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I. Introduction

In their IMF working paper (WP/26/94) titled, “*Systemic Banking Crisis Database: 1970 – 2025*”, Messrs. Luc Laeven and Fabian Valencia updated the Laeven and Valencia database to reflect episodes during 1970 – 2025 (last previous update was 2020). Although it is not considered an official document from the IMF, this working paper is a significant paper as the Laeven and Valencia database is considered a global benchmark for banking crisis analysis.

The Lebanese crisis shares several characteristics with past systemic bank crises but differs in three critical aspects, being: the magnitude of losses compared to Gross Domestic Product (GDP), length of the crisis with no solution, and the absence of a restructuring framework or plan.

In this spotlight, we will discuss the main points addressed in the above-mentioned working paper and relate it to the Lebanese Banking Crisis that flared up in October 2019. In other words, we will see how Lebanon's 2019 banking collapse map onto the typology and patterns in Laeven & Valencia (2026), what policy lessons, derived from the 55-year global dataset, apply to Lebanon's unresolved crisis and help in devising an optimal resolution path.

II. Systemic Banking Crisis Characteristics

The Leaven & Valencia (L&V) database timeline starts in 1970 and includes information about earlier banking crises, precisely crises starting dates, policy interventions, fiscal costs, and output losses. It offers a comprehensive toll for assessing cross-country weaknesses and procedures for banking crises resolution.

The new update released by L&V (2026) added 13 new crises episodes since the 2020 release and Lebanon's episode is one of these new ones.

As per L&V, a banking crisis meets two conditions:

- Substantial signals of financial distress in banking system (critical bank runs, shortfalls in banking system, and / or bank liquidations).
- Extensive banking policy intervention measures in response to significant losses in the banking system.

The paper considers the first year in which both criteria are met to be the year when the crisis became systemic. When the losses in the banking sector and/or liquidations are severe, we treat the first criterion as sufficient condition to date a systemic banking crisis. Severe losses denote either one of the below two criteria:

1. *Increase in the share of non-performing loans to total loans above 20% (or bank closures of more than 20% of banking system assets)*
2. *Fiscal reform policy costs exceed five percent of GDP.*

If fiscal reform policy expenses exceed five percent of GDP (second condition), then we can consider it a systemic banking sector crisis as relying on the first condition alone (substantial signals of financial distress in banking system) is problematic, since quantifying the degree of financial distress is not a straightforward process. The reason is that in middle -- and low -- income countries, losses can be mitigated, delayed or transferred by policy responses; and that is in fact what happened in Lebanon as losses were delayed by financial engineering, as we will discuss hereafter.

Banking sector policy interventions is considered when three out of the below six actions have been applied.

1. Deposit Freezes and / or Bank Holidays: When government imposes constraints on deposits drawings or bank holidays implemented.
2. Significant Banks' Nationalizations: In case the government acquire systematically prominent financial institutions (FIs) or a major stake in the capital of such FIs.
3. Bank Restructuring Fiscal Costs: Expressed as gross fiscal spending directed to financial sector restructuring, mainly recapitalization costs. If these expenses exceed three percent of GDP, without taking into account liquidity support provided directly from the treasury.
4. Extensive Liquidity Support: It is quantified as Central Bank (CB) requests from other depository institutions (from IMF's IFS) and liquidity support directly provided by the Treasury. This variable is normalized by total

deposits and bank liabilities to non-resident clients. Liquidity aid deemed extensive when this ratio surpasses five percent of GDP and more than doubles compared to its pre-crisis level.

5. Significant Bank Guarantees Put in Place: Indicates either guarantees issued by the government to assure full protection or guarantees that warrantee have been expanded to banks' non-deposit liabilities.
6. Significant Asset Purchases: This variable represents the purchases of FIs' assets (appraised for more than five percent of GDP) by CB, Treasury or any government entity.

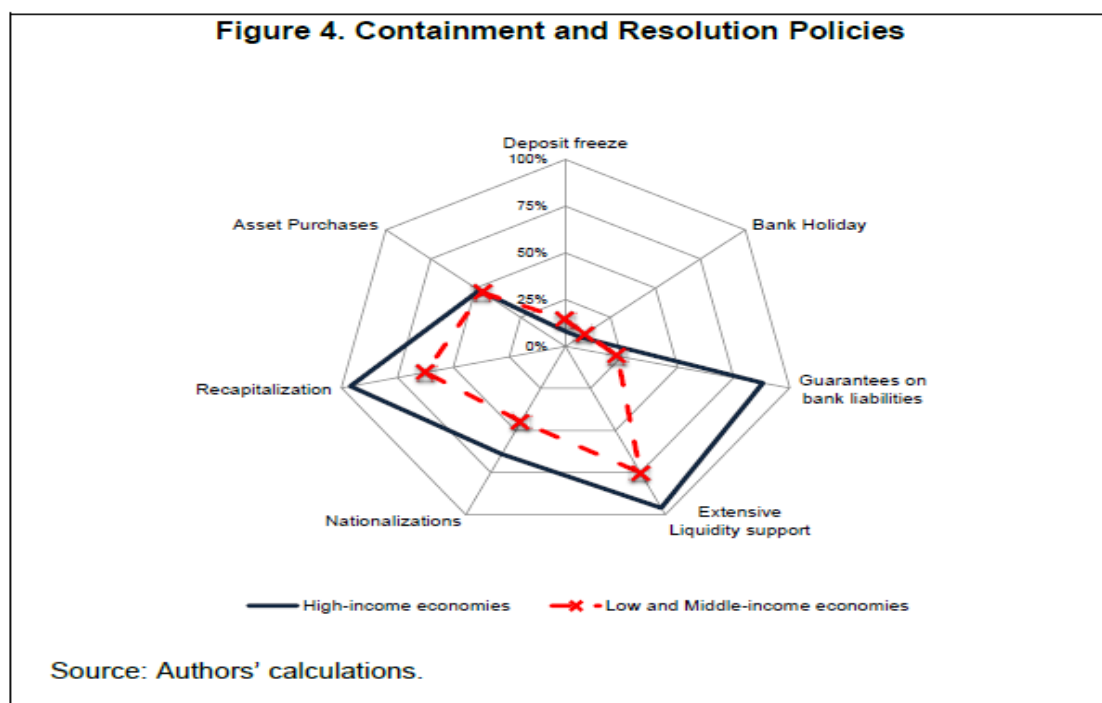
Interesting to note, that some of these new crises resulted from shocks outside the financial sector, which in turn affected banks' balance sheets. Some of these crises occurred in oil-producing countries after the sharp decline in oil prices starting 2014 such as Angola, Chad, and Azerbaijan to name a few.

Most countries witnessed systemic banking crises during the database period (1970 – 2025), with some countries experienced two or more crises (including borderline cases), such as Argentina (4), Chad (3), and Ukraine (3). Surprisingly, Lebanon witnessed only two episodes (1990 – 1993 and 2019 – present) and is not in the “three or more” group.

The database reveals that both high and low & middle-income countries relied heavily on liquidity support; however, high income countries had a broader variety of instruments to be used. Additionally, several studies showed that middle -- and low-income countries relied on liquidity provisions for a longer period than high-income countries. Also, liquidity supports are used before applying bank recapitalization and restructuring measures, probably during the period when there are difficulties in determining, in real time, the nature of the shock and its duration, as to whether it is a temporary solvency problem that needs bank recapitalization and restructuring.

The regulatory reforms implemented varied between pre --and post --global financial crisis of 2008. Prior to that global crisis, governments relied mainly on liquidity provisions measures even in solvency issues. However, after 2008 crisis, Basel III provided governments a wider crisis response toolkit such as structured capital buffers (capital conservation buffer and countercyclical capital buffer) in addition to liquidity coverage ratio. These allowed banks to accumulate capital liquidity in good times to be used in declines.

The paper stipulates that some measures were utilized at the early stages of banking crises such as liquidity support, government guarantees on banks' liabilities. In case of severe liquidity pressures, measures such as deposit freezes and bank holidays (temporary closure of banks to adapt their IT systems and procedures to new regime) were applied, though rarely used. Latest deposit freeze and bank holidays were applied in Greece (2015), Cyprus (2016), and Lebanon (2019). On the other hand, the most critical measure used was recapitalization and specifically through public funds. Government capital injection is one method used and acquiring common and preferred equity with some conditions such as having members on the board of directors or seizure of dividend payments. Below figure reveals policy mix utilized in banking crises.



Source: Laeven, L. & Valencia, F. (2026). Systemic Banking Crises Database: 1970–2025

From the figure above, we can conclude that the high-income countries rely on guarantees on bank liabilities whereas low --and middle-income countries do not; while other containment and resolution policies are generally used by both groups. The reason behind the more frequent usage of bank guarantees by high-income countries is the fact that such countries have stronger institutions, more fiscal ability or less dominance of foreign currency bank liabilities.

Several key findings can be obtained from previous episodes related to crisis outcomes, namely fiscal costs, peak nonperforming loans, duration, and output losses.

Starting with fiscal costs, it comprises of all fiscal outlays of government interventions to stabilize the banking system from the start of the crisis. Such interventions consist of capital injections in FI, operating expenses of asset management firms, given public guarantees, in addition to any fiscal costs directly assigned to the rescue of FIs.

For “Fiscal Costs” of banking crises, the paper’s researchers normalized the summation of the outlays by the nominal GDP of the year in which they were incurred. The paper concluded that median cost for crisis in low -- and middle-income countries were proportionally higher than in high-income countries. Median costs in low --and middle – income countries recorded 7.5% of GDP compared to 6.7% of GDP in high-income countries.

As in fiscal costs, the “Non-performing Loans” indicator in low -- and middle-income countries were higher than that of high-income countries. In details, the median peak of non-performing loans in low --and middle-income countries reached 30% compared to around 11% in high-income countries. This indicator lets us inspect ex-post the deterioration in asset quality during the crisis, although it might peak several years after the beginning of the crisis.

High income countries suffer greater “Duration” of crisis compared to the low -- and middle-income countries. Most crisis in high-income countries used to last for more than five years compared to four years or less in low and middle-income countries. This could be attributed to several factors such as severity of the crisis, size of financial systems and FIs, and the reliance on monetary and fiscal policies to mitigate the real effects of the banking crisis.

In the paper, output losses were computed as deviation of actual GDP from its trend (i.e. cumulative sum of the differences between actual and real trend over the period $(T, T+3)$, with T starting period of crisis. The paper’s examination shows that output losses in high-income countries is usually higher than that of low -- and middle-income countries. Larger output losses and longer duration are most probably driven by the presence of larger and deeper financial systems that lead to tougher consequences on real economy.

III. Lebanese Banking Crisis Overview

In this section and what follows, we will be discussing the Lebanese banking crisis in details. We will first examine the origin and reasons of the crisis and then the lessons learned from global evidence.

The Lebanese banking crisis is one of a kind. Although it is a banking sector crisis, the origin of the crises is the consequences of previous Lebanese governments decisions taken. We list below the Structural Weaknesses that led to the crisis, in addition to the Financial Engineering measures that tried, unsuccessfully, to postpone it.

Structural Weaknesses

- **Fixed Exchange Rate Regime:**

Exchange rate was pegged to USD since 1997 at 1507.5. Despite the fundamental weakness of the Lebanese pound, it played a vital role in easing inflation and promoting monetary stability after years of struggles and uncertainty. This regime required maintained confidence in banking sector in addition to continuous inflow of foreign currencies. However, the pegging had distortionary effects on the foreign currency deposits at the Central Bank, since this system became more dependent on CB interventions.

- **Chronic Fiscal Deficits:**

Lebanon has suffered from long-lasing fiscal deficit as public expenditures exceeded public revenues, forcing governments to depend on debt financing. The Lebanese government operated without a budget for around a decade, from 2005 till 2016. In other words, the consecutive governments functioned without financial planning or accountability. This lead to a decade of governmental spending that exceeded revenues resulting in yearly fiscal deficits. Instead of performing needed governmental reforms, it handled the issue to the Central Bank to solve the issue. As such, the Central Bank resorted to operations called “financial engineering” (will be discussed in more details later) to provide the governments with new foreign currency deposits to pay the public obligations while accumulating hidden losses that reached around \$70 billion.

▪ Large Public Debt

As stated above, previous persistent fiscal deficits forced previous governments to finance these deficits through debt, which resulted in accumulation of debt to levels that weighed on governments' finances. As such, repayment exceeded government's ability leaving it to barely settle debt service payments.

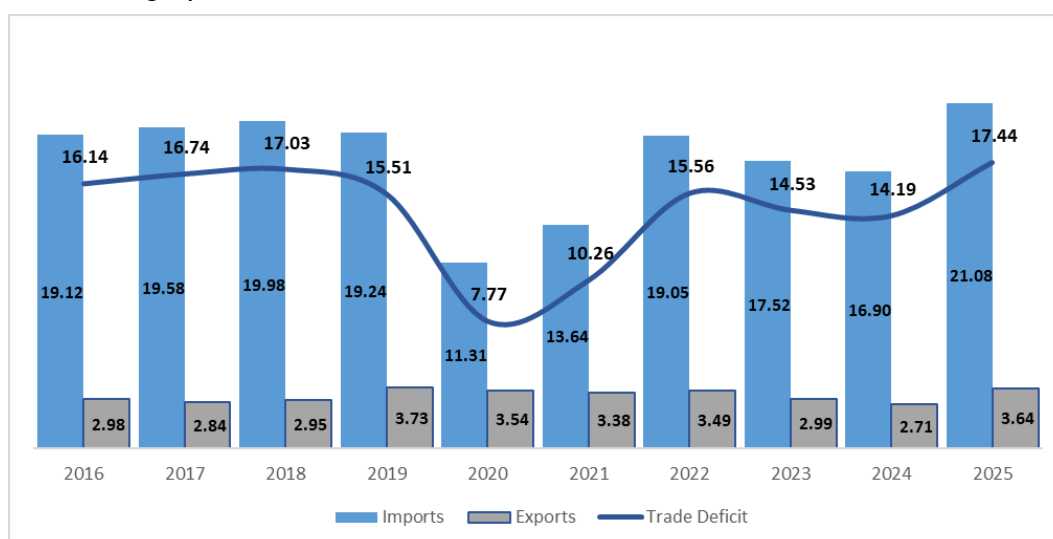
▪ Dependence on Capital Inflows

Lebanon's economic structure has historically depended on prolonged capital inflows, either from remittances from its large diaspora or from tourism sector (especially Arab tourists). The hard currency inflows played a critical role in financing fiscal deficits over the years and thus creating a fragile equilibrium highly sensitive to regional conditions. This was proved when the relations with GCC countries worsened, tourism inflows witnessed a huge decrease.

▪ Current Account Deficits (Trade Deficit):

Lebanon witnessed trade deficits for decades. Its free-market economy relied heavily on imported goods since the capacity of Lebanese goods' produced locally is relatively limited and uncompetitive.

Below graph shows the Lebanese trade deficits over the last decade.



Source: Lebanese Customs

- Financial Engineering: To help maintain the peg, and to provide the government with needed foreign currency to finance its expenditures, BDL created a high-interest scheme for channeling foreign currency deposits from banks to the Central Bank in 2026 that only helped to postpone the crisis and, sadly, to render it deeper

Uniqueness of Lebanon's Crisis

What makes Lebanon's case unique, are the three below main issues.

- One of the Largest Banking Losses in Modern History
 - Financial sector losses reached around \$70 billion (around 212% of 2025 GDP, assuming that GDP in 2025 is \$33 billion as per BDL's Macroeconomic review)
 - Extraordinary concentration of losses at Central Bank and the sovereign level
- Longest Deposit Freeze Without Resolution
 - Restrictions on clients' deposits for more than six years (since late 2019)
 - No comprehensive solution since late 2019, mainly due to absence of political will and consensus

As such, Lebanese crisis combines both systemic insolvency and persistent absence of legal solution.

- Political Economy Failure
 - A governance crisis arose as legislators repeatedly failed to legislate capital control, bank restructuring law, financial gap recognition, and loss allocation framework after several drafts prepared.

What Have Been Done vs. What Should Have Been Done

When the crisis erupted, foreign assets at the Central Bank were around \$38 billion in end of October 2019. However, due to several disastrous decisions were taken by previous governments and previous Central Bank officials, almost two-thirds of these foreign assets were wasted.

- **Done:** Subsidies to Food and Fuel Importers
The government that was formed just after the crisis, took a decision to subsidize imported goods related to food and fuel. It was a corrupt, wasteful, and costly program (some of the subsidized goods were even exported!). Reportedly, it spent around \$10-12 billion of foreign reserves on these subsidies.

Should Have Been Done: The government could have created a program similar to the programs currently done by Ministry of Social Affairs (for

instance “Aman” program). As such, each family could have benefitted from a specific amount of money, on a monthly basis, for food and fuel purchases.

- **Done:** Central Bank issued basic circular 161 (Sayrafa), selling FX at a subsidized rate, where some people and companies made huge profits on arbitrage through their Sayrafa operations, estimated at around \$3.23 billion.

Should Have Been Done: This circular should not have been issued since it only caused more hemorrhage of FX reserves and benefited largely the wrong people.

- **Done:** Central Bank issued intermediate circular 568 that allowed resident creditors to settle their retail and corporate loans either in LBP at official rate back then (1,507.5) or through local dollar checks that reached 10% of real value. These settlements resulted in losses to banks (from depositors' money) by around \$15 billion.

Should Have Been Done: Loans should have been either rescheduled with lower monthly payments or involved delayed maturities. As an example, if a client has a monthly installment of \$300 (being 30% of his \$1,000 monthly salary), then this loan could have been rescheduled so that it becomes \$150 per month (remains 30%, assuming that the new salary became equivalent to \$500).

- **Done:** Sovereign Bond Default: The reason stated by the officials back then was that Lebanese citizens should be prioritized not foreign creditors, but that didn't happen. Most of the foreign assets were wasted through subsidizing goods and perhaps transferred to other countries worldwide.

Should Have Been Done: The government should have not announced its default on these bonds. Even if they chose to default, it should have been a structured default with negotiations with Eurobond holders on a new mechanism for settlement.

- **Done:** Unofficial and Unethical Capital Control

Should Have Been Done: Legal capital control law should have been issued by the Lebanese Parliament within the 14 days' bank holiday to prevent transfers to officials and influential people. Typically, in all countries facing crises such law was issued in the first couple of days of the crisis.

Table of Comparison Between IMF Criteria and Lebanese Banking Crisis

IMF Criterion	Y/N
Severe Banking Distress	Y
Deposit Restriction	Y
Bank Insolvency	Y
Currency Collapse / Depreciation	Y
Sovereign Default	Y
IMF Involvement	Y
Large Output Losses	Y

Lessons Learned from Global Examples

Several lessons could be learned from previous global banking crisis.

Lesson One: Loss Recognition Cannot Be Delayed Forever

Rapid recognition of losses is a common feature in global crisis, in contrast to Lebanese case where it was delayed for years.

Lesson Two: Shareholders Must Absorb Losses First,

This is what happens when the origin of the crisis is in the banking system. However, since the Lebanese crisis is unique and its origin is in the Central Bank which wasted depositors' money on the peg and the government, then the hierarchy of claim should include Central Bank and the State. In addition, shareholders already lost most of their capital (more than \$15 billion) in addition to the new fresh capital (around \$4 billion) that they were obliged to inject as per CB instructions.

Lesson Three: Depositor Protection Is Vital

Protecting depositors and restoring confidence in the banking system is indispensable, e.g. Sweden's 1991 crisis, United States' financial crisis in 2008, and Cyprus 2013 crisis.

Lesson Four: Sovereign Reform Is Essential for Banking Recovery

Several previous international cases reveal that banking crises are rarely solved without addressing sovereign weaknesses and implementing the required reforms.

IV. Conclusion

The Lebanese Banking System crisis is a unique case that reveals that the systemic banking crisis becomes costlier when losses are camouflaged and restructuring is postponed. Despite its uniqueness in magnitude and duration, previous international evidence suggests that recovery is still possible in case authorities are keen to apply the required measures and reforms. We will have a chance to discuss these measures in a future spotlight, but suffice it to say that measures should include a transparent loss-recognition framework, restructuring of insolvent banks and financial institutions, protecting depositors and especially small depositors, and implementing credible economic /financial reforms. Finally, and most importantly, accountability is key in restoring confidence and legislators should not only enact laws consistent with both the lessons learned and the uniqueness involved, but also hold everyone into account with none immune to the law.

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