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

The year 2021 was supposed to be a recovery year for the international markets. In fact, international markets have taken a break, as most of the countries have eased pandemic restrictions, to the benefit of economic recovery. However, the biggest challenge was the high inflation rate that threatened economic growth. The Fed and the ECB were having a tough time by choosing the most effective monetary policy that can be applied in the year 2021. On the one hand, they wanted to increase consumption by lowering interest rate to accelerate the economy, and on the other hand, they wanted to control the high inflation rate that was caused by shortages due to supply chain bottlenecks, and an aggressive monetary policy adopted during the pandemic.

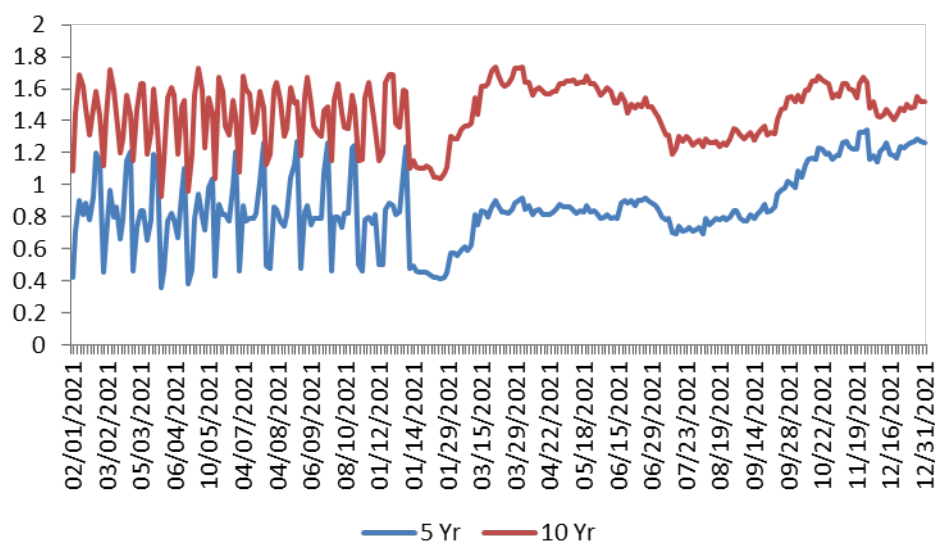
Lebanese hardship has continued in the year 2021, as no agreement has been reached with the IMF, while the government has not been productive, due to political tensions between the parties in the cabinet. Of course, the Lebanese Fixed income market is now fragile, specifically after the unprecedented default on Eurobonds on March 2020, noting that an agreement with the IMF and creditors will surely help to clarify the bonds market in Lebanon.

Tough year for the US bonds Market

Two essential factors have influenced the US bonds market in 2021. The first factor was the pandemic and the second one was the inflation rate. The Fed wanted to accelerate the economy by keeping interest rate low; however inflation reached almost a four-decade high near 7% in 2021 which has forced the Fed to reconsider its monthly bonds purchase. In details, the Fed plan was to apply a tighter monetary policy by the end of 2021. And as planned, with the decrease of Covid cases at the beginning of 2021, the first quarter of 2021 witnessed a surge in the yields; however, it plunged in the summer due to increase in Covid cases due to the Omicron variant.

For the year 2022, we expect that the yields will likely be higher for all maturities as the Fed will try to stop the increase in the inflation rate, without sabotaging economy growth. We expect a tight monetary policy but not an aggressive one.

US Five and Ten years Treasury yields



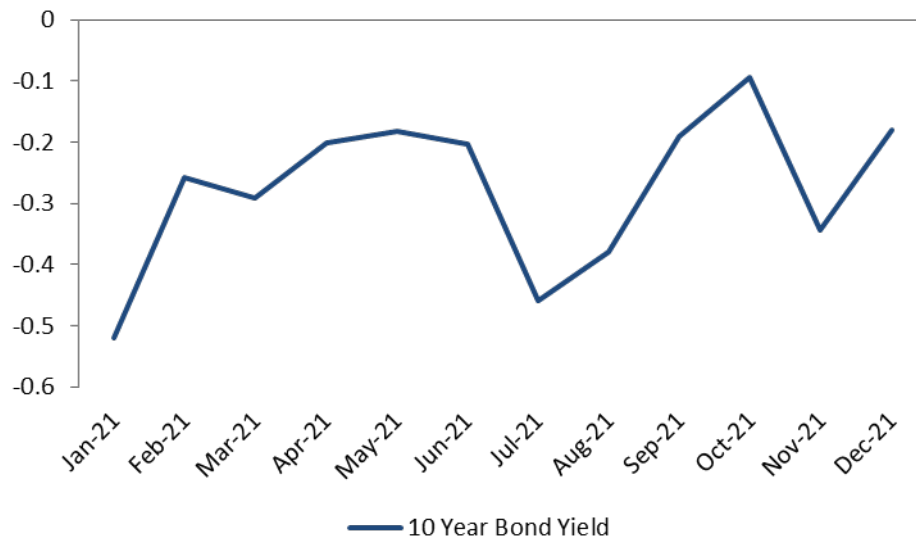
Europe Bonds Market

European countries had high hopes for the year 2021, amid the decrease of Covid cases. However, the increase in energy prices and the constraint on the supply side have slowed the global recovery. At the beginning of 2021, market had some positive sentiment with a remarkable increase of vaccinated people across Europe. However, in the second quarter of the year the Omicron variant has slowed the global recovery leaving ECB uncertain about the right monetary policy to adopt. Adding to that, high inflation rate was putting more pressure on the ECB to adopt a tighter monetary policy. Below, we will focus on Germany and the UK.

Germany

The German economy has somehow recovered in 2021, as its GDP has expanded by 2.7%. However, Germany has suffered also from the shortage of supply chain, which increased the inflation rate to a high level. As a result, yields on 10-year German bond remained negative and closed at -0.17% at the end of the year. It's important to mention that ECB will continue with the Emergency Purchase Prom until March 2022.

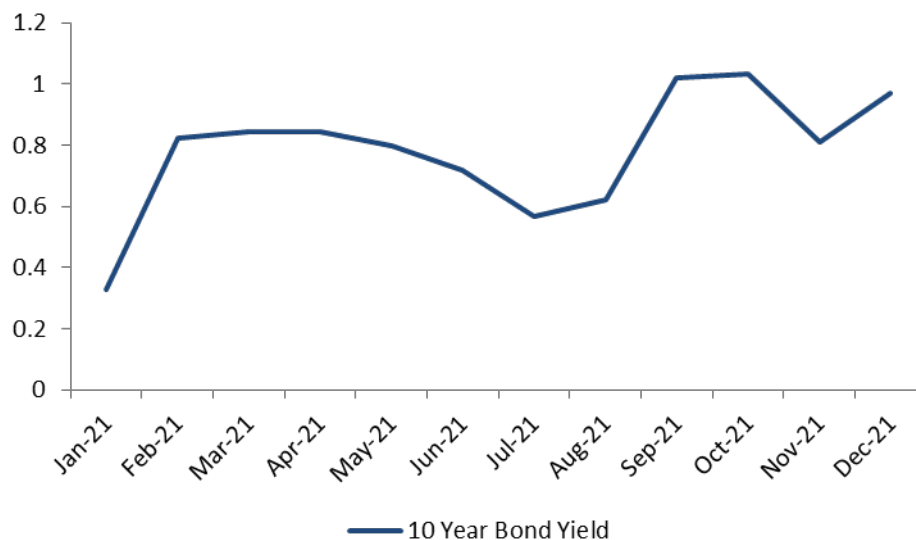
10-Year German bonds



UK

Despite the new variant that increased Covid-cases at the beginning of the year, the UK economy has grown 7.5% in 2021. Like all the European countries the UK has suffered from high inflation rates for the same reasons mentioned above, as inflation rate soared to a 30-year high in December. The yields on 10-year UK bonds remained less than 1% in 2021; however the Bank of England will definitely increase interest rates in 2022 in order to ease inflation.

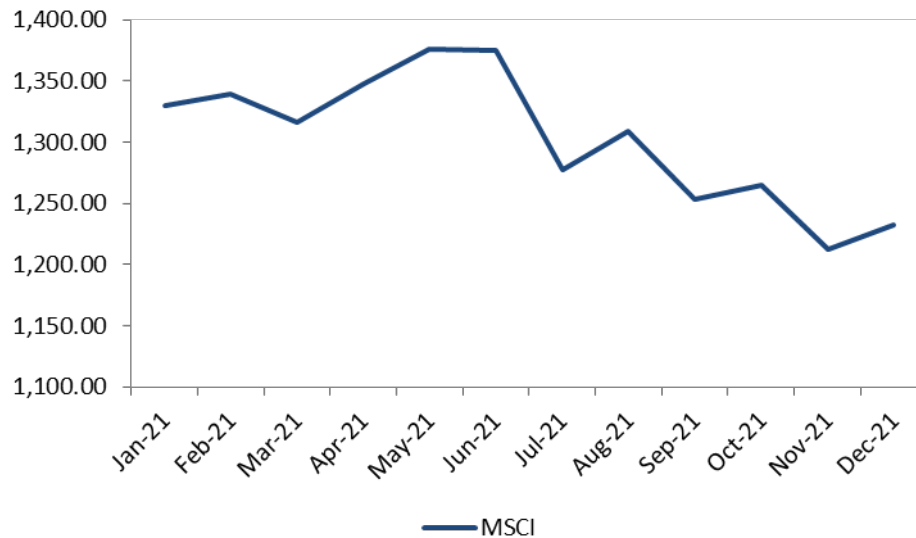
Yields on 10-year UK bonds



Emerging Markets

While many emerging market economies – with the possible exception of China -- are affected by US monetary policies, their bond markets did show some insulation in 2021. Though the MSCI Emerging Markets (EM) Index was down 5% in 2021, some bonds for EM had actually fared much better in 2021. Emerging-market bonds were supposed to be dragged down this year as central banks moved toward withdrawing stimulus. Instead, the best-performing global debt was all from developing nations. Sovereign bonds issued by South Africa, China, Indonesia, India and Croatia topped the rankings of 46 markets around the world in 2021. They alone managed to shrug off the biggest annual jump in U.S. Treasury yields since 2013, a shock that was powerful enough to upend also emerging-market stocks.³

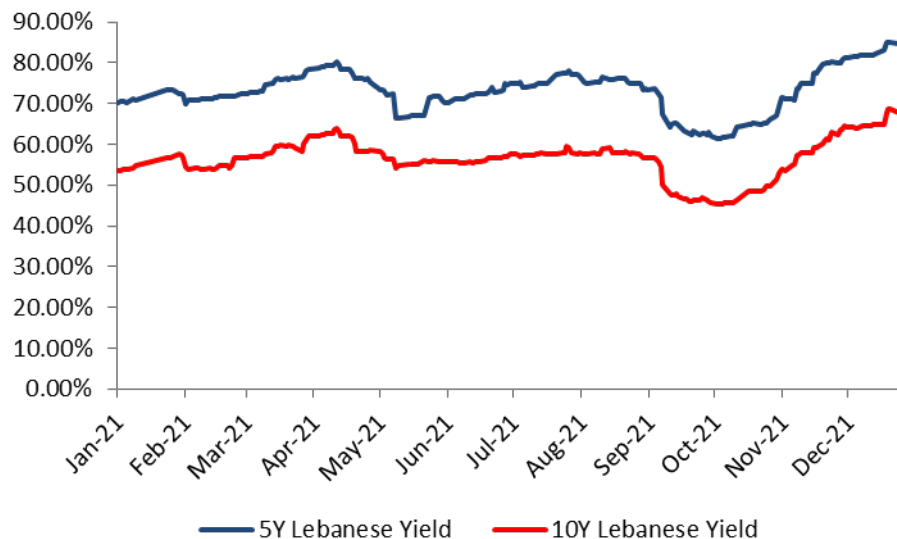
Morgan Stanley Emerging Market Bond Index



Lebanon

In analyzing the Lebanese bond market we must bear in mind the central bank has a minimal power to influence this market. Unlike many central banks around the world, who can change interest rates and adopt a monetary policy that can control spending and decrease inflation rate. In fact, Lebanon inflation rate has soared to more than 200% in 2021 due the continuous devaluation of the national currency, and the increase in energy prices around the world. We can say that BDL has lost its privilege to make any significant difference in the money market.

Lebanon yield curve 2020-2021

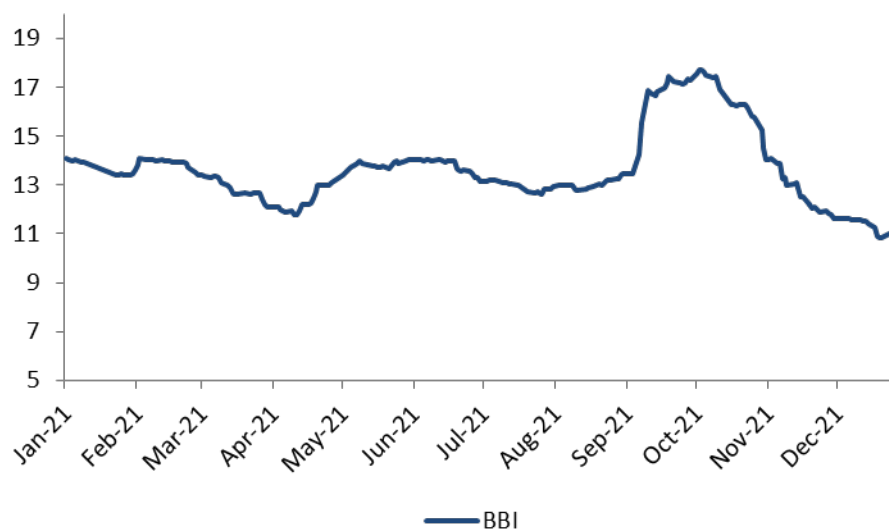


We can clearly see the dramatic increase in yields of 5 and 10 year Lebanese bonds. In 2017 and 2018, Lebanon had some sort of bond market stability as the bond yield was still reasonable around 5% and the BDL had the privilege to interfere in the market and steer a monetary policy that is convenient for the economy, to a large extent. However, it all changed when the Lebanese government has decided to not pay its debt on March 2020. The BDL has lost its control over monetary policy almost entirely, and now only foreign reserves are being used by BDL to stop further depreciations of the national currency.

Blom Bond Index Performance (BBI) in 2021

Given the turbulence in the FX market, and the lack of corrective measures including a deal with the IMF and foreign creditors, the bonds market continued to suffer from lack of confidence. As a result, the BBI stood at 88.06 in the end of 2019, but fell to 10.96 in the end of 2021. It specifically fell in 2021 by 22.64%.

Blom Bond Index 2021



Conclusion

The government should speed up the negotiations with the IMF in order to reach an agreement with them, and foreign creditors, as this step can increase credibility and prepare the ground for potential foreign investments. The Lebanese fixed income market must regain its usefulness as an instrument through which BDL's monetary policy can be implemented, as this will no doubt help economic recovery and maintain monetary stability.

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