

Has BDL Followed a Currency-Board Exchange Rate Regime in the Last Two Years?



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	1/2024	8/2025	$\Delta = (8/2025 - 1/2024)$
FR (Bn USD)	9.73	11.67	1.91
CC (Tn LBP)	57.08	72.86	15.78
CC (Bn USD)	0.638	0.814	0.176
M2 (Tn LBP)	100.78	144.65	43.87
M2(Bn USD)	1.13	1.61	0.486

Note: FR = Foreign Reserves; CC = domestic Currency in Circulation;

M2 = CC plus LBP deposits

In a Virtual Conference on Lebanon hosted by the Institute of International Finance (IIF) on 30/9/2025, the third Vice Governor of BDL, Dr. Salim Chahin, admitted that BDL has been following a **quasi-currency-board exchange rate regime** for the past two years. To our knowledge, that was the first time BDL has officially declared what its current operating monetary framework is. The Vice Governor added that this is only a stop-gap measure till the financial crisis is over and the financial system is back on track. Before we look at what the currency board involves for Lebanon, a brief note on what it means and implies is in order.

Has BDL Followed a Currency-Board Exchange Rate Regime in the Last Two Years?

A currency board is a monetary arrangement where the domestic currency is issued only when backed by equivalent foreign reserves (such as USD) at a fixed exchange rate¹. In addition, the currency board's foreign reserves must be sufficient to ensure that all holders of domestic money can convert them into the reserve currency, with the foreign reserves usually set equal to at least 100% of the domestic monetary base². This one-to-one relationship, or rule, between changes in foreign reserves and domestic currency ensures the stability of the fixed exchange rate and maintains monetary equilibrium. And to be credible, the currency board must assure full convertibility and strict adherence to the pre-defined rule.

The advantages of the currency board are that it helps prevent excessive money printing, thereby achieving price stability by tying the domestic currency to a low-inflation anchor currency; it is also presumably simple and not complicated to implement. However, it has disadvantages. These are centered on subordinating central bank objectives and independence to the exchange rate target; more than that, it renders monetary policy redundant in that neither changes in open market operations, or discount rates, or reserve requirements are needed, and this turns the central bank to a passive bystander³.

¹ Hong Kong is the country with the best known currency-board arrangement in the world, with the USD as the currency anchor.

² The monetary base is the sum of domestic currency in circulation and bank reserves.

³ As to macro adjustment under a currency board, the way it happens is as follows and it starts with the balance of payments (BOP): in case of a BOP surplus, the central bank accumulates foreign reserves, which in turn translate to higher domestic currency, but that leads to a larger money supply and, as result, to higher prices and lower interest rates, which in turn worsen respectively the current and capital accounts and end up eliminating the BOP surplus that we started with. And the opposite is true. That is what the theory says. In fact, the adjustment might be difficult to obtain, especially in the case of a BOP deficit. This is what Argentina suffered from in the late 1990s, and had to drop its currency-board arrangement as a result.

Coming back to the case in Lebanon, it was in January 2024 that BDL officially set the ‘market’ exchange rate at 89,500 LBP per USD and seems to have started to use operationally a quasi-currency board as its monetary framework. To start with, we need to highlight two important points relevant to this note. First, we know that the monetary base changes as a result of changes in domestic credit to the public and private sectors in LBP, in addition to changes in reserves. But the thing is, changes in credit to the public sector were zero during that period as the government actually ran budget surpluses; and as to changes in credit to the private sector in LBP, it hardly changed, staying at close to 9.5 trillion LBP during the period. Hence, it is quite valid to assume that changes in domestic currency are confined to changes in foreign reserves only. Second, we are going to consider the corresponding changes in domestic currency from two viewpoints, the narrow currency in circulation (CC) and the wider M2 comprising CC plus total deposits in LBP.

From the above, we see that FX liquid reserves at BDL stood at \$9.73 billion, which was more than 1500% currency in circulation that stood at a USD equivalent of \$0.638; and even more than 800% M2 which stood at a USD equivalent of \$1.13 billion. To err on the side of caution, BDL established as a result a reserve buffer of more than 1400% in the case of CC, for instance. And it is a very wide buffer indeed!

Dynamically, BDL was also able to accumulate, between 1/2024 and 8/2025, \$1.91 billion in foreign reserves⁴. But the USD equivalent increase in CC was only \$0.176 billion and similarly \$0.486 billion for M2. In other words, it wasn’t a one-to-one increase. BDL, then, has erred on side of caution again, and even more so dynamically. Perhaps this makes BDL’s operating monetary framework **not a quasi-currency-board but a restrictive-currency-board**. BDL should have allowed CC (and M2) to increase equally in LBP, but elected not to, as it was -- and still is – too risk averse and in awe of unexpected real, monetary, and speculative shocks to the economy in a very fragile political/security environment. The flip side of this policy is that it was too stringent, as inter-bank rates in LBP reached to more than 100% on some occasions; it was also too recessionary, as it denied adequate liquidity to the economy.

⁴ That is, it had a BOP surplus of \$1.9 billion during the period; see footnote 3.

But was it the right course of action for BDL? Under a currency board, central bank monetary instruments are redundant as we argued earlier, and as such BDL knew that with the banking sector in crisis, it can't use its monetary instruments anyways, so might as well adopt the currency board to secure at least exchange rate stability⁵. And once the banking crisis has been resolved, then – as the Vice Governor had said -- BDL can shift to a flexible exchange regime, with inflation targeting as the operating framework, and utilize its monetary instruments in a full-fledged way. However, that said, the currency board has not been too good of a course for the economy. But, then again, at least the exchange rate was stabilized and remains stable to this day. In a country living in an age of diminished expectations, perhaps this is all what we could hope for as a desired policy target!

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⁵ The only measure taken, as instrument, is the reduction in the required reserve ratio for USD deposits from 15% to 11%, but that was strictly for accounting not policy purposes as BDL has paid the 4% difference back to depositors via circulars 166 and 158.