الجمهورية اللبنانية
وزارة المالية

Situation Update for Lebanon’s Creditors

27 March 2020

Ministry of Finance of the Republic of Lebanon

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Overview

While the Government continues to develop its macroeconomic reform plan, Lebanon wishes to update its creditors on the following areas:

1. **The building up of financial imbalances over the years**
2. **Overview of the Government's Recovery Plan**
3. **Focus on Lebanon's public debt restructuring**
4. **Next Steps**

The most recent figures in these slides are estimates based on preliminary figures in Government databases and have not been independently audited or verified

1. The Building up of Financial Imbalances over Years

2. Overview of the Recovery Plan

3. Focus on Public Debt Restructuring

4. Next Steps

Lebanon is going through an unprecedented economic crisis

Lebanon is going through an unprecedented situation compared to past crisis episodes

1 **Lebanon is faced with very large balance of payment imbalances:**

- a Years of persistent wide external current account deficit have deteriorated the country's net external position
- b Inflows of foreign deposits have dried up in recent months and are not likely to recover
- c Banque du Liban's FX reserves are on a rapid downward trend reaching critical levels
- d The gap between the official and the parallel exchange rates keeps widening

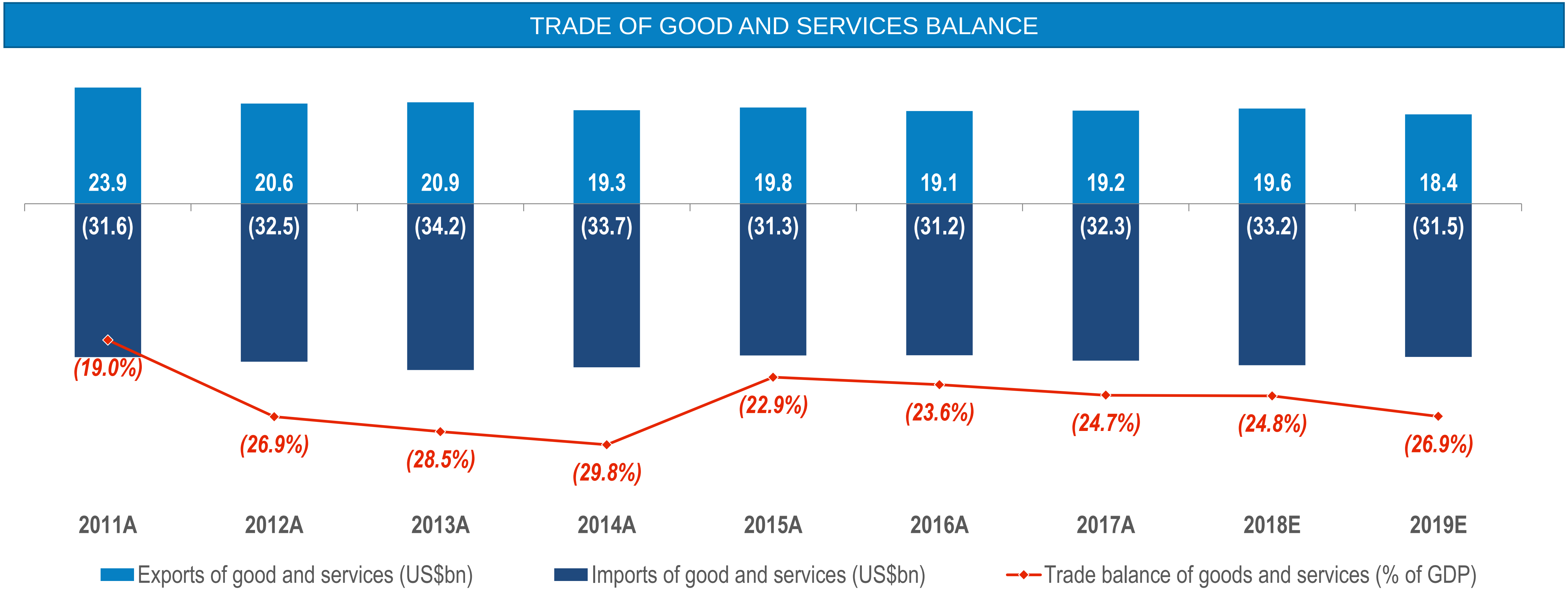
2 **All economic indicators point to a prolonged and sizable real GDP contraction, while unemployment and poverty are rising fast, reaching dangerous levels**

3 **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**

4 **Lebanon's banking sector is oversized, substantially above what is needed to fulfil its primary role of financing the development of a productive economy**

1 a

Large current account deficits have accumulated over time



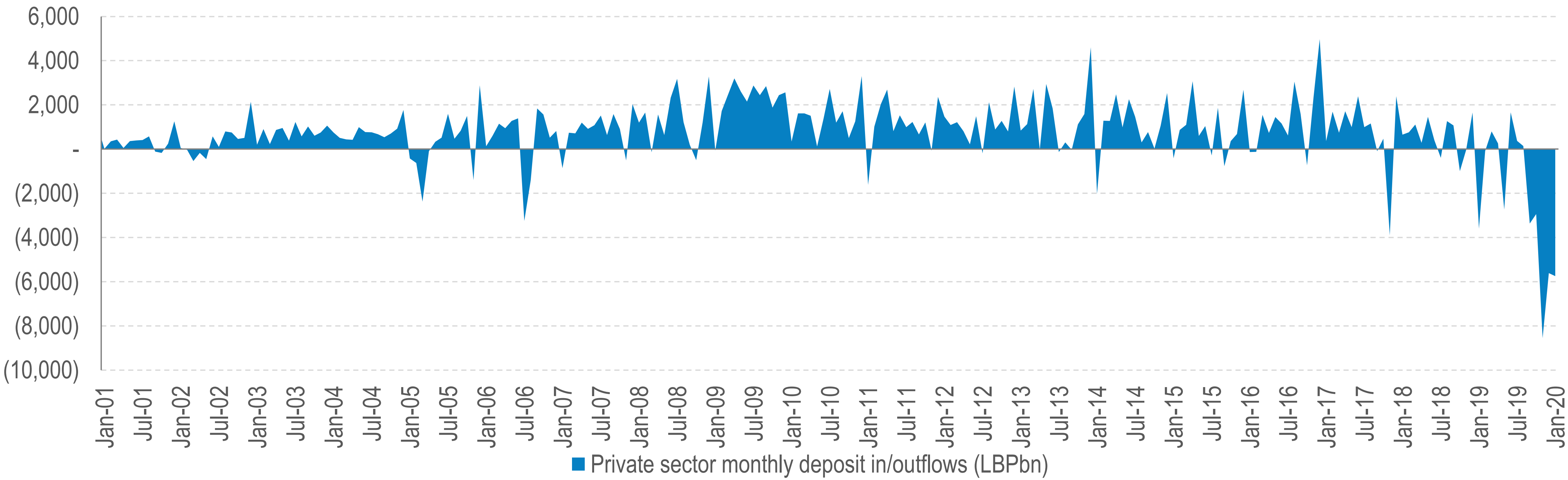
- Domestic consumption fueled by massive foreign inflows in the context of an overvalued exchange rate has contributed to <u>**persistently wide external trade deficits**</u>

Sources: Lebanese Authorities, IMF World Economic Outlook (October 2019)

1 b

Foreign capital inflows have dried up…

PRIVATE SECTOR DEPOSITS



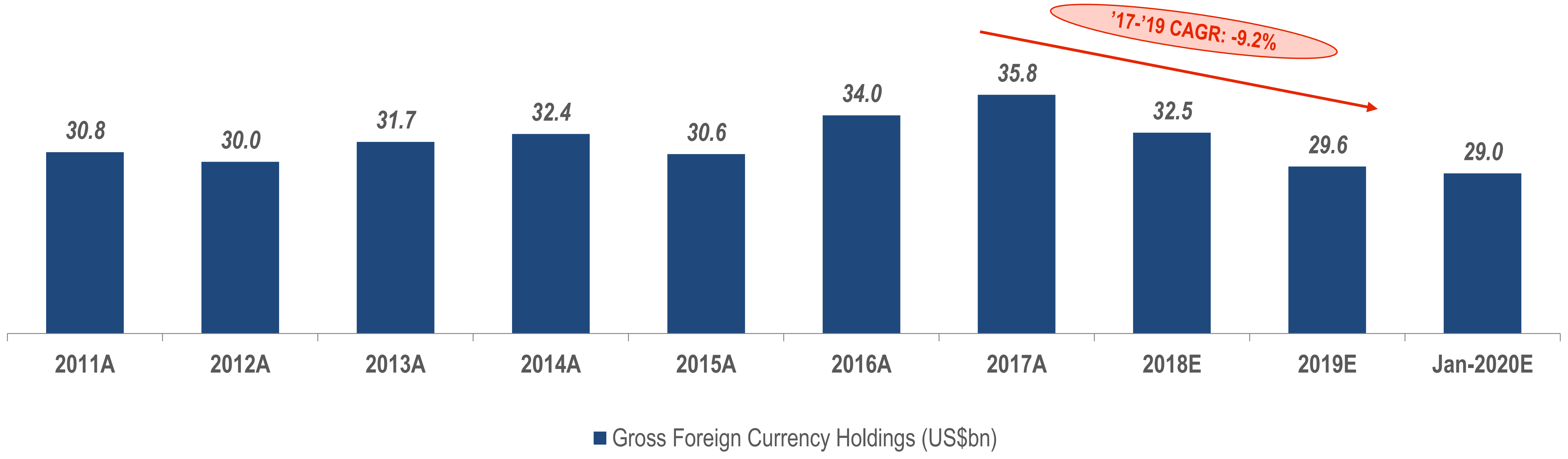
- Beginning mid-2019, **bank deposits outflows have reached unprecedented levels and any resumption in inflows is not likely to materialize in the near future**
- The US$11bn package pledged by the international community at the CEDRE conference in April 2018 has not yet materialized, pending the implementation of key structural reforms identified as pre-conditions to the disbursement

Sources: Banque du Liban

1 c

… Leading to a rapid depletion of Banque du Liban foreign currency holdings

BANQUE DU LIBAN GROSS FOREIGN CURRENCY HOLDINGS[1]



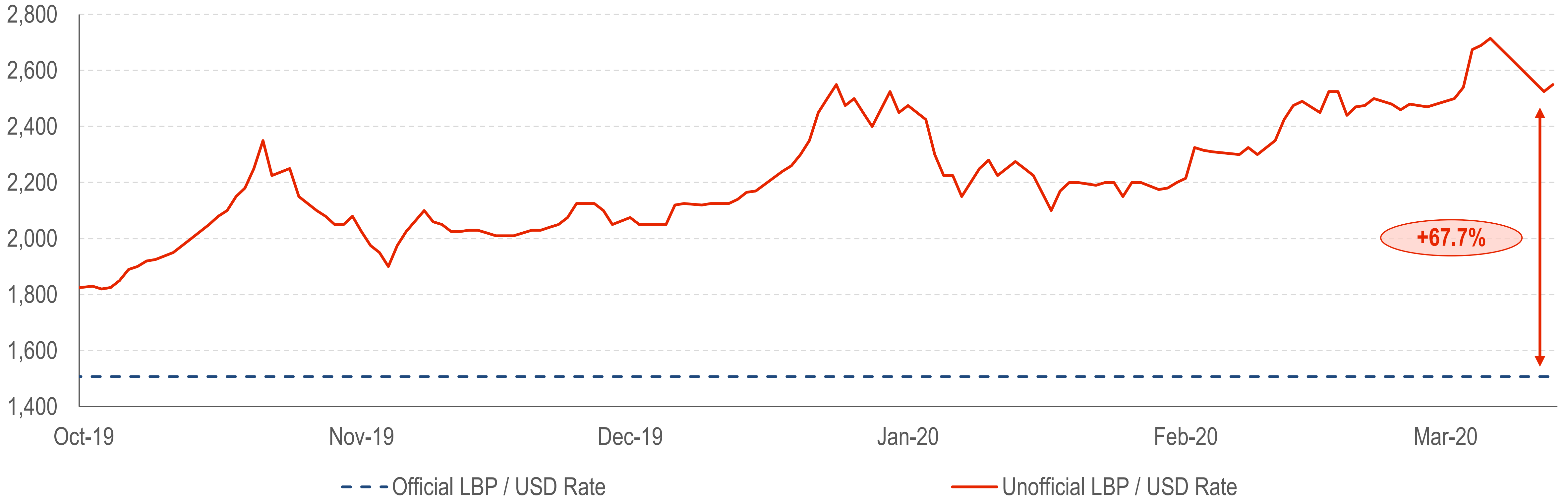
- Banque du Liban (BdL) FX holdings have come under high pressure, dropping to c. **US$ 29bn in January 2020**, of which US$ 22bn are liquid and US$ 18bn of those secure banks mandatory reserves in US$ are held at BdL for regulatory purposes

Sources: Lebanese Authorities, IMF World Economic Outlook (October 2019)
Note: (1) Excluding Government Eurobonds held by BdL

1 d

Also resulting in a widening between the official and parallel exchange rates

LBP / USD EXCHANGE RATES



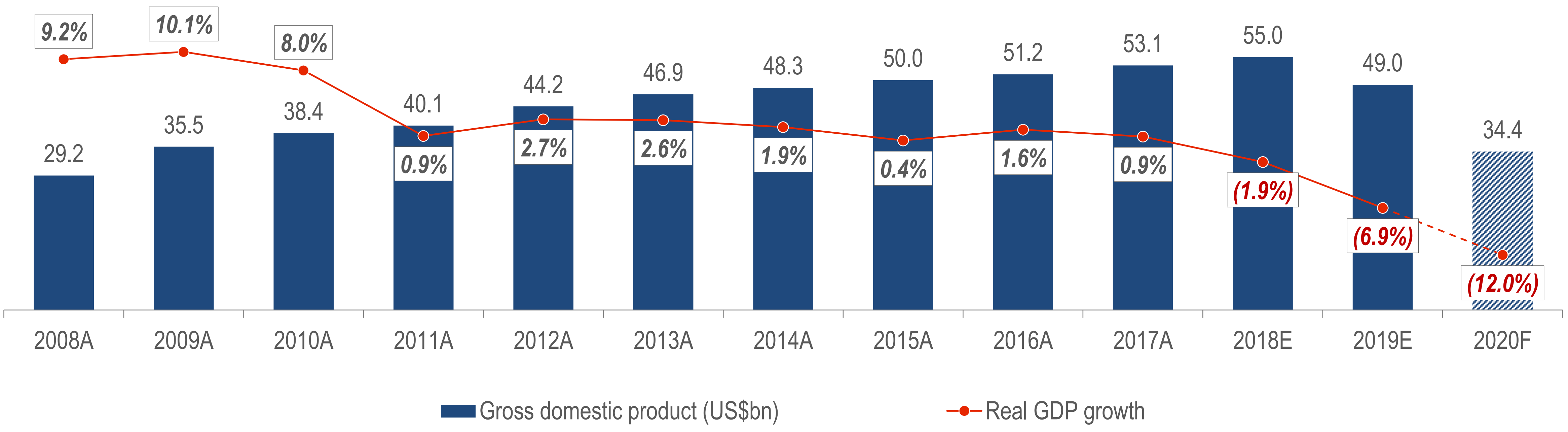
- Reduced access to external financing and foreign currency deposits accompanied by the sharp decrease in FX reserves have led to the **development of a parallel FX market** and the **de-facto sharp depreciation of the Lebanese Pound**

Sources: Bloomberg, lebaneselira.org as of 13 March 2020

2

The Lebanese economy is going through a deep contraction…

GROSS DOMESTIC PRODUCT



- **Real GDP growth** slumped in recent years, decreasing from 1.6% in 2016 to **-6.9% in 2019**.
- In 2020, real GDP could contract further by 12% as dollar shortage puts a **massive drag on nonfuel imports** and could be worsened with the additional impact of the **Coronavirus outbreak**

Sources: Lebanese Authorities, IMF World Economic Outlook (October 2019)

…Exacerbating the deterioration of social conditions

SOCIAL INDICATORS (2018/2019)

- **Poverty Rate**

45.0% *People living below the annual poverty line (LBP 4,729,000 per year)*

22.0% *People living below the extreme poverty line (US$ 2.40 per day)*

- **Unemployment Rate**

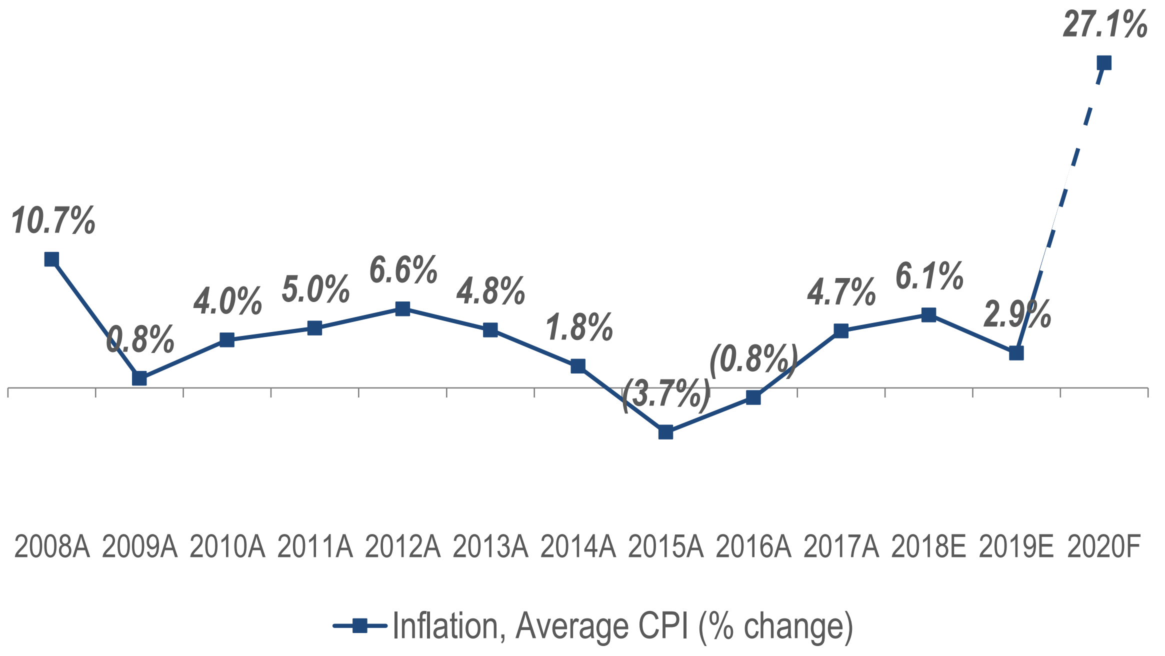
11.4% *Total population (aged 15 or more)*

+22% *Variation compared to 2011/2012 statistics*

23.3% *Youth (aged from 15 to 24)*

+29% *Variation compared to 2011/2012 statistics*

INFLATION

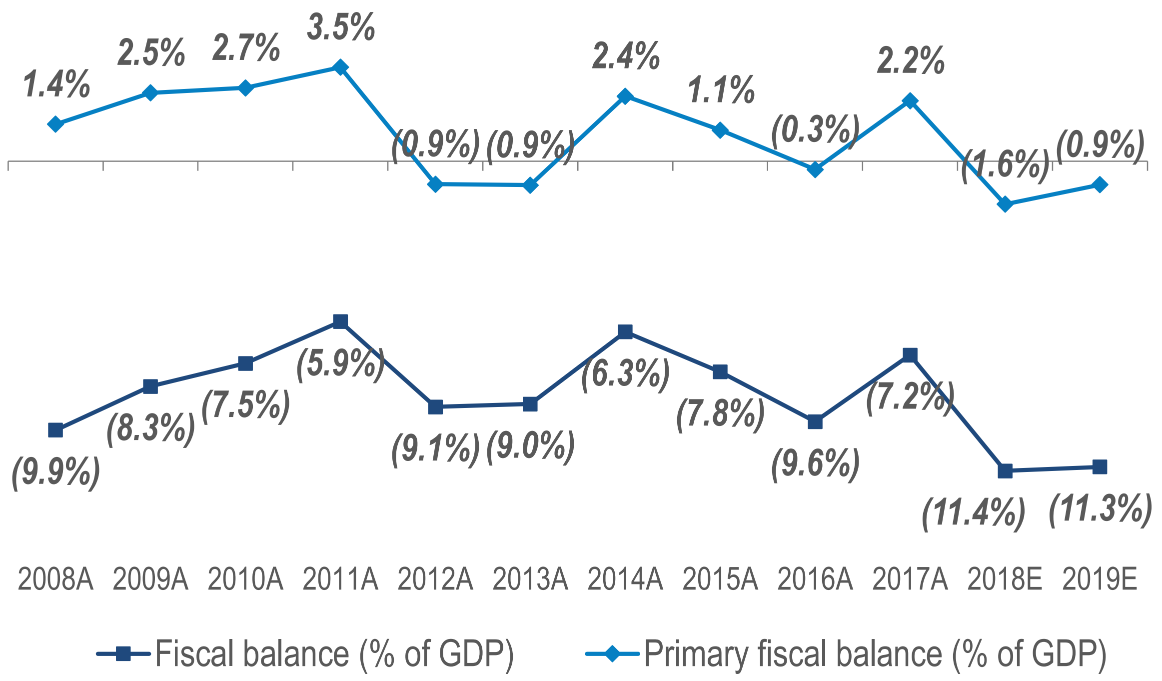


- On the back of a **rapidly deteriorating social situation**, on October 17th, 2019, **a popular uprising erupted** demanding better standards of living with equal opportunities for all and led to the **resignation of the previous government**
- Risks of **accelerating inflation** fueled by the ongoing sharp depreciation of the Lebanese pound on the parallel market will further dampen social indicators

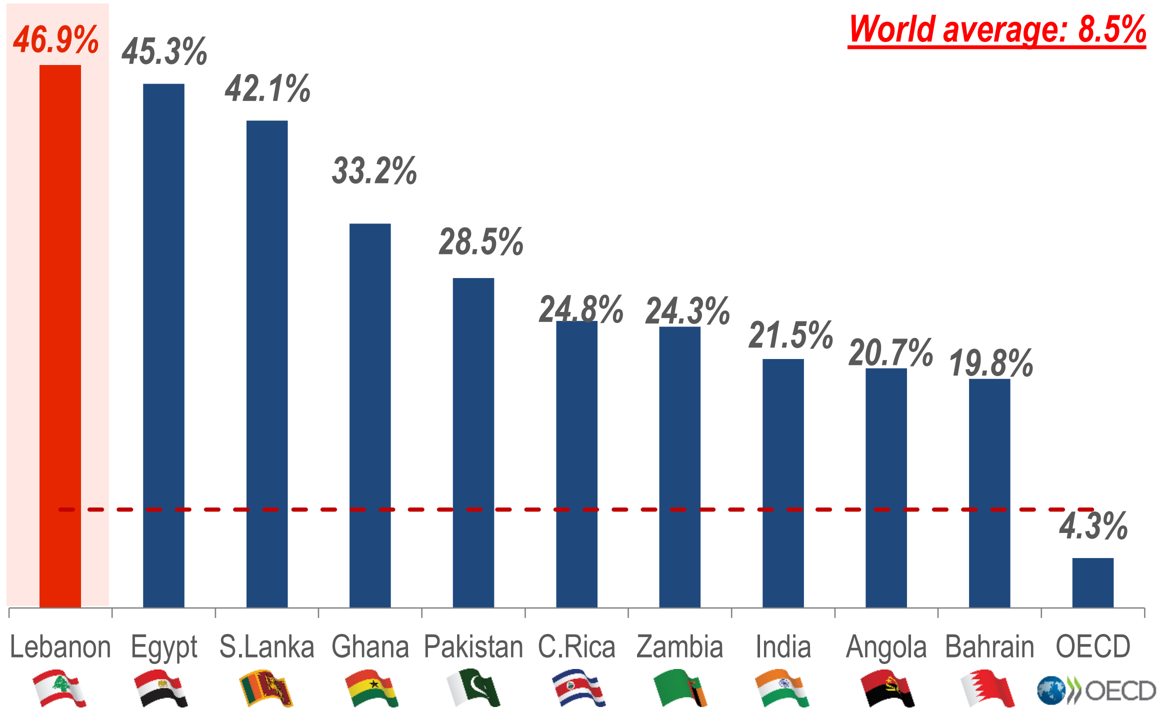
Sources: Lebanese Central Administration of Statistics, Labour Force and Household Living Conditions Survey 2018-2019

Years of large fiscal deficits …

FISCAL POSITION



2019 LEBANON INTEREST BILL IN % OF REVENUE VS. PEERS



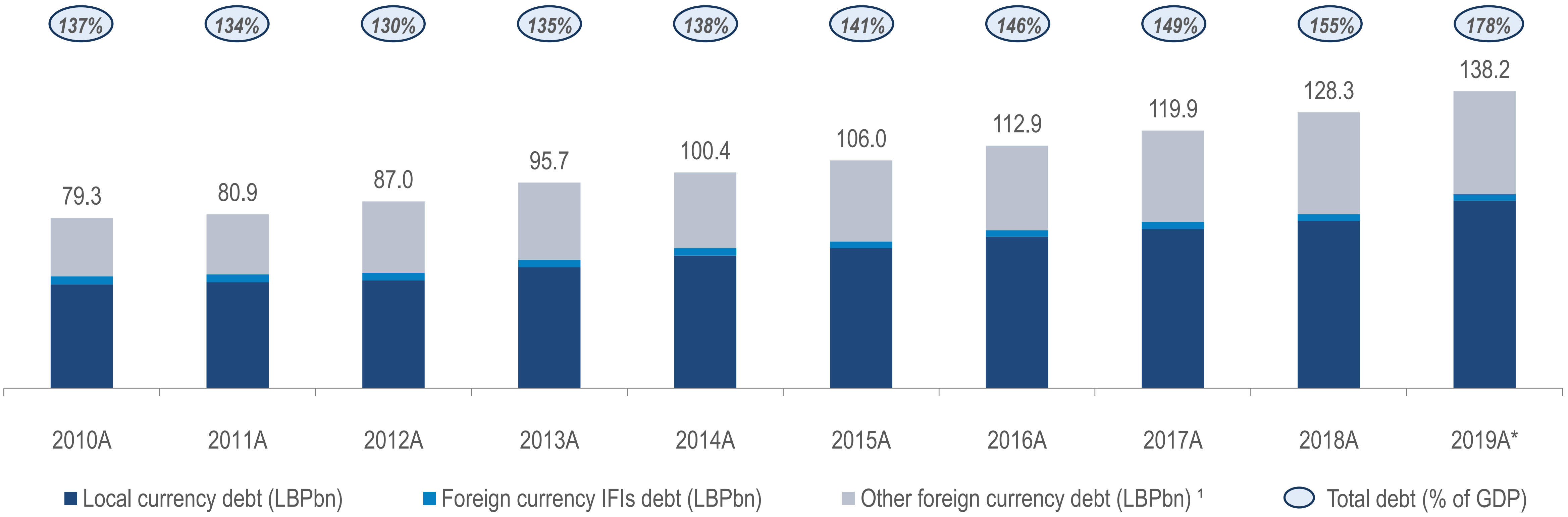
- Faced with **constant dollar inflow needs**, Lebanon is suffering from **large fiscal deficits**, peaking recently at **-11.4%** and **-11.3% of GDP in 2018** and **2019**, respectively
- Fiscal deficits were mainly due to the very high interest bill payable by the government: close to **50% of its revenues were dedicated to its interest bill in 2019**

Sources: Lebanese Authorities, IMF World Economic Outlook (October 2019)

3

… pushed the stock of Lebanon's government debt to an unsustainably high level

HISTORICAL GOVERNMENT DEBT STOCK OF LEBANON



- Lebanon's government debt has reached critical levels, up to **178% 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%) contributes to further rapid debt stock accumulation as interest service is financed with more debt

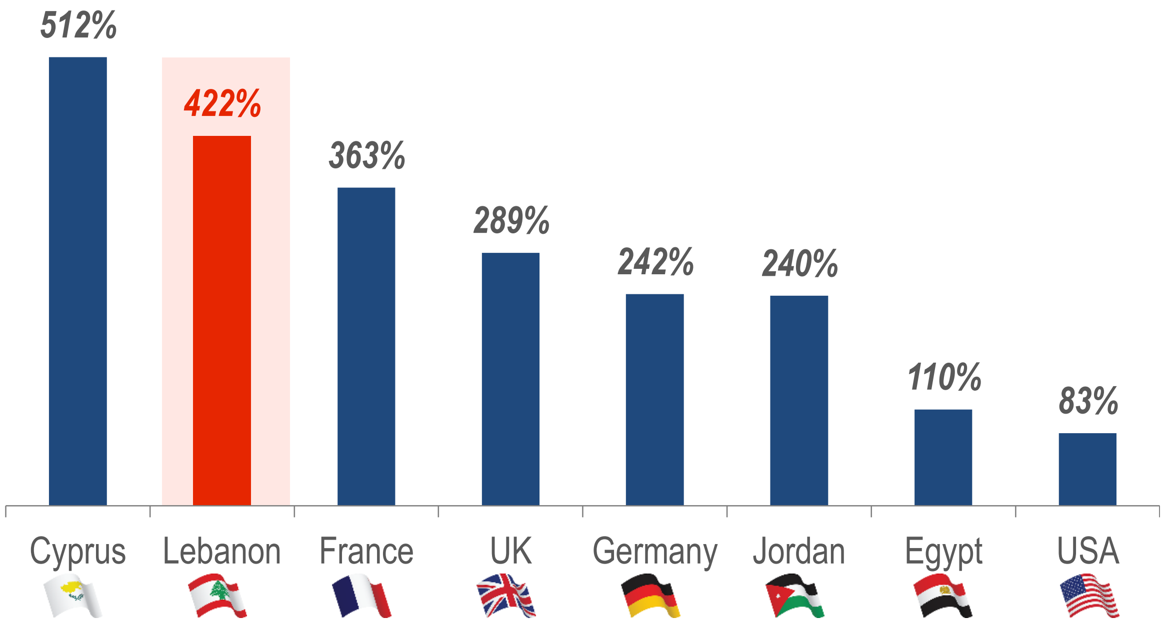
Sources: Lebanese Authorities, Bloomberg, World Economic Outlook (October 2019), Moody's Statistical Handbook Country Credit (November 2019)

Note: (1) Other FC debt includes foreign private sector loans, Eurobonds, Paris II loans, and Special T-bills in foreign currency; (*) 2019 Debt figures are actual while GDP is expected

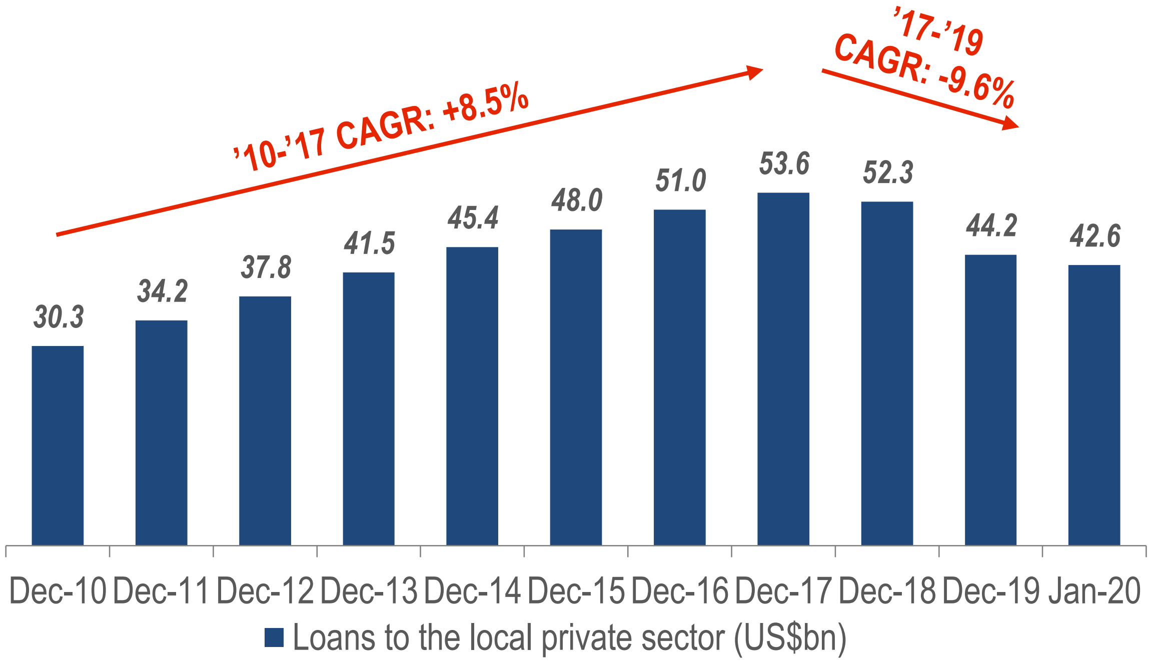
Banking sector is oversized way above what is needed to support the real economy

4

TOTAL BANKING ASSETS (% OF GDP) AS OF DEC-19[1]



LENDING TO THE ECONOMY



- **The Lebanese banking sector** is the 2nd largest in the world in terms of assets as a % of GDP, standing at **422% 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

Sources: Lebanese Authorities, IMF World Economic Outlook (October 2019), Banque du Liban, SNL, St Louis Fed, Central Bank of Egypt, European Central Bank
Note: (1) All data are presented as of December 2019 except for Cyprus as of December 2018

The current Lebanese economic model is broken

Over recent months, multiple risks materialized: 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

- <u>Confidence in the past economic model is shattered</u>

- <u>External and fiscal imbalances have become greater than Lebanon can bear</u>

- <u>Only a complete reshaping of Lebanon economic and banking systems will allow for the resolution of the current crisis</u>

Our newly elected government decided to take immediate actions required to tackle this deep and multi-faceted crisis

- On 7 March 2020, following the extraordinary crisis Cabinet meeting, the Prime Minister of Lebanon H.E. Hassan Diab announced the decision to withhold coupon and principal payments on its USD1.2bn Eurobonds due 9 March 2020 and pursue structural reforms to stabilize and restart the economy of Lebanon

- The decision was driven by the necessity to safeguard BdL’s available foreign currency and allocate it exclusively to the payment of priority imports

- As announced on 23 March 2020, Lebanon will withhold payments on all its foreign currency denominated Eurobonds

1. The Building up of Financial Imbalances over Years

2. Overview of the Recovery Plan

3. Focus on Public Debt Restructuring

4. Next Steps

Our recovery plan will draw on a comprehensive approach to resolve the Lebanon's economic and financial crisis

THE RECOVERY PLAN

Availability of external support

- *Dependent on policy responses*
- *Will smoothen the impact of adjustments*

Exchange rate framework

Banking sector reform

- Restructuring of the commercial banking sector
- Role of the BdL

Public debt restructuring

- FX debt
- LBP debt

Pro-growth and structural reform agenda

Fiscal Reform Plan

- Fiscal trajectory
- GDP growth path
- Inflation path
- FX rate path

Overview of the Government’s Recovery Plan

The reform of the banking sector

- *Restructuring of the commercial banking sector (size and organization), including disentangling the links between commercials banks and Banque du Liban*
- *Ensuring banking sector role to provide credit to the real economy*

The Fiscal Reform Plan

- *Reforming the electricity sector (3% 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 towards increasing the burden on rent income and privileges given on public properties and assets*

A growth-enhancing structural reforms agenda

- *Strengthening of the judicial system (continue ongoing reforms on bankruptcy law, procurement law, competition law, etc)*
- *Sectorial strategies with a focus on land reform, energy, water, waste management, education and health*
- *Promotion of new dynamic industries and development of productive economy*
- *Gather external support to finance high value-added infrastructure projects and initiatives*

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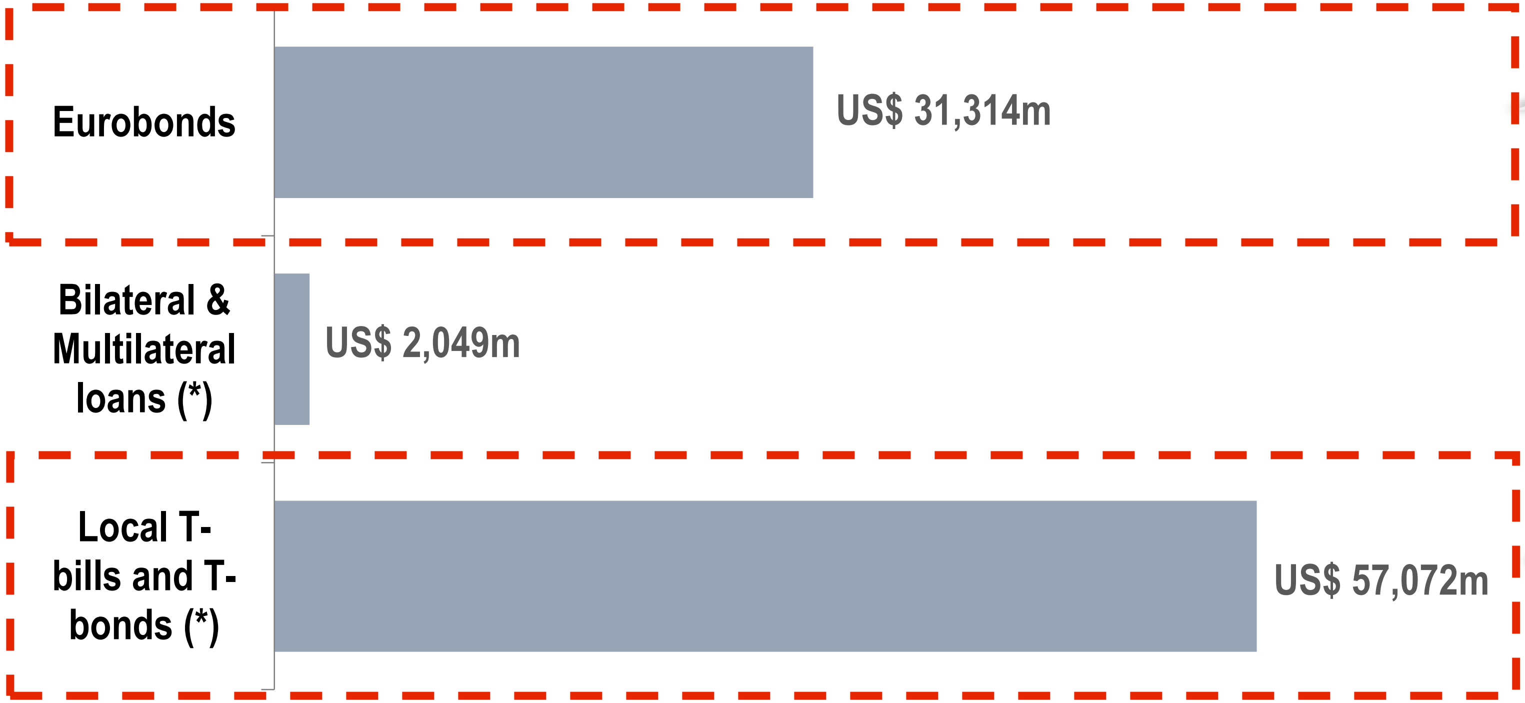
Perimeter of the public debt restructuring *(1/2)*

- A comprehensive public debt restructuring is needed to restore Lebanon's debt sustainability:

<u>Lebanon public debt stock as of 31 January, 2020:</u>



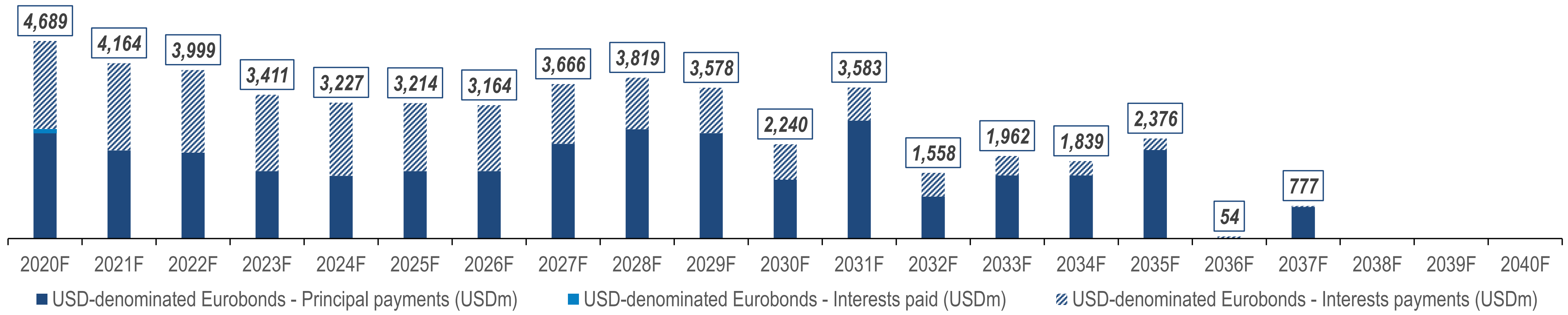
Foreign debt restructuring in line with available FX resources

Domestic debt restructuring in line with available LBP resources

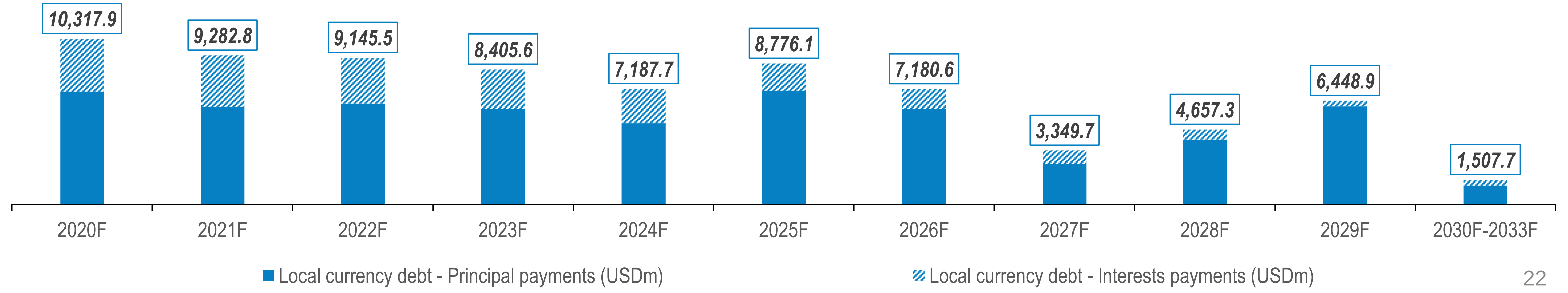
Note: (*) Stock numbers as at end of January 2020

Perimeter of the public debt restructuring *(2/2)*

EUROBONDS ANNUAL PAYMENT SCHEDULE



LOCAL CURRENCY T-BILLS DEBT ANNUAL PAYMENT SCHEDULE



Sources: Lebanese Authorities, Bloomberg

Main principles of the public debt restructuring

1 **Debt sustainability**

- *Government debt-to-GDP dynamics driven by medium and long-term government debt refinancing cost commensurate with economic growth trajectory and primary surplus target*

2 **Refinancing Capacity**

- *Government budget gross financing needs dynamics consistent with manageable Lebanese pound and foreign currency debt rollovers*

3 **External Financing Balance**

- *Public sector foreign currency debt payments compatible with current account dynamics and foreign exchange reserve accumulation objectives*

4 **Reasonable buffer to protect against exogenous shocks such as global trade shocks, financial shocks and unpredictable events**

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Next Steps and Indicative Timeline

NEXT STEPS WILL BE PROGRESSED IN PARALLEL
FROM MARCH TO DECEMBER 2020

Design and approval of a comprehensive economic recovery plan:

- Design of a detailed economic recovery plan
- Discussions with multilateral partners on potential external support
- Adoption of a comprehensive reform plan
- Required regulatory actions to be implemented

Engagement with Lebanon's private sector creditors:

- Interactions with private sector creditors on Lebanon's fundamentals
- Active negotiations with private sector creditors on restructuring parameters
- Expected agreement on the key financial and legal terms of the restructuring
- Closing of the public debt restructuring

Creditor Engagement Principles

- The Government of Lebanon is 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

- Mindful of the exceptional circumstances of the COVID-19 crisis, the government of Lebanon will conduct consultations with its bondholders via audio and video calls and will prioritize interactions with bondholders/bondholder groups demonstrating significant holdings
  - Bondholders willing to be part of these consultations should contact: **lb.bondholders@lazard.fr**

- We invite all bondholders to participate in the identification exercise launched in cooperation with D.F. King
  - Visit the following website **https://sites.dfkingltd.com/republic-of-lebanon** or contact the following email **lebanon@dfkingltd.com** to participate in the identification exercise

Logistics

- This presentation is available in English on the Ministry of Finance website at http://www.finance.gov.lb

- This Webcast will be available on replay during 48h following the investor presentation at http://www.finance.gov.lb/en-us/Finance/PublicDebt/Pages/Eurobonds-Restructuring-Information-for-Creditors.aspx

- A follow-up Q&A document, including answers to questions raised in writing during this webcast, will be posted subsequently on the Ministry of Finance website