# LEBANON ECONOMIC MONITOR

# Time for an Equitable Banking Resolution


Fall 2022

THE WORLD BANK
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# Lebanon
# Economic Monitor

## Time for An Equitable Banking Resolution

## حان الوقت لإعادة هيكلة
## القطاع المصرفي على نحو منصف

## L’urgence d’une résolution
## bancaire équitable

Fall 2022

Global Practice for Macroeconomics, Trade & Investment
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# TABLE OF CONTENTS

## List of Figures



## List of Tables



## List of Boxes

# ACRONYMS

| | |
|---|---|
| ABL | Association of Banks in Lebanon |
| AER | Average Exchange Rate |
| AML | Anti-Money Laundering |
| ATM | Automated Teller Machine |
| AUB | American University of Beirut |
| BCC | Banking Control Commission |
| BdL | Banque du Liban |
| BNR | Banknote Rate |
| BTA | Beirut Traders Association |
| CA | Current Account |
| CAS | Central Administration of Statistics |
| CEDRE | Conférence Economique pour le Développement, par les Réformes et avec les Entreprises |
| CFT | Combating the Financing of Terrorism |
| CPI | Consumer Price Index |
| DRF | Deposit Recovery Fund |
| EdL | Electricité du Liban |
| EFF | Extended Fund Facility |
| FCS | Fragile and Conflict States |
| FI(s) | Financial Institution(s) |
| fx | Foreign Exchange |
| gdp | Gross Domestic Product |
| GNI | Gross National Income (per capita) |
| GoL | Government of Lebanon |
| IMF | International Monetary Fund |
| LBP | Lebanese Pound |
| LEM | Lebanon Economic Monitor |
| LMIC | Lower Middle-Income Country |
| LNG | Liquid Natural Gas |
| LBP | Lebanese Pound |
| MoF | Ministry of Finance |
| NPL(s) | Non-performing Loan(s) |
| PA | Prior Action |
| pmi | Purchasing Manager's Index |
| pM | Prime Minister |
| pp | Percentage Points |
| SLA | Staff-Level Agreement |
| soe | State-Owned Enterprise |
| tb(s) | Treasury Bond(s) |
| TBTF | Too-Big-To-Fail |
| TMTF | Too-Many-To-Fail |
| ToR | Terms of References |
| UMIC | Upper Middle-Income Country |
| US$ | United States Dollar |
| VAT | Value Added Tax |
| WEO | World Economic Outlook |
| yoy | Year over Year |

# PREFACE

The *Lebanon Economic Monitor* provides an update on key economic developments and policies over the past six months. It also presents findings from recent World Bank work on Lebanon. The *Monitor* places these developments, policies, and findings in a longer-term and global context and assesses their implications on the outlook for Lebanon. Its coverage ranges from the macro-economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged in Lebanon.

The *Lebanon Economic Monitor* is a product of the World Bank's Lebanon Macroeconomics, Trade and Investment (MTI) team. It was written by Dima Krayem (Senior Economist), Naji Abou Hamde (Economic Analyst) and Ibrahim Jamali (Consultant), with contributions from Lars Jessen (Lead Debt Specialist), and Ulle Lohmus (Senior Financial Sector Economist). The Special Foci entitled *Global Comparators: The Hole is Greater Than the Sum of its Parts* and *Dollarization in Lebanon* have been led by Wissam Harake (Senior Economist), with contributions from Naji Abou Hamde (Economic Analyst) and Ibrahim Jamali (Consultant). The *Lebanon Economic Monitor* has been completed under the guidance of Eric Le Borgne (Practice Manager), Norbert Fiess (Lead Economist), and Jean-Christophe Carret (Country Director). Zeina Khalil (Communications Officer) is the lead on communications, outreach, and publishing.

The findings, interpretations, and conclusions expressed in this *Monitor* are those of World Bank staff and do not necessarily reflect the views of the Executive Board of The World Bank or the governments they represent.

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# EXECUTIVE SUMMARY

## Recent Economic Developments

**The economy continues to contract, albeit at a somewhat slower pace.** Owing to better-than-expected data, we are revising (upward) our estimated contraction in real GDP for 2021 to a nonetheless significant 7 percent (from 10.4 percent in the last LEM). Our 21.4 percent estimated contraction in real GDP in 2020 remains unchanged. While tourist arrivals have risen by 132 percent (yoy) in 12M-2021, up from a Covid-induced low base, the recovery has not been sufficient to compensate for the persistent increase in the current account deficit and the substantive drop in private consumption.

**Public finances improved in 2021, but only because spending collapsed faster than revenue generation.** Revenues are estimated to have declined from an already low 13.1 percent of GDP in 2020 to 6.6 percent of GDP in 2021, among the lowest rates globally. As the decline in revenue was, however, outpaced by an even larger decrease in total expenditures (10.5 percentage points (yoy) to 5.9 percent of GDP), the 2021 overall fiscal balance is estimated to have reached a surplus (of 0.7 percent of GDP).

**Testament to the continued atrophy of Lebanon's economy, the Lebanese Pound continues to depreciate sharply.** The Lebanese Pound (LBP) depreciated 137 percent in 2020, by 219 percent in 2021, and in the first 10 months of 2022 is already down an additional 145 percent (Average Effective Exchange Rate as estimated by the World Bank).[1] The steady depreciation is despite BdL's FX interventions to attempt to stabilize the banknote rate (BNR)/parallel market exchange rate at the expense of dwindling reserves.

**The sharp deterioration in the currency continues to drive surging inflation, in triple digits since July 2020, impacting the poor and vulnerable the most.** Inflation averaged 150 percent in 2021 and 218 percent (yoy) in the first half of 2022 (reaching a peak of 240 percent (yoy) in January 2022). Inflationary pressure was exacerbated by the rise in global food prices since the onset of the Ukraine war. Globally, Lebanon is one of the countries most affected by food price inflation owing to the destruction of its strategic wheat reserves in the Beirut port explosion, heavy dependance on Ukrainian and Russian wheat imports and the depreciation of the LBP; food inflation stood at 332 percent

[1] The Bank-calculated Average Exchange Rate (AER) methodology is detailed in the Lebanon Economic Monitor, Fall 2020: The Deliberate Depression.

(yoy) in June 2022. Inflation is a highly regressive tax, disproportionally affecting the poor and vulnerable, especially since basic goods including food items are the primary drivers of overall inflation.

**Surprisingly, for a country in a protracted and deep depression, and in sovereign default, Lebanon continues to run a sizable current account deficit.** The current account deficit increased from 2020 to 2021 (from 9.3 to 12.5 percent of GDP, respectively), and is expected to broaden further in 2022. Customs data point to: (i) a higher energy import bill (in US$) as lower volumes are offset by surging global energy prices, and (ii) a significant nominal increase in non-energy imports (by 21.1 percent in 2021). The current account deficit continues to be financed from the remaining usable gross foreign reserves at the central bank and a pervasive cash economy, in which importers have also relied on cash to access credit lines for imports that now require 100 percent cash collateral.

## Outlook and Risks

**Real GDP is projected to contract by a further 5.4 percent in 2022 assuming continued political paralysis and no implementation of a recovery strategy.** The BLOM-PMI index has inched up to 48.5 in the first nine months of 2022 and tourist arrivals have increased by 51.2 percent (yoy) until August. However, net exports remained negative, as imports increased faster (40.7 percent (yoy) in 7M-2022) than exports (12.7 percent). Part of the increase in imports was driven by industrial goods imports (42.7 percent).[2] Anticipated increases in custom duties and the customs duties exchange rate have likely contributed to the substantive increase in industrial goods imports and have driven the hoarding of those goods in anticipation of the price adjustment.

**Inflation is expected to average 186 percent in 2022, amongst the highest globally, partly due to the shrinking share of imports based on BdL subsidized rates.** This surge in the inflation rate arises despite a relative decrease in narrow money supply growth in 8M-2022, owing to a change in the dynamic relationship between inflation and depreciation. The increase in the pass-through is also linked to higher levels of dollarization in the economy-notably for services that had been previously priced in LBP at lower than market value exchange rates and have now been dollarized.

**An unprecedented institutional vacuum will likely further delay any agreement on crisis resolution and much needed reforms;** this includes prior actions as part of the April 2022 IMF staff-level agreement (SLA). While Lebanon is no stranger to political paralysis, the price of an institutional vacuum is at an all-time high, as it impedes decision-making and reform ratification, deepening Lebanon's long-term economic woes and the plight of the Lebanese people. An IMF program remains elusive as the authorities have yet to complete ten reforms up front. A fragmented parliament, coupled with governmental and presidential vacuum casts further doubt on the ability to complete prior actions and secure a final agreement in the next few months.

## Time for An Equitable Banking Resolution

**Divergent views among key stakeholders on how to distribute the financial losses remains the main bottleneck for reaching an agreement on a comprehensive reform agenda.** Such discord prevents banking sector resolution which is critical for restoring financial sector stability and economic recovery. Global best-practice principles endorse a financial sector rehabilitation strategy that recognizes and addresses the large losses in the sector upfront, respects the hierarchy of claims, protects small depositors, and refrains from recourse to public resources. Key stakeholders in Lebanon, however, strongly oppose such a resolution, calling on the State to bear responsibility for the ongoing crisis and to privatize public assets and/or draw on future government revenues to bail-out the financial sector.

[2] This includes imports of the following categories: Wood, Rubber and Chemical Products; Non-Metallic Products; Textiles; Capital Goods; and Equipment Other than Capital Goods.

**The size of the balance sheet and associated losses make Lebanon's financial sector, *too big to bail*.** Financial losses exceed US$72 billion, equivalent to more than three times of GDP in 2021. Combined losses stem from a public sector in default, a central bank holding the largest negative reserves position in the world, and an oversized and insolvent banking system. Therefore, the magnitude of the holes in the intertwined balances sheets of the Central Bank, the banking sector and the Sovereign, dwarfs the current and future assets that the sovereign could realistically mobilize for a bailout. State-owned assets and public real estate are worth only a fraction of the estimated financial losses, as are any potential revenues from oil and gas, which are still indeterminate and in any case years away. Given the uncertain valuation of both assets, any crisis resolution plan that relies on these would lack credibility and fail.

**A bailout of the financial sector by taxpayers would redistribute wealth from poorer to richer households, as the public would be asked to compensate bank equity holders and wealthy depositors.** Pre-crisis, 50 percent of deposits in Lebanon's banking system were owned by 1 percent of depositors; with 20 percent of deposits held among 0.01 percent of depositors. The heavy concentration of deposits amongst a few high-net-worth individuals, marking one of the most unequal distribution of deposits in history, must serve as a basis for equity and fairness considerations. As argued in our Spring 2021 Lebanon Economic Monitor issue *Lebanon Sinking (to the Top 3)*, not only is a bailout of the financial sector unviable, but it is also inconsistent with the restructuring principles that protect taxpayers and small depositors and foster equitable burden sharing.

**A bail-in solution, based on a creditors' hierarchy, along with comprehensive reforms is the only realistic option for Lebanon to turn the page on its flawed development model.** A bail-in, makes large creditors and shareholders bear the main cost of bank restructuring, by writing down, canceling and/or converting liabilities into equity; this allows viable banks to regain solvency and ensures the protection of small depositors. Lebanon's post-civil war development model has been characterized by strong interlinkages between the fiscal-monetary-financial sectors, rendering one overly dependent on the other, and in the end leading to systemic failure. With the sovereign default of March 2020, the erstwhile equilibrium has collapsed. Lebanon must now move to a new sustainable development model. Delays in the day of reckoning with the magnitude and viable distribution of financial losses will only compound human and social capital losses. As repeatedly called for, Lebanon needs to urgently adopt a domestic, equitable, and comprehensive solution that is predicated on: (i) addressing upfront the balance sheet impairments, (ii) restoring liquidity, and (iii) adhering to sound global practices of bail-in solutions based on a hierarchy of creditors (starting with banks' shareholders) that protects small depositors.

## Special Foci

**Lebanon's four-year contraction in real GDP has already wiped out 15 years of economic growth and is scarring the country's potential for recovery.** The depth of the cumulative economic contraction ranks Lebanon's ongoing crisis among the worst ever since the 1850s.[3] In **Special Focus I**, we assess the severity of Lebanon's crisis by comparing it to a select group of Fragile and Conflict States (FCS). We conclude that Lebanon's macroeconomic performance is worse—or—at best—on par, with those of this specific FCS group (Zimbabwe, Yemen, Venezuela and Somalia). Strikingly, the contraction to date is comparable to that Yemen during the first four years of war. The depth and duration of the Deliberate Depression[4] is reducing Lebanon's potential for growth as its physical, human, social, institutional, and environmental capital are rapidly and potentially irreparably being depleted.

**In Special Focus II, we analyze dollarization in Lebanon, and conclude that the current crisis will likely reinforce high levels of dollarization, even upon recovery.** Historically, multiple currency crises led to hysteresis in dollarization in the country,

[3] See Lebanon Economic Monitor, Spring 2021: Lebanon Sinking (to the Top 3).

[4] See Lebanon Economic Monitor, Fall 2020: The Deliberate Depression.

with the extent of dollarization widening over time for deposits, lending, and public debt. We find that Lebanon's financial system was not developed beyond the banking sector, and the lack of a capital market has prevented the development of diversification and hedging instruments that could have helped to reduce or reverse dollarization. Going forward, the current crisis will further reinforce the hysteresis driver of dollarization. The development of capital markets remains unattainable under current conditions and will require macroeconomic stability in the short term and new growth model in the long term.

# الموجز التنفيذي

## أحدث المستجدات الاقتصادية

**يواصل الاقتصاد اللبناني الانكماش، وإن كان بوتيرة أبطأ إلى حد ما.** ونظراً لتوافر بيانات أفضل من المتوقعة سابقاً، فإننا نراجع تقديراتنا لنسبة الانكماش في إجمالي الناتج المحلي الحقيقي لعام 2021 لتصبح 7%، وهي تُعد أيضًا نسبة مرتفعة، من نسبة 10.4% المقدرة في آخر تقرير لمرصد الاقتصاد اللبناني. ولا يطرأ أي تغيير على تقديرنا للانكماش في إجمالي الناتج المحلي الحقيقي في عام 2020 بنسبة 21.4%. على الرغم من ارتفاع عدد السائحين الوافدين خلال عام 2021 بنسبة 132% (على أساس سنوي)، من مستواه الذي كان منخفضاً بسبب جائحة فيروس كورونا، لم يكن هذا التعافي كافياً لتعويض الزيادة المستمرة في عجز الحساب الجاري والانخفاض الكبير في حجم الاستهلاك الخاص.

**تحسنت أوضاع المالية العامة في عام 2021، وهو ما يُعزى إلى التراجع الكبير في الإنفاق على نحو أسرع من الإيرادات.** وتشير التقديرات إلى أن الإيرادات تراجعت من مستوى منخفض بالفعل بلغ 13.1% من إجمالي الناتج المحلي في عام 2020، إلى 6.6% في عام 2021، وهذه النسبة من بين أدنى المعدلات عالمياً. مع ذلك، فإنه نظراً لأن الانخفاض في الإيرادات قد تجاوزه بالفعل انخفاض أكبر في إجمالي النفقات (10.5 نقطة مئوية، على أساس سنوي، إلى 5.9% من إجمالي الناتج المحلي)، تشير التقديرات إلى أن رصيد المالية العامة الكلي لعام 2021 قد حقق فائضاً (بلغ 0.7% من إجمالي الناتج المحلي).

**في دليل على استمرار الانكماش الشديد في الاقتصاد اللبناني، تواصل قيمة الليرة اللبنانية الانخفاض بشكل حاد.** انخفضت قيمة الليرة اللبنانية بنسبة 137% في عام 2020، وبنسبة 219% في عام 2021. ثم شهدت في الأشهر العشرة الأولى من عام 2022 مزيداً من الانخفاض بنسبة 145% (متوسط سعر الصرف الفعلي وفقاً لتقدير البنك الدولي).[5] ويأتي الانخفاض المستمر في قيمة العملة على الرغم من تدخلات مصرف لبنان في سوق الصرف الأجنبي لمحاولة تثبيت سعر الصرف للسحب النقدي / سعر الصرف في السوق الموازية على حساب الاحتياطيات الآخذة في التناقص.

**يستمر التدهور الحاد في قيمة العملة في دفع التضخم المتزايد، الذي سجل أرقاماً ثلاثية منذ يوليو/تموز 2020، مما كان له أشد الأثر على الفئات الفقيرة والأكثر احتياجاً.** وقد بلغ متوسط التضخم 150% في عام 2021 و 218% (على أساس سنوي) في النصف الأول من عام 2022 (إذ بلغ ذروته بنسبة 240%، على أساس سنوي، في يناير/كانون الثاني 2022). وتفاقمت الضغوط التضخمية بسبب ارتفاع الأسعار العالمية للمواد الغذائية منذ اندلاع الحرب في أوكرانيا. على الصعيد العالمي، يُعد لبنان من أكثر البلدان تضرراً من تضخم أسعار المواد الغذائية بسبب تدمير احتياطياته الإستراتيجية من القمح جراء انفجار مرفأ بيروت، والاعتماد الشديد على واردات القمح الأوكراني والروسي، وانخفاض قيمة الليرة اللبنانية. وقد بلغت نسبة تضخم أسعار المواد الغذائية 332% (على أساس سنوي) في يونيو/حزيران 2022. والتضخم ما هو إلا ضريبة تنازلية، تؤثر بشكل غير عادل على الفئات الفقيرة والأكثر احتياجاً، لا سيما وأن السلع الأساسية، بما فيها المواد الغذائية، هي العناصر الرئيسية التي تدفع معدل التضخم الكلي.

**من المثير للدهشة أن بلداً مثل لبنان الذي يعيش حالة كساد طويلة وعميقة وقد توقف أيضاً عن سداد ديونه السيادية، يستمر في تسجيل عجز كبير في الحساب الجاري.** فقد زاد هذا العجز من 9.3% من إجمالي الناتج المحلي في عام 2020 إلى 12.5% في عام 2021، ومن المتوقع أن يزداد أكثر في عام 2022. وتشير البيانات الجمركية إلى ما يلي: (1) ارتفاع فاتورة استيراد الطاقة (بالدولار) لأن انخفاض حجم الاستهلاك يقابله ارتفاع أسعار الطاقة عالمياً، و(2) زيادة كبيرة في القيمة الاسمية للواردات خلاف الطاقة (بنسبة 21.1% في عام 2021). ولا يزال عجز الحساب الجاري يموَّل مما تبقى من إجمالي الاحتياطيات الأجنبية القابلة للاستخدام لدى البنك المركزي ومن اقتصاد نقدي منتشر، يعتمد فيه المستوردون أيضاً على التمويل الذاتي (النقدي) ليتمكنوا من إجراء تحويلات مباشرة لتمويل الواردات.

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[5] يتضمن عدد الخريف لعام 2020 من تقرير مرصد الاقتصاد اللبناني توضيحاً مفصلاً لمنهجية احتساب متوسط سعر الصرف لدى البنك الدولي: الكساد المتعمَّد (الرابط)

## الآفاق المستقبلية والمخاطر المحيطة بها

**من المتوقع أن ينكمش إجمالي الناتج المحلي الحقيقي بنسبة 5.4% إضافية في عام 2022، بافتراض استمرار حالة الجمود السياسي وعدم تنفيذ إستراتيجية شاملة للتعافي.** وقد ارتفع مؤشر مديري المشتريات لبنك بلوم إلى 48.5 في الأشهر التسعة الأولى من عام 2022، وزاد عدد السائحين الوافدين بنسبة 51.2% (على أساس سنوي) حتى أغسطس/آب. على الرغم من ذلك، ظل صافي الصادرات سالباً، إذ زاد حجم الواردات (40.7%، على أساس سنوي، في فترة سبعة أشهر من عام 2022) بوتيرة أسرع من زيادة حجم الصادرات (12.7%). ويُعزى جزء من هذه الزيادة في الواردات إلى واردات السلع الصناعية (42.7%).[6] ومن المحتمل أيضاً أن تكون الزيادات المتوقعة في الرسوم الجمركية وسعر الصرف الجمركي قد ساهمت في الزيادة الكبيرة في واردات السلع الصناعية ودفعت إلى اكتناز تلك السلع تحسباً لتعديل الأسعار.

**من المتوقع أن يبلغ معدل التضخم 186% في المتوسط في عام 2022، وهو ما يُعد من بين أعلى المعدلات على مستوى العالم.** وتُعزى تلك الزيادة جزئياً إلى تقلص نسبة الواردات على أساس الأسعار المدعومة من مصرف لبنان. وتأتي هذه الزيادة في معدل التضخم على الرغم من الانخفاض النسبي في نمو المعروض النقدي بمعناه الضيق في فترة ثمانية أشهر من عام 2022، بسبب التغير في العلاقة الديناميكية بين التضخم والاستهلاك. وترتبط الزيادة في معدل انتقال تأثير الأسعار العالمية إلى الأسعار المحلية أيضاً بارتفاع مستوى الدولرة في الاقتصاد - لا سيما في الخدمات التي كانت تُسعَّر سابقاً بالليرة اللبنانية بأقل من أسعار الصرف بالقيمة السوقية والتي تم الآن تسعيرها بالدولار.

**من المرجح أن يؤدي الفراغ السياسي غير المسبوق في البلاد إلى زيادة تأخير التوصل إلى اتفاق بشأن حل الأزمات للأزمة وإجراء الإصلاحات التي تشتد الحاجة إليها.** ويشمل هذا الإجراءات المسبقة الواردة في الاتفاق الذي أُبرم في أبريل/نيسان 2022 مع صندوق النقد الدولي على مستوى الخبراء. في حين لا يُعد الشلل السياسي أمراً غريباً على الساحة اللبنانية، فإن ثمن الفراغ المؤسسي بلغ أعلى مستوياته على الإطلاق. فهو يعوق عمليتي اتخاذ القرار وإقرار الإصلاحات، مما يعمق مشاكل البلاد الاقتصادية ويزيد محنة الشعب اللبناني الممتدة منذ زمن طويل. ولا يزال تنفيذ برنامج صندوق النقد الدولي بعيد المنال لأن السلطات المعنية لم تنجز حتى الآن عشرة إصلاحات مطلوبة على الفور. يلقي المشهد الحالي في البلاد، من برلمان مجزأ وفراغ على المستوى الحكومي والرئاسي، بمزيد من الشكوك حول القدرة على استكمال الإجراءات المطلوب اتخاذها على الفور والتوصل إلى اتفاق نهائي في الأشهر القليلة المقبلة.

## حان الوقت لإعادة هيكلة القطاع المصرفي على نحو منصف

**لا يزال تباين وجهات النظر بين الأطراف المعنية الرئيسية بشأن كيفية توزيع الخسائر المالية يمثل العقبة الرئيسية أمام التوصل إلى اتفاق بشأن أجندة إصلاح شاملة.** ويحول هذا الخلاف دون إعادة هيكلة شاملة للقطاع المصرفي، وهو ما يُعد أمراً بالغ الأهمية لاستعادة استقرار القطاع المالي وتحقيق التعافي الاقتصادي. إن المبادئ الخاصة بأفضل الممارسات العالمية تؤيد اعتماد إستراتيجية لإعادة هيكلة القطاع المالي تعترف بالخسائر الكبيرة التي مُني بها هذا القطاع وتعالجها على الفور، وتحترم ترتيب المطالبات، وتحمي صغار المودعين، وتمتنع عن اللجوء إلى الموارد العامة. ومع ذلك، تعارض الأطراف المعنية الرئيسية في لبنان هذا الحل بشدة، وتطالب الدولة بتحمل المسؤولية عن الأزمة المستمرة وبخصخصة الأصول العامة، أو الاستفادة من الإيرادات الحكومية في المستقبل لإنقاذ القطاع المالي، أو كليهما.

**إن حجم الميزانية العمومية والخسائر المرتبطة بها تجعل القطاع المالي في لبنان أضخم من أن يعوم.** فقد تجاوزت الخسائر المالية 72 مليار دولار، أي ما يعادل أكثر من ثلاثة أضعاف إجمالي الناتج المحلي في عام 2021. وتنبع الخسائر المجمعة عن قطاع عام متعثر في سداد ديونه، وبنك مركزي لديه أكبر مركز احتياطي سلبي في العالم، ونظام مصرفي متضخم وفي حالة إعسار. لذلك، فإن الأصول الحالية والمستقبلية التي يمكن أن تعبئها الدولة بشكل واقعي من أجل عملية الإنقاذ تبدو ضئيلة للغاية أمام حجم الثغرات في الميزانيات العمومية المتشابكة للبنك المركزي والقطاع المصرفي والدولة. ولا تساوي الأصول المملوكة للدولة والعقارات العامة سوى جزء بسيط من الخسائر المالية المقدرة. وينطبق الأمر نفسه على أي إيرادات محتملة من النفط والغاز، التي لا تزال غير مؤكدة، بل وتحتاج سنوات لتتحقق على أي حال. وبالنظر إلى التقييم غير المؤكد لهذين الأصلين، فإن أي خطة تعتمد عليهما لحل الأزمة ستفتقر إلى المصداقية وستبوء بالفشل.

**إن تعويم القطاع المالي عبر الاستعانة بدافعي الضرائب من شأنه إعادة توزيع الثروة من الأسر الأفقر إلى الأسر الأغنى، إذ سيُطلب من عامة المواطنين تعويض المساهمين في المصارف والمودعين الأثرياء.** قبل نشوب الأزمة، كان 1% من المودعين يملكون 50% من الودائع في النظام المصرفي اللبناني، في حين توزعت ملكية 20% من الودائع على 0.01 % من المودعين. إن تركُّز الودائع بشكل كبير بين عدد قليل من الأفراد ذوي الملاءة المالية العالية، والذي يمثل إحدى أكثر حالات عدم الإنصاف في توزيع الودائع في التاريخ، يجب أن يُستخدم أساساً لاعتبارات تحقيق العدالة والإنصاف. وكما ورد في عدد الربيع لعام 2021 من تقرير مرصد الاقتصاد اللبناني، والذي يحمل عنوان لبنان يغرق: نحو أسوأ ثلاث أزمات عالمية، لا يُعد تعويم القطاع المالي أمراً غير قابل للاستمرار فحسب، بل يتعارض أيضاً مع مبادئ إعادة الهيكلة التي تحمي دافعي الضرائب وصغار المودعين، وتعزز تقاسم الأعباء على نحو منصف.

**إن الحل المتمثل في خطة إنقاذ قائمة على ترتيب الدائنين، إلى جانب إصلاحات شاملة، هو الخيار الواقعي الوحيد أمام لبنان لطي صفحة نموذجه غير المجدي للتنمية.** وتُحمِّل خطة الإنقاذ كبار الدائنين والمساهمين التكلفة الرئيسية لإعادة هيكلة القطاع المصرفي، عن طريق تخفيض الالتزامات أو إلغائها أو تحويلها إلى حقوق ملكية، أو عن طريق كل هذا. ويتيح هذا الأمر للمصارف التي تتوافر لها مقومات الاستمرار استعادة ملاءتها المالية، ويضمن حماية صغار المودعين. لقد اتسم نموذج التنمية في لبنان بعد الحرب الأهلية بوجود روابط قوية بين قطاع المالية العامة والقطاعين النقدي والمالي، مما جعل أحدهما يعتمد بشكل مفرط على الآخر، وهو ما أدى في نهاية المطاف إلى إخفاق النظام. ومع التوقف

[6] يشمل هذا الأمر الواردات من الفئات التالية: الخشب والمطاط والمنتجات الكيماوية، والمنتجات غير المعدنية، والمنسوجات، والسلع الرأسمالية، ومعدات أخرى غير السلع الرأسمالية.

عن سداد الديون السيادية في مارس/آذار 2020، انهار التوازن السابق. يجب على لبنان أن ينتقل الآن إلى نموذج جديد للتنمية المستدامة. ولن يؤدي تأخير يوم المحاسبة على حجم الخسائر المالية وتوزيعها القابل للتطبيق إلا إلى مضاعفة خسائر رأس المال البشري والاجتماعي في البلاد. وكما جاء في الدعوات السابقة والمتكررة، فإنه يتعين على لبنان المسارعة إلى تبني حل داخلي منصف وشامل يرتكز على ما يلي: (1) معالجة فورية للأضرار التي لحقت بالميزانية العمومية، (2) استعادة السيولة، (3) الالتزام بالممارسات العالمية السليمة لحلول الإنقاذ القائمة على ترتيب الدائنين (مع البدء بمساهمي المصارف) مما يحمي صغار المودعين.

## قسمان خاصان

**إن الانكماش الذي شهده لبنان في إجمالي الناتج المحلي الحقيقي على مدى أربع سنوات قد قوّض بالفعل ما تحقق من نمو اقتصادي على مدار 15 عاماً، بل ويضعف قدرة البلاد على التعافي.** إن عمق الانكماش الاقتصادي التراكمي يجعل أزمة لبنان المستمرة من بين أسوأ الأزمات منذ خمسينيات القرن التاسع عشر.[7] يقدم القسم الخاص الأول من التقرير تقييماً لحدة الأزمة في لبنان عبر مقارنتها بمجموعة مختارة من الدول الهشة والمتأثرة بالصراعات. ويستنتج أن أداء الاقتصاد الكلي في لبنان أسوأ من أداء هذه المجموعة المحددة من الدول الهشة والمتأثرة بالصراعات (وهي زيمبابوي واليمن وفنزويلا والصومال)، أو يضاهيها في أحسن الأحوال. ومن اللافت للنظر أن الانكماش الحاصل حتى الآن يمكن مقارنته بما حدث في اليمن خلال السنوات الأربع الأولى من الحرب. إن عمق الكساد المتعمد ومدته[8] يقللان من قدرة لبنان على النمو، إذ يجري استنفاد رأس المال المادي والبشري والاجتماعي والمؤسسي والبيئي بسرعة وعلى نحو يتعذر إصلاحه.

**يقدم القسم الخاص الثاني من التقرير تحليلاً لعملية الدولرة في لبنان، ويخلص إلى أن الأزمة الحالية ستعزز على الأرجح مستويات الدولرة المرتفعة، حتى بعد تحقيق التعافي.** تاريخياً، أدت أزمات العملات المتعددة إلى ازدياد كبير في عملية الدولرة في البلاد، مع اتساع نطاقها بمرور الوقت للودائع والإقراض والدين العام. لم يتطور النظام المالي في لبنان خارج القطاع المصرفي، وحال الافتقار إلى سوق رأس المال دون تطوير أدوات التنويع والتحوط التي كان من الممكن أن تساعد في تخفيض الدولرة أو عكس مسارها. ولا يزال تطوير أسواق رأس المال أمراً بعيد المنال في ظل الظروف الحالية، كما أنه سيتطلب تحقيق استقرار على صعيد الاقتصاد الكلي على المدى القصير وتبني نموذج نموٍ جديدٍ على المدى الطويل.

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7 انظر عدد الربيع لعام 2021 من تقرير مرصد الاقتصاد اللبناني: لبنان يغرق: نحو أسوأ 3 أزمات عالمية (الرابط)

8 انظر عدد الخريف لعام 2020 من تقرير مرصد الاقتصاد اللبناني: الكساد المتعمَّد (الرابط)

# RÉSUMÉ ANALYTIQUE

## Évolution économique récente

**L'économie continue de se contracter, mais à un rythme un peu plus lent.** En raison de données meilleures que prévu, l'estimation de la contraction du PIB réel pour 2021 est révisée à 7 %, ce qui est néanmoins considérable, contre 10,4 % dans le dernier Rapport de suivi (LEM pour Lebanon Economic Monitor). L'estimation de 21,4 % de contraction du PIB réel en 2020 demeure inchangée. Bien que les arrivées de touristes en 2021 aient augmenté de 132 % (en glissement annuel), à partir d'une faible base induite par la Covid, la reprise n'a pas été suffisante pour compenser l'augmentation persistante du déficit du compte courant et la baisse sensible de la consommation privée.

**Les finances publiques se sont améliorées en 2021, mais uniquement parce que les dépenses se sont effondrées plus rapidement que les recettes publiques.** Celles-ci sont passées, selon les estimations, d'un niveau déjà faible de 13,1 % du PIB en 2020 à 6,6 % du PIB en 2021, soit l'un des taux les plus bas au monde. La baisse des recettes ayant toutefois été compensée par une diminution encore plus importante des dépenses totales (10,5 points de pourcentage – en glissement annuel – pour passer à 5,9 % du PIB), le solde budgétaire global pour 2021 aurait atteint un excédent (de 0,7 % du PIB).

**Témoignage de l'atrophie continue de l'économie libanaise, la livre libanaise continue de se déprécier fortement.** La livre libanaise (LBP) s'est dépréciée de 137 % en 2020, de 219 % en 2021, et au cours des dix premiers mois de 2022, elle a déjà perdu 145 % de plus (taux de change effectif moyen selon les estimations de la Banque mondiale)[9]. Cette dépréciation constante se produit en dépit des interventions de la Banque du Liban (BdL) sur le marché des changes pour tenter de stabiliser le taux de change des billets de banque/taux de change du marché parallèle, au détriment des réserves qui s'amenuisent.

**La forte dépréciation de la monnaie continue d'entraîner une inflation galopante, à trois chiffres depuis juillet 2020, qui touche surtout les pauvres et les personnes vulnérables.** L'inflation a été en moyenne de 150 % en 2021 et de 218 % (en glissement annuel) au premier semestre 2022 (atteignant un pic de 240 % – en glissement annuel

[9] La méthodologie du taux de change moyen (TCM) calculé par la Banque est présentée en détail dans le *Lebanon Economic Monitor, Fall 2020 : The Deliberate Depression* (a).

– en janvier 2022). Les pressions inflationnistes ont été exacerbées par la flambée des prix mondiaux des denrées alimentaires depuis le début de la guerre en Ukraine. Au niveau mondial, le Liban est l'un des pays les plus touchés par l'inflation des prix des denrées alimentaires en raison de la destruction de ses réserves stratégiques de blé suite à l'explosion du port de Beyrouth, de sa forte dépendance à l'égard des importations de blé ukrainien et russe et de la dépréciation de la livre libanaise ; l'inflation des prix des denrées alimentaires a atteint 332 % (en glissement annuel) en juin 2022. L'inflation est une taxe particulièrement régressive, qui touche de manière disproportionnée les pauvres et les personnes vulnérables, d'autant plus que les produits de base, notamment les denrées alimentaires, sont les principaux vecteurs de l'inflation globale.

**Il est surprenant que, pour un pays en proie à une dépression prolongée et profonde et à une défaillance de sa dette souveraine, le Liban continue d'afficher un déficit de la balance courante appréciable.** Le déficit de la balance courante a augmenté entre 2020 et 2021 (de 9,3 à 12,5 % du PIB, respectivement), et devrait encore se creuser en 2022. Les données douanières indiquent : i) une facture d'importation d'énergie plus élevée (en dollars), la baisse des volumes étant compensée par la flambée des prix mondiaux de l'énergie, et ii) une augmentation nominale considérable des importations non énergétiques (de 21,1 % en 2021). Le déficit de la balance courante continue d'être financé par les réserves de change brutes utilisables restantes à la banque centrale et par une économie monétaire omniprésente, dans laquelle les importateurs comptent également sur l'autofinancement (en espèces) pour pouvoir effectuer des transferts directs afin de financer les importations.

## Perspectives et risques

**Le PIB réel devrait encore se contracter de 5,4 % en 2022, si la paralysie politique se poursuit et si aucune stratégie de relance n'est mise en œuvre.** L'indice BLOMPMI a légèrement augmenté à 48,5 au cours des neuf premiers mois de 2022 et les arrivées de touristes ont augmenté de 51,2 % (en glissement annuel) jusqu'en août. Cependant, les exportations nettes sont restées négatives, car les importations ont augmenté plus rapidement (40,7 % – en glissement annuel – sur les sept premiers mois de 2022) que les exportations (12,7 %). L'augmentation des importations est imputable en partie *à celles* de biens industriels (42,7 %)[10]. Les augmentations prévues des droits de douane et du taux de change des droits de douane ont probablement contribué à l'accroissement sensible des importations de biens industriels et ont favorisé la thésaurisation de ces biens en prévision de l'ajustement des prix.

**L'inflation devrait atteindre une moyenne de 186 % en 2022, soit l'une des plus élevées au monde, en partie en raison de la diminution de la part des importations sur la base des taux subventionnés de la BdL.** Ce taux d'inflation élevé survient malgré une diminution relative de la croissance de la masse monétaire étroite sur les huit premiers mois de 2022, en raison d'un changement dans la relation dynamique entre l'inflation et la dépréciation. L'augmentation de la transmission de l'inflation est également liée à des niveaux plus élevés de dollarisation de l'économie, notamment pour les services qui étaient auparavant facturés en LBP à des taux de change inférieurs à la valeur du marché et qui sont désormais dollarisés.

**Un vide institutionnel sans précédent retardera probablement davantage tout accord sur la résolution de la crise et les réformes indispensables,** y compris les mesures préalables dans le cadre de l'accord conclut au niveau des services du FMI en avril 2022. Si le Liban est coutumier de la paralysie politique, le prix d'un vide institutionnel n'a jamais été aussi élevé, car il entrave la prise de décision et la ratification des réformes, aggravant ainsi les difficultés économiques à long terme du pays et la situation critique de son peuple. Un programme du FMI reste insaisissable car les autorités doivent encore mener à bien dix réformes préalables. Un

[10] Cela comprend les importations des catégories suivantes : bois, caoutchouc et produits chimiques ; produits non métalliques ; textiles ; biens d'investissement ; et équipements autres que les biens d'investissement.

parlement fragmenté, associé à un vide gouvernemental et présidentiel, jette un doute supplémentaire sur la capacité à achever les mesures préalables et à obtenir un accord final dans les prochains mois.

## L'urgence d'une résolution bancaire équitable

**Les divergences de vues entre les principales parties prenantes sur la manière de répartir les pertes financières demeurent le principal obstacle à la conclusion d'un accord sur un programme complet de réforme.** Une telle discorde empêche la résolution du problème du secteur bancaire, qui est essentielle pour rétablir la stabilité du secteur financier et la reprise économique. Les principes issus des meilleures pratiques mondiales préconisent une stratégie de redressement du secteur financier qui reconnaît et traite d'emblée les pertes importantes du secteur, respecte la hiérarchie des créances, protège les petits déposants et s'abstient de recourir aux ressources publiques. Cependant, les principales parties prenantes au Liban s'opposent fermement à une telle résolution, appelant l'État à assumer la responsabilité de la crise actuelle et à privatiser les actifs publics et/ou à puiser dans les futures recettes publiques pour renflouer le secteur financier.

**La taille du bilan et les pertes associées font que le secteur financier libanais est *trop gros pour être renfloué*.** Les pertes financières dépassent 72 milliards de dollars, ce qui équivaut à plus de trois fois le PIB en 2021. Les pertes combinées proviennent d'un secteur public en défaut, d'une banque centrale détenant la plus grande position de réserves négatives au monde et d'un système bancaire surdimensionné et insolvable. Par conséquent, l'ampleur des trous dans les bilans entrelacés de la banque centrale, du secteur bancaire et de l'État dépasse les actifs actuels et futurs que l'État pourrait raisonnablement mobiliser pour un renflouement. Les actifs appartenant à l'État et les biens immobiliers publics ne valent qu'une fraction des pertes financières estimées, tout comme les revenus potentiels du pétrole et du gaz, qui sont encore incertains et ne seront pas disponibles avant plusieurs années. Compte tenu de l'évaluation incertaine de ces deux actifs, tout plan de résolution de la crise reposant sur ceuxci manquerait de crédibilité et échouerait.

**Un plan de renflouement du secteur financier par les contribuables entraînerait une redistribution de la richesse des ménages les plus pauvres vers les plus riches, car le public serait invité à dédommager les détenteurs d'actions des banques et les riches déposants.** Avant la crise, 50 % des dépôts dans le système bancaire libanais étaient détenus par 1 % des déposants, 20 % des dépôts étant détenus par 0,01 % des déposants. La forte concentration des dépôts entre les mains d'un petit nombre de particuliers fortunés, qui constitue l'une des distributions de dépôts les plus inégales de l'histoire, doit servir de base à des considérations d'équité et de justice. Comme cela a été soutenu dans le numéro du printemps 2021 du Rapport de suivi de la situation économique intitulé *Lebanon Sinking (to the Top 3)*, non seulement le renflouement du secteur financier n'est pas viable, mais il est également incompatible avec les principes de restructuration qui protègent contribuables et petits déposants et favorisent un partage équitable des charges.

**Une solution de mise à contribution, basée sur une hiérarchie des créanciers, et accompagnée de réformes globales, représente la seule option réaliste pour que le Liban tourne la page sur son modèle de développement défectueux.** Un plan de mise à contribution fait supporter aux grands créanciers et actionnaires l'essentiel du coût de la restructuration des banques, en dépréciant, annulant et/ou convertissant les dettes en capitaux propres ; cela permet aux banques viables de retrouver leur solvabilité et assure la protection des petits déposants. Le modèle de développement postguerre civile du Liban se caractérise par des liens étroits entre les secteurs fiscal, monétaire et financier, rendant les uns trop dépendants des autres et conduisant finalement à une défaillance systémique. Avec le défaut de paiement de la dette souveraine de mars 2020, l'équilibre antérieur s'est effondré. Le Liban doit maintenant passer à un nouveau modèle de développement durable. Tout retard dans la prise en compte de l'ampleur et de la répartition viable des pertes financières ne fera qu'aggraver les pertes en capital humain et social. Comme cela a été demandé à maintes reprises, le Liban doit adopter de toute urgence une solution nationale, équitable et globale qui repose sur : i) le traitement immédiat des dépréciations du bilan, ii) le rétablissement des liquidités, et iii) l'adhésion à des pratiques mondiales saines de mise à contribution fondées sur une hiérarchie des créanciers (en commençant par les actionnaires des banques) qui protège les petits déposants.

## Dossiers spéciaux

**La contraction de quatre ans du PIB réel du Liban a déjà réduit à néant 15 années de croissance économique et compromet le potentiel de redressement du pays.** L'ampleur de la contraction économique cumulée place la crise actuelle du Liban parmi les pires depuis les années 1850[11]. **Le Dossier spécial I** évalue la gravité de la crise du Liban en le comparant à une sélection d'États fragiles et touchés par un conflit (EFC). Il conclut que les résultats macroéconomiques du Liban sont pires – ou au mieux égaux – à ceux de ce groupe précis d'EFC (Zimbabwe, Yémen, Venezuela et Somalie). Il est frappant de constater que la contraction observée à ce jour est comparable à celle du Yémen pendant les quatre premières années de guerre. La gravité et la durée de la dépression délibérée[12] réduisent les potentialités de croissance du Liban, car son capital physique, humain, social, institutionnel et environnemental s'épuise rapidement et de manière potentiellement irrémédiable.

**Le Dossier spécial II présente une analyse de la dollarisation au Liban, et conclut que la crise actuelle va probablement renforcer les niveaux élevés de dollarisation, même après la reprise.** Traditionnellement, les crises monétaires multiples ont conduit à une hystérésis de la dollarisation dans le pays, son étendue s'élargissant au fil du temps pour les dépôts, les prêts et la dette publique. Il apparaît que le système financier du Liban n'a pas été développé audelà du secteur bancaire, et que l'absence d'un marché des capitaux empêche le développement d'instruments de diversification et de couverture qui auraient pu contribuer à réduire ou à inverser la dollarisation. Le développement des marchés de capitaux reste irréalisable dans les conditions actuelles et nécessitera une stabilité macroéconomique à court terme et un nouveau modèle de croissance à long terme.

[11] Voir *Lebanon Economic Monitor, Spring 2021 : Lebanon Sinking (to the Top 3)* (a).

[12] Voir *Lebanon Economic Monitor, Fall 2020 : The Deliberate Depression* (a).

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# THE POLICY CONTEXT

**In July 2022, the World Bank reclassified Lebanon as a lower-middle income country (LMIC), down from an upper-middle income country (UMIC).** This makes Lebanon one of only three countries downgraded to a lower income category—the other two being Zambia and Palau. Lebanon had held its UMIC position for almost 25 years. Income classification is based on the country's Gross National Income (GNI) per capita of the previous year, i.e., Lebanon's new classification is based on its 2021 GNI per capita, which is estimated at US$3,450 per capita.[13] While real GDP has been contracting for the past four years, the contraction in real GDP per capita has spanned eleven years to date. The decline has been driven most recently by the economic crisis, and prior to that, by low growth since 2011 and a 36 percent increase in the population between 2010 and 2021 (a denominator-led effect).[14]

**On April 7, 2022, the Government of Lebanon (GoL) and the IMF announced a staff-level agreement (SLA) on a US$3 billion, 46 months Extended Fund Arrangement** (EFF).[15] Securing IMF Board approval for the EFF will require the completion of ten prior actions (PAs). To date, limited progress in their implementation has been made since the signature of the preliminary agreement. The final agreement is also subject to the confirmation of international partners' financial support to meet Lebanon's external financing needs under the Program.

13 Official national accounts data are lagging (2020 is the latest official release).

14 Population of Lebanon includes Syrian refugees residing in Lebanon. As of 2021, the population of Lebanon is 6.77 million.

15 The comprehensive reform program consists of five key reform pillars: (i) restructuring the financial sector to restore banks' viability and financial intermediation functions; (ii) creating fiscal space by restructuring public debt and placing it on a sustainable footing; (iii) reforming state-owned enterprises, particularly Électricité du Liban (EdL); (iv) modernizing the central bank (Banque du Liban, BdL), governance and accountability arrangements and strengthening governance, anti-corruption, and anti-money laundering /combating the financing of terrorism (AML/CFT) frameworks; and (v) establishing a credible and transparent monetary and exchange rate system.

**The May 2022 Parliamentary elections produced a hung parliament with fragmented blocs and seats, challenging the ability to form a stable majority.** Non-party affiliates have garnered a significant presence. Prime Minister Mikati, whose government went into caretaker mode upon parliamentary elections, was re-appointed as prime minister designate in June 2022, with a new government yet to be formed. Moreover, President Aoun's term ended on October 30th, leaving a void at the top as the parliament has so far been unable to agree on his successor. Governmental and presidential vacuum, resulting in an unprecedented institutional vacuum, may sow the seeds for further discord and considerably complicate the political process.

**In October 2022, a historic agreement between Lebanon and Israel, negotiated through the United States, to delimit their maritime borders has been reached.** The agreement will likely bring relative stability on the security front and will allow Lebanon to begin the process of gas exploration. Even if Lebanon's offshore gas reserve is deemed commercially viable, it will take multiple years before the nascent industry becomes revenue generating, denting considerations to recover financial sector losses from those revenues.[16] In addition, an appropriate governance and regulatory framework in a context of multiple governance challenges, will need to be established to manage potential hydrocarbon wealth effectively and adequately.[17]

**Various stakeholders (including ABL and Lebanon's Economic Committees) continue to demand the use of public assets and/or future government revenues to *bail out* the financial sector.**[18] ABL—representing almost all of Lebanon's domestic financial institutions—remains opposed to important global principles of financial sector restructuring that include *bail in* solutions based on a hierarchy of creditors, starting with banks' shareholders. The outgoing Diab Government calculated losses in the financial sector at US$72 billion, which is close to three times (2022) GDP and, thus, is expected to wipe out shareholders' equity of many banks.[19] Almost three years into the crisis, ABL continues to advocate for mechanisms that incorporate state owned enterprises (SOEs), gold reserves, and public real estate in order to overhaul their impaired balance sheets. The Lebanon Economic Committees,[20] have also proposed an economic recovery plan that entails a state contribution of US$ 30 billion[21] to recover 74 percent of the funds of bank depositors. The plan proposes that the state establishes a holding company of around 15 state-owned enterprises, facilities and assets. The holding company will be managed by the private sector for a period of 10–12 years to repay deposits exceeding US$100,000. Such a plan (unrealistically) anticipates the gradual recovery of big deposits through revenues from state asset investments belonging to all citizens, a quasi-solution that constitutes a bailout of the financial sector's shareholders and big depositors and goes against equitable burden sharing.

**On September 26, the Lebanese parliament ratified a long overdue government budget for 2022.** The constitutional deadline to pass the budget law was end-January 2022. The budget calculates

16 The IMF (2014) estimate the revenues from Liquid Natural Gas (LNG) to amount to, at the peak, 4 percent of GDP under a baseline production profile. The same study estimates LNG revenues to GDP to stand at 7 percent of GDP at the peak of production under a hypothetical production profile assuming a long reserve horizon and increased production.

17 See for example: Jamali, I. and Le Borgne, E., 2014. A Lebanon Sovereign Wealth Fund: Preliminary Recommendations. Assadissa: A Journal of Public Finance & State Modernization, (5), pp.68–88.

18 In an open letter to the IMF's Head of Mission, an advisor to ABL specified ABL's preferred distribution of losses based on the following five pillars: (1) Mobilization of state assets (up to c. US$20 billion); (2) Use of BdL's gold reserves (up to c. US $15 billion); (3) Reversal of post-October 2019 book-entry FX transactions (up to c. US $10–15 billion); (4) Lirafication of deposits consistent with decreasing inflation (up to c. US $30 billion); and (5) Recognition of seigniorage profits accrued since 2020 (up to c. US $5 billion). This position is strongly opposed to the Financial Recovery Plan prepared by the Diab Government.

19 This would be subject to a bank-by-bank assessment but total equity of the Lebanese banking system at the onset of the crisis amounted to US$22 billion.

20 A grouping of Lebanon's main private sector businessmen and owners of major firms.

21 Equivalent to roughly three times the present value of state assets.

expenditures at LBP41 trillion and revenues at LBP30 trillion, for an overall fiscal deficit of LBP11 trillion. The exchange rate used to calculate tax revenues (including the customs' dollar tax) was set at 15,000 LBP/US$. The budget only came into effect on November 15th, following its publication in the Official Gazette, less than two months before the end of the year.[22] The ratified budget constitutes a missed opportunity for more progressive revenue measures. A change in approach is necessary to devise a credible and balanced budget for 2023, based on realistic macroeconomic assumptions and a unified exchange rate.

**On September 28, the Minister of Finance announced plans to (selectively) increase the official exchange rate from 1,507 to 15,000 LBP/US$ starting in November 2022**. Shortly after, the minister of finance clarified that the step was conditioned on the approval of a comprehensive recovery plan. The prime minister subsequently explained that the roll out of a new official exchange rate of 15,000 LBP/US$ will happen gradually, with preliminary exceptions to include banks' balance sheets and housing loan repayments to which the old official rate would still apply. He stated that the new official exchange rate will initially only apply to customs duties on imports and to VAT on those imports, collected at customs (as ratified by parliament in the 2022 budget).

[22] The outgoing president has refused to sign off on the government budget law prior to the end of his tenure; however, as stipulated in article 57 of the constitution, the 2022 budget will automatically come into force if the president does not sign or return the law to parliament within one month of its issuance. When the budget comes into force, it is considered applicable for the remainder of the year (i.e. cannot be retroactive).

2

# RECENT MACRO-FINANCIAL DEVELOPMENTS

## Output and Demand

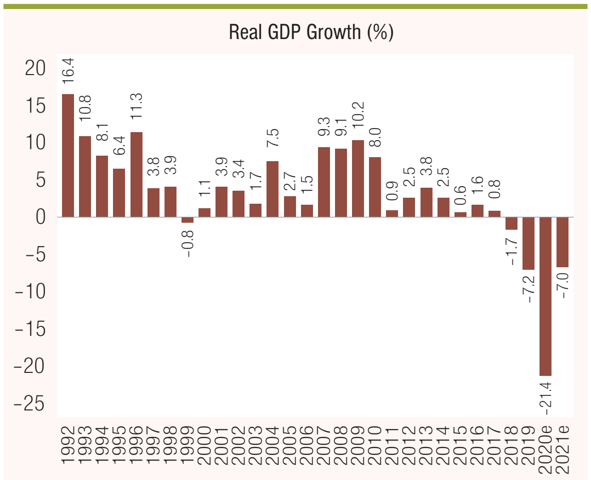
**We are revising (upward) our estimated contraction in real GDP for 2021 to a nonetheless significant 7 percent (from 10.4 percent).** Our 21.4 percent estimated contraction in real GDP in 2020 remains unchanged (Figure 1). The slightly slower contraction is supported by high frequency indicators: the real estate sector witnessed some progress, as construction permits (an indication of future activity) increased by 74.3 percent (yoy). However, this increase occurred largely from a low base effect, in part due to Covid-related stoppages in the sector-construction permits over 12M-2021 remained 15 percent below their seven-year average for the same period (12M-2013 ... 12M-2019). Real estate sales thrived in 2020 and 2021 as some depositors managed to capitalize on their otherwise untransferable bank deposits.[23] The BLOM-PMI index, which captures private sector activity (<50 represents a contraction of activity), still points to contraction but notched up to 46 in 2021, compared to 41.1 in 2020, and inching up to 48.5 over 9M-2022 compared to 45.8 over 9M-2021. The retail sector, however, suffered sizable losses, due to a combination of the financial crisis and COVID-19 lockdown measures; the BTA Fransabank retail trade index declined by 59.5 percent (in real terms) during 2021.

**On the demand side, net exports continue to be the only positive contributor to growth in 2021** (Figure 2).[24] This is driven by an improvement in trade in services, led by tourism. Tourist arrivals surged by 132 percent (yoy), while hotel occupancy rates (published by Ernst & Young) averaged 42 percent in 2021, a 120 percent increase from an average occupancy rate of 19 percent in 2020. This pattern continued in 2022 as tourist arrivals increased by 51.2 percent (yoy) in 8M-2022, compared to the

23 The financial sector facilitated real estate purchases with pre-October 2019 dollar deposits circumventing conditions of informal capital controls (and therefore, lack of alternatives to get those deposits out), leading to an increase in such purchases.

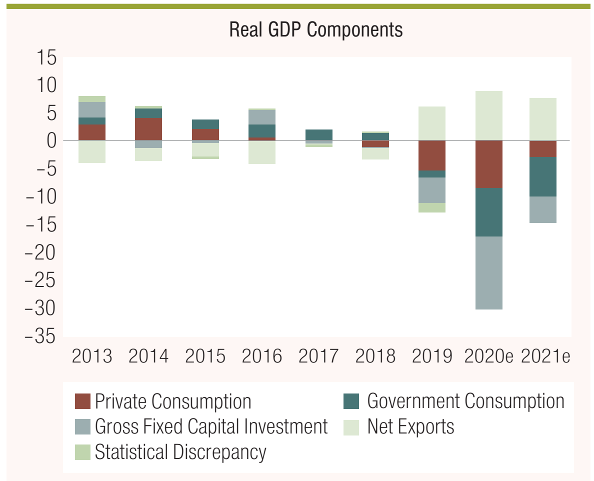
24 It is important to note, that over the past couple of years, net exports contributed positively to growth due to a collapse in domestic demand, which is historically concentrated on imported goods.

FIGURE 1 • Lebanon's Economy Contracted for a Fourth Consecutive Year in 2021




*Sources*: CAS and WB staff calculations.

FIGURE 2 • Net Exports Have Been the Sole Positive Contributor to Real GDP since 2019




*Sources*: CAS and WB staff calculations.

same period in 2021. Private consumption, which averaged 92.3 percent of GDP between 2015 and 2018, has taken a severe blow since the start of the crisis, with Byblos Bank/AUB's consumer confidence index declining by 65.1 percent (yoy) in the first nine months of 2020 (9M-2020; latest available).

## Fiscal Developments

**Public finances improved in 2021 as spending collapsed faster than revenue generation.** Revenues are estimated to have declined from an already low 13.1 percent of GDP in 2020 to 6.6 percent of GDP in 2021, among the lowest rates globally. This was more than offset by a larger decrease in total expenditures, falling by 10.5 pp (yoy) in 2021 to 5.9 percent of GDP. As a result, the fiscal balance is estimated to have recorded a surplus of 0.7 percent of GDP for the first time in decades, compared to a deficit of 3.3 percent of GDP in 2020, and despite a denominator-led effect (inflationary increase of nominal GDP). The primary balance is estimated to have reached 1.7 percent of GDP in 2021, up from −0.8 percent in 2020.

**A passive approach to fiscal policy led to a substantive decrease in primary spending while sovereign default curtailed debt service payments.** Expenditures continued to benefit from low debt service (a consequence of the default on foreign debt); a 71.1 percent (yoy) decline in interest payments on foreign debt led to a 10.6 percent (yoy) fall in debt service, in 2021. A favorable arrangement between the Government and BdL on treasury bonds (TBs) coupon payments further reduced interest expenditures; as part of fiscal relief for the Government, BdL does not receive coupon payments on its holding of Treasury Bonds.[25] Primary spending also fell over the same period, decreasing by 8.3 pp (yoy) to 5.6 percent of GDP, driven by a 6.5 percent nominal decline in primary spending (i.e., the numerator) as well as an inflation-driven increase in nominal GDP (Figure 8). When netting out transfers to the state-owned EdL, which fell by 0.9 pp of GDP over the same period,[26] primary spending declined by 7.5 pp of GDP (yoy). In fact, with inflation averaging 150 percent (yoy) in

25 This, however, pushes the cost of domestic debt to BdL's income statement and balance sheet, both of which are in dire conditions.

26 In March 2021, and in response to a request from the Ministry of Energy and Water for an allocation in the amount of LBP 900 billion (equivalent to US$600 million at the official exchange rate), Parliament ratified only LBP300 billion. Power generation was subsequently cut back to as much as 2 hours per day, as power cuts were increasingly used as a saving tool.

## BOX 1: GOVERNMENT BUDGET 2022

On September 26, the Lebanese parliament ratified a long overdue government budget for 2022. The constitutional deadline to pass the budget law was end-January 2022. The 2022 budget law targets an overall fiscal deficit of 2 percent of GDP. The budget only came into effect on November 15th, following its publication in the Official Gazette. Although the budget reflects an expansionary fiscal policy compared to 2021 (table 2), it is expected to have limited impact on public finances in the remainder of 2022 with only six weeks left in the year. However, the 2022 budget could have a considerable impact on public finances in 2023, as in the absence of a ratified 2023 budget, spending follows the 1/12th rule[a] based on the last approved budget law, i.e. spending in 2023 will be based on the budget law of 2022 until a 2023 budget comes into force.

The budget law relies on direct and indirect taxes to boost revenues. The budget projects an increase in customs duties on imported goods ( 10 percent on imports with a local equivalent). The budget also adjusts the exchange rate used to calculate the customs duties on imports, also known as the "customs dollar", now set at 15,000 LBP/US$. The new exchange rate will also apply to VAT on import goods collected at customs. . Moreover, income, profit, property and capital gain taxes brackets have been adjusted, and public service fees have been raised. Departure taxes are now to be paid in US$ and entrance fees for non-Lebanese entering via a land border have been introduced.

On the expenditure side, the budget law proposes a social benefits program for civil servants. The current salaries of public servants have been used as a basis to calculate the value of the temporary social benefit, ranging between LBP5 million to LBP12 million per month.

The 2022 budget law does not reflect clear policy objectives to address the root causes of the multi-pronged crisis. The budget law is lacking any structural transformation or reforms consistent with a new and viable economic model. The budget process remains an accounting exercise (summation of cost of inputs of public institutions, and deeply seated regressive tax revenues). Comprehensive tax reform and an overhaul of the taxation system in Lebanon starting with more targeted, direct, and progressive tax increases is crucial for addressing widening inequality. Notably, the budget law does not include the one-time wealth tax previously proposed by the former government (2020–2021). Future budgets need to be informed by a review and rationalization of public expenditures and be supported by comprehensive tax reform that promotes a shift towards more direct and progressive taxation.

### TABLE 1 • Fiscal Balance (2020-2022)

| | 2020 | | 2021 | | 2022 Budget | |
|---|---|---|---|---|---|---|
| | LBP Bln | % of GDP | LBP Bln | % of GDP | LBP Bln | % of GDP* |
| Total Expenditures | 19,236 | 16.4% | 17,861 | 7.5% | 40,870 | 7% |
| Total Revenues | 15,341 | 13.1% | 20,263 | 6.6% | 29,986 | 5% |
| Fiscal Balance | –3,895 | –3.3% | 2,401 | 0.9% | –10,884 | –2% |

* Calculations based on World Bank projections of 2022 GDP.

[a] The 1/12th rule stipulates that for each month of the new year that passes without an updated budget, the government can spend one-twelfth of the annual amount allocated in the last approved budget.

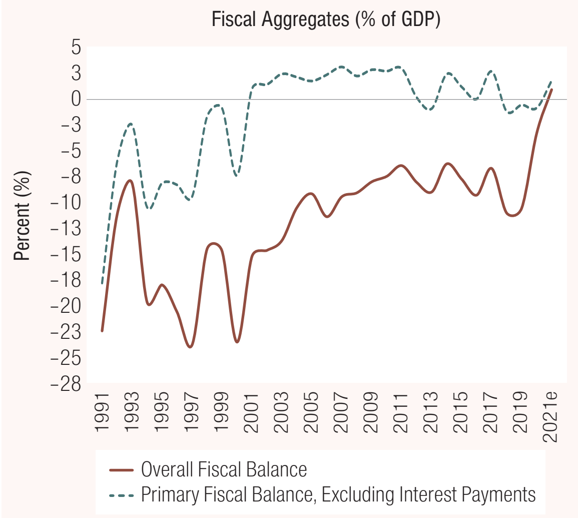
2021, real (non-EdL related) primary spending over this period contracted by 61.4 percent.[27]

**Significant tax revenue losses and an inflation-driven increase in nominal GDP continue to drive a sharp decrease in revenues as a percentage of GDP** (Figure 5). While the severe contraction in economic activity has depressed revenues, tax revenues have been further dampened by tax evasion due to (1) a significant shift to a cash-based economy, (2) distrust in the State, and (3) weakened capacity in the revenue administration; in addition to calculating VAT and customs duties at the official exchange rate of 1,500 LBP/US$. This is further compounded by lower collection of taxes on interest income due to declining deposits and a delay in tax declarations (granted by the tax authorities during the early COVID pandemic period).

**Economic contraction and currency depreciation are contributing to an already unsustainable debt dynamic.** The debt-to-GDP ratio

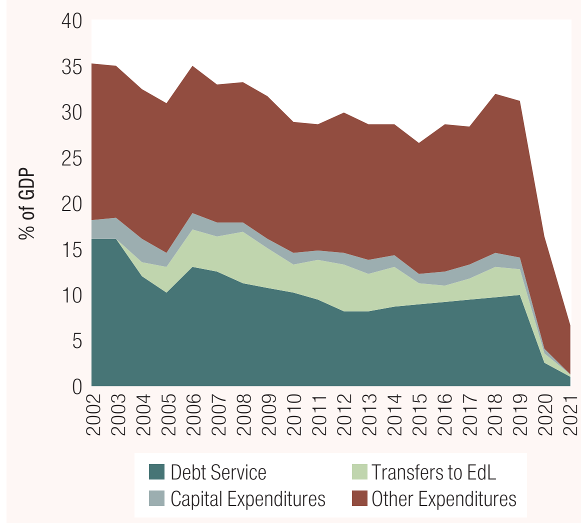
[27] The sharp decline in primary spending reflects a collapse in public service delivery, which is detailed in the World Bank's 2022 Lebanon Public Finance Review.

FIGURE 3 • Spending Collapsing Faster than Revenue Generation Inducing Positive Fiscal Balance in 2021



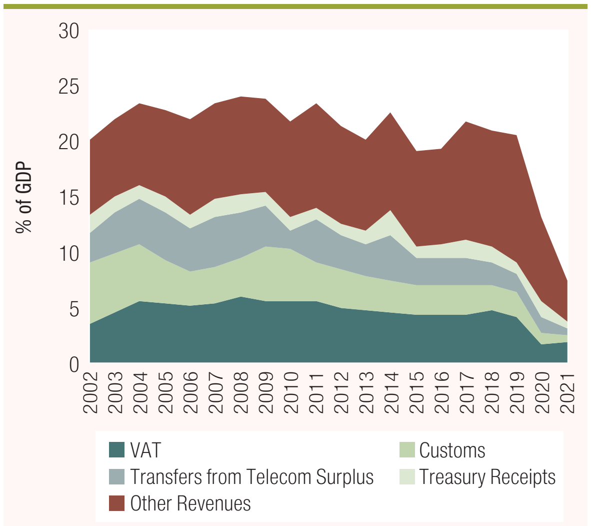

*Sources*: Lebanese authorities and WB staff calculations.

FIGURE 4 • Revenues Falling at a Slower Pace than Expenditures



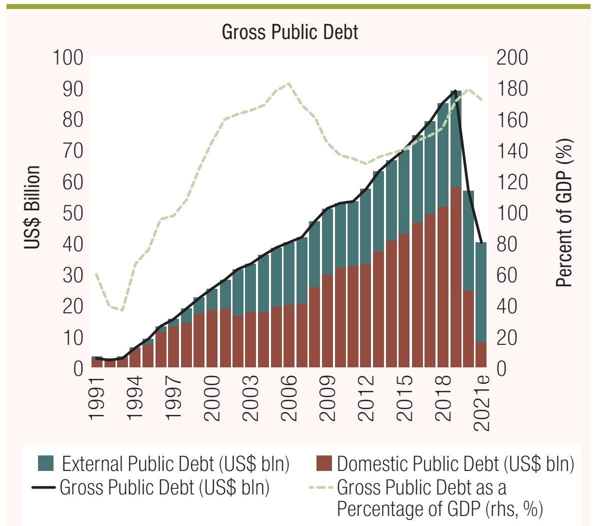

*Sources*: Lebanese authorities and WB staff calculations.

FIGURE 5 • Revenue Components Falling across the Board Causes a Decrease in Total Revenues (as a % of GDP)




*Sources*: Lebanese authorities and WB staff calculations.

FIGURE 6 • Valuation Effects from Exchange Rate Depreciations Will Pressure the Debt-to-GDP Ratio[a]




*Sources*: Lebanese authorities and WB staff calculations.
[a] To convert domestic debt to US$, we use the World Bank Average Exchange Rate for 2020 and 2021, estimated at LBP3,688/US$ and LBP11,755/US$, respectively.

is estimated to have reached 172.5 percent in 2021, a slight decrease from the estimated 179.2 percent in 2020. The sharp depreciation in the local currency continues to lower the dollar value of total debt (the numerator in the debt-to-GDP ratio); this, however, is offset by a lower denominator, GDP in US$, due also to the currency depreciation, leaving a larger debt-to-GDP ratio in 2020 and 2021 respectively (Figure 6).[28]

28 Out of the total debt stock, an estimated 86% of the total debt stock is denominated in foreign currency in 2020, and 80% in 2021.

Whereas the surge in inflation is rapidly eroding the real value of domestic debt, the sharp depreciation of the currency continues to make Lebanon's sovereign debt burden more unsustainable.[29]

## The External Sector

**The current account (CA) deficit-to-GDP witnessed a 34 percent increase in 2021 compared to 2020,despite a post-COVID induced rebound in tourism.** This was driven by (i) a widening trade-in-goods deficit led by increasing imports; and (ii) the crashing dollar value of GDP—a falling denominator effect due to the depreciating exchange rate. A 20.6 percent nominal expansion in imports outweighed a 9.6 percent increase in exports in 2021. Customs data suggest: (i) a higher energy import bill (in US$) due to surging global energy prices outweighed the effect of lower volumes imported; and (ii) non-energy imports also increased (nominally) by 21.1 percent. The tourism sector witnessed a rebound in 2021, albeit from a low threshold (covid-induced low base), improving the trade-in-services balance. Moreover, net remittances are estimated to have increased from 10.3 percent of GDP in 2020 to 15.9 percent of GDP in 2021, due largely to a sharp decline in US$ GDP (a denominator effect) and a 9 percent nominal increase in net remittances in 2021. Overall, the CA deficit reached 12.5 percent of GDP in 2021, up from a 9.3 percent of GDP in 2020, yet still lower than the medium-term (2013–2019) average of 22.6 percent of GDP. This sizable current account deficit continues to be predominantly financed from remaining foreign exchange reserves at the central bank[30] coupled with a growing cash economy, in which importers must rely on cash to access credit lines for imports that now require 100 percent cash collateral.

**High frequency data support a widening of the trade-in-goods deficit in 2021, extending to 2022, driven by a growth in imports out-pacing that in exports.** According to customs data for merchandise goods, imports grew by 20.6 percent in 2021, and 34.1 percent (yoy) in 7M-2022, which more than offset a 9.6 percent and 12.7 percent increase in exports in 2021 and 7M-2022 respectively. Energy imports, representing 29 percent of the total nominal value of imports (of goods), increased in nominal value by 40 percent (yoy) in 7M-2022. However, their weight decreased by 27 percent, revealing a shrinkage in volume of those imports. As such, the impact of surging global energy prices has outweighed the demand elasticity effect. Similarly, imports excluding energy increased (nominally) by 31.8 percent. This included yoy increases of 42.7 and 10.6 percent in imports of industrial goods[31] and food products,[32] respectively, in 7M-2022, compared to 7M-2021. Anticipated increases in custom duties and the customs duties exchange rate have likely contributed to the substantive increase in imports of industrial goods and have driven the hoarding of those goods in anticipation of the price adjustment.[33]

**The sudden stop in capital inflows, coupled with a large CA deficit, has steadily depleted BdL's gross FX reserves—net FX reserves have long been negative** (Figure 7). By end-August 2022, gross FX reserves (excluding gold reserves) reached US$14.8 billion, declining by US$23 billion since the onset of the crisis in October 2019. BdL's gross position includes Lebanese Eurobonds (currently in sovereign default status) and an unpublished amount lent to banks. The required reserves on banks' customer's FX deposits are estimated at around

29 For debt calculations, we use the Bank-calculated Average Exchange Rate (AER) whose methodology is detailed in the Lebanon Economic Monitor, Fall 2020: The Deliberate Depression.

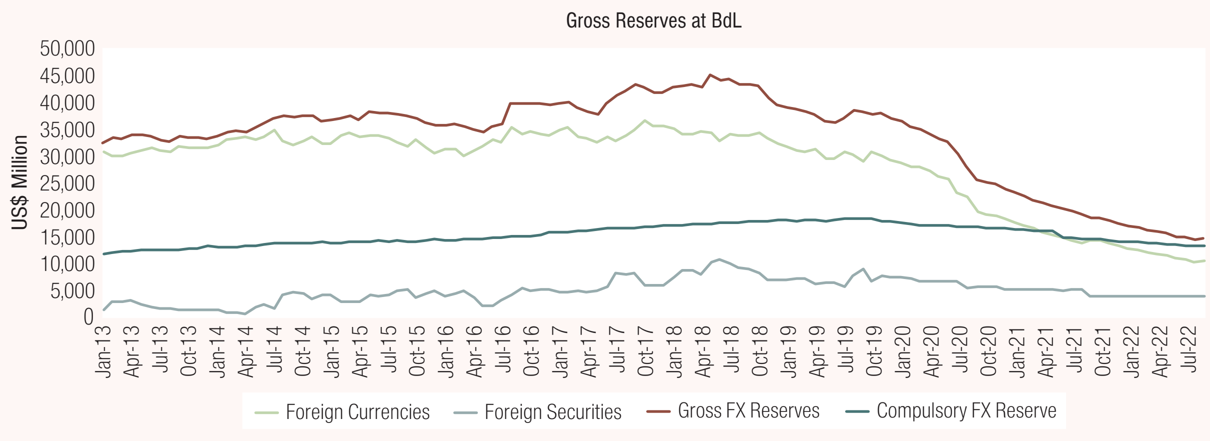
30 Gross FX reserves (excluding gold reserves) declined by US$6.3 billion in 2021.

31 This includes imports of the following categories: Wood, Rubber and Chemical Products; Non-Metallic Products; Textiles; Capital Goods; and Equipment Other than Capital Goods.

32 This includes imports of the following categories: Agricultural Products and Animals; and Food Industry Products.

33 Customs data for the combination of (i) vehicles, aircraft, vessels, and transport equipment; and (ii) machinery and electrical instruments, reveal a 117 percent (yoy) increase in 7M-2022, compared to 7M-2021; with the imports of the former increasing by 95.1 percent and the latter by 141 percent.

FIGURE 7 • A Steady Depletion in the Gross Foreign Exchange Position at BdL




*Sources*: CAS and WB staff calculations.

US$14 billion.[34] BdL's gross position differs widely from its net reserves (i.e., gross FX reserves at the central bank net of FX liabilities to others) and contrary to most central banks, BdL does not publish net reserves, which are estimated to be highly negative (in excess of US$60 billion).[35]

**The Ukraine war continues to add to Lebanon's woes.** Lebanon is highly dependent on imports for wheat consumption, and these are almost entirely sourced from Ukraine and Russia, which supplied 96 percent of the country's needs in 2021. Wheat prices are expected to increase by 40 percent in dollar terms in 2022. Lebanon has to quickly find alternative sources for its wheat imports, to avoid a food security crisis. Moreover, oil price spiked with the beginning of the war and is expected to average around US$100/bbl in 2022, up from US$70/bbl in 2021.[36] As an energy importer, the surge in global energy prices negatively impacts Lebanon's balance of payments, exacerbating already existing, crisis related exchange market pressures.[37]

## Money and Banking

**The Lebanese Pound depreciated by 145 percent in the first ten months of 2022, compared to 219 percent in 2021 and 137 percent in 2020** (Figure 8)—using the World Bank-estimated Average Exchange Rate (AER).[38] The BNR (i.e., the Banknote Rate; or parallel market rate) averaged 20,700 LBP/US$ in H2-2021, primarily driven by the disorderly removal rationing of the FX subsidy provided by BdL to fuel importers. Despite BdL's FX interventions to attempt to stabilize the BNR using its gross reserves starting in December 2021, the LBP has continued to steadily depreciate. The depreciation of the LBP accelerated since February 2022, with the BNR breaching LBP40,000/US$ by October 2022. The AER depreciated by 145 percent (yoy) over 10M-2022—from an average of LBP10,372/US$ over 10M-2021 to LBP25,407/US$ over 10M-2022. (Figure 8).

34 In June 2021, BdL lowered required reserve ratio on dollar deposits from 15 percent to 14 percent.

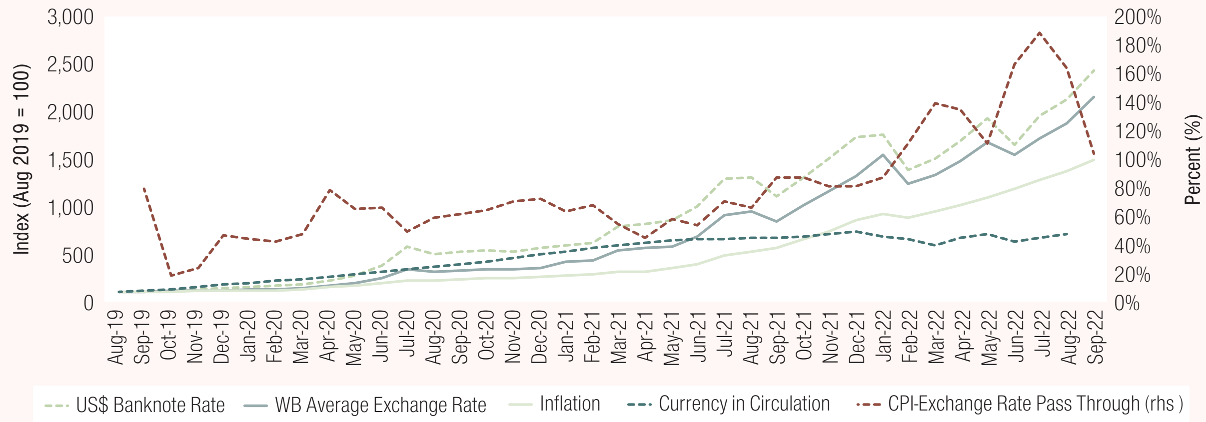
35 World Bank estimates, also see similar estimates in: "Mapping out the path to the Lebanese Economic Recovery", Goldman Sachs International, 2021; "Fitch Downgrades Lebanon to 'CC'", Fitch Ratings, 2019; Moubayed, A., & Zouein, G. (2020).

36 World Bank Commodity Markets Outlook, October 2022.

37 In 2020—when average crude oil price was US$41.3/barrel—the country imported US$3.2 billion in energy products, amounting to about 30 percent of the country's merchandize import bill.

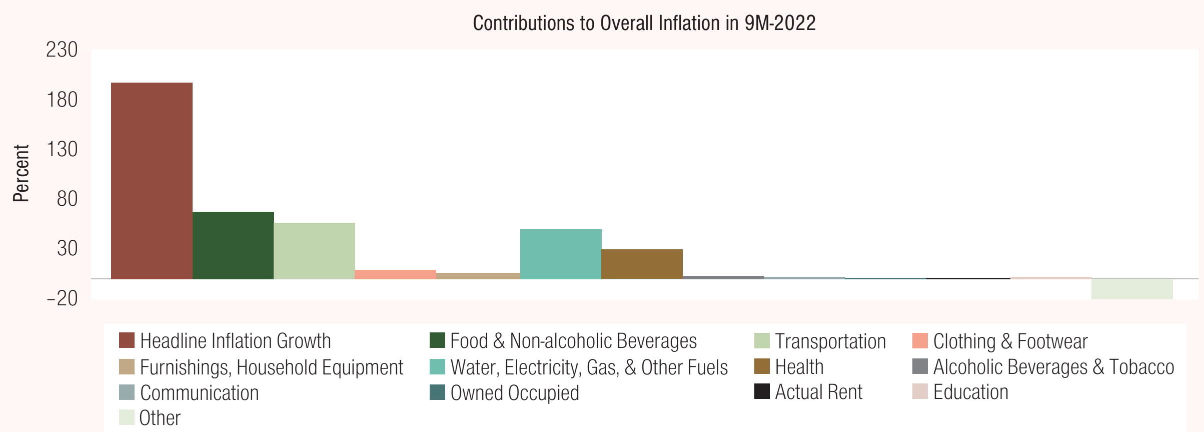
38 The AER is derived by applying consumption-based weights on the official, the platform and the US$ banknote exchange rates. For a detailed derivation please refer to: World Bank (2020), Lebanon Economic Monitor: The Deliberate Depression, Fall 2020.

FIGURE 8 • A Sharp Depreciation in the Exchange Rate along with Surging Inflation and Narrow Money




*Sources*: CAS and WB staff calculations.

FIGURE 9 • Inflation in Basic Items Is a Key Driver of Overall Inflation, Hurting the Poor and the Middle Class

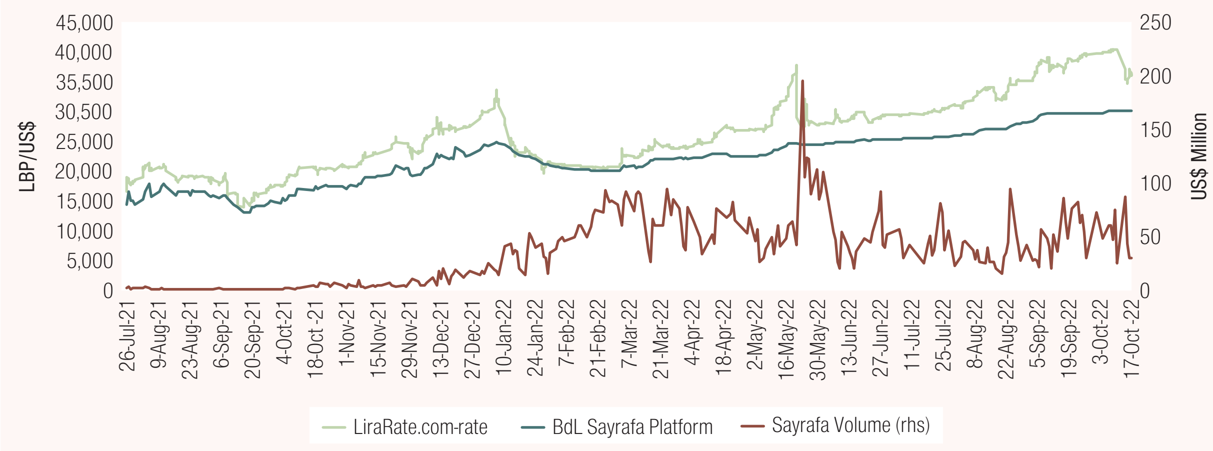



*Sources*: CAS and WB staff calculations.

**Inflation averaged 150 percent in 2021 and reached a high of 240 percent (yoy) in January 2022, primarily driven by an increase in the exchange rate pass-through.** Increasing global fuel and food prices have further exacerbated inflationary pressures and have threatened food security in Lebanon since the onset of the Ukraine war. In fact, Lebanon was among the countries worst hit by food price inflation since the onset of the Ukraine war, which breached 390 percent (yoy) over 6M-2022, having reached its highest mark of 483 percent (yoy) in January 2022. Overall inflation averaged a record 218 percent (yoy) in H1-2022.

**Inflation is a highly regressive tax, disproportionally affecting the poor and vulnerable, and more generally, people living on fixed incomes like pensioners.** This is especially so in Lebanon where basic items of the consumption basket are the primary drivers of overall inflation. The main contributors to inflation over 2021 and H1-2022 are food and non-alcoholic beverages, followed by transportation, water, electricity, and gas (Figure 9); prices for these basic consumption items have surged by 316.9, 323.3, 154.1 percent on average, respectively, in 2021 and the increase was sustained in H1-2022.

FIGURE 10 • Short-lived Appreciation in the US$ Banknote Rate following BdL's Active Interventions in the FX Market




*Sources*: IMF WEO and WB Staff Calculations.

**BdL's FX interventions have only triggered short-lived fluctuations in the BNR, suggesting limited ability to stem the currency depreciation amid continued growth in narrow money.** Circular 161 (December 16, 2021) removed all quotas on the monthly US$ liquidity provided by the Central Bank to the banking sector, essentially making available an unlimited supply of foreign currency for banks to sell to their clients on the BdL-managed Sayrafa Platform. Circular 614 (February 21,2022) expanded the access to Sayrafa to money transfer companies whose annual transactions volume exceeds US$50 million; thereby allowing money transfer companies to partake more broadly in foreign exchange transactions.[39] The surge in the daily volume of transactions on the Sayrafa platform was accompanied by a temporary deceleration in the growth rate of currency in circulation and a narrowing of the spread between the Sayrafa and US$ banknote exchange rates (Figure 10). The spread between the Sayrafa and the US$ banknote exchange rates tends to narrow (widen) when BdL intervenes in the FX market by easing (restricting) access to Sayrafa. However, lower Sayrafa volumes, and a marked increase in currency in circulation reaching a record LBP69.8 trillion by October 15, triggered another episode of rapid currency depreciation, with the BNR breaching 40,600 LBP/$. Interestingly, the precipitous increase in currency in circulation outside BdL coincided with an increase in BdL's foreign assets over the same period (September 15-October 15). BdL's foreign assets (foreign currencies and foreign securities which include US$5 billion in Lebanese Eurobonds) increased from US$14,621 million to US$15,038 million in the span of one month. Upon BdL's announcement on October 23rd that it would expand access to Sayrafa, the BNR dropped to 36,000 LBP/US$. BdL's interventions in the FX Sayrafa market, however, have only achieved short-lived appreciations in both the Sayrafa and the US$ banknote exchange rates, at the expense of dwindling foreign reserves, a testament to the unsustainability of such measures.

**The banking sector balance sheet remains impaired despite regressive deleveraging schemes.** As of August 2022, 72 percent of banking assets are in sovereign securities, 64 percent of which are with BdL in the form of deposits, while the remaining 8 percent are in government securities (TBs and Eurobonds) and claims on the public sector. Since June 2021, BdL has formally allowed for a gradual withdrawal of deposits, a lirafication scheme that has resulted in haircuts on deposits between 60–80 percent. During the first seven months of 2022, customer deposits at commercial

[39] Circulars 69 and 157 restricted the conduct of foreign exchange transactions to banks. From October 5, 2021 until February 2022, OMT was the only money transfer company allowed to transact on Sayrafa.

banks declined by about US$5 billion (5 percent), on top of a decline of US$9.6 billion (7 percent) in 2021, and of US$19.8 billion (12.5 percent) in 2020. Nonetheless, 80 percent of banks' liabilities are private deposits (only down from 90 percent at the onset of the crisis). Private deposits are highly concentrated, as pre-crisis, 50 percent of deposits in Lebanon's banking system were owned by 1 percent of depositors, i.e., the vast value of deposits belong to a few high-net-worth individuals (0.01 percent of depositors alone held 20 percent of deposits).[40] Deposits post-crisis are likely to have become even more concentrated, owing to the deposit lirafication scheme (financial sector regressive deleveraging) that has disproportionally burdened small and medium depositors.[41] The domestic credit portfolio has further contracted by US$4.4 billion as of end-July 2022;

40 World Bank-IMF (2017), *Financial System Stability Analysis*, January 2017.

41 About 77 percent of total deposits (US$98 billion) are in FX; most of them (98 percent) are estimated to be in pre-crisis dollars.

## BOX 2: TOO BIG TO BAIL

**Lebanon's financial sector is *too big to bail* due to the size of the balance sheet and the losses involved.** Losses in the financial sector stem primarily from (1) a sovereign that is in default on its public debt of approximately US$40 billion (173 percent GDP in 2021), and (2) a central bank, Banque du Liban (BdL) that has US$60 billion (259 percent of GDP)[a] in negative net foreign exchange reserves—by far the largest negative reserves of all central banks across the world; and (3) substantive losses in the private sector credit portfolio rendering the oversized banking system insolvent, against pre-crisis equity of US$22 billion. The financial sector's total losses are estimated at US$72 billion (311 percent of GDP)..

**Given the size of the balance sheet losses, Lebanon's financial crisis bears striking similarities with the 2008 financial crisis in Iceland (too big to bail)[b]; it is far from the Ireland case (too big to fail).** With a banking sector ten times the size of GDP and heavily reliant on foreign borrowing, the Icelandic government came to terms with the lack of means to bailout its financial sector-it thus allowed its banks to fail, and instead used public money to shield the domestic economy and safeguard its welfare system. Ireland on the other hand, guaranteed the liabilities of the country's six major failing banks, pumping close to 46 billion euros (30 percent of GDP) in the first two years, and only delaying the 'day of reckoning'. Such bailouts swelled their national debt, had significant fiscal costs, required deploying ample liquidity, and dented investor confidence (Table 2).[c]

### TABLE 2 • Bailout Costs in Ireland and Iceland

| | | Fiscal Costs[b] | | Liquidity Provision[c] | | | |
|---|---|---|---|---|---|---|---|
| | Output Loss[a] | % of GDP | % of Financial Sector Assets | Peak | Liquidity Support | Peak NPLs[d] | Increase in Public Debt[e] |
| **Ireland** | 107.7% | 37.6% | 4.5% | 18.1% | 15.4% | 25.7% | 76.5% |
| **Iceland** | 34.5% | 37.6% | 3.3% | 33.8% | 28.1% | 61.2% | 67.9% |

*Source*: Laeven, L., & Valencia, F., (2018). Systemic Banking Crises Revisited. IMF Working Paper, WP/18/206.
[a] In percent of GDP. Output losses are computed as the cumulative sum of the differences between actual and trend real GDP over the period.
[b] Fiscal costs refer to outlays directly related to the restructuring of the financial sector.
[c] Liquidity is measured as the ratio of central bank claims on deposit money banks (line 12 in IFS) and liquidity support from the Treasury to total deposits and liabilities to non-residents. Total deposits are computed as the sum of demand deposits (line 24), other deposits (line 25), to non-residents (line 26).
[d] In percent of total loans.
[e] In percent of GDP. For episodes starting in 2007 and later, the increase in public debt is measured as the change in debt projections, over [T-1, T+3], relative to the pre-crisis debt projections, where T is the starting year of the crisis.

**Lebanon's current and future assets (that belong to all the Lebanese) are insufficient to mobilize a financial sector bailout and will far from restore solvency and liquidity.** State-owned assets and public real estate are worth only a fraction of the estimated financial losses.[d] Potential revenues from the nascent oil and gas industry are all but certain, and still years away; the IMF (2014)[e] estimates the revenues from Liquid Natural Gas (LNG) to amount to, at the peak, 4 percent of GDP under a baseline production profile, denting expectations that such distant revenues are enough to cover financial sector losses. Furthermore, managing potential hydrocarbon wealth hinges on

*(continued on next page)*

## BOX 2: TOO BIG TO BAIL *(continued)*

adequate governance and regulatory frameworks, yet to be established, in a context of a confessional power-sharing system marred by elite capture and in deep crisis. Thus, such inadequate bailout options neither lessen the leverage and risk taking of the banking sector, nor restores solvency and liquidity. The inability of banks to kickstart lending amid a prolonged credit crunch is detrimental to economy recovery prospects.[f]

**A financial sector bailout constitutes a transfer from taxpayers to-financial sector shareholders and big depositors, making them (as individuals) once again owners of profitable assets.** Prior to the crisis, 50 percent of deposits in Lebanon's banking system were owned by 1 percent of depositors, i.e., the vast value of deposits belong to a few high-net-worth individuals (0.01 percent of depositors alone held 20 percent of deposits).[g] These high value accounts were offered significantly higher interest rates, both in LBP and in US$, than what the 99 percent of depositors were offered. Hence, not only do they have an ability to contribute to the necessary haircuts (an important equity consideration), but the high returns they have benefited from also account for a notable share of the losses currently in the system (a key fairness consideration).

**Bail-in solutions, based on a creditors' hierarchy, along with comprehensive reforms is the only realistic option for Lebanon to turn the page on its flawed development model.** Bail-in solutions, put forth in the wake of the 2008 global financial crisis, can successfully address the "too-big-to-fail" (TBFF)[h] and "too-many-to-fail" (TMTF) problems,[i] limit recourse to public assets, and circumvent the moral hazards of a bailout.[j] Bail-in solutions can also circumvent the distorted funds allocation of bailouts, dictated by banks' political and regulatory connections.[k] The pre-crisis strength of (i.e., confidence in) Lebanon's development model was that the sovereign-BdL-banking nexus was so intricately linked through large mutual balance sheet exposures, that, like the three legs of a stool, none of those actors could exit without making the whole system collapse (i.e., a stable inferior equilibrium in game theory).[l] With the sovereign default of March 2020, the erstwhile equilibrium has collapsed. It must now move to a new equilibrium development model, one that is superior to its previously flawed one. As repeatedly called for, Lebanon has to urgently adopt a domestic, equitable, and comprehensive solution that is predicated on: (i) addressing upfront the balance sheet impairments, (ii) restoring liquidity, and (iii) adhering to sound global practices of bail-in solutions based on a hierarchy of creditors (starting with banks' shareholders) that protects small depositors.

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[a] Based on World Bank estimates, also see similar estimates in: "Mapping out the path to the Lebanese Economic Recovery", Goldman Sachs International, 2021; "Fitch Downgrades Lebanon to 'CC'", 2019; Moubayed, A., & Zouein, G. (2020).
[b] Interestingly, part of the resolution of that banking crisis included an Investigation Commission aimed at "seeking the truth behind the events leading to, and the causes of, the downfall of the Icelandic banks in October 2008". It was able to produce accountability for the crisis by detailing the failure, incompetence, and mishandling of a large number of individuals.
[c] See for example: Byrne, E., & Þorsteinsson, H. F. (2012). Iceland: The accidental hero. What if Ireland defaults, 135–47.
[d] See for example: Kostanian, A. (2021). Privatization of Lebanon's Public Assets: No Miracle Solution to the Crisis. Online: Issam Fares institutes.
[e] The same study estimates LNG revenues to GDP to stand at 7 percent of GDP at the peak of production under a hypothetical production profile assuming a long reserve horizon and increased production.
[f] Chorafas, D.N., 2013. Public debt dynamics of Europe and the US. Elsevier.
[g] World Bank-IMF (2017), Financial System Stability Analysis, January 2017; deposits post-crisis are likely to have become even more concentrated, owing to the deposit lirafication scheme (financial sector regressive deleveraging) that has disproportionally burdened small and medium depositors.
[h] TBTF refers to government bail outs (from taxpayer money) of financial institutions/big firms in fear of their failure unleashing adverse consequences on the financial system and economy as a whole.
[i] Berger, A. N., & Roman, R. A. (2020)
[j] See for example: Goldstein, Morris and Veron, Nicolas. (2011); Stern, G. H., & Feldman, R. J. (2004)
[k] Berger, A. N., & Roman, R. A. (2020)
[l] This known forced resilience of system, inspired confidence and fed the source of the country's problem: the large structural fiscal deficits that required ever growing capital inflows (mostly remittances) attracted by high dollar (or dollar-equivalent at the time) interest rates offered by BdL and the banking system. Over time, however, this produced oversized balance sheets among these three actors (sovereign, BdL, banks)—broadly several times GDP which placed each of these actors at the top of the global league in terms of balance sheet size or losses (e.g., Lebanon's public debt consistently being among the highest in the world, or Lebanon's banking system being among the largest in the world, in relation to the size of its economy).

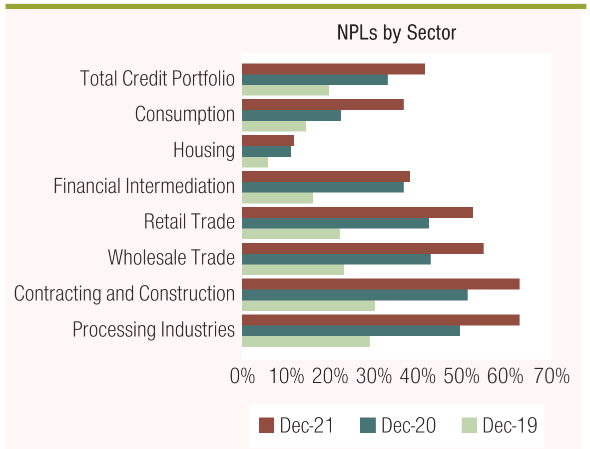
this is on top of a contraction by US$12.9 billion in 2021 and this brings the total credit contraction to about 53 percent since the beginning of the crisis in 2019.

**Lending from BdL has allowed Lebanese commercial banks to pay off liabilities to correspondent banks in order to retain linkages to the global financial system.** Correspondent banks have cut exposures to Lebanese banks by about half over the past three years, while tightening the terms on the remaining, mainly trade lines with 100 percent cash collateral. At end-August 2022 commercial banks' deposits and liabilities with non-resident financial institutions amounted to US$4 and US$4.4 billion, respectively, compared to US$4.6 and US$4.9 billion in December 2021 and US$6.8 and US$8.8 billion in December 2019.

**Lebanese banks have retreated from Cyprus and Iraq marking another milestone in the reversal of their international and regional expansion.** Nine Lebanese banks are set to wind down their operations in Cyprus following a request by the Central Bank of Cyprus to fully guarantee their deposits. As part of their consolidation strategy since 2019, Lebanese banks have also begun, according to media reports, to withdraw from the Iraqi market.

**Finally, the delay in the implementation of a meaningful and equitable banking resolution has triggered a series of bank raids.** Depositors demanding access to their deposits (in cash and in dollars) stormed banks on multiple occasions. In response, banks closed their doors in October, restricting their services to ATMs and by appointment only.

FIGURE 11 • A Steady and Sharp Deterioration in Credit Performance as Measured by NPL Ratio for Banks




*Sources*: BdL and WB staff calculations.

3

# OUTLOOK AND RISKS

**Subject to extraordinarily high uncertainty, we project real GDP to contract by a further 5.4 percent in 2022.** Our projections (Table 3) assume that macro policy responses remain inadequate. We also assume a minimum level of stability on the political and security scenes but refrain from assuming runaway inflation-depreciation or a complete depletion of FX reserves at BdL in the next few months.[42]

**Monetary and financial turmoil continue to drive crisis conditions.** The interactions between the exchange rate, narrow money, and inflation continue to shape unstable macroeconomic dynamics, and therefore remain central to our macroeconomic outlook. A first-degree effect of the sharp depreciation in the national currency (which has lost more than 95 percent of its value by September 2022) has been triple digit inflation rates associated with a very sharp increase in narrow money. Hence, policies with implications on narrow money supply, such as lirafication and monetization of the fiscal deficit, will continue to be critical to the inflationary environment.

**Inflation is expected to average 186 percent in 2022, amongst the highest rates globally, despite the relative deceleration of narrow money supply growth in 8M-2022**. This is primarily due to a change in the dynamic relationship between inflation and depreciation. Our preliminary estimates indicate that the CPI exchange rate pass-through has averaged 134 percent for 8M-2022, up from an average of 75 percent since the onset of the crisis (Figure 8). This increase is mainly on account of the reduced share of goods imported at BdL subsidized exchange rates, and increased dollarization in the Lebanese economy (notably in services that had been previously priced in LBP, at lower than market value exchange rates and have now been dollarized).

**In the absence of a macro-financial stabilization strategy, a sizable current account deficit is projected for 2022, further depleting BdL's useable gross reserves.** We expect the current account deficit to widen to 14.2 percent of GDP in 2022, primarily driven by the denominator led effect of an 8 percent contraction in nominal GDP in 2022. We estimate a slight worsening of the trade-in-goods

[42] Given the paucity of Lebanon's statistical system, our forecasts for the economy are based on advanced econometric techniques that are particularly well suited to extract information in data poor environments.

deficit in 2022. In fact, high frequency customs data for 7M-2022 indicate a 34 percent increase in the value of total imports, which more than offset a 12 percent increase in exports relative to 2021. Even more pronounced than import dynamics in 2021, vehicles, aircraft, vessels, and transport equipment witnessed a 95 percent increase in imports in 7M-2022, while machinery and electrical instruments rose by 117 percent over 7M-2022, in anticipation of the increases in custom duties and the customs duties exchange rate.

**Our economic forecast pays heed to persistent lack of political will for comprehensive reforms, and an unprecedented institutional vacuum.** A caretaker Government struggling to interpret the extent of its executive authority under a Presidential vacuum, and a divided Parliament lacking consensus to pass critical laws adds further material delays to the start of the EFF. The Lebanese political elite have proven to be remarkably resistant to comprehensive reforms despite the unprecedented multi-pronged crisis the past three years. The aversion towards reforms and a complete rethinking of an unsustainable development model stem from a deeply entrenched history of elite capture, and an economic model that has benefited a few at the expense of the rest of the population.[43]

**We continue to assert that Lebanon's financial sector is simply *too big to bail* due to the magnitude of the losses in an oversized balance sheet.** Recourse to public assets (worth only a fraction of the estimated financial losses), belonging to all the Lebanese people and future generations, represents a further socialization of (private sector) losses and goes against important global principles and equitable burden sharing. In addition, revenues from the nascent oil and gas industry remain distant and uncertain. The country should be mindful of a "presource curse" defined as elevated expectations from oil discoveries leading to economic jeopardy, an all too familiar phenomenon (Ghana, Mozambique).[44] Given this uncertain valuation of both public assets and future governmental revenues, any crisis resolution plan that relies on these would lack credibility and fail.

**Staunch inequality, and a heavy concentration of deposits with a few high-net-worth individuals, implies that a financial sector bailout would redistribute wealth from poorer to richer households.** Therefore, not only is a financial sector bailout unviable, but it would also entail taxpayers bailing out bank equity holders and wealthy depositors, undermining both equity and fairness considerations. The global literature also warns against the Distorted funds allocation of bailouts, dictated by banks' political and regulatory connections,[45] a risk that is especially pronounced in the case of Lebanon.

**We posit that delays in applying bail-in solutions, the only equitable resolution, further hinder the ability to protect small depositors, in cash and in dollars.** Bail in solutions remain the only credible, equitable and meaningful banking resolution, that will ultimately better position banks to play a central role in economic recovery. The lack of an equitable banking resolution only increases the economic costs of the crisis, as usable gross reserves are gradually depleted, impeding the ability to protect small depositors. Respecting the hierarchy of claims (the sequence in which liabilities should be written down), starting with banks' shareholders, is the only way to rectify the past years' regressive adjustment and financial deleveraging that has disproportionally burdened small depositors, and the bulk of the local labor force paid in LBP.

43 Previous editions of the LEM, as well as the 2015 Lebanon Systematic Country Diagnostic (Link**)** have documented the consistent dearth of significant reforms in the face of systemic risks. The country's lack of basic governance and accountability could also be seen by the lack of an approved budget law for over a decade in a row (likely the only country in the world with such a record).

44 See for example: Cust, J., & Mihalyi, D. (2017).

45 Berger, A. N., & Roman, R. A. (2020).

TABLE 3 • Selected Macroeconomic Indicators for Lebanon; 2013-2022

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 Act. | 2020 | 2021 Proj. | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| Real sector | (annual percentage change, unless otherwise specified) | | | | | | | | | |
| Real GDP | 3.8 | 2.5 | 0.6 | 1.6 | 0.8 | −1.7 | −7.2 | −21.4 | −7.0 | −5.4 |
| Real GDP per capita[a] | −2.8 | −3.2 | −3.6 | −1.1 | −0.7 | −2.2 | −7.2 | −21.8 | −7.5 | −5.9 |
| Agriculture (share of GDP) | 3.9 | 4.4 | 3.8 | 4.0 | 4.5 | 4.4 | 5.0 | 6.0 | 6.0 | 6.0 |
| Industry (share of GDP) | 14.2 | 13.4 | 12.7 | 12.8 | 12.3 | 12.0 | 10.7 | 12.8 | 12.8 | 12.8 |
| Services (share of GDP) | 70.9 | 71.3 | 71.9 | 71.6 | 71.6 | 72.2 | 74.1 | 76.9 | 78.6 | 78.8 |
| Net indirect taxes (share of GDP) | 11.0 | 10.9 | 11.6 | 11.7 | 11.6 | 11.4 | 10.3 | 4.3 | 2.6 | 2.4 |
| Money and prices | | | | | | | | | | |
| CPI inflation (p.a) | 2.7 | 1.2 | −3.7 | −0.8 | 4.5 | 6.1 | 2.9 | 84.3 | 150.0 | 186.0 |
| Money[b] | 9.0 | 6.0 | 5.1 | 7.3 | 4.2 | 3.0 | −6.7 | 227.0 | 109.0 | 11.0 |
| Investment & saving | (percent of GDP, unless otherwise specified) | | | | | | | | | |
| Gross capital formation | 27.6 | 24.9 | 22.2 | 22.6 | 21.3 | 20.7 | 12.3 | 7.7 | 5.0 | 7.4 |
| o/w private | 25.8 | 23.4 | 20.8 | 21.2 | 19.8 | 19.0 | 11.0 | 7.4 | 4.9 | 7.3 |
| Gross national savings | 2.1 | −1.3 | 5.1 | 2.2 | −1.5 | −3.5 | −9.6 | −1.6 | −7.4 | −6.8 |
| o/w private | −1.8 | −3.9 | 1.0 | −1.0 | −4.8 | −5.3 | −10.5 | 1.4 | −8.3 | −7.4 |
| Central government finance | (percent of GDP, unless otherwise specified) | | | | | | | | | |
| Revenue (including grants) | 20.1 | 22.6 | 19.1 | 19.3 | 21.8 | 20.9 | 20.7 | 13.1 | 6.6 | 6.0 |
| o/w tax revenues | 14.3 | 14.3 | 13.7 | 13.7 | 15.4 | 15.3 | 15.5 | 9.0 | 5.4 | 5.2 |
| Total expenditure and net lending | 29.0 | 28.9 | 26.8 | 28.5 | 28.5 | 31.8 | 31.2 | 16.4 | 5.9 | 5.5 |
| Current | 27.3 | 27.3 | 25.5 | 27.2 | 27.0 | 30.2 | 29.9 | 16.1 | 5.8 | 5.4 |
| o/w interest payment | 8.1 | 8.7 | 8.9 | 9.3 | 9.4 | 9.8 | 10.0 | 2.5 | 1.0 | 0.6 |
| Capital & net lending (excluding foreign financed) | 1.8 | 1.5 | 1.4 | 1.4 | 1.5 | 1.7 | 1.3 | 0.4 | 0.2 | 0.1 |
| Overall balance (deficit (−)) | −9.0 | −6.3 | −7.7 | −9.2 | −6.7 | −10.9 | −10.5 | −3.3 | 0.7 | 0.5 |
| Primary balance (deficit (−)) | −0.9 | 2.4 | 1.2 | 0.0 | 2.7 | −1.2 | −0.5 | −0.8 | 1.7 | 1.1 |
| External sector | (percent of GDP, unless otherwise specified) | | | | | | | | | |
| Current account balance | −25.6 | −26.2 | −16.9 | −20.4 | −22.9 | −24.3 | −21.9 | −9.3 | −12.5 | −14.2 |
| Trade balance | −28.4 | −29.9 | −22.8 | −23.6 | −24.6 | −24.6 | −24.9 | −20.3 | −31.0 | −31.9 |
| o/w export (GNFS) | 44.5 | 40.0 | 39.6 | 37.2 | 35.9 | 35.5 | 35.5 | 28.2 | 44.9 | 48.0 |
| Exports of goods | 11.0 | 9.5 | 8.0 | 7.7 | 7.6 | 7.0 | 9.3 | 12.9 | 20.1 | 19.7 |
| Exports of services | 33.5 | 30.6 | 31.6 | 29.5 | 28.3 | 28.5 | 26.1 | 15.3 | 24.7 | 28.4 |
| o/w import (GNFS) | 73.0 | 69.9 | 62.4 | 60.7 | 60.5 | 60.1 | 60.4 | 48.5 | 75.9 | 79.9 |
| Imports of goods | 45.3 | 42.5 | 35.1 | 34.9 | 34.6 | 34.2 | 35.1 | 33.4 | 55.4 | 57.7 |
| Imports of services | 27.7 | 27.4 | 27.3 | 25.8 | 26.0 | 25.9 | 25.3 | 15.1 | 20.5 | 22.2 |
| Net private current transfers: | 3.4 | 4.9 | 6.8 | 4.8 | 2.3 | 2.5 | 5.7 | 14.3 | 22.4 | 22.0 |
| Net remittances | 5.0 | 5.8 | 7.1 | 6.6 | 5.1 | 4.2 | 6.1 | 10.3 | 15.9 | 17.7 |
| Net income reciepts | −0.6 | −1.2 | −0.9 | −1.6 | −0.5 | −2.1 | −2.6 | −3.3 | −3.9 | −4.2 |

*(continued on next page)*

**TABLE 3 • Selected Macroeconomic Indicators for Lebanon; 2013-2022** *(continued)*

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 Act. | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | Proj. | |
| Capital accounts | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Gross reserves (months of imports GNFS)[c,d] | 11.7 | 13.1 | 13.8 | 15.2 | 15.6 | 14.3 | 14.3 | 18.8 | 12.0 | 9.7 |
| Total public debt | | | | | | | | | | |
| Total debt stock (in million US$) | 63,490 | 66,564 | 70,325 | 74,900 | 79,530 | 85,139 | 88,900 | 56,832 | 39,903 | 38,518 |
| Debt-to-GDP ratio (percent) | 135.3 | 138.3 | 140.5 | 145.7 | 149.1 | 154.0 | 171.1 | 179.2 | 172.5 | 180.7 |
| Memorandum items: | | | | | | | | | | |
| Exchange rate, average (LBP/US$)[e] | 1,507.5 | 1,507.5 | 1,507.5 | 1,507.5 | 1,507.5 | 1,507.5 | 1,554.0 | 3,688.0 | 11,755.0 | 26,713.0 |
| GDP (in million US$) | 46,909 | 48,133 | 50,066 | 51,389 | 53,325 | 55,276 | 51,954 | 31,712 | 23,132 | 21,317 |

*Sources:* Government data and World Bank staff estimates and projections.

[a] Population figures, which include Syrian refugees registered with the UNHCR, are taken from the United Nations Population Division.

[b] Prior to 2020 this is M3, including non-resident deposits; 2020 and after, this is M0 (currency in circulation).

[c] Gross Reserves (months of imports GNFS) = (Imports of Goods & Services / Gross Res. excl. Gold)*12.

[d] Total Imports using the BOP data from the Quarterly Bulletin of BdL.

[e] We use the WB-AER to calculate the total debt stock and GDP in US$ million for 2019 onwards.

# SPECIAL FOCUS I: GLOBAL COMPARATORS: THE HOLE IS GREATER THAN THE SUM OF ITS PARTS

In previous LEMs, we benchmarked Lebanon's financial crisis against Global Crisis Comparators. The results consistently highlighted the severity of the Lebanon episode as it compares globally.[46] In this Special Focus, we assess the severity of Lebanon's crisis by comparing it to a select group of Fragile and Conflict States (FCS). We note FCS commonalities between Lebanon and recent episodes in Zimbabwe, Yemen, Venezuela and Somalia, which have been marred by elite capture, extractive institutions, civil strife or war, state failure and fragmentation. This benchmarking exercise confirms that Lebanon's macroeconomic performance is worse—or—at best—on par, with those of this specific FCS group. Noting differences in GDP per capita classifications, Lebanon is strikingly unique in its middle-income category.

## Fundamentals of Fragility

**Somalia suffered from structural fragmentation that left political power historically dispersed between clans, Islamists and others.** State fragmentation, factional politics and recurrent conflicts ultimately led to a full-blown civil war in 1988. GDP per capita decreased from US$280 in 1989 to US$266 in 2001. Health indicators and standards in Somalia became among the worst in Africa. Alongside the human cost and suffering, and the destruction of political institutions, social and economic infrastructure, the conflict also led to large internal and external migration.

[46] The Fall 2020 LEM, entitled *The Deliberate Depression*, compares Lebanon's macroeconomic fundamentals in the lead-up to the crisis to two groups of global crises comparators: the Asian crisis countries of 1997–98, and a more eclectic set of crises that occurred in the 2000's [Argentina (2001), Greece (2008), Ireland (2008), Iceland (2008), and Cyprus (2012). We concluded that, leading up to the crisis point, Lebanon's macroeconomic fundamentals were weak compared to these global crises comparators, suggesting that the adjustment process will be more painful and will take longer, even with optimal policy measures in place. In the Spring 2021 LEM, entitled *Lebanon Sinking (To the Top Three)*, we compared the Lebanon crisis to the most severe global crises episodes (from the mid-1800's to 2013) and concluded that the Lebanon episode could rank in the top 10, possibly top three most severe crises globally.

**Venezuela has been historically marred by strident social inequalities, criminal violence, corruption and poor economic performance.** An over reliance on oil exports, exposed the economy to declines in oil prices, which in 2014 spelled the start of a massive contraction in economic activity. Venezuela's GDP is estimated to have contracted by 86 percent from its peak in December 2013 to the first quarter of 2020. The shortfall in revenues and the widening fiscal deficit—which is estimated to have stood at 31 percent of GDP in 2019—was met by printing money. This stoked inflationary pressures, which reached hyperinflation level at 130,060 percent in 2018 and 9,585 percent in 2019. Venezuela's economic crisis decimated human capital, leading to an exodus from the country.

**Zimbabwe has also been historically marred by fragility, conflict and violence.** To a large extent, these have stemmed from a racially troubled history associated with its colonized and post-colonized experience. Zimbabwe's gradual degradation culminated in a lack of provision of public services and, ultimately, a collapse of the State. At the heart of the collapse was a macroeconomic crisis that involved an inflation-depreciation spiral. By 2008, Zimbabwe's income per capita had halved relative to 1980 and the country witnessed the deadliest outbreak of cholera in Africa. In 2009, Zimbabwe replaced its official currency with the US dollar and other foreign currencies to stem persistent hyperinflation.

**Yemen was subject to elite capture of resources as well as tribal, regional and sectarian divisions**. The fragmentation and fragility ultimately helped pushed the country into an armed conflict in June 2014. This conflict has been part of a wider regional struggle, geopolitically linking Yemen to Syria, Iraq and Lebanon. The human toll of conflict proved to be devastating. An estimated 40 percent of households have lost their primary source of income and the conflict has left at least 24.1 million people in need of humanitarian assistance, 3.7 million people internally displaced and 70 percent of population facing hunger.

## The Macroeconomics

**We proceed to compare some of Lebanon's worst-performing macroeconomic indicators to those in the above FCS select group** (henceforth referred to as merely the FCS group). Specifically, we compare the following macroeconomic indicators: real GDP and real GDP per capita growth, the inflation rate, current account, fiscal revenues and public debt.[47]

**Lebanon's four-year contraction (through 2021) in real GDP is estimated to have erased 15 years of economic growth**. Although real GDP growth has been anemic since the onset of the Syrian conflict, the contraction commenced in 2018 (t-1), one year before the crisis broke. The downward trend has steepened since, with real GDP growth contracting by 21.4 percent in 2020 (t+1) and 7.0 percent in 2021 (t+2) (Figure 12). By the end of 2021, Lebanon's real GDP index (2019 = 100) is estimated to have stood at 73.1, representing a contraction of 34.6 percent since 2018; this is comparable to the 2007 real GDP index of 74.5 (Figure 13).

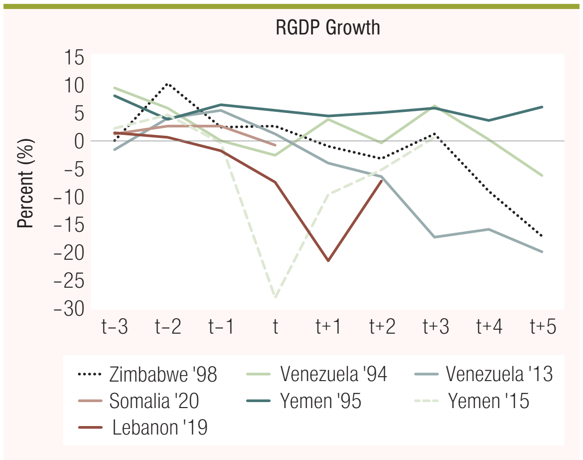
**Cumulatively, the contraction in Lebanon's real GDP between time t-1 and t+2 closely trails Yemen's to be the second largest among the FCS comparators.** Lebanon's contraction of 34.6 percent is marginally smaller than the cumulative contraction experienced by war-torn Yemen of 38.8 percent. The contraction in Lebanon's real GDP is comparable to Venezuela as far as duration is concerned.

**Real GDP per capita has been falling since 2016, reaching a trough in 2020 (t+1)** (Figure 14). Lebanon stands out as the only country with a negative growth in real GDP per capita in each of the years between t-3 and t+2. Further, the decline in real GDP per capita in 2020 (t+1) is the largest among comparators. Only Yemen (2015) and Venezuela (2013) have witnessed contractions of comparable, albeit still smaller magnitudes.

**Lebanon's inflation is the second highest among comparators, trumped only by Venezuela's hyperinflation (2013)**. Lebanon's inflation was in check in the lead up to the crisis, before increasing rapidly in 2020 (t+1) (Figure 15). As the exchange rate peg—which provided a nominal anchor for

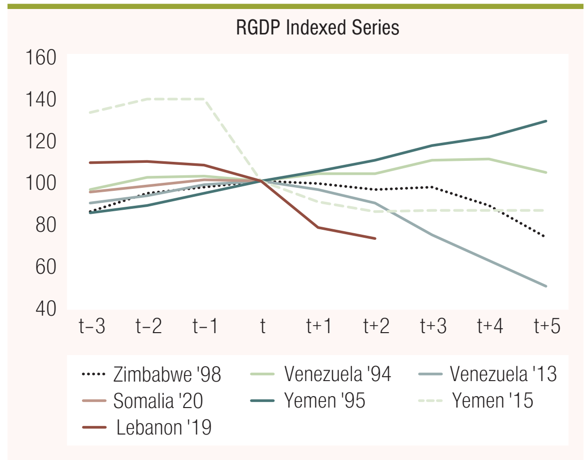
[47] The list of countries and data are sourced from the IMF's World Economic Outlook (WEO) and includes 196 countries. Lebanon's data are sourced from World Bank databases.

**FIGURE 12** • Lebanon Sees the 2nd Sharpest Contraction in Real GDP



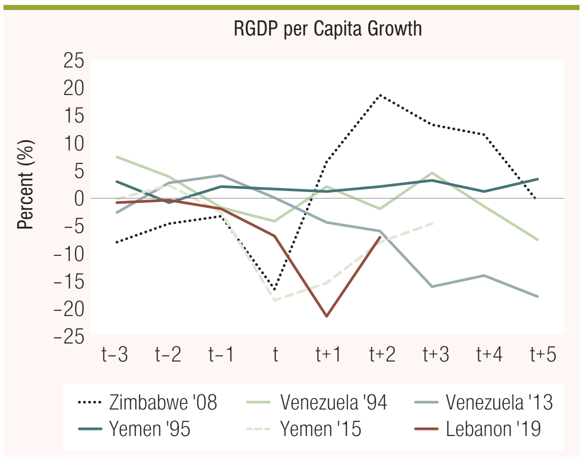

*Sources*: IMF WEO and WB staff calculations.

**FIGURE 13** • Sustained Real GDP Contraction Is Expected to Erase 15 Years of Progress by End-2022



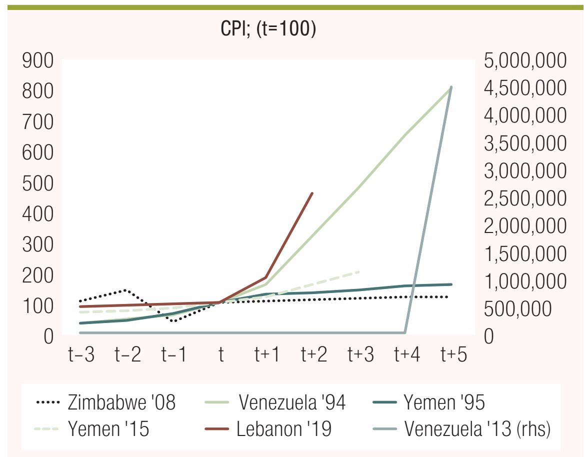

*Sources*: IMF WEO and WB staff calculations.

**FIGURE 14** • Real GDP Per Capita Contracting since 2011




*Sources*: IMF WEO and WB staff calculations.

**FIGURE 15** • Only Venezuela's Monumental Inflation Beats that in Lebanon



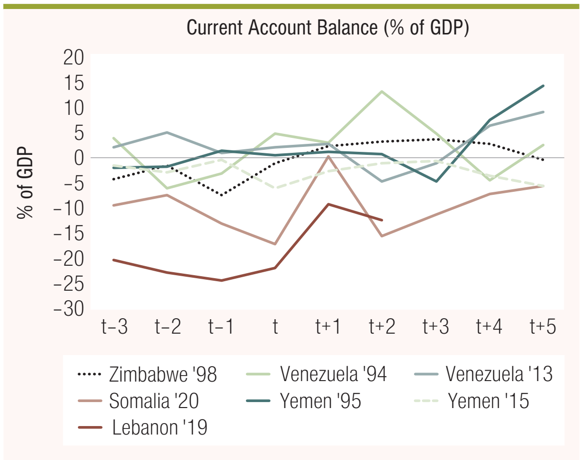

*Sources*: IMF WEO and WB staff calculations.

prices—collapsed, the exchange rate pass-through to prices was forceful. Inflation, which averaged 84.3 percent in 2020, increased markedly in 2021 to average 150 percent. The triple-digit inflation implies a staggering fivefold increase in the price level over the period 2019 (t)-2021 (t+2).

**Despite the import compression during the crisis, Lebanon's CA deficit is still the largest among comparators, but its overall fiscal deficit is narrower than most comparators.** Lebanon's post-civil war economic landscape is characterized by persistent and sizeable twin—fiscal and CA—deficits. In the lead-up to the crisis (t-3 till t), Lebanon maintained the largest CA deficit (Figure 16) among comparators while its fiscal deficit was consistently among the largest (Figure 17).[48] Despite the import compression during the crisis, Lebanon's CA deficit is the largest among comparators and is comparable only to Somalia's (2020). The declining debt service, as a consequence of the default on foreign debt, and the drastic cutbacks in primary spending, coupled with a

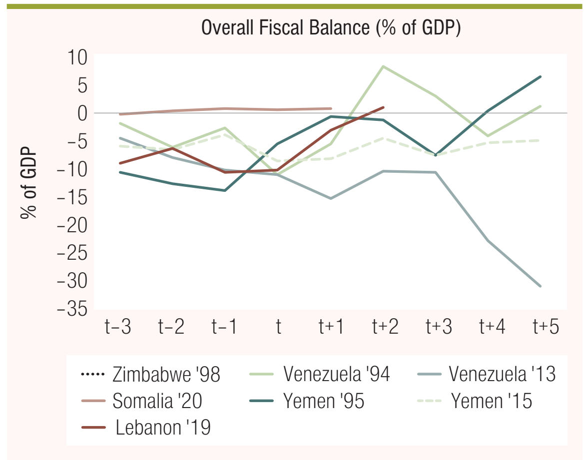
[48] Somalia ('20) data from 2019 onwards are estimates, according to IMF WEO.

FIGURE 16 • Lebanon Maintains the Worst CA Deficit Throughout



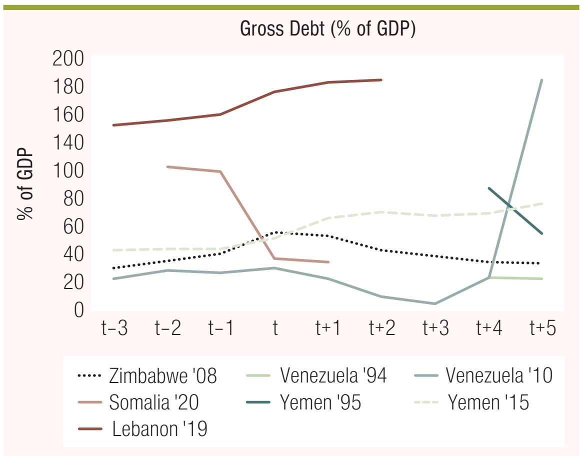

*Sources*: IMF WEO and WB Staff Calculations.

FIGURE 17 • While Its Fiscal Deficit Narrows Only after the Crisis




*Sources*: IMF WEO and WB Staff Calculations.

FIGURE 18 • Lebanon's Public Debt is the Worst among Comparators




*Sources*: IMF WEO and WB staff calculations.

denominator effect, have narrowed the fiscal deficit since 2019 (t). As a result, Lebanon fares better than Yemen (1995), Venezuela (1994), Yemen (2015) and Venezuela (2013) in terms of the overall fiscal deficit. In fact, Lebanon's overall fiscal deficit is the third smallest, following Venezuela (1994) and Zimbabwe (2008). Venezuela (2013), whose overall fiscal balance widened massively between (t+2) and (t+5), stands out as having the largest fiscal deficit among comparators.

**The crisis has increased Lebanon's notoriously high public debt making it the highest among comparators.** Hitherto among the highest in the world in the lead-up to the crisis, Lebanon's debt-to-GDP has increased since 2019 due to external debt revaluation, as a result of the depreciating LBP, on top of a persistent fiscal deficit financed by new debt. In fact, Lebanon's debt-to-GDP is the highest among the comparators prior to and during the crisis (Figure 18. Lebanon's Public Debt is the Worst Among). Only Venezuela's debt-to-GDP exhibits a similar steep upward trajectory five years into its crisis (t+5).

**The mere fact that Lebanon's macroeconomic performance is worse than that of states marred by fragility, conflict and violence speaks to the grave toll of the Deliberate Depression.** Lebanon's macroeconomic performance is, for most indicators, worse than that of a comparator group comprising countries that have been marred by elite capture, extractive institutions, civil strife or war, state failure and fragmentation. Our Fall 2021 LEM *The Great Denial* warned that the scale and scope of Lebanon's Deliberate Depression is leading to the disintegration of key pillars of Lebanon's post-civil war economy. Our Spring 2021 LEM *Lebanon Sinking (to the Top 3)* argued that brutal and rapid contractions in economic activity such as Lebanon's are usually associated with conflicts and wars. This latest benchmarking exercise confirms that Lebanon's macroeconomic performance is worse—or —at best—on par, with that of FCS.

# SPECIAL FOCUS II: DOLLARIZATION IN LEBANON

The use of the US dollar in Lebanon has a long history, going back to the 1975–1990 civil war. The extent of dollarization is a marker of confidence in the Lebanese Pound, and more generally macroeconomic policy management. Our analysis of dollarization in Lebanon, shows that multiple currency crises have historically led to hysteresis in dollarization, with the level of dollarization in deposits, lending and public debt increasing over time. We further find Lebanon's financial system did not offer sufficiently diverse investment and hedging opportunities, which, in turn, helped drive dollarization even higher. While macro and micro prudential measures were successful at lowering the dollarization rate, their quasi-fiscal nature led to sizable (and opaque) liabilities which eventually contributed to the ongoing systemic failures which has further reduced confidence in the LBP. We conclude that dollarization is expected to remain elevated in Lebanon, even upon recovery and macroeconomic stability.[49] The development of capital markets remains unattainable under current conditions and will require macroeconomic stability in the short term and a new growth model in the long term to reverse dollarization.

## Accounting for Dollarization

**Gauging the extent of dollarization in an economy is limited by data availability.** The paucity of data complicates the task of identifying the currency denomination of transaction payments and valuations of goods and services. Both *de jure* and *de facto* institutional factors underpin the denomination of foreign versus domestic currencies in an economy. Knowledge of these country-specific factors is essential. However, transaction-level data disaggregated into currency composition are difficult to obtain. As such, the literature has depended on key macro indicators that can quantify the dollarization rate in an economy.

**Dollarization is the process of replacing the domestic currency with a foreign one to serve the essential roles of money in the economy.** Money is often defined in terms of the three functions or services that it provides.[50] These are: (i) as

49 This note does not take a position on the currency board discussion that is taking place in Lebanon, as this would require further, more targeted examination. We caution that determinants and dynamics of dollarization are different from those of a currency board.

50 Calvo and Vegh (1996) differentiate between *currency substitution*—where a foreign currency replaces the domestic currency as a medium of exchange—and *dollarization*, which also includes the foreign currency being used as a unit of account and store of value. In fact, the authors lay out the following causal process; in a high inflationary environment, a foreign currency is first used as a store of value and/or a unit of account, and only later as a medium of exchange. Accordingly, *currency substitution* is the last stage of the dollarization process (Calvo and Vegh, 1996, pg. 1–2).

a medium of exchange that facilitates transactions, without which a barter system—the direct exchange of one good or service for another—takes hold; (ii) as a unit of account that provides a common measure of the value of goods and services being exchanged; and (iii) as a store of value that preserves its value over time.[51]

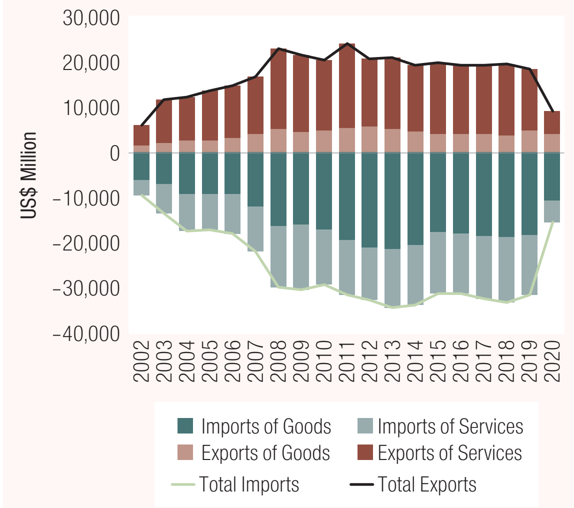
**Financial dollarization is associated with the loss of the local currency's functionality as a store of value** (Catão and Terrones, 2016, pg. 4). In Lebanon, financial dollarization—whereby commercial banks collect deposits and disburse loans in two or more currencies— is relatively easy to gauge. Toward that end, we use indicators based on published financial statistics; specifically, dollarization rates for private deposits in commercial banks and private loans by commercial banks. As a proxy for public sector financial dollarization, we can also examine the ratio of FX-denominated public debt to gross public debt.

**Less straight forward would be to quantify dollarization associated with the medium of exchange and unit of account functionalities of money.** While this is not a Lebanon-specific constraint,[52] it is especially limiting in our case due to the low statistical capacity in the country. Faced with data limitation we proceed as follows:

1. A good proxy for the medium of exchange functionality in the case of Lebanon would be ratios involving Value of FX Cleared Checks to Value of Total Cleared Checks (in FX and LBP).
2. At minimum, dollarization associated with the unit of account functionality is commensurate with the import share in the consumption basket.

While the first is self-explanatory, the second is justified by the sizable structural deficit in Lebanon's external account (Figure 19); a large import bill has imposed a substantial structural deficit in Lebanon's current account balance, averaging close to 22 percent of GDP (1991–2019). Hence, a consumption basket with a relatively high import component would channel more directly FX valuation effects. Item 2 proxy would be much weaker in an economy where the share of imports in the consumption basket is not considerable.

FIGURE 19 • Lebanon Suffered from Consistently Sizable External Deficits since the End of the Civil War




*Sources*: BdL, MoF and WB staff calculations.

**Foreign currency—primarily US dollars—constituted by far the main store of value for post-civil war Lebanon.** With variations on rates and instruments used, financial dollarization is clearly a fundamental characteristic of the pre-crisis economy (Figure 20. High rates of financial dollarization were a fundamental feature post-civil war Lebanon.). We highlight the following:

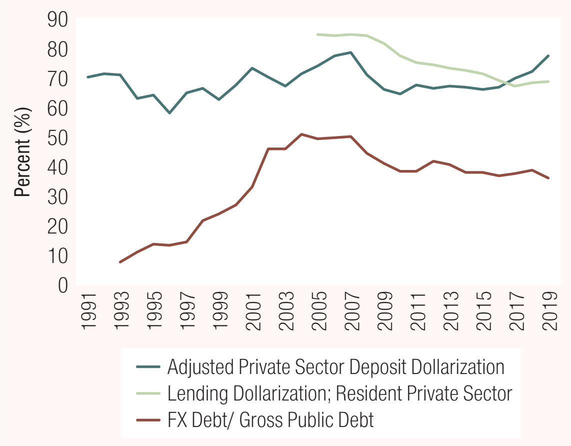
- Examining data available as of October 1991 through the eve of the financial crisis (October 2019), we find that (adjusted) dollarization rates[53] for private deposits in commercial banks have

[51] https://www.cliffsnotes.com/study-guides/economics/money-and-banking/functions-of-money.

[52] "Financial dollarization (the use of foreign currency as a store of value) is easy to measure because data are readily available in financial statistics. However, the true extent of dollarization, which should encompass payment dollarization (the use of foreign currency for transactions purposes) and real dollarization (the use of foreign currency for denominating prices and wages), is more difficult to assess because information is not readily available." (Abdelati, 2008, pg 91).

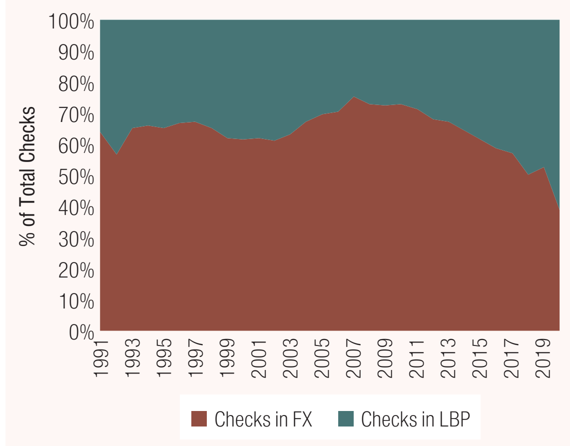
[53] Adjusted dollarization rates are dollarization rates that are adjusted for valuation effects from exchange rate variations in the period prior to the peg (pre-1998).

FIGURE 20 • High Rates of Financial Dollarization Were a Fundamental Feature Post-Civil War Lebanon




*Sources*: BdL, MoF and WB staff calculations.

FIGURE 21 • FX-Denominated Checks Consistently Out-Valued LBP-Denominated Checks over the 1991-2019 Period




*Sources*: BdL and WB staff calculations.

fluctuated between a peak of 86.7 percent in September 1992 and a trough of 56.4 percent in March 1997.

- Dollarization rates for private loans by commercial banks—available over a narrower times series of data from December 2005 to October 2019—ranged from a peak of 85.1 percent (May 2008) to a trough of 66.4 percent in July 2018.
- Examining dollarization in the public sector, the share of FX public debt to gross public debt has increased steadily to reach a peak of 52.5 percent by February 2005, before moderating to be in the high thirties by the eve of the crisis.

**Using currency breakdown of Cleared Checks, we find that foreign currency dominated as a medium of exchange in post-war Lebanon (**Figure 21). The ratio of FX-denominated checks to total checks in value fluctuated between a peak of 78.6 percent (August 2008) and a trough of 45.3 percent (October 2019).

**Agents used foreign currency as a main unit of account in post-war Lebanon**. We present in Box 3. Estimating the Import Share of the Consumption Basket. an approach to apply item 2 from paragraph. The result suggest that dollarization associated with the unit of account functionality is equal to X * 61.1 percent, such that X>1.

## Determinants of Dollarization in Lebanon

**Guided by the global literature, we identify principal determinants of dollarization, and find that in the case of Lebanon, multiple currency crises have historically driven high levels of dollarization.** Examining global episodes, the literature highlights the following important drivers relevant to the Lebanon case: (i) exchange rate and macroeconomic policies and environment; (ii) macro and micro-prudential policies and environment; and (iii) depth of financial and capital markets.

### Exchange rate and macroeconomic policies and environment

**Studies suggest that exchange rate flexibility inhibits dollarization up to a certain degree of volatility, beyond which dollarization is enhanced, and is difficult to reverse.** Allowing two-way exchange rate movements makes foreign exchange risk more apparent, helping to introduce incentives for lower dollarization (Hardy and Pazarbasioglu, 2006) and/or the development of hedging instruments. This is supported by empirical evidence in Kokenyne et al. (2010), who find it significant in two out of the four countries studied by Garcia-Escribano and Sosa (2011) in Latin

## BOX 3: ESTIMATING THE IMPORT SHARE OF THE CONSUMPTION BASKET

We use consumption-based weights to estimate the import components of the consumption basket in Lebanon. To proceed, we adopt the following nomenclature:

- $C_g$ denotes share of goods in the consumption basket;
- $C_s$ denotes share of services in the consumption basket;
- $C_g^m$ denotes ratio of imported goods to total goods in the consumption basket;
- $C_s^m$ denotes ratio of imported services to total services in the consumption basket;

$C_g$ and $C_s$ are derived from the weights for different components in the Consumer Price Index (CPI). Specifically, $C_s$ is calculated by summing up the weights of CPI components that are assumed to be focused on the consumption of services.[a] Remaining components in the CPI are assumed to be focused on the consumption of goods. Hence,

$$C_s = 53\%$$

$$C_g = 1 - C_s = 47\%^{b}$$

We assume $C_s$ and $C_g$ remain unchanged throughout the examined period.

We assume that 85 percent of goods in the consumption basket are imported, whereas only 40 percent of services in the consumption basket are imported. Hence,

$$C_g^m = 85\%$$

$$C_s^m = 40\%$$

We assume $C_g^m$ and $C_s^m$ remain unchanged throughout the examined period.

The estimated weighted import share of the consumption bask would be

$$= (C_g^m \times Cg) + (C_s^m \times C_s)$$

$$= (85\% \times 47\%) + (40\% \times 53\%) = 61.1\%$$

[a] Components assumed focused on the consumption of services and their associated weights are: Housing, rent (weight = 3.4%); Housing, owner occupied (13.2%); Health (7.8%); Transportation (13.1%); Communication (4.6%); Recreation, amusement and culture (2.3%); Education (5.9%); and Restaurant & hotels (2.6%).

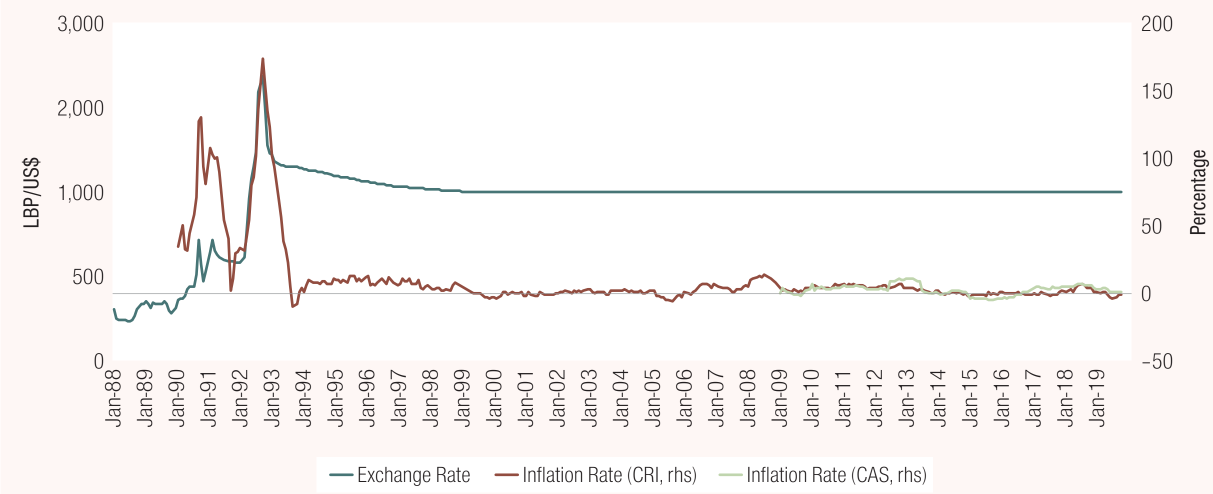
[b] While the above components that are assumed focused on the consumption of services also include goods (i.e. communication), we can assume that this is offset by components that are assumed focused on the consumption of goods but that also include services.

America. Everaert (2016) finds evidence in a panel of 33 emerging market countries of causality from greater exchange rate flexibility to lower dollarization. Excessive exchange rate volatility, however, can encourage dollarization, as the local currency loses important money functionalities (medium of exchange, unit of account and a store of value). Naceur et al (2015) examine dollarization rates in the Caucasus and Central Asia region, which are among the highest in the world. The authors find that currency depreciations and high volatility of exchange rates are associated with a rise in FX deposits, but not in FX loans.

**More generally, the literature emphasizes credible macroeconomic management as a precondition for durable de-dollarization.** De-dollarization requires restoring the functioning of, and trust in, the national currency. Stable and low inflation increases the confidence in the local currency, thereby reducing the need for using FX to preserve purchasing power. Credible monetary and fiscal policies along with the development of local currency markets supported de-dollarization in several countries (De Nicolo et al, 2005). Inflation targeting has also been found to be more conducive to de-dollarization than other monetary arrangements (Rennhack and Nozaki, 2006; and Catão and Terrones, 2016).

**Up to the dramatic failure of the peg brought about by the financial crisis in end-2019, Lebanon enjoyed exchange rate stability for over two decades.** The peg was introduced toward the end of 1998 setting the Lebanese Pound at LBP1,507.5/US$. This followed a tumultuous period for the LBP; over the last two years of the civil war (1988–90), the LBP depreciated by over 200 percent,

FIGURE 22 • The Lira Suffered Multiple Crises before the Peg Was Introduced




*Sources*: BdL, CRI, CAS and WB staff calculations.

and by 187 percent between November 1992 and November 1992, to reach a then peak of LBP2,500/US$ (Figure 22). Even prior to this, the Lira suffered multiple crises over the course of the civil war, starting the 1980s at around LBP3.5/US$ and falling to above LBP500/US$ by the end of the decade.[54]

**Prices of goods and services have mirrored exchange rate conditions.** Clearly other factors determine inflation, including inflation rates in trading partner countries and commodity prices etc. Nonetheless, surging inflation rates in Lebanon have mirrored the country's currency crisis episodes. Further, the period of exchange rate stability (1998–2019) has also witnessed price stability and moderation.

**Multiple currency crises left irreparable damage on the Lira's credibility, which clearly became a main driver of dollarization.** In fact, under such tumultuous conditions, dollarization can be a very persistent (Reinhart et al., 2003; Galindo and Leiderman, 2005; Castillo and Winkelried, 2005). Further, once macroeconomic stability is achieved, the impact of lower inflation or sovereign spreads (such as EMBI) has been found to be too small to contribute significantly to further de-dollarization (Garcia-Escribano and Sosa, 2011). Indeed, dollarization can be quite persistent even after macroeconomic stability is achieved.[55] Hence, despite the prolonged stability of the exchange rate over 1998–2019 period, concerns over Lira strength never abated sufficiently for dollarization to diminish significantly. The 2019 financial crisis will further aggravate the challenges in the process of de-dollarization.

**Dollarization in Lebanon was underpinned by weak macroeconomic fundamentals.** These include an integrated macro-financial structure of high debt levels, large twin deficits (fiscal and current account), an oversized banking sector and a strong peg. The pre-crisis financing needs were substantial, primarily funded via a banking sector whose balance sheet reached over four times GDP. BdL ensured that banks kept attracting foreign deposits and that the public and private sectors gross financing needs were met, thereby financing the sizable current and fiscal account deficits. To attract foreign deposits, BdL introduced dollar-denominated certificates of deposits and various subsidized FX refinancing schemes. To meet the needs of Government, BdL was the residual buyer of Government debt in the primary and secondary markets. Other critical push and pull factors laid fertile grounds for capital inflows. These include (i) a large diaspora; (ii) a banking secrecy law;

[54] Los Angeles Times, November 29, 1987.

[55] "There is a large literature that has documented that financial dollarization in some emerging economies displays "hysteresis"—that is, it rises in periods of economic disarray but does not fall proportionately when the economy is stabilized" (Catão and Terrones, 2016, pg 8).

and (iii) a banking business model that successfully expanded and linked to the diaspora.

**While deposit dollarization was critical to the post-war macro-financial structure, it also drove other dollarization in the economy, including the dollarization of lending as well as the public debt.** This causality is explained:

> "Dollarized deposits induce dollarization of loans. High levels of FX deposits encourage banks to lend to domestic borrowers in foreign currency to maintain matched balance sheet positions, in effect transferring the burden of exchange rate risk to depositors. Neanidis and Savva (2009) find that short-term loan dollarization is largely driven by currency matching by banks" (Naceur et al, 2015, pg. 11).

## Macro and micro-prudential policies and environment

**Macro and micro-prudential policies can help reduce dollarization over time.** These can include differential treatment of reserve requirements on FX versus local currency deposits (e.g. higher reserve requirements on FX deposits, different remuneration, or requiring reserve requirements on FX deposits to be in local currency), stricter prudential requirements (e.g. higher liquidity ratios on FX liquidity, charging higher risk premia on deposit insurance for FX deposits), lower loan-to-value limits and/or stricter limits on collateral evaluation or requirements, and limits on open FX positions. The latter typically are linked to the findings that reductions in deposit dollarization help speed up credit de-dollarization (Luca and Petrova, 2007). Kokenyne et al. (2010) provides empirical support for the effectiveness of micro-prudential measures. Garcia-Escribano and Sosa (2011) show that macro-prudential regulations (especially reserve requirements and prudential regulations) contributed to credit de-dollarization in four Latin American countries (including Peru) but had a more limited impact on deposit de-dollarization. Lower insurance for FX deposits, however, can also lead to lower financial intermediation (Moron and Castro, 2003).

**BdL has mandated compulsory reserve requirements on deposits (LBP and FX) in commercial banks to be placed with the central bank.** Commercial banks are required to place 25 and 15 percent of demand LBP deposits and time LBP deposits, respectively, as reserve requirements with BdL. FX deposits at commercial banks were subject to reserve requirement ratio of 15 percent until June 2021; it was thereafter brought down to 14 percent.

**As of 1997, Lebanon's central bank launched numerous initiatives to entice medium and long-term lending in LBP to the private sector** (World Bank, 2016). Notably, in 2001, BdL allowed for reductions in commercial banks' reserve requirements in return for undertaking lending in a number of sectors, including IT, agriculture and tourism.

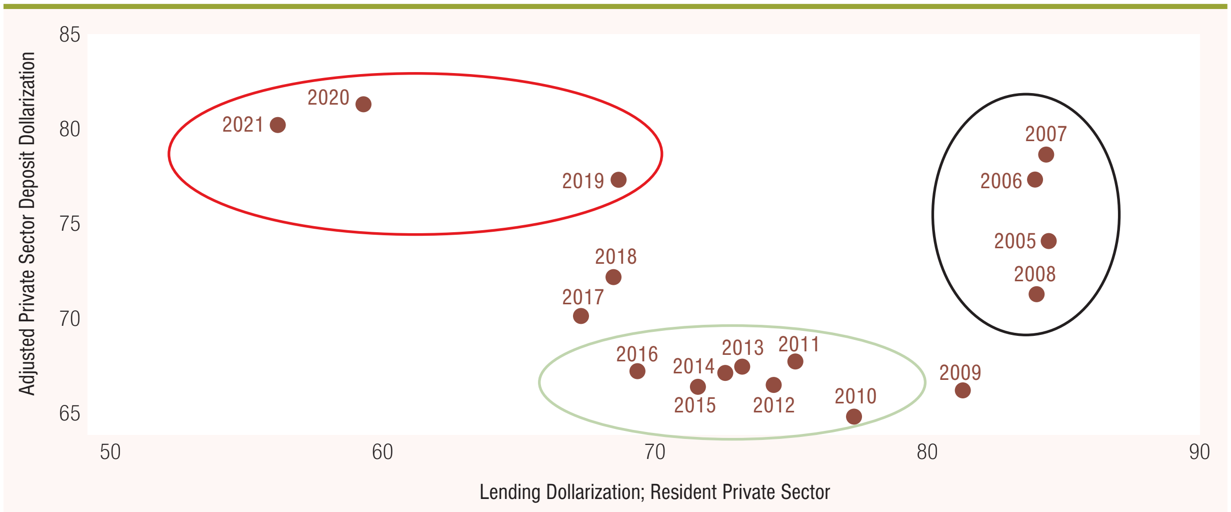
**The reductions in banks' reserve requirements were substantially expanded in 2009.** "The success of these incentives led BdL to increase the deduction ceiling to 90 percent in January 2011" (World Bank, 2016). As part of this subsidy scheme, BdL lent a total of US$3.37 billion over the 2013–15 period. In excess of 76 percent of this subsidized lending went to the housing sector.

**BdL's financial prudential measures[56] were seemingly effective in lowering dollarization rates across deposit and lending facilities.** While a more robust econometric analysis is needed, we see evidence on the efficacy of these macro and micro prudential measures on lowering dollarization. As illustrated in Figure 23. Dollarization rates on deposits and lending interacted in distinct ways over three main periods., dollarization rates generally varied over three periods.

i. The 2005–2008 period—in the black elliptical in Figure 23. Dollarization rates on deposits and lending interacted in distinct ways over three main periods.—preceded BdL's expanded measures; then, deposit dollarization rates hovered between low and high 70's percent, while lending dollarization rates were steady in the mid 80's percent.

[56] For a detailed description of these measures, please see the Special Focus in World Bank. 2016. *The Big Swap: Dollars for Trust*, Lebanon Economic Monitor, Fall 2016.

FIGURE 23 • Dollarization Rates on Deposits and Lending Interacted in Distinct Ways over Three Main Periods.




*Sources*: BdL and WB staff calculations.

ii. The 2010–2016 period—in the green elliptical in Figure 23. Dollarization rates on deposits and lending interacted in distinct ways over three main periods.—coincided with the full effect of BdL's policies; there we see significant declines give (~10 percentage points) for dollarization rates in both deposits and lending.

iii. The 2019–2021 period—in the red elliptical in Figure 23. Dollarization rates on deposits and lending interacted in distinct ways over three main periods.—is the crisis period. This period clearly illustrates crisis conditions; the complete shut down in the banking sector limit our ability to interpret these numbers, but we do note surging deposit dollarization rates.

**While BdL measures were successful in lowering dollarization rates, they helped accrue massive liabilities in both LBP and FX.** The buildup of liabilities eventually played a significant role in the downfall of the macro-financial system (World Bank, 2016, 2017 and 2021). As such, we consider these macro and micro prudential measures out of the context in which they were applied. Instead, we observe lower degree causality effects, with the caveat that this should be subject to more robust econometric analyses. Thus, while macro and micro prudential measures, were successful at lowering dollarization rates, their quasi-fiscal nature led to sizable liabilities which eventually helped lead to systemic failures.

## Depth of financial and capital markets

**Deepening local currency financial markets and broadening savings options are other factors contributing to de-dollarization**. Liquid bond markets offering a range of different savings instruments can act as alternative investment opportunities to dollar deposits (e.g., including the ability for the public to invest directly in local currency government bonds). It can also help extend the yield curve of public bonds. Garcia-Escribano and Sosa (2011) find this effect to be significant. Indexation, if credible, can provide a bridge to promote investments in local currency-denominated assets (Ize and Levy-Yeyati, 2005), and be gradually phased out over time as confidence in local currency denominated assets increases (for instance, as it was the case in Chile or Colombia).

**Lebanon's financial system did not offer sufficiently diverse investment and hedging opportunities, helping to drive dollarization higher.** The Lebanese financial system was dominated by commercial banks, with the non-bank financial sector marginal and relatively inconsequential. In fact, banks' assets constituted 97 percent of financial system assets in Lebanon at end-2015 (WB-IMF, 2017). BdL's list of commercial banks in Lebanon (February 2021) reached 142 in its count[57]—a very high number for a country the size of Lebanon. By end of 2019, total client deposit accounts in commercial banks numbered over 2,800,000, with banks total balance sheet reaching US$217 billion, equivalent to over 4 times GDP. Moreover, Lebanese firms depended significantly on the banking sector for their financing, as 53 percent of all firms—50 percent of small firms and 63 percent of medium-size firms—reported having received a bank loan (Le Borgne and Jacobs, 2016, pg. 43).

57 BdL, https://www.bdl.gov.lb/pages/index/4/25/List-of-Institutions-Supervised-by-BdL.html.

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