The Daily Star 19-2-2020

Debt restructuring only option for Lebanon: economists

Osama Habib|

BEIRUT: The government should opt for debt restructuring instead of debt rescheduling of all the outstanding Eurobonds in 2020 to place Lebanon on the path of financial and economic recovery, several economists and financial analysts said.
“We are no longer talking about debt default or debt rescheduling of the Eurobonds. What we are talking about now is debt restructuring of these bonds,” Ishac Diwan, a former World Bank staffer and professor of economics and finance in France, told The Daily Star in a phone interview.

The government of Prime Minister Hassan Diab is now facing its biggest challenge and test since it received the endorsement of the Parliament on Feb. 11 and that is to pay or not to pay the $1.2 billion Eurobonds due on March 9 of this year.

Faced with insurmountable pressure from the anti-government protesters and intense lobbying by Lebanese banks who hold most of these bonds, the Cabinet seems more inclined to skip paying the $1.2 billion Eurobonds but after securing an orderly exit of this crisis to avoid negative backlash.
“We need a rescue plan which is more comprehensive and I don’t think this decision should be made just on its own. Part of the plan we recommend is debt restructuring in order to facilitate fiscal adjustment, reduce the weight of spending and to be able to reopen the banking sector,” Diwan explained.
Fitch rating agency said Tuesday that Lebanon is likely to restructure the country’s public debt.
“The shortage of foreign currency available at the banks and in the wider economy is creating a deepening recession. This has raised questions about the government’s willingness to continue prioritizing foreign reserves to meet its debt obligations. The new government is about to decide on whether to pay the March Eurobond. Even if the decision is taken to pay, the debate will resurface over the coming months,” Fitch said.
It added that the Central Bank’s declining gross foreign-currency (FC) assets remain sufficient on paper for the sovereign to pay its external debt service in 2020 and into 2021, provided de facto capital controls are maintained.
Fitch Ratings estimates Lebanon’s gross external financing requirement at less than $10 billion annually in 2020-2021, while the Central Bank has $29 billion of gross FC reserves at its disposal.
“However, this capacity to pay will become increasingly stretched and it would be unrealistic, both economically and politically, to run these assets to zero. The net FC position of the Central Bank is negative. This is not of paramount importance as a near-term drain on foreign reserves, but does point to the deep problems in the financial sector balance sheet,” Fitch said.

Diwan recommended bringing the creditors and a team of lawyers to discuss ways how to restructure the outstanding Eurobonds without triggering negative reactions.
“The point of restructuring is to increase the capacity of the country. It is a bit disappointing that the government is not being able to move quicker on placing a rescue plan before deciding on whether or not to restructure the $1.2 billion Eurobonds,” he added.

Diwan said that the government can’t wake up on March 8 and decide whether to pay or not to pay the $1.2 billion Eurobonds.
But the Association of Banks in Lebanon, which groups all the lenders in the country, made it explicitly clear that the government needs to settle the $1.2 billion on March 9, arguing that banks also have to look after the interest of the depositors.

Nevertheless, the association did not dismiss the possibility of debt rescheduling of future bonds but on condition that the government should present a plan to exit the financial crisis.

Economists say that restructuring of the public debt would allow the government to drastically reduce the annual cost of debt servicing which is now close to $5 billion, representing the largest spending item.
Diwan said that the government should offer the creditors various options after agreeing on debt restructuring.
“The creditors want to see a rescue plan so that the economy gets in a better shape by saving the money on the short term. We have to think about this as a win win game,” he added.
Hala Bejjani, from activist group Kulluna Irada, also voiced strong support for the debt restructuring option as a way out of the crisis.

“We don’t at all support a default. We support a restructuring of the debt instead. We are calling on the bondholders to sit with the government and review this option,” Bejani said.

She stressed that even if the government could not secure an orderly solution for the $1.2 billion Eurobonds, the choice should still be “not to pay.”

Bejjani said she was aware that some of the bondholders have sold nearly $600 million of the Eurobonds to Ashmore financial group and Fidelity company.

“The banks have sold nearly 60 percent of the $1.2 billion Eurobonds to two foreign investment firms once they heard that there is a possibility of a swap. The Central Bank and the Lebanese lenders thought that by selling these bonds to the international market they could get fresh money from abroad,” Bejjani said.

Based on the information of Bejjani and her group, Ashmore is not a vulture investment company.

“Ashmore is being pressured by other investment funds not to file a lawsuit against the Lebanese state in case of debt default. These investment companies said that if the Lebanese state opted not to pay this debt they are merely doing it for humanitarian reasons,” Bejjani said.

She reminded that close to 50 percent of Lebanon’s population are below the poverty line.

“We don’t think that Ashmore is an aggressive fund that will resort to court to sue the Lebanese state,” Bejjani said.

Some bankers have expressed fear that any government decision to default on the payment of the entire outstanding Eurobonds for 2020 could literally wipe out close to two-thirds of these foreign-currency denominated sovereign bonds held by Lebanese lenders.

“The prices of the Eurobonds in general have dropped by almost 70 percent since the crisis started on Oct. 17, 2019. This means that if the government decides to reschedule the entire $4.5 billion Eurobonds that matures this year, the banking sector’s holdings of these bonds will drop from $14.5 billion to around $4 billion only,” one financial analyst told The Daily Star on condition of anonymity.

He added that this decision, if taken, would also trigger a writedown of the accounts of Lebanese commercial banks at the Central Bank that is estimated at $70 billion.

Ghassan Diab, a professor of economics and finance at Lebanese American University, also supported the idea of total debt restructuring and even consider a haircut of the large deposits.

“Debt restructuring is the only choice we have now in order to reduce the financial crisis in Lebanon. There is no other alternative except to restructure the debt,” Diab said.