# 01

# PART I
# GENERAL ECONOMIC DEVELOPMENTS

# I- WORLD ECONOMY

**1-1** Based on the latest information provided by the IMF, the world growth rate decreased to 3.1% in 2015 compared to 3.4% in the previous year due to the decline in the growth rates in emerging and developing economies as a group, especially the severe deterioration and negative growth in each of the Russian economy (with the drop in oil prices and the sanctions imposed by the West) and the Brazilian economy (that faces recession) and the less severe slowdown in the Chinese economy. It has become evident that the emerging and developing economies contribute lately to more than 70% of world growth based on Purchasing Power Parities (PPP). In return, the recovery in the group of advanced economies was limited in 2015 with a stable growth rate in the US economy and a moderate improvement in the growth of the economies of Japan and the Eurozone , faced by a decline in the economic performance of the United Kingdom and Canada (see schedule below).

**1-2** It is expected that the world growth rate will increase back slightly to 3.2% in 2016 and 3.5% in 2017 with the gradual recovery anticipated in some emerging and developing economies out of the economic distress they are witnessing now, such as Russia and Brazil where negative growth rates were recorded, and some oil-producing countries in the Middle-East, barring economic and political agitations or crises. This despite the expected decline in the Chinese economic activity faced by a slight even insignificant increase in the growth of advanced economies as a group.

**1-3** Based on the same source, there exist three major factors that still control in this period the world economic outlook. First, the gradual slowdown in the Chinese growth with a return of some balance to economic activity through the shift towards consumption and services away from investment and manufacturing industries. This is shown by the fast decline in the import-export activity. The decline in the demand and investment activities in China (and other countries) has repercussions on other economies through world trade channels and the demand for primary commodities especially oil. Second, the decline in energy prices and other commodities and the following pressure on public finances in oil-exporting countries and burden on their economic growth. This decline, however, contributes to a decrease in expenditure on energy and to supporting demand in oil-importing countries. The decrease in oil prices has also major effects on investments in the oil and gas sectors, especially in extracting them, which in its turn affects the activity of the world economy. The third factor is the gradual tightening of monetary policy in the US based on economic developments through an increase in interest rates in light of the prevailing though slow economic recovery. In return, central banks in some of the other major advanced economies, such as the Eurozone and Japan, continue adopting expansionary monetary financial policy to support economic activity and incentivize stimulate growth. The increase in the base interest rates in the US coupled with fears of declining growth in some emerging markets may have negative repercussions on external accounts, capital flows, and exchange rates in some emerging economies. It is to mention that the Federal Open-Market Committee (FOMC) expected lately that the average long-term interest rates will not exceed 3.25 % over the next three years.

World Economic Output growth rate (real GDP) in 2014 and 2015, Estimates for 2016 and 2017 (Percent change)

| | Realized | | Expected | |
|---|---|---|---|---|
| | **2014** | **2015** | **2016** | **2017** |
| **World economy** | **3.4** | **3.1** | **3.2** | **3.5** |
| **Developed countries, o/w:** | **1.8** | **1.9** | **1.9** | **2.0** |
| the US | 2.4 | 2.4 | 2.4 | 2.5 |
| The Euro area | 0.9 | 1.6 | 1.5 | 1.6 |
| Japan | 0.0 | 0.5 | 0.5 | -0.1 |
| Canada | 2.5 | 1.2 | 1.5 | 1.9 |
| United Kingdom | 2.9 | 2.2 | 1.9 | 2.2 |
| **Emerging and developing countries, o/w:** | **4.6** | **4.0** | **4.1** | **4.6** |
| Africa | 5.1 | 3.4 | 3.0 | 4.0 |
| East and Central Europe | 2.8 | 3.5 | 3.5 | 3.3 |
| Commonwealth of independent states CIS, including Russia | 1.1 | -2.8 | -1.1 | 1.3 |
| Russia | 0.7 | -3.7 | -1.8 | 0.8 |
| Brazil | 0.1 | -3.8 | -3.8 | 0.0 |
| **Developing Asian countries, o/w:** | **6.8** | **6.6** | **6.4** | **6.3** |
| China | 7.3 | 6.9 | 6.3 | 6.2 |
| India | 7.2 | 7.3 | 7.5 | 7.5 |
| Middle East and North Africa | 2.6 | 2.3 | 2.9 | 3.3 |
| Central and South America and the Caribbean | 1.3 | -0.1 | -0.5 | 1.5 |

**Source:** WEO report / IMF

### The Middle-East and North Africa (MENA) Region

**1-4** As is the case with the world economy, the growth rate in the MENA region declined reaching 2.3% in 2015 compared to 2.6% in the previous year influenced by the lack of confidence and the mounting uncertainty of the situation resulting from the geo-political developments i.e the political conflicts and the regional security tensions, in addition to the continuation of low oil prices with clear dissimilarity effects of this drop in oil prices on economic activity in oil-exporting and oil-importing countries as shown below. It is expected that the growth rate in this region will increase to 2.9% in 2016 and 3.3% in 2017 due to some possible recovery in the production and export of oil with the possibility of easing conflicts, a decline in the severity of the regional struggles in this area, and the expected improvement in the Iranian economy as its growth rate will increase from zero in 2015 to around 4% in 2016 and 2017.

**1-5** As far as **oil-exporting countries** are concerned, the growth rate slightly declined in the Gulf Cooperation Council Countries (GCC) to 3.3% in 2015 (3.4% in 2014). It is expected that the growth rate for this group will slowdown in 2016 to reach 2.8% in the context of the drop in oil prices and the necessity to reduce public spending and control public finances, with all the resulting impacts on the activity and growth of these countries, despite the attempt to stop the negative repercussions by increasing oil production in some Gulf countries. The decline in oil prices caused major losses in government revenues weakening the general budget and external accounts. After having a budget surplus equal to 2.9% of GDP in 2014, the account became negative representing – 13.2% of GDP in 2015 with the expectation that the overall deficit will reach –12.6% of the GDP in 2016. It is expected for the current account to decline from a surplus of 14.8% of GDP in 2014 to a deficit of –0.2% and –2.5% of GDP in 2015 and 2016 respectively. However, there exist many preventive margins in the form of foreign assets allowing some oil-exporting countries to avoid major public spending cuts and reduce the burden on growth. Countries where preventive margins are low or not available face more urgent needs for fiscal corrections such as applying reforms aimed at diversifying economies away from oil through an improvement in business environment, a stimulus to raise private commercial projects and to increase employment in the private sector.

**1-6** In oil-importing countries however, the situation differed as the growth rate rose to 3.8% in 2015 compared to 2.9% in the previous year. It is expected for the growth rate in these countries to reach 3.5% in 2016 and 4.2% in 2017 as these countries benefit as a group from the fall in oil prices due to an increase in confidence and investment level with the available capacity to achieve economic reforms and control public finances on one hand, and the improvement of the economic growth and performance in the euro area which supports the demand for their products and services on the other. The positive impacts differ among various countries especially for those that suffer from the complications of the security and political struggles in the region.

## II- THE LEBANESE ECONOMY

**2-1** In 2015, the performance of the Lebanese economy was weak as was the case in the preceding four years after the beginning of the bloody strife in Syria, and perhaps the weakest in the last ten years. The real GDP growth rate decreased to 1% compared to 2% in 2014 and 3% in 2013 based on the preliminary available data. The slowdown in economic growth is attributed to the decline in overall demand with the continuation of the political and institutional semi-stagnation and the presidential void since May 2014 which negatively affect the confidence of both consumers and investors causing wait and see attitude in making decisions concerning spending on durable goods and undertaking investment projects. This curtails the size of consumption and investment which constitute the two basic components of GDP. The slowdown is also due to the worsening of the already critical situation in Syria and the regional struggle which affect directly and indirectly tourism, exports, capital flows and foreign direct investment.

**2-2** It could be noticed that the growth rate in Lebanon experienced in 2015 the same declining trend witnessed in the world and the Middle-East region economies but came lower than the world average growth rate (3.1%), the oil-importing countries in the MENA region growth rate (3.8%) and the Arab world growth rate (2.8%). The IMF expects the real growth rate in Lebanon to be 1 % and 2% in 2016 and 2017 respectively. In this context, the improvement in the economic growth in the next period requires a relief in the domestic political situation with the election of a president of republic and the agreement on an electoral parliamentary law in order to restore confidence, revive economic activity, and conduct necessary structural reforms. In addition, there is a need for a decline in the pace of regional struggles as the Syrian conflict has shown the degree of its long term influence on the Lebanese economic outlook.

GDP, current account, growth & inflation rates

| | 2013 | 2014 | 2015 |
|---|---|---|---|
| Real Growth rate (%) | 3.0 | 2.0 | 1.0 |
| Change of the consumer price index (average per annum) (%) | 4.8 | 1.9 | - 3.7 |
| GDP Deflator (%) | 5.3 | 2.8 | 1.4 |
| GDP (LBP billion) | 71,185 | 74,714 | 76,518 |
| GDP (USD billion) | 47.2 | 49.6 | 50.8 |
| Balance of Payments (USD billion) | - 1.1 | - 1.4 | - 3.4 |

**Sources:** Central Administration of Statistics (CAS) - IMF.

**2-3** The available economic indicators in 2015 registered either a decrease or a slowdown in the pace of their improvement in comparison to their levels and performance a year earlier, thus reflecting the weak general economic activity in Lebanon that is influenced by the domestic and regional existing situation. We cite some of these following indicators:

- The decrease in cleared checks value by 6.6%, usually reflecting a decline in spending size or aggregate demand, which indicates especially the weak activity in trade and construction sectors. It is to mention that this decline in cleared checks value partly implies the decrease in some internal and external prices as mentioned in more than one place in this report.

- A decrease in 2015 in each of construction area permits by 8.9%, real estate fees by close to 9.4%, the number of real estate sales operations by 10.5%, and the delivered quantities of cement by 8.6%, all pointing out to a decline in the performance of real estate and construction sector.

- A decrease in each of exports of goods quantities by 13.2% and in their value by 10.9% in 2015, and a decline in the value of industrial exports by 11.2 % in the same year. The value of agricultural exports decreased as well by 6% with the increase in transport and insurance cost due to the war in Syria and the regional developments. This also indicates the decline in the performance of the agricultural and industrial sectors.

- A decline in the number of KAFALAT loans granted to small and medium enterprises, especially those operating in the agricultural and industrial sectors by 19.2% in 2015. Their value also decreased by 14.8% in the same year which also reflects the decline in the mentioned sectors as well the investment spending in them.

- The increase in imports of goods quantities by only 1.6% in 2015 as an indicator of the weak household consumption and the production of goods, services and investment. The value of imported goods declined by 11.8% in the mentioned year.

- An apparent improvement outside the general framework is recorded in tourism activity reflected by the increase in incoming passengers via Beirut Airport by 9.1% and the outgoing ones by 10.7%, and the increase in the number of tourists arriving to Lebanon by 12.1% in 2015, knowing that more than one third of them are from Arab countries. Additionally, hotel occupancy rates in Beirut increased to 56% in 2015 compared to 52% in 2014. It is to mention that the airport activity includes a large number of Syrian and Iraqi refugees.

- An improvement in BDL coincident indicator by only 2% in 2015 (+ 3.2% in 2013 and 2014) which is in line to a certain extent with the low economic growth and the performance of the economic indicators mentioned above.

  It is noticed that the economic indicators available for the first four months of 2016 improved when compared to the same 2015 period which we hope will be generalized over the full current year.

**2-4** The weak economic performance along with the decrease in prices in general, in addition to the drop in world oil prices impacted the public finances especially the growth of government revenues that increased outside the revenues from the telecom and treasury operations by only 0.6% in comparison to 2014[1]. Without such exclusion and considering total figures as they are and comparing them with 2014 figures (including sums of previous years as mentioned above), the total revenues from budget and treasury operations would have declined by 12%.

**2-5** In return, the decrease in the price of oil derivatives and oil bill contributed to the decrease in the costs of the Electricité Du Liban (EDL) by close to USD 1 billion in 2015, which had to lead to an important decline in government expenditure had it not been for the increase in other expenditures, for different reasons, and debt service due to the policy of managing public debt emphasizing issuing long-term bills with relatively high yields compared to short-term bills, and for other reasons related to country risk and monetary stability. It is also to mention the non -apparent burden of the Syrian refugees on public finances especially the presence of 1.5

1 We excluded from this comparison, for the sake of precision, the revenues from the telecommunications because starting January 2015, the telecom figures that are represented in the fiscal performance are the actual transfers from the Ministry of Telecom to the treasury account at BDL, whereas in the previous years, these figures were the one estimated by the Ministry of Telecom (MOT) or the Ministry of Finance (MOF). The revenues from telecom in 2014 practically included large sums dating back to previous years that were collected during that year. Thus, comparing 2015 and 2014 in this respect becomes imprecise and misleading. We also excluded resources in the treasury transactions due to collecting arrears from the Ministry of telecom in 2014, out of which part is for the municipalities, whereas the issue differs concerning the funds of the municipalities in 2015.

million Syrian refugees causing the increase in demand on public services such as health, education, electricity, transportation and others rising pressures on public expenditure. Accordingly, total expenditure from budget and treasury operations declined by only 2%.

**2-6** Ultimately, public deficit increased to 7.8% of GDP in 2015 from 6.2% in the previous year, whereas the primary surplus represented only 1.4% of GDP compared to 2.6% in the two years respectively, so that the deficit to GDP ratio remains one of the highest in the world. It could be noticed from analyzing the figures that the performance of public finances in 2015 as in the preceding year did not help reduce the occurring economic slowdown but it could have contributed to happen.

**2-7** After having stabilized at 134% in the previous two years, the debt to GDP ratio increased to 138.5% in 2015 with public debt growth by 5.6% exceeding in this year the nominal GDP growth. Thus, the arrangements to control public finances in Lebanon, activating the economic activity and stimulating growth are some of the priorities for sustainable growth over the long term and for turning the trend of public debt into a declining one. There is also a need to shift public expenditure more towards capital expenditure along with the implementation of structural reforms, such as limiting waste, tax evasion and corruption, all are measures conducive for economic growth on a large scale.

**2-8** In return, the monetary authorities pursued in 2015 the policy of stability, and stimulating economic growth and controlling inflation which registered a negative rate of around 3.7% in the mentioned year due to the slowdown in economic activity, and the drop in imported commodities prices, especially oil derivatives. The monetary authorities, in coordination with the Ministry of Finance and banks, have sought to preserve monetary stability which constitutes the principal goal of monetary policy in Lebanon, for what it represents as a benefit to the banking sector, the economy and the social situation. The BDL, in cooperation with the banking sector, was able to preserve a high level of foreign currency reserves reaching USD 30.6 billion at the end of 2015, excluding its investments in Lebanese Eurobonds and other international securities. Monetary policy also contributed to the support of economic activities by making available economic incentive packages, to involve banks in lending programs that encourage the private sector to invest at low cost in productive sectors and thus create new job opportunities and provide the necessary financing to launch new small and medium size enterprises to activate the economy. The BDL continued to launch these incentives for the fourth year in a row with their amount reaching around USD 1.0 billion in 2016.

**2-9** The decline in the external sector in 2015 had a negative effect on growth and economic activity, as Lebanon did not benefit as was supposed from the oil bill decrease and thus from the contraction in the merchandize trade deficit. In 2015, net exports (exports minus imports), one component of aggregate demand declined after its stability in the previous year. The value of imports decreased by 11.8% and of exports by 10.9%. And despite the decrease in the merchandize trade deficit by around USD 2 billion, the balance of payments recorded a noticeable deficit in 2015 to reach USD 3.4 billion compared to a lower deficit of USD 1.4 billion in 2014, as a sign that the net financial inflows to Lebanon decrease significantly in 2015 compared to the previous year.

**2-10** The banking sector activity as expressed by the growth of total assets of banks operating in Lebanon remained acceptable in 2015 despite its slowdown compared to the previous year. The total balance sheet of banks grew by 5.9% and customer deposits by 5% which provide the main source of the sector resources constituting 83.3% of the total balance sheet. The deposit increase is still sufficient to cover the financing needs of the economy in its public and private sectors. This is specifically due to the increase in resident deposits that accounted for more than three-fourth of total growth of deposits in 2015. Banks as well contributed to the functioning of the economy in as much as possible by increasing loans to the resident private sector which increased by 5.9% constituting with loans to the public sector close to 170% of GDP. The indicators of liquidity and capital solvency remained at their adequate level to protect the interests of depositors and investors simultaneously.

**2-11** At the end of the section on the Lebanese economy, it is necessary to recall three issues: First, the importance of the partnership between the public and private sectors according to transparent fundamentals to invest the large abilities of the private sector in areas of development that the economy needs, such as the sectors of telecommunication, transportation, water, and energy that require large investments and the availability of the domestic and regional political environment conducive for these investments. Second, the need to develop policies and measures aimed at reinforcing the competitive advantages of the Lebanese goods and find new markets for them. Third, reviving the vital and strategic oil file for the future of Lebanon as passing the decrees of oil and gas are to be priorities. The issue of extracting them in Lebanon is waiting for the political agreement despite the contribution of potential revenues resulting from them in revitalizing the economic and financial situation in the country, raising government revenues, and reducing the production cost in all productive sectors such as electricity, industry and transport. It is not possible also to disregard the negative effects resulting from the political maneuvering and the continuing delay in the drilling and extracting of oil, and thus prolonging the period of not benefitting from its revenue especially when the prices of oil derivatives rise again.

# III- PUBLIC FINANCES AND PUBLIC DEBT

**3-1** The public finances situation deteriorated in 2015 compared to the preceding year. Public deficit recorded LBP 5,958 billion or 7.8% of GDP compared to a deficit of LBP 4,632 billion (6.2% of GDP) in 2014, which is, however, less than the deficits that have approached 9% of GDP during the period 2006-2014. The realized primary surplus declined in 2015 to LBP 1,092 billion (1.4% of GDP) from LBP 1,970 billion achieved in 2014 (2.6% of GDP).This is due to many factors specifically the bolstering of the Treasury by the exceptional revenues from telecom dating back to many previous years, which contributed to achieving the results of 2014, whereas the results of 2015 only included yearly revenues from telecom. This partly explains the deterioration of the condition of public finances whereas the other part of the decline is related to the general slowdown in economic activity in the country and other issues detailed below.

Public Finances 2013 – 2015 (LBP Billion)

| | 2013 | 2014 | 2015 | Change (%) 2014/2013 | Change (%) 2015/2014 |
|---|---|---|---|---|---|
| Total Revenues (Budget +Treasury) | 14,201 | 16,400 | 14,435 | 15.5 | -12.0 |
| Total Expenditures (Budget + Treasury) | 20,563 | 21,032 | 20,393 | 2.3 | -3.0 |
| Overall Deficit | 6,362 | 4,632 | 5,958 | -27.2 | 28.6 |
| Primary Surplus | -361 | +1,970 | -1,092 | | |
| Overall Deficit / GDP % | 8.9 | 6.2 | 7,8 | | |
| Primary Balance / GDP % | -0.5 | 2.6 | 1,4 | | |

**Source:** Ministry of Finance.

**3-2** Total revenues decreased from LBP 16,400 billion in 2014 to LBP 14,435 billion in 2015 or by LBP 1,965 billion and by 12%. Such a drop in government revenues would be less sharp if we exclude from the revenues collected in 2014 the exceptional revenues from telecom for the period 2010-2013 which reached LBP 1,636 billion. The decline in revenues was also caused by the weak economic growth as was the case in the previous year and from the decrease in revenues from the value-added tax, especially with the fall in world oil prices. Based on that, the revenues would have declined to 18.9% of GDP in 2015 compared to 22% in the previous year and 22.4% on average during the period 2006-2014. This share is considered low in Lebanon due to the existing tax structure and tax evasion.

**3-3** There was a decline in 2015 in the tax revenue (- 0.5%), the non-tax revenue (-24.1%) and the treasury receipts (- 51.7%). The share of each out of total revenues constituted 71.6%, 22.9% and 5.5% respectively. The slight decline in tax revenue is caused by the decline in tax revenue on built properties (-5.3 %), and domestic taxes on goods and services (-2.5%), knowing that the revenues from the value-added tax (VAT) representing the primary source for the treasury decreased also by 4.3% affected largely by the decline in oil prices. Revenues from customs declined by 6.9% knowing that excises on energy products increased by 22.9% as larger quantities were imported in 2015 due to the decline in world oil prices, in addition to the measures applied effective January 2015 causing an increase in the excises on gasoline. This deterioration was compensated for, though by a partial amount, by the increase in the revenues from taxes on income, profits, & capital gains (+3.3 %) and other income taxes.

Total Revenues (LBP Billion)

| | 2013 | 2014 | 2015 | Share (%) |
|---|---|---|---|---|
| Taxes on income, profits and Capital gains | 2,502 | 2,795 | 2,887 | 20.0 % |
| *o/w: Tax on interest income* | *660* | *711* | *767* | *5.3 %* |
| Taxes on Property | 1,201 | 1,245 | 1,179 | 8.2 % |
| Domestic Taxes on Goods and Services | 3,782 | 3,811 | 3,717 | 25.7 % |
| *o/w: VAT* | *3,296* | *3,302* | *3,159* | *21.9 %* |
| Taxes on International Trade | 2,158 | 2,042 | 2,064 | 14.3 % |
| *o/w : Customs* | *817* | *766* | *713* | *4.9 %* |
| *Gasoline* | *483* | *512* | *629* | *4.4 %* |
| Other Tax Revenues | 473 | 495 | 483 | 3.3 % |
| **Tax Revenues** | **10,116** | **10,388** | **10,330** | **71.6 %** |
| Income from public institutions and Government properties | 2,518 | 3,498 | 2,313 | 16.0 % |
| *o/w : Transfer from the telecom surplus* | *2,156* | *3,034* | *1,860* | *12.9 %* |
| Other non-tax revenues | 751 | 856 | 992 | 6.9 % |
| **Non-tax revenues** | **3,269** | **4,354** | **3305** | **22.9 %** |
| **Treasury receipts** | **816** | **1,658** | **800** | **5.5 %** |
| **Total Revenues** | **14,201** | **16,400** | **14,435** | **100.0 %** |

**Source:** Ministry of Finance.

**3-4** Total expenditures decreased by 3% i.e by a lower scale than the decline in receipts reaching LBP 20,393 billion in 2015 compared to LBP 21,032 billion in 2014 and representing 26.7% of GDP in comparison to 28.2% in 2014 and 31.2% on average for the period 2006-2014. It is shown thus that the degree of benefitting from the decline in the oil bill due to the fall in oil prices was limited, viewing the structure of actual expenditures and its lack of flexibility, and the semi-paralysis in introducing structural reforms on the expenditure item and in approving the draft general budget and due to the pressing economic situation and the need to ensure fiscal and monetary stability through the policies of interest rates, maturities and the financial engineering process currently existing.

**3-5** Primary expenditures (excluding the debt service) declined to LBP 13,343 billion in 2015 from LBP 14,430 billion in 2014 or by 7.5%. The decline comes mainly from the decrease in transfers to the Electricity of Lebanon Company (EDL) by an amount of LBP 1,446 billion and thus the cost of subsidizing electricity declined to 2.2% of GDP in 2015 compared to 4.3% in 2014, while stressing that the implications of the decline in oil prices took effect in the second half of 2014. In contrast, the salaries, wages and related benefits of public sector employees increased by 5.2% between 2014 and 2015 with an increase in basic salaries and benefits to particular groups of these employees. The salaries and allowances in the public sector as percent of GDP constituted 9.3% in 2015. The size of capital spending approximately stabilized in 2015 to represent 1.2% only of GDP.

**3-6** In contrast, an increase in debt service by 6.8% was recorded coming mostly from interest payments on domestic debt reaching LBP 7,050 billion from LBP 6,602 billion in 2014. The issuance of long-term Treasury bills at relatively high interest rates in consistency with long maturities and risk type contributed to the increase in debt service which constituted 34.6% of total expenditures and 48.8% of total revenues in 2015. It is to mention that interest rates in Lebanon are determined for the medium and long-terms by the developments in risk premium and public finances, and the speed of economic activity. The ability of the public sector to finance debt service remains connected to the robustness of the bank deposits base and the will of the financial sector in continuing to purchase sovereign bonds, knowing that this connectedness represents a structural weakness and is partly the result of the lack of development of financial markets in the desired form.

Total expenditures (LBP Billion)

| | 2013 | 2014 | 2015 | Share (%) |
|---|---|---|---|---|
| Debt Service | 6,001 | 6,602 | 7,050 | 34.6 % |
| Primary Expenditures | 14,562 | 14,430 | 13,343 | 65.4 % |
| *o/w salaries, wages and other benefits (art.13)* | *6,473* | *6,727* | *7,080* | *34.7 %* |
| *transfers to EDL institution* | *3,056* | *3,157* | *1,711* | *8.4 %* |
| *Capital expenditures* | *987* | *883* | *888* | *4.4 %* |
| **Total Expenditures** | **20,563** | **21,032** | **20,393** | **100.0 %** |

**Source:** Ministry of Finance.

**3-7** As far as the budget draft of 2016 is concerned, it was sent by the Minister of Finance to the Council of Ministers during the constitutional period before the end of August 2015. The draft included an introductory report presenting the financial and economic facts and the orientation towards getting new revenues, and included an estimate of deficit ratio and the way to treat it. Expenditures for the mentioned year were estimated at LBP 23,200 billion (excluding the cost of the salary scale), and revenues at LBP 16,500 billion with an estimated deficit of around LBP 6,700 billion. Thus, the ambition has become to adapt with the declining growth rate and preserve the deficit ratio awaiting the passing of the draft budget postponed since 2005. For information, the increase in expenditures since 2005 was not matched by a similar increase in tax and non-tax revenue collection, due to the non-passage of tax laws and additional fees, given that there is a need to pursue activating collection and combating tax evasion.

It is to mention that the actual cost of the Syrian exodus on public finances is not clear based on the information of the Ministry of Finance despite many reports mentioning the burden of the exodus on public finances and its worsening in the latest period. This burden results from many issues especially the use of infrastructure such as roads, electricity, water, communications, schools and hospitals as mentioned before. Estimates indicate that the losses of Lebanon resulting from the Syrian war exceeded USD 12 billion in addition to the increase in the unemployment rate for some social groups.

At the end, we emphasize that it is required to take practical measures to pass the general budgets and reestablish the balance to government expenditure, from current to capital spending, and combat tax evasion, corruption, and wasted resources, and reform the retirement system.

**Treasury Bonds issues in LBP and foreign currencies**

In 2015, the Ministry of Finance issued Eurobonds in the amount of USD 3.8 billion distributed as follows:

**February:** bonds issued in the amount of USD 2.2 billion: USD 800 million at 6.20% coupon rate maturing in 2025 and bonds in the amount of USD 1,400 million at 6.65 % coupon rate maturing in 2030.This issuance comes after the passing of expedited Law no. 14 dated 11 November 2014 allowing the government to issue Eurobonds in foreign currencies for an amount not exceeding the equivalent of USD 2.5 billion.

**November:** Issuance of Eurobonds in the amount of USD 1.6 billion, out of which around USD 318 million for exchange from Eurobonds in the amount of USD 750 million issued in 2005 at 8.5% coupon rate. The exchange was distributed among bonds of 9 and 13 years categories, whereas the new issuance in the amount of USD 1.28 billion (out of which USD 600 million for the BDL) included a new bond with a maturity of 20 years. We point-out that expedited Law no. 36 dated 24 November 2015 allowed the government to issue Eurobonds of an amount not to exceed USD 3 billion, on condition to be used in the framework of restructuring of public debt.

**In January 2015,** the Ministry of Finance issued long-term Treasury Bills in LBP as part of a medium-term strategy to manage public debt for the period 2014-2016. These bills are added to the regular issuance of the short-term categories. The subscription of banks was concentrated in long-term securities due to their relatively high yields and the existence of a high level of liquidity at their disposal.

| Bills category | Months of issue | Yield |
|---|---|---|
| 7 years | February-April-June-August-October-November | 7.08% |
| 10 years | January-March-May-July-September-October December | 7.98% (first issue)<br>7.46% (other issues) |

It is to mention that the Ministry of Finance exchanged in January 2016 maturing Eurobonds of around USD 432 million in the framework of an agreement with BDL. This issuance was distributed among two tranches, the first in the amount of USD 38.5 million added to the bonds maturing in November 2024 at 6.25% coupon rate and the second in the amount of USD 393.2 million added to the bonds maturing in 2028 at 6.65% coupon rate. It also finished on 20 April 2016 the issuance of Eurobonds in the amount of USD 1 billion distributed among USD 700 million maturing in 2024 at 6.65% coupon rate and USD 300 million maturing in 2031 at 7.0% coupon rate. It also kept in the first months of 2016 issuing long-term bills in LBP to be added to the regular issuances. It issued bonds of the 7 years category in January and March, and of the 10 years category in February and April, and issued for the first time in March bonds of the 15 years category.

### Public Debt

3-8 Public debt increased to LBP 106,011 billion (the equivalent of USD 70.3 billion) at the end of 2015 from LBP 100,356 billion (USD 66.6 billion) at the end of 2014, thus recording an increase of 5.6% in 2015 in comparison to 4.9% in 2014. And since growth rate of public debt exceeded the growth rate in nominal GDP, the ratio of debt to GDP increased from 134.3% at the end of 2014 to around 138.5% at the end of 2015. This manifests itself in the necessity to reform public finances and multiply the efforts to activate the economy and stimulate growth as the high level of public debt conceals severe consequences and high costs especially that interest payments currently exhaust two-thirds of tax revenues and more than 9% of GDP.

3-9 However, when market debt is computed, i.e debt excluding the holdings of the BDL, public institutions, bilateral and multilateral debt, and debt of Paris 2 and Paris 3, the debt to GDP ratio decreased to 89.9% at the end of 2015 compared to 90.2 % at the end of 2014.

3-10 Net public debt computed after deducting the public sector deposits in the banking system, reached LBP 92,784 billion (USD 61.5 billion) at the end of December 2015, recording an increase of 7.4% compared to 7.7% increase in 2014 as the state used part of its deposits and accounts at the BDL to finance part of its expenditures. Thus, public sector deposits at the BDL decreased from LBP 9,123 billion at the end of 2014 to LBP 8,154 billion at the end of 2015 or by an amount of LBP 969 billion after having decreased by LBP 1,909 billion in the previous year. The state account at the BDL remains positive, which allows the financing of future deficits in case capital/cash inflows from abroad in the form of bank deposits and others slowed down or were reduced.

3-11 At the end of 2015, **local currency public debt** reached LBP 65,195 billion constituting around 61.5% of total public debt as at the end of 2014 compared to around LBP 40,816 billion of **foreign currency public debt** or 38.5% of total public debt. It is to mention that the distribution of debt and its concentration with resident subscribers reduces its risks since those subscribers are more tolerant to actual risks given that they are accustomed to the country's political, economic and security conditions.

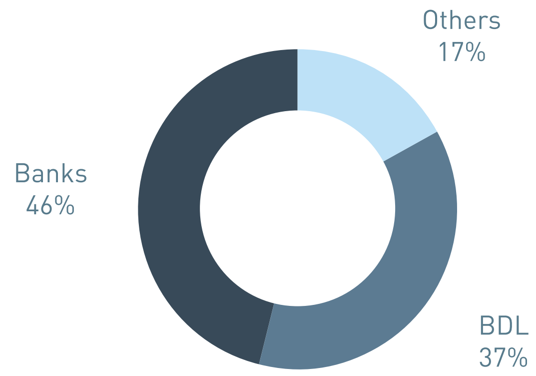
Public debt 2013-2015 (End of period – LBP billion)

| | 2013 | 2014 | 2015 | Change (%) 2014/2013 | Change (%) 2015/2014 |
|---|---|---|---|---|---|
| **Gross Public Debt** | **95,710** | **100,356** | **106,011** | **+ 4.9** | **+ 5.6** |
| **Distribution of total public debt:** | | | | | |
| - Debt in LBP | 56,312 | 61,752 | 65,195 | + 9.7 | + 5.6 |
| - Debt in Foreign Currencies | 39,398 | 38,604 | 40,816 | - 2.0 | + 5.7 |
| Deposit of the Public Sector at the Banking System | 15,495 | 13,965 | 13,227 | - 9.9 | - 5.3 |
| **Net Public Debt** | **80,215** | **86,391** | **92,784** | **+ 7.7** | **+ 7.4** |
| **Gross Public Debt Financing: estimates (%)** | | | | | |
| Banks in Lebanon | 59.0 | 55.9 | 53.3 | | |
| Central Bank (BDL) & Public Entities | 26.5 | 28.5 | 33.5 | | |
| Others (resident) | 4.7 | 5.1 | 4.4 | | |
| Non-residents | 9.8 | 10.5 | 9.0 | | |
| *o/w : bilateral & multilateral loans* | *4.8* | *4.4* | *3.5* | | |
| Others | 5.0 | 6.1 | 5.5 | | |

**Source:** BDL

**3-12** As far as **financing local currency public debt,** the share of banks decreased to 45.8% at the end of 2015 from 51% at the end of 2014 faced by an increase in the share of BDL to 37.3% from 32.2% for the two mentioned dates respectively and the share of the non-banking sector stabilizing at 16.9%. This is due to the weak turnout of banks to subscribe to Treasury-bills of 3 months to 5 years category in favor of ones of seven to ten years category and the satisfaction to a certain extent in renewing maturities. The BDL supplied the shortage when needed intervening by buying the excess supply to create market balance, knowing that the IMF has advised the BDL a while ago on the necessity to reduce the intermediary role between the banks and the state.

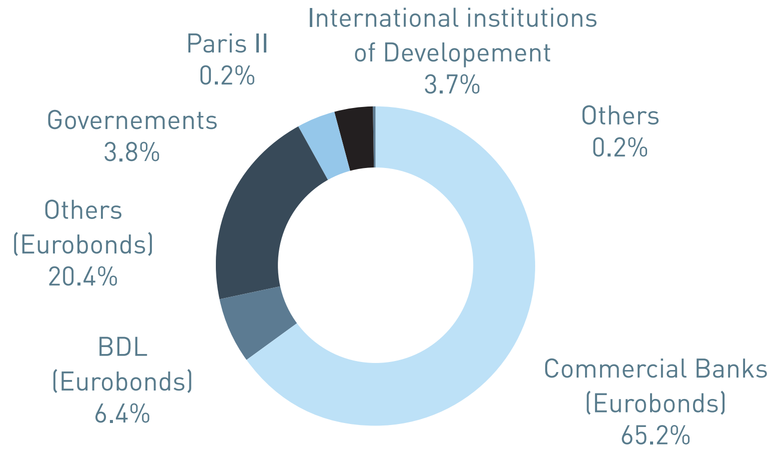
**Sources of financing local currency debt end 2015**




**Source:** BDL

**3-13** As far as **financing foreign currency public debt,** the share of banks in the portfolio of Eurobonds increased by USD 1,335 million in 2015 reaching USD 17,645 million at the end of the mentioned year compared to USD 16,310 million at the end of 2014. This is due to benefitting from the two laws that permit borrowing in foreign currency. The portfolio held by banks had decreased by USD 1.3 billion in 2014 due to maturing amounts exceeding subscription in these bonds and the absence of a law allowing borrowing. The share of banks in financing foreign currency debt increased from 63.7% at the end of 2014 to 65.2% at the end of 2015 given that it had registered 67.3% at the end of 2013.

**Sources of financing foreign currency debt end 2015**




**Source:** BDL

**3-14** The weighted average interest rate on the total portfolio of Treasury-bills in LBP stabilized generally during 2015 compared to the previous year and registered the following in the last issuance of the year: 4.44% for the 3-month category, 4.99% for the 6-month category, 5.35% for the 12-month category, 5.84% for the 24-month category, 6.50% for the 36-month category and 6.74% for the 60-month category. The yield on the 84-month category registered 7.08% falling from 7.50% from its last issuance. The yield on Bills of the 120-month category stood at 7.46% compared to 7.98% on the preceding issuance of the same category.

**3-15** Due to the developments in the Treasury bills market, the weighted average interest rate on the LBP Treasury bills portfolio increased to 6.94% at the end of 2015 from 6.89% at the end of 2014. The weighted average life of the portfolio increased to 1,222 days (3.4 years) from 1,193 days (3.3 years). Whereas in the Eurobonds market, the weighted average interest rate on this portfolio increased from 6.40% to 6.44%. The weighted average life on this portfolio increased from 5.35 years to 6.09 years in the two consecutive dates.

# IV- MONETARY POLICY DEVELOPMENTS

**4-1** The monetary situation recorded a solid performance in 2015 despite the difficult and critical economic and political conditions. It remained stable to a great extent and differed from the weak economic performance experienced since 2011. The monetary authorities were once again, in cooperation with the Ministry of Finance and the banks, able to achieve monetary stability that represents the principal goal of monetary policy in Lebanon. What helped in this respect, in addition to the confidence in the central bank which is tied to many factors especially the high level of BDL's foreign assets, is the continuous inflow of capital and growth of deposits though in a slow manner but in adequate sizes, supported by the remittances of Lebanese working abroad, to finance the needs of the country and preserve a high level of foreign reserves. Two additional factors also helped reflected in the passage of the law[2] that allows the government to raise the ceiling of new borrowing in foreign currency which reduced the reliance on the BDL to provide these currencies, along with the lower energy bill due to the drop in world oil prices. However, the significant decrease in the capital inflows to Lebanon in 2015 caused a large deficit in the balance of payments that negatively affected the gross reserves of the BDL in foreign currency.

The BDL took in 2015 many measures and made financial engineering dealings detailed in the next sections which helped it preserve its gross foreign currency reserves, control liquidity levels, and preserve the stability of the LBP interest rates.

**4-2** The monetary policy adopted in Lebanon is specifically directed to support tying the exchange rate of the LBP to the USD, which helped (and still is) secure confidence as well as financial, economic and social stability. Thus, the main priority of the BDL is to preserve an appropriate level of foreign currency reserves. In addition to the efforts spent to preserve the credibility of the peg, the BDL worked in a parallel and increasing manner at providing support for the government and the economy. It provided in the last years a stimulus package to the private sector approaching USD 4.5 billion represented specifically in pumping liquidity at low interest

2 The parliament passed in November 2014 Law no. 14/2014 allowing the government to issue Eurobonds in an amount not exceeding USD 2.5 billion. This also applies to 2016 as the parliament issued in November 2015 law no. 36/2015 that allowed the government to issue Eurobonds in an amount not exceeding USD 3 billion.

rates to banks to be relent to households and companies at a time when the economy registers low economic growth rates, in addition to the available mechanisms that provide incentives to banks by allowing them to use required reserves. Thus, the BDL has been practicing a non-conventional monetary policy aiming clearly at supporting economic growth and creating employment opportunities.

**4-3** The biggest challenge for the monetary situation in the next period may be the continuing trend of the slowdown in deposit inflows to Lebanon especially in the presence of many factors pressuring in this direction and toward an increase in the cost of financing, among which: competition among the regional markets to attract capital which will increase with some countries resorting to market borrowing and others to increasing their indebtedness, the contractionary effects of the decline in oil prices and the slowing of economic growth in the Gulf countries and other countries where Lebanese work on the size of remittances to Lebanon, the ongoing regional disturbances and the deterioration in the internal political environment, the delinquency in the governmental performance in managing the economic and social affairs of the country in addition to not conducting the necessary reforms in public finances. All these factors are conducive to the decline in the willingness of investors to be exposed to the risks of Lebanon. Despite this, the monetary situation remains immune to a great extent due to the high liquidity of the banking system which should be preserved as a major factor of immunity and as a sign of commitment to the macro-financial stability.

**4-4 Monetary situation: stable foreign exchange market, high level of BDL's reserves, and stable interest rates**

The foreign exchange market proved one more time in 2015 its immunity in the face of existing challenges, backed especially by an adequate level of BDL foreign currency reserves, as it did not witness any significant pressure during that year but remained overall stable due to the equilibrium between demand and supply. The interbank rate remained for the most at or close to its official level of 2.75%; this was accompanied by the availability of liquidity in LBP as the deposits of the private sector in LBP at commercial banks increased in 2015 by a larger amount than its increase in the previous year[3].

The BDL was able to preserve a high level of foreign currency reserves despite their slight decline to around USD 30.6 billion at the end of 2015 compared to USD 32.4 billion at the end of 2014, excluding its placements in Lebanese Eurobonds and other international securities that have increased, according to our estimates, to USD 6.5 billion at the end of 2015 in comparison to USD 5.5 billion at the end of 2014. Additionally, the Central Bank holds a large stock of gold reserves, ranking it as 19th internationally and as 2nd in the MENA region in terms of country reserves according to the list published by the "World Gold Council" in March 2016, knowing that the value of the gold reserves of Lebanon decreased to around USD 9.8 billion at the end of 2015 in comparison to around USD 11 billion at the end of 2014 with the decline in gold prices over the two mentioned dates due to weak demand. As it is known, foreign currency and gold reserves are some of the most important elements supporting confidence in the national currency. The foreign currency reserves held by the BDL are considered adequate to defend the value of the LBP against the USD and face any crisis that may occur, based on the acknowledgement of the most important international financial institutions.

3 Private sector deposits increased by LBP 5,609 billion in 2015 in comparison to LBP 5,123 billion in 2014.

On another level, interest rates remained stable on all categories of Treasury bills in LBP up to five years, while the interest rates on longer-term bonds were reduced for one time only at the beginning of 2015 to remain stable afterwards until the end of the mentioned year. Additionally, interest rates on the Eurobonds issued in 2015 (and until April 2016) were low compared to those issued by countries with the same risk classification of Lebanon.

### 4-5 Preventive operations mainly maturity extensions... for market easing

The monetary and fiscal authorities have taken in the last few years several preventive or precautionary measures among which are operations consisting of extending maturities, aiming at not keeping large amounts in LBP and foreign currency mature in a relatively short period, and alleviating the pressure on BDL's foreign currency reserves. In this context, we mention that the BDL allowed banks to subscribe to Eurobonds issued in February 2015 through USD CDs shortly maturing[4], which does not put pressure on their liquidity in foreign currency. On another hand, the issuance of Eurobonds in February 2015 - the largest historically- was used to finance part of the government obligations in foreign currencies for the remaining period of the year. In the same context, the BDL allowed banks to replace Eurobonds maturing in June and August 2015 (USD 500 million in each of the mentioned months) with CDs in USD for 10 or 15 years for many reasons among which to alleviate the pressure on its foreign currency reserves primarily and to absorb the ensuing liquidity. It is worth mentioning also that the Ministry of Finance issued in November 2015 Eurobonds aimed partly at replacing some of the ones maturing in 2016[5], and that the BDL allowed banks to subscribe in long-term Treasury Bills either in cash or through discounting the CDs in LBP issued by the BDL and shortly maturing[6].

### 4-6 Deposits of Banks in foreign currency at the central bank, among which CDs in USD...to reinforce BDL's reserves

Bank deposits in foreign currency at BDL are composed of required deposits, free deposits that are often remunerated at a higher interest rate than those placed abroad, and CDs issued by the BDL. These deposits reinforce to a great extent BDL's foreign currency reserves and help the central bank to manage its liquidity, and constitute thereby the basis of monetary stability which means the basis of the stability of the LBP purchasing power.

These deposits increased in 2015 by around USD 3 billion according to our estimates - i.e. by a lower amount than its significant increase in 2014[7] – and were one of the main factors that reinforced BDL's foreign currency reserves in 2015. Some of these deposits took the form of Repo on CDs. The BDL launched at an earlier time a new financial engineering measure establishing a platform to operate in short-term deposits up to six months. It is a Repo operation at interest rates reflecting the USD interbank rate[8] in the Beirut market, where interest rates are determined by the BDL to remain under control.

4 Euro- CDs issued by the BDL in April 2005 and maturing in April 2015. In fact, the portfolio of Euro-CDs declined by USD 500 million in February 2015.

5 Around USD 318 million.

6 Which also reduces slightly the cost of the CDs in LBP (on BDL) and prevents withdrawing additional liquidity from the market.

7 These deposits increased in 2014 by over USD 7 billion based on our estimates and were the main factor that reinforced the BDL foreign currency reserves in that year. The BDL implemented in 2012 and 2013 swap operations of part of its portfolio of LBP Treasury Bills with Eurobonds, followed by selling Eurobonds to banks in 2013 in an amount estimated at USD 4.5 billion which contributed to a great extent in reinforcing the BDL's FC reserves in 2013.

8 There are also Repo operations in LBP.

CDs in USD[9] issued by the BDL are included in foreign currency deposits. In 2015, the BDL kept issuing CDs in USD in an amount close to USD 3 billion based on our estimates, i.e. by a larger amount than those issued in 2014, against a lower amount of maturing CDs[10]. Thus, the portfolio of CDs in USD slightly increased to USD 9.1 billion at the end of 2015 from USD 7.8 billion at the end of 2014. It is to note that the BDL issued in 2015 for the first time CDs for 15, 20, and 30 years that have received adequate demand.

### 4-7 Certificates of Deposits in LBP... to control liquidity and maintain interest rates stability in LBP

The portfolio of CDs in LBP issued by the BDL and held by banks recorded a significant increase to reach LBP 34,697 billion at the end of 2015 from LBP 29,675 billion at the end of 2014. This increase came after it declined in 2014 knowing that 2015 and 2014 witnessed large issuances of CDs in comparable amounts whereas maturing CDs in 2015 were nearly non-existent[11] but were in large amounts in 2014. Consequently, the portfolio increased in 2015 and declined in 2014.

The new issuances in 2015 were concentrated in long-term categories in addition to relatively limited volume of the 45 and 60 days categories. It is worth noting that the BDL started since March 2015 issuing 20 year CDs in LBP at an interest of 8.32% and 30 year CDs in LBP at an interest of 9%. The purpose of such long-term issuances is to manage liquidity better, to extend the yield curve, and to develop financial markets. The monetary authorities see that issuing long-term CDs is considered the first principal step to extend the yield curve and would help promote the issuance of longer-term TBs by the treasury.

The issuance of the CDs allowed the BDL to control the financial sector's liquidity in LBP among which the liquidity resulting from monetizing debt in LBP and also helped to maintain interest rates stability in LBP, of which on Treasury Bills (for categories less than 7 years).
In this context, it is to mention that in a positive step aimed at motivating banks to subscribe more in the treasury bills with maturity shorter than 7 years, and thus to reduce the intervention of the BDL in the TBs primary market, the BDL lowered in April 2014 the interest rates on long-term CDs by 26 basis points as shown in the table below. For the same reason and in order to promote lower interest rates on long-term Treasury Bills (7 years and above) that are being issued regularly since the first month of 2015, the BDL one more time reduced the interest rates on the CDs between 26 and 92 basis points as per the table below to remain afterwards stable until the end of 2015.

9 In their usual form.
10 Maturities or swaps mostly the remaining part of the Euro-CDs issued by BDL in 2005.
11 The CDs issued in 2010 were mainly from the 7-year category and not the 5-year category.

Interest Rate cut on CDs in LBP- By category

| | 45-day | 60- day | 7 - year | 8 - year | 10 - year | 12 - year |
|---|---|---|---|---|---|---|
| **January-March 2014** | 3.57 % | 3.85 % | 7.6 % | 7.8 % | 8.24 % | 8.74 % |
| **April 2014** | 3.57 % | 3.85 % | 7.34 % | 7.54 % | 7.98 % | 8.48 % |
| **Reduction- Basis Points** | - | - | -26 % | -26 % | -26 % | -26 % |
| **January 2015** | 3.57 % | 3.85 % | 7.08 % | 7.22 % | 7.46 % | 7.56 % |
| **Reduction- Basis Points** | - | - | -26 % | -32 % | -52 % | -92 % |
| **December 2015** | 3.57 % | 3.85 % | 7.08 % | 7.22 % | 7.46 % | 7.56 % |

## 4-8 Intervention of the central bank in the primary market for Treasury Bills in LBP and large issuances of Long-Term categories... to maintain the stability of interest rates.

One more time, the intervention of the BDL buying Treasury Bills in LBP in the primary market as well as the issuance of the Ministry of Finance in 2015 of long-term Treasury Bills with relatively high yields (of the category of seven years or more) which became a regular event from the beginning of this year contributed to securing the large part of the government financial needs in LBP in 2015 on one hand, and in keeping the average interest rates stable on short and medium term Treasury Bills on all less than 7 year categories on the other.

As such, the portfolio of the BDL of Treasury Bills in LBP registered a remarkable increase to LBP 23,907 billion at the end of 2015 in comparison to LBP 19,454 billion at the end of 2014. Thus, the BDL's share increased significantly to 37.0% out of the total portfolio of Treasury Bills in LBP at the end of 2015 in comparison to 31.8% at the end of 2014. The Ministry of Finance also issued in 2015, in coordination with the BDL, 7-year and 10-year LBP Treasury Bills in a more intense way than those issued in 2014 which is a natural thing after regularizing long term issuances. The interest rates on 7-year or higher maturity TBs are similar to the ones on CDs after lowering them in January 2015. We mention that the BDL allowed banks to subscribe in long-term issuances either in available currency or by liquidating CDs issued by the BDL (maturing soon). This serves many purposes such as allowing the reduction in the size of the closely maturing CDs for the BDL, as well as preventing the withdrawal of additional liquidity from the market.

We mention in this context that the decision of the Ministry of Finance in January 2015 to issue long-term Treasury Bills regularly is considered a positive step as it reduces the intermediary role played by the BDL between banks and the treasury as it gives banks more incentives to increase subscribing in Treasury Bills and rely less on the BDL that was working in return on absorbing bank liquidity in LBP by issuing CDs at high rates[12]. Furthermore, with this step the interest rates on Treasury Bills will reflect in a better manner the market conditions to finance the government and make government financing more transparent.

12 Even though this was not realized in 2015 due to the large size of bank liquidity in LBP in comparison with the size of the issuances of long-term Treasury Bills in LBP implemented by the Ministry of Finance and with the limited opportunities to make placements with the private sector due to the weak economic activity.

## 4-9 Monetary Aggregates

The growth of the M3 monetary aggregate continued to slow down in 2015 reaching 5.1% in comparison to 5.9% in 2014, so that the growth rate for 2011-2015 remained moderate and lower than those registered in the previous years (2007-2010)[13]. Broad Money (M3) reached LBP 186,360 billion at the end of 2015, and its dollarization rate decreased slightly to 57.81% at the end of the mentioned year from 58.62% at the end of 2014 as a sign of relief in the foreign exchange market. The major components that have contributed to the increase of M3 by LBP 8,964 billion are summarized as follows:

Evolution of money supply and its counterparts
(End of period – billion LBP)

| | 2013 | 2014 | Change (%) 2014/2013 | 2015 | Change (%) 2015/2014 |
|---|---|---|---|---|---|
| Money in LBP (M1) | 7,620 | 8,301 | +681 | 9,042 | +741 |
| Money and quasi-money in LBP (M2) | 68,749 | 73,400 | +4,651 | 78,620 | +5,220 |
| **Money and quasi-money in LBP & FC (M3)** | **167,571** | **177,397** | **+ 9,826** | **186,360** | **+ 8,964** |
| **Counterparts** | | | | | |
| Net foreign assets | 56,555 | 53,661 | - 2,894 | 46,608 | - 7,053 |
| o/w : gold | 16,739 | 16,509 | -230 | 14,846 | -1,662 |
| foreign currencies | 39,817 | 37,153 | -2,664 | 31,762 | -5,391 |
| Net claims on public sector | 59,568 | 63,226 | +3,658 | 70,688 | +7,462 |
| Valuation adjustment | -8,426 | -8,146 | +280 | -6,401 | +1,745 |
| Claims on private sector | 65,949 | 71,217 | +5,268 | 75,695 | +4,478 |
| Other items (net) | -6,076 | -2,561 | +3,514 | -229 | +2,332 |

**Source:** BDL

The net loans to the public sector increased in the amount of LBP 7,462 billion or by twice the increase recorded in 2014, becoming unlike the previous years, the largest contributor to the growth of M3. Loans granted to the resident private sector continued their growth but at a lower rate as they increased by LBP 4,478 billion to become the second major contributor to the growth of M3 after being the most important contributor in the previous year. The other net items on the balance sheet of the banking system - representing monetization of financial claims- increased by LBP 2,332 billion, and contributed therefore positively to money creation. On the other hand, the decrease in the net foreign assets of the banking system (excluding gold) by LBP 5,391 billion in 2015, representing around USD 3.6 billion or twice the decrease recorded in the previous year, had a clear contractionary impact on the monetary aggregate M3 and contributed to a large extent to its moderate growth.

13 M3 increased by a compound annual growth rate (CAGR) of 14.7% for the period 2007-2010. The CAGR of M3 has fallen significantly to 6.1% for the years 2011-2015.

**4-10 Inflation**

According to data released by the Central Administration of Statistics, the CPI declined by -3.75% in 2015 – the first drop in prices in the last ten years-, after a moderate increase of 1.9% in 2014[14].

The decline in prices in 2015 came in the light of the weak growth in domestic demand in general (compared to the potential output), the sharp decline in world oil prices (by 45.7%), the continuous decline in the prices of food products internationally which came at a higher rate than previous years, in addition to the large depreciation of the Euro against the USD (more than 16%). In its part, the BDL works continuously at monitoring and sterilizing liquidity in order to contain inflationary pressures.

It is expected that year 2016 will be void of any inflationary pressures caused by external factors. In fact, average prices of oil and food products are expected to decline further in 2016 (in comparison to 2015), though at a slower pace, or at least to stay at the same low levels. In addition, the Euro is not expected to appreciate against the USD. Therefore, and in parallel to the weak expected economic growth, the inflation rate will probably remain negative or very low in 2016. It is worth mentioning that the IMF expected in its latest WEO report that the CPI will decrease by -0.7% in the stated year.

# V- EXTERNAL PAYMENTS

**Current Account and Balance of Payments**

**5-1** According to the BDL, the estimated current account deficit in Lebanon declined to around USD 8.2 billion in 2015 compared to USD 11.8 billion in 2014 as the goods trade deficit (FOB)[15] decreased to around USD 13.1 billion from USD 15 billion over the two respective years, whereas the estimated surplus in the balances of services, transfers and income increased to around USD 5 billion from around USD 3.3 billion. Thus, the share of the current account deficit to GDP reached 16%. The decline in the trade deficit in 2015 came about in light of the sharp decrease in the prices of oil and other commodities and the appreciation of the USD versus several other key currencies, despite a drop in goods exports.

**5-2** As for services trade, we mention the moderate improvement in tourism activity in 2015 for the second year in a row after its sharp decline in the preceding three years (2011-2013). The number of tourists to Lebanon increased at a rate of 12.1% in 2015 to reach 1,517,927 tourists according to the statistics of the Ministry of Tourism, but this figure stays far below the record level of 2010 standing at 2.2 million tourists. The largest increase in the number of tourists in 2015 came from Europe. The occupancy rate of Beirut 4 and 5 star hotels increased according to Ernst and Young to 56% in 2015 in comparison to 52% in 2014 (67% in 2010). The decline in the tourist activity in general and the one from the Gulf countries in particular in the last years happened largely due to the regional disturbances and the political and security situation in Lebanon.

14 + 4.8% in year 2013.
15 The goods trade deficit recorded in the balance of payments differs from the deficit published by the Lebanese Customs that adds the following: re-exported goods, goods for processing, and repairs on goods.

**5-3** The expatriates' remittances to Lebanon decreased by 3.3% in 2015 to reach USD 7.2 billion based on the latest estimates of the World Bank[16] compared to USD 7.4 billion in 2014 knowing that they sometimes differ from the figures estimated by the IMF and BDL. The BDL has stated that the net current transfers increased in 2015 to USD 3.4 billion compared to USD 2.3 billion in 2014. The decrease in the remittances could be attributed to the decline in oil prices and the slow-down in economic growth in the Gulf countries and some African and other countries where Lebanese are working. The remittances to Lebanon constituted 14% of the GDP in 2015 (compared to 15 % in 2014) which is one of the highest ratios in the world and the region. Lebanon occupies the 13th position in the world in terms of the amount of remittances, the 19th position in the world in terms of remittances as a share of GDP, and the second highest position in the region based on both criteria. The systematic and level of these remittances reflect the size of the Lebanese Diaspora in all parts of the world, its high level of competence and its continuous economic ties to its country and people.

**5-4** The high current account deficit in Lebanon, which is determined largely by the goods trade deficit, is financed by the surplus in the capital and financial accounts, i.e. through the net capital inflows in various forms from direct investments, portfolio investments, deposits at banks, net loans from abroad to the public and private sectors, and others. Based on the levels of current account deficits stated above, which are estimates always subject to adjustment, and the balance of payments figures provided by the BDL, the net capital flowing to Lebanon would have obviously declined in 2015 to USD 5.1 billion.

**5-5** Concerning the **foreign direct investments** whose size is estimated differently by various sources, several reports entirely agreed on their decline to Lebanon in the last years due to the internal and regional pressures.

The latest report of UNCTAD on world investments pointed out that net foreign direct investments to Lebanon reached around USD 1.2 billion in 2014 (2.4% of GDP) based on the latest available data compared to less than USD 1 billion in 2013 (USD 2.2 billion in 2012). Total foreign direct investments flowing to Lebanon based on the same source reached USD 3.1 billion in 2014 (6.2% of GDP) compared to USD 2.9 billion in 2013, knowing that the average for years 2008-2010 had exceeded USD 4 billion annually. It is to mention that foreign direct investments usually finance a large part of the current account deficits and are largely concentrated in the real estate sector differing from the nature of foreign direct investments in many emerging countries where they are diverse affecting several economic sectors.

**5-6** In conclusion and for the fifth year in a row, net capital inflows in 2015 could not cover the current account deficit contrary to the trend prevailing in the period 2002-2010. Despite the fact that the import bill benefitted in 2015 to a large extent from the decline in the price of commodities, exports of goods and net financial inflows to Lebanon –from remittances, service exports, and capital inflows- registered a significant decline in the given year. This resulted in a large deficit in the balance of payments in the amount of USD 3.4 billion in 2015 compared to a lower deficit reaching USD 1.4 billion in 2014, therefore the deficit during 2011-2015 reached around USD 1.9 billion annually on average.

16 The World Bank revised downward its estimate for remittance inflows in 2015 to USD 7.2 billion from previous estimates in October that have reached USD 7.5 billion. It also lowered its estimates for 2014 to USD 7.4 billion from previous estimates of USD 7.45 billion.

The decline in financial inflows in its many forms comes as a reaction to the uncertain environment, the deterioration in the political and economic conditions in the country and the aggravation of the situation in Syria. Despite the fact that Lebanon still enjoys a high level of liquid assets in foreign currency accumulated over the last years, this does not excuse the concerned authorities from acting swiftly to reduce the deficit in the balance of payments to avoid weakening or depleting foreign currency reserves and thus weakening the immunity of the monetary conditions. This may force them to increase the interest rates especially in the presence of several factors related to the situation in the Arab region that may pressure toward a decline in the inflow of deposits and an increase in the cost of borrowing. To cite an example, in addition to the necessity to improve the political conditions and end the situation of political paralysis that we have been living in for the last two years, it is possible to take measures aimed at improving productivity, fighting corruption and reducing the cost of doing business. Passing the law of partnership between the public and private sectors and passing the decrees on gas resources will convey positive signs to international investors which will probably raise the inflow of capital in general and foreign direct investments in particular.

### Foreign Trade

**5-7** According to the High Council of Customs, the value of imported goods dropped significantly to around USD 18.1 billion in 2015 compared to USD 20.5 billion in 2014 or by USD 2,425 million or 11.8%. This large drop is mainly attributed to the price effect as the imported quantities registered in general an increase, though weak, addressed in the next paragraph. The large fall in oil prices left its visible impact on the import bill in 2015 in addition to the decline in the world prices of food products and other commodities and in the value of the euro against the USD. The value of imported goods witnessed a decline for most customs items. The largest decline was recorded by the mineral products composed mostly of petroleum derivatives, by the amount of USD 1448 million or by 29.6 % whereas the imported quantities increased by 1.9%[17].

The imported quantities registered a slight increase of 1.6% to reach 15,699 thousand tons in 2015 compared to 15,452 thousand in the preceding year with an increase in the quantities imported of some products such as the ones considered as essential necessities namely vegetable products, prepared foodstuffs, and petroleum products- due to the additional consumption needs in the country resulting from the enormous numbers of Syrian refugees- while the quantities imported of some other products declined namely the ones tied to the construction sector and some industries (partly resulting from a decline in their export activities). Even after careful examination of the change in quantities imported by product type, or after excluding some goods that weigh heavily or that were exceptional during the period of the study, we find that the results do not change much as imported quantities remained quasi-stable during 2015 in comparison to the previous year[18].

17 Out of some of the most important category of goods that registered a decrease in the value of imports and contributed, though to a lesser extent, to the decline in the value of imported goods in 2015, we mention: the base metals and articles of base metal whose imports declined by USD 340 million or by 22.7% and their imported quantities declined by 13.0%, the machinery and electrical equipment whose imports declined by USD 195 million or by 8.9 % while the imported quantities increased substantially (+113.9%) affected by the import of an electric transformer, the precious stones and precious metals whose imports declined by USD 154 million or by 15.8 % with the decrease in world prices and also in the imported quantities, and the live animals and animal products whose imports declined by USD 142 million or 13.5 % accompanied by a decline in import quantities of 7.5%.

18 For example, after excluding the mineral products that weigh heavy and whose imported quantities increased in 2015, the machinery and electrical equipment whose imported quantities showed an exceptional increase in the given year, the base metals and articles of base metal that weigh heavy and whose imported quantities have decreased, the imported quantities of all other product type would have registered an increase by 0.9 % in 2015.

Based on that, it could be said that the import bill benefitted to a great extent in 2015 from the decline in world commodity prices, especially petroleum prices whereas the quantities imported remained cohesive in general without a major change, with an increase in the imported quantities of some items, mainly necessary consumption products, and a decline in others.

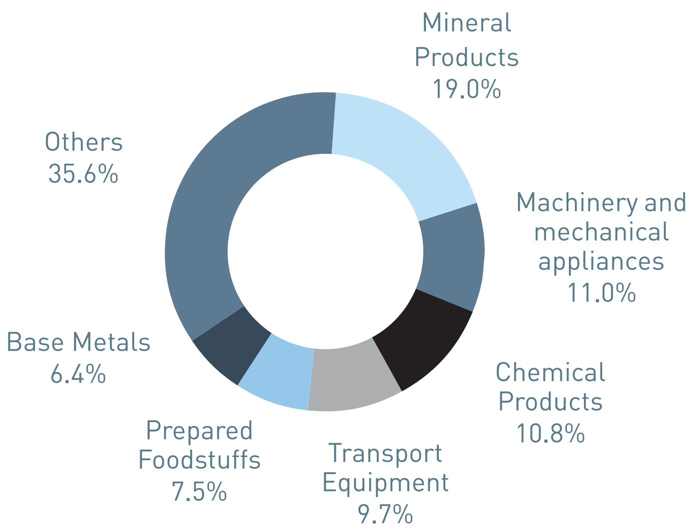
Imports of goods

| | 2013 | 2014 | 2015 |
|---|---|---|---|
| Value – USD million | 21,228 | 20,494 | 18,069 |
| Change (%) | -0.2 | -3.5 | -11.8 |
| Quantities – Thousand tons | 15,868 | 15,452 | 15,699 |
| Change (%) | +1.6 | -2.6 | +1.6 |

**Source:** Customs Higher Council.

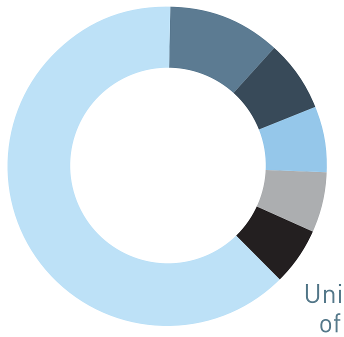
The two graphs below summarize the distribution of imported goods by type and country of origin in 2015.

**Main imported products in % of total in 2015**




**Source:** Customs Higher Council..

**Import by Countries of Origin**
**in % of total in 2015**




**Source:** Customs Higher Council..

**5-8** In another context, the value of exported goods continued its decline for the third year in a row to USD 2,952 million in 2015 compared to USD 3,313 million in 2014, i.e. by USD 361 million and by 10.9% due to the quantity effect and price effect. In 2015, the value of exports was specifically affected by the continuous decrease in the value of precious and semi-precious stones and precious metals to South Africa and the closure of the crossing of Nassib which had a great impact on exports to the Arab countries.

The value of exports declined for most product type. However, the largest decline was recorded by the precious and semi-precious stones and precious metals (USD -108 million) destined especially to South Africa followed by base metals and articles of base metals (USD -60 million), paper and paperboard (USD -52 million)[19]. Thus, as an example, after excluding all mentioned types, the value of exports for all other products would have registered a less negative decline of 6.4%.

The quantity of exports decreased in 2015 substantially by 13.2% to 1,941 thousand tons. Most customs items recorded a decline in the exported quantities thus in different degrees among items. Getting into details and isolating some products, we find that the decline in quantities exported was less severe than the first impression as the total was affected by some goods that weigh heavy. Quantities exported of vegetable products declined by 151 thousand tons or by more than 50% of total export quantities, the quantity of mineral products exports (or petroleum derivatives) declined by 79 thousand tons, the quantity of exports of base metals

19 Then: the prepared foodstuffs (USD – 32 million), the machinery and electrical instruments (USD – 31 million).

and articles of base metal declined by 72 thousand tons. On the other hand, the quantity of exports of the prepared foodstuffs increased by 37 thousand tons. Thus, if we exclude vegetable products only, the quantity exported of other products would have recorded a decrease by 8.8%. After excluding all of the products mentioned above from the total, the quantity exported of other products would have declined by 4.1%.
In conclusion, exports of goods have recorded a large decline in 2015 in quantity and value, but when we get into the details to exclude some items, this decline becomes more moderate or less severe concerning the other goods, or in other words, this large decline cannot be generalized over all products.

**Exports of Goods to the Arab World**
The value of exported goods to the Arab countries, which is considered the primary export market for Lebanon, declined to USD 1,590 million in 2015 compared to USD 1,729 million in 2014, i.e. by USD 139 million or 8%. The exported quantities to the Arab countries also substantially declined in 2015 by 17.9%, related specifically to the decline in the export quantities of vegetable and mineral products which weigh heavy. Thus, this result changes so that the decline in quantities to the Arab countries becomes more moderate if we make some exceptions. The export of goods to most Arab countries declined in 2015 in value and quantity, contrary to what happened in 2014 when this decline resulted almost completely from the decrease in mineral products exports to Syria.

Thus, it can be said that 2015 witnessed a decline in exports to the Arab countries after exports stayed cohesive in general until the end of 2014. This decrease covered most Arab countries for the first time since the beginning of the Syrian crisis. This was tied to a large degree to the closure of the crossing of Nassib which is the main land gateway between Lebanon and the Gulf countries.

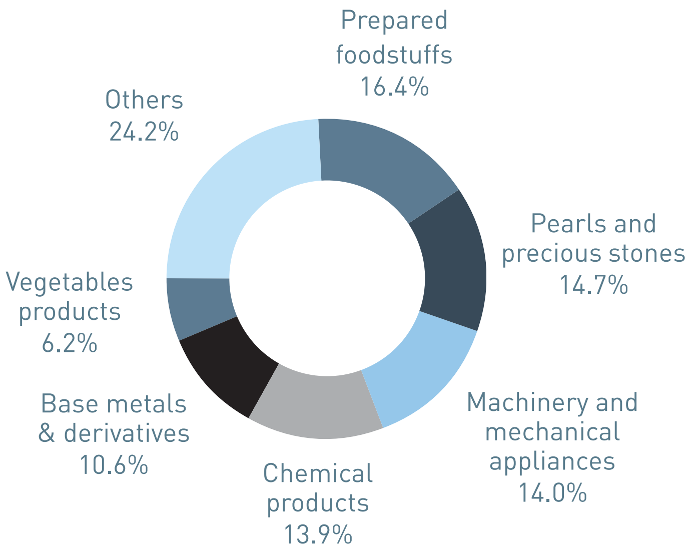
Exports of goods

| | 2013 | 2014 | 2015 |
|---|---|---|---|
| Value – USD million | 3,936 | 3,313 | 2,952 |
| Change (%) | -12.2 | -15.8 | -10.9 |
| Quantities – Thousand tons | 2,776 | 2,236 | 1,941 |
| Change (%) | +6.7 | -19.5 | -13.2 |

**Source:** Customs Higher Council.

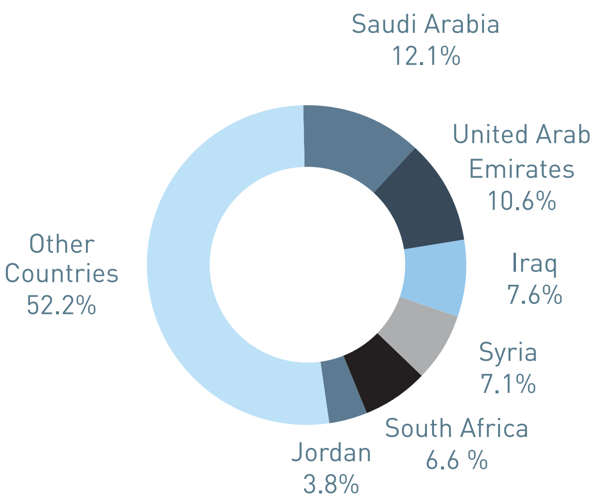
The two graphs below highlight the most important Lebanese exported goods and the most important countries that Lebanon exported to in 2015.

**Main exported products**
**in % of total in 2015**



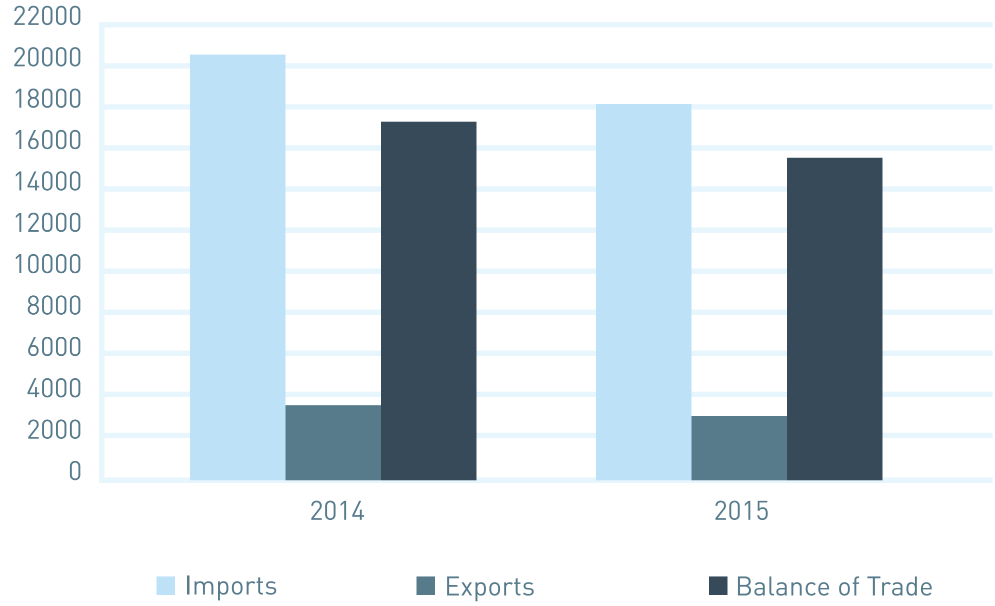

**Source:** Customs Higher Council..

**Export by Countries of Destination**
**in % of total in 2015**




**Source:** Customs Higher Council..

**Lebanon foreign trade (million USD)**




**Source:** Customs Higher Council.

# VI- BANKS AND THE FINANCING OF THE ECONOMY

**6-1** In a challenging operating environment, the decline in financial inflows from abroad and the weak economic activity limited the expansion of the total assets of commercial banks in Lebanon in 2015 as in the previous year. This expansion relies largely on the growth in the deposits of the resident and non-resident private sectors and is financed by external capital inflows and the lending activity to the economy in its private and public sectors. Thus, the contribution of the external factor or financial inflows was weak due to the continuation of the Syrian crisis and its negative internal political and economic repercussions and because of the unstable situation in the region as a whole. The contribution of the internal factor, especially the public sector, was also weak due to the current fiscal policy, and the absence of the general budget and minimum expenditure especially the investment one. In addition, there was a decline in bank lending to finance the needs of the public sector with the BDL compensating and the state using some of its deposits to cover what remains. The contribution of the private sector was better even though it remained lower than what could have been achieved in normal circumstances and in light of the support provided by monetary policy through the incentive package previously mentioned.The internal and external factors mentioned above and the weak internal economic situation necessitated reinforcing the deposits and liquidity at the BDL and thus protecting monetary stability.

**6-2** Based on these facts and developments, the consolidated balance sheet of commercial banks operating in Lebanon reached almost USD 186 billion at the end of 2015 compared to USD 175.7 billion at the end of 2014, thus registering an increase in sources/uses of funds amounting to USD 10.3 billion or by 5.9% in 2015 (compared to an increase of USD 10.9 billion or 6.6% in 2014). In 2015, the increase in the balance sheet was distributed over the deposit base (71.1% of resources increase), capital account (9.1% from the additional resources), and other sources of funds especially interbank operations (19.8% of additional resources).

**6-3** At the end of 2015, deposits at commercial banks operating in Lebanon reached USD 155 billion (o/w 20.6% from deposits of non-residents) without considering deposits of specialized banks and off-balance sheet fiduciary deposits reaching USD 2.4 billion and USD 3 billion respectively at the end of the mentioned year. The growth in deposits was enough to finance the needs of the economy, and reinforce the foreign currency reserves at the BDL. We also mention that the capital of the commercial banks in Lebanon reached USD 16.7 billion at the end of 2015, representing around 9% of total assets and close to 14% as an international capital ratio computed based on the Basel accord. This level of capitalization is considered acceptable even good by international standards and is in line with various risks that banks are exposed to in their work.

**6-4** Banks used the increase in their sources of funds to lend the private sector (USD + 3.3 billion) or 32.3% of the uses of funds. The loans to the resident private sector reaching USD 48 billion at the end of 2015 represented 96% of GDP compared to 91.6% at the end of 2014. Banks also used part of the growth in their sources of funds to lend the public sector (4.4% of the increase) as they subscribed in Eurobonds issued by the Treasury in February and November 2015, and in Treasury bills in LBP of the 7 and 10 years categories in light of their lack of interest to subscribe to categories less than seven years due to the existing interest rate levels, so they were satisfied in renewing maturing instruments. Banks also used part of the growth in their sources of funds to comply with required reserves and the required deposits and liquidity. Banks deposited the remaining part of their resources at the BDL in CDs in LBP & foreign currencies and as free deposits. It is to mention that the whole increase in vault and reserves at the BDL reached USD 7.1 billion in 2015. We finally mention that fixed assets increased by around USD 522 million, as a sign to the investments that banks did in their buildings and equipment, systems of operations and in internal procedures.

**6-5** Loans to the resident and non-resident private sectors net of doubtful loans reached USD 54.2 billion at the end of 2015 (of which 11.4% to non-resident private sector), registering an increase of 6.5% in 2015 compared to a higher increase of 7.4 % in 2014. This increase resulted largely from the special lending programs offered by the BDL through the incentive package at low cost to banks to be relent also at low cost to the private sector. The housing and technology sectors benefitted for the most from these loans. The support of the BDL to the knowledge economy **based on circular no 331** started giving the desired results in terms of banks investing in this sector, with a financing ability of around USD 623 million that banks can invest in this domain. We remind that the purpose of this circular is to activate the mechanisms of establishing new promising companies that could be transformed in the future to companies capable of enriching the national wealth and creating new job opportunities. At the time of preparing this report, banks had financed investment funds and emerging companies by close to USD 243 million. It is expected that the future of the Lebanese economy will be based to a great extent on the sector of the knowledge economy in addition to the financial sector and the sectors of gas and energy.

**6-6** At the end of 2015, loans to the public sector amounted to USD 37.8 billion compared to USD 37.4 billion at the end of 2014, thus increasing by 1.2% with these loans representing 75.6% of GDP. This slight increase is attributed to the subscription of banks in Treasury bills in foreign currencies that were issued in two batches: The first in February in the amount of USD 2.2 billion and the second in November in the amount of USD 1.6 billion. The portfolio of banks from Eurobonds increased from USD 16,311 million at the end of 2014 to USD 17,645 million at the end of 2015. In comparison, and despite the subscription of banks in long-term Treasury bills in LBP of 7 and 10 years categories due to their yields, their portfolio of bills in LBP decreased from LBP 31,564 billion to LBP 30,243 billion at the end of the two mentioned periods respectively due to their lack of interest in subscribing in categories less than seven years and be satisfied with renewing maturing instruments. Thus, the share of banks in Lebanon in financing total public debt, decreased from around 56% in 2014 to around 53.3% at the end of 2015 while the share of the BDL increased from 20.8% to 25.4% in the two mentioned dates respectively.

**6-7** Banks in Lebanon though remain the main financier of the public sector needs even if the financing size differs from one period to another taking into consideration liquidity, risk and other matters. The banks' financing to the state in Lebanon represents 25% of their total deposits in comparison to 23% in the Arab countries, while the figures for Europe and the USA remain below this level. Governments in Europe and the USA finance themselves directly from the markets or by subscriptions of individuals and institutions in bonds issued by the governments or sovereign bonds. Here, we mention that the share of the private sector from bank loans has started exceeding the share of the public sector since 2010 and is increasing.

**6-8** Lebanese Banks adopt a clear and transparent policy which is being implemented for more than two decades relying on legislations and systems existing in Lebanon on one hand, and based on the public interest and the safe professional principles that require protecting the deposits of customers and safeguarding the banks' relationships with the international correspondent banks on the other. Thus, Lebanese banks with a support from the monetary and supervisory authorities comply with international standards especially ones concerning money laundering and terrorist financing issued by FATF-GAFI, OECD, The Basle Committee, IMF, World Bank, and the G20. Banks also commit to what other banks operating in the international sphere do to especially US and European correspondent banks. The BDL issued in the last years a number of basic and intermediate circulars related to the subject of combating money laundering and terrorist financing stressing the compliance with international standards and reinforcing the organizational framework. Some of these circulars relate to revising the financial and banking operations control to combat money laundering and terrorist financing. The BDL issued in December 2015 basic circular no. 136 addressed to banks, financial institutions and other institutions subject to its licensing and supervision to apply United Nations decisions no. 1267 (1999), no. 1988 (2011), no. 1989 (2011), and the ensuing decisions, so that banks have to check regularly the webpage of the said council.

**6-9** The BDL issued the circulars governing dealing with correspondent banks as it is required of banks to be fully cognizant of the laws and systems that govern correspondent banks abroad by their local authorities or legal international organizations. We mention basic circular no. 126 issued in 2012 that calls for respecting legal provisions which govern correspondent banks. For this purpose, the Association organizes regular visits to the financial capitals in Europe and the USA to strengthen the relationships with correspondent banks for the sake of Lebanese banks and link with the official governments and the international financial and monetary authorities.

**6-10** The four financial laws passed by the parliament in November 2015 reflect the commitment of the Lebanese government in addition to the banks to the rules of work and the adopted international banking and financial standards especially the American ones related to the functioning of foreign banks in the US market. This is because most of the operations of the Lebanese banking sector with the outside world, the financing of Lebanon's external trade and the remittances of the Lebanese take place in USD through correspondent accounts with banks in New York City. Thus, these laws protect Lebanon from any international financial isolation, keep it out of any sanctions and prevent placing its name on international black lists. The four laws are: First, the joining of Lebanon of the United Nations Convention on combating terrorism; second, declaring the cross-border transportation of money given that this does not imply preventing money from crossing but declaring the amount in case it exceeds USD 15 thousand; third, exchanging of tax information to combat tax evasion which is required by OECD; and fourth, introducing major amendments to the law on fighting money laundering in accordance with FATF-GAFI which has considered Lebanon lately as fulfilling all international conditions. Banks are also committed to apply international sanctions as this is of the necessary requirements allowing them the safety and continuity of their operations through the international financial system. This issue applies to BDL basic circular no. 137 on the proper dealing with the US law issued on 18/12/2015 and its applied systems, as the Lebanese banks took the necessary measures for its proper application, to safeguard the highest interests of Lebanon and the safety of its banking and financial systems.