Lebanon: Selected Economic Indicators, 2007–09

	2007	2008	Prel. 2009
Output and prices	(Annual percentage change)		
(Annual percentage changeReal GDP (market prices)	7.5	9.3	9.0
GDP deflator	3.9	9.3	5.8
Consumer prices (period average) [1]	4.1	10.8	1.2
Central government finances (cash basis)	(In percent of GDP)		
Revenue (including grants)	24.0	23.8	24.6
Expenditure	34.9	33.4	32.7
Budget balance (including grants)	-10.8	-9.6	-8.1
Primary balance (including grants)	1.7	1.4	3.0
Total government debt	168	157	148
Monetary sector	(Annual percentage change, unless otherwise)		
Credit to the private sector	15.8	18.5	15.1
Broad money [2]	10.9	15.5	23.2
Interest rates (period average, in percent)			
Three-month treasury bill yield	5.2	5.2	5.0
Two-year treasury bill yield	8.7	8.6	7.6
External sector	(In percent of GDP, unless otherwise indicated)		
Exports of goods (in US$, percentage change)	26.8	29.1	-10.2
Imports of goods (in US$, percentage change)	27.6	36.3	-2.3
Current account (excluding official transfers)	-7.6	-9.7	-9.7
Foreign direct investment	7.5	8.8	10.7
Total external debt [3]	194	172	171
Gross reserves (excluding gold), in billions of U.S. dollars	11.5	18.8	27.4
In percent of short-term external debt [4]	29.7	45.7	55.2
In percent of total banking system deposits	17.1	24.1	28.6
Memorandum items:			
Nominal GDP (in billions of U.S. dollars)	25.1	29.9	34.5
Commercial bank total assets	328	315	334
Local currency per U.S. dollar (period average)	1507.5	1507.5	1507.5
Real effective exchange rate (annual average, percent change)	-1.0	-3.0	7.1
Stock market index	1454	1182	1566
EMBI Global - Lebanon (spread; basis points)	493	794	293

Sources: Lebanese authorities; and IMF staff estimates and projections.
[1] Through 2008: based on the CPI index by Consultation and Research Institute; from 2009: based on the CPI index by Central Administration of Statistics.
[2] Defined as currency in circulation plus resident and non-resident deposits.
[3] Includes non-resident deposits.
[4] Short-term debt on a remaining maturity basis, including short-term non-resident deposits.

Statement by Mr. Shaalan on Lebanon
Executive Board Meeting
July 30, 2010

1. On behalf of the Lebanese authorities, I would like to thank staff for the valuable and constructive discussions during the mission, including the useful exchange of views on key issues topical to Lebanon at this time. The authorities also wish to express their appreciation for the continued provision of timely and effective technical assistance.

Recent Developments and Outlook

2. Regained domestic political stability and improved regional conditions, as well as prudent macroeconomic policies and continued capital inflows, all contributed to the remarkable performance of the Lebanese economy during the global financial crisis. Real GDP growth averaged about 9 percent since 2008, one of the highest in the region, driven by construction, tourism, trade, and financial services. Inflation remained under control, although it has risen above the 2009 average, partly on account of fuel prices. Moreover, the authorities made further progress toward fiscal consolidation, as evidenced by the steady decline in the overall fiscal deficit. As a result, gross public debt-to-GDP is projected to reach 139 percent at end–2010 after peaking at 180 percent at end–2006. Deposit inflows continued to increase at a rapid pace—despite some moderation in recent months—deposit dollarization declined, and the Banque du Liban (BdL) accumulated significant international reserves. Moody's upgrade of Lebanon's sovereign ratings in April 2010 reflects these favorable developments.

3. The authorities' policy objective in the near term is to prevent the economy from overheating. They are well aware that vulnerabilities remain, notwithstanding the economy's strong performance. These vulnerabilities pertain to the fragile domestic and regional political environment, the high public debt-to-GDP ratio, and large gross public financing requirements which carry important rollover risks. To minimize the possible impact of the aforementioned risks and pave the way for stable and sustained growth, the authorities are committed to take advantage of the current favorable environment to address infrastructure bottlenecks and decisively reduce public debt over the medium term.

Fiscal Policy and Reforms

4. The draft budget for 2010, currently being discussed in parliament, aims at balancing essential spending needs with stability goals. It envisages a significant increase in capital spending—which will remain low in comparison with other countries in the region—to address pressing infrastructure bottlenecks, notably in electricity generation which has lagged far behind demand. Part of the increase in spending will be offset by revenue measures, including a 2 percentage point increase in the tax on interest income and higher registration fees for high-end properties. Taking account of the delayed implementation of the budget and given the higher than forecast revenue performance this year, the decline in the primary surplus is likely to be limited to about 1 ½ percentage points of GDP in 2010. The authorities view the relaxation of the budget as temporary, and they remain fully committed to fiscal consolidation and debt reduction in the medium term.

5. Further progress has been made in the area of budgetary reforms, notably with regard to public financial management with the provision in the 2010 draft budget law to cast future budgets in a multi-year framework. Moreover, further to the introduction of transparent reporting through the issuance of the Quarterly Debt and Debt Markets' report since Q2 2007, the Ministry of Finance is enhancing its debt management capacity by preparing a decree to activate the debt management unit.

6. Banks remain very liquid despite the slowdown in deposit growth in recent months. Accordingly, the government expects to meet its 2010 financing needs from the market. It intends, in close coordination with the BdL, to gradually lengthen the maturity profile and lower the foreign currency share of government debt, which has declined over the past few years (Tables 4 and 10). In doing so, due consideration will be given to preserving an adequate level of international reserves.

Monetary and Exchange Rate Policies

7. The monetary policy framework has helped to bolster confidence in the Lebanese financial system. The exchange rate peg continues to serve the economy well by providing a firm anchor for financial stability. At the same time, the level of international reserves preserves confidence in a country with underlying vulnerabilities, an open capital account, and a fixed exchange rate. In line with the intention that was expressed during the previous Article IV Consultation discussion, the authorities have markedly reduced policy interest rates (by more than 400 basis points since mid-2008 on 5-year Treasury-bills/BdL Certificates of Deposit) as market conditions became more predictable. This reduction resulted in a significant slowdown in deposit growth. Given the imperfect monetary transmission mechanism with uncertain lags in Lebanon, the authorities fully concur with staff that a pause in policy interest rate reductions is warranted.

8. The authorities appreciate staff's analysis regarding the merits and costs of further reserve accumulation. Nonetheless, the message on the relatively low "insurance" value of additional coverage and high associated sterilization costs ought to be interpreted with caution. While reserve holdings entail an opportunity cost, the model-based approaches outlined in Appendix 2 do not fully account for the positive confidence effects related to holding reserves. These were made clear during several crisis episodes during 1993-2009. Moreover, Lebanon's ratio of reserves-to-broad money—at about 28 percent in 2009—was below the emerging market median of 33 percent.[1] Finally, the reserve coverage of short-term external debt, currently at 56 percent, remains well-below the 100 percent Greenspan-Guidotti threshold, and the 153 percent median for emerging countries.[2] With potentially volatile non-resident deposits accounting for three quarters of short-term external debt, the country could be subject to rapid shifts in risk appetite during times of turbulence.

Banking Sector

9. Effective banking regulation and supervision, coupled with conservative bank funding and asset structures, have shielded the domestic financial sector from the global turmoil. At the same time, conservative prudential regulations on leverage and limited bank exposure to real estate, have protected banks from potential effervescence in the real estate market. In this regard, staff found little speculation in the real estate market, and developers generally use low leverage in their projects.

10. High liquidity and declining interest rates have led banks to increase private sector credit and expand their businesses in the region over the past few years. Bank regulation and supervision have particularly focused on preventing excessive risk taking in this regard. The BdL and the Banking Control Commission have indeed reinforced cross-border supervision and measures aimed at strengthening the oversight of Lebanese affiliates abroad, as detailed in Box 4 of the staff report.

Structural Reforms

11. The authorities are fully aware of the importance of structural reforms to create the conditions for sustainable growth. They have identified priority focus areas in which immediate reform and investments will help address the pressing needs of the population. These areas include electricity, water, telecoms, urban transport, local development, environment, public education, and social protection. The authorities believe that early successes with these actions will create favorable social and political space for building

[1] SM/10/166, June 30, 2010.

[2] EBS/10/146, July 16, 2010.