
Country Report

Lebanon

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Highlights

Editor: **Edward Bell**

Forecast Closing Date: **August 14, 2014**

Outlook for 2014-18

- Lebanon's new government balances the competing March 8th and March 14th political factions, along with a neutral bloc. This inherent instability will make policymaking a challenge in the forecast period.
- Parliament has so far been unable to approve a new president. The post has little real power, but neutral politicians can use it to bring rival factions together to encourage bilateral policymaking.
- The country will face new security challenges as Sunni militants are inspired by the violence occurring in Syria and now in Iraq. Wide-ranging sectarian clashes will be a major risk in the near term.
- Lebanon's services-oriented economy will suffer in the near term, expanding by an annual average of 2.3% in 2014-15, before a stalemate in Syria allows output to pick up over the remainder of the forecast period.
- The public finances will remain firmly in deficit in 2014-18, but the deficit will narrow from 11.8% of GDP in 2014 to 6.8% of GDP in 2018. Debt service will remain a burden on the government, accounting for one-third of spending.
- Banque du Liban (the central bank) will maintain the Lebanese pound's peg to the US dollar throughout the forecast period. It will continue to hold a large stock of foreign reserves to meet any downward pressure on the currency.
- The current account will remain in deficit in 2014-18, but the deficit will fall from around 9% of GDP in 2014 to 2% of GDP in 2018. Large capital flows will continue to enter the country, helping it to meet its external shortfalls.

Review

- Parliament has again failed in its attempts to elect a new president. Establishment figures are now working to find further candidates, although a change to the constitution that would lower the number of members of parliament needed to elect a president is also being considered.
- The military carried out operations in the eastern city of Arsal after Syrian militants fighting against the government of Bashar al-Assad took control of the city.
- In response to the threat from Syrian fighters, Saudi Arabia granted Lebanon US\$1bn to improve the capabilities of its armed forces.
- Solidere, Lebanon's largest listed company, reported strong profit growth for 2013, with net income up by 148% year on year. However, the figure is flattered by the company's terrible performance in 2012 and does not suggest there is much vigour to Lebanon's economy.
- The central bank governor, Riad Salameh, has tried to reassure investors that the government does not face a cash crunch after it hit its borrowing limit.

Outlook for 2014-18

Political stability

Lebanon will continue to endure political instability as the country reels from the effects of Syria's civil war. Since 2011 the country has had three prime ministers and spent nearly a year without a permanent government. The government of the prime minister, Tammam Salam, a Sunni, will struggle to achieve effective policymaking as officials will be preoccupied with avoiding civil and sectarian violence inspired by

the war across the border. The government balances the pro-Syrian March 8th political bloc with the nationalist March 14th alliance and also includes a neutral faction nominated by the former president, Michel Suleiman, and Mr Salam. This arrangement means that each of the main rival factions has, in effect, a veto over the other. Neither March 8th nor March 14th has clearly defined policies that would place them on the right or the left of a traditional political spectrum, leaving economic policymaking largely in the hands of officials at the technically competent Banque du Liban (BdL, the central bank).

Rebels fighting against the regime of the Syrian president, Bashar al-Assad, will take refuge in Lebanon, and there will be proxy battles between supporters and opponents of Mr Assad. In early August the military had to intervene to recapture the border town of Arsal that had been occupied by Syrian rebels. The presence of over 1m Syrian refugees in Lebanon could provoke social unrest. The refugees are largely Sunni Muslim, and the shifting demographic balance in the country may lead to clashes with Lebanon's Shia or Christian communities.

The central government will struggle to assert its authority across the entire country, as several regions are under the sway of Hizbullah, a powerful armed Shia political movement that is allied to the Syrian government and forms the core of March 8th. Several suicide attacks in the capital, Beirut, have raised fears that Lebanon could endure a new round of sectarian attacks, inspired by the violence perpetrated by a regional Sunni Islamist force, the Islamic State (formerly, the Islamic State of Iraq and al-Sham). Hizbullah and areas where it receives support will be a major target for Sunni militancy. So far Hizbullah has not responded to any recent provocations, but its vast arsenal of weapons suggests that it could survive prolonged sectarian violence.

Sectarian tensions are entrenched in Lebanese politics. The post of president is reserved for a Maronite Christian, that of prime minister for a Sunni Muslim and that of parliamentary speaker for a Shia Muslim. Parliament is divided along confessional lines, with 64 seats each for the Christian and Muslim communities, and split further by sect. Since 2011 Lebanon's Sunni Muslim community has been on the back foot as its unofficial political leader, Saad Hariri, a former prime minister, has been out of the country because of concern for his safety. This has allowed more radical Sunni figures to gain a share of the community's public voice, often leading to escalating tensions with the similarly sized Shia community. By contrast, Lebanon's Christian political groups are split in their allegiance between March 8th and March 14th, but will gradually see their influence eroded as sectarian tensions in Lebanon increasingly reflect regional divisions between Sunni and Shia Muslims.

Aware that its external patrons—Syria and Iran—will be preoccupied with domestic political instability and international pressure, Hizbullah is engaging more directly in Lebanese domestic politics. The partial defanging of Syria will mean that Hizbullah's regional importance—in its role as a threat to Israel—will be weakened slightly. However, with more of its attention focused domestically, Hizbullah will routinely be a barrier to effective policymaking, as it will be unwilling to accept any weakening of its position in Lebanon. Hizbullah-controlled areas have come under repeated attack from militants, who claim that the actions are in retaliation for the group's involvement in Syria. There have also been attacks on primarily Sunni targets in Lebanon that are believed to be directed by Hizbullah. Were the group to mobilise its fighters to secure its traditional locations of support, it could spark more sustained fighting, particularly in the suburbs of Beirut, and bring Lebanon back towards civil war.

Election watch

The next parliamentary election is scheduled for November after members of parliament (MPs) were unable to agree on a new electoral law for the poll that was originally scheduled for June 2013. No agreement on a new law has been reached, suggesting that the debate ahead of the election will be intense, and indeed the election could be pushed back again, as neither March 8th nor March 14th will be prepared to risk losing seats, even though parliament has relatively little influence.

Lebanon's parliament has failed to approve a new president to replace Mr Suleiman after his term expired in May. Lebanon's president must be drawn from the Christian community, and several leading politicians have been suggested as potential candidates, including the central bank governor, Riad Salameh, and the head of the armed forces, Jean Kahwaji. Although Lebanon's government can function without a president (with the prime minister acting in his stead in an interim capacity), the absence of a senior neutral figure means that there will be little direction for March 14th and March 8th to work together on critical issues such as avoiding further political violence. We expect the debate over the president to persist in the near term. Indeed, Mr Suleiman was approved only after six months of interim rule.

International relations

Lebanon is firmly embroiled in Syria's civil war, as political tensions in the country have been exacerbated by differences over the conflict. Hizbullah is actively supporting the Syrian military's efforts, leading to reprisal attacks by Syrian rebel groups on Hizbullah's positions within Lebanon itself. The government will try to maintain a neutral policy towards Syria in an attempt to keep relations with its main Arab allies, such as Saudi Arabia and Qatar, positive. Regional powers will continue to exert an influence on Lebanon; the approval of the government is believed to have been encouraged by both Saudi Arabia and Iran. Lebanon has in the past relied on assistance from the Arab Gulf states to resolve financial crises, and as a result we expect relations between Lebanon and the Gulf states to remain relatively constructive, despite the latter's distaste for Hizbullah and its Syrian and Iranian allies. For example, Saudi Arabia recently gave the Lebanese military US\$1bn to help improve its capabilities and increase its chances of defeating militant groups in the Beqaa Valley.

The escalation of Israeli-Palestinian violence in recent weeks could prompt a renewed clash between Hizbullah and Israel, as the Israeli military will already be on alert for any crossborder action. We do not at this time expect Hizbullah to launch a campaign against Israel in solidarity with Hamas, a Sunni Palestinian militant group, considering the intense sectarian divide currently affecting the region.

Policy trends

Economic policy in the short term will focus on limiting the effects of the Syrian civil war on Lebanon's service-oriented economy. As a result, we do not expect there to be much headway on reducing the state's role in the economy via privatisations or improving expenditure efficiency (for example, by ensuring that employees at state run companies add economic value to the country). However, aside from spending on infrastructure, the economic reach of the government is limited in many parts of the country, suggesting that even if serious reforms were approved, they would have little immediate impact on the economy. Some uncontroversial issues, such as improving Lebanon's poor telecommunications services, may receive support in a divided cabinet. Improving Internet speeds and lowering phone tariffs may help to improve investment sentiment (both local and foreign) towards Lebanon.

The development of Lebanon's potential hydrocarbons resources has been held hostage to the political unrest in the country. The government has pushed back the starting date for its licensing round to 2015, from May 2013 originally. Disagreement over how many blocks should be offered and the lack of a model production-sharing agreement mean that we expect the government to miss its target date. Another obstacle is the fact that ownership of several of the potential offshore areas is disputed by Israel. At present we do not expect any substantial investment in the development of oil and gas until the later years of our forecast period at the earliest, if indeed drilling proves that there are commercial deposits.

The BdL will maintain an accommodative policy stance in order to support the economy. In January 2013 the central bank launched a stimulus programme through the provision of cheap loans to banks that they can then lend on to customers (at interest rates capped at 6%), and in November the governor of the BdL confirmed that additional funds would be forthcoming in 2014, albeit at a lower level. The BdL is considering augmenting the 2014 stimulus with further funds to support growth this year.

Fiscal policy

The government will run persistent fiscal deficits during the forecast period, owing to high debt-servicing requirements. We expect a fiscal deficit in 2014, of almost 12% of GDP, as the economy remains in the doldrums and revenue collection grows at a meagre pace. The finance minister has brought the 2014 budget to the cabinet—the budget projects a widening of the deficit to US\$5.1bn from US\$4.2bn in 2013, reflecting sluggish revenue growth. Perennial political disputes will mean that the passing of budgets will be delayed in most years and spending will carry on in an ad hoc manner in most ministries.

The government has hit its borrowing limit and is relying on the central bank to help it meet some of its foreign-currency obligations. The central bank governor has said that the government is not facing a liquidity crisis, and we expect that parliament will eventually approve new borrowing as fiscal expenditure is one way that political leaders maintain support from their constituents. Much of the government's foreign-currency debt is held by local banks whose appetite for government debt will remain steady during the forecast period. Lebanon's public debt servicing accounts for around one-third of government spending, depriving the economy of productive expenditure. Local banks are the dominant market for both local- and foreign-currency government debt. With few other investment opportunities available for the banking system, we do not expect the government to encounter difficulty in marketing new securities.

Monetary policy

The economy's high level of dollarisation and the currency's peg to the US dollar mean that Lebanese pound interest rates tend to track US rates, but with a large positive differential. Mr Salameh's ongoing governorship of the BdL will help to preserve confidence in the Lebanese banking system (and also in the solvency of the government). Credit growth has slowed as the economy has weakened and the banking sector's exposure to the public finances has risen, as there are few other investment opportunities in the country. We expect demand for credit to be weak in 2014-15, muting the central bank's stimulus efforts.

International assumptions

	2013	2014	2015	2016	2017	2018
Economic growth (%)						
US GDP	1.9	1.7	3.2	2.5	2.4	2.6
OECD GDP	1.3	1.9	2.6	2.4	2.4	2.5
World GDP	2.0	2.5	3.0	2.9	2.9	3.0
World trade	2.7	4.4	5.0	5.3	5.4	5.5
Inflation indicators (% unless otherwise indicated)						
US CPI	1.5	1.8	2.2	2.3	2.3	2.5
OECD CPI	1.6	2.1	2.2	2.3	2.2	2.1
Manufactures (measured in US\$)	-3.1	0.0	0.9	1.8	1.9	1.6
Oil (Brent; US\$/b)	108.9	108.3	105.1	103.8	97.5	93.0
Non-oil commodities (measured in US\$)	-6.8	-3.1	0.0	0.9	3.0	2.9
Financial variables						
US\$ 3-month commercial paper rate (av; %)	0.1	0.1	0.4	1.4	2.4	2.9
US\$:€ (av)	1.33	1.35	1.30	1.28	1.27	1.26
¥:US\$	97.60	102.03	102.24	102.00	101.00	100.00

Economic growth

Lebanon's economy will grow at only a moderate pace in 2014–18 as the uncertain domestic political scene and the spillover from Syria's civil war affect investment and private consumption. We expect it to grow by little more than 2% in 2014, up from an estimated 1.3% in 2013. There have been some early signs of confidence this year, with automotive sales, construction permits and property sales up relatively strongly year on year in the first quarter. The local equity market also started 2014 very strongly, suggesting some confidence among domestic firms about the prospects for consumer demand this year. However, in the near term, political instability and the spillover into Lebanon of the Syrian civil war will be headwinds for the economy, keeping growth rates in 2014–15 well below historical highs. The reason Lebanon will be able to record even these modest levels of growth is that it serves as a hub for goods moving in and out of Syria through both official and unofficial channels. Growth will recover in 2016–18 as fixed investment is spurred by regional investors returning to the country and investing in the services sector, but in light of the major geopolitical disruptions in the region, there are substantial downside risks to the forecast.

Investment in Lebanon's hydrocarbons sector will be held up until the political scene is clearer. International firms have expressed their interest in investing but have also voiced their frustration at the political impasse that is holding up the drafting of necessary legislation for the oil and gas sector.

Economic growth

%	2013 ^a	2014 ^b	2015 ^b	2016 ^b	2017 ^b	2018 ^b
GDP	1.3	2.1	2.6	3.7	4.7	4.8
Private consumption	2.6	3.3	5.5	7.0	8.0	8.0
Government consumption	4.0	4.5	5.0	4.3	4.3	5.0
Gross fixed investment	-2.0	3.5	3.8	5.2	6.0	5.8
Exports of goods & services	3.5	4.5	5.5	4.0	3.0	4.0
Imports of goods & services	3.0	6.5	9.0	9.0	8.5	8.0
Domestic demand	1.6	3.4	4.7	6.0	6.8	6.5
Agriculture	2.0	2.0	4.0	4.5	4.5	3.0
Industry	3.0	4.0	4.0	6.2	6.8	5.0
Services	0.8	2.0	3.5	5.0	5.7	7.0

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts.

Inflation

The Central Administration of Statistics has rebased Lebanon's inflation data to December 2013 and now provides a much more comprehensive breakdown of prices and updated weightings in its inflation basket. (Housing and utility costs are now disaggregated, for example.) Inflation has been very low so far in 2014, reflecting a high base effect from a year earlier. We expect this effect to fade in the second half of 2014, but prices will still rise by only 2.8% on average. Inflation will be relatively manageable in 2015–18, averaging around 4%, as prices for imported commodities will show only modest increases.

Exchange rates

The Lebanese pound will remain pegged to the US dollar within a band of L£1,501–1,514:US\$1 in 2014–18. The BdL's firm commitment to defending the peg is aided by its ability to influence interest rates, a high level of assets and strong support from local commercial banks. The peg will also provide some insulation against any withdrawal of funds that had been searching for higher yields in frontier markets. Lebanon's stock of foreign reserves (including gold) is large relative to the size of its economy. However, the government is drawing these down temporarily while its borrowing remains constrained.

External sector

Lebanon will continue to record current-account deficits in 2014–18, with the shortfall narrowing from over 9% of GDP in 2014 to 2% of GDP in 2018 as nominal growth rates improve and oil prices decline. The trade balance will remain firmly in deficit as Lebanon relies on imports of expensive fuel, raw materials and capital goods. The external balances will benefit slightly from the country's role as a transshipment hub for moving goods into Syria. Any development of Lebanon's hydrocarbons potential would draw in capital inputs, although not until the later years of the forecast period.

The services balance will be the main surplus in Lebanon's external accounts. Tourism from the Lebanese diaspora has tended not to be particularly risk-averse (although it is generally less high-value than that from Gulf Arab visitors), and inflows into Lebanon's banking system will continue to grow as investors are attracted by the relatively high interest rates on offer and dollar-pegged returns. Remittances will help to offset the trade deficit. Low returns on Lebanon's stock of foreign reserves and high external debt payments will keep the income balance in deficit. The current-account deficit is normally covered by capital inflows (direct investment from other Arab countries and purchases of foreign-currency government bonds), although many of these inflows are unrecorded.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2013 ^a	2014 ^b	2015 ^b	2016 ^b	2017 ^b	2018 ^b
Real GDP growth	1.3	2.1	2.6	3.7	4.7	4.8
Consumer price inflation (av)	5.6 ^c	2.8	4.2	4.1	3.9	4.2
Consumer price inflation (end-period)	1.1 ^c	3.5	3.9	3.6	3.2	3.5
2-year Treasury bill rate	5.9 ^c	5.9	6.0	6.3	6.5	7.0
Government balance (% of GDP)	-9.3	-11.8	-9.3	-9.0	-8.9	-6.8
Exports of goods fob (US\$ bn)	4.9	4.4	4.5	4.7	4.9	5.2
Imports of goods fob (US\$ bn)	20.3	20.9	22.2	24.4	26.4	28.5
Current-account balance (US\$ bn)	-5.0	-4.5	-3.5	-3.3	-2.2	-1.4
Current-account balance (% of GDP)	-11.1	-9.4	-6.8	-5.8	-3.4	-2.0
External debt (year-end; US\$ bn)	31.6	33.4	33.2	32.8	33.1	32.8
Exchange rate L£:US\$ (av)	1,508 ^c	1,508	1,508	1,508	1,508	1,508
Exchange rate L£:€ (av)	2,002 ^c	2,040	1,952	1,930	1,915	1,899
Exchange rate L£:€ (end-period)	2,059 ^c	1,982	1,930	1,922	1,907	1,912
Exchange rate L£:¥100 (av)	1,545 ^c	1,477	1,474	1,478	1,493	1,508

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts. ^c Actual.

Data and charts

Annual data and forecast

	2009 ^a	2010 ^a	2011 ^a	2012 ^a	2013 ^b	2014 ^c	2015 ^c
GDP							
Nominal GDP (US\$ m)	34,651	37,124	40,094	42,945	45,382	47,533	52,100
Nominal GDP (£ bn)	52,236	55,965	60,442	64,740	68,414	71,656	78,541
Real GDP growth (%)	8.5	7.0	3.0	1.4	1.3	2.1	2.6
Expenditure on GDP (% real change)							
Private consumption	8.3	5.3	0.4	-1.0	2.6	3.3	5.5
Government consumption	8.6	6.4	3.0	6.9	4.0	4.5	5.0
Gross fixed investment	32.9	6.8	3.0	0.6	-2.0	3.5	3.8
Exports of goods & services	1.7	12.8	-2.3	3.8	3.5	4.5	5.5
Imports of goods & services	20.7	3.1	-3.2	0.3	3.0	6.5	9.0
Population and income							
Population (m)	4.2	4.2	4.3	4.6 ^b	4.9	5.4	5.4
GDP per head (US\$ at PPP)	14,873 ^b	15,987 ^b	16,911 ^b	16,230 ^b	15,457	14,764	15,366
Fiscal indicators (% of GDP)							
Central government revenue	24.3	22.7	23.3	21.9	20.8	20.2	22.2
Central government expenditure	32.9	30.5	29.1	31.0	30.1	32.0	31.4
Central government balance	-8.5	-7.8	-5.8	-9.1	-9.3	-11.8	-9.3
Net public debt	145.6	140.7	133.0	133.4	139.9	144.2	140.8
Prices and financial indicators							
Exchange rate £:US\$ (end-period)	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5 ^a	1,507.5	1,507.5
Exchange rate ¥:£ (end-period)	0.062	0.055	0.052	0.058	0.070 ^a	0.068	0.068
Consumer prices (end-period; %)	3.3	4.7	3.0	10.1	1.1 ^a	3.5	3.9
Stock of money M1 (% change)	13.4	18.4	7.2	15.7	7.3 ^a	3.0	13.5
Stock of money M2 (% change)	37.9	15.4	-1.3	11.0	5.6 ^a	6.1	12.2
Lending interest rate (av; %)	9.6	8.3	7.5	7.2	7.3 ^a	7.2	8.0
Current account (US\$ m)							
Trade balance	-11,207	-12,499	-13,919	-14,712	-15,348	-16,481	-17,688
Goods: exports fob	4,187	4,689	5,386	5,615	4,930	4,437	4,548
Goods: imports fob	-15,394	-17,188	-19,305	-20,327	-20,278	-20,918	-22,236
Services balance	2,867	3,006	6,709	9,991	9,575	11,043	12,834
Primary income balance	-228	-509	-174	391	-609	-683	-631
Secondary income balance	1,827	2,450	2,525	2,667	1,348	1,633	1,949
Current-account balance	-6,741	-7,552	-4,859	-1,663	-5,034	-4,488	-3,537
External debt (US\$ m)							
Debt stock	25,527	25,142	25,519	29,902	31,583	33,437	33,173
Debt service paid	4,611	4,152	5,327	4,219	4,441	4,016	5,204
Principal repayments	3,096	2,651	3,783	2,681	2,356	1,822	3,090
Interest	1,473	1,450	1,507	1,501	2,085	2,194	2,114
International reserves (US\$ m)							
Total international reserves	39,165	44,524	48,141	52,498	47,852 ^a	48,380	50,356

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts.

Source: IMF, International Financial Statistics.

Quarterly data

	2012		2013				2014	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
Central government finance (£ bn)								
Revenue	3,193	3,329	3,354	3,963	3,275	3,609	n/a	n/a
Expenditure	4,589	6,143	4,534	5,646	5,372	5,011	n/a	n/a
Balance	-	-	-	-	-	-	n/a	n/a
	1,396.3	2,813.6	1,179.8	1,682.3	2,097.1	1,402.6		
Output								
Coincident Indicator (end-period, 1993=100)	243.5	262.5	273.9	265.5	247.2	267.9	271.8	n/a
Coincident Indicator (% change, year on year)	-1.9	-1.1	3.4	1.7	1.5	2.1	-0.8	n/a
Financial indicators								
Exchange rate £:US\$ (av)	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5
Exchange rate £:US\$ (end-period)	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5
Deposit rate (av; %)	5.8	5.8	5.8	5.8	5.8	5.8	5.9	n/a
Discount rate (end-period; %)	10.0	10.0	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)	7.3	7.2	7.4	7.5	7.2	7.3	7.3	n/a
Treasury bill rate (av; %)	4.4	4.4	4.4	4.4	4.4	4.4	4.4	n/a
M1 (end-period; £ bn)	6,319	7,104	7,038	7,350	7,702	7,620	7,519	n/a
M1 (% change, year on year)	8.9	15.7	16.7	16.9	21.9	7.3	6.8	n/a
M2 (end-period; £ bn)	63,024	65,077	65,970	66,639	67,073	68,749	69,852	n/a
M2 (% change, year on year)	10.9	11.0	9.3	7.8	6.4	5.6	5.9	n/a
BDL financial market value weight stock market index (1998=100)	121.8	116.2	119.9	115.9	104.3	103.8	124.8	126.9
BDL financial market value weight stock market index (% change, year on year)	-26.4	-15.5	-13.0	-6.4	-14.3	-10.7	4.1	9.5
Sectoral trends								
Construction permits (end-period; '000 sq metres)	3,228	3,860	2,857	3,479	3,366	3,223	3,392	n/a
Foreign trade (£ bn)								
Exports fob	1,698	1,787	1,797	1,687	1,278	1,173	1,164	1,337
Imports cif	7,766	7,915	8,314	7,962	7,706	8,031	8,137	7,365
Trade balance	-6,068	-6,128	-6,517	-6,274	-6,428	-6,859	-6,973	-6,029
Reserves US\$ m)								
Reserves excl gold (end-period)	36,530	37,186	37,061	38,608	37,190	36,748	37,756	n/a

Source: IMF, International Financial Statistics.

Monthly data

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate £:US\$ (av)												
2012	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508
2013	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508
2014	1,508	1,508	1,508	1,508	1,508	1,508	n/a	n/a	n/a	n/a	n/a	n/a
Central government revenue (£ bn)												
2012	1,507	926	1,089	1,242	1,408	1,470	1,377	885	930	1,372	861	1,096
2013	1,543	805	1,007	1,374	1,585	1,005	1,454	924	897	1,348	904	1,357
2014	1,614	929	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Central government expenditure (£ bn)												
2012	1,771	1,199	1,560	1,879	1,483	1,458	1,432	1,368	1,790	2,303	2,079	1,761
2013	1,570	1,227	1,738	2,469	1,756	1,421	1,712	1,755	1,904	1,693	1,602	1,716
2014	1,793	1,118	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Central government balance (£ bn)												
2012	-265	-273	-471	-636	-75	12	-54	-483	-859	-931	-1,218	-665
2013	-27	-422	-731	-1,095	-171	-416	-259	-831	-1,007	-345	-699	-359
2014	-180	-189	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Gross domestic debt (£ trn)												
2012	49.4	49.7	50.5	50.9	51.2	48.5	48.9	49.1	50.1	51.0	51.3	50.2
2013	50.6	50.6	51.0	49.8	50.1	51.1	51.3	51.6	54.3	54.4	55.9	56.3
2014	57.0	58.2	58.4	58.4	58.6	59.7	n/a	n/a	n/a	n/a	n/a	n/a
External public debt (US\$ bn)												
2012	20.9	21.0	20.6	21.3	21.2	23.1	23.0	23.1	22.9	22.8	23.5	24.4

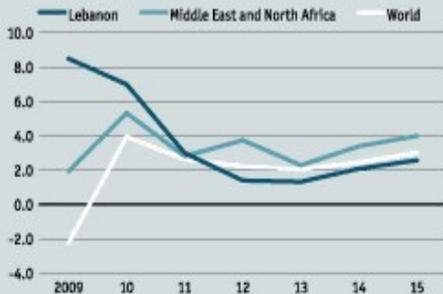
2013	24.5	24.5	23.9	26.1	26.0	26.1	26.2	26.2	26.4	26.4	26.2	26.1
2014	26.1	26.4	26.4	26.1	26.2	26.1	n/a	n/a	n/a	n/a	n/a	n/a
Total public debt (£ trn)												
2012	81.0	81.4	81.6	83.0	83.1	83.4	83.6	84.0	84.6	85.4	86.8	87.0
2013	87.5	87.6	87.1	89.1	89.3	90.5	90.8	91.2	94.1	94.1	95.4	95.7
2014	96.4	98.0	98.2	97.8	98.1	99.0	n/a	n/a	n/a	n/a	n/a	n/a
M1 (% change, year on year)												
2012	5.0	1.7	5.7	4.9	5.6	8.0	6.2	9.4	8.9	20.1	13.7	15.7
2013	17.1	16.5	16.7	17.1	18.9	16.9	18.1	17.8	21.9	10.8	10.3	7.3
2014	10.4	10.6	6.8	9.7	5.8	n/a						
M2 (% change, year on year)												
2012	5.3	6.6	7.8	8.0	9.5	12.0	11.8	11.5	10.9	11.6	11.1	11.0
2013	10.7	10.5	9.3	8.6	8.4	7.8	7.3	6.7	6.4	5.7	5.6	5.6
2014	5.7	5.6	5.9	6.0	6.9	n/a						
Deposit rate (av; %)												
2012	5.9	5.7	5.8	5.7	5.8	5.8	5.8	5.8	5.7	5.8	5.8	5.8
2013	5.8	5.8	5.8	5.8	5.9	5.8	5.8	5.9	5.8	5.9	5.9	5.8
2014	5.9	5.9	5.9	5.9	5.9	n/a						
Lending rate (av; %)												
2012	7.2	7.1	7.2	7.5	7.3	7.4	7.2	7.3	7.3	7.3	7.1	7.1
2013	7.3	7.5	7.3	7.3	7.4	7.9	7.1	7.2	7.4	7.6	7.0	7.3
2014	7.4	7.1	7.3	7.2	7.5	n/a						
BDL financial market value weight stock market index (1998=100)												
2012	136.3	136.5	140.4	131.2	117.8	122.6	130.8	117.7	116.7	113.1	113.0	122.6
2013	122.7	119.9	117.1	126.5	118.2	103.0	104.4	99.7	108.9	103.7	105.6	102.2
2014	125.7	129.9	118.8	122.5	130.5	128.1	n/a	n/a	n/a	n/a	n/a	n/a
BDL financial market value weight stock market index (1998=100) (% change, year on year)												
2012	-39.8	-36.9	-33.3	-37.3	-40.1	-36.4	-28.8	-26.5	-23.5	-20.7	-12.7	-12.9
2013	-10.0	-12.1	-16.6	-3.5	0.3	-16.0	-20.2	-15.3	-6.7	-8.3	-6.6	-16.6
2014	2.4	8.3	1.5	-3.2	10.4	24.3	n/a	n/a	n/a	n/a	n/a	n/a
Total exports fob (US\$ m)												
2012	348	429	377	319	355	345	317	339	471	440	364	381
2013	405	381	407	409	364	347	280	280	288	272	263	243
2014	244	253	275	300	308	278	n/a	n/a	n/a	n/a	n/a	n/a
Total imports cif (US\$ m)												
2012	1,454	2,800	1,723	1,548	1,646	1,713	1,739	1,782	1,630	1,774	1,605	1,872
2013	1,646	1,791	2,077	1,850	1,797	1,634	1,718	1,828	1,565	1,758	1,772	1,797
2014	1,873	1,732	1,792	1,641	1,677	1,568	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US\$ m)												
2012	-1,106	-2,370	-1,346	-1,230	-1,291	-1,368	-1,423	-1,443	-1,159	-1,334	-1,241	-1,490
2013	-1,242	-1,411	-1,670	-1,441	-1,434	-1,288	-1,438	-1,549	-1,277	-1,486	-1,509	-1,554
2014	-1,629	-1,479	-1,517	-1,341	-1,369	-1,290	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2012	33,673	33,794	33,939	34,556	34,425	36,718	36,431	36,700	36,530	36,588	37,121	37,186
2013	37,432	37,292	37,061	38,733	38,190	38,608	37,873	37,586	37,190	37,085	36,941	36,748
2014	37,075	37,674	37,756	n/a								

Sources: IMF, International Financial Statistics; Haver Analytics.

Annual trends charts

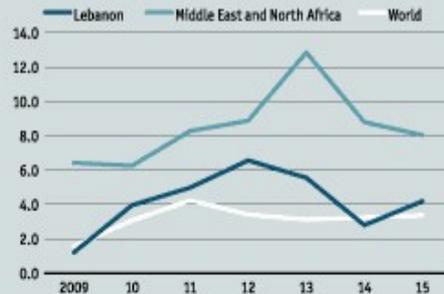
Annual trends charts

Real GDP growth
(% change)



Source: The Economist Intelligence Unit.

Consumer price inflation
(av; %)



Source: The Economist Intelligence Unit.

Budget balance
(% of GDP)



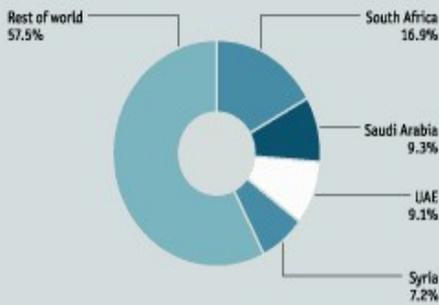
Source: The Economist Intelligence Unit.

Current-account balance
(% of GDP)



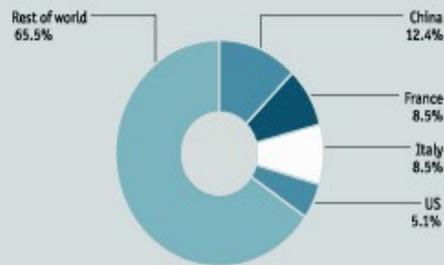
Source: The Economist Intelligence Unit.

Main destinations of exports, 2013
(share of total)



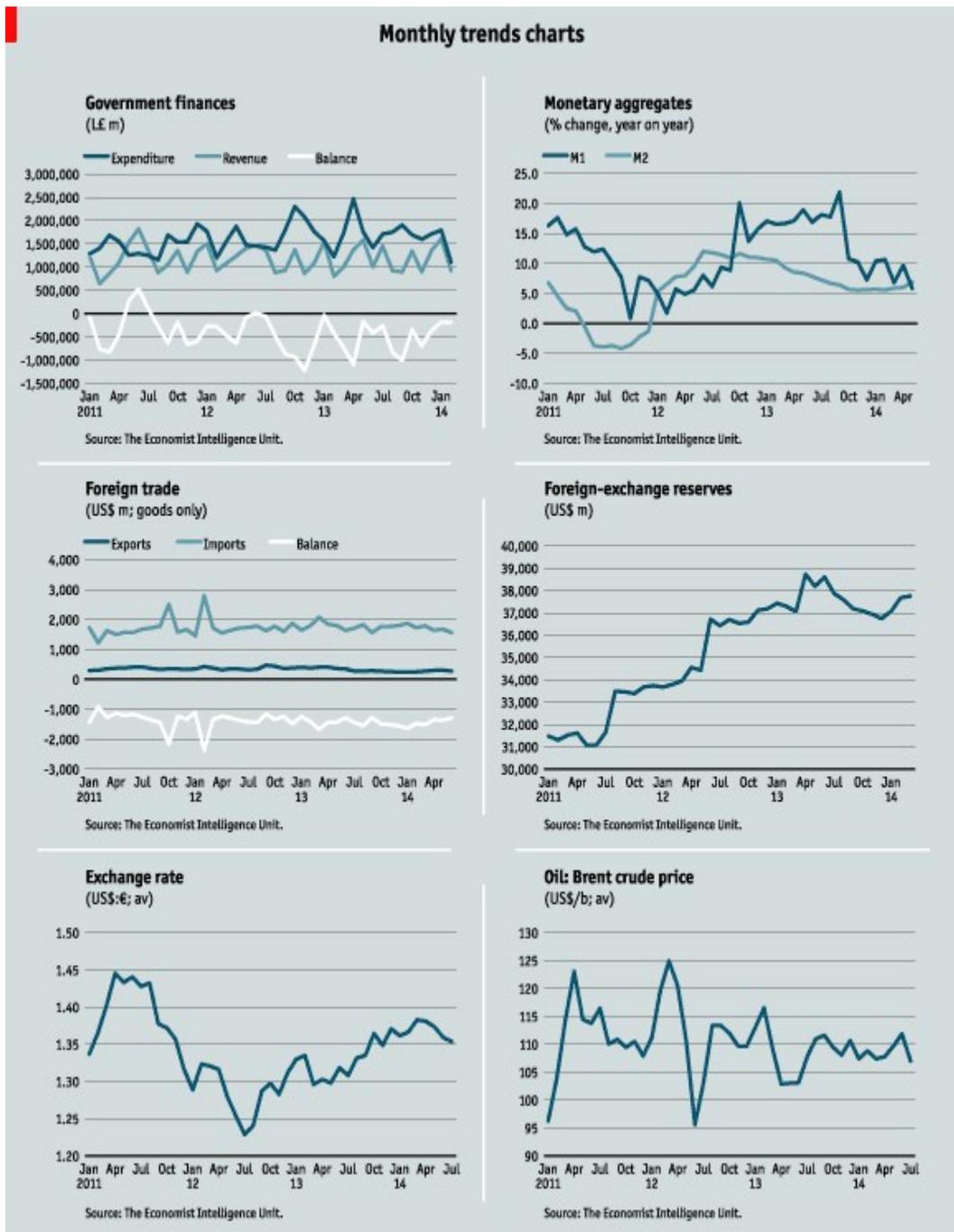
Source: The Economist Intelligence Unit.

Main origins of imports, 2013
(share of total)

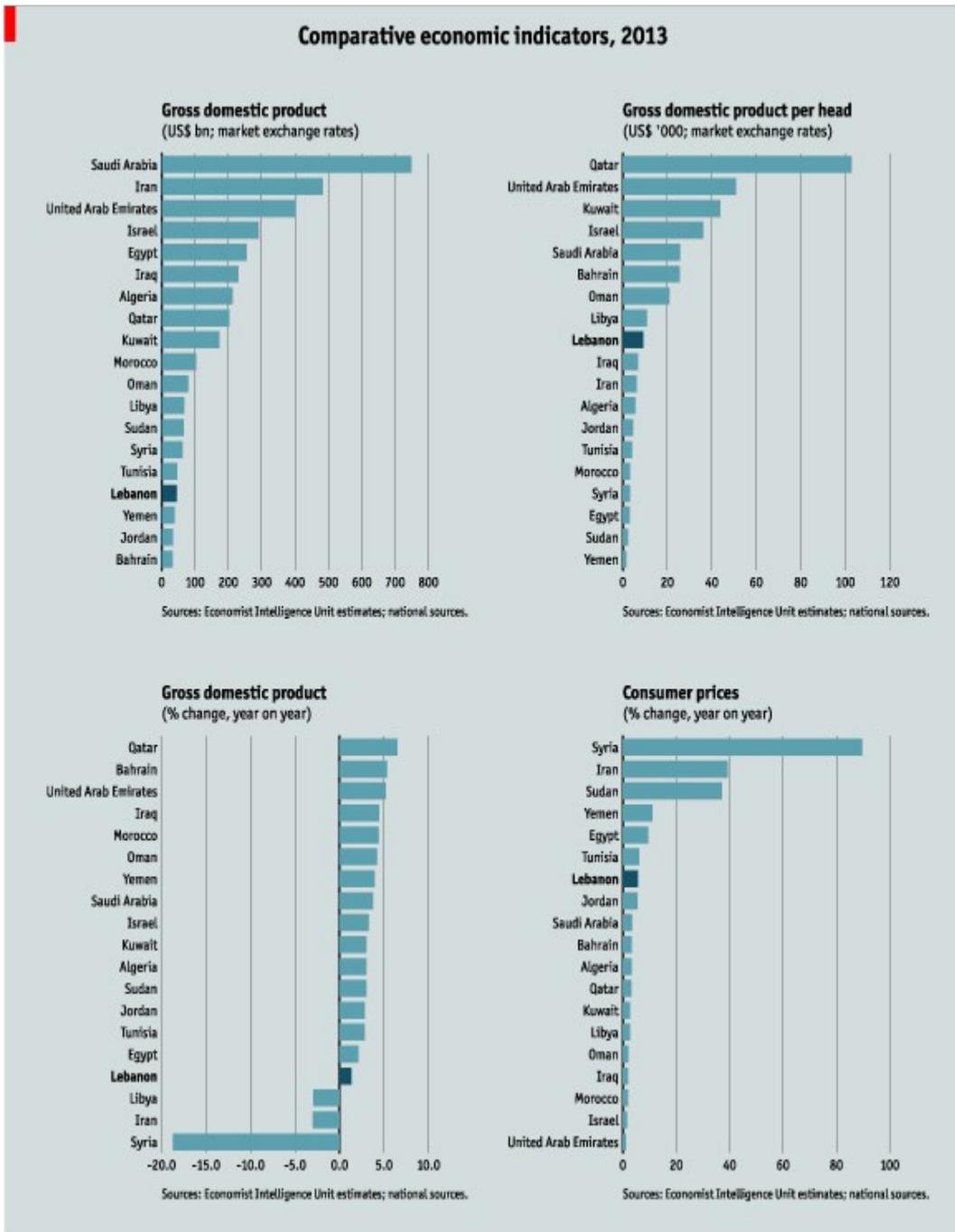


Source: The Economist Intelligence Unit.

Monthly trends charts



Comparative economic indicators



Basic data

Land area

10,452 sq km

Population

4.3m (UN estimate, 2012), excluding around 216,000 Palestinians living in refugee camps

Population in '000 by governorate administration (National Survey of Household Living Conditions, 2004)

Beirut (capital): 391

Mount Lebanon (Beirut environs): 1,502

North Lebanon: 769

The Beqaa: 471

South Lebanon: 401

Nabatiyeh: 221

Climate

Subtropical; cool in highlands

Weather in Beirut (altitude 34 metres)

Hottest month, August, 23-32°C; coldest month, January, 11-17°C (average daily minimum and maximum); driest months, July and August, 1 mm average rainfall; wettest month, January, 190 mm average rainfall

Languages

Arabic; English and French are widely spoken

Measures

Metric system

Currency

Lebanese pound (L£)

Time

Two hours ahead of GMT (Lebanese summer time is three hours ahead)

Fiscal year

January 1st-December 31st

Public holidays

The dates of Islamic holidays are based on the lunar calendar and are therefore approximate. New Year's Day (January 1st); Orthodox Armenian Christmas (January 6th); St Maroun's Day (February 9th); Prophet's birthday (January 13th 2014); Easter (April 18th-21st 2014); Orthodox Easter (April 18th|21st 2014); Labour Day (May 1st); Martyrs' Day (May 6th); Resistance and Liberation Day (May 25th); Assumption Day (August 15th); Eid al-Fitr (July 28th 2014); All Saints Day (November 1st); Eid al-Adha (October 4th 2014); Independence Day (November 22nd); Islamic New Year (October 25th 2014); Ashoura (November 3rd 2014); Christmas Day (December 25th)



Political structure

Official name

Republic of Lebanon

Form of state

Parliamentary republic

Legal system

Based on the 1926 constitution (with amendments incorporated in 1990) and the Civil Procedure Code, the Criminal Procedure Code and the Penal Code

National legislature

Under the electoral law of July 16th 1992, the unicameral National Assembly has 128 seats, equally divided between Muslims and Christians

Electoral system

Universal direct suffrage over the age of 21

National elections

The parliamentary election scheduled for June 2013 has been postponed following an extension of the term of parliament. The election will now take place in November 2014

Head of state

The president must be a Maronite Christian. Parliament has yet to elect a new president after Michel Suleiman's six-year term came to an end in May 2014

National government

The prime minister must be a Sunni Muslim and is chosen by the president after consultation with parliament. The current prime minister is holding the post in an acting capacity. The cabinet is appointed by the prime minister and the president. Ministers need not be part of the National Assembly, but are responsible to it. Cabinet seats are customarily distributed on a sectarian basis

Main political organisations

Political parties tend to be weak and organised on a sectarian basis. The "March 14th" alliance is headed by the Future Movement (Sunni) with the Lebanese Forces (Christian) in loose alliance with the Progressive Socialist Party (Druze) and the Phalange (Christian). The "March 8th" bloc comprises Hizbullah (Shia), Amal (Shia) and the Free Patriotic Movement (Christian)

Prime minister: Tammam Salam (Sunni Muslim)

Deputy prime minister and defence: Samir Mokbel (Greek Orthodox Christian)

Key ministers

Culture: Remon Areiji (Maronite Christian)

Economy & trade: Alain Hakim (Catholic Christian)

Education: Elias Abu Saab (Maronite Christian)

Energy & water: Arthur Nazarian (Armenian Orthodox)

Environment: Mohammed Mashnouq (Sunni Muslim)

Finance: Ali Hassan Khalil (Shia Muslim)

Foreign affairs: Gebran Bassil (Maronite Christian)

Health: Wael Abu Faour (Druze)

Industry: Hussein Hajj Hasan (Shia Muslim)

Information: Ramzi Joreige (Greek Orthodox)

Interior: Nuhad Mashnouq (Sunni Muslim)

Justice: Ashraf Rifi (Sunni Muslim)

Labour: Sejaan Azzi (Maronite Christian)

Public works & transportation: Ghazi Zeaiter (Shia Muslim)

Social affairs: Rashid Derbas (Sunni Muslim)

Telecommunications: Boutros Harb (Maronite Christian)

Tourism: Michel Pharaon (Greek Catholic)

Parliamentary speaker

Nabih Berri (Shia Muslim)

Central bank governor

Riad Salameh (Maronite Christian)

Recent analysis

Generated on August 20th 2014

The following articles have been written in response to events occurring since our most recent forecast was released, and indicate how we expect these events to affect our next forecast.

Politics

Forecast updates

August 15, 2014: Political stability

Saad Hariri returns to Lebanon

Event

A former prime minister, Saad Hariri, made an unannounced return to Lebanon on August 6th, ending three years of exile.

Analysis

Mr Hariri's surprise return to Lebanon has been described as a "circling of the wagons", reflecting the country's high vulnerability to regional insecurity. Timing his return with the announcement that Saudi Arabia—where he has spent much of the past three years—would provide US\$1bn in military aid to Lebanese security forces to help tackle Islamist militants, the former prime minister re-emphasised his credentials as a heavy hitter with formidable international contacts. Indeed, in Mr Hariri's own words, the Saudi cash had "opened the path for the return to my beloved country".

Mr Hariri's return will help to bring leadership to the Sunni community, filling a vacuum he had left three years ago. Recent sectarian polarisation has left Lebanon's Sunnis vulnerable to radical elements such as a Salafi cleric, Ahmad al-Assir, who has urged Sunnis to turn against the government.

With Mr Hariri once more an active player in Lebanese politics, the March 14th movement stands to regain some of its former force. His support for a national institution like the army, which has faced criticism from the Sunni community for its actions in Aarsal (fighting against Syrian Sunni rebels) and for collaborating with Hizbullah, could also prove important in rallying broader Sunni opinion behind state institutions.

The other significant element is that Mr Hariri's return may also signify better relations with the March 8th camp. Mr Hariri is reported to have renewed his contacts with the Shia parliamentary speaker, Nabih Berri. This, in turn, could pave the way towards a deal to elect a president, bridging differences between the rival factions over a potential unity candidate.

Even so, he will find it a challenge to wield influence in Lebanese politics. Extremists have gained ground in mainly Sunni areas such as Tripoli over the past three years, and Mr Hariri's support for institutions like the army will fail to convince hardline elements that view it as fatally compromised having followed an agenda shaped by Hizbullah (whose armed intervention in Syria has not yielded any response by Lebanese armed forces). Mr Hariri may be a totemic figure for Lebanon's Sunnis, but he may need more than Saudi money to win back the street.

Impact on the forecast

Mr Hariri's return suggests that political stability may improve in the short term and we will adjust our forecast accordingly.

Analysis

August 14, 2014

Combating the Islamic State

The extraordinary rise of the extremist jihadi Islamic State (IS) has left the world's governments scrambling to devise ways to counter the group. This has manifested itself most dramatically in Iraq, where a new, less divisive prime minister, Haider al-Abadi, has been appointed, and the US has launched a series of air strikes against IS positions. Yet defeating and dismantling the group, which now controls an area proximate in size to the kingdom of Jordan, will almost certainly prove a long-term undertaking, given both its near unassailable position in Syria and its control of over half a dozen oilfields.

However, at least in northern Iraq, its position is more vulnerable than is commonly assumed, with the group in serious danger of overreaching. Its tactics in Iraq thus far can probably be best categorized as conquer and plunder, with the movement focused on: recruiting personnel (often by freeing its prisoners from jails); seizing weaponry (as it spectacularly succeeded in doing after its capture of Mosul, when it amassed huge quantities of Iraqi army equipment); and, most recently, capturing and redistributing government food supplies, as evidenced by its recent seizure of some 40,000-50,000 tonnes of wheat from government silos in Nineveh province. Yet such a tactic naturally relies on maintaining the group's forward momentum, as well as, to an extent, the group's aura of invincibility after repeated astonishing military successes in the field against Iraqi and Kurdish forces.

Momentum shifting against IS in Iraq

Yet all this could move into reverse if the IS's advance in Iraq is halted. Thus far the group has successfully plucked the low-hanging fruit: it moved into fellow Sunni Arab areas, where resentment against the government of Iraq's contentious former prime minister, Nouri al-Maliki, was strongest, and exploited the obvious lack of motivation and discipline within Iraq's armed forces. However, both the political and military momentum has now shifted in four key areas.

- **A motivated and capable opponent.** Although the peshmeraga (armed Kurdish fighters) have suffered a series of surprising reverses, it retook two towns, Makhmour and Gweir, from IS on August 10th and is now benefiting from a veritable flood of donated military supplies (including new ammunition and French equipment).
- **Western military intervention.** The IS's heavy equipment—including the tanks and artillery seized from the Iraqi army—is hugely vulnerable to US air power out on the Nineveh plains. Although thus far these air strikes have been piecemeal, we expect the US to step up its air-delivered bomb and missile strikes once a new government of national unity is formed in Baghdad (albeit the US administration will almost certainly shy away from putting boots on the ground).
- **A plausible, national unity government.** A new, less sectarian (and less Shia) government would provide an alternative political route for those within IS territory, or on the front lines. Mr Maliki had alienated Iraq's Sunni Arab population to such an extent that it accepted (albeit perhaps not fully welcomed) the return of the jihadis less than seven years after bloodily evicting them. The nomination of Mr Abadi, although not universally welcomed among all Iraqi Sunni groups, has for the most part been positively received, including by puritanically Sunni Saudi Arabia.
- **International unity over the issue.** The backing given by all major external players to the new premiership of Mr Abadi—including Saudi Arabia, Qatar, Iran, and the US—should ensure that no major party will seek to undermine the transition (in the way that Iran did in Iraq after 2003).

Momentum behind IS in Syria

In contrast, however, the position of the IS in Syria looks almost impregnable. It is worth noting that the Islamic State of Iraq and al-Sham (now renamed the IS) was rebuilt in Syria, from the ashes of al-Qaida in Iraq. Unlike Iraq, the IS's Sunni strain of Islam overlaps more closely with Syria—over 60% of Syria is Sunni Arab, compared with just 20% in Iraq. Admittedly, prior to its civil war, Syria was viewed as a relatively secular place, under successive Assad regimes; however, three and a half years of war and 170,000 dead has undoubtedly unleashed increased religious extremism.

On the back of this, a plethora of Sunni Islamist groups has formed across Syria, most of whom are currently rivals of IS, but may be persuaded to shift into its camp. For example, al-Qaida-affiliated Jabhat al-Nusra co-operated with IS in the attack on the Lebanese town of Arsal on August 2nd, and there is speculation that, as IS advances on Syria's second city, Aleppo, the Salafi-oriented Ahrar al-Sham, which reportedly has more boots on the ground than IS (up to 20,000, compared with 10,000-15,000, respectively), is considering throwing in its lot with IS.

More importantly, however, arguably none of the four key political and security elements moving against IS in Iraq are being repeated in Syria.

- **A motivated and capable opponent.** In this regard, the Syrian regime certainly counts, but its focus is split by the multiplicity of opponents confronting it (including up to 1,000 rebel groups). Equally, until recently, the Syrian government had avoided confronting IS, as the group had previously served its purpose of both weakening and dividing the main rebel forces, and helped reinforce the narrative that the regime's opponents are terrorist extremists. On the other side, several of the various rebel groups are certainly motivated to take on IS, but lack the necessary weaponry—indeed, the Saudi-backed Syria Revolutionaries Front reportedly suffered a heavy defeat in Akhtar in on August 13th.
- **Western military intervention.** After President Barack Obama's abortive effort in August/September 2013 to launch air strikes against the Syrian regime to punish it for using chemical weapons, any sort of US military intervention in Syria is unlikely for the time being. This impression was reinforced by his speech on August 7th announcing the US's intervention in Iraq: first, he said it was to defend US interests in the Iraqi Kurdistan region—where a number of US personnel, and a US consulate, are based—and he cited the threat of "genocide" against Iraq's Yazidis. Neither situation applies in Syria.
- **A plausible, national unity government.** Although the Syrian president, Bashar al-Assad, might point to his thumping victory in the (highly dubious) presidential election in June, the mass uprising against his regime demonstrates the widespread loathing that his rule engenders. Meanwhile, the opposition political coalition, the Syrian National Coalition, has become at best peripheral and in many ways irrelevant to the ongoing war on the ground.
- **International unity over the issue.** In contrast to Iraq, the major external actors are divided over the best way to approach Syria's civil war. On the hand, Iran, Lebanon's Shia political/guerrilla group, Hizbullah, and Russia backs the Assad regime; on the other, the Saudis, Qatar, the US and EU back the rebels (and not necessarily the same ones). As a result, the key international players tend to focus on countering the influence of each other, rather than unifying against IS.

Halting the sale of "blood oil" will be key

Arguably, the best way to counter the IS in Syria would be to undermine its economic underpinnings: notably its oil. Currently, the Paris-based International Energy Agency (IEA) reports that the group has seven fields under its control,

largely based in the Euphrates, while the Iraq Oil Report estimates that IS is earning as much as US\$1m a day from its Iraqi oilfields alone (via smuggling routes through Turkey and Iran). Although the UN Security Council condemned the purchase of the IS's oil in a vote in late July, a much more co-ordinated crackdown on the trade of what might be called "blood oil" is necessary to stem the flow. Seeking to build a firmer foundation for its rule, the IS has an energetic hearts-and-minds programme in the areas it currently rules (with a focus especially on children), but its efforts would probably not add up to much without the cash behind them. Of course, it could revert to other, more violent options to cow the population, but such methods can only go so far: as al-Qaida in Iraq (AQI), which was roundly defeated by a combination of US forces and, in particular, armed Iraqi Sunni tribal groups, would attest.

Yet, even if IS's oil trade is curtailed, two crucial drivers necessary to undermine the group's grip are lacking in Syria. First, there is no obvious security (and financial) alternative to the IS—a key component of AQI's defeat was the controversial US surge, which reassured locals taking up arms against al-Qaida that the US was not about to abandon them. The IS's ideology may not be especially popular—they were recently kicked out of three villages near the Syria-Iraq border—but any would-be anti-IS fighter will desire outside reassurance before confronting such a fearsome organisation. Second, and as a corollary, Syria remains a fertile location for the IS's conquer and plunder approach. Even if its oil funds are cut off, IS could divert its pillage policy to the south, against the Syrian army and all the way to Damascus. Although the Assad regime could rely on Iran's full backing and Russian equipment, it is not clear that the Syrian government would be able to stem the IS tide. If the US is horrified at the prospect of IS rampaging through northern Iraq, it would explore a whole new level of anxiety should the group end up pressing up against the borders of its two closest political allies in the Middle East, Jordan and, above all, Israel.

Economy

Forecast updates

August 19, 2014: Economic growth

Local buyers are supporting property sector

Event

Increases in construction permits and rising real-estate transaction values highlight stronger local appetite for real estate, although foreign buyers are still staying clear of the market.

Analysis

New figures for real-estate transactions and construction permits in the first half of 2014 suggest a picture of reviving sentiment compared with 2013, when the deteriorating regional political and economic climate smothered investor appetite for property. Figures released by the Ministry of Finance indicate that the total number of real-estate transactions reached 34,109 in the first half of 2014, an increase of 6.8% from the same period last year.

Construction permit figures paint a similar picture, with the surface area of permits issued in the first six months of the year reaching 7.3m sq metres, an increase of 15.4% on the first half of 2013 (when there was a 16.6% decline from the same period of 2012). The cumulative value of real-estate transactions grew by 17.7% year on year to US\$4.48bn up to end-June, yielding an average increase per transaction of US\$131,742 compared with US\$119,231 in the first half of 2013.

Local investors are showing the strongest appetite for real estate, boosted by increased loans provided by the Public Housing Corporation. There were just 510 real-estate transactions executed by foreigners in the first half of 2014, down by 14.1% from 594 deals in the same period of 2013. Non-Lebanese investors accounted for just 1.5% of total real-estate deals in the six months. This lack of interest from Gulf investors—traditionally the strongest overseas buyers—has clearly affected the capital's real-estate market.

Demand has reoriented away from the central Beirut area towards Mount Lebanon and suburban Beirut. Mount Lebanon—the mountainous region stretching north of the capital—accounted for fully 43% of construction permits issued in the first half. In contrast, just 5% of permits were issued in Beirut itself.

There is no guarantee that the year-to-date trend will be sustained, given concerns that public housing loans could dry up—potentially removing a substantial source of support for Lebanese buyers. Figures show that for June, real-estate transactions slowed to 5,661 compared with 6,339 the previous month.

Impact on the forecast

We note the resilience of Lebanon's property sector in 2014 and may adjust our forecast for gross fixed investment upward slightly from growth of 4.5% currently.