

**FOR
AGENDA**

SM/02/374

CONTAINS CONFIDENTIAL
INFORMATION

December 6, 2002

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Lebanon—Staff Report for the 2002 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2002 Article IV consultation with Lebanon, which is tentatively scheduled for discussion on **Friday, December 20, 2002**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Lebanon indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Furtado (ext. 38423) and Mr. Erickson von Allmen (ext. 34764) in MED.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Commission and the Islamic Development Bank, following its consideration by the Executive Board.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

LEBANON

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation with Lebanon

Approved by George T. Abed and Mark Allen

December 6, 2002

Contents	Page
Executive Summary	3
I. Introduction	4
II. Background	4
A. Growth and Inflation	6
B. Fiscal Developments	7
C. Monetary and Financial Sector Developments	9
D. Developments in the Balance of Payments	13
III. Policy Discussions	14
A. The Authorities' Strategy	14
Fiscal policy	15
Financing and debt management	17
Monetary and exchange rate policies	19
B. Medium-Term Scenario and Debt Sustainability	20
Sensitivity analysis	22
C. Trade Policy	23
D. Poverty	24
E. Data Issues	24
IV. Staff Appraisal	25

Text Boxes

1.	Net Present Value (NPV) Effects of the Government's Strategy for Reducing Debt.....	21
----	--	----

Figures

1.	Credit to the Government.....	8
2.	M3 Growth and Dollarization.....	10
3.	International Reserves of the BdL.....	11
4.	Nominal and Real Effective Exchange Rates	14
5.	Debt Sustainability Analysis.....	23

Tables

1.	Summary of Macroeconomic Framework, 1999–2007	28
2.	Central Government Operations, 1999–2007	29
3.	Central Government Debt, 1999–2007.....	31
4.	Monetary Survey, 1999–2002	32
5.	Balance Sheet of the Banque du Liban, 1999–2002	33
6.	Balance Sheet of Commercial Banks, 1999–2002.....	34
7.	Banking Sector Macro-Prudential Indicators, 1998–2002.....	35
8.	Summary Balance of Payments, 1999–2007.....	36
9.	Indicators of Financial and External Vulnerability, 1998–2002	37
10.	Public Debt Sustainability Framework, 2001–07	39

Appendices

I.	Fund Relations	40
II.	Relations with the World Bank Group.....	43
III.	Statistical Issues	48
IV.	Public Information Notice (PIN).....	51

Executive Summary

Background—Years of high fiscal deficits and slow growth have led to a burgeoning public debt burden. Reducing the public debt (now at 183 percent of GDP) is the main economic policy challenge.

Growth and inflation—Economic growth picked up modestly in 2001–02 because of large foreign direct investment inflows into real estate and a strong tourism season this summer. Domestic demand continues to be subdued, however, due in large part to high real interest rates. Inflation remains low.

Fiscal policy in 2001–02—The overall fiscal deficit of the central government declined from 24.6 percent of GDP in 2000 to 19.4 percent in 2001 and is projected to be reduced to 15.6 percent in 2002. In 2002, the primary fiscal position is expected to improve by close to 5 percent of GDP. Most of the adjustment was achieved through a sharp reduction in spending in 2001 and the introduction of the VAT in February.

Monetary developments—The twelve-month growth rate of M3 declined from 7.4 percent in December 2001 to 3.6 percent in July 2002, but has since picked up to 6.3 percent. The dollarization of M3 rose in the first part of 2002, peaking at 70 percent in May, but has since come down to 67 percent. The Banque du Liban (BdL), which had financed almost the entire fiscal deficit in 2001, came under severe pressure in the first half of 2002 as banks did not fully roll over their treasury bills, because of the weakening in money demand and increase in dollarization. With a fixed exchange rate, the BdL lost substantial amounts of foreign exchange reserves. The recent improvements in money demand and foreign exchange market sentiment have allowed the BdL to strengthen somewhat its reserve position. Nonetheless, in January–October 2002, the BdL's gross reserves (excluding gold) and net reserves fell by about \$800 million, to \$3.6 billion and minus \$2.1 billion, respectively.

Bank soundness—Nonperforming loans have risen in recent years, but banks remain generally well provisioned and capitalized. Banks remain highly exposed to government debt, which accounts for about one-third of their assets.

The authorities' medium-term strategy—The authorities' strategy to reduce the government debt and restore sustainable economic growth over the medium term is based on continued fiscal adjustment (the draft 2003 budget seeks a primary surplus of 4.2 percent of GDP, which would be raised to 9.1 percent by 2007), large-scale privatization, concessional external financing, and a partial restructuring of the government debt held by the BdL. The privatization proceeds would allow for a reduction in the stock of debt. A portion of the remaining debt would be replaced by lower interest/longer maturity concessional loans from official creditors. Improved confidence, together with the infusion of liquidity caused by the inflows and the retirement of domestic debt, is expected to lead to a substantial decline in real interest rates, further reducing the interest burden and setting the stage for a recovery in economic growth.

Staff appraisal—The staff takes note of the significant fiscal adjustment already achieved. With respect to the authorities' strategy, the staff is of the view that if fully realized, it could lead to a decline in the public debt ratio over the medium term but the debt would remain high for several years. The strategy is very challenging and depends critically on implementation of a very ambitious privatization program, substantial amounts of concessional financing, and relentless fiscal adjustment.

I. INTRODUCTION

1. **Discussions for the 2002 Article IV consultation were held in Beirut during October 10–24, 2002.**¹ The mission met with the Governor of the Banque du Liban (BdL), the Ministers of Finance, Economy and Trade, and Labor; and other senior officials and private sector representatives.² In concluding the last consultation on October 17, 2001, Executive Directors expressed serious concerns about the vulnerability of the economy and the sustainability of the existing policies, pointing to the slow growth, the very large fiscal deficit and associated stock of public debt, the real appreciation of the currency, and the major loss of foreign exchange reserves. Directors urged the authorities to develop a comprehensive strategy to reduce the debt.

2. **Lebanon operates a liberal exchange system and has never made use of Fund resources.** It accepted the obligations of Article VIII, Sections 2, 3, and 4 in 1993, and maintains an exchange system free of restrictions on payments and transfers for current international transactions; restrictions on capital account transactions are minor.³ The coverage of macroeconomic statistics is very poor and hinders effective policy formulation and monitoring of economic developments, notably because of the lack of national accounts and price statistics, and gaps in the data on external transactions. In the context of efforts to address these deficiencies, Lebanon has decided to participate in the General Data Dissemination System (GDDS).

II. BACKGROUND

3. **The key focus of Fund surveillance in recent years has been on policies to reduce Lebanon's large fiscal deficits and address the rapidly growing government debt burden, improve competitiveness and bolster economic growth.** The need for fiscal adjustment to stabilize debt dynamics and reduce real interest rates has been a recurring theme in every Article IV consultation since 1994, and was the main topic of the 2001 consultation. While some fiscal consolidation was achieved in 1998–99, it was reversed in 2000, and it is only in the past two years that policies have begun to be put in place for a sustained reduction in the fiscal deficit. Nevertheless, the 2001 consultation expressed concern that the planned fiscal adjustment would still leave the debt ratio very high. On exchange rate policy, while the consultations have acknowledged the benefits of the fixed exchange rate in terms of price

¹ The mission team comprised Messrs. Furtado (head) and Erickson von Allmen, and Ms. Choueiri (all MED); Ms. Basu (MAE); Mr. Mottu (FAD); Mr. Rosenberg (PDR); and Mr. Srinivasan (ICM). Mr. Abed participated in the concluding policy discussions, some of which were also attended by Messrs. Shaalan and Bakhache (OED).

² Mr. Abed also met with the President, the Prime Minister, and the Speaker of the Parliament. Additional discussions were held in Washington between Fund management, senior staff, and Prime Minister Hariri and members of his economic team on November 4–5, and again on November 18–19.

³ Relations with the Fund are summarized in Appendix I and those with the World Bank group in Appendix II.

stability, the staff has expressed concern over the strong real appreciation of the pound in recent years and its harmful effects on export and GDP growth. It also argued that the peg has contributed to the high real interest rates, which in turn have stifled growth and investment. In addition to these arguments, the 2001 consultation also suggested that an exchange rate adjustment could help reduce the real burden of the public debt, while noting the risks of such a strategy for the banking system. The authorities have consistently argued that an exchange rate action would be highly destabilizing. To stimulate economic growth, recent consultations have also emphasized the need for structural reforms—an area where the authorities have made considerable progress in recent years, especially in trade liberalization, deregulation, and preparations for privatization.

4. **Macroeconomic conditions became increasingly difficult in 2001 and the first half of 2002.**⁴ Economic growth remained slow, despite some pickup in 2001, in the context of low inflation and high real interest rates. The government debt, built up over a decade of double digit fiscal deficits, reached over \$31 billion, or 183 percent of GDP in October 2002, of which 56 percent is owed to local banks. In the last two and a half years, despite a significant fiscal adjustment, the government has found it increasingly difficult to finance its deficit and has had to rely heavily on central bank credit. The BdL, having financed almost the entire deficit in 2001, came under additional pressure in the first half of 2002 as commercial banks, faced with a decline in deposits and increased deposit dollarization, did not roll over fully their treasury bill holdings. In the context of a fixed exchange rate and weak money demand, the BdL suffered heavy losses of foreign exchange reserves. Spreads on Lebanese Eurobonds in the secondary market rose to over 1,000 basis points, and remained there through end-November 2002.

5. **Since June 2002, economic performance and confidence have improved, but the underlying macroeconomic situation remains very adverse and vulnerable to shifts in sentiment.** Several factors have contributed to this more favorable situation, notably renewed regional interest in Lebanon for portfolio and real estate investments, and as a tourist destination. As a result, economic activity appears to have picked up, M3 growth has resumed, and the balance of payments has recorded a large surplus. Much of this turnaround is attributable to a change in Arab investment and travel behavior post 9-11. However, developments on the domestic front might also have played a role—including the successful introduction of the VAT in February (which signaled the start of tangible fiscal adjustment); the delisting of Lebanon by the FATF in June; approval of three laws in the summer enabling the initiation of the privatization program in the telecommunications and power sectors; and the timely adoption of a budget proposal for 2003 that aims at significant deficit reduction. The approval of privatization laws was particularly important as it signified a consensus among the President, the Prime Minister, and the Speaker of the Parliament over this key element of the government's economic strategy. Confidence may also have been helped by substantial sales

⁴ For a description of developments in preceding years, see the Board documents for the 2001 Article IV consultation (EBS/01/162 and SM/01/280).

of Eurobonds abroad, and announcements relating to the meeting of international donors (Paris II).⁵

A. Growth and Inflation

6. **Available indicators suggest that the modest recovery that began in 2001 has been sustained in 2002.** Although the absence of national accounts data seriously hampers the assessment of economic developments, growth seems to have picked up in 2001–02, mainly because of external factors, whereas domestic demand has remained subdued. Export growth has been strong, albeit from a small base. Large investments from Arab countries in hotel and residential construction⁶ led to strong recovery in construction activity in 2001 that has continued in 2002, albeit at a somewhat slower pace. In 2002, Lebanon enjoyed a record tourism season—tourism receipts are estimated to be about 60 percent higher than in 2001. However, domestic demand has remained weak, with the high real interest rates continuing to depress domestic private investment. Demand has also been affected by the ongoing fiscal adjustment, in particular the reduction in public investment. On balance, mainly because of the recovery in construction and strong tourism season, real GDP growth is estimated at 2 percent in both 2001 and 2002 (Table 1).⁷

Lebanon: Selected Economic Indicators

	1998	1999	2000	2001	Proj. 2002
Real GDP growth	3.0	1.0	-0.5	2.0	2.0
Inflation (twelve-month change in percent)	4.5	-2.7	-1.6	-0.1	4.7
Overall fiscal balance (in percent of GDP)	-18.1	-16.2	-24.6	-19.4	-15.6
Of which: primary balance	-4.5	-1.6	-7.6	-2.3	2.6
Gross public debt (in percent of GDP)	114.1	135.2	152.3	169.9	184.2
Debt owed to the Banque du Liban	1.2	0.5	8.0	27.1	23.7
Debt owed to other public institutions	7.4	8.8	11.0	12.2	12.4
Other debt	105.6	125.9	133.2	130.7	148.1
Of which: in foreign currency	26.1	35.3	44.9	59.4	66.1
M3 growth (12-month change in percent)	16.1	11.1	9.6	7.4	6.2
Current account balance (in percent of GDP)	-27.1	-20.0	-18.7	-21.9	-14.8
Gross international reserves (billions of U.S. dollars)	6,508	7,727	5,895	4,402	3,898
Net international reserves (billions of U.S. dollars)	3,330	4,980	2,615	-1,325	-1,900

Sources: Lebanese authorities and Fund staff estimates and projections. See Tables 1-9 for definitions.

⁵ See paragraph 29.

⁶ Real estate investments were spurred by a new real estate law, approved by parliament in March 2001, which eased the legal limits on foreign ownership of property and lowered real estate registration fees.

⁷ Given the lack of national accounts data, these estimates are clearly surrounded by a great deal of uncertainty.

7. **The consumer price index rose in the first quarter of 2002, but trend inflation has remained low.** Consumer price inflation was negative in 2000–01, reflecting the stagnant economy, the appreciation of the nominal effective exchange rate, and a cut in import tariffs in December 2000. In the first eight months of 2002, the CPI rose by 8.3 percent on account of the one-time effect of the 10 percent VAT introduced in February. The twelve-month rate of change through August was only 1.2 percent, however, because of the sharp price deflation in the fourth quarter of 2001.

B. Fiscal Developments

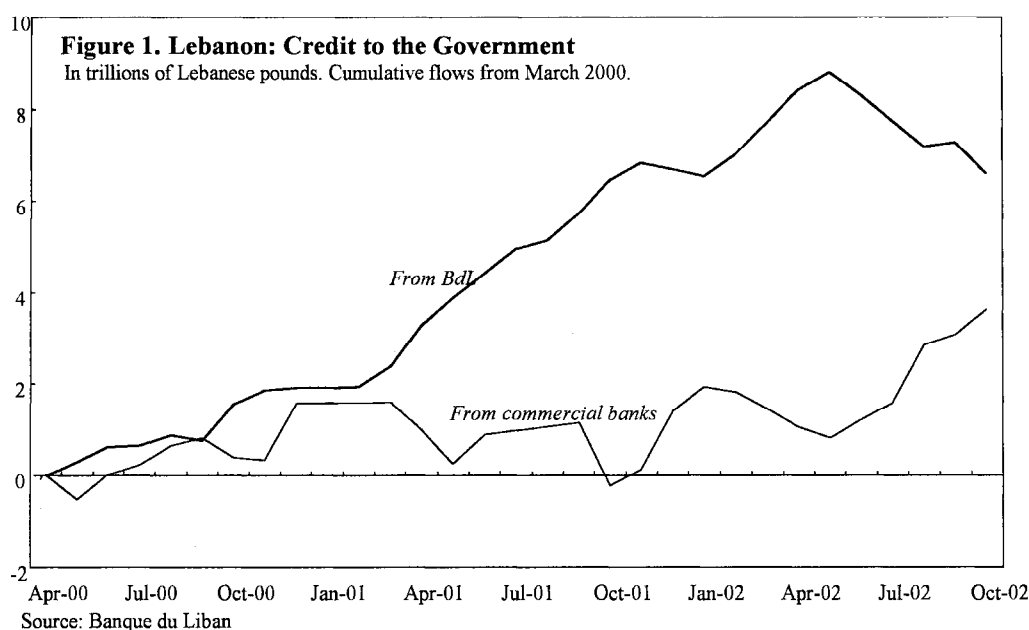
8. **Following a reduction in 2001, the overall fiscal deficit is projected to decline further in 2002 but continues to be very high.** The overall fiscal deficit declined from 24.6 percent of GDP in 2000 to 19.4 percent of GDP in 2001 and, based on the performance in the first three quarters, is projected to be reduced to 15.6 percent in 2002, despite a continuing increase in interest payments (Table 2).⁸ In 2002, the primary fiscal position is expected to improve by close to 5 percent of GDP. Most of the adjustment in 2001 was achieved through a sharp reduction in extra-budgetary (treasury) spending, lower transfers to the state-owned electricity company Electricité du Liban (EdL), and the containment of capital spending.⁹ The primary adjustment in 2002 has been mostly on the revenue side, with the VAT introduced in February 2002 with Fund technical assistance, yielding an estimated 3.6 percent of GDP. In addition to the VAT, income taxes are performing strongly—owing to improvements in the administration of withholding taxes on wages and salaries, computerization of the collection of tax arrears, and regularization of past taxes due. On the expenditure side, both discretionary (nonwage) current primary spending and capital outlays have continued to be contained.

9. **During 2001 and the first half of 2002, available market financing fell far short of the fiscal financing requirements, and the government relied heavily on credit from the BdL (Figure 1).** The government continued to have little access to international capital markets, and in 2001 and the first half of 2002, the capacity and willingness of local banks to take on more government debt were constrained by slowing deposit growth and growing concerns over the state of public finances. In 2001, the BdL financed close to 90 percent of the

⁸ On a checks-issued basis, including externally financed capital expenditure and expenditure financed by arrears. The data on a checks-issued basis may overstate the extent of the expenditure increase in 2000 and the subsequent reduction in 2001 because a large volume of checks was issued in late 2000 but not cleared until early 2001, which created a commensurate discrepancy between the deficits measured from above and below the line. The issue is mainly one of timing, though, rather than substance. On the basis of financing data, the overall deficit rose only to 21.7 percent of GDP in 2000 and remained at 21.9 percent of GDP in 2001.

⁹ During the second half of 2001 and the first four months of 2002, liquidity pressures led to the emergence of payments arrears to contractors and private hospitals, estimated at about 2.3 percent of GDP. These arrears were settled starting in May 2002 with the issuance of \$350 million in Eurobonds which were given to creditors instead of cash. In staff's fiscal accounts, the expenditures financed by arrears are imputed to the years in which they were incurred (about 1.6 percent of GDP in 2001 and 0.7 percent of GDP in 2002).

government's net financing requirement, and its holding of government debt rose to the equivalent of 27 percent of GDP (from 8 percent at end-2000). BdL credit to government rose further to 33 percent of GDP by June 2002. However, starting in June 2002, a recovery in local currency deposits (see below) has led to an increase in banks' demand for treasury bills, allowing the BdL to reduce its own holdings. Furthermore, the BdL has been able to sell about \$1.3 billion from its portfolio of Eurobonds (part of this, reportedly, to official creditors). For the period January–September as a whole, 43 percent of the government's net financing requirement (equivalent to \$2.2 billion) was met by the domestic commercial banks, only about 15 percent by the BdL, and the remainder by nonresidents and nonbank domestic investors. At end-October 2002, the BdL's holdings of government debt amounted to 26 percent of GDP.



10. After years of high fiscal deficits and slow growth, the gross government debt has reached the equivalent of \$31.4 billion, or 183 percent of GDP in October 2002, up from 170 percent at end-2001 and 152 percent at end-2000 (Table 3). Debt owed to creditors other than the BdL and public institutions (mainly the National Social Security Fund and the National Deposit Insurance Fund) amounted to 145 percent of GDP in October, up from 131 percent at end-2001. Due to a policy over the last two years of replacing domestic currency debt with lower interest dollar-denominated debt, 46 percent of the debt held outside of the public entities is now denominated in foreign currency, compared with 34 percent at end-2000. The government debt held by nonresidents is estimated at about 31 percent of GDP.

Lebanon: Public Debt

	1998	1999	2000	2001	Oct. 2002
	(In percent of GDP)				
Gross public debt	113.6	135.2	152.3	169.7	182.8
Of which: in foreign currency	25.6	35.3	45.9	61.4	74.3
Debt owed to the Banque du Liban and other public institutions	8.5	9.3	19.1	39.2	37.6
Other debt	105.1	125.9	133.2	130.5	145.1
Of which: in foreign currency	25.6	35.3	44.9	59.2	67.1
Debt with maturity up to one year 1/	18.2	22.3	24.7	15.8	12.5

Sources: Lebanese authorities and Fund staff estimates and projections. See Tables 1-9 for definitions.

1/ Original maturity.

11. **The financial situation of the National Social Security Fund (NSSF) has weakened following a reduction in contribution rates and extension of benefits in April 2001.** Based on preliminary data, the overall surplus of NSSF declined from 2.1 percent of GDP in 2000 to 0.9 percent of GDP in 2001. The full-year impact of the April 2001 measures is expected to cause a further decline in the overall surplus to 0.8 percent of GDP in 2002. The NSSF is facing long-standing problems related to collection of contributions and expenditure control.

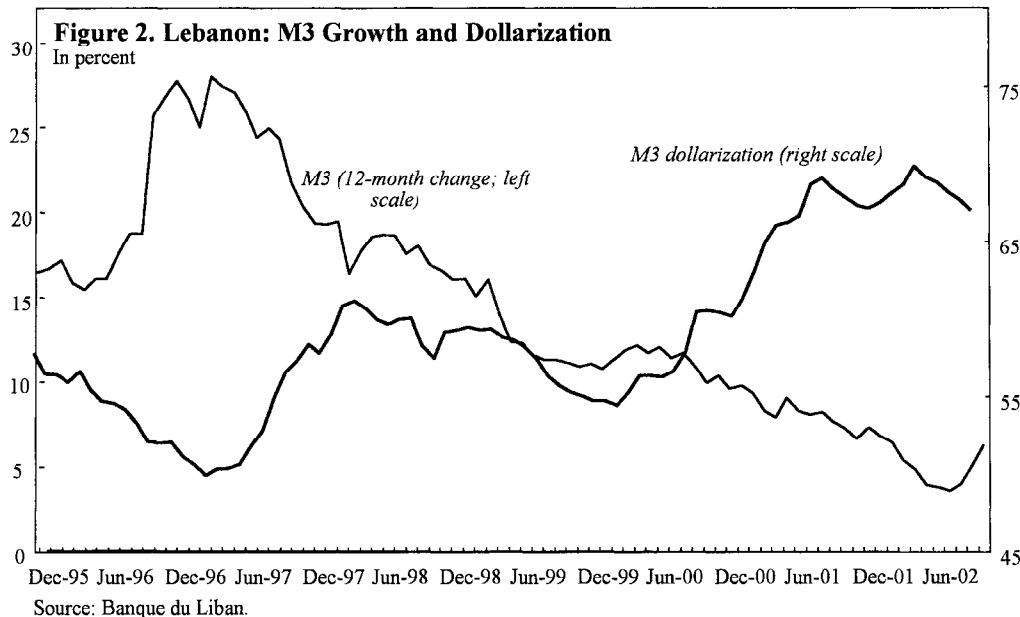
C. Monetary and Financial Sector Developments

12. **The growth of broad money continued to decelerate through the first half of 2002 but has picked up since July.** The twelve-month growth rate of M3 declined from 7.4 percent in December 2001 to 3.6 percent in July 2002, with the level of M3 actually declining (by 0.8 percent) during the first five months of 2002 (Table 4-6 and Figure 2). With the recovery since July, the twelve-month M3 growth rate reached 6.3 percent in October. The U.S. dollar share of M3 rose in the first part of 2002, peaking at 70 percent in May, but has since come down to 67 percent in October.¹⁰ In 2002, banks have extended credit to the government and accumulated net foreign assets (NFA), while credit to the private sector has declined in real terms.¹¹ Notwithstanding the slowdown in M3 growth and increased dollarization through the first half of 2002, since late 1999 the authorities have left yields on domestic currency treasury bills unchanged (ranging from 11.2 percent for three-month bills to 14.6 percent for 24-month

¹⁰ These percentages refer to bank deposits in U.S. dollars, and exclude U.S. dollars in circulation.

¹¹ Part of the increase in banks' NFA was in response to the revision in the 10 percent statutory foreign currency liquidity requirement, which, as of February 28, 2002, is defined to exclude banks' holdings of Lebanese government Eurobonds.

bills) on concerns over the government's interest bill.¹² Bank lending and deposit rates have declined modestly in recent years, with the spread between dollar and LL interest rates remaining broadly stable.

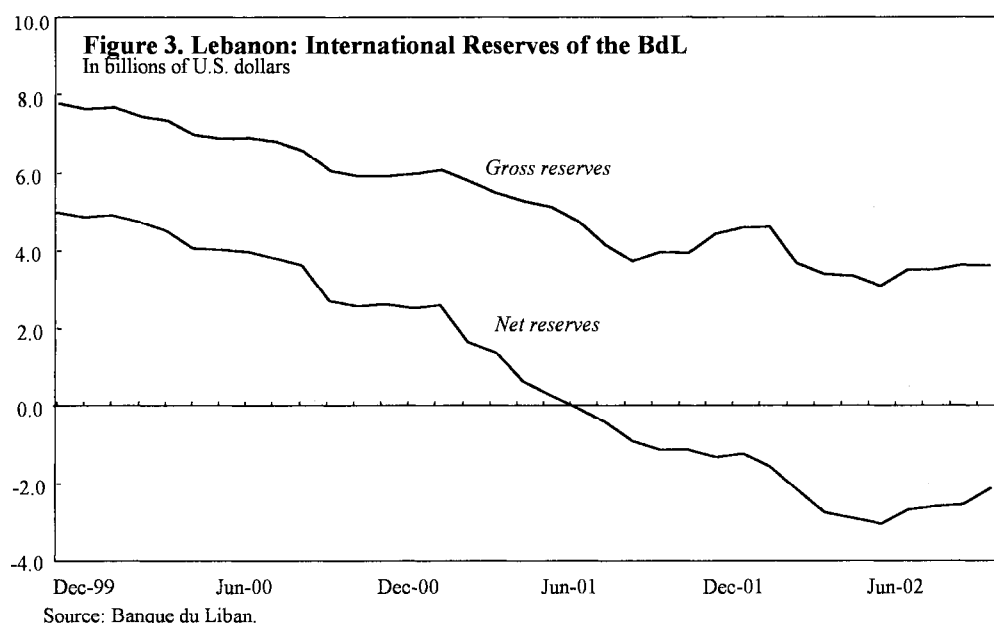


13. **Given the stance of fiscal and monetary policy, and the fixed exchange rate and open capital account, the BdL incurred large losses of foreign exchange reserves in 2000–01 and the first half of 2002, only a fraction of which has been reversed in recent months.** The expansion in BdL credit to the government equaled 80 percent of the initial stock of base money in 2000; 118 percent in 2001; and 55 percent during January–May 2002. This liquidity injection led to significant pressure in the foreign exchange market. In September 2001, in an effort to shore up its gross reserves, the BdL introduced a reserve requirement on foreign currency deposits, set at 10 percent during the last quarter of 2001, and at 15 percent as of January 1, 2002. Nonetheless, in the first five months of 2002, the BdL's foreign exchange reserves came under intensified pressure because M3 was on the decline and banks could not roll over all their treasury bills. The recent improvement in money demand and foreign exchange market sentiment has allowed the BdL to strengthen somewhat its reserve position (Figure 3). Gross reserves (excluding gold)¹³ stood at \$3.6 billion in

¹² In order to lengthen the maturity of domestic public debt, the BdL has sold in 2001–02 significant amounts of treasury bills with a 2 percent interest rate premium over the primary market rate, taking up the cost itself. Because of these costs, the BdL is projected to record a small deficit in its operating balance in 2002.

¹³ Gold holdings amount to about \$3 billion (at current market prices), but are not at the immediate disposal of the BdL.

October (10 percent of M3 or 5.8 months of imports), and net reserves (net of foreign currency deposits of banks and short-term foreign liabilities) at minus \$2.1 billion.



14. **Commercial banks remain highly exposed to government debt and nonperforming loans have continued to increase** (Table 7). The Lebanese banking sector is very large—total bank deposits (including those of nonresidents) equal about 240 percent of GDP—and highly dollarized, with 72 percent of total deposits and 83 percent of credit to the private sector being denominated in U.S. dollars.¹⁴ Commercial banks hold 56 percent of the total government debt, which represents about one-third of total bank assets and the associated interest income accounts for about 40 percent of banks' gross income. Credit to the private sector has declined in real terms in 2001–02, following years of very high growth rates. At the same time, nonperforming loans have risen from 12 percent of total loans at the end of 1998 to 26 percent in August 2002. However, despite some decline, the provisioning ratio for these loans remains high, at about 64 percent. Also, banks remain profitable and the average capital-adequacy ratio was 18.8 percent in June 2002.¹⁵

¹⁴ Banks use local currency deposits, with an average interest rate of 10.2 percent (in June 2002), predominantly to buy government treasury bills, at rates that have ranged from 11 percent to 16 percent in 2002, depending on maturity. The counterparts to dollar deposits, with an average interest rate of 4.2 percent, are mainly credit to the private sector (at 10.1 percent interest on average), net foreign assets, and Lebanese government Eurobonds.

¹⁵ This ratio is based on the standard zero risk-weighting of local currency government debt, which represents about 20 percent of banks' assets. Eurobonds are risk weighted at 20 percent for those with remaining maturity of less than one year, 30 percent for those with remaining maturity between one and three years, and 50 percent for those with maturity longer than three years.

15. The banking system is vulnerable to changes in sentiment, maturity mismatch, and indirect exchange rate risk. Although banks have recently accumulated net foreign assets, the banking system's liquid foreign exchange cover (measured as the ratio of banks' net claims on nonresident banks plus BdL's gross international reserves excluding gold and short-term foreign liabilities to total deposits) declined from 32.2 percent at end-1999 to 25.7 percent at end-2001, and to 24.1 percent in August 2002. With respect to maturity mismatch, while almost all bank deposits have a maturity of less than one year, and more than 60 percent of less than one month, only about 25 percent of banks' holdings of government paper have remaining maturities below one year, and less than 5 percent below one month. This mismatch has been aggravated by the BdL's policy to lengthen (through swaps) the maturity of the treasury bill stock, and the government's policy of replacing treasury bills with medium-term Eurobonds. Regarding exchange rate risk, banks have limited direct exposure to a devaluation (in August 2002, they had a net positive foreign currency position of just below \$900 million, or 25 percent of capital); however, banks have some indirect exposure through the corporate sector, as more than 80 percent of its bank loans are denominated in dollars.

16. Over the past several years, the authorities have addressed much of the institutional weaknesses in the banking sector, notably through a complete overhaul of the system of prudential oversight,¹⁶ and, more recently, a strengthening of the anti-money laundering framework. Recently, the Banking Control Commission (BCC) issued a circular that aims at improving credit risk management.¹⁷ With respect to money laundering, following the approval in April 2001 of the law that criminalized money laundering, the BdL took a decision requiring all banking institutions to report suspicions of criminal activity to the Special Investigative Commission (SIC). In investigating suspected money laundering activities and ascertaining observance with the anti-money laundering law, the SIC is authorized to lift banking secrecy over suspicious transactions. In June 2002, the Financial Action Task Force (FATF) dropped Lebanon from its list of non-cooperating countries. The SIC expects membership by 2003 in the Egmont group, which is an association of cooperating financial intelligence units.

¹⁶ See SM/01/281.

¹⁷ The circular, issued on October 23, 2002, and to be implemented in full from September 2003, requires, among other things, banks to report all credit exposure, including to the government; and to maintain files on their clients (including their exposure reports), financial information on corporations (including audited financial statements for the past three years); and to have independent expert appraisals of their clients' collateral. The BCC has also created a new unit to oversee corporate restructuring, particularly of large borrowers, and is in the process of mandating banks to ask large borrowers to provide consolidated group balance sheets.

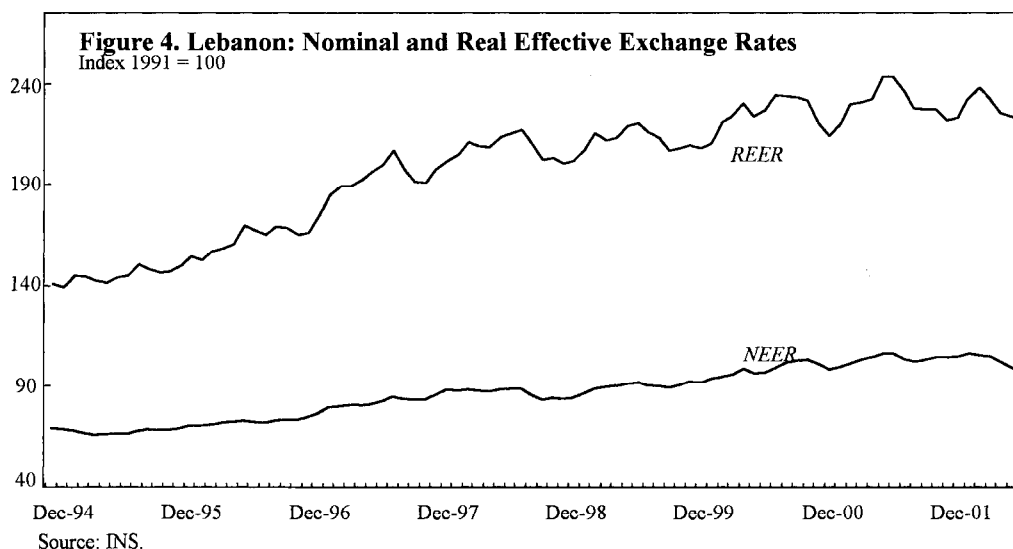
D. Developments in the Balance of Payments

17. **The overall balance of payments position deteriorated in 2001 and the first half of 2002 but improved in the third quarter** (Table 8). The current account deficit widened from 19 percent of GDP in 2000 to 21 percent (\$3.5 billion) in 2001, but has narrowed sharply, beginning in the second quarter of 2002. On this basis, the current account deficit for 2002 as a whole is projected at 15 percent of GDP. The current account developments in 2001–02 are driven by the trade deficit, in particular the behavior of imports. Imports were exceptionally high in 2001 in response to the tariff cuts of December 2000 and to the anticipated introduction of the VAT in February 2002. The value of recorded exports (which constitute about 6 percent of GDP and 17 percent of imports) grew by 24 percent in 2001, and further by 20 percent in the first nine months of 2002.¹⁸ Exports benefited from the government's cost-cutting measures, regional trade agreements, and some depreciation of the real effective exchange rate since July of last year.¹⁹ Following a sharp decline in private capital inflows in the first quarter of 2002, the capital account has improved markedly as the BdL has sold Eurobonds to nonresidents (including official creditors), while foreign investors, reportedly mainly from the Arab world, have recently also invested in local currency government securities. The overall balance of payments recorded a large surplus in the third quarter of 2002, and preliminary information indicate that the strong overall position continued in October.

18. **The recent weakening of the U.S. dollar has reversed some of the real appreciation of the Lebanese pound.** The real effective exchange rate (REER), which appreciated strongly in 1991–99, has stabilized in recent years, depreciated (by about 9 percent) over the 12 months through July 2002, reflecting the weakening of the U.S. dollar against world currencies and the low rates of inflation in Lebanon (Figure 4). Nonetheless, over the past five years, a period of economic stagnation, the REER has appreciated by 11 percent.

¹⁸ Lebanon's Association Agreement with the European Union (EU), signed on June 17, 2002, may contribute to a broadening of the export base. The agreement eliminated, with immediate effect, tariffs on most of Lebanon's exports of industrial products to the EU, while Lebanon must phase out its tariffs on imports from the EU over a 12-year period. The agreement also includes provisions for closer cooperation in financial services, customs operations, statistics, and anti-money laundering.

¹⁹ Some of the increase in exports may reflect increased *recording* of exports after the introduction of the VAT.



III. POLICY DISCUSSIONS

19. **The policy discussions centered on the economy's increasing vulnerabilities,²⁰ and on the authorities' strategy to alleviate the public debt burden and accelerate economic growth.** The authorities shared the staff's view that, given the magnitude of the debt problem, the further fiscal adjustment planned for 2003 and the medium term will not contain the growth of the public debt. In the absence of a significant reduction in the government debt burden, the improvements seen in recent months in money demand and the balance of payments could be short lived, and the outlook would remain very difficult. The financing requirement of the government would continue to be large, exceeding the projected available financing from domestic commercial banks and external sources. If monetized by the BdL, this borrowing could lead to sharp decline of foreign exchange reserves.

A. The Authorities' Strategy

20. **The authorities' medium-term strategy seeks to ease the government's debt problem through large-scale privatization, upfront concessional external financing, and continued fiscal adjustment.** The government envisages the following main developments: (i) substantial privatization proceeds, and a partial restructuring of the government debt held by the BdL, would allow for a reduction in the stock of debt; (ii) a portion of the remaining debt would be replaced by lower interest/longer maturity concessional loans from official creditors; and (iii) the primary fiscal surplus would rise steadily. Improved confidence, together with the infusion of liquidity caused by the retirement of domestic debt, could facilitate a reduction in interest rates on government debt to the banking sector, further

²⁰ Financial and external vulnerability indicators are summarized in Table 9.

reducing the interest burden and setting the stage for a recovery in economic growth. These developments would ensure a gradual but steady reduction in the government debt ratio over time.

21. **The staff expressed serious concerns that the strategy was excessively demanding and fraught with risks** (detailed below). Moreover, even if successfully implemented, it would still leave the debt ratio at very high levels over the medium term. In view of the risks, the staff discussed with the authorities additional policy actions that would address the level of public debt. The authorities said they would be prepared to consider any contingency measures that would not involve a breach of debt contracts.

Fiscal policy

22. **The draft 2003 budget now before parliament would be consistent with a primary surplus of 4.2 percent of GDP**—an adjustment of about 1½ percent of GDP relative to the projected 2002 outcome.²¹ The budget has received a generally supportive political response. In addition to benefiting from the full-year impact of the VAT and the implementation of a lump-sum business tax passed last year, the budget includes the following revenue measures: (i) extension of income taxation to pensions and end-of-service indemnities; (ii) reduction of the VAT turnover threshold; (iii) increase in fixed-line telephone tariffs and subscription fees; and (iv) increase in social security contributions for government employees. On the expenditure side, the main measures are wide-ranging cuts in discretionary current and capital spending (while preserving social expenditure); and a reduction in overtime payments and transportation allowances.²² These measures are expected to more than compensate for the additional expenditure associated with increases in security personnel, retirees, and pensioners; and with the conversion of some teachers from short-term to permanent employment status. The interest bill would decline by about 5.7 percent of GDP on account of the planned debt operations in the context of privatization, Paris II-related inflows, and the restructuring of the debt held by the BdL. Consequently, the overall fiscal deficit would be reduced from 15.6 percent of GDP in 2002 to 8.3 percent in 2003.

²¹ As presented, the draft budget projects a primary surplus of 4.8 percent of GDP. The staff's projection, which shows a primary surplus of 4.2 percent of GDP, takes into account the loss of fiscal revenue from securitization (equal to about 1.3 percent of GDP in 2003), and somewhat lower overall expenditure in view of the estimated 2002 outcome. The authorities concurred with the staff's projection.

²² Due to an increase in the number of working hours from 32 to 38 hours per week, and a reduction from six to five in working days per week.

23. **For the medium term, the authorities envisage a steady rise in the primary surplus to 9 percent of GDP by 2007.** The main measures would be an increase in the VAT rate to 12 percent and adoption of a comprehensive income tax,²³ both in 2004; a gradual reduction in public sector employment (facilitated by privatization) and a rationalization of benefits and pensions for security personnel, resulting in a decline in the real wage and pensions bills; and a freeze on discretionary current and capital outlays at the 2003 nominal levels. In addition, the government envisages significant improvements in tax collection, in particular for direct taxes, based on synergies from the administration of the VAT. Finally, the fiscal outlook would be helped by the privatization of EdL, the prospects for which are being enhanced by the ongoing improvements in its financial situation (discussed below).

24. **The staff indicated that, except for the marked drop in the interest bill, the budgetary projections for 2003 appeared robust, but that there were significant downside risks to the medium-term fiscal scenario.** The authorities concurred that the lower interest bill for 2003 hinges critically on their assumptions on the magnitudes and timing of privatization, securitization (see below), and Paris II inflows, as well as their impact on interest rates through debt retirement operations and improved confidence. Regarding the medium term, the staff expressed concern that the envisaged primary adjustment is very ambitious and relies heavily on expenditure restraint. The staff also indicated that the fiscal adjustment would require continuous broad political support for several years, including during the parliamentary elections in 2004. To reduce the risks, the staff encouraged the authorities to raise the VAT rate, as soon as possible, to 15–20 percent.²⁴ The mission also underscored the importance of accelerating preparations to introduce a comprehensive income tax, and of developing a plan for rationalizing and containing public employment and wages and benefits. Additional revenue could also be generated by increasing excises on petroleum, cars, tobacco, and alcohol. Measures should also be taken to ensure the financial viability of the NSSF, including by strengthening collection of social contributions, improving monitoring and control of social benefits, and reforming the pensions scheme. The authorities acknowledged that major work lies ahead to fully flesh out the adjustment programs beyond 2003. While they were not inclined to consider at this stage the suggested increase in the VAT rate, they indicated, in broad terms, that additional fiscal measures would be considered if necessary to keep the public debt ratio on a declining path over the medium term.

²³ The comprehensive income tax reform would include introducing a corporate income tax and consolidating the current system of schedular income taxes.

²⁴ The staff argued that, even with the VAT, the tax ratio remains low (at about 15½ percent of GDP in 2002) compared with other middle-income countries. A VAT rate up to 20 percent would not be out of line with international and regional practices (the standard VAT rate in the MENA countries ranges from 10 percent to 20 percent).

Financing and debt management

25. **A cornerstone of the authorities' strategy is a reduction in the government debt burden based on privatization/securitization, concessional Paris II loans, retirement of the debt owed to the BdL, and involvement of the banking sector.** The government envisages privatization proceeds of about \$7 billion in 2003–07, of which about \$3 billion in 2003 (16.5 percent of GDP). Extensive preparations have been undertaken over the past year in the telecommunications and power sectors. Twenty-year licenses for operating the two existing cellular phone networks are to be sold in auction in early-2003 (depending on the outcome of the auctions, the government may keep a 40 percent share in the revenues of the operators).²⁵ To privatize the fixed-line network by 2004, the government plans to establish a company, Liban Telecom, and to have a regulatory body in place in 2003. In the power sector, a law approved last August provides for the regulation of the electricity sector and the reorganization of EdL into two companies, one for production and distribution and one for transmission. A 40 percent stake in the first company would be sold to a strategic investor in the second quarter of 2003. Further privatization is envisaged in the medium term for the water agencies, ports and airports, and other assets.

26. **The authorities noted that the prospects for privatization in the power sector are being enhanced by the significant ongoing improvements in the financial situation of the state-owned electricity company.** The operating balance of the EdL is expected to shift from a deficit of 0.8 percent of GDP in 2001 to a surplus of about 0.6 percent of GDP in 2002—despite a sizable increase in fuel costs. This turnaround reflects improved collections (revenue was 36 percent higher in the first nine months of 2002 compared with the same period last year) and improvements in production, transmission, and distribution. In 2002, the company has only needed government financing to cover its debt service payments.

27. **The staff took note of the progress achieved in preparing for the very ambitious privatization program, including the important enabling legislative steps that have been taken this year.** However, while the timetable for auctioning the cellular network licenses seems plausible, privatization of the fixed telecommunications network and of the EdL might take longer than envisaged by the authorities, as it involves substantial restructuring in these areas. Furthermore, the amounts anticipated by the authorities from privatization are very large (\$4.5 billion in 2003–04, equal to 25 percent of annual GDP, and another \$2.7 billion in 2005–07).

²⁵ All operations of the cellular networks reverted to government ownership on August 31, 2002, and an agreement was signed with the two operators, LibanCell and FTML-Cellis to continue managing the operations on behalf of the government until end-January 2003, against a fee of about \$7.5 million a month for each.

28. **The authorities plan to mobilize \$1.75 billion in 2003 by securitizing customs revenue from tobacco imports and the revenue from the share that they may maintain in the cellular networks after privatization.** Plans for the former are well advanced, with expectations that receipts would amount to about \$750 million in the first quarter of 2003. In addition, based on the post-privatization revenue share in the cellular phone network, a further \$1 billion could be raised in the second quarter of 2002.²⁶ The mission cautioned the authorities against securitization. While this policy may, in the short run, relieve liquidity constraints and reduce the debt stock, it bears a number of risks that need to be carefully assessed. In particular, securitization will adversely affect budgetary revenue over the medium term and, possibly, increase the government's overall debt servicing costs by making unsecured borrowing more expensive.²⁷

29. **The authorities hope to mobilize, based on commitments received at the recent Paris II conference,²⁸ official financial assistance in the form of loans or loan guarantees on concessional terms or deposits with the BdL, amounting to about \$4.3 billion.** Excluding project-related financing (about \$1.3 billion), approximately \$3 billion is expected to be available in 2003 for budgetary support.²⁹ While the authorities are still in discussions with the Paris II participants on the precise modalities of their individual contributions, they expect that interest rates on Paris II funds will be in the range of 3–6 percent.³⁰

30. **The government and the BdL have agreed on the cancellation of treasury bills held by the BdL equivalent to \$1.8 billion.** This cancellation would be offset against a special government account held at the BdL representing the difference between the market and book value of government assets.³¹ In addition, the remaining treasury bill holdings of the

²⁶ To safeguard investor interests, the authorities would create a “special purpose vehicle” located offshore, which would issue the debt. The debt would be serviced through a trustee using hard currency receipts that would flow directly to an offshore account.

²⁷ This concern is shared by World Bank staff. The staff also noted that securitization can only be treated as non-debt-creating if there is no form of government guarantee involved. The authorities affirmed that this was indeed the case and, for that reason, were not treating the securitization proceeds as public debt.

²⁸ Paris II refers to the international conference hosted by the French government at the request of the Lebanese government on November 23, 2002, for the purpose of mobilizing support for Lebanon. It followed a preparatory meeting held in Paris in February 2001 (Paris I).

²⁹ The major sources of financial support were Saudi Arabia, other Arab countries, France, and Malaysia.

³⁰ For projection purposes, the staff has assumed for Paris II funds an average interest rate of 4.5 percent and a 15-year maturity, with a five-year grace period. The authorities considered these assumptions reasonable.

³¹ The staff understands that the main offsetting element on the liability side of the BdL's balance sheet would be the cumulative revaluation of gold holdings over time.

BdL (currently about \$1.2 billion) would be converted into a long-term Eurobond at an interest rate of 4 percent. The staff noted that the cancellation of debt to the BdL did not fundamentally improve the debt position of the public sector broadly defined (i.e., including the BdL). Moreover, the loss of interest revenue resulting from the two planned operations was likely to put serious strain on the BdL's net income position.³²

31. **The Lebanese banking sector has indicated its willingness to contribute to the government's strategy through a negotiated reduction in interest rates on its treasury bill holdings.** While the modalities of such a contribution are still being worked out, the authorities indicated that the interest rate on the treasury bills held by the commercial banks should decline by 3 percentage points in 2003. The authorities were confident that this part of their strategy would be facilitated by a decline in the overall interest rate structure (discussed below) and that it would not affect the projected growth in M3 and the de-dollarization of deposits.

Monetary and exchange rate policies

32. **The authorities intend to maintain the fixed exchange rate as the nominal anchor for monetary policy.** The authorities explained that, while they were not in principle against taking exchange rate action, they felt strongly that a policy change under the current circumstances would be very destabilizing (economically and politically), do little to enhance competitiveness, and disrupt the ongoing fiscal adjustment as well as the privatization process. They also stressed that, with the increased dollarization of the public debt over the last two years, a depreciation of the pound and the resulting inflation would not be effective in reducing the debt-to-GDP ratio. Moreover, the real exchange rate has depreciated somewhat over the last year, in line with the depreciation of the U.S. dollar against other major currencies. The staff concurred that an exchange rate action at this time could be destabilizing. It could also increase nonperforming loans in the banking system. The staff emphasized, however, that the strengthened external position following the Paris II and privatization/securitization inflows would provide an opportunity to take exchange rate action, which would help improve competitiveness and could facilitate a reduction in real interest rates. More generally, it was important that the resources raised in Paris II and from privatization be used to reduce the debt, rather than to defend the pegged exchange rate.

33. **The authorities expect that their debt management operations will bring about a decline in interest rates.** They envisage that interest rates would come down because of the positive confidence shock associated with the rise in the BdL's foreign exchange reserves and reduced perception of the risk of sovereign default. Improved confidence would boost the demand for money, in particular for the Lebanese pound, and the process of deposit de-dollarization that has already begun would accelerate. The expansion in liquidity from

³² The authorities have indicated that they would eliminate the remuneration of reserve requirements on local currency deposits, but this measure would only have a minor effect on the BdL's net income position.

retirement of treasury bills and Eurobonds would put further downward pressure on interest rates on treasury bills as well as on bank deposits and loans.

34. **The staff agreed that an upfront retirement of the debt held by the banking system, and large increase in the BdL's international reserves might reduce interest rates.** It cautioned, however, that the rapid retirement of treasury bills envisaged by the authorities would lead to a major expansion in liquidity, more than the market could reasonably be expected to absorb, and buybacks of debt ahead of maturity could be expensive. Specifically, the planned injection of liquidity in the first half of 2003 would equal 200 percent of base money, or 14 percent of M3. The BdL would therefore have to undertake large-scale sterilization operations, with the result that the broader debt problem would not be alleviated (as the additional decline in banks' holdings of government treasury bills would be offset by an increase in instruments issued by the BdL). The staff emphasized that sterilization operations could also lead to a substantial reduction in the BdL's net income. The authorities explained that the BdL would stand ready to intervene as necessary but that its interventions would have to take into account the desire to see a fall in interest rates. The staff expressed concern that the liquidity effects of the rapid retirement of treasury bills envisaged by the authorities could overwhelm the BdL and lead to pressure on the balance of payments, and therefore suggested that a more gradual retirement of treasury bills be considered.

B. Medium-Term Scenario and Debt Sustainability

35. **The staff has prepared an illustrative macroeconomic scenario which seeks to portray the authorities' program for the next five years.** This scenario incorporates detailed assumptions provided by the authorities to the staff regarding, among other things, the fiscal outlook; amounts and timing of privatization, securitization, and Paris II (as specified above); restructuring of the debt to the BdL; interest rates; real GDP growth; and the demand for M3 and its currency composition. On the strength of the privatization/securitization receipts (which would more than cover the fiscal deficit), and the restructuring of the debt to the BdL, the government debt would decline from the equivalent of \$32 billion (184 percent of GDP) at end-2002 to \$27 billion (141 percent) by end-2004 (see Tables 1, 2, 3, and 8) as high-interest yielding government securities are retired and interest rates decline. In net present value terms, the direct impact of privatization, securitization, restructuring of debt to the BdL, and concessional Paris II loans would be to reduce government debt by approximately 50–60 percentage points of GDP depending on the discount rate (Box 1). Gross foreign exchange reserves would rise from a projected \$3.9 billion at end-2002 to about \$9 billion by end-2004; net reserves would shift from a negative \$1.9 billion to a positive \$3.4 billion over the same period. Moreover, beyond this period, the scenario contains no financing gaps and suggests that—with maintenance of a strong primary fiscal adjustment, further declines in interest rates, and a steady improvement in the growth performance—the debt ratio would continue to decline. Specifically, by end-2007, government debt would be \$25.5 billion. Meanwhile, given the scenario's assumptions and parameters, the BdL's reserve position would continue to strengthen.

Box. 1. Lebanon: Net Present Value (NPV) Effects of the Government's Strategy for Reducing Debt

The government's strategy for reducing the debt burden involves using proceeds from privatization and securitization, and Paris II loans, to reduce the stock of domestic currency treasury bills and dollar-denominated Eurobonds. In addition, a portion of the treasury bills held by the BdL would be written off, while the remainder would be converted to Eurobonds paying an interest coupon of 4 percent.

Based on the assumption that the debt operations take place as of January 2003, two sets of NPV calculations were made, using discount rates of 15 percent, which is close to the current average yield on the government's domestic currency debt; and 7 percent, which is close to the long-run rate of growth of nominal GDP. These are snapshot calculations based on the debt outstanding at end-2002; however, as the major impact comes from privatization, which is fully taken into account, the NPV of the government debt is unlikely to decline further over the medium term.

On the basis of a discount rate of 15 percent, the NPV of the debt declines by about 40 percent, from \$27 billion to about \$16 billion. Using the discount rate of 7 percent, the decline in the NPV would be only about 30 percent.

Lebanon: Net Present Value Effects of the Authorities' Strategy

In millions of U.S. dollars, unless otherwise noted

	NPV	Reduction		
	(In billions of U.S. dollars)	(In billions of U.S. dollars)	(In percent)	(In percent of GDP)
Using 15 percent discount rate				
Debt at end-2002	27.0	...	...	...
after Paris II	25.5	1.5	5.6	8.7
after Paris II, BdL debt restructuring	23.3	3.7	13.7	21.3
after Paris II, BdL debt restructuring and privatization and securitization	16.3	10.7	39.6	61.7
Using 7 percent discount rate				
Debt at end-2002	30.7	...	...	...
after Paris II	30.1	0.6	2.0	3.5
after Paris II, BdL debt restructuring	28.0	2.7	8.8	15.6
after Paris II, BdL debt restructuring and privatization and securitization	22.1	8.6	28.0	49.6

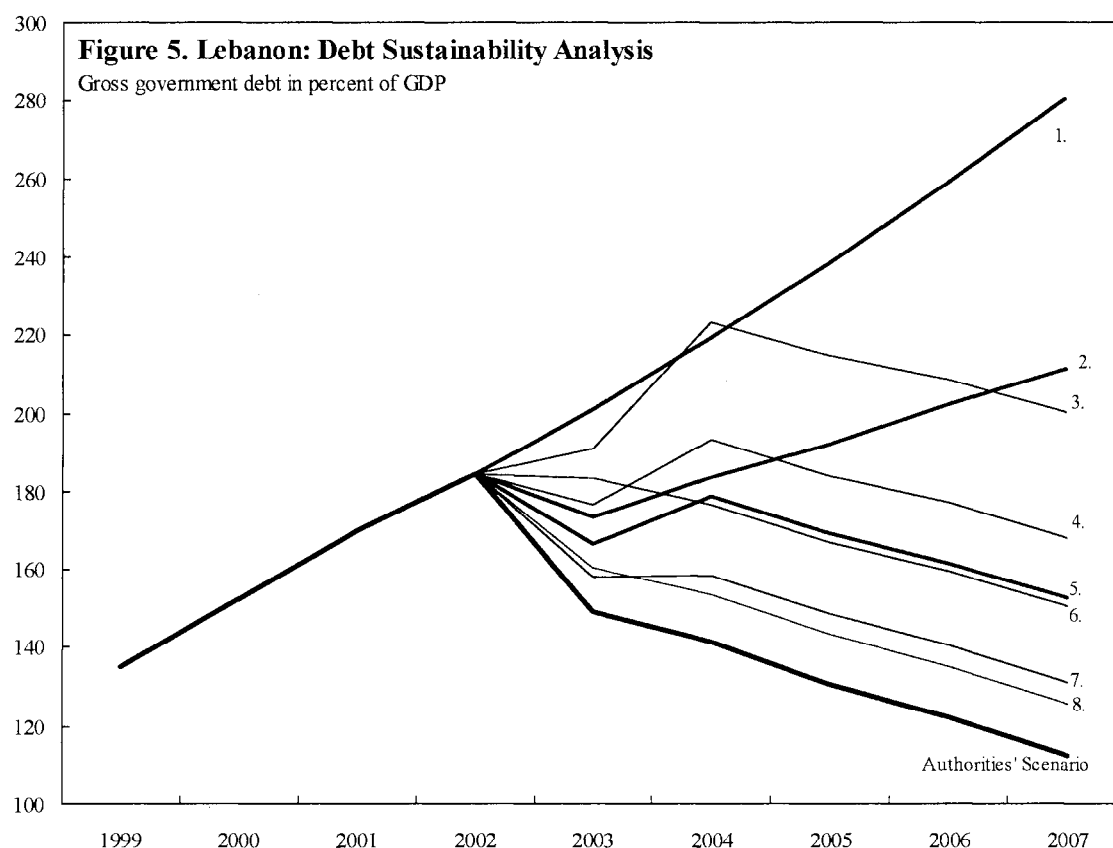
Note: For simplicity, the calculations assume that the debt operations take place on January 1, 2003.

36. **The staff cautioned that, even if successfully executed, the authorities' strategy would still leave the gross government debt at very high levels.** Furthermore, the foreign currency component in the total debt would rise from 39 percent at the end of 2002 to 54 percent by 2007. However, if the privatization and Paris II inflows materialize as envisaged, and demand for M3 stays strong, the government's gross financing requirements (projected at about 60 percent of GDP in 2003–04) would be easily met. Moreover, the retirement of short-term debt would sharply reduce the gross financing requirement to 25 percent of GDP by 2005, although this is still high by international standards.

Sensitivity analysis

37. **The decline in the debt ratio under the authorities' scenario is highly sensitive to assumptions regarding the decline in interest rates, the strength of the fiscal adjustment over the medium term, and, in particular, the size of the privatization proceeds.** In an alternative, less optimistic scenario with privatization proceeds of only half of those expected by the authorities and macroeconomic variables evolving somewhat less favorably, the debt ratio would only temporarily be stabilized, and would soon resume its upward trend. Moreover, a standardized debt sustainability analysis³³ undertaken by staff shows that if key macroeconomic variables remain at their historical averages (and there are no non-debt-creating inflows), the debt ratio would continue to grow along its current trajectory (Figure 5 and Table 10). The analysis also shows that, if all macroeconomic variables were affected simultaneously by an adverse shock during the next two years, the debt ratio would reach 223 percent of GDP in 2004, before declining modestly to 200 percent by 2007. Among the macroeconomic variables at play, debt sustainability is most sensitive to the interest rate assumptions—not surprisingly given the large debt stock—and to the primary fiscal balance. The challenge of reversing the debt dynamics is evident in the large gap between projections based on historical averages, and the outcome based on the authorities' scenario. This gap illustrates the scale of the combined external financing, policy adjustments, and turnaround in macroeconomic variables that is needed to achieve a reversal of the debt dynamics.

³³ Based on the methodology for assessing debt sustainability set out in SM/02/166, staff has modified key macroeconomic parameters of the authorities' scenario (interest rates, real GDP growth, inflation, and the primary balance). A first comprehensive test sets all variables (including non-debt-creating inflows) at their historical average of the past 10 years. A second series tests the sustainability by setting, one at a time, the four above-mentioned parameters at their historical averages plus two standard deviations during 2003–04, with variables returning to the baseline path afterwards. A third test sets the four variables simultaneously at their historical average plus one standard deviation in 2003–04. A fourth test simulates the effect on the debt ratio from a 30 percent real depreciation. Finally, the effect of halving privatization proceeds and adding one standard deviation to the other macroeconomic variables is simulated.



1. All variables are at average of past 10 years
2. Privatization receipts are half of baseline; interest rate, real GDP growth, and primary surplus are at baseline plus (minus) one standard deviation
3. Combination of 4-5 and 7-8 using one standard deviation shocks
4. Interest rate in 2003-04 is average plus two standard deviations
5. Primary balance in 2003-04 is average minus two standard deviations
6. One time 30 percent depreciation in 2003
7. Real growth in 2003-04 is average minus two standard deviations
8. Inflation in 2003 is average minus two standard deviations

C. Trade Policy

38. **Lebanon is making progress in further liberalizing its relatively open trade regime.** In December 2000, the government simplified the tariff structure and reduced the simple average import duty from 13 percent to 5 percent; consequently, the effective cumulative import duties (including also excise taxes and collection duties, and weighted by import volume) declined from 21 percent to 16 percent. Lebanon maintains almost no export subsidies, except for a small export promotion scheme for unprocessed food products. Following the conclusion of a series of bilateral trade agreements in recent years with the United Arab Emirates (1997), Syria (1998), Egypt (1999), and Iraq (2002), the authorities signed an association agreement with the EU on June 17, 2002, entailing the gradual dismantling of tariffs; pending ratification, an interim agreement was put in place that already gives Lebanon preferred access to the EU market. Finally, Lebanon has started the accession process to the WTO, which is expected to be concluded within two to three years.

D. Poverty

39. **Between 10 percent and 30 percent of the population are estimated to be poor (depending on the poverty line \$1 or \$2 a day, respectively) and the existing social policy instruments are poorly targeted.**³⁴ While poverty is relatively widespread in rural areas, the majority of the poor reside in urban areas, including refugee camps. Government spending on social protection exceeds 7 percent of GDP, but the existing social policy instruments largely benefit the nonpoor: excluding social security and health expenditures, the fiscal resources allocated to the various social assistance programs amounts to less than 1 percent of GDP. Against this background, the staff encouraged the authorities to consider reallocating specific budgetary resources to enhance the social safety net.³⁵

E. Data Issues

40. **Economic analysis and policymaking in Lebanon is severely hampered by the lack of data on national accounts and prices, and the paucity of balance of payments statistics.**³⁶ The BdL is making progress in preparing data on official reserves and foreign currency liquidity in accordance with the Special Data Dissemination Standard. The reliability and coverage of monetary statistics is satisfactory, while the coverage of fiscal statistics is incomplete and its full details are not available on a timely basis. An STA multisector statistics/GDDS mission that visited Beirut in March–April 2002 suggested a medium-term action plan for improving each of the macroeconomic statistical sectors (balance of payments, money and banking, government finance, and real sector statistics). To produce a GDP series for 1997–2001, the Ministry of Economy and Trade is receiving assistance from France, and preliminary estimates are expected to be published shortly. In parallel, the Central Administration for Statistics has developed its own working plan for improving the statistics system with the assistance from the EU, with key steps including: updating the census on buildings, dwellings, and establishments; developing and undertaking economic surveys; and conducting a household budget survey. Further, the BdL will introduce in early 2003 an International Transactions Reporting System (ITRS), which is expected to improve the balance of payments statistics.

³⁴ There is no official population data—the last census was undertaken in 1932. The World Bank estimates the population at 4.3 million in 2000.

³⁵ Analysis undertaken by the Fiscal Affairs Department suggests that such a reallocation of resources should be directed especially to social assistance benefits; public works programs; and an expansion of health care for the poor.

³⁶ Statistical issues are detailed in Appendix III.

IV. STAFF APPRAISAL

41. **Over the last two years, the Lebanese authorities have taken steps to address the severe macroeconomic imbalances.** In particular, they have achieved a major improvement in the primary fiscal balance, which is expected to register a surplus in 2002 following several years in deficit. A major accomplishment has been the successful introduction of a well-designed value-added tax, which has contributed importantly to budgetary revenue. On the expenditure side of the budget, the authorities have also exercised considerable restraint.

42. **These efforts come at a time when economic performance has become dominated by the public debt burden.** The interest bill arising from the exceptionally high debt stock has kept the overall fiscal deficit at such high levels, despite the turnaround in the primary balance, that available market financing has fallen far short of the government's borrowing requirements. As a result, the government has had to rely heavily on credit from the central bank, which has led to a substantial decline in official foreign exchange reserves.

43. **Against this background, the staff has noted to the authorities that restoring policy sustainability will require reducing the debt stock to a manageable level.** The staff has considered the possible economic merits of various options for restructuring the public debt, all of which are likely to be very disruptive in the short run, given the high concentration of the public debt in the hands of the domestic banks. Lebanon, therefore, faces the dilemma of having an unmanageable public debt, with increasingly difficult prospects for an orderly transition to a sustainable position.

44. In recent months, economic performance and confidence have improved somewhat reflecting renewed regional interest in Lebanon for portfolio and real estate investments, and as a tourist destination. **Nonetheless, the staff believes that these factors may be transient, and the policy framework will remain highly vulnerable because of Lebanon's high debt level.** Specifically, in the absence of actions to materially reduce the debt burden, real interest rates would remain high, growth would continue to be sluggish, and pressure on the BdL's reserves would likely re-emerge. Consequently, the improvements seen in recent months in money demand and the balance of payments could be short lived.

45. **The authorities have decided to pursue a strategy that seeks to reduce and restructure the government debt over the medium term,** based on additional fiscal adjustment, large-scale privatization, concessional external financing, and a restructuring of the government debt held by the BdL. If fully realized, the authorities' financing and interest rate assumptions could lead to a decline in the government debt ratio and no financing gaps over the medium term. However, this strategy depends critically on implementation of a very ambitious privatization program, substantial amounts of concessional financing, and relentless fiscal adjustment. In particular, there is enormous uncertainty surrounding the amounts and timing of privatization proceeds. In the event of shortfalls, the public debt would continue to rise and, with the maintenance of a fixed exchange rate, the initial gains of foreign exchange reserves by the central bank would tend to be eroded. However, even if all the inflows were to materialize as planned, debt sustainability would still be highly sensitive to the assumptions on

interest rates, growth, and the ability of the authorities to sustain an ambitious fiscal adjustment over the medium term. Moreover, even if the strategy were successfully implemented, the debt would remain at very high levels for many years and would also have become increasingly dollarized. Any slippage in policy implementation, negative shocks, or change in sentiment could set adverse events in motion.

46. **A strong fiscal stance is essential in any event, and the staff welcomes the 2003 budget proposal now before parliament,** which would be consistent with a primary surplus of 4.2 percent of GDP. It should be noted that the primary adjustment of about 1½ percent of GDP relative to the projected 2002 outcome understates the underlying fiscal effort since measures are needed to compensate for the loss of revenue due to privatization and securitization. Beyond 2003, the envisaged primary adjustment relies on yet-unspecified expenditure measures. Accordingly, the authorities should specify, early on, ways to rationalize public employment and the wage and pension bill. For a more balanced adjustment effort, additional revenue measures should also be considered. In this regard, the staff urges the authorities to raise the VAT rate, as soon as possible, to 15–20 percent. The authorities should also accelerate the introduction of a comprehensive income tax. Finally, attention should be given to ensuring the financial viability of the National Social Security Fund, whose surplus has declined in the last two years.

47. **Given the large fiscal imbalances, monetary policy has been essentially paralyzed in recent years,** because of the fear that an increase in interest rates would magnify the fiscal deficit without a significant response in demand for money and available market financing. Meanwhile, high real interest rates have depressed growth and investment, and increased nonperforming loans. The authorities expect that a positive confidence shock and large liquidity injection, associated with the envisaged inflows and the retirement of government debt and lengthening of its maturity, will lead to a substantial reduction in interest rates. The staff concurs that some reduction in interest rates could occur under those circumstances, although the maintenance of the fixed exchange rate could limit the scope of the decline. In undertaking debt retirement operations, the authorities should keep in mind the market's capacity to absorb additional liquidity. A fast retirement of local currency debt might require the BdL to undertake large-scale sterilization operations, and a retirement of debt ahead of maturity could also be expensive. As a result, a rapid retirement of treasury bills might not alleviate the overall public debt problem as it could be largely offset by an increase in instruments issued by the BdL for sterilization purposes. Large-scale sterilization operations would also negatively affect the BdL's net income.

48. **While the staff welcomes the inclusion of debt management elements in the authorities' strategy, these also raise significant concerns.** With regard to the planned reduction and restructuring of the debt held by the BdL, the BdL's financial position may be seriously undermined by the loss of interest income. Moreover, these operations will not fundamentally improve the debt position of the consolidated public sector broadly defined. With regard to the planned involvement of the banking sector, which the staff sees positively, attention should be given to banks' ability to withstand a reduction in interest income, which

will depend crucially on the evolution of the overall interest rate structure. To the extent that the interest rate reduction is passed on to deposit rates, the growth in M3—a crucial element of the medium-term strategy—might be negatively affected.

49. **While the staff concurs that exchange rate action at this time could be destabilizing, the strengthened external position following the Paris II and privatization/securitization inflows would provide an opportunity to take exchange rate action.** Such an action should help improve competitiveness, protect international reserves, and reduce the real value of the domestic currency debt, even if the dollarization of the debt has rendered the exchange rate a less powerful instrument for debt reduction. In addition, the staff stresses that the assistance that is being mobilized from the international community should not be dissipated in defense of the exchange rate.

50. **The staff welcomes the progress in preparing for the ambitious privatization program,** including the important enabling legislative steps taken this year and the managerial improvements in EdL. However, while the timetable for auctioning the cellular network licenses seems plausible, privatization of the fixed telecommunications network and of EdL might take more time than envisaged by the authorities. It is critical, therefore, to demonstrate early and concrete progress with the required sectoral restructuring operations, as a signaling device for the credibility of the government's debt strategy. On a related point, while the planned securitization of certain government revenues would, in the short run, relieve liquidity constraints, it also affects adversely budgetary revenue and, possibly, government borrowing costs. The authorities are therefore encouraged to reconsider this policy.

51. Regarding **structural and social issues**, the staff welcomes the significant actions taken by the authorities over the last two years to strengthen prudential oversight for the banking system and to prevent money laundering, which has allowed Lebanon to be removed from the FATF list of non-cooperating countries, as well as the further progress in liberalizing an already open trade regime. This progress has been instrumental for reaching the recent association agreement with the EU, and should facilitate Lebanon's accession process to the WTO. With regard to poverty alleviation, the staff encourages the authorities to better target the existing social expenditures and to reallocate specific budgetary resources so as to enhance the social safety net.

52. The staff welcomes Lebanon's decision to participate in the GDDS and the efforts now being made to construct official GDP estimates. However, major work remains to be done in the statistical area in order to fill the gaps that still hamper economic analysis and policymaking.

53. It is proposed that the next Article IV consultation with Lebanon be conducted on the standard twelve-month cycle. In addition, the participants at the Paris II conference requested the Fund staff to prepare six-monthly reports on developments in Lebanon, in conformity with Fund procedures. These reports will be circulated to the Executive Board.

Table 1. Lebanon: Summary of Macroeconomic Framework, 1999–2007 1/

	1999	2000	Prel. 2001	Est. 2002	Projections				
					2003	2004	2005	2006	2007
(Annual percentage changes)									
Real GDP	1.0	-0.5	2.0	2.0	3.0	3.0	3.5	3.5	4.0
Consumer price index (annual average)	0.2	-0.4	-0.4	2.0	2.0	2.5	2.0	2.0	2.0
Nominal GDP	1.2	-0.9	1.6	4.0	5.1	5.6	5.6	5.6	6.1
Broad money	11.1	9.6	7.4	6.2	5.0	5.6	5.6	5.6	6.1
(In percent of GDP)									
Government operations									
Revenue and grants	19.6	19.6	18.7	22.3	23.7	23.8	24.3	24.3	24.3
Expenditure	35.7	44.2	38.1	37.9	32.0	29.5	27.6	25.9	24.3
Overall balance	-16.2	-24.6	-19.4	-15.6	-8.3	-5.6	-3.2	-1.6	0.0
Of which: primary balance	-1.6	-7.6	-2.3	2.6	4.2	6.1	7.4	8.3	9.1
Gross government debt	135.2	152.3	169.7	184.2	148.9	141.2	130.6	122.0	112.0
External sector									
Current account balance	-20.0	-18.7	-20.7	-14.8	-14.3	-13.1	-12.0	-11.2	-9.9
Of which: exports, f.o.b.	4.2	4.3	5.3	5.7	6.4	6.9	7.5	7.9	8.5
Of which: imports, f.o.b.	-34.9	-35.3	-40.8	34.9	35.5	33.3	31.9	30.6	29.4
(In millions of U.S. dollars)									
Net foreign assets of the banking system	9,815	9,298	8,127	8,811	14,418	15,140	16,704	17,957	19,852
Of which: commercial banks	-482	969	1,269	2,088	2,281	2,981	3,481	3,981	4,778
Balance of payments surplus (+) or deficit (-)	261	-289	-1,172	274	5,608	722	1,564	1,253	1,895
Gross official reserves (excluding gold)	7,727	5,895	4,402	3,898	9,312	9,334	10,397	11,151	12,249
Net international reserves (excluding gold) 2/	4,980	2,615	-1,325	-1,900	3,572	3,433	4,332	4,917	5,819
Gross government debt	22,367	24,971	28,275	31,922	27,114	27,145	26,502	26,148	25,453
Privatization receipts	...	...	...	...	3,250	1,200	1,300	700	700
Nominal GDP	16,545	16,399	16,660	17,333	18,210	19,225	20,296	21,426	22,729
Memorandum item:									
Nominal GDP (in trillions of Lebanese pounds)	24.9	24.7	25.1	26.1	27.5	29.0	30.6	32.3	34.3

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

1/ Based on the authorities' medium-term policy scenario.

2/ Excludes short-term foreign liabilities and domestic banks' foreign currency deposits with the Banque du Liban.

Table 2. Lebanon: Central Government Operations, 1999–2007

	1999	2000	Prel. 2001	Budget 2002	Prel. Jan.-Sep. 2002	Proj. 2002	Proj. 1/ 2003	Proj.			
								2004	2005	2006	2007
(In billions of Lebanese pounds)											
Revenue and grants	4,880	4,849	4,685	5,850	4,336	5,830	6,493	6,911	7,443	7,853	8,325
Revenue	4,868	4,749	4,648	5,850	4,335	5,829	6,493	6,911	7,443	7,853	8,325
Tax revenue	3,536	2,936	2,961	4,036	2,989	4,075	4,414	4,962	5,400	5,711	6,071
Nontax revenue	1,332	1,813	1,688	1,814	1,345	1,754	2,079	1,949	2,043	2,142	2,255
Grants	12	100	36	0	1	1	0	0	0	0	0
Expenditure 2/	8,910	10,932	9,564	10,325	7,160	9,915	8,779	8,545	8,433	8,375	8,332
Of which: non-interest expenditure	5,285	6,734	5,253	5,825	3,909	5,160	5,339	5,143	5,165	5,187	5,210
Current expenditure	7,357	9,722	8,553	9,301	...	9,410	8,123	7,889	7,777	7,720	7,676
Wages, salaries, and pensions	2,760	2,932	3,002	3,155	...	3,155	3,283	3,316	3,349	3,383	3,417
Interest payments	3,625	4,197	4,312	4,500	3,251	4,755	3,440	3,401	3,268	3,188	3,122
Transfers to the Electricité du Liban	144	582	283	350	...	240	217	0	0	0	0
Other current expenditure	828	2,010	956	1,296	...	1,260	1,183	1,171	1,160	1,149	1,138
Capital expenditure	1,553	1,210	1,011	1,024	...	505	656	656	656	656	656
Of which: foreign-financed	456	310	292	200	136	204	302	302	302	302	302
Overall balance	-4,029	-6,083	-4,880	-4,475	-2,824	-4,085	-2,286	-1,633	-990	-522	-7
Of which: primary balance	-405	-1,885	-568	25	427	670	1,154	1,768	2,278	2,666	3,115
Float and statistical discrepancy 3/	38	722	-619	0	-546	-515	0	0	0	0	0
Financing	3,991	5,360	5,499	4,475	3,370	4,601	2,286	1,633	990	522	7
Banking system	2,512	4,884	4,664	...	1,940	2,750	-8,349	172	-1,028	-531	-1,138
Banque du Liban	-1,492	3,507	4,824	...	504	-571	0	0	0	0	0
Commercial banks 3/	4,004	1,378	-159	...	1,436	3,321	-8,349	172	-1,028	-531	-1,138
Domestic currency	2,462	-494	-2,909	...	833	2,556	-6,352	1,063	-1,028	-531	-1,138
Foreign currency	1,542	1,872	2,750	...	603	765	-1,997	-891	0	0	0
Other domestic financing	540	-7	-271	...	-37	365	-643	-73	150	150	150
Of which: net change in domestic arrears	-472	-396	261	...	-212	-510	0	0	0	0	0
External	939	483	1,106	...	1,467	1,486	-638	-274	-91	-152	-60
Official financing, net	287	75	44	...	103	54	1	-52	-91	-152	-60
Other	652	408	1,062	...	1,364	1,432	-639	-223	0	0	0
Exceptional financing	0	0	0	0	0	0	11,917	1,809	1,960	1,055	1,055
Privatization proceeds	0	0	0	0	0	0	4,899	1,809	1,960	1,055	1,055
Securitization	0	0	0	0	0	0	2,638	0	0	0	0
Paris II loans	0	0	0	0	0	0	4,379	0	0	0	0

Table 2. Lebanon: Central Government Operations, 1999–2007 (Concluded)

	1999	2000	Prel. 2001	Budget 2002	Prel. Jan.-Sep. 2002	Proj. 2002	Proj. 1/ 2003	2004	Proj. 2005	2006	2007
(In percent of GDP)											
Revenue and grants	19.6	19.6	18.7	22.4	16.6	22.3	23.7	23.8	24.3	24.3	24.3
<i>Of which:</i> tax revenue	14.2	11.9	11.8	15.4	11.4	15.6	16.1	17.1	17.6	17.7	17.7
<i>Of which:</i> nontax revenue	5.3	7.3	6.7	6.9	5.1	6.7	7.6	6.7	6.7	6.6	6.6
Expenditure 2/	35.7	44.2	38.1	39.5	27.4	37.9	32.0	29.5	27.6	25.9	24.3
<i>Of which:</i> non-interest expenditure	21.2	27.2	20.9	22.3	15.0	19.7	19.4	17.7	16.9	16.1	15.2
Current expenditure	29.5	39.3	34.1	35.6	...	36.0	29.6	27.2	25.4	23.9	22.4
Wages, salaries, and pensions	11.1	11.9	12.0	12.1	...	12.1	12.0	11.4	10.9	10.5	10.0
Interest payments	14.5	17.0	17.2	17.2	12.4	18.2	12.5	11.7	10.7	9.9	9.1
Transfers to the Electricité du Liban	0.6	2.4	1.1	1.3	...	0.9	0.8	0.0	0.0	0.0	0.0
Other current expenditure	3.3	8.1	3.8	5.0	...	4.8	4.3	4.0	3.8	3.6	3.3
Capital expenditure	6.2	4.9	4.0	3.9	...	1.9	2.4	2.3	2.1	2.0	1.9
<i>Of which:</i> foreign-financed	1.8	1.3	1.2	0.8	0.5	0.8	1.1	1.0	1.0	0.9	0.9
Overall balance	-16.2	-24.6	-19.4	-17.1	-10.8	-15.6	-8.3	-5.6	-3.2	-1.6	0.0
<i>Of which:</i> primary balance	-1.6	-7.6	-2.3	0.1	1.6	2.6	4.2	6.1	7.4	8.3	9.1
Float and statistical discrepancy 3/	0.2	2.9	-2.5	0.0	-2.1	-2.0	0.0	0.0	0.0	0.0	0.0
Financing	16.0	21.7	21.9	17.1	12.9	17.6	8.3	5.6	3.2	1.6	0.0
Banking system	10.1	19.8	18.6	...	7.4	10.5	-30.4	0.6	-3.4	-1.6	-3.3
Banque du Liban	-6.0	14.2	19.2	...	1.9	-2.2	0.0	0.0	0.0	0.0	0.0
Commercial banks	16.1	5.6	-0.6	...	5.5	12.7	-30.4	0.6	-3.4	-1.6	-3.3
Other domestic financing	2.2	0.0	-1.1	...	-0.1	1.4	-2.3	-0.3	0.5	0.5	0.4
External	3.8	2.0	4.4	...	5.6	5.7	-2.3	-0.9	-0.3	-0.5	-0.2
Official financing, net	1.1	0.3	0.2	...	0.4	0.2	0.0	-0.2	-0.3	-0.5	-0.2
Other	2.6	1.6	4.2	...	5.2	5.5	-2.3	-0.8	0.0	0.0	0.0
Exceptional financing	0.0	0.0	0.0	...	0.0	0.0	43.4	6.2	6.4	3.3	3.1
Privatization proceeds	0.0	0.0	0.0	...	0.0	0.0	17.8	6.2	6.4	3.3	3.1
Securitization	0.0	0.0	0.0	...	0.0	0.0	9.6	0.0	0.0	0.0	0.0
Paris II loans	0.0	0.0	0.0	...	0.0	0.0	16.0	0.0	0.0	0.0	0.0
Memorandum items:											
Gross public debt 4/	135.2	152.3	169.7	...	179.9	184.2	148.9	141.2	130.6	122.0	112.0
Domestic currency	99.9	106.4	108.4	...	108.4	111.7	67.7	68.3	61.8	57.4	51.2
Foreign currency	35.3	45.9	61.4	...	71.6	72.4	81.2	72.9	68.8	64.7	60.8
(In millions of U.S. dollars)											
Exceptional financing	0	0	0	...	0	0	7,905	1,200	1,300	700	700
Privatization proceeds	0	0	0	...	0	0	3,250	1,200	1,300	700	700
Securitization	...	...	...	...	...	...	1,750	0	0	0	0
Paris II loans	...	...	...	...	...	...	2,905	0	0	0	0
GDP (in billions of Lebanese pounds)	24,945	24,721	25,115	26,130	26,130	26,130	27,452	28,982	30,596	32,300	34,264

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

1/ Based on the draft 2003 budget.

2/ On a checks-issued basis, includes expenditure financed through the accumulation of arrears.

3/ Difference between the overall balance measured on a checks-issued basis and on identified financing.

4/ Excluding government arrears to the private sector.

Table 3. Lebanon: Central Government Debt, 1999–2007

	End-of-Period			Sep.	Oct.	Projections					
	1999	2000	2001	2002	2002	2002	2003	2004	2005	2006	2007
(In percent of GDP)											
Gross debt 1/	135.2	152.3	169.7	179.9	182.8	184.2	148.9	141.2	130.6	122.0	112.0
Domestic currency	99.9	106.4	108.4	108.4	108.5	111.7	67.7	68.3	61.8	57.4	51.2
Foreign currency	35.3	45.9	61.4	71.6	74.3	72.4	81.2	72.9	68.8	64.7	60.8
Debt to the Banque du Liban (BdL)	0.5	8.0	27.1	28.1	25.3	23.7	12.6	12.0	11.3	10.7	10.1
Domestic currency	0.5	7.0	24.9	22.2	18.0	17.4	0.4	0.4	0.4	0.4	0.3
Foreign currency	0.0	1.0	2.2	5.8	7.2	6.3	12.2	11.6	11.0	10.4	9.8
Debt to commercial banks	92.9	98.7	95.9	99.4	101.8	105.7	70.2	67.1	60.2	55.3	48.9
Domestic currency	74.8	73.0	59.6	61.6	64.2	67.6	41.2	42.7	37.1	33.5	28.2
Foreign currency	18.1	25.7	36.3	37.9	37.6	38.1	29.0	24.4	23.1	21.9	20.6
Debt to public entities (domestic currency) 2/	8.8	11.0	12.2	12.3	12.4	12.4	12.1	11.8	11.5	11.2	10.9
Other debt to nonbank sectors	33.0	34.5	34.6	40.1	43.3	42.5	53.9	50.3	47.5	44.7	42.1
Domestic currency	15.8	15.3	11.7	12.3	13.9	14.4	13.9	13.4	12.8	12.3	11.7
Foreign currency	17.2	19.1	22.9	27.9	29.4	28.0	40.0	36.9	34.7	32.4	30.4
(In millions of U.S. dollars)											
Gross debt 1/	22,367	24,971	28,275	30,888	31,372	31,922	27,114	27,145	26,502	26,148	25,453
Domestic currency	16,525	17,441	18,052	18,601	18,620	19,368	12,322	13,127	12,544	12,291	11,635
Foreign currency	5,842	7,529	10,223	12,287	12,752	12,555	14,792	14,019	13,958	13,857	13,817
Debt to the Banque du Liban	80	1,316	4,507	4,815	4,335	4,102	2,302	2,302	2,302	2,302	2,302
Domestic currency	76	1,145	4,146	3,814	3,094	3,008	77	77	77	77	77
Foreign currency	4	171	361	1,000	1,242	1,093	2,225	2,225	2,225	2,225	2,225
Debt to commercial banks	15,370	16,193	15,971	17,068	17,472	18,318	12,780	12,894	12,212	11,859	11,104
Domestic currency	12,377	11,974	9,929	10,568	11,013	11,711	7,498	8,203	7,521	7,169	6,413
Foreign currency	2,993	4,219	6,042	6,500	6,458	6,607	5,282	4,691	4,691	4,691	4,691
Debt to public entities (domestic currency) 2/	1,458	1,810	2,027	2,114	2,127	2,143	2,210	2,276	2,342	2,409	2,475
Other debt to nonbank sectors	5,458	5,651	5,770	6,891	7,438	7,359	9,823	9,674	9,646	9,579	9,572
Domestic currency	2,613	2,512	1,950	2,104	2,387	2,504	2,537	2,571	2,604	2,637	2,670
Foreign currency	2,845	3,139	3,820	4,786	5,051	4,855	7,285	7,103	7,042	6,942	6,902
(In percent of gross public debt)											
Gross debt 1/	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Domestic currency	73.9	69.8	63.8	60.2	59.4	60.7	45.4	48.4	47.3	47.0	45.7
Foreign currency	26.1	30.2	36.2	39.8	40.6	39.3	54.6	51.6	52.7	53.0	54.3
Debt to Banque du Liban	0.4	5.3	15.9	15.6	13.8	12.8	8.5	8.5	8.7	8.8	9.0
Debt to commercial banks	68.7	64.8	56.5	55.3	55.7	57.4	47.1	47.5	46.1	45.4	43.6
Debt to public entities (domestic currency) 2/	6.5	7.2	7.2	6.8	6.8	6.7	8.1	8.4	8.8	9.2	9.7
Other debt to nonbank sectors	24.4	22.6	20.4	22.3	23.7	23.1	36.2	35.6	36.4	36.6	37.6
Memorandum items:	(In millions of U.S. dollars, unless otherwise indicated) 2/										
Net debt 3/	20,088	23,341	27,295	29,740	30,090	30,626	25,818	25,849	25,206	24,853	24,157
(in percent of GDP)	121.4	142.3	163.8	173.3	175.3	176.7	141.8	134.5	124.2	116.0	106.3
Net debt, excluding accrued interest 3/	19,359	22,563	26,490	28,700	29,176	29,551	24,905	24,935	24,314	23,972	23,300
(in percent of GDP)	117.0	137.6	159.0	167.2	170.0	170.5	136.8	129.7	119.8	111.9	102.5
Gross debt held outside the public sector 4/	20,828	21,844	21,741	23,959	24,910	25,677	22,602	22,567	21,858	21,438	20,676
(in percent of GDP)	125.9	133.2	130.5	139.6	145.1	148.1	124.1	117.4	107.7	100.1	91.0
Domestic currency	14,990	14,486	11,879	12,673	13,400	14,216	10,036	10,774	10,125	9,806	9,084
Foreign currency	5,838	7,358	9,862	11,286	11,510	11,461	12,567	11,794	11,733	11,632	11,592
Gross debt held by the market 5/	19,597	20,543	20,396	22,547	23,498	24,277	18,297	18,296	17,647	17,328	16,606
(in percent of GDP)	118.4	125.3	122.4	131.4	136.9	140.1	100.5	95.2	86.9	80.9	73.1
Domestic currency	14,990	14,486	11,879	12,673	13,400	14,216	10,036	10,774	10,125	9,806	9,084
Foreign currency	4,607	6,057	8,517	9,874	10,098	10,061	8,261	7,522	7,522	7,522	7,522
Government arrears to the private sector	379	116	289	148	148	0	0	0	0	0	0
GDP	16,545	16,399	16,660	17,165	17,165	17,333	18,210	19,225	20,296	21,426	22,729

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

1/ Includes all debt contracted by the treasury on behalf of the central government and public agencies other than the central bank. Excludes government arrears to the private sector.

2/ In domestic currency, and mainly to the National Social Security Fund (NSSF) and the National Deposit Insurance Fund (NDIF).

3/ Gross debt minus government deposits with the banking system.

4/ Excludes debt to the BdL and public entities.

5/ Excludes debt to the BdL and public entities, as well as to official external creditors.

Table 4. Lebanon: Monetary Survey, 1999–2002

	Dec.			Mar.	Jun.	Sep.	Oct.	Proj. Dec.
	1999	2000	2001	2002	2002	2002	2002	2002
(Stocks in billions of Lebanese pounds)								
Net foreign assets	14,796	14,017	12,251	11,563	11,791	12,609	13,346	13,282
Banque du Liban	15,522	12,556	10,338	9,479	8,311	9,015	9,649	10,135
Commercial banks	-726	1,461	1,912	2,084	3,480	3,595	3,697	3,147
Net domestic assets	30,197	35,277	40,668	41,097	41,139	41,790	41,627	42,900
Net claims on the public sector	18,488	23,233	28,523	29,651	30,131	30,745	30,531	31,698
<i>Of which:</i> net claims on government	19,628	24,836	29,597	30,735	31,090	31,760	31,402	32,569
Banque du Liban	-1,969	1,648	6,583	7,674	8,264	7,086	6,181	6,011
Commercial banks	21,596	23,188	23,014	23,061	22,826	24,673	25,221	26,558
Lebanese pounds	17,294	16,829	13,905	13,789	13,425	14,861	15,472	16,584
Foreign currency	4,302	6,360	9,109	9,272	9,401	9,812	9,749	9,974
Claims on the private sector	21,210	22,488	22,393	22,310	22,791	23,052	23,124	23,084
Lebanese pounds	2,690	3,134	3,408	3,595	3,891	4,197	4,185	4,151
Foreign currency	18,521	19,354	18,985	18,715	18,901	18,854	18,939	18,933
Other items (net)	-9,502	-10,444	-10,249	-10,863	-11,783	-12,006	-12,027	-11,882
Broad money	44,993	49,294	52,918	52,660	52,929	54,399	54,973	56,182
In Lebanese pounds	20,240	19,493	17,283	16,801	16,331	17,601	18,140	18,539
Currency	1,369	1,423	1,382	1,311	1,234	1,270	1,296	1,406
Deposits in Lebanese pounds	18,870	18,069	15,901	15,489	15,097	16,331	16,844	17,134
Demand deposits	922	993	985	954	999	1,094	1,124	1,153
Time deposits	17,948	17,076	14,916	14,536	14,098	15,237	15,720	15,980
Deposits in foreign currency	24,753	29,802	35,635	35,860	36,598	36,798	36,833	37,643
(Year-to-date change in billions of Lebanese pounds)								
Net foreign assets	105	-779	-1,766	-688	-460	359	1,095	1,032
Net domestic assets	4,378	5,081	5,391	430	471	1,122	959	2,232
Net claims on the public sector	2,109	4,744	5,291	1,127	1,608	2,221	2,007	3,174
<i>Of which:</i> net claims on government	2,502	5,208	4,761	1,139	1,494	2,163	1,805	2,972
Central bank	-1,299	3,617	4,935	1,091	1,681	504	-402	-572
Commercial banks	3,800	1,592	-174	47	-188	1,660	2,207	3,544
Claims on the private sector	2,309	1,278	-95	-83	398	659	731	691
Lebanese pounds	396	444	274	187	483	789	776	743
Foreign currency	1,913	833	-369	-270	-84	-131	-46	-52
Other items (net)	-40	-941	195	-615	-1,535	-1,758	-1,778	-1,633
Broad money	4,483	4,302	3,624	-258	11	1,481	2,055	3,264
In Lebanese pounds	3,685	-747	-2,210	-482	-952	318	857	1,256
Deposits in foreign currency	798	5,049	5,834	224	963	1,163	1,197	2,008
(Year-to-date change in percent of beginning-of-period broad money)								
Net foreign assets	0.3	-1.7	-3.6	-1.3	-0.9	0.7	2.1	1.9
Net domestic assets	10.8	11.3	10.9	0.8	0.9	2.1	1.8	4.2
Net claims on the public sector	5.2	10.5	10.7	2.1	3.0	4.2	3.8	6.0
Claims on the private sector	5.7	2.8	-0.2	-0.2	0.8	1.2	1.4	1.3
Other items (net)	-0.1	-2.1	0.4	-1.2	-2.9	-3.3	-3.4	-3.1
Broad money	11.1	9.6	7.4	-0.5	0.0	2.8	3.9	6.2
Memorandum items:								
Net foreign assets (in millions of U.S. dollars)	9,815	9,298	8,127	7,670	7,821	8,364	8,853	8,811
Share of foreign currency deposits in broad money (in percent)	55.0	60.5	67.3	68.1	69.1	67.6	67.0	67.0
Credit to the private sector (in percent of GDP)	85.0	91.0	89.2	87.9	89.0	89.1	89.1	88.3

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

Table 5. Lebanon: Balance Sheet of the Banque du Liban, 1999–2002

	Dec.			Mar.	Jun.	Sep.	Oct.	Proj. Dec.
	1999	2000	2001	2002	2002	2002	2002	2002
(Stocks in billions of Lebanese pounds)								
Net international reserves	11,544	7,749	1,863	976	-136	659	1,197	1,535
Foreign exchange	11,649	8,887	6,635	5,526	4,634	5,429	5,390	5,877
Gold	4,037	3,806	3,861	4,225	4,440	4,495	4,399	4,399
Foreign currency deposits	3,905	4,735	8,403	8,431	8,372	8,281	8,377	8,525
Foreign liabilities	237	210	230	344	838	985	215	215
Net domestic assets	-7,041	-3,561	2,073	2,804	3,692	3,058	2,584	2,413
Claims on the public sector (net)	-2,651	682	5,982	7,073	7,727	6,530	5,801	5,631
Net claims on government	-1,969	1,648	6,583	7,674	8,264	7,086	6,181	6,011
Credit	69	1,985	6,755	7,783	8,377	7,352	6,670	6,277
Deposits	-2,038	-337	-172	-109	-113	-266	-489	-266
Net claims on nonfinancial public institutions	-682	-965	-601	-601	-537	-557	-380	-380
Claims on the private sector (net) 1/	189	213	114	151	160	164	161	161
Claims on commercial banks	406	735	781	802	1,418	1,693	1,666	1,666
Claims on specialized banks (net) 1/	-49	-100	-21	-21	-27	-23	-26	-26
Other items (net)	-4,942	-5,092	-4,783	-5,201	-5,586	-5,306	-5,019	-5,019
Base money	4,503	4,187	3,936	3,780	3,556	3,717	3,780	3,949
Currency in circulation	1,515	1,622	1,527	1,461	1,396	1,449	1,461	1,590
Commercial bank deposits 1/	2,988	2,566	2,409	2,319	2,160	2,268	2,320	2,359
(Year-to-date flows in billions of Lebanese pounds)								
Net international reserves	2,525	-3,796	-5,885	-887	-1,999	-1,204	-666	-328
Net domestic assets	-1,394	3,480	5,634	731	1,619	985	511	340
Claims on the public sector (net)	-1,434	3,333	5,300	1,091	1,745	548	-181	-351
Net claims on government	-1,299	3,617	4,935	1,091	1,681	504	-402	-572
Claims on the private sector (net) 1/	-1	25	-99	37	46	49	47	47
Claims on commercial banks	60	329	46	21	637	912	885	885
Claims on specialized banks (net) 1/	-16	-51	78	0	-6	-2	-5	-5
Other items (net)	-3	-150	309	-418	-803	-522	-235	-235
Base money	1,132	-316	-251	-156	-380	-219	-156	12
Currency in circulation	163	106	-95	-66	-131	-78	-67	62
Commercial bank deposits 1/	969	-422	-156	-90	-249	-141	-89	-50
(Year-to-date changes in percent of beginning-of-period base money)								
Net international reserves	74.9	-84.3	-140.6	-22.5	-50.8	-30.6	-16.9	-8.3
Net domestic assets	-41.3	77.3	134.6	18.6	41.1	25.0	13.0	8.6
Of which: net claims on government	-38.5	80.3	117.9	27.7	42.7	12.8	-10.2	-14.5
Base money	33.6	-7.0	-6.0	-4.0	-9.7	-5.6	-4.0	0.3
Memorandum items:	(In millions of U.S. dollars)							
Net foreign asset	10,297	8,329	6,858	6,288	5,513	5,980	6,401	6,723
Gross foreign exchange reserves (including gold)	10,405	8,420	6,963	6,468	6,019	6,583	6,494	6,816
Gross foreign exchange reserves (excluding gold)	7,727	5,895	4,402	3,666	3,074	3,601	3,576	3,898
Net foreign exchange reserves (including gold)	7,658	5,140	1,236	647	-90	437	794	1,018
Net foreign exchange reserves (excluding gold)	4,980	2,615	-1,325	-2,155	-3,035	-2,545	-2,124	-1,900
Exchange rate: LL per U.S. dollar, end-of-period	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508

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

1/ Excludes commercial bank deposits in foreign currency, which are netted out of international reserves.

Table 6. Lebanon: Balance Sheet of Commercial Banks, 1999–2002

		Dec.		Mar.	Jun.	Sep.	Oct.	Proj.
	1999	2000	2001	2002	2002	2002	2002	Dec.
								2002
(Stocks in billions of Lebanese pounds)								
Net foreign assets	-726	1,461	1,912	2,084	3,480	3,595	3,697	3,147
Foreign assets	8,910	12,300	12,988	12,799	13,922	14,207	14,282	13,732
Foreign liabilities	9,637	10,839	11,076	10,715	10,442	10,612	10,585	10,585
<i>Of which:</i> deposits of nonresidents	7,856	9,148	9,280	8,914	8,519	8,904	8,822	8,822
Net domestic assets	44,198	46,181	49,330	49,001	47,945	49,255	49,696	51,345
Net claims on the public sector	21,139	22,550	22,541	22,578	22,404	24,215	24,729	26,086
In Lebanese pounds	17,294	16,829	13,905	13,789	13,425	14,861	15,472	16,584
In foreign currency	4,302	6,360	9,109	9,272	9,401	9,812	9,749	9,974
Claims on the Banque du Liban	6,827	7,331	10,656	10,510	10,384	10,269	10,563	10,850
Currency	146	198	146	150	162	179	164	184
Deposits	6,681	7,132	10,510	10,360	10,222	10,089	10,399	10,666
Claims on the private sector	20,994	22,243	22,192	22,111	22,592	22,851	22,922	22,929
In Lebanese pounds	2,474	2,890	3,207	3,396	3,692	3,997	3,983	3,990
In foreign currency	18,521	19,354	18,985	18,715	18,901	18,854	18,939	18,939
Other items (net)	-4,762	-5,944	-6,059	-6,198	-7,436	-8,080	-8,519	-8,519
Liabilities to the private sector	43,471	47,642	51,242	51,085	51,424	52,850	53,392	54,492
In Lebanese pounds	18,794	17,938	15,793	15,421	15,031	16,272	16,778	17,067
In foreign currency	24,677	29,703	35,449	35,664	36,393	36,578	36,615	37,425
(Year-to-date change in billions of Lebanese pounds)								
Net foreign assets	-1,795	2,187	451	171	1,567	1,682	1,784	1,235
Net domestic assets	6,071	1,983	3,149	-329	-1,385	-75	366	2,016
Net claims on the public sector	3,543	1,411	-9	37	-137	1,674	2,188	3,544
Claims on the Banque du Liban	313	504	3,325	-146	-272	-387	-93	194
Claims on the private sector	2,313	1,249	-51	-81	400	659	730	737
In Lebanese pounds	400	416	318	188	485	790	776	783
In foreign currency	1,913	833	-369	-270	-84	-131	-46	-46
Other items (net)	-99	-1,181	-116	-138	-1,376	-2,020	-2,460	-2,460
Liabilities to the private sector	4,275	4,170	3,600	-157	182	1,608	2,150	3,250
In Lebanese pounds	3,544	-856	-2,145	-373	-762	479	985	1,274
In foreign currency	731	5,026	5,746	215	944	1,129	1,166	1,976
(Year-to-date percentage changes)								
Liabilities to the private sector	10.9	9.6	7.6	-0.3	0.4	3.1	4.2	6.3
In Lebanese pounds	23.2	-4.6	-12.0	-2.4	-4.8	3.0	6.2	8.1
In foreign currency	3.1	20.4	19.3	0.6	2.7	3.2	3.3	5.6
(In millions of U.S. dollars)								
Memorandum item:								
Net foreign assets	-482	969	1,269	1,382	2,308	2,385	2,452	2,088

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

Table 7. Lebanon: Banking Sector Macro-Prudential Indicators, 1998–2002

	1998	1999	2000	2001	Prel. Sep. 2002
(In percent, unless otherwise indicated)					
Capital					
Capital adequacy ratio	18.7	15.0	16.9	18.0	18.8 4/
Asset quality					
Problem loans/total loans	12.4	14.3	19.2	22.8	25.5 5/
Provisions against problem loans/problem loans	73.3	63.1	64.6	62.6	63.6 5/
Total provisions/problem loans	85.4	72.5	72.5	69.3	69.4 5/
Asset concentration					
Share of claims on government 1/	32.6	35.8	34.3	32.1	32.8
Share of claims on private sector 1/	33.9	35.7	33.8	31.9	30.3
Of which: trade and services	44.8	44.7	43.8	44.5	45.0 4/
Of which: construction	21.9	22.2	22.4	20.7	19.2 4/
Net foreign currency assets as percent of capital	19.9	24.6	25.3	26.3	24.5 5/
Earnings					
Average return on assets	1.4	1.0	0.7	0.5	0.9 4/
Average return on equity	23.8	15.7	11.1	9.1	14.8 4/
Liquidity					
Net liquid assets/total assets	55.4	54.3	56.0	45.9	39.4 5/
Net liquid assets/short-term liabilities	66.4	65.1	66.5	54.2	46.5 5/
Macro indicators 1/					
Change in assets	20.6	10.8	11.3	5.8	6.0
Change in private sector credit	20.9	12.4	5.9	-0.2	0.5
Change in claims on the public sector	35.6	21.7	6.5	-0.9	8.4
Change in deposits	19.8	11.6	10.8	6.2	4.0
Fiduciary accounts (in billions of Lebanese pounds)	194.0	249.7	448.0	727.8	927.2 5/
Dollarization of deposits 2/	65.0	60.8	66.0	71.9	71.6
Banking system's foreign exchange cover 3/	...	32.2	30.2	25.7	24.1
(In billions of Lebanese pounds, unless otherwise indicated)					
Memorandum items:					
Assets	58,283	63,862	71,614	75,161	77,648 5/
In percent of GDP	236.5	256.0	289.7	299.3	300.1 5/
Capital	4,179	4,522	4,872	5,126	5,433 5/
In percent of GDP	17.0	18.1	19.7	20.4	21.0 5/

Sources: Banque du Liban and Banking Control Commission.

1/ Commercial banks only.

2/ Foreign currency deposits of residents and nonresidents as a share of total deposits of residents and nonresidents.

3/ Commercial banks' net claims on nonresident banks plus the BdL's liquid foreign exchange reserves, in percent of total deposits.

4/ Data for June 2002.

5/ Data for August 2002.

Table 8. Lebanon: Summary Balance of Payments, 1999–2007

(In millions of U.S. dollars)

			Prel.	Est.	Projections					
	1999	2000	2001	Q1-Q3 2002	2002	2003	2004	2005	2006	2007
Current account	-3,317	-3,059	-3,449	-1,805	-2,572	-2,599	-2,512	-2,443	-2,393	-2,251
Trade balance	-5,086	-5,083	-5,919	-3,651	-5,058	-5,304	-5,075	-4,951	-4,870	-4,763
Exports f.o.b.	695	712	880	754	993	1,161	1,318	1,527	1,693	1,927
Imports f.o.b.	-5,780	-5,795	-6,800	-4,405	-6,051	-6,465	-6,393	-6,477	-6,563	-6,690
Services	790	1,002	1,200	1,018	1,379	1,622	1,482	1,408	1,360	1,358
Factor	165	449	-24	-230	-267	-392	-562	-696	-865	-1,007
Nonfactor	624	552	1,224	1,247	1,646	2,014	2,044	2,105	2,225	2,365
Unrequited transfers	979	1,022	1,270	829	1,106	1,084	1,081	1,099	1,117	1,154
Public	91	89	492	262	321	220	200	200	200	200
Private	888	932	778	567	785	864	881	899	917	954
Capital account	1,783	868	1,232	1,648	2,926	8,206	3,234	4,007	3,646	4,147
Public sector (net)	192	112	-45	605	1,193	2,330	-34	-60	-100	-40
Project loans (net)	-125	18	93	14	3	1	-34	-60	-100	-40
Paris II loans	0	0	0	0	0	2,905	0	0	0	0
Eurobonds	...	147	380	624	824	-212	0	0	0	0
Purchases by nonresidents	...	225	488	654	854	0	74	230	141	50
Principal repayment to nonresidents	...	-78	-109	-30	-30	-212	-74	-230	-141	-50
Treasury bill purchases held by nonresidents (net)	...	-54	-518	-34	366	-364	0	0	0	0
Securitization	0	0	0	0	0	500	0	0	0	0
Privatization	0	0	0	0	0	2,250	900	975	525	525
Private nonbank sector (net)	1,591	756	1,277	1,043	1,733	3,126	2,368	3,092	3,221	3,661
Direct investment	1,400	1,037	1,706	1,277	1,704	1,944	1,558	1,791	2,031	2,132
Portfolio investment and nonbank capital	191	-281	-429	-234	29	1,182	810	1,301	1,190	1,529
Errors and omissions	1,795	1,903	1,046	-79	-79	0	0	0	0	0
Overall balance	261	-289	-1,172	-236	274	5,608	722	1,564	1,253	1,895
Financing	-261	289	1,172	236	-274	-5,608	-722	-1,564	-1,253	-1,895
Change in the NFA of the Banque du Liban	-1,350	1,706	1,471	1,369	562	-5,414	-22	-1,064	-753	-1,098
Change in the NFA of the commercial banks	1,089	-1,417	-299	-1,133	-836	-194	-700	-500	-500	-797
Memorandum items:										
Exports (in percent of GDP)	4.2	4.3	5.3	5.8	5.7	6.4	6.9	7.5	7.9	8.5
Imports (in percent of GDP)	34.9	35.3	40.8	33.9	34.9	35.5	33.3	31.9	30.6	29.4
Current account balance (in percent of GDP)	-20.0	-18.7	-20.7	-13.9	-14.8	-14.3	-13.1	-12.0	-11.2	-9.9
External public debt (in millions of U.S. dollars) 1/	4,001	4,759	4,714	5,319	5,907	8,237	8,204	8,143	8,043	8,003
External public debt (in percent of GDP) 1/	24.2	29.0	28.3	31.0	34.1	45.2	42.7	40.1	37.5	35.2
External debt service (in percent of current receipts)	11.4	12.7	11.7	11.0	11.5	15.7	20.8	23.1	21.4	15.9
Gross official reserves (excluding gold)										
In millions of U.S. dollars	7,727	5,895	4,402	3,601	3,898	9,312	9,334	10,397	11,151	12,249
In percent of M3	25.9	18.0	12.5	10.0	10.5	23.8	22.6	23.8	24.2	25.1
In months of imports of goods and services	13.1	9.8	6.5	5.8	6.4	14.4	14.5	16.0	16.9	18.3
GDP (in millions of U.S. dollars)	16,545	16,399	16,660	13,000	17,333	18,210	19,226	20,296	21,426	22,729

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

1/ Foreign currency public debt adjusted for Eurobond holdings by Lebanese commercial banks and holdings of domestic currency-denominated government securities by nonresidents.

Table 9. Lebanon: Indicators of Financial and External Vulnerability, 1998–2002

(End of period, unless otherwise noted)

	1998	1999	2000	Prel. 2001	Prel. Sep. 2002
Monetary and financial indicators					
Broad money (annual percentage change)					
In current prices	16.1	11.1	9.6	7.4	5.1
In constant prices	11.0	10.9	10.0	7.5	2.4
Domestic currency broad liquidity (M2)					
In percent of broad money	40.9	45.0	39.5	32.7	32.4
In percent of domestic currency public debt	76.3	81.2	74.1	63.5	62.8
Private sector credit (annual percentage change)					
At current prices	20.5	12.2	6.0	-0.4	0.5
At constant prices	15.3	12.0	6.4	-0.3	-2.1
Public finance indicators					
Overall fiscal balance (in billions of Lebanese pounds) 1/	-4,450	-4,029	-6,083	-4,880	-4,085
In percent of GDP	-18.1	-16.2	-24.6	-19.4	-15.6
In percent of government revenue	-100	-83	-128	-105	-70
Gross debt (in billions of Lebanese pounds) 1/	27,983	33,718	37,643	42,674	48,123
In percent of government revenue	629	693	793	918	826
Interest payments on debt (in billions of Lebanese pounds) 1/	3,352	3,625	4,197	4,312	4,755
In percent of GDP	13.6	14.5	17.0	17.2	18.2
In percent of government revenue	75.3	74.5	88.4	92.8	81.6
(In percent)					
Banking sector indicators					
Problem loans/total loans 2/	12.4	14.3	19.2	22.8	25.5
Provisions against problem loans/problem loans 2/	73.3	63.1	64.6	62.6	63.6
Risk-weighted capital adequacy ratio 2/	18.7	15.0	16.9	18.0	18.8
Credit to the private sector (in percent of GDP)	75.8	84.2	91.0	89.2	89.1
(In millions of U.S. dollars)					
Debt indicators					
Gross public debt	18,557	22,367	24,971	28,275	30,888
In percent of GDP	113.6	135.2	152.3	169.7	179.9
<i>Of which:</i> foreign currency	4,176	5,842	7,529	10,223	12,287
In percent of GDP	25.6	35.3	45.9	61.4	71.6
External public debt	2,555	4,001	4,759	4,714	5,319
In percent of GDP	15.7	24.2	29.0	28.3	31.0
Gross public debt held by the market	16,041	19,597	20,543	20,396	22,547
In percent of GDP	98.2	118.4	125.3	122.4	131.4
Short-term external debt (public and private) 3/	6,593	7,969	8,750	8,375	9,154
<i>Of which:</i> foreign liabilities of commercial banks	5,908	6,393	7,190	7,347	7,039
Official reserves					
Gross official reserves 4/	6,508	7,727	5,895	4,402	3,601
In percent of M2	59.3	57.6	45.6	38.4	30.8
In percent of short-term external debt	98.7	97.0	67.4	52.6	39.3
Net official reserves 4/ 5/	3,330	4,980	2,615	-1,325	-2,545
In percent of M2	30.3	37.1	20.2	-11.6	-21.8
In percent of short-term external debt	50.5	62.5	29.9	-15.8	-27.8
Commercial banks' net foreign asset position	709	-482	969	1,269	2,385

Table 9. Lebanon: Indicators of Financial and External Vulnerability, 1998–2002 (Concluded)

(End of period, unless otherwise noted)

	1998	1999	2000	<u>Prel.</u> 2001	<u>Prel.</u> Sep. 2002
	(In millions of U.S. dollars)				
External current account indicators					
Merchandise exports, f.o.b.	668	695	712	880	754
Annual percentage change	2.8	4.1	2.5	23.6	20.3
Merchandise imports, f.o.b.	6,581	5,780	5,795	6,800	4,405
Annual percentage change	-4.6	-12.2	0.3	17.3	-8.3
External current account balance 1/	-4,399	-3,317	-3,059	-3,449	-2,572
In percent of GDP	-27.1	-20.0	-18.7	-20.7	-14.8
In percent of exports of goods and services	-247	-181	-173	-129	-81

Sources: Lebanese authorities; Bank for International Settlements; IMF, *World Economic Outlook*; and Fund staff estimates and projections.

1/ For 2002, projection for year as a whole or end of period.

2/ For 2002, the latest observation is for June for capital adequacy ratio and August for the other variables.

3/ Includes short-term public debt (nonresident treasury bill holdings, debt coming due in the next 12 months, and foreign liabilities of central bank) and total foreign liabilities of commercial banks.

4/ Excluding gold holdings of about \$3 billion (valued in September 2002).

5/ Excluding foreign currency deposits held by commercial banks with the BdL and the BdL's foreign liabilities.

Table 10. Lebanon: Public Debt Sustainability Framework, 2001–2007 1/

(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	Projections			
				2004	2005	2006	2007
I. Baseline Medium-Term Projections (Based on the Authorities' Scenario)							
1. Gross public debt	169.7	184.2	148.9	141.2	130.6	122.0	112.0
2. Change in gross public debt	17.4	14.5	-35.3	-7.7	-10.6	-8.5	-10.1
3. Identified debt-creating flows (lines 4+7+10)	21.2	12.0	-19.1	-8.7	-10.9	-8.7	-10.2
4. Primary deficit (financing basis, excluding grants)	4.9	-0.6	-4.2	-6.1	-7.4	-8.3	-9.1
5. Revenue	18.5	22.3	23.7	23.8	24.3	24.3	24.3
6. Primary expenditure+statistical discrepancy	23.4	21.7	19.4	17.7	16.9	16.1	15.2
7. Other non-debt creating inflows (negative sign)	-0.1	0.0	-17.8	-6.2	-6.4	-3.3	-3.1
8. Unrequited grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0
9. Privatization receipts	0.0	0.0	17.8	6.2	6.4	3.3	3.1
10. Automatic debt dynamics 2/	16.5	12.6	3.0	3.7	3.0	2.8	1.9
11. Contribution from real interest rate 3/	19.8	16.1	7.2	7.7	7.3	6.8	6.2
12. Contribution from real GDP growth 4/	-3.3	-3.5	-4.3	-4.0	-4.3	-4.0	-4.2
13. Residual, including change in assets (lines 2–3)	-3.8	2.4	-16.2	1.0	0.2	0.2	0.2
Change in government deposits	-3.0	-0.1	-0.4	-0.4	-0.4	-0.3	-0.3
Other residual 5/	-0.7	2.6	-15.8	1.3	0.6	0.5	0.5
Key Macroeconomic and External Assumptions							
Nominal GDP (in billions of Lebanese pounds)	25,115	26,130	27,452	28,982	30,596	32,300	34,264
Real GDP growth (in percent per year) (=g)	2.0	2.0	3.0	3.0	3.5	3.5	4.0
Nominal GDP deflator (in Lebanese pounds, change in percent per year) (=p)	-0.4	2.0	2.0	2.5	2.0	2.0	2.0
Average nominal interest rate on government debt (in percent) (=r) 6/	11.5	11.2	7.1	8.3	8.0	8.0	7.9
Average real interest rate (nominal rate minus GDP deflator growth (in percent))	11.9	9.2	5.1	5.8	6.0	6.0	5.9
Exchange rate (Lebanese pounds per U.S. dollar, average of period)	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5
Growth of revenue (deflated by GDP deflator, in percent per year)	-1.7	22.9	9.2	3.8	5.6	3.4	3.9
Growth of expenditure (deflated by GDP deflator, in percent per year)	-12.2	1.6	-13.2	-5.0	-3.2	-2.6	-2.5
Gross public debt/revenue (in percent)	916.9	825.6	629.5	592.1	536.8	502.0	460.9
II. Sensitivity Analysis for Public Debt-to-GDP Ratio							
1. Interest rate, real GDP growth, GDP deflator growth, primary balance, and non-debt flows are at average of past 10 years			201.1	219.2	238.4	258.9	280.6
2. Interest rate in 2003–04 is average plus two standard deviations			176.4	193.3	184.1	177.0	168.1
3. Real GDP growth rate in 2003–04 is average minus two standard deviations			158.3	158.5	148.5	140.6	131.0
4. GDP deflator growth in year 2003 is average minus two standard deviations			160.6	153.4	143.3	135.3	125.6
5. Primary balance in 2003–04 is average minus two standard deviations			166.7	178.6	169.1	161.6	152.5
6. Combination of 2–5 using one standard deviation shocks			191.0	223.3	214.8	208.4	200.0
7. One time 30 percent depreciation in 2003, other variables at baseline			183.7	177.1	167.6	160.1	150.8
8. Privatization receipts are half of baseline; interest rate, real GDP growth, and primary surplus are at baseline plus (minus) one standard deviation			173.3	183.7	192.2	202.2	211.0
Historical Statistics for Key Variables							
(Past 10 years 1993–2002, except for GDP deflator)		Historical Average		Standard Deviation		Average 2003–07	
Primary deficit		5.7		3.6		-7.0	
Net non-debt-creating inflows		0.7		...		7.4	
Interest rate (in percent) (=r)		15.5		3.5		7.9	
Real GDP growth rate (in percent) (=g)		3.7		2.6		3.4	
GDP deflator growth (past 9 years, in percent) (=p)		4.6		4.1		2.1	

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

1/ Based on the methodology set out in SM/02/166.

2/ Derived as $(r-g-(p+gp))/(1+g+p+gp)$ times previous period debt ratio, with r = nominal interest rate, g = real GDP growth rate, and p =growth rate of GDP deflator.

3/ Defined as $r-(p+gp)$ divided by the denominator in footnote 2.

4/ Defined as $-g$ divided by the denominator in footnote 2.

5/ Including a debt write-off by the central bank in 2003, equivalent to 9.9 percent of GDP.

6/ Interest payments in the period, divided by the stock of debt at the end of the previous period.

Lebanon: Fund Relations
(As of October 31, 2002)

I. Membership Status: Joined 04/14/47; Article VIII (07/01/93).		
II. General Resources Account:	<u>SDR million</u>	<u>% Quota</u>
Quota	203.00	100.00
Fund holdings of currency	184.17	90.72
Reserve position in Fund	18.83	9.28
III. SDR Department:	<u>SDR Million</u>	<u>% Allocation</u>
Net cumulative allocation	4.39	100.00
Holdings	19.92	453.45
IV. Outstanding Purchases and Loans:	None	
V. Financial Arrangements:	None	
VI. Projected Obligations to Fund:	None	

Nonfinancial Relations

VII. Exchange Arrangement

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

VIII. Article IV Consultation

The 2001 Article IV consultation was concluded by the Executive Board on October 17, 2001 (EBS/01/162).

IX. 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 (FO/DIS/99/113). 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 (SM/01/281).

X. Technical Assistance, 1997–2002

Fiscal area—In recent years, FAD has provided advice on introducing the VAT, reforming customs tariffs and income taxes, strengthening the tax and customs administrations, and improving public expenditure management. This technical assistance was well received by the Ministry of Finance and, notably on the VAT, its positive impact has been substantial. However, considerable needs remain in several areas of public finance, including tax policy, tax administration, budget preparation, fiscal management, and public accounting and reporting.

Financial sector—Over the past few years, the Monetary and Exchange Affairs Department has provided technical assistance in the areas of payments system and vulnerability indicators. The related missions undertook an assessment of compliance with Core Principles for Systemically Important Payments Systems, advised on development of 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 facilitate the development of capacity to monitor systemic financial sector vulnerabilities. The authorities have reported some progress in these areas. A technical assistance team is expected to be in Beirut later this year/early next year to assist in the area of securities settlement system.

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 and there are no official PPI and CPI data available, and the balance of payments data remains incomplete. In early 2002, a multisector statistics/GDDS mission provided an update on the status of data in all economic sectors, and prepared action plans for improvement. The Technology and General Services Department has provided technical assistance for creating a time-series database at the BdL. Technical assistance needs remain substantial, particularly in the areas of national accounts, price statistics, and balance of payments.

Missions—The technical assistance missions during the last five years were:

Date	Department	Topic
Feb. 24–Mar. 7, 1997	STA	Balance of payments statistics
Jul. 30–Aug. 15, 1997	FAD	Review of the 1995 tariff and excises reforms
Mar. 9–23, 1998	MAE	Payments system development
Nov. 10–23, 1998	MAE	Payments system development
Mar. 10–24, 1999	FAD	Review of public expenditure management and tax policy
Oct. 25–Nov. 5, 1999	STA	Price statistics
Nov. 8–19, 1999	FAD	Public finance management
Feb. 28–Mar. 10, 2000	STA	Balance of payments statistics

Jul. 3–10, 2000	FAD	Income tax administration
Oct. 23–Nov. 3, 2000	STA	Price statistics
Aug. 3–10, 2000	FAD	Public expenditure management
Aug. 9–21, 2000	FAD	Tariff reform
Mar. 27–Apr. 10, 2001	FAD	Tax policy and administration
Jun. 11–22, 2001	STA	Portfolio investment and capital flows
Jun. 20–Jul. 3, 2001	FAD	Tax policy and administration
Jun. 27–Jul. 6, 2001	FAD	Public expenditure management
Jul. 2–12, 2001	MAE	Development of macro-prudential indicators
Jul. 9–23, 2001	MAE	Payments system development
Oct. 29–Nov. 13, 2001	FAD	Tariff and VAT
Mar. 25–Apr. 5, 2002	STA	Multisector statistics/GDDS
Apr. 15–26, 2002	BTS	Database at Banque du Liban
Aug. 6–20, 2002	FAD	VAT and customs administration
Sep. 9–23, 2002	FAD	Income tax reform

XI. Resident Representatives

None

Lebanon: Relations with the World Bank Group¹

Background

1. The Bank reinitiated its activities in Lebanon in 1991 after a long hiatus. During 1991–92, the Bank undertook an economic assessment and an evaluation of priority post-war reconstruction needs, convened a donors’ meeting to mobilize support for reconstruction, and helped the government prepare a National Emergency Recovery Program (NERP). In early 1993, after economic stability had been reestablished, the Bank extended a \$225 million loan for the Emergency Reconstruction and Rehabilitation Project (ERRP) to finance high priority components of the NERP, particularly in the electricity, water and waste water, and solid waste sectors. The project closed in FY2002. Since then, the Bank extended 14 further loans for a total of \$564 million.

Current and medium-term initiatives

2. The Executive Directors last considered a Country Assistance Strategy (CAS) for Lebanon in November 1997, for the fiscal years 1998–2000. Three strategic objectives were identified: (i) rehabilitation and expansion of infrastructure and institutional development; (ii) environmentally sustainable development; and (iii) upgrading the human resource base and addressing poverty. A base-case program of \$600 million in loans and guarantees predicated upon good portfolio performance, and an improvement in macroeconomic performance (evidenced by sustained reduction in fiscal deficits and stabilization of the debt-to-GDP ratio) was envisaged. A low-case scenario of \$225 million in loans and a high-case program of \$825 million in loans and guarantees were also endorsed; portfolio and macroeconomic triggers would determine the actual scenario and lending levels.

3. Our current assistance strategy over the short-to medium-term recognizes the need to support the government of Lebanon in its efforts to restore economic growth and reverse the underlying debt dynamics that stem from fiscal imbalances. Lending operations and technical assistance programs have been designed to selectively engage the government in critical areas in which the Bank’s involvement would be catalytic. At the same time, the strategy recognizes that other instruments for needs assessment and service delivery—particularly, nongovernmental organizations (NGOs) and municipal councils—either already exist as successful counterparts to central ministries or, with targeted support, could be further strengthened, becoming effective links in the social safety net. Finally, the strategy recognizes that critical investments in the area of infrastructure reconstruction and rehabilitation and financed by Bank lending during the first two CAS periods needs follow-up investment in order to preserve their effectiveness and promote environmental sustainability. The Bank will begin shortly the preparation for a Country Assistance Strategy

¹ Prepared by World Bank staff.

covering the period of FY 2004–06, expected to be discussed at the Board in early Fiscal Year 2004.

4. Recent World Bank projects have an enhanced poverty focus, signaling a reorientation of our program to targeting the poorest parts of Lebanon with smaller, faster implementing projects. A \$20 million Bank loan for a Community Development Project was approved in June 2001. Demand for this project is high from NGOs and local communities. The Ba'albeck Water and Wastewater (approved in FY02) and the Cultural Heritage and Urban Development (under preparation) are expected to provide a comprehensive development orientation for poorer areas.

5. The Bank's **existing portfolio** in Lebanon consists of \$517.9 million in commitments for 13 projects, all approved in the period since 1993. As of November 30, 2002, \$150 million had been disbursed. The average age of the portfolio is five years. The current portfolio reflects an emphasis on addressing strategic priorities and rebuilding basic physical, social, and institutional infrastructure after the damage of 15 years of war: agriculture and rural development, environment, transport, health, education and vocational training, water supply and sanitation, municipal infrastructure, revenue enhancement and administrative rehabilitation.

6. The Bank's portfolio needs constant attention. The slow disbursements are evidence of the difficulties in making donor assistance effective. Following intense restructuring efforts since the June 2001 Country Portfolio Performance Review (CPPR), the overall portfolio ratings have improved significantly. The disbursement rate had, however, yet to pick up after the measures to solve implementation bottlenecks. The Bank conducted a second CPPR in October 2002 to agree on measures to accelerate the disbursement rate of the projects, to improve the projects' development impact, and reduce the government's commitment charges.

7. Analytical and advisory services include support on the overall economic reform process, asset liability management, and the social security/pension system. Requests have been made to further assist the government on developing a more detailed strategy for asset liability management, a public expenditure review in selected areas, and analysis of the impact of the proposed adjustment program on the balance sheet of the banking sector.

8. The International Finance Corporation (IFC) also resumed activities in 1993, and has since invested \$339 million in 35 projects, with an additional \$256 million in syndications. IFC has heavily invested in the financial sector, which accounted for three quarters of total investment for IFC's own account, much of it in credit lines to Lebanese banks. IFC has also invested in tourism, telecoms and cement sectors. Lebanon is the third largest market for IFC in the Middle East and North Africa (MENA) region with a held portfolio at the end of November 2002 of \$90 million plus another \$40 million in B-loans with participant banks. However, the slowdown in the economy has resulted in a lower overall deal flow for IFC. IFC is now looking at mechanisms to support the private sector during the current economic situation, such as trade finance. The Corporation was also awarded the mandate from the

government to provide advisory services for the privatization of Middle East Airlines (MEA). Many of IFC's recommendations were put into effect, resulting in significant improvements in its financial position. However the actual sale of MEA has been put on hold due to the difficult conditions in the airline business worldwide.

9. Lebanon is a member of the Multilateral Investment Guarantee Agency (MIGA). No guarantees nor commitments have been issued yet.

Status of Bank Group Operations in Lebanon

Statement of IBRD Loans (As of November 30, 2002)

Closed Projects

IBRD/IDA

Total disbursed (active)	144.04
Of which has been repaid	36.62
Total disbursed (closed)	360.40
Of which has been repaid	157.13
Total disbursed (active + closed)	504.44
Of which has been repaid	193.75
Total undisbursed (active)	367.97
Total undisbursed (closed)	0.00
Total undisbursed (active + closed)	367.97

Active Projects

Project ID	Fiscal Year	Project Name	Amounts in Millions of U.S. Dollars	
			IBRD Less Cancellations	Undisbursed
P034037	1997	Agri. Infra Devel.	24.00	12.2
P034004	1995	Health Project	35.70	19.4
P071113	2001	LB-Community Development Project	20.00	20.0
P034035	1996	LB-Admin. Rehab.	20.00	1.3
P074042	2002	LB-Ba'Albeck Water and Wastewater	43.53	43.5
P050544	2000	LB-First Municipal Infrastructure	80.00	64.4
P045174	2000	LB-General Education	56.57	55.2
P005344	1994	LB-Irrigation	57.23	13.6
P038674	1997	LB-National Roads	42.00	24.6
P005340	1994	LB-TA for Revenue Enhan.	19.94	3.9
P034038	2002	LB-Urban Transport Development Project	65.00	65.0
P005345	1995	Solid Waste/Environment	25.00	17.3
P038687	1998	Vocational and Tech. Ed.	29.00	27.6
Total			517.97	368.0

Statement of IFC Investments

(As of June 2002)

FY Approval	Company	Held				Disbursed			
		Loan	Equity	Quasi	Partic.	Loan	Equity	Quasi	Partic.
1997	ADC	2.92	0	0	0	2.92	0	0	0
1993/96	BBAC	2.5	0	0	3.1	2.5	0	0	3.1
1997	Bank of Beirut	5.86	0	0	0	5.86	0	0	0
1997/99	Banque Saradar	0	11	0	0	0	11	0	0
1993/96/99	Byblos Bank	22.83	0	0	17.74	22.83	0	0	17.74
1997	FTML Services	0	0	10	0	0	0	10	0
1993/94/96	Fransabank	2.4	0	0	2.95	2.4	0	0	2.95
1998	Idarat	5	1.5	0	0	5	1.5	0	0
1998	Idarat SHV	2.57	0	0	0	2.57	0	0	0
2000	Leb. Credit Ins.	0	0.5	0	0	0	0.5	0	0
1995/99/01	Lebanese Leasing	5.25	0	0	0	5.25	0	0	0
1994/96	Libano-Francaise	5	0	0	6.64	5	0	0	6.64
1996	MidEast Capital	0	3	0	0	0	3	0	0
1994/96	SGLEB	3.75	0	0	5.09	3.75	0	0	5.09
1993	Uniceramic	0	0	0.8	0	0	0	0.8	0
Total portfolio		58.08	16	10.8	35.52		16	10.8	35.52

Approvals Pending Commitment

		Loan	Equity	Quasi	Partic.
1996	SGLEB Housing CL	2	0	0	0
Total pending commitment		2	0	0	0

Source: World Bank.

Lebanon: Statistical Issues

1. **Gaps in the coverage of macroeconomic statistics since the civil war period hamper effective monitoring of economic developments.** At present, monetary accounts, financial markets data, public debt statistics, and central government budgetary accounts are available on a regular basis. Most other data (national income accounts, prices, employment, nongovernment public sector, and balance of payments) are estimated on the basis of partial information and indicators. The government has decided to participate in the GDDS and to use it as a framework for the development of the country's statistical system. A GDDS coordinator has been appointed and the authorities have provided STA with the required "meta data."
2. **The availability of real sector data remains very limited.** Official national accounts statistics have 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. The Central Administration for Statistics (CAS) is currently receiving technical assistance for the development of national accounts statistics and it hopes to compile the first set of national accounts estimates in 2003 for the 2001 reference year. A steering committee has been established under the Ministry of Economy and Trade that, with technical assistance from France, is working on producing GDP estimates for 1997–2001. In parallel, the CAS has developed its own working plan for the implementation of a sustainable improvement in the statistics system, with the assistance from the EU, and key steps include: updating the census on buildings, dwellings and establishments; developing and undertaking economic surveys; and conducting a household budget survey.
3. **No comprehensive official price index is produced.** Consumer price indices are prepared by the Ministry of Economy and private organizations on the basis of a limited basket of goods for the greater Beirut metropolitan area. With technical assistance from STA, quarterly price indices for 1999 were compiled using weights from the 1997 household survey. The index was released in 2000. The collection of CPI data has continued, but the CAS has not published the index since 2000.
4. **Published monthly data on the central government budgetary accounts are not comprehensive.** The published figures do not include financing data, omit foreign-financed capital expenditure, and do not cover arrears. Extra-budgetary (treasury) spending is only reported ex-post, and its economic classification with a lag.¹ However, these items are provided to the staff in the context of surveillance activities. No sub-annual data are currently reported for publication in IFS.

¹ Extra-budgetary spending may include some transfers 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).

5. **The monetary accounts are generally reliable and timely.** STA has been able to bridge occasional delays in reporting to IFS by obtaining the missing data from the Banque du Liban's website.

6. **Lebanon's balance of payments are on a weak statistical footing,** with the authorities' own estimate showing unrecorded inflows to the tune of \$3.3 billion (20 percent of GDP) in 2001. This reflects both deficiencies in the current account (unrecorded exports, underestimation private sector services and workers' remittances) and the capital account (equity investment in the nonbank private sector, corporate borrowing abroad). Correcting for some of these deficiencies still yields substantial errors and omissions of about \$1 billion in 2001. This is about half of what was estimated in previous years and, on the whole, reflects an improvement of the BdL's institutional capacity to produce adequate balance of payments statistics. The statistical base is expected to improve substantially with the introduction of an International Transactions Reporting System (ITRS), developed with technical assistance from STA and now scheduled for introduction in early 2003.

7. **The authorities are improving the measurement of international reserves and foreign currency liquidity.** In cooperation with the mission, the Banque du Liban has started to implement the Fund's guidelines for the standard data template recently developed by STA.

Table 1. Lebanon: Reporting of Main Statistical Indicators
(As of October 2002)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Public Debt/ Debt Service
Date of latest observation	10/02	9/02	9/02	9/02	9/02	10/02	8/02	6/02	6/02	9/02	Est. 2001	9/02
Date received	10/02	10/02	10/02	10/02	10/02	10/02	10/02	10/02	10/02	10/02	5/02	10/02
Frequency of data	D	M	M	M	M	D/W/M	M	M	M	M	A	M
Frequency of publication	D	M	M	M	M	W/M	M	M	M	M	A	M
Frequency of reporting	D	M	M	M	M	W/M	At the time of mission or on request	M	At the time of mission	M	At the time of mission	M
Source of update	Reuters	BdL	BdL	BdL	BdL	BdL/MoF	BdL	BdL	BdL	Ministry of Finance (MoF)	Ministry of Finance with Department of Statistics and BdL	BdL
Mode of reporting	Reuters	e-mail	e-mail	e-mail	e-mail	e-mail	e-mail	Internet	Obtained on mission	Internet	Obtained on mission	e-mail
Confidentiality	Unrestricted	Restricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Restricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Published data	BdL webpage	BdL webpage	BdL webpage	BdL webpage	BdL webpage	BdL/MoF webpages	Unpublished	BdL webpage	BdL webpage	MOF webpage	BdL webpage	BdL webpage

Public Information Notice (PIN) No. 02/...
FOR IMMEDIATE RELEASE
[December 20, 2002]

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

IMF Concludes 2002 Article IV Consultation with Lebanon

On [December 20, 2002], the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lebanon.¹

Background

Macroeconomic conditions became increasingly difficult in 2001 and the first half of 2002, despite a modest pickup in growth in 2001-02, led by foreign direct investment in construction, and more recently by a strong tourism sector. Domestic demand remains depressed by the high real interest rates, caused by the burgeoning government debt and the large fiscal deficits. Competitiveness has been adversely affected by the substantial appreciation of Lebanon's real effective exchange rate over the past several years—mainly a result of Lebanon's de facto peg to the U.S. dollar and the latter's strength vis-à-vis world currencies—even if some improvement has occurred over the past year with the weakening of the U.S. dollar.

The overall fiscal deficit was reduced from 24.6 percent of GDP in 2000 to 19.4 percent of GDP in 2001 and, based on the performance in the first three quarters, is projected to be reduced to 15.6 percent in 2002. Most of the adjustment in 2001 was achieved through a sharp reduction in spending, while in 2002, it was achieved mostly through higher revenue with the value-added tax (VAT) introduced in February 2002. The government debt, built up over a decade of double digit fiscal deficits, has continued to rise, reaching \$31 billion, or 183 percent of GDP in October 2002. In the last two and a half years, the government has found it increasingly difficult to finance its deficit from normal market sources, and has had to rely

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. This PIN summarizes the views of the Executive Board as expressed during the [December 20, 2002] Executive Board discussion based on the staff report.

heavily on central bank credit. The central bank, having financed almost the entire deficit in 2001, came under additional pressure in the first half of 2002 as commercial banks, faced with a decline in deposits and increased deposit dollarization, did not roll over fully their treasury bill holdings. In the context of a fixed exchange rate and weak money demand, the central bank suffered heavy losses of foreign exchange reserves. Spreads on Lebanese Eurobonds in the secondary market has risen to about 1,000 basis points.

After a period of intense pressure in the foreign exchange market for most of 2001 and the first five months of 2002, economic performance and confidence began to improve, but the underlying macroeconomic situation remains adverse and vulnerable to shifts in sentiment. The recent improvements reflect renewed regional interest in Lebanon for portfolio and real estate investments, and as a tourist destination. Domestic factors, including broader political consensus over the government's economic strategy, have also played a role. As a result, economic activity appears to have picked up, broad money growth has resumed, and the balance of payments has recorded a large surplus since June, helped by the sale of Eurobonds abroad in recent months. Consequently, the central bank has been able to improve somewhat its foreign exchange reserves position. At the end of October 2002, the central bank's gross international reserves (excluding gold) stood at \$3.6 billion, compared with \$3.1 billion in June 2002 and \$4.4 billion at the end of 2001. Its net international reserves amounted to minus \$2.1 billion in October, compared with minus \$3.0 billion in June and minus \$1.3 billion at end-2001.

The authorities' economic strategy for 2003 and the medium term aims at reducing the government debt and its servicing cost, and to restore growth. This strategy relies on a combination of fiscal adjustment and structural reforms with the mobilization of large amounts of financing from privatization and external financial assistance on concessional terms. The draft 2003 budget would be consistent with a primary surplus of 4.2 percent of GDP, compared with a projected primary surplus of 2.6 percent in 2002. Over the medium term the authorities aim for a primary surplus of 9 percent of GDP by 2007. The authorities also expect substantial proceeds from privatization in 2003–07, and have made extensive preparations over the past year in the telecommunications and power sectors. As for official assistance, at the Paris II conference held on November 23, 2002, the government secured commitments for about \$3 billion in budgetary support and another \$1.3 billion in project loans. The government would use privatization receipts and Paris II-related inflows to retire debt held by the private sector, expecting the improved confidence to put downward pressure on interest rates. Lower interest rates would reduce the debt burden and help revive investment and growth.

Executive Board Assessment

<Begin Typing Here>

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Lebanon: Selected Economic Indicators, 1996–2001

	1996	1997	1998	1999	2000	2001
(Annual percentage changes)						
Domestic economy						
Change in real GDP	4.0	4.0	3.0	1.0	-0.5	2.0
Change in consumer prices (period average) 1/	8.9	7.7	4.5	0.2	-0.4	-0.4
External economy						
(In billions of U.S. dollars, unless otherwise indicated)						
Exports, f.o.b.	0.8	0.6	0.7	0.7	0.7	0.9
Imports, f.o.b.	-7.0	-6.9	-6.6	-5.8	-5.8	-6.8
Current account balance	-4.8	-4.4	-4.4	-3.3	-3.1	-3.4
In percent of GDP	-37.1	-29.4	-27.1	-20.0	-18.7	-20.7
Capital account balance	5.6	4.8	3.9	1.8	0.9	1.2
Overall balance	0.8	0.4	-0.5	0.3	-0.3	-1.2
Gross official reserves 2/	9.3	8.6	9.2	7.7	5.9	4.4
Change in real effective exchange rate (in percent)	12.1	18.1	8.1	1.8	6.1	2.1
Financial variables						
(In percent of GDP, unless otherwise indicated)						
Central government						
fiscal balance 3/	-21.1	-27.0	-18.1	-16.2	-24.6	-19.4
Gross government debt	98.9	102.7	113.6	135.2	152.3	169.7
<i>Of which</i>						
In foreign currency	14.5	16.2	25.6	35.3	45.9	61.4
Change in broad money 4/	27.8	19.3	16.1	11.1	9.6	7.4
Yield on 24-month Lebanese pound treasury bills 5/	20.5	16.7	16.7	14.1	14.1	14.1

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

1/ For Beirut and suburbs.

2/ Excluding gold.

3/ Overall balance, after grants, on a checks-issued basis.

4/ In percent, end-of-period.

5/ In percent, end-of-period. Primary market rate.