A Time for Suicide

Economic, fiscal, and monetary crises



Two years: Oct 2019–Sept 2021

Chronology and Impact of public policies and lack thereof

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This report examines developments since the beginning of October 2019 until the formation of a new government on September 10, 2021.

Much ink has been spilled on the period prior to October 2019, analyzing what has led to the collapse of the financial and monetary structures of Lebanon. There have been thousands of analyses in the media and dozens of papers by 'experts' devoted to the issue. Everything in the Lebanese system has been blamed or put at fault, going back to the end of the Civil War: The laissez-faire economic system, the confessional political system, corruption and nepotism, lack of accountability in public spending, recurrent and growing budget deficits, burgeoning public debt, unchecked monetary policies, regional and international conspiracies, and many other issues. Due to fear, ignorance, or both, the impact of the crushing weight of Hezbollah's actions and reactions was mostly muffled by analysts, or blended within the 'All means all' slogan. Most of these analyses stopped at the advent of the events of October 2019.

This report does not attempt to add to the above mentioned plethora of causes. Our analysis of that period was articulated as part of the 'Revival 2021' (www.infopro.com.lb/revival) proposed program, first published in November 2019 with a fourth update published in December 2020.

The purpose of this report is to chronicle and analyze developments since the beginning of the economic, monetary, and fiscal crises. It starts with the date of October 17, 2019 and its immediate prequel, not because it was the birthdate of the debacle. The storm had been brewing for a long time. That date however has marked a new phase in the country's trajectory, and very little has been presented in a compiled format on the failed policies and national losses accumulating since then, and still ongoing. The period covered ends with the formation of a new government, and coincides with the second anniversary of the beginning of the systemic collapse.

We will keep our eyes open and chronicle the upcoming phase.



Content

Introduction: A Domino effect of negative outcomes 4

Summary of losses incurred in two years 10

Prequel to The Systemic Apocalypse 11

The Crises 16
Catalysts of a simmering situation that has exploded 17
Effect 18
Fair distribution of responsibilities 18

The Economy 20
Deliberate macroeconomic losses 21
'Financial Recovery Plan' and IMF program 22
Forensic audit missing in action 24
Fiscal performance 25
Default and its impact 26
Eating at currency reserves 27
Money supply 28
Devaluation and multiple exchange rates 29
Correlation between shortages of goods, subsidies, and devaluation 31
Inflation, prices and value deflation 32
The explosion blasts the capital and its politics 33
The Corona factor 36

Banking 39
The ever-shrinking banks 40
Failed capital increase 42
Restructuring the banking sector stalled 42
Access to depositors' savings / services 43
Deep and widespread haircuts 43
Uncontrolled Capital 45
Transfers abroad 45
Impact of lowering interest rates 46

Electricity 48

Social Impact 50
Almost 80 percent have become poor 51
Rise in unemployment and drop in salaries 52
Exodus from private schools 52
Breakdown of social insurance 53
Struggling Social Security Fund 54
Delayed Social Safety Net programs 54

Appendix 55
Timeline October 2019-September 2021 56
Major BDL Circulars 62

Introduction and Executive Summary



THE BOTTOM LINE: A DOMINO OF NEGATIVE CONSEQUENCES

The period starting on October 17, 2019 (first day of the uprising) and ending on September 10, 2021 (formation of the Mikati government) was characterized by a rapid collapse of the economy and the financial system amidst persistence of political impotence and a gridlock in governance. During that period, not a single structural reform was implemented. Quite the contrary, a series of haphazardly implemented measures created a chain of negative consequences that fed each other. There was a lack of urgency on the part of various officials to deal with the mounting multiple crises as testified by bewildered visiting foreign officials and reports by international organizations that characterized the government inaction as deliberate and the officials as living in a fantasy land.

There was a political gridlock that prevented any kind of reform. Even when the government presented its ill-fated 'Financial Recovery Program' on April 30, 2020, it could not find a single political party to endorse it. This stalemate, inherited from past years, is the core reason for the crises, their incessant deepening, and the failure to address them.

There was a clear lack of coordination, even antagonism, between various government agencies, ministries, and the Central Bank (BDL), with whom the relationship reached the stage of animosity. It seems that each of these entities was freelancing and focusing on saving its own skin and scoring points. When cornered, as they often were, the 'policies of the past 30 years' were the most frequently used scapegoat. One the one hand, some officials were trying to lessen political and popular pressure at the expense of foreign currency reserves, on the other hand, BDL was trying to camouflage its losses. There were winners and losers amid this disastrous mayhem. Those who have profited from the status quo included smugglers, holders of Credit Default Swaps (CDS), and even borrowers who were able to repay their debt at the official rate, gaining substantial asset value, at the expense of depositors. The losers were everybody and everything else including the institutionalized system which still had plenty remaining before the crises.

The losses incurred on all fronts during these two years exceeded what had been lost in one or more decades up to that time and they eroded most of the gains and development work achieved since the end of the Civil War.

The Cat Is Out of the Bag



In 2019, inexplicably, and without prior warning, and despite having sizeable foreign currency reserves, the Central Bank, unilaterally and without consultation or approval from the government, stopped its proactive interventions to defend the exchange rate of the lira – a long standing official policy mandated by all ministerial statements. This has led to the creation of a parallel exchange rate and market. The exchange rate slipped from the control of BDL which continued to ignore the parallel market and underestimate its significance. It insisted that the lira's value remains solidly pegged at LL1,507 to the dollar. At the onset of the demonstrations, the banks, also inexplicably, closed their doors, possibly fearing a rush of withdrawals by depositors who have lost trust in the system. This became a self-fulfilling prophecy that put the nail in the coffin of the banking system which took three decades to develop and grow. After living in denial for several months, and allowing self-imposed unofficial capital controls, BDL eased withdrawals by bank clients of very limited amounts of foreign currency to be converted and paid in lira, based on a new exchange rate (currently LL3,900), signaling for the first time its recognition of the collapse of the lira, and instituting a de facto haircut. The list of multiple exchange rates expanded with time, and the market also created a 'lollar' to dollar exchange rate. A growing and sizeable monetary mass in circulation (cash) escaped the regulated financial system and came into the hands of the more loosely supervised network of money changers. Cash became king, and the cash economy threw the doors wide open to a grey economy filled with illicit transactions including money laundering. The authorities failed to recognize that an immediate abandonment of the peg would have led to a V-shaped recovery in spite of its extremely high social cost. Two years into the crises, the social, economic, financial, and fiscal cost is multiple times what it would have been had the exchange rate been floated from the onset.

In Default

The collapse of the national currency and restrictions on cash withdrawals from banks brought drought upon both people's pockets and the State's Treasury. A moratorium on debt service, a.k.a default on Eurobonds, was decided and resulted in putting a halt on any prospects for additional external financing. The government justified its decision claiming that it was necessary to preserve gross foreign currency reserves which were at the time around $28 billion excluding gold. The default was done despite pleas from BDL and other stakeholders opposing it. The government also justified its default as a measure to reduce expenditure and public deficit. Halting debt service does not reduce the size of the deficit. Fiscal accounting on a cash basis may allow the State to camouflage its commitments by not including overdue debt obligations, but these remain outstanding and accumulate as accrued interest costs. Prior to the default, the debate around it took merely few weeks. It was ill-planned and disorganized, and negotiations with lenders never really occurred. It was the end of the 'Lebanon never defaults comes rain or sunshine' pledge, a track record that was one of the most

valuable national assets. The decision may have been made by panicked officials who were unprepared to take on what seemed to be a gargantuan task, but they were also pressured by influential stakeholders well invested in financial instruments that would multiply in value should a default occurs (Credit Default Swaps). The parties that politically benefit from the collapse of the central government's authority also exerted tremendous pressure to force the default. They ultimately had the upper hand in this catastrophic decision.

From the Same Disasters Toolbox: Subsidies of Goods



The final 'default' straw that broke the little remaining back of trust made the lira exchange rate go haywire. With all doors to significant financing being closed, the purchasing power of the national currency dropped sharply, fueling further anger on the streets. Rather than jumping into immediate reforms, the authorities instead resorted to the same toolbox that had initially led to the financial collapse.

The subsidy program was greatly expanded to include what has been qualified as basic necessities. A wide array of goods benefited from the new subsidies, including fuels, medicines and medical supplies, inputs to manufacturing, and some food items. Not having left any money of its own to pay for the subsidies, the State, through the Central Bank, resorted to what remained of the gross foreign currency reserves, whose net value was already heavily in deficit. This led to further depletion of foreign currency reserves, and created a price distortion in the market, which was immediately exploited by smugglers who trafficked the subsidized goods to other countries. The price distortion also created a black market domestically. As the subsidized quantities reached their maximum allowable size, shortages of these necessities became widespread. The crisis also affected electricity supplied by the Electricité du Liban (EDL) which declined to two to three hours per day. Even neighborhood generators were forced to ration their supply.

The government was pressured by street protests and special interest groups, as well as by its own political constituents who have become too weak to withstand unpopular decisions such as curtailing subsidies of products. It did not resort to economic advisors with experience in crisis management. It did not follow the recommendations of specialized international organizations (such as the World Bank) which had lobbied for cash transfers to the needy instead of a blanket subsidy of goods. The promised cash card program got lost between committees, ministries, advisors, the Council of Ministers, Parliament, the Central Bank, and donors such as the World Bank and the United Nations' World Food Program. It never saw the light. Was it incompetence, political bickering, turf fights, lack of coordination, or a more sinister reason, namely, to dole out the disbursements for political gain and to win electors' loyalties? It was most likely all of the above. The end result was the termination of most subsidies and no cash card alternative in place. It was as if a decision has been made to stop or delay income-based targeting through the cash card.

Crowding Out the Private Sector

Default, unofficial capital controls and other austerity measures were taken to preserve foreign currency reserves. They had the opposite effect. Foreign currency reserves shrank by $15 billion. Not much money was left for manufacturers and agri-producers to finance imports of raw materials and boost their exports, or even to serve the local market. It was a missed opportunity to improve the deficit in the Balance of Payments. No one was paying attention to the private sector which is the only economic engine left. The loss of jobs and reduced salaries in the private sector exacerbated the poverty rate and dwindling tax revenues. Funds transferred abroad (a.k.a evaded funds) at the onset of the crisis also deprived the private sector from much needed financing, especially for imports of raw material and exports of finished products. BDL and the banks have given priority to transferring abroad money belonging to fiduciary accounts over everybody else (Their exact amount is still being debated). It is not clear what the basis for this prioritization was.

Crisis Mismanagement

With their eyes on the rear mirror rather than looking ahead, the authorities and the political forces started an interminable debate on whose fault it was that matters got so bad. The crises opened the door for potential political gains and for the game of musical chairs of power to begin. The banks having closed their doors, BDL requested the authorization to impose capital controls. It was rejected by the political forces. The lack of capital controls crashed the financial system and ensured that the crisis will be deeper and longer. The concept slowly gained acceptance, at least publicly. Committees were formed and several drafts were worked on, with the IMF being consulted on the text of the last version. It didn't pass muster, and the authorities were reminded that capital controls must be part of a comprehensive restructuring program. The draft reached Parliament, but inexplicably, it never got to the floor for a vote – despite that the fact that most parties were by that time in favor of the move. A hidden agenda?

In parallel, enough political factions coalesced to push the government to mandate a forensic audit of the Central Bank, which was expanded to encompass all public sector entities. A saga ensued involving selecting a firm (Kroll then Alvarez), then in getting BDL to fully collaborate. Alvarez resigned from that mission, citing its inability to access the BDL accounts it had requested to audit. A law lifting banking secrecy was deemed necessary for the audit to continue. It was swiftly passed by Parliament. Alvarez returned to the job in the final days before the formation of the new government. A year was lost. The audit of other public entities remains just ink on paper.

Following the publication of the government's 'Financial Recover Program', official talks started with the IMF. Initially, Hezbollah was adamant in rejecting resorting to the IMF. It finally relented to the talks, but qualified its approval with a reminder of its veto



power on the final program. The Lebanese delegation included the Ministry of Finance, the Central Bank, and some advisors. The members of the delegation bickered with each other, and couldn't agree on numbers. Startled, IMF representatives advised the government to halt the meetings until the Lebanese side can come to the talks as a united front. This didn't happen. No one took responsibility for the failure of the talks with the IMF. Each side was blaming the other.

Throughout this period, the banks became cornered. Depositors rushed to their doors demanding to withdraw all their savings at once. When they couldn't, they demonstrated and even attacked some branches. Some political factions also encouraged people to turn their ire on banks and the Central Bank. Having nothing to offer, and without crisis management skills or plans, the banks failed to deal properly with their angry clients. The banks themselves rushed to BDL to withdraw their holdings there. The Central Bank wasn't able to be the last resort. The banks had kept a large portion of their money at BDL rather than at corresponding banks. They became illiquid, and their proverbial risk management talent turned out to be a fairy tale. Borrowers started settling their foreign currency debt in lira at the official rate, further exasperating the banks' financial position. It also came at the expense of depositors' money. The government and some 'experts' demanded an immediate revaluation of banks' assets and liabilities, and to fully write off the banks' holdings with BDL, i.e. declare bankruptcy of almost every bank. The pushback was predictable.

Failed Reset Post the Port Explosion

In one go, the Port Explosion in August 2020 destroyed parts of Beirut, with a long tally of losses: $3.8-4.6 billion in direct damages, losses to financial flows of $2.9 to $3.5 billion, and priority recovery and reconstruction needs of $1.8-2.2 billion. The political status quo floundered. The government quickly resigned.

Enters France, led by its president Emanuel Macron. In two visits, the first in solidarity and announcement of France's commitment, and the second trying to broker, even impose, a middle ground solution to the political and economic standstill. Macron and his aides got sucked in into the local quagmire which swallowed his initiative. On the political front, it led to an attempt to restore the entente between the various squabbling groups of the ruling class. On the economic front, it presented a reform plan on diet, centered on rebuilding the electricity sector and including some vaguely worded statements about reforms. It was perceived as too little. France had no muscle to impose its vision, and its bag of sticks and carrots was not enough. Bigger and more invested players were not really at the table, and Macron stood all by himself. He ended up extracting himself and blaming the political class for its failure to achieve what it already couldn't possibly do. The opportunity for a reset was lost.



A false start ensued with the re-nomination of Saad Hariri to form a government. It took more than a year for a political balance to be regained and a new cabinet to be formed by Najib Mikati, albeit with almost the same political configuration of the preceding one. Perhaps the only silver lining of this catastrophe was the wonderful display of solidarity and initiatives exhibited by ordinary citizens who hurried from the first minutes of the explosion to do what they can in order to mitigate the pain of those who directly suffered from the blast. It showed that the country still has what it takes to stand up on its feet, once an opportunity presents itself.

Hijacking the Public Narrative



The past two years also witnessed the development of new terms and personalities that dominated the public narrative in traditional and social media. 'Kellon ya3ni kellon' (All Means All), the 'Manzoumeh' (Deep State), the Irtitam al Kabeer (Great Collision), and other nomenclatures summarized and vulgarized the popular sentiments. The new terms were adopted by the media and even by political figures. Each used it to support and reinforce a particular position, and applied it to every issue in the public debate. Dozens of self-declared economic, financial, and fiscal experts (a.k.a mediaconomists) appeared on television programs, often subsidizing themselves for these appearances. They supported these appearances by promotions on social media. Unable to personally capitalize on their short-term fame, they subsequently withered into thin air. Hundreds of small protest or political groups were formed and collectively became known as the forces of Thawra (Revolution). They were also called Civil Society, Forces of Change, Independents, or Opposition. What most of these groups had in common was a call for the political class to voluntarily go away and call for early elections, peppered with broad demands such as fighting corruption and bringing the political class to justice. They shied away from pointing to the overwhelming role of Hezbollah which was barely mentioned. Short of that, they had nothing in common for what should come next. There was no leadership and no proposed political or economic programs. With little political experience or economic basic knowledge, these groups proposed individually a large number of random measures, not unlike the behavior of their government. Reason was absent in government, but also on the street. The Thawra was not able to present a viable alternative. It doesn't look like it had even tried.

The Bottom Line

The political hegemony, in its regional context, together with the multitude of divergent special interests and weakened political parties, led to a standstill and gridlock in government. The accelerating events pushed officials and economic stakeholders into a state of panic. Under pressure from various quarters, they refrained from taking tough but necessary decisions. Instead they implemented measures based on unsharpened instincts and lack of experience in crisis management. These measures ensured the deepening of the crises and now require a much longer and costlier journey for recovery and revival. **It didn't have to be this way.**

Summary of Losses Incurred in Two Years

GDP: $50+ billion in aggregate losses in output

90 percent loss in the real value of lira exchange rate

80 percent loss in the real value of USD bank deposits

Government deficit: $1.5 billion

Foreign Exchange reserves down by $15 billion

Balance of Payments deficit widened to $10.6 billion (2020) from a deficit of $5.9 billion (2019)

Inflation / CPI: triple digit when expressed in LL

Minimum monthly wage dropped from $425 to $32

Public servant starting monthly wage dropped from $630 to $48

Unemployment: from 11.4 percent pre-crisis to 28 percent in February 2020 (pre-Covid-19) then to 40 percent in the November-December period of the same year

Registrations at NSSF declined by 40 percent (by 500,000 adherents)

Poverty increased to 80 percent

Consolidated balance sheet of commercial banks decline by $83 billion (total assets decreased from $263 billion at the end of October 2019 to $180 billion at the end of August 2021)

Almost total loss of retail and corporate banking. Financing almost dry. Losses in headcount and branch closures

Beirut Stock Exchange in 2020: Volume down by 75 percent. Market capitalization down by 14 percent

Losses from Port Explosion: Damages of $3.8-4.6 billion, losses to financial flows of $2.9 to $3.5 billion, and priority recovery and reconstruction needs of $1.8-2.2 billion

Emigration: 10-30 percent (per sector) of highly skilled workforce

Major increase in air pollution from neighborhood generators

The number of tourists fell from 1.9 million in 2019 to just 414,000 in 2020

Imports down by more than 40 percent

Exports down by five percent

Port of Beirut's volume activity down by 30 percent in 2020

Imports of industrial machinery down by 56 percent

30 to 50 percent decline in real estate prices

New building permits down by 28 percent

Cement deliveries down by 38 percent

Sales of new vehicles down by 72 percent

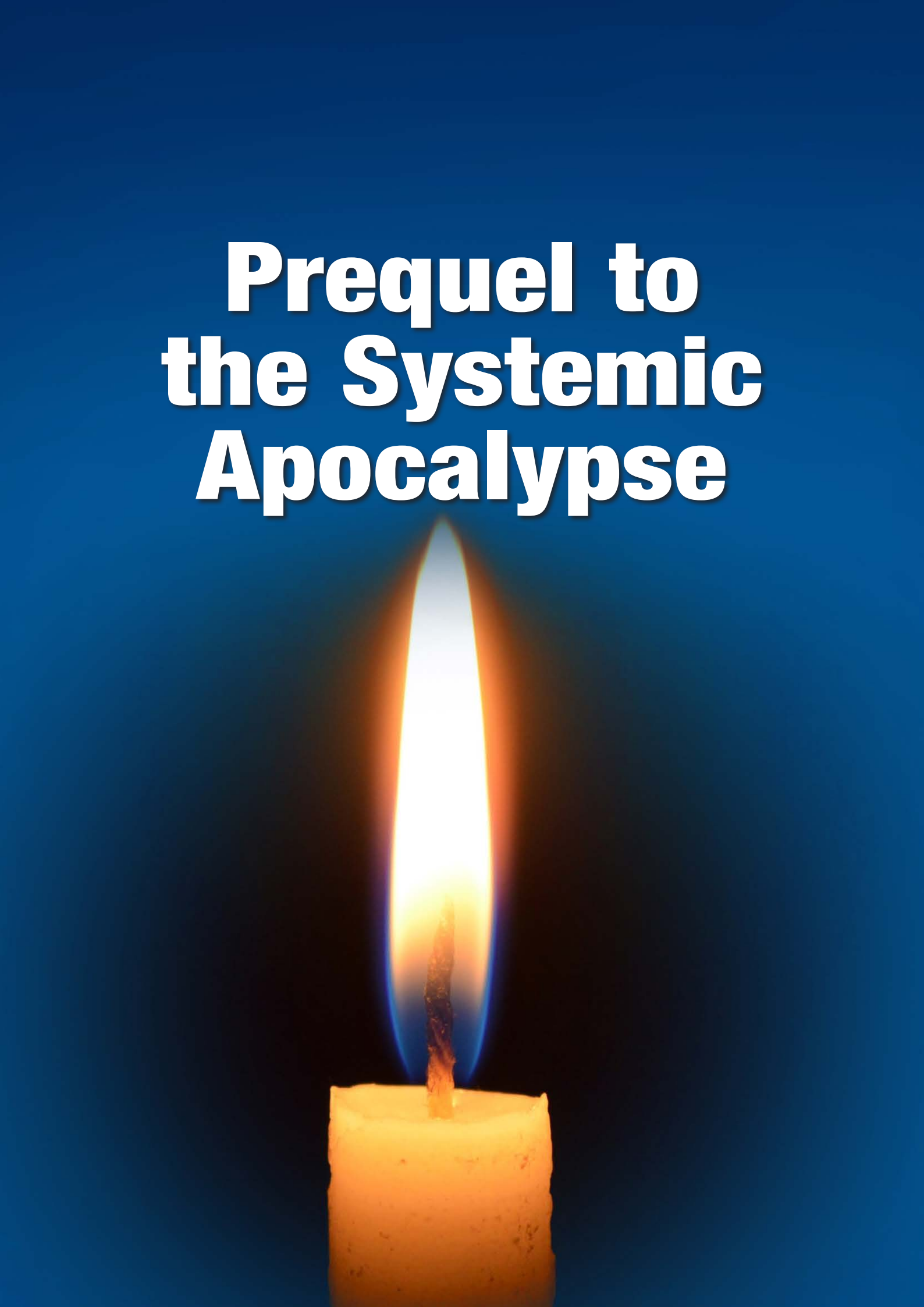
33 percent of citizens deprived of healthcare versus nine percent in pre-crisis times

Company closures: Nearly 17 percent of firms surveyed by the World Bank in 2019-2020 are confirmed or assumed to be permanently closed

Number of new firms registered (Beirut and Mount-Lebanon) down from 4,700 in 2019 to around 2,300 in 2020

54,000 students transferred from private to public schools

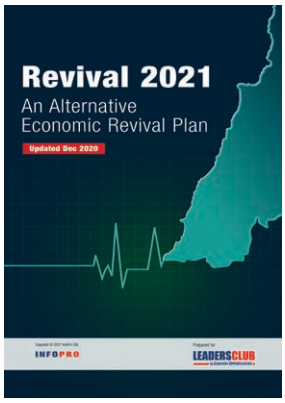
Prequel to the Systemic Apocalypse



Immediate Prequel and Catalysts for the Systemic Apocalypse

For a full narrative and discussion of structural and historical components of the crisis, please refer to Revival 2021 (www.infopro.com.lb/revival).

View Plan



In the few years preceding October 2019, calls for reform and for revising fiscal and debt structures were voiced by all economic stakeholders including the public-at-large, all political parties, donor countries and organizations, the media, and rating agencies, in addition to foreign financial institutions holding a stake in Lebanon's debt and even some who did not.

Since the end of the Civil War, Lebanon has been incurring budget deficits every year, a growing public debt, and corrupt and inefficient governance. But it was also experiencing sustainable economic growth, low inflation, shrinking unemployment, higher wages, development and growth of the private sector, a positive balance of payments, and a stable currency.

The crisis, which started with the war in Syria (2011), took its toll on all indicators. Economic growth came to a halt, unemployment began to climb, the public deficit and public debt started growing at a faster pace, and electricity supply was in decline. Aid and tourism from Arab Gulf countries disappeared. All this led to large deficits in the Balance of Payments (BoP) which in turn resulted in the collapse of the lira.

Before the war in Syria the BoP was consistently positive, which led to healthy foreign currency reserves. Starting in 2011, it registered large deficits, quickly eroding these accumulated reserves. By 2014, the Net Foreign Currency Reserves started becoming negative. The trend persisted, exasperated by the two-year presidential void following the end of the term of President Michel Sleiman and the inability of Parliament to elect a new President. Gridlock was instigated by political parties trying to force the election of Michel Aoun. The financial situation suffered as a result. The financial engineering operations undertaken by BDL, first quietly and on a small scale in 2015, then on a large scale in 2016, sparked a large public debate on the operations themselves, as well as on the State's management of fiscal and financial issues. The necessity of undertaking these operations, as well as their partial opacity, ignited a trend of rapid decline in public and investor trust in the credit worthiness of Lebanon. The erosion of trust was felt by depositors, rating agencies, and donors, and was further fueled by an rising crescendo of reports as well as rumors on the fragility of the Lebanese financial system and a possibility of an imminent collapse. A self-fulfilling prophecy.

The Sovereign's credit ratings got downgraded rapidly and successively. The IMF, which was normally mild in its criticism of the fiscal and financial sectors, raised its tone in its 2019 Article IV report (released mid-October), calling for structural reforms.

In November 2018, a government crisis erupted from the saga of Prime Minister Saad Hariri's (now public) fall out with the Saudi leadership and his controversial resignation. The relationship between the two sides remains complex and opaque with intertwined personal and political aspects.

On that backdrop, billions of dollars hurriedly exited the financial system, and were followed by a steady hemorrhage of foreign currencies, as well as large conversion operations of deposits from liras into dollars. A large portion of the converted amounts exited the system.

Until November 2018, it was apparent that the interests of the Central Bank and of commercial banks were almost always in synch. When the Central Bank started restricting extending foreign currencies to banks, and leaning on banks to use their own reserves placed abroad, tension started brewing between the two financial sector stakeholders. A tug-of-war set off quietly between the two. Large corporate clients started feeling a liquidity crunch when dealing with their banks. For example, opening letters of credit became more difficult, and gradually, exchanging liras for dollars, an instant operation until then, started taking time and was executed piecemeal. Foreign currencies (mostly US dollars), which were until then freely available at banks and foreign exchange counters, started becoming difficult to obtain. By the summer of 2019, the USD/LL exchange rate, solidly pegged since 1997 at an average of LL1,507, was dethroned by a nascent parallel market. The parallel exchange rate first began a slow downward path in the summer of 2019 and spiraled down almost uncontrollably after the start of the October 2019 events and the accompanying temporary closing of the banks.

In August 2019, another nail was put in the coffin of trust in the banking sector with the US sanctioning of Jammal Trust Bank. The bank was rapidly closed and its main shareholders lost most of their equity. While depositors didn't lose money in this debacle, the sanctions were perceived as a signal that the international community, led by the US, is not committed, as it was widely believed, to firmly protect the Lebanese financial system from collapse. It suddenly dawned on observers that the Trump administration's maximum pressure policy does not exclude the Lebanese financial system. This was not the first time that a Lebanese bank was targeted. The previous debacle of the Lebanese Canadian Bank (2011) was also harmless to depositors as well as to shareholders not implicated by US allegations. Most of the bank's assets and liabilities were transferred to another large bank, and the matter was settled between the bank management and US authorities. Not this time.





In 2018, the business community started sensing early tremors warning of a major crisis. By the second half of that year and throughout 2019, many companies started laying off employees, lowering salaries, and curtailing their operations. Real estate sales declined, the hospitality sector was suffering, so were many tourism-dependent businesses such as retailers of luxury goods. The successive security disruptions from the overflow of the Syrian war onto Lebanon had also taken their toll on the country following years of a threatening existence of ISIS at the eastern border, fighting in Palestinian camps in the North, bombings in Beirut and Tripoli, and rising sectarian tensions. For the first time ever, serious political tensions erupted with Saudi Arabia and other GCC countries, which led to their quasi-boycott of Lebanon and resulted in a moratorium on providing aid and investments, and a sharp decline in tourism.

The government, headed then by Prime Minster Saad Hariri, was faced by a gridlock in governance. The Cabinet was formed in January 2019 after nine-month difficult negotiations between major political parties. The new government came at the heels of parliamentary elections (May 2018) and the CEDRE conference held in France where Lebanon had committed to undertake a series of reforms as conditions to obtain concessional loans exceeding $11 billion. After the formation of the Cabinet, the various political parties failed to agree amongst each other on most of the major issues, especially fiscal, social, and infrastructure reform choices. Almost none of the reforms promised at the CEDRE conference, and in the electoral programs of several political parties and candidates, saw the light. Meanwhile economic growth was approaching zero, and a major economic crisis was brewing. The budget deficit was burgeoning and the deficit in the Balance of Payments mushrooming. One major contributor to the worsening of the fiscal situation was a 2017 decision by Parliament to drastically increase public wages without securing matching revenues. Some of the parties represented in the government were pushing for privatization and further liberating the economy and reducing the size of the State. Another group in the government was seeking to increase taxes on high income earners and requiring the banks to foot the bill by providing zero-interest loans to the government. The implementation of reforms in the electricity sector was also in a gridlock. Desperate for new revenues, and paralyzed by political obstruction, the government almost unanimously approved, on October 17, 2019, a decision to tax WhatsApp usage, a measure that is almost impossible to implement. This was the spark that ignited the growing popular anger. One hour after the decision was announced, a number of political parties of opposite sides (inside and outside the government), immediately took to the streets in protest. They were joined the following day and for months thereafter, by a large section of the general population, most of whom had no political affiliation and were fed up with the entire political class.

The government sensing that it had lost its popular mandate, proposed another hurriedly prepared reform plan. It was perceived as too little, too late. It resigned on October 29.

With the background of daily protests and clashes in the streets, a new government, headed by former minister Hassan Diab, was formed on January 21, 2020. Proclaimed as a Cabinet formed of independent technocrats, but actually commandeered by traditional political parties, the government started a journey mired by controversy, disasters, and mostly failures. It resigned on August 10, 2020 following the Port Explosion. It remained in power on a caretaking basis until a new a government was appointed more than a year later. A full year was lost with political parties squabbling over the composition of the government. Prime Minister Saad Hariri was asked to form a new government on October 20, 2020. In July 2021, he announced his abandonment of this mission. Prime Minister Najib Mikati was then mandated to form a government which he announced on September 10, 2021. The new government, like its predecessor, was announced as a technical cabinet, but this time with political affiliations unveiled from the onset.



THE CRISES



The Crises



The various pressures on the process of governance, and on the lira exchange rate, in addition to dollars in banks, which have been simmering for a long time with an accelerating momentum in the preceding few months, have together led to a political and economic explosion at the onset of the demonstrations that started on October 17, 2019.

CATALYSTS OF A SIMMERING SITUATION THAT HAS EXPLODED

Political

The post-2018 election balance between various political parties – which initially allowed a government to be formed, albeit with difficulties – has collapsed. Each political faction became terrified of the popular uprising and at the same time was looking for ways to capitalize on it to win public favor, or to score points against its adversaries. Nobody won. The collapse of the entente between political parties represented in the government and the pressure from demonstrations led to the collapse of the government. The crisis looked unstoppable.

After two months of teetering, a government headed by former minister Hassan Diab was finally formed on January 21, 2020. Heralded as a Cabinet of independent experts, as demanded in the streets, most appointed ministers were actually answering to the respective political parties that have proposed their names. Still, many of these parties, as well as those who saw themselves in the opposition, have from the onset become unfriendly to the government. The Cabinet was floating but without substantial political support, needed for any government to survive, especially when in crisis. It had no chance.

Throughout its tenure (until September 10 2021), the government was under extreme pressure from all political parties, unwelcomed by most Arab and foreign powers, and pressured by the street which rendered it unable to take necessary but unpopular measures. It was also cornered by competing economic and business interests represented by economic associations, the banks, the Central Bank, business-friendly politicians, mafia-like interests in smuggling, those interested in redeeming Eurobonds and those who gained from default, besides those benefiting from the subsidy scheme and others who suffered from it. The government was also facing a wide variety of issues emanating from the crisis such as the coronavirus pandemic, social, economic, and infrastructure pressures resulting from the collapses of the exchange rate, banking, and economic activity.

Balance of Payments
It all boils down to the large deficit in the Current Account component of the Balance of Payments (BoP). It is at the BoP level that the resultants of the large trade deficit and the exit of deposits, paint the gloomy picture. The BoP started its downward trajectory with the outbreak of the Syrian Crisis in 2011. Much more funds were exiting the country than entering it. It has led to the erosion of Net Foreign Currency reserves, reaching negative values in 2014. The Central Bank resorted to two measures that would have yielded short-term benefits but carried long-term risks. One was the clearance of dollars internally which rendered the greenback a local currency, by artificially creating much more dollars than there are actually. The other was undertaking financial engineering operations which temporarily attracted large funds into the country, but later got stuck in the financial system and exasperated an already untenable imbalance in the financial position of BDL.

EFFECT



Everyone in Lebanon is able to describe the fallout of these crises. Deep economic recession, loss of savings, depreciation of the currency, rationing of goods, lack of electricity, decline in social services, disruptions in education and healthcare, frequent business closures leading to an increase in unemployment and drastic upsurge in poverty levels.

All this has led to a new wave of emigration, especially of skilled labor in all sectors. The national brain and brawn trust, upon which any revival must depend, has seriously eroded.

FAIR DISTRIBUTION OF RESPONSIBILITIES

While everyone was busy tallying the financial losses in the Central Bank and at banks that preceded the financial crisis and proposing their 'fair distribution', and looking at how to liquidate the financial sector, almost no attention was given to the losses on all other fronts (see summary table on page 10), especially since October 2019. Everyone was concerned about 'how we got here', i.e. the past. No attention was given to the continuing losses, i.e. the present and the near future.

It is clear that all stakeholders got whiplashed by the events from October 17, 2019 to date. The government and State institutions, the Central Bank, friendly countries, donor organizations, and the private sector, all failed individually or collectively, to come up with a coherent and comprehensive plan to deal with the crises.



The government proposed a plan that has not found one single supporter. Instead, it resorted to some ad-hoc measures much of which were either poorly implemented or not at all. It has been mired by internal squabbles and backbiting amongst its members, as well as misunderstandings with local and international stakeholders.

While waiting to reach an agreement for a program with the IMF, a process that normally takes several months at best, the government did not have an interim plan to deal with urgent issues that need to be immediately addressed. Instead, it went ahead with a set of ill-planned random decisions in various fields, without carefully considering their impact on the rest of the economy, fiscal position, and monetary considerations. Each concerned ministry seemed to act unilaterally, often without coordinating with other stakeholders within or outside the government. The result was tumble and stumble, unintended consequences, and outcomes opposite to their objectives.

After being dethroned by the Port Explosion and its political ramifications, it even failed as a care-taking government. A few ministers did their best to carry on with their duties, but most of the others were either missing in action or working at a minimum level. The government as a body failed to keep up with the events, or take responsibility for almost anything.

The Central Bank, normally a beacon of reassurance and reliable information, became the laughing stock of the public. Its reassurances were either misguided or misunderstood. In either case, the onus fell upon it to send the right and correct signals. It was met with relentless vilification campaigns, often laden with misinformation. But BDL, cornered and with reserves drying up, was equally opaque, tight-lipped, and working only through backroom environments. Trying to please everyone, it ended up pleasing no one. As a result, the public expected the worst, and things got even grimmer than expected. The era of financial bandages to serious problems had gone, and no one seemed to notice it.

The efforts of donor countries and organizations were in disarray as well, as if it was the first crisis they had ever encountered. They all sang in unison that the only way out was to reach quickly a program with the IMF which rests on serious reforms. They knew very well that this was a mirage, given the political situation and the overwhelming dominance of Hezbollah. After the Port Explosion in 2020, France entered the scene in full force, upgrading the role it undertook during the CEDRE conference in 2018. It didn't go very far, and ended up blaming local politicians for not being able to achieve the non-achievable.



THE ECONOMY

The Economy

DELIBERATE MACROECONOMIC LOSSES

"The Lebanon financial and economic crisis is likely to rank in the top ten, possibly top three, most severe crises episodes globally since the mid-nineteenth century," said an April 2021 report by the World Bank, portraying the crisis as a "deliberate" act. Since 2018, the economy continues to witness its worst performance ever over the period 1993-2021. GDP has been shrinking in the last three years and culminated with a 20 percent contraction in 2020. The only other contraction over the 28-year period was a near-zero percent negative growth recorded in 1999. The economy is expected to shrink by another ten percent in 2021. According to the World Bank report, the current recession is likely to remain arduous and to linger given "the lack of policymaking leadership and reforms." The bank pointed in two consecutive reports to the deliberate inaction of the authorities to address the crisis despite the magnitude of the depression. It said: "Sadly [there is] no clear turning point on the horizon."

There is controversy around the new shrunken size of GDP, with the IMF and World Bank advancing widely different estimates. But it can be safely presumed that the cumulative losses in GDP in 2019-2021 exceed $50 billion. None of the stakeholders even attempted to address the drastic reduction in economic output. Plans advanced by the government, as well as most other suggested schemes, eyed restructuring, even liquidating, the banking sector and the Central Bank. None seriously addressed spurring economic growth. The government had estimated that its recovery plan will eventually lead in a few years to 4-5 percent growth – in the best case scenario.



'FINANCIAL RECOVERY PLAN' AND IMF PROGRAM

A 'Financial Recovery Plan' was finally officially announced by the government at the end of April 2020. It was met with strong opposition from banks and private sector bodies. The Central Bank (BDL) also expressed strong reservations on the plan. The private sector saw very little in the plan to revive the economy. BDL and banks saw It as surrender to total bankruptcy and a measure of liquidation. They also disagreed on the estimations in the government plan of the losses incurred by BDL and the banking sector. All opponents complained that they were not consulted prior to the approval of the plan by the government. A parliamentary Finance and Budget sub-committee, mediated between the government and the critics of its plan. It was perceived as siding against the government approach. Following the announcement of the plan, talks with the IMF debuted with government officials and their consultants, and BDL. During these meetings, strong divergences became apparent between members of the Lebanese delegation on various issues, especially about tallying the 'losses' in BDL's balance sheet. The IMF recommended that talks be suspended until the Lebanese side comes back with a unified assessment of figures. This led to a delay of an eventual IMF program – more than a year and a half as of this writing.

A full critique of the Financial Recovery Plan was published in our Revival 2021 document (www.infopro.com.lb/revival). The plan was concocted by consultants with no prior experience in managing fiscal and monetary crises. They were supported by the venerable Lazard consulting company, whose initial mandate was to assist the government negotiate with foreign bondholders. It is not clear how it got involved in the recovery plan, and what was its mandate in this regard. In a post-mortem review following the government's resignation, Lazard reportedly defended, behind closed doors, its role and the plan it assisted in developing. Its position was that the government had set the guidelines and objectives, and Lazard worked on developing the relating plan. It remains unclear, where did the 'liquidation' approach emanate from. But it is clear that it is ultimately the government's responsibility.

It looks like no one in the government had a real understanding of the process of getting to an agreement with the IMF, whose plan expected new loans of $10 billion. The timeline needed to get such an agreement and program in place was not taken into account. The eventual usage of sought funds was not clear. Also missing from the plan was how the borrowed funds were to be repaid, especially with very modest primary budget surpluses forecasted. The program also included financial statements and analysis of the Central Bank which BDL itself disagreed with. This probably has never happened in any other country in distress. As a result, the government failed to propose a coherent program, and therefore it did not get very far in its discussions with the IMF.

GDP (USD BILLION)

2017	2018	2019	2020	2021 (e)
53	55	52	31.7	20.5

GDP GROWTH (%)

2017	2018	2019	2020	2021 (e)
0.9	-1.9	-6.7	-21.4	-10.5

Source: World Bank

Summary of weaknesses of Financial Recovery Plan

No confidence-building measures

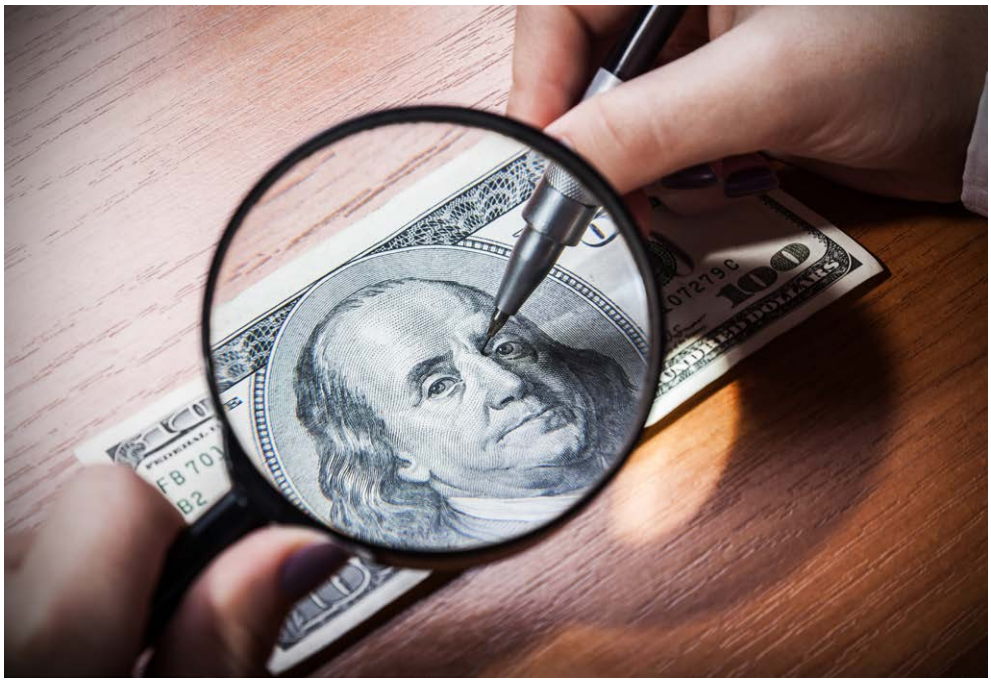
Paltry economic growth targets

The problem was not well diagnosed
- Absence of the political dynamic
- Daily nibble at the State
- Mixing unmixable debt and financial elements
- Inflating 'losses'
- No balance sheet presented
- Scapegoating Syrian refugees

Counterproductive solutions and non-realistic expectations
- Tripling foreign-held debt in hard currency
- Going to the IMF for the wrong reasons
- Non-realistic management of the peg
- Unconvincing budgetary reform
- Ambiguous capital controls
- Recovery of 'Stolen Funds'
- Recovery of 'Evaded Funds'
- Misunderstanding Excessive Interest Rates
- Non-recognition of the sanctioning of the State of Financial Engineering operations
- Crushing the financial sector
- Continuation of subsidies to the wealthy

FORENSIC AUDIT MISSING IN ACTION

Looking to nail the Central Bank, the government announced that it will vigorously pursue a forensic audit of the accounts of BDL which has been accused – in the press and by some political and special interest groups – to have seriously deviated from acceptable accounting practices, and of allegations of illegitimate channeling of funds. Donors and the IMF were also interested in validating a controversial BDL balance sheet. In parallel, enough political factions coalesced to push the government to mandate a forensic audit of the Central Bank. The government mandated KPMG and Oliver Wyman to carry out various audits of BDL. In July 2020, the Ministry of Finance (MoF) signed an agreement with corporate restructuring consultancy firm Alvarez and Marsal (A&M) to perform forensic audit of BDL's accounts. The government had previously announced that Kroll Inc. will be mandated, but it backed off under the pretext of Kroll's alleged ties to Israel. Both A&M and Kroll are global companies based in New York City. In November 2020, not being able to obtain all the documents it needed to complete its mission, A&M terminated the agreement. BDL used the banking secrecy law as a reason for it slack of full response to A&M's demands. Parliament subsequently legislated a law requiring all public administration accounts to be subjected to forensic audit including the accounts of BDL, ministries, councils, funds, and other public sector bodies without any obstruction including the pretext of preserving banking secrecy. In December 2020, Parliament passed a law to lift the banking secrecy for one year in order to clear the way for forensic audit. In April 2021, BDL submitted an updated list of the data required by A&M. In September 2021, the Ministry of Finance signed the new forensic audit contract with A&M. A year was lost. The audit of other public entities remains just ink on paper.



FISCAL PERFORMANCE

The government seems to have inadvertently succeeded in lowering the fiscal deficit to GDP ratio for 2020 to 3.3 percent from the targeted ratio of seven percent. This 'achievement' was not the outcome of improved fiscal performance but resulted from the government's default on its Eurobond obligations which reduced (or rather deferred) debt service by $3.5 billion. In fact, the primary deficit, which consists of the fiscal deficit before deducting debt service, more than doubled to $648 million (at the official LL1,507 exchange rate). The fiscal improvement as a percentage of GDP masks an actual deterioration. Revenues actually did not improve and non-debt service expenses increased. The accumulated primary deficit over the period 2018-2020 totaled $1.5 billion. Support to the electricity company, in the form of advances, made up the bulk of this deficit. The vital reforms demanded by the IMF and other international donors include, among other things, achieving a substantial primary surplus, were not close to be achieved.

In 2020, realized fiscal revenues were at LL15 trillion ($10 billion) ahead of LL13 trillion ($9 billion) budgeted. Primary expenditures (excluding debt service) came in at LL16 trillion ($11 billion) versus LL13.5 trillion ($9 billion) budgeted. The budget was off by $1 billion and the total deficit (including debt service, excluding defaulted amounts) came at $2.7 billion.

FISCAL PERFORMANCE

	2018	2019	2020
Total deficit (USD million)	-6,246	-5,837	-2,709
Total deficit (% of total expenditure)	-35%	-35%	-21%
Total Deficit (% of GDP)	-10.5	-3.3	-3.0
Primary deficit (USD million)	-636	-287	-648
Primary deficit (% of total expenditure)	-3.6%	-1.7%	-5%
Primary Deficit (% of GDP)	-0.5	-0.8	-2.3

Source: Ministry of Finance

GROSS PUBLIC DEBT

	2018	2019	2020	Jun-21
Outstanding amount (USD billion)	85.1	91.6	95.6	97.8
Annual increase	7%	8%	4%	2%

Source: Ministry of Finance

	2018	2019	2020	2021
Debt (% of GDP)	155	171	179	198

Source: World Bank

DEFAULT AND ITS IMPACT



In March 2020, barely one month after Parliament had passed a budget that accounted for debt service including payment of due Eurobonds, the government said it will not honor the $1.2 billion Eurobond due that month which triggered a cross default on all its outstanding Eurobonds. The Prime Minister had previously pledged that no default will happen under his watch. The government had also asked the IMF whether it should pay the due Eurobonds, to which it was answered that this is a Sovereign decision. It was not the place of the IMF to advise on the matter, especially without a program in place. That's an additional indication that the government did not fully comprehend the role of the IMF.

It was the first time in its history that Lebanon has defaulted on its debt. It was done against strongly-worded recommendation from the Central Bank against it, as well as the opposition of the Association of Banks and most economic stakeholders and business actors. The government claimed that its aim was to safeguard the country's foreign currency reserves and finance basic imports. At the time of the default, foreign currency reserves, excluding gold, amounted to $28 billion. At the time, the foreign holders of these bonds were estimated at owning around a third of the defaulted amount (a few hundred millions). The government did not attempt to negotiate with bondholders, local or foreign, and had no plan to deal with the default, not even a discussion. Much has been written and discussed since then on the merits of the default. But opponents as well as proponents of the default faulted the government for doing it in such a disorganized and unprepared fashion. Just like the Financial Recovery Plan, it was the work of amateurs.

In the immediate term, Lebanon, as a result of the default, was excluded from international capital markets. Its credit rating, already in the doldrums, reached the lowest possible notch on the scale. In the months that followed, as a result of other disastrous decisions, foreign currency reserves were depleted, with nothing left but unusable mandatory reserves.

Following the default on the $1.2 billion Eurobonds, a payment of nearly $400 million was ruled by a Credit Default Swap (CDS) committee in favor of investors holding credit insurance on the Eurobonds. This amount was to be paid by funds and banks that had sold the CDS. More CDSs are still out there. Their value has not been disclosed. An investigation must be conducted on whether insider trading occurred by examining CDS trades prior to the decision on defaulting on the Eurobonds.

Following the default, banks started selling part of their Eurobond portfolio at substantial discounts to foreign funds, to raise fresh dollars. Those funds currently own around one third of the foreign currency debt. They have formed an ad-hoc committee to coordinate their positions and negotiations. Conspicuously, they have not taken any legal action, nor exercised any pressure. Both the government and bondholders stated that they intend to negotiate in good faith. The government hired Lazard to advise on the matter. But no actual negotiations have taken place so far.

Of all the ad-hoc and ill-planned decisions taken by the government before and after the default, this was by far the most damaging in terms of cost, reputation, and ability to recover. Parliament, which had just passed a budget law mandating the payment of Eurobonds, did not react. The government had enough backing from political parties who were either shortsighted, or pressured by popular sentiment against honoring the debt, fueled by a focused campaign in the media.



EATING AT CURRENCY RESERVES

Rather than doing its utmost to preserve what remains of BDL's foreign currency reserves, and without a plan in place, the government exerted pressure on BDL to use them to subsidize the exchange rate of imports of basic goods while being oblivious to the fact that the quintessence of the multiple crises was the depletion of these reserves. The annual cost of the subsidies is estimated at $6 billion. The result was a huge attrition of reserves ($15 billion) that mainly benefited smugglers and some traders. BDL's foreign currency reserves plunged from $29 billion at the end of September 2019 (nearly two weeks before the uprising) to $14 billion at the end of August 2021. This has led BDL to put an end to most subsidies in the summer of 2021. The imports that are still subsidized include wheat flour for bread, medicines for chronic diseases and neurological disorders, as well as vaccines, infant formula, and some medical supplies. BDL halted the subsidies when it was only left with just its mandatory reserves which it is not allowed to use except by a parliamentary decision (according to its own legal interpretation).

In September 2021, the International Monetary Fund (IMF) deposited with BDL the equivalent of $1.1 billion in Special Drawing Rights (SDRs) it had allocated to Lebanon, as part of is effort with its member countries to mitigate the economic fallout of Covid-19. SDRs have the potential to strengthen BDL's foreign currency position but they need to be exchanged against reserve currencies. This is done at a cost as Lebanon must pay interests on used SDRs. Moreover there are concerns that the SDRs could be misused and cause more harm than good in light of the track record of the authorities.

The foreign exchange subsidy for imports of basic goods was a decision made at the Central Bank under pressure exercised by the government, parliamentarians and political parties, as well as the media and the public. The onus of using depositors' funds to finance the subsidy fell on BDL. For the longest time, no one questioned the soundness of this measure. The media and politicians actually blamed BDL for not doing enough. Demonstrations at the doors of the Central Bank intensified each time BDL was hesitant or delayed in subsidizing. The demonstrators wanted at the same time to free their deposits and to use them for subsidizing goods.

COST OF FOREIGN EXCHANGE IMPORT SUBSIDIES IN 2020

Product	Cost of Subsidy (USD million)
Wheat	99
Medicines, medical supplies and infant formula	811
Basic goods and foodstuff	303
Fuels	2,231
Total	3,444

* Cost of Subsidy is the cost incurred by BDL to support the difference between the official exchange rate and the parallel market rate

Source: Lebanon-Subsidy Reform Note, World Bank, December 2020

FX GROSS RESERVES EXCLUDING GOLD AND EUROBONDS (USD BILLION)

2018	2019	2020	2021 *
32.5	29.6	18.6	14.2

FX GROSS RESERVES INCLUDING GOLD AND EXCLUDING EUROBONDS (USD BILLION)

2018	2019	2020	2021 *
44.3	43.5	35.9	30.9

* August 2021

MONEY IN AMPLE SUPPLY



The collapse of the lira was accelerated by the upsurge in currency in circulation which led to a sharp increase in demand for dollars. Currency in circulation practically doubled in 2019 and then tripled in 2020. This is mainly attributed to fiscal deficit monetization by the Central Bank, substantial withdrawals from term deposits in lira, in addition to BDL's Basic Circular 151 which allows withdrawals from foreign currency accounts in lira at an exchange rate of LL3,900 to the dollar. Deficit monetization consists in BDL's additional lending to the State by subscribing to new Treasury bill issues in lira. The Central Bank is also purchasing T-bills from banks whose share in total outstanding T-bills decreased from 37 percent in December 2017 to 25 percent in May 2021. Conversely, BDL's share increased from 48 percent to 62 percent. In parallel to the surge in currency in circulation, term deposits in lira dropped by 28 percent and 42 percent over the same period. The end result was that broad money supply (M2), which includes currency in circulation and lira deposits (both term and demand deposits), decreased by 17 percent in 2019 and increased by six percent in 2020. In fact, M2 decreased by five percent between December 2017 and August 2021 while currency in circulation soared by almost eight times over the same period. Therefore the Central bank did not actually increase the total monetary mass in lira. The pressure on the lira came from the conversion of bank deposits into cash.

The total monetary mass in lira (M2) is equivalent to $50 billion when exchanged at LL1,500. It shrinks to $3.7 billion at a LL20,000 exchange rate. The value of the Currency in Circulation (M0) is $25 billion at the official rate, but its value on the parallel market is less than $2 billion.

In Lebanon, the definition of broad money needs to be expanded to include the M3 (M2 + deposits in dollars – which have become lollars) since funds in foreign currency have actually become a local currency.

Theoretically, the entire monetary mass in lira could be redeemed by gold reserves at LL4,500 per dollar. When including lollars (M3), the exchange rate would become LL12,000.

GOLD COVERAGE OF THE MONEY SUPPLY

	2018	2019	2020	2021*
M0 (LL billion)	5,008	9,818	29,242	37,992
M2 (LL billion)	76,828	63,484	67,510	75,147
M3 (LL billion)	212,993	202,831	200,052	200,811
Gold (USD billion)	11.8	13.9	17.3	16.7

* As in August 2021

Source: Central Bank

DEVALUATION AND MULTIPLE EXCHANGE RATES

The authorities dealt chaotically with the market depreciation of the lira. Both BDL and the Association of Banks (ABL) were reassuring depositors around two weeks before the October 2019 demonstrations that the lira was strong and that the monetary situation was stable, even as its value had started to teeter. BDL said that the volume on the parallel market was very small and does not represent the true exchange rate. But as people could no longer resort to their banks to exchange their liras for dollars, the currency exchange volume on the parallel market grew. It rapidly became the real exchange rate indicator. The exchange market underwent severe fluctuations in both directions, casting doubt on it being solely driven by demand. Even as late as April 2020, the Governor of BDL said that the peg to the dollar remains viable to protect the people's purchasing power. In January 2021, he said that the lira would not be floated until an agreement with the IMF was reached. In futile attempts to rein in the accelerating free fall of the lira, BDL tried to regulate the exchange market by setting a ceiling for the price of the dollar on the parallel market (money changers) while the authorities cracked down on money changers accusing them of speculative trading. Several money changers were arrested including the chairman of their syndicate. Arrests were not confined to money changers. A high ranking official at the Central Bank was detained as well to investigate alleged exchange rate manipulation. He was later released. The authorities also forced the closure of websites and mobile apps that monitor and publish the parallel market exchange rate. Most of them went back online, some having rebranded. The Central Bank also mandated that people could withdraw monthly a small portion of their dollar deposits at LL3,900. It has also introduced Sayrafa, a currency exchange platform intended to compete with the parallel market. It also set other exchange rates for the purchase of fuels. The result was six different exchange rates. Obviously, all these vain efforts didn't halt the rapid decline of the lira. In July 2021, the dollar broke the LL20,000 barrier for the first time. The lira hit a record low at around LL23,000 following Saad Hariri's resignation as prime minister-designate in July 2021. The lira exchange rate see-sawed since then, improving to LL13,800 in September before sagging back to the LL20,000 levels.

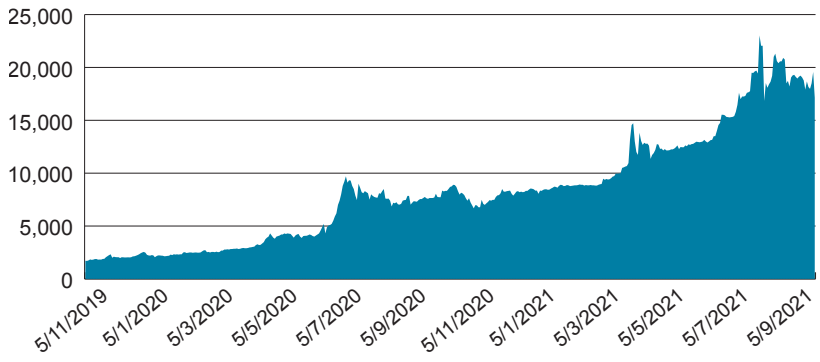


Not everyone suffered from the collapse of the lira. Retail debt in lollar (housing, car, personal, and credit card loans) was allowed to be repaid in the depreciated lira, so was a portion of corporate debt. Many settled their debt early. Those who could not benefit from actually buying liras at LL1,500 to repay their loans, were able to settle their debt in lollar, which created a parallel exchange rate from fresh US dollar to lollar (at around 17 cents at the time of this writing). This has allowed those debtors to practically acquire assets worth billions of real dollars at a sharp discount.

LOANS TO PRIVATE SECTOR (USD BILLION)

	Oct-19	Sep-21	Change
Claims on Resident Customers	**47.2**	**26.2**	**-45%**
-In Lira	14.2	11.2	-21%
-In Foreign Currencies	33.0	15.0	-55%
Claims on Nonresident Customers	**6.6**	**3.6**	**-45%**
-In Lira	1.7	1.3	-24%
-In Foreign Currencies	4.9	2.3	-53%
Total Loans	**53.8**	**29.8**	**-45%**

Exchange rate on parallel market



Source: InfoPro Research

SIX EXCHANGE RATES

Official rate	LL1,507.5
Withdrawals from FX accounts according to **Circular 151**	LL3,900
Withdrawals from FX accounts according to **Circular 158**	LL12,000
BDL's exchange rate platform (**Sayrafa**)	Trading above LL17,000 (In early November 2021)
Parallel market rate	Trading above LL20,000 (In early November 2021)
Lollar	17-20 percent below nominal value of dollar deposits

CORRELATION BETWEEN SHORTAGES OF GOODS, SUBSIDIES AND DEVALUATION

The value of the lira kept falling on the parallel market while official prices of some basic goods remained fixed at the official rate (LL1,507). The discrepancy between the real value of goods and their pricing became very wide. It opened the door for consumers as well as small and large traders to take advantage of the situation. Quickly, mafia-like smugglers organized themselves to monopolize most of the supply in order to resell it domestically and abroad at high margins. It was only when prices were revised for some goods that their supply became partially available again.

The most remarkable failure of the government's policy was registered in the subsidy of fuels. As a result of the subsidy, consumers faced severe shortages. By mid-July 2020, local official fuel prices were 60 percent lower than the average price in three oil producing countries (Saudi Arabia, Kuwait, and the UAE) and 90 percent lower than the average price in three European countries (Cyprus, France, and the UK).

This became a huge incentive to develop a black market for smuggling goods abroad. Manufacturers who were looking for opportunities to export and secure coveted hard currencies were exasperated because they could not easily get their fuel supply to operate their factories. Car drivers had to wait in long lines for hours and private district generators started, like Electricité du Liban (EDL), to ration electricity supply. Hospitals became unable to secure reliable electricity supply which put patients' life at risk. Another byproduct of the faulty subsidy scheme was the disappearance of baby milk (infant formula) from the shelves of pharmacies and the emergence of a black market for this basic good. Some people were stashing large quantities of baby milk in order to sell it to desperate parents at exorbitant prices through social media. Another misfortune was the shortage of medicine including badly needed drugs for chronic diseases. At some point, in a very rare event in the history of the country, many pharmacies went on strike to pressure the government to address this issue. Imports of medicine, medical supplies, and baby formula reached $1.2 billion in 2020, all of which subsidized by BDL.



FUEL IMPORTS (MILLION TONS)

2018	2019	2020	2021 *
8.1	8.0	7.7	3.2

* Until end of June 2021

Source: Central Bank

FUEL IMPORTS (USD BILLION)

2018	2019	2020	2021 *
4.1	6.5	3.2	0.8

* Until end of March 2021

Source: Customs



PHARMACEUTICAL IMPORTS (USD MILLION)

2018	2019	2020	2021 *
1,329	1,242	1,184	334

* Until end of March 2021

INFLATION, PRICE AND VALUE DEFLATION

The collapse of the exchange rate created confusion and chaos in pricing. There is a major inflation (in lira) and a parallel large deflation in prices (when expressed in equivalent fresh dollars). Consumers (and authorities), whose earnings are in lira or lollar, use the lira-benchmark to value goods and services on the market. For them, prices have risen stratospherically. For outsiders who value goods and services in real dollars, prices have either remained the same, or dropped significantly. What is being perceived as inflation is instead a decrease in the purchasing power of salaries denominated in liras or lollars. It was the salaries that have dropped in value rather than the real prices of goods that have increased.

Some basic goods had their prices based on the subsidized official exchange rate of LL1,507, and were therefore to be sold at pre-crisis levels. But wholesalers and retailers had also overhead costs that were in hard currency such as shipping and insurance. Prices in lira increased dramatically. Most consumers received their pay in lira or in 'lollar' which they had to exchange at a rate representing a 60 percent haircut. The cost of some basic goods and services remained unchanged such as mortgage payment or rent, utilities, and telecom. Other basic goods partially increased because of their fresh fund cost components. Goods that were not subsidized were priced at the parallel market rate, and some have completely disappeared from supermarket shelves and from showrooms. The Consumer Price Index, published by the Central Administration of Statistics failed to capture the real changes since it monitors prices as expressed in lira, and does not have the flexibility to adapt its weighing model to new consumer habits. They also include flagrant errors in data collection. Therefore the inflation estimates used in official reports and adopted by international agencies have a very wide margin of error. That is why CPI indicators are not included in this report.

The value of hard assets also experienced the same effect, but in reverse. These assets have increased tremendously in value (expressed in liras or even lollars). However when valued in hard currency, the assets' value drops. The most flagrant example is in real estate where property prices in hard currency have dropped 30 to 50 percent, even with much higher demand.

To mitigate the increase in prices, some goods and services have suffered a deflation in value. Bread is the most flagrant example, where the government allowed the reduction of the weight of a large bag of bread, from 900 grams at LL1,500 to 850 grams at LL6,500. Restaurants have also reduced their portions, quality of food, and free amenities.



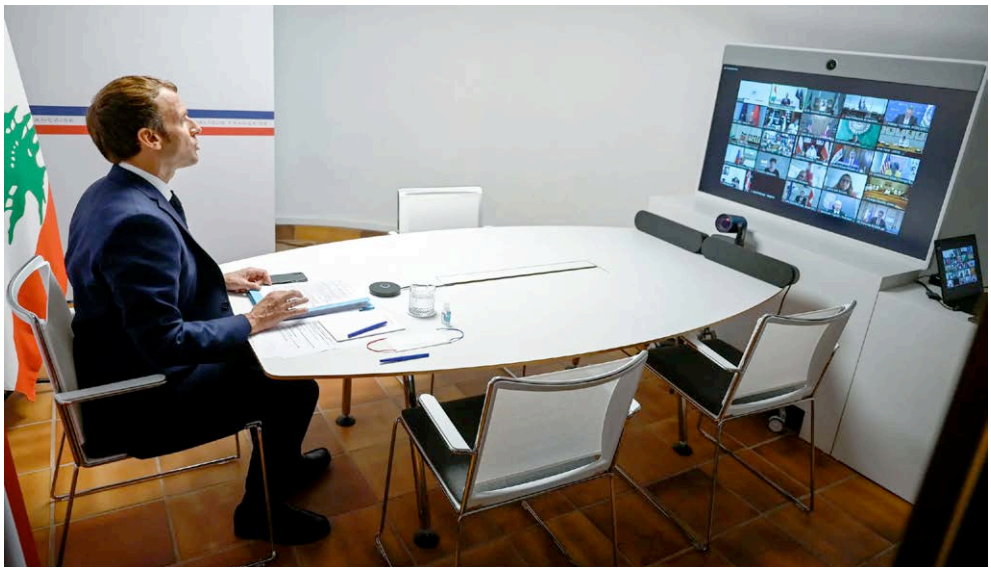
EXPLOSION BLASTS THE CAPITAL AND ITS POLITICS



The Port Explosion on August 4, 2020 was a game changer in many ways. It has ended and permanently maimed many lives, and dislodged thousands of people. Entire buildings, including high-rise buildings, became uninhabitable. The Explosion also led to the resignation of the government and for a search of a different political arrangement. It brought to the table France and its president who threw in the towel after trying to broker, even impose, the formation of a new cabinet and a slimmed reform plan. The explosion also led to criminal investigation that will prove to be disruptive to the political process and even to security, with its general prosecutor replaced in mid-course, and his successor placed under extreme political and security pressure.

At a time, when ordinary citizens, civic society, the private sector, and the international community volunteered in solidarity with people affected by the Port Explosion and showed generosity in alleviating their suffering and in contributing to the reconstruction efforts, the government's attitude was typically characterized by little action and mismanagement of its response to the disaster. Several officials are being suspected of criminal negligence in their handling of the ammonium nitrate cargo, according to Human Rights Watch. It said: "Some government officials foresaw and tacitly accepted the risks of death posed by the ammonium nitrate's presence in the port."

The blast considered one of the most powerful non-nuclear explosions in history, has caused up to $4.6 billion in damages to infrastructure and physical assets, according to the World Bank. Losses resulting from the decline in the output of the economic sectors are estimated to total up to $3.5 billion and public sector reconstruction and recovery needs for 2020-2021 are assessed at up to $2.2 billion. Insured losses, according to the latest update, are estimated at nearly $1 billion of which 79 percent are still unpaid. Nearly 95 percent of insurance policies don't cover terrorism and war risks. This means that most of the insured will not be compensated if the explosion was caused by a terrorism or war act.



France took the lead and called for a donor conference right after the blast, assembling 36 countries and donor organizations. It was attended at the highest level, including the French and US presidents. At the conference, $300 million were pledged for immediate relief.

As a follow-up to the conference, The United Nations (UN), European Union (EU), and World Bank Group (WBG) launched a $2.6 billion, 18-month reform, recovery, and reconstruction response plan to address urgent needs of the population affected by the Port Explosion. Based on in-depth consultations with government, civil society, and donors, the 'Lebanon Reform, Recovery and Reconstruction Framework (3RF)' aims to provide a common reference point and action plan on what needs to be done across various sectors over 18 months. The 3RF also sets out arrangements for the coordination, implementation and financing of recovery and, subject to reform progress, reconstruction priorities. The 3RF includes two parallel tracks: A reform and reconstruction track, and a socio-economic recovery one. The costs for the reform and reconstruction track are estimated at $2 billion. The socio-economic recovery track addresses the urgent needs, estimated at $584 million, of the most vulnerable populations and small businesses affected by the explosion. Around $426 million of this amount are needed for the first year. Financing will build on existing sources that have been mobilized so far, including humanitarian assistance, adjusted and scaled-up assistance by bilateral donors, Diaspora financing, and new forms of crowd funding. The recovery and reconstruction track will be financed in two phases. In the short term, international grant financing will be required to kick-start recovery and support urgent needs while advancing on essential reforms in parallel. Once progress has been made on key reforms and macroeconomic stabilization, concessional loans and private finance can support reconstruction and help set Lebanon back on a path toward stability, growth, and sustainable development. Lebanon Financing Facility (LFF) will be established to receive grant financing, support the recovery track, and prepare for reconstruction. It will provide a pooled financing mechanism as one of the instruments to channel support to selected priorities under the 3RF. LFF will focus on immediate recovery needs of poor and vulnerable households, support business recovery programs, promote inclusive ways of working with civil society, and prepare the ground for reform and reconstruction. LFF will adopt flexible, non-governmental implementation modalities, combined with strong fiduciary monitoring and independent oversight over the use of LFF funds.

On the first anniversary of the blast, a second International Conference on Aid to Lebanon, called for by France, raised around $370 million in pledges for urgent aid to confront the socio-economic crisis. The French government also offered a donation of €1.4 million ($1.6 million) for a project implemented by a French company that involves clearing the port from nearly 30,000 tons of grain. The World Bank provided a $25 million grant to support the recovery of targeted micro and small enterprises directly affected by the blast. It has also prepared a detailed study about 'Reforming and Rebuilding Lebanon's Port Sector'. The proposed reform strategy entails a governance model that consists of a three-tiered structure comprised of a national port administration, landlord port authorities, and private sector terminal and stevedoring operators.

The Ministry of Social Affairs provided cards for people with special needs to some of the injured by the explosion in order to enable them to get wheelchairs and discounts on the cost of treatment, and some in-kind and food aid. But the ministry does not have enough resources to cover the cost of the cards and has to seek the help of local and foreign partners. Parliament has allowed people who have become disabled by the explosion to benefit from the health services provided by the National Social Security Fund but they were not compensated for losing their job and being unable to lead a normal life. The government has not issued any report about the reconstruction process which is very slow.

More than 70 percent of nearly 200,000 residential units damaged by the blast have not been repaired yet according to news reports. Reconstruction work is mainly carried out by non-governmental organizations (NGOs) that are mostly financed by foreign donors. There is little coordination of NGO work, government institutions that are supposed to perform field supervision of reconstruction work are absent.



THE CORONA FACTOR

The Covid-19 pandemic worsened the already dire economic and social conditions. The pandemic's cumulative death toll reached more than 8,000. The cumulative number of published and confirmed Covid-19 cases exceeded 600,000.



The advent of the coronavirus led to an end to street demonstrations, which already had become smaller and less frequent. The mass panic turned everyone's attention from political and economic worries to the pandemic. Many initiatives were undertaken by the private sector to produce masks, sanitizers, and ventilators. It was the first post-collapse testimonial that citizens – who are not part of the government – can take action and contribute to rescuing the country.

Similar to other governments around the world, the authorities were caught totally off-guard by the pandemic, and some of Cabinet members, including the Minister of Public Health, were infected by the virus. There was no emergency plan in place. The government took its cues from the World Health Organization and what was being applied by authorities in other countries. Several flavors of lockdowns, including total and partial curfews, were imposed. The pandemic wreaked havoc on an already precarious economic situation. It accelerated the closure of companies already on the brink of collapse, and caused temporary and permanent unemployment. The government encouraged people to take hygienic precautions, but masks were mandated only sporadically. Some officials, including the Minister of Health, appeared on social media unmasked and socializing at a close distance from others. The lockdowns and curfews were well implemented in the capital and surrounding areas, but were largely ignored elsewhere in the country which greatly contributed to the spread of the disease.

Finally, the vaccines became available. Initially large quantities were promised, but smaller numbers reached the country. The rate of vaccination was initially fairly rapid, especially with older age groups and front-line health workers. It later tapered off as smaller quantities of vaccines were received from abroad. In parallel, a portion of the population resisted being vaccinated, under the influence of debates around it on social media.



New modules were added to IMPACT official application digital platform (Inter-Ministerial and Municipal Platform for Assessment, Coordination and Tracking) to support efforts to fight the pandemic such as registering for vaccination and getting passes for moving during curfews. The IMPACT platform provides information about Covid-19 quarantine facilities and about the distribution of infection cases across regions and demographics. It also gives an overview of the progress of the vaccination process and a timeline of vaccine registration. It provides statistics about vaccinated people such as total number of individuals registered for vaccination and the cumulative number of those who have received the vaccine in addition to a detailed breakdown of these figures across regions and demographics. The platform also provides different lockdown-related data including statistics about processed curfew passes

The frequent lockdowns and other restrictions have affected all sectors mainly tourism, education, and the retail sector. The number of visitors plunged from 1.9 million in 2019 to 414,000 in 2020 due to the unprecedented standstill in global travel. The sharp decline in tourist revenues has partially offset the improvement registered in the merchandise trade balance.

According to the World Bank's Enterprise Survey, the unemployment rate increased from 28 percent in February 2020 (pre-Covid) to nearly 40 percent in the November-December period of the same year. The economic and financial crisis, the Port Explosion, and the pandemic have together contributed to the closure of many businesses. The World Bank's survey conducted in 2019 with a follow up in November 2020 showed that nearly 17 percent of firms were confirmed or assumed permanently closed, while 72 percent were temporarily closed at some point since the beginning of the pandemic with a ten week average closure period. The adaptation of businesses to Covid-19 was relatively low. Few firms have ramped up online operations. "Around six percent of firms have either started or increased their online activities, while eight percent increased online delivery. A relatively higher share of firms (18 percent) has started to increase or has already increased remote work. There is a significant gap between small and large firms, with the latter showing more capacity to adapt," the World Bank said in its 'Lebanon Economic Monitor' for the spring of 2021.

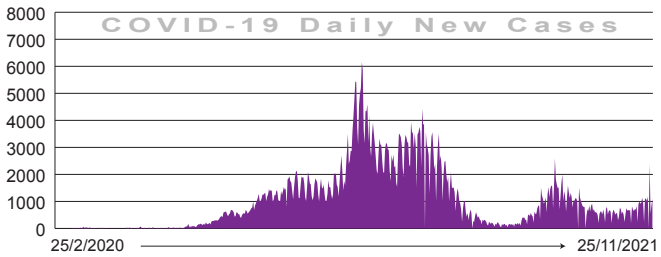


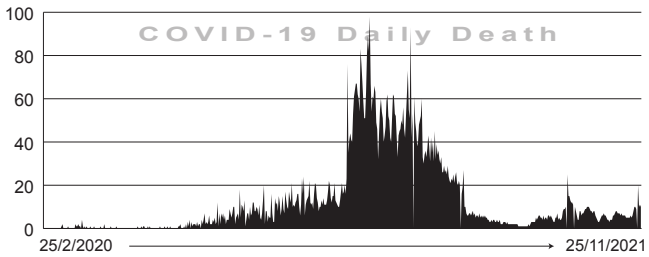
The pandemic has exacerbated the problems of the education system as the quality of education was already in decline. Only half of students were connected to online learning which started in February 2020 and continued in the following school year 2020-2021. Around 60 percent of students either did not have a computer or had to share it with at least three other family members. "Inequities in the education system have been further exposed with the pandemic—from access to broadband and computers needed for online education, to resourceful home environments needed to support learning, up to the misalignment between resources provided by the education sector and education needs," the World Bank said.

Covid-19 has worsened the plight of the poor who were already suffering from the rise in unemployment and the erosion of their purchasing power. It has further heightened their vulnerability since their living, working and health conditions place them at greater risk compared to wealthier segments of the population. To respond to the social problems caused by the economic crisis and the Covid-19 pandemic, the government launched in April 2020 the Emergency National Social Solidarity Program that involves providing monthly cash assistance of LL400,000 per household to the poorest families. Another program, the Emergency Crisis and Covid-19 Response Social Safety Net Project (ESSN) was launched in 2021. The three-year ESSN project involves scaling up the already existent National Poverty Targeting Program (NPTP). In January 2021, the World Bank approved a $246 million loan for the ESSN program which aims to provide emergency cash transfers and access to social services to nearly 786,000 poor and vulnerable people.

The authorities also extended the deadlines for the payment of taxes, utility bills, and contributions to the National Social Security Fund (NSSF) and offered options for rescheduling these payments. They also exempted taxpayers from some fines and interest charges on delays in payments including dues owed to NSSF. Legal or contractual clauses, including charging additional interests, which sanction borrowers who default on their loans, were suspended for six months. The law, which was passed in December 2020, applies to all kinds of private sector loans whether subsidized or not.

Covid-19






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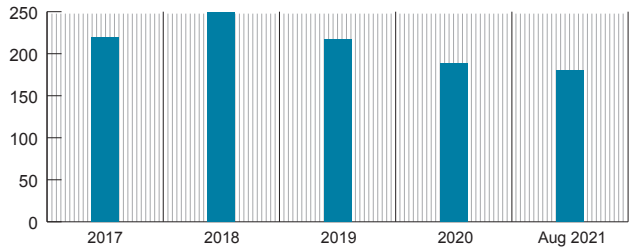
Banking

THE EVER-SHRINKING BANKS

Commercial banks are shrinking. Their total assets decreased by $69 billion, or 28 percent, between December 2018 and August 2021. Their term deposits plunged by $70 billion, or 45 percent over the same period as customers lost confidence in the sector and could no more engage in long-term commitments. Overall deposits decreased at a slower pace (24 percent) to $131 billion since the sharp decline in term deposits was partly offset by a surge in demand deposits which increased by nearly $29 billion. The drop in customer deposits, which is the main bank liability, and the planned increase of their capital, as required by BDL, are deleveraging the banking sector and reducing its default risk. The decline on the liability side of the banks' balance sheet was paralleled by a corresponding decline on the asset side. Loans to resident customers dropped sharply between December 2018 and August 2021, especially those denominated in foreign currencies which plummeted by 57 percent. The fall in the banks' domestic credit portfolio partially reflects the fact that customers were settling loans backed by real estate collateral by using deposits locked up in bank accounts. The banks' Eurobond portfolio more than halved from $16 billion at the end of 2018 to $7.7 billion at the end of August 2021, as the banks reduced their exposure to public debt by selling it at great discounts to foreign funds, as well as taking large provisions on their value (45 percent). Their Eurobond holdings currently have a nominal value of $11.6 to $11.8 billion. They also decreased their holdings in Treasury bills (see Money Supply section). The banks, however, remain highly exposed to BDL. Their deposits with the Central Bank dropped at a much slower pace (17 percent) over the December 2018-August 2021 period compared to the sharp decline in their private sector loans and Eurobond and T-bill portfolios. The decrease in the banks' operations was accompanied by downsizing. The commercial banks' workforce decreased by more than 3,700 employees (15 percent of their total labor) in the two-year period 2019-2020. The number of local branches of commercial banks dropped from 1,080 in 2018 to 965 branches in the first quarter of 2021.

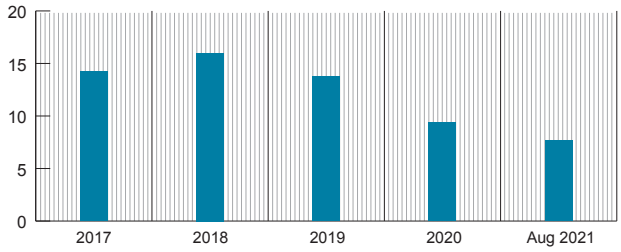


Total assets of commercial banks (USD billion)



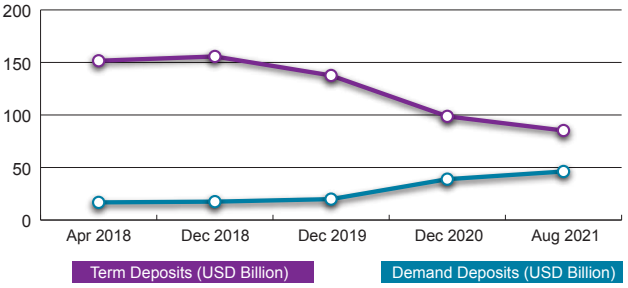
Source: Central Bank

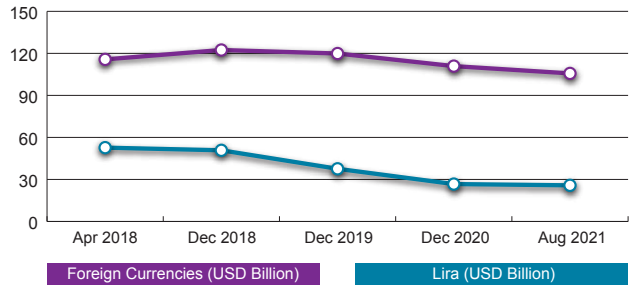
Banks Eurobonds portfolio (USD billion)



Source: Central Bank

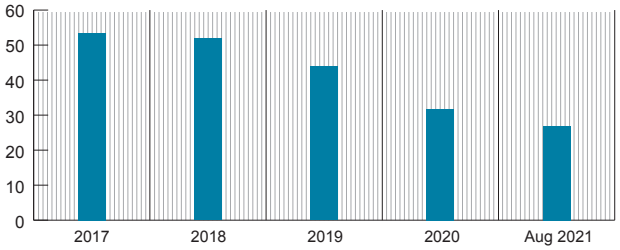
Bank Deposits





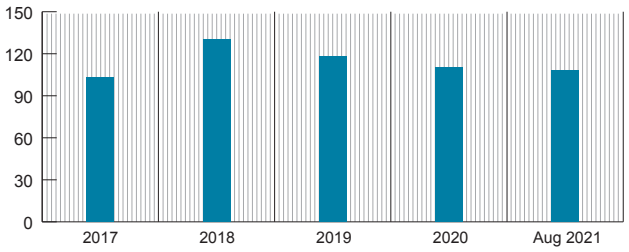
Source: Central Bank

Claims on resident customers (USD billion)



Source: Central Bank

Deposits of commercial banks with BDL (USD billion)



Source: Central Bank

FAILED CAPITAL INCREASE



Not all banks were able to abide by BDL's instruction to increase their capital by 20 percent through cash contributions in US dollars. The Central Bank had set the end of 2019 as deadline for the first tranche of the capital increase (ten percent) and the end of June 2020 for the second ten percent. The capital increase would add $4 billion to the combined shareholders' equity of the banks but this is an inconsequential amount in light of the huge losses suffered by the banking sector. The main solutions adopted by the banks that have complied with the capital increase requirement so far included resorting to contributions by existing shareholders, converting some local dollar (lollar) deposits into equity, or selling overseas operations. BDL's Basic Circular 154 permitted banks to take measures allowing customers to willingly convert their deposits into shares in the capital of the bank or into redeemable, tradable, and convertible perpetual bonds. While the increase in capital was achieved via local assets, no capital in fresh funds was injected into the financial system. Another challenge that the banks are facing is compliance with BDL's requirement to create accounts with corresponding banks abroad representing at least three percent of their customer deposits in foreign currencies. Banks were given the end of February 2021 as a deadline. BDL and the Banking Control Commission are following the matter with banks that are facing difficulties in applying this ruling.

STALLING THE RESTRUCTURING OF THE BANKING SECTOR

There are no indications that practical steps have been taken to restructure the banking sector. There are disagreements among the main players over the proposed solutions. BDL announced in mid-July 2020 the formation of a committee for restructuring the banks. Its task is to propose amendments to prudential regulations of banking activity, assess the financial performance of each bank on its own merits, and propose measures required to safeguard the soundness of the banking sector. The main task of the committee is to assess the Expected Credit Loss (ECL) of each bank on its foreign currency credit portfolio to BDL and the private sector. More than a year later, there has been no announcement regarding this matter.

LACK OF ACCESS TO DEPOSITORS' SAVINGS AND SERVICES

Spooked by reports from various quarters predicting one form or another of collapse, resident and non-resident bank depositors started withdrawing their bank deposits or transferred them abroad, accelerating a momentum that started with the Saad Hariri saga in Saudi Arabia in November 2017. Reassurances of the Governor of the Central Bank were not enough. Right before the outbreak of the October 2019 protests, he said that dollar liquidity was available in banks and that the social media and media reports were exaggerations. At the onset of the uprising, banks closed their doors at the encouragement of the Central Bank. ABL said that the move was the result of popular protests and unrest. However, while demonstrations were widespread, especially in the capital and its suburbs, attacks on banks did not start immediately. Banks had more than 1,000 branches. Only a handful of them were in areas overtaken by demonstrators. Obviously, it was not just a security concern. Insiders said that the banks were in a state of panic and were trying to avoid a rush on banks. They hoped the demonstrations would end and that the rush would subside. It did not.

The Central Bank privately urged the banks to reopen. It took the banks two weeks to do so. As soon as they did, people rushed to withdraw their deposits. BDL said that most banks were allowing dollar withdrawals through ATMs and that the unavailability of dollars in some places could be an issue of logistics. Notwithstanding all these reassurances, in the few following weeks, dollar withdrawals through ATMs were halted. Afterwards, banks started to impose tough restrictions on withdrawals (few hundred dollars per week), even at bank counters. The restrictions on accessing bank deposits fueled frequent and sometimes violent attacks on banks and BDL – often instigated by political forces interested in cornering the Governor of the Central Bank.

DEEP AND WIDESPREAD HAIRCUTS

The collapse of the lira led to a 90 percent depreciation of the value of all deposits in lira which is essentially a de facto severe haircut on deposits. The haircut also hit dollar deposits since depositors were allowed to withdraw their savings only in lira at an exchange rate of LL3,900 to the dollar when the dollar price was skyrocketing on the parallel market. In April 2020, BDL asked banks through Basic Circular 151 to allow customers to withdraw money from their foreign currency accounts at the exchange rate prevailing on its Electronic Platform for Exchange Operations (Sayrafa). Less than three weeks later, it fixed the exchange rate at LL3,900. Even BDL's Basic Circular 158, which was issued in June 2021, includes a hidden haircut because it capped withdrawals at $50,000 half of which must be in lira at LL12,000 to the dollar, way below the parallel market rate. Another haircut involves dollars stuck in bank deposits, nicknamed 'lollars'. These lollars are priced in the parallel market at around 17 to 20 percent of their nominal value.



UNCONTROLLED CAPITAL

The lack of capital controls crashed the financial system and ensured that the crisis will be deeper and longer. A capital control law, called for by most economic stakeholders and politicians, struggled and failed to pass. It is still being worked on. In the second half of October 2019, with banks having closed their doors, BDL requested the authorization to impose capital controls. The request was rejected by the political forces. Having been denied official capital controls that could be legally enforced and that deal with all bank customers in an equitable manner, the banking sector, encouraged by BDL, and anyway lacking available liquidity in foreign currencies, unilaterally implemented arbitrary and legally unsubstantiated restrictions starting from October 2019. In early January 2020, BDL asked the Ministry of Finance (MoF) and the government to take appropriate legal measures and give exceptional powers to BDL to enable it to regulate and standardize the de facto capital controls but to no avail. BDL said that through these restrictions the banks had prejudiced the rights of some of their clients and that capital controls must be implemented fairly and equally on all depositors and clients. It wasn't until March 2020 that a draft capital control law was proposed by MoF, only to be later withdrawn under political pressure. The concept slowly gained political acceptance, at least publicly. Committees were formed and several drafts were worked on, with the IMF being consulted on the text of the last version. It didn't pass muster, and the authorities were reminded that capital controls must be part of a comprehensive restructuring program. The draft reached Parliament, but inexplicably, it never got to the floor for a vote – despite that the fact that most parties were by that time in favor of the move. A hidden agenda?

The amended draft law stipulates that capital controls must be part of a comprehensive recovery plan that includes restructuring public debt, the banks, and BDL. The government also has to state the losses which must be assumed by the State, BDL, and the banks since depositors are currently bearing a large portion of the losses.

Draft Capital Control Law

- Forbids transfers abroad
- Monthly withdrawals capped at LL15 million-LL20 million for lira deposits and at $400-$800 for foreign currency deposits (Ceilings to be determined by Parliament).
- Withdrawals from foreign currency deposits to be priced at the real exchange rate (parallel market rate)
- Conversions from lira into foreign currencies were prohibited unless the concerned bank enjoys adequate cash coverage.
- **Exceptions**
  - Money deposited after October 17, 2019
  - Payments for university tuitions abroad
  - Internet subscriptions and applications
  - Transfers made by international organizations.

TRANSFERRED ABROAD



The banks extended their own de facto capital controls to money transfers outside the country. The absence of a capital control law provided a legal loophole allowing a select group of large bank depositors and politicians to transfer billions of dollars abroad. Since these capital controls were not official, banks made arbitrary exemptions to transfer restrictions, to the benefit of a privileged few. The Governor of BDL said that $2.7 billion were transferred abroad following the October 2019 uprising. This amount included $1.6 billion withdrawn from fiduciary accounts held by foreign depositors in local banks. The remaining $1.1 billion was transferred abroad from the accounts of bank customers. Various other officials had higher estimates. They said that, while imposing their own capital controls, bankers approved the transfer abroad of $5.5 billion to $6 billion between October 2019 and July 2020.

Figures from the Bank of International Settlements show an increase of $6.5 billion in the net deposits of resident Lebanese in non-resident (foreign) banks (see table) between the end of 2020 and right before bank closures in October 2019. The increase during the first three months after the beginning of the October 2019 demonstrations is $1.3 billion (one percent of total deposits). This increase includes all funds transferred: lollars that were selectively allowed by banks to be transferred in addition to fresh money transferred from Lebanon (which was 'permissible'). Therefore the controversial actual amount of 'lollars' transferred after the de-facto limitation on transferring bank deposits could not have exceeded these amounts, and are likely to be much less than the $5.5-$6 billion estimated by the afore mentioned officials.

RESIDENT FX ACCOUNTS

	Q4 2017	Q4 2018	Q3 2019	Q4 2019	Q4 2020
Deposits in foreign banks	5,058	5,110	5,824	7,202	11,826
Loans from foreign banks	3,300	3,465	3,323	3,434	2,826
Net position in foreign banks	1,758	1,645	2,501	3,768	9,000
FX deposits in local banks	115,902	123,072	124,137	120,000	111,000

Source: Bank of International Settlements

	Q4 - Q3 2019	Q4 2020 - Q3 2019
Net position in foreign banks	1,267	6,499
FX deposits in local banks	(4,137)	(13,137)

A BDL circular issued in August 2020 called on banks' major shareholders, chairmen, board members, and top management to repatriate 30 percent of their own funds that were transferred abroad since 2017 and that exceed $500,000. The banks were also required to urge customers who are Politically Exposed Persons (PEPs) to repatriate 30 percent. Ordinary customers are called on to repatriate 15 percent. The repatriated money was slated to be deposited in accounts to be blocked for five years. Banks that succeed in the repatriation of funds are to be exempt from mandatory placements with BDL as an incentive. It is not clear how much exactly was repatriated, but it is believed that the amounts were negligible when compared to what was actually transferred during the specified period. Besides these transfers, there is also the issue of recovering stolen public assets through corruption. The law governing this issue was ratified by Parliament in March 2021. Nothing has been achieved so far.

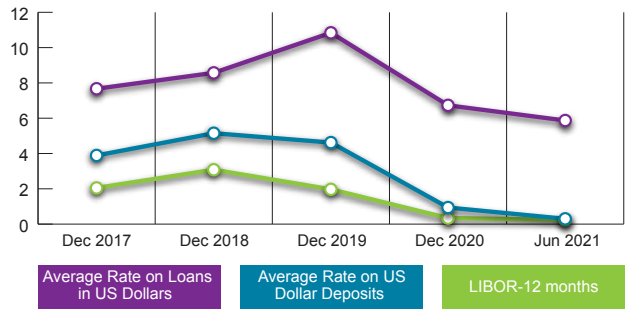
IMPACT OF LOWERING INTEREST RATES

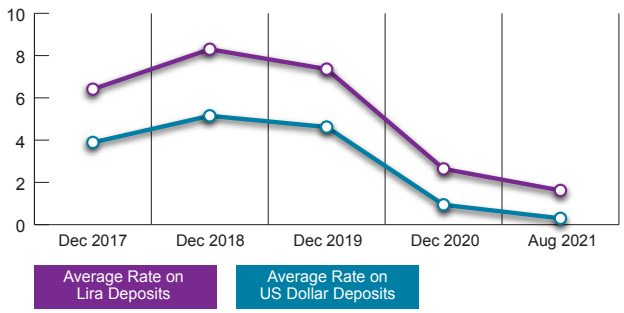


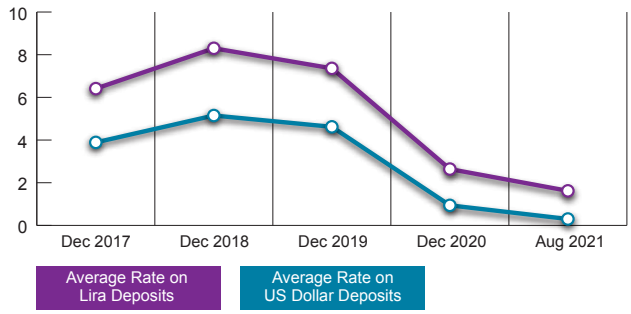
The Ministerial Statement of the government in 2020 included plans to cut interest rates in order to stimulate the economy and ease the debt service burden. The interest cuts, which apply on deposits and loans including housing loans, are part of efforts to support productive sectors, such as manufacturing, agriculture and trade. Lowering the debt service requires reducing interest rates on the banks' placements with BDL and on their holdings of Treasury bills, according to the Ministerial Statement. The call for reducing interest rates was already voiced by BDL, late in 2019, before the formation of the Cabinet in 2020. BDL had said that cutting interest rates on deposits and consequently on loans would stimulate economic activity and curb the increase in non-performing loans. The Association of Banks (ABL) recommenced reducing the Beirut Reference Rate (BRR) two times in January 2020 before the formation of the Cabinet later that month. Other cuts were recommended by ABL in 2020 following the formation of the government. In its turn, BDL lowered the interest rate ceilings on deposits. It also cut interest rates on different types of loans including housing loans. BDL also asked banks to provide zero-percent interest rate loans to customers in financial difficulties. Most of the banks didn't comply with this requirement. The average interest rate on lira deposits dropped from 8.3 percent in December 2018 to 1.62 percent in August 2021. The average rate on deposits in US dollars fell over the same period from 5.15 percent to 0.3 percent. Lowering interest rates to stimulate the economy by disincentivizing investment in deposits could work in normal times. Faced by low interest returns investors would look for other options in the real economy and inject capital in sectors like manufacturing, agriculture, tourism, or hospitality. Cutting interest rates amid a run on banks is unnecessary as depositors are already eager to withdraw their money and don't need any incentives. Reducing interest rates becomes absurd when de facto capital controls are applied and depositors are not allowed to withdraw their money to invest it in the economy. Even if some depositors succeed in withdrawing sufficient amounts, they are unlikely to invest the money in any local project with investor confidence hitting rock bottom. Capital controls remained and the recession continued to worsen amid low interest rates. Regarding the debt service, already in 2019, the banks started to reduce their holdings of the government's Eurobonds and T-bills. The default on the Eurobonds by the government alleviated the debt service temporarily while the interest cost on T-bills which are denominated in lira has decreased significantly when evaluated at the real exchange rate (parallel market rate).

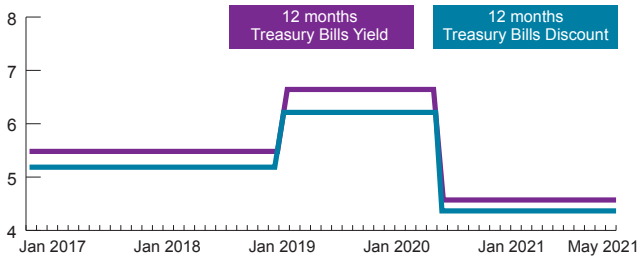
The banks have largely ignored BDL's instructions to help employers finance operating expenses and payroll (BDL Intermediate Circular 547). They turned down over 90 percent of applications from companies wishing to benefit from zero-interest loans to cover salaries and operating expenses during the Covid-19 lockdown, according to an InfoPro survey of 500 companies, released at the end of June 2020. The banks were wary of extending more loans, especially in dollar, fearing that borrowers will take advantage and repay their debts in lira at the 1,507 official rate. Many borrowers had already done so with existing loans, eroding not only banks' profitability and equity, but in the process also customer deposits. Most of the banks accepted to reschedule loans at zero-percent interest rate for a certain period of time but they were reluctant to provide new loans under this program due to rising risks and the restrictions they were imposing on dollar disbursements.

Interest Rates

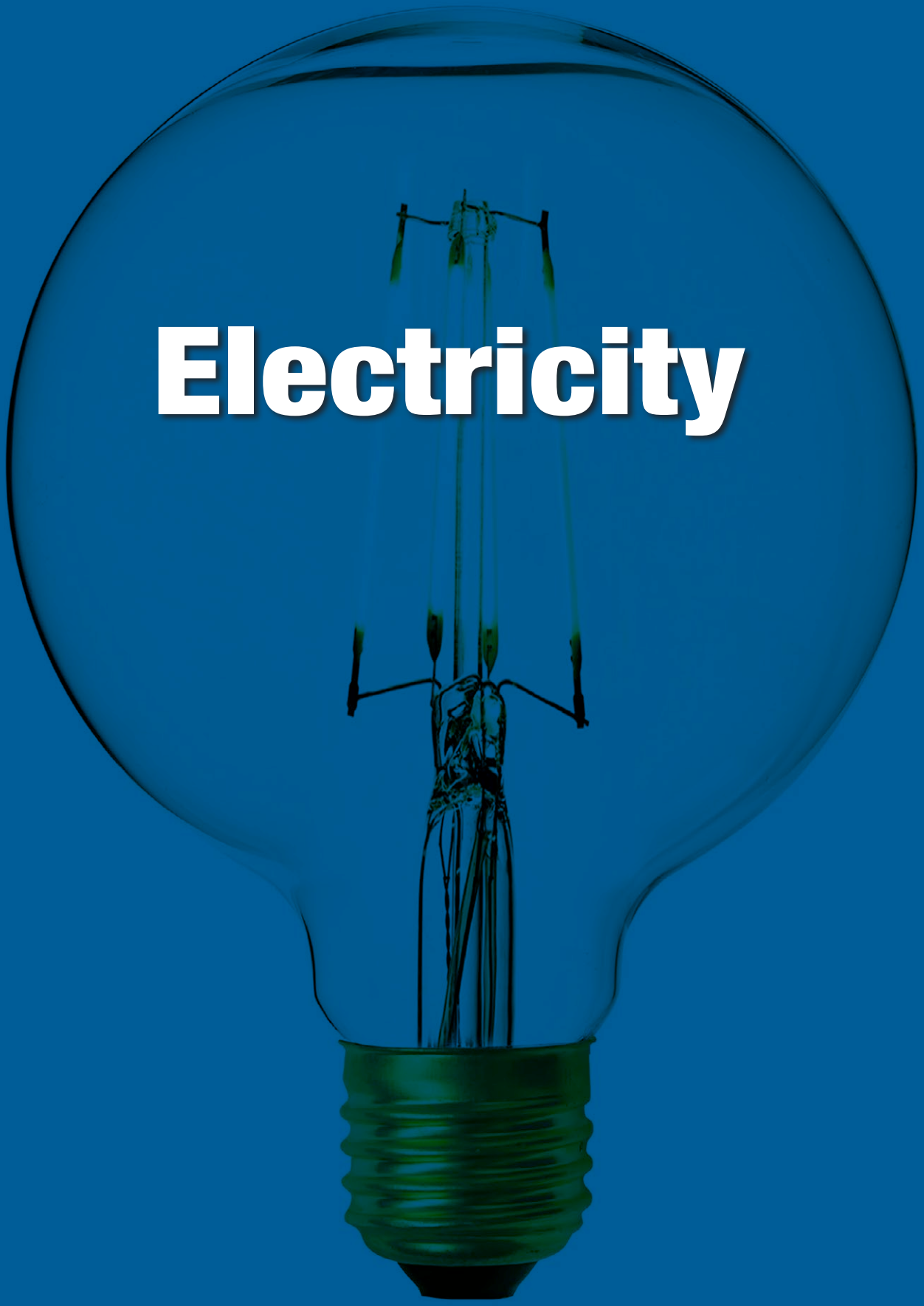






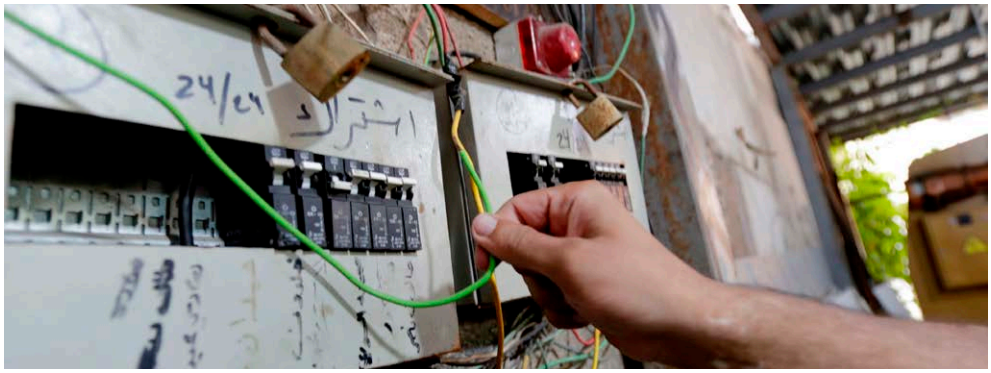


Source: Central Bank



Electricity

Electricity



In 2012, the Ministry of Energy promised that the country will enjoy a round-the-clock electricity supply by 2015. At present, Electricité du Liban (EDL) keeps on warning of complete blackout due to the lack of financing in dollars for its purchases of fuel oil and spare parts and to pay for maintenance. The lack of funding is the result of BDL's slowness in opening credit lines for fuel imports as it struggles to safeguard what remains of its foreign currency reserves. Before the collapse of the currency, loss-making EDL charged a tariff in lira that was nearly half the cost of production. At the devalued rate, the tariff represents around four percent of cost. EDL is selling electricity at a 96 percent discount! A change in tariff is a government decision, not EDL's. It would be politically very difficult to take such measure. It is therefore EDL's, BDL's, and the Treasury's best interest to produce as little electricity as possible. The severe decline in EDL's production transferred the burden of providing electricity onto private generators. They in turn had to also ration their power supply due to diesel shortages and to avoid overloading their generators. They are also concerned that their clients would not be able to pay their monthly bills after the lifting of subsidies.

ELECTRICITY PRODUCTION (BILLION KWH)

2017	2018	2019	2020	2021 *
15.2	15.2	14.8	12.3	5

* Until end of June 2021

Source: Central Bank

TREASURY TRANSFERS TO EDL (USD BILLION)

2018	2019	2020	2021*
1.8	1.5	0.9	0.3

*Until end of April 2021

Source: Ministry of Finance

In its recovery plan, the government has committed to the construction of power plants. It never looked at the alternatives of buying electricity instead. The alternatives of linking to Turkish, Egyptian, and Emirati power grids were never explored. Only at the end of the government's tenure, and under political pressure emanating from Iran's symbolic entry into the fuel import market did the authorities find a way to procure electricity from Jordan via Syria. But the bulk still rests on producing more electricity locally. Devising plans solely based on purchasing fuel in the long term only casts suspicion that special interests that had long benefited from fuel procurement contracts are still the ones puppeteering the sector.

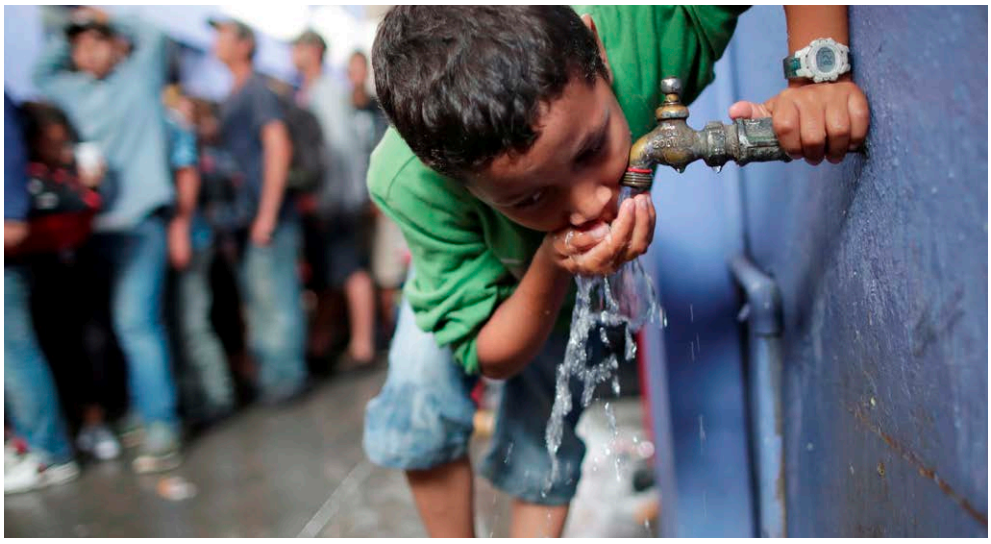


Social Impact

Social Impact

80 PERCENT POOR

The financial and economic crises, the Covid-19 pandemic, political and security instability, and the Port Explosion have coalesced to exacerbate the living conditions in the country. The headcount poverty rate doubled from 28 percent of the total population in 2019 to 55 percent in 2020. The percentage of those suffering from extreme poverty tripled to 23 percent from eight percent. The situation got worse in 2021. According to the United Nations, 78 percent of the population (around three million people) lives below the poverty line. Nearly 36 percent (more than one million people) live in extreme poverty. ESCWA said in its 'Multidimensional poverty in Lebanon (2019-2021)' report: "The poverty rate in Lebanon doubled from 42 percent in 2019 to 82 percent of the total population in 2021, with nearly four million people living in multidimensional poverty." Households are considered multi-dimensionally poor if they are deprived in one or more dimensions under the Multidimensional Poverty Index. The index is composed of six dimensions: education, health, public utilities, housing, assets and property, employment and income. According to the UNICEF, more than 30 percent of households had at least one child who skipped a meal or went to bed hungry in March 2021. Nearly 77 percent of families did not have enough food or enough money to purchase food.



POVERTY RATE

Income Group	2019	2020
Affluent	15%	5%
Upper middle income	11.5%	4.6%
Lower middle income	45.6%	35.2%
Poor	19.8%	32%
Extreme poor	8.1%	23.2%

Source: ESCWA

UNEMPLOYMENT UP AND FALTERING SALARIES

According to a World Bank survey conducted in 2019 and 2020, "one in five workers lost their jobs since October 2019, while 61 percent of firms surveyed decreased the number of permanent workers by 43 percent on average. Medium-size and large firms laid-off a larger number of workers: 76 percent of large firms surveyed downsized by an average of 37 percent, while 70 percent of medium firms downsized by 43 percent." Before the severe deterioration of the exchange rate, many businesses were already reducing the salaries of their workforce. Most companies stopped paying salaries in dollars. Employees that were being paid in lira saw their income eroding by the collapse of the currency. According to the World Bank survey, 29 percent of firms increased the salaries of their employees by around 40 percent. "These nominal increases were in fact negative in real terms, as inflation reached triple digits during this period," the World Bank said. The fate of public sector employees is grimmer. They continue to be paid entirely in lira and the bureaucracy is slow in adapting to new conditions besides the fact that the government cannot afford a salary hike. The collapse of the lira, and the government's inability to adjust public wages, productivity and attendance by public servants declined severely. Consequently, this led to a sharp decrease in the speed of completing official business and citizen transactions and increased the volume of petty bribes. Sizeable desertions from security forces were reported in the media, the impact of which is grimly predictable.

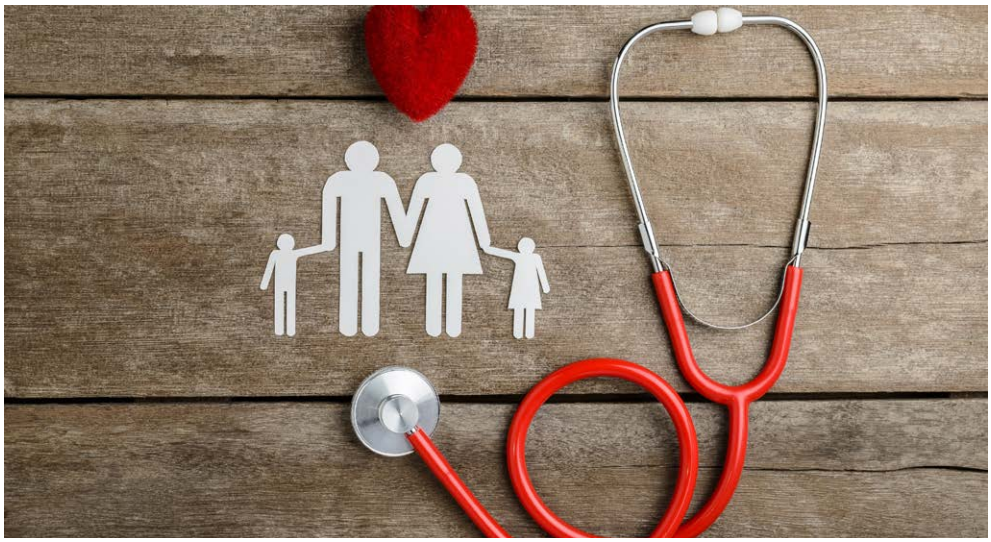
EXODUS FROM PRIVATE SCHOOLS

With rising poverty, the education sector is witnessing an exodus from private to public schools. In 2021 alone, 54,000 students (11 percent of public sector students) transitioned from private to the public schools, putting additional strain on a public education sector, which was already facing severe constraints in terms of available school infrastructure, education quality and service delivery. Education quality is also deteriorating. The World Bank said: "Expected austerity measures implemented by local universities, will lead to a further decline in higher education quality, likely exacerbating a brain drain as youth graduates seek employability abroad, particularly in critical sectors such as medicine."





BREAKDOWN OF SOCIAL INSURANCE



The health sector is not faring better. Nearly 400,000 out of 1.21 million households were deprived of healthcare in 2021. This represents 33 percent of the total compared with nine percent in 2019, according to ESCWA's report. "It is feared that the situation will worsen if subsidies are lifted, especially since 55 percent of the population is not covered by any form of health insurance," ESCWA said in its report which was released in September 2021. The subsidies on medications have been lifted except for medicines for chronic diseases and neurological disorders as well as vaccines, and infant formula. Shortages of subsidized medicines are likely to persist due to smuggling. Hospitals also have their own problems. A study by the Syndicate of Private Hospitals that compares the medical indicators of the first half of 2021 with pre-2020 indicators has shown that 30 percent of beds in private hospitals have become vacant, the percentage of admissions into hospitals decreased 25 percent, the hospital occupancy rate was less than 55 percent, visits to emergency rooms dropped 14 percent, and the number of surgery operations fell 37 percent. The study has also revealed that hospitals were facing difficulties in treating emergency patients due to severe shortages in vital drugs. There is a shortage of nurses and specialized doctors and a lack of medicines in general intensive care units and intensive care units for newborns. The shortage of medical staff is attributed to the brain drain which is occurring at alarming speed, according to the World Health Organization (WHO). "Almost 40 percent of skilled medical doctors and almost 30 percent of registered nurses have already left the country either permanently or temporarily. Mental health needs are greater than ever before, and the ongoing Covid-19 pandemic continues to create additional challenges for both the health sector and communities alike," said the Director General of WHO. The most dangerous brain drain is that of brain surgeons, vascular surgeons, orthopedic surgeons, and pediatric heart surgeons as well as physicians specialized in dialysis, laboratory, and radiology. The brain drain has resulted in the cancellation of a number of medical services and in closing down treatment departments in some hospitals. Most often only emergency operations and emergency medical services are provided, the other operations and medical services that are not urgent are put on a waiting list. Hospitals and patients are also suffering from the fact that the dues owed by the government and the advances paid by the National Social Security Fund (NSSF) are in lira and have lost their value. This is forcing patients to pay the large difference between the hospital bill and the NSSF compensation. The government is also slow in paying its obligations to hospitals which have not received yet any payment for their 2021 dues.

STRUGGLING SOCIAL SECURITY FUND



The government also owed the NSSF an accumulated debt of LL4.8 trillion as at the end of 2020. The NSSF, which provides coverage to more than 1.4 million individuals, is witnessing a decrease in interest income from its holdings of Treasury bills amounting to LL11 trillion due to the decline in interest rates. Contributions to the NSSF have also dropped due to layoffs and business shutdowns. The NSSF is also facing an unprecedented demand by the insured to withdraw their end-of-service indemnities which reached more than 13,600 people in the first half of 2020. The urgent challenge the NSSF is facing is to secure financial resources to enable it to pay compensations that reflect the actual cost of medical care, or it risks going bankrupt. This also applies to the Cooperative of Civil Servants, mutual funds, military and security forces, and the Ministry of Health.

DELAYED SOCIAL SAFETY NET PROGRAMS

In June 2021, Parliament approved the allocation of $556 million a year in cash cards to more than 500,000 vulnerable families. The move came in synch with the gradual lifting of subsidies. It was not until September, on the eve of the formation of a new Cabinet, that the caretaker Minister of Social Affairs launched the cash cards program. Each family will get around $93 per month under the program. Those who benefit from the Emergency Crisis and Covid-19 Response Social Safety Net Project (ESSN) targeting the poorest households cannot profit from the cash card program. In January 2021, the World Bank approved a $246 million loan for the ESSN program. In March of the same year, Parliament ratified the loan agreement. At the time of writing this report (in early November 2021) the implementation of both the cash card and ESSN programs had not yet started. The ESSN was delayed as the agreement needed some amendments by Parliament and the government was still looking for ways to finance the cash card program.


Appendix

Timeline October 2019-September 2021

2019

October
Start of demonstrations. New taxes including a tax on voice calls via messaging services such as WhatsApp were the straw that broke the camel's back
IMF calls for medium-term fiscal framework. It called on the government to implement fundamental structural reforms with two priorities: improving the electricity sector and reducing corruption
Banks close their doors nationwide
S&P Global Ratings placed Lebanon's 'B-' long-term and 'B' short-term foreign and local currency sovereign ratings on CreditWatch with negative implications
Council of Ministers approves the 2020 draft budget with expenditures of $13.5 billion and revenues of $13.1 billion. It targets a fiscal deficit representing 0.63 percent of GDP
Cabinet headed by PM Saad Hariri resigns amid nationwide protests
November
The banks reopen after closing for two weeks
Moody's downgrades the government's issuer ratings to 'Caa2' from 'Caa1'due to the increased likelihood of a debt rescheduling or other liability management exercise
S&P lowers long-term and short-term foreign and local currency sovereign credit ratings to 'CCC/C' from 'B-/B' with a 'negative outlook
BDL requires banks to raise their capital by 20 percent
BDL reiterates commitment to the stability of the lira peg to the US dollar
BDL says that even before the protests began in October 2019, nearly $3 billion had been withdrawn from banks. Another $2 billion was withdrawn after banks reopened following the first two weeks of protests
BDL extends to the end of 2020 the deadline given to banks to comply with the 25 percent ceiling on loan-to-deposit ratio in lira
BDL decides to provide foreign currency to banks to fund imports of pharmaceuticals, medical supplies, and raw materials used in the manufacturing of medicine
BDL settles the principal of a $1.5 billion Eurobond on behalf of the government
Foreign exchange dealers are required to submit a list of executed foreign exchange transactions that exceed $10,000 to Banking Control Commission
BDL denies rumors that depositors will be forced to convert 10-15 percent of their foreign currency deposits into lira. It says that BDL does not intend to restrict lira withdrawals from banks. Interest rates on deposits and loans are cut.
December
BDL says the country is moving towards a cash economy
BDL advises banks to exchange their holdings of Eurobonds maturing in 2020 for longer maturity instruments from BDL's portfolio
The government's request for technical assistance from the IMF and the World Bank to develop a reform plan

2020

January
The Association of Banks lowers the Beirut Reference Rate (BRR) in US dollars from 10.39 percent to 9.35 percent and in lira from 13.49 percent to 12.45 percent
BDL asks the authorities to grant it exceptional prerogatives to unify and regulate temporary restrictions imposed by banks on foreign transfers and cash withdrawals
The Association of Banks recommends a further cut in the BRR in US dollars to 8.5 percent and the BRR in lira to 11.5 percent
BDL allows real-time online transfers between customers of different local banks. Each customer can transfer in lira up to LL500,000 per day and LL5 million per month. Each client can receive lira transfers of up to LL1 million per day and LL10 million per month. Transfers in foreign currencies sent by each customer cannot exceed $300 per day and $3,000 per month. Transfers in foreign currencies received by one client can reach $600 per day and $6,000 per month
Formation of new Cabinet by PM Hassan Diab
Parliament approves the 2020 budget which forecasts a deficit of seven percent of GDP, or $4.3 billion. The previous government had proposed a 0.6 percent deficit
The guarantee that the National Institute for the Guarantee of Deposits offers on bank deposits is increased to a maximum of LL75 million from LL5 million
The 2020 Budget Law suspends penalties on borrowers who miss payments on their subsidized loans. The decision applies from October 1, 2019
BDL circular stipulating that fresh funds transferred to Lebanon after November 17, 2019 will not be subject to any restrictions. It will allow transfers abroad for urgent personal matters up to an annual maximum of $50,000
February
The new cabinet's policy statement includes a financial recovery plan and quick implementation of effective reforms. The policy will be implemented in three phases, the last one within three years
The authorities ask the IMF for technical assistance to address the economic challenges. The assistance, which is only technical not financial, will address macroeconomic issues and structural reforms
BDL caps the interest rate on lira deposits blocked for more than one year at 7.5 percent. It lowers the ceiling on foreign currency deposits blocked for more than one year to four percent
Association of Banks recommends an additional reduction in the BRR on loans in US dollars to 6.75 percent and on lira loans to nine percent
S&P lowers its long-term foreign and local currency sovereign credit ratings to 'CC' from 'CCC' with 'negative' outlook
Moody's downgrades the government's issuer rating to 'Ca' from 'Caa2' and changes the outlook to 'stable'
BDL cuts interest rates on different types of loans mainly housing loans. Interest rates and fees on outstanding housing loans are capped at three percent. The decision applies to bank loans provided through the Public Corporation for Housing
The government appoints international law firm Cleary Gottlieb Steen & Hamilton as legal adviser and asset management company Lazard as financial adviser. The two firms will give their advice regarding debt restructuring
March
BDL sets a ceiling for the purchasing price of foreign currency at foreign exchange businesses at 30 percent of the exchange rate that it uses in its operations with banks
The government will not pay a $1.2 billion Eurobond due on March 9, 2020. This is the first time in its history that Lebanon defaults on a foreign debt payment
BDL says a fund will be created to raise $750 million to help small and medium sized industrialists finance raw material imports. The 'Oxygen Fund' is a Europe-based platform with a mix of fintech and credit facilities
The Association of Banks and State Prosecutor agree that the banks will allow small depositors to withdraw LL25 million or more from their accounts per month, and will carry out transfers abroad for tuition fees. The banks will refrain from converting deposits denominated in foreign currencies into liras without the client consent. They will also allow withdrawals and overseas transfers of fresh funds. The banks also commit to finance imports of basic goods such as food and medical supplies
S&P lowers its foreign currency sovereign ratings to 'SD/SD' from 'CC/C'. It affirms the lira long-term and short-term ratings at 'CC/C' and keeps the 'negative' outlook on the long-term rating

2020

Fitch downgrades the Long-Term Foreign-Currency (LTFC) Issuer Default Rating (IDR) to 'C' from 'CC' following the default

BDL requires banks to provide loans in liras or US dollars to customers in financial difficulties at zero-percent interest rate and free from commission. Retail and corporate customers may use the proceeds exclusively from March 2020 to May 2020 to settle maturing debts, pay salaries and finance their operations

Lebanon defaults on all remaining Eurobonds

The Cabinet suspends discussions about a capital control draft law following opposition by political parties

The government decides to offer cash contributions to vulnerable people (LL400,000 per household)

April

The Association of Banks cuts USD BRR to 5.75 percent and LL to 7.75 percent

Depositors whose combined bank accounts don't exceed LL5 million or $3,000 are allowed to withdraw the entire amount in cash, according to a BDL circular. Deposits in foreign currencies will be paid in lira at the market rate

BDL sets up foreign exchange trading platform (Sayrafa)

Moody's revises the outlook on the banking sector from 'stable' to 'negative'

Banks are exempted from mandatory placements with BDL on new deposits in foreign currencies ('fresh' dollars)

The World Bank reallocates $40 million to help equip government hospitals and improve their ability to test and treat cases of coronavirus

The government approves the opening of a line of credit of LL450 billion as a supplement to the 2020 budget in order to pay part of amounts due to private hospitals

Parliament suspends for six months the repayment of the principals and interests of loans owed by companies and people affected by the coronavirus pandemic without penalty

Parliament enacts the anti-corruption law and the creation of the National Anti-Corruption Commission

Parliament legalizes the cultivation of cannabis for medical and industrial purposes

BDL issues Circular 151 allowing depositors to withdraw money from their foreign currency accounts, paid in lira at LL3,900/USD

The government hires KPMG, Kroll, and Oliver Wyman to audit the accounts of the BDL

BDL issues a circular requiring all money changers not to exceed the rate of LL3,200/USD

The government issues the final version of its 'Financial Recovery Plan' which estimated the losses in BDL's balance sheet at LL177 trillion and the aggregated losses in the banks' balance sheets at LL64 trillion

May

The Lebanese Economic Organizations issues a strongly-worded statement accusing the government's Financial Recovery Plan of containing unconstitutional elements and calls on Parliament to block parts of the plan that it considered 'destructive'

The Association of Banks says it was not consulted when the government prepared the recovery plan which is biased against the banks

The Council of Ministers approves the transfer of the management of the state-owned mobile phone networks Mobile Interim Company 1 (MIC 1) and Mobile Interim Company 2 (MIC 2) to the Ministry of Telecommunications

BDL says most of the proposals included in the government's Financial Recovery Plan require a careful legal and constitutional assessment and that he has reservations regarding measures that aim to address BDL's alleged losses. It said that the government did not consult BDL when it prepared the plan

BDL may increase the ratio of Expected Credit Losses (ECL) on the banks' holdings of Lebanese Eurobonds from 9.45 percent to 45 percent, following the government's decision to default on all outstanding Eurobonds. It may also increase the ECL ratio on the banks' foreign currency exposure to BDL from 1.89 percent to 30 percent.

Financial Prosecutor arrests the chairman of the Syndicate of Money Changers along with other money changers on allegations of selling the dollar in an illegal manner by not adhering to the rate set by BDL. They were released at a later date

Financial Prosecutor arrests the director of Monetary Operations at the BDL for alleged exchange rate manipulation. He was later released

2020

Moody's says that the 'Ca' government bond rating reflects an unsustainable debt trajectory and the likelihood that domestic and international creditors will suffer substantial losses under the government's debt restructuring plan

The Association of Banks (ABL) issues its 'Contribution to the Lebanese Government's Financial Recovery Plan' where it says that it is ready to make financial and economic concessions and proposes the creation of a Government-owned Debt Defeasance Fund (GDDF) to which the government will contribute public assets valued at $40 billion in exchange for the GDDF's entire shares

BDL says it will offer access to foreign currency to importers of basic foodstuff and of raw materials used in the manufacturing of food products

Parliament suspends legal, judicial and contractual deadlines between October 18, 2019 and July 30, 2020

BDL says it will provide in the next 12 months access to foreign currency financing for imports of raw materials used in the industrial sector. The banks may ask BDL to provide up to $100 million for financing 90 percent of the value of raw materials imported by licensed industrial firms

Parliament lifts banking secrecy on public sector employees including top officials, ministers, and members of Parliament as well as third parties in contractual agreements with the State

June

The Association of Banks cuts USD BRR to 4.53 percent. It keeps the LL BRR at 7.75 percent

Banks to reschedule loans owed by industrialists when needed and to cap the interest rate on industrial loans at the Beirut Reference Rate (BRR) plus one percent

The Banking Control Commission asks banks to give details about in and out foreign transfers

BDL requires money changers must carry out forex transactions through Sayrafa electronic platform

The Council of Ministers says BDL will inject foreign currency liquidity on the foreign exchange market to strengthen the lira on the parallel market. It mandates the Ministry of Justice to crackdown on those spreading rumors undermining confidence in the lira

Parliament allocates LL1.2 trillion to meet emerging needs caused by the coronavirus and its repercussions on economic sectors including health, social, agricultural, and industrial

July

BDL forms a committee to restructure the local banks headed by its second Vice Governor

The government replaces Kroll with Alvarez & Marsal (A&M) to perform forensic audit of the BDL

The World Bank suspends a $474 million loan for the Bisri Dam project due to non-adherance to loan requirements

Moody's downgrades the government's issuer rating to 'C' from 'Ca'

August

Huge explosion at the Port of Beirut

Money transfer companies are required to settle incoming transfers in US dollars

BDL requires banks to provide zero-interest loans in US dollars to individuals and businesses affected by the Port Explosion to help them repair their damaged homes and premises

Government resigns following the Port Explosion

An international donor video-conference raises $300 million in pledges for immediate humanitarian relief to be coordinated by the United Nations

Parliament extends deadlines for paying some taxes and allows some tax exemptions

BDL allows transfers to Lebanese students studying abroad

The physical damage caused by the Port Explosion ranges between $3.8 billion and $4.6 billion according to the World Bank

BDL requires banks to allow retail clients to repay dollar loans in lira at the official exchange rate of LL1,507.5

$344.5 million UN Flash Appeal

BDL Circular 154 asks banks to 'urge' regular customers who had transferred abroad over $500,000 in foreign currencies since 1/7/2017 to deposit 15 percent of the amount in accounts to be blocked for five years, and 30 percent for bank board members, top management, and major shareholders, as well as Politically Exposed Persons (PEPs)

2020

Banks required to create accounts with correspondent banks representing three percent of their foreign currency deposits

Banks are allowed to have their willing depositors convert their deposits into shares or into perpetual bonds

BDL's Basic Circular 154 also requires banks to open an account in foreign currencies with their correspondent banks abroad that represents three percent of their foreign currency deposits

BDL's Basic Circular 154 also calls on banks to take measures allowing customers to willingly convert their deposits into shares in the capital of the bank or into redeemable, tradable, and convertible perpetual bonds

September

BDL says is can provide for only three more months foreign exchange subsidy to imports of fuels, wheat and pharmaceutical products

The European Union (EU) will extend, in partnership with the World Food Programme (WFP), €103.2 million ($119 million) in financial support to vulnerable households affected by the multiple crises

Parliament approves a law allowing bank transfers of up to $10,000 to cover expenses of students enrolled prior to the academic year 2020-2021

Parliament passes the illicit enrichment law that requires senior public sector employees to disclose their financial assets and interests

October

The insured losses resulting from the explosion at the Port of Beirut could reach $1.5 billion

BDL extends until March 2021 the decision requiring banks to pay withdrawals from foreign currency accounts in lira at the exchange rate of BDL's foreign exchange platform. Does not apply to 'fresh money'

BDL requires importers of fuels, wheat, medicine, medical equipment, infant milk, and raw materials used in the manufacture of medicine, to deposit with banks the equivalent of their import bill in lira (cash) to benefit from foreign exchange subsidy

The authorities approve a framework agreement with the United States to negotiate the demarcation of the southern maritime borders with Israel

November

The Ministry of Social Affairs is working to expand the coverage of the National Poverty Targeting Program (NPTP) to 55,000 vulnerable households from 15,000 households

Alvarez & Marsal (A&M) terminates its BDL forensic audit agreement because it has not been able to obtain the necessary information and documents to start its work

December

The United Nations (UN), European Union (EU), and World Bank Group (WBG) launch a $2.6 billion, 18-month reform, recovery, and reconstruction response plan to address urgent needs caused by the Port Explosion

Parliament approves lifting banking secrecy on accounts of BDL, ministries, and public administrations for one year

UN-Habitat will provide cash-for-rent assistance to 800 households affected by the Port Explosion for three months

International contributions to the Lebanon Crisis Response Plan (LCRP) reach $1 billion in the first nine months of 2020. This represents just over a third of $2.7 billion its appeal

2021

January

Deal with Pfizer for 2.1 million doses of Covid vaccine

The World Bank approves a $246 million project to provide emergency cash transfers and access to social services to 786,000 poor and vulnerable people

USAID launches a $70 million program to support businesses in high-impact sectors and to boost exports

February

BDL's Intermediate Circular 580 asks banks to deposit the equivalent of 100 percent of "fresh funds" in foreign currencies transferred from abroad with it or with correspondent banks abroad

The Ministry of Finance submits the 2021 Budget Proposal to the Council of Ministers with a fiscal deficit of LL6,187 trillion, the equivalent of 5.6 percent of GDP which is in line with IMF requirement

2021

March
Circular 151, which allows depositors to withdraw money in lira from their foreign currency accounts at the rate of LL3,900/USD, is extended to the end of September 2021. (On September 29, 2021, Circular 151 was further extended to the end of January 2022)
April
German firms propose a project to rebuild the Port of Beirut and surrounding areas at a cost ranging from $5 billion to $15 billion, creating up to 50,000 jobs
May
The Ministry of Finance asks Electricité du Liban to set a timetable for repaying the advances it had received from the Treasury over the period 1997-2020 and which amount to LL37 trillion ($24.5 billion at the official exchange rate of LL1507.5)
JUNE
Parliament approves law public procurement law to enhance transparency
World Bank report warns that Lebanon is sinking to one of the top three most severe crises that the world has witnessed since the mid-nineteenth century
BDL's Circular 158 allows depositors to withdraw up to $50,000 of their foreign currency accounts over five years. Half of the amount is to be paid in US dollars. The remaining amount will be paid in lira at the exchange rate of LL12,000 to the dollar
IMF spokesman Gerry Rice warns that BDL decision (Basic Circular 158) allowing withdrawals from foreign currency deposits (half in lira at LL12,000/USD, half in dollars) would increase the amount of liras in circulation causing additional inflationary pressures and a further depreciation of the lira
Gerry Rice, spokesperson for the IMF, says: "We don't see the need to implement a capital control law. No, especially without the support of appropriate fiscal monetary and exchange rate policies."
BDL issues Circular 586 reducing the mandatory foreign currency reserves of banks from 15 percent to 14 percent
Parliament passes law approving Lebanon becoming a member of the Asian Infrastructure Investment Bank by subscribing to the capital of the bank. This will enable Lebanon to secure loans for infrastructure projects at favorable interest rates
Parliament enacts law that subjects to financial and forensic audit all businesses and other entities that had benefited from foreign exchange subsidies for imports of basic goods and imports of industrial raw materials and agricultural inputs
Parliament approves cash payments through prepaid cards to 500,000 vulnerable families at a total cost of $556 million a year
JULY
Saad Hariri steps down as prime minister-designate
AUGUST
The International Conference on Aid to Lebanon, called for by France on the first anniversary of the Port Explosion, raises $370 million in pledges for urgent aid to confront the socio-economic crisis, as requested by the United Nations
IMF allocates the equivalent of $1.1 billion in Special Drawing Rights (SDRs) to Lebanon
World Bank launches Building Beirut Businesses Back & Better (B5) Fund which consists of a $25 million grant to support the recovery of micro and small enterprises directly affected by the Port Explosion and sustain the operations of microfinance institutions. B5, which will be implemented by Kafalat, is financially supported by international donors
BDL says it will no longer provide foreign exchange subsidy for fuel imports
Fuel prices are increased by 66 percent
SEPTEMBER
The caretaker government launches subsidy cards for 500,000 families. The cards will consist of monthly payments of $25 per person and a maximum of $126 per family
Prime Minister Najib Mikati forms new Cabinet

Major BDL Circulars

Date	Circular number	Decision
30-Sep-19	**Intermediate Circular 530**	Importers of hydrocarbons, wheat, and pharmaceuticals are provided liquidity in foreign currencies by BDL to pay for 85 percent of their import bill
4-Nov-19	**Intermediate Circular 532**	Banks required to raise their capital by 20 percent
13-Feb-20	**Intermediate Circular 544**	BDL caps the interest rate on new deposits blocked for more than one year at 7.5 percent (for lira deposits) and at four percent (foreign currency deposits).
10-Mar-20	**BDL Statement**	Announcement that the Oxygen Fund will be launched in April . The fund plans to raise around $750 million to be provided to manufacturers to finance their imports of raw materials
23-Mar-20	**Intermediate Circulars 547-552**	Banks asked to provide zero-interest loans to customers in financial difficulties. The proceeds must be used for settling debts, paying salaries, and financing operations.
3-Apr-20	**Basic Circular 148**	BDL allows depositors whose total bank accounts don't exceed LL5 million or $3,000 to withdraw the entire amount in cash until November 3, 2020. Deposits in foreign currencies are paid in lira at the Sayrafa exchange rate. Lira deposits are converted into dollars at the official rate than converted back into lira at the Sayrafa rate.
3-Apr-20	**Basic Circular 149**	BDL sets up foreign exchange trading platform (Sayrafa)
9-Apr-20	**Basic Circular 150**	Banks are exempt from mandatory placements with BDL on new deposits in foreign currencies ('fresh' funds) provided the depositors are given the freedom to use the proceeds including cash withdrawals or transfers abroad.
21-Apr-20	**Basic Circular 151**	Depositors are allowed to withdraw money from their foreign currency accounts in lira at an exchange rate of LL3,900
27-May-20	**Intermediate Circular 556**	Banks are instructed by BDL to provide financing in foreign currencies for 90 percent of the value of industrial raw material imports. The aggregate amount for the whole sector must not exceed $100 million.
27-May-20	**Intermediate Circular 557**	BDL to provide liquidity in foreign currencies to importers of foodstuff and of raw materials used in the production of foodstuff
8-Jun-20	**Intermediate Circular 561**	BDL provides access to foreign currency for imports of fuels, wheat, medicine, medical equipment, infant milk, and raw materials used in the manufacture of medicine
8-Jul-20	**Intermediate Circular 564**	BDL adds importers of agricultural inputs to the list of importers benefiting from liquidity in foreign currencies to pay for their imports
6-Aug-20	**Basic Circular 152**	Banks are required to provide zero-interest loans to individuals and businesses to repair homes and premises damaged by the Port Explosion
6-Aug-20	**Intermediate Circular 566**	Non-banking financial institution involved in electronic cash transfers are required to settle incoming foreign currency transfers in US dollars
19-Aug-20	**Basic Circular 153**	BDL allows transfers to Lebanese students studying abroad
26-Aug-20	**Intermediate Circular 568**	Retail loans and housing loans denominated in US dollars must be repaid at the exchange rate of LL1,507.5 to the dollar within certain conditions including that the borrower resides in Lebanon
27-Aug-20	**Basic Circular 154**	• Banks permitted to take measures allowing customers to willingly convert their deposits into shares or into perpetual bonds • Banks required to repatriate funds transferred abroad • Banks required to create accounts with correspondent banks representing three percent of their foreign currency deposits
25-Feb-21	**Intermediate Circular 580**	BDL asks banks to deposit the equivalent of 100 percent of "fresh funds" in foreign currencies transferred from abroad with it or with correspondent banks abroad
8-Jun-21	**Basic Circular 158**	Depositors are allowed to withdraw up to $50,000 from their foreign currency accounts. Half of the amount must be in lira at an exchange rate of LL12,000 to the dollar
8-Jun-21	**Intermediate Circular 586**	The mandatory foreign currency reserves of banks at BDL are reduced from 15 percent to 14 percent



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