BDL's Changes in Foreign Reserves and Currency in Circulation: A Numerical Relationship

BLOMINVEST BANK

April 12, 2023

Contact Information

Dr. Ali Bolbol

ali.bolbol@blominvestbank.com

Trillion (T) LBP	**28/2/2023**	**31/3/2023**
Assets:		
Foreign Assets1	221.03	216.13
Securities Portfolio	68.01	67.82
Loans to Financial Inst.	17.13	16.70
Liabilities:		
Currency in Circulation	83.28	64.91
Financial Inst. Deposits	1,345.73	1,349.19

Source: BDL; 1. Valued at the official rate of 15,000 LBP per USD

It is pretty standard in monetary economics that changes in the monetary base MB, which is equal to the sum of currency in circulation CC and banks' reserves R (or financial sector deposits at the central bank), arise mainly from interventions in the FX market, monetization of public deficits, and loans to financial institutions through the discount window1. In the context of Lebanon, as the above table shows for BDL's balance sheet for the month of March 2023, this would imply:

Change in MB = Change in foreign assets + Change in securities portfolio + Change in loans to financial institutions

In other words, the MB will increase when: BDL buys FX in the market to shore up its foreign assets FA, increases its TBs portfolio to fund public deficits, and extends loans to elevate liquidity at banks mostly. But it is clear from the table that the two main items that witnessed notable and significant changes in March 2023 are CC on the liabilities side and FA on the assets side, specifically CC falling by 18.37 T LBP but FA falling by 4.90 T LBP only. How do we account for these changes and what are the factors behind them?
To start off, let us convert the changes in FA at 4.90 T LBP to USD, and this would lead to changes in FA equal to 326 Million (M) USD. But the thing is these changes in FA are

[1] Theoretically, these are the most important variables. But in practical terms, other variables could impact the relationship. However, in the context of Lebanon, the variables listed in the table would suffice.

governed by two essential processes: the first is BDL buying FX from the market, and the second is BDL selling FX through Sayrafa. The latter is a platform that BDL has established to slow down (sometimes even reverse!) the depreciation in the LBP against the USD and to absorb any excess LBP liquidity. As such, for the month of March 2023, we have the following:

Amount of FX sold – Amount of FX bought = 326 M USD
Amount of FX sold + Amount of FX bought = 1,099 M USD

The 326 M USD is simply the reduction in FA obtained earlier; and the 1,099 M LBP is sum of all (Sayrafa) FX transactions undertaken by BDL. If we solve the two relationships above, we get:

Amount of FX sold = 712 M USD
Amount of FX bought = 387 M USD

Moreover, and as important, the amount of FX sold is done at the Sayrafa rate which averaged 79,400 LBP in March 2023; this implies that 712 x 79,400 = 56.53 T LBP was absorbed from the market through the sale. On the other hand, the amount of FX bought is transacted at the market rate which averaged 99,000 LBP during the same month; accordingly, this implies that 326 x 99,000 = 38.31 T LBP was injected to the market through the purchase. Thus there is net absorption of LBP liquidity or CC equal to: 56.51 – 38.31 = 18.2 TLBP. And it is almost exactly equal to the reduction in CC reported in the table at 18.37 T LBP2.

Lastly, we would like to end the spotlight by a note on the transaction of public wages at rates below the Sayrafa rate. To wit, public sector wages were adjusted late last year by a multiple of three: previously, they amounted to around 833.33 Billion LBP per month, but now they have risen to 2.49 T LBP per month. And in order to provide additional support to public employees, they were given the advantage to transact their LBP wages to USD at the rate of 45,400 in March 2023, below the average Sayrafa rate of 79,400. As a result, the total wage bill expended was a monthly 55 M USD – close to 5% of the 1,099 M USD in FX transacted in March 2023[3].

It is interesting that, not only public employees have gotten 3-times their previous pay and more than 2-times the exchange rate advantage (45,400 vs an average market rate of 99,000), they have nevertheless been mostly on strike in the past few months![4]

2 In addition, the very negligible difference in the reduction of CC reported is due to the very small reductions in BDL's securities portfolio and loans to financial institutions, plus any rounding errors.

3 If we add the 840 B LBP that are presumably given for transport and "productivity incentives", then the monthly wage bill will rise to close to 74 M USD.

4 And that is in addition to the fact that they are notoriously superfluous and inefficient, as a considerable part of them are political-patronage appointees.

We have previously shown that the Sayrafa platform does slow down Lebanese exchange rate depreciations[5]; we have now shown in this spotlight that it does reduce LBP liquidity also. But its blessings do not come unalloyed, since it could be subject to abuse or misuse.

For your Queries:

BLOMINVEST BANK s.a.l.

Research Department

Bab Idriss, Weygand Str.

POBOX 11-1540 Riad El Soloh

Beirut 1107 2080 Lebanon

Dr. Ali Bolbol

ali.bolbol@blominvestbank.com

Research Department

Tel: +961 1 991 784

research@blominvestbank.com

5 See "Lebanese Sayrafa Volume and Market Exchange Rate: An Empirical Note", Blominvest Blog, Economic Digest, March 1, 2023.