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BANQUE DU LIBAN

# How Can Central Banks Stimulate an Economy: the Case of Lebanon

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Historical precedents of central banks' implementation of stimulus policies go back to the era of the Great Depression during the 1930s, when U.S. excess reserves reached historical records that continued till the end of World War II, contributing to the financing of war efforts and to the funding of the Treasury's debt at favorable rates.[i] Along the same lines, when Bank of Japan first implemented the policy termed "quantitative easing" in the early 2000s to fight domestic deflation,[ii] it was hardly predictable that this policy would be developed and implemented few years later on a global scale and in an unprecedented scope to cope with the fiercest global financial crisis the world has ever witnessed.

On the developing-countries scene, particularly the Arab region, the majority of these economies haven't had the luxury of mobilizing adequate effective and efficient macroeconomic tools, which are accessible by developed and emerging countries, in the aftermath of the global financial crisis and its repercussions, and in the wake of the successive regional turbulences and conflicts. As a matter of fact, the sluggish growth (projected at 1.7% in 2017) and stubborn budget deficits witnessed by MENA oil-exporting countries,[iii] along with the fiscal incompetence and high public indebtedness suffered by the MENA oil-importing countries (despite the projected rise in their growth at 4.3% in 2017)[iv] are mere symptoms of both profound structural socioeconomic challenges and contemporary macroeconomic adversities.

The structural socioeconomic challenges encompass lack of economic diversification and rentier economies; fiscal inefficiency and public-finance unsoundness; unemployment and job-market failures; weakness of intra-regional economic integration and uniformity; insufficiency and unsustainability in economic growth and development; retardation of technological innovation, knowledge economy, and research & development; weakness in financial inclusion and financial capabilities; exposure to financial crimes, compliance pressures, and malgovernance. As for the contemporary macroeconomic adversities, these are mainly the outcomes of regional political and security unrests and conflicts, accompanied by severe socioeconomic disturbances that are caused by massive population displacements, in addition to economic and resource-price shocks, as in the case of oil prices.

As a country in the MENA region, holding many of its intrinsic characteristics and bordering two of its most enflamed causes, i.e. the Palestinian cause and the Syrian war, Lebanon has been subject to most of the above-mentioned hardships and its embedded risks. The recent Syrian crisis, in particular, has significantly disrupted Lebanon's macroeconomics, stunting economic growth and development trajectories, locking traditional export markets, surging unemployment, and diminishing investor confidence. This has largely contributed in reducing Lebanon's GDP growth by an annual average of 2.9%.[v] Hence, GDP growth declined from 8–10% during the two years preceding the crisis to an average rate of 1–2% since its outburst, costing Lebanon more than US $18 billion so far, equivalent to a cumulative loss of almost 30% of its GDP, reducing the GDP by US $6 billion as opportunity cost.[vi]

The intensity of the regional turbulence, climaxing at the war in Syria, and decrease in oil prices, along with the persisting repercussions of the global financial crisis signified by the phenomenon of secular stagnation, inflicted severe contractionary effects in capital markets and deflationary outcomes on prices, in Lebanon and the region. This reality, however, has not halted Banque Du Liban (BDL) from persevering on implementing progressive monetary policy, in its conventional and unconventional forms.

In this sense, believing that the immunization of the economy is the foundation of its stimulation, the central bank has been committed to ensure the basis for comprehensive, sustainable, and independent social development and sustainable economic growth through achieving its conventional objectives of sustaining monetary stability through maintaining the exchange rate level and a high level of foreign reserves that has recorded US $43.5 billion in October 2017, excluding gold reserves that rank second on the Arab level and eighteenth globally. BDL has also pursued interest rate stability without disrupting market mechanisms, hence securing effective sources of financing for private and public sectors and enhancing financial inclusion, which reaches around 47% in Lebanon, compared to 18% in the Arab World. Moreover, BDL's efforts in managing excess liquidity, which currently exceeds US $20 billion, aiming at curbing inflationary pressures, in addition to targeting inflation, thus keeping it above zero-level, has reaped positive outcomes. As for conserving financial stability, BDL has set the stage for developing money and financial markets through initiating the Capital Markets Authority and launching the electronic platform project, thus enhancing equity financing. Launching a domestic payment system that provides a secure platform for money transfer operations and e-services has been also achieved. BDL's support of fiscal policy has been embodied in the effective management of public debt through its continuous commitment to allocate financial resources for financing the government's deficit at optimal costs.

The hard economic conditions have compelled BDL to implement an unconventional monetary policy and financial engineering tools that encompass monetary transmission mechanisms which benefit the economy and society. These tools serve to stimulate internal demand and support the government in creating the necessary conditions for sustainable growth through boosting lending activity and fueling economic growth to revitalize the labor market, thus reinforcing social and environmental security, and promoting human development. These packages, extending from 2013 through 2017 and amounting to an average of US $1 billion per year, proved to be successful by contributing around 50% of real GDP growth. These include incentives to support housing, education, renewable energy projects, innovative projects, research and development ventures, entrepreneurship, exporting industries, art-production projects, and other productive sectors of the economy. Moreover, BDL placed additional focus on targeting the knowledge industry, as being considered a strategic comparative advantage for the Lebanese economy, creating room for new employment opportunities through encouraging Lebanese banks to invest in the equity capital of companies working in the knowledge economy, therefore expanding the country's GDP and ensuring sustainable development. This innovative scheme made available around $600 million to support creativity and innovation.

Lately, starting 2016, BDL has further implemented a multipurpose and multidimensional financial engineering aiming at strengthening BDL's foreign-currency assets, consolidating the capital base of banks, increasing liquidity in local currency, improving the government debt profile, enforcing the confidence in Lebanese treasury bills, increasing inflation rate to a 2% target, improving Lebanon's credit rating, and improving the balance of payments (BOP) status by adopting the means needed to boost internal demand and productivity, hence bolstering growth and development. BDL's Financial Engineering has led to inflows amounting to USD 4.2 billion at end-2016, thus turning the BOP cumulative deficit of USD 1.7 billion in May 2016 into a cumulative surplus of USD 1.3 billion at the end of 2016.

In addition, BDL has been keen to sustain its regulatory role in maintaining the strength and stability of the banking and financial sectors, as one of the major national strategic sectors. In this context, banks were required to: maintain high levels of liquidity; exceed international standards on capitalization requirements (Basel III); comply with investment and balance-sheet regulations (IFRS 9); and avoid excessive leveraging along with building adequate provisions. BDL's regulatory initiatives also covered the implementation of corporate governance practices, setting an anti-money laundering and countering financing of terrorism process, enhancing risk management and effective internal control, and securing compliance with global sanctions.

In conclusion, the macroprudential policy, unconventional monetary stimulus packages, and the precautionary regulatory role are the pillars which BDL and the Lebanese banking sector have been using to successfully face the current challenges and evade their risks, while playing the strategic national role of nurturing resilience and stimulating the socioeconomic scene, thus capitalizing on the current global upswing in economic activity.[vii]

Thank you.

## References

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[iv] Ibid.

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[vii] http://www.imf.org/en/Publications/WEO/Issues/2017/09/19/world-economic-outlook-october-2017?cid=em-COM-123-36015.