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Lebanon – analyzing the government's draft reform plan

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Thematic Research

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Macro: a comprehensive draft reform program

The draft reform program of the authorities is a comprehensive plan to tackle the long-standing economic, financial and institutional vulnerabilities of the country, in our view. It assesses the scale of the losses and attempts to distribute them equitably across stakeholders. We think it is an adequate starting point to possible program negotiations with the IMF. We estimate the plan could likely bring the banking sector and the Banque du Liban (BdL) to a small net Fx long position. The parameters and losses of the draft reform plan are broadly consistent with our own estimates.

In search of reform credibility

The main risks to the draft plan are: a) popular opposition to the draft plan; b) execution; c) still high government debt levels post-restructuring; d) macro performance and optimistic projections or estimates; e) fiscal slippage; f) lack of engagement with the IMF; and, g) still low net Fx reserves level post-restructuring.

Large face-value cut to total debt being proposed

The government appears to be targeting a 55% face-value cut to total government debt. For eurobonds, the illustrative government scenario suggests this could be coupled with a 5-year extension and a low (1.2%) coupon rate stepping up to 3% afterwards. BdL and banks appear to be broadly treated in the same way as other bondholders. Face-value cuts are most sensitive to the exchange rate and real GDP growth, all else being equal.

A painful restructuring in the financial sector

In the absence of any additional sources of capital, we estimate the illustrative restructuring scenario in the government draft plan (post-devaluation of USD/LL to 2,979) is consistent with a bail-in of 63.5% of post-devaluation unguaranteed deposits of the top 10% depositors by value in the banking sector. We estimate every 1ppt increase in the nominal reduction of government debt held by banks increases by 0.2ppt the bail-in requirement. We estimate every US$1bn injection from other sources of external capital into the banking sector reduces the bail-in requirement by c1ppt.

EXD strategy: plan suggests downside from current prices

We estimate the eurobond recovery rate implied by the government draft plans to be below 20c, below current market pricing. This is mainly driven by an increase in exit yields and by a possible low coupon rate over 2021-24 (stepping up afterwards). The government reform plan as well as economic and legal challenges confirms our view that it could be difficult for bondholders to preserve value in the restructuring.

We are not including any Past Due Interest (PDI) consideration. We expect PDI (which could be haircut) could be worth 1-4pt for most bonds. Delays to cashflows would hurt value, down 2-3pt for a year delay. PDI negotiations may compensate for this. We estimate using a flat 3% coupon throughout would improve recovery value by c5pt.

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The draft reform program of the authorities is a comprehensive plan to tackle the long-standing economic, financial and institutional vulnerabilities of the country. We think it is an adequate starting point to likely forthcoming program negotiations with the IMF. We estimate the plan could likely bring the banking sector and the Banque du Liban (BdL) to a small net Fx long position. The parameters and losses of the draft reform plan are broadly consistent with our own estimates. Still, reform credibility is key and economic performance may prove worse than initial government projections.

We estimate the eurobond recovery rate implied by the government draft plans to be below 20c, below current market pricing. The government reform plan as well as economic and legal challenges confirms our view that it could be difficult for bondholders to preserve value in the restructuring.

Comprehensive reform program rests on multiple pillars

The draft reform plan incorporates a phased fiscal adjustment, debt restructuring, a restructuring of the banking sector and the Banque du Liban (BdL) balance sheets, a bail-in for large depositors, a more flexible exchange rate arrangement, growth-reforming and social assistance initiatives, institutional reforms (including those linked to the CEDRE donor conference), as well as engagement with international and multilateral partners (including the IMF and the World Bank).

Main parameters of the draft economic program

Continued decline in economic activity

Authorities assume real GDP growth contraction of 12% in 2020, easing to 7% in 2021, 3% in 2022, 0% in 2023 before a return to growth of 2% in 2024. CPI inflation is seen at 25.1% in 2020, easing to 5.2% in 2024.

More flexible exchange rate arrangement

The official USD peg would be devalued in 2021after the restructuring of the banking sector. The arrangement would then transition to a managed float regime based on a deflator differential-based regime that would see USD/LL move to c3,000 in 2024.

Financial sector balance sheet restructuring

BdL net losses are estimated by authorities at cUS$63.6bn, consisting of the recognition of accumulated past losses and the impairment of its portfolio of government securities but excluding losses from devaluation. The target net equity of the BdL is -US$5bn (-15% of GDP), in line with the metric in the IMF's program in Barbados. Banking sector losses are estimated at cUS$83.2bn, excluding losses from devaluation. Authorities plan a full bail-in of bank shareholders and a partial bail-in of depositors (which we read as the 10% of depositors holding more than US$100,000).

Still high external financing needs

Authorities see the cumulative external financing needs of US$27.3bn over 2020-24. These would be met mainly through US$15-18bn relief in the context of the eurobond restructuring, US$10-15bn in external support (CEDRE funds, IMF and other multilateral partners), and planned market access from 2022-23 onwards. The current account balance is seen at -13.9% of GDP in 2020 and hovering between -17% of GDP and -19%

of GDP over 2021-24. We estimate the government's trade balance projection for 2020 appears consistent with a 35% drop in imports and a 10% increase in exports.

Key to the size of the external support is the authorities' assumption that private sector inflows resume after the financial sector restructuring. Authorities assume that current transfers will increase to US$3.7bn in 2020, from US$2.9bn in 2019, dip to US$3.0bn in 2021 before increasing to US$3.9bn in 2024. The shift to a cash economy, continuing capital controls and likely deposit bail-ins suggest the recovery in remittances could be gradual, in our view. BdL's Basic Circular 150 of 9 April may support fresh inflows by providing a regulatory framework for such flows that allows the normal range of banking functions (including outflows) and exempts them from reserve requirements holdings.

Gradual multi-year fiscal consolidation efforts

Authorities see the 2020 fiscal balance and primary balance at -7.2% of GDP and -3.9% of GDP respectively. The fiscal balance and primary balance target are -1.3% of GDP and 1.6% of GDP respectively in 2024. Note that the primary balance target would stand at 3.4% of GDP, excluding CEDRE-financed capital expenditures.

Fiscal efforts will take place through both revenue and expenditure measures. The revenue expenditure effort over 2020-2024 is targeted to reach 4.1% of GDP in 2024. The gross primary expenditure effort, excluding CEDRE spending, is targeted to reach 4.5% of GDP in 2024. The net primary expenditure effort, excluding CEDRE spending and after the implementation of a safety net, is targeted to reach 3.3% of GDP in 2024. The implied primary fiscal consolidation effort, excluding CEDRE-financed capital expenditures, would thus amount to 7.5% of GDP in 2024.

On the expenditure side, the main measures are Electricite du Liban (EdL) reform (savings of 2.5% of GDP in 2024), wage bill reduction (including through a freeze in nominal salaries and hiring; savings of 0.7% of GDP in 2024), pension reform (savings of 0.5% of GDP in 2024), a reduction of transfers to State-Owned Enterprises (savings of 0.4% of GDP in 2024), and a reduction in domestically-financed capital spending (0.2% of GDP in 2024; to be shouldered by CEDRE donor disbursements), other measures (savings of 0.2% of GDP in 2024), and introduction of a social safety net (additional expenditures of 1.2% of GDP in 2024).

On the revenue side, the main measures include broadening the tax base through improving collection and removing exemptions (proceeds of 1.4% of GDP in 2024), tax measures (proceeds of 2.2% of GDP in 2024) and various other measures (proceeds of 0.5% of GDP in 2024). The tax measures include a 3ppt increase in the corporate tax rate to 20%, a 10ppt increase to 20% in the tax on interest income on deposits above US$1mn (large proceeds of 0.8% of GDP in 2024), a 5ppt increase in the income tax for high salaries to 30%, a 5ppt increase in the income tax on capital gains to 30%, a 4ppt increase in the VAT on luxury goods to 15%, a floor price on gasoline and the introduction of an excise tax on gas oil.

Government debt restructuring

The government aims to ambitiously complete the restructuring exercise by year-end. It is aiming to exit the restructuring with a debt/GDP ratio of 92.0% of GDP in 2020. The government's objective is to bring the debt/GDP ratio to c90% of GDP in 2027, with debt increasing in the first years of the program due to multilateral borrowing.

The draft plan suggests that the stock of bilateral and multilateral loans of US$2bn would not be restructured. We estimate an external debt service of US$0.3bn for these loans for 2020. A nominal debt reduction would be sought for domestic debt and Eurobonds. Authorities plan continued rollover of domestic debt principal maturities and the ongoing payment of interest due (except for BdL), albeit at a reduced rate, until a negotiated solution is achieved and with the parameters of the Eurobond restructuring to inform the government's decision. Restructuring of domestic debt approach will be further refined to exclude the social security fund and insurance companies.

We estimate the target interest rate on domestic service is 1.3%, well below the weighted average interest rate on domestic debt of 6.47% as of end-2019. As of end-2019, BdL held 58% of the domestic debt stock, banks 29%, and other holders (mainly social security and insurance funds) 13%. Authorities suggest domestic debt interest payments to BdL are waived. This means the interest rate on domestic debt holdings of banks and other holders would likely need to drop by 200bps to 4.4% under the government's budget 2020 plans. Interest rates on some Treasury instruments have already started to decline by 180bps in the primary market.

Next steps key for credibility

The next steps to monitor in terms of assessing reform credibility: a) approval, without major modifications, of the reform program by Cabinet and parliament by end-1H20; b) passage of a supplementary budget for 2020 in the next few months; c) steps to reduce Electricite du Liban (EdL) transfers from 2021; d) approval of a 2021 budget within Constitutional deadlines; e) steps to address the backlog of legislation related to structural reforms and, f) devaluation of the official USD peg and likely unification of exchange rate arrangements by mid-2021.

Our reading of the impact of the fiscal measures suggests that measures adding up to 0.2% of GDP are planned to be introduced for 2H20. These measures include a reduction to high-ranking military allowances and pensions, a VAT increase on luxury goods from 11% to 15%, removal of some VAT exemptions, measures to improve customs collection, an increase in the floor price on gasoline, introduction of an excise tax on gas oil, enforcement of licensing fees on quarries and crushers, reduction in capital spending and introduction of a safety net.

Macro risks remain

The main risks to the draft plan are: a) popular opposition to the draft plan; b) execution; c) still high government debt levels post-restructuring; d) macro performance; e) fiscal slippage; f) lack of engagement with the IMF; and, g) still low net Fx reserves level post-restructuring.

Possible popular opposition to the draft plan

The high sacrifices demanded of the Lebanese people suggest risks to socio-political stability, in our view. Protests pre-COVID19 lockdown suggested that the population viewed the current political class as having no moral authority to impose austerity. High-profile anti-corruption efforts, the deployment of a social safety net and greater accountability for the crisis are likely to be necessary to be pursued. The draft plan suggests that the parliament is expected to adopt legislation for the establishment of a National Anti-Corruption Commission. The introduction of a safety net is expected to cost 1.2-1.3% of GDP annually over 2021-24. Representatives of syndicates of liberal professions and of the National Social Security Fund (NSSF), as well as a number of political parties, have expressed dissatisfaction towards the draft reform plan.

Execution risks remain

Execution of the reform plan is key in light of the authorities' weak track record and possible regulatory capture. This reflects mixed developments: a) a proposed capital controls law has been withdrawn at the Cabinet level (which puts the ball back in the BdL court); b) no progress on BdL vice-governors or judicial appointments; but, c) some progress in terms of appointment of EdL board members. We expect the proposed option of compensating large depositors through a dedicated deposit recovery fund that will receive proceeds of an ill-gotten assets recovery program and of other state assets (potential privatization proceeds, portion of future oil and gas revenues, etc) could likely generate domestic controversy. There could be also a political economy angle to the debate, should large depositors include representatives from the political class.

High government debt levels to persist post-restructuring

The government draft program plans for central government debt to stand at 92.0% of

GDP in 2020 post-restructuring. It would remain at 103.1% of GDP in 2024 and decline to 76.9% of GDP in 2030. The high levels of central government debt would constrain policy-making, particularly as authorities plan gradual re-access to international capital markets from 2022-2023 onwards. The possible shift in the debt composition going forward could thus subordinate market participants to multilateral creditors.

Initial government projections could prove optimistic

The economic projections in the draft program could prove optimistic and the starting economic position could be weaker than assumed in the draft. In particular, the impact of the COVID-19 outbreak is not taken into account and is expected to be minimal by authorities. Exit yields could thus be elevated, particularly in the current backdrop.

Risk of fiscal slippage

Proposed plans to improve customs collection at ports, airports and land borders, to enforce fines on illegally built maritime and wild and river properties, as well as to recover stolen assets, could face political opposition from vested interests. Authorities assume the former two measures could generate annual revenues 0.5% of GDP (US$150mn) from 2021 onwards, and it is unclear how large is the existing leakage. Furthermore, economic contraction may lower the yield of planned tax reforms.

The EdL plan approved by the Cabinet in April 2019 may not fully eliminate the budget transfers by end-2024, although lower oil prices may provide support instead. Under the IMF assumptions of a reduction to total losses to 20% of production by 2025, 24/7 production capacity by end-2020 and gasification in 2022, EdL transfers would be reduced to 0.4% of GDP by 2025. Reduced losses near-term would occur through better collection and rationing. The bulk of the drop in EdL transfers would take place over 2021-2022 due to tariff hikes and gasification. In this scenario, the IMF estimated tariffs would need to increase to 16.2c/kWh, higher than the government's plans to bring EdL average tariffs to 14.4c/kWh, to fully eliminate EdL transfers by 2025.

The government's estimated proceeds of the planned 10ppt increase to 20% in the tax on interest income on deposits above US$1mn appears optimistic in the context of a bail-in. We see a gap of 0.3% of GDP versus the government projected proceeds (0.8% of GDP). We see proceeds of 0.4-0.5% of GDP, based on the government's implied bail-in size, and on the prevailing interest rate structure in the banking sector.

Lack of engagement with the IMF remains a risk

The authorities are gradually warming up to the idea of an IMF program, and the draft plan makes a cogent case for it given the alternatives. However, this is a key strategic policy decision that has not yet been officially taken. Positively, Hezbollah's Secretary General said in mid-March that his party is not opposed to external financing from the IMF subject to reasonable conditionality. The government projections assume a US$0.3bn disbursement of CEDRE funds in 2021 and US$0.6bn annually over 2022-24, suggesting an IMF program would need to be in place by year-end. IMF conditionality may require more stringent targets, particularly as the financing gap could be larger than government estimates, and we would thus expect arduous negotiations.

In the meantime, press reports have suggested that the government is examining whether to request a cUS$0.5bn Rapid Financing Instrument (RFI) facility from the IMF to support the fight against the coronavirus. Our reading of the IMF lending sheets suggests that the RFI is designed for situations where a program is either not necessary (due to a transitory shock) or not feasible (due to urgent BoP needs). The recipient country would need to cooperate with the IMF to make efforts to solve its BoP challenges and to describe its proposed economic policies, alongside potential prior actions. While the coronavirus shock could be transitory, the underlying unsustainable debt situation could likely to prevent Lebanon from qualifying for an RFI, in our view.

Still low net Fx reserves level post-restructuring

The implied net Fx reserves accumulation in the government draft plan appears modest given still high debt, in our view. It is unlikely to provide a material buffer in case of exogenous shocks, in our view. An IMF program and reforms may catalyse private sector inflows, once capital controls are lifted and the financial situation normalizes. However, the low implied net Fx reserves accumulation reflects the still large current account deficits expected to persist post-restructuring. As such, USD/LL could need to weaken beyond government projections under an IMF program with more ambitious targets.

Based on end-March data, we estimate the BdL net Fx reserves (excluding US$14.8bn in gold) could stand at US$0.2bn (0.7% of GDP) post-restructuring. This assumes: a) no loss of Fx reserves until conclusion of the restructuring; b) US$21.2bn in liquid gross Fx reserves at end-March; c) exclusion of US$7bn in BdL Fx loans to banks; d) exclusion of US$5.0bn in Eurobonds held by BdL (pre-restructuring); e) the write-off of banking sector Fx CDs and excess Fx deposits in a restructuring (seemingly implied by the government draft plan); and, f) the US$18.6bn in Fx Required Reserve Requirements (RRRs) remain an Fx liability of the BdL (even if a portion of the Fx RRRs shifts to being excess Fx deposits at the BdL after a bail-in of Fx deposits in the banking sector).

We estimate the government plan implies BdL net Fx reserves would increase to US$6.3-8.9bn (20.6-29.4% of GDP) in 2024. This reflects a) BoP projections of the authorities; b) US$10-15bn in external support; and, c) US$6.3bn of the external support package that is meant for BoP support, rather than budget support, and which we treat as BdL Fx liabilities. Gross liquid BdL Fx reserves excluding gold would increase to US$33.6-36.2bn (110-119% of GDP) in 2024, but it is unclear if the overall amount is usable. This is discussed further below.

Usable Fx reserves key to Eurobond recovery value

The level of usable BdL Fx reserves remains uncertain. Authorities suggested that, at end-January, US$22bn of the US$29bn of gross BdL Fx holdings (excluding eurobonds) are liquid. This is in line with the recent MoF TV interview suggesting that BdL extended US$7bn in Fx loans to domestic banks. Authorities also suggested US$18bn of the gross BdL Fx holdings represent bank mandatory reserves held for regulatory purposes.

On the economic side, Fx Required Reserve Requirements (RRRs) should be indistinguishable from other Fx reserves, but there could be an argument that BdL disposal of Fx RRRs is not possible without legal changes[1]. A Council of Ministers decision has given a month (ending on 26 April) for a finalization of a MoF report examining the causes of the crisis, and which would specifically include disclosure of BdL's P&L statement and Fx reserves level.

Recent circulars may lower BdL Fx reserves further

BdL's Intermediate Circular 547 of 3 March may deploy BdL Fx reserves domestically while incurring credit risk. As part of the coronavirus crisis response, BdL allowed banks to extend LL- and Fx-denominated exceptional loans at 0% during the three-month period between March and May to corporates facing liquidity issues. The usage of these loans would be solely to support corporates facing difficulties in the payment of loans, wages, operation and production costs due during this 3-month period.

Subsequently, BdL proposes to extend to banks the equivalent amount of exceptional loan facilities granted in USD-denominated 0% five-year loans (irrespective of the underlying currency of the bank loan). Repayment of corporate loans and back-to-back loans from the BdL would occur over a five-year period. The coronavirus lockdown (and associated bank closure), bank prudence and partial banking sector Fx mismatch implied by use of this facility could minimize take-up of this facility, in our view.

[1] Harb P and Chaoul H, "Are Lebanese banks' US dollar reserve requirements with BDL usable?" - An-Nahar. Retrieved at https://en.annahar.com/article/1149307-are-lebanese-banks-us-dollars-reserve-requirements-with-bdl-usable

BdL's Basic Circulars 148 and 149 of 3 April lays the ground to a more flexible exchange rate. The Circulars allow small depositors with deposits of less than LL5mn or US$3,000 net of any loans outstanding to withdraw all of their deposits for the next three-month period for one time only. We understand that these depositors form 62% of total depositors and represent 0.5% of total deposits. They would hold cUS$0.3bn in Fx deposits and US$0.5bn equivalent of LL deposits.

Fx deposits of small depositors would be withdrawn in LL at a defined USD/LL exchange rate (set in reference to the market rate and at 2,600 initially, just under the prevailing parallel rate). LL deposits of small depositors would be withdrawn initially by converting them into USD at the official rate, then withdrawn in LL at the defined USD/LL exchange rate above (generating a profit to the depositor). Banks are required to withdraw from their Fx holdings at the BdL to match the decrease in their liabilities at the defined USD/LL exchange rate generated by these operations. The maximum implied drop in BdL gross Fx reserves would thus be US$0.8bn, but net Fx reserves would remain unchanged. Should small depositors withdraw all of their deposits out of the banking sector, it would increase currency in circulation by 17% and could put pressure on the parallel rate, in our view.

A first glance at the government's negotiating strategy

The MoF investor presentation clarifies that the main principles for the public debt restructuring will involve a) debt sustainability (debt dynamics to be driven by medium- and long-term debt refinancing costs commensurate with economic growth trajectory and primary surplus target); b) refinancing capacity (manageable LL- and Fx-debt rollovers); c) external financing balance (Fx-denominated govern debt to be compatible with current account dynamics and Fx reserves accumulation objectives); and, d) reasonable buffers against exogenous shocks.

The presentation makes clear in our view that the authorities' focus is on restoring government debt sustainability rather than on minimizing banking sector recapitalization costs. The suggestion that banking sector and BdL balance sheets need to be disentangled likely indicates that banks' Fx exposure to the BdL would be restructured.

The government committed to seeking a transparent, good faith collaborative approach, and "equitable" treatment of stakeholders (which we note could be different from equal treatment). The government has launched an identification exercise (to conclude on 17 April) and will conduct "consultations" with bondholders. "Consultations" could suggest that the government prefers not to deal with a creditor committee, but with bondholders on an ad hoc basis. This may also reflect the potentially diverse investor base. Bilateral consultations could make it more challenging for bondholders to coordinate and coalesce around a unified negotiating position. We think the government's access to asymmetric information about broader bondholder preferences could help it formulate a restructuring proposal on more unfavourable terms to bondholders than otherwise.

Large face-value cut to total debt being proposed

Government appears to be targeting a 55% face-value cut to total government debt. We calibrate this by projecting the central government debt at end-2020 by using the government's deficit and GDP projections as well as its published debt estimates for 2019. Eurobond payments are not serviced until end-2020 when the government aims for the default to be cured. The bulk of the US$0.3bn in multilateral and bilateral debt payments for 2020 relates to principal payments, in our estimates.

Table 1: Government debt estimates and implied total government debt face-value cut

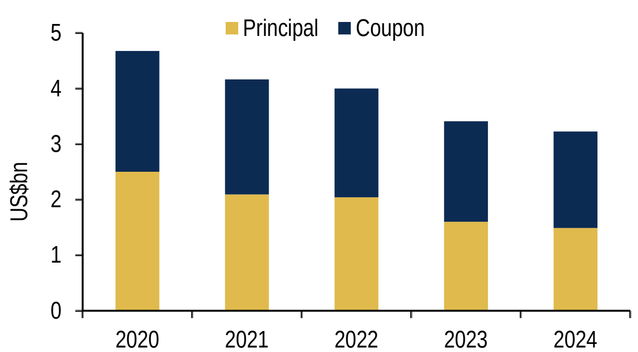
Government Debt (as of December 2019)	US$bn	LLbn	as a % of GDP
LL-denominated debt	56.8	85,701	110.7
Multilateral and bilateral debt	2.0	3,017	3.9
Eurobonds	31.3	47,206	61.0
Total	90.2	135.9	175.6
Government Debt (as of December 2020)	US$bn	LLbn	as a % of GDP
LL-denominated debt	39.0	89,885	114.2
Multilateral and bilateral debt	1.8	4,100	5.2
Eurobonds	31.3	72,053	91.5
Total	72.1	166,037	211.0
Total debt target under draft plan	31.5	72,410	92.0
Debt to be restructured	70.3	161,937	205.8
Targeted debt relief	38.9	89,528	113.8
Total implied debt face-value cut (%)	55.3	55.3	55.3

Source: Authorities, BofA Global Research.

A minimum coupon until 2024, followed by step-up

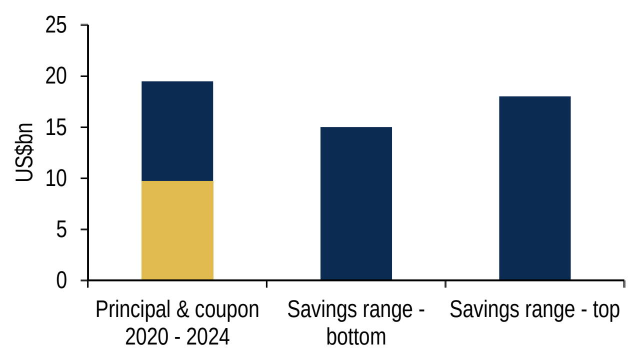
In regards to Eurobonds, authorities suggest "negotiation of a 5-year grace period on principal and the reduction of coupon to a minimum level during that same period would fill (…) US$15-18bn" of the cumulative US$27bn external financing requirements over 2020-24. Original scheduled Eurobond payments for that period are US$9.7bn (principal) and US$9.8bn (coupons). We therefore calculate that the proposed restructuring coupon payments will range from US$1.5-US$4.5bn.

Chart 1: Original scheduled Eurobond payments 2020 - 2024



Source: Bloomberg, BofA Global Research. 2020 is full year.

Chart 2: Total eurobond payments versus targeted savings



Source: Bloomberg, BofA Global Research. 2020 is full year.

We assume these coupons would be paid over the 4 year period 2021-24 (negotiations over 2020 means no payments are likely to be made this year). On an annual basis, these coupons make up 1.2-3.6% of the current gross Eurobond stock of US$31.3bn. The lower range of these Eurobond coupon payments is similar to the government income balance forecast over 2021-24, likely making the lower end of the range a possible illustrative government target, in our view. We therefore focus on the low coupon for our initial analysis, although this is likely to be a key subject of negotiation.

Following "the reduction of coupon to a minimum level during that same period", the government draft plan indicates that its objective to return to "a debt to GDP ratio of c. 90% by 2027" is "achieved under an illustrative scenario of principal discounts on domestic debt and on international bond debt, with a reduction of interest rates to 3% p.a.". As such, this could indicate that the Eurobond would step-up after 2024 to 3%, and we assume this refers to 3% of the current (pre-restructuring) gross stock. We believe this is likely to be a major part of negotiations with bondholders. (The weighted average interest rate on Fx-denominated government debt was 7.38% at end-2019). There appears to be no discussion on the subject of Past Due Interest (PDI) in the draft plan.

Targeted total debt face-value cut most sensitive to Fx assumptions

We present in the table below the sensitivity of the total debt face-value cut implied in the government's draft plan to changes to the government's macro assumptions for 2020. This assumes that the government would still want to keep its debt/GDP ratio target of 92.0% at end-2020. A 10% weaker parallel exchange rate would lead to a 1.7ppt increase in the targeted debt face-value to 57.0%, all else being equal. A 1ppt drop in real GDP growth and a 1ppt widening in the primary deficit would lead to a 0.5ppt and 0.2ppt increase in the targeted debt face-value to 55.8% and 55.5% respectively, all else being equal. A 1ppt increase in inflation would however lead to a 0.2ppt decrease in the targeted debt face-value to 55.1%, all else being equal.

Table 2: Total debt face-value cuts sensitivity to macro performance in 2020

	Total debt face-value cut required to achieve same debt/GDP ratio in 2020 (%)	Change in face-value cut versus illustrative government target (ppt)
1ppt drop in real GDP growth	55.8	0.5
1ppt widening in the primary deficit	55.5	0.2
1ppt increase in inflation	55.1	-0.2
10% weaker parallel exchange rate	57.0	1.7
memo: original implied debt face-value cut (%)	*55.3*	-

Source: Authorities, BofA Global Research. Authorities assume a USD/LL parallel Fx rate of 2,500, and an effective Fx rate of 2,302 derived by assuming that 20% of economic transactions are conducted at the official rate and 80% at the parallel rate.

BdL appears to be facing same face-value cut to its government debt holdings

We estimate that the implied face-value cut to the BdL's portfolio of sovereign debt (52.1%) is broadly equivalent to that required of other bondholders. Authorities estimate total losses of BdL at US$63.6bn as of end-March, including US$42.8bn in recognition of accumulated losses (as proxied by BdL's other assets and assets from exchange operations of financial instruments until an audit is completed). We deduce implied sovereign debt losses of US$20.8bn, representing a 52.1% face-value cut to BdL's holdings of sovereign debt.

Authorities intend to keep BdL's net equity position at -US$5bn (15% of GDP), in line with a metric we suggested was permitted in the IMF's program with Barbados. Authorities suggest the needed impairment of BdL liabilities is at US$54.9bn, and that it "will affect CDs and deposits held by the banking sector. The exact allocation of losses will have to take into account the need to restore a positive Net International Reserve position at BdL". We calculate this amount is equal to the banking sector holdings of BdL Fx CDs and excess Fx deposits. As such, this could likely imply that the face-value cut on those two line items could be near 100%. This would leave BdL net Fx reserves (excluding US$14.8bn in gold) at US$0.2bn (0.7% of GDP) post-restructuring.

Table 3: Implied face-value cut to total debt holdings of BdL

Impairment of BdL liabilities (US$bn)	54.9
Target equity position	-5.0
Current capital base	3.7
Total losses of BdL (US$bn)	63.6
Recognition of accumulated losses	42.8
Sovereign debt losses	20.8
Portfolio of sovereign debt	39.9
Eurobonds	5.0
Domestic debt	34.9
Implied face-value cut to total holdings of sovereign debt (%)	52.1
Banking sector holdings of BdL Fx CDs and excess Fx deposits (US$bn)	54.9
Implied face-value cut (%)	100.0

Source: Authorities, BofA Global Research. Official USD/LL exchange rate used. BdL balance sheet as of end-March 2020. We estimate BdL domestic debt holdings as of end-March 2020 using BdL 2019 holdings, government fiscal deficit 2020 projections and some increase due to BdL substituting for lack of rollover of domestic debt by banks. Authorities loss estimates do not take into account potential devaluation.

Banks appear to be facing broadly same face-value cut on government debt

We estimate that the implied face-value cut to the banking sector portfolio of sovereign debt (62.0%) is somewhat equivalent to that required of other bondholders. Authorities estimate total losses in the banking sector at US$83.2bn as of end-February, excluding the impact of devaluation. This includes US$54.9bn from losses on its BdL exposure and an estimated US$12.2bn in losses arising from banks' loan portfolio. We can thus deduce implied losses arising from the government securities portfolio to be US$16.1bn, representing a 62.0% face-value cut. We think the discrepancy versus total creditors reflects ongoing government work and is not at this stage a strategic policy decision.

Note that the government estimates impairment of 30% of banks' portfolio of claims on residents and will calibrate these losses after an Asset Quality Review (AQR) is completed. At February, bank claims on resident customers stood at US$40.6bn (of which, US$13.4bn are LL-denominated and US$27.2bn are Fx-denominated). Comparatively, bank claims on non-resident customers are much smaller at US$5.1bn (of which, US$1.7bn are LL-denominated and US$3.4bn are Fx-denominated).

Table 4: Implied face-value cut to total debt holdings of banking sector

Impairment of liabilities (US$bn)	62.4
Capital base	20.7
Total losses (US$bn)	83.2
Losses arising from banks' loans portfolio	12.2
Losses arising from assets held at BdL	54.9
Losses arising from government securities portfolio	16.1
Holdings of government securities	26.0
Holdings of LL-denominated debt	14.3
Holdings of eurobonds	11.6
Implied face-value cut to holdings of government securities (%)	62.0

Source: Authorities, BofA Global Research. Official USD/LL exchange rate used. Data as of end-February. Authorities loss estimates do not take into account potential devaluation.

Large deposit bail-in needed

In the absence of any additional sources of capital, we estimate the illustrative restructuring scenario in the government draft plan (post-devaluation to 2,979) is consistent with a bail-in of 52.1% of total banking sector deposits post-devaluation. This would bring banking sector Capital Adequacy Ratio (CAR) back to the minimum regulatory requirement of 10.5%.

The government announced that assets of 90% of depositors (holding less than US$100,000 pre-devaluation) would be preserved. As such, the bail-in requirement would represent 60.1% of post-devaluation total deposits of the top 10% depositors (c100% of the value of the same deposits pre-devaluation). We assume in our analysis that the guaranteed amount of LL75mn (US$49,751 at the official Fx rate) stands. As such, the bail-in requirement would represent 63.5% of post-devaluation unguaranteed deposits of the top 10% depositors by value in the banking sector. Deposit bail-in analysis is not conducted on a net basis (deposits net of loans) for lack of disaggregated data.

We expect all of the bail-in requirements to fall on the Fx-denominated deposits to allow the banking sector to improve its net Foreign-Currency position. Post-restructuring, devaluation and bail-in, we estimate that the Net Foreign Assets and Net Foreign-Currency positions would stand at -US$1.8bn and US$1.4bn respectively.

We estimate the bail-in requirement of post-devaluation unguaranteed deposits of the top 10% depositors by value in the banking sector would increase by 1.7ppt if authorities exclude social security and insurance funds from nominal reductions in the restructuring of domestic debt. We estimate every 1ppt increase in the nominal reduction of government debt held by banks increases by 0.2ppt the bail-in requirement of post-devaluation unguaranteed deposits of the top 10% depositors in the banking sector. We estimate every US$1bn injection from other sources of external capital into the banking sector reduces by c1ppt the bail-in requirement of post-devaluation unguaranteed deposits of the top 10% depositors in the banking sector.

Table 5: Breakdown of customer deposits (February 2020)

Minimum deposit, US$ '000	Maximum deposit, US$ '000	No of depositors	% of depositors	% of deposits	Total deposits, US$mn equiv	Total deposits in FC, US$mn equiv	Total deposits in LC, US$mn equiv	Dollarization
0	3	1,715,283	61.83%	0.5%	795	344	452	43.3%
3	20	451,161	16.26%	2.8%	4,214	2,309	1,905	54.8%
20	50	219,278	7.90%	4.7%	6,971	4,073	2,898	58.4%
50	100	143,435	5.17%	6.6%	9,892	6,203	3,689	62.7%
100	200	111,176	4.01%	10.1%	14,993	10,168	4,826	67.8%
200	500	83,295	3.00%	16.7%	24,859	18,508	6,350	74.5%
500	1,000	28,794	1.04%	12.8%	19,050	15,156	3,894	79.6%
1,000	2,000	12,739	0.46%	11.1%	16,517	13,801	2,716	83.6%
2,000	3,000	3,805	0.14%	5.9%	8,760	7,404	1,356	84.5%
3,000	5,000	2,452	0.09%	6.0%	8,903	7,649	1,254	85.9%
5,000	10,000	1,633	0.06%	7.1%	10,636	9,026	1,610	84.9%
10,000	20,000	648	0.02%	5.6%	8,348	7,194	1,153	86.2%
20,000	50,000	250	0.01%	4.9%	7,271	5,962	1,309	82.0%
50,000	100,000	42	0.00%	1.9%	2,872	2,208	664	76.9%
100,000	+	23	0.00%	3.3%	4,861	4,642	219	95.5%
Deposits above US$100,000		244,857	8.83%	85.32%	127,070	101,718	25,351	80.0%
Total customer deposits		2,774,014	100%	100%	148,942	114,647	34,295	77.0%

Source: Banking Control Commission of Lebanon (BCCL), BofA Global Research. Data excludes financial sector and public sector deposits.

Table 6: Illustrative breakdown of customer deposits post-restructuring and devaluation and bail-in

Minimum deposit, US$ '000	Maximum deposit, US$ '000	Bail-in as % of original total deposits	Bail-in as % of post-deval total deposits	Bail-in as % of post-deval FC deposits	Total deposits after bail-in, LLmn equiv	Total deposits after bail-in, US$mn equiv	Total FC deposits after bail-in, US$mn equiv	Total LC deposits after bail-in, US$mn equiv	Dollarization
0	3	0%	0%	0%	1,706,166	573	344	229	60.1%
3	20	0%	0%	0%	9,750,299	3,273	2,309	964	70.5%
20	50	0%	0%	0%	16,502,202	5,540	4,073	1,467	73.5%
50	100	0%	0%	0%	24,039,905	8,070	6,203	1,867	76.9%
100	200	82.1%	49.4%	61.2%	19,012,983	6,382	3,940	2,442	61.7%
200	500	99.0%	57.3%	67.3%	27,598,846	9,264	6,051	3,213	65.3%
500	1,000	108.0%	60.8%	68.7%	20,004,886	6,715	4,745	1,971	70.7%
1,000	2,000	112.8%	62.1%	68.3%	17,117,682	5,746	4,372	1,374	76.1%
2,000	3,000	114.5%	62.7%	68.5%	8,983,470	3,016	2,329	686	77.2%
3,000	5,000	115.8%	63.0%	68.2%	9,129,463	3,065	2,430	635	79.3%
5,000	10,000	115.6%	63.2%	68.9%	10,784,690	3,620	2,806	815	77.5%
10,000	20,000	116.6%	63.3%	68.5%	8,492,919	2,851	2,267	583	79.5%
20,000	50,000	114.2%	63.4%	70.5%	7,219,417	2,423	1,761	662	72.7%
50,000	100,000	111.1%	63.5%	73.1%	2,769,945	930	594	336	63.9%
100,000	+	122.6%	63.5%	65.0%	5,172,280	1,736	1,625	111	93.6%
Deposits above US$100,000		107.0%	60.1%	67.6%	136,286,580	45,749	32,920	12,829	72.0%
Total customer deposits		91.3%	52.1%	60.0%	188,285,151	63,204	45,849	17,355	72.5%

Source: Banking Control Commission of Lebanon (BCCL), BofA Global Research. Deposit bail-in analysis is not conducted on a net basis (deposits net of loans) for lack of disaggregated data.

Table 7: Banking sector net foreign assets and net foreign-currency assets as of February 2020, and post-restructuring and devaluation and bail-in

	Official FX rate		Official FX rate after haircuts		Deval scenario after haircuts		Deval scenario after haircuts & bail-in	
	USD/LL	1,507.5	USD/LL	1,507.5	USD/LL	2,979	USD/LL	2,979
Feb-20	LLbn	US$bn equiv.	LLbn	US$bn equiv.	LLBn	US$bn equiv.	LLbn	US$bn equiv.
Net foreign assets	-16,020	-10.6	-26,892	-17.8	-51,433	-17.3	-3,201	-1.1
Foreign assets	41,776	27.7	30,904	20.5	58,550	19.7	58,550	19.7
Foreign liabilities	57,796	38.3	57,796	38.3	109,983	36.9	61,751	20.7
Net foreign-currency assets	-6,235	-4.1	-101,617	-67.4	-200,808	-67.4	4,142	1.4
Foreign-currency assets	191,318	126.9	85,384	56.6	168,729	56.6	168,729	56.6
Foreign-currency liabilities	197,554	131.0	187,001	124.0	369,537	124.0	164,587	55.2

Source: Haver, BofA Global Research.

Table 8: Banking sector balance sheet as of February 2020, and post-restructuring and devaluation and bail-in

	Official FX rate			Official FX rate after haircuts		Deval scenario after haircuts		Deval scenario after haircuts & bail-in		
	USD/LL	1,507.5		USD/LL	1,507.5	USD/LL	2,979		USD/LL	2,979
Feb-20	LLbn	US$bn equiv.	Haircut %	LLbn	US$bn equiv.	LLbn	US$bn equiv.	Haircut %	LLbn	US$bn equiv.
Assets	315,098	209.0		189,681	125.8	273,026	91.7		273,026	91.7
Currency and deposits with Banque du Liban	178,044	118.1		95,283	63.2	122,653	41.2		122,653	41.2
Vault cash in LBP	1,074	0.7		1,074	0.7	1,074	0.4		1,074	0.4
Deposits with Banque du Liban	176,970	117.4		94,209	62.5	121,579	40.8		121,579	40.8
CDs issued by BDL in LL	48,043	31.9		48,043	31.9	48,043	16.1		48,043	16.1
CDs issued by BDL in USD	34,220	22.7	100%	0	0.0	0	0.0		0	0.0
RR LL	10,251	6.8		10,251	6.8	10,251	3.4		10,251	3.4
RR Fx	28,040	18.6		28,040	18.6	55,409	18.6		34,556	11.6
Excess deposits	56,416	37.4		7,876	5.2	7,876	2.6		28,729	9.6
Fx	48,540	32.2	100%	0	0.0	0	0.0		20,853	7.0
LL	7,876	5.2		7876	5.2	7,876	2.6		7,876	2.6
share of Fx deposits in excess deposits (%)	*86.0*								*72.6*	
Currency and deposits with other nonresident CBs	872	0.6		872	0.6	1,723	0.6		1,723	0.6
Claims on resident customers	61,241	40.6		42,869	28.4	70,887	23.8		70,887	23.8
In LL	20,235	13.4	30%	14,165	9.4	14,165	4.8		14,165	4.8
Foreign currencies	41,006	27.2	30%	28,704	19.0	56,723	19.0		56,723	19.0
Claims on non-resident customers	7,750	5.1		7,750	5.1	12,795	4.3		12,795	4.3
In LL	2,582	1.7		2,582	1.7	2,582	0.9		2,582	0.9
Foreign currencies	5,169	3.4		5,169	3.4	10,214	3.4		10,214	3.4
Claims on resident financial sector	474	0.3		474	0.3	784	0.3		784	0.3
In LL	156	0.1		156	0.1	156	0.1		156	0.1
Foreign currencies	318	0.2		318	0.2	628	0.2		628	0.2
Claims on non-resident financial sector	8,666	5.7		8,666	5.7	17,124	5.7		17,124	5.7
Claims on public sector	256	0.2		256	0.2	256	0.1		256	0.1
Resident securities portfolio	41,544	27.6		17,261	11.4	23,765	8.0		23,765	8.0
Lebanese treasury bills	21,631	14.3	62%	8,220	5.5	8,220	2.8		8,220	2.8
Lebanese republic sovereign eurobonds	17,535	11.6	62%	6,663	4.4	13,168	4.4		13,168	4.4
Other securities	2,377	1.6		2,377	1.6	2,377	0.8		2,377	0.8
Non-resident securities portfolio	855	0.6		855	0.6	1,689	0.6		1,689	0.6
Tangible assets	5,762	3.8		5,762	3.8	5,762	1.9		5,762	1.9
Intangible assets	2,306	1.5		2,306	1.5	2,306	0.8		2,306	0.8
Other foreign assets	6,098	4.0		6,098	4.0	12,051	4.0		12,051	4.0
Other assets (adj.)	1,231	0.8		1,231	0.8	1,231	0.4		1,231	0.4
Liabilities	315,098	209.0		189,681	125.8	273,026	91.7		273,026	91.7
Resident customers deposits (adj.)	179,528	119.1		179,528	119.1	308,531	103.6		151,813	51.0
In LL	47,369	31.4		47,369	31.4	47,369	15.9		47,369	15.9
Foreign currencies	132,159	87.7		132,159	87.7	261,161	87.7	60%	104,443	35.1
Non-resident customers deposits (adj.)	45,005	29.9		45,005	29.9	84,707	28.4		36,475	12.2
In LL	4,332	2.9		4,332	2.9	4,332	1.5		4,332	1.5
Foreign currencies	40,673	27.0		40,673	27.0	80,375	27.0	60%	32,143	10.8
Resident financial sector liabilities	2,187	1.5		2,187	1.5	3,533	1.2		3,533	1.2
In LL	809	0.5		809	0.5	809	0.3		809	0.3
Foreign currencies	1,379	0.9		1,379	0.9	2,724	0.9		2,724	0.9
Non-resident financial sector liabilities	12,469	8.3		12,469	8.3	24,640	8.3		24,640	8.3
Public sector deposits	7,286	4.8		7,286	4.8	7,286	2.4		7,286	2.4
Resident debt securities issued	447	0.3		447	0.3	447	0.1		447	0.1
Non-resident debt securities issued	322	0.2		322	0.2	637	0.2		637	0.2
Other liabilities	36,559	24.3		26,007	17.3	26,007	8.7		26,007	8.7
In LL (estimated)	26,007	17.3		26,007	17.3	26,007	8.7		26,007	8.7
Foreign currencies (estimated)	10,553	7.0	100%	0	0.0	0	0.0		0	0.0
Capital accounts	31,295	20.8		-83,569	-55.4	-182,760	-61.3		22,190	7.4

Source: Authorities, Haver, BofA Global Research. Balance sheet does not reflect netted-out line items in December 2019 (US$37.5bn in LL-denominated excess deposits at BdL and US$38.9bn in LL-denominated loans from the BdL). Customer deposits (excluding financial sector and public sector) are adjusted to match Banking Control Commission of Lebanon (BCCL) deposit breakdown data. We assume US$7bn of banks' other liabilities represent US$7bn in Fx-denominated loans from the BdL. Deposit bail-in analysis is not conducted on a net basis (deposits net of loans) for lack of disaggregated data. We estimate the domestic banking sector Capital Adequacy Ratio (CAR) is currently close to the regulatory requirement of 10.5%. We estimate that the banking sector's minimum capital requirement post restructuring, post-devaluation, post-bail-in, would stand at US$7.4bn as Risk-Weighted Assets (RWAs) would drop to US$70.9bn, from US$186.3bn in February 2020. This assumes Fx RRRs accrue a risk-weight of 150% and that other banking sector assets (excluding domestic sovereign debt and bank Fx CDs, excess deposits and Fx RRRs) are 65.5% LL-denominated, in line with banking sector asset breakdown. Banks are required to hold the sum of 25% of their demand liabilities in LL and 15% of their term and other liabilities in LL with the BdL at zero remuneration. Banks are required to hold 15% of all their Fx-denominated liabilities at the BdL, remunerated on the basis of prevailing market interest rates and according to their maturities. We assume the portion of Fx RRRs freed up by a deposit bail-in is held in excess Fx deposits at the BdL.

EXD strategy: draft plan suggests downside from current EXD prices

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To use an example of the LEBAN '26s, an investor would have previously expected to get a 100pt principal and a 6.6pt annual coupon. Under the illustrative restructuring scenario suggested in the government draft plan, we think one such bond would be exchanged for a new bond with a comparable principal of 45pt, and an annual comparable coupon of in the range of 1.2-3.6% for 2021-24, followed by a coupon of 3% until maturity. Note that since the principal is lower, that 3% coupon is equivalent to a 6.7% coupon rate. In the recovery tables below, we show a scenario with the initial 1.2% coupon + step-up coupon of 3% and a scenario with a 3% coupon throughout.

We still have little clarity on the actual way the restructuring will occur (i.e. if each bond's terms will be modified or exchanged into new bonds). We would be inclined to assume it will be an exchange into a new basket of maturities. The 5-year grace period could indicate authorities expect maturities to begin in 2025, but we show NPVs of different (longer) maturities.

Exit yield is the other area of debate. Given broader market stress, exit yields should now presumably be higher, comparable to high-risk countries like Sri Lanka, Ghana, and Iraq for example. We therefore use 13-17% yields, although clearly if broader risk sentiment improves, these numbers may well decline. If the yield curve is upward sloping post-restructuring, clearly the longer-dated bonds should be discounted at a higher yield. However, we note that Ukraine was flat initially post-restructuring, for example.

Table 9: Estimated recovery value assuming current bonds are exchanged

55.3% principal face-value cut (government illustrative scenario)					
				Exit yield	
	Initial coupon	*step-up coupon*	13%	15%	17%
10y step-up bond	*1.18*	*3.0*	21.6	18.5	15.8
15y step-up bond	*1.18*	*3.0*	19.0	15.8	13.2
20y step-up bond	*1.18*	*3.0*	17.6	14.5	12.1
10y bond	*3.0*	*NA*	26.7	23.3	20.4
15y bond	*3.0*	*NA*	24.1	20.6	17.8
20y bond	*3.0*	*NA*	22.7	19.3	16.6
50% principal face-value cut					
				Exit yield	
	Initial coupon	*step-up coupon*	13%	15%	17%
10y step-up bond	*1.18*	*3.0*	23.0	19.6	16.8
15y step-up bond	*1.18*	*3.0*	19.7	16.3	13.6
20y step-up bond	*1.18*	*3.0*	18.0	14.7	12.2
10y bond	*3.0*	*NA*	28.1	24.4	21.3
15y bond	*3.0*	*NA*	24.8	21.1	18.2
20y bond	*3.0*	*NA*	23.1	19.5	16.8
60% principal face-value cut					
				Exit yield	
	Initial coupon	*step-up coupon*	13%	15%	17%
10y step-up bond	*1.18*	*3.0*	20.4	17.5	15.0
15y step-up bond	*1.18*	*3.0*	18.4	15.3	12.9
20y step-up bond	*1.18*	*3.0*	17.3	14.2	11.9
10y bond	*3.0*	*NA*	25.5	22.3	19.6
15y bond	*3.0*	*NA*	23.4	20.1	17.4
20y bond	*3.0*	*NA*	22.3	19.0	16.5

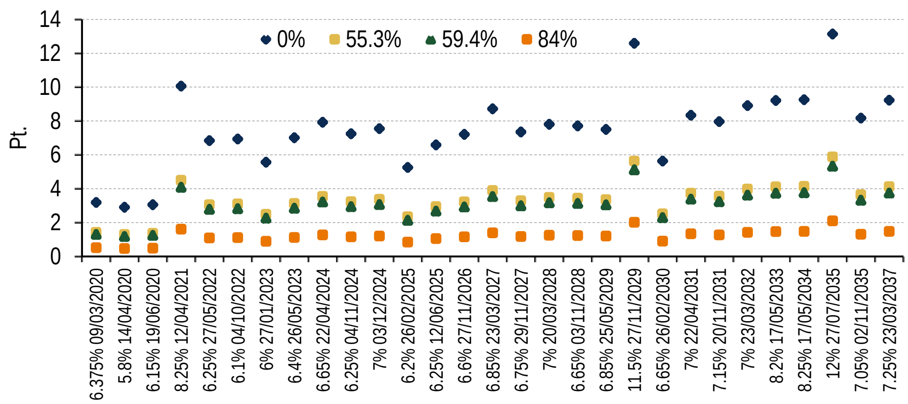
Source: BofA Global research. Coupons are annual and in reference to pre-restructured levels. I.e. a 3% coupon is 6.7% relative to the baseline principal. Bond issued 01/01/2021 with first coupon on 01/07/2021. PV calculated as of today. First step-up coupon date on 01/07/2025.

Under the government's illustrative scenario, there is some downside versus current 20c prices, particularly at higher yields. However, these figures are purely indicative and there are likely to be negotiations on many aspects of this proposal which could create upside for bondholders.

In particular, we emphasize that we are not including any Past Due Interest (PDI) consideration here. This could clearly support recovery value (note that the first cashflow is only paid in July 2021 in our illustrative exercise). Assuming a restructuring completed at start-2021, we would expect PDI (which will presumably be haircut) could be worth 1-4pt (FV) for most bonds, as shown below. However, this is likely to be another subject of intense negotiations with bondholders.

Delays to negotiations (and hence delays to cashflows) would further hurt value, down around 2-3pt for a year delay. Again, PDI negotiations may compensate for this. We estimate using a 3% coupon throughout would improve recovery value by around 5pt.

Chart 3: PDI estimates under various haircuts



Source: Bloomberg, BofA Global Research. Shows FV of PDI. PDI based on time between last paid coupon and 01/01/2021.

Haircuts to PDI are estimated as follows: 55.3% is the same as our baseline principal haircut. 59.4% is the haircut from the current average weighted coupon to 3%. 84% is the haircut from the current average weighted coupon to 1.18%.

Valuation & risk

Lebanon (LEBAN)

Lebanon faces a highly uncertain near-term outlook and we are concerned a restructuring could see bond prices fall lower. However, political willingness to pay is unclear and could potentially support bonds near-term. There are upside scenarios in softer restructurings which are possible given Lebanon's geopolitical importance. Amidst uncertainty, we Marketweight on bonds.

Upside risks come from the potential formation of a technocratic Cabinet, an end to mass protests, and a return of external depositors in particular. Fiscal consolidation could also lead to renewed donor support.

Downside risks stem from pressure on Fx reserves from deposit flight, ongoing mass protests, uncertain political direction and the potential for a disorderly adjustment.

Analyst Certification

I, Andrew MacFarlane, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Special Disclosures

Some of the securities discussed herein should only be considered for inclusion in accounts qualified for high risk investment.

Disclosures

Important Disclosures

Credit opinion history

Lebanon / LEBAN

Sovereign	Date^	Action	Recommendation
Lebanon / LEBAN	31-Mar-2017		Marketweight
	14-Sep-2017	Upgrade	Overweight
	06-Nov-2017	Downgrade	Marketweight

Table reflects credit opinion history as of previous business day's close. ^First date of recommendation within last 36 months. The investment opinion system is contained at the end of the report under the heading "BofA Global Research Credit Opinion Key."

BofA Global Research Credit Opinion Key

BofA Global Research provides recommendations on an issuer's bonds (including corporate and sovereign external debt securities), loans, capital securities, equity preferreds and CDS as described below. Convertible securities are not rated. An issuer level recommendation may also be provided for an issuer as explained below. BofA Global Research credit recommendations are assigned using a three-month time horizon.

Issuer Recommendations: If an issuer credit recommendation is provided, it is applicable to bonds and capital securities of the issuer except bonds and capital securities specifically referenced in the report with a different credit recommendation. Where there is no issuer credit recommendation, only individual bonds and capital securities with specific recommendations are covered. Loans, CDS and equity preferreds are rated separately and issuer recommendations do not apply to them.

BofA Global Research credit recommendations are assigned using a three-month time horizon:

Overweight: Spreads and /or excess returns are likely to outperform the relevant and comparable market over the next three months.

Marketweight: Spreads and/or excess returns are likely to perform in-line with the relevant and comparable market over the next three months.

Underweight: Spreads and/or excess returns are likely to underperform the relevant and comparable market over the next three months.

BofA Global Research uses the following rating system with respect to Credit Default Swaps (CDS):

Buy Protection: Buy CDS, therefore going short credit risk.

Neutral: No purchase or sale of CDS is recommended.

Sell Protection: Sell CDS, therefore going long credit risk.

Sovereign Investment Rating Distribution: Global Group (as of 31 Mar 2020)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	7	16.67%	Buy	4	57.14%
Hold	26	61.90%	Hold	10	38.46%
Sell	9	21.43%	Sell	7	77.78%

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