Economic crisis and challenges in Lebanon

Change Lebanon

October 2021

Ishac Diwan

themes

- The collapse: current economic situation
- Where do we stand on adjusting to the triple crisis?
- Mikati and the IMF: Subsidies, Energy sector, K-control, Banking reforms?

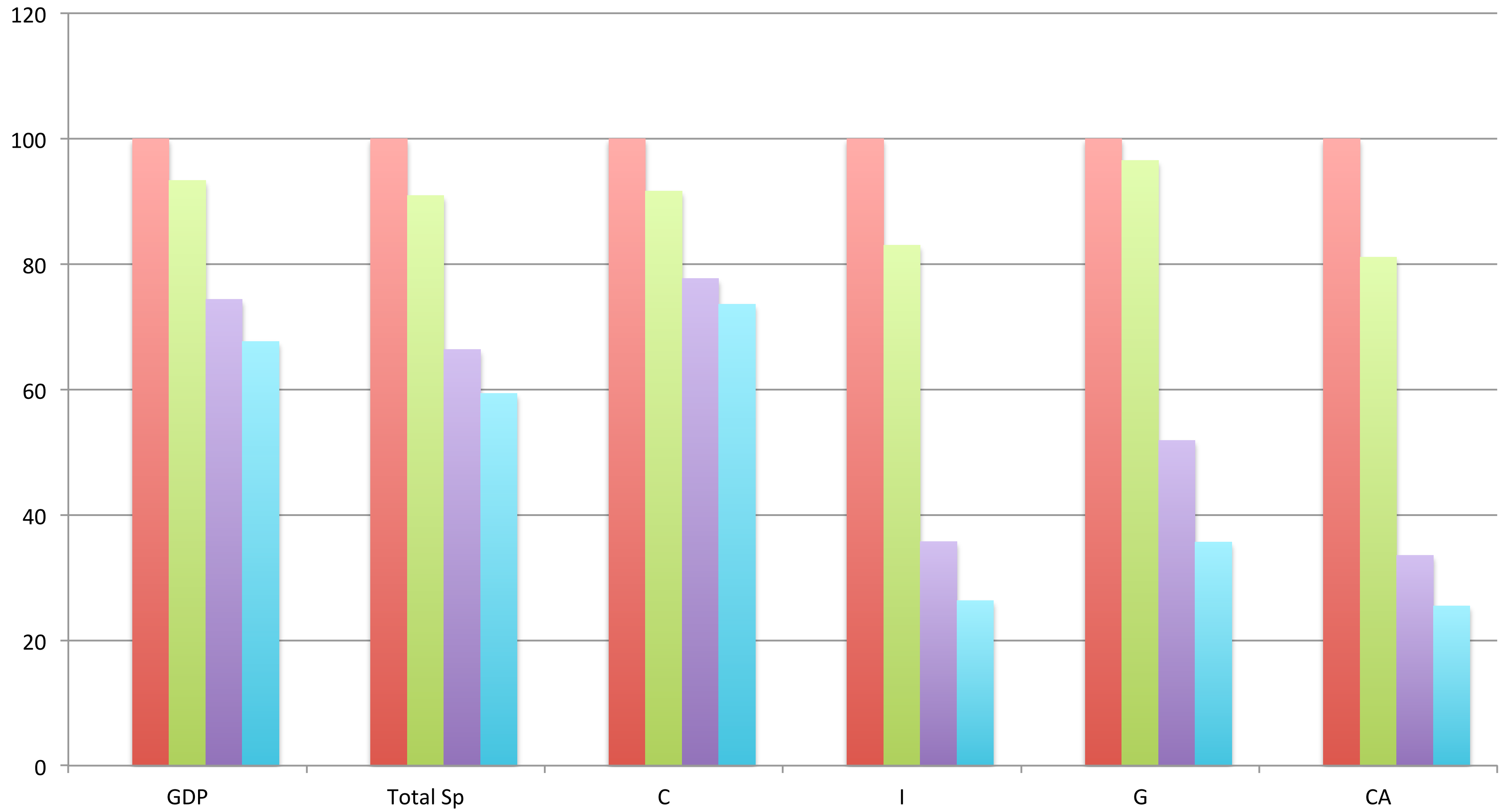
diagnostic: an exaggerated collapse

- The initial shock is a sudden of external flows
- But aggregate spending decreased by much more
- Because GDP collapse as well, bringing poverty and misery
- Exacerbating elements: fiscal crisis and inflation; banking crisis
- Policies that help fasten a recovery - Fiscal, Credit, devaluation, external support – did not follow.
- What resulted is an exaggerated adjustment

	Actual 2018	Actual 2019	Estimated 2020	Change 2018-20 (% 2018 level)
GDP	100	93.3	74.4	-25.6
External funding	24.4	19.8	8.2	-66.5
Aggregate Spending	124.4	113.1	82.5	-33.6

In shares of 2018 GDP (except last column)

“Ajustement par le bas”



National accounts 2018 to 2021: percentage change

Adjustment of the External Accounts

Lots of capital flight, competing with imports, leading to an enormous real devaluation

External financing (in $ billions)

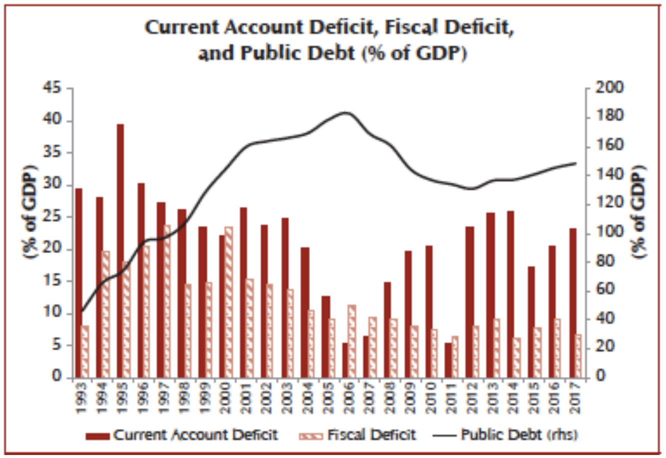
	2017	2018	2019	2020
Imports of Goods and Services	32.2	33.3	31.4	15.0
Exports of Goods and Services	19.1	19.6	18.4	9.0
Trade Balance (- =deficit)	-13.1	-13.6	-12.9	-6.0
Net Income (+=inflow)	-0.3	-1.2	-1.0	-0.9
Net Transfers (+=inflow)	1.2	1.4	2.9	3.2
Bal. of Payments (-=deficit)	-12.2	-13.4	-11.0	-3.7
Net financial flows (+=inflow)	12.9	3.2	4.9	-1.1
BdL Reserves (+=use)	-2.3	2.3	2.3	14.2
Errors (+=inflows)	1.6	7.7	4.0	-9.3

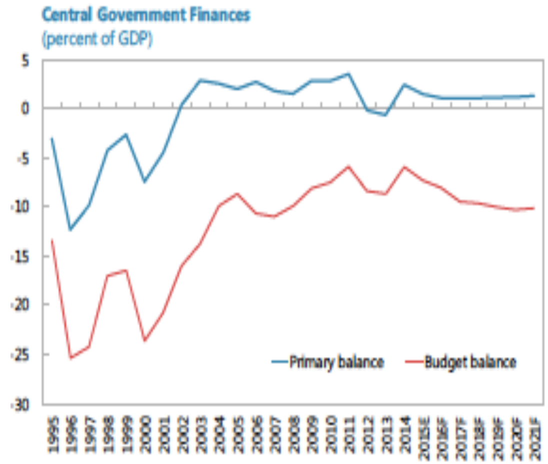
Source: BdL last bulletin

Understanding the triple crisis

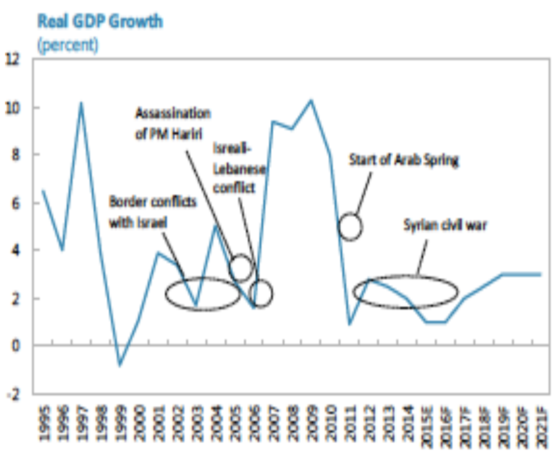
1. Capital inflows: ~20% GDP, ~ $10 bil./year, into bank accounts
2. Banks mainly deposit at BdL ($CDs about $80bn)
   - High Interest Rate and fixed XR keep the money coming
3. BdL sells a lot of the $$ (at LBP1505) to importers
   - This finances the trade deficit
   - If IR was lower, flow would stop, and a devaluation needed
4. BdL lends much of the LBP to the Gov.
   - At lower IR − explains some of the losses of BdL
   - The rest of the losses is “cost of carry” for the “Reserves”
5. Government finances its deficit
   - But primary deficit about balanced -> most of the funds back to depositors
   - Rise of “paper wealth” pushes consumption and import
6. Overvalued XR and high IR tax domestic production and exports

How did we get there? Debt dynamics

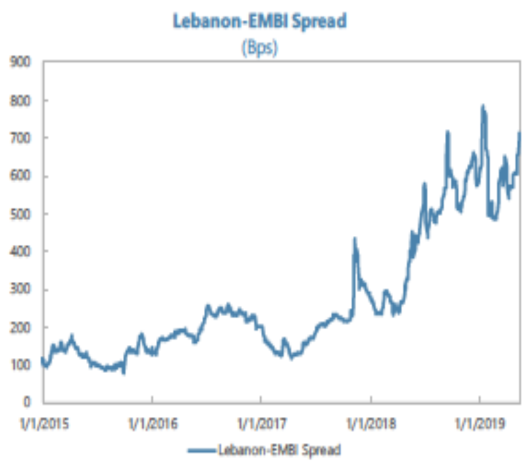




Sources: IMF World Economic Outlook Database, Oct 2016



Sources: IMF World Economic Outlook Database, Oct 2016



Source: Bloomberg.

Early height in debt ratio did not trigger crisis – deficit was falling, and GCC/West supportive

In past decade, primary in balance-> deficit was financing debt service

Debt ratio deterioration after 2011 largely due to growth collapse and rising interest rates

Source: IMF art 4, 2019

10 points action plan and achievements

1. Empowered economic emergency steering committee
2. Government imposed capital and banking controls
3. Decisively deal with public sector debt
4. Embark on a credible fiscal reform
5. Deal with private sector debt
6. Repair BdL's balance sheet
7. Bring the banking sector back to health
8. Preserve social peace through a focus on social justice
9. Re-think the FX/monetary policy mix
10. Stabilization and Structural Reform Facility

Dec 2019. Firas Abi Nassif, Edward Asseily, Bilal Bazzy, Hala Bejani, Amer Bisat, Henri Chaoul, Ishac Diwan, Haneen el Sayed, Ali El Reda Youssef, Saeb el Zein, Nabil Fahed, Philippe Jabr, Sami Nader, May Nasrallah, Paul Raphael, Jean Riachi, Nisreen Salti, Nasser Saidi, Kamal Shehadi, Maha Yahya, Bassam Yammine, Gerard Zouein.

IMF requirements

- PM: “some things we can, others we cannot do”
  - Seems focused on energy, subsidies/SSN
- IMF main “prior action”: at minima, start process to reduce public debts so that IMF loans can be reimbursed in future with a high enough probability
  - Also, capital control (so new $$ do not leak out)
  - Safety net (reputational)
- Negotiable time-table and “effort” for:
  - XR unification
  - Plan for fiscal adjustment
  - Banking reforms

Subsidies and Safety Net

- Unsustainable
  - Draining national assets (~$5 bil/y)
  - More than total fiscal expenditures!
- Regressive and full of leakages
  - Less than 20% of "subsidy" goes needy
  - A good share goes in contraband
- Generates corruption and inefficiency
  - High incentives for speculative storage
  - Support over-consumption, esp. of energy

- To be replaced by a SN
  - WB 200-300 mil project
  - Government has a ~1 bil. Plan wt no financing plan yet
  - Discussions ongoing on modalities

Total ($millions)	**5,238**
Fuel EDL	900
Gaz (LPG)	99
Diesel	1,076
Other fuel	963
Medicines & supplies	1,105
Wheat	135
Essential items	960

Energy sector

- Goal: lower production cost (from c27 to 17/KW) AND increase EDL supply to 24h (1500MW), AND full cost recovery (from c10 to ~c20).
- This eliminates private generators (~c35/KW), saves the Gvt $1-2 bil in subsidies (EDL + mazout), reduces pollution (shift to gas)
- The plan requires time/money: to fix generators, add capacity, improve governance
- Regional help: Iraq. Egypt/Jordan: $400 mil. Each (about 800MW)

Distributing the losses

Highly imbricated balance sheets. Losses are:

- Government debt = $90 bil (LBP + Eurobonds) [BdL, Banks, Eurobonds]
- BdL's own losses, $35 bil+ ? [Bank deposits]
- Bank losses loans to private sector ($15bn?)
- Total losses to digest: $50-90bn??

Banque du Liban: $138 (243%GDP) - in $ billion eq.	
Eurobonds: 6	Banks LBP deposits: 68
LBP Public debt: 34	Banks $$ deposits: 84
Int. reserves, Gold	Other liabilities
Other assets	

Commercial Banks: $262 (465%GDP) - in $ billion eq.	
Deposits at BdL 152	LBP Deposits: 51
LBP Public debt: 17	$$ Deposits: 124
Eurobonds: 15	Equity: 21
Other assets	Other liabilities

Public Debt : $90 (155% GDP) - in billion eq.	LBP	$$
Loans by banks: 32	17	15
Loans by BdL: 40	34	6
Other Eurobonds: 18	-	18

Note: figures in table from Sep 2019, later figures include lots of netting out

Debates on Banking sector reforms

All choices distributive as Debt (mainly) internal. To repay is take from Fadi to give to Nabil, and to default is to take from Nabil to give to Fadi.

1. Banks equity (first line of defense) - but resisting
2. Haircuts [plain/reprofiling/good-bad banks] − Distributive fight
3. State assets (incl. gold, privatize, put in a fund) − Distribution? State revenues?

<u>Differences in plans</u>

- Government/Lazard: all of 1 (22bn), a bit of 3 (not gold, "corruption refunds"), 2 paid by large depositors, new banks
- ABL: default only on Eurobonds; lots of 3 ($40bn, incl. gold), some bank capital preserved
- (Salame: leave BdL debt out of the mix)
- Status quo: the small depositors taxed heavily through Lirification

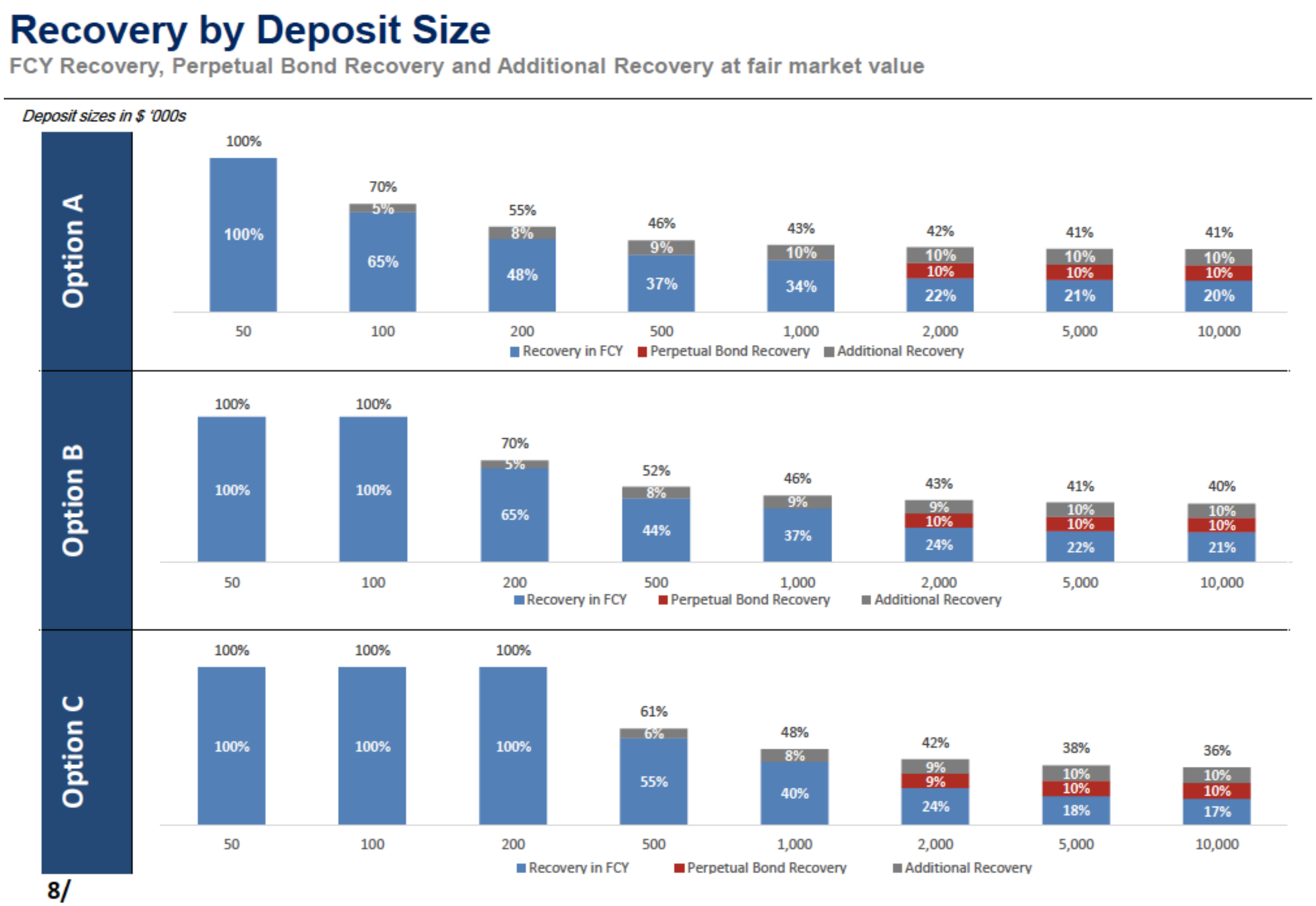
A large and unequal deposit base

			Dec 31, 2018		Dec 31, 2019	
$$	#Clients	%Total clients	Total deposit	%Total deposit	Total deposit	%Total deposit
less than 3K	1,678,671	58.43%	1,101	0.65%	956	0.62%
3 to 20K	573,151	19.95%	4,941	2.90%	4,456	2.88%
20 to 50K	236,944	8.25%	7,498	4.40%	7,049	4.56%
50 to 100K	142,648	4.97%	9,908	5.82%	9,761	6.31%
.1 to .2	106,528	3.71%	14,467	8.49%	14,786	9.56%
.2 to .5	79,954	2.78%	24,091	14.14%	24,900	16.10%
0.5 to 1 mil	29,875	1.04%	20,030	11.76%	19,773	12.78%
TOTAL GROUP A	**2,847,771**	**99.13%**	**82,036**	**48.17%**	**81,681**	**52.81%**
$1-2 mil	14,515	0.51%	19,144	11.24%	17,529	11.33%
2-3	4,395	0.15%	10,314	6.06%	9,059	5.86%
3-5	2,949	0.10%	10,914	6.41%	9,585	6.20%
5-10	2,017	0.07%	13,133	7.71%	11,116	7.19%
10-20	812	0.03%	10,734	6.30%	8,891	5.75%
20-50	337	0.01%	9,778	5.74%	8,160	5.28%
50-100	76	0.00%	5,049	2.96%	2,812	1.82%
Above 100	36	0.00%	9,215	5.41%	5,831	3.77%
TOTAL GROUP B	**25,137**	**0.87%**	**88,281**	**51.83%**	**72,982**	**47.19%**
TOTAL A+B	**2,872,908**	**100%**	**170,317**	**100%**	**154,663**	**100.00%**

Deposits went down by $15 bil during 2019. from very large depositors
Lack of capital controls have reduced the "taxable base" further

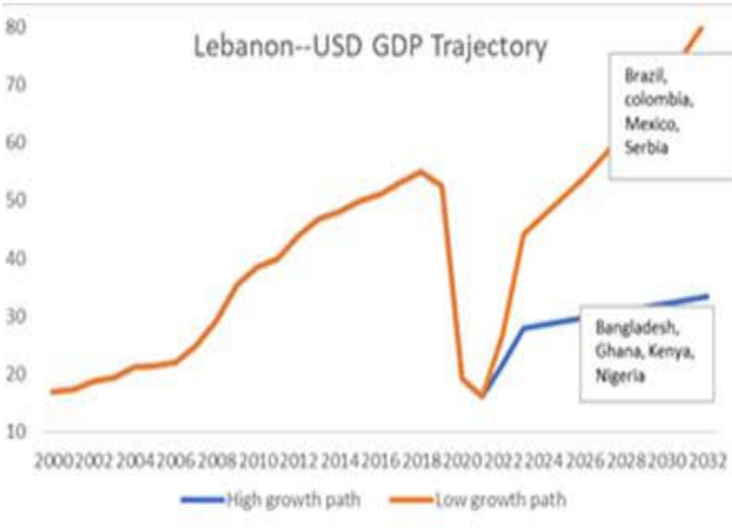
How much haircuts, how much can small depositors be protected?

How much recovery? mid-2021



In 2019, could have protected all accounts below $500,000

Long Term prospects

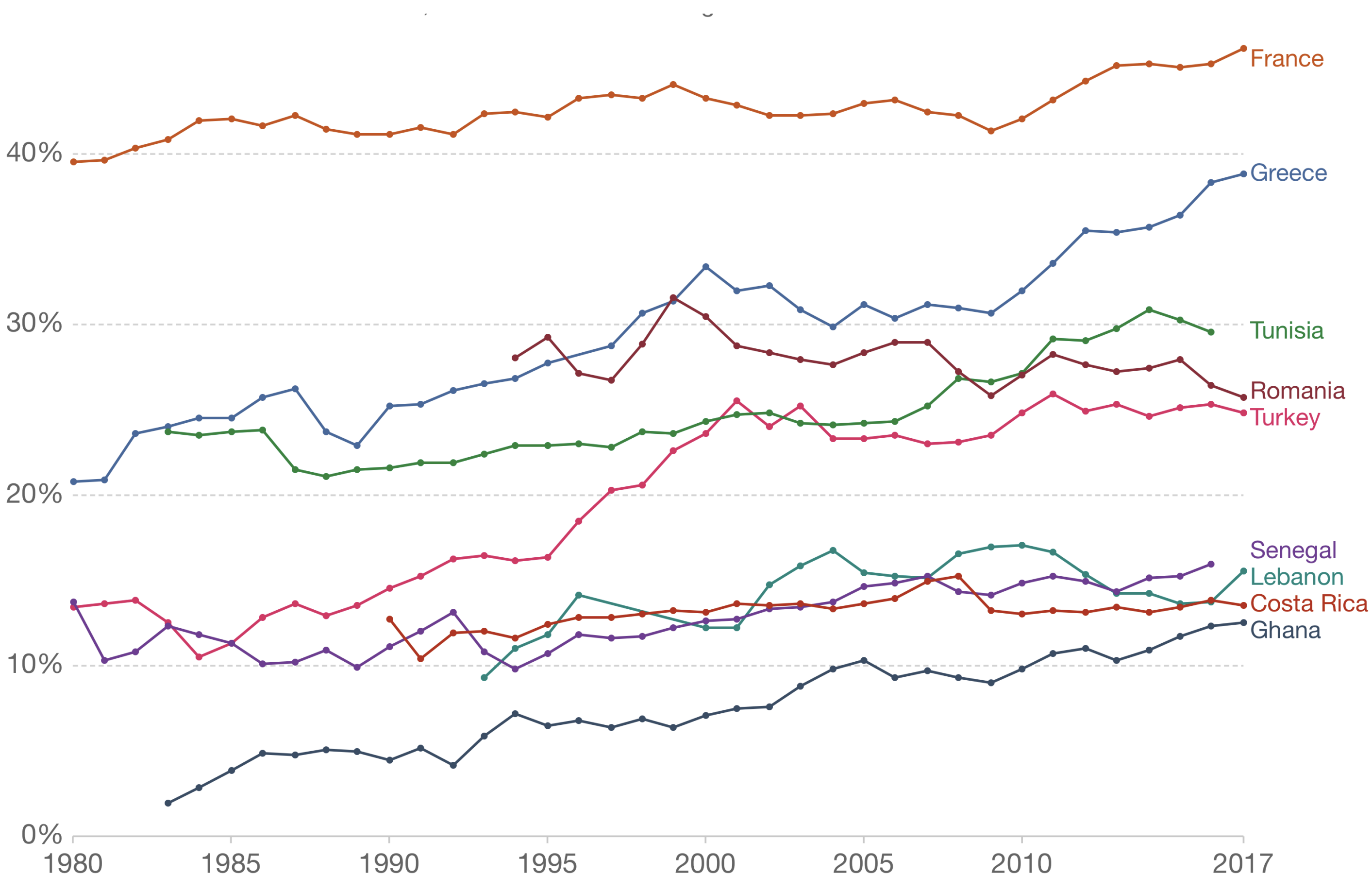


- Igniting growth – stabilization with a human face
- Sustaining growth: inclusive growth, a strong state, social justice, environment

Comparative advantages

- entrepreneurial culture
- rich intellectual capital (educational system)
- valuable "brand", steeped in culture
- Integration in the global economy /Diaspora
- Closeness to the GCC and European markets.

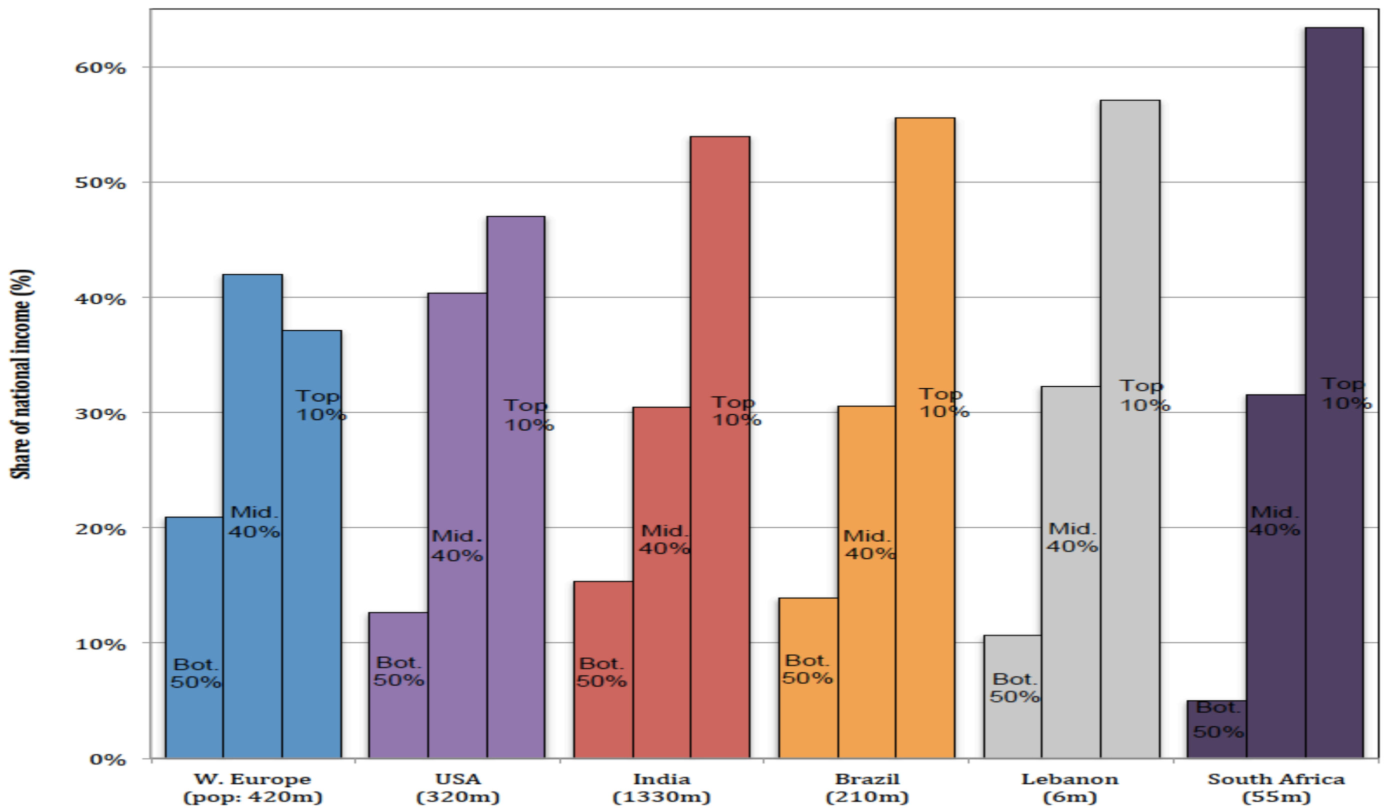
Tax revenues/GDP



Source: ICTD/UNU-WIDER Government Revenue Dataset, September 2019

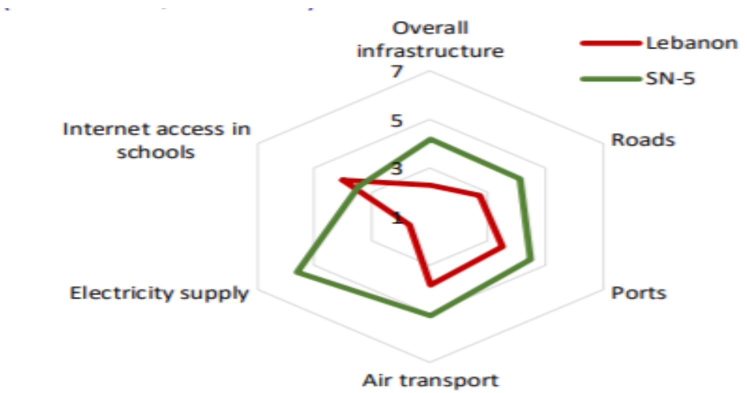
OurWorldInData.org/taxation/ • CC BY

Income distribution



World Inequality Database

Infrastructure and Business climate



Sources: World Economic Forum Arab World Competitiveness Report 2018, Global Competitiveness Report 2017. SN-5 denotes median values for the Southern Neighbourhood non-oil-producing and non-conflict countries Egypt, Israel, Jordan, Morocco and Tunisia.