

LEBANON

Key conditions and challenges

Table 1 **2020**

Population, million	6.8
GDP, current US\$ billion	33.4
GDP per capita, current US\$	4891.3
National poverty rate ^a	27.4
Gini index ^a	31.8
Life expectancy at birth, years ^b	78.9

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2011).

(b) Most recent WDI value (2018).

Lebanon is enduring a severe and prolonged economic depression in part due to inadequate policy responses to an assault of compounded crises—the country’s largest peace-time financial crisis, COVID-19 and the Port of Beirut explosion. Real GDP growth contracted by 20.3 percent in 2020. Inflation reached triple digit while the exchange rate keeps losing value; poverty is rising sharply. Lebanon lacks a fully functioning executive authority as it attempts to form its third Government in a little over a year.

Monetary and financial turmoil continue to drive crisis conditions, with interactions between the exchange rate, narrow money and inflation a key dynamic. A multiple exchange rate system includes the official exchange (LL 1,515/ US\$), central bank (BdL)-backed lower rates for critical imports, as well as a highly volatile US\$ bank-note exchange rate; in fact the banknote rate depreciated by about 50 percent over March 12-16, 2021. Overall, the World Bank Average Exchange Rate (AER) depreciated by 129 percent in 2020 (Figure 1). Meanwhile, currency in circulation (CIC) surged by 227 percent, while inflation rates are in the triple-digits, averaging 84.3 percent in 2020. Regression estimates suggest a coefficient of 0.8 for the impact of growth in CIC on inflation. The banking sector, which informally adopted severe capital controls, has ceased lending and does not attract deposits. Instead, it endures in a segmented payment system that distinguishes between older (pre-October 2019) dollar deposits and minimum new inflows of “fresh dollars”. The former is subject to sharp deleveraging through de facto liraification and haircuts (up to 70 percent) on dollar deposits. Deleveraging is also facilitated by netting out bank positions between assets (loans) and liabilities (deposits). The burden of the ongoing adjustment/deleveraging is highly

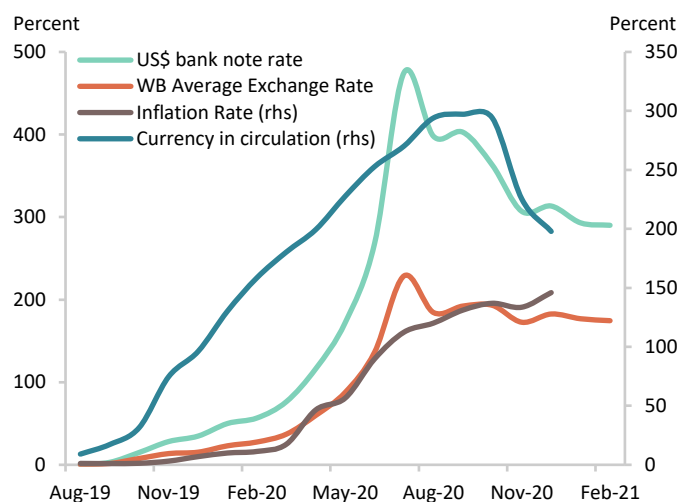
regressive concentrated on the smaller depositors and SMEs.

The social impact, which is already dire, could become catastrophic; more than half the population is likely below the upper income poverty line, higher shares of households are facing challenges in accessing food, healthcare and other basic services and unemployment is on the rise. Inflationary effects are highly regressive factors, disproportionately affecting the poor and middle class. Inflation in the food and non-alcoholic beverages category averaged 254 percent in 2020 and has been a key driver of overall inflation (Figure 2). Those paid in Lira—the bulk of the labor force—are seeing potent purchasing power declines. Phone surveys conducted in November-December by the World Food Program found that 41 percent of households reported challenges in accessing food and other basic needs. The share of households having difficulties in accessing health care rose from 25 percent (July-August) to 36 percent (Nov-Dec). The unemployment rate also rose among the respondents, from 28 percent in February (pre-COVID) to nearly 40 percent in Nov-Dec. Violent street action has erupted across the country even under COVID conditions.

Recent developments

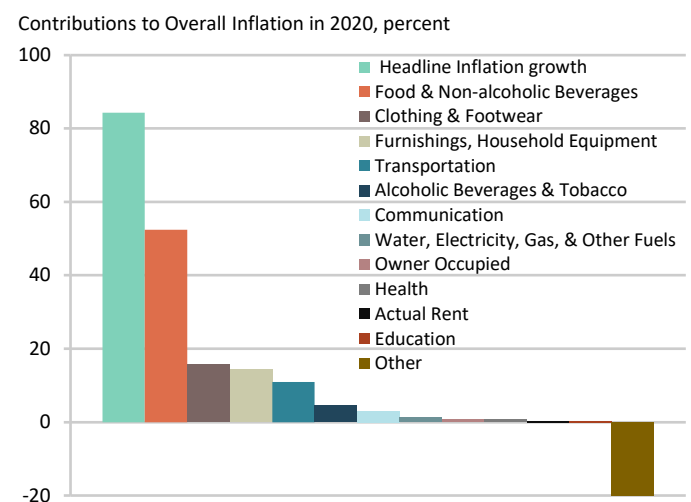
Real GDP is estimated to have declined by 20.3 percent in 2020. High frequency indicators support a substantial contraction in economic activity. The BLOM-PMI index, which captures private sector activity,

FIGURE 1 Lebanon / Exchange rate depreciation along with surging inflation



Sources: Lebanese authorities and WB staff calculations.

FIGURE 2 Lebanon / Inflation in basic items has been a key driver of overall inflation, hurting the poor and the middle class



Sources: Lebanese authorities and WB staff calculations.

averaged 41.1 in 2020 (<50 represents a contraction of activity), the lowest since it was first published in 2013. Construction permits and cement deliveries, which are indicators of construction activities, suffered yoy declines of 33.4 and 48.3 percent, respectively, over 9M-2020. On the demand side, net exports, is expected to be the sole positive contributor to GDP, driven by falling imports (merchandise imports declined by 45.4 percent in 11M-2020, yoy).

The sudden stop in capital inflows, coupled with a continued large current account deficit, has implied a steady depletion in foreign exchange (FX) reserves at BdL. By end-2020, gross FX reserves at BdL reached \$24.1 billion, declining by \$12.5 billion since end-2019. The gross position, however, disguises key pressure points (BdL, contrary to other central banks, does not publish net reserves; these are however estimated to be negative). The breakdown includes \$5 billion in Lebanese Eurobonds and an unpublished amount lent out to banks since October 2019, leaving much of the remainder as required reserves on banks' customer FX deposits.

Partial-year fiscal data confirm severe fiscal stress. Over the 8M-2020 period, total revenues declined by 20.2 percent (yoy), driven by 56.5, 49.7 and 34.5 percent

yoy decreases in telecoms, VAT and customs revenues, respectively. Total expenditures over 8M-2020 have also decreased by 18.4 percent. This, however, is almost exclusively due to cuts in interest payments resulting from the March 2020 Eurobond default and a favorable arrangement with BdL on TBs it holds.

Outlook

Subject to unusually high uncertainty, we project real GDP to contract by a further 9.5 percent in 2021. Our projection assumes that COVID-19 effects carry through 2021, while macro policy responses remain inadequate. We also assume a minimum level of stability on the political and security scenes (i.e. formation of Government) and refrain from assuming runaway inflation-depreciation, which is a realistic scenario.

Lebanon's recession is likely to be arduous and prolonged given the lack of policymaking leadership and reforms. Lebanon's GDP/capita has fallen by around 40 percent over the 2018-2020 period and is expected to decline further. Hence, Lebanon's World Bank income classification is likely to be downgraded from an upper-middle income economy, which should

enjoy a GNI per capita of between US\$4,046 and US\$12,535—to a lower-middle income status.¹

Macroeconomic stabilization is a key prior action for Lebanon's recovery process. This necessarily includes comprehensive restructurings of the public debt and the financial sector, a new monetary policy framework and a fiscal adjustment program. Meanwhile, discussions with the IMF have stalled and remain at the diagnostic stage.

A contraction of real GDP per capita and high inflation in 2020 will undoubtedly result in substantial increase in poverty rates affecting all groups of the population in Lebanon through different channels such as loss of productive employment, decline in real purchasing power, and so forth. Tracking population wellbeing on a regular basis and protecting the poor and the most vulnerable is an urgent priority for the country. Lebanon also continues to host the largest number of refugees on a per capita basis globally. With poverty levels exceeding those of the host population, their vulnerability has increased with the compounding effects of the economic and health crises in the country.

1/ Latest available Gross National Income per capita for Lebanon is for 2019 US\$7,380.

TABLE 2 Lebanon / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f
Real GDP growth, at constant market prices	-1.9	-6.7	-20.3	-9.5
Private Consumption	-1.3	-5.7	-10.7	-7.2
Government Consumption	6.7	-6.2	-55.4	-8.5
Gross Fixed Capital Investment	-0.2	-16.9	-59.3	-57.3
Exports, Goods and Services	-4.7	-1.2	-53.5	3.7
Imports, Goods and Services	1.2	-9.2	-46.6	-8.0
Real GDP growth, at constant factor prices	-1.7	-5.3	-16.0	-9.8
Agriculture	-4.0	6.0	29.7	-9.5
Industry	-4.2	-17.4	-15.8	-9.4
Services	-1.1	-4.0	-19.0	-9.9
Inflation (Consumer Price Index)	6.1	2.9	84.3	80.0
Current Account Balance (% of GDP)	-24.3	-21.2	-11.0	-6.7
Net Foreign Direct Investment (% of GDP)	3.7	3.4	9.3	4.9
Fiscal Balance (% of GDP)	-11.0	-10.5	-4.9	-2.8
Debt (% of GDP)	154.9	171.0	186.7	180.7
Primary Balance (% of GDP)	-1.2	-0.5	-2.7	-1.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.