From Theory to Practice: When a Weaker Currency Doesn't Boost Exports – The Case of Lebanon

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In its Spring 2025 issue titled "Turning the Tide?", the World Bank's (WB) **Lebanon Economic Monitor (LEM)** featured a special analysis of **real effective exchange rate (REER)** dynamics. This topic has drawn growing attention since the onset of the financial crisis, which put Lebanon's large trade deficit under the spotlight. Many economists argue that a **chronically overvalued REER** played a pivotal role in undermining Lebanon's product competitiveness prior to the crisis. This analysis examines how both REER misalignments—overvaluation and undervaluation—have influenced Lebanon's goods trade performance (excluding services) and assesses whether these shifts aligned with global trade patterns and theoretical expectations.

To understand the findings, it's important to first clarify the concepts underpinning the analysis—namely, the distinction between the Real Exchange Rate (RER) and the REER. The **RER** is a measure that compares the price of goods between countries after adjusting for exchange rates. While the **RER** captures competitiveness between two countries, economists and policymakers often focus on the **REER**—a broader index that averages the RERs across all trading partners, weighted by each partner's share in trade.

The REER is also used to assess whether a currency is aligned with its fair value, helping determine if the currency is overvalued or undervalued. Generally:

- 📉 **REER Decline** → Improving competitiveness, as domestic goods become relatively cheaper abroad.
- 📈 **REER Increase** → Reduced competitiveness, as exports become relatively more expensive.

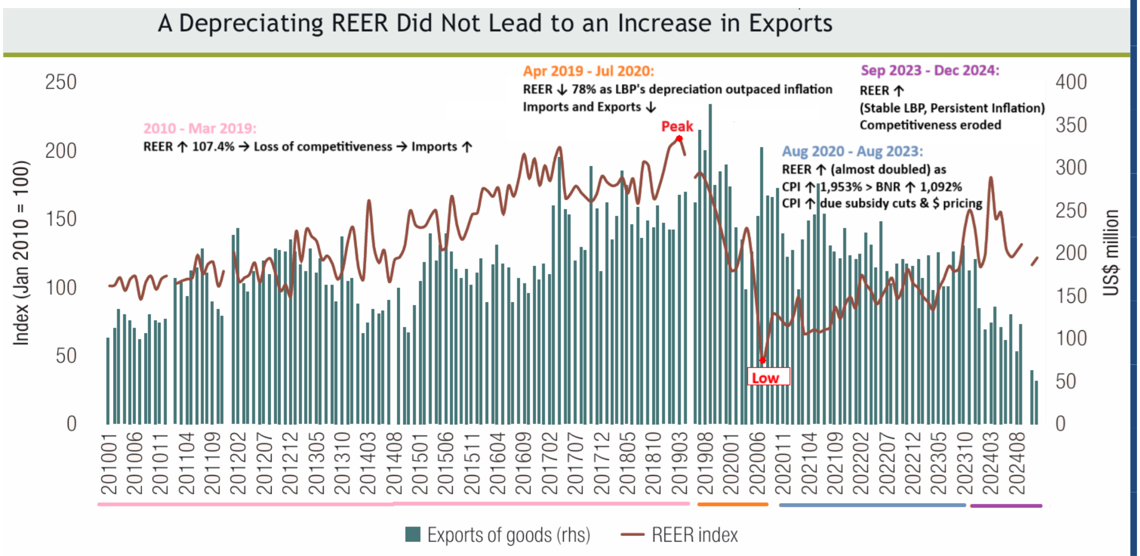
The core equation is:

$$\mathrm{REER} = \prod_{i=1}^{n} \left(\frac{P_{\text{Lebanon}} \cdot E_{\text{Lebanon}}}{P_{\text{country } i} \cdot E_{\text{country } i}} \right)^{w_i}$$

Where:

- $\mathbf{P}_{Lebanon}$ = Price index in Lebanon
- $\mathbf{P}_{country\ i}$ = Price index in partner country i
- $\mathbf{E}_{Lebanon}$ = Nominal exchange rate of Lebanon (in $ per local currency)
- $\mathbf{E}_{country\ i}$ = Nominal exchange rate of partner country i (in $ per local currency)
- $\mathbf{w}_i$ = Trade weight of partner i with Lebanon
- **n** = Number of trading partners

The chart below traces the evolution of Lebanon's REER and goods exports from 2010 through the end of 2024.



Source: Central Administration of Statistics, IMF, COMTRADE and WB calculations

Note: Lebanon's Bank Note Rate (BNR) is used in place of the official exchange rate starting September 2019 to better reflect the impact of LBP depreciation on competitiveness

Graphic: WB

Adaptation & Annotation: BLOMINVEST Bank

In the pre-crisis period, from 2010 to March 2019, Lebanon's REER appreciated by 107.4%, making imports cheaper but eroding the country's export competitiveness. As a result, imports surged during this period from $13.2 billion in 2010 to $19.3 billion in 2018 as the REER peaked in March 2019 (for the studied period). Surprisingly, however, exports also rose during this period—despite diminished price competitiveness relative to international peers—yet the increase was modest compared to the surge in imports, and the **trade deficit** continued to widen.

Between April 2019 and July 2020—the onset of the crisis—the REER sharply depreciated by 78% from its March 2019 high, reaching its lowest point in July 2020, a period theoretically associated with peak competitiveness. During the same period, the lira lost 475% of its value, while inflation surged by 112%. In theory, this adjustment should have curbed imports and boosted exports. On the ground, imports did fall significantly—from $16.1 billion in 2019 to $9.8 billion in 2020—as expected. However, exports also dropped, from $3.8 billion to $2.9 billion, defying expectations. The narrowing **trade** deficit was therefore driven not by export gains, but by a collapse in domestic demand. Instead of supporting trade, the improved price competitiveness failed to translate into stronger exports, which continued to weaken.

Following the July 2020 trough, the REER began a renewed upward trajectory from August onward, driven largely by the gradual removal of subsidies and widespread price **dollarization** leading **up to August 2023**. **Since September 2023**, the lira has stabilized for the first time since the end of the currency peg in 2019. As expected, the REER's appreciation eroded the gains made during the crisis and led to a decline in exports—visible in the chart—and a renewed increase in imports, ultimately widening the **trade deficit**.

So, does Lebanon’s goods trade performance follow global and theoretical patterns?

As the chart demonstrates, the answer is largely no. In the decade that precedes the crisis’ eruption, while the REER appreciated, exports also rose, defying expectations. Similarly, while the depreciation of the REER led to a notable decline in imports during the crisis, exports failed to register a corresponding rise. According to the WB report, this divergence stems from a combination of external and internal constraints. These include restricted access to key markets in the Arab Gulf—such as Saudi Arabia’s ban on Lebanese exports—the closure of trade routes through Syria, weak global demand during the COVID-19 pandemic, and limited business infrastructure and elevated costs, especially in electricity and internet.

Moreover, Lebanon’s near-total **dollarization** continues to dilute the benefits of a weaker REER for trade. In fact, as is the case with Lebanon, under conditions of sticky prices, dollar-based costing and pricing, Calvo pricing, and oligopolistic market structures, a weaker REER does not necessarily improve export competitiveness. Although this analysis focuses solely on goods, the limited impact of exchange rate shifts on exports is particularly evident in service sectors like tourism, where **price pass-through** remains minimal.

Finally, while imports declined during the crisis, this was not solely the result of improved price competitiveness. It also reflected rigid restrictions on cross-border transfers, further compressing demand and trade flows—besides, of course, compressed income.

At a time when the newly elected reformist government is prioritizing export growth—particularly in goods—as a pathway to economic recovery, the urgency is clear. As highlighted by the WB, Lebanon’s GDP has plummeted from $55 billion in 2018 to an estimated $26 billion in 2024. Reversing this trajectory requires boosting exports through tackling the *real* underlying structural barriers that have long undermined Lebanon’s trade competitiveness.

Recent positive signals, such as the return of Emirati tourists and ongoing discussions to resume exports to Saudi Arabia, mark important steps forward. Notably, Saudi Arabia was the largest market for Lebanese agricultural exports in 2019, accounting for 22.1% according to a 2020 government report—underscoring the magnitude of such a breakthrough.

But to sustain momentum, the Lebanese government should move beyond these temporary wins and avoid relying solely on exchange rate adjustment for export revival. Lebanon needs a **durable strategy** focusing on **structural reform, regional trade diplomacy,** and **competitiveness enhancement**. As outlined in *Towards a Productive "New" Lebanon*, co-authored by Minister Amer Bisat, export volumes must nearly triple—from roughly USD 10 billion to USD 30 billion—to meaningfully contribute to GDP recovery and external balance stabilization. Now is not the time for Lebanon to pause. The road ahead demands sustained reform and strategic ambition to unlock the country's full economic potential.

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