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# Crunch time as govt  to decide on bond payment

**Marton Eder- Bloomberg**

Crisis-ridden Lebanon finally has a government again and at the top of its agenda will be whether to repay a Eurobond that will be maturing in six weeks. After lawmakers passed the 2020 budget Monday, the new Cabinet’s next major decision will be what to do about the $1.2 billion of bonds due on March 9.

The team of 20, led by Prime Minister Hassan Diab, a computing-engineering professor, faces the reality of continuing nationwide protests, falling Central Bank foreign reserves, and the slowing to a trickle of diaspora inflows that have kept the economy afloat for decades. Government debt stands at more than 150 percent of gross domestic product, one of the highest levels for any country.

For most investors, it’s a question of when, not if, Lebanon defaults on its debt, which includes more than $30 billion of Eurobonds.

Around a third are held by foreigners, with the rest owned by the Central Bank and local lenders, according to Oxford Economics. Lebanese banks also have billions of dollars of foreign-currency deposits parked at the Central Bank.

“A restructuring at some point over the next year or so seems inevitable,” said Gabriele Foa, a money manager at Algebris Investments in London.

What are the government’s options for the March bond?

It could still repay the bond. Markets are nervous, however. It trades at just 78 cents on the dollar - down from 97 cents before the protests began in October - equating to an annualized yield of 263 percent if it’s paid back fully. The government might instead revive a Central Bank plan to get local holders to swap into longer-dated Eurobonds. That would help stem the bleeding of reserves. The downside is that rating companies would probably treat it as a distressed exchange, with Fitch Ratings saying it would likely downgrade Lebanon to restricted default.

Would Lebanon benefit from a default?

Repaying debt before an inevitable restructuring may be a waste of money and make a future overhaul more difficult. It would further deplete reserves that stand at about $12 billion when adjusted for Central Bank liabilities, according to Fitch.

The government would also be prioritizing the provision of scarce dollars to creditors over importers of vital goods such as medicine and food. That wouldn’t go down well with protesters, some of who are already calling on the new government to step down.

“The ability to repay the Eurobond maturing in March exists, but the political pressure against doing so is rising,” Nafez Zouk, a London-based strategist at Oxford Economics, said Jan. 21.

**Does it make more sense to delay a restructuring?**

Diab’s government may opt to hold off on a restructuring until it’s drawn up an economic plan to go with it. A credible strategy, along with the support of an institution such as the International Monetary Fund, would typically help win the backing of bondholders.

“It’s only worth starting a restructuring process if you can show a path to debt sustainability,” said Viktor Szabo, an investment director at Aberdeen Asset Management in London, who is steering clear of Lebanon. “There’s no sign of that so far.”

What would happen after a debt moratorium?

In theory, bondholders would form a creditor committee and start negotiations with Lebanese officials and their advisers. Lebanon’s credit-default swap contracts, among the most expensive in the world, would likely be triggered. Any deal would need the backing of 75 percent of bondholders by volume.

Discussions could be arduous. Argentina’s default in 2001 dragged on for 15 years, while Venezuela has made almost no progress on a restructuring after it defaulted in 2017. Ukraine’s 2015 restructuring, however, was completed within a year, partly because the nation carried it out with the backing of an IMF program.

Goldman Sachs Group Inc. said investors could face losses of around 65 percent in a restructuring. Most of Lebanon’s Eurobonds maturing beyond 2020 trade slightly below 40 cents on the dollar, suggesting investors broadly agree with the Wall Street firm.

The Central Bank’s influence over local creditors may help steer them toward accepting restructuring terms. But the high domestic ownership would limit the scope for debt relief as lenders would likely need to be recapitalized, potentially placing an additional burden on state coffers.

Is there a chance Lebanon just tries to muddle through?

It might if the government’s too weak to carry out the painful reforms needed to fix the economy, including reducing subsidies and potentially ending a long-standing currency peg. There’s a chance the protests worsen and force the new administration’s collapse, according to analysts at Texas-based Stratfor.

“They can somehow survive until debt maturities in 2022,” Aberdeen’s Szabo said. “That will require the continuation of the strictest of capital controls, which would continue to kill the economy.”