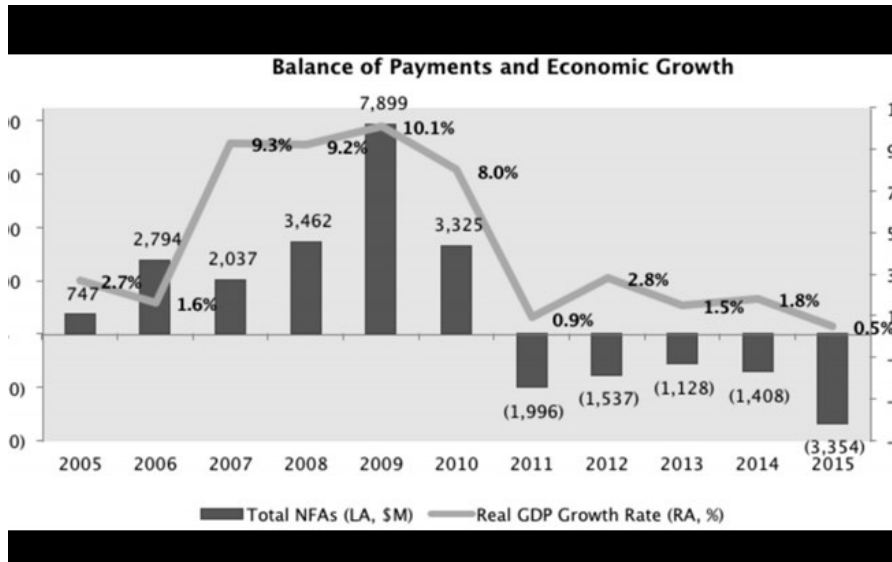


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Lebanon's balance of payments: Challenges and remedies



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Being the result of all the incoming and outgoing flows of money in the economy, the Balance of Payments gains increasing importance in a country like Lebanon where there is a pegged exchange rate, and where the economy is dollarized. The link between economic performance and the BoP has been proven during the last 5 years where the deficit in the BoP was accompanied by low economic growth.

Primarily, the period 2007-2010 was characterized by high growth rates averaging 9.2 percent with the BoP registering sequential surpluses amounting for a cumulative \$16.72 billion.

Between 2011 and 2015, numerous political and security developments took place on both the local and regional fronts, hindering the economic performance of the country as well as its external position. On one hand, Lebanon has been suffering from a presidential void for more than 2 years with the country enduring recurring security disturbances in different regions. On the other hand, the lingering war in Syria that emerged in 2011 is still weighing on Lebanon's economic, social and demographic standing. As a result, Lebanon saw a substantial economic slowdown with growth rates dipping below the 3 percent. This came in line with the BoP registering recurring deficits over the period totaling \$9.42 billion.

Hence, the continuous deficit in the BoP during the last 5 years is eating up the resilience of the Lebanese economy to shocks. As economic growth came close to zero in 2015, the BoP recorded a critical deficit of \$3.35 billion, which is the highest seen since 1980.

Of course, a negative BoP is reflected in the decline of the net foreign assets of the banking sector (Banque du Liban and commercial banks). During the last few years, Banque du Liban was preserving its foreign currency reserves, but this was at the expense of the decline in the commercial banks' NFAs. Amid a low global interest rates environment, commercial banks were attracted by the relatively high yields on the Central Bank's CDs therefore they were repatriating their foreign assets and investing in

papers issued by the Central Bank. In this context, the NFAs of BdL rose by \$18.35 billion between 2007 and 2010 while those of the commercial banks decreased by \$1.62 billion.

During the period 2011-2015, the total increase of BdL NFAs slowed to \$8.04 billion amid a steeper contraction of USD17.46 billion in the NFAs of the commercial banks.

Scrolling through the main components of the BoP would give a clearer view of Lebanon's interface with the external world. However, it is worth noting that the computation of the BoP components entails lots of inaccuracies which result in a considerable amount of transactions remaining unclassified and categorized under "unrecorded transactions."

In effect, these transactions can sometimes amount for as much as \$6 billion, which could have a distortive effect on the accuracy and analysis of the retrieved data.

The negative BoP in the past five years was the result of weak capital and financial accounts as reflected in low Foreign Direct Investments and a steep decline in the inflow of capital for portfolio investment.

In fact, the frail business environment was mainly behind the fading demand as revealed by the BLOM Purchasing Managers' Index.

The index pointed to the deterioration of demand in the private sector economy as the gauge failed to surpass the 50-mark that separates economic expansion from contraction since the survey's inception in May 2013.

Hence, FDIs narrowed by almost 19.4 percent year-on-year to reach \$2.34 billion in 2015. In addition, the Lebanese BoP has structural current account deficits that are usually counterbalanced by capital inflows in the capital and financial accounts.

This has been the case between 2007 and 2010 when the accumulated deficits of Lebanon's current account valued \$19.91 billion, yet were more than offset by the \$36.76 billion surplus in capital and financial accounts. In contrast, the current account deficit couldn't be counterbalanced by the diminishing surplus of the capital and financial accounts during 2011-2015.

In 2015 alone, the surplus recorded in the capital and financial accounts stood at \$4.80 billion and hence failed to offset the \$8.15 billion deficit in the current account deficit. The contraction of the current account deficit in 2015 did not signal an improving trading activity, but resulted from imports decreasing at a faster pace than exports.

This was mainly caused by bearish international oil prices and weak currencies, mainly the euro and the yen, that helped in reducing the country's import bill.

Hence, trade deficit gradually narrowed from \$17.18 billion to \$15.12 billion by the end of 2015.

Despite the tightening trade deficit and given the unstable environment, several countries, mostly Gulf Cooperation Council's states, issued travel warnings against their nationals visiting Lebanon, triggering lower travel receipts in 2015 by almost 35 percent from 2010's level.

These travel bans also took their toll on real estate activity especially with Gulf investors being, aside from Lebanese expats, the prime clientele of luxurious apartments in Beirut.

On the brighter side, Lebanese workers' remittances are a core element of the BoP that is characterized by its resilience to domestic and external shocks.

With remittances' contribution to the GDP standing near the 14 percent in 2015, expats' inflows to Lebanon remained, more or less, immune to the country's political and economic situation.

Aiming to ease the aggravating situation of the external sector, several measures could be adopted in the context of the fixed exchange rate regime prevailing in the country:

Promoting Lebanese exports is a way to reduce the existing structural trade deficit of goods. In fact, the deflationary pressures that emerged in 2015 failed to improve the competitiveness of Lebanon's top exported goods on the global front. Hence, the best approach is to target high-value added products where Lebanon could benefit mainly from comparative advantages in terms of educated labor force, suitable resources in terms of weather and climate, and a strategic location in the Middle East.

For instance, the Lebanese wine industry could be a potential target especially after recording net trade surpluses in the past few years.

Other envisioned industries include dairy, agro-industrial products, and technology related goods and services.

Exporting tourism services is also important and has a great potential, however the geopolitical situation in Lebanon and the region constitutes a setback to the sector and makes it difficult for now to rely on tourism amid the existing uncertainty.

Providing a welcoming business environment remains fundamental to attract FDIs and Greenfield investments.

Restoring investors' confidence by securing a stable and safe investment and capital flows environment is crucial to boost financial and capital flows into Lebanon, which in turn can counterbalance the country's unwavering trade deficit.

Engaging the Lebanese Diaspora, by strengthening the economic ties with their land of origin, is another step that could help in the recovery of Lebanon's external sector.

Given that part of Lebanon's FDIs derives from expats, creating an "expatriate fund" could be a tool to encourage Lebanese expats in financing economic projects and get a decent return on investments in infrastructure and IT, for instance.

Lastly, even though the external sector is actually in distress, recovery is still possible.

This can be rendered by at least two positive developments. First, improvement in the surrounding regional conditions is essential to re-establish foreigners' confidence in the country.

Second, the election of a new president could also relieve the country from its ongoing political deadlock, which will help in attracting additional capital inflows. Moreover, launching a strategy for the Lebanese oil and gas sector, so as to initiate the long-awaited exploration and production processes, will certainly be a source of external income that will help in the revival of both the external sector in specific and the economy as a whole.

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