

# An Overview of The Lebanese Monetary Policy

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## I. General Overview

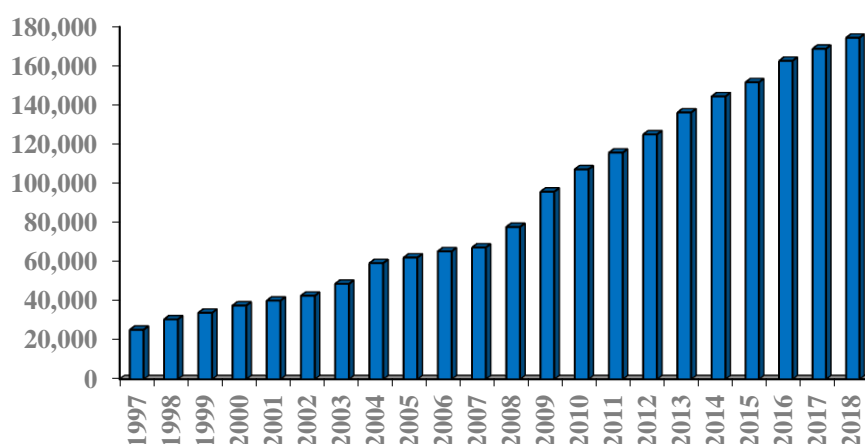
Unstable political circumstances in the country, along with regional unrest and the burdens of the Syrian crisis, have impaired the Lebanese economy for several years now. The political vacuum caused by absence in presidency for two-and-a-half years and a nine-month absence of a government in 2018 further exacerbated the economic environment. As a result, main economic indicators such as foreign investment, tourism, and real estate, marked their lowest levels since 2011. GDP growth stood at around 1% compared to 2% growth in the region, while the inflation rate reached approximately 6%. Lebanon's singularity, however, continues to lie in its resilience and its unique ability to prevail under exceptionally arduous social, political, and economic pressures.

At the monetary front and despite the recent rise in demand for dollar banknotes, Banque Du Liban (BDL) is maintaining its commitment to exchange rate stability which has become the cornerstone of financial stability in Lebanon. In fact, BDL is deploying all its efforts to ensure that monetary stability is safeguarded. With its solid stock of foreign assets accumulated over the years, BDL remains well-equipped to confront any economic crisis.

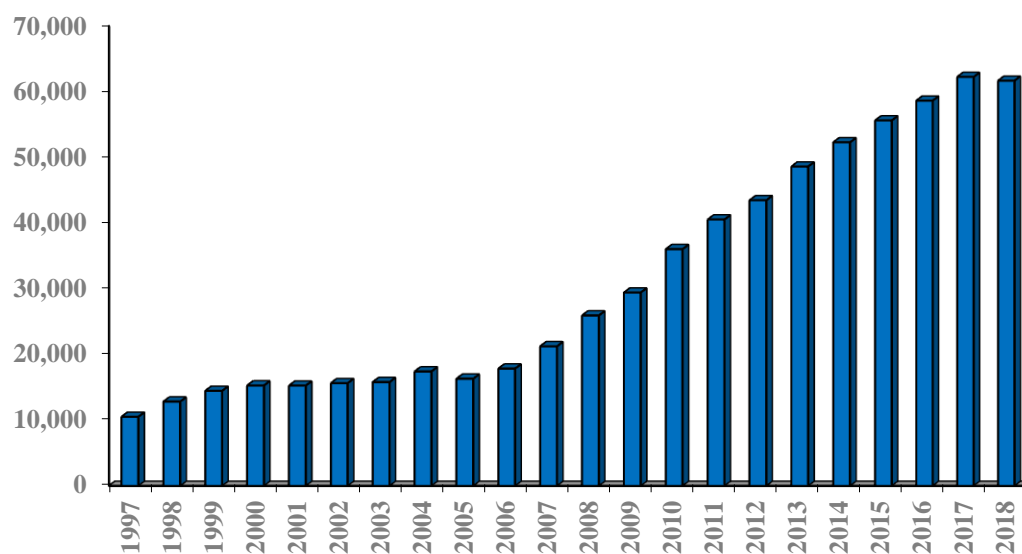
A reliable banking system has been established in strict compliance with international banking and accounting standards, particularly with respect to capital adequacy, good governance, transparency, profitability, liquidity, and combating money laundering. The Lebanese banking sector has thus the appropriate regulatory and supervisory frameworks to maintain its resilience and strength and to withstand unexpected events.

In spite of challenges that hampered its progress, the banking sector's performance remained healthy, recording an annual growth of 10% in total assets of banks which exceeded USD 261 billion in August 2019. Bank deposits stood at USD 182 billion with a decrease of 0.79% since December 2018 (Figure 1). In parallel, bank loans to the private sector stood at USD 57.5 billion at end August 2019, as compared to 61.7 at end 2018 (Figure 2). The dollarization of deposits reached 72%, up from 70.62% last year, while the loan dollarization ratio witnessed a slight increase of less than 1% since December 2018, registering 60.95% by end August 2019.

**Figure 1: Total Private Sector Deposits of Commercial Banks (in millions of USD)**

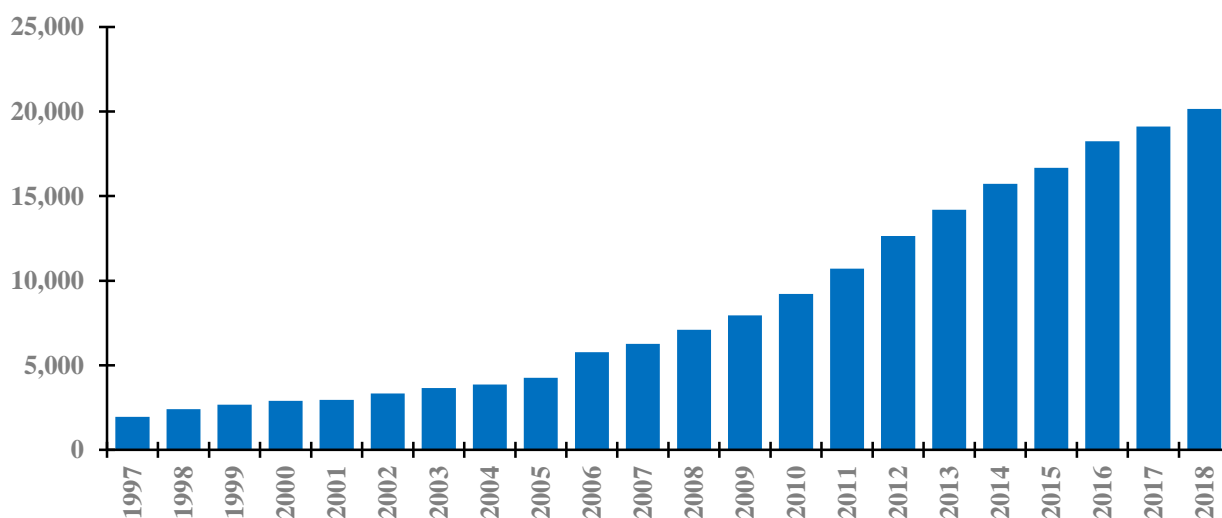


**Figure 2: Total Banks' Loans to the Private Sector (in millions of USD)**



In terms of capitalization, BDL has been keen to reinforce banks' capitalization in a way to enable banking institutions to confront any crisis that may hit the economy. With a capital base exceeding USD 20 billion in August 2019 (Figure 3), banks were able to reach a high capital adequacy ratio of 16% according to Basle III and more particularly to build general reserves. A downgrade in Lebanon's credit rating would bring down this ratio to around 12%, which is still largely exceeding the requirements of Basle III.

**Figure 3: Commercial Banks' Equity (in millions of USD)**



## **II. The Operational Framework of Monetary Policy in Lebanon: Objectives and Instruments**

BDL's mandate includes safeguarding the national currency and maintaining financial and economic stability. Its main functions consist of the issuance of the national currency, regulating the money supply, controlling interest rates, setting the monetary policy, and overseeing and developing the banking and financial sectors. BDL's policies are considered the foundation for sustained social and economic growth in Lebanon, as much as for the development of the banking sector, which is considered one of the strongest sectors in the Lebanese economy.

In order to fulfill its mandate, and particularly safeguarding monetary and economic stability, BDL resorts to conventional tools as well as nonconventional ones as needed.

### **A. Conventional Monetary Policy Tools**

For the past two decades, BDL's monetary policy has been first and foremost targeted at stabilizing the Lebanese pound exchange rate and controlling inflation. The central bank's continuous commitment to a stable exchange rate has proved to be key in the stability of the financial system.

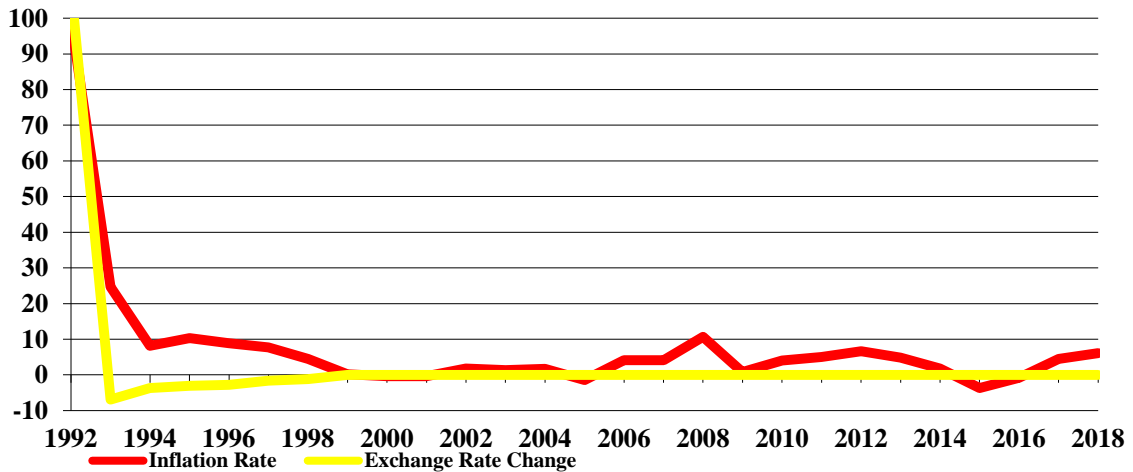
#### **1- Maintaining Exchange Rate Stability**

After the deterioration of the Lebanese pound (LBP) during the 1980s and early 1990s, BDL has realized that maintaining monetary stability using the exchange rate as a nominal anchor is an essential prerequisite for financial stability. BDL has followed a managed exchange rate regime, keeping the LBP-USD rate within a narrow band that has been set at LBP 1501-1514 to the dollar. A gradual appreciation of the Lebanese pound was recorded over the 1992-1999 period, followed by relative stability since then. Drastic price containment came along with exchange rate appreciation.

#### **2- Maintaining Low Rates of Inflation**

The three-digit inflation rate that crippled the Lebanese economy in the early 1990s has been successfully contained at a single digit rate over the past twenty years. With the public sector wage hike approved in 2017, and the increase in oil prices, the inflation rate has increased from 4.5% in 2017 to reach around 6% in 2018. (Figure 4)

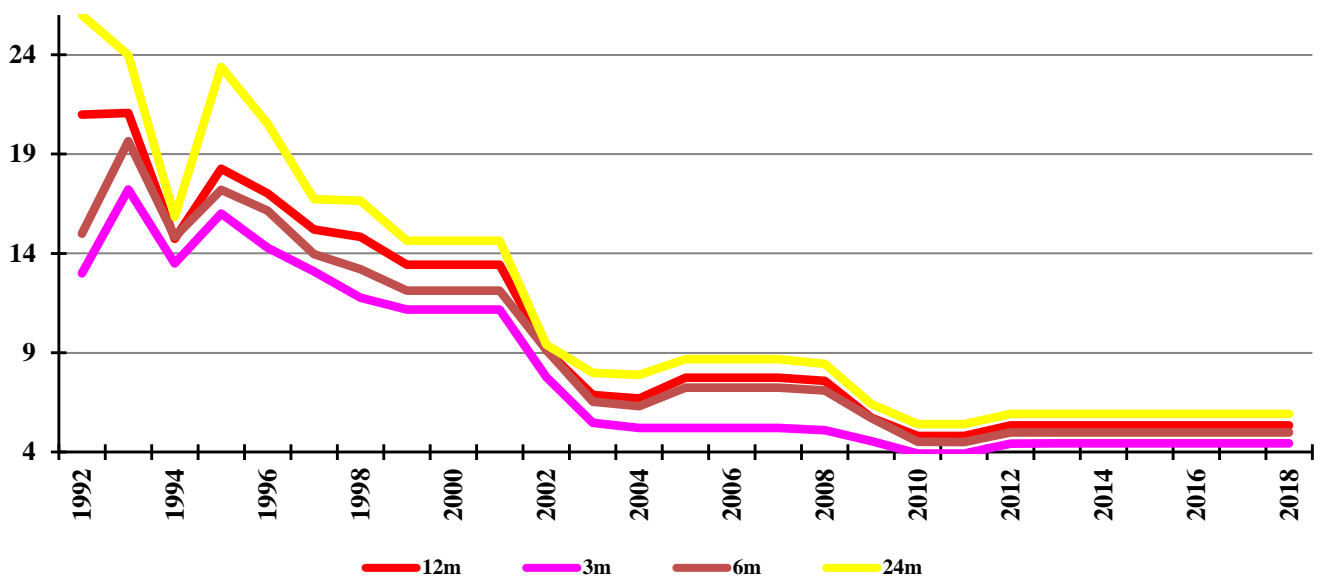
**Figure 4: Inflation Rate versus Exchange Rate Change**



**3- Ensuring a Gradual Decrease in Interest Rates**

BDL’s compliance with market tendencies in the determination of interest rates maintained the latter at appropriate levels to spur capital inflows and strengthen the external position. Growing confidence in the local currency has resulted in gradual interest rate cuts since the 1990s. The massive cash injection into the Lebanese market during 2008-2010 has also helped the interest rate structure to decline further; which resulted in debt service savings over the past years. Starting 2018, interest rates were witnessing an increase, in line with market tendencies and a global increase in interest rates, thus accounting for a rise in the budget deficit. (Figure 5)

**Figure 5: Primary Market Rates on Treasury Bills**



## **B. Nonconventional Monetary Policy Tools**

The pressing regional and local challenges that have hindered the Lebanese economy for the past few years have incited BDL to resort to unconventional monetary policy tools in order to boost socioeconomic development.

### **1- Stimulus Packages**

BDL launched its first stimulus package amounting to USD 1.47 billion back in 2013. These credit incentives, provided through the banking sector, have played a key role in boosting and supporting the numerous segments of the Lebanese economy: fostering traditional sectors through productive loans; development of human capital and entrepreneurship through education, research and development, and knowledge and innovation loans; reinforcement of the middle class through housing loans; preservation of the environment through green incentives.

During the past seven years, the stimulus packages have amounted to USD 7.2 billion and have targeted productive sectors (40%) and the housing sector (60%). These incentives, together with the exemption of banks from reserve requirements and government loan subsidies, have led to the injection of almost USD 16 billion to support economic activity since 2009. The importance of these catalyst endeavors lies in their sizable contribution to real GDP, and their momentum in job creation.

Recently, BDL has taken additional measures to support the Lebanese industry sector by increasing the percentage of BDL contribution to the industrial subsidized loan, thus enabling commercial banks to provide the necessary loans to industrialists, including working capitals. Moreover, BDL has increased the ceiling of the loan granted to finance the working capital from USD three million to USD five million.

### **2- Equity Financing and Knowledge Economy**

Supporting productive sectors is essential yet not sufficient alone to boost Lebanon's economy. Sustainable growth and development are largely linked to improving Lebanon's competitiveness, with the knowledge economy playing a pivotal role.

Considering that the wealth of Lebanon lies in its pool of high skilled labor, and aiming at enhancing its innovative potentials, BDL launched in August 2013 a new initiative enabling banks to contribute, for the first time, in equity financing of startup companies, incubators, accelerators, and venture capital. This has come in conformity with the belief that market economy and the enhancement of entrepreneurship are the right approach for creating wealth and job opportunities in Lebanon.

By issuing its circular 331 dated August 22, 2013, BDL was the first institution to foster the Lebanese knowledge economy on a national scale through motivating the banking sector to invest around USD 600 million in startups. BDL has been focusing on developing and supporting Lebanon's highly qualified human capital that is capable of effectively turning innovative ideas into successful businesses and creating job opportunities in the process, thus contributing to economic prosperity.

### **III. The Regulatory Framework of Monetary Policy in Lebanon: Stability, Governance, and Compliance**

For almost three decades now, BDL has been keen on channeling its efforts towards developing a sound and secure banking sector in order to build a prudent financial model that inspires confidence in the system. In fact, practices implemented in the Lebanese model are similar to many of the recent reforms suggested by international financial regulators, most important of which are: decreasing leverage, regulating derivatives and structured products, strengthening banks capital and liquidity requirements, enhancing the corporate governance and transparency of financial institutions, enabling the central bank's monitoring of all financial players, enhancing financial inclusion, drawing a clear demarcation between commercial banks and investment banks, and prohibiting any defaulting of banks that threatens financial stability. Furthermore, intensive actions have been enacted towards implementing compliance measures with respect to Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT), risk management and effective internal control, and global sanctions.

During the past two years, BDL has persisted on implementing major regulatory measures that are consistent with the above mentioned practices. The most significant of these measures can be highlighted as follows:

- 1- *Enhancing financial inclusion*: BDL has issued circulars that encourage banks to establish branches in remote areas and install ATMs that are accessible by people with special needs. Furthermore, BDL has permitted the establishment of a new category of financial institutions to be limited to micro-financing.
- 2- *Reinforcing banks' reserves in consistence with IFRS9 standards*: BDL issued the necessary regulations that require banks to constitute the reserves needed to cover expected credit losses and retail loans, according to IFRS9 standards.
- 3- *Strengthening corporate governance*: BDL has directed banks to set recovery and board members succession plans.
- 4- *Enhancing transparency and protecting against cybercrime acts*: BDL has required banks to enact common reporting standards that are related to the disclosure of tax information to the Ministry of Finance, in addition to compelling banks to take the necessary measures for protection against cybercrime acts. Moreover, BDL has demanded that banks comply with the General Data Protection Regulation (GDPR) for personal data protection.
- 5- *Boosting AML/CFT compliance measures*: BDL has enacted and determined the notion of "beneficial owner" in the financial and banking operations control system for combating money laundering and financing of terrorism. In addition, BDL has required banks to introduce clear justification for any AML/CFT measures.
- 6- *Reducing financial systemic risks*: BDL has required banks to acquire its approval for any mandatory contributions, partnerships, placements, and deposits required by laws, regulations, and/or authorities at foreign host countries. In addition, BDL committed banks to maintain a liquidity coverage ratio that reflects their self-assessment of liquidity risk and

- commensurate with the characteristics of the liquidity risk they may be exposed to.
- 7- *Enacting the Law of Electronic Transactions and Personal Data:* BDL has contributed to the preparation of the draft law on electronic transactions and personal data, which has been passed by the Lebanese Parliament in October 2018. This long-awaited law recognizes electronic support and electronic signature, in addition to regulating electronic payment orders, electronic transfers, bank cards, electronic money, and electronic cheques.
  - 8- *Expanding digitalization:* on the front of financial technology, the Central Bank has established a committee in charge of issuing the circulars needed for the development and regulation of the fintech sector, based on the Code of Money and Credit and on the incoming law related to electronic transactions. In parallel, BDL has made significant progress in the project of establishing a digital currency, and it is finalizing its legal aspect before its launching. BDL has also set the stage, through the Capital Market Authority (CMA), for launching the electronic trading platform that will ensure that active financial markets attract the necessary liquidity for the growth of various economic sectors and open multiple options to obtain required funding for SMEs and other corporations in Lebanon.

#### **IV. Conclusion**

Since its inception, the Central Bank of Lebanon has been keen on safeguarding the national currency and maintaining financial and economic stability. And it never spared any efforts to ensure the resilience and soundness of the Lebanese economy in general and the financial sector in particular.

The policies undertaken by BDL, whether conventional or not, have proven their effectiveness and have been recognized as major drivers of the Lebanese economy. BDL will remain vigilant to the financial and economic needs of Lebanon, and will continue to be proactive in light of persisting challenges.

Nonetheless, to ensure sustainable development and to pave the way for real inclusive growth, the government needs to undertake a number of structural reforms: revamping infrastructure, enhancing the quality and quantity of public services, simplifying and modernizing administrative procedures, enforcing fiscal discipline, reforming the energy sector, and passing the budget law, among others. Furthermore, BDL has strived to create the adequate environment to promote the banking and financial sectors on one hand, and the knowledge ecosystem on the other, with the expectation that the government would in turn support the creation of the necessary environment for a cross-sectorial and diversified productive economic growth.