Overview on Lebanon's Eurobonds Market in 2020 Amid the Financial Crisis

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In this report, we will provide an overview of Lebanon' s Eurobond market, but with a brief introduction on the US, EU, and Chinese markets.

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The whole world has suffered in 2020. Powerful countries like USA, UK, and China have found themselves in the worst economic crisis in decades, due to the deadly pandemic that started affecting the world at the beginning of the year. The interventions by both the Fed and the European Central Bank (ECB) minimized the catastrophic effect of the pandemic on the economy. However, investors were still leaning towards safer assets such as governmental bills and bonds. Lebanon was no exception. The pandemic was not the only factor influencing the Lebanese Eurobonds market. Political upheavals, worsening economic conditions, and the unpreceded default weighed heavily on the Lebanese Fixed Income market

The US bonds market Pre-pandemic

The US economy in 2019 was doing just fine. The unemployment rate was at its lowest of 3.5%. Investors were more bullish on the stock market. The S&P 500 was up yearly by 28.9% in 2019, its biggest one-year gain since 2013, and the GDP was up by 2.3%. The yields on treasury bonds for 5Y and 10Y closed at highs rates in the last days of 2019.

The US bonds market during the pandemic

Covid-19 had a big impact over the world, especially in the United Sates. The causalities were the worst compared to other countries. In these circumstances, the Trump administration was obligated to impose a national lockdown starting March 2020 in order to ease the spread of the deadly virus. The US economy suffered during this year and the unemployment rate increased to an unprecedented level and reached 14.4% on April 2020. High uncertainty increased investors' appetite for treasury bonds. As a result, the yields on TBs went down, and by March 2020, the 10Y yield fell to a record low of 0.54%. It's worth mentioning that the 2020 inversion began on 14 February 2020, when the yield on 10-year notes fell to 1.59% while those of the one-month and two-month bills rose to 1.60%, each. The inversion kept on worsening as the pandemic became nastier and uncertainty grew.

Post-Pandemic US Recovery Plan under Biden Administration - Outlook for 2021

President Joe Biden's stimulus plan consists of injecting $1.9T in the US market. Investors believe that this recovery plan will have a big impact on inflation rate. As more dollars are injected, its value will depreciate against other strong currencies. Further, the

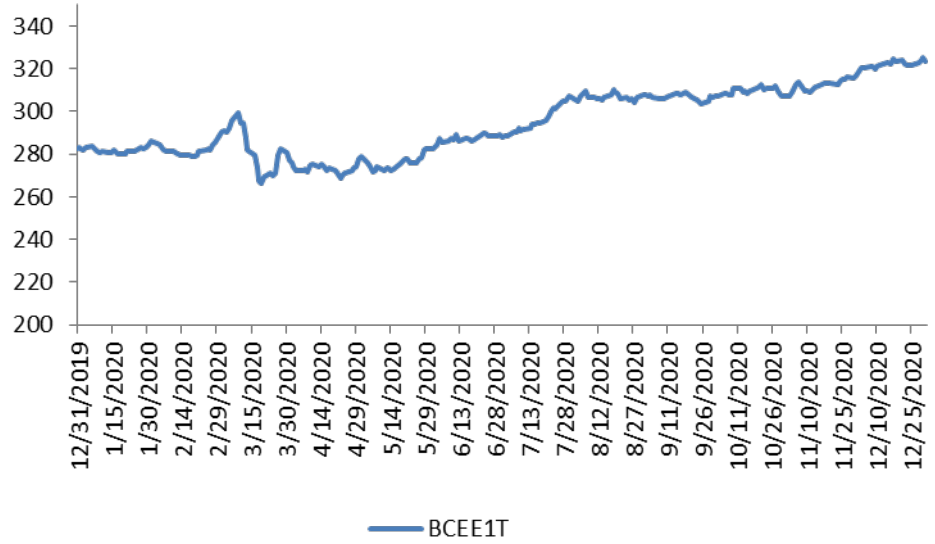
demand for treasury bonds especially that of long maturities like the 10Y and the 30Y will decrease. As a result, US 30Y yields rose to 2% on January 2021.

Given both the economic stimulus and the vaccine rollout, we believe that the US economy will recover starting fall 2021, however inflation rate will be higher than expected but will remain controllable.

Europe in the Heart of the Pandemic

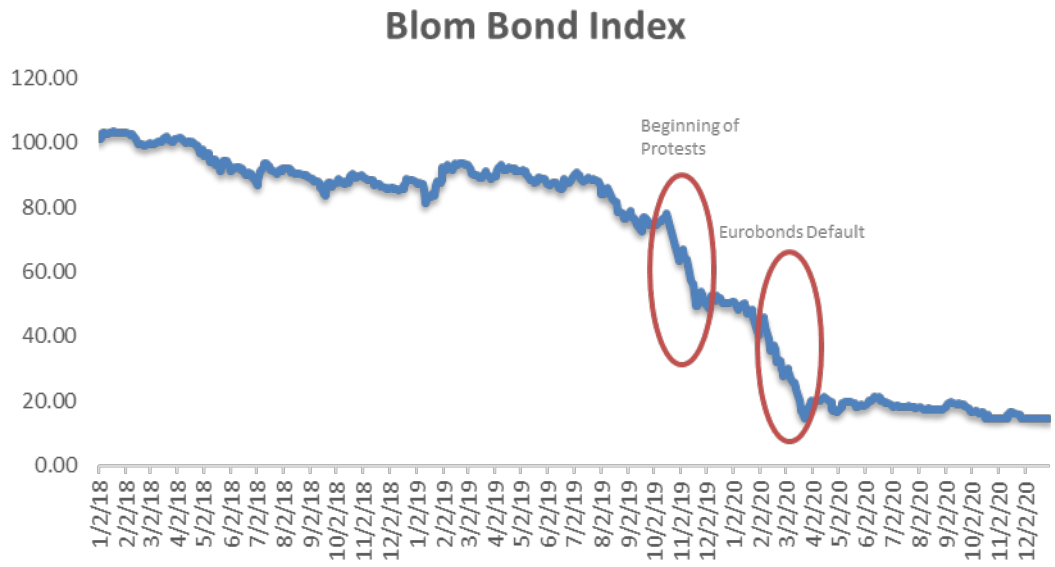
The European Investment Bank (EIB) submitted a study about the European economy during the crisis, by targeting more than 13,000 firms. In their study they concluded that 55% of EU firms reduced employment in 2020. Furthermore, 45% of EU firms affirmed that they are investing less due to the pandemic. Amid this critical condition, the ECB adopted an expansionary monetary policy to keep interest rates at a low level to support borrowing. Hence, it issued the Emergency Purchase Program in Mach 2020, which consists of buying asset from both public and private sectors to provide liquidity and support the financial condition of all sectors of the Eurozone. As a result, yields on the 10-year German bond remained steady throughout most of 2020, including the fourth quarter. However, the spreads in European periphery countries such as Spain and Portugal have tightened significantly. The yield on Portugal's 10-year government bonds went negative for the first time in December, while Spain's has fallen to near zero. This shows that the monetization of the EU economy has been effective.

BCCE1T: Bloomberg Barclays EU Govt All Bonds 2020



China's Bond Market in 2020

The second largest economy in the world fared well in 2020, despite the deadly pandemic that started in Wuhan city at the end of 2019. The Chinese economy bounced back in the last quarter of 2020 and recorded an increase of 6.5% in GDP. Overall, the Chinese economy expanded by 2.3% in 2020. As a result, the yield on 10Y bonds witnessed an increase from 2.4% to 3%, returning to its pre-Covid 19 level. The increase of yields is due to the quick rebound in Chinese markets, as investors became more bullish towards riskier assets. However, the fiscal deficit in China, which has risen by 5%, obligated the government to issue new bonds to finance the gap, increasing supply of bonds and their yields.



Lebanon's Crisis

Lebanon is facing an unparalleled financial crisis that threatens its economic livelihood. In fact, the crisis results from the accumulation of bad economic decisions during the past years. In details, the Lebanese economy was known for its robust banking sector. However, the downturn began in October 2019, when Lebanon witnessed a massive protest against the Lebanese government. Since that date, Lebanon faced several unfortunate events, starting with the worldwide pandemic Covid-19, and ending by the blast at the port of Beirut on the 4th of August 2020.

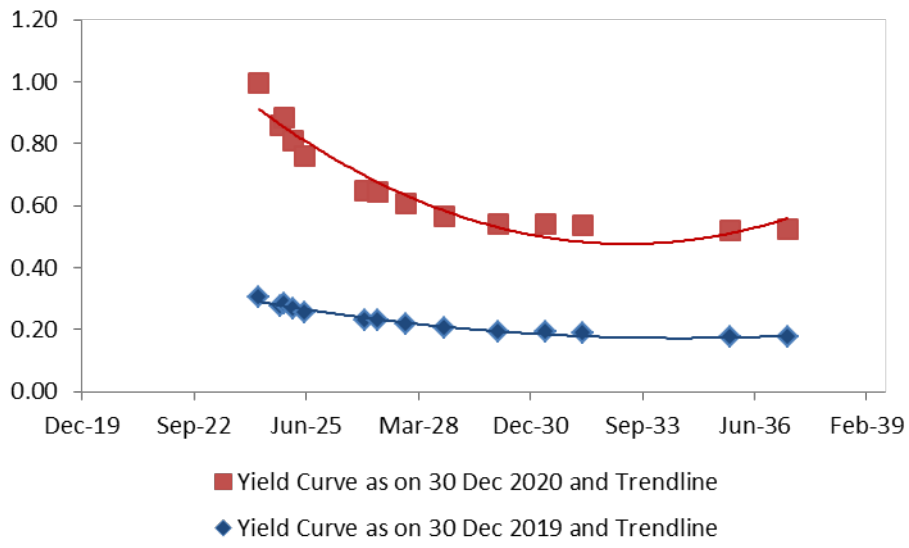
Lebanon Defaults for the First Time in its History

On March 9, 2020 Prime Minster Hassan Diab declared that Lebanon will not pay its debt, by stating: "How can we pay creditors abroad when Lebanese cannot get their money from their bank accounts?" PM Diab added: "Our debt has become greater than Lebanon can bear, and greater than the ability of the Lebanese to meet interest payments".

The Blom Bond Index Performance (BBI) in 2020

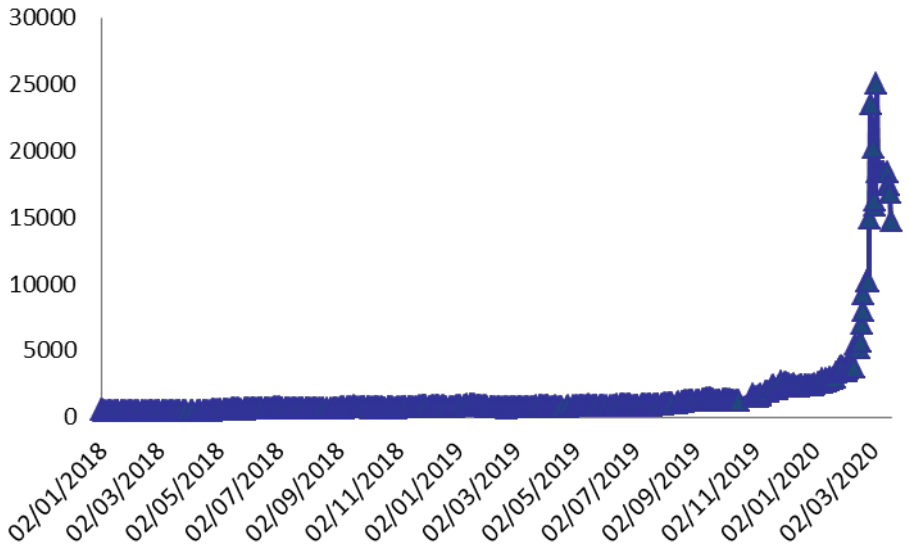
The Lebanese fixed income market witnessed a further deterioration in 2020. The default on Eurobonds that took place on March 2020 had a negative impact on the Lebanese bond market. However, the decline of this index was notable since 2018, as many investors anticipated that Lebanon is heading to an economic disaster due to political instability, and poor economic plans. For instance, the BBI was 88.06 in the end of 2018, and fell to 14.96 in the end of 2020.

Lebanon Yield Curve 2019-2020



The yield curve in 2020 has transformed from a flat curve in 2019 yield to an inverted one in 2020 due to the deep recession in Lebanon. In fact, an inverted yield curve is when the yields on bonds with a shorter duration are higher than the yields on bonds that have a longer duration. The uncertainty about the future made the long maturities unpopular. As a matter of fact, the weighted yield index increased from 30.07% in the end of 2019 to 82.86% in the end of 2020.

Credit Default Swap (basis points)



CDS Performance and Foreign Investors' Concerns amid the Financial Crisis

The CDS is an indicator of foreign investor's perception of Lebanon's default risk. The performance of CDS was quite low in 2018, due to some stability, especially in the banking sector. However, investors' concern began to rise starting October 2019, amid the massive protests against the Lebanese government. The economic and political turbulence that began in October 2019 has encouraged foreign investors to bet against the Lebanese market sending CDS to the roof. Unfortunately, investors' projections were correct, and Lebanon defaulted for the first time in its history in March 2020.

Lebanon's Sovereign Rating

The credit rating is used by funds, and measures the credit worthiness of Lebanon. S&P, Moody's and Fitch downgraded their ratings of Lebanon, from "highly speculative" to "in default", amid all those unfortunate events.

Lebanon's Credit Ratings in 2019 and 2020

Agency	2019	2020
S&P	CCC	D
Moody's	Caa2	C
Fitch	CC	RD

Negotiations with the IMF

Lebanon defaulted in March 2020 and the Lebanese government declared that it would stop paying all commercial foreign currency debt obligations worth $32.2B. This obliged Lebanon to negotiate with its creditors through the IMF. The aim of this negotiation is to achieve restructuring deal with creditors. Doing so, combined with applying the reforms requested, will allow Lebanon to unlock the international financial aid that it much needed. However, the negotiations with the IMF stalled due to the resignation of P.M. Hassan Diab's government after the deadly blast in port of Beirut on the 4th of August 2020. Since that date Lebanon has failed to form a new government.

Lebanon Outlook for 2021

Forming a new government, applying the reforms needed, and achieving an agreement with the IMF are the three main conditions to stop the economic collapse in 2021. However, a new economic vision is needed in order to reaccelerate growth in the Lebanese economy and build a sustainable one. Relying only on fixed income to finance the government deficit and expenses is not the best solution to achieve economic stability. Unfortunately, Lebanon is considered right now as a "failed" state that defaulted on its debt. Several steps must be taken by the government to correct the economic path of the country, such as:

1- Achieving restructuring deals with creditors in order to regain the trust between Lebanon and the international market

2- Fighting tax evasions and improving tax collections should be an essential source for the government in order to shrink its fiscal deficit. As a result, the government will be relying less on deficit financing to cover its expenses.

3- Executing the necessary reforms in order to unlock the international financial aid.

4- Increasing the competitiveness of the economy by improving the investment climate and the productivity of the tradable goods sector.

5- Maintaining political stability is essential in order to attract foreign investment; the government must make sure to reinforce security and political stability.

Lebanon was known for its robust financial sector in the past years. Even during the civil war, Lebanon has maintained some sort of financial stability. However, new economic vision is in dire need right now in order to rebuild our economy.

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