

2019 a critical year for Lebanon's finances

[Benjamin Redd](#) | The Daily Star 8-3-2019

BEIRUT: Despite a recent downgrade in Lebanon's sovereign debt outlook, the country will have no problems rolling over 2019's debt, experts told The Daily Star. But they also cautioned that debt levels were at unsustainably high levels. Last Friday, Standard and Poor's changed the outlook for Lebanon's sovereign debt rating from stable to negative, indicating that a ratings downgrade could be in the offing sometime in the next year.

The ratings giant laid blame specifically on concerns over "Lebanon's ability to service foreign currency debt."

The country holds the third-highest debt burden in the world - some \$85 billion, or about 150 percent of GDP. Over \$30 billion of that is in U.S. dollars, meaning the country cannot print its way out of debt.

With interest, the country is obliged to pay almost \$50 billion in dollars over the next two decades.

A WALL OF DEBT

This year alone, Lebanon must repay \$4.7 billion in dollar-denominated debt, Finance Minister Ali Hasan Khalil told MPs Wednesday.

Some \$2 billion of that must be paid by the end of May, according to calculations by The Daily Star based on Finance Ministry figures.

Hence the scramble to authorize issuing new debt to pay off the old: Essentially, the state will ask investors to lend it dollars, then turn around and use those dollars to pay this year's bills.

The Cabinet gave authorization to roll over debt at its meeting on Feb. 28; Parliament approved a similar motion Wednesday.

But the new debt will almost certainly be more costly than the old.

For instance, the state had to pay 5.5 percent in interest each year on \$500 million in debt issued in 2013.

In April, the government must pay back this \$500 million; if it issues similar debt to cover the bill, current market rates suggest it will have to offer to pay investors more than 9 percent in interest each year.

It is still unclear how the coming dollar debt will be issued - the terms are still being worked out by Khalil and Central Bank Gov. Riad Salameh, according to a source familiar with the matter who requested anonymity.

Most likely, there would be a mix of market and Central Bank involvement, the source said. This could involve the Central Bank buying a portion of the debt - or even intervening in the market beforehand to drive the price toward a preferred point, although the bank has not previously said it has done this.

Qatar's promise to buy \$500 million in bonds will also likely come to fruition - at least in part - in this round, the source added.

FIXING THE STATE'S FINANCES

Qatar's offer, made in January, gave a glimmer of hope just as Lebanon's fiscal problems appeared to be coming to a crescendo.

Investors were selling off debt, then-caretaker Minister Khalil brought up debt restructuring then retracted his comments, and there was no government to deal with any of the problems.

Moody's downgraded the country's credit rating to the lowest level since at least the '90s, issuing a particularly scathing critique: "The capacity for a government to implement significant fiscal consolidation is limited, even if a government were formed in the near future."

The Cabinet that was formed 10 days later resolved to try anyway.

Committing to a key reform pledge made at the April 2018 CEDRE conference, the government's policy statement laid out a goal of reducing the deficit-to-GDP ratio by at least 1 percentage point per year over the next five years.

Deficits typically drive debt - a country spends more than it has, and borrows to make up the difference. But in recent times, Lebanon has fallen into a situation where debt also drives deficits.

Debt servicing drains around a third of the state budget each year - a hole set to grow as debt becomes more costly.

Breaking this vicious debt-and-deficit cycle is thus key to fixing the state's finances - and experts believe there is reason to be hopeful.

"There has to be a change in economic policies; this is why CEDRE is very important," said Marwan Mikhael, head of economic and equity research at BlomInvest Bank.

But "once you start attracting money from donors, things will change," he added.

Essentially, CEDRE's promise of \$11 billion in investment can help turn a vicious cycle into a virtuous one where reforms beget investment, which begets economic dividends, more money to state coffers and more reforms.

Nassib Ghobril, head of economic research at Byblos Bank, expressed belief that there was plenty of room for fiscal reform.

While reforms to Electricite du Liban have long been at the top of the to-do list, Ghobril said there were also many less-publicized ways to improve the state's finances, from eliminating United Nations Development Program assistance to state administrations - a program costing Lebanon some \$66 million per year, he said - to slashing MPs' salaries. "If you're talking about sending positive signals to the market, I suggest ... reducing politicians' salaries by 50 percent for 2019."

To bring in more money, he said, the state should fight tax evasion, another long-held dream of reformers. While it failed before, "the difference this time is the urgency."

A SECOND TRACK

One solution Ghobril does not believe is necessary yet: restructuring the debt.

But rethinking Lebanon's debt structure may be in order, argued Jamil Hallak, a debt expert. While reforms are absolutely necessary, "at the same time there is a window for the country to revamp their debt structure that puts it on a more sustainable footing," he said.

Referring to the \$2 billion due over the next three months and another \$2 billion due in November, he said, "There is a short-term stress with all these walls of redemptions that come successively. You need to take these out and let the country breathe."

Hallak recommended a "voluntary exchange that stretches out the debt and simplifies it." Such an exchange, he said, would align Lebanon's debt structure with its economic prospects, "which are in the medium to long term."

This is uniquely possible in Lebanon due to the small number of investors and even smaller number of foreign investors, he said.

It is unclear how long the window Hallak refers to will be open - that will almost certainly depend on Lebanon's politicians. But this year will be critical.

As the anonymous source put it: "[Repaying the] 2019 debt is guaranteed; 2020 is the problem."