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Report | Lebanon's Macro Economy in the Second Quarter of 2019

I. General Introduction

Lebanon's macro economy has continued its weak growth during the first half of 2019, due mainly to continued internal political conflict and unfavorable regional conditions.

Some real-sector activities improved, while others contracted, leading to diverse effects on aggregate demand and supply in the national economy.

The monetary authorities have maintained its monetary stabilization and interest rate policies. The country recorded inflation due to expanding economic activity and money supply.

The balance of payments achieved a substantial deficit in the first half of 2019, compared to a moderate deficit for the same period last year.

The fiscal conditions, however, remain highly unfavorable due to continued fiscal deficits and growing public indebtedness.

Economic growth is expected to continue in 2019, but remains at a moderate level. Economic reforms must be the major priority of domestic authorities in order to support economic growth rates in the years to come, especially following the Cedre Conference which allocated a foreign aid of USD 11.6 million for Lebanon. This should be accompanied by special efforts to address the continued negative repercussions of the Syrian crisis on the domestic economy and society.

II. Real Sector

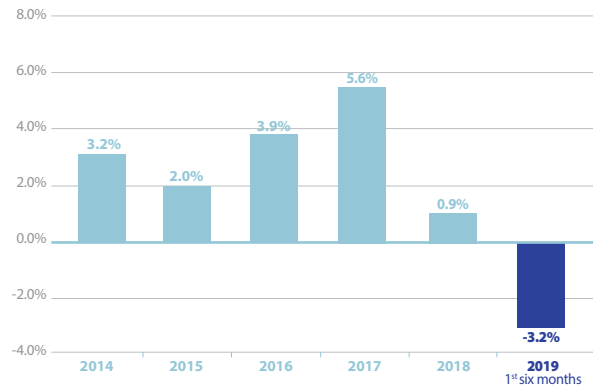
The real sector of Lebanon's economy experienced a sluggish performance in the first half of 2019 relative to the corresponding period last year. The activity of some economic sectors enhanced, while that of other sectors contracted, thus producing diverse effects on aggregate economic activity, both on the demand and supply sides.

The Central Bank's Coincident Indicator, reflecting the overall performance of the real sector (since it comprises 11 real-sector indicators) reported an annual decline of 3.2% for the first six months of 2019. This level is lower than the one recorded in 2018 (0.9%), 2017 (5.6%), 2016 (3.9%), similar to that in 2013 and 2014 (3.2% for each year), but higher than the one recorded in 2015 (2%).

The indicators that registered growth are: airport passengers, exports, imports, hotel occupancy, and tourists. The indicators that registered a decline are: construction permits, property sales, Beirut Port's activity, new car sales, cement deliveries, and cleared checks.

During this period, private consumption has increased, fueled mainly by the rise in wages of the public-sector employees following the ratification of the wage scale, and better tourism activity. However, private investment remains stagnant, due to the wait-and-see situation prevailing in Lebanon.

- | **Development of Central Bank's Coincident Indicator (CI) (growth rates)**



1- Agriculture and Industry

The value of agricultural and industrial exports reached USD 1.7 billion for the first half of 2019, relative to USD 1.5 billion for the corresponding period of 2018, with an annual growth of 12.1%. Also, the value of agricultural and industrial imports grew by 5.8% from USD 9.6 billion to USD 10.1 billion during the same period.

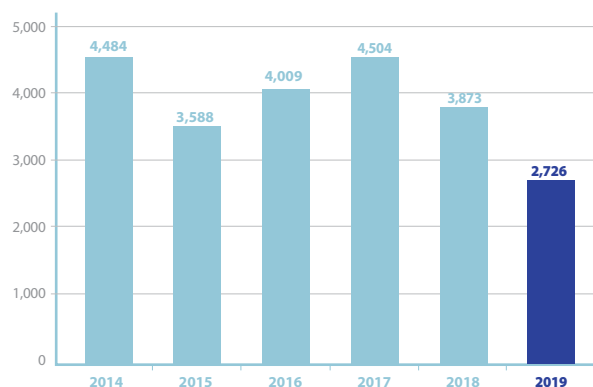
These figures clearly reflect a better performing export and trade activity, due to the re-opening of road routes especially the Jordan-Syrian border. These figures also reflect a positive contribution of the export activity to overall demand in the economy, besides better production operations.

Electricity Production, an indicator of industrial activity, declined by 1.9%, from 7,247 mkw in the first six months of 2018 to 7,112 mkw in the first six months of 2019.

2- Real Estate and Construction

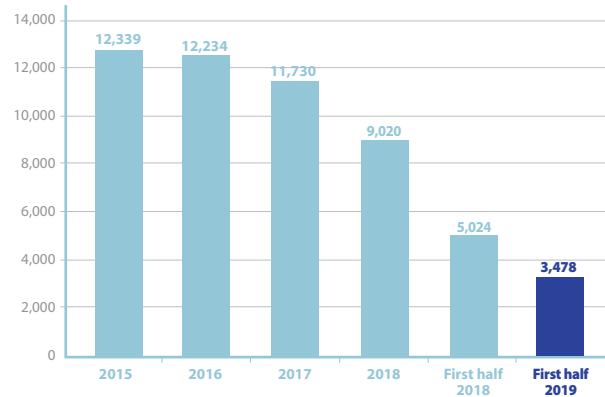
According to the figures of the Real Estate Registry and Ministry of Finance, the number of property sales operations decreased by 20.1% on annual basis to reach 21,957 operations in the first half of 2019. Also, the value of property sales dropped by 29.6% annually to reach USD 2.7 billion during the same period. This is partially affected by the recent seizure of housing loans by the Public Institution for Housing. These figures reflect a declining real-estate activity in the first half of 2019 as far as the demand side is considered.

- | **Value of Real-Estate Transactions, First Half (USD, million)**



Construction permits declined by 30.8%, from nearly 5 million sqm in the first half of 2018 to 3.5 million sqm in the same period of 2019. Cement deliveries dropped by 32.4% on annual basis to reach 1.3 million tons at end-June 2019. This suggests a curbed supply in the real-estate sector during this period of 2019 relative to the same period last year.

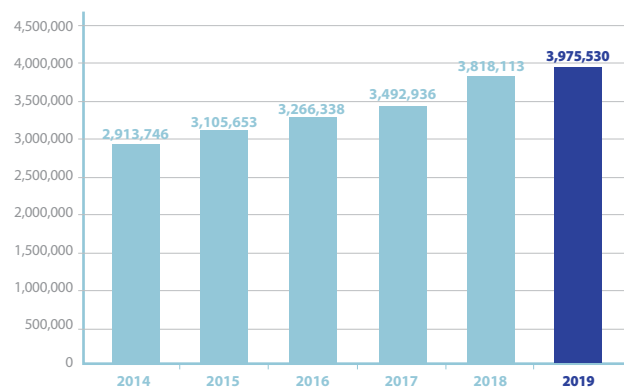
- | **Construction Permits Area (sqm)**



3- Trade and Services

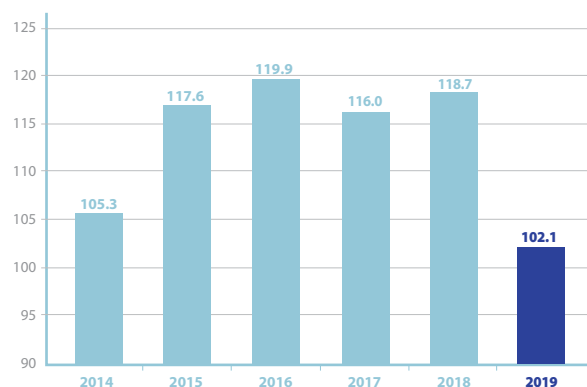
The statistics released by Beirut-Rafic Hariri International Airport indicate that the total number of passengers increased by 3.5% on annual basis to reach 3,976 thousand passengers in the first half of 2019. The number of aircraft recorded an increase of 0.7% on annual basis to reach 33,546 planes during the said period. These figures suggest an improvement in the airport activity.

- | **Passengers at the Airport - First Half**



According to the statistics of the Port of Beirut, its revenues recorded a drop by 14% on annual basis to reach USD 102.1 million in the first half of 2019. The number of ships recorded an annual decrease of 6.4% to reach 861 ships in the first half of 2019. In parallel, the number of containers recorded an annual decrease of 10.5% to reach 386 thousand containers during the same period. Also, the quantity of goods declined by 10.4% year-on-year to reach 3,511 thousand tons in the first half of 2019. These figures indicate that the Port of Beirut activity, an indicator of maritime transport and trade, was curbed during the period under consideration.

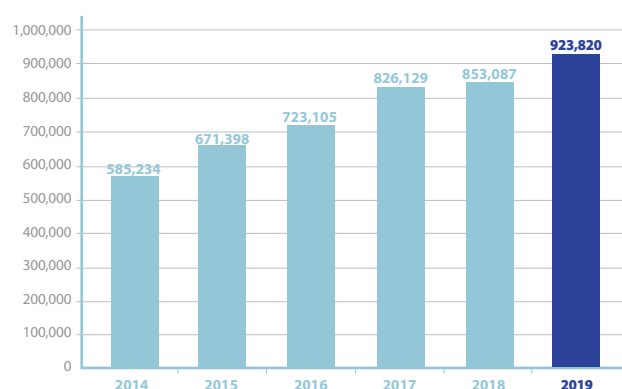
- | **Port of Beirut Revenues, First Half (USD, million)**



The number of visitors to Lebanon totaled 923,820 tourists in the first half of 2019, growing by 8.3% from 853,087 tourists in the corresponding period last year. The distribution of these tourists according to nationality shows that visitors from the Gulf Region increased by 70% in the first half of 2019 relative to the same period last year. The spending of tourists grew by 12% in the first half of 2019.

According to the Survey of Ernst and Young, the Beirut's hotel occupancy rate, an indicator of tourism activity, increased from 58.9% in the first half of 2018 to 69.2% in the first half of 2019. The average room rate rose from USD 160.6 to USD 201, and the rooms yield went up by 29.9% to USD 139 during the same period. These figures reflect a better hotel activity during the period under consideration.

• Evolution of Tourists in Lebanon (First Half)



The statistics of the Association of Automobile Importers in Lebanon show that the number of new sold cars decreased by 23.4% in the first half of 2019 relative to the corresponding period last year.

According to the statistics of the Association of Banks in Lebanon, the total value of cleared checks, mirroring private consumption and investment spending, decreased by 16.3% on annual basis, from USD 32.8 billion in the first half of 2018 to USD 27.5 billion in the first half of 2019. This reflects a curbed private spending during the period under consideration.

The Kafalat loan guarantees decreased in number from 223 in the first half of 2018 to 36 guarantees in the first half of 2019. SMEs constitute a major pillar of the corporate sector, and supporting it is a driving force of economic activity and job creation in Lebanon.

• Real-Sector Indicators

Indicators	2018 First Half	2019 First Half	% Change
Agricultural & Industrial Exports (USD, billion)	1,539	1,725	12.1
Real-Estate Sales (number)	27,472	21,957	(20.1)
Real-Estate Fees (USD, million)	203	144	(29.1)
Real-Estate Sales (USD, million)	3,783	2,726	(29.6)
Real-Estate Transactions (number)	79,868	67,728	(15.2)
Number of Tourists	853,087	923,820	8.3
Spending of Tourists (% growth)	-	-	11.5
Number of Passengers at HIA (thousand)	3,818	3,976	3.5
Aircraft Activity at HIA	33,315	33,546	0.7
Cleared Checks (USD, billion)	32,845	27,495	(16.3)
New Car Sales (number)	-	-	(23.4)
Hotel Occupancy Rate (%)	58.9	69.2	-
Average Room Rate (USD)	160.6	201	25.5
Average Room Yield (USD)	107	139	29.9
Goods Quantity at Beirut Port (000, tons)	3,916	3,511	(10.4)
Numbers of Containers at Beirut Port (thousand)	432	386	(10.5)
Number of Ships at Beirut Port	920	861	6.4
Revenues of Beirut Port (USD, million)	118.7	102.1	(14.0)
Kafalat Loan Guarantees (number)	223	36	(84.0)
Cement Deliveries (tons)	2,307,098	1,559,797	(32.4)
Construction Permits (sqm)	5,024,281	3,477,763	(30.8)
Electricity Production (mkw)	7,247	7,112	(1.9)

Sources: Official and Related Directorates.

III. Fiscal Policy and Indebtedness

The fiscal conditions in Lebanon remain highly unfavorable in light of continued fiscal deficits and growing public indebtedness, and the crowding-out effect of private investment fueled by continued public borrowing.

1- Fiscal Deficit

The figures of the Ministry of Finance show that Lebanon recorded a lower fiscal deficit in the first five months of 2019, reaching USD 2,386 million, relative to a higher deficit of USD 2,921 million for the same period last year, pointing to an annual decline of 18.3%. This deficit represents 34.8% of total expenditures as of end-May 2019, compared to 37.9% for the same period of 2018. The total primary deficit for the first five months of 2019 was USD 37.6 million, compared to a larger deficit of USD 354.2 million for the same period last year.

The recorded fiscal deficit was the result of a decline in total expenditures by 8.6% between May 2018 and May 2019, and a decrease of 1.2% in total revenues during the same period. Total expenditures stood at nearly USD 6.9 billion and total revenues at USD 4.5 billion as of end-May 2019.

The budget revenues dropped by 1.2% and budget expenditures decreased by 8.6% on annual basis to reach USD 4.3 billion and USD 6.3 billion respectively. The tax revenues increased by 0.6%, while non-tax revenues dropped by 9.2% during this period. The Telecom revenues decreased by 8.5% to USD 291 million as of end-May 2018.

The Treasury receipts fell by 58.2% on annual basis to reach USD 201 million as of end-May 2019, and Treasury expenditures dropped by 34.6% to USD 506 million during this period.

Debt servicing totaled USD 2.35 billion in the first five months of 2019, down by 8.5% from the same period last year. It accounted for 34.3% of total expenditures and 52.7% of total revenues.

• Fiscal Indicators (First Five Months, USD million)

Indicators	2018	2019	% Change
Budget Revenues	4,315	4,264	(1.2)
Budget Expenditures	6,942	6,344	(8.6)
Treasury Receipts	480	201	(58.2)
Treasury Expenditures	774	506	(34.6)
Total Revenues	4,795	4,464	(6.9)
Total Expenditures	7,717	6,850	(11.2)
Total Deficit	2,921	2,386	(18.3)
% of Total Spending	(37.9)	(34.8)	-
Total Primary Surplus or Deficit	(354.2)	(37.6)	(89.4)
Tax Revenues	3,533	3,553	0.6
Non-Tax Revenues	782	710	(9.2)
Debt Service	2.57	2.35	(8.5)
Telecom Revenues	318	291	(8.5)

Source: Ministry of Finance.

2- 2019 General Budget

The Lebanese Parliament enacted the 2019 Budget Law on July 19, 2019. It shows that budget revenues are estimated at USD 12,460 million for 2019, relative to a realized level of USD 10,739 million in 2018. Also, budget spending is estimated at USD 16,985 million for 2019 against a realized figure of USD 16,361 million in 2018. The budget deficit, thus, is estimated at USD 4,526 million for 2019, down by 19.5% from the realized amount in 2018.

The budget estimates total revenues and spending at USD 11,546 million and USD 17,792 million respectively for 2019, leading to a total deficit of USD 6,246 million for 2019.

The telecom revenues are estimated at USD 1.3 billion for 2019, with debt servicing at USD 5.5 billion and transfers to EDL at USD 1.7 billion. Capital spending stands at only USD 966 million for 2019.

• Estimated Revenues & Expenditures in 2019 Budget (USD, million)

	2019 Budget	Realized Figures for 2018	% Change
Budget Revenues	12,460	10,739	16.0
Tax Revenues	9,665	8,468	14.1
Non-Tax Revenues	2,794	2,271	23
of which Telecom Revenues	1,253	1,071	17
Budget Expenditures	16,985	16,361	3.8
Current Spending, of which	16,020	15,359	4.3
Interest Payments	5,514	5,410	1.9
Retirement Salaries	1,679	1,558	7.8
Transfers to EDL	1,658	1,756	(5.6)
End of Service Indemnities	299	568	(47.4)
Capital Spending	966	917	5.3
Budget Deficit	(4,526)	(5,622)	(19.5)
Treasury Receipts	737	807	(8.6)
Treasury Expenditures	-	1,431	-
Total Revenues	13,197	11,546	14.3
Total Expenditures	-	17,792	-

Source: Ministry of Finance.

3- Public Debt

According to the Ministry of Finance figures, gross public indebtedness of Lebanon increased by 3.4% in the first half of 2019, from USD 83 billion at end-June 2018 to USD 85.7 billion at end-June 2019. Between the end of 2015 and end-June 2019, the gross public debt of Lebanon increased by more than USD 15.4 billion. The debt-to-GDP ratio stands currently at more than 150%.

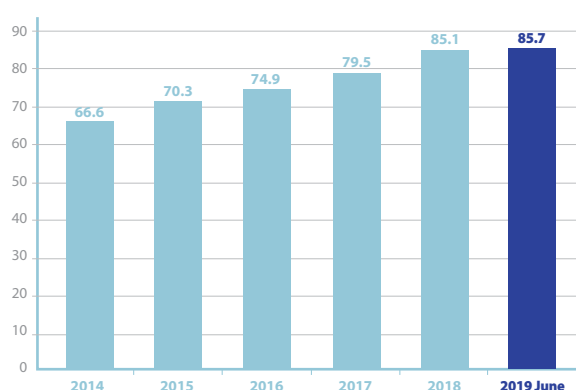
• Debt Indicators (USD, billion)

Indicators	2018 First Half	2019 First Half	% Change
Gross Public Debt	83.0	85.7	3.4
Domestic Debt	47.9	53.5	11.7
Foreign Debt	35.1	32.3	(8.1)
Net Public Debt	72.2	76.5	5.9

Sources: Ministry of Finance and Central Bank of Lebanon.

The debt in LBP grew by 11.7% on annual basis to reach USD 53.5 billion at end-June 2019. The debt in foreign currencies declined by 8.1% to reach USD 32.3 billion for the same period.

The net public debt of Lebanon went up by 5.9% on annual basis to reach USD 76.5 billion at end-June 2019.

• Evolution of the Public Debt (USD, Billion)


IV. Inflation and Monetary Policy

The monetary authorities have maintained, over the first half of 2019, its monetary stabilization policy as well as its interest-rate policy, targeting currency stability. This period experienced lower inflation.

1- Central Bank

The Central Bank's statistics reveal that its assets in foreign currencies reached USD 29.75 billion at the end of June 2019, with a decrease of 10.12% from USD 33.10 billion at the end of June 2018.

This is caused by the increased intervention of the Central Bank in the monetary market following a greater demand for the US dollar, to stabilize the national currency.

The Central Bank continued its policy of controlling money supply to keep inflation moderate (only 3.3% in the first half of 2019).

Also, it has maintained its interest rate policy, whereby commercial banks increased interest rates on lending and deposits.

• Monetary Indicators

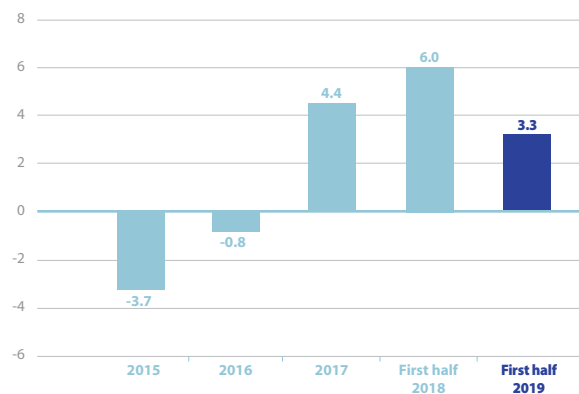
Indicators	2018 First Half	2019 First Half	% Change
USD/LBP Exchange Rate	1507.5	1507.5	0.0
Central Bank's Assets in FX (USD, billion)	33.10	29.75	(10.12)
Money Supply M3 (USD, billion)	141.3	139.9	(0.97)
Lending Rate in LBP (%)	8.82	10.94	-
Deposit Rate in LBP (%)	6.72	8.80	-
Lending Rate in USD (%)	7.93	9.49	-
Deposit Rate in USD (%)	4.09	5.84	-
Inflation Rate (%)	6.0	3.3	-

Sources: Central Bank of Lebanon, Association of Banks in Lebanon, and Central Administration of Statistics.

2- Inflation

The Price Index of the Central Administration of Statistics increased by 3.3% on annual basis for the first half of 2019, compared to a higher level of 6% in the same period of 2018. This reflects the decline of inflation in the first half of 2019.

• Evolution of Average Annual Inflation Rate (%)



3- Beirut Traders Association – Fransabank Retail Index

BEIRUT TRADERS ASSOCIATION
FRANSABANK
RETAIL INDEX
 2nd Quarter 2019
44.14



The Lebanese economic scene did not witness any positive developments that would help improve the situation prevailing in the markets or trigger any amelioration in the consumption trend during the second quarter of 2019.

Rather, all attention remained focused on the 2019 budget chapters as presented by the MOF and the consequent deliberations of the government on that matter, especially on all identified means to generate revenues that would help lower the budget deficit through the bias of the BOP by increasing customs on imported goods, as well as increasing taxes on deposits' generated interests.

In this respect, the debate was largely dominated by the deliberations on increasing the tariffs and customs on a wide spectrum of imported goods based on a protectionist approach to sustain the Lebanese industrial sector, without any serious study or documentation on the impact of such measures on the trading activities in particular, and on the overall economic situation in the country in general. Another aspect that is not rigorously investigated is the negative impact of raising taxes on interests on large deposits that would go elsewhere and the difficulty to luring similar new deposits, on one hand, while banks' interest rates will increase and tighten the possibilities for extension of facilities that smooth the mechanism of a healthy economy in the country. Thus, good intentions are never enough to revitalize market activity and regain growth, if they are not accompanied by scientifically proven economic policies and impact measurement documentation ...

In light of the above, all trading market players – in the capital and all around the country's market places, adopted a "wait and see" attitude, some of whom still having the strength to sustain the current market conditions and remain operational until the time comes when the situation starts improving, while quite a few others decided to cease activities and close their shops or companies, or rent them to non-Lebanese, as they could not bear anymore the burden of accumulated dues and commitments and expenditures, while experiencing an increasingly harming lack of activity and a sharp drop in their turnover figures, in parallel with increasing bank interest rates, as well as the lack of extended facilities with regards to penalties due to the Treasury, the Social Security, and other public entities ... (for the sake of reference, shop closures reached between 4% and 13% in Beirut as per a comprehensive survey, and even more in other regions of Lebanon).

Consequently, the momentum of retail trading markets and the pace of consumption were weak and below expectations during the second quarter of this year, despite the fact that the Holy month of Ramadan and Eid Al Fitr and Easter all coincided during this period. However, the country did not witness the arrival of a sufficient number of tourists and visitors from abroad, mainly from Gulf countries, nor the visit of Lebanese emigrants who usually come back home on such occasions and hence shops and retailers did not experience the usual surge in sales that represents an important share of their annual turnover.

Hence, retailers continued, in most sectors, to experience a deterioration in their sales figures, including vital sectors such as food products or basic necessities, as compared to their previous year performance during the same quarter.

Concurrently, the CPI posted a + 1.69% figure between the second quarter of 2018 and the second quarter of 2019 as per the official CAS figures, in spite of the permanent discounts and generous offers conceded by traders during this period, especially after the official launch of the #ThinkofLebanon campaign last March, whereby BTA incited all traders, across Lebanon, to make further concessions in their price margins.

It should also be noted that inflation was high in some sectors, and did reach – for this period:

- + 14.28 % in the Clothing and footwear sector,
- + 7.10 % in the Recreation, amusement, and culture sector,
- + 5.42 % in the Furniture & decoration sector,
- + 5.08 % in the Education sector,
- + 2.36 % in the Food and non-alcoholic beverages sector,

CPI (as per CAS official results)	
Q4 '14 / Q4 '13	- 0.71 %
Q1 '15 / Q1 '14	- 3.38 %
Q2 '15 / Q2 '14	- 3.37 %
Q3 '15 / Q3 '14	- 4.67 %
Q4 '15 / Q4 '14	- 3.40 %
Q1 '16 / Q1 '15	- 3.57 %
Q2 '16 / Q2 '15	- 0.98 %
Q3 '16 / Q3 '15	+ 1.03 %
Q4 '16 / Q4 '15	+ 3.14 %
Q1 '17 / Q1 '16	+ 5.12 %
Q2 '17 / Q2 '16	+ 3.48 %
Q3 '17 / Q3 '16	+ 4.15 %
Q4 '17 / Q4 '16	+ 5.01 %
Q1 '18 / Q1 '17	+ 5.35 %
Q2 '18 / Q2 '17	+ 7.61 %
Q3 '18 / Q3 '17	+ 6.53 %
Q4 '18 / Q4 '17	+ 3.98 %
Q1 '19 / Q1 '18	+ 4.08 %
Q2 '19 / Q2 '18	+ 1.69 %
Q4 '14 / Q3 '14	- 1.49 %
Q1 '15 / Q4 '14	- 0.98 %
Q2 '15 / Q1 '15	- 1.12 %
Q3 '15 / Q2 '15	- 1.18 %
Q4 '15 / Q3 '15	- 0.16 %
Q1 '16 / Q4 '15	- 1.15 %
Q2 '16 / Q1 '16	+ 1.54 %
Q3 '16 / Q2 '16	+ 0.82 %
Q4 '16 / Q3 '16	+ 1.93 %
Q1 '17 / Q4 '16	+ 0.74 %
Q2 '17 / Q1 '17	- 0.04 %
Q3 '17 / Q2 '17	+ 1.47 %
Q4 '17 / Q3 '17	+ 2.78 %
Q1 '18 / Q4 '17	- 1.06 %
Q2 '18 / Q1 '18	+ 2.10 %
Q3 '18 / Q2 '18	+ 0.45 %
Q4 '18 / Q3 '18	+ 0.32 %
Q1 '19 / Q4 '18	+ 1.16 %
Q2 '19 / Q1 '19	- 0.25 %

As a result, the consolidated real retail turnover figures (i.e. after applying the inflation rate weight on the nominal results) have posted a decline of – 6.00% between the second quarter of 2018 and the second quarter of 2019, compared to -7.94% in the previous quarter.

By excluding the fuel sector results (where an increase of + 7.09 % in volume was reported between the levels of Q2 '18 and Q2 '19), the real consolidated turnover drop reaches – 9.89 % in comparison to the Q2 '18 figures (also excluding fuel), compared to -10.05% in the previous quarter.

• Yearly Variation between 2nd Quarter '18 and 2nd Quarter '19

	Q2 2018	Q2 2019	
Nominal Year to Year Variation (incl. Liquid Fuels)	100.00	95.62	
Nominal Year to Year Variation (excl. Liquid Fuels)	100.00	91.66	
CPI between Jun '18 and Jun '19 (as per the official CAS figures)		+ 1.69	
Real Year to Year Variation (incl. Liquid Fuels)	100.00	94.00	- 6.00%
Real Year to Year Variation (excl. Liquid Fuels)	100.00	90.11	- 9.89%

* CAS – CPI – Jun '19

Such results do confirm that retail traders are in all evidence facing a very hard situation, and that some of them are not able to cope with it any longer, as mentioned earlier, so they have to resort to terminating the services of their employees, close their shops and trades, or rent those to generally non-Lebanese individuals, who usually perform types of activities different from their original sector.

The impact of economic reforms promised to the various economic bodies has been long-awaited in vain, the materialization of support funds and measures in the form of structural projects decided at the CEDRE conference more than a year ago is taking too long to be implemented, private investments are not coming back, while the 2019 budget did not allocate any funds for expenditure on public investments that would help re-activate the engines of the economy, and interest rates are climbing, and no measures have been taken to alleviate the burden of penalties and other dues, giving some breathing space to traders to safely overcome these difficult times. This has obviously resulted into a chain of closures, and the fears for further dangers are mounting.

The analysis of the performance during the second quarter of this year, and of the various retail trade market sectors, clearly translates the downtrend in the overall turnover figures, and shows that austerity has become normality in the spending pattern of Lebanese households, with selective consumption channeling main spending to necessities.

The main sectors where declines were registered between Q2 '19 and Q2 '18 include:

- > Shoes and Leather Products (- 54.78 % against - 25.59 % in the previous quarter)
- > Musical Instruments (- 53.55 % against - 6.86 %)
- > Cellular Phones (- 51.25 % against - 35.03 %)
- > Construction Equipment (- 38.51 % against - 29.97 %)
- > Toys (- 28.78 % against - 17.97 %)
- > Silverware and Decoration (- 27.18 % against - 7.23 %)
- > Household Electrical Equipment (- 22.15 % against - 15.62 %)
- > Optical and Hearing Aid Instruments (- 19.37 % against - 13.26 %)
- > Pharmaceuticals (- 15.57 % against - 11.30 %)
- > Furniture (- 14.41 % against - 6.42 %)
- > Clothing (- 14.10 % against - 17.49 %)
- > Commercial Shopping Centers (- 13.27 % against - 18.25 %)
- > Books & Stationery & Office Supplies (- 12.88 % against - 18.73 %)
- > Make-up Accessories (-10.15% against -7.23%)
- > Home Accessories (- 7.78 % against - 4.61 %)
- > Supermarkets and Food Shops (- 5.69 % against - 8.41 %)
- > Sports Items & Equipment (- 2.89 % against + 1.88 %)
- > Watches and Jewelry (- 2.63 % against - 13.41 %)
- > Perfumes and Cosmetics (- 2.41 % against - 1.40 %)

The sectors that witnessed better results were, in addition to the fuel sector (+ 7.09 % in volume):

- > Liquor & Spirits (+ 8.47 % against - 1.68 %)
- > Restaurants and Snacks (+ 7.37 % against + 1.42 %)
- > Tobacco (+ 7.01 % against + 1.52 %)
- > Used Cars Dealers (+ 4.03 % against + 4.04 %)
- > Medical Equipment (+ 2.64 % against + 1.26 %)
- > Bakeries & Pastries (+ 1.50 % against - 5.16 %)

On the other hand, and despite the fact that the CPI between Q1 '19 and Q2 '19 indicated a drop in prices (- 0.25 %), the second quarter figures of retail trade sectors do reflect a lower activity level in comparison to the previous quarter results, despite the major religious events mentioned above, and despite a relative improvement in some sectors, as a natural result of seasonality factors.

The decline did affect various sectors of the retail trade, specifically those sectors that are considered as non-basic or essential, while some other sectors – along with the fuel sector, did experience improved results because of seasonal and religious circumstances (toys, food products and bakeries, perfumes and cosmetics, electrical household appliances ...), but also because of an improvement in the CPI specific to these sectors [for instance – 3.55 % in the food products and non-alcoholic beverages sector, against a consolidated – 0.25 % as per official CAS figures].

Yet, the overall consolidated real result for the second quarter was negative, and displayed a real decrease of - 3.28 % as compared to the previous quarter (excluding Liquid Fuels, where a + 8.34 % increase was reported in terms of volume). Sectors where declining activity was reported included, in addition to the - 5.96 % decline in commercial malls:

- > Shoes and Leather Products (- 54.39 %)
- > Musical Instruments (- 50.66 %)
- > Cellular Phones (- 36.67 %)
- > Sports Items & Equipment (- 19.23 %)
- > Clothing (- 11.50 %)
- > Optical Instruments (- 10.85 %)
- > Pharmaceuticals (- 9.95 %)
- > Home Accessories (- 9.48 %)
- > Construction Equipment (- 9.15 %),
- > Books & Stationery & Office Supplies (- 5.93 %)
- > Watches and Jewelry (- 5.25 %)
- > Used Cars Dealers (- 3.15 %)
- > Silverware and Decoration (- 0.33 %)

Positive results were posted, in addition to the fuels sector, in the following sectors:

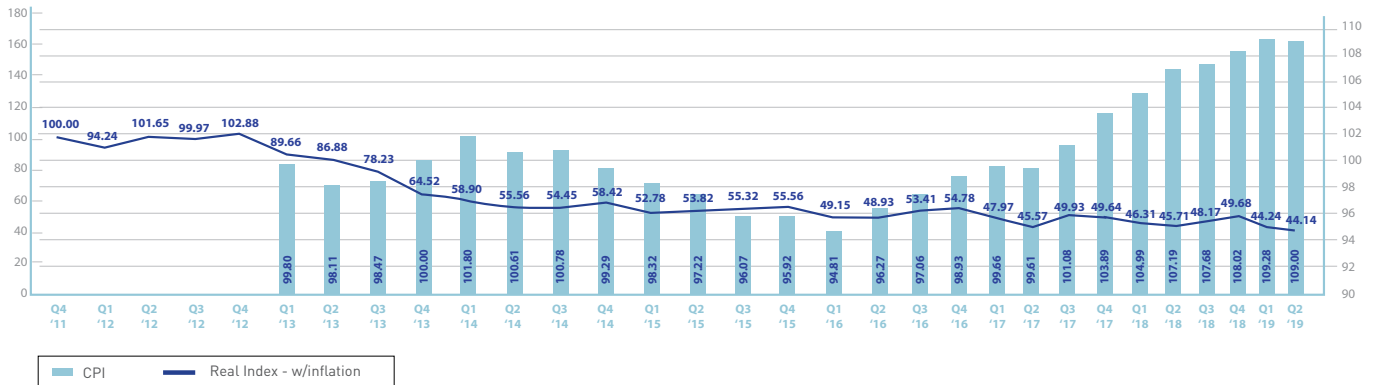
- > Liquors (+ 21.47 % %)
- > Tobacco (+ 14.81 %)
- > Furniture (+ 14.65 %)
- > Bakeries & Pastries (+ 12.10 %)
- > Restaurants and Snacks (+ 10.24 %)
- > Medical equipment (+ 10.02 %)
- > Household Electrical Equipment (+ 8.14 %)
- > Toys (+ 7.02 %)
- > Supermarkets and Food Shops (+ 5.60 %)
- > Perfumes and Cosmetics (+ 3.03 %)

As a result, with the base index 100 fixed at the fourth quarter of 2011, and with a quarterly inflation rate of +1.69% for the second quarter of 2019, as per the official CAS report, the "BTA-Fransabank Retail Index" is (with all sectors included) 44.14 for the second quarter of the year 2019. This figure compares to the level of 44.24 for the first quarter of 2019.

• BTA - Fransabank Retail Index for Q1 - 2019 (Base 100 : Q4 - 2011)

	2011		2012				2013				2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Real Index - w/out inflation	100	95.77	100.55	108.54	112.66	90.83	87.85	78.60	65.87	59.68	55.30	55.22	57.57	51.51	51.94	52.77	52.91	
Real Index - w/ inflation	100	94.24	101.65	99.97	102.88	89.66	86.88	78.23	64.52	58.90	55.56	54.45	58.42	52.78	53.82	55.32	55.36	
CPI						99.80	98.11	98.47	100.00	101.80	100.61	100.78	99.29	98.32	97.22	96.07	95.92	

	2016				2017				2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Real Index - w/out inflation	46.27	46.79	51.49	53.86	47.51	46.76	52.00	53.17	49.09	49.49	52.38	54.25	48.88	48.65
Real Index - w/ inflation	49.15	48.93	53.41	54.78	47.97	45.57	49.93	49.64	46.31	45.71	48.17	49.68	44.24	44.14
CPI	94.81	96.27	97.06	98.93	99.66	99.61	101.08	103.89	104.99	107.19	107.68	108.02	109.28	109.00

• Evolution of the BTA - Fransabank Retail Index (Base 100 : Q4 - 2011)


The “BTA-Fransabank Retail Index” for the second quarter of 2019 displays a sustained deterioration in the consumption momentum in retail trade markets activities, while all attention is focused on the fate of the 2019 budget and its various chapters, on the upcoming new ratings by international agencies (S&P), on the World Bank’s appraisal, on the positive willingness of donors participating in CEDRE, but also on the positive and tranquilizing statements made by the Governor of BDL, especially on the monetary issues.

V. Financial Markets

The banking sector has continued its growth in the first half of 2019, but the capital market and financial institutions recorded a declining in their activity during the same period.

1- Banking Sector

The statistics of the Association of Banks in Lebanon and the Central Bank indicate that the total assets of commercial banks stood at USD 256 billion as of end-June 2019, with an annual growth of 9.1% from end-June 2018.

The loans extended by commercial banks to the private sector decreased by 6% annually to reach 56 billion at end-June 2019. The dollarization rate of private sector lending increased from 67.6% at end-June 2018 to 70% at end-June 2019.

The total private-sector deposits were 0.69% lower on annual basis to reach USD 172.1 billion at end-June 2019. The dollarization rate of these deposits increased from 68.4% at end-June 2018 to 71.5% at end-June 2019.

The private-sector loans-to-deposit ratio was 32.5% at end-June 2019, compared to 34.4% at end-June 2019.

The commercial banks’ capital base expanded by 2.6% year-on-year to reach USD 21 billion at end-June 2019.

• Indicators of Commercial Banks (USD, billion)

Indicators	2018 First Half	2019 First Half	% Change
Total Assets	234.6	256.0	9.1
Private-Sector Deposits	173.3	172.1	(0.69)
Private-Sector Loans	59.6	56.0	(6.0)
Dollarization of Lending (%)	67.6	70.0	-
Dollarization of Deposits (%)	68.4	71.5	-
Total Capital	20.4	21.0	2.6

Sources: Central Bank of Lebanon and Association of Banks in Lebanon.

2- Financial Institutions

The total balance sheet of financial institutions in Lebanon totaled nearly USD 1.5 billion as of end-June 2019, down by 4.6% from end-2018. The claims on resident customers increased by 2.6% to USD 692.4 million. The resident customer deposits decreased by 0.8% to USD 156.4 million as of end-June 2019.

The capital accounts of financial institutions grew by 4%, from USD 476.2 million as of end-2018 to USD 478.1 million as of end-June 2019.

These figures suggest a shrinking activity of the financial institutions operating in Lebanon in the first half of 2019.

• Indicators of Financial Institutions (USD, million)

Indicators	End 2018	2019 First Half	% Change
Total Balance Sheet	1.54	1.47	(4.6)
Claims on Resident Customers	674.8	692.4	2.6
Deposits of Resident Customers	157.7	156.4	(0.8)
Capital Accounts	476.2	478.1	4.0

Source: Central Bank of Lebanon.

3- Beirut Stock Exchange

The figures announced by the Beirut Stock Exchange (BSE) indicate that total trading value reached USD 103 million in the first half of 2019, with a substantial decrease of 71.9% from USD 367 million at end-2018.

Market capitalization of BSE decreased by 9.5% on annual basis to reach USD 8.2 billion at end-June 2019. The market price index was 75.9 as of end-June 2019, relative to 83.9 at end-2018.

• Beirut Stock Exchange Indicators

Indicators		2019 First Half	% Change
Market Capitalization (USD, billion)	9,117	8,248	(9.5)
Total Trading Value (USD, million)	367	103	(71.9)
Price Index	83.9	75.9	-

Sources: BSE and Central Bank of Lebanon.

VI- Foreign Sector

The balance of payments, mirroring the aggregate foreign sector activity, experienced a substantial deficit in the first half of 2019 relative to a lower deficit for the same period of 2018, due to lower capital inflows and growing trade deficit.

1- Trade Balance

For the first half of 2019, the value of total exports reached USD 1.7 billion, with an increase of 12.1% from a year later. In parallel, total imports grew by 5.8% to reach USD 10.1 billion during the same period. As such, the trade deficit expanded to USD 8.4 billion, by 4.6% on annual basis.

The export-to-import coverage ratio was 17.6% in the first half of 2019, relative to 16.1% in the same period last year, thus reflecting a slight improvement in this coverage ratio due to better export growth over import growth.

The total trade value of Lebanon recorded USD 11.9 billion for the first half of 2019, against USD 11.1 billion for the same period of 2018.

These figures indicate a better trade activity for Lebanon, fueled by an improving export activity.

2- Capital Balance

The financial inflows to Lebanon are estimated at nearly USD 3 billion in the first half of 2019, relative to USD 7.8 billion a year earlier, thus decreasing annually by 61.4%. This mirrors a shrinking inflow of financial funds from foreign markets.

• Foreign Sector Indicators (USD, billion)

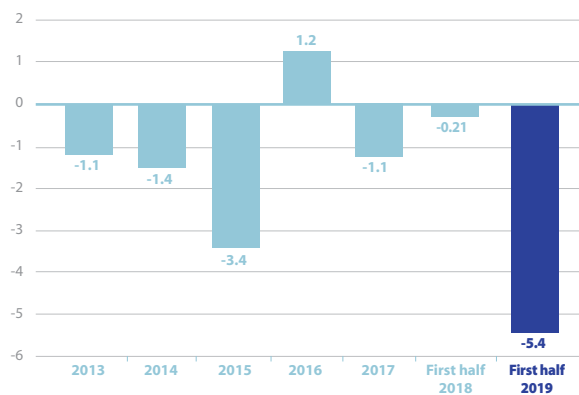
Indicators	2018 First Half	2019 First Half	% Change
Trade Deficit	8,042	8,414	4.6
Exports	1,539	1,725	12.1
Imports	9,580	10,138	5.8
Capital Inflows	7,834	3,023	(61.4)
Balance of Payments	(208)	(5,391)	2492

Sources: Higher Customs Council and Central Bank of Lebanon.

3- Balance-of-Payments

The statistics announced by the Central Bank show that Lebanon's balance-of-payments recorded a substantial deficit of USD 5.3 billion in the first six months of 2019, relative to a lower deficit of USD 208 million in the same period last year. The recorded deficit was due to a decrease of USD 2.1 billion in the net foreign assets of banks and financial institutions, and a decrease of USD 3.3 billion in the net foreign assets of the Central Bank.

• Balance of Payments (USD, billion)



VII- Growth Prospects

Real economic growth is expected to continue during 2019, still at a moderate rate as in 2018. The IMF estimates real GDP growth at 1.3% in 2019. This will be stimulated by active consumption spending, ongoing aggregate economic activity, continued monetary stabilization, and continued capital inflows. However, investment spending remains stagnant due to the hesitation of the productive sectors to invest in the economy.

The implementation of economic, fiscal and sectoral reforms as per the Cedre Conference Commitments could stimulate higher growth rates in the coming years. The government has committed to drop the fiscal deficit by 1% of GDP in 2019, in the context of the 2019 general budget which was enacted by the Parliament. This is a crucial step towards fiscal recovery. Also, the government has recently approved a reform plan for the electricity sector, targeting financial balance by year 2023, and a deficit of USD 1.7 billion for 2019. The plan also targets decreasing the technical and non-technical losses of EDL, enhancing the power generation, and raising electricity tariffs.

Very recently, in September 2, 2019 the President of the Republic has organized a meeting at the Baabda Presidential Palace devoted for discussing practical solutions to the current economic crisis in Lebanon. The meeting was attended by the Parliament President, Prime Minister, Governor of the Central Bank, concerned Ministers, and heads of the Lebanese Parties.

The Baabda Meeting has focused on several key issues, namely:

- Formation of an Economic Emergency Commission to follow the implementation of the undertaken resolutions.
- Maintaining the exchange rate stabilization policy.
- Approving a medium-term fiscal framework for the years 2020, 2021 and 2022, that would achieve an annual primary fiscal surplus of 3%, 4% and 5% of GDP respectively, and a fiscal deficit of 7%, 6% and 5% of GDP respectively.
- Abiding by the estimated targets of the 2019 general budget, and approving the 2020 general budget with a primary surplus of 3% of GDP.
- Decreasing the public debt by implementing PPP projects.
- Decreasing the electricity deficit to LBP 1,500 million.
- Seizing employment in the public sector for three years.
- Releasing the investment projects enacted by the Parliament with a total value of USD 3.3 billion.

Such economic measures could stimulate the overall economic activity and strengthen fiscal consolidation. These priorities are vital to raise real economic growth rates and foster the economic contribution of the private sector in Lebanon. However, they should be complemented by serious measures to halt corruption, tax evasion, customs smuggling, and increase the government's control over public maritime and river properties. The funds that could be generated from such measures could help in covering the annual fiscal deficit and lowering public indebtedness.

Study | A Practical Framework for Public Deficit and Debt Reduction in Lebanon

I. Introduction

This study sheds light on, and analyses, the critical fiscal developments Lebanon has been experiencing for quite a long time to date, the real causes of fiscal imbalance, and its consequences on the economy and public indebtedness. It suggests a practical and effective framework for fiscal-deficit and public-debt reduction, including revenue-enhancement, spending control, debt management, and downsizing the public sector measures. It also suggests policy recommendations to allow Lebanon to avoid the debt trap.

II. Current Position of Public Finances

Lebanon has been suffering, for several years so far, from high fiscal deficits and public indebtedness, both in absolute values and when deflated by the country's GDP, reaching "critical zones". The major reasons for this fiscal imbalance problem is the growing spending over public revenues caused mainly by certain negative developments which include the following:

- (i) Lower economic growth rates that lowered revenues from taxation and, hence, overall revenues.
- (ii) Non-collection of total revenues from the activity of various public utilities, mainly the electricity sector, and from public maritime properties.
- (iii) No attempts have been made so far to privatize some or all public enterprises, or even implementing the existing PPP Law. Hence, the government lost income from new private sector initiatives.
- (iv) Excess and growing expenditure, mainly on current items such as wages and salaries of the public sector and debt service.
- (v) Corruption and huge waste in public money caused by high rates of tax evasion and customs smuggling.
- (vi) The civil war, which erupted in 1975 and ended in 1989 with the Taef Accord. This war has caused great damages, on all levels, to the country. This has placed high pressures on the government's public finances.
- (vii) The Israeli attacks on Lebanon and the produced destruction of some parts of physical infrastructure, which also necessitated discretionary government spending.

Following is a discussion of the fiscal deficit and debt developments over the past years and their future trends, and their real causes:

1- Effects of the Civil War

A major source of Lebanon's fiscal imbalance is the civil war, which broke out in 1975 and lasted for 15 years, causing great physical and human costs. During this period, the government was forced to increase its spending on current, social and investment items, while the war decreased the authority of the government over the country and mainly its income resources, leading to growing fiscal deficits and public indebtedness. By 1992, Lebanon experienced a fiscal deficit of USD 620 million, and a debt of nearly USD 4 billion, an equivalent of 50% of the country's GDP.

During the civil war period, the private sector was reluctant to engage in recovery and reconstruction efforts, a mission that fell completely on the shoulders of the public sector.

• Evolution of Budget Deficit (USD, billion)

Year	Budget Deficit
1992	0.62
1993	0.69
1994	1.87
1995	2.05
1996	2.68
1997	3.18
1998	2.44
1999	2.52
2000	3.90
2001	2.80
2002	2.85
2003	2.61
2004	2.01
2005	1.86
2006	3.04
2007	2.55
2008	2.92
2009	2.96
2010	2.89
2011	2.34
2012	3.93
2013	4.22
2014	3.07
2015	3.95
2016	4.94
2017	3.72
2018	6.25

Source: Ministry of Finance.

2- Post-War Reconstruction Program

Between 1992 and 2004, Late Prime Minister Rafic Hariri led the first post-war reconstruction efforts, together with an effective exchange rate stabilization policy where the LBP was pegged at a rate of 1507.5 to the USD, following a sharp devaluation in 1992 where 1 USD = 2,300.

The reconstruction program necessitated a substantial rehabilitation of the country's infrastructure besides economic recovery. Financing of the reconstruction program was maintained via internal and external borrowing. As a result, the budget deficit grew from USD 0.62 billion in 1992 to USD 2.01 billion in 2004, reaching high peaks in 1997 (USD 3.18 billion) and 2000 (USD 3.90 billion). By 2004, the fiscal deficit accounted for 8.8% of GDP. In parallel, the country's gross public debt rose from USD 4.2 billion in 1993 to USD 35.9 billion in 2004 and its ratio to GDP from 56% to 170% during the same period.

3- Sluggish Economic Growth

Low or declining economic growth rates did not support the increase in public revenues (mainly revenues from direct and indirect taxes) and, thus, affected negatively the ability to downsize fiscal deficits and indebtedness. Lebanon's real GDP growth was at a rate of 1.1% in 2000, climbed up to 3.9% and 3.4% in 2001 and 2002 respectively, then fell down to 1.7% in 2003, mainly due to reconstruction spending. Following the assassination of Former Prime Minister Rafic Hariri in 2005, the economy experienced a sharp drop, where real GDP growth was 2.7% in 2005 and 1.7% in 2006.

Real GDP growth reached peak levels in 2007 (9.3%), 2008 (9.2%), 2009 (10.1%), and 2010 (8.0%). Later, growth started to go down to low levels since 2011 to date, reaching 1% in 2018, influenced mainly by continued domestic political conflict, regional instability, and worsening fiscal and economic conditions in Lebanon.

The average annual growth rate of real GDP during the 2000-2018 period was nearly 3.7%, a rate that is insufficient to curb the growth of fiscal deficits and debt. The budget deficit ranged, during this period, from a low level of USD 1.86 billion in 2005 to a high or peak level of USD 6 billion in 2018, representing nearly 10.2% of GDP in 2018. In parallel, the gross public debt rose substantially to a peak level of USD 85.1 billion in 2018, representing nearly 153% of GDP, putting Lebanon in a critical fiscal zone. What should be noticed here is that the average annual growth rate of gross public debt has experienced a slower growth since 1993, as the rate dropped from 123% for the period 1993-1995 and 171% during 1995-2005 to an average of 22% during 2005 and 2018. But the debt growth remains higher than GDP growth (7% against 1% respectively in 2018).

• Evolution of Public Debt and GDP

Years	Gross Public Debt (USD, billion)	GDP Growth Rate (%)	GDP (USD, billion)	Debt-to-GDP Ratio (%)
1993	4.2	n.a.	7.53	56.0
1995	9.3	n.a.	11.12	85.0
1997	15.6	n.a.	15.75	100.0
1999	22.4	n.a.	17.41	130.0
2000	25.2	1.1	17.25	148.0
2001	28.3	3.9	17.60	163.0
2002	31.4	3.4	19.09	167.0
2003	33.4	1.7	19.75	171.0
2004	35.9	7.5	20.96	170.0
2005	38.5	2.7	21.29	179.0
2006	40.4	1.7	21.80	183.0
2007	42.0	9.3	24.58	169.0
2008	47.1	9.2	28.83	161.0
2009	51.2	10.1	35.14	144.0
2010	52.6	8.0	38.01	137.0
2011	53.7	0.9	40.08	134.0
2012	57.7	2.8	44.10	131.0
2013	63.5	2.7	47.60	137.0
2014	66.6	2.0	49.94	137.0
2015	70.3	0.2	51.17	141.0
2016	74.9	1.7	51.80	145.0
2017	79.5	1.5	53.09	149.0
2018	85.1	1.0	55.6	153.0

Sources: Ministry of Finance, IMF.

4- Public Waste and Corruption

Other major causes of growing fiscal deficits and indebtedness is the observed corruption and huge waste in public money, caused mainly by tax evasion (with a cost estimated in excess of USD 2 billion), customs smuggling (with a cost estimated in excess of USD 1.5 billion), non-collection of all duties and fees for public utilities mainly electricity (collection stands at less than 50%), and non-collection of fees and duties from the government's maritime and river properties (with a cost estimated in excess of USD 1 billion), in addition to annual losses incurred by EDL estimated at USD 1.5 billion a year, besides other sources of corruption. In fact, the overall cost of public waste and corruption stands currently over USD 5 billion, an amount, if halted, could transform the existing deficit in the budget to a surplus, which could affect an effective downsizing of the country's indebtedness in the intermediate to long terms.

• Fiscal Balance as percentage of GDP

Year	Ratio (%)
2002	(13.8)
2003	(13.5)
2004	(8.8)
2005	(8.1)
2006	(11.4)
2007	(10.9)
2008	(9.9)
2009	3.0
2010	3.2
2011	(5.8)
2012	(8.9)
2013	(9.1)
2014	(6.3)
2015	(7.9)
2016	(9.6)
2017	(6.9)
2018	(10.2)

Source: Ministry of Finance.

5- Higher Interest Rates

Another major source of growing fiscal deficits and debt is the substantial depreciation of the LBP in the beginning of 1990s period, where its exchange rate vis-a-vis the USD was LBP 2,300 for each US dollar. Domestic authorities resorted to a money stabilization policy pegging the exchange rate at 1507.5 LBP for every USD to halt depreciation of the national currency, and also a rising interest rate policy to control increased dollarization of the national economy. Interest rates on domestic TBs reached in some years between 1993 and 1998 more than 20% and 35%. Real interest rates during that period were well above 10% of the local CPI during the 1994-2002 period. The average annual interest rate paid on the capital of the debt was 14.6% during the 1993-2006 period. Such a rate was quite high by international standards and relative to the domestic inflation rates. This development has fueled further debt service. Had interest rates were not so high during that period, the debt service would have been lower, and the debt-to-GDP would not have reached 100%.

Rising interest rates during that period fueled a surge in debt service to rates ranging between a low level of USD 2.3 billion in 2005 to a high level of USD 5.3 billion in 2018, thus accounting to nearly 10% of GDP, 43% of total revenues, and almost one third of total expenditures in 2018.

Today, interest rates are kept high (at 5-8% on deposits in USD, and 10-14% on deposits in LBP) in order to attract foreign capital and recover the balance-of-payments position. High interest rates on domestic debt instruments, which may seem necessarily given the current unfavorable political and economic conditions, continue to fuel more debt service and, hence, growing spending and fiscal deficit.

• Total Debt Service (USD, billion)

Years	Debt Service
2002	3.1
2003	3.3
2004	2.6
2005	2.3
2006	2.9
2007	3.1
2008	3.3
2009	3.8
2010	4.1
2011	4.0
2012	3.8
2013	4.0
2014	4.4
2015	4.7
2016	4.8
2017	5.0
2018	5.3

Source: Ministry of Finance.

6- Composition of Public Debt

Most of Lebanon's public debt is of domestic source. In fact, domestic debt (or local-currency debt) is mainly held by the Central Bank and commercial banks. This debt has short-term, medium-term and long-term maturities. Foreign-currency debt (or foreign debt) consists of Eurobonds held by foreign economic and financial agents.

Out of a gross public debt of USD 85.1 billion in 2018, USD 51.6 billion was from domestic sources (or 60.6%), and USD 33.5 billion was from foreign sources (or 39.4%). Net domestic debt stood at USD 75.7 billion in 2018, growing by an annual rate of 9.5% from 2017.

Lebanon's sovereignty remains protected from external pressures, since the local banking system hold the majority of domestic debt. However, any form of debt, whether local or external and its un-controlled growth is harmful to the national economy.

What is alarming is that the public debt has become a perpetual debt, meaning that it can grow alone, even the domestic authorities do not tend to borrow more, since the debt service and transfers to EDL are fueling further increases in public indebtedness.

• Interest Payments as a Ratio to Total Revenues and GDP [%]

Years	Interest Payments to GDP [%]	Interest Payments to Total Revenues [%]
2000	n.a.	n.a.
2001	n.a.	n.a.
2002	16.6	80.6
2003	16.8	74.9
2004	12.3	52.4
2005	10.5	46.1
2006	13.2	58.5
2007	12.6	54.4
2008	11.3	47.0
2009	10.8	45.5
2010	10.2	46.5
2011	9.4	40.2
2012	8.2	38.5
2013	8.2	40.2
2014	8.6	38.5
2015	8.9	46.6
2016	9.3	48.0
2017	9.2	44.6
2018	9.5	48.6

Sources: Ministry of Finance, IMF.

7- Growing Foreign Borrowing

Lebanon has resorted to foreign donor governments and organizations to get foreign aid to support its efforts in fiscal consolidation and project financing mainly for infrastructure.

Foreign debt has surged gradually from USD 19.13 billion in 2005 to USD 33.5 billion in 2018, i.e. by nearly USD 14.37 billion in 14 years or by nearly USD 2.1 billion on average per annum.

Foreign debt would have been even higher, had the Lebanese government utilized fully the foreign aid it received from international donors, under international conferences which were held since 2001.

The Paris I Conference, which convened on February 27, 2001 in Paris, allocated some 500 million euros to support funding developmental projects in Lebanon.

The Paris II Conference which was held on November 23, 2002 in Paris, Lebanon received commitments of USD 4.4 billion, of which USD 3.1 billion was geared towards public debt reduction and USD 1.3 billion was dedicated to the financing of economic, social and developmental projects. One year following the Conference, seven countries gave Lebanon an amount of USD 2.4 billion in foreign aid by 2003.

Later, on 30 August 2006, the Stockholm Conference was held to support Lebanon following the war launched by Israel for 33 days, causing direct damages in excess of USD 3.6 billion. The Conference allocated around USD 537 million in foreign aid to help Lebanon meet immediate recovery needs.

The Paris III Conference was organized on January 25, 2007 in Paris. Lebanon managed to secure USD 7.53 billion in foreign aid of which 25% was in grants. Of this amount, only USD 3.7 billion were effectively received by Lebanon in December 2009. The aid was geared towards supporting project financing, the budget, and the private sector.

• Components of Gross Public Debt (USD, billion)

Years	Local Currency Debt	Foreign Currency Debt
2005	19.33	19.13
2006	20.04	20.33
2007	20.18	21.22
2008	25.88	21.8
2009	29.83	21.32
2010	32.01	2.059
2011	32.73	20.93
2012	33.30	24.39
2013	37.35	26.13
2014	40.96	25.61
2015	43.25	27.06
2016	44.02	27.64
2017	49.2	30.4
2018	51.6	33.5

Source: Ministry of Finance.

Lebanon also received, under the Cedre Conference held in Paris last year, foreign aid commitments in excess of USD 11 billion. The foreign aid was conditioned for implementing fiscal, economic and sectoral reforms. Due to the delay in the 2019 general budget by the government and the Parliament up till July 2019, the government of Lebanon did not receive so far any amount of this financial aid. The government should implement the Electricity Plan already approved besides radical reforms to foster fiscal consolidation and economic recovery. This should go in line with the economic stimulus packages of the Central Bank in coordination with domestic banks which have continued over the last years and helped in the development and growth of some productive and technological sectors.

The approval and implementation of a new wage scale for the public sector in 2017 was a major source of spending explosion in 2018, a scale with a cost of nearly USD 2 billion instead of the government's original forecasted cost of USD 850 million. This new huge cost was a major cause for the sharp increase in public spending from USD 15.4 billion to USD 17.8 billion, and in the fiscal deficit from USD 3.75 billion to USD 6 billion between 2017 and 2018. Consequently, the deficit-to-GDP ratio climbed from 6.9% to 10.2% during this period.

• Total Revenues and Spending (USD, billion)

Year	Total Revenues	Total Spending	Total Deficit
2012	1.84	5.77	3.93
2013	1.95	6.17	4.22
2014	10.88	13.95	3.07
2015	9.58	13.53	3.95
2016	9.92	14.86	4.94
2017	11.6	15.37	3.72
2018	11.55	17.8	6.25

Source: Ministry of Finance.

III. A Framework for Fiscal Deficit and Debt Reduction

It is now generally recognized that the current path of growth of both the fiscal deficit and public debt is unsustainable in the long run. The government of Lebanon needs to reduce drastically the fiscal deficit as a necessary and sufficient prerequisite for controlling and even lessening the size of the public debt. The political will here is a must to secure such a deficit-debt reduction.

A proper fiscal adjustment policy should tackle significant issues such as: what level of expenditures can the country afford? What pattern and level of taxation is fair and appropriate? What size of public sector is proper?

An effective framework for reducing the fiscal deficit and public debt in Lebanon should include the issues mentioned above, and the mechanisms and kind of measures that would need to be considered in constructing an effective fiscal deficit reduction in Lebanon.

This framework should focus on the following main measures:

- (i) Stimulating real economic growth to levels above the current depressed rates of 1-1.5% per annum.
- (ii) Revenue growth in line with the expansion in GDP.
- (iii) Discretionary additional revenues.
- (iv) Freezing the level of total expenditures at accepted and practical levels for several coming years.
- (v) Decreasing the burden of the public debt.

Following is an explanation of each of these measures.

• Indicators of Public Finances (USD, billion)

Indicators	2017	2018	% Change
Fiscal Deficit	3.75	6.25	66.6
Total Spending	15.4	17.8	15.7
Total Revenues	11.65	11.55	(0.7)
Tax Receipts	8.22	8.47	3.1
Non-Tax Budgetary Receipts	2.56	2.27	(11.5)
Transfers to EDL	1.33	1.76	32.3
Debt Service:	5.2	5.6	8.2
- % of Total Expenditures	33.8	31.5	-
- % of Total Revenues	44.6	48.6	-

Source: Ministry of Finance.

1- Revenue-Enhancement Measures

On this front, the measures should focus on expanding the base of total revenues, from traditional and discretionary sources, to raise the ratio of revenues-to-GDP in the coming years.

In this context, the following measures are needed:

(i) Strengthening the efficiency of the tax system. Tax laws would need to be enforced and collection measures improved. Duties, fees and utilities charges should be collected. Tax evasion should be halted. Also, customs smuggling should be seized. Furthermore, collection of revenues from the state's public maritime properties is crucial for reducing the overall deficit. Corruption should be reduced substantially and even halted. In addition, collection of electricity tariffs should be substantially enhanced from all sectors and all regions. If such measures are applied, revenues from such actions could pile up to more than USD 5-7 billion, an amount that could cover the overall fiscal deficit and result in a surplus in the state's budget.

(ii) Additional revenues should be raised from discretionary sources such as privatization and public private-partnership structures (mainly B.O.T.) in some public utilities such as the electricity sector, Port of Beirut, water sector, telecoms sector and others. Proceeds from such structures could ensure to the state immediate financial resources, in addition to annual income from those utilities. Such discretionary income could total more than USD 5 billion, a significant rain fall income that could restructure the revenues portfolio of the state and erode any fiscal deficit. Proceeds of privatization could be used for the purpose of repaying part of the debt.

• Yearly Growth Rates of Gross Public Debt for Certain Intervals

Interval	Rate (%)
1993-1995	123.0
1995-2000	171.0
2000-2005	53.0
2005-2008	22.0
2008-2012	23.0
2012-2015	22.0
2015-2018	21.0

Source: Ministry of Finance.

2- Expenditure Control Measures

The objective here is to place an absolute ceiling on total expenditures of the state. The ceiling should be comprehensive and include all disbursements from the specialized funds (CDR, Council for the Development of the South, the Fund for the Displaced people, and the like), and from cash borrowing abroad. What is exempted from this ceiling could be the project expenditures financed by external loans allocated for appropriate items. The externally financed projects should be also subject to a separate ceiling. Such two ceilings on expenditures could be expected to reduce effective government spending.

Under a spending ceiling, the authorities can continuously review and follow to make sure that expenditures remain under the set ceiling. In current budgets, the government has no flexibility on the expenditure side, since the majority of this expenditure goes to two major items: wages and salaries of the public sector and interest payments on the public debt where both constitute nearly two-thirds of the total expenditures.

The integration of spending on special funds mentioned above into the general budget is crucial in controlling overall expenditure. This is important for detecting the major sources of the fiscal deficit. Hence, total spending should be grouped into one account and compared with total revenues. The excess of the former over the latter is the cause of the fiscal deficit, and not any particular expenditure.

Such an integrated fiscal account would enforce the Parliamentary review and approval of the budget, and the Parliament's general discussions would be a substantive shaping of the fiscal policy, rather than a formal procedure.

It is about time now that the government of Lebanon discloses voluntarily to the Parliament and the people at large a fully comprehensive fiscal plan. Great consideration should be given to streamlining the budgetary process through legal requirements that the budget should contain all government expenditures, revenues and borrowing, as well as implementing full and prompt auditing and closing of the government's financial accounts.

• Debt Indicators (USD, billion)

Debt Form	2018	2017	% Growth
Gross Public Debt	85.1	79.5	7.0
Net Public Debt	75.7	69.3	9.5
Domestic Debt	51.6	49.2	5.1
Foreign Debt	33.5	30.4	10.2

Source: Ministry of Finance.

3- Debt Management Measures

By controlling public expenditure through fiscal ceilings, and enhancing public revenues from traditional and discretionary sources, the fiscal deficit growth could be effectively controlled. In this sense, the level of the public debt and its ratio to GDP would be placed on a downtrend trajectory.

A crucial element in downsizing public deficits and indebtedness is to reduce the cost or burden of interest payments on internal and external public debt, which currently accounts for nearly one-third of the fiscal deficit. In fact, every Lebanese pound or US dollar not paid for interest payments is a freed resource that could be used to finance other outlays.

Eventually, there are four major ways to reduce interest payments on the public debt, which could be implemented in a simultaneous way. These ways are:

- (i) Reducing the fiscal deficit itself, and consequently the financing needs of the budget.
- (ii) Reducing interest rates on debt instruments, i.e. the domestic TBs and Eurobonds.
- (iii) Reducing the debt stock.
- (iv) Rearranging the debt structure, migrating from high-interest instruments towards relatively lower-interest instruments.

• Comparative Fiscal Results (% of GDP)

	2017	2018
Budget Revenues	20.2	19.1
Tax Revenues	15.4	15.1
Non-Tax Revenues	4.8	4.0
of which Telecom Revenues	2.4	1.9
Budget Expenditures	26.4	29.1
Budget Surplus / Deficit	(6.2)	(10.0)
Budget Primary Surplus	3.5	(0.2)
Treasury Receipts	1.6	1.4
Treasury Expenditures	2.4	2.5
Total Deficit	21.8	20.6
Total Expenditures	28.8	31.7
Total Deficit	(7.0)	(11.1)
Total Primary Surplus / Deficit	2.7	(1.1)

Sources: Ministry of Finance, Institute of International Finance.

The contracting fiscal deficit would lower the financing needs of the budget and, hence, interest rates at which financing is obtained. It would also help in lowering the debt growth and interest rates on the refinancing of maturing debt instruments.

Domestic authorities could rely also on liquidity management to effect a significant lowering of the interest rates structure. The public-sector deposits are quite substantial in recent years. Its current level are quite higher than the needs for normal transactional purposes. In this sense, domestic authorities could allow a withdrawal of part of these deposits to finance a major portion of the projected budget deficit. This, in turn, will cause a significant drop in interest rates. Lower interest rates would allow refinancing maturing debt to reduce further the burden of interest payments, thereby leading to a double effect: reducing the fiscal deficit and debt, and also stimulating domestic economic activity and, hence, economic growth and income from taxation (and so overall revenues of the government).

It is crucial here to stress that the use of privatization or PPP proceeds should be surrounded by strong safeguards designed to ensure that the proceeds are used only for the purpose of a permanent reduction in the stock of public debt.

No one should imagine that with a 99% debt-to-GDP ratio there is no danger, and that at 101% a crisis would erupt. Jordan presents an example of a country that allowed its debt-to-GDP ratio to rise significantly above 100% in the 1980s. However, after that, and for several years, it implemented several fiscal adjustment programs, negotiated debt reschedulements and sought debt relief before recovering to below the 100% mark.

Since the debt service is a function of the gross debt level, then reducing the debt stock would effect a lowering of its service. This has a positive impact on the reduction of the fiscal deficit and debt itself.

• **Financial Transfers to EDL (USD, billion)**

Year	Transfer to EDL
1992-2009	6.40
2010	1.19
2011	1.74
2012	2.26
2013	2.03
2014	2.09
2015	1.13
2016	1.20
2017	1.33
2018	1.76

Sources: Ministry of Finance, EDL.

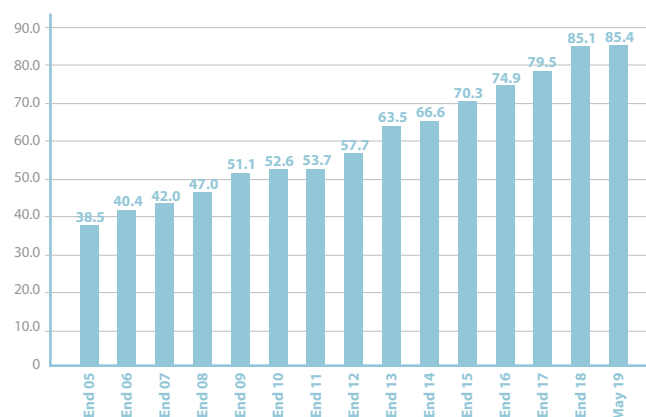
4- Impact on the Foreign Sector

We have above stressed that reducing domestic interest rates is crucial in order to contain the fiscal deficit. However, such a measure could have a negative effect on the balance of payments. The surplus achieved in the balance of payments in some past years was the result of high interest rates which helped in attracting foreign funds.

In fact, in recent years, and despite the existing high interest rates in Lebanon, capital inflows have declined leading to high deficits in the balance of payments in recent years (more than USD 4 billion in 2018). This points to the importance of confidence in Lebanon as a major supporter to the economy, its balance of payments and exchange-rate stability. Confidence is generated by strong economic and fiscal policies and reforms that should be designed to eliminate the fiscal deficit and the performance of the national economy as a whole.

If the government perceives fiscal-deficit reduction as a prime priority, and this should be the case, then policy makers in Lebanon will need to consider how to reduce interest rates, hence the burden on the budget and public debt, while protecting the balance of payments. This necessitates strengthening domestic and international confidence in the country. But over the medium term, as fiscal consolidation gets greater momentum, a strong fiscal position is expected to support the foreign or external sector. Much will depend upon the strength and credibility of the total reform program designed to reduce the fiscal deficit and debt.

• | **Gross Public Debt (USD, Billion)**



Sources: Central Bank, Ministry of Finance.

5- The Size of Public Sector

The public sector in Lebanon is quite large, and even growing due to random employment influenced by politicians in public institutions. Also, the public sector comprises a wide variety of activities – water, electricity, communication, ports, airports, railways and national airline, as well as real estate. Government expenditures, both current and investment expenditures, probably reach 40% of GDP – a proxy that assumes the large size of the domestic public sector.

This over-sized public sector is leading to greater degrees of crowding out of private investments. This is because the lucrative government treasury bills are attracting a larger part of banking funds due to its high interest rates, rather than directing greater funds to finance the private sector (commercial banks' credit to the public sector stood at USD 30 billion in 2018, against USD 60 billion for the private sector). Certainly, these trends will change once measures focusing on fiscal deficit reduction are implemented.

In fact, the smaller the government sector is the better. This would be in line with Lebanon's traditional policy of relying on the private sector to drive the national economy, which is also the global trend today in world economy. Definitely, if fiscal deficits and debts are effectively reduced, with also effective measures to enhance and widen the base of revenues, the size of the public sector would be positioned on a downturn trajectory. This would be enforced if the government implements a practical privatization program and PPP model with respect to public utilities. Surely, these issues are complex and require an adequate regulatory framework to protect the public interest.

Lebanon has now a PPP Law that needs to be put into proper implementation. Also, several public utilities need to be privatized, using different schemes such as B.O.T. It is about time to put these utilities under the management and operation of the private sector which is more capable and able to run these activities in a proper, sound and profitable manner. Privatization and PPP schemes would contribute, significantly, to a major reduction in the fiscal deficit and debt positions, mainly by producing immediate proceeds in addition to annual income from the privatized enterprises or from the PPP projects, mainly in the infrastructure sectors.

• Debt Indicators Growth (USD, billion)

Indicator	End May 2019	% Change from end 2018
Gross Public Debt	85.4	0.3
Domestic Debt	53.2	3.1
External Debt	32.1	(4.0)
Public Sector Deposits at Central Bank	3.8	(24.9)
Public Sector Deposits at Commercial Banks	4.9	12.3
Net Public Debt	76.7	1.3

Sources: Ministry of Finance and Central Bank of Lebanon.

IV. Privatization, PPP, Oil and CEDRE Considerations

The privatization and PPP programs are not any more a matter of choice, but rather a matter of urgency and necessity. The proceeds of privatizing most of state-owned enterprises and of carrying out PPP projects has become a fundamental and crucial factor in fiscal consolidation and debt reduction.

In addition, the government of Lebanon should consider the potential oil and gas resources. It should undertake prompt and serious actions in discovering such resources in its regional waters. An "oil and gas" economy, if reached, would position Lebanon on a much different economic and financial path and structure capable of supporting its long-term growth, fiscal stability, sustainable development and wealth creation.

The implementation of "Cedre" commitments by the government is a necessary step to free foreign aid. This means that the government should implement the fiscal, economic and sectoral reforms to support fiscal consolidation, economic growth and sectoral development.

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