J.P. Morgan: Lebanese Eurobonds' Haircut at 70% but Caution Still Warranted

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On 4 February 2025, J.P. Morgan issued a report on Lebanon, Lebanon: Politics and stability before economics, in which it indicated that "Lebanon bonds have seen a steep rise following a cease-fire deal with Israel and as a multi-year political vacuum begins to be filled, given that parliament was finally able to agree on a Presidential candidate".

However, it added that "the recent turn of positive events raises hope of normalization, but politics is still far from being fixed given the complicated framework". Nevertheless, the focus towards rebuilding and reconstruction of the economy should start once political stability and governability is achieved, with the confirmation of the new, capable government that was put in place. In this respect, "though a more comprehensive assessment is needed, but the World Bank's interim damage and loss assessment (DaLA) report estimates the cost to Lebanon of the Middle East conflict to be around $8.5bn – roughly 35% of GDP".

In addition, the stabilization in the political environment should also lead to a shift in focus towards fixing Lebanon's severe economic crisis. As such, "support from external partners will be the key for reconstruction and rebuilding the economy, which in turn will depend on the ongoing political developments and the eventual reform plan". To that effect, "a recovery plan needs to be put in place with external support, notably from the IMF. While the authorities didn't manage to execute the 2022 IMF SLA plans, the starting point for any potential new IMF deal will likely be based on the 2022 agreement".

As important, "the recovery in Lebanon' s $31.3bn face value stock of Eurobonds has been strong, but needs caution as a lot needs to be done before restructuring negotiations can begin, even if one has an optimistic view on politics" . The report postulates that "markets are already pricing close to a 70% haircut and 10y maturity extension with some coupon relief, according to its estimates, although a Debt Sustainability Analysis (DSA) is required for a more comprehensive analysis" . More specifically, the report arrives at this estimate by using the current bond pricing and a hypothetical structure to analyze the market pricing of relief. It assumes a package of bonds with 10y maturity extension, i.e. bonds mature between 2030 and 2047 (Figure below). In terms of coupon payments, it also assumes token 1% coupons during the initial years (until 2027) with a step up to 2% in 2027 and to 7% from 2028. And using a higher exit yield of 16%, given the risks despite the higher haircut, it estimates markets are pricing close to 70% notional haircut on bonds given the current levels of 17pts (now higher at more than 19pts).

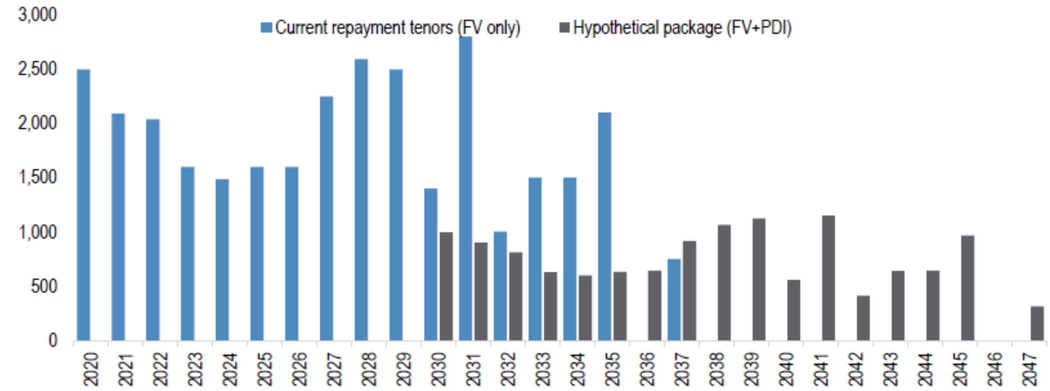
That said, the report argues that "if we assume that the politics can stabilize over the near term, raising hopes of a lasting peace and international support, several steps still need to be taken for the talks to at least begin. First, the authorities need to address the data reliability issue and provide up-to-date and accurate economic data that can help in making policy decisions and formulating the reform path. Furthermore, banking data will also likely require another round of audits and an asset quality review to understand and estimate the losses in the sector. Once the data issue is addressed, the authorities could move towards mapping out a recovery and reform plan with an external supporter (IMF). And an IMF DSA would be a crucial requirement to determine the extent of relief needed as well as the financing support required" .

In addition, the report believes that authorities would continue prioritizing reconstruction of the economy and recapitalization of the banking sector over restructuring Eurobonds. As such, it concludes that there is some way to go before discussions on restructuring of Eurobonds can begin. Also, it lastly notes that "given Lebanese bonds have no aggregate collective action clauses (CACs) embedded in them, the overall negotiations could end up being longer with each series requiring at least 75% of holders to agree on a deal" .

To close, it is interesting – though expected -- to note that the haircut has a decreasing relationship with bonds' market prices. Back when prices were slightly above 10pts, Goldman Sachs had postulated a haircut of 75%; but now that prices are close to 20pts, the haircut has decreased to at least 70%!.

Figure 5: Principal repayment schedule assuming 70% haircut and 10y maturity extension

Current outstanding sovereign bonds repayment schedule vs hypothetical scenario repayment schedule



Source: J.P. Morgan. Note: we have assumed no amortizers in the repayment schedule i.e. 100% principal repayments happen on maturity dates

Graphic: J.P. Morgan

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