Lebanon's Gold Reserves: To Lock or to Unlock?

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Following the recent appointment of Karim Souaid as the governor of Lebanon's Central Bank, Banque Du Liban (BDL), on March 27, 2025, a central debate has emerged regarding the potential use of the nation's significant gold reserves. These reserves, valued at $28.34 billion at the end of March 2025 and constituting 30.28% of the BDL's total assets, position Lebanon as the 21st largest gold reserve holder globally and 2nd in the MENA region. In light of this, Governor Souaid has suggested investing a portion of these assets to provide liquidity for depositors, while firmly rejecting their sale. This proposal prompts crucial considerations regarding how the BDL might leverage its gold holdings to aid Lebanon's financial recovery, pending parliamentary approval.

In this analysis, we will discuss the costs of keeping gold reserves inactive, the downsides of selling them, key investment options beyond selling, and the potential risks associated with these investment strategies, drawing on international case studies to offer valuable perspectives for Lebanon.

The Cost of Inactive Gold Reserves

Notably, one-third of the BDL's gold reserves are held in the United States, resulting in annual storage fees, while the remaining two-thirds are stored in the central bank's vaults in Beirut. This arrangement means the BDL is effectively incurring losses on a significant portion of its gold holdings.

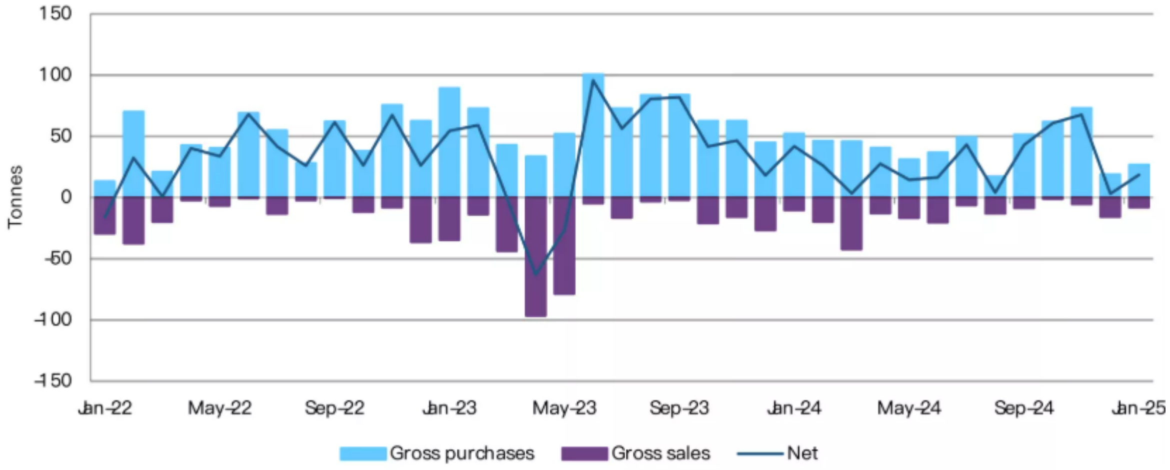
More importantly, the decision to keep these substantial reserves unutilized represents a significant opportunity cost. This is the potential profit or benefit Lebanon is missing out on by not investing or strategically utilizing these valuable assets for economic growth and stability.

The Case Against Selling Lebanon's Gold Reserves

Analysts widely agree with Governor Souaid's rejection of selling Lebanon's gold reserves, considering it an irreversible loss of a vital national asset with no lasting economic benefit. This stance is further supported by the global trend of central banks increasing their gold reserves as a hedge against rising geopolitical instability, a trend expected to persist in 2025.

Official gold reserves rose by a further 18t in January

Monthly reported central bank activity, tonnes*



*Data to 31 January 2025, where available. Note: chart includes only purchases/sales of a tonne or more.

Source: IMF IFS, Respective Central Banks, World Gold Council

Graphic: World Gold Council

Given the threats to dollar dominance and the Lebanese currency's near-peg to this currency, the BDL should prioritize utilizing its gold strategically, rather than selling it. Furthermore, selling gold would likely diminish accountability for those who misused depositors' funds, effectively acting as a general amnesty for the actions that caused the economic crisis.

Key Investment Options for Lebanon's Gold Reserves Beyond Selling

1. Gold Leasing

Central banks can lease their gold to financial institutions like bullion banks, which can then lend the metal to various borrowers, such as jewelry manufacturers. The borrower uses the gold temporarily and returns it after the lease period, along with a lease interest called the Gold Lease Rate (GLR).

2. Gold Swaps

Central banks exchange their gold for foreign currency with a financial institution, like a bullion bank. This exchange is temporary, and both parties agree to reverse the transaction at a set date in the future for a fixed price. It's like using the gold as a temporary loan (Collateral) to get the foreign money. Lebanon still owns the gold the whole time.

3. Gold-Backed Securities

Central banks can issue gold-backed bonds or securities. If the central bank can't repay the securities in cash, the investor receives gold instead. Because these securities are backed by gold, they typically have lower interest rates due to reduced risk. The central bank can then invest the money raised from these securities in higher-yield assets generating additional revenue.

It's important to note the **profit mechanisms for these options**. With gold leasing, the revenue generated is the GLR paid by the borrower. In contrast, gold swaps and gold-backed securities allow Lebanon to access foreign currency or raise capital at a relatively low cost. The potential profit in these cases arises from strategically investing these obtained funds in other ventures that yield a higher return than the cost incurred. For gold swaps, this cost is the difference in the agreed-upon fixed prices for the future reversal, while for gold-backed securities, it is the interest paid on the issued bonds.

The Downsides to Consider When Investing Lebanon's Gold

While investing gold reserves offer potential benefits, they also entail several risks and considerations that the BDL must carefully evaluate.

The most pressing concern when thinking about investing Lebanon's gold reserves is the risk of corruption in how these investments are made. Self-serving decisions could lead to the loss of this national wealth without any real return. Therefore, ensuring strong, honest oversight and the involvement of highly competent individuals in these decisions, with the best interests of Lebanon as the foremost priority, is absolutely crucial.

Another primary concern is counterparty risk, which is the possibility that the other party in a transaction might fail to meet their obligations, such as returning the gold or agreed-upon interest. In gold leasing, for example, the leased gold's value is added to the lessee bank's assets. Consequently, if that bank were to become bankrupt, the gold could be seized. However, some reputable central banks offer guarantees that mitigate this risk. Therefore, the BDL must exercise extreme caution in selecting counterparties, employing thorough risk assessment and due diligence procedures.

Moreover, using gold as collateral presents a notable risk for BDL due to the inherent volatility of gold prices. If the market value of gold declines after it has been pledged, the BDL faces potential margin calls from lenders, requiring the provision of additional collateral or loan repayment.

Besides, the process of transporting gold in a region historically susceptible to security concerns and the presence of various non-state actors inherently carries substantial security dangers.

Global Perspectives: Case Studies of Central Bank Gold Reserve Utilization

Several countries' experiences offer valuable lessons for BDL as it considers utilizing its gold reserves beyond outright sales.

For instance, in 1967-1968, an increase in gold buying left the Fed with large delivery obligations at the storage site in London. To manage this, the German Bundesbank swapped gold with the Fed: it provided the Fed with $1 billion worth of Good Delivery gold, and in return, the Fed delivered government-stamped gold bars worth $350 million at a New York storage site and $650 million worth of Good Delivery gold at a storage site in Ottawa, Canada. As a result of the swaps, the Bundesbank earned a profit of $470,651.

Similarly, in 2014, the Central Bank of Ecuador strategically utilized half of its gold reserves as collateral in a transaction with Goldman Sachs, which ultimately yielded around $20 million profit.

More recently, in 2021, the Central Bank of Ecuador used its gold reserves as collateral to double its emergency borrowing capacity with the Bank for International Settlements (BIS) to $840 million, aiming to improve its financial resilience against potential economic downturns.

However, not all such attempts have been successful. Venezuela, for example, lost $1.4 billion worth of gold, which was used as collateral for loans. In 2019, following U.S. sanctions on the Central Bank of Venezuela (BCV), Citibank and Deutsche Bank used contract conditions to keep the gold bars. They decided that a "default" had happened because of the sanctions, as stated in the agreements supporting the gold swap deals.

Should the BDL use gold reserves to repay depositors?

It's easy to see why Governor Souaid suggests using gold reserves to give money back to depositors, as this would offer quick help, especially for those who urgently need it. However, this might only solve the problem for a little while. Instead, using the earnings from gold reserve to invest in important infrastructure, key businesses, and helpful social programs can create jobs, make things more productive, and build a strong economy that benefits all Lebanese people, including depositors, both now and in the future. Still, it's important to also think about how to give some immediate help to the depositors. Maybe some of the first profits from smart gold reserve investments could be used for this. As for the rest of the depositors' funds, this problem needs to be fixed, but it should be part of a bigger plan to get Lebanon's economy working again and make sure things stay stable for the long run.

Who should manage these investments?

The management of these investments is generally considered best entrusted to an independent authority rather than direct oversight by the BDL itself, for several compelling reasons. Firstly, an independent body enhances transparency and accountability through external oversight and audits, crucial for maintaining public trust and ensuring prudent reserve management. This approach also reduces political influence, fostering more prudent long-term decisions that are less likely to be swayed by short-term political agendas. Additionally, an independent authority can increase credibility and international confidence in the management of gold reserves, positively impacting the nation's financial stability. Given the unsuccessful outcomes of the BDL's previous "financial engineering" strategies, engaging external expertise with demonstrable competence and ethical standards warrants consideration. While the potential for influence that could compromise the effectiveness of an independent body remains a concern, and the BDL's ownership of the reserves may necessitate its approval on certain matters, the benefits of enhanced transparency, reduced political interference, and increased international credibility make an independent authority a superior choice compared to self-management by the BDL.

Final Thoughts

The potential for Lebanon to leverage its substantial gold reserves for economic recovery is evident in the strategies employed by nations like Germany and Ecuador. However, the negative outcome experienced by Venezuela underscores the critical importance of rigorous risk management. Poor choices or corruption could deplete reserves without meaningful returns, especially given unfavorable global economic conditions. Crucially, a transparent and independent audit of the BDL's gold reserves must be a foundational step before any investment strategies are implemented. Additionally, establishing a transparent, independent oversight body to manage investments and prevent political interference is essential.

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