

# LEBANON

The election of President Michel Aoun in October 2016 after almost two and a half years of a presidential vacancy, and the subsequent formation of a unity government, have resuscitated the political process in Lebanon. Nonetheless, the protracted Syrian conflict is exacerbating the country's vulnerabilities and remains an impediment to the return to potential growth. For the fifth year, Lebanon remains the largest host (on a per capita basis) for displaced Syrians, which has significantly strained already weak public finances in a situation of limited international assistance.

## Recent developments

In 2016, Lebanon's real GDP growth accelerated slightly to reach an estimated 1.8 percent, compared to 1.3 percent in 2015. This was driven by an improvement in the real estate sector—cement deliveries expanded by 4.4 percent in 2016 compared to a contraction of 8.6 percent in 2015—as well as continued increase in tourist arrivals. From the demand side, private consumption continues to be a principal driver, helped by improved security conditions and low oil prices.

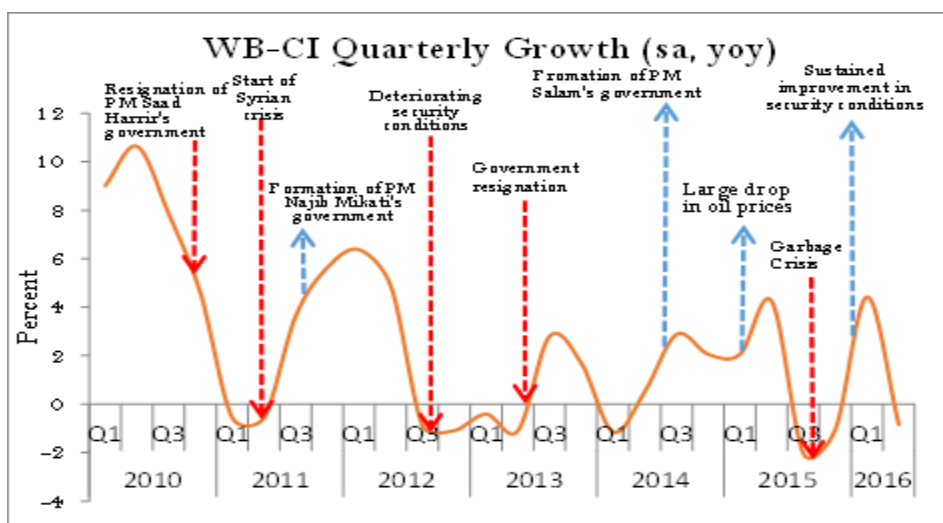
In the absence of any fiscal reforms, an increase in tax revenues in 2016 from a marginally improving economy was not able to offset higher expenditures, leading to an increase in the overall fiscal deficit to an estimated 10 percent of GDP and a small primary surplus at 0.1 percent of GDP. With subdued GDP growth and high interest rates, such a surplus remains insufficient to prevent the debt-to-GDP ratio from continuing on its unsustainable path, reaching an elevated 157.5 percent by end-2016. On the external front, a pickup in imports of merchandise goods combined with deteriorating exports led to a worsening of the goods trade balance. Furthermore, after being largely unaffected by lower oil prices in the past two years, remittances declined by 0.5 percentage points (pp) to 5.5 percent of GDP in 2016 due to spending cuts in the GCC countries. As a result, the already sizable current account deficit is estimated to have widened to an estimated 21 percent

of GDP, which is among the largest in the world, exposing the country to significant financing risks. As such, the economy is structurally and heavily dependent on capital inflows to finance its current account deficit. In 2016, faced with weaker capital inflows, Banque du Liban (BdL) financially engineered a swap that was able to boost its foreign exchange reserves and capitalization in local currency at commercial banks. As a result, gross foreign exchange reserves at BdL rose by 11.1 percent by end-2016 to reach US\$34 billion after registering a decline of 5.4 percent in 2015.

## Outlook

The boost to confidence generated from the resumption of the political process in combination with easing of tensions with the GCC following President Aoun's visit to the region in January 2017, are likely to translate into a pick-up in GDP growth in 2017, which we project at 2.5 percent. Specifically, a stronger real estate sector as well as a continued increase in tourist arrivals are expected to lead to a pickup in economic activity in 2017. Lebanon's economic prospects over the medium term are highly affected by geopolitical and security conditions, and those remain volatile. Projections assume that the Syrian war persists and that spillovers into Lebanon, while significant, remain contained. Based on this, we forecast growth over the medium term to remain around 2.5 percent annually. Potential growth is contin-

FIGURE 1 Lebanon / Volatile economic activity reflects frequent shocks



Sources: Lebanese authorities and WB staff calculations.

gent on the resolution of the Syrian conflict in a manner that does not compromise the structure and stability of Lebanon, as well as on the resumption of the domestic political process.

Also in 2017, higher oil prices will lead to an increase in government transfers to the loss-making public electricity company, likely inducing a small widening in the fiscal deficit. More expensive fuel imports will in addition further enlarge Lebanon's import bill. Despite this, and continued deceleration in remittances, the current account deficit, boosted by the tourism sector, will for the most part remain unvaried as a percentage of GDP.

## Risks and challenges

Security and political challenges continue to be Lebanon's primary concerns. Tense discussions on the forthcoming parliamentary election law, if unresolved, could revert the political process back to stalemate conditions, reintroducing the pre-presidential elections' negative atmosphere.

Assuming no further financial engineering by the central bank in order to boost capital inflows, Lebanon can once again be vulnerable to a slowdown in net foreign

asset accumulation in the face of persistent and sizable fiscal and current account deficits. If financial engineering persists, then it will be subject to a combination of declining positive returns and increasing associated risks. As such, unless foreign currency financing needs are reduced, balance of payment pressures will reemerge. More generally, a frail macro-fiscal framework, underpinned by unsustainable debt ratios and persistent and sizable fiscal and current account deficits, exposes the country to significant refinancing risks. Attracting sufficient capital, and in particular deposits, to finance larger budgetary and current account deficits could prove challenging based on recent commercial banks' deposit growth data.

One of the key challenges to improving empirically informed policy is to strengthen the data and analytical base of the government. An improved data system would better inform understanding of the micro-implications of the crisis and build capacity in the Central Administration of Statistics for poverty measurement and monitoring.

**TABLE 1 Lebanon / Macro outlook indicators**

(annual percent change unless indicated otherwise)

	2014	2015	2016 e	2017 f	2018 f	2019 f
<b>Real GDP growth, at constant market prices</b>	1.8	1.3	1.8	2.5	2.6	2.6
Private Consumption	-1.9	7.1	4.0	-3.0	0.1	3.1
Government Consumption	2.0	-0.3	7.1	-2.5	0.9	-0.6
Gross Fixed Capital Investment	5.5	-8.6	5.8	1.4	2.2	3.8
Exports, Goods and Services	3.2	-2.3	6.7	4.9	4.6	5.1
Imports, Goods and Services	-1.5	1.2	9.7	-3.1	0.4	4.4
<b>Real GDP growth, at constant factor prices</b>	1.4	2.6	3.2	2.4	2.6	2.6
Agriculture	4.5	0.6	-19.0	2.5	0.0	-0.7
Industry	11.0	0.7	-22.9	3.4	2.5	2.6
Services	-0.7	3.2	10.2	2.3	2.7	2.8
<b>Inflation (Consumer Price Index)</b>	1.2	-3.7	-0.8	3.8	2.7	2.0
<b>Current Account Balance (% of GDP)</b>	-25.4	-17.1	-20.9	-20.2	-19.2	-19.2
<b>Financial and Capital Account (% of GDP)</b>	27.9	23.5	16.7	8.1	11.8	9.6
Net Foreign Direct Investment (% of GDP)	3.6	3.6	3.7	3.8	3.8	3.9
<b>Fiscal Balance (% of GDP)</b>	-6.6	-8.2	-10.0	-9.5	-9.8	-9.4
<b>Debt (% of GDP)</b>	145.6	149.4	157.5	166.2	170.4	173.6
<b>Primary Balance (% of GDP)</b>	2.6	1.3	0.1	0.9	1.2	1.5

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice.  
Notes: e = estimate, f = forecast.