Euler Hermes Economic Research

Country Risk Analysis

Lebanon

Fragile, but resilient

General Information

GDP	USD42.945bn (World ranking 83, World Bank 2012)
Population	4.43 million (World ranking 123, World Bank 2012)
Form of state	Republic
Head of government	Michel SULAYMAN
Next elections	2014, Presidential

Strengths

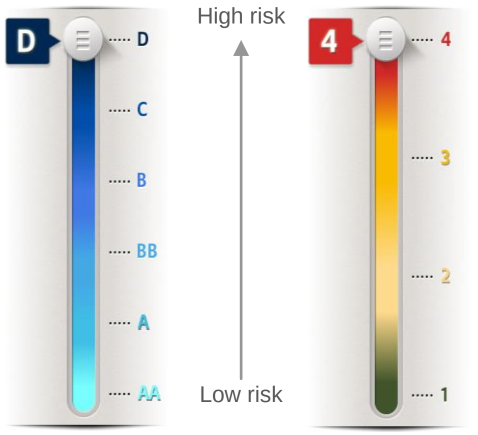
- Regional support from the GCC states.
- There are more Lebanese domiciled overseas than in the country itself and this large diaspora provides a major source of funding.
- Lebanese debt remains financially marketable and the country has been able to raise international financial support in need.
- Ownership of public debt is largely domestic, or with the diaspora.
- Educated workforce.
- Banking system relatively sound.
- Strong FX reserves and import cover.

Weaknesses

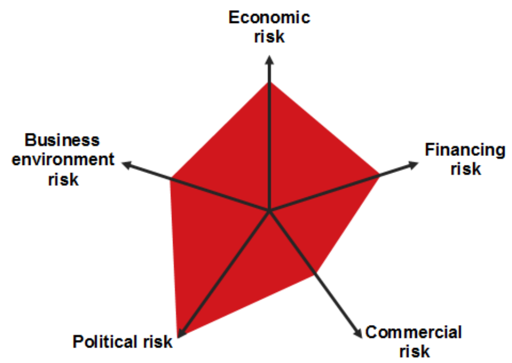
- Tensions between the religious factions spill over into the political arena and into periodic outbreaks of violence.
- Regional factors, including relationship with Syria and tensions arising directly and indirectly from Iranian influence.
- Large fiscal deficits and high public debt (among the highest in the world when expressed as a percentage of GDP).
- Wide current account deficits.
- A fixed exchange rate (the LBP is pegged to the USD) prevents economic management through that mechanism.
- Relatively poor data provision.

Country Rating D4

Country Grade **Country Risk Level**

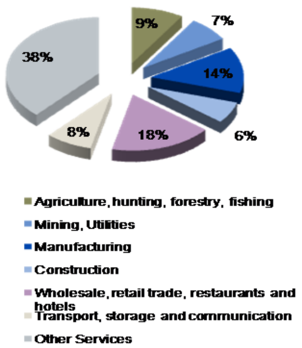


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2011)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Trade structure (% of total, 2011)

By destination/origin

Exports		Rank		Imports
United Arab Emirates	11%	1	10%	Italy
Saudi Arabia	8%	2	9%	United States
Switzerland	7%	3	8%	France
Iraq	7%	4	8%	China
Turkey	7%	5	7%	Ukraine

By product

Exports		Rank		Imports
Non metallic mineral manufactures	10%	1	20%	Petroleum, petroleum products and related
Gold, non-monetary	10%	2	8%	Iron and steel
Metalliferous ores and metal scrap	9%	3	7%	Gold, non-monetary
Miscellaneous manufactured articles	7%	4	6%	Road vehicles
Vegetables and fruits	7%	5	4%	Medicinal and pharmaceutical products

Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	8.5	7.0	1.4	2.0	2.0	3.5
Inflation (%, end-year)	3.4	5.1	3.1	10.1	2.6	2.6
Fiscal balance (% of GDP)	-8.3	-7.8	-5.9	-9.2	-8.1	-7.4
Public debt (% of GDP)	147.6	141.7	135.9	135.7	129.4	124.7
Current account (% of GDP)	-19.5	-20.4	-12.3	-15.0	-16.6	-17.3
External debt (% of GDP)	71.6	66.2	62.7	67.9	65.2	63.1

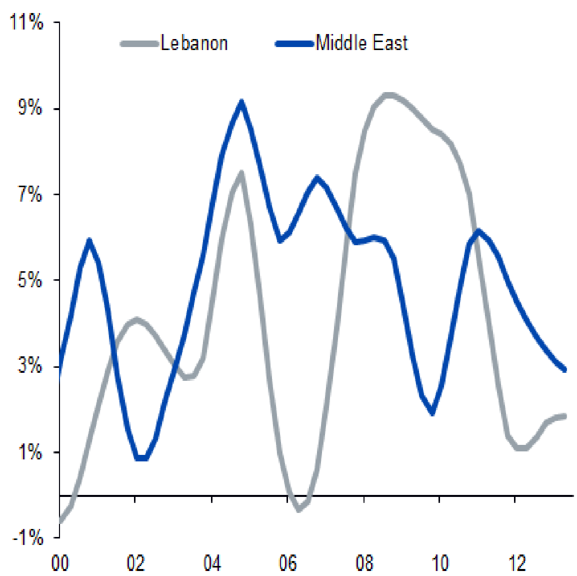
Sources: IHS Global Insight, National sources, Euler Hermes

Economic Overview

The economy is essentially service-oriented (over 60% of GDP, compared with 8% for agriculture, 14% for manufacturing and 6% for construction) so is vulnerable to oscillations in regional and global developments. Annual average GDP growth in the ten-year period to end-2012 was +4.8% but with considerable volatility (see chart) and the direction of the rate of growth often moving against the regional average. The latter outcome is partly a result of political and social factors but also reflects that, unlike many regional economies, Lebanon is an oil importer (20% of the overall import bill) and the surge provided for oil exporters during times of high energy prices weighs against Lebanon.

The impact on the Lebanese economy of events in Syria is severe, particularly as the two countries have a long trading history and record of significant movements of workers and assets across the common boundary. Heightened tensions and violence have resulted in reduced consumer and investor confidence and a weak tourism sector. Additionally, an estimated 720,000 Syrian refugees (probably an under-estimate) are currently housed within Lebanon, exerting pressures on fiscal accounts and jobs (with social repercussions). EH expects GDP growth of +2% in 2013 and +3.5% in 2014, but with significant downside risks because of a highly uncertain regional environment.

GDP growth (%)



Sources: IHS Global Insight, Euler Hermes

Economic Overview (continued)

Official statistics on inflation were not made available in H1 2013, reflecting a lack of data collection [overall, data provision is poor for a country of such stature]. Accordingly, EH forecasts for inflation are based on unofficial reports and other statistical evidence, which suggests that inflationary pressures waned from the end of 2012 when inflation was 10.1% and had averaged 6.6% in that year.EH works on the assumption that, despite upward price pressures emanating from the large influx of Syrian refugees, the bias is for price pressures to ease, reflecting relatively weak upward movements in food prices. Overall, EH expects inflation to average 5.3% in 2013 and end the year at 2.6%.

The central bank has maintained its exchange rate policy of a fixed USD peg (LBP1,507.5:USD1) since the mid-1990s, despite considerable economic and financial volatility and political uncertainty. Strong FX reserves have helped by providing currency support and the central bank has maintained a relatively tight monetary policy, which has also supported the LBP. EH expects the exchange rate system to be maintained over the course of the forecast period.

The fiscal deficit widened to -9.2% of GDP in 2012 from a relatively low -5.9% in 2011. As a result, the fiscal policy authorities moved to cut spending but EH expects an annual fiscal deficit of around -8% of GDP in 2013, although this could be even higher, given the domestic costs involved in housing Syrian refugees.

The size of the deficit on the current account this year and next (in 2012 it was equivalent to -15% of GDP) is difficult to assess, given uncertainties relating to regional events, particularly in Syria. Losses of exports to Syria itself are to be expected but some merchandise trade diversion because of difficult conditions in that country may provide a trade boost. Even so, EH expects current account deficits of -16.6% and -17.3% of GDP in 2013 and 2014, respectively.

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