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Lebanon: IMF Deal a Significant Step Forward, but Is More of a Carrot Than a Parachute

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Bottom Line: The IMF today (April 7) concluded a two-week mission to Beirut with an announcement of a staff level agreement for a $3bn, 46-month Extended Fund Facility (EFF). The news likely comes as a positive surprise to markets, as prospects for an IMF deal prior to parliamentary elections (due in May) were widely seen as being low. In our view, this is the most significant step toward normalising the economic crisis that has gripped Lebanon since the months prior to its sovereign default in March 2020. It also potentially paves the way to a resolution of the default, and the outstanding Eurobonds were up around 1.5 cents on the dollar (to around 13.8 cents) on the news.

While we welcome today's announcement, we remain cautious with respect to the prospects for a successful implementation of the prior actions required by the IMF before formal approval of the programme by the board. These include: (i) cabinet/parliamentary approval of a bank restructuring strategy and enabling legislation, in conjunction with an audit of the 14 largest banks; (ii) parliamentary approval of a reformed bank secrecy law; (iii) completion of the BdL's audit, (iv) a restructuring of the outstanding commercial debt (including the Eurobonds); (v) parliamentary approval of the 2022 budget; and (vi) unification by the BdL of the exchange rates for authorized current account transactions.

We think each of these is economically and politically challenging, but none more so in our view than the restructuring of the local banks. We have previously estimated losses at the local banks at around $65-$70bn, in line with the government's own estimates. This is approaching three times existing bank capital, and four times GDP. With no prospect for the government to recapitalise the banks, we maintain our view that a bail-in of depositors is required to restore viability to the banking sector. The distribution of losses between the government, bank shareholders and depositors is a politically challenging question and is unlikely to be resolved easily (or quickly), in our view.

The implementation of the prior actions is further complicated by the upcoming political agenda, with parliamentary elections due in May and presidential elections due before the end of October. In our view, given previous experience of government formation, it is likely to be several months after parliamentary elections before a new government is formed (even if the incumbent prime minister Najib Mikati is returned to office). This could mean a caretaker government would effectively be charged with implementing the prior actions.

Overall, we think this staff level agreement is more of a carrot to incentivise the Lebanese political class into action than a promise of near-term financial assistance. Successful implementation of the prior actions will unlock significant benefits for the Lebanese economy and the Lebanese people, in our view, including billions of Dollars in soft financing pledged during the CEDRE conference in 2018. We remain cautious regarding the prospects for this, but nonetheless see it as the most positive economic development in Lebanon over the past three years.

Key Figures:

- Staff-level agreement reached on comprehensive economic policies that could be supported by a 46-month Extended Fund Arrangement (EFF) with requested access of SDR 2,173.9 million (equivalent to about US$3 billion);
- This agreement is subject to approval by IMF management and the Executive Board;
- Timely implementation of all prior actions and confirmation of international partners' financial support required before formal approval by the Executive Board.

Main Points:

- The IMF concluded a two-week mission to Beirut today with an announcement of a staff level agreement for a $3bn, 46-month Extended Fund Facility (EFF). The news likely comes as a positive surprise to markets, as prospects for an IMF deal prior to parliamentary elections (due in May) were widely seen as being low. In our view, this is the most significant step toward normalising the economic crisis that has gripped Lebanon since the months prior to its sovereign default in March 2020. It also potentially paves the way to a resolution of the default, and the outstanding Eurobonds were up around 1.5 cents on the dollar (to around 13.8 cents) on the news.
- While we welcome today's announcement, we remain cautious with respect to the prospects for a successful implementation of the prior actions required by the IMF before formal approval of the programme by the board. These include: (i) Cabinet/parliamentary approval of a bank restructuring strategy and enabling legislation, in conjunction with an audit of the 14 largest banks; (ii) parliamentary approval of a reformed bank secrecy law; (iii) completion of the BdL's audit, (iv) a restructuring of the outstanding commercial debt (including the Eurobonds); (v) parliamentary approval of the 2022 budget; and (vi) unification by the BdL of the exchange rates for authorized current account transactions.
- Each of these is economically and politically difficult to implement, but none more so in our view than the restructuring of the local banks. We have previously estimated losses at the local banks at around $65-$70bn, in line with the government's own estimates. This is approaching three times existing bank capital, and four times GDP. With no prospect for the government to recapitalise the banks, we maintain our view that a bail-in of depositors is required to restore viability to the banking sector. The distribution of losses between the government, bank shareholders and depositors is a politically challenging question and is unlikely to be resolved easily (or quickly), in our view.

- The implementation of the prior actions is further complicated by the upcoming political agenda, with parliamentary elections due in May and presidential elections due before the end of October. In our view, given previous experience of government formation, it is likely to be several months after parliamentary elections before a new government is formed (even if the incumbent prime minister Mikati is returned to office). This could mean a caretaker government would effectively be in charge of implementing the prior actions which is potentially controversial.
- Overall, we think this staff level agreement is more of a carrot to incentivise the Lebanese political class into action than a promise of near-term financial assistance. Successful implementation of the prior actions will unlock significant benefits for the Lebanese economy and the Lebanese people, in our view, including billions of Dollars in soft financing pledged during the CEDRE conference in 2018. We remain cautious regarding the prospects for this, but nonetheless see it as the most positive economic development in Lebanon over the past three years.

Farouk Soussa and Madhvee Bangur

**Madhvee is an intern in the CEEMEA economics team.*

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