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Today Lebanon is battling a deep economic crisis and the situation underscores the size of the problem facing the central bank, largely exposed to one of the world's most indebted State. For years, Banque du Liban has used complex series of financial engineering to shore up the financial sector, attract foreign currency and stabilize the Lebanese pound. These activities, combined with the default occurred on March 2020 and a sharp devaluation in the value of the currency, have left the central bank in accumulated losses of about billions and made it an everyday headline in Lebanon.

Although BDL's foreign currency reserves are rationally important, however the more conclusive parameter to shed the light on is the "Net Foreign Reserves of the Central Bank" which catches the position for the whole balance sheet of the banking system. For instance, the IMF has warned Lebanon about the losses of BDL that reached \$49B¹ by summer 2020. However, the Central Bank argues that its losses are substantially lower. So, in this context, we adapted a method defined by combining the balance sheets of the commercial banks with the central bank in order to calculate the estimated losses of BDL which reached, by our calculation, \$61.94B by end of February 2021.

For a meticulous explanation of the above mentioned parameter, we will examine the total placements in foreign currencies of the commercial banks along with the total reserves of commercial banks at the Central Bank. In more details, 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.

To check the current net foreign reserves of BDL, given the above definition, we have to work with the following model:

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

¹ BDL Losses claimed by IMF taken from Financial Times's article published on 25th June, 2020 by Chloe Cornish in Beirut.

Breakdown of the net foreign reserves of BDL:

Equations	NFA of BDL (usd M)	Dec-19	Feb-20	Dec-20	Feb-21
A-1	Deposits in FC	120,773	117,769	111,821	111,143
	Financial Sector Liabilities	8,829	8,271	6,583	6,456
	Total Deposits in FC	129,602	126,040	118,405	117,599
A-2	Total Placements in FC	59,862	53,200	40,640	40,662
A	Deposits at other CBs	588	578	578	718
	Loans to Residents in FC	30,167	27,201	18,788	18,599
	Eurobonds held by banks	13,815	11,632	9,391	9,462
	claims to non-Resident financial sector	6,767	5,748	4,716	4,924
	Loans to Non-Resident Customers	3,852	3,429	2,573	2,391
	Non-Resident Securities Portfolio	620	567	487	478
	Other Foreign Assets	4,053	4,045	4,106	4,090
A	Total Reserves of CBs at BDL	69,740	72,840	77,765	76,938
B-1	Foreign currencies of BDL	29,553	28,340	18,604	17,494
B-2	Securities Portfolio	7,730	7,459	5,494	5,406
B-3	Foreign Liabilities including special LT liabilities	2,401	2,520	2,992	2,882
B	Net Assets in FC	34,882	33,279	21,107	20,019
C	Total Reserves of CBs at BDL	69,740	72,840	77,765	76,938
	Eurobonds held by BDL	5,700	5,030	5,030	5,030
C	Net Foreign Reserves (deducting Eurobonds)	(40,558)	(44,591)	(61,688)	(61,949)

Source: BDL, BLOMINVEST

We begin by calculating the total deposits in foreign currency for February 2021 (in M\$):

(A-1) Equation: Total Deposits in FC= Deposits in FC + Financial Sector Liabilities

Numbers:

$$\mathbf{\$117,599 = \$111,143 + \$6,456}$$

Total Deposits in FC are extracted from the CB's balance sheet, liability side; it's the sum of "Resident's and non-resident's customer deposit in foreign currency and the "resident financial sector liabilities in foreign currencies".

The second step is to go over the total placements in FC outside BDL for February 2021,

(A-2) Equation: Total placements in FC = Deposits at other CBs + Loans to Residents in FC + Eurobonds held by banks + claims to non-resident financial sector + loans to non-resident customers + non-resident securities portfolio + other foreign assets:

$$\mathbf{\$40,662 = \$718 + \$18,599 + \$9,462 + \$4,924 + \$2,391 + \$478 + \$4,090}$$

The third step is to calculate the total reserves of CBs at BDL

(A) Equation: Total Reserves of BDL= Total Deposits in FC – Total placements in FC

$$\mathbf{\$76,938 = \$117,559 - \$40,662}$$

Fourthly, **Equation (B)** is about the Net Assets in FC at BDL is composed of the “Foreign Currency of BDL” plus “Securities Portfolio” minus the “Foreign Liabilities” of BDL.

$$\mathbf{\$20,019 = \$17,494 + \$5,406 - \$2,882}$$

The fifth and the final step, we calculate the Net Foreign reserve of the Central Bank:

(C) Equation: Net Foreign Reserve= Net Assets in FC – Total Reserves of CBs at BDL - Eurobonds held by BDL

$$\mathbf{-\$61,949= \$20,019 -\$76,938 – \$5,030}$$

As we can see from this equation, BDL’s estimated losses are about \$61.949B. This number represents what BDL owes for the commercial banks in Lebanon. For the Eurobonds held by BDL, we believe that it should be subtracted from Net foreign reserve calculation due to their price that is considered as very negligible after the government default on March 2020.

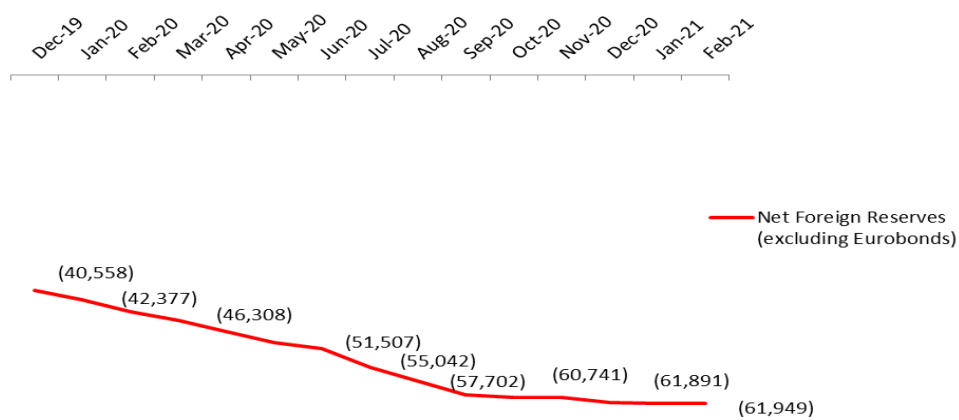
On the whole, the net foreign reserves of BDL, that reached a negative record of \$61.94B by February 2021, have been on a steady decrease since October’s revolution. In more details, the net assets in FC had decreased by 39.85% YOY to reach \$20.01B by February 2021, whereas the total reserves of commercial banks in FC at BDL had increased by 5.63% yearly to stand at \$76.93B by the same period. In addition, the Eurobonds held by BDL stood at \$5.03B by end of February 2021.

In term of the foreign currencies of the Central Bank that is watched by all the Lebanese people it had sharply decreased by 38.27% from \$28.34B by February 2020 to \$17.49B by February 2021. In the same token, the securities portfolios decreased by 27.52% to stand at \$5.40B by end of February 2021.

To conclude, BDL’s balance sheet does not reveal the whole position about the financial situation in Lebanon. As per our logical calculation, BDL has suffered from massive losses since the beginning of the crisis in 2019. Obviously, that was the result of accumulative years of wrong economic and monetary policies by both the government and the Central Bank.

In turn, the Central Bank’s efforts to maintain foreign exchange reserves today are weak, therefore the rationalization of the expenses and subsidies, in addition to a capital control law, are mandatory to stop the collapse. Forming a new government and reaching an agreement with the IMF in order to unlock the international financial aid are mandatory to stop the consequences of the economic deterioration.

Net Foreign Reserves Evolution in Millions USD



Source: BDL, BLOMINVEST

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