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Wazni: Lebanon's GDP could slip by 12 percent in 2020

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BEIRUT: Lebanon's Finance Minister Ghazi Wazni warned that the country's GDP could drop by 12 percent in 2020 due to the deteriorating conditions.
"In 2020, real GDP could contract further by 12 percent as the dollar shortage puts a massive drag on nonfuel imports and could be worsened with the additional impact of the coronavirus outbreak," Wazni said in his presentation to investors and bond holders on March 27.
The minister presented a 27-page powerpoint illustrated with elaborate charts and tables to the investment companies holding part of the country's Eurobonds in a bid to persuade them that Lebanon could not afford to keep financing the public debt, which has reached 178 percent of the GDP.
Lebanon has defaulted in the payment of a $1.2 billion Eurobond due on March 9 and said it would no longer finance the remaining maturing Eurobonds in the future.
"Lebanon is going through an unprecedented situation compared to past crisis episodes. Lebanon is faced with very large balance of payment imbalances. Years of a persistent wide external current account deficit have deteriorated the country's net external position," Wazni said in his presentation.
He added that inflows of foreign deposits have dried up in recent months and were not likely to recover.
" Banque du Liban's FX reserves are on a rapid downward trend, reaching critical levels. The gap between the official and the parallel exchange rates keeps widening. All economic indicators point to a prolonged and sizable real GDP contraction, while unemployment and poverty are rising fast, reaching dangerous levels," the minister said.
He added that constant dollar inflow needs of past years resulted in years of large fiscal deficits, which pushed the stock of public debt to an unsustainably high level.
Wazni stressed that it was illogical that the size of the banking sector was four times larger than the size of the Lebanese economy.
"Lebanon's banking sector is oversized, substantially above what is needed to fulfil its primary role of financing the development of a productive economy. Domestic consumption fueled by massive foreign inflows in the context of an overvalued exchange rate has contributed to persistently wide external trade deficits," he added.
Wazni noted that at the beginning mid-2019, bank deposit outflows had reached unprecedented levels and any resumption in inflows was not likely to materialize in the near future.
"Banque du Liban FX holdings have come under high pressure, dropping to $29 billion in January 2020, of which $22 billion are liquid and $18 billion of those secure banks' mandatory reserves in US dollars and are held at BdL for regulatory purposes," he added.
Wazni indicated that the $11 billion package pledged by the international community at the CEDRE conference in April 2018 has not yet materialized, pending the implementation of key structural reforms identified as pre-conditions to the disbursement, leading to a rapid depletion of BDL foreign currency holdings.
"Reduced access to external financing and foreign currency deposits, accompanied by the sharp decrease in FX reserves, has led to the development of a parallel FX market and the de-facto sharp depreciation of the Lebanese pound. Real GDP growth slumped in recent years, decreasing from 1.6 percent in 2016 to -6.9 percent in 2019," the minister said.

He cautioned that risks of accelerating inflation fueled by the ongoing sharp depreciation of the Lebanese pound on the parallel market will further dampen social indicators.
"Faced with constant dollar inflow needs, Lebanon is suffering from large fiscal deficits, peaking recently at -11.4 percent and -11.3 percent of GDP in 2018 and 2019, respectively. Fiscal deficits were mainly due to the very high interest bill payable by the government: close to 50 percent of its revenues were dedicated to its interest bill in 2019," Wazni said.
He noted that Lebanon's government debt has reached critical levels, up to 178 percent of GDP in 2019, and the ongoing economic turmoil is amplifying the risk of distress.
"The high weighted average cost of government debt (6.7 percent) contributes to further rapid debt stock accumulation as interest service is financed with more debt," Wazni said.
He reminded that the Lebanese banking sector is the second largest in the world in terms of assets as a percentage of GDP, standing at 422 percent of GDP.
"The size of our banking sector is therefore way above what is needed to fulfil its primary role of financing the development of a productive economy. Additionally, the cost of attracting dollars through commercial banks is weighing heavily on BDL's balance sheet," Wazni said.
The presentation pointed out that over recent months, multiple risks materialized, adding that external capital flows dried up, deteriorating the net reserve position of the BDL and limiting access by the Lebanese people to their foreign currency bank deposits.
The presentation insisted on the need to restructure the commercial banking sector (size and organization), "including disentangling the links between commercials banks and Banque du Liban."

It added that the government would endeavor to ensure that the banking sector play a role in providing credit to the real economy.
The presentation also highlighted some of the reform measures the government intends to take, including: “Reforming the electricity sector (3 percent of GDP) and the pension system to reduce transfers, rationalizing current expenditures and streamlining the government’s institutions and enterprises, improving tax collection, compliance rates and reorienting the tax system toward increasing the burden on rent income and privileges given on public properties and assets,” the presentation said.
It also focused on growth-enhancing structural reforms agenda.
The minister assured that the government was prepared to engage in good faith discussions with its creditors to explore options to make Lebanon’s public debt sustainable.
“Lebanon is committed to undertake consultations with its creditors on the basis of: Transparency both in terms of process and availability of information; good faith efforts for a collaborative approach; equitable treatment so as to ensure fair burden-sharing among all stakeholders; and the need for a credible, permanent and sustainable solution to Lebanon’s structural debt problem,” he added.
Mindful of the exceptional circumstances of the COVID-19 crisis, Wazni said the government would conduct consultations with its bondholders via audio and video calls and would prioritize interactions with bondholders/bondholder groups demonstrating significant holdings.