MENA ECONOMICS UPDATE

A closer look at Lebanon’s FX debt burden

- The political crisis in Lebanon has raised fears that the authorities will be forced to devalue the pound. One thing that has often been overlooked, though, is the risk that this could force the government to default on its large foreign currency debts.

- Of course, there could be some benefits for Lebanon from a devaluation, including a boost to net exports. But this would take time to materialise and, in the near-term, be outweighed by the negative repercussions. Inflation would jump, eroding real incomes and weighing on consumer spending. Perhaps most alarming, though, is what a devaluation would mean for the government’s large foreign currency debt burden, a legacy of the country’s persistent twin budget and current account deficits over the past few decades.

- By our estimates, Lebanon’s sovereign FX debt amounts to almost $30bn, which is larger than in other EMs such as South Africa, Peru and Czech Republic. It is only a bit smaller than in the Philippines, an economy that is six times larger than Lebanon. (See Chart 1.) As a share of GDP, Lebanon’s sovereign FX debt is equal to around 50% – by some way, the largest ratio in the emerging world. (See Chart 2.)

- Chart 3 shows the rise in the government’s total debt-to-GDP ratio under various devaluation scenarios. At around 150% of GDP, Lebanon’s government debt is already among the highest in the world and we estimate that every 10% fall in the Lebanese pound against the US dollar would cause government debt to jump by 5.5%-pts of GDP. A 40% devaluation would cause Lebanon’s government debt-to-GDP to reach 170% of GDP, close to the level of Greece before its debts were restructured in 2012.

- The structure of the government’s foreign currency debt is also a concern; almost half of it is due to mature over the next five years. (See Chart 4.) The country’s foreign exchange reserves – which stand at $42bn – provide the authorities with a bit of a buffer. But given Lebanon’s large current account deficit and the risk of capital flight, these could be rapidly depleted and leave the authorities with few resources to fund foreign currency debt repayments. At the same time, borrowing costs may become prohibitively high and the government could ultimately be pushed into an outright default.
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