INTERNATIONAL MONETARY FUND

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LEBANON

July 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR LEBANON

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Lebanon, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 26, 2014, following discussions that ended on May 7, 2014, 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 June 12, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its June 26, 2014 consideration of the staff report that concluded the Article IV consultation with Lebanon.
- A **Statement by the Executive Director** for Lebanon.

The following document has been or will be separately released.

Selected Issues Paper

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

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LEBANON

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

June 12, 2014

KEY ISSUES

Context: The economy is being severely tested by the Syria crisis. The refugee influx has reached one quarter of the population, fueling already high unemployment and poverty. The political impasse from the presidential elections—following months of negotiations over a new government—adds to the uncertainty. The economy is meanwhile suffering from a broad-based deterioration, with subdued growth and widening fiscal imbalances. Public debt is on the rise. Progress on structural reforms has been limited. On the positive side, deposit inflows have held up and foreign exchange reserves are sizeable; and security conditions have significantly improved, lifting tourism prospects.

Key challenges: There is an urgent need for fiscal adjustment to achieve a sustainable debt reduction, and structural reforms to boost growth and address social inequities.

Key policy recommendations:

- **Fiscal policy**. The immediate priority is to stop the fiscal deterioration and return to primary surpluses, to avoid a possible loss of market confidence and put debt on a sustainable path. The consolidation strategy should minimize the impact of a planned salary increase for the public sector; include broad-based and non-distortionary revenue measures; and rebalance expenditure away from electricity transfers toward capital and social spending, to promote inclusive growth. Passing a budget for 2014 would help anchor confidence. Fiscal management should be strengthened and anchored in a medium-term perspective.
- **Monetary policy**. The Banque du Liban (BdL) should continue to maintain high foreign exchange reserves as a buffer and signal of commitment to macro-financial stability. It should gradually withdraw from T-bill auctions, and adopt a strategy to improve its balance sheet over time.
- **Financial sector.** Capital buffers should be strengthened, and the loan classification and restructuring rules and the AML/CFT regime further enhanced.
- **Structural reforms**. Reforms in the electricity sector and the labor market are imperative to address current competitiveness pressures, lay the foundations for higher-productivity growth, and improve social conditions.
- **Refugee crisis**. Lebanon cannot shoulder the costs of the massive inflow of Syrian refugees alone, and international budget support is needed. Strong government commitment to adjustment and reforms—along with a concerted policy framework to deal with the refugee crisis—would bolster credibility and help mobilize support.

Approved By
Adnan Mazarei (MCD) and Ranil Salgado (SPR)

Discussions took place in Beirut during April 23–May 7, 2014. The staff team comprised Mses. Fedelino (head), Luca, and Nakhle (local economist), Messrs. Alshahrani and Parodi (all MCD), Mr. Jarmuzek (FAD), Mr. Lambert (MCM), and Mr. Takizawa (SPR). Mr. Mazarei (MCD) and Ms. Choueiri (OED) joined some of the policy discussions. The team met Prime Minister Salam, Minister of Finance Khalil, Governor of the Banque du Liban (BdL) Salame, members of parliament, and representatives of the private sector, civil society, academia and the international community. The team held a workshop, jointly with the BdL and the ministry of finance, to discuss background papers covering the impact of the Syria crisis on Lebanon's economy; the development of capital and insurance markets; and options for the design of a fiscal framework for Lebanon's prospective gas and oil resources (to be included in the Selected Issue Papers accompanying this report). The mission issued a concluding statement, published at http://www.imf.org/external/np/ms/2014/050914.htm.

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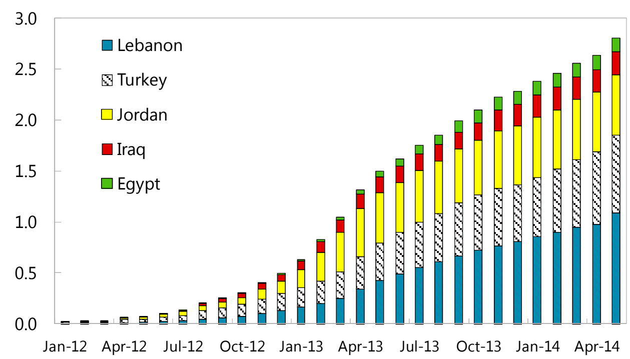
CONTEXT

1. **The crisis in Syria is having a dramatic impact on Lebanon.** It has created unprecedented inflows of refugees, now exceeding one million or about one quarter of Lebanon's population—the largest level among neighboring countries despite Lebanon's smaller size. The refugees have settled throughout the country in more than 1,600 locations; in some areas, the number of refugees is now larger than the host population. Security has been severely affected and local communities and public services have been strained. Unemployment and poverty have increased. The humanitarian support for the refugees has been substantial, though regional and international support to the government and affected host communities has so far been significantly below the authorities' estimated needs.

Syrian Refugees in the Region
(In millions)

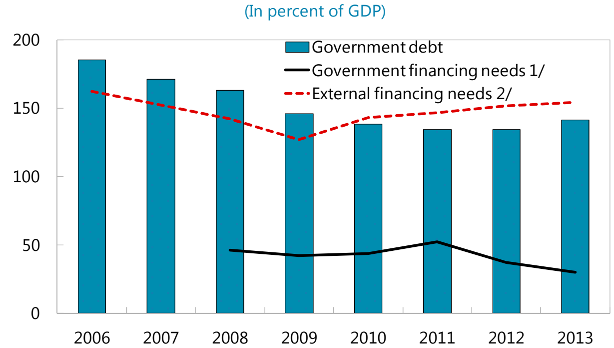


Source: UNHCR.

2. **Political uncertainty remains high.** The Syria crisis has further exacerbated sectarian divisions and complicated domestic politics, resulting in prolonged periods of impasse. It took eleven months to form and ratify (in March) a national unity government. Parliament failed to elect a new president within the constitutional deadline of May 25. This vacuum could last several months before consensus on a new president could be reached; it is currently disrupting efforts to pass legislation—including a much debated salary increase for the public sector, which is causing repeated strikes. Parliamentary elections in November (already postponed from June 2013) add to the uncertainty in 2014.

3. **Vulnerabilities have increased.** Fiscal performance has worsened, and public debt—already one of the highest in the world as a share of GDP—has been on an upward trajectory since 2012. Financing needs remain high. Deposit inflows have held up, thus continuing to feed into commercial banks' foreign exchange deposits with the Banque du Liban (BdL)—the main source of reserves—and to fund the government. The nexus between the sovereign and banks—whereby banks hold most of the government debt and support reserves—continues to provide stability but could amplify shocks.

Debt and Financing Needs
(In percent of GDP)



Sources: Lebanese authorities; and IMF staff estimates.
1/ Central government fiscal deficit plus domestic and external amortization.
2/ Current account deficit plus total external amortization (incl. nonresident deposits).

4. **Lebanon has an opportunity to change course**. It has a history of weathering severe shocks, but unlike in the past, pressures are now multi-faceted and prolonged. The government has shown determination in addressing security conditions, which have significantly improved in recent months. But the same resolve is also needed to tackle widening imbalances and advance reforms to promote stronger, sustainable, and more equitable growth. The 2014 Article IV Consultation provided an opportunity to discuss these themes and identify areas for change.

KEY DEVELOPMENTS OVER THE PAST TWO YEARS

Macroeconomic conditions have suffered a broad-based deterioration since the last Article IV—largely driven by the Syria crisis—though signs of resilience remain.

5. **Economic growth has remained significantly below pre-Syria crisis levels**. Spillovers from the Syria crisis have weighed on the economy—already in a downturn in 2011—through far-reaching real, external, and fiscal channels (Box 1 and Selected Issue Paper). Growth stood at 2.5 percent in 2012, and further decelerated to 1.5 percent in 2013 as traditional drivers of growth—real estate-related activities, construction and tourism—have been affected by increasing uncertainty and deteriorating security (Figure 1). Tourism, in particular, was badly hit by the GCC countries' advisories against travel to Lebanon, in place during the past two years. Some restrictions were lifted in May, reflecting improved security conditions.

6. **Inflation appears contained, though there are measurement issues.** At 4 percent, the average official CPI for the last two years does not show pressures in housing and food prices, which have been particularly affected by additional demand from refugees. However, rent increases were not included until recently in the CPI;[1] while in areas where the refugees have settled, rents have reportedly increased by at least 20 percent last year. Official food inflation has also not increased, as Syria-related disruptions to transit routes have diverted to domestic markets food previously exported to regional markets, thus relieving demand pressures.

7. **The external current account deficit has remained large**, at about 13 percent of GDP in both 2012 and 2013 (Figure 1). The trade balance has remained broadly unchanged as a share of GDP over the two years, as both imports and exports contracted—the latter reflecting a drop in gold exports and lower exports to the region. Similarly, the service balance has been affected by a drop in tourism receipts from the GCC countries, though partly contained by additional spending on services by a growing number of non-resident Syrians.[2] Net current transfers have picked up, reflecting significant humanitarian assistance, as well as lower outflows due to Syrian workers likely supporting relatives that moved to Lebanon.

[1] Housing prices were not regularly surveyed in the past; a survey was conducted in July 2012 after a three-year break. Since January 2014, the Central Administration of Statistics (CAS) has been compiling a new index, which now includes monthly housing price surveys.

[2] Unregistered refugees are treated as non-residents for balance of payments purposes. Reportedly a large number of well-off Syrians have moved to Beirut.

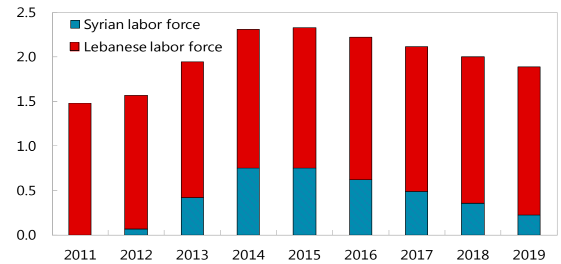
Box 1. Spillovers from the Syria Crisis

The conflict in Syria is overshadowing Lebanon. Over 1 million refugees have arrived to Lebanon since the onset of the conflict. The impact of the crisis has been felt throughout the economy, though quantification is hampered by the lack of reliable data (see Selected Issues Paper).

The Syria crisis is also having a profound and perhaps long-lasting social impact. The World Bank estimates that poverty increased by 4 percentage points in 2013,[1] and the labor supply will rise by about 50 percent by end-2014, with a pronounced impact on unskilled labor, youth and women.

Lebanon could not create sufficient jobs even before the Syria crisis. According to the World Bank, only some 3,800 jobs were generated per year (one for every six new entrants to the labor market) in 2005–09.[1] Reflecting insufficient job opportunities, the unemployment rate stood at 11 percent in 2011, slightly above the MENA average of 10 percent. Like in the MENA region, unemployment was much higher among the youth—over one third of labor force participants aged 15–24 are unemployed. Around half of the labor force was employed in the informal sector.

Labor Force Estimates and Projections, 2011–19
(In millions)

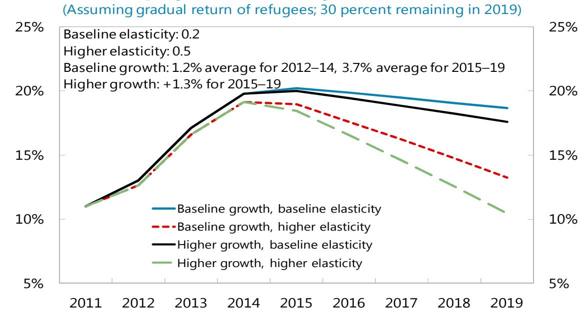


Sources: ILO Economically Active Population, Estimates and Projections (6th edition, October 2011); UNHCR for Syrian refugee population estimates; and IMF staff estimates and projections.

The influx of refugees has deeply impacted the labor market, potentially increasing unemployment to about 20 percent. The unemployment rate among refugees is roughly 30 percent.[2] More than 60 percent of refugees work in the low-skilled sector (agriculture, personal services and construction), and are willing to accept much lower wages than Lebanese workers, putting downward pressure on wages and displacing Lebanese workers.

Illustrative scenarios highlight the challenge of reducing unemployment, even when assuming that the refugees begin to return to Syria as early as 2016 (see Selected Issue Paper).[3] Under the baseline scenario, unemployment would be reduced only marginally, to around 18–19 percent (blue line in the chart). Growth alone might not be a game changer. Higher growth rates (of 5–6 percent) would help reduce unemployment, but would not bring it significantly below the baseline level (black line in the chart; this, however, assumes that the employment elasticity would remain unchanged). This analysis underscores the need for reforms that create job-rich growth.

Unemployment Rate Projections - Baseline
(Assuming gradual return of refugees; 30 percent remaining in 2019)



Sources: Country authorities; and IMF staff estimates and projections.

The authorities have appealed to the international community to help fund the costs of the Syrian crisis. There has been significant humanitarian support (amounting to close to $1 billion in 2013 alone, see Selected Issue Paper), though so far budget support, including through a dedicated trust fund established by the World Bank, has been limited.

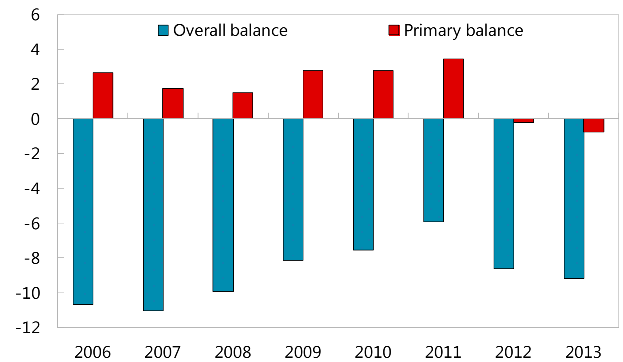
[1] World Bank, 2012, "Republic of Lebanon: Good Jobs Needed, the Role of Macro, Investment, Education, Labor and Social Protection Policies ("Miles")" Report No. 76008-LB.

[2] International Labor Organization, 2013, "Assessment of the Impact of Syrian Refugees in Lebanon and their Employment Profile."

[3] These trajectories are based on the MCD employment template (see Chami et al., 2012, "A Template for Projecting Labor Market Indicators," IMF Technical Notes and Manual 12/01).

8. **Fiscal imbalances have widened**. In 2012, a primary deficit—the first since 2006—of ¼ percent of GDP was recorded, and the public debt-to-GDP ratio increased to 134 percent of GDP, reversing its previously-declining trend; debt further rose to 141 percent of GDP in 2013, as the primary deficit reached 1 percent of GDP. This deterioration reflected broad-based spending pressures and revenue declines from weak economic activity, but also policy decisions adopted in 2012, namely the introduction of a VAT exemption on gasoil (with an estimated annual impact of ½ percent of GDP) and a cost of living adjustment for public sector wages (with an annual cost of 1¼ percent of the 2012 GDP, Box 2).

Fiscal Deficit
(In percent of GDP)

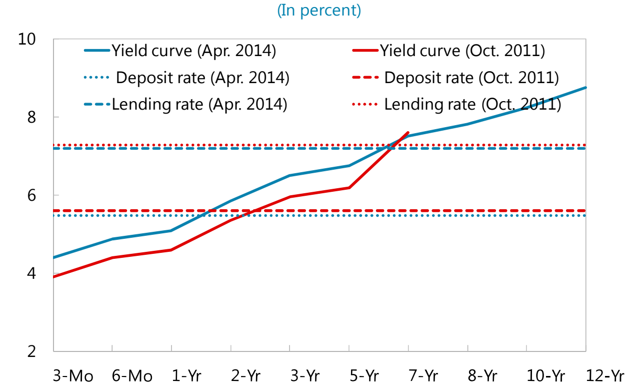


Sources: Lebanese authorities; and IMF staff estimates.

9. **Hosting the large refugee population is adding to fiscal strains**. The direct budgetary costs are not known with precision, as there are no dedicated budgetary lines for refugee-related spending by line ministries; expenditure tracking is further hampered by the fact that refugees are not concentrated in specific areas or camps. The World Bank estimated the overall fiscal impact of the Syria crisis at a cumulative $2.6 billion over the period 2012–14 (about 6 percent of the 2013 GDP), with an additional $2.5 billion needed to return public services to their pre-crisis quality (Box 1 and Selected Issue Paper).[3]

10. **Despite the higher risks, T-bill rates have remained broadly unchanged.** The government raised interest rates on T-bills with maturity shorter than 7 years in March 2012, by 50 basis points, in line with Fund advice (Box 3). This increase managed to temporarily boost banks' appetite for government paper. Despite higher risks and market pressures for further increases from mid-2012 onward, the government has kept rates on existing maturities unchanged. Instead, it has resorted to infrequent issuances of longer-term higher-yielding T-bills outside the regular auctions, and has continued to rely on BdL purchases on the primary market (see below).[4]

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



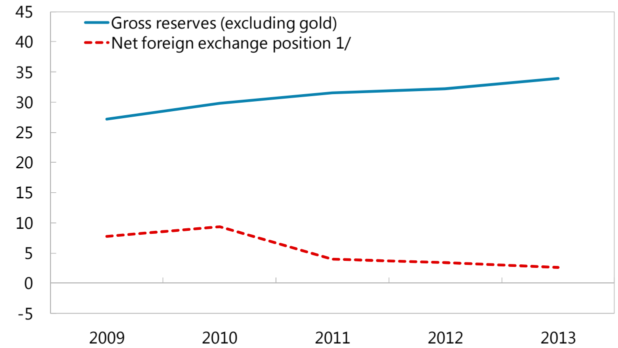
Sources: Lebanese authorities; and IMF staff estimates.

[3] World Bank, "Lebanon: Economic and Social Impact Assessment of the Syrian Conflict," September 2013.

[4] The government issued 10-year T-bills for the first time in September 2012, and then in June and September 2013; 8-year T-bills in October 2012 and then in June 2013; and 12-year T-bills in September 2013.

11. **The BdL has proactively sought to maintain stability**. Supported by sustained deposit inflows, the BdL has continued to attract banks' foreign exchange deposits, keeping gross reserves at a comfortable $35 billion at end-April—about 11 months of imports or 25 percent of broad money. The BdL has also continued to finance the government. On the pound side, it has been offering banks long-term deposits with yields generally matching T-bills with similar maturities, and channeled this liquidity to cover demand shortfalls in the T-bill auctions. On the foreign currency side, it has been increasingly providing funding to the government, with an impact on its net foreign exchange position. Finally, the BdL has supported credit to the private sector—still growing at an annual rate of 10 percent—by providing $1 billion in low-cost funds to banks to on-lend to specific economic sectors.[5] All these operations have further weakened its balance sheet.

BdL's Foreign Exchange Reserves
(In billions of U.S. dollars)



Sources: Lebanese authorities; and IMF staff estimates.
1/ Gross reserves (excluding gold) minus foreign currency liabilities.

12. **Foreign exchange and financial markets have been largely resilient**. Deposits have continued to grow at 7–8 percent a year, though with some occasional outflows. Dollarization declined in 2012, but has been since on an upward trend, reaching 65.8 percent at end-April—still below the end-2011 level (Figure 3). Eurobond spreads have moved in line with regional averages and stand at levels similar to end-2011. Standard & Poor's upgraded the outlook in April, from negative to stable—on account of the continued resilience of deposit inflows and improved political conditions following the government formation—while maintaining the rating for the sovereign and the three largest banks at B-.

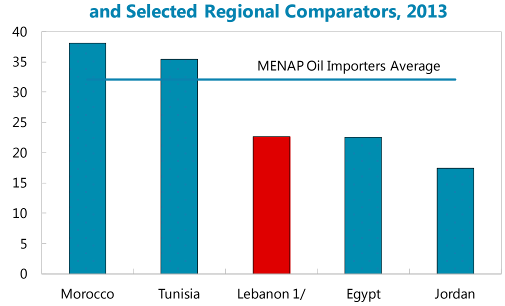
[5] The BdL has launched another stimulus plan of about $800 million—similar to the $1 billion package for 2013—and a new scheme for banks of about $400 million to invest in start-ups in the knowledge economy.

Box 2. Public Sector Wages

A substantial increase of public sector wages was set in motion in 2012. This includes three components: (i) an increase in the minimum wage; (ii) the application of a cost of living adjustment; and (iii) the adoption of a new salary scale.[1] The first two elements were approved in September 2012, effective February 1, 2012. The salary scale adjustment has been subject to considerable debate and changes, by cabinet and two parliamentary committees; it still has not been passed by parliament. If approved as per the latest draft, it would add another LL970 billion annually (1.3 percent of the 2014 GDP) to the wage bill.

If implemented, the salary scale adjustment would further exacerbate budget rigidities. Lebanon's wage bill—while not higher than comparators in the region—represents a large share of spending and absorbs more than 30 percent of government revenue. The planned increase—and its possible impact on pensions and other personnel costs—would thus further limit fiscal space.

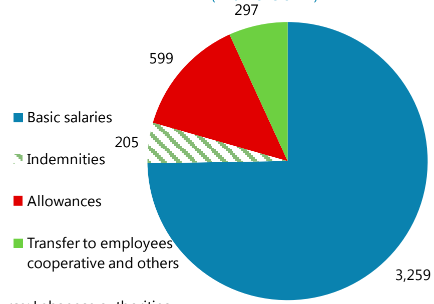
Wages as a Share of Total Expenditure for Lebanon and Selected Regional Comparators, 2013



Sources: Country authorities; and IMF staff estimates.
1/ Central government.

Focusing on wages only can be misleading. Central government employees receive about twenty different allowances and indemnities in addition to their basic salary—exceeding it in some cases. On average these represent about one third of basic salary spending. Over the period 2003–12, allowances and indemnities amounted to an average of 2.7 percent of GDP, bringing total personnel costs to around 10 percent of GDP.

Central Government Wages and Salaries, 2012 1/
(In billions of LL)



Source: Lebanese authorities.
1/ Central government employees include military, education, civil and customs personnel.

Measures were proposed to mitigate the costs of the salary scale adjustment. In addition to revenue measures (see text), it was proposed to increase working hours in the public administration from 32 to 35 per week; other originally proposed measures (such as reducing the maximum number of overtime hours; capping bonuses and benefits as a share of total monthly salaries; and revising the number of years of service for eligibility to retirement) are currently not under consideration.

Salary increases will directly and permanently impact pensions. Pensions are adjusted in line with salary increases granted to those in active duty, and not just to reflect cost of living adjustments, as standard practice in many countries. In addition, pension benefits are also granted to surviving spouses and unmarried, divorced or widowed daughters of retirees, if unemployed—thus significantly extending the period over which pension benefits are drawn. All these elements, which add to the costs of the salary adjustment scale, have not been considered explicitly in the ongoing debate.

[1] The monthly minimum wage was increased to LL675,000 from LL500,000 (equivalent to $448 and $332, respectively). Prior to this increase, a cost of living adjustment for the public sector was last granted in 1999. A minimum wage increase for the private sector was implemented in 2008.

Box 3. Policies Since the 2011 Article IV Consultation

Macro policies have been partly in line with staff advice. The 2011 consultation called for fiscal discipline (preserving a primary surplus position) and a reduction in the public debt-to-GDP ratio. However, the fiscal position has deteriorated substantially starting in 2012—a primary deficit was recorded in 2012 for the first time since 2006—reflecting weak growth and expansionary policy measures (most notably, the reduction of excises, the removal of VAT on gasoil, and public sector wage increases). In line with staff recommendations, the authorities raised in 2012 interest rates on T-bills with maturities less than seven years to reduce the budget's reliance on BdL financing.

There was some progress on structural reforms. The 2011 consultation highlighted the need for reforms toward faster and more inclusive growth and economic resilience. On the positive side, measures included the approval of the capital markets law and continued strong bank supervision, along with initial steps toward exploring offshore oil and gas reserves. In addition, the ministry of finance established a macro-fiscal unit (which has produced a medium-term expenditure framework), and a public debt directorate (which has developed a Medium-Term Debt Strategy). There was some progress in implementing the comprehensive electricity sector strategy (see Box 4). Investment in the electricity sector to increase capacity is welcome, though it will need to be accompanied in the future by tariff increases toward cost recovery levels to reduce the sizeable subsidies to the electricity company, once electricity provision increases. Other reforms have been slow to implement—particularly in telecommunication, the global income tax and the Treasury Single Account. The provision of statistical information has generally remained weak, though progress is being made in a number of areas.

OUTLOOK AND RISKS

Risks remain high given Lebanon's exposure to developments in Syria, and would be amplified by a lack of corrective policies.

13. **Without a resolution in Syria, economic performance is expected to remain weak.** Growth is likely to linger at around 2 percent this year, reflecting domestic and regional uncertainties. For projection purposes, staff assumes that the Syria conflict will be resolved by 2016, when growth will return to potential—a moderate 4 percent—and refugees will start gradually returning to Syria. Inflation is projected to pick up later this year and next year, reflecting the impact of a planned wage increase (see next section). The current account deficit is projected to decline only slightly over the medium term, as a rebound in exports will be to a large extent offset by higher imports. Financing needs would remain high, reflecting large fiscal and current account deficits.

14. **Downside risks—outlined in the Risk Assessment Matrix—are high.** While Syria poses the most serious threat to the economy, domestic risks from a further weakening of fiscal policies and delays in structural reforms, along with other external risks (e.g., from a higher-than-expected increase in global interest rates) are also looming. A materialization of these risks could dampen growth and push up government financing costs, with further adverse effects on debt dynamics. It could also trigger a loss of confidence, which would set in motion negative feedback loops to deposits, dollarization, and reserves. In particular, more spillovers from the Syria crisis could further destabilize social structures and increase economic costs; a prolonged refugee crisis would strain the already-weak public service provision, with added costs to the budget, put further pressure on the labor and housing markets, and threaten law and order. Failure to address infrastructure bottlenecks could reduce Lebanon's competitiveness and growth potential. Higher-than-expected increases in global interest rates could push Lebanon into tighter monetary policy, with rising financing costs negatively affecting the government and the banking sector.

Lebanon: Fiscal and External Financing Needs

(In billions of U.S. dollars, unless otherwise indicated)

		2013 Est.	2014 Proj.	2015 Proj.
Fiscal financing needs[1]		5.3	6.5	5.6
(In percent of GDP)		11.9	13.8	11.1
Fiscal financing needs[2]		13.5	14.9	14.8
(In percent of GDP)		30.0	31.5	29.2
External financing needs[3]	B+C	69.0	75.0	80.3
(In percent of GDP)		153.3	158.4	158.5
Current account deficit	B	5.8	5.9	6.2
Amortization scheduled	C	63.2	69.1	74.2
of which: Nonresident deposits		53.9	60.2	65.1

Sources: National authorities; and IMF staff calculations.

1/ General government fiscal deficit (excl. grants) plus general government external amortization.

2/ General government fiscal deficit (excl. grants) plus general government domestic and external amortization.

3/ Current account deficit plus total external amortization (incl. nonresident deposits).

Authorities' views

15. **The authorities broadly shared staff's assessment of the outlook and risks.** They agreed that further spillovers from the Syria crisis present the most serious risk to the economy. More specifically, they expressed high concern about the impact of the refugees on Lebanon's economy and local communities, especially if significant donor budget support fails to materialize. Some noted that the lack of a government strategy on refugees was taking its toll, and the open border policy needed to be revisited; consideration of alternative forms of hosting the refugees (e.g., in designated areas) was taking hold in some political quarters.

16. **The authorities nonetheless remained confident in Lebanon's ability to withstand shocks.** They underlined the proven resilience of deposits and BdL's large reserve buffer. Finally, they also noted the upside potential stemming from Lebanon's possible involvement in Syria's post-conflict reconstruction, which could significantly boost growth.

POLICY DISCUSSIONS

17. **Policy discussions centered on the urgent need for credible fiscal adjustment and structural reforms.** The current fiscal deterioration needs to be reversed and the primary surplus restored, while addressing underlying weaknesses in public service provision and social safety nets. Tackling these challenges will help ensure fiscal sustainability, anchor market confidence, and improve equity. Strong commitment to fiscal discipline could also help mobilize budget support for the costs of the refugee crisis, by providing a policy framework and dispelling skepticism about the government's ability to tackle pressures head on.

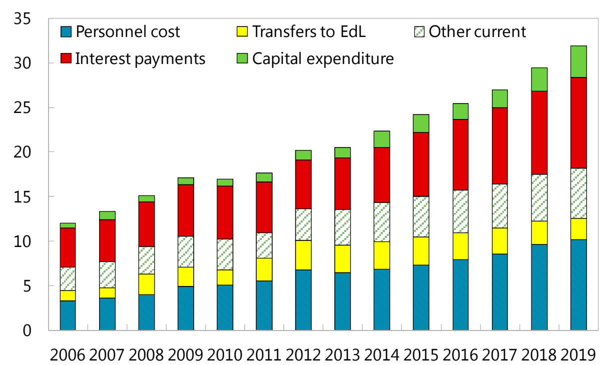
A. Ensuring Fiscal Sustainability

Discussions on fiscal policy were overshadowed by the still unresolved debate on a salary scale adjustment for the public sector and revenue measures to offset its costs. The size, composition, and timing of the package are still under parliamentary consideration.

18. **Fiscal policy needs an anchor.** There have been no approved budgets since 2005 and accounts have not been officially closed since 1993. Fiscal policy has been lacking a medium-term perspective, with spending conducted largely through treasury advances and ad-hoc measures in times of pressures. Despite progress on fiscal reforms, policymaking continues to fare low in terms of transparency (Figure 4).

19. **Large budget rigidities persist**. Over 70 percent of current spending comprises of transfers to the loss-making Electricité du Liban (EdL), public sector wages, and interest payments. Capital spending—already compressed by regional standards—has been often cut to curb deficits, further exacerbating Lebanon's infrastructure deficit (Figure 2).

Expenditure Composition
(In billions of Lebanese pounds)



Sources: Lebanese authorities; and IMF staff estimates.

20. **Significant spending pressures are building up**. The main increase will stem from a much debated salary scale adjustment for the public sector, with an estimated cost (excluding pensions) of 1.3 percent of the 2014 GDP on a permanent basis.[6] This increase is part of a salary package proposed by cabinet in 2012 (Box 2). Parliament approved some elements (including offsetting revenue measures), before legislative sessions were suspended due to the presidential

[6] Staff assumed that the salary increase will start being paid in the second half of 2014, with retroactive payment as of July 1, 2014 and no installments, as proposed by the latest parliamentary committee. All accompanying revenue measures would be implemented on January 1, 2015.

elections.[7] At the same time, ongoing capital projects in the electricity sector (about 1 percent of GDP, see below) and additional social spending related to the Syrian refugees (about 0.3 percent of GDP through 2016) add to spending pressures in the near term. On the positive side, transfers to EdL are projected to decline, but largely on account of lower oil prices (Box 4). Staff thus noted that the authorities should not rely on these savings, which are subject to significant oil price uncertainty; and that without reforms of the electricity sector and increases in tariffs—unchanged since 1996—EdL will continue to be a significant drag on public finances.

21. **The revenue measures approved so far will be insufficient to offset higher spending.** These measures include: (i) an increase in the interest income tax rate from 5 to 7 percent; (ii) an increase in the corporate income tax rate from 15 to 17 percent; (iii) a new capital gain tax on real estate transactions; (iv) increases in tobacco excises; and (v) increases in various stamps and fees. Staff estimated the measures' annual yield at around 1 percent of the 2015 GDP. Increases in the VAT rate from 10 to 11 percent, and to 15 percent for selected luxury items; and the application of penalties on illegal seashore buildings are still under discussion.

22. **On current policies, risks to public debt sustainability would increase**. The budget deficit would rise to about 12 percent of GDP in 2015, largely reflecting the salary scale adjustment, and remain broadly at that level afterwards (text table). The primary position would reach a deficit of 2.5 percent of GDP in 2015, and then gradually improve—largely benefitting from a reduction in transfers to EdL as oil prices are projected to decline over the medium term—but remain negative. Under this scenario, debt and financing needs would continue to rise, reaching 155 percent and 40 percent of GDP, respectively, thus exposing Lebanon to considerable debt vulnerabilities (Annex I).

Lebanon: Main Fiscal Indicators Under Baseline Scenario

(In percent of GDP; unless otherwise indicated)

	2011 Act.	2012 Act.	2013 Est.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Revenue, *of which* :	22.8	22.3	20.9	20.8	21.8	21.9	22.0	22.2	22.1
Income tax on profits	1.7	1.6	1.4	1.4	1.6	1.6	1.6	1.6	1.6
Income tax on interest income	1.1	1.0	1.0	1.0	1.4	1.5	1.6	1.7	1.8
Income tax on capital gains and dividends	0.4	0.5	0.3	0.3	0.5	0.5	0.5	0.5	0.5
VAT revenues	5.5	5.1	4.9	4.8	4.8	4.8	4.8	4.8	4.8
Excises	2.3	2.2	2.0	1.9	2.0	2.0	2.0	2.0	2.0
Other taxes 1/	0.8	0.7	0.7	0.7	1.0	1.0	1.0	1.0	1.0
Total spending	29.1	31.1	30.2	32.0	33.7	33.2	32.9	33.1	33.4
Current spending, *of which* :	27.5	29.5	28.4	29.4	31.1	31.1	30.8	30.9	31.2
Personnel costs	9.2	10.4	9.5	10.2	11.5	11.5	11.5	11.5	11.5
Transfers to the EdL	4.2	5.2	4.5	4.3	4.0	3.7	3.2	3.0	2.9
Other current 2/	4.7	5.5	6.0	6.2	6.2	6.2	6.0	6.0	6.0
Interest payments	9.4	8.4	8.4	8.7	9.4	9.7	10.1	10.4	10.7
Capital spending	1.6	1.6	1.8	2.6	2.7	2.2	2.2	2.2	2.2
Overall balance	-5.9	-8.6	-9.2	-11.1	-11.9	-11.4	-11.0	-10.9	-11.3
Primary balance	3.5	-0.2	-0.8	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Public debt	134	134	141	145	148	149	151	153	155
Memorandum items:									
Real GDP growth rate	2.0	2.5	1.5	1.8	2.5	4.0	4.0	4.0	4.0
GDP deflator growth rate	3.4	4.6	3.2	3.4	4.4	2.9	2.3	2.3	2.4

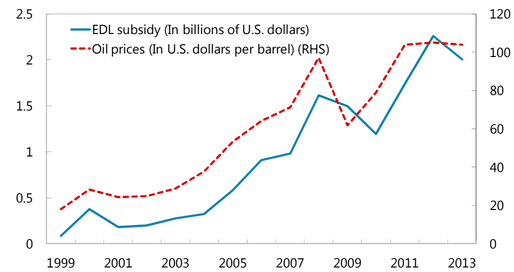
Sources: Lebanese authorities; and IMF staff estimates.
1/ Includes various stamps and fees.
2/ Includes social spending.

[7] At this stage, it is not clear when parliament will resume discussions on the wage proposal. Since other elements of the package are pending decision, the fate of the salary scale adjustment was left hanging.

Box 4. Electricity Sector Reforms

The electricity subsidy absorbs a large share of public spending. The government transferred 4.5 percent of GDP to Electricité du Liban (EdL) in 2013. As electricity tariffs have remained unchanged since 1996 (when the price of oil was $23 per barrel) while oil prices have generally increased, the size of the transfers has surged over the years.

EdL Subsidy and Oil Prices



Sources: Lebanese authorities; and IMF staff estimates.
1/ In 2010, transfers to EDL dropped 20 percent because of the use of natural gas as a substitute to gasoil, paid for with a lag of 6 months.

EdL's production is both inefficient and insufficient to meet demand—reducing competitiveness and potential growth. Close to half of total electricity production costs are not recovered (15 percent in technical losses—due to transmission and distribution problems, as well as the use of fuel in two power plants designed to operate on natural gas; and about 30 percent in non-technical losses—from illegal connections/theft and uncollected bills).[1] In addition, EdL currently has 2,019 MW of installed generating capacity, compared to a peak demand of 3,195 MW.[2] Supply covers only some 18 hours per day on average, with frequent blackouts. Back-up private generators are extensively used, but at a cost that is three times the level of EdL tariffs. Seventy five percent of Lebanese firms identify electricity as a major constraint to business operations (compared to 52 percent in the MENA region).[3]

Reforms of the electricity sector have long been on the table, but progress has been scant. The 2011 "Policy Paper for the Electricity Sector" aimed at increasing production to 4,000 MW by 2014, with an estimated total cost of $6.5 billion, to be funded equally by the government and the private sector. The plan hinged on increasing generation, transmission and distribution infrastructure; diversifying fuel sources by converting most plants to natural gas; adopting a new tariff structure; and revising the legal framework (including ultimately EdL corporatization). Some progress was made to build a new power plant and rehabilitate existing ones, and launch a Liquefied Natural Gas Public-Private Partnership. Three private distribution service providers started operations; and two power barges were rented to supplement power production while power plants are being built. However, demand from refugees is estimated to equal roughly the electricity supplied by the barges, setting back expected supply improvements.

On current policies, transfers to EdL are expected to decline on the back of decreasing oil prices. These declines account for a large reduction in transfers (0.6 percent of GDP in the medium term), but as the experience in the late 2000s shows, they do not provide sustainable savings.

Transfers to EdL
(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018	2019
Transfers to EdL	4.5	4.3	4.0	3.7	3.2	3.0	2.9
Change in EdL transfers, of which:		-0.2	-0.5	-0.8	-1.3	-1.4	-1.5
Effect of fuel type switch		0.0	0.0	0.0	-0.2	-0.2	-0.2
Effect of changes in oil prices		0.0	-0.1	-0.3	-0.5	-0.6	-0.6
Effect of changes in GDP deflator		-0.1	-0.3	-0.4	-0.5	-0.6	-0.7
Memorandum							
Potential average tariff increase from 9 cents/kwh to 15 cents/kwh			-0.9	-0.8	-0.8	-0.8	-0.8
WEO oil prices	104.1	104.2	97.9	93.0	90.0	88.1	86.6

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

Raising the average EdL tariff toward cost recovery levels would reduce transfers by an additional 0.8 percent of GDP—and in a more sustainable way. The Ministry of Energy and the EdL have prepared a proposal, with assistance from the World Bank, which would simplify the structure of tariffs and safeguard lower-end consumers (who generally have lower income). So far the proposal, while endorsed by various stakeholders, has not been acted upon. Switching to gas will also generate savings of 0.2 percent of GDP.

[1] World Bank, 2012, "Republic of Lebanon, Electricity Sector Public Expenditure Review."

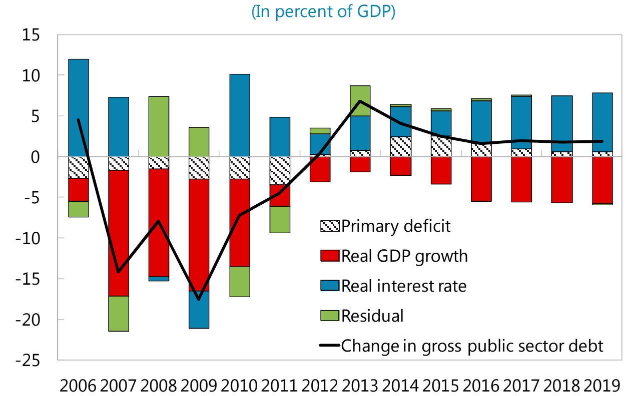
[2] World Bank, 2013, "Economic and Social Impact Assessment of the Syrian Conflict," (September 2013).

[3] World Bank Enterprise Survey: http://enterprisesurvey.org.

23. **Putting the public debt on a sustainable downward path can only be achieved through strong fiscal consolidation**. Lebanon managed to reduce its debt by an impressive 50 percent of GDP during 2007–12, from 180 percent of GDP at end-2006 to 134 percent of GDP at end-2012. The main drivers were high economic growth (9 percent on average over the period 2007–10), and, to a much lower extent, primary surpluses. With growth expected to return gradually to only 4 percent, staff noted that debt reduction has to come from sustained and large primary surpluses above the debt stabilizing level (Annex I). Fiscal adjustment should be complemented by structural reforms to rekindle private activity.

Debt Dynamics Decomposition

(In percent of GDP)



Source: IMF staff estimates and projections.

24. **Staff recommended a fiscal adjustment strategy that is credible, balanced, and anchored in a multi-year framework**. Staff noted that the salary scale adjustment debate had focused excessively on revenue measures, while the size and composition of spending should be addressed as well; the debate had also diverted attention away from the need for broader fiscal consolidation. More specifically, in staff's view:

- **Passing a budget is a necessary initial step to anchor fiscal policy**. Staff welcomed the ministry of finance's renewed efforts to close earlier accounts, especially as a precondition for parliamentary consideration of a 2014 budget. A budget including all government spending and revenue plans—and their impact on deficit and debt—will help policymakers shift to a more comprehensive approach to fiscal policy.

- **The costs of the salary scale adjustment should be contained.** At a minimum, salary increases should be phased in in installments and without retroactive payments, and based on clear performance measures. Staff also recommended factoring in all costs of the scale adjustment, including on pensions (Box 2). Measures to increase public sector productivity should be adopted; in this regard, staff recommended civil service reform, noting though that it would take time and political will to implement it.

- **Reforming electricity tariffs is key to reducing transfers to the EdL in a sustainable way.** There have been proposals to simplify the tariff structure and increase its average level toward cost recovery, while protecting the lower-tier consumers (Box 4). However, vested interests and general lack of governance in the electricity sector have prevented progress. Staff endorsed the tariff reform, noting that its implementation is subject to cabinet's decision and could therefore proceed regardless of the parliamentary schedule. In addition, ongoing projects to switch to cheaper generation should also be properly funded, monitored, and executed.

- **Staff sees scope to rebalance spending composition.** Higher capital spending is needed to support growth and reduce infrastructure gaps, starting from planned projects in the electricity sector. Higher social spending, including through the National Poverty Targeting Program, would help reduce poverty and address social needs.

- **Revenue measures should be equitable and minimize distortions.** Staff welcomed efforts to broaden tax bases, though regretted that the removal of the VAT exemption on gasoil was not being pursued. It advised against applying multiple VAT rates to avoid complicating tax administration. Instead, staff proposed a gradual increase of the overall VAT rate to 12 percent in 2015 and 15 percent in 2017, in line with past Fund advice; and noted the VAT's sizeable tax base (consumption is about 90 percent of GDP), its efficiency, and ease of administration. Staff recommended avoiding double taxation.[8] Finally, it called for limiting the reliance on fees and stamps, as they would likely generate low yields while complicating the tax system, noting that previous Fund advice had recommended their simplification.

25. **Staff's proposed adjustment would reverse the debt dynamics.** The bulk of the adjustment would come from revenue—and particularly from the still under-tapped VAT potential—while spending would remain broadly unchanged as a share of GDP, though with a composition rebalanced in favor of higher capital and social spending. The primary position would turn into surplus as early as 2015, and reach 2½-3 percent of GDP over the medium term. There would be some growth dividends, as confidence effects—in an environment where good policy news have been limited—would drive a rebound in private investment, further enhanced in the medium term by higher-quality spending and electricity sector reform. Public debt would thus be put on a downward path, though would still remain above 130 percent of GDP by 2019.

Lebanon: Main Fiscal Indicators Under Staff's Proposed Adjustment Scenario

(In percent of GDP; unless otherwised indicated)

	2011 Act.	2012 Act.	2013 Est.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
Revenue, *of which* :	22.8	22.3	20.9	20.9	23.1	23.2	24.4	24.7	24.8
Income tax on profits	1.7	1.6	1.4	1.4	1.6	1.6	1.6	1.7	1.8
Income tax on interest income	1.1	1.0	1.0	1.0	1.3	1.4	1.5	1.6	1.6
Income tax on capital gains and dividends	0.4	0.5	0.3	0.3	0.5	0.5	0.5	0.5	0.5
VAT revenues	5.5	5.1	4.9	4.9	6.1	6.1	7.3	7.4	7.5
Excises	2.3	2.2	2.0	1.9	2.3	2.3	2.3	2.3	2.3
Other taxes 1/	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Total spending	29.1	31.1	30.2	31.5	31.5	31.5	31.1	31.5	31.2
Current spending, *of which* :	27.5	29.5	28.4	28.9	28.9	28.9	28.2	28.4	27.9
Personnel costs	9.2	10.4	9.5	9.5	10.2	10.4	10.6	11.1	10.7
Transfers to the EdL	4.2	5.2	4.5	4.3	3.1	2.8	2.0	1.8	1.8
Other current 2/	4.7	5.5	6.0	6.3	6.3	6.3	6.3	6.3	6.3
Interest payments	9.4	8.4	8.4	8.7	9.3	9.3	9.3	9.2	9.2
Capital spending	1.6	1.6	1.8	2.6	2.7	2.6	2.9	3.1	3.3
Overall balance	-5.9	-8.6	-9.2	-10.6	-8.4	-8.3	-6.7	-6.9	-6.3
Primary balance	3.5	-0.2	-0.8	-1.9	0.8	1.0	2.7	2.3	2.9
Public debt	134	134	141	145	144	142	138	135	132
Memorandum items:									
Real GDP growth rate	2.0	2.5	1.5	1.8	3.0	4.5	4.5	5.0	5.0
GDP deflator growth rate	3.4	4.6	3.2	3.1	4.0	2.9	3.2	3.2	2.4

Sources: Lebanese authorities; and IMF staff estimates.

1/ Includes various stamps and fees.

2/ Includes social spending.

[8] The elimination of the tax credit applied to banks' income taxes for the withheld interest income tax would represent double taxation.

26. **There is a need for a more transparent government financing framework**. Last year, the government reached the cap on new foreign currency borrowing.[9] Meanwhile, the gap between its foreign currency payments (including transfers to the EdL, and interest and some capital spending payments) and receipts (mainly profit transfers from the telecommunication company) has been widening. This reflects temporary factors (delays in transfers from Telecom), but also a structural deterioration (an increase in foreign currency payments). Thus, the government has been increasingly borrowing in foreign currency from the BdL in overdraft, which has reached $6.6 billion at end-April (about 14 percent of GDP). Staff welcomed the authorities' effort to seek parliamentary approval to raise the cap on new foreign currency borrowing to reduce the government's reliance on the BdL; it also recommended returning to regular and timely Telecom transfers to the budget.

27. **Strong fiscal management should underpin adjustment.** Staff welcomed ongoing capacity building at the ministry of finance. It reiterated the importance of adhering to a budget calendar and pursuing a medium-term budget framework; and noted the need for greater transparency of government spending and its funding. Staff also underlined the importance of strengthening cash management, in particular the transparency and timeliness of transfers to and from the budget. Finally, staff noted that strengthening revenue administration and combating reportedly pervasive tax evasion and corruption could generate considerable gains.

28. **Windfalls from prospective gas resources are no substitute for adjustment.** According to recent seismic surveys, Lebanon could benefit from offshore gas resources, though their size remains uncertain and production is not expected to begin before 2020 (Box 5). The bidding process for exploration is currently scheduled for August, after repeated delays. Staff underscored that gas resources represent an asset of the whole country; and that strong policies and institutions are needed to manage the related revenue stream in a sustainable and equitable way (Selected Issue Paper). The first step to manage gas resources properly is to define a fiscal regime that ensures a fair revenue share for the government while encouraging investors' participation in exploration and production activities. Staff also called for a proper macro-fiscal anchor to ensure the sustainability of the gas revenue; and strong institutions to manage the gas wealth responsibly and transparently. In this context, it cautioned that discussions on a sovereign wealth fund are premature; and earmarking different revenue sources to specific uses would lead to fiscal fragmentation.

[9] The government can only roll over existing foreign currency debt now, as last done in April. Raising the cap to allow for new foreign currency borrowing requires parliamentary approval.

Box 5. Designing a Fiscal Framework for a Prospective Commodity Producer: Options for Lebanon

Lebanon might become a commodity producer over the next decade, with petroleum set to be an important source of government revenue. Recent seismic surveys suggest that Lebanon's oil and gas resources could be in excess of 25 trillion cubic feet (tcf). While not particularly large by international standards, this estimate still points to the potential for a substantial revenue increase for many years (though not starting before 2020 at the earliest).

Changing status to a commodity producer introduces challenges to macro-fiscal management. High dependence on natural resources can result in high volatility of revenues and spending—typically higher than for non-commodity producers—with associated procyclicality. Indeed, spending in commodity producers during boom and bust commodity price episodes is found to be more procyclical than in non-commodity producers. In addition, resource revenue is exhaustible, raising issues of sustainability and intergenerational equity. This calls for smoothing government consumption over time, and avoiding the need for massive fiscal adjustment once resource wealth has been depleted.

To address these challenges, Lebanon's fiscal framework needs to move on three fronts:

- **Fiscal regime**. Appropriate laws and regulations defining the revenue potential from exploration and production of natural resources should be guided by a number of objectives and design principles:
    - The state should receive an appropriate share of the economic rents from exploiting natural resources.
    - The tax rules applying to the extractive industries should be set out clearly in legislation, to avoid negotiating project-specific fiscal arrangements.
    - The government's take should adjust to price and cost fluctuations, to secure a larger profit share of the most profitable projects, but impose a lower tax burden in times of low profitability.
    - The fiscal regime should avoid distorting investment incentives and decisions, especially in the initial production stages, when governments typically favor early and dependable revenue.
    - Tax regimes should be competitive relative to those of other countries in attracting investment, taking account of the relative stage of exploration and discoveries and their expected characteristics. They should also be simple for taxpayers to comply with and the revenue authority to administer.
- **Macro-fiscal anchor**. As Lebanon's resource revenues are uncertain at this stage, the government should conservatively assume a short reserve horizon. Fiscal policy should therefore be guided by resource exhaustibility considerations, and anchored in a saving strategy for intergenerational equity reasons. The literature offers guidance on the formulation of fiscal policy in these circumstances (see Selected Issue Paper). Fiscal targets consistent with the Permanent Income Hypothesis (PIH)-based frameworks—whereby a constant share of revenue is consumed every year to preserve resource wealth—can be useful. Two related frameworks—based on the Modified Permanent Income Hypothesis and Fiscal Sustainability—allow for scaling up of expenditure to address specific needs (for example in human and physical investment), while still ensuring long-term fiscal sustainability. These frameworks may be relevant to Lebanon given its infrastructure gaps and social needs.
- **Institutions**. Natural resource windfalls significantly complicate fiscal management, and therefore strong institutional arrangements are called for. A sound PFM system helps ensure, as part of the budget process, (i) a transparent and comprehensive presentation of oil revenue and the underlying non-oil fiscal position; (ii) a sustainable long-term fiscal strategy based on prudent revenue projections, realistic medium-term fiscal frameworks and a good budget classification; and (iii) transparent mechanisms for appraisal, selection, and prioritization of investment projects, to ensure that resource revenue is used to support long-term economic development. In addition, adopting a fiscal responsibility law could potentially strengthen fiscal discipline by anchoring fiscal decisions in a rule-based framework (see Selected Issue Paper).

Authorities' views

29. **The authorities acknowledged the need to revert the debt dynamics**. But political uncertainty overshadows policy decisions and adjustment could only come over time.

30. **The authorities reaffirmed their commitment to putting in place a budget for 2014.** They noted that work on closing past accounts was almost complete, and agreed that passing a budget would send a strong signal.

31. **There was a large degree of uncertainty regarding the parameters of the salary scale adjustment**. The authorities also noted significant implementation uncertainties, in part related to the presidential vacuum, and felt than an early resolution was less likely.

32. **The authorities felt confident that their proposed revenue measures would more than offset the salary increases.** They stressed that sectors of the economy that had largely remained outside the tax net should share the adjustment burden. They disagreed, however, with the mission's assessment that fees and stamps would generate only limited yield; and noted that a large and broad-based VAT increase could affect disproportionally the lower segments of the population, and would be politically difficult to implement.

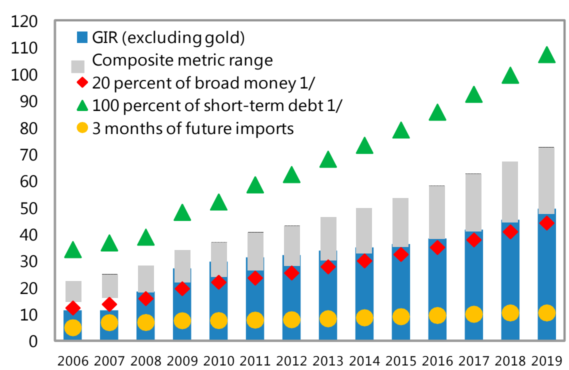
B. Maintaining Reserves and Activating Market Signals

Discussions centered on the role played by the BdL in maintaining stability, and the need for high reserves and lower government financing by the BdL.

33. **The exchange rate peg is the nominal anchor for Lebanon**. Staff acknowledged the key role the peg has been playing as lynchpin of financial stability, given the government's high debt and debt service in foreign currency, and substantial household and corporate currency mismatches from the large credit dollarization. Strong and supportive policies are needed to underpin the continued viability of the peg.

34. **Maintaining high reserves is warranted given large risks and vulnerabilities.** Official foreign exchange reserves are adequate, at 110 percent of the reserve metric at end-2013. The reserve coverage is larger—at 147 percent—if commercial banks' estimated foreign liquid net assets are considered as an additional buffer in case of deposit outflows. Staff underscored the need to maintain high reserves, but noted that reserve accumulation and the associated sterilization costs have weakened the BdL's balance sheet. With bank deposits expected to remain the main source of reserves, a deposit growth rate of about 8 percent would be sufficient to broadly maintain the reserve coverage while meeting

Reserve Adequacy
(In billions of U.S. dollars)

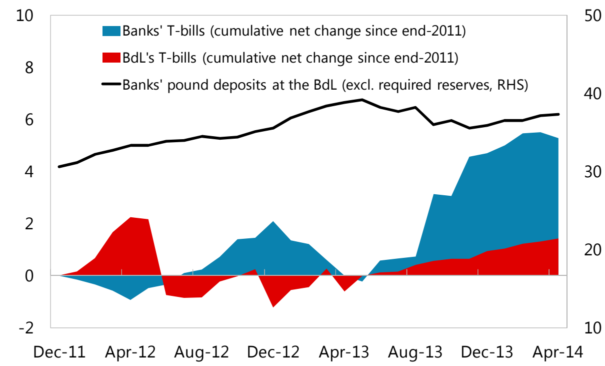


1/ Includes nonresident deposits.
Source: IMF staff estimates.

fiscal and external financing needs under current policies. Going forward, there is a need for a strategy to gradually strengthen the BdL's balance sheet.

35. **Staff called for lower government financing by the BdL.** Banks have continued to shy away from T-bills with maturity shorter than 7 years—offered in the regular auctions. To mop up banks' pound liquidity and keep T-bill rates unchanged, the BdL has increasingly offered long-term deposits—of 7-year or higher maturity—with yields generally matching T-bills with similar maturities, and channeled this liquidity to cover demand shortfalls in the T-bill auctions.[10] In a positive step to encourage banks to reduce deposits with the BdL and invest in government paper instead, the BdL has recently reduced by 26 basis points the interest rate it pays on banks' deposits. Staff encouraged the BdL to go one step further and gradually withdraw from T-bill auctions. It noted though that rate cuts on BdL's instruments might only have a marginal effect on the T-bill market, and T-bill rates will likely have to rise to attract more bank participation in the auctions if fiscal imbalances are not addressed.

Pound Liquidity and T-bill Holdings
(In trillions of Lebanese pounds)



Sources: Lebanese authorities; and IMF staff estimates.

36. **Ending the fiscal dominance and activating market signals require a reduction of vulnerabilities.** Staff underlined that lower government financing by the BdL can only be sustained if combined with fiscal restraint—key to ensuring a sustainable reduction in government's large debt and financing needs. To allow the interest rates to reflect market conditions and enhance the transparency of government financing, staff also recommended regularizing the issuances of T-bills with maturities longer than 7 years and making the T-bill auction process more transparent, including by providing more detailed auction results.

37. **Staff cautioned against the adverse effects of a rise in global interest rates.** In this context, it again recommended maintaining a high level of reserves to signal commitment to macro-financial stability. It also called for strengthening banks' capital buffers to absorb potential losses from an increase in funding costs and a decline in Eurobond prices.

Authorities' views

38. **There was agreement on the importance of maintaining high reserves**. The authorities felt comfortable with the current level of reserves. While they acknowledged the costs

[10] The sharp declines in BdL's T-bill holdings in June and December 2012 and April 2013 correspond to swaps of T-bills for Eurobonds (of about LL6 trillion) conducted with the government. The large increases in banks' T-bill holdings in the second half of 2012 and in late-2013 reflect placements in 8-, 10-, and 12-year T-bills (of about LL7 trillion); banks' holding of T-bills of 7-year or shorter maturity have declined during this period.

of maintaining high reserves in an environment of low global rates, they felt there was no alternative in the near term. They noted that in the medium term the BdL's balance sheet will benefit from larger remuneration on reserves driven by higher global rates.

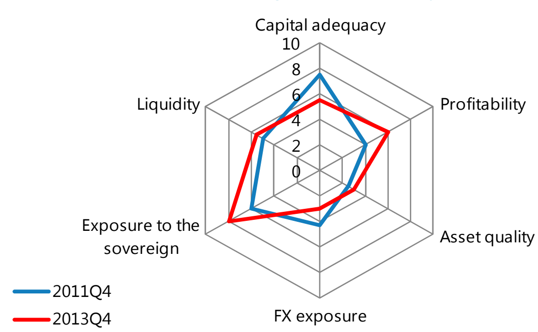
39. **The authorities broadly shared staff's position on government financing and interest rates, but pointed to limited policy alternatives in the current environment**. They underlined the need to stay vigilant and underpin monetary policy changes by strong fiscal consolidation. They remained open to further gradual changes in BdL rates if and when conditions permit, while noting that increases in T-bill rates would likely raise financing costs for the private sector, as lending rates are generally linked to short-term T-bill rates. The T-bill auction system was already transparent, in their view, and recent progress was made on debt management coordination between the BdL and the ministry of finance.[11] Finally, they felt that banks' capital buffers were sufficient and valuation effects from a rise in global rates likely limited, as most Eurobonds are held to maturity.

C. Strengthening the Financial System

The resilience of the banking sector in the current challenging environment and the authorities' plans to develop capital markets were the focus of discussions.

40. **Banks have so far been resilient, but the environment is increasingly challenging.** Regional instability has halted banks' expansion in neighboring countries, and opportunities for credit to the private sector are currently limited. Nonperforming loans (NPLs) have slightly increased over the past year, but remain low. Loans under watch have increased though and the use of overdraft facilities is widespread. Provisioning on NPLs has decreased. Banks' profitability has deteriorated, with an average return on assets now of about 1 percent. Liquidity buffers, including large deposits with the BdL, are strong. Banks' already high exposure to the sovereign has continued to increase.

Banking Sector Stability Map



Source: IMF staff calculations.
Note: Away from center signifies higher risks.

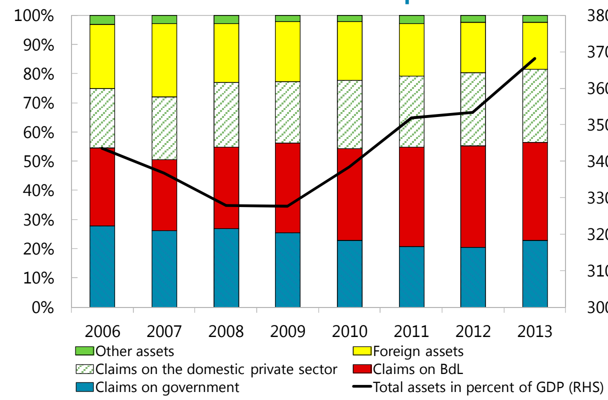
41. **Capital buffers should be further strengthened given banks' large exposure to the sovereign**. The BdL requires by end-2015 an additional capital buffer of 1.5 percent on top of the Basel III minimum plus a 2.5 percent conservation buffer. Staff welcomed this measure, though urged the authorities to have a consistent approach to banks' exposures to the government and the central bank in accordance with the Basel capital adequacy framework.[12]

[11] A joint new debt management strategy was launched in May.

[12] The risk weight on foreign currency deposits with the BdL has been recently reduced from 100 to 50 percent, while holdings of Lebanese government debt in foreign currency still carry a 100 percent risk weight. Exposures in pound to both the BdL and the government carry a zero risk weight.

42. **Staff called for an improvement of loan classification and restructuring rules.** The increase in loans under watch and the widespread use of overdrafts warrant tighter rules guiding the classification of NPLs and the restructuring of loans, including re-aging of overdrafts and arrears. While the authorities are monitoring banks' credit exposures to neighboring countries, staff nonetheless encouraged them to stay vigilant for signs of further asset deterioration, both domestically and abroad. Staff took note of the positive steps to enhance supervision by establishing supervisory colleges to strengthen the cross-border supervision of the largest banks.

Bank Asset Level and Composition



Sources: Lebanese authorities; and IMF staff estimates.

43. **Staff encouraged progress on the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime.** A better understanding of the source of deposits and adequate identification of beneficial owners would allow more effective monitoring of transactions and strengthening of risk-based supervision—necessary to enhance the integrity of the financial sector. In this context, staff called also for strengthening the AML/CFT regime, including by taking the necessary legislative steps to bring the existing AML law and other related legislation in line with the revised international standards.

44. **Over time, there might be scope to encourage banks to reconsider their business model, which currently revolves around channeling deposits to the public sector.** Staff estimates that a deposit growth rate of about 8 percent would cover the economy's financing needs while keeping reserves high. Banks should thus avoid returning to the double-digit deposit growth rate experienced in previous years, which would generate high sterilization costs for the BdL. In this context, banks could lower deposit spreads (relative to international rates) to help slow deposit growth—if and when needed. At the same time, staff saw a need to reduce over time banks' reliance on the sovereign. Banks might have to consider downsizing their balance sheets if public financing needs decline significantly and regional opportunities remain limited.

45. **Preliminary steps to develop capital markets are welcome.** While the banking sector is almost fourfold the size of GDP, the insurance sector and the stock market remain underdeveloped (Selected Issue Paper). The newly established Capital Markets Authority (CMA) issued its first regulations in June 2013; the transfer of part of supervision from the BdL to the CMA is under way. Staff welcomed progress, noting that developing capital markets to complement the banking sector could promote growth, but cautioned that tight regulation and supervision of the financial system are essential to avoid excessive risk taking.

Authorities' views

46. **The authorities felt that staff's assessment underplayed ongoing progress in the prudential framework**. They stressed both the high quality of banks' capital (mostly core Tier 1) and the strict bank capital requirements, which go beyond the Basel III minimum. The authorities justified the different weighting system on the basis of BdL's conservative investment strategy for the international reserves. They also emphasized the efforts made to assess capital adequacy with respect to banks' cross-border exposures through ongoing stress tests. They considered that Lebanon's AML/CFT regime is in practice fully compliant with international standards, while noting that Lebanon's financial intelligence unit, the Special Investigation Commission, is actively cooperating with its foreign counterparts. Finally, they regretted that banks had become overly-cautious by refusing to open accounts to some foreign nationals instead of classifying them as high-risk for increased scrutiny.

47. **A few success stories would allow the stock market to take off.** The authorities acknowledged that the development of capital markets might be held back by current conditions; though they were confident that it could take off if a few large companies (e.g., Telecom) were to be listed.

D. Structural Reforms for Stronger and More Equitable Growth

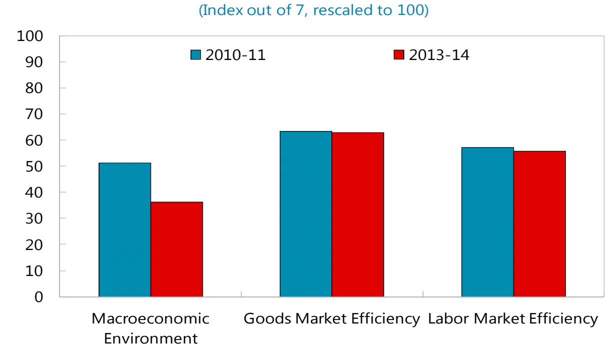
Advancing structural reforms is key to raising Lebanon's growth potential and improving labor market and social conditions.

48. **Reviving the economy and achieving strong, sustainable, and inclusive growth are key challenges**. The sectors that have traditionally been the main drivers of growth—real estate, construction, and tourism—are particularly exposed to security and political conditions. In addition, the refugee crisis has amplified economic and social challenges. There is also a widespread perception that past episodes of high growth have disproportionally benefitted selected sectors or groups, and future growth would need to be more inclusive, create jobs, and make significant inroads to reducing poverty.

49. **Staff underscored the need to advance structural reforms to strengthen the economy and enhance its resilience to shocks**. It noted that Lebanon might have lost some competitiveness, and the pending wage increase could pose additional problems. Staff called for measures to lower the cost of doing business, improve services—in particular electricity provision—and promote jobs, while also strengthening social safety nets. Given the currency peg, pushing structural reforms forward is essential to improving competitiveness and growth, and correcting the moderate real

Deterioration in Competitiveness

(Index out of 7, rescaled to 100)



Source: World Economic Forum, Global Competitiveness Indicators.

exchange rate misalignment (Box 6). Higher and more robust growth would also reduce Lebanon's exposure to shocks and help restore debt sustainability.

50. **There is an urgent need to strengthen electricity provision and lower its cost.** As noted above, transfers to EdL absorb a sizeable share of government resources, and inefficient and inadequate electricity provision adds to the cost of doing business. Staff viewed increases in average electricity tariffs as the main measure to sustainably address these problems (Box 4)—though noting that the associated social impact should be properly mitigated. A more reliable service by EdL would price out expensive private generators, even after tariff increases, and contribute to more efficiency in the economy at large. Staff also called for improving transmission and distribution systems to reduce inefficiencies and minimize losses due to theft and inadequate collections. Finally, it recommended improving governance of the energy sector, as past reform attempts were stalled by vested interests and a lack of political resolve; and expressed disappointment that the debate on the salary scale adjustment had missed an opportunity to put electricity tariff increases and the reform of the sector on the agenda.

51. **More efforts are needed to improve labor markets and support job creation**. Lebanon's ability to create jobs for new labor market entrants has been traditionally inadequate, resulting in high unemployment and emigration of highly-educated people. The refugee crisis has added to these pressures, by increasing the labor force but also shifting the economy toward lower-productivity sectors as most refugees are lower-skilled (Box 1). This de-skilling process could become even more pronounced if the refugee crisis continues. Improving economic prospects could help retain higher-skilled workers and move to higher-productivity sectors. There is also an immediate need to tackle poverty. Cash-for-work programs, micro-finance initiatives, and local economic development plans for the most affected communities are among possible options. Over time, modernizing labor market legislation and improving compliance with labor laws would limit the informal labor market.

52. **Increased private sector participation in infrastructure investment could lift Lebanon's growth potential**. The framework law for Public Private Partnerships (PPPs) has been awaiting parliament approval; its passage would clarify the legal framework and pave the way for better governance and transparency of public projects.

Authorities' views

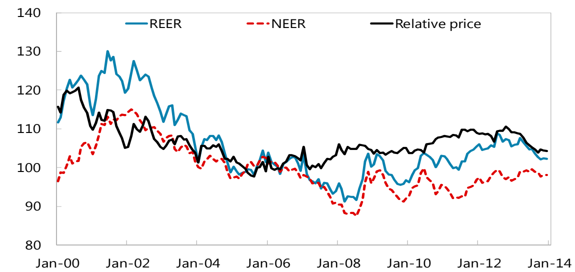
53. **The authorities agreed on the importance of structural reforms**. Given the government's budget constraint, they saw potential from increased private sector participation in infrastructure projects—though some noted that at times this had happened in the context of a weak regulatory environment and little cabinet oversight. They acknowledged though that a number of structural reforms had long been on the agenda, and current political conditions might not permit advancing it.

Box 6. Real Exchange Rate Assessment

Lebanon's CPI-based real effective exchange rate (REER) has appreciated slightly since 2011. This reflects appreciation of the nominal effective exchange rate, while the relative CPI inflation has remained broadly stable. Over a longer horizon, the REER has appreciated by about 9 percent from the level in 2008, a year in which the REER hit a trough, reflecting nominal effective exchange rate appreciation.

CPI-Based Effective Exchange Rates

(Index, 2005=100)



Sources: Information Notice System; and IMF staff estimates.

Lebanon's external current account deficit has remained large and is expected to improve only gradually over the medium term. The deficit is estimated at 12¾ percent of GDP in 2013. Goods exports and tourism-related receipts have declined on account of disruptions to transit routes and heightened domestic and regional uncertainty; however, these effects were offset by increases in the number of nonresident Syrians in Lebanon—unregistered Syrian refugees are treated as nonresidents for balance of payments statistics purposes—and increased humanitarian aid flows. The current account deficit is projected to narrow to about 10½ percent of GDP over the medium term, as exports of goods and services recover with subsiding uncertainty.

The extent of the REER misalignment is assessed using Consultative Group on Exchange Rate (CGER)-type methodologies. Two standard approaches—the macroeconomic balance (MB) and external sustainability (ES)—are estimated using a new toolkit.[1,,2]

Lebanon's exchange rate appears to be moderately overvalued. The assessment is in line with the finding at the time of the last Article IV consultation.

Real Exchange Rate Overvaluation Estimates Using CGER Approaches 1/

(In percent of GDP, unless indicated otherwise)

	MB	ES
CA norm	-9.7	-7.2
Underlying CA balance	-10.4	-10.4
CA gap	-0.7	-3.2
Exchange rate overvaluation (In percent)	2.2	9.8
Exchange rate overvaluation adjusted for multilateral consistency (In percent)	13.0	11.9

Source: IMF staff estimates.

1/ Using a current account elasticity of 0.32.

- **MB approach**. The estimated current account norm is -9.7 percent of GDP and the underlying current account balance is 10.4 percent of GDP. The REER is estimated to be overvalued by 2.2 percent.
- **The ES approach**. The current account balance that would stabilize Lebanon's net external asset position (NEAP) at its estimated end-2012 level of -122 percent of GDP is 7.2 percent of GDP. This would imply a REER overvaluation of 9.8 percent.[3]

Structural reforms are needed to improve competitiveness. While temporary factors underline current weak export performance, no significant improvements in competitiveness can be expected absent structural reforms to reduce the cost of doing business and boost productivity.

[1] The toolkit was developed to facilitate external assessments for countries that are not included in the Consultative Group on Exchange Rate Issues (CGER) sample; it applies the same analytical approaches as those proposed by the CGER, but to a larger panel spanning emerging and developing countries, including Lebanon, unlike in earlier assessments. Additional methodological information can be found at http://www.imf.org/external/pubs/ft/dp/2014/dp1401.pdf.

[2] A third approach commonly used—the Equilibrium Real Exchange Rate (ERER)—could not be applied as it relies on labor productivity data, which are not available for Lebanon. If employment is approximated by a fixed share of the population, the ERER estimation would suggest that the REER is undervalued by about 1½ percent.

[3] While adjusting for multilateral consistency would produce a larger REER overvaluation than suggested by these estimates, the sizeable discrepancy between the two sets of estimates calls into question the validity of this adjustment.

E. Data Issues

54. **The quality of statistics is improving, but further steps are needed.** The Central Administration of Statistics (CAS) released a new CPI index in March with Fund assistance;[13] the production of national accounts was transferred to CAS from the prime minister's office, and quarterly national accounts are under preparation. Staff also noted ongoing efforts to improve balance of payments statistics and plans to release international investment position data; and encouraged the authorities to address the longer delays recently experienced in the release of fiscal data. Adequate and stable funding and high-level support for CAS, along with enhanced cooperation with other agencies, will help further improve statistics. Finally, staff called for better data to underpin much needed communication and monitoring of government's economic plans, thus contributing to their overall transparency and effectiveness; and to strengthen surveillance.

Authorities' views

55. **There was some frustration at the challenges involved in data compilation**. Technical staff—at CAS and other institutions—underscored the inadequate cooperation from other institutions in providing timely inputs; and thought that policymakers need a better appreciation of the importance of reliable statistics.

STAFF APPRAISAL

56. **Lebanon's renowned resilience is being severely tested**. When the Syria crisis erupted in 2011, the economy was already in downturn after four years of strong growth and impressive reduction in public debt. Lebanon has since remained shackled to spillovers from the Syria crisis and political paralysis. Growth has sharply decelerated, the primary fiscal balance has turned into deficit, and public debt has been on an upward trend. The massive refugee population is straining economic and social structures. Unemployment and poverty have increased.

57. **The outlook remains weak without decisive action.** Strong regional and domestic headwinds will continue to weigh on the economy. Persistent imbalances expose Lebanon to large downside risks. Absent strong policies and reforms, potential growth will remain subdued.

58. **A comprehensive, balanced, and multi-year fiscal strategy is key for achieving a sustainable debt reduction**. In this context, there is a need to stop urgently the fiscal deterioration and reestablish primary surpluses. Fiscal adjustment should include both revenue and spending measures, and tilt the composition of spending away from EdL transfers into capital and social outlays. It should also include broadening the tax base and strengthening revenue collections, also by combating evasion and corruption. The authorities' plan to pass a budget is a welcome first step in this direction.

[13] The CPI was not compiled during January–May last year reflecting lack of funding due to disputes between CAS and the prime minister's office. Funding to CAS and data compilation resumed last summer under strong Fund pressure.

59. **The budgetary impact of the proposed salary scale adjustment should be contained**. The ongoing debate on salary increases has detracted attention from the need for broader fiscal consolidation. At a minimum, any salary adjustment should be implemented in installments, with no retroactive payments, and in conjunction with productivity-enhancing measures.

60. **Stronger fiscal management should support fiscal consolidation**. Resuming a regular budget calendar would promote government accountability and enhance the transparency of government spending and its funding. In this context, seeking parliamentary approval for new borrowing in foreign currency would help reduce the government's reliance on the BdL.

61. **Prospective gas resources are not a substitute for adjustment.** There has been excessive focus on how to use rather than properly manage these resources. It is essential to set up a transparent fiscal framework and supporting institutions to manage the related revenue transparently and equitably.

62. **Monetary policy should remain geared to supporting the peg.** The peg has served well as nominal anchor for the economy, and the BdL should continue to maintain high reserves. As fiscal consolidation gains ground, the BdL should gradually withdraw from T-bill auctions. Increasing over time the flexibility of T-bill rates and the transparency of T-bill auctions would lead to interest rates that better reflect the cost of funding the government and to better allocation of banks' assets—without jeopardizing financial stability.

63. **BdL's balance sheet needs to be strengthened.** Reserve accumulation, government financing and quasi-fiscal credit schemes to support the economy—and the associated sterilization costs—have all taken a toll on the BdL's finances. Going forward, there is a need for a strategy to improve them.

64. **Continued efforts to enhance bank regulation and supervision are critical.** Capital buffers should be strengthened, given banks' large exposure to the sovereign; loan classification and restructuring rules improved; and the AML/CFT framework further enhanced—to bring it in line with international standards—by taking necessary legislative steps and strengthening related risk-based banking supervision. Proper regulation and supervision of the financial system are also key to avoiding excessive risk taking and fostering a balanced development of capital markets.

65. **Progress on structural reforms would unlock Lebanon's growth potential and address social inequalities**. Given the recent loss in competitiveness and the moderately overvalued real exchange rate, there is a need to lower the cost of doing business. Electricity sector reform, in particular, could yield immediate benefits. Plans to strengthen generation capacity, switch to natural gas, and increase average electricity tariffs toward cost recovery levels—while protecting more vulnerable consumers—should be implemented without further delay. Social safety nets should be strengthened and unemployment reduced.

66. **Tackling the extremely large refugee crisis requires strong international support.** Absent additional support, the needs of both the Lebanese communities and the refugees will not be met. Sound government policies—including a concerted policy framework to deal with refugee issues and a commitment to fiscal discipline—will send credible signals to donors and will also help mobilize the needed budget support.

67. **Despite ongoing progress, data remain inadequate in some areas**. Reliable and timely statistics are necessary for effectiveness, transparency and accountability of policymaking. High-level support for CAS and cooperation across institutions will help secure continued progress.

68. **Staff proposes to hold the next Article IV consultation on the standard 12-month cycle**.

Lebanon—Risk Assessment Matrix[1]

Domestic and Regional Risks		
Nature/Source of Main Threats	**Likelihood/Time Horizon/Expected Impact**	**Recommended Policy Response**
Continued spillovers from Syria crisis and prolonged refugee crisis	**High/Short to Medium Term/High** Intensification of the Syria crisis could further strain host communities, increase economic costs (including budgetary costs), weaken already-limited public service provision, and put further pressure on labor and housing markets. The deterioration in security and fiscal position could undermine confidence, which could affect deposit flows and reserve, raise dollarization, and lead to tighter fiscal and external financing conditions and lower growth.	Renew efforts to secure donor assistance to cover humanitarian costs related to refugees and mitigate impact on Lebanese host communities. Formulate a comprehensive strategy to deal with the refugee crisis. Strengthen fiscal transparency and undertake fiscal consolidation to create fiscal space to accommodate spending pressures; these actions would send strong signals and help secure donor support. Continue to maintain a high level of international reserves as a buffer and signal of commitment to macro-financial stability. Further strengthen banks' capital buffers.
Further weakening of public finances	**High/Short Term/High** Higher current spending in response to domestic and Syria-related developments, and weaker revenue administration or tax cuts, would further increase the fiscal deficit, government financing needs, and public debt. Financing pressures could undermine confidence and affect deposit flows and reserve, raise dollarization, and lead to tighter fiscal and external financing conditions and lower growth.	Secure parliamentary approval of a 2014 budget consistent with generating primary fiscal surpluses and thus putting public debt on a downward path over the medium term. Reinvigorate the electricity sector reform process with a view to reducing transfers to Electricité du Liban (EdL). Gradually increase electricity tariffs to levels consistent with cost recovery, while protecting lower-tier consumers. Continue to maintain a high level of international reserves and further strengthen banks' capital buffers (see above).
Delays in structural reforms	**High/Short to Medium Term/Medium** Failure to address infrastructure bottlenecks, particularly in the electricity sector, and continued ad-hoc enforcement of regulations could reduce Lebanon's competitiveness and growth potential. Protracted low growth could worsen debt dynamics and unemployment and threaten social stability.	Shift spending composition away from EdL subsidies into capital and social spending. In this context, increase electricity production efficiency through electricity sector reform (see above).

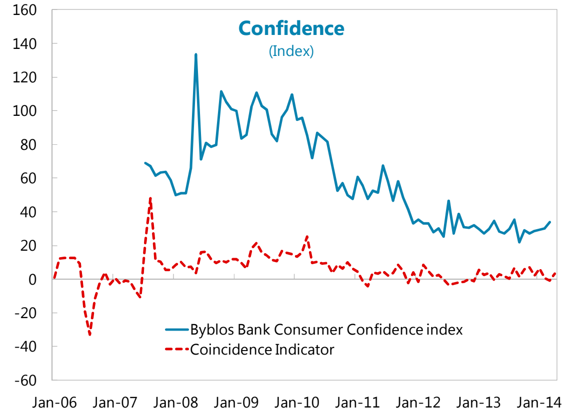
Lebanon—Risk Assessment Matrix (concluded)		
Global Risks		
Nature/Source of Main Threats	**Likelihood/Time Horizon/Expected Impact**	**Recommended Policy Response**
Side-effects from global financial conditions (surges in global financial market volatility)	**High/Medium Term/Medium** Higher-than-expected increases in global interest rates could push Lebanon into a tighter monetary policy stance, with rising financing costs negatively affecting the government and the banking sector. Declines in the price of the sovereign debt could impact banks' balance sheets**.**	Strengthen fiscal discipline to maintain confidence and reduce government's financing needs. Continue to maintain a high level of international reserves and further strengthen banks' capital buffers (see above).
A sharp increase in geopolitical tensions surrounding Russia/Ukraine that creates significant disruptions in global financial, trade and commodity markets	**Medium/Short Term/Low** Higher costs of fuel imports would lead to higher electricity subsidies, with negative effects on the fiscal balance.	Increase electricity production efficiency through electricity sector reform (see above).

[1] The Risk Assessment Matrix (RAM) shows events that occur materially after the baseline path (the scenario most likely to materialize in the view of the IMF staff). The likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" indicates a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks at the time of the discussions with the authorities.

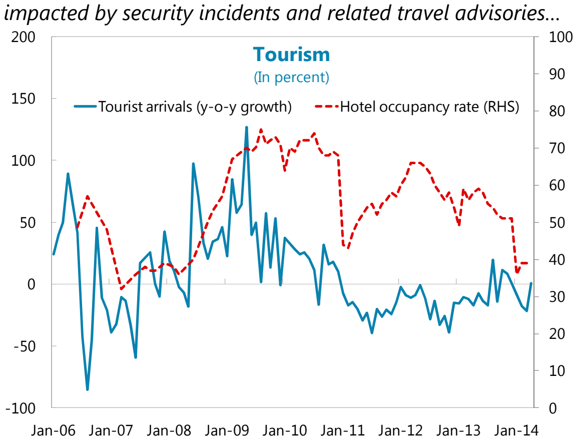
Figure 1. Lebanon: Real Sector Developments, 2002–14

Growth has decelerated sharply….

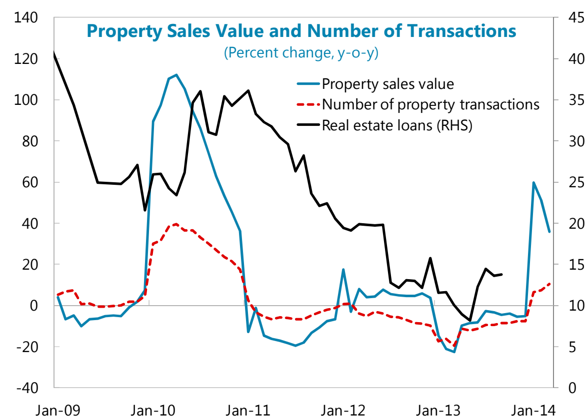
…as confidence was sapped by regional and domestic developments.



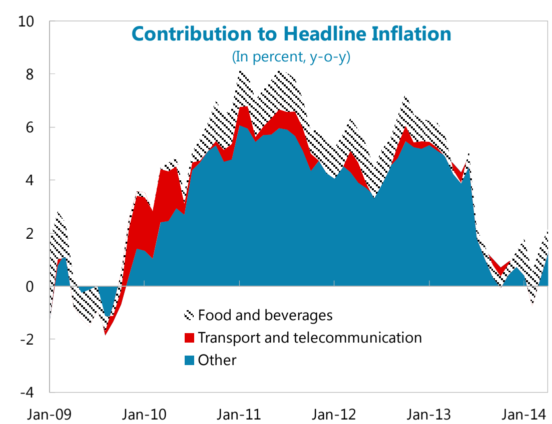
Traditional growth engines have suffered. Tourism was impacted by security incidents and related travel advisories…



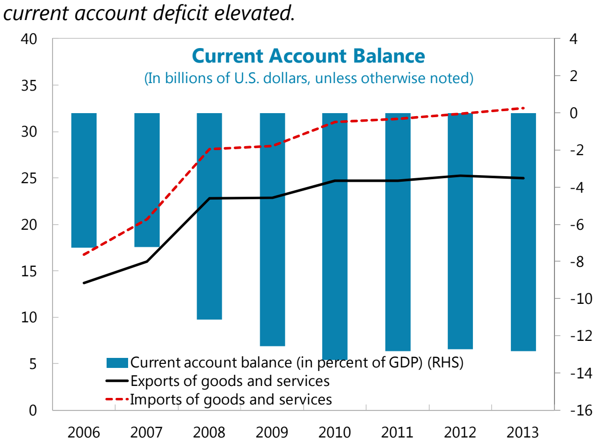
…and the real estate sector contracted.



Inflationary pressures remain subdued.



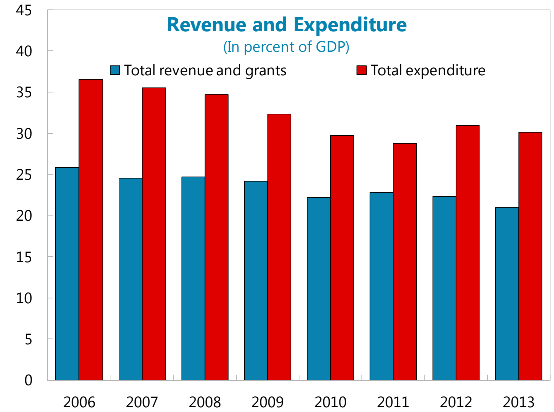
Imports increased modestly and exports stagnated, keeping the current account deficit elevated.



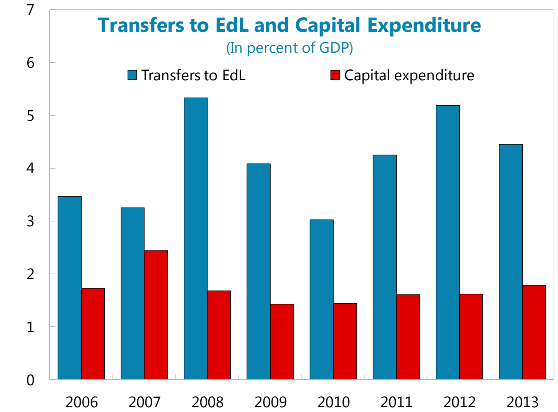
Sources: Lebanese authorities; Byblos Bank; and IMF staff estimates.

Figure 2. Lebanon: Fiscal Sector Developments, 2006–13

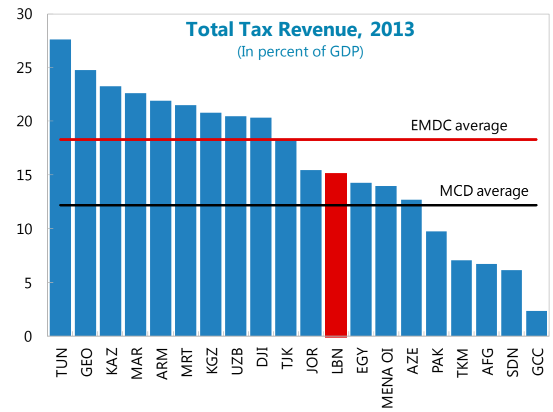
Revenue has slowed down while spending has not adjusted.



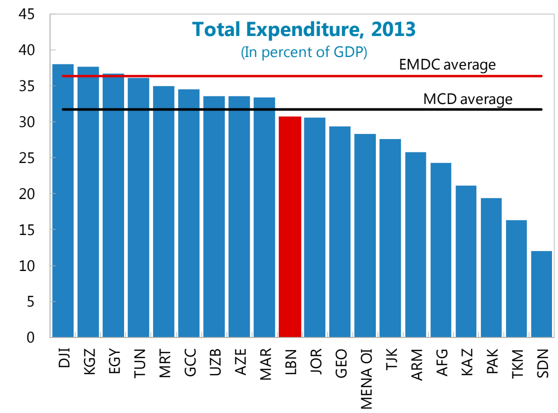
Transfers to the EdL remain elevated, crowding out capital spending.



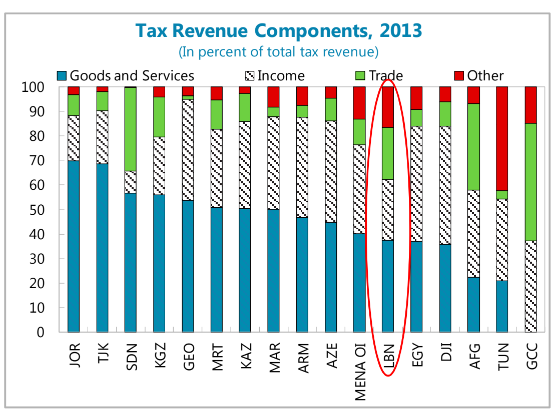
Tax revenue remains below emerging markets...



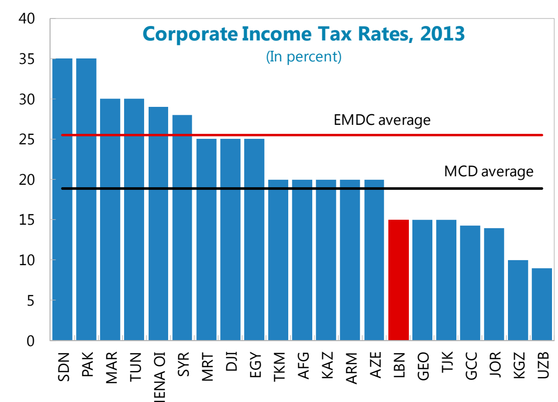
...while spending is closer to comparators.



Reliance on indirect taxes could be increased...



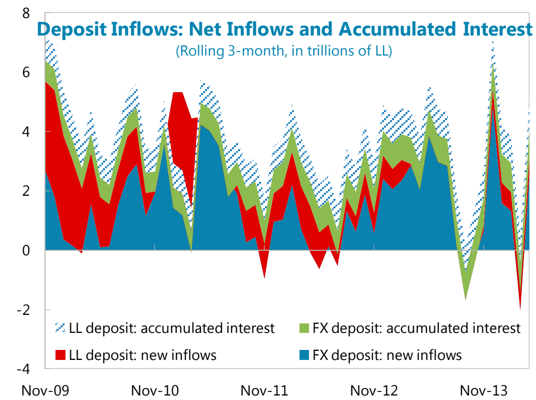
....and there is likely scope to increase income taxes as well.



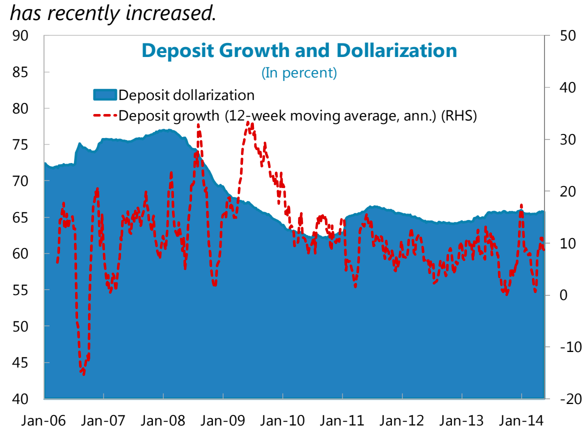
Sources: Lebanese authorities; and IMF staff estimates.

Figure 3. Lebanon: Monetary and Financial Sector Developments, 2006–14

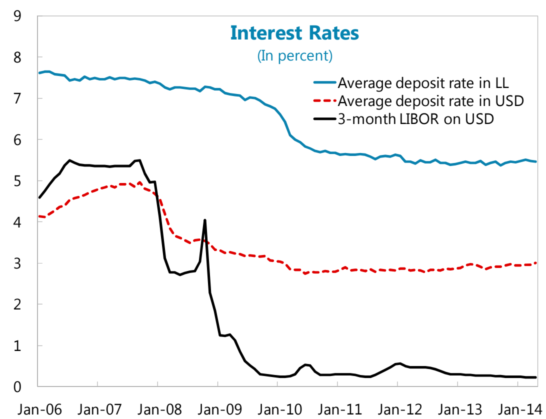
There have been occasional deposit outflows…



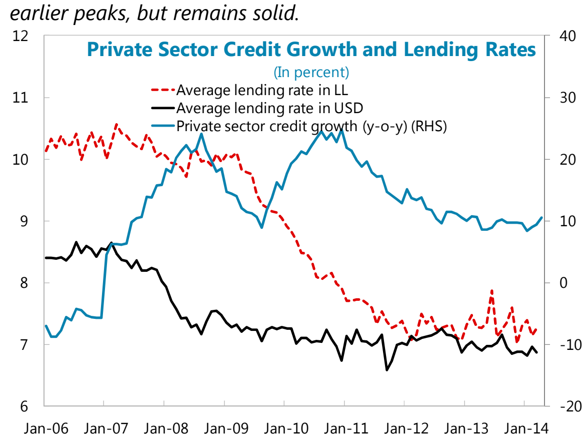
…but deposit growth has generally held up, while dollarization has recently increased.



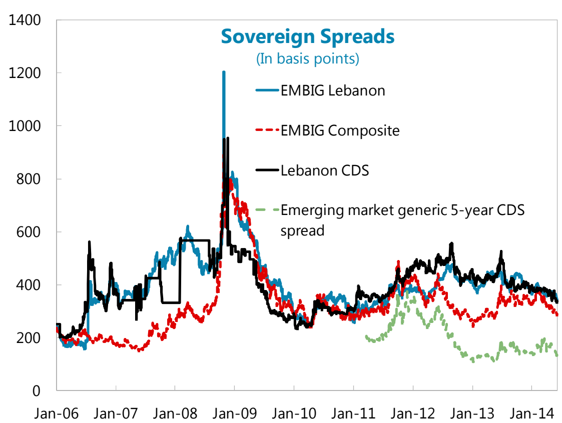
Deposit interest rates are highly competitive.



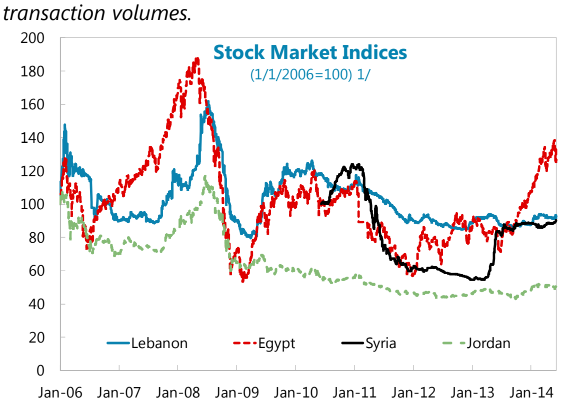
Credit to the private sector growth has decelerated from earlier peaks, but remains solid.



Spreads have moved in line with comparators…



… while the stock market has remain muted reflecting limited transaction volumes.

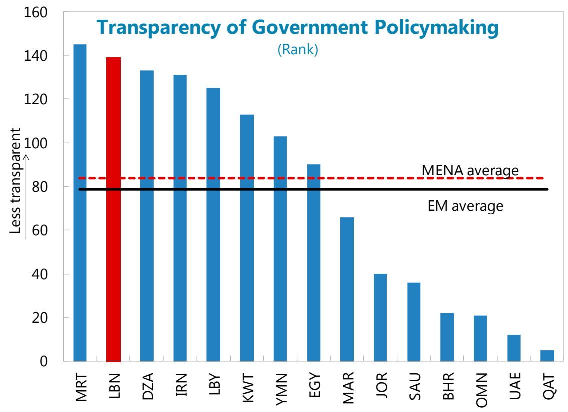


1/ For Syria, 06/08/2010=100.

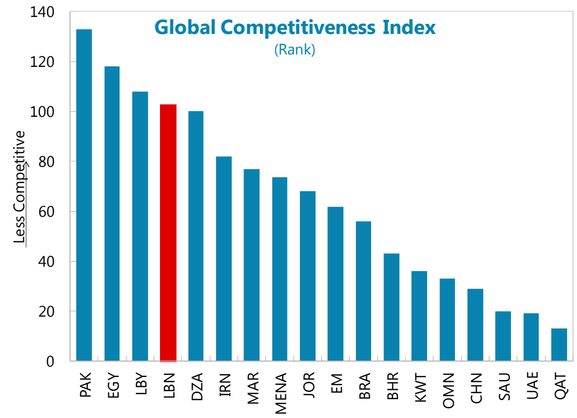
Sources: Lebanese authorities; Bloomberg; Haver; and IMF staff estimates.

Figure 4. Lebanon: Structural Indicators, 2013

Lebanon ranks low on transparency...



...and in terms of competitiveness.



While standing out on education, Lebanon fares poorly on infrastructure, labor market issues, and corruption.

Sources: Lebanese authorities; World Bank; World Economic Forum; PRS Group; and IMF staff calculations.

Table 1. Lebanon: Selected Economic Indicators, 2011–19

(Population: est. 4.4 million; 2012)
(Per capita GDP: est. US$9,609; 2012)
(Quota: SDR 266 million, 0.11 percent of total)
(Poverty rate: 28 percent; 2004-05)
(Unemployment: 11.0 percent; 2011) 1/
(Main products and exports: services, jewelry)
(Key export markets: UAE, Saudi Arabia, Switzerland)

	2011	2012	2013	Proj.					
	Act.	Prel.	Est.	2014	2015	2016	2017	2018	2019
Output and prices				(Annual percentage change)					
Real GDP (market prices)	2.0	2.5	1.5	1.8	2.5	4.0	4.0	4.0	4.0
GDP deflator	3.4	4.6	3.2	3.4	4.4	2.9	2.3	2.3	2.4
Consumer prices (end-of-period)	5.4	6.3	1.3	4.5	3.5	2.5	2.5	2.5	2.5
Consumer prices (period average)	7.2	5.9	3.2	3.1	4.0	3.0	2.5	2.5	2.5
Investment and saving				(In percent of GDP)					
Gross capital formation	26.9	24.9	24.6	24.5	23.8	24.2	24.9	25.8	26.9
Government	1.6	1.6	1.8	2.6	2.7	2.2	2.2	2.2	2.2
Nongovernment	25.3	23.2	22.8	21.9	21.1	22.0	22.8	23.6	24.7
Gross national savings	14.1	12.1	11.8	11.9	11.6	12.5	13.8	15.0	16.5
Government	-4.3	-7.0	-7.4	-8.5	-9.2	-9.2	-8.8	-8.8	-9.0
Nongovernment	18.4	19.1	19.2	20.4	20.8	21.7	22.6	23.7	25.5
Central government finances (cash basis)				(In percent of GDP)					
Revenue (including grants)	22.8	22.3	20.9	20.9	21.9	21.9	22.0	22.2	22.1
of which: grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	28.7	31.0	30.1	32.0	33.7	33.2	33.0	33.1	33.4
Budget balance (including grants)	-5.9	-8.6	-9.2	-11.1	-11.9	-11.4	-11.0	-10.9	-11.3
Primary balance (including grants)	3.5	-0.2	-0.8	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Total government debt	134	134	141	145	148	149	151	153	155
Monetary sector				(Annual percentage change, unless otherwise indicated)					
Credit to the private sector	12.9	10.5	9.6	7.1	6.9	7.0	6.3	6.4	6.5
Reserve money	28.4	47.8	3.5	7.6	13.8	16.7	16.3	9.9	4.7
Broad money 2/	7.2	7.9	9.0	8.0	8.0	8.0	8.0	8.0	8.0
Deposit dollarization (level)	66.1	64.9	66.2	66.2	65.5	65.0	64.5	64.0	64.0
Interest rates (period average, in percent)									
Three-year treasury bill yield	6.0	6.5	6.6	6.7	7.0	7.6	8.0	8.3	8.4
Five-year treasury bill yield	6.2	6.7	6.8	...	...	...	...	...	...
External sector				(In percent of GDP, unless otherwise indicated)					
Exports of goods and services(in US$, percentage change)	0.1	2.0	-1.0	4.7	5.2	5.7	6.2	6.0	5.8
Imports of goods and services (in US$, percentage change)	1.0	1.9	1.9	4.7	4.1	4.6	4.7	4.8	4.8
Balance of goods and services	-16.5	-15.6	-16.8	-16.7	-15.7	-14.8	-13.8	-13.0	-12.3
Current account	-12.8	-12.7	-12.8	-12.6	-12.2	-11.7	-11.1	-10.8	-10.4
Foreign direct investment	6.8	6.7	6.7	7.1	7.7	7.9	8.2	8.5	8.8
Total external debt 3/	169	168	174	177	177	177	178	180	181
Gross reserves (in billions of U.S. dollars) 4/	31.6	32.2	33.9	35.0	36.3	38.5	41.6	45.6	49.6
In months of next year imports of goods and services	11.9	11.9	11.9	11.8	11.8	11.9	12.3	12.8	12.8
In percent of short-term external debt 5/	53.8	51.5	49.6	47.6	45.9	44.8	44.9	45.7	46.1
In percent of banking system foreign currency deposits	41.4	39.7	37.6	35.9	34.9	34.5	34.8	35.5	35.7
In percent of total banking system deposits	27.3	25.7	24.9	23.8	22.8	22.4	22.4	22.7	22.8
Memorandum items:									
Nominal GDP (in billions of U.S. dollars)	40.1	43.0	45.0	47.4	50.7	54.2	57.7	61.4	65.4
Foreign-exchange-denominated bank deposits (percent change)	12.7	5.9	11.1	8.1	6.9	7.2	7.2	7.2	8.0
Commercial bank total assets	351	354	366	376	380	383	389	395	401
Real effective exchange rate (annual average, percent change)	-1.2	-0.1	4.0	-0.4	1.4	0.1	-0.5	0.0	0.0

Sources: Lebanese authorities; and IMF staff estimates.
1/ According to a labor force survey conducted by the World Bank in April 2011. The latest official unemployment rate is 9.7 percent in 2007.
2/ Defined as currency in circulation plus resident and nonresident deposits.
3/ Includes nonresident deposits.
4/ Excluding gold and encumbered assets.
5/ Short-term debt on a remaining maturity basis, including short-term nonresident deposits.

Table 2. Lebanon: Central Government Overall Deficit and Financing, 2011–19

	2011 Act.	2012 Act.	2013 Act.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
	(In billions of Lebanese pounds, unless otherwise indicated)								
Revenue and grants	13,769	14,462	14,199	14,887	16,690	17,869	19,104	20,518	21,811
Revenue	13,769	14,462	14,199	14,885	16,687	17,865	19,100	20,513	21,807
Tax revenue	9,885	10,185	10,115	10,627	12,168	13,047	13,995	15,103	16,069
Taxes on income and profits	2,423	2,514	2,501	2,635	3,367	3,694	4,035	4,413	4,765
Income Tax on Profits	1,032	1,006	974	1,025	1,217	1,302	1,385	1,474	1,570
Income Tax on Wages and Salaries	455	523	587	618	661	707	752	801	853
Income Tax on Capital Gains & Dividends	243	296	231	243	400	428	456	485	516
Income Tax on Interest Income	652	647	660	697	1,034	1,197	1,379	1,586	1,755
Penalties on Income Tax	40	42	49	52	55	59	63	67	71
Taxes on property	1,144	1,193	1,201	1,274	1,363	1,458	1,551	1,651	1,758
Taxes on domestic goods and services	3,685	3,749	3,782	3,974	4,250	4,507	4,814	5,146	5,445
of which: VAT revenues	3,300	3,276	3,296	3,463	3,703	3,921	4,191	4,482	4,739
Taxes on international trade 1/	2,179	2,251	2,158	2,246	2,456	2,604	2,761	3,005	3,155
Tariffs	777	796	817	860	920	984	1,047	1,115	1,187
Excises	1,402	1,455	1,341	1,386	1,536	1,620	1,713	1,891	1,968
Other taxes	454	478	473	498	733	784	834	888	945
Nontax revenue	3,166	3,586	3,268	3,428	3,667	3,933	4,184	4,453	4,743
of which: Telecom	1,960	2,458	2,156	2,269	2,428	2,598	2,764	2,942	3,133
Other treasury revenue	718	691	816	830	851	885	920	957	996
Grants	0	0	0	1	3	4	4	5	5
Total expenditures	17,590	20,143	20,512	22,851	25,771	27,168	28,650	30,636	32,916
Current primary expenditure	10,951	13,628	13,576	14,771	16,571	17,457	18,011	19,027	20,142
Personnel cost 2/	5,533	6,723	6,473	7,298	8,778	9,393	9,993	10,636	11,326
Transfers to EdL 3/	2,565	3,361	3,021	3,062	3,045	2,993	2,783	2,819	2,881
Other current 4/	2,853	3,544	4,082	4,411	4,749	5,071	5,235	5,572	5,935
Interest payments	5,665	5,465	5,720	6,220	7,169	7,945	8,751	9,592	10,575
Domestic currency debt	3,552	3,333	3,341	3,888	4,595	5,110	5,606	6,029	6,572
Foreign currency debt	2,113	2,132	2,379	2,332	2,574	2,835	3,145	3,564	4,002
Capital expenditure	974	1,050	1,216	1,861	2,030	1,766	1,889	2,016	2,199
Domestically financed	554	649	949	1,403	1,471	1,140	1,212	1,289	1,372
Foreign financed	420	401	267	458	559	626	677	727	827
Overall balance (checks issued)	-3,822	-5,681	-6,313	-7,965	-9,081	-9,300	-9,546	-10,118	-11,104
Primary balance (checks issued)	1,843	-216	-593	-1,745	-1,912	-1,354	-796	-525	-530
Statistical discrepancy/float	243	84	77	30	0	0	0	0	0
Overall balance (cash basis)	-3,578	-5,597	-6,235	-7,935	-9,080	-9,300	-9,546	-10,118	-11,104
Primary balance (cash basis)	2,087	-132	-515	-1,715	-1,912	-1,354	-796	-525	-530
Net financing	3,578	5,597	6,235	7,935	9,080	9,300	9,546	10,118	11,102
of which: Banking system	4,240	4,416	5,939	6,330	7,159	7,467	7,660	8,065	8,808
of which: Government institutions	270	-59	638	344	672	726	722	750	829
of which: Other	-894	326	483	1,261	1,249	1,106	1,165	1,302	1,465
Memorandum items:									
Primary balance (on a checks issued basis, excluding Telecom revenues)	-116	-2,674	-2,749	-4,014	-4,340	-3,952	-3,560	-3,467	-3,662
Total government gross debt	80,887	86,959	95,692	103,705	112,785	122,085	131,631	141,749	152,851
of which: foreign currency denominated debt	31,547	36,761	39,380	42,904	46,527	49,929	53,614	57,637	62,007

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

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

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

3/ Excludes principal and interest payments paid on behalf of Électricité du Liban (EdL).

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

Table 3. Lebanon: Central Government Overall Deficit and Financing, 2011–19

	2011 Act.	2012 Act.	2013 Act.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
	(In percent of GDP, unless otherwise indicated)								
Revenue and grants	22.8	22.3	20.9	20.8	21.8	21.9	22.0	22.2	22.1
Revenue	22.8	22.3	20.9	20.8	21.8	21.9	22.0	22.2	22.1
Tax revenue	16.4	15.7	14.9	14.9	15.9	16.0	16.1	16.3	16.3
Taxes on income and profits	4.0	3.9	3.7	3.7	4.4	4.5	4.6	4.8	4.8
Income Tax on Profits	1.7	1.6	1.4	1.4	1.6	1.6	1.6	1.6	1.6
Income Tax on Wages and Salaries	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Income Tax on Capital Gains & Dividends	0.4	0.5	0.3	0.3	0.5	0.5	0.5	0.5	0.5
Income Tax on Interest Income	1.1	1.0	1.0	1.0	1.4	1.5	1.6	1.7	1.8
Penalties on Income Tax	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on property	1.9	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Taxes on domestic goods and services	6.1	5.8	5.6	5.6	5.6	5.5	5.5	5.6	5.5
of which: VAT revenues	5.5	5.1	4.9	4.8	4.8	4.8	4.8	4.8	4.8
Taxes on international trade 1/	3.6	3.5	3.2	3.1	3.2	3.2	3.2	3.2	3.2
Tariffs	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Excises	2.3	2.2	2.0	1.9	2.0	2.0	2.0	2.0	2.0
Other taxes	0.8	0.7	0.7	0.7	1.0	1.0	1.0	1.0	1.0
Nontax revenue	5.2	5.5	4.8	4.8	4.8	4.8	4.8	4.8	4.8
of which: Telecom	3.2	3.8	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Other treasury revenue	1.2	1.1	1.2	1.2	1.1	1.1	1.1	1.0	1.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditures	29.1	31.1	30.2	32.0	33.7	33.2	32.9	33.1	33.4
Current primary expenditure	18.1	21.0	20.0	20.7	21.7	21.4	20.7	20.6	20.4
Personal cost 2/	9.2	10.4	9.5	10.2	11.5	11.5	11.5	11.5	11.5
Transfers to EdL 3/	4.2	5.2	4.5	4.3	4.0	3.7	3.2	3.0	2.9
Other current 4/	4.7	5.5	6.0	6.2	6.2	6.2	6.0	6.0	6.0
Interest payments	9.4	8.4	8.4	8.7	9.4	9.7	10.1	10.4	10.7
Domestic currency debt	5.9	5.1	4.9	5.4	6.0	6.3	6.4	6.5	6.7
Foreign currency debt	3.5	3.3	3.5	3.3	3.4	3.5	3.6	3.9	4.1
Capital expenditure	1.6	1.6	1.8	2.6	2.7	2.2	2.2	2.2	2.2
Domestically financed	0.9	1.0	1.4	2.0	1.9	1.4	1.4	1.4	1.4
Foreign financed	0.7	0.6	0.4	0.6	0.7	0.8	0.8	0.8	0.8
Overall balance (checks issued)	-6.3	-8.8	-9.3	-11.2	-11.9	-11.4	-11.0	-10.9	-11.3
Primary balance (checks issued)	3.1	-0.3	-0.9	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Statistical discrepancy/float	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-5.9	-8.6	-9.2	-11.1	-11.9	-11.4	-11.0	-10.9	-11.3
Primary balance (cash basis)	3.5	-0.2	-0.8	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Net financing	5.9	8.6	9.2	11.1	11.9	11.4	11.0	10.9	11.3
Banking system	7.0	6.8	8.8	8.9	9.4	9.1	8.8	8.7	8.9
Government institutions	0.4	-0.1	0.9	0.5	0.9	0.9	0.8	0.8	0.8
Other	-1.5	1.9	-0.3	1.8	1.6	1.4	1.3	1.4	1.5
Memorandum items:									
Primary balance (on a checks issued basis, excluding Telecom revenues)	-0.2	-4.1	-4.1	-5.6	-5.7	-4.8	-4.1	-3.7	-3.7
Nominal GDP (annual and in billions of LL)	60,419	64,766	67,839	71,405	76,388	81,747	86,964	92,560	98,570
Total government gross debt (in percent of GDP)	134	134	141	145	148	149	151	153	155
of which: foreign currency denominated debt (in percent of gross	39	42	41	41	41	41	41	41	41

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

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

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

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

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

Table 4. Lebanon: Government Debt, 2011–19 1/

	2011 Act.	2012 Act.	2013 Act.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
	(In millions of U.S. dollars)								
Net debt 2/	51,407	54,457	59,112	64,428	70,452	76,621	82,953	89,665	97,030
Gross debt by holder	53,656	57,684	63,477	68,793	74,816	80,985	87,318	94,029	101,393
Banking system	39,786	43,637	48,153	52,403	57,152	62,105	67,187	72,537	78,379
Treasury bills	26,649	27,213	30,384	32,977	35,947	39,157	42,346	45,663	49,327
Other domestic loans	163	105	85	137	137	137	137	137	137
Eurobonds	12,975	16,318	17,684	19,289	21,068	22,812	24,704	26,737	28,916
Nonbanks	13,870	14,048	15,325	16,390	17,664	18,880	20,131	21,493	23,014
Treasury bills	5,918	5,980	6,886	7,219	7,869	8,571	9,270	9,996	10,798
Government institutions 3/	4,337	4,298	4,721	4,949	5,395	5,877	6,356	6,854	7,403
Other	1,581	1,682	2,165	2,269	2,474	2,694	2,914	3,142	3,394
Eurobonds	5,261	5,433	5,887	6,422	7,014	7,595	8,225	8,901	9,627
Concessional loans	2,638	2,561	2,462	2,697	2,760	2,696	2,636	2,594	2,588
Foreign currency T-bonds	53	74	90	52	21	17	0	1	2
Government deposits	2,249	3,227	4,366	4,364	4,364	4,364	4,364	4,364	4,364
	(In percent of GDP)								
Net debt 2/	128	127	131	136	139	141	144	146	148
Gross debt by holder	134	134	141	145	148	149	151	153	155
Banking system	99	102	107	111	113	115	116	118	120
Treasury bills	66	63	68	70	71	72	73	74	75
Other domestic loans	0	0	0	0	0	0	0	0	0
Eurobonds	32	38	39	41	42	42	43	44	44
Nonbanks	35	33	34	35	35	35	35	35	35
Treasury bills	15	14	15	15	16	16	16	16	17
Government institutions 3/	11	10	10	10	11	11	11	11	11
Other	4	4	5	5	5	5	5	5	5
Eurobonds	13	13	13	14	14	14	14	14	15
Concessional loans	7	6	5	6	5	5	5	4	4
Foreign currency T-bonds	0	0	0	0	0	0	0	0	0
Government deposits	6	8	10	9	9	8	8	7	7
Memorandum items:									
Nominal GDP (in billions of Lebanese pounds)	60,419	64,766	67,839	71,405	76,388	81,747	86,964	92,560	98,570
Foreign currency debt (in percent of gross debt)	39	42	41	41	41	41	41	41	41

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

1/ Includes all debt contracted by the treasury on behalf of the central government and public agencies other than the Banque du Liban, accrued interest; and Banque du Liban lending to Électricité 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, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
				(In trillions of Lebanese pounds)					
Net foreign assets	96.2	99.8	98.2	101.8	107.1	113.9	122.5	132.6	143.0
Banque du Liban	66.5	69.3	65.6	66.5	69.1	72.8	78.1	84.6	91.1
Commercial banks	29.7	30.5	32.6	35.2	38.0	41.1	44.4	48.0	51.8
Net domestic assets	82.8	93.3	112.4	125.7	138.5	151.4	163.9	176.8	191.2
Net claims on public sector	51.7	55.9	62.0	68.3	75.4	82.9	90.6	98.6	107.4
of which: Net claims on government	55.5	61.7	68.0	74.3	81.5	88.9	96.6	104.7	113.5
Banque du Liban	11.4	14.7	11.2	12.8	11.0	9.0	7.1	5.1	2.9
Commercial banks	44.1	46.9	56.8	61.6	70.5	79.9	89.5	99.5	110.6
Claims on private sector	52.0	57.4	63.0	67.5	72.1	77.2	82.1	87.3	93.0
Other items (net)	-20.9	-20.0	-12.5	-10.1	-9.1	-8.7	-8.7	-9.1	-9.2
Broad money (M5) 1/	179.0	193.2	210.6	227.4	245.6	265.3	286.5	309.4	334.2
In Lebanese pounds	62.7	70.1	73.8	79.7	87.7	96.0	105.1	114.9	124.1
Currency in circulation	2.9	3.2	3.4	3.7	4.0	4.3	4.6	5.0	5.4
Deposits in Lebanese pounds	59.8	66.9	70.4	76.0	83.7	91.7	100.4	109.9	118.7
Deposits in foreign currency	116.3	123.1	136.8	147.7	157.9	169.3	181.4	194.5	210.1
				(Year-on-year percent change)					
Net foreign assets	3.0	3.8	-1.7	3.7	5.3	6.3	7.6	8.2	7.8
Net domestic assets	12.5	12.8	20.4	11.8	10.2	9.3	8.3	7.9	8.1
Net claims on public sector	6.1	8.1	10.9	10.2	10.5	9.9	9.2	8.9	8.9
Claims on private sector	12.9	10.5	9.6	7.1	6.9	7.0	6.3	6.4	6.5
Broad money (M5) 1/	7.2	7.9	9.0	8.0	8.0	8.0	8.0	8.0	8.0
In Lebanese pounds	-1.7	11.8	5.3	8.0	10.1	9.4	9.4	9.4	8.0
Deposits in foreign currency	12.7	5.9	11.1	8.0	6.9	7.2	7.2	7.2	8.0
Memorandum items:				(In trillions of Lebanese pounds, except where otherwise indicated)					
Banque du Liban:									
Net foreign exchange position 2/	28.2	28.7	21.2	18.4	18.8	19.5	21.4	24.3	25.3
Foreign assets	70.0	72.0	68.2	68.9	71.1	74.7	79.7	86.2	92.8
Foreign currency liabilities	41.8	43.3	47.1	50.5	52.4	55.2	58.3	62.0	67.4
Net foreign exchange position, in billions of U.S. dollars 2/	18.4	18.8	13.8	11.9	12.2	12.6	13.9	15.8	16.5
Claims on public sector (net)	10.6	13.0	9.6	11.2	9.4	7.5	5.6	3.6	1.3
Claims on commercial banks	-22.0	-20.5	-19.6	-21.3	-20.0	-17.4	-15.2	-15.1	-15.1
Reserve money	13.4	19.8	20.5	22.0	25.1	29.3	34.0	37.4	39.2
Gross international reserves (including gold), in billions of U.S. dollars 3/	46.0	47.5	45.0	45.4	46.9	49.3	52.6	56.9	61.2
Gross international reserves (excluding gold), in billions of U.S. dollars 4/	31.6	32.2	33.9	35.0	36.3	38.5	41.6	45.6	49.6
in percent of banking system foreign currency deposits	41.4	39.7	37.6	35.9	34.9	34.5	34.8	35.5	35.7
in percent of total banking system deposits	27.3	25.7	24.9	23.8	22.8	22.4	22.4	22.7	22.8
Share of foreign currency deposits in total private sector deposits (in percent)	66.1	64.9	66.2	66.2	65.5	65.0	64.5	64.0	64.0

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

1/ Broad money (M5) is defined as M3 (currency + resident deposits) + nonresident deposits.
2/ Defined 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.
3/ Defined as all official foreign currency assets, less encumbered foreign assets.
4/ Defined as all official foreign currency assets, less encumbered foreign assets and gold.

Table 6. Lebanon: Balance of Payments, 2011–19

	2011 Act.	2012 Act.	2013 Est.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.	2019 Proj.
	(In millions of U.S. dollars, unless otherwise indicated)								
Current account (excl. official transfers)	-5,142	-5,469	-5,776	-5,947	-6,162	-6,332	-6,429	-6,660	-6,803
Goods (net)	-13,927	-14,713	-15,504	-16,216	-16,533	-16,972	-17,522	-18,090	-18,677
Exports, f.o.b.	5,426	5,627	5,117	5,227	5,528	5,884	6,274	6,714	7,172
Imports, f.o.b.	-19,354	-20,340	-20,621	-21,443	-22,061	-22,856	-23,796	-24,805	-25,849
Services (net)	7,300	8,006	7,952	8,315	8,591	8,955	9,562	10,102	10,616
Receipts	19,301	19,601	19,864	20,933	22,004	23,217	24,639	26,048	27,491
Payments	-12,001	-11,595	-11,912	-12,618	-13,412	-14,262	-15,077	-15,946	-16,875
o/w: Tourism (net)	2,966	2,344	1,962	2,090	2,212	2,368	2,675	2,946	3,239
o/w: Other services (net)	4,333	5,662	5,990	6,225	6,379	6,587	6,887	7,156	7,376
Income (net)	-1,065	-1,162	-1,733	-1,880	-2,029	-2,164	-2,486	-2,859	-3,085
Credit	1,628	1,750	1,578	1,631	2,051	2,979	3,869	4,873	5,601
Debit	-2,692	-2,912	-3,311	-3,511	-4,080	-5,143	-6,355	-7,732	-8,686
o/w: Interest of government debt	-484	-458	-475	-500	-542	-583	-617	-661	-716
Current transfers (net) 1/	2,550	2,400	3,509	3,834	3,809	3,848	4,018	4,187	4,343
Official (net)	0	0	0	0	0	0	0	0	0
Private (net)	2,550	2,400	3,509	3,834	3,809	3,848	4,018	4,187	4,343
Capital and financial account	9,207	6,988	7,511	7,048	7,517	8,466	9,565	10,642	10,755
Capital transfers (net)	51	41	40	27	28	28	29	29	29
Direct investment (net) 2/	2,730	2,881	3,026	3,350	3,891	4,295	4,744	5,239	5,784
Portfolio investment, loans and other (C&D) (net)	6,426	4,067	4,445	3,671	3,598	4,143	4,792	5,374	4,941
Government (net)	-99	539	723	482	420	288	295	356	405
BdL 3/	-168	-502	2	-200	-200	-100	-200	0	0
Banks (net)	6,428	3,827	5,027	3,112	3,361	3,630	3,921	4,234	4,573
Foreign assets of banks 4/	1,543	-582	-1,348	-1,741	-1,881	-2,031	-2,193	-2,369	-2,558
Nonresident deposits 5/	4,884	4,409	6,376	4,854	5,242	5,661	6,114	6,603	7,132
Nonbank private sector (net)	265	203	-1,307	276	17	325	776	784	-37
Errors and omissions	-2,265	-891	0	0	0	0	0	0	0
Overall balance	1,800	628	1,734	1,101	1,355	2,133	3,136	3,983	3,951
Financing	-1,800	-628	-1,734	-1,101	-1,355	-2,133	-3,136	-3,983	-3,951
Official reserves (- increase)	-1,760	-589	-1,715	-1,101	-1,355	-2,133	-3,136	-3,983	-3,951
Use of Fund Resources	-40	-39	-19	0	0	0	0	0	0
Purchases	0	0	0	0	0	0	0	0	0
Repurchases	-40	-39	-19	0	0	0	0	0	0
Memorandum items:									
Current account balance (incl. official transfers)	-5,142	-5,469	-5,776	-5,947	-6,162	-6,332	-6,429	-6,660	-6,803
Current account balance (in percent of GDP)									
Including official transfers	-12.8	-12.7	-12.8	-12.6	-12.2	-11.7	-11.1	-10.8	-10.4
Goods and services balance (in percent of GDP)	-16.5	-15.6	-16.8	-16.7	-15.7	-14.8	-13.8	-13.0	-12.3
Gross reserves (excl. gold, year-end) 6/	31,588	32,177	33,892	34,993	36,348	38,481	41,617	45,599	49,551
External debt (year-end; in percent of GDP) 7/	169.2	168.2	174.3	177.3	177.4	177.4	178.4	179.9	181.3
Government external debt (in percent of GDP)	19.7	19.6	20.3	20.3	19.8	19.1	18.4	17.9	17.4
GDP	40,079	42,962	45,001	47,366	50,672	54,227	57,687	61,400	65,387

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

1/ Excluding official budgetary transfers.
2/ From 2009: includes new data source for real estate investment.
3/ Change in the foreign liabilities of the BdL, excluding IMF purchases.
4/ Net of non-deposit foreign liabilities.
5/ Differs from banks' reported data, to include estimated deposit flows by Lebanese nationals living abroad but classified as residents.
6/ Excludes Lebanese Eurobonds and encumbered reserves.
7/ Includes all banking deposits held by nonresidents, including estimated deposits of Lebanese nationals living abroad but classified as residents.

Table 7. Lebanon: Financial Soundness Indicators for the Banking Sector, 2011–13

	2011	2012	2013
	(In percent, end of period)		
Capital			
Regulatory capital to risk-weighted assets	11.6	13.0	12.2
Regulatory Tier 1 capital to risk-weighted assets	11.0	12.1	11.4
Asset quality			
Non-performing loans net of provisions to capital	5.2	5.2	6.1
Non-performing loans to gross loans	3.8	3.8	4.0
Asset concentration			
Claims on the public sector (BdL excluded) to total assets	20.8	20.5	22.9
Placements with the BdL to total assets	33.6	34.6	33.0
Foreign assets to total assets	18.1	17.2	16.2
Profitability			
Return on assets	1.1	1.0	1.0
Return on equity	14.5	12.8	11.9
Liquidity			
Deposits to total liabilities	87.9	87.9	87.5
Liquid assets to total assets	22.7	23.2	22.7
Liquid assets to short-term liabilities	32.5	33.9	33.8
FX exposure			
Foreign-currency-denominated loans to total loans	78.4	77.4	76.5
Foreign-currency-denominated liabilities to total liabilities	66.2	65.1	65.5
Net open FX position to regulatory capital	16.9	13.9	11.8

Sources: Lebanese authorities; and Financial Soundness Indicators (FSI).

Annex I. Public Debt Sustainability Analysis[1]

With public debt already exceeding 140 percent of GDP and gross financing needs around 30 percent of GDP, Lebanon faces significant risks to public debt sustainability. Under the baseline scenario, debt and financing needs will continue to rise as a share of GDP, reaching 155 percent and 40 percent, respectively. In addition, debt dynamics and financing needs are subject to significant macro-economic shocks, especially to growth and the interest rate, and contingent liability shocks. Large liquidity buffers and a captive investor base represent important mitigating factors.

The baseline scenario assumes that the conflict in Syria is resolved by 2016. This is also underpinned by the following assumptions:

- *Real GDP growth* is projected to stay below 2 percent in 2013 and 2014, mainly as a result of the impact of the conflict in Syria on Lebanon. Growth is projected to increase to 2.5 percent in 2015, and return to its potential estimated at 4 percent from 2016 onward.

- *Inflation* (measured by the GDP deflator) is projected to gradually decelerate from 4.6 percent in 2012 to 2.9 percent on average in 2015–19.

- The *primary balance* will further worsen in 2014 and 2015, but gradually improve starting in 2016. These projections are based on (i) an estimate of the salary scale adjustment; (ii) a gradual reduction in subsidies to the state-owned electricity company, Electricité du Liban (EdL); (iii) higher capital spending; and (iv) tax measures encompassing income and profits, capital gains, selected excises, and some stamp fees and charges.

The baseline assumptions are realistic. Lebanon's forecast track record is not systematically biased, as reflected in projection errors not being consistently on one side. The median forecast errors for real GDP growth and inflation during 2004–12 are generally in line with those observed in other countries. The median forecast error for the primary balance and its projected level are consistent with experiences of fiscal adjustments in surveillance countries. While the cumulative change in the primary balance appears ambitious compared to the track record of comparator group, staff views it within reach, as it is based on both revenue and expenditure measures.

The deteriorating debt outlook reflects the projected path of fiscal adjustment and positive interest rate-growth differential. The public debt-to-GDP ratio is forecast to increase from 141 percent in 2013 to 155 percent in 2019. The planned fiscal consolidation, measured by changes in the primary balance, is assumed to take effect only gradually; however, part of the adjustment is subject to uncertainty as it is driven by lower transfers to the electricity company due to projected lower oil prices. While economic growth will make increasing negative contributions to the debt dynamics over time, these will not be large enough to offset positive contributions from real interest rates. The gross financing needs-to-GDP ratio is forecast to exceed 30 percent of GDP over the projection period, with an increase to 40 percent of GDP in 2017. The upward financing needs

[1] Prepared by Mariusz Jarmuzek (FAD).

trajectory is primarily driven by large fiscal deficits and relatively short average maturity on debt, with the average maturity of around 3 and 5 years, for domestic and foreign debt, respectively.

The debt and financing needs projections are particularly sensitive to growth and contingent liability shocks:

- *Growth shock*. Slower growth remains the principal risk to debt sustainability. Assuming a decline in growth by one standard deviation for 2015 and 2016, the debt-to-GDP ratio is forecast to reach almost 172 percent in 2019. Financing needs are projected to exceed 40 percent of GDP in 2017 and remain at this level until the end of the projection horizon.

- *Interest rate shock*. Higher interest rates also pose a significant risk to debt sustainability. A shock to the interest rate of 200 basis points results in the debt-to-GDP ratio reaching 164 percent at the end of the projection horizon. Financing needs are projected to reach 44 percent of GDP in 2019.

- *Macro-fiscal shock*. If shocks to growth, interest rate, and primary balance occurred simultaneously, the debt-to-GDP ratio would exceed 187 percent at the end of the projection horizon. Financing needs would reach 50 percent of GDP in 2019.

- *Contingent liability shock*. In the absence of concrete estimates of contingent liabilities, a standardized shock of 10 percent of financial sector assets is used to represent a hypothetical realization of such contingent liabilities. In such a scenario, the debt-to-GDP ratio would exceed 190 percent at the end of the projection horizon. Financing needs would exceed 45 percent of GDP in 2019. The large effect reflects the significant size of Lebanon's banking sector relative to the size of its economy.

Lebanon's debt profile reveals weaknesses. External financing needs are well above the upper risk-assessment benchmark, which along with public debt in foreign currency above the lower risk-assessment benchmark points to risks in case of pressures on the exchange rate and foreign exchange reserves. While bond spreads are above the lower risk assessment benchmark, they have been relatively stable even in times of stress. Public debt held by nonresidents is estimated to be only slightly above the lower risk assessment benchmark, while the level of, and the change in, short-term debt are below the lower risk assessment benchmarks.

Risks to debt sustainability need to be weighed against a number of mitigating factors.

- *Investor base*. Debt is held largely by domestic financial institutions that are tightly regulated in terms of their net open positions and investment strategies. This factor, coupled with relatively low demand for private sector credit and limited regional investment opportunities, has resulted in a captive investor base. In turn, domestic financial institutions fund their positions from deposits largely held by nonresidents, which have shown resilience in times of stress.[2] In addition, a significant share of domestic debt is held by the BdL. Given that the debt is held predominantly by domestic investors, a metric that better captures risks to debt sustainability is the public debt-to-broad money ratio. This ratio decreased from 66 percent in 2003 to 45 percent in 2012 and is forecasted to stay below 50 percent over the projection horizon.

- *Debt financing profile*. The large external financing needs amounting to around 155 percent of GDP reflect payments related to debt but also, to a significant extent, large nonresident short-term deposits. The exclusion of nonresident deposits—given their past stability—reduces external financing needs to around 40 percent of GDP over the projection horizon—still well above benchmark values but possibly capturing immediate risks more accurately. Although debt denominated in foreign currency accounts for more than 40 percent of total public debt, it is held mostly by domestic financial institutions and is underpinned by sizeable external buffers in the form of international reserves. The level of, and the change in, short-term debt are very low, substantially reducing refinancing risk.

- *Buffers*. The high level of gross international reserves remains an anchor for investors' confidence (the real effective exchange rate is moderately overvalued, Annex II). In addition, banks' NFA also represent a substantial buffer. Finally, there are also significant cash cushions in the form of deposits accumulated by the government. The average figure for government deposits points to around 20 percent of GDP,[3] which implies a significantly lower public debt-to-GDP ratio on a net basis and coverage of financing needs for more than half a year.

The authorities broadly concurred with staff's analysis. They noted challenges to formulating a credible medium-term fiscal framework, while underscoring mitigating factors to debt sustainability risks. In particular, they singled out the issue of the large external financing needs as an example of an indicator that does not capture well Lebanon's specific circumstances.

[2] See IMF (2002) "Lebanon—2011 Article IV Staff Report" IMF Country Report No. 12/39 and Schimmelpfennig and Gardner (2008),"Weathering the Perfect Storm," IMF Working Paper 08/17. These sizeable deposits (around 120 percent of GDP) have consistently behaved as long-term deposits, despite their short maturity profile, reflecting the loyalty of the Lebanese diaspora and other regional investors.

[3] The government's foreign exchange account has, however, been in overdraft by around 5 percent on average over the past few years, which reduces the size of the buffer.

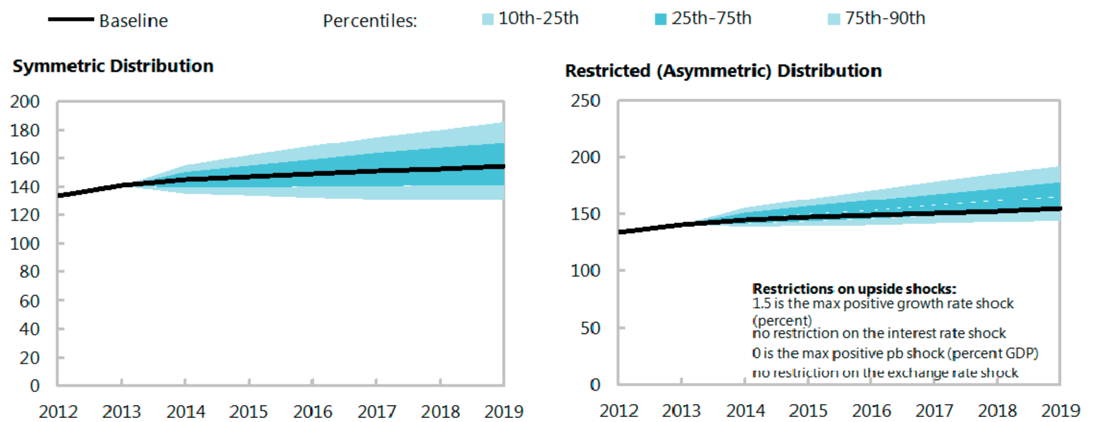
Lebanon Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

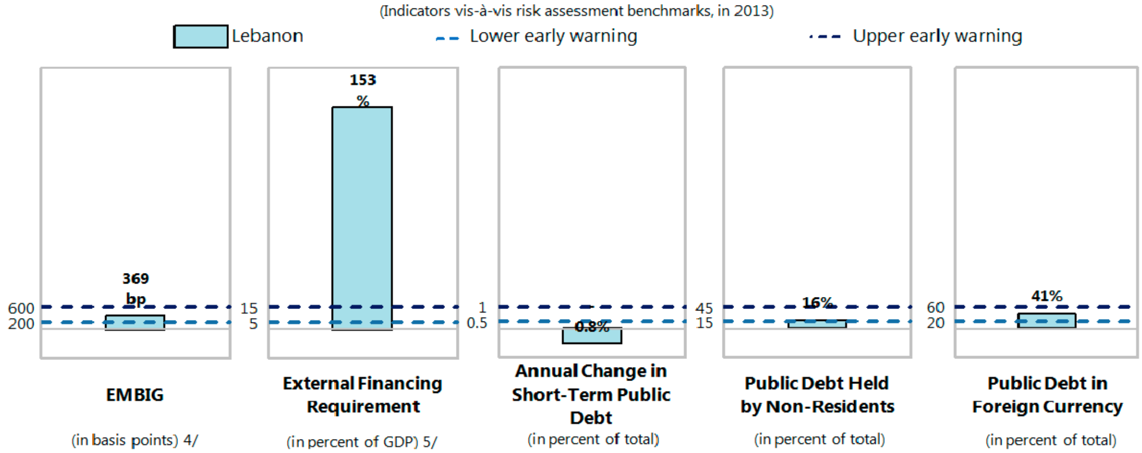
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

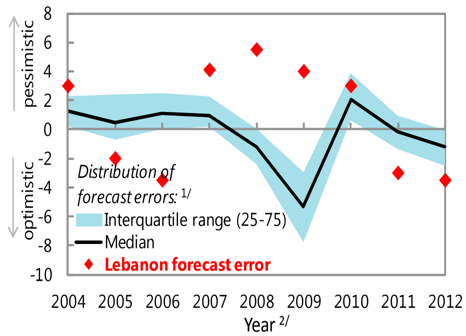
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 28-Feb-14 through 29-May-14.

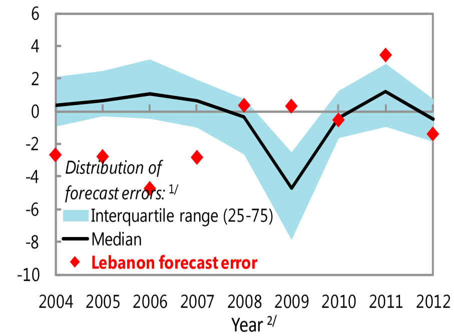
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Forecast Track Record, versus surveillance countries

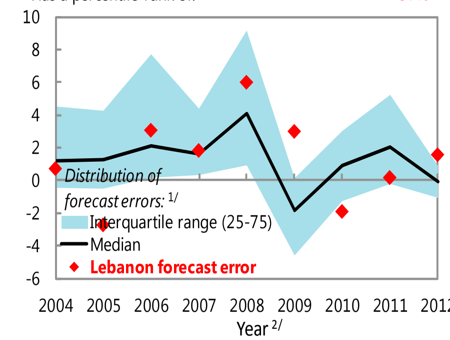
Real GDP Growth
(in percent, actual-projection)
Lebanon median forecast error, 2004-2012: **3.00**
Has a percentile rank of: **93%**



Primary Balance
(in percent of GDP, actual-projection)
Lebanon median forecast error, 2004-2012: **-1.39**
Has a percentile rank of: **17%**

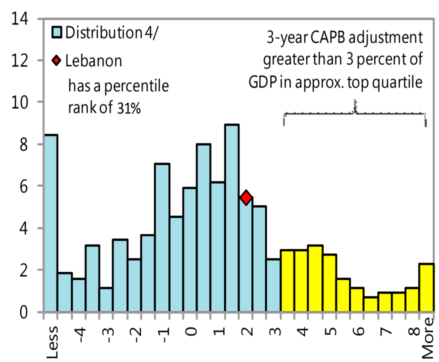


Inflation (Deflator)
(in percent, actual-projection)
Lebanon median forecast error, 2004-2012: **1.57**
Has a percentile rank of: **57%**

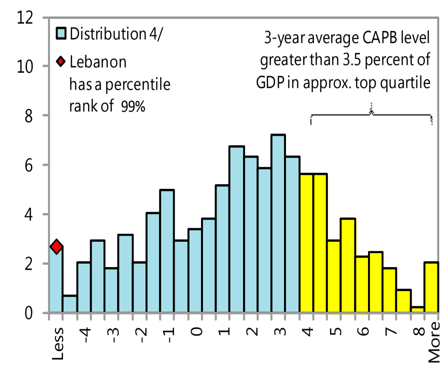


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

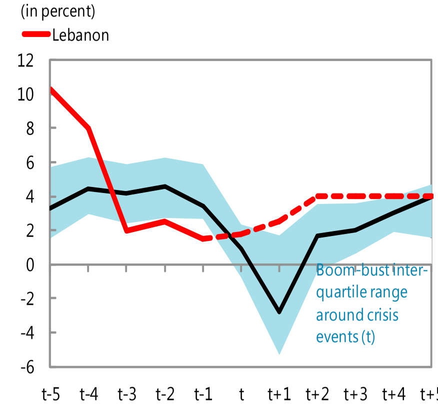


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

Real GDP growth
(in percent)



Source : IMF Staff.
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Lebanon has had a positive output gap for 3 consecutive years, 2011-2013. For Lebanon, t corresponds to 2014; for the distribution, t corresponds to the first year of the crisis.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Lebanon Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

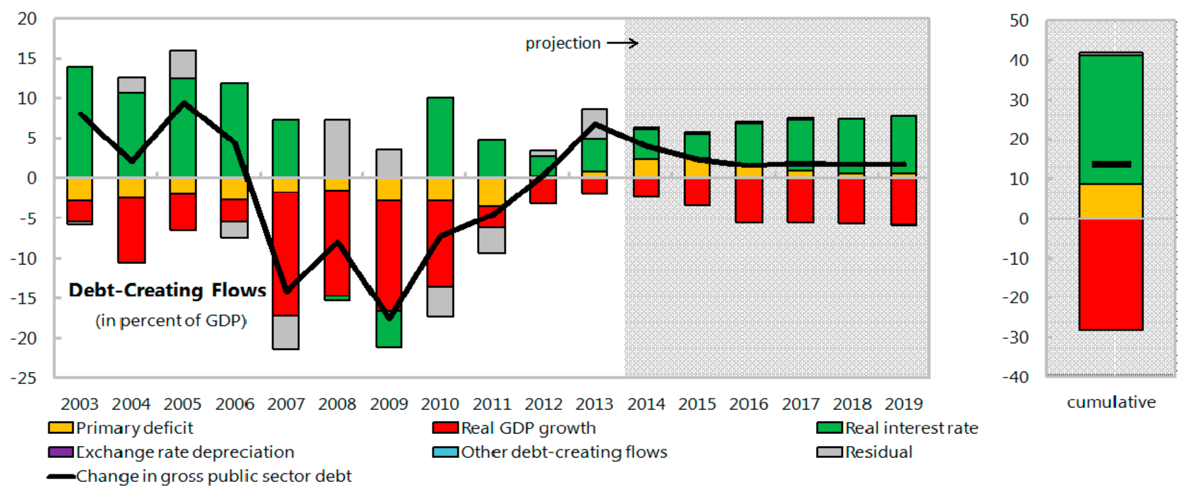
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of May 29, 2014		
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019	Sovereign Spreads		
Nominal gross public debt	162	134	141	145	148	149	151	153	155	EMBIG (bp) 3/		355
Public gross financing needs	53.7	37.0	29.4	31.1	28.8	28.3	40.0	39.9	39.2	5Y CDS (bp)		348
Real GDP growth (in percent)	5.5	2.5	1.5	1.8	2.5	4.0	4.0	4.0	4.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3.0	4.6	3.2	3.4	4.4	2.9	2.3	2.3	2.4	Moody's	B1	B1
Nominal GDP growth (in percent)	8.8	7.2	4.7	5.3	7.0	7.0	6.4	6.4	6.5	S&Ps	B-	B-
Effective interest rate (in percent) [4/]	7.9	6.8	6.6	6.3	6.7	6.8	7.0	7.3	7.5	Fitch	B	B

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing
Change in gross public sector debt	-3.0	0.4	6.8	4.1	2.4	1.6	2.0	1.8	1.8	13.7	primary
Identified debt-creating flows	-3.3	-0.3	3.1	3.8	2.2	1.4	1.7	1.8	2.1	12.9	balance [9/]
Primary deficit	-2.5	0.2	0.8	2.4	2.5	1.7	0.9	0.6	0.5	8.6	1.5
Primary (noninterest) revenue and gr	23.7	22.3	20.9	20.8	21.8	21.9	22.0	22.2	22.1	130.8	
Primary (noninterest) expenditure	21.2	22.5	21.7	23.3	24.4	23.5	22.9	22.7	22.7	139.4	
Automatic debt dynamics [5/]	0.9	0.5	2.3	1.4	0.3	0.3	0.8	1.2	1.5	4.3	
Interest rate/growth differential [6/]	-0.9	-0.5	2.3	1.4	-0.3	-0.3	0.8	1.2	1.5	4.3	
Of which: real interest rate	7.4	2.6	4.3	3.8	3.1	5.2	6.4	6.9	7.3	32.6	
Of which: real GDP growth	-8.2	-3.1	-1.9	-2.3	-3.4	-5.5	-5.6	-5.7	-5.7	-28.3	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., drawdown of	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euro	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.3	0.7	3.7	0.3	0.3	0.2	0.2	0.0	-0.2	0.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = 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).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

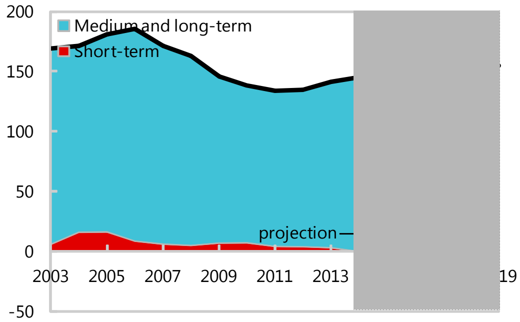
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Lebanon Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

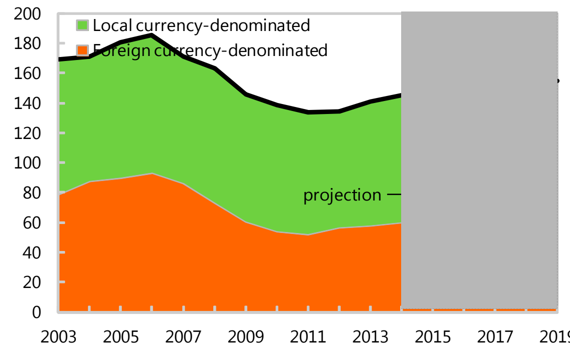
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

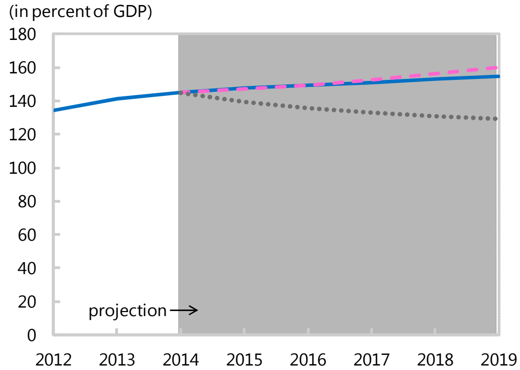


Alternative Scenarios

Baseline Historical Constant Primary Balance

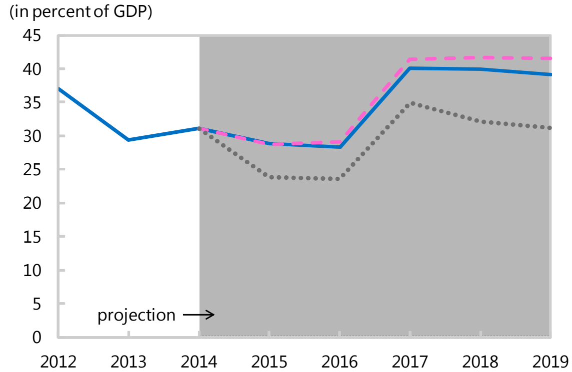
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

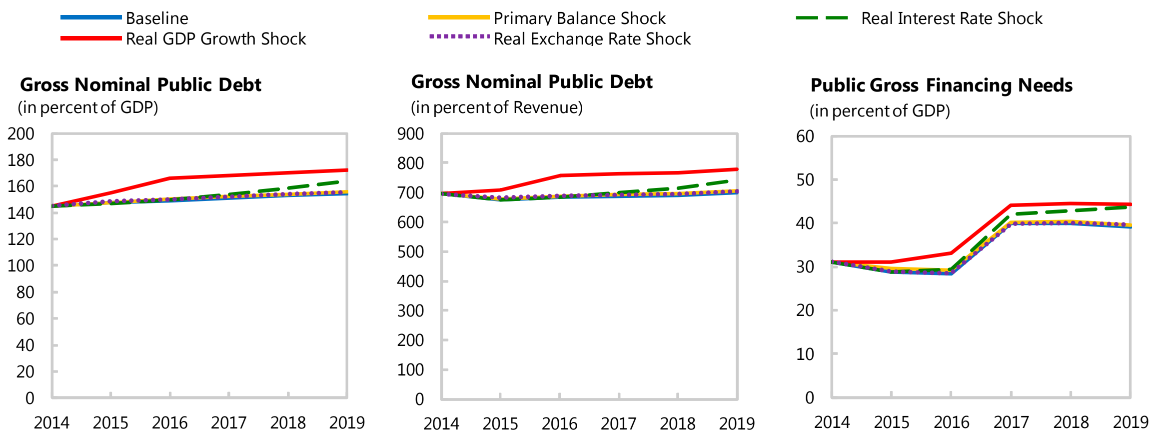
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	1.8	2.5	4.0	4.0	4.0	4.0
Inflation	3.4	4.4	2.9	2.3	2.3	2.4
Primary Balance	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Effective interest rate	6.3	6.7	6.8	7.0	7.3	7.5
Constant Primary Balance Scenario						
Real GDP growth	1.8	2.5	4.0	4.0	4.0	4.0
Inflation	3.4	4.4	2.9	2.3	2.3	2.4
Primary Balance	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4
Effective interest rate	6.3	6.7	6.8	7.0	7.3	7.5

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	1.8	5.2	5.2	5.2	5.2	5.2
Inflation	3.4	4.4	2.9	2.3	2.3	2.4
Primary Balance	-2.4	1.8	1.8	1.8	1.8	1.8
Effective interest rate	6.3	6.7	6.8	7.0	7.4	7.7

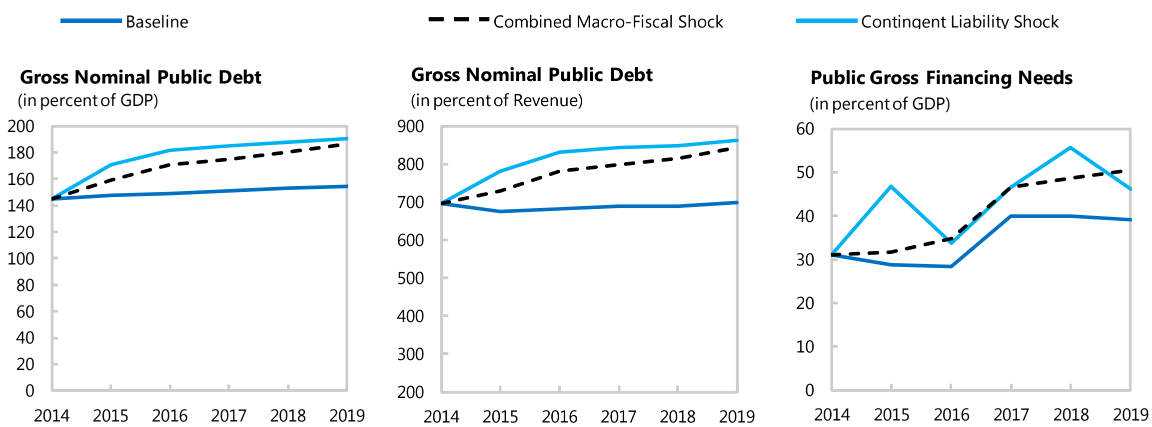
Source: IMF staff.

Lebanon Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	1.8	2.5	4.0	4.0	4.0	4.0
Inflation	3.4	4.4	2.9	2.3	2.3	2.4
Primary balance	-2.4	-3.2	-2.3	-0.9	-0.6	-0.5
Effective interest rate	6.3	6.7	6.8	7.0	7.3	7.6
Real Interest Rate Shock						
Real GDP growth	1.8	2.5	4.0	4.0	4.0	4.0
Inflation	3.4	4.4	2.9	2.3	2.3	2.4
Primary balance	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Effective interest rate	6.3	6.7	7.5	8.3	9.3	10.0
Combined Shock						
Real GDP growth	1.8	-1.1	0.4	4.0	4.0	4.0
Inflation	3.4	3.5	2.0	2.3	2.3	2.4
Primary balance	-2.4	-3.6	-3.8	-0.9	-0.6	-0.5
Effective interest rate	6.3	6.9	7.5	8.3	9.3	9.9

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	1.8	-1.1	0.4	4.0	4.0	4.0
Inflation	3.4	3.5	2.0	2.3	2.3	2.4
Primary balance	-2.4	-3.6	-3.8	-0.9	-0.6	-0.5
Effective interest rate	6.3	6.7	6.9	7.1	7.4	7.6
Real Exchange Rate Shock						
Real GDP growth	1.8	2.5	4.0	4.0	4.0	4.0
Inflation	3.4	6.0	2.9	2.3	2.3	2.4
Primary balance	-2.4	-2.5	-1.7	-0.9	-0.6	-0.5
Effective interest rate	6.3	6.9	6.8	6.9	7.2	7.5
Contingent Liability Shock						
Real GDP growth	1.8	-1.1	0.4	4.0	4.0	4.0
Inflation	3.4	3.5	2.0	2.3	2.3	2.4
Primary balance	-2.4	-18.8	-1.7	-0.9	-0.6	-0.5
Effective interest rate	6.3	7.0	7.9	8.0	7.7	7.8

Source: IMF staff.

Annex II. Lebanon: External Debt Sustainability Analysis[1]

Lebanon's external debt will remain high. The external debt is estimated at 174 percent of GDP at end-2013, an increase from a bottom of 163 percent at end-2010. This increase reflects nonresident deposits inflows and a large current account deficit in recent years. The bulk of the external debt (about 77 percent) is accounted for by short-term nonresident deposits in the banking sector. Under the baseline scenario, external debt is projected to slightly increase to 181 percent of GDP by 2019. While growth is projected to pick up and the noninterest current account deficit to shrink, a projected rise of nonresident deposit inflows, together with increases in nominal interest rates, will contribute to the increase in external debt.

Two main factors mitigate the extent of underlying vulnerabilities from high external debt.

- While almost all nonresident deposits are short-term, they are largely owned by the Lebanese diaspora. These deposits have been relatively stable during past stress episodes. Nonresident deposits account for about 80 percent of gross external financing needs over the projection horizon (see also Annex I).

- Due to lack of information on maturity, all external non-deposit liabilities of banks and the full amount of external debt of nonbanks (about 10 percent of gross external financing needs over the projection horizon) are treated as short-term debt in this analysis. This implies that gross annual financing needs and short-term external debt are likely overestimated.

Standard bound tests suggest the debt dynamics are sensitive to macroeconomic shocks, particularly shocks to the exchange rate. A one-time real depreciation of 30 percent of the exchange rate in 2015 would raise, on impact, the debt level to 276 percent of GDP (Figure 1, panel 6). This underscores the importance of the exchange rate peg as a linchpin of macroeconomic and financial stability in Lebanon. In addition, a permanent shock of a ½ standard deviation from past distribution, relative to the baseline, would lead to the following:

- For the interest rate, it would raise the debt ratio to 186 percent of GDP by 2019 (Figure 1, panel 2);

- For the growth rate, it would raise the debt ratio to 197 percent of GDP by 2019 (Figure 1, panel 3); and

- For the noninterest current account balance, it would raise the debt ratio to 193 percent of GDP by 2019 (Figure 1, panel 4).

A combined permanent shock of a ¼ standard deviation from past distribution, relative to the baseline, applied to the interest rate, growth rate, and noninterest current account balance would raise the debt ratio to 198 percent of GDP by 2019 (Figure 1, panel 5).

[1] Prepared by Hajime Takizawa (SPR).

Table 1. Lebanon: External Debt Sustainability Framework, 2009–2019

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	166.1	163.1	169.2	168.2	174.3			**177.3**	**177.4**	**177.5**	**178.5**	**179.9**	**181.4**	**-8.5**
2 Change in external debt	-8.5	-3.0	6.1	-1.0	6.1			3.0	0.1	0.0	1.0	1.5	1.5	
3 Identified external debt-creating flows (4+8+9)	-29.3	-9.2	-2.2	-4.7	-0.7			3.0	0.6	-2.2	-2.7	-3.4	-4.0	
4 Current account deficit, excluding interest payments	7.2	8.0	8.1	8.5	8.3			7.6	6.4	4.8	3.2	1.2	0.3	
5 Deficit in balance of goods and services	16.0	16.7	16.8	16.2	17.6			17.1	15.9	15.3	14.3	13.7	13.2	
6 Exports	65.0	65.0	61.7	58.2	55.3			55.0	54.5	53.7	53.7	53.3	52.9	
7 Imports	81.0	81.7	78.5	74.4	72.9			72.1	70.4	69.0	68.0	67.0	66.1	
8 Net non-debt creating capital inflows (negative)	-10.5	-10.0	-6.8	-6.7	-6.7			-7.1	-7.7	-7.9	-8.2	-8.5	-8.8	
9 Automatic debt dynamics 1/	-26.0	-7.2	-3.5	-6.6	-2.3			2.5	1.9	0.9	2.3	3.9	4.5	
10 Contribution from nominal interest rate	5.3	5.3	5.0	4.8	5.4			5.4	6.1	7.5	9.0	10.6	11.3	
11 Contribution from real GDP growth	-14.8	-12.3	-3.1	-3.9	-2.4			-2.9	-4.1	-6.6	-6.7	-6.7	-6.8	
12 Contribution from price and exchange rate changes 2/	-16.6	-0.3	-5.3	-7.4	-5.2			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	20.7	6.2	8.3	3.8	6.8			0.0	-0.5	2.3	3.7	4.9	5.5	
External debt-to-exports ratio (in percent)	255.5	251.0	274.2	289.1	315.2			322.4	325.6	330.4	332.5	337.4	343.2	
Gross external financing need (in billions of US dollars) 4/	44.6	54.4	58.7	65.2	69.4			75.2	80.4	86.6	93.7	100.6	108.7	
in percent of GDP	127.1	143.2	146.5	151.7	154.2			158.8	158.7	159.7	162.4	163.8	166.2	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	**177.3**	**172.7**	**168.4**	**164.6**	**162.0**	**160.0**	**-15.7**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	10.3	8.0	2.0	2.5	1.5	5.2	3.6	1.8	2.5	4.0	4.0	4.0	4.0	
GDP deflator in US dollars (change in percent)	10.5	0.2	3.4	4.6	3.2	3.3	3.5	3.4	4.4	2.9	2.3	2.3	2.4	
Nominal external interest rate (in percent)	3.7	3.5	3.2	3.0	3.3	4.4	1.1	3.3	3.7	4.5	5.4	6.3	6.7	
Growth of exports (US dollar terms, in percent)	0.3	8.1	0.1	1.1	-0.4	11.7	13.7	4.7	6.0	5.5	6.3	5.7	5.6	
Growth of imports (US dollar terms, in percent)	1.2	9.1	1.3	1.6	2.7	10.7	12.6	4.1	4.4	4.9	4.8	4.9	5.0	
Current account balance, excluding interest payments	-7.2	-8.0	-8.1	-8.5	-8.3	-4.9	4.8	-7.6	-6.4	-4.8	-3.2	-1.2	-0.3	
Net non-debt creating capital inflows	10.5	10.0	6.8	6.7	6.7	9.3	2.2	7.1	7.7	7.9	8.2	8.5	8.8	

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

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

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

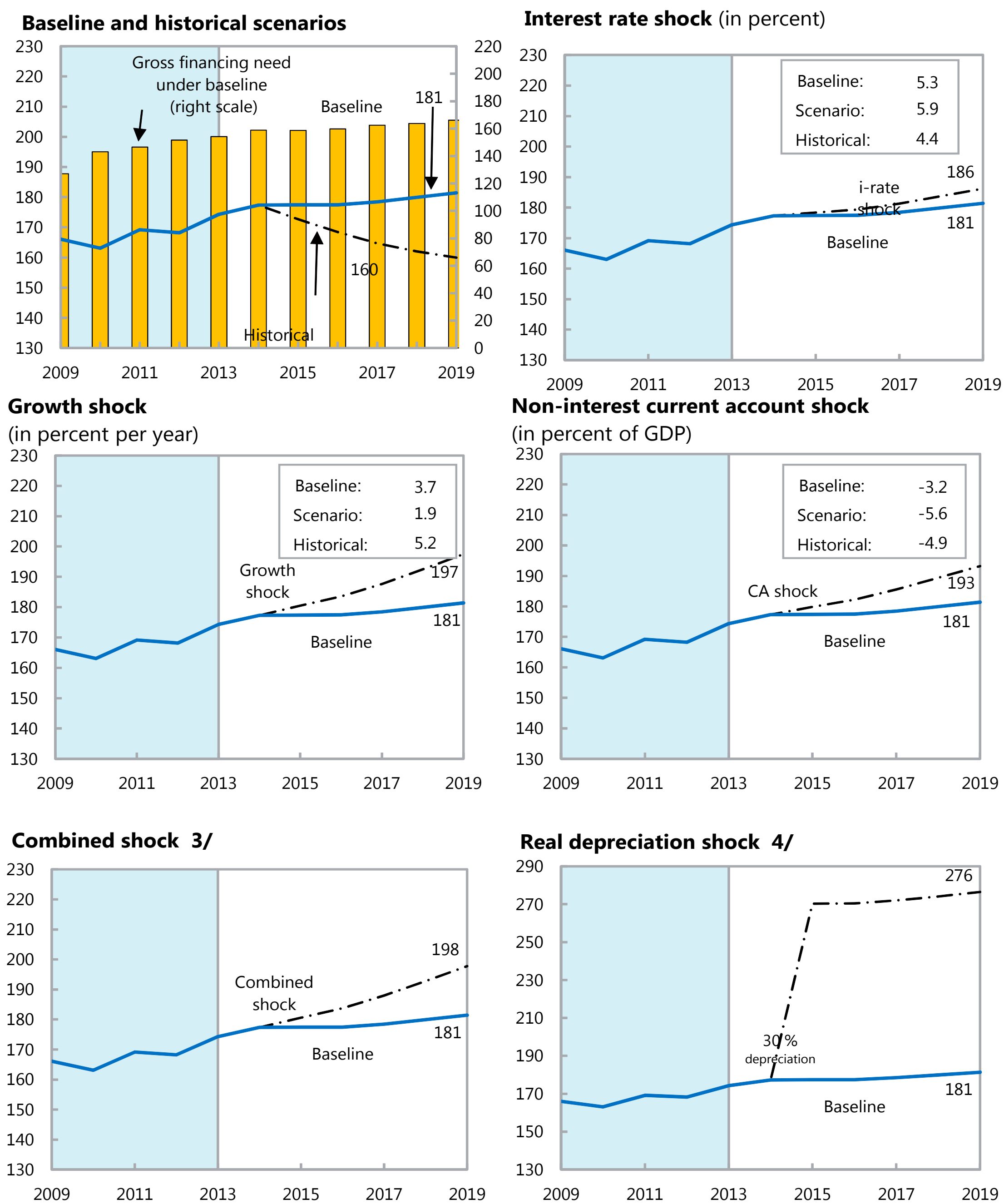
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

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

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2015.

INTERNATIONAL MONETARY FUND

LEBANON

June 12, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

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

CONTENTS

FUND RELATIONS

(As of May 30, 2014)

Membership Status:
Joined: April 14, 1947; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	266.40	100.00
Fund holdings of currency	231.72	86.98
Reserve position in Fund	34.68	13.02

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	193.29	100.00
Holdings	192.30	99.49

Use of Fund Resources

Lebanon has no outstanding credit from/obligations to the IMF.

Latest Financial Arrangements

None.

Implementation of HIPC Initiative and Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Safeguards Assessment:

Pursuant to Fund policy, the Banque du Liban (BdL) was subject to a full safeguards assessment in conjunction with the first Emergency Post-Conflict Assistance (EPCA) in April 2007. The 2008 safeguards assessment report proposed several specific measures for enhancing the BdL's financial reporting, audit and control procedures, and recommended an update of the central bank law. An update safeguards assessment was completed in August 2009 in the context of the second EPCA. The update noted progress achieved in enhancing procedures for reserve management and external audit, but recommended further actions to strengthen internal audit, financial reporting transparency, oversight, and central bank legislation.

Nonfinancial Relations

Exchange Arrangement

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

Last Article IV Consultation

The 2011 Article IV Consultation was concluded by the Executive Board on January 23, 2012. At the time, Directors noted that domestic political uncertainty and regional unrest eroded market confidence, bringing an end to Lebanon's four-year spell of impressive economic growth. They underscored the need to maintain fiscal discipline and to reduce government's reliance on central bank financing. Directors welcomed the planned investment in the electricity sector, but stressed that reforms should proceed in parallel to reduce the large budgetary transfers to the sector.

Financial Sector Assessment Program

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

Resident Representative Office

The IMF Resident Representative Office in Lebanon was opened in January 2008 and closed in August 2011. The Fund maintains a local office hosted by the Middle East Technical Assistance Center (METAC).

Technical Assistance (TA)

Fiscal area—The Fiscal Affairs Department (FAD) has provided advice on introducing the VAT, reforming customs tariffs and income taxes, strengthening tax and customs administration, and improving expenditure policy and public expenditure management. A fiscal ROSC was published in May 2005. During 2008–11, FAD provided assistance on tax policy options and reform priorities in tax administration and public financial management, and FAD and METAC provided targeted follow-up support to ongoing initiatives in both tax administration and public financial management (e.g., tax audit program, treasury single account, and cash management). During 2012–14, FAD provided assistance on the tax regime and revenue administration of oil and gas resources, PFM reform, the budget system law, public accounting, while METAC continued to provide TA on tax and customs administration.

Financial area—The Monetary and Capital Markets Department (MCM) has provided TA mainly in the areas of banking supervision, early warning system, non-bank financial institutions supervision, and the coordinated direct investment survey.

Statistical area—The Statistics Department has provided TA in national accounts, price and balance of payments statistics. Several missions on the consumer price index (CPI) were undertaken in 2007 through METAC, and a monthly country-wide CPI was launched in March 2008; a new country-wide CPI index and regional indices were launched in March this year. TA in building capacity for national accounts statistics and economic surveys was provided through the resident advisor in real sector statistics. METAC has been providing assistance on balance of payments and international investment position statistics, and recommendations on improving work processes in the Statistics and Economic Research Department of the BdL.

WORLD BANK-IMF COLLABORATION

1. **The Lebanon teams of the Fund and the World Bank met to discuss macrocritical structural reforms and coordinate their work in 2014.**[1] The teams agreed that economic performance is expected to remain weak without a resolution of the Syria crisis. Lebanon's main medium-term macroeconomic challenges are to reduce the very high and growing public debt burden and secure sustained and inclusive growth. To meet these challenges, Lebanon needs to pursue fiscal consolidation in the context of a medium-term framework, implement long-delayed structural reforms, covering in particular the electricity sector, the delivery of social services, and the social safety net. Finally, the authorities need to continue to protect the financial sector from excessive risks and maintain sizeable reserve buffers.

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

- **Electricity sector reform:** There is an urgent need to strengthen and lower the costs of electricity provision, and reduce budgetary transfers to the Electricité du Liban (EDL) by (i) reducing the cost of production, including through reducing systems losses and the reliance on expensive fuel oil; (ii) increasing revenue collection; (iii) enhancing electricity supply by making necessary investments; and (iv) gradually adjusting average tariff toward cost recovery levels, while protecting poor households. These measures should be accompanied by a comprehensive reform of the regulatory and institutional framework. Electricity sector reform is macrocritical because the large budgetary transfers to the sector (4½ percent of GDP in 2013) undermine fiscal sustainability; while insufficient and unreliable electricity supply adds to the cost of doing business and is an impediment to growth.

- **Tax reform:** Move toward an efficient and equitable tax system by broadening tax bases and increasing tax rates on capital gains and excisable products. Tax policy reforms should be accompanied by reforms to restructure and modernize revenue administration and enhance compliance. Tax reform is macrocritical because it will help support fiscal adjustment.

- **Public financial management (PFM) reform:** Key reform elements include: (i) strengthening the macrofiscal unit in the Ministry of Finance; (ii) strengthening budget preparation, cash and debt management; (iii) strengthening accounting, payment and auditing functions, including by introducing a Government Financial Management Information System; and (iv) completing the coverage of the Treasury Single Account. These reforms are macrocritical because they will improve the management of public finances.

[1] The IMF team was led by Ms. Annalisa Fedelino (mission chief) and the World Bank team by Mr. Ferid Belhaj (Country Director).

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

- **Investment climate reform:** Lebanon's corporate sector is held back by the high costs of doing business, arising from weaknesses in governance, regulatory systems, and contract enforcement. Reforms in this area are macrocritical because they will improve competitiveness and help increase the growth potential.

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

- **Reform of the statistical system:** Lebanon's statistical system suffers from fragmentation and limited capacity to provide timely and reliable data. Strengthening statistical systems is macrocritical because timely and reliable data are needed to monitor economic and social developments and support decision making.

3. The teams agreed to the following division of labor:

- **Electricity sector reform:** The Bank will continue to elaborate reform options and discuss them with the authorities. The Country Partnership Strategy of the Bank provides for technical and possibly financial support to the electricity sector to assist the government in implementing its strategic plan.

- **Tax reform:** The Fund and the Bank are providing technical assistance (TA) on the fiscal regime for the oil and gas sector. The Fund is also providing revenue administration technical assistance in this sector. If requested, the Fund will also provide TA on the design and implementation of the capital gain tax. If requested, the Bank could build on tax work available to perform analytical work on growth and welfare impact of fiscal policy options.

- **Public financial management reform:** The Fund is providing TA on (i) capacity building for the newly-established macro-fiscal department, in collaboration with the World Bank; (ii) improving the transparency and accountability of public accounts; and (iii) improving cash management.

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

- **Investment climate reform:** The Bank is planning to conduct an assessment of the investment climate, with a special focus on the large informal sector.

- **Financial sector stability assessment:** The Fund is providing TA on the supervision of nonbank financial institutions and the cross-border supervision of banks, including by establishing supervisory colleges. The Bank is providing TA on the development of the insurance sector and capital markets. The Bank and the Fund will continue to encourage the authorities to undertake a Financial System Stability Assessment given the systemic importance of the banking sector (the last update was done in 2001).

- **Reform of the statistical system:** The Fund will continue to provide TA on the consumer price index, national accounts, and balance of payments statistics. The Bank is providing advisory services on the national household income and expenditure survey.

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

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

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

- The two teams will continue to exchange views on the macroframework and the results of an upcoming update for the Economic and Social Impact Assessment of the Syrian Conflict (planned for September 2014).

- The table below lists the teams' separate and joint work programs in 2014–15.

Lebanon—Bank and Fund Planned Activities in Macrocritical Structural Reform Areas			
Title	**Products**	**Provisional Timing of Missions**	**Expected Delivery Date**
1. Bank Work Program	Urban Transport Development Project ($134.7 m)	Ongoing	12/31/2015
	Education Development Project II ($40 m)	Ongoing	12/31/2016
	Greater Beirut Water Supply ($200 m)	Ongoing	06/30/2016
IBRD Lending Program	Emergency Social Protection Imp. Support 2 ($6m – Trust Fund for Lebanon)	Ongoing	08/31/2014
	Displaced People in LB ($0.9 m – SPBF)	Ongoing	01/31/2015
	Improve Capacity for Environmental Compliance ($0.3 m – IDF)	Ongoing	10/7/2016
	Capital Markets Regulation & Development TA ($0.48 m – FIRST)	Ongoing	08/31/2014
	Development of National Payments Systems Strategy TA ($0.18 m – FIRST)	Ongoing	08/31/2014
	Support to Gas Unit for LNG at Ministry of Energy and Water TA ($0.2 m – PPIAF)	Ongoing	09/30/2014
	Wind Energy Resource Mapping TA ($0.12 m – ESMAP)	Ongoing	10/31/2016
	Fiscal Management Reform 2 ($5.2 m)	Ongoing	09/16/2016
Grants/Trust Funds	Update of Economic and Social Impact Assessment of the Syrian Conflict	Ongoing	Sept. 2014
	Systematic Country Diagnostic	Ongoing	Dec. 2014
	Lebanon Investment Climate Assessment (2014)	Planned	05/09/2015
	Country Partnership Framework	Planned	June 2015
	Social Protection and HD Strategy	Ongoing	06/30/2014
	Toward Universal Health Coverage: A Comprehensive Review of the Health Financing Systems in Jordan and Lebanon	Ongoing	06/23/2014
	Wind Power Development Study	Completed	04/19/2014

2. Fund Work Program	**Article IV Consultation Staff Report**	**April–May 2014**	**June 2014**
	TA on:		
	➢ Public Accounting	Ongoing	2014
	➢ Capital Gain Tax	If requested	2015
	➢ Public Financial Management Reform	Ongoing	2014
	➢ Budget System Law	Ongoing	2014
	➢ Statistics (National Accounts, CPI, BoP)	Ongoing	2014
	➢ Direct Investment Survey	Completed	2014
	➢ Cross Border Banking Supervision	Ongoing	2014
	➢ Nonbank Financial Institutions Supervision	Ongoing	2014
	➢ Oil and Gas Taxation and Revenue Administration	Ongoing	2014
	FSAP Update	If requested, 2015	2015
3. Joint Work Program	Fund and Bank teams will coordinate on the macroeconomic framework for the update of the Economic and Social Impact Assessment of the Syrian Conflict	2014	Sept. 2014

STATISTICAL ISSUES

Lebanon—Statistical Issues Appendix

As of May 29, 2014

I. Assessment of Data Adequacy for Surveillance

General: Data provision has serious shortcomings that significantly hamper surveillance, particularly in national accounts and external sector statistics. Lack of timely, comprehensive and reliable national accounts data and social and labor market indicators undermine economic analysis.

National accounts: National accounts data are weak, with only annual data publicly available, currently until 2011; there are plans to start publishing quarterly data. The responsibility of producing national accounts statistics has been transferred to the Central Administration of Statistics (CAS) in 2012 for the publication of 2011 accounts. Data sources are still mostly administrative— despite improvements, including by using quarterly VAT declarations—and the compilation methods do not conform to best practices. The Fund's Statistics Department (STA) will be assisting CAS in reviewing the methodology and data collection for the annual national accounts, and starting the compilation of quarterly national accounts.

Price statistics: A new Consumer Price Index (CPI), including regional indices and reflecting improved survey and compilation methods, was released in March 2014 by the CAS with Fund assistance. Since May 2008, CAS has been compiling and disseminating a monthly CPI following internationally-accepted methodology. The CPI covers all areas in Lebanon and is disseminated within three weeks after the end of the reference month. The CPI was not compiled during January–May last year reflecting disputes with the prime minister's office over funding for CAS. Funding to CAS and data compilation resumed last summer under strong Fund pressures. Housing prices are now surveyed monthly—in the previous index, they were surveyed infrequently due to lack of funding. There is a need to develop regular and timely statistics on producer prices, wages, and real estate prices.

Government finance statistics: Significant delays have been recently experienced in the release of fiscal data. While the dissemination of central government finance statistics (GFS) has improved in recent years, the coverage of government finance statistics is not comprehensive. Published monthly data on the central government budgetary accounts do not cover items such as certain transfers, financing data, foreign-financed capital expenditure, and arrears. Some (treasury) spending is only identified ex post, and presented in an economic classification with a lag. These items are nonetheless provided to the Lebanon team in the context of surveillance activities. Government finance statistics are on a modified cash basis for revenue (transfers from the Telecom) and budgetary expenditure data (issuance of payment orders). GFS data for budgetary central government based on *Government Finance Statistics Manual 2001* are published on a yearly basis in the IMF publication the *Government Finance Statistics Yearbook;* however, these data cover only transactions and no balance sheet data are reported.

Lebanon—Statistical Issues Appendix (concluded)
Monetary and financial statistics: Monetary statistics are adequate. At the same time, sectoralization of institutional units and classification of financial instruments in the data reported to STA fall short of what is needed for the compilation of Standardized Report Forms. Reflecting in part restrictions imposed by domestic legislation, the Banque du Liban (BdL) does not publish externally-audited financial statements, and its reporting practices are not fully compliant with the International Financial Reporting Standards (IFRS). The lack of a reliable classification of deposits by residency (also due to bank secrecy) complicates the balance of payments analysis.
Financial sector surveillance: Lebanon is a regular reporter of Financial Soundness Indicators (FSIs). All core and eight encouraged FSIs are reported on regular quarterly basis, except for the two indicators on capital adequacy that are reported on semi-annual basis. Compilation of FSIs for other sectors (other financial corporations, non-financial corporations, households, real estate markets) is needed to expand the list of FSIs compiled by Lebanon for macro prudential analysis.
Balance of payments: There have been efforts to improve Balance of Payments (BoP) statistics, including the quality of surveys through better compliance. However, there remain significant challenges to compiling reliable BoP data. In particular, there are data issues in the current account (unrecorded exports and imports, uncertainty with respect to the estimates of private sector services, workers' remittances, and investment income), the capital account (grants), and the financial account (foreign direct investment, equity investment in the nonbank private sector, and corporate borrowing abroad). A Foreign Direct Investment (FDI) survey is currently in progress. An International Investment Position (IIP) statement had been completed, but not yet published. The forms and the reporting requirements for banks and non-banks were amended in January 2010 and more recently last year to include more comprehensive and detailed breakdown of BoP components. The lack of effective inter-agency cooperation and data sharing between the BdL, CAS, and the ministry of finance are among the main factors impeding progress.
II. Data Standards and Quality
Lebanon joined the General Data Dissemination System in January 2003. Metadata and plans for improvement need to be updated. No Report on the Observance of Standards and Codes (ROSC) for data dissemination is available for Lebanon.
III. Reporting to STA
Lebanon currently reports annual data based on *GFSM 2001* to be published in the *Government Finance Statistics Yearbook (GFSY)*, but the data suffer from weaknesses, mainly limited coverage. CAS does not currently report any data to STA. In September 2011, the BdL started regular submission of core *Financial Soundness Indicators* data and metadata, and data for 2013 were posted on the IMF website.

Lebanon—Table of Common Indicators Required for Surveillance					
	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	28/05/14	28/05/14	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	31/03/14	02/05/14	M	M	M
Reserve/Base Money	31/03/14	02/05/14	M	M	M
Broad Money	31/03/14	02/05/14	W/M	W/M	M
Central Bank Balance Sheet	31/03/14	02/05/14	M	M	M
Consolidated Balance Sheet of the Banking System	31/03/14	02/05/14	M	M	M
Interest Rates[2]	23/05/14	27/05/15	W/M	W/M	W/M
Consumer Price Index	30/04/14	21/05/14	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	31/12/13	26/02/14	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	30/4/2014	31/3/2014	M	M	M
External Current Account Balance	31/12/12	26/04/2014	Q	Q	Q
Exports and Imports of Goods and Services	31/12/12	26/04/2014	Q	Q	Q
GDP/GNP	31/12/11	21/10/13	A	A	A
Gross External Debt	30/4/14	26/5/14	M	M	M
International Investment Position[6]	N/A	N/A	N/A	N/A	N/A

[1] Includes reserve assets pledged or otherwise encumbered. These are reported to the country team with a lag.
[2] Both market-based and officially-determined policy interest rates (including discount rates, rates on treasury bills, notes and bonds).
[3] 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 local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); and not available (N/A).

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IMF Executive Board Concludes 2014 Article IV Consultation with Lebanon

On June 26, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lebanon.[1]

Lebanon is facing a number of difficult challenges. The economy is suffering from abroad-based deterioration. Growth stood at 2.5 percent in 2012 and decelerated to 1.5 percent in 2013 as traditional drivers of growth—real estate-related activity, construction and tourism—have been affected by increasing uncertainty and worsening security. Inflation appears contained, though there are reportedly pressures on housing prices. The external current account deficit remained large at about 13 percent of GDP in 2012–13.

The crisis in Syria is having a dramatic impact on Lebanon. The refugee influx, according to United Nations figures, has reached one quarter of the population, fueling already high unemployment and poverty, and straining local communities and public services. The crisis has further exacerbated domestic political uncertainties. The term of the president ended in May, and the presidential vacuum is disrupting efforts to pass legislation, including a salary increase for the public sector. Parliamentary elections in November (already postponed from June 2013) add to uncertainty.

Fiscal imbalances have widened. The primary fiscal position turned negative in 2012 and deteriorated to about 1 percent of GDP in 2013, reflecting cyclical factors—spending pressures and revenue declines from weak economic activity—as well as discretionary policies, namely the introduction of a Value Added Tax exemption on gasoil and a cost-of-living adjustment for public sector wages in 2012. Hosting the large refugee population is adding to fiscal strains. As a result, public debt—already one of the highest in the world as a share of GDP—has been on an upward trajectory since 2012, reaching 141 percent of GDP in 2013.

The Banque du Liban has continued to finance the government and attract commercial banks' foreign currency deposits, which brought international reserves to US$35 billion at

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

end-April. It has also supported credit to the private sector by providing low-cost funds to banks to on-lend to specific economic sectors.

Financial markets have been largely resilient, but the environment is increasingly challenging. Banks' profitability has deteriorated, and their high exposure to the sovereign has continued to increase. Nonperforming loans remain low, but their provisioning has declined and the use of overdraft facilities is widespread. On the positive side, deposits have continued to grow at 7–8 percent a year, and liquidity buffers are strong. Eurobond spreads have moved in line with regional averages and stand at levels similar to those at the end of 2011.

Without a resolution in Syria, economic performance is expected to remain weak, with high downside risks from a further weakening of public finances and delays in structural reforms. Growth is likely to be subdued at around 2 percent this year, reflecting domestic and regional uncertainties, and return only gradually to potential—a moderate 4 percent. Inflation could pick up with the planned salary increase. Financing needs would remain high, due to large fiscal and current account deficits.

Executive Board Assessment[2]

Directors noted that the conflict in Syria and domestic political uncertainty are adding stress to Lebanon's already difficult economic situation. Growth is subdued, fiscal imbalances are widening, and public debt is rising. Directors emphasized that commitment to sound macroeconomic policies and structural reforms is essential to foster strong and sustainable growth and improve social conditions.

Directors commended the authorities' efforts for receiving an unprecedented inflow of Syrian refugees. They recognized, however, that this is straining the economic and social structures and fueling already high unemployment and poverty. They agreed that Lebanon needs additional support from the international community to address the adverse impact of the refugee crisis.

Directors emphasized the importance of a credible and balanced fiscal adjustment strategy to prevent further fiscal deterioration, reestablish primary surpluses, and put public debt on a sustainable path. In this context, they urged caution in implementing the planned salary scale adjustment for public sector employees. Directors encouraged the authorities to undertake revenue-enhancing measures, such as broadening the tax base and strengthening collection, while ensuring that they are equitable and minimize distortions. They also underscored the need to reform the electricity sector by raising average tariffs toward costs recovery, while mitigating the impact on the poor and rebalancing freed-up resources toward capital and social spending. In addition, Directors considered that stronger fiscal management, including

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

adhering to a budget calendar and pursuing a medium-term budget framework, would contribute to fiscal sustainability.

Directors agreed that monetary policy should remain geared towards maintaining adequate foreign exchange reserves and supporting the exchange rate peg as a signal of commitment to macrofinancial stability. They encouraged the authorities to scale back the government's reliance on central bank financing as fiscal consolidation advances, and take measures to further strengthen the central bank's balance sheet.

Directors noted that the banking sector has been resilient, but is facing an increasingly challenging environment. They emphasized the need to further strengthen capital buffers and improve loan classification and restructuring rules. Directors also encouraged further strengthening of the AML/CFT framework.

Directors emphasized the importance of undertaking structural reforms to unlock Lebanon's growth potential and improve social conditions. They called for measures to lower the cost of doing business and improve services, starting from electricity provision. Additional efforts are also needed to enhance labor markets and support job creation, while strengthening social safety nets. Directors encouraged the authorities to take further steps to improve Lebanon's statistical system, building on ongoing progress.

Lebanon--Selected Economic Indicators, 2011–15

	2011 Act.	2012 Prel.	Projections 2013	2014	2015
Output and prices			(Annual percentage change)		
Real GDP (market prices)	2.0	2.5	1.5	1.8	2.5
GDP deflator	3.4	4.6	3.2	3.4	4.4
Consumer prices (period average)	7.2	5.9	3.2	3.1	4.0
Central government finances (cash basis)			(In percent of GDP)		
Revenue	22.8	22.3	20.9	20.9	21.9
Expenditure	28.7	31.0	30.1	32.0	33.7
Budget balance	-5.9	-8.6	-9.2	-11.1	-11.9
Primary balance	3.5	-0.2	-0.8	-2.4	-2.5
Total government debt	134	134	141	145	148
Monetary sector			(Annual percentage change, unless otherwise indicated)		
Credit to the private sector	12.9	10.5	9.6	7.1	6.9
Broad money 1/	7.2	7.9	9.0	8.0	8.0
Interest rates (period average, in percent)					
Three-year Treasury bill yield	6.0	6.5	6.6	6.7	7.0
Five-year Eurobond yield	5.2	5.0	5.4	5.7	6.1
External sector			(In percent of GDP, unless otherwise indicated)		
Exports of goods (in US$, percentage change)	0.1	2.0	-1.0	4.7	5.2
Imports of goods (in US$, percentage change)	1.0	1.9	1.9	4.7	4.1
Current account balance	-12.8	-12.7	-12.8	-12.6	-12.2
Foreign direct investment	6.8	6.7	6.7	7.1	7.7
Total external debt 2/	169	168	174	177	177
Gross reserves (in billions of U.S. dollars) 3/	31.6	32.2	33.9	35.0	36.3
In percent of short-term external debt 4/	53.8	51.5	49.6	47.6	45.9
In percent of total banking system deposits	27.3	25.7	24.9	23.8	22.8
Exchange rate					
Real effective exchange rate (annual average, percentage change)	-1.2	-0.1	4.0	-0.4	1.4

Sources: Lebanese authorities; and IMF staff estimates.
1/ Defined as currency in circulation plus resident and nonresident deposits.
2/ Includes nonresident deposits.
3/ Excluding gold and encumbered assets.
4/ Short-term debt on a remaining maturity basis, including short-term nonresident deposits.

Statement by Mr. Shaalan on Lebanon
June 26, 2014

1. On behalf of the Lebanese authorities, I would like to thank staff for the valuable Article IV discussions and the resulting informative reports. The authorities also wish to express their appreciation for the continued provision of technical assistance.

Recent Developments and Outlook

2. The Lebanese economy faces difficult challenges associated with the conflict in Syria, which exacerbate already difficult domestic conditions. Since the onset of the Syrian crisis in early 2011, Lebanon has maintained an open border policy and has permitted refugees to freely settle across the country. Registered Syrian refugees account for about 25 percent of Lebanon's pre-crisis population; including unregistered refugees raises this ratio to about 35 percent of the population. This has negatively impacted security and put serious pressures on virtually all aspects of the economy. As a result, growth is expected to be subdued in 2014 and the fiscal deficit and public debt are expected to increase. On the positive side, security conditions have recently improved since the formation of the government, deposit capital inflows remain resilient and foreign exchange reserves are high. Reflecting these developments, Standard & Poor's upgraded Lebanon's outlook from negative to stable last March.

3. The authorities remain committed to policies that ensure macroeconomic stability while addressing infrastructure bottlenecks and improving social conditions. However, Lebanon does not have the fiscal space to address the impact of the Syrian refugee crisis on the economy and local communities. Dealing with the refugee crisis requires strong international support.

Fiscal Policy and Reforms

4. In order to signal their commitment to fiscal discipline, the authorities are committed to putting in place a budget for 2014 aimed at balancing essential spending needs with stability goals.

5. The fiscal impact of the Syrian crisis is extensive. The negative impact on investor and consumer confidence and the disruption in the trade routes for exports and imports of goods, tourism, and financial services are placing downward pressure on government revenues. Combined with rising demand for public services due to the large refugee influx, this is further damaging Lebanon's public finances. While the direct budgetary costs are not

yet known with precision, the World Bank[1] envisaged an immediate negative fiscal impact of $2.6 billion in 2012–14 (about 6 percent of 2013 GDP) through lower revenue and higher expenditure. It estimated the stabilization needs to be an additional $2.5 billion.

6. Large uncertainties surround the salary scale adjustment, which is still under parliamentary consideration. The authorities are confident, however, that the revenue measures they envisaged, if passed by parliament in a timely manner, would be sufficient to offset the cost of the salary scale adjustment. These measures include (i) an increase in the interest income tax rate from 5 to 7 percent; (ii) an increase in the corporate income tax rate from 15 to 17 percent; (iii) a new capital gain tax on real estate transactions; (iv) increases in tobacco excises; and (v) increases in various stamps and fees.

7. The authorities take note of staff's work on a fiscal adjustment strategy that would reverse the debt dynamics. They consider that broadening the tax base and addressing tax loopholes are preferable to a large increase in VAT, which proved politically difficult to adopt in the past given its regressive nature.

8. The authorities do not share staff's assessment that commitment to fiscal discipline will help mobilize budget support to deal with the refugee crisis. Fiscal discipline is necessary in itself in order to avoid a possible loss of market confidence and put debt on a sustainable path, although the current uncertainty overshadows policy decisions and may delay fiscal adjustment. In order to deal with the present refugee crisis and its repercussions on the Lebanese communities, the authorities reiterate their call for support from the international community.

Monetary and Exchange Rate Policies

9. Monetary policy helped maintain confidence in the Lebanese financial system, with the exchange rate peg providing a firm anchor for financial stability. The authorities share staff's view on the importance of maintaining a high level of reserves. They are keen on reducing the Treasury's reliance on central bank financing and agree with staff that this will have to be accompanied by a strong fiscal consolidation effort. The central bank remains open to further gradual reductions in the deposit remuneration rates and to increases in the Treasury-bill rates if and when conditions permit.

Banking Sector

10. The banking sector remains resilient despite the challenging environment, which has limited credit opportunities to the private sector and the banks' expansion in neighboring

[1] World Bank, Poverty Reduction and Economic Management Department, Middle East and North Africa Region, "Lebanon, Economic and Social Impact Assessment", September 2013.

countries. The authorities consider that staff's assessment does not sufficiently acknowledge ongoing progress in the regulatory and supervisory framework. The central bank required banks to hold by end-2015 a supplementary capital buffer of 1.5 percent on top of the Basel III minimum, in addition to a 2.5 percent conservation buffer. Moreover, supervision was further enhanced with the establishment of colleges to strengthen the cross-border supervision of the largest banks. In addition, efforts to assess capital adequacy with respect to banks' cross-border exposures through stress tests are ongoing. Lebanon's AML/CFT regime is in practice fully compliant with international standards, and Lebanon's financial intelligence unit, the Special Investigation Commission, actively cooperates with its foreign counterparts.