Euler Hermes Economic Research

Country Report

Lebanon

Regional events are negative for an already fragile state

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	PM Tamam Salam
Next elections	2014, legislative

Strengths

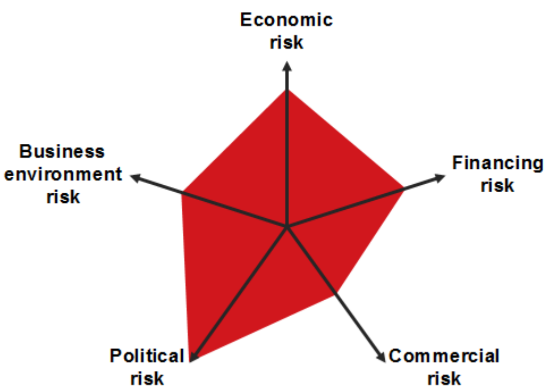
- Regional support from the GCC states.
- There are more Lebanese domiciled overseas than in the country itself and this large diaspora provides a major source of funding.
- Lebanese debt remains financially marketable and the country has been able to raise international financial support, in need.
- 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 events in Iraq and 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



Source: Euler Hermes

Trade structure

By destination/origin (% of total)

Exports		Rank		Imports
South Africa	11%	1	8%	China
Switzerland	11%	2	8%	United States
Saudi Arabia	9%	3	8%	Italy
United Arab Emirates	9%	4	8%	France
Syrian Arab Republic	7%	5	5%	Germany

By product (% of total)

Exports		Rank		Imports
Gold, non-monetary	17%	1	22%	Petroleum and related materials
Miscellaneous manufactured	10%	2	7%	Iron and steel
Non metallic mineral manufactures, n.e.s.	8%	3	7%	Road vehicles
Metalliferous ores and metal scrap	7%	4	5%	Gold, non-monetary
Vegetables and fruits	7%	5	4%	Medicinal and pharmaceutical products

Source: UNCTAD (2012)

GDP growth is subject to a double negative influence: domestic constraints and adverse regional effects

The economy is essentially service-oriented (over 60% of GDP, compared with 9% 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-2013 was over +4.5% 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 (22% 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 official estimated 775,000 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 only +1.5% in 2014 and +2.5% in 2015, but with significant downside risks because of a highly uncertain regional environment.

Inflationary pressures emanating from the influx of Syrian refugees are partially offset by current weaker prices for imported foodstuffs

Official statistics on inflation were seriously disrupted from H1 2013, partly because of a lack of data collection. Data remain uncertain and annual inflation rates are yet to be made available since that date. Despite current softer commodity prices and beneficial base effects, inflationary pressures are evident, partly stemming from pressures because of the large influx of Syrian refugees. EH works on the assumption that the bias is for price pressures to remain containable, despite these upward influences emanating from the large influx of Syrian refugees, partly reflecting relatively weak upward movements in food prices. Overall, EH expects inflation to average 2% in 2014 and end the year at 3.2%.

The exchange rate system is highly unlikely to change in the forecast period

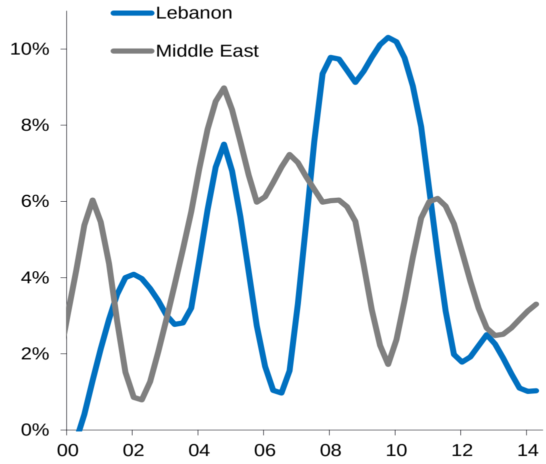
The central bank has maintained its exchange rate policy of a fixed USD peg (LBP1,507.5:USD1) since the mid-1990s, despite considerable economic and financial volatility and political uncertainty. Strong FX reserves have helped by providing currency support and the central bank has maintained a relatively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

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	2.5	1.1	1.5	2.5
Inflation (%, end-year)	10.1	1.1	3.2	4.3
Fiscal balance (% of GDP)	-9.1	-11.0	-9.4	-8.3
Public debt (% of GDP)	134.2	138.0	137.3	137.3
Current account (% of GDP)	-8.2	-9.2	-8.3	-8.1
External debt (% of GDP)	67.4	67.4	67.9	68.3

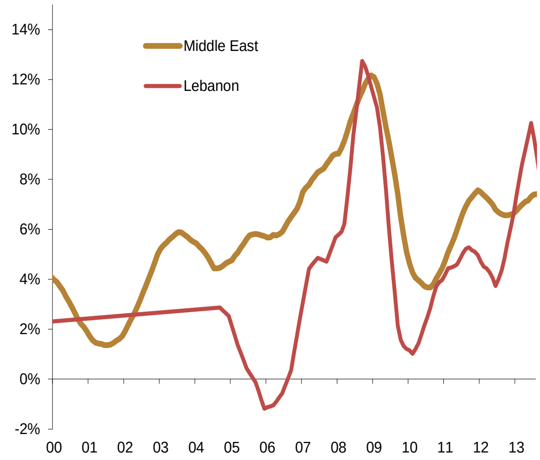
Sources: IHS Global Insight, Euler Hermes

GDP growth (% y/y, 4 quarters cumulated)



Sources: IHS Global Insight, Euler Hermes

Inflation (%)



Sources: IHS Global Insight, Euler Hermes

Large fiscal deficits...

The fiscal deficit widened to -9.1% of GDP in 2012, from a relatively low -5.8% in 2011, and widened further in 2013, to -10.97%. Despite the authorities conducting fiscal policy pledging to cut spending, EH expects fiscal deficits of around -9% of GDP in 2014 and -8% in 2015, although this could be even higher, given the domestic costs involved in housing Syrian refugees and current levels of interest payments that are equivalent to around 50% of tax revenues.

...and similarly large current account shortfalls...

The size of the deficit on the current account this year and next (in 2013 it was equivalent to -9% of GDP) continues to be difficult to assess, given uncertainties relating to regional events, particularly in Syria. The tourism sector continues to be adversely affected by domestic and regional insecurity issues, particularly as some governments advise against travel to the country. Losses of exports to Syria itself have been substantial but some merchandise trade diversion because of difficult conditions in that country has partially compensated. Even so, EH expects current account deficits of -8.3% and -8.1% of GDP in 2014 and 2015, respectively.

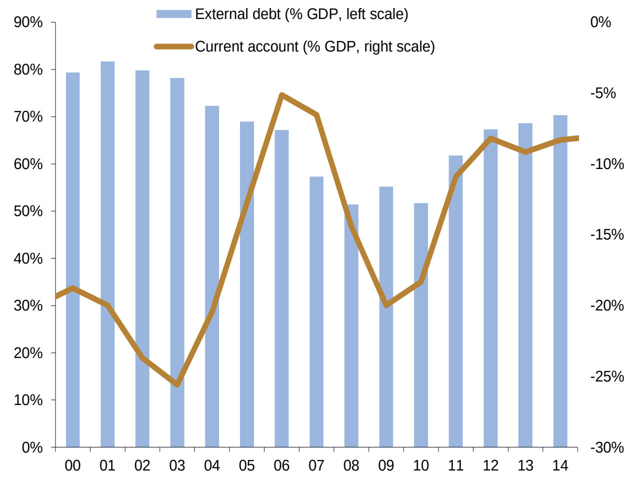
...although external debt obligations, despite rising, are manageable

External debt ratios are deteriorating, with debt/GDP and debt/export earnings at 68% and 93% forecast for 2014, compared with 62% and 73% in 2011, respectively. The external debt service ratio (repayments/total export earnings) is likely to increase to over 16% in 2014, compared with just below 14% in 2011. However, against a background of increasing FX reserves and high import cover (over 13.5 months in 2014) and continuing support from the region (GCC states, in particular) external debt servicing is unlikely to constitute a severe problem in the forecast period.

Resilient banking sector

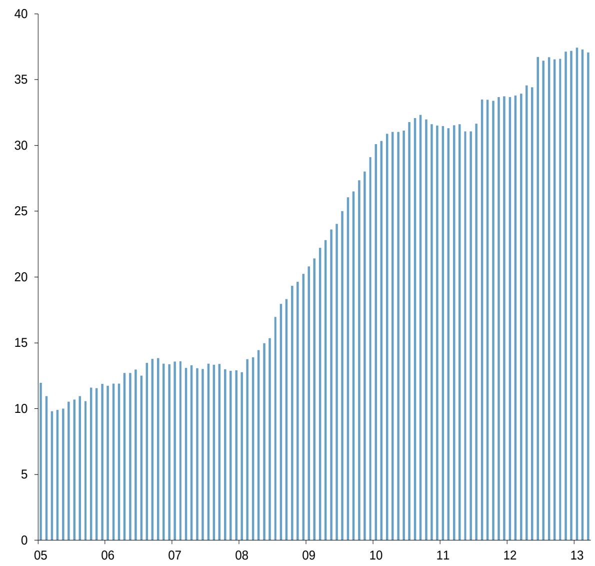
In addition to the country's large FX reserves relative to import requirements and costs, the banking system remains robust. This reflects prudent management and a sound regulatory environment. Liquidity is high, capital requirements exceed the regulatory minimum and the ratio of non-performing to total loans is only around 4%.

External debt and current account balance (% of GDP)



Sources: IHS Global Insight, Euler Hermes

Foreign Exchange Reserves (USD bn)



Sources: IHS Global Insight, Euler Hermes

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