Monetary Literature

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Initial Notice

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Research & Intelligence Script

1. Monthly Anticipation

A) October Outlook: dated September 30, 2020

Tags: Insolvency, Devaluation, Cash

Looking for the month ahead of us, after analyzing what occurred in September, and while holding all else equal (political developments), Lebanon is **expected** to face some severe **capital restrictions**, more severe than the ones we have now. Indeed, this relates to the old fact that the banks and the BDL are **insolvent**, and are unable to honor their obligations, whether it be interior or exterior. This insolvency could all be realized through the collapse of the fictitious official exchange rate (1,500 LBP/USD), which can in turn trigger a major wave of revaluations for the books of the banks (since they are held at their historic value), rendering a large part of these banks' **net worth** (equity) **negative** (some USD 67 billion). However, some players in the financial system are unwilling to **allocate their losses**, causing a postponement of a much-needed systematic restructuring of the domestic financial system, and this would consequently, worsen the outcome of this unfortunate debacle, and that is if any outcome is allowed to be expressed further in the future.

The **release valve** is expected to be the national currency for October, and this is a direct result of having to depend on a **cash economy**. Many reasons are at play here, assuming the conditions are ripe for **excess currency devaluation**.

The continuous **flooding** of the market with worthless local currency, topped with **inaccessible** banking services creates a **vicious cycle** of further dependence on cash for daily transactions, but this would all materialize if two important conditions would be met. An increase in the demand for **legal tender**, and in the **velocity of money**.

This sort of situation, assuming **no major change** happens, is described as "muddling through", and that includes **no ultimate collapse**, but slowly-worsening economic conditions.

With no introduction of foreign money, in the form of **aid or loan program**, Lebanon would be left to its own devices. This is, of course, assuming that no **positive political advancements** are achieved.

Concerning other sectors of the Lebanese economy (industrial or services), they are either **impaired or struggling to survive**. We emphasize our focus on the financial sector, particularly banks, because our economy was practically **built upon** them. Adding to this, Lebanon held no **industrial base** and that made our country more dependent on imports, which were naturally **financed** by the banks and the BDL.

B) November Notice: dated October 31, 2020

Tags: Foreign Aid, Subsidy, Uncertainty

In anticipation of November's economic developments, following October's **stagnant**, but **indicative** events, it can be partially assured that a "**muddling through**" scenario can be the case for Lebanon.

Clear **reluctance** can be seen from the **political** and **financial** classes of Lebanon to act upon the current despair. The chances of receiving **foreign aid** seems minimal at this point, and all is dependent upon some obscure **political factors**. However, what is certain of the monetary policy, to be pursued by BDL in November, is a gradual "**scaling down**" of subsidized imports, by virtue of **dollar amount**.

An **inflationary** trend can be assured for certain subsidized imports following the policy's effect. This will apply further **pressure** on the domestic USD **black market** as funding turns more **desperate** for the merchants operating in related segments of the economy as a **consequence** of this policy.

This move to decelerate the **squandering** of what **accessible reserves** are left in the BDL, aims to lengthen the **time horizon** of subsidizing these chosen imports. It is similar to a "**holding out**" strategy. For instance, instead of subsidizing 90% of hydrocarbon imports, a 60% rate can be introduced. Such a scenario is indicative of a **weak** and **insolvent** monetary authority. Yet obviously so, its **fiscal counterpart** does not even appear to be any different, but particularly **bankrupt**, and insolvent too.

The symptoms of Lebanon's economic woes suggest that if an **adjustment** were "allowed" to happen, then it would be a **brutal** one. Such brutality is expressed through the **instantaneous** implementation of the IMF's accords, the likes of which include the **lifting** of all **subsidies**, especially that on hydrocarbon imports, a **unified exchange rate**, and a **higher tax rate**. However, the political implications to pursue this path is domestically deemed as **suicidal**.

An adjustment that involves the realization of the preceding **accords** is certainly not a **popular** one. After all, Lebanon's **consecutive cabinets** have been running on economically unreasonable **populous policies**, and so an accommodative **preference** from the people has been rightfully developed over the years.

The **uncertainty** contained herein is simply due to the fact of political **unpredictability**, yet, relatable scenarios can be laid out for the sake of **conceptualizing** the possible outcomes.

C) December Decay: dated November 30, 2020

Tags: Ration, Reserves, Deposits

In adjustment to the upcoming month's expected events, following the official decision to "**ration**" the remaining reserves for the sake of supporting **subsidies**, a strategy of "**holding out**" seems quite evident. At this point, BDL has reportedly flaunted the idea of partially **tapping into** the **required reserves**, some odd **USD 17.5 billion**, in order to progress with the decreed support of **funding** subsidies.

All is reliant upon what mandated policies are left to be taken in Lebanon. The idea of **rationing** the remainder of **allowable reserves** may suggest the government's need to create a **centralized system**, for purposes of **managing** this undertaking. A system as such, can be rolled out in the form of "**income bracket**" **targeting** where classes of specified net worth are entitled to a **formal membership** to this "rationing program".

Policies of this nature are **indicative** of a failed state. The trouble that both **banking** and **political** classes have to endure in order to **avoid** a brutal economic adjustment would bluntly imply a "**harder**" way out for Lebanon, since the nation is now left for its own **financial demise**.

The demise that is repetitively mentioned is greatly related to the status of the domestics banks. Their **reputation** has been severely **impaired**, which happens to relate to the status of their **balance sheets** (still held at **book value**). While efforts of **bank recapitalization** are famously held in complete **secrecy**, no major explicit change can be seen for the banking sector in December, other than incremental **restrictions** on capital.

Indeed, the **fate** of the dollar-denominated deposits its arguably unknown. This can be explained by the **multiple** options of "**reinstating**" them, following the mandatory **adjustment** and **restructuring** of the Lebanese financial system. Even gullibly so, the government seeks to **guarantee** them, under no clear framework, and BDL seems to **reassure** their integrity, through **little transparency**. Nonetheless, a **static environment** will most likely be the case in the upcoming month concerning this crucial topic.

Due to the **continuous** political meddling, no vision of foreign aid seems visible for December 2020. It is also expected, that with such meddling, no honest **forensic audit** can either be conducted. This simple fact may weaken any **hope** of receiving **external support** for the short or long term, thereby prolonging Lebanon's **unfortunate** economic **decay**.

D) January Juncture: dated December 31, 2020

Tags: Recapitalization, Merger, Banks

Closing on the final days of 2020, much of the **stagnant** economic developments have yet to fully reflect on the upcoming **structural changes** awaiting Lebanon in 2021. With **bank recapitalization** already under way, the domestic banking system is witnessing a **silent overhaul** of its established **construct**. The results of such would arguably appear by **February** and **March** of 2021, if deemed **politically possible**.

As decreed by BDL, commercial banks shall **replenish** their Net Worth by **retracting** capital through various methods. Efforts as such may involve staff, branch, and loan book **downsizing**, balance sheet **restructuring**, and additional injection of **shareholder capital**, all for the sake of enhancing **bank liquidity.** An important option to consider, as to the support of bank recapitalization, are **bank mergers**. This very option can **tremendously** aid in reinstating bank liquidity by **combining** balance sheets of two separate entities. Naturally, mergers force the **incorporation** of **small** and "**insignificant**" banks into their **larger** and "**systemic**" counterparts, and as a result, the banking sector emerges more **concentrated** upon a selected bunch of **depository institutions**.

Along the recapitalization process, the economic environment for the month of January is also expected to be a **stagnant** one. Any major effort towards **political** or **financial systemic reform** have yet to begin. The **uncertainties** enshrined in Lebanese politics tend to obscure the **possibility** of certain upcoming reforms, but there may emerge a new set of **financial regulations** in anticipation of "recapping" and merging domestic banks. Such regulations may concern **bank withdrawals**, **liquidity**, **leverage**, **credit creation**, **asset purchases**, and **AML/KYC operations**.

Further developments expected in January await the **creation** of a "digital" Lira. BDL still maintains a degree of **ambiguity** concerning this matter. Nevertheless, the appearance of such a **weak innovation** proves the sovereign's **failure** in "properly" implementing monetary policy. A clear example of this is the existence of **multiple exchange rates**.

Moreover, prospects of receiving **foreign aid** seem far from it. The only aid that may be acquired can only be found **within**. Reforms are slow to achieve in a **Lebanese consensus**, however, it is **forthcoming**.

January is believed to be an **economic turning point** for Lebanon, plenty of changes lay beyond that month.

E) February Falter: dated January 31, 2020

Tags: Stagnation, Deposits, Regulation

In the Outlook for the month of **February**, 2021, a **crucial event** is set to take sway in the nation's banking sector. At the unraveling of "bank **recapitalization**", certain "**weak**" players will be **casted out** of their business through manners of a **merger & acquisition**. In **hindsight**, the banking sector is expected to become a much **concentrated** one, given the fact that such a sector had already been **dominated** by **few commercial institutions**. On BDL's side, subsequent **regulatory adjustments** on matters of **bank liquidity**, **reserve requirements** and **allocation**, **risk tolerance**, **credit policy** and **facility**, **net worth adjustment**, and other **AML & KYC operations** must be ensured of their **implementation** following the initial steps of **reforming** the financial system. If the **sovereign authorities** are in fact **serious** of initiating the **essential** process of **systemic reform**, then no **disruption** or **postponement** of such an undertaking must occur.

With a **continuing projection** in economic **stagnation**, there exists no prospect of any actual or effective change on the **macro** side. The severe **contraction** in **bank credit** and **restriction** to **bank deposits** have rendered a **prolonged period** of conditions similar to that of the past three months, which are broadly associated with the quasi-exchange-rate regime (**USD black market**), **faltering** living conditions, and **fateful uncertainty** of depositors' claim on banks (depositors' money).

It is, by now, an **implicit truth** that depositor's **holdings** with banks may not **wholly recover** their supposed **nominal amount** (some **USD 115 billion**), the **skew** in bank deposit **composition** and the **loses** incurred through past **banking operations** suggests such an outcome. In anticipation of any **future regulation** or **reform**, the banks would want to opt for various methods of "**relieving themselves**" for such **obligations** (deposits) by offering their clients certain "**products**" or "**deals**" that concern a **mix** of **equity**, **debt instruments**, **long-maturity term deposits**, and **currency swap contracts**. Operations of this kind have been **ongoing** for quite some time, ever since October 2019.

Further **expectations** for the month of February revolve around the **status** of the Required Reserves, **supposedly available** at BDL. At this pace, with **no vision** of a **rescue plan**, all remaining FX reserves (about USD 1.8 billion), purposed for **supporting subsidies**, would eventually be **depleted**. Therefore, if this were to happen, then **tapping into** the Required Reserves would emerge as a considerable **option**. However, this has yet to be realized, knowing that various government officials have **falsely argued** that such **support** would **not sustain** the nation beyond **November 2020**.

End of section…

2. Weekly Analysis

A) A Weaker Lira In Retrospect: dated October 5, 2020

Tags: Banks, Currency, Interest Rates

Talking about the **quasi-heist** that the average depositor fell victim to **(fictitious interest rates)** would be an elaborate expression of injustice. It is true that injustice exists here, though the causes of such can be traced back to **2011**.

The Lebanese economy began to experience a **decline**. 2011 was the climax. The 2012 GDP growth rate failed to exceed its preceding rate of **8%**, and had scored only **0.9%**. This is a natural **consequence** of the geopolitical quarrels that appeared in the region (outbreak of the Syrian protests). Coincidentally, the **"Beirut Reference Rate"** on **LBP** and **USD** began their slow march to the top.

Analyzing the ongoing events from this point of view may suggest a lot to us. With a **low-growth** economy, repetitive **hikes** in interest rates (from 2012 til 2019), and no national ability of **exporting**, the Lira was bound for **devaluation**. Adding to this, Lebanon's main source of USD funding were either **remittances** from its diaspora, or outright issuance of **sovereign debt**. Any other source would be considered minor. No major **Foreign Direct Investment** (FDI) had been made to Lebanon. The BDL and the banking system were left to deal with this predictable fate of the Lira, and so they **erroneously** chose to keep the peg alive.

Many issues of the LBP could have been easily solved by allowing an **orderly depreciation** of its value, and that would have relieved the central bank, and in turn the banks, of their **FX obligations** (demand for FX imports), but decisions were made on the basis of political interests (regarding self-interest) and not **economical** ones.

A natural response to a situation like that of Lebanon, of which no major source of USD is present, and where a considerable **dependency** on imports persists, would be to devaluate the local currency. Having done this, it would **reduce** the purchasing power of the locals to buy foreign goods/assets. This would have **incentivized** the growth of the Lebanese **industrial base**. But of course, what can be feasibly produced in Lebanon will be, under the strict condition that the state may set forth the **suitable accommodation** and **incentive structure** for potential industrialists.

The reality for 2020 has shown that the **monetary** and financial issues continue to aggravate. This whole **quagmire** was the direct result of **intentional incompetency**. Surely, a sudden or **rapid** devaluation of the national currency would lead to many consequences, like **defaults**, **currency arbitrage**, **fire sale**, and **price inflation** of non-productive assets (Real Estate).

B) Forward Guidance As A Remedy: dated October 12, 2020

Tags: Industrial Base, Incentive, Credit

As an omnipotent **monetary authority**, whether it be a **central bank**, currency board, or any other convoluted form of a **quasi-sovereign**, its entrusted duty is to set forth an integrated, and well-mannered, **incentive structure** for its enablers to partake in.

Such is the case of BDL, along with the political establishment that forged this currency peg in 1997, and sought to intentionally **maintain** it against all economic and monetary reasoning. The BDL's enablers, the banks, were also incentivized to act in a **non-economic** fashion. One way an economy can witness a "boom" is through the expansion of **bank credit** to the private sector, but not the public counterpart, especially in the case of Lebanon.

Facilitating **bank lending** to **productive** parts of the economy requires the proper, but optimal, incentive structure to be put in place. It required the BDL to implement the needed **"guidance"** in anticipation of a growing economy, thus assigning the term **"forward guidance"**. Such guidance needed a **regulatory** twist to it, and the rest of banking activities would have been sorted out. Banks are **subjective profit-seeking** institutions that would **manufacture** a loan, if deemed profitable. Instead of **leveraging** the real estate market, financing **speculative** government ventures, and reinforcing the ever-rising **interest rates** on deposits, such credit could have been easily allocated to desperate parts of the economy. These desperate segments could have been majorly supported.

First, Lebanon's **industrial base** could have been build from the ground up, even following the civil war, and that would have saved the government from ever needing to excessively borrow from internal or external **creditors**. Plus, FX reserves would have been, to a greater extent, **preserved**.

Second, the agriculture sector could have been well-nurtured to satisfy, even a significant part of, domestic demand for needed **consumer and agri products**.

Plenty of useful initiatives could have seen the light, were the incentives and regulations in line with **national interest**.

Such form of a "planned" capitalist system would have favored Lebanon at best, with regards to forward guidance. With **limited** monetary and natural resource, bearing in mind that our national is no **swap line** recipient of **hard currency** (USD, GBP, or EUR), many unnecessary consequences could have been avoided.

C) Banking On Inconsistency: dated October 17, 2020

Tags: Liquidity, Reserves, Banks

As predicted in our first Monthly Outlook for October 2020, **capital restrictions** have been implemented on certain **withdrawals**, but it comes as a surprise that such restrictions were applied on **LBP-denominated** accounts. This form of decree from the BDL was issued against the **current accounts** of the commercial banks, which are deposited at the central bank itself. In defiance of this new restriction, the Association of Banks in Lebanon (ABL) announced **no change** in policies on customer withdrawals, and this poses a serious inconsistency and **divergence** in bank policies.

The **reasonable** motive behind BDL's latest decree is to curb, and even control, any further **LBP devaluation** against the USD in the local black market. In this scenario, demand on cash would be **normalized**, thereby limiting any **inflationary surge** in consumer goods prices. It all appears to be a decent economic decision to take, but the refusal of ABL to march along this decree raises some concerns. Logic dictates that implementation of limits on **institutional** withdrawals in local currency should directly be followed by a relevant limit on customer LBP withdrawals.

Clearly, the situation serves as a **dichotomy**, and in fact, an **inconsistency** in bank policies. With a restricted limit on the **bank level**, and with no such thing on the **depositor level**, **liquid reserves** would eventually run dry or reach a critical level, unless, some other **implicit monetary operation** is at play.

An explanation to this whole **ploy** of restricting banks from LBP **liquidity**, arranged by BDL, may be to **incentivize** the banks to liquidate parts of their **financial assets** (bills, notes, and bonds), still held at **book value**. If this were the case, then BDL would be exploiting the present **schism** it has with ABL, thereby relieving their **obligations** due to the banks. However, if this assumption was ruled out, then i**ntentional incompetency** would be our **pristine** explanation.

Lebanon has fell victim to reckless and **populous policies** over the years. For every crisis, such as ours, we would need to incur some **severe adjustments** through **deleveraging balance sheets**, **allocating losses**, and **recapitalizing banks**. But the political willingness to realize such a **brutal rebalancing** of the whole banking system, and ultimately, the economy, seems **frail**.

What remains of the current dictated and **inconsistent** bank policies is just an expression of "**holding out**". The social and economic implications of this adjustment is too costly for a **political** or **banking career**.

D) Supply-Side Fiat Manipulation: dated October 26, 2020

Tags: Black Market, Dollar, Supply

Fiat black markets operate in a fashionable but unorthodox (**unregulated**) manner, and to an extent, in accordance to the natural forces of Supply and Demand. Such is the case for the Lebanese **fiat black market**. Truly, the implications of an unregulated economic entity can be expressed through the many cases of **distortion**, **manipulation**, and **political meddling**.

By the end of summer 2019, market participants began facing some obscure symptoms of a **liquidity crunch** in FX currency, namely, the USD. The black market came into play shortly thereafter, and by early September the unofficial "**devalued**" rate of the Lira reached an average of 1700 LBP/ USD.

This **nascent** market gained notable attention from **speculators**, of whom usual and unusual participants came to profit off the unreasonable **fluctuations**. Of course, some of these **volatile** changes in the black market rate could be attributed to the ongoing Lebanese **political plays**. Yet, as much as politics is concerned, there are some intriguing **economic phenomena** that can be observed.

First, the **modest** size of this immature domestic market is highly susceptible to manipulative **adjustments**. Such a fact holds true in that no actual **serious** player is needed to further cause a noticeable change in the **Bid-Ask prices**. All it needs is a rumor to be spread and a **loose network** of USD-holder to be able to **bid up** the price, thereby causing an **unforeseen** commotion.

Second, such a miniature entity renders its "supply" of USD as **insufficient** in satisfying its desperate and **hardly-quantifiable** demand, so this in turn puts no limit on the **lows** that the Lira can reach. Further reinforcing this point is the fact that Lebanese merchants are developing a **dependance** on such a market in order to maintain their **business activities**, and this holds true in the absence of a **central** and **solvent** monetary authority to properly intervene and **support** these local enterprises, and ultimately terminate such **illegal currency manipulation**.

Third, and finally, fear, as a substance of emotion, is an important factor to consider, and in some cases, it may cause a **reinforcing cycle** of bidding up the price for dollars, in **anticipation** of a weaker Lira. Many Lebanese seek to preserve what purchasing power their **savings** have left for them, and so we realize this **incentive** of turning Liras into dollars, by ultimately bidding prices up.

E) The Beacon Of Financial Stability: dated November 2, 2020

Tags: Banking Base, Neutral, Stability

The story of a strong and "safe" **banking base** is one that recounts the initial narrative that the "**establishment**" in Lebanon sought to nurture. Such an establishment is primarily composed of the **political** and **banking** classes that be. Other classes which constitute the Lebanese **sovereign** (government) could also include public institutions, such as ministries, and law enforcement (national security) entities.

The **construct** of Lebanon's **modern banking establishment** has forged some deep **beneficial** ties with its compatriot **political class**. This may directly explain the intentionally **inconsistent** and **incompetent** policies, whether of monetary or fiscal nature, that have been implemented over the years. Indeed, the Lebanese populous were sold with the false **narrative** of a "nation's pride" that laid in a robust and prosperous banking sector, which supposedly **mirrored** the "health" and status of the national economy.

In Lebanon's case, the actual way to manage such a **miniature** economy, while accounting for the ravaging troubles that plague the **Middle East**, is through an **outright neutral policy**.

Neutrality in the likes of its **Swiss** counterpart. All sorts of **pacified** foreign policies would have branded Lebanon's image as a **stable** country, but this of course would allude to the presence of a **formidable** central government.

In retrospect, having adopted this alternative policy, all **trust** in the sovereign of Lebanon, and in turn, its currency, would have meant an actual **robust monetary economy** due to the **perceived** stability. Showcasing such stability, while fostering a "**bank secrecy**" law and some relatively low **tax rates**, would have boosted Lebanon's "**Safe Haven**" status.

With all the accumulated trust, comes the great **responsibility** of maintaining it. This responsibility comes well in conflict with the known **reckless** policies of **raising** interest rates on deposits and **funding** non-productive government ventures. Such recklessness was the direct result of the aforementioned beneficial ties that both the present political and banking classes have formed. The emphasis on a **neutral banking base** may directly imply its **prosperity**, because by eliminating all sorts of political meddling in this base, economic and sound decisioning would have flipped all odds. Furthermore, in light of a competent banking establishment, Lebanon would have witnessed a forthcoming development of its industrial base, with great benefit.

F) A Lebanese Model Of Credit Creation: dated November 9, 2020

Tags: Credit, Speculation, Economy

A nation such as Lebanon, constrained by its geographic position, and apparent status of a "**negative**" **swap line nation**, with the US, must naturally redirect its sovereign focus on initiating **domestic economic activity**. Such activity must reach the sectors of **Industry**, **Tourism**, and **Technology**. The **Banking** sector however, is considered as a **useful tool** to **credit** these mentioned economic constituents, in an effort of **jumpstarting** the whole economy.

Usually, a simple model of stimulating an economy entails the "**credit creators**", which are the **commercial banks** of the nation, to expand **lending operations** to the **private sector**. The **incentive** for such operations is derived from the **general rate of interest**.

This crucial function of **credit issuance** will absolutely effect the rate of **growth** of the economy, and must be supported by a **central** and **solvent** monetary authority (BDL in Lebanon's case), in order to ensure market **stability**, **liquidity**, and **compliance**.

However, such a model can always be prone to **euphoric speculation** in the long run, and such is the case of Lebanon until 2016, as **unproductive lending** began to grow. The spawn of such **non-economic** lending can be attributed to the growing optimism and **appetite for risk** amongst economic participants, and after all, Lebanon had a great run since 2008. Unproductive lending refers to investments in unproductive assets, such as Real Estate (property development), Financial Assets (corporate or bank stocks), and large Bank-issued CD's (certificate of deposits) with high interest.

A competent approach to **allocating** credit in the Lebanese economy entails its credit creators, or **creditors**, to recognize where the **moderate**, but **assured**, return on investment exists. This proper method of allocating the required **financial resources** can either be administered by BDL, through **Forward Guidance**, or by the **Boards** of the national commercial banks, assuming the **integrity** of their competence in the banking profession and **compliance** with national regulations.

The sectors mentioned at the beginning are the most **worthy** of obtaining credit, and this is due to their "real" **economic construct**, as lending is considered to be **collateralized** (with tangible assets), **productive** (with assured interest payments), and **ensured** against a steady **cashflow** stream (because of actual economic performance). Industry, Tourism, and Technology, can all provide a means of **capital inflows** to Lebanon, instead of relying upon **remittances** or **foreign lending**.

G) A Lebanese Digital Currency: dated November 16, 2020

Tags: Digital Lira, Incentive, Cashless

A **Central Bank Digital Currency** (CBDC) has appeared as a recent "**game-changer**" in the realm of **bank regulators**. This **centralized** amalgamation of a **proposed** monetary value and **outright** regulatory control offers many implications for Lebanon's financial system, now that this very system is practically **impaired**.

Initially, for a **Digital Lira** to take hold, the BDL must outline an **incentive structure** for participants to opt into. Probably, the easiest way to do such is through offering a "**reward of participation**" on a supposed **platform** that BDL itself controls. This platform could likely be **monitored** by specialized authorities, thereby asserting more **power** under their mandate. The possibility of implementing this is hard to tell, because by issuing this form of **liability**, BDL could look into the means of **creating** simple **Current accounts** for consumers, since it already controls this platform, and that may consequently come into direct **conflict** with the commercial banks' roles.

The prospects of a **regulatory public** institution (BDL), which accounts to no private holder, being pinned against the **privately-held** financial establishments is already a **disastrous** scenario to picture for Lebanon. The dynamics of banking would dramatically change, as banks are already **insolvent** and can no longer **profit off** of loan issuance. However, all this remains to be seen, and is rather complicated to materialize, because undertaking such a **bold** move towards a **cashless society** requires sufficient political backing, while greatly **dissatisfying** the Association of Banks in Lebanon (ABL).

Since April 2020, BDL has miserably attempted to impose **demand-side control** (on USD) by stifling domestic black market activities through the launch of a separate rate (3950 LBP/USD) **parallel** to the official one (1515 LBP/USD) with further useless **complications** down the line. Yet now, there seems to be a **change of strategy** by imposing a **supply-side control** (on LBP), through the introduction of **bank withdrawal restrictions**, and later on, a **BDL-sponsored CBDC**. Such a combination means more power to the enabler, and therefore, further **monetary oppression** for the private sector as this same currency, in any form it were to exist, has already suffered from its demise in **national confidence**.

While the financial system is **obscenely paralyzed** by tenacious political **bickering**, Lebanon is left to **muddling through**. Talks of a cashless society can benefit **no public** or **private sector** without a needed **brutal adjustment** to the national economy.

H) The Experiment Of Domestic Credit: dated November 23, 2020

Tags: Narrative, Resilience, Solvency

In the common days of neglect, the public was fed a **narrative of resilience**. A seemingly **optimistic** view that Lebanon's **pride** were to be found in its **robust** Banking sector, without the slightest of attention being turned to the **detrimental effects** of the **irresponsible** public policies, pursued by the fiscal (political establishment) and monetary authorities (BDL).

Onto that narrative, the **Lebanese banks** had **forged** some seriously **beneficial ties** with the **political establishment** of the nation. This gave both parties tremendous **collective sway** over the economy. Initially, the sovereign (government) had a policy of **selling** their **debt** to the **domestic** Banking sector, and in turn, those same banks would get their "suitable" **compensations** through **lucrative** "financial engineering" schemes and other **monetary operations** that the public might not have been aware of. From this very complex, the central bank sat in between, **greatly facilitating** these activities.

Above this whole debacle, the Lebanese public was **entertained** by a s**econd narrative**, which revolved around the **true solvency** of their nation's **treasury**. A story that most of the sovereign debt incurred was "**beneficially**" held by **internal parties** (the Banks), and no "**foreigner**" could have a claim on that debt. Somehow, this narrative made sense to the public, through pure **neglect** or outright **illiteracy**, in a view that Lebanon was only **liable** to itself, in case of a **faltering economy**.

One can surely realize that no **foreign creditor** would ever partake in the sale of such debt belonging to a **risky counter-party**. They would need to **ensure** the return of that debt, with the accrued interest.

Part of the outstanding debt held by foreign creditors, which is quite **minimal**, subjects the Lebanese sovereign to **international law** and to **unnecessary responsibility**. The reason that such responsibility is deemed **unworthy** is because that same sovereign has already **developed** "easier" way to **acquire debt**. That "easier" **route** taken back then, with **persistent reliance** throughout the years, around the time when Rafiq Hariri was Prime Minister, is the one which **consequences** are experienced today.

Of course, the phenomenon of **irresponsibly** incurring debt stems from the fact that Lebanon operates upon an **unsustainable economic model**. The **provision** of credit from the **incompetent** domestic Banking sector has lead to some serious **repercussions**.

I) Domesticated Foreign Credit: dated December 1, 2020

Tags: Foreign, Credit, Regulation

In the realm of global finance, **free flow** of capital has always been a natural aspect of **advanced financial markets**, in which **complex** banking activities constitute the bulk of its daily transactions. Through this undeniable construct, the **regulations** and **incentives** incorporated in such markets tend to explain their **degree** of **inflows** and **outflows**.

In the case of Lebanon, a **non-mercantilist** state (**minimal** export), its capital markets are well **in need** of foreign inflows. However, having built a dangerously "**dollarized**" **economy** on a nationally **homogenous banking base**, with **no inclusion** of any major **foreign bank**, has ultimately lead the nation to adopt a form of **systematic cronyism**. This type of cronyism solely favors its **national constituents**, rendering them only **liable** to the consequences of their **internal affairs**, subject to Lebanese law and **safe** from any **foreign jurisdiction**. This may explain why no foreign institution has partaken **any role** in BDL's **obscure** financial engineering schemes, thereby suggesting the imbedded **high risks** associated with these schemes. Yet, the only **victims** of the recent **monetary fallout**, partly aggravated by these discrete monetary operations, were the same **clique of bankers** that had initially joined in.

Lebanon was known for its "**resilient**" banks and **arguable** "safe haven" status. This reputation was held high as the **general consensus** championed the domestic banking system as **largely** being Lebanese. The reason that no foreign bank has had a taste of such **superficial success** was because of the domestic regulation that allegedly "**favored**" Lebanese banks, as the narrative of old dictated. It may not have been widely known that these foreign banks have long regarded Lebanon as a **lost cause**, **unworthy** of domestic or foreign **credit provisioning**. The fact that foreign banks, like HSBC and others, have not attempted to **expand** their banking operations or **balance sheets** is greatly indicative of Lebanon's **failed status** as a **banking hub**.

The prospect of **reintroducing** and **integrating** foreign banks into the national system can reinstate **competent behavior** in banking activities. This is true, because a process as such would directly **expose** Lebanon's financial economy to foreign **regulation** and **interest**, thereby instigating the initial step (**rule of law**) for **incentivizing** these foreign institutions to penetrate the Lebanese financial system. Indeed, a sovereign state would never **forfeit** its duty of **protecting** the rights of its private institutions abroad, and so one of the possible ways of **restoring order** in the Lebanese financial markets is to **subject domestic players** (BDL and domestic banks) to **greater forces** found abroad.

J) Centralized Dollar Insolvency: dated December 7, 2020

Tags: Deposits, Dollar, Insolvency

For the countless discussions that revolve around the **fate** of Lebanon's **dollar-denominated deposits** plenty of discomforted solutions can be found as to how a bank may honor its **obligations** (**deposits due to**) to its customers. However, as **capitalism** implies a **hierarchical structure**, in terms of its **construct**, such an honoring of obligations must begin from the **very top** of this structure, starting with BDL. The various methods of "**freeing up**" deposits have an **implied cost** to doing so, whether at an **artificially** low exchange rate, or under a **restricted** term of withdrawal.

BDL, by nature, is **arguably** immune to **insolvency**, especially if its **liabilities**, whether denominated in USD or LBP, were due to **internal counter-parties**, such as the national commercial banks. However, this matter evolves into further **complication** once these counter-parties are of **foreign origin**.

Seignorage (the outright printing of banknotes) was heavily used by BDL in order to compliment its infamous **financial engineering** schemes. This monetary tactic can be used in case of a **decision** to **honor** any upheld liability. The conditions may **drastically** differ as to how the results of such a policy may work out, but it remains as an option since BDL may have intentionally lacked a **vision** to proceed with the **current crisis**. A direct example of this can be referred to the issuance of **Circular 151**, which offers an **optional**, yet "implicit" **haircut**, on dollar-denominated deposits at an exchange rate of **3900 LBP/USD**.

Besides the aforementioned Circular, the recent **withdrawal restrictions** on LBP accounts explains some **unintended** competence from BDL itself. Their view might be concerned with the much-awaited **inflationary** wave, if too many banknotes were put into circulation. This is true, but **no underlying** market **fundamentals** seem to guide the domestic USD black market.

It is clear by now that the central bank, along with its **ABL associates**, are desperately aiming to **rid** themselves of their **dollar liabilities**, through any means of financial or monetary **ploys**. This certainly explains the extent to which Lebanon **lacks** any **significant** FX reserves, which evidently seem critical at the moment.

Attempting to restore the **integrity** of **unfunded bank liabilities** (deposits) through multiple distinct approaches requires a **structured** and **term-abiding** plan. The ongoing and **insignificant** changes in monetary and bank policies have **no intrinsic purpose**, and so having no underlying suitable solution shall come at a **heavy price** for the Lebanese economy.

K) New Regimes Of Exchange: dated December 14, 2020

Tags: Exchange, Peg, Reserve

Following the **cognizant failure** of the established currency peg (1500 LBP/USD) were some obscure parallel rates ranging from 3900 til 9000 LBP/USD. The indecisiveness of designating a unified rate was a direct result of **incompetence** from the sovereigns of Lebanon. The peg seemed unsustainable to hold despite the **overlapping narratives** of resilience told by the political and banking establishment. However, had Lebanon established a reasonable, but viable, source of **FX inflows** (from the industrial or banking base) the scenario would have played out quite differently.

Since 1997, a "**conventional**" fixed exchange rate regime had been the official mandate of BDL to peg the Lira to the USD, thereby importing US monetary policy. A mandate as such may be subject to change if the currency itself is rendered in excess or short of its actual value. The fact which facilitated a likely, but imminent, change in this **mandate** were the monetary schemes undertaken by the political and banking establishment. The schemes, so infamous, required banks to **recycle deposits** into sovereign debt securities so that this same sovereign (government) may fund its **failed projects** and the nation's structural **current account deficits** (imports exceeding exports). These operations had been ongoing for several years, and as a consequence the financial system was drained of any material reserves. This chain of events directly attribute to the **overvaluation** of the Lira, hence, an expensive peg.

In retrospect, the authorities responsible of setting policies of such nature could have simply altered the mandate that governs the peg. A probable amendment could have included a systematic and coordinated devaluation of the Lira, similar to that of **Crawling Peg system**. This would have, to some extent, alleviated any monetary pressures on remaining and future **FX reserves**. At this point, options of reestablishing a new exchange rate regime seem numerous. Some of the most suitable alternatives for Lebanon's situation might be a **Currency Board** or a **Crawling Peg system**. Either option shall depend on the underlying economic plan, expected to draw in foreign aid in form of **capital** and **incentives**.

For a **supposedly-mercantilist** (export-focused) state such as Lebanon, its present economic construct favors a Currency Board, however, at later mature stages a Crawling Peg system seems to be the ultimate **consideration**. The former puts a check on inflation, unifies the exchange rates, and institutes desired credibility into the exchange rate commitment. Yet, the latter, assuming that economic prosperity has been reestablished, liberates the currency of any **unjust overvaluation**, rendering it as a **competitive fiat** in the realm of exports.

L) Navigating Fateful Policies: dated December 21, 2020

Tags: Reserves, Policies, Recapitalization

Reaching the "rockbottom" **Required Reserves** at BDL, in times of economic peril, demonstrates to the Lebanese audience the **severity of incompetence** that plagues the central authorities of the land. What may result of the odd **USD 17 billion**, with some additional reserves left for supporting subsidies, are some **short-sighted**, **limited**, and **fateful** decisions.

Short-sighted decisioning is greatly **indicative** of the **monetary** and **banking** policies upheld by the financial system ever since the inception of the **currency peg**. The **convoluted methods** through which the national government acquired **unnecessary** sovereign debt (from **national savers**), through **schemes** deemed too "sophisticated" for the public to know about, suggested that there was more than meets the eye. Through time, the results of these decisions have unfolded, proving the short-sightedness and **political** meddling in **monetary affairs**. Currency **weakened**, reserves **depleted**, and credit **restricted** are the common phenomena of a **failed** banking base.

By now, Lebanese policy makers are limited in **decision maneuverability**. Plenty of time has already been lost for meaningless policies at the expense of a **swift adjustment** to the new, but weaker, economic conditions. **Bank recapitalization** is one crucial turning point for the system to **sustain** itself. Such a decision, is expected to lay the initial framework of **reforming** the whole financial system in Lebanon.

Matters of **retracting capital** to banks connected to political figures are somewhat **discrete** in conducting their policies. Their **history** of applying these same policies is neither healthily riddled with **competence** nor **responsibility**.

Naturally, the monetary and fiscal decisions that are needed to be taken up til now are certainly fateful for the masses and their institutions. Readjusting the **Lira's worth** is simply a subject of **brutal implementation**, **respected coordination**, and **monetary recapitalization**.

Reviving the **perceived utility** in a nation's currency is predicated upon the people's **confidence** in its established sovereign (government). The **rule of law** is too an important point to stress upon if **inflows** of capital are needed to be **reintroduced** to the domestic banking system.

The path to **reinstating** a **modern economic model** requires abundant competence.

M) Bank Net Worth & Credit Extension: dated December 28, 2020

Tags: Net Worth, Credit, Trade

Prior to the realization of an **economic contraction**, commercial banks begin to **restrict credit extension** to the real economy through distinct methods of **over-collateralizing** loans, increasing **lending standards**, or even **downsizing** their respective **loan book**. Conventionally, the process of **credit creation** (lending) subjects the Bank's initial **Net Worth** (capital) and the consumer's assigned **collateral** to the risk of loss, if the latter **defaults** on their obligation. This illustration generally outlines the view of a **credit-creating institution**.

Indeed, our **modern-day** "Capitalism" is built upon the **continuous expansion** of debt, since the material drive of an **economic expansion** is indicative of a similar **expansion in credit**. There may even be some concern as to how a nation can **dampen** such a **relentless** accumulation in debt, and that rests in **global trade**. The **trade deficits** and **surpluses**, maintained by various nations, greatly attribute to their respective **private** and **public debt** stocks.

Over the last decade, Lebanon has famously accumulated some **unnecessary** public debt, with no means of **attracting** capital through **national industry** (exported products), but through a **seemingly** "**robust**" banking sector. The result of such a construct left the fiscal authorities (government) with a **structural** (running) **trade deficit**, thereby gradually squandering the nation's FX reserves (mainly USD).

By early 2020, bank credit had **brutally contracted**, and bank Net Worth (capital) came under **ironic scrutiny** from BDL. The initial response from the central bank was to **rejuvenate** the banking sector through an order of "**Bank Recapitalization**", citing the **recovery** of **public confidence** in this sector as an important objective.

Recapitalization simply refers to the **replenishment** of a bank's Net Worth through its respective **shareholders**. This is a fatal undertaking to consider in the case of Lebanon. The possible **success** or **failure** of this effort could largely determine the fate of the sector's **integrity**, as a whole, along with the stock of dollar-denominated **deposits**, supposedly found within it.

By committing to the **injection** of fresh capital, **overhaul** of current management, and **preservation** of customer deposits, there may be a slight chance of **reinitiating** credit extension to the real economy. Nevertheless, such hopeful results remain dependent upon the **decisions** of the **sovereign**.

N) De-Pegging A Monetary Legacy: dated January 11, 2021

Tags: Free Float, Peg, Lira

Following some obscure **proclamations**, brought forth to the public, about a **free float** (market-adjusted) Lira suggests some future **drastic alterations** to Lebanon's economic construct. However, one underlying **condition** remains as to the realization of this major change in **managing** the nation's currency and that is the **success** of a **brokered deal** with the **International Monetary Fund** (IMF).

Indeed, plenty of insights and analyses, surrounding the decision of **ending the peg**, offer distinct future scenarios where **speculation**, **trade**, and **banking** are greatly concerned. Additionally, a **central monetary authority**, such as BDL, would need to designate the **nature** of this exchange rate regime to be either a **Managed float** or **Clean float**.

Arguably so, at the start of initiating a **free float regime**, a market that is not subject to **mild government intervention** tends to challenge the float as a **natural response** of "**testing**" the **newly-established monetary construct**. This can roughly be equated to the phenomenon of "**Price Discovery**", wherein buyers and sellers of **fiat currency** engage in trades of **speculative** and **non-speculative** nature. This initial phase may eventually fade out as **aggregate demand** settles with **aggregate supply** on the **best possible price** for the sovereign currency in question, thereby **validating** the **market's tolerance** for the designated price of its **goods** and **services**.

It must be noted that for nations that adopt a **mercantilist** (export-driven) view on **international trade**, **fiat devaluation** may serve them greatly, and so is that true for an "**emerging market**" state, such as Lebanon, which must focus its national effort on exports in order to **accumulate** a **significant** and **healthy base** of **FX reserves**. In the initial phase of a free float regime, the official rate changes from LBP 1500/USD to whatever devalued rate which the market deems **suitable** and this may in turn boost the **competitiveness** of Lebanese exports, following certain **market adjustments**.

Through the years of **neglecting** exchange rate risk under a currency peg, domestic banks would have to **seriously readjust** their **balance sheets** at the realization of a new free float regime. Mainly, all **assets** possessed, **loan books** created, or **banking operations** undertaken would have to undergo a stringent process of **revaluation**/**readjustment** in accordance to the Lira's newly-assigned market rate.

It is indeed an **overhaul** of Lebanon's **economic construct** in order to progress with the **revitalization** of the domestic economy.

O) Downsizing Lebanese Banks: dated January 18, 2021

Tags: Dollar, Recapitalization, Banking

The effects of **bank recapitalization** is gradually taking effect. **Implicit layoffs** are in full play, and **branch closures** appear quite evident. The prospects of such **systemic change** shall undoubtedly alter the dynamics of the **domestic banking system**.

With a **downsized** and far more **consolidated** banking base, Lebanese banks may forcefully **reorganize** and **scale back** their **banking operations**, specifically in matters due to **credit creation** (lending) and **deposit custody**. However, public **confidence** is what haas been **impaired** following such a severe crisis. The price **distortions** caused in the domestic black market, due to **outright speculation** and **weakening** public confidence, have shown the extent of the monetary authorities' **failure** in maintaining the Lira's **perceived worth**.

At the **order** of recapitalizing, various banking entities have sought to **liquidate** their **holdings** (assets), in Lebanon and abroad, in order to satisfy the **required threshold** of **additional bank net worth** (equity), but if they fail to reach the **30% target** the bank in question shall be subject to a **merger** or **liquidation** process.

Under the guise of "recapping" the banks, which is expected to **mature** by the month of **February 2021**, it is more than probable that the **small** and **insignificant banks** may be subject to **merge** with their so-called "**Alpha**" counterparts, in the name of "enhancing" bank liquidity. This **phenomenon** nearly holds true in the **aftermath** of any **modern banking crisis**. It is the **systemic** and **large** banks that **survive**, resulting in a much **concentrated** and **downsized** banking base.

Usually, when economies face crises, under a **Capitalist framework** (free of any serious **government intervention**), bank credit **contracts** and a massive **deleveraging phase** begins. This is evident of a **similar contraction** in bank balance sheets, whereby loans get **paid off**, for instance, through one form or another. Yet, in respect to the **current situation**, there remains a single **component** on these balance sheets, **unmatched** by virtue of its **size** and **undressed** by official policies, and that is the "existing" **customer deposits**. Recapping the whole banking sector is **certainly** not enough to **ensure** the public of their **supposed** claims. Such a matter is in desperate need of a plan in order to set out the probable policies of **justifiably allocating** the **losses** due to the commercial banks' **past operations** with BDL.

Either way, a **forceful downsizing** of the nation's banking sector was **forthcoming**. Lebanon had been an **over-banked** state run by **intentionally incompetent** "professionals".

P) Matching Bank Liabilities: dated January 25, 2021

Tags: Deposits, Assets, Liabilities

Following up on "**recapping**" Lebanese banks, the current **progress** at which some particular **institutions** appear to be **liquidating** their assets or **downsizing** their presence suggests that a **considerable part** of this operation appears mostly accomplished, however, some lurking interpretations suggests that some commercial banks may be falling behind, and are in fact at **risk** of **exiting** the banking scene.

Amongst the crucial matters that lay ahead, assuming that the whole recapitalization process is well and done, is the **fate** of the **Depositor's aggregate stock** (plainly put, depositor's money). The composition of such is greatly **skewed** to the **right side**, where the **few** and **powerful** hold a large chunk of the amount (some odd 90%), thereby rendering BDL at a **difficult juncture** in making and taking the **sound**, but **rightful**, decisions for determining the **outcome** of the depositor's money. The insane **bureaucrac**y and **corruption** simply complicates the flow of decision-making for the **monetary** and **fiscal authorities**.

There exists **several alternatives/solutions** when addressing the financial crisis in Lebanon, the same also applies for **redefining** bank Liabilities (deposits). Indeed, the result of "recapping" bank net worth will simply **not satisfy** the **rebalancing** of their balance sheets, a **mismatch** between Bank **Assets** and **Liabilities** persists, and so this leaves the whole system **tilted** to the **right side** (Liabilities side of the balance sheet).

A **direct** and **historic** solution to fixing this "**tilt**" is a controversial **bail-in program**. In Lebanon's case, a bail-in requires **ample political** and **social support.** Wiping out existing **shareholder equity**, changing **bank management staff**, and converting a designated **portion of deposits to equity** is what concerns such a program.

Other than "bailing in" the **failed** banking system, banks may opt to "**hold**" their **safeguarded deposits** until certain **maturities** for the years ahead. This may be the case for now, but certain upcoming **regulatory measures** may change the habit of imposing **unofficial capital controls**.

Without delving too much into the **minutia** of any other proposed "**solutions**", the **simplest** and **most honest** way for tackling such a topic would be an i**nitial recognition** and **allocation** of the **incurred losses** for each bank. This path would ultimately sort out the **failures** of the system and **cleanse** it of its underlying **weak players**. The **discomfort** that may ensue such a **systemic change** of "loss allocation" would hopefully serve the **beneficiaries** of this crumbling system a lesson on **greed** and **incompetence**.

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