LEBANON

Table 1	2017
Population, million	6.1
GDP, current US$ billion	51.8
GDP per capita, current US$	8524
National poverty line[a]	27.4
Gini coefficient[a]	31.8
School enrollment, primary (% gross)[b]	92.4
Life expectancy at birth, years[b]	79.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2011).
(b) Most recent WDI value (2015)

2017 was a politically capricious year, commencing with much optimism emanating from the election of President Aoun and the passage of a series of long-disputed reform measures. The Hariri-Saudi Arabia crisis in November brought anxiety and exchange market pressures, followed by rediscovered unity among the political class. As elections scheduled for May 2018 get closer, domestic political tensions re-emerge. The Paris Investor Conference planned for early April is a rare opportunity for Lebanon to emerge from its economic conundrums, with success hinging on the implementation of a structural reform program.

Recent developments

In 2017, real GDP growth rate is estimated at 2 percent, unchanged from 2016, with the main driver being services and tourism in particular. Over the first 11 months of 2017 (11M-2017), tourist arrivals rose by 10.9 percent (yoy), while hotel occupancy rates averaged 64.4 percent (10M-2017), with the latter registering an increase of 6.9 percentage points (pp) over 2016 and the highest rate since 2010. From the demand side, private consumption is once again driving growth and reversing a three-year (2014-2016) decline in the contribution to GDP growth. On the other hand, both gross fixed capital formation and net exports dragged growth, with the former held by a stagnant real-estate sector (Figure 1). Structurally, the economy remains heavily based on real estate, retail and financial services and oriented towards the region, rendering it vulnerable to security perceptions.

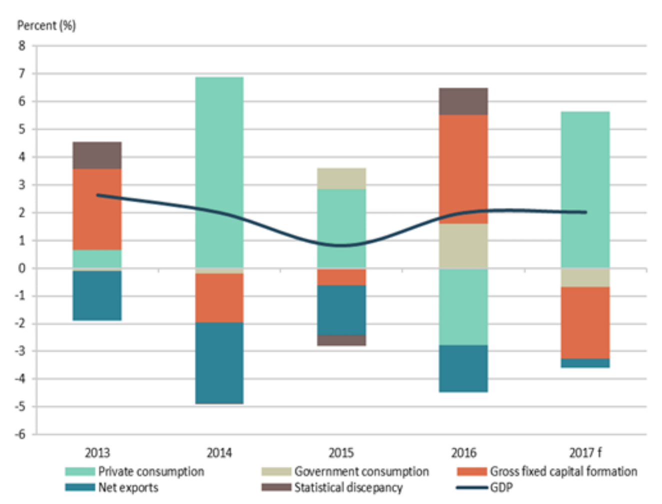
A one-off tax windfall in 2017 generated from large banking sector profits reaped from financial engineering in 2016, boosted tax revenues by an estimated 3 pp to reach 17 percent of GDP. This improvement is reflected on the overall fiscal deficit, which is estimated to have narrowed to 6.6 percent of GDP from 9.6 percent in 2016, along with a larger primary surplus. However, subdued GDP growth and high interest payments mean that the debt-to-GDP ratio persisted in an unsustainable path toward an estimated 153.4 percent by end-2017.

The Hariri-Saudi Arabia crisis on November 4th constituted a significant negative shock for financial markets leading to substantial exchange market pressures. The deposit dollarization rate increased by 288 basis points (bp) in 2017, 145 of which occurred in November and December, to reach 68.72 percent. While outright capital outflows remained inconsequential, dollarization did put pressure on foreign exchange reserves at the Central Bank, Banque Du Liban (BdL).

Slowing deposit inflows combined with large external financing needs has been steadily draining foreign assets from the economy since 2011 (except for 2016 due to large financial engineering operations). In 2017, the net foreign assets (NFA) position accumulated a loss of US$156 million, led by a worsened trade in goods deficit. However, increasingly challenging measures continue to be undertaken by BdL to replenish its reserves, overcoming pressures from the November Crisis; by end-2017, foreign exchange reserves were back at US$42 billion, compared to US$43 billion before the crisis and US$39.6 billion end-2016.

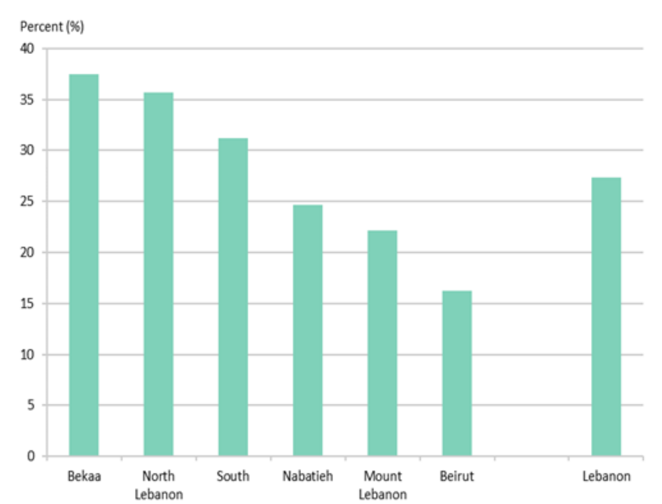
According to the most recent household budget survey in 2011/12, about 27 percent of the population was classified as poor. The highest poverty rates were recorded in the North Lebanon and Bekaa regions, while the largest poverty count was observed in the most populous Mount Lebanon (Figure 2). Poverty rates were significantly higher for workers employed in the agricultural and construction sectors who are paid on a weekly or daily basis. Given the large refugee influx

FIGURE 1 Lebanon / Volatile economic activity reflects frequent shocks.



Sources: Lebanese authorities and WB staff calculations.

FIGURE 2 Lebanon / Poverty rate highest in the Bekaa and North 2011/12.



Sources: Lebanese authorities and WB staff calculations.

after 2011, the poverty rate for 2011/12 most probably does not adequately reflect the current situation.

Outlook

Medium-term economic prospects remain sluggish and macro-financial risks high. Projections of annual growth persist to be around 2 percent over the medium term. In 2018, expected boost to spending motivated by the forthcoming parliamentary elections scheduled in May, will be offset by tightened lending provisions imposed by BdL (as NPL ratios are reportedly significantly higher following a reclassification exercise). Moreover, with imports rising further, net exports of goods and services are projected to continue being a drag.

On the fiscal side, the absence of a tax windfall in 2018 and the persistent rise in interest payments on the public debt will widen the fiscal deficit to a projected 8.3 percent of GDP. Externally, a growing trade deficit along with increasing difficulty in attracting capital inflows are expected to reflect on the foreign exchange position. The November crisis along with more long-term financing challenges and rising FED rates are translating into tightening of liquidity conditions; average deposit rates on LBP and US$ has increased by 850 and 370 bps to reach 6.41 and 3.89 percent, respectively.

The Paris Investor Conference in early April 2018 presents a unique opportunity for Lebanon to effect a sustained boost to the economy, attract much needed capital inflows, help stabilize financial and foreign exchange markets, and catalyze job creation. An essential component of this process is the adoption and implementation of a structural reform program, including a strategy to lower the public debt -to-GDP ratio toward a more sustainable trajectory.

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 large part due to the large refugee influx.

Risks and challenges

Security and political challenges continue to be Lebanon's primary concern. A frail macro-fiscal framework, underpinned by unsustainable debt ratios and persistent and sizable twin deficits, within the context of the dollar peg, exposes the country to significant foreign exchange and refinancing risks. The reliance on deposits to finance these imbalances could prove challenging based on recent commercial banks' deposit growth data.

Critical structural reforms in public finances, energy, safety nets and the business environment still elude the government, though some important decisions have recently been made. The draft 2018 budget uses a combination of revenue measures and non-wage recurrent spending restraint to aim for further deficit reduction. But reform is ever more urgent as BdL's solo activism is facing macro-financial risks. The expected increases in global interest rates will make it harder to attract hard currency deposits unless domestic interest rates also rise. Higher NPLs for banks suggest that BdL subsidized loans, in effect now for several years, have run into diminishing returns.

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

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

	2015	2016	2017 e	2018 f	2019 f	2020 f
Real GDP growth, at constant market prices	0.8	2.0	2.0	2.0	2.0	2.0
Private Consumption	3.1	-3.0	6.6	2.0	1.1	0.1
Government Consumption	6.0	12.1	-4.8	5.1	3.6	2.0
Gross Fixed Capital Investment	-2.6	17.3	-10.2	9.1	4.8	2.9
Exports, Goods and Services	7.2	-5.0	0.9	7.2	5.6	2.8
Imports, Goods and Services	6.9	0.2	1.1	8.1	4.3	0.3
Real GDP growth, at constant factor prices	0.3	4.6	1.7	1.0	1.9	2.1
Agriculture	-14.0	1.5	3.4	2.5	0.0	2.6
Industry	-5.5	-2.8	-21.1	3.4	2.5	2.6
Services	2.2	6.1	5.3	0.6	1.9	2.1
Inflation (Private Consumption Deflator)	-3.1	-0.8	4.5	4.5	3.5	3.0
Current Account Balance (% of GDP)	-16.3	-19.9	-21.2	-21.6	-20.4	-18.2
Financial and Capital Account (% of GDP)	22.3	18.8	16.7	17.4	15.5	14.2
Net Foreign Direct Investment (% of GDP)	3.4	4.0	3.3	3.2	3.1	3.0
Fiscal Balance (% of GDP)	-7.8	-9.6	-6.6	-8.3	-8.9	-9.3
Debt (% of GDP)	142.2	151.0	151.1	149.3	149.6	150.6
Primary Balance (% of GDP)	1.2	0.0	3.2	2.1	2.0	2.1

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