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PART 1: GENERAL ECONOMIC DEVELOPMENTS

I- World Economy

1-1 The world economic growth rate stabilized at 3.0% in 2013 with a slight decrease from 3.1% in 2012 according to the reports of the International Monetary Fund. This is largely due to the decline in the growth rate in the USA from 2.8% in 2012 to 1.9% in 2013 largely offset by the decelerating economic recession in the Euro zone from -0.7% to -0.4%, and the increase in growth in the United Kingdom from 0.3% to 1.7%, in Japan from 1.4% to 1.7% and the constant growth rate in Canada at 1.7% and China at 7.7%. It is to mention that the decline in growth in the USA in 2013 resulted from the weak activity in the first half of the year due to the large efforts aimed at fiscal consolidation which offset the recovering internal demand of the private sector. However, in the second half of the year, the US economy grew at a fast rate exceeding expectations due to an increase in domestic demand, the accumulation of a strong inventory, and the growth in exports especially derived oil products. It is to mention that due to the increase in local oil production and decline in oil imports, the current account deficit to GDP ratio declined in the USA in 2013 to 2.3% which is the lowest in 15 years and lower than the account deficit figures of the United Kingdom and Canada. The diminished recession in the Euro zone in 2013 is the result of a modest positive growth starting in the second half of the year which is partly due to the improvement in the domestic private demand and the decline in the degree of fiscal contraction as public finances became more convenient for the economy.

1-2 According to the same source, the world economy will become more active in the next period which will raise its average growth to 3.7% in 2014 and 3.1% in 2015 due largely to the improvements in the conditions in the advanced economies. Growth in these economies will increase overall to 2.25% in 2014-2015 (or by 1% more than 2013) due to many reasons such as less contractionary fiscal policies and highly accommodative monetary conditions. The average growth rate in the emerging and developing economies will modestly improve from 4.7% in 2013 to 5.2% in 2014-2015 (or by half-percent more than 2013) due to two main opposing factors: First, the contractionary fiscal conditions in many of these countries affecting growth in domestic demand and, second, the increase in foreign demand from the advanced economies which will cause positive growth. Based on that, the US economy will be the major factor driving world economic growth as expectations show an increase in the US growth rate to 2.8% in 2014, and 3% in 2015, resulting from a strong growth in residential investment, consumption of durable goods, fixed non-residential investment, with an improvement in consumer and business confidence. This growth will also be backed by improving public finances (less fiscal contraction) and a postponement of debt ceiling debates to March 2015 which would limit the uncertainty surrounding the US fiscal policy in the previous years. It is also expected that Europe will come-out of the economic recession witnessed in the last few years to resume its moderate growth rates which will reach 1% in 2014, 1.4% in 2015 (despite the divergence in growth rates among highly indebted countries and other ones) with stability and improvement in domestic demand and an increase in net exports. In comparison, several negative factors remain affecting economic recovery and growth rates in the Euro zone such as increasing unemployment rates and debt, low investment, remaining gaps between actual and potential output, low credit and fiscal imbalances. These factors are largely related to structural reforms, incomplete fiscal reforms, external issues, in addition to lower inflation rates. It is to mention that the average inflation rate in the Euro zone will only be 1 % in 2014-2015 (or by less than half-percent of the average of the advanced economies). The average unemployment rate in this zone will reach 12% in comparison to around 7.5% in the advanced economies. The United Kingdom and Canada will witness an increase in average growth rates by more than 1 % while China will witness positive but decreasing growth rates from 7.7% in 2013 to 7.5% in 2014, 7.3% in 2015 for periodic and structural reasons with the attempts of the Chinese authorities to curtail credit and go forward with reforms.

1-3 As far as policies are concerned, the reports of the International Monetary Fund show based on the current and expected international economic developments summarized above that advanced economies, especially the Euro zone ought to adopt a basket of policies. The first policy is monetary quantitative easing through non-conventional measures to help achieve rates of growth and inflation in line with stated policy objectives preventing the possibility of very low inflation rates and economic contraction. The second policy is to continue reforming the banking system especially banks' balance sheets with respect to recapitalization of weak banks and reviewing capital quality to revive credit and improve confidence. The third policy is to adopt a banking union due to its many advantages. The fourth policy is to stimulate potential output by adopting, for example, reforms that achieve equal opportunities and flexibility in the labor markets and reduce barriers to entry in commodity and service markets. There is also a need in the USA to carefully manage the change in monetary policy by avoiding reducing quantitative easing in a speedy manner in line with the goals of growth, inflation and fiscal stability previously discussed. This is because the economic structure is still characterized by fiscal contraction, large output gaps and very low inflation necessitating an accommodative monetary policy in the near future.

1-4 There is also a need for economic policy-makers in developing and emerging economies to first allow their exchange rates to fluctuate with changes in economic fundamentals to correct international accounts, while being careful to unorganized corrections through intervention when necessary to prevent monetary disturbances. Second, and always according to the IMF, they should control public finances unless the economy witnesses a slow-down. Third, they should tighten monetary policy to avoid inflation and adopt a strategy for this policy characterized by transparency and credibility for policy effectiveness. Fourth, they should adopt special measures to protect fiscal stability and fifth, conduct more structural reforms in public infrastructural investment and eliminate the measures facing the entry of commodities and products and restore balanced growth by emphasizing in the case of China, for example, consumption instead of investment.

1-5 The classical recommendations to the developing and emerging economies are important as they recommend returning to a standard monetary policy in the sense of ceasing quantitative easing and levels of interest rates nearing zero as markets and concerned parties are convinced day after day that the US monetary policy has approached a reversal. This change is reflected by beginning the gradual termination of quantitative easing which is expected to end next fall. The implications of this new reversal is the increase in the yield on long-term securities in the USA and many other economies causing an increase in real interest rates, a gradual capital inflow (from developing countries to advanced ones) and a return to investing funds in the USA. This will endanger countries with weak public finances or high inflation (the danger of limiting investment and growth). It is to mention that funds flowing from developing to developed countries increased from $28 billion in 2012 to $50 billion in 2013.

Thus, a return to a standard US monetary policy may cause weak emerging economies to conduct desired economic corrections reflected in redistributing capital inflows and devaluing currencies, which will help reduce the rising problems of competitiveness and balance of payments. The recommendations to the advanced economies are also important given inflationary expectations in the countries especially in the Euro zone where inflation figures are even lower than expected caused largely by very high output gaps and a reduction in the prices of primary commodities. This low inflation causes high real interest rates and, thus, an increase in the debt burden on the private and public sectors and a reduction in aggregate demand and gross domestic product in advanced economies.

World Economic Output growth rate (real GDP) in 2012 and 2013, Estimations for 2014 and 2015 (Percent change)

	Realized		Expected	
	2012	2013	2014	2015
World economy	**3,1**	**3,0**	**3,7**	**3,9**
Developed countries, o/w:	**1,4**	**1,3**	**2,2**	**2,3**
The US	2,8	1,9	2,8	3,0
The Euro area	-0,7	-0,4	1,0	1,4
Japan	1,4	1,7	1,7	1,0
Canada	1,7	1,7	2,2	2,4
United Kingdom	0,3	1,7	2,4	2,2
Emerging and developing countries, o/w:	**4,9**	**4,7**	**5,1**	**5,4**
Africa	4,8	5,1	6,1	5,8
East and Central Europe	1,4	2,5	2,8	3,1
Commonwealth of independent states CIS, including Russia	3,4	2,1	2,6	3,1
Developing Asian countries, o/w:	**6,4**	**6,5**	**6,7**	**6,8**
China	7,7	7,7	7.5	7,3
India	3,2	4,4	5,4	6,4
Middle East and North Africa	4,1	2,4	3,3	4,8
Central and South America and the Caribbean	3,0	2,6	3,0	3,3

Source: WEO report / IMF

Middle East and North Africa Region (MENA)

1-6 In 2013, the growth rate declined in the MENA region to 2.2% from 4.1% in 2012. It stood below the world average growth rate in 2013 after having exceeded it in the previous year. It is expected though that this growth rate will resume its increase to 3.2% in 2014 and 4.5% in 2015. It is to mention that growth rates in 2013 differed between oil-exporting and non-oil exporting countries.

1-7 As far as oil-exporting countries are concerned, the reduction in oil production caused a reduction in the average growth rate to around 2% in 2013 from more than 4% in 2012 with an expectation that it would resume increasing in 2014 to around 3.4% due to the strength of the non-oil sector and stabilization in oil production. With the possibility of a decline in oil revenues in oil-exporting countries, the surplus in the current account to GDP ratio will decline from 3.9% in 2013 to 3.3% in 2014. The non-oil sectors especially construction and retail trade would remain the engine of economic activity backed by high public spending on infrastructure and the strong bank credit facilities to the private sector in the Gulf Cooperation Council countries as well as spending on reconstruction when military strife ends in countries that are not members of the council (Algeria, Iraq, Libya, Yemen). Lowering the dependence on oil will raise productivity and potential growth and lower fluctuations in GDP. Many countries have achieved progress in diversifying their economies as reflected in the increase in the share of non-oil production to GDP.

1-8 It is to mention that the recovery of oil production in the near future outside the Gulf Cooperation Council and the continuing increase in production from non-traditional sources in the USA may influence oil production in the Council and international oil prices. In this respect, prices of oil futures indicate a decline in the price of crude oil by $6 a barrel between 2013 and 2015. The decline in oil prices will affect most countries outside the Council which will record, despite the improvement in their external balances lately, a deficit in their current accounts when the price of an oil barrel declines below $85 given that they also suffer from continuous budget deficits.

1-9 On another issue, it is expected that inflation will be contained in most oil producing countries. The inflation rate, for example, would remain around 3% in the Gulf Cooperation Council countries in 2014 due to the decline in import prices and the lower wages of the incoming labor force. This rate is expected to decline gradually in non-Council member countries with the continuing contractionary monetary policy.

1-10 As far as oil-importing countries are concerned, growth remains limited stabilizing at around 3% in 2013 far away from its historical average of 5% with a possibility of remaining at 3% in 2014. The 2013 growth rate resulting from consumers' domestic demand was initially based on large capital inflows from expatriates, subsidies to commodities and spending on public sector wages. Private investments remained weak in the midst of political transformation and conflicts in these countries causing economic losses. The conflict in Syria had wide regional implications causing some countries to witness socio-economic problems in addition to security and political ones. The weak confidence and in some cases large budget deficits, security challenges and economic uncertainty were all factors that have and are still causing obstacles to growth and job opportunities to meet the fast increase in the labor force. In 2013, inflation rates fell in oil-importing countries due to the slow economic activity in addition to contractionary monetary policy in some cases. These countries should conduct major economic transformation stimulating investments and exports to achieve more growth and create job opportunities.

II- The Lebanese Economy

2-1 The economic situation did not change much in Lebanon in 2013 compared to the previous two years. The preliminary estimates of the Central Bank of Lebanon show that the Lebanese economy grew in 2013 at an average of 2.5% with the same rate estimated by the Central Administration of Statistics for 2012 and 2% for 2011. The sources of the International Monetary Fund (The mission of the fund in charge of article IV) show an average growth rate of 2% for the last two years. Some may inaccurately compare these averages to the exceptional ones existing for the period 2007-2010 reaching on average 9% to show the implications of the Syrian crisis on the performance of the Lebanese economy. The reality and objectivity require adopting for comparison a longer period including normal circumstances for proper long-term assessment. The average growth rate in the last two decades was around 4% which is a preferable basis for comparison. It is to be noticed that the average growth rate in 2013 for Lebanon was below the world average of 3% and also below the average of the oil-importing countries in the MENA region estimated at 2.7% and far below the rate of 4% estimated for the Gulf Cooperation Council. Despite the fact that the Lebanese economy is closely tied to the Council's economies in terms of exports, tourism activities, remittances and foreign investments, the situation prevailing in Lebanon did not allow this connection to reach its full potential.

2-2 The country also witnessed in 2013 political instability, security breaches and the entrance of additional Syrian refugees with the worsening situation in Syria, in addition to ministerial paralysis for close to a year which affected negatively several economic activities especially construction, trade, tourism and thus the whole economic performance. The tourism activity greatly declined in 2013 for the third consecutive year causing a decline in revenue sources as this activity affects many economic sectors. This decline in tourism did not only result from the reduction in the crossing activity on the Lebanese –Syrian border but also due to the absence of an effective state authority which caused the governments of the Gulf countries to advise their citizens against traveling to Lebanon. The domestic and foreign investments figures also remained modest causing a decline in the real estate sector activities for the third consecutive year and in foreign direct investment. The trade sector was also affected negatively as a result of the security situation and moving explosions which enhanced the feelings of insecurity and fear among consumers and reduced investors' confidence in addition to the losses in lives and property damage. The fiscal situation as well as debt also deteriorated in 2013, whereas there was a slight increase in remittances and a large increase in bank loans resulting to a great extent from the loan facilities package of the Central Bank which contributed as usual to support consumption and investment activities. Additionally, the presence of Syrian refugees from both poor and well to do groups increased the demand for goods and services.

GDP, current account, growth & inflation rates

	2011	2012	2013
Real Growth rate (%)	2,0	2,5	2,5
Change of the consumer price* index (average per annum) (%)	5,0	6,6	5,5
GDP Deflator (%)	3,4	4,6	3,5
GDP (LBP billion)	60419	64778	68721
GDP (USD billion)	40,1	43,0	45,6
Current account deficit/ GDP (%)	-15,7	-15,7	-16,2

Sources: Central Administration of Statistics (CAS)- BDL - IMF

*preliminary and subject to revision

2-3 The political conflict in 2013 also affected the issue of oil and gas extraction as benefitting from this natural wealth got postponed to a future period due to political and technical backgrounds. It is feared that the continuation of the political division and lack of common vision will weaken Lebanon's negotiating and marketing abilities making it lose its credibility and international reputation and the withdrawal of large multinational corporations from the oil bidding process. This is in addition to having Israel exploit the slow-down in the extraction of oil and gas to take control of part of the oil wealth on its borders.

2-4 Proceeding from the figures of the Central Administration of Statistics for GDP of 60419 billion LBP ($40.1 billion) in 2011 and its estimates for economic growth and inflation for 2012, GDP would have reached 64778 billion LBP ($43.0 billion) in 2012. Based on the Central Bank figures on real growth of 2.5% and inflation of 3.5% in 2013, nominal GDP would have reached 68721 billion LBP ($45.6 billion). These figures are to be adopted with caution pending the release of final official figures.

2-5 Most of the available economic indicators in 2013 registered a moderate increase compared to the previous year while few declined, clearly reflecting the perceived rate of economic growth in the country. We cite some of these indicators:

- The slight increase in the value of cleared checks at a rate of 1.9% against a decrease of 1.5% in 2012, most probably due to the regression of the construction and trade sectors.
- The increase of 4.7% of passengers arrivals via Beirut airport in comparison to 2.9% increase in 2012.
- The slight increase of imported goods by 1.6% in 2013 in comparison to 3.8% in 2012, as an indicator of household consumption and the production of goods.
- The slight increase of exported goods by 6.7% in 2013 in comparison to their decline by 4.3% in the previous year.
- A slight increase in the revenues from value-added taxes at a rate of 0.6% after a decline by 0.7% in the previous year, knowing that this tax is a vital indicator of consumption.
- The number of tourists retracted at a slower rate of 6.7% in 2013 compared to a contraction at a rate of 17.5% in 2012.
- The area of construction permits dropped by 12% in comparison to a decline of 10.8% in 2012. Conversely, the quantity of cement delivered increased by 9.8% in 2013.
- An increase in the amount of goods received and shipped via Beirut port by 14.2% in 2013 in comparison to 8.1% in 2012.
- An increase in the production of electricity by 10.3% in 2013 in comparison to a decline of 11.5% in 2012.

2-6 In parallel, the international rating agencies changed Lebanon's sovereign rating. Moody's agency which maintained Lebanon's sovereign rating at "B1", proceeded in May 2013 to change the outlook from "stable" to "negative". In November 2013, Standard & Poor's reduced the rating of Lebanon from B to B- with a negative outlook. In December 2013, Fitch maintained Lebanon's long-term rating in LBP and foreign currencies at "B" while reducing the outlook from "stable to negative". The market did not get affected by the negative outlook as the return on government securities remained stable. Even the CDS rate reflecting market view of sovereign risk declined to around 410 points at the end of 2013 in comparison to 460 points at the end of 2012 given that, as the report is being prepared, the margin reached 350 points which is its lowest level. Lebanon borrows now at its lowest rate at levels similar to the ones of countries classified as B+ or even BBB. In a positive development, Standard & Poor's raised in April 2014 Lebanon's outlook to "stable" from "negative" relying on the ability of the Lebanese government to secure its borrowing needs backed by the strength of deposit flows to the financial system despite the relatively difficult internal and external environments. It also confirmed its sovereign long and short term ratings in foreign and domestic currencies at (B-/B).

It is to note that these ratings ought to be considered seriously as they affect the decisions of international investors and constitute a burden on capital risk weights of banks. The malfunctioning of constitutional institutions will lead to the reduction of the sovereign ratings of Lebanon and the adjustment of outlook from stable to negative as per the latest practice of the international rating agencies. The biggest problem for the financial sector in Lebanon is for this situation to remain causing further decline in the sovereign ratings. This will force banks and financial institutions to apply higher capital weights on their assets necessitating an increase in capital levels in a period where investors shy away from Lebanon.

2-7 Despite the fact that the formation of the ministerial cabinet in February 2014 and what followed in terms of successful security measures reflected positively on the confidence factor and the performance of various economic activities, the Lebanese economy is still faced with various old and new challenges. In addition to the challenges of the Syrian refugees in Lebanon and their security, economic and social implications, and the challenges of the extraction of oil and gas, there exists the challenge of electing a new president of the Lebanese republic, the formation of a new effective council of ministers, the election of a new parliament and the ratification of salary scale.

2-8 These challenges may negatively pressure various economic sectors, public finances and debt, as well as economic growth if elections do not take place on time, the ministerial cabinet is not formed in a speedy manner, or the salary scale is approved hastily. It is difficult to estimate the rate of economic growth in Lebanon in 2014 due to its link to the aforementioned issues and the developments in Syria and the whole region. It is to mention that encouraging the citizens of the Gulf to travel to Lebanon which was lately announced positively contributes to economic growth. The International Monetary Fund mission to Lebanon concerned with article IV mentioned in its specific report lately that average growth would stabilize at 2% in 2014.

2-9 Economic growth in Lebanon for the medium and long terms is tied to many factors most notably securing political and security stability to ensure the continuation of capital inflows and flow of tourists, the preservation of the confidence of domestic and foreign investors and local consumers, and interest rate stability. Lebanon also needs to develop economic policies and measures to enhance the competitiveness of its commodities, search for new export markets, improve the quality of domestic products to reduced competitive imports, control public finances, increase infrastructural investments, improve work environment, and diversify the sources of tourism and foreign direct investment. It is in the interest of Lebanon also to have the Gulf Cooperation Council countries achieve high growth rates due to its ties to their economies that constitute major markets for its exports, remittances and contribute to foreign direct investment in it.

2-10 Last but not least, continuous growth requires that the government conducts the desired structural reforms especially the privatization of some vital sectors and the involvement of the private sector in public sector projects through BOT, PPP and other vehicles, and increases domestic and foreign investments. Additionally, the government needs to launch the process of administrative reforms, fight corruption, increase productivity, reform the social security system to strengthen the social safety nets by securing a retirement system and an appropriate protection to private sector workers, in addition to securing long-term savings for usage in long-term investments.

III- Public Finances in 2013

3-1 The performance of public finances in 2013 reflected the inconvenient security and economic situation prevailing in the country, the impact of the conditions in Syria, and the continuation of the performance witnessed first in 2012. Public finances deteriorated as the deficit rose by 7.5% to reach 9.3% of estimated GDP compared to 9.1% in 2012. The primary balance registered for the second consecutive year a deficit that exceeded double the one prevailing in the previous year representing 0.5% of GDP (0.3% in 2012). In retrospect, the world witnessed a move away from expansionary fiscal policies and a concentration on contractionary ones to remedy the problems of high budget deficits and public debt, which is considered a major priority for advanced as well as emerging economies.

Public Finances
2011 – 2013 (LBP Billion)

	2011	2012	2013	Change 2012/2011 (%)	Change 2013/2012 (%)
Total Revenues (Budget+ Treasury)	14070	14164	14201	0,7	0,3
Total Expenditures (Budget + Treasury)	17600	20081	20563	14,1	2,4
Overall Deficit	3530	5918	6362	67,6	7,5
Primary Surplus	+2504	-166	-361		
Overall Deficit / GDP	5,9	9,1	9,3		
Primary Balance / GDP	4,2	-0.3	-0.5		

Source: Ministry of Finance.

3-2 The total revenue stabilized in 2013 as it slightly increased by 0.3% to reach 14201 billion LBP whereas it decreased to 20.7% of GDP from 21.9% in 2012. Tax revenue which is usually affected by economic activity and tax policy decreased by 0.7%. Specifically, it declined due to the decrease in tobacco excise from 516 to 395 billion LBP, income tax on capital gains & dividends from 296 to 231 billion LBP, the income tax on profit from 1006 to 974 billion LBP, and the real estate registration fees from 870 billion LBP to 847 billion LBP. The non-tax revenues also declined by 0.5% as they are tied to a large extent to the revenues from public institutions and government properties. In return, Treasury receipts increased by 18.1% due to the reimbursement of treasury advance by the Ministry of Economy and Trade and also due to accrued interest received in Treasury accounts on the settlement of the dual tranche offering on April 2013. It is to mention that the share of Treasury revenue out of total revenue remained low constituting only 5.8% in 2013 in comparison to 23% for non-tax revenue and 71.2% for tax revenue.

3-3 The table below details the progression of the components of tax and non-tax revenues as well as their share of total revenue. It is shown that the largest share goes to the domestic taxes on goods and services (26.6% of total revenue) especially the value added tax (VAT) followed by taxes on income, profit and capital gains (17.6%), then by taxes on international trade and the transfer from the Telecom surplus (15.2% for each).

Total Revenues (LBP Billion)

	2011	2012	2013	Share (%)
Taxes on income, profits and Capital gains	2423	2516	2502	17,6%
Taxes on Property	1144	1193	1201	8,5%
Domestic Taxes on Goods and Services	3685	3749	3782	26,6%
o/w: VAT	3300	3275	3296	23,2%
Taxes on International Trade	2179	2251	2158	15,2%
o/w : Customs	777	796	817	5,8%
Gasoline	542	495	483	3,4%
Other Tax Revenues	454	478	473	3,3%
Tax Revenues	**9885**	**10187**	**10116**	**71,2%**
Income from public institutions and Government properties	2679	2530	2518	17,7%
o/w : Transfer from the telecom surplus	2261	2156	2156	15,2%
Other non-tax revenues	789	756	751	5,3%
Non-tax revenues	**3468**	**3286**	**3269**	**23,0%**
Treasury receipts	**718**	**691**	**816**	**5,8%**
Total Revenues	**14070**	**14164**	**14201**	**100,0%**

Source: Ministry of Finance

3-4 In return, general expenditure increased by 2.4% in 2013 to reach 20563 billion LBP or 29.9% of GDP in comparison to 31% in 2012. This increase is related to the increase in debt service, classified in budget expenditure, by 4.3% to reach 6000 billion LBP due to the increase in public debt and the increase in the interest payment on foreign currency debt to reach 29.2% of total expenditure. Capital expenditure increased by around 30% due partly to expenditure related to the Syrian severe exodus to Lebanon knowing that it only constituted 4.8% of total expenditure in 2013. In comparison, wages, salaries and benefits decreased by 3.7% to constitute 31.5 % of total expenditures. Transfers to Electricite Du Liban (EDL) decreased by more than 10% to reach 3056 billion LBP in 2013 representing 14.9% of total expenditures and 4.4% of GDP which constitutes a heavy burden on the Lebanese Treasury. Eliminating the inefficiency in this sector alone may possibly reduce the deficit by half. The electricity sector in general requires large necessary reforms represented in increasing the production of energy, improving transportation and distribution, activating collection, and boosting the effectiveness of the EDL. Shifting the subsidies of the EDL towards expenditures on investments and social issues will boost economic growth. Capital expenditure is not enough to support the needs of infrastructure whereas government support to social safety nets and the poor is still deficient.

Total expenditures (LBP Billion)

	2011	2012	2013	share (%)
Debt Service	6034	5752	6000	29,2%
Primary Expenditures	11566	14329	14562	70,8%
o/w salaries and other allowances (art. 13)	5533	6723	6473	31,5%
transfers to EDL institution	2626	3408	3056	14,9%
Capital expenditures	676	760	987	4,8%
Total Expenditures	**17600**	**20081**	**20563**	**100,0%**

Source: Ministry of Finance.

3-5 Expectations about public finances in 2014 are still not clear given the attempts to approve the salary scale and secure the financing sources in the absence of government budgets since 2006. Knowing that the passing of the annual general budget is a necessity as it represents the major tool to enhance government accountability.

As far as the salary scale is concerned, increasing taxes in a period of low economic growth may weaken the economy further even if this is matched by additional general expenditures as most of them are transfers and not productive. According to the International Monetary Fund, the figures of the salary scale are to be absorbed through consecutive payments without a retroactive effect and coupled with reform measures. There is a need to adopt transparency in adjusting salaries by including all employees and wage earners taking into consideration retirement salaries, productivity, and performance standards. The revenue package is to include trusted and fair measures including: capital gain tax on real estate transactions, an increase in the interest income tax rate, immediate elimination of the exemption of the VAT on gasoline and, for application at a later stage, a gradual increase in the VAT rate, an increase in the corporate income tax rate and the increase in various stamps and fees on some selected items. Additionally, the passing of the general budget for 2014 is the first necessary step to set a fiscal policy. The healthy budget that covers all government revenues and expenditures within a general framework crystalizes the intentions of the government and restores credibility to fiscal policy. Irrespective of the salary scale, the problems of public finances in Lebanon are not recent and it is essential to address the issue of accumulating budget deficits.

3-6 It goes without saying that the Syrian crisis has implications on the conditions of public finances in Lebanon that initially suffer from imbalances. According to the World Bank report of September 2013, it is expected that government revenues will decline by $1.6 billion for the period 2012-2014 due to direct and indirect implications on some economic sectors and, thus, from a slow-down in economic activity. In comparison, it is expected that public expenditure will increase by $1.2 billion for the same period due to the increase in demand for public services. It is also expected that an additional $2.7 billion will be spent to restore the quality of public services to levels available in the period before the Syrian crisis. The cost of the social side such as health and education is expected to reach $311-363 million with the increase in the number of Syrian refugees expected to reach 1.7 million persons at the end of 2014. It is to mention that the United Nations estimated the needs of Lebanon resulting from the Syrian refugees for 2014 to be around $1.9 billion with Lebanon receiving only 14% of this amount so far.

3-7 In general, the fiscal situation in Lebanon remains stable due to its ability to finance its needs at stable interest rates from the Lebanese banking sector that is trusted by depositors especially the diaspora. Knowing that addressing the public finances in Lebanon requires the passing of structural reforms as part of long-term plans. Without these reforms, the monetary and regulatory authorities may place ceilings on lending to the government tied to bank capitals, the structure of bank liabilities in foreign and domestic currencies and the maturity of deposits. This will reduce over the next few years the size of government debt on bank books to acceptable levels in comparison to their capital, that banks commit not to surpass or to a fixed percent of their assets that banks agree to. In this respect, the standards of the banking industry for what is known as major risks or sovereign risks may constitute an avenue to place constraints on lending to the government. Financing infrastructural projects may be excluded from the ratios or the ceilings if it is executed and managed by the private sector in legal acceptable frameworks.

What follows is a synopsis on the issuance of the Eurobonds and the long –term Treasury bills in LBP that took place in 2013 and the first quarter of 2014.

April: Eurobonds in a value of $1.1 billion with the value of the first part reaching $600 million with a coupon rate of 6% maturing in January 2023. The value of the second part reached $500 million with a coupon rate of 6.75% maturing in November 2027. In the same month, the Ministry of Finance issued Eurobonds in the amount of $1.1 billion to replace Treasury Bills in LBP from the portfolio of the BDL in the same amount. They were distributed as follows: $600 million with a coupon rate of 4.5% maturing in April 2016 and $500 million with a coupon rate of 5.5% maturing in April 2019.

June: The Ministry of Finance issued long-term Treasury Bills in LBP of 8 years category (valued at 66 billion LBP at an interest of 7.80%) and 10 years category (valued at 1124 billion LBP at an interest of 8.24%). The BDL in the same month conducted a voluntary swap operation for bills in LBP of 24 and 36 months categories in a value exceeding 1200 billion LBP that would have matured in the second half of 2013, with Treasury Bills in LBP of 7 years category and an interest of 7.5%. The Ministry of Finance also issued Eurobonds, in which the BDL subscribed, in the amount of $600 billion and a coupon rate of 6.15 % maturing in June 2020.

September: The Ministry of Finance issued Treasury Bills in LBP of 10 years category amounting to 569 billion LBP at an interest of 8.24%. For the first time, the Ministry issued Treasury Bills in LBP for 12 years category valued at 1904 billion LBP at an interest of 8.74%. In the same month, the Ministry of Finance issued Eurobonds in the amount of $175 million at a coupon rate of 5% maturing in October 2017 to replace Treasury Bills in LBP from the portfolio of the BDL in the same amount.

November: The Ministry of Finance issued Treasury Bills in LBP of 12 years category valued at 1469 billion LBP at an interest of 8.74%.

It is to mention that in April 2014, the Ministry of Finance issued Eurobonds in the amount of $1400 million out of which $704 million was used to replace Bills maturing in the same year. The coupon rates reached 5.8% on the Bills maturing in April 2020 valued at $600 million and 6.6% on the Bills maturing in November 2026 valued at $800 million.

Public Debt

3-8 2013 witnessed high growth in public debt which is the largest in the last five years (10% compared to an average of 6%) causing the debt figure to reach 95696 billion LBP equivalent to $63.5 billion at the end of the year. Debt thus increased by 8737 billion LBP exceeding by 37% the level of deficit which stood at 6362 billion LBP. The rate of debt growth exceeded the rate of nominal GDP growth causing the debt to GDP ratio to reach 139% at the end of 2013 in comparison to 134% in the previous year. Thus, the improvement in this ratio that Lebanon started achieving in 2012 stopped which was mentioned in the latest report of the International Monetary Fund.

3-9 The growth in gross public debt as mentioned above was partly due to the willingness of the Ministry of Finance to form a liquidity surplus exceeding its current needs, that have increased, to constitute a reserve fund in case conditions develop in more negative ways in addition to other issues related to liquidity management in the country and currency stability. Thus, government deposits in the banking system increased from 12916 billion LBP at the end of 2012 to 15495 billion LBP at the end of 2013 (or by around 20%) distributed between 11032 billion LBP at the Central Bank and 4463 billion LBP at commercial banks. It is to mention that deposits in LBP at the Central Bank during 2013 increased by 5251 billion LBP distributed between 4646 billion LBP in the Treasury bills account number 100 and 197 billion LBP in Treasury account number 36. Thus, net public debt excluding the deposits of the public sector in the banking system increased from 74043 billion LBP at the end of 2012 to 80201 billion LBP at the end of 2013 or in the range of 8.3%.

3-10 The event that low growth rates continue in the next few years necessitates the conduct of a courageous fiscal reform to reduce the debt to GDP ratio. However, it is to mention that when computing market debt or debt excluding the amount held by the Central Bank, the National Social Security Fund, the bilateral and multilateral loans and Paris 2 and Paris 3 loans, the gross debt to GDP ratio is reduced to 95% and the net debt to GDP ratio to 72.7% which reflects in more detail the size of risk and its implications.

3-11 The factors that reduce the degree of risk when evaluating the imbalances in public finances and public debt are first the fact that a large part of this debt in LBP and foreign currencies (90%) is held by local subscribers that are used and have adjusted to sovereign risk and will not withdraw from the market upon the first signal endangering the country. Second, the Central Bank holds large amounts of foreign currency reserves and gold exceeding by 160% foreign currency debt at the end of 2013.

3-12 At the end of 2013, the debt denominated in LBP constituted 58.8% of the gross public debt in comparison to 41.2% for the debt in foreign currency. The banks remain the main sources of funds for the government in terms of protecting and preserving stability followed by the Central Bank and public enterprises whereas foreign bilateral and multilateral entities hold only a low share.

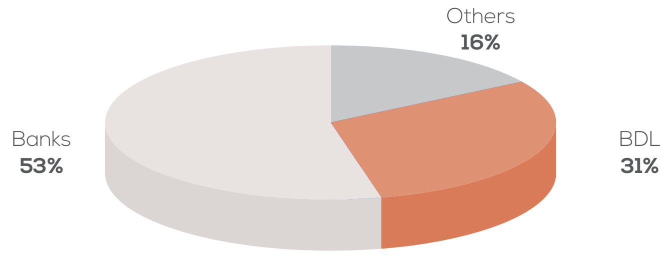
Public debt 2011-2013
(End of period – LBP billion)

	2011	2012	2013	Change (%) 2012/2011	Change (%) 2013/2012
Gross Public Debt	**80887**	**86959**	**95696**	**+7,5**	**+10,0**
Distribution of total public debt:					
Debt in LBP	49340	50198	56312	+1,7	+12,2
Debt in Foreign Currencies	31547	36761	39384	+16,5	+7,1
Deposit of the Public Sector at the Banking System	10984	12916	15495	+17,6	+20,0
Net Public Debt	**69903**	**74043**	**80201**	**+5,9**	**+8,3**
Gross Public Debt Financing: estimates (%)					
Banks in Lebanon	54,7	54,0	59,0		
Central Bank (BDL) & Public Entities	30,1	31,1	26,5		
Others (resident)	2,8	3,7	3,9		
Non-residents	12,4	11,1	10,6		
o/w: bilateral & multilateral loans	6,7	5,8	4,8		
Others	5,7	5,3	5,8		

Source: BDL

3-13 As far as financing public debt issued in LBP, the share of banks declined to 53.1% at the end of 2013 (54.3% at the end of the preceding year) faced by the increase in the share of the Central Bank to 30.5% (30% at the end of 2012) and the share of the non-banking sector to 16.4% (15.7% at the end of the preceding year). This is due to the weak subscription by banks except for the months of June, September and November where they subscribed in long-term Treasury Bills as mentioned earlier. The Central bank would offset the shortage when needed intervening in the market for Bills from time to time to restore its equilibrium.

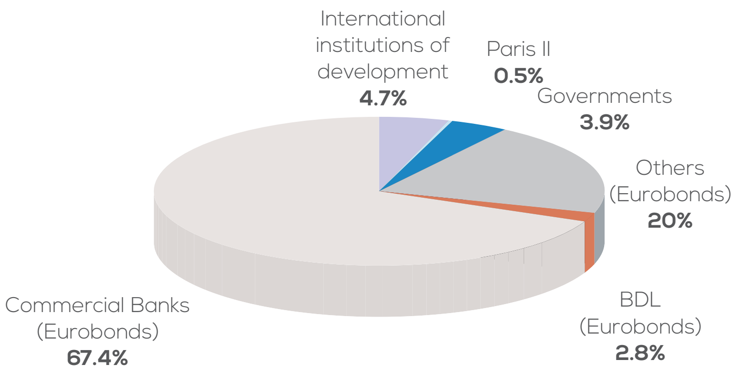
Financing Sources of public debt denominated in LBP
End 2013 (%)



3-14 As far as debt in foreign currency is concerned, the share of Eurobonds reached 90% at the end of 2013 whereas the share of other subscribers were as follows: Development & international institutions (6.4%), governments (4.5%), Paris 2 loans (0.4%), and other sources (0.6%). Whereas the portfolio of banks in Eurobonds largely increased in 2013 due to the banks purchase of the largest share of the Central Banks in these Bills, and their subscription in the new issuance launched by the Ministry of Finance in that year.

The banks portfolio in Eurobonds increased to 124% of banks capital in 2013. As a result, the share of banks in the financing of government debt in LBP and foreign currency increased from around 54% at the end of 2012 to 59% at the end of 2013. The Central Bank aims by selling its Eurobonds to raise the size of foreign currency reserves it holds which is a necessary and vital issue for the stability of the LBP, as well as ensuring liquidity to cover the needs of the government in foreign currency.

Financing Sources of public debt denominated in foreign currencies End 2013 (%)



3-15 The interest rates on government bills and bonds stabilized in 2013 on all categories and closed in the last issue of the year on the following: 4.43% for the 3 months category, 4.99% for the six months category, 5.35% for one year, 5.84% for the 2 years category, 6.50% for the 3 years category, 6.74% for the 5 years category, 7.50% for the 7 years category, whereas the interest rate on the new categories reached: 8 years (7.80%), 10 years (8.24%), and 12 years (8.74%).

3-16 As a result of the developments in the Treasury Bills market in LBP, the weighted interest rate on the overall portfolio increased from 6.54% at the end of 2012 to 6.86% at the end of 2013. The weighted maturity increased from 1105 days to 1274 days. Whereas in the Eurobonds market, the weighted interest rate declined on this portfolio from 6.66% at the end of 2012 to 6.5% at the end of 2013. The weighted maturity on it declined from 6.06 years to 5.60 years respectively.

IV- Monetary Policy Developments

4-1 The monetary situation showed a strong immunity and remained coherent to a great extent in 2013 despite the major deceleration in the Lebanese economic activity since 2011 and the escalation of the political tensions and the security chaos. 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. This goal is of interest to the banking sector, the economy and the social situation. The Central Bank took in 2013 several financial engineering measures detailed in the what follows that allowed it to secure necessary liquidity in foreign currencies to cover the needs of the government and preserve and even beef-up its foreign currency reserves and maintain interest rate stability on the LBP.

4-2 The monetary stability in its existing tools is expected to remain probably for a long-time and not only for the short-term. The existing monetary equation directed by the Central Bank and banks is based in both of its sides on a studied equilibrium of the common management of the inflows and stock of the foreign currencies in Lebanon. This management is trusted by both sides of the equation and has been experienced for the last twenty years with the relatively large crisis encountered during this period.

4-3 What is worth considering here is the cost of the policy of monetary stability. Banks bare a large part of this cost through an average return on assets that is lower than what could be achieved due to the high liquidity that banks have to hold at correspondent banks and at the Central Bank and the high required reserve ratios in LBP. The economy also and the Central bank bare part of this cost through debt that could have been raised at lower rates in normal circumstances and through the money creation and the issuance of certificate of deposits at higher interest rates.

4-4 The policy of currency peg adopted in Lebanon required the intervention of the Central Bank to subsidize loans to social groups and economic sectors that suffered from the high financing cost or that are initially not qualified on their own for market credit. In this respect, the Central Bank developed a monetary policy aimed at supporting economic growth in line with the practice of Central Banks in advanced economies since the beginning of the financial crisis of 2008.

4-5 The Monetary Situation: stable currency market, an increase in the foreign assets of the Central Bank, stable interest rates.

The LBP was not subject to major pressure in 2013 causing the interbank rate to remain at its official level of 2.75%. The Central Bank was able to preserve a high level of foreign currency reserves raising it to around $31.7 billion at the end of 2013 in comparison to around $ 30 billion at the end of 2012 excluding its investments in Lebanese Eurobonds and other international securities estimated at $3,5 billion at the end of 2013. Additionally, the Central Bank holds a large amount of gold reserves ranking it as 19th internationally and as 2nd in the MENA region in terms of country reserves according to the list of the "World Gold Council" of March 2014, given that the value of the gold reserves decreased to $11.1 billion at the end of 2013 in comparison to $15.3 billion at the end of 2012 with the decline in the price of the ounce of gold internationally. As it is known, foreign currency and gold reserves are some of the most important factors supporting confidence in the national currency. On another level, average interest rates remained stable on all categories of Treasury Bills in LBP for reasons to be discussed later on. Additionally, average interest rates on the issuance of Eurobonds that took place in 2013 were low and acceptable compared to the issuance of countries in the same risk classification of Lebanon.

4-6 Operations of lengthening maturity ... for market easing

In the framework of the cautionary strategy followed for the last few years by the monetary and fiscal authorities which aims at not leaving large sums in LBP and foreign currency mature in a relatively short period, we mention that the Central Bank, in June 2013, in cooperation with the Ministry of Finance, conducted swap operations to replace around 1240 billion LBP from its portfolio of Treasury Bills in LBP which would have matured in the second half of 2013 with Treasury Bills of the seven year category, knowing that this operation would allow at a later stage the Central Bank to reduce its government debt because of the possibility of selling the bills to banks. We also mention in this framework that the Central Bank allowed banks to subscribe in long-term Treasury Bills either in cash or through discounting the CDs in LBP issued by the Central Bank and maturing in 2013 and 2014. The Central Bank had in the first few months of 2013 replaced CDs in LBP maturing in 2013 and 2014 with other CDs with longer maturity. The Ministry of Finance had issued in 2012 Eurobonds aimed partly to replace part of the securities maturing in 2013.

4-7 Replacing and selling portfolios by the Central Bank ... to beef-up foreign currency reserves

At the same time of the maturity transformation, the Central Bank also replaced part of its portfolio of Treasury Bills in LBP with Eurobonds in cooperation with the Ministry of Finance, followed by the selling of portfolios. In April 2013, swap operations were conducted in the amount of $1.1 billion and in September in the value of $175 million, after conducting swap operations in June 2012 in the value of $2 billion and in December in the value of $1 billion.

The purpose of these operations is to reduce government debt of the Central Bank and help in the slight reduction of debt service. These replacement operations also help beef-up the future Central Bank holdings of foreign currency reserves or to improve the quality of securities to allow selling them later on in the market place. This is what really happened since the Central Bank sold in 2013 in our estimates around $4.5 billion of Eurobonds to banks reducing the value of its portfolio, also according to our estimates, to less than $1 billion at the end of 2013 in comparison to more than $3.5 billion in 2012.

4-8 CDs denominated in dollar and other measures... also to support the foreign assets of the Central Bank

The Central Bank continued in 2013 to issue CDs in $ even at a lower level than the last two years in the amount of $1.2 billion. The portfolio of CDs in $ issued by the Central Bank stabilized at $8.3 billion at the end of 2013 in comparison to $8.7 billion at the end of 2012 due to the fact that some CDs in $ matured in 2013. This measure, without doubt, contributed to supporting or a least preserving the foreign currency reserves of the Central Bank. The increase of the foreign currency deposits of banks at the Central Bank and the issuance of the Ministry of Finance in June 2013 of Eurobonds in the amount of $600 million to the Central Bank which, most probably were sold lately to the banks, contributed also to the increase of the foreign assets of the Central Bank.

4-9 CDs denominated in Lebanese pound... to control liquidity and preserve stability of interest rates in LBP

The portfolio of CDs in LBP issued by the Central Bank recorded a substantive increase to reach 33815 billion LBP at the end of 2013 in comparison to 23073 billion LBP at the end of 2012. Long-term CDs in LBP were issued in large amounts in 2013, after an absence in the previous year, partly to replace CDs maturing in 2013 and 2014 and in another part in return for cash payment. Some CDs matured in 2013 without replacement. The new issuance concentrated in 2013 on the 7-year category at an average interest rate of 7.6%, 8-year category at an average interest rate of 7.8%, 10-year category at an average interest rate of 8.24%, and the 12-year category at an average interest rate of 8.74% in addition to relatively limited issuance of the 45 and 60-day categories at their regular interest rates of 3.57% and 3.85% respectively. The issuance of the CDs allowed the Central Bank to control the liquidity in LBP at the financial sector, and also helped to stabilize the interest rates in LBP and on Treasury Bills.

4-10 The intervention of the Central Bank in the primary market of the Treasury Bills in LBP and large issuance of long-term categories... to secure the stability of interest rates

The intervention of the Central Bank buying Treasury Bills in LBP in the primary market as well as the inclination of the Ministry of Finance in 2013 and the preceding year to issue long-term Treasury Bills with the direct coordination with the Central Bank contributed to securing the large part of the government financial needs in LBP and to a great extent in keeping the interest rates stable on all categories of Treasury Bills.

As such, the portfolio of the Central Bank of Treasury Bills in LBP registered an increase to 16761 billion LBP at the end of 2013 in comparison to 14594 billion LBP at the end of 2012. Thus, the Central Bank's share slightly increased to 30.1% out of the total portfolio of Treasury Bills in LBP at the end of 2013 in comparison to 29.4% at the end of 2012. It is to mention at this juncture that the portfolio (and share) of the Central Bank in Treasury Bills in LBP would have been higher at the end of 2013 had it not replaced over 1900 billion LBP of them with Eurobonds as stated earlier. The issuance of the Ministry of Finance in coordination with the Central Bank of long-term Treasury Bills in LBP (7, 8, 10, 12 years) as detailed in another part of this report contributed to a large extent in securing the stability of the interest rates on the LBP. We mention that the Central Bank allowed banks to subscribe in the long-term issuance either in cash or through the CDs issued that will mature in 2013 and 2014. This subscription serves many purposes such as reducing the size of the approaching maturing CDs as we mentioned, reducing the cost of CDs in LBP on the Central Bank, and preventing the withdrawal of additional liquidity from the market.

4-11 Monetary Aggregates

The growth of the M3 monetary aggregate that stood at 6.9% in 2013 (7.0% in 2012) remained relatively stable for the third year in a raw in comparison to the averages of the previous years as this aggregate reached 167571 billion LBP at the end of 2013. The dollarization rate increased slightly to 58.97% at the end of this year in comparison to 58.5% at the end of 2012. It is possible to summarize the major components that contributed to the increase of M3 by 10774 billion LBP as follows:
The claims on the resident private sector increased by around 6259 billion LBP continuing their growth at the same speed (in percent) as 2012, becoming the major

contributor in the growth of M3. The net claims on the public sector (after excluding public sector deposits at the banking system) increased to a great extent in the amount of 4972 billion LBP becoming the second largest contributor to the growth of M3. Other net items in the balance sheets of the banking system increased by 1143 billion LBP and contribute positively to money creation. Conversely, the net foreign assets of the banking system excluding gold declined by 1537 billion LBP in 2013 representing over $1 billion with a clear contractionary impact on the monetary aggregate causing a decline in its growth following the continuation of the regressive path recorded in 2011 and 2012 but at a slower rate.

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

	2011	2012	Change 2012/2011	2013	Change 2013/2012
Money in LBP (M1)	6138	7104	+965	7620	+517
Money and quasi-money in LBP (M2)	58643	65077	+6434	68749	+3672
Money and quasi-money in LBP & FC (M3)	**146576**	**156797**	**+10221**	**167571**	**+10774**
Counterparts					
Net foreign assets	65464	64437	-1026	56555	-7882
o/w : gold	21709	23083	+1374	16739	-6345
foreign currencies	43755	41354	-2401	39817	-1537
Net claims on public sector	50909	54596	+3687	59568	+4972
Valuation adjustment	-13285	-14708	-1423	-8426	+6282
Claims on private sector	54164	59690	+5526	65949	+6259
Other items (net)	-10676	-7219	+3457	-6076	+1143

Source: BDL

4-12 Inflation

The inflation rate was contained at 3.5% in 2013 according to the estimates of the Central Bank. The average consumer price index increased for Beirut and its suburbs based on the **Consultation & Research Institute** by 2.6% in 2013 after increasing by 5.7% in 2012. The International Monetary Fund estimated the inflation rate to be 3.2% in 2013 in comparison to 5.9% in the previous year.

The average consumer price index according to the **Central Administration of Statistics** increased by 5.5% in 2013 after increasing by 6.6% in the previous year. This index took into consideration since July 2012 the results of the study conducted by this administration on the increase in rent based on a sample of 1200 dwelling units including old and new rents over the whole Lebanese territory. The rent item increased by 44.1% between July 2009 and July 2012. This inflated the average consumer price index based on this Central Administration in year 2012 compared to 2011 and in 2013 compared to 2012.

The inflation rate became more moderate in 2013 compared to the previous year due to the non-increase in the world prices of food products which Lebanon imports a large part of. The price index of FAO recorded a decline by 1.6% in 2013, coupled with the decrease in world oil prices by 3%. The increase in prices was partly due to the continuation of the inflationary waves – even at a lower rate than before – caused by the increase in salaries passed by the government in 2012, and the moderate increase in the Euro exchange rate from $1.28 in 2012 to $1.33 in 2013 given that Lebanon imports a large part of its commodities from the Euro zone. The price increase was also due to the increase in demand for some type of commodities in addition to the liquidity availability in the economy in the presence of a weak price control mechanism and the lack of a law on competition. It is to mention that the Central Bank works always at controlling and sterilizing liquidity with the objective of alleviating the inflationary pressure that may arise from it.

4-13 The inflation rate in 2014 is expected to be tied first to the implications of the passing of the salary scale and its financing from the increase in taxes on goods and services especially if it is passed in a random manner. This rate will also be affected by oil prices with a possibility of a decrease in these prices due to the improvement of expectations on world chain supply (from Iraq, Libya, Iran and North America) coupled with the increase in world demand. The possibility of an increase in prices remains due to the presence of regional and international conflicts (not agreeing with Iran on its nuclear projects, the Russian-Ukrainian crisis...). The inflation rate will also be affected by the direction of the change in food prices knowing that expectations about their progress point to their general decline in 2014.

V- External Payments

Balance of payments

5-1 The estimated current account deficit increased in Lebanon to around $7.2 billion in 2013 in comparison to $6.7 billion in 2012 according to the report of World Economic Outlook issued by the International Monetary Fund in April 2014. Its share of GDP increased to 16.2% from 15.7% in the two respective years. It is estimated that the current account deficit expansion in 2013 was caused by the increase in deficit merchandize trade by $500 million in this year, with a stability in imported goods and a reduction in exports and the possibility of remaining at the level recorded in the previous year the sum of each balance on services, remittances, and investment income.

It has become a constant for Lebanon to record a current account deficit (from $15 billion to $16 billion a year)(2) and a deficit in the return on factors of production (around $1 billion) in comparison to a surplus in balance on services (around $6 billion) and a surplus in remittances (over $3 billion).

(2) The deficit in merchandize trade recorded in the balance of payments differs from the deficit published by the Lebanese Customs that adds the following: re-exported goods, goods temporarily exported to be transformed or that are re-exported after being domestically equipped, and reformed goods).

The table below shows the large current account deficit as percent of GDP in Lebanon in comparison to deficits (-) and surpluses (+) in some other countries, developing and advanced, noting that the average in Lebanon is very high in comparison to what is accepted internationally. This issue has implications for currency stability which will be addressed later on.

Deficit/Surplus of the current account balance to GDP in selected countries (%)

	2012	2013
Lebanon	**-15,7**	**-16,2**
Tunisia	-8,2	-8,4
Turkey	-6,2	-7,9
Morocco	-9,7	-7,4
USA	-2,7	-2,3
Egypt	-3,9	-2,1
Belgium	-2,0	-1,7
France	-2,2	-1,6
Cyprus	-6,8	-1,5
Italy	-0,4	+0,8
Denmark	+6,0	+6,6
Switzerland	+9,6	+9,6
The Netherlands	+9,4	+10,4
Saudi Arabia	+22,4	+17,4
Kuwait	+43,2	+38,8

Source: IMF- World Economic Outlook - April 2014

5-2 It is difficult to predict the current account deficit in 2014 due to several factors affecting its components such as: the domestic political and security developments, the situation in Syria, economic growth in Lebanon, the return of tourists especially Arabs to Lebanon with the possibility of lifting the advisory against travel to Lebanon, the price of food products and oil... The International Monetary Fund has predicted in its last report on World Economy that the current account deficit in absolute value in Lebanon will stabilize on $7.2 billion in 2014 with its share of GDP declining to 15.8%.

5-3 Before addressing the balance of trade in detail at the end of this section, it is enough to mention here in the subject of balance on services, the continuous decline in tourism activity in 2013 for the third year in a row at a slower rate than the past. The number of tourists to Lebanon declined at a rate of 6.7% to reach 1,274,362 tourists which is the lowest since 2008 according to the statistics of the Ministry of Tourism. The occupancy rate of Beirut 4 and 5 star hotels declined to 51% in 2013 from 54% in 2012 according to Ernst and Young. This happened in particular due to the calls by some Arab governments to their citizens to avoid travel to Lebanon and also due to the decline in land travel because of the increased risk with the deterioration in the Syrian security situation. It is to mention that Gulf countries encouraged their citizens lately to visit Lebanon.

5-4 The remittances to Lebanon increased by 4.1% in 2013 to reach $7.2 billion based on the latest estimates of the World Bank that reduced the value of these estimates to $6.9 billion for each of 2011 and 2012 from previous estimates of $7.3 billion for both years, given that they differ from the ones of the International Monetary Fund. The remittances to Lebanon constituted 16% of GDP which is one of the highest in the world and the highest in the region. This regular level of remittances reflects the size of the Lebanese diaspora in all parts of the world and its high quality in all respects. The remittances of those working in Lebanon to the rest of the world reached, according to the latest available figures of the World Bank, around $4.2 billion in 2012. Thus, the net remittances to Lebanon cover around 17% to 18% of the merchandize trade deficit.

5-5 The large current account deficit in Lebanon is largely caused by the deficits in merchandize trade financed by the surplus in the capital account or through the inflow of net capital in various forms from direct investments, portfolio investments, deposits at banks and net loans from abroad to the public and private sectors and others. Based on the current account deficit expected or estimated by the International Monetary Fund, which are figures subject to adjustment, and the figures of the balance of payments provided by the Central Bank, the net inflow of capital to Lebanon reached in 2013 around $6 billion (around 13% of GDP).

5-6 As far as foreign direct investments whose size is estimated differently by various sources, several reports concluded on their decline in the last years due to the domestic and regional pressures. The Investment Development Authority of Lebanon (IDAL) expected a decline in foreign direct investments by around 3% in 2013 to reach $3.6 billion in comparison to $3.7 billion in 2012. The latest report of UNCTAD on world investments pointed out that net foreign direct investments to Lebanon reached around $3.2 billion in 2012 (7.4% of GDP) whereas foreign direct investments to Lebanon reached $3.8 billion in the same year (8.8% of GDP). It is to mention that foreign direct investments usually finance a large part of the current account deficits. These investments are largely concentrated in the real estate sector differing from the nature of foreign investments in many similar emerging markets where they are diverse affecting several economic sectors.

5-7 In conclusion and for the third year in a row, net financial inflows in 2013 could not cover the current account deficit which is the opposite of the trend prevailing in 2002-2010. This is due to several reasons such as the high level of imports in goods, the political tension in Lebanon and the developments in Syria and their negative impacts on tourism and exports that is on the current account on one hand and capital account that includes foreign direct investments on the other. This caused a deficit in the balance of payments reaching $1.1 billion in 2013 in comparison to a slightly higher deficit reaching $1.5 billion in 2012. As this deficit reflects the latest developments in the region, it is possible to say that Lebanon has accumulated in a previous period a large size of savings in foreign currencies allowing the financing of deficits in the size achieved in the last three years. This does not mean though not to deal with the subject in a new vision and policies.

5-8 The pressure of large current account deficits and their widening requires securing the proper financing through capital inflows in their various forms from foreign direct investments, portfolio investments and others (i.e an increase in external debt). Otherwise, there is a need to rely on foreign currency reserves which may constitute pressure on the currency market. An increase in the need to attract funds to Lebanon can also as well cause an increase in average interest rates on debit and credit accounts. It is known that Lebanon did not encounter difficulties in attracting large and sufficient amounts of capital since 2002 except in the period 2011-2013 with the widening of current account deficits for known reasons. It is feared that this trend would remain over the short-term, i.e large current account deficit and weakening in net financial inflows with their remaining causes. This represents one of the most important challenges in the next period.

Foreign trade

5-9 In 2013, the value of imported goods according to the High Council of Customs reached $21228 million in comparison to $21280 in 2012 (i.e a decline of 0.2%) whereas the imported quantities reach a slight increase of 1.6% to reach 15868 thousand tons in 2013 which is a new record. The picture changes when we get into the details of imported goods in 2013. Excluding metal products composed primarily of derived oil products, precious and semi-precious stones, and precious metals (3), most of the imported products witnessed an increase in their values and quantities even in different degrees. Imported goods with the exclusion of metal products and precious metals increased by 9.7% in value and 17.8% in quantity. The increase in imports in 2013 comes as a natural result of the increase in demand for a large number of goods and services given the presence of over one million Syrian refugees on the Lebanese territory.

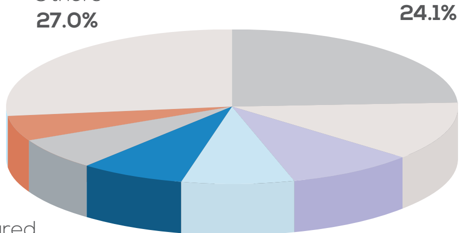
Imports of goods

	2011	2012	2013
Value – USD million	20158	21280	21228
Change (%)	+12,2	+5,6	-0.2
Quantities – Thousand tons	15050	15623	15868
Change (%)	+0,3	+3,8	+1,6

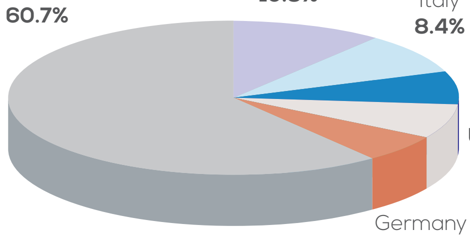
Source: Customs automated center

The two graphs below summarize the distribution of imported goods by type and country of origin in 2013.

Main imports of goods
Share of total in 2013



Main countries of destination
Share of total in 2013



Source: Customs automated center

(3) The imported goods of metal products declined by $925 million in 2013 in comparison to 2012 caused partly by the high level recorded in 2012. The value of imported precious and semi-precious stones and precious metals decreased by $449 million in 2013 in comparison to the previous year and this is partly due to the decline in world gold prices and possibly the decline in the exports of stones and metals.

5-10 From its part, the value of exported goods according to the High Council of Customs decreased to $3936 million in 2013, or by 12.2% in comparison to 2012. This result coincided on one hand with the major decline in the export value of precious and semi-precious stones and precious metals (value of $954 million) especially to South Africa and Switzerland and on the other hand with the increase in the value of exports of metal products especially to Syria (+$225 million). Excluding the two mentioned items, exports of goods would have recorded a moderate increase of 6.9% in 2013.The quantity of exports on its part increased by 6.7% in 2013 in comparison to the previous year.

It is to mention that the value of exported goods to the Arab countries which is considered the principal export market for Lebanon reached a record level of $2020 million in 2013 (an increase of 16.2%) after increasing by 15.4% in 2012 to look coherent in general and not being negatively affected by the situation in Syria knowing that these exports recorded a decline in 2011. These exports were able in general to adjust to the developments with an increase in the share of sea and air exports and changing the land trajectory according to the destination of exports.

These results become less positive when getting into the details. It is true that exports to Syria increased by a large amount reaching $229 million in 2013 after increasing by $79 million in the previous year. However, this increase was fully due to the increase in mineral products (derived oil products) as mentioned earlier. When mineral products are excluded, exports to Syria remain without change in 2013 in comparison to 2012 and 2011 whereas exports to the Arab countries excluding Syria would have increased by 3.6% (instead of 16.2%) in 2013 and by 11.8% (instead of 15.4%) in 2012.

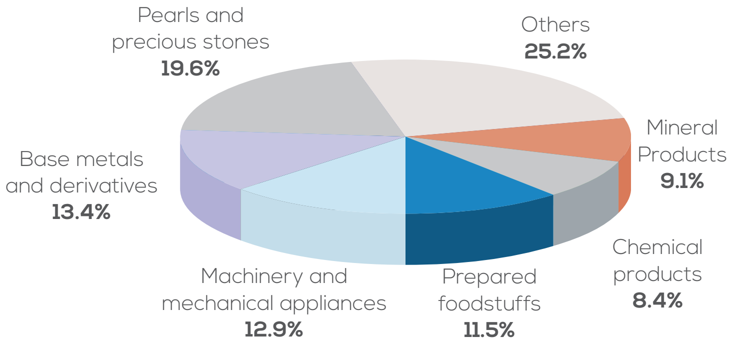
Exports of goods

	2011	2012	2013
Value – USD million	4265	4483	3936
Change (%)	+0.3	+5,1	-12,2
Quantities – Thousand tons	2717	2602	2776
Change (%)	-12,6	-4,2	+6,7

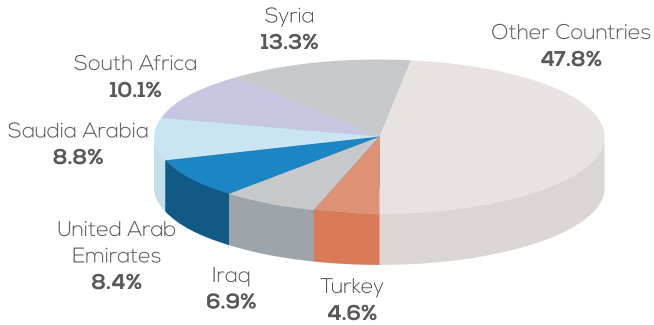
Source: Customs automated center

The two graphs below highlight the most important Lebanese exports of goods and the most important countries of exports in 2013.

Main exports of goods
Share of total in 2013

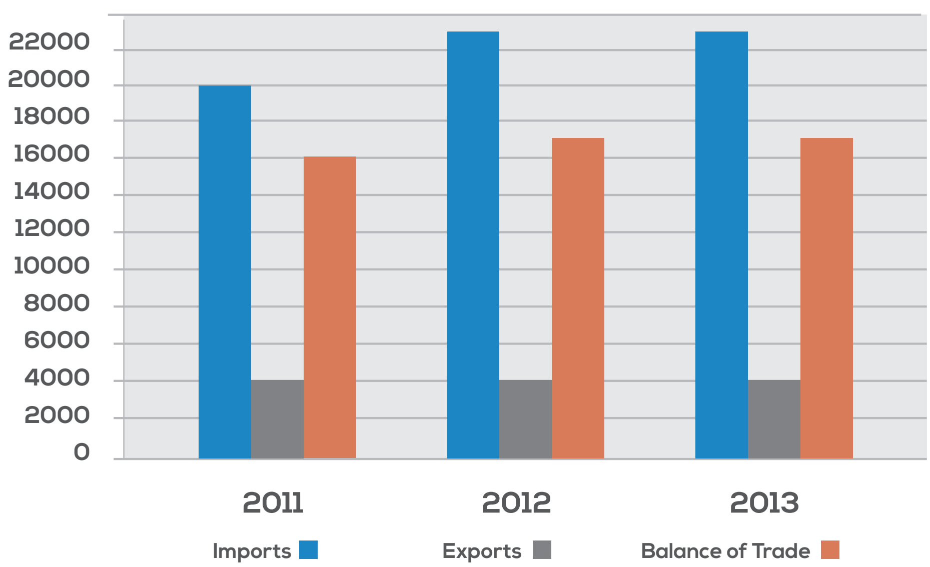


Main countries of origin
Share of total in 2013



Source: Customs automated center

Lebanon foreign trade (USD million)



5-11 In conclusion, and as stated by the International Monetary Fund in the final report of the visit of the mission of article IV in May 2014, Lebanon needs to increase its competitive abilities to boost the possibilities of growth by exporting more and relying less on imported products, instead of having the merchandize trade constitute a large burden on the economy, especially by improving the business climate, reducing the cost of business practice, and increasing the productivity in the public and private sectors.

VI- Banks and the financing of the economy

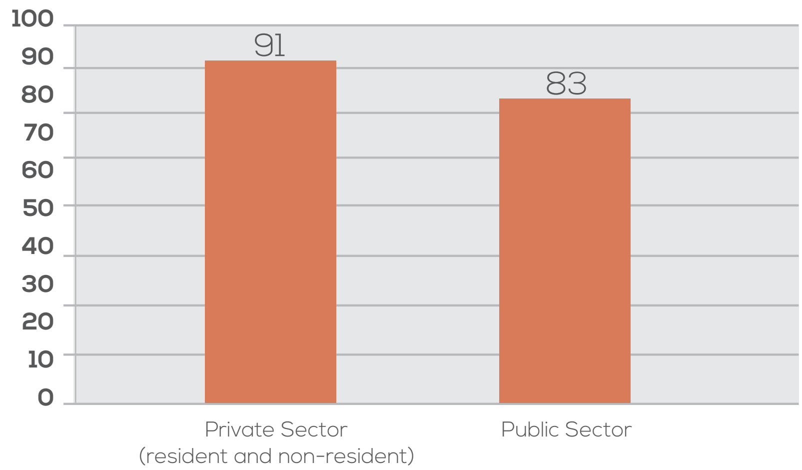
6-1 The Lebanese banking sector is considered to be one of the most contributing factors to economic growth. It contributes to 6% of GDP despite the fact that it employs a limited proportion of the Lebanese total labor force. The banking sector constitutes the most notable financial intermediary in the country in the presence of weak financial markets. It is the largest source of funds and the main financier of the national economy in its public and private sectors by favorable size and conditions. Very few banking sectors in the world finance the public sector by the quantities provided by Lebanese banks. Banks in Lebanon finance part of the government deficit despite its high sovereign risk and its low credit rating (B-). Bank government financing represents 30% of total deposits whereas the average does not exceed 15% to 20% in the Arab World, Europe and America where governments are involved in direct finance from the markets i.e from the subscriptions of the non-bank public and firms in sovereign bonds.

6-2 In its turn, financing the needs of the government requires banks to strengthen their capital base to confirm to the Basel accord that ties bank capital to bank risk with the sovereign risk weight for Lebanon amounting to 100%. Banks strive to make available the required capital in the next years to meet Lebanon's high risks. The banking profession is always subject to international rules stipulated by the Basel committee, the International Monetary Fund and other regulations in the fields of capital adequacy, liquidity, anti-money laundering and countering the financing of terrorism and to the related parties. Complying with these accords and rules represents a necessary condition to be active in international markets and deal with correspondent banks. Conducting banking business internationally armed with sufficient capital is necessary. It is through this correspondent banking link that remittances are transmitted to Lebanon, exports and imports are financed, savings are mobilized, and foreign currency reserves are made available to the Central Bank to ensure monetary stability.

6-3 At the end of 2013, deposits at commercial banks operating in Lebanon reached $139,2 billion (20,5% represent deposits of non-residents) without considering off-balance sheet fiduciary deposits and the deposits of specialized banks reaching $1,9 billion and $2,1 billion respectively at the end of 2013. In the last year, banks were able to slightly increase their deposits due to capital inflows from abroad and the lending activity to the national economy causing the total deposits to increase by 9% in comparison to 8.5% in 2012. It is to mention that the growth of deposits at banks is tied to the conditions of the Lebanese diaspora that represents the major source of capital inflows and remittances either to its families or to its private accounts.

6-4 The Lebanese banking sector remains the first and largest financing source to the Lebanese economy evidenced by the ratio of loans granted to both private and public sectors to GDP. In 2013, the share of loans granted to the private resident sector accounted for around 91% of GDP against 88% in 2012, whereas the shares of loans granted to the public sector nearly accounted for 82.6% of GDP in 2013 and 72.4% in 2012. The credit values to both sectors reached around $85.1 billion by the end of 2013 distributed between 44.3% to the public sector and 55.7% to private resident and non-resident sectors. It is worth noting that since 2010, the share of bank credits to the private sector started exceeding that of the public sector.

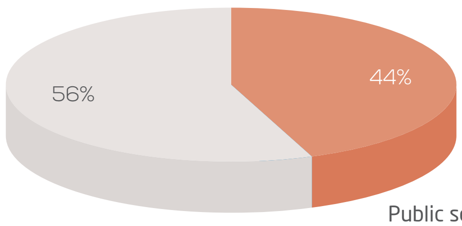
Loans/GDP (End of period -%)



6-5 The value of loans granted to resident and non-resident private sector reached $47.4 billion net of doubtful loans at the end of 2013 (of which 12.4% to non-resident private sector) registering an increase of 9%, which is lower than the percent increase for 2012 (10.4%.) Lending to institutions and families represent the main support to domestic demand and investment in light of the weakness or absence of the external component of aggregate demand. Lately, the policy of the Central Bank aiming at stimulating the private sector relied on several diverse pillars. The first pillar is the liquidity incentive bundle at low costs to banks as the Central Bank launched at the beginning of 2013 an incentive program for loans covering most economic sectors especially the housing one in order to give a new boost to economic growth through bank loans in LBP at acceptable rates. The Central Bank through its initiative placed at the disposal of banks $1.4 billion at 1% interest so that they can continue lending institutions and families using this new mechanism after exhausting the required reserve mechanism given that banks alone bear credit risk. The Central Bank also determined the economic activities that can benefit from this mechanism and set a ceiling on the lending rate that cannot exceed 5%.

There was a large cooperation with the new program by banks and the market as funds targeted for new projects were quickly used along with a large amount of ones specified for housing loans. The Central Bank also placed at the beginning of 2014 an additional sum of $800 million through this mechanism for additional economic incentives and the preservation of positive economic growth rates and activating both the housing sector and especially the technological one. The second incentive package related to circular 331 addressing the knowledge economy given that this sector constitutes an engine for growth in the future with the Central Bank providing for these projects an insurance coverage of 75% causing banks not to risk their capital base. This circular allows banks and financial institutions to participate within a limit of 3% of their capital in financing start-up projects, business incubators and accelerators whose business is centered around the knowledge economy. This is because the human power in Lebanon has the ability to succeed in this domain which allows the improvement of the competitive abilities of traditional sectors. The purpose of this circular is to activate the procedures of establishing new promising companies that in the future could turn into companies capable of enriching the national wealth and creating new jobs. Capitalizing through partnerships and capital contributions are new functions allowing banks to support the mental capabilities and professional inventions that fit into the framework of the knowledge economy. It is hoped that a stock market specialized in these areas would allow the possibility of including the shares of these companies on the market after meeting the proper requirements. The third pillar consists of extending from 7 to 10 years, including for new credit, the maturity of subsidized loans to the productive sectors such as tourism that was one of the most affected sectors by domestic and international conditions.

Share of loans to public and private sectors as end 2013 (% & USD billion)



Source: BDL

6-6 Public sector credit reached the equivalent of $37.7 billion by the end of 2013 against $31.1 billion at the end of 2012, an increase by nearly $6.5 billion. This is due mostly to the banks' subscription in long-term Treasury Bills in LBP in categories of 7, 8 and 10-year maturity in addition to the 12-year category issued by the Ministry of Finance for the first time in 2013 and the purchase by banks of a large part of the Eurobonds held by the Central Bank and their subscription in new Eurobonds issued by the Ministry. By the end of 2013, banks' share of the public debt that reached $63.5 billion was around 59%. It is to note that banks continued financing a large part of public debt. The other financing groups represent the Central Bank (around 19%), and other residents such as public institutions, financial institutions and the public (around 12%).This means that around 90% of Lebanese public debt is held by resident groups, which gives Lebanon a margin of independence towards foreign parties such as other nations, financial institutions and individuals.

6-7 Banks are also fully coordinating with the Central Bank on what applies to technical systems and aspects related to payments, reporting, and disclosure, which facilitates and protects the credit and financing operations, knowing that the payments' systems constitute one of the pillars of the functions of Central Banks due to their significance in achieving monetary and financial stability. 2013 witnessed major developments in the payments systems in Lebanon. One of the major achievements is the creation of a working mechanism between the Ministry of Finance and commercial banks to settle taxes and fees electronically (e-payment), increasing efficiency and contributing to savings in resources and costs. Those benefiting from this service are the taxpayers, the treasury and the Lebanese banks, noting that the systems involved in launching this service preserve the confidentiality of the electronic information and prevent any outside party from accessing it. This mechanism is in line with the payments' systems that the Central Bank develops and manages, and follows the application of the Real Time Gross Settlement (BDL-RTGS) that was successfully launched by the Central Bank in July 2012.

6-8 Banks believe that improvement is necessary given the changes experienced in the workplace with social responsibility drastically becoming part of their objectives as there exist several agreements between banks and associations for support. Banks also aim at creating working means to merge social and humanitarian causes in their strategy and plans so that social responsibility becomes a working style and a method of performance. On another level, the Central Bank launched initiatives aimed at protecting the consumer in its banking dealings. It asked to establish a special unit in the Banking Control Commission as it is in direct contact with the sector monitoring its performance regularly, which means that it is capable to follow-up through a qualified and professional staff. The purpose is to make sure that customers are aware that their dealings with banks are subject to high transparency and wise administration. The Central Bank also established a working plan with banks requiring them to form committees to study the bonus system in banks to have clear and transparent standards satisfying shareholders. These measures are part of the international principles of good governance issued by the Association of Banks as an ethical guide to follow by banks operating in Lebanon. This document relies on the Lebanese law provisions, the Central Bank's regulations, the recommendations of the Basel Banking Committee, Corporate Governance Principles Policies and Practices published by the OECD and the publications of the UASB (IAS, IFRS).

6-9 The fast development witnessed by the banking profession and the new techniques of modern banking require a continuous follow-up at the levels of legislation, organization and implementation. Despite the improvement that Lebanon has developed at this level, it still needs additional efforts concerning the development of the legislative, financial and banking legal documents. In 2013, the monetary authorities took several measures and issued circulars capable of ensuring that the funds available in the Lebanese banking sector are legal ones that do not violate Lebanese laws and are in conformity with international ones. This is essential as Lebanon belongs to a region subject to financial sanctions due to the political and security incidents. Lebanon is keen on remaining a member of the global banking community and on respecting the principles and rules developed by the countries it deals with or the ones whose currency it uses. For years, the high administration of Lebanese banks has been clearly and strongly committed to enhance the tools, systems and procedures necessary to fight money laundering and the financing of terrorism. Year after year, the "compliance unit" has been updating its work as it was created in each bank of professional experts fully dedicated to these tasks and constantly aware of the recent global developments. Naturally, banks apply all the circulars of the Central Bank and the Special Investigation Commission in addition to the relating international standards of which the Know Your Customers (KYC) rules. Lebanon is also committed to applying the Foreign Account Tax Compliance ACT (FATCA) as every bank operating in Lebanon will individually sign this agreement.

6-10 In 2013, banks strengthened their work with the INTERPOL creating a model to be used by international banks in this cooperation. It is hoped that this model would secure for the banks within the Lebanese laws and for international banks within the conventional standards a shield for the banking industry and a protection from financial organized crime. Banks are currently working on exploring future cooperation in the fight against financial crime and money laundering given that the cooperation with the INTERPOL goes back to several decades. Banks will be able upon opening an account for any person to make sure whether the name is part of the INTERPOL records. Currently, banks are obliged upon opening accounts for new customers and in order to investigate their background to consult many international records including American, European, British and lists of private information firms.