# Lebanon's Cash Economy: Some Thoughts and Figures

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| Monetary Aggregate[1] | Jan. 2018 (Trillion LBP) | Jan. 2024 (Trillion LBP) | Jan. 2025 (Trillion LBP) | Δ = Jan.2025 -Jan.2024 (Trillion LBP) |
|---|---|---|---|---|
| **CC** | 5.39 | 57.08 | 84.93 | 27.85 |
| **DD LBP** | 4.90 | 28.66 | 36.65 | 7.99 |
| **M1** | 10.29 | 85.74 | 121.58 | 35.84 |
| **SD LBP** | 69.47 | 15.04 | 34.89 | 19.85 |
| **M2** | 79.76 | 100.78 | 156.47 | 55.69 |
| **D USD** | 129.03 | 6,299.53 | 6,057.51 | -242.02 |
| **M3** | 208.79 | 6,400.31 | 6,213.98 | -186.33 |
| **GDP** | 82.76 | 1,723.31 | 2,324.46 | 601.15 |
| | | | | |
| **V=GDP/M3** | 0.39 | 0.27 | 0.37 | |

Source: BDL; WB

1. CC = Currency in Circulation; DD LBP = Demand Deposits in LBP ;

   SD = Savings Deposits in LBP; D USD = Deposits in USD ;

   M1 = CC + DD LBP; M2 = M1 + SD LBP; M3 = M2 + D USD;

   V = Velocity of money .

   Note that monetary aggregates are for residents only

It is customary these days -- and it is largely true as we will show below -- to describe the Lebanese economy as being mostly (but not entirely) cash based. But what does that mean in proper economic terms? And how can it be measured? As important, what are some of its important economic implications? We intend to answer these questions in this brief note .

Analytically, we will do that by studying developments of the various 'monetary aggregates' and by looking at the mechanics of the 'equation of exchange'.

Empirically, we will utilize data for January 2018 as our pre-crisis benchmark, and data for January 2024 and January 2025 as our crisis years. We choose January as our end of period month because it was on January 2024 onward that the exchange rate of 89,500 LBP per USD was used in the valuation of monetary assets and liabilities in the banking system, and as such makes the figures between January 2024 and January 2025 validly comparable, based on a common valuation.

To start with, the standard monetary aggregates are usually defined in Lebanon as follows: the narrow monetary concept M1 as the sum of LBP currency in circulation CC and LBP demand deposits DD; the broader concept M2 as the sum of M1 and LBP savings deposits SD; and the broadest concept M3 as the sum of M2 and USD deposits D. Two things to note: first, the monetary aggregates are for resident accounts only; second, USD cash is not part of the monetary aggregates as issuing it is the preserve of the US Federal Reserve .

A crucial analytical construct that is also highly useful is the equation of exchange:

$$MV = GDP$$

$$V = GDP/M$$

Which simply says that money (M3) circulating at the rate or velocity V generates exchanges or transactions equal ultimately to GDP. Alternatively, the velocity of circulation V can be calculated ex-post as GDP/M3.

Keeping all that in mind, and looking at the table above, we can deduce two important observations. First, the dominance of USD deposits in M3, equal to about 62%, compared to 35.5% for LBP deposits and 2.5% for currency, in Jan 2018. This dominance gets worse in Jan 2025 because of the steep depreciations in the LBP exchange rate, as the ratio for USD deposits rises to 97.5%, compared to 1.3% for LBP deposits and 1.2% for currency. The irony, of course, is that despite the super dominance of USD deposits, it is mostly currency and LBP deposits that are doing the circulation at equal ratios, because the USD deposits are largely locked (not counting USD cash, but more about this later.(

Second, in Jan 2018, the velocity of circulation V was 0.39, meaning that a unit of M3 circulated 0.39 on average. That is actually very low, the reason being that

Lebanon at the time had a huge deposit base (close to 400% of GDP) that stayed largely 'idle' and couldn't be pumped into the domestic economy in full because of low absorptive capacities. The irony, again, is that in Jan 2025 the velocity of circulation was actually almost identical to Jan 2018, at 0.37, but this time the bulk of M3 was not idle but locked or as if it doesn't exist. However, where Jan 2018 and Jan 2025 crucially differ is that in USD terms M3 in 2018 was $138.58 billion and was able to generate a GDP of $54.91 billion, but in Jan 2025 M3 fell to $64.42 billion and generated a GDP of $25.97 billion as the economy's broad liquidity fell by more than half.

To see more clearly the current significance of the cash economy, we have to move from 'stock' to 'flow' analysis. This is reflected in the changes in monetary aggregates between Jan 2024 and Jan 2025; and from the table above we can derive two essential points:

First, changes in the monetary aggregates were interesting, though not surprising. Currency increased by 27.8 trillion LBP, however note that this increase declined in the consecutive months as BDL followed a restrictive monetary policy (though recessionary!) to deter any speculative attacks on the exchange rate. Deposits in LBP also increased by 27.8 trillion LBP, considered a welcome development for banks and financial intermediation in LBP. But deposits in USD fell by 242 trillion LBP ($2.7 billion), driven by withdrawals based on BDL circulars 158 and 166 and even withdrawals of USD fresh deposits because of the Hezbollah-Israel war in Fall 2024, though anecdotal evidence shows that fresh deposits resumed their increase in the later months to reach up to $4 billion currently. Nevertheless, the fact remains that these withdrawals – especially those related to Circulars 158 and 166 – are an indication that most banks still lack enough trust and confidence on the part of the public for USD deposits; hence the resort to USD cash and to LBP cash and deposits.

Second, another interesting but reasonable notion to consider is to assume that the USD deposit withdrawals of 242 trillion LBP or $2.7 billion between Jan 2024 and Jan 2025 resemble the USD cash in circulation, instead of being parked at banks. If we add those to the increase in LBP currency and the increase in LBP deposits, at 27.8 trillion LBP each, we arrive at a total of around 298 trillion LBP. And given that the increase in GDP during that period was almost double that at 601 trillion LBP, then the velocity of circulation for changes in USD cash and LBP cash and deposits is around 2. This means that these aggregates were circulating two times on average to generate transactions twice their size in GDP.

Aside from issues relating to tax avoidance and money laundering/terrorist financing as a result of the cash economy, we would like to conclude with three important remarks. These are:

First, though preliminary estimates put the velocity of flow cash at a decent 2, the amount involved at less than $3.4 billion is too small. These are used for mostly consumption purposes, hardly even on consumer durables. What the economy needs to grow and to grow strongly is private and public investments that can only be facilitated by bank credit and financial intermediation; hence the obvious need for a banking system.

Second, the hemorrhage of USD deposits form the Lebanese banking sector and the wide use of LBP and USD cash can only be stopped by financial and economic reforms that cleanse the banking system and restore rigorous growth. If these are done well, then banks will resume their unique role as a safe haven and an abode of confidence to the public. Worries and skepticism about whether this will happen are over-exaggerated, for according to the ever-true adage: 'if you built it well, they will come.'

Third, restructuring of the banking sector will surely involve reduction in its number and size. And this actually is a blessing in disguise, because in the pre-crisis years the Lebanese banking sector suffered from bloating and from excess deposits way above the country's absorptive capacity. And that had resulted in misdirected asset/liability management, and made banks an attractive source of 'poaching' by BDL. So a small but efficient banking system is the way to go.

Lastly, we would like to revisit these issues once the figures for Jan 2026 are out. Hopefully by then, some serious financial and economic reforms would have been completed, and the conclusions would be more upbeat!

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