

# Interview on Lebanon, hyperinflation & the way forward, TRENDS magazine, 5 Sep 2021

An interview with Dr. Nasser Saidi was published in the article titled “Hyperinflation imminent in Lebanon”, in TRENDS magazine dated 5th Sep 2021.

Excerpts from the conversation are posted below; the entire article can be accessed [here](#).

*In an exclusive interview with **TRENDS**, Dr Nasser H. Saidi – former Minister of Economy and Trade and Minister of Industry of Lebanon between 1998 and 2000 and the first Vice-Governor of the Central Bank of Lebanon for two successive mandates, 1993-1998 and 1998-2003 – describes the present Lebanon’s economic crisis as “one of the most massive depressions in Lebanese history”.*

*Dr Saidi, who is also Founder and President of Nasser Saidi & Associates and Former Chief Economist and Head of External Relations at the DIFC Authority, said that Lebanon got here because of multiple crises occurring at the same moment. However, the primary issue was non-sustainable indebtedness, both government and central bank debt, as well as an increasingly unsustainable balance of payments and an inflated value of the Lebanese pounds. These factors have contributed to the current crisis in Lebanon.*

*He claimed that the government’s borrowing was not used to fund the construction of real assets or infrastructure. The Central Bank, on the other hand, was borrowing to defend an overvalued Lebanese pound, so it had to pay high interest; this was referred to as financial engineering, but it was a*

like "Ponzi scheme."

### **How far will Lebanon's inflation fly?**

The Lebanese economy, according to Saidi, is heavily dollarized, which means Lebanon imports a lot of commodities and the currency rate plays a big role in goods and services. As a result of the collapse of the financial exchange rate system, prices began to rise. Furthermore, the Lebanese Central Bank continued to fund the government's deficit, which means infusing more money into the system, resulting in higher inflation rates.

"As a result, we are on the edge of hyperinflation unless the government implements significant deep reforms, such as fundamental, monetary, fiscal, and structural reforms," he said.

Saidi felt that the Lebanese government and Central Bank should issue a new currency, a new lira, and cancel the old currency. "This is because we are on the verge of hyperinflation, with monthly price increases of 25 percent, because of cost adjustments that the government is willing to take," he pointed out.

### **Recovery takes time**

According to Saidi, predicting when Lebanon would emerge again is difficult since it depends on whether changes are implemented, whether a credible government is in place to implement these reforms, and whether Parliament passes the necessary legislation.

He believes that if the Lebanese government started a program right now, it would take Lebanon 5-7 years to re-emerge. However, poverty and unemployment will persist, and it will take a long time to return to Lebanon's productive levels.

Saidi went on to say that Lebanon needed to confront the

humanitarian issue and begin the reform process. As a result, it might require around US\$1.5bn, which we could raise through humanitarian aid meetings, the World Bank, Gulf countries, the EU, and other well-donors.

### **Reasons for banking crisis**

The banking sector is illiquid and insolvent, but, according to Saidi, the reason for its insolvency is that the banks lent money to the Central Bank, which then used those deposits to finance the government and defend the Lebanese lira. As a result, the central bank suffered massive losses of more than US\$60bn.

By the end of 2019, the banking sector had invested over 75 percent of its assets in the Central Bank, government treasury bills, and Eurobonds. The Lebanese Eurobond is now being sold for 12 cents on the dollar, meaning it has lost 88 percent of its value.

This means that the banks' holdings, including their holdings of Central Bank, secured certificates of deposits, and bonds, have also been reduced, resulting in massive losses.

Saidi believes that Lebanon's banking sector, before the crisis, was too big for the size of the economy. Hence the government must reduce the size by at least 50 percent, if not more, which means a total restructuring of the banking sector.

He also added that the Lebanese banks now require an equity injection and must sell some of their assets abroad, which some banks have started so.

The banking system has failed, and there is no longer trust in the financial sector. The Central Bank had a significant role in the failure because of the fixed exchange policy and the government's continuous financing, he said.

### **Regaining the customers' trust**

*To regain the customer's trust, the banks should recapitalize, which requires a large injection of around US\$20bn from the bank's shareholders.*

*According to Saidi, bank bailouts are necessary. Still, they must be followed by a plan to stabilize the economy, such as fiscal and structural changes companies with international aid and financing from the IMF, World Bank, EU, and of course, the GCC countries.*

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## **Comments on hyperinflation in Lebanon in L'Orient Today, 21 Jul 2021**

*Dr. Nasser Saidi's comments were published as part of the article titled "[With Lebanon edging closer to hyperinflation, a family of five now pays five times the minimum wage for food each month](#)" in L'Orient Today; these are copied below.*

Nasser Saidi, a former economy and industry minister, warned that although the country has not yet crossed the hyperinflation threshold, salary stagnation, especially in the public sector, is likely to push it there. Workers in several sectors, including transportation, education and banking, have already held multiple strikes to protest worsening living conditions.

As the security forces and other public sector employees up their demands for a so-called cost-of-living adjustment, Saidi told L'Orient Today, "politicians and parliamentarians will want to placate pressure in the streets [and] vote for a [cost-of-living] adjustment, leading to an increase in

government spending financed by printing money, which will then lead to hyperinflation. That is the looming, likely scenario."

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## **"Staring into the Abyss: Where does Lebanon go from here?", Brookings Doha Centre webinar, 17 Aug 2020**

Dr. Nasser Saidi joined the Brookings Doha Center webinar (held on 17th Aug 2020) for a discussion on the dire political and economic situation in Lebanon.

The session addressed the following questions: Is the country on its way to becoming a failed state, or will the repercussions of the Beirut blast lead to serious reform? Does the French political initiative steered by President Emmanuel Macron have the potential to resolve the crisis? What are the prospects for economic recovery amid stalled negotiations between the Lebanese government and International Monetary Fund? And what role can the international community play in order to assist Lebanon?

Watch the webinar below:

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# How to save Lebanon from looming hyperinflation, Article in The National, 31 Jul 2020

The article titled "How to save Lebanon from looming hyperinflation" was published in The National on 31st Jul 2020. The original article can be accessed [here](#) & is also posted below.

## How to save Lebanon from looming hyperinflation

*To bring the country's economic chaos to an end, it is important to examine how it all began*

In June 2020, Lebanon's inflation rate was 20 per cent, month-on-month. In other words, prices in the country were, on average, 20 per cent more than they were a month before. Compared to a year earlier, in June 2019, they had nearly doubled.

Lebanon is well on its way to hyperinflation – when prices of goods and services change daily, and rise by more than 50 per cent in a month.

Hyperinflation is most commonly associated with countries like Venezuela and Zimbabwe, which this year have seen annual inflation rates of 15,000 per cent and 319 per cent, respectively. Lebanon is set to join their league; food inflation surged by 108.9 per cent during the first half of 2020.

When hyperinflation takes hold, consumers start to behave in very unusual ways. Goods are stockpiled, leading to increased shortages. As the money in someone's pocket loses its worth, people start to barter for goods.

What characterises [countries with high inflation](#) and

hyperinflation? They have a sharp acceleration in growth of the money supply in order to finance unsustainable overspending; high levels of government debt; political instability; restrictions on payments and other transactions and a rapid breakdown in socio-economic conditions and the rule of law. Usually, these traits are associated with endemic corruption.

Lebanon fulfils all of the conditions. Absent immediate economic and financial reforms, the country is heading to hyperinflation and a further collapse of its currency.

### **How and why did this happen?**

Lebanon is in the throes of an accelerating meltdown. Unsustainable economic policies and an overvalued exchange rate pegged to the US dollar have led to persistent deficits. Consequently, public debt in 2020 is more than 184 per cent of GDP – the third highest ratio in the world.

The trigger to the banking and financial crisis was a series of policy errors starting with an unwarranted closure of banks in October 2019, supposedly in connection with political protests against government ineffectiveness and corruption. Never before – whether in the darkest hours of Lebanon's civil war (1975-1990), during Israeli invasions or other political turmoil – have banks been closed or payments suspended.

The bank closures led to an immediate loss of trust in the entire banking system. They were accompanied by informal controls on foreign currency transactions, foreign exchange licensing, the freezing of deposits and other payment restrictions to protect the dwindling reserves of Lebanon's central bank. All of this generated a sharp liquidity and credit squeeze and the emergence of a system of multiple exchange rates, resulting in a further loss of confidence in the monetary system and the Lebanese pound.

Multiple exchange rates are particularly nefarious. They create distortions in markets, encourage rent seeking (when someone gains wealth without producing real value) and create new opportunities for cronyism and corruption. Compounded by the Covid-19 lockdown, the result has been a sharp 20 per cent

contraction in economic activity, consumption and investment and surging bankruptcies. Lebanon is experiencing rapidly rising unemployment (over 35 per cent) and poverty rates exceeding 50 per cent of the population.

With government revenues declining, growing budget deficits are increasingly financed by the Lebanese central bank (BDL), leading to the accelerating inflation. The next phase will be a cost-of-living adjustment for the public sector, more monetary financing and inflation: an impoverishing vicious circle!

We are witnessing the bursting of a Ponzi scheme engineered by the BDL, starting in 2016 with a massive bailout of the banks, equivalent to about 12.6 per cent of GDP. To protect an overvalued pound and finance the government, the BDL started borrowing at ever-higher interest rates, through so-called “financial engineering” schemes. These evolved into a cycle of additional borrowing to pay maturing debt and debt service, until confidence evaporated and reserves were exhausted.

By 2020, the BDL was unable to honour its foreign currency obligations and Lebanon defaulted on its March 2020 Eurobond, seeking to restructure its domestic and foreign debt. The resulting losses of the BDL exceeded \$50 billion, equivalent to the entire country’s GDP that year. It was a historically unprecedented loss by any central bank in the world.

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.

As part of Lebanon’s negotiations with the IMF to resolve the situation, the government of Prime Minister Hassan Diab prepared a [financial recovery plan](#) that comprises fiscal, banking and structural reforms. However, despite the deep and multiple crises, there has been no attempt at fiscal or monetary reform.

In effect, Mr Diab’s government and Riad Salameh, the head of the central bank, are deliberately implementing a policy of imposing an inflation tax and an illegal “Lirafication”: a forced conversion of foreign currency deposits into Lebanese



pounds in order to achieve internal real deflation.

The objective is to impose a 'domestic solution' and preclude an IMF programme and associated reforms. The inflation tax and Lirafication reduce real incomes and financial wealth. The sharp reduction in real income and the sharp depreciation of the pound are leading to a massive contraction of imports, reducing the current account deficit to protect the remaining international reserves. Lebanon is being sacrificed to a failed exchange rate and incompetent monetary and government policies.

What policy measures can be implemented to rescue Lebanon? Taming inflation and exchange rate collapse requires a credible, sustainable macroeconomic policy anchor to reduce the prevailing extreme policy uncertainty.

**Here are four measures that would help:**

First, a "Capital Control Act" should be passed immediately, replacing the informal controls in place since October 2019 with more transparent and effective controls to stem the continuing outflow of capital and help stabilise the exchange rate. This would restore a modicum of confidence in the monetary systems and the rule of law, as well as the flow of capital and remittances.

Second is fiscal reform. It is time to bite the bullet and eliminate wasteful public spending. Start by reform of the power sector and raising the prices of subsidised commodities and services, like fuel and electricity. This would also stop smuggling of fuel and other goods into sanctions-laden Syria, which is draining Lebanon's reserves. Subsidies should be cut in conjunction with the establishment of a social safety net and targeted aid.

These immediate reforms should be followed by broader measures including improving revenue collection, reforming public procurement (a major source of corruption), [creating a "National Wealth Fund"](#) to incorporate and reform state commercial assets, reducing the bloated size of the public sector, reforming public pension schemes and introducing a credible fiscal rule.

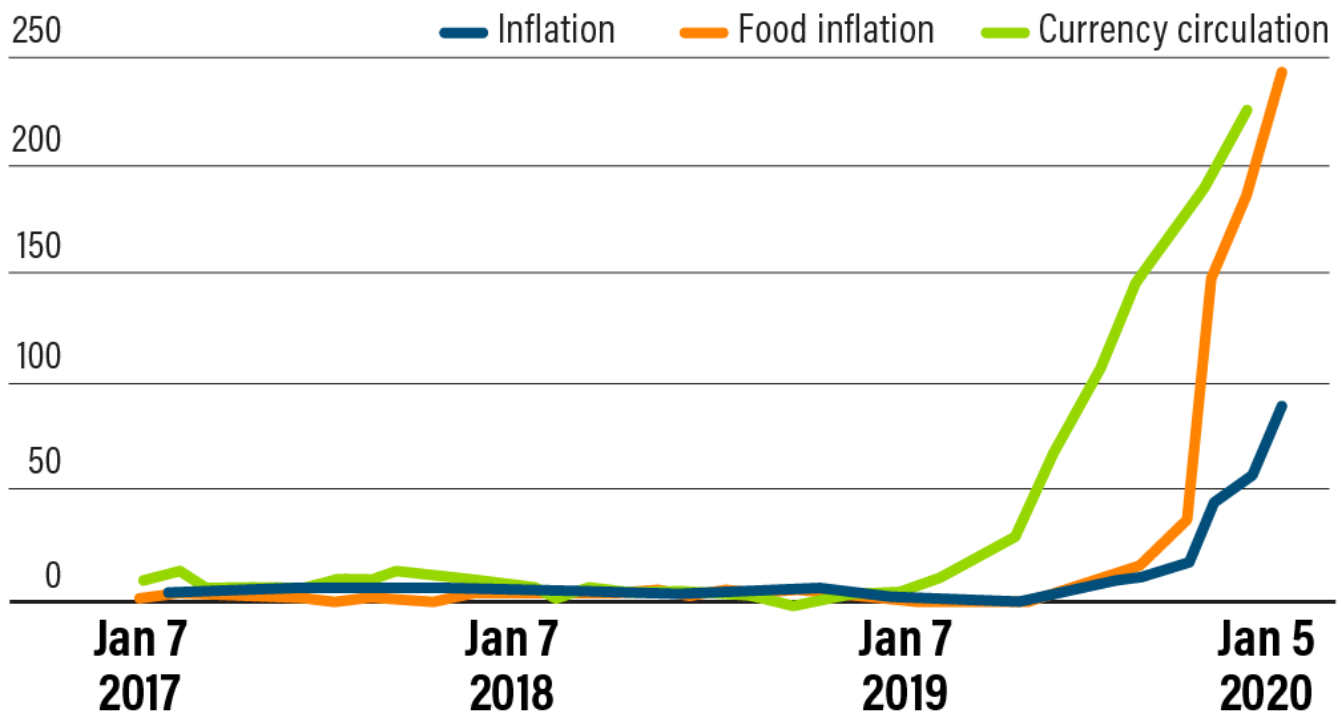
Third, unify exchange rates and move a to flexible exchange rate regime. The failed exchange rate regime has contributed to large current account deficits, hurt export-oriented sectors, and forced the central bank to maintain high interest rates leading to a crowding-out of the private sector. Monetary policy stability also requires that the BDL should be restructured and stop financing government deficits and wasteful and expensive quasi-fiscal operations, such as subsidising real estate investment.

Fourth, accelerate negotiations with the IMF and agree to a programme that sets wide-ranging conditions on policy reform. Absent an IMF programme, the international community, the GCC, EU and other countries that have assisted Lebanon previously will not come to its rescue.

Lebanon is at the edge of the abyss. Absent deep and immediate policy reforms, it is heading for a lost decade, with mass migration, social and political unrest and violence. If nothing is done, it will become "Libazuela".

*Nasser Saidi is a former Lebanese economy minister and first vice-governor of the Central Bank of Lebanon*

## LEBANESE CENTRAL BANK'S MONEY SURGE IS FUELLING INFLATION (%)



Source: Central Administration of Statistics, BDL, Nasser Saidi & Associates

