LEBANON

Highlights

- **The macroeconomic position is challenging as a result of the political situation and regional instability.** Growth remained low in 2016 at an estimated 1 per cent, fiscal performance deteriorated and the external position remains difficult.
- **The debt burden in Lebanon is among the highest in the world.** This puts a strain on public finances as interest payments account for half of revenues, leaving limited space for capital and social spending.
- **Policy-making improved and reforms progressed after the resolution of the political deadlock.** Once the new government was appointed in December 2016, reforms advanced, including decrees regulating oil and gas exploration (approved by the Cabinet in January 2017), and an electricity reform plan and draft 2017 budget in March 2017.

Key priorities for 2018

- **A sustained and balanced fiscal adjustment is essential.** Without further adjustment, Lebanon's public debt burden will continue to rise, adding to existing vulnerabilities and ultimately crowding out essential public spending.
- **Lebanon's infrastructure deficit needs to be addressed.** The current situation is the result of protracted under-investment and is exacerbated by the refugee presence. Slow internet speeds are a major burden for firm operation and growth, and strengthening infrastructure would help the development of a knowledge economy.
- **There is a critical need for electricity reform.** The electricity sector has been identified as the most pressing bottleneck for doing business and for competitiveness. Reforming this sector has been long-delayed, resulting in large fiscal implications.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.50	2.0	0.8	1.0	2.3
Inflation (average)	4.8	1.9	-3.7	-0.8	3.6
Government balance/GDP	-9.0	-6.3	-7.6	-9.3	-9.9
Current account balance/GDP	-26.7	-26.4	-18.7	-18.6	-18.0
Net FDI/GDP [neg. sign = inflows]	-1.6	-3.5	-3.5	-4.6	-4.5
External debt/GDP	170.4	175.0	175.8	183.9	n.a.
Gross reserves/GDP	73.7	78.0	74.3	84.6	n.a.
Credit to private sector/GDP	136.9	143.8	147.4	147.1	n.a.

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Macroeconomic performance

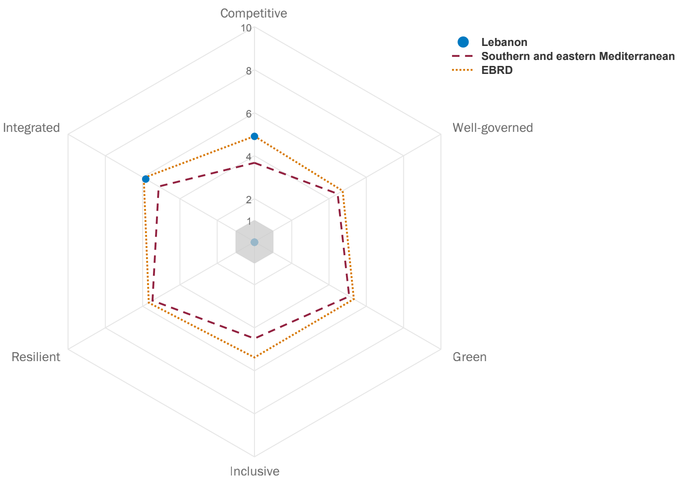
Growth remains sluggish. The economy grew by just 1 per cent in 2016, the same rate as in 2015. Lebanon has been in a protracted period of low growth since the start of the Syrian conflict in 2011 and the collapse of Syria's economy. In 2016, tourism, real estate and construction, traditionally the main drivers of growth, continued to be weak, reflecting regional insecurity and the political situation in Lebanon. In 2017, growth is still subdued despite positive political developments, as external imbalances remain wide.

Fiscal performance deteriorated in 2016. The fiscal deficit reached 8.1 per cent of GDP in 2016, up from 7.4 per cent of GDP in 2015, as a result of several factors. On the positive side, transfers to Electricité du Liban (EdL) decreased as a result of the global drop in oil prices, and tax revenues were stronger supported by higher excise tax collection, a steady increase in income and property taxes, and higher treasury receipts. However, interest payments, hospital spending and capital expenditures also increased, as did transfers to municipalities. Moreover, wages for military personnel represented two-thirds of the total wage bill as the deterioration in the security situation at the borders led to the hiring of additional troops. Interest payments consumed around 48 per cent of total revenues, the highest level since 2007, crowding out more productive forms of public expenditures. The large number of Syrian refugees, representing almost one-third of the total population, is placing further pressure on the economy's public finances and infrastructure, straining local communities, and adding to poverty and unemployment. Gross debt increased to 143.4 per cent of GDP, the third-highest level in the world, as a result of persistent fiscal deficits and moderate growth.

The external position remains challenging. The current account deficit is estimated to have widened to 18.9 per cent of GDP in 2016 from 16.3 per cent in 2015, owing to the impact of regional conflict on key trading partners and routes. Exports of goods and services declined in 2016, partly offset by decreases in imports. Remittances from the large diaspora increased by 9.0 per cent in 2016 to 7.5 per cent of GDP and supported growth through private consumption, which constitutes around 90.0 per cent of GDP. Gross remittances, which also include non-resident deposits, reached 14.6 per cent of GDP in 2016, with remittance flows from the Gulf Cooperation Council (GCC) accounting for almost 25.0 per cent of the total. The reliance on GCC countries for remittances and trade mitigates the growth benefit from lower oil prices to the extent that GCC countries' growth and fiscal accounts are affected by lower oil prices. Net foreign direct investment (FDI) increased to 3.8 per cent of GDP from 3.4 per cent in 2015, while net portfolio investment increased five-fold to reach 5.1 per cent of GDP. As a result, international reserves have remained high and stable and amounted to US$ 40.2 billion as of May 2017, over 14 months of imports, bolstering confidence in the peg and the financial system despite weak public finances.

Growth is expected to rebound but remains subdued at 2.3 per cent. A recovery in the construction and financial sectors, thanks to renewed political stability and the continuation of reforms, is expected to boost confidence, increase inflows and help debt dynamics. Meanwhile, sizeable vulnerabilities and risks remain, including from regional turmoil and increased spending pressures.

Assessment of transition qualities (1-10)



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Major structural reform developments

Lebanon's economy suffers from a number of structural weaknesses. In 2017, The World Economic Forum ranked Lebanon 101st out of 138 countries in its Competitiveness Ranking, due to poor macroeconomic conditions, infrastructure and electricity, and institutions. Corruption, government instability and inadequate infrastructure were identified as the most problematic factors for doing business. The World Bank's *Doing Business 2018* report ranked Lebanon 133rd out of 190 countries, down from 126th in the 2017 report. According to the assessment, the lack of investment in infrastructure has eroded the country's competitiveness.

Progress was made in setting up public-private partnerships in the energy sector. The electricity sector remains a key bottleneck to improved competitiveness and a large drain and source of uncertainty on the budget because of ageing infrastructure, unpaid consumption and low tariffs. Efforts to reform the national electricity company, Electricité du Liban (EdL), have been hindered for years. A chronic electricity crisis has existed since the end of the Civil War in 1990, with successive governments failing to make large investments to improve the ailing sector and its outdated infrastructure. The electricity reform plan announced in March 2017 calls for the lease of power barges aimed at improving power supply in the summer.

Decrees regulating oil and gas exploration have been approved. In January 2017, the cabinet approved decrees that would allow the start of offshore oil and gas exploration, by setting out both the exploration blocks that it will offer and the terms and conditions for exploration and production agreements. Lebanon is the last country in the eastern Mediterranean region to explore its hydrocarbon reserves, which are shared with Cyprus, Israel and Egypt. After passing a hydrocarbon law in 2010, Lebanon fell behind neighbouring countries in exploring the Levant Basin owing to internal political strife. The authorities in Lebanon expect to open five new offshore gas blocks for exploration in 2017. The government is now pushing to receive bids by mid-September to speed up the process.

Efforts to reform taxes and public sector wage scales face legal barriers. In July 2017, parliament passed a series of laws to raise taxes and ensure funding for the long-awaited new public-sector wage scale. Parliament voted to approve 38 separate measures to provide the funding for increased public-sector salaries and an 85 per-cent increase in public-sector pensions, to be delivered over three years. The changes included a tax on bank profits, a fine on those encroaching on public maritime properties, and a new fee on foreigners entering the country, among others. The package was supposed to pave the way for parliament to ratify the country's first budget since 2005. However, in August, the constitutional council suspended the implementation of the law, and in September it annulled the law in its entirety. It is worth noting that the passage of a new wage scale has been delayed for five years and the latest revenue measures to be passed were a decade ago.

Spending plans are still formulated ad hoc but progress is being made in improving the situation. Political deadlock has resulted in parliament not formally approving a budget for the past 12 years, with spending plans formulated on an ad hoc basis. In March the cabinet approved the 2017 draft budget, and parliament approved it during an extraordinary session in October and is set to begin drafting the 2018 budget. Parliamentary ratification of an annual budget going forward would improve the transparency and predictability of public finances, allow further reforms and facilitate donor funding. The World Bank recently agreed to new loans and grants for two separate road projects totalling more than US$ 400 million, conditional on Lebanon passing a budget. The absence of an approved budget continued to impede the formulation and implementation of debt-stabilising reforms. While the agreement on a budget within the cabinet raises the prospect of one now being passed by parliament, its likely impact is unclear and the associated delays increase fiscal risks.