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IMF Country Report No. 07/382

Lebanon: 2007 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Lebanon

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 Article IV consultation with Lebanon, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 28, 2007, 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 September 18, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of October 3, 2007 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 3, 2007 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for Lebanon.

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

Report on Performance Under the Program Supported by Emergency Post-Conflict Assistance

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

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LEBANON

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with Lebanon

Approved by Juan Carlos Di Tata and Scott Brown

September 17, 2007

- **Discussions were held in Beirut May 14–28, 2007.** The mission comprised Mr. Gardner (head), Ms. Oner, Messrs. Schimmelpfennig and Sdralevich (all MCD), Finger (PDR), Hoffmann (MCM), and Le Borgne (FAD). Mr. Di Tata (MCD) and Ms. Choueiri (OED) participated in some of the policy discussions. The mission met with the central bank governor, the ministers of finance, economy and trade, tourism, and energy, the Banking Control Commission, senior government officials, the director of the electricity company, and representatives of the banking sector, the business community, the trade union, and donor countries.
- **Lebanon accessed Fund resources under Emergency Post-Conflict Assistance (EPCA) (25 percent of quota or SDR 50.75 million) in April 2007.** 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; controls on capital account transactions are minor, and relate mostly to a prohibition on domestic borrowing by nonresidents. The Lebanese pound is de facto pegged to the U.S. dollar; since October 1999, the Banque du Liban has intervened to keep the pound within a narrow corridor of LL 1501 to LL 1514 per U.S. dollar. The 2006 Article IV consultation was concluded by the Executive Board on May 3, 2006.
- Lebanon participates in the **General Data Dissemination Standards.** The **fiscal ROSC** was published May 16, 2005, and the last **FSAP update** was concluded in 2001.
- This report reflects information through May 2007. A progress report on performance under EPCA at end-June 2007 was issued to the Executive Board for information (IMF Staff Country Report No. 07/371) on September 5. A forthcoming staff statement will discuss more recent developments.

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EXECUTIVE SUMMARY

Background and recent developments

The economy is slowly recovering from the 2006 conflict with Israel. A political stalemate continues to paralyze legislative activity, and, combined with repeated security incidents, is weighing negatively on economic activity. Money demand has remained robust. In support of the government's 2007 program, the Executive Board approved EPCA in April 2007.

Outlook and policy discussions

- The government's five-year reform program lays out an ambitious strategy aimed at reducing Lebanon's large debt overhang and financial vulnerabilities. The strategy is subject to recognized risks from domestic and regional tensions, macroeconomic shocks, contingent fiscal liabilities, and the difficulty of mobilizing political support for sustained adjustment. To address some of these risks, the authorities' fiscal strategy is complemented by structural reforms to promote private sector growth (with privatization at its core) and social sector reforms.
- The objectives of the 2007 program are to contain the budget deficit and to maintain financial stability during this difficult transition year, while preparing for sizeable fiscal adjustment and structural reforms in 2008. Revenue, expenditure and public financial management reforms have been identified; structural reforms in the key power and social sectors are being finalized in collaboration with the World Bank.
- Successful fiscal adjustment would provide an opportunity to strengthen the central bank's balance sheet and reform the monetary policy framework by relying on short-term monetary instruments.
- Banks face balance sheet risks from dollarization and exposure to the sovereign. They are diversifying their portfolio through regional expansion and increased retail lending. The sector appears well prepared for the introduction of Basel II in 2008.

Staff appraisal

- Performance in the first quarter was consistent with the 2007 program objectives, but the uncertain economic and financial outlook requires monitoring. The authorities rightly intend to create a fiscal buffer through tight expenditure control. Early introduction of a floor on gasoline excises would help safeguard revenues.
- Full implementation of major reforms and adjustment measures planned for 2008 will be important to establish the credibility of the strategy and safeguard external stability over the medium term.
- The exchange rate peg remains key to financial stability, and needs to be supported by the authorities' planned fiscal adjustment as well as greater interest rate flexibility and a strengthening of the central bank's balance sheet.

I. INTRODUCTION

1. **The Lebanese authorities presented an ambitious five-year reform program to donors at the Paris III conference in January 2007.** The program aims at raising growth, improving living standards, and reducing Lebanon's large debt overhang and financial vulnerabilities, taking account of the special challenges created by the conflict with Israel in July–August 2006. A number of reforms were developed in close consultation with the Fund (Box 1), and, on April 9, 2007, the Executive Board approved the authorities' request for EPCA in support of their 2007 program.

Box 1. Implementation of Past Fund Advice

Since the Paris II conference of 2003, Fund advice has focused on the implementation of the authorities' medium-term strategy of fiscal adjustment, privatization, and structural reforms. The pace of reform and fiscal adjustment has fallen short of the initial plans and of Fund recommendations because of political instability and insufficient domestic consensus on the reform agenda. The conflict between Hezbollah and Israel in 2006 caused a further setback and led to the authorities' decision to delay most adjustment measures until 2008.

In developing their reform strategy, the authorities have, to a large extent, relied on Fund advice. Most of the tax policy and administration measures, as well as the public financial management reforms, embedded in the revised strategy presented by the authorities at the Paris III conference were developed in close consultation with staff, and have benefited from extensive Fund technical assistance. The Fund has supported the authorities' view that the exchange rate peg remains key to financial stability.

2. **Even with the strong fiscal adjustment envisaged for 2008-12, Lebanon will continue to be highly vulnerable to swings in investor confidence, and the level of public debt will remain high for years to come.** Against this background, discussions for the Article IV consultation stepped back from the immediate program context and focused on: (i) making the reform strategy more resilient to inherent risks and potential shocks; (ii) reforms in the monetary policy framework and banking sector; and (iii) policies for 2007 and 2008 to support the authorities' medium-term objectives.

II. BACKGROUND AND RECENT DEVELOPMENTS

3. **Economic developments in 2006 were significantly affected by the conflict with Israel (Tables 1–10).**[1] Real GDP is estimated to have been flat in 2006, with strong growth in the first half offsetting the disruptions created by the conflict (Figure 1). Inflation

[1] Developments in 2006 were discussed in more detail in IMF Staff Country Report No. 07/177.

accelerated in July–August, largely reflecting supply shortages during the conflict and the ensuing blockade. Financial pressures were managed effectively owing to the banking system's strong liquidity position. Immediately after the conflict, donors pledged $1.7 billion for relief and recovery (mostly at the Stockholm conference in August 2006), and disbursements in 2006 roughly offset the immediate fiscal costs of the conflict (Text Table 1). Nonetheless, the overall fiscal deficit increased in 2006 because of rising interest expenditures and higher than expected transfers to the power company, Electricité du Liban (EdL). Government debt rose to over $40 billion (178 percent of GDP) at end-2006.

Text Table 1. Lebanon: Economic Impact of the July–August 2006 Conflict, 2006–09
(In billions of U.S. dollars)

	2006 Act.	2007 Proj.	2008 Proj.	2009 Proj.	Cumulative Proj. 1/
Damage	2.0	…	…	…	2.0
Of which: to housing	1.1	…	…	…	1.1
Budgetary impact	0.7	0.9	0.4	…	2.0
Estimated conflict-related revenue loss	0.5	…	…	…	0.5
Conflict-related spending	0.2	0.9	0.4	…	1.5
Grant disbursements (including Stockholm conference) 2/	0.7	0.6	0.2	…	1.4

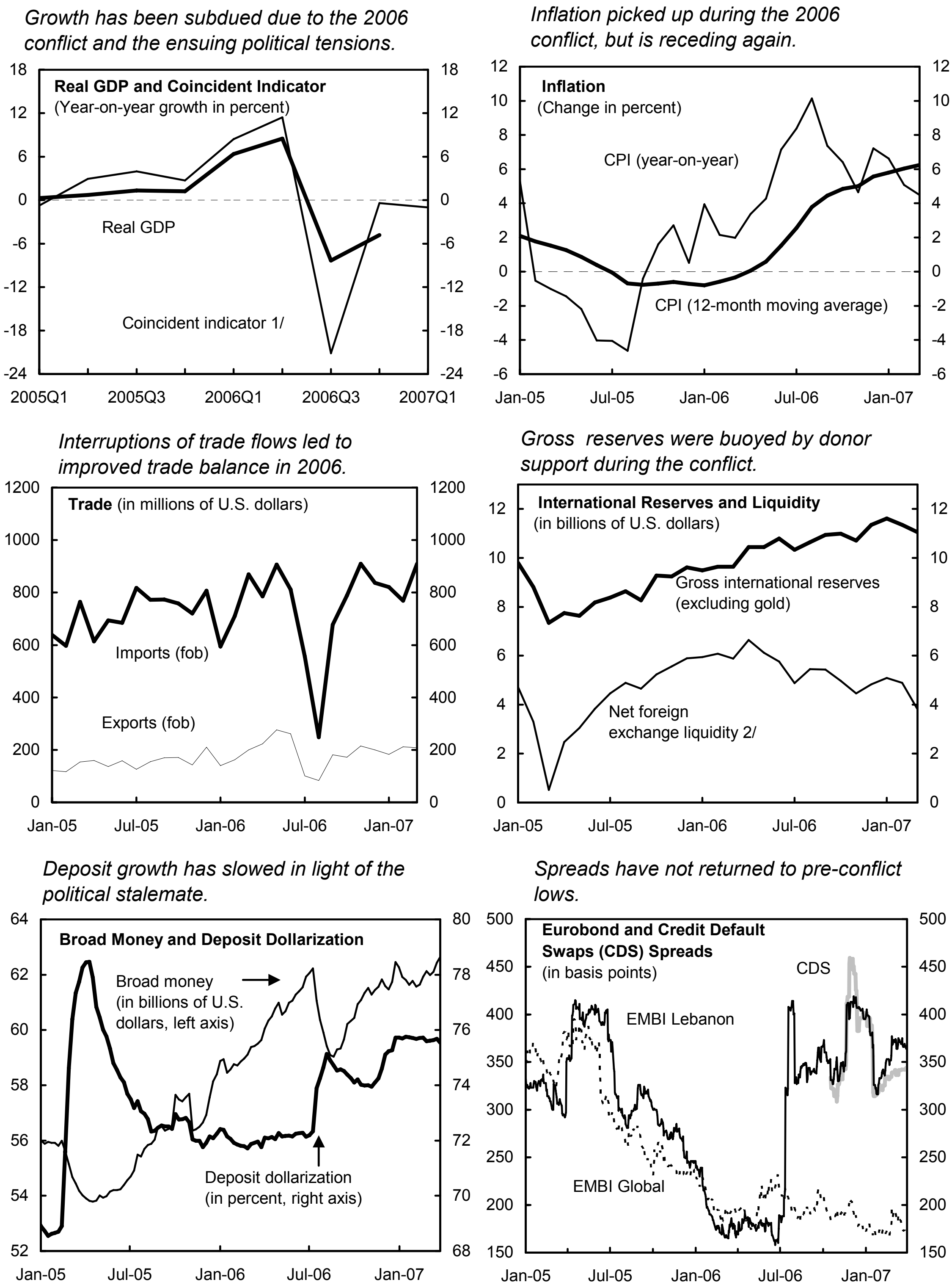
Sources: Lebanese authorities; and Fund staff estimates.
1/ May not add up due to rounding.
2/ Excluding support pledged at the Paris III conference.

4. **Despite continued political uncertainty, economic developments in the first quarter of 2007 pointed to an incipient recovery.** Indicators of economic activity during the first quarter suggest that GDP had recovered, faster than expected, to the level of early 2006. Inflation has receded as the impact of supply shortages during the 2006 conflict is fading out, notwithstanding the depreciation of the U.S. dollar to which the currency is pegged. Due to strong year-on-year import growth, the trade deficit widened in the first quarter of 2007. With lower capital inflows and limited donor disbursements, gross international reserves fell by $300 million, to $11 billion at end-March.[2]

5. **The political tensions that erupted after the conflict with Israel between the government and the opposition remain high.** If not resolved, the political confrontation could lead to a constitutional crisis by the time of the presidential election later this year. On June 10, the United Nations established a tribunal to investigate the assassination of former Prime Minister Hariri. After a period of calm, the security situation deteriorated again in late May with fighting between the Lebanese army and the Fatah al-Islam militants in northern Lebanon and several bomb explosions in and around Beirut.

[2] Excluding gold valuation changes.

Figure 1. Lebanon: Recent Developments, January 2005–March 2007



Source: Lebanese authorities; J.P. Morgan; Bloomberg; and Fund staff calculations.

1/ Coincident indicator is a composite indicator of economic activity monitored by the central bank.

2/ Defined as gross international reserves minus principal and interest due over the next 12 months on all foreign currency liabilities of the central bank to entities other than the government of Lebanon. Excludes long-term foreign exchange liabilities of the central bank.

6. **The political tensions have also affected financial markets, though money demand remains robust.** Notwithstanding considerable monthly volatility, bank deposits have grown at an average (annualized) rate of 9 percent between October 2006 and May 2007.[3] Lebanese Eurobond and Credit Default Swap spreads remain some 200 basis points above the levels prevailing prior to the 2006 conflict, but have also been quite volatile reflecting political developments. Deposit dollarization (currently at 76 percent) is also higher than prior to the conflict, while the stock market index has remained broadly constant since end-2006 in very low trading.

III. Outlook and Authorities' Views on Policies[4]

7. **Discussions were based on a scenario developed by staff that incorporates full implementation of the Paris III reform program (Text Table 2).** Fiscal adjustment and privatization are expected to begin in 2008, and, as a result, government debt would be reduced by almost 50 percentage points to below 130 percent of GDP by 2012, in line with the authorities' targets. In addition to the contribution of fiscal adjustment (7 percentage points), the debt reduction comes from privatization (31 percentage points), the projected Paris III donors assistance (6 percentage points), and the transfer of unrealized gold valuation gains from the Banque du Liban (BdL) to the budget (7 percentage points). The associated improvement in confidence is assumed to result in a pick-up of growth to 4–5 percent a year (similar to the historical average rate over the last 15 years), and a narrowing of interest rate spreads. The authorities considered the macroeconomic scenario realistic, but believed that they will obtain a higher fiscal yield from their reforms.

A. Minimizing Risks to the Paris III Reform Strategy

8. **The Paris III reform strategy is subject to a number of risks, which were acknowledged by the authorities.** Given the large debt overhang and fiscal and external imbalances that are financed by short-term deposit inflows, Lebanon will remain vulnerable to shocks to confidence for years, even with full implementation of the reforms. The most immediate risk to the strategy is the political risk that reforms cannot be initiated or would be reversed. Shortfalls in growth or higher than projected real interest rates constitute the main macroeconomic risks. Lastly, there are some uncertainties over the yield of reforms, as well contingent liabilities that have yet to be quantified. The effects of these risks are illustrated by the debt sustainability analysis (Box 2).

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[3] A temporary peak in deposits at end-2006 was reportedly related to some "window dressing" by banks aimed at posting high deposit growth rates for the year.

[4] Staff's views are given in Section IV.

Text Table 2. Lebanon: The Paris III Fiscal Adjustment Objectives, 2006–12

Measures	Timeline to Implementation	Executive or Legislative Prerogative	Cumulative Yield in Percent of GDP (2006 to 2008)	Cumulative Yield in Percent of GDP (2006 to 2012)
Revenue			**2.8**	**5.4**
Increase in the VAT rate (from 10 to 12, and then to 15 percent)	Rate to 12 percent is already in the 2007 draft budget law with implementation on January 1, 2008. Increase to 15 percent is scheduled for 2010.	Legislative	1.1	2.5
Introduce a global income tax	Law needs to be passed before end-2007 for the tax to be collected in 2008. Administrative reforms and taxpayer information require significant lead time between the passage of the law and the implementation of the new tax regime.	Legislative	0.0	1.0
Increase in gasoline excises to their pre-capping level	Implementation is immediate following a Council of Ministers decree. First increase by September 2007, thereafter annual until pre-capping levels of 2004 have been re-instated.	Executive	0.8	1.1
Increase in the rate of tax on interest income (from 5 to 7 percent)	2007 budget law with implementation on January 1, 2008.	Legislative	0.4	0.4
Improved revenue from government properties (Casino du Liban, etc.)	Immediate. Negotiations have been completed.	Executive	0.4	0.4
Improvement in property tax administration and taxation of seashore properties	Reforms are ongoing.	Executive	0.2	0.2
Expenditure			**0.4**	**4.5**
Reforms leading to a nominal freeze of the wage bill	Ongoing	Executive	0.1	0.9
Reduction in EdL losses	Reforms are ongoing. The World Bank is actively involved.	Executive	0.2	2.1
Reduction in other current expenditures (mostly transfers)	Key measures include closing the Council of the South and the Fund for the Displaced (now scheduled for end-2009).	Executive	0.6	1.9
Increased capital spending (growth enhancing)	To be implemented each year within the new budget law.	Legislative	-0.3	-0.4
Adjustments			**-2.4**	**-5.9**
Revenue loss due to privatization	Ongoing	Executive	-1.6	-3.4
Change in grants	Ongoing	Executive	-0.4	-3.0
Conflict-related expenditure	Ongoing	Executive	-0.5	1.0
Other 1/			0.0	-0.6
Change in primary fiscal balance (including grants)			**0.9**	**3.9**

Sources: Lebanese authorities; and Fund staff.
1/ Includes the fiscal impact of exogenous factors and one-off effects.

Box 2. Debt Sustainability Analysis

The debt sustainability analysis (DSA) reveals that under a number of shocks, the debt-to-GDP ratio would revert to an unsustainable path. The DSA shows the impact of six shocks on the baseline debt trajectory as well as the implications of using historical values for the interest rate, growth rate, and the primary balance (Figure 2, and Table 11):

Panel 1: The baseline scenario—full implementation of the Paris III agenda.

Panel 2: A permanent increase in the real interest rate by 170 basis points (i.e., one-half standard deviation from its past distribution) relative to the baseline.

Panel 3: A drop in average GDP growth from 4 percent in the baseline to 3 percent, i.e., the average rate for 2002–06.

Panel 4: A shortfall in the yield from fiscal reforms, i.e. halving of the yield of the fiscal reform package. This reduces the average primary surplus to just over 1 percent of GDP in 2007–12, compared with over 4 percent of GDP in the baseline, and implies that the primary surplus converges to 1 percent of GDP in the long-run, compared with 3 percent of GDP in the baseline.

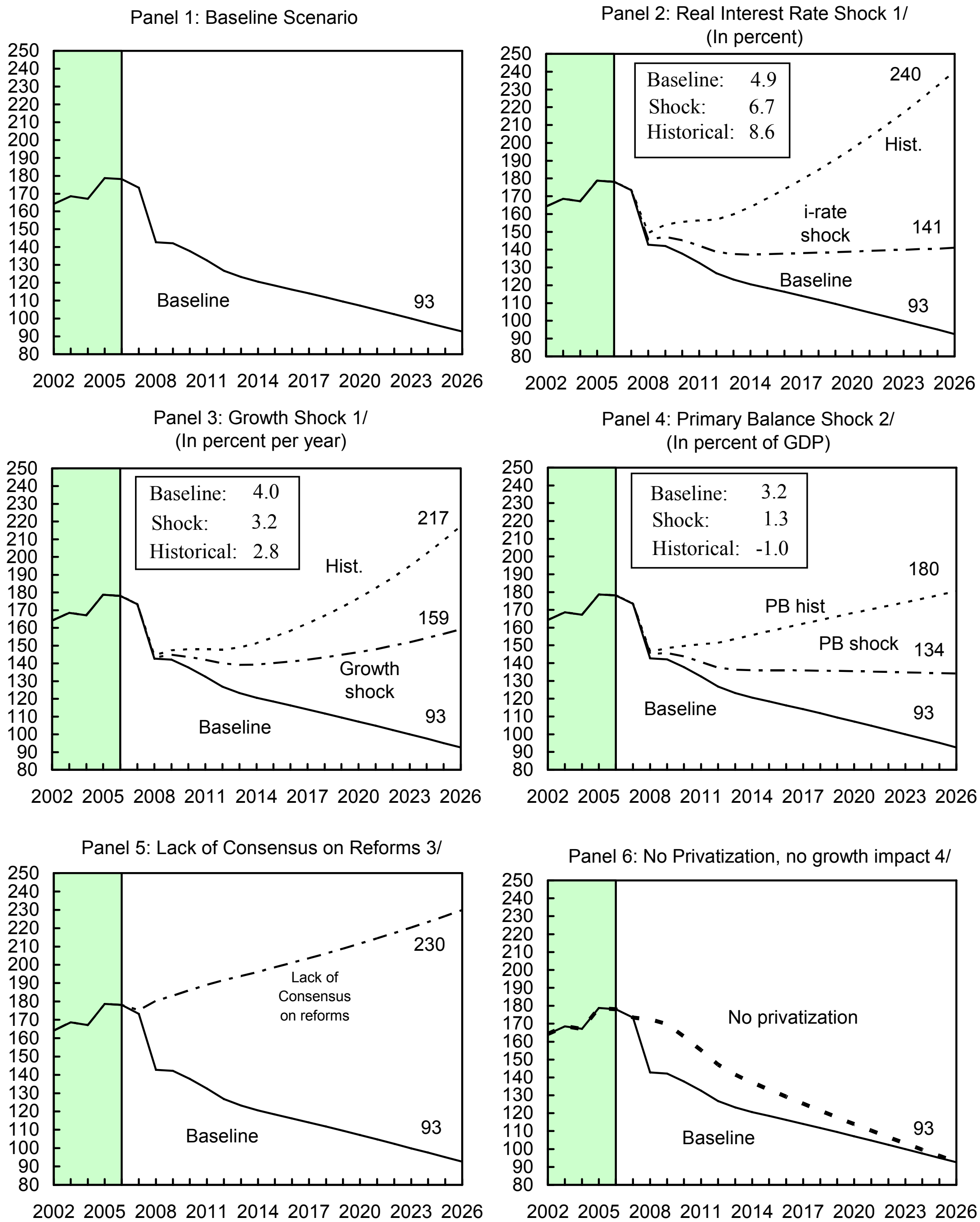
Panel 5: Absent sustained reforms, no privatization and only partial fiscal adjustment (the primary surplus reaches only 3 percent by 2012); growth remains sluggish at 3 percent per annum, while interest rate spreads widen by 220 basis points relative to the baseline.

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

9. **The authorities concurred with staff that broad domestic support was needed to achieve and sustain the targeted fiscal adjustment.** They considered that the tranched donor support, which was conditional on reform implementation, would provide an effective incentive to maintain the reform momentum over time. Beyond that, they noted that the growth and social pillars of their Paris III program were intended to build public support for reforms by compensating for the inevitable difficulties of fiscal adjustment.

10. **The program's growth pillar is centered on privatization, improvements in the business climate, and opening of markets.** The authorities emphasized that privatization of the telecom sector was the lynchpin of their growth strategy, and that additional public sector enterprises were also being slated for privatization. Furthermore, they were establishing a competitiveness council, consisting of private sector and government representatives that would be tasked with identifying legal and administrative impediments to growth. In this context, they were taking steps to streamline the process of obtaining business licenses, and, more generally, to lower the cost of doing business. The authorities also thought that accession to the World Trade Organization—envisaged for 2008—would contribute to further liberalizing markets; they expected to have all relevant legislative changes ready for parliament by the end of 2007.

Figure 2. Lebanon: Public Debt Sustainability, 2002–26
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Growth shock based on average 2002–06 values. Interest rate shock is permanent one-half standard deviation shock. Figures in the boxes represent average projections for the respective variables in the baseline scenario and shock scenario; historical refers to 10-year averages.
From 2012, the primary fiscal surplus reverts slowly to a long-term level of 3 percent of GDP.
2/ Through 2012, the planned revenue and expenditures reforms generate half of their estimated yield in the scenario; after 2012, the primary surplus slowly declines to 1 percent of GDP.
3/ Lack of consensus on reform prevents privatization and allows only partial fiscal adjustment.
4/ No privatization in the projected period. Assumes no adverse dynamic impact of no privatization.

11. **The main elements of the social pillar are to improve service delivery in health and education and strengthen the social safety nets.** The authorities noted they could achieve a lot by redirecting the existing envelope of social spending, improving public services, and creating public social safety nets (including through a cash transfer system).

12. **The authorities were less concerned about uncertainties over the yield of reforms, arguing that there was also an upside potential.** For example, the ongoing revision of the reform plan for EdL was expected to lower reform costs, while yielding the same reduction in transfers from the budget. They also expected tax administration reforms to increase tax buoyancy relative to staff's revenue projections. However, the authorities acknowledged the risk of added spending pressures on account of the security situation.

13. **Reforms to address imbalances (and possible contingent liabilities) in the pension and health system are being developed.** The authorities did not see immediate pressures developing in the public pension system, and felt therefore that they had time to assess imbalances (ongoing) and introduce reforms. The reform of the private pension system—currently in parliament—envisions the system's transformation from an end-of-service allowance to a fully funded pension system. Transition costs may have to be borne by the state, but their extent would only be revealed once the audits of the National Social Security Fund's (NSSF's) accounts are completed (Table 12), and the contribution and replacement rates for the new system are finalized. In the meantime, the authorities plan to introduce professional asset management to raise the private pension systems' return on investment. Another source of open-ended budget transfers are the losses of the health fund of the NSSF. In this regard, the authorities are discussing with the World Bank options for addressing underlying structural problems in contribution rates and coverage, which, among other problems, create a bias toward hospitalization that is pushing up costs.

14. **In parallel, the authorities plan to develop institutions that will help sustain the adjustment effort.** They have taken steps to develop a medium-term budget framework to better align short-term policies with strategic objectives, and are also aiming to move gradually toward program budgeting. They also consider adopting a fiscal responsibility law to provide a self-reinforcing mechanism of fiscal adjustment and debt reduction that reduces the risk of backtracking. The authorities acknowledged that such institutional reforms will require substantial preparation.

B. Monetary and Exchange Rate Policies

15. **The authorities consider that their monetary policy framework has enabled them to deal effectively with financial pressures.** They believe that interest rate stability, notably in treasury bill (T-bill) rates, played a key role in maintaining confidence during periods of pressure (Table 13). However, they recognized that the counterpart to that was the need for the BdL to occasionally rely on alternative instruments (central bank CDs, special discount windows, swaps, etc.) to manage liquidity and safeguard international reserves. The

authorities also reiterated that the BdL's mandate was to maintain financial stability, and that, in their view, this involved providing financing to the government in times of shortfalls from other sources. Nonetheless, they agreed that such financing should only be temporary, and that prolonged shortfalls in market demand would have to be met by raising T-bill rates.

16. **The monetary authorities confirmed their intention to introduce new short-term instruments for managing liquidity once the financial situation improves.** They considered a resolution of the political and security situation, and an improved fiscal environment as preconditions for moving toward short-term, market-based instruments of monetary control (such as repos and reverse repos). However, they acknowledged that this would require greater price flexibility in T-bill auctions. In the context of monitoring performance relative to the EPCA monetary and fiscal targets, the authorities are planning to establish a technical working group to enhance information sharing between the ministry of finance and the BdL.

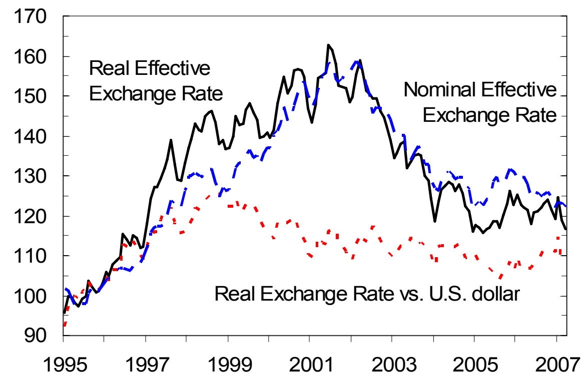
17. **The authorities continue to regard the exchange rate peg as key to financial stability.** Exchange rate stability was particularly important given balance sheet risks related to widespread dollarization and the government's high foreign currency debt servicing obligations. They agreed with staff that fiscal imbalances, but also temporary factors related to the post-conflict environment, were at the core of Lebanon's high current account deficit, and noted that the planned fiscal adjustment would help improve the current account position significantly. Against this background, and the fact that trade competitiveness was being maintained, the authorities concurred with the staff analysis (Box 3), which does not suggest that the exchange rate is misaligned. Furthermore, the authorities were confident that the envisaged structural reforms would generate the competitiveness gains needed to sustain growth.

18. **The authorities were confident that the weakening of the BdL's balance sheet has not impaired monetary control.** They noted that the weakening was largely the result of managing past crises, although quasi-fiscal activities carried out by the BdL had also contributed. They did not see an immediate risk to their ability to control liquidity, and thought that the BdL's balance sheet could absorb the transfer to the government of unrealized gold valuation gains. Looking forward, the authorities expected that fiscal adjustment and improvements in confidence would help reduce dollarization, which would facilitate a further build-up of net international reserves and strengthen the BdL's income position.

Box 3. Assessment of the Level of the Real Exchange Rate

Traditional indicators do not suggest that Lebanon has an external competitiveness problem.

Lebanon: CPI-Based Real Exchange Rate Developments
(Index, 1995=100; January 1995-March 2007)



Sources: National authorities; and Fund staff calculations.

- Largely reflecting the weakening of the U.S. dollar, the real effective exchange rate (REER) has depreciated 20 percent relative to its 2000–02 average, offsetting some competitiveness losses since the mid-1990s. The bilateral real exchange rate vis-à-vis the U.S. dollar—to which the Lebanese pound is pegged—has remained broadly stable over the past decade.
- Lebanese exports have remained competitive during difficult times. Merchandise exports grew at an average rate of 5 percent a year in volume terms in 2004–05 (staff estimate based on Lebanese customs data), and maintained positive momentum in 2006 (2 percent) and into 2007, despite the conflict-related disruptions in production and the two-month air, land, and sea blockade. As such, Lebanon's exports have more than kept pace with the buoyant demand in the region; the market shares vis-à-vis all trading partners have been stable in 2005–06. Exports of services (primarily but not exclusively tourism) have suffered from the political and security disruptions of 2005–07, but still have strong growth potential as was demonstrated in 2004.

Applying the three methodologies proposed by the IMF's Consultative Group on Exchange Rate Issues (CGER) does not suggest that the REER is misaligned.

- *Equilibrium real exchange rate approach:* An estimation of the long-run equilibrium REER derived from key macroeconomic fundamentals (the net external asset position (NEAP), the productivity differential with trading partners, terms of trade, and government consumption) suggests that the REER could actually be modestly undervalued relative to its estimated equilibrium level. However, the result is well within the margins of error in this type of analysis.
- *External sustainability approach:* In this approach, the underlying current account deficit in 2007 is compared to the current account deficit that would stabilize Lebanon's NEAP at the end of 2006. The empirical estimate of Lebanon's NEAP is subject to large uncertainty, and depending on the choice of the NEAP, the REER is either slightly undervalued or slightly overvalued, also within the typical margin of error.
- *Macroeconomic balance approach:* For this approach, a current account norm of –5 to –6 percent of GDP is derived based on macroeconomic fundamentals (fiscal balance, dependency ratio, population growth, NEAP, oil balance, output growth, income relative to the United States in purchasing power parity terms). The current account norm is then compared to medium-term projections based on the authorities' planned policies under the Paris III program. With full implementation of the authorities' program, the projected current account deficit for 2012 would narrow to –5½ percent of GDP. However, if the fiscal adjustment planned under the Paris III program is not achieved in full, the projected current account deficit under current policies would exceed the norm which could potentially lead to external instability. This result is also reflected in the historical scenarios of the DSA (Figure 2) that show an unsustainable debt path if the program is not implemented and the key macroeconomic variables remain at their average levels over the last decade.

19. **The BdL has introduced a scheme to provide relief to banks and businesses affected by the 2006 conflict.** Under the scheme, the BdL would provide loans to banks at below-market interest rates which the banks would re-invest in fresh T-bills. Banks would then use the interest differential to provide a 60 percent subsidy toward the reconstruction of productive facilities destroyed during the conflict. The authorities argued that in the absence of any assistance, some banks with large exposures would find it difficult to absorb conflict-related losses. The authorities estimated the total subsidy under the scheme would be at most $180 million, although disbursements could be significantly lower owing to strict eligibility requirements.

C. Banking Sector Vulnerabilities

20. **The banking sector is profitable and its capitalization is increasing, though vulnerabilities remain high (Tables 14–15).** The balance sheet of domestic banks stands at $77 billion (320 percent of GDP) and exposure to the sovereign (government and central bank) is around 50 percent of assets. The authorities were concerned about the substantial maturity mismatch that banks carry on their books, largely from sourcing their holdings of government paper from short-term deposits (Table 16). In addition, the high degree of dollarization exposes banks to substantial credit risk. Reducing these vulnerabilities will ultimately depend on the success of the debt reduction strategy, although the authorities are working in parallel to encourage banks to strengthen risk management and diversify their portfolio. While some banks are targeting a reduction in their sovereign exposure, their systemic exposure to the government makes it difficult for them as a group not to roll over government paper. The authorities took some comfort in the fact that banking sector profitability increased in 2006 and early 2007, although this was in part the reflection of regulatory measures to ease provisioning rules in the wake of the conflict.

21. **The authorities welcomed the regional diversification strategy of commercial banks.** The larger banks are expanding very rapidly their presence in countries where their expertise puts them at a strong comparative advantage by setting up local subsidiaries and branches, and potentially by cross-border lending.[5] They are also developing domestic private sector lending, in particular retail lending. Among the larger banks, 20 percent of assets are by now in foreign operations, with the objective of generating half of their profits abroad within three years. The banking control commission has taken steps to facilitate and enhance its monitoring of the banks' diversification strategy. Thus, for instance, in 2006 it issued a circular raising the limits on the exposure of Lebanese banks to non-resident borrowers, and has signed, or is negotiating, memoranda of understanding on consolidated supervision with supervisory authorities in countries where Lebanese banks are expanding.

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[5] In addition to their traditional bases in Europe and Cyprus, Lebanese banks are (or plan to be) present in Algeria, Egypt, Iraq, Jordan, Nigeria, Oman, Qatar, Sudan, Syria, Tunisia, and the United Arab Emirates.

22. **The authorities expect commercial banks to strengthen risk management in response to the introduction of Basel II standards in 2008.** The banking system seems well-prepared for the introduction of Basel II, and the authorities expect all banks to meet the tightened capital adequacy criteria. The increased risk weight on foreign currency denominated government and BdL debt instruments would force banks to internalize in part the systemic risks associated with sovereign foreign currency debt.[6] The authorities are also trying to encourage banks to better manage their maturity mismatch. To that end, they decided, for the time being, not to reopen the repo window for Lebanese lira T-bills which they had closed during last year's conflict to ease pressures on the Lebanese lira.

23. **The authorities saw scope for consolidation of the banking sector over the medium term.** In particular, smaller banks whose main source of income is lending to the government may lose ground to larger banks which are better positioned to adapt to Basel II and diversify their asset structure. The promotion of mergers, including through financial incentives provided by the BdL, has been the main instrument to facilitate the exit of non-viable banks in the past. The BdL believes this is the most suitable instrument in the Lebanese context, because of concerns that outright bank failures would destabilize the system. However, this instrument could give rise to moral hazard, notably in terms of depositor, shareholder, and management behavior.

D. Policies for 2007 and 2008

24. **Political tensions and outbreaks of violence are key obstacles to reform implementation and economic recovery.** The political stalemate is constraining the government's room for maneuver and paralyzing legislative activity. This, combined with security concerns, is expected to weigh negatively on economic activity. As such, real GDP growth is projected at about 2 percent in 2007. Under the fixed exchange rate regime, CPI inflation should return to around 2 percent by year-end. Capital (including deposit) inflows are subject to a high degree of uncertainty and are therefore projected conservatively—money growth is put at 5 percent for the year as a whole. Reflecting reconstruction expenditure and replenishment of inventories, the current account deficit is expected to increase to 11 percent of GDP in 2007, largely financed by official inflows and foreign direct investment.

25. **The authorities expected to be able to contain the primary fiscal deficit (excluding grants) to 3.7 percent of GDP in 2007 as programmed.** First-quarter performance was within program targets (Box 4). However, the authorities recognized the

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[6] The risk weight on Eurobonds would increase from 20–50 percent presently to 100 percent, and that on central bank foreign currency debt from zero to 100 percent. The risk weight on domestic currency sovereign debt is expected to remain at zero.

risks of unforeseen expenditure pressures, such as from security measures and transfers to EdL on account of higher oil prices. They indicated that, as in 2006, they would maintain tight expenditure control—delaying low-priority spending until later in the year—to build up a buffer in the event of unforeseen shocks. On the revenue front, the widening gap between domestic and international oil prices reduced the gasoline excise to near zero in May. On current trends, gasoline excise revenues would fall short of program targets by around ½ percent of GDP for the year. However, the authorities were confident that, if the political situation stabilized, they could introduce a floor on excises (of $0.20 per liter) by September 2007, as agreed under the program, which is expected to yield ½ percent of GDP during the remainder of 2007. At the same time, they noted that other revenues have been more buoyant than expected.

Box 4. Performance Under the Program Supported by EPCA[1]

The authorities met all end-March 2007 quantitative targets under EPCA, except for the ceiling on government borrowing from the BdL, which was exceeded by a small margin (Table 17). Stronger than projected revenue collection helped contain the primary deficit and the accumulation of net debt in the first quarter. However, insufficient demand for government paper by commercial banks led the government to rely more on BdL financing than programmed. The outcome was LL 106 billion ($70 million) above the LL 903 billion ($602 million) flow envisaged for the first quarter. Despite the difficult market situation, the gross reserves target was met with a modest margin. No domestic or external arrears were accumulated.

The authorities also reported on progress toward achieving the monitorable actions for end-June (Table 18). On May 21, the cabinet approved the draft budget for 2007, which includes the foreign financed component of the Council of Development and Reconstruction and activities of the Higher Relief Council. The auditing of EdL has already started, and the launching of the audit of NSSF is on track. With respect to privatization, the authorities have modified their strategy to privatize only the licenses of the two mobile phone companies and effect the transfer of assets and contracts through separate transactions. This would avoid the need for a special law prior to privatization, and ensure that privatization can proceed as planned, making the end-June submission of such a law to parliament no longer relevant.

[1] IMF Staff Country Report No. 07/177.

26. **The authorities were confident that they could meet their financing needs through donor support and from the market during the remainder of 2007.** They pointed to recent T-bill auctions and a Eurobond issue in May as indications that commercial banks had returned to the market, and, therefore, saw no immediate need for raising T-bill rates. At the same time, negotiations with key donors are proceeding, and disbursements of grants and loans could amount to $1.9 billion in 2007 (Text Table 3). As such, the authorities were confident that they would reduce net borrowing from the BdL and achieve the programmed build-up of international reserves over the rest of 2007 (Tables 19–20). As another risk to their financing strategy, they listed EdL's fuel payments over which they had only limited control. Negotiations with domestic banks on a possible Paris III contribution have not progressed, with banks being reluctant to make commitments before reform implementation is underway.

Text Table 3. Lebanon: Paris III Aid
(In millions of U.S. dollars, unless otherwise specified)

	Total Pledges	New Grants and Loans to Government						
		Paris III Pledges			Rev. Proj. for 2007—10 1/		2007	
		Total	Budget Support	Project Assistance	Total	Grant Element 2/ (Estimate, in percent)	Rev. Proj.	Received Jan-May
Total	7,565	5,018	2,327	2,691	3,083	51.5	1,888	100
Multilateral	3,978	2,213	835	1,378	738	37.7	306	0
Bilateral	3,587	2,805	1,492	1,313	2,346	55.9	1,583	100

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

1/ Projection assumes partial conversion of project assistance pledges to budget support, and non-acceptance of a majority of remaining project assistance, particularly project loans.
2/ Discounting debt service projections at Lebanon's average projected interest rate for market financing in U.S. dollars (7.45 percent).

27. **The authorities reported on recent steps toward fiscal adjustment in 2008.** On the revenue side, the draft 2007 budget already provides for increasing the value-added tax rate and the tax on interest income as of 2008. Preparations for the introduction of a global income tax in 2008 were advancing, with a view to submitting the draft law to parliament in 2007. The authorities also expected ongoing revenue administration reforms, such as the introduction of a medium taxpayer office, new audit procedures, and changes to the property valuation system, to yield revenue gains. On the expenditure side, they were finalizing the reform plans for EdL (Box 5) and NSSF, and were developing a reform plan for the health sector, all in cooperation with the World Bank. With respect to EdL, they were more optimistic than staff about the potential yield of reforms.[7] Moreover, they were aiming for an

[7] Staff's scenario envisages that net transfers to EdL (excluding debt service, but including investment costs) would decline to 1.3 percent of GDP by 2012, from 3.3 percent of GDP in 2006.

across-the-board cut in discretionary spending of five percent in 2008, and a reduction of expenditure duplication across ministries through better cooperation and information sharing. They also pointed to the planned establishment of a debt management office charged with reducing debt service costs and improving asset management, although details remain to be worked out.

Box 5. Energy Sector Reforms

Electricity production in Lebanon comes at a high budgetary cost, while service delivery is of poor quality. Budget transfers to EdL net of debt service amounted to $750 million (3.3 percent of GDP) in 2006. Weak management, poor governance, inadequate infrastructure, and reliance on oil instead of less expensive gas are the sector's main problems. Technical losses are estimated at 15 percent of production, while non-technical losses (essentially illegal connections) account for another 18 percent. At the same time, power cuts are endemic.

The government is finalizing a comprehensive energy sector reform plan in close cooperation with the World Bank. EdL's financial management will be enhanced through: corporatization (which would allow hiring a more professional work force); the appointment of a new board of directors and qualified advisors; auditing of EdL's accounts; and installing remote meters. Reforms also seek to promote private sector involvement and increase capacity through independent power producers; tendering is envisaged for early 2008. Fuel costs are to be reduced by switching to natural gas in at least one power plant in the second quarter of 2008; this plant might also be privatized alongside the entry of independent power producers. A National Control Center, planned for 2008, is expected to realize efficiency gains in distribution. Toward the end of the reform period, the authorities plan to unbundle and partially privatize the sector. A regulator would be set up in parallel.

The tariff structure is far from achieving cost recovery and suffers from inefficiencies. Given the high production costs and losses, the average tariff of 9.4 cents/kWh achieves cost recovery at a fuel price of $25/barrel. The above reforms would narrow the gap relative to current oil prices, but an increase in tariffs may also be required, although international experience suggests that tariff increases should be introduced following improvements in service quality to avoid even higher non-payment and illegal connections. At the same time, Lebanon's tariff is already significantly higher than regional tariffs which puts Lebanese producers at a disadvantage. In addition, there are inefficiencies in the tariff structure, for example, the peak tariff for industry encourages self generation.

28. **The authorities also emphasized ongoing efforts toward strengthening public financial management.** The carryover of committed and uncommitted spending from one budget year to the next has seriously weakened the ability to control budgetary outcomes and to align spending to current priorities. To address this problem, the authorities intend to roll-back the carry-over of committed spending starting in the 2008 budget. As a first step, they plan to explicitly revoke the ability of line ministries to carryover uncommitted

expenditures beyond one month into the new budget year in the 2007 budget. The authorities explained that the 2008 budget circular also introduces the notion of medium-term planning and top-down spending envelopes for line ministries. In particular, they would pilot medium-term budgeting that incorporates the implications of investment spending for future current spending in four ministries and agencies.

E. Other Issues

29. **The authorities are working on improving the statistical system, but significant data problems remain.** With support from INSEE, they are revising the national accounts, including the compilation of quarterly GDP data. The 2004 National Accounts have just been released. However, statistical provision in other areas (balance of payments, prices, employment, wage and social indicators) remains seriously deficient. Lebanon is due to be assessed by the Middle East North Africa Financial Action Task Force in January 2008.

IV. Staff Appraisal

30. **The authorities' reform strategy lays out a promising path toward reducing Lebanon's large debt overhang and financial vulnerabilities.** The authorities' medium-term fiscal adjustment objectives are appropriately ambitious in the circumstances. The reform measures are designed to yield the targeted improvement in the primary balance, and, combined with pledged donor support and privatization, should reduce the debt-to-GDP ratio significantly over the next five years. The challenge now is to move from the planning stage to implementation, which would be facilitated by improvements in the political and security situation.

31. **Performance in the first quarter of 2007 bodes well for the attainment of the program objectives for the year, but the uncertain economic and financial environment requires close monitoring.** The authorities' intention to create a buffer by maintaining strict expenditure discipline is welcome. At the same time, gasoline excise revenues should be safeguarded by promptly raising gasoline prices in line with recent increases in international oil prices. The authorities' commitment to reduce reliance on central bank financing over the remainder of the year is equally welcome. Every effort should be made to limit any new borrowing from the BdL to short-term bridge financing in order to safeguard international reserves. To that end, greater interest rate flexibility is necessary.

32. **This transition year is the time to prepare the ground for sizeable adjustment and deep-seated reforms starting in 2008.** The decision to include in the draft 2007 budget law the 2008 increase in the value-added tax and the tax on interest income provides a strong positive signal in this direction. The authorities are also encouraged to ensure that all legislative and administrative work for the introduction of the GIT in 2008 is completed before the end of 2007. The largest source of adjustment on the expenditure side over the medium term is to come from structural reforms of the energy and social sectors, which have

been a source of large fiscal leakages over the years. Completion of these reform plans and their swift implementation are therefore key priorities for 2007–08. The success of energy sector reforms will require a careful sequencing of infrastructural and governance initiatives to avoid compounding existing problems, and NSSF reforms should be guided by fiscal considerations.

33. **Significant improvements in public financial management are necessary to strengthen budgetary control, improve the allocation of scarce resources to priority areas, and enhance the effectiveness of policies.** Staff encourages the authorities to follow-up on the action plan developed with Fund technical assistance to improve cash and budget management functions. At the same time, across-the-board expenditure cuts should, in general, be avoided because they are hard to sustain and undermine the quality of public spending. More generally, comprehensive public financial management reforms would be a prerequisite for the envisaged adoption of a fiscal responsibility law.

34. **Fiscal adjustment will facilitate the reform of the monetary policy framework.** Once more stable and predictable market conditions prevail, the central bank should be able to focus on guiding interest rates through transparent short-term instruments, which would allow the BdL to achieve its balance of payments and monetary objectives more efficiently. This will need to be accompanied by price flexibility in T-bill auctions. Such an environment would create the conditions for the government securities market to develop, thereby attracting a wider range of investors and helping the government diversify its financing base. As a first step, the authorities could consider reopening the repo window and relying on the repo rate to influence banks' behavior. In the short term, the interlinkages between the government's cash and debt management and the BdL's liquidity and reserve management call for close cooperation between the two institutions to increase the efficiency of financial policies. Steps being taken in this direction are welcome.

35. **Progress is also needed on strengthening the central bank's balance sheet to preserve the monetary authority's ability to control liquidity over the medium term.** An improvement in the overall financial situation and de-dollarization will help in this regard. However, financing operations, such as the transfer of unrealized gold valuation gains to the budget, and quasi-fiscal activities, such as providing subsidized lending to banks, adversely impact on the BdL's income and balance sheet positions and should therefore be avoided. More generally, public support to the private sector should be provided through the budget to ensure consistency with policy priorities. The privatization of the assets held by the BdL would also strengthen its financial position, while contributing to the government's growth agenda.

36. **The exchange rate peg to the U.S. dollar has contributed significantly to maintaining financial stability under very difficult circumstances and without impairing competitiveness.** The peg played an important role as a nominal anchor during recent financial pressures. In the current circumstances, international reserves held by the

BdL combined with the banking system's liquidity cushion appear sufficient to meet temporary pressures on the exchange rate, and the REER appears broadly in line with fundamentals. Going forward, macroeconomic policies need to be geared toward supporting the exchange rate peg. The debt overhang and the large external current account deficits are the counterpart of fiscal imbalances and, therefore, should be addressed by implementing the authorities' Paris III fiscal adjustment program.

37. **Domestic banks remain the primary source for the government's financing needs.** The resulting interdependence of the government, the central bank, and the commercial banks has created incentives for all actors to behave in a concerted way to preserve financial stability. However, this interdependence also creates systemic risks, in that shocks to either the fiscal or the financial sector would be quickly passed on to other sectors. In this regard, the commercial banks' strategy of regional expansion and focus on private sector lending is welcome both from a risk management perspective, and given the envisaged decline in government financing needs over the medium term. The authorities have been aptly accompanying this process through regulatory and supervisory reforms, and it is important that they deepen these efforts as banks expand into new cross-border activities, including by implementing the applicable Basel Core Principles. Moreover, there is a need to strengthen the bank resolution mechanism to facilitate consolidation when needed, while minimizing moral hazard and increasing banks' management accountability and shareholder responsibility.

38. **The authorities' program appropriately emphasizes private sector growth and improved delivery of social services.** Privatization of the telecom sector is a crucial element of the growth strategy and should be accompanied by endowing the regulatory authority with the powers and capacity to ensure proper competition in the sector. Staff also welcomes the authorities' intention to widen the privatization agenda to other sectors, as well as ongoing efforts to improve the business climate. In this regard, the growth agenda should be complemented by actions to dismantle oligopolistic practices and eliminate barriers to entry and exit.

39. **Timely and flexible disbursement of Paris III pledges is another important element for the success of the authorities' strategy.** Progress has been made in locking in the terms and conditions for the release of funds from some key donors, but negotiations are still underway with others. Staff fully supports the authorities' request that donors make timely disbursements and convert their pledges from project to budget support, or at least align their project disbursements to the government's own spending priorities.

40. **Risks to the reform strategy call for a continuous reassessment of policies.** Shocks to the macroeconomic environment, shortfalls in the privatization program, and contingent fiscal liabilities (from actuarial imbalances in the public and private pension systems, open-ended transfers to the health fund, and unforeseen costs from power sector reform) all have the potential to throw the economy off course relative to the targeted debt

reduction path, and to require corrective actions. Equally important are implementation risks, particularly in view of domestic and regional tensions and the need to maintain consensus around the reform program. The authorities' emphasis on a multipillar approach of fiscal adjustment, growth promotion, and improved social services should help mitigate these risks. In addition, a wider public debate about the economic and financial challenges facing Lebanon would be important to sustain public and political support for reform and adjustment during and beyond the Paris III horizon.

41. Data gaps hamper the analysis of real and external sector developments. High level commitment is needed to address these shortcomings through a comprehensive strategy to strengthen the statistical system.

42. It is proposed that the next Article IV consultation will be held on the standard 12-month cycle. Quarterly reports on performance under the program supported by EPCA will be issued for the information of Executive Directors, as requested by Directors at the time of the EPCA approval.

Table 1. Lebanon: Selected Economic Indicators, 2003–12

	2003 Act.	2004 Act.	2005 Act.	2006 Prel. Act.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Output and prices	(Annual percentage change)									
Real GDP (market price)	4.1	7.4	1.0	0.0	2.0	3.5	4.5	5.0	5.0	5.0
Consumer prices (end-of- period)	2.2	2.0	0.5	7.2	2.0	3.0	2.0	3.5	2.0	2.0
Consumer prices (period average)	1.3	1.7	-0.7	5.6	3.5	2.5	2.5	2.8	2.8	2.0
Investment and saving	(In percent of GDP)									
Gross capital formation	19.3	22.0	17.0	11.4	17.6	17.1	18.7	20.1	21.3	21.4
Government	3.1	3.3	2.2	2.5	4.9	3.0	2.8	2.9	2.9	2.9
Nongovernment	16.2	18.8	14.8	8.9	12.7	14.1	15.9	17.2	18.4	18.5
Gross national savings	6.1	6.5	3.4	5.2	7.0	7.7	9.2	12.1	15.5	15.9
Government	-10.2	-5.4	-6.3	-8.6	-7.3	-6.1	-5.3	-2.1	-0.8	-0.1
Nongovernment	16.3	11.9	9.6	13.8	14.3	13.8	14.5	14.2	16.4	15.9
Public finances	(In percent of GDP)									
Revenue (including grants)	22.1	23.1	22.8	24.8	26.5	25.9	22.0	23.2	23.4	23.3
Expenditure	35.4	31.8	31.2	35.9	38.7	35.1	30.1	28.2	27.1	26.3
Budget balance (including grants)	-13.3	-8.6	-8.4	-11.1	-12.2	-9.1	-8.1	-5.0	-3.8	-3.0
Primary balance (including grants)	3.3	3.5	2.1	1.7	0.1	2.6	1.8	4.4	5.2	5.6
Total government debt	169	167	179	178	173	143	142	138	133	127
Monetary sector	(Annual percentage change, unless otherwise indicated)									
Credit to the private sector	0.3	5.2	1.9	6.0	6.3	24.0	6.0	6.0	6.0	6.0
Base money	12.3	10.3	4.7	8.2	5.9	5.1	5.1	5.1	5.1	5.0
Broad money 1/	15.5	12.3	3.5	6.4	5.0	5.0	5.0	5.0	5.0	5.0
Velocity of broad money (level)	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Interest rates (period average, in percent)										
Three-month treasury bill rate	6.7	5.2	5.2	5.2	...	...	...	...	...	...
Two-year treasury bill rate	8.0	7.9	8.5	8.7	8.7	8.5	8.2	7.8	7.6	7.4
External sector	(In percent of GDP, unless otherwise indicated)									
Exports of goods (in US$, percentage change)	43.2	18.3	11.1	22.5	14.8	13.2	11.8	11.8	11.6	10.3
Imports of goods (in US$, percentage change)	10.4	30.3	-1.2	1.8	17.3	7.4	6.0	5.9	5.1	8.7
Merchandise trade balance	-24.2	-30.1	-28.4	-25.3	-28.4	-28.2	-27.3	-26.1	-24.7	-24.8
Current account excluding official transfers	-13.9	-16.0	-14.2	-7.4	-13.0	-12.0	-10.5	-8.5	-6.3	-5.9
Current account including official transfers	-13.2	-15.5	-13.6	-6.2	-10.6	-9.4	-9.4	-8.0	-5.8	-5.5
Foreign direct investment	8.7	10.9	12.2	12.0	9.6	24.7	9.1	8.9	8.7	8.5
Total external debt	175	187	190	198	195	186	176	168	161	152
Gross reserves (in millions of U.S. dollars)	10,271	9,575	9,611	11,353	11,121	12,347	10,920	10,963	11,574	11,897
In months of next year imports of goods and services	8.1	7.7	7.2	7.6	6.9	7.2	6.0	5.7	5.5	5.7
In percent of short-term external debt 2/	35.6	27.1	28.5	32.1	31.0	34.0	29.9	29.1	29.5	30.8
In percent of banking system foreign currency deposits	40.3	31.9	29.0	30.1	27.9	29.9	26.0	24.9	25.5	25.4
In percent of total banking system deposits	24.8	21.0	20.1	21.9	20.3	21.5	18.1	17.3	17.4	17.0
Memorandum items:										
Nominal GDP (in billions of U.S. dollars)	19.8	21.5	21.5	22.7	24.0	25.3	27.0	28.9	31.0	33.2
Net imports of petroleum products (in millions of U.S. dollars)	-1,057	-1,833	-2,082	-2,172	-2,094	-2,310	-2,404	-2,515	-2,620	-2,729
Local currency per U.S. dollar (period average)	1,508	1,508	1,508	1,508	...	...	...	...	...	...
Real effective exchange rate change										
(annual average, percent change)	-10.7	-6.8	-4.1	2.2	...	...	...	...	...	...
Stock market index	457	637	1,309	1,184	...	...	...	...	...	...

Sources: Lebanese authorities; and Fund staff estimates.

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

2/ Short-term debt on a remaining maturity basis.

Table 2. Lebanon: Central Government Primary Balance, 2003–08
(In billions of Lebanese pounds)

	2003	2004	2005	2006	2007				2008
					Q1		Year		
	Year Act.	Year Act.	Year Act.	Year Act.	IMF Country Report 07/177	Prel Act	IMF Country Report 07/177	Proj.	Year Proj.
Primary balance	975	1,129	680	578	-575	-98	-1	27	979
Revenue and grants	6,597	7,485	7,405	8,486	1,763	2,155	9,534	9,591	9,895
Revenue	6,597	7,485	7,405	7,490	1,763	2,153	8,218	8,273	8,931
Tax revenue	4,527	5,169	4,867	4,922	1,175	1,353	5,394	5,374	6,414
Taxes on income and profits	783	908	1,047	1,166	281	273	1,236	1,233	1,408
Taxes on property	321	405	414	579	106	125	441	441	522
Taxes on domestic goods and services	1,560	1,971	1,896	1,844	430	547	1,996	2,023	2,618
Of which: VAT revenues	1,386	1,763	1,693	1,659	389	499	1,802	1,830	2,385
Taxes on international trade 1/	1,645	1,617	1,268	1,074	300	344	1,450	1,406	1,580
Tariffs	475	530	481	461	109	131	493	493	520
Excises	1,170	1,087	787	613	191	213	957	913	1,060
Other taxes	217	268	241	259	59	64	271	271	286
Nontax revenue	2,070	2,316	2,538	2,568	588	800	2,824	2,899	2,517
Entrepreneurial and property income	1,252	1,420	1,663	1,702	393	559	1,914	1,984	1,417
Profit transfer from BdL	0	0	0	0	0	113	113	113	0
Other	1,252	1,420	1,662	1,702	393	446	1,801	1,872	1,417
Administrative fees and charges	383	365	365	426	90	97	393	393	415
Other nontax revenue	81	93	89	91	23	20	92	92	231
Fines and forfeits	6	5	4	4	1	1	4	4	4
Other	75	88	85	87	22	19	88	88	227
Other treasury revenue	354	439	421	349	82	124	425	429	454
Grants	0	0	0	996	0	2	1,316	1,318	964
Primary expenditure 2/	5,622	6,356	6,725	7,908	2,338	2,253	9,535	9,564	8,916
Current primary expenditure	4,708	5,304	6,025	7,051	2,008	1,943	7,770	7,799	7,754
Wages, salaries and pensions	3,078	3,094	3,193	3,307	856	914	3,529	3,529	3,677
Wages and salaries	2,234	2,284	2,329	2,386	643	682	2,568	2,568	2,632
Pensions	844	810	864	927	213	232	961	961	1,044
Transfers to EDL 3/	174	184	637	1,137	315	310	1,450	1,430	1,206
Other current	1,456	2,026	2,195	2,607	837	719	2,790	2,840	2,871
Materials and supplies	120	116	213	140	68	47	195	182	187
External services	81	113	82	87	21	24	90	90	92
Transfers 4/ 5/	271	360	655	878	419	334	819	887	853
Of which: NSSF	...	89	290	200	230	230	230	230	230
Other	440	452	377	507	176	154	814	808	829
Of which: "Housing compensations" 6/	...	...	...	136	60	80	452	452	465
Other treasury outflows 7/	544	985	868	995	153	160	872	872	909
Capital expenditure	914	1,052	700	857	331	310	1,765	1,765	1,162
Domestically financed	713	817	534	446	116	131	490	490	586
Foreign financed	201	235	166	411	215	179	1,275	1,275	576
Of which: conflict reconstruction 6/	...	...	...	111	120	99	895	895	95
Memorandum items:									
Underlying primary balance (excl. conflict impact)	975	1,129	680	-73	-395	116	30	56	575
Total conflict-related budgetary spending	...	...	...	345	180	216	1,347	1,347	560
Primary balance excluding grants	975	1,129	680	-418	-575	-100	-1,317	-1,291	15

Sources: Ministry of Finance; and Fund staff estimates and projections.
1/ Domestic excises, which are collected at customs, are classified as taxes on international trade.
2/ On checks issued basis.
3/ Excludes principal and interest payments paid on behalf of EdL.
4/ From 2005 onward includes additional transfers to the social security funds (NSSF) to clear the stock of arrears.
5/ Includes (i) $275 million for telecom settlements (2006 and 2007); and (ii) $500 million to the Council of the South and the Displaced Fund (2007 to 2009).
6/ The budgetary cost of the 2006 conflict is estimated to at $1.48 billion.
7/ Includes transfers to municipalities.

Table 3. Lebanon: Central Government Primary Balance, 2003–08

(In percent of GDP)

	2003 Year Act.	2004 Year Act.	2005 Year Act.	2006 Year Act.	2007 Q1 IMF Country Report 07/177	2007 Q1 Prel Act.	2007 Year IMF Country Report 07/177	2007 Year Proj.	2008 Year Proj.
Primary balance	3.3	3.5	2.1	1.7	-1.6	-0.3	0.0	0.1	2.6
Revenue and grants	22.1	23.1	22.8	24.8	4.9	6.0	26.7	26.5	25.9
Revenue	22.1	23.1	22.8	21.9	4.9	6.0	23.1	22.9	23.4
Tax revenue	15.2	16.0	15.0	14.4	3.3	3.7	15.1	14.9	16.8
Taxes on income and profits	2.6	2.8	3.2	3.4	0.8	0.8	3.5	3.4	3.7
Taxes on property	1.1	1.3	1.3	1.7	0.3	0.3	1.2	1.2	1.4
Taxes on domestic goods and services	5.2	6.1	5.8	5.4	1.2	1.5	5.6	5.6	6.9
Of which: VAT revenues	4.6	5.4	5.2	4.8	1.1	1.4	5.1	5.1	6.2
Taxes on international trade 1/	5.5	5.0	3.9	3.1	0.8	1.0	4.1	3.9	4.1
Tariffs	1.6	1.6	1.5	1.3	0.3	0.4	1.4	1.4	1.4
Excises	3.9	3.4	2.4	1.8	0.5	0.6	2.7	2.5	2.8
Other taxes	0.7	0.8	0.7	0.8	0.2	0.2	0.8	0.7	0.7
Nontax revenue	6.9	7.2	7.8	7.5	1.6	2.2	7.9	8.0	6.6
Entrepreneurial and property income	4.2	4.4	5.1	5.0	1.1	1.5	5.4	5.5	3.7
Administrative fees and charges	1.3	1.1	1.1	1.2	0.3	0.3	1.1	1.1	1.1
Other nontax revenue	0.3	0.3	0.3	0.3	0.1	0.1	0.3	0.3	0.6
Other treasury revenue	1.2	1.4	1.3	1.0	0.2	0.3	1.2	1.2	1.2
Grants	0.0	0.0	0.0	2.9	0.0	0.0	3.7	3.6	2.5
Primary expenditure 2/	18.8	19.6	20.7	23.1	6.6	6.2	26.7	26.4	23.3
Current primary expenditure	15.8	16.4	18.6	20.6	5.6	5.4	21.8	21.6	20.3
Wages, salaries and pensions	10.3	9.6	9.8	9.7	2.4	2.5	9.9	9.8	9.6
Wages and salaries	7.5	7.1	7.2	7.0	1.8	1.9	7.2	7.1	6.9
Pensions	2.8	2.5	2.7	2.7	0.6	0.6	2.7	2.7	2.7
Transfers to EDL 3/	0.6	0.6	2.0	3.3	0.9	0.9	4.1	4.0	3.2
Other current	4.9	6.3	6.8	7.6	2.3	2.0	7.8	7.9	7.5
Materials and supplies	0.4	0.4	0.7	0.4	0.2	0.1	0.5	0.5	0.5
External services	0.3	0.3	0.3	0.3	0.1	0.1	0.3	0.2	0.2
Transfers 4/ 5/	0.9	1.1	2.0	2.6	1.2	0.9	2.3	2.5	2.2
Of which: NSSF	...	0.3	0.9	0.6	0.6	0.6	0.6	0.6	0.6
Other	1.5	1.4	1.2	1.5	0.5	0.4	2.3	2.2	2.2
Of which: "Housing compensations" 6/	...	...	...	0.4	0.2	0.2	1.3	1.3	1.2
Other treasury outflows 7/	1.8	3.0	2.7	2.9	0.4	0.4	2.4	2.4	2.4
Capital expenditure	3.1	3.3	2.2	2.5	0.9	0.9	5.0	4.9	3.0
Domestically financed	2.4	2.5	1.6	1.3	0.3	0.4	1.4	1.4	1.5
Foreign financed	0.7	0.7	0.5	1.2	0.6	0.5	3.6	3.5	1.5
Of which: conflict reconstruction 6/	...	...	...	0.3	0.3	0.3	2.5	2.5	0.2
Memorandum items:									
Underlying primary balance (excl. conflict impact)	3.3	3.5	2.1	-0.2	-1.1	0.3	0.1	0.2	1.5
Total conflict-related budgetary spending	...	...	...	1.0	0.5	0.6	3.8	3.7	1.5
Primary balance excluding grants	3.3	3.5	2.1	-1.2	-1.6	-0.3	-3.7	-3.6	0.0

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

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

2/ On checks issued basis.

3/ Excludes principal and interest payments paid on behalf of EdL.

4/ From 2005 onward includes additional transfers to the social security funds (NSSF) to clear the stock of arrears.

5/ Includes (i) $275 million for telecom settlements (2006 and 2007); and (ii) $500 million to the Council of the South and the Displaced Fund (2007 to 2009).

6/ The budgetary cost of the 2006 conflict is estimated to at $1.48 billion.

7/ Includes transfers to municipalities.

Table 4. Lebanon: Government Expenditure by Function, 2002–06 1/

	2002	2003	2004	2005	2006
	(In billions of Lebanese pounds)				
Total expenditure	9,778	10,564	10,278	10,135	12,289
General public services	1,190	1,229	1,313	1,407	1,335
Defense	879	877	866	888	1,005
Public order and safety	352	368	354	381	427
Education	721	785	795	902	835
Health	240	346	315	287	321
Social security and welfare	169	201	165	156	194
Housing	54	79	62	50	47
Recreation, culture, and religious affairs	55	52	85	72	52
Economic affairs and services	1,095	1,275	1,596	1,742	2,590
Fuel and energy	306	413	494	839	1,371
Agriculture, forestry, and fishing	29	28	36	28	23
Mining, manufacturing, and construction	4	11	10	5	3
Transportation and communication	210	217	178	123	395
Other economic affairs and services	546	606	879	747	798
Interest payments	4,712	4,942	3,921	3,410	4,381
Unclassified treasury expenditure 2/	310	412	806	840	1,103
	(In percent of GDP)				
Total expenditure	34.7	35.4	31.8	31.2	35.9
General public services	4.2	4.1	4.4	4.3	3.9
Defense	3.1	2.9	2.9	2.7	2.9
Public order and safety	1.2	1.2	1.2	1.2	1.2
Education	2.6	2.6	2.7	2.8	2.4
Health	0.9	1.2	1.1	0.9	0.9
Social security and welfare	0.6	0.7	0.6	0.5	0.6
Housing	0.2	0.3	0.2	0.2	0.1
Recreation, culture, and religious affairs	0.2	0.2	0.3	0.2	0.2
Economic affairs and services	3.9	4.3	5.3	5.4	7.6
Fuel and energy	1.1	1.4	1.7	2.6	4.0
Agriculture, forestry, and fishing	0.1	0.1	0.1	0.1	0.1
Mining, manufacturing, and construction	0.0	0.0	0.0	0.0	0.0
Transportation and communication	0.7	0.7	0.6	0.4	1.2
Other economic affairs and services	1.9	2.0	2.9	2.3	2.3
Interest payments	16.7	16.6	13.1	10.5	12.8
Unclassified treasury expenditure 2/	1.1	1.4	2.7	2.6	3.2
Memorandum item:					
GDP (in billions of Lebanese pounds)	28,216	29,851	32,357	32,446	34,253

Sources: Ministry of Finance; IMF *Government Finance Statistics;* and Fund staff estimates.

1/ Includes treasury and foreign-financed capital expenditure by the Council for Reconstruction and Development.
2/ Includes subsidies on diesel oil and interest, and transfers to municipalities.

Table 5. Lebanon: Overall Fiscal Deficit and Financing, 2003–08

	2003	2004	2005	2006	2007				2008
					Q1		Year		
	Year Act.	Year Act.	Year Act.	Year Act.	IMF Country Report 07/177	Est.	IMF Country Report 07/177	Proj.	Year Proj.
	(In billions of Lebanese pounds)								
Primary balance	975	1,129	680	578	-575	-98	-1	27	979
Interest bill	4,942	3,921	3,410	4,381	1,071	1,077	4,408	4,424	4,471
Overall balance (checks-issued basis)	-3,968	-2,793	-2,730	-3,803	-1,646	-1,175	-4,409	-4,398	-3,492
Float and statistical discrepancy	125	346	86	-148	...	287	...	...	...
Overall balance (cash basis)	-4,093	-3,139	-2,816	-3,655	-1,646	-1,462	-4,409	-4,398	-3,492
Net financing	4,093	3,139	2,816	3,655	1,646	1,462	4,409	4,398	3,492
Banking system	3,555	4,268	3,189	1,904	1,481	416	-793	-2,075	-8,560
Banque du Liban 1/	8,779	654	602	-2,342	905	1,005	-2,162	-2,280	-3,061
Commercial banks 1/	-5,224	3,614	2,587	4,247	576	-589	1,369	205	-5,500
Government institutions	-605	-352	245	835	61	775	348	1,740	372
Other creditors	-1,375	-1,163	-465	1,067	105	345	-216	24	-761
Net change in arrears	0	0	-419	0	0	0	0	0	0
Exceptional financing	2,999	601	-133	39	0	-49	5,070	4,732	12,441
Privatization	-280	0	0	0	0	0	0	0	11,743
Bilateral and multilateral	3,279	84	-133	39	0	-49	2,690	2,352	698
Other 2/	0	517	0	0	0	0	2,380	2,380	0
Valuation adjustment	-480	-215	399	-190	0	-24	0	-24	0
	(In percent of GDP)								
Primary balance	3.3	3.5	2.1	1.7	-1.6	-0.3	0.0	0.1	2.6
Interest bill	16.6	12.1	10.5	12.8	3.0	3.0	12.3	12.2	11.7
Overall balance (checks-issued basis)	-13.3	-8.6	-8.4	-11.1	-4.6	-3.2	-12.3	-12.2	-9.1
Float and statistical discrepancy	0.4	1.1	0.3	-0.4	...	0.8	...	...	...
Overall balance (cash basis)	-13.7	-9.7	-8.7	-10.7	-4.6	-4.0	-12.3	-12.2	-9.1
Net financing	13.7	9.7	8.7	10.7	4.6	4.0	12.3	12.2	9.1
Banking system	11.9	13.2	9.8	5.6	4.1	1.1	-2.2	-5.7	-22.4
Banque du Liban 1/	29.4	2.0	1.9	-6.8	2.5	2.8	-6.0	-6.3	-8.0
Commercial banks 1/	-17.5	11.2	8.0	12.4	1.6	-1.6	3.8	0.6	-14.4
Government institutions	-2.0	-1.1	0.8	2.4	0.2	2.1	1.0	4.8	1.0
Other creditors	-4.6	-3.6	-1.4	3.1	0.3	1.0	-0.6	0.1	-2.0
Net change in arrears	0.0	0.0	-1.3	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	10.0	1.9	-0.4	0.1	0.0	-0.1	14.2	13.1	32.6
Privatization	-0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	30.8
Bilateral and multilateral	11.0	0.3	-0.4	0.1	0.0	-0.1	7.5	6.5	1.8
Other 2/	0.0	1.6	0.0	0.0	0.0	0.0	6.6	6.6	0.0
Valuation adjustment	-1.6	-0.7	1.2	-0.6	0.0	-0.1	0.0	-0.1	0.0
Memorandum item:	(In billions of Lebanese pounds)								
Nominal GDP (annual)	29,851	32,357	32,446	34,253	35,805	36,173	35,805	36,173	38,188

Sources: Lebanese authorities; and Fund staff estimates and calculations.
1/ Figures in 2003 are affected by the role played by the Banque du Liban (BdL) in the debt exchange with banks that tends to increase BdL financing and decrease commercial bank financing of the government.
2/ Debt cancellation and Banque du Liban revaluation of gold and foreign exchange.

Table 6. Lebanon: Government Debt, 2003–12 1/

	2003	2004	2005	2006	2007				2008	2009	2010	2011	2012
					March		December						
	Year	Year	Year	Year	IMF Country		IMF Country		Year	Year	Year	Year	Year
	Act.	Act.	Act.	Act.	Report 07/177	Est.	Report 07/17	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of U.S. dollars)												
Net debt 2/	32,838	34,719	36,700	39,452	40,544	40,389	40,799	40,757	35,284	37,458	38,908	40,072	41,064
Gross debt by currency	33,381	35,875	38,465	40,464	41,358	41,232	41,612	41,600	36,160	38,368	39,851	41,048	42,073
Domestic currency debt	17,806	17,493	19,331	20,036	20,379	20,787	19,587	19,966	16,140	19,401	20,142	20,701	21,209
Foreign currency debt	15,575	18,382	19,135	20,428	20,979	20,445	22,025	21,634	20,021	18,966	19,709	20,346	20,864
Of which: Eurobonds (including Paris II)	13,007	15,709	16,413	17,540	18,172	17,633	17,571	17,367	15,090	13,843	14,506	15,084	15,704
Gross debt by holder	33,381	35,875	38,483	40,405	41,358	41,232	41,612	41,600	36,160	38,368	39,851	41,048	42,073
Debt to Banque du Liban	7,937	9,052	10,106	7,785	8,186	8,269	6,152	6,090	4,093	3,538	3,234	3,053	2,838
Domestic currency	5,929	7,066	7,752	6,360	6,786	6,967	4,839	4,906	2,961	2,712	2,486	2,442	2,278
Foreign currency	2,009	1,986	2,355	1,424	1,400	1,302	1,313	1,184	1,132	826	748	612	560
Debt to commercial banks	14,543	16,916	18,698	21,620	22,002	21,215	22,528	21,743	18,094	19,592	20,290	20,535	21,549
Domestic currency	8,161	8,105	9,373	10,937	10,813	10,525	11,777	11,125	8,997	12,178	12,729	12,890	13,085
Foreign currency	6,382	8,810	9,325	10,684	11,190	10,690	10,751	10,618	9,098	7,414	7,561	7,645	8,463
Debt to public entities 3/	1,701	1,451	1,623	2,198	2,238	2,718	2,429	3,359	3,606	3,869	4,151	4,453	4,777
Debt to non-bank sector	9,200	8,457	8,056	8,803	8,931	9,029	10,503	10,409	10,367	11,369	12,175	13,006	12,909
Domestic currency	2,016	871	583	541	541	576	541	576	576	642	775	917	1,069
Foreign currency	7,184	7,586	7,473	8,261	8,390	8,453	9,962	9,833	9,791	10,727	11,401	12,089	11,841
Central government deposits	543	1,156	1,765	1,012	813	843	813	843	876	909	943	976	1,009
	(In percent of GDP)												
Net debt	166	162	171	174	171	168	172	170	139	139	135	129	124
Gross debt by currency	169	167	179	178	174	172	175	173	143	142	138	133	127
Domestic currency debt	90	82	90	88	86	87	82	83	64	72	70	67	64
Foreign currency debt	79	86	89	90	88	85	93	90	79	70	68	66	63
Gross debt by holder	169	167	179	178	174	172	175	173	143	142	138	133	127
Debt to Banque du Liban	40	42	47	34	34	34	26	25	16	13	11	10	9
Debt to commercial banks	73	79	87	95	93	88	95	91	71	73	70	66	65
Debt to public entities 3/	9	7	8	10	9	11	10	14	14	14	14	14	14
Debt to non-bank sector	46	39	37	39	38	38	44	43	41	42	42	42	39
Central government deposits	3	5	8	4	3	4	3	4	3	3	3	3	3
Memorandum items:	(In millions of U.S. dollars, unless otherwise indicated)												
Nominal GDP (annual)	19,802	21,464	21,523	22,722	23,751	23,995	23,751	23,995	25,332	27,001	28,918	30,971	33,170
Foreign currency debt in percent of gross debt	46.7	51.2	49.7	50.5	50.7	49.6	52.9	52.0	55.4	49.4	49.5	49.6	49.6

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

1/ Includes all debt contracted by the treasury on behalf of the central government and public agencies other than the Banque du Liban; accrued interest; and Banque du Liban lending to Electricite du Liban. Excludes government arrears to the private sector.

2/ Defined as gross debt less central government deposits.

3/ Denominated in domestic currency; mainly to the National Social Security Fund, and the National Deposit Insurance Fund.

Table 7. Lebanon: Monetary Survey, 2003–08

	2003	2004	2005	2006	2007				2008
					March		December		
	Year	Year	Year	Year	IMF Country		IMF Country		Year
	Act.	Act.	Act.	Act.	Report 07/177	Act.	Report 07/177	Proj.	Proj.
	(Stocks in billions of Lebanese pounds)								
Net foreign assets	33,509	36,803	37,832	43,594	41,460	43,224	43,181	46,578	52,753
Banque du Liban	20,970	20,185	21,078	23,047	22,211	23,057	22,132	23,211	25,086
Commercial banks	12,539	16,618	16,754	20,547	19,249	20,167	21,049	23,367	27,667
Net domestic assets	42,848	48,930	50,888	50,784	52,446	51,530	54,529	52,504	51,284
Net claims on public sector	30,670	34,029	36,891	38,619	40,100	39,403	37,826	36,544	27,984
Of which: Net claims on government	31,989	35,646	38,898	40,984	42,465	41,400	40,192	38,910	30,349
Banque du Liban	10,983	11,490	12,201	9,791	10,696	10,797	7,630	7,511	4,451
Lebanese pounds	8,278	9,415	9,537	8,935	9,576	9,904	6,640	6,758	3,817
Foreign currency	2,706	2,076	2,664	856	1,121	893	990	753	634
Commercial banks	21,006	24,155	26,697	31,193	31,769	30,603	32,562	31,398	25,899
Lebanese pounds	11,366	10,853	12,608	15,043	14,858	14,425	16,317	15,334	12,132
Foreign currency	9,640	13,302	14,089	16,150	16,911	16,178	16,245	16,064	13,766
Claims on private sector	23,233	24,375	24,774	26,209	26,345	26,663	27,508	27,844	34,468
Lebanese pounds	4,254	4,622	4,613	5,048	4,982	5,141	5,230	5,304	5,605
Foreign currency	18,980	19,752	20,161	21,162	21,362	21,523	22,278	22,540	28,863
Other items (net)	-11,056	-9,474	-10,777	-14,044	-13,998	-14,536	-10,805	-11,883	-11,168
Broad money (M5) 1/	76,357	85,733	88,720	94,378	93,906	94,754	97,710	99,083	104,037
In Lebanese pounds	27,458	27,427	25,503	24,159	24,138	24,383	25,580	25,468	27,738
Currency in circulation	1,531	1,586	1,535	1,809	1,667	1,695	1,742	1,765	1,853
Deposits in Lebanese pounds	25,927	25,840	23,968	22,350	22,471	22,688	23,838	23,704	25,886
Deposits in foreign currency	48,900	58,306	63,217	70,219	69,768	70,372	72,130	73,614	76,298
	(Year-to-date change in billions of Lebanese pounds)								
Net foreign assets	8,754	3,294	1,029	5,762	-2,134	-370	-413	2,984	6,175
Net domestic assets	1,502	6,082	1,959	-104	1,662	746	3,744	1,720	-1,221
Net claims on public sector	2,480	3,359	2,863	1,727	1,481	784	-793	-2,075	-8,560
Net claims on government	2,912	3,657	3,252	2,086	1,481	416	-793	-2,075	-8,560
Banque du Liban	8,484	507	711	-2,410	905	1,005	-2,162	-2,280	-3,061
Commercial banks	-5,572	3,150	2,541	4,496	576	-589	1,369	205	-5,500
Broad money (M5) 1/	10,256	9,375	2,987	5,658	-472	376	3,332	4,704	4,954
In Lebanese pounds	6,338	-31	-1,924	-1,344	-21	224	1,421	1,309	2,270
Deposits in foreign currency	3,918	9,406	4,911	7,002	-451	152	1,911	3,395	2,684
	(Year-to-date change in percent of beginning of period broad money)								
Broad money (M5) 1/	15.5	12.3	3.5	6.4	-0.5	0.4	3.5	5.0	5.0
In Lebanese pounds	9.6	0.0	-2.2	-1.5	0.0	0.2	1.5	1.4	2.3
Deposits in foreign currency	5.9	12.3	5.7	7.9	-0.5	0.2	2.0	3.6	2.7
Memorandum items:									
Net foreign assets (in millions of U.S. dollars)	22,228	24,413	25,096	28,918	27,503	28,673	28,644	30,898	34,994
Share of foreign currency deposits in total private sector deposits	66.2	70.1	73.2	76.2	76.0	76.0	75.5	76.0	75.0
Credit to private sector (in percent of GDP)	77.8	75.3	76.4	76.5	...	...	77.2	77.0	90.3
Credit to private sector (in twelve month percent change)	0.3	5.2	1.9	6.0	5.0	6.3	5.0	6.3	24.0
M5 to GDP (in percent)	255.8	265.0	273.4	275.5	...	...	274.1	273.9	272.4

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

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

Table 8. Lebanon: Balance Sheet of the Banque du Liban, 2003–08

	2003	2004	2005	2006	2007				2008
					March		December		
	Year Act.	Year Act.	Year Act.	Year Act.	IMF Country Report 07/177	Act.	IMF Country Report 07/177	Proj.	Year Proj.
	(Stocks in billions of Lebanese pounds)								
Net foreign exchange position 1/	8,935	6,712	2,873	3,465	2,449	3,080	2,684	3,541	6,442
Foreign assets	21,263	20,473	22,081	26,321	25,485	26,330	25,570	26,648	28,497
Of which: gold	5,779	6,039	7,140	8,755	9,379	9,215	9,379	9,432	9,432
Foreign currency liabilities	12,328	13,762	19,208	22,856	23,036	23,250	22,886	23,107	22,055
Of which: commercial bank deposits 2/	11,776	13,213	17,901	19,189	19,382	19,660	19,067	19,328	18,303
Of which: other foreign liabilities 3/	293	288	1,003	3,274	3,274	3,273	3,439	3,438	3,411
Net domestic assets	-2,528	1,411	4,491	3,762	4,893	4,401	5,052	4,657	2,403
Claims on public sector (net)	10,990	11,354	11,900	9,005	9,910	10,010	6,843	6,725	3,664
Net claims on government	10,983	11,490	12,201	9,791	10,696	10,797	7,630	7,511	4,451
Credit	11,800	13,232	14,860	11,318	11,922	12,069	8,856	8,783	5,772
Treasury bills	8,772	10,238	11,310	9,170	9,813	10,106	6,877	6,998	4,067
Eurobonds	3,028	2,994	3,550	2,147	2,110	1,963	1,979	1,785	1,706
Deposits	817	1,741	2,659	1,526	1,226	1,272	1,226	1,272	1,322
Net claims on non financial public institutions	7	-137	-302	-787	-787	-787	-787	-787	-787
Claims on private sector in Lebanese pounds (net)	375	313	257	232	240	238	240	242	242
Claims on commercial banks	-9,859	-7,657	-6,163	-3,796	-3,879	-3,814	-3,847	-2,923	-2,837
Of which: Certificates of deposit in Lebanese pounds	-11,686	-9,516	-7,959	-5,639	-5,639	-5,579	-5,608	-4,679	-4,593
Claims on specialized banks in Lebanese pounds (net)	-1,032	-1,004	-837	-539	-509	-513	-509	-524	-524
Other items (net)	-3,002	-1,595	-665	-1,140	-869	-1,520	2,324	1,137	1,857
Reserve money	6,407	8,123	7,364	7,227	7,342	7,481	7,736	8,198	8,845
Currency issued	1,717	1,783	1,736	2,010	1,916	1,931	1,993	2,019	2,120
Commercial bank deposits in Lebanese pounds	4,690	6,340	5,628	5,217	5,426	5,550	5,743	6,179	6,725
	(Year-to-date flows in billions of Lebanese pounds)								
Reserve money	1,753	1,715	-759	-137	115	254	509	971	646
Currency issued	176	66	-47	274	-95	-79	-17	9	101
Commercial bank deposits in Lebanese pounds	1,577	1,649	-711	-412	210	333	526	963	545
	(Year-to-date changes in percent of beginning-of-period reserve money)								
Reserve money	38	27	-9	-2	2	4	7	13	8
	(In millions of U.S. dollars)								
Memorandum items:									
Gross international reserves (including gold) 4/	14,105	13,581	14,347	17,160	16,605	17,166	16,662	17,377	18,603
Gross international reserves (excluding gold) 4/	10,271	9,575	9,611	11,353	10,383	11,053	10,440	11,121	12,347
In percent of banking system foreign currency deposits	40	32	29	30	27	29	27	28	30
In percent of total banking system deposits	25	21	20	22	20	21	19	20	21
Program gross reserves 5/	16,113	15,567	16,202	18,084	17,505	17,647	17,475	17,613	18,837
Lebanese pound money multiplier	4.3	3.4	3.5	3.4	3.3	3.3	3.3	3.2	3.2

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

1/ Defined by currency (not by residency), as official foreign currency assets, including gold and SDR, less foreign currency liabilities.
These include the $1.5 billion deposits by the Saudi and Kuwaiti governments in August 2006, but exclude liabilities to the government of Lebanon and other official creditors.

2/ Includes certificates of deposits in foreign currency held by commercial banks.

3/ Includes the deposits by the Saudi and Kuwaiti governments. Excludes all other special bilateral long-term deposits.

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

5/ Defined as gross international reserves including gold and Eurobonds issued by the Republic of Lebanon.

Table 9. Lebanon: Commercial Banks' Balance Sheet, 2003–08

	2003	2004	2005	2006	2007				2008
					March		December		
	Year	Year	Year	Year	IMF Country		IMF Country		Year
	Act.	Act.	Act.	Act.	Report 07/177	Act.	Report 07/177	Proj.	Proj.
	(Stocks in billions of Lebanese pounds)								
Net foreign assets	12,539	16,618	16,754	20,547	19,249	20,167	21,049	23,367	27,667
Foreign assets	14,937	20,431	20,017	24,784	22,784	25,107	24,584	28,307	32,607
Foreign liabilities	2,398	3,813	3,263	4,236	3,534	4,940	3,534	4,940	4,940
Net domestic assets	60,974	66,223	69,240	71,042	72,047	72,018	73,975	73,039	73,609
Net claims on public sector	19,680	22,675	24,992	29,614	30,190	29,393	30,983	29,819	24,320
Of which: Treasury bills	11,366	10,853	12,608	15,043	14,858	14,425	16,317	15,334	12,132
Of which: Foreign currency bonds	9,621	13,281	14,057	16,105	16,868	16,115	16,207	16,006	13,715
Claims on Banque du Liban	28,339	29,265	31,690	30,245	30,696	31,025	30,669	30,441	29,888
Currency in vault	186	197	201	201	248	236	251	255	267
Deposits with Banque du Liban	16,466	19,552	23,530	24,405	24,808	25,210	24,810	25,507	25,027
Certificates of deposit in Lebanese pounds	11,686	9,516	7,959	5,639	5,639	5,579	5,608	4,679	4,593
Claims on private sector	22,836	24,020	24,467	25,930	26,059	26,382	27,223	27,559	34,183
Other items (net)	-9,881	-9,738	-11,908	-14,747	-14,899	-14,781	-14,899	-14,781	-14,781
Liabilities to private sector	73,513	82,841	85,994	91,590	91,296	92,185	95,025	96,406	101,277
Lebanese pounds 1/	24,873	24,796	23,081	21,763	21,913	22,130	23,280	23,137	25,319
Foreign currency 2/	48,641	58,046	62,914	69,826	69,383	70,055	71,745	73,269	75,957
	(Year-to-date flows in billions of Lebanese pounds)								
Net foreign assets	72	4,079	136	3,793	-1,298	-380	502	2,820	4,300
Net domestic assets	9,010	5,249	3,017	1,802	1,004	976	2,933	1,997	570
Net claims on public sector	-6,306	2,995	2,316	4,622	576	-221	1,369	205	-5,500
Claims on Banque du Liban	16,323	926	2,425	-1,444	451	779	423	196	-554
Claims on private sector	78	1,185	446	1,463	130	452	1,293	1,630	6,624
Other items (net)	-1,085	143	-2,170	-2,839	-152	-35	-152	-35	0
Liabilities to private sector	9,082	9,328	3,153	5,595	-294	596	3,435	4,817	4,870
Lebanese pounds 1/	5,187	-77	-1,715	-1,318	150	367	1,516	1,374	2,182
Foreign currency 2/	3,895	9,405	4,868	6,913	-443	228	1,919	3,442	2,689
Memorandum items:									
Foreign currency assets to liabilities (in percent)	108.4	107.8	109.0	109.7	110.3	109.9	109.1	110.2	115.5
Local currency assets to liabilities (in percent) 3/	83.6	81.6	75.8	69.1	68.0	68.0	72.3	67.5	53.0
Exposure to the government (percent of total assets)	23.2	23.6	25.2	27.2	27.8	26.3	27.3	25.8	20.3
Exposure to the sovereign (percent of total assets)	54.5	52.3	55.1	53.5	54.6	53.1	53.1	50.9	43.7

Source: Banque du Liban.

1/ Includes nonresident deposits.

2/ Includes bonds denominated in foreign currency.

3/ Includes other items net as assets.

Table 10. Lebanon: Balance of Payments, 2003–12

					2007						
	2003 Est.	2004 Est.	2005 Est.	2006 Est.	IMF Country Report 07/177	Proj.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
	(in millions of U.S. dollars, unless otherwise indicated)										
Current account	-2,615	-3,332	-2,926	-1,406	-2,596	-2,546	-2,391	-2,546	-2,314	-1,798	-1,829
Goods (net)	-4,794	-6,452	-6,118	-5,755	-6,895	-6,820	-7,140	-7,362	-7,560	-7,645	-8,235
Exports, f.o.b.	1,733	2,050	2,278	2,792	3,151	3,206	3,630	4,059	4,538	5,067	5,588
Imports, f.o.b.	-6,528	-8,502	-8,397	-8,547	-10,046	-10,026	-10,771	-11,421	-12,098	-12,712	-13,823
Services (net)	983	1,691	2,467	3,045	2,898	2,491	2,633	2,921	3,464	4,078	4,584
Receipts	7,009	8,411	8,974	10,501	10,671	10,497	11,147	12,064	13,256	14,565	15,815
Payments	-6,026	-6,720	-6,508	-7,456	-7,773	-8,006	-8,515	-9,143	-9,792	-10,487	-11,232
Income (net)	-1,231	-1,473	-1,474	-1,284	-993	-1,260	-1,113	-1,058	-1,085	-1,149	-1,156
Of which: interest on government debt	-525	-502	-696	-457	-522	-529	-545	-546	-579	-610	-647
Current transfers (net)	2,427	2,902	2,200	2,588	2,393	3,043	3,229	2,952	2,867	2,918	2,979
Government	134	111	139	275	1,012	580	659	302	152	139	139
Other sectors	2,293	2,791	2,061	2,314	1,382	2,463	2,570	2,651	2,715	2,779	2,840
Capital and financial account	5,682	4,254	2,048	1,977	-1,885	721	3,154	923	2,295	2,408	2,153
Capital transfers (net)	29	50	27	1,319	0	463	150	30	30	33	35
Direct investment (net)	1,722	2,333	2,629	2,723	1,800	2,297	6,251	2,464	2,578	2,698	2,824
Portfolio investment, loans, other capital	3,931	1,871	-609	-2,064	-3,685	-2,039	-3,246	-1,570	-313	-323	-706
Government (net)	-773	-87	297	764	-342	-160	-500	233	240	320	-418
BdL 1/	-18	-3	474	1,507	109	108	-18	-550	-69	-88	-69
Of which: IMF (net)	0	0	0	0	77	77	0	0	-19	-38	-19
Banks (net) 2/	3,845	1,293	469	-1,446	-167	-1,730	-2,582	-1,164	-808	-782	-754
Foreign assets of banks 3/	-48	-2,706	-90	-2,516	-333	-1,871	-2,852	-1,658	-1,327	-1,327	-1,327
Non-resident deposits 2/	3,892	3,999	560	1,071	166	140	271	494	519	545	572
Non-bank private sector (net)	876	668	-1,849	-2,889	-3,285	-257	-147	-89	323	228	535
Errors and omissions	-38	-1,619	914	1,170	0	0	0	0	0	0	0
Overall balance	3,030	-696	36	1,742	-4,481	-1,824	763	-1,623	-19	610	324
Financing	-3,030	696	-36	-1,742	4,481	1,824	-763	1,623	19	-610	-324
Official reserves (- increase)	-5,125	696	-36	-1,742	912	232	-1,226	1,427	-43	-610	-324
Exceptional financing	2,095	0	0	0	3,569	1,593	463	196	63	0	0
Memorandum items:											
Current and capital grants: Stockholm and Paris III	0	0	0	662	873	874	640	163	13	0	0
Current account balance (in percent of GDP)	-13.2	-15.5	-13.6	-6.2	-11.0	-10.6	-9.4	-9.4	-8.0	-5.8	-5.5
excluding official transfers (in percent of GDP)	-13.9	-16.0	-14.2	-7.4	-15.3	-13.0	-12.0	-10.5	-8.5	-6.3	-5.9
Gross official reserves (excl. gold, end-year) 4/											
in millions of U.S. dollars	10,271	9,575	9,611	11,353	10,440	11,121	12,347	10,920	10,963	11,574	11,897
in months of next year's goods and services imports	8.1	7.7	7.2	7.6	6.7	6.9	7.2	6.0	5.7	5.5	5.3
in percent of short-term external debt 5/	35.6	27.1	28.5	32.1	32.5	31.0	34.0	29.9	29.1	29.5	30.8
in percent of short-term foreign currency debt 6/	26.8	20.4	19.3	21.0	19.9	19.4	20.8	18.0	17.4	17.5	18.1
net of foreign assets of commercial banks	34.3	26.7	26.0	28.7	28.1	27.6	31.3	27.8	27.1	27.4	28.5
External debt (year end) 5/											
in percent of GDP	174.8	187.5	189.9	197.9	182.6	195.4	185.8	175.8	168.4	160.9	152.4
in percent of goods and services exports	396.0	384.6	363.3	338.4	312.4	342.1	318.5	294.5	273.6	253.8	236.1
Government external debt (in percent of GDP)	36.8	33.9	35.6	37.1	41.7	41.0	38.6	37.8	36.4	35.0	31.4
Government external debt service											
in millions of U.S. dollars	1,669	2,218	3,209	1,677	1,528	1,488	1,633	1,853	1,539	1,715	2,436
in percent of goods and services exports	19.1	21.2	28.5	12.6	11.1	10.9	11.1	11.5	8.7	8.7	11.4
GDP (in millions of U.S. dollars)	19,802	21,464	21,523	22,722	23,646	23,995	25,332	27,001	28,918	30,971	33,170

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

1/ Change in the foreign liabilities of the BdL.
2/ Differs from banks' reported data, to include estimated deposit flows by Lebanese nationals living abroad but classified as residents.
3/ Net of non-deposit foreign liabilities.
4/ Excludes Eurobonds and encumbered reserves.
5/ Includes all banking deposits held by non-residents, including estimated deposits of Lebanese nationals living abroad but classified as residents.
6/ Includes private sector foreign currency deposits in commercial banks.

Table 11. Lebanon: Public Sector Debt Sustainability Framework, 2003–26
(In percent of GDP, unless otherwise indicated)

	Actual				Projections									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2017	2022	2026	Debt-Stabilizing Primary Balance 7/
Baseline: Public sector debt 1/	168.6	167.1	178.7	178.1	173.4	142.7	142.1	137.8	132.5	126.8	114.1	102.4	92.6	0.5
Of which: foreign-currency denominated	78.7	85.6	88.9	89.9	90.2	79.0	70.2	68.2	65.7	62.9	57.0	51.2	46.3	
Change in public sector debt	4.4	-1.4	11.6	-0.6	-4.7	-30.6	-0.6	-4.3	-5.3	-5.7	-2.2	-2.4	-2.5	
Identified debt-creating flows	5.2	-6.0	8.0	1.7	-3.9	-30.8	-0.8	-4.4	-5.4	-5.8	-2.2	-2.4	-2.5	
Primary deficit	-3.3	-3.5	-2.1	-1.7	-0.1	-2.6	-1.8	-4.4	-5.2	-5.6	-3.0	-3.0	-3.0	
Revenue and grants	22.1	23.1	22.8	24.8	26.5	25.9	22.0	23.2	23.4	23.3	20.6	20.6	20.6	
Primary (noninterest) expenditure	18.8	19.6	20.7	23.1	26.4	23.3	20.2	18.8	18.1	17.7	17.6	17.6	17.6	
Automatic debt dynamics 2/	7.6	-0.9	10.1	3.4	2.8	2.6	1.1	0.0	-0.1	-0.2	0.8	0.6	0.5	
Contribution from interest rate/growth differential 3/	7.6	-0.9	10.1	3.4	2.8	2.6	1.1	0.0	-0.1	-0.2	0.8	0.6	0.5	
Of which: contribution from real interest rate	14.0	10.6	11.7	3.4	6.1	8.3	7.1	6.6	6.3	6.0	5.2	4.6	4.1	
Of which: contribution from real GDP growth	-6.4	-11.6	-1.7	0.0	-3.4	-5.7	-6.0	-6.6	-6.4	-6.2	-4.4	-4.0	-3.6	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.9	-1.6	0.0	0.0	-6.6	-30.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.9	0.0	0.0	0.0	0.0	-30.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (Paris II and III assistance)	0.0	-1.6	0.0	0.0	-6.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 5/	-0.8	4.6	3.6	-2.3	-0.8	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	762.8	722.5	783.1	718.8	653.9	550.9	645.2	593.4	567.0	544.3	554.9	498.1	450.7	
Key Macroeconomic and Fiscal Assumptions Underlying Baseline														
Real GDP growth (in percent)	4.1	7.4	1.0	0.0	2.0	3.5	4.5	5.0	5.0	5.0	4.0	4.0	4.0	
Average nominal interest rate on public debt (in percent) 6/	10.7	7.8	6.3	7.6	7.3	7.1	7.4	7.1	7.0	6.9	6.8	6.7	6.7	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	9.1	6.9	7.0	2.0	3.7	5.1	5.4	5.1	5.0	4.9	4.9	4.9	4.9	
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	1.6	0.9	-0.7	5.6	3.5	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.2	12.1	6.6	11.4	16.8	-8.6	-9.6	-2.1	1.1	2.7	4.0	4.0	4.0	
Primary deficit	-3.3	-3.5	-2.1	-1.7	-0.1	-2.6	-1.8	-4.4	-5.2	-5.6	-3.0	-3.0	-3.0	
Memorandum items:														
Public sector debt based on historical GDP growth data 8/	168.6	167.1	178.7	178.1	173.4	145.1	145.5	142.8	139.9	136.8	130.8	126.4	122.6	
Public sector debt based on historical data 9/	168.6	167.1	178.7	178.1	173.4	151.0	156.7	160.3	163.9	167.6	200.1	245.1	290.9	

Sources: Lebanese authorities; and Fund staff projections.
1/ Central government gross debt.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.
8/ This path assumes that, from 2008 onwards, real GDP growth is set at its 10-year average level while the primary fiscal balance and real interest rates are the same as in the baseline scenario.
9/ This path assumes that, from 2008 onwards, real interest rate and real GDP growth are set at their 10-year average level while the primary fiscal balance is the same as in the baseline scenario.

Table 12. Lebanon: National Social Security Fund Operations, 2000–06

	2000 Year Act.	2001 Year Act.	2002 Year Act.	2003 Year Act.	2004 Year Act.	2005 Year Act.	2006 Year Est.
	(In percent of GDP)						
Total NSSF operations							
Revenue	4.7	4.1	3.8	3.7	3.5	3.9	3.8
Expenditure	2.6	3.3	3.5	3.0	2.7	2.6	2.7
Balance	2.0	0.8	0.4	0.7	0.8	1.3	1.1
Healthcare							
Revenue	1.3	1.1	1.0	0.9	1.0	1.5	1.2
Expenditure	1.0	1.4	1.5	1.5	1.4	1.4	1.5
Balance	0.3	-0.3	-0.5	-0.6	-0.3	0.1	-0.3
Family allowances							
Revenue	1.1	0.8	0.6	0.5	0.5	0.7	0.5
Expenditure	0.8	0.8	0.8	0.8	0.8	0.8	0.7
Balance	0.3	-0.1	-0.3	-0.3	-0.2	-0.1	-0.2
Retirement							
Revenue	2.2	2.3	2.3	2.3	1.9	1.8	2.1
Expenditure	0.7	1.0	1.1	0.7	0.5	0.5	0.5
Balance	1.5	1.2	1.2	1.6	1.4	1.3	1.6
NSSF assets (end-of-period)							
Treasury bills	8.6	9.4	8.9	5.9	4.2	4.6	n.a.
Bank deposits	0.8	0.7	0.7	3.8	5.7	6.5	n.a.
Other	0.5	0.7	0.8	1.1	1.1	0.1	n.a.
Total assets	10.0	10.7	10.4	10.8	11.0	11.2	n.a.
GDP (in billions of Lebanese p	25,359	25,947	28,216	29,851	32,357	32,446	34,253

Source: National Social Security Fund (NSSF).

Table 13. Lebanon: Interest Rates, 2003–07
(In percent, end-of-period)

	2003 Year	2004 Year	2005 Year	2006 Year	2007 Apr.
Government (yield)					
Treasury bills, 3 months	5.5	5.2	5.2	5.2	5.2
Treasury bills, 6 months	6.5	6.3	7.2	7.2	7.2
Treasury bills, 1 year	6.9	6.7	7.8	7.8	7.8
Treasury bills, 2 years	8.0	7.9	8.7	8.7	8.7
Treasury bills, 3 years	8.9	8.9	9.6	9.5	9.5
Eurobond, 5 years	7.0	7.0	7.5	7.5	8.8
Banque du Liban					
Certificates of deposit in LL, 60 days	4.9	4.9	4.9	4.9	4.9
Certificates of deposit in LL, 3 years	9.4	9.4	9.4	9.4	9.4
Certificates of deposit in USD, 3 years	…	…	7.5	7.5	7.5
Foreign currency deposits, 2 years or more	…	3.8	5.3	5.1	5.1
Commercial banks					
Deposits in LL, 1 year or more	8.3	7.6	8.5	7.6	7.1
Deposits in LL, weighted average	7.8	7.0	7.7	7.5	7.5
Deposits in USD, 1 year or more	4.7	4.3	6.0	6.2	6.2
Deposits in USD, weighted average	3.4	3.3	4.1	4.8	4.8
Lending in LL, weighted average	11.3	10.5	10.1	10.4	10.4
Lending in USD, weighted average	8.8	8.0	8.4	8.6	8.4

Source: Banque du Liban.

Table 14. Lebanon: Banking Sector Financial Soundness Indicators, 2003–07

	2003 Year	2004 Year	2005 Year	2006 Year	2007 Feb.
	(In percent, unless otherwise specified)				
Assets (in millions of U.S. dollars)	61,589	70,595	73,565	79,948	79,140
Capital					
Capital adequacy ratio 1/	22.3	21.2	22.9	24.7	n/a
Capital to asset ratio	6.9	6.8	7.5	8.4	9.4
Asset quality					
Net problem loans/net total loans	12.8	10.6	9.1	6.9	6.8
Provisions against problem loans/problem loans	46.3	46.1	49.0	53.9	54.2
Total provisions/problem loans	53.1	57.3	63.3	72.0	73.0
Asset concentration					
Share of claims on government 2/	23.2	23.6	25.2	27.2	26.2
Of which: T-bills	12.6	10.6	11.9	13.1	12.4
Of which: Eurobonds	10.6	13.0	13.3	14.0	13.8
Share of claims on BdL 2/	31.3	28.6	29.9	26.3	27.0
Of which: Certificates of Deposit	16.1	12.0	13.4	11.5	11.4
Share of claims on private sector 2/	25.2	23.5	23.1	22.6	23.1
Share of claims on nonresidents 2/	14.4	17.6	16.4	12.3	11.3
Of which: foreign banks	13.4	16.3	14.9	14.7	n/a
Net foreign currency assets as percent of capital	22.0	23.3	18.3	17.1	17.0
Earnings					
Average return on assets (post tax) 3/	0.7	0.7	0.7	0.9	0.9
Average return on equity (post tax) 3/	10.9	9.3	11.0	10.6	9.8
Net interest margin	2.1	1.7	1.8	2.0	n/a
Liquidity					
Net liquid assets/total assets	49.1	43.2	45.2	42.9	42.9
Net liquid assets/short-term liabilities	56.6	57.0	52.8	51.0	51.3
Private sector deposits/assets 2/	68.2	66.8	67.6	67.4	69.0
Nonresident deposits/assets	12.9	14.1	13.5	12.3	11.3
Other indicators 4/					
Change in assets (12 month, in percent)	12.8	15.2	4.2	8.7	5.8
Change in private sector credit (12 month, in percent) 2/	0.3	5.2	1.9	6.0	6.1
Change in deposits (12 month, in percent) 2/	15.5	12.3	3.5	6.8	3.7
FC deposits/total deposits 5/	66.2	70.1	73.2	75.7	75.5
FC loans/total loans	87.0	86.4	86.6	87.0	87.0
FC loans/GDP	62.8	61.7	69.5	75.7	76.4
Exports of goods and services/GDP	42.7	49.0	54.1	58.5	n/a
Memorandum items: 2/					
LL deposit rate (average)	7.8	7.1	7.7	7.5	7.6
LL loan rate (average)	13.4	10.8	10.6	10.3	10.4
FC deposit rate (average)	3.6	3.3	3.7	4.4	4.3
FC loan rate (average)	9.0	8.3	8.2	8.5	8.4
Government's 2-year T-bill rate (marginal)	8.0	7.9	8.7	8.7	8.7
Spread over 6-month USD Libor	6.8	6.1	4.8	3.4	3.3
Government's Eurobond rate (marginal)	7.0	7.0	7.5	7.5	8.8
Spread over 5-year U.S. note	4.0	3.5	2.7	1.8	3.2
GDP (in millions of U.S. dollars)	19,802	21,464	21,523	22,722	n/a

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

1/ As of June 2006.
2/ 2007 figures are as of April.
3/ 2007 figures are the annualized February data.
4/ FC and LL stand for "foreign currency" and "Lebanese pound", respectively.
5/ FC deposits of residents and nonresidents as a share of total deposits of residents and nonresidents.

Table 15. Lebanon: Indicators of Financial and External Vulnerability, 2003–07

	2003 Year	2004 Year	2005 Year	2006 Year	2007 March
Monetary and financial indicators					
Broad money, M5 (annual percentage change)	15.5	12.3	3.5	6.4	4.7
Private-sector credit (annual percentage change)	0.3	5.2	1.9	6.0	6.3
Broad money, M5 (in millions of U.S. dollars)	50,652	56,871	58,852	62,606	62,855
Public finance indicators					
Overall fiscal balance (in millions of U.S. dollars)	-2,632	-1,852	-1,811	-2,523	-780
In percent of GDP 1/	-13.3	-8.6	-8.4	-11.1	-13.4
In percent of government revenue	-60.1	-37.3	-36.9	-44.8	-54.5
Interest payments on debt (in millions of U.S. dollars)	3,280	2,602	2,263	2,906	715
In percent of GDP 1/	16.6	12.1	10.5	12.8	12.3
In percent of government revenue	74.9	52.4	46.0	51.6	50.0
Nominal GDP (in millions of U.S. dollars) 1/	19,802	21,464	21,523	22,722	23,234
Government revenue (in millions of U.S. dollars)	4,377	4,967	4,914	5,631	1,430
			(In percent)		
Banking-sector indicators					
Problem loans/total loans (net of provisions and unearned interest) 2/	12.8	10.6	9.1	6.9	6.8
Provisions against problem loans/problem loans 2/	46.3	46.1	49.0	53.9	54.2
Capital adequacy ratio	22.3	21.2	22.9	24.7	n/a
Credit to the private sector (in percent of GDP)	77.8	75.3	76.4	76.5	0.0
			(In millions of U.S. dollars)		
Debt indicators					
Gross public debt	33,381	35,875	38,483	40,405	41,232
In percent of government revenue 1/	762.6	722.3	783.2	717.6	720.9
In percent of GDP 1/	168.6	167.1	178.8	177.8	177.5
Of which: foreign currency	15,575	18,382	19,135	20,428	20,445
In percent of GDP 1/	78.7	85.6	88.9	89.9	88.0
Gross public debt held by the market	23,743	25,372	26,754	30,423	30,934
In percent of GDP 1/	119.9	118.2	124.3	133.9	133.1
External debt 3/	34,621	40,236	40,879	44,977	45,701
In percent of GDP 1/	174.8	187.5	189.9	197.9	196.7
External public debt (central government and Banque du Liban)	7,483	7,462	8,328	10,599	10,641
In percent of GDP 1/	37.8	34.8	38.7	46.6	45.8
Short-term external public debt 4/	1,716	2,512	1,220	960	947
Short-term foreign currency public debt 4/	1,770	2,452	2,838	1,827	n/a
Short-term external debt 3/ 4/	28,855	35,286	33,770	35,338	36,007
Short-term foreign currency debt 4/ 5/	38,318	46,875	49,707	54,038	46,471
Total foreign currency deposits (resident and non-resident) 3/	32,266	38,505	41,734	46,319	46,471
International reserves					
Gross official reserves 6/	10,271	9,575	9,611	11,353	11,053
In percent of short-term external debt	35.6	27.1	28.5	32.1	30.7
In percent of short-term ext. debt, plus short-term domestic public debt in f.c. 7/	34.4	26.2	27.0	31.1	...
In percent of short-term ext. debt, plus residents' f.c. deposits minus banks' foreign assets	34.3	26.7	26.0	28.7	27.4
Gross official reserves and commercial banks' foreign assets	18,589	20,599	20,725	24,983	24,431
In percent of short-term external debt	64.4	58.4	61.4	70.7	67.8
In percent of short-term foreign currency debt 5/	48.5	43.9	41.7	46.2	52.6
			(In millions of U.S. dollars)		
External current account indicators					
Merchandise exports, f.o.b.	1,733	2,050	2,278	2,792	769
Annual percentage change	43.2	18.3	11.1	22.5	…
Merchandise imports, f.o.b.	6,528	8,502	8,397	8,547	2,306
Annual percentage change	10.4	30.3	-1.2	1.8	…
External current account balance	-2,615	-3,332	-2,926	-1,406	-569
In percent of GDP	-13.2	-15.5	-13.6	-6.2	-9.8
In percent of exports of goods and services	-29.9	-31.9	-26.0	-10.6	…

Sources: Lebanese authorities; Bank for International Settlements; and Fund staff estimates and projections.
1/ On an annualized basis.
2/ 2007 refers to February data.
3/ Includes estimates for public debt and banking deposits held by non-residents, and non-resident claims on the nonfinancial sector.
4/ On a remaining maturity basis (scheduled amortization over the next year).
5/ Short-term foreign currency debt of the public sector and the banking sector plus external debt of the nonbank sector.
6/ Excludes gold and encumbered assets.
7/ "F.C." denotes foreign currency.

Table 16. Lebanon: Size and Distribution of Deposits, February 28, 2007 1/

Deposit Size	Number of Depositors	Deposits in L.L.	Deposits in F.C. 2/	Total Deposits	Deposits <1 month
			(in billions of LL)		
< 5 million L.L.	…	721	575	1,296	483
> 5 million L.L., < 10 million L.L.	…	624	705	1,330	426
> 10 million L.L., < 50 million L.L.	…	3,782	5,136	8,918	2,756
> 50 million L.L., < 250 million L.L.	…	7,206	14,444	21,650	5,765
> 250 million L.L., < 750 million L.L.	…	4,110	13,532	17,643	3,410
> 750 million L.L., < 1500 million L.L.	…	1,788	8,273	10,061	1,493
> 1500 million L.L., < 4000 million L.L.	…	1,723	9,478	11,201	1,405
> 4000 million L.L., < 6500 million L.L.	…	791	3,573	4,364	591
> 6500 million L.L.	…	1,930	10,983	12,913	1,184
Total	2,151,848	22,675	66,701	89,376	17,512
In percent of GDP		*62.7*	*184.4*	*247.1*	*48.4*
			(in percent of total)		
< 5 million L.L.		3.2	0.9	1.5	2.8
> 5 million L.L., < 10 million L.L.		2.8	1.1	1.5	2.4
> 10 million L.L., < 50 million L.L.		16.7	7.7	10.0	15.7
> 50 million L.L., < 250 million L.L.		31.8	21.7	24.2	32.9
> 250 million L.L., < 750 million L.L.		18.1	20.3	19.7	19.5
> 750 million L.L., < 1500 million L.L.		7.9	12.4	11.3	8.5
> 1500 million L.L., < 4000 million L.L.		7.6	14.2	12.5	8.0
> 4000 million L.L., < 6500 million L.L.		3.5	5.4	4.9	3.4
> 6500 million L.L.		8.5	16.5	14.4	6.8

Source: Banque du Liban, Banking Control Commission.
1/ "L.L." denotes Lebanese pounds.
2/ "F.C." denotes foreign currency.

Table 17. Lebanon: Quantitative Indicative Targets Under the EPCA, March–December 2007
(Preliminary. In billions of Lebanese pounds, unless otherwise indicated; end-of-period) 1/

	2006	2007					
	December	March			June	September	December
	Act.	Prog.	Adj. Prog.	Prel. Act.	Prog.	Prog.	Prog.
I. Gross reserves of the Banque du Liban (stocks) 2/	18,084	17,505	17,257	17,647	17,166	16,863	17,475
II. Net debt of the government (stocks) 3/	59,376	61,121	61,121	60,804	59,766	60,507	61,504
III. Primary balance of the government, before grants (cumulative flows)	...	-575	-575	-324	-848	-1,005	-1,317
IV. Accumulation of government gross arrears (cumulative flows, continuous)	...	0	...	0	0	0	0
V. Accumulation of external arrears by the government and the Banque du Liban (cumulative flows, continuous)	...	0	...	0	0	0	0
VI. Government net borrowing from the Banque du Liban (stocks) 4/	9,791	10,696	10,694	10,800	9,237	8,696	7,630
Memorandum items:							
Letters of credit contracted by Electricité du Liban (stock)	690	...	...	690	...	...	...
Disbursements of official grants and loans to the public sector (cumulative flows)	...	0	...	2	620	2,197	4,006
Banque du Liban's holdings of Eurobonds (stock)	2,147	...	...	1,963	...	...	...
Disbursements of grants to the government (cumulative flows)	...	0	...	2	318	983	1,316
Of which: disbursements of project grants (cumulative flows)	...	0	...	0	0	43	91
Receipts from privatization/securitization operations (cumulative flows)	...	0	...	0	0	0	0
Transfers of gold valuation gains from Banque du Liban to government (cumulative flows)	...	0	...	0	2,380	2,380	2,380
Projection of revenue from companies slated for privatization (cumulative flows)	...	331	...	...	521	1,036	1,566

Source: Lebanese authorities.

1/ At program exchange rates.
2/ In millions of U.S. dollars. Defined as Banque du Liban's foreign exchange deposits abroad, foreign exchange holdings (including SDR), gold and holdings of investment grade liquid foreign currency-denominated securities, less encumbered foreign assets.
3/ Includes CDR and HRC balances at the Banque du Liban.
4/ Includes the decline in net borrowing of LL2380 billion on account of the gold revaluation transfer.

Table 18. Lebanon: Monitorable Actions for the Period March–December 2007

Measure	Target Date	Implementation Status
Fiscal		
Submit to parliament a draft 2007 budget law consistent with the targeted primary balance of the central government, and including detailed HRC operations and CDR foreign-financed expenditures. The budget law should not allow budget carryovers for expenditures for which no third-part liability already exists, and treasury advances of more than one month after the fiscal year.	End-June 2007	Draft budget approved by cabinet on May 21.
Issue a Cabinet of Ministers decision setting a specific floor on gasoline excise of LL 300 per liter of gasoline.	End-September 2007	
Appoint auditor for NSSF accounts. Auditor to prepare an audit plan of NSSF for 2001–06.	End-June 2007	
Power sector		
Appoint auditor for EdL accounts. Auditor to prepare an audit plan of EdL for 2002–06. Publish 2001 audit report.	End-June 2007	
Privatization		
Submit to parliament the draft law to authorize the sale of the mobile sector's assets and relevant operating licenses by the government.	End-June 2007	Privatization might proceed without new law.
Issue an invitation for expression of interest (EOI) in participating in the process of acquiring the licenses and assets of the two mobile telephone companies (MIC1 and MIC2).	End-December 2007	

Table 19. Lebanon: External Financing Requirements and Sources, 2003–08

(In millions of U.S. dollars)

	2003 Act.	2004 Act.	2005 Act.	2006 Act.	2007 Proj.	2008 Proj.
Gross financing requirements	-27,847	-27,209	-32,330	-31,945	-32,201	-33,851
External current account balance 1/	-2,615	-3,332	-2,926	-1,568	-2,987	-2,911
Government debt amortization	-1,143	-1,716	-2,512	-1,220	-960	-1,088
Non-resident deposits	-18,964	-22,857	-26,856	-27,415	-28,486	-28,626
Repayment of arrears	0	0	0	0	0	0
Gross reserves accumulation (- increase)	-5,125	696	-36	-1,742	232	-1,226
IMF repurchases	0	0	0	0	0	0
Available financing	25,752	27,209	32,330	31,283	29,657	32,749
Capital transfers (net) 1/	29	50	27	819	30	30
Foreign direct investment (net)	1,722	2,333	2,629	2,723	2,297	6,251
Portfolio investment, loans, other capital	24,038	26,444	28,759	26,571	27,330	26,468
Government (excl. exceptional financing)	370	1,629	2,809	1,984	800	587
Banque du Liban (liabilities, net) 2/	-18	-3	474	1,507	32	-18
Commercial Banks	22,809	24,150	27,325	25,970	26,756	26,045
Non-resident deposits	22,857	26,856	27,415	28,486	28,626	28,897
Other (net)	-48	-2,706	-90	-2,516	-1,871	-2,852
Non-bank private sector (net)	876	668	-1,849	-2,889	-257	-147
Errors and omissions	-38	-1,619	914	1,170	0	0
Financing gap	-2,095	0	0	-662	-2,544	-1,103
Exceptional financing	2,095	0	0	662	2,544	1,103
Exceptional grants to government	0	0	0	662	874	640
Exceptional loans to government	2,095	0	0	0	1,593	463
IMF purchases	0	0	0	0	77	0
Residual financing gap	0	0	0	0	0	0

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

1/ Excluding exceptional grants to government.

2/ Excluding IMF.

Table 20. Lebanon: Indicators of Capacity to Repay the Fund, 2003–12

	2003 Act.	2004 Act.	2005 Act.	2006 Prel. Act.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.
Fund repurchases and charges 1/										
In millions of SDRs	0.0	0.0	0.0	0.0	1.4	2.8	2.8	15.3	26.9	12.9
In millions of U.S. dollars	0.0	0.0	0.0	0.0	2.1	4.2	4.2	23.2	40.6	19.5
In percent of exports and goods and NFS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.1
In percent of government external debt service	0.0	0.0	0.0	0.0	0.1	0.3	0.2	1.5	2.4	0.8
In percent of quota	0.0	0.0	0.0	0.0	0.7	1.4	1.4	7.6	13.2	6.4
In percent of gross official reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.4	0.2
Fund credit outstanding										
In millions of SDRs	0.0	0.0	0.0	0.0	50.8	50.8	50.8	38.1	12.7	0.0
In millions of U.S. dollars	0.0	0.0	0.0	0.0	76.8	76.8	76.8	57.6	19.2	0.0
In percent of quota	0.0	0.0	0.0	0.0	25.0	25.0	25.0	18.7	6.3	0.0
In percent of GDP	0.0	0.0	0.0	0.0	0.3	0.3	0.3	0.2	0.1	0.0
In percent of gross official reserves	0.0	0.0	0.0	0.0	0.7	0.6	0.7	0.5	0.2	0.0
Memorandum items:										
Exports of goods and NFS (in millions of US$)	8,742	10,461	11,252	13,292	13,703	14,778	16,123	17,794	19,632	21,404
Government external debt service (in millions of US$)	1,669	2,218	3,209	1,677	1,488	1,633	1,853	1,539	1,715	2,436
Quota (in millions of SDRs)	203	203	203	203	203	203	203	203	203	203
Quota (in millions of US$)	284	301	301	250	307	307	307	307	307	307
Gross official reserves (in millions of US$)	10,271	9,575	9,611	11,353	11,121	12,347	10,920	10,963	11,574	11,897

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

1/ Projections are based on repurchase obligations and are at February 28, 2007, exchange rates.

INTERNATIONAL MONETARY FUND

LEBANON

Staff Report for the 2007 Article IV Consultation—Informational Annex

Prepared by Middle East and Central Asia Department

September 17, 2007

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Annexes

Annex I. Lebanon: Fund Relations
(As of August 31, 2007)

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

II.	**General Resources Account:**	**SDR Million**	**Percent of Quota**
	Quota	203.00	100.00
	Fund holdings of currency	234.92	115.72
	Reserve position in Fund	18.83	9.28

III.	**SDR Department:**	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	4.39	100.00
	Holdings	23.14	526.81

IV.	**Outstanding Purchases and Loans:**	**SDR Million**	**Percent of Quota**
	Post-Conflict Emergency Assistance	50.75	25.00

V. **Latest Financial Arrangements:** None

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

	Forthcoming				
	2007	2008	2009	2010	2011
Principal	0.00	0.00	0.00	12.69	25.38
Charges/Interest	0.69	2.71	2.70	2.58	1.44
Total	0.69	2.71	2.70	15.27	26.82

VII. Implementation of HIPC Initiative: Not applicable

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

IX. **Safeguards Assessment**:

Under the Fund's safeguards assessment policy, the Banque du Liban is subject to safeguards assessment with respect to EPCA approved on April 9, 2007. The necessary documentation have been requested from the authorities on March 30, 2007. Information received so far has been partial and staff is following up with the authorities to obtain a complete set of documentation necessary for the assessment.

Nonfinancial Relations

X. **Exchange Arrangement**

The Lebanese pound is a de facto peg. Since October 1999, the Banque du Liban has intervened to keep the pound around a mid-point parity of LL 1,507.5 per $1, with a bid-ask spread of LL+/-6.5.

XI. **Article IV Consultation**

The 2006 Article IV consultation was concluded by the Executive Board on May 3, 2006 (IMF Staff Country Report No. 06/201).

XII. **Financial Sector Assessment Program**

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

XIII. **Technical Assistance**

Fiscal area—FAD has provided advice on introducing the VAT, reforming customs tariffs and income taxes, strengthening tax and customs administration, improving public expenditure management, and consolidating fiscal accounts. A fiscal ROSC report was published in May 2005. This technical assistance was well received by the ministry of finance and, notably on the VAT, its impact has been positive and substantial. Considerable needs remain in tax policy, tax administration, budget preparation, fiscal management, and public accounting and reporting. Technical assistance missions in 2005 primarily dealt with (i) the consolidation of fiscal accounts, and (ii) public liquidity management. In October 2006, a multi-sector mission provided advice on fiscal reform priorities after the conflict with Israel.

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

Statistical area—The Statistics Department has provided technical assistance on the development of price and balance of payments statistics, but so far, little progress has been achieved. There is no official producer price index (PPI) or consumer price index (CPI); balance of payments data remain incomplete and Lebanon does not report balance of payments data to the Statistics Department. In early 2002, a multisector statistics/GDDS mission provided an assessment of statistical needs and prepared action plans for improvements. In February–March 2007, three missions provided assistance for the compilation of the CPI. Statistical gaps remain substantial, particularly in the areas of national accounts, price statistics, and the balance of payments, but stronger political commitment to filling these gaps is needed in order for further technical assistance to be effective.

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

Date	Department	Topic
March 25–April 5, 2002	STA	Multisector statistics/GDDS
April 15–26, 2002	BTS	Database at Banque du Liban
August 6–20, 2002	FAD	VAT and customs administration
Sept. 9–23, 2002	FAD	Income tax reform
Jan. 27–31,2003	MAE	Payment systems
July 29–23, 2003	FAD	Revenue administration
July 26–August 10, 2003	FAD	Public expenditure management
Aug. 27–Sept. 8, 2003	FAD	Tax policy
September 24–29, 2003	LEG	Income Tax Law
March 18–29, 2004	MFD	Payments and Settlement Systems and Developing Early Warning Systems
September 6–17, 2004	FAD	Fiscal transparency ROSC
October 2004	IMF	Creation of METAC
December 8–22, 2004	FAD	Tax policy
January 11–15, 2005	MFD	Payments and Settlement Systems and Developing Early Warning Systems
February 1–11, 2005	MFD	Liquidity Forecasting, Monetary Operations and the Interbank Money Market
May 22–June 6, 2005	FAD	Consolidation of Fiscal Accounts
June 24–July 2, 2005	LEG	Income Tax Law
August 25–31, 2005	MFD	Follow-up on Early Warning Systems
April 12–20, 2006	MFD	An Assessment of Banking System
April 24–May 5, 2006	STA/METAC	Government Finance Statistics
October 9–16, 2006	FAD	Post-Conflict Reform Challenges and priorities
February 19–23,	STA	Consumer Price Statistics
March 12–30,	STA	Consumer Price Statistics
April 16–27, 2007	STA	Consumer Price Statistics
March 2007	FAD	Improving Cash Management

XIV. Resident Representatives None

Annex II. Lebanon: Relations with the World Bank Group

The World Bank (Bank) presented a Country Assistance Strategy (CAS) covering fiscal years 2006–09 to the Board in December 2005. The CAS aimed at assisting Lebanon in addressing its macro-economic imbalances and its deficient public infrastructure and services, with attention to associated social and environmental issues. The key pillars of the CAS were: (i) governance for economic management and to support growth; (ii) the development of human capital and the mitigation of the poverty effects of transition; and (iii) resource and environmental management. The CAS foresaw up to $700 million over the four year implementation period, subject to significant progress in addressing fiscal imbalances and improving the debt outlook. The major deterioration in Lebanon's fiscal balances since the hostilities temporarily placed Lebanon in the CAS low case which precludes Bank lending.

In response to its inability to lend at a time of great need for assistance, the Bank set up a Trust Fund for Lebanon (TFL) in September 2006 with a transfer of $70 million from IBRD surplus. The funds from the TFL support projects that are geared towards addressing immediate post-conflict needs ($30 million for municipal development and $15 million for water sector improvements), providing technical assistance in key reform areas ($5 million for power sector reform) and, through IFC, an SME guarantee facility ($15 million).

In addition, through grant financing from its post-conflict fund the Bank is providing technical assistance to the government for developing a financial tracking system for donor funds and for simplifying government procurement and financial management procedures. Upon the minister's request, the Bank also temporarily placed two staff in Ministry of Finance, focusing on local development and donor coordination and programming.

Immediately after the cessation of hostilities and at the request of the government, a multi-sector Bank team undertook an assessment of the economic and social impact of the hostilities and an analysis of macro and structural reform priorities for the future. The process involved intensive consultations with government officials, donor partners, the private sector and other stakeholders in Lebanon. The study was an important input into the preparation of the government's reform program which was adopted in January 2007.

At the occasion of the Paris III donors' conference on January 25, 2007, the Bank agreed to provide up to $700 million in IBRD lending subject to and phased in with the implementation of the government's reform program. A CAS update will be presented to the Board once the Bank and the government have reached clarity on the proposed lending program.

Following interruptions in project implementation and delays in restarting work due to the hostilities, the Bank's project portfolio is progressing well. This is in large part the result of early and intensive efforts of the Bank's task teams and their Lebanese counterparts. The portfolio currently consists of seven projects (see Annex) totaling a commitment of $314.6 million (of which $186.9 million remains undisbursed).

IFC's activities

IFC began work on a post-conflict program while the hostilities were ongoing, building on previous experiences in other conflict or post-disaster situations. IFC joined the Bank's assessment team and developed a comprehensive program of investment and technical assistance in support of private sector recovery.

At the core of the program, which is now under implementation, is the Lebanon Rebuild Program in the financial sector, consisting of (1) an up to $200 million investment program with a number of partner banks to which IFC will provide credit lines with a tenor of up to seven years and/or risk sharing facilities; this will enable these banks to lend to conflict-affected enterprises, primarily SMEs, and (2) an up to $75 million increase in funding under IFC's existing Global Trade Finance Program in Lebanon.

In addition to investments in companies through the financial sector, IFC expects to support select real sector companies in the retail and services sectors.

Technical assistance activities continue to focus on improving the environment for the private sector, including a roundtable on techniques for recovery of microfinance portfolios and an expanded corporate governance program focusing on improving transparency and management practices in the private sector. Programs to assist SMEs in the agriculture sector and capacity-building support to entities lending to SMEs are being considered. Finally, IFC is in discussions with the government on the next steps in administrative reform which impact private sector activity, particularly in relation to issues raised by the recent administrative barriers study carried out by FIAS which identified administrative and governmental barriers to private sector development and proposed solutions to remove these.

FINANCIAL RELATIONS WITH THE WORLD BANK GROUP

I. Status of World Bank Group Operations
As of February 28, 2007
(In millions of U.S. dollars)

Closed Projects	15
IBRD / IDA	
Total Disbursed (Active)	127.7
of which has been repaid	*10.2*
Total Disbursed (Closed)	570.2
of which has been repaid	*390.1*
Total Disbursed (Active + Closed)	697.9
of which has been repaid	*400.4*
Total Undisbursed (Active)	186.9
Total Undisbursed (Closed)	*0.0*
Total Undisbursed (Active + Closed)	186.9

Active Projects		Last PSR Supervision		Amounts (US $ millions)			
Project ID	**Project Name**	**DO**	**IP**	**FY**	**IBRD**	**Canc.**	**Undisb.**
Status of Bank Group Activities (B8)							
Port. Stat.	Active						
Country	Lebanese Republic						
Approval FY							
Project ID (SPN)							
P071113	Communtiy Development	MU	MS	2001	20.0		13.5
P074042	Ba'albeck Water & Wastewater	S	S	2002	43.5		31.8
P050529	Cultural Heritage and Urban Developme	S	MS	2003	31.5		25.5
P045174	Education Development	S	S	2000	56.6	12.0	22.7
P050544	First Municipal Infrastructure (FMIP)	S	S	2000	80.0		14.5
P103875	FMIP additional grant	S	S	2007	30.0		30.0
P034038	Urban Transport Development	S	S	2002	65.0		48.9
					326.6	12.0	186.9

II. Status of International Finance Corporation Operations
Statement of IFC's Held and Disbursed Portfolio
(As of January 31, 2007)
(In millions of U.S. dollars)

Approval Fiscal Year	Institution Short Name	LN Cmtd-IFC	ET Cmtd-IFC	QL+QE Cmtd-IFC	GT Cmtd-IFC	RM Cmtd-IFC	All Cmtd-Part	LN Out Bal-IFC	ET Out-IFC	QL+QE Out-IFC	GT Out-IFC	RM Out-IFC	All Out-Part
1993/ 1996/ 1999/ 2001/ 2003	Byblos Bank	8.15	0.00	0.00	0.00	0.15	0.00	8.15	0.00	0.00	0.00	0.15	0.00
1993/ 1994/ 1996/ 2001/ 2006	Fransabank	0.00	0.00	0.00	1.09	0.00	0.00	0.00	0.00	0.00	1.09	0.00	0.00
2006	GTFP BLF	0.00	0.00	0.00	10.65	0.00	0.00	0.00	0.00	0.00	10.26	0.00	0.00
2006	GTFP Bank Beiru	0.00	0.00	0.00	14.56	0.00	0.00	0.00	0.00	0.00	14.56	0.00	0.00
1998	Idarat SHV	0.43	0.00	0.00	0.00	0.00	0.00	0.43	0.00	0.00	0.00	0.00	0.00
2005	SIS Adma	8.00	0.00	0.00	0.00	0.00	0.00	6.00	0.00	0.00	0.00	0.00	0.00
Total Portfolio:		**16.58**	**0.00**	**0.00**	**26.30**	**0.15**	**0.00**	**14.58**	**0.00**	**0.00**	**25.91**	**0.15**	**0.00**

Annex III. Lebanon: Statistical Issues

Gaps in the coverage of macroeconomic statistics hamper effective surveillance. In some cases, these gaps widened, owing to the effects of the 2006 conflict. In particular, there is a need for further work on the compilation of the international reserves template in order to facilitate monitoring of the gross and net international reserves and for compiling accurately the counterpart data in the central bank balance sheet. At present, it appears that most components of the monetary and financial statistics, the public debt statistics, and data on the central government budgetary accounts are available on a regular basis. However, other macroeconomic statistics (national accounts, prices, employment, general government and the rest of the nonfinancial public sector, and balance of payments) are largely estimated on the basis of partial information. Lebanon participates in the GDDS.

The availability of real sector data remains very limited, although there has been progress in compiling the national accounts. The ministry of economy and trade is currently receiving technical assistance from the French National Institute of Statistics and Economic Studies (INSEE), for the development of national accounts statistics, including the compilation of quarterly GDP data. The first set of national accounts estimates for 1997 (the base year) was published in 2003 and estimates for 1998–2004 are now available. Prior to this initiative, official national accounts statistics had not been produced since the mid-1970s, although preliminary estimates for the major components of GDP at current prices for the years 1994 and 1995 were published in October 1997. A household income survey was published in 1997. With assistance from the EU, progress is being made toward a new census on buildings, dwellings and establishments; developing and undertaking economic surveys; and conducting a household budget survey on a national level.

Consumer price indices are prepared by the Central Administration for Statistics (CAS) and private organizations on the basis of a limited basket of goods for the greater Beirut metropolitan area. The CAS index is a quarterly index based on price collection from Beirut and its suburbs. The index weights are based on the 1997 Household Budget Survey and are in need of an update. Preparations for the new index are well under way and will have national coverage.

Published monthly data on the central government budgetary accounts are not comprehensive. The published figures do not include certain transfers[1] and financing data, omit foreign-financed capital expenditure, and do not cover arrears. In addition, there are no data on the widespread quasi-fiscal activities conducted by public corporations. Certain (treasury) spending is only identified ex-post, and its economic classification with a lag. However, these items are provided to the staff in the context of surveillance activities. No monthly data are available on

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

central government, as available data do not cover the social security funds. No sub-annual fiscal data are currently reported for publication in *International Financial Statistics (IFS)*. Cash-based annual government finance statistics limited to the budgetary central government are published in the *Government Finance statistics Yearbook* (GFSY). The latest data received are for 2004, and were published in the *2006 GFSY*.

Lebanon has not received technical assistance in monetary and financial statistics in many years. An assessment was undertaken during the 2002 GDDS/multisector mission which left an action plan for improvement. The monetary and financial statistics are timely although the institutional coverage is limited to the central bank and other depository corporations. However, recently questions have emerged about the central bank's statistical treatment of repos. On the basis of available data and supporting information, it appears that some Eurobond repo transactions undertaken by the central bank in mid-2005 were not recorded in its balance sheet until end-2006.

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

The balance of payments statistics (BOP) are weak. The data reflect deficiencies in the current account (unrecorded exports, underestimation of private sector services and workers' remittances), the capital account (grants), and the financial account (equity investment in the nonbank private sector, and corporate borrowing abroad). As a follow-up to the 2002 multisector mission, a technical assistance mission in November 2005, made the following recommendations: (i) the Central Bank of Lebanon and the CAS need to give high priority to extending the coverage of their existing inter-agency agreement on the share of work for data collection and compilation in balance of payments statistics; (ii) develop new data sources, with regard particularly to direct investment; (iii) adopt the definition for official reserve assets as set out in the international guidelines; and (iv) improve the periodicity of dissemination of detailed balance of payments data to a quarterly frequency.

BOP source data improved with the implementation in 2003 of the International Transactions Reporting Systems (ITRS). In July 2005, Lebanon provided STA for the first time with quarterly data for 2002–04 and with methodological notes. Data currently covering 2002-2005 are published in the *IFS* and the *Balance of Payments Statistics Yearbook (BOPSY).* However, there have been significant revisions in financial account data and the flows in the investment income-portfolio investment data (debit) for 2003 remained very large; even larger then the flows in the financial account for the same instrument. The official reserve assets are currently compiled on a gross basis consistent with the international guidelines.

LEBANON: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
AS OF JUNE 18, 2007

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	05/2007	6/04/2007	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	02/2007	03/2007	M	M	M
Reserve/Base Money	03/2007	5/15/2007	M	M	M
Broad Money	03/2007	5/15/2007	M	M	M
Central Bank Balance Sheet	03/2007	5/15/2007	M	M	M
Consolidated Balance Sheet of the Banking System	03/2007	5/15/2007	M	M	M
Interest Rates[2]	03/2007	5/15/2007	M	M	M
Consumer Price Index	07/2005	09/2005	M	At the time of mission or on request	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]					
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	07/2005	09/2005	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	08/2005	09/2005	M	M	M
External Current Account Balance	Q4/2005	07/2006	Q	A	unpublished
Exports and Imports of Goods and Services	08/2006	11/2006	M	Q	M
GDP/GNP	2004 (est)	05/2005	A	At the time of mission	A
Gross External Debt	06/2005	09/2005	M	M	M

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

Statement by the IMF Staff Representative
October 3, 2007

1. This statement reports on most recent developments and their impact on the economic outlook and the staff appraisal. It complements information contained in the *Staff Report for the 2007 Article IV Consultation* and in the *Report on Performance Under the Program Supported by Emergency Post-Conflict Assistance* (IMF Staff Country Report No. 07/371).

A. Recent Developments

2. **The parliamentary majority and the opposition are still in discussion over the choice of a compromise presidential candidate.** The current president's term comes to an end on November 24, 2007, and the presidential election (by parliament) has been postponed to October 23. The security situation remains tense in the wake of the latest assassination of a member of the parliamentary majority on September 19. Main military operations at the Nahr al-Bared Palestinian refugee camp were successfully completed. The authorities estimate the cost of rebuilding the camp and the surrounding communities at $300–400 million. They will be seeking additional donor assistance to fill this need.

3. **The latest economic activity indicators are consistent with the earlier projection of 2 percent real GDP growth for 2007 (IMF Country Report No. 07/371).** The economic recovery in the first half of 2007 was relatively modest (economic activity remained well below the very strong first half of 2006), and is unlikely to pick up momentum in the second half given the unsettled political and security situation. CPI inflation decelerated to below 2 percent year-on-year in July, consistent with the end-year inflation projection of 2 percent or lower.

4. **Financial markets have weathered relatively well the domestic political uncertainty and the recent global financial turbulence.** The Eurobond market has reportedly been very quiet with hardly any trading, suggesting that investors are maintaining their positions and waiting for the political situation to evolve. Eurobond spreads stood at 492 basis points on September 27, or 120 basis points higher than in mid-July. Deposit inflows have continued at a sustained pace, with broad money growth of 7 percent since the beginning of the year. Deposit dollarization is broadly unchanged at 76 percent.

5. **Despite the strength of monetary growth, commercial banks provided no new net financing to the government in July and August.** In the absence of fresh donor support, the government turned to central bank financing. Still, riding on the strength of capital inflows, gross international reserves increased by $300 million in July–August to $11.9 billion. Gross government debt stood at $40.2 billion at end-August.

6. **Government revenue and expenditure performance through July is in line with annual program objectives, but the authorities have not yet taken steps to increase gasoline excises to the level agreed for end-September (monitorable action under the**

program). At current international prices, the excise rate has declined to near zero, and reaching the target rate of $0.20 a liter would require a 30 percent increase in gasoline retail prices. Such an increase would yield about 0.5 percent of GDP over three months. The authorities have indicated that they expect to meet the primary deficit target for 2007 even without this measure, thanks to over performance on other revenue items and lower expenditures, related in part to delays in capital spending.

7. **The authorities have requested technical assistance from the IMF's Fiscal Affairs Department to prepare for the removal of various subsidies and the liberalization of gasoline prices, and to advise on the final stages of preparation of the General Income Tax (GIT).** Preparations for a staff mission are underway, awaiting receipt of information on a household expenditure survey. The GIT is still under review before its submission to the Cabinet for approval. The law would have to be approved by parliament this year, if it is to come into effect in 2008 as planned. However, this deadline remains challenging as considerable preparatory administrative work is still needed to meet this objective.

8. **Disbursements of Paris III budget support this year are likely to fall significantly short of program assumptions.** Since June, the authorities have received a U.S. budgetary grant of $75 million, and a $100 million World Bank Development Policy Loan is in the process of being disbursed. They are also expecting the disbursement of $300 million in budgetary loans from the United Arab Emirates. However, out of total outright budgetary support (loans and grants) of around $1.6 billion projected for 2007, only $0.6–0.9 billion is likely to be disbursed this year, mainly on account of technical and administrative reasons. Moreover, the Paris III program was premised on the expectation that a significant portion of project loans would be converted into indirect budget support (by financing existing or planned government capital projects), but negotiations on this are still under way.

9. **A safeguards assessment of the Banque du Liban is currently in progress with respect to Lebanon's Emergency Post-Conflict Assistance.** A mission visited Lebanon September 10–17, and a draft report is being prepared for the authorities comments prior to completion of the assessment.

B. Changes to the Outlook and Implications for the Staff Appraisal

10. **Recent developments do not alter the thrust of the staff appraisal of the Article IV Staff Report:**

- Relative to the projections underlying the Article IV Staff Report, deposit inflows have been stronger than expected, which should enable the government to increase its reliance on domestic market financing at a time when donor support appears to be falling short of program assumptions. However, as noted in the staff report, tapping the market will likely require an upward adjustment in domestic interest rates, particularly given the authorities' commitment to rely on central bank credit only as short-term bridge financing.

- The upward revision in oil prices relative to those assumed in the Article IV report will adversely affect the financial position of the loss-making power utility (EdL). However, the budgetary impact is likely to be felt only starting in 2008 because of lags in the financial support provided by the government to EdL.

- The 2007 budget target remains achievable. Early action to increase the gasoline excise would enhance the chances of meeting the target, and is also key to meeting the authorities' medium-term fiscal objectives, as spelled out in the Paris III program.

- While a resolution of the political impasse is expected to lower Eurobond spreads, Lebanon's financing costs are likely to have increased on account of the global re-assessment of risk. The adverse impact on debt sustainability reinforces the need for a prompt implementation of the adjustment and reform measures planned for 2008. Realizing the expected privatization receipts and securing donor disbursements will be important to meet projected foreign currency debt service payments of over $4 billion in 2008 (of which $3.6 billion for Eurobond debt service).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/137
FOR IMMEDIATE RELEASE
November 26, 2007

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

IMF Executive Board Concludes 2007 Article IV Consultation with Lebanon

On October 3, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lebanon.[1]

Background

Economic developments in 2006 were significantly affected by the July–August conflict with Israel. Real GDP is estimated to have been flat, with strong growth in the first half of the year offset by the disruptions during and after the conflict. Inflation increased, mainly reflecting supply shortages during the conflict and the ensuing blockade. Financial pressures associated with the conflict were managed effectively owing to the banking system's strong liquidity position. Immediately after the conflict, donors pledged US$1.7 billion for relief and recovery (including at the Stockholm conference in August 2006), with disbursements in 2006 roughly offsetting the immediate fiscal costs of the conflict. Nonetheless, the overall fiscal deficit increased in 2006 because of rising interest expenditures and higher than expected transfers to the power company, Electricité du Liban. Government debt rose to over US$40 billion (178 percent of GDP) at end-2006.

The economic situation continues to be overshadowed by the political stalemate and episodes of violence, including the assassination of a member of parliament in June 2007 and a fifteen-week long battle between the army and Fatah al-Islam militants in northern Lebanon. In this environment, economic activity, including tourism, remains

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

subdued, and real GDP is expected to rebound only slowly in 2007. Inflation as measured by the Consumer Price Index declined through mid-2007 from its 2006 peak, notwithstanding the depreciation of the U.S. dollar to which the currency is pegged. Trade flows have recovered from the near- standstill during and after the conflict, with the trade deficit in the first half of 2007 deteriorating slightly relative to the same period in 2006.

The financial system has remained resilient to the political uncertainty. Owing to moderate capital inflows and slow deposit growth as well as limited donor disbursements, international reserves declined by US$300 million to US$11 billion in the first quarter. However, deposit growth accelerated subsequently, and by end-June broad money was already 4½ percent higher than prior to the conflict with Israel, with international reserves more than recovering to US$11.6 billion at end-June 2007. Still, the political deadlock has increased risks, as reflected by Eurobond spreads of 495 basis points as of end-August and deposit dollarization of around 76 percent, significantly higher than prior to the 2006 conflict. The recent turbulence in international financial markets has not had, up to now, a significant impact on Lebanon. While spreads have increased by around 80 basis points between mid-July and mid-August, there has been no pressure on the currency, and deposit inflows have remained robust, though at a more moderate pace than in the second quarter.

Executive Board Assessment

Directors commended a good policy performance under the program supported by the Fund's Emergency Post-Conflict Assistance. The economy is recovering despite the persistent high oil price and political uncertainty, inflationary pressures have eased, and gross international reserves have increased further.

At the same time, Directors underscored that major challenges remain, including the large debt overhang, financial and macroeconomic vulnerabilities, and high energy costs. They considered the authorities' 2007–12 reform program to be an ambitious and credible strategy for meeting these challenges. They acknowledged that implementation of the program will be a challenging task given the difficult political and security situation. While Directors were encouraged by the authorities' reiterated commitment to reform, they noted that the authorities will need to pay close attention to the timing of the reform process. Directors stressed that donor support is an important pillar of the reform strategy, and called for timely disbursement of such support.

Directors welcomed the authorities' success in containing the primary fiscal deficit in the first half of 2007. They emphasized the need for determined action to achieve the 2007 budget deficit target and the medium-term debt reduction objectives. In this regard, Directors commended the steps taken to initiate reforms in the social security and power sectors. They encouraged the authorities to give priority to raising gasoline excises as soon as the political situation allows.

Directors welcomed the fiscal adjustment and privatization plans for 2008. They noted the planned increases in the value-added tax and the tax on interest income in 2008, the preparations for the introduction of a global income tax in 2008, and the administrative reforms underway. Directors emphasized that further progress is needed on energy sector reforms to realize the expected medium-term expenditure savings. They supported the planned privatization of the telecom sector as crucial to the success of the reform strategy.

Directors stressed the importance of strengthening public financial management. They encouraged the authorities to follow up on their action plan to improve the cash and budget management functions. While they called for expenditure restraint, Directors advised against across-the-board expenditure cuts, and recommended that efforts focus instead on curtailing low-priority current spending rather than capital spending. Directors also emphasized the need to strengthen the social safety nets. They welcomed the establishment of a debt management office.

Directors noted that the monetary policy framework has served Lebanon well, especially in helping to maintain financial stability in the face of disruptions in international financial markets. They underscored that central bank financing of the government will need to be gradually reduced in order to safeguard the central bank’s balance sheet, and supported the authorities’ intentions to rely increasingly on market finance.

Going forward, Directors supported the planned introduction of transparent short-term monetary instruments, and underscored the importance of allowing greater interest rate flexibility in Treasury bill auctions. Directors advised that the central bank refrain from quasi-fiscal activities, and supported the establishment of a joint working group in the Ministry of Finance and the central bank to better coordinate interventions in the financial market.

Directors considered that the exchange rate peg to the U.S. dollar has helped maintain financial stability without impairing competitiveness. They noted that gross international reserves, combined with the banking system’s liquidity cushion, appear to be sufficient to meet temporary pressures on the exchange rate. Directors agreed that the real effective exchange rate appears broadly in line with fundamentals. Going forward, Directors stressed that continued sound macroeconomic policies and structural reforms, particularly full implementation of fiscal adjustment plans, will be essential to support the exchange rate peg.

Directors noted that the banking sector, though profitable and well capitalized, faces vulnerabilities associated with high sovereign exposure, maturity mismatches, and the high degree of dollarization. They agreed that a reduction in the government debt will be crucial to reduce these vulnerabilities, but also emphasized the need to strengthen risk management, diversify loan portfolios, and enhance cross-border supervision. Directors welcomed commercial banks' readiness to adopt Basel II requirements in 2008.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Lebanon: Selected Economic Indicators, 2003–08

	2003 Act.	2004 Act.	2005 Act.	2006 Prel. Act.	2007 Proj.	2008 Proj.
Domestic economy	(In percent)					
Change in real GDP	4.1	7.4	1.0	0.0	2.0	3.5
Change in consumer prices (period average) 1/	1.3	1.7	-0.7	5.6	3.5	2.5
External economy	(In billions of U.S. dollars; unless otherwise indicated)					
Exports, f.o.b.	1.7	2.1	2.3	2.8	3.2	3.6
Imports, f.o.b.	-6.5	-8.5	-8.4	-8.5	-10.0	-10.8
Current account balance	-2.6	-3.3	-2.9	-1.4	-2.5	-2.4
In percent of GDP	-13.2	-15.5	-13.6	-6.2	-10.6	-9.4
Capital and financial account balance	5.7	4.3	2.0	2.0	0.7	3.2
Overall balance	3.0	-0.7	0.0	1.7	-1.8	0.8
Gross official reserves, exc. Gold	10.3	9.6	9.6	11.4	11.1	12.3
Change in real effective exchange rate (in percent)	-10.7	-6.8	-4.1	2.2	...	...
Financial variables	(In percent of GDP; unless otherwise indicated)					
Budget balance 1/	-13.3	-8.6	-8.4	-11.1	-12.2	-9.1
Gross government debt	169	167	179	178	173	143
Of which: in foreign currency	78.7	85.6	88.9	89.9	90.2	79.0
Change in broad money 2/	15.5	12.3	3.5	6.4	5.0	5.0
Two-year Lebanese pound treasury bill rate 3/	8.0	7.9	8.5	8.7	8.7	8.5

Sources: Lebanese authorities; and IMF staff calculations.

1/ Overall balance, after grants, on a checks-issued basis.
2/ In percent, end-of-period.
3/ Primary market rate, in percent, end-of-period.

Statement by A. Shakour Shaalan, Executive Director for Lebanon
October 3, 2007

1. On behalf of the Lebanese authorities, I would like to express my appreciation to the staff, Management, and the Executive Board for their continued constructive engagement with Lebanon. The authorities view the consultation process, as well as the continued provision of technical assistance, as being of great value to the country.

2. The authorities remain committed to their ambitious medium-term reform program, which was presented to donors at the Paris III conference in January 2007. The program, developed in close cooperation with the Fund, aims at raising growth, improving living standards, and reducing Lebanon's large debt overhang and financial vulnerabilities, while carefully considering the timing of adjustment measures, given the current difficult post-war environment. The program includes a strong phased fiscal adjustment which, along with privatization proceeds and Paris III contributions, should gradually strengthen the primary balance and result in a significant reduction in the debt-to-GDP ratio over the medium term. The institutional structure that the government has put in place to monitor the implementation of the Paris III program aims at ensuring sustainability of the reform momentum generated under Paris III. The authorities acknowledge, however, that proper implementation of the program remains subject to improved political and security conditions.

Recent Developments

3. The current year continues to be particularly difficult, with persistent serious political tension and security concerns ahead of the presidential election, which is expected to be held by November 2007. Notwithstanding the daunting political and security challenges, economic indicators point to a slow recovery from the 2006 Israeli attack on Lebanon. Real GDP is expected to rebound to about 2 percent in 2007. CPI inflation is projected to fall to around 2 percent by year's end, following price pressures in the summer of 2006, due to supply shortages related to the war and the subsequent blockade. The financial system remains resilient. Gross international reserves recovered to about $12 billion at end-August, supported by strong deposit inflows. Moreover, trade flows have resumed after an interruption occasioned by the 2006 war.

4. Against this background, the authorities continue to consider the Fund-supported Emergency Post-Conflict Assistance (EPCA) to be critical in supporting their efforts to implement the 2007 agenda, thereby paving the way for more ambitious fiscal adjustment and structural reforms in subsequent years. Performance under the EPCA was strong, with all end-March 2007 quantitative targets observed, with the exception of the ceiling on government borrowing from the Banque du Liban (BdL), which was exceeded by a small margin. Indeed, in the first months of 2007, the government had to solicit further direct financing from the BdL, amidst serious political tensions and ensuing tight market

conditions, as commercial banks failed to roll over maturing government paper. Moreover, all the quantitative targets for the second quarter of 2007 were observed with large margins.

5. Economic policy and performance in the first half of 2007, particularly the strong revenue collection and continued expenditure restraint, augur well for the achievement of the program's end-year quantitative fiscal targets. However, actual disbursements of pledges committed at the Paris III and Stockholm conferences have so far fallen well below EPCA assumptions. While of the total US$7.6 billion pledged at the Paris III conference, agreements have been signed for about US$3.4 billion, out of US$1.6 billion in budgetary support pledged for 2007, only US$0.6–0.9 billion is likely to be received this year. At the same time, US$175 million has been disbursed to date and a US$100 million World Bank Development Policy Loan is in the process of being disbursed. Should disbursement fail to accelerate considerably in the last quarter of 2007 in line with Paris III pledges, the authorities would find it extremely difficult to identify additional fiscal measures to offset the resulting sizable shortfall, as rightly pointed out by staff. This outcome would weigh on the government's indebtedness.

6. Notwithstanding their strong commitment to the objectives of the EPCA and the medium-term reform agenda, the authorities are aware of persistent vulnerabilities. In the short-term, the economy remains vulnerable to swings in confidence. Moreover, the political deadlock has increased risks, as reflected by Eurobond spreads and deposit dollarization, which remain higher than prior to the 2006 war. Looking ahead, despite the strong fiscal adjustment and structural reforms embedded in the authorities' program to bring down the debt-to-GDP ratio significantly, the debt dynamics are likely to remain fragile and vulnerabilities high. Accordingly, in addition to the commitment of the authorities to pursue their ambitious reform agenda under the EPCA and beyond, continued strong international support remains essential to help Lebanon reduce its economic vulnerabilities. In particular, it is important that donors fully carry through their financial commitments made at the Paris III conference, in a timely fashion, and in line with the authorities' macroeconomic objectives and policy priorities. The authorities continue to actively seek flexibility from donors to convert project loans pledges into budgetary support to further reduce the debt burden. They are particularly grateful for the Fund's assistance in this regard.

Fiscal Policy and Reforms

7. Sound fiscal management to date in 2007 succeeded not only in avoiding a deterioration in the fiscal position, but also in improving the primary balance, while attempting to meet the large social and reconstruction needs of the Lebanese population. The first and second quarter performance was within the EPCA targets. Stronger than projected revenue collection, and containment of expenditures below the EPCA targets, helped contain the primary deficit and the accumulation of net debt. Moreover, the cabinet approved the draft budget for 2007, which includes the foreign financed component of the Council of Development and Reconstruction and activities of the Higher Relief Council.

8. In spite of unanticipated and sizeable conflict-related expenditure, the primary budget deficit, excluding grants, is expected to be contained at 3.7 percent of GDP at end-2007, as programmed, supported by higher than projected revenues. On the revenue front, the authorities remain committed to introducing a floor on gasoline excises of $0.20 per liter. Given the continued political instability, however, implementation of this measure may have to be postponed until after the presidential elections. Uncapping domestic gasoline prices in a context of high international oil prices would translate in a substantial hike in gasoline retail prices, which, in the present political and economic environment, may seriously exacerbate existing tensions. It is well to note that delaying implementation of this measure will not jeopardize the primary balance target for 2007, as envisaged under the EPCA. Indeed, the potential loss stemming form a delayed introduction of a floor on gasoline excises has already been largely compensated for by increases in other sources of revenue, including VAT, customs, income tax, and telecom transfer. Preliminary estimates indicate that the end-September 2007 revenue performance already exceeds the end-of-year target under the EPCA. The authorities have also requested technical assistance from the Fund to prepare for the removal of various subsidies and the liberalization of gasoline prices.

9. Important progress has been achieved in preparing the fiscal adjustment effort envisaged for 2008. On the revenue side, the draft 2007 budget already provides for increasing the value-added tax rate and the tax on interest income as of 2008. The draft Global Income Tax law is near completion and should be ready for submission to parliament by year end. In addition, the review of the Tax Procedure Code has been finalized by the parliamentary committees, and is awaiting ratification by Parliament. Ongoing revenue administration reforms, including the introduction of a medium taxpayer office, new audit procedures, and the update of the real estate tax database, are expected to yield revenue gains. On the expenditure side, the authorities' medium-term program aims at gradually eliminating transfers to the public sector, which hinges on reforming the energy and social sectors that have drained budget resources over the years. In this connection, and in close cooperation with the World Bank, reform plans for Electricité du Liban (EdL) and the

National Social Security Fund (NSSF) are being finalized.[1] Administrative measures include better cooperation and information sharing across ministries and the planned establishment of a debt management office, in addition to measures aimed at strengthening treasury and debt management capabilities. The authorities have achieved further progress in implementing the public financial management reform plan developed with Fund assistance, and aimed at enhancing budget monitoring and control procedures. A pilot project for program budgeting at the Ministry of Public Health was also introduced in the draft 2008 budget.

Monetary Policy and Banking Sector Policies and Reforms

10. The monetary policy framework has enabled the authorities to effectively control financial pressures. The exchange rate peg continues to serve the economy well by providing a firm anchor to financial stability. It proved crucial given balance sheet risks related to widespread dollarization and the government's high foreign currency debt servicing obligations. The debt overhang and the large external current account deficits are the counterpart of fiscal imbalances, as well as temporary factors related to the post-conflict environment. They would be addressed by implementing the Paris III fiscal adjustment program. In this context, the authorities are of the view that the current exchange level is appropriate, and agree with staff's assessment outlined in Box 3. Furthermore, they are confident that Lebanon's competitiveness could significantly benefit over the medium term from the planned structural reforms.

11. Interest rate stability has largely contributed to facing financial pressures, reflected in higher dollarization and pressures in the foreign exchange market. Admittedly, these conditions have required the BdL to occasionally resort to various financial and long-term monetary instruments to manage liquidity and safeguard international reserves. These included the issuance of dollar-denominated certificate of deposits, special discount windows, and swaps. While the authorities believe that the BdL could temporarily provide financing to the government under tight market conditions, in line with its mandate to maintain financial stability, they concur with staff that prolonged shortfalls in market demand for government paper would have to be met by raising treasury bills rates. The authorities are of the view that flexible interest rates are essential to counter further increases in dollarization, which might adversely affect the central bank's foreign reserves levels. They consider that an appropriate spread between returns on foreign currency and Lebanese

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[1] Key progress has been achieved in reforming EdL, including: (i) the appointment of an auditor for the 2002-2006 fiscal years, and the publication of the audited 2001 financial statements; (ii) the appointment of international consultants at the Ministry of Energy and Water, EdL and the Higher Council for Privatization, to assist in implementing the restructuring of the electricity sector; (iii) the appointment of a transaction advisor for the sale of Beddawi power plant in Northern Lebanon and the investment in new capacity by the private sector; (iv) the signature of an agreement with Egypt for the import of Natural Gas to the Beddawi power plant in the North; and (v) the appointment of a consultant to prepare a generation and transmission Master Plan for the energy sector.

pounds in the domestic market should thus be assured in order for commercial banks to subscribe in government paper. On the current account level, an adequate spread between domestic returns on dollar investments and international rates would help ensure the necessary inflows of capital into the economy. The authorities are of the view, however, that an upward adjustment in domestic interest rates at this stage may not attract sufficient market financing given the existing uncertainties, and thus have an adverse signaling effect. Once more stable and predictable market conditions prevail, the central bank should be in a better position to maintain price stability using short-term monetary instruments. This would help strengthen its balance sheet and reduce its cash losses. Going forward, fiscal adjustment and improved confidence would help reduce dollarization, which would facilitate a further buildup of net international reserves and strengthen the BdL's income position. Improved political and security conditions, however, remain essential to the reform of the monetary policy framework.

12. The banking sector remains profitable, well-capitalized, and well-supervised. However, vulnerabilities are high, as reflected in domestic bank's high exposure to the sovereign, the substantial maturity mismatch on their books, as well as the high degree of dollarization which exposes them to credit risk. In this context, and given potential systemic risks between the fiscal and the financial sector, the authorities welcome the commercial banks' focus on private sector lending and their strategy of regional diversification. The regulatory and supervisory framework has appropriately adapted to these developments. This is evidenced in the circular issued by the banking control commission in 2006, raising the limits on the exposure of Lebanese banks to non-resident borrowers, and the progress in developing memoranda of understanding on consolidated supervision with supervisory authorities in countries where Lebanese banks are expanding. Commercial banks are expected to further strengthen risk management with the introduction of Basel II standards in 2008.

Other Structural Reforms

13. Reforming the social and energy sectors, which have drained the government's financial resources for years, is pivotal to the medium-term structural reform agenda. Reforms to address imbalances, and possible contingent liabilities, in the pension and health system are being developed. A draft pension law, providing for transforming the private pension systems from an end-of-service allowance to a fully funded system, has been submitted to parliament. Furthermore, the authorities, supported by the World Bank, are looking into options for addressing the losses of the health fund of the NSSF. The government is currently finalizing a comprehensive energy sector reform plan in close cooperation with the World Bank, with the objective of restructuring EdL to pave the way for partial privatization. The main reform measures envisaged for 2008 include: (i) the completion of an audit of EdL accounts for 2002–2006, (ii) the completion of EdL's asset registration and valuation, (iii) the corporatization of the company, (iv) the launch of a pilot project for remote meter installation and distribution management by private operators,

(v) launching the privatization of the Beddawi power plant, and (vi) soliciting private sector investment in new capacity.

14. The privatization of the telecommunications sector is expected to start as early as October 2007. A legal opinion by the ministry of justice concluded that the law for the sale of the fixed assets of the two state-owned mobile phone operators was no longer necessary. Accordingly, the government expects that invitations for expressions of interest for the two companies to be issued by the end of 2007. The authorities are committed to undertaking the privatization of the mobile sector companies through a transparent public offering. The privatization of the fixed line, as well as a third mobile license, are planned to be launched in 2008.

15. In conclusion, looking forward, for the reform agenda for 2008 and beyond to be successfully implemented, three critical conditions have to be met. First, a satisfactory outcome of the current ongoing presidential elections. Second, the international community's delivery of aid committed under Paris III. And finally, a reasonable environment of peace and security in Lebanon and the region as a whole.