June 2006
IMF Country Report No. 06/201

Lebanon: 2006 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 2006 Article IV consultation with Lebanon, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 13, 2006, 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 March 29, 2006. 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 May 3, 2006 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Lebanon.

The documents listed below have been or will be separately released.

Selected Issues Paper
Statistical Appendix

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 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Lebanon

Approved by Juan Carlos Di Tata and Scott Brown

March 29, 2006

- **Discussions were held in Beirut October 17–27, 2005, and concluded February 7–13, 2006.** The missions comprised Messrs. Gardner (head), Mongardini, Poddar, and di Giovanni (all MCD), Le Borgne (FAD), Mumssen and Tzanninis (both PDR), and Josefsson (MFD). Messrs. Di Tata (MCD), Shaalan, and Nauphal (both OED) participated in policy discussions. The missions met with the prime minister; the governor of the central bank; the ministers of finance, economy and trade, telecommunications, and energy; other senior officials; and representatives of the public electricity company, the social security administration, the banking sector, the chamber of commerce and industry, and the labor union.

- **Lebanon has never used Fund resources.** It 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; controls on capital account transactions are minor, and relate mostly to a prohibition on domestic borrowing by nonresidents. Lebanon is on the standard 12-month cycle, but interim staff reports are issued for information of the Executive Board in between Article IV consultations. The last such report (IMF Country Report No. 04/313) was issued on September 2004. The 2005 Article IV consultation was delayed by political developments in 2005.

- Lebanon participates in the **General Data Dissemination Standards**. The **fiscal ROSC** was published in May 16, 2005, and the last **FSAP update was concluded in 2001**.

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EXECUTIVE SUMMARY

Background and recent developments

Lebanon was able to weather the confidence shock created by Mr. Hariri's assassination in February 2005, although GDP growth slowed down considerably. The deposit base shrank by 4 percent in the first half of the year and dollarization shot up. By mid-year, monetary policy intervention and a peaceful exit from the political crisis had restored confidence. In the absence of new policy initiatives, the primary fiscal surplus dipped to 2½ percent of GDP in 2005, and government debt rose to 175 percent of GDP. Part of the cost of financial stabilization in recent years, and again in 2005, has been absorbed by the central bank with a resulting increase in its losses.

Outlook and policy discussions

- Vulnerabilities remain very high and the events of 2005 weakened an already fragile financial situation. The high concentration of government debt in the banks' balance sheets heightens systemic risks. Short-term liquidity conditions remain favorable, not least because of the ample regional liquidity. However, in the absence of adjustment, the large fiscal financing need could create new pressures on international reserves.
- The authorities see a soft exit out of the debt overhang as the sole viable option and have prepared a program of fiscal adjustment, privatization and structural reforms. However, political instability has so far prevented cabinet approval of the program.
- The staff's illustrative adjustment scenario, based on fiscal measures equivalent to 7 percent of GDP and privatization, would reduce the debt ratio to 133 percent by 2011. Concessional financial assistance would be needed to reduce the debt ratio further, and closer to a sustainable level. The authorities concurred with the overall size of the fiscal adjustment, but left open the issue of its phasing over the medium term. The scenario does not envisage exchange rate changes or debt restructuring.

Staff appraisal

- Because Lebanon will continue to operate at very high levels of debt into the medium term, the strategy of gradual debt reduction through sustained fiscal adjustment is not without risks. Given the high exposure of Lebanon to financial shocks and political uncertainty, the government program should lock in a large upfront fiscal adjustment backed by vigorous privatization and reform.
- The exchange rate peg remains the appropriate monetary anchor for Lebanon, and needs to be supported by a flexible interest rate policy, a strengthened central bank balance sheet, and close policy coordination between the fiscal and monetary authorities. Financial stability relies crucially on depositor confidence, and continued close supervision of the banking sector should be another key element of the strategy.

I. Introduction

1. **Following the Paris II donor conference of November 2002, Fund staff intensified the frequency of surveillance at the behest of donors.** The Paris II conference endorsed the authorities' exit strategy out of the high debt overhang, based on a package of fiscal adjustment, privatization and structural reforms. However, implementation of the strategy suffered numerous setbacks, and advice provided in the context of Fund surveillance has had limited success in steering policies in the direction of faster adjustment and reform, mainly because of domestic political gridlock and instability. While Lebanon weathered successfully the confidence shock created by Mr. Hariri's assassination in February 2005, the associated financial turmoil weakened what was an already fragile situation. The authorities see in the political transformation heralded by the June 2005 parliamentary elections an opportunity to relaunch a broad program of economic and institutional reform. Against this background, Article IV discussions focused on the macroeconomic risks ahead and a medium-term strategy to restore the financial health of the state and establish the foundations for strong economic growth.

II. Background and Recent Developments

2. **Economic and financial developments since 2003 have been shaped by major changes in the political landscape.** Policy initiatives were frozen during the political stalemate that prevailed prior to and following the extension of President Lahoud's term in September 2004. Mr. Hariri's assassination led to the resignation of the government and plunged the country into a period of political and financial turbulence. Despite continued political assassinations and bombings, market confidence was gradually restored following the withdrawal of Syrian troops from Lebanon and the June parliamentary elections. Upon taking office in July, Prime Minister Siniora announced that the government would seek the support of the international community for an ambitious economic reform and adjustment program to be introduced by end-2005. Renewed political tensions—over relations with Syria, the legitimacy of the president, and UN calls for the disarmament of Hezbollah (one of the coalition partners in the government)—have caused repeated delays in the adoption of these plans.

3. **Economic growth slowed down considerably in 2005.**[1] A surge in tourism and construction activity, and strong exports contributed to GDP growth of 6 percent in 2004. However, in the wake of the political crisis, private and public demand contracted in 2005, though export growth remained strong. In the event, real GDP is estimated to have grown by 1 percent, and inflation declined to 0.3 percent in 2005.

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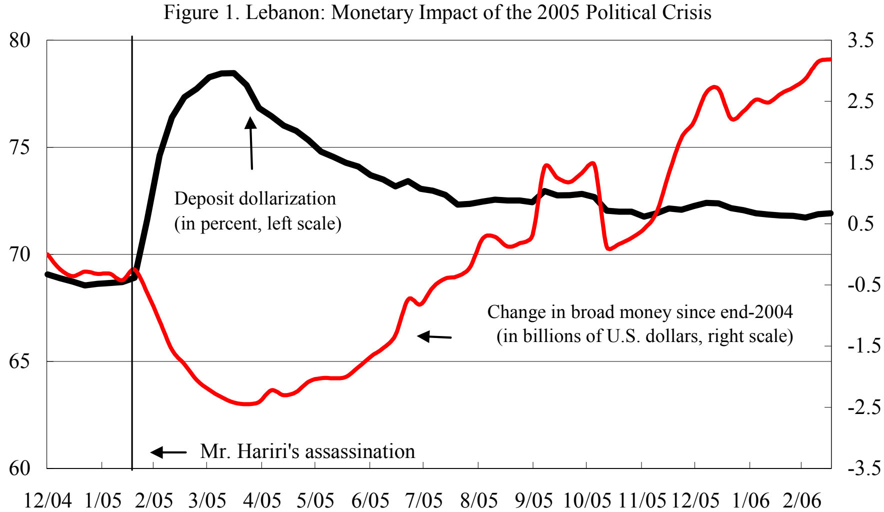
[1] A set of national accounts covering the period 1997-2002 was released for the first time in 2005, with preliminary estimates for 2003–04. Based on these accounts, nominal GDP is about 12 percent higher than previous estimates.

4. **Mr. Hariri's assassination and subsequent political crisis triggered significant financial turmoil and pressures on international reserves.** In the two months that followed the assassination, some $2 billion in deposits was withdrawn and another $5½ billion was converted into dollar deposits (Figure 1). The central bank absorbed some of the pressure through its international reserves (Figure 2), and also took action to counter financial pressures through: (i) swap operations, backed by higher interest rates and financial sweeteners, to lengthen the maturity of commercial banks' claims on government and the central bank; and (ii) the issuance of 10-year dollar CDs yielding 10 percent interest to attract and lock in some of the foreign assets of the commercial banks. In order to avoid a downgrading of banks' ratings and its possible impact on confidence, incentives provided to banks included upfront cash payments to shore up profits. A sharp rise in interest rates on Lebanese pound (LL) deposits eventually contributed to stabilize the situation, until the effects of the political crisis waned.

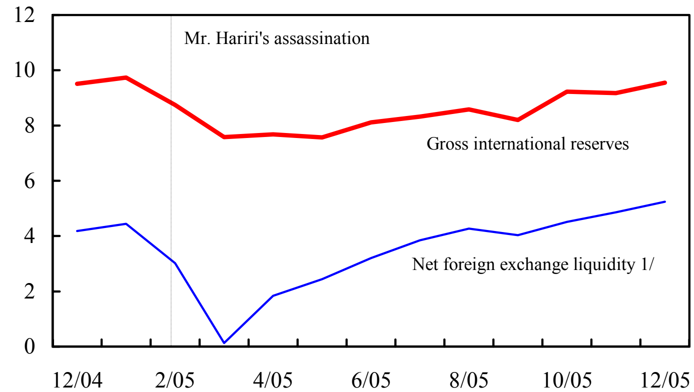
5. **By mid-year, the financial situation had stabilized.** Deposit inflows resumed at a high pace, accompanied by gradual dedollarization. The $750 million Eurobond issue of October 2005 was heavily oversubscribed, notably by international investors; by mid-March 2006 Eurobond spreads had declined to a record low of 180 basis points, broadly in line with the global emerging market index (Figure 3). The stock market similarly picked up steam after the June parliamentary elections. Despite a sizeable correction in February 2006, by March the stock index was still 150 percent above its end-2004 level. Still, total capitalization remains small by emerging market standards (20 percent of GDP), with *Solidere* (the real estate holding company which owns much of downtown Beirut) accounting for over 60 percent of it, and banks for much of the rest.

Figure 1. Lebanon: Monetary Impact of the 2005 Political Crisis



Source: Banque du Liban.

Figure 2. Lebanon: Central Bank Gross International Reserves
and Net Foreign Exchange Liquidity, 2005
(In billions of U.S. dollars)



Sources: Banque du Liban; and Fund staff estimates.
1/ Defined as: Gross international reserves minus principal and interest due over the next 12 months on all foreign currency liabilities of the central bank to entities other than the government of Lebanon. Excludes long-term foreign exchange liabilities of the central bank.

6. **The economic slowdown as well as buoyant exports helped narrow the current account deficit to an estimated 12.7 percent of GDP in 2005, notwithstanding higher oil prices and losses in tourism.** The negative shock to the capital account in the first half of the year was more than offset by the recovery of FDI and portfolio inflows in the second half, and by end-2005 gross international reserves were back at their end-2004 level. Owing to very low domestic inflation, the real effective exchange rate depreciated by 5 percent in 2005, despite the international appreciation of the dollar, to which the currency is pegged (Figure 4). Although labor costs tend to be higher than in neighboring countries, recent gains in export market shares do not suggest the presence of an immediate competitiveness problem. From 2000 to 2005, Lebanon's global market share rose from 1.1 to 2.1 percent, and its regional (Middle East) market share grew from 18.4 to 36.1 percent.

7. **In the absence of new policy initiatives to counter the adverse fiscal effects of rising oil prices and the economic slowdown, the primary surplus dipped to 2½ percent of GDP in 2005 from 3½ percent in 2004** (Figure 5). Since the 2005 budget was only approved (ex-post) in February 2006, most expenditure categories were effectively frozen in nominal terms. However, this form of fiscal austerity was not enough to offset: (i) a one-time transfer (0.3 percent of GDP) to cover losses in the social security funds; (ii) growing subsidies to the state electricity company (EdL), whose financial losses are estimated at 3.2 percent of GDP in 2005;[2] and (iii) revenue shortfalls attributable in large part to the cap on gasoline prices introduced in May 2004.

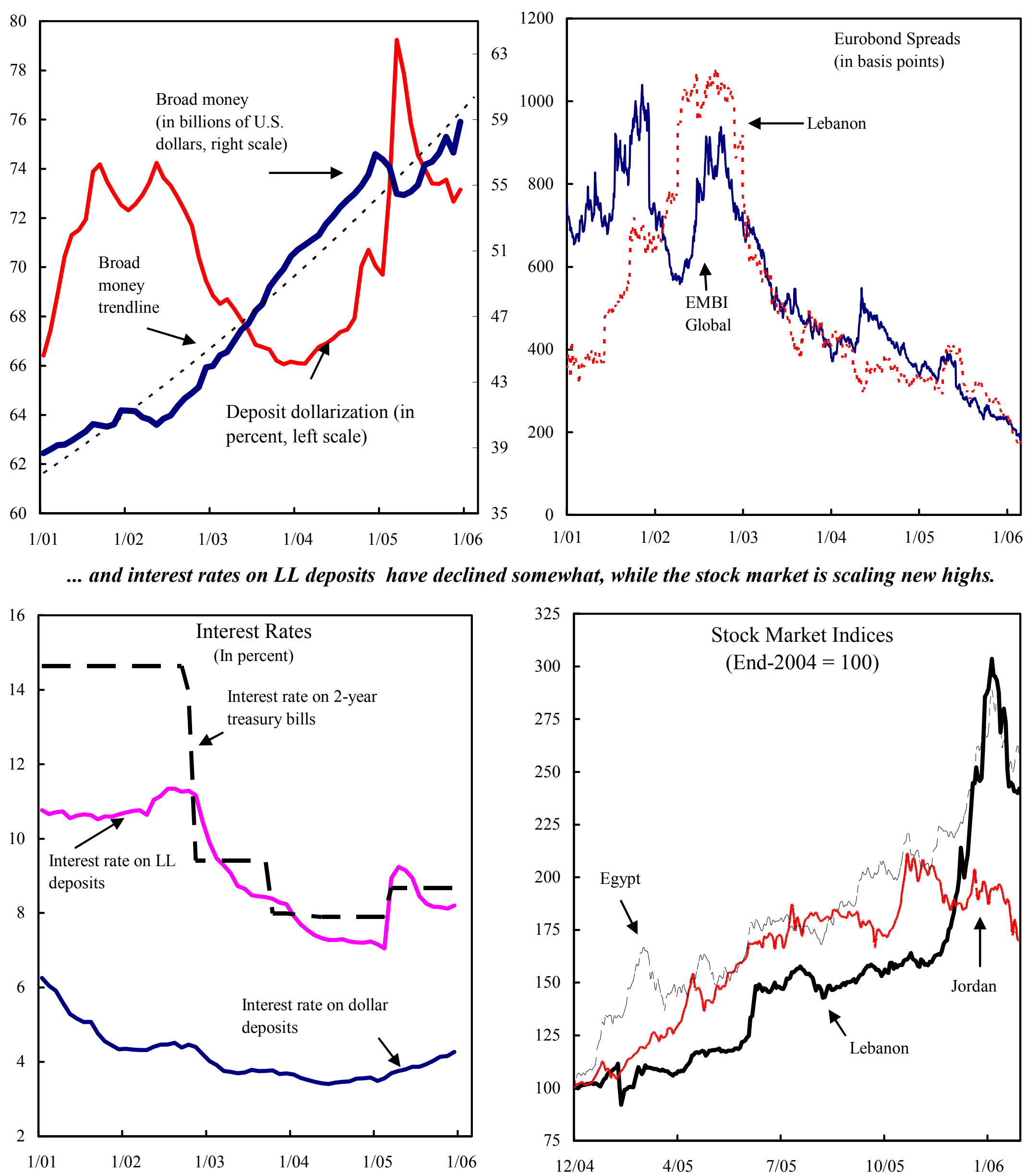
[2] Operational losses alone came to 1.9 percent of GDP.

Figure 3. Lebanon: Monetary and Financial Indicators

Financial market pressures, which increased markedly following Mr. Hariri's assassination, have subsided.

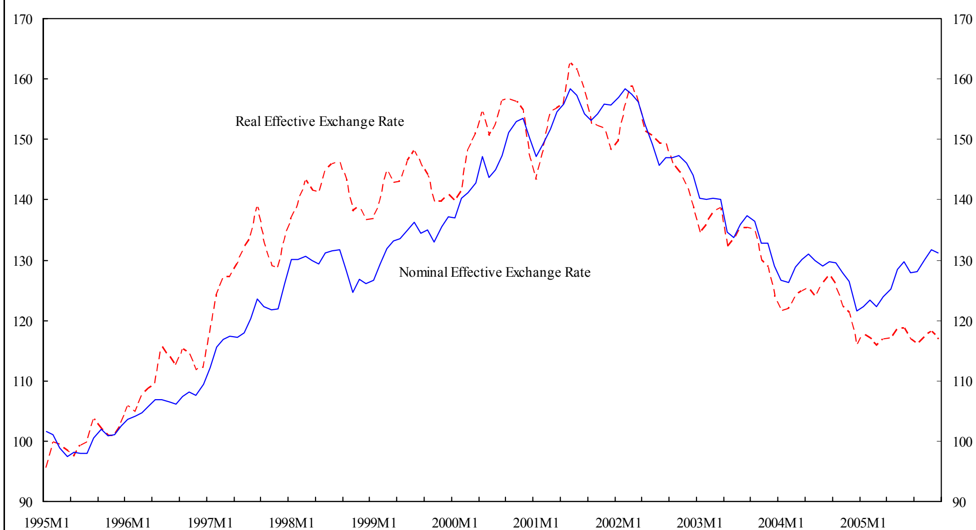
Broad money growth has picked up, deposit dollarization has fallen, Eurobond spreads have narrowed ...

... and interest rates on LL deposits have declined somewhat, while the stock market is scaling new highs.



Sources: Banque du Liban, Bloomberg, and Reuters.

Figure 4. Lebanon: Real and Nominal Effective Exchange Rate, 1995–2005
(1995=100)



Source: INS.

8. **The gradual lowering of the effective interest rate paid on government debt has contributed to a steady reduction in the overall fiscal deficit (to 8 percent in 2005).** However, the maturing of the zero-interest loans received from banks in the context of Paris II and the scheduled repayment of below market financing from the central bank will tend to raise the effective interest rate in 2006. A near stabilization of the government debt ratio since 2002, was followed by another increase in 2005 owing to weak GDP growth, the settlement of arrears equivalent to 1.3 percent of GDP, and a new government prefinancing strategy.[3]

9. **The central bank has increased markedly its intermediation role since 2002, but at the expense of its financial strength.** Its balance sheet has grown from \$13 billion at end-2002 to \$29 billion by end-2005, reflecting (below market) financing of the government and parallel sterilization operations as well as efforts to replenish international reserves. The expansion of the balance sheet has been accompanied by growing losses that reflect these operations, as well as: (i) the transfer to the government of unrealized capital gains on gold holdings; (ii) the high cost of long-term dollar debt issued in the first half of 2005; and (iii) the favorable conditions accorded to commercial banks to protect their profitability in 2005. Central bank losses have not compromised monetary control.

[3] The strategy is to create a sufficient buffer in government deposits to cover treasury operations for at least two months. In 2005, this implied an increase in government deposits of 2½ percent of GDP.

10. **The banking sector continues to record profits but remains vulnerable, with claims on government and the central bank accounting for over 50 percent of assets.** The capital adequacy ratio was 22 percent as of mid-2005, although this high ratio reflects in large part the low risk weighting applied to government paper. Banks took advantage of abundant excess liquidity in the region in 2005 to raise capital. Profitability rose by about 13 percent in 2005, buttressed by the cash premium paid by the central bank to rollover maturing government paper. Still, on average, the return on equity is low by international standards—although higher for the larger banks. Banks remain highly liquid, with a net liquid to total asset ratio of 45 percent, and hold nearly $10½ billion in liquid assets abroad. Lending has stagnated, in part because of widespread over-leveraging in the private sector. The quality of the loan portfolio has stabilized at a ratio of non-performing loans to total loans of 10 percent (net of provisions).

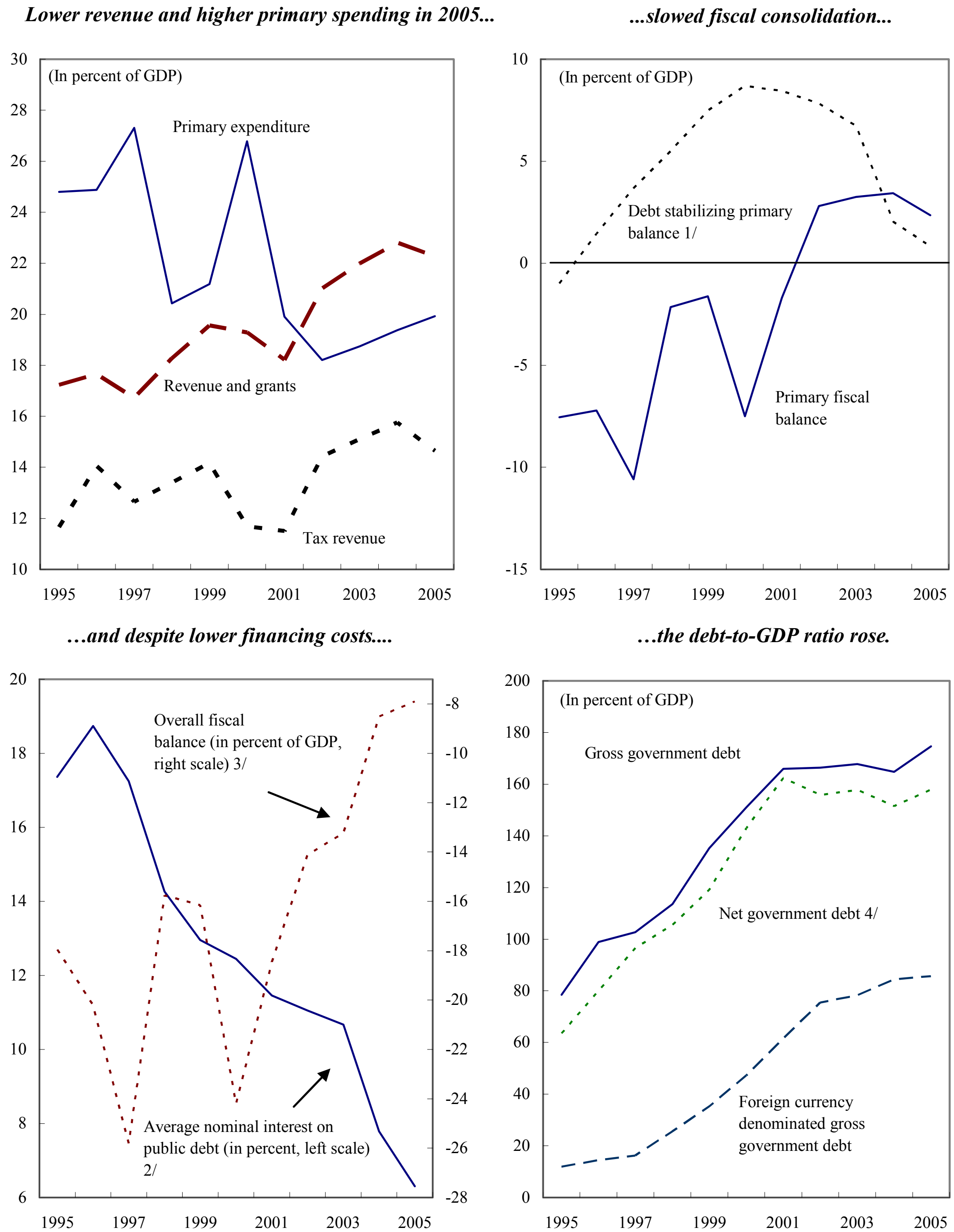
11. **Only moderate progress has been made on the structural reform agenda since 2004.** Most public sector reforms have been of an administrative nature, with a number of legislative reforms pending in parliament (Box 1). The EU Association Agreement will come into effect on April 1, 2006.

III. Outlook and Policy Discussions

12. **Despite the recovery of confidence, the macroeconomic and financial picture is still one of high vulnerabilities.** Underlying financial imbalances have grown.[4] The government debt ratio has edged up again, and, with some of the financial benefits of Paris II coming to an end, the interest bill is expected to start rising. Moreover, the financial standing of the sovereign (central bank and government) has deteriorated at a much faster rate, owing to the fact that the central bank has absorbed in its balance sheet many of the fiscal costs of financial stabilization. On the positive side, liquidity conditions have improved markedly since mid-2005, in terms of international reserve coverage, commercial banks' liquidity, and access to market financing. Although Lebanon is well placed to continue capturing some of the portfolio outflows from Gulf Cooperation Council countries (over $100 billion in 2005), delays in fiscal adjustment will cause the fiscal financing need to rise with possible new pressures on international reserves.

[4] Balance sheet vulnerabilities are also discussed in the accompanying IMF Country Report No. 06/200.

Figure 5. Lebanon: Central Government Operations, 1995–2005



Sources: Banque du Liban; Ministry of Finance; and Fund staff estimates.

1/ Estimated using the implicit interest rate prevailing in that year (see footnote 2) and a centered five-year moving average of growth and inflation.
2/ Ratio of interest payments to gross government debt at the end of the preceding year.
3/ Cash basis.
4/ Gross government debt minus central government deposits.

Box 1. Lebanon: Structural Reform Initiatives in 2004–06

Public sector reforms

- **Reorganization of revenue administration.** Large taxpayer's office established in May 2005, although not yet fully operational.
- **VAT directorate.** Law establishing a VAT directorate passed in August 2005.
- **Tax procedure code.** Draft law establishing a modern tax procedure code (based on IMF technical assistance) to be sent to cabinet for approval.
- **Deduction at source of tax on salaries.** Registration of all private sector employees virtually completed by May 2005.
- **Treasury single account (TSA).** Draft law establishing a TSA pending in parliament.
- **Public debt.** Draft law establishing an independent public debt directorate at the ministry of finance pending in parliament.
- **Public procurement.** Draft law modernizing public procurement to be submitted to parliament.
- **Strengthening financial control of state-owned enterprises.** An amendment to the 2001 budget law to be submitted to parliament in the near future, requiring annual external audits of all public institutions.

Capital markets and bank mergers

- **Capital markets.** Draft law on capital market development and the establishment of a regulatory commission with powers to oversee the Beirut Stock Exchange pending in parliament.
- **Securitization.** Legislation allowing the securitization of financial assets passed in December 2005.
- **Collective investment schemes.** Legislation giving legal status to investment funds passed in December 2005.
- **Insider trading.** Draft legislation outlawing insider trading pending in parliament.
- **Insurance regulatory commission.** Draft legislation establishing an insurance regulatory commission under review by government.
- **Bank mergers.** Amendment to the law regulating the central bank's role in facilitating bank mergers approved by parliament in February 2005.

Competition and domestic market reform

- **Anti-dumping.** Draft anti-dumping legislation in line with WTO standards pending in parliament.
- **Streamlining import licensing procedures.** Draft law on International Trade and Licensing in line with WTO agreements pending in parliament.
- **Consumer protection.** Legislation increasing consumer protection passed in February 2005.
- **E-commerce.** Set of laws enacted covering e-signature, e-contracts, e-payments, and protection of personal rights.

13. **Discussions were organized around the four main pillars of the authorities' program**: (i) fiscal adjustment and debt management; (ii) monetary and exchange rate policies; (iii) the role of the financial sector; and (iv) the growth and social agendas. In the absence of a detailed government program, discussions were informed by an "unchanged policies" (baseline) scenario and an illustrative "adjustment" scenario developed by Fund staff. The latter draws from policy proposals discussed with the authorities since the last Article IV consultation.

A. Medium-Term Scenarios and Debt Sustainability Analysis

14. **The government's solvency problem is illustrated in the staff's baseline scenario, which shows that under unchanged policies the debt ratio would rise steadily to over 210 percent of GDP by 2011** (Figure 6). The scenario assumes a vicious circle of growing debt, rising interest rate spreads, and weak economic growth. It is difficult to predict where the breaking point lies, but it is clear that such growing financing needs cannot be filled indefinitely by ever increasing capital inflows.

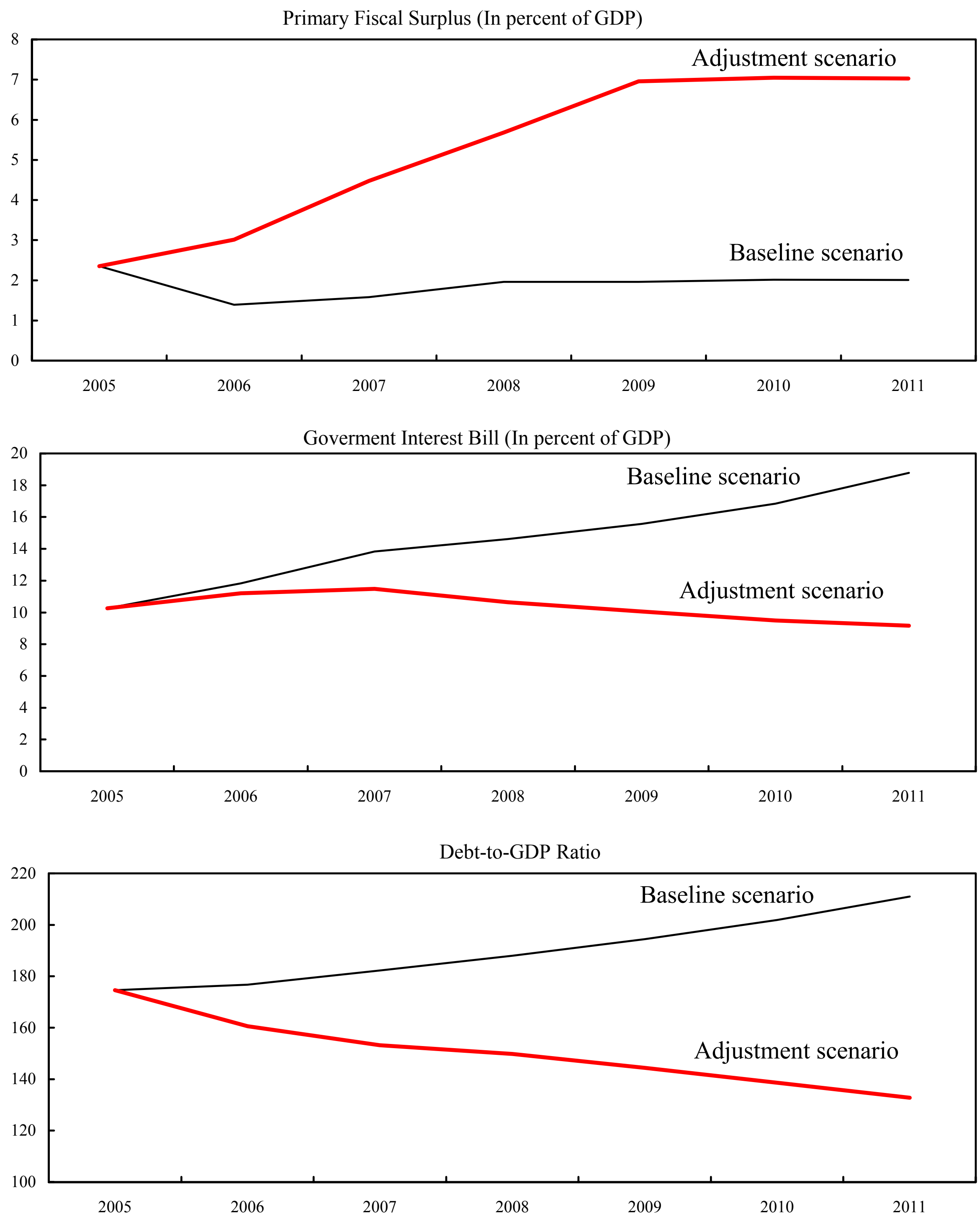
15. **In the staff's illustrative adjustment scenario, an ambitious fiscal effort and privatization reduce the debt ratio to 133 percent of GDP by 2011.** The scenario is based on: (i) fiscal effort of about 7 percent of GDP (much of it front loaded in the first three years); and (ii) partial privatization of the telecom sector in 2006–07, yielding receipts of 19 percent of GDP.[5] The scenario excludes exchange rate adjustment, debt restructuring and concessional financing.

16. **The illustrative adjustment scenario is predicated on a mix of (mainly upfront) revenue and (phased) expenditure measures, as detailed in the table below.** The revenue effort (4.3 percent of GDP) comes from an upfront increase in the VAT rate from 10 to 15 percent, reform of the income tax system (including an increase of interest income taxation), and a phased increase in gasoline excises back to their 2003 level. The expenditure compression is assumed to take place over time in line with structural reforms in the public pension system, civil service and wage policy, and the electricity sector. An expansion of capital spending, which has taken the brunt of the adjustment to date, is assumed to offset in part the above budgetary gains.

17. **The authorities took a slightly more optimistic view of interest rate and growth prospects than the staff.** The staff's adjustment scenario assumes that interest rates would remain roughly unchanged from their present level, despite a projected increase in LIBOR. This further narrowing of spreads (by 110 basis points for LL deposits, and 60 basis points for dollar deposits) reflects confidence gains and a lesser financing need. The authorities were of the view that interest rates could decline further. As for GDP growth, the authorities expected a stronger rebound in 2006 than the 3 percent growth projected by staff.

[5] The transaction has a one-time effect on the level of debt, but no impact on debt dynamics because the loss in revenue from the privatized entity is broadly offset by a reduction in interest costs.

Figure 6. Lebanon: Medium-Term Scenarios, 2005–11



Source: Fund staff estimates and projections.

Primary Fiscal Effort Between 2005 and 2011 in the Staff's Adjustment Scenario 1/
(In percent of GDP)

Measure	2005–06 (Net Gain)	2006–07 (Net Gain)	2007–11 (Net Gain)
Primary fiscal effort	**1.4**	**2.7**	**2.8**
Revenue	*1.1*	*1.8*	*1.4*
• Increase in the VAT rate: (from 10 to 15 percent)	0.9	1.5	0.0
• Other 2/	0.2	0.3	1.4
Expenditure	*0.3*	*0.9*	*1.3*
• Pension (adoption of reforms suggested in the World Bank's Public Expenditure Review (PER))	0.3	0.1	0.4
• Wages (reforms suggested in the World Bank's PER within a fixed nominal envelope for the wage bill)	0.2	0.3	0.5
• Reduction in EdL losses (adoption of reforms suggested in World Bank's PER)	0.5	0.4	0.5
• Other 3/	-0.6	0.2	-0.2
Offsetting Factors	**-0.7**	**-1.3**	**-0.3**
Revenue loss due to privatization	-0.4	-1.3	-0.3
Higher transfer to EdL due to higher oil price	-0.6	0.0	0.0
One-off expenditures in 2005 4/	0.3	0.0	0.0
Improvement in primary surplus	**0.7**	**1.5**	**2.5**

Source: IMF staff estimates and projections.

1/ Figures may not add up due to rounding. Net gains refer to incremental changes.

2/ Other measures include (i) eliminating the cap on domestic gasoline retail prices and gradually increasing gasoline excises to their pre-capping level ; (ii) increasing the tax rate on interest income from 5 to 7 percent; (iii) introducing a global income tax; and (iv) eliminating various inefficient fees.

3/ This category includes (i) an increase in capital expenditures (from the low 2005 base, as advised in the World Bank's PER so as to adequately maintain the current capital stock and support the needed medium-term growth); and (ii) a nominal freeze in other current expenditures.

4/ Mainly an exceptional transfer to the social security system.

18. **The staff's Debt Sustainability Analysis shows that the illustrative adjustment scenario is not without risks, and that, even if successful, the strategy would still leave Lebanon with a high debt ratio well into the medium term.** Adverse growth and interest rate shocks can slow down the pace of debt reduction, as illustrated in the stochastic debt sustainability analysis presented in Figures 7a and 7b, which show confidence intervals for the debt ratio under the adjustment scenario, based on the observed distribution of shocks to interest rates and GDP growth. The shocks to interest rates are cumulated from year to year in Figure 8a, and are not in Figure 8b.[6] There are also significant risks that fiscal adjustment will fall short of target, due to political factors or the emergence of contingent fiscal liabilities, notably from the social security funds and the electricity sector. Even if the debt reduction target were to be achieved by 2011, at 133 percent of GDP, the debt ratio would still leave Lebanon exposed to the risk of liquidity shocks unraveling into a debt crisis.

Figure 7a. Lebanon: Adjustment Scenario's Debt-to-GDP Confidence Intervals: Permanent Shocks, 2006–11

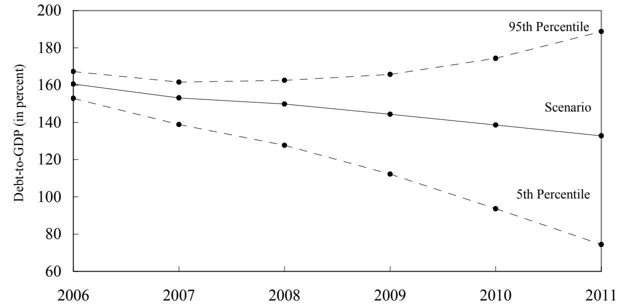
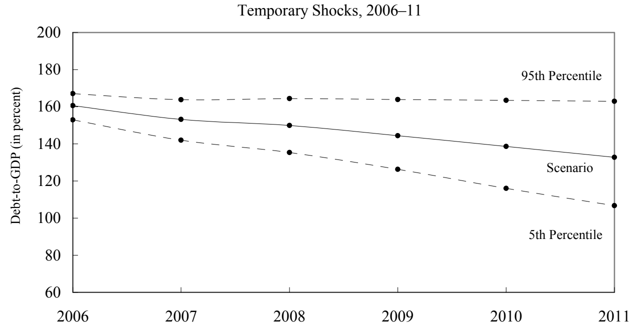


Figure 7b. Lebanon: Adjustment Scenario's Debt-to-GDP Confidence Intervals: Temporary Shocks, 2006–11



19. **Concessional financial assistance from donors and domestic creditors, would accelerate convergence toward debt sustainability.** By way of example, for every $1 billion of grant-equivalent assistance in 2006, the debt ratio would be reduced by an additional 5.6 percentage points of GDP by 2011. The authorities have approached the commercial banks for a voluntary contribution akin to that provided under Paris II, which came to $3.6 billion in loans at zero interest for three years.

B. Fiscal Policy and Debt Management Strategy

20. **The authorities decided to postpone the 2006 budget in order to integrate it with their medium-term program, but in the meantime they have introduced a number of administrative measures to improve budgetary performance.** The ministry of finance has put in place a cash management system to avoid overruns by line ministries and to strengthen fiscal reporting. Losses in the social security funds (NSSF), and the health fund in particular,

[6] The methodology underlying this exercise is discussed in the IMF Country Report No. 06/200.

constitute a large contingent liability for the budget, and the government has initiated an audit of the fund with a view to assessing the exposure of the state. The government has also launched an audit of arrears and begun to settle arrears to the private sector (mostly related to expropriations).

21. **The authorities generally agreed with the overall size of the fiscal adjustment effort embedded in the staff's adjustment scenario.** However, in their view, the nature and timing of fiscal adjustment would need to be carefully calibrated to be supportive of the political and economic renewal of the country, avoid backlashes, and not forestall an incipient recovery in economic activity. The authorities concurred that the strategy would have to rely on an increase of the VAT rate—although possibly not of the magnitude suggested by staff for 2006—a reform of the income tax system, and a gradual increase of gasoline taxation back to its 2003 level. Plans for introduction of a Global Income Tax system to replace the current schedular system are under way, based on technical assistance provided by the IMF's Fiscal Affairs Department (FAD). The authorities also saw scope for increasing the withholding tax on interest, presently at 5 percent.[7] In the absence of any noticeable response to the introduction of this tax in 2003, the authorities felt that a modest increase in the rate would not have a significant effect on money demand.

22. **There was broad agreement that the sustainability of the adjustment effort depends critically on expenditure reforms, the elimination of open-ended subsidies, and measures to protect the budget from contingent liabilities.** On pension reforms, the government is working in collaboration with the World Bank to establish a financially-sustainable and more equitable system, notably by consolidating the private and public pension systems. The healthcare system managed by the NSSF is another source of fiscal strain which the government plans to address mainly by strengthening financial management. The authorities planned to maintain the nominal wage freeze and to rely on attrition to reduce the size of the civil service, but also acknowledged that these measures would need to be replaced by a proper civil service reform.

23. **Addressing EdL's losses is seen as key to fiscal sustainability, although a reform plan has yet to be finalized.** EdL has long been beset by organizational inefficiencies, governance problems (there are no audited accounts since 2001),[8] high technical losses, and widespread theft and non-payment. Plans to reduce costs by switching to gas imported from Syria have not come to fruition. There has been a marked reduction in non-technical losses (from 29 percent in 2001 to 17 percent in 2005), backed by other measures to improve collection and lower the cost structure, such as improved fuel procurement practices. However, the breakeven price of oil in electricity production is still around $25 dollars per barrel. The menu of measures being considered include governance reforms, a partial

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[7] An increase to 7 percent, for instance, would generate additional revenues equivalent to 0.4 percent GDP.

[8] The 2001 accounts have yet to be released officially, and have been questioned by the auditors on several points.

privatization of EdL (to realize efficiency gains), increases in tariffs (unchanged since 1996), and investments to reduce operational inefficiencies.

24. **The authorities recognized that fiscal adjustment would need to be backed by stronger budgetary and expenditure management to minimize leakages and overruns.** Public financial management remains relatively weak in Lebanon: hard budget constraints are not always applied, and cash rationing remains the only effective constraint on spending. The authorities have been developing a detailed action plan to address these shortcomings, with assistance from FAD and are considering the introduction of a Fiscal Accountability Law. The ministry of finance is also in the process of reorganizing its activities to move towards a more modern function-based administrative structure.

25. **The authorities emphasized the importance of proactive debt management to reduce interest costs and rollover risk.** In line with this approach, they have built up a significant liquidity buffer in the central bank. In addition to setting up a Public Debt Directorate, the ministry of finance is also keen to expand the range of financing instruments to attract longer-term investors, both domestic and international, as a way of reducing rollover risk.

C. Monetary and Exchange Rate Policies

26. **In the authorities' view, the exchange rate peg remains key to the stability of the financial system.** In the absence of a clear need for an exchange rate adjustment, and given the high level of dollarization, the authorities considered that the risks from exchange rate movements (in terms of balance sheet exposures) significantly outweigh any potential benefits (in terms of adjustment to external shocks). This belief was reinforced by the events of 2005 and the important role played by the peg in preserving confidence.

27. **Based on the strength of capital inflows and the recovery of international reserves, the authorities did not see a need to match recent increases in international interest rates.** Capital inflows have remained strong, even as interest rate spreads have narrowed.[9] Gross international reserves (GIR) are the indicator followed most closely by the market. Differences of views between the ministry of finance and the central bank on the international reserve target have, at times, led to poor policy coordination and tensions over interest rate policy. This time, staff found a convergence of views between the two institutions that GIR is presently at an appropriate level. Even though the reserve coverage of short-term foreign currency liabilities remains low by emerging market standards, based on the experience of 2005—the worst financial shock suffered since the end of the civil war—the authorities felt that the present reserve buffer would be sufficient to withstand a similar large shock until fiscal and other measures can be taken.

[9] The IMF Country Report No. 06/200 reports on the close but less than one-for-one empirical relationship between Lebanese and international interest rates.

28. **Coordination between the central bank and the ministry of finance has improved markedly.** At the root of this are the recent convergence of views on the level of reserves, a commitment by the ministry not to resort to central bank financing (and to repay maturing loans), and an agreement to coordinate the bunching of central bank and government maturities coming due in 2006. To some extent, improved collaboration also reflects the current benign economic environment.

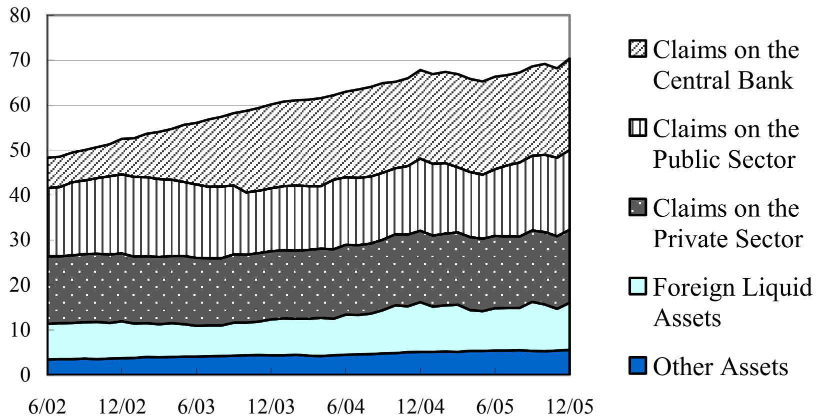
29. **The central bank recognized the need to eliminate central bank losses over time.** It noted, however, that the losses it has incurred until now have had no monetary impact, since the associated liquidity injection has been absorbed by growing money demand, or mopped up by the issuance of long-term central bank paper. The authorities indicated that loss-making operations had been entered into as a matter of necessity rather than choice, and that they hoped to unwind them as the financial situation settled down. Based on existing obligations, central bank (cash) losses should decline rapidly only after 2009. To help improve its financial situation, the central bank has already introduced fees on many of its operations, lowered remuneration of commercial bank deposits, and realized gains from the sale of a bank in its portfolio. The sale of Middle East Airlines (owned by the central bank) and other real assets is also under consideration. However, these measures can only cover a fraction of the losses, and additional measures would be necessary to close the financial gap at a faster rate.

D. Financial Sector Vulnerabilities

30. **The ability of banks to tap into the pool of regional savings has enabled Lebanon to finance large fiscal and external imbalances over the last 15 years, but the mutual dependency of the government and the commercial banks has also heightened the transmission of shocks between the fiscal and financial sectors.** The main systemic risk lies in the possibility of large-scale deposit withdrawals, possibly triggered by concerns over the solvency of the sovereign. Because of the high degree of dollarization, such withdrawals could unravel into a banking, balance of payments, and debt crisis. Until now, weaknesses in fiscal fundamentals have had limited effects on depositor confidence, despite the high exposure of banks to sovereign debt (Figure 8). The authorities and bankers attributed this to the strong reputation of domestic banks, the authorities' demonstrated ability to honor their financial obligations, and the banking sector's ample liquidity buffer in foreign exchange—the liquid foreign assets of commercial banks and the central bank combined provide cover for 35 percent of total deposits.

Figure 8. Lebanon: Commercial Banks' Assets, 2002–05

(In billions of U.S. dollars)



Sources: Banque du Liban; and Fund staff estimates.

31. **Given the importance of maintaining confidence in the banking system, the authorities continue to place emphasis on effective banking supervision.** In order to further enhance confidence in banks, and increase incentives for prudent risk management, the authorities and the banks are keen to phase in Basle II standards, starting possibly in 2008. They stressed that the move to 100 percent risk weighting for foreign currency government debt under Basle II would still leave the banking sector adequately capitalized—the average capital adequacy ratio would fall to about 10 percent.[10] While there is no currency mismatch in the balance sheet of banks, banks carry significant indirect exchange rate risk related to domestic dollar lending—particularly to households and non-exporting firms. In general, such risk seems to be considered of a systemic nature and therefore not one that banks have an incentive in guarding against at the individual level.

32. **Ample regional liquidity has contributed to the appreciation of bank shares on the Beirut stock exchange and is making it possible for them to raise large amounts of new capital.** Banking sector capital is expected to increase from around \$4 billion in 2004 to around \$5½ billion by end-2006. The banks concerned noted that the increases in capital were intended to meet new capital requirements under Basle II and to finance their regional expansion plans (into Algeria, Egypt, Iraq, Jordan, Sudan, and Syria). Still, an overleveraged private sector and a financially strained public sector suggest that Lebanon may be overbanked and point to the need for banking sector consolidation over the medium term. The view of the authorities, shared by banks, was that some of the smaller banks would have to exit the market, but that the larger banks were well placed to develop alternative activities.

[10] A possible FSAP update would look into these issues in greater depth.

33. **The underdeveloped capital market is seen as an impediment to better risk diversification and private investment.** The authorities believe that the capital market could provide the overleveraged private sector with a fresh infusion of capital, help mobilize longer term financing from abroad, and support the privatization drive. However, the absence of an independent stock market regulator, and of a law against insider trading, were of concern to many officials and market participants, and raised doubts about the foundations on which the stock market boom is based. The authorities noted that legislation addressing these issues was pending in parliament.

E. Structural Policies

34. **Structural impediments to private sector development could limit the growth dividend associated with debt reduction.** Despite the overall market-orientation of the Lebanese economy, private sector observers and public officials recognized that private initiative and competition have been stymied and distorted by government intervention, red tape and corruption, and by the strong hold that special interests have on government subsidy, tax, and competition policies. The World Bank estimates that monopoly rents may account for as much as 15 percent of GDP. Governance problems were particularly high on the list of private sector complaints, as reflected in business surveys.[11]

35. **A broad growth agenda is intended to address these shortcomings.** The government's priorities include: liberalization and privatization of the telecom sector and sale of other government assets; a new competition policy backed by a newly created competition authority; ongoing streamlining of administrative impediments in collaboration with the business community; improved efficiency of government spending; and membership in the WTO (targeted for end-2006). Privatization of the telecom sector is at the core of the structural agenda. The secretary general of the telecom regulatory authority was appointed in February 2006, and the authorities are in the process of finalizing the appointment of the board, ahead of the privatization of the two mobile telephone companies, slated for 2006. Privatization of the fixed telephone line and a third mobile license should follow in 2007.

36. **High on the list of government priorities is the establishment of a modern and well-functioning social safety net.** Income distribution in Lebanon remains very uneven and the most vulnerable segments of society are presently protected only though generalized subsidies. Based on available information, Lebanon's social indicators have improved in recent years, but they still fall short of expectations.

IV. Staff Appraisal

37. **The events of 2005 exposed the significant vulnerabilities of the Lebanese economy, but also its resilience in the face of shocks.** The very heavy public debt overhang, the high degree of dollarization, large fiscal and current account deficits, and

[11] The IMF Country Report No. 06/200 reports on these and other measures of competitiveness.

reliance on short-term deposit inflows to finance these deficits remain the core vulnerabilities. The risks associated with these imbalances have been muted by a benign external environment, ample regional liquidity, and the relative stability of the depositor base, even in the face of worsening fundamentals. Factors explaining this unique strength include the liquidity cushion held by banks, a strong reputation of safe banking built over decades, and the authorities' skillful handling of the financial pressures experienced in 2005.

38. **With market confidence restored, the ongoing political transformation creates an opportunity to address the country's macroeconomic imbalances through fundamental and lasting reforms.** The ultimate objective of the adjustment and reform program should be to protect Lebanon against the risk of a financial crisis and raise the country's growth potential. A positive external environment has helped revitalize economic activity in 2003-04, and the recovery that began in the second half of 2005 should gain strength in 2006. However, the uncertainty associated with the large macroeconomic imbalances continues to exact a cost in terms of private investment, while inefficiencies and red tape thwart competition and productivity growth. Delays in the adoption of the authorities' program could also create renewed financing pressures.

39. **Although not without risks, the strategy of gradual debt reduction through sustained fiscal adjustment remains the most promising way out of the debt overhang.** Upfront debt restructuring carries too large a risk that it will not converge to a stable macroeconomic situation. Still, Lebanon will continue to operate at high levels of debt into the medium term, and the highly fractured political system may not be able to deliver the sustained pace of adjustment required. To restore credibility, the authorities should aim at locking in a large upfront adjustment based on a strong fiscal effort in the first year of their program. With additional measures in 2007–08 and a vigorous privatization effort, the strategy would place the debt-to-GDP ratio on a clear downward path. Concessional financial assistance from abroad and a contribution from domestic creditors, commensurate with their financial strength, would also be required to accelerate convergence to a sustainable debt level.

40. **The magnitude of the required fiscal adjustment calls for both revenue and expenditure measures, backed by institutional reforms to strengthen budgetary control.** Expenditure reforms are likely to yield meaningful gains only over time, and revenue measures should necessarily be part of the initial package. Given the fiscal adjustment need, the tax revenue yield could be raised by aligning the VAT rate to that of other countries in the region, and introducing a more efficient and more progressive income tax system. The taxation of gasoline should also be revisited, since the state cannot afford to shield the economy from the high cost of oil. On the expenditure front, there is scope for reducing non-productive outlays, such as subsidies, and poorly targeted capital and current spending. The impact of rising fuel costs on the losses of the electricity company has overtaken efforts to improve collection and reduce technical losses, and restoring the financial viability of the electricity sector should be a core element of the adjustment strategy. Pension reform also appears urgent to correct looming imbalances in the system. Needed improvements in the statistical framework would help strengthen policy formulation and implementation.

41. **The exchange rate peg remains the appropriate monetary anchor for Lebanon, and needs to be supported by a flexible interest rate policy and a comfortable international reserve buffer.** Not only does the high degree of dollarization constrain the effectiveness of the exchange rate as an instrument of adjustment, but until confidence can be anchored to stronger fundamentals, the exchange rate peg is also key to financial stability. Shocks to confidence are transmitted mostly through the large deposit base, and the large liquid foreign holdings of commercial banks offer an important first line of defense against such shocks. With this added buffer, and in light of recent experience, the present level of international reserves appears to strike a reasonable balance between the competing objectives of minimizing the cost of holding reserves and maintaining sufficient liquidity.

42. **The central bank's balance sheet is no longer in a position to carry the full cost of sterilization operations or to finance the public sector. Strong policy coordination between the fiscal and monetary authorities, backed by enhanced institutional arrangements, is required to improve monetary management and strengthen the central bank's balance sheet over time.** Until now, the monetary impact of central bank losses has been muted by the buoyant demand for money. However, in the event of an adverse shock to deposits, it will become increasingly difficult to sterilize the liquidity impact of central bank losses and maintain, at the same time, an adequate cushion of international reserves. Timely actions to strengthen the balance sheet of the central bank should be an integral part of the adjustment strategy. They should include a recentering of central bank operations on monetary and liquidity management, and an unburdening of its balance sheet of real assets. It is also important to capitalize on the improved degree of collaboration between the central bank and the ministry of finance to place explicit constraints on central bank financing of the government, to institutionalize policy coordination, and to achieve a better distribution of the fiscal costs of financial stabilization.

43. **The success of the adjustment strategy depends crucially on preserving depositor confidence.** Confidence is linked to the credibility of the government's program, the effectiveness of the central bank's financial management, and perceptions about the soundness of the banking sector. On the last point, staff is encouraged by the proactive stance of banking sector supervision in monitoring risks and providing an effective regulatory framework, which could be reinforced by providing legal protection to supervisors. Although the systemic problem of the commercial banks' exposure to the government cannot be addressed fundamentally by regulatory means, a strong supervisory framework can help mitigate the exposure of banks to market and other credit risk. This is particularly important in a context where the Lebanese banks will gradually have to develop profitable activities other than intermediating government paper. This will likely entail a consolidation of the banking sector. The authorities would be well served by preparing the necessary safeguards, including a well functioning deposit guarantee scheme, for such consolidation to take place in an orderly market-based manner. Adoption of an independent and strong securities regulator with adequate legal protection is also urgent to build confidence in and protect the stability of the burgeoning stock market.

44. **In order to revitalize economic growth, the short-run costs of adjustment should be counterbalanced by an explicit growth agenda.** There appears to be considerable scope for productivity gains in the private sector. To realize them, there is a need to: (i) enhance the quality of government services, raise the productivity of government capital spending, and reduce the burden of red tape on the private sector; (ii) reactivate the liberalization and privatization of the telecom sector, to lower input costs for the economy and promote the creation of new services; and (iii) improve the business climate and competition by reducing the high costs of entry and exit, strengthening contract enforcement, eliminating monopolistic practices, and addressing corruption decisively.

45. **In all, there is considerable convergence of views between the authorities and staff on the reforms that are needed in the period ahead, but Lebanon can ill afford protracted delays in these reforms.** In the view of staff, vulnerabilities and risks remain very high, and an incremental approach to reform will remain exposed to political risks down the road. The authorities should seize the unique opportunity offered by the ongoing political transformation and the interest of the international community in supporting Lebanon to make sizeable upfront progress in their reform and adjustment agenda.

46. It is proposed that the next Article IV consultation with Lebanon take place on the standard 12-month cycle.

Table 1a. Lebanon: Selected Indicators (Baseline Scenario), 2002–11

	2002	2003	2004	Prel. Est. 2005	Baseline Scenario 1/ 2006	2007	2008	2009	2010	2011
	(Annual percentage changes; unless otherwise indicated)									
National income and prices 2/										
Real GDP	2.9	5.0	6.0	1.0	3.0	2.0	2.0	2.0	2.0	2.0
Consumer price index (annual average)	1.8	1.3	3.0	0.3	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP	8.2	7.8	9.4	1.3	5.1	4.0	4.0	4.0	4.0	4.0
Nominal GDP (In billions of Lebanese pounds)	27,832	29,991	32,815	33,243	34,925	36,336	37,804	39,331	40,920	42,573
Nominal GDP (In millions of U.S. dollars)	18,462	19,895	21,768	22,052	23,167	24,103	25,077	26,090	27,144	28,241
Per capita GDP (In dollars)	5,049	5,370	5,799	5,799	6,014	6,177	6,344	6,516	6,692	6,873
Broad money	6.4	15.4	12.3	3.5	4.5	3.0	3.0	3.0	3.0	3.0
(In percent of GDP)	237.7	254.6	261.3	266.9	265.4	262.8	260.3	257.8	255.3	252.8
Deposit dollarization (In percent of total deposits)	69.4	66.2	70.1	73.2	70.0	70.0	70.0	70.0	70.0	70.0
	(In percent of GDP)									
Government operations										
Revenue and grants	21.0	22.0	22.8	22.3	22.1	22.0	22.1	22.1	22.1	22.2
Expenditure 3/	35.1	35.2	31.3	30.2	32.5	34.2	34.8	35.7	36.9	39.0
Overall balance 3/	-14.1	-13.2	-8.5	-7.9	-10.4	-12.2	-12.6	-13.6	-14.8	-16.8
of which: primary balance	2.8	3.2	3.4	2.4	1.4	1.6	2.0	2.0	2.0	2.0
Gross government debt	166.4	167.8	164.7	174.6	176.8	182.3	188.0	194.4	201.9	211.0
of which: in foreign currency	75.5	78.3	84.4	85.7	84.9	86.2	88.1	90.2	91.6	95.2
Net debt of government and BDL (incl. accrued interest) 4/	143.7	150.2	149.3	160.3	...	...	...	...	...	...
	(In millions of U.S. dollars)									
Gross government debt	30,727	33,381	35,861	38,507	40,954	43,938	47,144	50,732	54,806	59,591
Paris II budgetary support	300	2,090	0	0	0	0	0	0	0	0
	(In percent of GDP)									
External sector										
Current account balance	-15.4	-15.2	-18.2	-12.7	-13.5	-13.7	-14.2	-14.8	-16.0	-17.1
of which: exports, f.o.b.	5.5	7.3	7.3	8.3	8.5	8.7	8.8	9.0	9.2	9.3
of which: imports, f.o.b.	32.4	33.5	40.0	39.4	39.5	40.3	40.7	41.0	41.4	41.8
	(In millions of U.S. dollars)									
Gross official reserves (excluding gold)	5,094	10,213	9,513	9,852	8,742	8,401	8,170	7,690	6,619	4,700
Net official foreign currency liquidity 5/	-2,006	4,217	4,422	5,895	...	...	...	...	...	...
	(In percent)									
Interest rates										
Average Lebanese pound deposit rate	10.3	7.8	6.8	7.7	7.8	8.3	9.0	9.7	10.3	11.0
Average dollar deposit rate	4.2	3.6	3.6	4.0	5.3	5.7	6.0	6.3	6.7	7.0
Marginal interest rate on 2-year T-bill in Lebanese pounds	14.1	7.8	8.3	8.5	9.2	9.8	10.5	11.2	11.8	12.5
Marginal interest rate on 5-year Eurobonds	7.9	7.0	7.5	8.0	8.3	8.7	9.0	9.3	9.7	10.0
Memorandum items:										
Population (in millions) 6/	3.7	3.7	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.1
Exchange rate (LL per U.S. dollar)	1,508	1,508	1,508	1,508	...	...	...	...	...	...

Sources: Lebanese authorities; and Fund staff estimates and projections.

1/ Based on the end-December WEO projections of oil price, international interest rates, and external demand.
2/ GDP figures reflect revised national accounts published in July 2005.
3/ On checks issued basis. The underlying primary surplus for 2005, excluding one-off arrears repayments to the social security fund and settlement of central bank advances to the electricity company, is equivalent to 3.4 percent of GDP.
4/ Defined as: gross debt of the government of Lebanon; minus deposits; minus liabilities of the government of Lebanon to the central bank (BdL; plus total liabilities of the BdL to entities other than the government of Lebanon; minus gross international reserves of the BdL; minus gold at the market price; minus SDR and reserve position in the IMF; minus fixed assets; minus other claims of the BdL on entities other than the government of Lebanon.
5/ Defined as: gross international reserves minus principal and interest due over the next 12 months on all foreign currency liabilities of the BdL to entities other than the government of Lebanon.
6/ 2004 Household Survey and UN projections.

Table 1b. Lebanon: Selected Indicators (Adjustment Scenario), 2002–11

				Prel. Est.	Adjustment Scenario 1/					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(Annual percentage changes; unless otherwise indicated)									
National income and prices 2/										
Real GDP	2.9	5.0	6.0	1.0	3.0	3.4	3.7	4.0	4.0	4.0
Consumer price index (annual average)	1.8	1.3	3.0	0.3	2.5	2.0	2.0	2.0	2.0	2.0
Nominal GDP	8.2	7.8	9.4	1.3	5.6	5.5	5.8	6.1	6.1	6.1
Nominal GDP (In billions of Lebanese pounds)	27,832	29,991	32,815	33,243	35,096	37,015	39,152	41,532	44,057	46,736
Nominal GDP (In millions of U.S. dollars)	18,462	19,895	21,768	22,052	23,281	24,554	25,971	27,550	29,225	31,002
Per capita GDP (In dollars)	5,049	5,370	5,799	5,799	6,044	6,292	6,570	6,880	7,205	7,545
Broad money	6.4	15.4	12.3	3.5	5.0	5.0	5.0	5.0	5.0	5.0
(In percent of GDP)	237.7	254.6	261.3	266.9	265.4	264.1	262.1	259.4	256.7	254.0
Deposit dollarization (In percent of total deposits)	69.4	66.2	70.1	73.2	70.0	70.0	70.0	70.0	70.0	70.0
	(In percent of GDP)									
Government operations										
Revenue and grants	21.0	22.0	22.8	22.3	22.8	23.0	23.5	24.1	24.0	23.9
Expenditure 3/	35.1	35.2	31.3	30.2	31.0	30.0	28.5	27.2	26.4	26.0
Overall balance 3/	-14.1	-13.2	-8.5	-7.9	-8.2	-7.0	-5.0	-3.1	-2.4	-2.1
of which: primary balance	2.8	3.2	3.4	2.4	3.0	4.5	5.7	7.0	7.0	7.0
Gross government debt	166.4	167.8	164.7	174.6	160.6	153.2	149.9	144.4	138.6	132.8
of which: in foreign currency	75.5	78.3	84.4	85.7	80.2	76.5	72.6	69.9	67.1	64.3
Net debt of government and BDL (incl. accrued interest) 4/	143.7	150.2	149.3	160.3	...	...	...	...	...	...
	(In millions of U.S. dollars)									
Gross government debt	30,727	33,381	35,861	38,507	37,395	37,616	38,928	39,791	40,511	41,180
Paris II budgetary support	300	2,090	0	0	0	0	0	0	0	0
Privatization receipts	0	0	0	0	3,000	1,500	0	0	0	0
	(In percent of GDP)									
External sector										
Current account balance	-15.4	-15.2	-18.2	-12.7	-12.9	-12.1	-11.7	-11.3	-11.0	-10.8
of which: exports, f.o.b.	5.5	7.3	7.3	8.3	8.7	9.0	9.2	9.4	9.7	9.9
of which: imports, f.o.b.	32.4	33.5	40.0	39.4	40.0	40.3	40.6	40.9	41.3	41.6
	(In millions of U.S. dollars)									
Gross official reserves (excluding gold)	5,094	10,213	9,513	9,852	10,647	11,504	11,674	12,467	13,749	14,409
Net official foreign currency liquidity 5/	-2,006	4,217	4,422	5,895	...	...	...	...	...	...
	(In percent)									
Interest rates										
Average Lebanese pound deposit rate	10.3	7.8	6.8	7.7	7.0	7.0	7.0	7.0	7.0	7.0
Average dollar deposit rate	4.2	3.6	3.6	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Marginal interest rate on 2-year T-bill in Lebanese pounds	14.1	7.8	8.3	8.5	8.5	8.5	8.5	8.5	8.5	8.5
Marginal interest rate on 5-year Eurobonds	7.9	7.0	7.5	8.0	7.0	7.0	7.0	7.0	7.0	7.0
Memorandum items:										
Population (in millions) 6/	3.7	3.7	3.8	3.8	3.9	3.9	4.0	4.0	4.1	4.1
Exchange Rate (LL per U.S. dollar)	1,508	1,508	1,508	1,508	...	...	...	...	...	...

Sources: Lebanese authorities; and Fund staff estimates and projections.

1/ Based on the end-December WEO projections of oil price, international interest rates, and external demand.
2/ GDP figures reflect revised national accounts published in July 2005.
3/ On checks issued basis. The underlying primary surplus for 2005, excluding one-off arrears repayments to the social security fund and settlement of central bank advances to the electricity company, is equivalent to 3.4 percent of GDP.
4/ Defined as: gross debt of the government of Lebanon; minus deposits; minus liabilities of the government of Lebanon to the central bank (BdL; plus total liabilities of the BdL to entities other than the government of Lebanon; minus gross international reserves of the BdL; minus gold at the market price; minus SDR and reserve position in the IMF; minus fixed assets; minus other claims of the BdL on entities other than the government of Lebanon.
5/ Defined as: gross international reserves minus principal and interest due over the next 12 months on all foreign currency liabilities of the BdL to entities other than the government of Lebanon.
6/ 2004 Household Survey and UN projections.

Table 2. Lebanon: Central Government Primary Balance, 2002–11
(In billions of Lebanese pounds)

	2002	2003	2004	Prel. Est. 2005	Adjustment Scenario 2006	2007	2008	2009	2010	2011
Primary balance	782	975	1,126	782	1,057	1,658	2,222	2,890	3,103	3,285
Revenue and grants	5,848	6,597	7,483	7,405	7,999	8,530	9,218	10,015	10,553	11,148
Revenue	5,846	6,597	7,483	7,405	7,999	8,530	9,218	10,015	10,553	11,148
Tax revenue	4,015	4,527	5,169	4,867	5,446	6,321	7,008	7,680	8,086	8,542
Taxes on income and profits	727	783	908	1,047	1,156	1,251	1,516	1,750	1,818	1,915
Taxes on property	300	321	405	414	437	461	488	517	549	582
Taxes on domestic goods and services	1,181	1,560	1,971	1,896	2,316	3,001	3,209	3,407	3,626	3,851
of which: VAT revenues	1,013	1,386	1,763	1,693	2,105	2,778	2,974	3,158	3,361	3,570
Taxes on international trade 1/	1,618	1,645	1,617	1,268	1,368	1,482	1,682	1,885	1,965	2,058
Tariffs	595	475	530	481	509	464	498	523	552	583
Excises	1,023	1,170	1,087	787	859	1,017	1,184	1,362	1,413	1,476
Other taxes	189	217	268	241	169	127	114	121	128	136
Nontax revenue	1,832	2,070	2,314	2,538	2,552	2,208	2,210	2,335	2,466	2,606
Entrepreneurial and property income	933	1,252	1,417	1,663	1,639	1,254	1,210	1,284	1,362	1,445
Profit transfer from BdL	20	0	0	0	0	0	0	0	0	0
Other	913	1,252	1,417	1,662	1,639	1,254	1,210	1,284	1,362	1,445
Administrative fees and charges	373	383	365	365	385	406	430	456	484	513
Other nontax revenue	98	81	93	89	94	99	105	111	118	125
Fines and forfeits	22	6	5	4	4	4	5	5	5	6
Other	76	75	88	85	90	95	100	106	113	120
Other treasury revenue	428	354	439	421	434	448	465	484	503	523
Grants	2	0	0	0	0	0	0	0	0	0
Primary expenditure 2/	5,066	5,622	6,356	6,623	6,941	6,872	6,996	7,125	7,450	7,864
Current primary expenditure	4,485	4,708	5,304	5,939	5,998	5,940	5,961	5,937	6,141	6,431
Wages, salaries and pensions	3,008	3,078	3,094	3,193	3,197	3,214	3,258	3,240	3,436	3,641
Wages and salaries	2,151	2,234	2,284	2,329	2,381	2,400	2,448	2,497	2,649	2,810
Pensions	857	844	810	864	815	813	810	743	787	831
Transfers to EDL 3/	60	174	184	637	842	730	643	613	584	555
Other current	1,417	1,456	2,026	2,109	1,959	1,996	2,060	2,083	2,120	2,236
Materials and supplies	130	120	116	213	150	153	156	169	178	186
External services	80	81	113	82	84	86	87	94	101	103
Transfers 4/ 5/	227	271	360	569	488	526	555	525	486	545
Other	425	440	452	377	386	394	402	410	448	457
Other treasury outflows 6/	555	544	985	868	850	837	859	885	908	944
Capital expenditure	581	914	1,052	684	943	932	1,036	1,188	1,309	1,432
Domestically financed	392	713	817	534	740	717	809	947	1,059	1,157
Foreign financed	188	201	235	150	204	215	227	241	250	275

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Domestic excises, which are collected at customs, are classified as taxes on international trade.
2/ On checks issued basis.
3/ Excludes principal and interest payments paid on behalf of EdL.
4/ From 2004 onward includes additional transfers to the social security funds (NSSF) to avoid reoccurrence of arrears.
5/ Includes two transfers for telecom settlements of $97 million (LL 146 billion) each (paid in equal installments over three years) starting in 2006 and 200
6/ Includes transfers to municipalities.

Table 3. Lebanon: Central Government Primary Balance, 2002–11
(In percent of GDP)

				Prel. Est.	Adjustment Scenario					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Primary balance	2.8	3.2	3.4	2.4	3.0	4.5	5.7	7.0	7.0	7.0
Revenue and grants	21.0	22.0	22.8	22.3	22.8	23.0	23.5	24.1	24.0	23.9
Revenue	21.0	22.0	22.8	22.3	22.8	23.0	23.5	24.1	24.0	23.9
Tax revenue	14.4	15.1	15.8	14.6	15.5	17.1	17.9	18.5	18.4	18.3
Taxes on income and profits	2.6	2.6	2.8	3.1	3.3	3.4	3.9	4.2	4.1	4.1
Taxes on property	1.1	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Taxes on domestic goods and services	4.2	5.2	6.0	5.7	6.6	8.1	8.2	8.2	8.2	8.2
of which: VAT revenues	3.6	4.6	5.4	5.1	6.0	7.5	7.6	7.6	7.6	7.6
Taxes on international trade 1/	5.8	5.5	4.9	3.8	3.9	4.0	4.3	4.5	4.5	4.4
Tariffs	2.1	1.6	1.6	1.4	1.5	1.3	1.3	1.3	1.3	1.2
Excises	3.7	3.9	3.3	2.4	2.4	2.7	3.0	3.3	3.2	3.2
Other taxes	0.7	0.7	0.8	0.7	0.5	0.3	0.3	0.3	0.3	0.3
Nontax revenue	6.6	6.9	7.1	7.6	7.3	6.0	5.6	5.6	5.6	5.6
Entrepreneurial and property income	3.4	4.2	4.3	5.0	4.7	3.4	3.1	3.1	3.1	3.1
Profit transfer from BdL	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	3.3	4.2	4.3	5.0	4.7	3.4	3.1	3.1	3.1	3.1
Administrative fees and charges	1.3	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Other nontax revenue	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other treasury revenue	1.5	1.2	1.3	1.3	1.2	1.2	1.2	1.2	1.1	1.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary expenditure 2/	18.2	18.7	19.4	19.9	19.8	18.6	17.9	17.2	16.9	16.8
Current primary expenditure	16.1	15.7	16.2	17.9	17.1	16.0	15.2	14.3	13.9	13.8
Wages, salaries and pensions	10.8	10.3	9.4	9.6	9.1	8.7	8.3	7.8	7.8	7.8
Wages and salaries	7.7	7.4	7.0	7.0	6.8	6.5	6.3	6.0	6.0	6.0
Pensions	3.1	2.8	2.5	2.6	2.3	2.2	2.1	1.8	1.8	1.8
Transfers to EDL 3/	0.2	0.6	0.6	1.9	2.4	2.0	1.6	1.5	1.3	1.2
Other current	5.1	4.9	6.2	6.3	5.6	5.4	5.3	5.0	4.8	4.8
Materials and supplies	0.5	0.4	0.4	0.6	0.4	0.4	0.4	0.4	0.4	0.4
External services	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Transfers 4/ 5/	0.8	0.9	1.1	1.7	1.4	1.4	1.4	1.3	1.1	1.2
Other	1.5	1.5	1.4	1.1	1.1	1.1	1.0	1.0	1.0	1.0
Other treasury outflows 6/	2.0	1.8	3.0	2.6	2.4	2.3	2.2	2.1	2.1	2.0
Capital expenditure	2.1	3.0	3.2	2.1	2.7	2.5	2.6	2.9	3.0	3.1
Domestically financed	1.4	2.4	2.5	1.6	2.1	1.9	2.1	2.3	2.4	2.5
Foreign financed	0.7	0.7	0.7	0.5	0.6	0.6	0.6	0.6	0.6	0.6

Sources: Ministry of Finance; and Fund staff estimates and projections.
1/ Domestic excises, which are collected at customs, are classified as taxes on international trade.
2/ On checks issued basis.
3/ Excludes principal and interest payments paid on behalf of EdL.
4/ From 2004 onward includes additional transfers to the social security funds (NSSF) to avoid reoccurrence of arrears.
5/ Includes two transfers for telecom settlements of $97 million (LL 146 billion) each (paid in equal installments over three years) starting in 2006 and 2007.
6/ Includes transfers to municipalities.

Table 4. Lebanon: Overall Fiscal Deficit and Financing, 2002–11

				Prel. Est.	Adjustment Scenario					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
					(In billions of Lebanese pounds)					
Primary balance	782	975	1,126	782	1,057	1,658	2,222	2,890	3,103	3,285
Interest bill	4,712	4,942	3,921	3,410	3,928	4,248	4,165	4,178	4,178	4,285
Overall balance (checks-issued basis)	-3,930	-3,968	-2,795	-2,628	-2,871	-2,591	-1,943	-1,288	-1,075	-1,000
Float and statistical discrepancy	520	-215	242	299	0	0	0	0	0	0
Overall balance (cash basis)	-4,450	-3,753	-3,037	-2,927	-2,871	-2,591	-1,943	-1,288	-1,076	-1,000
Net financing	4,450	3,753	3,037	2,927	2,871	2,591	1,943	1,288	1,076	1,000
Banking system	-872	3,047	4,265	2,653	-2,366	-328	913	-225	-255	739
BdL 1/	-4,170	8,305	673	53	-4,980	-1,665	-2,622	-303	-327	-294
Deposits	-1,083	437	-924	-918	0	0	0	0	0	0
Treasury bills	-5,376	7,869	1,597	971	-4,980	-1,665	-2,340	-21	-45	-12
Eurobonds	2,289	0	0	0	0	0	-282	-282	-282	-282
Commercial banks 1/	3,298	-5,258	3,592	2,600	2,614	1,337	3,534	78	71	1,033
Treasury bills	2,157	-4,652	-13	1,823	3,512	1,643	3,962	485	397	215
Eurobonds	1,141	-596	3,602	777	-898	-306	-428	-407	-326	818
Government institutions	157	-616	-357	245	0	-63	-6	-26	-63	0
Other creditors	2,746	-1,197	-1,219	183	715	720	1,037	1,539	1,394	261
Treasury bills	1,169	-1,050	-1,684	-12	169	231	239	240	260	283
Eurobonds	1,522	-341	412	265	907	805	1,121	1,626	1,456	154
Foreign currency bonds	0	0	0	0	0	0	0	0	0	0
Other foreign currency loans	55	195	54	-70	-362	-316	-323	-326	-322	-176
Net change in arrears	-436	0	0	-419	0	0	0	0	0	0
Exceptional financing	3,152	2,999	517	0	4,523	2,261	0	0	0	0
Privatization	0	-280	0	0	4,523	2,261	0	0	0	0
Paris II loans	452	3,279	0	0	0	0	0	0	0	0
Debt cancellation and BdL revaluation of gold and foreign exchange	2,700	0	517	0	0	0	0	0	0	0
Valuation adjustment	-297	-480	-169	265	0	0	0	0	0	0
					(In percent of GDP)					
Primary balance	2.8	3.2	3.4	2.4	3.0	4.5	5.7	7.0	7.0	7.0
Interest bill	16.9	16.5	12.0	10.3	11.2	11.5	10.6	10.1	9.5	9.2
Overall balance (checks-issued basis)	-14.1	-13.2	-8.5	-7.9	-8.2	-7.0	-5.0	-3.1	-2.4	-2.1
Float and statistical discrepancy	1.9	-0.7	0.7	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-16.0	-12.5	-9.3	-8.8	-8.2	-7.0	-5.0	-3.1	-2.4	-2.1
Net financing	16.0	12.5	9.3	8.8	8.2	7.0	5.0	3.1	2.4	2.1
Banking system	-3.1	10.2	13.0	8.0	-6.7	-0.9	2.3	-0.5	-0.6	1.6
BdL 1/	-15.0	27.7	2.1	0.2	-14.2	-4.5	-6.7	-0.7	-0.7	-0.6
Commercial banks 1/	11.9	-17.5	10.9	7.8	7.4	3.6	9.0	0.2	0.2	2.2
Government institutions	0.6	-2.1	-1.1	0.7	0.0	-0.2	0.0	-0.1	-0.1	0.0
Other creditors	9.9	-4.0	-3.7	0.6	2.0	1.9	2.6	3.7	3.2	0.6
Net change in arrears	-1.6	0.0	0.0	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	11.3	10.0	1.6	0.0	12.9	6.1	0.0	0.0	0.0	0.0
Privatization receipts	0.0	-0.9	0.0	0.0	12.9	6.1	0.0	0.0	0.0	0.0
Paris II loans	1.6	10.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt cancellation and BdL revaluation of gold and foreign exchange	9.7	0.0	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation adjustment	-1.1	-1.6	-0.5	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Total public sector financial support to EdL	1.1	2.0	2.1	3.2	...	...	...	...	...	...
Budgetary support to EdL (including debt service) 2/	1.1	1.3	1.3	3.2	...	...	...	...	...	...
Central bank financing to EdL	0.0	0.7	0.8	0.0	...	...	...	...	...	...

Sources: Lebanese authorities; and Fund staff estimates and projections.

1/ Figures for 2003 are affected by the intermediation role played by the BdL in the debt exchange with banks, that tends to increase BdL financing and decrease commercial bank financing of the government.

2/ Includes letters of credit equivalent to 0.7 percent of GDP in 2005 for oil deliveries to EdL from Algeria and Kuwait.

Table 5. Lebanon: Gross Financing Requirement, 2004–07
(In billions of Lebanese pounds; unless otherwise indicated)

		Prel. Est.	Adjustment Scenario	
	2004	2005	2006	2007
Primary deficit (- = surplus)	-1,126	-782	-1,057	-1,658
Interest payments	3,921	3,410	3,928	4,248
Foreign currency	1,676	1,877	1,987	1,864
Domestic currency	2,246	1,533	1,941	2,385
Overall balance (checks-issued basis)	2,795	2,628	2,871	2,591
Principal payments 1/	20,396	19,089	15,005	8,538
Banking system	13,349	11,521	11,244	6,661
Banque du Liban	769	4,461	4,980	1,665
Commercial banks	12,580	7,060	6,264	4,996
Public institutions	2,463	1,683	1,667	337
Other creditors	4,584	5,885	2,094	1,540
Gross financing requirement	23,191	21,717	17,876	11,129
Financing sources 1/	23,433	22,016	17,876	11,129
Banking system	17,614	14,174	8,878	6,333
Banque du Liban	1,442	4,514	0	0
Commercial banks	16,172	9,660	8,878	6,333
Public institutions	2,106	1,928	1,667	274
Other creditors	3,365	5,650	2,809	2,260
Exceptional financing	517	0	4,523	2,261
Privatization	0	0	4,523	2,261
Paris II loans	0	0	0	0
Debt cancellation and BdL revaluation of gold and foreign exchange	517	0	0	0
Valuation adjustment	-169	265	0	0
Float and statistical discrepancy	-242	-299	0	0
	(In percent of GDP)			
Memorandum items:				
Gross financing requirement	70.7	65.3	50.9	30.1
Gross financing				
BdL and public institutions	10.8	19.4	4.7	0.7
Commercial banks and other creditors	59.5	46.1	33.3	23.2
Privatization	0.0	0.0	12.9	6.1
Paris II	0.0	0.0	0.0	0.0
Debt cancellation and BdL revaluation of gold and foreign exchange	1.6	0.0	0.0	0.0
Valuation adjustments and statistical discrepancy	-1.3	-0.1	0.0	0.0
Nominal GDP (in billions of Lebanese pounds)	32,815	33,243	35,096	37,015

Sources: Lebanese authorities; and Fund staff estimates and projections.

1/ In the projections, all the new T-bills issued are assumed to have a two-year maturity.

Table 6. Lebanon: Government Debt, 2002–11

	2002	2003	2004	Prel. Est. 2005	Adjustment Scenario 2006	2007	2008	2009	2010	2011
	(In millions of U.S. dollars)									
Gross debt 1/ 2/	30,727	33,381	35,861	38,507	37,395	37,616	38,928	39,791	40,511	41,180
Domestic currency	16,784	17,806	17,493	19,609	18,731	18,829	20,083	20,541	20,911	21,239
Foreign currency	13,943	15,575	18,368	18,899	18,665	18,787	18,845	19,250	19,599	19,940
Debt to Banque du Liban	2,351	7,937	9,052	9,606	6,303	5,199	3,459	3,258	3,042	2,847
Domestic currency	479	5,929	7,066	7,752	4,448	3,344	1,792	1,778	1,748	1,740
Foreign currency	1,872	2,009	1,986	1,855	1,855	1,855	1,668	1,481	1,294	1,107
Debt to commercial banks	18,256	14,526	16,898	18,680	20,401	21,290	23,653	23,712	23,765	24,455
Domestic currency	11,417	8,161	8,106	9,373	11,690	12,781	15,428	15,757	16,026	16,173
Foreign currency	6,839	6,365	8,792	9,307	8,711	8,509	8,225	7,955	7,739	8,282
Debt to public entities 3/	2,137	1,701	1,451	1,623	1,620	1,579	1,577	1,561	1,519	1,520
Other debt to non-bank sector	7,983	9,217	8,461	8,598	9,071	9,549	10,238	11,260	12,185	12,358
Domestic currency	2,751	2,016	871	861	972	1,126	1,285	1,445	1,618	1,806
Foreign currency	5,232	7,201	7,590	7,737	8,099	8,423	8,953	9,815	10,567	10,552
	(In percent of GDP)									
Gross debt 1/	166.4	167.8	164.7	174.6	160.6	153.2	149.9	144.4	138.6	132.8
Domestic currency	90.9	89.5	80.4	88.9	80.5	76.7	77.3	74.6	71.6	68.5
Foreign currency	75.5	78.3	84.4	85.7	80.2	76.5	72.6	69.9	67.1	64.3
Debt to Banque du Liban	12.7	39.9	41.6	43.6	27.1	21.2	13.3	11.8	10.4	9.2
Domestic currency	2.6	29.8	32.5	35.2	19.1	13.6	6.9	6.5	6.0	5.6
Foreign currency	10.1	10.1	9.1	8.4	8.0	7.6	6.4	5.4	4.4	3.6
Debt to commercial banks	98.9	73.0	77.6	84.7	87.6	86.7	91.1	86.1	81.3	78.9
Domestic currency	61.8	41.0	37.2	42.5	50.2	52.1	59.4	57.2	54.8	52.2
Foreign currency	37.0	32.0	40.4	42.2	37.4	34.7	31.7	28.9	26.5	26.7
Debt to public entities 3/	11.6	8.5	6.7	7.4	7.0	6.4	6.1	5.7	5.2	4.9
Other debt to non-bank sector	43.2	46.3	38.9	39.0	39.0	38.9	39.4	40.9	41.7	39.9
Domestic currency	14.9	10.1	4.0	3.9	4.2	4.6	4.9	5.2	5.5	5.8
Foreign currency	28.3	36.2	34.9	35.1	34.8	34.3	34.5	35.6	36.2	34.0
	(In percent of gross public debt)									
Gross debt 1/ 2/	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Domestic currency	54.6	53.3	48.8	50.9	50.1	50.1	51.6	51.6	51.6	51.6
Foreign currency	45.4	46.7	51.2	49.1	49.9	49.9	48.4	48.4	48.4	48.4
Debt to Banque du Liban	7.7	23.8	25.2	24.9	16.9	13.8	8.9	8.2	7.5	6.9
Debt to commercial banks	59.4	43.5	47.1	48.5	54.6	56.6	60.8	59.6	58.7	59.4
Debt to public entities 3/	7.0	5.1	4.0	4.2	4.3	4.2	4.1	3.9	3.8	3.7
Other debt to non-bank sector	26.0	27.6	23.6	22.3	24.3	25.4	26.3	28.3	30.1	30.0
Memorandum items:	(In millions of U.S. dollars, unless otherwise noted)									
Central government deposits	1,966	2,002	2,892	3,708	3,708	3,708	3,708	3,708	3,708	3,708
of which: at commercial banks	392	879	982	1,130	1,130	1,130	1,130	1,130	1,130	1,130
Net debt 4/	28,760	31,379	32,970	34,799	33,687	33,908	35,219	36,082	36,803	37,471
(in percent of GDP)	155.8	157.7	151.5	157.8	144.7	138.1	135.6	131.0	125.9	120.9
Gross debt held outside the public sector 5/	26,239	23,743	25,358	27,278	29,472	30,839	33,891	34,972	35,950	36,813
(in percent of GDP)	142.1	119.3	116.5	123.7	126.6	125.6	130.5	126.9	123.0	118.7
Gross debt held by the market 6/	24,448	19,550	21,018	23,073	23,349	24,925	29,211	30,291	31,294	32,197
(in percent of GDP)	132.4	98.3	96.6	104.6	100.3	101.5	112.5	109.9	107.1	103.9
(in percent of M5) 7/	37.0	25.7	24.5	26.0	25.7	26.1	29.1	28.7	28.0	27.1
Gross debt (in percent of M5) 7/	70.0	66.2	63.1	65.4	62.0	59.5	58.4	56.9	54.6	52.3

Sources: Lebanese authorities; and Fund staff estimates and projections.

1/ Includes all debt contracted by the treasury on behalf of the central government and public agencies other than the central bank. Excludes government arrears to the private sector. Includes accrued interest.

2/ Excludes domestic arrears.

3/ In domestic currency, and mainly to the National Social Security Fund (NSSF) and the National Deposit Insurance Fund (NDIF).

4/ Gross debt minus central government deposits.

5/ Excludes debt to Banque du Liban and public entities.

6/ Excludes debt to Banque du Liban and public entities, as well as to official external creditors.

7/ M5 is defined as the sum of M3 and nonresident deposits.

Table 7. Lebanon: Monetary Survey, 2002–11

				Prel. Est.	Adjustment Scenario					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(Stocks in billions of Lebanese pounds)									
Net foreign assets	24,832	33,587	36,880	38,663	41,023	43,662	44,700	47,020	50,116	52,471
Banque du Liban	12,365	21,048	20,262	21,909	23,106	24,398	24,654	25,850	27,782	28,778
Commercial banks	12,467	12,539	16,618	16,754	17,916	19,264	20,046	21,169	22,334	23,693
Net domestic assets	41,326	42,771	48,852	50,057	52,110	54,098	57,922	60,711	62,979	66,258
Net claims on public sector	28,191	30,670	34,029	35,966	33,599	33,272	34,184	33,959	33,704	34,444
Of which : Net claims on government	29,035	31,970	35,625	38,113	35,747	35,419	36,332	36,107	35,851	36,590
Banque du Liban	2,499	10,983	11,491	11,448	6,468	4,803	2,181	1,878	1,551	1,257
Lebanese pounds	-322	7,955	8,497	8,652	3,672	2,007	-333	-354	-399	-411
Foreign currency	2,821	3,028	2,994	2,796	2,796	2,796	2,514	2,232	1,950	1,668
Commercial banks	26,536	20,987	24,134	26,665	29,279	30,616	34,151	34,229	34,300	35,333
Lebanese pounds	16,214	11,366	10,853	12,608	16,120	17,763	21,725	22,210	22,607	22,822
Foreign currency	10,323	9,621	13,281	14,057	13,159	12,853	12,426	12,019	11,693	12,511
Claims on private sector	22,963	23,233	24,375	24,774	27,166	28,781	30,493	32,307	34,231	36,269
Lebanese pounds	4,261	4,254	4,622	4,613	4,993	5,277	5,578	5,898	6,236	6,595
Foreign currency	18,702	18,980	19,752	20,161	22,173	23,504	24,914	26,410	27,994	29,674
Other items (net)	-9,828	-11,133	-9,551	-10,682	-8,655	-7,955	-6,755	-5,555	-4,955	-4,455
Broad money 1/	66,158	76,357	85,733	88,720	93,133	97,760	102,622	107,731	113,096	118,729
In Lebanese pounds	21,177	27,458	27,427	25,503	29,787	31,185	32,650	34,275	35,982	37,774
Currency	1,375	1,531	1,586	1,535	1,774	1,857	1,944	2,041	2,143	2,249
Deposits in Lebanese pounds	19,801	25,927	25,840	23,968	28,013	29,328	30,705	32,234	33,839	35,525
Demand deposits	1,219	2,351	2,460	2,246	2,596	2,718	2,845	2,987	3,135	3,292
Time deposits	18,582	23,576	23,380	21,722	25,417	26,610	27,860	29,248	30,704	32,233
Deposits in foreign currency	44,981	48,900	58,306	63,217	63,346	66,575	69,972	73,456	77,114	80,955
	(Year-to-date change in billions of Lebanese pounds)									
Net foreign assets	3,302	8,754	3,294	1,782	2,360	2,639	1,038	2,320	3,097	2,354
Net domestic assets	658	1,445	6,082	1,205	2,053	1,987	3,824	2,789	2,268	3,279
Net claims on public sector	-333	2,480	3,359	1,937	-2,366	-328	913	-225	-255	740
of which : Net claims on government	-561	2,934	3,656	2,487	-2,366	-328	913	-225	-255	739
Central bank	-4,084	8,484	508	-43	-4,980	-1,665	-2,622	-303	-327	-294
Commercial banks	3,523	-5,550	3,148	2,531	2,614	1,337	3,534	78	71	1,033
Claims on private sector	570	270	1,141	400	2,392	1,615	1,712	1,814	1,923	2,039
Lebanese pounds	852	-7	369	-9	380	284	301	319	338	359
Foreign currency	-282	277	772	409	2,012	1,331	1,410	1,495	1,585	1,680
Other items (net)	421	-1,305	1,582	-1,131	2,027	700	1,200	1,200	600	500
Broad money	3,960	10,199	9,375	2,987	4,413	4,627	4,862	5,109	5,365	5,633
In Lebanese pounds	3,061	6,281	-31	-1,924	4,284	1,398	1,465	1,626	1,707	1,792
Deposits in foreign currency	899	3,918	9,406	4,911	129	3,229	3,397	3,484	3,658	3,841
	(Year-to-date change in percent of beginning of period broad money)									
Net foreign assets	5.3	13.2	4.3	2.1	2.7	2.8	1.1	2.3	2.9	2.1
Net domestic assets	1.1	2.2	8.0	1.4	2.3	2.1	3.9	2.7	2.1	2.9
Net claims on public sector	-0.5	3.7	4.4	2.3	-2.7	-0.4	0.9	-0.2	-0.2	0.7
of which : Net claims on government	-0.9	4.4	4.8	2.9	-2.7	-0.4	0.9	-0.2	-0.2	0.7
Central bank	-6.6	12.8	0.7	-0.1	-5.6	-1.8	-2.7	-0.3	-0.3	-0.3
Commercial banks	5.7	-8.4	4.1	3.0	2.9	1.4	3.6	0.1	0.1	0.9
Claims on private sector	0.9	0.4	1.5	0.5	2.7	1.7	1.8	1.8	1.8	1.8
Other items (net)	0.7	-2.0	2.1	-1.3	2.3	0.8	1.2	1.2	0.6	0.4
Broad money	6.4	15.4	12.3	3.5	5.0	5.0	5.0	5.0	5.0	5.0
In Lebanese pounds	4.9	9.5	0.0	-2.2	4.8	1.5	1.5	1.6	1.6	1.6
Deposits in foreign currency	1.4	5.9	12.3	5.7	0.1	3.5	3.5	3.4	3.4	3.4
Memorandum items:										
Net foreign assets (in millions of U.S. dollars)	16,478	22,287	24,473	25,655	27,221	28,973	29,661	31,201	33,256	34,818
Share of foreign currency deposits in total private sector deposits (in percent)	69.4	66.2	70.1	73.2	70.0	70.0	70.0	70.0	70.0	70.0
Credit to private sector (in percent of GDP)	82.5	77.5	74.3	74.5	77.4	77.8	77.9	77.8	77.7	77.6
Credit to private sector (in twelve month percent change)	2.5	0.3	5.2	1.9	10.0	6.0	6.0	6.0	6.0	6.0
M5 (in twelve month percent change)	6.4	15.4	12.3	3.5	5.0	5.0	5.0	5.0	5.0	5.0
M3 to GDP (in percent)	204.6	215.7	217.3	226.9	222.7	221.6	219.9	217.7	215.4	213.2
M5 to GDP (in percent)	237.7	254.6	261.3	266.9	265.4	264.1	262.1	259.4	256.7	254.0

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

1/ Broad money is taken to be M5 which is defined as M3 (currency + resident deposits) + Non-resident deposits.

Table 8. Lebanon: Balance Sheet of the Banque du Liban, 2002–11

				Prel. Est.	Adjustment Scenario					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
				(Stocks in billions of Lebanese pounds)						
Net foreign exchange position 1/	3,888	8,935	6,712	3,627	6,335	8,444	9,294	9,742	10,504	11,461
Foreign assets	12,527	21,174	20,380	21,993	23,191	24,483	24,738	25,934	27,867	28,862
Foreign exchange	7,679	15,395	14,340	14,853	16,050	17,342	17,598	18,794	20,726	21,722
Gold	4,849	5,779	6,039	7,140	7,140	7,140	7,140	7,140	7,140	7,140
Foreign currency liabilities	8,639	12,239	13,668	18,366	16,694	15,877	15,282	16,031	17,202	17,240
of which: commercial bank deposits	8,164	11,776	13,213	17,901	16,391	15,574	14,979	15,728	16,898	16,937
of which: other foreign liabilities 2/	239	204	195	161	161	161	161	161	161	161
Net domestic assets	767	-2,528	1,411	3,738	1,437	-297	-755	-766	-1,070	-1,546
Claims on public sector (net)	2,204	10,990	11,354	10,974	5,994	4,329	1,707	1,404	1,077	783
Net claims on government	2,499	10,983	11,491	11,448	6,468	4,803	2,181	1,878	1,551	1,257
Credit	3,755	11,800	13,232	14,106	9,126	7,461	4,839	4,536	4,210	3,916
Deposits	-1,256	-817	-1,741	-2,659	-2,659	-2,659	-2,659	-2,659	-2,659	-2,659
Net claims on non financial public institutions	-295	7	-138	-474	-474	-474	-474	-474	-474	-474
Claims on private sector (net) 3/	148	375	313	257	257	257	257	257	257	257
Claims on commercial banks	1,148	-9,859	-7,657	-6,163	-4,684	-5,454	-4,489	-5,398	-5,975	-6,657
of which : CDs and special deposits	-572	-11,686	-9,516	-7,959	-6,480	-7,249	-6,285	-7,193	-7,770	-8,453
Claims on specialized banks (net) 3/	-58	-1,032	-1,004	-837	-837	-837	-837	-837	-837	-837
Other items (net)	-2,675	-3,002	-1,595	-493	707	1,407	2,607	3,807	4,407	4,907
Base money	4,655	6,407	8,123	7,364	7,771	8,146	8,539	8,975	9,433	9,914
Currency in circulation	1,542	1,717	1,783	1,736	2,007	2,101	2,199	2,308	2,423	2,544
Commercial bank deposits 3/	3,113	4,690	6,340	5,628	5,765	6,046	6,340	6,667	7,010	7,370
				(Year-to-date flows in billions of Lebanese pounds)						
Net foreign exchange position (including gold)	2,024	5,048	-2,224	-3,085	2,708	2,109	850	447	762	957
Net domestic assets	-1,261	-3,295	3,939	2,327	-2,301	-1,734	-458	-11	-304	-476
Claims on public sector (net)	-3,778	8,786	364	-379	-4,980	-1,665	-2,622	-303	-327	-294
Net claims on government	-4,084	8,484	508	-43	-4,980	-1,665	-2,622	-303	-327	-294
Claims on private sector (net) 3/	33	227	-62	-56	0	0	0	0	0	0
Claims on commercial banks	412	-11,007	2,203	1,493	1,479	-769	964	-908	-577	-683
Claims on specialized banks (net) 3/	-37	-974	28	167	0	0	0	0	0	0
Other items (net)	2,108	-327	1,406	1,102	1,200	700	1,200	1,200	600	500
Base money	763	1,753	1,715	-759	407	375	393	436	458	481
Currency in circulation	14	176	66	-47	271	94	98	109	115	121
Commercial bank deposits 3/	749	1,577	1,649	-711	136	281	294	327	343	360
				(Year-to-date changes in percent of beginning-of-period base money)						
Net foreign exchange position	52.0	108.4	-34.7	-38.0	36.8	27.1	10.4	5.2	8.5	10.1
Net domestic assets	-32.4	-70.8	61.5	28.6	-31.2	-22.3	-5.6	-0.1	-3.4	-5.1
of which : Net claims on government	-104.9	182.3	7.9	-0.5	-67.6	-21.4	-32.2	-3.5	-3.6	-3.1
Base money	19.6	37.7	26.8	-9.3	5.5	4.8	4.8	5.1	5.1	5.1
Memorandum items:				(In millions of U.S. dollars)						
Net foreign assets	8,151	13,911	13,390	14,482	15,276	16,133	16,303	17,097	18,378	19,039
Gross international reserves (including gold)	8,310	14,046	13,519	14,589	15,383	16,241	16,410	17,204	18,485	19,146
Gross international reserves (excluding gold)	5,094	10,213	9,513	9,852	10,647	11,504	11,674	12,467	13,749	14,409
Net foreign exchange liquidity 4/	-2,006	4,217	4,422	5,895	...	...	...	...	...	...
Lebanese pound money multiplier	4.5	4.3	3.4	3.5	3.8	3.8	3.8	3.8	3.8	3.8

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

1/ Defined by currency (not by residency).

2/ Excludes special bilateral long-term deposits.

3/ Excludes deposits in foreign currency.

4/ Defined as: gross international reserves minus principal and interest due over the next 12 months on all foreign currency liabilities of the Banque du Liban to entities other than the government of Lebanon, less encumbered reserves.

Table 9. Lebanon: Commercial Banks' Balance Sheet, 2002–11

				Prel. Est.	Adjustment Scenario					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
				(Stocks in billions of Lebanese pounds)						
Net foreign assets	12,467	12,539	16,618	16,754	17,916	19,264	20,046	21,169	22,334	23,693
Foreign assets	14,326	14,937	20,431	20,017	21,180	22,527	23,309	24,433	25,597	26,956
Foreign liabilities	1,859	2,398	3,813	3,263	3,263	3,263	3,263	3,263	3,263	3,263
Net domestic assets	51,964	60,974	66,223	69,240	72,252	75,448	79,441	83,330	87,428	91,596
Net claims on public sector	25,986	19,680	22,675	24,992	27,605	28,943	32,477	32,555	32,627	33,661
of which: Treasury bills and bonds in LL	16,214	11,366	10,853	12,608	16,120	17,763	21,725	22,210	22,607	22,822
of which: Treasury bills and bonds in FX	10,323	9,621	13,281	14,057	13,159	12,853	12,426	12,019	11,693	12,511
Claims on Banque du Liban	11,960	28,332	29,879	30,917	28,868	29,112	27,859	29,855	31,959	33,054
Currency	166	186	197	201	232	243	255	267	281	295
Deposits with Banque du Liban	11,222	16,460	20,166	22,757	22,156	21,619	21,319	22,395	23,908	24,307
Of which: deposits in Lebanese pounds	3,057	4,684	6,953	4,856	5,765	6,046	6,340	6,667	7,010	7,370
Of which: deposits in foreign currency 1/	8,164	11,776	13,213	17,901	16,391	15,574	14,979	15,728	16,898	16,937
CDs in LL	572	11,686	9,516	7,959	6,480	7,249	6,285	7,193	7,770	8,453
Claims on private sector	22,758	22,836	24,020	24,467	26,914	28,528	30,240	32,054	33,978	36,016
in Lebanese pounds	4,055	3,856	4,268	4,306	4,736	5,020	5,322	5,641	5,979	6,338
in foreign currency	18,702	18,980	19,752	20,161	22,177	23,508	24,918	26,413	27,998	29,678
Other items net	-8,740	-9,874	-10,351	-11,135	-11,135	-11,135	-11,135	-11,135	-11,135	-11,135
Liabilities to private sector 2/	64,431	73,513	82,841	85,994	90,168	94,712	99,487	104,499	109,762	115,289
Lebanese pounds	19,686	24,873	24,796	23,081	27,125	28,440	29,818	31,347	32,952	34,637
Foreign currency 3/	44,746	48,641	58,046	62,914	63,043	66,272	69,669	73,152	76,810	80,651
				(Cumulative flows in billions of Lebanese pounds)						
Net foreign assets	10,555	72	4,079	136	1,162	1,347	782	1,124	1,165	1,359
Net domestic assets	2,634	9,010	5,249	3,017	3,011	3,196	3,993	3,889	4,098	4,168
Net claims on public sector	3,445	-6,306	2,995	2,316	2,614	1,337	3,534	78	71	1,034
of which: Treasury bills and bonds in LL	2,309	-4,848	-513	1,755	3,512	1,643	3,962	485	397	215
of which: Treasury bills and bonds in FX	1,214	-702	3,661	776	-898	-306	-428	-407	-326	818
Claims on Banque du Liban	5,133	16,373	1,546	1,039	-2,049	244	-1,253	1,997	2,104	1,095
Claims on private sector	566	78	1,185	446	2,447	1,615	1,712	1,814	1,923	2,039
in Lebanese pounds	848	-199	412	38	431	284	301	319	338	359
in foreign currency	-282	277	1,050	409	2,016	1,331	1,410	1,495	1,585	1,680
Other items net	-6,510	-1,134	-477	3,302	3,464	3,799	3,993	4,191	4,400	4,620
of which: capital accounts	-562	-473	-310							
Liabilities to private sector	13,189	9,082	9,328	3,153	4,174	4,544	4,775	5,013	5,263	5,526
Lebanese pounds 2/	3,893	5,187	-77	-1,715	4,045	1,315	1,378	1,529	1,605	1,685
Foreign currency 3/	9,297	3,895	9,405	4,868	129	3,229	3,397	3,484	3,658	3,841
Memorandum items:										
Total foreign currency assets (billions of U.S. dollars)	34.2	36.7	44.2	47.9	48.4	49.4	50.2	52.1	54.5	57.1
Total foreign currency liabilities (billions of U.S. dollars)	30.9	33.9	41.0	43.9	44.0	46.1	48.4	50.7	53.1	55.7
Ratio of local currency assets to liabilities 4/	0.76	0.84	0.82	0.81	0.82	0.89	0.97	0.98	0.99	0.99
Exposure to the government (percent of total assets)	33.6	23.2	23.6	25.3	26.7	26.8	28.7	27.6	26.5	26.2
Exposure to the sovereign (percent of total assets)	48.7	54.4	52.9	54.8	53.2	52.5	52.3	51.8	51.4	50.9

Source: Banque du Liban.

1/ Includes special dollar denominated CDs.

2/ Includes nonresident deposits.

3/ Includes bonds denominated in foreign currency.

4/ Includes other items net as assets.

Table 10. Lebanon: Balance of Payments, 2002–11

	Est.	Est.	Est.	Prel. Est.	Adjustment Scenario					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(in millions of U.S. dollars, unless otherwise indicated)									
Current account	-2,842	-3,026	-3,969	-2,792	-2,995	-2,964	-3,027	-3,113	-3,226	-3,352
Goods (net)	-4,956	-5,221	-7,105	-6,861	-7,275	-7,695	-8,138	-8,663	-9,229	-9,830
Exports, f.o.b.	1,018	1,444	1,598	1,821	2,030	2,208	2,398	2,602	2,827	3,070
Imports, f.o.b.	-5,974	-6,665	-8,704	-8,682	-9,304	-9,903	-10,535	-11,266	-12,056	-12,900
Services (net)	896	983	1,666	2,794	3,084	3,389	3,672	3,964	4,298	4,641
Receipts	6,484	7,009	8,411	8,981	9,665	10,382	11,132	11,941	12,807	13,719
Payments	-5,588	-6,026	-6,745	-6,187	-6,581	-6,993	-7,460	-7,977	-8,509	-9,079
Income (net)	-1,002	-1,237	-1,432	-830	-1,309	-1,462	-1,600	-1,686	-1,821	-1,929
of which: interest on government debt	-528	-532	-409	-459	-508	-536	-564	-545	-573	-544
Current transfers (net)	2,220	2,449	2,902	2,105	2,505	2,804	3,038	3,272	3,526	3,766
Capital and financial account	2,415	5,792	3,257	3,397	3,789	3,821	3,197	3,907	4,508	4,013
Direct investment (net)	1,385	1,558	1,478	1,682	2,600	2,180	1,380	1,600	1,820	1,895
Portfolio investment, loans, other capital	1,030	4,234	1,780	1,715	1,189	1,641	1,817	2,307	2,688	2,118
Government (net)	1,210	-505	-105	408	451	177	161	347	328	-53
Eurobonds (net)	743	-207	343	373	628	316	305	484	455	-36
Treasury bills (net)	506	-268	-484	82	63	71	71	79	87	99
Loans (net)	-39	-29	36	-46	-240	-210	-214	-216	-214	-117
Banks (net) 1/	506	3,845	1,293	1,331	1,200	1,007	1,432	1,319	1,413	1,412
Foreign assets of banks 2/	-846	-48	-2,706	-90	-771	-894	-519	-745	-773	-901
Non-resident deposits 1/	1,351	3,892	3,999	1,422	1,971	1,901	1,951	2,065	2,185	2,313
Non-bank private sector (net)	-685	894	591	-24	-461	456	223	641	947	759
Errors and omissions	738	257	12	-265	0	0	0	0	0	0
Overall balance	312	3,024	-700	340	795	857	169	794	1,282	660
Financing	-312	-3,024	700	-340	-795	-857	-169	-794	-1,282	-660
Official reserves (- increase)	-612	-5,119	700	-340	-795	-857	-169	-794	-1,282	-660
Exceptional financing	300	2,095	0	0	0	0	0	0	0	0
Memorandum items:										
Current account balance (in percent of GDP)	-15.4	-15.2	-18.2	-12.7	-12.9	-12.1	-11.7	-11.3	-11.0	-10.8
Exports of goods (in percent of GDP)	5.5	7.3	7.3	8.3	8.7	9.0	9.2	9.4	9.7	9.9
Imports of goods (in percent of GDP)	32.4	33.5	40.0	39.4	40.0	40.3	40.6	40.9	41.3	41.6
Services receipts (in percent of GDP)	35.1	35.2	38.6	40.7	41.5	42.3	42.9	43.3	43.8	44.3
Services payments (in percent of GDP)	30.3	30.3	31.0	28.1	28.3	28.5	28.7	29.0	29.1	29.3
Gross official reserves (excl. gold, end-year)										
in millions of U.S. dollars	5,094	10,213	9,513	9,852	10,647	11,504	11,674	12,467	13,749	14,409
in months of next year's g&s imports	4.8	7.9	7.7	7.4	7.6	7.7	7.3	7.3	7.5	7.4
in percent of short-term external debt 3/	22.0	35.4	27.0	28.1	29.3	29.5	28.3	28.4	29.4	29.5
in percent of short-term foreign currency debt 4/	14.8	26.7	20.3	19.6	21.8	22.0	21.3	21.7	22.9	23.3
net of foreign assets of commercial banks	19.9	34.1	26.6	26.3	29.6	30.3	29.2	29.5	30.9	31.3
External debt (end-year) 3/										
in percent of GDP	149.7	173.9	184.5	188.6	187.1	187.7	186.5	186.9	188.0	186.9
in percent of g&s exports	368.3	409.3	401.3	385.0	372.4	366.1	358.0	354.0	351.4	345.2
Public external debt (in percent of GDP)	30.3	37.5	34.0	34.7	34.8	33.7	32.5	31.9	31.2	29.3
Public external debt service										
in millions of U.S. dollars	724	1,675	2,125	2,891	1,642	1,396	1,707	1,776	1,796	1,498
in percent of g&s exports	9.6	19.8	21.2	26.8	14.0	11.1	12.6	12.2	11.5	8.9
GDP (in millions of U.S. dollars)	18,462	19,895	21,768	22,052	23,281	24,554	25,971	27,550	29,225	31,002

Sources: Lebanese authorities; BIS; and Fund staff estimates and projections.

1/ Differs from banks' reported net foreign asset data, to include estimated deposit flows by Lebanese nationals living abroad but classified as residents.
2/ Net of non-deposit foreign liabilities.
3/ Includes all banking deposits held by non-residents, including estimated deposits of Lebanese nationals living abroad but classified as residents.
4/ Includes private sector foreign currency deposits in commercial banks.

Table 11. Lebanon: Public Sector Debt Sustainability Framework, 2001–11
(In percent of GDP, unless otherwise indicated)

	Actual							Adjustment Scenario						
	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	
								I. Adjustment Scenario						**Debt-stabilizing primary balance 8/**
Public sector debt 1/	165.9	166.4	167.8	164.7	174.6			**160.6**	**153.2**	**149.9**	**144.4**	**138.6**	**132.8**	**1.2**
of which: foreign-currency denominated	59.9	75.5	78.3	84.4	85.7			80.2	76.5	72.6	69.9	67.1	64.3	
Change in public sector debt	14.8	0.5	1.4	-3.0	9.9			-14.0	-7.4	-3.3	-5.5	-5.8	-5.8	
Identified debt-creating flows (4+7+12)	15.0	1.6	1.2	-5.1	5.8			-1.0	-13.5	-9.2	-5.5	-5.8	-5.8	
Primary deficit	1.7	-2.8	-3.2	-3.4	-2.4			-3.0	-4.5	-5.7	-7.0	-7.0	-7.0	
Revenue and grants	18.2	21.0	22.0	22.8	22.3			22.8	23.0	23.5	24.1	24.0	23.9	
Primary (noninterest) expenditure	19.9	18.2	18.7	19.4	19.9			19.8	18.6	17.9	17.2	16.9	16.8	
Automatic debt dynamics 2/	13.3	4.4	4.5	-2.5	8.1			2.0	3.2	2.3	1.5	1.2	1.2	
Contribution from interest rate/growth differential 3/	13.3	4.4	4.5	-2.5	8.1			2.0	3.2	2.3	1.5	1.2	1.2	
of which: contribution from real interest rate	12.4	8.8	12.2	6.7	9.8			6.9	8.3	7.6	7.1	6.7	6.4	
of which: contribution from real GDP growth	1.0	-4.4	-7.7	-9.2	-1.6			-5.0	-5.2	-5.4	-5.7	-5.4	-5.2	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0			...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.9	0.0			0.0	-12.2	-5.8	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.9	0.0			0.0	-12.2	-5.8	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Other (tobacco excise securitization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.2	-1.0	0.1	2.0	4.1			-13.0	6.1	5.9	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	911.0	792.1	762.8	722.5	783.9			704.8	664.8	636.6	598.9	578.7	556.8	
Key macroeconomic and fiscal assumptions						Average	Deviation							Average
Real GDP growth (in percent)	-0.6	2.9	5.0	6.0	1.0	2.7	2.3	3.0	3.4	3.7	4.0	4.0	4.0	3.7
Average nominal interest rate on public debt (in percent) 6/	11.3	11.0	10.7	7.8	6.3	12.3	3.8	6.8	7.5	7.3	7.1	7.0	7.0	7.1
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	8.4	5.9	8.0	4.6	6.0	8.7	2.6	4.3	5.5	5.3	5.1	5.0	5.0	5.0
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.6	1.0	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.0	5.1	2.6	3.2	0.3	3.6	3.0	2.5	2.0	2.0	2.0	2.0	2.0	2.1
Growth of real primary spending (deflated by GDP deflator, in percent)	-26.2	-5.9	8.1	9.5	3.9	1.6	16.0	2.3	-2.9	-0.2	-0.2	2.5	3.5	0.8
Primary deficit	1.7	-2.8	-3.2	-3.4	-2.4	1.9	5.1	-3.0	-4.5	-5.7	-7.0	-7.0	-7.0	-5.7
								II. Stress Tests for Public Debt Ratio						**Debt-stabilizing primary balance 8/**
A. Alternative Scenarios														
A1. Unchanged policies: no further primary adjustment after 2006								**160.6**	**154.7**	**154.0**	**152.6**	**150.9**	**149.2**	**1.3**
A2. Fiscal adjustment and unchanged nominal interest rates from 2005 onwards								**158.7**	**147.3**	**140.6**	**132.0**	**123.2**	**114.3**	**0.2**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2007 and 2008								**160.6**	**166.0**	**176.3**	**171.1**	**165.5**	**159.9**	**1.4**
B2. Real GDP growth is at historical average minus two standard deviations in 2007 and 2008								**160.6**	**162.6**	**170.8**	**167.5**	**163.8**	**160.1**	**1.4**
B3. Primary balance is at historical average minus two standard deviations in 2007 and 2008								**160.6**	**169.7**	**184.3**	**179.2**	**173.7**	**168.2**	**1.5**
B4. Combination of B1-B3 using one standard deviation shocks								**160.6**	**178.4**	**204.3**	**199.4**	**194.1**	**188.8**	**1.7**
B5. One time 30 percent real depreciation in 2007 7/								**160.6**	**191.5**	**188.8**	**183.7**	**178.2**	**172.8**	**1.5**
B6. 10 percent of GDP increase in other debt-creating flows in 2007								**160.6**	**163.2**	**160.0**	**154.7**	**148.9**	**143.3**	**1.3**

1/ Central government gross debt.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = 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/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

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

7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

8/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 12. Lebanon: Indicators of Financial and External Vulnerability, 2002–05

	2002	2003	2004	Prel. 2005
Monetary and financial indicators				
Broad money, M5 (annual percentage change)	6.4	15.4	12.3	3.5
Domestic currency broad money (M2)				
In percent of broad money	30.8	34.4	30.3	27.6
In percent of domestic currency public debt	80.6	97.7	98.5	82.8
Private-sector credit (annual percentage change)	2.5	0.3	5.2	1.9
Broad money, M5 (in millions of U.S. dollars)	43,901	50,669	56,890	58,872
Public finance indicators				
Overall fiscal balance (in millions of U.S. dollars)	-2,608	-2,633	-1,855	-1,744
In percent of GDP	-14.1	-13.2	-8.5	-7.9
In percent of government revenue	-67	-60	-37	-35
Gross debt (in millions of U.S. dollars)	30,727	33,381	35,861	38,507
In percent of government revenue	792	763	722	784
Interest payments on debt (in millions of U.S. dollars)	3,127	3,280	2,602	2,263
In percent of GDP	16.9	16.5	12.0	10.3
In percent of government revenue	80.6	74.9	52.4	46.0
Nominal GDP (in millions of U.S. dollars)	18,462	19,895	21,768	22,052
Government revenue (in millions of U.S. dollars)	3,880	4,377	4,965	4,914
	(In percent)			
Banking-sector indicators				
Problem loans/total loans (net of provisions and unearned interest) 1/	12.4	12.8	10.1	9.9
Provisions against problem loans/problem loans 1/	62.3	64.6	68.4	68.4
Risk-weighted capital adequacy ratio 1/	19.4	22.3	21.1	21.6
Credit to the private sector (in percent of GDP)	82.5	77.5	74.3	74.5
	(In millions of U.S. dollars)			
Debt indicators				
Gross public debt	30,727	33,381	35,861	38,507
In percent of GDP	166.4	167.8	164.7	174.6
of which: foreign currency	13,943	15,575	18,368	18,899
In percent of GDP	75.5	78.3	84.4	85.7
Gross public debt held by the market	24,448	19,550	21,018	23,073
In percent of GDP	132.4	98.3	96.6	104.6
External debt 2/	27,630	34,597	40,171	41,585
In percent of GDP	149.7	173.9	184.5	188.6
External public debt	5,601	7,460	7,399	7,659
In percent of GDP	30.3	37.5	34.0	34.7
Short-term external public debt 3/	1,143	1,716	2,432	1,134
Short-term foreign currency public debt 3/	1,645	1,770	2,452	2,869
Short-term external debt 2/ 3/	23,171	28,854	35,204	35,060
Short-term foreign currency debt 3/ 4/	34,391	38,317	46,873	50,251
Total foreign currency deposits (resident and non-resident)	29,682	32,266	38,505	41,734
International reserves				
Gross official reserves 5/	5,094	10,213	9,513	9,852
In percent of short-term external debt	22.0	35.4	27.0	28.1
In percent of s.t. ext. debt, plus s.t. domestic public debt in foreign currency	20.9	34.2	26.0	26.7
In percent of s.t. ext. debt, plus residents' foreign currency deposits minus banks' foreign assets	19.9	34.1	26.6	26.3
Gross official reserves and commercial banks' foreign assets	13,364	18,530	20,536	20,966
In percent of short-term external debt	57.7	64.2	58.3	59.8
In percent of short-term foreign currency debt 4/	38.9	48.4	43.8	41.7
	(In millions of U.S. dollars)			
External current account indicators				
Merchandise exports, f.o.b.	1,018	1,444	1,598	1,821
Annual percentage change	15.7	41.9	10.7	13.9
Merchandise imports, f.o.b.	5,974	6,665	8,704	8,682
Annual percentage change	-12.1	11.6	30.6	-0.2
External current account balance	-2,842	-3,026	-3,969	-2,792
In percent of GDP	-15.4	-15.2	-18.2	-12.7
In percent of exports of goods and services	-37.9	-35.8	-39.7	-25.8

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

1/ For 2005, the latest observation is June 2005.
2/ Includes estimates for public debt and banking deposits held by non-residents, and non-resident claims on the nonfinancial sector.
3/ On a remaining maturity basis (scheduled amortization over the next year).
4/ Short-term foreign currency debt of the public sector and the banking sector plus external debt of the nonbank sector.
5/ Excluding gold.

Table 13. Lebanon: Banking Sector Financial Soundness Indicators, 2000–05

	2000	2001	2002	2003	2004	2005 H1
(In percent, unless otherwise specified)						
Assets (in millions of U.S. dollars) 1/	47,505	49,858	54,587	62,151	70,978	68,921
Capital						
Capital adequacy ratio	16.9	18.0	19.4	22.3	21.2	21.6
Capital to asset ratio	6.8	6.8	6.8	6.8	6.3	6.8
Asset quality						
Net problem loans/net total loans	7.8	10.0	12.4	12.8	10.1	9.9
Provisions against problem loans/problem loans	64.6	62.6	62.3	64.6	68.4	68.4
Total provisions/problem loans	72.5	69.3	68.2	70.6	75.1	75.8
Asset concentration						
Share of claims on government	34.3	32.1	33.6	23.3	23.6	22.4
of which: T-bills	24.8	19.4	20.5	12.6	10.6	9.5
of which: Eurobonds	8.4	11.5	13.0	10.6	13.0	12.8
Share of claims on BdL	10.5	14.6	14.9	31.2	29.2	31.2
of which: Certificates of Deposit	...	0.1	0.7	12.9	9.3	8.2
Share of claims on private sector	33.8	31.9	28.8	24.9	23.5	24.3
Share of claims on nonresidents	18.1	18.1	18.1	16.5	19.1	17.8
of which: foreign banks	15.3	15.5	15.7	13.4	15.5	13.9
Net foreign currency assets as percent of capital	25.3	26.3	24.9	22.0	23.9	24.2
Earnings						
Average return on assets (post tax) 2/	0.7	0.5	0.6	0.7	0.6	0.7
Average return on equity (post tax) 2/	11.1	9.1	9.4	10.9	10.6	9.8
Net interest margin	2.1	1.9	2.0	2.6	2.1	1.9
Liquidity						
Net liquid assets/total assets	56.0	45.9	41.3	49.1	45.6	43.6
Net liquid assets/short-term liabilities	66.5	54.2	49.2	56.6	52.6	50.7
Private sector deposits/assets 3/	83.6	84.2	81.3	80.9	80.9	80.1
Nonresident deposits/assets 3/	13.5	12.9	11.6	12.9	14.1	12.6
Other indicators 3/						
Change in assets (12 month)	11.3	5.8	10.0	14.2	12.8	5.3
Change in private sector credit (12 month)	5.9	-0.2	2.5	0.3	5.2	3.7
Change in deposits (12 month)	10.8	6.2	6.3	14.7	12.6	3.5
Fiduciary accounts (in millions of USD)	297	483	616	951	1,143	...
FC deposits/total deposits 4/	66.0	71.9	68.7	65.0	70.7	77.8
FC loans/total loans	87.0	86.9	82.2	83.5	82.2	82.4
FC loans/GDP	78.3	75.6	71.7	69.3	60.2	60.3
Exports of goods and services/GDP	31.2	32.9	38.1	40.7	34.5	...
Banking system's foreign exchange cover 5/	30.2	25.7	27.8	33.5	32.1	28.5
Memorandum items:						
LL deposit rate (average)	10.7	10.2	10.3	8.3	7.1	8.2
LL loan rate (average)	18.2	17.2	16.6	13.4	10.8	11.0
FC deposit rate (average)	5.9	5.0	4.2	3.6	3.3	3.6
FC loan rate (average)	11.3	10.7	10.0	9.0	8.3	8.2
Government's 2-year T-bill rate (marginal)	14.6	14.6	9.4	8.0	7.9	8.5
Spread over 6-month USD Libor	8.4	12.6	8.0	6.8	5.7	5.0
Government's Eurobond rate (marginal)	10.5	10.6	9.8	7.0	7.0	8.0
Spread over 5 year U.S. note	5.3	6.2	6.8	3.7	3.6	4.4
GDP (in millions of U.S. dollars) 3/	16,679	17,065	18,462	19,895	21,768	22,052

Sources: Banque du Liban, Banking Control Commission and Staff own estimates.

1/ LL and FC stand for "Lebanese pound" and "foreign currency," respectively.

2/ On an annualized basis.

3/ Preliminary end-2005 figures.

4/ FC deposits of residents and nonresidents as a share of total deposits of residents and nonresidents.

5/ Commercial banks' net claims on nonresident banks plus the BdL's liquid foreign exchange reserves (excluding gold and foreign liabilities), in percent of total deposits.

Lebanon: Fund Relations
(As of February 28, 2006)

I. **Membership Status:** Joined 04/14/47; Article VIII (07/01/93).

		SDR Million	Percent of Quota
II.	**General Resources Account:**	**SDR Million**	**Percent of Quota**
	Quota	203.00	100.00
	Fund holdings of currency	184.17	90.72
	Reserve position in Fund	18.83	9.28
III.	**SDR Department:**	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	4.39	100.00
	Holdings	21.77	495.63
IV.	**Outstanding Purchases and Loans:**	None	
V.	**Financial Arrangements:**	None	
VI.	**Projected Obligations to Fund:**	None	

Nonfinancial Relations

VII. **Exchange Arrangement**

The Lebanese pound is a conventional peg. Since October 1999, the Banque du Liban 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.

VIII. **Article IV Consultation**

The 2004 Article IV consultation was concluded by the Executive Board on May 7, 2004.

IX. **Financial Sector Assessment Program**

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

X. Technical Assistance, 2000–05

Fiscal area—In recent years, FAD has provided advice on introducing the VAT, reforming customs tariffs and income taxes, strengthening the tax and customs administrations, improving public expenditure management, and consolidating fiscal accounts. This technical assistance was well received by the ministry of finance and, notably on the VAT, its positive impact has been substantial. However, considerable needs remain in several areas of public finance, including tax policy, tax administration, budget preparation, fiscal management, and public accounting and reporting. A number of technical assistance missions took place in 2004 in support of the government's reform initiatives and dealt with: (i) treasury and budget reforms, (ii) reforms in revenue administration, and (iii) tax policy. Technical assistance missions in 2005 primarily dealt with (i) the consolidation of fiscal accounts, and (ii) public liquidity management. A fiscal ROSC mission visited Beirut in September 2004 and published its report in May 2005.

Financial sector—Over the past few years, the Monetary and Financial Systems Department has provided technical assistance in the areas of payments system and vulnerability indicators. The related missions undertook an assessment of compliance with Core Principles for Systemically Important Payments Systems, advised on development of systems to improve efficiency and liquidity management in public sector payments and receipts, and assisted in the elaboration of a framework for collecting and analyzing macro-prudential indicators to facilitate the development of capacity to monitor systemic financial sector vulnerabilities. The authorities have reported some progress in these areas. A mission provided technical assistance in financial sector indicators and payments systems in March 2004. Follow up missions in January and August 2005 provided further technical assistance on the payment system and development of an early warning system, including a bank-level "watch list" based on, among other indicators, an econometric model to forecast bank performance. A technical mission in December 2005 examined issues concerning liquidity management in the monetary system.

Statistical area—The Statistics Department has provided technical assistance on the development of price and balance of payments statistics, but so far, little progress has been achieved. There are no official producer price index (PPI) and consumer price index (CPI) data available, and the balance of payments data remain incomplete. In addition, Lebanon still does not report balance of payments data to the Statistics Department. In early 2002, a multisector statistics/GDDS mission provided an update on the status of data in all economic sectors, and prepared action plans for improvement. As a participant in the Coordinated Compilation Exercise, the BdL is compiling financial soundness indicators (FSIs) in accordance with the IMF's *Compilation Guide on Financial Soundness Indicators.* The Technology and General Services Department has provided technical assistance for creating a time-series database at the BdL. Technical assistance needs remain substantial, particularly in the areas of national accounts, price statistics, and balance of payments.

Missions—Technical assistance missions during the last five years were:

Date	Department	Topic
Feb. 28–Mar. 10, 2000	STA	Balance of payments statistics
July 3–10, 2000	FAD	Income tax administration
Oct. 23–Nov. 3, 2000	STA	Price statistics
August 3–10, 2000	FAD	Public expenditure management
August 9–21, 2000	FAD	Tariff reform
March 27–April 10, 2001	FAD	Tax policy and administration
June 11–22, 2001	STA	Portfolio investment and capital flows
June 20–July 3, 2001	FAD	Tax policy and administration
June 27–July 6, 2001	FAD	Public expenditure management
July 2–12, 2001	MAE	Development of macro-prudential indicators
July 9–23, 2001	MAE	Payments system development
Oct. 29–Nov. 13, 2001	FAD	Tariff and VAT
March 25–April 5, 2002	STA	Multisector statistics/GDDS
April 15–26, 2002	BTS	Database at Banque du Liban
August 6–20, 2002	FAD	VAT and customs administration
Sept. 9–23, 2002	FAD	Income tax reform
Jan. 27–31,2003	MAE	Payment systems
July 29–23, 2003	FAD	Revenue administration
July 26–August 10, 2003	FAD	Public expenditure management
Aug. 27–Sept. 8, 2003	FAD	Tax policy
September 24–29, 2003	LEG	Income Tax Law
March 18–29, 2004	MFD	Payments and Settlement Systems and Developing Early Warning Systems
September 6–17, 2004	FAD	Fiscal transparency ROSC
October 2004	IMF	Creation of METAC
December 8–22, 2004	FAD	Tax policy
January 11–15, 2005	MFD	Payments and Settlement Systems and Developing Early Warning Systems
February 1–11, 2005	MFD	Liquidity Forecasting, Monetary Operations and the Interbank Money Market
May 22–June 6, 2005	FAD	Consolidation of Fiscal Accounts
June 24–July 2, 2005	LEG	Income Tax Law
August 25–31, 2005	MFD	Follow-up on Early Warning Systems
November 14–22, 2005	FAD	Public Financial Management
December 5–9, 2005	MFD	Liquidity Management

XI. **Resident Representatives** No

Lebanon: Relations with the World Bank Group

The World Bank (Bank) has prepared a full-fledged new Country Assistance Strategy (CAS), which was scheduled to be presented to the Board during the first quarter of calendar year 2005. The CAS was postponed after the assassination of former Prime Minister Rafic Hariri, and the ensuing political uncertainty and upheaval. The Bank is currently discussing the draft CAS with the new Government, and could submit the strategy to the Board in December 2005. The strategy covers the fiscal years 2006–09 and is being prepared together with the International Finance Corporation (IFC) in a fully participatory manner, including discussions with donors and civil society. Extensive consultations have taken place with the government, parliamentarians, private sector, and civil society. The Bank foresees the CAS to encompass three clusters of activities:

(i) Economic management and growth support: restructuring of state-owned enterprises, statistical capacity building, pension and social security reform, public investment information systems, trade facilitation, secondary cities economic development;

(ii) Resource and environmental management: surface water, ground water, waste water treatment, other environmental issues; and

(iii) Developing human capital and mitigating the poverty effects of transition: demand driven/small-scale operations implemented by local governments/non-governmental organizations.

The Bank's existing portfolio in Lebanon consists of $322 million in commitments for seven projects (of which $227 million is undisbursed). The current portfolio still largely reflects an emphasis on addressing strategic priorities and rebuilding basic physical, social, and institutional infrastructure after the damage of 15 years of civil war. The portfolio continues to suffer from slow disbursements and serious delays, reflecting weak implementation capacity of most public agencies.

Analytical and advisory services provided by the Bank include support on the overall economic reform process, assessing poverty, public expenditures, the social security/pension system, and the agriculture, energy, and water sectors.

As of April 30, 2005, IFC's held portfolio in Lebanon was $42 million, which included $35 million in loans, and $1 million in equity. The Corporation's activities have focused heavily on the financial sector (mostly credit lines to the Lebanese banks). Due to Lebanon's macroeconomic situation and high level of indebtedness, IFC has focused on strengthening its portfolio and providing technical assistance to the government. In early June 2005, IFC made its first investment in the Education sector in Lebanon, with a $8 million loan to the Sabis International School in Adma.

The Bank is maintaining a close dialogue with the Fund on macroeconomic issues, as well as on statistical issues. The Bank is also collaborating with the Fund to develop an Action Plan Program on Central Government Debt Management and Domestic Debt Market Development, upon Lebanon's request.

FINANCIAL RELATIONS WITH THE WORLD BANK GROUP

I. Status of World Bank Group Operations

As of September 19, 2005
(In millions of U.S. dollars)

Closed Projects	**14**
IBRD/IDA *	
Total Disbursed (Active)	95.16
of which has been repaid	12.97
Total Disbursed (Closed)	545.47
of which has been repaid	281.99
Total Disbursed (Active + Closed)	640.64
of which has been repaid	294.96
Total Undisbursed (Active)	226.53
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	226.53

Active Projects		**Last PSR Supervision Rating**		**Original Amount (in millions of U.S. dollars)**			
Project ID	**Project Name**	**DO**	**IP**	**Fiscal Year**	**IBRD**	**Cancel.**	**Undisb.**
	Status of Bank Group Operation (B8)						
Prot Stat	Active						
Country	Lebanese Republic						
Approval FY							
Proj ID (SPN)							
P071113	Community Development Project	MU	MU	2001	20		18.45534
P074042	Ba'albeck Water and Wastewater	MS	U	2002	43.53		40.82222
P050529	Cultural Heritage and Urban Dev.	S	MU	2003	31.5		29.9519
P045174	Education Development	MS	MU	2000	56.57		46.87254
P050544	First Municipal Infrastructure	S	S	2000	80		27.68449
P005340	TA For Revenue Enhancement	S	S	1994	25.25		0.781896
P034038	Urban Transport Dev. Project	S	U	2002	65		61.96433
Overall Result					**321.85**		**226.5327**

CAS Annex B8 (IFC) for Lebanon

Lebanon: Statement of IFC's Held and Disbursed Portfolio
As of 06/30/2005
(In millions of U.S. dollars)

		Held				Disbursed			
FY Approval	**Company**	**Loan**	**Equity**	**Quasi**	**Partic**	**Loan**	**Equity**	**Quasi**	**Partic**
1997	ADC	0.58	0	0	0	0.58	0	0	0
1997	Bank of Beirut	7.53	0	0	0	7.53	0	0	0
1997	Banque Saradar	1.88	0	0	0	1.88	0	0	0
1996/99	Byblos Bank	13.04	0	0	4.43	13.04	0	0	4.43
1996	Fransabank	0.6	0	0	0.55	0.6	0	0	0.55
1998	Idarat SHV	1.29	0	0	0	1.29	0	0	0
2001	Lebanese Leasing	0.75	0	0	0	0.75	0	0	0
1996	MidEast Capital	0	1.5	0	0	0	1.5	0	0
1996	SGLEB	0.94	0	0	0.94	0.94	0	0	0.94
2005	SIS Adma	8	0	0	0	0	0	0	0
	Total Portfolio:	**34.61**	**1.5**	**0**	**5.92**	**26.61**	**1.5**	**0**	**5.92**

Lebanon: Statistical Issues

Gaps in the coverage of macroeconomic statistics since the civil war have hampered effective surveillance. At present, monetary accounts, financial markets data, public debt statistics, and central government budgetary accounts are available on a regular basis. Most other data (national accounts, prices, employment, nongovernmental public sector, and balance of payments) are estimated on the basis of partial information and indicators. Lebanon participates in the General Data Dissemination Standard (GDDS), and in January, 2003 its metadata were posted on the IMF's Dissemination Standards Bulletin Board. Since then, however, these metadata have not been updated.

The availability of real sector data remains very limited, although there has been progress in compiling national accounts. The Ministry of Economy and Trade (MoET) is currently receiving technical assistance from the French National Institute of Statistics and Economic Studies, for the development of national accounts statistics. The first set of national accounts estimates for 1997 (the base year) was published in 2003, and the estimates for 1998–2003 were published in July 2005. Prior to this initiative, official national accounts statistics had not been produced since the mid-1970s, although preliminary estimates for the major components of GDP at current prices for the years 1994 and 1995 were published in October 1997.

No comprehensive official price index is produced. Consumer price indices are prepared by the MoET and private organizations on the basis of a limited basket of goods for the greater Beirut metropolitan area. With technical assistance from STA, quarterly price indices for 1999 were complied using weights from the 1997 household survey. The index was released in 2000.

Published monthly data on the central government budgetary accounts are not comprehensive. The published figures do not include certain transfers[12] or financing data, omit foreign-financed capital expenditure, and do not cover arrears. Certain (treasury) spending is only identified ex-post, and the economic classification of spending is disseminated with a lag. However, these items are provided to Fund staff in the context of surveillance activities. No monthly data are available on the consolidated central government, as available data do not cover the social security funds. No sub-annual fiscal data are currently reported for publication in *International Financial Statistics (IFS)*. Cash-based annual government finance statistics, limited to the budgetary central government, are published in the *Government Finance statistics Yearbook* (GFSY). The latest data received for publication in the GFSY are for 2004.

[12] These transfers apparently include those to municipalities, subsidies for the state-owned electricity company, foreign-financed capital expenditure, and payments to service providers (e.g., for waste management and cleaning services in Beirut).

Monetary statistics are generally reliable and usually provided to the Fund on a timely basis. STA has been able to bridge occasional delays in reporting to *IFS* by obtaining the missing data from the Banque du Liban (BdL) website.

Lebanon is participating in the IMF's Coordinated Compilation Exercise for Financial Soundness Indicators (FSIs), in which participating countries compile a benchmark set of FSIs and metadata in accordance with the standards in the *Compilation Guide on Financial Soundness Indicators*.

The balance of payments statistics are weak. The data reflect deficiencies in the current account (unrecorded exports, underestimation of private sector services and workers' remittances), the capital account (grants), and the financial account (equity investment in the nonbank private sector, and corporate borrowing abroad). A technical assistance mission visited the BdL in November 2005 and found limited implementation of the 2002 multisector mission. It then made the following recommendations: (i) BdL and the Central Authority for Statistics need to give high priority to extending the existing inter-agency agreement on the share of work in the data collection and compilation in balance of payments statistics and to include each agency's responsibilities with regard to establishing work plans for balance of payments statistics, allocating resources, and disseminating the statistical results; (ii) new data sources need to be developed; (iii) the definition for official reserve assets as set out in the international guidelines should be adopted; and (iv) the periodicity of dissemination of detailed balance of payments data should be improved to a quarterly frequency.

The statistical base improved with the implementation in 2003 of the International Transactions Reporting System, developed with technical assistance from STA. In July 2005, Lebanon provided STA for the first time with data for 2002–04 and with methodological notes. The data are published in the *IFS* and the *Balance of Payments Statistics Yearbook*.

LEBANON: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF MARCH 9, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	02/20/2006	03/2006	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/2005	02/2006	M	M	M
Reserve/Base Money	12/2005	02/2006	M	M	M
Broad Money	12/2005	02/2006	M	M	M
Central Bank Balance Sheet	12/2005	02/2006	M	M	M
Consolidated Balance Sheet of the Banking System	12/2005	02/2006	M	M	M
Interest Rates[2]	12/2005	02/2006	D/W/M	W/M	W/M
Consumer Price Index	12/2005	02/2006	M	At the time of mission or on request	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]					
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/2005	02/2006	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/2005	02/2006	M	M	M
External Current Account Balance	12/2005	02/2006	M	At the time of mission	unpublished
Exports and Imports of Goods and Services	12/2005	02/2006	M	M	M
GDP/GNP	2004 (est)	05/2005	A	At the time of mission	A
Gross External Debt	12/2005	02/2006	M	M	M

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); or Not Available (NA)

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2006 Article IV Consultation with Lebanon

On May 3, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the 2006 Article IV consultation with Lebanon.[1]

Background

Economic developments since 2003 have been shaped by major changes in the political landscape. Former Prime Minister Hariri's assassination in February 2005 plunged the country into a period of political and financial turbulence. Significant deposit withdrawals and a sharp rise in dollarization put pressure on international reserves, which declined by about $2 billion in the first quarter of 2005. However, by mid-year, the financial situation had stabilized, and with a resumption of deposit inflows, liquidity conditions have improved markedly. Upon taking office in July, Prime Minister Siniora announced that the government would pursue an ambitious economic reform and adjustment program. However, adoption of the program has been delayed by renewed political tensions.

GDP growth slowed down considerably in 2005, following a strong showing in 2004. A surge in tourism and construction activity, and strong exports contributed to increase GDP growth to 6 percent in 2004. In the wake of the political crisis, public and private demand contracted in

[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.

2005, though export growth remained strong. In the event, real GDP is estimated to have grown by 1 percent, and inflation declined to 0.3 percent in 2005.

Rising oil prices, the economic slowdown, and payments of arrears all weakened public finances, although a decline in the interest bill helped mitigate these factors, and the overall fiscal deficit declined slightly to 8 percent of GDP in 2005. Still, the government debt rose to 175 percent of GDP. Part of the cost of financial stabilization in recent years has been absorbed by the central bank.

The economic slowdown as well as buoyant exports helped narrow the current account deficit to an estimated 13 percent of GDP in 2005, notwithstanding higher oil prices and losses in tourism. The negative shock to the financial account of the balance of payments in the first half of the year was more than offset by the recovery of Foreign Direct Investment and portfolio inflows in the second half, and by end-2005 gross international reserves were back at their end-2004 level.

Moderate progress has been made on the structural reform agenda since 2004. Most public sector reforms have been of an administrative nature, with a number of legislative proposals pending in parliament, including those on revenue administration and debt management, laws to regulate capital markets and bank mergers, as well as competition and domestic market reform.

Executive Board Assessment

Executive Directors welcomed Lebanon’s swift recovery from the financial shock triggered by Prime Minister Hariri’s assassination in February 2005, and praised the authorities for their skillful handling of the economy during this period, which helped restore market confidence by mid-2005.

Directors pointed to recent developments that exposed not only the Lebanese economy’s resilience to shocks, but also the significant vulnerabilities that need to be addressed. In particular, they emphasized the risks deriving from the large and growing public debt overhang, the high degree of dollarization, the large fiscal and current account deficits, and Lebanon’s reliance on short-term inflows to finance these deficits. While the benign external environment, ample regional liquidity, and the stability of the depositor base have muted these risks so far, continued capital inflows are highly dependent on depositor confidence, which may not prevail indefinitely if reforms are delayed further.

Directors were encouraged by the broad convergence of views on the necessary policy and institutional reforms, and urged the authorities to seize the opportunity provided by the restoration of market confidence and the ongoing political transformation to press forward with these reforms.

Directors supported the authorities’ strategy of debt reduction through sustained fiscal adjustment to reduce the debt overhang. As regards the pace of fiscal adjustment, many

Directors felt that a gradual, sustained fiscal consolidation effort was appropriate. However, a number of Directors considered that the size of the imbalances called for a more rapid pace of fiscal consolidation to establish forward momentum and underscore the credibility of the reform program.

Directors supported the authorities' view that the required fiscal adjustment necessitated strong revenue and expenditure measures, backed by institutional reforms to strengthen budgetary control. On the revenue side, possible measures included an increase in the Value Added Tax rate, the introduction of a more efficient and progressive income tax system, and a return of the taxation of gasoline to its 2003 level. On the expenditure side, they saw scope for reducing non-productive and poorly targeted outlays. Directors urged the authorities to restore the financial viability of the state electricity company to reduce the associated large drain on the budget. They also called upon the authorities to correct looming imbalances in pensions and the social security system.

Directors agreed that a vigorous privatization effort, generous external concessional assistance, and a voluntary contribution of domestic creditors commensurate with their financial strength would have to complement fiscal adjustment to accelerate debt reduction. However, even with an ambitious program in place, it will take several years before Lebanon's debt-to-GDP ratio reaches a sustainable level.

Directors agreed that the exchange rate peg remains the appropriate monetary anchor for Lebanon, and saw no immediate competitiveness problems. The high degree of dollarization also tended to limit the effectiveness of the exchange rate as a policy tool. They considered that the current level of international reserves provides a reasonable buffer against liquidity shocks given the costs of holding reserves.

Directors called on the authorities to establish stricter constraints on central bank financing of the government and share more evenly the fiscal cost of financial stabilization, not least to restore the health of the central bank's balance sheet. Directors noted that the monetary impact of central bank losses has so far been limited by the buoyant demand for money, but emphasized that the conduct of monetary policy and the central bank's capacity to fend off financial pressures in the event of another financial shock would be much diminished by continuing losses. Directors also recommended that the central bank re-center its operations on monetary and liquidity management and unburden its balance sheet of real assets.

Directors underscored that the success of the adjustment strategy depends crucially on preserving depositor confidence. In this regard, they were encouraged by the high degree of capitalization and liquidity in the banking system, and welcomed the proactive stance of banking sector supervision. In this respect, they observed that the regulatory framework could be reinforced by providing legal protection to supervisors. They also considered it necessary to put in place a well-functioning deposit guarantee scheme to ensure that the expected consolidation of the banking system takes place in an orderly, market-based manner. Directors encouraged the authorities to adopt an independent and strong securities regulator with adequate legal protection to enhance the stability of the stock market.

Directors noted that there is considerable scope to strengthen the environment for private sector activity, including by enhancing the productivity of government spending, reducing red tape and corruption, reactivating the liberalization and privatization of the telecom sector, lowering the high costs of entry and exit, and strengthening contract enforcement. In this regard, Directors encouraged the authorities to reinvigorate the Paris II structural reform agenda in formulating their program.

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.

Lebanon: Selected Economic Indicators

	1999	2000	2001	2002	2003	2004	2005 Prel. Act.
Domestic economy	(In percent)						
Change in real GDP	-1.2	1.2	4.2	2.9	5.0	6.0	1.0
Change in consumer prices (period average) 1/	0.2	-0.4	-0.4	1.8	1.3	3.0	0.3
External economy	(In billions of U.S. dollars; unless otherwise indicated)						
Exports, f.o.b.	0.7	0.7	0.9	1.0	1.4	1.6	1.8
Imports, f.o.b.	5.8	5.8	6.8	6.0	6.7	8.7	8.7
Current account balance	-3.2	-2.9	-3.3	-2.8	-3.0	-4.0	-2.8
In percent of GDP	-18.8	-17.1	-19.2	-15.4	-15.2	-18.2	-12.7
Capital and financial account balance	4.2	0.7	1.6	2.4	5.8	3.3	3.4
Overall balance	1.3	-1.7	-1.5	0.3	3.0	-0.7	0.3
Gross official reserves 2/	7.7	5.9	4.4	5.1	10.2	9.5	9.9
Change in real effective exchange rate (in percent)	0.9	5.6	1.9	-2.8	-10.7	-7.5	-5.0
Financial variables	(In percent of GDP; unless otherwise indicated)						
Central government fiscal balance 3/	-15.7	-24.2	-18.5	-14.1	-13.2	-8.5	-7.9
Gross government debt	131.5	151.1	165.9	166.4	167.8	164.7	174.6
Of which: in foreign currency	34.3	46.5	60.1	75.5	78.3	84.4	85.7
Change in broad money 4/	10.6	10.6	6.4	6.4	15.4	12.3	3.5
Yield on 24-month Lebanese pound treasury bills 5/	14.1	14.1	14.0	14.1	7.8	8.3	8.5

Sources: Data provided by the Lebanese authorities; and IMF staff calculations.

1/ For Beirut and suburbs.
2/ Excluding gold.
3/ Overall balance, after grants, on a checks-issued basis.
4/ In percent, end-of-period.
5/ Primary market rate, in percent, end-of-period.

Statement by Shakour Shaalan, Executive Director for Lebanon
May 3, 2006

1. This year's consultation comes at a time where Lebanon has witnessed events of unprecedented proportions that have changed in a fundamental way the political and economic landscape. After 30 years of civil strife and unsettled political situation, Lebanon has entered a new era that is full with promises but not without risks. The historic events of 2005, tragic as they are, offer Lebanon a historic opportunity for fundamental reforms on which the authorities have already embarked. They have formulated a bold and comprehensive medium-term economic reform program that is now the subject of wide consultation with domestic and international stakeholders and will be presented to international donors in the context of the Beirut conference that will take place in the coming months.

2. During the past year, the Fund has been very supportive of Lebanon and on behalf of the Lebanese authorities, we would like to thank management and staff for their continued constructive dialogue with Lebanon, as well as for highly appreciated technical assistance support. We would also like to thank staff for a very good set of papers that contain a well-balanced assessment of the current situation of the Lebanese economy and future prospects. The Lebanese authorities welcome the staff's assessment that there is a considerable convergence of views on the reforms that are needed in the years ahead.

Developments in 2005

3. The Lebanese economy was severely tested in 2005 by a number of adverse momentous events, foremost of which was the assassination of Prime Minister Hariri in February. While the economic and financial ramifications of the shock were severe, especially during the first half of 2005, the economy exhibited a remarkable ability to weather the impact of the political turmoil, and reverse the initially strong and negative market reactions. While a surge in capital outflows and dollarization put pressures on the Lebanese pound and international reserves, swift and decisive actions by the authorities, contributed to stabilizing the markets by mid-year. These actions included increases in domestic interest rates and intervention in the foreign exchange market to defend the currency. By July, capital inflows had resumed, helped by the confidence created by the formation a new government with wide political support, and were sustained throughout the remainder of the year resulting in a balance of payments' surplus of US$747 million by the end of the year. While interest rates declined to record lows on foreign currency denominated debt, strong investor's interest in Eurobonds issues was unabated, with the broadening of the subscribers' base beyond dedicated investors as demonstrated in the latest Eurobond issuances, where international participation reached 50 percent on longer-dated Eurobond issuances. Furthermore, the process of de-dollarization of deposits was renewed.

4. The authorities made tremendous efforts in the second half of the year to improve revenue collection, contain spending, and keep the fiscal position under control. The fiscal situation started to show signs of recovery after July 2005. Whereas primary expenditures

had increased by 6.8 percent during January-July compared to the previous year, they declined by 4.6 percent in Aug-Dec 2005. Meanwhile, revenues also showed an improvement of 2 percent during the last five months of 2005 reversing partially the 4 percent decline in the first part of the year. As a result, the primary surplus ended at 2.4 percent despite weak economic activity, reduction in gasoline tax, and most importantly, the surge in transfers to the national electricity company (EDL) due to higher fuel prices and continued management and technical problems.

5. The Ministry of Finance (MOF) pursued a proactive approach at financing and debt management. In fact, the pre-funding decision taken as soon as the present government came into power was well received by the market which showed signs of reassurance, mostly demonstrated through the increased demand witnessed on the Eurobond secondary market performance and its reflection on decreased secondary market yields to their lowest levels. As of end April 2006, the Ministry of Finance has financed two-third of the domestic currency principal payments due for the year and has exchanged 70 percent of the Eurobond principal payments for 2006. It is worth noting that 2006 was one of the most difficult years in terms of financing, most specifically the period extending from January-April 2006.

Major Elements of the Reform Program

6. Despite the fact that the Lebanese economy has so far withstood shocks and averted major crises, the authorities are keenly aware of the need to address key vulnerabilities, most notably the worsening debt dynamics. Consequently, they have set up a high-level economic team mandated to prepare a medium-term economic program that addresses these vulnerabilities and promotes the economy's growth potential. The objectives of this program are to raise the growth rate to 5-6 percent, promote job creation, reduce poverty, and improve social indicators. The preparation of the multi-pronged program has benefited from broad consultations at the domestic level, as well as with international financial organizations and donors.

A. Fiscal Policy

7. The fiscal adjustment pillar of the authorities' program is broadly consistent with the staff's adjustment scenario. There is broad agreement on the overall magnitude of the necessary adjustment in the primary surplus over the medium term, and on the nature of the measures to achieve the target. The differences lie in the timing and sequencing of the policy actions, where the authorities take account of the political reality on the ground and of the impact of a severe and too frontloaded adjustment on economic activities and growth at a time when the country has begun to pick the pieces from the events of 2005. The core revenue measures consist of a VAT increase of 2 to 3 percentage points in 2006 reaching the overall rate of 15 percent (from the present 10 percent level) by 2008, an increase in the tax on interest rates on interest income, the introduction of a global income tax, the lifting of the cap on gasoline prices, and a gradual increase in the excise tax to pre-cap levels. These measures will be accompanied, between 2006 and 2008, by structural measures to substantially reform tax administration.

8. Revenue measures will be complemented by decisive action on the expenditure side. The government's plan emphasizes the rationalization of current expenditures, including through a reduction in transfers to public sector entities, and the containment of the wage bill over the medium term through limiting government hiring, freezing wages in real terms, reviewing the salary and benefit structure in some public entities including for current and former members of parliament, reducing waste in the public sector, and closing the Fund for the displaced and the Council of the South. Of critical importance is the need to strengthen public expenditure management, and improve transparency and accountability in the budget process. The MOF has developed, with the Fund's assistance, an action plan for public financial management reform, with a clear time-bound outline of measures. The government also plans to adopt a Fiscal Accountability Act and a new Public Procurement Law, and intends to strengthen the financial control of state-owned enterprises.

9. The government is establishing a comprehensive strategy to deal with the EDL, given the deep-rooted and complex problems of this sector. Short-term initiatives include negotiating new fuel and gas supply contracts to reduce the premium on imports, reducing losses by improving metering, cracking down on illegal networks, and increasing collection rates with the support of the justice and security services. Selected tariff increases may also be considered. The implementation of the EDL plan is estimated to generate savings in the order of 2 to 3 percent of GDP over the medium term, and is considered a critical element to the fiscal adjustment process. A special cabinet session was held recently to discuss the reform plan of EDL to be followed by other sessions.

10. The coordination between the BDL and the MOF has substantially improved recently, as the staff report indicates. In this context, the MOF has agreed to refrain from central bank borrowing, and to repay its maturing obligations rather than roll them over. In fact, the Ministry of Finance repaid US$2.9 billion worth of LL TBs to the BDL for the period of June 2005 till March 2006, slashing BDL's portfolio by 33 percent. There has been a convergence of views on the appropriate level of international reserves, and better coordination between the two institutions regarding the timing and maturities of their respective debt instruments. The implementation of a clearer division of labor between the institutions has improved with the regular meetings at the senior level of officials of the two institutions under the aegis of the Prime Minister.

B. Privatization

11. The government aims to proceed with privatization of major public sector entities, not only to strengthen public finances and reduce debt, but also to improve efficiency in the delivery of services, reduce the cost of doing business, improve competitiveness, and foster growth. The privatization effort includes the telecommunication and energy sectors, and assets under the control of the BDL. The government is finalizing the appointment of the Board of the new Telecommunication Regulatory Authority, ahead of the privatization of the two existing mobile licenses at the end of the year. A hiring of a financial advisor to specify pre-qualification criteria and request expression of interest will follow. Fixed line operator Liban Telecom is expected to follow suit in 2007 and a third mobile license is expected to be sold in 2008-09, in the context of a comprehensive strategy for the sector. Regarding EDL,

after completion of steps outlined above, and the appointment of the regulatory agency, the selection of strategic investors and privatization will proceed.

12. The central bank successfully restructured and executed the sale of the commercial bank it owned (BLC) to Gulf investors. This transaction reflected a strong interest in the Gulf in investment opportunities in Lebanon and the substantial increase in oil revenue in the region on account of high oil prices, and an inflow of close to US$1 billion came to the Beirut Stock Exchange (BSE), essentially into banks' shares. The increase in banks' capital reflects also the decision of BDL to move to Basil II capital adequacy ratios. The BDL is considering the sale of the shares it holds, including Middle East Airlines and Intra Investment Company, which will contribute to strengthening its own financial position, while stimulating activity in the capital markets.

C. Capital Markets

13. The Lebanese authorities consider financial sector reforms as a major pillar in the reform strategy, as developed capital markets are necessary to diversify the financial sector in view of the relative size of the banking sector and the stock exchange. Major strides were made over the past few months in order to deepen further capital markets, attracting longer term capital to the country, and diversifying risks, most notably through the issuance of Lebanon's first longer dated bond—5 years in Lebanese Pounds—as a new benchmark instrument, in accordance with international practice. The Securitization Law, which was waiting approval by Parliament since 1999, was enacted on December 9, 2005. By enabling institutions to securitize assets, the law introduces adequate long-term investment instruments to such institutions as pension funds and insurance companies which hold long-term liabilities. In the same vein, the Investment Fund law, enacted in December 2005, provides the enabling environment for marketing and operating collective investment schemes, including the protection of depositors' assets. The Capital Market Law, which provides a framework for the regulation and development of capital markets in Lebanon, including through the establishment of an independent regulatory body, the Capital Market Council, was approved by the Cabinet in March 2006 and awaits Parliament ratification.

14. The authorities acknowledge that more remains to be done to promote a well-functioning capital market. They agree that developing a secondary market for fixed-income instruments and removing obstacles to the development of the insurance sector and other institutional investors, in line with staff recommendations, remain a priority. Several steps were undertaken in this direction, including the following draft legislations that await Parliament approval: the law on Dematerialization of Securities, the Securities Lending law, the Insider Trading law, improvements to the Bank Mergers law, and the Insurance Regulatory Commission law.

D. Growth and Competitiveness

15. The private sector remains the backbone of the Lebanese economy and the main engine of growth. As the Selected Issues paper indicates, although available macroeconomic indicators suggest that competitiveness is not an immediate concern, Lebanon's competitiveness could significantly benefit over the medium-term from improvements in the

business environment. While a number of steps were implemented in recent years to eliminate administrative and legal bottlenecks, the authorities are cognizant that further efforts remain to be undertaken in this regard. The authorities' reform program envisages several measures to facilitate the conduct of business, including the simplification of the tax code, streamlining administrative procedures, and easing restrictions on entry and exit. Also, work on legislative reform to modernize and improve the legal framework is ongoing. A new consumer protection law was already ratified by parliament, a WTO compatible anti-dumping law and a basket of E-commerce laws are awaiting ratification, and a modern competition law is currently being finalized. Support of small and medium-term enterprises (SMEs) is also a priority, and an SME unit and a guarantee fund to facilitate access to credit were already set up. Furthermore, trade liberalization remains a core element of the government's policy, and Lebanon is steadily advancing toward membership in WTO. It also has recently committed to the European Neighborhood policy which would further enhance harmonization of standards and regulations with those of the EU.

E. Social Sector

16. The authorities are mindful of the effects of the adjustment strategy on lower income groups and are developing a comprehensive medium term social strategy to be finalized in 2006. This will involve the establishment of an Interministerial Committee for Social Development Policy to monitor, coordinate and implement the new strategy, and reduce overlap in the provision of social services. In line with this effort, the Pension System is being reformed with assistance of the World Bank. The aim will be to put the system on a financially sound and sustainable basis and a special cabinet session was held recently to discuss the reform of the National Social Security Fund (NSSF). The reforms will also aim at preserving the acquired rights while relieving fiscal burdens, promoting equity and social protection, and paving the way for a more flexible labor market as the private scheme restricts labor mobility. Moreover, the social safety nets will be strengthened and expanded, and the health and education sectors will be enhanced, to insure affordability, improve quality, and ultimately achieve universal coverage.

International Support

17. The authorities are committed to the implementation of the comprehensive strategy contained in their reform program. However, notwithstanding the strong fiscal adjustment and structural reforms that are embedded in the program to bring down significantly the debt to GDP ratio, the debt dynamics will remain fragile and vulnerabilities will remain high. In view of the necessity to bring the debt to GDP ratio significantly below the adjustment scenario level of 133 percent in 2011, and the exposure of the financial system to the sovereign, the authorities intend to request concessional financial support from the international community in the context of an international conference to be held in Beirut.

18. International financial support will ease the pains of adjustment and will help the authorities sustain their reform efforts in the years ahead. It is worth noting that the authorities undertook a substantial domestic adjustment effort during 2000-04. Most notably, on the fiscal side, the primary balance shifted from a deficit of 7.6 percent of GDP in 2000 to a surplus of 3.4 percent in 2004, an impressive adjustment of about 11 percent of GDP.

Furthermore, the central bank increased its gross reserves from US$5.9 billion at end-2000 to US$9.5 billion at end-2004, thereby strengthening overall confidence in the economy.

19. Concessional assistance would contribute significantly to reducing the debt level. Staff calculations indicate that, for every US$1 billion of grant-equivalent support in 2006, the debt ratio would be reduced by about 5.7 percentage points by 2011. The indirect positive effects of such assistance would also be much larger as the confidence generated would have critical implications for boosting investments, lowering interest rates, and providing a positive stimulus to market participants and expectations, which would translate into significantly higher growth rates. These effects on confidence and growth were indeed clearly observed after the Paris-II conference that was convened in November 2002. The authorities expect that, with such donor support, the growth rate levels achieved in 2004 (of about 6 percent) could be easily reached and exceeded, and that for every percentage point increase in the growth rate, the debt-to-GDP ratio would decline by about 1.7 percentage point. Similarly, a one percentage point decline in the interest rate would lead to an equal decline in the debt ratio. Therefore, in order to decisively reverse the debt dynamics and break the vicious circle of high deficit and high debt ratios, domestic reforms would need to be complemented with sizeable financial support from the international community. Preparations are under way for the holding of a conference in Beirut in the coming months to solicit such support.

Conclusion

20. In conclusion, the Lebanese authorities have undertaken significant adjustment efforts over the past few years, which have allowed the Lebanese economy to avoid crises despite major shocks. They highly appreciate the continued support Lebanon has received from the Fund. They are keenly aware that key vulnerabilities remain, and have decided to embark on a major adjustment effort to address these vulnerabilities in a decisive manner with the support of the international community.