"Overcoming Lebanon's economic crisis", viewpoint in The Banker, Oct 2020

This article, titled "Overcoming Lebanon's economic crisis", appeared as a viewpoint in the Oct 2020 edition of The Banker. The article, posted below, can be directly accessed on The Banker's website.

Overcoming Lebanon's economic crisis

Lebanon's financial and economic crises can only be solved with meaningful reform, without which it faces a lost decade of mass migration, social and political unrest and violence.

Violence and crises have shattered Lebanon's pre-1975 Civil War standing as the banking and financial centre of the Middle East. Lebanon is engulfed in overlapping fiscal, debt, banking, currency and balance of payments crises, resulting in an economic depression and humanitarian crisis with poverty and food poverty affecting some 50% and 25% respectively of the population. The Lebanese Pound has depreciated by some 80% over the past year, with inflation running at 120% and heading to hyperinflation. A Covid-19 lockdown and the Port of Beirut horrendous explosion on August 4th created an apocalyptic landscape, aggravating the economic and unprecedented humanitarian crises. The cost of rebuilding is estimated to exceed $10 billion, more than 25% of current GDP, which Lebanon is incapable of financing.

The economic and financial meltdown is a culmination of unsustainable fiscal and monetary policies, combined with an overvalued fixed exchange rate. Persistently large budget deficits (averaging 8.6% of GDP over the past 10 years), structural budget rigidities, an eroding revenue base, wasteful subsidies, government procurement riddled with endemic corruption, all exacerbated fiscal imbalances.

Meanwhile, a monetary policy geared to protecting an increasingly overvalued exchange rate, led to growing trade and current account imbalances and increasingly higher interest rates to attract deposits and capital inflows to shore up dwindling international reserves. Deficits financed current spending, with limited real investment or buildup of real assets, while high real interest rates stifled investment and growth.

The unsustainable twin (current account and fiscal) deficits led to a rapid build-up of public debt. Public debt in 2020 is running at $111 bn, including $20 bn of debt at Banque du Liban (BdL), the country's central bank. This figure represents more than 184% of GDP– the second highest ratio in the world behind Japan, according to the the IMF, Most of this debt is held by domestic banks and BdL, with 13% held by foreigners.

Financing government spend

The BdL's financing of government budget deficits, debt monetisation, large quasi-fiscal operations (such as subsidising real estate investment) and bank bailouts, created an organic link between the balance sheets of the government, the BdL and banks. In effect, depositors' monies were used by the banks and the BdL to finance budget deficits, contravening Basel III rules and prudent risk management.

BdL policies led to a crowding-out of both the private and public sectors, and to disintermediation: the government could no longer tap markets, so BdL acted as financial intermediary i.e. paying high rates to the banking system, while allowing the government to borrow at lower rates. The higher rates increased the cost of servicing the public debt, with debt service representing some 50% of government revenue in 2019 and over one third of spending. Credit worthiness rapidly deteriorated, leading to a 'sudden stop' in 2019, with expatriate remittances and capital inflows moving into reverse.

The crisis Lebanon is now experiencing is the dramatic collapse of what economists describe as a Ponzi-like scheme engineered by the BdL, starting in 2016 with a massive bailout of the banks equivalent to about 12.6% of GDP. Ina bid to protect an overvalued LBP and finance the workings of government, the BdL started borrowing at ever higher interest rates, through so-called “financial engineering” schemes, which evolved into a vicious cycle of additional borrowing to pay maturing debt and debt service, until confidence evaporated and reserves were exhausted.

With the BdL unable to honour its foreign currency obligations, Lebanon defaulted on its March 2020 Eurobond and is seeking to restructure its domestic and foreign debt. The resulting losses of the BDL exceed $50 bn, equivalent to 2019 GDP, a historically unprecedented loss by any central bank.

With the core of the banking system, the BDL, unable to repay banks’ deposits, the banks froze payments to depositors. The banking and financial system imploded. The bubble burst in the last quarter of 2019, with a rapid depreciation of the LBP during 2020. The BDL’s costly attempt to defy the “impossible trinity” by simultaneously pursuing an independent monetary policy, with fixed exchange rates and free capital mobility resulted in growing imbalances, a collapse of the exchange rate and an unprecedented financial meltdown.

Economic disaster

A series of policy errors triggered the banking and financial crisis, starting with the closure of banks in October 2019, ostensibly because of anti-government protests decrying government endemic corruption, incompetence and lack of reforms. A predictable run on banks ensued, followed by informal capital controls, foreign exchange licensing, freezing of deposits, inconvertibility of the LBP and payment restrictions to protect the dwindling reserves of the BDL. These errors precipitated the financial crisis, generating a sharp liquidity and credit squeeze, the sudden stop of remittances and the emergence of a system of multiple exchange rates.

The squeeze severely curtailed domestic and international trade and resulted in a loss of confidence in the monetary system and the Lebanese pound. With the outbreak of Covid19 and lockdown measures came a severe drop in tax receipts, resulting in the printing of currency to cover the fiscal deficit, generating a vicious cycle of exchange rate depreciation and inflation. The black market exchange rate touched a high of LBP 9800 in early July, before steadying to around LBP 7400 in early September (versus the official peg at 1507). In turn these policy measures led to a severe economic depression, with GDP forecast to decline by 25% in 2020, with unemployment rising to 50%.

In response to the crisis, the government of Hassan Diab prepared a financial recovery plan that comprised fiscal, banking, and structural reforms as a basis for negotiations with the IMF. In effect, the Diab government and Riad Salameh, governor of the BDL deliberately implemented an inflation tax and an illegal 'lirafication' – a forced conversion, a spoliation, of foreign currency deposits into LBP to achieve internal real deflation. The objective is to impose a 'domestic solution' and preclude an IMF programme and associated reforms.

The apocalyptic Port of Beirut explosion on August 4, compounded by official inertia in responding to the calamity, has led to the resignation of the Diab government and appointment of a new PM, Mustafa Adib. Economic activity, consumption and investment are plummeting, unemployment rates are surging, while inflation is accelerating. Confidence in the banking system and in macroeconomic and monetary stability has collapsed.

Rebuilding the economy

Prospects for an economic recovery are dismal unless there is official recognition of the large fiscal and monetary gaps, and a comprehensive, credible and sustainable reform programme is immediately implemented by a new Adib government. Such a programme needs to include immediate confidence building measures with an appropriate sequencing of reforms. The government must immediately passing a credible capital controls act to help restore confidence and encourage a return flow of remittances and capital inflows. Immediate measures need to be taken to cut the budget deficit, including by removing fuel subsidies and all electricity subsidies (which account for one-third of budget deficits). The removal of these subsidies is necessary to stop smuggling into neighbouring Syria, which has been a major drain on international reserves.

Monetary policy reform is needed to unify the country’s multiple exchange rates, moving to inflation targeting and a flexible exchange rate regime. Multiple rates create market distortions and incentivise more corruption. In addition, the BdL will have to repair and strengthen its balance sheet, stop all quasi-fiscal operations and government lending. Credible reform requires a strong and politically independent regulator and policy-maker.

There is a need to restructure the public domestic and foreign debt (including BdL debt) to reach a sustainable debt to GDP in the range of 80 to 90% over the medium term; this implies a write down of some 60 to 70% of the debt. Given the exposure of the banking system to government and BDL debt, a debt restructuring implies a restructuring of the banking sector whose equity has been wiped out.

A bank recapitalization and restructuring process should top the list of reforms, including a combination of resolving some banks and merging smaller banks into larger banks. Bank recapitalisation requires a bail-in of the banks and their shareholders (through a cash injection, sale of foreign subsidiaries and assets) of some $25 bn to minimise a haircut on deposits. As part of such far-reaching reforms, Lebanon needs a well-targeted social safety net to provide support for the elderly and vulnerable segments of the population

Crucially, the new government needs to rapidly implement an agreement with the IMF. Lebanon desperately needs the equivalent of a Marshall Plan, a “Reconstruction, Stabilisation and Liquidity Fund’ of about $30 to 35bn, along with policy reform conditionality.

A comprehensive IMF macroeconomic-fiscal-financial reform

programme that includes structural reforms, debt, and banking sector restructuring would help restore faith in the economy in the eyes of the Lebanese diaspora, foreign investors/aid providers and help attract multilateral funding from international financial institutions and Cedre conference participants, including the EU and the Gulf Cooperation Council. This would translate into financing for reconstruction, access to liquidity, stabilise and revive private sector economic activity.
Without such deep and immediate policy reforms, Lebanon is heading for a lost decade, with mass migration, social and political unrest and violence. If the new government fails to act, Lebanon may turn into "Libazuela"!

How GCC countries can adapt policies for a post Covid-19 world, Article in The National, 23 Jun 2020

This article titled "How GCC countries can adapt policies for a post Covid-19 world" appeared in The National on 23rd June, 2020. The original article can be accessed here.

How GCC countries can adapt policies for a post Covid-19 world

by Dr. Nasser Saidi and Aathira Prasad

As countries emerge from three-months of Covid-19 containment, policy makers need to plan for a transformed post-pandemic world and create a new development model

Covid19 continues to be part of life as we know it. The GCC nations are gradually emerging from lockdown. There are nodes of optimism as the number of recoveries outpace the confirmed cases, including in the UAE.

Stimulus packages across the GCC included a number of common policy actions – rate cuts, liquidity enhancing measures, deferment of loans and credit card payments. Also noteworthy is the support extended to small and medium sizes enterprises (SMEs) and affected sectors impacted by the pandemic-induced lockdowns which include tourism, hospitality and aviation.

After almost 3 months of lockdowns, countries are phasing their recovery plans. As we gradually emerge from Covid-19 containment, policy makers need to plan for a transformed post-pandemic world, which underscores the need to create a new development model.

For the GCC countries, this means reviewing three broad policy measures related to monetary and fiscal policies as well as structural reforms.

Most GCC nations are pegged to the dollar except for Kuwait which pegs its dinar to a basket including the greenback. Hence, the countries follow the Fed's interest rate moves, which may limit the use of other instruments of monetary policy and might restrict other policy moves from the central banks other than stimulus packages to increase liquidity.

So what can the central banks do to support their economies, while maintaining a peg or moving to a currency basket? Two innovative ways of providing support would be the establishment of GCC central bank swap lines and monetising new government debt issued for deficit financing.

The establishment of GCC central bank swap lines, with an option for the larger central banks (SAMA, UAE) to tap the Fed or People's Bank of China (PBoC) would enable regional central banks to tap additional liquidity during times of market stress, support financial stability and provide a liquidity backstop.

Monetising new government debt issued for deficit financing can help avoid the crowding out of the private sector and inject liquidity, given the lack of developed local currency debt markets and central banks' limited ability to conduct open market operations.

On the fiscal policy front as part of their pivot towards diversifying their economies and becoming less reliant on oil revenues, a move towards deficit financing along with the institution of fiscal rules for long-term fiscal sustainability can help accelerate the development of local currency debt and mortgage markets to finance housing and long-term infrastructure projects.

Rationalising government spending either by reducing the size of government, shifting activities to the private sector, and moving to targeted subsidies is another element of fiscal reform. In conjunction governments can issue long term debt that can be bought by central banks during a crisis period which is happening in the US and Europe today.

Diversify government revenues by improving the management of public commercial assets and increasing the efficiency of tax collection is an important element of fiscal reform. Consolidating the large number of fees and charges on consumers and businesses into fewer broad-based taxes, can help lower business and living costs.

The Covid pandemic is also an incentive for "Green New Deals" through investment in public health, domestic AgriTech for food security, renewable energy, clean cities and technologies, that will support job creation and economic diversification. Governments can take the first step to ensure a project pipeline, focusing on public-private partnerships, with targeted incentives for SME participation.

Accelerating the digitisation drive will also lower the cost of broadband internet and accessibility while speeding up the implementation of 5G.

The establishment of social safety nets and protection programs and pension schemes will also help reduce financial burdens that can come around in periods of crisis. For employees, a contribution towards a pension fund would ensure sufficient savings in the event of job losses or retirement and for employers, this provides them with an investment fund and support end-of-service or gratuity payments.

Structural reforms including the acceleration of privatisation, working closer with private sector participation is key. Developing insolvency frameworks to support out-of-court settlement, corporate restructuring and adequately protect creditors' rights is another important element. Enhancing the environment that continues to attract and retain human capital through a permanent residency programme could help generate significant economic gains.

A positive side-effect of Covid-19 is the realisation that working from home is a feasible option. Companies can offer flexible work options, reduce office space and rents, while employees can stay at cheaper home locations, save on rents, and telecommute. To realise these benefits, requires removing barriers by amending labour laws and liberalising voice over Internet Protocol (VoIP).

The Covid-19 perfect storm is an unprecedented opportunity for the GCC countries for a policy reset, to steer toward a new development model for a post-pandemic world and move away from business as usual.

"What Are the Top Three

Priorities for Lebanon's New Government in the Coming Weeks?", Comment in Inquiring Minds, Diwan (Middle East Insights from Carnegie), 30 Jan 2020

Dr. Nasser Saidi was asked to provide his responses to the question “What Are the Top Three Priorities for Lebanon’s New Government in the Coming Weeks?” as part of a comment in Inquiring Minds, published by Diwan (Middle East Insights from Carnegie) on 30th Jan 2020. The comment is posted below and link to the original article is here.

What Are the Top Three Priorities for Lebanon’s New Government in the Coming Weeks?

Nasser al-Saidi | President of Nasser Saidi & Associates, former Lebanese economy minister

The Lebanese government must focus, first, on a macro-fiscal-financial-banking program. Lebanon’s key macroeconomic indicators point to a severe economic, financial, banking, currency, and current account crisis: a fiscal deficit of 15 percent of GDP and climbing; a sovereign debt equivalent to 160 percent or more of GDP; inflation nearing 30 percent; a depreciation of the Lebanese pound in the parallel market of around 40 percent; and officially declared international reserves of $31.5 billion, while Morgan Stanley estimated net reserves at $11.5 billion at the end of 2019.

The immediate step required is for a ministerial crisis task force (not another "committee") tasked to prepare a macro-fiscal-financial-banking reform plan, in coordination with the International Monetary Fund (IMF) and the World Bank to include sovereign and central bank debt restructuring. The aim is to rapidly, within the next four weeks, establish an Economic Stabilization and Liquidity Fund for Lebanon, multilaterally funded by the IMF and World Bank, along with the Paris IV participants amounting to some $25 billion in order to stabilize the economy, support growth promoting infrastructure investment (in partnership with the private sector), fiscal reform, balance of payments support, banking sector (including the central bank) restructuring and debt restructuring, by providing guarantees of principal of restructured, longer maturity debt.

Second, the government must provide a social safety net. The sharp drop in economic activity (given the lack of government, business, and consumer confidence amid growing protests) has led to growing layoffs and unemployment, business closures and bankruptcies, falling incomes, a severe decline in household consumption, thereby pushing more people into poverty. The World Bank estimates the extreme poverty rate, that is people below the food poverty level, at 20 percent of the population (760,000), while 41 percent of the population (1,500,000) is below the poverty line. The government needs to set-up a targeted social safety net (via cash transfers mainly) to provide support for the elderly and most vulnerable segments during the painful reform process, with the aim of lowering inequality and reducing poverty in the medium term.*

Third, the government must introduce an anti-corruption and stolen asset recovery program. Endemic corruption, bribery, nepotism are a cancer eating and destroying Lebanon's economy and its social and political fabric. Lebanon is the 37th most corrupt nation out of total 180 countries. Protestors have, justifiably, focused on high-level corruption. The new *government must prioritize combating corruption at all levels by appointing and empowering a special anti-corruption prosecutor and unit and implementing an anti-corruption program with respect to taxation and revenue collection as well as reforming government procurement law and procedures. In addition, the state must recover assets that have illicitly and criminally appropriated by politicians and their associates.*

Recovering stolen assets can be a wealth-generating strategy if implemented properly with complete transparency. Lebanon will require international cooperation and building appropriate capacity to support asset recovery. It must abolish the Banking Secrecy Law of 1956, lifting the veil on the misappropriated monies and assets of politicians, their cronies, and civil servants.

Podcast on Lebanon with The National, 23 Jan 2020

In this episode of Beyond the Headlines, The National's Willy Lowry reported from the tear gas-filled streets of Beirut. He spoke to young people angry at what they've called Mr Diab's "one-colour" government.
Also on the show is Dr. Nasser Saidi *(from 10:00 onwards)***, a former Lebanese economy minister and former vice governor of the central bank of Lebanon. He lays out plainly the scale of the crisis and his recommendations of what the new government should do.**

https://audioboom.com/posts/7486040-tear-gas-fireworks-and-politics-in-lebanon-s-revolution

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Interview with Sky News Arabiya (Arabic) on Lebanon's economic crisis, 21 Jan 2020

Dr. Nasser Saidi discusses Lebanon’s ongoing economic & financial crisis, need to restructure public debt & the banking sector, and undertake an Economic Stabilisation & Liquidity programme with the IMF in an interview (in Arabic) that aired on SkyNews Arabiya on 21st Jan 2020.
The video can be viewed below:

Interview with Dubai TV (Arabic) on Lebanon's protests and economic crisis, 10 Nov 2019

Dr. Nasser Saidi discusses Lebanon’s Economic -Fiscal-Financial-Exchange Rate crises and urgency of appointing a National Emergency Cabinet to implement deep fiscal-monetary &

structural reforms, seek multilateral funding to avoid a crash landing & lost decade of depression & austerity.
The interview (in Arabic), which aired on Nov 10th 2019, can be viewed below: