

Haigazian University



National Debt Management in Developing Countries

**The Role and Constraints of the Lebanese Banking System
in financing the Lebanese Government during the War and
its aftermath**

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May 20, 2005

Beirut

Outline

- n Comparisons of the financial & banking systems
 - n 1975 vs. 2005
 - n A SWOT analysis of the present systems
- n Reasons compelling the Lebanese Government to borrow
 - n Lebanon's Rating History with Fitch
- n The Role of the Central Bank in assisting the Lebanese treasury to market the short-term treasury bills and bonds
- n Investors in the Lebanese government financial papers
- n Constraints of the banking system in supporting public deficits & debt
- n National Debt Management : Actions to Take

Comparison of the Financial and Banking Systems

n 1975

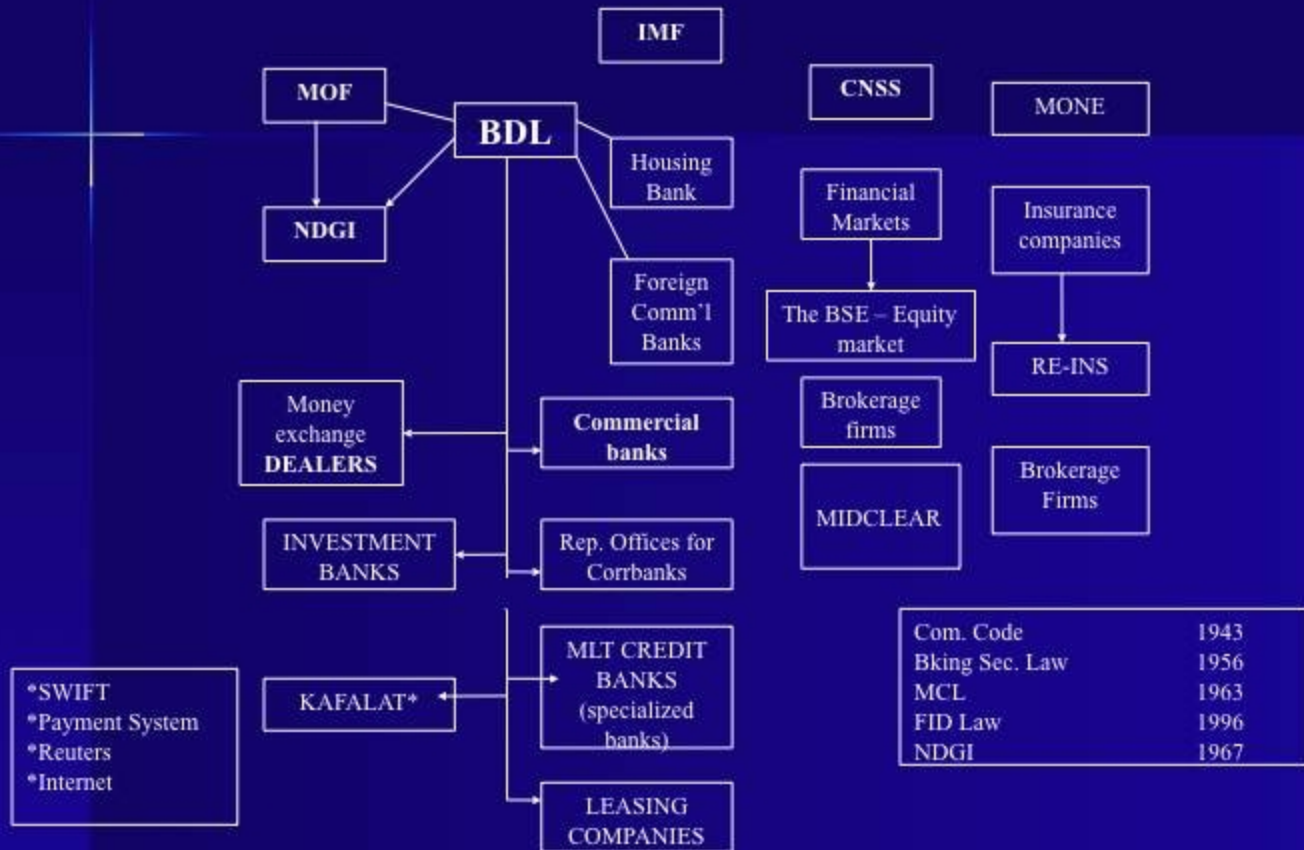
- An active Beirut Stock Exchange mainly Equity shares
- No Lebanese government paper in the circulation
- Limited Money Market Financial products
 - Inter-bank deposit market
 - The FX spot & forward markets
 - Commercial Paper
- Several International bond issues in LBP by Foreign borrowers
 - The WB, EIB, SB India, Renault

Comparison of the Financial and Banking Systems

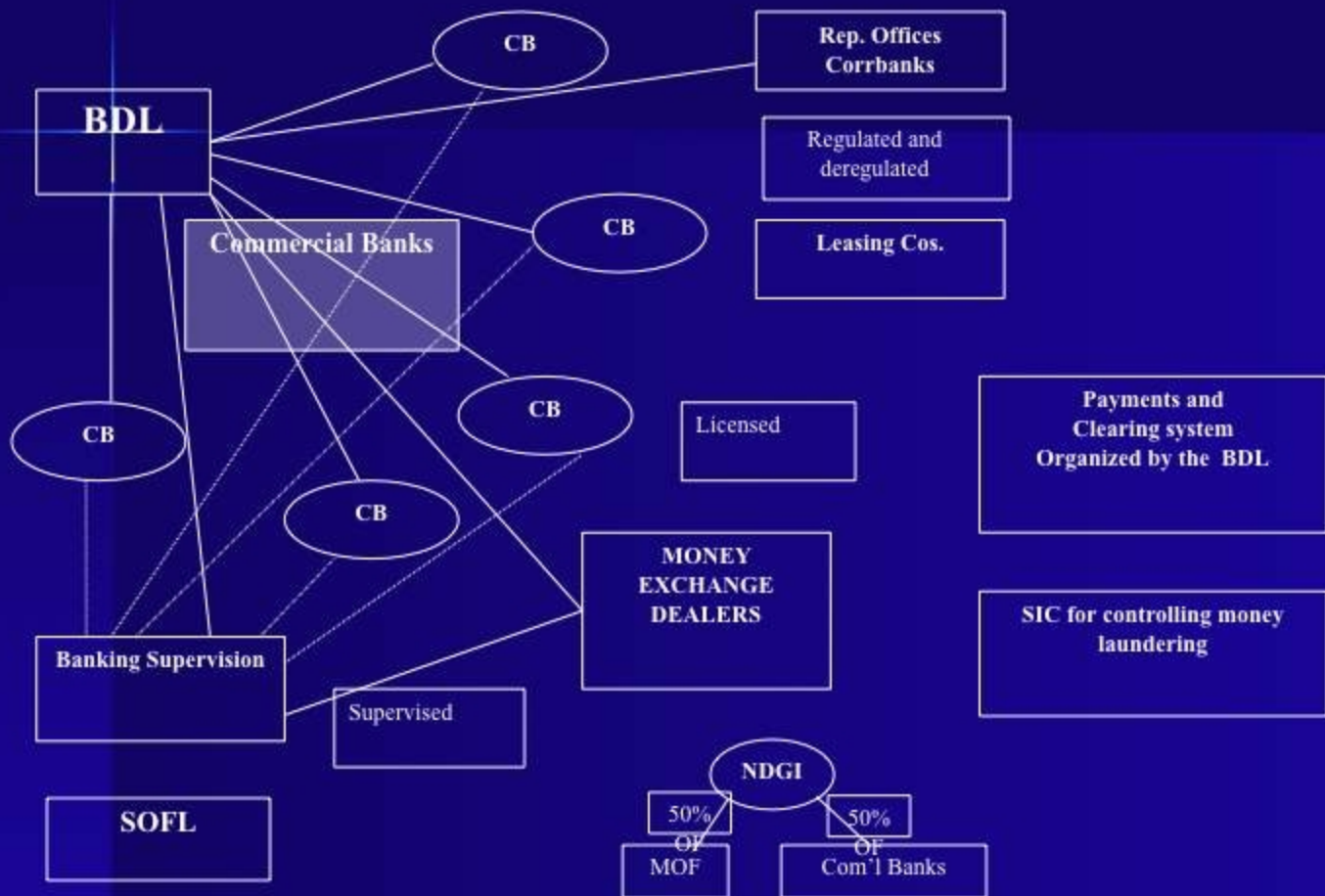
n 2005

- An Active Capital Market
- Lebanese government Bonds of various maturities, currencies & interest rates. The preponderance of the government sector financial papers
- Short-term Treasury Bills in LBP
- A dull foreign exchange market U.S \$ to LBP
- No international issues allowed in LBP
- An emerging Beirut Stock Exchange with limited listed equity shares
- An active Money Market
 - Short term Treasury Bills of different maturities
 - RP's
 - Inter-bank Deposit market
 - CD's – various issuers, the Central Bank and commercial banks with various maturities, interest rates and currencies

The Financial & Banking System NOW



Organization of the banking system



A SWOT Analysis of the Banking System

Strengths

- n Liberal economic system
- n Mature central banking authority
- n Widespread developed banking culture
- n Political Situation in positive Transition
- n Support from BDL in case of a crisis
- n Enhanced BDL regulations & supervision
- n A healthy banking system
- n Banking Secrecy Law & SIC

Strengths

- n Sound bank management
- n Improved risk management & compliance
- n Diversity in bank funding : core deposits, CD's, Preferred Shares, IFC syndicated loans, EuroNotes, EuroCD's
- n High systemic liquidity
- n Overall confidence in Lebanese banks
- n Safety of depositors' funds comes in priority
- n Correspondent banks' loyalty to Lebanese client Banks in times of crisis

Weaknesses

- n Government financing by banks out of acceptable norms and standards
- n Emerging corporate governance
- n The gradual disappearance of the bill of exchange in local trade finance
- n Shortage of economic recovery fundamentals and delayed reforms
- n Annual reports of many banks need more transparency, information, analysis & corporate governance

Opportunities

- n Privatization will create ample opportunities for economic growth
- n Banking over borders – extension to regional countries
- n Securitization of government properties will create new assets for banks
- n More deregulation & re-regulation is expected from the Central Bank for overall risk management and compliance

Challenges

- n The burden of the public debt – a potential threat in case financial reforms are not introduced and implemented
- n Basel II requirements might challenge the viability of several banks in the system
- n Financial Innovation & Information Technology

Reasons Compelling the Lebanese government to borrow since 1978

- n The war that started in 1975 crippled the government in collecting its revenues for reasons all of you know
- n The increasing non-productive public expenditures since then
- n Resulting to ever-growing budget deficit since 1980

Reasons Compelling the Lebanese government to borrow since 1978

- n Hence fiscal imbalances due to unusual events, resulting to:

The increase of

- n Sovereign risk
- n Economic and social risk
- n Currency risk & depreciation
- n Credit & default risk
- n High inflation

Lebanon's rating History with Fitch for the past 9 years.

Current Rating Level with Fitch

Affirmed in January 2003

Long-Term Foreign Currency rating	B-
Short-Term Foreign Currency rating	B
Local Currency (Long-Term) rating	B-
Outlook	Stable

December 1996:	First rating visit by Fitch	
February 1997:	Assignment of first ratings	
	Long-Term Foreign Currency rating:	BB
	Short-Term Foreign Currency rating:	B
	Local Currency rating:	BBB-
	<i>First Sovereign Report</i>	
May 1998:	Downgrade of the Long-Term Foreign and Domestic Currency Rating	
	Long-Term Foreign Currency rating:	BB-
	Short-Term Foreign Currency rating:	B
	Local Currency rating:	BB+
	<i>Second Sovereign Report</i>	

June 1999:		Downgrade of the Local Currency Rating	
		Long-Term Foreign Currency rating:	BB-
		Short-Term Foreign Currency rating:	B
		Local Currency rating:	BB
		Third Sovereign Report	
August 2000:		All Ratings Affirmed	
		Long-Term Foreign Currency rating:	BB-
		Short-Term Foreign Currency rating:	B
		Local Currency rating:	BB
		Fourth Sovereign Report	
September 2000:		Outlook newly assigned to all Sovereign Ratings	
		Outlook: Negative Outlook assigned to Lebanon	

February 2001:	Downgrade of the Long Term Foreign & Local Currency ratings	
	Outlook changed to Stable from Negative	
	Long-Term Foreign Currency rating:	B+
	Short-Term Foreign Currency rating:	B
	Local Currency rating:	B+
	<i>Fifth Sovereign Report</i>	
September 2001:	Downgrade of the Long Term Foreign & Local Currency ratings	
	Outlook Stable	
	Long-Term Foreign Currency rating:	B-
	Short-Term Foreign Currency rating:	B
	Local Currency rating:	B-
April 2002:	Publishing of Sovereign Comment	

January 2003:	Ratings Affirmed (current rating)	
	Long-Term Foreign Currency rating:	B-
	Short-Term Foreign Currency rating:	B
	Local Currency (Long-Term) rating:	B-
	Outlook:	Stable
	<i>Sixth Sovereign report</i>	
June 21, 2004:	Sovereigns	
	<u>FC</u>	
	Long-Term	B-
	Short-Term	B
	Outlook	Stable
	<u>Local Currency</u>	
	Long-Term	B-
	Outlook	Stable
	Country Ceiling	B-

The role of the Central Bank in assisting the Lebanese Treasury to market the short-term treasury Bills and Bonds

- n The initial difficulties faced by the CB authorities
- n Incomprehension and reluctance by banks in marketing TB's to individual investors
- n Conflict between the Central Bank and Bankers Association
- n Success in the end to both parties

Investors in the Lebanese government financial paper

- n Banks - percentage holdings
- n Private individual
- n Non-residents
- n Non-bank financial institutions
- n Investment banks on behalf of their clients
- n Société Financière Du Liban

Constraints of the Banking System in supporting public deficits & government debt

Constraints:

- n Undercapitalization of many banks
- n Competition with private sector financing – GDP growth weakened
- n Correspondent banking watch
- n Basel II requirements
- n The lack of policy guidelines for funds commitment and for the average maturity of the portfolio **main**

National debt management

Actions to take

- n There is consensus among the Lebanese that public debt should be reduced, budget deficits eliminated and fiscal reforms implemented. This means fiscal adjustments. The latter cannot be realized overnight, as you know. It requires:
 - Time
 - Commitment
 - Perseverance
 - People-decision makers
 - People of breakthroughs.

National debt management

Actions to take

- n Commitment for structural reforms of which privatization programs come first. Securitization of government properties can be implemented simultaneously.
- n Public expenditures must be rationalized
- n So far financial engineering implemented by the MOF officials as well as the central bank has been successful to maintain "confidence" in Lebanon, its reputation, liquidity and solvency of the banking system and the credibility of banks operating in Lebanon.

National debt management

Actions to take

- n Short term solutions such as support from outside –Paris II effect or future Paris III, swapping of debt maturities and interest rates swaps cannot be permanent and sound solutions to the government's huge debt stock.
- n The Lebanese government's reputation in its financial commitments, since independence has been outstanding, in spite of the political bickering between decision makers especially over the past 10

National debt management

Actions to take

- n Many scenarios can be planned if there is real commitment by public authorities for a solution to the deficit & debt problems
- n An organism for the debt management, under a new structured ministry of finance or even a temporary new ministry for government budgeting and debt management is one of the priorities of the Lebanese state today

National debt management

Actions to take

- n Having told this, public debt instruments must exist in Lebanon as it exists in all banking systems to feed up the assets side of the balance sheet of banks.
- n A solution to the debt burden does not mean a total elimination of public debt. Banks, investors, private or institutional, residents or non-residents look for such investment vehicles everywhere.

National debt management

Actions to take

- n Banks need government securities, specially during the time of recessions, when loan opportunities are low.
- n If you look into the U.S., European Union and other international banks' balance sheets, sovereign bond holdings by banks under "Investments" range from 13% to 28% ; there is no international law forbidding banks or limiting their holdings of government bonds
- n In the case of Lebanese banks this ratio as presented earlier in our SWOT analysis is over the generally accepted norms. This is an excess to be adjusted.

National debt management

Actions to take

- n The burden of debt must be reduced, as fiscal adjustment is necessary to alleviate the heavy burden of debt on the National Economy.
- n This will happen.
- n I do not foresee any debt crisis in Lebanon

THANK YOU