BANQUE DU LIBAN

Overview of the Recent Monetary, Banking, and Financial Developments in Lebanon

2002

A favorable environment has characterized the Lebanese economy in 2003. Lebanon is maintaining its commitment to exchange rate stability and to the soundness of its banking sector, in addition to implementing an ambitious fiscal adjustment program.

Confidence was boosted by the successful outcome of Paris-II conference, held in November 2002 with the participation of a number of countries and international organizations. An aggregate amount of USD 4.3 billion was pledged in 15-year loans at reduced rates to support the government's economic reform plan for lowering the servicing cost of public debt, which accumulated over the years due to costly reconstruction efforts.

Other significant initiatives were taken in the same direction :

- Banks reached an agreement with the Banque du Liban (BDL) to subscribe for the equivalent of USD 3.7 billion in two-year, zero-interest Treasury bills (TBs).
- The BDL cancelled USD 1.8 billion worth of TBs against a reduction in the revaluation account for gold and foreign exchange. Simultaneously, most of BDL's remaining holdings of government debt were exchanged for a 15-year Eurobond issue, with 4% interest coupons.

These developments led to a significant drop in TBs' interest rates, followed by a cut in commercial banks' average deposit and lending rates in Lebanese pound (LBP) and in foreign currencies. In parallel, USD holdings were being converted on a wide scale into LBP holdings. Moreover, the BOP performance, which started to improve in May 2002, remained on the same trend, with cumulative surpluses exceeding USD 2 billion at end-April 2003, while BDL assets in foreign currencies stood at more than USD 10 billion, excluding gold.

In the last few months, a strong demand emerged on Lebanese government paper in local and foreign currencies, due to increased confidence, reinforced in April by the Government's ability to pay from the Treasury a maturing USD 500 million Eurobond issue, without resorting to rollover as in the past. This was accompanied by a positive assessment by the IMF and major international rating agencies, which considered that Lebanon is on the right track in trying to end its economic and financial difficulties, and that its performance in coping with the aftermath of the war in Iraq is the best in the region.

In the banking sector, equity capital continued to increase, reaching USD 3.5 billion at end-April, and pushing the average capital adequacy ratio to 18%. Despite their modest growth, private sector loans attained 100% of GDP, a unique performance in itself. Deposits grew at an annual 11% rate, reaching USD 47 billion at end-April - more than double the GDP - with a dollarization rate dropping to 68%, from a 74% peak in May 2002. This excellent performance was buttressed by the BDL's efforts to strengthen prudential supervision, paving the way for compliance with Basle-II requirements by a sound banking sector, ready to better manage operational risks, and to improve transparency and good governance.

The government's commitment to decelerate the growth of public debt and to reduce its servicing cost was reflected in the conservative budgets of 2002 and 2003. Coupled with measures to achieve the highest possible proceeds from privatization and securitization, this strategy will be pursued over the medium term, expectedly leading to a public finance recovery.