

## LEBANON—PROGRAM NOTE

**IMF-Supported Program:** US\$37.6 million in Emergency Post-Conflict Assistance (EPCA), approved by the IMF's Executive Board on November 19, 2008, in support of the authorities' economic program through June 2009.

### **Background**

On paper, the Lebanese economy looks highly vulnerable, but it nevertheless retains a surprising ability to weather storms. Lebanon's government debt-to-GDP ratio (over 150 percent) remains among the highest in the world, its large banking system (assets of more than three times GDP) is excessively exposed to the sovereign (56 percent of assets) and dependent on inflows of nonresident deposits, and the country lies at the crossroads of regional political tensions.

With large government and private sector currency mismatches, the maintenance of the Lebanese Pound's peg to the U.S. dollar remains essential for continued financial stability. Despite all this, the Lebanese economy has proven remarkably robust to economic shocks. But this resilience cannot be taken for granted. Following the Israeli invasion in 2006, the international community therefore agreed to support an ambitious Lebanese program of reconstruction and macroeconomic stabilization.

### **Role of the IMF**

In the aftermath of the 2006 invasion, the authorities, backed by the international community, developed a comprehensive economic reform program (the Paris III agenda). The reform agenda aims at:

- fiscal adjustment, related structural measures and privatization to tackle the large public debt overhang and reinvigorate the economy; and
- social sector reforms to alleviate poverty, reduce regional income disparities, and improve education and health indicators.

The Fund supported this agenda through a quarterly monitoring framework and a first drawing of EPCA in 2007. Domestic political conflict interrupted progress in implementing the Paris III agenda. To help maintain economic and financial stability, the Fund supported the authorities through a second EPCA drawing in 2008. The EPCA-supported program expired last June.

## **Progress under EPCA**

The EPCA-supported program met its key objective of reducing vulnerabilities and helped Lebanon to weather the global financial crisis. The government debt-to-GDP ratio declined by nearly 30 percentage points since end-2006 thanks to sustained economic growth and fiscal discipline. Strong deposit inflows, key for covering the government's large financing needs, boosted the Banque du Liban's gross reserves, which have doubled over the past 18 months. Real GDP is estimated to have grown by around 7 percent in 2009, helped by prudent policies and an improvement of the political and security situation after the May 2008 Doha agreement. Progress on structural reforms was limited, though, given the political impasse in the period leading up to the June 2009 parliamentary elections and subsequent protracted negotiations toward the formation of the new national unity government.

## **The Road Ahead**

The formation of the government in December has opened a new window of opportunity for reinvigorating economic reforms. The authorities have announced the resumption of economic reforms in the spirit of the Paris III reform agenda, while at the same time focusing on improvements to public infrastructure and services. Continued debt reduction will be key to addressing Lebanon's main vulnerabilities.

The main downside risks to this outlook stem from the possible confluence of domestic political uncertainty, regional instability, and a renewed weakening of global and regional economic conditions, which could again test the country's fiscal and financial vulnerabilities.