مصرف لبنان
BANQUE DU LIBAN

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

2003

The Lebanese economy witnessed a 3% growth rate during 2003, mostly driven by a boost in exports, tourism and capital flows. Macroeconomic conditions have been favorable due to Lebanon's continuous commitment to a stable exchange rate, a sound banking sector, in addition to the government's history of honoring its commitments.

Following the Paris-II donor conference in November 2002, Lebanon received financial commitments to restore public finance sustainability. Thereafter, new debt management measures were taken to alleviate the debt burden and lengthen debt maturity. Among these measures: Banque du Liban's (BDL) subscriptions to low interest TBs, cancellation of part of its TB holdings against a reduction in the revaluation account of gold, and debt swaps at lower rates and longer maturities, as well as commercial banks' subscriptions to zero-interest government debt.

Since November 2002, growing confidence has been evidenced by the drop in interest rates and spreads, as well as renewed demand for the local currency. The interest rate on 1-year TBs declined by 48%, from a high of 13.2% in November 2002 to 6.8% in February 2004. On the other hand, Lebanese Eurobonds still retain positive appraisal from rating agencies with little price downside risk expected.

BDL's launch of special 3-year CDs during May-November 2003 allowed it to further boost its foreign exchange reserves, while sterilizing excess liquidity in the market (resulting from considerable amounts of maturing TBs and in the absence of new TB issues during February-November). The buildup of BDL foreign assets, which reached an all-time high exceeding USD 14 billion at end-February 2004, helped maintain market confidence. The surge in capital inflows reversed the balance of payments in May 2002 into a surplus reaching a cumulative record of USD 3.6 billion at end-February 2004.

With a balance sheet equivalent to 330% of GDP, the soundness of the Lebanese banking sector is key to economic growth and stability. Total equity continued to increase, reaching USD 3.7 billion at end-February 2004, and pushing the average capital adequacy ratio to 22%. Deposits grew at an annual 14% rate, reaching around USD 50 billion at end-February with a dollarization rate dropping to 66%, from a 74% peak in May 2002. In order to boost bank lending to the private sector, which has been relatively stagnant at around USD 15 billion since 1999, a new benchmark interest rate (the Beirut Basic Rate) will be soon adopted, against which lending rates will be determined. Positive initiatives were also taken to clean up non-performing loans from bank balance sheets.

In an attempt to open new investment channels for the excess liquidity and to expand financial services, banks have been recently allowed to purchase foreign bonds with a minimum BBB rating and extend credit facilities to non-residents. On another front, the newly promulgated Islamic Banking Law will help widen the range of financial products. Moreover, BDL policy that was limited to encouraging mergers between small and medium banks has been broadened to include mergers between big banks.

While the current regional and domestic political climate may not be supportive of major fiscal initiatives, the general principles projected for the 2005 budget highlight the government's commitment to its adjustment efforts, thus paving the way for improved public finance conditions.