Preliminary Estimates of the USD Cash Holdings by Lebanese Households: Q3 2019 to Q3 2021

BLOMINVEST BANK

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Dr. Ali Bolbol

Head of Research Department,
BLOMINVEST

Contact Information

Dr. Ali Bolbol

ali.bolbol@blominvestbank.com

Towards the end of year 2020, Governor Salameh mentioned in an interview that "Lebanese households hoard $10 billion in cash"[1]. That Lebanese households should hoard dollars in a crisis that is considered one of the worst three crises that the world has seen since the middle of the 19th century is not really surprising; what is surprising, however, is the extent of the hoard, equal to close to one fifth of the country's GDP before the crisis, as declared by the Governor. Also surprising is that hardly any rigorous attempts were undertaken to estimate the actual USD hoardings by Lebanese households.

What we would like to do in this short note is to provide a preliminary estimate of these USD hoardings. We are going to adopt a two-steps methodology towards that end: first, calculate USD deposit withdrawals and then estimate how much of these withdrawals were kept in the country; second, estimate the excess LBP currency holdings and then calculate their conversions to USD cash holdings at the parallel or free-market exchange rate.

[1] *The Daily Star*, 10/11/2020.

In details, the Lebanese financial crisis erupted in *October 2019*, the result of which that Lebanese banks were obliged to impose informal but porous capital controls; *they also had to limit USD withdrawals and stopped these withdrawals altogether in April 2020* when Circular 151 was issued (more about this later). As a result, between October 2019 and April 2020, *$7.1 billion were withdrawn from Lebanese banks* that literally turned banks' branches solely into cash machines! Of course, with informal capital controls – that were not legally binding, especially to politically connected persons – some of these deposits had to leave the country, but by how much?

To answer the above question, we have to arrive at a reasonable estimate of capital outflows, which in turn requires we understand the mechanics of the balance of payments (BOP). The equation below does that:

$$(1) \qquad TB + IT + IN + KA + \Delta FR = 0 \quad \text{or} \quad TB + IT + IN + KA = -\Delta FR$$

In equation (1), TB is the trade balance; IN is income and IT is transfers from abroad such that TB + IT + IN is equal to the current account CA; KA is the capital and financial account; and ΔFR is the change in foreign reserves. For the BOP to be in balance, the items in equation (1) should add to zero. This means, alternatively, that if TB + IT + IN + KA are negative or in deficit, then the BOP is in deficit and for it to balance ΔFR has to decline by the same and equal amount.

If we restrict our computations to the period from October 2019 to April 2020, then it is reasonable to assume that TB would be mostly represented by TB in *goods*, IT would be represented by *remittances*, and IN would be given mostly by interest and principal payments to foreign holders of Lebanese Eurobonds *before Default in March 2020*[2]. During that period, TB was in deficit at $6 billion, IT was positive at $4.3 billion, and IN was negative at about $0.4 billion[3]; and ΔFR was of course negative at $4.1 billion. This leaves KA at a negative $2 billion, *implying net capital outflows of $2 billion*[4].

It is also not unreasonable to assume that all of these outflows were siphoned away from bank deposit withdrawals, as other financial markets (stocks and bonds) went into a seizure, especially during the first phase of the crisis. What this means is that what is left in cash hoardings with Lebanese households were close to **$5.1 billion accumulated during that period (equal to $7.1 billion minus $2 billion).** This represented more than 70% of deposit withdrawals and of course was a big drain on banks' liquidity in foreign currency.

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[2] Trade is services in Lebanon is dominated by tourism, which had been largely absent during that period, or at least up to April 2020.

[3] The IT figure is calculated based on remittances that equaled $7.4 billion in 2019; and the IN figure is based on Lebanese Eurobonds' debt service payments of $1.5 billion in November 2019, close to 28% of which went to foreign holders of the Eurobond (equal to the ratio of foreigners' holdings of Eurobonds at the time).

[4] These outflows match Makram Sader's estimates published in *Annahar* , 4/9/2020.

But that is not all. Starting in October 2019, if not earlier, the Lebanese economy experienced major infusions of LBP liquidity. These were driven by three factors: LBP deposits withdrawals, which saw these withdrawals reach LBP 29.7 trillion between Q3 2019 and Q3 2021; BDL's Circular 151 of April 2020 which allowed depositors to withdraw limited amounts of their USD deposits at an exchange rate of 3900 LBP to the USD; and Circular 158 of June 2021 which allowed depositors to withdraw $400 in cash and another $400 credited to a LBP account at an exchange rate of 12000 (though this Circular has had minimal effect so far because of the short duration and the limited takers). The resulting liquidity of currency in circulation (CC) and as a ratio of GDP is recorded below:

Trillion LBP	**Q3 2019**	**Q3 2020**	**Q3 2021**
CC*	6.5	23.7	41.7
GDP**	60.6	94.9	160.9
CC/GDP %	10.7	23.8	25.9

*CC figures are from BDL bi-monthly balance sheet

**GDP 2019 figures are from CAS; GDP 2020 figures were calculated using World Bank data of GDP deflator rate of 90% and real growth rate of -25%; and similarly for GDP 2021, using figures of 70% and -9% respectively.

As we can see, CC increased by more than 6 times during the above period, and the ratio of CC to GDP (CC ratio) increased from 10.7% to a hefty 25.9%. Also, actual CC averaged LBP 15.1 trillion between Q3 2019 and Q3 2020 and LBP 32.7 trillion between Q3 2020 and Q3 2012. In other words, Lebanese households were left with excess liquidity, and a huge one too!. How huge? In answering this question, it is congenial to note that the CC ratio *averaged 6.6% in 2017-2018, two "normal" years before the crisis. If we regard this ratio as the desired ratio, then we can use it to calculate the desired average CC that corresponds to the average GDP of each period*, and then compare it with *actual average CC*, as in the table below:

Average CC in Trillion LBP	Q3 2019-Q3 2020	Q3 2020-Q3 2021
Actual	15.1	32.7
Desired	5.3	8.6
Difference	9.8	24.1
Average Market Exchange Rate in LBP	4420	12420
Converted Excess in Billion USD	2.2	1.9

We can see that between Q3 2019 and Q3 2020, Lebanese households had excess liquidity that averaged LBP 9.8 trillion, which in all likelihood was converted to USDs as the most reliable alternative asset to LBPs at the average market exchange rate of 4420 and yielded **$2.2 billion in USD cash holdings**. Similarly, between Q3 2020 and Q3 2021, the excess reached LBP 24.1 trillion, and when converted at the average exchange rate of 12420 yielded **$1.9 billion in USD cash holdings**. As a result, when we add the $5.1 billion accumulated from *net USD deposit withdrawals* to these two USD cash conversions, we **arrive at a total of USD cash hoardings of $9.2 billion by Lebanese households.**

A relevant question at this stage is, what about remittances? Don't remittances add to USD cash hoardings? This is possible but there are two arguments that can work against it: first, why would expatriates send money to their families if the latter are going to hoard it at zero interest when the expatriates can keep it in their country of residence and earn positive interest on it? Second, remittances, as the country's perennial "safety valve" especially in these dire times, are usually destined to cover for needed living expenses and are ultimately exchanged and spent[5]; in fact, it is remittances and to a lesser extent export earnings which constitute the source for most of the foreign exchange that is traded in the parallel exchange market. However, it is possible that the proceeds from remittances that are used for investment purposes like real estate are hoarded -- if not transferred abroad; which in that case our estimate of $9.2 billion in cash hoardings by Lebanese households becomes a *lower bound or a reasonable minimum.*

[5] However, it is sometimes argued that remittances are Lebanon's economic "Achilles' Heels" as they act as a disincentive to work and they create a dependency on external sources. But in the context of the current crisis they surely have been a life boat to the economy.

Another interesting question is that, are these USD cash hoardings considered large? The answer is, relatively speaking, yes. At the end of Q3 2021, the United States' stock of currency in circulation stood at $2.2 trillion, which implies that Lebanese households' USD hoardings of $9.2 billion were 0.41% the US's currency in circulation. But given that Lebanon's population is only 0.055% of the world's population, then its *hoardings of the USD stock in circulation is 7.5 times its share in world population*. Moreover, with Lebanese population estimated at 4.4 million[6], the Lebanese per-capita USD hoarding is close to *$2100, which is more than two thirds the estimated current per capita income of around $3000 (*at the average market exchange rate*).* So yes, the Lebanese love their USDs and they love them close!

More important, what is the significance of these USD hoardings? We can suggest in reply three significant implications, *all positive*. First, notwithstanding the likely skewed or unequal distribution of these hoardings, the fact that on a per capita basis they reached $2100 means that the measure of poverty among Lebanese households of 77% is perhaps overdone[7]. That is not to say that Lebanon has not gotten poorer – it surely has – but the extent of poverty luckily might not be that extremely widespread, and talk about the obliteration of the middle class could be a bit pre-mature. Second, the loss of BDL's foreign reserves during the Q3 2019 to Q3 2021 period was unfortunate at $19.8 billion – especially if we consider the waste from prolonged subsidies and the smuggling of subsidized goods – but parallel to that we saw that households were to able accumulate about half of those, if not more, in USD hoardings. This should reflect positively on the future availability of resources to close the external financing gap and on the future path of the exchange rate. Third, it should also bode well for helping to restore the health of the banking sector. Lebanese banks have been going through a crisis of confidence in the past two years but ultimately this will have to pass as the country can't survive without a viable banking sector and there is no alternative to it. And once the country has gotten back on its feet, confidence in the banking sector will be reinforced by channeling these hoardings back to the banking sector and they could be the harbinger for deposits growth in the future.

Lastly, our estimate is not far off from Governor Salameh's figure of $10 billion – though his figure was for late 2020, so by now it should have grown larger. But the fact that our estimate is close to his, and can be considered at end Q3 2021 as a lower bound estimate, then this proximity gives it perhaps a "quasi-official" seal. And that is good enough for a preliminary calculation, as the title of this note aptly indicates.

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[6] The population living in Lebanon is estimated at about 6 million though, with around 1.6 million as mostly Syrian and Palestinian refugees. It is also estimated that Lebanese expatriates are close to 1.6 million too (*Information International, 2020)*.

[7] ESCWA, "*Multidimensional Poverty Index for Lebanon 2019-2020*", September 2021.

For your Queries:

BLOMINVEST BANK s.a.l.

Research Department

Bab Idriss, Weygand Str.

POBOX 11-1540 Riad El Soloh

Beirut 1107 2080 Lebanon

Research Department

Tel: +961 1 991 784

research@blominvestbank.com