	**126.8**	**125.0**	**0.3**
Scenario with no policy change (constant primary balance) in 2011-2016								**134.3**	**131.2**	**129.0**	**129.0**	**129.2**	**129.8**	**1.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	0.6	7.5	9.3	8.5	7.0	5.2	3.1	1.5	3.5	4.0	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 6/	7.6	7.8	7.9	8.2	7.7	8.6	1.7	7.2	7.0	7.1	7.1	7.3	7.6	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.5	3.9	-2.0	1.2	4.7	5.5	4.1	3.5	1.9	3.2	4.9	5.1	5.4	
Inflation rate (GDP deflator, in percent)	2.0	3.9	9.8	7.0	3.0	3.1	3.5	3.7	5.1	3.9	2.2	2.2	2.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	11.0	8.5	7.4	4.3	-5.0	2.6	10.8	13.8	16.0	1.8	3.7	3.6	3.9	
Primary deficit	-2.6	-1.3	-1.4	-2.9	-2.9	-2.1	1.5	-1.0	-0.4	-0.6	-0.6	-0.6	-0.6	

1/ Includes all debt contracted by the Treasury on behalf of the central government and public agencies other than the Banque du Liban; accrued interest; and Banque du Liban lending to the Electricite du Liban. Excludes possible government arrears to the private sector.

2/ Derived as $[(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp))$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as $-g$.

4/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

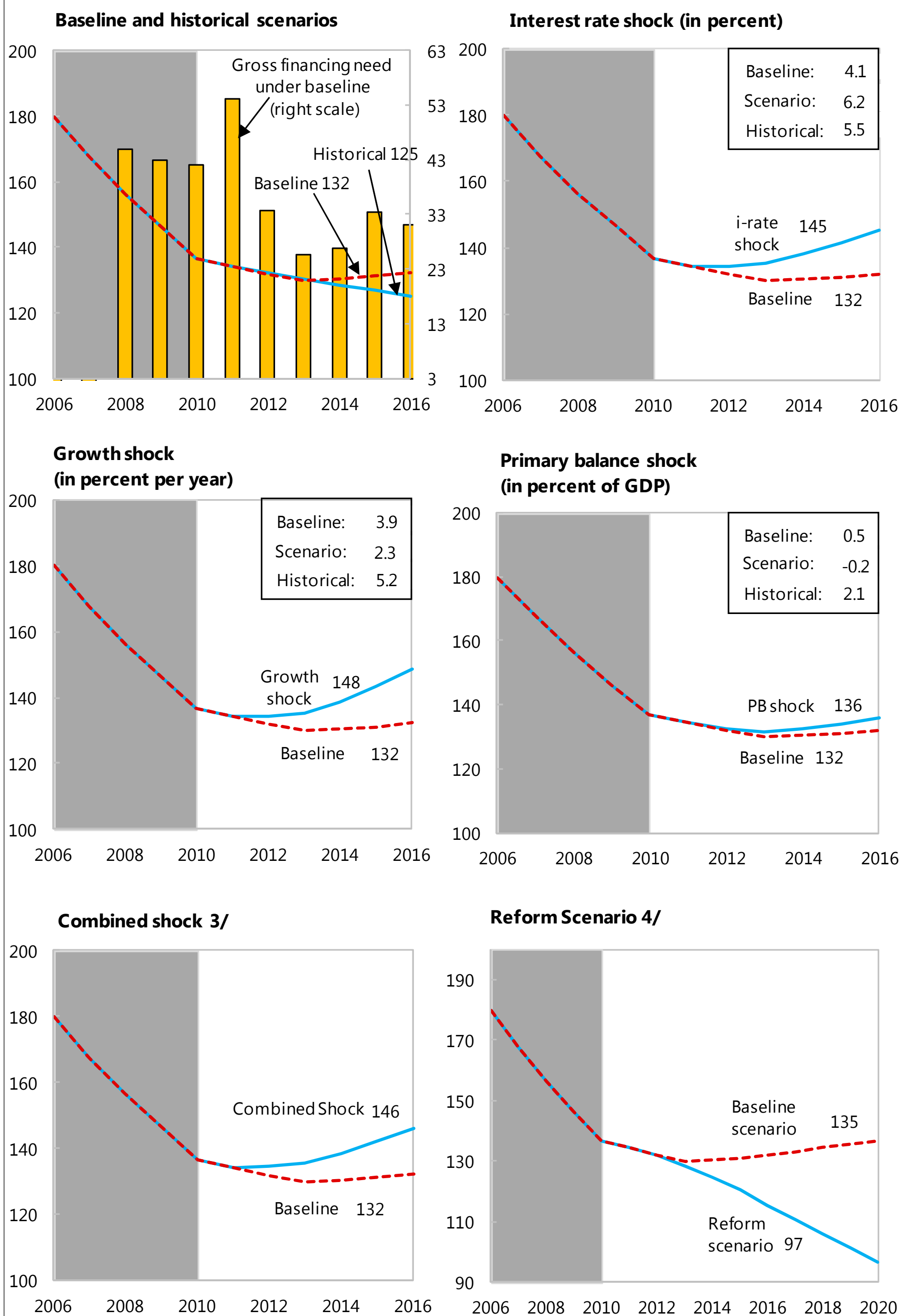
5/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 1. Lebanon: Public Debt Sustainability: Bound Tests 1/ 2/

(Public debt in percent of GDP)



Sources: International Monetary Fund country desk data and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. The ten-year historical average for the variable is also shown.
2/ For historical scenario, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to the real interest rate, the growth rate, and the primary balance.
4/ The reform scenario assumes higher primary balance, higher growth, and lower interest rates, relative to the baseline scenario.

Annex 2. Lebanon: External Debt Sustainability Analysis

Lebanon's external debt is expected to remain among the highest in the world. The external debt-to-GDP is estimated at 161 percent in 2010, down from 199 percent in 2006, reflecting mostly rapid nominal GDP growth. About 80 percent of external debt consists of short-term nonresident deposits in the banking sector. Medium-term projections reflect persistent (though narrowing) current account deficits projected through 2016. Under the baseline scenario, external debt is expected to increase to 178 percent of GDP by 2016, largely reflecting the impact of an expected increase in nominal interest rates (in line with global projections) and continuous inflows of nonresident deposits.

Several factors mitigate the extent of underlying vulnerabilities from the high debt ratio.

- While almost all nonresident deposits are short-term, they are largely owned by the Lebanese diaspora. These deposits have proven to behave like long-term deposits and demonstrated resilience during past stress episodes. Nonresident deposits comprise about 85 percent of gross financing needs over the medium term.

- Due to lack of information on maturity, all external nondeposit liabilities of banks and the full amount of external debt of nonbanks are treated as short-term debt in this exercise. This implies a substantial upward bias in estimates of gross annual financing needs and short-term external debt.

Standard bound tests suggest high sensitivity of the debt dynamics to exchange rate, growth, current account balance, and interest rate shocks. Debt dynamics are most sensitive to exchange rate shocks. A one-time real depreciation of 30 percent in the exchange rate in 2012 would raise, on impact, the debt level to 244 percent of GDP, which would rise further to 273 percent of GDP by 2016 (Figure 1, panel 6). This underscores the importance of the exchange rate peg as a linchpin of macroeconomic and financial stability in Lebanon. In addition, a permanent shock of a ½ standard deviation from past distribution, relative to the baseline, applied to the

- Interest rate would raise the debt ratio to 183 percent of GDP by 2016 (Figure 1, panel 2);

- Growth rate would raise the debt ratio to 191 percent of GDP by 2016 (Figure 1, panel 3); and

- Noninterest current account balance would raise the debt ratio to 194 percent of GDP by 2016 (Figure 1, panel 4).

A combined permanent shock of a ¼ standard deviation from past distribution, relative to the baseline, applied to the interest rate, growth rate, and noninterest current account balance would raise the debt ratio to 195 percent of GDP by 2016 (Figure 1, panel 5).

Table 1. Lebanon: External Debt Sustainability Framework, 2006–16

(In percent of GDP, unless otherwise indicated)

		Actual							Projections						
		2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	**Debt-stabilizing non-interest current account 6/**
1	**Baseline: External debt**	198.8	194.0	173.0	174.9	161.1			**157.6**	**158.6**	**163.5**	**169.7**	**174.0**	**177.7**	**-10.3**
2	Change in external debt	13.1	-4.9	-21.0	1.9	-13.8			-3.5	1.0	4.9	6.2	4.3	3.7	
3	Identified external debt-creating flows (4+8+9)	-11.4	-21.5	-31.9	-24.8	-16.3			3.5	-0.5	-2.1	-3.5	-4.7	-5.8	
4	Current account deficit, excluding interest payments	-11.0	-8.8	-2.5	0.8	3.6			6.9	6.6	5.4	3.5	1.9	0.8	
5	Deficit in balance of goods and services	13.5	18.2	17.8	16.1	15.9			18.9	18.3	17.4	16.7	16.0	15.3	
6	Exports	61.1	63.9	75.7	65.4	64.7			63.7	62.8	62.8	64.0	65.2	66.4	
7	Imports	74.6	82.1	93.5	81.5	80.6			82.6	81.1	80.3	80.8	81.3	81.8	
8	Net non-debt creating capital inflows (negative)	-11.9	-7.5	-8.7	-10.5	-9.9			-8.3	-9.3	-9.2	-9.4	-9.5	-9.7	
9	Automatic debt dynamics 1/	11.4	-5.3	-20.7	-15.0	-10.0			4.9	2.2	1.8	2.3	2.9	3.1	
10	Contribution from nominal interest rate	16.2	15.5	11.7	9.0	6.9			7.2	7.3	7.6	8.5	9.3	9.6	
11	Contribution from real GDP growth	-1.1	-13.4	-15.0	-12.7	-11.8			-2.3	-5.1	-5.9	-6.2	-6.4	-6.6	
12	Contribution from price and exchange rate changes 2/	-3.7	-7.4	-17.4	-11.3	-5.1			...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	24.5	16.6	11.0	26.7	2.4			-7.0	1.5	7.0	9.7	9.1	9.5	
	External debt-to-exports ratio (in percent)	325.4	303.8	228.6	267.5	248.9			247.4	252.5	260.2	265.1	266.8	267.4	
	Gross external financing need (in billions of US dollars) 4/	34.9	37.3	40.8	45.1	55.1			58.3	60.5	66.1	73.4	80.7	88.3	
	in percent of GDP	155.5	148.9	135.8	129.2	143.2			144.0	137.4	138.9	145.3	150.2	154.7	
	Scenario with key variables at their historical averages 5/								**157.6**	**155.4**	**157.2**	**158.9**	**159.7**	**160.9**	**-11.8**
	Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
	Real GDP growth (in percent)	0.6	7.5	9.3	8.5	7.5	5.2	3.2	1.5	3.5	4.0	4.0	4.0	4.0	
	GDP deflator in US dollars (change in percent)	2.0	3.9	9.8	7.0	3.0	3.1	3.5	3.7	5.1	3.9	2.2	2.2	2.2	
	Nominal external interest rate (in percent)	9.0	8.7	7.3	6.0	4.4	7.0	1.4	4.7	5.0	5.2	5.5	5.8	5.9	
	Growth of exports (US dollar terms, in percent)	21.8	16.7	42.3	0.3	9.0	15.3	11.6	3.5	7.2	8.1	8.3	8.3	8.3	
	Growth of imports (US dollar terms, in percent)	12.4	22.8	36.7	1.2	9.0	12.2	12.1	7.7	6.9	6.9	6.9	6.9	6.9	
	Current account balance, excluding interest payments	11.0	8.8	2.5	-0.8	-3.6	-0.5	6.6	-6.9	-6.6	-5.4	-3.5	-1.9	-0.8	
	Net non-debt creating capital inflows	11.9	7.5	8.7	10.5	9.9	9.5	1.8	8.3	9.3	9.2	9.4	9.5	9.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

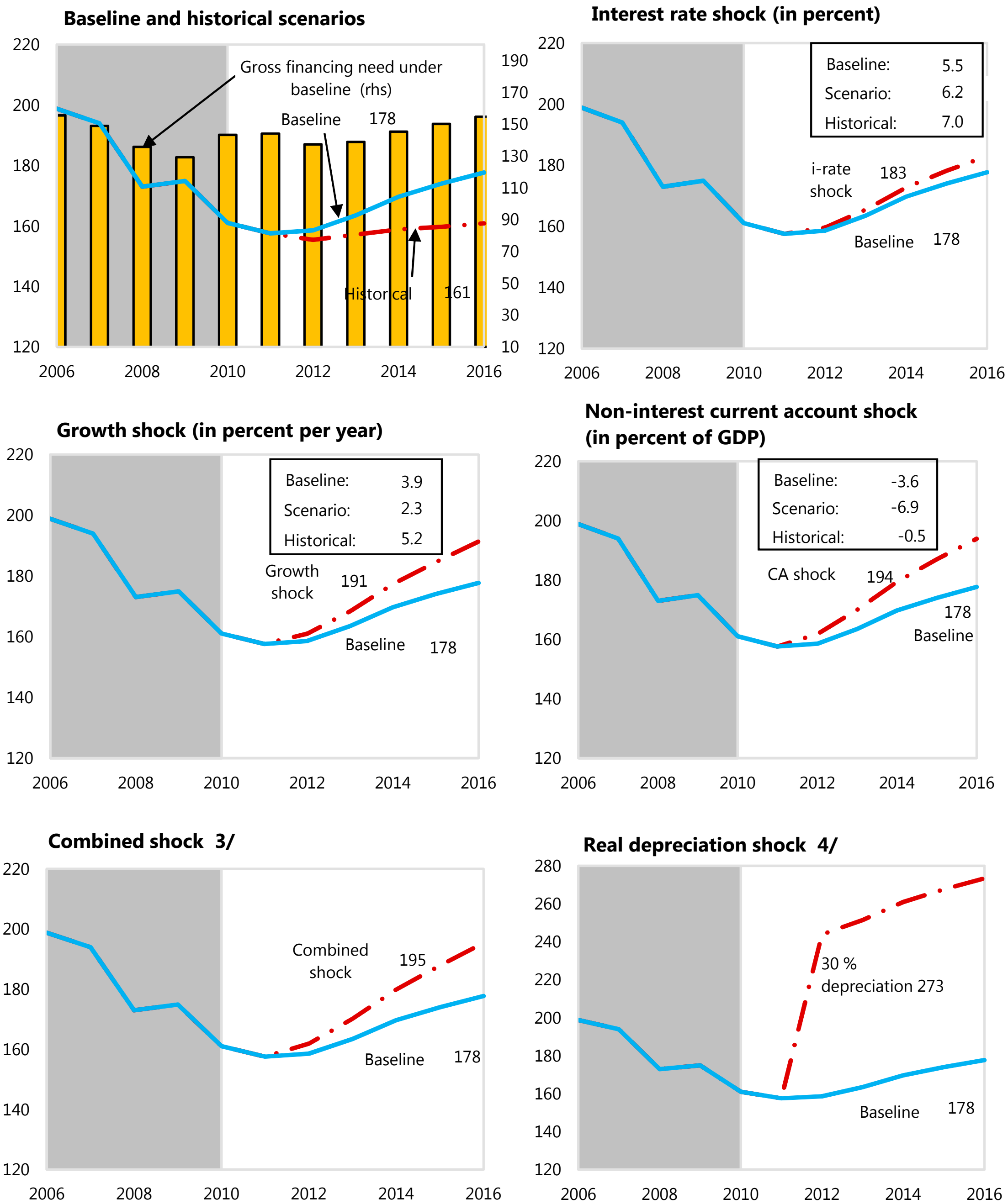
3/ For projection, line includes the impact of price changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure 1. Lebanon: External Debt Sustainability: Bound Tests 1/ 2/
(external debt in percent of GDP)



Sources: International Monetary Fund country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. The ten-year historical average for the variable is also shown.
2/ For historical scenario, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to the real interest rate, the growth rate, and the current account balance.
4/ One-time real depreciation of 30 percent occurs in 2012.

INTERNATIONAL MONETARY FUND

LEBANON

January 10, 2012

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

ANNEX I. LEBANON—FUND RELATIONS

(As of November 30, 2011)

Membership Status:

Joined: April 14, 1947; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	266.40	100.00
Fund holdings of currency	269.78	101.27
Reserve position in Fund	34.68	13.02

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	193.29	100.00
Holdings	192.61	99.65

Use of Fund Resources

Lebanon's outstanding credit to the IMF comes from two drawings under Emergency Post-Conflict Assistance (EPCA) in April 2007 and November 2008. The last EPCA assessment report was issued in November 2009.

Outstanding Purchases

	SDR Million	Percent Quota
EPCA	38.06	14.29

Latest Financial Arrangements

None.

Projected Obligations to Fund[1] (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2012	2013	2014	2015
Principal	25.38	12.69	0.00	0.00
Charges/interest	0.30	0.10	0.01	0.00
Total	**25.68**	**12.79**	**0.01**	**0.00**

Implementation of HIPC Initiative

Not applicable.

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Safeguards Assessment

Pursuant to Fund policy, the Banque du Liban (BdL) was subject to a full safeguards assessment in conjunction with the first EPCA. The 2008 safeguards assessment report proposed several specific measures for enhancing the BdL's financial reporting, audit and control procedures, and recommended an update of the central bank law. An update safeguards assessment was completed in August 2009 in the context of the second EPCA. The update noted progress in enhancing procedures for reserve management and external audit, but recommended further actions to strengthen financial reporting transparency, oversight, central bank legislation, and internal audit.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Nonfinancial Relations

Exchange Arrangement

Lebanon has accepted the obligations of Article VIII, Sections 2, 3 and 4 in 1993 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The exchange arrangement, which maintains a *de-facto* peg to the U.S. dollar, is classified as stabilized. Since October 1999, the BdL has intervened to keep the pound around a mid-point parity of LL 1,507.5 per $1, with a bid-ask spread of LL+/-6.5.

Last Article IV Consultation

The 2010 Article IV Consultation was concluded by the Executive Board on July 30, 2010. At the time, Directors welcomed Lebanon's strong economic and financial performance during the global recession. They underscored the need to address the high government debt and implement growth-enhancing structural reforms and called for continued vigilance to prevent the build-up of new vulnerabilities.

Financial Sector Assessment Program

Lebanon participated in the Financial Sector Assessment Program in 1999, and the related report was presented to the Executive Board at the time of the 1999 Article IV consultation (FO/DIS/99/113). A Financial System Stability Assessment update was conducted in 2001, and the related report presented to the Executive Board at the time of the 2001 Article IV consultation (SM/01/281).

Resident Representative Office

The IMF Resident Representative Office in Lebanon was opened in January 2008 and closed in August 2011. Mr. Edward Gardner held the position of Resident Representative from January 2008 to March 2009, followed by Mr. Eric Mottu from September 2009 to August 2011. The Fund maintains a local office which is headed by Ms. Najla Nakhle and hosted by the Middle East Technical Assistance Center (METAC).

Technical Assistance (TA)

Fiscal area—The Fiscal Affairs Department (FAD) has provided advice on introducing the VAT, reforming customs tariffs and income taxes, strengthening tax and customs administration, and improving expenditure policy and public expenditure management. A fiscal ROSC was published in May 2005. During 2005–07, TA focused on (i) consolidating fiscal accounts; (ii) improving liquidity management; (iii) identifying fiscal reform priorities; (iv) reforming subsidies and restoring gasoline excises; and (v) improving the budget preparation and execution processes. During 2008–09, FAD, including through METAC, provided targeted follow-up support to ongoing initiatives in both tax administration and public financial management (PFM) (e.g., tax audit program, treasury single account and cash management). During 2010–11, FAD provided assistance on tax policy options and reform priorities in tax administration and PFM, while METAC continued to provide TA on tax and customs administration, including on compliance management in the banking sector and merging the VAT and income tax directorates.

Financial area—The Monetary and Capital Markets Department (MCM) has provided TA mainly on the payment and settlement systems and vulnerability indicators. The related missions undertook an assessment of compliance with Core Principles for Systemically Important Payment Systems and advised on developing systems to improve the efficiency and liquidity management of public sector payments and receipts. MCM also advised on developing an early warning system (EWS) for the financial sector based on prudential data. During 2010–11, METAC provided training on consolidated supervision and assessing banks' business and strategic plans, and continued assistance in developing an EWS.

Statistical area—The Statistics Department has provided TA in national accounts, price and balance of payments statistics. Several missions on the consumer price index (CPI) were undertaken in 2007 through METAC, and a new monthly country-wide CPI was launched in March 2008. TA in building capacity for national accounts statistics and economic surveys was provided through the resident advisor in real sector statistics. METAC provided in 2008 assistance on balance of payments and international investment position statistics, and more recently, recommendations on improving work processes in the Statistics and Economic Research Department of the BdL. During 2010–11, TA focused on (i) assessing the work processes at the BdL; (ii) developing a producer price index; (iii) discussing plans to move the compilation of national accounts statistics from the Prime Minister's office to the Central Administration of Statistics; and (iv) improving balance of payments/international investment position statistics.

ANNEX II. LEBANON—WORLD BANK-IMF COLLABORATION

1. The Lebanon teams of the Fund and the World Bank met to discuss macrocritical structural reforms and to coordinate their work in 2012.[2] The teams agreed that Lebanon's main medium-term macroeconomic challenges are to secure sustained inclusive growth and economic resilience and to reduce the very high government debt-to-GDP ratio. To meet these challenges, Lebanon needs to implement long-delayed structural reforms, achieve fiscal consolidation over a number of years, reform the tax system by making it more equitable, strengthen the delivery of social services and the social safety net, and continue to protect the financial sector from excessive risks.

2. Based on this shared assessment, the teams identified eight structural reform areas as macrocritical, in view of their central role in achieving fiscal consolidation and sustained growth:

- **Electricity sector reform:** Reduce budgetary transfers to the electricity provider by (i) reducing the cost of production, including through reducing systems losses and reliance on expensive fuel oil; (ii) increasing revenue collection; (iii) enhancing electricity supply by making necessary investments; and (iv) gradually adjusting tariffs toward cost recovery levels, possibly in conjunction with transfers to poor households. These measures should be accompanied by a comprehensive reform of the regulatory and institutional framework. Electricity sector reform is macrocritical because the large budgetary transfers to the sector (4½ percent of GDP in 2011) undermine fiscal sustainability, and insufficient and unreliable electricity supply weighs on growth, social development and the budget of households and businesses, which are forced to pay for expensive alternatives.

- **Telecommunications sector reform:** Reduce costs and enhance the quality and scope of telecom services by making necessary investments and implementing the regulatory framework needed for increased private sector involvement (until now limited mostly to internet service provision). Telecommunications sector reform is macrocritical because (i) the sector generates large revenue for the government (about 3½ percent of GDP in 2011); (ii) improvements in the sector can lift the country's growth potential; (iii) reducing the prices in the sector would be beneficial to households and enterprises; and (iv) proceeds from licensing and/or privatization could be used to repay part of the government debt.

- **Tax reform:** Move toward an equitable tax system by broadening tax bases and increasing tax rates on capital gains and excisable products. Tax policy reforms should be accompanied by reforms to restructure and modernize revenue administration and enhance compliance. Tax reform is macrocritical because the tax burden on wages is currently very high and

[2] The IMF team was led by Ms. Kristina Kostial (mission chief) and the World Bank team by Mr. Hedi Larbi (Country Director).

a more equitable income distribution and tax system as well as a more effective and transparent revenue administration are needed for inclusive growth.

- **Public financial management (PFM) reform:** Lebanon's PFM is compartmentalized and not very effective. Key elements of a reform are: (i) establishing a macrofiscal unit in the Ministry of Finance; (ii) completing the coverage of the Treasury Single Account; (iii) strengthening expenditure programming, budget preparation, aid and debt management, and coordination with the Central Bank; and (iv) strengthening accounting, payment and auditing functions, including by introducing a Government Financial Management Information System. These reforms are macrocritical because they will help create fiscal space needed for fiscal consolidation and for higher public investment and targeted social spending. They will also help establish an accountability framework for government and allow stakeholders in the economy to monitor developments. Potential plans to enter into public-private partnerships (PPPs) could help address infrastructure bottlenecks, but a sound institutional and legal framework must be put in place to control fiscal risks and maximize benefits.

- **Social services and safety net reform:** Delivery of social services in Lebanon and the social safety net are weak. The following reforms would help: (i) health: rationalizing health spending and expanding health insurance coverage; (ii) education: improving the quality of public education including strengthening higher education and vocational training; (iii) pension systems: strengthening financial sustainability and administration of the National Social Security Fund, reforming the end-of-service indemnity, and ultimately creating a new pension system for private sector workers; and (iv) social safety nets: improving targeting to the most needy. These reforms are macrocritical because they will increase the efficiency of public spending, and also because better health and education services, stronger pensions systems and a more effective social safety are needed to enhance the productivity of the workforce and strengthen growth prospects, reduce inequalities, and generate political support for the needed fiscal consolidation.

- **Investment climate reform:** Lebanon's corporate sector is held back by the high costs of doing business. High costs arise mainly from weaknesses in governance, power supply, regulatory systems, and weak contract enforcement. Wide-ranging reforms are needed to address these issues. They are macrocritical because a more conducive investment climate is needed to increase growth.

- **Financial sector stability assessment:** Given the very large financial sector and the high dollarization, financial sector stability is key for macroeconomic stability. Assessing financial system stability is macrocritical because it will help the authorities identify potential threats to it and provide suggestions for addressing them.

- **Reform of the statistical system:** Lebanon's statistical system suffers from fragmentation and has limited capacity to provide timely and reliable data.

Strengthening the statistical authorities is macrocritical because timely and reliable data are needed to monitor economic and social developments and to enable evidence-based decision making.

3. The teams agreed the following division of labor:

- **Electricity sector reform:** The Bank will continue to elaborate reform options and discuss them with the authorities. In this context, the Bank will draw on the recently completed "Electricity Strategic Plan" prepared by the Ministry of Energy to focus its support on priority measures to be taken by the government. The Country Partnership Strategy of the Bank provides for technical and possibly financial support to the electricity sector to assist the government in implementing its strategic plan.

- **Telecommunications sector reform:** The Bank will support the Government's objective to structure the telecommunications sector in a way that introduces competition, improves capacity and quality of services, and reduces cost to consumers. The Bank Group will continue the dialogue accompanying the implementation of the telecommunication sector strategy. An Institutional Development Fund Grant has been mobilized to finance capacity building in the Telecommunications Regulatory Authority. In addition, IFC Advisory and Investment products could be leveraged to the extent the private sector becomes part of the government's strategy for telecom reform. The Fund will lead work on taxation and broader implications of the sector reform on the budget.

- **Tax reform:** The Fund will provide technical assistance (TA) on the implementation of the capital gain tax. It could also provide further support to integrating the direct and indirect tax departments at the Ministry of Finance. The Bank will build on tax work available from the Fund to perform analytical work on the growth and welfare impact of fiscal policy options.

- **Public financial management reform:** The Bank is providing TA on budget preparation and execution, debt management and aid coordination through the Emergency Fiscal Management project (EFMIS). The project also includes macro-fiscal projections and capacity building activities covering all four fields of TA mentioned above. If requested, the Fund would provide TA (via METAC) on (i) the preparation of an explicit PFM reform strategy that would build the technical reforms into a coordinated program of procedural improvements and capacity building actions; and (ii) the assessment of the new draft Budget System Law, which is expected to replace the current Public Accounting Law. The Fund and the Bank will work jointly to assist in establishing a sound framework for PPPs, if requested by the authorities. The Fund would assist in building capacity for assessing and containing fiscal risks, while the Bank would lead in setting up a mechanism for competitive bidding procedures and incentive-based regulation.

- **Social services and safety net reform:** The Bank will continue its analytical work in the area of social safety nets and provide a prioritized list of policy recommendations.

It launched the poverty-targeting project in October 2011, with the first package of benefits expected to be disbursed by mid-2012.

- **Investment climate reform:** The Bank has completed the update of its survey-based investment climate assessment in March 2010. This update includes a list of policy recommendations. A national workshop sponsored by the Prime Minister held in June 2010 shared the results of the survey and discussed an action plan for the government to address the main binding constraints to private sector development. Working groups led by the Prime Minister's office are working on policy measures to improve the business environment.

- **Financial sector stability assessment:** The Fund will continue to provide TA on the development of an EWS. If requested, it will assist the Banking Control Commission in enhancing the supervisory skills and capacities of its supervisors through a series of seminars and workshops. It could also assist in strengthening bank supervisory and regulatory frameworks. The Bank and the Fund will continue to encourage the authorities to undertake a Financial System Stability Assessment given the systemic importance of the banking sector (the last update was done in 2001). The update would provide a prioritized list of recommendations for addressing any threats to financial sector stability.

- **Reform of the statistical system:** The Bank is completing a household survey with the Central Administration of Statistics for the purpose of the National Poverty Targeting Program. The Bank will assist the authorities in implementing a statistical master plan and reforming the legal framework for the statistical activity in Lebanon. Fund TA will continue to focus on national accounts, monetary, price and balance of payments statistics.

4. The teams have the following requests for information from their counterparts:

- The Fund team requests to be kept informed of progress in the Bank's work in the above macrocritical structural reform areas. Timing: when milestones are reached (and at least semi-annually).

- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects, as well as of Fund's TA in the above reform areas. Timing: in the context of Article IV Consultation and other missions (and at least semi-annually).

- The table below lists the teams' separate and joint work programs in 2012.

Lebanon: Bank and Fund Planned Activities in Macrocritical Structural Reform Areas, 2012

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Bank Work Program	Country Assistance Strategy	Ongoing	Implementation between July 2010 and July 2014
	Assistance to the Electricity Sector	Possible investment lending in support of the strategic plan of the government. Technical assistance for LNG and energy efficiency	Board discussion in 2012
	Assistance for Private Sector Development (SMEs)	Possible lending and TA for SME growth and innovation	Tentative board date: March 2012
	Technical assistance on PFM (budget preparation, debt and aid management)	Implementation of the TA project started in May 2009. Progress will be monitored through the Bank's semi-annual supervision reports and the authorities' quarterly progress reports	Implementation through June 2013
	National Poverty Targeting Program - Phase I	Ongoing	Implementation throughout FY2012-13
	National Poverty Targeting Program – Phase II / Community Social Development	Possible lending	Tentative board date: July 2012
	Lending operation in the education sector	Ongoing	Implementation throughout FY2012-16
	Lending operation – Greater Beirut water project	Ongoing	Implementation throughout FY2010-16

Title	Products	Provisional Timing of Missions	Expected Delivery Date
	Lending operation – Baalbek water project	Ongoing	Closing in 2012
	Analytical and sector work and technical assistance in the area of social services (including education, health and pensions systems)	Ongoing	Implementation throughout FY2012–13
	Analytical work and technical assistance on labor market	Ongoing	Completion throughout FY2012
	Analytical and sector work on growth and welfare in a context of fiscal consolidation	Preparatory work is ongoing	Initiation in December 2011
	Sector work on gender and environment	Ongoing throughout FY12	
	Survey-Based Investment Climate Assessment (ICA) Update	Completed	Draft report submitted to the government
	Foreign Inflows and Broad Based Growth—Impact of Policy Choices	Completed	Dissemination in FY2012
	Assistance in implementing the statistical master plan	Initiation mission in December 2011	Implementation throughout FY2012–13

Title	Products	Provisional Timing of Missions	Expected Delivery Date
2. Fund Work Program	Article IV Consultation Staff Report	November 2011	January 2012
	TA on:		
	- Capital gain tax	Early 2012	2012
	- PFM reform	If requested, 2012	2012
	- Budget System Law	If requested, 2012	2012
	- Statistics (national accounts, BOP)	Ongoing	2012
	- Banking Supervision	If requested, 2012	Completion by April 2013
	- Early Warning System	Ongoing	Completion by December 2013
3. Joint Work Program	FSAP Update	If requested, 2012	2012

ANNEX III. LEBANON—STATISTICAL ISSUES

(As of January 6, 2012)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has serious shortcomings. In particular, there are weaknesses in the compilation of data on national accounts, the labor market, general government and the other nonfinancial public sector, and balance of payments. There are no national data on wages and real estate activity and prices. In addition, data on poverty and income distribution are patchy, impairing social policy formulation. Raising the statistical capacity in Lebanon to those of other upper middle income countries requires a firm commitment and high-level support from the government, including the allocation of sufficient resources and provision of a clear legal mandate to the Central Administration of Statistics (CAS).
National accounts: The national accounts data are weak. Only annual data are publicly available, currently until 2009. National accounts statistics are still being produced by a team in the Prime Minister's office with some bilateral support, using mostly administrative data sources and compilation methods that do not conform to best practices. The launch of comprehensive economic surveys and the transfer of national accounts statistics compilation to CAS have been repeatedly delayed, with the transfer now being planned for the 2011 accounts. The Statistics Department (STA) has been assisting CAS in building capacity to produce national accounts estimates based on a sound methodology and a comprehensive data collection program. Work is underway to incorporate the 2004 economic survey data into the national accounts estimates.
Price statistics: Since May 2008, CAS compiles and disseminates a monthly Consumer Price Index (CPI) following internationally accepted methodology. The CPI covers all areas in Lebanon and is disseminated within three weeks after the end of the reference month. Staff has adopted the new CAS index as the primary CPI for Lebanon since 2009 after previously using a private sector-produced index based on prices collected from Beirut and its suburbs. There is a need to address remaining shortcomings in the CAS index, including delays in the survey of some prices (e.g., housing), and to develop regular and timely statistics on producer prices, wages, and real estate prices. A METAC mission in 2010 produced a plan to develop a monthly producer price index to be compiled and released on a quarterly basis.
Government finance statistics: The dissemination of central government finance statistics has improved markedly in recent years. However, the coverage of government finance statistics is not comprehensive. Published monthly data on the central government budgetary accounts do not cover items such as certain transfers, financing data, foreign-financed capital expenditure, and arrears. Certain (treasury) spending is only identified ex-post, and presented in an economic classification with a lag. This said, these items are provided to the MCD country team in the context of surveillance activities. Government finance statistics are on a cash basis for revenue data, with a modified cash basis for budgetary expenditure data, corresponding to the issuance of payment orders.

Monetary and financial statistics: Monetary statistics are adequate. At the same time, sectoralization of institutional units and classification of financial instruments in the data reported to STA fall short of what is needed for the compilation of Standardized Report Forms. Reflecting in part restrictions imposed by domestic legislation, the Banque du Liban (BdL) does not publish externally audited financial statements, and its reporting practices are not yet fully compliant with the International Financial Reporting Standards. The lack of a reliable classification of deposits by residency complicates the balance of payments analysis.	
Balance of payments: Balance of payments (BoP) statistics are weak. There are deficiencies in the current account (unrecorded exports, uncertainty with respect to the estimates of private sector services, workers' remittances, and investment income), the capital account (grants), and the financial account (foreign direct investment, equity investment in the nonbank private sector, and corporate borrowing abroad). There has been no progress in the implementation of a Foreign Direct Investment survey. The forms and the reporting requirements for banks and nonbanks were amended in January 2010 to include a more comprehensive and detailed breakdown of BoP components. The lack of effective inter-agency cooperation and staff constraints at both the BdL and CAS are among the main factors impeding progress.	
II. Data Standards and Quality	
Participant in the General Data Dissemination System since January 2003. Metadata and the plans for improving the real and fiscal statistics need to be updated.	No data ROSC is available.
III. Reporting to STA	
Lebanon currently reports annual data based on *GFSM 2001* to be published in the *Government Finance Statistics Yearbook*, but the data suffer from weaknesses, mainly limited coverage. The reporting of monetary data to STA is irregular, though the MCD country team receives them on a timely basis. In September 2011, the BdL started submitting to STA core *Financial Soundness Indicators* data and metadata; data for 2011 have been posted on the IMF website.	

LEBANON: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of January 6, 2012)

	Date of Latest Observation	Date Received	Frequency of Data[8]	Frequency of Reporting[8]	Frequency of Publication[8]
Exchange Rates	01/05/12	01/05/12	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	11/2011	01/2012	M	M	M
Reserve/Base Money	11/2011	01/2012	M	M	M
Broad Money	11/2011	01/2012	M	M	M
Central Bank Balance Sheet	11/2011	01/2012	M	M	M
Consolidated Balance Sheet of the Banking System	11/2011	01/2012	M	M	M
Interest Rates[2]	12/2011	12/2011	W/M	W/M	W/M
Interest Rates[3]	10/2011	12/2011	M	M	M
Consumer Price Index	11/2011	12/2011	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing[4]– Central Government	09/2011	12/2011	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	10/2011	11/2011	M	M	M
External Current Account Balance	Q4/2010	Q2/2011	Q	Q	Q
Exports and Imports of Goods and Services	Q4/2010	Q2/2011	Q	Q	Q
GDP/GNP	2009	12/2010	A	A	A
Gross External Debt[7]	10/2011	11/2011	M	M	M
International Investment Position	N/A	N/A	N/A	N/A	N/A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. These are reported to the country team with a lag.
[2] Both market-based and officially-determined policy interest rates (including discount rates, rates on treasury bills, notes and bonds).
[3] Market interest rates (including average deposit and lending rates in Lebanese pounds and U.S. dollar).
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.
[7] Staff estimate based on public external debt, non-resident deposits, and claims of the BIS banks on nonfinancial private sector.
[8] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); or Not Available (NA).

INTERNATIONAL MONETARY FUND
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IMF Executive Board Concludes 2011 Article IV Consultation with Lebanon

On January 23, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lebanon.[1]

Background

Lebanon's economy lost momentum after four years of impressive economic growth. The fall of the coalition government in January 2011, and prolonged talks over the make-up of the new government until its formation in June, shook market confidence. Compounded with the regional unrest, this led to an economic downturn. Growth is expected to drop to 1–2 percent in 2011 from 8 percent on average during 2007–10, with real estate, tourism, retail and wholesale trade—key drivers of recent high growth—having been hit hard. Headline inflation averaged 5 percent in 2011, though core inflation remained moderate. Real Gross Domestic Product (GDP) could grow at 3–4 percent in 2012 but this hinges on strong domestic policies and an improved regional environment. Downside risks are large, mostly because of the uprising in Syria, further escalation of which could have serious political and economic repercussions on Lebanon. Lebanon is also facing risks related to the worsening outlook in Europe, primarily through second-round effects.

The authorities have so far managed the downturn skillfully, using buffers built up during the upswing. The Banque du Liban (BdL) relied on its large foreign reserves to intervene forcefully when the Lebanese pound came under pressure from deposit outflows and currency conversions in January 2011. Despite these interventions, gross foreign reserves increased to

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

$32 billion by end-November 2011 as the BdL issued foreign currency Certificates of Deposit and banks placed large foreign currency excess reserves with the BdL. The improved fiscal position—thanks to the marked decline in the debt-to-GDP ratio since 2006 and the sizeable primary surplus in 2010—freed up room for an accommodative fiscal stance in 2011. Tax revenue dropped in 2011, reflecting the downturn and a reduction in the fuel excise. Overall revenue though should increase slightly as a share of GDP because of the transfer of telecommunications revenues to the budget. With primary spending up, the primary surplus is expected to fall to about one percent of GDP from 2.7 percent of GDP in 2010. The government continues to have favorable access to the foreign currency debt market, but the BdL covered shortfalls in demand for domestic T-bills.

The banking sector has accumulated buffers but is facing an increasingly challenging environment. Thanks to prudent management and conservative regulation, banks report capital above the regulatory minimum, high liquidity buffers, low levels of nonperforming loans and stable profits. However, the recent expansion abroad exposes banks to heightened risks from the regional turmoil. Deposit inflows resumed in March following outflows and currency conversions after the fall of the government in January 2011, and are growing at an annualized rate of 9 percent. With pound deposits picking up recently, deposit dollarization is on a downward trend though still above its end-2010 level. Sovereign and Credit Default Swaps (CDS) spreads have risen broadly in line with emerging market averages.

The economy became more resilient in recent years thanks to a marked reduction in the government debt-to-GDP ratio and a build-up of large foreign reserves. Still, government debt at 134 percent of GDP at end-October 2011 remains among the highest in the world and gives rise to large recurrent financing needs. The large banking sector funds itself from short-term deposits to roll over its large exposure to the sovereign, exposing itself to a maturity mismatch. Continued nonresident deposit inflows are also needed to finance persistent and large current account deficits. At the same time, the ongoing unrest in the region brought to fore the need to address the important issues of unemployment and social inequality.

Executive Board Assessment

Executive Directors noted that domestic political uncertainty and regional unrest eroded market confidence in 2011, bringing an end to Lebanon's four-year spell of impressive economic growth. They commended the authorities for skillfully managing the downturn using buffers built during the upswing.

Looking ahead, Directors noted that downside risks are high due to the uprising in Syria, the uncertain outlook for the region, and the financial crisis in Europe. Also, underlying vulnerabilities remain large, especially those stemming from the high government debt and the continuing current account deficit. Against this background, Directors agreed that near-term policies should aim at instilling confidence and preserving macroeconomic stability. Over the medium term, the main challenge is to generate sustained and inclusive growth while reducing vulnerabilities.

Directors underscored the need to maintain fiscal discipline in 2012 and beyond. They suggested that contingency measures be incorporated in the 2012 budget in case downside risks materialize. Directors supported the authorities' intention to embed the 2012 budget into a medium-term agenda so as to facilitate prioritization. They agreed that the medium-term fiscal strategy should target a significant reduction in the debt-to-GDP ratio, while creating space for higher social and capital spending and making fiscal policy more equitable. This will require effective implementation of revenue administration and tax measures, tighter expenditure controls and better targeted social spending, and expenditure rationalization with improved public financial management.

Directors noted that the government needs to reduce its reliance on central bank financing and to finance itself fully from the market. To this end, they supported greater but prudent use of foreign currency borrowing by the government in the near term. Directors also noted that increasing interest rates on T-bills with maturities of less than 7 years would make them more attractive to banks. Some Directors, however, cautioned about the fiscal and economic impact of higher interest rates.

Directors agreed that the currency peg is central to the financial stability of Lebanon's highly dollarized economy, and should be backed by strengthening competitiveness. They cautioned that wage increases beyond productivity gains could pose problems for competitiveness. Directors also underscored the need for a medium-term plan to improve the central bank's balance sheet.

Directors noted that the banking sector has accumulated buffers, and that banking indicators appear to be sound. Nevertheless, large cross-border exposures and an increasingly challenging domestic and regional environment have heightened banking risks. Directors recommended continued vigilance, and welcomed plans to further strengthen bank regulation and supervision, including cross-border supervision, and to implement Basel III regulations. They encouraged the authorities to focus on early problem detection through enhanced stress-testing and improved loan classification and provisioning, and to continue strengthening the regime against money laundering and terrorism financing.

Directors recommended that the authorities implement a medium-term strategy that aims at sustained, broad-based growth and employment generation. This would require launching long-delayed reforms to develop the infrastructure, improve the business climate, and remove labor market inefficiencies. In this regard, Directors welcomed the planned investment in the electricity sector, but stressed that reforms should proceed in parallel to reduce the large budgetary transfers to the sector.

Directors urged the authorities to move decisively to improve Lebanon's statistical system.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2011 Article IV Consultation with Lebanon is also available.

Lebanon: Selected Economic Indicators, 2009–12

	2009	2010	Proj.	
	Act.	Prel.	2011	2012
Output and prices	(Annual percentage change)			
Real GDP (market prices)	8.5	7.0	1.5	3.5
GDP deflator	7.0	3.0	3.7	5.1
Consumer prices (period average) 1/	1.2	4.5	5.4	5.3
Central government finances (cash basis)	(In percent of GDP)			
Revenue (including grants)	24.3	22.0	22.4	24.3
Expenditure	32.5	29.4	30.7	32.6
Budget balance (including grants)	-8.2	-7.5	-8.3	-8.3
Primary balance (including grants)	2.8	2.7	1.0	0.4
Total government debt	146	137	134	132
Monetary sector	(Annual percentage change, unless otherwise indicated)			
Credit to the private sector	15.1	24.8	11.0	10.0
Broad money 2/	23.2	12.2	9.0	10.0
Interest rates (period average, in percent)				
Three-month treasury bill yield	4.9	4.2	...	...
Three-year treasury bill yield	8.4	6.4	6.0	6.5
External sector	(In percent of GDP, unless otherwise indicated)			
Exports of goods and services (in US$, percentage change)	0.3	9.0	3.5	7.2
Imports of goods and services (in US$, percentage change)	1.2	9.0	7.7	6.9
Current account	-9.7	-10.6	-14.1	-13.9
Foreign direct investment	10.5	9.9	8.3	9.3
Total external debt 3/	175	161	158	159
Gross reserves (in billions of U.S. dollars) 4/	27.4	30.2	30.6	34.4
In percent of short-term external debt 5/	52.6	56.4	55.4	56.9
In percent of total banking system deposits	28.6	28.1	26.0	26.5
Memorandum items:				
Nominal GDP (in billions of U.S. dollars)	34.9	38.5	40.5	44.0
Commercial bank total assets	330	335	351	355
Local currency per U.S. dollar (period average)	1507.5	1507.5	...	...
Real effective exchange rate (annual average, percent change)	3.2	2.6	...	...

Sources: Lebanese authorities; and IMF staff estimates.

1/ Through 2008: based on the CPI index by Consultation and Research Institute; from 2009: based on the CPI index by Central Administration of Statistics.

2/ Defined as currency in circulation plus resident and nonresident deposits.

3/ Includes nonresident deposits.

4/ Excluding gold and encumbered assets.

5/ Short-term debt on a remaining maturity basis, including short-term nonresident deposits.

Statement by Mr. Shaalan on Lebanon
Executive Board Meeting
January 23, 2012

On behalf of the Lebanese authorities, I would like to thank staff for the valuable policy discussions during the 2011 Article IV Consultation. The authorities also wish to express their appreciation for the continued provision of effective technical assistance.

Recent Developments and Outlook

The Lebanese economy lost momentum in 2011 amidst difficult domestic and regional conditions. GDP growth is expected to fall to 1–2 percent in 2011 from 8 percent on average over the preceding four years. This deterioration could have been much more pronounced given negative spillovers from developments in the region, particularly Syria, with whom political and economic links are very close. However, the prudent policies that have been followed over a number of years, which led to the build-up of fiscal and foreign reserve buffers, provided the authorities with the policy space needed to support the economy and limit adverse impacts.

The authorities remain fully committed to policies that ensure macroeconomic stability while addressing infrastructure bottlenecks and improving social conditions. This would help to pave the way for higher, sustainable, and inclusive growth. The authorities are well aware of the risks facing the economy. These pertain mainly to the difficult regional environment, as well as to the large gross public financing requirements related to the high public debt ratio.

Fiscal Policy and Reforms

The draft budget for 2012 aims at balancing essential spending needs with stability goals. The authorities view the relaxation of the budget as temporary and needed to meet pressing infrastructure and social needs. The budget envisages a significant increase in capital spending, notably in needed electricity production. It also provides for an increase in public wages and allowances, which has been approved by the Cabinet in December but whose magnitude and modalities are still under discussion. The authorities are cognizant of the need to finance the envisaged increase in current spending with recurrent revenues or permanent savings elsewhere. Substantial tax measures are planned, which include an increase in the VAT rate, an increase in the withholding tax on interest and the introduction of a fee on real estate sales. The authorities remain fully committed to fiscal consolidation and debt reduction in the medium term.

Further progress has been made in the area of budgetary reforms, notably with the ongoing modernization of revenue administration and public financial management, as well as work on embedding fiscal priorities in a medium-term fiscal framework.

Monetary and Exchange Rate Policies

Monetary policy has helped to bolster confidence in the Lebanese financial system, with the exchange rate peg providing a firm anchor for financial stability. Despite intervention by the Banque du Liban (BdL) in support of the Lebanese pound, holding interest rates stable in the midst of strong regional and domestic uncertainty has helped maintain market confidence over the past year. The authorities are fully aware of the costs for the BdL's balance sheet and foreign reserves. Nonetheless, while they are keen to reduce the Treasury's reliance on the BdL, they do not concur with staff's recommendation to raise interest rates on Treasury bills with maturities of less than 7 years. In the current turbulent times, confidence is paramount, and the authorities are concerned that raising interest rates would risk undermining depositor confidence. Moreover, the recent pick-up in Lebanese pound deposit inflows is expected to increase demand for Treasury bills. The reduction in the government's financing needs in 2012, as well as the potential parliamentary approval for new foreign currency borrowing, is also expected to reduce reliance on BdL financing.

Banking Sector

Effective banking regulation and supervision, coupled with conservative bank funding, asset structures, and management, have allowed the banking sector to build buffers. Lebanese banks report capital above the regulatory minimum, high liquidity buffers, low levels of nonperforming loans and stable profits. Lebanese banks are well-placed to implement Basel III and work in this direction is ongoing. The authorities intend to introduce supervisory colleges to strengthen the oversight of cross-border activities of the largest banks. This would include annual group audits and assessing risks, capital, and liquidity within the group. Work on enhancing the framework on anti-money laundering and combating the financing of terrorism is also ongoing.

Structural Reforms

Economic and social reforms, particularly in the electricity, water, telecommunications and social protection sectors, rank high on the authorities' agenda. These reforms are essential for sustainable and inclusive growth, as well as improved competitiveness. To accelerate the design and implementation of their reform agenda, the authorities are cooperating with the World Bank in specific areas. These comprise (i) creating a competitive business environment, (ii) improving basic infrastructure services, (iii) ensuring a quality public education system, (iv) creating an expanded, sustainable and inclusive social protection system—including social safety nets, pensions, health insurance, and other forms of income protection for the most vulnerable—and (v) public finance management reform.