Lebanon: a veteran regional center for Islamic finance

The country has seen rapid and positive expansion of the Islamic banking sector. However, political unrest may reduce the flow of foreign investment and could affect the expansion of Islamic banking. Dr. Hatim El-Tahir shares his insight into the development of Islamic finance in the country.

In recent years, Lebanon has increasingly focused on efforts to promote Islamic finance. The government, represented by Banque du Liban (BDL), the central bank of Lebanon, has introduced several regulatory and practice-related policies including Law No.575 of 2004, which regulates the industry.

In September this year, the International Monetary Fund (IMF) reported that Lebanon's real GDP growth for 2011 will remain low at 1.5%. Inflation is estimated at 5.9%, which remains in line with inflation rates in the MENA region. It should be noted that economic growth has remained positive despite the regional unrest and Lebanon's domestic political issues.

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The country's competitive edge as a leading business and tourism hub rests mainly on its banking sector. This has been further enhanced by the introduction of Islamic banking services. The country hosts four fully-fledged Islamic banks: the Arab Finance House, Al Baraka Bank Lebanon, Lebanese Islamic Bank and Blom Development. BDL does not allow conventional banks to offer Islamic windows. The country's consistent efforts to introduce a sound and prudential regulatory environment, coupled with the introduction of internationally-accepted best practices, will boost the flow of investments into the country.

Over the past year, the service-based economy enjoyed growth in almost all sectors and industries. The services sector, which accounts for two thirds of the country's GDP, led the growth engine. This growth was driven by three main sectors: trade, tourism and banking. Other sectors that contributed to growth were agriculture, education and health services. In effect, the growth was largely driven by the private sector.

The government's management of the economy can perhaps best be measured by the level of success in meeting targets set by the IMF's Emergency Post-Conflict Assistance program. Key to these was the overarching goal to reduce the debt-to-GDP ratio, which was successfully cut to about 130% in 2011 from 150% in 2009. Each year, about 10% of the annual GDP - currently estimated at USD 40 billion - goes to service the country's debts.

In September, 2011, the total assets of the banking sector reached USD154 billion: an increase of 7% from the same period last year, when they totaled USD143.8 billion. In contrast, the capitalization of the Beirut Stock Exchange recorded a slight drop to USD12.8 billion in April 2011, according to BDL.

Islamic banking

In general Islamic banking grew steadily over the past year, with more bank branches opening across the country and an increase in the customer base, which expanded to include small and medium-sized enterprises in several sectors of the economy. This trend is likely to continue in the years to come.

The outlook for Islamic banking is optimistic and Islamic banks operating in Lebanon will likely take the lead in financing service sectors and investment projects. Projections for GDP growth, estimated at 4% for 2012, boost confidence in the economy and the banking sector in particular. Government support for Islamic banking is paramount and will give more assurance to potential investors in this important emerging sector. One area of industry growth potential lies in leveraging the country's reputation as a fiduciary service center and developing Shariah-compliant asset and wealth management services.

However, this growth cannot take place without challenges and, needless to say, will hinge on domestic and regional political stability. Lebanon offers a viable investment growth opportunity for bigger Islamic banks with bigger balance sheets to invest. In its favor, the country offers an abundance of professional talent and reasonable operational costs. This is crucial for a competitive and efficient Islamic financial sector.

The current regulation of Islamic banks stipulates that: "Investments and placements in Lebanon must account [for] at least 50% of assets and rights included in the balance sheet items in each Islamic bank." This guidance will ensure that Islamic banks operating in Lebanon will continue to invest and finance local industries and play an important role in economic growth.

Restriction on Islamic windows

Nevertheless, the restriction on conventional banks preventing them from offering Islamic windows poses challenges and may impede the growth of Shariah-complaint banking services in the country. This means that licensed Islamic banks will have to expand efficiently to accommodate the rising demand for Islamic financing. Similar regulatory changes have been made in Qatar, which also restricted conventional banks from operating Islamic windows, effective 2012.

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Conclusion

The broader global economic and political unrest may reduce the flow of foreign investment in the country and delay the Gulf-led initiatives for Islamic banking expansion into Lebanon. However, the government should continue its support of this emerging sector in the country and nurture its growth. Regulatory reforms should provide a level playing field for Islamic banks. Issues such as double taxation, Zakat, land registry, tax incentives for foreign investors in the sector and the establishment of leading practices in arbitration and business disputes, to name just a few, should be tackled.

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