

LEBANON'S DEBT MANAGEMENT FRAMEWORK FOR 2010-2015

MARCH 2010

DEBT MANAGEMENT FRAMEWORK FOR 2010-2015

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DEBT MANAGEMENT FRAMEWORK FOR 2010-2015

I. PURPOSE OF THE REPORT

"Debt Management Framework for 2010-2015" is the framework that should enable the Ministry of Finance (MOF) to identify and manage the trade-offs between expected cost and risk in the government debt portfolio. This document summarizes the government's debt management policy for 2010 in a medium-term framework and addresses debt sustainability, which lies at the heart of the government's medium-term economic reform program.

The objective of a debt management framework is to finance the government and meet servicing obligations, while minimizing cost, subject to containing risks. This will be served by the promotion and development of the domestic debt markets.

Sound debt management is crucial because it makes the government less vulnerable to (market-related) shocks. Furthermore, it demonstrates if and how debt management can be done more efficiently and which optimal combination of cost versus risk could be achieved within the constraints specific to the country. Finally, with these constraints explicitly identified, developing markets so as to minimize or remove some of the constraints will on one hand allow more efficient debt management, while at the same time improving the domestic capital market which would benefit the broader economy. All in all, a debt strategy framework will contribute to the credibility of the macro policy framework.

The debt framework is comprised of three main parts. The first part provides an overview of the legal and regulatory framework of debt management. The second part looks at the environment for the 2010-2015 debt framework, and describes the structure and related risks of the debt portfolio. Third part covers the targets of the debt management framework over the medium-term.

The data in the report is as of end-December 2009 unless where otherwise specified.

II. REGULATORY FRAMEWORK

1. INSTITUTIONAL SETUP

The Public Debt Directorate at the MoF has the mandate for public debt management. A modern Public Debt Directorate law (Nº 17) was ratified by Parliament in September 2008 to institutionalize debt management functions at the Ministry of Finance. Implementation decrees for this establishment are being developed.

Currently, the front office functions of a debt management office are divided between: (i) the Ministry of Finance that undertakes Eurobond issuances in international capital markets, (ii) the Council for Development and Reconstruction that is responsible for bilateral and multilateral project loans in line with its mandate; and (iii) Banque du Liban that is responsible for managing the domestic debt auctions.

The back office functions are located at the Ministry of Finance responsible for foreign currency debt and the Banque du Liban for domestic debt and bilateral multilateral project loans.

2. LEGAL FRAMEWORK

Under existing borrowing laws, the government has a standing authority to issue in foreign currency for refinancing principal maturities of Eurobonds, special T-Bills in foreign currency (FX) and budget support loans issued under the law 476. Remaining provisions under existing borrowing laws allow for financing new issuances up to USD 400 million. Any additional issuance in foreign currencies requires the ratification of a new borrowing authorization in foreign currency under the Budget 2010 or as a stand-alone law. All issuances in foreign currency debt will be authorized through a Council of Ministers resolution provided the availability of a law. The Ministry of Finance will be empowered to execute the transactions.

The legal framework for issuances in domestic currency pertains to an authorization granted by Article 5 of Budget 2005. The same article will be reiterated in Budget 2010.

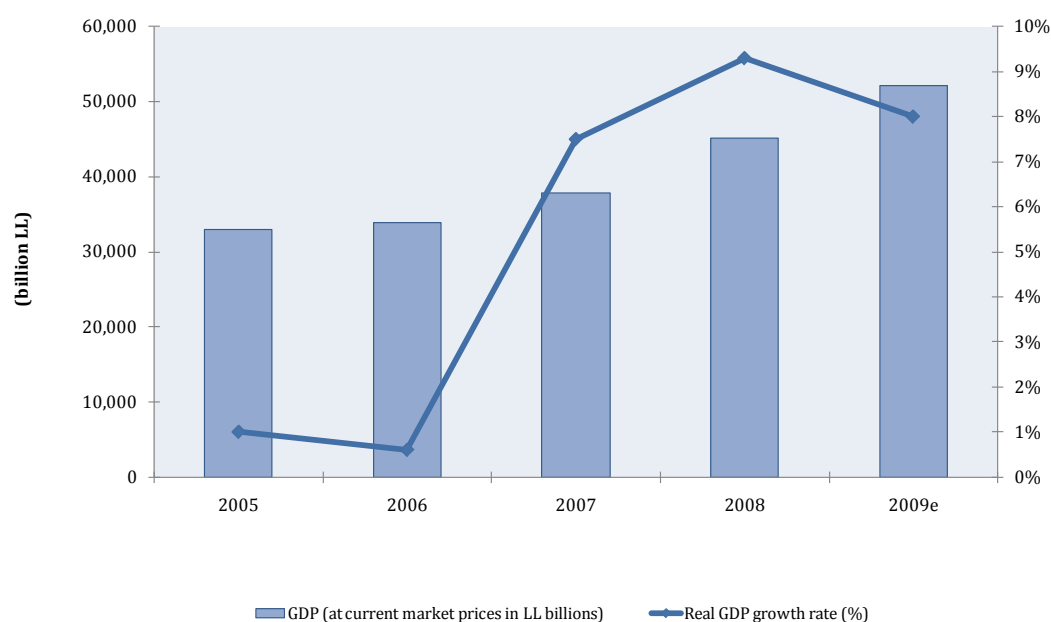
III. DEBT MANAGEMENT ENVIRONMENT IN 2010

A. MACROECONOMIC SITUATION

3. REAL GROWTH DEVELOPMENTS

The political and macroeconomic situation have improved over the last few years, with record growth levels achieved in 2007, 2008 and 2009. Driven by construction and tourism, real GDP achieved an average real growth rate of at least 7.5 percent for the last three consecutive years, following periods of much slower activity in 2005 and 2006. In fact, the global financial crisis and recession has had only a limited impact on the Lebanese economy.

FIGURE 1: GDP VS. REAL GDP GROWTH (2005-2009)



Source: 2005-2008 are National Accounts Committee figures; 2009 GDP real growth rate as per the Lebanese authorities' latest estimates.

4. INFLATION RATE DEVELOPMENTS

Meanwhile, in line with international price trends, inflation declined from a recent high of 10.8 percent in 2008 to 1.2 percent in 2009 on a period average basis (and 3.4 percent year-on-year in December 2009).

TABLE 1: BASIC INFLATION RATE (CPI) (CONSUMER PRICES PERIOD AVERAGE) (2005-2009)

	2005	2006	2007	2008	2009
Basic Inflation rate (CPI) (consumer prices period average)	-0.7%	5.6%	4.1%	10.8%	1.2%

Source: Central Administration of Statistics, International Monetary Fund

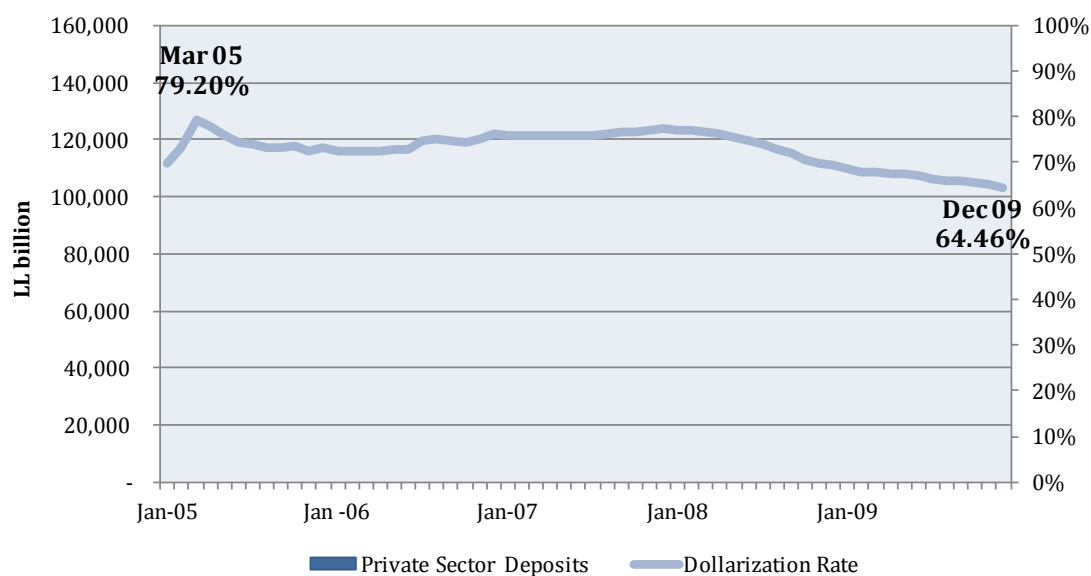
5. MONETARY AND BANKING INDICATORS

Meanwhile, **monetary indicators** witnessed a growth in 2009. **M5^[1]** (broad money) stood at LL 148,716 billion at end-December 2009, about 23 percent higher than end-December 2008 at LL 120,850 billion. While it grew by 6 percent in 2006, the rate of growth of M5 accelerated gradually to 11 percent in 2007 and 15 percent in 2008, to reach its peak in 2009. **Foreign exchange reserves** attained an exceptionally high level of US\$ 25.7 billion by the end of 2009, more than doubling when compared to their June 2008 levels and registering a 161 percent increase from the December 2005 level of US\$ 9.84 billion. The increase of foreign exchange reserves is coupled with a de-dollarization trend witnessed since December 2007 with **dollarization of deposits** down to 64.46 percent compared to the highest dollarization rate witnessed in March 2005 at 79.2 percent.

^[1] M5 is equal to M3 (resident deposits in LL and FX, bonds, and currency in circulation) plus non-resident deposits in LL and FX.

FIGURE 2: MONTHLY DOLLARIZATION RATES AND PRIVATE SECTOR DEPOSITS

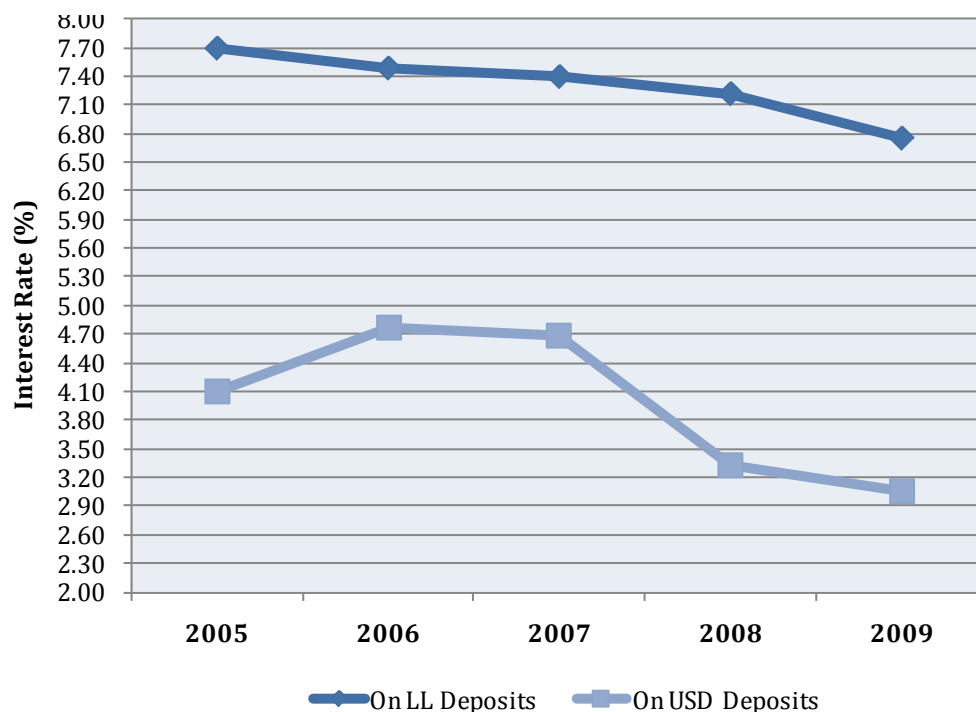
(JAN 05 – DEC 09)



Source: Ministry of Finance, Banque du Liban

At the same time, the banking sector remained in a strong position. **Private sector bank deposits** achieved a positive and rapidly accelerating growth of 7 percent, 11 percent and 16 percent in December 2006, 2007 and 2008, respectively; thus leveling at a notable peak of LL 144,367 billion in December 2009. On a year-on-year basis (Dec 09- Dec 08), the same indicator registered a remarkable increase of about 23.1 percent and up by 68 percent from the December 2005 level of LL 85,906 billion. Since December 2005, private sector bank deposits have been increasing by 14 percent on average.

FIGURE 3: AVERAGE RATES ON DEPOSITS (2005-2009)



Source: Ministry of Finance, Banque du Liban

6. INTEREST RATES

Interest rates maintained a downward trend. Average commercial bank rates on LL deposits slightly decreased to 6.75 percent in December 2009, thus dropping by 47 bps, from 7.22 percent December 2008, and 95 bps, from 7.70 percent in December 2005. Average rates on US\$ deposits decreased by 28 bps to 3.05 percent in December 2009 from 3.33 percent in December 2008 and 104 bps, from 4.09 percent in December 2005.

Yields on Treasury bills and bonds as auctioned in the primary market are at historically low levels with the most recent decreasing yield trend since June 2008. In particular, primary market rates on Treasury bills and bonds continued their downward trend across all maturities in 2009. The highest decrease in rates was seen for the 24-month instrument whose rate went down by 194 bps since year-end 2008 to reach 6.32 percent at end- 2009. The 36-month instrument's rate went down by 190 bps during the same period reaching 7.10 percent at end 2009.

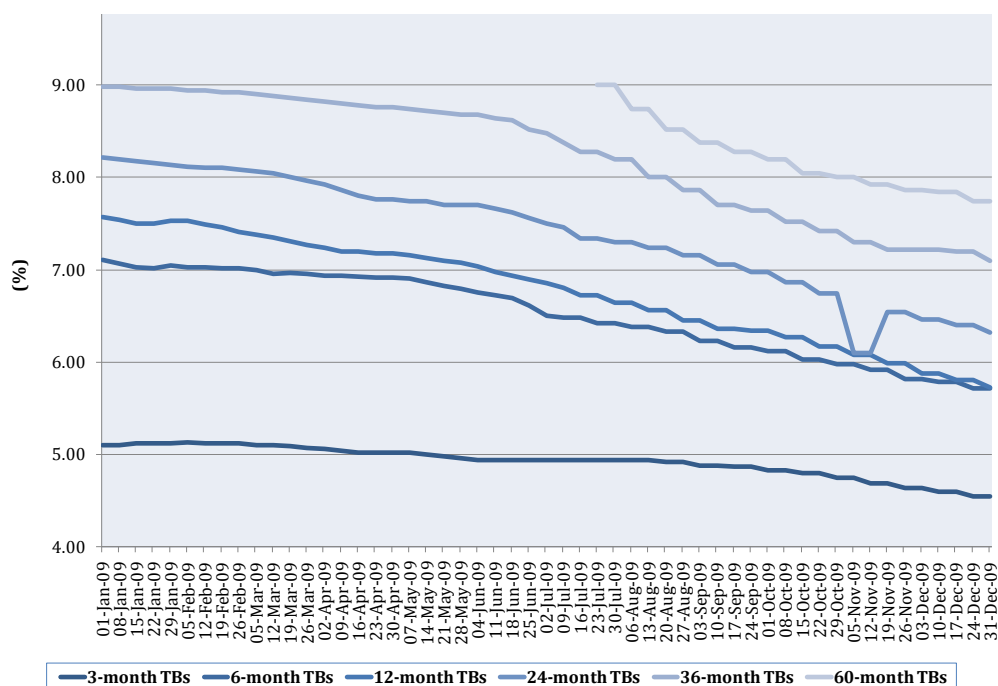
TABLE 2: EVOLUTION OF TREASURY BILL YIELDS (2005-2009)

Maturity	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2007	Dec. 31, 2008	Dec. 31, 2009
3-month	5.22 percent	5.22 percent	5.22 percent	5.10 percent	4.55 percent
6-month	7.24 percent	7.24 percent	7.24 percent	7.10 percent	5.72 percent
12-month	7.75 percent	7.75 percent	7.75 percent	7.58 percent	5.73 percent
24-month	8.50 percent	8.50 percent	8.50 percent	8.26 percent	6.32 percent
36-month	9.34 percent	9.32 percent	9.32 percent	9.00 percent	7.10 percent
60-month⁽¹⁾	N/A	N/A	N/A	N/A	7.74 percent

Source: Ministry of Finance

(1) 60-month Treasury bonds were issued as part of the Treasury Bill Auction Process as of the week of July 20, 2009 (value date 23 July 2009).

FIGURE 4: YIELDS ON TBS (JANUARY TO DECEMBER 2009)



Source: MoF

B. FISCAL OUTLOOK 2010 AND BEYOND

One of the Government's main objectives is to **maintain a gradual decline of the debt to GDP ratio**. Helped by fiscal consolidation and a positive overall environment, the debt to GDP ratio has declined from 180 percent by the end of 2006 to 148 percent by the end of 2009. The declining path of the debt to GDP ratio should be preserved over the medium term. Meanwhile, Lebanon remains vulnerable to shocks such as higher interest rates and lower growth. Hence, a careful and safe borrowing strategy is needed along with fiscal consolidation.

The primary balance on a cash basis is expected to reach **LL 154 billion** by the end of 2010¹, equivalent to 0.27 percent of GDP, deteriorating from a high of 2.5 percent achieved by the end of 2009. Under this base scenario, interest payments are projected to reach 10.8 percent of GDP in 2010, declining when compared with the performance of 2009, based on a continuation of the gradually declining interest rates and in line with the existing pre-funding levels. As a result, net financing requirement is expected to reach LL 5,929 billion or 10.5 percent of GDP by the end of 2010. Over the medium term, assuming that interest rate for new borrowing remains at their 2010 level, the primary balance will remain at almost the same level in 2011, but will jump to 2.4 percent in 2012. Net financing requirements will also stabilize in 2011 at 10.1 percent of GDP and decrease to 7.6 percent of GDP in 2012 as a result of an improved primary balance and a stabilization of the debt to GDP ratio.

TABLE 3: MEDIUM-TERM FISCAL BALANCES

(LL billion)	2007	2008	2009	2010e	2011e	2012e
Total Revenues & Grants	8,747	10,554	12,702	13,780	14,734	15,654
Primary expenditures	8,718	10,238	11,388	13,626	14,574	14,135
Total Expenditures	13,413	15,195	17,172	19,709	20,862	20,551
Primary Balance	29	316	1,314	154	160	1,519
Overall Balance	-4,666	-4,641	-4,470	-5,929	-6,128	-4,897
Primary Balance (in % of GDP)	0.08%	0.70%	2.5%	0.27%	0.26%	2.36%
Overall balance or Net financing	-12.4%	-10.3%	-8.6%	-10.5%	-10.1%	-7.6%

Source: Ministry of Finance

¹ Based on scenario of April 1st, 2010 reflecting the execution on cash basis of the 2010 Budget proposal – Concessional loans repayment for Project Loans are not included unlike budget presentation.

C. DEBT STRUCTURE

1. DEBT STOCK AND DEBT TO GDP RATIO

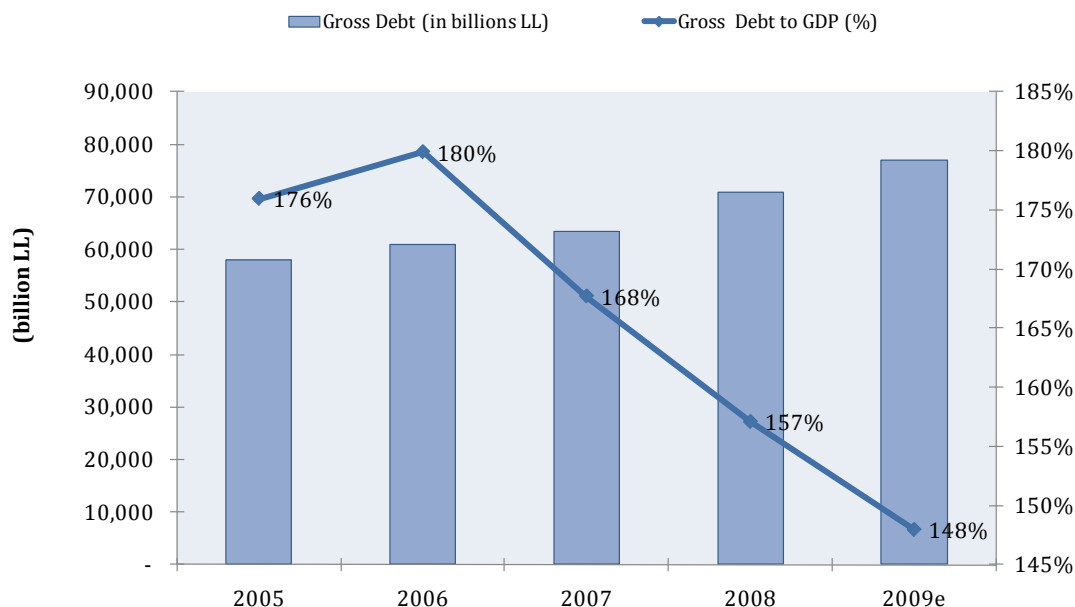
As of end-2009, gross public debt reached LL 77,019 billion (US\$ 51.09 billion), an 8.7 percent increase of the end-December 2008 stock, led by a 15 percent increase in domestic currency debt to LL 44,973 billion.

Since a high of 180 percent end-2006, the debt to GDP ratio has been on a consistent decline attaining 157 percent as of end-2008 and 148 percent as of end-2009 (Refer to Figure 5). The decrease in the debt to GDP ratio has been due to a number of factors including healthy GDP growth estimated at 9.3 percent in 2008 and 8.0 percent in 2009 (Refer to Figure 1). Additionally, the decrease in the debt to GDP ratio has been a result of primary surpluses as of 2007 due to the Government's fiscal consolidation policy and overall positive environment with primary surpluses of 0.7 percent of GDP in 2008 and 2.5 percent in 2009. This contrasted with the spike in the debt to GDP ratio in 2006 to 180 percent following the ratio's stabilization around 165 percent in the period 2002-2004 and increase to 176 percent in 2005. Political and security incidents since the assassination of former Prime Minister Rafic Hariri in February 2005 and the July 2006 War which had serious repercussions on public finances², resulted in unfavorable environments and a primary deficit in 2006 (although contained at -0.02 percent of GDP), negating improvements in the debt to GDP ratio till then and as a result of the Paris II Donor Conference.

It is expected that the debt stock will slightly decline to 147 percent of GDP by end-2010, reaching around US\$ 55 billion. This slow decline will break away from the sharp decrease which was witnessed since 2006. In the medium term, the debt to GDP ratio is expected to slightly decline in 2011 and to reach 145 percent in 2012.

² Kindly refer to the publication entitled "Impact of the July War on Public Finances 2006" on the MOF website

FIGURE 5: GDP AND GROSS DEBT TO GDP (2005-2009)



Source: MOF, BDL; Note: 2009 GDP figure estimate based on Lebanese authorities' latest estimates for GDP growth.

TABLE 4: EVOLUTION OF GROSS DEBT IN PERCENT OF GDP (2007-2012)

(LL billion)	2007	2008	2009	2010e	2011e	2012e
Gross Debt	63,364	70,888	77,019	83,054	88,900	93,252
GDP	37,774	45,124	52,051	56,406	60,422	64,404
Gross Debt in % of GDP	167.8%	157.1%	148.0%	147.2%	147.1%	144.8%

Source: Ministry of Finance; GDP 2007-2008 National Accounts Committee; 2009-2012 are estimates.

2. COMPOSITION OF DEBT

The currency composition of the outstanding stock of debt as of end-2009 was 58 percent in domestic currency debt with the remaining 42 percent in foreign currency debt composed of USD-denominated debt (36 percent of outstanding stock) and Euro-denominated debt (4 percent of outstanding stock) (Refer to Figure 6). The share of domestic currency debt has increased since 2007 and reflects a decrease in the foreign currency risk on the debt

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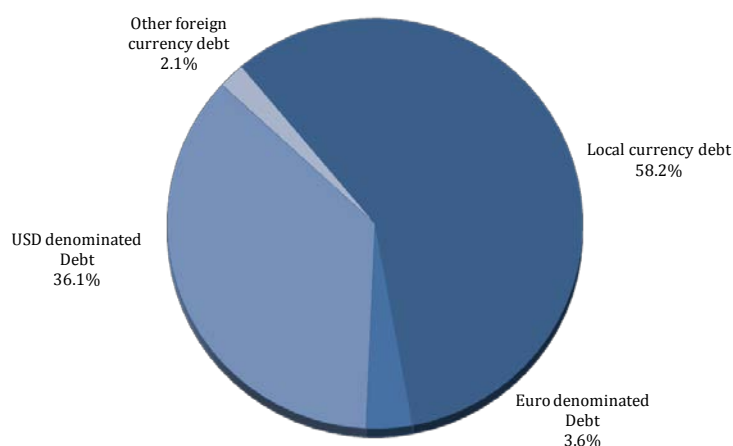
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portfolio. Over the period 2005-2007, the share of domestic currency debt was 50 percent in each of those years and increased to 55 percent in 2008 following increased liquidity in domestic currency, de-dollarization of deposits leading to greater demand for Treasury bills and bonds and a pre-funding policy by the government. The highest share of foreign currency debt was 51 percent in 2004. Prior to this, the share of domestic currency debt was on a consistently declining trend from 89 percent in 1993, with a notable 9 percent reduction in share from 66 percent end-2001 to 54 percent end-2002 as a result of the debt restructuring and reduction in interest rates related to the Paris II Donor

FIGURE 6: OUTSTANDING DEBT BY CURRENCY COMPOSITION (AS OF END DECEMBER 2009)
Conference.



Source: MoF

Note: Excluding accrued interest.

3. HOLDERS OF DEBT

As of end-2009, Lebanese commercial banks held 58 percent of total debt outstanding (LL and FX)³. The remaining 42 percent of the Republic's debt is held by other market and non-market holders including multilateral and bilateral entities, the central bank, public entities

³ This figure was calculated based on the "claims on the public sector" from the commercial banks consolidated balance sheet divided by the stock of gross debt (excluding accrued interest) as of end-2009.

and financial institutions, and the public. The holders of debt by currency of debt are as follows:

- ⇒ 61 percent of local currency debt is held by commercial banks, and 23 percent is held by the Central Bank. The other holders of domestic currency debt are mainly public entities who hold 13.5 percent of domestic currency debt. The remaining amount of outstanding stock is held by the resident and non-resident public and financial institutions.
- ⇒ 68 percent of foreign currency debt is market-issued Eurobonds. Debt that was issued in the context of the Paris II International Donor Conference to Lebanon (loans and Eurobonds) makes up 15 percent of the foreign currency debt stock.⁴ Eurobonds and loans issued in the context of the Paris III International Donor Conference to Lebanon constitute 6.1 percent of foreign currency debt. This is made up of a Eurobond issued to Malaysia as part of its Paris III contribution and loans consisting of a US\$ 100 IBRD loan, a US\$ 300 million loan from the UAE, the first tranche of a French loan received in February 2008 (€150 million), a total of SDR 76.13 million under the IMF's policies for EPCA⁵ I and II, the first tranche of an EC/EU loan (€25 million) and a US\$ 32 million loan from the AMF. U.S. Dollar-denominated bonds issued in satisfaction of expropriation claims make up 1.4 percent of the stock of foreign currency debt. Similarly, accrued interest constitutes the remaining 1.4 percent.

4. PATH OF INTEREST PAYMENTS

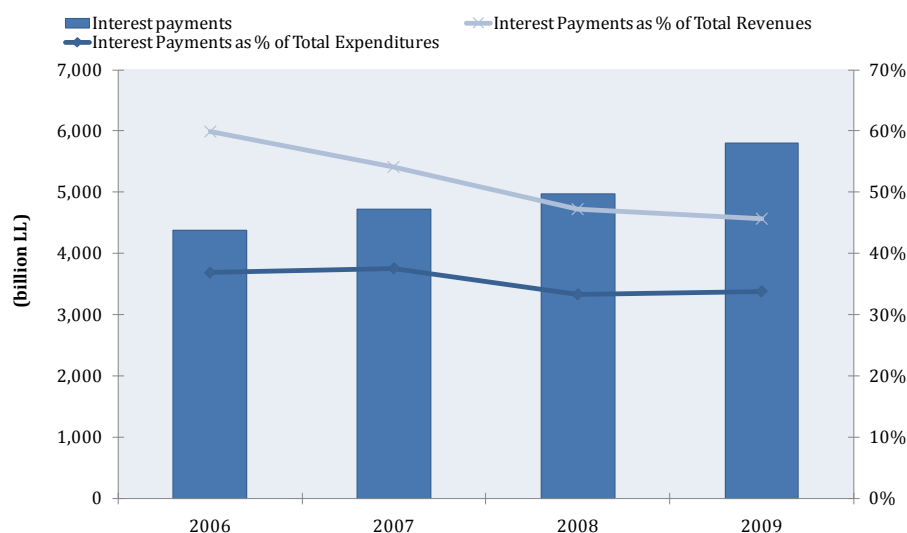
Interest payments⁶ in 2009 totaled LL 5,799 billion, a 16.5 percent increase from 2008 mostly driven by an increase in the stock of domestic currency treasury bills. Although interest payments have been increasing in value since 2006, their proportion relative to total expenditures and to total revenues have decreased, particularly with regards to the latter. In 2006, interest payments constituted 60 percent of total revenues decreasing to 45.6 percent by end-2009. In parallel, primary market interest rates have been on a decreasing trend since June 2008 [Refer to Section III. A. 6.]

⁴ The Eurobonds issued in the context of Paris II have an amortized repayment structure and are redeemable in 20 equal semiannual payments starting from year 6 (grace period 5 years from issue date). This includes a Eurobond originally issued at USD 1,870 billion.

⁵ EPCA being the Emergency Post-Conflict Assistance programs

⁶ Interest payments include interest payments to EDL.

FIGURE 7: INTEREST PAYMENTS (2006-2009)



Source: Ministry of Finance.

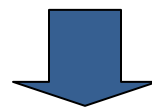
Note: Interest payments include interest payments to EDL.

5. DEBT PAYMENTS FOR 2010

Total committed debt payments for the period January – December 2010 are expected to reach LL 23,940 billion (US\$ 15.9 billion) subdivided as follows:



Treasury bill principal and interest:
LL 17,487 billion (US\$ 11.6 billion) of
which almost 57 percent are held
with the market.



Eurobonds, C-loans and Special T-
bills: LL 6,453 billion (US\$ 4.3
billion).

TABLE 5: COMMITTED DEBT PAYMENTS FOR 2010

<i>LL billion</i>	Quarter I 2010	Quarter II 2010	Quarter III 2010	Quarter IV 2010	Total 2010
Total Debt payments	5,596	5,395	6,283	6,667	23,940
Debt service payments in LL (TBs & Bonds)	3,230	4,448	5,528	4,281	17,487
Principal maturities	2,379	3,615	4,586	3,523	14,103
Coupon	851	833	942	758	3,384
Debt payments in foreign currencies	2,366	947	755	2,386	6,453
Eurobonds	2,127	771	477	1,754	5,130
Eurobond principal	1,681	215	75	1,271	3,242
Eurobond coupon	447	556	402	483	1,888
Expropriation Bond	2	12	2	431	446
Principal	-	-	-	419	419
Interest	2	12	2	12	27
Concessional loans^{2/}	237	163	276	201	877
Principal	180	102	218	140	641
Interest	57	61	58	60	236

Note: Treasury bills with maturities less than 24 months are issued at a discount to their face value.

Coupons represent interest on treasury bills of 24 months or greater maturity.

Source: Ministry of Finance, data as of December 2009

6. TREASURY ACCOUNT BALANCES

The total available balance at the treasury accounts (Ministry of Finance Treasury and Debt accounts) as of end December 2009 equaled LL 5,159 billion.

According to the cash treasury balances as of end December 2009, the aggregate prefunding level for debt maturities in both currencies are sufficient to finance until the end of February 2010.

D. RISK ASSOCIATED WITH THE DEBT PROFILE

The debt burden may be evaluated on the basis of various criteria. The debt to GDP ratio is one of the most important indicators. At 148 percent of GDP by end 2009, Lebanon's debt to GDP is high when compared to comparable emerging market sovereigns. Interest expenditures to GDP may be viewed as a second indicator. By the end of 2009, it stood at 11.2 percent. During the next three years, it is projected to gradually decline to around 10.4 percent. However, these levels depend on public finance policies as well as on interest rates prevailing in international capital markets, and their pass-through on domestic yields.

Based on these indicators and the debt structure, several key risks may be inferred which should be kept in mind when objectives are set for debt management.

1. ROLLOVER RISK

Rollover risk is associated with the issuance of debt to cover the repayment of already existing debt. It applies to two main factors:

- The opportunity of accumulating the required funds
- The price of financing
- The degree of risk is a function of the volume of debt payments and their amortization over time.

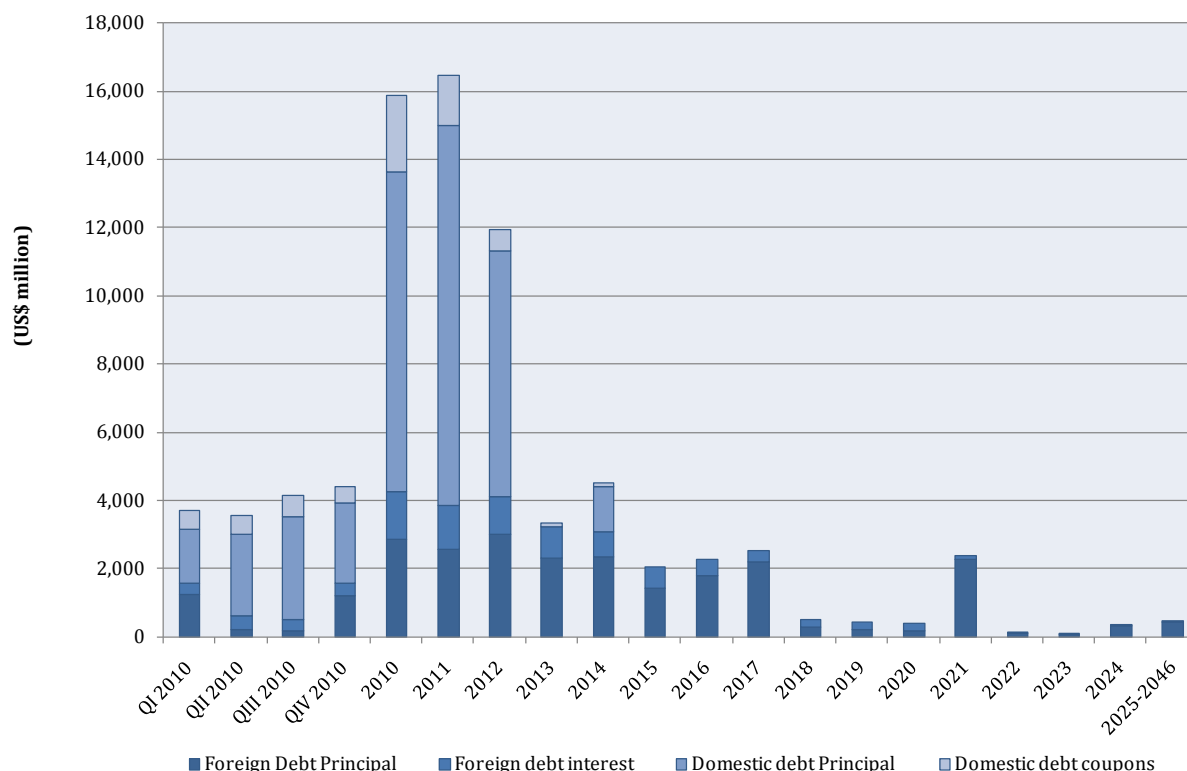
The Lebanese Republic's debt portfolio is amortized until 2046 with a maturity extension achieved through the concessional borrowing as well as Paris II and III financings, although there is some bunching of maturities over the period 2010-2012. The debt stock has an average time to maturity of 2.9 years. The percentage of debt falling due within a year is 24 percent, whereas the percentage of debt falling due within two years is 51 percent.

Domestic currency debt is due over the period 2010-2014 with an average time maturity of 1.6 years. A third of the domestic currency debt is falling due within a year, and 72 percent within two years. This reflects the spike in domestic currency debt due in 2011 when principal redemptions as of end-2009 at LL 16,803 billion.

On the foreign currency debt front, amortization of concessional loans is till 2046 due to their expected disbursement with the longest dated Eurobond due in 2024. Foreign currency debt is longer-dated than the domestic currency debt portfolio with an average time to maturity of 4.6 years. The percentage of foreign currency debt due in one year is 13

percent, rising to a 25 percent due in two years. As of end-2009, the highest foreign currency debt principal amounts due in a single year is in 2012 at US\$ 3,021 million.

FIGURE 8: AMORTIZATION SCHEDULE OF OUTSTANDING DEBT AS OF END 2009



Source: Ministry of Finance

2. MARKET RISK:

Market risk is associated with the movement of the foreign exchange rates and interest rates on the domestic and foreign currency debt.

2.1 Currency risk:

The exposure to foreign currency debt stands at around 42 percent of total debt, albeit declining over the past few years; it has in fact declined from a high of 51 percent in 2004. However, out of this 42 percent, 86 percent is debt denominated in USD which poses lower risk for the government than other foreign currencies as the LBP is pegged to the USD. This

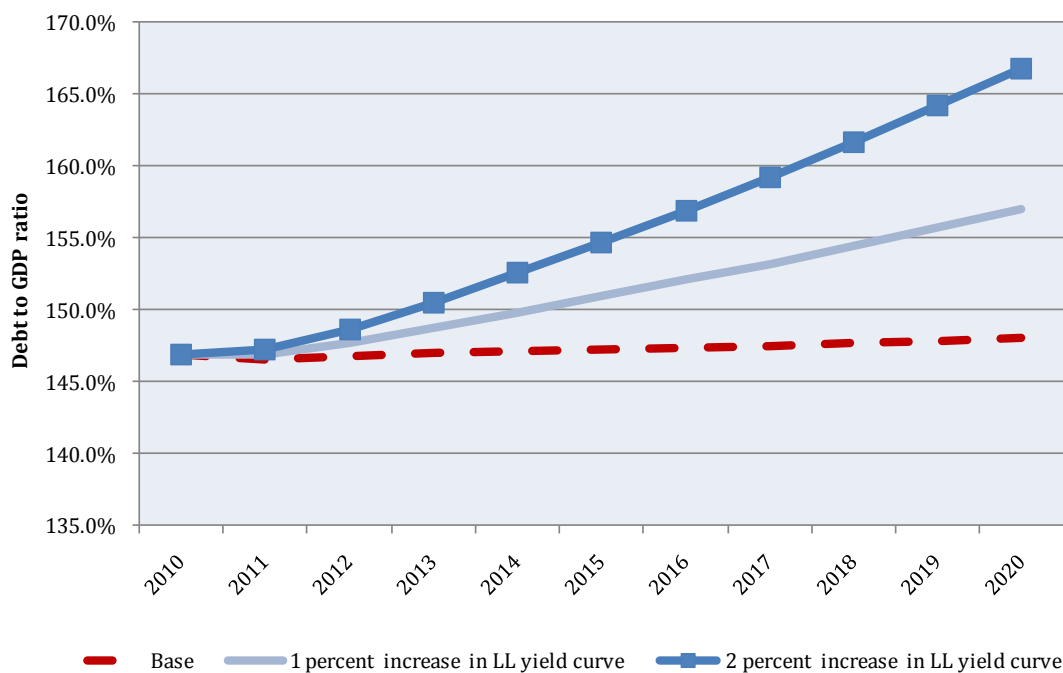
ratio needs to be closely monitored given that only part of government revenues is denominated in foreign currencies.

Since September 1999, BDL has maintained its policy of pegging the value of the Lebanese Pound to the U.S. Dollar at a fixed rate of LL 1,507.5 per U.S.\$1.00.

2.2 Interest rate risk:

Although MOF has been issuing three and five year treasury bonds, the domestic debt portfolio still has a short duration of 1.5 years and average time to re-fixing of 1.6 years, which means that debt servicing payments and therefore fiscal deficits are highly exposed to changes in domestic yields. To illustrate, a one percent increase in the LL yield curve will lead to an increase in the debt to GDP ratios in the order of 10 percentage points of GDP over a ten year period. Similarly, a two percent increase will trigger a worsening in debt to GDP by 20 percent over the same period of time.

FIGURE 9: SIMULATIONS OF AN INCREASE IN THE LL YIELD CURVE ON DEBT TO GDP



Source: Ministry of Finance

TABLE 6: RISK INDICATORS FOR GOVERNMENT, DEBT, PROJECTED AS OF END - DECEMBER 2009

	Domestic	Foreign	Total
Outstanding debt in trillion LBP^{1/}	44,973	32,046	77,019
Outstanding debt billion USD	29.8	21.3	51.1
Debt to GDP^{2/}	86.4 %	61.6%	148.0%
Market risk			
Share of foreign debt	-	-	42%
Duration, years	1.5	3.6	2.4
Average time to re-fixing, years	1.6	4.6	2.9
Rollover risk			
Average time to maturity, years	1.6	4.6	2.9
% of debt falling due within 12 months	33%	13%	24%
% of debt falling due within 24 months	72%	25%	51%

1/ Excluding accrued interest and BDL Loan for EDL and other loans central government.

3. LIQUIDITY RISK

Liquidity risk is associated with the possibility of meeting short-term obligations and expenditures. In practice a level of buffer reserves is maintained above the minimum financing short-term needs to withstand (a) the risk of exogenous shocks to the system, including political instability; and (b) the need to improve cash management.

4. RISK ASSOCIATED WITH CONTINGENT LIABILITIES

At present, government guaranteed debt is integrated in the stock of debt and stands at US\$ 193 million. This debt represents a loan extended in 2003 by BDL to the EDL. In addition, to this loan the government guarantees the fuel oil and gasoil purchases for the EDL. This is due to the inability of the loss making electricity company to meet its financing needs.

5. THE COST/ RISK TRADEOFF

The impact of cost and risk tradeoffs can be illustrated by **five scenarios** reflecting different currencies and maturities borrowing mix [Refer to Box 1].

- ⇒ The first scenario reflects a borrowing mix based on LL short term instrument. The results for 2012 show that the Average Time to Maturity (ATM) will drop to 2.2 years in 2012 with an interest cost⁷ of 6.4 percent.
- ⇒ The second scenario is based on LL medium term instruments. This would increase the ATM to 3.9 years along with a rise in the interest cost to reach 7.4 percent in 2012.
- ⇒ The remaining three scenarios are a combination of currencies (USD and LL) and maturities mixtures (short to medium term LL instruments versus Short to long term USD instruments). When borrowing is made through a mixture of foreign currency and Lebanese lira instruments, the cost and risk indicators will depend on the maturity of each instrument. In summary, the ATM will vary within a range of 3.0 to 5.8 years while interest cost will be contained between 6.6 percent and 7.2 percent.

Box 1: LIST OF COST-RISK TRADEOFF SCENARIOS

Scenario 1: Borrowing mix based on LL short term instrument only.

Scenario 2: Borrowing mix based on LL medium- term instrument only.

Scenario 3: Borrowing mix based on a 50 percent domestic LT (5- years) and 50 percent of foreign ST (3 years).

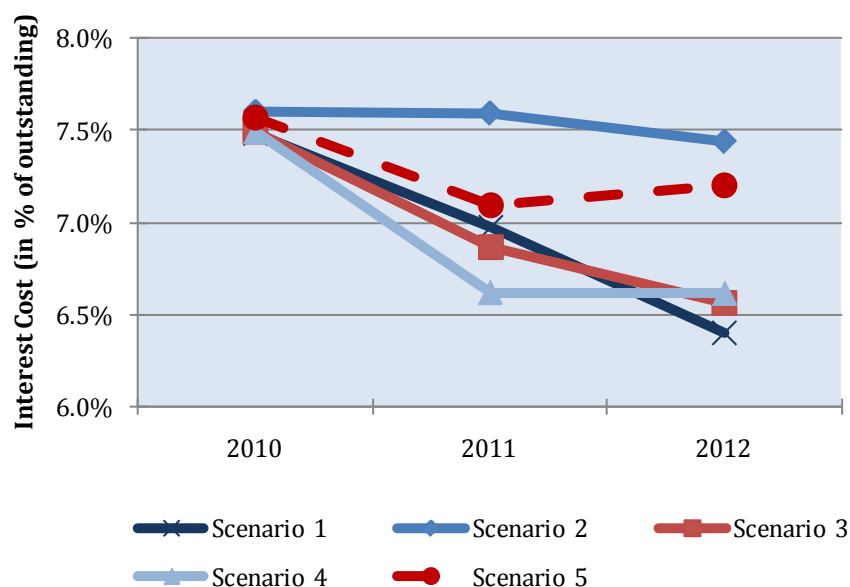
Scenario 4: Borrowing mix based on a 50 percent domestic ST (1- year) and 50 percent of foreign LT (10 years).

Scenario 5: Borrowing mix based on a 50 percent domestic LT (5 years) and 50 percent of foreign LT (10 years).

⁷ Interest cost is calculated as interest payments divided by the debt stock.

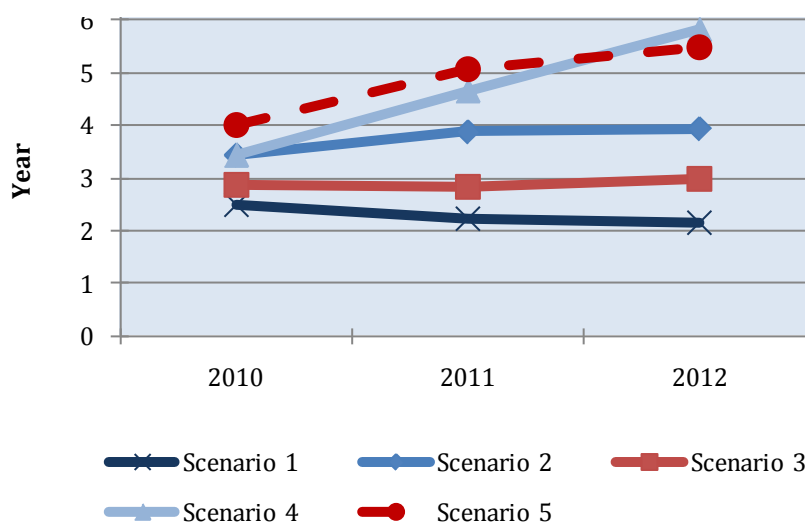
THE RISKS LISTED ABOVE ARE NOT EXHAUSTIVE, BUT ILLUSTRATE THE MAIN PROBLEMS ASSOCIATED WITH THE DEBT AND PROVIDE THE BASIS FOR SETTING DEBT MANAGEMENT OBJECTIVES.

FIGURE 10: SIMULATIONS FOR INTEREST COST IN PERCENT OF OUTSTANDING



Source: Ministry of Finance

FIGURE 11: SIMULATIONS FOR AVERAGE TIME TO MATURITY (ATM)



Source: Ministry of Finance

IV. TARGETS OF THE DEBT MANAGEMENT FRAMEWORK OVER THE MEDIUM-TERM

TABLE 7: TARGETS RISK INDICATORS FOR GOVERNMENT DEBT(2010-2015)

	2010 (projection)	2012 (projection)	2015 (medium term targets)
Market risk			
Share of foreign debt	41%	37%	< 40%
Duration, years	2.4	2.5	>2.5
Average time to re-fixing, years	3.0	3.1	2.2<ATM <3.0
Rollover risk			
Average time to maturity, years	3.0	3.1	>2.5
% of debt falling due within 12 months	30%	22%	25-30%
% of debt falling due within 24 months	44%	45%	>50%

Source: Ministry of Finance

The debt strategy framework is based on the expected macroeconomic context as of March 2010 and relies exclusively on market principles. It is also anchored in a continued relationship with market participants on the basis of a high degree of transparency.

Taking into account the risk profile of government debt, there are five main objectives for the debt management framework over the medium-term:

1. REDUCE RE-FINANCING RISK THROUGH MAINTAINING A SMOOTH REPAYMENT PROFILE

The amortization schedule of interest and principal maturities over the three-year period (refer to Figure 7) implies a careful distribution of debt service repayments for new borrowings. This can be achieved by improving the redemption profile of the overall public debt through active liability management operations.

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2. REDUCE THE ROLLOVER RISK BY LENGTHENING THE AVERAGE MATURITY OF THE DEBT PORTFOLIO

As of end-December 2009, the debt portfolio had an average time to maturity (ATM) of 2.9 years, with the domestic debt ATM at 1.6 years and foreign currency debt ATM at 4.6 years. It is expected that by end-2010, the ATM of total debt would slightly increase to 3.0, that of domestic debt to 1.9 years and that of foreign currency debt to 4.8 years. Over the medium-term and by 2015, the ATM of the total debt portfolio is expected at 2.7 years, with the domestic currency debt at 1.8 years and foreign currency debt at 4.5 years.

3. REDUCE THE RISK RELATED TO DEBT SERVICE

Interest payments on the debt in the next three years will gradually decrease from 10.8 percent to 9.9 percent of GDP, below the level of 11.1 percent in 2009, based on current interest rate levels and the preservation of a primary surplus of 0.26 percent of GDP in 2010-2011 along with a deficit range of 10.5 percent-10.1 percent of GDP.

Support the reduction of the interest rate risk: There is significant interest rate risk arising from the domestic debt portfolio with duration of 1.5 years and an average time for re-fixing of 1.6 years. The overall objective of the conducted debt transactions is to improve the interest rate risk taking into account the cost tradeoff of such operations.

4. MAINTAIN THE SHARE OF FX DENOMINATED DEBT AT MOST, AT 50 PERCENT

With the current de-dollarization trends and high level of FX reserves, and in the absence of new Parliamentary authorizations for foreign currency borrowing, the share of debt denominated in FX decreased from 50 percent to 42 percent in the past three years.

5. INCREASE LEVEL OF FINANCING OF INVESTMENTS PROJECTS WITH CONCESSIONAL LOANS

There is scope for the increased usage of concessional funding for investment projects in order to decrease the share of market debt. US\$ 2.95 billion of project financing loans was pledged during the Paris III conference of which US\$ 1.9 billion are not yet disbursed nor committed to a project.