The Daily star 12-2-2020

Bail in or bail out? Lebanese banks in need of rescue as crisis bites

Tom Arnold- Reuters

LONDON: The worst is yet to come for Lebanon's banks.
The old-style way of running the economy – attracting capital via investments from the diaspora – created the sixth-largest banking system by assets in the world relative to GDP, with deposits swelling to about 280 percent of annual economic output.
But now that the flow of money from overseas has stopped and the government can no longer finance its budget deficits, the banks are in the firing line as Lebanon grapples with its worst financial crisis since the Civil War.
Deposits have drained away and the banks need to urgently restock their balance sheets. Estimates of how much the sector needs to recapitalize range from $15 billion to $25 billion, with the latter figure assuming a sizable haircut on bank holdings of sovereign debt.

"If we want to serve the economy we need a solid banking sector. A zombie banking sector will mean a lost decade," said Jean Riachi, chairman and chief executive of Lebanon's FFA Private Bank.
Banks' efforts to raise capital have fallen flat so far. Lenders have been trying to raise by the end of June an extra 20 percent in tier 1 capital – equating to around $4 billion – through cash injections, as required by the Central Bank. Several have approved raising part of that amount from existing shareholders.
Overall, the capital raising was unlikely to succeed as, given that bank valuations were 80 percent below book value, the move would dilute shareholders' positions by more than 100 percent, Arqaam Capital analyst Jaap Meijer said.
Under a government rescue plan aimed at pulling the country from crisis and expected to be approved by Parliament this week, banks are urged to sell their investments abroad to help restore shore up their finances.
Bank Audi (AUDI.BY) is in talks with First Abu Dhabi Bank (FAB.AD) to sell its Egyptian unit.
An immediate concern for banks is what the government might do about a $1.2 billion Eurobond maturing in March.
After years of funneling much of their deposits to the government, rather than lending to the private sector, about 70 percent of banks' assets are tied up in state debt instruments.
With their exposure to the government and Central Bank at multiples to available capital, a potential default could hit the banks very hard.

The government is leaning toward repayment for foreign holders and swapping the holdings of local banks, which own more than half of the debt, for long-dated issues, sources previously told Reuters.
Ultimately, any rescue of the banks hinged on how much government debt needed to be restructured, Meijer said, adding he didn't rule out a bail in, requiring creditors and holders of local currency and FX deposits to take losses.
"We could end up with a full nationalization of a large part of the Lebanese banking system," he said.
Long considered pillars of financial strength, banks sat on around $25 billion in shareholders' equity before the crisis broke and enjoyed capital adequacy levels comfortably above international standards.
But their capital positions have eroded as the crisis has worsened, with banks losing $10 billion in deposits between August and December. Banks' supplies of foreign currency at their correspondent banks have fallen below the $8 billion they held at the end of November, two bankers said.
In an effort to preserve liquidity, banks have imposed limits on access to cash and transfers abroad, prompting angry attacks on their ATMs and branches. One irate customer even used his company's forklift and two trucks to block its entrance.

One step that might help to alleviate some of the pressure on banks is a haircut on deposits, although the Central Bank has ruled out any such move.
As Lebanon's crisis has dragged on, banks have increasingly become pariahs of the international finance system.
"We are near zero in dollars with correspondent banks abroad which is what you need to cover withdrawals by customers of dollars in Lebanon and to allow for the urgent payment of transfers abroad," a former treasury head at one of Lebanon's largest banks said.
He estimates banks' dollar liquidity overseas has fallen from around 5 percent of their total capital position in October to 3 percent.

An international banker said his institution was running down existing correspondent banking relationships with Lebanese banks and not increasing its exposure to the country until there was tangible progress in tackling the crisis.
"Banks have problems opening letters of credit and have to put up cash collateral to do so because of the credit downgrades," said Riachi, referencing recent downgrades by rating agencies that have placed several banks in selective default for not paying full interest on customers' deposits.