Lebanese Banking Sector in 2021

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The banking sector continued its retrenchment in 2021. It was a year where the economic and financial crisis continued un-abated with no corrective measures whatsoever to arrest the decline, especially a reform program with the IMF. Below, we will discuss the banking sector's balance sheet, net foreign assets, regulation, and the main issues that the sector faced in 2021.

Balance Sheet:

As the table below shows, assets stood at $174.9 billion, less by 7% from 2020. Similarly, deposits fell to $129.8 billion, lower by 4%, with the dollarization rate mostly stable at 79%. Loans declined the most, falling by 24% to $27.5 billion, while the dollarization rate fell by 3% to 56%; as to shareholders' equity, it fell by 11% to $17.7 billion. Note that all these figures are converted at the official rate of 1,507 LBP per USD, a t a time during the period the parallel market rate increased from 8,300 LBP to 27,600 LBP per USD.

USD Billion (per 1,507 LBP)	December 2020	December 2021
Assets	188.1	174.9
Deposits:	139.2	129.8
Dollarization Rate (%)	80%	79%
Loans:	35.9	27.5
Dollarization Rate (%)	59%	56%
Shareholders' Equity	19.9	17.7
(EOP Parallel Exchange Rate in LBP)	8,300	27,600

Also, and to be expected, the retrenchment involved as well shrinkage in the physical spread of the banks and in their staff, but no so much in the number of banks. For the number of branches fell from 1,058 branches to 919 branches, the number of employees fell from around 25,000 to 20,000, but the number of banks fell from 63 to 61 banks.

Net Foreign Assets:

An analysis of the net foreign asset (NFA) position of the banking sector expressed in USD is highly useful, given the dearth but increasing significance of the USD in the banking sector and the economy as a whole.

Assets	USD Billion
Deposits at BDL	87
Loans (Resident)	13.9
Eurobonds	6.9
Claims on NR Financial Sector	4.6
Other	4.7
Total	117.1

Liabilities	USD Billion
Customers’ Deposits	102.8
NR Financial Sector Liabilities	4.9
Capital Account	9
NR Debt Securities	0.2
Total	116.9

Hence, as can be seen from the table above for end December 2021, NFAs were positive at $0.2 billion, signifying mostly no foreign currency exposure of Lebanese banks. As important, notice that banks’ deposits at BDL were a hefty $87 billion; in other words, more than 85% the size of customers’ bank deposits, which stood at $102.8 billion. Also interesting is that almost half of banks’ capital was in USD at about $9 billion; and that banks’ holdings of Eurobonds were only $6.2 billion. In addition, financial claims on non-residents (NR) were only $0.3 billion in net liabilities.

Regulation:

First thing to note, is the policy failure of not enacting a capital control law since the beginning of the crisis. As a result, banks had to resort to informal but porous capital controls, especially in relation to international transfers

On the other hand, banks were subjected to various regulatory measures in 2020-2021. In chronological order, the main circulars by BDL addressed to banks were:

- Circular 151 issued on 21/4/2020: allows limited USD deposit monthly withdrawals at exchange rate 3,900 LBP; the Circular was updated by Intermediate Circular 601 on 9/12/2021 to increase the rate to 8,000 LBP.
- Basic Decision 13236 issued on 10/6/2020; establishes the Sayrafa exchange rate platform.
- Circular 154 issued on 27/8/2020: requires banks to hold 3% of their USD deposits in foreign liquidity; and requires banks to increase their capital by 20%.
- Circular 158 issued on 8/6/2021: allows 800 USD in monthly withdrawals, 400 paid in cash and 400 in LPB at exchange rate 12,000 LBP
- Circular 161 issued on 16/12/2021: allows banks to exchange limited amounts of LBP to USD provided by BDL at the Sayrafa exchange rate; on 11/1/2022 the Circular was amended to involve unlimited LBP for exchange.
- In terms of provisions, BDL mainly requested banks to take 1.89% on their deposits with it and 45% on their Eurobonds holdings. Generally, banks complied by BDL standards, and suspended complying by international standards because of the severity of the crisis.

The Circulars, especially 151 and 158, led to higher LBP liquidity (increasing from 10 to 46 trillion LBP over the 2020-2021 period) but eased somewhat people’s needs, as they were designed to “replace” subsidies on basic goods. As such, Circular 161 was introduced not only to help absorb some of the injected LBP liquidity but to push down the parallel market rate.

Issues:

Three issues are worth addressing when it comes to Lebanese banks’ relation to the financial and economic crisis:

1) It was not bad bank management that was responsible for the crisis. Most Lebanese banks were well-managed; otherwise they could not have succeeded abroad in tough and competitive markets. Of course, not all banks were solid – like in any other country – but overall the sector was OK. Alternatively, it can be strongly argued that he main reasons behind the crisis are unsustainable fiscal (high deficits and debt) and monetary (fixed exchange rate regime) policies, poor public governance (corruption and nepotism), and political instability (internal and regional conflicts). What is worse is that after more than two years of a worsening crisis, not a single corrective measure has been taken by the government.

2) Banks’ large investments in the sovereign, especially in BDL, were mostly an outcome of regulation, not done entirely voluntarily, so banks should not be held responsible for their depletion. However, banks should be held responsible for the losses incurred on voluntary investments, primarily private sector loans and public debt (TBs and Eurobonds).

3) While it is true that the country has a large number of banks, the size of the banking sector at more than 300% of GDP is not unique. Countries like Singapore and Switzerland have similar ratios – the difference is that they have good and responsible governments. But it is natural to expect that the number of banks will be reduced voluntarily and through attrition, as the economy gets smaller (GDP was estimated at $20 billion in 2021 compared to $56 billion in 2018) and the cost of running the business is increased, given the lower interest margins from the halt in investments in government bonds and BDL placements and given the higher cost of compliance and risk management.

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