مصرف لبنان
BANQUE DU LIBAN

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

**2010**

The Lebanese economy continued to expand at a fast pace in 2010 backed by growing confidence and large capital inflows. Real growth has recorded impressive rates of 9 and 8.5% respectively in 2008 and 2009, and has remained within the expectations of 7 to 8% in 2010. Inflation has been contained at around 4.5% and the BDL's target is to keep it below 5%.

The BDL's continuous commitment to the stability of the Lebanese Pound’s exchange rate against the U.S. dollar plays a pivotal role in maintaining financial and price stability. Its strategy of preserving a high stock of assets in foreign currencies as a precautionary measure proved to be essential in dealing with any crisis that may hit the economy.  The BDL is currently holding around USD 31 billion in foreign currency assets. This figure does not include gold reserves which are approaching USD 13 billion at current prices. It is worth noting that Lebanon is the second-biggest holder of gold in the MENA region, and maintaining those reserves is very important to preserve confidence in the Lebanese currency.

While complying with market tendencies, interest rates are maintained at appropriate levels to spur capital inflows, rapid dedollarization and a strengthening of the external position. The massive cash injection into the Lebanese market over the past 3 years has helped the interest rate structure in Lebanon to decline. The interest rate differential in favor of the Pound has brought the level of dollarization from 77% at end-2007 to 69% at end-2008, reaching a low of around 63% at end-2010. It is worth to be noted that the World Bank has increased its estimate of remittances into Lebanon for 2009 to USD 7.6 billion, and estimated they would reach USD 8.2 billion in 2010, which is around 20% of GDP. Annual remittances from the large and wealthy Lebanese Diaspora represent an important and continuous source of external funding that spurs the Lebanese economy. The Balance of Payments has also recorded a cumulative surplus of more than USD 2 billion for the year 2010.

As for the banking sector, it is keeping on its robust performance by remaining profitable, highly liquid and well-capitalized. Banks in Lebanon have clean balance sheets as the BDL has forbidden them from making subprime investments since 2004. Bank deposits, which grew by 10% on an annual basis, have exceeded USD 110 billion at end-2010. It is worth noting that Lebanon has attracted the largest share of bank deposits in the MENA region in 2010. Despite global credit tightening, credits to the private sector have reached a historical level of USD 36 billion in 2010, thus recording a growth rate of around 22% which is the highest in the region. The average capital adequacy ratio of banks in Lebanon has exceeded 12% with banks fully abiding by Basle II standards. As regarding the new criteria of Basle III which focus on liquidity and capital requirements as well as on the quality of capital, Lebanese banks have a high level of liquidity and the structure and quality of their capital is generally in line with the outlook of the Basle committee. However, there is a need to evaluate each bank on an individual basis. The BDL is also planning to set a target for banks' top-quality capital reserves that is much higher than the level agreed upon in Basle III.

Moreover, Lebanese banks are still seeking new growth opportunities outside of Lebanon supported by BDL regulations. Further consolidation is encouraged in the Lebanese banking sector except for the first 11 banks. The BDL is also emphasizing the clear distinction between the role of commercial banks and investment banks, which will protect both banks and customers' interests.

The Central Bank has not only set out rules for banks but has also created incentives in order to secure adequate financing in the economy. It has issued circulars aiming at encouraging lending in Lebanese pounds at a lower cost, by setting new exemptions from mandatory reserve requirements. Such credit incentives include loans to productive sectors (agricultural, industrial, tourist, information-technology…), housing loans, high-educational loans and environmentally-friendly projects such as renewable energy, waste management, waste water treatment and recycling.

Yet, the main challenge in Lebanon lies not so much with its high indebtedness but with the increasing yearly deficit in the budget of the government. The public debt does not pose a threat to the economy as long as the flow of funds to Lebanon remains high. The main challenge in the future is to reduce the size of the deficit by maintaining high growth rates which depends heavily on the improvement in infrastructure and the introduction of reforms in vital economic sectors. With the liquidity available, privatization programs can be successful and the government should make greater use of the private sector to implement new projects especially in the field of energy.