

# BDL’s Net Foreign Reserves: A Neglected Predictor or Signal to the Lebanese Exchange Rate Crisis!

Blominvest Bank

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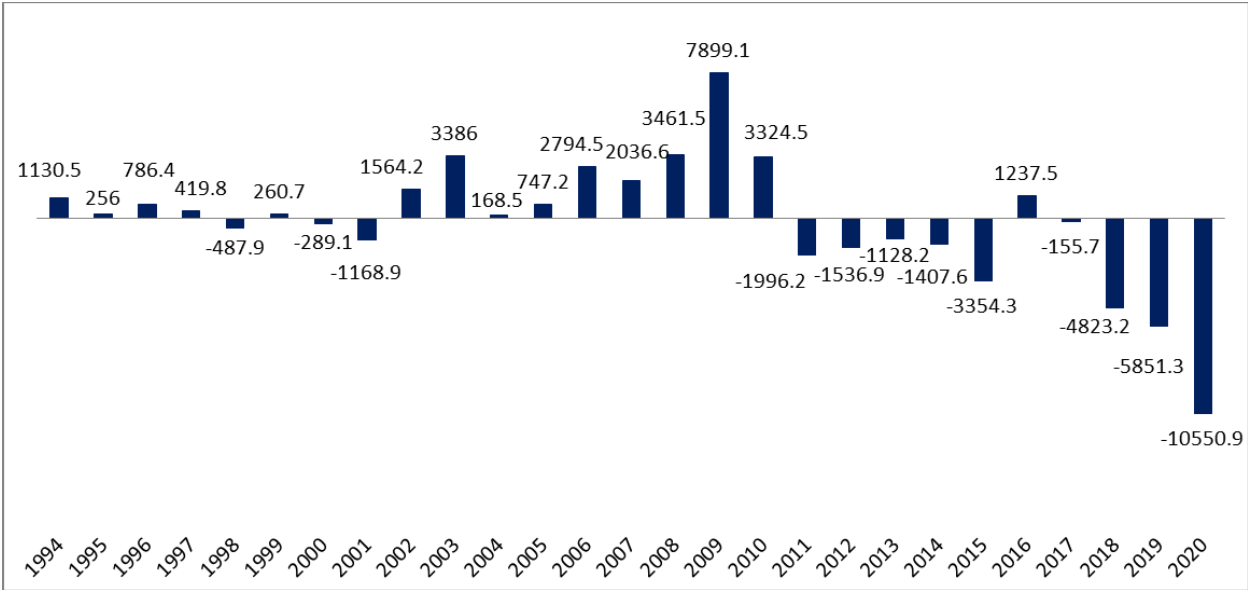
Today, Lebanon is witnessing the fallout of years of political and financial mismanagement. The economic structure adopted supported a financial model defined by shoring up foreign reserves, attracting external currency and supporting a fixed exchange rate regime. This model has left the financial system in accumulated losses and made BDL’s foreign currency reserves on everybody’s mind. Despite the importance of the latter, however a superior or an equally important parameter to consider is “BDL’s Net Foreign Reserves” (NFR).

The Net Foreign Reserves of the Central Bank catches the position of the whole banking system because it combines the balance sheets of the commercial banks with the Central Bank in order to calculate the losses of the financial system. In short, the net foreign reserves of BDL refer to the net assets held on reserve by the Central Bank in foreign currencies minus the total reserves of the commercial banks (CB) at the central bank after deducting the Eurobonds held by Banque du Liban. So, the following model is used to calculate the NFR:

$$\text{Net Foreign Reserves} = \text{Net Assets in FC} - \text{Total Reserves of CB at BDL} - \text{Eurobonds}$$

For a meticulous explanation of the current crises, we will examine the historical data of the balance of payment, NFR of BDL, and total reserves of commercial banks at BDL in three different time phases.

## Pre-start of the alarming phases – year of 2011 onwards:



Source: BDL, BLOMINVEST

A look into the Lebanese recent financial history can detect that the signs of trouble were there. Year 2011 onwards signaled the starting year of Lebanese financial problems. In more details, the balance of payment recorded its first deficit since a decade and reached a shortfall of \$1.99B at Dec 2011. This trend continued until end of 2015 where the BoP registered the biggest drop of \$3.35B. The worsening of country's external position is the result of lower capital inflows following the unrest in neighboring Syria and local turmoil. Year of 2016, the BoP gained up due to BDL's financial engineering and recorded a surplus of \$1.23B by the end of the year. However this trend didn't last for a long period as it fell back on recording accumulated deficit till date.

### Quarterly Net Foreign Reserves 2017-2021:

NFA of BDL ( usd M)	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Total Deposits in FC	108,691	111,887	113,122	115,902	116,907	118,580	120,251	123,073	121,808	123,059	124,138	120,773	116,593	115,359	114,054	111,821	109,886	107,744	106,052
Financial Sector Liabilities	6,417	6,573	7,131	7,481	7,739	8,230	8,460	9,261	9,361	9,360	9,661	8,829	8,168	7,669	7,430	6,583	5,952	5,259	4,943
Total Deposits in FC	115,108	118,460	120,253	123,383	124,646	126,810	128,711	132,334	131,168	132,419	133,799	129,602	124,761	123,028	121,484	118,405	115,838	113,003	110,995
30 % of CB capital at BDL	5,538	5,661	5,595	5,738	6,483	6,108	6,026	6,046	6,616	6,267	6,189	6,217	6,216	5,868	5,544	5,979	5,086	4,913	5,072
Total Placements in FC	75,264	74,437	71,413	72,629	70,308	72,312	73,093	74,907	72,481	70,157	67,555	59,864	50,756	46,101	42,776	40,640	38,655	36,224	34,351
Deposits at other CBs	901	943	974	1,045	1,145	1,157	1,095	987	954	983	804	588	626	486	657	578	647	846	988
Loans to Residents in FC	34,515	35,399	35,156	36,056	34,970	35,060	34,876	35,465	34,547	34,074	33,116	30,167	26,328	22,985	20,706	18,788	17,814	16,233	15,019
Eurobonds held by banks	16,571	16,250	15,365	14,178	13,918	16,085	16,640	16,839	16,060	15,399	14,859	13,815	10,773	10,381	10,037	9,391	8,442	8,182	7,622
claims to non-Resident financial sector	12,649	11,692	9,647	11,300	10,381	10,728	10,334	11,989	10,664	9,796	8,976	6,767	5,146	4,511	4,464	4,716	4,889	4,655	4,724
Loans to Non-Resident Customers	5,260	4,870	5,096	4,865	4,845	4,887	5,000	5,318	5,100	4,840	4,919	3,852	3,335	3,178	2,864	2,573	2,333	2,250	2,296
Non-Resident Securities Portfolio	1,184	1,050	998	934	1,133	1,067	1,056	1,064	1,113	1,000	877	620	519	507	481	487	471	425	399
Other Foreign Assets	4,184	4,233	4,176	4,252	3,966	3,929	4,092	4,045	4,043	4,065	4,004	4,053	4,028	4,052	3,566	4,106	4,059	3,632	3,302
Total Reserves of CBs at BDL	45,383	49,684	54,435	56,491	60,821	60,006	61,644	63,473	65,303	68,529	72,432	75,955	80,221	82,795	84,253	83,744	82,269	81,693	81,717
Foreign currencies of BDL	33,906	33,887	35,058	35,806	34,284	33,142	34,150	32,514	31,088	29,750	29,297	29,553	28,233	25,870	20,083	18,604	16,752	15,185	14,620
Securities Portfolio	5,317	6,029	8,418	6,186	9,114	11,027	9,381	7,160	7,480	6,651	9,228	7,730	7,012	7,101	5,937	5,494	5,413	5,381	4,184
Foreign Liabilities including special LT liabilities	883	889	890	890	891	889	889	888	888	893	2401	2401	2517	2520	2521	2992	2913	2917	1416
Net Assets in FC	38,341	39,026	42,585	41,103	42,507	43,280	42,642	38,786	37,680	35,967	36,134	34,881	32,728	30,451	23,418	21,107	19,252	17,648	17,388
Total Reserves of CBs at BDL	45,383	49,684	54,435	56,491	60,821	60,006	61,644	63,473	65,303	68,529	72,432	75,955	80,221	82,795	84,253	83,744	82,269	81,693	81,717
Eurobonds held by BDL	6,183	7,199	8,969	6,180	9,104	11,021	9,374	7,153	7,473	6,643	9,218	7,719	7,001	7,091	5,926	5,404	5,402	5,370	5,030
Net Foreign Reserves	(13,226)	(17,857)	(20,819)	(21,569)	(27,418)	(27,747)	(28,376)	(31,840)	(35,097)	(39,665)	(45,526)	(48,794)	(54,494)	(59,435)	(66,761)	(68,121)	(68,419)	(69,415)	(69,359)

Source: BDL, BLOMINVEST Bank

### Phase A: Mar 2017 – Dec 2017

This phase endorsed the beginning of an intensified financial engineering period that led to significant increase in Total Reserves of Commercial Banks at BDL from \$45.38B by March 2017 to \$56.49B by Dec 2017 and foreign currencies of BDL peaked at 35.8B. In parallel, the NFR went from a loss of \$13.22B by March 2017 to end up the year at losses of \$21.57B.

### Phase B: March 2018 – Dec 2018

NFR plunged further and recorded losses of \$27.41B by March 2018 at a time foreign currencies of the Central Bank started their downfall trend and remarkably declined from \$35.80B at Dec 2017 to \$32.51B at Dec 2018. This phase marked by the beginning of loss of confidence in the Lebanese financial sector.

### Phase C: March 2019 — Sept 2019

Just before the Lebanese realizing their economy was in trouble, the Lebanese pound began to look shaky and the NFR registered the largest quarterly drop in history and went from losses of \$39.66B by June 2019 to \$45.52B by September 2019. It also coincided with BDL's foreign currencies falling below \$30B.

As important, in late summer 2019, confidence in the Lebanese financial sector was lost and consequently the peg broke in August 2019. More crucially, this happened at the time when NFR recorded its biggest all-time drop and the foreign currencies of BDL fell below the "critical level" of \$30B. These observations lead us to the tentative conclusion that, besides foreign reserves, NFR at BDL is at least an equally good and reliable predictor of the exchange rate crisis in Lebanon, though it has often been neglected, but perhaps not anymore!

Barely a month after, in October 2019, Lebanese gradually recognized their economy was collapsing and social unrest erupted in Beirut and spread nationwide. In March 2020, Lebanon defaulted on its foreign debt and then on August 4 a huge explosion took place in the port of Beirut.

Lastly, the irony today that the economy of Lebanon has collapsed and the Lebanese pound has gone down sharply with it, yet in addition foreign reserves are still evaporating at the same time. That is contrary to most country's experiences where either event usually takes place: foreign reserves are sacrificed to maintain and preserve the currency; or foreign reserves survive and are held steady as the exchange rate is sacrificed through (sometimes needed) depreciations. Unfortunately, Lebanon has lost both and hasn't reached the bottom yet!