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August 9, 1999

To: Members of the Executive Board

From: The Secretary

Subject: Lebanon—Staff Report for the 1999 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1999 Article IV consultation with Lebanon, which will be brought to the agenda for discussion on a date to be announced.

Mr. Allum (ext. 38535) and Mr. Al-Atrash (ext. 38579) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

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.

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LEBANON

Staff Report for the 1999 Article IV Consultation

Prepared by the Staff Representatives for
the 1999 Consultation with Lebanon

Approved by P. Chabrier and I. Kapur

August 6, 1999

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EXECUTIVE SUMMARY

- **Background.** Five years of double-digit fiscal deficits and sharply rising public debt have contributed to concerns about policy sustainability in Lebanon, reflected in high and volatile real interest rates. Reflecting these macroeconomic tensions, as well as a possible loss of competitiveness and excessive bureaucracy, economic growth has been sluggish.
- **1999 fiscal outlook.** An initial reduction in the fiscal deficit was achieved in 1998, and further gains are projected under the 1999 budget. However, while the envisaged deficit of 15 percent of GDP will be substantially lower than in 1996–97, net public debt will continue to rise, reaching a projected 120 percent of GDP at end-1999.
- **Fiscal program for 2000–01.** The new government has reaffirmed its intention to continue a program of fiscal consolidation. For 2000, the deficit goal is 11–12 percent of GDP, falling to 7 percent in 2001. Adjustment would be achieved through recently approved income tax increases, enhanced property taxation, introduction of a value-added tax (VAT) (in 2001), reduced capital spending, and tight controls on the public wage bill. The authorities also envisage privatization proceeds of up to US\$4 billion (over 20 percent of GDP) by 2003.
- **Exchange regime and structural reform.** The authorities intend to maintain the exchange rate peg for the present, arguing that a reduction before fiscal conditions are durably improved would be destabilizing. On balance, the staff can support this strategy, provided that fiscal policies are tightened in a determined and credible manner, and that structural reforms are accelerated. In the latter regard, key priorities are the reduction of tariff and nontariff trade barriers, and streamlining the public sector to make it more efficient and transparent.
- **Financial system assessment.** The May 1999 FSAP review of Lebanon's financial system, regulatory structure, and supervisory arrangements found that the system displays considerable institutional strengths, and regulatory arrangements are, in the main, generally effective. At the same time, stress tests reveal that a number of banks are vulnerable to credit and interest risk. While these banks represent only a modest share of the total system, this would likely complicate macroeconomic management in the event of a financial crisis.
- **Staff appraisal.** In the appraisal, the staff emphasizes: (i) determined fiscal efforts will be needed to achieve the deficit targets for 2000–01; (ii) maintenance of the exchange rate peg will only be sustainable if fiscal policies are credibly tightened in this manner; (iii) an acceleration of structural reform is urgently needed to improve Lebanon's supply responsiveness; (iv) while the banking system is currently sound, continuing efforts are needed to strengthen supervision; and (v) a strong priority should be given to improving economic data.

I. INTRODUCTION

1. **1999 Article IV consultation.** Discussions for the 1999 Article IV consultation with Lebanon were held in Beirut during June 8–22, 1999.^{1 2} Staff representatives met with the prime minister, minister of finance, minister of economy, trade, and industry, minister of labor and social affairs, the governor of the central bank, other senior officials, and private sector representatives. This year's Article IV exercise was supplemented by a review of financial sector developments and policies under the joint IMF-World Bank Financial Sector Assessment Program (FSAP);³ based on this review, a Financial Sector Stability Assessment (FSSA) is being circulated to the Executive Board in parallel with this report.

2. **Last consultation.** In the last Article IV consultation, completed in December 1997,⁴ Directors commended the authorities for the significant progress made in restoring the country's infrastructure and administrative capacity, and in strengthening financial market regulation and supervision. They expressed concern, however, about Lebanon's very sizable budget deficit and the increasingly uncomfortable debt dynamics, which were considered a major threat to macroeconomic and financial stability. They welcomed the measures in the 1998 budget, which, if fully implemented, would contribute to a fiscal adjustment path that would stabilize the debt dynamics.

3. **The new government took office in early December 1998.** General Emile Lahoud, with broad political support, won parliamentary elections to president in October 1998. Following consultations with parliament, Selim Al-Hoss was appointed prime minister in November 1998, replacing Rafiq Hariri, who had led the reconstruction efforts of the 1990s.

¹ The staff team included Mr. Allum (head), Messrs. Al-Atrash and Helbling, and Ms. Bhattacharya (all MED). Mr. Dhonte (MED), Mr. Shaalan, Executive Director, and Mr. Elhage, Advisor, participated in the policy meetings. The mission built on a March 10–23, 1999, staff visit, which focused on fiscal policies and prospects, including preparations for the 1999 budget.

² Lebanon accepted the obligations of Article VIII, Sections 2, 3, and 4 as of July 1, 1993, and maintains an exchange system that is free from restrictions on current international transactions.

³ The FSAP mission was headed by Mr. Honohan (World Bank) and Mr. Marston (IMF, MAE).

⁴ The delay in conducting the current Article IV consultation discussions was requested by the new government to give time for the formulation of economic policies, including the 1999 budget.

The new government vowed to continue and reinforce the former government's fiscal consolidation program (adopted in late 1997), as well as to promote privatization, administrative and structural reform, and a strengthening of transparency and governance.

II. RECENT DEVELOPMENTS AND PROSPECTS FOR 1999

4. **Overview.** Lebanon's five-year history of double-digit fiscal deficits has contributed to a sharp rise in public debt and a heavy interest burden. As a result, although the exchange rate peg to the U.S. dollar has contributed to low rates of inflation, real domestic interest rates remain high, reflecting concerns about policy sustainability. As the bulk of private sector credit is dollar denominated, the burden of high interest rates falls primarily on the budget. At the same time, economic growth has been sluggish for a number of years, reflecting growing macroeconomic instability and a possible loss of competitiveness, as well as excessive bureaucracy and other structural impediments. On the statistical front, efforts to assess economic developments in Lebanon continue to be severely hampered by the lack of adequate and reliable real sector and balance of payments data (see Box 1 and Appendix III).

A. Economic Activity and Growth

5. **From boom to sluggish expansion.** During 1996–98, the Lebanese economy saw disappointingly slow growth as the post-war real estate boom of 1994–95 failed to translate into broad-based recovery (Table 1 and Chart 1). This slowdown had multiple causes. On the structural front, important progress had been made by 1996–98 in restoring key infrastructures (power, roads, ports, etc.), but the business sector continued to face excessive state bureaucracy and other impediments, as well as an appreciating real exchange rate; accordingly, new investments in the industrial and agricultural sectors proved modest. In addition, while the *Horizon 2000* public reconstruction program (combined with a surge in private real estate investments from abroad) gave an initial impulse to growth, fiscal imbalances associated with the public investment program undermined macroeconomic stability.⁵ These factors were exacerbated by a downswing in domestic and external confidence as the 1995 presidential elections revealed continuing weaknesses in the political fabric, and as bold regional moves toward peace in the mid-1990s were followed by a relative hiatus from 1996, including Israeli bombing of Lebanon in April 1996. More recently, the weakening of world oil prices is believed to have had an additional effect on Lebanon through the compression of imports and regional investments by Gulf countries.

⁵ For a detailed discussion of developments and economic policies in Lebanon during 1993–97, see Occasional Paper No. 176 “Back to the Future: Postwar Reconstruction and Stabilization in Lebanon”, IMF, 1999.

Box 1. Lebanon: Estimating Real GDP Growth

In the absence of national account data in constant prices, the authorities estimate real GDP growth using various economic indicators. The real and nominal GDP levels are anchored by an estimate for the 1988 GDP in current prices that was derived in the context of a study conducted by the UNDP. Given the severe limitations of this approach, GDP estimates are subject to a high degree of uncertainty. Notwithstanding this, there is broad-based evidence of a slowdown in real growth during 1996–98.

Coincident indicator: The Banque du Liban (BdL) compiles a coincident indicator, based on both real and U.S. dollar-based variables.⁶ The rate of increase of this indicator slowed from 15.5 percent during 1994–95 to 4.9 percent in 1996–98 (Chart 2). BdL economists have also compiled an alternative indicator, adjusting the dollar-based series for inflation.⁷ This shows a somewhat larger slowdown, with the indicator rising at a 2.2 percent pace in 1996–98, compared to over 9 percent during 1994–95.

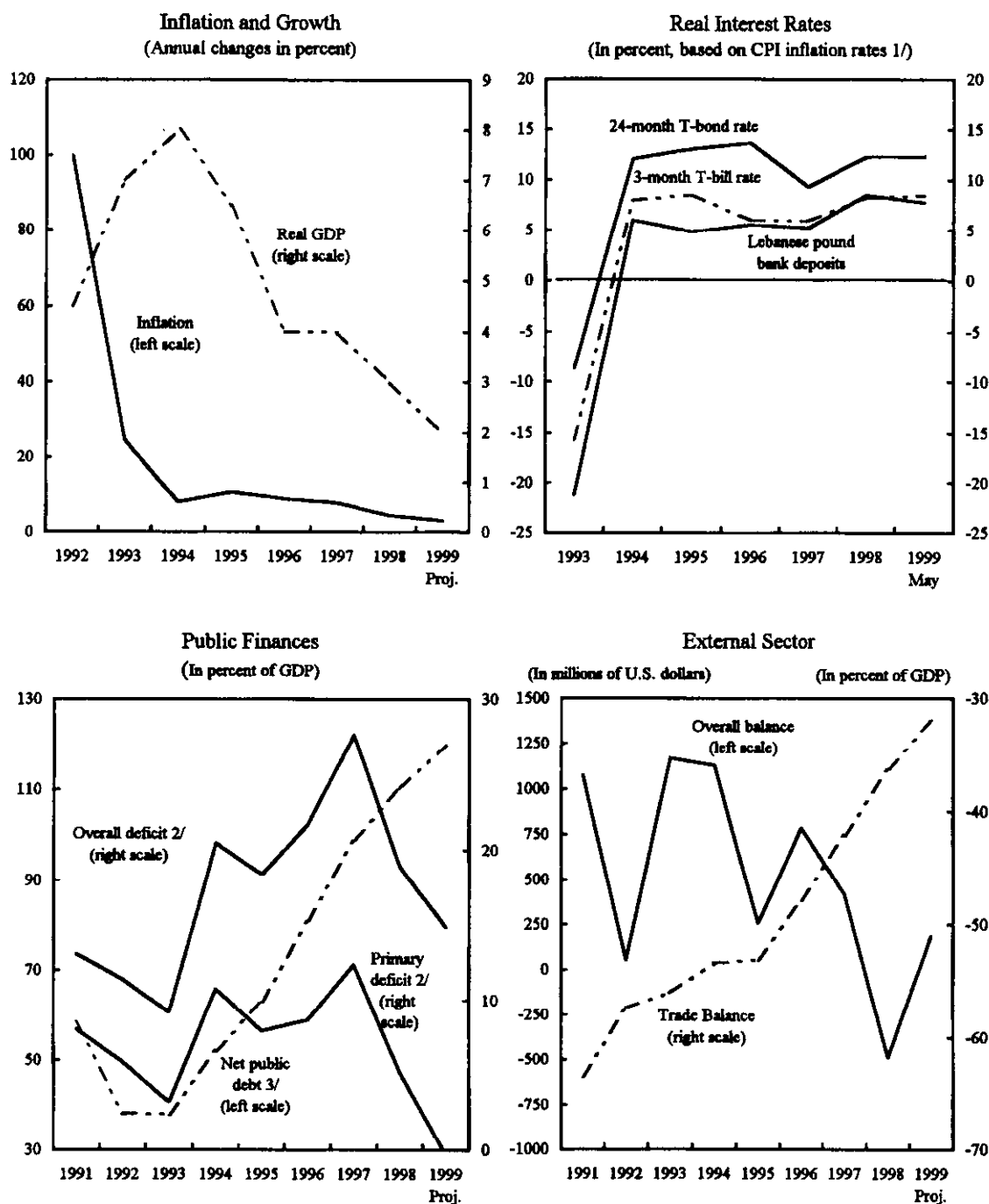
Money-based estimates: The BdL also estimates real GDP growth using a “quantity equation” for broad money, M3. This approach suggests a slowdown in real GDP growth—from 5.2 percent during 1994–95 to 3.1 percent in 1996–98.

Economic trends survey: The quarterly economic trends survey of industrial and commercial establishments confirms the slowdown during 1996–98, and suggests a deepening downturn in early 1999 (Chart 2).

⁶ The coincident indicator is a weighted average of eight series: four are measured in volume terms (electricity production (kWh); imports of petroleum derivatives (tons); passengers using Beirut International Airport; and cement deliveries (tons)) and four are measured in U.S. dollars (imports c.i.f., exports f.o.b., cleared checks, and broad liquidity (M3)).

⁷ This adjustment is complicated by the absence of an official consumer price index; instead, two series compiled by independent agencies are used.

Chart 1. Lebanon: Selected Economic Indicators, 1991-99



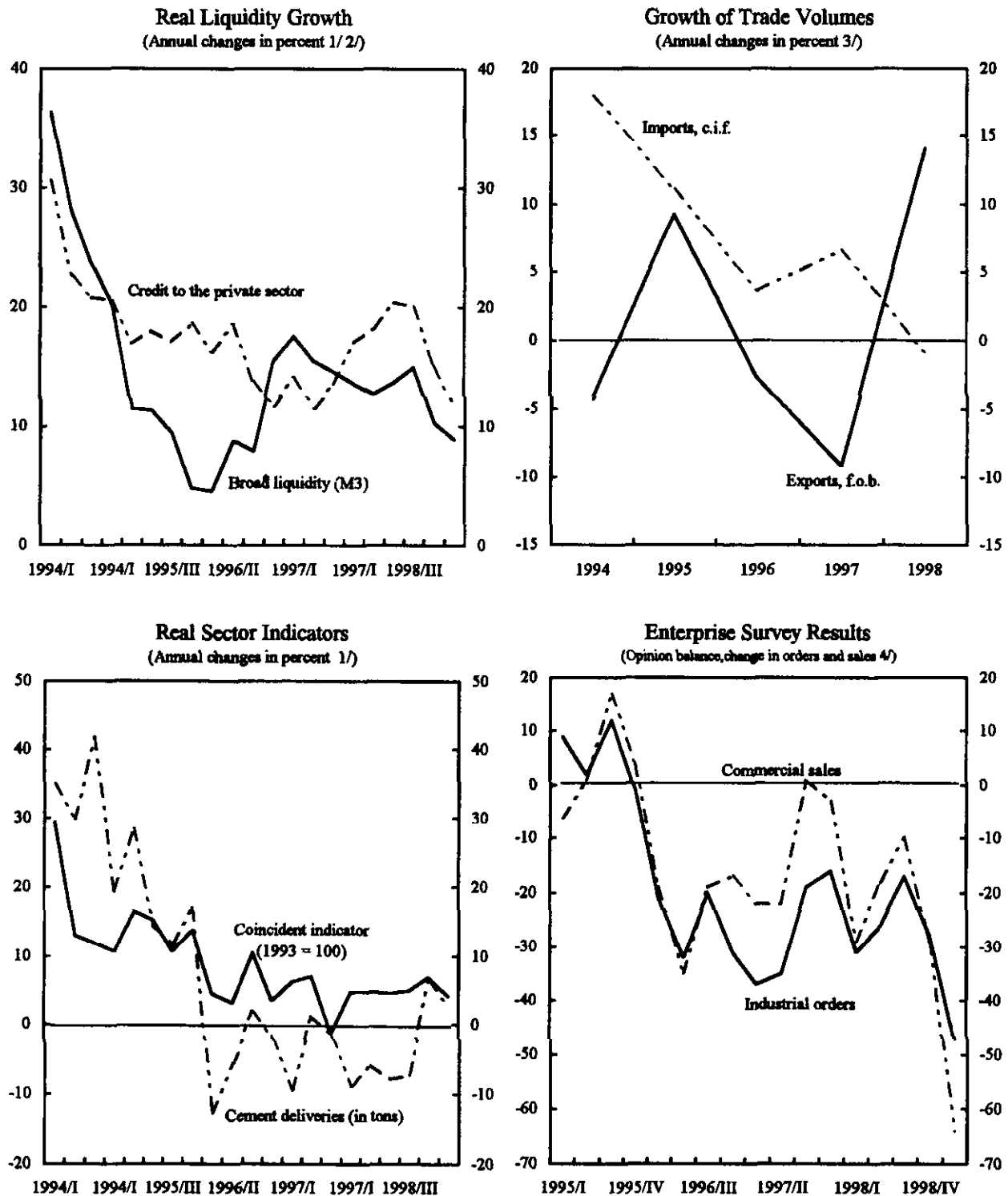
Sources: Data provided by the authorities; and staff estimates.

1/ Annual average of monthly rates; based on centered 12-month moving average of CPI inflation rates.

2/ Excluding foreign grants but including accumulation of arrears to the private sector.

3/ End of period, including arrears to private sector.

Chart 2. Lebanon: Growth Indicators, 1994-99



Sources: Data provided by the authorities; IMF, *World Economic Outlook (WEO)*, and staff estimates.

1/ Percent changes against same period of previous year.

2/ Deflated by consumer price index (quarterly averages).

3/ Derived on the basis of partner country price indices or deflators (source: IMF, *WEO* database).

4/ Difference between percentage of respondents experiencing a rise in sales or orders from the preceding quarter and those experiencing a decline.

6. **Further economic weakening in early 1999.** Anecdotal evidence points to a further slowdown of growth to near-recessionary conditions in the opening months of 1999, a view supported by business survey results (Chart 2). Two factors appear relevant. The most important was the run-up of government arrears to construction contractors in the second half of 1998 amounting to over 2½ percent of GDP (or one-third of public capital expenditures); this evidently created a cash-flow squeeze, with cascading effects through the system. In addition, there may have been a lull in spending as the private sector gauged the intentions of the new government. Based on the planned debt-based settlement of public arrears in the near future, growth is expected to recover in the second half of 1999, resulting in full year real GDP growth of 2 percent, about half the average for the preceding three years.

7. **Slowing inflation.** In the first four months of 1999, consumer price inflation averaged 3 percent, down from 4.5 percent in 1998. The progressive decline in inflation reflects the appreciation of the Lebanese pound (LL) (with the U.S. dollar) against major trading partners, low inflation in the latter countries, and the effects of slowing domestic demand.

B. Public Finance Developments

8. **Massive fiscal imbalances.** Lebanon's fiscal deficit, already 9 percent of GDP in 1993, surged to 20 percent of GDP in 1994 and peaked at over 27 percent of GDP in 1997 as new expenditure claims overwhelmed a slow recovery in revenue collections (Tables 2 and 3).⁸ While revenues rose a little over 2 percent of GDP between 1993 and 1997, expenditures rose a massive 20 percent of GDP—initially as a result of higher capital spending, but also, over time, through higher interest and other current expenditures. Following tensions between loose fiscal policies and the exchange rate peg, efforts were initiated to tackle the deficit in both 1996 and 1997. These failed, however, due to limited broader support for adjustment, revenue shortfalls as growth slowed, and unexpected expenditure overruns. By 1997, net public debt had risen to 99 percent of GDP (up from 38 percent at end-1992), generating an interest burden of about 15 percent of GDP, the size of which continues to represent a major fiscal problem.

9. **Fiscal measures in 1998.** The 1998 budget saw a more concerted attack on Lebanon's fiscal imbalances. On the revenue side, the budget included a 2 percentage point increase in customs tariffs, a new 5 percent tax on hotel and restaurant services, and other excise and fee increases.⁹ Deep cuts were also sought in capital expenditures and transfers, while a freeze

⁸ Between 1993 and 1997, the primary deficit increased from 3 to 12 percent of GDP.

⁹ Including a doubling of the excise on cement, sharp increases in the road tax and cargo truck fees, and increased fees for passports and expatriate work permits. The 1998 budget also benefited from a number of revenue measures adopted in the summer of 1997 to contain deviations from budgetary targets, including increases in excise duties on cars and tobacco products and higher user charges for cellular phones.

was imposed on the overall wage bill. In addition, steps were taken to improve expenditure management and control.¹⁰ In April 1998, a second 2 percentage point tariff increase was implemented, together with a 10 percentage point increase in excises on tobacco and cigarettes, to build up revenues ahead of the 20 percent public sector wage increase effective January 1, 1999.

10. **Higher revenues.** Although nominal revenue growth in 1998 was slightly less than projected, reflecting weak economic growth, the increase to over 18 percent of GDP was slightly better than budgeted. About two-thirds of this increase reflected higher customs tariff rates, while the remainder was accounted for by increased revenues from property incomes and user charges on mobile phones.

11. **Expenditure overruns, but a start to fiscal consolidation.** The budgeted expenditure savings were achieved in 1998—but only on a cash basis. As capital spending and (to a lesser extent) interest payments went over budget, overall cash spending limits were held through the accumulation of payments arrears. These arrears, which were largely confined to construction projects, amounted to an estimated 2.8 percent of GDP, or about 8 percent of budgeted expenditures.¹¹ Despite this, there was progress: including accrued obligations, total expenditures fell in 1998 by 7 percentage points of GDP, while non-interest expenditures fell 5½ percentage points.¹² The largest savings were on transfers and subsidies (down by 3½ percent of GDP), while accrued outlays on wages and salaries and capital projects were also each reduced by a little over 1 percentage point of GDP. Reflecting the

¹⁰ The long-standing problem of expenditure overruns based on spending out of unused appropriations from earlier years' budgets was addressed by canceling noncommitted amounts approved through 1995. Steps were also initiated to improve expenditure forecasting in areas where overruns had occurred, and the budget presentation was made more comprehensive by including all expenditures, including provisions for carryovers from earlier budget appropriations.

¹¹ In addition, a further LL 565 billion (or 2.3 percent of GDP) of arrears that were accumulated in 1996–97 remained outstanding at end-1998 (subject to auditing). These amounts largely reflect unpaid claims for private hospital services provided under government entitlement programs as well as claims in respect of expropriated land and properties.

¹² These two figures would have been broadly comparable, except for an interest rate subsidy provided by the central bank in 1998 amounting to an estimated 2 percent of GDP (see below). Expenditure reduction on both measures is also probably overstated, to some extent, because at least some obligations falling due in 1998 were prepaid in late-1997, so that outlays were overstated in 1997, and understated in 1998.

strengthened revenue performance and expenditure savings, the primary fiscal balance is estimated to have strengthened by 5½ percentage points of GDP relative to the average for 1996–97 (Table below).

Lebanon: Fiscal Developments, 1996–99

(In percent of GDP)

	1996	1997	1998	<u>Projected</u> 1999
Overall fiscal balance	-21.7	-27.6	-18.9	-14.9
Primary balance	-8.7	-12.4	-5.2	0.3
Total revenues	17.3	16.4	18.1	19.9
Total expenditures	39.0	44.0	37.0	34.8
Non-interest expenditures	26.0	28.8	23.3	19.7
<i>Of which accumulated as arrears</i>				
Interest expenditures	1.1	1.5	2.8	0.0
	13.0	15.2	13.7	15.1
Net public debt (including arrears)	81.0	99.0	110.4	120.0

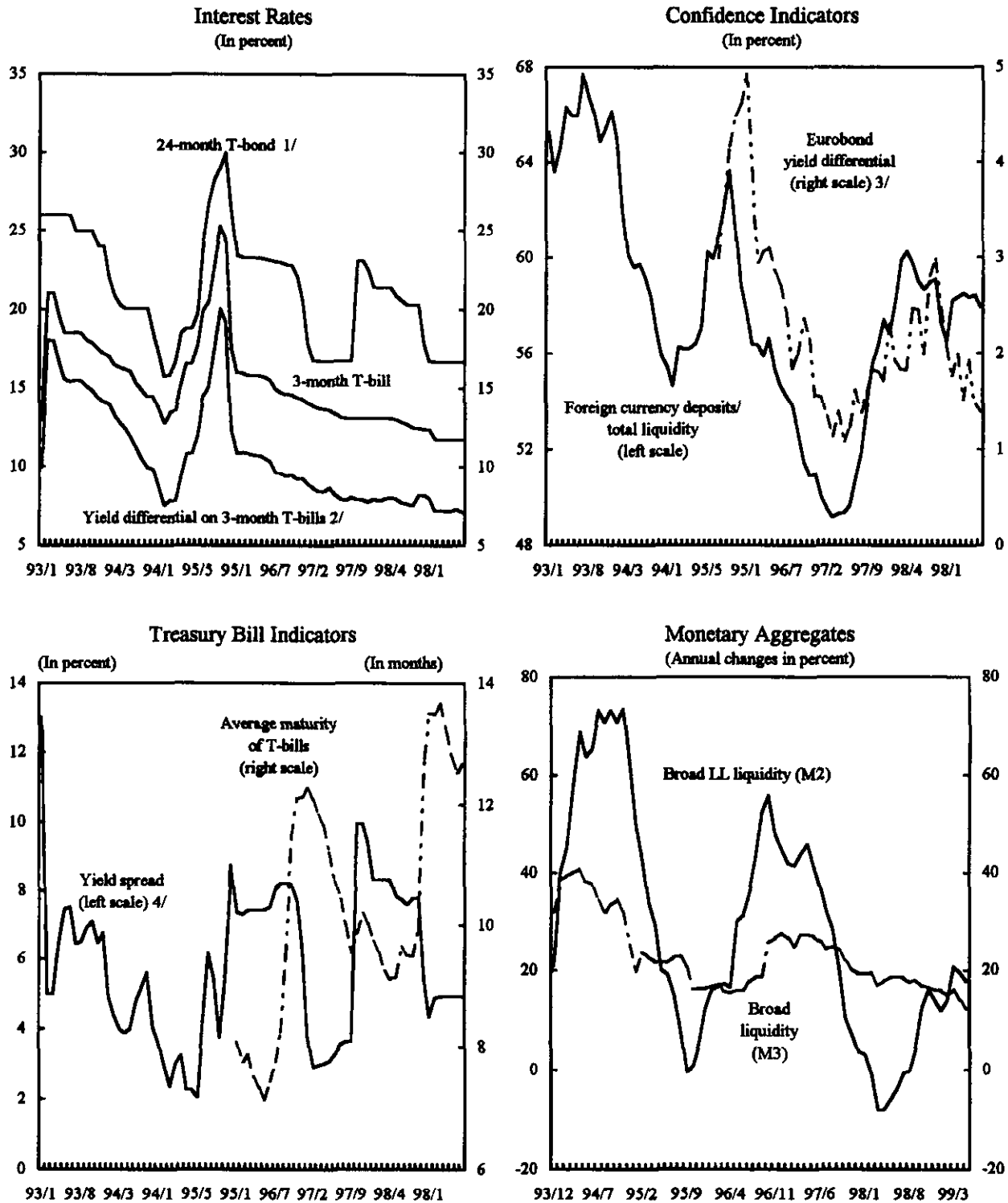
Sources: Lebanese authorities; and IMF staff estimates.

12. **Shift to foreign financing of the deficit.** Domestic banks' appetite for Lebanese treasury bills diminished from mid-1997, as dollarization rose following concern about the Asian crisis and the Lebanese budget (Chart 3). In response, the government sharply increased its foreign currency borrowing, largely through eurobond issues totaling US\$1.4 billion;¹³ as a result, foreign currency financing covered 64 percent of the deficit (excluding arrears), compared to less than 15 percent in 1997. Reflecting this, foreign currency public debt rose to 26 percent of GDP at end-1998, up from 16 percent a year earlier.¹⁴ Further eurobond placements amounting to US\$530 million (3 percent of GDP) were made in March 1999.

¹³ In March 1998, US\$1 billion of three- and five-year bonds were issued at a spread of about 300 basis points. In September–October 1998, a further US\$450 million of seven-year bonds were issued at a spread of a little under 400 basis points.

¹⁴ The proportion of gross public debt denominated in foreign currencies rose from 15.4 percent at end-1997 to 21.5 percent at end-1998.

Chart 3. Lebanon: Monthly Financial Market Indicators, 1993-99



Sources: Data provided by the authorities; and IMF, Treasurer's Department and *International Financial Statistics*.

1/ Secondary market ask yield on 24-month bonds (operations with Central Bank).

2/ Differential between returns on 3-month Lebanese and U.S. Government Treasury bills.

3/ Differential between returns on 5-year Lebanese Eurobond issued in July 1995 and comparable U.S. Treasury bonds.

4/ Spread between secondary market ask yield on 24-month bonds (operations with Central Bank) and primary market yield on 3-month T-bills.

13. **Domestic banks absorb eurobonds.** Lebanon's successful eurobond issues, at a time of shrinking developing country access to global market financing, reflected the ready appetite of domestic commercial banks for dollar assets (to balance the shift by depositors from domestic currency to dollar accounts). Domestic banks had already begun to buy Lebanese eurobonds in the secondary market in the final quarter of 1997 as nonresident investors reduced their exposure to Lebanon, and net acquisitions in 1998 (in the primary and secondary markets) were equivalent to 94 percent of the US\$1.4 billion of new government issues.¹⁵

14. **The 1999 budget: further fiscal consolidation.** The new government has moved to intensify the earlier fiscal adjustment effort. On the revenue side, excises were increased in April 1999 for gasoline, tobacco products, and beer and spirits,¹⁶ while tariff rates of 9 percent and above were increased by 1 percentage point (except for clothing and selected luxury goods, which saw larger tariff increases). In addition, the budget (approved in mid-July 1999) included tax increases for wages and salaries, professional incomes, corporate profits, and corporate dividend payments,¹⁷ as well as higher inheritance taxes and selected fee increases (passports, work permits, etc.). Revenues are also projected to benefit in 1999 from larger profit transfers from public enterprises and continuing improvements in income and property tax collection. Total revenue collections are projected to reach 19.9 percent of GDP in 1999, up from 18.1 percent in 1998.

15. Expenditures are projected to decline by a little over 2 percent of GDP this year, as increases in interest payments and the public sector wage bill¹⁸ are more than offset by a large cut in capital expenditures, elimination of the subsidy to the electricity company, and reduced transfers.¹⁹ This, together with higher revenues, is projected to reduce the overall budget

¹⁵ Banks' eurobond holdings, which represent a claim on a resident entity, are not included in their net foreign assets (Chart 4).

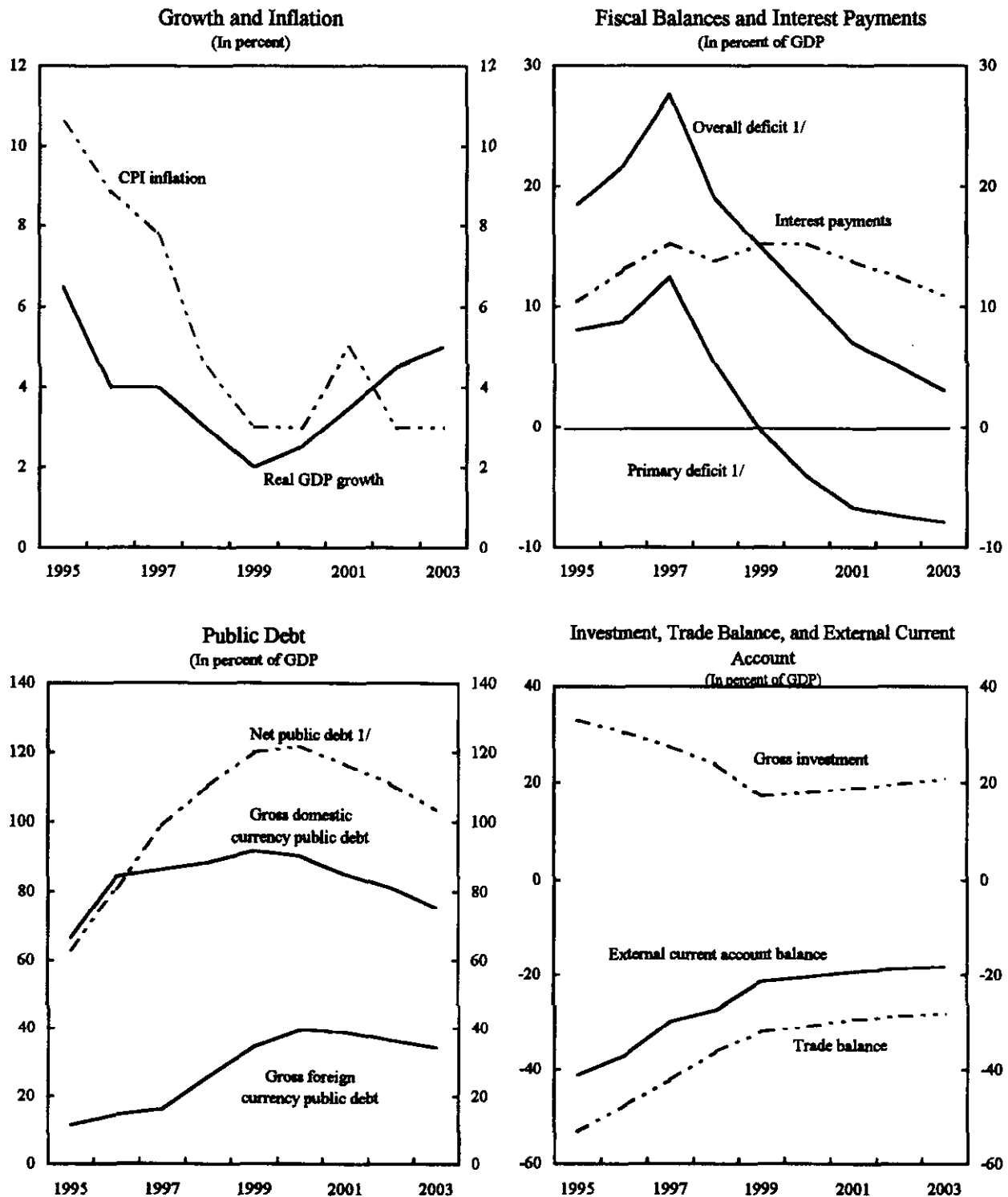
¹⁶ The higher gasoline excise raised the retail price from US\$1.33 to the equivalent of US\$1.57 per U.S. gallon; tobacco product excises were increased by up to 90 percent; and beer and spirits excises by 40–50 percent.

¹⁷ The top tax rate on wages and salaries will rise from 10 to 20 percent; that on professional incomes from 10 to 21 percent; that on corporate profits from 10 to 15 percent; and the flat tax on corporate dividend payments from 5 to 10 percent.

¹⁸ Defense expenditures are projected to increase from 3.3 percent of GDP in 1998 to 3.7 percent in 1999 on account of the public wage increase.

¹⁹ Indeed, expenditures are expected to come in lower than budgeted, since late approval of the budget (only in July 1999) resulted in a squeeze on outlays that is not expected to be fully unwound in the remaining months of the year.

Chart 4. Lebanon: Medium-Term Macroeconomic Framework, 1995-2003



Sources: Staff calculations based on data provided by the authorities;

1/ Including accumulation of arrears to the private sector.

deficit by 4 percentage points of GDP in 1999 (to about 15 percent); the primary balance is projected to strengthen by 5½ percentage points, to achieve a surplus for the first time in many years. Reflecting a continuing large financing need as well as the debt-financed arrears clearance exercise,²⁰ net public debt is projected to rise to 120 percent of GDP at end-1999 (Table 3).

C. Financial Market Developments

16. **Active use of interest rates.** Following the adoption of the exchange rate peg in 1992, monetary policy has been geared to avoiding destabilizing increases in dollarization that could undermine the exchange regime or demand for treasury bills. Given Lebanon's highly open capital account and the fragility of confidence, this has required an active use of interest rates.

17. **Central bank quasi-fiscal losses in 1997–98.** The most recent financial market pressures gathered pace from mid-1997, as unease about the Asian crisis coincided with Lebanon's deteriorating fiscal situation and uncertainties about the 1998 municipal and presidential elections. As dollarization surged, bank demand for treasury bills dried up, except for three-month issues. Given the already difficult fiscal situation, the central bank sought to insulate the budget from higher treasury bill interest rates by acquiring government paper at the formerly prevailing yields in the six-month to two-year auctions, selling it to banks at a higher yield (and lower price). This effective hike in yields—financed by the central bank—allowed commercial banks to offer somewhat higher rates on domestic currency deposits, slowing the shift to dollar accounts (Chart 3). Following positive fiscal news and the success in obtaining foreign currency financing, pressures started to wane from June 1998, and the operations were phased out by end-October. The central bank absorbed the estimated cost of about 2 percent of GDP by writing down its capital.

18. **Slowing credit growth.** While 1996–98 saw marked swings in deposit dollarization, broad money (M3), which combines both dollar and pound deposits, saw a gradual deceleration from 19 percent growth during 1997 to 16 percent during 1998 (Table 4). This slowdown reflected slowing credit to the government (as banks pulled back from treasury bills) and a parallel easing of private sector loan demand (which is largely dollar denominated), despite a small decline in dollar lending rates.

²⁰ In May 1999, parliament approved the settlement of the arrears accumulated through end-1998, authorizing the government to issue debt up to a ceiling of LL 1,242 billion (4.8 percent of GDP). The authorities plan to issue U.S. dollar-denominated three-year treasury bonds priced at U.S. dollar LIBOR rates. Prior to settlement, all claims will be audited; reflecting this process, it is likely that only about 60 percent (about LL 750 billion) will be cleared by end-1999.

D. External Developments

19. **Continuing peg against the dollar.** The Lebanese pound continues to be managed within a narrow band (± 0.5 percent) relative to the U.S. dollar, although the long-standing practice of announcing a small weekly appreciation of the central parity was abandoned in early October 1998, leaving the parity stable since (Chart 4). With lower domestic inflation, this slowed the appreciation of the real effective exchange rate to about 1.5 percent during the course of 1998.

20. **Improved trade record offset by weaker capital account.** Lebanon's external current account deficit is projected to continue to narrow, falling to 21 percent of GDP in 1999 (Table 5). The bulk of this correction reflects falling merchandise imports, down 5 percent in dollar terms in 1998 with a similar fall projected for 1999, largely due to weak economic activity, especially in the construction sector.²¹ Although merchandise exports rose 11 percent in 1998 and a further 5 percent in the first five months of 1999, the longer-term trend remains broadly flat, with the projected 1999 outcome only back to 1996 levels (Table 5). Information on capital transactions is partial, but appear to indicate a broad-based easing of net inflows in 1998, with lower public sector borrowing,²² a contraction of trade credits, and reduced private capital inflows. Capital inflows are expected to fall further in 1999 as increased public borrowing²³ is more than offset by a continuing decline in foreign investments in the real estate sector and lower other private inflows.

21. **Financing from nonresident deposit inflows.** The overall balance of payments recorded a deficit in 1998 of US\$0.5 billion (or 3 percent of GDP)—the first since 1990. This was financed by a US\$1.1 billion decline in the net foreign assets of Lebanese commercial banks (associated with increased nonresident dollar deposit inflows), which more than offset a rise in official net international reserves of US\$0.6 billion.²⁴ A further small balance of payments deficit (US\$0.1 billion) was recorded in the first five months of 1999.

²¹ Imports in January–May 1999 were 17 percent lower than a year earlier in dollar terms, but are expected to recover in the second half of 1999.

²² Although the US\$1.4 billion of eurobond placements was sharply up from a year earlier, this was largely absorbed by the domestic banking system, and therefore did not represent a balance of payments inflow.

²³ Projected eurobond financing of US\$1,030 million, including an assumed US\$500 million placement in the months ahead, exceeds the total projected balance of payments inflow of US\$460 million (Table 5) because the latter is measured net of purchases by domestic banks.

²⁴ This increase benefited from US\$0.7 billion of medium- to long-term balance of payments support from Gulf countries in 1998.

22. **Measures of reserve adequacy.** Lebanon's gross official reserves stood at US\$8.9 billion at end-April 1999 (including gold): these reserves are reported by the Lebanese authorities as freely usable, though US\$3 billion represented dollar time deposits from domestic commercial banks of between one month and two years' maturity. Gross reserves represented 134 percent of the short-term external debt of the public and banking sectors at end-1998, down from 153 percent at end-1997 (Table 8); they also represent more than 14 months of imports of goods and services.²⁵ The role of Lebanon's reserve cushion and other factors in avoiding the type of full-blown currency crisis seen in other countries during the 1990s is reviewed in Box 2.

III. REPORT ON POLICY DISCUSSIONS

23. **Overview.** The transition to a new government in Lebanon has been achieved without undue financial or economic dislocation. The new administration has underlined its intention to intensify the fiscal efforts initiated in the closing years of the last government, while giving a reinforced emphasis to structural issues, including privatization, public sector reform, and addressing corruption. In this respect, just as the 1997 Article IV discussions found an emerging consensus within Lebanese society on the need to strengthen fiscal policy in a durable fashion, the intervening period of sluggish economic growth has contributed to a growing recognition of the need for intensified structural reform, notably in the public sector. The authorities and the mission agreed that the challenges facing Lebanon were clear, and that the room for maneuver, particularly on the macroeconomic front, has narrowed further. There was also broad agreement on key elements of the government's policy agenda, which the mission urged should be implemented in a forceful and front-loaded manner. The government concurred that adjustment efforts should be ambitious, but would need to be implemented with a view to maintaining popular support.

24. **Focus of discussions.** Against this background, discussions focused on the appropriate design and goals for the next phase of fiscal consolidation; policies for debt reduction and restructuring, including privatization; the merits of the pegged exchange rate regime and its implications for competitiveness; sources of risk to the financial system and the operation of financial policies; and the structural reforms required to achieve a sustained acceleration of private sector-led growth.

²⁵ The bulk of this debt comprises the nonresident deposit liabilities of the banking sector; the short-term liabilities of the public sector to nonresidents is limited.

Box 2. Lebanon: Factors Contributing to Financial Stability

Several features of the Lebanese economy in the 1990s have been associated, in other contexts, with financial crisis: large and persistent fiscal imbalances; substantial real appreciation under an exchange rate peg; a surge in capital inflows; and an asset market (real estate) boom and subsequent downturn. However, the regime has endured, notwithstanding episodic pressures. Important contributions to this stability are summarized below:

- **Unfaltering commitment to the peg and strong reserve cover.** The authorities have shown strong commitment to the peg, including through large increases in interest rates in 1995–96 and (financed by the central bank) in 1997–98. Gross official reserves have also been maintained at a level high enough to deter speculation. Thus, at end-1998, gross reserves stood at 134 percent of the short-term foreign debt of the public and banking sectors.
- **A robust financial system.** A good record of financial market supervision and regulation and an absence of directed credits have left Lebanon's banking system in a stronger position than many "crisis" countries in Asia or Latin America. Banks were not heavily committed to the real estate boom.
- **Good access to additional foreign currency financing.** During periods of exchange market pressure (including 1997–98), Lebanon has obtained financing from friendly Gulf countries to rebuild reserves.
- **Small financial system and targeted capital market restrictions.** The local financial market is small, with a few large banks controlling a large share of deposits. This makes it easier for the central bank to communicate with and influence market players. In addition, though probably less important, while the capital market is generally open, a few restrictions, such as the prohibition on domestic currency borrowing by nonresidents, may have contributed to deterring speculation.
- **A relatively passive investor base.** A large part of the foreign direct investments and other capital inflows to Lebanon during the 1990s is believed to have been financed by the Lebanese diaspora and Gulf investors. These investors are reportedly making long-term investments in Lebanon's reconstruction, and are less susceptible to short-term volatility than "arms-length" capital market flows.
- **Selling eurobonds to domestic banks.** Sharp rises in dollarization typically put pressure on the exchange rate as banks transfer funds abroad to acquire dollar assets. This, in turn, requires the authorities to obtain additional external financing to replenish reserves, which at a time of crisis may not be straightforward. For Lebanon, this result was achieved in 1998 by selling eurobonds, which were bought by the domestic banks. Thus, capital outflows (by banks) returned as inflows (to the government), neutralizing the effects of the higher dollarization.
- **Dollar-based private sector credit.** Although Lebanon's high level of dollar-based private sector credit may well pose risks in the event of a devaluation, it makes it easier to defend the currency peg, as the impact of higher interest rates on expenditures is diminished. Indeed, the private sector has a large net creditor position in domestic currency. (There would, however, be possible implications for the banking system in the form of interest risk.)

A. The Next Phase of Fiscal Consolidation

25. **Swimming against a stronger tide.** The mission's review of fiscal prospects found a marked deterioration in the economic variables central to the arithmetic of debt reduction. With projected real GDP growth of 2½ percent in 2000 (rather than 6½ percent in the "soft-landing scenario" of the last Article IV consultation), the prospects for growing out of debt have worsened. Equally, with an end-1999 debt stock of 120 percent of GDP (previously 100 percent) and projected real interest rates of almost 10 percent (previously 6 percent), the autonomous growth of public debt will be much stronger. Thus, it is sobering to note that although Lebanon is on track to achieve this year the small primary surplus that was targeted in the 1997 soft-landing scenario, the debt-GDP ratio will now only start to decline in 2001 (rather than 2000), and will require an additional fiscal effort of 6½ percentage points of GDP, compared to an earlier projection of less than 2 percent (Table 6).

26. **Importance of front-loading.** The authorities concurred with this assessment and underlined their commitment at the highest level to continuing the fiscal consolidation. The mission urged that the remaining adjustment should be front-loaded, to the maximum extent possible, to allow the budget to benefit as soon as possible from slower public debt growth, and to foster a quick strengthening of market confidence. Moreover, an earlier adjustment would provide the best possible assurance that the program would not be blown off course in the event that macroeconomic conditions prove less favorable than expected.

27. **Agreed deficit targets.** Based on the above considerations, the mission urged a reduction of the overall fiscal deficit to 11 percent in 2000, and to 7 percent in 2001 (Table 6).²⁶ This would put the debt-GDP ratio on a definite—if modest—downward path, even if the privatization program should fail to meet expectations, real growth remain modest, and domestic interest rates not fall by more than a point or two from current levels. The authorities concurred with these ambitious targets, with one reservation. They noted that at a time of very weak economic activity, and after two years of tough fiscal adjustment (involving a 10 percentage point strengthening of the primary balance since 1996–97), some flexibility should be retained for the 2000 budget; accordingly, they intend to reduce the deficit to about 11–12 percent of GDP. For 2001, they saw the 7 percent of GDP target as realistic, given the likely revenue gains from introduction of a VAT. Reflecting these targets, an updated macroeconomic framework was developed in collaboration with the authorities for the period 1999–2003 (see Box 3).

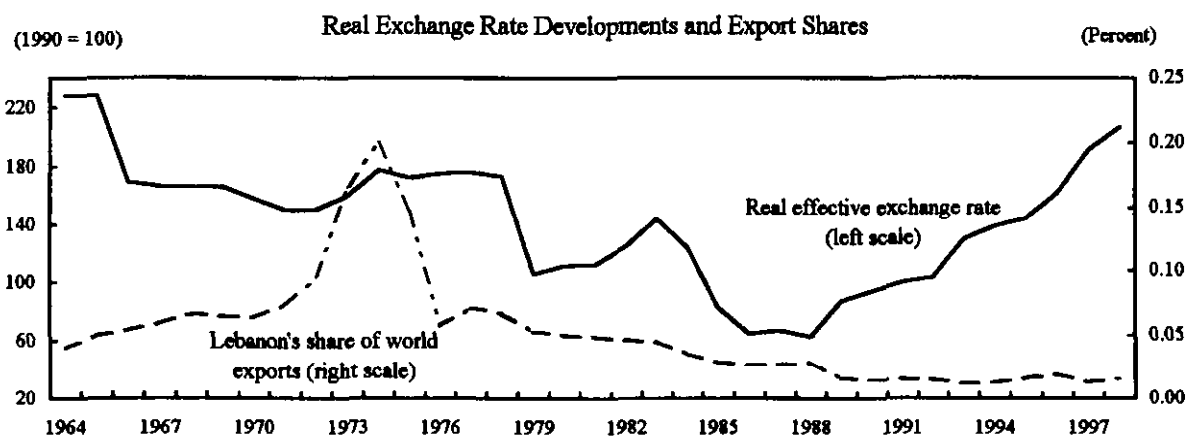
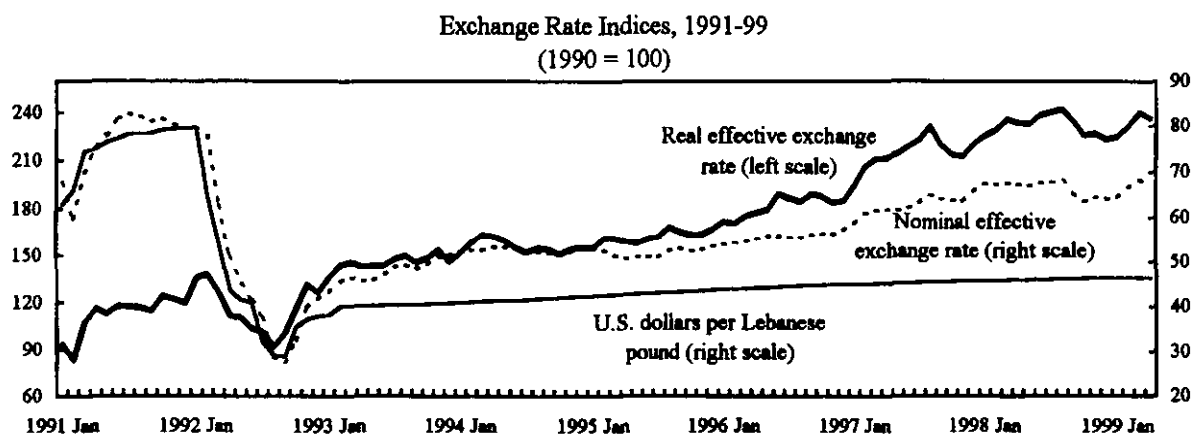
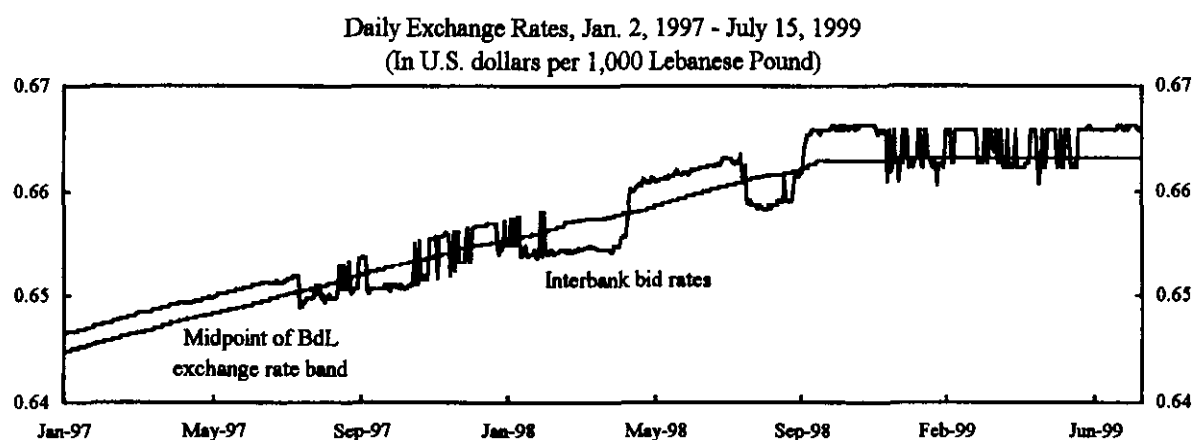
²⁶ This would require a degree of front-loading, in that the primary deficit would be strengthened by 3.8 percent of GDP in 2000 and 2.6 percent in 2001.

Box 3. Lebanon: The Medium-Term Macroeconomic Framework

In collaboration with the authorities, the mission developed a medium-term macroeconomic framework consistent with the government's plans for fiscal adjustment. The main features are described below and in Tables 6–7 and Chart 5.

- **Overview:** Sustained fiscal correction and broad-based structural reform are projected to lay the foundations for improved confidence, a recovery in growth, lower domestic interest rates, and broad exchange rate stability. On the assumption that structural reforms deliver a marked improvement in competitiveness, Lebanon's export growth is projected at a little over 10 percent in real terms during 2000–03, partially reversing the decline in exports as a share of GDP in recent years (Table 7). U.S. short interest rates are assumed to average about 6 percent during 2000–2003, and world oil prices US\$16.9 per barrel.
- **Fiscal balance and public debt.** VAT and other measures are assumed to boost government revenues to 24 percent of GDP by 2003 (up from 18 percent in 1998), while non-interest expenditures decline to a little over 16 percent of GDP (from over 23 percent). As a result, a primary surplus of 7½–8 percent of GDP, combined with higher real GDP growth (5 percent by 2003) and lower real interest rates (7 percent), are projected to lay the foundations for a progressive reduction in the debt-GDP ratio. Assisted also by assumed privatization proceeds of US\$2 billion, net public debt is projected to decline to 103 percent of GDP at end-2003 after peaking at 122 percent of GDP in 2000.
- **Private sector response.** The private sector is expected to absorb a large share of the resources released by fiscal consolidation. Improved confidence is assumed to contribute to a fall in the private sector saving ratio, even as private investment strengthens. Reflecting these shifts, the projected improvement in the current account position of just 3 percentage points of GDP between 1999 and 2003 is considerably smaller than the assumed fiscal adjustment. The current account deficit is thus projected to remain close to 20 percent of GDP, though, as in the past, this likely overstates the true deficit, in that exports of services, merchandise re-exports, and receipts of remittances are not adequately captured in the database. Notwithstanding this point, Lebanon would continue to rely on large capital inflows and remittances, even after deficit reduction.
- **Inflation.** With exchange rate stability, inflation is expected to remain close to current low levels, except in 2001, when VAT introduction produces a temporary increase.

Chart 5. Lebanon: Exchange Rate Developments



Sources: Data provided by the authorities; Reuters; Fund staff calculations based on data provided by the authorities; and IMF, *Information Notice System*, and *Direction of Trade Statistics*.

28. **Fiscal policies for year 2000.** The measures to achieve the fiscal goal for 2000 have not been finalized, but a number of elements are clear. Because the income tax measures in the 1999 budget will become operational only in late 1999, the initial impact will benefit the 2000 budget. In addition, legislation will be proposed in the fall of 1999 to impose fines and subsequent rent collections on properties illegally constructed on public seashores as well to impose a presumptive tax on professionals that would reinforce income tax collections. These combined measures will generate estimated revenues in 2000 of about 1.7 percent of GDP. The government will also freeze public sector salaries which, assuming a small initial reduction in public sector employment, would yield expenditure savings of 0.7–0.8 percent of GDP. The mission suggested that additional measures could include: an additional 25 cents per gallon on gasoline excises (equivalent to 0.6–0.7 percent of GDP); extension of the sales tax on hotel and restaurant services to a broader set of services and a doubling of its 5 percent rate (worth 0.3 percent of GDP); and a reduction in capital expenditure by 0.8 percentage points of GDP.²⁷ The authorities intend to review these and other options in the months ahead.

29. **VAT introduction and other tax reforms.** The authorities view introduction of a VAT by 2001 as a top priority. As a robust and flexible source of revenues, it will not only reinforce fiscal adjustment, but also allow a progressive reduction and consolidation of the tariff structure, which has become burdensome and distortionary. The authorities have initiated preparations for the VAT, and will receive EU-financed technical assistance to this end. On other tax issues, the authorities intend to adopt a global (rather than schedular) income tax from 2002.

30. **Strengthening tax administration.** Progress is also underway to strengthen tax administration, including by using supplementary information to identify taxable entities. The mission underlined the importance of implementing quickly the administrative reforms that the VAT would require, including establishment of a centralized large taxpayer unit. More generally, priority should be given to recruiting new tax auditors, computerizing the revenue department, strengthening desk audit and control, and broadening payment options for the settlement of tax obligations.

31. **Public sector restructuring.** Discussions on medium-term expenditure restructuring focused on streamlining public sector employment, where the 1999 wage bill of 7½ percent of GDP is high by the standard of developing countries.²⁸ The authorities agreed that this was

²⁷ These measures would offset a decline in tariff collections on account of a projected fall in the import-GDP ratio, as well as preferential tariff reductions for members of the Pan-Arab Free Trade Agreement.

²⁸ The average for a sample of 19 non-Middle Eastern developing countries is calculated at 5½ percent of GDP.

a priority. However, while pockets of overstaffing have been identified, preparations for comprehensive public sector reform are at a preliminary stage: implementation will require the development of appropriate safety nets, and will be conducted with an eye to the costs of early retirement and other programs.

32. **Improving budget management and expenditure control.** Fiscal management has been buffeted in recent years by expenditure overruns, primarily on account of weak expenditure forecasting, limited centralized control of spending by autonomous public agencies, and uncertainties about carryovers of unspent allocations from previous years' budgets. To address these problems, the government has further limited the scope to carry over unspent budgets,²⁹ and the 2000 budget will include expenditure and revenue projections for all public entities, including autonomous "councils"; subsequently, the budget law would be amended to ensure that all such public agencies are subject to parliamentary spending limits. More generally, the authorities are committed to avoiding any recurrence of expenditure arrears.

33. **Risks to the fiscal outlook.** An important risk to the government's fiscal program for 2000-01 relates to the projected revenue effort. While enhanced revenue collection in 1998-99 was based, in large part, on customs tariff and excise increases, which are straightforward to collect, this avenue is largely exhausted,³⁰ and future efforts will rely on the more difficult task of income and property taxation (in 2000) as well as putting in place the legislative and administrative requirements for the VAT (by 2001). Given the risks of slippage in both areas, the mission emphasized that the authorities should stand ready to reinforce efforts to reduce expenditures, if needed, to safeguard the overall adjustment program.

34. **Policy transparency.** As a step to strengthen transparency, the government presented to parliament in June a report detailing Lebanon's fiscal situation and prospects and outlining its medium-term economic strategy. This report, currently viewed as a working document, will be discussed in parliament and with interested private sector bodies before publication.

²⁹ For 1999, the authority to carry over expenditures will be limited to amounts approved by parliament in 1998 and committed in that year (except where otherwise authorized by the minister of finance). From 2000, it is intended that the practice of carryovers will be fully eliminated.

³⁰ While the mission would urge a further increase in the excise on gasoline in 2000, the scope for additional customs tariff increases is limited due to their already high level and the distortions that would be fostered as a result of further increases in effective protection. In addition, customs tariffs and excises are now close to the level at which smuggling becomes a problem.

Notwithstanding differences in coverage and assumptions, especially on privatization (see below), the macroeconomic and fiscal projections in the report are broadly consistent with the policy goals agreed with the mission. The mission welcomed this report, which should help inform public debate about and strengthen confidence in the government's adjustment and reform strategy. A further step toward greater transparency was the publication of the 1999 Article IV mission's concluding statement.

B. Debt Reduction and Restructuring

35. **Reducing and restructuring the public debt.** As a second prong in the government's adjustment strategy, it plans to tackle Lebanon's high-cost, high-level debt through a program of debt reduction and restructuring. Debt reduction would be financed using privatization revenues which, on the authorities' estimates, could total up to US\$4 billion through 2003, or one-fifth of Lebanon's net public debt at end-1999 (see Box 4). Every effort would be made to advance the prospective proceeds, including through debt issues by state enterprises following their corporatization. The mission welcomed this strategy, while cautioning that the projected proceeds were high compared to international experience. Moreover, debt reduction can only offer a breathing space; unless fiscal conditions are improved on a lasting basis, the benefits would be quickly swamped by the continuing deficits. It was agreed that the scenario developed with the mission should include more cautious assumptions, with aggregate privatization proceeds of US\$2 billion through 2003 (Table 6).

36. **Foreign currency borrowing.** The authorities see merit in further foreign borrowing to take advantage of favorable yields and maturities,³¹ with scope for a gradual increase in such debt to perhaps 30 percent of the public debt stock, compared to 22 percent at end-1998. Staff agreed that further modest increases in medium- and long-term foreign currency borrowing could be accommodated without undue risk, given current levels of official reserves. However, it would be unwise to encourage a further rise in eurobond holdings by local banks which would increase their already high exposure to the government and potentially crowd-out credit to the private sector. The authorities concurred on this point, and noted that prudential regulations had been tightened in this regard (paragraph 46).

³¹ The US\$1.4 billion of eurobond financing in 1998 is estimated to save the budget about 0.7–0.8 percent of GDP on an annual basis.

Box 4. Lebanon: Prospects for Privatization

Introduction. Although the intended coverage of the new government's medium-term privatization program has not been finalized, potential candidates include the state telecommunications and electricity companies (*Liban Telecom* and *Electricité du Liban*) as well as the national lottery, the tobacco monopoly, various regional water offices, Middle Eastern Airlines (MEA), and the *Casino du Liban*.

Policy priorities. A draft enabling law has been submitted to parliament, with passage envisaged later this year. The draft law seeks to establish the legal and organizational basis for the corporatization and privatization of public entities, including the creation of a privatization council to oversee the process and a privatization agency to manage the process. Parliamentary authority for privatization would be sought subsequently, either on a case-by-case or sector-by-sector basis. The government has also begun to develop plans for the legislative and other steps that will be required to establish regulatory agencies for the telecommunications and other sectors.

Potential timing. The earliest prospects for privatization are primarily in the telecommunications sector (see below), though a few smaller units including the casino and national lottery might also be divested during 2000–01. Prospects for other entities are more uncertain as they are not yet profitable and would need to be restructured prior to sale.

Privatization in the telecommunication sector. The government intends to seek additional license fees from the two build-operate-transfer cellular phone operators to extend their contracts beyond the current 2005 expiration date. Combined with an increase in the ceiling on permitted subscribers, this is calculated to yield potential revenues of US\$0.7–1.0 billion. In addition, very preliminary calculations suggest that the state-owned fixed-line service, *Liban Telecom*, could be worth US\$3–4 billion, with perhaps US\$1 billion available in the very short run through a collateralized bond offering and initial investment by a strategic partner.

C. Monetary and Exchange Rate Policies

37. **Policies to improve competitiveness.** Lebanon's exchange rate peg to the U.S. dollar since 1992 has provided a successful nominal anchor during the period of national reconstruction, though low inflation was achieved in the context of a substantial (about 75 percent) real appreciation of the exchange rate. The impact of this real appreciation on competitiveness is difficult to gauge. Although there has been an evident deterioration in relative prices, this has been in comparison to the position at the end of the 1975–92 war (Chart 4), when a weak exchange rate was the counterpart to enormous institutional and other impediments to production and trade. Thus, the current level of the real exchange rate is estimated to be only slightly higher than in the pre-war decade of 1965–75, and undoubtedly the impact of the latest real appreciation has been offset, at least in part, by a restoration of more normal business conditions. Consistent with this, Lebanon's share of world exports has not been eroded under the currency peg—though neither has it increased toward pre-war levels (Chart 4).³² On balance, while a more depreciated exchange rate would undoubtedly strengthen growth in some sectors, the mission concluded that, given the serious structural impediments, the aggregate supply response would probably be relatively weak. This assessment was broadly supported in discussions with industrialists. While there was a broad-based recognition that the costs of doing business are high compared to many neighboring countries and some expressed a need for exchange rate adjustment, others emphasized the difficulties of dealing with bureaucracy, and argued that as Lebanon's comparative advantage lay in quick-response, high technology industries (fashion garments, publishing, computer software), the priority was not an early exchange rate adjustment, but rather an accelerated pace of structural reform.

38. **Conditions for success of exchange rate peg.** The authorities see continued exchange rate stability as key to underpinning the macroeconomic architecture for the present. In their view, a move to greater exchange rate flexibility without a much stronger fiscal position could trigger increased dollarization, a price-exchange rate spiral (given perceived high rates of implicit indexation),³³ and a collapse of demand for treasury bills, making it difficult to roll over the existing public debt. In addition, a resumption of high inflation could be socially destabilizing, since the wages and savings of the poorer segments of the Lebanese society are less effectively indexed. In response, the mission noted that

³² The “spike” in Lebanon's world export share in 1973–75 in Chart 4 was apparently related to re-exports to the Gulf countries following the 1973 oil price increase: it did not reflect improved competitiveness of Lebanon's own economy.

³³ Although there is no formal system of indexation, the widespread adoption of the dollar as means of account during the war is only gradually unwinding. Thus, domestic prices are likely to remain very sensitive to changes in the exchange rate.

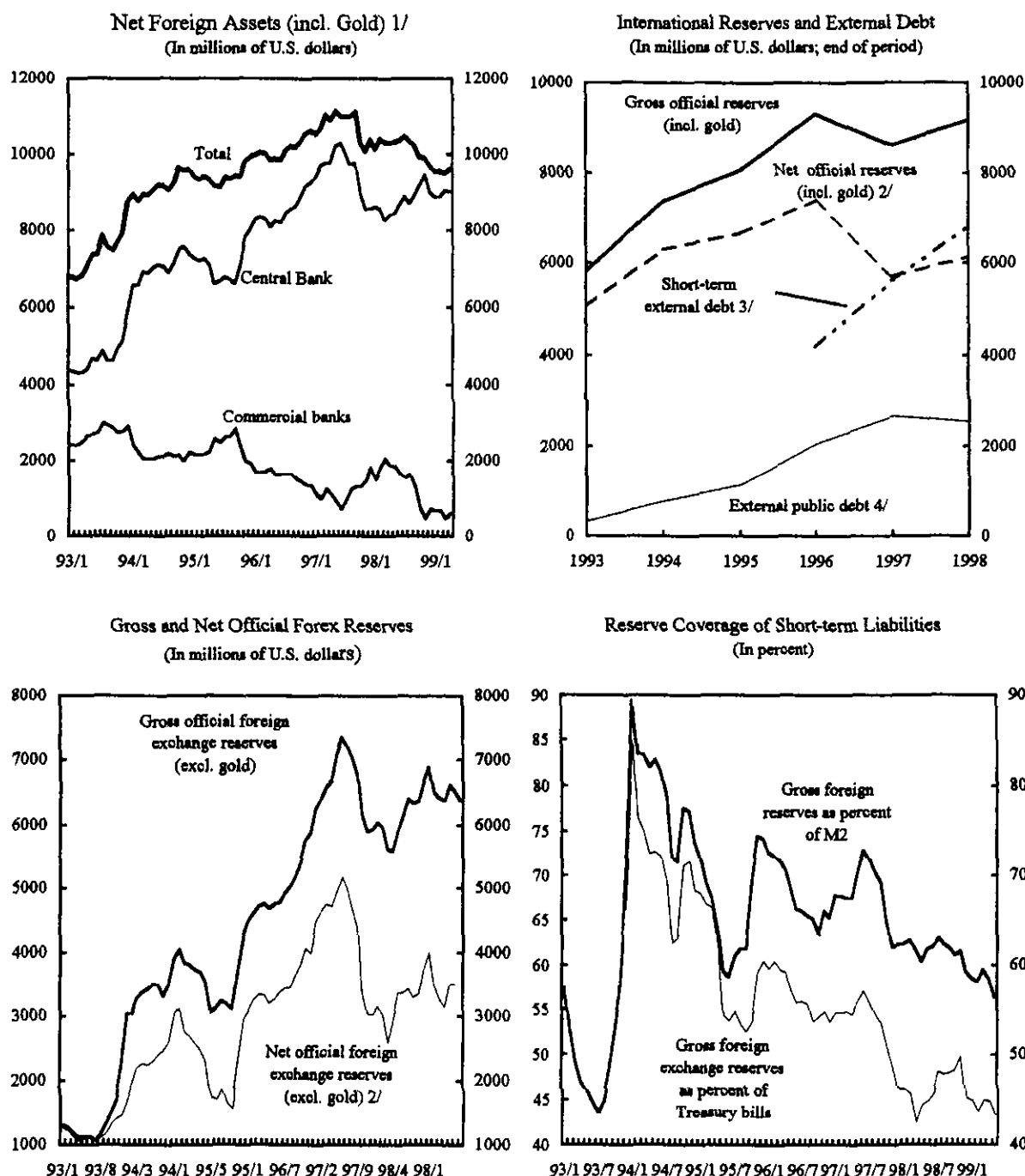
tensions between the exchange rate peg and uncertainty about the sustainability of fiscal policies and the external environment had, at times, resulted in high and volatile domestic real interest rates. Moreover, this policy environment had contributed to sluggish investment and growth. Accordingly, although the mission could, on balance, support the authorities' strategy of retaining this anchor for the present, it emphasized that success will depend crucially on a rapid strengthening of policies. Specifically, it will require much stronger fiscal adjustment—most immediately in the context of the 2000 budget—as well as efforts to eliminate red tape and other impediments to competitiveness. The mission also underlined that, in implementing this strategy, it will be essential to monitor closely developments in the real exchange rate, and the consequences for competitiveness and growth.

39. **Maintaining an adequate level of gross official reserves.** A further consideration in maintaining the currency peg will be to ensure that official reserves remain substantial in relation to potential balance of payments outflows. Although gross reserves currently cover a high proportion of short-term foreign debt, the level of reserves has been broadly unchanged over the last two years (Chart 6), leading to some decline in the coverage ratio (Table 8). Accordingly, consideration should be given, as conditions improve, to further increasing the level of reserves.

40. **Preparing for greater exchange rate flexibility in the future.** Looking ahead, the authorities see merit in greater exchange rate flexibility for a small open economy such as Lebanon's, now that inflation is reduced. They intend to consider such a move as soon as stronger fiscal policies and an improved climate of confidence permits. To prepare for this, the mission underlined the importance of developing stronger and more flexible financial markets as well as broadening the central bank's set of instruments for monetary control. The mission also welcomed the authorities' decision to require an increase in bank capitalization, which would strengthen banks' ability to weather potential credit risks that might arise under greater exchange rate flexibility. Banking supervision should also be conducted with a view to ensuring that banks make an appropriate allowance for possible exchange rate adjustments when extending dollar-based credit.

41. **Interest rate policy.** Discussions on interest rate policy focused on the tensions imposed by the high interest burden on the budget. The mission noted that the central bank's intervention in the primary treasury bills markets to keep interest rates low during 1997–98 was inconsistent with efforts to develop strong markets; indeed, a degree of interest rate rigidity appeared to have emerged in the market for 12- and 24-month bills following the central bank intervention (Chart 3). The authorities responded that intervention in 1997–98 was exceptional, and necessary to rebuild the markets after a virtual breakdown in mid-1997. Flexibility was now returning to the markets, and rates had recently edged downward. Looking ahead, the central bank noted that domestic interest rates will continue to be oriented toward avoiding increased currency conversion. In this connection, it shared the view of the mission that forceful fiscal action is needed—not only to bring borrowing under control, but

Chart 6. Lebanon: External Assets and Liabilities, 1993-99



Sources: Data provided by the authorities; Bank for International Settlement; and IMF, *International Financial Statistics*.

1/ Gold valued at market prices.

2/ Excluding foreign currency deposits held by commercial banks with the Central Bank.

3/ Short-term public debt (non-resident treasury bill holdings, debt coming due during the next 12 months, and foreign liabilities of the Central Bank) and foreign liabilities of commercial banks.

4/ Gross foreign currency public debt plus non-resident holdings of treasury bills minus Eurobond holdings of Lebanese commercial banks.

also to strengthen the budget's ability to cope with higher interest rates should this be required for monetary purposes. In any event, the central bank expressed its intention to avoid a repetition of the 1997–98 interest subsidies to the budget.

D. Structural Policies

Financial sector policies and reforms

42. **The FSAP review.** The May 1999 FSAP review of Lebanon's financial system, regulatory structure, and supervisory arrangements found that the financial system displays considerable institutional strengths, and that the regulatory arrangements are, in the main, generally effective.³⁴ Most banks in Lebanon are profitable, liquid, and well-capitalized: the average risk-weighted Basel ratio was almost 19 percent at end-1998, and problem loans continue to decline as a share of the total loan book, while remaining well provisioned (Table 4). Compared to a group of reference countries,³⁵ the average risk-adjusted capital ratio and return on assets in Lebanon ranked highest, while their average return on equity ranked in second place. In regard to the supervisory and regulatory arrangements, the FSAP mission established that although transparency practices are generally commendable, additional efforts are warranted to bring greater compliance with the Basel Core Principles. In this regard, the relationship between the central bank, the Higher Banking Council, and the Banking Control Commission should be clarified to avoid compromising institutional independence and complicating the supervisory process. In addition, the Bank Secrecy Law does not conform with best international practice in providing the supervisory authorities with the required access to information to address risks of money laundering.

43. **Sources of financial sector vulnerability.** Financial sector risks for Lebanon relate primarily to the sustainability of the exchange rate peg and the impact of an exit under "crisis" conditions. While official reserve levels are high relative to short-term foreign borrowing by banks and the public sector, large interest premia on Lebanese paper continue to indicate concern about the risks of devaluation stemming from inconsistencies between sizeable fiscal deficits and the exchange rate peg.³⁶ A severe financial crisis could pose exchange rate and interest risk for banks, as well as credit risk relating to the high level of

³⁴ The findings of the FSAP review and its policy recommendations are summarized in the FSSA report circulated for the current Article IV consultation.

³⁵ Chile, Hong Kong, and Hungary.

³⁶ As of July 1999, the interest premium on Lebanese treasury bills (relative to the U.S. equivalent) ranged from 7.2 percent for three-month bills to 10.6 percent for two-year bills. This reflects a combined devaluation and sovereign risk for Lebanon. Sovereign risk, based
(continued...)

foreign currency credit to the private sector. In the absence of steps to reduce Lebanon's fiscal imbalances, banks might also face risks in regard to their concentrated holdings of Lebanese sovereign debt.

44. **Results of stress tests.** On the basis of stress tests conducted by the FSAP mission, banks appear secure against exchange risk, reflecting tight prudential limits on currency exposure. However, a moderate deterioration of loan quality and a more realistic provisioning requirement for substandard loans could make a few banks (accounting for 7 percent of banking assets) technically insolvent with a similar number remaining solvent but falling below the required 8 percent capital ratio.³⁷ There is also a degree of interest rate mismatch that could cause problems for the former institutions in the event of a sustained increase in domestic interest rates.³⁸ Equally important, the infrastructure to realize liquidity is less robust than appears given current central bank arrangements. A key issue is the likely impact of an exchange rate depreciation on credit to the private sector, of which almost 90 percent is dollar-denominated. The authorities noted that, because the economy is highly indexed,³⁹ companies would be largely protected against the increased cost of servicing dollar debt through the impact of higher domestic prices on their earnings. The mission noted, however, that this effect might be partial, not complete; moreover, the degree of indexation may diminish over time, as markets adjust to low rates of domestic inflation. Accordingly, the risks associated with foreign currency credit bear close monitoring.

45. **Implications for macroeconomic management.** The FSAP findings underline that notwithstanding the current strengths of Lebanon's financial system, including the carefully hedged foreign currency position of banks, a currency crisis could lead to a significant deterioration in segments of the banking system. Moreover, the risks to banks of dollar-based lending to the private sector will only become apparent as the system comes under stress, and may be larger than the authorities anticipate. Thus, while Lebanon's banking system is

on the dollar-denominated eurobond issues, is about 2 percent—though this chart may be biased downwards by the large absorption of eurobond debt by domestic banks, which may bear less default risk than foreign investors.

³⁷ This stress test assumed a 50 percent increase in nonperforming loans (with a 50 percent provisioning requirement) combined with additional substandard loans equal to 20 percent of banks' total portfolios, provisioned at 20 percent (compared with a zero provisioning requirement for such loans at present).

³⁸ Specifically, a sustained one-third increase in the level of interest rates could result in these banks falling somewhat below the required 8 percent solvency ratio.

³⁹ See footnote 33.

currently a force for stability, emerging strains as conditions deteriorate would complicate macroeconomic management in the event of a crisis. On this basis, the FSAP and Article IV missions encouraged the authorities to ensure that ongoing efforts to strengthen financial supervision take full account of the pressures on the system that could emerge if financial market pressures were to resume and intensify.

46. **Strengthening prudential requirements.** The authorities noted that a key focus of ongoing steps to strengthen the financial sector is on improving the soundness of the insurance sector.⁴⁰ Draft legislation before parliament will introduce new solvency requirements, authorize crop and credit insurance, promote insurance industry mergers, and require a two-year increase in the minimal capital requirement to US\$1.5 million from the current US\$0.2 million. In the banking sector, the authorities have announced a phased increase in the minimum risk-weighted capital ratio from 8 to 12 percent, and the 30 percent foreign asset liquidity requirement is being modified to progressively disqualify Lebanese banks' eurobond holdings by end-2001.

47. **Secondary market for treasury bills.** Despite its well-developed banking sector, Lebanon's capital markets remain relatively thin. In particular, little progress has been made in developing the secondary market for treasury bills, a goal discussed at the time of the last Article IV consultation. As noted in the FSSA report, the absence of a secondary market, together with relatively high central bank discounting charges, may contribute to the steep yield curve, and thus to the costs of financing the budget. The authorities responded that this matter, as well as other recommendations in the FSAP report, would be carefully reviewed.

Real sector policies

48. **Overview.** As noted above, there is a growing recognition that improved growth performance depends critically on an intensification of structural reform. In part, the present sclerosis reflects distortions accumulated during the war years. An additional factor, however, is that Lebanon's strength as a regional commercial and financial center relied, historically, on its more liberal economic and social policies. Thus, while Lebanon has stood still in recent decades, the region has moved forwards, eroding Lebanon's comparative advantage. While the agenda for reform is large and will require confronting a range of well-entrenched interests, the authorities recognize that it is a priority, and have initiated preparatory work in a number of areas. Continuous and forceful implementation will be key.

⁴⁰ The FSAP review found unsatisfactory conditions in the insurance sector, with excessively lax entry standards and a number of companies operating despite being insolvent. However, the industry is not large enough to pose systemic risks.

49. **Privatization.** The mission welcomed the new government's commitment to a program of privatization, enabling legislation for which has been submitted to parliament (see Box 4). While state ownership is less extensive than in many other countries in the region, privatization can make an important contribution to improving the efficiency of key infrastructures (telecommunications, electricity, ports, fuel distribution, etc). This could permit a reduction of business charges, including for electricity, the cost of which is viewed by industry as burdensome.⁴¹ In preparation for privatization, the mission underlined the importance of establishing regulatory bodies that can protect against excessive post-privatization market power.

50. **Tariff reduction.** Fiscal pressures have contributed to a substantial increase in Lebanon's tariffs in recent years, from an average of a little under 14 percent in January 1996 to over 21 percent in 1999. The authorities intend that, following introduction of the VAT in 2001, priority would be given to consolidating and reducing tariffs.⁴² At the same time, a degree of tariff reduction is being implemented under a number of regional agreements (see Box 5). In this connection, the mission advised that broad-based liberalization would provide a stronger platform for maximizing Lebanon's comparative advantages than a series of bilateral and regional trading preferences.

51. **Addressing nontariff barriers.** At the same time, notwithstanding a streamlining of customs procedures in 1997, inefficient security and other port services continue to represent significant nontariff barriers to exports as well as imports. To address these impediments, the government has created a number of taskforces to implement reforms suggested by a recent World Bank financed study.⁴³ In addition, the ministry of trade is working to establish, in cooperation with the private sector, an export promotion board, and a draft enabling law will be prepared later this year. A taskforce has also been established to identify impediments to private investment (including from abroad) and to propose appropriate reforms. An important measure in this regard was the passage in March 1999 of a law to safeguard intellectual property rights, which will strengthen Lebanon's regional comparative advantage in areas such as computer software and publishing.

⁴¹ For electricity, any price reduction will be conditional on both efficiency improvements and greatly improved collection rates, as the current average price does not cover production costs.

⁴² The current tariff regime includes 14 bands, ranging from 2 to 105 percent. However, most products, accounting for 98 percent of revenue collections, fall into 8 core bands, ranging from 6 to 40 percent.

⁴³ The report argued that enhanced computerization together with streamlined regulations and procedures could reduce significantly the time required to clear shipments, currently estimated at 17 days for imports and 7 days for exports.

Box 5. Lebanon: Recent Trade Agreements and Initiatives

Lebanon has recently concluded (or nearly concluded) a number of trade agreements and initiatives, as follows:

Pan-Arab Free Trade Agreement. Lebanon was one of 14 Arab countries establishing the Agreement from January 1, 1998, under which tariffs will be reduced for participating members by 10 percent annually (establishing free trade from 2007); accordingly, Lebanon's tariffs were reduced by 20 percent from January 1, 1999. With approval of the Economic and Social Council of the Arab League, certain industrial goods may be exempted from tariff reduction, while exemptions for agricultural goods are limited to 10 products and cannot exceed 45 months. As Arab countries account for 40 percent of Lebanon's total exports, it could be a major beneficiary of the Agreement.

Free Trade Agreement with Syria. This agreement, which came into effect in January 1999, calls for a 25 percent annual reduction in tariffs on industrial products. Certain products produced by Syria fall outside the Agreement, including tobacco, ceramics, and porcelain.

Free Trade Agreements with Egypt and Kuwait. These agreements, concluded in 1998, are less comprehensive, involving selective tariff reductions.

EU Association Agreement. An Association Agreement with the EU is in the final stages of negotiations, and is expected to be concluded by end-1999. Key unresolved issues relate to liberalization of agricultural trade, rules of origin definition, and the terms of financial assistance from the EU. (See Occasional Paper No. 176, "Back to the Future: Postwar Reconstruction and Stabilization in Lebanon", for further details on the intended agreement.)

World Trade Organization (WTO). Lebanon gained observer status at the WTO on April 14, 1999, and a committee has recently been formed to negotiate terms of accession.

52. **Public sector reform and strengthening governance.** The authorities recognize that interactions between the business sector and the government often involve excessive bureaucracy as well as opaque and unpredictable procedures, conditions that too often lay the foundations for corruption. The government has emphasized its determination to strengthen governance, and a number of investigations have been launched of alleged abuse of public office by former senior officials. The mission welcomed this determined stand on governance, and indicated that for a durable impact, it would be important to move in parallel to reform the public sector, including through the elimination of unnecessary bureaucracy and the establishment of greater transparency and accountability in areas such as contracting.

53. **Social security reform.** Hiring incentives are currently undermined by high social security costs, which some businesses calculate at over 60 percent of the wage bill, after allowing for mandatory end-of-service payments.⁴⁴ Notwithstanding this, the state pension represents a weak safety net because of partial coverage and because the defined-contribution lump-sum benefit has been eroded by negative real returns on past fund savings. The authorities recognize the need for reform and have begun to review alternative arrangements, including a mixed private-public system along the Chilean lines.

54. **Strengthening and broadening markets.** A number of initiatives are underway to strengthen market functioning, including through the preparation of antitrust legislation. Programs have also been launched to improve access to credit markets in rural areas and for small businesses, the latter through micro-credit schemes supported by the European Union. Steps to strengthen the market for middle- and low-income housing are also underway, including through a draft law to liberalize residential rents and plans for a system of mortgage lending to lower-income families through the Public Housing Corporation.

55. **Avoiding new restrictions and distortions.** The mission noted that slowing growth would likely exacerbate calls for targeted economic relief through trade protection, credit subsidies, and favorable tax treatment. The mission urged the authorities to resist such pressures, while also working to eliminate existing distortions in these areas, including the system of reduced reserve requirements for bank lending to favored sectors, and seasonal restrictions on the import of certain agricultural goods.

⁴⁴ In addition to social security contributions of 35 percent of the wage bill, employers are liable for end-of-service payments to retiring workers with 20 years or more of service. Excluding the latter element and including employee contributions, Lebanon's total social insurance taxes, equivalent to 39 percent of the gross wage bill, are substantially higher (on World Bank estimates) than the 23 percent average for MENA countries, including such countries as Syria (24 percent), Morocco (20 percent), Jordan (15 percent), and Israel (14 percent). The only MENA country with higher social security taxes is Egypt, at 48 percent.

E. Other Issues

56. **Social issues.** Social issues remain important in Lebanon, but the continuing absence of comprehensive data on social indicators makes assessment of the current situation very difficult. Available information suggests that there are wide regional social and economic differences, and that: (i) the unemployment rate is high; (ii) there are large disparities in the income distribution; (iii) the housing market is particularly difficult for new households and poor segments of the population (concurrent with an excess supply of more costly urban residences); and (iv) there are weaknesses in the design and coverage of the social security system. The mission welcomed the authorities' intention to work to further strengthen Lebanon's social fabric, including through revamping the social security system. It also welcomed the increasing involvement of the Council for Development and Reconstruction (CDR) in strengthening its regional activities, including through developing social infrastructures such as schools, and providing irrigation in poorer agricultural areas.⁴⁵

57. **Tackling environmental problems.** Efforts to strengthen Lebanon's environmental record have been an important element of the reconstruction program since the war. Programs financed by the World Bank have focused on sewage and solid waste management (since 1993) and the development of the legislative framework for the protection of the environment. The draft environment protection law, approved by the Council of Ministers, has been submitted to parliament but is still to be enacted. Environmentally sustainable development is viewed as key for the tourism and other industries, and is a focus of the current Country Assistance Strategy of the World Bank formulated in 1997 (see Appendix II).

58. **Year 2000 problem.** A government committee is assessing and monitoring Y2K readiness, and Lebanon has received grants from the World Bank for planning and implementation. As of June 1999, ministries and agencies had developed action and contingency plans, and the authorities were satisfied with progress in testing and upgrading computer systems in key sectors, including civil aviation, telecommunications, and the central bank. In the financial sector, the central bank has required all commercial banks and financial institutions (including brokerage houses) under its jurisdiction to check their computer systems for Y2K compliance and develop appropriate contingency plans by end-July 1999. The nonfinancial private sector has also been urged to take appropriate steps. For this group, a recent official survey suggests that Y2K issues may be less of a risk, as most private computer systems were installed after the mid-1990s, when steps had been initiated to address Y2K concerns.

⁴⁵ Earlier in the reconstruction effort, CDR's priorities were rebuilding national road, electricity, and water services, with a particular focus on restoring conditions in Beirut.

59. **Data problems continue to hamper economic analysis.** The mission commended the authorities for recent progress in preparing aggregate fiscal data, which are now available with a short lag. It also noted the continuing progress in disseminating comprehensive monetary and financial data through the internet and welcomed the conclusion of a major survey on household expenditure, which will underpin the compilation of an official consumer price index, scheduled for publication in late 1999. At the same time, the mission underscored the urgent need for progress in preparing data on domestic production, national income and expenditure accounts, and balance of payments transactions: economic monitoring and analysis continue to be problematic given the lack of reliable data in these areas. Staff also encouraged the authorities to initiate the collection of data on the external assets and liabilities of the nonbank private sector to improve the monitoring of financial vulnerabilities. It will also be important to move ahead expeditiously with plans to compile consolidated public sector accounts, including for the municipalities.

60. **Technical assistance.** Although the pace of assistance has diminished compared to the mid-1990s, the authorities remain appreciative of the Fund's assistance, which most recently has focused on introducing a real-time bank settlement system (in 1998) and public expenditure management and tax policy in the context of this year's budget preparations (Appendix I). The authorities envisage a continuing need for advice from the Fund in the area of public expenditure management and improving the statistical database.

IV. STAFF APPRAISAL

61. The key economic challenges facing Lebanon today are clear—fiscal adjustment and structural reform. Accordingly, the commitment of the new government to extend the program of fiscal consolidation while rejuvenating structural reform is welcome, as are the indications of growing popular consensus that such policies, even if difficult, are necessary. Good progress is being made on the fiscal front, with the 1999 budget establishing the prospect of a second year of significant deficit reduction. Although the budget targets were missed in 1998, the projected small primary surplus in 1999 is in line with the soft-landing scenario developed at the time of the last Article IV discussions. On the structural front, reforms are, on balance, less well advanced, but even here the priority areas are well established, and a range of initiatives is underway. The key issue facing the authorities is the speed with which such adjustment and reform can be put in place.

62. At the same time, Lebanon's accumulated problems are sobering, and the room for maneuver has narrowed further. On the fiscal front, the downside risks highlighted at the time of the last Article IV consultations have materialized: the weaker economic outlook and an increase, rather than decline, in real interest rates have raised the bar as to the necessary fiscal adjustment. Accordingly, even if the 1999 fiscal targets are achieved in full—leading to improved confidence, a progressive recovery of economic growth, and lower interest rates—

the fiscal consolidation will need to be maintained and intensified through 2000 and 2001. While this will require great courage and determination, there is little alternative. Renewed concern about the fiscal outlook could quickly translate into pressure on the exchange rate and public financing which the authorities could find difficult to resist—particularly as the 1997–98 strategy of central bank interest subsidies and large eurobond absorption by domestic banks is seen as unrepeatable. The argument for determined implementation holds equally true for structural reform. Efforts to roll back the currently excessive levels of bureaucracy, strengthen governance, and liberalize the business environment will face well-entrenched interest groups. But without reform, Lebanon would continue to languish, falling behind not only the global economy, but also regional competitors with increasingly business-friendly policies, at a time when the renewed peace process offers hope of a more conducive business climate.

63. Given the challenges ahead, the staff welcomes the fiscal measures implemented in the initial months of the new government and its commitment to sustaining fiscal consolidation in the period ahead. In this connection, the staff commends the government's intention to limit the overall deficit in 2000 to 11–12 percent of GDP, and that in 2001 to 7 percent of GDP. Such objectives should be clearly spelled out and made public. The decision to implement a VAT from 2001 will make an important contribution to this goal. At the same time, successful adjustment will require determined efforts to strengthen tax administration and improve public expenditure management and control. In this context, the staff urges the authorities to make operational a centralized large taxpayer unit, move rapidly to integrate all public expenditures within the budget request, and strengthen ministry of finance monitoring and control of outlays by quasi-autonomous agencies. The staff notes that a key risk to the fiscal program for 2000–01 is the potential for a revenue shortfall, reflecting complications in implementing the proposed income and property taxes as well as preparing for VAT introduction. To ensure that the fiscal program is kept on track, the authorities are urged to stand ready, if necessary, to intensify efforts to reduce public expenditures.

64. The government's plans for a multiyear privatization effort will make an important contribution to debt reduction as well as to strengthening efficiency in key infrastructures. To maximize the returns in the latter regard, the staff recommends that a high priority be given to establishing regulatory frameworks that can protect against post-privatization monopoly power. More generally, it will be important to resist pressures to use privatization proceeds to postpone the needed fiscal adjustment.

65. The staff notes that Lebanon's exchange rate peg to the dollar has served to reduce inflation to low single digit levels, while providing a degree of stability for the capital inflows that have financed large merchandise trade deficits. At the same time, it has been associated with a large real appreciation, and sluggish export growth, as well as high and volatile real interest rates. The staff understands the authorities' concerns about moving to greater exchange rate flexibility before achieving the improved confidence that would come with reducing Lebanon's large fiscal imbalances. However, the staff emphasizes that

continuation of the exchange rate peg will depend crucially on a rapid strengthening of policies, including a determined and credible tightening of fiscal policies so as to ease existing policy tensions; this will imply early work on next year's budget and its speedy implementation. Moreover, in implementing this policy it will be essential to monitor closely developments in the real exchange rate and the consequences for competitiveness and growth. To prepare for greater exchange rate flexibility in the future, it will also be important to develop the depth and flexibility of financial markets and the instruments of the central bank.

66. The staff welcomes Lebanon's cooperation in conducting the FSAP review and the review's broadly positive findings as regards the considerable institutional strengths of the banking system and the broad effectiveness of regulatory arrangements. At the same time, stress tests reveal that a number of banks are vulnerable to credit and interest risk. While these banks represent only a modest share of the total system, this would likely complicate macroeconomic management in the event of a financial crisis. The staff urges the authorities to continue to strengthen regulatory and supervisory arrangements to address such risks. In particular, the staff would urge early steps to clarify the relationship between the central bank and the banking agencies (BCC and HBC); in addition, to bring Lebanon into line with best international practice, the staff recommends that the Banking Secrecy Law be amended to provide an appropriate level of supervisory access to the information necessary to address risks of money laundering.

67. Lebanon's disappointing overall growth rates and export performance in recent years underline the importance of accelerating the pace of structural reform. Liberalization of the trade regime will be key. Given the increase in the average customs tariff from 14 percent to 21 percent over the last three years, further tariff increases should be avoided, and rates reduced and consolidated as soon as fiscal conditions permit. In addition, the staff urges prompt steps to address existing nontariff trade impediments. The staff also recommends an acceleration of efforts to modernize the public sector to eliminate bureaucracy and make government operations simpler and more transparent, thereby reinforcing the drive to address corruption. Progress in this area remains at a very preliminary stage, and concrete improvements will require an ambitious and forceful commitment to change.

68. The slowdown in economic growth is likely to have its most severe consequences for the poorest segments of the population. Accordingly, the mission welcomes the government's intention to better focus the transfers provided through the budget while expanding expenditure on priority social areas in the context of a medium-term expenditure restructuring. Steps to strengthen social safety nets through reform of the social security system are also important. But for these reforms to be meaningful, fiscal space has to be created through a sharp improvement in the fiscal position.

69. Progress continues to be made in strengthening the statistical system and the authorities have given staff ready access to such economic and financial data as are available.

However, data in the real and external sectors as well as social indicators remain inadequate. The staff urges the authorities to accelerate progress in addressing these data deficiencies to further enhance the scope for economic analysis and policy making, including for the conduct of surveillance.

70. It is proposed that the next Article IV consultation with Lebanon takes place on the standard 12-month cycle.

Table 1. Lebanon: Selected Social, Economic, and Financial Indicators, 1992-99

I. Social and Demographic Indicators								
Surface area (sq km)	10,400							
Population density (people per sq km)	391							
Roads, paved (%)	95							
Population		Health						
Population, total	4,100,000	Life expectancy at birth, female (years)		71.2				
Labor force, total	1,314,688	Life expectancy at birth, male (years)		67.5				
Labor force growth, total (annual %)	2.97	Life expectancy at birth, total (years)		70.0				
Population growth (annual %)	1.90	Mortality rate, infant (per 1,000 live births)		31.0				
Urban population (% of total)	88.00	Mortality rate, under 5 (per 1,000 live births)		40.0				
Urban population growth (annual %)	2.70	Immunization, DPT (% of children under 12 months)		92.0				
Age-dependency ratio (dependents to working-age population)	0.70	Immunization, measles (% of children under 12 months)		88.0				
Fertility rate, total (births per woman)	2.83							
Education		Infrastructure						
Illiteracy rate, adult male (% of males 15+)	5.30	Personal computers (per 1,000 people)		12.5				
Illiteracy rate, adult total (% of people 15+)	15.00	Mobile phones (per 1,000 people)		30.0				
Gross primary enrollment (% of school age population)	109	Telephone mainlines (per 1,000 people)		82.4				
		Television sets (per 1,000 people)		268.4				
II. Economic and Financial Indicators								
	1992	1993	1994	1995	1996	Prel. 1997	Prel. 1998	Proj. 1999

Table 1. Lebanon: Selected Social, Economic, and Financial Indicators, 1992-99 (concluded)

	1992	1993	1994	1995	1996	Prel. 1997	Prel. 1998	Proj. 1999
(In percent of GDP)								
Consumption 3/	..	132.0	125.1	120.7	114.2	111.0	111.0	109.0
Investment 3/	...	29.1	32.4	33.0	30.5	27.3	23.9	17.2
Central government								
Revenue	12.0	14.1	14.6	16.8	17.3	16.4	18.1	19.9
Expenditure 2/	23.4	23.4	35.1	35.2	39.0	44.0	37.0	34.8
Of which								
Capital expenditure	1.5	3.4	9.3	9.4	8.8	9.5	8.8	5.5
Overall balance								
(including grants)	-11.4	-7.7	-17.2	-18.0	-21.3	-27.4	-18.9	-14.9
Overall balance								
(excluding grants)	-11.4	-9.2	-20.5	-18.4	-21.7	-27.6	-18.9	-14.9
Gross public debt	49.0	48.5	69.4	78.1	100.0	105.2	119.2	128.3
Domestic currency	44.0	44.2	61.1	66.5	84.4	86.5	88.5	91.8
Foreign currency	5.3	4.3	8.3	11.5	14.5	16.2	25.6	34.6
Net public debt	38.1	37.9	52.2	63.1	81.0	99.0	110.4	120.0
Exports (f.o.b.)	10.8	9.1	7.4	7.3	6.0	4.4	4.5	4.6
Imports (f.o.b.)	68.3	65.1	60.8	60.5	53.8	46.6	40.7	36.6
External current account balance	-49.8	-49.0	-45.0	-41.2	-37.1	-29.8	-27.4	-21.4
(In millions of U.S. dollars)								
External sector								
Exports, f.o.b.	601	684	676	816	783	649	723	784
Imports, f.o.b.	-3,786	-4,908	-5,541	-6,722	-6,992	-6,923	-6,581	-6,250
Private transfers	416	565	685	836	555	959	740	850
Current account balance	-2,763	-3,688	-4,100	-4,578	-4,817	-4,429	-4,424	177
Overall balance (+ surplus)	54	1,170	1,131	256	786	420	-488	189
Central bank reserves (end of period)	4,524	5,824	7,375	8,059	9,296	8,602	9,159	9,336
(In months of next year's imports of goods and services)	9.9	11.4	11.7	12.4	13.6	12.8	14.6	14.5
External public debt outstanding (end of period)	257	327	772	1,147	2,062	2,673	2,557	3,321
External debt-service payments	...	58	99	180	151	676	413	301
Principal	...	41	90	109	21	439	81	125
Interest	...	17	9	72	130	237	333	176
Debt service (as percent of current receipts)		3.5	5.0	6.1	4.8	16.2	9.8	7.8
(Lebanese pounds per U.S. dollar)								
Exchange rate (period average)	1,713	1,741	1,680	1,621	1,571	1,539	1,516	...
(end of period)	1,838	1,711	1,647	1,596	1,552	1,527	1,508	...
(In billions of Lebanese pounds)								
GDP 1/	9,499	13,122	15,305	18,028	20,417	22,880	24,509	25,749

Sources: Ministry of Finance; Banque du Liban (BdL); Council for Development and Reconstruction (CDR); World Bank Social Indicators of Development; World Development Indicators, CD-ROM World Bank; and Fund staff estimates.

1/ Based on BdL and Fund staff estimates.

2/ Starting in 1993, includes externally financed capital (reconstruction) expenditures by the CDR.

3/ Fund staff estimates based on data provided by the authorities.

Table 2. Lebanon: Government Operations, 1994-99 1/

	Actuals				Prel.	Proj.	Slippages relative to budget	
	1994	1995	1996	1997	1998	1999	1997	1998
(In billions of Lebanese pounds)								
Revenue 2/	2,241	3,033	3,534	3,753	4,441	5,135	-347	-159
Tax revenue	1,656	2,100	2,869	2,894	3,315	3,797	-258	-251
Of which:								
Taxes on income and profits	250	191	257	340	403	457	-100	-37
Taxes on property	219	265	322	377	373	442	...	-37
Taxes on domestic goods and services 3/	176	157	139	245	231	247	...	-65
Taxes on international trade 3/	791	1,320	1,632	1,741	2,102	2,398	-449	-88
Nontax revenue 4/	585	933	665	616	907	1,107	...	-127
Other treasury revenue	0	0	0	243	219	231	...	219
Expenditure 5/	5,379	6,342	7,958	10,067	9,062	8,965	3,104	642
Current expenditures	3,954	4,640	6,153	7,904	6,909	7,553	2,079	86
Wages and salaries 6/	1,710	1,869	2,261	2,466	2,352	2,830	205	-128
EDL fuel subsidy 7/	246	217	122	150	100	0	150	0
Other current 8/	510	678	1,117	1,806	1,105	823	942	62
Interest payments	1,488	1,875	2,653	3,482	3,352	3,900	782	152
Domestic	1,472	1,745	2,468	3,224	3,051	3,428	724	...
Foreign	15	131	185	258	301	472	58	...
Capital expenditures	1,425	1,702	1,805	2,164	2,153	1,412	1,026	556
Of which: foreign financed	175	486	507	500	479	475	-30	-21
Overall balance (excluding grants) 5/	-3,138	-3,309	-4,424	-6,314	-4,622	-3,830	-3,451	-802
Financing	3,503	3,357	5,240	6,318	4,355	3,830	3,455	535
Foreign currency 9/	1,206	782	943	957	2,515	1,877	-275	1,715
Grants	507	73	71	72	0	0	...	...
Net borrowing 10/	698	709	872	884	2,515	2,631	...	...
Disbursements	849	885	921	1,556	2,637	2,821	...	...
Amortization	-151	-176	-33	-672	-122	-189	...	...
Settlement of payment arrears 11/	0	0	0	0	0	-754	...	...
Domestic currency 9/	2,297	2,576	4,297	5,362	1,840	1,952	3,731	-1,180
Banking system	1,504	1,124	2,954	3,609	1,771	1,301	...	...
BDL	-1,492	22	-1,207	2,647	-700	0	...	...
Commercial banks	2,996	1,103	4,161	963	2,471	1,301	...	...
Nonbank domestic	793	1,452	1,117	1,414	-609	651	...	...
Accumulation of payment arrears 11/	0	0	226	339	677	0	339	677
Discrepancy 12/	365	48	816	4	-267	0	...	...
(In percent of GDP)								
Revenue 2/	14.6	16.8	17.3	16.4	18.1	19.9	-0.8	0.4
Tax revenue	10.8	11.6	14.0	12.6	13.5	14.7	-0.6	-0.2
Of which:								
Taxes on income and profits	1.6	1.1	1.3	1.5	1.6	1.8	-0.4	-0.1
Taxes on property	1.4	1.5	1.6	1.6	1.5	1.7	...	-0.1
Taxes on domestic goods and services 3/	1.2	0.9	0.7	1.1	0.9	1.0	...	-0.2
Taxes on international trade 3/	5.2	7.3	8.0	7.6	8.6	9.3	-1.6	0.1
Nontax revenue 4/	3.8	5.2	3.3	2.7	3.7	4.3	...	-0.3
Other treasury revenue	0.0	0.0	0.0	1.1	0.9	0.9	...	0.9
Expenditure 5/	35.1	35.2	39.0	44.0	37.0	34.8	14.8	4.5
Current expenditure (excluding interest payment	16.1	15.3	17.1	19.3	14.5	14.2	6.2	0.6
Interest payments	9.7	10.4	13.0	15.2	13.7	15.1	3.9	1.3
Capital expenditure	9.3	9.4	8.8	9.5	8.8	5.5	4.7	2.6

Table 2. Lebanon: Government Operations, 1994-99 1/ (concluded)

	Actuals				Prel.	Proj.	Slippages relative to budget	
	1994	1995	1996	1997	1998	1999	1997	1998
Overall balance (excluding grants) 5/	-20.5	-18.4	-21.7	-27.6	-18.9	-14.9	-15.6	-4.1
Current balance (excluding grants)	-11.2	-8.9	-12.8	-18.1	-10.1	-9.4	-10.9	-1.5
Primary balance (excluding grants)	-10.8	-8.0	-8.7	-12.4	-5.2	0.3	-11.7	-2.8
(excluding foreign financed investment)	-9.6	-5.3	-6.2	-10.2	-3.2	2.1	-11.7	-2.8
Domestic currency financing	12.7	13.9	21.0	23.4	7.5	7.6	16.6	-4.1
Memorandum items:								
Interest payments/total revenue	66.4	61.8	75.1	92.8	75.5	75.9	26.9	5.9
Custom duties/total revenue	35.3	43.5	46.2	46.4	47.3	46.7	-7.0	-0.3
Revenue/total expenditure	41.7	47.8	44.4	37.3	49.0	57.3	-21.6	-5.6
Overall balance/total expenditure	-58.3	-52.2	-55.6	-62.7	-51.0	-42.7	-21.6	-5.6
GDP (billions of LL)	15,305	18,028	20,417	22,880	24,509	25,749	-960	-1,437

Sources: Ministry of Finance; Banque du Liban; Council for Development and Reconstruction; and Fund staff estimates and projections.

1/ Cash data on a calendar year basis corrected for arrears. Includes the Treasury and the foreign financed CDR capital expenditure. Other public entities are included on a net basis only. Up to and including 1997, data are based on treasury accounts at the central bank. In 1998, revenue and expenditure figures were adjusted for compensatory transactions, which have no effect on net receipts or payments registered in the treasury account but increase gross revenues and expenditures. The increase in gross revenues attributable to this change was estimated at 0.8 percent of GDP.

2/ Includes revenue collected by the central government on behalf of municipalities.

3/ In July 1995, after the tariff reform, several excise taxes on imported goods started to be collected at the Customs. Excises levied on imports are included in customs duties from 1995 onward.

4/ Includes profit transfers from public entities and the lottery, various tax penalties, and other fees and nontax revenue.

5/ The expenditure data was revised to include expenditure financed through the accumulation of arrears to the private sector. The included amounts of expenditure financed with arrears are preliminary estimates provided by the authorities in their 5-year plan. The expenditure breakdown is estimated on the basis of a reconciliation of payments order data with cash expenditure data.

6/ Including wage and salary related transfers, e.g., pensions to civil servants or end-of-service indemnities to government employees. The 1998 wage data is directly comparable with previous years as the methodology underlying the calculations was revised.

7/ Petroleum subsidy paid to the electricity company (autonomous public entity).

8/ Including advances and transfers to public entities for current expenditure.

9/ Financing is distinguished by the currency of issue as asset holdings of nonresidents cannot be identified for all instruments.

10/ Includes external loans to CDR and foreign currency bonds issued by the Lebanese Republic.

11/ Government arrears to the private sector.

12/ Discrepancy between deficit and financing. Budget figures (except for arrears and expenditure of certain autonomous public entities) are on a cash basis while financing items include changes in accrued interest payments on government papers (treasury bills are recorded at market value in the public debt statistics). In 1996, changes in accrued interest payments amounted to LL506 billion, i.e., about 70 percent of the discrepancy. Other sources of the discrepancy are the valuation of disbursed foreign loans and differences in the timing of expenditure recording at the central bank and public entities.

Table 3. Lebanon: Public Debt, 1994-99

	Actuals				Prel.	Proj.
	1994	1995	1996	1997	1998	1999
(In billions of Lebanese pounds; end of period)						
Gross public debt 1/	10,619	14,079	20,415	24,065	29,210	33,040
Gross domestic currency public debt	9,348	11,997	17,229	19,787	21,686	23,638
By instrument						
Treasury bills and bonds 2/	9,266	11,838	17,022	19,578	21,436	23,388
Long-term treasury bonds						
24-month bonds	5,020	4,644	8,835	12,430	16,102	...
Accrued interest	272	230	429	580	594	...
Short-term treasury bills	3,974	6,965	7,759	6,307	4,479	...
12-month bills	2,687	5,129	4,103	4,618	3,296	...
6-month bills	1,024	987	2,762	1,270	852	...
3-month bills	262	850	893	419	331	...
Loans	82	159	207	209	250	250
By holder						
BDL	105	195	124	375	281	281
Treasury bills and bonds	27	92	24	274	178	178
Other	78	103	100	101	104	104
Commercial banks	7,345	8,453	12,638	13,532	16,133	17,434
Treasury bills and bonds	7,341	8,397	12,532	13,424	15,987	17,288
Other	4	57	106	109	146	146
Nonbank (treasury bills and bonds)	1,898	3,349	4,467	5,880	5,272	5,922
Gross foreign currency public debt 3/	1,271	2,082	2,961	3,713	6,282	8,914
Sovereign bonds	659	1,117	1,242	1,594	3,761	5,164
Other foreign currency debt 4/	612	965	1,719	2,119	2,521	3,750
Government arrears to private sector	0	0	226	565	1,242	488
Public sector deposits	2,636	2,710	3,871	1,406	2,142	2,142
Net public debt 5/	7,983	11,369	16,545	22,659	27,068	30,898
(In percent of GDP)						
Gross public debt	69.4	78.1	100.0	105.2	119.2	128.3
Domestic currency	61.1	66.5	84.4	86.5	88.5	91.8
Foreign currency	8.3	11.5	14.5	16.2	25.6	34.6
Government arrears to the private sector	0.0	0.0	1.1	2.5	5.1	1.9
Government deposits	17.2	15.0	19.0	6.1	8.7	8.3
Net public debt	52.2	63.1	81.0	99.0	110.4	120.0
Memorandum items:						
Short-term treasury bills (in percent of treasury bills)	42.9	58.8	45.6	32.2	20.9	...
Treasury bills (in percent of gross public debt)	87.3	84.1	83.4	81.4	74.2	70.8
GDP (in billions of Lebanese pounds)	15,305	18,028	20,417	22,880	24,509	25,749

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

1/ Includes debt contracted by the Lebanese treasury on behalf of the central government and public agencies other than the central bank. Includes government arrears to the private sector. Estimates of the amounts of outstanding arrears are preliminary.

2/ Market value of the outstanding treasury bills and bonds (i.e., including accrued interest).

3/ The market value of the stock of foreign currency public debt is evaluated at the end of period exchange rate.

4/ Including U.S. dollar-denominated Lebanese treasury bonds issued to settle payment arrears to the private sector.

5/ Defined as gross public debt minus public sector deposits with the banking system.

Table 4. Lebanon: Monetary Survey and Banking System Indicators, 1994-99

	1994	1995	1996	1997	Prel. 1998	Proj. 1999
(End of period stocks; in billions of Lebanese pounds)						
Total liquidity (M3)	19,651	22,883	29,241	34,898	40,509	45,800
Money (M1)	1,437	1,561	1,753	1,935	2,052	2,198
Currency	939	1,046	1,161	1,210	1,241	...
Demand deposits in domestic currency	498	514	593	725	821	...
M2-Domestic currency component of liquidity	8,587	9,663	14,002	14,530	16,554	18,428
Domestic currency time and savings deposits	7,150	8,103	12,248	12,595	14,503	...
Foreign currency deposits	11,065	13,220	14,913	20,040	23,585	27,002
Bonds issued by banks	0	0	326	328	371	371
Net foreign assets 1/	15,829	15,862	16,477	15,749	14,691	14,958
Domestic credit	12,183	15,716	21,244	28,193	35,214	40,672
Net credit to public sector	4,275	5,276	8,218	12,154	15,881	18,540
Central bank	-2,378	-2,412	-3,557	-863	-1,715	-1,715
Commercial banks	6,653	7,688	11,775	13,018	17,596	20,255
Credit to private sector	7,908	10,440	13,026	16,039	19,333	22,132
Lebanese pounds	1,126	1,398	1,725	2,214	2,413	2,656
Foreign currency	6,782	9,042	11,300	13,824	16,919	19,476
Other items (net)	-8,361	-8,694	-8,480	-9,044	-9,395	-9,830
(Change in percent of total liquidity at beginning of period)						
Total liquidity (M3)	25.3	16.4	27.8	19.3	16.1	13.1
Net foreign assets	5.3	0.2	2.7	-2.5	-3.0	0.7
Net credit to public sector	10.6	5.1	12.9	13.4	10.7	6.6
Credit to private sector	12.2	12.9	11.3	10.3	9.4	6.9
Other items (net)	-2.7	-1.7	0.9	-1.9	-1.0	-1.1
(In percent)						
Memorandum items:						
Credit to public sector (12-month change)	63.3	23.4	55.8	47.9	30.7	16.7
Credit to private sector (12-month change)	32.0	32.0	24.8	23.1	20.5	14.5
Foreign currency deposits as share of M3	56.3	57.8	51.0	57.4	58.2	59.0
Interest rate (3-month treasury bill yield), end of period	13.5	16.0	14.3	13.1	11.8	11.3
Inflation adjusted 2/	1.9	4.1	7.6	6.4	5.9	8.5
Income velocity of total liquidity	0.78	0.79	0.70	0.66	0.61	0.56
Credit to private sector (in percent of GDP)	51.4	57.8	63.8	70.1	78.5	86.0
Banking System Indicators 3/						
Net foreign currency exposure (assets minus liabilities) 4/	-149	312	1,351	652	-1,452	...
(As percent of capital)	-22.0	27.0	69.0	22.0	-40.1	...
Total loans/total assets	32.0	35.5	34.1	33.9	33.9	...
Problem loans/total loans	19.7	15.7	14.7	14.1	13.8	...
Provisions against problem loans/problem loans	49.6	45.6	41.4	75.7	68.6	...
Total provisions/problem loans	61.4	58.1	55.2	88.3	81.1	...
Total capital/problem loans	43.9	70.7	104.2	137.0	139.8	...
Total loans for construction/total loans	18.9	20.9	21.6	20.6	21.8	...
Foreign currency lending/total private lending	85.8	86.6	86.8	86.2	87.5	88.0
Credits in foreign currency/deposits in foreign currency	54.2	60.7	63.8	54.7	55.0	...
Average return on assets	1.2	1.1	1.3	1.3	1.2	...
Average return on equity	44.4	27.3	25.2	23.4	18.8	...
Total capital/total assets	2.8	3.9	5.2	6.5	6.6	...
Risk-weighted capital adequacy ratio	12.9	16.2	17.0	19.9	18.9	...

Sources: Banque du Liban; and Fund staff projections.

1/ Including IMF reserve position.

2/ Treasury bill yield (3-months) minus inflation rate (over preceding 12-months), all at end of period.

3/ Commercial banks only. Loans are loans to private sector entities.

4/ In billions of Lebanese pounds.

Table 5. Lebanon: Balance of Payments, 1994-99

(In millions of U.S. dollars)

	1994	1995	Rev. 1996	Prel. 1997	Prel. 1998	Proj. 1999
Current account	-4,100	-4,578	-4,817	-4,429	-4,424	-3,654
Trade balance	-4,866	-5,906	-6,209	-6,274	-5,858	-5,466
Export f.o.b. 1/	676	816	783	649	723	784
Imports f.o.b. 1/	-5,541	-6,722	-6,992	-6,923	-6,581	-6,250
Services	31	447	790	838	685	962
Factor	400	501	387	287	135	233
Interest	125	137	136	135	26	174
Bank of Lebanon (net)	134	209	266	372	359	350
Interest on external public debt 2/	-9	-72	-130	-237	-333	-176
Investment income	275	364	251	152	109	58
Commercial banks (net)	109	136	72	39	31	0
Nonbanks 3/	166	228	179	114	78	59
Nonfactor	-369	-54	403	552	549	729
Insurance and freight	-449	-545	-574	-575	-565	-515
Travel and transportation	80	91	150	200	204	225
Other services 4/	...	400	827	927	911	1,019
Unrequited transfers	735	881	602	1,007	750	850
Public	50	45	47	48	10	0
Private	685	836	555	959	740	850
Capital account	5,231	4,834	5,603	4,849	3,936	3,831
Direct investment	2,100	2,933	2,552	1,793	1,900	1,560
External public debt disbursements	505	389	536	714	341	900
Contracted loans	105	246	486	366	289	440
Eurobond 2/	400	143	50	348	52	460
Amortization or external public debt	-90	-109	-21	-438	-80	-125
Nonbank short-term capital 3/	110	450	186	127	-447	0
Claims on foreign banks (-increase)	60	150	135	-158	-59	0
Liabilities to foreign banks	50	300	51	285	-388	0
Other capital 5/	2,605	1,170	2,350	2,653	2,223	1,496
Overall balance	1,131	256	786	420	-488	177
Net foreign assets of the banking system (-increase)	-1,131	-256	-786	-420	488	-177
Bank of Lebanon	-1,861	-591	-1,428	-62	-576	-177
Commercial banks	730	335	642	-358	1,064	0
Memorandum items:						
Current account balance as a percent of GDP	-45.0	-41.2	-37.1	-29.8	-27.4	-21.4
External public debt (in millions of U.S. dollars) 2/	772	1,147	2,062	2,673	2,557	3,321
(in percent of GDP)	8.3	10.3	15.9	18.0	15.8	19.4
Debt service (in millions of U.S. dollars)	99	180	151	676	413	301
Principal (in millions of U.S. dollars)	90	109	21	439	81	125
Interest (in millions of U.S. dollars)	9	72	130	237	333	176
Debt service in percent of current receipts	5.0	6.1	4.8	16.2	9.8	7.8
Gross official reserves (in millions of U.S. dollars)	7,375	8,059	9,296	8,602	9,159	9,336
Gross official reserves (in months of imports of goods and services)	11.7	12.1	13.6	12.8	14.6	14.5
GDP (in millions of U.S. dollars)	9,110	11,119	12,997	14,862	16,166	17,075

Sources: Banque du Liban; Council for Development and Reconstruction; Ministry of Finance; Bank for International Settlements; IMF, Direction of Trade Statistics, International Financial Statistics; and Fund staff estimates and projections.

1/ For 1993, IMF, Direction of Trade Statistics; customs data thereafter. Export data were adjusted to reflect changes in valuation of transfers of banknotes abroad, previously included at face value.

2/ Foreign currency public debt adjusted for Eurobond holdings by Lebanese commercial banks and holdings of domestic currency government securities by nonresidents. Interest payments adjusted on the basis of stocks held by commercial banks and nonresidents, respectively.

3/ Data on the flow of international bank lending to nonbank residents of Lebanon and on the flow of deposits by residents of Lebanon with international banks are obtained from stock data provided by the Bank for International Settlements. Estimates of interest payments and receipts are derived by applying the average three-month Eurodollar rate to the average stock.

4/ Includes information, construction, financial, business, medical, and communication services. Data available as of 1995.

5/ Includes portfolio investment, other capital flows, valuation adjustments, and errors and omissions (mainly unrecorded flows of both current and capital account items).

Table 6. Lebanon: Illustrative Medium-Term Scenarios of Public Debt Dynamics, 1997–2003

(In percent of GDP, unless otherwise noted)

	Prel. 1997	Prel. 1998	5-year scenario				
	1999	2000	2001	2002	2003		
November 1997 softlanding scenario 1/							
Overall balance (excluding foreign grants)	-19.6	-14.6	-11.7	-9.4	-7.8	-6.1	...
Primary balance (excluding foreign grants)	-4.9	-2.2	0.4	1.2	2.2	3.1	...
Net public debt	93.0	98.7	100.4	99.7	97.6	93.9	...
Implied interest rate on net public debt (in percent) 2/	20.8	15.2	13.9	12.0	11.3	10.5	...
Consumer price inflation (in percent)	8.5	8.0	7.0	6.0	5.5	5.0	...
Implied real interest rate on net public debt (in percent) 2/	12.3	7.2	6.9	6.0	5.8	5.5	...
Real GDP growth (in percent)	4.0	5.0	6.0	6.5	6.5	7.0	...
Updated scenario for 1999 Article IV consultation							
Overall balance (excluding foreign grants) 3/	-27.6	-18.9	-14.9	-11.0	-7.0	-5.0	-3.0
Primary balance (excluding foreign grants) 3/	-12.4	-5.2	0.3	4.1	6.7	7.4	7.9
Implied interest rate on net public debt (in percent) 2/	21.0	14.8	14.4	13.3	12.2	11.4	10.6
Consumer price inflation (in percent)	7.8	4.5	3.0	3.0	5.0	3.0	3.0
Implied real interest rate on net public debt (in percent) 2/ 4/	14.1	9.4	9.7	9.6	8.8	8.0	7.2
Real GDP growth (in percent)	4.0	3.0	2.0	2.5	3.5	4.5	5.0
Memorandum items for 1999 scenario:							
Revenues (excluding foreign grants)	16.4	18.1	19.9	22.4	24.1	24.2	24.2
Tax revenues	12.6	13.5	14.7	17.0	18.8	19.0	19.5
Income, profits, and capital gains	1.5	1.6	1.8	2.6	2.6	2.8	2.9
Property taxes	1.6	1.5	1.7	2.6	2.6	2.4	2.4
Excises 5/	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Sales taxes (including VAT)	0.0	0.1	0.1	0.4	3.0	3.5	4.0
Trade taxes	7.6	8.6	9.3	9.5	8.5	8.3	8.1
Of which: excises levied on imports	...	...	3.3	3.8	3.1	3.1	3.1
Other taxes	1.8	1.6	1.8	1.8	1.9	2.0	2.0
Nontax receipts	2.7	3.7	4.3	4.5	4.5	4.3	3.8
Expenditures	44.0	37.0	34.8	33.4	31.2	29.2	27.2
Current expenditures	34.5	28.2	29.3	28.7	26.6	24.6	22.6
Wages and salaries	10.8	9.6	11.0	10.2	9.5	9.0	8.4
Of which: wage and salaries	...	6.5	7.5	6.9	6.4	6.0	5.5
Of which: wage and salary related transfers	...	3.1	3.5	3.3	3.1	3.0	2.9
Interest payments	15.2	13.7	15.1	15.1	13.7	12.4	10.9
EDL fuel subsidy	0.7	0.4	0.0	0.0	0.0	0.0	0.0
Other current expenditures	7.9	4.5	3.2	3.3	3.3	3.3	3.3
Capital expenditures	9.5	8.8	5.5	4.7	4.6	4.6	4.6
Exceptional financing from sales of government assets	...	...	...	2.8	2.6	2.4	2.2
Total public debt (e.o.p) 3/	105.2	119.2	128.3	129.8	123.9	117.7	109.6
Domestic currency	86.5	88.5	91.8	90.4	85.1	81.3	75.4
Foreign currency	16.2	25.6	34.6	39.4	38.8	36.4	34.3
Government arrears to private sector	2.5	5.1	1.9	0.0	0.0	0.0	0.0
Net public debt	99.0	110.4	120.0	121.9	116.6	111.0	103.4

Sources: Data provided by the Lebanese authorities; Fund staff calculations and projections.

1/ SM/97/270.

2/ Interest payments as percent of initial public debt.

3/ Including (accumulation of) arrears to the private sector.

4/ Based on centered 5-year moving average of CPI inflation rate.

5/ Excises on domestically produced goods.

Table 7. Lebanon: Economic and Financial Indicators, 1995-2003

	1995	1996	Prel. 1997	Prel. 1998	5-year scenario				
					1999	2000	2001	2002	2003
(Annual changes in percent)									
Real GDP at 1990 market prices	6.5	4.0	4.0	3.0	2.0	2.5	3.5	4.5	5.0
Consumer price index (annual average)	10.6	8.9	7.8	4.5	3.0	3.0	5.0	3.0	3.0
Merchandise exports, f.o.b. (in millions of U.S. doll	20.8	-4.1	0.0	11.3	8.6	10.0	15.0	15.0	15.0
Merchandise imports, f.o.b. (in millions of U.S. dol	21.3	4.0	-1.0	-4.9	-5.0	3.0	5.0	6.0	8.0
Gross official exchange reserves (in millions of U.S. dollars)	8,059	9,296	8,602	9,159	9,336	9,448	9,669	9,895	10,045
In months of imports of goods and services	12.1	13.6	12.8	14.6	14.5	13.8	13.3	12.6	11.9
In percent of net public debt (e.o.p.)	113.1	87.2	58.0	51.0	45.6	43.0	42.3	42.3	42.6
Total liquidity (M3)	16.4	27.8	19.3	16.1	13.1	...	...	...	...
Domestic currency liquidity (in percent of M3)	5.5	19.0	1.8	5.8	4.6	...	...	...	...
Credit to the private sector (in percent of M3)	12.9	11.3	10.3	9.4	6.9	...	...	...	...
Credit to the public sector (in percent of M3)	5.1	12.9	13.5	10.7	6.6	...	...	...	...
(In percent of GDP)									
Gross national savings	-8.2	-6.6	-2.2	-3.5	-4.2	-2.5	-0.7	0.7	2.2
Private	0.3	5.9	15.6	6.5	5.2	3.8	1.7	1.1	0.6
Government	-8.5	-12.5	-17.8	-10.0	-9.4	-6.3	-2.4	-0.4	1.6
Gross investment	33.0	30.5	27.5	23.9	17.2	18.0	18.9	19.7	20.8
Private	23.5	21.7	18.0	15.1	11.7	13.3	14.3	15.1	16.2
Government	9.4	8.8	9.5	8.8	5.5	4.7	4.6	4.6	4.6
External current account balance	-41.2	-37.1	-29.8	-27.4	-21.4	-20.4	-19.3	-18.7	-18.3
Trade balance	-53.1	-47.8	-42.2	-36.2	-32.0	-30.9	-29.4	-28.6	-28.2
Exports, f.o.b.	7.3	6.0	4.4	4.5	4.6	4.8	5.1	5.4	5.8
Imports, f.o.b.	-60.5	-53.8	-46.6	-40.7	-36.6	-35.7	-34.5	-34.0	-33.9
Services (net)	4.0	6.1	5.6	4.2	5.6	5.6	5.3	5.2	5.3
Private transfers (net)	7.5	4.2	6.6	4.6	5.0	5.0	4.8	4.7	4.5
Memorandum items									
Lebanese pound/US\$ exchange rate (e.o.p.)	1,596	1,552	1,527	1,508	...	...	...	...	...
Lebanese pound/US\$ exchange rate (p.a.)	1,621	1,571	1,539	1,516	...	...	...	...	...
Real effective exchange rate	3.9	12.0	18.1	8.0	...	...	...	...	...
GDP (in billions of LL)	18,028	20,417	22,880	24,509	25,749	27,185	29,543	31,799	34,390
GDP (in millions of U.S. dollars)	11,119	12,997	14,862	16,166	17,075	18,027	19,591	21,087	22,805

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

Table 8. Lebanon: Indicators of Financial Vulnerability, 1994-99
(End of period, unless otherwise noted)

	1994	1995	1996	1997	Prel. 1998	Proj. 1999
Monetary and financial indicators						
Gross domestic currency public debt (in percent of GDP)	61.1	66.5	84.4	86.5	88.5	91.8
Public sector domestic currency borrowing requirement 1/	12.7	13.9	19.9	22.0	4.7	7.6
Broad money (annual changes in percent)						
In current prices	25.3	16.4	27.8	19.3	16.1	13.1
In constant prices 2/	16.1	5.3	17.3	10.8	11.0	9.7
Broad domestic currency liquidity (M2)						
In percent of broad money	43.7	42.2	47.9	41.6	40.9	40.2
In percent of domestic currency public debt	91.9	80.5	81.3	73.4	76.3	78.0
Private sector credit (annual changes in percent)						
In current prices	32.0	32.0	24.8	23.1	20.5	14.5
In constant prices 2/	22.2	19.4	14.6	14.3	15.3	11.1
(In millions of U.S. dollars)						
Foreign currency and external debt indicators						
Gross foreign currency public debt	772	1,335	1,908	2,432	4,166	5,911
In percent of GDP	8.3	11.5	14.5	16.2	25.6	34.6
Gross external public debt	772	1,147	2,062	2,673	2,557	3,321
In percent of GDP	8.3	10.3	15.9	18.0	15.8	19.5
Short-term external debt 3/	...	...	4,195	5,622	6,817	7,191
Of which: commercial banks	1,580	2,067	2,990	4,189	5,908	5,908
Commercial banks' net foreign asset position	2,227	1,907	1,340	1,825	712	...
Commercial banks' net open foreign exchange position	-149	312	1,351	652	-1,452	...
Official reserves indicators						
Gross official reserves 4/	7,375	8,059	9,296	8,602	9,159	9,336
In percent of M2	141.4	133.1	103.0	90.4	83.4	76.4
In percent of short-term external debt	...	...	221.6	153.0	134.4	129.8
Net official reserves 5/	6,291	6,663	7,399	5,701	6,144	6,320
In percent of M2	120.7	110.0	82.0	59.9	56.0	51.7
In percent of short-term external debt	...	...	176.4	101.4	90.1	87.9
Banking sector indicators						
Problem loans (as percent of capital)	227.8	141.4	96.0	73.0	71.5	...
Provisions against problem loans (as percent of problem loans)	49.6	45.6	41.4	75.7	68.6	...
Risk-weighted capital adequacy ratio	12.9	16.2	17.0	19.9	18.9	...
Share of construction loans in total privatization credit (in percent)	18.9	20.9	21.6	20.6	21.8	...
Credit to private sector (in percent of GDP)	51.4	57.8	63.8	70.1	78.5	86.0
External current account indicators (annual flows)						
Merchandise exports, f.o.b.	676	816	783	649	723	784
In constant prices (annual changes in percent)	-4.3	9.3	-2.7	-9.2	14.1	11.5
Merchandise imports, c.i.f.	5,990	7,267	7,566	7,498	7,146	6,765
In constant prices (annual changes in percent)	17.9	11.1	3.6	6.6	-0.8	-3.2
External current account balance	-4,100	-4,578	-4,817	-4,429	-4,424	-3,654
In percent of GDP	-45.0	-41.2	-37.1	-29.8	-27.4	-21.4

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

1/ In percent of GDP, excluding accumulation of arrears to private sectors.

2/ On the basis of the annual average CPI.

3/ Short-term public debt (non-resident treasury bill holdings, debt coming due during next 12 months, and foreign liabilities of central bank) and total foreign liabilities of commercial banks.

4/ Including gold.

5/ Excluding foreign currency deposits held by commercial banks with the central bank.

Lebanon: Fund Relations
(As of June 30, 1999)

I. **Membership Status:** Joined 4/14/47; Article VIII.

II. General Resources Account:	<u>SDR Million</u>	<u>Percent Quota</u>
Quota	146.00	100.0
Fund holdings of currency	127.17	87.1
Reserve position in Fund	18.83	12.9
III. SDR Department:	<u>SDR Million</u>	<u>Percent Allocation</u>
Net cumulative allocation	4.39	100.0
Holdings	15.91	362.2

IV. **Outstanding Purchases and Loans:** None.

V. **Financial Arrangements:** None.

VI. **Projected Obligations to the Fund:** None.

VII. **Foreign Exchange Policy:**

The Lebanese pound is classified as independently floating. The Bank of Lebanon's (BdL) stated policy is to intervene in exchange markets to smooth out short-term fluctuations. De facto, the Lebanese pound has gradually but steadily appreciated from its historical low of LL2,528 per US\$1 in September 1992 to its mid-December 1998 midpoint parity of LL1,508 per US\$1, which has been maintained since. The BdL intervenes with a small bid-ask spread (+/- 6LL per US\$1) around the midpoint parity. Effective July 1, 1993, Lebanon accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

VIII. **Article IV Consultations**

Lebanon is on the 12-month Article IV consultation cycle. The 1997 Article IV consultation took place in Beirut during August 21–September 1, 1997 and October 29–November 1, 1997 (SM/97/270 and SM/97/276), and was completed by the Executive Board on December 12, 1997.

IX. Technical Assistance

Date	Department	Purpose
Dec. 1-12, 1991	MAE	Monetary management issues
Mar. 16-31, 1992	FAD	Review of tax system
Oct. 20-Nov. 2, 1992	FAD	Reform of customs tariff
Jan. 25-Feb. 13, 1993	FAD	Taxes on income and profits
Feb. 7-11, 1993	RES	Monetary policy
Feb. 8-30, 1993	FAD	Public expenditure management
Apr. 13-24, 1993	INS	Financial programming
May 2-14, 1993	MAE	Reorganization of BDL
Sept. 6-17, 1993	STA	Government finance statistics
Sept. 9-17, 1993	FAD	Expenditure control
Oct. 5-18, 1993	MAE	Central bank accounting
Nov. 2-12, 1993	STA	Multitopic statistical issues
Jan. 24-Feb. 4, 1994	MAE	Monetary instruments and controls
Jan. 23-Feb. 5, 1994	STA	Balance of payments statistics
Feb. 10-25, 1994	FAD	Taxes on goods and services
Apr. 22-29, 1994	FAD	IBRD technical assistance project
Sept. 21-27, 1994	FAD	Customs policy and administration
Oct. 25-Nov. 11, 1994	FAD	Public expenditure management
Nov. 30-Dec. 15, 1994	FAD	Selective taxes and customs issues
Dec. 6-16, 1994	STA	Balance of payments statistics
May 18-Jul. 6, 1995	FAD	Tax administration
May 18-Sept. 15, 1995	FAD	Customs administration
Aug. 22-Sept. 8, 1995	FAD	Budget nomenclature
Aug. 30, 1995-Nov 30, 1997	FAD	Budget and treasury management
Nov. 6-17, 1995	STA	Balance of payments statistics
Nov. 16-30, 1996	FAD	Tax policy implications of Association Agreement with EU
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

X. Resident Representatives

None

Lebanon: Relations with the World Bank

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 US\$175 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.
2. Since then, the Bank for a total of US\$237.9 million extended six further loans during fiscal years (FY) 1994-96 for (i) irrigation, (ii) health, (iii) solid waste and environmental management, (iv) revenue enhancement and fiscal management, and (v) administrative rehabilitation, and a supplement (US\$50 million) to the ERRP, which also included funding for repair of damages sustained during the April 1996 hostilities. The FY96 Administrative Rehabilitation Loan (US\$20 million) supports a broader National Administrative Rehabilitation Program (NARP) that aims at rehabilitating public administration, while initiating the process of administrative reform. The FY94 Revenue Enhancement and Fiscal Management technical assistance loan (US\$19.94 million) also finances part of the Fund's fiscal technical assistance to Lebanon.
3. Levels of support increased in FY97, with loans for US\$138 million and a guarantee for US\$100 million, for national roads (US\$42 million), agricultural infrastructure (US\$31 million), power sector restructuring and transmission system expansion (US\$65 million loan and a US\$100 million guarantee). An additional loan for coastal pollution control and water supply (US\$53 million) was also approved by the Board but later canceled, as it was not ratified by the legislative authorities. A Vocational and Technical Education loan (US\$63 million) was approved in FY98. No new loans were approved in FY99. Operations being considered for FY2000 include: General Education, a Municipal Development Fund, and a Fiscal Consolidation adjustment loan.
4. Lebanon's disbursed and outstanding debt to the IBRD amounted to US\$212 million, inclusive of exchange rate adjustments, as of June 30, 1999. The undisbursed balance of loans for projects under implementation was US\$366.9 million as of the same date.
5. The International Finance Corporation also resumed activities in 1993, and has since invested US\$244 million in 28 projects (including 12 banks), with an additional US\$204 million in syndications. Capital market operations represented a large part of the total, with credit lines to commercial banks of close to US\$300 million (of which US\$161 million on IFC's own account) supporting small and medium enterprises and housing.
6. Lebanon is a member of MIGA. No guarantees nor commitments have been issued yet.

7. The Bank has extended grants under the Population and Human Resources Development Facility, funded by Japan, for the preparation of most of the projects being supported or considered by the Bank. Institutional Development Fund grants were extended for Judicial Reform, Strengthening of Higher Education, Capital Markets Development, Social Security Reform, and Procurement Reform.

8. The World Bank Country Assistance Strategy for Lebanon, as defined in November 1997, envisages support for (i) infrastructure rehabilitation and expansion, and institutional development; (ii) environmentally sustainable development; and (iii) upgrading the human resource base to support long-term recovery and address poverty.

Lebanon: Statistical Issues

1. The analysis of developments and prospects in Lebanon continues to be hampered by the lack of reliable data on most sectors of the economy. Despite the six STA technical assistance missions in recent years, progress in the construction of a consistent statistical data base has been slow.¹ At present, only the monetary accounts, financial markets data, public debt statistics, and, to a more limited extent, central government budgetary accounts are available on a regular basis.² Most other data (national income accounts, prices, employment, nongovernment public sector, and balance of payments) have had to be estimated on the basis of fragmentary information or partial indicators. The authorities attribute the apparent lack of progress in the statistical area largely to lack of manpower and other technical resources that could be devoted to these tasks.

A brief summary of the status of the data is as follows:

2. **Real sector:** The most glaring gap in the economic data base remains in the real sector data. Comprehensive official national accounts statistics have not been produced since the closure of the statistical office in the mid-1970s, although preliminary estimates for the major components of GDP in current prices for the years 1994 and 1995 were published in October 1997 (these estimates are very similar to previous staff estimates derived on the basis of GDP assumptions provided by the authorities, and BOP and government finance data). A household income survey was published in 1997 while a household expenditure survey is being finalized. A real estate survey is nearly completed. Together with surveys on industrial and commercial activities to be initiated shortly, they will eventually form the basis for a new set of national account statistics.

3. No official price statistics exist; some consumer price indices are prepared by private organizations on the basis of a limited basket of goods for the greater Beirut metropolitan area. The Central Administration for Statistics (CAS) has started to collect consumer price data and indicated that it will publish its own consumer price index shortly. An STA mission to provide technical assistance in price statistics is planned for FY 2000, once the results of the 1997 household expenditure survey have been analyzed. In an effort to expedite the collection of real sector data, a law authorizing the immediate creation of an "Institute for Statistical Services" has recently been passed.

¹The recommendations of the STA technical assistance missions are contained in the reports "Aide-Mémoire on the Government Finance Statistics Mission," January 14, 1994; "Aide-Mémoire on the Multisector Statistics Mission," January 4, 1994; "Aide-Mémoire on the Balance of Payments Statistics Mission," May 4, 1994; "Balance of Payments Report," March 9, 1995, "Balance of Payments Report," April 2, 1996; and "Balance of Payments Report," July 31, 1997.

²Currentness of data on core economic indicators is summarized in Attachment I.

4. **Government finance:** Data for 1998 are the latest provided for publication in the *GFS Yearbook*. No data are currently reported for publication in *IFS*.
5. **Monetary accounts:** The monetary accounts are received on a current and timely basis.
6. **Balance of payments:** The main weaknesses of the balance of payments concern the current account: data on exports suffer from undervalued declarations and incomplete recording; and data on services, compensation of employees, and private transfers are virtually absent. Procedures for reporting capital account transactions by the financial sector were established in 1997. However, survey-based estimates of real estate transactions and other private foreign direct investment, which are believed to be a major source of capital inflows, are not available. These shortcomings are reflected in large positive errors and omissions. Some progress in improving the quality and coverage of balance of payments data has been made, including in the areas of merchandise trade and public sector external transactions. The latter, however, suffer from reporting problems as they are defined by the currency of denomination rather than by the residency of the holder.

Table 1. Lebanon: Core Statistical Indicators
(As of end-June 1999)

	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	April (Available through BdL Internet Site and Reuters on daily basis)	April	April	April	April	April (Available through BdL Internet Site and Reuters on weekly basis)	April	April	1998	May	1998	April
Date received	5/99	5/99	5/99	5/99	5/99	5/99	5/99	5/99	5/99	5/99	5/99	5/99
Frequency of data	Monthly (official) Daily (unofficial)	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Monthly (partial data)	Annual	Monthly
Frequency of reporting	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Monthly	Annual	Monthly
Source of data	BdL	BdL	BdL	BdL	BdL	BdL	BdL	BdL	BdL	BdL	BdL	BdL
Mode of reporting	Fax/BdL Bulletin	Fax/BdL Bulletin	Fax/BdL Bulletin	Fax/BdL Bulletin	Fax/BdL Bulletin	Fax/BdL Bulletin	Fax	Fax/BdL Bulletin	Fax	Fax	Fax	Fax/BdL Bulletin
Confidentiality <u>1/</u>	High	High	High	High	High	High	High	High	High	High	High	High
Frequency of Publication <u>2/</u>	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Not published	Monthly	Not published	Monthly (partial data)	Not published	Monthly

1/ If provided by fax.

2/ The BdL monthly bulletin is available on the Internet since January 1997 with a one to two month delay.

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

IMF Concludes Article IV Consultation with Lebanon

On September 8, 1999, the Executive Board concluded the Article IV consultation with Lebanon.¹

Background

Considerable progress has been made in restoring Lebanon's infrastructure, including power, water supplies, roads, and transport facilities. Inflation has been reduced to just 3 percent in the opening months of 1999, from over 100 percent in 1992, with the peg to the U.S. dollar since 1992 providing considerable exchange rate stability. Capital inflows, while moderating somewhat in recent years, have been persistently large, averaging 40 percent of GDP during 1994–98. At the same time, public finances have been under great strain. The costs of financing the public reconstruction program, combined with rising interest and other current outlays, far outstripped the slow recovery in revenue collections, resulting in fiscal deficits averaging over 20 percent of GDP during 1994–98. Financing these shortfalls, public debt rose sharply, reaching 110 percent of GDP by end-1998. In addition, concerns about the fiscal situation have contributed to periodic tensions in the foreign exchange markets, and defense of the currency peg has involved, at times, high and volatile real interest rates. Notwithstanding this, the transition to a new government in late-1998 was achieved without significant financial dislocation.

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. In this PIN, the main features of the Board's discussion are described.

While Lebanon experienced a brief post-war boom in 1993–95, fueled in part by real estate investments, this failed to translate into broad-based recovery, and growth has subsequently slowed, falling to an estimated 3 percent in 1998 and, on preliminary indications, rather less in the opening months of 1999. The absence of sustained strong growth reflects the difficult economic situation, marked by large fiscal imbalances; episodic concerns about the domestic and regional political situation; generally excessive levels of bureaucracy and other restrictions to investment and trade; and the appreciation of the real exchange rate.

Following earlier, unsuccessful efforts to tackle Lebanon's fiscal imbalances, initial progress was made from late-1997. Reflecting new revenue measures, including higher customs tariffs, and expenditure restraint, the fiscal deficit was reduced to 19 percent of GDP in 1998 from an average of 24 percent in 1996-97. Notwithstanding this, conditions for financing the deficit became more challenging. Domestic banks reduced their purchases of Lebanese treasury bills from mid-1997 following concerns about the Asian financial crisis and Lebanon's weak fiscal position. In response, the authorities shifted to foreign currency financing, which had formerly been limited. Following eurobond issues of US\$1.4 billion in 1998—the large majority of which were ultimately acquired by domestic banks—foreign currency public debt rose to US\$2.6 billion at end-1998, or 26 percent of GDP. In the domestic currency markets, the budget was shielded from upward pressure on treasury bill interest rates (for six-month to two-year notes) by an effective subsidy from the central bank: these subsidies were phased out by end-October 1998, following an easing of financial market pressures.

The new government has indicated its commitment to a continuing multi-year program of fiscal adjustment. Accordingly, in April 1999, excise taxes were increased (notably for gasoline) together with most customs tariffs (by 1 percentage point). The 1999 budget, approved in mid-July, also provides for tax increases on wages and salaries, professional incomes, corporate profits, dividend payments, and inheritances, the main impact of which will be from 2000. At the same time, while public sector wage and salaries saw a 20 percent increase in January 1999, substantial cuts are being sought in capital and selected current outlays with a view to reducing the 1999 deficit to about 15 percent of GDP. As in 1998, a large part of the deficit is being financed by foreign currency borrowing, including through additional eurobond placements of US\$530 million in March 1999 (equivalent to 3 percent of GDP).

The Lebanese pound continues to be managed within a narrow band (± 0.5 percent) relative to the U.S. dollar, although the long-standing practice of announcing a small weekly appreciation was ended in October 1998. Lebanon's trade deficit continues to narrow, reflecting declines in merchandise imports on account of weak domestic demand, notably in the construction sector. This trend was more than offset in 1998, however, by a downturn in capital inflows, resulting in an overall balance of payments deficit of 3 percent of GDP—the first since 1990. Lebanon's gross official reserves stood at an estimated US\$8.9 billion at end-April 1999 (including gold), equivalent to 14 months of imports of goods and services, or 130 percent of the short-term external debt of the public and banking sectors.

Most banks in Lebanon are profitable, liquid and well-capitalized: the average risk-weighted Basel ratio was almost 19 percent at end-1998, and problem loans continue to decline as a share of the total loan book, while remaining well provisioned. Total credit growth slowed to

16 percent in 1998 from 19 percent in 1999, reflecting a moderation in borrowing by both the public and private sectors. Private sector credit remains almost 90 percent dollar-denominated.

A number of programs have been initiated to strengthen business conditions in Lebanon. In March 1999, a law was approved to protect intellectual property rights, while parliamentary approval is being sought for an enabling law for privatization and a law to reform and strengthen the insurance sector. The new government has also initiated a high-profile campaign to address corruption.

Executive Board Assessment

Lebanon: Selected Economic Indicators

	1993	1994	1995	1996	1997	1998
Domestic economy			In percent			
Change in real GDP	7.0	8.0	6.5	4.0	4.0	3.0
Change in consumer prices (period average) 1/	24.7	8.0	10.6	8.9	7.8	4.5
External Economy			In billions of U.S. dollars 2/			
Exports, f.o.b.	0.7	0.7	0.8	0.8	0.6	0.7
Imports, f.o.b.	-4.9	-5.5	-6.7	-7.0	-6.9	-6.6
Current account balance	-3.7	-4.1	-4.6	-4.8	-4.4	-4.4
In percent of GDP	-49.0	-45.0	-41.2	-37.1	-29.8	-27.4
Capital account balance	4.9	5.2	4.8	5.6	4.8	3.9
Overall balance	1.2	1.1	0.2	0.8	0.4	-0.5
Gross official reserves	5.8	7.4	8.1	9.3	8.6	9.2
Change in real effective exchange rate (in percent)	24.5	8.0	3.9	12.0	18.1	8.0
Financial variables			In percent of GDP 2/			
Central Government balance 3/	-9.2	-20.5	-18.4	-21.7	-27.6	-18.9
Net Public debt 3/	37.9	52.2	63.1	81.0	99.0	110.4
Of which: foreign currency denominated	4.3	8.3	11.5	14.5	16.2	25.6
Change in broad money 4/	32.1	25.3	16.4	27.8	19.3	16.1
Yield on 3-month Lebanese pound treasury bills 4/	17.2	13.5	16.0	14.3	13.1	11.8

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

1/ For Beirut and suburbs.

2/ Unless otherwise noted.

3/ Including the accumulation of arrears to the private sector.

4 In percent, end of period.