November 2008
IMF Country Report No. 08/363

Lebanon: Use of Fund Resources—Request for Emergency Post-Conflict Assistance—Staff Report; and Press Release on the Executive Board Discussion

In the context of the use of Fund resources—request for emergency post-conflict assistance, the following documents have been released and are included in this package:

- The staff report for the Use of Fund Resources—Request for Emergency Post-Conflict Assistance, prepared by a staff team of the IMF, following discussions that ended on October 3, 2008, 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 November 3, 2008. 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 Press Release summarizing the views of the Executive Board as expressed during its November 14, 2008 discussion of the staff report that completed the request.

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

Letter of Intent sent to the IMF by the authorities of Lebanon*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

Use of Fund Resources—Request for Emergency Post-Conflict Assistance

Prepared by Middle East and Central Asia Department
(In consultation with other departments)

Approved by Juan Carlos Di Tata and Adnan Mazarei

November 3, 2008

- Discussions on the authorities' request for emergency assistance took place in Beirut September 22–October 3. The staff met with the governor of the central bank, the ministers of finance, economy and trade, energy, and telecommunications, and other senior officials. The staff team comprised Messrs. Fanizza (head), Schimmelpfennig, Sdralevich (all MCD), Finger (SPR), and Mati (FAD), and was assisted by Mr. Gardner (Senior Resident Representative) and Ms. Pineda (MCD). Ms. Caracalla (OED) attended the policy meetings.

- In the attached Letter of Intent (LOI), the Lebanese authorities request a purchase of 12.5 percent of quota (SDR 25.375 million) under Emergency Post-Conflict Assistance (EPCA). In the view of the staff, the authorities' program for 2008–09 constitutes an adequate basis for an EPCA request.

- Fund support through EPCA is a key part of the concerted international effort to provide financial assistance to Lebanon. A large number of bilateral donors and multilateral agencies are supporting the reconstruction and reform of the Lebanese economy.

- The 2007 Article IV consultation concluded that Lebanon's real effective exchange rate was broadly in line with fundamentals, and staff believes that this still holds. A full update of the assessment of Lebanon's exchange rate will be undertaken at the time of the 2009 Article IV consultation.

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EXECUTIVE SUMMARY

The authorities have requested follow-up Emergency Post-Conflict Assistance (EPCA) with an access of 12.5 percent of quota (SDR 25.375 million) to support their economic program for 2008–09 and continue benefiting from the macroeconomic and financial discipline provided by Fund involvement. The program is part of the concerted international effort to provide financial assistance to Lebanon.

Background and recent developments

The 2006 war with Israel led to political stalemate and repeated outbreaks of domestic fighting until the formation of a national unity government in July 2008. Macroeconomic conditions have improved, but fuel and food prices have boosted inflation. Financial market developments have been favorable, despite the global financial crisis, which so far has had little effect on Lebanon also thanks to prudent regulation.

Outlook and policy discussions

- Despite difficult circumstances, the government intends to pursue fiscal consolidation and further debt reduction and implement key measures from the Paris III agenda, in particular the privatization of the mobile phone companies and an adjustment in electricity tariffs. The authorities plan to meet their financing needs from the market, and use the expected privatization receipts to retire government debt.

- The authorities intend to further strengthen international reserves, also to create a buffer against the ongoing global crisis. They are closely monitoring the position of the commercial banks and possible effects of the global financial crisis on Lebanon.

- The main risks to the program consist of a worsening of the political and security situation, which could in particular delay reforms, and a fallout from the global financial crisis, which could jeopardize the authorities' financing strategy.

Staff appraisal

The authorities' program is adequately ambitious. It will help to bring the debt towards sustainable levels, maintain the deposit inflows needed to satisfy the government's large financing requirements, and reduce external vulnerabilities. As financial stability is necessary but not sufficient to sustain the recent growth acceleration over the medium term, the program also focuses on jump-starting the structural reforms needed to tackle the obstacles that have held back economy-wide productivity, in particular in the energy and telecom sectors.

I. Introduction

1. **The 2006 war with Israel led to political stalemate and repeated outbreaks of domestic fighting until the formation of a national unity government in July 2008.** Shortly after the war, the parliamentary minority withdrew from cabinet, and parliament did not convene for over a year. A string of security incidents culminated in an armed domestic conflict in May 2008. The Doha agreement, brokered by the Qatar government, provided for the election of a president, the reconvening of parliament, and the formation of a national unity government to lead the country to the May 2009 general elections. The security situation remains tense.

2. **The authorities have requested a follow-up EPCA to continue benefiting from the macroeconomic and financial discipline provided by Fund involvement.** Their request is based on an economic program for 2008 and 2009 that builds on the achievements in 2007 (Box 1), and seeks to further reduce the government debt-to-GDP ratio, build up the international reserve buffer, and start to implement key reforms under the Paris III framework.

3. **Staff's judgment is that Lebanon continues to meet the eligibility criteria for EPCA.**

- *Balance of payments need.* Continued balance-of-payments support is urgently needed in 2008–09 to maintain confidence in the face of a growing current account deficit, which is now projected at around 10–11 percent of GDP in 2008 and 2009 (partly because of delayed reconstruction spending), large foreign currency debt obligations, and the need to rollover foreign exchange deposits in the context of a volatile international financial environment. While improved, the level of international reserves needs to be further increased to support investor confidence in the still fragile post-conflict (and pre-election) political environment.

- *Institutional and administrative capacity.* The protracted political paralysis and domestic conflicts in 2007–08 have prevented the full restoration of institutional and administrative capacity, weakened by the 2006 war—key ministries were vacant, and parliament did not convene for over a year. In this context, it will take time to deal with the substantial legislative backlog (including passage of the budgets for 2006–08), and for the new ministers to rebuild the administrative capacity needed to implement a comprehensive economic program that could warrant upper credit tranche support from the Fund.

Box 1. Lebanon: The Authorities' 2007 Program Supported by EPCA[1]

The program, with an access of 25 percent of quota (SDR 50.75 million), aimed at maintaining financial stability, containing the budget deficit, and initiating structural reforms that are critical to the success of the medium-term Paris III reform program. The authorities:

- Succeeded in *maintaining confidence* in the domestic banking system and the exchange rate peg, which translated into an acceleration of deposit growth and an increase in international reserves.
- Achieved a *primary fiscal surplus* (excluding grants) which contributed to a reduction in the debt-to-GDP ratio.
- Advanced preparations for the *privatization* of two mobile phone operators to near completion. Given the political stalemate, the auction was postponed.
- Prepared *audit* plans for the National Social Security Fund (NSSF) and the power utility Electricité du Liban (EdL).

However, they did not:

- Introduce a *floor on gasoline excises* as envisaged in the program, because they considered that the implied increase in retail prices was not politically feasible at the time.
- Manage to fully restore *administrative and institutional capacity*, largely because of continuing political and security issues.

[1] See also April 2008 EPCA report (IMF Staff Country Report No. 08/150).

- *Capacity for policy planning and implementation and demonstrated commitment.* Some progress in capacity rebuilding has been made, and the government's commitment and capacity for policy planning remain adequate, as demonstrated by the successful implementation of the 2007 program and the good performance during the first half of 2008.

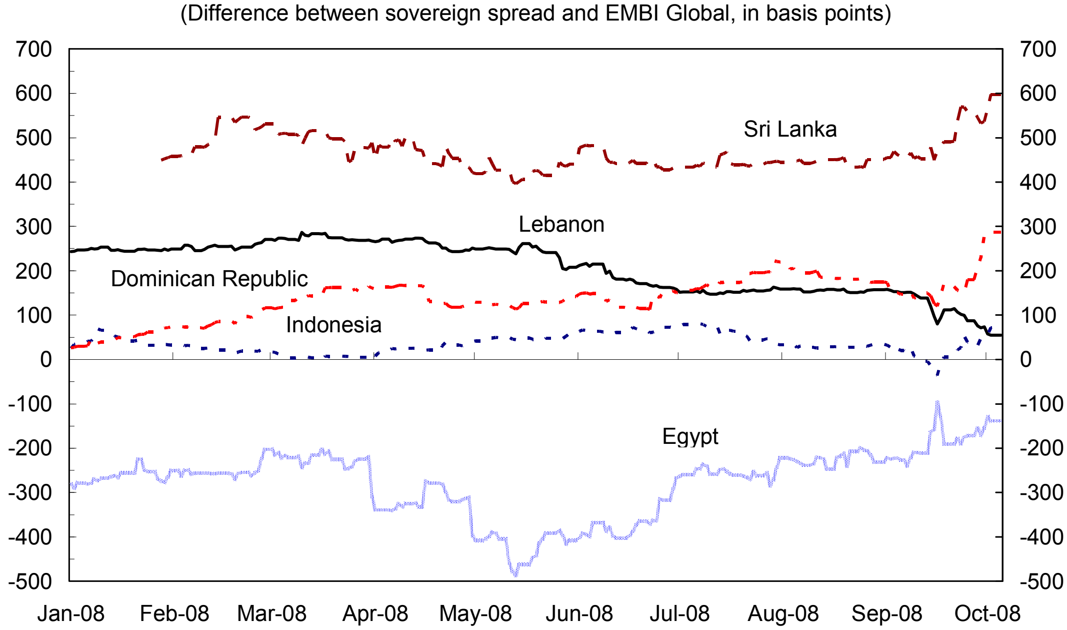
- *Fund support as part of a concerted international effort.* EPCA would constitute an integral and catalytic part of the overall financial assistance package in the context of the Paris III reform program. Donor support has been delayed because many Paris III projects could not be initiated in the absence of a working parliament and continuing security problems. Several donors have indicated that their continued support would depend on Fund involvement.

II. Background

4. **Macroeconomic conditions have improved since the Doha agreement, but international price developments have boosted inflation (Box 2).** Real GDP growth is likely to reach at least 6 percent in 2008 and 5 percent in 2009, led by construction and tourism—but significant downside risks have emerged in light of the global financial meltdown. Pushed by rising international commodity prices and the past depreciation of the U.S. dollar, average consumer price inflation is likely to reach 12 percent in 2008, and decline to 8 percent in 2009—somewhat higher than inflation in trading partners on account of an increase in domestic wages (Box 3). The external current account deficit has widened, reflecting commodity price increases, a recovery in domestic demand, and continued reconstruction needs. A global recession would further widen the current account deficit mainly through lower remittances and tourism inflows.

5. **Financial market developments have been favorable, despite the global financial crisis.** Eurobond spreads declined after the Doha agreement, and, more recently, have increased less than in other emerging markets. Annual broad money growth has accelerated to 15 percent reflecting deposit inflows, and boosted gross international reserves (excluding gold) to $16.7 billion in August (also thanks to seasonal factors). Dollarization has declined in response to lower dollar interest rates and broadly unchanged returns in Lebanese pounds. There have been no noticeable direct effects of the recent global financial turbulence on Lebanon (Box 4).

Figure 1. Lebanon: EMBI Sovereign Spreads in Selected Countries
(Difference between sovereign spread and EMBI Global, in basis points)



Source: JPMorgan.

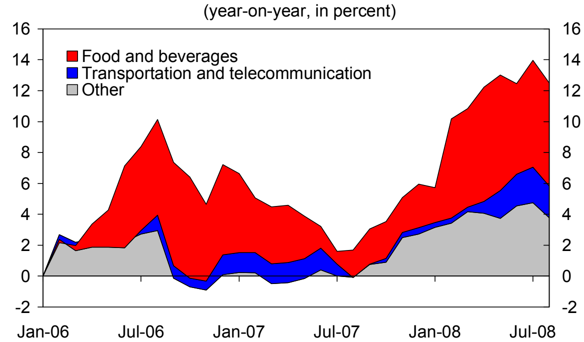
Box 2. Lebanon: Food and Fuel Price Inflation

As in most countries, rising international food prices have pushed up headline inflation. Food import prices in Lebanon have risen by around 31 percent year-on-year in July 2008, with net food imports accounting for 2.9 percent of annual GDP. As a result, the food and beverage component of the CPI increased by 21 percent year-on-year in July, contributing about 50 percent to headline inflation. Food and beverages have a weight of 35 percent in the CPI.

International fuel prices have only now started to affect headline inflation. The CPI component for transportation and communications increased by 16 percent year-on-year in July 2008, explaining another 17 percent of headline inflation.[1] Transportation and communication have a weight of 14 percent in the CPI. With the recent decline in oil prices, inflationary pressures should subside.

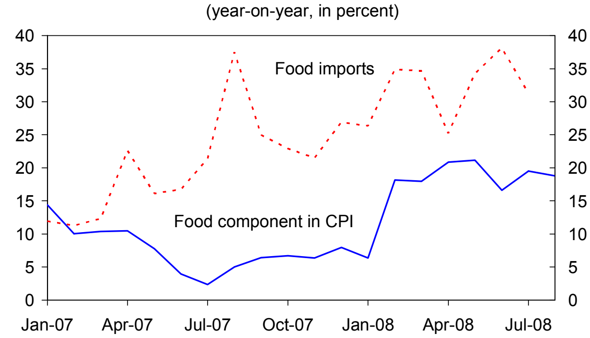
The government has taken some steps to protect low-income groups from rising food prices. In May, the government reduced customs duties on selected food items. Moreover, starting in September (the new school year), the government increased cash transfers for public school students.

Lebanon: Contribution to Headline Inflation, January 2006–August 2008
(year-on-year, in percent)



Sources: Lebanese authorities; and Fund staff calculations.

Lebanon: Food Price Inflation, January 2007–August 2008
(year-on-year, in percent)



Sources: Lebanese authorities; and Fund staff calculations.

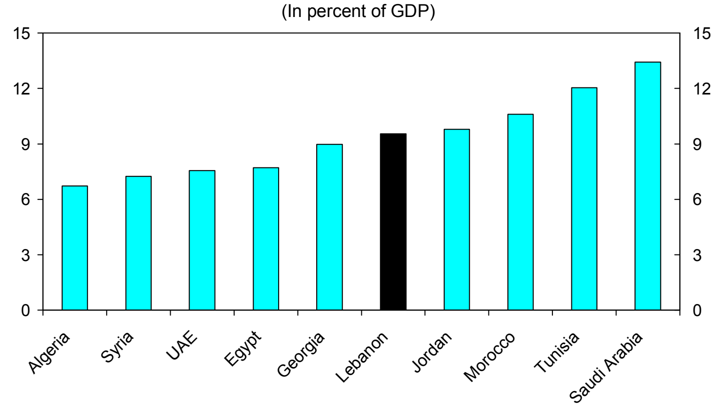
[1] The impact of rising international petroleum prices on headline inflation was mitigated until November 2007 by the government lowering excises on gasoline products, until these reached zero.

Box 3. Lebanon: The September 2008 Wage Increase

In September 2008, the government raised the private sector minimum wage and civil service wages and pensions, retroactively effective as of May 2008. However, high nominal GDP growth will keep wages broadly constant in percent of GDP.

- The *private sector minimum wage* increased by 67 percent to $333 per month, after being frozen at $200 since 1996. This will shift up the whole wage structure, and the authorities estimate that this implies an increase in the average wage of around 15 percent.
- *Public sector wages and pensions* rose by a flat $110–130 per month. The authorities estimate that this would imply an increase in the average public sector wage of around 17 percent (the last increase took place in 1998). More than half of the retroactive component will be paid out in 2008, and the remainder in the first two months of 2009. The annual cost of the wage increase is estimated at 1.4 percent of GDP. Still, the public sector wage bill is projected to remain constant in percent of GDP owing to the ongoing hiring freeze and strong nominal GDP growth. In all, the public sector wage bill in Lebanon is still comparable to that in similar countries.

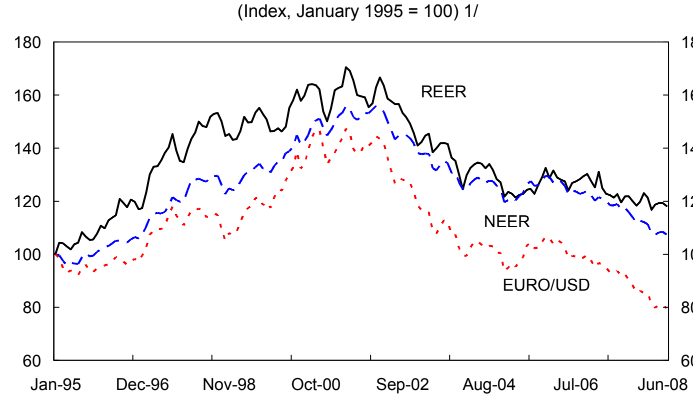
Public Sector Wages and Pensions in Lebanon and Regional Neighbors, 2007
(In percent of GDP)



Sources: National authorities and IMF staff calculations.

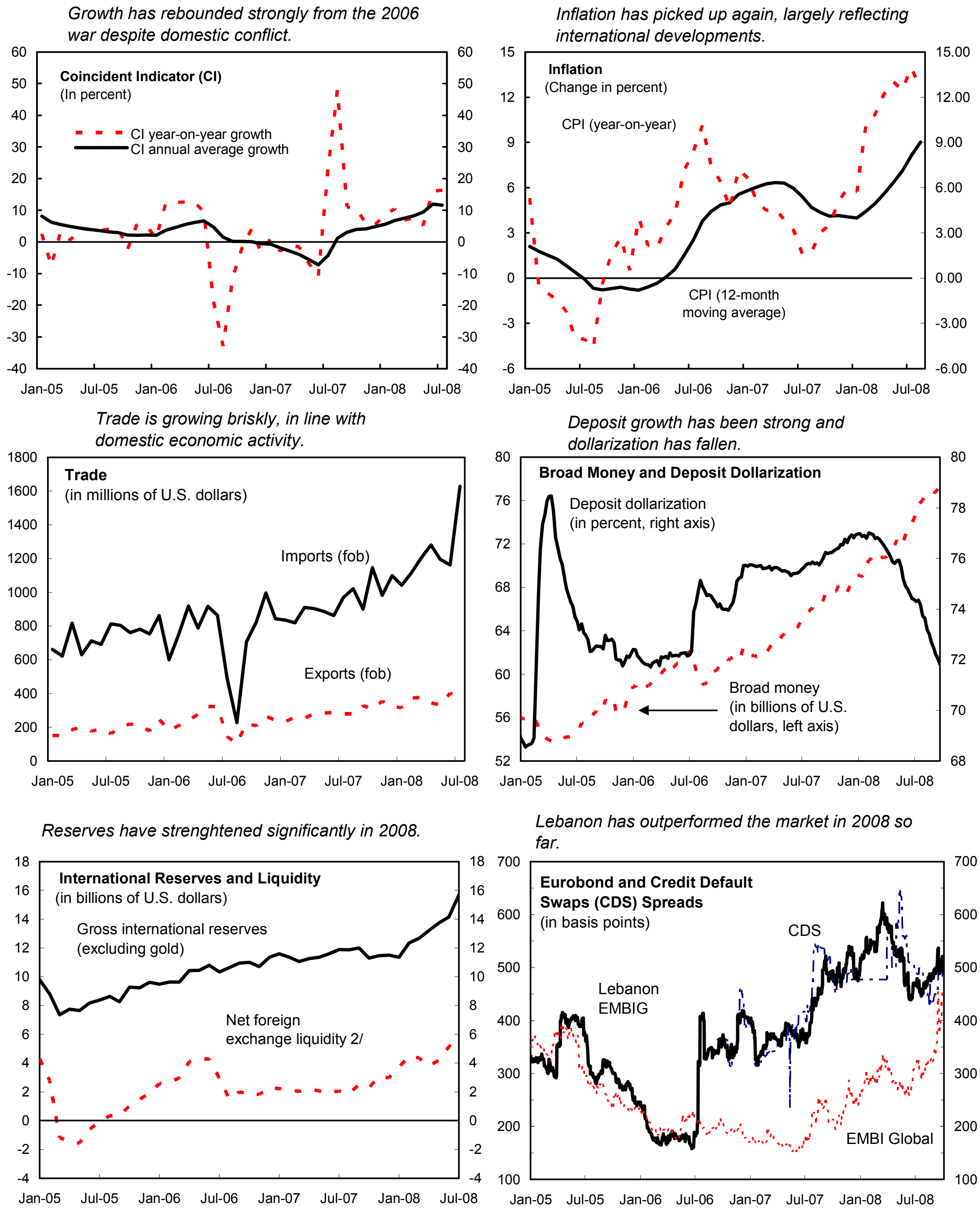
The wage increase will put some upward pressure on domestic prices in 2008–09. The authorities estimate that the wage increase will temporarily raise inflation by around three percentage points, as producers will pass on cost increases to some degree. Demand effects should be minor given that real wages are projected to stay broadly constant in 2008–09. The impact will be felt mostly in 2009, pushing domestic inflation somewhat above that in trading partners, and thus leading to a modest loss of competitiveness. However, this comes after a period of sustained depreciation of the real effective exchange rate.

Lebanon: Exchange Rate Developments, January 1995–July 2008
(Index, January 1995 = 100) 1/



Sources: National authorities; and Fund staff calculation.
1/ Increase indicates appreciation.

Figure 2. Lebanon: Recent Developments, January 2005–August 2008



Sources: Lebanese authorities; J.P. Morgan; Bloomberg; and Fund staff calculations.
1/ Coincident indicator is a composite of economic activity monitored by the central bank.
2/ 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 and other official creditors.

Box 4. Lebanon: Impact of the Recent Financial Turbulence

Lebanese banks have only few direct links to foreign counterparties affected by the recent global financial market turmoil, and, under BdL directives, had no exposure to structured products.

- *On the liability side*, the banks' funding model relies mostly on deposits, which account for 82 percent of banks' liabilities and come mostly from residents, the Lebanese Diaspora, and regional investors. Banks have no significant exposure to the international wholesale funding markets.
- *On the asset side*, about 51 percent of banks' assets are invested in government and BdL instruments (treasury bills, Eurobonds, certificates of deposits); lending to the private sector accounts for 23 percent of assets, and liquid foreign assets for about 13 percent of assets. Over the last few years, banks have pursued a regional expansion strategy to diversify away from the sovereign.

The non-bank financial sector is not of systemic importance, though individual institutions may have some exposure to the U.S. market.

Lebanon could eventually be affected indirectly through a regional slowdown and a fall in stock market valuations as a result of the global financial crisis (and/or falling oil prices):

- GDP growth could be adversely affected by sluggish tourism and subdued FDI.
- The external current account could widen if remittances and tourism receipts were to slow.
- A sharp slowdown in deposit inflows, combined with a rising current account deficit, could put pressure on reserves and interest rates, with adverse impact on the government's financing strategy.

6. **Donor support is expected to continue in 2008–09.** Only $930 million of the pledges for government support made at the Paris III conference were received through June 2008, because of political and security conditions and longer than expected negotiations.[1] During the remainder of 2008 and in 2009, disbursements of Paris III pledges could reach $910 million, helped by the resumption of Paris III reforms and the authorization of new project loans by the reconvened parliament.

[1] Moreover, $325 million in in-kind support was received or under preparation by end-June 2008, and private sector support totaling $1.27 billion was signed. Other support is being channeled through UN agencies and civil society organizations. In addition to the Paris III pledges, in 2007 Malaysia agreed to a debt exchange that lengthened maturities and lowered interest costs.

Lebanon: Foreign Assistance to the Government
(In millions of U.S. dollars, unless otherwise specified)

	2007	2008			2009		
	Act.	Jan–Jun Act.	Jul–Dec Proj.	Year Proj.	Jan–Jun Proj.	Jul–Dec Proj.	Year Proj.
Total	773	481	384	865	242	707	949
Grants	348	158	188	346	75	82	157
Loans	425	322	196	518	168	624	792
Memorandum item:							
Paris III disbursements	572	362	186	548	162	560	722

Sources*:* Lebanese authorities, and Fund staff estimates.

III. POLICY DISCUSSIONS

7. **Discussions took place against the backdrop of a worsening global economic and financial outlook.** So far there have been no spillovers to Lebanon from the global financial crisis. However, the authorities are well aware of Lebanon's vulnerabilities and exposure to both domestic and regional political and economic shocks. In particular, there is a significant risk that the evolving crises could affect the growth and interest rate projections for 2009. The authorities remain committed to their Paris III debt reduction objectives, and discussions focused on three main challenges for 2008–09:

- Making further progress toward fiscal adjustment and debt reduction;
- Maintaining financial stability and reducing external vulnerabilities; and
- Re-invigorating the authorities' medium-term reform program.

A. Fiscal Program and Financing

8. **The authorities' fiscal and structural program for 2008–09 includes key measures from their medium-term fiscal reform agenda,** in particular the privatization of the two existing mobile phone licenses and actions to reduce the fiscal drain from the energy sector. The effort on the primary balance and the favorable interest rate-growth differential should help lower the government debt-to-GDP ratio by 9 percentage points in 2009 while privatization should contribute at least another 16 percentage points. As a result, the government debt ratio would decline to 136 percent of GDP by end-2009.

9. **For 2008, the authorities aim at maintaining a modest primary surplus.** Fiscal performance has been strong so far in 2008, but the impact of increasing transfers to EdL on

account of high oil prices weigh on the outlook for the year.[2] Still, the authorities target a primary surplus (excluding grants) of 0.2 percent of GDP in 2008, broadly the same as in 2007, corresponding to an overall deficit of just above 10 percent of GDP.

10. **The authorities plan for further consolidation in 2009.** On the revenue side, they will (a) raise the withholding tax on interest income from 5 to 7 percent; (b) remove provisions in the VAT law that allow refunds on exempted activities; (c) impose rental charges on illegal seashore constructions; and (d) allow firms to revalue their assets, and raise the capital gains tax on this one-off revaluation from 1.5 percent to 2 percent.[3] On the expenditure side, the authorities intend to (a) reduce transfers to EdL by revising the electricity tariff structure;[4] and (b) rationalize other existing subsidies, while, in parallel, introducing a targeted social transfer system. At the same time, the envisaged privatization would entail a substantial loss of non-tax revenues (1.2 percent of GDP). Despite this, the authorities aim for a primary surplus (excluding grants) of 0.6 percent of GDP with their 2009 budget, which corresponds to an overall deficit in percent of GDP broadly unchanged from 2008.

Lebanon: Measures Underlying the Authorities' 2009 Adjustment Scenario

	Projected Yield	Actions Needed	Timeline
	(In percent of GDP)		
Fiscal measures	**2.5**		
Revenue	**0.9**		
Increase capital gains tax on one-off revaluation of assets	0.3	Decree	Dec-08
Remove provisions in VAT law allowing refunds on exempted activities	0.1	Decree	Dec-08
Apply rental charges on illegal seashore structures	0.1	Decree	Dec-08
Increase in the tax rate on interest income (from 5 to 7 percent)	0.4	Budget Law	Dec-08
Expenditure	**1.5**		
Reduction in subsidies	0.3	Administrative	Ongoing
Reduction in EdL losses	1.2	Decision by Council of Ministers	Dec-08
Other developments 1/	**2.1**		
Revenue loss due to privatization	1.2	Mobile company sale	Apr-09
WTO accession (costs)	0.1	Administrative	Ongoing
Other 2/	0.7	n.a.	n.a.
Change in primary balance (excluding grants)	**0.4**	n.a.	n.a.

Sources: Lebanese authorities; and IMF staff projections. Figures may not add up due to rounding.
1/ + equals loss of revenue or higher spending.
2/ Includes changes in capital and foreign financed spending, and settlement of past NSSF dues.

[2] The increase in oil prices affects the budgetary transfers to EdL with a six-month lag because EdL's oil imports are financed through letters of credit.

[3] The last time enterprises were allowed to realize revaluation gains was in 1993.

[4] The current electricity tariff structure would achieve cost recovery at an oil price of around $25/bl.

11. **The authorities intend to meet their financing needs from the market.** The government has already met most of its 2008 foreign currency needs by issuing Eurobonds, and will continue to fund its domestic currency needs from the market. Foreign currency financing needs for 2009 are likely to reach $6 billion (of which around $1.3 billion are on behalf of EdL). The authorities plan to meet these foreign currency requirements from the Eurobond market, expected donor financing, and the government's foreign currency revenues. The impact of the global financial crisis on Eurobond issuances should be limited as Eurobonds are mainly placed with domestic commercial banks. The expected privatization receipts would be used to retire government debt. The government intends to refrain from central bank financing in 2009, after succeeding to reduce the stock of government net-borrowing from the BdL so far in 2008.

B. Monetary Policy, Exchange Rate Policy, and Financial Markets

12. **The authorities view the exchange rate peg as an effective nominal anchor that has supported financial stability.** They cautiously project deposit growth to slow somewhat in 2009 and deposit dollarization to stabilize, but intend to further strengthen reserves (Box 5). The authorities stand ready to adjust interest rates as needed to meet their balance of payments objectives.

13. **The authorities view domestic financial market developments favorably.** Bank profitability is rising, and balance sheets are expanding. They noted that their regulatory framework has prevented Lebanese banks from having an exposure to structured products that have been at the core of the global financial market turmoil, even though banks remain vulnerable to a fall in deposit inflows that could result from a slowdown in the Gulf. The BdL continues to support the banks' regional expansion strategies and their emphasis on growing private sector credit. At the same time, the BdL has recently tightened mortgage lending regulations in the face of rapidly rising real estate prices in 2008 to prevent a real estate bubble. The Banking Control Commission (BCC) has also stepped up supervision to limit the risks stemming from the global crisis. The authorities are reconsidering the main features of the deposit insurance fund and the principles for the supervision of the non-banking financial sector.

C. Structural Reforms

14. **The authorities believe that the current political environment offers a good opportunity to push forward their privatization agenda.** They view privatization as important to enhance competition and raise Lebanon's growth potential over the medium term. In the telecom sector, the authorities aim to re-launch the sale of the two existing mobile phone licenses by holding an auction in April 2009.[5] The timetable for this is

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[5] Earlier this year, the auction had to be postponed because of political and security developments.

ambitious, but the authorities believe that there is sufficient domestic consensus to move ahead before the elections, and that there will be strong interest for the two licenses. In addition, the authorities are preparing to corporatize the fixed line operator Telecom du Liban, and to auction broadband licenses. Outside the telecom sector, the authorities are assessing whether conditions are right for the sale of the BdL's non-financial assets, including shares in the national airline and a holding company that owns Casino du Liban.

Box 5. Lebanon: Measures of Reserve Adequacy

Based on two common approaches, estimates for reserve adequacy in Lebanon range from $18 billion to $27 billion using 2008 data. This compares to gross international reserves excluding gold of $16.7 billion as of August 2008, suggesting that Lebanon should continue to gradually strengthen its reserve position. In addition, commercial banks hold $12 billion in liquid foreign assets that serve as a buffer against capital outflows.

Building on rules of thumb such as the Greenspan-Guidotti rule, Wijnholds and Kapteyn (2001), and Lipschitz, Messmacher, and Mourmouras (2006) have proposed composite minimum reserve adequacy thresholds. Based on the first approach, thresholds are calculated as full coverage of short-term external debt plus 20 percent of broad money.[1] For Lebanon, this yields a minimum reserve level of $20 billion. Based on the second approach, thresholds are calculated as full coverage of foreign debt service, plus 10 percent of broad money, plus 20 percent of annual imports.[1] This yields a minimum reserve level of $18 billion.

Jeanne and Ranciere (2006) derive optimal reserves based on a calibrated model where reserves are costly (foregone interest), but also yield benefits in case of a sudden stop (crisis mitigation).[2] Using standard parameterization adapted to Lebanon, the model suggests an optimal level of reserves of $22 billion. However, this point estimate is sensitive to the model's key parameters which are difficult to measure. With more conservative values for the model's parameters, an optimal level of reserves of $27 billion results.

Lebanon: Main Calibration Parameters
(In percent, otherwise indicated)

Parameter	Baseline 1/	Conservative Case
Deposit coverage ratio	20	25
Size of the sudden stop	76	91
Probability of a crisis	10	15
Cumulative output loss	14	18
Term premium	1.5	1.5
Risk aversion (in absolute terms)	2	2

Source: Fund staff.

1/ *Size of the sudden stop*, is measured as short-term foreign currency debt, plus the deposit coverage ratio times total deposits (in percent of GDP).

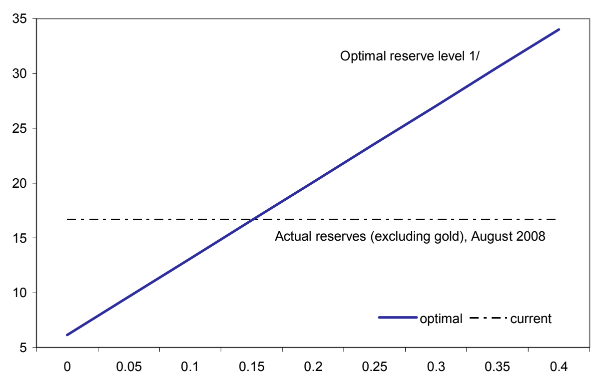
Probability of a crisis is set at the probability of a sudden stop for a typical emerging market, as estimated by Jeanne and Ranciere (2006).

Cumulative output loss is set in line with estimates on output losses during twin crisis episodes (Hutchison and Noy, 2006).

Term premium is set as in Jeanne and Ranciere (2006) close to the average differential between the yield on 10-year U.S. Treasury bonds and the federal fund rate over the last 10 years.

Risk aversion is set in line with the standard in the real business cycle literature.

Lebanon: Sensitivity of Optimal Level of Reserves (in billions of U.S. dollars)



Sources: Lebanese authorities; and Fund staff calculations.
1/ Model-based optimal level of reserves for different deposit coverage ratio values, leaving all other parameters at their baseline value.

[1] Short-term debt is on a remaining maturity basis and does not include deposits, which are covered by the broad money term.

[2] The model does not include the benefit of crisis prevention, so that the optimal reserve level could be viewed as a lower bound.

15. **The authorities are taking initial steps toward reforming the energy sector.** Besides revising the electricity tariff structure to reduce budgetary transfers to the power utility (5.2 percent of GDP in 2008), the planned switching to less expensive gas at one power plant would yield additional savings. Moreover, the government is finalizing an energy sector reform plan in collaboration with the World Bank that seeks to enhance generation capacity and service quality while restoring EdL's financial health.

16. **The government is also reinvigorating its structural fiscal reform agenda, which stalled during the political stalemate.** The government will finalize the global income tax law with a view to submitting it to parliament by March 2009, adopt a new tax procedure, and pilot a new risk-based tax audit manual. On the public finance management side, a public debt directorate has been formed, and a treasury single account will be introduced. With World Bank assistance, the authorities are also developing a reform program for the National Social Security Fund that will seek to restore its financial health, including through an actuarial study of the pension plan.

17. **The central bank is further strengthening its governance structure.** The BdL is developing a roadmap toward full implementation of the International Financial Reporting Standards. The BdL will also adopt a formal policy for the selection, appointment, and rotation of its external auditors, in line with good practices. In addition, it will adopt formal guidelines for foreign reserve management and establish an investment committee.

18. **The authorities intend to seek further technical assistance** from the Fund in the areas of consumer price statistics, national accounts, balance of payments, revenue administration, and public finance management.

D. Medium-Term Outlook and Debt Sustainability Analysis

19. **The government's debt-to-GDP ratio has declined faster than targeted at the time of Paris III.** Buoyant revenues and expenditure control have yielded a quicker improvement in the primary balance than initially envisaged, even though some of the fiscal adjustment measures planned for 2008 in the Paris III program were delayed. In addition, debt reduction has benefited from favorable real interest rate developments.

20. **Successful implementation of the authorities' 2008–09 program and continued decisive fiscal adjustment would ensure further progress toward sustainability.** From 2010, phased implementation of the Paris III fiscal consolidation measures, together with further privatization and pledged donor support, would reduce the debt-to-GDP ratio by 21 percentage points to 115 percent of GDP in 2013. The associated improvement in confidence is expected to sustain growth at 4–5 percent a year (similar to the historical average over the last 15 years) and a narrowing of interest rate spreads.

Lebanon: Measures Underlying Staff's Adjustment Scenario: 2010–13

	2010	2011	2012	2013	Gain	Technical Risk 1/	Implementation Risk 2/
	(In percent of GDP)						
Fiscal Measures	**3.3**	**3.1**	**0.6**	**0.3**	**7.3**		
Revenue	2.7	2.6	0.2	0.0	5.6		
Increase in the VAT rate (from 10 to 15 percent)	1.1	1.7	0.0	0.0	2.8	Medium	High
Introduction of the global income tax	0.3	0.3	0.2	0.0	0.8	Medium	Medium
Increase in gasoline excises to their pre-capping level	1.0	0.6	0.0	0.0	1.7	Low	High
Taxation of seashore properties (penalties)	0.3	0.0	0.0	0.0	0.3	Low	Unknown
Expenditure	0.6	0.4	0.4	0.3	1.7		
Cuts in non-essential spending	0.1	0.1	0.0	0.0	0.2	Low	Medium
Reduction in EdL losses	0.5	0.3	0.4	0.3	1.5	Medium	High
Other developments 3/	**1.4**	**0.6**	**0.2**	**0.2**	**2.5**		
Revenue loss due to privatization	0.7	0.0	0.0	0.0	0.7	Medium	High
WTO accession (costs)	0.1	0.0	0.0	0.0	0.1	n.a.	n.a.
Other 4/	0.6	0.6	0.2	0.2	1.6	n.a.	n.a.
Change in primary balance (excluding grants)	**1.9**	**2.4**	**0.4**	**0.1**	**4.8**	n.a.	n.a.

Sources: IMF staff projections. Figures may not add up due to rounding.
1/ Refers to the technical risk (e.g., simulations based on inadequate data, etc.) in achieving the expected yield.
2/ Refers mainly to political risk.
3/ + equals loss of revenue or higher spending.
4/ Includes increases in capital spending; and settlement of past NSSF dues.

21. **The authorities are aware of the risks to their strategy.** Given Lebanon's large debt overhang—the debt-to-GDP ratio is projected at 136 percent at end-2009—and fiscal and external imbalances, the country will remain vulnerable to liquidity shocks for years, even with full implementation of the reforms. Delays in privatization and the implementation of fiscal adjustment imply that these vulnerabilities would be reduced more slowly than envisaged. Moreover, Lebanon is vulnerable to macroeconomic shocks, such as shortfalls in growth or higher than projected real interest rates, that could materialize also as a consequence of the ongoing global financial crisis. Lastly, there are some uncertainties over the yield of reforms, as well as contingent liabilities (mainly from NSSF) that are being quantified. The effects of these risks are illustrated by the debt sustainability analysis (Box 6 and Figure 3).

E. Access, Program Monitoring, and Capacity to Repay the Fund

22. **The authorities have indicated that they would seek access to Fund resources of 12.5 percent of quota (SDR 25.375 million, $37.6 million).** Staff considers that this level of access is justified. While access would be small relative to Lebanon's financing needs, Fund involvement would facilitate continued donor support. Exceptional financing for 2008–09 is projected at close to $1.5 billion (Table 6). As in the past, staff intends to update the Executive Board regularly on progress under EPCA in the form of short factual reports.

23. **Lebanon is expected to meet its financial obligations to the Fund in a timely manner.** The authorities note that, to date, Lebanon has maintained a perfect record of meeting external debt payments, even during its civil war and recent episodes of financial pressures. Fund credit would be low relative to quota and in absolute terms, and debt service to the Fund would remain below 0.2 percent of exports of goods and non-factor services. An update of the 2007 safeguard assessment of the Banque du Liban has been initiated.

Box 6. Lebanon: Shock Scenarios for Debt Sustainability Analysis

The debt sustainability analysis (DSA) shows that the decline in the debt-to-GDP ratio is broadly stable under most shocks. The DSA shows the impact of five shocks:

Panel 1: The baseline scenario—continued implementation of Paris III reform measures.

Panel 2: A permanent increase in the real interest rate of 210 basis points (i.e., one-half standard deviation from its past distribution) relative to the baseline.

Panel 3: A permanent decrease in real GDP growth of 1.2 percent (i.e., one-half of the standard deviation from its past distribution).

Panel 4: Limited implementation of the fiscal reforms that would halve the yield from the fiscal reform package during 2010–13. This implies that the primary surplus converges to about 3 percent of GDP in 2013, compared with 6 percent in the baseline.

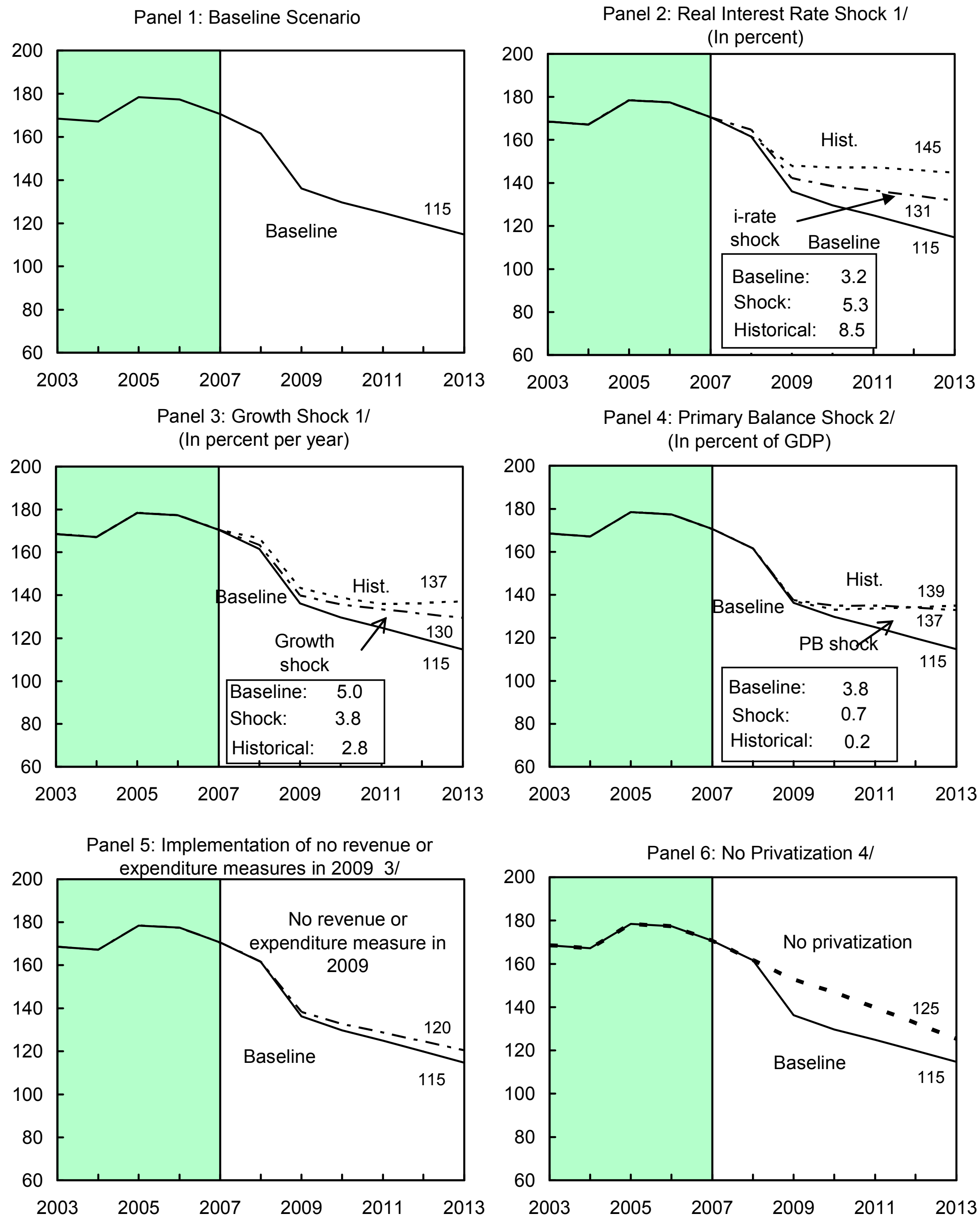
Panel 5: Failure to implement the revenue and expenditure measures planned for 2009. This worsens the primary balance by about 2.5 percent of GDP in 2009, leading to a 5 percentage point increase in the debt-to-GDP ratio in 2013 relative to the baseline.

Panel 6: No privatization—since privatization essentially brings forward the income stream from the privatized companies, the scenarios with and without privatization converge to the same debt ratio in the long run. However, this abstracts from the negative impact that abandoning privatization plans would have on growth and, possibly, interest rates, relative to the baseline.

24. **The provision of Fund financing to Lebanon under the existing circumstances poses risks to the Fund, owing to Lebanon's very high debt ratio.** Staff and management have consulted with the authorities and, through the relevant Executive Directors, with the bulk of Lebanon's official bilateral donors and creditors to address the risks that are posed by the provision of Fund financing. Based on these consultations, Management has understood that these members confirm the Fund's preferred creditor status in respect of drawing by Lebanon under the EPCA and, similarly, that they acknowledge the importance of timely repayment to the Fund of the amounts provided under the EPCA.

25. **The main risks to program implementation stem from a deterioration in the political and security situation, and a possible impact of the global financial crisis.** The government is committed to its economic program and determined to move ahead with reforms. However, a renewed political stalemate in the run-up to the 2009 elections or pre-election pressures could delay or derail the implementation of specific measures. A spill-over of the global financial market crisis to the region could jeopardize the authorities' financing strategy, set back the schedule for privatization, and exacerbate existing vulnerabilities.

Figure 3. Lebanon: Public Debt Sustainability, 2003–13
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Growth and interest rate shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline scenario and shock scenario; historical refers to 10-year averages.
2/ The planned revenue and expenditures reforms generate half of the estimated yield of the baseline scenario. This leads to a primary surplus of 3 percent of GDP by 2013.
3/ None of the revenue (i.e, increase in the tax on interest income), or expenditure measure (i.e., revision of the electricity tariff schedule) planned for 2009 are implemented.
4/ No privatization in the projected period. Assumes no adverse dynamic impact of no privatization.

IV. Staff Appraisal

26. **Achievements:** Lebanon's macroeconomic conditions have improved, despite the political strife and security problems. Growth remains strong, the government debt-to-GDP ratio is on a downward trend, deposit inflows have accelerated, and the BdL's foreign reserve position is now much stronger. The improved political climate that has followed the formation of the national unity government provides the opportunity to: (a) solidify these achievements by addressing the country's major vulnerabilities, and (b) start much needed reforms to lift Lebanon's growth potential.

27. **Challenges:** The top priority remains further lowering the public debt-to-GDP ratio toward sustainable levels to shore up market confidence and maintain strong deposit inflows, which are needed to satisfy the government's large financing requirements. This is also key to reducing external vulnerabilities and safeguarding BdL's foreign exchange position by ensuring full market financing of the government's foreign currency needs. To sustain the recent growth acceleration experienced recently over the medium term, financial stability is necessary, but not sufficient. Structural reforms need to tackle the obstacles that have held back economy-wide productivity, in particular in the energy and telecom sectors. The authorities' program starts to address these challenges, despite the close electoral deadline and the need to build broad consensus on policy actions.

28. **Fiscal policy:** The authorities' fiscal targets are appropriately ambitious. The targeted improvement in the primary surplus (excluding grants) would help bring down the debt-to-GDP ratio, even if the privatization of the telecom companies were not to materialize in 2009. The envisaged fiscal effort is substantial, given that telecom privatization would imply a large loss of non-tax revenues. To achieve these targets, the authorities need to timely implement the planned revenue measures and maintain strict control on outlays, not least in the run-up to the May elections. In particular, it will be essential to ensure that lower transfers to EdL materialize as envisaged through a combination of sufficiently higher electricity tariffs and savings in power generation. In light of the recent increases in food prices, a well-targeted and cost-effective safety net—under preparation by the authorities—is also needed. Such a safety net would be more efficient than generalized wage increases, which are costly, compress the pay scale, hurt external competitiveness, and do not necessarily benefit the most vulnerable people. The decision to submit the draft GIT law to parliament signals the government's commitment to tax reform, which should help make the tax system more efficient and equitable, and mobilize much needed tax resources. The authorities should profit from the decline in oil prices from their 2008 peak and gradually restore gasoline excises to 2004 levels.

29. **The peg and monetary policy:** The exchange rate has constituted the effective anchor for Lebanon's financial stability in the face of persisting large vulnerabilities and repeated shocks. Monetary policy will need to continue to safeguard the peg, with fiscal consolidation addressing the external imbalance. Although the surge in inflation reflected trends in international prices, there is a risk that wage increases could ignite inflationary pressures that may require shoring up confidence in the peg through higher interest rates, in addition to fiscal tightening. The BdL targets an accumulation of gross international reserves that is appropriate, but close monitoring of its net-foreign-asset position is needed. The government's intention to avoid central bank financing should help the BdL to achieve its international reserve target.

30. **The impact of the global financial turmoil:** Prudent oversight by the central bank and the supervisory authority has so far shielded the banking system from a direct impact by limiting exposure to structured products. Nevertheless, the global crisis could eventually affect Lebanon's economic outlook, in particular via a weakening of conditions in the Gulf. Deposit inflows, remittances, and direct investment from the region may slow down and erode banks' profitability. The BCC and the BdL should stand ready to step up supervision to minimize risks to the banking system, which has been the linchpin of financial stability. In this context, the recent regulation that limits bank financing of real estate speculation is welcome. Moreover, since banks have tried to reduce their excessive exposure to sovereign risk by rapidly increasing lending to the private sector, there is a need for continued close monitoring of the quality of the loan portfolio.

31. **Energy sector reform:** The revision of the tariff structure is only an initial step of a broader medium-term reform strategy that aims at increasing electricity supply, improving the quality of service, and reducing the high fiscal cost of power generation. In collaboration with the World Bank, the authorities are finalizing a comprehensive reform plan that envisages private sector participation. The potential benefits that such a plan could bring in terms of productivity gains and eventually higher economic growth cannot be overstated.

32. **Telecom privatization:** The government's intention to speed up the sale of the telecom companies is welcome. However, completing the sale by June 2009 requires immediate action to ensure broad political support across all parties. The authorities' projections and the staff's DSA conservatively assume that this sale does not affect the fiscal position over the medium term. However, a liberalized telecom sector has the potential to generate significant additional fiscal resources in the future.

33. **Donor support:** The success of the authorities' reform strategy requires sustained donor support. Unfortunately, in 2007–08, disbursements fell short of the pledges made under Paris III, also because of the protracted stalemate and security incidents. Donor should take advantage of the improved situation to step up implementation of several reconstruction

projects and deliver on their pledges. Staff stands ready to provide the needed technical assistance to help restore institutional and administrative capacity, particularly in the fiscal area.

34. **Risks:** An unraveling of the domestic political situation and a deterioration of the highly volatile regional security conditions constitute the main risks for program implementation. Lebanon remains highly vulnerable to shifts in market confidence, and could also be affected by the evolving global financial crisis. The BdL has prudently sought to increase international reserves to build a buffer against these risks. Support from donors and the Fund is an essential component for the success of this strategy.

35. The staff considers that the criteria for Fund support under EPCA have been met, and, therefore, recommends that the Board approve the authorities' request.

Table 1. Lebanon: Selected Economic Indicators, 2003–13

	2003 Act.	2004 Act.	2005 Act.	2006 Prel. Act.	2007 Est.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
Output and prices	(Annual percentage change)										
Real GDP (market price)	4.1	7.5	1.1	0.0	4.0	6.0	5.0	4.5	4.5	5.0	5.0
GDP deflator	1.6	0.9	-0.6	5.6	4.1	10.1	7.8	3.2	3.4	2.7	2.2
Consumer prices (end-of- period)	2.2	2.0	0.5	7.2	6.0	13.1	2.7	8.1	6.3	2.2	2.2
Consumer prices (period average)	1.3	1.7	-0.7	5.6	4.1	12.1	7.9	5.4	7.2	4.3	2.2
Investment and saving	(In percent of GDP)										
Gross capital formation	19.3	22.0	21.1	13.6	18.8	20.8	22.2	23.7	24.1	24.3	24.7
Government	3.1	3.3	2.2	2.5	2.4	2.0	2.6	3.7	4.1	4.3	4.7
Nongovernment	16.2	18.8	19.0	11.1	16.3	18.8	19.5	20.0	20.0	20.0	20.0
Gross national savings	6.1	6.5	7.5	8.1	11.5	9.9	11.5	14.8	15.4	16.2	17.3
Government	-10.7	-6.4	-6.4	-7.7	-8.6	-8.2	-7.8	-2.8	-0.7	0.4	1.6
Nongovernment	16.8	13.0	13.9	15.8	20.1	18.1	19.3	17.6	16.1	15.8	15.7
Public finances (cash basis)	(In percent of GDP)										
Revenue (including grants)	22.1	23.1	22.8	24.7	24.8	24.9	23.1	25.1	27.6	27.8	27.9
of which: grants	0.0	0.0	0.0	2.9	1.4	1.2	0.5	0.5	0.5	0.5	0.6
Expenditure	35.8	32.8	31.3	35.0	35.9	35.1	33.6	31.6	32.3	31.7	30.9
Budget balance (including grants)	-13.7	-9.7	-8.5	-10.2	-11.0	-10.2	-10.4	-6.4	-4.7	-3.9	-3.0
Primary balance (including grants)	2.8	2.4	1.9	2.5	1.7	1.4	1.1	3.0	5.4	5.8	6.0
Primary balance (excluding grants)	2.8	2.4	1.9	-0.4	0.3	0.2	0.6	2.5	4.9	5.3	5.4
Total government debt	169	167	178	177	171	162	136	130	125	120	115
Monetary sector	(Annual percentage change, unless otherwise indicated)										
Broad money 1/	15.5	12.3	3.5	6.4	10.9	14.0	13.0	11.0	9.0	9.0	9.0
Velocity of broad money (level)	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3
External sector	(In percent of GDP, unless otherwise indicated)										
Current account including official transfers	-13.2	-15.5	-13.6	-5.6	-7.2	-10.9	-10.7	-8.9	-8.7	-8.1	-7.3
Total external debt	175	187	188	196	197	190	175	169	159	151	143
Gross reserves (in millions of U.S. dollars)	10,271	9,575	9,611	11,353	11,494	17,115	21,446	24,437	25,789	27,768	30,171
In percent of total banking system deposits	24.8	21.0	20.1	21.9	19.7	25.7	28.5	29.3	28.3	28.0	28.0
Memorandum item:											
Nominal GDP (in billions of U.S. dollars)	19.8	21.5	21.6	22.8	24.6	28.8	32.6	35.1	37.9	40.9	43.9

Sources: Lebanese authorities; and Fund staff estimates.

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

Table 2. Lebanon: Central Government Overall Deficit and Financing: 2003–09

	2003 Year Act.	2004 Year Act.	2005 Year Act.	2006 Year Act.	2007 Year Act.	2008 Year Proj.	2009 Year Proj.
(In billions of Lebanese pounds, unless otherwise indicated)							
Revenue and grants	6,597	7,485	7,405	8,486	9,221	10,814	11,352
Revenue	6,597	7,485	7,405	7,490	8,696	10,292	11,115
Tax revenue	4,527	5,169	4,867	4,922	5,581	6,791	7,888
Taxes on income and profits	783	908	1,047	1,166	1,307	1,613	2,087
Taxes on property	321	405	414	579	532	741	865
Taxes on domestic goods and services	1,560	1,971	1,896	1,844	2,224	2,744	3,129
Of which: VAT revenues	1,386	1,763	1,693	1,659	2,003	2,474	2,815
Taxes on international trade 1/	1,645	1,617	1,268	1,074	1,247	1,374	1,446
Other taxes	217	268	241	259	271	320	362
Nontax revenue	1,716	1,877	2,117	2,219	2,648	2,976	2,719
Entrepreneurial and property income	1,252	1,420	1,663	1,702	2,141	2,393	2,101
Administrative fees and charges	383	365	365	426	421	470	500
Other nontax revenue	81	93	89	91	86	113	119
Other treasury revenue	354	439	421	349	467	525	507
Grants	0	0	0	996	525	522	237
Total expenditures	10,564	10,277	10,135	12,289	13,291	15,239	16477
Current primary expenditure	4,708	5,304	6,025	7,051	7,657	9,336	9,544
Wages, salaries and pensions	3,078	3,094	3,193	3,307	3,583	4,142	4,706
Transfers to EDL 2/	174	184	637	1,137	1,182	2,250	1,940
Other current	1,456	2,026	2,195	2,607	2,892	2,944	2,898
Materials and supplies	120	116	213	140	198	220	237
External services	81	113	82	87	84	101	109
Transfers 3/ 4/	271	360	655	878	828	807	835
Other	440	452	377	507	952	775	676
Of which: housing compensation	…	…	…	136	612	282	121
Other treasury outflows 5/	544	985	868	995	830	1,041	1,041
Interest payments	4,942	3,921	3,410	4,381	4,732	5,026	5,645
Domestic currency debt	3,207	2,246	1,533	2,368	2,515	2,853	3,477
Foreign currency debt	1,735	1,676	1,877	2,013	2,217	2,174	2,169
Capital expenditure	914	1,052	700	857	903	877	1,288
Domestically financed	713	817	534	446	442	494	838
Foreign financed	201	235	166	411	461	383	450
Overall balance (checks issued)	-3,968	-2,792	-2,730	-3,803	-4,070	-4,425	-5,126
Primary balance (checks issued)	975	1,129	680	578	662	601	519
Statistical discrepancy/float	-135	-344	-48	293	-34	0	0
Overall balance (cash basis)	-4,103	-3,136	-2,778	-3,510	-4,104	-4,425	-5,126
Primary balance (cash basis)	839	785	632	871	627	601	519
Net financing	4,103	3,136	2,778	3,510	4,104	4,425	5,126
Banking system	3,345	4,183	3,350	1,935	-1,173	2,699	-2,749
Deposits	704	-924	-918	1,022	-511	-1,919	250
Treasury Bills	3,123	1,480	2,937	267	-141	4,990	2,499
Eurobonds	-482	3,627	1,331	646	-521	-372	-5,498
Government institutions	-657	-377	259	867	1,483	434	491
Other creditors	1,834	-1,120	-632	1,094	1,728	1,643	-707
Net change in arrears	0	0	-419	0	0	0	0
Exceptional financing 6/	-280	517	0	0	2,380	0	8,091
Change in accrued interest	342	-215	-179	-196	-45	-67	0
Valuation adjustment	-480	149	399	-190	-268	-284	0
Memorandum items:							
Primary balance on a checks issued basis (excluding grants)	975	1,129	680	-418	137	79	283
Total government debt	50,322	54,082	57,985	60,851	63,364	70,066	66,852
Of which: foreign denominated debt	23,479	27,711	28,844	30,647	31,991	33,357	27,165

Sources: Lebanese authorities; and Fund staff estimates and calculations.
1/ Domestic excises, which are collected at customs, are classified as taxes on international trade.
2/ Excludes principal and interest payments paid on behalf of EdL.
3/ From 2005 onward includes additional transfers to the social security funds (NSSF) to clear the stock of arrears.
4/ Includes $275 million for telecom settlements (2006 and 2007).
5/ Includes transfers to municipalities.
6/ Debt cancellation and Banque du Liban revaluation of gold and foreign exchange and privatization proceeds.

Table 3. Lebanon: Central Government Overall Deficit and Financing: 2003–09

	2003 Year Act.	2004 Year Act.	2005 Year Act.	2006 Year Act.	2007 Year Act.	2008 Year Proj.	2009 Year Proj.
(In percent of GDP, unless otherwise indicated)							
Revenue and grants	22.1	23.1	22.8	24.7	24.8	24.9	23.1
Revenue	22.1	23.1	22.8	21.8	23.4	23.7	22.6
Tax revenue	15.2	16.0	15.0	14.3	15.0	15.7	16.1
Taxes on income and profits	2.6	2.8	3.2	3.4	3.5	3.7	4.3
Taxes on property	1.1	1.3	1.3	1.7	1.4	1.7	1.8
Taxes on domestic goods and services	5.2	6.1	5.8	5.4	6.0	6.3	6.4
Of which: VAT revenues	4.6	5.4	5.2	4.8	5.4	5.7	5.7
Taxes on international trade 1/	5.5	5.0	3.9	3.1	3.4	3.2	2.9
Other taxes	0.7	0.8	0.7	0.8	0.7	0.7	0.7
Nontax revenue	5.7	5.8	6.5	6.5	7.1	6.9	5.5
Entrepreneurial and property income	4.2	4.4	5.1	5.0	5.8	5.5	4.3
Administrative fees and charges	1.3	1.1	1.1	1.2	1.1	1.1	1.0
Other nontax revenue	0.3	0.3	0.3	0.3	0.2	0.3	0.2
Other treasury revenue	1.2	1.4	1.3	1.0	1.3	1.2	1.0
Grants	0.0	0.0	0.0	2.9	1.4	1.2	0.5
Total expenditures	35.4	31.8	31.2	35.8	35.8	35.1	33.6
Current primary expenditure	15.8	16.4	18.5	20.6	20.6	21.5	19.4
Wages, salaries and pensions	10.3	9.6	9.8	9.6	9.6	9.6	9.6
Transfers to EDL 2/	0.6	0.6	2.0	3.3	3.2	5.2	4.0
Other current	4.9	6.3	6.8	7.6	7.8	6.8	5.9
Materials and supplies	0.4	0.4	0.7	0.4	0.5	0.5	0.5
External services	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Transfers 3/ 4/	0.9	1.1	2.0	2.6	2.2	1.9	1.7
Other	1.5	1.4	1.2	1.5	2.6	1.8	1.4
Of which: housing compensation	…	…	…	0.4	1.6	0.7	0.2
Other treasury outflows 5/	1.8	3.0	2.7	2.9	2.2	2.4	2.1
Interest payments	16.6	12.1	10.5	12.8	12.7	11.6	11.5
Capital expenditure	3.1	3.3	2.2	2.5	2.4	2.0	2.6
Domestically financed	2.4	2.5	1.6	1.3	1.2	1.1	1.7
Foreign financed	0.7	0.7	0.5	1.2	1.2	0.9	0.9
Overall balance (checks issued)	-13.3	-8.6	-8.4	-11.1	-11.0	-10.2	-10.4
Primary balance (checks issued)	3.3	3.5	2.1	1.7	1.8	1.4	1.1
Statistical discrepancy/float	-0.5	-1.1	-0.1	0.9	-0.1	0.0	0.0
Overall balance (cash basis)	-13.7	-9.7	-8.5	-10.2	-11.0	-10.2	-10.4
Primary balance (cash basis)	2.8	2.4	1.9	2.5	1.7	1.4	1.1
Net financing	13.7	9.7	8.5	10.2	11.0	10.2	10.4
Banking system	11.2	12.9	10.3	5.6	-3.2	6.2	-5.6
Government institutions	-2.2	-1.2	0.8	2.5	4.0	1.0	1.0
Other creditors	6.1	-3.5	-1.9	3.2	4.7	3.8	-1.4
Net change in arrears	0.0	0.0	-1.3	0.0	0.0	0.0	0.0
Exceptional financing 6/	-0.9	1.6	0.0	0.0	6.4	0.0	16.5
Change in accrued interest	1.1	-0.7	-0.6	-0.6	-0.1	-0.2	0.0
Valuation adjustment	-1.6	0.5	1.2	-0.6	-0.7	-0.7	0.0
Memorandum items:							
Primary balance on a checks issued basis (excluding grants)	3.3	3.5	2.1	-1.2	0.4	0.2	0.6
Nominal GDP (Annual and in billions of LL)	29,851	32,359	32,499	34,309	37,144	43,369	49,085
Total government debt (in percent of GDP)	169	167	178	177	171	162	136
Of which: foreign denominated debt (in percent of gross debt)	47	51	50	50	50	48	41

Sources: Lebanese authorities; and Fund staff estimates and calculations.
1/ Domestic excises, which are collected at customs, are classified as taxes on international trade.
2/ Excludes principal and interest payments paid on behalf of EdL.
3/ From 2005 onward includes additional transfers to the social security funds (NSSF) to clear the stock of arrears.
4/ Includes $275 million for telecom settlements (2006 and 2007).
5/ Includes transfers to municipalities.
6/ Debt cancellation and Banque du Liban revaluation of gold and foreign exchange and privatization proceeds.

Table 4. Lebanon: Government Debt, 2003–09 1/

	2003 Year Act.	2004 Year Act.	2005 Year Act.	2006 Year Act.	2007 Year Act.	2008 Year Proj.	2009 Year Proj.
	(In millions of U.S. dollars)						
Net debt 2/	32,838	34,719	36,699	39,278	40,606	43,779	41,812
Gross debt by holder	33,381	35,875	38,464	40,365	42,033	46,478	44,346
Banking system	22,480	25,968	28,804	29,405	28,942	32,010	30,021
Treasury bills	13,856	14,838	16,786	16,963	16,870	20,180	21,837
Other domestic loans	234	334	339	334	310	315	315
Eurobonds	8,391	10,797	11,679	12,108	11,762	11,516	7,869
Nonbanks	10,901	9,907	9,660	10,961	13,090	14,468	14,325
Treasury bills	3,717	2,322	2,206	2,739	3,631	3,857	4,173
Government institutions 3/	1,701	1,451	1,623	2,198	3,181	3,469	3,795
Other	2,016	871	583	541	450	387	379
Eurobonds	4,616	4,913	4,734	5,432	6,214	7,072	6,238
Concessional loans	2,568	2,673	2,442	2,512	2,967	3,262	3,636
Foreign currency Tbonds	-	-	278	278	278	278	278
Government deposits	543	1,156	1,765	1,087	1,426	2,699	2,534
	(in percent of GDP)						
Net debt 2/	166	162	170	173	165	152	128
Gross debt by holder	169	167	178	177	171	162	136
Banking system	114	121	134	129	117	111	92
Treasury bills	70	69	78	75	68	70	67
Other domestic loans	1	2	2	1	1	1	1
Eurobonds	42	50	54	53	48	40	24
Nonbanks	55	46	45	48	53	50	44
Treasury bills	19	11	10	12	15	13	13
Government Institutions 3/	9	7	8	10	13	12	12
Other	10	4	3	2	2	1	1
Eurobonds	23	23	22	24	25	25	19
Concessional loans	13	12	11	11	12	11	11
Foreign currency Tbonds	0	0	1	1	1	1	1
Government deposits	3	5	8	5	6	9	8
Memorandum items:							
Nominal GDP	29,851	32,359	32,499	34,309	37,144	43,369	49,085
Foeign currency debt (in percent of gross debt)	47	51	50	50	50	48	41

Sources: Lebanese authorities; and Fund staff estimates and calculations.
1/ Includes all debt contracted by the treasury on behalf of the central government and public agencies other than the Banque du Liban; accrued interest; and Banque du Liban lending to Electricite du Liban. Excludes possible government arrears to the private sector.
2/ Defined as gross debt less government deposits.
3/ Denominated in domestic currency; mainly to the National Social Security Fund, and the National Deposit Insurance Fund.

Table 5. Lebanon: Monetary Survey, 2003–09 1/

	2003 Year Act.	2004 Year Act.	2005 Year Act.	2006 Year Act.	2007 Year Act.	2008 Year Proj.	2009 Year Proj.
	(In billions of Lebanese pounds)						
Net foreign assets	33,509	36,803	37,832	43,594	50,612	59,376	67,876
Banque du Liban	20,970	20,185	21,078	23,047	25,500	33,913	40,442
Commercial banks	12,539	16,618	16,754	20,547	25,112	25,464	27,434
Net domestic assets	42,848	48,930	50,888	50,784	54,042	59,930	66,940
Net claims on public sector	30,670	34,029	36,891	38,981	38,663	40,054	37,662
of which: Net claims on government	31,989	35,646	38,898	40,871	39,957	42,457	39,708
Banque du Liban	10,983	11,490	12,201	9,678	7,534	5,924	4,407
Commercial banks	21,006	24,155	26,697	31,193	32,423	36,533	35,301
Claims on private sector	23,233	24,375	24,774	26,209	27,059	30,648	37,758
Other items (net)	-11,056	-9,474	-10,777	-14,407	-11,680	-10,773	-8,480
Broad money (M5) 2/	76,357	85,733	88,720	94,378	104,655	119,306	134,816
In Lebanese pounds	27,458	27,427	25,503	24,159	25,535	32,925	38,461
Currency in circulation	1,531	1,586	1,535	1,809	1,929	1,965	2,220
Deposits in Lebanese pounds	25,927	25,840	23,968	22,350	23,606	30,961	36,240
Deposits in foreign currency	48,900	58,306	63,217	70,219	79,119	86,381	96,355
	(Year-on-year percent change)						
Broad money (M5) 2/	15.5	12.3	3.5	6.4	10.9	14.0	13.0
In Lebanese pounds	30.0	-0.1	-7.0	-5.3	5.7	28.9	16.8
Deposits in foreign currency	8.7	19.2	8.4	11.1	12.7	9.2	11.5
Memorandum items:							
	(In billions of Lebanese pounds, except where otherwise noted)						
Banque du Liban:							
Net foreign exchange position 3/	8,935	6,712	2,873	3,465	4,490	9,854	14,751
Foreign assets	21,263	20,473	22,081	26,321	29,298	37,856	44,385
Foreign currency liabilities	12,328	13,762	19,208	22,856	24,808	28,002	29,634
Net foreign exchange position, in millions of U.S. dollars 3/				2,299	2,978	6,537	9,785
Claims on public sector (net)	10,990	11,354	11,900	9,367	7,403	4,978	3,461
Claims on commercial banks	-9,859	-7,657	-6,163	-3,796	-2,467	-3,934	-8,504
Reserve money	6,407	8,123	7,364	7,227	7,919	9,497	10,601
Gross international reserves (excluding gold), in millions of U.S. dollars 4/	10,271	9,575	9,611	11,353	11,494	17,115	21,446
in percent of banking system foreign currency deposits	40.3	31.9	29.0	30.1	26.5	36.4	41.1
in percent of total banking system deposits	24.8	21.0	20.1	21.9	19.7	25.7	28.5
Share of foreign currency deposits in total private sector deposits (in percent)	66.2	70.1	73.2	76.2	77.4	74.0	73.0

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

1/ The monetary projections assume that the mobile telecom companies are privatized in Q2 2009, with financing partly from domestic banks and partly from FDI.

2/ Broad money (M5) is defined as M3 (currency + resident deposits) + non-resident deposits.

3/ Defined by currency (not by residency), as official foreign currency assets, including gold and SDR, less foreign currency liabilities.

Liabilities include the exceptional deposits by GCC governments, but exclude liabilities to the government of Lebanon and other official creditors.

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

Table 6. Lebanon: Balance of Payments, 2003–13

	2003 Est.	2004 Est.	2005 Est.	2006 Est.	2007 Est.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
	(In millions of U.S. dollars, unless otherwise indicated)										
Current account (excl. official transfers) 1/	-2,749	-3,443	-3,065	-1,538	-1,979	-3,327	-3,572	-3,133	-3,326	-3,353	-3,252
Goods (net)	-4,794	-6,452	-6,118	-6,138	-7,850	-10,603	-11,427	-12,419	-13,463	-14,524	-15,663
Exports, f.o.b.	1,733	2,050	2,278	3,207	4,077	5,259	6,022	6,774	7,553	8,384	9,306
Imports, f.o.b.	-6,528	-8,502	-8,397	-9,345	-11,926	-15,862	-17,448	-19,193	-21,017	-22,908	-24,970
Services (net)	983	1,691	2,467	3,022	3,197	4,352	4,798	5,290	5,812	6,411	7,134
Income (net)	-1,231	-1,473	-1,474	-1,200	-782	-714	-815	-189	-194	-126	-20
Of which: interest on government debt	-525	-502	-696	-457	-536	-590	-603	-590	-659	-660	-578
Current transfers (net) 2/	2,294	2,791	2,061	2,778	3,455	3,638	3,872	4,186	4,519	4,886	5,298
Capital and financial account	5,862	4,254	2,048	1,901	1,625	8,238	7,114	5,720	4,167	4,993	5,252
Capital transfers (net)	29	50	27	1,340	590	161	60	153	172	187	226
Direct investment (net)	1,722	2,333	2,629	2,669	3,077	3,529	6,577	4,764	4,545	4,898	5,276
Portfolio investment, loans, other capital	4,111	1,871	-609	-2,109	-2,042	4,549	478	803	-550	-92	-250
Government (net) 3/	-593	-87	297	666	-225	-216	-823	-284	-489	-471	-846
BdL 4/	-18	-3	474	1,507	270	57	0	-20	-140	-62	-42
Of which: IMF repurchases	0	0	0	0	0	0	0	-20	-40	-40	-20
Banks (net) 5/	3,845	1,293	469	-1,446	-2,369	2,414	691	-366	-491	-380	471
Foreign assets of banks 6/	-48	-2,706	-90	-2,516	-3,028	-233	-1,307	-1,725	-1,725	-1,725	-995
Non-resident deposits 5/	3,892	3,999	560	1,071	659	2,647	1,998	1,359	1,234	1,345	1,466
Non-bank private sector (net)	876	668	-1,849	-2,836	282	2,294	609	1,473	570	821	167
Errors and omissions	-218	-1,619	914	1,105	-176	0	0	0	0	0	0
Overall balance	2,895	-807	-103	1,467	-530	4,911	3,543	2,587	840	1,640	2,000
Financing	-2,895	807	103	-1,467	530	-4,911	-3,543	-2,587	-840	-1,640	-2,000
Official reserves (- increase)	-5,125	696	-36	-1,742	-142	-5,621	-4,331	-2,991	-1,351	-1,980	-2,403
Exceptional financing	2,229	111	139	275	672	710	789	404	511	339	403
Budgetary grants	134	111	139	275	195	185	98	19	21	23	26
Budgetary loans	2,095	0	0	0	400	484	691	385	490	316	378
IMF purchases	0	0	0	0	77	40	0	0	0	0	0
Memorandum items:											
Current account (incl. official transfers)	-2,614	-3,332	-2,926	-1,264	-1,784	-3,142	-3,474	-3,114	-3,305	-3,330	-3,226
Current account balance (in percent of GDP)											
Including official transfers	-13.2	-15.5	-13.6	-5.6	-7.2	-10.9	-10.7	-8.9	-8.7	-8.1	-7.3
Excluding official transfers	-13.9	-16.0	-14.2	-6.8	-8.0	-11.6	-11.0	-8.9	-8.8	-8.2	-7.4
Gross official reserves (excl. gold, year-end) 7/	10,271	9,575	9,611	11,353	11,494	17,115	21,446	24,437	25,789	27,768	30,171
External debt (year-end; in percent of GDP) 8/	174.8	187.4	188.3	196.0	197.3	190.4	174.6	168.5	158.8	151.4	143.0
Government external debt (in percent of GDP)	36.8	33.9	34.2	35.4	35.9	32.2	28.0	26.3	24.3	22.2	19.6
GDP	19,802	21,465	21,558	22,759	24,640	28,769	32,561	35,116	37,940	40,909	43,914

Sources: Lebanese authorities; BIS; and IMF staff estimates and projections.
1/ Classification of some large-scale flows into current account or capital and financial account transactions for 2007 remains uncertain.
2/ Excluding official budgetary transfers.
3/ Excluding budgetary loan disbursements.
4/ Change in the foreign liabilities of the BdL, excluding IMF purchases.
5/ Differs from banks' reported data, to include estimated deposit flows by Lebanese nationals living abroad but classified as residents.
6/ Net of non-deposit foreign liabilities.
7/ Excludes Eurobonds and encumbered reserves.
8/ Includes all banking deposits held by non-residents, including estimated deposits of Lebanese nationals living abroad but classified as residents.

Table 7. Lebanon: Banking Sector Financial Soundness Indicators, 2003–08

	2003 Year	2004 Year	2005 Year	2006 Year	2007 Year	2008 June
	(In percent, unless otherwise specified)					
Assets (in millions of U.S. dollars)	61,589	70,595	73,565	78,855	88,854	95,219
Capital						
Capital adequacy ratio	22.3	21.2	22.9	25.0	24.0	n.a.
Capital to asset ratio	6.9	6.8	7.5	9.1	8.1	8.1
Asset quality						
Net problem loans/net total loans	12.8	10.6	9.1	6.8	4.8	3.7
Provisions against problem loans/problem loans	46.3	46.1	50.2	54.4	56.6	57.4
Total provisions/problem loans	53.1	57.3	64.1	72.4	78.1	79.1
Asset concentration						
Share of claims on government	23.2	23.6	25.2	27.2	26.1	26.1
Of which: T-bills	12.5	10.6	11.9	13.1	12.6	14.0
Of which: Eurobonds	10.6	13.0	13.3	14.0	13.5	12.0
Share of claims on BdL	31.3	28.6	29.9	26.3	24.7	25.4
Of which: Certificates of Deposit	16.1	12.0	13.4	11.5	9.0	9.9
Share of claims on private sector	25.2	23.5	23.1	22.6	21.6	22.8
Share of claims on nonresidents	14.4	17.6	16.4	18.3	20.9	17.8
Of which: foreign banks	13.4	16.3	14.9	16.1	17.7	13.8
Net foreign currency assets as percent of capital	22.0	23.3	18.3	15.5	20.3	19.2
Earnings						
Average return on assets (post tax)	0.7	0.7	0.7	0.9	1.0	0.7
Average return on equity (post tax)	10.9	9.3	11.0	10.1	12.1	8.3
Net interest margin	2.1	1.7	1.8	2.0	2.0	1.0
Liquidity						
Net liquid assets/total assets	49.1	43.2	45.2	42.9	40.3	38.8
Net liquid assets/short-term liabilities	56.6	57.0	52.8	51.0	47.9	46.0
Private sector deposits/assets	68.2	66.8	67.6	67.4	70.1	69.6
Nonresident deposits/assets	12.9	14.1	13.5	12.3	11.7	11.9
Other indicators 1/						
Change in assets (12 month, in percent)	12.8	15.2	4.2	7.2	12.7	11.9
Change in private sector credit (12 month, in percent) 2/	0.3	5.2	1.9	6.0	3.2	8.8
Change in deposits (12 month, in percent)	14.1	12.7	3.8	6.5	10.8	14.1
FC deposits/total deposits	66.2	70.1	73.2	76.2	77.4	75.3
FC loans/total loans	87.0	86.4	86.6	87.1	87.5	88.2
FC loans/GDP	62.8	61.7	62.7	64.0	73.3	85.4
Exports of goods and services/GDP	42.7	49.0	54.1	58.5	59.2	66.4
Memorandum items:						
LL deposit rate (average)	7.8	7.1	7.7	7.5	7.4	7.3
LL loan rate (average)	13.4	10.8	10.6	10.3	10.1	9.9
FC deposit rate (average)	3.6	3.3	3.7	4.4	4.7	3.9
FC loan rate (average)	9.0	8.3	8.2	8.5	8.0	7.6
Government's 2-year T-bill rate (marginal)	8.0	7.9	8.5	8.7	8.7	8.7
Spread over 6-month USD Libor	6.8	6.1	4.8	3.4	3.5	5.7
Government's Eurobond rate (marginal)	7.0	7.0	7.5	7.5	9.4	9.0
Spread over 5-year U.S. note	4.0	3.6	3.5	2.8	5.2	5.2
GDP (in millions of U.S. dollars)	19,802	21,465	21,558	22,759	24,639	28,769

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

1/ FC and LL stand for "foreign currency" and "Lebanese pound," respectively.
2/ For 2007, the low headline growth reflects a change in reporting of non-performing loans.
Underlying private sector credit growth has trended above 10 percent in 2007.

Table 8. Lebanon: Public Sector Debt Sustainability Framework, 2003–13

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Debt-Stabilizing Primary Balance 7/
Baseline: Public sector debt 1/	168.6	167.1	178.4	177.4	170.6	161.6	136.2	129.7	124.9	119.8	114.7	0.8
Of which: foreign-currency denominated	78.7	85.6	87.5	88.1	85.0	75.9	54.5	47.7	43.5	39.6	32.5	
Change in public sector debt	4.4	-1.4	11.3	-1.1	-6.8	-9.0	-25.4	-6.5	-4.8	-5.1	-5.1	
Identified debt-creating flows	5.2	-6.0	7.7	1.7	-9.0	-14.3	-24.9	-6.6	-4.9	-5.1	-5.2	
Primary deficit	-3.3	-3.5	-2.1	-1.7	-1.8	-1.4	-1.1	-3.0	-5.4	-5.8	-6.0	
Revenue and grants	22.1	23.1	22.8	24.7	24.8	24.9	23.1	25.1	27.6	27.8	27.9	
Primary (noninterest) expenditure	18.8	19.6	20.7	23.0	23.0	23.5	22.1	22.2	22.2	22.0	21.9	
Automatic debt dynamics 2/	7.6	-0.9	9.8	3.4	-0.8	-12.9	-7.3	-0.5	0.5	0.7	0.8	
Contribution from interest rate/growth differential 3/	7.6	-0.9	9.8	3.4	-0.8	-12.9	-7.3	-0.5	0.5	0.7	0.8	
Of which: contribution from real interest rate	14.0	10.6	11.6	3.4	5.8	-4.1	-0.2	5.2	5.9	6.5	6.4	
Of which: contribution from real GDP growth	-6.4	-11.6	-1.8	0.0	-6.6	-8.8	-7.1	-5.7	-5.4	-5.8	-5.6	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.9	-1.6	0.0	0.0	-6.4	0.0	-16.5	-3.1	0.0	0.0	0.0	
Privatization receipts (negative)	0.9	0.0	0.0	0.0	0.0	0.0	-16.5	-3.1	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 (Paris II and III assistance)	0.0	-1.6	0.0	0.0	-6.4	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 5/	-0.8	4.6	3.6	-2.7	2.2	5.3	-0.5	0.1	0.1	0.1	0.1	
Public sector debt-to-revenue ratio 1/	762.8	722.5	783.0	717.1	687.2	647.9	588.9	515.9	452.5	430.9	411.1	
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.1	7.5	1.1	0.0	4.0	6.0	5.0	4.5	4.5	5.0	5.0	
Average nominal interest rate on public debt (in percent) 6/	10.7	7.8	6.3	7.6	7.8	7.9	8.1	7.4	8.5	8.4	8.1	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	9.1	6.9	6.9	2.0	3.7	-2.2	0.3	4.2	5.1	5.7	5.9	
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	1.6	0.9	-0.6	5.6	4.1	10.1	7.8	3.2	3.4	2.7	2.2	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.2	12.1	6.5	11.4	4.0	8.3	-1.6	5.0	4.5	4.0	4.7	
Primary deficit	-3.3	-3.5	-2.1	-1.7	-1.8	-1.4	-1.1	-3.0	-5.4	-5.8	-6.0	
Memorandum items:												
Public sector debt based on historical GDP growth data 8/		168.6	167.1	178.7	178.1	168.9	152.1	149.0	146.3	143.4	140.3	
Public sector debt based on historical data 9/		168.6	167.1	178.7	178.1	168.9	157.4	159.5	162.9	166.3	169.8	

Sources: Lebanese authorities; and Fund staff projections.

1/ Central government gross debt.

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

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

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

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

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

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

8/ This path assumes that, from 2008 onwards, real GDP growth is set at its 10-year average level while the primary fiscal balance and real interest rates are the same as in the baseline scenario.

9/ This path assumes that, from 2008 onwards, real interest rate and real GDP growth are set at their 10-year average level while the primary fiscal balance is the same as in the baseline scenario.

Table 9. Lebanon: Indicators of Financial and External Vulnerability, 2003–08
(In millions of U.S. dollars, unless otherwise specified)

	2003	2004	2005	2006	2007	Proj. 2008
Monetary and financial indicators						
Broad money, M5	50,652	56,871	58,852	62,606	69,423	79,142
Annual percentage change	15.5	12.3	3.5	6.4	10.9	14.0
Private sector credit (annual percentage change)	1.2	4.9	1.6	5.8	3.2	13.3
Public finance indicators						
Overall fiscal balance	-2,632	-1,852	-1,811	-2,523	-2,700	-2,935
In percent of GDP	-13.3	-8.6	-8.4	-11.1	-11.0	-10.2
In percent of government revenue	-60.1	-37.3	-36.9	-44.8	-44.1	-40.9
Interest payments on debt	4,942	3,921	3,410	4,381	4,732	5,026
In percent of GDP	25.0	18.3	15.8	19.2	19.2	17.5
In percent of government revenue	112.9	79.0	69.4	77.8	77.3	70.0
Nominal GDP	19,802	21,465	21,558	22,759	24,640	28,769
Government revenue	4,377	4,967	4,914	5,631	6,119	7,176
Banking-sector indicators						
Problem loans (in percent of total loans, net of provisions and unearned interest)	12.8	10.6	9.1	6.8	4.8	…
Provisions against problem loans (in percent of problem loans)	46.3	46.1	50.2	54.4	56.6	…
Capital adequacy ratio	22.3	21.2	22.9	25.0	24.0	…
Credit to the private sector (in percent of GDP)	77.8	75.3	76.2	76.4	72.8	70.7
Debt indicators						
Gross public debt	33,381	35,875	38,464	40,365	42,033	46,478
In percent of government revenue	762.6	722.3	782.8	716.8	687.0	647.7
In percent of GDP	168.6	167.1	178.4	177.4	170.6	161.6
Of which: foreign currency	15,575	18,382	19,133	20,330	21,221	22,127
In percent of GDP	78.7	85.6	88.8	89.3	86.1	76.9
Gross public debt held by the market	21,175	22,700	24,293	27,871	29,206	…
In percent of GDP	106.9	105.8	112.7	122.5	118.5	…
External debt 1/	34,621	40,236	40,599	44,617	48,625	54,773
In percent of GDP	174.8	187.4	188.3	196.0	197.3	190.4
External public debt (central government and Banque du Liban)	7,483	7,462	8,049	10,222	11,371	11,873
In percent of GDP	37.8	34.8	37.3	44.9	46.1	41.3
Short-term external public debt 2/	1,716	2,512	1,308	1,455	1,424	1,477
Short-term foreign currency public debt 2/	1,770	2,452	2,933	2,039	2,791	5,649
Short-term external debt 1/ 2/	28,855	35,286	33,858	35,850	38,678	44,377
Short-term foreign currency debt 2/ 3/	38,318	46,875	49,802	54,268	62,999	73,755
Total foreign currency deposits (resident and non-resident) 1/	32,266	38,505	41,734	46,319	52,099	56,998
International reserves						
Gross official reserves 4/	10,271	9,575	9,611	11,353	11,494	17,115
In percent of short-term external debt	36	27	28	32	30	39
Gross official reserves and commercial banks' foreign assets	20,180	23,128	22,889	27,793	32,204	38,538
In percent of short-term external debt	70	66	68	78	83	87
In percent of short-term foreign currency debt 3/	53	49	46	51	51	52
External current account indicators						
Merchandise exports, f.o.b.	1,733	2,050	2,278	3,207	4,077	5,259
Annual percentage change	43.2	18.3	11.1	40.8	27.1	29.0
Merchandise imports, f.o.b.	6,528	8,502	8,397	9,345	11,926	15,862
Annual percentage change	10.4	30.3	-1.2	11.3	27.6	33.0
External current account balance	-2,614	-3,332	-2,926	-1,264	-1,784	-3,142
In percent of GDP	-13.2	-15.5	-13.6	-5.6	-7.2	-10.9
In percent of exports of goods and services	-29.9	-31.9	-26.0	-9.2	-11.1	-15.7

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

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

Table 10. Lebanon: External Financing Requirements and Sources, 2003–09

(In millions of U.S. dollars)

	2003 Act.	2004 Act.	2005 Act.	2006 Act.	2007 Act.	2008 Proj.	2009 Proj.
Gross financing requirements	-27,980	-27,320	-32,469	-32,004	-32,062	-39,516	-41,171
External current account balance 1/	-2,749	-3,443	-3,065	-1,538	-1,979	-3,327	-3,572
Government debt amortization	-1,143	-1,716	-2,512	-1,308	-1,455	-1,424	-1,477
Non-resident deposits	-18,964	-22,857	-26,856	-27,415	-28,486	-29,145	-31,792
Repayment of arrears	0	0	0	0	0	0	0
Gross reserves accumulation (- increase)	-5,125	696	-36	-1,742	-142	-5,621	-4,331
IMF repurchases	0	0	0	0	0	0	0
Available financing	25,751	27,209	32,330	31,729	31,390	38,807	40,383
Capital transfers (net)	29	50	27	1,340	590	161	60
Foreign direct investment (net)	1,722	2,333	2,629	2,669	3,077	3,529	6,577
Portfolio investment, loans, other capital	24,218	26,444	28,759	26,615	27,899	35,117	33,746
Government (excl. budget loans)	550	1,629	2,809	1,974	1,230	1,208	654
Banque du Liban (liabilities, net) 2/	-18	-3	474	1,507	270	57	0
Commercial Banks	22,809	24,150	27,325	25,970	26,117	31,558	32,483
Non-resident deposits	22,857	26,856	27,415	28,486	29,145	31,792	33,790
Other (net)	-48	-2,706	-90	-2,516	-3,028	-233	-1,307
Non-bank private sector (net)	876	668	-1,849	-2,836	282	2,294	609
Errors and omissions	-218	-1,619	914	1,105	-176	0	0
Financing gap	-2,229	-111	-139	-275	-672	-710	-789
Exceptional financing	2,229	111	139	275	672	710	789
Exceptional grants to government	134	111	139	275	195	185	98
Exceptional loans to government	2,095	0	0	0	400	484	691
IMF purchases	0	0	0	0	77	40	0
Residual financing gap	0	0	0	0	0	0	0

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

1/ Excluding official transfers.

2/ Excluding IMF.

Table 11. Lebanon: Indicators of Capacity to Repay the Fund, 2003–13

	2003 Act.	2004 Act.	2005 Act.	2006 Act.	2007 Act.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.
Fund repurchases and charges											
In millions of SDRs	0.0	0.0	0.0	0.0	1.5	2.3	3.0	15.7	27.5	26.4	13.1
In millions of U.S. dollars	0.0	0.0	0.0	0.0	2.4	3.5	4.8	24.7	43.3	41.7	20.7
In percent of exports and goods and NFS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.1	0.1
In percent of government external debt service	0.0	0.0	0.0	0.0	0.1	0.2	0.2	1.1	1.9	1.7	0.8
In percent of quota	0.0	0.0	0.0	0.0	0.8	1.1	1.5	7.7	13.6	13.0	6.4
In percent of gross official reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.2	0.1
Fund credit outstanding											
In millions of SDRs	0.0	0.0	0.0	0.0	50.8	76.1	76.1	63.4	38.1	12.7	0.0
In millions of U.S. dollars	0.0	0.0	0.0	0.0	77.7	119.8	119.0	99.7	59.9	20.0	0.0
In percent of quota	0.0	0.0	0.0	0.0	25.0	37.5	37.5	31.3	18.7	6.3	0.0
In percent of GDP	0.0	0.0	0.0	0.0	0.3	0.4	0.4	0.3	0.2	0.0	0.0
In percent of gross official reserves	0.0	0.0	0.0	0.0	0.7	0.7	0.6	0.4	0.2	0.1	0.0
Memorandum items:											
Exports of goods and NFS (in millions of US$)	8,742	10,461	11,252	13,711	16,005	19,994	22,631	24,801	27,127	29,633	32,369
Government external debt service (in millions of US$)	1,669	2,218	3,209	1,765	1,991	2,014	2,080	2,160	2,228	2,393	2,442
Quota (in millions of SDRs)	203	203	203	203	203	203	203	203	203	203	203
Quota (in millions of US$)	284	301	300	299	311	324	318	319	320	320	321
Gross official reserves (in millions of US$)	10,271	9,575	9,611	11,353	11,494	17,115	21,446	24,437	25,789	27,768	30,171

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

APPENDIX. LEBANON—LETTER OF INTENT

November 3, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

The agreement reached at Doha in May 2008 paved the way for the election of a new president and the formation of a new national unity government, which was sworn in on July 11, 2008. The government's principal task is now to prepare for the legislative elections of May 2009. In parallel, the country's main political forces have resumed their national dialogue under the auspices of President Suleiman, with a view to finding a solution to the contentious political issues that have fueled internal strife and dissent.

The 2007 program supported by Emergency Post-Conflict Assistance (EPCA) was concluded successfully and was instrumental in strengthening internal financial discipline and mobilizing external financial support, although less than envisaged under Paris III. Since the 2006 conflict, Lebanon has made progress toward fiscal consolidation and has shored up its external position despite difficult circumstances. The primary fiscal balance (excluding grants) shifted into surplus in 2007, lowering the government debt-to-GDP ratio beyond what we envisaged under EPCA. Fiscal developments in the first seven months of 2008 have been favorable. In response to the heightened political uncertainty and the international financial turmoil, the policies of the Banque du Liban (BdL) ensured a steady increase in international reserves, which grew by $5.2 billion to $16.7 billion during the first eight months of 2008. The effective shielding of the domestic financial sector from exposure to international financial risks, also helped by prudent regulation, contributed to strengthening confidence in the exchange rate peg and the financial system, as reflected by the marked acceleration of deposit growth and dedollarization of deposits. As a consequence, the government was able to finance its domestic and foreign exchange currency needs largely from the market.

While macroeconomic developments have been favorable, Lebanon has not yet fully recovered from the 2006 conflict and the following stalemate. The absence of a functioning parliament and vacancies in key ministries created a substantial legislative backlog and the reconstruction and reform efforts did not progress as envisaged, also because of security issues. Finally, Lebanon will need considerable external support in 2008–09 to reinforce our balance of payments position—which has been adversely affected by the conflict and by the rise in food and energy prices—and to finance the reconstruction effort.

The government's policy statement to parliament includes an explicit commitment to the Paris III reform objectives and restates the government's intention of working closely with the IMF toward the implementation of these objectives. In this text, we hereby request continued IMF support in the form of a second drawing under the Fund's EPCA policy, in an amount equivalent to SDR 25.375 million, or 12.5 percent of quota. In support of this request, and as described in the attached tables, the government and the BdL have selected key fiscal and financial indicators and structural measures that they intend to monitor closely and report on during the period December 2008–June 2009.

Our 2008–09 program aims at addressing Lebanon's main vulnerabilities, chief among them the very high level of public indebtedness and the large external financing needs. We expect tourism and strong domestic demand to boost GDP growth to at least 6 percent in 2008 and 5 percent in 2009. The surge in consumer prices in 2008 reflects the increase of international commodity prices and the dollar weakness, and, as the impact of these factors wanes, we expect inflation to decline in 2009. Against this background, macroeconomic policies in 2008–09 will be geared toward safeguarding our achievements of 2007 and strengthening our international reserve buffer. The government will also introduce key measures from its medium-term reform agenda, including the privatization of the telecom sector and the reform of the energy sector.

In addition to fiscal consolidation efforts, the government has also taken steps to alleviate the impact of higher food prices on the poor. The government has introduced cash transfers for public school students starting this school year, and reduced customs duties on 28 selected food items in May 2008. More broadly, the government is also working with the World Bank to strengthen its social safety net. In addition, the government approved, with retroactive effect as of May 2008, an increase of public sector wages, public pensions, and the private sector monthly minimum wage, with the aim to preserve the purchasing power of the population. Public sector wages and pensions had remained stagnant since 1998, and the minimum wage had not been increased since 1996. The increase in the minimum wage was negotiated with the social partners and, while substantial, we expect that the private sector will be able to absorb it without undue pressures, partly because many private firms have already increased salaries over the past few years. With prices in Lebanon largely being determined by international developments, we also expect that the second round inflation effect from wage increases will be moderate.

We intend to achieve a further reduction in the government debt-to-GDP ratio. In 2008, the government aims at maintaining a primary surplus of the central government (excluding grants), despite mounting EdL transfers and the budgetary cost of the new social measures. In 2009, the government plans to continue fiscal consolidation through the following measures: (i) increase in the withholding tax on interest income from 5 to 7 percent; (ii) application of rental charges related to seashore real estate; (iii) elimination of the VAT law provision which allows for a refund on some exempted activities; (iv) increase of capital gains tax on revaluation of assets by companies from 1.5 to 2 percent; (v) rationalization of subsidies; and (vi) reduction of transfers to EdL, mainly by adopting a new tariff structure. In addition, the government will consider reforming the determination of regulated profit margins for fuel importers, which would allow to increase the gasoline excise without affecting retail prices.

On current trends, continued strong deposit inflows in the rest of 2008 and in 2009 should allow the government to meet its financing needs from the market and avoid relying on BdL borrowing to the extent possible. While the government expects to continue meeting its financing needs in local currency at current interest rates, it stands ready to adjust rates on Treasury bills in line with market conditions. We expect that parliament will soon raise the ceiling on contracting foreign currency debt, enabling the government to meet all of its remaining foreign currency financing needs ($6 billion during 2009) in the market. In the second half of 2009, the government will use the proceeds from the expected sale of the telecom companies to reduce, as envisaged under the law, foreign exchange and domestic currency debt held by the private sector and the BdL, which will help increase international reserves.

The exchange rate peg to the U.S. dollar has been key to maintaining financial stability and remains appropriate. In this context, our objective is to further strengthen our gross international reserves position. So far, Lebanon has remained relatively insulated from the ongoing global financial crisis, as banks are severely restricted from entering positions in derivative products. Nevertheless, we have closely followed developments in international financial markets and their possible impact on Lebanon, including via the Gulf countries, to which Lebanon has been increasingly linked. To limit risks, the Banking Control Commission is stepping up controls on allocation and quality of banks' assets with foreign banks. We will also stand ready to adjust interest rates if needed.

Reforms to strengthen fiscal management are ongoing. On the revenue side, the government will finalize the remaining steps for the introduction of the global income tax by (i) adopting the revision of the tax procedure code; (ii) submitting the GIT law to parliament by end-March 2009; and (iii) eventually merging taxpayer services, auditing and collection for VAT and income tax administration. At present, the government is also reviewing procedures related to domestic VAT refund claims, which have recently increased by more than expected. Similarly, the government is improving the administration of the built-property tax and stamp duties, which we envisage to continue yielding additional revenue gains. On the public financial management side, the government expects parliament to approve the 2009 budget, by end-year, and the Treasury Single Account, which we want to make operational by end-June 2009. In addition, parliament has just approved the law establishing the public debt directorate.

EdL's losses remain a large drain on budget resources. Transfers in 2008 are estimated at $1.5 billion or 5.2 percent of GDP. The government will contain losses by revising electricity tariffs with a yield of about $240 million. Further savings will be obtained in 2009 as production is switched from oil to less expensive natural gas at the Beddawi power plant starting in January 2009, lowering fuel costs by $100 million. In parallel, the government plans to enhance the service quality in the power sector (e.g., through the installation of remote meters).

To strengthen Lebanon's growth potential, the government intends to resume the privatization of the telecom mobile companies, which was interrupted by the May conflict. It also intends to gather broad parliamentary support for the modalities of the telecom sale and issue the request for applications in March 2009 with the objective to complete the sale by June 2009.

The government intends to restore actuarial balance of the National Social Security Funds (NSSF) to limit demands on the budget. Losses in the medical and family allowance branches constitute a large and open-ended drain on public finances. Initial steps to address these problems have been taken through auditing and the full computerization of the database of users. The government is discussing plans to reform access to medical care with the World Bank, and is considering the need to revise contribution rates and the income ceiling for calculating insurance premia. With the help of the World Bank, it is also carrying out an actuarial study of the NSSF liabilities.

The BdL is taking steps to strengthen its operating procedures. In particular, the BdL is working toward full adoption of the International Financial Reporting Standards, and will adopt an implementation roadmap by end-2008. In addition, the BdL will establish a formal investment committee, draft formal guidelines for foreign reserve management, and adopt formal policies for the selection, appointment, and rotation of its external auditors. It will also sharpen its focus on core activities by starting the privatization of shares in the BdL's non-financial assets, notably Middle Eastern Airlines and the investment company Intra.

In the context of the program, we remain committed to an open trade and exchange system, and are taking steps to become a full member of the World Trade Organization. We will avoid imposing restrictions on payments and transfers for international transactions, introducing or intensifying trade restrictions for balance of payments purposes, or resorting to multiple currency practices.

A satisfactory implementation of our 2008 program under EPCA, a further strengthening of capacity, including through technical assistance from the Fund, and an improvement in economic and social conditions should allow the government to move to a more ambitious part of its reform program in the second half of 2009. At that stage, we intend to explore the possibility of further Fund support for our program through a Stand-By Arrangement.

The Government of Lebanon and the BdL will provide the IMF with any available information it may request on the implementation of the program, consistent with the understandings reflected in the attached Technical Memorandum of Understanding, and will consult with Fund staff regarding any revision to the policies described above.

Sincerely yours,

/s/	/s/
Mohamad Chatah	Riad T. Salamé
Minister of Finance	Governor
	Banque du Liban

Attachments to LOI

I. Quantitative Indicative Targets, December 2008–June 2009
II. Monitorable Actions, December 2008–June 2009
III. Technical Memorandum of Understanding

Attachment I. Lebanon: Quantitative Indicative Targets Under the Program Supported by Emergency Post-Conflict Assistance, December 2008–June 2009
(In billions of Lebanese pounds unless otherwise indicated; end-of-period) 1/

	2008	2009			
	Dec	Mar	Jun	Sept	Dec
	Prog	Prog	Prog	Proj	Proj
I. Gross reserves of the Banque du Liban (stocks) 2/	24,718	24,867	25,436	27,818	29,049
II. Primary balance of the government, before grants (cumulative flows)	79	-346	314	157	283
III. Government net borrowing from the Banque du Liban (stocks)	5,905	5,700	5,700	4,469	4,388
IV. Accumulation of government gross arrears (cumulative flows, continuous)	0	0	0	0	0
V. Accumulation of external arrears by the government and the Banque du Liban (cumulative flows, continuous)	0	0	0	0	0
Memorandum items:					
Outstanding letters of credit contracted by Electricité du Liban (stock, millions of U.S. dollars)	1,046	766	733	777	777
Disbursements of official grants and loans to government (cumulative flows)	1,304	222	365	822	1,431
Banque du Liban's holdings of Republic of Lebanon Eurobonds (stock)	1,187	1,187	1,187	1,187	1,187
Disbursements of grants to the government (cumulative flows)	522	39	113	186	237
Of which: disbursements of project grants (cumulative flows)	242	39	56	73	90
Transfers of gold valuation gains from Banque du Liban to government (cumulative flows)	0	0	0	0	0
Projection of revenue from companies slated for privatization (cumulative flows)	...	415	830	909	988

Source: Lebanese authorities.

1/ At program (end-December 2007) exchange rates.
2/ In millions of U.S. dollars. Defined as Banque du Liban's foreign exchange deposits abroad, foreign exchange holdings (including SDRs), gold and holdings of liquid foreign currency-denominated securities, less encumbered foreign assets.
3/ Defined by currency (not by residency), as official foreign currency assets, including gold and SDR, less foreign currency liabilities.
Liabilities include the exceptional deposits by foreign governments at the BdL, but exclude liabilities to the government of Lebanon and other official creditors.

Attachment II. Lebanon: Monitorable Actions, December 2008–June 2009

Measure	Target Date	Implementation
Fiscal		
Submit to parliament the Global Income Tax draft law	End-March 2009	
Establish a Treasury Single Account	End-June 2009	
Banque du Liban		
Establish an investment committee and draft formal guidelines for foreign reserve management.	End-December 2008	
Adopt formal policies for the selection, appointment, and rotation of the BdL's external auditors.	End-June 2009	
Power sector		
Revise electricity tariff structure consistent with program objectives.	End-December 2008	
Privatization		
Issue a Request for Application in participating in the process of acquiring the licenses and assets of the two mobile telephone companies (MIC1 and MIC2).	End-March 2009	

ATTACHMENT III. LEBANON: TECHNICAL MEMORANDUM OF UNDERSTANDING

I. INTRODUCTION

1. This memorandum sets out the commitments of the Lebanese authorities for the period to June 30, 2009 relating to the Emergency Post-Conflict Assistance (EPCA) requested in the Letter of Intent. Section II defines the indicative quantitative targets and relative adjustors reported in Attachment I, and Section III establishes the content and frequency of the data to be provided to IMF staff for monitoring the program.

II. QUANTITATIVE INDICATIVE TARGETS

A. Definitions and Concepts

2. **Test dates.** Quantitative indicative targets are set quarterly starting December 31, 2008 through June 30, 2009, and are to be met at the end of each quarter unless otherwise specified.

3. **Government.** For the purposes of the program, "government" includes the central government, the Council for Development and Reconstruction (CDR), and the grant-financed operations of the Higher Relief Commission (HRC). It excludes all other agencies not specifically listed, including, but not limited to, the following: Electricité du Liban (EDL), municipalities, the Régie, and NSSF. The government balance is defined on a modified cash basis to include foreign-financed expenditure of the CDR, all operations of the HRC, any treasury advance, and arrears (as defined below). Unless otherwise specified, fiscal data are compiled according to the Government Finance Statistics (GFS) manual 1986.

4. **Project grants** are defined as those grants to the government (as defined above) linked to specific project financing, and do not include grants received for general budgetary support. **Budgetary grants** are grants received for general budgetary support, including grants in support of specific budget lines and grants to be applied to debt reduction. These concepts include—but are not limited to—conflict-related and Paris III grants.

5. **Arrears.** Domestic arrears are defined as government expenditures that have not been paid within 90 days of a payment order being issued. External arrears are defined as overdue payments (principal or interest) on external debt contracted or guaranteed by the government or the Banque du Liban (BdL).

6. **Valuation changes**. All data are expressed in Lebanese pounds (LL), unless otherwise indicated. To exclude foreign exchange valuation effects: (i) gold will be valued at the December 31, 2007 price of US$ 828.4 per fine troy ounce; (ii) the U.S. dollar value of foreign assets and liabilities will be converted into LL at the exchange rate of US$1 = LL 1507.5; and (iii) all foreign assets and liabilities denominated in currencies other

than the U.S. dollar will be converted into U.S. dollars and/or LL at their respective exchange rates prevailing as of December 31, 2007, as published in the IFS.

B. Indicative Targets

7. **Target 1**. For the purpose of the program, the **Gross Reserves (GR) of the BdL** (floor, U.S. dollars) are defined as BdL's callable foreign exchange deposits abroad, foreign exchange holdings (including SDR), gold, Eurobonds issued by the Republic of Lebanon (henceforth "Eurobonds"), and holdings of investment grade liquid foreign currency-denominated securities. Encumbered assets will be excluded from GR. The floor for GR will be adjusted (i) downward (upward) for the full amount of any shortfall (excess) in disbursements of official grants and loans to the government relative to those projected in the program; and (ii) downward (upward) for the full amount of sale (purchase) by the BdL of Eurobonds relative to the baseline projection of BdL holdings.

8. **Target 2**. **The primary balance of the government, before grants** (floor) is defined as the **overall fiscal balance on a modified cash basis** plus interest payments minus grants received. Securitization proceeds will not be counted as above-the-line revenue. For the purpose of the program, any transfer from the BdL not related to realized profits (including from gold revaluation) will be considered to be capital (below the line) transfers and therefore excluded from the primary balance.

9. **Monitoring of the primary balance before grants**, for the purpose of the program, will be carried out from the financing side. The **overall balance on a modified cash basis** is calculated as the negative of the sum of the following: (i) the change in net BdL claims on the central government; (ii) the change in net claims on the central government by the rest of the banking system; (iii) the change in net claims on the central government by public sector institutions; (iv) the change in net claims on the central government by other creditors; (v) the net change in government arrears; (vi) proceeds from exceptional financing (items such as privatization revenues, gold or foreign exchange revaluation proceeds, and securitization proceeds); minus (vii) the net change in the CDR and HRC accounts at the BdL. Budgetary and project grants to the government (as defined above) will also be measured through BdL. All changes will be calculated as the difference between end-period stocks, net of any valuation changes resulting from currency movements and changes in accrued interest reflected in the gross debt stock that are reported separately by instrument. For the purpose of the program, interest payments will be measured on a cash basis.

10. **The floor on the primary balance before grants will be adjusted** (i) downward (upward) for higher (lower) than projected project grant disbursements and (ii) downward for the net amount of the revenues lost due to privatization pro-rated on the basis of the revenue projections specified in Attachment I.

11. **Target 3**. **Net government borrowing from the BdL** (ceiling) is defined as the difference between the BdL claims on the government, in domestic and foreign currency, including all holdings of government securities; and the deposits in domestic and foreign currency of the government at the BdL. For the purpose of the program, any transfers from the BdL other than realized profits (e.g., from securitization of future profits) will be treated as net government borrowing from the BdL. The ceiling for net government borrowing from the BdL will be adjusted: (i) downward for the full amount of any excess in transfers from the BdL's gold revaluation relative to those projected under the program; and (ii) downward (upward) for higher (lower) than projected budgetary grant disbursements.

12. **Target 4. New gross domestic arrears of the government** (continuous ceiling) are defined as the change in gross domestic arrears arising after September 30, 2008. "Gross" arrears indicates that the taxes and contributions owed to the government are not netted out of the arrears.

13. **Target 5. New external arrears of the government and the BdL** (continuous ceiling) are defined as the change in external arrears after September 30, 2008.

III. Reporting Requirements

14. To permit the monitoring of developments under the program, and as part of and in addition to the regularly reported data, the government will provide to the office of the Resident Representative of the IMF in Beirut the information specified below:

- Gross Reserves and components (monthly).
- BdL's net foreign exchange position, defined, on the basis of currency, as official foreign currency assets, including gold and SDRs, less foreign exchange liabilities. These are defined to include the exceptional deposits by foreign government at the BdL and IMF purchases, but exclude liabilities to the government of Lebanon and other official creditors.
- Weekly BdL gross foreign exchange market purchases and sales.
- Monetary aggregates, including currency in circulation, M3 and non-resident deposits (weekly).
- BdL balance sheet, including a break down of all assets and liabilities by instrument, by currency and remaining time to maturity (monthly).
- Data on outstanding BdL instruments by type (coupon or discount), currency, amounts, remaining maturity, and yield (monthly). Data on auctions or sale of

CDs by the BdL, including amount, maturity, yield, and any premium paid (monthly).

- BdL income statement on an accrual basis (quarterly).
- Commercial banks' balance sheet (monthly).
- On a checks-issued basis, summary budget operations, revenues, expenditures (including net advances), net domestic financing, balances in the government accounts with the BdL and commercial banks (including privatization accounts), the receipt and use of privatization proceeds (monthly), monthly cash data on foreign-financed capital expenditures, and relief and reconstruction expenditures.
- Government debt and financing: Government debt statistics as per the usual reporting format provided by the BdL, including BdL lending to EdL. Government interest expenditure on a cash basis by debt instrument and currency. Grants received by government (including CDR and HRC), of which project-related grants. Privatization proceeds. Valuation changes to the outstanding stock of debt due to currency fluctuations. Changes in the outstanding stock of accrued interest that is reflected in the debt stock. The new stock of domestic and external arrears. Any put or call options, collateral guarantees, warrants or similar derivative arrangements entered into by the government or the BdL. On-lending operations of the government. Securitization of future payment flows to the government or resulting in future payment flows to or from the government. Amortization payments by debt instrument.
- Outstanding debt contracted by EdL and guaranteed by the government, including letters of credit entered into, with breakdown of principal and interest (monthly).
- The annual accounts of the NSSF, including the disaggregated accounts of each of the three NSSF funds and any contractual arrears (as defined above) from the central government on NSSF contributions.
- Foreign assistance received (separating grants from loans and budget support from project financing), and full terms of the newly-contracted but not disbursed loans (monthly).
- Balance of payments (current, capital, and financial accounts) (monthly);

- List of short-, medium-, and long-term public or publicly guaranteed external loans contracted during each quarter; identifying, for each loan: the creditor, the borrower, the amount and currency, the maturity and grace period, and interest rate arrangements (quarterly);

- Revision of electricity tariff structure and resulting savings for EdL.

15. Weekly data and data on the central bank CD auctions should be sent to the Resident Representative's office in Beirut with a lag of no more than one week. Monthly and quarterly data should be sent within a period of no more than four weeks, except for balance of payments data, which should be sent within a period of no more than eleven weeks. Any revisions to previously reported data should be communicated to the Resident Representative's office in the context of the regular updates.

16. The authorities will prepare and send to the Resident Representative's office reports, with appropriate documentation, indicating progress achieved, explaining any deviations relative to the initial targets, and specifying expected revised completion dates of the monitorable actions specified in Section III.

17. Details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as new legislation on decrees) will be sent in a timely manner to the Resident Representative's office.

INTERNATIONAL MONETARY FUND

Lebanon

Use of Fund Resources—Request for Emergency Post-Conflict Assistance—Informational Annex

Prepared by Middle East and Central Asia Department

November 3, 2008

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Annex I. Lebanon: Fund Relations

(As of September 30, 2008)

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

II. **General Resources Account:**

	SDR Million	Percent of Quota
Quota	203.00	100.00
Fund holdings of currency	234.92	115.72
Reserve position in Fund	18.83	9.28

III. **SDR Department:**

	SDR Million	Percent of Allocation
Net cumulative allocation	4.39	100.00
Holdings	22.26	506.72

IV. **Outstanding Purchases and Loans:**

	SDR Million	Percent of Quota
Post-Conflict Emergency Assistance	50.75	25.00

V. **Latest Financial Arrangements:** None

VI. **Projected Obligations to Fund:**
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2008	2009	2010	2011	2012
Principal			12.69	25.38	12.69
Charges/Interest	0.50	1.85	1.76	0.99	0.15
Total	**0.50**	**1.85**	**14.45**	**26.36**	**12.84**

VII. **Implementation of HIPC Initiative:** Not Applicable

VIII. **Implementation of Multilateral Debt Relief Initiative (MDRI):** Not Applicable

IX. **Safeguards Assessment**:

The Fund completed a safeguards assessment of the Banque du Liban in March. The report suggested areas for enhancing the BdL's financial reporting, audit, and control procedures, and the authorities have outlined steps to follow up on these recommendations. The report has also suggested an update of the central bank law. An updated safeguards assessment would be required to be conducted within the EPCA program period.

Nonfinancial Relations

X. 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.

XI. Article IV Consultation

The 2007 Article IV consultation was concluded by the Executive Board on October 3, 2007 (IMF Country Report No. 07/382).

XII. Financial Sector Assessment Program

Lebanon participated in the Financial Sector Assessment Program in 1999, and the related report was presented to the Executive Board at the time of the Article IV consultation. A Financial System Stability Assessment update was conducted in 2001, and the related report similarly presented to the Executive Board at the time of the Article IV consultation.

XIII. Technical Assistance

Fiscal area—FAD has provided advice on introducing the VAT, reforming customs tariffs and income taxes, strengthening tax and customs administration, improving public expenditure management, and consolidating fiscal accounts. A fiscal ROSC report was published in May 2005. Considerable needs remain in tax policy, tax administration, budget preparation, fiscal management, and public accounting and reporting. Technical assistance missions in 2005 primarily dealt with (i) the consolidation of fiscal accounts, and (ii) public liquidity management. In October 2006, a multi-sector mission provided advice on fiscal reform priorities after the conflict with Israel. In November 2007, a FAD mission provided advice for reforming subsidies and restoring gasoline excises. During 2007 and early 2008, FAD and METAC also provided targeted follow-up support to ongoing initiatives in both tax administration and public financial management (i.e., tax audit program or cash management).

Financial area—Over the past few years, the now Monetary and Capital Markets Department has provided technical assistance in the areas of the payments system and vulnerability indicators. The related missions undertook an assessment of compliance with Core Principles for Systemically Important Payments Systems, advised on developing 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 develop capacity to monitor systemic financial sector vulnerabilities. Progress in implementing IMF recommendations has been limited. In 2006, a mission conducted an assessment of banking sector soundness, including a stress-test exercise, with a view to developing a strategy for banking sector consolidation.

Statistical area—The Statistics Department has provided technical assistance in national accounts, price and balance of payments statistics. There is no official producer price index (PPI); and balance of payments data remain incomplete. During 2007, several missions on the consumer price index (CPI) were undertaken through the Middle East Technical Assistance Center (METAC). As a result, in March 2008 a new monthly country-wide CPI was launched. Technical assistance on national accounts statistics will continue through 2008. In March 2008, a METAC mission provided technical assistance on balance of payments and international investment position statistics. Nevertheless, statistical gaps remain substantial, particularly in the areas of national accounts, price statistics, and the balance of payments. Stronger political commitment to filling these gaps is needed in order for further technical assistance to be effective.

Annex II. Lebanon: Relations with the World Bank Group

The World Bank (Bank) presented an Interim Strategy Note (ISN) covering fiscal years 2007–08 to the Board in August 2007. Anchored in the Lebanon's Paris III reform program, the ISN aims at providing a transitional framework of technical and financial assistance. The ISN emphasizes the medium-term public expenditure and social reform agenda (particularly energy and social protection reforms) to support quick and demonstrable reform actions given their importance for: (i) commencing a transition to fiscal sustainability over the medium term; (ii) garnering support for the government's growth and social reform agenda; and (iii) galvanizing donors to disburse their Paris III pledges to underpin reform implementation. The key pillars of the ISN are: (i) governance for economic management and to support growth; (ii) the development of human capital and the mitigation of the poverty effects of transition; and (iii) resource and environmental management. The ISN foresaw up to $175 million in development policy-based lending over its implementation period, subject to progress in improving the debt outlook and progress in implementation in critical elements of the Paris III reform program.

The ISN builds on the analytical and advisory activities that were carried out by the Bank in close collaboration with the government and key stakeholders in Lebanon following the summer-2006 hostilities. These include the Economic and Social Impact Assessment (ESIA) that analyzed macroeconomic and sector development challenges in the aftermath of the hostilities and outlined sector reform priorities.

The active portfolio consists of five IBRD-financed projects focusing on education, infrastructure, transport and water, for a total net commitment of US$264.58 million of which US$190.75 million has been disbursed to-date.[6] In addition, a Reform Implementation Development Policy Loan (RIDPL) for US$100 million was approved in August 2007 to advance key elements of the initial reform phase under the Government of Lebanon's economic reform program, with a particular emphasis on energy, business environment and social services.

The Bank's investment support is complemented by grant financing provided from the Trust Fund for Lebanon. In order to assist Lebanon in a time of exceptional need, the Bank's Board of Directors approved the creation of a Trust Fund for Lebanon (TFL) in September 2006, with a transfer of US$70 million from IBRD surplus. The TFL is assisting in municipal and water infrastructure rehabilitation and supporting reform implementation in the energy and social sectors. In addition, US$15 million is being used by IFC to scale up its Risk Sharing

[6] As of August 31, 2008.

Facility to Lebanese banks by providing a first loss grant (US$14 million) and to provide technical assistance (US$1 million) to expand the coverage of Kafalat, the Lebanese SME guarantee agency.

Technical assistance is provided under two ongoing TFL grants. The ongoing *Emergency Social Protection Implementation Support Project* (ESPISP I) is designed to accelerate and improve the quality of the implementation of the package of social sector reforms presented by Lebanon at the Paris III donor conference in the areas of social insurance, safety nets, and health expenditures. The *Emergency Power Sector Reform Capacity Reinforcement Project* is designed to accelerate the implementation of reforms and restructuring of Lebanese Power Company (EdL) by enhancing the capacity in the Ministry of Energy and Water, the Electricity utility and a multi-Ministry Higher Level Committee overseeing the reform process and in particular the restructuring of EdL, both in the short and the longer term. Two additional TFL grants will finance respectively i) an *Emergency Fiscal Management Reform Implementation Support Project (EFMISP)* to help strengthen public expenditure, debt and financial management capacity at the Ministry of Finance (grant negotiated in July 2008 and awaiting final approval), and ii) a *Second Emergency Social Protection Implementation Support Project (ESPISP II)* to build on the success of ESPISP I and to maintain the momentum for reform in the social sectors (grant negotiated in September 2008 and awaiting final approval).

Further to the TFL, Lebanon has been able to access a variety of existing Bank-administered trust funds, including institutional development and post conflict grants. The current portfolio includes 5 grants for a total of $2.3 million. These grants focus on building the institutional capacity of key institutions.

Portfolio performance showed considerable improvements following the hostilities, as a result of a concerted effort by project management units, supported by Bank staff. Overall performance of the portfolio both from the perspective of implementation and development impact is good. All, but one, projects are performing satisfactorily and the average disbursement ratio over the last two years stands at about 25 percent, well above the regional average of 15 percent. Three projects, however, remain at risk of not achieving their development objectives. The Bank will engage in a participatory CPPR to identify implementation bottlenecks and establish an action plan to ensure effective and satisfactory completion of the projects.

IFC's activities

IFC continues to execute its post-conflict program while seeking additional opportunities to extend its contribution to private sector development in Lebanon. IFC exceeded its Paris

III/Reconstruction pledge of US$250–275 million having committed $315 million. In FY08, IFC added US$212 million to the portfolio, including trade finance. An additional project totaling US$12 million is in final negotiations at present. In total, more than $160 million has been channeled to local banks to lend to smaller businesses while IFC supported $120 million on trade flows through trade finance guarantees to Lebanese banks since the end of the conflict. In the real sector, IFC has concluded 2 equity investments with one in appraisal over last 18 months, demonstrating responsiveness to GoL's request that IFC do more equity and look beyond the banking sector.

IFC is delivering a comprehensive technical assistance program with 8 technical assistance activities underway or having been completed since the end of the conflict, addressing some of the underlying issues of investment climate in Lebanon. IFC has completed Phase 1 of the Deair Amaar and new IPP project, and has delivered the proposed transaction structure report to the Government. Specific ongoing technical assistance activities include:

- Assisting Societe Financiere du Liban, a private bank-owned implementing agency, to assess the potential for establishing a private credit bureau.
- Advising Kafalat, an SME guarantee agency, to help it improve service, move into new markets, and expand capacity. This is the second project with Kafalat to expand access to finance to the SME sector.
- Support to the Lebanon Transparency Association to enable it to champion stronger corporate governance.
- Assistance to simplify the business registration process.

In FY09 and beyond, emphasis will be on equity investments in the retail and manufacturing sectors, particularly those companies seeking regional growth, as well as in select investments in the financial sector. IFC's technical assistance will continue to focus on long-term reforms, removal of obstacles for growth of MSMEs, and encouragement of public-private partnerships and privatizations.

FINANCIAL RELATIONS WITH THE WORLD BANK GROUP

I. Status of World Bank Group Operations

As of September 29, 2008
(In millions of U.S. dollars)

Closed Projects	**17**

IBRD/IDA	
Total Disbursed (Active)	190.75
of which has been repaid	*30.20*
Total Disbursed (Closed)	690.13
of which has been repaid	*524.17*
Total Disbursed (Active + Closed)	880.88
of which has been repaid	*554.37*
Total Undisbursed (Active)	70.08
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	70.08

Active Projects

		Last ISR		**Supervision Amounts (US$ millions)**				
Project ID	**Project Name**	**DO**	**IP**	**FY**	**IBRD**	**Grant**	**Cancel.**	**Undisb.**
Status of Bank Group Activities (B8)								
Port. Stat.	Active							
Country	Lebanese Republic							
Approval FY								
Project ID (SPN)								
P103885	Bekaa Emergency Water Supply Project	MS	MS	2007		15		14.7
P074042	Ba'albeck Water and Wastewater	MS	MU	2002	43.5			19.1
P050529	Cultural Heritage and Urban Dev.	S	MS	2003	31.5			16.4
P045174	Education Development Project	S	S	2000	56.6		12.00	8.4
P104774	Emergency Power Reform Capacity Reinfor	S	S	2007		5		3.3
P050544	First Municipal Infrastructure	S	S	2000	80			8.2
P103875	Municipal Infrastructure	S	S	2007		30		23.8
P034038	Urban Transport Dev. Project	S	S	2002	65			18.0
P111849	Lebanon ESPISP 2	N/A	N/A	2009		6		
					276.6	**56**	**12.0**	**111.9**

II. Status of International Finance Corporation Operations

Statement of IFC's Held and Disbursed Portfolio

As of September 29, 2008

(In millions of U.S. dollars)

Current IFC Portfolio				
Debt ($m)	Equity ($m)	Quasi Equity ($m)	Total ($m)	
187.7	6.5	15	209	
Investment Business -- Top sectors and Clients			TA Business --	
Sector 1	Financial Markets (US$188 m)		Sector 1	Corporate Governance
Sector 2	Manufacturing & Services (US$35 m)		Sector 2	Business Regulatory Reform
Sector 3	Health & Education (US$7.8 m)		Sector 3	PPP Projects
Top client	Fransabank (Finance & Insurance)			
Ranking in Doing Business Report: 99				

Annex III. Lebanon: Statistical Issues

Data provision has serious shortcomings that significantly hamper surveillance. Some gaps in the coverage of macroeconomic statistics have widened, owing to the effects of the 2006 conflict. In particular, there are serious shortcomings in the compilation of the national accounts, employment, general government and the rest of the nonfinancial public sector, international reserves template, and balance of payments. While Lebanon began participating in the GDDS in January 2003, the metadata and the plans for improving the real and fiscal statistics have not been updated in line with Lebanon's commitments under the GDDS.

The national accounts data are weak. Despite of the technical assistance from the French National Institute of Statistics and Economic Studies (July 2005), the Central Administration of Statistics (CAS) still does not have the capacity to produce national accounts statistics in line with accepted international standards. STA is assisting the authorities to produce national accounts estimates based on a comprehensive data collection program and the 2004 economic survey. Lebanon does not report the national accounts data for publication in the *International Financial Statistics.*

Since May 2008, the CAS compiles and disseminates a new monthly Consumer Price Index (CPI) following international accepted methodology. The CPI is disseminated within three weeks after the end of the reference month. Sub-indices according to the twelve main categories of the Classification of Individual Consumption by Purpose are also disseminated. The new weights are based on the Household Budget Survey 2004–05, and the geographical coverage is expanded to include all areas in Lebanon (the previous CAS index was based on prices collected from Beirut and its suburbs). Lebanon does not report the consumer price index data for publication in the *International Financial Statistics.*

The fiscal statistics are weak. Published monthly data on the central government budgetary accounts are not comprehensive, omit certain transfers[7] and financing data, omit foreign-financed capital expenditure, and do not cover arrears. In addition, there are no data on the widespread quasi-fiscal activities conducted by public corporations. Certain (treasury) spending is only identified ex-post, and its economic classification with a lag. However, these items are provided to the staff in the context of surveillance activities. Cash-based annual government finance statistics limited to the budgetary central government are published in the *Government Finance Statistics Yearbook* (GFSY). Lebanon reports some annual fiscal data for publication in the *International Financial Statistics* with a lag of up to 4-years.

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[7] 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).

The 2002 GDDS/multisector mission found limited institutional coverage for the central bank and other depository corporations. Recently questions also have emerged about the central bank's statistical treatment of repos. On the basis of available data and supporting information, it appears that some Eurobond repo transactions undertaken by the central bank in mid-2005 were not recorded in its balance sheet until end-2006. Lebanon reports monthly monetary and financial statistics for publication in the *International Finance Statistics* with a lag of three months.

Lebanon participated in the Coordinated Compilation Exercise for Financial Soundness Indicators (FSIs). Data and metadata on a benchmark set of indicators of the soundness of the financial system (for year-end 2005) are posted on the IMF website (http://dsbb.imf.org/Applications/web/fsi/fsicountrycategorylist/?strcode=LBN). Lebanon attached high priority to the compilation of FSIs and has produced a very comprehensive set of indicators.

The balance of payments statistics (BOP) 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 METAC technical assistance mission in March 2008 noted that the coverage of foreign direct investment (FDI) transactions remains limited, and that no progress was made in advancing work on an FDI survey, as recommended by a previous METAC mission in 2005. The lack of effective interagency cooperation, and staff constraints at both BDL and CAS were among the main factors impeding progress. The 2008 mission provided technical advice on methodological aspects of some components of the balance of payments, including on insurance services, coverage and valuation adjustments on imports, split of grants in current and capital transfers, and derivation of transactions from stocks. The estimation procedure for workers' remittances was assessed and proposals were made to improve the estimates.

The source data for balance of payments has improved with the implementation in 2003 of the International Transactions Reporting Systems (ITRS). However, there have been significant revisions in financial account data and the flows in the investment income-portfolio investment data (debit) for 2003 remained very large. Data on trade credits are not compiled. The official reserve assets are currently compiled on a gross basis consistent with the international guidelines, and the authorities have made progress in improving the periodicity of the balance of payments data, and in disseminating detailed information on sources and methods, via the BDL's *Annual External Sector Reports*.. Lebanon reports quarterly balance of payment statistics for publication in the *International Financial Statistics* with a lag of up to 1-year.

Lebanon: Table of Common Indicators Required for Surveillance As of October 3, 2008					
	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	06/2008	8/1/2008	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	06/2008	08/2008	M	M	M
Reserve/Base Money	05/2008	7/24/2008	M	M	M
Broad Money	05/2008	7/24/2008	M	M	M
Central Bank Balance Sheet	05/2008	7/24/2008	M	M	M
Consolidated Balance Sheet of the Banking System	05/2008	7/24/2008	M	M	M
Interest Rates[2]	05/2008	8/1/2008	M	M	M
Consumer Price Index	07/2005	09/2005	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	07/2005	09/2005	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	08/2005	09/2005	M	M	M
External Current Account Balance	Q4/2007	06/2008	Q	A	unpublished
Exports and Imports of Goods and Services	Q4/2007	06/2008	M	Q	M
GDP/GNP	2004 (est)	05/2005	A	At the time of mission	A
Gross External Debt	06/2005	09/2005	M	M	M
International Investment Position [6]					

[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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); or Not Available (NA).

Press Release No. 08/295
FOR IMMEDIATE RELEASE
November 19, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$37.6 Million in Emergency Post-Conflict Assistance to Lebanon

The Executive Board of the International Monetary Fund (IMF) has approved an amount equivalent to SDR 25.375 million (about US$ 37.6 million) in Emergency Post-Conflict Assistance (EPCA) to Lebanon in support of the authorities' economic program for 2008–09. The amount approved adds to the SDR 50.75 million (about US$ 76.7 million) in Emergency Post-Conflict Assistance provided to Lebanon in April 2007 (see Press Release No. 07/86).

The IMF's support through EPCA is part of a concerted international effort to provide financial assistance to Lebanon. The IMF supported program aims to further reduce the government debt-to-GDP ratio, build up the international reserve buffer, and start implementation of key reforms.

Following the Executive Board's discussion on Lebanon on November 14, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

"Following the successful completion of their 2007 economic program, which was supported by an EPCA, the authorities have made further progress toward improving Lebanon's public finances and keeping the debt-to-GDP ratio on a downward path. Despite difficult circumstances, the external position has improved significantly, with a steady increase in international reserves under the fixed exchange rate regime. Moreover, the government has been able to finance its domestic and foreign currency needs largely from the market.

"The impact of the global financial crisis on Lebanon has been limited so far. The effective shielding of the domestic financial sector from exposure to international financial risks, helped by prudent regulation and effective supervision, has contributed to strengthening confidence in the exchange rate peg and the financial system, as reflected by the sustained deposit growth and dedollarization of deposits.

"Despite these important achievements, Lebanon is still facing sizeable vulnerabilities, notably a very high level of public indebtedness and large external financing needs. Lebanon's drawing under a follow-up EPCA is intended to support the authorities' economic and financial policies through June 2009. These policies are geared toward making continued progress on fiscal consolidation by further improving the primary surplus, strengthening further the international reserve buffer, and initiating the privatization of the telecom sector and a broader reform of the energy sector, consistent with the authorities' medium-term economic and reform agenda presented at the Paris III conference in January 2007. The 2008–09 economic program aims at achieving a further reduction of the debt-to-GDP ratio. The policy commitment under the EPCA should help the authorities sustain the financial support of the international community. The timely disbursement of the pledges made at the Paris III Conference is instrumental in furthering these objectives," Mr. Portugal said.