Republic of Lebanon
Office of the Minister of State for Administrative Reform
Center for Public Sector Projects and Studies
(C.P.S.P.S.)

الجمهورية اللبنانية
مكتب وزير الدولة لشؤون التنمية الإدارية
مركز مشاريع ودراسات القطاع العام

ONE-YEAR PROGRESS AFTER PARIS II

SPECIAL REPORT
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EXECUTIVE SUMMARY

The financing of Lebanon's reconstruction and the rebuilding of its human and physical capacities following the end of the civil war (1975-1990) lead to a rapid growth in public debt which reached US$ 32 billion by November 2002, or around 185 percent of GDP. Consequently, debt service increased substantially and represented around 80 % of total revenues. This resulted in a chronic budget deficit that required borrowing to finance it, leading to an ever growing public debt.. In order to break this cycle, it was necessary to reduce the fiscal deficit and hence the Government's financing needs, and to bring down the stock of public debt and the level of interest rates.

The Lebanese Government launched a series of internal fiscal reforms aimed at increasing the primary budget surplus by growing revenues and controlling expenses. It also initiated a privatization and securitization program, the proceeds of which are to be used exclusively for debt reduction. However, further steps were needed to complement these reforms in order to change the composition of the public debt, reduce its cost, and lengthen its maturity. To this end, the ***Paris II Conference*** *was held on November 23, 2002 to request external support from the international community to help Lebanon in its efforts to reduce and manage the large public debt.*

The financial outcome of the conference translated into ***commitments*** *dedicated to debt reduction and management totaling US$ 3.1 billion (an additional amount of US$ 1.3 billion was secured to fund projects earmarked for socio-economic development). To date, proceeds totaling* ***US$ 2.4 billion*** *dedicated for debt restructuring have been* ***received*** *by the Lebanese Treasury. This amount represents around 77 percent of the US$ 3.1 billion pledged for debt management in the form of long term and less expensive financing. The funds received to date carry an interest rate of 5 percent and a final maturity of 15 years with grace periods of up to five years.*

Additional funding was secured locally from the Central Bank of Lebanon and the Lebanese commercial banks through two financial support schemes. The first scheme, in the equivalent amount of ***US$ 4.1 billion,*** *was concluded with the* ***Central Bank*** *of Lebanon in December 2002 and consisted of the following: (a) the cancellation of the equivalent of $1.8 billion of BDL's Lebanese Pound Treasury bills portfolio against reserves due to the Lebanese Treasury as per Article 115 of the Code of Money and Credit, (b) the exchange of the equivalent of US$ 1.9 billion of BDL's Lebanese Pounds Treasury bills, Eurobonds, and accrued interest for new debt with longer maturity (15 years) and lower interest (4%), and (c) the roll over of $0.4 billion of principal and interest on maturing Treasury bills held by BDL via a new issue of 5-year, 4% special Treasury bills in July 2003.*
The second scheme, in the equivalent amount of ***US$ 3.6 billion,*** *was concluded with the Lebanese* ***commercial banks,*** *and involved a voluntary supply of two-year, zero interest financing to the Government.*

Therefore, the financial inflows of the Paris II conference from lender countries, coupled with the two schemes from the Central Bank and Lebanese commercial banks discussed above, represent a ***financial package*** *worth* ***US$ 10.1 billion,*** *which has re-profiled, to date, the equivalent of 32% of the total stock of debt outstanding at the time of the Paris II conference. In addition, these developments improved the profile of the debt by extending its maturity, reducing its cost, and changing its composition (lower share of market vs. non-market debt). In fact, the overall average cost of total debt has been reduced by 347 basis points since Paris II (from 11.97 percent at end-November 2002 to 8.50 percent at end-October 2003) and is expected to decline further once the full impact of the debt management measures bear fruit starting in 2004. The share of market debt to total debt has declined from 79 percent, prior to Paris II, to 61 percent.*

The rapid execution of the above mentioned measures was well received by the market and resulted in a series of positive developments on the macroeconomic front. In the weeks following the conference, interest rates on government Treasury bills dropped drastically, by more than 30 percent compared to their level before the convening of Paris II. In fact, the secondary market yield on the 24-month Treasury bill (the most widely floated category) declined from a level of above 16 percent to around 9 percent in less than two months - a level not witnessed in over two decades. Moreover, prices of all outstanding Eurobond issues of the Lebanese Republic increased. Gross foreign exchange reserves (excluding gold) reached their highest ever level of US$10.4 billion by end-October 2003, while the balance of payments registered an important improvement recording a surplus of US$3.3 billion in the first 10 months of the year compared to US$0.3 billion for the same period of 2002.

Following is a detailed update on all aspects related to the implementation of Paris II, its impact on public debt, and the major economic developments that have taken place since the conference.

SECTION I. IMPLEMENATION OF THE PARIS II FINANCIAL PACKAGE

A. THE MOBILIZATION OF FUNDS AND THE RE-PROFILING OF PUBLIC DEBT

The overall Paris II financial package consists of three major sources of funding: (1) lender countries that participated in the Conference, (2) the Central Bank of Lebanon (Banque Du Liban, 'BDL'), and (3) the commercial banks operating in Lebanon.

The **total funds mobilized** from all three sources by end-September 2003 amounted to the equivalent[1] of **US$ 10.1 billion**, which represents around 56% of GDP[2]. These funds consist of **US$ 2.4 billion** from 7 **lender countries**[3], **US$ 3.6 billion** from the **commercial banks** scheme, and **US$ 4.1 billion** from the **BDL** scheme. The details of each source are provided in the following sections.

In accordance with Law 476, these proceeds were used to **re-profile close to one third of the total stock of debt** that was outstanding as of end-November 2002 at the time of the Paris II conference. The re-profiling involved the retirement or replacement of high-cost and short-term public debt by new debt with concessional terms, and consisted of the following: US$ 1.8 billion of debt **cancelled,** US$ 2.7 billion of debt **exchanged** prior to maturity, and US$ 5.6 billion of principal and interest **repaid or rolled over** at maturity.

Table 1. Summary of Debt Transactions Concluded since the Paris II Conference
Status as of End-September 2003
Amounts expressed in US$ billion

		Utilization of Funds		
	Amount	**Cancellation**	**Exchange**	**Repayment / Roll Over***
BDL Scheme	4.1	1.8	1.9	0.4
Paris II Inflows	2.4			2.4
Commercial Banks Total	3.6			
of which: Cash	*2.7*			2.7
Securities < 3 months	*0.3*		0.3	
Securities > 3 months	*0.6*		0.6	
TOTAL	**10.1**	**1.8**	**2.7**	**5.6**

Note: * Includes principal and interest.
Source: Ministry of Finance

[1] The LL/US$ exchange rate used throughout this report is LL 1,507.5
[2] GDP is estimated at LL 27,121 billion for 2003 and LL 26,068 billion for 2002. These estimates are used for the calculation of GDP ratios throughout this report.
[3] Does not include contributions from multilateral institutions that participated in the Paris II conference.

B. Paris II Lender Contributions

Lender Commitments:

The Paris II Conference (please refer to Box 1) translated into **commitments** dedicated to debt reduction and management totaling **US$ 3.1 billion** from participating countries and institutions. The lenders also pledged additional amounts totaling US$ 1.3 billion dedicated to projects earmarked for socio-economic development. This report does not address development loans, and focuses solely on the funding dedicated to debt management.

Box 1. The Paris II Conference

In November 2002, a conference was held in Paris hosted by the French President Jacques Chirac where the international community, composed of friendly countries of Lebanon and multilateral institutions, convened to support the medium term economic program presented to them by the Lebanese government. The conference, known as the Paris II conference, was considered an unprecedented and unique event in terms of the number of participating delegations and their wide representation, the financial outcome, and the input of the local financial community that complemented it. The Paris II conference followed a preparatory meeting, Paris I, held in February 2001 and concluded two years of a major reform program launched by the Lebanese Government.

The objective of the Paris II conference was to seek the support of the international community in helping Lebanon in its endeavor to alleviate the burden of the public debt and to reverse the macroeconomic and fiscal imbalances of the Lebanese economy. The economic program that was presented to the Paris II participants defined a strategy that would, over the medium term, lead to a gradual decline in the high level of the public debt, a convergence in the budgetary situation and the achievement of better growth prospects. In order for the Lebanese government to be able to reach its objective, the international community was asked to help in tackling the debt problem, by extending long-term financing at interest rates significantly lower than the rates at which the government was borrowing in the domestic and international capital markets. Coupled with expected proceeds from privatization/securitization, reduction in expenses, and increase in revenues, the new financing at concessional terms would be the driving factor that would lead to a virtuous cycle of lower fiscal deficits, declining debt ratios, and lower interest rates. The financial contributions of the participating countries and institutions are, by virtue of Law 430, to be deposited in a special account for debt management at the Central Bank of Lebanon ("BDL") to be exclusively utilized to replace the short term and high cost debt.

The Paris II conference was complemented by the execution of two additional financial support schemes initiated by the Lebanese financial community to help the government in addressing the debt issue. The first scheme, was concluded with the Central Bank of Lebanon and entailed a cancellation of a portion of its Lebanese Pound denominated Treasury bill portfolio against reserves due to the Lebanese Treasury as per Article 115 of the Code of Money and Credit, and the replacement or roll over of the remaining balance of BDL's Lebanese Pound securities portfolio and Eurobonds into a new Eurobond with longer maturity and lower interest rate, hence replacing a short-term and expensive portfolio into one that fits the Paris II profile.

In the second scheme, the Lebanese commercial banks provided two-year, zero percent interest financing to the Government. The commercial banks were given the option to subscribe to the non-interest bearing securities in cash or through the delivery of Treasury bills or Eurobonds previously issued by the Lebanese Republic

Mobilization of Lender Funds:

Proceeds totaling approximately **$2.4 billion** have been **received** from 7 countries. These amounts correspond to around 77 percent of the total US$ 3.1 billion pledges of support for debt management. They have been deposited in the Special Account for Debt Management[4], and have been subsequently used to retire and replace maturing debt (both principal and interest).

The following table shows the sequence and amount of the funds received from the 7 lender countries:

Table 2. Monthly Disbursement from Paris II Lender Countries:
Expressed in USD million

	Countries							
	Malaysia	**Oman**	**UAE**	**Kuwait**	**France**	**KSA**	**Qatar**	**Total**
Dec-02	300	50						350
Jan-03			300	300				600
Feb-03								-
Mar-03					540*	700		1,240
Apr-03								-
May-03							200	200
Total	300	50	300	300	540	700	200	**2,390**

Source: Ministry of Finance
Note: *Counter value of contributions in Euro at USD/Euro 1.08 rate.

- The first transaction consisted of the issuance of a 15-year **USD 950 million**, 5 percent Eurobond on Friday, December 27, 2002. These notes were subscribed by four countries with the following shares:
  - - **Malaysia** USD 300 million
  - - **Sultanate of Oman** USD 50 million
  - - **United Arab Emirates** USD 300 million
  - - **Kuwait** USD 300 million

- The **Kingdom of Saudi Arabia** transferred **USD 700 million** on March 7, 2003, with the financing scheme being identical to the Eurobonds subscribed to by the first four lender countries (discussed above).

- The transaction with the **State of Qatar** was signed on May 23, 2003 and the **$200 million** were received on May 27th. The Notes purchased were also identical in nature to the ones subscribed to by Malaysia, Oman, the United Arab Emirates, Kuwait, and the Kingdom of Saudi Arabia.

[4] The Special Account for Debt Management has been opened in accordance with Law No.430, allowing for the creation of a separate account at BDL to place funds from loans and grants dedicated for debt management as well as potential privatization and securitization receipts.

Table 3. Summary of Terms and Conditions of the Eurobonds Issued

Issue Price	100 percent
Final Maturity date	15 years from issue date
Coupon rate	5.00 percent per annum payable semi-annually in arrear
Amortization of Principal	Redeemable in 20 equal semiannual payments starting from year 6 (grace period of 5 years).
Form of Notes	Registered
Representations, warranties, and covenants	As per the issuer's Global MTN program
Listing	Luxembourg Stock Exchange
Governing law	New York

- **France:** The Agence Française du Développement extended a **Euro 500 million** loan guaranteed by the French Government. The loan has a 15-year maturity, 5 percent interest, and a 3-year grace period.. The loan agreement was signed on February 28, 2003, and the funds were transferred to the Special Account for Debt Management at Banque du Liban on March 3, 2003.

Discussions with the remaining countries that committed funds during the Paris II conference are underway and are at various stages of development. The Ministry of Finance is proceeding with the proposed Islamic Ijara Sukuk transaction with **Bahrain**. The transaction would involve a five-year, US$ 200 million Ijara Sukuk in principle fully underwritten by a group of Islamic Banks. The final terms and conditions are still subject to negotiation. Discussions with **Belgium, Italy,** and **Canada** are also proceeding. The Belgian contribution is expected to be received after the completion of the required procedures.

In addition to the US$2.4 billion received from the 7 lender countries mentioned above, contributions have been received from 2 multilateral institutions: The **Arab Monetary Fund** (AMF) contributed **US$ 15 million** in the form of a medium term loan for structural adjustment. Additionally, the AMF extended a **US$ 40 million** trade finance facility to be used for the financing of fuel imports by Electricité du Liban.

The **European Union** contributed **Euro 12.25 million** as a grant to be used for structural adjustment and fiscal reforms.

The following table presents a summary of the funds received from lender countries:

Table 4. Summary of Lender Country Contributions

Creditor	*Amounts Received*	*Date of Receipt of Funds*	*Type of Financing*	*Terms*
Malaysia	US$ 300 million	Dec. 27, 2002	Eurobonds	- Issue Price: 100 percent - Final Maturity date: 15 years from issue date - Coupon rate**: 5 % per annum payable semi-annually in arrear. - Amortization of Principal: Redeemable in 20 equal semiannual payments starting from year 6 (grace period of 5 years). - Representations, warranties, and covenants: As per the issuer's Global MTN program - Listing: Luxembourg Stock Exchange
Sultanate of Oman	US$ 50 million	Dec. 30, 2002		
United Arab Emirates	US$ 300 million	Jan. 15, 2003		
Kuwait	US$ 300 million	Jan. 22, 2003		
Kingdom of Saudi Arabia	US$ 700 million	Mar. 7, 2003		
State of Qatar	US$ 200 million	May 27, 2003		
France French Treasury & Agence Française de Développement (AFD)	US$ 540 million*	Mar. 3, 2003	Loan through AFD	- 15-year maturity - Coupon rate**: 5 % per annum payable semi-annually. - 3-year grace period for principal repayment.
Total Lender Country Contributions	**US$ 2,390 million**			

Notes:
* Counter value of contributions in Euro at USD/Euro 1.08 rate.
** This coupon rate represents a spread of approximately 85 basis points above 10-year US treasuries at the time of the Paris II conference. This represents a major improvement given that the average cost of the Republic's foreign currency debt was at around 9.2% before Paris II, i.e. a spread of 505 basis points for shorter maturities.

Source: Ministry of Finance

Use of Lender Funds:

As of end-September 2003, the entire US$ 2.424 billion[5] of the amounts collected from the Paris II lender countries were utilized on a weekly basis to retire market debt denominated in Lebanese Pounds, US Dollars, and Euros, by paying back maturing principal and coupons.

[5] The amount is approximate given the volatility of the Euro/US$ exchange rate in the calculation of the Euro 500 million contribution of France which was used at different times and at different Euro/US$ rates.

The table below summarizes the utilization of the received amounts on a monthly basis since January 2003. Out of the total amounts redeemed, the equivalent of US$ 1,486 million of principal of Lebanese Pounds Treasury bills, Eurobonds, and concessional loans, in addition to over US$ 938 million in coupons falling due, were repaid during the period Jan-Sept 2003.

Table 5. Use of Paris II Lender Country Contributions

ACCOUNT	**SPECIAL ACCOUNT FOR DEBT MANAGEMENT**							
CURRENCY	Lebanese Pound Sub-Account		US$ Account				Euro Sub-Account	
USE OF PROCEEDS	Retirement of LL Treasury Bills		Retirement of US$ Eurobonds		Retirement of Concessional Loans		Retirement of EURO denominated Eurobonds	
	Amounts in LBP		Amounts in US$		Amounts in US$		Amounts in EURO	
	Principal	**Coupons**	**Principal**	**Coupons**	**Principal**	**Coupons**	**Principal**	**Coupons**
JANUARY			100,000,000	79,611,958				
FEBRUARY	457,574,630,000	128,147,718,391						
MARCH	328,033,460,000	86,565,827,299		77,616,125				36,177,500
APRIL	236,487,880,000	112,187,659,304	367,190,000	121,064,010	14,459,997	18,555,920		
MAY	374,437,370,000	158,820,168,213		60,000,000				
JUNE				146,439,875				
JULY	117,180,054,779			33,630,083				
AUGUST				37,968,750				
SEPTEMBER				1,502,204				
TOTAL	**1,513,713,394,779**	**485,721,373,207**	**467,190,000**	**557,833,005**	**14,459,997**	**18,555,920**	**0**	**36,177,500**
GRAND TOTAL (in original currency)	**1,999,434,767,986**		**1,025,023,005**		**33,015,917**		**36,177,500**	
Total Principal (expressed in US$)	**1,485,771,652**							
Total Coupons (expressed in US$)	**938,387,407**							
GRAND TOTAL (expressed in US$)	**2,424,159,059**							

Source: Ministry of Finance

C. The Special Scheme with The Central Bank of Lebanon

Overall, the BDL scheme involved debt transactions (including cancellation, exchange, and roll over of both local currency and foreign currency debt) **totaling** around **US$ 4.1 billion.**

Debt Cancellation:

By end-December 2002, Banque du Liban (BDL) held a portfolio of Lebanese Pound denominated Treasury bills and Eurobonds worth approximately LL 6,000 billion. A special scheme for the portfolio of the BDL in government securities was concluded on December 31, 2002 whereby the amount of LL 2,700 billion, or the equivalent of **US$ 1.79 billion** of BDL's 24-month Lebanese Pound Treasury bill portfolio was cancelled against reserves due to the Lebanese Treasury as per Article 115 of the Code of Money & Credit.

Debt Exchange:

An additional LL 1,221 billion of BDL's Lebanese Pound denominated bills along with its Eurobond portfolio (US$ 1.04 billion) and accrued interest were exchanged into a new **US$ 1.87 billion**, 15-year, 4 percent Eurobond with a 5-year grace period for principal.

Debt Roll Over:

In addition, and following the Paris II implementation, the equivalent of **US$ 0.43 billion** of principal and interest on maturing Treasury bills held by BDL were rolled over in July 2003 via a new issue of 5-year, 4% special Treasury bills.

D. The Special Scheme with Lebanese Commercial Banks

As part of the measures adopted to reduce public debt service, and as per the arrangement with the commercial banks, BDL issued on December 16, 2002, circular N° 8312, pursuant to which most of the banks operating in Lebanon will subscribe to Lebanese Government securities which do not bear interest. These securities have a maturity of two years, with the amount subscribed to by each participating bank equaling 10 percent of the bank's deposits in all currencies as of October 31, 2002. The decision provided the commercial banks with the option to subscribe to the non-interest bearing securities in cash or through the delivery of Treasury bills or Eurobonds previously issued by the Lebanese Republic.

The total contributions to the special scheme amounted to approximately **US$ 3.6 billion**, of which 85 percent was in the form of cash or near cash securities, i.e. maturing within three months from the date of submission. The exchange operation of Treasury bills and Eurobonds was concluded by end-May 2003, while the execution of the cash portion was extended to August 2003 to better match the cash flow needs of the Treasury (given the comfortable liquidity position of the Treasury resulting from the inflow of the Paris II funds in the first half of the year).

Table 6. Summary of Commercial Banks' Scheme
Amounts expressed in US$ million

	Amount	% of total
A. CASH OR CASH EQUIVALENT*	3,051	85%
1. LL Cash**	760	24%
2. US$ Cash**	1,986	52%
3. LL denominated T-bills with av. maturity of less than 3 months	164	5%
4. Eurobonds with av. maturity of less than 3 months	141	4%
B. SECURITIES (Eurobonds with av. maturity of over 3 months)	546	15%
GRAND TOTAL	3,597	100%

Source: Ministry of Finance

Notes: * Securities with maturities of less than three months as of the date of submission to the special scheme are assumed as near-cash amounts in this table.
** Two-year zero interest Lebanese Pound Treasury bills have been issued for the cash submitted in LL and US$.

Use of Commercial Banks' Cash Contributions:

The cash contributions of commercial banks amounted to the equivalent of **US$ 2.745 billion** during Jan-Aug 2003. These amounts were periodically deposited in a sub-account at the BDL and have been used, alongside the Paris II funds, exclusively to retire, on a weekly basis, the principal and interest of maturing debt.

Table 7. Use of Commercial Banks' Cash Contributions as of end-Sept 2003

ACCOUNT	**COMMERCIAL BANKS SPECIAL SCHEME***	
CURRENCY	Lebanese Pounds	
USE OF CASH PROCEEDS	Retirement of LL Treasury Bills	
	Principal	**Coupons**
JANUARY	-	-
FEBRUARY	-	-
MARCH	73,914,500,000	45,859,912,742
APRIL	501,683,070,000	212,728,696,922
MAY	686,019,130,000	228,065,618,935
JUNE	331,265,050,000	211,510,284,937
JULY	998,151,805,221	201,151,853,732
AUGUST	216,693,180,000	129,875,706,282
SEPTEMBER	188,696,690,000	112,075,585,711
TOTAL in Lebanese Pounds	**2,996,423,425,221**	**1,141,267,659,261**
GRAND TOTAL in Lebanese Pounds	**4,137,691,084,482**	
GRAND TOTAL expressed in US$	**2,744,737,038**	

Source: Ministry of Finance

Notes:

* Contributions in the form of securities previously issued by the Lebanese Republic are not included in this table.

SECTION II. IMPACT OF PARIS II ON PUBLIC DEBT

A. PUBLIC DEBT

Gross public debt as of end-October 2003 amounted to LL 49,462 billion, registering an increase of LL 1,221 billion or 2.5 percent over the level as of end-November 2002. This increase in public debt is less than the amount needed to finance the interest that fell due during that period, and the **rate of growth** of the public debt has slowed down drastically over the past year, from an annualized rate of 14.3% for the 11 months of Jan-Nov 2002 to 2.8% for the 11 months of Dec2002-Oct 2003, due to two main reasons:

1. The achievement of primary surpluses throughout this period (the primary surplus achieved during the period Dec 2002 -Oct 2003 amounted to LL 744 billion or around 2.7% of GDP), and
2. The cancellation of LL 2,700 billion from the Banque du Liban's Treasury bills portfolio at the end of 2002.

The increase in foreign currency debt was larger than that of domestic debt during the period of November 2002- October 2003 due to the issuance of foreign currency debt (Eurobonds and loans) to the Paris II contributing countries and to BDL, the proceeds of which were used mainly to redeem or replace more costly debt denominated in Lebanese Pounds.

Net public debt, defined as public debt less public sector deposits, amounted to LL 46,140 billion as of end-October 2003, registering an increase of LL 554 billion or 1.2 percent since end-November 2002.

The composition of public debt improved in the past year. **Market debt**, defined as gross public debt excluding the portfolios of the Banque du Liban, public institutions, bilateral and multilateral loans, and debt issued to the Paris II lender countries, declined by LL 8,302 billion or 15 percent since end-November 2002 and was replaced by debt with a lower cost and longer maturity to reach LL 29,950 billion at end-October 2003, or the equivalent of US$ 19.9 billion.

Table 8. Public Debt Outstanding by Holder as of End-October2003
Amounts expressed in LL billion

(Stocks, end of period)	2001	2002		2003	% change
	Dec-01	Nov-02	Dec-02	Oct-03	Oct 03-Nov 02
Total debt	**42,637**	**48,241**	**47,274**	**49,462**	**2.5%**
Domestic debt	**28,214**	**28,989**	**25,302**	**26,229**	**-9.5%**
a. Central Bank	6,251	4,619	723	8,486	
o/w Zero interest T-bills				*3,508*	
o/w Special T-bills issued at 4% (issued against CDs)				*4,299*	
b. Commercial Banks	15,830	17,166	17,211	12,186	
*o/w Zero interest T-bills**				*880*	
c. Other Domestic Debt (T-bills)	6,133	7,205	7,368	5,557	
o/w Public entities	*2,729*	*3,212*	*3,221*	*2,207*	
Foreign debt	**14,423**	**19,252**	**21,972**	**23,233**	**20.7%**
a. Bilateral and Multilateral	2,046	2,158	2,214	2,334	8.1%
b. Paris II related FX debt (incl. BDL Ebond)			4,251	6,485	
c. Market Eurobonds	11,477	16,122	14,611	12,515	-22.4%
o/w Zero interest Eurobonds issued to Comm. Bnks				1,054	
e. Other foreign Debt**	900	972	896	845	-13.1%
Public sector deposits	**1,913**	**2,655**	**2,964**	**3,322**	**25.1%**
Net debt	**40,724**	**45,586**	**44,310**	**46,140**	**1.2%**
Net market debt***	**29,699**	**35,598**	**33,902**	**26,628**	**-25.2%**
% of Net debt	**72.9%**	**78.1%**	**76.5%**	**57.7%**	
Gross market debt	**31,612**	**38,253**	**36,866**	**29,950**	**-15.1%**

Source: Ministry of Finance, Banque du Liban

Notes:
* Includes new Treasury bills issued for existing Treasury bills submitted during Jan-May 2003 in addition to the LL cash tranche of March, July and August 2003. Treasury bills issued in exchange for the LL and USD cash tranches of Jan and Feb in addition to the USD cash tranche of March, July and August 2003 are held by the BDL which has issued zero interest CDs to the commercial banks. The BDL only played an intermediation role in the commercial banks scheme and does not hold any position in net terms.
** Includes accrued interest and foreign currency private sector loans.
***Net market debt equals net debt (gross public debt less public sector deposits) less the portfolios of the BDL, NSSF, bilateral and multilateral loans, and Paris II related debt.

B. Cost of Public Debt

As a result of the implementation of the Paris II financial package (from lender countries, BDL, and commercial banks), the overall weighted average cost of total public debt outstanding (domestic and foreign combined) declined by 361 basis points, from 11.97 percent in November 2002 (at the time of the Paris II conference) to 8.36 percent as of the end of November 2003. The overall average cost of outstanding domestic debt declined by 459 basis points from 13.82 percent to 9.23 percent and the overall average cost of outstanding foreign debt declined by 181 basis points from 9.21 percent to 7.39 percent during the same period.

Table 9. Overall Weighted Average Cost of Outstanding Public Debt

	Date	Total Debt	Domestic Debt	Foreign Currency Debt
Before Paris II	Nov-02	11.97%	13.82%	9.21%
After Paris II	Nov-03	8.36%	9.23%	7.39%
Change		**-3.61**	**-4.59**	**-1.81**

The weighted average **cost of new financing** raised in 2003 (up till end November 2003) dropped substantially to around **3.7%.**

C. Evolution of Interest Rates

The financial markets have reacted favorably to the outcome of the Paris II conference. Most interest rates on public debt recorded a substantial drop while the value of Lebanese Republic securities increased as described below.

Interest Rates on Lebanese Pound Treasury Bills:

Primary market interest rates on Lebanese Pound Treasury Bills of all categories have declined by more than 30 percent following the Paris II conference, and the yield curve flattened between the 12 and 24-month maturities. The issuance of T-bills was halted for 9 months (February-November 2003) given the liquidity provided by the Paris II package. In November 2003, the Ministry of Finance resumed its Treasury Bill issuances, and the yields dropped further. The yield curve was also extended with the introduction of the longer 3-year maturity Treasury bills.

Table 10. Evolution of Primary Market Treasury Bill Yields

	Pre-Paris II (End-October 2002)	**Post-Paris II** (January/February 2003)	**November 24th, 2003**
3-months T-bills	11.18%	6.96%	5.37%
6-months T-bills	12.12%	8.18%	6.55%
12-months T-bills	13.43%	9.13%	6.89%
24-months T-bills	14.64%	9.41%	7.84%
36-months T-bills	-	-	8.66%

Source: Ministry of Finance

Yields on Foreign Currency Eurobonds:

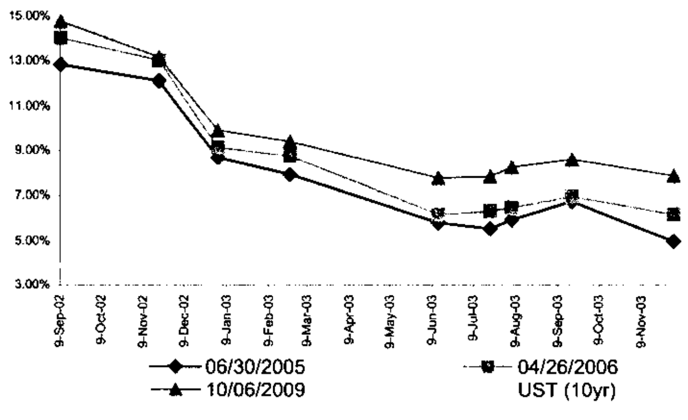
The yields and prices of all outstanding Eurobond issues of the Republic marked a substantial improvement following Paris II. Since January 30, 2003, all maturities have been trading above par.

Table 11. Secondary Market Prices of Selected USD Denominated Eurobonds of the Lebanese Republic

		2002		2003	
Coupon Rate	Maturity Date (mm/yy)	Sept. 9 Mid Price	Nov. 25 Mid Price	Jan. 10 Mid Price	Dec. 19 Mid Price
8 1/2	03/04	94.00	97.75	100.00	101.38
9 1/2	12/04	96.50	98.75	102.50	104.00
9 3/8	06/05	92.00	95.50	102.00	106.47
8 3/4	09/05	87.50	93.00	100.00	105.25
9 7/8	04/06	88.50	95.00	102.50	108.00
8 5/8	10/07	80.00	86.50	99.00	105.25
10 1/8	08/08	83.00	89.00	102.00	110.00
10 1/4	10/09	80.50	90.00	102.00	110.75

Source: Morgan Stanley

Chart 1. Evolution of Mid-Yields of Selected USD Denominated Eurobonds of the Lebanese Republic



Source: Ministry of Finance and Morgan Stanley

SECTION III. RECENT ECONOMIC DEVELOPMENTS SINCE PARIS II

A. MONETARY DEVELOPMENTS

Foreign Exchange Reserves:
The Central Bank continued to build up its foreign exchange reserves which reached US$ 10.4 billion (gross excluding gold) at end-October 2003, compared to US$ 3.5 billion before the Paris II Conference at end-October 2002.

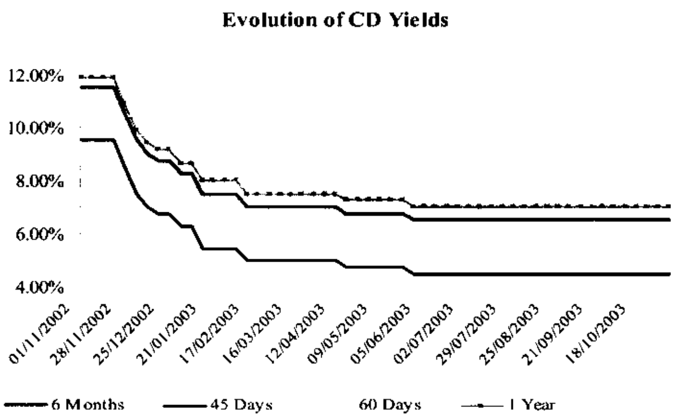
Money Market Rates:
Short-term money market rates decreased sharply after Paris II. BDL cut the rate on the 45 days CDs to 4.50 percent as of end-May 2003 from a level of 9.50 percent during November 2002. This rate dropped further in November 2003 to 4.40 percent.

Table 12. Comparison of Certificate of Deposit Yields

Length of Maturity*	End-October 2002	End-December 2002	October/November 2003
45 Days	9.50%	6.75%	4.40%
60 Days	10.25%	7.50%	4.89%
6 Months	11.15%	8.75%	6.36%
1 Year	11.90%	9.15%	7.00%
2 Years	-	-	8.00%
3 Years**	-	-	9.00%
5 Years	-	-	9.25%

Source: Banque du Liban
Notes: * Two, three and five year maturity CDs were introduced in 2003.
** Following QI 2003, BDL began issuing a portion of its Lebanese Pounds 3 year CDs at a discount, in return for US dollars at a rate of 12%. These CDs are not taken into consideration in the calculation of the yields.

Chart 2. Evolution of CD Yields



Source: Banque du Liban

Lending Rates:

Average lending rates in Lebanese Pounds decreased by around 430 basis points between October 2002 and September 2003 while lending rates in USD decreased by 110 basis points for the same period.

Table 13. Average Lending Rates

	LL Lending Rates	US$ Lending Rates
	in percent	
October 2002	16.32	9.74
November 2002	16.11	9.69
December 2002	16.10	9.62
January 2003	15.39	9.44
February 2003	15.40	9.48
March 2003	15.01	9.34
April 2003	14.53	9.22
May 2003	14.74	9.11
June 2003	13.43	9.13
July 2003	12.96	8.95
August 2003	12.78	8.95
September 2003	12.04	8.63

Source: Banque du Liban

Deposit Rates:

Average deposit rates in LL decreased by 270 basis points between October 2002 and September 2003 while deposit rates in USD decreased by 70 basis points for the same period.

Table 14. Average Deposit Rates

	LL Deposit Rates	US$ Deposit Rates
	in percent	
October 2002	10.65	4.20
November 2002	10.44	4.14
December 2002	9.83	4.00
January 2003	9.27	3.80
February 2003	8.68	3.77
March 2003	8.73	3.74
April 2003	8.51	3.64
May 2003	8.23	3.47
June 2003	8.30	3.53
July 2003	8.08	3.54
August 2003	7.93	3.48
September 2003	7.93	3.48

Source: Banque du Liban

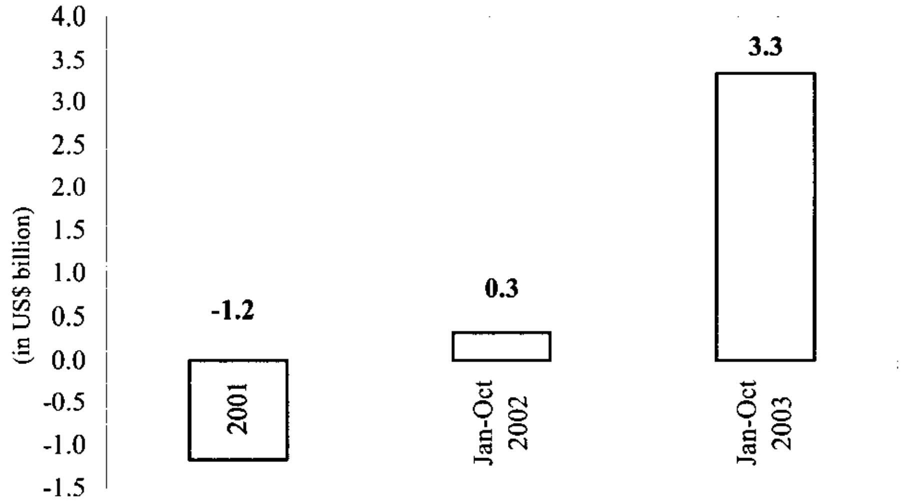
Dollarization:

The dollarization rate of commercial banks deposits declined substantially since the Paris II Conference. As of end-October 2003, it stood at 66.3 percent compared to 71.6 percent as of end-October 2002.

Balance of Payments:

Following the Paris II conference, capital inflows increased due to Paris II proceeds as well as private capital inflows. Consequently the balance of payments registered a marked improvement with a surplus of US$ 3.34 billion for the first 10 months of 2003, compared to a US$ 0.32 billion for the same period of 2002.

Chart 3. Evolution of the Balance of Payments



Source: Banque du Liban

Progress on Fiscal Reforms:

The Government's program of fiscal reforms was strengthened in 2003 in order to increase the level of the primary budget surplus by further controlling expenditures and increasing revenues through new tax measures. Among the main successes of this program is the introduction of the **Value Added Tax** in February 2002 that resulted in a marked increase in revenues. The Government is also preparing for the introduction of the **General Income Tax** in 2005. In addition, the program involves complementary fiscal reforms and financial consolidation summarized below. The success of these fiscal reforms, however, will hinge on the implementation of other prerequisite reforms detailed in the documents presented at the Paris II Conference.

The following include some of the major revenue enhancing developments for 2002 and 2003:

- The introduction of a new **5% tax on interest generating income** in all currencies, which generated since its effective implementation date in February 2003 LL 95 billion by end-September 2003.

- The establishment of a **Large Taxpayers Unit** (LTU) in order to audit and review large taxpayers' income tax declarations, and hence expand the audit capacity at the Ministry of Finance.

- The modernization of the **Deduction At Source on Salaries** (DASS, Title II of the Income Tax Law) administration by creating a reliable and exhaustive database covering the active and retired labor force in both the private and public sectors. This is in addition to the increase in the frequency of tax filing and payment from semi-annually to quarterly resulting in lower tax arrears.

- The lowering of the mandatory **VAT threshold** from the current minimum annual turnover of LL 500 million to LL 300 million which came into effect in April 2003.

- The increasing in some **fees** including fixed phone line fees (monthly subscriptions and fees per minute), and road usage fees.

- The installment of **outstanding tax regularization** dues pursuant to the tax amnesty law ratified in December 2002 through payments to be made during 2002-2005. The total sums due amount to LL 162 billion out of which LL 94 billion were collected in 2002 and the remaining will be paid in installments through 2005.

In addition to the above mentioned revenue enhancing measures, the Ministry of Finance is currently implementing a number of fiscal reform projects which will lead toward rationalization of expenditures. These projects include:

- **Expenditures and treasury management reforms,** which consist mainly of the following projects: - Social Expenditure Rationalization (20/20 Project)
  - Public Expenditures Rationalization
  - Modernization of the Government Payment Systems
  - Budget and Accounting Reform
  - Treasury Management Reform (integrated treasury system)

- **Public pension system** reform, through various initiatives: restructuring of pension department at MOF, automation of payment of pension, actuarial assessment and analysis of contingent liabilities of public pension, and adjustment of legal framework for public pension system.

Fiscal Performance:

As an indication of the improved fiscal performance in 2003, the **primary surplus** reached LL 710 billion for Jan-Oct 2003, or double the amount achieved during the same period of the previous year, while the **budget deficit** recorded a 13 percent decrease. This improved budgetary performance when compared to Jan-Oct 2002 stems from a 13 percent increase in **revenues** which more than offset the additional spending (inclusive of debt service). **Debt service** during the first 10 months of 2003 increased by LL 193 billion compared to the same period of 2002 mainly because the bulk of interest expense was still based on the debt committed prior to the debt re-profiling that took place after Paris II (re-profiling was not done in a one-shot transaction and was implemented at various stages throughout 2003). On a cash flow basis, the full impact of the debt re-profiling measures (replacing high cost debt with debt at lower cost) will be apparent in 2004 and thereafter. The re-profiling of debt generated cost savings of close to LL 800 billion for 2003 (as compared to what debt service would have been had there not been any re-profiling).

Treasury payments during Jan-Oct 2003 recorded a 10 percent increase over Jan-Oct 2002, mainly due to an increase in payments to Electricité du Liban (from LL 220 billion to LL 373 billion) and in the spending from previous years' budgets (from LL 458 billion to LL 553 billion). The **total deficit** amounted to LL 3,308 billion for Jan-Oct 2003, representing a 4.7 percent improvement over the Jan-Oct 2002 level.

Table 15. Summary of Fiscal Performance
Amounts expressed in LL billion

	2002 Jan-Oct	2003 Jan-Oct	change 2002-2003	% change
Budget revenue	4,543	5,208	665	14.6%
Budget expenditures	7,071	7,417	346	4.9%
o/w Debt service	*3,825*	*4,018*	*193*	*5.0%*
Budget (deficit)/surplus	-2,528	-2,209	319	-12.6%
in % of budget expenditures	-35.8%	-29.8%		
Budget primary (deficit)/surplus	1,297	1,809	512	39.5%
in % of budget expenditures	18.3%	24.4%		
Treasury receipts	386	369	-17	-4.4%
Treasury payments	1,330	1,469	139	10.5%
Total budget and treasury receipts	4,930	5,578	648	13.1%
Total budget and treasury payments	8,401	8,886	485	5.8%
Total cash (deficit)/surplus	-3,471	-3,308	163	-4.7%
in % of total expenditures	-41.3%	-37.2%		
Primary (deficit)/surplus	354	710	356	100.6%
in % of total expenditures	4.2%	8.0%		

Source: Ministry of Finance (MOF), Directorate General of Finance (DGF)

Mobile Telecommunication Sector:

In June 2002, Parliament passed a law authorizing and regulating the sale of two licenses for the provision of mobile telephony services (limited to GSM and GPRS) in Lebanon for a 20 year term and the sale of related assets which were held by the existing operators of the mobile networks. This law authorizes qualified bidders to submit offers for one or more of the following :

- the first option authorizes bidders to submit a cash offer on the basis that the Government retains 40% of the revenues from domestic calls and all other services provided to customers and 100% of the revenues from international calls;
- the second option authorizes bidders to submit a cash offer on the basis that the Government shall not retain any portion of the revenues from domestic calls and other services provided to customers while retaining 100% of the revenues from international calls;
- the third option authorizes bidders to submit an offer for the management of the mobile networks for a period of up to three years; the Government has indicated that it would consider this option only in the case where it is not satisfied with the results of the other options.

On August 31, 2002, the status of the mobile phone operators was changed from a BOT to a management contract, namely the Network Custody and Operation Contract. Starting September 1, 2002, revenues from the mobile phone sector were totally transferred to the Treasury. Moreover, by virtue of the Council of Ministers' resolution dated January 29, 2003, the Government settled the net book value of the two companies assets and all incidental costs incurred due to early termination of their contracts.

The Government has already launched the tender process for the two mobile businesses. The process was conducted with the assistance of an investment bank and other specialists. The Higher Privatization Council "HPC" - after consulting with the Technical Committee which valuated the financial offers of the participants along with HSBC- released the names of companies that are eligible to participate in the two auctions, the first being the sale of the two licenses and the second being the awarding of management contracts for the two existing networks (this will come as an alternative in case the financial offers submitted by potential buyers are declined).

In September 2003, mobile licenses were extended for an additional 4 months, while the mobile licenses auction bidding process was launched. The five qualified bidders were given access to the Data Rooms and are reviewing the transaction documents before submitting their offers.

Fixed Telecommunication Sector:

The privatization of the fixed telecommunication sector is also progressing. The legal framework and the audit compilation required for the consolidation of functions related to the transfer of fixed line services into a new company (Liban Telecom) are being prepared. An auction is expected to be launched in 2004 permitting the sale of 40% of Liban Telecom's shares.

Electricity Sector:

In September 2002, Parliament passed a law regulating the electricity sector which, among other matters, provides for the establishment of an independent regulator, the separation of production, transmission and distribution activities, and the creation of a commercial public corporation responsible for the production and distribution activities. The shares of this company would be initially owned by the Government and subsequently transferred (up to 40%) to a strategic partner.

As for the transmission company, its management will be solely transferred to the private sector through a management contract.

In the interim, the Government has appointed an investment bank and other specialists to assist in the sector's privatization and has received interest from 20 potential investors/ operators pursuant to a call for expression of interest launched in October 2002.

Water sector:

A draft law regulating the water sector is in the process of being prepared by the Government for submission to Parliament. Work on the privatization of this sector has commenced, with the Government appointing an investment bank and other specialists to assist in the privatization.

Securitization:

Following its desire to reduce borrowing costs and its debt levels, the Government submitted to Parliament a law authorizing the Government to engage in securitization transactions and mandating that the Government deposits in a special account at the Central Bank, dedicated to the payment, management and reduction of public debt, the proceeds of any securitization transaction, as well as the revenues derived by the Government from specific sectors, such as telecommunications, tobacco, Casino du Liban and others. Parliament adopted this law in June 2002.

The Government has announced its intention to securitize customs revenues from the importation of tobacco products into the Republic and has appointed two investment banks to arrange this transaction. As such, the structure and the legal documentation have been finalized, the Paying and Listing Agent has been appointed, and the rating agency has been selected. Additionally, a new Customs Duties Draft Law authorizing the payment by the international tobacco companies of customs duties in U.S. dollars and into an off-shore account was submitted to the Council of Ministers.

D. Real Economy Developments

As a result of the positive atmosphere after Paris II, the first nine months of 2003 witnessed a **growth in economic activity**. Though no direct statistics measuring economic growth are available, some macro-economic indicators are a good reflection of economic activity, and show an improvement in 2003.

- The **coincident indicator**, a BDL index composed of money stock, trade, passengers' flows, cleared checks, and electricity production fluctuations, increased by 6.2 percent by August 2003, as compared to the same period in 2002.

- Trade activity grew during Jan-Sep 2003 as compared to Jan-Sep 2002, with total **exports** increasing by 37 percent and total **imports** increasing by almost 7 percent. **Consumption tax revenues** also increased. A month by month comparison reveals that 2003 VAT collection is significantly higher than 2002 collection by an average of 17 percent.

  This may be attributed to an overall higher aggregate consumption in 2003, which in turn may have resulted from the boost in **tourism** activity during the summer season. The number of tourist arrivals as published by the Ministry of Tourism for the first nine months of 2003 cumulated at 818,554, rising by 5.6 percent as compared to the same period of 2002. The number of tourists peaked in July and August 2003, rising by over 23 percent in August 2003 as compared to August 2002, and reaching an unprecedented level since 2000.

- Construction activity improved during the first nine months of 2003, with **construction permits**, the indicator of potential construction activity, increasing by almost 10 percent as compared to the January-September 2002 level. **Cement deliveries**, which reflect actual construction activity, also registered a 1 percent improvement. This modest increase in cement deliveries (as compared to the improvement in construction permits) is due mainly to the slowdown in cement deliveries that was experienced during the first few months of 2003 as a result of the harsh winter.

- **Cleared cheques** in local currency increased by almost 11 percent during January-September 2003, as compared to the same period in 2002, alluding to an increase in business activity. This also applies to cleared cheques in foreign currencies, which registered close to 3 percent increase for the same time period.

- **Electricity production** also increased by around 4 percent during January-September 2003 as compared to the same period in 2002.

Table 16. Selected Macroeconomic Indicators
Amounts expressed in LL billion unless otherwise indicated

Item	2002 Jan-Sept	2003 Jan-Sept	% change
Exports *in millions of USD*	767	1,051	37%
Imports *in millions of USD*	4,753	5,068	6.6%
Cleared cheques in local currency	9,047	10,018	10.73%
Cleared cheques in foreign currencies *in millions of USD*	14,941	15,334	2.63%
Total Flow of passengers (B.I.A.) *in thousands*	2,062	2,213	7.29%
Arrivals	995	1,053	5.82%
Departures	998	1,067	6.93%
Transit	69	92	33.83%

Source: Banque du Liban website

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