

Rhyming with the Past: What Lebanon's Inflation Says About Its Future



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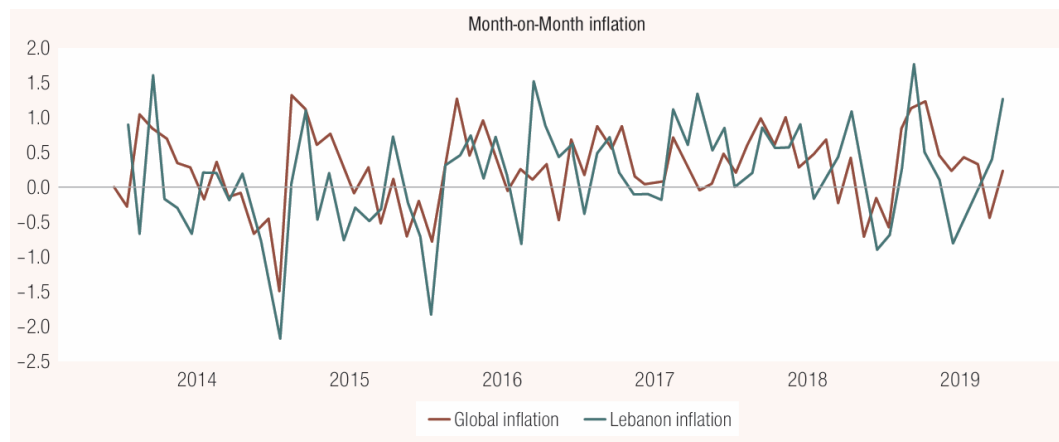
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In its Spring 2025 issue titled “*[Turning the Tide?](#)*”, the World Bank’s (WB) **Lebanon Economic Monitor (LEM)** featured a special analysis on Lebanon’s inflation. Since Lebanon’s financial crisis began, the consumer price index (CPI) has drawn growing attention, especially after Lebanon registered the [highest inflation rate globally in August 2021](#). With that peak now behind us, understanding what’s driving inflation is critical to forecasting its future trajectory, particularly in light of the election of a new government believed to be pro-reform. This analysis zooms in on Lebanon’s inflation dynamics, comparing trends before and after the crisis began, and pinpointing the main drivers that are likely to shape inflation in the coming period. After all, as the proverb goes, “*History may not repeat, but it often rhymes—especially in prices.*”

Lebanon’s inflation historically aligned with global trends, though domestic factors played a decisive role. Before the 2019 crisis, Lebanon’s inflation moderately tracked global trends—measured as the first principal component of G7 CPI rates—with a 0.47 correlation (Dec 2013–Oct 2019), though it was more closely linked to U.S. inflation. A 1% rise in global inflation typically led to a 0.57–0.63% increase in domestic prices, well above pass-through levels seen in Egypt (0.36, statistically insignificant) and Jordan (0.24), and close to zero in Saudi Arabia, the UAE, Morocco, and Qatar—all MENA economies with fixed or flexible exchange regimes.

Figure 1: Inflation in Lebanon Tracked Global Inflation in the pre-Crisis Period



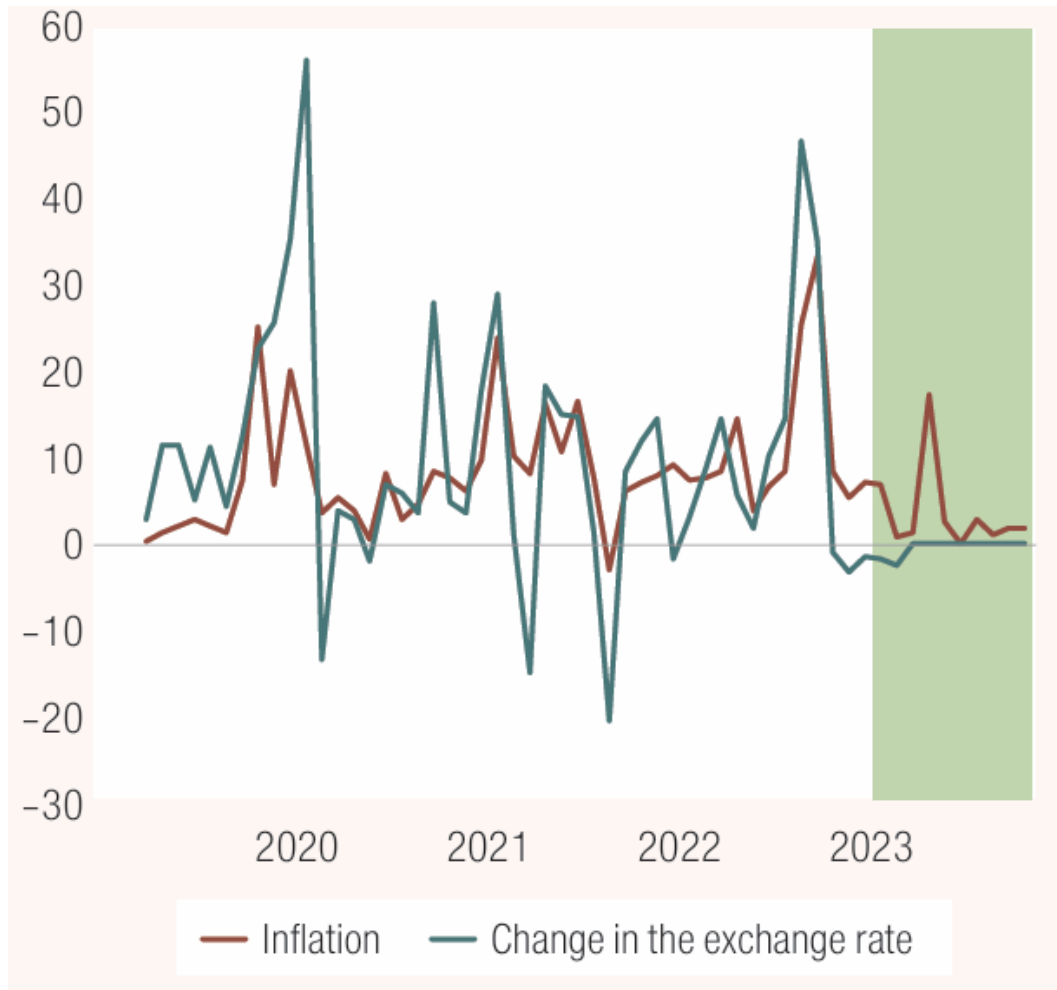
Sources: WB Calculations

Following the crisis, Lebanon's inflation diverged from global trends and closely tracked exchange rate movements—particularly from 2020 to 2023, as illustrated in Figure 2—highlighting a strong correlation during this period. Surging currency issuance amid financial collapse pushed inflation into triple digits, with exchange rate changes explaining over two-thirds of monthly variation. At the same time, global inflation effects waned, as reflected in a 30% drop in regional shipping activity—which under normal conditions would have exerted upward pressure on prices—but still had limited influence on Lebanon's inflation.

Lebanon displays a high exchange rate pass-through, where a 10% currency depreciation leads to a 5.74% increase in inflation—higher than rates observed in peer economies. This reflects Lebanon's import-heavy consumption structure. Still, about 26.6% of inflation changes remain unexplained by exchange rate movements, suggesting that domestic pricing dynamics still play a role, though more limited than before the crisis.

The shaded green area in Figure 2 starting August 2023 is the period where the exchange rate stabilized at around LBP 89,500 per USD. During that period, the relationship between exchange rate changes and inflation weakened notably by October. Yet, monthly inflation surged that month, driven by dollarization in the education sector, where price adjustments typically occur at the start of the academic year.

Figure 2: Inflation and the change in the exchange rate



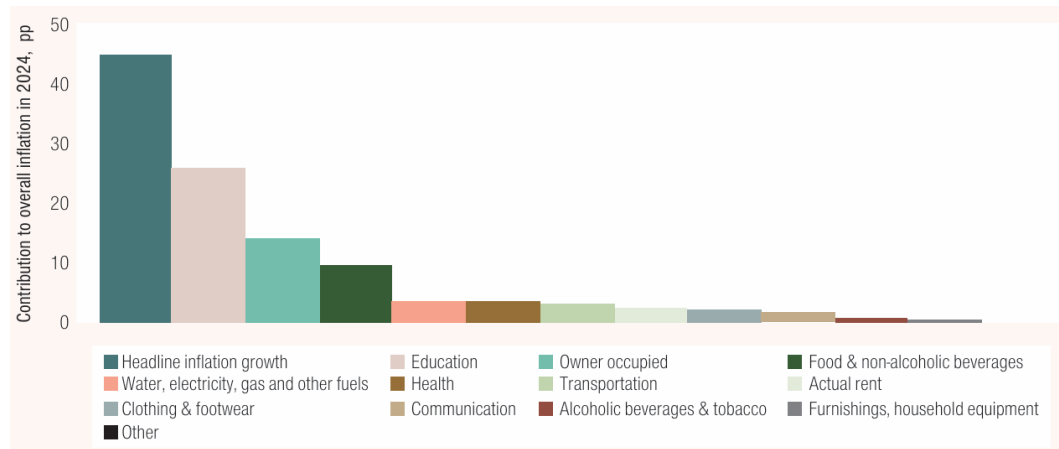
Sources: BDL and WB Calculations

CPI subcomponents in Lebanon respond unevenly to exchange rate depreciation, reflecting differences in import reliance, tradability, and price-setting mechanisms. This divergence is evident in the degree of pass-through across categories:

- **High Pass-Through (Coefficient > 0.7):**
 - **Alcoholic beverages, tobacco, narcotics:** Prices react strongly and consistently to exchange rate changes, reflecting heavy import reliance.
 - **Furnishing, household equipment, maintenance:** Near-complete pass-through driven by import dependency and market pricing mechanisms.
 - **Restaurants and hotels:** Elevated sensitivity as this industry relies on foreigners and expatriate spending.
 - **Health services:** Notable responsiveness, largely reflecting imported medical equipment and pharmaceuticals.
- **Strong but Slightly Lower Sensitivity:**
 - **Food and non-alcoholic beverages:** Exchange rate movements explain ~80% of price variation; vulnerability stems from high import share and limited domestic substitution.
- **Minimal or No Pass-Through:**
 - **Education:** Inflation primarily driven by dollarization of tuition fees, manifesting as annual one-off increases—no direct link to FX volatility.
 - **Communication:** Government-administered pricing insulates the sector from exchange rate effects.
 - **Housing:** Pass-through is weak, reflecting structural price rigidity.

In 2024, the main driver of inflation in Lebanon was education costs, followed by owner occupied housing costs, and food and non-alcoholic beverages. Other prices had already been dollarized in the previous year, limiting their year-on-year change. In contrast, the mentioned prices—typically more rigid—adjusted with a delay, making their eventual increase the most impactful on overall inflation.

Figure 3: CPI Subcategories' Monthly Contribution to CPI (2024)



Sources: CAS and WB staff calculations

As for the 1st half of 2025, figure 4 reveals a shift in the main categories driving price increases. The most significant rises in inflation were in Housing, water, electricity, gas, and other fuels, which increased the CPI by 4.9%, primarily driven by the Israeli war's effects on Lebanon. While this sector was also severely affected by the war in the 2nd half of 2024, the war's effects in the 1st half of that same were marginal, hence not reflected in the annual change. This sector also experienced a delayed shift toward dollarization. Food and non-alcoholic beverages also played a major role, increasing the CPI by 4.2%. Education continued to be a notable factor, increasing the CPI by 2.0%, though at a significantly slower pace compared to 2024. Health also contributed significantly, increasing the CPI by 1.7%. The average CPI for the 1st half of 2025 stands at 14.73%. If this trend holds, it will mark the lowest average since 2019.

Figure 4: Sectoral Contributions to Lebanon's CPI in H1 2025

Expenditure Divisions	Contribution to CPI (H1 2025)
Housing water,electricity,gas and other fuels	4.9%
Food and non-alcoholic beverages	4.2%
Education	2.0%
Health	1.7%
Miscellaneous goods & services	1.0%
Clothing and footwear	0.6%
Transportation	0.5%
Restaurant & hotels	0.4%
Alcoholic beverages, tobacco	0.2%
Recreation,amusement, and culture	0.1%
Furnishings, household equipment and routine household maintenance	-0.1%
Communication	-0.1%
Average CPI in H1 2025	14.73%

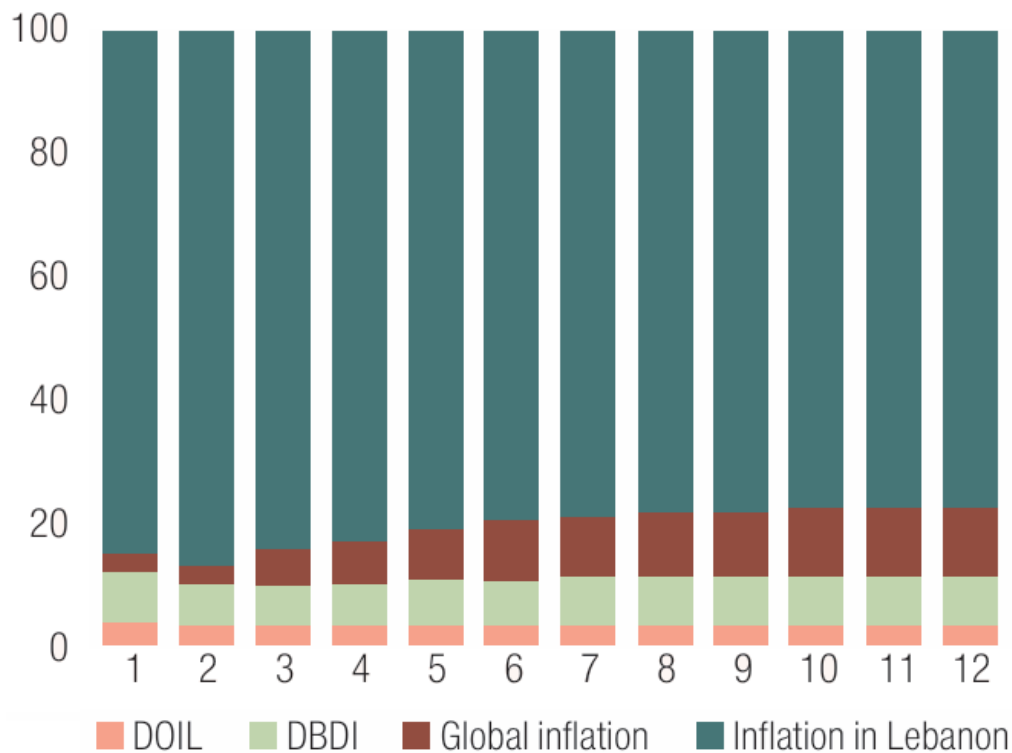
Sources: CAS and BLOMINVEST staff calculations

Now that the majority of the crisis' effect on Lebanon's inflation has faded, what can Lebanon's past inflation dynamics tell us about what lies ahead?

As the exchange rate holds firm and the transitory effects of dollarization recede, inflation is expected to remain below peak crisis levels but still above historical averages—driven by structural inefficiencies, weak competition, and persistent markup pricing. The nation's import dependence continues to anchor inflation to global trends, notably U.S. inflation, with Lebanon's CPI exhibiting a 0.7 correlation with U.S. price movements. This relationship is not coincidental; when countries peg their currencies to others, inflationary trends tend to move in similar directions. Unfortunately for Lebanon, current dynamics in the U.S.—including trade tensions and political pressure on the Federal Reserve to lower interest rates—risk fueling a rebound in American inflation, which could fuel Lebanon's price landscape.

Yet, as shown in Figure 5, 75% of Lebanon's inflation volatility over the next 12 months is expected to be driven by domestic factors (past values of inflation in Lebanon and internal dynamics like weak market competition, pricing power, and regulatory gaps). This means that external shocks to oil prices (DOIL), shipping costs (DBDI), and global inflation, collectively account for less than a quarter of the fluctuations in Lebanon's inflation. This implies that domestic policy plays a comparatively larger role in addressing inflationary pressures—a double-edged sword in Lebanon's case. While recent political reforms have catalyzed some economic initiatives, the chronic fragility of the political environment leaves progress vulnerable to setbacks, exposing inflation dynamics to renewed instability.

Figure 5: Variance decomposition of inflation in Lebanon



Sources: BDL and WB calculations

Meanwhile, daily Israeli strikes not only jeopardize security and civilian livelihoods but also obstruct domestic production and disincentivize investment in the country's sectors, notably the agriculture and industry sectors, further intensifying import reliance and price pass-through. A renewed military escalation with Israel would critically destabilize Lebanon's economic recovery, threatening the Lira's fragile exchange rate stability and amplifying inflationary pressures through disrupted production, investment flight, and increased import dependence. In the absence of further escalation, although overall inflation volatility may ease, Lebanon's track record of economic surprises and geopolitical fragility calls for cautious forecasting. Tackling inflation sustainably will require more than monetary discipline; it necessitates robust structural reforms, renewed investor confidence, and a stabilizing political and security environment to shift the trajectory from resilience to recovery.

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