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## **Country Report**

# **Lebanon**

**September 2013**

Economist Intelligence Unit  
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United Kingdom

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"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

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# Highlights

Editor: **Edward Bell**

Forecast Closing Date: **September 17, 2013**

## Outlook for 2013-17

- Tammam Salam, the prime minister-designate, will struggle in attempting to form a cabinet after the resignation of his predecessor, Najib Mikati, in March. Political tension will stay high as rival factions compete for influence.
- Lebanon will continue to suffer from political violence as long as the civil war in Syria continues. The risk of Western military intervention remains and would undermine stability in Lebanon further if the Syrian regime retaliates.
- The economy, which is dependent on services, such as tourism, that are sensitive to political risk, will underperform as the unrest in Syria continues. Growth will be minimal in 2013, but will improve in 2014-17, to average 4.6%.
- Fiscal reform will be a low priority, as Lebanon's policymakers are preoccupied with the potential for political unrest. The fiscal deficit is expected to decline from 8.3% of GDP in 2013 to 4.4% of GDP in 2017.
- Banque du Liban (the central bank) will maintain the Lebanese pound's peg to the US dollar during the forecast period. It will hold a high level of foreign reserves to meet any downward pressure on the currency.
- Lebanon's external balances will be highly sensitive to changes in energy prices. The current-account deficit is expected to fall from around 12% of GDP in 2013 to around 5% of GDP in 2017.

## Review

- A large car bombing on a Sunni mosque in Tripoli has killed nearly 50 people. Allies of the Syrian regime were believed to have been behind the attack.
- The Tripoli bombing followed a smaller attack in the capital, Beirut, in a Hizbullah-controlled suburb. The two attacks in August raised the prospect of further sectarian violence in Lebanon.
- Hizbullah's leadership has said that it is "considering" its response if a Western attack on Syria's chemical weapons capabilities occurs. The most likely retaliation would be to attack Israel, although this would invite a devastating reprisal.
- Mr Salam has said that key politicians in Lebanon lack a "serious intent" to form a government. Representatives from rival factions continue to make countervailing demands for their positions in a future cabinet.
- The Ministry of Energy has delayed the timeline for submitting bids for offshore oil and gas exploration licences. This is likely to push back any potential drilling and some companies have said that they are losing patience in developing Lebanon's hydrocarbons potential.

# Outlook for 2013-17

## Political stability

Lebanon's political scene remains highly unstable, as the country has been without a government since March. Tammam Salam, an independent Sunni member of parliament, is struggling to balance the competing demands of Lebanon's political factions in his efforts to form a cabinet. His predecessor, Najib Mikati, resigned earlier this year in a stand-off with Hizbullah, a powerful Shia armed political group, over the appointment of a security official. Hizbullah, which is a prominent member of the pro-Syrian "March 8th" political alliance, has demanded that it have the power of veto in any future cabinet. However, this point is being fiercely resisted by the nationalist (and broadly pro-Western) "March 14th" bloc, under the leadership of a former prime minister, Saad Hariri. The impasse over the formation of a government is likely to continue in the short term, as the pre-existing divisions between the political blocs have widened owing to their opposing stances on the civil war in Syria. Parliament was suspended for two weeks in July owing to a dispute over extending the head of the army's term beyond the legal retirement age, contributing to further political instability.

Mr Mikati's resignation was a symptom of the spillover of Syria's civil war into Lebanon, and The Economist Intelligence Unit now expects that the country will experience heightened episodes of violence as long as the uprising against the regime of the Syrian president, Bashar al-Assad, continues. Clashes between supporters and opponents of the Syrian regime will flare up occasionally in religiously mixed cities such as the capital, Beirut, or Tripoli. A large car bombing in Tripoli in late August killed nearly 50 people, in an attack believed to be linked to Syrian agents provocateurs. The army, which is widely seen as a neutral political force, is at risk of being drawn into the sectarian fighting as it tries to separate clashing factions; military forces have pursued an outspoken Sunni cleric in the southern city of Sidon, and are believed to have been assisted by Hizbullah forces. The presence of armed groups and Lebanon's recent history of violence mean that any dispute can escalate quickly and severely.

Sectarian tensions are built into Lebanese politics. By an unwritten national pact, 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. The division between March 8th and March 14th has replaced, to a degree, the largely Christian-Sunni-Shia split that predominated during the civil war; the largest Christian party in parliament, the Free Patriotic Movement, is currently tied, albeit loosely, to Hizbullah in March 8th.

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 as it agrees to send its chemical weapons out of the country by 2014 will mean that its regional importance—by acting as a threat to Israel—will be weakened slightly. This may prompt Hizbullah to re-examine its capabilities with respect to Israel, as the group will not be able to count on the near unlimited support of its ally.

## Election watch

A parliamentary election had been expected to take place in June, but at the start of the month parliament voted to extend its term until 2014. Given the roughly even balance between March 14th and March 8th in the chamber, no side was prepared to risk losing ground as a result of an election. A new electoral law will need to be approved prior to the vote, with Hizbullah favouring a proposal that would divide Lebanon into fewer, larger constituencies with voters restricted to voting for candidates from their own sect.

An indirect presidential election (the post is named by parliament) will take place in 2014, with the chief of the armed forces, Jean Khawaji, a likely candidate to succeed the incumbent, Michel Suleiman. The president is meant to be a neutral and expediting figure and not engage directly in domestic politics.

## International relations

Lebanon is firmly embroiled in the Syrian civil war, as political tensions in the country have been exacerbated by differences over Syria. Hezbollah has now become an active participant in the war, supporting the Syrian military's efforts. The group's involvement is disrupting Lebanon as Syrian rebel groups have begun to retaliate by attacking Hezbollah's positions within Lebanon itself. The threat of a military strike on Syria will drag in Lebanon, as the Assad regime is likely to try to move some of its military assets across the border, making Lebanon a potential target.

Lebanon will be at risk of losing the support of its Arab allies—mainly Saudi Arabia and Qatar—if it maintains its relatively neutral policy towards Syria. However, the government, regardless of its character, will strive to maintain constructive relationships with Gulf nations, as their tourists are a key determinant of Lebanon's economic performance.

Israeli attacks on targets inside Syria that are believed to have links with Hezbollah have raised the prospect of a renewed clash with Israel. We do not yet expect a conflict similar to the 2006 war to break out, but occasional skirmishes or air strikes are possible.

## Policy trends

Policymakers will not make much progress on economic reform, as they will be preoccupied with the risk of political unrest. Fiscal reform, particularly the expansion of revenue collection, is vital to the reduction of the structural deficit (a result largely of the high cost of servicing the massive public debt incurred after the 1975-90 civil war). Some level of debt restructuring will be required in order to make servicing costs more manageable (the public debt stock was an estimated 120% of GDP in 2012), although this is unlikely to happen in the near future.

The development of Lebanon's potential hydrocarbons resources is one point of unity across the political scene, as it would help to reduce dramatically Lebanon's reliance on imports of expensive energy products. The government has pre-approved firms to carry out the operation, but the deadline for exploration bids has been extended owing to slow progress by the caretaker government in approving critical pieces of legislation. We expect progress in this sector to be slowed by political uncertainty and local government inexperience in managing hydrocarbons projects. Some international firms have already expressed scepticism about investing in the sector given Lebanon's propensity towards political instability. Moves to boost the electricity supply, another relatively politically neutral issue, will benefit from a US\$5bn investment programme to expand capacity and the establishment of a new regulatory authority.

In January, in an attempt to revive the economy, Banque du Liban (BdL, the central bank) launched a US\$1.3bn stimulus programme through the provision of cheap loans to banks that they can then extend to customers (at interest rates capped at 6%). These have begun to trickle into the economy, most notably through increased automotive loans. The governor of BdL announced in September that further stimulus would be forthcoming in 2014 if the economy required it, although it is unlikely to match the scale of the first intervention into the economy. The central bank maintains a policy of holding high levels of foreign reserves—US\$37bn in the first quarter of 2013, or around 19 months of import cover—to offset any flight to quality and to maintain the currency's peg.

## Fiscal policy

The finance minister, Mohammed Safadi, submitted a revised 2013 budget to the cabinet prior to its dissolution, with spending forecast at US\$14.1bn, down from the original plan of US\$15.3bn. However, Mr Safadi has already prepared a draft budget for 2014 in August, which, given the current political situation, means that the 2013 budget is unlikely to be passed, meaning that ministries will continue to spend in an ad hoc manner. Total spending in the first quarter was relatively unchanged from a year earlier, but revenue was 5% lower year on year; value-added tax (VAT) receipts were down by more than 8% year on year. We expect another wide deficit of more than 8% of GDP in 2013 as revenue is affected by the economic weakness caused by political uncertainty.

Thereafter, the shortfall is expected to decline gradually as the economy improves (assuming the security situation does not deteriorate further). The civil war in Syria has been a boon for Beirut's port, supporting customs payments (shipments through Beirut port were up by 17.5% year on year in the first five months of 2013), a situation which could continue should the conflict be resolved, as Lebanon would have infrastructure in better condition. A precedent has been set for the politicisation of revenue streams after the Ministry of Telecommunications, which normally provides a large portion of non-tax revenue to the government from the operation of Lebanon's mobile-phone networks, withheld revenue for much of 2010 because the telecoms and finance ministers were from rival political groups.

Much of the government's foreign-currency debt is held by local banks, and debt servicing is in effect a form of government support for the banks. The total public debt stock rose in 2012, to L£81.6trn (US\$54bn), or 120% of estimated GDP. However, the government's heavy debt burden soaks up a considerable portion of banks' domestic claims, depriving the economy of a large share of financing.

## 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. We expect the central bank to follow the Federal Reserve, its US counterpart, in raising rates. Riad Salameh's ongoing governorship of the BdL will help to preserve confidence in the Lebanese banking system. Moreover, uncertainty over political stability and the still weak economy may limit demand for the central bank's supply of cheaper stimulus loans.

## International assumptions

	2012	2013	2014	2015	2016	2017
<b>Economic growth (%)</b>						
US GDP	2.8	1.6	2.6	2.4	2.5	2.4
OECD GDP	1.5	1.2	2.1	2.1	2.2	2.2
World GDP	2.2	2.0	2.7	2.8	2.8	2.8
World trade	2.4	3.7	5.2	5.4	5.5	5.6
<b>Inflation indicators (% unless otherwise indicated)</b>						
US CPI	2.1	1.5	2.2	2.2	2.3	2.3
OECD CPI	2.2	1.6	2.1	2.2	2.3	2.1
Manufactures (measured in US\$)	-0.6	-3.8	-0.1	1.2	1.8	1.9
Oil (Brent; US\$/b)	112.0	107.0	104.8	107.3	103.8	97.0
Non-oil commodities (measured in US\$)	-10.7	-6.7	-1.3	0.7	1.4	3.0
<b>Financial variables</b>						
US\$ 3-month commercial paper rate (av; %)	0.2	0.1	0.2	0.3	1.2	2.2
US\$:€ (av)	1.29	1.30	1.27	1.26	1.26	1.27
¥:US\$	79.79	98.19	101.97	103.00	102.00	101.00

## Economic growth

Economic growth in 2013 will be lacklustre, at 1.3%, as domestic political uncertainty is heightened by the debate over forming a new government and as the civil war in Syria, which shows no signs of ending, continues to have a negative impact on Lebanon's economy. Growth prospects also depend heavily on perceptions of political risk and regional performance, as Arab states are the principal consumers of Lebanon's services. As the unrest in Syria continues and spreads into Lebanon, tourism and related investment in property will suffer further, dragging down growth. We now expect the civil war in Syria to continue until at least the middle of 2014 and to be potentially amplified by Western military intervention. We expect the Lebanese economy to grow by 2.5% in real terms next year, an improvement on 2012-13, provided the war in Syria does not escalate. Were the conflict to worsen further, with more unrest in Lebanon, then we would be likely to lower our forecast for 2014. We forecast that growth will pick up substantially thereafter, averaging 5.2% in 2015-17.

Growth will be driven by strong private consumption, as well as a robust recovery in services export volumes. We expect fixed investment to increase its share of GDP as international firms are tempted by the potential of offshore natural gas reserves. However, this is a relatively benign scenario, and there are significant downside risks that have the potential to drag down Lebanon's economy. A further escalation of inter-communal violence could lead to a sharp economic contraction and see investors pull their money out of Lebanon, depriving the economy of capital and choking liquidity in the banking system.

Weak performances in tourism and construction in 2012 have demonstrated how quickly Lebanon's economy can fall victim to political uncertainty. Tourism indirectly supports around one-quarter of jobs and generates much of the demand that supports construction. Banking is vital to the economy and continues to benefit from strong inflows of deposits and interest income from government debt. Lebanon could derive some unreported benefits from the unrest in Syria, as it serves as a channel for smuggling goods into the country, and some Syrians may deposit money in Lebanese banks. There are questions about the quality of official GDP data, and timely economic indicators outside the three key sectors are in short supply.

### Economic growth

%	2012 <sup>a</sup>	2013 <sup>b</sup>	2014 <sup>b</sup>	2015 <sup>b</sup>	2016 <sup>b</sup>	2017 <sup>b</sup>
GDP	1.7	1.3	2.5	4.8	5.1	5.8
Private consumption	5.0	3.0	4.0	8.7	9.2	8.0
Government consumption	5.8	3.3	4.5	4.2	4.5	4.6
Gross fixed investment	1.5	-3.0	5.0	8.2	10.0	10.6
Exports of goods & services	3.5	2.5	4.5	10.0	11.0	12.3
Imports of goods & services	9.0	4.5	8.0	13.4	15.2	13.5
Domestic demand	4.6	2.6	4.8	8.1	9.2	8.7
Agriculture	1.8	2.0	3.5	4.0	4.5	4.5
Industry	1.5	3.0	4.5	4.5	6.2	6.8
Services	1.8	0.8	2.0	5.0	5.0	5.7

<sup>a</sup> Economist Intelligence Unit estimates. <sup>b</sup> Economist Intelligence Unit forecasts.

## Inflation

Inflation will be manageable in 2013-14, dropping from 5.6% in 2013 to 4.5% in 2014 as commodity prices ease. Average inflation will be relatively steady during the forecast period, averaging around 4.4%. The Central Administration for Statistics has resumed publishing inflation data, but some of its underlying methodology (including accounting for three years of rental increases in a single month's data release) casts doubt on the accuracy of inflation reporting in Lebanon. Higher minimum wages for public- and private-sector workers will lead to some inflation as merchants pass on costs to consumers.



## Exchange rates

The Lebanese pound is expected to remain pegged to the US dollar within a band of L£1,501-1,514:US\$1. The BdL's firm commitment to defending the peg is aided by its ability to influence interest rates, high levels of assets and strong support from local commercial banks. Were Lebanon to experience serious capital flight, it would need to draw down its foreign reserves to support the pound. Lebanon's reserves provide it with an ample 19 months of import cover. A risk to the currency, however, is the high proportion of Lebanon's reserves that is held in gold (which the BdL marks to market). Since the start of 2013, Lebanon's reserves have fallen by nearly US\$3bn, most of which is attributable to lower gold values on the central bank's balance sheet.

## External sector

Lebanon will continue to record wide current-account deficits in 2013-17, although they will narrow from around 12% of GDP in 2013 to around 5% of GDP in 2017. Export earnings have proved surprisingly resilient in 2013, in spite of the political uncertainty, and Lebanon is now serving as a transshipment hub for moving goods into Syria. Nevertheless, Lebanon will still record a sizeable trade deficit, of US\$15bn, this year as it relies on imports of energy, industrial raw materials and food. The trade balance will continue to be in deficit throughout the forecast period as the expected investment in offshore hydrocarbons projects draws in capital inputs, although lower oil prices in 2016-17 will help to ease import costs.

We expect growth in the services surplus to accelerate in 2014, assuming the civil war in Syria cools down around the middle of the year. Tourism from the diaspora has tended not to be particularly risk-averse, and inflows into Lebanon's banking system continue to grow. Remittances will help to offset the trade deficit (although they may decline, as the UAE has hardened its visa policy towards Lebanese nationals). 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)

	2012 <sup>a</sup>	2013 <sup>b</sup>	2014 <sup>b</sup>	2015 <sup>b</sup>	2016 <sup>b</sup>	2017 <sup>b</sup>
Real GDP growth	1.7	1.3	2.5	4.8	5.1	5.8
Consumer price inflation (av)	6.4 <sup>c</sup>	5.6	4.5	4.0	3.9	3.9
Consumer price inflation (end-period)	10.1 <sup>c</sup>	3.2	3.8	5.0	3.6	2.7
2-year Treasury bill rate	5.9 <sup>c</sup>	5.9	6.4	6.5	6.5	6.8
Government balance (% of GDP)	-8.7	-8.3	-7.5	-5.6	-4.8	-4.4
Exports of goods fob (US\$ bn)	5.7	5.9	6.0	6.1	6.3	6.6
Imports of goods fob (US\$ bn)	20.4	21.0	22.7	25.1	27.7	30.0
Current-account balance (US\$ bn)	-6.6	-6.0	-6.3	-6.7	-5.8	-3.9
Current-account balance (% of GDP)	-14.7	-12.2	-11.9	-11.3	-8.7	-5.2
External debt (year-end; US\$ bn)	25.2	26.7	28.9	31.1	32.0	29.3
Exchange rate L£:US\$ (av)	1,508 <sup>c</sup>	1,508 <sup>c</sup>	1,508	1,508	1,508	1,508
Exchange rate L£:€ (av)	2,098 <sup>c</sup>	1,938 <sup>c</sup>	1,959	1,915	1,899	1,910
Exchange rate L£:€ (end-period)	1,951 <sup>c</sup>	1,973 <sup>c</sup>	1,926	1,899	1,905	1,909
Exchange rate L£:¥100 (av)	1,889 <sup>c</sup>	1,889 <sup>c</sup>	1,535	1,478	1,478	1,493

<sup>a</sup> Economist Intelligence Unit estimates. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Actual.

# Data and charts

## Annual data and forecast

	2008 <sup>a</sup>	2009 <sup>a</sup>	2010 <sup>a</sup>	2011 <sup>a</sup>	2012 <sup>b</sup>	2013 <sup>c</sup>	2014 <sup>c</sup>
<b>GDP</b>							
Nominal GDP (US\$ m)	29,684	34,650	37,124	40,031 <sup>b</sup>	45,254	48,956	52,854
Nominal GDP (£ bn)	44,748	52,235	55,965	60,347 <sup>b</sup>	68,221	73,801	79,677
Real GDP growth (%)	9.3	8.5	7.0	1.5 <sup>b</sup>	1.7	1.3	2.5
<b>Expenditure on GDP (% real change)</b>							
Private consumption	10.2	8.3	5.3	6.0 <sup>b</sup>	5.0	3.0	4.0
Government consumption	6.6	8.6	6.4	8.0 <sup>b</sup>	5.8	3.3	4.5
Gross fixed investment	18.5	32.9	6.8	4.0 <sup>b</sup>	1.5	-3.0	5.0
Exports of goods & services	13.7	1.7	12.8	2.8 <sup>b</sup>	3.5	2.5	4.5
Imports of goods & services	16.9	20.7	3.1	12.3 <sup>b</sup>	9.0	4.5	8.0
<b>Population and income</b>							
Population (m)	4.2	4.2	4.2	4.3 <sup>b</sup>	4.6	4.9	4.9
GDP per head (US\$ at PPP)	11,975 <sup>b</sup>	13,012 <sup>b</sup>	14,009 <sup>b</sup>	14,423 <sup>b</sup>	13,887	13,328	13,773
<b>Fiscal indicators (% of GDP)</b>							
Central government revenue	23.7	24.3	22.7	23.3 <sup>b</sup>	20.8	19.4	20.4
Central government expenditure	33.4	32.9	30.5	29.2 <sup>b</sup>	29.4	27.7	27.9
Central government balance	-9.7	-8.5	-7.8	-5.8 <sup>b</sup>	-8.7	-8.3	-7.5
Net public debt	156.6	145.6	140.7	133.2 <sup>b</sup>	119.6	118.9	117.5
<b>Prices and financial indicators</b>							
Exchange rate £:US\$ (end-period)	1,507.5	1,507.5	1,507.5	1,507.5	1,507.5 <sup>a</sup>	1,507.5	1,507.5
Exchange rate ¥:£ (end-period)	0.060	0.062	0.055	0.052	0.058 <sup>a</sup>	0.067	0.068
Consumer prices (end-period; %)	5.5	3.4	4.6	3.1	10.1 <sup>a</sup>	3.2	3.8
Stock of money M1 (% change)	19.3	13.4	18.4	7.2	15.7 <sup>a</sup>	15.0	12.0
Stock of money M2 (% change)	50.3	37.9	15.4	-1.3	11.0 <sup>a</sup>	7.0	14.6
Lending interest rate (av; %)	10.0	9.6	8.3	7.5	7.2 <sup>a</sup>	7.5	7.6
<b>Current account (US\$ m)</b>							
Trade balance	-11,077	-11,207	-12,499	-13,919	-14,718	-15,110	-16,721
Goods: exports fob	4,454	4,187	4,689	5,386	5,662	5,874	5,992
Goods: imports fob	-15,531	-15,394	-17,188	-19,305	-20,380	-20,984	-22,713
Services balance	4,177	2,867	2,820	6,803	6,781	7,294	8,250
Primary income balance	437	-228	-509	-178	-516	-186	-213
Secondary income balance	2,360	1,827	2,601	2,429	1,804	2,046	2,396
Current-account balance	-4,103	-6,741	-7,588	-4,866	-6,649	-5,956	-6,288
<b>External debt (US\$ m)</b>							
Debt stock	24,788	25,092	24,707	24,884	25,173	26,743	28,900
Debt service paid	4,427	4,611	4,152	5,334	5,544	3,961	3,953
Principal repayments	2,905	3,096	2,651	3,789	3,658	2,355	2,135
Interest	1,481	1,473	1,450	1,508	1,886	1,605	1,818
<b>International reserves (US\$ m)</b>							
Total international reserves	28,276	39,165	44,524	48,141	52,498 <sup>a</sup>	52,014	54,443

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit estimates. <sup>c</sup> Economist Intelligence Unit forecasts.

Source: IMF, International Financial Statistics.

□

## Quarterly data

	2011		2012				2013	
	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr
<b>Central government finance (£ bn)</b>								
Revenue	3,294	3,590	3,522	4,120	3,193	3,329	3,354	n/a
Expenditure	4,093	5,016	4,531	4,819	4,589	6,143	4,534	n/a
Balance	-798.8	-1,426.4	-1,008.7	-699.0	-1,396.3	-2,813.6	-1,179.8	n/a
<b>Output</b>								
Coincident Indicator (end-period, 1993=100)	248.1	265.5	264.8	261.0	243.5	262.5	273.9	n/a
Coincident Indicator (% change, year on year)	8.3	3.9	4.7	-0.3	-1.9	-1.1	3.4	n/a
<b>Financial indicators</b>								
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	5.9	5.8	5.8	5.8	5.8	5.8	5.8
Discount rate (end-period; %)	10.0	10.0	10.0	10.0	10.0	10.0	n/a	n/a
Lending rate (av; %)	7.4	7.3	7.1	7.4	7.3	7.2	7.4	7.5
Treasury bill rate (av; %)	3.9	3.9	4.1	4.4	4.4	4.4	4.4	4.4
M1 (end-period; £ bn)	5,805	6,138	6,033	6,288	6,319	7,104	7,038	7,350
M1 (% change, year on year)	7.7	7.2	5.7	8.0	8.9	15.7	16.7	16.9
M2 (end-period; £ bn)	56,805	58,643	60,357	61,807	63,024	65,077	65,970	n/a
M2 (% change, year on year)	-4.2	-1.3	7.8	12.0	10.9	11.0	9.3	n/a
BLOM stockmarket index (end-period; Jan 22nd 1996=1,000)	166	138	138	124	122	116	120	116
BLOM stockmarket index (% change, year on year)	-25.9	-36.3	-36.8	-38.0	n/a	n/a	n/a	n/a
<b>Sectoral trends</b>								
Construction permits (end-period; '000 sq metres)	3,595	3,996	3,608	3,985	3,228	3,860	2,822	n/a
<b>Foreign trade (£ bn)</b>								
Exports fob	1,678	1,561	1,740	1,535	1,698	1,787	1,797	1,694
Imports cif	7,808	8,674	9,011	7,398	7,766	7,915	8,314	7,963
Trade balance	-6,130	-7,113	-7,271	-5,862	-6,068	-6,128	-6,517	-6,269
<b>Reserves US\$ m)</b>								
Reserves excl gold (end-period)	33,462	33,741	33,939	36,718	36,530	37,186	37,061	38,608

Source: IMF, International Financial Statistics.

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## Monthly data

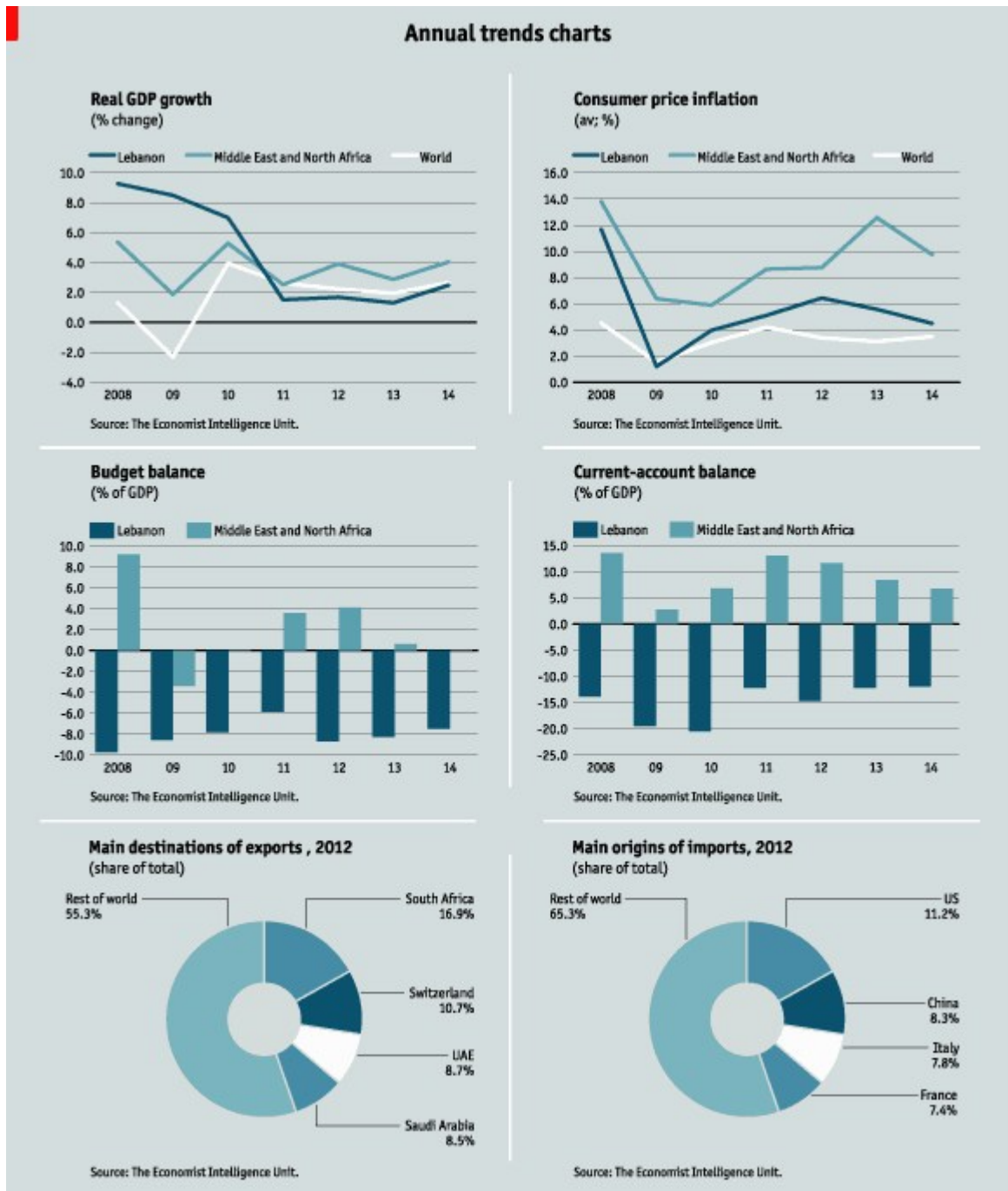
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Exchange rate £:US\$ (av)</b>												
2011	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508
2012	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508
2013	1,508	1,508	1,508	1,508	1,508	1,508	1,508	1,508	n/a	n/a	n/a	n/a
<b>Central government revenue (£ bn)</b>												
2011	1,221	649	858	1,101	1,534	1,823	1,350	885	1,059	1,357	893	1,339
2012	1,507	926	1,089	1,242	1,408	1,470	1,377	885	930	885	930	1,372
2013	1,543	805	1,007	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Central government expenditure (£ bn)</b>												
2011	1,294	1,404	1,684	1,555	1,258	1,295	1,249	1,153	1,690	1,536	1,551	1,929
2012	1,771	1,199	1,560	1,879	1,483	1,458	1,432	1,368	1,790	1,368	1,790	2,303
2013	1,570	1,227	1,738	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Central government balance (£ bn)</b>												
2011	-73	-755	-827	-454	276	528	101	-268	-632	-179	-658	-590
2012	-265	-273	-471	-636	-75	12	-54	-483	-859	-859	-931	-1,218
2013	-27	-422	-731	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Gross domestic debt (£ trn)</b>												
2011	47.3	46.9	47.8	47.8	48.1	48.0	48.3	48.4	50.3	50.1	49.7	49.3
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>External public debt (US\$ bn)</b>												
2011	21.0	21.0	20.9	20.9	20.8	20.7	20.8	21.3	21.0	21.1	21.1	20.9
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total public debt (£ trn)</b>												
2011	78.9	78.5	79.3	79.3	79.5	79.2	79.6	80.5	82.0	81.8	81.5	80.9

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	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>M1 (% change, year on year)</b>												
2011	16.3	17.6	14.8	15.7	12.7	12.0	12.4	10.2	7.7	0.9	7.8	7.2
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>M2 (% change, year on year)</b>												
2011	11.0	9.7	156.0	9.8	9.4	8.4	7.3	6.9	6.0	6.1	5.8	5.5
2012	6.3	6.5	6.5	5.7	6.0	6.5	6.2	6.2	6.2	6.5	6.8	7.0
2013	6.8	6.7	7.0	6.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Deposit rate (av; %)</b>												
2011	5.9	5.9	5.9	5.9	5.9	5.9	5.9	5.8	5.9	5.8	5.8	5.9
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>Lending rate (av; %)</b>												
2011	7.7	7.7	7.7	7.7	7.7	7.6	7.3	7.5	7.4	7.3	7.3	7.4
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>BLOM stockmarket index (end-period; Jan 22nd 1996=1,000)</b>												
2011	226.3	216.5	210.7	209.3	196.7	192.9	183.7	160.2	152.6	142.6	129.4	140.8
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>BLOM stockmarket index (% change, year on year)</b>												
2011	-16.0	-22.6	-29.5	-27.9	-32.0	-28.9	-23.7	-24.6	-29.7	-33.7	-40.0	-35.2
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	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total exports fob (US\$ m)</b>												
2011	297	304	354	375	377	411	416	363	334	351	347	338
2012	348	429	377	319	355	345	317	339	471	440	364	381
2013	405	381	407	412	364	348	280	n/a	n/a	n/a	n/a	n/a
<b>Total imports cif (US\$ m)</b>												
2011	1,730	1,218	1,632	1,501	1,579	1,572	1,679	1,720	1,780	2,509	1,580	1,665
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	1,798	1,635	1,718	n/a	n/a	n/a	n/a	n/a
<b>Trade balance fob-cif (US\$ m)</b>												
2011	-1,433	-914	-1,278	-1,126	-1,202	-1,161	-1,264	-1,357	-1,446	-2,158	-1,233	-1,328
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	-1,438	-1,434	-1,286	-1,438	n/a	n/a	n/a	n/a	n/a
<b>Foreign-exchange reserves excl gold (US\$ m)</b>												
2011	31,478	31,301	31,523	31,617	31,067	31,066	31,657	33,493	33,462	33,383	33,679	33,741
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	n/a	n/a	n/a	n/a	n/a	n/a

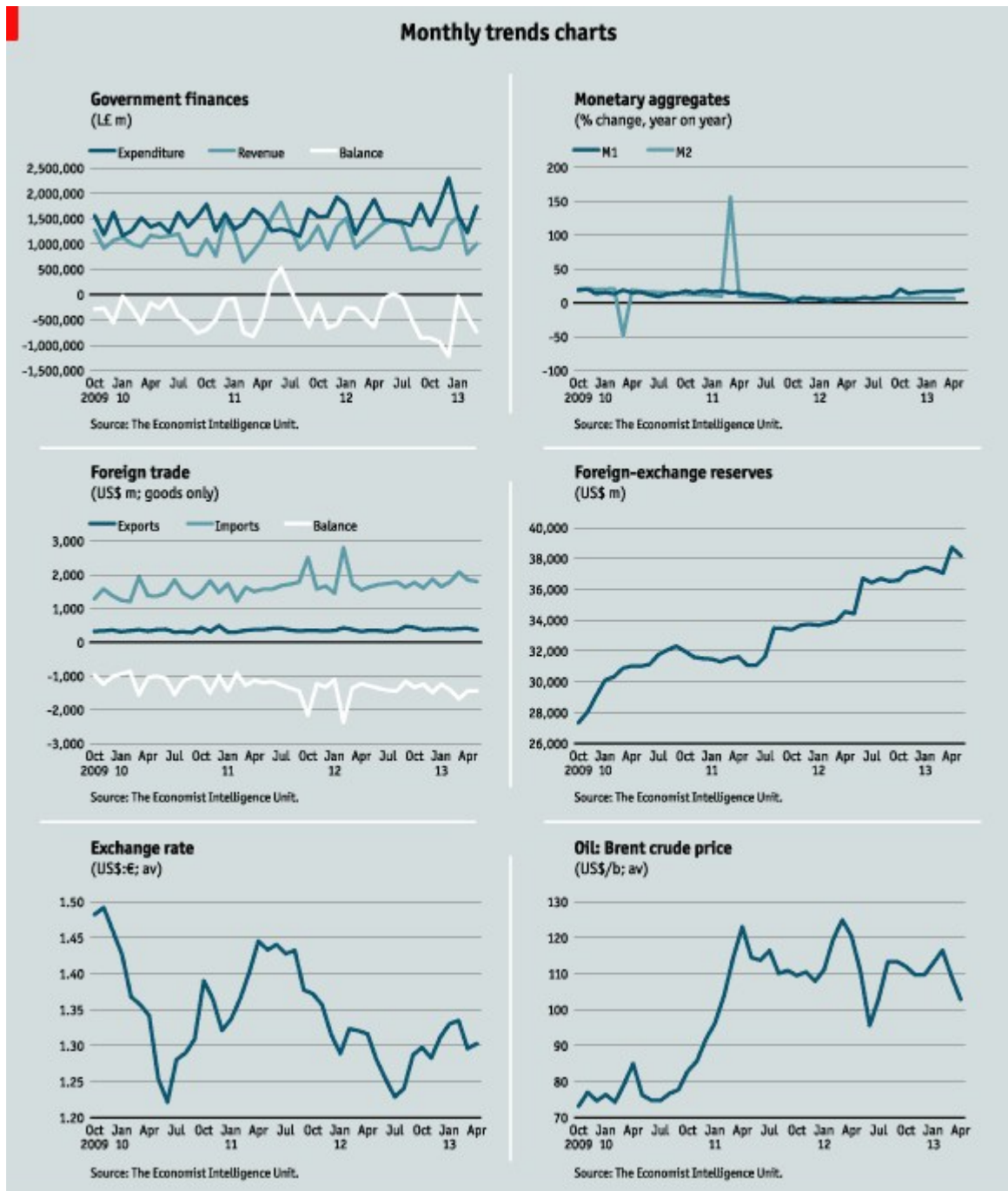
Sources: IMF, International Financial Statistics; Haver Analytics.

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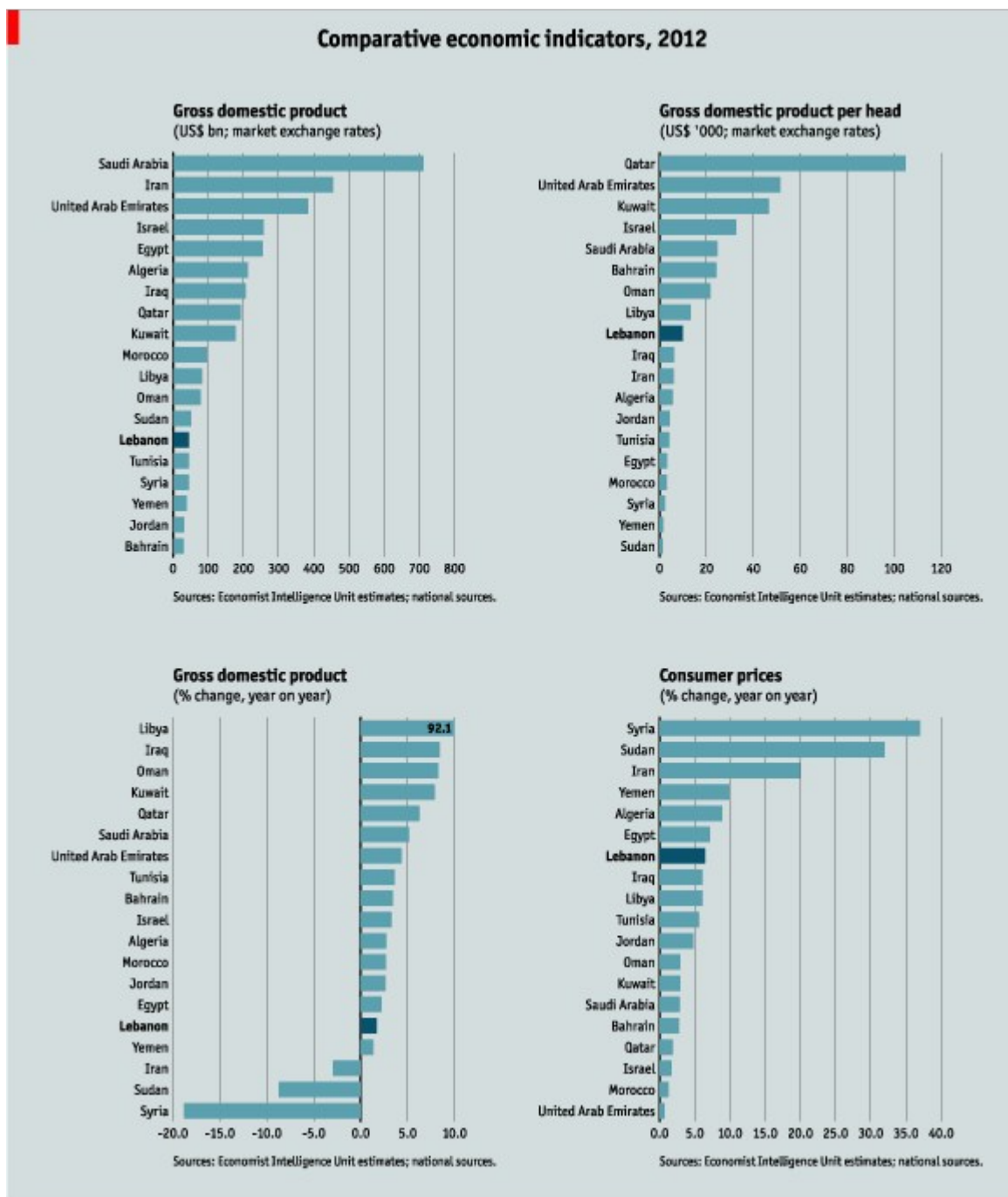
# Annual trends charts



# 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 24th 2013); Easter (March 29th-April 1st 2013); Orthodox Easter (May 3rd/6th 2013); Labour Day (May 1st); Martyrs' Day (May 6th); Resistance and Liberation Day (May 25th); Assumption Day (August 15th); Eid al-Fitr (August 8th 2013); All Saints Day (November 1st); Eid al-Adha (October 15th 2013); Independence Day (November 22nd); Islamic New Year (November 4th 2013); Ashoura (November 14th 2013); 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. Michel Suleiman was elected by parliament on May 25th 2008 for a six-year term

## National government

The prime minister must be a Sunni Muslim and is chosen by the president after consultation with parliament. 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. Following the resignation of the cabinet in March 2013, all ministers are holding their positions on a caretaker 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-designate: Tammam Salam (Sunni Muslim)

Deputy prime minister: Samir Mokbel (Greek Orthodox Christian)

## Key ministers

Culture: Gaby Layoun (Greek Orthodox Christian)

Defence: Fayez Ghosn (Greek Orthodox Christian)

Economy & trade: Nicolas Nahas (Greek Orthodox Christian)

Education: Hassan Diab (Sunni Muslim)

Energy & water: Gebran Bassil (Maronite Christian)

Environment: Nazem Khoury (Maronite)

Finance: Mohammed Safadi (Sunni Muslim)

Foreign affairs: Adnan Mansour (Shia Muslim)

Health: Ali Hassan Khalil (Shia Muslim)

Industry: Freij Sabounjian (Armenian Christian)

Information: Waleed Daouk (Sunni Muslim)

Interior: Marwan Charbel (Maronite Christian)

Justice: Shakib Kortbawi (Maronite Christian)

Labour: Salim Jreissati (Maronite Christian)

Public works & transportation: Ghazi Aridi (Druze)

Social affairs: Wael Bou Faour (Druze)

Telecommunications: Nicolas Sehnaoui (Catholic Christian)

Tourism: Fadi Abboud (Maronite Christian)

## **Parliamentary speaker**

Nabih Berri (Shia Muslim)

## **Central bank governor**

Riad Salameh (Maronite Christian)

# Recent analysis

Generated on October 8th 2013

The following articles were published on our website in the period between our previous forecast and this one, and serve here as a review of the developments that shaped our outlook.

## Politics

### Forecast updates

#### August 16, 2013: Political stability

### Bombing in Hizbullah neighbourhood kills at least 16

#### Event

A massive explosion has killed at least 16 people in a suburb of Lebanon's capital, Beirut.

#### Analysis

The explosion appears to have been caused by a car bomb and it affected the neighbourhood of Ruwaiss, a stronghold of Hizbullah, a Shia party-cum-militia. This is the second large bombing in as many months in mainly Hizbullah-supporting areas of Beirut. The bombing was denounced by Lebanese politicians from across the political spectrum, with Saad Hariri, a former prime minister and leader of the opposition Future Movement, saying it was a "horrific crime", and the speaker of parliament and Hizbullah ally, Nabih Berri, saying that Israel was to blame for the attack (although he did not provide any reasoning for the link).

After the bombing, a previously unknown group calling itself the "Brigade of Ayesha" claimed responsibility for the attack. In a video posted online, members of the group said that Hizbullah's leader, Hassan Nasrallah, was a "pig" and an agent of Israel and Iran (a somewhat strange combination).

Although it is unclear if the Brigade of Ayesha has any links to militant groups across the region, the attack on a Hizbullah neighbourhood is likely to be retribution by Sunni militias for Hizbullah's intervention in Syria's civil war and its support for the Syrian president, Bashar al-Assad. Shia communities have come under assault in Lebanon in recent months, either through bombings such as this one or via rocket-propelled grenade attacks or ambushes in more rural areas. So far, Hizbullah has not yet retaliated openly in Lebanon and seems aware that it is in a highly precarious position with the regional mood set firmly against its principal foreign patron.

Although political figures—including Hizbullah—will all denounce the attack on civilians and will call for moderation among their supporters, the escalating violence demonstrates that Lebanon's political elite has little connection to or ability to control groups in the country seeking to take advantage of the absence of state authority. Lebanon remains without a government nearly five months after Najib Mikati resigned as prime minister. The amplification of hostility towards Hizbullah from militants supporting rebels in their fight against the Assad regime is unlikely to be attenuated by any of Lebanon's current political leaders.

#### Impact on the forecast

This most recent bombing sadly reinforces our view that Lebanon will suffer from political instability and violence as the war in Syria continues. We do not expect the war there to end until the middle of 2014, at the earliest.

## August 27, 2013: Political stability

### Two large bombs kill nearly 50 in Tripoli

#### Event

Two car bombs have killed nearly 50 people in the northern city of Tripoli, Lebanon's second-largest city.

#### Analysis

The bombings appeared to target a mosque and were detonated shortly after the end of Friday prayers on August 23rd. According to local press, the explosions damaged around 700 apartments in nearby buildings.

Tripoli has been a flashpoint for sectarian violence in the past two years as supporters and opponents of the regime of Syria's president, Bashar al-Assad, have engaged in street gun battles that have at times required the intervention of the Lebanese military. Fighting and bombings have occurred elsewhere, with large bombings in several Shia neighbourhoods, some of which are under the jurisdiction of Hizbullah, a powerful party/cum militia. This latest attack in Tripoli, a mainly Sunni city, may therefore be a retaliatory attack against a community that is openly antagonistic towards Mr Assad and his allies in Lebanon.

Many suspect that Hizbullah was behind the the bombings. There had been an expectation that the group would retaliate for attacks in its neighbourhoods and following the most recent one at the start of August, Hassan Nasrallah, Hizbullah's leader, warned that Lebanon would experience more bombings. Members of the Lebanese opposition party, the Future Movement, have blamed Hizbullah for the attack, as has the North African affiliate of al-Qaida.

Coming at the same time as increased international tension over possible Western military intervention in Syria over an alleged chemical weapons attack by Assad forces, this latest bombing will destabilise Lebanon further. Tripoli is a base for many militant Sunnis in Lebanon, and the absence of attempts by any state or sectarian leadership to calm tensions means that further retaliatory attacks are likely.

#### Impact on the forecast

We are already forecasting that Lebanon will suffer from episodes of political and sectarian violence so long as the civil war in Syria continues. We will now adjust our forecast slightly to include the prospect of sustained fighting between rival groups in the country, although we still believe that a full-scale civil war will be avoided. This is mainly premised on the fact that Hizbullah's arsenal so heavily outweighs that of other factions that prolonged fighting over a year or more would be unlikely without external assistance to Hizbullah's opponents.

## August 28, 2013: Political stability

# Investigation into Tripoli attack points to Syria

### Event

An investigation into two large car bombings in Tripoli on Friday August 23rd suggests that the Syrian government may have been behind the attack.

### Analysis

At least 45 people were killed and more than 500 wounded when two devices exploded near mosques in the northern city of Tripoli, in one of the largest attacks in Lebanon since the 1975-90 civil war.

As both mosques were Sunni, suspicion fell on Shia groups (including Hezbollah), as well as the Syrian regime, which is fighting mainly Sunni rebel groups. By destabilising Lebanon further, the Syrian government may be trying to shift attention away from the civil war in its country. The bombings came shortly after allegations emerged that the Syrian army had used chemical weapons on targets in the suburbs of Damascus.

The expectation that the US and its allies will intervene in the civil war in Syria—by using missiles to target the Syrian military—will destabilise Lebanon further. We would expect further flows of refugees to try to cross the border into Lebanon, altering the sectarian balance in the country. Indeed, some may seek reprisals against Hezbollah, which has fought openly on behalf of the Assad regime.

After Friday's attacks, there were fears that they could trigger a more widespread breakdown of civil peace in Lebanon. This led to a concerted political response. For example, Najib Miqati, the caretaker prime minister—who is from Tripoli—travelled to the city and chaired a meeting with the interior minister and heads of security agencies. They committed to find the bombers and improve security. But, on past experience, there is little prospect of the government either identifying or prosecuting those responsible. The Lebanese state has only a very tenuous control over security in the country at the best of times, and has almost always been powerless to prevent such attacks.

### Impact on the forecast

Following the attacks, we indicated that we would adjust our forecast and now expect more sustained violence between rival groups in Lebanon. We will maintain this view and note that further escalation is likely if Syria is attacked by Western forces.

## August 29, 2013: International relations

# Hizbullah considers response to an attack on Syria

### Event

With a US and allied military strike on targets of the regime of the Syrian president, Bashar al-Assad, appearing likely by the end of August, a Hizbullah member of parliament has said that the Shia militia would "deal seriously" with an attack on its main ally.

### Analysis

Hizbullah forces have actively participated in the Syrian civil war on behalf of the Assad regime, but the group has little ability to deter cruise missile strikes launched from US warships in the Mediterranean Sea.

The clearest form of reprisal Hizbullah could take would be to launch its own missiles against targets in Israel, the US's main regional ally. Israel's armed forces have mobilised reserve forces and moved an anti-missile defence system, Iron Dome, to the northern regions of the country. A Hizbullah attack on Israel could do substantial damage to the country, but would mean that the Shia group was risking serious return damage, as the US and its allies would be unlikely to hold Israel back from retaliating. Hizbullah did manage to resist and fend off an Israeli assault in 2006, but at that time its main ally was not engaged in a life-or-death conflict against rebel groups nor facing the prospect of Western bombardment.

If a Western assault on Syria was of limited scope and specifically targeted positions or units associated with the suspected use of chemical weapons, Hizbullah may respond only in a limited fashion, perhaps by sending further forces against Syrian rebels. The group's leaders would be well aware that the involvement of the Israeli military against it at a time when being resupplied is a challenge would weaken it sharply. Hizbullah has extended its influence over domestic politics since 2011 (when its cabinet members resigned, prompting the collapse of the Lebanese government and beginning over two years of political uncertainty) and if it were severely weakened militarily in a clash with Israel, its opponents in Lebanon might seek to press their advantage and reduce the group's presence in state institutions (such as internal security services).

There is a risk, however, that Hizbullah's leaders may decide that the destruction of the Assad regime may mean that there is nothing left to lose and retaliate by launching large-scale missile attacks against Israel, although this is not part of our central scenario.

### Impact on the forecast

At present we maintain our forecast that Lebanon will experience political violence across the country. Should the US and its allies engage in a sustained campaign against the Assad regime, we would alter our forecast to take into account much greater political disarray in Lebanon, with negative consequences for economic performance as well.

## September 11, 2013: Political stability

### New government no closer

#### Event

Tammam Salam, the man charged with forming the next administration, has accused politicians of deliberately delaying the process.

#### Analysis

The civil war in Syria is imposing a huge burden on its neighbour Lebanon, which is now hosting about 700,000 refugees—almost 20% of its population—and suffering a worsening security situation. Lebanon has also been without a government for five months because of disputes over Syria—and this is making the security situation worse. Last month, there were a series of car bombs and clashes in south Beirut and the northern city of Tripoli, in which nearly 80 people were killed and hundreds injured.

Some figures and groups seem intent on blocking any new government, until they know which side will prevail in Syria. Mr Salam recently said that "Conditions and counter-conditions put by the political forces are preventing the [government] formation", adding that key figures lacked "a serious intent to form a government". His comments were an implicit criticism of Hizbullah, the powerful Shia Muslim political-military movement, which the day before had again rejected a proposal for a 24-member cabinet. Hizbullah is accused of stalling over the government, and its actions elsewhere are also discouraging others. In May it began overtly fighting in the Syrian civil war on the side of the Assad regime. Political opponents in Lebanon—led by the nationalist March 14th alliance—now refuse to enter government with Hizbullah until it withdraws from Syria. The Sunni Muslim Future Movement, a key component of March 14th, last week urged a rapid formation of a new administration, and called for a re-start of a national dialogue between top powerbrokers to resolve the issue of Hizbullah's weapons. Hizbullah, however, rejected this.

Amid the uncertainty, hope rests on the work of neutrals. These include Michel Suleiman, the president; Walid Jumblatt, one of the country's most important powerbrokers; and Nabih Berri, the parliamentary speaker. Mr Jumblatt has said he "backs every call for dialogue because it will help prevent Lebanon from plunging into the abyss". Yet, without political will from Hizbullah, and without the support of March 14th, their efforts seem in vain.

#### Impact on the forecast

The ongoing impasse over the formation of a government is in line with our forecast. It is likely to continue in the short term, as divisions between political blocs have widened owing to their opposing stances on the civil war in Syria.

## Analysis

August 12, 2013

### Four months on, no closer to a cabinet

**Lebanon continues to linger on without a cabinet, four months after the caretaker prime minister, Najib Mikati, resigned. Since then, Lebanon's rival political factions have prevented the prime minister/designate, Tammam Salam, from forming a cabinet. With the country directly affected by the civil war in Syria—bombings and gun attacks are sadly becoming a familiar aspect of life in the country—Lebanon can ill afford the current round of political listlessness. Mr Mikati, serving as caretaker prime minister since his resignation, has proposed reforming his cabinet to provide the country with some political normalcy, but it remains far from certain if political groups would accept his offer.**

Mr Mikati resigned in March after the cabinet became deadlocked over preparations for the parliamentary election and the extension of a security official's term of office. The following month, Tammam Salam, another Sunni Muslim political heavyweight, was designated as prime minister and began efforts to form a cabinet. But four months on, the country's rival political groupings—March 8th, supported by Hizbullah, and the nationalist March 14th alliance—have been unable to reach agreement on the new government.

#### Political violence escalating

At the same time, security in Lebanon has steadily worsened as a result of the civil war across the border in Syria,



which has inflamed domestic sectarian tensions and led to reprisal attacks by Syrian Sunni rebels against Hizbullah (in retaliation for its assistance to the regime of the Syrian president, Bashar al-Assad).

In recent days there have been a series of armed clashes between partisans of rival Muslim groups in the eastern Beqaa Valley region. Lebanon has also faced the spectre of a return to kidnapping, after two pilots of Turkish Airlines were kidnapped on August 9th. A group calling for the release of Shia pilgrims kidnapped in Syria has claimed responsibility for the abduction of the Turkish pilots. Following the kidnapping, the Turkish government advised its citizens to leave Lebanon, damaging again the already weak Lebanese tourism sector.

Despite the mounting political pressure, there seems little prospect that a new government will be formed soon. Mr Mikati's cabinet was formed in 2011, only after five months of negotiations. This time around—and four months down the line—both sides seem as far apart as ever. There were hopes that after Ramadan the situation would improve. But Mohammed Raad, a senior political figure within Hizbullah, told Voice of Lebanon radio in recent days that it was "premature" to think of forming a new government now. Equally, members of the March 14th bloc are adamant that they will not accept a role for Hizbullah in a new government so long as it is militarily involved in the war in Syria. Even Michel Suleiman, Lebanon's president—who is generally held to be neutral and above politics—said in recent days that the previous relationship between Hizbullah and the state (known as the "army people resistance" formula) could no longer be used now that Hizbullah was fighting a foreign war, without consulting Lebanon's army or the people, the local Arabic language *Al Liwaa* newspaper reported.

## De facto decision

In such circumstances, the president hinted that he would agree to the formation of any neutral or "de facto" cabinet proposed by Mr Salam. Many other senior figures have tacitly supported such a plan, but both Hizbullah and many in March 14th have their reservations. Mr Suleiman has also called again for the resumption of the National Dialogue, an unofficial gathering of the country's senior political figures that cuts across parties and blocs, and which could be the basis itself for a new cabinet.

It is into this mix that Mr Mikati made his comments about reviving his cabinet—after a meeting with Nabih Berri, the speaker of parliament and a key powerbroker. Mr Berri said that he would propose a new cabinet initiative at the end of August, implying that Lebanon will continue to linger on for a few additional months without a government.

## Outlook poor

Security is getting worse in Lebanon, and all political factions realise that the country needs a widely supported government to have any hope of tackling these issues. However, it seems unlikely that Hizbullah will immediately withdraw from Syria or that the March 14th alliance will agree to sit around the same table as the Shia group any time soon.

Forming a *de facto* cabinet or the revival of the Mikati administration therefore seem the only pragmatic options for the country moving forward, but, given the current standoff, it is far from assured that either of these options could in itself be achieved in the short term.

**August 27, 2013**

## Iran faces grim choices if the West intervenes in Syria

**Iran's new government will face its first major diplomatic challenge in managing the increasing discussion of a Western military intervention into its main Arab ally, Syria. Iran has limited options for response should the West attack Syria, and any escalation in the war is likely to foster further Sunni-Shia enmity in the region. Moreover, it would all but scupper any chance that the US and Iran could engage in negotiations over the Islamic Republic's disputed nuclear programme. The new president of Iran, Hassan Rowhani, will be forced to maintain support for the regime of Syria's president, Bashar al-Assad, lest he risk provoking a harsh response from hardline conservatives at home.**

The tone from the US administration following a meeting between the president, Barack Obama, and his national security team has increased the expectation that the US and its allies will attack Syria after the alleged use of chemical weapons by Mr Assad's forces. The likely means would be missiles from warships or submarines in the eastern Mediterranean or Persian Gulf, or via combat aircraft. Targets could include Syria's air-defence system, command bunkers, communications hubs, government buildings, missile sites or, perhaps, the units thought responsible for chemical attacks.

Syria's government has warned that any US military action would "create a ball of fire that will inflame the Middle

East", and many in the US government may be reluctant to reengage in a conflict in the region. Any intervention carries substantial risks. Syria has relatively sophisticated Russian air-defence systems, which were close to locking on Israeli jets during the 2007 attack on the alleged nuclear site at Dayr al-Zawr. There are also particular problems with trying to neutralise a chemical weapons target. Although such weapons are generally delivered through conventional systems—aircraft, artillery or missiles—that could be targeted, any attack on chemical plants risks contamination and the chance of unguarded nerve agents and other substances falling into the hands of Sunni militants.

## Iranian reaction: violence or diplomacy?

Throughout the two-year conflict in Syria, Iran has given logistical support to the Assad regime, with Syria a long-term ally as far back as the 1980–88 Iran–Iraq war. As part of the fallout from the Arab Spring and war in Syria, the Middle East has been increasingly polarised between Sunnis (especially the Sunni-led Gulf states) and Shia (primarily the Iranians, plus Iraq and Hizbullah in Lebanon). Sustaining an alliance with at least one friendly Arab state has been vital for Iran to exert influence over the region.

Iran is well aware of the reluctance within the US towards intervention, and its response to the prospect has been to talk up the dangers of such an attack. Massoud Jazayeri, deputy chief of staff of the armed forces, warned the US of "severe consequences" if it crossed "the red line of the Syrian front". The director of parliament's international affairs committee, Hossein Sheikholeslam, said that the first victim of any attack would be "the Zionist regime [Israel], because the army in Damascus has the ability to attack with severity the occupied territories"; he added that he did not expect Russia to repeat "the same mistake" it made in Libya by tolerating Western intervention. A more sober assessment in a reforming newspaper, *Shargh*, referred to "a swordplay opportunity for the two superpowers", but warned that despite "the high cost" of previous US interventions, "force" remained an option.

The official Iranian response during Syria's civil war has generally favoured diplomacy. The foreign minister, Mohammed Javad Zarif, has reiterated Iran's long-standing opposition to chemical weapons, which were employed by Iraqi forces during the 1980–88 war. Mr Zarif and Abbas Araghchi, a foreign ministry spokesman, have suggested that it was the rebels and not the Assad regime who used the chemicals.

Mr Araghchi has also stressed Iran's co-operation with Russia and their shared preference for negotiations over Syria. However, the diplomatic process over Syria appears deadlocked, with the regional Sunni powers—led by Saudi Arabia and Turkey—and the US insisting that Mr Assad should leave power as soon as possible, while Russia and Iran argue that this should not be a precondition for talks.

Lakhdar Brahimi, the UN and Arab League envoy for Syria, reiterated earlier this month his belief that Iran should be included in Geneva-2, the international conference on Syria scheduled for July but postponed by the US. No details have emerged from the visit to the Iranian capital, Tehran, on August 26th by Jeffrey Feltman, the UN undersecretary-general and a former senior US diplomat with experience of the Middle East: while Mr Feltman's agenda was the UN's interest in Syria, Egypt and Lebanon, he may also represent a back-channel to the US (this was his second visit in a year: in September 2012 he accompanied the UN secretary-general, Ban Ki-moon, to a summit of the Non-Aligned Movement in Tehran).

## Possible Iranian retaliatory options

Iran's options for retaliation against US attacks on Syria are limited. Western defence analysts have flagged up the possibility that it might encourage Palestinian or Sunni Islamist attacks on Israel, or attempts to foment a "third intifada" in the Israeli-occupied Palestinian Territories; however, these are groups with whom Iranian influence is diminishing, given the Sunni–Shia polarisation that the Syrian war is encouraging. Among vulnerable Western targets could be the NATO base at Incirlik in south-east Turkey, or even the British bases in Cyprus (where a member of Hizbullah was jailed in May for surveying Israeli tourists).

However, an overt attack on a NATO or allied facility would invite reprisal from the US and its allies—a dynamic that the Iranian leadership will seek to avoid at all costs. Whatever response Iran makes, the Israeli leadership seems fixed on its enmity with the country. After evidence of chemical attacks emerged, Israel's prime minister, Binyamin Netanyahu, described Syria as "the test field of Iran."

## Rowhani in a corner

While the effect of US strikes on Syria is uncertain, they would be likely, in the short term at least, to undermine prospects for negotiations between the US and Iran over the latter's disputed nuclear programme. It seems likely that any inflammation of the war in Syria would domestically weaken Mr Rowhani, who stressed the need for dialogue both during his election campaign and following his inauguration at the start of August. In the aftermath of the

chemical weapons attack, Mr Rowhani called for the international community to prevent the use of such materials in Syria, but he stopped short of saying who he thought had used the arms.

Likewise, military strikes on Syria would be likely to strengthen those in Iran who are most sceptical over—or even opposed to—talks with the US. During the two years of the Syrian conflict, Iran has given no indication that it would abandon its Syrian ally. Mr Rowhani will be pressed into a corner by hardline conservatives in Iran to maintain support for Mr Assad.

## Economy

### Forecast updates

**September 16, 2013: Policy trends**

#### Exploration bid deadline extended

##### Event

Lebanon's Ministry of Energy and Water has pushed back the deadline for submitting bids for offshore oil and gas exploration.

##### Analysis

The caretaker energy and water minister, Gebran Bassil, extended the deadline for firms to submit bids to December 10th (from November 4th). He said that the extension was needed because the cabinet has not yet approved two necessary pieces of legislation for oil and gas exploration: a demarcation of the blocks to be offered and a template production-sharing agreement. Mr Bassil did hold out hope that the government decrees could be approved earlier, meaning that the submission process could be moved forward.

Lebanon is one of the newest frontiers for oil and gas exploration and earlier this year over 40 companies were preapproved to carry out exploration work. However, with the collapse of the cabinet led by the prime minister, Najib Mikati, in March, Lebanon's political scene has been racked by political instability, compounded by the civil war across the border in Syria. Hence, getting the necessary political quorum and support to approve the oil and gas laws has been a relatively low priority, despite the country facing another year of high energy import costs (which we estimate at around US\$6bn).

According to reports in the local press, several international companies have pulled their interest away from Lebanon as a result of the political dithering and security risks, and it is likely that more will follow. The commerciality of Lebanon's potential reserves is highly uncertain at this stage and other regions, including Israel, also in the eastern Mediterranean basin, or offshore gasfields in eastern Africa, may prove more attractive.

Although oil and gas firms necessarily take a multi-year perspective when considering projects given the capital and technology-intensive nature of the work, the current political impasse in Lebanon will mean that even the earliest stages of developing the country's hydrocarbons industry will be delayed further.

##### Impact on the forecast

The deadline extension reinforces our view that political instability in Lebanon will negatively affect major economic policy decisions and will also deter foreign firms from participating in the sector. Even if the necessary decrees are passed before the new deadline, any actual drilling is likely to be pushed back by half a year, meaning that any hydrocarbons production would now probably fall outside our forecast period.

## Analysis

August 20, 2013

### Services sectors enjoy mixed fortunes amid political unrest

**Lebanon's heavily services-oriented economy has suffered since 2011 as political unrest has gripped the nation. First, the relatively liberal government led by former prime minister Saad Hariri collapsed, and since mid-2011 the country has been subsumed into the civil war across the border in Syria. Nevertheless, some sectors have managed to display growth, although the near-term prospects still appear poor.**

Lebanon's listed banks remained profitable during the first half of 2013, despite the civil war in neighbouring Syria, which is leading to renewed sectarian conflict in Lebanon and undermining economic growth and confidence. The five banks listed on the Beirut Stock Exchange (Audi Saradar, Byblos, Blom, Bank of Beirut and Bemo) reported aggregate net profits of US\$502.7m for the first half, down by 4.8% on the same period in 2012. The profit figure was equal to a return on average assets of 0.56%, which is low by international comparison, reflecting the sector's conservative reputation; Lebanon's banks hold a high level of reserve assets on their balance sheets. The lower earnings were attributed to tougher local and regional operating conditions, particularly in Syria. For example, in the first three months of 2013 the profits of Lebanese banks operating in Syria fell by 98% year on year to US\$640,000, according to the Lebanese Banks' Association. There was a similar fall from those with exposure to Egypt.

As well as these tougher conditions, the fall in profits reflected a move by most banks to set aside more funds as provisions against non-performing loans, which are expected to rise as a result of the regional uncertainty. For example, Byblos Bank stated that it had made provisions in the second quarter of US\$30m, up by 25% compared with the same period in 2012. While profits were lower, at an aggregate level, the five main banks reported growing assets, loans and deposits. Aggregate assets reached US\$89.49bn, up by 11.1% from the same point in 2012; loans were US\$26.85bn, up by 18.2%; and deposits were US\$75.44bn, up by 11.5%, according to a report from Byblos Bank.

### Resilience tested

Lebanon's financial sector has a reputation for resilience, having survived the 1975-90 civil war and ridden out the 2008 global credit crunch unscathed. Secrecy laws and a reputation as a regional safe haven help to explain the continued growth of deposits, despite political tensions. However, the current challenge, say Beirut bankers, is to find private-sector lending opportunities as the institutions try to diversify away from lending to the Lebanese state. François Bassil, the head of the banks' association, said in an interview with local media that profits would fall further in 2013 unless the political situation stabilised. He was, however, more sanguine about banks remaining profitable despite the challenging political and economic conditions. Mr Bassil said that Lebanese banks had high levels of liquidity despite the political tensions, but that there were few local opportunities for investment.

### Terrible for tourism

In the politically sensitive tourism industry, sentiment is more dour. According to the secretary-general of Lebanon's Hotel Owners' Association, demand for hotel rooms during the normally busy Eid al-Fitr holiday at the end of Ramadan was very poor, with hotels reaching a maximum of 70% capacity, and that level only for two days. Industry leaders have appealed to Lebanon's leaders, saying that the sector had reached a "catastrophic" situation.

But despite appeals for government assistance and large discounts at some hotels, the political situation in Lebanon will remain too volatile for many visitors. The kidnapping of two Turkish Airlines pilots led to a travel warning from the Turkish government. Similar warnings have also been issued in many Gulf Arab states, advising their citizens, who are normally the drivers of tourist spending in Lebanon, to avoid the country.

We expect Lebanon's economy to grow at an even weaker rate in 2013 than the 1.7% we estimate for 2012, and believe there are downside risks to our current forecast of 1.6%. Perhaps as an indicator of the government's sensitivity to the poor performance of the economy, it has not published official GDP data since 2010. With politicians still deadlocked over the formation of a cabinet, we expect Lebanon's economic lingering to continue in the near term.