Overview of the Recent Monetary, Banking, and Financial Developments in Lebanon

2020

Since 2011, the Lebanese economy has not been shielded from political tensions, security challenges, and regional unrest combined with the burdens of the Syrian crisis. The outbreak of nationwide anti-government protests in October 2019 has further exacerbated the economic environment, cutting deeper into Lebanon’s main economic indicators such as foreign investment, consumption, tourism, and real estate.

Over the years, Lebanon has shown extreme resilience and a unique ability to prevail under exceptionally arduous external and domestic challenges that would have shaken many other countries. Yet economic imbalances have intensified deeply in 2020 and vulnerabilities have continued growing, thus giving rise to severe financial challenges.

In summary, Lebanon has been living multiple shocks in the past few months, starting with the liquidity crisis that erupted in the last quarter of 2019, followed by the government’s decision to discontinue payments on all its outstanding US dollar-denominated Eurobonds in March 2020, the COVID-19 pandemic imposing lockdowns in the country starting the second quarter of 2020, and the Beirut port explosion in August 2020 which caused major destruction in the Lebanese capital and led to the resignation of the government.

The Lebanese economy has indeed plunged into a severe contraction across all economic sectors, combined with an unprecedented surge in prices. According to the IMF's updated October 2020 forecast, GDP growth in Lebanon has been projected to fall by 25% in 2020, while growth contraction has been estimated by BDL at -21.5% in 2020. The end-of-year inflation for 2020 has been forecasted at 145% against 7.0% in 2019, raising the average inflation to 85.5%.

At the monetary level, the year was marked by a massive decline in capital inflows, a drastic shortage of US dollars and a sharp depreciation in the value of the local currency, hitting as high as LBP 10,000 to the US Dollar in the parallel market. The Central Bank is still maintaining the official rate of LBP 1507.5 in bank transactions and for critical imports such as medicine, fuel and wheat, while allowing bank withdrawals at a rate of LBP 3,900 to the dollar. As a result, BDL's assets in foreign currencies have fallen dramatically from USD 37.3 billion at end December 2019 to $24.1 billion at end December 2020.

As for the banking sector, operating conditions had worsened during 2020, especially after the state default which weighed on the country's ability to attract external funds, coupled with the deteriorated economic situation and business environment. Total banking activity has witnessed both deposit and loan contractions, with the consolidated assets of banks declining by 13% over the year to reach USD 188 billion at end December 2020.

Total deposits registered a contraction of 12% in 2020, with the deposit dollarization ratio reaching a new high of 80.4% at end December 2020, as compared to 76% at end December 2019. In parallel, bank loans to the private sector dropped by 26% to reach USD 38 billion at end December 2020, with the loan dollarization ratio witnessing a slight decline to stand at 59.6%. In terms of capitalization, banks' equity decreased by 3.8% to reach USD 19.9 billion at end December 2020. As per BDL latest circulars, banks are in the process of recapitalizing or increasing their capital, depending on their needs, by the first quarter of 2021.

In the midst of these challenging circumstances, BDL has been deploying all measures to help the economy survive, protect depositors' money at Lebanese banks, support businesses during pandemic to ensure that workers still have jobs to return to, and provide assistance to individuals and companies affected by the Beirut Port explosion.

In the past few months, BDL has issued a series of circulars aiming at easing the burdens of the consecutive shocks on businesses and individuals, as well as strengthening the conditions of banks in terms of securing liquidity and

capital requirements. The most significant of these circulars can be highlighted as the following:

With the start of the lockdown in Lebanon as a result of the outbreak of the Corona virus in March 2020, and in order to help the Lebanese companies and employees survive the economic impact of this pandemic, BDL asked banks and financial institutions operating in the country to extend, exceptionally and on their own responsibility, interest free loans over five years in Lebanese pounds or US dollars to clients that already have credit facilities and that are unable to meet their obligations from March till June 2020.

In the same context, BDL provided support to individuals and businesses affected by Beirut Port explosion by allowing banks to extend exceptional loans that are not subject to any interest or commission and that can be repaid over a period of five years.

Furthermore, in order to alleviate the burden on banks' clients that were negatively affected by the Corona virus outbreak, BDL asked banks to refrain from downgrading the loan classification of these borrowers in case they missed payments of interest and/or principal on their loans.

In order to help the Lebanese industries, BDL announced in March 2020 the decision to launch the "Lebanese Economy Oxygen Fund" in partnership with Lebanese banks and in coordination with the Association of Lebanese Industrialists and the Ministry of Industry. This rescue initiative aims to extend short-term credit facilities to help small and medium sized Lebanese industrial firms finance raw material imports by raising around USD 750 million with the support of BDL, international investors, development finance institutions, and family offices. This fund will be a Europe based platform with a mix of fintech and credit facilities, and it will constitute a permanent solution for the import of raw materials, following the recent introduction by BDL of a temporary USD 100 million import facility for the industrial sector in February 2020.

Among other measures taken by BDL to strengthen the Lebanese banking sector and revive its activity, BDL issued in August 2020 Circular 154 asking banks to conduct a fair evaluation of their assets and liabilities to be able to meet all *capitalization, solvency and liquidity requirements, as well as to resume regular business activities and banking operations. Further, the circular noted that by the end of February 2021, each bank should have an external account at foreign correspondent banks that is not subject to any obligations in foreign currency, and that has funds equivalent to at least 3% of the aggregate amount of the bank's total deposits in foreign currencies as of end July 2020. In parallel, the circular indicated that each bank should seek the approval of BDL to recapitalize or increase its capital, depending on its needs, by the first quarter of 2021.*

In the same context, and in order to further strengthen the banking sector, BDL asked banks to refrain from distributing dividends for financial years 2019 and 2020, and to increase their capital by 20%.

BDL also asked each bank to build a capital conservation buffer of 2.5% of its risk-weighted assets.

In November 2020 and in order to further boost banks' capital, BDL modified the Basic Circular related to the capital adequacy regulatory framework for banks operating in Lebanon. The new circular allows banks to book exceptionally, under Tier Two Capital, one third of the capital gains arising from the revaluation of their fixed assets held in settlement of debt (Article 154 of the Code of Money and Credit) under specified conditions.

In conclusion, the situation in Lebanon is becoming very difficult, and it could worsen if a new government is not quickly formed, because confidence must be restored in order to reach economic recovery.

Currently, there are three pillars to restore confidence: the first is to prepare a budget with a reduced deficit, the second is to negotiate with the lenders, especially after the state default on international debts, and thirdly there is the reform of the banking system that the Central Bank has initiated.

However, to ensure sustainable economic recovery and pave the way for real inclusive growth, there are other factors that play an important role: the need for political stability and a working government that will undertake a number of structural reforms and set a viable economic plan in coordination with international institutions in order to revamp infrastructure, enhance the quality and quantity of public services, simplify administrative procedures, enforce fiscal discipline, reform the energy sector, among others.

Once a recovery plan is initiated and reforms are launched, financial support will be pledged by international community, and the Central Bank will be ready to help the economy according to the prerogatives given to it by the Code of Money and Credit. This will be done in accordance with the new government recovery plan and goals.