

Lebanon's slow, painful slide into financial meltdown

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Behind a black gate in an upscale Beirut suburb, the head of Lebanon's banking lobby implored the government to hold firm against the latest crisis, pay the country's debts and safeguard its financial industry.

"A stable economy is largely dependent on a strong banking sector," said Salim Sfeir, perched on the edge of his chair near a large corner window overlooking the garden of his villa.

Across town, the metal encasing his office at the Association of Banks in Lebanon told the other side of the story as a nation with barely enough money for essentials hurtled toward the first debt default in its history.

Now covered in anti-bank graffiti, the protective panels were put up months ago to keep out protesters at the epicenter of a revolt that laid bare what Lebanese had long suspected: through a mix of mismanagement and corruption, a class of politicians and their business partners bled the country to the point of bankruptcy.

With foreign currency reserves at what the new prime minister described as "dangerous levels," the government is now in talks to restructure \$90 billion of borrowing, which, at 170 percent of gross domestic product, makes Lebanon one of the most indebted countries in the world.

Dollars are in such short supply that the central bank will only give them to importers of wheat, medicine and fuel. Banks that kept their doors open in the darkest days of Lebanon's 15-year civil war are now closing early, cutting card limits, restricting the transfer of dollars abroad and allowing most customers to access only a few hundred dollars of their savings a month.

The arrival of the coronavirus is compounding the misery. Schools and sports clubs have been shuttered as have Beirut's legendary nightclubs as people fret that the underfunded health system can't cope with an epidemic.

"Declaring they won't pay is just an admission that the state, the central bank and the banks are bankrupt," Charbel Nahas, a former minister of labor and telecommunications, said on Twitter. "They now have a duty to announce the system of sectarian leaders is bankrupt too, because with politics comes responsibility, and society is in danger."

Lebanon has been teetering for years. Once a byword for sectarian violence, Beirut has been rebuilt since the war, but power games between Saudi Arabia, Iran, Israel and others still play out on its streets, fueling internal divisions and complicating decision-making.

In a somber speech that acknowledged the scale of the crisis and the corruption at its heart, Prime Minister Hassan Diab promised a whole package of measures that economists have advocated—with growing urgency—for years. The country would reduce borrowing, cut spending, improve tax collection, restructure the loss-making electricity industry, and introduce a safety net for the poor. What he didn't say, however, was how Lebanon would fund what could be a painful period of adjustment.

Nasser Saidi, a former economy minister and first vice-governor of the central bank from 1993-2003, has said Lebanon needs a fiscal stabilization fund worth at least \$20 billion to ease the transition. That would require buy-in from the International Monetary Fund and World Bank, a prospect that has alarmed both protesters and militants Hezbollah.

The Iranian-backed group is concerned it would be used as a political weapon by the U.S., which classifies it as a terrorist organization and has been tightening sanctions. It could also lose control over areas of the economy where it wields influence. Without external help, Lebanon is left facing up to some dire metrics. Though growth flat-lined years ago, a group of leading economists and development specialists including Saidi estimate the economy could shrink by at least 10 percent this year—to near levels experienced by the U.S. in the Great Depression. The World Bank has warned that half of all Lebanese could slip into poverty.

For former teacher Mona, that scenario no longer feels so unlikely. She retired last year after 44 years teaching in state schools and opted to take her pension as a lump sum, putting it in the bank and living off the interest.

Now, that money is stuck so she's surviving on emergency cash she had stashed at home and her husband's pension. With prices rising, that's barely enough to cover living costs.

"I was waiting to get my pension so I could relax, maybe spoil myself, maybe travel, but it's been nothing but stress," she said, declining to be identified by her full name because of the tension in the country. "As usual, it's ordinary people who'll pay the price. I feel like we're entering a terrifying crisis."

The Lebanese pound has depreciated by 40 percent on the parallel market, now the main source of dollars for companies and families, since protests began. Inflation, by official estimates, was running at a year-on-year rate of 10 percent in January. The leading consumer association says prices have risen 45 percent since October, hitting purchasing power at an "unprecedented rate" as companies slash jobs and pay.

"They're going up," said a supermarket worker in Beirut, leaning into a deep freezer to change the price labels on an assortment of frozen vegetables. At the bread counter, bags of flat loaves still sell for a government-regulated 1,500 pounds but they've

shrunk. Packs labeled 1,000 grams, now weigh 900 grams. And they're shrinking again as bakery-owners complain of narrowing margins.

Across the downtown area, lavishly rebuilt from the wreckage of the 1975-1990 civil war, youths have smashed up ATMs and pried cladding off buildings to hurl at police.

Shop-fronts of luxury brands like Louis Vuitton and Rolex now gleam behind protective metal cages. Other upscale stores have closed altogether. Entrances to Nijmeh Square, bustling a decade back with restaurants and shops, have been sealed off for years to protect parliament following previous bouts of unrest.

For a few weeks in October and November, people reclaimed the streets. They set up food stalls and shisha cafes furnished with plastic chairs, to entertain tens of thousands who converged on the capital, demanding the removal of the warlords who tossed away their fatigues when the civil war ended and emerged to lead the country for the ensuing 30 years of peace.

People converged on the streets from the north to the south of Lebanon, hinting at a desire for change that crossed religious boundaries. The outpouring built on earlier bursts of public anger that coalesced around quality-of-life issues affecting Christian, Sunni, Shiite and others alike and appealed to a younger, more urbanized generation born after the war.

They raised a profound question: was it time to tear up the sectarian power-sharing system that led to a political sclerosis so deep that state institutions can no longer provide 24-hour electricity, reliable water supplies and garbage disposal. Even in the face of financial ruin, however, efforts to transform grass-roots mobilization into a more organized alternative have struggled to gain momentum.

"We are at a crossroads," said Mona Fawaz, a professor of urban planning at the American University of Beirut and a prominent activist. "If we organize enough, we save the country. If we don't organize enough, we hit the wall."

It's hard to pinpoint when Lebanon's post-war order began to unravel.

Once the banking capital of the Middle East, this tiny country prided itself since independence on its laissez-faire reputation as a hub for free trade and free speech in a turbulent region. With beauty queens, political exiles, tycoons and spies mingling in its seaside hotels, Lebanon's edgy prewar reputation belied the domestic, regional and international rivalries that would soon tip it into all-out conflict.

As Lebanon emerged from devastation, former Prime Minister Rafik Hariri borrowed to rebuild, betting on remittances from a sizeable expatriate population and tourism from Gulf countries like Saudi Arabia, where he'd amassed his fortune and built political alliances. Casting off the privations of war, Lebanese grew addicted to imports of everything from food to fast cars. Agriculture and industry were neglected in favor of real estate and banking, an industry whose assets came to be worth more than four times the country's entire economic output. Their eyes on re-election, politicians stuffed the public sector with cronies instead of investing in health or education.

When the global financial crisis erupted in 2008, Lebanon, with its stable banking sector and high returns became a go-to destination for investors, fueling a property boom that saw luxury high-rises beyond the reach of most shoot up where red-roofed Ottoman villas and French mandate-era apartments once stood. As the outbreak of the Syria war in 2011 brought 1.5 million refugees to Lebanon, and the region plunged into violence, confidence ebbed.

The religious diversity that sets Lebanon apart from its neighbors also still makes it vulnerable to regional ups and downs, most recently the standoff between Saudi Arabia and Iran that has contributed to political deadlock.

Lebanon went 29 months without a president before Michel Aoun was named in 2016. Following the 2018 parliamentary election, it took nine months to assemble a "unity" government so divided it was unable to implement reforms required by international donors to unlock \$11 billion in desperately needed loans. Divisions also delayed lucrative gas exploration in the Mediterranean while neighbors Israel and Cyprus raced ahead.

Under Crown Prince Mohammed bin Salman, Saudi Arabia withdrew its long-standing financial support for Lebanon, which failed over the years to counterbalance Hezbollah, whose political wing took an increasingly assertive role in government. Gulf investment and tourism dried up.

In a bid to buy time, central bank Governor Riad Salameh began "financial engineering" operations to lure liquidity from abroad and maintain the currency peg with soaring interest rates. The complex swap operations saw an ever larger proportion of commercial bank deposits tied up at the central bank, which used them to fund a government struggling to manage the economy. Systemic risks rose, growth stuttered and the day of reckoning could be delayed no longer.

"Today, we're facing three heavily distressed balance sheets; the government of Lebanon, the central bank, the commercial banks," said Freddie Baz, who was vice-chairman of Audi, the country's biggest bank, before he resigned in July. "Those balance sheets are intertwined. It's a Molotov cocktail of challenges. Difficult measures are required and we cannot waste our time with side-squabbles like we used to."

In the meantime, for ordinary people, unable to withdraw dollar savings from cash-strapped banks, it's time to renegotiate rent, cut luxuries and stockpile food in preparation for tough days ahead.

Hani Bohsali, who heads a trade association representing importers of food and consumer products, said imports had dropped about a third, pushing some businesses to the brink. Companies can only process shipments if they bring “fresh” dollars to the bank—either transferred from abroad or as bundles of cash, increasingly the only payment some shops and suppliers accept. “The entire economic cycle is seizing up,” Bohsali said. “We’re in a major crisis and I can’t see signs that a solution’s in the works. I hope for one, but I can’t see it.”