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Million USD	End September 2023	End September 2024	End October 2024
BDL Liquid Foreign Exchange Reserves	8,414	10,698*	10,263
Public USD Deposits at BDL	351	591*	--

Source: BDL

* Our Estimate

Lately, there seems to be a serious discussion, if not outright pressure, that BDL should use its foreign exchange (FX) reserves, even liquidate its Gold holdings, to pay for the living expenses of the internal refugees that were displaced as a result of the current war between Hezbollah and Israel. Of course, from a humanitarian perspective, this is perhaps a fair request. But from a legal and institutional perspective, this is a no-starter: BDL's mandate is to ensure monetary and exchange rate stability, not to act as a treasury or cash register for the Government. Technically, also, in the context of the Lebanese crisis, BDL FX reserves belong to depositors, so even from a fairness point of view, spending them on the refugees comes at the expense of depositors' rightful claims on these reserves.

What about the economic perspective? Are there valid grounds to support such a request? To start with, when it comes to FX reserves which are the crux of the matter, there are two motives behind holding them by central banks: a *transactions motive* to cover payments imbalances that presumably grow with international transactions; and a *precautionary motive* to smooth unpredictable imbalances in international payments. The precautionary motive is of course the more critical, as it aims at avoiding upheavals in the FX market. As important, what would constitute *adequate and/or optimal FX reserves that would satisfy these two motives*? The economic literature identifies three ratios that can ensure reserve adequacy: first, a ratio covering 3-4 months of imports to support the country' s current level of imports; second, a ratio covering 100% of short-term debt obligations to avoid roll-over problems; and third, a ratio covering 10% of broad money[1] to forestall any excess demand for FX from local money.

In the case of Lebanon, the second ratio doesn' t apply, of course, because the country is in default. However, there are three factors that make the said reserve adequacy ratios (first and third) *undervalued*: first, Lebanon is a small open economy with a *high propensity to import*; second, BDL is trying to stabilize the exchange rate at 89,500 LBP per USD so *pursuing and maintaining this parity requires more FX reserves at its disposal*; and third, Lebanon is shut off form international capital markets (because of default) *so it has no access whatsoever to private capital flows that can buttress its FX reserves.*

[1] Broad money is M2, composed of currency in circulation and deposits in LBP.

As a result, sound economic reasoning would imply that the said ratios should be at *least doubled to preserve reserve adequacy*. This would make the import cover ratio at 7 months and the broad money (M2) cover ratio at 20%. In this respect, latest imports figures for 2023 put goods imports at 17,524 million USD, so the imports cover would require 10,222 million USD of FX reserves; as to M2, it stood at 1,180 million USD at end October 2024 so its cover requires 236 million USD of FX reserves[2]; as such, adequate FX reserves from these two ratios would add to 10,458 million USD. However, as the above table shows, at end October 2024, actual FX (liquid) reserves stood at 10,263 million USD – *in other words, close to 200 million USD short. So economically speaking, BDL can't afford to embark on refugee payments.*

But that is not all. Between end September 2023 and end September 2024 (see table above), BDL accumulated roughly 2,284 million USD in liquid FX reserves. Given that it has 'spent' around 200 million USD monthly (around 140 million USD on public wages in USD and 60 million USD on Circulars 166 and 158[3]), at an annual cost of 2,400 million USD, then BDL must have been able to 'hoover' from the FX market close to 4,684 million USD during that year[4]. However, in October 2024 alone, its liquid FX reserves fell by 435 million USD to stand at 10,263 million at the end of that month, due to its continued commitment to public wages in addition to its 3-months payments to Circulars 166 and 158 and, apparently, its limited extraction (buying) of FX reserves from the market because of the intensity of the war and/or limited remittances inflows at the time. At any rate, things will get even worse if BDL takes on the burden of refugee payments. It is estimated that each refugee costs around 6 USD a day, and with 1.2 million refugees[5], the monthly cost would come to 216 million USD, which makes it almost equal to what BDL allocates for public wages and Circulars 166 and 158.

[2] Note that at end October 2019, just before the economic crisis, BDL's liquid FX reserves were 30,980 million USD whereas M2 stood at 45,780 million USD!
[3] The government pays for these wages in LBP to BDL and the latter converts them into USD at the going 'official' rate of 89,500 LBP. Circular 166 involves monthly payment of 150 USD, and Circular 158 monthly payment of 300/400 USD, per eligible depositor.
[4] Interestingly, this is almost exactly equal to *annual net remittances* (inflows minus outflows).
[5] *Annahar Newspaper*, November 4, 2024 issue.

The result will be further *depletion of BDL’s FX reserves but at a faster rate than October 2024*. But the worst part is that with depleting FX reserves -- as commonly happens in such situations -- the LBP will be hit by panic and speculative attacks that will take it to new, deeper lows and render the life of all citizens – not just the refugees – more miserable. In other words, an *exchange rate crisis will emerge way before BDL’s reserves are exhausted; pretty much what happened in 2020-2021 after the Diab Government started on its infamous subsidization program.*

If the legal and economic perspectives don’t support using BDL’s FX reserves to assist the refugees, that is not to say however that the ethical perspective doesn’t hold as well. It does. The ethical perspective is based on the moral argument that the refugees are Lebanese citizens whose dire need demands assistance. But assistance should come, first and foremost and as soon as feasibly possible, from finding a durable political solution to the cause of the refugee crisis. As such, the crisis would be a looked at as a transitory short-term crisis, whose solution in this case would require special funding to smooth out expenditures. This special funding could come from official grants and/or concessional lending from multilateral institutions and donor countries.

Lastly, what about government revenues, couldn’t they be used to fund expenditures on refugees? If we stick to government expenditures in USD so as not to jeopardize monetary stability, we estimate that public deposits in USD at BDL were at least 591 million USD by end September 2024 (see table above). That is, they can only last for at most three months of expenditures on refugees, but their main drawback is that they would decrease BDL’s FX reserves by an equal amount and spark a needless depletion in those reserves. They also would require a special law to be enacted by parliament for that purpose or inclusion as an addendum in the 2025 budget. However, barring any access to grants and concessional lending, these government deposits can be used as a very last resort.

In a lot of ways, Lebanon's economic crisis and crisis of governance had emanated from the reckless spending of BDL's FX reserves that had made the latter easily disposable: to pay for EDL's fuel bills, to fund subsidized housing, to service the foreign debt, to subsidize basic commodities, and to lend uncritically to the government. That proved disastrous, as it removed any budget constraints on the government and eliminated the urgency of reform, and created the wrongful impression that problems can be solved if BDL simply 'throws' its FX reserves on them -- let alone the fact that these actions were not part of its mandate or illegal. In the process, BDL dissipated good money after bad, till judgment day arrived on October 17, 2019 and the whole house of Lebanese financial cards came down crashing. Now the story is repeating itself, with new calls from certain political quarters for BDL to assume expenditures on the refugees. This time, however, BDL seems to be cognizant of this anomaly and its dreadful ramifications. So, luckily, we hope the lesson has been fully learned, for BDL's own good and for the good of the country.

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