

Lebanon basks in the calm eye of the financial storm – By Marwan Mikhael

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There is no doubt that the sheer scale and global consequences of the financial crisis are staggering. The financial meltdown translated into a deep economic recession that reached the US, Europe and parts of Asia. All over the world, financial systems are being re- examined not only to define acceptable levels of capital and leverage, but also to introduce necessary financial regulations. Authorities in advanced countries are trying to speed up the process of improving transparency, developing a higher degree of corporate governance and creating new clearing and monitoring institutions.

While governments and central banks all over the world are taking every possible measure to stimulate the economy, their efforts are being hampered by three main factors. First, companies, banks and financial institutions are engaged in a deleveraging process that is squeezing the credit market even more and deepening economic recession, thus dumping the impact of concerted and non-concerted interest rate cuts by central banks. Second, the financial crisis has shaken investor and consumer confidence alike during the last few months and it will need more effort and time to be restored. Third, measures that are being implemented will feed into the economy with a lag of nine to 18 months. Therefore it will not be before the last quarter of 2009 or the first half of 2010 that we can expect to see the end of the tunnel.

In this context, Lebanese banks appear to have weathered the storm perfectly. At a time when the credit crunch was entangling the international markets, with interbank rates going through the roof during the month of October, Lebanese banks seized the opportunity and lent their ample liquidity to foreign financial institutions. Consequently, they realized high returns with the three-month US dollar LIBOR rates reaching 4.85 percent on October 10, 2008, and staying above the four percent level for several weeks.

Being less integrated into the global financial system than other emerging economies, Lebanon was not negatively affected by the financial turmoil. The capital outflow that resulted from position liquidation by some investors to cover their losses on the international markets was more than offset by private capital inflows. These inflows came primarily from Lebanese expatriates and some Arab

businessmen and tourists. They consisted of remittances, tourists spending and transfers for investment purposes or just to flee disturbed markets in other parts of the world. As a result, the balance of payment registered a surplus of \$2.4 billion during the first 10 months of 2008. In addition, based on the latest update of the report on remittances released by the World Bank, remittances from Lebanese expatriates are expected to reach six billion dollars in 2008, thus registering an increase of nine percent compared to 2007.

Banks' balance sheets remain strong despite the negative performance of the Beirut stock market. The Blom Stock Index (BSI) followed the downward trend of international markets and declined by 22 percent year up to December 16, 2008. By contrast, total deposits at commercial banks increased by 10 percent in the first 10 months of the year and the dollarization of deposits declined from 77 percent to 70 percent. Furthermore, published results for the third quarter of 2008 show a large increase in banks profits. On the assets side, banks increased their lending to the private sector by 17 percent, bringing their claims on the private sector to 90 percent of GDP. Thus, no liquidity problems or credit squeeze were witnessed on the Lebanese market.

This confidence in the Lebanese banking system and the Lebanese Lira stems from the solid balance sheets of commercial banks and the conservative approach adopted by the central bank. Banks enjoy high liquidity ratios, high returns on assets and a leverage ratio of 12 to one (liabilities/equity), which is considered very conservative by international standards. The central bank's conformist approach resulted from a circular issued in 2004 banning financial institutions, including banks, from investing in the subprime market and the related structured products in the US.

In the midst of the global financial turmoil, Lebanon has to foster the established confidence in its system and take advantage of the global economic recession to catch up with peer countries. The challenges ahead for Lebanese banks are many with the development of e-banking topping the list. Banks should also improve their penetration rate by developing their Islamic banking activities more. Being an important source of income for commercial banks, the large outstanding stock of government Treasury Bills and Eurobonds helped them survive the financial crisis. However, banks should try to reduce their reliance on government debt for their income in the future.

Finally, providing that Lebanon remains in the calm eye of the financial cyclone, where blue skies, light financial wind and low political pressure persist, the economy is set to thrive. The economic growth rate is expected to register more than seven percent in 2008 — above the six percent expected by the International Monetary Fund — and six percent in 2009 despite the global economic recession. The government as well as the banking sector have a golden opportunity to introduce the necessary reforms in their respective areas and to be ready by the end of 2009 or mid- 2010 to play a leading regional economic and financial role.

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