LEBANON

Table 1	2018
Population, million	6.8
GDP, current US$ billion	56.6
GDP per capita, current US$	8270
National poverty rate[a]	27.4
Gini index[a]	31.8
School enrollment, primary (% gross)[b]	93.4
Life expectancy at birth, years[b]	79.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2011).
(b) Most recent WDI value (2017).

Upon formation (January 2019), Government efforts converged on the electricity sector, Budget 2019 and Budget 2020. First, Cabinet formally endorsed an update of the 2010 electricity plan, which was drafted with the support of the World Bank. This was followed by an austere 2019 budget, and discussions over Budget 2020, with an aim to make it the first budget in a decade to be ratified within the constitutional period. This is occurring within a context of heightened macro-financial risk, illustrated by a sovereign downgrade by Fitch.

Recent developments

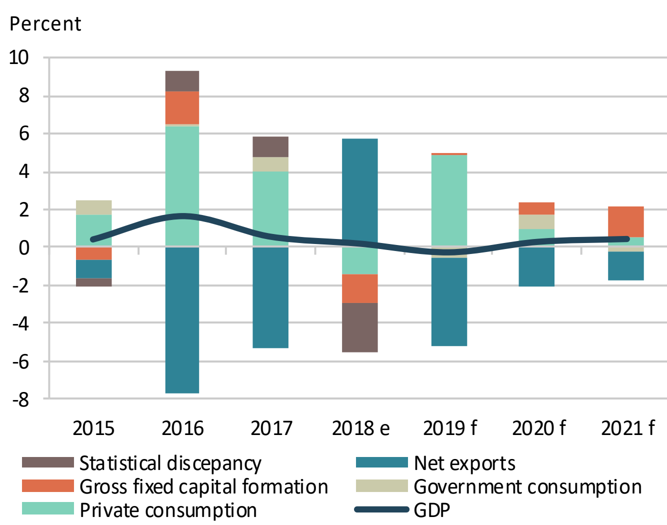
The economy has stagnated in 2018-19, with a bias in the latter towards a minor recession. While slow growth has been in effect since 2011, the past couple of years have specifically reflected decelerated growth that is linked to a policy of liquidity tightening meant to counter rising macro-financial risks. This includes a halt in subsidized lending by the central bank (BdL) that was being channeled via commercial banks to (mostly) the real estate sector, providing a rare source of growth impetus since 2012.

Indeed, high frequency indicators over the first part of 2019 (6 months: 6M-2019; 7: months 7M-2019) point to a broad-based slowdown, with tourism an exception—tourist arrivals rose by 8.1 percent, year-on-year (yoy), in 7M-2019. The real estate sector is a main drag on the economy as illustrated by a 32.4 percent yoy decline in cement deliveries in 6M-2019. Further, the BLOM-PMI Index, which captures private sector activity, averaged 46.7 in 7M-2019, indicating a contraction (< 50 represents contraction). Net exports is also a negative contributor to GDP, as the rise in exports is projected to be more than offset by import growth, with the latter driven by fuel imports; in fact, even as total imports rose by 5.8 percent over 6M-2019, non-fuel imports decreased by 14.7 percent, in strong reflection of the sluggish economy. On the demand side, private consumption, driven by tourism, regains its traditional role of leading real GDP growth (Figure 1).

Following a sharp deterioration in the Government's fiscal position in 2018 (by 4 percentage points, pp, of GDP), a belatedly ratified Budget 2019 (in July) aimed for a reduction in the overall deficit via a number of revenue and expenditure measures. 6M-2019 fiscal data show that despite a 10 percent decrease in VAT revenues, reflecting the slow economy, the overall deficit fell by 21 percent, driven by a 11 percent decline in expenditures. The latter is likely partially due to accumulated arears since Budget 2019 measures were not yet in effect. Similarly, the primary balance improved by 300 percent over the same period to register a surplus. Nonetheless, the debt-to-GDP ratio is expected to persist in an unsustainable path, at 151 percent by end-2019.

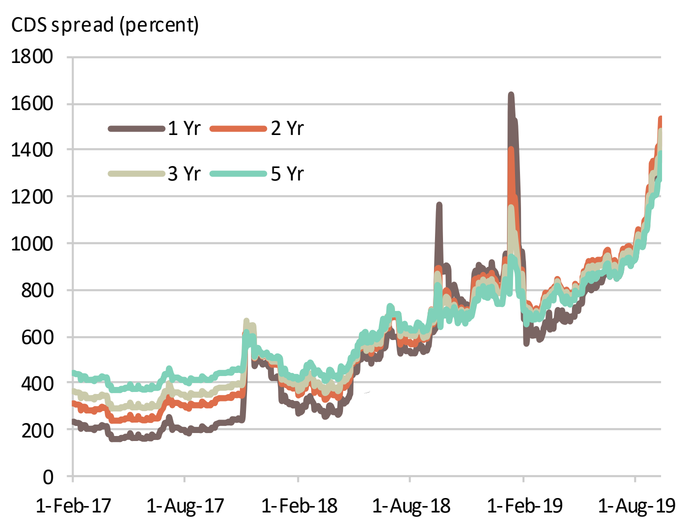
Monetary conditions have tightened significantly since the November 2017 Hariri resignation crisis, with BdL using direct, indirect, conventional and non-conventional tools; average interest rates on deposits in dollars and LL rose by 324 and 212 basis point (bps), respectively, over the October 2017-Jun2 2019 period. A principal objective for the policy-induced monetary tightening has been to boost BdL's foreign exchange reserves and limit the LL resources in the market that can be used against the exchange rate. This is in a context of surging risk premia (Figure 2). As a result, the stock of banks' credit to the private sector has been on an uninterrupted retraction since its peak in December 2017, declining by 7.3 by June 2019. The 12-month headline inflation rate averaged 3 percent in 6M-2019, compared to 6.2 percent over 6M-2018, as commodity prices soften.

FIGURE 1 Lebanon / Volatile economic activity reflects frequent shocks



Sources: Lebanese authorities and WB staff calculations.

FIGURE 2 Lebanon / Already elevated risk premium on the rise due to global monetary conditions



Source: World Bank staff calculations.

The latest official poverty rate is based on data from 2011/12 and cannot be used for poverty projections due to the substantial structural changes that the country has been undergoing in part due to the large refugee influx. A Labor Force and Household Living Conditions Survey conducted in 2018/2019 is expected to provide a more up-to-date picture of the non-monetary living conditions in the country.

Outlook

The Government continues to express its commitment to a structural reform program with an objective to effect the CEDRE opportunity. While this constitutes a positive signal, our baseline scenario precludes this outlook over the medium term. Instead, lack of obvious sources for an economic boost suggests medium-term economic prospects remain sluggish at best. We assume a marginal increase in public investment reflecting minimum progress on infrastructural projects. On the fiscal side, the full-year impact of Budget 2019 measures is accounted for in our projections, while new (yet unidentified) measures in Budget 2020 is not. Overall, a higher debt service and increased capital expenditures leaving the fiscal deficit at close to 10% of GDP.

Risks and challenges

Despite BdL's persistent financial operations over the past few years in support of the Net Foreign Asset (NFA) position, the economy has been steadily draining US dollars since 2011. More recently, this hemorrhaging has intensified. Private sector deposits at commercial banks have been in decline in 2019, suggesting outright outflows. Moreover, the deposit dollarization rate reached 73 percent by June 2019, compared to 69.8 in June 2018. In consequence, the economy's NFA position declined by US$ 5.4 billion over only the first 6 months of 2019, amounting to approximately 9 percent of GDP. This compares to NFA losses of US$ 4.8 billion for all of 2018 and US$ 156 million in 2017. Critically, this has reflected on BdL's gross foreign exchange reserves, which underwent a year-on-year (yoy) decline of US$ 7.8 billion to reach US$ 36.4 billion by end-June 2019, of which foreign currencies amounted to $ 29.7 billion. In response, BdL initiated in July 2019 a new financial operation to encourage the inflow of hard currency. Nonetheless, Fitch downgraded sovereign risk by two notches to CCC (from B-). A slight reprieve is the expected slowing in global monetary tightening conditions.

Lebanon remains significantly vulnerable to confidence shocks, especially those emanating from political quarters. Should this materialize, the stabilizing tools available are limited. The dollar peg is a central pillar for its macro-financial structure and cannot be abandoned without a significant risk of systemic financial failures. Moreover, due to the narrow export base, it lacks the routes to an export-led adjustment.

Even netting out such a shock scenario, the monetary tightening along with slower growth is likely to further degrade loan performance, leading to balance sheet vulnerabilities for banks.

One of the key challenges to improving empirically informed policy is to strengthen the data and analytical base of the government, especially the Central Administration of Statistics for poverty measurement and monitoring. In the absence of such data, distributional analysis of the impact of shocks and reform scenarios is severely constrained, including for extremely urgent reforms as in the electricity sector.

TABLE 2 **Lebanon** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	1.6	0.6	0.2	-0.2	0.3	0.4
Private Consumption	6.9	4.1	-1.4	5.5	1.0	0.5
Government Consumption	1.3	6.3	0.4	-3.8	5.0	-1.5
Gross Fixed Capital Investment	7.2	-0.3	-6.6	0.4	5.2	8.6
Exports, Goods and Services	-3.5	-3.2	8.4	2.6	2.0	2.8
Imports, Goods and Services	10.9	6.4	-4.6	9.4	4.4	3.7
Real GDP growth, at constant factor prices	0.9	0.4	2.1	1.0	-0.1	0.5
Agriculture	6.1	11.7	0.0	-4.6	2.5	0.0
Industry	0.6	-3.9	3.9	-0.7	0.3	2.5
Services	0.7	0.6	1.9	1.6	-0.3	0.2
Inflation (Consumer Price Index)	-0.9	4.5	6.1	1.6	1.5	2.3
Current Account Balance (% of GDP)	-20.4	-22.7	-22.0	-20.8	-21.4	-21.3
Net Foreign Direct Investment (% of GDP)	3.1	2.3	2.4	2.5	2.4	2.4
Fiscal Balance (% of GDP)	-9.3	-6.7	-10.7	-9.0	-9.8	-9.8
Debt (% of GDP)	146.3	149.0	150.3	150.8	155.6	159.7
Primary Balance (% of GDP)	0.0	2.7	-1.1	0.3	0.0	0.4

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.