LEBANON

Highlights

- **Lebanon continues to sink into financial, economic and social crises.** Currency depreciation has deepened, the government has yet to rein in the parallel foreign exchange market, inflation continues to spiral and external imbalances point to further economic decline.
- **The pressure on financial resources is at a record high.** The government is unable to access international financial markets following the March 2020 Eurobond default, remittances and foreign direct investment are minimal and foreign currency reserves have shrunk to record low levels.
- **Progress on reforms in the past year has been negligible.** Several reforms were stalled or undermined by political paralysis, as well as the Covid-19 pandemic and the implications of the Beirut port blast.

Key priorities for 2022

- **Agreement on an International Monetary Fund (IMF)-supported stabilisation and structural reform programme remain the most immediate priority.** An agreement would help rebuild credibility and improve access to much-needed external financing. Comprehensive banking sector restructuring needs to accompany fiscal and structural reforms.
- **Comprehensive social safety nets are a pressing necessity in tandem with the reform programme.** Economic hardship, record inflation and the Covid-19 crisis have led to alarming unemployment and poverty levels.
- **Strong commitment is needed to carry on and expedite the forensic audit of Banque du Liban (BdL), retrieve stolen assets and combat corruption.** Progress in these areas would help to restore credibility in Lebanese institutions and garner public support for any proposed reform agenda.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	0.8	-1.7	-7.3	-25.0	-10.0
Inflation (average)	4.5	4.6	2.9	84.9	150.0
Government balance/GDP	-8.6	-11.2	-10.3	-3.2	n.a.
Current account balance/GDP	-26.3	-28.4	-27.6	-15.6	n.a.
Net FDI/GDP [neg. sign = inflows]	-2.3	-3.7	-3.3	-15.8	n.a.
External debt/GDP	189.6	191.7	198.3	472.3	n.a.
Gross reserves/GDP	68.0	59.3	45.9	92.9	n.a.
Credit to private sector/GDP	111.6	106.6	92.4	56.5	n.a.

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Covid-19: macroeconomic implications

Lebanon is sinking further into multi-dimensional crises. The economy is estimated to have contracted by 25 per cent in 2020, reflecting dried-up fiscal resources following the Eurobond default in March 2020, almost no capital inflows, diminishing reserves and spiralling inflation on the back of a falling exchange rate that effectively wiped out purchasing power. Political inaction prolonged the economic crisis and exacerbated unemployment and poverty. The unemployment rate is estimated to be around 50 per cent, while more than 75 per cent of the population is estimated to have fallen below the poverty line in 2020. The situation is likely to be even worse in 2021, as the economic turmoil continues to worsen and households face greater challenges accessing food, electricity, water and medicine.

The currency has continued to depreciate and the central bank is struggling to manage the parallel foreign exchange market. The *de facto* official pegged exchange rate of 1,507.5 Lebanese pounds per US dollar has been abandoned *de jure*, with the BdL allowing banks to exchange at a rate of LBP 3,900 per US dollar in April 2021 through its Sayrafa platform. The BdL later introduced a different mechanism, whereby the rate for withdrawals of US dollar deposits (up to US$ 400) was raised to LBP 12,000 per US dollar. This remains well below the parallel market rate of LBP 21,000 per US dollar as of early November 2021, implying a 90 per cent depreciation. Meanwhile, inflation continued to spiral, reaching 157.9 per cent year-on-year in March 2021, before slowing slightly to 144.1 per cent in September, as the Lebanese pound continued to depreciate. Rebuilding efforts following the August 2020 explosion in Beirut have been derailed, as importing building materials is becoming increasingly difficult without fresh US dollars. Meanwhile, the foreign currency reserves of the BdL dropped by 38 per cent year-on-year to US$ 14.2 billion in August 2021, as they were used to subsidise a range of essential imports. The country's actual net foreign assets are negative.

The ongoing political, economic and social crises, coupled with the external debt default, contributed to a narrowing of the fiscal deficit in 2020. Revenues declined by 14 per cent, with both non-tax and tax revenues dropping significantly due to the worsening economic crisis. Expenditures also fell, by 27 per cent, mainly owing to a 93 per cent decline in foreign debt service costs, traditionally the main expenditure component, and to a decline in transfers to Electricité du Liban, which are usually around 4 per cent of gross domestic product (GDP). Overall, a primary deficit of 0.2 per cent of GDP was achieved and public debt increased. Meanwhile, Lebanon is struggling to access capital markets and is opting for domestic borrowing.

External imbalances remain wide. The current account deficit was 27.6 per cent of GDP in 2019, one of the highest in the world. In 2020, it remained large, at 15.6 per cent of GDP, as both exports and imports declined, by 15 and 42 per cent, respectively. Remittances and non-resident deposits continued to decline in 2021.

The outlook remains highly uncertain and any recovery depends on the speed of reforms and the outcome of elections in March 2022. A further contraction of 10.0 per cent is expected in 2021 as a result of the ongoing economic, political and social crises, the government's inability to borrow on international markets, delays in implementing critical reforms and the drying-up of financial resources. The economy is expected to record positive growth in 2022, at 3.0 per cent, conditional on an IMF-supported programme being successfully implemented by a reform-minded government, which would allow negotiations to resume with international partners.

Policy response to Covid-19

The vaccination campaign was rolled out in March 2021 and the uptake was initially slow. However, it is picking up pace as the government attempts to minimise damages to public health in light of the worsening economic crisis. As of early November 2021, more than 22 per cent of the population was fully vaccinated.

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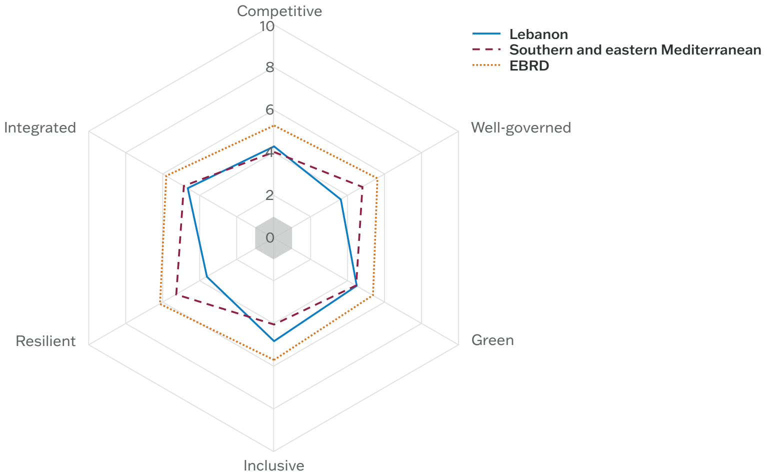
Assessment of transition qualities (1-10)



Structural reform developments

Efforts to reach agreement on an IMF-supported financing programme were derailed. Discussions with the IMF began in April 2020, but were placed on hold in July 2020. Resuming talks is conditional on the government agreeing a common approach towards – and starting to implement – reforms in key sectors. The Eurobond default in March 2020 further underlined Lebanon's inability to access external financing without IMF support. Several conferences were held to attract support for crisis-stricken Lebanon and, while some participants offered immediate relief and aid to reconstruct the port of Beirut following the August 2020 explosion, these pledges were conditional on successful government formation, which only took place in September 2021, 13 months after the previous government had resigned following the explosion.

Some reforms in early 2020 have been either halted or undermined. As an example, the forensic audit that was agreed with management consultants Alvarez & Marsal in September 2020 faced several obstacles, mainly BdL management's refusal to share necessary documentation, citing bank secrecy laws. Parliament voted to lift bank secrecy for public officials in December 2020, but the BdL did not agree to hand over documents until April 2021.

The draft capital control law proposed in mid-2020 was held back in parliament until June 2021. The draft law, which is part of the overall reform package, prompted significant opposition and was deemed ineffective unless appropriate fiscal, monetary and exchange rate policies were put in place. Irrespective of the law, it is noteworthy that informal capital controls have been enforced by the banking system since late 2019.

Lebanon's Public Procurement Law was approved by parliament and published in the Official Gazette in July 2021. The law, which was formulated in line with international best practice and will enter into force in July 2022, will improve financial governance and market competition and promote transparency and accountability in the use of revenues, especially tax revenues. Completing the main reforms mandated by the law will be essential to ensuring its correct and efficient implementation.

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Some subsidy reforms were implemented, in part to ease the unprecedented pressures on foreign currency reserves, but access to basic goods is becoming progressively difficult. From June 2020 the government hiked the price of subsidised bread seven times; it raised fuel prices in June and August 2021. It is negotiating new import destinations, such as Egypt, Jordan and Syria, for fuel in a bid to lower the energy bill. The BdL also announced it would offer credit lines for fuel imports, starting in August 2021, based on the market price of the Lebanese pound, signalling an effective end to fuel subsidies. However, delays in implementing concrete measures in a timely manner led to a further depletion of reserves and prompted the population to hoard medical and food stocks in anticipation of the remaining subsidies being lifted. As a result, access to medicine, food, fuel and other basic necessities became increasingly difficult, leading to nationwide power outages in August 2021. Access to basic necessities for the Lebanese public is further undermined by eroded purchasing power and sizeable smuggling activities along the borders.

Parliament approved a ration card programme for poor families in June 2021, which has been announced, but yet to be launched. The programme, which will cost US$ 556 million a year and support 500,000 households, will replace the direct subsidy for essential goods, including medicine, fuel and wheat, which costs between US$ 5 billion and US$ 6 billion annually, thus moving to a better-targeted regime. The application process for the pre-paid cards started in September 2021, but the system will take time to implement and targeting is expected to be complicated by weak transparency and political concerns.