IMPACT OF THE JULY WAR ON THE PUBLIC FINANCES

2006

REPUBLIC OF LEBANON
MINISTRY OF FINANCE

IMPACT OF THE JULY WAR
ON THE PUBLIC FINANCES IN 2006
BRIEF PRELIMINARY REPORT

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EXECUTIVE SUMMARY

1. The Israeli war on Lebanon of July 2006 has resulted in severe repercussions on the Lebanese economy as a whole. Notwithstanding their immediate impact, these ramifications will most likely continue to be felt in the years ahead. In fact, while the full picture of the physical damage assessment will shortly be clearer and quantified, the impact of the war on the economic, financial and public finance indicators will span over the short and medium term.

2. Prior to the war, on the public finance front, the government was able to raise revenues, decrease primary expenditures, and therefore improve the deficit and the primary surplus. Indeed, despite the difficulties which faced the country following the assassination of Prime Minister Hariri in February 2005, all public finance indicators were showing improvements in the one-year period spanning from June 2005 to June 2006 due to the efforts that were exerted by the government to tighten the grip on the fiscal situation. As a strong sign of this amelioration, the **primary surplus more than quadrupled during the first half of 2006 compared to the first half of 2005.**

Table 1: Public Finance Results until June 2006

(LL Billion)	*HI 2005*	*HI 2006*
Revenues (1)	3,533	4,063
Expenditures	4,856	5,230
Debt service	1,555	2,161
Primary Expenditures	3,301	3,069
EDL	*433*	*151*
Municipalities	*166*	*163*
Fiscal Deficit	-1,323	-1,167
Primary Surplus / Deficit	232	994

Source: Ministry of Finance
1) Total revenues do not include grants

3. The improvement in the primary surplus in the first half of 2006, prior to the Israeli war on Lebanon, was due to increased efforts to raise revenues, through enhancing collection and regularizing transfers from public entities and utilities. The revenues were 4,063 billion L.L. for the first half of 2006, which marks a 15% increase compared to the first half of 2005. Not only did the government enhance revenues, but it also controlled expenditures through better management, particularly non-interest expenditures. Non-interest expenditures dropped by 7% from **3,309 billion L.L. (US$ 2,195 million)** in the first half of 2005, to **3,070 billion L.L. (US$ 2,036 million)** in the first half of 2006.

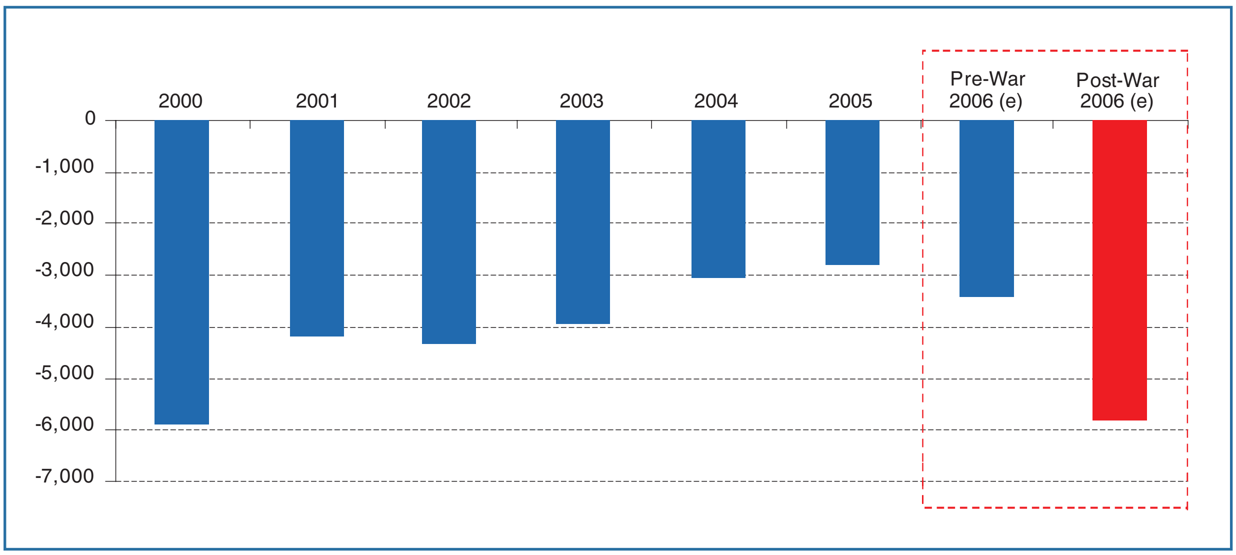
All figures in this report are preliminary and subject to internal revisions

4. Also, the progress on the debt management front helped decrease the financing risk and the government was able to raise financing solely through the market, without any reliance on the Central Bank. In fact, between the time it took office and the beginning of the war, the government was able to repay slightly less than **US$ 3 billion (4,523 billion L.L.)** to the Central Bank through a reduction of its treasury bills portfolio.

5. However, the war of July 2006 has put an end to this amelioration. While GDP looked poised to grow at 5% in 2006, with a record of 1.6 million tourists anticipated to visit Lebanon, the heavy destruction and loss of capital and human resource base will surely result in a loss of output as per preliminary estimates by INSEE.

6. In sum, **the loss in public finance** due to the Israeli war against Lebanon in July 2006 is estimated at around **US$ 1.6 billion (2,419 billion L.L.)** until the end of 2006, taking into consideration the Israeli blockade which lasted for a two-months period, barring the full impact of the infrastructure cost on public finances, and keeping in mind that the full impact will be felt throughout 2007 and the medium-term.

Figure 1: Evolution of Total Deficit – Pre and Post War Assumptions



7. More specifically, for the two months of July and August, **the slide in revenues** has already amounted to around **US$ 314 million (473 billion L.L.)** (according to preliminary estimates), which is equivalent to 1.44% of GDP[1], and is expected to sum up to more than **US$ 920 million (1,386 billion L.L.)**, only in 2006 when compared against previous expectations, taking into account the spanning of the blockade for a period of two months. The war has resulted in lower tax and non-tax revenues, mainly trade and international exchange duties, the value-added tax.

8. At the same time, the **increase in primary public spending** will amount to around **US$ 800 million (1,218 billion L.L.),** which is additional spending of around 3.7% of GDP[2], only in 2006 when compared against 2005. The reasons behind skyrocketing expenditures are to compensate for the heavy toll in human life, to cover for the massive destruction in housing and infrastructure, to finance health and relief needs arising from the war, and to pay for the security expenses resulting from the implementation of UN Security Council Resolution 1701.

1- The post-war GDP forecasted for 2006 is LL 32,756 billion (please refer to the table of GDP estimates 2003-2006)
2- Please refer to the previous footnote

9. The end result is expected to be worsening fiscal dynamics and the emergence of **a primary deficit** for the first time in six years, following years of exerted efforts towards containing the fiscal situation. The primary surplus of **994 billion L.L. (US$ 659 million)** that was recorded for the first half of 2006 is now estimated to be reversed into a primary deficit of **1,173 billion L.L. (US$ 778 million)** by the end of 2006 – **1,909 billion L.L. (US$ 1.266 billion)** higher than 2005 and far from the original target of a primary surplus of **1,246 billion L.L. (US$ 827 million),** in the absence of external shocks. As a result of the war, the Ministry also estimates, for 2006, a total deficit of **5,808 billion L.L. (US$ 3.85 billion)**, which is almost twice the total deficit for 2005. Rising deficits will call for additional financing needs, and worsening debt dynamics, in a country which was already battling to redress its fiscal imbalances.

Figure 2: Comparison of Primary Balance – Pre and Post War Assumptions

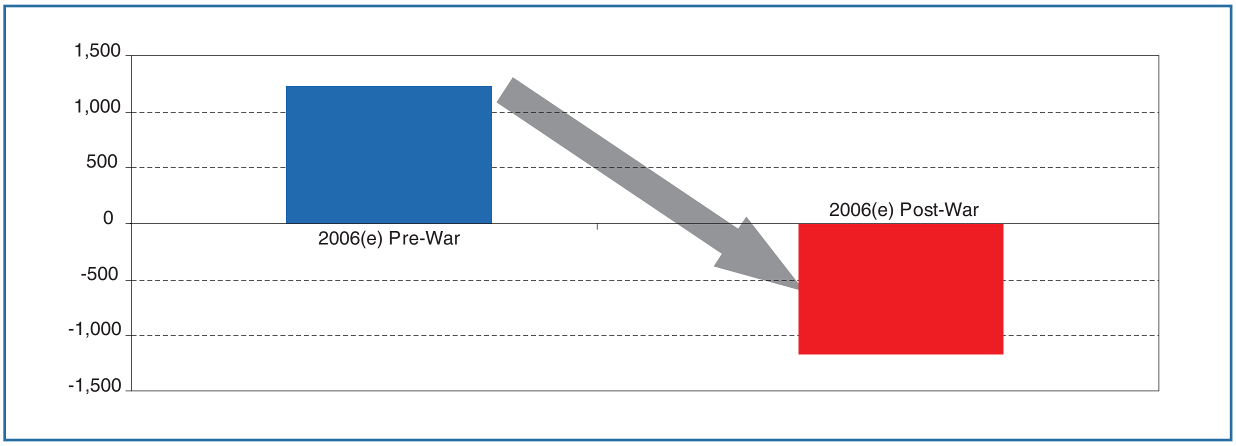


Table 2: Fiscal Impact of the July War – Historical Evolution of Fiscal Performance

(LL Billion)	*2003*	*2004*	*2005*	*2006 Pre-War*	*2006 Post-War*
Revenues	6,654	7,514	7,405	8,100	6,714
Expenditures	10,592	10,540	10,203	11,489	12,522
of which Primary Expenditures	*5,718*	*6,519*	*6,669*	*6,854*	*7,887*
Fiscal Balance	-3,938	-3,026	-2,978	-3,389	-5,808
Primary Balance	936	995	736	1,246	-1,173

Source: Ministry of Finance

Table 3. Fiscal Impact of July War (Historical Evolution of Fiscal Performance in % of GDP)

(In % of GDP)	*2003*	*2004*	*2005*	*2006 Pre-War*	*2006 Post-War*
Fiscal Balance	-13%	-9%	-9%	-10%	-18%
Primary Balance	3%	3%	2%	3%	-4%
Total Revenues	22%	23%	22%	23%	20%
Primary Expenditures	19%	20%	20%	19%	24%
GDP (in billion LL)	29,846	32,655	33,081	35,603	32,765

Source for GDP: National account data 2003, BDL estimates for 2004 and 2005, Real growth 2006 preliminary forecast (INSEE consultant)
Note:
1) Post war Inflation estimates in 2006 is assumed to be similar to 2005
2) Post conflict real growth 2006 is estimated between -0.5 percent and -2 percent

Box 1: Financial Assistance from Friendly Countries

Significant confidence in the system was injected with the transfer of US$1.5 billion from the Kingdom of Saudi Arabia and Kuwait. In fact, in early August, **Saudi Arabia** provided financial support through a **US$ 1 billion** deposit at the Central Bank of Lebanon accompanied by a commitment of **US$500 million** as a grant for reconstruction. **Kuwait** also deposited **US$ 500 million** at the BDL and committed a grant of **US$ 300 million** for reconstruction. Saudi Arabia and Kuwait's grants for reconstruction will constitute the seed money for a reconstruction fund.

To address immediate early recovery needs amounting to **US$ 537 million**, a donors' conference organized by the Swedish government took place on August 31, 2006 in **Stockholm** and resulted in around **US$ 900 million** of assistance. The largest donors were Qatar with slightly more than 33% of contributions, the Arab Fund for Economic & Social Development with around 13%, the Kingdom of Saudi Arabia with 6.7%, and the EC & USA with around 6%.

In addition to funds spent to date by the Lebanese Government on relief, the Lebanese Government - High Relief Committee has received a total of **US $103 million** as of August 29th in terms of **cash donations** (excluding in kind donations). These funds are for the sole purpose of relief and will be spent accordingly. These funds do not include donations channeled through non-governmental and multinational organization such as the International Red Cross and the United Nations. The main sources of funding are governments, multilaterals, companies, individuals and embassies and organizations. As expected, governments are the largest donors accounting for 97% of all donations (mainly Saudi Arabia, Iraq, & Kuwait).

PROJECTED REVENUES IN 2006

10. By June 2006, revenues totaled **4,063 billion L.L. (US$ 2,695 million)** rising by 15 percent compared to the first half of 2005, i.e. **531 billion L.L. (US$ 352 million)** of additional revenues, 390 billion L.L. (US$ 259 million) of which stemming from most tax fronts, namely income taxes, property taxes, VAT and fiscal stamps; and 161 billion L.L. (US$ 107 million) originating from non tax revenue items, namely income from government properties (telecommunications) and administrative fees and charges (vehicle control fees).

11. This positive environment was expected to continue throughout the year, and revenues were therefore assumed to end the year 2006 at **8,100 billion L.L. (US$ 5.373 billion).** However, the Israeli war against Lebanon has devastated this projection. Instead, revenues for 2006 are now estimated at **6,714 billion L.L. (US$ 4.45 billion)**, which is **1,386 billion L.L. (US$ 920 million)** lower than original projections.

12. When compared to 2005, total expected revenues for 2006 indicate 9 percent lower collection **(6,714 billion L.L.** versus **7,405 billion L.L.**), keeping in mind that the year 2005 also witnessed a series of dramatic events which disrupted economic activity and therefore revenue collection.

13. Tax revenues for 2006 are expected to generate **4,596 billion L.L. (US$ 3,049 million)**, which is approximately 6 percent lower than the collection level of 2005, as a result of the interruption of economic activity and the consequent slowdown in consumption. The situation has been further exacerbated by the air and sea blockade which lasted for two months and the resulting interruption of the trading activity for nearly two months.

14. As an immediate impact of the Israeli war, revenues from taxes on international trade are expected to fall by 35 percent in 2006. In fact, despite a 33 percent rise in imports in the first half of 2006 compared to the equivalent period in 2005, total imports for this year are anticipated at 15 percent below the import level in 2005. On the other hand, maintaining the capping on the retail price of fuel in the face of rising international oil prices exacerbates the loss in trade revenues. Revenues from fuel excise have plummeted throughout the year, reaching a close-to-zero collection level in June 2006. Consequently, 2006 year-end revenues from fuel excises are projected to be 75 percent less than those for year-end 2005. The share of taxes on international trade out of total revenues is expected to drop from a historical average of 25 percent to barely 12 percent in 2006.

15. Domestic taxes on goods and services are anticipated to collect 7 percent lower revenues in 2006 than total collection in 2005, namely on account of lower VAT revenues. The disruption of economic activity, and namely tourism, the expected slowdown in consumption and the nearly two month blockade adversely impacted VAT collection. The second half of 2006 is projected to collect 24 percent less VAT revenues than the first half of 2006, ending the year with 8 percent lower revenues on a year on year basis.

16. Non tax revenues for 2006 are expected to decline by 20 percent compared to the 2005 revenue level. The causes behind the fall in non tax revenues are the lower transfers from the budget surplus of telecommunications - due to settlement to the two previous mobile operators - and lower transfers from the Port of Beirut due to the damages to the cellular and fixed line networks, and to the interruption of all trans-boarding activity in the port resulting from the sea blockade.

Table 4: Pre-War and Post-War Revenue Projections

(LL Billion)	*2005*	*Expected 2006 Pre-War*	*Expected 2006 Post-War*	*% Change 2006*
Tax Revenues	**4,864**	**5,579**	**4,596**	**-17.62%**
Taxes on Income Profits & Capital gains*	1,047	1,161	1,120	-3.53%
Taxes on Property	414	729	637	-12.62%
Domestic Taxes on Goods & services	1,896	2,183	1,761	-19.33%
Value Added Tax (VAT)	*1,693*	*1,939*	*1,565*	*-19.29%*
Taxes on International Trade	1,268	1,179	828	-29.77%
*Excise***	*787*	*673*	*448*	*-33.43%*
Customs	*481*	*506*	*380*	*-24.90%*
Other Tax Revenues (fiscal stamps)	241	327	250	-23.55%
Non Tax Revenues	**2,116**	**2,089**	**1,695**	**-18.86%**
Entrepreneurial & Property Income***	1,662	1,490	1,238	-16.91%
Administrative Fees & Charges	365	494	367	-25.71%
Treasury Revenues	**421**	**432**	**423**	**-2.08%**
Total Revenues	**7,401**	**8,100**	**6,714**	**-17.11%**

Source: Ministry of Finance:

*The taxes on income, profit & capital gains revenue figure shows that the collection of these taxes is not relatively impacted by the Israeli aggression on Lebanon as around 70% of the expected amount for 2006 was already collected prior to the Israeli war.

**Please note that the 33% loss in excise revenues post war 2006 when compared to the pre-war 2006 expectation is explained by the higher than expected rise in international oil prices (pre war projection figures account for lower fuel prices), which under the capping regime, erodes the fuel excise revenue base.

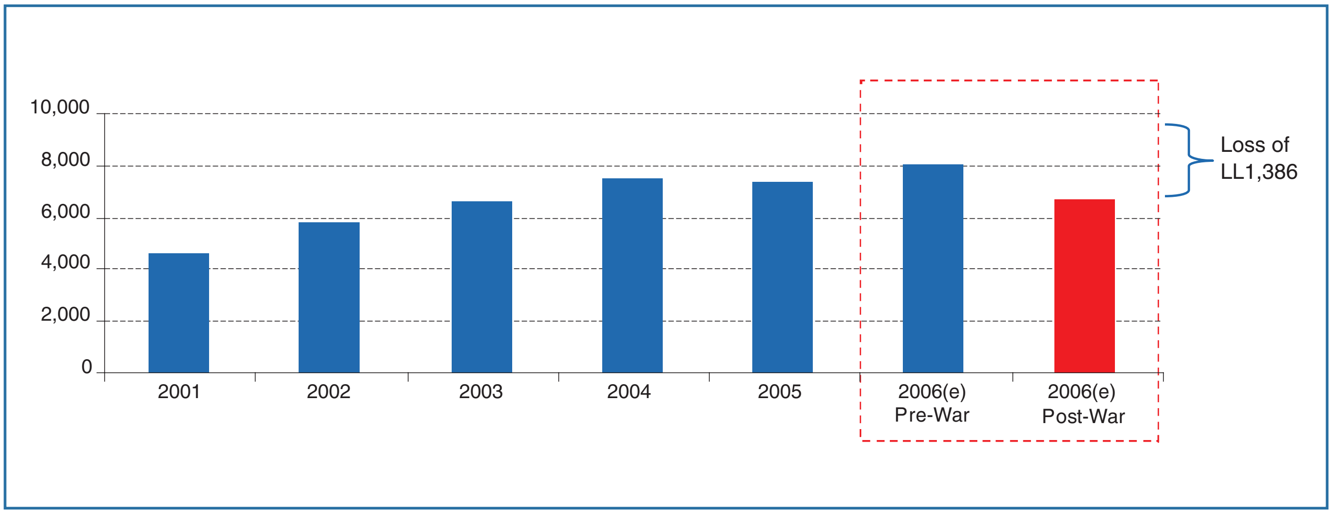
***The 2006 pre-war & post-war projections account for the settlement to the 2 previous mobile operators. The 2006 post-war projection also accounts for the damages to the telephone network resulting from the Israeli war.

17. It is worth noting that the war against Lebanon will only partially impact total revenues in 2006. This is because income taxes on profits and capital gains and property taxes were largely collected during the first half of the year. This is also because the 15 percent improvement in revenues witnessed during the first half of 2006 will to a certain extent outweigh the expected deterioration for the remainder of the year. As such, it is expected that the adverse impact of the war will be more severe in 2007 onwards, mostly in the first half of 2007.

18. To ascertain the harmful impact of the war on public finances, and the corrosion of the revenue base, preliminary figures reveal a 35 percent fall in total revenues for the months of July and August 2006 compared to the cashed amount in July and August 2005. In total, the magnitude of the loss in revenues over the period July-August 2006 is calculated at near **475 billion L.L. (US$ 315 million)**, or 1.5% of GDP.

PROJECTED REVENUES IN 2006

Figure 3: Historical Revenues & Pre and Post-War Projections



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PROJECTED EXPENDITURES IN 2006

19. Total expenditures for January-June 2006 reached **5,230 billion L.L. (US$ 3,469 million)**, compared to **4,867 billion L.L. (US$ 3,229 million)** during the same period in 2005, an increase of **7.5 percent**. This increase is mainly due to a rise in debt service by **602 billion L.L. (US$ 400 million)** or **38 percent** comparing these two periods. Meanwhile, non-interest expenditures decreased by **7 percent** (the equivalent of **239 billion L.L. or US$ 150 million)** during the first half of the year compared to the same period in 2005 due to efforts by the Ministry of Finance to curb expenditures and to manage the timing of payments to better meet available liquidity.

20. However the events of July 2006, have reversed the trend of lower primary spending during 2006. In fact, while non-interest spending was originally expected to end the year at **6,854 billion L.L. (US$ 4.5 billion)**, post-war projections reveal higher non-interest expenditures – reaching **7,887 billion L.L. (US$ 5.3 billion)** - due to the relief and reconstruction efforts that have started to be undertaken by the Government, as well as the additional security measures required for implementation of UN Security Council Decision 1701. This implies a deterioration of **1,031 billion L.L. (US$ 684 million)**, or around 3 per cent of GDP, compared to the year-end projections prior to the commencement of hostilities. At the same time, total expenditure (including debt service) will reach **12,522**[3] **billion L.L. (US$ 8,306 million)** by end of 2006, an increase of **2,319 billion L.L. (US$ 1,538 million)** compared to 2005 or by 23 percent. These numbers are estimates and do not take into account total additional capital expenditures covering the rebuilding of destroyed houses and the complete restoration of the damaged infrastructure.

Box 2: Preliminary Impact of Israeli War

The Israeli war against Lebanon has caused immeasurable destruction to the lives, livelihoods and infrastructure of its people. The hostilities have claimed over 1,100 civilian lives, left more than 4,000 people wounded, and displaced more than a quarter of the Lebanese population (close to one million people).

Since the cessation of hostilities, an estimated 500,000 internally displaced people have returned to their areas of residence, in addition to an estimated 150,000 from outside the country. Around 60-70% of returned individuals are currently occupying inhabitable houses. According to estimates by the Order of Engineers, the war has lead to the destruction of **30,000 housing and commercial units**, mainly in the South, the Bekaa and Beirut's southern suburbs.

The scale and the scope of the damage to **infrastructure** have also been great. Direct bombardments have targeted all infrastructure sectors from transport, to electricity, telecommunications, water, health and education, directly affecting the livelihoods of hundreds of thousands of Lebanese citizens.

A **preliminary assessment by the Council for Development and Reconstruction** indicates that 137 roads have been damaged, and 107 bridges and overpasses have been damaged or destroyed. The impact on the health sector has been three-fold: damage to health facilities and infrastructure, lack of access and epidemic risks and exhaustion of supplies. The following table provides a damage assessment based on preliminary estimates from the Council for Development and Reconstruction.

3- Includes payments incurred by EDL for purchasing fuel oil and gas oil (Kuwait Petroleum Corporation and Sonatrach Petroleum Corporation.) from July - December 2006.

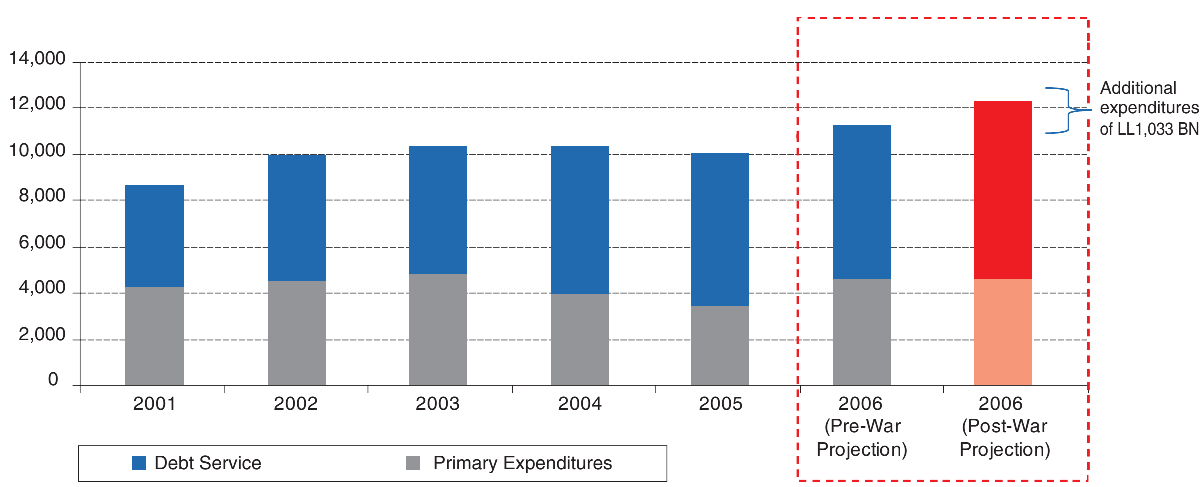
Box 2: Preliminary Impact of Israeli War (continued)

Table 1: CDR Damage Assessment Figures By Field

	Total Damages (US$ millions)
Transport	484
Electricity	244
Telecommunications	116
Water	80
Health and Education	34
Housing & commercial spaces	2,406
Industry	220
Military	16
Fuel Distribution Stations	12
TOTAL	**3,612**

In addition, the Israeli war has brought about large **environmental damage**, due to the oil spill from the bombarded Jiyyeh power plant, the widespread destruction that has resulted in massive waste amounts and the use of heavy bombs that have left toxin residues in the air.

Figure 4: Historical Expenditures and Pre and Post-War Projections



21. The projected increase in expenditures is mainly due to four reasons, namely higher military spending, relief costs, EDL, and reconstruction outlays.

22. In order to meet the requirements of UN Security Council Resolution 1701, **military spending** is expected to rise to accommodate sending 15,000 troops to South Lebanon through calling back some of the reservists (retired personnel), in addition to new recruits. The main increases are expected to be reflected in military salaries and wages and other items namely “materials and supplies”, in addition to the rise in capital spending mainly for army-related equipment. The additional military expenditures are estimated at **105 billion L.L. (US$ 70 million)** during the remainder of 2006.

23. Expenditures related to **relief efforts** include hospital charges for war-related injuries, and expenses incurred by the High Relief Council to accommodate the needs of refugees and compensation for the deceased, injured and disabled. Such expenditures are expected to reach approximately **70 billion L.L. (US$ 46 million)** in the remainder of the year.

24. Initiating the **reconstruction efforts** particularly those pertaining to basic needs such as main roads, bridges, in addition to rehabilitation of schools and hospitals requires significant additional spending. As a result of these costs, additional capital expenditures are expected to reach a minimum of **500 billion L.L. (US$ 330 million)** in 2006.

25. **Debt service** expenses are not expected to be impacted by the July hostilities during 2006. Based on available data as of end of July, debt service in 2006 is expected to reach **4,635 billion L.L. (US$ 3,075 million),** of which **2,375 billion L.L. (US$ 1,576 million)** is for local currency debt and **2,261 billion L.L. (US$ 1,500 million)** for foreign currency debt. The impact of the war on debt service will become evident starting 2007 when coupon payments are due for medium and long-term bonds.

26. **Electricité du Liban** is expected to incur significantly higher payments for the Treasury than initially projected during the remainder of 2006, due to the Utility’s inability to cover these payments from its own resources after the damages it has incurred because of the war. The main expected payments include:
    (a) Payment of amounts due for the purchase of fuel oil and gas oil through agreements with Sonatrach (Algeria) and Kuwait Petroleum Corporation (Kuwait) estimated in the amount of **744 billion L.L. (US$ 494 million)** by the end of 2006;
    (b) Arrears for fuel importers in the amounts of **210 billion L.L. (US$ 139 million)**;
    (c) Maturing concessional loans in the amount of **116 billion L.L. (US$ 77 million).**

27. The main impact of the war on expenses related to Electricité du Liban will be the Treasury’s payment of the company’s dues to Sonatrach (Algeria) and Kuwait Petroleum Corporation (Kuwait), due to the company’s expected incapability to perform them. In fact, in July 2006, the Treasury paid **US$ 131 million (198 billion L.L.)** of the **US$ 133 million (200 billion L.L.)** total due for the month. The assumption that Electricité du Liban will not be able to meet its part of the payments is based on the fact that Electricité du Liban has suffered damages amounting to approximately **US $114 million (172 billion L.L.)** in the areas of generation, transmission and distribution.

PROJECTED EXPENDITURES IN 2006

Table 5: Pre-War and Post-War Expenditure Projections (LL billion)

	2005	2006 (e) Pre-War	2006 (e) Post-War	Change 2006	Change 2006 %
Current expenditures, of which	**7,925**	**8,961**	**9,010**	**49**	**0.55%**
Personnel Cost	3,193	3,286	3,322	36	1.09%
Debt service	3,534	4,636	4,636	0	-0.02%
Consumption goods	213	165	173	8	5.01%
External services	82	90	90	-1	-1.01%
Other transfers	569	447	468	21	4.76%
of which NSSF	*290*	*150*	*150*	*0*	*0.00%*
Other current expenditures	258	261	252	-9	-3.53%
of which hospitals	*192*	*213*	*230*	*17*	*8.13%*
Capital expenditures	**534**	**564**	**1,122**	**558**	**98.84%**
Other treasury expenditures, of which	**1,477**	**1,701**	**2,359**	**658**	**38.70%**
Electricite du Liban	*833*	*1,136*	*1,433*	*297*	*26.14%*
Municipalities	*384*	*314*	*354*	*40*	*12.73%*
Higher Relief Council			*50*	*50*	
Total expenditures	**10,203**	**11,490**	**12,521**	**1,031**	**8.97%**

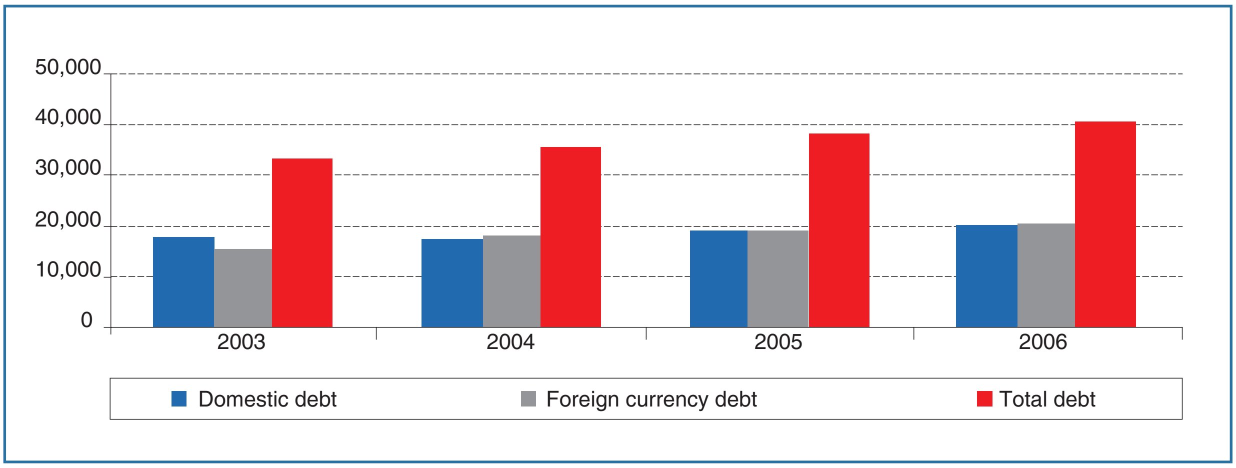
Source: Ministry of Finance:

DEBT GROWTH TRENDS IN 2006

28. Before the war, gross public debt was expected to stay below the **60,000 billion L.L. (US$ 40 billion)** mark at the end of 2006. This estimate did not take into consideration potential privatization revenues that would lower the debt stock. At the end of 2005, public debt stood at **58,031 billion L.L. (US$ 38.5 billion).**

29. The July 2006 war is expected to accelerate the growth of the debt owing to the expected increase in the overall deficit and the emergence of a primary deficit. The debt is therefore expected to reach **62,000 billion L.L. (around US$ 41 billion)** by the end of 2006.

Figure 5: Post-War Gross Public Debt Growth (2003-2006)



30. The war against Lebanon has generated a decline in investor confidence, and has raised refinancing risks in both local and foreign currencies. The Ministry of Finance succeeded in the first half of the financial year in issuing **US$ 750 million** and **175 million** worth of new Eurobonds, and in exchanging 71 percent of Eurobonds outstanding for 2006 **(US$ 1.7 billion)**. These issuances were executed at low coupon rates and long maturities[4], despite high yield rates prevalent in international financial markets at the time. The Ministry of Finance was planning to issue new Eurobonds in the financial markets towards the end of July. Due to the unforeseen developments, the anticipated transaction was not possible.

31. The Israeli war against Lebanon has lowered Lebanese Eurobond prices in secondary markets, and increased their yields. In fact, Eurobond spreads rose markedly when the conflict erupted, but have since declined. The average yield increased from 6.99% in end June to 7.63% on August 19.[5] This is a change in the spread over the 6-month Libor from 135 basis points to 216, an increase of 81 basis points, during this period, reflecting the heightened risk associated with these bonds. The international rating agencies FITCH and Standard and Poor's have emphasized these risks by revising Lebanon's credit outlook downwards after the war.

32. The negative repercussions of this war, most notably the deterioration of the primary surplus and the emergence of a primary deficit, are expected to lead to a significant increase in the overall deficit, and thus to accelerated debt growth. Coupled with the reluctance of local commercial banks to purchase Treasury Bills, this will result in additional interest payments whose financial impact would start appearing by the first half of 2007 at the latest.

4- 7.375% for April 2014 maturity, 8.25% for April 2021 maturity and 5.875% for Eurobond in € of April 2012 maturity
5- Weighted-average yield from Blominvest Bank

DEBT GROWTH TRENDS IN 2006

Box 3: Impact of July War on Monetary Indicators

The Balance of Payments as of end July 2006 registered a surplus of **US$ 1,373 million** as compared to **US$ 2,562 million** as of end-June 2006. In July 2006, the balance of payments registered a deficit of **US$ 1,189 million** due to a monthly **US$ 735 million** deficit from Banks and the **US$ 454 million** deficit from BDL.

The Dollarization level increased from 72.76% in June 2006 to 74.81% in July 2006. After Prime Minister Hariri's assassination the dollarization level peaked in March 2005 at 79.2% and then started to decline gradually in 2005 and 2006, to reach 72.52% in January 2006. The dollarization level remained almost stable until end-June 2006, to rise again due to July war.

Total private sector deposits were constantly increasing during 2006. However, by the end of July 2006 the trend reversed and private sector deposits registered **88,158 billion L.L. (US$ 58 billion)** down from **91,408 billion L.L. (US$ 61 billion)** in June 2006, a 3.55 percent decrease. As compared to July 2005, total private sector deposits are still higher by 8 percent. In May 2006 and June 2006 the growth rate of total sector deposits reached 1.43% and 1.55%, respectively. Note that in 2006 and before the war of July, the average monthly increase in total private sector deposits was about 1 percent.

Resident private sector deposits registered **74,061 billion L.L. (US$ 49 billion)** in July 2006, decreasing by 2.42 percent as compared to the month before, and increasing by 8.57% year on year.

As for non-resident deposits, they amounted to **14,097 billion L.L., (US$ 9 billion)** decreasing by 9.11% compared to the previous month, and increasing by nearly 5.1% year on year. In 2006 and before the war of July, the average monthly increase in non-resident private sector deposits was about 1.5 percent. Some resemblance can be inferred when comparing July 06 decline with March 2005, the month after Prime Minister Hariri's assassination, where non-resident deposits also decreased by 9.64%.

The M3 level in July 2006 was 1.89% lower than the previous month, and 7.98% higher than that of July 2005. After Prime Minister Hariri's assassination the M3 level also decreased by 1.5 percent when comparing March 2005 to February 2005.

Foreign exchange reserves ended the month of July 2006 at **US$ 10,563 million** down from **US$ 11,020 million** in June 2006, which was the highest level ever attained and constituted about 115 percent of imports.

Monetary Indicators

(LL Billion)	*June 2005*	*July 2005*	*June 2006*	*July 2006*	*% Change Jun-Jul 06*
M3	70,301	71,358	78,540	77,054	-1.89 %
Bank Deposits	80,034	81,632	91,408	88,158	-3.55 %
Deposits of Private Non-residents	12,615	13,414	15,510	14,097	-9.11 %
Dollarization rate (%)	74.51%	73.95%	72.76%	74.81%	-205

Source: Banque du Liban

APPENDIX I: FISCAL DATA AS OF JUNE 2006

Table A-1: Summary of Fiscal Performance

(LL Billion)	*2005 June*	*2006 June*	*2005 Jan-June*	*2006 Jan-June*	*Change 2005-2006*	*% Change*
Budget Revenue	543	390	3,327	3,877	550	16.5%
Budget Expenditures	933	854	3,653	4,098	444	12.2%
o/w Debt Service	*290*	*409*	*1,559*	*2,161*	*602*	*38.6%*
Budget Deficit/Surplus	**-390**	**-463**	**-327**	**-221**	**106**	**-32.4%**
in % of Budget Expenditures	-41.8%	-54.3%	-8.9%	-5.4%		
Budget Primary Deficit/Surplus	**-100**	**-54**	**1,232**	**1,940**	**708**	**57.5%**
in % of Budget Expenditures	-10.7%	-6.4%	33.7%	47.3%		
Treasury Receipts	25	25	206	186	-20	-9.5%
Treasury Payments	190	189	1,214	1,132	-82	-6.7%
Total Budget and Treasury Receipts	569	415	3,533	4,063	531	15.0%
Total Budget and Treasury Payments	1,123	1,043	4,867	5,230	363	7.5%
Total Cash Deficit/Surplus	**-554**	**-627**	**-1,335**	**-1,167**	**168**	**-12.6%**
in % of Total Expenditures	-49.4%	-60.2%	-27.4%	-22.3%		
Primary Deficit/Surplus	**-264**	**-218**	**224**	**994**	**770**	**343.6%**
in % of Total Expenditures	-23.5%	-20.9%	4.6%	19.0%		

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

Table A-2: Total Revenues

(LL Billion)	*June 2005*	*June 2005*	*Jan-June 2005*	*Jan-June 2006*	*% Change*
Budget Revenues, *of which*:	**543**	**390**	**3,327**	**3,877**	**16.5%**
Tax Revenues	*499*	*335*	*2,493*	*2,882*	*15.6%*
Non-Tax Revenues	*44*	*55*	*834*	*995*	*19.3%*
Treasury Receipts	**25**	**25**	**206**	**186**	**-9.5%**
Total Revenues	**569**	**415**	**3,533**	**4,063**	**15.0%**

Source: MOF, DGF

APPENDIX: FISCAL DATA AS OF JUNE 2006

Table A-3: Tax Revenues

(LL Billion)	*2005 June*	*2006 June*	*2005 Jan-June*	*2006 Jan-June*	*% Change*
Tax Revenues:	**499**	**337**	**2,493**	**2,882**	**15.6%**
Taxes on Income, Profits, & Capital Gains, *of which:*	**219**	**51**	**691**	**771**	**11.6%**
Income Tax on Profits	*181*	*12*	*353*	*397*	*12.5%*
Income Tax on Wages and Salaries	*4*	*3*	*102*	*104*	*1.3%*
Income Tax on Capital Gains & Dividends	*14*	*7*	*54*	*66*	*22.2%*
Tax on Interest Income (5%)	*19*	*28*	*173*	*194*	*12.0%*
Penalties on Income Tax	*1*	*1*	*6*	*9*	*33.3%*
Taxes on Property, *of which:*	**33**	**39**	**178**	**398**	**123.7%**
Built Property Tax	*5*	*6*	*50*	*63*	*25.9%*
Real Estate Registration Fees	*23*	*28*	*112*	*156*	*39.6%*
Domestic Taxes on Goods & Services, *of which:*	**121**	**133**	**866**	**995**	**15.0%**
Value Added Tax	*106*	*114*	*783*	*886*	*13.3%*
Other Taxes on Goods and Services, of which:	*15*	*19*	*79*	*100*	*27.8%*
Private Car Registration Fees	*10*	*13*	*47*	*65*	*38.0%*
Passenger Departure Tax	*5*	*7*	*31*	*35*	*12.9%*
Taxes on International Trade, *of which:*	**109**	**93**	**648**	**569**	**-12.2%**
Customs	*38*	*47*	*228*	*254*	*11.2%*
Excises, of which:	*71*	*46*	*420*	*315*	*-25.0%*
Petroleum Tax	*36*	*0*	*233*	*90*	*-61.5%*
Tobacco Tax	*18*	*17*	*91*	*93*	*3.2%*
Tax on Cars	*18*	*29*	*95*	*130*	*37.9%*
Other Tax Revenues (namely fiscal stamp fees)	**18**	**20**	**110**	**148**	**35.0%**

Table A-4: Non-Tax Revenues

(LL Billion)	*2005 June*	*2006 June*	*2005 Jan-June*	*2006 Jan-June*	*% Change*
Non-Tax Revenues	44	55	834	995	19.3%
Income from Public Institutions and Government Properties, *of which:*	**9**	**11**	**631**	**697**	**10.5%**
Income from Non-Financial Public Enterprises, *of which:*	*7*	*8*	*609*	*677*	*11.1%*
Revenues from Casino Du Liban	*4*	*4*	*31*	*21*	*-32.4%*
Revenues from Port of Beirut	*0*	*0*	*33*	*0*	*-100.0%*
Budget Surplus of National Lottery	*3*	*4*	*20*	*40*	*100.0%*
Transfer from the Telecom Surplus	*0*	*0*	*525*	*616*	*17.2%*
Property Income (namely rent of Rafic Hariri International Airport)	2	2	19	17	-10.1%
Other Income from Public Institutions (interests)	1	0	2	3	16.8%
Administrative Fees & Charges, *of which:*	**28**	**35**	**158**	**247**	**55.9%**
Administrative Fees, *of which:*	23	29	125	196	56.3%
Notary Fees	*1*	*2*	*8*	*10*	*19.9%*
Passport Fees/ Public Security	*8*	*10*	*40*	*59*	*46.6%*
Vehicle Control Fees	*9*	*10*	*55*	*94*	*71.9%*
Judicial Fees	*2*	*2*	*10*	*11*	*16.5%*
Driving License Fees	*1*	*3*	*6*	*13*	*103.1%*
Administrative Charges	1	1	9	9	-3.8%
Sales (Official Gazette and License Number)	0	0	1	2	18.8%
Permit Fees (mostly work permit fees)	3	5	19	32	68.5%
Other Administrative Fees & Charges	1	0	4	9	141.8%
Penalties & Confiscations	**0**	**1**	**2**	**3**	**77.0%**
Other Non-Tax Revenues (mostly retirement deductibles)	**7**	**8**	**43**	**48**	**11.2%**

Source: MOF, DGF

APPENDIX I: FISCAL DATA AS OF JUNE 2006

Table A-5: Expenditures by Transaction Classification

(LL Billion)	*2005 June*	*2006 June*	*2005 Jan-June*	*2006 Jan-June*	*% Change*
Total Expenditures	**1,123**	**1,043**	**4,867**	**5,230**	**7.5%**
Budget Expenditures	**933**	**854**	**3653**	**4,098**	**12.2%**
Expenditures Excluding Debt Service	643	445	2,095	1,937	-7.5%
Debt Service, of which:	290	409	1,559	2,161	38.6%
Local Currency Debt	*124*	*221*	*620*	*1,108*	*78.7%*
Foreign Currency Debt, of which:	*166*	*188*	*939*	*1,053*	*12.1%*
*Eurobond Coupon Interest**	*148*	*147*	*814*	*916*	*12.4%*
*Specialbond Coupon Interest**		*13*		*13*	
Concessional Loans Principal Payments	*14*	*23*	*74*	*78*	*6.2%*
Concessional Loans Interest Payments	*4*	*4*	*50*	*46*	*-9.3%*
Treasury Expenditures, *of which:*	**190**	**189**	**1214**	**1132**	**-6.7%**
Municipalities	*23*	*60*	*166*	*163*	*-1.7%*
Previous Years' Appropriations	*1*	*1*	*468*	*467*	*-0.1%*
Non-Interest Expenditures (Total Expenditures minus Debt Service)	**833**	**634**	**3,309**	**3,070**	**-7.2%**

Source: MOF, DGF

Table A-6: Expenditures by Economic Classification

(LL Billion)	*2005 Jan-June*	*2006 Jan-June*	*% Change*
1. Current expenditures	**3,861**	**4,299**	**11.3%**
1.a Personnel cost, *of which*	1,540	1,607	4.4%
Article 13: Salaries and wages	*1,030*	*1,056*	*2.5%*
Retirement and end of service compensations	*416*	*446*	*7.1%*
1.b Debt Service payments	1,559	2,161	38.6%
1.c Materials and supplies	121	71	-41.8%
1.d External services	43	53	22.0%
1.e Various transfers	434	247	-43.1%
o/w NSSF	*290*	*100*	*-65.5%*
1.f Other current	127	123	-3.4%
Hospitals	*79*	*105*	*32.5%*
Others	*48*	*17*	*-64.1%*
1.g Reserves (3)	37	38	3.7%
Interest subsidy	*37*	*38*	*3.7%*
2. Capital expenditures	**269**	**336**	**25.0%**
2.a Acquisitions of land, buildings, for the construction of roads, ports, airports, and water networks	3	11	252.6%
2.b Equipment	11	12	11.1%
2.c Construction in Progress	206	254	23.6%
2.d Maintenance	28	30	5.4%
2.e Other Expenditures Related to Fixed Capital Assets	21	29	37.5%
3. Other treasury expenditures, *of which*	**713**	**579**	**-18.8%**
Municipalities	166	163	-1.7%
EDL	295	151	-49.0%
Treasury advances for water authorities	48	0	-100.0%
Treasury advances for diesel oil subsidy	12	52	345.4%
Treasury advances for Telecom companies	15		
4. Unclassified expenditures	**3**	**1**	**-73.3%**
5. Customs cashiers	**21**	**15**	**-29.8%**
6. Total expenditures (excluding CDR foreign financed)	**4,867**	**5,230**	**7.5%**

Source: statement of account 36, cashier spending, Public Debt Department figures , Fiscal performance gross adjustment figures

APPENDIX I: FISCAL DATA AS OF JUNE 2006

Table A-7: Transfers to EDL

(LL Billion)	*2005 Jan-June*	*2006 Jan-June*	*% Change*
EDL *of which:*	**434**	**151**	**-65.3%**
Debt Service *of which:*	**113**	**112**	**-0.6%**
C-Loans and Eurobonds, *of which:*	113	96	-15.4%
Principal Repayment	77	68	-12.3%
Interest Payment	36	28	-21.9%
Loans for Fuel Oil Payment	0	17	100.0%
BDL Guaranteed Loan Payment	0	0	0.0%
Treasury Advance for Fuel Purchase	**127**	**0**	**0.0%**
Treasury Advance for EDL' s Losses	**55**	**0**	**0.0%**
Material and Supplies (Electricity bills)	**91**		**0.0%**
Treasury advance to Water Authorities	**48**	**0**	**-100.0%**
Payments of Sonatrach and Kuwait Oil Agreement[6]	**0**	**38**	**0.0%**
Expropriations	**0**	**0**	**0.0%**

Source: MOF, DGF

6-These payments cover principles and interests in relation to KPC (Kuwait Petroleum Corporation) and Sonatrach Petroleum Corporation.

Table A-8: Public Debt Outstanding by Holder as of End - June 2006

Assumes full LBP Replacement	*Dec-03*	*Dec-04*	*Dec-05*	*Jun-06*	*Change Dec 05 - June 06*	*% Change Dec 05 - June 06*
Gross Public debt	**50,285**	**54,048**	**58,018**	**58,524**	**506**	**0.87%**
Local currency debt	**26,843**	**26,371**	**29,141**	**28,556**	**-585**	**-2.01%**
a. Central Bank (including REPOs and Loans to EDL to finance fuel purchases)*	8,938	10,652	11,686	7,835	-3,851	-32.95%
b. Commercial Banks	12,303	12,220	14,130	16,910	2,780	19.67%
c. Other Local Currency Debt (T-bills)	5,603	3,500	3,325	3,811	486	14.62%
o/w Public entities	*2,564*	*2,187*	*2,446*	*2,957*	*511*	*20.89%*
Foreign currency debt	**23,442**	**27,677**	**28,877**	**29,968**	**1,091**	**3.78%**
Ratio to total debt	**46.6%**	**51.2%**	**49.8%**	**51.2%**		
a. Bilateral, Multilateral and Foreign Private sector loans	2,934	2,970	2,822	2,892	70	2.48%
b. Paris II related debt (Eurobonds and Loans)	3,731	3,814	3,682	3,748	66	1.79%
c. BDL Eurobond (Paris II)	2,819	2,819	2,819	2,819	0	0.00%
d. Market Eurobonds	13,631	17,686	18,729	19,684	955	5.10%
e. Accrued Interest on foreign currency debt	327	388	406	406	0	0.02%
f. Special Tbls in Foreign currency**			419	419	0	0.00%
Public sector deposits	**3,019**	**4,360**	**5,590**	**5,153**	**-437**	**-7.82%**
Net debt	**47,266**	**49,688**	**52,428**	**53,371**	**943**	**1.80%**
Gross Market debt* **	**29,638**	**31,861**	**34,759**	**38,451**	**3,692**	**10.62%**
% of total debt	**59%**	**59%**	**60%**	**66%**		

Source: Ministry of Finance, Banque du Liban
Notes:
* BDL has extended loans to EDL for the equivalent amount of US$ 300 million to purchase fuel oil. These loans are listed as Public debt as they are government guaranteed.
** Special Tbls in Foreign currency (expropriation bonds)
*** Gross market debt equals gross debt less the portfolios of the BDL, NSSF, bilateral and multilateral loans, and Paris II related debt.
**** Figures of Dec03 - Dec04 - Jan06 change because of exchange rate of Euro

APPENDIX II: UPDATED 2006 FISCAL PROJECTIONS

November 14, 2006

The Ministry of Finance has revised the end-year fiscal projections it had issued in August 2006, in the immediate aftermath of the July 2006 Israeli War on Lebanon.

Table 1: Comparison of 2006 end-year projections

(LL Billion)	*Total 2006 (expected as of November 2006)*	*Total 2006 (expected as of August 2006)*
Revenues	7,828	6,714
grants	*809*	
revenues excl grants	*7,020*	
Expenditures	12,598	12,521
Debt service	*4,635*	*4,636*
Primary exp	*7,963*	*7,885*
of which/disbursement from grants	*809*	
Deficit	**(4,770)**	**(5,808)**
Primary balance	**(-135)**	**(1,171)**

Source: Ministry of Finance estimates
Notes: The Ministry of Finance revised the year end 2006 estimates based on the most recent available data and updated war damage assessment figures. When the previous estimates were published in August 2006, only the first half of the year fiscal performance figures were available, the blockade was ongoing and there was still no clear view on damage assessment.

Total deficit and primary balance

The total deficit is expected to be lower than originally planned due to better revenues than expected back in August. The primary balance is also anticipated to reach a deficit of LL 135 billion whereas it was then thought to deteriorate to a deficit of LL 1,171 billion. Debt service was kept unchanged at LL 4,635 billion.

Revenues

On the revenue side the difference between the new projection of **LL 7,828 billion**[7] (based on January September revenue performance) and the **LL 6,714 billion** projected revenues at the outset of the war in the document entitled "Fiscal Impact of the July 2006 War" arises mainly from:

1. The early figure does not account for LL 809 billion **grants** received; LL 78 billion of which are direct transfer to the Treasury account 36 and are recorded as part of Treasury revenues.

2. **VAT** estimate for year-end turned out to be higher than anticipated immediately after the July 2006 war. While VAT revenues for QIII internal operations were projected at LL 80 billion, MOF received LL 104 billion and the declared amount is LL 131 billion[8]. Even for the second quarter, with which filing and payment date coincided with the beginning of the July war, and despite the installment scheme granted over four months (November and December 2006; February and March 2007), MOF nearly received 68 percent of the declared amount[9].

7- Revenues are accounted to be LL7,097 billion in the 2006 draft budget because they only include the LL78 billion grant received to the Treasury accounts. The other $500MN Saudi grant was deposited in a special account at the BDL.
8- In 2005 QIII, MOF received LL 144 billion and in 2004 QIII, MOF received LL 138 billion.
9- QII 2006 = LL142billion; QII 2005 = LL 113 billion; and QII 2004 = LL120 billion

3. **Higher projected revenues from car gasoline** due to the decrease in international oil prices. Back in August 2006, the Treasury had not collected excises from car gasoline for 3 months in a row. With the surprisingly lower than previously forecasted effective prices of car gasoline at imports, come September, the Treasury resumed its collection of excises. Today it is levying approximately LL 6,000 per 20 liters.

4. **Revenues from the Telecom Surplus** are projected to be higher because the initial forecast took assumptions of higher figures for damages and losses as a result of the war, as provided by the Ministry of Telecommunication.

5. **Port revenues** are expected to generate LL 50 billion to the Treasury. During the period of preparation of the document entitled "Fiscal Impact of the July 2006 War", the blockade was still ongoing and given damages to the Port of Beirut, the expectation was that the Treasury will not receive anything from that source.

Table 2: Immediate Post-War (August 2006) and Recent (November 2006) year end Revenue Projections

(LL Billion)	*2005*	*Expected 2006 August Projections*	*Expected 2006 Nov. Projections*	*% Change 2006*
Tax Revenues	**4,864**	**4,596**	**4,677**	**1.76%**
Taxes on Income Profits & Capital gains	1,047	1,120	1,110	-0.89%
Taxes on Property	414	637	556	-12.72%
Domestic Taxes on Goods & services	1,896	1,761	1,818	3.24%
Value Added Tax (VAT)	*1,693*	*1,565*	*1,625*	*3.83%*
Taxes on International Trade	1,268	828	933	12.68%
Excise	*787*	*448*	*533*	*18.97%*
Customs	*481*	*380*	*400*	*5.26%*
Other Tax Revenues (fiscal stamps)	241	250	260	4.00%
Non Tax Revenues	**2,116**	**1,695**	**1,980**	**16.81%**
Entrepreneurial & Property Income*	1,662	1,238	1,446	16.80%
Administrative Fees & Charges	365	367	443	20.71%
Treasury Revenues*	**421**	**423**	**362**	**-14.42%**
Grants			**809**	
Total Revenues	**7,401**	**6,714**	**7,828**	**16.59%**

Source: Ministry of Finance estimates
*Treasury Revenues figure for 2006 (based on September figures) are net of the LL 78 billion grants received directly to the Treasury Account 36. The total amount of grants is consolidated with the LL 809 billion.

APPENDIX II: UPDATED 2006 FISCAL PROJECTIONS

Expenditures

The difference (*LL 78 billion lower)* between the new projection for primary spending of **LL 7,963 billion** estimated in November 2006 (based on preliminary data till September 2006), and the **LL 7,885 billion** expected primary spending as reported in the document titled "Fiscal Impact of the July 2006 War" is mainly due to:

1. The early figure accounted for LL 500 billion for war-related spending, while the recently updated figure is in the order of LL 732 billion. However, this increase was partially offset by a slight reduction in non-war related capital spending, which, until October 2006, did not resume its pre-war average level. As a result, capital expenditures are expected to increase by LL99 billion.

2. Higher transfers than originally expected were reported to the Higher Relief Council, compared to what was expected immediately after the end of the war; at the time, it was estimated that this transfer will not exceed LL 50 billion. However, the entire LL78 billion received as grants to the Treasury were transferred to the HRC, on top of the treasury advances that were provided to the HRC earlier.

   Against this increase, some other items reported a drop relative to the early estimation, as suggested by the trends reported so far, for instance:

3. Higher spending was expected for hospitals in August projections, as a result of the mass war injuries received by these hospitals. As such, expenditures were assumed to rise by LL 30 billion compared to 2005. However realized figures until October 2006 suggest that spending on hospitals will exceed 2005 figures only by only 10 billion, noting that the latter figure is the estimated cost for covering war-related injuries.

4. The remaining regular spending witnessed a slowdown, with a higher magnitude than what was accounted for in the early estimate reported in the document entitled "Fiscal Impact of the July 2006 War".

5. The EDL transfer has been reduced by LL 31 billion. This is the net effect of two variables: The payment by EdL of 71 billion LL of fuel oil and gas oil purchases through a revolving loan (ULOC loan) and its own account, and the increase of fuel oil and gas oil purchase accruals for December by LL 50 billion.

Table 3. Immediate Post-War (August 2006) and Recent (November 2006) year end Expenditure Projections

(LL Billion)	*2005*	*Expected 2006 August Projections*	*Expected 2006 Nov. Projections*	*% Change 2006*
Current expenditures, of which	**7,925**	**9,010**	**8,952**	**-58%**
Personnel Cost	3,193	3,322	3,311	-11%
Debt service (1)	3,534	4,636	4,635	-1%
Consumption goods	213	173	154	-19%
External services	82	90	81	-9%
Other transfers	569	468	458	-10%
of which NSSF	*290*	*150*	*170*	*20%*
Other current expenditures	258	252	237	-15%
of which hospitals	*192*	*230*	*203*	*-27%*
Capital expenditures (2)	**534**	**1,122**	**1,242**	**120%**
War-related spending		*500*	*732*	*232%*
Other treasury expenditures, of which	**1,701**	**2,359**	**2,372**	**-13%**
Electricite du Liban (3)	*833*	*1,433*	*1,402*	*-31%*
Municipalities	*384*	*354*	*398*	*44%*
Higher Relief Council (war-related)		*50*	*99*	*49%*
Unclassified expenditures	**44**	**30**	**32**	**+2%**
Total expenditures	**10,203**	**12,521**	**12,598**	**+77%**

Source: Ministry of Finance estimates
Notes:
1) includes the principal payment of c-loans
2) excluding foreign financed capital expenditures
3) Transfers to EDL includes debt service payments related to EDL

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