Lebanon's Monetary Overview 2017

BLOMINVEST BANK

February 23rd, 2018

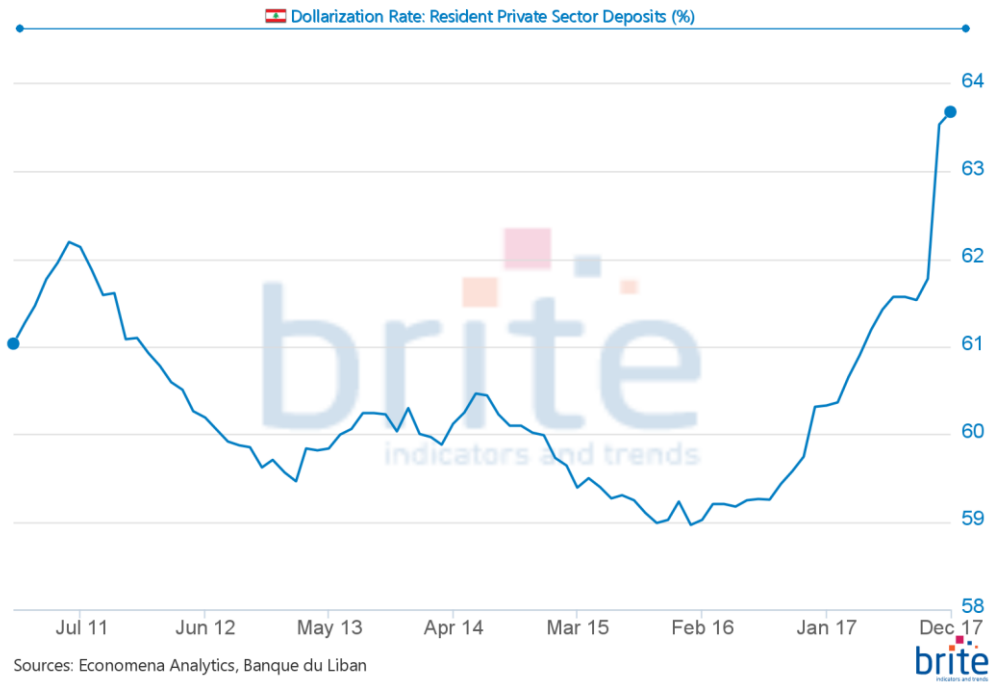
Contact Information

Research Analyst: Riwa Daou

Head of Research: Marwan Mikhael

Confidence: the underlying driver behind every market's boom or bust. Currencies are no strangers to this concept; pegged or free-floating, a strong currency is one that has a vote of confidence. In Lebanon, establishing confidence in the LBP was not always a given or an easy feat. Historically, the LBP has seen its times of gloom with the value of the LBP tumbling during the Lebanese civil war from $/LBP 3.43 to $/LBP 1,621.33 in 1995. However, for a little over two-decades, the Central Bank of Lebanon has maintained the Lebanese Pound's peg against the dollar stable and at the official conversion rate of $/LBP 1,507.5. With that, the Central Bank's monetary policy would have met an essential goal of its mandate.

In a country as politically-driven as Lebanon, the importance of confidence is even greater. The main political event in 2017 was the surprise resignation of Prime Minister Saad al Hariri, announced from Saudi Arabia in November 2017. The ambiguity of this move rattled depositors and sparked manageable but sizeable capital flight and demand on the dollar (reflected in the increased dollarization ratio of resident private sector deposits in the graph below). Capital outflows in the month of November amounted to $2.59 billion, given that non-resident private sector deposits slid by $1.13 billion and $1.46 billion of resident private sector deposits fled the country. Despite the heavy demand on the dollar and some pressure on the peg, the situation was contained; on the one hand, the Central Bank of Lebanon's foreign assets stood at a healthy $41.9 billion in November and on the other commercial banks are well capitalized and were able to meet the demand on the dollar by selling some of their Eurobonds holdings.



Brite.blominvestbank.com

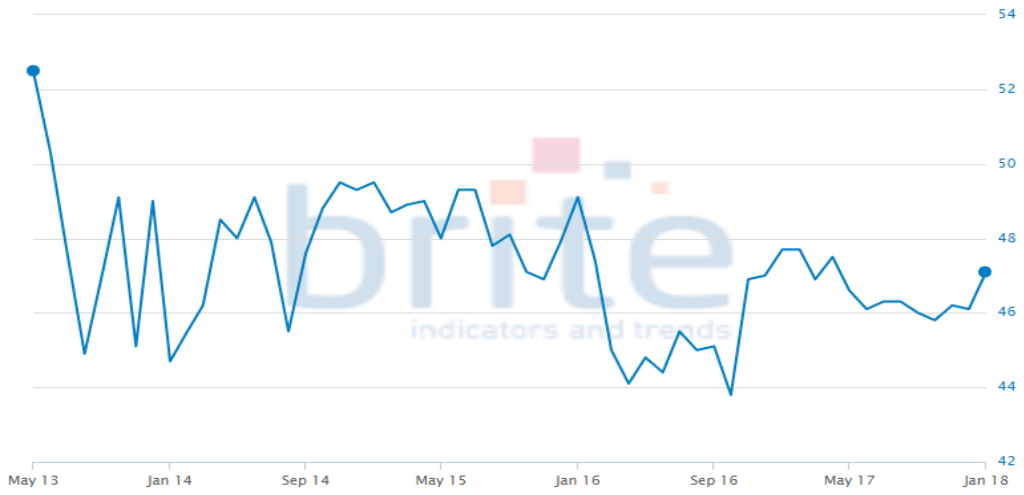
The Central Bank's role, however, is not limited to preserving the Lebanese pound's peg to the dollar. The Central Bank of Lebanon is also responsible for preserving the stability of the financial system. Ensuring the stability and soundness of the financial system assumes different forms depending on the challenges of each period. In 2008, Lebanon was shielded from the financial crisis thanks to the Central Bank's ban on banks to invest in the US subprime market which entails complex and risky financial products. Today, the financial system is being puzzled by the emergence of cryptocurrencies and the blockchain technology. Experts have not yet drawn a clear picture of the risks and the disruption that cryptocurrencies and blockhain can create. For now, the Central Bank of Lebanon publicly opposed bitcoin[1] use in Lebanon based on its lack of regulation but stated that it will launch its own digital currency under Lebanese law.

Monetary policy is no static task; it's an endeavor that requires a constant update with global financial and economic developments. The rise of cryptocurrencies and blockchain technology bring the risk of cybercrime to the forefront of debate. The Central Bank of Lebanon issued Circular # 144 in that regard, where it stresses on the importance of financial cybersecurity. The Central Bank called on commercial banks to seek the assistance of the Central Bank's Special Investigation Commission (SIC) should any cybercrime suspicion arise. The circular also calls for vigilance in terms of which external IT contractors are being hired by the banks to run their IT systems.

[1] Bitcoin's price proved to be quite volatile reaching a high of $19,188 in December 2017 but then tumbled to a price of $6,874.27 in February 2018

While cryptocurrencies and technological advancements are new challenges, boosting growth, especially since the economic downturn triggered in 2011, has long been on the agenda. The Lebanese economy has been growing at a rate of 1% to 2% since 2011, far from the range of 8% to 10% seen back in the period 2007-2010. The private sector, which has an essential contribution to Lebanon's economic output, has suffered the burden of regional conflicts (especially the Syrian war) and local political inertia. The BLOM Lebanon Purchasing Managers' Index (PMI) has been tracking the performance of the Lebanese private sector economy since May 2013; the survey has shown as detailed in the graph below that the index has been below the 50 mark separating economic expansion from economic recession every month since July 2013.

BLOM Lebanon Purchasing Managers Index (PMI)



Source: Blominvest Bank, Economena Analytics, brite.blominvestbank.com

The stimulus packages created by the Central Bank of Lebanon are especially designed to boost the activity of core sectors in the Lebanese economy. These packages were created every year since 2013 and they consist of soft loans offered by the Central Bank of Lebanon to commercial banks "in order to encourage investments in vital economic sectors such as tourism, agriculture, industry, IT, environment, housing and education". According to the Central Bank, these stimulus packages will generate new job opportunities for the Lebanese youth and offer small and medium enterprises (which according to the Ministry of Economy represent between 93% and 95% of enterprises in the country) the financing they need.

According to Circular #486 issued by the Central Bank of Lebanon, the interest rates on subsidized loans are no longer in accordance with the rates on Lebanese Treasury bills but they are now in accordance with the average placement rates at the Central Bank of Lebanon. A new stimulus package is to be launched in 2018.

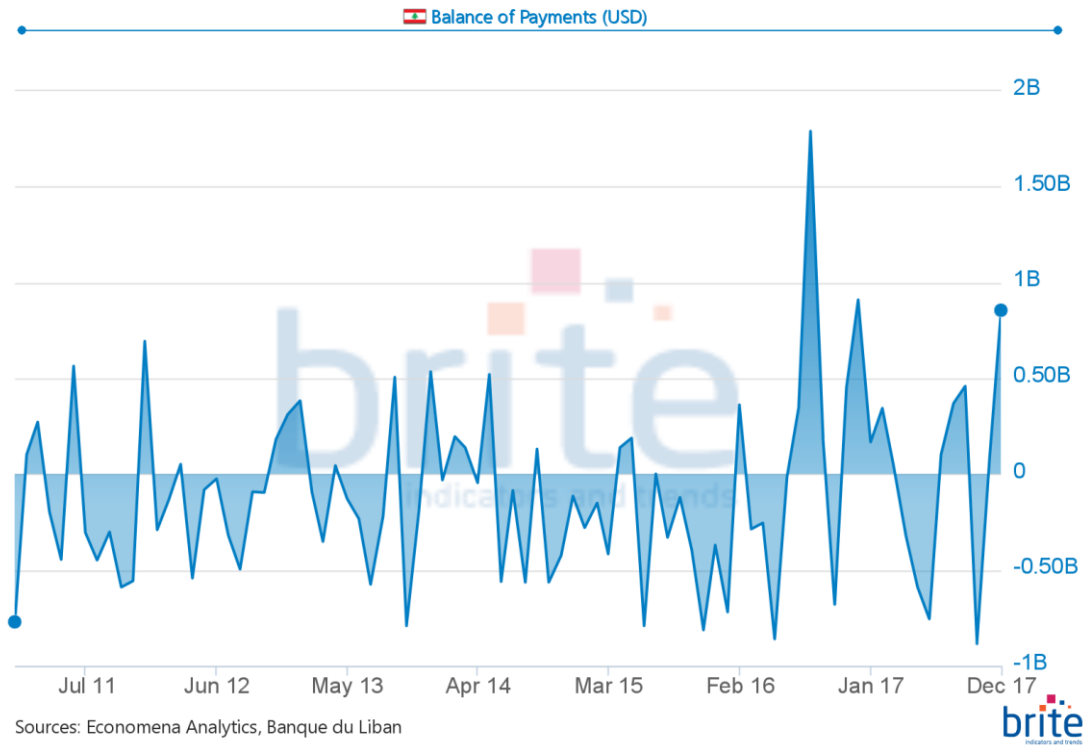
Central Bank of Lebanon's Stimulus Packages

Year	Stimulus Package, in billions of LBP
2013	2,210
2014	1,400
2015	1,500
2016	1,500
2017	2,261.25

Source: Banque du Liban

*: If funds are not fully disbursed in a given year, they are added to the stimulus package of the following year

However, the prolonged nature of the economic downturn and political tensions at that time compelled the Central Bank to resort to unconventional measures as of June 2016. The Central Bank of Lebanon engaged in a financial engineering scheme starting June 2016. The Central Bank bought $2 billion worth of Lebanese Eurobonds from the Ministry of Finance in exchange for the equivalent amount in Lebanese Treasury bills. Secondly, according to an official statement from the Banque du Liban (BDL) "the Central Bank sold these acquired Eurobonds and issued dollar Certificates of Deposits to commercial banks, investment banks and financial institutions for an approximate amount of $11 billion against fresh dollar inflows transferred by banks and financial institutions from abroad." The Central Bank discounted the treasury bills or LBP Certificates of Deposits held by commercial banks at a premium with the income being split equally between the Central Bank and commercial banks. This operation allowed the Balance of payments to register its first monthly surplus and for the Central Bank of Lebanon to boost its foreign assets position.



Despite the vigilance and the proactivness of the Central Bank of Lebanon, monetary policy needs to be accompanied by an efficient fiscal policy. After over a decade long absence of a proper budget, the first draft budget was approved in 2017 and the long-lingering issue of the public sector's employee salary raise was finally passed and financed through tax increases. However, fiscal policy, same as monetary policy, needs to be inscribed in a long-term vision for the country. Although any progress is commendable, more is needed to create a true, structural economic reform.

For your Queries:

BLOMINVEST BANK s.a.l.
Research Department
Beb Idriss, Downtown Beirut

Riwa Daou
Riwa.daou@blominvestbank.com
+961 1 991 784

Marwan Mikhael
Marwan.mikhael@blominvetbank.com
+961 1 991 782