Lebanon

Highlights

- **Lebanon's recovery is being held back by political inaction and an impasse on key reforms.** The currency has continued to depreciate, with multiple exchange rates still in place, while inflation is soaring, pushing the poverty rate above 80 per cent of the population.
- **Rising global prices have put added pressure on the external accounts, while Lebanon remains locked out of international markets.** The current account deficit remains large, despite some relief from rising tourism revenues and remittances, and the government is still unable to access international financial markets.
- **Parliament has failed to elect a new president, paralysing other branches of government and holding back progress on reforms.** As a result, there has been no progress on key preconditions to an International Monetary Fund (IMF) programme, including restructuring of banking-sector debt and electricity-sector reforms.

Key priorities for 2024

- **Meeting the reforms required for an IMF-supported stabilisation and structural reform programme remains the most immediate priority.** An agreement with the IMF would help rebuild credibility as to reform commitment and provide access to necessary external financing. Urgent progress is, therefore, necessary on electing a president and forming a government, in addition to comprehensive bank restructuring and regulatory reform.
- **Establishing comprehensive social safety nets has become even more pressing as the population suffers from rising prices for essential products and services.** Wider coverage and improving the transparency of targeted subsidies are critical to addressing the deepening rate of poverty. Given its severe financing constraints, the government will need to attract donor assistance and gradually build robust support networks.
- **Progress on energy-sector reforms, including on the legislative side, is necessary to unlock the financing needed to develop sectoral capacity.** Stronger commitment to greener energy production and improved efficiency will greatly help to address severe shortages and limit import dependence.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	-6.9	-25.9	-10.0	0.0	0.0
Inflation (average)	2.9	84.3	150.6	183.8	229.0
Government balance/GDP	-10.6	-4.1	1.2	-5.2	-6.9
Current account balance/GDP	-27.9	-15.7	-17.3	-29.0	-12.5
Net FDI/GDP [neg. sign = inflows]	-3.4	-5.3	-2.1	n.a.	n.a.
External debt/GDP	201.0	135.0	392.0	391.0	n.a.
Gross reserves/GDP	48.1	72.2	48.6	58.6	n.a.
Credit to private sector/GDP	88.3	54.3	n.a.	n.a.	n.a.

Macroeconomic developments and policy response

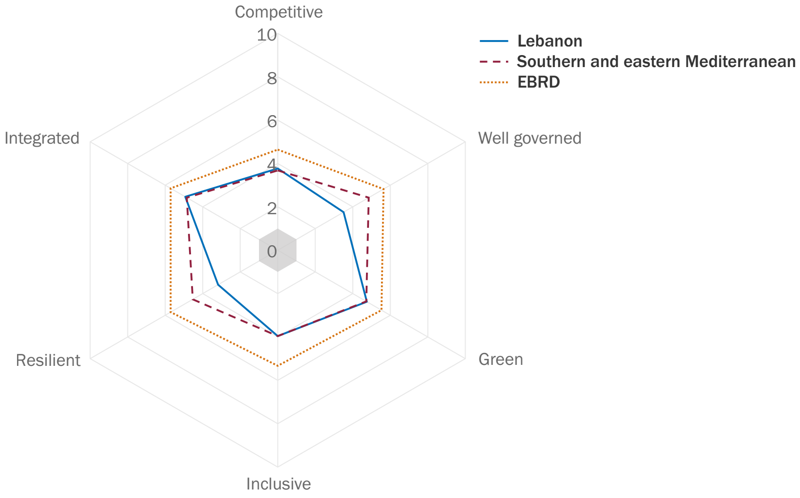
Political deadlock is still holding back economic recovery, and the population's living conditions are dire. The economy is estimated to have recorded zero growth in 2022 after two years of deep recession (a 10 per cent contraction in gross domestic product [GDP] in 2021, on top of a decline of 25.9 per cent in 2020). The resulting surge in the cash economy and informal sector has further deprived the state of highly needed fiscal revenues, underpinning the overall deterioration of macroeconomic fundamentals. Throughout most of 2023, Lebanon has seen little progress on reforms, as the lack of a functioning government has stalled progress and left the country unable to access international donor support. The black-market exchange rate deteriorated further in the first half of 2023 to a peak of LBP 134,800 per US dollar, despite improvements in the inflow of fresh dollars, before stabilising at around LBP 89,700 per dollar at the end of October (compared with an official rate of LBP 15,000 per dollar). This fuelled even higher inflation, which reached 208 per cent in September 2023. The prolonged crisis continues to threaten the livelihoods of most households; the International Labour Organization estimated the unemployment rate at 29.6 per cent in January 2022, with more than 80 per cent of the population estimated to be living in poverty at the end of 2021. Elevated prices for food and energy have placed more pressure on vulnerable households, with only limited targeted support available to those most in need.

Multiple exchange rates persist, amid a dire fiscal and public debt situation. Banque du Liban (BDL) announced a new official exchange rate of LBP 15,000 per US dollar in February 2023. The gap to the black-market rate remains significant, however; the BDL's most widely used Sayrafa platform rate stood at LBP 85,500 per dollar at the end of August 2023. Steps have been taken to end Sayrafa, unify the exchange rate and move to an electronic FX trading platform, as announced by the new BDL leadership team in August. Meanwhile, the fiscal deficit is estimated to have widened due to severe revenue shortfalls, reflecting distorted exchange-rate pricing for taxes and customs, as well as eroded collection capacity. The diminishing real salaries of public-sector employees have resulted in high numbers of resignations and increased absenteeism, further undermining the country's already weakened public administration capacity. Public debt stood at 282 per cent of GDP at the end of 2022 and is forecast to be around 250 per cent by end of 2023.

The current account deficit peaked in 2022 and the population's access to basic goods remains precarious. The deficit is estimated to have exceeded 29 per cent of GDP in 2022, but is expected to ease in 2023, helped by increasing tourism receipts and rising remittances from Lebanese nationals abroad. Access to wheat imports have remained largely secure in 2023, owing to a US$ 150 million (around €142 million) World Bank loan to help stabilise bread prices. However, fuel prices continue to change based on availability, exchange-rate fluctuations and global prices, while access to electricity in some areas is limited to two hours a day, increasing the population's dependence on private generators. Regional agreements to supply Lebanon with energy remain on hold pending progress on electricity reforms, including the gas import agreement signed by Egypt, Syria and Lebanon in July 2022 and the agreement signed with Jordan to import electricity in January 2022. The fuel supply deal with Iraq was extended for another year in the middle of 2023.

The outlook remains highly uncertain, and any recovery depends on the speed of government formation and agreement on an IMF deal. The economy is expected to see zero growth again in 2023, amid political inaction and stalled reforms. A return to growth is possible in 2024 – provisionally forecast at 3 per cent – conditional on an IMF-supported programme being successfully implemented by a reform-minded government, which would also allow negotiations to resume with international partners.

Assessment of transition qualities (1-10)



Structural reform developments

Lebanon has made little progress on the prerequisites to the IMF staff-level agreement reached in April 2022. The proposed IMF programme would be a 46-month US$ 3 billion (around €2.8 billion) Extended Fund Arrangement. Discussions with the IMF have been on hold, with no progress on forming a new government since May 2022 or electing a new president since October 2022. In its June 2023 Article IV consultation, the IMF identified gaps in the draft banking secrecy and capital controls laws (both are programme prerequisites), which are still being discussed in parliament. Political support for the draft banking resolution law, necessary for financial-sector restructuring, has also been limited. Delays in adopting the 2022 draft budget law, and now the 2023 budget law, also point to political and capacity constraints that are hindering the implementation of crucial fiscal reforms.

Consensus on the proposed economic recovery plan and subsequent bank restructuring is still out of reach. The plan, approved by the cabinet in May 2022, introduces sweeping banking-sector restructuring, including for the BDL. Banking-sector losses are estimated at roughly US$ 70 billion (€66 billion), and reforms are likely to result in large haircuts on deposits over US$ 100,000 (around €94,000). The plan initially received pushback from the Association of Banks in Lebanon (ABL) regarding the distribution of losses and continues to face political opposition.

The much-awaited central bank forensic audit findings have finally come to light. The audit was concluded in August 2023 after numerous delays. The findings provide evidence of misconduct and financial mismanagement, including the disguising of substantial losses incurred by the BDL. They also highlight gaps in governance, risk management, transparency and accountability. An interim management team for the BDL was appointed in August 2023. The interim management team announced its intention to gradually stop financing the state budget, phase out the Sayrafa platform and liberalise the exchange rate, all of which signal a new approach to monetary policy and central bank independence, though it remains to be seen whether it will get the necessary political support.

Electricity reform remains stuck. More than a year after cabinet approval, the government's electricity reform plan remains stuck in parliament, blocking international support and energy imports from neighbouring countries. The plan should involve the creation and operationalisation of an electricity regulatory authority, for which management hiring is facing delays. Other elements include a comprehensive audit of the state power company, Electricité du Liban (EDL), and tariff adjustment. EDL increased its electricity prices in November 2022 for the first time since the 1990s, but further revisions to the tariff structure are likely to be needed.

International donor support has been much more limited recently, with the exception of crisis-response financing from the World Bank. The World Bank approved financing worth a total of US$ 500 million (around €470 million) so far in 2023 for agricultural sector support and social safety nets, building on previous emergency and Covid-19 response funding.